CENTRAL FEDERAL CORP
Form 10KSB
March 29, 2007

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U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-KSB

þ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2006

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 0-25045

CENTRAL FEDERAL CORPORATION.

(Name of Small Business Issuer in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	34-1877137 (I.R.S. Employer Identification No.)
2923 Smith Road, Fairlawn, Ohio (Address of Principal Executive Offices)	44333 (Zip Code)

(330) 666-7979
(Issuer s Telephone Number, Including Area Code)
Securities registered under Section 12(b) of the Exchange Act:
Common Stock, par value $.01 per share
(Title of Class)
Securities registered under Section 12(g) of the Exchange Act: None

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act o

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12(b)-2 of the Exchange Act) YES o NO þ

The registrant s revenues for the fiscal year ended December 31, 2006 were $14.5 million.

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates as of March 15, 2007 was $27,687,000 based upon the closing price as reported on the Nasdaq® Capital Market for that date.

As of March 15, 2007, there were 4,559,787 shares of the registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Rule 14a-3(b) Annual Report to Shareholders for its fiscal year ended December 31, 2006 and its Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on May 17, 2007, which was filed with the Securities and Exchange Commission (the Commission) on March 29, 2007, are incorporated herein by reference into Parts II and III, respectively, of this Form 10-KSB.

Transitional Small Business Disclosure Format (Check One): YES o NO þ

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Forward-Looking Statements

This Form 10-KSB contains forward-looking statements which may be identified by the use of such words as may, believe, expect, anticipate, should, plan, estimate, predict, continue and potential or the negative of t other comparable terminology. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to (i) general and local economic conditions, (ii) changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values and competition, (iii) changes in accounting principles, policies or guidelines, (iv) changes in legislation or regulation and (v) other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in this Form 10-KSB and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed and we caution readers not to place undue reliance on any such forward-looking statements. We undertake no obligation to publicly release revisions to any forward-looking statements to reflect events or circumstances after the date of such statements.

PART I

Item 1 Description of Business

General

Central Federal Corporation (the Company), formerly known as Grand Central Financial Corp., was organized as a Delaware corporation in September 1998 as the holding company for CFBank, a community-oriented savings institution which was originally organized in 1892, formerly known as Central Federal Savings and Loan Association of Wellsville and more recently as Central Federal Bank, in connection with CFBank s conversion from a mutual to stock form of organization. As used herein, the terms we, us, our and the Company refer to Central Federal Corporation and its subsidiaries, unless the context indicates to the contrary. As a savings and loan holding company, we are subject to regulation by the Office of Thrift Supervision (OTS). Reserve Mortgage Services, Inc. (Reserve), a wholly owned subsidiary of CFBank from October 2004 until May 12, 2005 when it was merged into CFBank, was acquired in October 2004 to expand our mortgage services business. Central Federal Capital Trust I (the Trust), a wholly owned subsidiary of the Company, was formed in 2003 to raise additional funding for the Company. Under accounting guidance in Financial Accounting Standards Board (FASB) Interpretation No. 46, as revised in December 2003, the Trust is not consolidated with the Company. Accordingly, the Company does not report the securities issued by the Trust as liabilities, and instead reports as liabilities the subordinated debentures issued by the Company and held by the Trust. Ghent Road, Inc., a wholly owned subsidiary of the Company, was formed in 2006 and owns land adjacent to CFBank s Fairlawn office. Currently, we do not transact any material business other than through CFBank and the Trust. At December 31, 2006, assets totaled $236.0 million and stockholders equity totaled $29.1 million.

CFBank is a community-oriented financial institution offering a variety of financial services to meet the needs of the communities we serve. Our client-centric method of operation emphasizes personalized service, clients access to decision makers, solution-driven lending and quick execution, efficient use of

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technology and the convenience of remote deposit, telephone banking, corporate cash management and online internet banking. We attract deposits from the general public and use the deposits, together with borrowings and other funds, primarily to originate commercial and commercial real estate loans, single-family and multi-family residential mortgage loans and home equity lines of credit. We also invest in consumer loans, construction and land loans and securities. In 2003, we began originating more commercial, commercial real estate and multi-family mortgage loans than in the past as part of our expansion into business financial services. Revenues are derived principally from the generation of interest and fees on loans originated and, to a lesser extent, interest and dividends on securities. Our primary sources of funds are retail savings deposits and certificates of deposit and, to a lesser extent, brokered certificates of deposit, principal and interest payments on loans and securities, Federal Home Loan Bank (FHLB) advances and other borrowings and proceeds from the sale of loans. Our principal market area for loans and deposits includes the following Ohio counties: Summit County through our office in Fairlawn, Ohio; Franklin County through our office in Columbus, Ohio; and Columbiana County through our offices in Calcutta and Wellsville, Ohio. We have a residential mortgage origination office in Akron, Ohio. We originate commercial and conventional real estate loans and business loans throughout Ohio.

Market Area and Competition

Our primary market area is a competitive market for financial services and we face competition both in making loans and in attracting deposits. Direct competition comes from a number of financial institutions operating in our market area, many with a statewide or regional presence, and in some cases, a national presence. Many of these financial institutions are significantly larger and have greater financial resources than us. Competition for loans and deposits comes from savings institutions, mortgage banking companies, commercial banks, credit unions, brokerage firms and insurance companies.

Lending Activities

Loan Portfolio Composition. The loan portfolio consists primarily of mortgage loans secured by single-family and multi-family residences and commercial real estate loans. At December 31, 2006, gross loans receivable totaled $187.1 million. Commercial, commercial real estate and multi-family mortgage loans totaled $126.6 million and represented 67.7% of the gross loan portfolio at December 31, 2006 compared to 57.7% at December 31, 2005 and 48.3% at December 31, 2004. The increase in the percentage of commercial, commercial real estate and multi-family mortgage loans in the portfolio was a result of the growth strategy implemented in 2003 to expand into business financial services. Single-family residential mortgage loans totaled $30.2 million and represented 16.2% of total gross loans at year-end 2006 compared to $23.6 million or 18.8% at year-end 2005 and $42.6 million or 39.0% at year-end 2004. The decline in single-family residential loans in 2005 was due to a securitization of $18.6 million of these loans in June 2005. The remainder of the portfolio consisted of consumer loans, which totaled $30.2 million, or 16.2% of gross loans receivable at year-end 2006.

The types of loans originated are subject to federal and state law and regulations. Interest rates charged on loans are affected by the demand for such loans, the supply of money available for lending purposes and the rates offered by competitors. In turn, these factors are affected by, among other things, economic conditions, fiscal policies of the federal government, monetary policies of the Federal Reserve Board and legislative tax policies.

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The following table sets forth the composition of the loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated.

	At December 31,					
	2006		2005		2004	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
Real estate mortgage loans:						
Single-family	$ 30,209	16.15%	$ 23,627	18.81%	$ 42,577	38.97%
Multi-family	47,247	25.25%	30,206	24.04%	25,602	23.43%
Commercial real estate	47,474	25.37%	25,937	20.64%	20,105	18.40%
Total real estate mortgage loans	124,930	66.77%	79,770	63.49%	88,284	80.80%
Consumer loans:						
Home equity loans	865	0.46%	734	0.58%	663	0.61%
Home equity lines of credit	22,148	11.84%	23,852	18.98%	5,928	5.43%
Automobile	6,448	3.45%	4,237	3.37%	6,735	6.16%
Other	785	0.42%	717	0.57%	626	0.57%
Total consumer loans	30,246	16.17%	29,540	23.50%	13,952	12.77%
Commercial loans	31,913	17.06%	16,347	13.01%	7,030	6.43%
Total loans receivable	187,089	100.00%	125,657	100.00%	109,266	100.00%
Less:						
Net deferred loan fees	(285)		(136)		(139)	
Allowance for loan losses	(2,109)		(1,495)		(978)	
Loans receivable, net	$ 184,695		$ 124,026		$ 108,149	

Real estate mortgage loans include $4,454, $1,466 and $9,774 in construction loans at year-end 2006, 2005 and 2004.

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Loan Maturity. The following table shows the remaining contractual maturity of the loan portfolio at December 31, 2006. Demand loans and other loans having no stated schedule of repayments or no stated maturity are reported as due within one year. The table does not include potential prepayments or scheduled principal amortization.

	At December 31, 2006			
	Real Estate Mortgage Loans	Consumer Loans	Commercial Loans	Total Loans Receivable
	(Dollars in thousands)			
Amounts due:				
Within one year	$ 9,676	$ 1,002	$ 21,802	$ 32,480
After one year:				
More than one year to three years	8,519	2,131	2,410	13,060
More than three years to five years	12,122	4,781	3,072	19,975
More than five years to 10 years	44,596	2,107	3,425	50,128
More than 10 years to 15 years	20,397	148	1,178	21,723
More than 15 years	29,620	20,077	26	49,723
Total due after 2007	115,254	29,244	10,111	154,609
Total amount due	$ 124,930	$ 30,246	$ 31,913	$ 187,089

The following table sets forth at December 31, 2006, the dollar amount of total loans receivable contractually due after December 31, 2007, and whether such loans have fixed interest rates or adjustable interest rates.

	Due after December 31, 2007		
	Fixed	Adjustable	Total
	(Dollars in thousands)		
Real estate mortgage loans	$ 42,281	$ 72,973	$ 115,254
Consumer loans	7,447	21,797	29,244
Commercial loans	6,438	3,673	10,111
Total loans	$ 56,166	$ 98,443	$ 154,609

Origination of Loans. Lending activities are conducted through our offices. In 2003, we began originating commercial, commercial real estate and multi-family mortgage loans to take advantage of opportunities for expansion into business financial services and growth in the Fairlawn and Columbus, Ohio markets. These loans are predominantly adjustable rate loans. A majority of our single-family mortgage loan originations are fixed-rate loans. Current originations of long-term fixed-rate single-family mortgages are generally sold rather than retained in portfolio. Although the decision to sell current single-family mortgage originations rather than retain the loans in portfolio has resulted in declining single-family loan portfolio balances and lower earnings from that portfolio in the near term, it protects future profitability, and we believe it is not prudent to retain all of these long-term, fixed-rate loan originations and subject our performance to the interest rate risk and reduced future earnings associated with a rise in interest rates. In a transaction with Freddie Mac in the second quarter of 2005, we securitized single-family residential mortgage loans held in our portfolio with an outstanding principal balance of $18.6 million, reducing single-family mortgage loan balances. The securitization increased

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liquidity as the securities retained were readily marketable, eliminated credit risk on the loans and reduced CFBank s risk-based capital requirement. Although we currently expect that most of the long-term fixed-rate mortgage loan originations will continue to be sold on a servicing-released basis, a portion of the loans may be retained for portfolio within our interest rate risk and profitability guidelines.

Single-Family Mortgage Lending. A significant lending activity has been the origination of permanent conventional mortgage loans secured by single-family residences located predominantly in our primary market area. We currently sell substantially all of the fixed-rate single-family mortgage loans that we originate on a servicing released basis. Prior to 2004, servicing rights were generally retained on loans sold. Most single-family mortgage loans are underwritten according to Freddie Mac guidelines. Loan originations are obtained from our loan officers and their contacts with the local real estate industry, existing or past customers, and members of the local communities. At December 31, 2006, single-family mortgage loans totaled $30.2 million, or 16.2% of total loans, of which $13.7 million, or 45.5% were fixed-rate loans.

Our policy is to originate single-family residential mortgage loans in amounts up to 80% of the appraised value of the property securing the loan and up to 95% of the appraised value if private mortgage insurance is obtained. Mortgage loans generally include due-on-sale clauses which provide us with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property without our consent. Due-on-sale clauses are an important means of adjusting the rates on the fixed-rate mortgage loan portfolio, and we exercise our rights under these clauses. The single-family mortgage loan originations are generally for terms to maturity of up to 30 years.

We offer several adjustable-rate mortgage (ARM) loan programs with terms of up to 30 years and interest rates that adjust with a maximum adjustment limitation of 2.0% per year and a 6.0% lifetime cap. The interest rate adjustments on ARM loans currently offered are indexed to a variety of established indices and these loans do not provide for initial deep discount interest rates or for negative amortization.

The volume and types of single-family ARM loans originated have been affected by such market factors as the level of interest rates, consumer preferences, competition and the availability of funds. In recent years, demand for single-family ARM loans in our primary market area has been weak due to the low interest rate environment and consumer preference for fixed-rate loans. Consequently, in recent years our origination of ARM loans on single-family residential properties has not been significant as compared to our origination of fixed-rate loans.

Commercial and Multi-Family Real Estate Lending. Beginning in 2003, we expanded into business financial services and positioned ourselves for growth in the Fairlawn and Columbus, Ohio markets and, as a result, originations of commercial real estate and multi-family residential mortgage loans increased significantly. Commercial real estate and multi-family residential mortgage loans totaled $94.7 million at December 31, 20006 or 50.6% of gross loans, an increase of $38.6 million or 68.8% from $56.1 million at December 31, 2005 or 44.7% of gross loans, and an increase of $49.0 million or 107.2% from $45.7 million or 41.8% of gross loans at December 31, 2004. We anticipate that commercial real estate and multi-family residential mortgage lending activities will continue to grow in the future as we continue to execute our strategic growth plan.

We originate commercial real estate loans that are secured by properties used for business purposes, such as manufacturing facilities, office buildings or retail facilities. Commercial real estate and multi-family residential mortgage loans are secured by properties generally located in our primary market area. Underwriting policies provide that commercial real estate and multi-family residential mortgage loans may be made in amounts up to 80% of the appraised value of the property. In underwriting commercial real estate and multi-family residential mortgage loans, we consider the appraisal value and net operating income of the property, the debt service ratio and the property owner s financial strength, expertise and credit history.

Commercial real estate and multi-family residential mortgage loans are generally considered to involve a greater degree of risk than single-family residential mortgage loans. Because payments on loans secured by commercial real estate and multi-family properties are dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. We seek to minimize these risks through underwriting policies which require such loans to be qualified at origination on the basis of the property s income and debt coverage ratio and the financial strength of the owners.

Commercial Lending. Expansion into business financial services in 2003 also resulted in increased originations of commercial loans. Commercial loans totaled $31.9 million, or 17.1% of gross loans at December 31, 2006, an increase of $15.6 million or 95.7% from $16.3 million, or 13.0% of gross loans at December 31, 2005, and an increase of $24.9 million or 355.7% from $7.0 million or 6.4% of gross loans at December 31, 2004. We anticipate that commercial lending activities will continue to grow in the future.

We make commercial business loans primarily to small businesses that are generally secured by business equipment, inventory, accounts receivable and other business assets. In underwriting commercial loans, we consider the net operating income of the company, the debt service ratio and the financial strength, expertise and credit history of the owners.

Commercial loans are generally considered to involve a greater degree of risk than loans secured by real estate. Because payments on commercial loans are dependent on successful operation of the business enterprise, repayment of such loans may be subject to a greater extent to adverse conditions in the economy. We seek to minimize these risks through underwriting policies which require such loans to be qualified at origination on the basis of the enterprise s income and debt coverage ratio and the financial strength of the owners.

Construction and Land Lending. To a lesser extent, we originate construction and land development loans in our primary market areas. Construction loans are made to finance the construction of residential and commercial properties. Construction loans are fixed or adjustable-rate loans which may convert to permanent loans with maturities of up to 30 years. Policies provide that construction loans may be made in amounts up to 80% of the appraised value of the property, and an independent appraisal of the property is required. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant and regular inspections are required to monitor the progress of construction. Land loans are determined on an individual basis, but generally they do not exceed 75% of the actual cost or current appraised value of the property, whichever is less.

Construction and land financing is considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value at completion of construction or development compared to the estimated cost (including interest) of construction. If the estimate of value proves to be inaccurate, we may be confronted with a project, when completed, having a value which is insufficient to assure full repayment.

Consumer and Other Lending. The consumer loan portfolio generally consists of home equity lines of credit, automobile loans, home equity and home improvement loans and loans secured by deposits. At December 31, 2006, the consumer loan portfolio totaled $30.2 million, or 16.2% of gross loans receivable.

Home equity lines of credit comprise the majority of consumer loan balances and totaled $22.1 million at December 31, 2006. We offer a variable rate home equity line of credit with rates adjusting monthly at up to 2% above the prime rate of interest as disclosed in *The Wall Street Journal.* The amount of the line

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is based on the borrower s income and equity in the home. When combined with the balance of the prior mortgage liens, these lines generally may not exceed 100% of the appraised value of the property at the time of the loan commitment. These loans are secured by a subordinate lien on the underlying real estate.

Prior to 2003, we were in the business of making indirect automobile loans and loans secured by automobiles declined to $6.7 million or 6.2% of total loans at year-end 2004. We no longer originate indirect automobile loans and make few direct automobile loans. In 2005, we purchased $5.1 million in auto loans and, as a result, balances increased to $6.4 million, or 3.5% of total loans at December 31, 2006 compared to $4.2 million or 3.4% of total loans at December 31, 2005.

Delinquencies and Classified Assets. The Board of Directors monitors the status of all delinquent loans thirty days or more past due, past due statistics and trends for all loans monthly. Procedures with respect to resolving delinquencies vary depending on the nature and type of the loan and period of delinquency. In general, we make every effort, consistent with safety and soundness principles, to work with the borrower to have the loan brought current. If the loan is not brought current, it then becomes necessary to repossess collateral and/or take legal action.

Federal regulations and CFBank s asset classification policy require use of an internal asset classification system as a means of reporting and monitoring assets. We have incorporated the OTS internal asset classifications as a part of our credit monitoring system. In accordance with regulations, problem assets are classified as substandard, doubtful or loss and the classifications are subject to review by the OTS. An asset is considered substandard under the regulations if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. An asset considered doubtful under the regulations has all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets considered loss under the regulations are those considered uncollectible and having so little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets are required to be designated special mention when they posses weaknesses but do not currently expose the insured institution to sufficient risk to warrant classification in one of these categories. In order to more closely monitor credit risk as we employ our growth strategy in business financial services, we have developed internal loan review procedures and a credit grading system for commercial, commercial real estate and multi-family mortgage loans, and also utilize an independent, external firm for loan review annually.

At December 31, 2006, $965,000 in assets were designated as special mention, representing one commercial real estate loan; $460,000 in assets were classified as substandard, including $288,000 in single-family mortgage loans, $163,000 in commercial loans and $9,000 in auto loans; and no assets were classified as doubtful or loss.

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The following table sets forth information concerning delinquent loans in dollar amounts and as a percentage of the total loan portfolio. The amounts presented represent the total remaining principal balances of the loans rather than the actual payment amounts which are overdue.

	December 31, 2006				December 31, 2005				December 31, 2004			
	60-89 Days		90 Days or More		60-89 Days		90 Days or More		60-89 Days		90 Days or More	
	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
	(Dollars in thousands)											
Real estate loans:												
Single-family		$	5	$ 288		$	10	$ 800	2	$ 149	8	$ 276
Consumer loans:												
Home equity loans and lines of credit									1	7		
Automobile	1	1	1	9	4	30			5	44	2	9
Other					1	2					1	1
Commercial loans	2	509										
Total delinquent loans	3	$ 510	6	$ 297	5	$ 32	10	$ 800	8	$ 199	11	$ 286

The table does not include delinquent loans less than 60 days past due. At December 31, 2006, 2005 and 2004, total loans past due 30 to 59 days totaled $1,533,000, $859,000 and $549,000, respectively.

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Nonperforming Assets. The following table contains information regarding nonperforming loans and real estate owned (REO). At December 31, 2006, nonperforming loans totaled $297,000. CFBank s policy is to stop accruing interest on loans 90 days or more past due and set up reserves for all previously accrued interest. At December 31, 2006, the amount of additional interest income that would have been recognized on nonaccrual loans, if such loans had continued to perform in accordance with their contractual terms, was approximately $16,000. At December 31, 2006, 2005 and 2004, there were no impaired loans or troubled debt restructurings.

	At December 31,		
	2006	**2005**	**2004**
	(Dollars in thousands)		
Nonaccrual loans:			
Single-family real estate	$ 288	$ 800	$ 276
Consumer	9		10
Total[1]	297	800	286
Real estate owned (REO)			132
Total nonperforming assets[2]	$ 297	$ 800	$ 418
Nonperforming loans to total loans	0.16%	0.64%	0.26%
Nonperforming assets to total assets	0.13%	0.46%	0.24%

(1) Total nonaccrual loans equal total nonperforming loans.

(2) Nonperforming assets consist of nonperforming loans and REO.

Allowance for Loan Losses. Management analyzes the adequacy of the allowance for loan losses regularly through reviews of the performance of the loan portfolio considering economic conditions, changes in interest rates and the effect of such changes on real estate values and changes in the composition of the loan portfolio. Such evaluation, which includes a review of all loans for which full collectibility may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience, changes in the size and growth of the loan portfolio and other factors that warrant recognition in providing for an adequate loan loss allowance. The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risk in its loan portfolio. Various regulatory agencies, as an integral part of the examination process, periodically review the allowance for loan losses. Such agencies may require additional provisions for loan losses based upon information available at the time of the review. At December 31, 2006, the allowance for loan losses totaled 1.13% of total loans as compared to 1.19% at December 31, 2005.

The OTS, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances in accordance with generally accepted accounting principles and guidance for banking agency examiners to use in evaluating the allowances. The policy statement requires that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management analyze all significant factors that affect the collectibility of the portfolio in a reasonable manner; and that management establish acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. CFBank adopted an Allowance for Loan Losses Policy designed to provide a thorough, disciplined and consistently applied process that incorporates management s current judgments about the credit quality of the loan portfolio into determination of the

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allowance for loan losses in accordance with generally accepted accounting principles and supervisory guidance. Management believes that an adequate allowance for loan losses has been established. However, actual losses are dependent upon future events and, as such, further additions to the level of allowances for estimated loan losses may become necessary.

The following table sets forth activity in the allowance for loan losses for the periods indicated.

	At or for the Year ended December 31, (Dollars in thousands)		
	2006	**2005**	**2004**
Allowance for loan losses, beginning of period	$ 1,495	$ 978	$ 415
Charge-offs:			
Single-family real estate	159	170	
Consumer	143	85	117
Total charge-offs	302	255	117
Recoveries on loans previously charged off:			
Single-family real estate	53	27	
Consumer	43	71	34
Total recoveries	96	98	34
Net charge-offs	206	157	83
Provision for loan losses	820	674	646
Allowance for loan losses, end of period	$ 2,109	$ 1,495	$ 978
Allowance for loan losses to total loans	1.13%	1.19%	.90%
Allowance for loan losses to nonperforming loans	710.10%	186.88%	341.96%
Net charge-offs to the allowance for losses	9.77%	10.50%	8.49%
Net charge-offs to average loans	.13%	.14%	.10%

Expansion into business financial services and the significant growth in commercial, commercial real estate and multi-family mortgage loans during 2004 through 2006 required an increase in the provision and allowance for loan losses related to these loan types. The provision for loan losses totaled $820,000 in 2006 compared to $674,000 in 2005 and $646,000 in 2004. At December 31, 2006, the allowance for commercial, commercial real estate and multi-family mortgage loans totaled $1.9 million, an increase of $628,000 from $1.3 million at December 31, 2005 and $1.1 million from $862,000 at December 31, 2004 as these loan types grew from 48.3% at year-end 2004 to 67.7% at year-end 2006. These loans tend to be larger balance, higher risk loans and, as a result, 92.3% of the allowance was allocated to these loan types at December 31, 2006.

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The following table sets forth the allowance for loan losses in each of the categories listed at the dates indicated and the percentage of such amounts to the total allowance and loans in each category as a percent of total loans. Although the allowance may be allocated to specific loans or loan types, the entire allowance is available for any loan that, in management s judgment, should be charged-off.

	At December 31,								
	2006			2005			2004		
	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in Each Category to Total Loans
				(Dollars in thousands)					
Single-family mortgage loans	$ 110	5.22%	16.15%	$ 57	3.81%	18.81%	$ 4	.41%	38.97%
Consumer loans	53	2.51%	16.17%	120	8.03%	23.50%	112	11.45%	12.77%
Commercial, commercial real estate and multi-family mortgage loans	1,946	92.27%	67.68%	1,318	88.16%	57.69%	862	88.14%	48.26%
Total allowance for loan losses	$ 2,109	100.00%	100.00%	$ 1,495	100.00%	100.00%	$ 978	100.00%	100.00%

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Real Estate Owned

At December 31, 2006, there was no real estate owned. Assets acquired through or instead of loan foreclosure are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Investment Activities

Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certificates of deposit of insured banks and savings institutions, bankers acceptances and federal funds. Subject to various restrictions, federally chartered savings institutions may also invest their assets in commercial paper, municipal bonds, investment-grade corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly.

The investment policy established by the Board of Directors is designed to provide and maintain liquidity, generate a favorable return on investments without incurring undue interest rate and credit risk, and complement lending activities. The policy provides authority to invest in United States Treasury and federal agency securities meeting the policy s guidelines, mortgage-backed securities guaranteed by the U.S. government and agencies thereof, and municipal bonds. To improve liquidity and eliminate the credit risk associated with mortgages held in our portfolio, we securitized single-family residential mortgage loans with an outstanding principal balance of $18.6 million in a transaction with Freddie Mac in 2005. The securitization (i) increased liquidity as the securities retained were readily marketable, (ii) eliminated credit risk on the loans and (iii) reduced CFBank s risk-based capital requirement. At December 31, 2006, the securities portfolio totaled $29.3 million.

At December 31, 2006, all mortgage-backed securities in the securities portfolio were insured or guaranteed by Freddie Mac or Fannie Mae.

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The following table sets forth certain information regarding the amortized cost and fair value of securities at the dates indicated.

	At December 31,					
	2006		2005		2004	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
Securities available for sale:						
Federal agency	$ 6,005	$ 5,883	$ 6,007	$ 5,838	$ 5,018	$ 4,983
State and municipal	2,014	1,979	2,020	1,987		
Mortgage-backed	21,345	21,464	22,803	23,047	8,398	8,525
Total securities available for sale	29,364	29,326	30,830	30,872	13,416	13,508
Net unrealized gain (loss) on securities available for sale	(38)		42		92	
Total securities	$ 29,326	$ 29,326	$ 30,872	$ 30,872	$ 13,508	$ 13,508

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The table below sets forth certain information regarding the carrying value, weighted average yields and contractual maturities of securities available for sale as of December 31, 2006. Yields are stated on a fully taxable equivalent basis.

	At December 31, 2006									
	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
					(Dollars in thousands)					
Federal agency	$		$ 5,883	3.52%	$		$		$ 5,883	3.52%
State and municipal	995	4.12%	984	4.34%					1,979	4.23%
Mortgage-backed	112	4.97%	270	6.00%	2,924	4.79%	18,159	5.63%	21,464	5.51%
Total securities at fair value	$ 1,107	4.21%	$ 7,137	3.73%	$ 2,924	4.79%	$ 18,159	5.63%	$ 29,326	5.02%

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Sources of Funds

General. Primary sources of funds are deposits, principal and interest payments on loans and securities, borrowings, and funds generated from operations of the Bank. Contractual loan payments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general market interest rates and economic conditions. Borrowings may be used on a short-term basis for liquidity purposes or on a long-term basis to fund asset growth.

Deposits. CFBank offers a variety of deposit accounts with a range of interest rates and terms including savings accounts, retail and business checking accounts, money market accounts and certificates of deposit. Management regularly evaluates the internal cost of funds, surveys rates offered by competitors, reviews cash flow requirements for lending and liquidity and executes rate changes when necessary as part of its asset/liability management, profitability and growth objectives. For the year ended December 31, 2006, certificates of deposit constituted 56.9% of total average deposits. The term of the certificates of deposit offered vary from seven days to five years at rates established by management. Specific terms of an individual account vary according to the type of account, the minimum balance required, the time period funds must remain on deposit and the interest rate, among other factors. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. At December 31, 2006, certificate accounts maturing in less than one year totaled $77.3 million. Most of these accounts are expected to be reinvested and we do not believe that there is any material risk associated with the respective maturities of these certificates. We rely primarily on a willingness to pay market-competitive interest rates to attract and retain retail deposits. Accordingly, rates offered by competing financial institutions affect our ability to attract and retain deposits. Deposits are obtained predominantly from the areas in which CFBank offices are located, and brokered deposits are accepted. We consider brokered deposits to be a useful element of a diversified funding strategy and an alternative to borrowings. Management regularly compares rates on brokered certificates of deposit with other funding sources in order to determine the best mix of funding sources balancing the costs of funding with the mix of maturities. At December 31, 2006, brokered deposits totaled $30.5 million.

Certificate accounts in amounts of $100,000 or more totaled $44.6 million at December 31, 2006, maturing as follows:

Maturity Period	**Amount**	**Weighted Average Rate**
	(Dollars in thousands)	
Three months or less	$ 10,055	4.68%
Over 3 through 6 months	9,264	5.08%
Over 6 through 12 months	12,271	5.10%
Over 12 months	13,001	5.13%
Total	$ 44,591	

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The following table sets forth the distribution of average deposit account balances for the periods indicated and the weighted average interest rates on each category of deposits presented. Averages for the periods presented are based on month-end balances.

	For the Year ended December 31,								
	2006			2005			2004		
	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid
	(Dollars in thousands)								
Interest-bearing checking accounts	$ 9,522	6.37%	2.16%	$ 11,321	9.59%	1.26%	$ 11,602	13.82%	.58%
Money market accounts	31,754	21.25%	4.23%	23,202	19.65%	3.01%	10,688	12.73%	2.34%
Savings accounts	12,770	8.55%	.60%	16,121	13.65%	.61%	18,730	22.30%	.57%
Certificates of deposit	85,010	56.88%	4.30%	59,957	50.78%	3.14%	39,285	46.78%	2.57%
Noninterest-bearing deposits:									
Demand deposits	10,386	6.95%		7,471	6.33%		3,674	4.37%	
Total average deposits	$ 149,442	100.00%	3.80%	$ 118,072	100.00%	2.55%	$ 83,979	100.00%	1.79%

The following table presents by various rate categories, the amount of certificate accounts outstanding at the dates indicated and the periods to maturity of the certificate accounts outstanding at December 31, 2006.

	Period to Maturity from December 31, 2006				At December 31,		
	Less than One Year	One to Two Years	Two to Three Years	Over Three Years	2006	2005	2004
	(Dollars in thousands)						
Certificate accounts:							
0 to 1.99%	$ 10	$	$	$	$ 10	$ 4,273	$ 11,847
2.00 to 2.99%	4,614	82			4,696	7,850	17,555
3.00 to 3.99%	7,996	2,806	988	165	11,955	21,376	9,984
4.00 to 4.99%	15,870	671	2,186	523	19,250	34,676	6,273
5.00 to 5.99%	48,832	3,241	1,071	8,393	61,537	442	655
6.00% and above	10				10	10	10
Total certificate accounts	$ 77,332	$ 6,800	$ 4,245	$ 9,081	$ 97,458	$ 68,627	$ 46,324

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Borrowings. FHLB advances are used as an alternative to retail deposits to fund operations as part of our operating strategy. The advances are collateralized primarily by certain mortgage loans, home equity lines of credit, commercial real estate loans and mortgage-backed securities and secondarily by investment in capital stock of the FHLB. FHLB advances are made pursuant to several credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the FHLB will advance to member institutions fluctuates from time to time in accordance with the policies of the FHLB.

The Company obtained a $5.0 million line of credit with a commercial bank in 2006. Interest on the line is at the fed funds rate plus .63%. There was no outstanding balance at year-end 2006.

A revolving line of credit with an unaffiliated bank acquired in the Reserve acquisition in 2004 provided financing primarily for single-family mortgage loan originations and was collateralized by loans held for sale. This line of credit was repaid and closed in 2005.

In 2003, we formed the Trust, which issued $5.0 million of 3-month London Interbank Offered Rate (LIBOR) plus 2.85% floating rate trust preferred securities as part of a pooled private offering of such securities. We issued $5.2 million of subordinated debentures to the Trust in exchange for ownership of all of the common stock of the Trust and the proceeds of the preferred securities sold by the Trust. The subordinated debentures mature on December 30, 2033 and we may redeem the subordinated debentures, in whole or in part, at par plus accrued and unpaid interest, any time after December 30, 2008. We have the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years. There are no required payments on the subordinated debentures over the next 5 years. Under FASB Interpretation No. 46, as revised in December 2003, the Trust is not consolidated with the Company. Accordingly, we do not report the securities issued by the Trust as liabilities, and instead report the subordinated debentures issued by the Company and held by the Trust as liabilities.

The following table sets forth certain information regarding borrowed funds at or for the periods ended on the dates indicated:

	At or for the Year ended December 31,		
	2006	**2005**	**2004**
	(Dollars in thousands)		
FHLB advances and other borrowings:			
Average balance outstanding	$33,201	$24,860	$31,265
Maximum amount outstanding at any month-end during the period	41,604	47,062	48,574
Balance outstanding at end of period	37,675	28,150	48,574
Weighted average interest rate during the period	4.85%	3.62%	2.28%
Weighted average interest rate at end of period	5.28%	4.25%	2.76%

Subsidiary Activities

As of December 31, 2006, we maintained CFBank, Ghent Road, Inc. and the Trust as wholly owned subsidiaries.

Personnel

As of December 31, 2006, we had 57 full-time and five part-time employees.

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Regulation and Supervision

General. CFBank is a federally-chartered savings association. It is subject to regulation, examination and supervision by the OTS and the Federal Deposit Insurance Corporation (FDIC) as its deposit insurer. CFBank s deposit accounts are insured up to applicable limits by the FDIC through the Deposit Insurance Fund (DIF). The FDIC merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) to form the DIF on March 31, 2006, in accordance with the Federal Deposit Insurance Reform Act of 2005. CFBank also is a member of the FHLB of Cincinnati, which is one of the 12 regional FHLBs. CFBank must file reports with the OTS concerning its activities and financial condition, and must obtain regulatory approvals prior to entering into certain transactions, such as mergers with, or acquisitions of, other depository institutions. The OTS conducts periodic examinations to assess CFBank s compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which a savings association can engage and is intended primarily for the protection of the insurance fund and depositors. Under the holding company form of organization, the Company is also required to file certain reports with, and otherwise comply with the rules and regulations of the OTS and of the Securities and Exchange Commission (the Commission) under the federal securities laws.

The OTS and the FDIC have significant discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such policies, whether by the OTS, the FDIC, the Commission or the United States Congress, could have a material adverse impact on the Company, CFBank and our operations and shareholders. The following discussion is intended to be a summary of the material statutes and regulations applicable to savings associations and their holding companies, but it does not purport to be a comprehensive description of all such statutes and regulations.

Regulation of Federal Savings Associations

Business Activities. CFBank derives its lending and investment powers from the Home Owners Loan Act, as amended (HOLA), and OTS regulations. Under these laws and regulations, CFBank may invest in mortgage loans secured by residential and commercial real estate, commercial and consumer loans, certain types of debt securities and certain other assets. CFBank may also establish service corporations that may engage in activities not otherwise permissible for CFBank, including certain real estate equity investments and securities and insurance brokerage activities. CFBank s authority to invest in certain types of loans or other investments is limited by federal law.

Loans to One Borrower. CFBank is generally subject to the same limits on loans to one borrower as is a national bank. With specified exceptions, CFBank s total loans or extensions of credit to a single borrower cannot exceed 15% of CFBank s unimpaired capital and surplus, which does not include accumulated other comprehensive income. CFBank may lend additional amounts up to 10% of its unimpaired capital and surplus which does not include accumulated other comprehensive income, if the loans or extensions of credit are fully-secured by readily marketable collateral. CFBank currently complies with applicable loans-to-one-borrower limitations.

QTL Test. The HOLA requires that CFBank, as a savings association, comply with the qualified thrift lender (QTL) test. Under the QTL test, CFBank is required to maintain at least 65% of its portfolio assets in certain qualified thrift investments for at least nine months of the most recent twelve-month period. Portfolio assets means, in general, CFBank s total assets less the sum of (i) specified liquid assets up to 20% of total assets, (ii) goodwill and other intangible assets and (iii) the value of property used to conduct

CFBank s business. CFBank may also satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code of 1986, as amended (the Code). CFBank met the QTL test at December 31, 2006 and in each of the prior 12 months, and, therefore, qualified as a thrift lender. If CFBank fails the QTL test, it must either operate under certain restrictions on its activities or convert to a national bank charter.

Capital Requirements. The OTS regulations require savings associations to meet three minimum capital standards: (i) a tangible capital ratio requirement of 1.5% of total assets as adjusted under the OTS regulations; (ii) a leverage ratio requirement of 3.0% of core capital to such adjusted total assets, if a savings association has been assigned the highest composite rating of 1 under the Uniform Financial Institutions Rating System; and (iii) a risk-based capital ratio requirement of 8.0% of core and supplementary capital to total risk-based assets. The minimum leverage capital ratio for any other depository institution that does not have a composite rating of 1 will be 4%, unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. In determining the amount of risk-weighted assets for purposes of the risk-based capital requirement, a savings association must compute its risk-based assets by multiplying its assets and certain off-balance sheet items by risk weights, which range from 0% for cash and obligations issued by the United States Government or its agencies to 100% for consumer and commercial loans, as assigned by the OTS capital regulation based on the risks found by the OTS to be inherent in the type of asset.

Tangible capital is defined, generally, as common shareholders equity (including retained earnings), certain non-cumulative perpetual preferred stock and related earnings, minority interests in equity accounts of fully consolidated subsidiaries, less intangibles (other than certain mortgage servicing rights), and investments in and loans to subsidiaries engaged in activities not permissible for a national bank. Core capital is defined similarly to tangible capital, but core capital also includes certain qualifying supervisory goodwill and certain purchased credit card relationships. Supplementary capital currently includes cumulative and other preferred stock, mandatory convertible debt securities, subordinated debt and intermediate preferred stock and the allowance for loan and lease losses. In addition, up to 45% of unrealized gains on available-for-sale equity securities with a readily determinable fair value may be included in tier 2 capital. The allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets, and the amount of supplementary capital that may be included as total capital cannot exceed the amount of core capital. At December 31, 2006, CFBank met each of its capital requirements, in each case on a fully phased-in basis.

	Actual Capital	Required Capital	Excess (Deficiency) Amount	Capital Actual Percent	Capital Required Percent
	(Dollars in thousands)				
Tangible	$22,863	$ 3,503	$19,360	9.8%	1.5%
Core (Leverage)	22,863	9,342	13,521	9.8%	4.0%
Risk-based	24,972	15,915	9,057	12.6%	8.0%

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Capital Distributions. OTS regulations impose limitations upon all capital distributions by savings institutions, such as cash dividends, payments to repurchase or otherwise acquire the savings institution s shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The rule establishes three tiers of institutions, which are based primarily on an institution s capital level. An institution that exceeds all fully phased-in capital requirements before and after a proposed capital distribution (Tier 1 Bank) and that has not been advised by the OTS that it is in need of more than normal supervision, could, after prior notice, but without obtaining approval of the OTS, make capital distributions during a calendar year equal to the greater of (i) 100% of its net earnings to date during the calendar year plus the amount that would reduce by one-half its surplus capital ratio (the excess capital over its fully phased-in capital requirements) at the beginning of the calendar year or (ii) 75% of its net earnings for the previous four quarters. Any additional capital distributions would require prior regulatory approval. In the event CFBank s capital fell below its regulatory requirements or the OTS notified it that it was in need of more than normal supervision, CFBank s ability to make capital distributions could be restricted. In addition, the OTS could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OTS determines that such distribution would constitute an unsafe or unsound practice. At December 31, 2006, CFBank was classified as a Tier 1 Bank.

Under OTS capital distribution regulations, an application to and the prior approval of the OTS is required before an institution makes a capital distribution if (i) the institution does not meet certain criteria for expedited treatment for applications under the regulations, (ii) the total capital distributions by the institution for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, (iii) the institution would be undercapitalized following the distribution or (iv) the distribution would otherwise be contrary to a statute, regulation or agreement with the OTS. If an application is not required, the institution may still need to give advance notice to the OTS of the capital distribution. The Company s ability to pay dividends, service debt obligations and repurchase common stock is dependent upon receipt of dividend payments from CFBank.

Branching. OTS regulations permit federally-chartered savings associations to branch nationwide under certain conditions. Generally, federal savings associations may establish interstate networks and geographically diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings associations.

Community Reinvestment. Under the Community Reinvestment Act (the CRA), as implemented by OTS regulations, a savings association has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the OTS, in connection with its examination of a savings association, to assess the association s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the association. The CRA also requires each institution to publicly disclose its CRA rating. CFBank s CRA rating based on the latest assessment by the OTS was satisfactory .

The CRA regulations establish an assessment system that bases an association s rating on its actual performance in meeting community needs. In particular, the assessment system focuses on three tests: (i) a lending test, to evaluate the institution s record of making loans in its assessment areas; (ii) an investment test, to evaluate the institution s record of investing in community development projects, affordable housing and programs benefiting low- or moderate-income individuals and businesses; and (iii) a service test, to evaluate the institution s delivery of services through its branches, ATMs and other offices.

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Transactions with Related Parties. CFBank s authority to engage in transactions with related parties or affiliates (i.e., any company that controls or is under common control with an institution, including the Company and any non-savings institution subsidiaries that the Company may establish) is limited by Sections 23A and 23B of the Federal Reserve Act (FRA). Section 23A restricts the aggregate amount of covered transactions with any individual affiliate to 10% of the capital and surplus of the savings institution and also limits the aggregate amount of transactions with all affiliates to 20% of the savings institution s capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A and the purchase of low quality assets from affiliates is generally prohibited. Section 23B generally requires that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. A savings association also is prohibited from extending credit to any affiliate engaged in activities not permitted for a bank holding company and may not purchase the securities of an affiliate (other than a subsidiary).

Section 22(h) of the FRA restricts a savings association with respect to loans to directors, executive officers and principal stockholders. Under Section 22(h), loans to directors, executive officers and stockholders who control, directly or indirectly, 10% or more of voting securities of a savings association, and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the savings association s total unimpaired capital and unimpaired surplus. Section 22(h) also prohibits any loan above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who directly or indirectly control 10% or more of voting securities of a stock savings association, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the savings association. Any interested director may not participate in the voting. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of $25,000 or 5% of capital and surplus. Furthermore, any loan, when aggregated with all other extensions of credit to that person, which exceeds $500,000, must receive prior approval by the board**.** Further, pursuant to Section 22(h), loans to directors, executive officers and principal stockholders must be made on terms substantially the same as offered in comparable transactions to other persons except for extensions of credit made pursuant to a benefit or compensation program that is widely available to the institution s employees and does not give preference to insiders over other employees. Section 22(g) of the FRA places additional limitations on loans to executive officers.

Section 402 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act) prohibits the extension of personal loans to directors and executive officers of issuers. The prohibition, however, does not apply to mortgages advanced by an insured depository institution, such as CFBank, which are subject to the insider lending restrictions of Section 22(h) of the FRA.

Enforcement. The OTS has primary enforcement responsibility over savings associations, including CFBank. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist orders and to remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and to unsafe or unsound practices.

Standards for Safety and Soundness. Under federal law, the OTS has adopted a set of guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings standards, compensation, fees and benefits. In general, the guidelines require appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. In addition, the OTS adopted regulations that authorize, but do not require, the OTS to order an institution that has been given notice that it is not satisfying these safety and soundness standards to submit a compliance plan. If, after being notified, an institution fails to submit an acceptable plan of compliance or fails in any material respect to implement an accepted plan, the OTS must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized association is subject under the prompt corrective action provisions of federal law. If an institution fails to comply with such an order, the OTS may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Real Estate Lending Standards. The OTS and the other federal banking agencies adopted regulations to prescribe standards for extensions of credit that (i) are secured by real estate or (ii) are made for the purpose of financing the construction of improvements on real estate. The OTS regulations require each savings association to establish and maintain written internal real estate lending standards that are consistent with safe and sound banking practices and appropriate to the size of the association and the nature and scope of its real estate lending activities. The standards also must be consistent with accompanying OTS guidelines, which include loan-to-value ratios for the different types of real estate loans. Associations are also permitted to make a limited amount of loans that do not conform to the proposed loan-to-value limitations so long as such exceptions are reviewed and justified appropriately. The guidelines also list a number of lending situations in which exceptions to the loan-to-value standards are justified.

Prompt Corrective Regulatory Action. Under the OTS prompt corrective action regulations, the OTS is required to take certain, and is authorized to take other, supervisory actions against undercapitalized savings associations. For this purpose, a savings association would be placed in one of the following four categories based on the association s capital: (i) well-capitalized; (ii) adequately capitalized; (iii) undercapitalized; or (iv) critically undercapitalized.

At December 31, 2006, CFBank met the criteria for being considered well-capitalized. When appropriate, the OTS can require corrective action by a savings association holding company under the prompt corrective action provision of federal law.

Insurance of Deposit Accounts. The FDIC has adopted a risk-based insurance assessment system. The FDIC assigns an institution to one of three capital categories based on the institution s financial information, as of the reporting period ending seven months before the assessment period, consisting of (i) well capitalized, (ii) adequately capitalized or (iii) undercapitalized, and one of three supervisory subcategories within each capital group. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution s primary federal regulator and information that the FDIC determines to be relevant to the institution s financial condition and the risk posed to the deposit insurance funds. An institution s assessment rate depends on the capital category and supervisory category to which it is assigned. Assessment rates for DIF member institutions currently range from 0 basis points to 27 basis points. The FDIC is authorized to raise the assessment rates in certain circumstances. The FDIC has exercised this authority several times in the past and may raise insurance premiums in the future. If the FDIC takes such action, it could have an adverse effect on the earnings of CFBank and the Company.

In addition to the assessment for deposit insurance, institutions are required to pay on bonds issued in the late 1980s by the Financing Corporation (FICO) to recapitalize the predecessor to the SAIF (now a predecessor to the DIF).

A significant increase in DIF insurance premiums would likely have an adverse effect on the operating expenses and results of operations of CFBank. Under the FDI Act, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is

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in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS. The management of the Company does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Federal Home Loan Bank System. CFBank is a member of the FHLB of Cincinnati, which is one of the regional FHLBs composing the FHLB System. Each FHLB provides a central credit facility primarily for its member institutions: (i) the greater of $1,000 or 0.20% of the member s mortgage-related assets; and (ii) 4.50% of the dollar amount of any outstanding advances under such member s advances, collateral pledge and security agreement with the FHLB. CFBank, as a member of the FHLB of Cincinnati is required to acquire and hold shares of capital stock in the FHLB of Cincinnati in an amount at least equal to 0.12% of the total assets of CFBank. CFBank is also required to own activity based stock, which is based on 4.45% of CFBank s outstanding advances. These percentages are subject to change by the FHLB. CFBank was in compliance with this requirement with an investment in FHLB of Cincinnati stock at December 31, 2006 of $2.8 million. Any advances from a FHLB must be secured by specified types of collateral, and all long-term advances may be obtained only for the purpose of providing funds for residential housing finance.

The FHLBs are required to provide funds for the resolution of insolvent thrifts and to contribute funds for affordable housing programs. These requirements could reduce the amount of earnings that the FHLBs can pay as dividends to their members and could also result in the FHLBs imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future FHLB advances increased, CFBank s net interest income would be affected. Under the Gramm-Leach-Bliley Act (the GLB Act), membership in the FHLB is now voluntary for all federally-chartered savings associations, such as CFBank. The GLB Act also replaces the existing redeemable stock structure of the FHLB System with a capital structure that requires each FHLB to meet a leverage limit and a risk-based permanent capital requirement. Two classes of stock are authorized: Class A (redeemable on six-month notice) and Class B (redeemable on five-year notice).

Federal Reserve System. CFBank is subject to provisions of the FRA and the FRBs regulations pursuant to which depositary institutions may be required to maintain non-interest-earning reserves against their deposit accounts and certain other liabilities. Currently, reserves must be maintained against transaction accounts (primarily NOW and regular checking accounts). The FRB regulations generally require that reserves be maintained in the amount of 3.0% of the aggregate of transaction accounts up to $45.8 million. The amount of aggregate transaction accounts in excess of $45.8 million are currently subject to a reserve ratio of $1.119 million plus 10.0%. The FRB regulations currently exempt $8.5 million of otherwise reservable balances from the reserve requirements, which exemption is adjusted by the FRB at the end of each year. CFBank is in compliance with the foregoing reserve requirements. Because required reserves must be maintained in the form of vault cash, a non interest-bearing account at a Federal Reserve Bank, or a pass-through account as defined by the FRB, the effect of this reserve requirement is to reduce CFBank s interest-earning assets. The balances maintained to meet the reserve requirements imposed by the FRB may be used to satisfy liquidity requirements imposed by the OTS. FHLB System members are also authorized to borrow from the Federal Reserve discount window, but FRB regulations require such institutions to exhaust all FHLB sources before borrowing from a Federal Reserve Bank.

Privacy Regulations. The OTS has published final regulations implementing the privacy protection provisions of the GLB Act. The new regulations generally require that CFBank disclose its privacy policy, including identifying with whom it shares a customer s non-public personal information, to any customer at the time of establishing the customer relationship and annually thereafter. In addition, CFBank is required to provide its customers with the ability to opt-out of having their personal information shared with unaffiliated third parties and not to disclose account numbers or access codes to non-affiliated third parties for marketing purposes. CFBank currently has a privacy protection policy in place and believes that such policy is in compliance with the regulations.

The USA PATRIOT Act. The USA Patriot Act of 2001 was enacted on October 26, 2001 and was renewed in substantially the same form on March 9, 2006. This act contains the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the IMLAFA). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt new policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institutions operations.

Holding Company Regulation

The Company is a savings and loan holding company regulated by the OTS and, as such, is registered with and subject to OTS examination and supervision, as well as certain reporting requirements. In addition, the OTS has enforcement authority over the holding company and any of our non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the financial safety, soundness or stability of a subsidiary savings institution. Unlike bank holding companies, federal savings and loan holding companies are not subject to any regulatory capital requirements or to supervision by the Federal Reserve System.

Permissible Activities of Central Federal Corporation. Because we acquired CFBank prior to May 4, 1999, we are permitted to engage in the following non-financial activities under the GLB Act: (i) furnishing or performing management services for a savings institution subsidiary; (ii) conducting an insurance agency or escrow business; (iii) holding, managing or liquidating assets owned or acquired from a savings institution subsidiary; (iv) holding or managing properties used or occupied by a savings institution subsidiary; (v) acting as trustee under a deed of trust; (vi) any other activity (a) that the FRB, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956 (the BHC Act), unless the Director of the OTS, by regulation, prohibits or limits any such activity for savings and loan holding companies, or (b) in which multiple savings and loan holding companies were authorized by regulation to directly engage in on March 5, 1987; (vii) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such holding company is approved by the Director of the OTS; and (viii) any activity permissible for financial holding companies under section 4(k) of the BHC Act.

Permissible activities which are deemed to be financial in nature or incidental thereto under section 4(k) of the BHC Act include: (i) lending, exchanging, transferring, investing for others or safeguarding money or securities; (ii) insurance activities or providing and issuing annuities, and acting as principal, agent or broker; (iii) financial, investment or economic advisory services; (iv) issuing or selling instruments representing interests in pools of assets that a bank is permitted to hold directly; (v) underwriting, dealing in or making a market in securities; (vi) activities previously determined by the FRB to be closely related to banking; (vii) activities that bank holding companies are permitted to engage in outside of the United States; and (viii) portfolio investments made by an insurance company.

Restrictions Applicable to All Savings and Loan Holding Companies. Federal law prohibits a savings and loan holding company, including us, directly or indirectly, from acquiring: (i) control (as defined under HOLA) of another savings institution (or a holding company parent) without prior OTS approval; (ii) through merger, consolidation or purchase of assets, another savings institution or a holding company thereof, or acquiring all or substantially all of the assets of such institution (or a holding company) without prior OTS approval; or (iii) control of any depository institution not insured by the FDIC (except through a merger with and into the holding company s savings institution subsidiary that is approved by

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the OTS).

A savings and loan holding company may not acquire as a separate subsidiary an insured institution that has a principal office outside of the state where the principal office of its subsidiary institution is located, except (i) in the case of certain emergency acquisitions approved by the FDIC, (ii) if such holding company controls a savings institution subsidiary that operated a home or branch office in such additional state as of March 5, 1987 or (iii) if the laws of the state in which the savings institution to be acquired is located specifically authorize a savings institution chartered by that state to be acquired by a savings institution chartered by the state where the acquiring savings institution or savings and loan holding company is located or by a holding company that controls such a state-chartered association.