

BROADWAY FINANCIAL CORP \DE\

Form 10-Q

November 15, 2012

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2012

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-27464

**BROADWAY FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

|                                                                                                     |                                                              |
|-----------------------------------------------------------------------------------------------------|--------------------------------------------------------------|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization)                | <b>95-4547287</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>4800 Wilshire Boulevard, Los Angeles, California</b><br>(Address of principal executive offices) | <b>90010</b><br>(Zip Code)                                   |
| <b>(323) 634-1700</b><br>(Registrant's telephone number, including area code)                       |                                                              |

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 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, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

|                                                  |                                                               |
|--------------------------------------------------|---------------------------------------------------------------|
| Large Accelerated Filer <input type="checkbox"/> | Accelerated Filer <input type="checkbox"/>                    |
| Non-Accelerated Filer <input type="checkbox"/>   | Smaller Reporting Company <input checked="" type="checkbox"/> |

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 1,859,951 shares of the Company's Common Stock, par value \$0.01 per share, were outstanding as of October 31, 2012.

**Table of Contents****TABLE OF CONTENTS**

|                                                                                                                                                            | Page |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| <b>PART I. FINANCIAL INFORMATION</b>                                                                                                                       |      |
| Item 1. Financial Statements                                                                                                                               |      |
| <u>Consolidated Balance Sheets as of September 30, 2012 (unaudited) and December 31, 2011</u>                                                              | 1    |
| <u>Consolidated Statements of Operations and Comprehensive Earnings (Loss) (unaudited) for the three and nine months ended September 30, 2012 and 2011</u> | 2    |
| <u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2012 and 2011</u>                                             | 3    |
| <u>Notes to Unaudited Consolidated Financial Statements</u>                                                                                                | 4    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                                       | 25   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                                                                  | 32   |
| Item 4. <u>Controls and Procedures</u>                                                                                                                     | 33   |
| <b>PART II. OTHER INFORMATION</b>                                                                                                                          |      |
| Item 1. <u>Legal Proceedings</u>                                                                                                                           | 34   |
| Item 1A. <u>Risk Factors</u>                                                                                                                               | 34   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                                                                                 | 34   |
| Item 3. <u>Defaults Upon Senior Securities</u>                                                                                                             | 34   |
| Item 4. <u>Mine Safety Disclosures</u>                                                                                                                     | 34   |
| Item 5. <u>Other Information</u>                                                                                                                           | 34   |
| Item 6. <u>Exhibits</u>                                                                                                                                    | 34   |
| <u>Signatures</u>                                                                                                                                          | 36   |
| Ex 31.1 <u>Section 302 Certification of CEO</u>                                                                                                            |      |
| Ex 31.2 <u>Section 302 Certification of CFO</u>                                                                                                            |      |
| Ex 32 <u>Section 906 Certifications of CEO and CFO</u>                                                                                                     |      |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets**

|                                                                                                                                                                                                                                                                                                                                                                                            | September 30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| <i>(Dollars in thousands, except per share amounts)</i>                                                                                                                                                                                                                                                                                                                                    |                                      |                      |
| <b>Assets</b>                                                                                                                                                                                                                                                                                                                                                                              |                                      |                      |
| Cash                                                                                                                                                                                                                                                                                                                                                                                       | \$ 15,805                            | \$ 12,127            |
| Federal funds sold                                                                                                                                                                                                                                                                                                                                                                         | 40,740                               | 19,470               |
| Cash and cash equivalents                                                                                                                                                                                                                                                                                                                                                                  | 56,545                               | 31,597               |
| Securities available-for-sale, at fair value                                                                                                                                                                                                                                                                                                                                               | 14,584                               | 18,979               |
| Loans receivable held for sale, net                                                                                                                                                                                                                                                                                                                                                        | 11,215                               | 12,983               |
| Loans receivable, net of allowance of \$16,984 and \$17,299                                                                                                                                                                                                                                                                                                                                | 282,292                              | 322,770              |
| Accrued interest receivable                                                                                                                                                                                                                                                                                                                                                                | 1,395                                | 1,698                |
| Federal Home Loan Bank (FHLB) stock, at cost                                                                                                                                                                                                                                                                                                                                               | 3,901                                | 4,089                |
| Office properties and equipment, net                                                                                                                                                                                                                                                                                                                                                       | 2,672                                | 4,626                |
| Real estate owned                                                                                                                                                                                                                                                                                                                                                                          | 2,292                                | 6,699                |
| Bank owned life insurance                                                                                                                                                                                                                                                                                                                                                                  | 2,669                                | 2,609                |
| Investment in affordable housing limited partnership                                                                                                                                                                                                                                                                                                                                       | 1,549                                | 1,675                |
| Deferred tax assets                                                                                                                                                                                                                                                                                                                                                                        | 0                                    | 850                  |
| Other assets                                                                                                                                                                                                                                                                                                                                                                               | 5,166                                | 5,162                |
| <b>Total assets</b>                                                                                                                                                                                                                                                                                                                                                                        | <b>\$ 384,280</b>                    | <b>\$ 413,737</b>    |
| <b>Liabilities</b>                                                                                                                                                                                                                                                                                                                                                                         |                                      |                      |
| Deposits                                                                                                                                                                                                                                                                                                                                                                                   | \$ 262,808                           | \$ 294,686           |
| Federal Home Loan Bank advances                                                                                                                                                                                                                                                                                                                                                            | 83,000                               | 83,000               |
| Junior subordinated debentures                                                                                                                                                                                                                                                                                                                                                             | 6,000                                | 6,000                |
| Other borrowings                                                                                                                                                                                                                                                                                                                                                                           | 5,000                                | 5,000                |
| Advance payments by borrowers for taxes and insurance                                                                                                                                                                                                                                                                                                                                      | 1,085                                | 813                  |
| Other liabilities                                                                                                                                                                                                                                                                                                                                                                          | 7,347                                | 5,962                |
| <b>Total liabilities</b>                                                                                                                                                                                                                                                                                                                                                                   | <b>365,240</b>                       | <b>395,461</b>       |
| <b>Shareholders Equity:</b>                                                                                                                                                                                                                                                                                                                                                                |                                      |                      |
| Senior preferred cumulative and non-voting stock, \$.01 par value, authorized, issued and outstanding 9,000 shares of Series D at September 30, 2012 and December 31, 2011; liquidation preference of \$10,069 at September 30, 2012 and \$9,731 at December 31, 2011                                                                                                                      | 8,963                                | 8,963                |
| Senior preferred cumulative and non-voting stock, \$.01 par value, authorized, issued and outstanding 6,000 shares of Series E at September 30, 2012 and December 31, 2011; liquidation preference of \$6,713 at September 30, 2012 and \$6,488 at December 31, 2011                                                                                                                       | 5,974                                | 5,974                |
| Preferred non-cumulative and non-voting stock, \$.01 par value, authorized 985,000 shares; issued and outstanding 55,199 shares of Series A, 100,000 shares of Series B and 76,950 shares of Series C at September 30, 2012 and December 31, 2011; liquidation preference of \$552 for Series A, \$1,000 for Series B and \$1,000 for Series C at September 30, 2012 and December 31, 2011 | 3,657                                | 3,657                |
| Preferred stock discount                                                                                                                                                                                                                                                                                                                                                                   | (698)                                | (994)                |
| Common stock, \$.01 par value, authorized 8,000,000 shares at September 30, 2012 and December 31, 2011; issued 2,013,942 shares at September 30, 2012 and December 31, 2011; outstanding 1,859,951 shares at September 30, 2012 and 1,744,565 shares at                                                                                                                                    | 20                                   | 20                   |

Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|                                                                                                           |                   |                   |
|-----------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| December 31, 2011                                                                                         |                   |                   |
| Additional paid-in capital                                                                                | 9,559             | 10,824            |
| Accumulated deficit                                                                                       | (6,915)           | (7,295)           |
| Accumulated other comprehensive income, net of taxes of \$400 at September 30, 2012 and December 31, 2011 | 449               | 571               |
| Treasury stock-at cost, 153,991 shares at September 30, 2012 and 269,377 shares at December 31, 2011      | (1,969)           | (3,444)           |
| <b>Total shareholders equity</b>                                                                          | <b>19,040</b>     | <b>18,276</b>     |
| <b>Total liabilities and shareholders equity</b>                                                          | <b>\$ 384,280</b> | <b>\$ 413,737</b> |

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Operations and Comprehensive Earnings (Loss)****(Unaudited)**

|                                                      | <b>Three Months</b>                                     |              | <b>Nine Months Ended</b>      |               |
|------------------------------------------------------|---------------------------------------------------------|--------------|-------------------------------|---------------|
|                                                      | <b>Ended<br/>September 30,<br/>2012</b>                 | <b>2011</b>  | <b>September 30,<br/>2012</b> | <b>2011</b>   |
|                                                      | <i>(Dollars in thousands, except per share amounts)</i> |              |                               |               |
| Interest and fees on loans receivable                | \$ 4,595                                                | \$ 6,062     | \$ 14,955                     | \$ 18,730     |
| Interest on mortgage backed and other securities     | 109                                                     | 176          | 392                           | 539           |
| Other interest income                                | 19                                                      | 9            | 55                            | 28            |
| <b>Total interest income</b>                         | <b>4,723</b>                                            | <b>6,247</b> | <b>15,402</b>                 | <b>19,297</b> |
| Interest on deposits                                 | 707                                                     | 1,056        | 2,562                         | 3,492         |
| Interest on borrowings                               | 789                                                     | 859          | 2,437                         | 2,699         |
| <b>Total interest expense</b>                        | <b>1,496</b>                                            | <b>1,915</b> | <b>4,999</b>                  | <b>6,191</b>  |
| Net interest income before provision for loan losses | 3,227                                                   | 4,332        | 10,403                        | 13,106        |
| Provision for loan losses                            | 129                                                     | 3,814        | 1,190                         | 8,488         |
| Net interest income after provision for loan losses  | 3,098                                                   | 518          | 9,213                         | 4,618         |
| <b>Non-interest income:</b>                          |                                                         |              |                               |               |
| Service charges                                      | 146                                                     | 176          | 442                           | 533           |
| Net losses on mortgage banking activities            | (6)                                                     | (21)         | (168)                         | 15            |
| Net losses on sale of loans                          | (280)                                                   | (59)         | (280)                         | (88)          |
| Net gains (losses) on sales of REO                   | (107)                                                   | (7)          | 288                           | (56)          |
| Gain on sale of office properties and equipment      | 0                                                       | 0            | 2,523                         | 0             |
| Gain on sale of securities                           | 0                                                       | 0            | 50                            | 0             |
| Other                                                | 30                                                      | 25           | 75                            | 90            |
| <b>Total non-interest income</b>                     | <b>(217)</b>                                            | <b>114</b>   | <b>2,930</b>                  | <b>494</b>    |
| <b>Non-interest expense:</b>                         |                                                         |              |                               |               |
| Compensation and benefits                            | 1,534                                                   | 1,618        | 4,661                         | 4,982         |
| Occupancy expense, net                               | 358                                                     | 330          | 942                           | 1,018         |
| Information services                                 | 212                                                     | 200          | 664                           | 647           |
| Professional services                                | 246                                                     | 284          | 530                           | 744           |
| Provision for losses on loans held-for-sale          | (267)                                                   | 702          | (81)                          | 728           |
| Provision for losses on REO                          | 427                                                     | 1,251        | 739                           | 2,033         |
| FDIC insurance                                       | 229                                                     | 144          | 662                           | 781           |
| Office services and supplies                         | 113                                                     | 135          | 330                           | 417           |
| Other                                                | 640                                                     | 447          | 1,609                         | 1,380         |
| <b>Total non-interest expense</b>                    | <b>3,492</b>                                            | <b>5,111</b> | <b>10,056</b>                 | <b>12,730</b> |
| Earnings (loss) before income taxes                  | (611)                                                   | (4,479)      | 2,087                         | (7,618)       |
| Income tax expense                                   | 2                                                       | 3,055        | 849                           | 1,767         |

Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|                                                         |           |            |          |             |
|---------------------------------------------------------|-----------|------------|----------|-------------|
| Net earnings (loss)                                     | \$ (613)  | \$ (7,534) | \$ 1,238 | \$ (9,385)  |
| Other comprehensive income (loss), net of tax:          |           |            |          |             |
| Unrealized gain (loss) on securities available for sale | \$ 7      | \$ (11)    | \$ (72)  | \$ 60       |
| Reclassification of net gains included in net earnings  | 0         | 0          | (50)     | 0           |
| Income tax effect                                       | 0         | (2)        | 0        | (30)        |
| Other comprehensive income (loss), net of tax           | 7         | (13)       | (122)    | 30          |
| Comprehensive earnings (loss)                           | \$ (606)  | \$ (7,547) | \$ 1,116 | \$ (9,355)  |
| Net earnings (loss)                                     | \$ (613)  | \$ (7,534) | \$ 1,238 | \$ (9,385)  |
| Dividends and discount accretion on preferred stock     | (287)     | (264)      | (858)    | (830)       |
| Earnings (loss) available to common shareholders        | \$ (900)  | \$ (7,798) | \$ 380   | \$ (10,215) |
| Earnings (loss) per common share-basic                  | \$ (0.48) | \$ (4.47)  | \$ 0.21  | \$ (5.86)   |
| Earnings (loss) per common share-diluted                | \$ (0.48) | \$ (4.47)  | \$ 0.21  | \$ (5.86)   |
| Dividends declared per share-common stock               | \$ 0.00   | \$ 0.00    | \$ 0.00  | \$ 0.00     |

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(Unaudited)**

|                                                                                            | <b>Nine Months Ended September 30,</b> |               |
|--------------------------------------------------------------------------------------------|----------------------------------------|---------------|
|                                                                                            | <b>2012</b>                            | <b>2011</b>   |
|                                                                                            | <i>(Dollars in thousands)</i>          |               |
| <b>Cash flows from operating activities:</b>                                               |                                        |               |
| Net earnings (loss)                                                                        | \$ 1,238                               | \$ (9,385)    |
| Adjustments to reconcile net earnings (loss) to net cash provided by operating activities: |                                        |               |
| Provision for loan losses                                                                  | 1,190                                  | 8,488         |
| (Recapture of) provision for losses on loans receivable held-for-sale                      | (81)                                   | 728           |
| Provision for losses on REO                                                                | 739                                    | 2,033         |
| Depreciation                                                                               | 249                                    | 306           |
| Net amortization of deferred loan origination costs                                        | 115                                    | 3             |
| Net amortization of premiums on mortgage-backed securities                                 | 44                                     | 78            |
| Amortization of investment in affordable housing limited partnership                       | 126                                    | 0             |
| Stock-based compensation expense                                                           | 60                                     | 66            |
| Earnings on bank owned life insurance                                                      | (60)                                   | (66)          |
| Gain on sale of office properties and equipment                                            | (2,523)                                | 0             |
| Gain on sale of securities                                                                 | (50)                                   | 0             |
| Net (gains) losses on sales of REO                                                         | (288)                                  | 56            |
| Net losses on sales of loans                                                               | 280                                    | 88            |
| Proceeds from sales and principal repayments of loans receivable held-for-sale             | 1,852                                  | 15,661        |
| Net change in:                                                                             |                                        |               |
| Accrued interest receivable                                                                | 303                                    | 457           |
| Deferred tax assets                                                                        | 850                                    | 2,466         |
| Other assets                                                                               | (4)                                    | (1,388)       |
| Other liabilities                                                                          | 1,173                                  | 1,377         |
| <b>Net cash provided by operating activities</b>                                           | <b>5,213</b>                           | <b>20,968</b> |
| <b>Cash flows from investing activities:</b>                                               |                                        |               |
| Net change in loans receivable                                                             | 35,096                                 | 24,413        |
| Available-for-sale securities:                                                             |                                        |               |
| Sales, maturities, prepayments and calls                                                   | 4,279                                  | 1,898         |
| Held-to-maturity securities:                                                               |                                        |               |
| Maturities, prepayments and calls                                                          | 0                                      | 1,733         |
| Proceeds from sales of REO                                                                 | 7,750                                  | 3,712         |
| Investment in affordable housing limited partnership                                       | (350)                                  | (417)         |
| Net redemption of Federal Home Loan Bank stock                                             | 188                                    | 0             |
| Proceeds from sale of office properties and equipment                                      | 4,237                                  | 0             |
| Additions to office properties and equipment                                               | (9)                                    | (33)          |
| <b>Net cash provided by investing activities</b>                                           | <b>51,191</b>                          | <b>31,306</b> |
| <b>Cash flows from financing activities:</b>                                               |                                        |               |
| Net change in deposits                                                                     | (31,878)                               | (53,595)      |
| Proceeds from FHLB advances                                                                | 17,000                                 | 7,000         |
| Repayments on FHLB advances                                                                | (17,000)                               | (7,000)       |
| Reissuance of treasury stock                                                               | 150                                    | 6             |
| Net change in advance payments by borrowers for taxes and insurance                        | 272                                    | 312           |



Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|                                                                                            |           |           |
|--------------------------------------------------------------------------------------------|-----------|-----------|
| Net cash used in financing activities                                                      | (31,456)  | (53,277)  |
| Net change in cash and cash equivalents                                                    | 24,948    | (1,003)   |
| Cash and cash equivalents at beginning of period                                           | 31,597    | 21,978    |
| Cash and cash equivalents at end of period                                                 | \$ 56,545 | \$ 20,975 |
| <b>Supplemental disclosures of cash flow information:</b>                                  |           |           |
| Cash paid for interest                                                                     | \$ 4,464  | \$ 5,661  |
| Cash paid for income taxes                                                                 | \$ 0      | \$ 980    |
| <b>Supplemental disclosures of non-cash investing and financing activities:</b>            |           |           |
| Transfers of loans receivable to REO                                                       | \$ 3,461  | \$ 7,691  |
| Transfers of loans receivable held-for-sale to REO                                         | \$ 333    | \$ 266    |
| Transfers of loans receivable from loans receivable, net to loans receivable held for sale | \$ 616    | \$ 2,544  |

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

**September 30, 2012**

**NOTE (1) Basis of Financial Statement Presentation**

The accompanying unaudited consolidated financial statements include Broadway Financial Corporation (the Company) and its wholly owned subsidiary, Broadway Federal Bank, f.s.b. (the Bank). Also included in the unaudited consolidated financial statements is Broadway Service Corporation, a wholly owned subsidiary of the Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for quarterly reports on Form 10-Q. These unaudited consolidated financial statements do not include all disclosures associated with the Company's consolidated annual financial statements included in its Annual Report on Amended Form 10-K/A for the year ended December 31, 2011 and, accordingly, should be read in conjunction with such audited consolidated financial statements. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

Some items in the consolidated financial statements for the prior period were reclassified to conform to the current presentation.

**NOTE (2) Recently Issued Accounting Pronouncements**

In May 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of this standard did not have a material effect on the Company's consolidated financial statements.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance are effective as of the beginning of a fiscal reporting year, and interim periods within that year, that begins after December 15, 2011. Early adoption is permitted. The adoption of this amendment had no impact on the Company's consolidated financial statements as the prior presentation of comprehensive income was in compliance with this amendment.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012****NOTE (3) Earnings (Loss) Per Common Share**

Basic earnings (loss) per common share is computed by dividing earnings (loss) available to common shareholders by the weighted average number of shares of common stock outstanding for the period. Diluted earnings (loss) per common share is computed by dividing earnings (loss) available to common shareholders by the weighted average number of shares of common stock outstanding for the period, increased for the dilutive effect of common stock equivalents.

The following table shows how the Company computed basic and diluted earnings (loss) per common share for the three and nine months ended September 30, 2012 and 2011.

|                                                             | <b>Three Months Ended September 30,</b>         |             | <b>Nine Months Ended September 30,</b> |             |
|-------------------------------------------------------------|-------------------------------------------------|-------------|----------------------------------------|-------------|
|                                                             | <b>2012</b>                                     | <b>2011</b> | <b>2012</b>                            | <b>2011</b> |
|                                                             | <b>(Dollars in thousands, except per share)</b> |             |                                        |             |
| <b>Basic</b>                                                |                                                 |             |                                        |             |
| Net earnings (loss)                                         | \$ (613)                                        | \$ (7,534)  | \$ 1,238                               | \$ (9,385)  |
| Less: Preferred stock dividends and accretion               | (287)                                           | (264)       | (858)                                  | (830)       |
| Earnings (loss) available to common shareholders            | \$ (900)                                        | \$ (7,798)  | \$ 380                                 | \$ (10,215) |
| Weighted average common shares outstanding                  | 1,858,697                                       | 1,744,565   | 1,782,887                              | 1,744,251   |
| Basic earnings (loss) per common share                      | \$ (0.48)                                       | \$ (4.47)   | \$ 0.21                                | \$ (5.86)   |
| <b>Diluted</b>                                              |                                                 |             |                                        |             |
| Net earnings (loss)                                         | \$ (613)                                        | \$ (7,534)  | \$ 1,238                               | \$ (9,385)  |
| Less: Preferred stock dividends and accretion               | (287)                                           | (264)       | (858)                                  | (830)       |
| Earnings (loss) available to common shareholders            | \$ (900)                                        | \$ (7,798)  | \$ 380                                 | \$ (10,215) |
| Weighted average common shares outstanding                  | 1,858,697                                       | 1,744,565   | 1,782,887                              | 1,744,251   |
| Add: dilutive effects of assumed exercises of stock options | N/A                                             | N/A         | N/A                                    | N/A         |
| Average shares and dilutive potential common shares         | 1,858,697                                       | 1,744,565   | 1,782,887                              | 1,744,251   |
| Diluted earnings (loss) per common share                    | \$ (0.48)                                       | \$ (4.47)   | \$ 0.21                                | \$ (5.86)   |

Stock options for 227,075 shares of common stock were not considered in computing diluted earnings per common share for the three and nine months ended September 30, 2012 and 2011 because they were anti-dilutive.

**NOTE (4) Securities**

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolios at September 30, 2012 and December 31, 2011 and the corresponding amounts of unrealized gains which are recognized in accumulated other comprehensive income (loss) were as follows:

|                                     | Amortized Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|-------------------------------------|----------------|------------------------------|-------------------------------|------------|
|                                     | (In thousands) |                              |                               |            |
| <b>September 30, 2012:</b>          |                |                              |                               |            |
| Residential mortgage-backed         | \$ 13,735      | \$ 849                       | \$ 0                          | \$ 14,584  |
| Total available-for-sale securities | \$ 13,735      | \$ 849                       | \$ 0                          | \$ 14,584  |
| <b>December 31, 2011:</b>           |                |                              |                               |            |
| Residential mortgage-backed         | \$ 17,008      | \$ 902                       | \$ 0                          | \$ 17,910  |
| U.S. Government and federal agency  | 1,000          | 69                           | 0                             | 1,069      |
| Total available-for-sale securities | \$ 18,008      | \$ 971                       | \$ 0                          | \$ 18,979  |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

At September 30, 2012, the Bank's investment portfolio consisted of residential mortgage-backed securities with an estimated remaining life of 4.6 years. 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 pledged had a carrying amount of \$1.6 million and \$1.5 million, respectively, at September 30, 2012 and December 31, 2011, and were pledged to secure public deposits. At September 30, 2012 and December 31, 2011, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity. During the nine months ended September 30, 2012, \$1.0 million of U.S. federal agency bonds were sold and the Company recognized a gain of \$50 thousand. There were no sales of securities during the nine months ended September 30, 2011.

There were no securities with unrealized losses at September 30, 2012 and December 31, 2011. We evaluate securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the financial condition and near-term prospects of the issuer, the length of time and the extent to which the fair value has been less than the cost, and our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, we consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

**NOTE (5) Loans Receivable Held-for-Sale, Net**

Loans receivable held-for-sale at September 30, 2012 and December 31, 2011 were as follows:

|                                                           | September 30,<br>2012 | December 31,<br>2011 |
|-----------------------------------------------------------|-----------------------|----------------------|
|                                                           | (In thousands)        |                      |
| Five or more units residential                            | \$ 5,856              | \$ 6,395             |
| Commercial real estate                                    | 1,362                 | 1,712                |
| Church                                                    | 4,318                 | 5,550                |
| Valuation allowance for unrealized losses                 | (321)                 | (674)                |
| <b>Loans receivable, held for sale, net</b>               | <b>\$ 11,215</b>      | <b>\$ 12,983</b>     |
| Non-performing loans receivable held for sale (1)         | \$ 3,568              | \$ 5,612             |
| Valuation allowance                                       | 0                     | (382)                |
| <b>Non-performing loans receivable held for sale, net</b> | <b>\$ 3,568</b>       | <b>\$ 5,230</b>      |
| Performing loans receivable held for sale (2)             | \$ 7,968              | \$ 8,045             |
| Valuation allowance                                       | (321)                 | (292)                |
| <b>Performing loans receivable held for sale, net</b>     | <b>\$ 7,647</b>       | <b>\$ 7,753</b>      |

Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

- (1) Net of charge-offs of \$719 thousand and \$953 thousand at September 30, 2012 and December 31, 2011.
- (2) Includes \$5.5 million and \$5.6 million of loans that were carried at cost at September 30, 2012 and December 31, 2011.

Upon our decision to sell certain delinquent and non-performing loans held in portfolio, we reclassify them to held-for-sale at the lower of cost or fair value, less estimated selling costs. During the nine months ended September 30, 2012, two non-performing loans, which had a total carrying amount of \$616 thousand and were secured by commercial real estate, were transferred to held-for-sale.

Certain delinquent and non-performing loans, primarily commercial real estate and church loans, totaling \$1.8 million were sold during the three months and nine months ended September 30, 2012. Net loss on sales of non-performing loans totaled \$280 thousand for the three and nine months ended September 30, 2012.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

During the nine months ended September 30, 2012, two loans receivable held-for-sale were transferred to REO. The loans were secured by commercial real estate properties, which had a total carrying amount of \$333 thousand, net of charge-offs of \$327 thousand. A loan receivable held-for-sale secured by a church building, which had a carrying amount of \$266 thousand, net of a charge-off of \$292 thousand, was transferred to REO during the nine months ended September 30, 2011.

Net lower of cost or market recoveries on non-performing loans receivable held-for-sale totaled \$296 thousand and \$109 thousand for the three and nine months ended September 30, 2012, compared to write-downs of \$702 thousand and \$667 thousand for the comparable periods in 2011. Additionally, during the three and nine months ended September 30, 2012, we increased our valuation allowance by \$29 thousand and \$28 thousand on loans held for sale that are still considered performing loans compared to increases of \$0 and \$61 thousand during the same periods in 2011.

**NOTE (6) Loans Receivable**

Loans at September 30, 2012 and December 31, 2011 were as follows:

|                                     | September 30,<br>2012 | December 31,<br>2011 |
|-------------------------------------|-----------------------|----------------------|
|                                     | (In thousands)        |                      |
| Real estate:                        |                       |                      |
| One to four units                   | \$ 72,213             | \$ 76,682            |
| Five or more units                  | 92,711                | 108,161              |
| Commercial real estate              | 44,588                | 54,259               |
| Church                              | 82,778                | 89,099               |
| Construction                        | 1,019                 | 3,790                |
| Commercial:                         |                       |                      |
| Sports                              | 1,721                 | 1,996                |
| Other                               | 3,631                 | 4,900                |
| Consumer:                           |                       |                      |
| Loan on savings                     | 0                     | 821                  |
| Other                               | 131                   | 108                  |
| <b>Total gross loans receivable</b> | <b>298,792</b>        | <b>339,816</b>       |
| Less:                               |                       |                      |
| Loans in process                    | 96                    | 202                  |
| Net deferred loan costs             | (597)                 | (473)                |
| Unamortized discounts               | 17                    | 18                   |
| Allowance for loan losses           | 16,984                | 17,299               |
| <b>Loans receivable, net</b>        | <b>\$ 282,292</b>     | <b>\$ 322,270</b>    |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2012 and 2011:

|                           | <b>Three Months Ended September 30, 2012</b> |                           |                               |               |                     |                   |                 |              |
|---------------------------|----------------------------------------------|---------------------------|-------------------------------|---------------|---------------------|-------------------|-----------------|--------------|
|                           | <b>One to four units</b>                     | <b>Five or more units</b> | <b>Commercial real estate</b> | <b>Church</b> | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b> |
|                           | (In thousands)                               |                           |                               |               |                     |                   |                 |              |
| Beginning balance         | \$ 4,701                                     | \$ 2,897                  | \$ 2,640                      | \$ 7,223      | \$ 106              | \$ 201            | \$ 88           | \$ 17,856    |
| Provision for loan losses | 453                                          | (326)                     | 135                           | 3             | (1)                 | (126)             | (9)             | 129          |
| Recoveries                | 0                                            | 1                         | 15                            | 3             | 0                   | 97                | 3               | 119          |
| Loans charged off         | (539)                                        | (14)                      | (346)                         | (221)         | 0                   | 0                 | 0               | (1,120)      |
| Ending balance            | \$ 4,615                                     | \$ 2,558                  | \$ 2,444                      | \$ 7,008      | \$ 105              | \$ 172            | \$ 82           | \$ 16,984    |

|                           | <b>Nine Months Ended September 30, 2012</b> |                           |                               |               |                     |                   |                 |              |
|---------------------------|---------------------------------------------|---------------------------|-------------------------------|---------------|---------------------|-------------------|-----------------|--------------|
|                           | <b>One to four units</b>                    | <b>Five or more units</b> | <b>Commercial real estate</b> | <b>Church</b> | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b> |
|                           | (In thousands)                              |                           |                               |               |                     |                   |                 |              |
| Beginning balance         | \$ 4,855                                    | \$ 2,972                  | \$ 3,108                      | \$ 5,742      | \$ 249              | \$ 247            | \$ 126          | \$ 17,299    |
| Provision for loan losses | 654                                         | (401)                     | (305)                         | 1,864         | (144)               | (427)             | (51)            | 1,190        |
| Recoveries                | 0                                           | 1                         | 45                            | 10            | 0                   | 352               | 7               | 415          |
| Loans charged off         | (894)                                       | (14)                      | (404)                         | (608)         | 0                   | 0                 | 0               | (1,920)      |
| Ending balance            | \$ 4,615                                    | \$ 2,558                  | \$ 2,444                      | \$ 7,008      | \$ 105              | \$ 172            | \$ 82           | \$ 16,984    |

|                           | <b>Three Months Ended September 30, 2011</b> |                           |                               |               |                     |                   |                 |              |
|---------------------------|----------------------------------------------|---------------------------|-------------------------------|---------------|---------------------|-------------------|-----------------|--------------|
|                           | <b>One to four units</b>                     | <b>Five or more units</b> | <b>Commercial real estate</b> | <b>Church</b> | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b> |
|                           | (In thousands)                               |                           |                               |               |                     |                   |                 |              |
| Beginning balance         | \$ 4,229                                     | \$ 2,892                  | \$ 6,253                      | \$ 7,197      | \$ 68               | \$ 1,538          | \$ 68           | \$ 22,245    |
| Provision for loan losses | 181                                          | 249                       | 204                           | 564           | (1)                 | 2,627             | (10)            | 3,814        |
| Recoveries                | 0                                            | 0                         | 0                             | 0             | 0                   | 0                 | 15              | 15           |
| Loans charged off         | (519)                                        | (289)                     | (207)                         | (1,623)       | 0                   | (3,631)           | 0               | (6,269)      |
| Ending balance            | \$ 3,891                                     | \$ 2,852                  | \$ 6,250                      | \$ 6,138      | \$ 67               | \$ 534            | \$ 73           | \$ 19,805    |

|  | <b>Nine Months Ended September 30, 2011</b> |                           |                               |               |                     |                   |                 |              |
|--|---------------------------------------------|---------------------------|-------------------------------|---------------|---------------------|-------------------|-----------------|--------------|
|  | <b>One to four units</b>                    | <b>Five or more units</b> | <b>Commercial real estate</b> | <b>Church</b> | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b> |
|  | (In thousands)                              |                           |                               |               |                     |                   |                 |              |



Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|                           |          |          |          |          |       |          |          |           |
|---------------------------|----------|----------|----------|----------|-------|----------|----------|-----------|
| Beginning balance         | \$ 4,579 | \$ 2,469 | \$ 3,493 | \$ 6,909 | \$ 74 | \$ 1,300 | \$ 1,634 | \$ 20,458 |
| Provision for loan losses | (64)     | 821      | 3,573    | 1,041    | (7)   | 2,865    | 259      | 8,488     |
| Recoveries                | 0        | 0        | 0        | 0        | 0     | 0        | 23       | 23        |
| Loans charged off         | (624)    | (438)    | (816)    | (1,812)  | 0     | (3,631)  | (1,843)  | (9,164)   |
| Ending balance            | \$ 3,891 | \$ 2,852 | \$ 6,250 | \$ 6,138 | \$ 67 | \$ 534   | \$ 73    | \$ 19,805 |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2012 and December 31, 2011:

|                                                 | <b>September 30, 2012</b>    |                               |                                   |                  |                     |                   |                 |                   |
|-------------------------------------------------|------------------------------|-------------------------------|-----------------------------------|------------------|---------------------|-------------------|-----------------|-------------------|
|                                                 | <b>One to<br/>four units</b> | <b>Five or<br/>more units</b> | <b>Commercial<br/>real estate</b> | <b>Church</b>    | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b>      |
|                                                 | <b>(In thousands)</b>        |                               |                                   |                  |                     |                   |                 |                   |
| <b>Allowance for loan losses:</b>               |                              |                               |                                   |                  |                     |                   |                 |                   |
| Ending allowance balance attributable to loans: |                              |                               |                                   |                  |                     |                   |                 |                   |
| Individually evaluated for impairment           | \$ 1,335                     | \$ 34                         | \$ 237                            | \$ 1,618         | \$ 87               | \$ 0              | \$ 69           | \$ 3,380          |
| Collectively evaluated for impairment           | 3,280                        | 2,524                         | 2,207                             | 5,390            | 18                  | 172               | 13              | 13,604            |
| <b>Total ending allowance balance</b>           | <b>\$ 4,615</b>              | <b>\$ 2,558</b>               | <b>\$ 2,444</b>                   | <b>\$ 7,008</b>  | <b>\$ 105</b>       | <b>\$ 172</b>     | <b>\$ 82</b>    | <b>\$ 16,984</b>  |
| <b>Loans:</b>                                   |                              |                               |                                   |                  |                     |                   |                 |                   |
| Loans individually evaluated for impairment     | \$ 13,867                    | \$ 2,236                      | \$ 8,333                          | \$ 30,431        | \$ 284              | \$ 0              | \$ 69           | \$ 55,220         |
| Loans collectively evaluated for impairment     | 58,346                       | 90,475                        | 36,255                            | 52,347           | 735                 | 5,352             | 62              | 243,572           |
| <b>Total ending loans balance</b>               | <b>\$ 72,213</b>             | <b>\$ 92,711</b>              | <b>\$ 44,588</b>                  | <b>\$ 82,778</b> | <b>\$ 1,019</b>     | <b>\$ 5,352</b>   | <b>\$ 131</b>   | <b>\$ 298,792</b> |

|                                                 | <b>December 31, 2011</b>     |                               |                                   |                  |                     |                   |                 |                   |
|-------------------------------------------------|------------------------------|-------------------------------|-----------------------------------|------------------|---------------------|-------------------|-----------------|-------------------|
|                                                 | <b>One to<br/>four units</b> | <b>Five or<br/>more units</b> | <b>Commercial<br/>real estate</b> | <b>Church</b>    | <b>Construction</b> | <b>Commercial</b> | <b>Consumer</b> | <b>Total</b>      |
|                                                 | <b>(In thousands)</b>        |                               |                                   |                  |                     |                   |                 |                   |
| <b>Allowance for loan losses:</b>               |                              |                               |                                   |                  |                     |                   |                 |                   |
| Ending allowance balance attributable to loans: |                              |                               |                                   |                  |                     |                   |                 |                   |
| Individually evaluated for impairment           | \$ 1,678                     | \$ 161                        | \$ 255                            | \$ 1,683         | \$ 97               | \$ 0              | \$ 70           | \$ 3,944          |
| Collectively evaluated for impairment           | 3,177                        | 2,811                         | 2,853                             | 4,059            | 152                 | 247               | 56              | 13,355            |
| <b>Total ending allowance balance</b>           | <b>\$ 4,855</b>              | <b>\$ 2,972</b>               | <b>\$ 3,108</b>                   | <b>\$ 5,742</b>  | <b>\$ 249</b>       | <b>\$ 247</b>     | <b>\$ 126</b>   | <b>\$ 17,299</b>  |
| <b>Loans:</b>                                   |                              |                               |                                   |                  |                     |                   |                 |                   |
| Loans individually evaluated for impairment     | \$ 13,246                    | \$ 3,837                      | \$ 7,396                          | \$ 31,494        | \$ 302              | \$ 0              | \$ 70           | \$ 56,345         |
| Loans collectively evaluated for impairment     | 63,436                       | 104,324                       | 46,863                            | 57,605           | 3,488               | 6,896             | 859             | 283,471           |
| <b>Total ending loans balance</b>               | <b>\$ 76,682</b>             | <b>\$ 108,161</b>             | <b>\$ 54,259</b>                  | <b>\$ 89,099</b> | <b>\$ 3,790</b>     | <b>\$ 6,896</b>   | <b>\$ 929</b>   | <b>\$ 339,816</b> |

A loan is impaired when it is probable, based on current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. When it is determined that a loss is probable, a valuation allowance is established and included in the allowance for loan losses. The amount of impairment is determined by the difference between the recorded investment in the loan and the present value of expected cash flows, or estimated net realizable value of the underlying collateral on collateral dependent loans.





Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|              |                  |               |                  |                 |
|--------------|------------------|---------------|------------------|-----------------|
| Church       | 31,094           | 237           | 31,709           | 834             |
| Construction | 288              | 3             | 294              | 12              |
| Commercial:  |                  |               |                  |                 |
| Sports       | 0                | 0             | 0                | 0               |
| Other        | 70               | 2             | 70               | 4               |
| <b>Total</b> | <b>\$ 56,112</b> | <b>\$ 487</b> | <b>\$ 56,811</b> | <b>\$ 1,514</b> |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)**

September 30, 2012

|                        | Three Months Ended September 30, 2011 |                                                   | Nine Months Ended September 30, 2011 |                                                   |
|------------------------|---------------------------------------|---------------------------------------------------|--------------------------------------|---------------------------------------------------|
|                        | Average<br>Recorded<br>Investment     | Cash<br>Basis<br>Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment    | Cash<br>Basis<br>Interest<br>Income<br>Recognized |
|                        | (In thousands)                        |                                                   |                                      |                                                   |
| One to four units      | \$ 11,171                             | \$ 86                                             | \$ 10,158                            | \$ 227                                            |
| Five or more units     | 3,663                                 | 5                                                 | 2,981                                | 18                                                |
| Commercial real estate | 12,410                                | 39                                                | 12,617                               | 132                                               |
| Church                 | 31,099                                | 144                                               | 29,790                               | 556                                               |
| Construction           | 315                                   | 0                                                 | 317                                  | 0                                                 |
| Commercial:            |                                       |                                                   |                                      |                                                   |
| Sports                 | 2,740                                 | 0                                                 | 3,336                                | 0                                                 |
| Other                  | 285                                   | 0                                                 | 259                                  | 0                                                 |
| Consumer:              |                                       |                                                   |                                      |                                                   |
| Loan on savings        | 0                                     | 0                                                 | 1,035                                | 0                                                 |
| <b>Total</b>           | <b>\$ 61,683</b>                      | <b>\$ 274</b>                                     | <b>\$ 60,493</b>                     | <b>\$ 933</b>                                     |

Cash-basis interest income recognized represents cash received for interest payments on accruing impaired loans. Interest income that would have been recognized for the nine months ended September 30, 2012 had loans performed in accordance with their original terms was \$3.4 million.

The following table presents the recorded investment in non-accrual loans by class of loans as of September 30, 2012 and December 31, 2011:

|                                         | September 30, 2012 | December 31, 2011 |
|-----------------------------------------|--------------------|-------------------|
|                                         | (In thousands)     |                   |
| <b>Loans receivable, held for sale:</b> |                    |                   |
| Five or more units                      | \$ 2,001           | \$ 2,496          |
| Commercial real estate                  | 0                  | 338               |
| Church                                  | 1,567              | 2,778             |
| <b>Loans receivable, net:</b>           |                    |                   |
| One to four units                       | 8,597              | 7,974             |
| Five or more units                      | 1,856              | 3,450             |
| Commercial real estate                  | 6,676              | 5,449             |
| Church                                  | 20,306             | 21,891            |
| Construction                            | 284                | 302               |
| Consumer:                               |                    |                   |
| Other                                   | 69                 | 70                |
| <b>Total non-accrual loans</b>          | <b>\$ 41,356</b>   | <b>\$ 44,748</b>  |

As of September 30, 2012, five loans to a single borrower totaling \$1.5 million were 90 days past due and were accruing interest. There were no loans 90 days or more delinquent that were accruing interest as of December 31, 2011.



**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)**

September 30, 2012

The following tables present the aging of the recorded investment in past due loans, including loans held for sale, as of September 30, 2012 and December 31, 2011 by class of loans:

|                                         | September 30, 2012        |                           |                                                       |                   |                             |
|-----------------------------------------|---------------------------|---------------------------|-------------------------------------------------------|-------------------|-----------------------------|
|                                         | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater than<br>90 Days<br>Past Due<br>(In thousands) | Total<br>Past Due | Total Loans<br>Not Past Due |
| <b>Loans receivable, held for sale:</b> |                           |                           |                                                       |                   |                             |
| Five or more units                      | \$ 0                      | \$ 0                      | \$ 2,001                                              | \$ 2,001          | \$ 3,855                    |
| Commercial real estate                  | 0                         | 0                         | 0                                                     | 0                 | 1,362                       |
| Church                                  | 0                         | 0                         | 1,567                                                 | 1,567             | 2,751                       |
| <b>Loans receivable, net:</b>           |                           |                           |                                                       |                   |                             |
| One to four units                       | 4,906                     | 47                        | 10,115                                                | 15,068            | 57,145                      |
| Five or more units                      | 169                       | 470                       | 1,856                                                 | 2,495             | 90,216                      |
| Commercial real estate                  | 241                       | 1,266                     | 6,676                                                 | 8,183             | 36,405                      |
| Church                                  | 1,169                     | 556                       | 20,306                                                | 22,288            | 60,747                      |
| Construction                            | 0                         | 0                         | 284                                                   | 284               | 735                         |
| <b>Commercial:</b>                      |                           |                           |                                                       |                   |                             |
| Sports                                  | 0                         | 0                         | 0                                                     | 0                 | 1,721                       |
| Other                                   | 183                       | 98                        | 0                                                     | 281               | 3,350                       |
| <b>Consumer:</b>                        |                           |                           |                                                       |                   |                             |
| Loan on savings                         | 0                         | 0                         | 0                                                     | 0                 | 0                           |
| Other                                   | 0                         | 0                         | 69                                                    | 69                | 62                          |
| <b>Total</b>                            | <b>\$ 6,668</b>           | <b>\$ 2,437</b>           | <b>\$ 42,874</b>                                      | <b>\$ 51,979</b>  | <b>\$ 258,349</b>           |

|                                         | December 31, 2011         |                           |                                                       |                   |                             |
|-----------------------------------------|---------------------------|---------------------------|-------------------------------------------------------|-------------------|-----------------------------|
|                                         | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater than<br>90 Days<br>Past Due<br>(In thousands) | Total<br>Past Due | Total Loans<br>Not Past Due |
| <b>Loans receivable, held for sale:</b> |                           |                           |                                                       |                   |                             |
| Five or more units                      | \$ 0                      | \$ 0                      | \$ 2,496                                              | \$ 2,496          | \$ 3,899                    |
| Commercial real estate                  | 0                         | 0                         | 338                                                   | 338               | 1,374                       |
| Church                                  | 0                         | 0                         | 2,778                                                 | 2,778             | 2,772                       |
| <b>Loans receivable, net:</b>           |                           |                           |                                                       |                   |                             |
| One to four units                       | 921                       | 2,464                     | 7,974                                                 | 11,359            | 65,323                      |
| Five or more units                      | 1,324                     | 63                        | 3,450                                                 | 4,837             | 103,324                     |
| Commercial real estate                  | 2,247                     | 525                       | 5,449                                                 | 8,221             | 46,038                      |
| Church                                  | 2,647                     | 1,440                     | 21,891                                                | 25,978            | 63,121                      |
| Construction                            | 0                         | 264                       | 302                                                   | 566               | 3,224                       |
| <b>Commercial:</b>                      |                           |                           |                                                       |                   |                             |
| Sports                                  | 0                         | 0                         | 0                                                     | 0                 | 1,996                       |



Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

|                 |          |          |           |           |            |
|-----------------|----------|----------|-----------|-----------|------------|
| Other           | 125      | 0        | 0         | 125       | 4,775      |
| Consumer:       |          |          |           |           |            |
| Loan on savings | 0        | 0        | 0         | 0         | 821        |
| Other           | 0        | 0        | 70        | 70        | 38         |
| Total           | \$ 7,264 | \$ 4,756 | \$ 44,748 | \$ 56,768 | \$ 296,705 |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012****Troubled Debt Restructurings**

The Company has allocated \$2.9 million and \$2.6 million of specific reserves for loans the terms of which have been modified in troubled debt restructurings and were performing as of September 30, 2012 and December 31, 2011. At September 30, 2012, loans classified as a troubled debt restructuring totaled \$37.8 million, of which \$19.8 million were included in non-accrual loans and \$18.0 million were on accrual status. At December 31, 2011, loans classified as a TDR totaled \$37.1 million, of which \$19.4 million were included in non-accrual loans and \$17.7 million were on accrual status. TDRs on accrual status are comprised of loans that were accruing at the time of restructuring or loans that have complied with the terms of their restructured agreements for a satisfactory period of time, and for which the Bank anticipates full repayment of both principal and interest. TDRs that are on non-accrual can be returned to accrual status after a period of sustained performance, generally determined to be six months of timely payments as modified. As of September 30, 2012 and December 31, 2011, the Company has no commitment to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

During the nine months ended September 30, 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 1 year to 7 years. Modifications involving an extension of the maturity date were for 2 year and 7 year periods.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three and nine months ended September 30, 2012:

|                        | Three Months Ended September 30, 2012 |                                                  |                                                   | Nine Months Ended September 30, 2012 |                                                  |                                                   |
|------------------------|---------------------------------------|--------------------------------------------------|---------------------------------------------------|--------------------------------------|--------------------------------------------------|---------------------------------------------------|
|                        | Number of Loans                       | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Loans                      | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|                        | (Dollars in thousands)                |                                                  |                                                   |                                      |                                                  |                                                   |
| One to four units      | 0                                     | \$ 0                                             | \$ 0                                              | 1                                    | \$ 36                                            | \$ 36                                             |
| Commercial real estate | 0                                     | 0                                                | 0                                                 | 2                                    | 734                                              | 740                                               |
| Church                 | 1                                     | 503                                              | 503                                               | 9                                    | 3,902                                            | 3,907                                             |
| Total                  | 1                                     | \$ 503                                           | \$ 503                                            | 12                                   | \$ 4,672                                         | \$ 4,683                                          |

The troubled debt restructurings described above increased the allowance for loan losses by \$0 thousand and \$228 thousand for the three and nine months ended September 30, 2012 and resulted in charge offs of \$100 thousand during the three and nine months ended September 30, 2012.

Table of Contents**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)**

September 30, 2012

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three and nine months ended September 30, 2012:

|        | Three Months Ended September 30, 2012<br>Pre-Modification |                                                                 | Nine Months Ended September 30, 2012<br>Pre-Modification |                                       |
|--------|-----------------------------------------------------------|-----------------------------------------------------------------|----------------------------------------------------------|---------------------------------------|
|        | Number of Loans                                           | Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Number of<br>Loans                                       | Outstanding<br>Recorded<br>Investment |
| Church | 0                                                         | \$ 0                                                            | 5                                                        | \$ 3,791                              |
| Total  | 0                                                         | \$ 0                                                            | 5                                                        | \$ 3,791                              |

The terms of certain other loans were modified during the nine months ended September 30, 2012 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as of September 30, 2012 of \$2.2 million. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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.

**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. For one-to-four family residential, consumer and other smaller balance homogenous loans, a credit grade is established at inception, and generally only adjusted based on performance. Information about payment status is disclosed elsewhere. The Company analyzes all other loans individually by classifying the loans as to credit risk. This analysis is performed at least on a quarterly basis. The Company uses the following definitions 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 the institution'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 the institution will sustain 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.

***Loss.*** Loans classified as loss are considered uncollectible and of such little value that to continue to carry the loan as an active asset is no longer warranted.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Based on the most recent analysis performed, the risk category of loans by class of loans as of September 30, 2012 and December 31, 2011 is as follows:

|                        | <b>September 30, 2012</b> |                        |                    |                 |             |
|------------------------|---------------------------|------------------------|--------------------|-----------------|-------------|
|                        | <b>Pass</b>               | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> |
|                        | <b>(In thousands)</b>     |                        |                    |                 |             |
| One to four units      | \$ 57,791                 | \$ 2,130               | \$ 12,263          | \$ 29           | \$ 0        |
| Five or more units     | 83,669                    | 3,233                  | 5,809              | 0               | 0           |
| Commercial real estate | 31,087                    | 1,170                  | 12,268             | 63              | 0           |
| Church                 | 35,859                    | 15,491                 | 31,203             | 225             | 0           |
| Construction           | 471                       | 264                    | 284                | 0               | 0           |
| Commercial:            |                           |                        |                    |                 |             |
| Sports                 | 0                         | 1,721                  | 0                  | 0               | 0           |
| Other                  | 2,227                     | 1,306                  | 98                 | 0               | 0           |
| Consumer:              |                           |                        |                    |                 |             |
| Other                  | 62                        | 0                      | 69                 | 0               | 0           |
| <b>Total</b>           | <b>\$ 211,166</b>         | <b>\$ 25,315</b>       | <b>\$ 61,994</b>   | <b>\$ 317</b>   | <b>\$ 0</b> |

|                        | <b>December 31, 2011</b> |                        |                    |                 |             |
|------------------------|--------------------------|------------------------|--------------------|-----------------|-------------|
|                        | <b>Pass</b>              | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> |
|                        | <b>(In thousands)</b>    |                        |                    |                 |             |
| One to four units      | \$ 63,483                | \$ 3,044               | \$ 9,846           | \$ 309          | \$ 0        |
| Five or more units     | 95,621                   | 7,450                  | 4,939              | 151             | 0           |
| Commercial real estate | 36,098                   | 6,721                  | 11,364             | 76              | 0           |
| Church                 | 37,532                   | 13,100                 | 37,873             | 594             | 0           |
| Construction           | 500                      | 2,988                  | 302                | 0               | 0           |
| Commercial:            |                          |                        |                    |                 |             |
| Sports                 | 0                        | 1,996                  | 0                  | 0               | 0           |
| Other                  | 2,363                    | 2,369                  | 168                | 0               | 0           |
| Consumer:              |                          |                        |                    |                 |             |
| Loan on savings        | 821                      | 0                      | 0                  | 0               | 0           |
| Other                  | 108                      | 0                      | 0                  | 0               | 0           |
| <b>Total</b>           | <b>\$ 236,526</b>        | <b>\$ 37,668</b>       | <b>\$ 64,492</b>   | <b>\$ 1,130</b> | <b>\$ 0</b> |

**NOTE (7) Junior Subordinated Debentures, Other Borrowings and Management's Capital Plan**

On March 17, 2004, the Company issued \$6.0 million of Floating Rate Junior Subordinated Debentures in a private placement. The debentures mature in 10 years and interest is payable quarterly at a rate per annum equal to the 3-month LIBOR plus 2.54%. The interest rate is determined as of each March 17, June 17, September 17, and December 17, and was 2.93% at September 30, 2012. The Company stopped paying interest on the debentures and the senior line of credit discussed below in September 2010. The accrued interest on the debentures was \$409 thousand as of September 30, 2012. Under the cease and desist order applicable to the Company discussed in Note 10, the Company is not permitted to make

payments on its debt without prior notice to and receipt of written notice of non-objection from the Board of Governors of the Federal Reserve System, acting through the Federal Reserve Bank of San Francisco, (the FRB ). In addition, under the terms of the subordinated debentures, the Company is not allowed to make payments on the subordinated debentures if the Company is in default on any of its senior indebtedness, which term includes the senior line of credit described below.

**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**September 30, 2012**

On February 28, 2010, the Company borrowed an aggregate of \$5.0 million under its \$5.0 million line of credit with another financial institution, and invested all of the proceeds in the equity capital of the Bank. The interest rate on the line of credit adjusts annually, subject to a minimum of 6.00% and increases by an additional 5% in the event of default. Borrowings under this line of credit are secured by the Company's assets. The full amount of this borrowing became due and payable on July 31, 2010. On April 7, 2011, the lender agreed to forbear from exercising its rights (other than increasing the interest rate by the default rate margin) pursuant to the line of credit agreement until January 1, 2012 subject to certain conditions. The lender has declined to extend the forbearance agreement. This senior line of credit has not been repaid and the Company is now in default under the line of credit agreement.

The Company is pursuing a comprehensive recapitalization plan to improve the Company's capital structure. To date, the Company has entered into a written agreement with the U.S. Department of the Treasury pursuant to which the U.S. Treasury will exchange its holdings of the Company's Series D and Series E Fixed Rate Cumulative Perpetual Preferred Stock for common stock at a discount of 50% of the liquidation amount, plus an undiscounted exchange of the accumulated but unpaid dividends on such preferred stock, for common stock. The exchange by the U.S. Treasury is subject to various conditions, including the exchange of the Company's other outstanding series of preferred stock at discounts of 50% of the aggregate liquidation values, the placement of at least \$5 million of new common equity capital, and other conditions. The Exchange is expected to close contemporaneously with the closing of the private placement and the other exchange transactions. In addition, the Company has entered into a written agreement with the holder of its Series A Perpetual Preferred Stock pursuant to which the holder will exchange its holdings of Series A Preferred for common stock at a discount of 50% of the liquidation amount. This exchange is subject to various conditions, including the exchange of the Company's other outstanding series of preferred stock, the placement of new common equity capital, and other conditions.

The Company is negotiating written agreements with the holders of its Series B Perpetual Preferred Stock and Series C Noncumulative Perpetual Convertible Preferred Stock to exchange their holdings for common stock at a discount of 50% of the liquidation amount. Also, the Company is negotiating documentation with its senior lender, pursuant to which the lender will exchange a portion of the line of credit, which is currently in default, for common stock at 100% of the face amount to be exchanged; forgive the accrued interest on the entire amount of the line of credit to the date of the exchange; and enter into a modified credit agreement for the remainder of the facility that would be outstanding after the exchange. As presently contemplated, the series of transactions related to the exchange of debt and Series B and C Preferred Stock will reduce the Company's line of credit facility by approximately \$2.5 million and eliminate the accrued interest on the line of credit, which was approximately \$1.3 million as of September 30, 2012.

As a condition to consummating these exchanges, the Company plans to concurrently complete private placements or other sales of the Company's common stock aggregating \$5 million, or \$3.5 million if approved by the U.S. Department of the Treasury, or more in gross proceeds. The Company anticipates that these exchanges and placements and sales of common stock would, if completed, result in the issuance of approximately 17.0 million new shares of the Company's common stock, which would constitute approximately 90% of the pro forma outstanding shares of the Company's common stock. The 17.0 million new shares of common stock exceed the Company's current unissued and authorized shares. Accordingly, the Company plans to issue a form of common stock equivalent to the lender and holders of Preferred Stock in exchange for their securities to consummate the recapitalization, after which the Company plans to seek shareholder approval to increase the Company's authorized shares, and issue a portion of such authorized shares to replace the common stock equivalents issued in the recapitalization.

There can be no assurance that management's capital plan will be achieved. If the Company is unable to raise capital, management plans to continue to shrink assets, decrease nonperforming assets and implement strategies to increase earnings. Failure to maintain capital sufficient to meet the higher capital requirements could result in further regulatory action, which could include the appointment of a conservator or receiver for the Bank. For further information relating to the cash position and requirements of the Company, see Note 12 - Going Concern.

---

**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**September 30, 2012**

**NOTE (8) Fair Value**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) 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 fair value:

The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique 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 inputs).

The fair value of non-performing loans receivable held-for-sale is generally based upon the fair value of the collateral which is obtained from recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. Non-performing loans held for sale are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

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



**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)**

September 30, 2012

**Assets Measured on a Recurring Basis**

Assets measured at fair value on a recurring basis are summarized below:

|                                                             | Fair Value Measurements at September 30, 2012 Using                                 |                                                           |                                                    | Total     |
|-------------------------------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-----------|
|                                                             | Quoted Prices<br>in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           |
|                                                             | (In thousands)                                                                      |                                                           |                                                    |           |
| <b>Assets:</b>                                              |                                                                                     |                                                           |                                                    |           |
| Securities available-for-sale - residential mortgage-backed | \$ 0                                                                                | \$ 14,584                                                 | \$ 0                                               | \$ 14,584 |

|                                                                  | Fair Value Measurements at December 31, 2011 Using                                  |                                                           |                                                    | Total     |
|------------------------------------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-----------|
|                                                                  | Quoted Prices<br>in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           |
|                                                                  | (In thousands)                                                                      |                                                           |                                                    |           |
| <b>Assets:</b>                                                   |                                                                                     |                                                           |                                                    |           |
| Securities available-for-sale - residential mortgage-backed      | \$ 0                                                                                | \$ 17,910                                                 | \$ 0                                               | \$ 17,910 |
| Securities available-for-sale U.S. government and federal agency | 0                                                                                   | 1,069                                                     | 0                                                  | 1,069     |

There were no transfers between Level 1, Level 2, or Level 3 during the three and nine months ended September 30, 2012 and 2011.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012****Assets Measured on a Non-Recurring Basis**

The following table provides information regarding our assets measured at fair value on a non-recurring basis at the dates indicated. The fair value measurement for all of these assets falls within Level 3 of the fair value hierarchy.

|                                                         | Principal<br>Amount<br>September 30, 2012 | Valuation<br>Allowance<br>(In thousands) | Principal<br>Amount<br>December 31, 2011 | Valuation<br>Allowance |
|---------------------------------------------------------|-------------------------------------------|------------------------------------------|------------------------------------------|------------------------|
| <b>Assets:</b>                                          |                                           |                                          |                                          |                        |
| Non-performing loans receivable held-for-sale (1):      |                                           |                                          |                                          |                        |
| Five or more units                                      | \$ 2,001                                  | \$ 0                                     | \$ 2,496                                 | \$ 382                 |
| Commercial real estate                                  | 0                                         | 0                                        | 338                                      | 0                      |
| Church                                                  | 1,567                                     | 0                                        | 2,778                                    | 0                      |
| Impaired loans carried at fair value of collateral (2): |                                           |                                          |                                          |                        |
| One to four units                                       | 4,483                                     | 184                                      | 6,697                                    | 496                    |
| Five or more units                                      | 978                                       | 29                                       | 1,025                                    | 151                    |
| Commercial real estate                                  | 4,146                                     | 0                                        | 2,869                                    | 0                      |
| Church                                                  | 10,852                                    | 225                                      | 13,706                                   | 553                    |
| Construction                                            | 284                                       | 87                                       | 302                                      | 97                     |
| Other                                                   | 69                                        | 69                                       | 70                                       | 70                     |
| Real estate owned:                                      |                                           |                                          |                                          |                        |
| One to four units                                       | 0                                         | 0                                        | 759                                      | 41                     |
| Commercial real estate                                  | 574                                       | 55                                       | 3,374                                    | 248                    |
| Church                                                  | 2,144                                     | 371                                      | 2,913                                    | 58                     |

- (1) Includes \$1.7 million and \$2.7 million of loans held for sale that were carried at cost at September 30, 2012 and December 31, 2011 as the fair value of the collateral on these loans exceeded the book value as a result of charge-offs.
- (2) Includes \$19.1 million and \$18.6 million of loans that were carried at cost at September 30, 2012 and December 31, 2011 as the fair value of the collateral on these loans exceeded the book value as a result of charge-offs.

Collateral-dependent impaired loans and non-performing loans held for sale are measured for impairment using the fair value of the collateral. To determine the fair value of collateral, the Company primarily relies on third party appraisals, which are generally obtained every six to nine months. For one-to-four family residential loans, appraised values are based on the comparable sales approach. A significant unobservable input in the sales approach is the adjustment for the differences between the comparable sales. At September 30, 2012, these adjustments ranged from an upward adjustment of 7% to a discount of 30%. For five or more unit residential, commercial real estate and church loans, appraisers may use a single valuation approach or a combination of approaches such as the comparable sales, cost or income approaches. At September 30, 2012, adjustments made on five or more units residential, commercial real estate and church loans valued using the comparable sales approach ranged from an upward adjustment of 5% to a discount of 45%. A significant unobservable input in the income approach is the estimated income capitalization rate. At September 30, 2012, capitalization rates of 7% and 9% were utilized to determine the fair value of the underlying collateral of a commercial real estate loan, a church loan and two five or more units residential loans. The Company's calculation of net realizable value considers any third party liens in place on the underlying collateral.

Real estate owned is measured at fair value less estimated costs to sell, The fair value of REO is determined using a third party appraisal and is based on the comparable sales, cost or income approach, or a combination of these approaches. A significant unobservable input in the sales approach is the adjustment for the differences between the comparable sales. At September 30, 2012, these adjustments ranged from an upward adjustment of 17% to a discount of 45%. A significant unobservable input in the income approach is the estimated income capitalization rate. At September 30, 2012, capitalization rates of 10.50% and 12% were utilized to determine the fair value of the underlying collateral of two commercial real estate loans and a church loan.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

The following table provides information regarding gains (losses) recognized on assets measured at fair value on a non-recurring basis for the three and nine months ended September 30, 2012 and 2011.

|                                                        | <b>Three Months Ended</b> |                      | <b>Nine Months Ended</b> |                      |
|--------------------------------------------------------|---------------------------|----------------------|--------------------------|----------------------|
|                                                        | <b>September 30,</b>      | <b>September 30,</b> | <b>September 30,</b>     | <b>September 30,</b> |
|                                                        | <b>2012</b>               | <b>2011</b>          | <b>2012</b>              | <b>2011</b>          |
|                                                        | <b>(In thousands)</b>     |                      |                          |                      |
| Non-performing loans receivable held-for-sale, net (1) | \$ 296                    | \$ (702)             | \$ 109                   | \$ (667)             |
| Impaired loans carried at fair value of collateral (2) | (669)                     | (4,463)              | (1,585)                  | (9,523)              |
| Real estate owned (3)                                  | (427)                     | (1,251)              | (739)                    | (2,033)              |
| Total                                                  | \$ (800)                  | \$ (6,416)           | \$ (2,215)               | \$ (12,223)          |

- (1) Gains (losses) are charged to provision for losses on loans receivable held-for-sale.
- (2) Gains (losses) are charged against the allowance for loan losses.
- (3) Losses are charged against the allowance for loan losses in the case of a write-down upon the transfer of a loan to REO. Gains (losses) subsequent to the transfer of a loan to REO are charged to provision for losses on REO.

**Fair Values of Financial Instruments**

The carrying amounts and estimated fair values of financial instruments, at September 30, 2012 and December 31, 2011 were as follows:

|                                     | <b>Carrying Value</b> | <b>Fair Value Measurements at September 30, 2012 Using</b> |                |                |              |
|-------------------------------------|-----------------------|------------------------------------------------------------|----------------|----------------|--------------|
|                                     |                       | <b>Level 1</b>                                             | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|                                     |                       | <b>(In thousands)</b>                                      |                |                |              |
| <b>Financial Assets:</b>            |                       |                                                            |                |                |              |
| Cash and cash equivalents           | \$ 56,545             | \$ 56,545                                                  | \$ 0           | \$ 0           | \$ 56,545    |
| Securities available-for-sale       | 14,584                | 0                                                          | 14,584         | 0              | 14,584       |
| Loans receivable held for sale, net | 11,215                | 0                                                          | 0              | 11,215         | 11,215       |
| Loans receivable, net               | 282,292               | 0                                                          | 0              | 282,037        | 282,037      |
| Federal Home Loan Bank stock        | 3,901                 | 0                                                          | 0              | N/A            | N/A          |
| Accrued interest receivable         | 1,395                 | 0                                                          | 50             | 1,345          | 1,395        |
| <b>Financial Liabilities:</b>       |                       |                                                            |                |                |              |
| Deposits                            | \$ (262,808)          | \$ 0                                                       | \$ (261,696)   | \$ 0           | \$ (261,696) |
| Federal Home Loan Bank advances     | (83,000)              | 0                                                          | (88,931)       | 0              | (88,931)     |
| Junior subordinated debentures      | (6,000)               | 0                                                          | 0              | (5,537)        | (5,537)      |
| Other borrowings                    | (5,000)               | 0                                                          | 0              | (4,615)        | (4,615)      |
| Accrued interest payable            | (1,837)               | 0                                                          | (169)          | (1,668)        | (1,837)      |

|                                                       | December 31, 2011  |                         |
|-------------------------------------------------------|--------------------|-------------------------|
|                                                       | Carrying<br>Amount | Estimated<br>Fair Value |
| <b>Financial Assets:</b>                              |                    |                         |
| Cash and cash equivalents                             | \$ 31,597          | \$ 31,597               |
| Securities available-for-sale                         | 18,979             | 18,979                  |
| Loans receivable held for sale, net                   | 12,983             | 12,983                  |
| Loans receivable, net                                 | 322,770            | 323,090                 |
| Federal Home Loan Bank stock                          | 4,089              | N/A                     |
| Accrued interest receivable                           | 1,698              | 1,698                   |
| <b>Financial Liabilities:</b>                         |                    |                         |
| Deposits                                              | \$ (294,686)       | \$ (294,313)            |
| Federal Home Loan Bank advances                       | (83,000)           | (88,911)                |
| Junior subordinated debentures                        | (6,000)            | (5,319)                 |
| Other borrowings                                      | (5,000)            | (4,434)                 |
| Advance payments by borrowers for taxes and insurance | (813)              | (813)                   |
| Accrued interest payable                              | (1,302)            | (1,302)                 |

**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**September 30, 2012**

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

*(a) Cash and Cash Equivalents*

The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1.

*(b) Loans receivable held for sale*

The fair value of loans held for sale is estimated based on quoted prices from third party sale analyses, existing sale agreements or appraisal reports adjusted by sales commission assumptions resulting in a Level 3 classification.

*(c) Loans receivable*

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

*(d) FHLB Stock*

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

*(e) Deposits*

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

*(f) Federal Home Loan Bank Advances*

The fair values of the Federal Home Loan Bank advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

*(g) Subordinated Debentures and Other Borrowings*

The fair values of the Company's Subordinated Debentures and other borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

*(h) Accrued Interest Receivable/Payable*

The carrying amounts of accrued interest are classified the same as the related asset / liability.



**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**September 30, 2012**

**NOTE (9) Stock-based Compensation**

In 2008, we adopted the 2008 Long-Term Incentive Plan ( 2008 LTIP ), which was approved by the shareholders. The 2008 LTIP replaced the Company's 1996 Long-Term Incentive Plan ( 1996 LTIP ) and 1996 Stock Option Plan ( Stock Option Plan ), which have expired and are no longer effective except as to outstanding awards. The 2008 LTIP permits the grant of non-qualified and incentive stock options, stock appreciation rights, full value awards and cash incentive awards to the Company's non-employee directors and certain officers and employees for up to 351,718 shares of common stock. Option awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant; those option awards have vesting periods ranging from immediate vesting to 5 years and have 10-year contractual terms. The Company has a policy of using shares held as treasury stock to satisfy share option exercises. Currently, the Company has a sufficient number of treasury shares to satisfy expected share option exercises.

No options were granted during the nine months ended September 30, 2012 and 2011. The Company recorded \$36 thousand of stock-based compensation expense, net of tax, during the first nine months of 2012 compared to \$39 thousand for the first nine months of 2011.

**NOTE (10) Regulatory Matters**

The Bank is subject to regulatory capital requirements now administered by the Office of the Comptroller of the Currency, or OCC, which is the statutory successor under the Dodd-Frank Act to the former Office of Thrift Supervision, or OTS. The capital requirements, which remain the same as when administered by the OTS, 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 the OCC. Failure to meet capital requirements can result in regulatory action.

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

The Company and the Bank consented to the issuance to them of cease and desist orders by the OTS effective September 9, 2010 requiring, among other things, that the Company and the Bank take remedial actions to improve the Bank's loan underwriting and internal asset review procedures, to reduce the amount of its non-performing assets and to improve other aspects of the Bank's business, as well as the Company's management of its business and the oversight of the Company's business by the Board. The cease and desist orders, which are now administered by the OCC with respect to the Bank and the FRB with respect to the Company, require the Bank to attain, and thereafter maintain, a Tier 1 (Core) Capital to Adjusted Total Assets ratio of at least 8% and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least 12%, both of which ratios are greater than the respective 5% and 10% levels for such ratios that are generally required under OTS (now OCC) regulations. The cease and desist orders also prohibit the Bank from paying dividends to the Company, and prohibit the Company from paying dividends to its shareholders, without the prior written approval of the OCC and the FRB, respectively. In addition, the Company is not permitted to incur, issue, renew, repurchase, make payments on or increase any debt or redeem any capital stock without prior notice to and receipt of written notice of non-objection from the FRB.



**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (continued)****September 30, 2012**

The Bank met the minimum capital requirements at September 30, 2012 to conform to the general regulatory definition of well-capitalized under the prompt corrective action regulations, as well as the higher capital standards under the cease and desist orders, however it cannot be considered well capitalized while under the cease and desist order. The Bank did not meet the minimum capital requirements under the cease and desist order at December 31, 2011.

Actual and normally required capital amounts and ratios at September 30, 2012 and December 31, 2011, together with the higher capital requirements that the Bank is required to meet under the cease and desist order applicable to it, are presented below.

|                                               | Actual    |        | Required for<br>Capital Adequacy<br>Purposes |       | To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Regulations |        | Capital<br>Requirements<br>under Cease and<br>Desist Order |        |
|-----------------------------------------------|-----------|--------|----------------------------------------------|-------|----------------------------------------------------------------------------|--------|------------------------------------------------------------|--------|
|                                               | Amount    | Ratio  | Amount                                       | Ratio | Amount                                                                     | Ratios | Amount                                                     | Ratios |
| <b>(Dollars in thousands)</b>                 |           |        |                                              |       |                                                                            |        |                                                            |        |
| <b>September 30, 2012:</b>                    |           |        |                                              |       |                                                                            |        |                                                            |        |
| Tangible Capital to adjusted total assets     | \$ 33,200 | 8.65%  | \$ 5,759                                     | 1.50% | N/A                                                                        | N/A    | N/A                                                        | N/A    |
| Tier 1(Core) Capital to adjusted total assets | \$ 33,200 | 8.65%  | \$ 15,357                                    | 4.00% | \$ 19,196                                                                  | 5.00%  | \$ 30,713                                                  | 8.00%  |
| Tier 1(Core) Capital to risk weighted assets  | \$ 33,200 | 12.61% | N/A                                          | N/A   | \$ 15,803                                                                  | 6.00%  | N/A                                                        | N/A    |
| Total Capital to risk weighted assets         | \$ 36,661 | 13.92% | \$ 21,070                                    | 8.00% | \$ 26,338                                                                  | 10.00% | \$ 31,606                                                  | 12.00% |
| <b>December 31, 2011 :</b>                    |           |        |                                              |       |                                                                            |        |                                                            |        |
| Tangible Capital to adjusted total assets     | \$ 30,961 | 7.27%  | \$ 6,396                                     | 1.50% | N/A                                                                        | N/A    | N/A                                                        | N/A    |
| Tier 1(Core) Capital to adjusted total assets | \$ 30,961 | 7.27%  | \$ 17,055                                    | 4.00% | \$ 21,319                                                                  | 5.00%  | \$ 34,111                                                  | 8.00%  |
| Tier 1(Core) Capital to risk weighted assets  | \$ 30,961 | 10.31% | N/A                                          | N/A   | \$ 18,019                                                                  | 6.00%  | N/A                                                        | N/A    |
| Total Capital to risk weighted assets         | \$ 34,882 | 11.61% | \$ 24,026                                    | 8.00% | \$ 30,032                                                                  | 10.00% | \$ 36,039                                                  | 12.00% |

**NOTE (11) Income Taxes**

The Company and its subsidiaries are subject to U.S. federal and state income taxes. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion, or all, of the deferred tax asset will not be realized. In assessing the realization of deferred tax assets, management evaluates both positive and negative evidence, including the existence of cumulative losses in the current year and the prior two years, the amount of taxes paid in available carry-back years, the forecasts of future income and tax planning strategies. This analysis is updated quarterly. Based on this analysis, the Company determined that a valuation allowance of \$8.5 million was required as of September 30, 2012, resulting in \$0 net deferred tax assets. The Company had recorded a valuation allowance of \$8.2 million and net deferred tax assets of \$850 thousand as of December 31, 2011. The decrease in net deferred tax assets from \$850 thousand at December 31, 2011 to \$0 at September 30, 2012 was due to the Company's inability to project future taxable income to be able to utilize its deferred tax assets.

**Table of Contents**

**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**September 30, 2012**

**NOTE (12) Going Concern**

The Company's financial statements have been prepared assuming that the Company will continue as a going-concern, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business. However, the Company has a tax sharing liability to the Bank which exceeds operating cash at the Company level. The Company used its cash available at the holding company level to pay a substantial portion of this liability pursuant to the terms of the Tax Allocation Agreement between the Bank and the Company on March 30, 2012 and does not have cash available to pay its operating expenses. Additionally, the Company is in default under the terms of a \$5.0 million line of credit with another financial institution lender (see Note 7).

Due to the regulatory cease and desist order that is in effect, the Bank is not allowed to make distributions to the Company without regulatory approval, and such approval is not likely to be given. Accordingly, the Company will not be able to meet its payment obligations within the foreseeable future unless the Company is able to secure new capital. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Management's plan to address the conditions described above is to raise additional equity capital for the Company and exchange senior securities for common equity (see Note 7). The Company's ability to continue as a going concern is dependent on the timely implementation and success of this plan. There can be no assurance that management's plan will be achieved.

---

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to provide a reader of our financial statements with a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A should be read in conjunction with the Consolidated Financial Statements and related Notes included in Part I Item 1, Financial Statements, of this Quarterly Report on Form 10-Q and our amended Annual Report on Form 10-K/A for the year ended December 31, 2011.

**Overview**

Total assets decreased during the first nine months of 2012 primarily due to a decrease in our loan portfolio, as loan repayments, foreclosures and charge-offs exceeded loan originations during the period. The decrease in our loan portfolio consisted of a \$15.4 million decrease in our five or more units residential real estate loan portfolio, a \$9.7 million decrease in our commercial real estate loan portfolio, a \$6.3 million decrease in our church loan portfolio, a \$4.5 million decrease in our one-to-four family residential real estate loan portfolio, a \$2.8 million decrease in our construction loan portfolio, a \$1.5 million decrease in our commercial loan portfolio, and a \$798 thousand decrease in our consumer loan portfolio.

Total deposits decreased during the first nine months of 2012, while FHLB borrowings, subordinated debentures and other borrowings remained unchanged.

Our net earnings (loss) for the three and nine months ended September 30, 2012 were (\$613) thousand and \$1.2 million, respectively, compared to net losses of (\$7.5) million and (\$9.4) million, respectively, for the same periods a year ago, representing an increase in net earnings of \$6.9 million and \$10.6 million, respectively. The increase from a net loss to net earnings was primarily due to lower provisions for loan losses, a \$2.5 million gain on the sale of our headquarters building, lower provisions for losses on REO and loans held for sale, and lower income tax provision expense for the three and nine months ended September 30, 2012.

**Results of Operations***Net Interest Income*

For the third quarter of 2012, our net interest income before provision for loan losses was \$3.2 million, which represented a decrease of \$1.1 million, or 26%, from the third quarter of 2011. The decrease in net interest income was primarily attributable to a decrease in average interest-earning assets, primarily loans receivable, combined with a decrease in net interest margin.

Interest income decreased \$1.5 million, or 24%, to \$4.7 million for the third quarter of 2012 from \$6.2 million for the third quarter of 2011. The decrease in interest income was primarily due to a \$71.9 million decrease in the average balance of loans receivable from \$391.2 million for the third quarter of 2011 to \$319.3 million for the third quarter of 2012, which resulted in a \$1.1 million reduction in interest income. Additionally, the average yield on loans decreased from 6.20% for the third quarter of 2011 to 5.76% for the third quarter of 2012, which resulted in a \$411 thousand reduction in interest income. The decrease in the average yield on loans was primarily a result of continued higher levels of non-performing loans, payoffs of loans which carried a higher average yield than the average yield of loans receivable and lower yields on loan originations as a result of the low interest rate environment.

Interest expense decreased \$419 thousand, or 22%, to \$1.5 million for the third quarter of 2012 from \$1.9 million for the third quarter of 2011. The decrease in interest expense was primarily attributable to a 23 basis point decline in the average cost of interest bearing liabilities, to 1.67% for the third quarter of 2012 from 1.90% for the third quarter of 2011, which resulted in a \$243 thousand reduction in interest expense. The decrease in interest expense reflected a 32 basis point reduction in the cost of deposits and borrowings as a result of the low interest rate environment, and repayment of higher costing FHLB advances that were replaced by lower costing advances. Additionally, the volume of average interest-bearing liabilities decreased \$43.3 million, which resulted in a \$176 thousand reduction in interest expense.

---

**Table of Contents**

For the nine months ended September 30, 2012, net interest income before provision for loan losses totaled \$10.4 million, down \$2.7 million, or 21%, from \$13.1 million of net interest income before provision for loan losses for the same period a year ago. The \$2.7 million decrease in net interest income primarily resulted from a \$63.9 million decrease in average interest-earning assets and a 30 basis point decrease in net interest margin.

*Provision and Allowance for Loan Losses*

We record a provision for loan losses as a charge to earnings when necessary in order to maintain the allowance for loan losses at a level sufficient, in management's judgment, to absorb losses inherent in the loan portfolio. At least quarterly, we conduct an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical loss experience for each type of loan, the size and composition of our loan portfolio, the levels and composition of our loan delinquencies, non-performing loans and net loan charge-offs, the value of underlying collateral on problem loans, regulatory policies, general economic conditions, and other factors related to the collectability of loans in the portfolio.

The provision for loan losses for the third quarter of 2012 totaled \$129 thousand, compared to \$3.8 million for the same period a year ago. The decrease in loan provision was primarily due to our loan portfolio shrinkage of \$13.6 million during the third quarter of 2012 and a \$5.2 million decrease in charge-offs.

For the nine months ended September 30, 2012, the provision for loan losses totaled \$1.2 million compared to \$8.5 million of provisions for the same period a year-ago. The decrease in loan loss provision was primarily due to a \$40.8 million decrease in our gross loan portfolio and a \$7.2 million decrease in charge-offs.

At September 30, 2012 our allowance for loan losses was \$17.0 million, or 5.68% of our gross loans receivable, compared to \$17.3 million, or 5.09% of our gross loans, at year-end 2011. The ratio of the allowance for loan losses to NPLs, excluding loans held for sale, was 43.21% at September 30, 2012, compared to 44.20% at year-end 2011. As of September 30, 2012, 64% of our NPLs had been written down to their adjusted fair value less estimated selling costs, by establishing specific reserves or charge-offs as necessary. The remaining 36% of NPLs are reported at cost as the fair value of collateral less estimated selling costs exceeded the recorded investment in the loan.

Loan charge-offs during the first nine months of 2012 were \$1.9 million, or 0.77% of average loans, compared to \$9.2 million, or 2.99% of average loans, during the first nine months of 2011. Of the \$1.9 million of charge-offs, \$255 thousand were reserved for at year-end 2011. The remaining \$1.7 million of charge-offs were reserved for during 2012 and were primarily related to loans that became impaired during 2012 and with respect to which recent valuations of the underlying collateral reflected impairment losses. Charge-offs in one-to-four family residential real estate loans totaled \$894 thousand and represented 46% of charge-offs during 2012. Charge-offs in church loans totaled \$608 thousand and represented 32% of charge-offs during 2012. Charge-offs in commercial real estate loans totaled \$404 thousand and represented 21% of charge-offs during 2012. Charge-offs in five or more unit residential real estate loans totaled \$14 thousand and represented 1% of charge-offs during 2012.

Impaired loans at September 30, 2012 were \$55.2 million, compared to \$56.3 million at December 31, 2011. Specific reserves for impaired loans were \$3.4 million, or 6.12% of the aggregate impaired loan amount at September 30, 2012, compared to \$3.9 million, or 7.00%, at December 31, 2011. Excluding specific reserves for impaired loans, our coverage ratio (general allowance as a percentage of total non-impaired loans) was 5.59% at September 30, 2012, compared to 4.71% at December 31, 2011.

We performed an impairment analysis for all non-performing and restructured loans, and established specific reserves for impaired loans of \$3.4 million at September 30, 2012. Of the \$3.4 million specific reserves at September 30, 2012, \$594 thousand was related to \$1.7 million of loans that are non-performing. Additionally, we recorded \$2.8 million of specific reserves for impairment related to \$17.7 million of accruing loans that were modified in troubled debt restructurings. On \$16.7 million of impaired loans, the fair value of collateral less estimated selling costs exceeded the recorded investment in the loan and did not require a specific reserve. The remaining \$19.1 million of impaired loans had been written down to fair value after charge-offs of \$13.5 million.

---

## **Table of Contents**

Management believes that the allowance for loan losses is adequate to cover probable incurred losses in the loan portfolio as of September 30, 2012, but there can be no assurance that actual losses will not exceed the estimated amounts. In addition, the OCC and the FDIC periodically review the allowance for loan losses as an integral part of their examination process. These agencies may require an increase in the allowance for loan losses based on their judgments of the information available to them at the time of their examinations. The provisions for loan losses and corresponding allowance for loan losses in these financial statements contained in Part 1, Item 1 of this Form 10-Q reflect judgments by the OCC made during its supervisory examination of our Bank completed in July 2012.

### *Non-interest Income*

Non-interest income (loss) for the third quarter of 2012 totaled (\$217) thousand compared to \$114 thousand for the third quarter of 2011. The decrease from income to a loss was primarily due to higher losses on sales of loans and REOs.

For the nine months ended September 30, 2012, non-interest income totaled \$2.9 million compared to \$494 thousand for the same period a year ago. The increase primarily reflects the gain on the sale of our headquarters building and higher net gains on sales of REO, which were partially offset by lower service charges and higher losses on sales of loans for the first nine months of 2012.

### *Non-interest Expense*

Non-interest expense for the third quarter of 2012 totaled \$3.5 million, compared to \$5.1 million for the third quarter of 2011. Lower non-interest expense in the third quarter of 2012 was primarily due to lower provisions for losses on REO and loans held for sale and lower compensation and benefits expense, which were partially offset by higher FDIC insurance expense and higher other expenses, primarily appraisal expenses and directors and officers liability insurance expense.

For the nine months ended September 30, 2012, non-interest expense totaled \$10.1 million compared to \$12.7 million for the same period a year ago. The decrease in non-interest expense during the first nine months of 2012 primarily reflected lower provisions for losses on REO and loans held for sale, lower compensation and benefits expense and lower legal expenses, which were partially offset by higher other expenses, primarily REO and appraisal expenses and director and officer s liability insurance expense.

### *Income Taxes*

The Company s effective income tax rate was (0.33%) and 40.68% for the three and nine months ended September 30, 2012 compared to (68.21%) and (23.20%) for the three and nine months ended September 30, 2011. Income taxes for interim periods are computed by applying the projected annual effective income tax rate for the year to the year-to-date earnings plus discrete items (items incurred in the quarter). The projected effective tax rate incorporates certain non-taxable federal and state income items and expected increases to the valuation allowance for projected deferred tax assets.

## **Financial Condition**

### *Total Assets*

Total assets were \$384.3 million at September 30, 2012, which represented a decrease of \$29.5 million, or 7%, from December 31, 2011. During the first nine months of 2012, net loans decreased by \$40.5 million, loans held for sale decreased by \$1.8 million, securities decreased by \$4.4 million, REO decreased by \$4.4 million, office properties and equipment decreased by \$2.0 million and deferred tax assets decreased by \$850 thousand, while cash and cash equivalents increased by \$24.9 million.

### *Loan Portfolio*

Our gross loan portfolio decreased by \$41.0 million to \$298.8 million at September 30, 2012 from \$339.8 million at

## Table of Contents

December 31, 2011, as loan repayments, foreclosures and charge-offs exceeded loan originations during the first nine months of 2012. The decrease in our loan portfolio consisted of a \$15.4 million decrease in our five or more units residential real estate loan portfolio, a \$9.7 million decrease in our commercial real estate loan portfolio, a \$6.3 million decrease in our church loan portfolio, a \$4.5 million decrease in our one-to-four family residential real estate loan portfolio, a \$2.8 million decrease in our construction loan portfolio, a \$1.5 million decrease in our commercial loan portfolio, and a \$798 thousand decrease in our consumer loan portfolio.

Loan originations for the first nine months of 2012 totaled \$18.2 million, compared to \$3.6 million for the first nine months of 2011. Loan repayments for the first nine months of 2012 totaled \$53.2 million, compared to \$28.3 million for the comparable period in 2011. The increase in loan repayments was primarily attributable to a higher level of refinancings by borrowers who could take advantage of historically low interest rates and new financing opportunities in the stabilized commercial and single family markets. Loan charge-offs for the first nine months of 2012 totaled \$1.9 million, compared to \$9.2 million of charge-offs for the first nine months of 2011. Loans transferred to REO during the first nine months of 2012 totaled \$3.5 million, compared to \$7.7 million during the first nine months of 2011. Loans transferred to loans held for sale during the first nine months of 2012 totaled \$616 thousand, compared to \$2.5 million of loans transferred to loans held for sale during the first nine months of 2011.

Loans held for sale decreased from \$13.0 million at December 31, 2011 to \$11.2 million at September 30, 2012. The \$1.8 million decrease during the first nine months of 2012 was primarily due to non-performing loan sales of \$1.8 million and loan repayments of \$367 thousand. Loans held for sale that were transferred to REO during the nine months ended September 30, 2012 totaled \$333 thousand.

### *Deposits*

Deposits totaled \$262.8 million at September 30, 2012, down \$31.9 million, or 11%, from year-end 2011. During the first nine months of 2012, core deposits (NOW, demand, money market and passbook accounts) decreased by \$7.0 million and represented 35% and 33% of total deposits at September 30, 2012 and December 31, 2011, respectively. Our certificates of deposit ( CDs ) decreased by \$24.9 million during the first nine months of 2012 and represented 64% of total deposits at September 30, 2012 and December 31, 2011, respectively. Of the \$24.9 million decrease in CDs during 2012, \$6.3 million were from brokered deposits. At September 30, 2012, brokered deposits represented 1% of total deposits, compared to 3% of total deposits at December 31, 2011.

### *Borrowings*

Since year-end 2011, FHLB borrowings, subordinated debentures and other borrowings remained unchanged at \$83.0 million, \$6.0 million, and \$5.0 million, respectively. FHLB advances were 22% and 20% of total assets at September 30, 2012 and December 31, 2011, respectively. During the second quarter of 2012, \$13.5 million of FHLB advances were restructured which resulted in a decrease of the weighted average cost of advances from 3.09% at December 31, 2011 to 2.52% at September 30, 2012. See Liquidity for further information on subordinated debentures and other borrowings.

### *Non-Performing Assets*

Non-performing assets ( NPAs ) include loans that are 90 days or more delinquent and still accruing, non-accrual loans and real estate owned through foreclosure or deed in lieu of foreclosure ( REO ). NPAs at September 30, 2012 were \$45.2 million, or 11.75% of total assets, compared to \$51.4 million, or 12.43% of total assets, at December 31, 2011.

As of September 30, 2012, five loans to a single borrower totaling \$1.5 million were 90 days past due and were accruing interest.

At September 30, 2012, non-accrual loans were \$41.4 million compared to \$44.7 million at December 31, 2011. These loans consist of delinquent loans that are 90 days or more past due and troubled debt restructurings ( TDRs ) that do not qualify for accrual status. The non-accrual loans at September 30, 2012 included 31 church loans totaling \$22.1 million, 22 one-to-four family residential real estate loans totaling \$8.6 million, 13 commercial real estate loans totaling \$6.4 million, 8 five or more units residential real estate loans totaling \$3.9 million, a land loan for \$284 thousand, and a consumer loan for \$69 thousand.

## **Table of Contents**

During the first nine months of 2012, REO decreased by \$4.4 million to \$2.3 million at September 30, 2012, from \$6.7 million at the end of 2011. At September 30, 2012, the Bank's REO consisted of seven commercial real estate properties, four of which are church buildings. As part of our efforts to reduce non-performing assets, we sold thirteen REO properties for total proceeds of \$7.8 million, and recorded a corresponding net gain of \$288 thousand, during the first nine months of 2012.

### *Performance Ratios*

The annualized return (loss) on average equity for the three and nine months ended September 30, 2012 were (12.52%) and 8.76%, compared to annualized losses on average equity of (104.17%) and (39.86%) for the three and nine months ended September 30, 2011. The annualized return (loss) on average assets for the three and nine months ended September 30, 2012 were (0.64%) and 0.41%, compared to annualized losses on average assets of (6.89%) and (2.71%) for the three and nine months ended September 30, 2011. The efficiency ratios for the three and nine months ended September 30, 2012 was 110.70% and 70.49%, compared to 71.03% and 73.30% for the three and nine months ended September 30, 2011.

### **Liquidity**

The objective of liquidity management is to ensure that we have the continuing ability to fund operations and meet other obligations on a timely and cost-effective basis. The Bank's sources of funds include deposits, advances from the FHLB and other borrowings, proceeds from the sale of loans, mortgage-backed and investment securities, and principal and interest payments from loans and mortgage-backed and other investment securities. Primary uses of funds include withdrawal of and interest payments on deposits, originations of loans, purchases of mortgage-backed and other investment securities, and payment of operating expenses.

Net cash inflows from operating activities totaled \$5.2 million and \$21.0 million during the nine months ended September 30, 2012 and 2011, respectively. Net cash inflows from operating activities for the first nine months of 2012 were primarily attributable to proceeds from sales of loans receivable held for sale and interest payments received on loans and securities.

Net cash inflows from investing activities totaled \$51.2 million and \$31.3 million during the nine months ended September 30, 2012 and 2011, respectively. Net cash inflows from investing activities for the first nine months of 2012 were attributable primarily to principal repayments on loans and securities, proceeds from the sales of REOs and proceeds from sale of the headquarters building.

Net cash outflows from financing activities totaled \$31.5 million and \$53.3 million during the nine months ended September 30, 2012 and 2011, respectively. Net cash outflows from financing activities for the first nine months of 2012 were attributable primarily to the net decrease in deposits.

When the Bank has more funds than required for reserve requirements or short-term liquidity needs, the Bank sells federal funds to other financial institutions. Conversely, when the Bank has less funds than it requires, the Bank may borrow funds from the FHLB. The Bank is currently approved by the FHLB to borrow up to \$100.0 million to the extent the Bank provides qualifying collateral and holds sufficient FHLB stock. That approved limit and collateral requirement would have permitted the Bank, as of September 30, 2012, to borrow an additional \$15.9 million.

At times we maintain a portion of our liquid assets in interest-bearing cash deposits with other banks, in overnight federal funds sold to other banks, and in securities available-for-sale that are not pledged. The Bank's liquid assets at September 30, 2012 consisted of \$56.5 million in cash and cash equivalents and \$13.0 million in securities available-for-sale that are not pledged, compared to \$31.6 million in cash and cash equivalents and \$17.4 million in securities available-for-sale that are not pledged at December 31, 2011.

The Company has a tax sharing liability to the Bank which exceeds operating cash at the Company level. The liability

**Table of Contents**

was partially settled pursuant to the terms of the Tax Allocation Agreement between the Bank and the Company on March 30, 2012, which settlement consumed the Company's operating cash. During the three months ended September 30, 2012, we sold 115,386 shares of our common stock held as treasury shares to certain directors and officers for \$150,000. This capital was retained by the Company to help offset outstanding payables. Our ability to service our debt obligations and pay dividends and holding company expenses is dependent primarily on the recapitalization plan discussed herein under the caption "Capital Resources". The Company's debt obligations, which are included in other borrowings, are described below.

On March 17, 2004, the Company issued \$6.0 million of Floating Rate Junior Subordinated Debentures in a private placement. The debentures mature in 10 years and interest is payable quarterly at a rate per annum equal to the 3-month LIBOR plus 2.54%. The interest rate is determined as of each March 17, June 17, September 17, and December 17, and was 2.93% at September 30, 2012. The Company stopped paying interest on the debentures in September 2010. As disclosed previously, the Company is not permitted to make payments on any debts without prior notice to and receipt of written notice of non-objection from the FRB. In addition, under the terms of the subordinated debentures, the Company is not allowed to make payments on the subordinated debentures if the Company is in default on any of its senior indebtedness, which term includes the senior line of credit described below.

On February 28, 2010, the Company borrowed an aggregate of \$5.0 million under its \$5.0 million line of credit with another financial institution, and invested all of the proceeds in the equity capital of the Bank. Borrowings under this line of credit are secured by the Company's assets. The interest rate on the line of credit adjusts annually, subject to a minimum of 6.00%, and increases by an additional 5% in the event of default. The full amount of this borrowing became due and payable on July 31, 2010. The Company does not have sufficient cash available to repay the borrowing at this time and would require approval of the FRB to make any payment on this senior line of credit or to obtain a dividend from the Bank for such purpose. On April 7, 2011, the lender agreed to forbear from exercising its rights (other than increasing the interest rate by the default rate margin) pursuant to the line of credit agreement until January 1, 2012 subject to certain conditions. The lender has declined to extend the forbearance agreement. This senior line of credit has not been repaid and the Company is now in default under the line of credit agreement. The accrued interest on this line was approximately \$1.3 million as of September 30, 2012. See Note 7 of the Notes to Consolidated Financial Statements.

Due to the current regulatory cease and desist order that is in effect, the Bank is not allowed to make distributions to the Company without regulatory approval, and such approval is not likely to be given. Accordingly, the Company will not be able to meet its payment obligations within the foreseeable future unless the Company is able to secure new capital.

These conditions and the Company's operating losses raise substantial doubt about the Company's ability to continue as a going concern. These and related matters are discussed in Note 12 "Going Concern" of the Notes to Consolidated Financial Statements.

**Capital Resources**

On November 14, 2008, the Company issued 9,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series D, having a liquidation preference of \$1,000 per share, together with a ten-year warrant to purchase 183,175 shares of Company common stock at \$7.37 per share which was subsequently cancelled, to the U.S. Treasury Department for gross proceeds of \$9.0 million. The sale of the Series D Preferred Stock was made pursuant to the U.S. Treasury Department's TARP Capital Purchase Program.

On December 8, 2009, the Company issued 6,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series E, having a liquidation preference of \$1,000 per share, to the U.S. Treasury Department for gross proceeds of \$6.0 million. The sale of the Series E Preferred Stock was made pursuant to the U.S. Treasury Department's TARP Capital Purchase Program.



---

## **Table of Contents**

We are pursuing a comprehensive recapitalization plan to improve the Company's capital structure. To date, we have entered into written agreements with:

The U.S. Treasury Department pursuant to which the U.S. Treasury will exchange the shares of our Series D and E Fixed Rate Cumulative Perpetual Preferred Stock held by it for our common stock at a discount of 50% of the liquidation amount, plus an undiscounted exchange of the accumulated but unpaid dividends on such preferred stock for common stock, subject to various conditions, including the exchange of the Company's other outstanding series of preferred stock at discounts of 50% of the aggregate liquidation values, the placement of at least \$5 million of new common equity capital, and other conditions; and

The holder of our Series A Perpetual Preferred Stock to exchange its holdings for common stock at a discount of 50% of the liquidation amount, subject to various conditions, including the exchange of the Company's other outstanding series of preferred stock, the placement of new common equity capital, and other conditions.

We are also in negotiations regarding definitive agreements with the holders of our Series B Perpetual Preferred Stock and Series C Noncumulative Perpetual Convertible Preferred Stock regarding exchange of their holdings for common stock on a similar basis as the exchange of the Series A Perpetual Preferred Stock, and we are negotiating documents with our senior bank lender regarding the exchange of a portion of the \$5 million outstanding amount borrowed under our line of credit, which is currently in default, for common stock at 100% of the face amount to be exchanged; the forgiveness of the accrued interest on the entire amount of the line of credit to the date of the exchange; and the execution of a modified credit agreement for the remainder of the facility that would be outstanding after the exchange. As presently contemplated, the series of transactions related to the exchange of debt and Series B and C Preferred Stock will reduce the Company's line of credit facility by approximately \$2.5 million and eliminate the accrued interest on the line of credit, which was approximately \$1.3 million as of September 30, 2012.

The conditions to each of the above proposed exchanges include, or are expected to include, requirements that the holders of each series of our outstanding preferred stock concurrently exchange their preferred stock for our common stock on similar terms and that we concurrently complete private placements or other sales of new shares of common stock as discussed above, although we intend to seek approval from the U.S. Treasury to reduce the minimum amount of common equity we raise to \$3.5 million or more. Based on the agreements that we have executed, we anticipate that these exchanges and placements and sales of common stock would, if completed, result in the issuance of approximately 17.0 million new shares of the Company's common stock, which would constitute approximately 91% of the pro forma outstanding shares of the Company's common stock. The 17.0 million new shares of common stock exceed the Company's current unissued and authorized shares. Accordingly, the Company plans to issue a form of common stock equivalent to the lender and holders of Preferred Stock in exchange for their securities to consummate the recapitalization, after which we plan to seek shareholder approval to increase the Company's authorized shares, and issue a portion of such shares to replace the common stock equivalents issued in the recapitalization.

In addition, we completed the sale of our Bank's headquarters building during the second quarter and are working to decrease NPAs through proactive management and loan sales as part of our efforts to raise capital and increase earnings.

There can be no assurance our recapitalization plan will be achieved on the currently contemplated terms, or at all. If we are unable to raise capital, we plan to continue to shrink assets and implement other strategies to increase earnings. Failure to maintain capital sufficient to meet the higher capital requirements could result in further regulatory action, which could include the appointment of a conservator or receiver for the Bank. The Company or its creditors could also initiate bankruptcy proceedings.

### **Regulatory Capital**

The capital regulations applicable to the Bank, which are now administered by the OCC, include three separate minimum capital requirements. First, the tangible capital requirement mandates that the Bank's shareholder's equity, less intangible assets, be at least 1.50% of adjusted total assets as defined in the capital regulations. Second, the core capital requirement currently mandates that core capital (tangible capital plus certain qualifying intangible assets) be at least 4.00% of adjusted total assets as defined in the capital regulations. Third, the risk-based capital requirement presently mandates that core capital plus supplemental capital (as defined by the OCC) be at least 8.00% of risk-weighted assets as prescribed in the capital regulations. The capital regulations assign specific risk weightings to all assets and off-balance-sheet items for this purpose.

The Bank was in compliance with all capital requirements in effect at September 30, 2012, and met the generally applicable capital ratio standards necessary to be considered "well-capitalized" under the prompt corrective action



**Table of Contents**

regulations adopted pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991. However, in March 2010, the Company and the Bank were determined to be in troubled condition by the OTS and they consented to the issuance to them of cease and desist orders by the OTS effective September 9, 2010, which orders remain in effect and are now administered by the OCC. The cease and desist orders require the Bank to achieve and maintain higher levels of regulatory capital than normally required. Under the applicable regulations, the Bank is therefore precluded from being considered to be more than adequately capitalized until such special capital requirements are terminated and the Company and the Bank are no longer considered to be in troubled condition.

The Bank met the minimum capital requirements under the cease and desist order at September 30, 2012. However, it did not meet the minimum capital requirements under the cease and desist order at December 31, 2011. Actual and normally required capital amounts and ratios at September 30, 2012 and December 31, 2011, together with the higher capital requirements that the Bank is required to meet under the cease and desist order applicable to it, are presented below.

|                                               | Actual    |        | Required for<br>Capital Adequacy<br>Purposes |       | To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Regulations |        | Capital<br>Requirements<br>under Cease and<br>Desist Order |        |
|-----------------------------------------------|-----------|--------|----------------------------------------------|-------|----------------------------------------------------------------------------|--------|------------------------------------------------------------|--------|
|                                               | Amount    | Ratio  | Amount                                       | Ratio | Amount                                                                     | Ratios | Amount                                                     | Ratios |
| <b>(Dollars in thousands)</b>                 |           |        |                                              |       |                                                                            |        |                                                            |        |
| <b>September 30, 2012:</b>                    |           |        |                                              |       |                                                                            |        |                                                            |        |
| Tangible Capital to adjusted total assets     | \$ 33,200 | 8.65%  | \$ 5,759                                     | 1.50% | N/A                                                                        | N/A    | N/A                                                        | N/A    |
| Tier 1(Core) Capital to adjusted total assets | \$ 33,200 | 8.65%  | \$ 15,357                                    | 4.00% | \$ 19,196                                                                  | 5.00%  | \$ 30,713                                                  | 8.00%  |
| Tier 1(Core) Capital to risk weighted assets  | \$ 33,200 | 12.61% | N/A                                          | N/A   | \$ 15,803                                                                  | 6.00%  | N/A                                                        | N/A    |
| Total Capital to risk weighted assets         | \$ 36,661 | 13.92% | \$ 21,070                                    | 8.00% | \$ 26,338                                                                  | 10.00% | \$ 31,606                                                  | 12.00% |
| <b>December 31, 2011 :</b>                    |           |        |                                              |       |                                                                            |        |                                                            |        |
| Tangible Capital to adjusted total assets     | \$ 30,961 | 7.27%  | \$ 6,396                                     | 1.50% | N/A                                                                        | N/A    | N/A                                                        | N/A    |
| Tier 1(Core) Capital to adjusted total assets | \$ 30,961 | 7.27%  | \$ 17,055                                    | 4.00% | \$ 21,319                                                                  | 5.00%  | \$ 34,111                                                  | 8.00%  |
| Tier 1(Core) Capital to risk weighted assets  | \$ 30,961 | 10.31% | N/A                                          | N/A   | \$ 18,019                                                                  | 6.00%  | N/A                                                        | N/A    |
| Total Capital to risk weighted assets         | \$ 34,882 | 11.61% | \$ 24,026                                    | 8.00% | \$ 30,032                                                                  | 10.00% | \$ 36,039                                                  | 12.00% |

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not Applicable

## **Table of Contents**

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was performed under the supervision of the Company's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) as of September 30, 2012. Based on that evaluation and due to the material weaknesses identified below, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2012. The Company has implemented a number of changes to its policies and procedures during the quarter ended September 30, 2012 that are described below.

The Company's external auditors identified certain material misstatements in the course of their audit of our consolidated financial statements for the year ended December 31, 2011 and appropriate adjustments to the consolidated financial statements, resulting in an additional net loss of \$677 thousand, were made prior to their issuance. The adjustments included corrections of errors in the determination of specific allowances for impaired loans, errors in the calculation of the amortization of our investment in low-income housing projects and errors in the calculation of our income tax provision and the determination of the valuation allowance on our deferred tax assets.

Subsequent to the issuance of our 2011 consolidated financial statements and the filing of our Annual Report on Form 10-K on March 30, 2012, management became aware of certain additional errors in the preparation of our 2011 consolidated financial statements. The errors included failure in connection with preparation of our financial statements to obtain and take into account certain appraisals of the values of properties securing impaired loans that had been ordered and received by the Bank prior to the issuance date of our financial statements and failure to follow appropriate methods for calculating expected future payments on loans in connection with our discounted cash flow analysis for measuring impairment of loans deemed to be troubled debt restructurings. In addition, certain appraisals received after year-end 2011 indicated that impairment losses that had been determined using values based on broker provided opinions of value ( BPOs ) understated the losses inherent in those loans. We have determined that these additional errors also constituted material weaknesses in our system of internal controls over financial reporting.

Management, with the oversight of the Audit Committee, has taken actions to address the material weaknesses discovered in our internal control over financial reporting during the quarter ended September 30, 2012. These include implementing changes in our accounting policies and procedures to assure that appropriate methods are used in determining the values of collateral dependent loans and that all appraisals that have been ordered by the Bank to determine the values of properties securing our loans and REO are obtained and appropriately considered by accounting personnel in connection with preparation of our financial statements. In addition, we have discontinued our former practice of obtaining and relying upon BPOs in connection with valuing properties securing our loans. Management has consulted with subject matter experts when appropriate to determine appropriate loan valuation procedures and has implemented a second review procedure over financial reporting. The Audit Committee has also increased its oversight of the financial reporting process.

Except as described above, there has been no change in our internal control over financial reporting in our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION**

## Item 1. LEGAL PROCEEDINGS

***OTS Investigation***

In 2010, the OTS notified us that it had initiated a formal investigation of the activities of a former loan officer of the Bank whose employment was terminated in March 2010. In connection with the investigation, the OTS issued subpoenas to the chief lending officer and chief executive officer requesting documents relating to our former loan officer and loans he originated while employed by the Bank. The subpoenas also contemplate taking oral testimony from the officers. While the OTS did not inform us of the scope of its investigation, we believe the investigation includes, but may not be limited to, inquiry into whether documentation submitted in connection with loan applications for loans originated by the loan officer contained inaccurate or deliberately falsified information and whether the loan officer received unauthorized direct or indirect benefits from payments made by the borrowers on such loans to loan brokers or other persons associated with the lending process. All of the loans originated by the former loan officer have been reviewed by us and by the independent loan review firm we engaged to perform a general review of our loan portfolio pursuant to the C&D issued to us by the OTS. We have taken the results of these loan reviews into account, along with all other relevant information known to us, in determining the amounts of our loan loss provisions and the level of our loan loss reserves that we believe to be appropriate as of September 30, 2012.

## Item 1A. RISK FACTORS

Not Applicable

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

## Item 3. DEFAULTS UPON SENIOR SECURITIES

None

## Item 4. MINE SAFETY DISCLOSURES

Not Applicable

## Item 5. OTHER INFORMATION

None

## Item 6. EXHIBITS

## Exhibit

## Number\*

- |     |                                                                                                                                                                                                                                                                                 |
|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1 | Plan of Conversion, including Certificate of Incorporation and Bylaws of the Registrant and Federal Stock Charter and Bylaws of Broadway Federal (Exhibit 2.1 to Amendment No. 2 to Registration Statement on Form S-1, No. 33-96814, filed by Registrant on November 13, 1995) |
| 3.1 | Certificate of Incorporation of Registrant (contained in Exhibit 2.1)                                                                                                                                                                                                           |
| 3.2 | Bylaws of Registrant                                                                                                                                                                                                                                                            |
| 4.1 | Form of Common Stock Certificate (Exhibit 4.1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on September 12, 1995)                                                                                                                               |
| 4.2 |                                                                                                                                                                                                                                                                                 |

## Edgar Filing: BROADWAY FINANCIAL CORP \DE\ - Form 10-Q

Form of Series A Preferred Stock Certificate (Exhibit 4.2 to Amendment No. 1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on November 6, 1995)

- 4.3 Form of Certificate of Designation for Series A Preferred Stock (contained in Exhibit 2.1)
- 4.4 Form of Series B Preferred Stock Certificate (Exhibit 4.4 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2003)

**Table of Contents**

Exhibit

Number\*

|         |                                                                                                                                                                        |
|---------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.5     | Form of Certificate of Designation for Series B Preferred Stock (Exhibit 4.5 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2003)       |
| 4.6     | Form of Series C Preferred Stock Certificate (Exhibit 4.6 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)                          |
| 4.7     | Form of Certificate of Designation for Series C Preferred Stock (Exhibit 4.7 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)       |
| 4.8     | Form of Series D Preferred Stock Certificate (Exhibit 4.8 to Form 8-K filed by the Registrant on November 19, 2008)                                                    |
| 4.9     | Form of Certificate of Designation for Fixed Rate Cumulative Perpetual Preferred Stock Series D (Exhibit 3.3 to Form 8-K filed by the Registrant on November 19, 2008) |
| 4.11    | Form of Series E Preferred Stock Certificate (Exhibit 4.2 to Form 8-K filed by the Registrant on December 9, 2009)                                                     |
| 4.12    | Form of Certificate of Designation for Fixed Rate Cumulative Perpetual Preferred Stock Series E (Exhibit 4.1 to Form 8-K filed by the Registrant on December 9, 2009)  |
| 31.1    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                     |
| 31.2    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                     |
| 32.1    | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                      |
| 32.2    | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                      |
| 101.INS | XBRL Instance Document                                                                                                                                                 |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                                                                                                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                  |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document                                                                                                                  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                 |

\* Exhibits followed by a parenthetical reference are incorporated by reference herein from the document filed by the Registrant with the SEC described therein. Except as otherwise indicated, the SEC File No. for each incorporated document is 000-27464. Pursuant to SEC rules, these interactive data file exhibits shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act or Section 18 of the Exchange Act or otherwise subject to the liability of those sections. Pursuant to SEC rules, these interactive data file exhibits shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act or Section 18 of the Exchange Act or otherwise subject to the liability of those sections.

**Table of Contents**

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2012

By: /s/ Wayne-Kent A. Bradshaw  
Wayne-Kent A. Bradshaw  
Chief Executive Officer

Date: November 14, 2012

By: /s/ Samuel Sarpong  
Samuel Sarpong  
Chief Financial Officer