

CENTRAL FEDERAL CORP  
Form 10-Q  
November 09, 2018  
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 September 30, 2018

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 34-1877137  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

7000 North High St., Worthington, Ohio 43085

(Address of principal executive offices) (Zip Code)

(614) 334-7979

(Registrant's telephone number, including area code)

---

(Former name or former address, 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 1, 2018, there were 4,298,044 shares of the registrant's Common Stock outstanding.

---

Table of Contents

CENTRAL FEDERAL CORPORATION

INDEX

<u>PART I. Financial Information</u>	Page
<u>Item 1. Financial Statements</u>	3
<u>Consolidated Balance Sheets as of September 30, 2018 (unaudited) and December 31, 2017</u>	3
<u>Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017 (unaudited)</u>	4
<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017 (unaudited)</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity for the three and nine months ended September 30, 2018 and 2017 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 (unaudited)</u>	7
<u>Notes to Consolidated Financial Statements (three and nine months ended September 30, 2018 and 2017 unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	38
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	53
<u>Item 4. Controls and Procedures</u>	54
<u>PART II. Other Information</u>	55
<u>Item 1. Legal Proceedings</u>	55
<u>Item 1A. Risk Factors</u>	55
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	55
<u>Item 3. Defaults Upon Senior Securities</u>	55
<u>Item 4. Mine Safety Disclosures</u>	55
<u>Item 5. Other Information</u>	55

Item 6. Exhibits

56

Signatures

57



Table of Contents

## CENTRAL FEDERAL CORPORATION

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	September 30, 2018 (unaudited)	December 31, 2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 59,368	\$ 45,498
Interest-bearing deposits in other financial institutions	100	100
Securities available for sale	11,064	11,773
Loans held for sale, at fair value	24,079	1,124
Loans and leases, net of allowance of \$7,005 and \$6,970	493,529	406,406
FHLB and FRB stock	3,476	3,227
Premises and equipment, net	3,723	3,533
Bank owned life insurance	5,168	5,065
Accrued interest receivable and other assets	5,872	4,699
Total assets	\$ 606,379	\$ 481,425
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits		
Noninterest bearing	\$ 91,083	\$ 89,588
Interest bearing	440,979	329,440
Total deposits	532,062	419,028
FHLB advances and other debt	21,500	13,500
Advances by borrowers for taxes and insurance	449	489
Accrued interest payable and other liabilities	3,626	2,992
Subordinated debentures	5,155	5,155
Total liabilities	562,792	441,164
Commitments and contingent liabilities	-	-
Stockholders' equity		
Common stock, \$.01 par value; shares authorized: 9,090,909(1); shares issued: 4,279,657 at September 30, 2018 and 4,273,085(1) at December 31, 2017	43	43
Series B Preferred stock, \$.01 par value; 480,000 shares authorized; 0 issued at September 30, 2018 and 0 at December 31, 2017	-	-
Additional paid-in capital	61,174	60,676
Accumulated deficit	(14,174)	(17,087)
Accumulated other comprehensive loss	(132)	(47)

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Treasury stock, at cost; 27,701 shares of common stock at September 30, 2018 and December 31, 2017	(3,324)	(3,324)
Total stockholders' equity	43,587	40,261
Total liabilities and stockholders' equity	\$ 606,379	\$ 481,425

(1) Restated for 1-for-5.5 reverse stock split on August 20, 2018 – See Note 1

See accompanying notes to consolidated financial statements.

3

---

Table of Contents

## CENTRAL FEDERAL CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Interest and dividend income				
Loans and leases, including fees	\$ 6,380	\$ 4,225	\$ 16,863	\$ 11,944
Securities	49	44	139	139
FHLB and FRB stock dividends	50	45	145	108
Federal funds sold and other	142	83	445	247
	6,621	4,397	17,592	12,438
Interest expense				
Deposits	1,707	771	4,037	2,115
FHLB advances and other debt	163	68	420	195
Subordinated debentures	68	54	194	156
	1,938	893	4,651	2,466
Net interest income	4,683	3,504	12,941	9,972
Provision for loan and lease losses	-	-	-	-
Net interest income after provision for loan losses	4,683	3,504	12,941	9,972
Noninterest income				
Service charges on deposit accounts	128	106	364	290
Net gains on sales of loans	451	23	1,268	70
Earnings on bank owned life insurance	34	33	102	100
Other	30	33	122	78
	643	195	1,856	538
Noninterest expense				
Salaries and employee benefits	2,116	1,544	6,026	4,450
Occupancy and equipment	224	170	573	503
Data processing	275	197	733	775
Franchise and other taxes	103	88	308	264
Professional fees	358	218	862	694
Director fees	106	76	301	218
Postage, printing and supplies	44	46	145	138
Advertising and marketing	367	48	1,004	97
Telephone	43	29	113	89
Loan expenses	29	45	72	124
Foreclosed assets, net	-	-	-	18
Depreciation	67	49	188	150



Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

FDIC premiums	141	64	328	221
Regulatory assessment	34	31	103	95
Other insurance	22	21	63	70
Other	103	56	297	149
	4,032	2,682	11,116	8,055
Income before incomes taxes	1,294	1,017	3,681	2,455
Income tax expense	239	332	704	810
Net income	1,055	685	2,977	1,645
Dividends on Series B preferred stock and accretion of discount	(26)	(214)	(64)	(643)
Net income attributable to common stockholders	\$ 1,029	\$ 471	\$ 2,913	\$ 1,002
Earnings per common share:				
Basic (Restated - See Note 1)	\$ 0.24	\$ 0.16	\$ 0.69	\$ 0.34
Diluted (Restated - See Note 1)	\$ 0.24	\$ 0.15	\$ 0.67	\$ 0.31

See accompanying notes to consolidated financial statements.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income	\$ 1,055	\$ 685	\$ 2,977	\$ 1,645
Other comprehensive loss:				
Unrealized holding losses arising during the period related to securities available for sale, net of tax of (\$3) and (\$2) and (\$18) and (\$3)	(16)	(3)	(85)	(6)
Other comprehensive loss, net of tax	(16)	(3)	(85)	(6)
Comprehensive income	\$ 1,039	\$ 682	\$ 2,892	\$ 1,639

See accompanying notes to consolidated financial statements.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands except per share data)

(Unaudited)

	Series		Additional Paid-In Capital	Accumulated Deficit	Accumulated		Total Stockholders' Equity
	Common Stock	Preferred Stock			Other Comprehensive (Loss)	Treasury Stock	
Balance at January 1, 2018	\$ 43	\$ -	\$ 60,676	\$ (17,087)	\$ (47)	\$ (3,324)	\$ 40,261
Net income				2,977			2,977
Other comprehensive loss					(85)		(85)
Issuance of 727 stock based incentive plan shares, net of forfeitures(1)	-		-				-
Restricted stock expense, net of forfeitures			290				290
Stock option expense, net of forfeitures							-
Exercise of warrants to common stock	-		144				144
Accretion of discount on warrants			64	(64)			-
Balance at September 30, 2018	\$ 43	\$ -	\$ 61,174	\$ (14,174)	\$ (132)	\$ (3,324)	\$ 43,587

(1) Restated for 1-for-5.5 reverse stock split on August 20, 2018 – See Note 1

	Series		Additional Paid-In Capital	Accumulated Deficit	Accumulated		Total Stockholders' Equity
	Common Stock	Preferred Stock			Other Comprehensive Income (Loss)	Treasury Stock	

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Balance at January 1, 2017	\$ 30	\$ 5	\$ 60,297	\$ (17,767)	\$ 2	\$ (3,275)	\$ 39,292
Net income				1,645			1,645
Other comprehensive loss					(6)		(6)
Restricted stock expense, net of forfeitures			181				181
Cash dividends declared on Series B preferred stock and accretion of discount			81	(643)			(562)
Balance at September 30, 2017	\$ 30	\$ 5	\$ 60,559	\$ (16,765)	\$ (4)	\$ (3,275)	\$ 40,550

See accompanying notes to consolidated financial statements.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands, except per share data)

(Unaudited)

	Nine months ended September 30,	
	2018	2017
Net Income	\$ 2,977	\$ 1,645
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan and lease losses	-	-
Depreciation	188	150
Amortization, net	(19)	(83)
Deferred income tax (benefit)	10	(30)
Originations of loans held for sale	(158,595)	(15,318)
Proceeds from sale of loans held for sale	136,908	14,691
Net gains on sales of loans	(1,268)	(70)
Write-down of premises and equipment	33	-
Loss on sale of foreclosed assets	-	7
Earnings on bank owned life insurance	(102)	(100)
Stock-based compensation expense	290	181
Net change in:		
Accrued interest receivable and other assets	(1,173)	(785)
Accrued interest payable and other liabilities	634	176
Net cash from (used by) operating activities	(20,117)	464
Cash flows from investing activities		
Available-for-sale securities:		
Maturities, prepayments and calls	2,089	2,148
Purchases	(1,475)	-
Loan and lease originations and payments, net	(61,147)	(41,517)
Loans purchased	(25,958)	-
Additions to premises and equipment	(411)	(293)
Purchase of FRB Stock	(249)	(1,285)
Proceeds from the sale of foreclosed assets	-	197
Net cash used by investing activities	(87,151)	(40,750)
Cash flows from financing activities		
Net change in deposits	113,034	5,589
Proceeds from FHLB advances and other debt	74,600	34,200
Repayments on FHLB advances and other debt	(66,600)	(28,700)
Net change in advances by borrowers for taxes and insurance	(40)	(226)
Cash dividends paid on Series B preferred stock	-	(562)

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Exercise of warrants to common stock	144	-
Net cash from financing activities	121,138	10,301
Net change in cash and cash equivalents	13,870	(29,985)
Beginning cash and cash equivalents	45,498	57,941
Ending cash and cash equivalents	\$ 59,368	\$ 27,956
Supplemental cash flow information:		
Interest paid	\$ 4,533	\$ 2,479
Income tax paid	660	605
Supplemental noncash disclosures:		
Loans issued to finance the sale of repossessed assets	\$ -	\$ 288
Dividends payable on Series B preferred stock	-	187

See accompanying notes to consolidated financial statements.

7

---

Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation:

The consolidated financial statements include Central Federal Corporation (the “Holding Company”) and its wholly-owned subsidiary, CFBank, National Association (“CFBank”). The Holding Company and CFBank are sometimes collectively referred to herein as the “Company”. Intercompany transactions and balances are eliminated in consolidation. 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 and nine months ended September 30, 2018 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 Annual Report on Form 10-K on file with the SEC. Reference is made to the accounting policies of the Company described in Note 1 to the Audited Consolidated Financial Statements contained in the Company’s 2017 Annual Report to Stockholders that was filed as Exhibit 13.1 to the Company’s Form 10-K for the year ended December 31, 2017 (referred to herein as the “2017 Audited Financial Statements”). The Company has consistently followed those policies in preparing this Form 10-Q.

**Reverse Stock Split:** On August 20, 2018, the Company effected a 1-for-5.5 reverse stock split, whereby each 5.5 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.

**Loans and Leases:** Loans and leases that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, adjusted for purchase premiums and discounts, deferred loan fees and costs and an allowance for loan and lease losses (ALLL). Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level yield method without anticipating prepayments.

The accrual of interest income on all classes of loans, except other consumer loans, is discontinued and the loan is placed on nonaccrual status at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Other consumer loans are typically charged off no later than 90 days past due. Past due status is based on the contractual terms of the loan for all classes of loans. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90

days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Commercial loans, multi-family residential real estate loans and commercial real estate loans placed on nonaccrual status are individually classified as impaired loans.

All interest accrued but not received for each loan placed on nonaccrual is reversed against interest income in the period in which the loan is placed in a nonaccrual status. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual status. Loans are considered for return to accrual status if and when all the principal and interest amounts that are contractually due are brought current, there is a current and well documented credit analysis, there is reasonable assurance of repayment of principal and interest, and the customer has demonstrated sustained, amortizing payment performance of at least six months.

Allowance for Loan and Lease Losses (ALLL): The ALLL is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using 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. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that CFBank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans within any loan class for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and classified as impaired.



Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Factors considered by management in determining impairment for all loan classes include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

All loans within the commercial, multi-family residential and commercial real estate segments, regardless of size, and loans of all other classes with balances over \$250 are individually evaluated for impairment when they are 90 days past due, or earlier than 90 days past due if information regarding the payment capacity of the borrower indicates that payment in full according to the loan terms is doubtful. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral, less costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and single-family residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

TDRs of all classes of loans are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using each loan's effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. If the payment of the loan is dependent on the sale of the collateral, then costs to liquidate the collateral are included when determining the impairment. For TDRs that subsequently default, the amount of reserve is determined in accordance with the accounting policy for the ALLL.

Interest income on all classes of impaired loans that are on nonaccrual status is recognized in accordance with the accounting policy for nonaccrual loans. Cash receipts on all classes of impaired loans that are on nonaccrual status are generally applied to the principal balance outstanding. Interest income on all classes of impaired loans that are not on nonaccrual status is recognized on the accrual method. TDRs may be classified as accruing if the borrower has been current for a period of at least six months with respect to loan payments and management expects that the borrower will be able to continue to make payments in accordance with the terms of the restructured note.

The general reserve component covers non-impaired loans of all classes and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by loan class and is based on the actual loss history experienced by the Company over a three-year period. The general component is calculated based on CFBank's loan balances and actual historical three-year loss rates. For loans with little or no actual loss experience, industry estimates are used based on loan segment. This loss experience is supplemented with other economic and judgmental factors based on the risks present for each loan class. These economic and judgmental factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of

lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

CFBank's charge-off policy for commercial loans, single-family residential real estate loans, multi-family residential real estate loans, commercial real estate loans, construction loans and home equity lines of credit requires management to record a specific reserve or charge-off as soon as it is apparent that the borrower is troubled and there is, or likely will be, a collateral shortfall related to the estimated value of the collateral securing the loan. Other consumer loans are typically charged off no later than 90 days past due.

Joint Ventures: The Holding Company has contributed funds into a series of joint ventures (equity stake) for the purpose of allocating excess liquidity into higher earning assets while diversifying its revenue sources. The funding for the joint ventures is related to shorter term operating activities and is related to the development of single family real estate in the form of condominiums. Income is recognized based on a rate of return on the outstanding investment balance. As units are sold, the Holding Company receives an additional incentive payment, which is recognized as income.

Low Income Housing Tax Credits (LIHTC): CFBank has invested in low income housing tax credits through funds that assist corporations in investing in limited partnerships and limited liability companies that own, develop and operate low income residential rental properties for purposes of qualifying for the Housing Tax credit. These investments are accounted for under the proportional amortization method which recognizes the amortization of the investment in proportion to the tax credit and other tax benefits received.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Earnings Per Common Share: The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings available to common stockholders for the period are allocated between common stockholders and participating securities (unvested share-based payment awards) according to dividends declared (or accumulated) and participation rights in undistributed earnings. The factors used in the earnings per share computation follow:

	Three months ended September 30, 2018		Nine months ended September 30, 2017	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
<b>Basic</b>				
Net income	\$ 1,055	\$ 685	\$ 2,977	\$ 1,645
Dividends on Series B preferred stock and accretion of discount	(26)	(214)	(64)	(643)
Net income allocated to common stockholders	\$ 1,029	\$ 471	\$ 2,913	\$ 1,002
<b>Weighted average common shares outstanding including unvested share-based payment awards(1)</b>				
Less: Unvested share-based payment awards	4,251,820	2,960,378	4,247,800	2,961,376
Average shares	-	-	-	-
Basic earnings per common share	4,251,820	2,960,378	4,247,800	2,961,376
	\$ 0.24	\$ 0.16	\$ 0.69	\$ 0.34
<b>Diluted</b>				
Net earnings allocated to common stockholders	\$ 1,029	\$ 471	\$ 2,913	\$ 1,002
Add back: Dividends on Series B preferred stock and accretion of discount	-	214	-	-
Net earnings allocated to common stockholders	\$ 1,029	\$ 685	\$ 2,913	\$ 1,002
<b>Weighted average common shares outstanding for basic earnings per common share(1)</b>				
Add: Dilutive effects of assumed exercises of stock options	4,251,820	2,960,378	4,247,800	2,961,376
Add: Dilutive effects of preferred stock conversion	49,508	41,688	43,344	36,370
Add: Dilutive effects of assumed exercises of stock warrants	-	1,246,753	-	-
Average shares and dilutive potential common shares	65,894	209,477	51,127	209,477
Diluted earnings per common share	4,367,222	4,458,296	4,342,271	3,207,223
	\$ 0.24	\$ 0.15	\$ 0.67	\$ 0.31

(1) Adjusted for 1-for-5.5 reverse stock split on August 20, 2018

The following securities exercisable for or convertible into common shares were anti-dilutive and not considered in computing diluted earnings per common share:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
Stock options	883	990	895	990
Series B preferred stock	-	-	-	1,246,753

Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

**Dividend Restriction:** Banking regulations require us to maintain certain capital levels and may limit the dividends paid by CFBank to the Holding Company or by the Holding Company to stockholders. The ability of the Holding Company to pay dividends on its common stock is generally dependent upon the receipt of dividends and other distributions from CFBank. CFBank is a legal entity that is separate and distinct from the Holding Company and has no obligation to make any dividends or other funds available to the Holding Company for the payment of dividends by the Holding Company. The Holding Company also is subject to various legal and regulatory policies and guidelines impacting the Holding Company's ability to pay dividends on its stock. In addition, the Holding Company's ability to pay dividends on its stock is conditioned upon the payment, on a current basis, of quarterly interest payments on the subordinated debentures underlying the Company's trust preferred securities.

Effective October 6, 2017, all of the Holding Company's outstanding shares of Series B Preferred Stock were converted into shares of Common Stock of the Company. The conversion of the Series B Preferred Stock resulted in the elimination of the non-cumulative preferred dividend payments on the Series B Preferred Stock beginning with the fourth quarter of 2017.

**Adoption of New Accounting Standards:**

In May 2014 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09, including all subsequent amendments to the ASU, (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606, primarily service charges on deposits, are presented within noninterest income and are recognized as revenue as the Company satisfies its obligation to the customer. ASU 2014-09 became effective for us on January 1, 2018 and had no material effect on how we recognize revenue or to our consolidated financial statements and disclosures. See Note 2 – Revenue Recognition for additional information related to revenue generated from contracts with customers.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 amends the guidance in U.S. GAAP on the accounting for equity investments, financial liabilities under the fair value option and the presentations and disclosure requirements of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted the methodologies prescribed by the ASU by the date required. Adoption of ASU 2016-01 did not have a significant effect on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments which may change how an entity classifies certain cash receipts and cash payments on its

statement of cash flows to reduce diversity in practice. The update also provides guidance on when an entity should separate cash flows and classify them into more than one class and when an entity should classify the aggregate of those cash flows into a single class based on the predominance principle. The guidance in this ASU became effective for interim and annual reporting periods beginning after December 15, 2017. Adoption of ASU 2016-15 did not have a significant impact on the Company's consolidated financial statements.

The FASB has issued ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting. ASU 2017-09 applies to entities that change the terms or conditions of a share-based payment award. The FASB adopted ASU 2017-09 to provide clarity and reduce diversity in practice as well as cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to the modification of the terms and conditions of a share-based payment award. The amendments were effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of ASU 2017-09 did not have a significant impact on the Company's consolidated financial statements.

Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Future Accounting Matters:

On February 25, 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under the new ASU, lessees will recognize lease assets and liabilities on their balance sheets for all leases with terms of more than 12 months. The new lessee accounting model retains two types of leases, and is consistent with the lessee accounting model under existing GAAP. One type of lease (finance leases) will be accounted for in substantially the same manner as capital leases are accounted for today. The other type of lease (operating leases) will be accounted for (both in the income statement and statement of cash flows) in a manner consistent with today's operating leases. Lessor accounting under the new standard is fundamentally consistent with existing GAAP. Lessees and lessors would be required to provide additional qualitative and quantitative disclosures to help financial statement users assess the amount, timing, and uncertainty of cash flows arising from leases. These disclosures are intended to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an organization's leasing activities. For public business entities, the final lease standard will be effective for fiscal years beginning after December 15, 2018 including interim periods within those fiscal years. Early application is permitted. The Company continues to evaluate the provision of the new lease standard and although we have not yet reasonably determined the estimated financial statement impact. Due to the small number of lease agreements presently in effect for the Company, we believe the new guidance will not have a significant impact on the Company's consolidated financial statements, including disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Once effective, ASU 2016-13 will significantly change current guidance for recognizing impairment of financial instruments. Current guidance requires an "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. ASU 2016-13 replaces the incurred loss impairment methodology with a new methodology that reflects expected credit losses over the lives of the loans and requires consideration of a broader range of information to inform credit loss estimates. The ASU requires an organization to estimate all expected credit losses for financial assets measured at amortized cost, including loans and held-to-maturity debt securities, based on historical experience, current conditions, and reasonable and supportable forecasts. Additional disclosures are required. ASU 2016-13 also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. Under the new guidance, entities will determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. Any credit loss will be recognized as an allowance for credit losses on available-for-sale debt securities rather than as a direct reduction of the amortized cost basis of the investment, as is currently required. As a result, entities will recognize improvements to estimated credit losses on available-for-sale debt securities immediately in earnings rather than as interest income over time, as currently required. ASU 2016-13 eliminates the current accounting model for purchased credit impaired loans and debt securities. Instead, purchased financial assets with credit deterioration will be recorded gross of estimated credit losses as of the date of acquisition and the estimated credit losses amounts will be added to the allowance for credit losses. Thereafter, entities will account for additional impairment of such purchased assets using the models listed above. ASU 2016-13 will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While the Company generally expects that the implementation of ASU 2016-13

has the potential to increase its allowance for loan losses balance, the Company is continuing to evaluate the potential impact on the Company's financial statements and disclosures. Management is currently assessing any additional data and system requirements necessary for adoption. At this time, the estimated impact on the Company's consolidated financial statement, including disclosures, cannot be reasonably determined.

The FASB has issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The new standard is intended to improve and simplify accounting rules around hedge accounting. The new standard refines and expands hedge accounting for both financial (e.g., interest rate) and commodity risks. Its provisions create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes, for investors and analysts. The new standard takes effect for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, for public companies and for fiscal years beginning after December 15, 2019 (and interim periods for fiscal years beginning after December 15, 2020), for private companies. Early adoption is permitted in any interim period or fiscal years before the effective date of the standard. Adoption of ASU 2017-12 is not expected to have a significant impact on the Company's consolidated financial statements.

The FASB issued ASU No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220)—Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU provides financial statement preparers with an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded.



Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The ASU requires financial statement preparers to disclose:

- A description of the accounting policy for releasing income tax effects from AOCI;
- Whether they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act; and
- Information about the other income tax effects that are reclassified.

The amendments affect any organization that is required to apply the provisions of Topic 220, Income Statement—Reporting Comprehensive Income, and has items of other comprehensive income for which the related tax effects are presented in other comprehensive income as required by GAAP. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Adoption of ASU 2018-02 is not expected to have a material impact on the Company's consolidated financial statements.

General Litigation

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. In the opinion of management, the disposition or ultimate resolution of such claims and lawsuits is not anticipated to have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company.

Reclassifications

Reclassification of certain amounts in the 2017 consolidated financial statements have been made to conform to the 2018 presentation.

NOTE 2 – REVENUE RECOGNITION

Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers ("ASC 606"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage activities related to net gains on sale of loans.

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within Noninterest Income. Descriptions of our revenue-generating activities that are within the scope of ASC 606, which are presented in our income statements as components of non-interest income are as follows:

- Service charges on deposit accounts - these represent general service fees for monthly account maintenance and activity, or transaction-based fees, and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

## NOTE 3 – SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at September 30, 2018 and December 31, 2017 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
September 30, 2018 (unaudited)				
Issued by U.S. government-sponsored entities and agencies:				
U.S. Treasury	\$ 10,975	\$ -	\$ 171	\$ 10,804
Mortgage-backed securities - residential	184	3	-	187
Collateralized mortgage obligations	72	1	-	73
Total	\$ 11,231	\$ 4	\$ 171	\$ 11,064

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Issued by U.S. government-sponsored entities and agencies:				
U.S. Treasury	\$ 11,499	\$ -	\$ 82	\$ 11,417
Mortgage-backed securities - residential	236	8	-	244
Collateralized mortgage obligations	110	2	-	112
Total	\$ 11,845	\$ 10	\$ 82	\$ 11,773

There was no other-than-temporary impairment recognized in accumulated other comprehensive income (loss) for securities available for sale at September 30, 2018 or September 30, 2017.

There were no sales of securities for the three and nine months ended September 30, 2018 and 2017.

The amortized cost and fair value of debt securities at September 30, 2018 and December 31, 2017 are shown in the table below by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	September 30, 2018		December 31, 2017	
	(unaudited)			
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 3,498	\$ 3,476	\$ 3,002	\$ 2,993
Due from one to five years	7,477	7,328	8,497	8,424
Mortgage-backed securities - residential	184	187	236	244
Collateralized mortgage obligations	72	73	110	112
Total	\$ 11,231	\$ 11,064	\$ 11,845	\$ 11,773

Fair value of securities pledged was as follows:

	September	December
	30, 2018	31, 2017
	(unaudited)	
Pledged as collateral for:		
FHLB advances	\$ 4,540	\$ 4,641
Public deposits	1,988	2,018
Interest-rate swaps	113	145
Total	\$ 6,641	\$ 6,804

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

At September 30, 2018 and December 31, 2017, 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.

The following table summarizes securities with unrealized losses at September 30, 2018 and December 31, 2017, aggregated by major security type and length of time in a continuous unrealized loss position.

September 30, 2018 (unaudited)	Less than 12		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Description of Securities Issued by U.S. government-sponsored entities and agencies:						
U.S. Treasury	\$ 4,893	\$ 82	\$ 5,911	\$ 89	\$ 10,804	\$ 171
Total temporarily impaired	\$ 4,893	\$ 82	\$ 5,911	\$ 89	\$ 10,804	\$ 171

December 31, 2017	Less than 12		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Description of Securities Issued by U.S. government-sponsored entities and agencies:						
U.S. Treasury	\$ 6,947	\$ 51	\$ 4,470	\$ 31	\$ 11,417	\$ 82
Total temporarily impaired	\$ 6,947	\$ 51	\$ 4,470	\$ 31	\$ 11,417	\$ 82

The unrealized losses in U.S. Treasuries at September 30, 2018 and December 31, 2017 are related to multiple securities. 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 September 30, 2018 and December 31, 2017.

## NOTE 4 – LOANS AND LEASES

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

	September 30, 2018 (unaudited)	December 31, 2017
Commercial (1)	\$ 131,176	\$ 101,975
Real estate:		
Single-family residential	93,982	95,578
Multi-family residential	48,400	35,665
Commercial	151,385	111,866
Construction	46,081	42,862
Consumer:		
Home equity lines of credit	23,849	25,054
Other	5,661	376
Subtotal	500,534	413,376
Less: ALLL	(7,005)	(6,970)
Loans and leases, net	\$ 493,529	\$ 406,406

(1) Includes \$5,557 and \$6,008 of commercial leases at September 30, 2018 and December 31, 2017, respectively.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

## Mortgage Purchase Program

CFBank has participated in a Mortgage Purchase Program with Northpointe Bank (Northpointe), a Michigan banking corporation, since December 2012. Pursuant to the terms of a participation agreement, CFBank purchases participation interests in loans made by Northpointe related to fully underwritten and pre-sold mortgage loans originated by various prescreened mortgage brokers located throughout the U.S. The underlying loans are individually (MERS) registered loans which are held until funded by the end investor. The mortgage loan investors include Fannie Mae and Freddie Mac, and other major financial institutions. This process on average takes approximately 14 days. Given the short-term holding period of the underlying loans, common credit risks (such as past due, impairment and TDR, nonperforming, and nonaccrual classification) are substantially reduced. Therefore, no allowance is allocated by CFBank to these loans. These loans are 100% risk rated for CFBank capital adequacy purposes. Under the participation agreement, CFBank agrees to purchase a 95% ownership/participation interest in each of the aforementioned loans, and Northpointe maintains a 5% ownership interest in each loan it participates. At September 30, 2018 and December 31, 2017, CFBank held \$13,466 and \$37,665, respectively, of such loans which have been included in single-family residential loan totals above.

## Allowance for Loan and Lease Losses

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 and lease losses is charged to operations based on management's periodic evaluation of these and other pertinent factors described in Note 1 to the 2017 Audited Financial Statements.

The following table presents the activity in the ALLL by portfolio segment for the three and nine months ended September 30, 2018:

	Three months ended September 30, 2018 (unaudited)							Total
	Real Estate			Consumer				
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit	Other	
Beginning balance	\$ 1,889	\$ 1,039	\$ 697	\$ 2,149	\$ 614	\$ 486	\$ 107	\$ 6,981
Addition to (reduction in) provision for loan losses	40	(20)	-	10	5	(25)	(10)	-
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	19	-	-	-	5	-	24

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Ending balance                    \$ 1,929   \$ 1,038   \$ 697     \$ 2,159     \$ 619     \$ 466   \$ 97     \$ 7,005

	Nine months ended September 30, 2018 (unaudited)								
	Real Estate						Consumer Home Equity lines of		
	Commercial	Single-family	Multi-family	Commercial	Construction	credit	Other	Total	
Beginning balance	\$ 1,984	\$ 912	\$ 660	\$ 2,143	\$ 672	\$ 597	\$ 2	\$ 6,970	
Addition to (reduction in) provision for loan losses	(57)	111	37	16	(53)	(149)	95	-	
Charge-offs	-	(6)	-	-	-	-	-	(6)	
Recoveries	2	21	-	-	-	18	-	41	
Ending balance	\$ 1,929	\$ 1,038	\$ 697	\$ 2,159	\$ 619	\$ 466	\$ 97	\$ 7,005	



Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents the activity in the ALLL by portfolio segment for the three and nine months ended September 30, 2017:

	Three months ended September 30, 2017 (unaudited)					Consumer Home Equity lines of credit	Other	Total
	Real Estate							
	Commercial	Single-family	Multi-family	Commercial	Construction			
Beginning balance	\$ 1,770	\$ 956	\$ 725	\$ 2,365	\$ 586	\$ 554	\$ 2	\$ 6,958
Addition to (reduction in) provision for loan losses	113	(20)	72	(246)	52	29	-	-
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	1	-	-	-	5	-	6
Ending balance	\$ 1,883	\$ 937	\$ 797	\$ 2,119	\$ 638	\$ 588	\$ 2	\$ 6,964

	Nine months ended September 30, 2017 (unaudited)					Consumer Home Equity lines of credit	Other	Total
	Real Estate							
	Commercial	Single-family	Multi-family	Commercial	Construction			
Beginning balance	\$ 1,647	\$ 735	\$ 716	\$ 2,727	\$ 580	\$ 486	\$ 34	\$ 6,925
Addition to (reduction in) provision for loan losses	234	184	81	(608)	58	83	(32)	-
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	2	18	-	-	-	19	-	39
Ending balance	\$ 1,883	\$ 937	\$ 797	\$ 2,119	\$ 638	\$ 588	\$ 2	\$ 6,964

The following table presents the balance in the ALLL and the recorded investment in loans and leases by portfolio segment and based on the impairment method as of September 30, 2018 (unaudited):

	Real Estate			Consumer Home Equity lines of credit			Other	Total
	Commercial	Single-family	Multi-family	Commercial	Construction			
ALLL:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 24	\$ -	\$ -	\$ -	\$ 24
Collectively evaluated for impairment	1,929	1,038	697	2,135	619	466	97	6,981
Total ending allowance balance	\$ 1,929	\$ 1,038	\$ 697	\$ 2,159	\$ 619	\$ 466	\$ 97	\$ 7,005
Loans:								
Individually evaluated for impairment	\$ 201	\$ 112	\$ -	\$ 3,038	\$ -	\$ -	\$ -	\$ 3,351
Collectively evaluated for impairment	130,975	93,870	48,400	148,347	46,081	23,849	5,661	497,183
Total ending loan balance	\$ 131,176	\$ 93,982	\$ 48,400	\$ 151,385	\$ 46,081	\$ 23,849	\$ 5,661	\$ 500,534

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents the balance in the ALLL and the recorded investment in loans and leases by portfolio segment and based on the impairment method as of December 31, 2017:

	Real Estate			Consumer			Other	Total
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit		
ALLL:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 26	\$ -	\$ -	\$ -	\$ 26
Collectively evaluated for impairment	1,984	912	660	2,117	672	597	2	6,944
Total ending allowance balance	\$ 1,984	\$ 912	\$ 660	\$ 2,143	\$ 672	\$ 597	\$ 2	\$ 6,970
Loans:								
Individually evaluated for impairment	\$ 277	\$ 116	\$ -	\$ 3,183	\$ -	\$ -	\$ -	\$ 3,576
Collectively evaluated for impairment	101,698	95,462	35,665	108,683	42,862	25,054	376	409,800
Total ending loan balance	\$ 101,975	\$ 95,578	\$ 35,665	\$ 111,866	\$ 42,862	\$ 25,054	\$ 376	\$ 413,376

The following table presents loans individually evaluated for impairment by class of loans as of and for the period ended September 30, 2018. 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, and deferred loan fees and costs. The table presents accrual basis interest income recognized during the three and nine months ended September 30, 2018. Cash payments of interest on these loans during the three and nine months ended September 30, 2018 totaled \$52 and \$151, respectively.

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

	As of September 30, 2018 (unaudited)			Three months ended September 30, 2018 (unaudited)		Nine months ended September 30, 2018 (unaudited)	
	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	Average Recorded Investmen	Interest Recognized	Average Recorded Investmen	Interest Recognized
With no related allowance recorded:							
Real estate:							
Commercial:							
Owner occupied	\$ 382	\$ 128	\$ -	\$ 129	\$ 5	132	16
Total with no allowance recorded	382	128	-	129	5	132	16
With an allowance recorded:							
Commercial (1)							
Commercial (1)	201	201	-	202	3	212	11
Real estate:							
Single-family residential (1)							
Single-family residential (1)	112	112	-	112	2	114	5
Multi-family residential							
Multi-family residential	-	-	-	-	-	-	-
Commercial:							
Non-owner occupied							
Non-owner occupied	2,826	2,826	23	2,832	39	2,841	117
Owner occupied							
Owner occupied	84	84	1	150	2	175	6
Total with an allowance recorded	3,223	3,223	24	3,296	46	3,342	139
Total	\$ 3,605	\$ 3,351	\$ 24	\$ 3,425	\$ 51	\$ 3,474	\$ 155

(1) Allowance recorded is less than \$1 resulting in rounding to zero.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2017. 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, and deferred loan fees and costs. The table presents accrual basis interest income recognized during the three and nine months ended September 30, 2017. Cash payments of interest during the three and nine months ended September 30, 2017 totaled \$52 and \$164, respectively.

	As of December 31, 2017			Three months ended September 30, 2017 (unaudited)		Nine months ended September 30, 2017 (unaudited)	
	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	Average Recorded Investmen	Interest Recognized	Average Recorded Investmen	Interest Recognized
With no related allowance recorded:							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Real estate:							
Commercial:							
Owner occupied	391	137	-	140	6	144	20
Total with no allowance recorded	391	137	-	140	6	144	20
With an allowance recorded:							
Commercial	277	277	-	339	2	346	7
Real estate:							
Single-family residential (1)	116	116	-	118	2	119	5
Multi-family residential	-	-	-	32	1	34	2
Commercial:							
Non-owner occupied	2,856	2,856	24	2,989	42	3,001	120
Owner occupied	190	190	2	972	5	1,098	14
Total with an allowance recorded	3,439	3,439	26	4,450	52	4,598	148
Total	\$ 3,830	\$ 3,576	\$ 26	\$ 4,590	\$ 58	\$ 4,742	\$ 168

(1) Allowance recorded is less than \$1 resulting in rounding to zero.

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

	September 30, 2018	December 31, 2017
--	-----------------------	----------------------

	(unaudited)	
Loans past due over 90 days still on accrual	\$ -	\$ -
Nonaccrual loans:		
Commercial	104	115
Real estate:		
Single-family residential	182	253
Consumer:		
Home equity lines of credit:		
Purchased for portfolio	91	102
Total nonaccrual	377	470
Total nonaccrual and nonperforming loans	\$ 377	\$ 470

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 September 30, 2018 or December 31, 2017.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents the aging of the recorded investment in past due loans and leases by class of loans as of September 30, 2018 (unaudited):

	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	\$ -	\$ -	\$ -	\$ -	\$ 131,176	\$ 104
Real estate:						
Single-family residential	23	20	33	76	93,906	149
Multi-family residential	-	-	-	-	48,400	-
Commercial:						
Non-owner occupied	-	-	-	-	96,587	-
Owner occupied	-	-	-	-	46,667	-
Land	-	-	-	-	8,131	-
Construction	-	-	-	-	46,081	-
Consumer:						
Home equity lines of credit:						
Originated for portfolio	-	-	-	-	23,453	-
Purchased for portfolio	34	-	-	34	362	91
Other	22	-	-	22	5,639	-
Total	\$ 79	\$ 20	\$ 33	\$ 132	\$ 500,402	\$ 344

The following table presents the aging of the recorded investment in past due loans and leases by class of loans as of December 31, 2017:

	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	\$ -	\$ -	\$ -	\$ -	\$ 101,975	\$ 115
Real estate:						
Single-family residential	1,610	27	104	1,741	93,837	149
Multi-family residential	-	-	-	-	35,665	-
Commercial:						

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Non-owner occupied	-	-	-	-	67,792	-
Owner occupied	-	-	-	-	38,787	-
Land	-	-	-	-	5,287	-
Construction	-	-	-	-	42,862	-
Consumer:						
Home equity lines of credit:						
Originated for portfolio	-	-	-	-	24,592	-
Purchased for portfolio	-	-	102	102	360	-
Other	24	-	-	24	352	-
Total	\$ 1,634	\$ 27	\$ 206	\$ 1,867	\$ 411,509	\$ 264

Troubled Debt Restructurings (TDRs):

From time to time, the terms of certain loans are modified as TDRs, where concessions are granted to borrowers experiencing financial difficulties. The modification of the terms of such loans may have included one or a combination of the following: a reduction of the stated interest rate of the loan; an increase in the stated rate of interest lower than the current market rate for new debt with similar risk; an extension of the maturity date; or a change in the payment terms.



Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

As of September 30, 2018 and December 31, 2017, TDRs totaled \$3,266 and \$3,386, respectively. The Company allocated \$24 and \$26 of specific reserves to loans whose terms had been modified in TDRs as of September 30, 2018 and December 31, 2017, respectively. The Company had not committed to lend any additional amounts as of September 30, 2018 or December 31, 2017 to customers with outstanding loans classified as nonaccrual TDRs.

During the three and nine months ended September 30, 2018 there were no loans modified as a TDR. During the three months ended September 30, 2017, there were no loans modified as a TDR. During the nine months ended September 30, 2017, one commercial real estate loan in the amount of \$841 was modified as a TDR during the second quarter, where concessions were granted to a borrower experiencing financial difficulties. The loan was re-written at a lower interest rate than otherwise would have been offered on this credit grade in the current market.

There were no TDRs in payment default or that became nonperforming during the quarters ended September 30, 2018 and September 30, 2017. 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 quarters ended September 30, 2018 and 2017 that did not meet the definition of a TDR. These loans had a total recorded investment of \$10,210 and \$10,843 as of September 30, 2018 and 2017, respectively. 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 payments that was considered to be insignificant or a modification where no concessions were 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.

Nonaccrual loans include loans that were modified and identified as TDRs and the loans are not performing. At September 30, 2018 and December 31, 2017, nonaccrual TDRs were as follows:

	September 30, 2018 (unaudited)	December 31, 2017
Commercial	\$ 104	\$ 115
Total	\$ 104	\$ 115

Nonaccrual loans at September 30, 2018 and December 31, 2017 do not include \$3,163 and \$3,271, respectively, of TDRs where customers have established a sustained period of repayment performance, generally six months, the 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.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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.

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 and leases by risk category and by class of loans and leases as of September 30, 2018 and based on the most recent analysis performed follows. There were no loans or leases rated doubtful at September 30, 2018.

(unaudited)	Not Rated	Pass	Special Mention	Substandard	Total
Commercial	\$ -	\$ 128,587	\$ 2,388	\$ 201	\$ 131,176
Real estate:					
Single-family residential	93,799	-	-	183	93,982
Multi-family residential	-	47,808	436	156	48,400
Commercial:					
Non-owner occupied	77	93,975	1,701	834	96,587
Owner occupied	-	45,482	973	212	46,667
Land	-	8,131	-	-	8,131
Construction	2,946	43,135	-	-	46,081
Consumer:					
Home equity lines of credit:					
Originated for portfolio	23,344	38	-	71	23,453
Purchased for portfolio	306	-	-	90	396
Other	5,661	-	-	-	5,661
	\$ 126,133	\$ 367,156	\$ 5,498	\$ 1,747	\$ 500,534

The recorded investment in loans and leases by risk category and by class of loans and leases as of December 31, 2017 follows. There were no loans or leases rated doubtful at December 31, 2017.

	Not Rated	Pass	Special Mention	Substandard	Total
--	-----------	------	--------------------	-------------	-------

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Commercial	\$ -	\$ 98,829	\$ 2,869	\$ 277	\$ 101,975
Real estate:					
Single-family residential	95,317	-	-	261	95,578
Multi-family residential	-	35,036	466	163	35,665
Commercial:					
Non-owner occupied	88	65,161	1,711	832	67,792
Owner occupied	-	37,453	1,008	326	38,787
Land	-	5,287	-	-	5,287
Construction	2,239	40,623	-	-	42,862
Consumer:					
Home equity lines of credit:					
Originated for portfolio	24,516	-	-	76	24,592
Purchased for portfolio	360	-	-	102	462
Other	376	-	-	-	376
	\$ 122,896	\$ 282,389	\$ 6,054	\$ 2,037	\$ 413,376

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

## Leases:

The following lists the components of the net investment in direct financing leases:

	September	December
	30, 2018	31, 2017
	(unaudited)	
Total minimum lease payments to be received	\$ 6,244	\$ 6,838
Less: unearned income	(687)	(830)
Net investment in direct financing leases	\$ 5,557	\$ 6,008

(1) There were no initial direct costs associated with these leases.

The following summarizes the future minimum lease payments receivable in fiscal year 2018 and in subsequent fiscal years:

2018	\$ 198
2019	793
2020	793
2021	793
2022	793
Thereafter	2,874
	\$ 6,244

## NOTE 5 - 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 of each type of asset and liability:

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).

Derivatives: The fair value of derivatives, which includes yield maintenance provisions, interest rate lock commitments and interest rate swaps, is based on valuation models using observable market data as of the measurement date (Level 2).

TBA mortgage – back securities: To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into either a forward sales contract to sell loans to investors when using best efforts or a trade of “to be announced (TBA)” mortgage-backed securities for mandatory delivery. The forward sales contracts lock in a price for the sale of loans with similar characteristics to the specific rate lock commitments based on a valuation model using observable market data for pricing commitments (Level 2).

Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Impaired loans: The fair value of impaired loans with specific allocations of the ALLL is generally 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 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.

Appraisals for collateral-dependent impaired loans 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 if warranted and to cover disposition costs (including selling expenses) based on the intended disposition method of the property. 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.

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

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

September 30,  
2018 using  
Significant

Other  
 Observable  
 Inputs  
 (Level 2)  
 (unaudited)

Financial Assets:	
Securities available for sale:	
Issued by U.S. government-sponsored entities and agencies:	
U.S. Treasury	\$ 10,804
Mortgage-backed securities - residential	187
Collateralized mortgage obligations	73
Total securities available for sale	\$ 11,064
Loans held for sale	\$ 24,079
Yield maintenance provisions (embedded derivatives)	\$ 9
Interest rate lock commitments	\$ 203
TBA Mortgage-back securities	\$ 128
Financial Liabilities:	
Interest-rate swaps	\$ 9



Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

	Fair Value Measurements at
	December 31, 2017 using Significant
	Other Observable Inputs (Level 2)
Financial Assets:	
Securities available for sale:	
Issued by U.S. government-sponsored entities and agencies:	
U.S. Treasury	\$ 11,417
Mortgage-backed securities - residential	244
Collateralized mortgage obligations	112
Total securities available for sale	\$ 11,773
Loans held for sale	1,124
Yield maintenance provisions (embedded derivatives)	\$ 56
Interest rate lock commitments	\$ 11
Financial Liabilities:	
Interest-rate swaps	\$ 56

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 September 30, 2018 or December 31, 2017. There were no transfers of assets or liabilities measured at fair value between levels during the periods ended September 30, 2018 and December 31, 2017.

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

Fair Value Measurements at  
September 30, 2018 Using  
Significant Unobservable Inputs

(Level 3)

(unaudited)

Impaired loans:

Commercial \$ 103

Real Estate:

Single-family residential 112

Commercial:

Non-owner occupied 2,803

Total impaired loans \$ 3,018

Fair Value Measurements at  
December 31, 2017 Using  
Significant Unobservable Inputs

(Level 3)

Impaired loans:

Commercial \$ 115

Real Estate:

Single-family residential 116

Commercial:

Non-owner occupied 2,832

Total impaired loans \$ 3,063

The Company had no material assets or liabilities measured at fair value on a non-recurring basis that were measured using Level 1 or Level 2 inputs at September 30, 2018 or December 31, 2017.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$3,042 with a valuation allowance of \$24 at September 30, 2018. There were no write-downs of impaired collateral dependent loans during the three and nine months ended September 30, 2018 or 2017. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$3,087, with a valuation allowance of \$24 at December 31, 2017.

During the three and nine months ended September 30, 2018, the Company did not have any transfers of assets or liabilities between those measured using Level 1, 2 or 3 inputs. The Company recognizes transfers of assets and liabilities between Level 1, 2 and 3 inputs based on the information relating to those assets and liabilities at the end of the reporting period.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2018 (unaudited):

	Fair Value	Valuation Technique(s)	Unobservable Inputs	(Range) Weighted Average
Impaired loans:				
Commercial Real estate:	\$ 103	Comparable sales approach	Adjustment for differences between the comparable market transactions	3.48%
Single-family residential:				(1.81% , 3.61%)
Commercial:	112	Comparable sales approach	Adjustment for differences between the comparable market transactions	2.91%
Non-owner occupied	2,803	Comparable sales approach	Adjustment for differences between the comparable market transactions	(3.48%, 9.64%) 5.15%

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2017:

	Fair Value	Valuation Technique(s)	Unobservable Inputs	(Range) Weighted Average
Impaired loans:				
Commercial Real estate:	\$ 115	Comparable sales approach	Adjustment for differences between the comparable market transactions	3.48%
Single -family residential	116	Comparable sales approach	Adjustment for differences between the comparable market transactions	(1.81% , 3.61%)

Commercial:				2.91%
Non-owner occupied	2,832	Comparable sales approach	Adjustment for differences between the comparable market transactions	(3.48%, 9.64%) 5.15%

#### 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. Loans originated as construction loans, that were subsequently transferred to held for sale, are carried at the lower of cost or market and are not included. 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 September 30, 2018 or December 31, 2017.

As of September 30, 2018 and December 31, 2017, the aggregate fair value, contractual balance and gain or loss of loans held for sale were as follows:

	September 30, 2018 (unaudited)	December 31, 2017
Aggregate fair value	\$ 24,079	\$ 1,124
Contractual balance	24,009	1,120
Gain (loss)	\$ 70	\$ 4

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The total amount of gains and losses from changes in fair value included in earnings for the three and nine months ended September 30, 2018 and 2017 for loans held for sale were:

	Three months ended September 30, 2018		Nine months ended September 30, 2017	
	2018	2017	2018	2017
Interest income	\$ 285	\$ 10	\$ 451	\$ 39
Interest expense	-	-	-	-
Change in fair value	(208)	13	66	4
Total change in fair value	\$ 77	\$ 23	\$ 517	\$ 43

The carrying amounts and estimated fair values of financial instruments at September 30, 2018 were as follows:

(unaudited)	Fair Value Measurements at September 30, 2018 Using:				
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 59,368	\$ 59,368	\$ -	\$ -	\$ 59,368
Interest-bearing deposits in other financial institutions	100	100	-	-	100
Securities available for sale	11,064	-	11,064	-	11,064
Loans held for sale	24,079	-	24,079	-	24,079
Loans and leases, net	493,529	-	-	493,232	493,232
FHLB and FRB stock	3,476	n/a	n/a	n/a	n/a
Accrued interest receivable	1,791	19	61	1,711	1,791
Yield maintenance provisions (embedded derivatives)	9	-	9	-	9
Interest rate lock commitments	203	-	203	-	203
TBA mortgage-back securities	128	-	128	-	128
Financial liabilities					
Deposits	\$ (532,062)	\$ (272,873)	\$ (257,256)	\$ -	\$ (530,129)
FHLB advances and other borrowings	(21,500)	-	(21,595)	-	(21,595)
Advances by borrowers for taxes and insurance	(449)	-	-	(449)	(449)

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Subordinated debentures	(5,155)	-	(5,053)	-	(5,053)
Accrued interest payable	(196)	(10)	(186)	-	(196)
Interest-rate swaps	(9)	-	(9)	-	(9)

27

---

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The carrying amounts and estimated fair values of financial instruments at December 31, 2017 were as follows:

	Fair Value Measurements at December 31, 2017 Using:				Total
	Carrying Value	Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 45,498	\$ 45,498	\$ -	\$ -	\$ 45,498
Interest-bearing deposits in other financial institutions	100	100	-	-	100
Securities available for sale	11,773	-	11,773	-	11,773
Loans held for sale	1,124	-	1,124	-	1,124
Loans and leases, net	406,406	-	-	402,719	402,719
FHLB stock	3,227	n/a	n/a	n/a	n/a
Accrued interest receivable	1,326	27	38	1,261	1,326
Yield maintenance provisions (embedded derivatives)	56	-	56	-	56
Interest rate lock commitments	11	-	11	-	11
<b>Financial liabilities</b>					
Deposits	\$ (419,028)	\$ (236,797)	\$ (181,659)	\$ -	\$ (418,456)
FHLB advances and other borrowings	(13,500)	-	(13,466)	-	(13,466)
Advances by borrowers for taxes and insurance	(489)	-	-	(489)	(489)
Subordinated debentures	(5,155)	-	(4,094)	-	(4,094)
Accrued interest payable	(79)	(6)	(73)	-	(79)
Interest-rate swaps	(56)	-	(56)	-	(56)

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

**Cash and Cash Equivalents and Interest-Bearing Deposits in Other Financial Institutions**

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

**FHLB and FRB Stock**

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

**Loans and Leases**

Fair values of loans and leases as of September 30, 2018, excluding loans held for sale, are estimated utilizing an exit pricing methodology 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. The discount rate for the discounted cash flow analyses includes a credit quality adjustment. 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 at December 31, 2017, do not necessarily represent an exit price and are not comparable period to period.

#### Deposits

The fair values disclosed for demand deposits (e.g., interest and noninterest bearing 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.

#### Other Borrowings

The fair values of the Company's long-term FHLB advances and other long-term debt 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.



Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value resulting in a Level 1, 2 or 3 classification, consistent with the asset or liability with which they are associated.

Advances by Borrowers for Taxes and Insurance

The carrying amount of advances by borrowers for taxes and insurance approximates fair value resulting in a Level 3 classification, consistent with the liability with which they are associated.

Off-Balance-Sheet Instruments

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

NOTE 6 – 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 (which is classified as a 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, 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 for a period not to exceed five consecutive years.

The subordinated debentures have a variable rate of interest, reset quarterly, equal to the three-month London Interbank Offered Rate plus 2.85%, which was 5.25% at September 30, 2018 and 4.54% at December 31, 2017.

## NOTE 7 – FHLB ADVANCES AND OTHER DEBT

FHLB fixed rate advances and other debt were as follows:

	Weighted Average Rate	September 30, 2018	December 31, 2017
FHLB fixed rate advances :			
Maturities:			
2019	1.62%	\$ 3,500	\$ 3,500
2020	1.98%	4,500	4,500
2021	2.32%	4,000	4,000
2022	2.05%	1,500	1,500
Total FHLB fixed rate advances		13,500	13,500
Variable rate other debt:			
Maturities:			
2020	5.61%	8,000	-
Total variable rate other debt		8,000	-
Total		\$ 21,500	\$ 13,500

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

Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

In February 2018, the Holding Company entered into a credit facility with a third-party bank pursuant to which the Holding Company could borrow up to an aggregate principal amount of \$6,000. In July 2018, the Holding Company increased the credit facility by \$2,000, which increased the total borrowing limit to \$8,000. The purpose of the credit facility is to provide an additional source of liquidity for the Holding Company and to provide funds for the Holding Company to downstream as additional capital to CFBank to support growth. During the first quarter of 2018, the Holding Company drew \$6,000 on the credit facility and downstreamed \$5,000 as a capital contribution to CFBank. During the third quarter of 2018, the Holding Company drew an additional \$2,000 on the credit facility and downstreamed \$1,500 as a capital contribution to CFBank. As of September 30, 2018, the outstanding principal balance under the credit facility was \$8,000. Loans under the credit facility bear interest at a rate equal to the Prime Rate plus 0.75%. The credit facility is secured by a pledge of the Holding Company's stock of CFBank. The credit facility will expire in February 2020 unless extended or replaced.

NOTE 8 – STOCK-BASED COMPENSATION

The Company has outstanding awards under two stock-based compensation plans (collectively, the "Plans"), as described below. Total compensation cost that has been charged against income for those Plans totaled \$99 and \$290, respectively, for the three and nine months ended September 30, 2018 and \$59 and \$181, respectively, for the three and nine months ended September 30, 2017. The total income tax effect was \$21 and \$61, respectively, for the three and nine months ended September 30, 2018 and \$20 and \$62, respectively, for the three and nine months ended September 30, 2017. All exercise prices and share amounts have been restated for the 1-for-5.5 reverse stock split on August 20, 2018 (see Note 1).

The Plans are both stockholder-approved and authorize stock option grants and restricted stock awards to be made to directors, officers and employees. The 2003 Equity Compensation Plan (the "2003 Plan"), as amended and restated, provided an aggregate of 18,181 shares for stock option grants and restricted stock awards, of which up to 5,454 shares could be awarded in the form of restricted stock awards. The 2009 Equity Compensation Plan (the "2009 Plan"), which was approved by stockholders on May 21, 2009, replaced the 2003 Plan and provided for 36,363 shares, plus any remaining shares available to grant or that are later forfeited or expire under the 2003 Plan, to be made available to be issued as stock option grants, stock appreciation rights or restricted stock awards. On May 16, 2013, the Company's stockholders approved the First Amendment to the 2009 Plan to increase the number of shares of common stock reserved for stock option grants and restricted stock awards thereunder to 272,727.

Stock Options:

The Plans permit the grant of stock options to directors, officers and employees of the Holding Company and CFBank. 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 of 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. Employee and management 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. Treasury yield curve in effect at the time of the grant.

There were no options granted or exercised during the three and nine months ended September 30, 2018 and September 30, 2017 (unaudited).

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

A summary of stock option activity in the Plans for the nine months ended September 30, 2018 follows (unaudited):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Intrinsic Value
Outstanding at beginning of year	98,046	\$ 7.91		
Expired	(72)	119.35		
Cancelled or forfeited	(1,401)	11.42		
Outstanding at end of period	96,573	\$ 7.78	4.7	\$ 758,466
Expected to vest	-	\$ -	-	\$ -
Exercisable at end of period	96,573	7.78	4.7	\$ 758,466

During the nine months ended September 30, 2018, there were 72 stock options that expired. There were 54 stock options that expired during the nine months ended September 30, 2017. During the nine months ended September 30, 2018, there were 1,401 cancelled or forfeited stock options compared to 545 for the nine months ended September 30, 2017. As of September 30, 2018, all stock options granted under the Plans were vested.

## 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 awards based on the fair value of the stock at grant date. The fair value of the stock is determined using the closing share price on the date of grant and shares generally have vesting periods of one to three years.

There were 727 shares of restricted stock granted during the nine months ended September 30, 2018. There were no shares of restricted stock issued during the nine months ended September 30, 2017.

A summary of changes in the Company's nonvested restricted stock awards as of September 30, 2018 follows (unaudited):

		Weighted Average Grant-Date Fair Value
Nonvested Shares	Shares	
Nonvested at January 1, 2018	84,483	\$ 11.16
Granted	727	13.42
Forfeited	(7,999)	11.79
Nonvested at September 30, 2018	77,211	\$ 11.12

As of September 30, 2018 and 2017, the unrecognized compensation cost related to nonvested restricted stock awards granted under the Plans was \$544 and \$439, respectively.

There were 7,999 shares of restricted stock forfeited during the nine-month period ended September 30, 2018. There were 2,606 shares of restricted stock forfeited during the nine months ended September 30, 2017. There were no shares of restricted stock that vested during the nine months ended September 30, 2018 and 2017.

There were 70,457 shares of common stock remaining available for stock option grants and restricted stock awards under the 2009 Plan at September 30, 2018.

#### NOTE 9 – REGULATORY CAPITAL MATTERS

CFBank is subject to regulatory capital requirements administered by federal banking agencies. 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.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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

In July 2013, the Holding Company's primary federal regulator, the FRB, published final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules provide higher capital requirements and more restrictive leverage and liquidity ratios than those previously in place. In addition, in order to avoid limitations on capital distributions, such as dividend payments and certain bonus payments to executive officers, the Basel III Capital Rules require insured financial institutions to hold a capital conservation buffer of common equity tier 1 capital above the minimum risk-based capital requirements. The capital conservation buffer will be phased in over time, becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets. The Basel III Capital Rules revise the regulatory agencies' prompt corrective action framework by incorporating the new regulatory capital minimums and updating the definition of common equity. The Basel III Capital Rules became effective for the Company on January 1, 2015, and will be fully phased in by January 1, 2019. Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios of Common Equity Tier 1 capital, Tier 1 capital and Total capital, as defined in the regulations, to risk-weighted assets, and of Tier 1 capital to adjusted quarterly average assets ("Leverage Ratio"). CFBank's implementation of the new rules on January 1, 2015 did not have a material impact on our capital needs or classifications.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require CFBank to maintain: 1) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of 4.5%, plus a 2.5% "capital conservation buffer" (resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of 7.0% upon full implementation); 2) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, plus the capital conservation buffer (resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); 3) a minimum ratio of Total capital to risk-weighted assets of 8.0%, plus the capital conservation buffer (resulting in a minimum Total capital ratio of 10.5% upon full implementation); and 4) a minimum Leverage Ratio of 4.0%.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period increasing by increments of that amount on each subsequent January 1 until it reaches 2.5% on January 1, 2019. As of September 30, 2018, the capital conservation buffer was 1.88%. The capital conservation buffer is designed to absorb losses during periods of economic stress. Failure to maintain the minimum Common Equity Tier 1 capital ratio plus the capital conservation buffer will result in potential restrictions on a banking institution's ability to pay dividends, repurchase stock and/or pay discretionary compensation to its employees.

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

The following tables present actual and required capital ratios as of September 30, 2018 and December 31, 2017 for CFBank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of September 30, 2018, based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum Capital Required-Basel III Phase-In Schedule		Minimum Capital Required-Basel III Fully Phased-In		To Be Well Capitalized Under Applicable Regulatory Standards	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2018 (unaudited)								
Total Capital to risk weighted assets	\$ 59,974	12.05%	\$ 49,184	9.88%	\$ 52,271	10.50%	\$ 49,782	10.00%
Tier 1 (Core) Capital to risk weighted assets	53,740	10.80%	39,228	7.88%	42,314	8.50%	39,826	8.00%
Common equity tier 1 capital to risk-weighted assets	53,740	10.80%	31,761	6.38%	34,847	7.00%	32,358	6.50%
Tier 1 (Core) Capital to adjusted total assets (Leverage ratio)	53,740	9.41%	22,832	4.00%	22,832	4.00%	28,540	5.00%



Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

	Actual		Minimum Capital Required-Base III Phase-In Schedule		Minimum Capital Required-Base III Fully Phased-In		To Be Well Capitalized Under Applicable Regulatory Capital Standards	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017								
Total Capital to risk weighted assets	\$ 48,271	11.91%	\$ 37,492	9.25%	\$ 42,559	10.50%	\$ 40,532	10.00%
Tier 1 (Core) Capital to risk weighted assets	43,179	10.65%	29,386	7.25%	34,452	8.50%	32,426	8.00%
Common equity tier 1 capital to risk-weighted assets	43,179	10.65%	23,306	5.75%	28,372	7.00%	26,346	6.50%
Tier 1 (Core) Capital to adjusted total assets (Leverage ratio)	43,179	9.37%	18,432	4.00%	18,432	4.00%	23,040	5.00%

CFBank converted from a mutual to a stock institution in 1998, and a "liquidation account" was established in the amount of \$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 its assets exceeded its 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 by CFBank 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. Any future dividend payments by CFBank to the Holding Company would be based on future earnings and, if necessary, regulatory approval.

The Holding Company's ability to pay dividends on its stock is also conditioned upon the payment, on a current basis, of quarterly interest payments on the subordinated debentures underlying the Company's trust preferred securities.

Additionally, CFBank does not intend to make distributions to the Holding Company that would result in a recapture of any portion of its thrift bad debt reserve as discussed in Note 11-Income Taxes.

NOTE 10 – 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 \$1,378 at September 30, 2018 and \$2,185 at December 31, 2017.

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.

The counterparty to CFBank's interest-rate swaps is exposed to credit risk whenever the interest-rate swaps are in a liability position. At September 30, 2018, CFBank had \$113 in securities and cash pledged as collateral for these derivatives. Should the liability increase, beyond the collateral value, 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 may be called by the counterparty if CFBank fails to maintain well-capitalized status under regulatory capital standards. As of September 30, 2018, CFBank was well-capitalized under regulatory capital standards.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Summary information about the derivative instruments is as follows:

	September 30, 2018 (unaudited)	December 31, 2017
Notional amount	\$ 1,378	\$ 2,185
Weighted average pay rate on interest-rate swaps	3.12%	3.75%
Weighted average receive rate on interest-rate swaps	2.20%	1.52%
Weighted average maturity (years)	2.2	2.1
Fair value of interest-rate swaps	\$ (9)	\$ (56)
Fair value of yield maintenance provisions	9	56

The fair value of the yield maintenance provisions and interest-rate swaps is recorded in other assets and other liabilities, respectively, in the consolidated balance sheet. Changes in the fair value of the yield maintenance provisions and interest-rate swaps are reported currently in earnings, as other noninterest income in the consolidated statements of operations. There were no net gains or losses recognized in earnings related to yield maintenance provisions and interest-rate swaps for the three and nine months ended September 30, 2018 or 2017.

## Mortgage banking derivatives:

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market are considered derivatives. These mortgage banking derivatives are not designated in hedge relationships. The Company had approximately \$46,683 and \$2,390 of interest rate lock commitments related to residential mortgage loans at September 30, 2018 and December 31, 2017, respectively. The fair value of these mortgage banking derivatives was reflected by a derivative asset of \$203 and \$11 at September 30, 2018 and December 31, 2017, respectively, which was included in other assets in the consolidated balance sheet. Fair values were estimated based on anticipated gains on the sale of the underlying loans. Changes in the fair values of these mortgage banking derivatives are included in net gains on sales of loans.

Mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate locked with the customer. The commitments are generally for periods of 30-60 days and are at market rates. In order to mitigate the effect of the interest rate risk inherent in providing rate lock commitments, we economically hedge our commitments by entering into either a forward loan sales contract under best efforts or a trade of “to be announced (TBA)” mortgage-backed securities (“notional securities”) for mandatory delivery. The changes in fair value related to movements in market rates of the rate lock commitments and the forward loan sales contracts and notional securities generally move in opposite

directions, and the net impact of changes in these valuations on net income during the loan commitment period is generally inconsequential. The Company has not formally designated these derivatives as a qualifying hedge relationship and, accordingly, accounts for such forward contracts as freestanding derivatives with changes in fair value recorded to earnings each period.

The following table reflects the amount and market value of mortgage banking derivatives included in the consolidated balance sheet as of the period end (in thousands):

	September 30, 2018		December 31, 2017	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Assets:				
Interest Rate commitments	\$ 46,683	\$ 203	\$ 2,390	\$ 11
TBA mortgage-back securities	\$ 35,500	\$ 128	\$ -	\$ -

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table represents the revenue recognized on mortgage activities for the three and nine months ended September 30, 2018 and 2017:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Gain on loans sold	\$ 695	\$ 20	\$ 985	\$ 59
Gain (loss) from change in fair value of loans held-for-sale	(208)	(3)	66	(12)
Gain (loss) from change in fair value of derivatives	(36)	6	217	23
	\$ 451	\$ 23	\$ 1,268	\$ 70

## NOTE 11 – INCOME TAXES

At September 30, 2018, the Company had a deferred tax asset recorded in the amount of \$1,600. At December 31, 2017, the Company had a deferred tax asset recorded of approximately \$1,600. At September 30, 2018 and December 31, 2017, the Company had no unrecognized tax benefits recorded. The Company is subject to U.S. federal income tax and is no longer subject to federal examination for years prior to 2014.

Our deferred tax assets are composed of U.S. net operating losses (“NOLs”), and other temporary book to tax differences. When determining the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded as a benefit, the Company conducts a regular assessment of all available information. This information includes, but is not limited to, taxable income in prior periods, projected future income and projected future reversals of deferred tax items. Based on these criteria, the Company determined as of September 30, 2018 that no valuation allowance was required against the net deferred tax asset.

In 2012 the Company completed a recapitalization program pursuant to which the Holding Company sold \$22,500 in common stock, which improved the capital levels of CFBank and provided working capital for the Holding Company. The result of the change in stock ownership associated with the stock offering, however, was that the Company incurred an ownership change within the guidelines of Section 382 of the Internal Revenue Code of 1986. At year-end 2017, the Company had net operating loss carryforwards of \$23,059, which expire at various dates from 2024 to 2032. As a result of the ownership change, the Company's ability to utilize carryforwards that arose before the 2012 stock offering closed is limited to \$163 per year. Due to this limitation, management determined it is more likely than not that \$20,520 of net operating loss carryforwards will expire unutilized. As required by accounting standards, the Company reduced the carrying value of deferred tax assets, and the corresponding valuation allowance, by the \$6,977 tax effect of this lost realizability.

Federal income tax laws provided additional deductions, totaling \$2,250, for thrift bad debt reserves established before 1988. Accounting standards do not require a deferred tax liability to be recorded on this amount, which otherwise would have totaled \$473 at year-end 2017. However, if CFBank were wholly or partially liquidated or otherwise ceases to be a bank, or if tax laws were to change, this amount would have to be recaptured and a tax liability recorded. Additionally, any distributions in excess of CFBank's current or accumulated earnings and profits would reduce amounts allocated to its bad debt reserve and create a tax liability for CFBank.

On December 22, 2017, the “Tax Cuts and Jobs Act” was enacted into law reducing the federal corporate tax rate to 21%, effective January 1, 2018. The Company conducted a revaluation of its existing deferred tax asset (DTA) to reflect the impact of the new tax rates, which resulted in the Company recording an additional tax expense in the fourth quarter of 2017 in the amount of \$979.

The Company records income tax expense based on the federal statutory rate adjusted for the effect of bank owned life insurance and other miscellaneous items. The effective tax rate for the three and nine months ended September 30, 2018 was approximately 18.4% and 19.1%, respectively, and 32.6% and 33.0%, respectively, for the three and nine months ended September 30, 2017, which management believes is a reasonable estimate for the effective tax rate.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table summarizes the major components creating differences between income taxes at the federal statutory tax rate and the effective tax rate recorded in the consolidated statements of income for the three and nine months ended September 30, 2018 and 2017:

	For the three months ended September 30, 2018		For the nine months ended September 30, 2017	
	(unaudited)		(unaudited)	
Statutory tax rate	21.0%	34.0%	21.0%	34.0%
Increase (decrease) resulting from:				
Restricted stock	(1.6%)	0.0%	(0.9%)	0.0%
Tax exempt income on bank owned life insurance	(0.6%)	(1.1%)	(0.6%)	(1.4)%
Low income housing credits	(0.6%)	0.0%	(0.6%)	0.0%
Other, net	0.2%	(0.3%)	0.2%	0.4%
Effective tax rate	18.4%	32.6%	19.1%	33.0%

## NOTE 12- ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table summarizes the changes within each classification of accumulated other comprehensive income, net of tax, for the three and nine months ended September 30, 2018 and 2017 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive loss:

## Changes in Accumulated Other Comprehensive Loss by Component (1)

	Three months ended September 30, 2018		Nine months ended September 30, 2017	
	(unaudited)		(unaudited)	
	Unrealized Gains and Losses on		Unrealized Gains and Losses on	

	Available-for-Sale Securities		Available-for-Sale Securities					
Accumulated other comprehensive income (loss), beginning of period	\$	(116)	\$	(47)	\$	2		
Other comprehensive loss before reclassifications (2)		(16)		(3)		(85)	(6)	
Net current-period other comprehensive loss		(16)		(3)		(85)	(6)	
Accumulated other comprehensive loss, end of period	\$	(132)	\$	(4)	\$	(132)	\$	(4)

s in Accumulated Other Comprehensive Income by Component (1)

(1) All amounts are net of tax. Amounts in parentheses indicate a reduction of other comprehensive income.

(2) There were no amounts reclassified out of other comprehensive income for the three and nine months ended September 30, 2018 and 2017.



Table of Contents

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

NOTE 13 - PREFERRED STOCK

Series B Preferred Stock:

Commencing in April 2014, the Company conducted a private placement of up to 480,000 shares of its 6.25% Non-Cumulative Convertible Perpetual Preferred Stock, Series B (“Series B Preferred Stock”) for an offering price of \$25.00 per share (the “Private Placement”). Pursuant to the Private Placement, the Company sold an aggregate of 480,000 shares of Series B Preferred Stock on May 12, 2014 and July 15, 2014, for an aggregate offering price of \$12,000. After payment of approximately \$482 in placement fees and approximately \$149 of other offering expenses, the Company’s net proceeds from its sale of the 480,000 shares of Series B Preferred Stock in the Private Placement were approximately \$11,369.

For each share of Series B Preferred Stock sold in the Private Placement, the Company also issued, at no additional charge, a Warrant to purchase common stock of the Company. See Note 14-Common Stock Warrants for additional information.

Conversion of Series B Preferred Stock to Common Stock:

On September 29, 2017, the Company announced the conversion of its Series B Preferred Stock into shares of Common Stock of the Company. The conversion was effective October 6, 2017, and resulted in the conversion of all 480,000 of the Company’s issued and outstanding shares of Series B Preferred Stock into approximately 6,857,143 shares of Common Stock (prior to the 1-for-5.5 reverse stock split effective August 20, 2018), or approximately 1,246,753 shares of Common Stock on a post-reverse-split basis.

The conversion of the Series B Preferred Stock resulted in the elimination of the non-cumulative preferred dividend payments on the Series B Preferred Stock in the aggregate amount of approximately \$187,500 quarterly (\$750,000 annually) beginning with the 4th quarter of 2017.

NOTE 14 - COMMON STOCK WARRANTS

Series B Preferred Stock – Warrants:

For each share of Series B Preferred Stock issued by the Company in the Private Placement, the Company also issued, at no additional charge, a Warrant to purchase (i) 2.00 shares of common stock of the Company (or 0.364 shares on a post-reverse-split basis) if the purchaser purchased less than \$700 (28,000 shares) of Series B Preferred Stock in the

Private Placement, or (ii) 3.25 shares of common stock (or 0.591 shares on a post-reverse-split basis) if the purchaser purchased \$700 (28,000 shares) or more of Series B Preferred Stock in the Private Placement. Warrants to purchase an aggregate of 1,152,125 shares of common stock (or 209,477 shares on a post-reverse-split basis) were issued by the Company to the purchasers of the 480,000 shares of Series B Preferred Stock sold in the Private Placement. The Warrants are exercisable for a period of approximately five (5) years expiring on July 15, 2019, at an exercise price of \$10.18 (on a post-reverse-split basis) per share of common stock. As of September 30, 2018, warrants to purchase an aggregate of 191,569 shares of common stock (on a post-reverse-split basis) were outstanding.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

FORWARD LOOKING STATEMENTS

This quarterly report and other materials we have filed or may file with the Securities and Exchange Commission (“SEC”) contain or may contain forward-looking statements within the meaning of the safe harbor provisions of the U.S. Private Securities Reform Act of 1995, which are made in good faith by us. Forward-looking statements include, but are not limited to: (1) projections of revenues, income or loss, earnings or loss per common share, capital structure and other financial items; (2) plans and objectives of the management or Boards of Directors of Central Federal Corporation (the “Holding Company”) or CFBank, National Association (“CFBank” and, together with the Holding Company, the “Company”); (3) statements regarding future events, actions or economic performance; and (4) statements of assumptions underlying such statements. Words such as "estimate," "strategy," "may," "believe," "anticipate," "expect," "predict," "will," "intend," "plan," "targeted," and the negative of these terms, or similar expressions, are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Various risks and uncertainties may cause actual results to differ materially from those indicated by our forward-looking statements, including, without limitation, those detailed from time to time in our reports filed with the SEC, including those identified in “Item 1A. Risk Factors” of Part I of our Form 10-K filed with SEC for the year ended December 31, 2017.

Forward-looking statements are not guarantees of performance or results. A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We believe that we have chosen these assumptions or bases in good faith and that they are reasonable. We caution you, however, that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. The forward-looking statements included in this quarterly report speak only as of the date of the report. We undertake no obligation to publicly release revisions to any forward-looking statements to reflect events or circumstances after the date of such statements, except to the extent required by law.

Business Overview

The Holding Company is a financial holding company that owns 100% of the stock of CFBank, which was formed in Ohio in 1892 and converted from a federal savings association to a national bank on December 1, 2016. Prior to December 1, 2016, the Holding Company was a registered savings and loan holding company. Effective as of December 1, 2016 and in conjunction with the conversion of CFBank to a national bank, the Holding Company became a registered bank holding company and elected financial holding status with the FRB.

CFBank has a presence in four major metro Ohio markets – Columbus, Cleveland, Cincinnati and Akron, as well as its two locations in Columbiana County, Ohio. CFBank provides personalized Business Banking products and services including commercial loans and leases, commercial and residential real estate loans and treasury management depository services. As a full service commercial bank, our business, along with our products and services, is focused on serving the banking and financial needs of closely held businesses. Our business model emphasizes personalized service, customer access to decision makers, quick execution, and the convenience of online internet banking, mobile banking, remote deposit and corporate treasury management. In addition, CFBank provides residential lending and full service retail banking services and products. Most of our deposits come from our market area. We originate

commercial, commercial real estate and business loans primarily throughout Ohio and residential real estate loans both in Ohio and nationwide. Because of CFBank's concentration of business activities in Ohio, the Company's financial condition and results of operations depend in large part upon economic conditions in Ohio.

Our principal market area for loans and deposits includes the following Ohio counties: Franklin County through our office in Worthington, Ohio and our loan production office (opened in February 2018) in Columbus, Ohio; Summit County through our office in Fairlawn, Ohio; Hamilton County through our office in Glendale, Ohio; Columbiana County through our offices in Calcutta and Wellsville, Ohio; and Cuyahoga County, through our agency office in Woodmere, Ohio.

#### General

Our net income is dependent primarily on net interest income, which is the difference between the interest income earned on loans and securities and our cost of funds, consisting of interest paid on deposits and borrowed funds. Net interest income is affected by regulatory, economic and competitive factors that influence interest rates, loan demand, the level of nonperforming assets and deposit flows.

Net income is also affected by, among other things, provisions for loan losses, loan fee income, service charges, gains on loan sales, operating expenses, and taxes. Operating expenses principally consist of employee compensation and benefits, occupancy, FDIC insurance premiums and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, changes in market interest rates and real estate values, government policies and actions of regulatory authorities. Our regulators have extensive discretion in their supervisory and enforcement activities, including the authority to impose restrictions on our operations, to classify our assets and require us to increase the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our business, financial condition, results of operations and/or cash flows.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

Dividend Restrictions

Banking regulations limit the amount of dividends that may be paid by CFBank to the Holding Company without prior approval of regulatory agencies. Generally, CFBank may pay dividends to the Holding Company without prior approval as long as the dividend does not exceed the total of the current calendar year-to-date earnings plus any earnings from the previous two years not already paid out in dividends, and as long as CFBank would remain well capitalized after the dividend payment. Future dividend payments by CFBank to the Holding Company would be based on future earnings and, if necessary, regulatory approval. Management believes that the Holding Company has adequate operating capital for the foreseeable future. The Holding Company had \$1.5 million in cash and cash equivalents at September 30, 2018.

Management's Discussion and Analysis represents a review of our consolidated financial condition and results of operations for the periods presented. This review should be read in conjunction with our consolidated financial statements and related notes.

Financial Condition

General. Assets totaled \$606.4 million at September 30, 2018 and increased \$125.0 million, or 26.0%, from \$481.4 million at December 31, 2017. The increase was primarily due to an \$87.1 million increase in net loan balances, a \$23.0 million increase in loans held for sale, and a \$13.9 million increase in cash and cash equivalents.

Cash and cash equivalents. Cash and cash equivalents totaled \$59.4 million at September 30, 2018, and increased \$13.9 million, or 30.5%, from \$45.5 million at December 31, 2017. The increase in cash and cash equivalents was primarily attributed to increased deposits.

Securities. Securities available for sale totaled \$11.1 million at September 30, 2018, and decreased \$709,000, or 6.0%, compared to \$11.8 million at December 31, 2017. The decrease was primarily due to principal maturities.

Loans and Leases. Net loans and leases totaled \$493.5 million at September 30, 2018, and increased \$87.1 million, or 21.4%, from \$406.4 million at December 31, 2017. The increase was primarily due to a \$39.5 million increase in commercial real estate loan balances, a \$29.2 million increase in commercial loan balances and a \$12.7 million increase in multi-family residential loan balances. The increases in the aforementioned loan balances were primarily due to increased sales activity and new relationships. Single-family residential mortgage loan balances declined slightly as a result of a decrease in balances in our Northpointe mortgage purchase program, partially offset by an increase in balances due to the purchase of residential mortgage loan-pools and organic growth in the residential mortgage portfolio due to sales activity.

CFBank has participated in a Mortgage Purchase Program with Northpointe Bank (Northpointe), a Michigan banking corporation, since December 2012. Pursuant to the terms of a participation agreement, CFBank purchases participation interests in loans made by Northpointe related to fully underwritten and pre-sold mortgage loans originated by various prescreened mortgage brokers located throughout the U.S. The underlying loans are

individually (MERS) registered loans which are held until funded by the end investor. The mortgage loan investors include Fannie Mae and Freddie Mac, and other major financial institutions. This process on average takes approximately 14 days. Given the short-term holding period of the underlying loans, common credit risks (such as past due, impairment and TDR, nonperforming, and nonaccrual classification) are substantially reduced. Therefore, no allowance is allocated by CFBank to these loans. These loans are 100% risk rated for CFBank capital adequacy purposes. Under the participation agreement, CFBank agrees to purchase a 95% ownership/participation interest in each of the aforementioned loans, and Northpointe maintains a 5% ownership interest in each loan it participates. During the three and nine months ended September 30, 2018, loan origination activity totaled \$155.2 million and \$442.9 million, respectively, and payoffs for the same period totaled \$176.4 million and \$467.1 million, respectively. At September 30, 2018 and December 31, 2017, CFBank held \$13.5 million and \$37.7 million, respectively, of such loans which are included in single-family residential loan totals.

Allowance for loan and lease losses (ALLL). The allowance for loan and lease losses totaled \$7.0 million at September 30, 2018, and increased \$35,000, or 0.5%, from \$7.0 million at December 31, 2017. The increase in the ALLL is due to net recoveries during the nine months ended September 30, 2018. The ratio of the ALLL to total loans was 1.40% at September 30, 2018, compared to 1.69% at December 31, 2017. In addition, the ratio of the ALLL to nonperforming loans was 1858.1% at September 30, 2018, compared to 1483.0% at December 31, 2017.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

The ALLL is a valuation allowance for probable incurred credit losses. The ALLL methodology is designed as part of a thorough process that incorporates management's current judgments about the credit quality of the loan portfolio into a determination of the ALLL in accordance with generally accepted accounting principles and supervisory guidance. Management analyzes the adequacy of the ALLL quarterly through reviews of the loan portfolio, including the nature and volume of the loan portfolio and segments of the portfolio; industry and loan concentrations; historical loss experience; delinquency statistics and the level of nonperforming loans; specific problem loans; the ability of borrowers to meet loan terms; an evaluation of collateral securing loans and the market for various types of collateral; various collection strategies; current economic conditions, trends and outlook; and other factors that warrant recognition in providing for an adequate ALLL. Based on the variables involved and the significant judgments management must make about outcomes that are uncertain, the determination of the ALLL is considered to be a critical accounting policy. See the section titled "Critical Accounting Policies" for additional discussion.

The ALLL consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that CFBank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans of all classes within the commercial, commercial real estate and multi-family residential loan segments, regardless of size, and loans of all other classes over \$250,000, are individually evaluated for impairment when they are 90 days past due, or earlier than 90 days past due if information regarding the payment capacity of the borrower indicates that payment in full according to the loan terms is doubtful. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral, less costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance loans, such as consumer and single-family residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Loans within any class for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and are classified as impaired. See Notes 1 and 4 to our consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the ALLL.

Individually evaluated impaired loans totaled \$3.4 million at September 30, 2018, and decreased \$225,000, or 6.3%, from \$3.6 million at December 31, 2017. The decrease was primarily due to loan repayments. The amount of the ALLL specifically allocated to individually impaired loans totaled \$24,000 at September 30, 2018 and \$26,000 at December 31, 2017. The decrease in the ALLL specifically allocated to impaired loans was primarily due to management's updated analysis.

The specific reserve on impaired loans is based on management's estimate of the present value of estimated future cash flows using the loan's effective rate or the fair value of collateral, if repayment is expected solely from the collateral. On at least a quarterly basis, management reviews each impaired loan to determine whether it should have a specific reserve or partial charge-off. Management relies on appraisals or internal evaluations to help make this determination. Determination of whether to use an updated appraisal or internal evaluation is based on factors including, but not limited to, the age of the loan and the most recent appraisal, condition of the property and whether we expect the collateral to go through the foreclosure or liquidation process. Management considers the need for a

downward adjustment to the valuation based on current market conditions and on management's analysis, judgment and experience. The amount ultimately charged-off for these loans may be different from the specific reserve, as the ultimate liquidation of the collateral and/or projected cash flows may be different from management's estimates.

Nonperforming loans, which are nonaccrual loans and loans at least 90 days past due but still accruing interest, totaled \$377,000 at September 30, 2018, and decreased \$93,000, or 19.8%, from \$470,000 at December 31, 2017. The ratio of nonperforming loans to total loans was 0.08% at September 30, 2018 compared to 0.11% at December 31, 2017.

Nonaccrual loans include some loans that were modified and identified as TDRs and are not performing. TDRs included in nonaccrual loans totaled \$104,000 at September 30, 2018 and \$115,000 at December 31, 2017. The decrease in TDRs included in nonaccrual loans was primarily due to loan repayments.

Nonaccrual loans at September 30, 2018 and December 31, 2017 do not include \$3.2 million and \$3.3 million, respectively, in 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. See Note 1 and 4 to the consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding impaired loans and nonperforming loans.



Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

The general reserve component of our ALLL covers non-impaired loans of all classes and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by loan class and is based on the actual loss history experienced by CFBank over a three-year period. The general component is calculated based on CFBank's loan balances and actual three-year historical loss rates. For loans with little or no actual loss experience, industry estimates are used based on loan segment. This actual loss experience is supplemented with other economic and judgmental factors based on the risks present for each loan class. These economic and judgmental factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

Management's loan review process is an integral part of identifying problem loans and determining the ALLL. We maintain an internal credit rating system and loan review procedures specifically developed as the primary credit quality indicator to monitor credit risk for commercial, commercial real estate and multi-family residential real estate loans. We analyze these loans individually and categorize 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. Credit reviews for these loan types are performed at least annually, and more often for loans with higher credit risk. Loan officers maintain close contact with borrowers between reviews. Adjustments to loan risk ratings are based on the reviews and at any time information is received that may affect risk ratings. Additionally, an independent third party review of commercial, commercial real estate and multi-family residential loans is performed at least annually. Management uses the results of these reviews to help determine the effectiveness of the existing policies and procedures and to provide an independent assessment of our internal loan risk rating system.

We have incorporated the regulatory asset classifications as a part of our credit monitoring and internal loan risk rating system. In accordance with regulations, problem loans are classified as special mention, substandard, doubtful or loss, and the classifications are subject to review by the regulators. Assets designated as special mention are considered criticized assets. Assets designated as substandard, doubtful or loss are considered classified assets. See Note 4 to our consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding descriptions of the regulatory asset classifications.

The level of total criticized and classified loans decreased by \$846,000, or 10.5%, during the nine months ended September 30, 2018 primarily due to loan repayments. Loans designated as special mention decreased \$556,000, or 9.2%, and totaled \$5.5 million at September 30, 2018, compared to \$6.1 million at December 31, 2017. Loans classified as substandard decreased \$290,000, or 14.2%, and totaled \$1.7 million at September 30, 2018, compared to \$2.0 million at December 31, 2017. No loans were classified as doubtful at September 30, 2018 and December 31, 2017. See Note 4 to our consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding risk classification of loans.

In addition to credit monitoring through our internal loan risk rating system, we also monitor past due information for all loan segments. Loans that are not rated under our internal credit rating system include groups of homogenous loans, such as single-family residential real estate loans and consumer loans. The primary credit indicator for these groups of homogenous loans is past due information.

Total past due loans decreased \$1.7 million, or 92.9%, and totaled \$132,000 at September 30, 2018, compared to \$1.9 million at December 31, 2017. Past due loans totaled 0.03% of the loan portfolio at September 30, 2018, compared to 0.45% at December 31, 2017. See Note 4 to our consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding loan delinquencies.

All lending activity involves risk of loss. Certain types of loans, such as option adjustable-rate mortgage (ARM) products, junior lien mortgages, high loan-to-value ratio mortgages, interest only loans, subprime loans and loans with initial teaser rates, can have a greater risk of non-collection than other loans. CFBank has not engaged in subprime lending or used option ARM products.

Loans that contain interest only payments may present a higher risk than those loans with an amortizing payment that includes periodic principal reductions. Interest only loans made by CFBank primarily consist of commercial lines of credit secured by business assets and inventory, and consumer home equity lines of credit secured by the borrower's primary residence. Due to the fluctuations in business assets and inventory of our commercial borrowers, there is increased risk due to a potential decline in collateral values without a corresponding decrease in the outstanding principal. Interest only commercial lines of credit totaled \$52.4 million, or 39.9%, of CFBank's commercial portfolio at September 30, 2018 compared to \$31.6 million, or 30.9%, at December 31, 2017. Interest only home equity lines of credit totaled \$21.7 million, or 91.0%, of the total home equity lines of credit at September 30, 2018 compared to \$22.5 million, or 90.0%, at December 31, 2017.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

We believe the ALLL is adequate to absorb probable incurred credit losses in the loan portfolio as of September 30, 2018; however, future additions to the allowance may be necessary based on factors including, but not limited to, deterioration in client business performance, recessionary economic conditions, declines in borrowers' cash flows and market conditions which result in lower real estate values. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the ALLL. Such agencies may require additional provisions for loan losses based on judgments and estimates that differ from those used by management, or on information available at the time of their review. Management continues to diligently monitor credit quality in the existing portfolio and analyze potential loan opportunities carefully in order to manage credit risk. An increase in loan losses could occur if economic conditions and factors which affect credit quality, real estate values and general business conditions worsen or do not improve.

Foreclosed assets. There were no foreclosed assets at September 30, 2018 and December 31, 2017. The level of foreclosed assets and charges to foreclosed assets expense may increase in the future in connection with workout efforts related to foreclosed assets, nonperforming loans and other loans with credit issues.

Deposits. Deposits totaled \$532.1 million at September 30, 2018, an increase of \$113.0 million, or 27.0%, from \$419.0 million at December 31, 2017. The increase is primarily attributed to a \$77.0 million increase in certificate of deposit account balances, a \$29.6 million increase in checking account balances, and a \$6.1 million increase in money market account balances. The increase in certificate of deposit account balances was primarily attributed to a combination of management's use of short-term CDARS (1-way) deposits in anticipation of quarter end fluctuations associated with our mortgage business and the timing of loan fundings, an increase in core certificate of deposits due to on-going sales and marketing activities, and to a lesser extent, the use of brokered CDs for longer term duration in its certificate of deposit portfolio. The increase in checking accounts is due to an increase in customer relationships and balances from on-going sales activities.

CFBank is a participant in the Certificate of Deposit Account Registry Service® (CDARS) and Insured Cash Sweep (ICS) programs offered through Promontory Interfinancial Network. Promontory works with a network of banks to offer products that can provide up to approximately \$50 million of FDIC insurance coverage through these innovative products. Brokered deposits, including CDARS deposits that qualify as brokered, totaled \$89.4 million at September 30, 2018, and increased \$42.4 million, or 90.3%, from \$46.9 million at December 31, 2017. The increase was primarily in short-term CDARS deposits to address certain anticipated balance sheet fluctuations at quarter end related to our mortgage business. Customer balances in the CDARS reciprocal and ICS reciprocal programs, which no longer qualify as brokered, totaled \$42.3 million at September 30, 2018 and increased \$28.8 million, or 211.7%, from \$13.6 million at December 31, 2017.

FHLB advances and other debt. FHLB advances and other debt totaled \$21.5 million at September 30, 2018 and increased \$8.0 million, or 59.3%, compared to \$13.5 million at December 31, 2017. In February 2018, the Holding Company entered into a credit facility with a third-party bank pursuant to which the Holding Company could borrow up to an aggregate principal amount of \$6.0 million, which was subsequently increased to \$8.0 million in July 2018. The purpose of the credit facility is to provide an additional source of liquidity for the Holding Company and to provide funds for the Holding Company to downstream as additional capital to CFBank to support growth. Loans

under the credit facility bear interest at a rate equal to the Prime Rate plus 0.75%. As of September 30, 2018, the Holding Company had drawn \$8.0 million on the credit facility and downstreamed \$6.5 million as capital contributions to CFBank.

Subordinated debentures. Subordinated debentures totaled \$5.2 million at both September 30, 2018 and December 31, 2017. These debentures were issued in 2003 in exchange for the proceeds of a \$5.0 million trust preferred securities offering issued by a trust formed by the Holding Company. The terms of the subordinated debentures allow for the Holding Company to defer interest payments for a period not to exceed five years.

Stockholders' equity. Stockholders' equity totaled \$43.6 million at September 30, 2018, an increase of \$3.3 million, or 8.3%, from \$40.3 million at December 31, 2017. The increase in total stockholders' equity was primarily attributed to net income.

Management continues to proactively monitor capital levels and ratios in its on-going capital planning process. CFBank has leveraged its capital to support balance sheet growth and drive increased net interest income. Management remains focused on growing capital through improving results from operations; however, should the need arise, CFBank has additional sources of capital and alternatives it could utilize as further discussed in the "Liquidity and Capital Resources" section in this quarterly report on Form 10-Q.

Currently, the Holding Company has excess cash to cover its expenses for the foreseeable future, and could inject capital into CFBank if necessary. Also, CFBank has the flexibility to manage its balance sheet size as a result of the short duration of the assets as discussed with the Northpointe mortgage program, as well as to deploy those assets into higher earning assets to improve net interest income as the opportunity presents itself.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

Comparison of the Results of Operations for the Three Months Ended September 30, 2018 and 2017.

General. The Company's income before income tax expense for the quarter ended September 30, 2018 totaled \$1.3 million and increased \$277,000, or 27.2%, compared to \$1.0 million for the quarter ended September 30, 2017. The increase in income before income tax expense was due to a \$1.2 million increase in net interest income and a \$448,000 increase in noninterest income, partially offset by a \$1.4 million increase in noninterest expense.

Net income for the three months ended September 30, 2018 totaled \$1.1 million and increased \$370,000, or 54.0%, compared to net income of \$685,000 for the three months ended September 30, 2017. The increase in net income was due to a \$1.2 million increase in net interest income, a \$448,000 increase in noninterest income, and a \$93,000 decrease in income tax expense, partially offset by a \$1.4 million increase in noninterest expense. The decrease in income tax expense was due to the reduction in the federal corporate tax rate, effective January 1, 2018, as a result of the Tax Cuts and Jobs Act.

Net income attributable to common stockholders for the three months ended September 30, 2018, totaled \$1.0 million or \$0.24 per diluted common share, and increased \$558,000, or 118.5%, compared to net income attributable to common stockholders of \$471,000, or \$0.15 per diluted common share, for the three months ended September 30, 2017. For the three months ended September 30, 2018, the accretion of discount from the Company's warrants reduced net income by \$26,000. For the three months ended September 30, 2017, preferred dividends on the Company's Series B Preferred Stock and accretion of discount reduced net income attributable to common stockholders by \$214,000. The decrease in the preferred dividends on the Series B preferred stock and accretion of discount is due to the conversion of the Company's Preferred Stock into shares of Common Stock of the Company, effective October 6, 2017, resulting in the elimination of the preferred dividend payments beginning with the fourth quarter of 2017 of approximately \$187,500 quarterly.

Net interest income. Net interest income is a significant component of net income, and consists of the difference between interest income generated on interest-earning assets and interest expense incurred on interest-bearing liabilities. Net interest income is primarily affected by the volumes, interest rates and composition of interest-earning assets and interest-bearing liabilities. The tables in the sections below titled "Average Balances, Interest Rates and Yields" and "Rate/Volume Analysis of Net Interest Income" provide important information on factors impacting net interest income and should be read in conjunction with this discussion of net interest income.

Net interest income totaled \$4.7 million for the quarter ended September 30, 2018 and increased \$1.2 million, or 33.6%, compared to \$3.5 million for the quarter ended September 30, 2017. The increase in net interest income was primarily due to a \$2.2 million, or 50.6%, increase in interest income, partially offset by a \$1.0 million, or 117.0%, increase in interest expense. The increase in interest income was primarily attributed to a \$142.2 million, or 35.2%, increase in average interest-earning assets outstanding, resulting primarily from an increase in net loans, and a 49bp increase in average yield on interest-earning assets. The increase in interest expense was primarily attributed to a \$120.0 million, or 38.8%, increase in average interest-bearing liabilities and a 65bps increase in the average cost of funds on interest-bearing liabilities. As a result, net interest margin of 3.43% for the quarter ended September 30, 2018 decreased 4bps compared to the net interest margin of 3.47% for the quarter ended September 30, 2017.

Interest income totaled \$6.6 million and increased \$2.2 million, or 50.6%, for the quarter ended September 30, 2018, compared to \$4.4 million for the quarter ended September 30, 2017. The increase in interest income was primarily attributed to a \$142.1 million, or 38.7%, increase in average loans and loans held for sale outstanding, and a 41bp increase in average yield on loans and loans held for sale.

Interest expense totaled \$1.9 million and increased \$1.0 million, or 117.0%, for the quarter ended September 30, 2018, compared to \$893,000 for the quarter ended September 30, 2017. The increase in interest expense was primarily attributed to a \$113.5 million, or 39.1%, increase in average interest-bearing deposit balances. The overall cost of funds on total interest-bearing deposits increased 63bps to 169bps at September 30, 2018 compared to 106bps at September 30, 2017.

Provision for loan and lease losses. There was no provision for loan and lease losses for either the quarter ended September 30, 2018 or the quarter ended September 30, 2017, which is due to strong credit quality, favorable trends in certain qualitative factors and net recoveries. Net recoveries for the quarter ended September 30, 2018 totaled \$24,000, compared to net recoveries of \$6,000 for the quarter ended September 30, 2017.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## PART 1. Item 2

## MANAGEMENT DISCUSSION AND ANALYSIS

The following table presents information regarding net charge-offs (recoveries) for the three months ended September 30, 2018 and 2017.

	For the three months ended September 30, 2018 2017 (Dollars in thousands)	
(unaudited)		
Commercial	\$ -	\$ -
Single-family residential real estate	(19)	(1)
Home equity lines of credit	(5)	(5)
Total	\$ (24)	\$ (6)

**Noninterest income.** Noninterest income for the quarter ended September 30, 2018 totaled \$643,000 and increased \$448,000, or 229.7%, compared to \$195,000 for the quarter ended September 30, 2017. The increase was primarily due to a \$428,000 increase in net gain on sale of loans and a \$22,000 increase in service charges on deposit accounts. The increase in net gain on sale of loans was a result of increased sales volume due to the expansion of the mortgage business. The increase in service charges on deposit accounts was related to increased account relationships and pricing.

**Noninterest expense.** Noninterest expense for the quarter ended September 30, 2018 totaled \$4.0 million and increased \$1.4 million, or 50.3%, compared to \$2.7 million for the quarter ended September 30, 2017. The increase in noninterest expense during the three months ended September 30, 2018 was primarily due to a \$572,000 increase in salaries and employee benefits expense, a \$319,000 increase in advertising and marketing expense and a \$140,000 increase in professional fees. The increase in salaries and employee benefits expense was primarily due to the hiring of mortgage personnel in connection with the expansion of our mortgage business, consistent with our focus on driving noninterest income. The increase in salaries and employee benefits expense also resulted from an increase in personnel associated with the opening of our Glendale branch in the Cincinnati market, the addition of experienced treasury management personnel, and an increase in credit and finance personnel to support our growth, infrastructure and risk management practices. The increase in advertising and marketing expense is primarily due to increased expenditures related to the expansion of our mortgage business, coupled with increased advertising focused on increasing core deposits. Professional fees increased primarily due to the reverse stock split that occurred during the third quarter and professional fees associated with the expansion of our mortgage business.

**Income taxes.** Income tax expense was \$239,000 for the quarter ended September 30, 2018, a decrease of \$93,000 compared to \$332,000 for the quarter ended September 30, 2017. The decrease was due primarily to the reduction of the federal corporate tax rate to 21%, effective January 1, 2018, pursuant to the Tax Cuts and Jobs Act, which was

partially offset by an increase in earnings. As a result, the effective tax rate for the quarter ended September 30, 2018 decreased to approximately 18.4%, as compared to approximately 32.6% for the quarter ended September 30, 2017.

Our deferred tax assets are composed of NOLs, and other temporary book to tax differences. When determining the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded as a benefit, the Company conducts a regular assessment of all available information. This information includes, but is not limited to, taxable income in prior periods, projected future income and projected future reversals of deferred tax items. Based on these criteria, the Company determined as of September 30, 2018 that no valuation allowance was required against the net deferred tax asset.

The Company records income tax expense based on the federal statutory rate adjusted for the effect of other items such as bank owned life insurance and other miscellaneous items.

#### Comparison of the Results of Operations for the Nine Months Ended September 30, 2018 and 2017

General. Income before income tax expense for the nine months ended September 30, 2018 totaled \$3.7 million and increased \$1.2 million, or 49.9%, compared to \$2.5 million for the nine months ended September 30, 2017. The increase in income before income tax expense was due to a \$3.0 million increase in net interest income and a \$1.3 million increase in noninterest income, partially offset by a \$3.1 million increase in noninterest expense.

Net income for the nine months ended September 30, 2018 totaled \$3.0 million and increased \$1.3 million, or 81.0%, compared to net income of \$1.6 million for the nine months ended September 30, 2017. The increase in net income was due to a \$3.0 million increase in net interest income, a \$1.3 million increase in noninterest income, and a decrease in income tax expenses of \$106,000, partially offset by a \$3.1 million increase in noninterest expense. As discussed above, the decrease in income tax expense was due to the reduction in the federal corporate tax rate, effective January 1, 2018, as a result of the Tax Cuts and Jobs Act.



Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

Net income attributable to common stockholders for the nine months ended September 30, 2018, totaled \$2.9 million, or \$0.67 per diluted common share, and increased \$1.9 million, or 190.7%, compared to net income attributable to common stockholders of \$1.0 million, or \$0.31 per diluted common share, for the nine months ended September 30, 2017. For the nine months ended September 30, 2018, the accretion of discount from the Company's warrants reduced net income by \$64,000. For the nine months ended September 30, 2017, preferred dividends on the Company's Series B Preferred Stock and accretion of discount reduced net income attributable to common stockholders by \$643,000. The decrease in the preferred dividends on the Series B preferred stock and accretion of discount is due to the conversion of the Company's Preferred Stock into shares of Common Stock of the Company, effective October 6, 2017, as discussed above.

Net interest income. Net interest income is a significant component of net income, and consists of the difference between interest income generated on interest-earning assets and interest expense incurred on interest-bearing liabilities. Net interest income is primarily affected by the volumes, interest rates and composition of interest-earning assets and interest-bearing liabilities. The tables in the sections below titled "Average Balances, Interest Rates and Yields" and "Rate/Volume Analysis of Net Interest Income" provide important information on factors impacting net interest income and should be read in conjunction with this discussion of net interest income.

Net interest income totaled \$12.9 million for the nine months ended September 30, 2018 and increased \$2.9 million, or 29.8%, compared to \$10.0 million for the nine months ended September 30, 2017. The increase in net interest income was primarily due to a \$5.2 million, or 41.4%, increase in interest income, partially offset by a \$2.2 million, or 88.6%, increase in interest expense. The increase in interest income was primarily attributed to a \$109.4 million, or 27.7%, increase in average interest-earning assets outstanding, resulting primarily from an increase in net loans, and a 45bp increase in average yield on interest-earning assets. The increase in interest expense was primarily attributed to an \$87.7 million, or 28.9%, increase in average interest-bearing liabilities and a 51bps increase in the average cost of funds on interest-bearing liabilities. As a result, net interest margin of 3.42% for the nine months ended September 30, 2018 increased 5bps compared to the net interest margin of 3.37% for the nine months ended September 30, 2017.

Interest income totaled \$17.6 million and increased \$5.2 million, or 41.4%, for the nine months ended September 30, 2018, compared to \$12.4 million for the nine months ended September 30, 2017. The increase in interest income was primarily attributed to a \$111.6 million, or 31.9%, increase in average loans and loans held for sale outstanding, and a 32bp increase in average yield on loans and loans held for sale.

Interest expense totaled \$4.7 million and increased \$2.2 million, or 88.6%, for the nine months ended September 30, 2018, compared to \$2.5 million for the nine months ended September 30, 2017. The increase in interest expense was primarily attributed to an \$82.0 million, or 28.8%, increase in average interest-bearing deposits and a 48bps increase in the average cost of funds on deposits. The cost of funds on interest-bearing deposits increased 48bps to 147bps at September 30, 2018 compared to 99bps at September 30, 2017.

Provision for loan and lease losses. There was no provision for loan and lease losses for either the nine months ended September 30, 2018 or the nine months ended September 30, 2017, which is due to strong credit quality, favorable

trends in certain qualitative factors and net recoveries. Net recoveries for the nine months ended September 30, 2018 totaled \$35,000, compared to net recoveries of \$39,000 for the nine months ended September 30, 2017.

The following table presents information regarding net charge-offs (recoveries) for the nine months ended September 30, 2018 and 2017.

	For the nine months ended September 30, 2018 2017 (Dollars in thousands)	
(unaudited)		
Commercial	\$ (2)	\$ (2)
Single-family residential real estate	(15)	(18)
Home equity lines of credit	(18)	(19)
Total	\$ (35)	\$ (39)

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

**Noninterest income.** Noninterest income for the nine months ended September 30, 2018 totaled \$1.9 million and increased \$1.3 million, or 245.0%, compared to \$538,000 for the nine months ended September 30, 2017. The increase was primarily due to a \$1.2 million increase in net gain on sale of loans and a \$74,000 increase in service charges on deposit accounts. The increase in net gain on sale of loans was a result of increased sales volume due to the expansion of the mortgage business. The increase in service charges on deposit accounts was related to increased account relationships and pricing.

**Noninterest expense.** Noninterest expense for the nine months ended September 30, 2018 totaled \$11.1 million and increased \$3.0 million, or 38.0%, compared to \$8.1 million for the nine months ended September 30, 2017. The increase in noninterest expense during the nine months ended September 30, 2018 was primarily due to a \$1.6 million increase in salaries and employee benefits expense, a \$907,000 increase in advertising and marketing expense and a \$168,000 increase in professional fees. The increase in salaries and employee benefits was primarily due to the hiring of mortgage personnel in connection with the expansion of our mortgage business, consistent with our focus on driving noninterest income. The increase in salaries and employee benefits also resulted from an increase in personnel associated with the opening of our Glendale branch in the Cincinnati market, the addition of experienced treasury management personnel, and an increase in credit and finance personnel to support our growth, infrastructure and risk management practices. The increase in advertising and marketing expense is primarily due to increased expenditures related to the expansion of our mortgage business, coupled with increased advertising focused on increasing core deposits. Professional fees increased primarily due to the reverse stock split that occurred during the third quarter and professional fees associated with the expansion of our mortgage business.

**Income taxes.** Income tax expense was \$704,000 for the nine months ended September 30, 2018, a decrease of \$106,000 compared to \$810,000 for the nine months ended September 30, 2017. The decrease was due primarily to the reduction of the federal corporate tax rate to 21%, effective January 1, 2018, pursuant to the Tax Cuts and Jobs Act, which was partially offset by an increase in earnings. As a result, the effective tax rate for the nine months ended September 30, 2018 decreased to approximately 19.1%, as compared to approximately 33.0% for the nine months ended September 30, 2017.

Our deferred tax assets are composed of NOLs, and other temporary book to tax differences. When determining the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded as a benefit, the Company conducts a regular assessment of all available information. This information includes, but is not limited to, taxable income in prior periods, projected future income and projected future reversals of deferred tax items. Based on these criteria, the Company determined as of September 30, 2018 that no valuation allowance was required against the net deferred tax asset.

The Company records income tax expense based on the federal statutory rate adjusted for the effect of other items such as bank owned life insurance and other miscellaneous items.



Table of Contents

## CENTRAL FEDERAL CORPORATION

## PART 1. Item 2

## MANAGEMENT DISCUSSION AND ANALYSIS

Average Balances, Interest Rates and Yields. The following table presents, for the periods indicated, the total dollar amount of fully taxable equivalent interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Average balances are computed using month-end balances.

	For Three Months Ended September 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
(Dollars in thousands)						
Interest-earning assets:						
Securities (1) (2)	\$ 11,589	\$ 49	1.67%	\$ 12,909	\$ 44	1.36%
Loans and loans held for sale (3)	509,513	6,380	5.01%	367,436	4,225	4.60%
Other earning assets	21,648	142	2.62%	20,277	83	1.64%
FHLB and FRB stock	3,275	50	6.11%	3,193	45	5.64%
Total interest-earning assets	546,025	6,621	4.85%	403,815	4,397	4.36%
Noninterest-earning assets	25,390			27,193		
Total assets	\$ 571,415			\$ 431,008		
Interest-bearing liabilities:						
Deposits	\$ 403,650	1,707	1.69%	\$ 290,137	771	1.06%
FHLB advances and other borrowings	25,595	231	3.61%	19,118	122	2.55%
Total interest-bearing liabilities	429,245	1,938	1.81%	309,255	893	1.16%
Noninterest-bearing liabilities	99,340			81,534		
Total liabilities	528,585			390,789		
Equity	42,830			40,219		
Total liabilities and equity	\$ 571,415			\$ 431,008		
Net interest-earning assets	\$ 116,780			\$ 94,560		
Net interest income/interest rate spread		\$ 4,683	3.04%		\$ 3,504	3.20%
Net interest margin			3.43%			3.47%
Average interest-earning assets to average interest-bearing liabilities	127.21%			130.58%		

- (1) Average balance is computed using the carrying value of securities. Average yield is computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields and interest earned are stated on a fully taxable equivalent basis.
- (3) Average balance is computed using the recorded investment in loans net of the ALLL and includes nonperforming loans.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## PART 1. Item 2

## MANAGEMENT DISCUSSION AND ANALYSIS

	For Nine Months Ended September 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Interest-earning assets:						
Securities (1) (2)	\$ 11,670	\$ 139	1.57%	\$ 13,612	\$ 139	1.36%
Loans and loans held for sale (3)	461,075	16,863	4.88%	349,467	11,944	4.56%
Other earning assets	28,024	445	2.12%	28,791	247	1.14%
FHLB and FRB stock	3,252	145	5.95%	2,778	108	5.18%
Total interest-earning assets	504,021	17,592	4.65%	394,648	12,438	4.20%
Noninterest-earning assets	24,781			26,396		
Total assets	\$ 528,802			\$ 421,044		
Interest-bearing liabilities:						
Deposits	\$ 366,297	4,037	1.47%	\$ 284,345	2,115	0.99%
FHLB advances and other borrowings	24,767	614	3.31%	19,056	351	2.46%
Total interest-bearing liabilities	391,064	4,651	1.59%	303,401	2,466	1.08%
Noninterest-bearing liabilities	96,123			77,853		
Total liabilities	487,187			381,254		
Equity	41,615			39,790		
Total liabilities and equity	\$ 528,802			\$ 421,044		
Net interest-earning assets	\$ 112,957			\$ 91,247		
Net interest income/interest rate spread		\$ 12,941	3.06%		\$ 9,972	3.12%
Net interest margin			3.42%			3.37%
Average interest-earning assets to average interest-bearing liabilities	128.88%			130.07%		

(1) Average balance is computed using the carrying value of securities. Average yield is computed using the historical amortized cost average balance for available for sale securities.

(2) Average yields and interest earned are stated on a fully taxable equivalent basis.

(3) Average balance is computed using the recorded investment in loans net of the ALLL and includes nonperforming loans.





Table of Contents

## CENTRAL FEDERAL CORPORATION

## PART 1. Item 2

## MANAGEMENT DISCUSSION AND ANALYSIS

Rate/Volume Analysis of Net Interest Income. The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the increase and decrease related to changes in balances and/or changes in interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e., changes in volume multiplied by the prior rate) and (ii) changes in rate (i.e., changes in rate multiplied by prior volume). For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017			Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017		
	Increase (decrease) due to			Increase (decrease) due to		
	Rate	Volume	Net	Rate	Volume	Net
	(Dollars in thousands)			(Dollars in thousands)		
Interest-earning assets:						
Securities (1)	\$ 28	\$ (23)	\$ 5	\$ 27	\$ (27)	\$ -
Loans and loans held for sale	403	1,752	2,155	885	4,034	4,919
Other earning assets	53	6	59	209	(11)	198
FHLB and FRB Stock	4	1	5	17	20	37
Total interest-earning assets	488	1,736	2,224	1,138	4,016	5,154
Interest-bearing liabilities:						
Deposits	563	373	936	1,202	720	1,922
FHLB advances and other borrowings	60	49	109	141	122	263
Total interest-bearing liabilities	623	422	1,045	1,343	842	2,185
Net change in net interest income	\$ (135)	\$ 1,314	\$ 1,179	\$ (205)	\$ 3,174	\$ 2,969

(1) Securities amounts are presented on a fully taxable equivalent basis.

## Critical Accounting Policies

We follow financial accounting and reporting policies that are in accordance with U.S. generally accepted accounting principles and conform to general practices within the banking industry. These policies are presented in Note 1 to our 2017 Audited Financial Statements. Some of these accounting policies are considered to be critical accounting policies, which are those policies that are both most important to the portrayal of the Company's financial condition and results of operations, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Application of assumptions different than those used by management could result in material changes in our financial condition or results of operations. These policies, current assumptions and estimates utilized, and the related disclosure of this process, are determined by management and routinely reviewed with the Audit Committee of the Board of Directors. We believe that the judgments, estimates and assumptions used in the preparation of the consolidated financial statements were appropriate given the factual circumstances at the time.

We have identified accounting policies that are critical accounting policies, and an understanding of these policies is necessary to understand our financial statements. The following discussion details the critical accounting policies and the nature of the estimates made by management.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

Determination of the ALLL. The ALLL represents management's estimate of probable incurred credit losses in the loan portfolio at each balance sheet date. The allowance consists of general and specific components. The general component covers loans not classified as impaired and is based on historical loss experience, adjusted for current factors. Current factors considered include, but are not limited to, management's oversight of the portfolio, including lending policies and procedures; nature, level and trend of the portfolio, including past due and nonperforming loans, loan concentrations, loan terms and other characteristics; current economic conditions and outlook; collateral values; and other items. The specific component of the ALLL relates to loans that are individually classified as impaired. Loans exceeding policy thresholds are regularly reviewed to identify impairment. A loan is impaired when, based on current information and events, it is probable that CFBank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Determining whether a loan is impaired and whether there is an impairment loss requires judgment and estimates, and the eventual outcomes may differ from estimates made by management. The determination of whether a loan is impaired includes: review of historical data; judgments regarding the ability of the borrower to meet the terms of the loan; an evaluation of the collateral securing the loan and estimation of its value, net of selling expenses, if applicable; various collection strategies; and other factors relevant to the loan or loans. Impairment is measured based on the fair value of collateral, less costs to sell, if the loan is collateral dependent, or alternatively, the present value of expected future cash flows discounted at the loan's effective rate, if the loan is not collateral dependent. When the selected measure is less than the recorded investment in the loan, an impairment loss is recorded. As a result, determining the appropriate level for the ALLL involves not only evaluating the current financial situation of individual borrowers or groups of borrowers, but also current predictions about future events that could change before an actual loss is determined. Based on the variables involved and the fact that management must make judgments about outcomes that are inherently uncertain, the determination of the ALLL is considered to be a critical accounting policy. Additional information regarding this policy is included in the previous section titled "Financial Condition - Allowance for loan losses", in Note 4 to the consolidated financial statements included in this Quarterly Report on Form 10-Q and in Notes 1, 4 and 6 to our 2017 Audited Financial Statements.

Valuation of the deferred tax asset. Our deferred tax assets are composed of NOLs, and other temporary book to tax differences. When determining the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded as a benefit, the Company conducts a regular assessment of all available information. This information includes, but is not limited to, taxable income in prior periods, projected future income and projected future reversals of deferred tax items. Based on these criteria, the Company determined as of September 30, 2018 that no valuation allowance was required against the net deferred tax asset.

In 2012, the Company completed a recapitalization program pursuant to which the Holding Company sold \$22.5 million in common stock, which improved the capital levels of CFBank and provided working capital for the Holding Company. The result of the change in stock ownership associated with the stock offering, however, was that the Company incurred an ownership change within the guidelines of Section 382 of the Internal Revenue Code of 1986. At year-end 2017, the Company had net operating loss carryforwards of \$23.1 million, which expire at various dates from 2024 to 2033. As a result of the ownership change, the Company's ability to utilize carryforwards that arose before the 2012 stock offering closed is limited to \$163,000 per year. Due to this limitation, management

determined it is more likely than not that \$20.5 million of net operating loss carryforwards will expire unutilized. As required by accounting standards, the Company reduced the carrying value of deferred tax assets, and the corresponding valuation allowance, by the \$7.0 million tax effect of this lost realizability.

Federal income tax laws provided additional deductions, totaling \$2.3 million, for thrift bad debt reserves established before 1988. Accounting standards do not require a deferred tax liability to be recorded on this amount, which otherwise would have totaled \$473,000 at year-end 2017. However, if CFBank were wholly or partially liquidated or otherwise ceases to be a bank, or if tax laws were to change, this amount would have to be recaptured and a tax liability recorded. Additionally, any distributions in excess of CFBank's current or accumulated earnings and profits would reduce amounts allocated to its bad debt reserve and create a tax liability for CFBank.

At September 30, 2018 and December 31, 2017, the Company had a deferred tax asset recorded in the amount of \$1.6 million. At September 30, 2018 and December 31, 2017, the Company had no unrecognized tax benefits recorded. The Company is subject to U.S. federal income tax and is no longer subject to federal examination for years prior to 2014. Additional information is included in Notes 1 and 14 to our 2017 Audited Financial Statements.

Fair value of financial instruments. Another critical accounting policy relates to the fair values of financial instruments, which are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. Additional information is included in Note 5 to the consolidated financial statements included in this Quarterly Report on Form 10-Q and in Notes 1 and 6 to our 2017 Audited Financial Statements.

Table of Contents

## CENTRAL FEDERAL CORPORATION

## PART 1. Item 2

## MANAGEMENT DISCUSSION AND ANALYSIS

Fair value of foreclosed assets. Another critical accounting policy relates to the fair values of foreclosed assets, which are estimated based on real estate appraisals which may use 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 changes in assumptions or market conditions could significantly affect the values. Additional information is included in Note 5 to the consolidated financial statements included in this Quarterly Report on Form 10-Q and in Notes 1, 5 and 6 to our 2017 Audited Financial Statements.

## Liquidity and Capital Resources

In general terms, liquidity is a measurement of an enterprise's ability to meet cash needs. The primary objective in liquidity management is to maintain the ability to meet loan commitments and to repay deposits and other liabilities in accordance with their terms without an adverse impact on current or future earnings. Principal sources of funds are deposits; amortization and prepayments of loans; maturities, sales and principal receipts of securities available for sale; borrowings; and operations. While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

CFBank is required by regulation to maintain sufficient liquidity to ensure its safe and sound operation. Thus, adequate liquidity may vary depending on CFBank's overall asset/liability structure, market conditions, the activities of competitors, the requirements of our own deposit and loan customers and regulatory considerations. Management believes that each of the Holding Company's and CFBank's current liquidity is sufficient to meet its daily operating needs and fulfill its strategic planning.

Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets, primarily cash, short-term investments and other assets that are widely traded in the secondary market, based on our ongoing assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and securities and the objective of our asset/liability management program. In addition to liquid assets, we have other sources of liquidity available including, but not limited to, access to advances from the FHLB and borrowings from the FRB and our commercial bank line of credit.

The following table summarizes the Company's cash available from liquid assets and borrowing capacity at September 30, 2018 and December 31, 2017.

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Cash, unpledged securities and deposits in other financial institutions	\$ 60,591	\$ 46,767
Additional borrowing capacity at the FHLB	54,769	51,503

Edgar Filing: CENTRAL FEDERAL CORP - Form 10-Q

Additional borrowing capacity at the FRB	56,485	40,448
Unused commercial bank line of credit	8,000	8,000
Total	\$ 179,845	\$ 146,718

Cash, unpledged securities and deposits in other financial institutions increased \$13.8 million, or 29.6%, to \$60.6 million at September 30, 2018 compared to \$46.8 million at December 31, 2017. The increase is primarily attributed to increased customer deposits.

CFBank's additional borrowing capacity with the FHLB increased \$3.3 million, or 6.3%, to \$54.8 million at September 30, 2018, compared to \$51.5 million at December 31, 2017.

CFBank's additional borrowing capacity at the FRB increased \$16.0 million, or 39.6%, to \$56.5 million at September 30, 2018 from \$40.4 million at December 31, 2017. CFBank is eligible to participate in the FRB's primary credit program, providing CFBank access to short-term funds at any time, for any reason, based on the collateral pledged.

CFBank's borrowing capacity with both the FHLB and FRB may be negatively impacted by changes such as, but not limited to, further tightening of credit policies by the FHLB or FRB, deterioration in the credit performance of CFBank's loan portfolio or CFBank's financial performance, or a decrease in the balance of pledged collateral.

CFBank had \$8.0 million of availability in an unused line of credit with a commercial bank at September 30, 2018 and December 31, 2017.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 2

MANAGEMENT DISCUSSION AND ANALYSIS

Deposits are obtained predominantly from the markets in which CFBank's offices are located. We rely primarily on a willingness to pay market-competitive interest rates to attract and retain retail deposits.

CFBank relies on competitive interest rates, customer service, and relationships with customers to retain deposits. To promote and stabilize liquidity in the banking and financial services sector, the FDIC, pursuant to the provisions of the Dodd-Frank Act as previously discussed, permanently increased deposit insurance coverage from \$100,000 to \$250,000 per depositor.

The Holding Company has more limited sources of liquidity than CFBank. In general, in addition to its existing liquid assets, sources of liquidity include funds raised in the securities markets through debt or equity offerings, funds borrowed from third party banks or other lenders, dividends received from CFBank or the sale of assets.

Management believes that the Holding Company had adequate funds at September 30, 2018 to meet its current and anticipated operating needs at this time. The Holding Company's current cash requirements include operating expenses and interest on subordinated debentures and other debt. The Company may also elect to pay dividends on its common stock, if and when declared by the Board of Directors.

Currently, annual debt service on the subordinated debentures, underlying the Company's trust preferred securities, is approximately \$273,000. The subordinated debentures have a variable rate of interest, reset quarterly, equal to the three-month LIBOR plus 2.85%. The total rate in effect was 5.25% at September 30, 2018. An increase in the three-month LIBOR would increase the debt service requirement of the subordinated debentures.

In February 2018, the Holding Company entered into a credit facility with a third-party bank pursuant to which the Holding Company could borrow up to an aggregate principal amount of \$6 million. In July 2018, the Holding Company increased the credit facility by \$2.0 million, which increased the total borrowing limit to \$8.0 million. The purpose of the credit facility is to provide an additional source of liquidity for the Holding Company and to provide funds for the Holding Company to downstream as additional capital to CFBank to support growth. Loans under the credit facility bear interest at a rate equal to the Prime Rate plus 0.75%. The credit facility is secured by a pledge of the Holding Company's stock of CFBank. The credit facility will expire in February 2020 unless extended or replaced. As of September 30, 2018, the Holding Company had drawn \$8.0 million on the credit facility and downstreamed \$6.5 million as capital contributions to CFBank. The total rate in effect on this credit facility was 6.00% at September 30, 2018.

Banking regulations limit the amount of dividends that can be paid to the Holding Company by CFBank without prior regulatory approval. Generally, financial institutions may pay dividends without prior approval as long as the dividend does not exceed the total of the current calendar year-to-date earnings plus any earnings from the previous two years not already paid out in dividends, and as long as the financial institution remains well capitalized after the dividend payment. Any future dividend payments by CFBank to the Holding Company would be based on future earnings and, if necessary, regulatory approval.

The ability of the Holding Company to pay dividends on its common stock is generally dependent upon the receipt of dividends and other distributions from CFBank. CFBank is a legal entity that is separate and distinct from the Holding Company and has no obligation to make any dividends or other funds available to the Holding Company for the payment of dividends by the Holding Company. The Holding Company also is subject to various legal and regulatory policies and requirements impacting the Holding Company's ability to pay dividends on its stock. In addition, the Holding Company's ability to pay dividends on its stock is conditioned upon the payment, on a current basis, of quarterly interest payments on the subordinated debentures underlying the Company's trust preferred securities.



Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management believes that, as of September 30, 2018, there has been no material change in the Company's market risk from the information contained in the Company's Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2017.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART 1. Item 4

CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 (Exchange Act) reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective as of and for the quarter ended September 30, 2018.

Changes in internal control over financial reporting. We made no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) in the second quarter of 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

CENTRAL FEDERAL CORPORATION

PART II. Item 4

OTHER INFORMATION

Item 1. Legal Proceedings

The Holding Company and CFBank may, from time to time, be involved in various legal proceedings in the normal course of business. Periodically, there have been various claims and lawsuits involving CFBank, such as claims to enforce liens, condemnation proceedings on properties in which CFBank holds security interests, claims involving the making and servicing of real property loans and other claims and lawsuits incident to our banking business.

We are not a party to any pending legal proceeding that management believes would have a material adverse effect on our financial condition or results of operations, if decided adversely to us.

Item 1A. Risk Factors

There were no material changes to the risk factors as presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

- (a) None.
- (b) Not applicable.
- (c) No repurchases of the Holding Company's common shares were made by or on behalf of the Holding Company or any "affiliated purchaser" as defined in Rule 10b-18(a)(3) under the Exchange Act during the second quarter of 2018.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

55

---

Table of Contents

CENTRAL FEDERAL CORPORATION

PART II. Item 4

OTHER INFORMATION

Item 6. Exhibits

Exhibit

Number Description of Exhibit

- 3.1 Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, filed with the Commission on November 9, 2017 (File No. 0-25045))
- 3.2 Amendment to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.2 to the registrant's Registration Statement on Form S-2, filed with the Commission on October 28, 2005 (File No. 333-129315))
- 3.3 Amendment to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.4 to the registrant's Form 10-Q for the quarter ended June 30, 2009, filed with the Commission on August 14, 2009 (File No. 0-25045))
- 3.4 Amendment to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.5 to the registrant's Form 10-Q for the quarter ended September 30, 2011, filed with the Commission on November 10, 2011 (File No. 0-25045))
- 3.5 Amendment to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.5 to the registrant's Post-Effective Amendment to the Registration Statement on Form S-1, filed with the Commission on May 4, 2012 (File No. 333-177434))
- 3.6 Certificate of Designations to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K dated May 7, 2014 and filed with the Commission on May 13, 2014 (File No. 0-25045))
- 3.7 Amendment to Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K dated August 20, 2018, filed with the commission on August 20, 2018 (File No. 0-25045))
- 3.8 Second Amended and Restated Bylaws of the registrant (incorporated by reference to Exhibit 3.3 to the registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Commission on March 27, 2008 (File No. 0-25045))
- 11.1 Statement Re: Computation of Per Share Earnings
- 31.1 Rule 13a-14(a) Certifications of the Chief Executive Officer
- 31.2 Rule 13a-14(a) Certifications of the Chief Financial Officer
- 32.1 Section 1350 Certifications of the Chief Executive Officer and Chief Financial Officer
- 101.1 Interactive Data File (XBRL)



Table of Contents

CENTRAL FEDERAL CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CENTRAL FEDERAL CORPORATION

Dated: November 9, 2018 By: /s/ Timothy T. O'Dell  
Timothy T. O'Dell  
President and Chief Executive Officer

Dated: November 9, 2018 By: /s/ John W. Helmsdoerfer  
John W. Helmsdoerfer, CPA  
Treasurer and Chief Financial Officer