

CENTRAL FEDERAL CORP
Form 10-Q
May 15, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

or

TRANSITION REPORT PURSUANT TO 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

(Exact name of registrant as specified in its charter)

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

34-1877137
(IRS Employer
Identification No.)

2923 Smith Road, Fairlawn, Ohio 44333

(Address of principal executive offices) (Zip Code)

(330) 666-7979

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 15, 2012, there were 825,640 shares of the registrant's Common Stock outstanding.

FORM 10-Q

QUARTER ENDED MARCH 31, 2012

INDEX

	Page
<u>PART I. Financial Information</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets as of March 31, 2012(unaudited) and December 31, 2011</u>	3
<u>Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011 (unaudited)</u>	4
<u>Consolidated Statements of Comprehensive Loss for the three months ended March 31, 2012 and 2011 (unaudited)</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity for the three months ended March 31, 2012 and 2011 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011 (unaudited)</u>	8
<u>Notes to Consolidated Financial Statements</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	52
<u>Item 4. Controls and Procedures</u>	74
<u>PART II. Other Information</u>	
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	75
<u>Item 6. Exhibits</u>	75
<u>Signatures</u>	76

CENTRAL FEDERAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	March 31, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash and cash equivalents	\$ 63,284	\$ 61,436
Interest-bearing deposits in other financial institutions	1,984	1,984
Securities available for sale	18,108	18,516
Loans held for sale, at fair value	833	1,210
Loans, net of allowance of \$5,641 and \$6,110	140,282	151,160
FHLB stock	1,942	1,942
Loan servicing rights	35	37
Foreclosed assets, net	2,453	2,370
Premises and equipment, net	5,485	5,534
Assets held for sale	167	167
Other intangible assets	79	89
Bank owned life insurance	4,306	4,273
Accrued interest receivable and other assets	2,482	2,202
	\$ 241,440	\$ 250,920
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits		
Noninterest bearing	\$ 18,343	\$ 18,409
Interest bearing	189,529	198,640
Total deposits	207,872	217,049
Long-term FHLB advances	15,742	15,742
Advances by borrowers for taxes and insurance	124	159
Accrued interest payable and other liabilities	3,326	2,871
Subordinated debentures	5,155	5,155
Total liabilities	232,219	240,976
Stockholders' equity		
Preferred stock, Series A, \$.01 par value; aggregate liquidation value \$7,788 in 2012, \$7,691 in 2011 1,000,000 shares authorized; 7,225 shares issued	7,133	7,120
Common stock, \$.01 par value, 50,000,000 shares authorized; 937,347 shares issued	9	9
Additional paid-in capital	27,843	27,837
Accumulated deficit	(23,012)	(22,163)
Accumulated other comprehensive income	493	386
Treasury stock, at cost; 111,707 shares	(3,245)	(3,245)
Total stockholders' equity	9,221	9,944
	\$ 241,440	\$ 250,920

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended March 31,	
	2012	2011
Interest and dividend income		
Loans, including fees	\$ 1,891	\$ 2,442
Securities	63	155
FHLB stock dividends	22	22
Federal funds sold and other	40	30
	2,016	2,649
Interest expense		
Deposits	593	702
Long-term FHLB advances and other debt	109	167
Subordinated debentures	47	41
	749	910
Net interest income	1,267	1,739
Provision for loan losses	200	1,419
Net interest income after provision for loan losses	1,067	320
Noninterest income		
Service charges on deposit accounts	59	61
Net gains on sales of loans	43	40
Loan servicing fees, net	8	8
Earnings on bank owned life insurance	33	32
Other	15	15
	158	156
Noninterest expense		
Salaries and employee benefits	991	1,041
Occupancy and equipment	74	85
Data processing	142	144
Franchise taxes	55	66
Professional fees	218	301
Director fees	45	46
Postage, printing and supplies	48	48
Advertising and promotion	3	10
Telephone	17	22
Loan expenses	8	10
Foreclosed assets, net	18	33
Depreciation	67	114
FDIC premiums	156	175
Amortization of intangibles	10	10
Regulatory assessment	45	37
Other insurance	42	17
Other	25	31

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

	1,964	2,190
Net loss	(739)	(1,714)
Preferred stock dividends and accretion of discount on preferred stock	(110)	(104)
Net loss attributable to common stockholders	\$ (849)	\$ (1,818)
Loss per common share:		
Basic	\$ (1.03)	\$ (2.20)
Diluted	\$ (1.03)	\$ (2.20)
	See accompanying notes to consolidated financial statements.	

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended March 31,	
	2012	2011
Net loss	\$ (739)	\$ (1,714)
Other comprehensive income (loss):		
Change in unrealized holding gains (losses) on securities available for sale	107	(65)
Net change in unrealized gains (losses)	107	(65)
Tax effect		
Total other comprehensive income (loss)	107	(65)
Comprehensive loss	\$ (632)	\$ (1,779)

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands except per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2012	\$ 7,120	\$ 9	\$ 27,837	\$ (22,163)	\$ 386	\$ (3,245)	\$ 9,944
Net loss				(739)			(739)
Other comprehensive income					107		107
Accretion of discount on preferred stock	13			(13)			
Release of 600 stock-based incentive plan shares			3				3
Stock option expense, net of forfeitures			3				3
Preferred stock dividends				(97)			(97)
Balance at March 31, 2012	\$ 7,133	\$ 9	\$ 27,843	\$ (23,012)	\$ 493	\$ (3,245)	\$ 9,221

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands except per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders Equity
Balance at January 1, 2011	\$ 7,069	\$ 9	\$ 27,797	\$ (16,313)	\$ 672	\$ (3,245)	\$ 15,989
Net loss				(1,714)			(1,714)
Other comprehensive loss					(65)		(65)
Accretion of discount on preferred stock	13			(13)			
Release of 627 stock-based incentive plan shares, net of forfeitures			8				8
Stock option expense, net of forfeitures			4				4
Preferred stock dividends				(91)			(91)
Balance at March 31, 2011	\$ 7,082	\$ 9	\$ 27,809	\$ (18,131)	\$ 607	\$ (3,245)	\$ 14,131

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Three months ended March 31,	
	2012	2011
Net loss	\$ (739)	\$ (1,714)
Adjustments to reconcile net loss to net cash from operating activities:		
Provision for loan losses	200	1,419
Valuation gain on mortgage servicing rights	(1)	(2)
Depreciation	67	114
Amortization, net	177	192
Originations of loans held for sale	(6,180)	(12,499)
Proceeds from sale of loans held for sale	6,490	13,130
Net gains on sales of loans	(43)	(40)
Loss on disposal of premises and equipment	4	
Stock-based compensation expense	6	13
Net change in:		
Bank owned life insurance	(33)	(32)
Accrued interest receivable and other assets	(280)	26
Accrued interest payable and other liabilities	359	(103)
Net cash from operating activities	27	504
Cash flows from investing activities		
Available-for-sale securities:		
Maturities, prepayments and calls	2,906	2,671
Purchases	(2,537)	
Loan originations and payments, net	10,708	10,396
Additions to premises and equipment	(22)	(1)
Proceeds from the sale of foreclosed assets		1,000
Net cash from investing activities	11,055	14,066
Cash flows from financing activities		
Net change in deposits	(9,199)	21,485
Net change in short-term borrowings from the FHLB and other debt		1,500
Repayments on long-term FHLB advances and other debt		(2,200)
Net change in advances by borrowers for taxes and insurance	(35)	(72)
Net cash from (used by) financing activities	(9,234)	20,713
Net change in cash and cash equivalents	1,848	35,283
Beginning cash and cash equivalents	61,436	34,275
Ending cash and cash equivalents	\$ 63,284	\$ 69,558
Supplemental cash flow information:		
Interest paid	\$ 670	\$ 823
Supplemental noncash disclosures:		
Transfers from loans to repossessed assets	\$ 83	\$
Loans transferred from held for sale to portfolio	(109)	

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIESBasis of Presentation:

The consolidated financial statements include Central Federal Corporation (the Holding Company) and its wholly owned subsidiaries, CFBank, Ghent Road, Inc., and Smith Ghent LLC, together with the Holding Company referred to as the Company. The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and in compliance with U.S. generally accepted accounting principles (GAAP). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of the management of the Company, the accompanying unaudited interim consolidated financial statements include all adjustments necessary for a fair presentation of the Company's financial condition and the results of operations for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The financial performance reported for the Company for the three months ended March 31, 2012 is not necessarily indicative of the results that may be expected for the full year. This information should be read in conjunction with the Company's latest Annual Report to Stockholders and Form 10-K. Reference is made to the accounting policies of the Company described in Note 1 of the Notes to Consolidated Financial Statements contained in the Company's 2011 Annual Report that was filed as Exhibit 13.1 to the Company's Form 10-K for the year ended December 31, 2011. The Company has consistently followed those policies in preparing this Form 10-Q.

Reclassifications and Reverse Stock Split: Some items in the prior period financial statements were reclassified to conform to the current presentation. Reclassifications did not impact prior period net loss or total stockholders' equity. On May 4, 2012, the Company completed a 1-for-5 reverse stock split, whereby each 5 shares of the Company's common stock were reclassified into one share of common stock. All share and per share amounts for all periods presented have been adjusted to reflect the reverse split as though it had occurred prior to the earliest period presented.

Earnings (Loss) Per Common Share: Basic earnings (loss) per common share is net income (loss) available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options and the stock warrant.

	Three months ended March 31,	
	2012	2011
Basic		
Net loss	\$ (739)	\$ (1,714)
Less: Preferred dividends and accretion of discount on preferred stock	(110)	(104)
Less: Net loss allocated to unvested share-based payment awards	3	13
Net loss allocated to common stockholders	\$ (846)	\$ (1,805)
Weighted average common shares outstanding including unvested share-based payment awards	825,447	825,358
Less: Unvested share-based payment awards	(3,300)	(5,705)
Average shares	822,147	819,653
Basic loss per common share	\$ (1.03)	\$ (2.20)
Diluted		
Net loss allocated to common stockholders	\$ (846)	\$ (1,805)

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Weighted average common shares outstanding for basic loss per common share	822,147	819,653
Add: Dilutive effects of assumed exercises of stock options		
Add: Dilutive effects of assumed exercises of stock warrant		
Average shares and dilutive potential common shares	822,147	819,653
Diluted loss per common share	\$ (1.03)	\$ (2.20)

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The following potential average common shares were anti-dilutive and not considered in computing diluted loss per common share because the Company reported a net loss for the periods presented.

	Three months ended March 31,	
	2012	2011
Stock options	43,066	54,650
Stock warrant	67,314	67,314

Adoption of New Accounting Standards:

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04 to Fair Value Measurement (ASC 820), *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This ASU amends existing guidance to achieve common fair value measurement and disclosure requirements between U.S. and international accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements, but the additional disclosures are included in Note 6.

In June 2011, the FASB issued ASU No. 2011-05 to Comprehensive Income (ASC 220), *Presentation of Comprehensive Income*. This ASU amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in stockholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively. The adoption of this amendment changed the presentation of the statement of comprehensive income for the Company to two consecutive statements instead of presented as part of the consolidated statement of shareholders' equity.

In December 2011, the FASB issued ASU No. 2011-12 to Comprehensive Income (ASC 220), *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05*. This ASU amended the guidance in ASU 2011-05 related to the presentation of the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. The amendments in this ASU are effective at the same time as the amendments in ASU 2011-05 so that entities will not be required to comply with the presentation requirements in ASU 2011-05 that this ASU is deferring. The amendments in this ASU are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 2 GOING CONCERN CONSIDERATIONS AND MANAGEMENT S PLANS

Going Concern Considerations:

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. However, the events and circumstances described in this Note create substantial doubt about the Company's ability to continue as a going concern.

On May 25, 2011, the Holding Company and CFBank each consented to the issuance of an Order to Cease and Desist (the Holding Company Order and the CFBank Order, respectively, and collectively, the Orders) by the Office of Thrift Supervision (OTS), the primary regulator of the Holding Company and CFBank at the time the Orders were issued. In July 2011, in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Board of Governors of the Federal Reserve System (FED) replaced the OTS as the primary regulator of the Holding Company and the Office of the Comptroller of the Currency (OCC) replaced the OTS as the primary regulator of CFBank.

The Holding Company Order requires it, among other things, to: (i) submit by June 30, 2011 (and update by December 31, 2011 and every December 31 thereafter) a capital plan to regulators that establishes a minimum tangible capital ratio commensurate with the Holding Company's consolidated risk profile, reduces the risk from current debt levels and addresses the Holding Company's cash flow needs; (ii) not pay cash dividends, redeem stock or make any other capital distributions without prior regulatory approval; (iii) not pay interest or principal on any debt or increase any Holding Company debt or guarantee the debt of any entity without prior regulatory approval; (iv) obtain prior regulatory approval for changes in directors and senior executive officers; and (v) not enter into any new contractual arrangement related to compensation or benefits with any director or senior executive officer without prior notification to regulators.

The CFBank Order requires it, among other things, to: (i) have by September 30, 2011, and maintain thereafter, 8% core capital and 12% total risk-based capital, after establishing an adequate allowance for loan and lease losses; (ii) submit by June 30, 2011 (and update by December 31, 2011 and every December 31 thereafter) a capital and business plan to regulators that describes strategies to meet these required capital ratios and contains operating strategies to achieve realistic core earnings; (iii) submit a contingency plan providing for a merger or voluntary dissolution of CFBank if capital does not reach the required levels, which requirement was extended by the OCC until the earlier of 15 days after termination of the stock offering or January 31, 2012, and a further extension of this date has been requested of the OCC; (iv) not originate, participate in or acquire any nonresidential real estate loans or commercial loans without regulatory approval, which prohibition was waived by OCC on November 9, 2011 subject to certain Board approval conditions, loan policies and credit administration procedures; (v) adopt a revised credit administration policy, problem asset reduction plan, management succession plan and liquidity management policy; (vi) limit asset growth to net interest credited on deposit liabilities absent prior regulatory approval for additional growth; (vii) not pay cash dividends or make any other capital distributions without prior regulatory approval; (viii) obtain prior regulatory approval for changes in directors and senior executive officers; (ix) not enter into any new contractual arrangement related to compensation or benefits with any director or senior executive officer without prior notification to regulators; (x) not enter into any significant arrangement or contract with a third party service provider without prior regulatory approval; and (xi) comply with the Federal Deposit Insurance Corporation (FDIC) limits on brokered deposits. As a result of the CFBank Order, CFBank is considered adequately capitalized for regulatory purposes.

The Company has been unprofitable for over the past three years and, unless additional capital is infused into the Holding Company and CFBank, it is unlikely that we will be able to generate profits in the future. This would cause our capital levels to continue to erode. If that happens, the regulators could take additional enforcement action against us, including the imposition of further operating restrictions. The regulators could also direct us to seek a merger partner or liquidate CFBank.

The Holding Company is significantly dependent on dividends from CFBank to provide the liquidity necessary to meet its obligations. As of March 31, 2012, pursuant to the CFBank Order, CFBank may not declare or pay dividends or make any other capital distributions without receiving the prior written approval of the OCC. Future dividend payments by CFBank to the Holding Company would be based on future earnings and the approval of the OCC. The payment of dividends from CFBank to the Holding Company is not likely to be approved by the OCC while CFBank is suffering significant losses.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 2 GOING CONCERN CONSIDERATIONS AND MANAGEMENT S PLANS (continued)

The significant directives contained in the Orders, including higher capital requirements, requirements to reduce the level of our criticized and classified assets, growth and operating restrictions, restrictions on brokered deposits, restrictions on certain types of lending and restrictions on dividend payments have impeded and may further impede our ability to operate our business and to effectively compete in our markets. In addition, the regulators must approve any deviation from our business plan, which could limit our ability to make any changes to our business and could negatively impact the scope and flexibility of our business activities.

The requirements of the Orders will remain in effect until terminated, modified or suspended by regulators.

Management s Plans:

The Company announced the terms of a registered common stock offering of up to \$30,000 on August 9, 2011. The restructured registered common stock offering consisted of a \$24,965 rights offering and a \$5,035 offering to a group of standby purchasers. Under the terms of the rights offering, all record holders of the Company s common stock as of February 8, 2012 received, at no charge, one subscription right for each share of common stock held as of the record date. Each subscription right entitled the holder of the right to purchase 6.0474 shares of Company common stock at a subscription price of \$1.00 per share. Shares were also available to the public at \$1.00 per share. In addition, for each three shares of company stock purchased, purchasers were to receive, at no charge, one warrant to purchase one additional share of common stock at a purchase price of \$1.00 per share. The warrants were to be exercisable for three years. The Company had separately entered into a series of standby purchase agreements with a group of investors led by Timothy T. O Dell, Thad R. Perry and Robert E. Hoeweler. Under the standby purchase agreements, the standby purchasers were to acquire 5.0 million shares of Company common stock at a price of \$1.00 per share and receive warrants with the same terms and conditions as all purchasers in the rights offering. The standby purchasers had conditioned their purchase of shares of common stock upon the receipt by the Company of at least \$16,500 in net proceeds from the rights offering. The registration statement related to the rights offering is on file with the SEC and became effective on February 8, 2012.

The Company was unable to complete this offering and returned all subscriptions received. The Company has modified the terms of the offering and filed a post-effective amendment to its registration statement with the SEC.

The terms of the restructured offering are as follows: a rights offering of up to \$25,500 and a \$4,500 offering to a group of standby purchasers, as well as a public offering of any unsold shares. Under the terms of the rights offering, all holders of the Company s common stock as of a record date to be established will receive, at no charge, one subscription right for each share of common stock held as of the record date. Each subscription right entitles the holder of the right to purchase 20.5901 shares of Company common stock at a subscription price of \$1.50 per share. Shares are also available to the public at \$1.50 per share. The Company has separately entered into a series of standby purchase agreements with a group of investors led by Timothy T. O Dell, Thad R. Perry and Robert E. Hoeweler. Under the standby purchase agreements, the standby purchasers will acquire 3.0 million shares of Company common stock at a price of \$1.50 per share. The standby purchasers have conditioned their purchase of shares of common stock upon the receipt by the Company of at least \$13,500 in net proceeds from the rights offering and a public offering. A post-effective amendment to the registration statement related to the offering is on file with the SEC but has not yet become effective.

A portion of the proceeds from the restructured registered common stock offering is expected to be retained by the Holding Company for general corporate purposes and is estimated to be sufficient to support the Holding Company s cash requirements. Given the uncertainty surrounding CFBank s future ability to pay dividends to the Holding Company, the current levels of problem assets, the continuing depressed economy and the longer periods of time necessary to work out problem assets in the current economy, the Board of Directors and management are relying on completion of the restructured registered common stock offering to provide additional funding to support the Holding Company s working capital needs. Should the restructured registered common stock offering be unsuccessful, there can be no assurance that additional funding sources will be available, which would have a material adverse impact on our financial condition. Without additional capital, it is unlikely that the Holding Company will have sufficient liquidity to continue to meet its operating expenses as they become due. This could result in the Holding Company being subject to additional regulatory restrictions which could ultimately result in the Holding Company being instructed to seek a merger

partner or in CFBank being liquidated.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 2 GOING CONCERN CONSIDERATIONS AND MANAGEMENT S PLANS (continued)

The Holding Company's available cash at March 31, 2012 is sufficient to cover operating expenses and expenses in connection with the restructured registered common stock offering, at their current projected levels, through approximately June 30, 2012. The Board of Directors elected to defer scheduled dividend payments related to the Preferred Stock, as defined in Note 11 to these consolidated financial statements, beginning with the November 15, 2010 payment, and the interest payments on the subordinated debentures beginning with the December 30, 2010 payment, in order to preserve cash at the Holding Company. The Company expects that the Board will also elect to defer future payments until the Company is recapitalized. Pursuant to the Holding Company Order, the Holding Company may not pay dividends on the Preferred Stock or interest on the subordinated debentures without the prior written notice to and written non-objection from the FED.

As of March 31, 2012, the Company had incurred \$915 in costs related to the registered common stock offering that are included in other assets in the consolidated balance sheet. The Company expects to incur additional costs prior to completion of the restructured stock offering. In the event the restructured registered common stock offering is not successful, these costs will be charged against current operations and will have a negative impact on earnings.

Because CFBank is no longer considered to be well-capitalized for regulatory purposes, it is prohibited from accepting or renewing brokered deposits, including reciprocal deposits in the Certificate of Deposit Account Registry Service® (CDARS) program, without FDIC approval. CFBank received limited waivers from the prohibition on renewal of reciprocal CDARS deposits from the FDIC, each for 90 day periods which expired on September 20, 2011, December 19, 2011, March 18, 2012 and a current limited waiver which expires on June 16, 2012. The current limited waiver allows CFBank to roll over or renew core deposits in the reciprocal CDARS program that have yet to mature or have matured and remained with CFBank between March 19, 2012 and June 16, 2012. Management intends to submit additional requests for waivers in the future; however, there can be no assurance that the requests will be granted by the FDIC or that customers will roll over or renew their CDARS deposits even if CFBank is granted additional waivers.

The prohibition on brokered deposits significantly limits CFBank's ability to participate in the CDARS program and impacts CFBank's liquidity management. As a result of the losses in 2009, 2010 and the first quarter of 2011, management had been concerned that CFBank would be restricted from accepting or renewing brokered deposits, in addition to other regulatory restrictions, and moved aggressively in 2011, prior to receipt of the CFBank Order, to build on-balance-sheet liquidity to deal with scheduled brokered deposit maturities and the potential impact of other regulatory restrictions on liquidity. At March 31, 2012, CFBank had \$46,806 in brokered deposits with maturity dates from April 2012 through August 2016. At March 31, 2012, cash, unpledged securities and deposits in other financial institutions totaled \$65,460, which was sufficient to cover all brokered deposit maturities. Brokered deposit maturities over the next five years are as follows:

March 31, 2013	\$ 21,844
March 31, 2014	14,943
March 31, 2015	433
March 31, 2016	9,387
March 31, 2017	199
	\$ 46,806

We have taken such actions as we believe are necessary to comply with all requirements of the Orders which are currently effective, except the higher capital requirements, and we are continuing to work toward compliance with the provisions of the Orders having future compliance dates.

These financial statements do not include any adjustments that may result should the Company be unable to continue as a going concern.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 3 SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at March 31, 2012 and December 31, 2011 and the corresponding amounts of unrealized gains and losses recognized in accumulated other comprehensive income (loss):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>March 31, 2012</u>				
Issued by U.S. government-sponsored entities and agencies:				
Mortgage-backed securities - residential	\$ 2,290	\$ 204	\$	\$ 2,494
Collateralized mortgage obligations	15,325	289		15,614
Total	\$ 17,615	\$ 493	\$	\$ 18,108

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>December 31, 2011</u>				
Issued by U.S. government-sponsored entities and agencies:				
Mortgage-backed securities - residential	\$ 1,475	\$ 198	\$	\$ 1,673
Collateralized mortgage obligations	16,655	204	16	16,843
Total	\$ 18,130	\$ 402	\$ 16	\$ 18,516

There was no other-than-temporary impairment recognized in accumulated other comprehensive income (loss) for securities available for sale at March 31, 2012 or December 31, 2011.

There were no proceeds from sales of securities during the three months ended March 31, 2012 or 2011.

At March 31, 2012 and December 31, 2011, there were no debt securities contractually due at a single maturity date. The amortized cost and fair value of mortgage-backed securities and collateralized mortgage obligations which are not due at a single maturity date, totaled \$17,615 and \$18,108 at March 31, 2012, respectively, and \$18,130 and \$18,516 at December 31, 2011, respectively.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 3 SECURITIES (continued)

Fair value of securities pledged was as follows:

	March 31, 2012	December 31, 2011
Pledged as collateral for:		
FHLB advances	\$ 8,015	\$ 9,336
Public deposits	1,784	2,820
Customer repurchase agreements	4,240	3,557
Interest-rate swaps	2,077	1,464
Total	\$ 16,116	\$ 17,177

At March 31, 2012 and December 31, 2011, there were no holdings of securities of any one issuer, other than U.S. government-sponsored entities and agencies, in an amount greater than 10% of stockholders' equity.

There were no securities with unrealized losses at March 31, 2012. The following table summarizes securities with unrealized losses at December 31, 2011 aggregated by major security type and length of time in a continuous unrealized loss position.

December 31, 2011 Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Issued by U.S. government-sponsored entities and agencies:						
Collateralized mortgage obligations	\$ 2,882	\$ 16	\$	\$	\$ 2,882	\$ 16
Total temporarily impaired	\$ 2,882	\$ 16	\$	\$	\$ 2,882	\$ 16

The unrealized loss at December 31, 2011 is related to two Ginnie Mae collateralized mortgage obligations. These securities carry the full faith and credit guarantee of the U.S. government. Because the decline in fair value is attributable to changes in market conditions, and not credit quality, and because the Company does not have the intent to sell these securities and it is likely that it will not be required to sell these securities before their anticipated recovery, the Company did not consider these securities to be other-than-temporarily impaired at December 31, 2011.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS

The following table presents the recorded investment in loans by portfolio segment. The recorded investment in loans includes the principal balance outstanding adjusted for purchase premiums and discounts, deferred loan fees and costs and includes accrued interest.

	March 31, 2012	December 31, 2011
Commercial	\$ 21,500	\$ 25,994
Real estate:		
Single-family residential	16,918	18,214
Multi-family residential	24,894	27,163
Commercial	66,849	69,757
Consumer:		
Home equity lines of credit	14,590	14,921
Other	1,172	1,221
Subtotal	145,923	157,270
Less: ALLL	(5,641)	(6,110)
Loans, net	\$ 140,282	\$ 151,160

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The ALLL is a valuation allowance for probable incurred credit losses in the loan portfolio based on management's evaluation of various factors including past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. A provision for loan losses is charged to operations based on management's periodic evaluation of these and other pertinent factors described in Note 1 of the Notes to Consolidated Financial Statements contained in the Company's 2011 Annual Report that was filed as Exhibit 13.1 to the Company's Form 10-K for the year ended December 31, 2011.

The following tables present the activity in the ALLL by portfolio segment for the three months ended March 31, 2012:

	Real Estate			Consumer Home equity lines of			Total
	Commercial	Single-family	Multi-family	Commercial	credit	Other	
Beginning balance	\$ 2,281	\$ 207	\$ 1,470	\$ 1,863	\$ 272	\$ 17	\$ 6,110
Addition to (reduction in) provision for loan losses	(508)	(19)	370	347	19	(9)	200
Charge-offs	(15)		(416)	(434)	(20)		(885)
Recoveries	44	2	22	136	3	9	216
Ending balance	\$ 1,802	\$ 190	\$ 1,446	\$ 1,912	\$ 274	\$ 17	\$ 5,641

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following tables present the activity in the ALLL by portfolio segment for the three months ended March 31, 2011:

	Real Estate			Consumer			Total	
	Commercial	Single-family	Multi-family	Commercial	Construction	Home equity lines of credit Other		
Beginning balance	\$ 1,879	\$ 241	\$ 2,520	\$ 4,719	\$ 74	\$ 303	\$ 22	\$ 9,758
Addition to (reduction in) provision for loan losses	1,705	(3)	218	(372)	(40)	(104)	15	1,419
Charge-offs	(500)	(7)	(800)	(500)			(18)	(1,825)
Recoveries	71	2	1	1		2	2	79
Reclass of ALLL on loan-related commitments ⁽¹⁾	(14)							(14)
Ending balance	\$ 3,141	\$ 233	\$ 1,939	\$ 3,848	\$ 34	\$ 201	\$ 21	\$ 9,417

⁽¹⁾ Reclassified from (to) accrued interest payable and other liabilities in the consolidated balance sheet

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents the balance in the ALLL and the recorded investment in loans by portfolio segment and based on the impairment method as of March 31, 2012:

	Real Estate			Consumer			Total
	Commercial	Single-family	Multi-family	Commercial	Home equity lines of credit	Other	
ALLL:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 573	\$ 13	\$ 286	\$	\$	\$	\$ 872
Collectively evaluated for impairment	1,229	190	1,433	1,626	274	17	4,769
Total ending allowance balance	\$ 1,802	\$ 190	\$ 1,446	\$ 1,912	\$ 274	\$ 17	\$ 5,641
Loans:							
Individually evaluated for impairment	\$ 831	\$ 132	\$ 4,053	\$ 6,388	\$ 135	\$	\$ 11,539
Collectively evaluated for impairment	20,669	16,786	20,841	60,461	14,455	1,172	134,384
Total ending loan balance	\$ 21,500	\$ 16,918	\$ 24,894	\$ 66,849	\$ 14,590	\$ 1,172	\$ 145,923

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents the balance in the ALLL and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2011:

	Real Estate			Consumer Home equity lines of credit			Other	Total
	Commercial	Single-family	Multi-family	Commercial				
ALLL:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ 624	\$	\$ 11	\$ 262	\$	\$	\$	\$ 897
Collectively evaluated for impairment	1,657	207	1,459	1,601	272	17		5,213
Total ending allowance balance	\$ 2,281	\$ 207	\$ 1,470	\$ 1,863	\$ 272	\$ 17		\$ 6,110
Loans:								
Individually evaluated for impairment	\$ 821	\$	\$ 5,090	\$ 6,085	\$ 135	\$	\$	\$ 12,131
Collectively evaluated for impairment	25,173	18,214	22,073	63,672	14,786	1,221		145,139
Total ending loan balance	\$ 25,994	\$ 18,214	\$ 27,163	\$ 69,757	\$ 14,921	\$ 1,221		\$ 157,270

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents loans individually evaluated for impairment by class of loans at March 31, 2012. The unpaid principal balance is the contractual principal balance outstanding. The recorded investment is the unpaid principal balance adjusted for partial charge-offs, purchase premiums and discounts, deferred loan fees and costs and includes accrued interest. There was no cash-basis interest income recognized during the three months ended March 31, 2012.

	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	For the three months ended March 31, 2012 Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 686	\$ 146	\$	\$ 67	\$
Real estate:					
Multi-family residential	4,970	3,961		4,244	10
Commercial:					
Non-owner occupied	2,625	2,069		1,367	
Owner occupied	852	422		429	
Land	480	454		224	1
Consumer:					
Home equity lines of credit:					
Originated for portfolio	135	135		135	
Total with no allowance recorded	9,748	7,187		6,466	11
With an allowance recorded:					
Commercial	685	685	573	696	13
Real estate:					
Single-family residential	132	132		90	
Multi-family residential	92	92	13	92	1
Commercial:					
Non-owner occupied	2,657	2,657	264	2,340	57
Owner occupied	407	407	7	736	6
Land	398	379	15	384	6
Total with an allowance recorded	4,371	4,352	872	4,338	83
Total	\$ 14,119	\$ 11,539	\$ 872	\$ 10,804	\$ 94

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents loans individually evaluated for impairment by class of loans at December 31, 2011. The unpaid principal balance is the contractual principal balance outstanding. The recorded investment is the unpaid principal balance adjusted for partial charge-offs, purchase premiums and discounts, deferred loan fees and costs and includes accrued interest. There was no cash-basis interest income recognized during the three months ended March 31, 2011.

	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	For the three months ended March 31, 2011 Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 573	\$ 47	\$	\$ 144	\$
Real estate:					
Single-family residential				95	
Multi-family residential	6,742	4,996			
Commercial:					
Non-owner occupied	2,177	1,755		77	
Owner occupied	876	446			
Land				694	10
Consumer:					
Home equity lines of credit:					
Originated for portfolio	135	135		137	
Total with no allowance recorded	10,503	7,379		1,147	10
With an allowance recorded:					
Commercial	796	774	624	1,862	
Real estate:					
Multi-family residential	94	94	11	3,719	
Commercial:					
Non-owner occupied	2,823	2,823	210	2,253	
Owner occupied	411	411	20		
Land	766	650	32	1,051	
Total with an allowance recorded	4,890	4,752	897	8,885	
Total	\$ 15,393	\$ 12,131	\$ 897	\$ 10,032	\$ 10

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents the recorded investment in nonaccrual loans by class of loans:

	March 31, 2012	December 31, 2011
Nonaccrual loans:		
Commercial	\$ 145	\$ 47
Real estate:		
Single-family residential	619	736
Multi-family residential	2,053	4,996
Commercial:		
Non-owner occupied	2,069	1,910
Owner occupied	422	446
Land	372	
Consumer:		
Home equity lines of credit:		
Originated for portfolio	135	157
Purchased for portfolio	9	9
Other consumer	29	
Total nonaccrual and nonperforming loans	\$ 5,853	\$ 8,301

Nonaccrual loans include both smaller balance single-family mortgage and consumer loans that are collectively evaluated for impairment and individually classified impaired loans. There were no loans 90 days or more past due and still accruing interest at March 31, 2012 or December 31, 2011.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of March 31, 2012:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Nonaccrual Loans Not > 90 Days Past Due
Commercial	\$ 75	\$	\$ 9	\$ 84	\$ 21,416	\$ 136
Real estate:						
Single-family residential	674	315	101	1,090	15,828	518
Multi-family residential			2,053	2,053	22,841	
Commercial:						
Non-owner occupied	326		201	527	33,763	1,868
Owner occupied			422	422	26,969	
Land			372	372	4,796	
Consumer:						
Home equity lines of credit:						
Originated for portfolio			135	135	11,908	
Purchased for portfolio			9	9	2,538	
Other	33			33	1,139	29
Total	\$ 1,108	\$ 315	\$ 3,302	\$ 4,725	\$ 141,198	\$ 2,551

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2011:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Nonaccrual Loans Not > 90 Days Past Due
Commercial	\$ 103	\$	\$	\$ 103	\$ 25,891	\$ 47
Real estate:						
Single-family residential	714	474	491	1,679	16,535	245
Multi-family residential			3,065	3,065	24,098	1,931
Commercial:						
Non-owner occupied	173	275	68	516	35,899	1,842
Owner occupied					27,900	446
Land					5,442	
Consumer:						
Home equity lines of credit:						
Originated for portfolio	22		135	157	12,126	22
Purchased for portfolio			9	9	2,629	
Other		30		30	1,191	
Total	\$ 1,012	\$ 779	\$ 3,768	\$ 5,559	\$ 151,711	\$ 4,533

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

Troubled Debt Restructurings (TDRs):

The Company has allocated \$872 and \$897 of specific reserves to loans whose terms have been modified in TDRs as of March 31, 2012 and December 31, 2011. The Company has not committed to lend additional amounts as of March 31, 2012 or December 31, 2011 to customers with outstanding loans that are classified as nonaccrual TDRs.

During the quarter ended March 31, 2012, the terms of one loan was modified as a TDR, where concessions were granted to a borrower experiencing financial difficulties. The modification of the terms of this single-family residential loan included a reduction in the stated interest rate of the loan from 10% to 5%, a waiver of a portion of the accrued and unpaid interest, addition of the remaining accrued and unpaid interest to the principal balance and extension of the maturity date from 2034 to 2042. This modification involved a reduction in the stated interest rate of the loan for a period of 30 years.

The following table presents loans modified as TDRs by class of loans during the three months ended March 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate:			
Single-family residential	1	\$ 132	\$ 138
Total	1	\$ 132	\$ 138

The TDR described did not impact the ALLL and did not result in a charge-off during the three months ended March 31, 2012.

There were no TDRs in payment default or that became nonperforming during the period ended March 31, 2012, that had been modified within the twelve months ended March 31, 2012. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms, at which time the loan is re-evaluated to determine whether an impairment loss should be recognized, either through a write-off or specific valuation allowance, so that the loan is reported, net, at the present value of estimated future cash flows, or at the fair value of collateral, less cost to sell, if repayment is expected solely from the collateral.

The terms of certain other loans were modified during the three months ended March 31, 2012 that did not meet the definition of a TDR. These loans had a total recorded investment as of March 31, 2012 of \$2,815. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties, a delay in a payment that was considered to be insignificant or there were no concessions granted.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

There were no loans which were modified during the three months ended March 31, 2012 that did not meet the definition of a TDR due to a delay in payment that was considered to be insignificant.

Nonaccrual loans include loans that were modified and identified as TDRs and the loans are not performing. At March 31, 2012 and December 31, 2011, nonaccrual TDRs were as follows:

	March 31, 2012	December 31, 2011
Commercial	\$ 9	\$ 47
Real estate:		
Single-family residential	132	
Multi-family residential		2,527
Commercial:		
Owner occupied	422	446
Total	\$ 563	\$ 3,020

Nonaccrual loans at March 31, 2012 and December 31, 2011 do not include \$6,211 and \$4,597, respectively, of TDRs where customers have established a sustained period of repayment performance, generally six months, loans are current according to their modified terms and repayment of the remaining contractual payments is expected. These loans are included in total impaired loans.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes loans individually by classifying the loans as to credit risk. This analysis includes commercial, commercial real estate and multi-family residential real estate loans. Internal loan reviews for these loan types are performed at least annually, and more often for loans with higher credit risk. Adjustments to loan risk ratings are made based on the reviews and at any time information is received that may affect risk ratings. The following definitions are used for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of CFBank's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that there will be some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as 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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

Loans not meeting the criteria to be classified into one of the above categories are considered to be not rated or pass-rated loans. Loans listed as not rated are primarily groups of homogeneous loans. Past due information is the primary credit indicator for groups of homogenous loans. Loans listed as pass-rated loans are loans that are subject to internal loan reviews and are determined not to meet the criteria required to be classified as special mention, substandard or doubtful. The recorded investment in loans by risk category and by class of loans as of March 31, 2012 and based on the most recent analysis performed follows. There were no loans rated doubtful at March 31, 2012.

	Not Rated	Pass	Special Mention	Substandard	Total
Commercial	\$ 424	\$ 15,142	\$ 1,663	\$ 4,271	\$ 21,500
Real estate:					
Single-family residential	16,299			619	16,918
Multi-family residential		14,188	5,870	4,836	24,894
Commercial:					
Non-owner occupied	351	21,539	5,764	6,636	34,290
Owner occupied		23,703	1,378	2,310	27,391
Land	930	710		3,528	5,168
Consumer:					
Home equity lines of credit:					
Originated for portfolio	11,908			135	12,043
Purchased for portfolio	2,096		442	9	2,547
Other	1,143			29	1,172
	\$ 33,151	\$ 75,282	\$ 15,117	\$ 22,373	\$ 145,923

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 4 LOANS (continued)

The recorded investment in loans by risk category and by class of loans as of December 31, 2011 follows.

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 432	\$ 19,591	\$ 2,062	\$ 3,909	\$	\$ 25,994
Real estate:						
Single-family residential	17,478			736		18,214
Multi-family residential		15,395	4,539	6,822	407	27,163
Commercial:						
Non-owner occupied	365	22,159	5,717	8,176		36,417
Owner occupied		22,526	3,474	1,898		27,898
Land	954	1,123		3,365		5,442
Consumer:						
Home equity lines of credit:						
Originated for portfolio	12,126			157		12,283
Purchased for portfolio	2,182		447	9		2,638
Other	1,221					1,221
	\$ 34,758	\$ 80,794	\$ 16,239	\$ 25,072	\$ 407	\$ 157,270

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 5 FORECLOSED ASSETS

Foreclosed assets were as follows:

	March 31, 2012	December 31, 2011
Real estate:		
Single-family residential	\$ 83	\$
Commercial	3,509	3,509
Subtotal	3,592	3,509
Valuation allowance	(1,139)	(1,139)
Total	\$ 2,453	\$ 2,370

There was no activity in the valuation allowance for the three months ended March 31, 2012 or 2011.

Expenses related to foreclosed assets included operating expenses, net of rental income and totaled \$18 and \$33, respectively, for the three months ended March 31, 2012 and 2011.

Foreclosed assets at March 31, 2012 and December 31, 2011 included three commercial real estate properties. Foreclosed assets at March 31, 2012 also included one single-family residential property. The valuation allowance was established in the second quarter of 2011 due to a decline in real estate values on one of the commercial real estate properties, which is undeveloped commercial real estate located in Columbus, Ohio.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value:

Securities available for sale: The fair value of securities available for sale is determined using pricing models that vary based on asset class and include available trade, bid and other market information or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Loans held for sale, at fair value: Loans held for sale are carried at fair value, as determined by outstanding commitments from third party investors (Level 2).

Derivatives: The fair value of derivatives is based on valuation models using observable market data as of the measurement date (Level 2).

Loan servicing rights: On a quarterly basis, loan servicing rights are evaluated for impairment based on the fair value of the rights as compared to carrying amount. If the carrying amount of an individual tranche exceeds fair value, impairment is recorded on that tranche so that the servicing asset is carried at fair value. Fair value is determined at a tranche level based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model utilizes assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data (Level 2).

Impaired loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the ALLL. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Foreclosed assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

Appraisals for both collateral-dependent impaired loans and foreclosed assets are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by a third-party appraisal management company approved by the Board of Directors annually. Once received, the loan officer or a member of the credit department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are updated as needed based on facts and circumstances associated with the individual properties. Real estate appraisals typically incorporate measures such as recent sales prices for comparable properties. Appraisers may make adjustments to the sales prices of the comparable properties as deemed appropriate based on the age, condition or general characteristics of the subject property. Management applies an additional discount to real estate appraised values, typically to reflect changes in market conditions since the date of the appraisal and to cover disposition costs (including selling expenses) based on the intended disposition method of the property.

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurements at March 31, 2012 Using Significant Other Observable Inputs (Level 2)
Financial Assets:	
Securities available for sale:	
Issued by U.S. government-sponsored entities and agencies:	
Mortgage-backed securities - residential	\$ 2,494
Collateralized mortgage obligations	15,614
Total securities available for sale	\$ 18,108
Loans held for sale	\$ 833
Yield maintenance provisions (embedded derivatives)	\$ 970
Interest rate lock commitments	\$ 33
Financial Liabilities:	
Interest-rate swaps	\$ 970

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

	Fair Value Measurements at December 31, 2011 Using Significant Other Observable Inputs (Level 2)
Financial Assets:	
Securities available for sale:	
Issued by U.S. government-sponsored entities and agencies:	
Mortgage-backed securities - residential	\$ 1,673
Collateralized mortgage obligations	16,843
Total securities available for sale	\$ 18,516
Loans held for sale	\$ 1,210
Yield maintenance provisions (embedded derivatives)	\$ 999
Interest rate lock commitments	\$ 39
Financial Liabilities:	
Interest-rate swaps	\$ 999

The Company had no assets or liabilities measured at fair value on a recurring basis that were measured using Level 1 or Level 3 inputs at March 31, 2012 or December 31, 2011.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at March 31, 2012	
		Using Significant Unobservable Inputs (Level 3)
Impaired loans:		
Commercial	\$	145
Real Estate:		
Multi-family residential		3,961
Commercial:		
Non-owner occupied		2,069
Owner occupied		422
Land		166
Total impaired loans	\$	6,763
Foreclosed assets		
Land	\$	1,209

	Fair Value Measurements at December 31, 2011 Using Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
Loan servicing rights	\$	9	
Impaired loans:			
Commercial	\$		108
Real Estate:			
Multi-family residential			3,065
Commercial:			
Non-owner occupied			2,887
Owner occupied			516
Land			233
Total impaired loans	\$		6,809

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Foreclosed assets	
Land	\$ 1,209

The Company had no assets or liabilities measured at fair value on a non-recurring basis that were measured using Level 1 inputs at March 31, 2012 or December 31, 2011. The Company had no assets or liabilities measured at fair value on a non-recurring basis that were measured using Level 2 inputs at March 31, 2012.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

There were no impaired loan servicing rights at March 31, 2012. At December 31, 2011, impaired loan servicing rights, which are carried at fair value, were \$9, which was made up of the amortized cost of \$11, net of a valuation allowance of \$2. There was a \$1 increase in earnings with respect to servicing rights for the three months ended March 31, 2012. There was a \$2 increase in earnings with respect to servicing rights for the three months ended March 31, 2011.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had an unpaid principal balance of \$9,344 and a fair value of \$6,763, with no valuation allowance at March 31, 2012. Impaired collateral dependent loans were written down to the fair value of collateral during the quarter ended March 31, 2012, and there were no specific valuation allowances on these loans. The amount of charge-offs on these loans totaled \$865 for the three months ended March 31, 2012. Impaired loans carried at the fair value of collateral had an unpaid principal balance of \$10,069 and a fair value of \$6,809, with no valuation allowance at December 31, 2011. There was a \$35 increase in the valuation allowance for the three months ended March 31, 2011.

Foreclosed assets which are carried at fair value less costs to sell, had a net carrying amount of \$1,209, which was made up of the outstanding balance of \$2,348, net of a valuation allowance of \$1,139 at both March 31, 2012 and December 31, 2011. There was no charge against earnings for the three months ended March 31, 2012 or 2011.

During the three months ended March 31, 2012, the Company did not have any significant transfers of assets or liabilities between those measured using Level 1 or 2 inputs. The Company recognizes transfers of assets and liabilities between Level 1 and 2 inputs based on the information relating to those assets and liabilities at the end of the reporting period.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)Financial Instruments Recorded Using Fair Value Option

The Company has elected the fair value option for loans held for sale. These loans are intended for sale and the Company believes that the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Company's policy on loans held for investment. None of these loans were 90 days or more past due or on nonaccrual as of March 31, 2012 or December 31, 2011.

As of March 31, 2012 and December 31, 2011, the aggregate fair value, contractual balance (including accrued interest) and gain or loss was as follows:

	March 31, 2012	December 31, 2011
Aggregate fair value	\$ 833	\$ 1,210
Contractual balance	828	1,196
Gain	5	14

The total amount of gains and losses from changes in fair value included in earnings for the three months ended March 31, 2012 and 2011 for loans held for sale were:

	Three months ended March 31,	
	2012	2011
Interest income	\$ 12	\$ 11
Change in fair value	(9)	(12)
Total change in fair value	\$ 3	\$ (1)

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

The carrying amounts and estimated fair values of financial instruments at March 31, 2012 were as follows:

	Carrying Value	Fair Value Measurements at March 31, 2012 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$ 63,284	\$ 63,284	\$	\$	\$ 63,284
Interest-bearing deposits in other financial institutions	1,984	1,984			1,984
Securities available for sale	18,108		18,108		18,108
Loans held for sale	833		833		833
Loans, net	140,282			144,180	144,180
FHLB stock	1,942				n/a
Accrued interest receivable	84	11	73		84
Yield maintenance provisions (embedded derivatives)	970		970		970
Interest rate lock commitments	33		33		33
Financial liabilities					
Deposits	\$ (207,872)	\$ (81,868)	\$ (128,114)	\$	\$ (209,982)
FHLB advances	(15,742)		(16,250)		(16,250)
Subordinated debentures	(5,155)		(2,807)		(2,807)
Accrued interest payable	(359)		(359)		(359)
Interest-rate swaps	(970)		(970)		(970)

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

The carrying amounts and estimated fair values of financial instruments at December 31, 2011 were as follows:

	December 31, 2011	
	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	\$ 61,436	\$ 61,436
Interest-bearing deposits in other financial institutions	1,984	1,984
Securities available for sale	18,516	18,516
Loans held for sale	1,210	1,210
Loans, net	151,160	155,159
FHLB stock	1,942	n/a
Accrued interest receivable	92	92
Yield maintenance provisions (embedded derivatives)	999	999
Interest rate lock commitments	39	39
Financial liabilities		
Deposits	\$ (217,049)	\$ (219,235)
FHLB advances	(15,742)	(16,327)
Subordinated debentures	(5,155)	(2,810)
Accrued interest payable	(300)	(300)
Interest-rate swaps	(999)	(999)

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and Cash Equivalents

The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Interest-Bearing Deposits in Other Financial Institutions

The carrying amounts of interest bearing deposits in other financial institutions approximate fair values and are classified as Level 1.

FHLB Stock

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans

Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 6 FAIR VALUE (continued)

Other Borrowings

The fair values of the Company's long-term FHLB advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value resulting in a Level 1 or 2 classification, consistent with the asset or liability they are associated with.

Off-Balances-Sheet Instruments

The fair value of off-balance-sheet items is not considered material.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 7 FHLB ADVANCES

Advances from the FHLB were as follows:

	Rate	March 31, 2012	December 31, 2011
Fixed-rate advances:			
Maturing:			
April 2012	2.30%	\$ 5,000	\$ 5,000
June 2012	2.05%	742	742
January 2014	3.12%	5,000	5,000
May 2014	3.06%	5,000	5,000
Total		\$ 15,742	\$ 15,742

Each advance is payable at its maturity date, with a prepayment penalty for fixed-rate advances.

The advances were collateralized as follows:

	March 31, 2012	December 31, 2011
Single-family mortgage loans	\$ 10,245	\$ 11,141
Multi-family mortgage loans	5,679	4,222
Commercial real estate loans	1,879	3,384
Securities	8,015	9,336
Cash	1,800	800
Total	\$ 27,618	\$ 28,883

Based on the collateral pledged to FHLB and CFBank's holdings of FHLB stock, CFBank was eligible to borrow up to a total of \$20,334 from the FHLB at March 31, 2012. In May 2011, CFBank was notified by the FHLB that, due to regulatory considerations, CFBank was only eligible for future advances with a maximum maturity of one year. CFBank was notified by the FHLB that the maximum maturity for future advances was further reduced to 180 days in November 2011 and 30 days in April 2012.

Payment information

Payments due during the twelve months ended:	
March 31, 2013	\$ 5,742
March 31, 2014	5,000
March 31, 2015	5,000
Total	\$ 15,742

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 8 OTHER BORROWINGS

There were no outstanding borrowings with the Federal Reserve Bank (FRB) at March 31, 2012 or at December 31, 2011.

Assets pledged as collateral with the FRB were as follows:

	March 31, 2012	December 31, 2011
Commercial loans	\$ 5,933	\$ 6,559
Commercial real estate loans	20,639	21,007
	\$ 26,572	27,566

Based on the collateral pledged, CFBank was eligible to borrow up to \$14,976 from the FRB at March 31, 2012. In April 2011, CFBank was notified by the FRB that, due to regulatory considerations, it was no longer eligible for borrowings under the FRB's Primary Credit Program, but was only eligible to borrow under the FRB's Secondary Credit Program. Under the FRB's Primary Credit Program, CFBank had access to short-term funds at any time, for any reason based on the collateral pledged. Under the Secondary Credit Program, which involves a higher level of administration, each borrowing request must be individually underwritten and approved by the FRB, CFBank's collateral is automatically reduced by 10% and the cost of borrowings is 50 basis points higher.

CFBank had a \$1.0 million line of credit with a commercial bank at both March 31, 2012 and at December 31, 2011. There was no outstanding balance on this line of credit at March 31, 2012 or December 31, 2011. Interest on this line accrues daily and is variable based on the commercial bank's cost of funds and current market returns.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 9 SUBORDINATED DEBENTURES

In December 2003, Central Federal Capital Trust I, a trust formed by the Holding Company, closed a pooled private offering of 5,000 trust preferred securities with a liquidation amount of \$1 per security. The Holding Company issued \$5,155 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 Holding Company is not considered the primary beneficiary of this trust (variable interest entity); therefore, the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. The Holding Company's investment in the common stock of the trust was \$155 and is included in other assets.

The Holding Company may redeem the subordinated debentures, in whole or in part, in a principal amount with integral multiples of \$1, on or after December 30, 2008 at 100% of the principal amount, plus accrued and unpaid interest. The subordinated debentures mature on December 30, 2033. The subordinated debentures are also redeemable in whole or in part, from time to time, upon the occurrence of specific events defined within the trust indenture. There are no required principal payments on the subordinated debentures over the next five years. The Holding Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years. The Company's Board of Directors elected to defer interest payments beginning with the quarterly payment due on December 31, 2010 in order to preserve cash at the Holding Company. Cumulative deferred interest payments totaled \$256 at March 31, 2012 and \$210 at December 31, 2011.

The trust preferred securities and subordinated debentures have a variable rate of interest, reset quarterly, equal to the three-month London Interbank Offered Rate (LIBOR) plus 2.85%. The total rate in effect was 3.32% at March 31, 2012 and 3.43% at December 31, 2011.

Pursuant to the Holding Company Order, as defined in Note 2 - Going Concern Considerations and Management's Plans, the Holding Company may not, directly or indirectly, incur, issue, renew, rollover, or pay interest or principal on any debt (including the subordinated debentures) or commit to do so, increase any current lines of credit, or guarantee the debt of any entity, without prior written notice to and written non-objection from the FED.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 10 STOCK-BASED COMPENSATION

The Company has three stock-based compensation plans (the Plans), as described below, under which awards have been or may be issued. Total compensation cost that was charged against income for those Plans totaled \$6 and \$13, respectively, for the three months ended March 31, 2012 and 2011. The total income tax (expense) benefit was \$1 and \$3, respectively, for the three months ended March 31, 2012 and 2011.

The Plans, which are stockholder-approved, provide for stock option grants and restricted stock awards to directors, officers and employees. The 1999 Stock-Based Incentive Plan, which expired July 13, 2009, provided 38,778 shares for stock option grants and 15,511 shares for restricted stock awards. The 2003 Equity Compensation Plan (2003 Plan), as amended and restated, provided an aggregate of 100,000 shares for stock option grants and restricted stock awards, of which up to 30,000 shares could be awarded in the form of restricted stock awards. The 2009 Equity Compensation Plan, which was approved by stockholders on May 21, 2009, replaced the 2003 Plan and provides 200,000 shares, plus any remaining shares available to grant or that are later forfeited or expire under the 2003 Plan, that may be issued as stock option grants, stock appreciation rights or restricted stock awards.

Stock Options

The Plans permit the grant of stock options to directors, officers and employees for up to 338,778 shares of common stock, net of restricted stock awards. Option awards are granted with an exercise price equal to the market price of the Company's common stock on the date of grant, generally have vesting periods ranging from one to three years and are exercisable for ten years from the date of grant. Unvested stock options immediately vest upon a change in control.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. Management and other employee stock options are tracked separately. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Department of the Treasury (Treasury) yield curve in effect at the time of the grant.

There were no options granted during the three months ended March 31, 2012. The fair value of the options granted during the three months ended March 31, 2011 was determined using the following weighted-average assumptions as of the grant dates.

	Three months ended March 31, 2011
Risk-free interest rate	2.98%
Expected term (years)	7
Expected stock price volatility	46%
Dividend yield	1.41%

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 10 STOCK-BASED COMPENSATION (continued)

A summary of stock option activity in the Plans for the three months ended March 31, 2012 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Intrinsic Value
Outstanding at beginning of year	43,296	\$ 24.87		
Granted				
Exercised				
Expired				
Cancelled or Forfeited	(230)	3.73		
Outstanding at end of year	43,066	\$ 24.98	6.1	\$
Expected to vest	11,980	\$ 4.96	8.6	\$
Exercisable at end of period	31,086	\$ 32.70	5.1	\$

During the three months ended March 31, 2012, there were 230 stock options canceled or forfeited. Previously recognized expense associated with nonvested forfeited shares is reversed.

Information related to the Plans during the three months ended March 31, 2012 and 2011 follows.

	Three months ended March 31,	
	2012	2011
Weighted average fair value of options granted	n/a	\$ 3.75

As of March 31, 2012, there was \$7 of total unrecognized compensation cost related to nonvested stock options granted under the Plans. The cost is expected to be recognized over a weighted-average period of 1.2 years. Substantially all of the 11,980 nonvested stock options at March 31, 2012 are expected to vest.

Restricted Stock Awards

The Plans permit the grant of restricted stock awards to directors, officers and employees. Compensation is recognized over the vesting period of the shares based on the fair value of the stock at grant date. The fair value of the stock was determined using the closing share price on the date of grant and shares have vesting periods ranging from one to three years. There were 231,842 shares available to be issued, net of option awards under the Plans at March 31, 2012. There were no shares issued during the three months ended March 31, 2012.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 10 STOCK-BASED COMPENSATION (continued)

A summary of changes in the Company's nonvested restricted shares for the three months ended March 31, 2012 follows:

Nonvested Shares	Shares	Weighted Average Grant- Date Fair Value
Nonvested at January 1, 2012	4,800	\$ 6.88
Granted		
Vested		
Forfeited		
Nonvested at March 31, 2012	4,800	\$ 6.88

As of March 31, 2012, there was \$9 of total unrecognized compensation cost related to nonvested shares granted under the Plans. The cost is expected to be recognized over a weighted-average period of 1.0 year. There were no shares vested during the three months ended March 31, 2012. The total fair value of shares vested during the three months ended March 31, 2011 was \$4.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 11 PREFERRED STOCK

On December 5, 2008, in connection with the Troubled Asset Relief Program (TARP) Capital Purchase Program, the Company issued to Treasury 7,225 shares of Central Federal Corporation Fixed Rate Cumulative Perpetual Preferred Stock, Series A (Preferred Stock) for \$7,225. The Preferred Stock initially pays quarterly dividends at a five percent annual rate, which increases to nine percent after February 14, 2014, on a liquidation preference of \$1 per share.

The Preferred Stock has preference over the Company's common stock with respect to the payment of dividends and distribution of the Company's assets in the event of a liquidation or dissolution. Except in certain circumstances, the holders of Preferred Stock have no voting rights. If any quarterly dividend payable on the Preferred Stock is in arrears for six or more quarterly dividend periods (whether consecutive or not), the holders will be entitled to vote for the election of two additional directors. These voting rights terminate when the Company has paid the dividends in full.

The Holding Company's Board of Directors elected to defer the dividends beginning with the dividend payable on November 15, 2010 in order to preserve cash at the Holding Company. As of March 31, 2012, six quarterly dividend payments had been deferred. Cumulative deferred dividends totaled \$563 at March 31, 2012 and \$466 at December 31, 2011. Although deferred, the dividends have been accrued with an offsetting charge to accumulated deficit.

As required under the TARP Capital Purchase Program in connection with the sale of the Preferred Stock to Treasury, dividend payments on, and repurchases of, the Company's outstanding preferred and common stock are subject to certain restrictions. For as long as any Preferred Stock is outstanding, no dividends may be declared or paid on the Company's outstanding common stock until all accrued and unpaid dividends on Preferred Stock are fully paid. In addition, Treasury's consent was required on any increase in quarterly dividends declared on shares of common stock in excess of \$.25 per share before December 5, 2011, the third anniversary of the issuance of the Preferred Stock, unless the Preferred Stock was redeemed by the Company or transferred in whole by Treasury. Further, Treasury's consent was required for any repurchase of any equity securities or trust preferred securities, except for repurchases of Preferred Stock or repurchases of common shares in connection with benefit plans consistent with past practice, before December 5, 2011, the third anniversary of the issuance of the Preferred Stock, unless redeemed by the Company or transferred in whole by Treasury. The Company did not seek to declare quarterly dividends in excess of \$.25 per share or repurchase any equity securities or trust preferred securities before December 5, 2011.

As a recipient of funding under the TARP Capital Purchase Program, the Company must comply with the executive compensation and corporate governance standards imposed by the American Recovery and Reinvestment Act of 2009 (ARRA) for as long as Treasury holds the above securities. The Company believes it is in full compliance with the executive compensation and corporate governance standards imposed by ARRA.

Pursuant to the Holding Company Order, as defined in Note 2 - Going Concern Considerations and Management's Plans, the Holding Company may not declare, make, or pay any cash dividends (including dividends on the Preferred Stock, or the Holding Company's common stock) or other capital distributions or purchase, repurchase or redeem or commit to purchase, repurchase, or redeem any Holding Company equity stock without the prior written non-objection of the FED.

The Holding Company has not declared, made, or paid any cash dividends (including dividends on the Preferred Stock, or the Holding Company's common stock) or other capital distributions or purchased, repurchased or redeemed any Holding Company equity stock since entering into the Holding Company Order.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 12 COMMON STOCK WARRANT

In connection with the issuance of the Preferred Stock, the Company also issued to Treasury a warrant to purchase 67,314 shares of the Company's common stock at an exercise price of \$16.10 per share, which would represent an aggregate investment, if exercised for cash, of approximately \$1,100 in Company common stock. The exercise price may be paid either by withholding a number of shares of common stock issuable upon exercise of the warrant equal to the value of the aggregate exercise price of the warrant, determined by reference to the market price of the Company's common stock on the trading day on which the warrant is exercised, or, if agreed to by the Company and the warrant holder, by the payment of cash equal to the aggregate exercise price. The warrant may be exercised any time before December 5, 2018.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 13 REGULATORY CAPITAL MATTERS

CFBank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

Actual and required capital amounts and ratios of CFBank are presented below:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations		Required By Terms Of CFBank Order	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>March 31, 2012</u>								
Total Capital to risk weighted assets	\$ 14,696	10.55%	\$ 11,143	8.00%	\$ 13,929	10.00%	\$ 16,715	12.00%
Tier 1 (Core) Capital to risk weighted assets	12,906	9.27%	5,572	4.00%	8,357	6.00%	N/A	N/A
Tier 1 (Core) Capital to adjusted total assets	12,906	5.39%	9,576	4.00%	11,970	5.00%	19,152	8.00%
Tangible Capital to adjusted total assets	12,906	5.39%	3,591	1.50%	N/A	N/A	N/A	N/A

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 13 REGULATORY CAPITAL MATTERS (continued)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations		Required By Terms Of CFBank Order	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2011								
Total Capital to risk weighted assets	\$ 15,351	10.30%	\$ 11,918	8.00%	\$ 14,897	10.00%	\$ 17,876	12.00%
Tier 1 (Core) Capital to risk weighted assets	13,436	9.02%	5,959	4.00%	8,938	6.00%	N/A	N/A
Tier 1 (Core) Capital to adjusted total assets	13,436	5.39%	9,968	4.00%	12,460	5.00%	19,937	8.00%
Tangible Capital to adjusted total assets	13,436	5.39%	3,738	1.50%	N/A	N/A	N/A	N/A

The CFBank Order required CFBank to have by September 30, 2011, and maintain thereafter, 8% Tier 1 (Core) Capital to adjusted total assets and 12% Total Capital to risk weighted assets, which it did not meet at September 30, 2011, December 31, 2011 or March 31, 2012. CFBank will not be considered well-capitalized as long as it is subject to individual minimum capital requirements. See Note 2 Going Concern Considerations and Management's Plans for additional information regarding the CFBank Order.

The Qualified Thrift Lender test requires at least 65% of assets be maintained in housing-related finance and other specified areas. If this test is not met, limits are placed on growth, branching, new investments, FHLB advances and dividends, or CFBank must convert to a commercial bank charter. Management believes that this test has been and continues to be met at March 31, 2012.

CFBank converted from a mutual to a stock institution in 1998, and a liquidation account was established at \$14,300, which was the net worth reported in the conversion prospectus. The liquidation account represents a calculated amount for the purposes described below, and it does not represent actual funds included in the consolidated financial statements of the Company. Eligible depositors who have maintained their accounts, less annual reductions to the extent they have reduced their deposits, would receive a distribution from this account if CFBank liquidated and sufficient funds were available after payment of all CFBank liabilities. Dividends may not reduce CFBank's stockholder's equity below the required liquidation account balance.

Dividend Restrictions

The Holding Company's principal source of funds for dividend payments is dividends received from CFBank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. CFBank must receive regulatory approval prior to any dividend payments. See Note 11 Preferred Stock for a description of restrictions on the payment of dividends on the Company's common stock as a result of participation in the TARP Capital Purchase Program and pursuant to the Holding Company Order. See Note 2 Going Concern Considerations and Management's Plans for additional information on the Holding Company Order.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

NOTE 14 DERIVATIVE INSTRUMENTS

Interest-rate swaps

CFBank utilizes interest-rate swaps as part of its asset/liability management strategy to help manage its interest rate risk position, and does not use derivatives for trading purposes. The notional amount of the interest-rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest-rate swap agreements. CFBank was party to interest-rate swaps with a combined notional amount of \$7,900 at March 31, 2012 and \$7,949 at December 31, 2011.

The objective of the interest-rate swaps is to protect the related fixed rate commercial real estate loans from changes in fair value due to changes in interest rates. CFBank has a program whereby it lends to its borrowers at a fixed rate with the loan agreement containing a two-way yield maintenance provision, which will be invoked in the event of prepayment of the loan, and is expected to exactly offset the fair value of unwinding the swap. The yield maintenance provision represents an embedded derivative which is bifurcated from the host loan contract and, as such, the swaps and embedded derivatives are not designated as hedges. Accordingly, both instruments are carried at fair value and changes in fair value are reported in current period earnings. CFBank currently does not have any derivatives designated as hedges.

Contingent Features: The counterparty to CFBank's interest-rate swaps is exposed to credit risk whenever the interest-rate swaps are in a liability position. At March 31, 2012, CFBank had pledged \$2,077 in securities as collateral for these derivatives. Should the liability increase, CFBank will be required to pledge additional collateral.

Additionally, CFBank's interest-rate swap instruments contain provisions that require CFBank to remain well capitalized under regulatory capital standards. The interest-rate swaps could be called by the counterparty as a result of CFBank's failure to maintain well-capitalized status due to the CFBank Order. While the counterparty has not requested payment at this time, it may elect to do so at any time while CFBank's capital is less than required for well-capitalized status. If the counterparty elected to request payment, CFBank would be required to remit \$970 based on the March 31, 2012 valuation of the interest-rate swaps. The yield maintenance provisions may not be unwound to offset the repayment of the interest-rate swaps, as they may only be invoked in the event of prepayment of the borrowers' loans. Should market interest rates decrease from March 31, 2012 levels, the payment may increase in the event the swaps are called. In the event the interest-rate swaps are called and CFBank is unable to replace them, CFBank will be exposed to the market risk of the valuation of the yield maintenance provisions and, absent the borrowers' prepaying the loans, as of March 31, 2012 would incur a net \$970 expense, subject to valuation fluctuations, over the remaining lives of the related loans.

Summary information about the derivative instruments is as follows: