CENTRAL FEDERAL CORP
Form 10-Q
May 15, 2014
UNITED STATES

SECURITIES AND EXCHANGE COMMISION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2014

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)

Delaware	34-1877137
(State or other jurisdiction of incorporation or organization)	(IRS Employer 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, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] 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 [X] No [ ]

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

Large accelerated filer [ ]Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

As of May 15, 2014, there were 15,823,710 shares of the registrant's Common Stock outstanding.

CENTRAL FEDERAL CORPORATION

CENTRAL FEDERAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	March 31, 2014 (unaudited)	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 21,578	$ 19,160
Interest-bearing deposits in other financial institutions	1,486	1,982
Securities available for sale	9,074	9,672
Loans held for sale, at fair value	4,090	3,285
Loans, net of allowance of $5,763 and $5,729	208,902	207,141
FHLB stock	1,942	1,942
Foreclosed assets, net	1,636	1,636
Premises and equipment, net	3,753	3,547
Bank owned life insurance	4,567	4,535
Accrued interest receivable and other assets	1,961	2,848
Total assets	$ 258,989	$ 255,748
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$ 30,772	$ 27,652
Interest bearing	184,916	180,657
Total deposits	215,688	208,309
FHLB advances	13,000	10,000
Other secured borrowings	-	6,526
Advances by borrowers for taxes and insurance	137	575
Accrued interest payable and other liabilities	2,309	2,319
Subordinated debentures	5,155	5,155
Total liabilities	236,289	232,884
Commitments and Contingent Liabilities		
Stockholders' equity		
Common stock, $.01 par value; shares authorized: 50,000,000; shares issued: 15,935,417 in 2014 and 2013	159	159
Additional paid-in capital	48,141	48,067
Accumulated deficit	(22,429)	(22,215)
Accumulated other comprehensive income	74	98
Treasury stock, at cost; 111,707 shares	(3,245)	(3,245)

Total stockholders' equity	22,700	22,864
	$ 258,989	$ 255,748

See accompanying notes to consolidated financial statements.

3

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF LOSS

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended March 31,	
	2014	2013
Interest and dividend income		
Loans, including fees	$ 2,122	$ 1,596
Securities	44	60
FHLB stock dividends	20	21
Federal funds sold and other	17	34
	2,203	1,711
Interest expense		
Deposits	355	408
FHLB advances and other debt	45	76
Subordinated debentures	42	41
	442	525
Net interest income	1,761	1,186
Provision for loan losses	20	326
Net interest income after provision for loan losses	1,741	860
Noninterest income		
Service charges on deposit accounts	103	73
Net gains on sales of loans	17	6
Earnings on bank owned life insurance	32	32
Other	93	22
	245	133
Noninterest expense		
Salaries and employee benefits	1,103	892
Occupancy and equipment	158	75
Data processing	207	163
Franchise taxes	50	85
Professional fees	297	212
Director fees	12	5
Postage, printing and supplies	84	58
Advertising and promotion	3	6
Telephone	25	16
Loan expenses	4	17
Foreclosed assets, net	11	(19)
Depreciation	52	54
FDIC premiums	79	111

Amortization of intangibles		-		9
Regulatory assessment		39		39
Other insurance		36		37
Other		40		43
		2,200		1,803
Income (loss) before incomes taxes		(214)		(810)
Income tax expense		-		-
Net income (loss)		(214)		(810)
Earnings (loss) attributable to common stockholders	$	(214)	$	(810)
Earnings (loss) per common share:				
Basic	$	(0.01)	$	(0.05)
Diluted	$	(0.01)	$	(0.05)

See accompanying notes to consolidated financial statements.

4

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands except per share data)

(Unaudited)

	Three months ended March 31, 2014	Three months ended March 31, 2013
Net income (loss)	$ (214)	$ (810)
Other comprehensive income (loss):		
Change in unrealized holding gains (losses) on securities available for sale	(24)	25
Reclassification adjustment for gains realized in income	-	-
Net change in unrealized gains (losses)	(24)	25
Tax effect	-	-
Other comprehensive income (loss)	(24)	25
Comprehensive income (loss)	$ (238)	$ (785)

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands except per share data)

(Unaudited)

	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2014	$ 159	$ 48,067	$ (22,215)	$ 98	$ (3,245)	$ 22,864
Net loss			(214)			(214)
Other comprehensive Income (loss)				(24)		(24)
Stock option expense, net of forfeitures		74				74
Balance at March 31, 2014	$ 159	$ 48,141	$ (22,429)	$ 74	$ (3,245)	$ 22,700

	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2013	$ 159	$ 47,919	$ (21,297)	$ 107	$ (3,245)	$ 23,643
Net loss			(810)			(810)
Other comprehensive income (loss)				25		25
Release of 100 stock-based incentive plan shares		(6)				(6)
Stock option expense, net of forfeitures		27				27
Offering costs associated with issuance of common stock		(11)				(11)
Balance at March 31, 2013	$ 159	$ 47,929	$ (22,107)	$ 132	$ (3,245)	$ 22,868

See accompanying notes to consolidated financial statements.

CENTRAL FEDERAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Three months ended March 31, 2014	2013
Net loss	$ (214)	$ (810)
Adjustments to reconcile net loss to net cash from operating activities:		
Provision for loan losses	20	326
Depreciation	52	54
Amortization, net	70	134
Originations of loans held for sale	(7,821)	(4,658)
Proceeds from sale of loans held for sale	7,033	3,152
Net gains on sales of loans	(17)	(6)
Gain on sale of foreclosed assets	-	(21)
Earnings on bank owned life insurance	(32)	(32)
Stock-based compensation expense	74	21
Net change in:		
Accrued interest receivable and other assets	887	(116)
Accrued interest payable and other liabilities	(11)	68
Net cash from (used by) operating activities	41	(1,888)
Cash flows from investing activities		
Net (increase) decrease in interest-bearing deposits in other financial institutions	496	-
Available-for-sale securities:		
Maturities, prepayments and calls	539	3,076
Loan originations and payments, net	(1,807)	(14,094)
Additions to premises and equipment	(259)	(6)
Proceeds from the sale of foreclosed assets	-	68
Proceeds from mortgage insurance on foreclosed assets	-	14
Net cash from (used by) investing activities	(1,031)	(10,942)
Cash flows from financing activities		
Net change in deposits	7,372	(4,793)
Net change in short-term borrowings from the FHLB and other debt	(1,026)	6,955
Proceeds from long-term FHLB advances and other debt	2,500	-
Repayments on long-term FHLB advances and other debt	(5,000)	-
Net change in advances by borrowers for taxes and insurance	(438)	(67)
Cost associated with issuance of common stock	-	(11)

Net cash from (used by) financing activities	3,408	2,084
Net change in cash and cash equivalents	2,418	(10,746)
Beginning cash and cash equivalents	19,160	25,152
Ending cash and cash equivalents	$ 21,578	$ 14,406
Supplemental cash flow information:		
Interest paid	$ 411	$ 479

See accompanying notes to consolidated financial statements.

7

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 subsidiaries, CFBank, Ghent Road, Inc., and Smith Ghent LLC, (together referred to as the “Company”). Ghent Road, Inc. was formed in 2006 and owned the land adjacent to the corporate office, and Smith Ghent LLC owned the office building on such land. During October 2013, the Company consummated a sale of its corporate office building and adjacent land, and relocated its main office branch to a nearby location. After the sale was finalized, Ghent Road, Inc. and Smith Ghent LLC were legally dissolved, prior to year-end 2013. However, the results of operations of Ghent Road, Inc. and Smith Ghent LLC for 2013 prior to dissolution are included in these consolidated financial statements. 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 months ended March 31, 2014 is not necessarily indicative of the results that may be expected for the full year. This information should be read in conjunction with the Company’s latest Annual Report to Stockholders and Form 10-K. Reference is made to the accounting policies of the Company described in Note 1 of the Notes to Consolidated Financial Statements contained in the Company’s 2013 Annual Report that was filed as Exhibit 13.1 to the Company’s Form 10-K for the year ended December 31, 2013. The Company has consistently followed those policies in preparing this Form 10-Q.

Loans: Loans 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, accrued interest receivable and an allowance for loan 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 recorded investment in loans includes accrued interest receivable.

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, 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 loans placed on nonaccrual is reversed against interest income in the period in which it 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 provided all the principal and interest amounts 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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Allowance for Loan 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.

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.

Loans of all classes 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 loans 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 the 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 on 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 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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

During the fourth quarter, after running parallel calculations and analyzing results for the last two quarters, the Bank revised its ALLL methodology for the general reserve. Previously, the base methodology relied more heavily on industry data and loss given default rates and probability of default. Based on the fact that the Bank has been tracking historical loss rates for a significant time, the new methodology uses a historical three year loss rate as its base methodology. Similar to before, the base methodology may be supplemented with economic and judgmental factors. Based on the change in methodology which considered portfolio migration, three year loss rates and revised economic and judgmental factors, a $250 reduction to the allowance for loan loss was recorded. The impact on prior quarters was not considered material.

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.

Earnings (Loss) 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:

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

	Three months ended March 31, 2014	2013
Basic		
Net loss	$ (214)	$ (810)
Less: Net loss allocated to unvested share-based payment awards	-	-
Earnings (loss) allocated to common stockholders	$ (214)	$ (810)
Weighted average common shares outstanding including unvested share-based payment awards	15,823,710	15,824,181
Less: Unvested share-based payment awards	-	(854)
Average shares	15,823,710	15,823,327
Basic earnings (loss) per common share	$ (0.01)	$ (0.05)
Diluted		
Earnings (loss) allocated to common stockholders	$ (214)	$ (810)
Weighted average common shares outstanding for basic loss per common share	15,823,710	15,823,327
Add: Dilutive effects of assumed exercises of stock options	-	-
Add: Dilutive effects of assumed exercises of stock warrant	-	-
Average shares and dilutive potential common shares	15,823,710	15,823,327
Diluted earnings (loss) per common share	$ (0.01)	$ (0.05)

The following stock options were not considered in computing diluted earnings (loss) per common share because the options were anti-dilutive or the Company reported a net loss for the periods presented.

	Three months ended March 31, 2014	2013
Stock options	632,126	259,076

Adoption of New Accounting Standards:

In July 2013, the FASB amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a portion thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. These amendments are effective for interim and annual reporting periods beginning after December 15, 2013. Early adoption and retrospective application is permitted. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220); Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The objective of this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this Update require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this ASU did not have a material impact on the Company; however, disclosures have been presented as part of notes to the financial statements.

In December 2011, the FASB amended existing guidance on disclosures about offsetting assets and liabilities. These amendments will enhance disclosures required by U.S. GAAP by requiring improved information about derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the Codification or subject to a master netting arrangement or similar agreement, irrespective of whether they are offset. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. In January 2013, the FASB clarified that ordinary trade receivables and receivables are not in the scope of the December 2011 amended guidance. These amendments are effective for fiscal years beginning on or after January 1, 2013, and interim periods within those years. Retrospective disclosure is required for all comparative periods presented. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition.

NOTE 2- REGULATORY ORDER CONSIDERATIONS

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

The Orders have imposed significant directives applicable to the Holding Company and CFBank, including requirements that we reduce the level of our classified and criticized assets, achieve growth and operating metrics in line with an approved business plan, and comply with restrictions on brokered deposits and on certain types of lending and prohibitions on dividends and repurchases of our capital stock. The CFBank Order required CFBank to have 8% core capital and 12% total risk-based capital, and CFBank could not be considered well-capitalized under the prompt corrective action regulations so long as the CFBank Order remained in place, even if it met or exceeded these capital levels. In addition, the regulators were required to approve any deviation from our business plan and certain compensation arrangements with directors and executive officers.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

On August 20, 2012, the Holding Company announced the successful completion of its restructured registered common stock offering. The Holding Company sold 15.0 million shares of its common stock at $1.50 per share, resulting in gross proceeds of $22.5 million before expenses. With the proceeds from the stock offering, the Holding Company contributed $13.5 million to CFBank to improve its capital ratios and support future growth and expansion, bringing CFBank into compliance with the capital ratios required by the CFBank Order. In addition, the Holding Company used proceeds from the common stock offering to redeem its TARP obligations on September 26, 2012. The remaining proceeds from the restructured registered common stock offering were retained by the Company for general corporate purposes.

Effective as of January 23, 2014, the OCC released and terminated the CFBank Order based upon the improved capital position of CFBank, among other factors. Notwithstanding the release of the CFBank Order, CFBank is required to continue to maintain a minimum Tier 1 Leverage Capital Ratio of 8% and a Total Risk-based Capital to Risk-Weighted Assets ratio of 12%. In addition, in connection with the release and termination of the CFBank Order, CFBank has made certain commitments to the OCC to continue to adhere to certain prudent practices, including, without limitation, maintaining a written program to continue to improve CFBank's credit underwriting and administrative process; take actions to protect its interest in criticized assets as identified by CFBank, the OCC examiners or its external loan review process; implement its written program to effectively identify, monitor, control and continue to reduce the level of credit risk to CFBank; review and monitor progress against such plan with the Board of Directors; and continue CFBank's aggressive workout efforts and individualized workout plans on all criticized assets greater than $250,000.

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

The significant directives contained in the Orders, including the requirement to reduce the level of our criticized classified assets, maintain growth and operating parameters in line with our business plan, restrictions on broker deposits, restrictions on certain types of lending and restrictions on dividend payments, have provided challenges for our operation of our business and our ability to effectively compete in our markets. In addition, the Orders have required that we obtain approval from our regulators for any deviations from our business plan, which has limited our flexibility to make changes to the scope of our business activities. We have also incurred significant additional regulatory compliance expense in connection with the Orders, and it is possible that regulatory compliance expenses related to the Orders could continue to have a material adverse impact on us in the future.

The Company has been unprofitable for the past three years. If we do not generate profits in the future, our capital levels will be negatively impacted and the regulators could take additional enforcement action against us, including the imposition of further operating restrictions.

13

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

At March 31, 2014, CFBank had $18,408 in brokered deposits with maturity dates from April 2014 through August 2016. At March 31, 2014, cash, unpledged securities and deposits in other financial institutions totaled $24,614, which is sufficient to cover brokered deposit maturities in 2014. Brokered deposit maturities over the next three years are as follows:

March 31, 2015	$ 8,003
March 31, 2016	10,206
March 31, 2017	199
	$ 18,408

Previously, because CFBank was under a regulatory order, it was prohibited from accepting or renewing brokered deposits, including reciprocal deposits in the Certificate of Deposit Account Registry Service® (CDARS) program, without FDIC approval. While under the CFBank Order, the Bank received limited waivers from the prohibition on renewal of reciprocal CDARS deposits from the FDIC, each for 90 day periods which expired on September 20, 2011, December 19, 2011, March 18, 2012, June 16, 2012, September 14, 2012 and December 31, 2013. On January 8, 2014, CFBank received a waiver for a 90-day period to allow the bank to renew deposits under the CDARS program. With the release of the CFBank Order, CFbank is no longer subject to these restrictions.

CFBank dividends serve as a potential source of liquidity to the Holding Company to meet its obligations. As of December 31, 2013, CFBank was not permitted to declare or pay dividends or make any other capital distributions without receiving the prior written approval of the OCC. Future dividend payments by CFBank to the Holding Company would be based on future earnings. The payment of dividends from CFBank to the Holding Company is not likely to be approved by the OCC while CFBank is suffering losses.

The directives contained in the Orders, and in commitments with our regulators, including higher capital requirements, requirements to reduce the level of our classified and criticized assets and various operating restrictions, may impede our full ability to operate our business and compete effectively in our markets.

We have taken such actions as we believe are necessary to comply with all requirements of the Orders and the other regulatory requirements and directives to which we are subject, and we are continuing to work toward compliance with the provisions having future compliance dates. Management believes we have received or provided all required approvals, non-objections, notifications and waivers with regard to the Orders.

As previously noted, the CFBank Order was terminated by the OCC on January 23, 2014. The Holding Company Order will remain in effect until terminated, modified or suspended by the FRB.

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 March 31, 2014 and December 31, 2013 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
March 31, 2014				
Corporate debt	$ 4,343	$ 13	$ 5	$ 4,351
State and municipal	1,918	-	29	1,889
Issued by U.S. government-sponsored entities and agencies:				
Mortgage-backed securities - residential	840	42	-	882
Collateralized mortgage obligations	1,899	53	-	1,952
Total	$ 9,000	$ 108	$ 34	$ 9,074

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value

December 31, 2013								
Corporate debt	$	4,360	$	11	$	8	$	4,363
State and municipal		1,926		-		7		1,919
Issued by U.S. government-sponsored entities and agencies:								-
Mortgage-backed securities - residential		934		49		-		983
Collateralized mortgage obligations		2,354		53		-		2,407
Total	$	9,574	$	113	$	15	$	9,672

There was no other-than-temporary impairment recognized in accumulated other comprehensive income (loss) for securities available for sale at March 31, 2014 or March 31, 2013.

There were no sales of securities for the three months ended March 31, 2014 or March 31, 2013.

The amortized cost and fair value of debt securities at March 31, 2014 are shown 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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

	March 31, 2014		December 31, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 2,379	$ 2,373	$ 2,386	$ 2,379
Due from one to five years	3,882	3,867	3,900	3,903
Mortgage-backed securities	840	882	934	983
Collateralized mortgage obligations	1,899	1,952	2,354	2,407
Total	$ 9,000	$ 9,074	$ 9,574	$ 9,672

Fair value of securities pledged was as follows:

	March 31, 2014	December 31, 2013
Pledged as collateral for:		
FHLB advances	$ 1,789	$ 2,024
Public deposits	604	905
Interest-rate swaps	422	443
Total	$ 2,815	$ 3,372

At March 31, 2014 and December 31, 2013, 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 March 31, 2014 and December 31, 2013 aggregated by major security type and length of time in a continuous unrealized loss position.

March 31, 2014	Less than 12 Months	12 Months or More	Total

Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate debt	$ 238	$ -	$ 1,001	$ 5	$ 1,239	$ 5
State and municipal	1,011	1	878	28	1,889	29
Total temporarily impaired	$ 1,249	$ 1	$ 1,879	$ 33	$ 3,128	$ 34

December 31, 2013	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate debt	$ 239	$ 1	$ 1,002	$ 7	$ 1,241	$ 8
State and municipal	1,015	1	904	6	1,919	7
Total temporarily impaired	$ 1,254	$ 2	$ 1,906	$ 13	$ 3,160	$ 15

The unrealized losses in Corporate debt and State and municipal securities at March 31, 2014 and December 31, 2013, 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 March 31, 2014 and December 31, 2013.

There was no unrealized loss in Collateralized mortgage obligations at March 31, 2014 and December 31, 2013.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

NOTE 4 – LOANS

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

	March 31, 2014	December 31, 2013
Commercial	$ 43,105	$ 37,526
Real estate:		
Single-family residential	25,169	32,219
Multi-family residential	28,671	32,197
Commercial	82,466	83,752
Construction	17,306	11,465
Consumer:		
Home equity lines of credit	15,377	14,851
Other	2,571	860
Subtotal	214,665	212,870
Less: ALLL	(5,763)	(5,729)
Loans, net	$ 208,902	$ 207,141

Commercial loans included $14,371 and $12,918, respectively, of commercial lines of credit which required interest only payments at March 31, 2014 and December 31, 2013.

Home equity lines of credit included $12,983 and $12,144, respectively, of loans which required interest only payments at March 31, 2014 and December 31, 2013.

Mortgage Purchase Program

On December 11, 2012, CFBank entered into a Mortgage Purchase Program with Northpointe Bank (Northpointe), a Michigan banking corporation. Through a participation agreement, CFBank agreed to purchase an 80% interest from

Northpointe fully underwritten and pre-sold mortgage loans originated by various prescreened mortgage brokers located throughout the U.S. The participation agreement provides for CFBank to purchase individually (MERS registered) loans from Northpointe and hold them until funded by the end investor. The mortgage loan investors include Fannie Mae and Freddie Mac, and other major financial institutions such as Wells Fargo Bank. This process on average takes approximately 14 days. Given the short term nature of each of these individual loans common credit risks such as the following are substantially reduced: past due, impairment and TDR, nonperforming, and nonaccrual classification, therefore no allowance is allocated to these loans. NorthPointe maintains a 20% ownership interest in each loan it participates. The agreement further calls for full control to be relinquished by the Broker to NorthPointe and its Participants with recourse to the broker after 120 days, at the sole discretion of Northpointe. As such, these purchased loans are classified as portfolio loans. These loans are 100% risk rated for CFBank capital adequacy purposes. At March 31, 2014 and December 31, 2013, CFBank held $4,998 and $12,743, respectively, of such loans which have been included in single-family residential loan totals above.

The ALLL is a valuation allowance for probable incurred credit losses in the loan portfolio based on management's evaluation of various factors including past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. A provision for loan losses is charged to operations based on management's periodic evaluation of these and other pertinent factors described in Note 1 to the consolidated financial statements in the Company's 2013 Annual Report to Stockholders incorporated by reference into our 2013 Annual Report on Form 10-K.

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 months ended March 31, 2014:

	Three months ended March 31, 2014							
		Real Estate				Consumer		
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit	Other	Total
Beginning balance	$ 1,759	$ 120	$ 1,262	$ 2,325	$ 119	$ 139	$ 5	$ 5,729
Addition to (reduction in) provision for loan losses	(175)	38	196	(265)	259	(35)	2	20
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	3	1	-	4	-	5	1	14
Ending balance	$ 1,587	$ 159	$ 1,458	$ 2,064	$ 378	$ 109	$ 8	$ 5,763

The following table presents the activity in the ALLL by portfolio segment for the three months ended March, 2013:

	Three months ended March 31, 2013							
		Real Estate				Consumer		
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit	Other	Total
Beginning balance	$ 1,311	$ 332	$ 1,396	$ 1,946	$ -	$ 241	$ 11	$ 5,237
Addition to (reduction in) provision for loan losses	81	(94)	179	197	1	(23)	(15)	326
Charge-offs	-	-	-	-	-	-	-	-

Recoveries	17	1	29	54	-	2	16	119
Ending balance	$ 1,409	$ 239	$ 1,604	$ 2,197	$ 1	$ 220	$ 12	$ 5,682

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 by portfolio segment and based on the impairment method as of March 31, 2014:

		Real Estate				Consumer		
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit	Other	Total
ALLL:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 487	$ -	$ 369	$ 163	$ -	$ -	$ -	$ 1,019
Collectively evaluated for impairment	1,100	159	1,089	1,901	378	109	8	4,744
Total ending allowance balance	$ 1,587	$ 159	$ 1,458	$ 2,064	$ 378	$ 109	$ 8	$ 5,763
Loans:								
Individually evaluated for impairment	$ 926	$ 311	$ 1,725	$ 5,706	$ -	$ -	$ -	$ 8,668
Collectively evaluated for impairment	42,179	24,858	26,946	76,760	17,306	15,377	2,571	205,997
Total ending loan balance	$ 43,105	$ 25,169	$ 28,671	$ 82,466	$ 17,306	$ 15,377	$ 2,571	$ 214,665

The following table presents the balance in the ALLL and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2013:

		Real Estate				Consumer		
	Commercial	Single-family	Multi-family	Commercial	Construction	Home Equity lines of credit	Other	Total
ALLL:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 532	$ -	$ 402	$ 191	$ -	$ -	$ -	$ 1,125
Collectively evaluated for impairment	1,227	120	860	2,134	119	139	5	4,604
Total ending allowance balance	$ 1,759	$ 120	$ 1,262	$ 2,325	$ 119	$ 139	$ 5	$ 5,729
Loans:								
Individually evaluated for impairment	992	$ 317	$ 1,759	$ 5,845	$ -	$ -	$ -	$ 8,913
Collectively evaluated for impairment	36,534	31,902	30,438	77,907	11,465	14,851	860	203,957
Total ending loan balance	$ 37,526	$ 32,219	$ 32,197	$ 83,752	$ 11,465	$ 14,851	$ 860	$ 212,870

19

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents loans individually evaluated for impairment by class of loans at March 31, 2014. The unpaid principal balance is the contractual principal balance outstanding. The recorded investment is the unpaid principal balance adjusted for partial charge-offs, purchase premiums and discounts, deferred loan fees and costs and includes accrued interest. The table presents accrual basis interest income recognized during the three months ended March 31, 2014. Cash payments of interest during the three months ended March 31, 2014 totaled $54.

	As of March 31, 2014			Three months ended March 31, 2014	
	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 135	$ 120	$ -	$ 121	$ -
Real estate:					
Single-family residential	346	185	-	185	-
Multi-family residential	-	-	-	-	-
Commercial:					
Non-owner occupied	2,009	1,440	-	1,444	-
Owner occupied	1,987	1,036	-	1,044	-
Land	-	-	-	-	-
Total with no allowance recorded	4,477	2,781	-	2,794	-
With an allowance recorded:					
Commercial	806	806	487	817	6
Real estate:					
Single-family residential	126	126	-	126	2
Multi-family residential	1,725	1,725	369	1,736	1
Commercial:					
Non-owner occupied	2,117	2,117	44	2,122	33
Owner occupied	392	392	7	394	5
Land	766	721	112	733	5
Total with an allowance recorded	5,932	5,887	1,019	5,928	52
Total	$ 10,409	$ 8,668	$ 1,019	$ 8,722	$ 52

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The following table presents loans individually evaluated for impairment by class of loans at December 31, 2013. The unpaid principal balance is the contractual principal balance outstanding. The recorded investment is the unpaid principal balance adjusted for partial charge-offs, purchase premiums and discounts, deferred loan fees and costs and includes accrued interest. The table presents accrual basis interest income recognized during the three months ended March 31, 2013. Cash payments of interest during the three months ended March 31, 2013 totaled $57.

	As of December 31, 2013			Three months ended March 31, 2013	
	Unpaid Principal Balance	Recorded Investment	ALLL Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 135	$ 120	$ -	$ 172	$ -
Real estate:					
Single-family residential	352	191	-	-	-
Multi-family residential	-	-	-	1,860	-
Commercial:					
Non-owner occupied	2,022	1,453	-	1,928	-
Owner occupied	2,021	1,070	-	1,219	-
Land	-	-	-	-	-
Total with no allowance recorded	4,530	2,834	-	5,179	-
With an allowance recorded:					
Commercial	872	872	532	884	5
Real estate:					
Single-family residential	126	126	-	128	2
Multi-family residential	1,759	1,759	402	280	1
Commercial:					
Non-owner occupied	2,158	2,158	46	2,230	34
Owner occupied	397	397	7	393	6
Land	812	767	138	386	6
Total with an allowance recorded	6,124	6,079	1,125	4,301	54
Total	$ 10,654	$ 8,913	$ 1,125	$ 9,480	$ 54

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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

	March 31, 2014	December 31, 2013
Nonaccrual loans:		
Commercial	$ 523	$ 563
Real estate:		
Single-family residential	463	479
Multi-family residential	1,669	1,701
Commercial:		
Non-owner occupied	1,440	1,453
Owner occupied	1,036	1,070
Land	381	420
Consumer:		
Home equity lines of credit:		
Originated for portfolio	52	52
Total nonaccrual and nonperforming loans	$ 5,564	$ 5,738

Nonaccrual loans include both smaller balance single-family mortgage and consumer loans that are collectively evaluated for impairment and individually classified impaired loans. There were no loans 90 days or more past due and still accruing interest at March 31, 2014 or December 31, 2013.

The following table presents the aging of the recorded investment in past due loans by class of loans as of March 31, 2014:

	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	$ -	$ 9	$ 121	$ 130	$ 42,975	$ 402

Real estate:						
Single-family residential	334	61	354	749	24,420	109
Multi-family residential	548	-	-	548	28,123	1,669
Commercial:						
Non-owner occupied	-	-	923	923	41,506	517
Owner occupied	-	-	-	-	34,691	1,036
Land	-	-	381	381	4,965	-
Construction	309	-	-	309	16,997	-
Consumer:						
Home equity lines of credit:						
Originated for portfolio	-	-	-	-	13,535	52
Purchased for portfolio	-	-	-	-	1,842	-
Other	42	-	-	42	2,529	-
Total	$ 1,233	$ 70	$ 1,779	$ 3,082	$ 211,583	$ 3,785

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 by class of loans as of December 31, 2013:

	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	$ -	$ -	$ 121	$ 121	$ 37,405	$ 442
Real estate:						
Single-family residential	352	268	247	867	31,352	232
Multi-family residential	-	-	-	-	32,197	1,701
Commercial:						
Non-owner occupied	-	-	923	923	42,199	530
Owner occupied	-	-	-	-	35,202	1,070
Land	-	-	420	420	5,008	-
Construction	-	-	-	-	11,465	-
Consumer:						
Home equity lines of credit:						
Originated for portfolio	52	-	-	52	12,930	52
Purchased for portfolio	123	-	-	123	1,746	-
Other	2	11	-	13	847	-
Total	$ 529	$ 279	$ 1,711	$ 2,519	$ 210,351	$ 4,027

Troubled Debt Restructurings (TDRs):

As of March 31, 2014 and December 31, 2013, TDRs totaled $5.9 million and $6.1 million, respectively. The Company allocated $918 and $998 of specific reserves to loans whose terms had been modified in TDRs as of March 31, 2014 and December 31, 2013, respectively. The Company had not committed to lend any additional amounts as of March 31, 2014 or December 31, 2013 to customers with outstanding loans classified as nonaccrual TDRs.

During the quarter ended March 31, 2014 and March 31, 2013, no loans were modified as a TDR, where concessions were granted to a borrower experiencing financial difficulties.

There were no TDRs in payment default or that became nonperforming during the period ended March 31, 2014 and 2013. 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 quarter ended March 31, 2014 and 2013 that did not meet the definition of a TDR. These loans had a total recorded investment of $379 and $6,635 as of March 31, 2014 and 2013, 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 there were no concessions granted.

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

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Nonaccrual loans include loans that were modified and identified as TDRs and the loans are not performing. At March 31, 2014 and December 31, 2013, nonaccrual TDRs were as follows:

	March 31, 2014	December 31, 2013
Commercial	$ 402	$ 442
Real estate:		
Single-family residential	185	190
Multi-family residential	1,668	1,701
Commercial:		
Non-owner occupied	-	-
Owner occupied	224	238
Total	$ 2,479	$ 2,571

Nonaccrual loans at March 31, 2014 and December 31, 2013 do not include $3,435 and $3,517, 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.

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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The recorded investment in loans by risk category and by class of loans as of March 31, 2014 and based on the most recent analysis performed follows. There were no loans rated doubtful at March 31, 2014.

	Not Rated	Pass	Special Mention	Substandard	Total
Commercial	$ 196	$ 41,431	$ 586	$ 892	$ 43,105
Real estate:					
Single-family residential	24,653	-	-	516	25,169
Multi-family residential	-	26,180	-	2,491	28,671
Commercial:					
Non-owner occupied	159	37,243	519	4,508	42,429
Owner occupied	-	31,219	858	2,614	34,691
Land	86	2,011	-	3,249	5,346
Construction	5,295	12,011	-	-	17,306
Consumer:					
Home equity lines of credit:					
Originated for portfolio	13,383	-	-	152	13,535
Purchased for portfolio	1,265	-	409	168	1,842
Other	2,571	-	-	-	2,571
	$ 47,608	$ 150,095	$ 2,372	$ 14,590	$ 214,665

The recorded investment in loans by risk category and by class of loans as of December 31, 2013 follows. There were no loans rated doubtful at December 31, 2013.

	Not Rated	Pass	Special Mention	Substandard	Total
Commercial	$ 228	$ 35,424	$ 921	$ 953	$ 37,526

Real estate:					
Single-family residential	31,685	-	-	534	32,219
Multi-family residential	-	29,667	-	2,530	32,197
Commercial:					
Non-owner occupied	3,170	34,834	556	4,561	43,121
Owner occupied	-	31,489	1,045	2,669	35,203
Land	87	2,023	-	3,318	5,428
Construction	2,115	9,350	-	-	11,465
Consumer:					
Home equity lines of credit:					
Originated for portfolio	12,828	-	-	154	12,982
Purchased for portfolio	1,285	-	414	170	1,869
Other	860	-	-	-	860
	$ 52,258	$ 142,787	$ 2,936	$ 14,889	$ 212,870

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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).

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 both 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 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.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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 March 31, 2014 using Significant Other Observable Inputs(Level 2)	
Financial Assets:		
Securities available for sale:		
Corporate debt	$	4,351
State and municipal		1,889
Issued by U.S. government-sponsored entities and agencies:		
Mortgage-backed securities - residential		882
Collateralized mortgage obligations		1,952
Total securities available for sale	$	9,074
Loans held for sale		4,090
Yield maintenance provisions (embedded derivatives)	$	553
Interest rate lock commitments	$	32
Financial Liabilities:		
Interest-rate swaps	$	553

Fair Value
Measurements
at December

	31, 2013 using Significant Other Observable Inputs(Level 2)
Financial Assets:	
Securities available for sale:	
Corporate debt	$ 4,363
State and municipal	1,919
Issued by U.S. government-sponsored entities and agencies:	
Mortgage-backed securities - residential	983
Collateralized mortgage obligations	2,407
Total securities available for sale	$ 9,672
Loans held for sale	3,285
Yield maintenance provisions (embedded derivatives)	$ 599
Interest rate lock commitments	$ 16
Financial Liabilities:	
Interest-rate swaps	$ 599

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The Company had no assets or liabilities measured at fair value on a recurring basis that were measured using Level 1 or Level 3 inputs at March 31, 2014 or December 31, 2013.

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

	Fair Value Measurements at March 31, 2014 Using Significant Unobservable Inputs (Level 3)
Impaired loans:	
Commercial	$ -
Real Estate:	
Single-family residential	310
Multi-family residential	1,301
Commercial:	
Non-owner occupied	-
Owner occupied	231
Land	609
Total impaired loans	$ 2,451

	Fair Value Measurements at December 31, 2013 Using Significant Unobservable Inputs (Level 3)
Impaired loans:	
Commercial	$ -
Real Estate:	
Single-family residential	316
Multi-family residential	1,301
Commercial:	
Non-owner occupied	-
Owner occupied	234

Land		629
Total impaired loans	$	2,480

The Company had no assets or liabilities, that were material, measured at fair value on a non-recurring basis that were measured using Level 1 or Level 2 inputs at March 31, 2014 or December 31, 2013.

The Impaired loan servicing rights, which are carried at fair value at March 31, 2014 and December 31, 2013, are not material based on the value of the asset.

Impaired loans carried at the fair value of the collateral for collateral dependent loans, had an unpaid principal balance of $3,337 with a valuation allowance of $886, at March 31, 2014. There were no write-downs of impaired collateral dependent loans during the three months ended March 31, 2014 or 2013. Impaired loans carried at the fair value of collateral had an unpaid principal balance of $3,465, with a valuation allowance of $985 at December 31, 2013.

During the three months ended March 31, 2014, the Company did not have any significant 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 and 2 inputs based on the information relating to those assets and liabilities at the end of the reporting period.

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

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 March 31, 2014:

	Fair Value	Valuation Technique(s)	Unobservable Inputs	Range (Weighted Average)	
Impaired loans:					
Commercial real estate:					
Single-family residential	310	Comparable sales approach	Adjustment for differences between the comparable market transactions	(-17.67% - 2.35)	-8.33%
Multi-family residential	1,301	Comparable sales approach	Adjustment for differences between the comparable market transactions	-20.59%	
Commercial:					
Owner occupied	231	Comparable sales approach	Adjustment for differences between the comparable market transactions	-12.21%	
Land	609	Comparable sales approach	Adjustment for differences between the comparable market transactions	(-8.59% - 8.10%)	1.44%

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measures at fair value on a non-recurring basis at December 31, 2013:

			Unobservable Inputs	Range (Weighted Average)

	Fair Value	Valuation Technique(s)			
Impaired loans:					
Commercial real estate:					
Single -family residential	316	Comparable sales approach	Adjustment for differences between the comparable market transactions	(-17.67% - 2.35)	-8.33%
Multi-family residential	1,301	Comparable sales approach	Adjustment for differences between the comparable market transactions	-20.59%	
Commercial:					
Owner occupied	234	Comparable sales approach	Adjustment for differences between the comparable market transactions	-12.21%	
Land	629	Comparable sales approach	Adjustment for differences between the comparable market transactions	(-8.59% - 8.10%)	1.44%

29

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

Financial Instruments Recorded Using Fair Value Option

The Company has elected the fair value option for loans held for sale. These loans are intended for sale and the Company believes that the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Company's policy on loans held for investment. None of these loans were 90 days or more past due or on nonaccrual as of March 31, 2014 or December 31, 2013.

As of March 31, 2014 and December 31, 2013, the aggregate fair value, contractual balance (including accrued interest) and gain or loss were as follows:

	March 31, 2014	December 31, 2013
Aggregate fair value	$ 4,090	$ 3,285
Contractual balance	4,059	3,270
Gain (loss)	31	15

The total amount of gains and losses from changes in fair value included in earnings for the three months ended March 31, 2014 and 2013 for loans held for sale were:

	Three months ended March 31,	
	2014	2013
Interest income	$ 16	$ 5
Interest expense	-	-
Change in fair value	16	(11)
Total change in fair value	$ 32	$ (6)

CENTRAL FEDERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)

The carrying amounts and estimated fair values of financial instruments at March 31, 2014 were as follows:

	Fair Value Measurements at March 31, 2014 Using:				
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 21,578	$ 21,578	$ -	$ -	$ 21,578
Interest-bearing deposits in other financial institutions	1,486	1,486	-	-	1,486
Securities available for sale	9,074	-	9,074	-	9,074
Loans held for sale	4,090	-	4,090	-	4,090
Loans, net	208,902	-	-	209,472	209,472
FHLB stock	1,942	n/a	n/a	n/a	n/a
Accrued interest receivable	69	4	65	-	69