BROADWAY FINANCIAL CORP $\backslash D E \backslash$
Form 10-K
March 27, 2015

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BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY Index to Consolidated Financial Statements Years ended December 31. 2014 and 2013

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# UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION <br> Washington, DC 20549 <br> FORM 10-K 

(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014
o
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from $\qquad$ to
Commission file number 0-27464

## BROADWAY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

5055 Wilshire Boulevard Suite 500
90036
Los Angeles, California
(Address of principal executive offices)
(Zip Code)

95-4547287
(I.R.S. Employer Identification No.)
(323) 634-1700
(Registrant's Telephone Number, Including Area Code)
Securities registered under Section 12(b) of the Act:

Title of each class
Common Stock, par value $\$ 0.01$ per share Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section $15(\mathrm{~d})$ of the Act. Yes o No ý

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

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past 90 days. Yes ý No o

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

Large accelerated filer o Accelerated filer o

Non-accelerated filer o Smaller reporting company ý
(Do not check if a
smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $\$ 26,831,000$

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: As of March 11 , $2015,21,405,188$ shares of the Registrant's voting common stock and 7,671,520 shares of the Registrant's non-voting common stock were outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for its 2015 annual meeting of stockholders are incorporated by reference in Part III, Items 10 through 14 of this report.

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## Forward-Looking Statements

Certain statements herein, including without limitation, certain matters discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of this Form 10-K, are forward-looking statements, within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933, that reflect our current views with respect to future events and financial performance. Forward-looking statements typically include the words "anticipate," "believe," "estimate," "expect," "project," "plan," "forecast," "intend," and other similar expressions. These forward-looking statements are subject to risks and uncertainties, including those identified below, which could cause actual future results to differ materially from historical results or from those anticipated or implied by such statements. Readers should not place undue reliance on these forward-looking statements, which speak only as of their dates or, if no date is provided, then as of the date of this Form $10-\mathrm{K}$. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except to the extent required by law.

The following factors, among others, could cause future results to differ materially from historical results or from those anticipated by forward-looking statements included in this Form 10-K: (1) the level of demand for mortgage loans, which is affected by such external factors as general economic conditions, market interest rate levels, tax laws and the demographics of our lending markets; (2) the direction and magnitude of changes in interest rates and the relationship between market interest rates and the yield on our interest-earning assets and the cost of our interest-bearing liabilities; (3) the rate and amount of loan losses incurred and projected to be incurred by us, increases in the amounts of our nonperforming assets, the level of our loss reserves and management's judgments regarding the collectability of loans; (4) changes in the regulation of lending and deposit operations or other regulatory actions, whether industry wide or focused on our operations, including increases in capital requirements or directives to increase loan loss allowances or make other changes in our business operations; (5) actions undertaken by both current and potential new competitors; (6) the possibility of continuing adverse trends in property values or economic trends in the residential and commercial real estate markets in which we compete; (7) the effect of changes in economic conditions; (8) the effect of geopolitical uncertainties; (9) an inability to obtain and retain sufficient operating cash at our holding company level; and (10) other risks and uncertainties detailed in this Form 10-K, including those described in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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## PART I

## ITEM 1. BUSINESS

## General

Broadway Financial Corporation (the "Company") was incorporated under Delaware law in 1995 for the purpose of acquiring and holding all of the outstanding capital stock of Broadway Federal Savings and Loan Association ("Broadway Federal" or the "Bank") as part of the Bank's conversion from a federally chartered mutual savings association to a federally chartered stock savings bank. In connection with the conversion, the Bank's name was changed to Broadway Federal Bank, f.s.b. The conversion was completed, and the Bank became a wholly-owned subsidiary of the Company, in January 1996.

The Company is currently regulated by the Board of Governors of the Federal Reserve System ("FRB"). The Bank is currently regulated by the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured up to applicable limits by the FDIC. The Bank is also a member of the Federal Home Loan Bank ("FHLB") of San Francisco. See "Regulation" for further descriptions of the regulatory system to which the Company and the Bank are subject.

## Recent Transactions

On October 16, 2014, after receiving the requisite approvals from the trust that holds the Floating Rate Junior Subordinated Debentures (the "Debentures"), we completed a modification of the terms of our Debentures in which we extended the maturity of the Debentures to March 17, 2024 in exchange for payment of $\$ 900$ thousand of the principal of the Debentures at face value and payment of all accrued interest on the Debentures through the effective date of the extension.

On October 16, 2014, we concurrently consummated private placements of $8,829,549$ shares of common stock, including $6,973,320$ shares of non-voting common stock, for gross proceeds of $\$ 9.7$ million; made the required payments of principal and accrued interest on Debentures; executed a Supplemental Indenture for the Debentures that extended the maturity of the remaining $\$ 5.1$ million principal amount of the Debentures to March 17, 2024 and modified the payment terms thereof; and repaid the outstanding principal amount of the defaulted senior debt of $\$ 2.4$ million, together with all accrued interest thereon. The modified terms of the Debentures require quarterly payments of interest only for the next five years at the original rate of 3-Month LIBOR plus $2.54 \%$. Starting in June 2019, we will be required to make quarterly payments of equal amounts of principal, plus interest, until the Debentures are fully amortized on March 17, 2024. We have the right to call the Debentures for redemption at any time.

In August 2013, we completed a series of transactions to recapitalize the Company's balance sheet (the "Recapitalization"). The transactions that comprised the Recapitalization included: a private placement of new common stock; exchanges of common equity capital for preferred stock, associated accumulated dividends, and senior debt; and a modification of the terms of the remaining senior debt. Collectively, these transactions have strengthened the balance sheet of the Company and the Bank, significantly simplified the capital structure of the Company, reduced the Company's annual requirements for servicing debt and preferred stock by $\$ 1.2$ million, eliminated all cumulative dividends on preferred stock and improved the capital and liquidity of both the Company and the Bank. See "Capital Resources" for more information on these transactions and their effects.

## Regulatory Cease and Desist Orders

The Recapitalization described above was part of our overall plan to address operating losses and elevated levels of loan delinquencies and non-performing assets that the Bank experienced since the latter part of 2008. Also due to these factors and an assessment of our business and assets in the course of a regulatory examination of the Bank in March 2010, the Company and the Bank were designated as being "in troubled

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condition." The Company and the Bank agreed to the issuance of cease and desist orders to them in September 2010, which we refer to collectively as the "Orders." The Orders mandated improvements in enumerated aspects of our business operations and placed limitations on us, including prohibition of the payment of dividends by the Bank or the Company, or the incurrence of any new debt or payment on existing debt by the Company, in each case without prior regulatory approval. Effective October 30, 2013, the Order for the Bank was superseded by a Consent Order entered into by the Bank with the OCC (the "Consent Order"). The Consent Order requires the Bank to maintain a Tier 1 (Core) Capital to Adjusted Total Assets ratio of at least $9 \%$ and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least $13 \%$, both of which ratios are greater than the respective $4 \%$ and $8 \%$ levels for such ratios that are generally required under OCC regulations. The Bank's capital exceeded both of these higher capital ratio requirements at the end of each quarter of 2014 and 2013.

The Consent Order imposed new requirements on the Bank, including the following among others:

The Bank was required to create a Compliance Committee consisting of at least three independent directors to monitor compliance with the Consent Order.

The Board of the Bank was required to prepare and submit a strategic plan, and a capital plan that is consistent with the strategic plan, for approval by the OCC. The capital plan requirement includes requirements regarding targeted capital ratios and prior approval requirements for the payment of dividends, both as mentioned above.

The Bank must implement an enhanced set of lending, other business and corporate governance procedures, and must develop and adhere to a written commercial real estate loan concentration risk management program and a written program to reduce the level of assets considered doubtful, substandard or special mention. This latter program requirement includes requirements to monitor the levels of such assets on an on-going basis and to prepare and implement corrective actions as deemed necessary.

The Bank must also implement an independent on-going loan review system and adopt new policies with respect to maintaining an adequate allowance for loan and lease losses.

The Consent Order does not include certain explicit restrictions on the Bank that had been imposed by the prior Order issued to the Bank, such as the specific limitation on the Bank's ability to increase its assets during any quarter or certain limitations on employment agreements and compensation arrangements. The strategic plan required by the Consent Order, however, must include the Bank's plans regarding growth and compliance with regulatory loan concentration limits. The Bank will not be permitted to commence any new business strategies, or any variation from the strategic plan, prior to receiving an OCC statement of no supervisory objection thereto. The Bank submitted its revised strategic plan and capital plan to the OCC in August 2014, and has created a Compliance Committee and implemented other operating changes to conform to the provisions of the Consent Order. The Bank has received a written statement of non-objection from the OCC with respect to the capital plan, but not with respect to the strategic plan.

The Order issued to the Company, which has been administered by the FRB since July 2012, remains in effect. This Order imposes the following restrictions, among other limitations and requirements:

The Company may not declare or pay any dividends or make any other capital distributions without the prior written approval of the FRB.

The Company may not make any changes in its directors or senior executive officers without prior notice to and receipt of notice of non-objection from the FRB.

The Company is subject to limitations on severance and indemnification payments and on entering into or amending employment agreements and compensation arrangements, and on the payment of bonuses to directors and officers.

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The Company may not 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.

On October 9, 2014, the Company received acknowledgement from the FRB that the revised business plan and capital plan submitted to the FRB by the Company in August 2014 are acceptable and that the plans include all items required by the Order. Management believes the Company is in compliance with all aspects of the FRB order.

## Business Overview

We are headquartered in Los Angeles, California and our principal business is the operation of our wholly-owned subsidiary, Broadway Federal, which has two offices in Los Angeles and one in the nearby city of Inglewood, California. Broadway Federal's principal business consists of attracting deposits from the general public in the areas surrounding our branch offices and investing those deposits, together with funds generated from operations and borrowings, primarily in five or more unit ("multi-family") mortgage loans, commercial real estate loans and one-to-four unit ("single family") mortgage loans. In addition, we invest in securities issued by the federal government and federal agencies, residential mortgage-backed securities and other investments.

Our revenue is derived primarily from interest income on loans and investments. Our principal costs are interest expenses that we incur on deposits and borrowings, together with general and administrative expenses. Our earnings are significantly affected by general economic and competitive conditions, particularly monetary trends and conditions, including changes in market interest rates and the differences in market interests rates for the interest bearing deposits and borrowings that are our principal funding sources and the interest yielding assets in which we invest, which include loans, U.S. Treasury securities and other debt instruments, as well as government policies and actions of regulatory authorities.

## Lending Activities

## General

Our loan portfolio is comprised primarily of mortgage loans which are secured by multi-family properties, commercial real estate, including churches, and single family residential properties. The remainder of the loan portfolio consists of commercial business loans, construction loans, consumer loans and other loans. At December 31, 2014, our net loan portfolio totaled $\$ 276.6$ million, or $79 \%$ of total assets.

We emphasize the origination of adjustable-rate mortgage loans ("ARMs") and hybrid ARM loans (ARM loans having an initial fixed rate period) for our portfolio of loans held for investment. We originate these loans in order to maintain a high percentage of loans that are subject to more frequent repricing, thereby reducing our exposure to interest rate risk. At December 31, 2014, more than $99 \%$ of our mortgage loans had adjustable rates.

The types of loans that we originate are subject to federal laws and regulations. The interest rates that we charge on loans are affected by the demand for such loans, the supply of money available for lending purposes and the rates offered by competitors. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, including the Federal Reserve Board, and legislative tax policies.

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The following table sets forth the composition of our portfolio of loans held for investment by type, dollar amount and percentage of loan portfolio at the dates indicated.


| Plus: |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Premiums on loans purchased |  | 228 |  | 272 |  |  |  |  |  |  |
| Deferred loan costs, net |  | 1,333 |  | 901 |  | 557 |  | 473 |  | 889 |
| Less: |  |  |  |  |  |  |  |  |  |  |
| Unamortized discounts |  | 16 |  | 17 |  | 17 |  | 18 |  | 33 |
| Allowance for loan losses |  | 8,465 |  | 10,146 |  | 11,869 |  | 17,299 |  | 20,458 |
| Total loans held for investment | \$ | 276,643 | \$ | 247,847 | \$ | 251,723 | \$ | 322,770 |  | 382,616 |

## Multi-Family and Commercial Real Estate Lending

Our primary lending emphasis has been on the origination of multi-family loans and, to a lesser extent, commercial real estate loans. These loans are secured primarily by apartment buildings or by properties used for business purposes, such as small office buildings, health care facilities and retail facilities located in our primary market area. However, since 2012, we have primarily focused our efforts on the origination of multi-family loans.

Our multi-family loans amounted to $\$ 171.8$ million and $\$ 113.2$ million at December 31, 2014 and 2013, respectively. Multi-family loans represented $61 \%$ of our gross loan portfolio at December 31, 2014 compared to $44 \%$ of our gross loan portfolio at December 31, 2013. All of the multi-family residential mortgage loans outstanding at December 31, 2014 were ARMs. The vast majority of our multi-family loans amortize over 30 years. As of December 31, 2014, our single largest multi-family credit had an outstanding balance of $\$ 3.8$ million, was current and was secured by a 26 -unit apartment complex in Burbank, California. At December 31, 2014, the average balance of a loan in our multi-family portfolio was $\$ 579$ thousand.

Our commercial real estate loans amounted to $\$ 16.7$ million and $\$ 26.7$ million at December 31, 2014 and 2013, respectively. Commercial real estate loans represented $6 \%$ of our gross loan portfolio at December 31, 2014 compared to $10 \%$ of our gross loan portfolio at December 31, 2013. All except one commercial real estate loan outstanding at December 31, 2014 were ARMs. Most commercial real estate loans are originated with principal repayments on a 30 year amortization schedule, but are due in 15 years. As of December 31, 2014, our single largest commercial real estate credit had an outstanding principal balance of $\$ 1.7$ million, was current and was secured by a gasoline station located in Los Angeles, California. At December 31, 2014, the average balance of a loan in our commercial real estate portfolio was $\$ 484$ thousand.

The interest rates on multi-family and commercial ARM loans are based on a variety of indices, including the 6-Month London InterBank Offered Rate Index ("6-Month LIBOR"), the 1-Year Constant Maturity

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Treasury Index ("1-Yr CMT"), the 12-Month Treasury Average Index ("12-MTA"), the 11th District Cost of Funds Index ("COFI"), and the Wall Street Journal Prime Rate ("Prime Rate"). We currently offer loans with interest rates that adjust monthly, semi-annually, and annually. Borrowers are required to make monthly payments under the terms of such loans.

Loans secured by multi-family and commercial real properties are granted based on the income producing potential of the property and the financial strength of the borrower. The primary factors considered include, among other things, the net operating income of the mortgaged premises before debt service and depreciation, the debt service coverage ratio (the ratio of net operating income to required principal and interest payments, or debt service), and the ratio of the loan amount to the lower of the selling price or the appraised value of the collateral.

We seek to mitigate the risks associated with multi-family and commercial real estate loans by applying appropriate underwriting requirements, which include limitations on loan-to-value ratios and debt service coverage ratios. Under our underwriting policies, loan-to-value ratios on our multi-family and commercial real estate loans usually do not exceed $75 \%$ of the lower of the selling price or the appraised value of the underlying property. We also generally require minimum debt service coverage ratios of $115 \%$ for multi-family loans and $125 \%$ for commercial real estate loans. Properties securing multi-family and commercial real estate loans are appraised by management-approved independent appraisers. Title insurance is required on all loans.

Multi-family and commercial real estate loans are generally viewed as exposing the lender to a greater risk of loss than single family residential loans and typically involve higher loan principal amounts than loans secured by single family residential real estate. Because payments on loans secured by multi-family and commercial real properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or general economy. Adverse economic conditions in our primary lending market area could result in reduced cash flows on multi-family and commercial real estate loans, vacancies and reduced rental rates on such properties. We seek to reduce these risks by originating such loans on a selective basis and generally restrict such loans to our general market area. In 2008, we ceased out-of-state lending for all types of lending. As of December 31, 2014, our out-of-state loans totaled $\$ 3.9$ million and our single largest out-of-state credit had an outstanding principal balance of $\$ 684$ thousand, was current and was secured by a church building located in Chandler, Arizona.

Originating loans secured by church properties is a market niche in which we had been active since our inception. Adverse economic conditions have resulted in increased delinquencies and foreclosures on church loans. In addition to the risks encountered in other types of commercial lending, church lending is subject to additional risks not necessarily related to economic factors such as the stability, quality and popularity of church leadership. Because of these factors, we do not believe the current real estate market and economic environment support the origination of additional church loans. Additionally, the Order issued to Broadway Federal in September 2010 prohibited us from originating church loans. As a result, we suspended the origination of church loans in 2010. At December 31, 2014, the average balance of a loan in our church loan portfolio was $\$ 610$ thousand. Our church loans totaled $\$ 54.6$ million and $\$ 67.9$ million at December 31, 2014 and 2013, respectively. Church loans represented $19 \%$ of our gross loan portfolio at December 31, 2014 compared to $26 \%$ of our gross loan portfolio at December 31, 2013.

The underwriting standards for loans secured by church properties are different than for other commercial real estate properties in that the ratios used in evaluating the loans are based upon the level and history of church member contributions as a repayment source rather than income generated by rents or leases.

## Single Family Mortgage Lending

While we are primarily a multi-family and commercial real estate lender, we also originate ARMs and fixed rate loans secured by single family residences, including investor-owned properties, with maturities of

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up to 30 years. Substantially all of our single family loans are secured by properties located in Southern California, with most being in our primary market areas of Mid-City and South Los Angeles. Loan originations are generally obtained from our loan representatives or third party brokers, existing or past customers, and referrals from members of churches or other organizations in the local communities where we operate. Single family loans totaled $\$ 39.8$ million and $\$ 46.5$ million at December 31, 2014 and 2013, respectively. Of the $\$ 39.8$ million single family loans at December 31, 2014, $\$ 24.0$ million are secured by investor-owned properties. Single family loans represented $14 \%$ of our gross loan portfolio at December 31, 2014, compared to $18 \%$ at December 31, 2013. Of the single family residential mortgage loans outstanding at December 31, 2014, $2 \%$ were fixed rate loans and $98 \%$ were ARMs.

The interest rates for our single family ARMs are indexed to COFI, 6-Month LIBOR, 12-MTA and 1-Yr. CMT. We currently offer loans with interest rates that adjust monthly, semi-annually, and annually. Borrowers are required to make monthly payments under the terms of such loans.

We qualify our ARM borrowers based upon the fully indexed interest rate (LIBOR or other index plus an applicable margin, rounded to the nearest one-eighth of $1 \%$ ) provided by the terms of the loan. However, the initial rate paid by the borrower may be discounted to a rate we determine to adjust for market and other competitive factors. The ARMs that we offer have a lifetime adjustment limit that is set at the time the loan is approved. In addition, because of interest rate caps and floors, market rates may exceed or go below the respective maximum or minimum rates payable on our ARMs.

Mortgage loans that we originate generally include due-on-sale clauses, which provide us with the contractual right to declare the loan immediately due and payable in the event the borrower transfers ownership of the property.

## Commercial Lending

We originate non-real estate commercial loans that are secured by business assets, the franchise value of the business, if applicable, and individual assets such as deposit accounts, securities and automobiles. Most of these loans are originated with maturities of up to 5 years. Commercial loans amounted to $\$ 262$ thousand and $\$ 2.1$ million at December 31, 2014 and 2013, respectively. Commercial loans represented less than $1 \%$ of our gross loan portfolio at December 31, 2014 and 2013.

## Construction Lending

Construction loans totaled $\$ 387$ thousand and $\$ 424$ thousand at December 31, 2014 and 2013, respectively, representing less than $1 \%$ of our gross loan portfolio. We provide loans for construction of single family, multi-family and commercial real estate projects and for land development. We generally make construction and land loans at variable interest rates based upon the Prime Rate. Generally, we require a loan-to-value ratio not exceeding $75 \%$ to $80 \%$ on a purchase and a loan-to-cost ratio of $80 \%$ to $90 \%$ on a refinance of construction loans.

Construction loans involve risks that are different from those for completed project lending because we advance loan funds based upon the security and estimated value at completion of the project under construction. If the borrower defaults on the loan, we may have to advance additional funds to finance the project's completion before the project can be sold. Moreover, construction projects are affected by uncertainties inherent in estimating construction costs, potential delays in construction schedules, market demand and the accuracy of estimates of the value of the completed project considered in the loan approval process. In addition, construction projects can be risky as they transition to completion and lease-up. Tenants who may have been interested in leasing a unit or apartment may not be able to afford the space when the building is completed, or may fail to lease the space for other reasons such as more attractive terms offered by competing lessors, making it difficult for the building to generate enough cash flow for the owner to obtain permanent financing. Many construction project owners are faced with these

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risks given the current economic conditions. Consequently, we are not originating construction loans at this time.

## Loan Originations, Purchases and Sales

The following table sets forth loan originations, purchases, sales and principal repayments for the periods indicated:

|  | 2014 |  | $\begin{gathered} 2013 \\ \text { (In thousands) } \end{gathered}$ |  | 2012 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Gross loans (including loans held for sale): |  |  |  |  |  |  |
| Beginning balance | \$ | 256,837 | \$ | 282,421 | \$ | 353,271 |
| Loans originated: |  |  |  |  |  |  |
| Single family |  |  |  | 1,040 |  | 3,095 |
| Multi-family |  | 95,495 |  | 37,349 |  | 17,133 |
| Commercial real estate |  |  |  |  |  | 180 |
| Church |  |  |  |  |  |  |
| Construction |  |  |  |  |  |  |
| Commercial |  | 56 |  | 103 |  | 169 |
| Consumer |  |  |  |  |  | 2 |
| Total loans originated |  | 95,551 |  | 38,492 |  | 20,579 |
| Loans purchased: |  |  |  |  |  |  |
| Multi-family |  |  |  | 10,610 |  |  |
| Total loans purchased |  |  |  | 10,610 |  |  |
| Less: |  |  |  |  |  |  |
| Principal repayments |  | 42,900 |  | 51,853 |  | 70,965 |
| Sales of loans |  | 3,291 |  | 16,490 |  | 2,901 |
| Loan charge-offs |  | 693 |  | 3,302 |  | 7,412 |
| Transfer of loans to real estate owned |  | 2,648 |  | 3,041 |  | 10,151 |
| Ending balance (1) | \$ | 302,856 | \$ | 256,837 | \$ | 282,421 |

(1)

Includes loans receivable held for sale totaling $\$ 19.3$ million and $\$ 19.4$ million at December 31, 2014 and 2012, respectively, exclusive of $\$ 188$ thousand in deferred origination costs at December 31, 2014 and a $\$ 318$ thousand valuation allowance at December 31, 2012. We did not have any loans receivable held for sale at the end of 2013.

Loan originations are derived from various sources including our loan personnel, local mortgage brokers, advertising and referrals from customers. For all loans that we originate, upon receipt of a loan application from a prospective borrower, a credit report is ordered and certain other information is verified by an independent credit agency and, if necessary, additional financial information is requested. An appraisal of the real estate intended to secure the proposed loan is required, which appraisal is performed by an independent licensed or certified appraiser designated and approved by us. The Board of Directors (the "Board") annually reviews our appraisal policy. Management reviews annually the qualifications and performance of independent appraisers that we use.

It is our policy to obtain title insurance on all real estate loans. Borrowers must also obtain hazard insurance naming Broadway Federal as a loss payee prior to loan closing. If the original loan amount exceeds $80 \%$ on a sale or refinance of a first trust deed loan, we may require private mortgage insurance and the borrower is required to make payments to a mortgage impound account from which we make

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disbursements to pay private mortgage insurance premiums, property taxes and hazard and flood insurance as required.

The Board has authorized the following loan approval limits: if the total of the borrower's existing loans and the loan under consideration is $\$ 1,000,000$ or less, the new loan may be approved by a Senior Underwriter plus the Chief Executive Officer or Chief Credit Officer; if the total of the borrower's existing loans and the loan under consideration is from $\$ 1,000,001$ to $\$ 2,000,000$, the new loan must be approved by three Loan Committee members, one of whom must be Board-appointed non-management committee members; if the total of the borrower's existing loans and the loan under consideration is from $\$ 2,000,001$ to $\$ 3,000,000$, the new loan must be approved by four Loan Committee members, two of whom must be Board-appointed non-management committee members; and if the total of existing loans and the loan under consideration is more than $\$ 3,000,000$, the new loan must be approved by four Loan Committee members, three of whom must be non-management committee members appointed by the Board or by the Executive Committee of the Board. In addition, it is our practice that all loans approved be reported to the Loan Committee no later than the month following their approval, and be ratified by the Board.

From time to time, we purchase loans originated by other institutions based upon our investment needs and market opportunities. The determination to purchase specific loans or pools of loans is subject to our underwriting policies, which consider, among other factors, the financial condition of the borrower, the location of the underlying collateral property and the appraised value of the collateral property. We did not purchase any loans during the year ended December 31, 2014. During 2013, we purchased $\$ 10.6$ million of loans secured by multi-family residential units.

We originate loans for investment and for sale. Loan sales are made from the loans receivable held for sale portfolio and from loans originated during the period that are designated as held for sale. In 2013, the Bank reclassified $\$ 7.4$ million in performing loans that were previously held for sale to held for investment as management determined that such loans were no longer to be marketed for sale. During the fourth quarter of 2014 , in order to comply with regulatory loan concentration limits, we transferred $\$ 22.8$ million of loans receivable held for investment, primarily multi-family loans, to held for sale and have begun marketing these loans for sale. We sold $\$ 2.2$ million in performing multi-family loans and $\$ 1.1$ million in non-performing multi-family and church loans during the fourth quarter of 2014. At December 31, 2014, we had 25 loans totaling $\$ 19.5$ million in our held for sale portfolio.

We receive monthly loan servicing fees on loans sold and serviced for others, primarily insured financial institutions. Generally, we collect these fees by retaining a portion of the loan collections in an amount equal to an agreed percentage of the monthly loan installments, plus late charges and certain other fees paid by the borrowers. Loan servicing activities include monthly loan payment collection, monitoring of insurance and tax payment status, responses to borrower information requests and dealing with loan delinquencies and defaults, including conducting loan foreclosures. At December 31, 2014 and 2013, we were servicing $\$ 7.5$ million and $\$ 12.1$ million, respectively, of loans for others. The servicing rights associated with sold loans are recorded as assets based upon their fair values. At December 31, 2014 and 2013, we had $\$ 63$ thousand and $\$ 121$ thousand, respectively, in mortgage servicing rights.

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## Loan Maturity and Repricing

The following table sets forth the contractual maturities of loans in our portfolio of loans held for investment at December 31, 2014, and does not reflect the effect of prepayments or scheduled principal amortization.

|  | Single family |  | Multifamily |  | Commercial real estate |  | Church <br> (In thousa |  | $\begin{aligned} & \text { Construction } \\ & \text { ands) } \end{aligned}$ |  | CommercialConsumer |  |  |  | Gross <br> loans <br> receivable |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Amounts Due: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| One year or less | \$ | 6 | \$ |  | \$ |  | \$ | 206 | \$ |  | \$ | 59 | \$ | 9 | \$ | 280 |
| After one year: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| One year to five years |  | 304 |  | 627 |  | 1,803 |  | 411 |  | 387 |  |  |  |  |  | 3,532 |
| After five years |  | 39,482 |  | 171,165 |  | 14,919 |  | 53,982 |  |  |  | 203 |  |  |  | 279,751 |
| Total due after one year |  | 39,786 |  | 171,792 |  | 16,722 |  | 54,393 |  | 387 |  | 203 |  |  |  | 283,283 |
| Total | \$ | 39,792 | \$ | 171,792 | \$ | 16,722 | \$ | 54,599 | \$ | 387 | \$ | 262 | \$ | 9 |  | 283,563 |

The following table sets forth the dollar amount of gross loans receivable at December 31, 2014 that are contractually due after December 31, 2015, and whether such loans have fixed interest rates or adjustable interest rates.

|  | $\begin{array}{c}\text { Adjustable } \\ \text { (Dollars in thousands) }\end{array}$ | Fotal |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
|  | $\$$ | 39,060 | $\$$ | 726 | $\$$ |$) 39,786$

Some of our adjustable rate loans behave like fixed rate loans because the loans may still be in their initial fixed rate period or may be subject to interest rate floors.

## Asset Quality

## General

The underlying credit quality of our loan portfolio is dependent primarily on each borrower's ability to continue to make required loan payments and, in the event a borrower is unable to continue to do so, the value of the collateral securing the loan, if any. A borrower's ability to pay typically is dependent, in the case of single family residential loans and consumer loans, primarily on employment and other sources of income, and in the case of multi-family and commercial real estate loans, on the cash flow generated by the property, which in turn is impacted by general economic conditions. Other factors, such as unanticipated expenditures or changes in the financial markets, may also impact a borrower's ability to make loan payments. Collateral values, particularly real estate values, are also impacted by a variety of factors, including
general economic conditions, demographics, property maintenance and collection or foreclosure delays.

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We believe our underwriting and loan review procedures are appropriate for the various kinds of loans we originate or purchase; however, our results of operations and financial condition were adversely affected by weakness in the local economy and the resulting deterioration in the quality of our loan portfolio. Therefore, during the past three years, one of our most important operating objectives has been to improve asset quality. We have used a number of strategies to achieve this goal, including maintaining sound credit standards in loan originations, regular, recurring monitoring of the loan portfolio, including through independent third party loan reviews, and employing active collection and workout processes for delinquent or problem loans.

## Delinquencies

We perform a weekly review of all delinquent loans and loan delinquency reports are made monthly to the Internal Asset Review Committee of the Board of Directors. When a borrower fails to make a required payment on a loan, we take a number of steps to induce the borrower to cure the delinquency and restore the loan to current status. The procedures we follow with respect to delinquencies vary depending on the type of loan, the type of property securing the loan, and the period of delinquency. In the case of residential mortgage loans, we generally send the borrower a written notice of non-payment promptly after the loan becomes past due. In the event payment is not received promptly thereafter, additional letters are sent and telephone calls are made. If the loan is still not brought current and it becomes necessary for us to take legal action, we generally commence foreclosure proceedings on all real property securing the loan. In the case of commercial real estate loans, we generally contact the borrower by telephone and send a written notice of intent to foreclose upon expiration of the applicable grace period. Decisions not to commence foreclosure upon expiration of the notice of intent to foreclose for commercial real estate loans are made on a case-by-case basis. We may consider loan workout arrangements with these types of borrowers in certain circumstances.

The following table sets forth our loan delinquencies by type and amount at the dates indicated.

| December 31, 2014 | December 31, 2013 | December 31, 2012 |
| :---: | :---: | :---: |
| Loans delinquent | Loans delinquent | Loans delinquent |



| Delinquent loans to gross loans, <br> including loans receivable held for sale | $0.06 \%$ | $0.33 \%$ | $0.13 \%$ | $2.73 \%$ | $1.73 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- |

## Non-Performing Assets

Non-performing assets ("NPAs") include non-accrual loans and real estate owned through foreclosure or deed in lieu of foreclosure ("REO"). NPAs at December 31, 2014 decreased to $\$ 10.9$ million, or $3.12 \%$ of total assets, from $\$ 19.8$ million, or $5.95 \%$ of total assets, at December 31, 2013.

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Non-accrual loans decreased $\$ 8.8$ million to $\$ 8.9$ million at December 31, 2014, from $\$ 17.7$ million at December 31, 2013. These loans consist of delinquent loans that are 90 days or more past due and other loans, including troubled debt restructurings ("TDRs") that do not qualify for accrual status. As of December 31, 2014, $\$ 6.8$ million, or $77 \%$ of our non-accrual loans, were current in their payments, but were treated as non-accruals primarily because of deficiencies in non-payment matters related to the borrowers, such as lack of current financial information and an insufficient period of satisfactory performance. The $\$ 8.8$ million decrease in non-accrual loans was primarily due to payoffs of $\$ 4.4$ million, transfers to REO of $\$ 2.6$ million, sales of $\$ 1.1$ million, return to accrual status of $\$ 1.3$ million, repayments of $\$ 930$ thousand and charge-offs of $\$ 693$ thousand, which were partially offset by the placement of five church loans totaling $\$ 2.1$ million to non-accrual status.

REO decreased slightly during 2014 but remained essentially flat at $\$ 2.1$ million at the end of both 2014 and 2013. During 2014, one multi-family and three church loans totaling $\$ 2.6$ million were foreclosed and the properties securing the loans with total fair values of $\$ 3.3$ million became REO. As part of our efforts to reduce non-performing assets, seven REO properties were sold during 2014 for net proceeds of $\$ 2.9$ million and a net gain of $\$ 12$ thousand. At December 31, 2014, the Bank's REO consisted of two church buildings.

The following table provides information regarding our non-performing assets at the dates indicated.

|  | December 31, |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  | 2012 |  | 2011 |  | 2010 |  |
|  | (Dollars in thousands) |  |  |  |  |  |  |  |  |  |
| Non-accrual loans: |  |  |  |  |  |  |  |  |  |  |
| Single family | \$ | 736 | \$ | 1,441 | \$ | 8,145 | \$ | 7,974 | \$ | 6,227 |
| Multi-family |  | 1,618 |  | 2,985 |  | 4,268 |  | 5,946 |  | 2,250 |
| Commercial real estate |  | 1,174 |  | 1,391 |  | 7,090 |  | 5,787 |  | 10,321 |
| Church |  | 5,232 |  | 11,735 |  | 17,245 |  | 24,669 |  | 18,281 |
| Construction |  |  |  |  |  | 273 |  | 302 |  | 320 |
| Commercial |  | 102 |  | 150 |  | 69 |  | 70 |  | 3,768 |
| Consumer |  |  |  |  |  |  |  |  |  | 2,265 |
| Total non-accrual loans |  | 8,862 |  | 17,702 |  | 37,090 |  | 44,748 |  | 43,432 |
| Loans delinquent 90 days or more and still accruing |  |  |  |  |  |  |  |  |  |  |
| Real estate owned acquired through foreclosure |  | 2,082 |  | 2,084 |  | 8,163 |  | 6,699 |  | 3,036 |
| Total non-performing assets | \$ | 10,944 | \$ | 19,786 | \$ | 45,253 | \$ | 51,447 | \$ | 46,468 |


| Non-accrual loans as a percentage of gross loans, including loans <br> receivable held for sale | $2.93 \%$ | $6.89 \%$ | $13.13 \%$ | $12.66 \%$ | $10.02 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Non-performing assets as a percentage of total assets | $3.12 \%$ | $5.95 \%$ | $12.11 \%$ | $12.43 \%$ | $9.60 \%$ |

There were no accrual loans that were contractually past due by 90 days or more at December 31, 2014 or 2013. We had no commitments to lend additional funds to borrowers whose loans were on non-accrual status at December 31, 2014.

We discontinue accruing interest on loans when the loans become 90 days delinquent as to their payment due date (missed three payments). In addition, we reverse all previously accrued and uncollected interest through a charge to interest income. While loans are in non-accrual status, interest received on such loans is credited to principal, until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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We may agree to modify the contractual terms of a borrower's loan. In cases where such modifications represent a concession to a borrower experiencing financial difficulty, the modification is considered a TDR. Non-accrual loans modified in a TDR remain on non-accrual status until we determine that future collection of principal and interest is reasonably assured, which requires that the borrower demonstrate performance according to the restructured terms, generally for a period of at least six months. Loans modified in a TDR which are included in non-accrual loans totaled $\$ 5.5$ million at December 31, 2014 and $\$ 11.5$ million at December 31, 2013. Excluded from non-accrual loans are restructured loans that were not delinquent at the time of modification or loans that have complied with the terms of their restructured agreement for six months or such longer period as management deems appropriate for particular loans, and have therefore been returned to accruing status. Restructured accruing loans totaled $\$ 15.0$ million at December 31, 2014 and $\$ 15.8$ million at December 31, 2013.

During 2014, gross interest income that would have been recorded on non-accrual loans had they performed in accordance with their original terms, totaled $\$ 1.4$ million. Actual interest recognized on non-accrual loans and included in net income for the year 2014 was $\$ 260$ thousand.

We update our estimates of collateral value on loans when they become 90 days past due and to the extent the loans remain delinquent, every nine months thereafter. We obtain updated estimates of collateral value earlier than at 90 days past due for loans to borrowers who have filed for bankruptcy or for certain other loans when our Internal Asset Review Committee believes repayment of such loans may be dependent on the value of the underlying collateral. For single family mortgage loans, updated estimates of collateral value are obtained through appraisals and automated valuation models. For multi-family and commercial real estate properties, we estimate collateral value through appraisals or internal cash flow analyses when current financial information is available, coupled with, in most cases, an inspection of the property. Our policy is to make a charge against our allowance for loan losses, and correspondingly reduce the book value of a loan, to the extent that the collateral value of the property securing a loan is less than our recorded investment in the loan. See "Allowance for Loan Losses" for full discussion of the allowance for loan losses.

REO is real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at the lower of cost or fair value less estimated selling costs. Any excess of carrying value over fair value at the time of acquisition is charged to the allowance for loan losses at the time of foreclosure. Thereafter, we charge non-interest expense for the property maintenance and protection expenses incurred as a result of owning the property. Any decreases in the property's estimated fair value after foreclosure are recorded in a separate allowance for losses on REO. At December 31, 2014, we had $\$ 2.1$ million in REO, which consisted of two church buildings. We had $\$ 2.1$ million in REO at December 31, 2013, which consisted of one commercial building and four church buildings.

## Classification of Assets

Federal regulations and our internal policies require that we utilize an asset classification system as a means of monitoring and reporting problem and potential problem assets. We have incorporated asset classifications as a part of our credit monitoring system and thus classify potential problem assets as "Special Mention," and problem assets as "Substandard," "Doubtful" or "Loss" assets. An asset is considered "Special Mention" if the loan is current but there are some potential weaknesses that deserve management's close attention. An asset is considered "Substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "Doubtful" have all of the weaknesses inherent in those classified "Substandard" with the added characteristic that the weaknesses make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "Loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets

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which do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories, but that are considered to possess some weaknesses, are designated "Special Mention."

Our Internal Asset Review Department reviews and classifies our assets and independently reports the results of its reviews to the Internal Asset Review Committee of our Board of Directors monthly. The following table provides information regarding our criticized and classified assets at the dates indicated.

|  | Decemb <br> Number | r 3 | 2014 <br> incipal <br> lance <br> Dollars in | Decemb <br> Number <br> ousands) | r 3 | $2013$ <br> incipal <br> alance |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Special Mention | 26 | \$ | 6,612 | 37 | \$ | 25,455 |
| Substandard | 41 |  | 18,750 | 57 |  | 33,135 |
| Doubtful |  |  |  |  |  |  |
| Total | 67 | \$ | 25,362 | 94 | \$ | 58,590 |

Classified assets decreased $\$ 14.3$ million to $\$ 18.8$ million at December 31, 2014, from $\$ 33.1$ million at December 31, 2013, primarily due to $\$ 11.1$ million of payoffs, $\$ 2.9$ million of REO sales, $\$ 2.5$ million of classification upgrades, $\$ 1.1$ million of loan sales and $\$ 693$ thousand of charge-offs, which were partially offset by $\$ 4.0$ million of classification downgrades. Criticized assets decreased $\$ 18.9$ million to $\$ 6.6$ million at December 31, 2014, from $\$ 25.5$ million at December 31, 2013, primarily due to $\$ 14.1$ million of classification upgrades and $\$ 4.7$ million of payoffs.

## Allowance for Loan Losses

In originating loans, we recognize that losses will be experienced on loans and that the risk of loss may vary as a result of many factors, including the type of loan being made, the creditworthiness of the borrower, general economic conditions and, in the case of a secured loan, the quality of the collateral for the loan. We are required to maintain an adequate allowance for loan losses ("ALLL") in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Our ALLL represents our management's best estimate of the probable incurred credit losses in our loan portfolio as of the date of the consolidated financial statements. It is intended to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable, but not specifically identifiable. There can be no assurance, however, that actual losses incurred will not exceed the amount of management's estimates.

Our Internal Asset Review Department issues reports to the Board of Directors and continually reviews loan quality. This analysis includes a detailed review of the classification and categorization of problem loans, potential problem loans and loans to be charged off, an assessment of the overall quality and collectability of the portfolio, and concentration of credit risk. Management then evaluates the allowance, determines its appropriate level and the need for additional provisions, and presents its analysis to the Board of Directors which ultimately reviews management's recommendation and, if deemed appropriate, then approves such recommendation.

The ALLL is increased by provisions for loan losses which are charged to earnings and is decreased by the amount of charge-offs, net of recoveries. Provisions are recorded to increase the ALLL to the level deemed appropriate by management. The Bank utilizes an allowance methodology that considers a number of quantitative and qualitative factors, including the amount of non-performing loans, our loss experience, conditions in the real estate and housing markets, current economic conditions and trends, particularly levels of unemployment, and changes in the size of the loan portfolio.

The ALLL consists of specific and general components. The specific component relates to loans that are individually classified as impaired.

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A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties are considered TDRs and classified as impaired. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

If a loan is impaired, a portion of the allowance is allocated to the loan so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. TDRs are separately identified for impairment and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral less estimated selling costs. For TDRs that subsequently default, we determine the amount of any necessary additional charge-off based on internal analyses and appraisals of the underlying collateral securing these loans. At December 31, 2014, impaired loans totaled $\$ 23.8$ million and had an aggregate specific allowance allocation of $\$ 1.5$ million.

The general component of the ALLL covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. Each month, we prepare an analysis which categorizes the entire loan portfolio by certain risk characteristics such as loan type (single family, multi-family, commercial real estate, construction, commercial and industrial and consumer) and loan classification (pass, special mention, substandard and doubtful). With the use of a migration to loss analysis, we calculate our historical loss rate and assign estimated loss factors to the loan classification categories on the basis of our assessment of the potential risk inherent in each loan type. These factors are periodically reviewed for appropriateness giving consideration to our historical loss experience, levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

In addition to loss experience and environmental factors, we use qualitative analyses to determine the adequacy of our ALLL. This analysis includes ratio analysis to evaluate the overall measurement of the ALLL and comparison of peer group reserve percentages. The qualitative review is used to reassess the overall determination of the ALLL and to ensure that directional changes in the ALLL and the provision for loan losses are supported by relevant internal and external data.

Based on our evaluation of the housing and real estate markets and overall economy, including the unemployment rate, the levels and composition of our loan delinquencies and non-performing loans, our loss history and the size and composition of our loan portfolio, we determined that an ALLL of $\$ 8.5$ million, or $2.99 \%$ of loans held for investment was appropriate at December 31, 2014, compared to $\$ 10.1$ million, or $3.95 \%$ of loans held for investment at December 31, 2013.

A federally chartered savings association's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OCC. The OCC, in conjunction with the other federal banking agencies, provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate valuation allowances and guidance for banking agency examiners to use in determining the adequacy of valuation allowances. It is required that

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all institutions have effective systems and controls to identify, monitor and address asset quality problems, analyze all significant factors that affect the collectability of the portfolio in a reasonable manner and establish acceptable allowance evaluation processes that meet the objectives of the federal regulatory agencies. While we believe that the ALLL has been established and maintained at adequate levels, future adjustments may be necessary if economic or other conditions differ materially from the conditions on which we based our estimates at December 31, 2014. In addition, there can be no assurance that the OCC or other regulators, as a result of reviewing our loan portfolio and/or allowance, will not require us to materially increase our ALLL, thereby affecting our financial condition and earnings.

The following table sets forth our allocation of the ALLL to the various categories of loans held for investment and the percentage of loans in each category to total loans at the dates indicated.


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The following table sets forth the activity in our ALLL related to our loans held for investment for the years indicated.

|  | 2014 |  | 2013 |  | 2012 |  | 2011 |  | 2010 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (Dollars in thousands) |  |  |  |  |  |  |  |  |  |
| Allowance balance at beginning of year | \$ | 10,146 | \$ | 11,869 | \$ | 17,299 | \$ | 20,458 | \$ | 20,460 |
| Charge-offs: |  |  |  |  |  |  |  |  |  |  |
| Single family |  | (133) |  | (220) |  | $(5,138)$ |  | (896) |  | $(1,999)$ |
| Multi-family |  |  |  | (661) |  | (104) |  | (438) |  | (21) |
| Commercial real estate |  | (8) |  | $(1,180)$ |  | (544) |  | $(4,544)$ |  | (210) |
| Church |  | (533) |  | (770) |  | $(1,354)$ |  | $(3,787)$ |  |  |
| Commercial |  | (19) |  |  |  |  |  | $(3,916)$ |  | $(1,738)$ |
| Consumer |  |  |  |  |  |  |  | $(1,843)$ |  | (504) |
| Total charge-offs |  | (693) |  | $(2,831)$ |  | $(7,140)$ |  | $(15,424)$ |  | $(4,472)$ |
| Recoveries: |  |  |  |  |  |  |  |  |  |  |
| Single family |  | 2 |  | 300 |  | 25 |  |  |  |  |
| Multi-family |  |  |  |  |  | 1 |  | 2 |  |  |
| Commercial real estate |  |  |  | 116 |  | 60 |  | 15 |  |  |
| Church |  | 859 |  | 25 |  | 15 |  | 4 |  |  |
| Commercial |  | 1,083 |  | 253 |  | 412 |  | 67 |  |  |
| Consumer |  |  |  |  |  | 7 |  | 24 |  | 5 |
| Total recoveries |  | 1,944 |  | 694 |  | 520 |  | 112 |  | 5 |
| Provision (recapture) charged to earnings |  | $(2,932)$ |  | 414 |  | 1,190 |  | 12,153 |  | 4,465 |
| Allowance balance at end of year | \$ | 8,465 | \$ | 10,146 | \$ | 11,869 | \$ | 17,299 | \$ | 20,458 |


| Net charge-offs (recoveries) to average loans, excluding loans |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| receivable held for sale | $(0.46 \%)$ | $0.84 \%$ | $2.12 \%$ | $4.04 \%$ | $1.01 \%$ |
| ALLL as a percentage of gross loans, excluding loans receivable    <br> held for sale    | $9.99 \%$ | $3.95 \%$ | $4.51 \%$ | $5.09 \%$ | $5.08 \%$ |
| ALLL as a percentage of total non-accrual loans | $95.52 \%$ | $57.32 \%$ | $32.00 \%$ | $38.66 \%$ | $47.10 \%$ |
| ALLL as a percentage of total non-performing assets | $77.35 \%$ | $51.28 \%$ | $26.23 \%$ | $33.62 \%$ | $44.03 \%$ |

## Investment Activities

The main objectives of our investment strategy are to provide a source of liquidity for deposit outflows, repayment of borrowings and loan fundings, and to generate a favorable return on investments without incurring undue interest rate or credit risk. Subject to various restrictions, our investment policy generally permits investments in money market instruments such as Federal Funds Sold, certificates of deposit of insured banks and savings institutions, direct obligations of the U. S. Treasury, Federal Agency securities, Agency-issued securities and mortgage-backed securities, mutual funds, municipal obligations, corporate bonds and marketable equity securities. Mortgage-backed securities consist principally of FNMA, FHLMC and GNMA securities backed by 30 -year amortizing hybrid ARM loans, structured with fixed interest rates for periods of three to seven years, after which time the loans convert to one-year or six-month adjustable rate mortgage loans. At December 31, 2014, our securities portfolio, consisting primarily of residential mortgage-backed securities and one U.S federal agency bond, totaled $\$ 17.1$ million, or $5 \%$ of total assets.

We classify investments as held-to-maturity or available-for-sale at the date of purchase based on our assessment of our internal liquidity requirements. Securities in the held-to-maturity category consist of securities purchased for long-term investment in order to enhance our ongoing stream of net interest income. Securities deemed held-to-maturity are classified as such because we have both the intent and

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ability to hold these securities to maturity. Securities purchased to meet investment-related objectives such as liquidity management or interest rate risk and which may be sold as necessary to implement management strategies, are designated as available-for-sale at the time of purchase. Held-to-maturity securities are reported at cost, adjusted for amortization of premium and accretion of discount. Available-for-sale securities are reported at fair value. We currently have no securities classified as held-to-maturity securities.

There were no sales of securities during 2014 and 2013. During 2014, we purchased $\$ 8.6$ million of residential mortgage-backed securities and $\$ 1.9$ million of U.S. government and federal agency securities and classified these securities as available-for-sale.

The table below sets forth certain information regarding the carrying amount, weighted average yields and contractual maturities of our securities as of December 31, 2014. The table reflects stated final maturities and does not reflect scheduled principal payments or expected payoffs.


At December 31, 2014, the mortgage- backed securities in our portfolio have an estimated remaining life of 4.3 years.

## Sources of Funds

## General

Deposits are our primary source of funds for supporting our lending and other investment activities and general business purposes. In addition to deposits, we obtain funds from the amortization and prepayment of loans and residential mortgage-backed securities, sales of loans and residential mortgage-backed securities, advances from the FHLB, and cash flows generated by operations.

## Deposits

We offer a variety of deposit accounts featuring a range of interest rates and terms. Our deposits principally consist of passbook savings accounts, checking accounts, NOW accounts, money market accounts, and fixed-term certificates of deposit. The maturities of term certificates generally range from one month to five years. We accept deposits from customers within our market area based primarily on posted rates, but from time to time we will negotiate the rate based on the amount of the deposit. We primarily rely on customer service and long-standing customer relationships to attract and retain deposits. We seek to maintain and increase our retail "core" deposit relationships, consisting of passbook accounts, checking accounts and money market accounts; these deposit accounts tend to be a stable funding source and are available at a lower cost than term deposits. However, market interest rates, including rates offered by competing financial institutions, the availability of other investment alternatives, and general economic conditions significantly affect our ability to attract and retain deposits.

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We also open deposit accounts for customers throughout the United States through the Internet and deposit listing services. Deposits from the Internet and deposit listing services totaled $\$ 8.1$ million and $\$ 55.0$ million, respectively, at December 31, 2014 compared to $\$ 13.4$ million and $\$ 37.1$ million, respectively, at December 31, 2013. During 2011 and prior, we generated term certificates through the use of brokers and Internet-based network deposits. We also participated in a deposit program called Certificate of Deposit Account Registry Service ("CDARS"), which is a deposit placement service that allows us to place our customers' funds in FDIC-insured certificates of deposit at other banks and, at the same time, receive an equal sum of funds from the customers of other banks in the CDARS Network. The Bank no longer accepts brokered deposits or CDARS deposits. At December 31, 2014, we had no brokered deposits or deposits obtained through CDARS.

Pursuant to the Order, we can no longer accept brokered deposits. Under applicable regulations, the term "brokered deposits" includes both deposits acquired through third party brokers and deposits that an institution solicits by offering rates of interest that are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in the institution's normal market area.

The following table sets forth the maturity periods of our certificates of deposit in amounts of $\$ 100$ thousand or more at December 31, 2014.

|  | December 31, 2014 <br> Weighted <br> Amount <br> (Dollars in thousands) |  |  |
| :--- | :---: | :---: | :---: |
| Certificates maturing: | $\$ 12,331$ | $0.88 \%$ |  |
| Less than three months | 44,362 | $0.95 \%$ |  |
| Three to six months | 20,687 | $0.95 \%$ |  |
| Six to twelve months | 26,031 | $1.59 \%$ |  |
| Over twelve months |  |  |  |
| Total | $\$$ | 103,411 | $1.11 \%$ |

The following table sets forth the distribution of our average deposits for the years indicated and the weighted average interest rates during the year for each category of deposits presented.

|  | Average balance |  | For the Year Ended December 31, |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | 2014 <br> Percent of total | Weighted average rate |  | Average balance <br> (Dolla | 2013 <br> Percent <br> of total <br> s in thousa | Weighted average rate nds) |  | Average balance | $2012$ <br> Percent of total | Weighted average rate |
| Money market deposits | \$ | 15,669 | 7.33\% | 0.38\% | \$ | 16,585 | 7.12\% | 0.39\% | \$ | 18,980 | 6.90\% | 0.43\% |
| Passbook deposits |  | 36,752 | 17.20\% | 0.32\% |  | 37,376 | 16.05\% | 0.32\% |  | 36,530 | 13.28\% | 0.32\% |
| NOW and other demand deposits |  | 30,684 | 14.36\% | 0.08\% |  | 33,600 | 14.42\% | 0.08\% |  | 37,814 | 13.74\% | 0.07\% |
| Certificates of deposit |  | 130,593 | 61.11\% | 1.16\% |  | 145,366 | 62.41\% | 1.40\% |  | 181,849 | 66.08\% | 1.66\% |
| Total | \$ | 213,698 | 100.00\% | 0.81\% | \$ | 232,927 | 100.00\% | 0.96\% | \$ | 275,173 | 100.00\% | 1.18\% |

## Borrowings

We utilize short-term and long-term advances from the FHLB of San Francisco as an alternative to retail deposits as a funding source for asset growth. FHLB advances are generally secured by mortgage loans and mortgage-backed securities. Such advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the FHLB will advance to member institutions fluctuates from time to time in accordance with the policies of the FHLB. At December 31, 2014, we had $\$ 86.0$ million in FHLB advances and had the ability to borrow up to an additional $\$ 14.0$ million based on available and pledged collateral.

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The following table sets forth information concerning our FHLB advances at or for the periods indicated.

|  | At or For the Year Ended |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | $\mathbf{2 0 1 4}$ | $\mathbf{2 0 1 3}$ |  | $\mathbf{2 0 1 2}$ |
| (Dollars in thousands) |  |  |  |  |

On March 17, 2004, we issued $\$ 6.0$ million of the Debentures in a private placement to a trust that was capitalized to purchase subordinated debt and preferred stock of multiple community banks. Interest on the Debentures 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 $2.78 \%$ at December 31, 2014. We stopped paying interest on the Debentures in September 2010 and were not able to pay the principal or accrued interest on the Debentures at their March 17, 2014 maturity date. Pursuant to the Order, we are not permitted to make payments on our debt without prior notice to and receipt of written notice of non-objection from the FRB. In addition, under the terms of the Debentures, we are not allowed to make payments on the Debentures if we are in default on any of our senior indebtedness, which term includes the senior debt described below.

In January 2014, we submitted a proposal to the trustee for the trust that holds the Debentures to extend the maturity of the Debentures to March 17, 2024 in return for paying all accrued interest on the Debentures and $\$ 900$ thousand, or $15 \%$, of the principal amount of the Debentures at face value, subject to satisfaction of certain conditions. We subsequently satisfied the conditions of this proposal, including, among others, obtaining the requisite Debenture holder approval of the final terms of the transaction, obtaining written confirmation of non-objection to the proposal and related transactions from the FRB, securing approval by our senior lender, and raising at least $\$ 6.0$ million of additional common equity capital. We completed the modification of the Debentures and related transactions on October 16, 2014, on which date we concurrently consummated private placements of $8,829,549$ shares of common stock, including $6,973,320$ shares of non-voting common stock, for gross proceeds of $\$ 9.7$ million, made the required payments of principal and accrued interest on Debentures, executed a Supplemental Indenture for the Debentures that extended the maturity of the Debentures to March 17, 2024, and modified the payment terms of the remaining $\$ 5.1$ million principal amount thereof and repaid the outstanding defaulted senior debt of $\$ 2.4$ million, together with all accrued interest thereon. The modified terms of the Debentures require quarterly payments of interest only for the next five years at the original rate of 3-Month LIBOR plus $2.54 \%$. Starting in June 2019, we will be required to make quarterly payments of equal amounts of principal, plus interest, until the Debentures are fully amortized on March 17, 2024. The Debentures may be called for redemption at any time by the Company.

As part of the Recapitalization that we completed on August 22, 2013, we exchanged shares of common stock in settlement of $\$ 2.6$ million of the principal amount of our $\$ 5.0$ million senior debt. The modified terms for the remaining $\$ 2.4$ million principal amount of the senior debt included, among others items, an extension of the maturity of the senior debt to February 22, 2019, an adjustment to the formula for calculating the interest rate, and a change to the payment schedule for the senior debt. We obtained approval from the FRB and paid the interest payments due in November 2013, February 2014, May 2014 and August 2014, and in October 2014, we repaid the full amount of the outstanding senior debt and related accrued interest using proceeds from the private placement described above. As a result, the Company's only debt outstanding at December 31, 2014 is the $\$ 5.1$ million of remaining principal amount of the Debentures.

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## Market Area and Competition

Broadway Federal is a community-oriented savings institution offering a variety of financial services to meet the needs of the communities it serves. Our retail banking network includes full service banking offices, automated teller machines and internet banking capabilities. We have two banking offices in Los Angeles and one banking office located in the nearby City of Inglewood.

The Los Angeles metropolitan area is a highly competitive market in which we face substantial competition in making loans and in attracting deposits. Although our offices are primarily located in low to moderate income minority areas that have historically been under-served by other financial institutions, we are facing increasing competition for deposits and residential mortgage lending in our immediate market areas, including direct competition from mortgage banking companies, commercial banks and savings and loan associations. Most of these financial institutions are significantly larger than we are and have greater financial resources, and many have a regional, statewide or national presence.

## Personnel

At December 31, 2014, we had 71 employees, which consisted of 66 full-time and 5 part-time employees. We believe that we have good relations with our employees and none are represented by a collective bargaining group.

## Regulation

## General

Broadway Federal is regulated by the OCC, as its primary federal regulator, and by the FDIC, as its deposit insurer. We, as a savings and loan holding company, are regulated, examined and supervised by the FRB. The Bank is subject to regulation and examination by the OCC with respect to most of its business activities, including, among other things, capital standards, general investment authority, deposit taking and borrowing authority, mergers and other business combination transactions, establishment of branch offices, and permitted subsidiary investments and activities. The OCC has primary enforcement responsibility over federally chartered savings associations and has substantial discretion to impose enforcement action on an institution that fails to comply with applicable regulatory requirements, including with respect to capital requirements. In addition, the FDIC has the authority to recommend to the OCC that enforcement action be taken with respect to a particular federally chartered savings association and, if action is not taken by the OCC, the FDIC has authority to take such action under certain circumstances.

Broadway Federal is a member of the FHLB System. The Bank is also subject to the regulations of the FRB concerning reserves required to be maintained against deposits, transactions with affiliates, Truth in Lending and other consumer protection requirements and certain other matters. The Company is also required to file certain reports with and otherwise comply with the rules and regulations of the Securities and Exchange Commission ("SEC") under the federal securities laws.

Changes in the applicable laws or regulations of the OCC, the FDIC, the FRB or other regulatory authorities could have a material adverse impact on the Bank and the Company, their operations, and the value of the Company's debt and equity securities. The Company and its stock are also subject to rules and regulations issued by The NASDAQ Stock Market, LLC ("NASDAQ"), the principal exchange on which the Company's common stock is traded. Changes in the rules and regulations published by NASDAQ, or failure of the Company to conform to NASDAQ's rules and regulations, could have an adverse impact on the Company and the value of the Company's equity securities.

The following paragraphs summarize certain of the laws and regulations that apply to us and to the Bank. These descriptions of statutes and regulations and their possible effects do not purport to be complete

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descriptions of all of the provisions of those statutes and regulations and their possible effects on us, nor do they purport to identify every statute and regulation that may apply to us.

## Regulatory Orders

As a result of significant deficiencies in the Company's and the Bank's operations noted in a regulatory examination in early 2010, the Company and the Bank were declared to be in "troubled condition" and agreed to the issuance of the Orders by the OCC's regulatory predecessor 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 of Directors.

Effective October 30, 2013, the Order for the Bank was superseded by a Consent Order entered into by the Bank with the OCC. As part of the Consent Order, the Bank is required to attain, and thereafter maintain, a Tier 1 (Core) Capital to Adjusted Total Assets ratio of at least $9 \%$ and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least $13 \%$, both of which ratios are greater than the respective $4 \%$ and $8 \%$ levels for such ratios that are generally required under OCC regulations. The Bank is in compliance with these ratios as of December 31, 2014.

Additionally, the Consent Order issued by the OCC imposes certain other requirements on the Bank. These requirements include the following, among others:

The Bank must create a Compliance Committee consisting of at least three independent Directors to monitor compliance with the Consent Order, among other matters.

The Board of the Bank must prepare and submit a Strategic Plan and a Capital Plan that is consistent with the Strategic Plan. The Capital Plan requirement includes requirements regarding targeted capital ratios and prior approval requirements for the payment of dividends.

The Bank must implement an enhanced set of business operational and corporate governance processes, as well as create a commercial real estate concentration risk management program and a written program to reduce the level of assets considered doubtful, substandard or special mention. This latter program requirement includes requirements to monitor the levels of such assets on an ongoing basis and to prepare and implement corrective actions as deemed necessary.

The Bank must also implement an independent ongoing loan review system and adopt new policies with respect to maintaining an adequate ALLL.

The Consent Order does not include certain restrictions on the Bank that had been imposed by the Order, such as the specific limitation on the Bank's ability to increase its assets during any quarter or certain limitations on employment agreements and compensation arrangements. The strategic plan required by the Consent Order, however, must include the Bank's plans regarding growth. The Bank will not be permitted to commence any new business strategies, or any variation from the strategic plan, prior to receiving an OCC statement of no supervisory objection thereto.

In November 2013, management submitted updated policies and procedures to the OCC with respect to determining and maintaining an appropriate level of ALLL. In December 2013, the Board established a Consent Order Compliance Committee to oversee the operating changes implemented by the Bank to comply with the Consent Order. In January 2014, the Bank submitted its strategic plan and capital plan to the OCC for approval and in August 2014 submitted revised forms of the plans. In November 2014, the Bank received a written statement of non-objection from the OCC with respect to the capital plan, but not with respect to the strategic plan requirements.

We believe that the Bank is in compliance with all aspects of the Consent Order, other than the Consent Order's strategic plan and loan concentration risk management plan requirements.

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We are amending the strategic plan to incorporate the provisions of a revised loan concentration risk management plan that is intended to reduce the Bank's concentration limit established for multi-family loans.

Based on the Bank's current capital levels, we anticipate that the Bank will find it necessary to sell more multi-family loans than previously planned in order to comply with the reduced concentration limit for multi-family loans set by the OCC, which we expect will result in lower levels of net interest income and higher gains on the sale of loans. During the fourth quarter of 2014, in order to comply with regulatory loan concentration limits, we transferred $\$ 22.8$ million of loans receivable held for investment, primarily consisting of multi-family loans, to held for sale, and have begun marketing these loans for sale. Also, during the fourth quarter of 2014, we sold $\$ 2.2$ million in performing multi-family loans and $\$ 1.1$ million in non-performing multi-family and church loans. At December 31, 2014, we had 25 loans totaling $\$ 19.5$ million in our held for sale portfolio.

Management believes that the cost of implementing further reductions in criticized assets will not have a material impact on the Bank's financial condition. The costs of complying with other aspects of the Consent Order are included in several expense categories in the Bank's results of operations and are difficult to separately quantify.

Management believes that the Order issued to the Company, which has been administered by the FRB since July 2012, remains in effect. This Order imposes limitations and restrictions on several aspects of our business, including the following:

The Company may not declare or pay any dividends or make any other capital distributions without the prior written approval of the FRB.

The Company may not make any changes in its directors or senior executive officers without prior notice to and receipt of notice of non-objection from the FRB.

The Company is subject to limitations on severance and indemnification payments and on entering into or amending employment agreements and compensation arrangements, and on the payment of bonuses to Bank directors and officers.

The Company may not 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.

## Recent Regulatory Reform Legislation

In July 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which is intended to address perceived weaknesses in the U.S. financial regulatory system and prevent future economic and financial crises.

As a result of the Dodd-Frank Act, on July 21, 2011, the Office of Thrift Supervision ("OTS"), our previous primary federal regulator, was merged into the OCC, which has taken over the regulation of all federal savings associations. The FRB acquired the OTS' authority over all savings and loan holding companies.

The Dodd-Frank Act requires the federal banking agencies to establish consolidated risk-based and leverage capital requirements for insured depository institutions, depository institution holding companies and certain non-bank financial companies. These requirements must be no less than those to which federally insured depository institutions have been previously subject. As a result, by July 2015, the Company will become subject to consolidated capital requirements to which it had not been previously subject to.

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The Dodd-Frank Act also includes provisions changing the assessment base for federal deposit insurance from the amount of insured deposits to the amount of consolidated assets less tangible capital, and making permanent the $\$ 250,000$ limit for federal deposit insurance that had initially been established on a temporary basis in reaction to the economic downturn in 2008

The Dodd-Frank Act also provided for the creation of the Bureau of Consumer Financial Protection ("CFPB"). The CFPB has authority to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB's supervisory authority does not generally extend to insured depository institutions having less than $\$ 10$ billion in assets.

The Dodd-Frank Act also includes other provisions, subject to further rulemaking by the federal bank regulatory agencies, which may affect our future operations. We will not be able to determine the impact of these provisions until final rules are promulgated to implement these provisions and other regulatory guidance is provided interpreting these provisions.

## Capital Requirements

The current OCC capital regulations require federally chartered savings associations to meet three minimum capital ratios: (1) tangible capital must equal at least $1.5 \%$ of total adjusted assets; (2) "core capital" must generally equal at least $4.0 \%$ of total adjusted assets (this ratio is referred to as the "leverage ratio"); and (3) risk-based capital must equal at least $8.0 \%$ of total risk-based assets. In assessing an institution's capital adequacy, the OCC takes into consideration not only these numeric factors, but also qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions to the extent it considers necessary.

A savings institution is required to maintain "tangible capital" in an amount not less than $1.5 \%$ of adjusted total assets. "Tangible capital" is defined for this purpose to mean core capital less any intangible assets, plus mortgage servicing rights, subject to certain limitations.

The core capital requirement generally requires a savings institution to maintain a ratio of core capital to adjusted total assets of not less than $4 \%$ ( $3 \%$ for certain highly evaluated institutions not experiencing or anticipating significant growth). "Core capital" includes common stockholders' equity (including retained earnings), non-cumulative perpetual preferred stock and any related surplus and minority interests in the equity accounts of fully consolidated subsidiaries. The amount of an institution's core capital is, in general, calculated in accordance GAAP, with certain exceptions. Intangible assets must be deducted from core capital, with certain exceptions and limitations for mortgage servicing rights and certain other intangibles, which may be included on a limited basis.

The risk-based capital requirements provide that the capital ratios applicable to various classes of assets are to be adjusted to reflect the degree of risk associated with such assets. In addition, the asset base for computing a savings institution's capital requirement includes off-balance sheet items, including assets sold with recourse. Generally, the OCC capital regulations require savings institutions to maintain "total capital" equal to $8.00 \%$ of risk-weighted assets. "Total capital" for these purposes consists of core capital and supplementary capital. Supplementary capital includes, among other things, certain types of preferred stock and subordinated debt, subject to limitations, and, subject to certain limitations, loan and lease general valuation allowances. At December 31, 2014 and 2013, the general valuation allowance included in our supplementary capital was $\$ 3.1$ million and $\$ 2.8$ million, respectively. A savings institution's supplementary capital may be used to satisfy the risk-based capital requirement only to the extent of that institution's core capital.

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At December 31, 2014 and 2013, Broadway Federal exceeded each of these capital requirements as shown in the following table, and the higher capital requirements under the Consent Order:

|  | As of December 31, |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  |  |  |  | 2013 |  |  |  |  |  |  |
|  | Tangible Capital |  | Tier 1 <br> (Core) <br> Capital |  | Total  <br> Risk-  <br> Based Tangible <br> Capital Capital <br> $\quad$ (In thousands)  |  |  |  | Tier 1 (Core) Capital |  | Total <br> Risk- <br> Based <br> Capital |  |
| Equity capital-Broadway Federal (1) | \$ | 39,779 | \$ | 39,779 | \$ | 39,779 | \$ | 34,047 | \$ | 34,047 | \$ | 34,047 |
| Additional supplementary capital: |  |  |  |  |  |  |  |  |  |  |  |  |
| General valuation allowance |  |  |  |  |  | 3,097 |  |  |  |  |  | 2,810 |
| Disallowed mortgage servicing rights assets |  | (6) |  | (6) |  | (6) |  | (12) |  | (12) |  | (12) |
| Disallowed deferred tax assets |  |  |  |  |  |  |  |  |  |  |  |  |
| Regulatory capital balances |  | 39,773 |  | 39,773 |  | 42,870 |  | 34,035 |  | 34,035 |  | 36,845 |
| Minimum requirement |  | 5,260 |  | 14,028 |  | 19,390 |  | 4,986 |  | 13,295 |  | 17,394 |
| Excess over minimum requirement | \$ | 34,513 | \$ | 25,745 | \$ | 23,480 | \$ | 29,049 | \$ | 20,740 | \$ | 19,451 |

(1)

Excluding accumulated other comprehensive income, net of taxes.

In July 2013, the OCC and the other federal bank regulatory agencies issued a final rule to revise their capital requirements and their method for calculating risk-weighted assets. Among other things, the final rule establishes a new common equity Tier 1 minimum capital requirement ( $4.5 \%$ of risk-weighted assets), increases the minimum Tier 1 capital to risk-weighted assets requirement (from $4 \%$ to $6 \%$ of risk-weighted assets) and assigns a higher risk weight $(150 \%)$ to exposures that are more than 90 days past due and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of $2.5 \%$ of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule became effective for us on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1,2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective. We have estimated our capital ratios as of December 31 , 2014 using the new standards and the pro forma ratios already exceed the requirements of the fully implemented capital rules.

## Prompt Corrective Action

Federal banking laws requires the relevant federal banking regulator, which is the OCC in the case of the Bank, to take "prompt corrective action" with respect to a depository institution if that institution does not meet certain capital adequacy standards, including requiring the prompt submission of an acceptable capital restoration plan. Generally, a capital restoration plan must be filed with the OCC within 45 days after the date an association receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," and the plan must be guaranteed by any parent holding company. In addition, various mandatory supervisory actions become immediately applicable to the institution, including restrictions on growth of assets and other forms of expansion. Under the OCC regulations, generally, an institution is treated as well capitalized if its Total Risk-based capital ratio is $10 \%$ or greater, its Tier 1 Risk-based capital ratio is $6 \%$ or greater and its Leverage ratio is $5 \%$ or greater, and it is not subject to any order or directive by the OCC to meet a specific capital level. The United States banking agencies' new capital regulations described above also change the capital standards set forth in these capital category definitions to refer to the new capital ratios requirements and generally increase the levels of capital required to be considered "well capitalized" under those regulations. Effective January 1, 2015,

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the minimum capital ratios required to be considered "well capitalized" will be: (1) total capital to risk-weighted assets of $10 \%$, (2) Tier 1 capital to risk-weighted assets of $8 \%$, (3) Common Equity Tier 1 capital to risk-weighted assets of $6.5 \%$ and (4) a leverage ratio (Tier 1 capital to average assets) of $5 \%$.

The Bank was in compliance with all capital requirements in effect at December 31, 2014 and 2013, and met the generally applicable capital ratio standards necessary to be considered "well-capitalized" under the current prompt corrective action 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 of the Orders by the OTS effective September 9, 2010. On October 30, 2013, the Bank entered into a Consent Order with the OCC that superseded the cease and desist order applicable to the Bank. The Consent Order raised the Bank's minimum capital requirements to $9 \%$ for Tier 1 (Core) Capital and $13 \%$ for Total Capital to risk weighted assets. The Bank met the minimum capital requirements under the Consent Order at December 31, 2014 and 2013. Actual required capital amounts and ratios at December 31, 2014 and December 31, 2013, together with the higher capital requirements that the Bank is required to meet under the Consent Order applicable to it, are presented below.
$\left.\begin{array}{lllllllllll} & & & & \begin{array}{c}\text { Capital } \\ \text { Requirements } \\ \text { under Consent } \\ \text { Order }\end{array} \\ \text { Required for } \\ \text { Capital Adequacy } \\ \text { Purposes }\end{array}\right)$

|  | Actual |  |  | Required for Capital Adequacy Purposes |  |  | Capital Requirements under Consent Order |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amount |  | Ratio | Amount Ratio(Dollars in thousands) |  |  |  | Ratio |
| December 31, 2013: |  |  |  |  |  |  |  |  |
| Tangible Capital to adjusted total assets | \$ | 34,035 | 10.24\% | \$ | 4,986 | 1.50\% |  | N/A |
| Tier 1(Core) Capital to adjusted total assets | \$ | 34,035 | 10.24\% | \$ | 13,295 | 4.00\% | \$ | 9.00\% |
| Tier 1(Core) Capital to risk weighted assets | \$ | 34,035 | 15.65\% |  | N/A | N/A |  | N/A |
| Total Capital to risk weighted assets | \$ | 36,846 | 16.95\% | \$ | 17,394 | 8.00\% | \$ | 13.00\% |

## Deposit Insurance

The FDIC is an independent federal agency that insures deposits of federally insured banks and savings institutions, up to prescribed statutory limits for each depositor. Pursuant to the Dodd-Frank Act, the maximum deposit insurance amount has been permanently increased to $\$ 250,000$.

The FDIC charges an annual assessment for the insurance of deposits based on the risk a particular institution poses to the FDIC's Deposit Insurance Fund ("DIF"). The amount of the assessment paid by an institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. The FDIC's overall premium rate structure is subject to change from time to time to reflect its actual and anticipated loss experience. The financial crisis that began in 2008 resulted in substantially higher levels of bank failures than had occurred in the immediately preceding years. These failures dramatically increased the resolution costs of the FDIC and substantially reduced the available amount of the DIF.

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As required by the Dodd-Frank Act, the FDIC adopted a new Deposit Insurance Fund restoration plan which became effective on January 1, 2011. Among other things, the plan increased the minimum designated deposit insurance reserve ratio from $1.15 \%$ to $1.35 \%$ of insured deposits, which must be reached by September 30, 2020, and provides that in setting the assessments necessary to meet the new requirement, the FDIC is required to offset the effect of this provision on insured depository institutions with total consolidated assets of less than $\$ 10$ billion, so that more of the cost of raising the reserve ratio will be borne by the institutions with more than $\$ 10$ billion in assets.

On February 7, 2011, as mandated by the Dodd-Frank Act, the FDIC approved a final rule that redefines the deposit insurance premium assessment base to be an institution's average consolidated total assets minus average tangible equity and adopts a new assessment rate schedule, as well as alternative rate schedules that become effective when the reserve ratio reaches certain levels.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank's depositors.

## Guidance on Commercial Real Estate Lending

In October 2009, the federal banking agencies adopted a policy statement supporting workouts of commercial real estate ("CRE") loans, which is referred to as the CRE Policy Statement. The CRE Policy Statement provides guidance for examiners, and for financial institutions that are working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties. The CRE Policy Statement details risk-management practices for loan workouts that support prudent and pragmatic credit and business decision-making within the framework of financial accuracy, transparency, and timely loss recognition. The CRE Policy Statement states that financial institutions that implement prudent loan workout arrangements after performing comprehensive reviews of borrowers' financial conditions will not be subject to criticism for engaging in these efforts, even if the restructured loans have weaknesses that result in adverse credit classifications. In addition, performing loans, including those renewed or restructured on reasonable modified terms, made to creditworthy borrowers, will not be subject to adverse classification solely because the value of the underlying collateral declined. The CRE Policy Statement reiterates existing guidance that examiners are expected to take a balanced approach in assessing institutions' risk-management practices for loan workout activities.

## Loans to One Borrower

Savings institutions generally are subject to the lending limits that are applicable to national banks. With certain limited exceptions, the maximum amount that a savings institution may lend to any borrower (including certain related persons or entities of such borrower) is an amount equal to $15 \%$ of the savings institution's unimpaired capital and unimpaired surplus, or $\$ 7.2$ million for Broadway Federal at December 31, 2014, plus an additional $10 \%$ for loans fully secured by readily marketable collateral. Real estate is not included within the definition of "readily marketable collateral" for this purpose. We are in compliance with the limits that are applicable to loans to any one borrower. At December 31, 2014, our largest aggregate amount of loans to one borrower totaled $\$ 4.4$ million. Both of the loans for the largest borrower were performing in accordance with their terms and the borrower had no affiliation with Broadway Federal.

## Community Reinvestment Act

The Community Reinvestment Act ("CRA") requires each savings institution, as well as other lenders, to identify the communities served by the institution's offices and to identify the types of credit the institution is prepared to extend within those communities. The CRA also requires the OCC to assess the

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performance of the institution in meeting the credit needs of its communities as part of its examination of a savings institution, and to take such assessments into consideration in reviewing applications for mergers, acquisitions and other transactions. An unsatisfactory CRA rating may be the basis for denying an application. Community groups have successfully protested applications on CRA grounds. In connection with the assessment of a savings institution's CRA performance, the OCC assigns ratings of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." The Bank's "outstanding" rating was reaffirmed in its most recent CRA examination.

## Qualified Thrift Lender Test

The Home Owners Loan Act ("HOLA") requires savings institutions to meet a Qualified Thrift Lender ("QTL") test. Under the QTL test, a savings association is required to maintain at least $65 \%$ of its portfolio assets (total assets less (1) specified liquid assets up to $20 \%$ of total assets, (2) intangibles, including goodwill, and (3) the value of property used to conduct business) in certain "qualified thrift investments" on a monthly basis during at least 9 out of every 12 months. Qualified thrift investments include, in general, loans, securities and other investments that are related to housing, shares of stock issued by any Federal Home Loan Bank, loans for educational purposes, loans to small businesses, loans made through credit cards or credit card accounts and certain other permitted thrift investments. A savings institution's failure to remain a QTL may result in required conversion of the institution to a bank charter, which would change the savings association's permitted business activities in various respects, or operation under certain restrictions including limitations on new investments and activities, and the imposition of the restrictions on branching and the payment of dividends that apply to national banks. At December 31, 2014, the Bank was in compliance with the QTL test requirements.

## The USA Patriot Act, Bank Secrecy Act ('BSA'"), and Anti-Money Laundering ("AML") Requirements

The USA PATRIOT Act was enacted after September 11, 2001 to provide the federal government with powers to prevent, detect, and prosecute terrorism and international money laundering, and has resulted in promulgation of several regulations that have a direct impact on savings associations. Financial institutions must have a number of programs in place to comply with this law, including: (i) a program to manage BSA/AML risk; (ii) a customer identification program designed to determine the true identity of customers, document and verify the information, and determine whether the customer appears on any federal government list of known or suspected terrorists or terrorist organizations; and (iii) a program for monitoring for the timely detection and reporting of suspicious activity and reportable transactions. Failure to comply with these requirements may result in regulatory action, including the issuance of cease and desist orders, impositions of civil money penalties and adverse changes in an institution's regulatory ratings, which could adversely affect its ability to obtain regulatory approvals for business combinations or other desired business objectives.

## Privacy Protection

Broadway Federal is subject to OCC regulations implementing the privacy protection provisions of federal law. These regulations require Broadway Federal to disclose its privacy policy, including identifying with whom it shares "nonpublic personal information," to customers at the time of establishing the customer relationship and annually thereafter. The regulations also require Broadway Federal to provide its customers with initial and annual notices that accurately reflect its privacy policies and practices. In addition, to the extent its sharing of such information is not covered by an exception, Broadway Federal is required to provide its customers with the ability to "opt-out" of having Broadway Federal share their nonpublic personal information with unaffiliated third parties.

Broadway Federal is also subject to regulatory guidelines establishing standards for safeguarding customer information. The guidelines describe the agencies' expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and

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physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of such records and protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

## Savings and Loan Holding Company Regulation

As a savings and loan holding company, we are subject to certain restrictions with respect to our activities and investments. Among other things, we are generally prohibited, either directly or indirectly, from acquiring more than $5 \%$ of the voting shares of any savings association or savings and loan holding company that is not a subsidiary of the Company.

The Change in Bank Control Act prohibits a person or group of persons acting in concert from acquiring control of a savings and loan holding company unless the FRB has been given 60 days prior written notice of such proposed acquisition and within that time period the FRB has not issued a notice disapproving the proposed acquisition or extending for up to another 30 days the period during which such a disapproval may be issued. The term "control" is defined for this purpose to include ownership or control of, or holding with power to vote, $25 \%$ or more of any class of a savings and loan holding company's voting securities. Under a rebuttable presumption contained in the regulations of the FRB, ownership or control of, or holding with power to vote, $10 \%$ or more of any class of voting securities of a savings and loan holding company having a class of securities registered under Section 12 of the Exchange Act would also be deemed to constitute the acquisition of control. In addition, any company would be required to obtain the approval of the FRB under the Home Owners' Loan Act before acquiring control of a savings and loan holding company. For this purpose, a company is deemed to have control of a savings and loan holding company if the company owns, controls, holds with power to vote, or holds proxies representing, $25 \%$ or more of any class of voting shares of the savings and loan holding company or controls in any manner the election of a majority of the holding company's directors, and may also be deemed to acquire control of a savings and loan holding company based on a consideration of all relevant facts by the FRB.

## Restrictions on Dividends and Other Capital Distributions

In general, the prompt corrective action regulations prohibit an OCC-regulated savings association from declaring any dividends, making any other capital distribution, or paying a management fee to a controlling person, such as its parent holding company, if, following the distribution or payment, the institution would be within any of the three undercapitalized categories. In addition to the prompt corrective action restriction on paying dividends, OCC regulations limit certain "capital distributions" by savings associations. Capital distributions are defined to include, among other things, dividends and payments for stock repurchases and payments of cash to stockholders in mergers.

Under the OCC capital distribution regulations, a savings association that is a subsidiary of a savings and loan holding company must notify the OCC at least 30 days prior to the declaration of any capital distribution by its savings association subsidiary. The 30 -day period provides the OCC an opportunity to object to the proposed dividend if it believes that the dividend would not be advisable.

An application to the OCC for approval to pay a dividend is required if: (a) the total of all capital distributions made during that calendar year (including the proposed distribution) exceeds the sum of the institution's year-to-date net income and its retained income for the preceding two years; (b) the institution is not entitled under OCC regulations to "expedited treatment" (which is generally available to institutions the OCC regards as well run and adequately capitalized); (c) the institution would not be at least "adequately capitalized" following the proposed capital distribution; or (d) the distribution would violate an applicable statute, regulation, agreement, or condition imposed on the institution by the OCC.

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As previously noted, the Order issued by the OTS, which is now administered by the FRB with respect to the Company, prohibits the Company from declaring or paying any dividends or making any other capital distributions without the prior written approval of the FRB. The Bank's ability to pay dividends to the Company is also subject to restrictions imposed by the Consent Order and the restriction that the Bank is not permitted to pay dividends to the Company if its regulatory capital would be reduced below the amount required for the liquidation account established in connection with the conversion of the Bank from the mutual to the stock form of organization.

See Item 5, "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" and Note 15 of the Notes to Consolidated Financial Statements for a further description of dividend and other capital distribution limitations to which the Company and the Bank are subject.

## Tax Matters

## Federal Income Taxes

We report our income on a calendar year basis using the accrual method of accounting and are subject to federal income taxation in the same manner as other corporations with certain exceptions, including particularly the Bank's tax reserve for bad debts. The Bank has qualified under provisions of the Internal Revenue Code (the "Code") that in the past allowed qualifying savings institutions to establish reserves for bad debts, and to make additions to such reserves, using certain preferential methodologies.

## California Taxes

As a savings and loan holding company filing California franchise tax returns on a combined basis with its subsidiaries, the Company is subject to California franchise tax at the rate applicable to "financial corporations." The applicable statutory tax rate is $10.84 \%$.

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## ITEM 2. PROPERTIES

We conduct our business through three branch offices and a corporate office. Our loan service operation is also conducted from one of our branch offices. Our administrative and corporate operations are conducted from our corporate facility located at 5055 Wilshire Boulevard, Suite 500, Los Angeles. There are no mortgages, material liens or encumbrances against any of our owned properties. We believe that all of the properties are adequately covered by insurance, and that our facilities are adequate to meet our present needs.

As of December 31, 2014, the net book value of our investment in premises, equipment and fixtures, excluding computer equipment, was $\$ 2.3$ million. Total occupancy expense, inclusive of rental payments and furniture and equipment expense, for the year ended December 31, 2014 was $\$ 1.2$ million. Total annual rental expense (exclusive of operating charges and real property taxes) was approximately $\$ 478$ thousand during 2014.

| Location | Leased or Owned | Original Date Leased or Acquired | Date of Lease Expiration |
| :---: | :---: | :---: | :---: |
| Administrative/Loan Origination Center: |  |  |  |
| 5055 Wilshire Blvd, Suite 500 <br> Los Angeles, CA | Leased | 2013 | April 2021 |
| Branch Offices: |  |  |  |
| 5055 Wilshire Blvd, Suite 100 <br> Los Angeles, CA | Leased | 2013 | April 2021 |
| 170 N. Market Street <br> Inglewood, CA <br> (Branch Office/Loan Service Center) | Owned | 1996 |  |
| 4001 South Figueroa Street Los Angeles, CA | Owned | 1996 |  |

## ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of business, we are defendants in various litigation matters from time to time. In our opinion, the disposition of any of the litigation matters currently pending against us would not have a material adverse effect on our financial position, results of operations or cash flows.

## ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Capital Market under the symbol "BYFC." The table below shows the high and low sale prices for our common stock during the periods indicated.

| 2014 | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| :---: | :---: | :---: | :---: | :---: |
| High | $\$ 1.39$ | $\$ 1.80$ | $\$ 2.95$ | $\$ 1.75$ |
| Low | $\$ 0.96$ | $\$ 1.08$ | $\$ 1.31$ | $\$ 1.25$ |
|  |  |  |  |  |
| $\mathbf{2 0 1 3}$ | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| High | $\$ 1.49$ | $\$ 0.95$ | $\$ 1.50$ | $\$ 1.31$ |
| Low | $\$ 0.66$ | $\$ 0.68$ | $\$ 0.52$ | $\$ 0.83$ |

The closing sale price for our common stock on the Nasdaq Capital Market on March 11, 2015 was $\$ 1.30$ per share. As of March 11, 2015, we had 346 stockholders of record and 21,405,188 shares of voting common stock outstanding. At that date, we also had 7,671,520 shares of non-voting common stock outstanding. Our non-voting common stock is not listed for trading on the Nasdaq Capital Market, but is convertible into our voting common stock in connection with certain sale or other transfer transactions.

In general, we may pay dividends out of funds legally available for that purpose at such times as our Board of Directors determines that dividend payments are appropriate, after considering our net income, capital requirements, financial condition, alternate investment options, prevailing economic conditions, industry practices and other factors deemed to be relevant at the time. We suspended our prior policy of paying regular cash dividends in May 2010 in order to retain capital for reinvestment in the Company's business. In addition, pursuant to the Order issued to the Company in September 2010, the Company may not declare or pay dividends or make other capital distributions, which term includes repurchases of stock, without receipt of prior written notice of non-objection to such capital distribution from the FRB.

Our financial ability to pay permitted dividends is primarily dependent upon receipt of dividends from Broadway Federal. Broadway Federal is subject to certain requirements which may limit its ability to pay dividends or make other capital distributions. See Item 1 "Business Regulation" and Note 15 of the Notes to Consolidated Financial Statements in Item 8 "Financial Statements and Supplementary Data" for an explanation of the impact of regulatory capital requirements on Broadway Federal's ability to pay dividends.

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## Equity Compensation Plan Information

The following table provides information about the Company's common stock that may be issued under equity compensation plans as of December 31, 2014.

| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights <br> (a) | Weighted average exercise price of outstanding options, warrants and rights <br> (b) |  | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) <br> (c) |
| :---: | :---: | :---: | :---: | :---: |
| Equity compensation plans approved by security holders: 2008 Long Term Incentive Plan | 93,750 | \$ | 4.94 | 1,906,250 |
| Equity compensation plans not approved by security holders: None |  |  |  |  |
| Total | 93,750 | \$ | 4.94 | 1,906,250 |

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion 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 other factors that have affected our reported results of operations and financial condition or may affect our future results or financial condition. Our MD\&A should be read in conjunction with the Consolidated Financial Statements and related Notes included in Item 8, "Financial Statements and Supplementary Data," of this Annual Report on Form 10-K.

## Overview

In order to generate growth in net interest income, we continued to rebuild our loan portfolio by originating $\$ 95.5$ million in multi-family loans during the year ended December 31, 2014. In addition, during 2014 we further reduced our non-performing assets, primarily through payoffs and sales of loans and sales of REOs. As part of the reductions in non-performing assets over the past three years, we lowered the Bank's delinquent loans to less than $\$ 2.5$ million at the end of 2014; consequently, we can now focus on removing the regulatory orders that are currently in effect and growing interest earning assets and income for the future.

During the fourth quarter of 2014, we completed the modification of our Debentures, paid off the Company's senior debt and issued additional common stock in private placement transactions. As part of the private placement of common stock, which we consummated on October 16, 2014, the Company sold $8,829,549$ shares of common stock, including $6,973,320$ shares of new non-voting common stock, for gross proceeds of $\$ 9.7$ million. The proceeds were used to make payments of $\$ 900$ thousand of principal amount and approximately $\$ 805$ thousand of accrued interest on the Debentures, and to repay the outstanding defaulted senior bank debt of $\$ 2.4$ million, together with all accrued interest thereon, in full. The modified terms of the Debentures require quarterly payments of interest only for the next five years at the original rate of 3-Month LIBOR plus $2.54 \%$. Starting in June 2019, we will be required to make quarterly payments of equal amounts of principal, plus interest, until the Debentures are fully amortized on March 17, 2024. The Debentures may be called for redemption at any time by the Company.

Total assets increased by $\$ 18.4$ million during the year ended December 31, 2014, primarily reflecting an increase of $\$ 28.8$ million in our net loan portfolio, an increase of $\$ 19.5$ million in loans receivable held for

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sale, an increase of $\$ 7.7$ million in our securities portfolio and a decrease of $\$ 37.4$ million in cash and cash equivalents as we invested our excess liquidity into mortgage-backed securities and multi-family loans in order to improve the yield on interest-earning assets and grow total interest income.

Consistent with the increase in assets during 2014, we increased our total deposits by $\$ 3.5$ million and FHLB advances by $\$ 6.5$ million. During 2014, senior debt and related deferred restructuring gain decreased by $\$ 2.9$ million and the balance of the Company's Debentures decreased by $\$ 900$ thousand as a result of the transactions described above.

We recorded net income of $\$ 2.5$ million for the year ended December 31, 2014, compared to a net loss of $\$ 301$ thousand for the year ended December 31, 2013. Results during 2014 included a recapture of loan losses of $\$ 2.9$ million whereas in 2013, we recorded a $\$ 414$ thousand provision for loan losses. During 2014, we generated higher net interest income before recapture of loan losses, lower non-interest income and higher non-interest expense compared to 2013. Results for 2013 included a gain of $\$ 1.2$ million on the restructuring of the Company's senior debt as part of the Recapitalization, as compared to a gain of $\$ 365$ thousand in 2014; these gains were included in non-interest income.

## Comparison of Operating Results for the Years Ended December 31, 2014 and 2013

## General

Our most significant source of income is net interest income, which is the difference between our interest income and our interest expense. Generally, interest income is generated from our loans and investments (interest-earning assets) and interest expense is incurred from deposits and borrowings (interest-bearing liabilities). Typically, our results of operations are also affected by our provision for (recapture of) loan losses, non-interest income generated from service charges and fees on loan and deposit accounts, gains or losses on the sale of loans, REO and securities, non-interest expenses and income taxes.

## Net Income (Loss)

For the year ended December 31, 2014, we recorded net income of $\$ 2.5$ million, or $\$ 0.11$ earnings per diluted common share, compared to a net loss of $\$ 301$ thousand, or $\$ 0.13$ loss per diluted common share. The increase in net income was primarily due to a recapture of loan losses of $\$ 2.9$ million during the year ended December 31, 2014, compared to a provision for loan losses of $\$ 414$ thousand during the year ended December 31, 2013.

In addition, during 2014 we increased net interest income before recapture of loan losses by $\$ 759$ thousand, or $7 \%$, over the amount generated in 2013, and received a grant of $\$ 200$ thousand from the U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund. Offsetting most of these increases was a decrease in the amount of recognized gain on debt restructuring that was included in non-interest income; in 2013 we reported $\$ 1.2$ million of gain on the restructuring of the Company's senior debt as part of the Recapitalization but only recognized $\$ 365$ thousand of such gain in 2014. Also, we incurred higher non-interest expense during 2014 compared to 2013.

## Net Interest Income

For the year ended December 31, 2014, net interest income before recapture of loan losses totaled $\$ 11.9$ million, up $\$ 759$ thousand, or $7 \%$, from $\$ 11.1$ million of net interest income before provision for loan losses for the same period a year ago. The increase of $\$ 759$ thousand in net interest income primarily resulted from a decrease of $\$ 513$ thousand in interest expense on deposits, a decrease of $\$ 483$ thousand in interest expense on borrowings and an increase of $\$ 100$ thousand in interest income on securities and other sources, which were partially offset by a decrease of $\$ 337$ thousand in interest income on loans.

Total interest income decreased $\$ 237$ thousand, or $1 \%$, to $\$ 15.7$ million for the year 2014 from $\$ 16.0$ million for the year 2013. The decrease in interest income was primarily due to a $\$ 337$ thousand

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decrease in interest income on loans. The average yield on loans decreased 47 basis points from $5.90 \%$ for the year 2013 to $5.43 \%$ for the year 2014, which decreased interest income by $\$ 1.3$ million. The lower average loan yield on loans for the year 2014 was primarily due to payoffs of loans which carried a higher average yield than the average yield on total loans, and lower yields on loan originations as a result of the low interest rate environment. The decrease in loan yield was partially offset by an increase of $\$ 920$ thousand in interest income resulting from an increase of $\$ 16.2$ million in the average balance of loans receivable. During 2014, we originated $\$ 95.5$ million in multi-family loans with an average interest rate of $3.70 \%$. To supplement interest income, we purchased $\$ 8.6$ million of mortgaged-backed securities and $\$ 1.9$ million of U.S. government and federal agency securities in March 2014 with an average yield of $2.23 \%$, which resulted in a net increase in interest income attributable to securities of $\$ 64$ thousand.

Total interest expense decreased $\$ 996$ thousand, or $20 \%$, to $\$ 3.9$ million for the year 2014 from $\$ 4.9$ million for the year 2013. Interest expense on deposits decreased $\$ 513$ thousand primarily due to a 15 basis point decrease in the cost of deposits and a $\$ 19.2$ million decline in the average balance of deposits. The decreases in the average balance and average cost of deposits reflected the maturities of certificates of deposit bearing higher rates. Interest expense on FHLB advances decreased $\$ 105$ thousand primarily due to a decrease of 16 basis points in the average cost of FHLB advances. The decrease in the average cost of FHLB advances was due to the maturities of $\$ 10.5$ million of FHLB advances with an average interest rate of $3.54 \%$ which were replaced by $\$ 17.0$ million of new advances with an average interest rate of $\$ 1.26 \%$.

No interest expense was recognized on the senior debt during 2014, compared to $\$ 355$ thousand of interest expense recognized during 2013. As a result of the modification of the senior debt in August 2013, which was accounted for as a troubled debt restructuring, the carrying amount of the senior debt exceeded total expected cash payments due under the modified agreement, including accrued and future interest payable, resulting in a gain on debt restructuring. A portion, related to the future interest, of this gain was deferred and was being recognized as we made interest payments on the modified senior debt. As a result, no interest expense has been recorded with respect to this modified senior debt since the completion of the debt restructuring in August 2013. The entire balance of the senior debt was repaid in October 2014. Accordingly, the remaining deferred gain on debt restructuring of $\$ 365$ thousand was taken into income in the fourth quarter of 2014.

## Analysis of Net Interest Income

Net interest income is the difference between income on interest-earning assets and the expense on interest-bearing liabilities. Net interest income depends upon the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on them. The following table sets forth average balances, average yields and costs, and certain other information for the periods indicated. All average balances are daily average balances. The yields set forth below include the effect of deferred loan fees, and discounts and premiums that are amortized or accreted to interest income or expense. We

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do not accrue interest on loans on non-accrual status; however, the balance of these loans is included in the total average balance, which has the effect of reducing average loan yields.

| (Dollars in Thousands) | For the year ended December 31, |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance |  | 2014 |  | Average Yield/ Cost | Average <br> Balance | 2013 |  | Average <br> Yield/ <br> Cost |
|  |  |  |  | terest |  |  |  | nterest |  |
| Assets |  |  |  |  |  |  |  |  |  |
| Interest-earning assets: |  |  |  |  |  |  |  |  |  |
| Interest-earning deposits | \$ | 2,975 | \$ | 13 | 0.44\% \$ | 4,832 | \$ | 21 | 0.43\% |
| Federal Funds sold and other short-term investments |  | 29,386 |  | 69 | 0.23\% | 55,375 |  | 120 | 0.22\% |
| Securities |  | 15,493 |  | 370 | 2.39\% | 10,707 |  | 306 | 2.86\% |
| Loans receivable (1) |  | 275,905 |  | 14,994 | 5.43\% | 259,747 |  | 15,331 | 5.90\% |
| FHLB stock |  | 3,778 |  | 283 | 7.49\% | 3,822 |  | 188 | 4.92\% |
| Total interest-earning assets |  | 327,537 | \$ | 15,729 | 4.80\% | 334,483 | \$ | 15,966 | 4.77\% |
| Non-interest-earning assets |  | 8,267 |  |  |  | 15,330 |  |  |  |
| Total assets | \$ | 335,804 |  |  | \$ | 349,813 |  |  |  |


| Liabilities and Stockholders' Equity |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest-bearing liabilities: |  |  |  |  |  |  |  |  |  |
| Money market deposits | \$ | 15,669 | \$ | 60 | 0.38\% \$ | 16,585 | \$ | 64 | 0.39\% |
| Passbook deposits |  | 36,752 |  | 119 | 0.32\% | 37,376 |  | 120 | 0.32\% |
| NOW and other demand deposits |  | 30,684 |  | 26 | 0.08\% | 33,600 |  | 27 | 0.08\% |
| Certificate accounts |  | 130,593 |  | 1,521 | 1.16\% | 145,366 |  | 2,028 | 1.40\% |
| Total deposits |  | 213,698 |  | 1,726 | 0.81\% | 232,927 |  | 2,239 | 0.96\% |
| FHLB advances |  | 80,345 |  | 1,962 | 2.44\% | 79,544 |  | 2,067 | 2.60\% |
| Senior debt (2) |  | 2,206 |  |  |  | 4,127 |  | 355 | 8.60\% |
| Junior subordinated debentures (3) |  | 5,792 |  | 180 | 3.11\% | 6,000 |  | 203 | 3.38\% |
| Total interest-bearing liabilities |  | 302,041 | \$ | 3,868 | 1.28\% | 322,598 | \$ | 4,864 | 1.51\% |
| Non-interest-bearing liabilities |  | 4,872 |  |  |  | 6,782 |  |  |  |
| Stockholders' Equity |  | 28,891 |  |  |  | 20,433 |  |  |  |
| Total liabilities and stockholders' equity | \$ | 335,804 |  |  | \$ | 349,813 |  |  |  |


| Net interest rate spread (4) | $\$ 11,861$ | $3.52 \%$ | $\$ 11,102$ | $3.26 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- |


| Net interest rate margin (5) | $3.62 \%$ | $3.32 \%$ |
| :--- | ---: | ---: |
| Ratio of interest-earning assets to interest-bearing | $108.44 \%$ | $103.68 \%$ |
| liabilities |  |  |

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(1)

Amount is net of deferred loan fees, loan discounts, and loans in process, and includes loans receivable held for sale.
(2)

Includes default rate margin that was in effect to August 22, 2013. No interest expense was recognized on the senior debt post restructuring because the floating interest rate on the remaining modified loan did not exceed the floor rate of $6 \%$ post modification. Paid off in October 2014.
(3)

Includes compounding on past due interest. Interest on the Debentures was brought current in October 2014.
(4)

Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
(5)

Net interest rate margin represents net interest income as a percentage of average interest-earning assets.

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Changes in our net interest income are a function of changes in both rates and volumes of interest-earning assets and interest-bearing liabilities. The following table sets forth information regarding changes in our interest income and expense for the years indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate), (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the total change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.


## Provision for (Recapture of) Loan Losses

For the year 2014, we booked a recapture of $\$ 2.9$ million of previously recorded provisions for loan losses, compared to a provision for loan losses of $\$ 414$ thousand for the year 2013. The recapture of loan losses during 2014 primarily reflected recoveries for loan losses of $\$ 1.1$ million from the payoffs of two non-accrual loans which had been fully written off in late 2011 and $\$ 671$ thousand from the settlement of a loan which had been previously written down in exchange for property received in foreclosure, the fair value of which exceeded the cost basis of the related loan. In addition, the recapture of loan losses reflected a decline in net charge-offs and overall historical loss factors and improvements in our asset quality.

## Non-Interest Income

Non-interest income for the year ended December 31, 2014 totaled $\$ 1.1$ million compared to $\$ 2.1$ million for the year ended December 31, 2013. The $\$ 1.0$ million decrease in non-interest income during 2014 was

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primarily due to a decrease of $\$ 856$ thousand in the reported amount of gain on restructuring of debt. In 2013, $\$ 1.2$ million of the $\$ 1.8$ million accrued interest expense that was forgiven on the senior debt as part of the Recapitalization was recognized as gain on restructuring of debt. The balance of the interest forgiven, $\$ 535$ thousand, was added to the amount of the obligation reported on the Company's balance sheet in accordance with Accounting Standards Codification ("ASC") 470-60 Troubled Debt Restructurings by Debtors, and was being amortized to interest expense over the remaining life of the restructured senior debt as payments are being rendered. When we paid off the senior debt in October 2014, the remaining unamortized deferred gain on debt restructuring of $\$ 365$ thousand was settled as gain on restructuring of debt. In addition, during 2014, service fees on retail deposits decreased $\$ 99$ thousand, net gains on sales of loans decreased $\$ 91$ thousand, net gains on sales of REO decreased $\$ 100$ thousand and other income decreased $\$ 91$ thousand, primarily reflecting a reduction of $\$ 35$ thousand in miscellaneous loan fees and $\$ 48$ thousand in loan servicing fees, which were partially offset by a grant of $\$ 200$ thousand received from the CDFI Fund in early 2014.

## Non-Interest Expense

Non-interest expense for the year ended December 31, 2014 totaled $\$ 13.3$ million compared to $\$ 13.1$ million for the year ended December 31, 2013. The $\$ 239$ thousand increase in non-interest expense was primarily due to an increase of $\$ 1.0$ million in compensation and benefits expense and an increase of $\$ 224$ thousand in professional services expense. Compensation and benefits expense increased during 2014 primarily due to salary increases, accruals for bonus and severance payments and an increase in full-time equivalent employees from 67 in December 2013 to 71 in December 2014. Professional services expense increased during 2014 primarily due to $\$ 140$ thousand of legal and consulting fees incurred as a result of the modification of the Debentures and an increase of $\$ 43$ thousand in the cost of an independent third party loan review.

The above increases in non-interest expense were partially offset by a decrease of $\$ 169$ thousand in loan related expenses, a decrease of $\$ 133$ thousand in provision for losses on REOs, a decrease of $\$ 153$ thousand in provision for losses on loans held for sale, a decrease of $\$ 125$ thousand in corporate insurance expense, a decrease of $\$ 42$ thousand in FDIC insurance expense, a decrease of $\$ 33$ thousand in occupancy expense and a decrease of $\$ 313$ thousand in other expense. The decrease of $\$ 313$ thousand in other expense was primarily due to lower REO expenses, lower marketing and public relations expenses, lower NASDAQ listing fees and lower SEC compliance expense.

## Income Taxes

The Company's income tax expense was $\$ 3$ thousand for the year ended December 31, 2014 compared to $\$ 4$ thousand for the year ended December 31, 2013. The tax expense for the years 2014 and 2013 primarily reflected the statutory minimum taxes paid to the state of California, and the use of tax carryforwards to offset current taxable income in the periods presented. As of December 31, 2014, we had net deferred tax assets of $\$ 8.8$ million that were fully reserved, federal net operating loss carryforwards of $\$ 14.8$ million, expiring beginning in 2032 through 2034, and California net operating loss carryforwards of $\$ 32.1$ million, expiring beginning in 2030 through 2034. See Note 1 "Summary of Significant Accounting Policies" and Note 13 "Income Taxes" of the Notes to Consolidated Financial Statements for a further discussion of income taxes and a reconciliation of income tax at the federal statutory tax rate to actual tax expense (benefit).

Section 382 of the Internal Revenue Code imposes limitations on a corporation's ability to utilize net operating loss carryovers, tax credit carryovers and other income tax attributes when there is an ownership change. Generally, the rules provide that an ownership change is deemed to have occurred when the cumulative increase of each 5\% or more stockholder and certain groups of stockholders treated as $5 \%$ or more shareholders, as determined under Section 382, exceeds $50 \%$ over a specified "testing" period, generally equal to three years. Section 382 applies rules regarding the treatment of new groups of

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stockholders treated as $5 \%$ shareholders due to issuances of stock and other equity transactions, which may cause a change of control to occur. The Company has performed an analysis of the potential impact of Section 382 related to the Recapitalization that occurred on August 22, 2013 and the equity issuance on October 16, 2014, and has determined that the Company did not undergo an ownership change as of either date and any potential limitations imposed under Section 382 do not currently apply.

## Comparison of Financial Condition at December 31, 2014 and 2013

## Total Assets

Total assets were $\$ 350.9$ million at December 31, 2014, which represented an increase of $\$ 18.4$ million, or $6 \%$, from December 31, 2013. During 2014, net loans held for investment increased by $\$ 28.8$ million, loans receivable held for sale increased by $\$ 19.5$ million, securities increased by $\$ 7.7$ million and cash and cash equivalents decreased by $\$ 37.4$ million as we invested excess federal funds in securities and loans in order to grow total interest income and improve the yield on interest-earning assets.

## Securities Available-for-Sale

In March 2014, we purchased $\$ 8.6$ million of mortgaged-backed securities and $\$ 1.9$ million of U.S. government and federal agency securities with an average yield of $2.23 \%$.

## Loans Receivable Held for Sale

Loans receivable held for sale at December 31, 2014 totaled $\$ 19.5$ million, consisting of multi-family loans. We had no loans receivable held for sale at December 31, 2013. During the fourth quarter of 2014, in order to comply with regulatory loan concentration limits, we transferred $\$ 22.8$ million of loans receivable held for investment, primarily multi-family loans, to held for sale and have begun marketing these loans for sale. We sold $\$ 3.3$ million during the fourth quarter of 2014 and recorded a net gain on sale of loans of $\$ 19$ thousand.

## Loans Receivable Held for Investment

Our gross loan portfolio increased by $\$ 26.8$ million to $\$ 283.6$ million at December 31, 2014 from $\$ 256.8$ million at December 31, 2013. The increase in our loan portfolio during 2014 consisted of an increase of $\$ 58.6$ million in our multi-family residential real estate loan portfolio which was partially offset by a decrease of $\$ 6.7$ million in our single family residential real estate loan portfolio, a decrease of $\$ 10.0$ million in our commercial real estate loan portfolio, a decrease of $\$ 13.3$ million in our church loan portfolio and a decrease of $\$ 1.8$ million in our commercial loan portfolio.

Loan originations for the year ended December 31, 2014 totaled $\$ 95.6$ million, compared to loan originations of $\$ 49.1$ million, including loan purchases of $\$ 10.6$ million, for the year ended December 31, 2013. Loan repayments for the year ended December 31, 2014 totaled $\$ 43.3$ million, compared to $\$ 50.4$ million for the year ended December 31, 2013.

Loan charge-offs during 2014 totaled $\$ 693$ thousand, compared to charge-offs of $\$ 2.8$ million during 2013. Loans transferred to REO during 2014 totaled $\$ 2.6$ million, excluding a $\$ 671$ thousand fair value adjustment, compared to $\$ 2.3$ million during 2013. Loans transferred to loans receivable held for sale during 2014 totaled $\$ 22.8$ million, compared to $\$ 7.3$ million during 2013.

## Allowance for Loan Losses

We record a provision for loan losses as a charge to earnings when necessary in order to maintain the ALLL at a level sufficient, in management's judgment, to absorb probable incurred losses 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

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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.

Our ALLL decreased by $\$ 1.5$ million from $\$ 10.1$ million, or $3.95 \%$ of our loans receivable held for investment, at December 31, 2013, to $\$ 8.6$ million, or $2.99 \%$ of our loans receivable held for investment, at December 31, 2014, primarily reflecting $\$ 2.9$ million of recapture of loan losses and $\$ 693$ thousand of loan charge-offs, which were partially offset by $\$ 1.9$ million of recoveries on previously charged-off loans. We continue to maintain our allowance at a level that we believe is appropriate given the significant reduction in delinquencies and non-performing loans, the continued improvement in our asset quality metrics and the high quality of our loan originations.

Our asset quality continues to show signs of improvement as our loan delinquencies and non-performing loans are at their lowest levels since December 2009. As of December 31, 2014, we had total delinquencies of $\$ 2.5$ million, compared to total delinquencies of $\$ 11.1$ million at December 31, 2013. Loan delinquencies decreased by $\$ 8.6$ million during 2014 as $\$ 3.6$ million of delinquent loans were brought current, $\$ 3.7$ million were paid off, $\$ 207$ thousand were repaid and $\$ 2.6$ million were foreclosed and transferred to REO, which were partially offset by $\$ 1.6$ million of loans that became delinquent in 2014. Of the $\$ 2.5$ million delinquent loans at December 31, 2014, $\$ 987$ thousand were greater than 90 days delinquent.

Non-performing loans ("NPLs") consist of delinquent loans that are 90 days or more past due and other loans, including troubled debt restructurings that do not qualify for accrual status. At December 31, 2014, NPLs totaled $\$ 8.9$ million, compared to $\$ 17.7$ million at December 31, 2013. The $\$ 8.8$ million decrease in NPLs was primarily due to payoffs of $\$ 4.4$ million, transfers to REO of $\$ 2.6$ million, sales of $\$ 1.1$ million, return to accrual status of $\$ 1.3$ million, repayments of $\$ 930$ thousand and charge-offs of $\$ 693$ thousand which were partially offset by the placement of five church loans totaling $\$ 2.1$ million to non-accrual status.

In connection with our review of the adequacy of our ALLL, we track the amount and percentage of our NPLs that are paying currently, but nonetheless must be classified as NPL for reasons unrelated to payments, such as lack of current financial information and an insufficient period of satisfactory performance. As of December 31, 2014, $\$ 6.8$ million, or $77 \%$, of our total NPLs of $\$ 8.9$ million were current in their payments. Also, in determining the ALLL we consider the ratio of the ALLL to NPLs. During 2014, this ratio increased to $95.52 \%$ at December 31, 2014 from $57.32 \%$ at December 31, 2013, primarily due to the $\$ 8.8$ million decrease in NPLs.

When reviewing the adequacy of the ALLL, we also consider the impact of charge-offs, including the changes and trends. Loan charge-offs during 2014 were $\$ 693$ thousand compared to $\$ 2.8$ million during 2013. Charge-offs during 2014 were related to losses on impaired loans and consisted of charge-offs of $\$ 533$ thousand on church loans, a charge-off of $\$ 133$ thousand on a single family residential real estate loan, a charge-off of $\$ 18$ thousand on a commercial loan and a charge-off of $\$ 9$ thousand on a commercial real estate loan. In determining charge-offs we update our estimates of collateral values on NPLs by obtaining new appraisals at least every nine months. If the estimated fair value of the loan collateral less estimated selling costs is less than the recorded investment in the loan, a charge-off for the difference is recorded to reduce the loan to its estimated fair value, less estimated selling costs. Therefore, certain losses inherent in our total NPLs are recognized periodically through charge-offs. The impact of updating these estimates of collateral value and recognizing any required charge-offs is to increase charge-offs and reduce the ALLL required on these loans. As of December 31, 2014, we had written down $70 \%$ of our NPLs to estimated fair value less estimated selling costs. The remaining $30 \%$ of our NPLs at December 31, 2014 had specific reserves or were reported at cost because the fair value of collateral less estimated selling costs exceeded the recorded investment in the loan.

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Recoveries during 2014 totaled $\$ 1.9$ million compared to $\$ 694$ thousand during 2013. Recoveries during 2014 were primarily due to payoffs of two non-accrual loans secured by church properties and two commercial loans which had been fully written off in late 2011 and due to a settlement of a loan which had been previously written down in exchange for property received in foreclosure, the fair value of which exceeded the cost basis of the related loan.

Impaired loans at December 31, 2014 were $\$ 23.8$ million, compared to $\$ 33.5$ million at December 31, 2013. Specific reserves for impaired loans were $\$ 1.5$ million, or $6.32 \%$ of the aggregate impaired loan amount at December 31, 2014, compared to $\$ 2.2$ million, or $6.53 \%$, at December 31, 2013. Excluding specific reserves for impaired loans, our coverage ratio (general allowance as a percentage of total non-impaired loans) was $2.68 \%$ at December 31, 2014, compared to 3.56\% at December 31, 2013. The decrease in our coverage ratio reflected a decline in our historical loss factors and the continued improvements in our asset quality.

Management believes that the ALLL is adequate to cover probable incurred losses in the loan portfolio as of December 31, 2014, 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 ALLL as an integral part of their examination process. These agencies may require an increase in the ALLL based on their judgments of the information available to them at the time of their examinations.

## Real Estate Owned

REO decreased slightly during 2014 but remained essentially flat at $\$ 2.1$ million at the end of both 2014 and 2013. During 2014, one multi-family and three church loans totaling $\$ 2.6$ million were foreclosed and the properties securing the loans, with total fair values of $\$ 3.3$ million, became REO. As part of our efforts to reduce non-performing assets, seven REO properties were sold during 2014 for net proceeds of $\$ 2.9$ million and a net gain of $\$ 12$ thousand. At December 31, 2014, the Bank's REO consisted of two church buildings.

## Deposits

Deposits totaled $\$ 217.9$ million at December 31, 2014, up $\$ 3.5$ million from December 31, 2013. During 2014, certificates of deposit increased by $\$ 5.1$ million and represented $62 \%$ of total deposits at December 31, 2014, compared to $61 \%$ of total deposits at December 31, 2013. Core deposits (NOW, demand, money market and passbook accounts) decreased by $\$ 1.6$ million during 2014 and represented $38 \%$ of total deposits at December 31, 2014, compared to 39\% of total deposits at December 31, 2013.

## Borrowings

At December 31, 2014, total borrowings consisted of advances to the Bank from the FHLB of $\$ 86.0$ million and Debentures issued by the Company of $\$ 5.1$ million. At December 31, 2013, borrowings consisted of advances from the FHLB of $\$ 79.5$ million, Debentures of $\$ 6.0$ million and our modified senior debt of $\$ 2.9$ million, which balance included the unamortized deferred gain on debt restructuring of $\$ 498$ thousand.

At December 31, 2014, advances from the FHLB increased by $\$ 6.5$ million from $\$ 79.5$ million, or $24 \%$ of total assets, at year-end 2013 to $\$ 86.0$ million, or $25 \%$ of total assets, at year-end 2014. The weighted average cost of advances decreased 5 basis points from $2.49 \%$ at December 31, 2013 to $2.31 \%$ at December 31, 2014 primarily due to maturities of $\$ 10.5$ million of FHLB advances with an average interest rate of $3.54 \%$ and new advances totaling $\$ 17.0$ million with an average interest rate of $\$ 1.26 \%$.

Amounts due pursuant to our Debentures decreased by $\$ 900$ thousand to $\$ 5.1$ million at December 31, 2014 from $\$ 6.0$ million at December 31, 2013 as we completed the modification of the Debentures and related transactions on October 16, 2014. Senior debt decreased by $\$ 2.9$ million during 2014, as we repaid in full the $\$ 2.4$ million outstanding principal amount of the senior debt with a portion of the proceeds from

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the 2014 private placement described above, and amortized the remaining deferred gain on debt restructuring during the fourth quarter of 2014. See Borrowings and Note 11 "Junior Subordinated Debentures and Senior Debt" of the Notes to Consolidated Financial Statements for information regarding the Debentures and senior debt.

## Stockholders' Equity

Stockholders' equity was $\$ 37.3$ million, or $10.62 \%$ of the Company's total assets, at December 31, 2014, compared to $\$ 25.6$ million, or $7.70 \%$ of the Company's total assets, at December 31, 2013. The increase in stockholders' equity during 2014 was due to the completion of the private placement in October 2014 and net earnings for the year.

## Capital Resources

Our principal subsidiary, Broadway Federal, must comply with capital standards established by the OCC in the conduct of its business. Failure to comply with such capital requirements may result in significant limitations on its business or other sanctions. We are not currently subject to separate holding company capital requirements, but by July 2015 the Dodd-Frank Act will, among other things, impose specific capital requirements on us as a savings and loan holding company as well. These requirements must be no less than those to which federally insured depository institutions are currently subject. The current regulatory capital requirements and possible consequences of failure to maintain compliance are described in Part I, Item 1 "Business-Regulation" and in Note 15 of the Notes to Consolidated Financial Statements.

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, to the U.S. Treasury for gross proceeds of $\$ 9.0$ million. The warrant was subsequently retired without cost because of our status as a Certified Community Development Financial Institution. The sale of the Series D Preferred Stock was made pursuant to the U.S. Treasury'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 for gross proceeds of $\$ 6.0$ million. The sale of the Series E Preferred Stock was made pursuant to the U.S. Treasury's TARP Capital Purchase Program.

In 2013, the Company simplified its capital structure through completion of the following Recapitalization transactions:

The issuance of 8,776 shares of Series F Common Stock Equivalent (the "Common Stock Equivalents") in exchange for the five series of the Company's formerly outstanding preferred stock that had an aggregate liquidation value or preference of $\$ 17.6$ million, including the two series of preferred stock, which we refer to as the TARP preferred stock, that the Company issued to the Treasury Department pursuant to the Capital Purchase Program component of the Treasury Department's Troubled Asset Relief Program. The parties agreed to value the Common Stock Equivalents issued for this purpose at $\$ 8.8$ million based on the price at which shares of our common stock were sold in the subscription offering referred to below.

The issuance of 2,646 shares of Common Stock Equivalents in exchange for all of the accumulated dividends on the TARP preferred stock, totaling $\$ 2.6$ million as of the date of the exchange;

The issuance of 2,575 shares of Common Stock Equivalents in exchange for $\$ 2.6$ million principal amount of the Company's $\$ 5.0$ million principal amount of borrowings under its then outstanding senior debt;

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The forgiveness of the $\$ 1.8$ million of accrued interest on the entire $\$ 5.0$ million principal amount of the senior debt as of the date of the above-described exchange of Common Stock Equivalents for $\$ 2.6$ million of the principal amount of the senior debt;

The modification of the terms of the remaining $\$ 2.4$ million principal amount of the senior debt to, among other matters, extend the maturity and terminate application of the default interest rate thereon;

The exchange of 698 shares of Common Stock Equivalents issued in the senior debt principal exchange for 6,982 shares of Series G Non-Voting Preferred Stock; and

The issuance of $4,235,500$ shares of common stock in private sales at a price of $\$ 1.00$ per share, yielding $\$ 4.2$ million in gross proceeds. A portion of the proceeds of the subscription offering were used to invest additional capital in the Bank and to repay all of the inter-company payables owed to the Bank by the Company.

The Common Stock Equivalents were a series of preferred stock of the Company, the terms of which provided that they would automatically convert into shares of the Company's common stock, at the rate of 1,000 shares of common stock for each share of Common Stock Equivalents, upon stockholder approval of an amendment to the Company's certificate of incorporation increasing the number of shares of common stock the Company is authorized to issue so as to permit such conversion. The Series G Non-Voting Preferred Stock provided that it would automatically convert into shares of non-voting common stock of the Company upon approval by the stockholders of an amendment of the Company's certificate of incorporation authorizing the Company to issue non-voting common stock. The amendments required to effect such conversions were approved at the Company's annual meeting of stockholders held on November 27, 2013 and the conversions of the Common Stock Equivalents and the Series G Non-Voting Preferred Stock became effective December 5, 2013.

On October 16, 2014, concurrent with the completion of the modification of the Debentures and related transactions described above, the Company consummated private placements of $8,829,549$ shares of common stock, including $6,973,320$ shares of non-voting common stock, for gross proceeds of $\$ 9.7$ million; made the payments of principal and accrued interest on Debentures described above; executed a Supplemental Indenture for the Debentures that extended the maturity of the remaining $\$ 5.1$ million principal amount of the Debentures to March 17, 2024 and modified the payment terms thereof; and repaid the outstanding principal amount of the defaulted senior debt of $\$ 2.4$ million, together with all accrued interest thereon.

## 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, REO, and investment securities, and payments of principal and interest on loans and investment securities. 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. This approved limit and collateral requirement would have permitted the Bank, as of December 31, 2014, to borrow an additional $\$ 14.0$ million. Also, the Bank has received funds from investments made by the Company into the equity of the Bank, including the investments made as part of the Recapitalization in August 2013 and the private placement transactions completed in October 2014.

The Bank's primary uses of funds include withdrawal of and interest payments on deposits, originations of loans, purchases of investment securities, and payment of operating expenses. Also, when the Bank has more funds than required for reserve requirements or short-term liquidity needs, the Bank sells federal funds to the Federal Reserve Bank or other financial institutions. The Bank's liquid assets at December 31,

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2014 consisted of $\$ 20.8$ million in cash and cash equivalents and $\$ 15.9$ million in securities available-for-sale that were not pledged, compared to liquid assets of $\$ 58.2$ million in cash and cash equivalents at December 31, 2013.

Currently, we believe that the Bank has sufficient liquidity to support growth over the foreseeable future.

The Company's liquidity is based primarily on the proceeds from financing transactions, such as the private placements completed in August 2013 and October 2014 discussed above. The Company has not been able to obtain funds from the Bank since 2010. Through the first nine months of 2014, the Company had limited liquidity to pay operating expenses and needed to raise additional capital to continue paying its operating expenses, including allocations of shared expenses from the Bank, on a timely basis. This need was addressed with the completion of the private placements on October 16, 2014, which raised $\$ 9.7$ million of gross proceeds from the sale of our common stock. A portion of the proceeds was used to retire the full amount of the outstanding balance of the Company's senior debt, pay $\$ 900$ thousand principal amount and all of the accrued interest on the Debentures, which was approximately $\$ 805$ thousand as of the closing date, and invest $\$ 2.5$ million in the Bank's common equity as a capital contribution. The balance of the proceeds from the private placement are being used to pay operating expenses of the Company and fund its working capital.

The Company recorded consolidated net cash inflows from operating activities of $\$ 1.0$ million and $\$ 1.6$ million during 2014 and 2013, respectively. Net cash inflows from operating activities during 2014 were primarily attributable to interest payments received on loans and securities.

The Company recorded consolidated net cash outflows from investing activities of $\$ 54.4$ million during 2014, compared to consolidated net cash inflows from investing activities of $\$ 31.4$ million during 2013. Net cash outflows from investing activities during 2014 were primarily attributable to originations of loans and purchases of securities by the Bank.

The Company recorded consolidated net cash inflows from financing activities of $\$ 16.0$ million during 2014, compared to consolidated net cash outflows of $\$ 39.2$ million during 2013. Net cash inflows from financing activities during 2014 were primarily attributable to the net proceeds from the issuance of common stock, advances from the FHLB and net increase in deposits.

## Off-Balance-Sheet Arrangements and Contractual Obligations

We are party to financial instruments with off-balance-sheet risk in the normal course of our business primarily in order to meet the financing needs of our customers. These instruments involve, to varying degrees, elements of credit, interest rate and liquidity risk. In accordance with GAAP, these instruments are either not recorded in the consolidated financial statements or are recorded in amounts that differ from the notional amounts. Such instruments primarily include lending commitments and lease commitments as described below.

Lending commitments include commitments to originate loans and to fund lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate creditworthiness on a case-by-case basis. Our maximum exposure to credit risk is represented by the contractual amount of the instruments.

In addition to our lending commitments, we have contractual obligations related to operating lease commitments. Operating lease commitments are obligations under various non-cancelable operating leases

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on buildings and land used for office space and banking purposes. The following table details our contractual obligations at December 31, 2014.

|  | Less than one year |  | More than one year to three years |  | More than three years to five years |  | More than five years |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (Dollars in thousands) |  |  |  |  |  |  |  |  |  |
| Certificates of deposit | \$ | 99,411 | \$ | 33,118 | \$ | 2,428 | \$ | 161 | \$ | 135,118 |
| FHLB advances |  | 35,000 |  | 43,000 |  | 8,000 |  |  |  | 86,000 |
| Subordinated debentures |  |  |  |  |  | 765 |  | 4,335 |  | 5,100 |
| Commitments to originate loans |  | 1,000 |  |  |  |  |  |  |  | 1,000 |
| Commitments to fund unused lines of credit |  |  |  |  |  |  |  | 365 |  | 365 |
| Operating lease obligations |  | 425 |  | 889 |  | 965 |  | 661 |  | 2,940 |
| Total contractual obligations | \$ | 135,836 | \$ | 77,007 | \$ | 12,158 | \$ | 5,522 | \$ | 230,523 |

## Impact of Inflation and Changing Prices

Our consolidated financial statements including accompanying notes have been prepared in accordance with GAAP which require the measurement of financial position and operating results primarily in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in increased costs of our operations. Unlike industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

## Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. This discussion has highlighted those accounting policies that management considers critical. All accounting policies are important, however, and therefore you are encouraged to review each of the policies included in Note 1 "Summary of Significant Accounting Principles" of the Notes to Consolidated Financial Statements beginning at page F-8 to gain a better understanding of how our financial performance is measured and reported. We consider the following to be critical accounting policies:

## Allowance for Loan Losses

The determination of the allowance for loan losses is considered critical due to the high degree of judgment involved, the subjectivity of the underlying assumptions used, and the potential for changes in the economic environment that could result in material changes in the amount of the allowance for loan losses considered necessary. The allowance is evaluated on a regular basis by management and the Board of Directors and is based on a periodic review of the collectability of the loans in light of historical experience, the nature and size of the loan portfolio, adverse situations that may affect borrowers' ability to repay, the estimated value of any underlying collateral, prevailing economic conditions and feedback from regulatory examinations. See Item 1, "Business Asset Quality Allowance for Loan Losses" for a full discussion of the allowance for loan losses.

## Real Estate Owned ('REO')

REO consists of property acquired through foreclosure or deed in lieu of foreclosure and is recorded at the fair value, less estimated costs to sell, at the time of acquisition. The excess, if any, of the loan balance over the fair value of the property at the time of transfer from loans to REO is charged to the allowance for loan losses. Subsequent to the transfer to REO, if the fair value of the property less estimated selling

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costs declines to an amount less than the carrying value of the property, the deficiency is charged to income as a provision expense and a valuation allowance is established. Operating costs after acquisition are expensed as incurred. Due to changing market conditions, there are inherent uncertainties in the assumptions made with respect to the estimated fair value of REO. Therefore, the amount ultimately realized may differ from the amounts reflected in the accompanying consolidated financial statements.

## Income Taxes

Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is established against deferred tax assets when, based upon the available evidence including historical and projected taxable income, it is more likely than not that some 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 any cumulative losses in the current year and the prior two years, the amount of taxes paid in available carry-back years, forecasts of future income and available tax planning strategies. This analysis is updated quarterly. Based on this analysis, the Company determined that a valuation allowance of $\$ 8.8$ million was required as of December 31, 2014, resulting in $\$ 0$ net deferred tax assets. The Company had recorded a valuation allowance of $\$ 9.7$ million and net deferred tax assets of $\$ 0$ as of December 31, 2013. The full valuation allowance against our net deferred tax assets at December 31, 2014 and 2013 was due to the Company's inability to project consistent future taxable income against which it could apply its net deferred tax assets. See Note 13 "Income Taxes" of the Notes to Consolidated Financial Statements in Item 8, "Financial Statements and Supplementary Data."

## Fair Value Measurements

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 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.

Fair values are estimated using relevant market information and other assumptions, as more fully disclosed in Note 7. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Index to Consolidated Financial Statements of Broadway Financial Corporation and Subsidiaries.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

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## ITEM 9A. CONTROLS AND PROCEDURES

## Evaluation of disclosure controls and procedures

As of December 31, 2014, an evaluation was performed under the supervision of the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of December 31, 2014.

## Management's annual report on internal control over financial reporting

The management of Broadway Financial Corporation is responsible for establishing and maintaining adequate internal control over financial reporting for the Company as defined in Rule 13a-15(f) under the Exchange Act. This system, which management has chosen to base on the framework set forth in Internal Control-Integrated Framework, published by the 1992 Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and which is effected by the Company's Board of Directors, management and other personnel, is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and the Directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time.

With the participation of the Company's Chief Executive Officer and Chief Financial Officer, management has conducted an evaluation of the effectiveness of the Company's system of internal control over financial reporting. Based on this evaluation, management determined that the Company's system of internal control over financial reporting was effective as of December 31, 2014.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

## Changes in internal control over financial reporting

There were no significant changes in the Company's internal control over financial reporting identified in connection with the evaluation of internal control over financial reporting that occurred during the fourth

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quarter of 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

| /s/ Wayne-Kent A. Bradshaw | $\frac{\text { /s/ Brenda J. Battey }}{\text { Brenda J. Battey }}$ |
| :---: | :---: |
| Wayne-Kent A. Bradshaw | Chief Financial Officer |
| Chief Executive Officer | (Principal Financial Officer and Principal Accounting Officer) |
| (Principal Executive Officer) | Los Angeles, CA |
| Los Angeles, CA | March 27, 2015 |

ITEM 9B. OTHER INFORMATION

None

## PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to the definitive Proxy Statement, under the captions "Election of Directors", "Executive Officers", "Code of Ethics" and "Section 16(a) Beneficial Ownership Reporting Compliance", to be filed with the Securities and Exchange Commission in connection with the Company's 2015 Annual Meeting of Stockholders (the "Company's Proxy Statement").

## ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the Company's Proxy Statement, under the caption "Executive Compensation" and "Director Compensation".

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference to the Company's Proxy Statement, under the caption "Security Ownership of Certain Beneficial Owners and Management".

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to the Company's Proxy Statement, under the caption "Certain Relationships and Related Transactions" and "Election of Directors".

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated herein by reference to the Company's Proxy Statement, under the caption "Ratification of the Appointment of the Independent Registered Public Accounting Firm".

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)

1. See Index to Consolidated Financial Statements.
2. 

Financial Statement Schedules have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes included under Item 8, "Financial Statements and Supplementary Data."
(b)

List of Exhibits

## Exhibit

Number*
3.1 Certificate of Incorporation of Registrant and amendments thereto (Exhibit 3.1 to Form 10-Q filed by the Registrant on November 13, 2014)
3.2 Bylaws of Registrant (Exhibit 3.2 to Form 10-Q filed by the Registrant on November 14, 2013)
4.1 Certificate of Designation for Series A Preferred Stock (Exhibit 4.3 to Form 10-Q filed by the Registrant on November 14, 2013)
4.2 Certificate of Designation for Series B Preferred Stock (Exhibit 4.5 to Form 10-Q filed by the Registrant on November 14, 2013)

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## Exhibit

## Number*

4.3 Certificate of Designation for Series C Preferred Stock (Exhibit 4.7 to Form 10-Q filed by the Registrant on November 14, 2013)
4.4 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)
4.5 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)
4.6 Certificate of Designations of Series F Common Stock Equivalents (Exhibit 4.13 to Form 10-Q filed by the Registrant on November 14, 2013)
4.7 Certificate of Designations of Series G Non-Voting Preferred Stock (Exhibit 4.14 to Form 10-Q filed by the Registrant on November 14, 2013)
10.1 Broadway Federal Bank Employee Stock Ownership Plan (Exhibit 4.1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on September 12, 1995)
10.2 Broadway Financial Corporation 2008 Long Term Incentive Plan (Exhibit A to Proxy Statement filed by Registrant on Schedule 14A on November 17, 2009)
10.3 Deferred Compensation Plan (Exhibit 10.14 to Registration Statement on Form S-1 filed by the Registrant on November 20, 2013)
10.4 Salary Continuation Agreement Between Broadway Federal Bank and former Chief Executive Officer Paul C. Hudson (Exhibit 10.15 to Registration Statement on Form S-1 filed by the Registrant on November 20, 2013)
10.5 Securities Purchase Agreement Between Broadway Financial Corporation and United States Department of the Treasury (Exhibit 10.16 to Form 8-K filed by the Registrant on November 19, 2008)
10.6 Letter Agreement, dated December 4, 2009, which includes the Securities Purchase Agreement Between Broadway Financial Corporation and United States Department of the Treasury (Exhibit 10.1 to Form 8-K filed by the Registrant on December 9, 2009)
10.7 Business Loan Agreement between Broadway Financial Corporation and Nara Bank, dated July 31, 2009 (Exhibit 10.18 to Form 10-K filed by the Registrant for the fiscal year ended December 31, 2009)
10.8.1 Exchange Agreement by and between Broadway Financial Corporation and The United States Department of the Treasury (Exhibit 10.19 to Form 10-K filed by the Registrant on April 1, 2013)
10.8.2 Amendment No. 1 to Exchange Agreement by and between the Registrant and The United States Department of the Treasury (Exhibit 10.19.2 to Registration Statement on Form S-1 filed by the Registrant on November 20, 2013)
10.9 Exchange Agreement by and among Broadway Financial Corporation, the Insurance Exchange of the Automobile Club and the Automobile Club of Southern California (Exhibit 10.20 to Form 10-K filed by the Registrant on April 1, 2013)
10.10.1 Exchange Agreement by and between the Registrant and BBCN Bancorp, Inc. (Exhibit 10.21 .1 to Form 10-Q filed by the Registrant on November 14, 2013)
10.10.2 Investor Rights Letter by and between the Registrant and BBCN Bancorp, Inc. (Exhibit 10.21 .2 to Form 10-Q filed by the Registrant on November 14, 2013)

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## Exhibit

## Number*

10.11.1 Exchange Agreement by and between the Registrant and National Community Investment Fund (Series C for Series F Preferred Stock) (Exhibit 10.22.1 to Form 10-Q filed by the Registrant on November 14, 2013)
10.11.2 Investor Rights Letter by and between the Registrant and National Community Investment Fund (Exhibit 10.22.2 to Form 10-Q filed by the Registrant on November 14, 2013)
10.11.3 Exchange Agreement by and between the Registrant and National Community Investment Fund (Series F for Series G Preferred Stock) (Exhibit 10.22.3 to Form 10-Q filed by the Registrant on November 14, 2013)
10.12 Registration Rights Agreement between the Registrant, CJA Private Equity Financial Restructuring Master Fund I LP, National Community Investment Fund and BBCN Bancorp, Inc. (Exhibit 10.23 to Form 10-Q filed by the Registrant on November 14, 2013)
10.13 Form of Subscription Agreements entered into by the Registrant with various purchasers of the Registrant's common stock (Exhibit 10.24 to Form 10-Q filed by the Registrant on November 14, 2013)
10.14.1 Subscription Agreement between the Registrant and CJA Private Equity Financial Restructuring Master Fund I LP (Exhibit 10.25.1 to Form 10-Q filed by the Registrant on November 14, 2013)
10.14.2 Investor Rights Letter between the Registrant and CJA Private Equity Financial Restructuring Master Fund I LP (Exhibit 10.25.2 to Form 10-Q filed by the Registrant on November 14, 2013)
10.15.1 Subscription Agreement between the Registrant and Valley Economic Development Center, Inc. (Exhibit 10.26.1 to Form 10-Q filed by the Registrant on November 14, 2013)
10.15.2 Investor Rights Letter between the Registrant and Valley Economic Development Center, Inc. (Exhibit 10.26.2 to Form 10-Q filed by the Registrant on November 14, 2013)
10.16 Agreement for Partial Satisfaction of Debt Previously Contracted by and between BBCN Bank and the Registrant (Exhibit 10.27 to Form 10-Q filed by the Registrant on November 14, 2013)
10.17 Form of Subscription Agreement entered into between the Registrant and various investors, dated October 16, 2014 (Exhibit 10.1 to Form 10-Q filed by the Registrant on November 13, 2014)
10.18.1 Subscription Agreement entered into between the Registrant and Gapstow Financial Growth Capital Fund I LP, dated October 16, 2014 (Exhibit 10.2.1 to Form 10-Q filed by the Registrant on November 13, 2014)
10.18.2 Investor Rights Letter Agreement entered into between the Registrant and Gapstow Financial Growth Capital Fund I LP, dated October 16, 2014 (Exhibit 10.2.2 to Form 10-Q filed by the Registrant on November 13, 2014)
10.19.1 Subscription Agreement entered into between the Registrant and National Community Investment Fund, dated October 16, 2014 (Exhibit 10.3.1 to Form 10-Q filed by the Registrant on November 13, 2014)
10.19.2 Investor Rights Letter Agreement entered into between the Registrant and National Community Investment Fund, dated October 16, 2014 (Exhibit 10.3.2 to Form 10-Q filed by the Registrant on November 13, 2014)

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## Exhibit

Number*
10.20 Registration Rights Agreement entered into among the Registrant, Gapstow Financial Growth Capital Fund I LP, and National Community Investment Fund, dated October 16, 2014 (Exhibit 10.4 to Form 10-Q filed by the Registrant on November 13, 2014)
21.1 List of Subsidiaries (Exhibit 21.1 to Registration Statement on Form S-1 filed by the Registrant on November 20, 2013)
23.1 Consent of Moss Adams LLP
23.2 Consent of Crowe Horwath LLP
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
99.1 Order to Cease and Desist, issued by Office of Thrift Supervision to Broadway Financial Corporation, Order No.: WN-10-026, effective September 9, 2010 (Exhibit 99.1 to Form 8-K filed by the Registrant on September 16, 2010)
99.2 Order to Cease and Desist, issued by Office of Thrift Supervision to Broadway Federal Bank, f.s.b., Order No.: WN-10-025, effective September 9, 2010 (Exhibit 99.2 to Form 8-K filed by the Registrant on September 16, 2010)
99.3 Consent Order, issued by Office of Comptroller of the Currency to Broadway Federal Bank, f.s.b., Order No.: AA-EC-2013-XX, effective October 30, 2013 (Exhibit 99.1 to Form 8-K filed by the Registrant on November 5, 2013)
99.4 Certification of Chief Executive Officer pursuant to Interim Final Rule TARP Standards for Compensation and Corporate Governance at 31 CFR Part 30
99.5 Certification of Chief Financial Officer pursuant to Interim Final Rule TARP Standards for Compensation and Corporate Governance at 31 CFR Part 30)
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.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BROADWAY FINANCIAL CORPORATION

By: /s/ Wayne-Kent A. Bradshaw
Wayne-Kent A. Bradshaw
Chief Executive Officer
Date: March 27, 2015
Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Wayne-Kent A. Bradshaw<br>Wayne-Kent A. Bradshaw<br>Chief Executive Officer and President Date: March 27, 2015<br>(Principal Executive Officer)<br>/s/ Brenda J. Battey<br>Brenda J. Battey<br>Chief Financial Officer<br>Date: March 25, 2015<br>(Principal Financial Officer and Principal Accounting Officer)<br>/s/ Virgil P. Roberts<br>Virgil P. Roberts<br>Chairman of the Board<br>Date: March 26, 2015<br>/s/ Kellogg Chan<br>Kellogg Chan<br>Director<br>Date: March 25, 2015<br>/s/ Robert C. Davidson, Jr.<br>Robert C. Davidson, Jr.<br>Director<br>Date: March 27, 2015<br>/s/ Albert Odell Maddox<br>Albert Odell Maddox<br>Director<br>Date: March 25, 2015<br>/s/ Daniel A. Medina<br>Daniel A. Medina<br>Director<br>Date: March 27, 2015

# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY <br> Index to Consolidated Financial Statements 

Years ended December 31, 2014 and 2013
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Consolidated Statements of Operations and Comprehensive Income (Loss) ..... F-4Consolidated Statements of Changes in Stockholders' Equity
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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Broadway Financial Corporation

We have audited the accompanying consolidated statement of financial condition of Broadway Financial Corporation and Subsidiary (the "Company") as of December 31, 2014, and the related consolidated statement of operations and comprehensive income (loss), changes in stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Broadway Financial Corporation and Subsidiary as of December 31, 2014, and the consolidated results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.
/s/ Moss Adams LLP

San Francisco, California
March 27, 2015

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Broadway Financial Corporation

We have audited the accompanying consolidated statement of financial condition of Broadway Financial Corporation and Subsidiary as of December 31, 2013, and the related consolidated statements of operations and comprehensive income (loss), changes in stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013, and the results of its operations and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.
/s/ Crowe Horwath LLP

Costa Mesa, California
March 31, 2014

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Financial Condition

|  | December 31, <br> 2014 <br> (In thousands, except share and per <br> share) |
| :--- | ---: | ---: |
| 2013 |  |

## Liabilities and stockholders' equity

Liabilities:

| Deposits | $\$ 17,867$ | $\$$ |
| :--- | ---: | ---: |
| FHLB advances | 214,405 |  |
| Senior debt | 86,000 | 79,500 |
| Junior subordinated debentures | 5,923 |  |
| Advance payments by borrowers for taxes and insurance | 5,100 | 7,081 |
| Accrued expenses and other liabilities | 3,557 | 3,287 |
|  |  |  |
| Total liabilities | $\mathbf{3 1 3 , 6 0 5}$ | $\mathbf{3 0 6 , 8 9 1}$ |

Commitments and Contingencies (Notes 8 and 16)

## Stockholders' Equity:

Common stock, \$. 01 par value, voting, authorized 50,000,000 shares at December 31, 2014 and
December 31, 2013; issued 21,509,179 shares at December 31, 2014 and 19,630,473 shares at
December 31, 2013; outstanding 21,405,188 shares at December 31, 2014 and 19,526,482 shares at
December 31, 2013
215
Common stock, \$. 01 par value, non-voting, authorized 25,000,000 shares at December 31, 2014 and
$5,000,000$ shares at December 31, 2013; issued and outstanding 7,671,520 shares at December 31, 2014
and 698,200 shares at December 31, 2013
$77 \quad 7$
$\begin{array}{ll}\text { Additional paid-in capital } & 44,669\end{array}$
Accumulated deficit
$(6,539) \quad(9,068)$

Accumulated other comprehensive income 80
Treasury stock-at cost, 103,991 shares at December 31, 2014 and December 31,2013 $(1,329)$

| Total stockholders' equity | $\mathbf{3 7 , 2 5 8}$ | $\mathbf{2 5 , 5 9 0}$ |  |
| :--- | :--- | :--- | :--- |
| Total liabilities and stockholders' equity | $\$$ | $\mathbf{3 5 0 , 8 6 3}$ | $\$$ |

See accompanying notes to consolidated financial statements.

## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Operations and Comprehensive Income (Loss)



## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Operations and Comprehensive Income (Loss) (Continued)

|  | Year Ended December 31, <br> 20142013 <br> (In thousands, except per share) |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Other comprehensive income (loss), net of tax: |  |  |  |  |
| Change in unrealized gains on securities available-for-sale | \$ | 85 | \$ | (238) |
| Income taxes |  |  |  |  |
| Other comprehensive income (loss), net of tax |  | 85 |  | (238) |
| Comprehensive income (loss) | \$ | 2,614 | \$ | (539) |
| Net income (loss) | \$ | 2,529 | \$ | (301) |
| Dividends and discount accretion on preferred stock |  |  |  | (779) |
| Income (loss) allocable to common stockholders | \$ | 2,529 | \$ | $(1,080)$ |
| Income (loss) per common share-basic | \$ | 0.11 | \$ | (0.13) |
| Income (loss) per common share-diluted | \$ | 0.11 | \$ | (0.13) |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Changes in Stockholders' Equity

## (In thousands, except share and per share)



## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Cash Flows

|  | Year Ended December 31 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  |
|  | (In thousands) |  |  |  |
| Cash flows from operating activities: |  |  |  |  |
| Net income (loss) | \$ | 2,529 | \$ | (301) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |  |  |  |  |
| Provision for (recapture of) loan losses |  | $(2,932)$ |  | 414 |
| Provision for losses on loans receivable held for sale |  |  |  | 153 |
| Provision for losses on REO |  | 457 |  | 590 |
| Depreciation |  | 241 |  | 214 |
| Net amortization of deferred loan origination costs |  | 221 |  | 208 |
| Net amortization of premiums on mortgage-backed securities |  | 57 |  | 35 |
| Amortization of investment in affordable housing limited partnership |  | 192 |  | 219 |
| Stock-based compensation expense |  | 11 |  | 45 |
| Earnings on bank owned life insurance |  | (65) |  | (68) |
| Net gains on sales of loans |  | (19) |  | (110) |
| Net gains on sales of REO |  | (12) |  | (112) |
| Loss on sale/disposal of office properties and equipment |  |  |  | 19 |
| Gain on restructuring of debt |  | (365) |  | $(1,221)$ |
| Amortization of deferred gain on debt restructuring |  | (133) |  | (37) |
| Stock-based compensation non-employee |  | 25 |  |  |
| Net change in accrued interest receivable |  | (109) |  | 143 |
| Net change in other assets |  | 636 |  | 1,711 |
| Net change in advance payments by borrowers for taxes and insurance |  | 305 |  | 65 |
| Net change in accrued expenses and other liabilities |  | 270 |  | (257) |
| Net cash provided by operating activities |  | 1,309 |  | 1,710 |
| Cash flows from investing activities: |  |  |  |  |
| Net change in loans receivable held for investment |  | $(52,153)$ |  | 11,950 |
| Purchase of loans receivable held for investment |  |  |  | $(10,849)$ |
| Proceeds from sales of loans receivable held for sale |  | 3,292 |  | 16,600 |
| Principal repayments on loans receivable held for sale |  |  |  | 1,520 |
| Available-for-sale securities: |  |  |  |  |
| Maturities, prepayments and calls |  | 2,813 |  | 3,708 |
| Purchases |  | $(10,463)$ |  |  |
| Proceeds from sales of REO |  | 2,871 |  | 8,642 |
| Redemption of FHLB stock |  |  |  | 540 |
| Purchase of FHLB stock |  | (517) |  | (376) |
| Additions to office properties and equipment |  | (213) |  | (341) |
| Net cash (used in) provided by investing activities |  | $(54,370)$ |  | 31,394 |
| Cash flows from financing activities: |  |  |  |  |
| Net change in deposits |  | 3,462 |  | $(42,666)$ |
| Proceeds from FHLB advances |  | 17,000 |  | 36,000 |
| Repayments on FHLB advances |  | $(10,500)$ |  | $(36,000)$ |
| Net proceeds from issuance of common stock |  | 9,018 |  | 3,398 |
| Repayments on junior subordinated debentures |  | (900) |  |  |
| Repayments on senior debt |  | $(2,425)$ |  |  |
| Net cash provided by (used in) financing activities |  | 15,655 |  | $(39,268)$ |
| Net change in cash and cash equivalents |  | $(37,406)$ |  | $(6,164)$ |
| Cash and cash equivalents at beginning of the year |  | 58,196 |  | 64,360 |

## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Consolidated Statements of Cash Flows (Continued)

|  | Year Ended December 31 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  |
|  | (In thousands) |  |  |  |
| Supplemental disclosures of cash flow information: |  |  |  |  |
| Cash paid for interest | \$ | 4,517 | \$ | 4,331 |
| Cash paid for income taxes |  | 3 |  | 4 |
| Supplemental disclosures of non-cash investing and financing activities: |  |  |  |  |
| Transfers of loans receivable held for investment to REO | \$ | 3,314 | \$ | 2,288 |
| Transfers of loans receivable held for sale to REO |  |  |  | 753 |
| Transfers of loans receivable from held for investment to held for sale |  | 22,754 |  | 7,259 |
| Transfers of loans receivable from held for sale to held for investment |  |  |  | 7,394 |
| Exchange of other borrowings for common stock |  |  |  | 2,575 |
| Exchange of dividends payable for common stock |  |  |  | 2,646 |
| Transfer of accrued interest to senior debt |  |  |  | 535 |
| Issuance of common stock for services |  | 25 |  |  |

See accompanying notes to consolidated financial statements.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

## December 31, 2014 and 2013

## Note 1 Summary of Significant Accounting Policies

## Nature of Operations and Principles of Consolidation

Broadway Financial Corporation (the "Company") is a Delaware corporation primarily engaged in the savings and loan business through its wholly owned subsidiary, Broadway Federal Bank, f.s.b. (the "Bank"). The Bank's business is that of a financial intermediary and consists primarily of attracting deposits from the general public and using such deposits, together with borrowings and other funds, to make mortgage loans secured by residential and commercial real estate located in Southern California. At December 31, 2014, the Bank operated two retail-banking offices in Los Angeles, California and one in the nearby city of Inglewood, California. The Bank is subject to significant competition from other financial institutions, and is also subject to regulation by certain federal agencies and undergoes periodic examinations by those regulatory authorities.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Broadway Federal Bank, f.s.b.. All significant inter-company transactions and balances have been eliminated in consolidation.

## Use of Estimates

To prepare consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP"), management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ from these estimates. The allowance and provision for loan losses, specific reserves for impaired loans, fair value of real estate owned, deferred tax asset valuation allowance, and fair values of investment securities and other financial instruments are particularly subject to change.

## Cash Flows

Cash and cash equivalents include cash, deposits with other financial institutions with original maturities less than 90 days, and federal funds sold. Net cash flows are reported for net proceeds from issuance of common stock, loans held for investment, deposit transactions, accrued interest receivable, other assets, deferred income taxes, accrued interest payable, other liabilities, and advance payments by borrowers for taxes and insurance.

## Securities

Debt securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available-for-sale when they might be sold before maturity. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income (loss), net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an 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 the intent and ability of management to retain its 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, management considers 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.

## Loans Receivable Held for Sale

The Bank originates loans for investment but may from time to time, decide to sell certain loans in order to manage loan concentrations. When a decision is made to sell a loan(s), such loan(s) is transferred from held for investment portfolio to held for sale portfolio at the lower of cost or fair value, as determined by outstanding commitments from investors. If a reduction in value is required at time of the transfer, a charge-off is recorded against the allowance for loan losses ("ALLL"). Any subsequent decline in value of the loan(s) is recorded as a valuation allowance with a corresponding charge to non-interest expense.

Loans receivable held for sale are generally sold with servicing rights released. Gains and losses on sales of loans are based on the difference between the selling price and the carrying value of the related loan sold. When loans receivable held for sale are sold, existing deferred loan fees or costs are an adjustment of the gain or loss on sale.

## Loans Receivable Held for Investment

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of allowance for loan losses, deferred loan fees and costs and unamortized premiums and discounts. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs are deferred, and recognized in income using the level-yield method without anticipating prepayments.

Interest income on all loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

## Concentration of Credit Risk

Concentrations of credit risk arise when a number of customers are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The Company's lending activities are predominantly in real estate loans that are secured by properties located in Southern California and many of the borrowers reside in Southern California. . Therefore, the Company's exposure

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

to credit risk is significantly affected by changes in the economy and real estate market in the Southern California area.

Loans Purchased

The Bank purchases or participates in loans originated by other institutions from time to time. Subject to regulatory restrictions applicable to savings institutions, the Bank's current loan policies allow all loan types to be purchased. The determination to purchase specific loans or pools of loans is based upon the Bank's investment needs and market opportunities and is subject to the Bank's underwriting policies, which require consideration of the financial condition of the borrower and the appraised value of the property, among other factors. Premiums or discounts incurred upon the purchase of loans are recognized in income using the interest method over the estimated life of the loans, adjusted for prepayments. No loans were purchased during 2014. Loans purchased during 2013 totaled $\$ 10.8$ million.

## Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent cash recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, could be charged off. In addition, the OCC and 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 allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings ("TDR") and classified as impaired.

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

If a loan is impaired, either a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or alternatively a charge-off is taken to record the loan at the fair value of the collateral, less estimated selling costs, if repayment is expected solely from the collateral.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of any necessary additional charge-off based on internal analyses and appraisals of the underlying collateral securing these loans.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment with the use of a migration to loss analysis and is based on the actual loss history experienced by the Company over the most recent three years. This actual loss experience is supplemented with information about other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

The following portfolio segments have been identified: one-to-four units ("single family"), five or more units ("multi-family"), commercial real estate, church, construction, commercial loans, and consumer loans. The risks in our various portfolio segments are as follows:

Single Family Subject to adverse employment conditions in the local economy leading to increased default rate; decreased market values from oversupply in a geographic area; impact on borrowers' ability to maintain payments in the event of incremental rate increases on adjustable rate mortgages.

Multi-Family Subject to adverse various market conditions that cause a decrease in market value or lease rates; change in personal funding sources for tenants; oversupply of units in a specific region; a shift in population; reputational risks.

Commercial Real Estate Subject to adverse conditions in the local economy which may lead to reduced cash flows due to vacancies and reduced rental rates; decreases in the value of underlying collateral.

Church Subject to adverse economic and employment conditions leading to reduced cash flows from members' donations and offerings; the stability, quality and popularity of church leadership.

Construction Subject to adverse conditions in the local economy which may lead to reduced demand for new commercial, multi-family or single family buildings or reduced lease or sale opportunities once the building is complete.

Commercial Subject to industry conditions including decreases in product demand.

Consumer Subject to adverse employment conditions in the local economy, which may lead to higher default rates.

## Real Estate Owned

Assets acquired through, or instead of, loan foreclosure are initially recorded at fair value less estimated 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. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through a provision that is charged to non-interest expense. Operating costs after acquisition are expensed as incurred.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Office Properties and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 10 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 10 years. Leasehold improvements are amortized over the lease term or the estimated useful life of the asset, whichever is shorter.

## Federal Home Loan Bank (FHLB) stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

## Bank-Owned Life Insurance

The Bank has purchased life insurance policies on a former key executive. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

## Investment in Affordable Housing Limited Partnership

The Bank owns a less than $5 \%$ interest in an affordable housing limited partnership. The investment is recorded using the cost method and is being amortized over the life of the related tax credits. The tax credits are being recognized in income tax expense in the consolidated financial statements to the extent they are utilized on the Company's income tax returns. The investment is reviewed for impairment on an annual basis or on an interim basis if an event occurs that would trigger potential impairment.

## Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

## Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## 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 the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than $50 \%$ likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest related to income tax matters in interest expense and penalties related to tax matters in income tax expense.

## Retirement Plans

Employee $401(\mathrm{k})$ expense is the amount of matching contributions made by the Company. Deferred compensation plan expense allocates the benefits over years of service. The Bank makes discretionary cash contributions to participant ESOP accounts at $1.5 \%$ of eligible compensation.

## Preferred Stock

As part of the recapitalization completed by the Company in August 2013 (the "Recapitalization"), all series of preferred stock were exchanged for shares of common stock. See Note 2 for more information on the Recapitalization.

The Series A and Series B preferred stock were non-convertible, non-cumulative, non-redeemable and non-voting perpetual preferred stock, with a par value of $\$ 0.01$ per share and a liquidation preference of $\$ 10.00$ per share. The Series C perpetual convertible preferred stock was non-voting and non-cumulative, with a par value of $\$ 0.01$ per share and a liquidation preference of $\$ 13.00$ per share. The Series $C$ preferred stock was convertible at a conversion price of $\$ 13.00$ per share, subject to certain anti-dilution adjustment provisions. The Series A, B and C preferred stock had non-cumulative annual dividend rates of $5 \%$ of their liquidation preference. Dividends were accrued when declared.

The Series D and Series E preferred stock were cumulative and non-voting perpetual preferred stock with a par value of $\$ 0.01$ per share and a liquidation preference of $\$ 1$ thousand per share. The Series D and E preferred stock accrued cumulative compounding dividends at the rate of $5 \%$ of their liquidation preference per year up to August 22, 2013, the date on which they were exchanged for common equity. Accretion of the discount recognized in connection with the original issuance of the Series D and E preferred stock was recorded up to the date of the Recapitalization and is shown as a reduction of retained earnings in the accompanying consolidated financial statements.

## Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is net income (loss) allocable to common stockholders divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted earnings (loss) per common share includes the dilutive effect of additional potential common shares issuable under stock options.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

## Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available-for-sale, net of tax, which are also recognized as separate components of equity.

## Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that any such matters existed as of the balance sheet date that will have a material effect on the consolidated financial statements.

## Restrictions on Cash

Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements. At December 31, 2014, the amount of cash reserves with the Federal Reserve Bank was $\$ 2.3$ million.

## Fair Value Measurements

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 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.

Fair values are estimated using relevant market information and other assumptions, as more fully disclosed in Note 7. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

## Operating Segments

The Company operates as a single segment. The operating information used by management to assess performance and make operating decisions about the Company is the consolidated financial data presented in these financial statements. For the years ended 2014 and 2013, the Company had one active operating subsidiary, Broadway Federal Bank, f.s.b. The Company has determined that banking is its one reportable business segment.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Reclassifications

Some items in the prior year consolidated financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year consolidated net loss or stockholders' equity.

## Adoption of New Accounting Standards

In July 2013, the FASB amended ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". These amendments provide that an unrecognized tax benefit, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except that to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. These amendments are effective for interim and annual reporting periods beginning after December 15, 2013. Adopting this standard did not have a material effect on the Company's operating results or financial condition as the Company had no unrecognized tax benefits.

In January 2014, the FASB issued ASU 2014-01, "Investments Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects". ASU 2014-01 permits a reporting entity to make an accounting policy election to account for its investments in affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the amount of tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense or benefit. ASU 2014-01 becomes effective for interim and annual periods beginning on or after December 15, 2014, with early adoption permitted. The provisions of ASU 2014-01 must be applied retrospectively to all periods presented. Adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Receivables Troubled Debt Restructurings by Creditors". ASU 2014-04 requires entities to reclassify consumer mortgage loans collateralized by residential real estate to REO when either (1) the creditor obtains legal title to the residential real estate property or (2) the borrower conveys all interest in the property to the creditor to satisfy the loan by completing a deed in lieu of foreclosure or similar agreement. A reporting entity is required to make interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in process of foreclosure. ASU 2014-04 becomes effective for interim and annual periods beginning on or after December 15, 2014. Adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". ASU 2014-15 incorporates into U.S. GAAP a requirement that management complete a going concern evaluation similar to that performed by an entity's external auditor. Under the new guidance, management will be required to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements. Further, an entity must provide certain disclosures if there is substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. Adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

## Note 2 Restructuring of the Company's Capital Structure and Regulatory Matters

During 2013 and 2014, the Company implemented a number of initiatives designed to enhance the Company's liquidity, simplify its capital structure and raise common equity. These matters, and the revision of the Orders which the Company and the Bank have been operating under, are described below.

## Holding Company Liquidity

The Company's principal sources of funds have historically been dividends from the Bank and, to a lesser extent, additional capital from investors. Since 2010, however, the Bank has not been able to pay dividends to the Company because of its recent operating losses and because of limitations in a Consent Order that the Bank entered into with the Office of the Comptroller of the Currency ("OCC") on October 30, 2013. Management does not anticipate that the Bank will receive approval to pay dividends for at least the next several quarters. Accordingly, the Company had to raise new equity capital from investors to generate liquidity over the past three years. Initially, the Company sold $\$ 200,000$ of common stock to certain directors and officers in 2012. Subsequently, the Company raised approximately $\$ 4.2$ million of additional equity capital in August 2013 as part of the Recapitalization, and another $\$ 9.7$ million of equity capital on October 16, 2014. These transactions improved the Company's liquidity, simplified its capital structure, reduced debt and associated servicing requirements, and enhanced the Bank's capital ratios, as more fully described below.

The Company increased its liquidity and strengthened its balance sheet by completing the Recapitalization in 2013, which included the following transactions:

The issuance of 8,776 shares of Series F Common Stock Equivalents in exchange for the five series of the Company's formerly outstanding preferred stock with an aggregate liquidation value or preference of $\$ 17.6$ million, including the TARP Preferred Stock that was issued to the United States Department of the Treasury (the "U.S. Treasury") pursuant to the Capital Purchase Program component of the U.S. Treasury's Troubled Asset Relief Program, which the parties agreed to value at $\$ 8.8$ million based on the price at which shares of the Common Stock were sold in the Subscription Offering referred to below;

The issuance of 2,646 shares of Series F Common Stock Equivalents in exchange for all of the accumulated dividends on the TARP Preferred Stock, totaling $\$ 2.6$ million as of the date of the exchange;

The issuance of 2,575 shares of Series F Common Stock Equivalents in exchange for $\$ 2.6$ million principal amount of the Company's bank debt (the "Debt Exchange");
(4)

The modification of the terms of the remaining $\$ 2.4$ million principal amount of the senior debt to, among other matters, extend the maturity and eliminate the default rate. Under the modified terms, the Company was required to make quarterly payments of interest only for 18 months and then monthly equal payments of principal and accrued interest thereon over the ensuing 48 months. The Company was required to obtain approval from the Federal Reserve Bank of San Francisco (the "FRB") before making principal or interest payments on the remaining $\$ 2.4$ million principal amount of the modified senior loan. The Company obtained approval from the FRB and paid the interest payments due in November 2013, February 2014, May 2014 and August 2014. In October 2014, the Company repaid the full amount of the outstanding senior debt and related accrued interest using the proceeds from the private placement described below;

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

The forgiveness of the $\$ 1.8$ million of accrued interest on the entire amount of the Company's bank debt as of the date of the exchange;

The exchange of 698 shares of Series F Common Stock Equivalents issued in the Debt Exchange for 6,982 shares of Series G Non-Voting Preferred Stock ("Series G Preferred"); and

The issuance of $4,235,500$ shares of Common Stock in private sales (the "Subscription Offering") at a price of $\$ 1.00$ per share, yielding $\$ 4.2$ million in gross proceeds. Of the $\$ 4.2$ million in gross proceeds, $\$ 1.2$ million was used to invest additional capital into the Bank and $\$ 1.0$ million was used to repay all of the inter-company payables due to the Bank from the Company.

Subsequent to the closing of the Recapitalization, the Company's stockholders approved all of the proposals presented at the Annual Meeting on November 27, 2013, including the proposals to amend the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock to $50,000,000$ shares and authorize the Company to issue up to $5,000,000$ shares of a new class of non-voting Common Stock. As a result, on December 5, 2013 the Company's 13,299 outstanding shares of Common Stock Equivalents automatically converted into $13,299,000$ shares of Common Stock, representing $65.8 \%$ of the Company's total equity at year-end, and its 6,982 shares of Series G Preferred automatically converted into 698,200 shares of non-voting Common Stock, representing $3.5 \%$ of the Company's total equity at year-end. Effective with these automatic conversions, the Company no longer has any outstanding series of preferred stock, and all of its equity capital consists of Common Stock or non-voting Common Stock.

After the Recapitalization, the Company had over $\$ 1.2$ million of cash at December 31, 2013, which provided the Company with sufficient cash resources to pay normal operating expenses over the near term, including allocations of shared expenses from the Bank, on a timely basis, but not sufficient cash to service the Company's debt. In particular, the Company had insufficient cash resources to pay the interest and principal on the Company's Floating Rate Junior Subordinated Debentures (the "Debentures"), which had been in default as to interest payments since September 2010 and as to the full amount of principal due since they matured on March 17, 2014. Accordingly, the Company began implementing the next phase of its capital plan in late 2013 to raise additional equity capital.

In January 2014, the Company submitted a proposal to the trustee for the trust that holds the Debentures to extend the maturity of the Debentures to March 17, 2024 in return for paying all accrued interest on the Debentures and $\$ 900$ thousand, or $15 \%$, of the principal amount of the Debentures at face value, subject to satisfaction of certain conditions, including a requirement to raise at least $\$ 6$ million of additional equity. The Company subsequently satisfied the conditions to implementation of this proposal and completed the modification of the Debentures and related transactions on October 16, 2014 as described below.

On October 16, 2014, the Company concurrently consummated private placements of $8,829,549$ shares of common stock, including $6,973,320$ shares of non-voting common stock, for gross proceeds of $\$ 9.7$ million. These proceeds were used in part to concurrently make payments on the Debentures of $\$ 900$ thousand of principal and approximately $\$ 805$ thousand of interest, representing all of the accrued interest on all of the Debentures. Also, the Company and the trustee for the Debentures concurrently executed a Supplemental Indenture for the Debentures that extended the maturity of the Debentures to March 17, 2024 and modified the payment terms of the remaining $\$ 5.1$ million principal amount thereof. As a result of modification of the terms of the Debentures through the execution of a Supplemental Indenture and the

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

corresponding payments of principal and all accrued interest, the Debentures are now current and not in default.

In addition, the Company used a portion of the proceeds from the private placements to invest $\$ 2.5$ million as common equity in the Bank and repay the outstanding defaulted senior debt of $\$ 2.4$ million, together with all accrued interest thereon. As a result, the Company's only remaining debt outstanding is the $\$ 5.1$ million of Debentures, all of which are current and no longer in default.

The balance of the net proceeds from the private placements, approximately $\$ 2.2$ million, have been retained by the Company to enhance its liquidity

## Regulatory Matters

As a result of significant deficiencies in the Company's and the Bank's operations noted in a regulatory examination in early 2010, the Company and the Bank were declared to be in "troubled condition" and agreed to the issuance of the cease and desist orders (the "Orders") by the regulatory predecessor of the OCC for the Bank and the FRB for the Company 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 of Directors. Effective October 30, 2013, the Order for the Bank was superseded by a Consent Order entered into by the Bank with the OCC. As part of the Consent Order, the Bank is required to attain, and thereafter maintain, a Tier 1 (Core) Capital to Adjusted Total Assets ratio of at least $9 \%$ and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least $13 \%$, both of which ratios are greater than the respective $4 \%$ and $8 \%$ levels for such ratios that are generally required under OCC regulations. The Bank's regulatory capital exceeded both of these higher capital ratios at December 31, 2014 and 2013 (see Note 15).

The Consent Order imposed new requirements on the Bank, including the following, among others:

The Bank was required to create a Compliance Committee consisting of at least three independent directors to monitor compliance with the Consent Order.

The Board of the Bank was required to prepare and submit a strategic plan, and a capital plan that is consistent with the strategic plan, for approval by the OCC. The capital plan requirement includes requirements regarding targeted capital ratios and prior approval requirements for the payment of dividends.

The Bank must implement an enhanced set of lending, other business and corporate governance procedures, and must develop and adhere to a written commercial real estate loan concentration risk management program and a written program to reduce the level of assets considered doubtful, substandard or special mention. This latter program includes requirements to monitor the levels of such assets on an on-going basis and to prepare and implement corrective actions as deemed necessary.

The Bank must also implement an independent on-going loan review system and adopt new policies with respect to maintaining an adequate allowance for loan and lease losses.

In November 2013, management submitted updated policies and procedures to the OCC with respect to determining and maintaining an appropriate level of ALLL. In December 2013, the Board of Directors established a Consent Order Compliance Committee to oversee the operating changes implemented by the

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

Bank to comply with the Consent Order. In January 2014, the Bank submitted its strategic plan and capital plan to the OCC for approval and in August 2014 submitted revised forms of the plans. In November 2014, the Bank received a written statement of non-objection from the OCC with respect to the capital plan, but not with respect to the strategic plan requirements.

Management believes that the Bank is in compliance with all aspects of the Consent Order, other than the Consent Order's strategic plan and loan concentration risk management plan requirements.

The Company is amending the strategic plan to incorporate the provisions of a revised loan concentration risk management plan that is intended to reduce the Bank's concentration limit established for multi-family loans.

Based on the Bank's current capital levels, management anticipates that the Bank will find it necessary to sell more multi-family loans than previously planned in order to comply with the reduced concentration limit for multi-family loans set by the OCC. During the fourth quarter of 2014, in order to comply with regulatory loan concentration limits, $\$ 22.8$ million of loans receivable held for investment, primarily multi-family loans, were transferred to held for sale. See Note 4 for more information regarding loans receivable held for sale.

The Consent Order does not include certain restrictions on the Bank that had been imposed by the Order, such as the specific limitation on the Bank's ability to increase its assets during any quarter or certain limitations on employment agreements and compensation arrangements.

Management believes that the Order issued to the Company, which has been administered by the FRB since July 2012, remains in effect. This Order imposes limitations and restrictions on several aspects of the Company's business, including the following:

The Company may not declare or pay any dividends or make any other capital distributions without the prior written approval of the FRB.

The Company may not make any changes in its directors or senior executive officers without prior notice to and receipt of notice of non-objection from the FRB.

The Company is subject to limitations on severance and indemnification payments and on entering into or amending employment agreements and compensation arrangements, and on the payment of bonuses to Bank directors and officers.

The Company may not 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.

See Note 11 for more information regarding the Debentures and the senior loan and Note 17 for information regarding the separate condensed financial information of Broadway Financial Corporation.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Note 3 Securities

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolios at December 31, 2014 and December 31, 2013 and the corresponding amounts of unrealized gains which are recognized in accumulated other comprehensive income (loss):

|  | Amortized Cost |  | Gross Unrealized Gains |  | Gross <br> Unrealized <br> Losses | Fair Value |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| December 31, 2014: |  |  |  |  |  |  |  |
| Residential mortgage-backed | \$ | 14,578 | \$ | 540 | \$ | \$ | 15,118 |
| U.S. Government and federal agency |  | 1,932 |  | 25 |  |  | 1,957 |
| Total available-for-sale securities | \$ | 16,510 | \$ | 565 | \$ | \$ | 17,075 |


| December 31, 2013: | $\$$ | 8,917 | $\$$ | 480 | $\$$ | $\$$ | 9,397 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Residential mortgage-backed $\$$ 8,917 $\$$ 480 | $\$$ | $\$$ | 9,397 |  |  |  |  |

The amortized cost and fair value of the investment securities portfolios are shown by contractual maturity at December 31, 2014. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily residential mortgage-backed securities, are shown separately.

| Maturity | Available-for-Sale <br> Amortized Cost <br> Fair Value <br> (In thousands) |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Within one year | $\$$ | $\$$ |  |  |
| One to five years | 1,932 | 1,957 |  |  |
| Five to ten years <br> Beyond ten years <br> Residential mortgage-backed |  |  |  |  |
| Total | $\$$ | 14,578 | 15,118 |  |

At December 31, 2014, securities pledged to secure public deposits had a carrying amount of $\$ 1.2$ million. At December 31, 2013, securities pledged to secure public deposits and FHLB advances had a carrying amount of $\$ 9.4$ million. At December 31, 2014 and 2013, 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 stockholders' equity.

There were no sales of securities during the year ended December 31, 2014 and 2013.

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## Note 4 Loans Receivable Held for Sale

Loans receivable held for sale at December 31, 2014 totaled $\$ 19.5$ million and consisted of multi-family loans. There were no loans receivable held for sale at December 31, 2013.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Note 5 Loans Receivable Held for Investment

Loans at year-end were as follows:

|  | December 31, 2014 <br> (In thousands) | December 31, 2013 |  |
| :--- | ---: | ---: | ---: |
| Real estate: | $\$$ | 39,792 | $\$$ |
| Single family | 171,792 | 46,459 |  |
| Multi-family | 16,722 | 113,218 |  |
| Commercial real estate | 54,599 | 26,697 |  |
| Church | 387 | 67,934 |  |
| Construction | 262 | 424 |  |
| Commercial other | 9 | 2,067 |  |
| Consumer |  | 38 |  |
|  | 283,563 |  |  |
| Gross loans receivable | 1,545 | 256,837 |  |
| Unamortized net deferred loan costs and premium | $(8,465)$ | 1,156 |  |
| Allowance for loan losses |  | $(10,146)$ |  |
|  |  | 276,643 | $\$$ |
| Loans receivable, net | $\$$ | 247,847 |  |

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2014 and 2013:

|  | Single family |  | Multifamily |  | Real Estate Commercial real estate |  | Church <br> (In thou |  | ConstructionCommercial usands) |  |  |  | Consumer |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | \$ | 1,930 | \$ | 1,726 | \$ | 1,473 | \$ | 4,949 | \$ | 7 | \$ | 55 | \$ | 6 | \$ | 10,146 |
| Provision for (recapture of) loan losses |  | (625) |  | 1,000 |  | (969) |  | $(1,228)$ |  |  |  | $(1,107)$ |  | (3) |  | $(2,932)$ |
| Recoveries |  | 2 |  |  |  |  |  | 859 |  |  |  | 1,083 |  |  |  | 1,944 |
| Loans charged off |  | (133) |  |  |  | (8) |  | (533) |  |  |  | (19) |  |  |  | (693) |
| Ending balance | \$ | 1,174 | \$ | 2,726 | \$ | 496 | \$ | 4,047 | \$ | 7 | \$ | 12 | \$ | 3 | \$ | 8,465 |

For the year ended December 31, 2013
Real Estate


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| Provision for loan losses |  | (210) |  | 265 |  | (148) |  | 876 |  | (1) |  | (365) |  | (3) |  | 414 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Recoveries |  | 300 |  |  |  | 116 |  | 25 |  |  |  | 253 |  |  |  | 694 |
| Loans charged off |  | (220) |  | (661) |  | $(1,180)$ |  | (770) |  |  |  |  |  |  |  | $(2,831)$ |
| Ending balance | \$ | 1,930 | \$ | 1,726 | \$ | 1,473 | \$ | 4,949 | \$ | 7 | \$ | 55 | \$ | 6 | \$ | 10,146 |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

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 December 31, 2014 and 2013:


## Loans:

| Loans individually evaluated for impairment | \$ | 1,400 | \$ | 2,762 | \$ | 4,650 | \$ | 14,905 | \$ |  | \$ | 102 | \$ |  | \$ | 23,819 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans collectively evaluated for impairment |  | 38,392 |  | 169,030 |  | 12,072 |  | 39,694 |  | 387 |  | 160 |  | 9 |  | 259,744 |
| Total ending loans balance | \$ | 39,792 | \$ | 171,792 | \$ | 16,722 | \$ | 54,599 | \$ | 387 | \$ | 262 | \$ | 9 | \$ | 283,563 |


|  | December 31, 2013 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Single family |  |  | Multifamily | Real Estate Commercial real estate |  | Church Construction (In thousands) |  |  |  | Commercial <br> other |  | Consumer |  | Total |  |
| Allowance for loan losses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Ending allowance balance attributable to loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Individually evaluated for impairment | \$ | 382 | \$ | 143 | \$ | 206 | \$ | 1,444 | \$ |  | \$ | 12 | \$ |  | \$ | 2,187 |
| Collectively evaluated for impairment |  | 1,548 |  | 1,583 |  | 1,267 |  | 3,505 |  | 7 |  | 43 |  | 6 |  | 7,959 |
| Total ending allowance balance | \$ | 1,930 | \$ | 1,726 | \$ | 1,473 | \$ | 4,949 | \$ | \$ 7 | \$ | 55 | \$ | 6 | \$ | 10,146 |

## Loans:

| Loans individually evaluated for impairment | \$ | 3,053 | \$ | 4,163 | \$ | 4,894 | \$ | 21,243 | \$ |  | \$ | 150 | \$ |  | \$ | 33,503 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans collectively evaluated for impairment |  | 43,406 |  | 109,055 |  | 21,803 |  | 46,691 |  | 424 |  | 1,917 |  | 38 |  | 223,334 |
| Total ending loans balance | \$ | 46,459 | \$ | 113,218 | \$ | 26,697 | \$ | 67,934 | \$ | 424 | \$ | 2,067 | \$ | 38 | \$ | 256,837 |

## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

The following table presents information related to loans individually evaluated for impairment by type of loans as of December 31, 2014 and 2013:

| December 31, 2014 |  | December 31, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Allowance |  |  | Allowance |
| Unpaid |  | for Loan | Unpaid |  | for Loan |
| Principal | Recorded | Losses | Principal | Recorded | Losses |
| Balance | Investment | Allocated | Balance | Investment | Allocated |

(In thousands)

| With no related allowance recorded: |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Single family | \$ | 1,448 | \$ | 722 | \$ |  | \$ | 2,114 | \$ | 1,441 | \$ |  |
| Multi-family |  | 1,384 |  | 1,259 |  |  |  | 2,690 |  | 2,598 |  |  |
| Commercial real estate |  | 4,836 |  | 1,177 |  |  |  | 4,867 |  | 1,391 |  |  |
| Church |  | 6,234 |  | 4,471 |  |  |  | 11,806 |  | 8,446 |  |  |
| Commercial other |  | 34 |  | 34 |  |  |  | 3,850 |  |  |  |  |
| With an allowance recorded: |  |  |  |  |  |  |  |  |  |  |  |  |
| Single family |  | 678 |  | 678 |  | 132 |  | 1,612 |  | 1,612 |  | 382 |
| Multi-family |  | 1,541 |  | 1,503 |  | 115 |  | 1,578 |  | 1,565 |  | 143 |
| Commercial real estate |  | 3,473 |  | 3,473 |  | 161 |  | 3,503 |  | 3,503 |  | 206 |
| Church |  | 10,751 |  | 10,434 |  | 1,088 |  | 12,862 |  | 12,797 |  | 1,444 |
| Commercial other |  | 68 |  | 68 |  | 10 |  | 150 |  | 150 |  | 12 |
| Total | \$ | 30,447 | \$ | 23,819 | \$ | 1,506 | \$ | 45,032 | \$ | 33,503 | \$ | 2,187 |

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net, due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for net charge-offs.

The following table presents the monthly average of individually impaired loans by type of loan and the related interest income for the years ended December 31, 2014 and 2013.

|  | For the year ended December 31, 2014 |  |  |  | For the year ended December 31, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | erage orded stment | Cash Basis Interest Income Recognized |  | Average Recorded Investment |  | Cash Basis Interest Income Recognized |  |
| Single family | \$ | 2,327 | \$ | 67 | \$ | 3,738 | \$ | 132 |
| Multi-family |  | 3,425 |  | 79 |  | 3,438 |  | 61 |
| Commercial real estate |  | 4,762 |  | 373 |  | 7,291 |  | 456 |
| Church |  | 17,212 |  | 787 |  | 22,768 |  | 677 |
| Construction |  |  |  |  |  | 62 |  | 12 |
| Commercial other |  | 124 |  | 9 |  | 155 |  | 12 |
| Total | \$ | 27,850 | \$ | 1,315 | \$ | 37,452 | \$ | 1,350 |

Cash-basis interest income recognized represents cash received for interest payments on accruing impaired loans. Interest payments collected on non-accrual loans are characterized as payments of principal rather than payments of the outstanding accrued interest on the loans until the remaining principal on the

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

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## December 31, 2014 and 2013

non-accrual loans is considered to be fully collectible. Foregone interest income that would have been recognized had loans performed in accordance with their original terms amounted to $\$ 1.3$ million and $\$ 1.9$ million for the years ended December 31, 2014 and 2013, respectively, and were not included in the consolidated results of operations.

The following tables present the aging of the recorded investment in past due loans as of December 31, 2014 and 2013 by type of loans:

|  | $\begin{aligned} & \text { 30-59 Days } \\ & \text { Past Due } \end{aligned}$ |  | $\begin{gathered} \text { 60-89 Days } \\ \text { Past Due } \end{gathered}$ |  | December 31, 2014Greater than90 DaysPast Due(In thousands) |  | Total <br> Past Due |  | Current |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans receivable held for investment: |  |  |  |  |  |  |  |  |  |  |
| Single family | \$ |  | \$ |  | \$ |  | \$ |  | \$ | 39,792 |
| Multi-family |  | 455 |  |  |  |  |  | 455 |  | 171,337 |
| Commercial real estate |  | 856 |  |  |  |  |  | 856 |  | 15,866 |
| Church |  |  |  | 180 |  | 987 |  | 1,167 |  | 53,432 |
| Construction |  |  |  |  |  |  |  |  |  | 387 |
| Commercial other |  | 34 |  |  |  |  |  | 34 |  | 228 |
| Consumer |  |  |  |  |  |  |  |  |  | 9 |
| Total | \$ | 1,345 | \$ | 180 | \$ | 987 | \$ | 2,512 | \$ | 281,051 |


|  | 30-59 DaysPast Due |  | 60-89 Days Past Due |  | December 31, 2013 <br> Greater than <br> 90 Days <br> Past Due <br> (In thousands) |  | Total <br> Past Due |  | Current |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans receivable held for investment: |  |  |  |  |  |  |  |  |  |  |
| Single family | \$ | 802 | \$ |  | \$ | 585 | \$ | 1,387 | \$ | 45,072 |
| Multi-family |  |  |  |  |  | 545 |  | 545 |  | 112,673 |
| Commercial real estate |  | 346 |  |  |  | 1,016 |  | 1,362 |  | 25,335 |
| Church |  | 2,557 |  | 323 |  | 4,877 |  | 7,757 |  | 60,177 |
| Construction |  |  |  |  |  |  |  |  |  | 424 |
| Commercial other |  | 82 |  |  |  |  |  | 82 |  | 1,985 |
| Consumer |  |  |  |  |  |  |  |  |  | 38 |
| Total | \$ | 3,787 | \$ | 323 | \$ | 7,023 | \$ | 11,133 | \$ | 245,704 |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

The following table presents the recorded investment in non-accrual loans by type of loans as of December 31, 2014 and 2013:

|  | $\begin{gathered} \text { December 31, } \\ 2014 \end{gathered}$ |  | $\begin{gathered} \text { December 31, } \\ 2013 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
|  | (In thousands) |  |  |  |
| Loans receivable held for investment: |  |  |  |  |
| Single family | \$ | 736 | \$ | 1,441 |
| Multi-family |  | 1,618 |  | 2,985 |
| Commercial real estate |  | 1,174 |  | 1,391 |
| Church |  | 5,232 |  | 11,735 |
| Commercial other |  | 102 |  | 150 |
| Total non-accrual loans | \$ | 8,862 | \$ | 17,702 |

There were no loans 90 days or more delinquent that were accruing interest as of December 31, 2014 and 2013.

## Troubled Debt Restructurings

At December 31, 2014, loans classified as troubled debt restructurings ("TDRs") totaled $\$ 20.5$ million, of which $\$ 5.5$ million were included in non-accrual loans and $\$ 15.0$ million were on accrual status. At December 31, 2013, loans classified as TDRs totaled $\$ 27.3$ million, of which $\$ 11.5$ million were included in non-accrual loans and $\$ 15.8$ million were on accrual status. The Company has allocated $\$ 1.3$ million and $\$ 1.9$ million of specific reserves for accruing TDRs as of December 31, 2014 and December 31, 2013, respectively. 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 status can be returned to accrual status after a period of sustained performance, generally determined to be six months of timely payments as modified. A well-documented credit analysis that supports a return to accrual status based on the borrower's financial condition and prospects for repayment under the revised terms is also required. As of December 31, 2014 and 2013, the Company had no commitment to lend additional amounts to customers with outstanding loans that are classified as TDRs.

No loans were modified during the year ended December 31, 2014. The terms of certain loans were modified as TDRs during the year ended December 31, 2013. The modification of the terms of such loans included payments of delinquent property taxes by the Bank on behalf of the borrower, which would be required to be repaid by the borrower over a period greater than six months.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

The following table presents loans by type modified as troubled debt restructurings that occurred during the year ended December 31, 2013:

|  | For the year ended December 31, 2013 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Number of Loans | Pre-Modification Outstanding Recorded Investment |  | Post-Modification Outstanding Recorded Investment |  |
| Single family | 5 | \$ | 739 | \$ | 789 |
| Commercial real estate | 1 |  | 1,456 |  | 1,497 |
| Church | 1 |  | 409 |  | 432 |
| Total | 7 | \$ | 2,604 | \$ | 2,718 |

The troubled debt restructurings described above increased the allowance for loan losses by $\$ 57$ thousand and resulted in charge offs of \$23 thousand during the year ended December 31, 2013.

At December 31, 2014 and 2013, none of the loans modified as troubled debt restructurings within the previous 12 months experienced a payment default. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

## 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 single 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 herein. 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.

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December 31, 2014 and 2013

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Pass rated loans are generally well protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Pass rated assets are not more than 59 days past due and are generally performing in accordance with the loan terms. Based on the most recent analysis performed, the risk category of loans by type of loans as of December 31, 2014 and 2013 is as follows:

|  | December 31, 2014 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Pass |  | Special Mention ${ }_{\text {(In }}$ |  | Substandard ousands) |  | D | Loss |
| Single family | \$ | 35,630 | \$ | 3,436 | \$ | 726 |  | \$ |
| Multi-family |  | 168,949 |  | 610 |  | 2,233 |  |  |
| Commercial real estate |  | 13,210 |  | 282 |  | 3,230 |  |  |
| Church |  | 41,938 |  | 2,284 |  | 10,377 |  |  |
| Construction |  | 387 |  |  |  |  |  |  |
| Commercial other |  | 160 |  |  |  | 102 |  |  |
| Consumer |  | 9 |  |  |  |  |  |  |
| Total | \$ | 260,283 | \$ | 6,612 | \$ | 16,668 | \$ | \$ |

December 31, 2013

|  | Pass |  | Special Mention |  | Substandard |  | Doubtful | Loss |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Single family | \$ | 41,481 | \$ | 3,537 | \$ | 1,441 | \$ | \$ |
| Multi-family |  | 105,377 |  | 2,305 |  | 5,536 |  |  |
| Commercial real estate |  | 18,154 |  | 529 |  | 8,014 |  |  |
| Church |  | 34,367 |  | 17,657 |  | 15,910 |  |  |
| Construction |  | 424 |  |  |  |  |  |  |
| Commercial other |  | 490 |  | 1,427 |  | 150 |  |  |
| Consumer |  | 38 |  |  |  |  |  |  |
| Total | \$ | 200,331 | \$ | 25,455 | \$ | 31,051 | \$ | \$ |

## Note 6 Real Estate Owned

Real estate owned, net at December 31, 2014 and 2013 were as follows:

|  | December 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  |
|  | (In thousands) |  |  |  |
| Commercial real estate | \$ | \$ |  | 173 |
| Church |  |  |  | 2,045 |


| Gross real estate owned | 2,082 | 2,218 |  |
| :--- | :---: | :---: | :---: |
| Less valuation allowance |  | $(134)$ |  |
|  | $\$$ | 2,082 | $\$$ |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

Real estate owned activity was as follows:

|  | 2014 |  | 2013 |  |
| :---: | :---: | :---: | :---: | :---: |
|  | (In thousands) |  |  |  |
| Beginning balance | \$ | 2,218 | \$ | 8,709 |
| Loans transferred to real estate owned |  | 3,314 |  | 3,041 |
| Direct write-downs |  | (591) |  | $(1,002)$ |
| Sales of real estate owned |  | $(2,859)$ |  | $(8,530)$ |
| Ending balance | \$ | 2,082 | \$ | 2,218 |

Activity in the valuation allowance was as follows:

|  | $\mathbf{2 0 1 4}$ |  |  | $\mathbf{2 0 1 3}$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  |  |  |  |  |$)$

Expenses related to foreclosed assets include:

|  | (In thousands) |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Net gains on sales | \$ | (12) | \$ | (112) |
| Provision for losses |  | 457 |  | 590 |
| Operating expenses |  | 127 |  | 301 |
| Total net expenses | \$ | 572 | \$ | 779 |

## Note 7 Fair Value

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 impaired loans that are collateral dependent 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

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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.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013
Assets acquired through or by transfer in lieu 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, which are updated every nine months. 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 properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, an independent third-party licensed appraiser reviews the appraisals for accuracy and reasonableness, reviewing the assumptions and approaches utilized in the appraisal. as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

## Assets Measured on a Recurring Basis

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

Fair Value Measurements at December 31, 2014
Quoted Prices

| in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) (In thou | Significant Unobservable Inputs (Level 3) <br> ands) |  | Total |
| :---: | :---: | :---: | :---: | :---: |
|  | \$ 15,118 | \$ | \$ | 15,118 |
| 1,957 |  |  |  | 1,957 |

Fair Value Measurements at December 31, 2013
Quoted Prices in Active
Markets for
Identical
Assets

| Significant |  |
| :---: | :---: |
| Other | Significant |
| Observable | Unobservable |
| Inputs | Inputs |
| (Level 2) | (Level 3) |

Total
$\left.\begin{array}{llllllllll} & & & & \\ \text { (In thousands) }\end{array}\right)$

There were no transfers between Level 1, Level 2, or Level 3 during the years ended December 31, 2014 and 2013.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Assets Measured on a Non-Recurring Basis

The following table provides information regarding the carrying values of 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.

|  | December 31, 2014 <br> (In thousands) | December 31, 2013 |  |
| :--- | ---: | ---: | ---: |
| Assets: |  |  |  |
| Impaired loans carried at fair value of collateral: | 549 | $\$$ | 1,245 |
| Single family | 323 | 900 |  |
| Multi-family | 1,177 | 1,391 |  |
| Commercial real estate | 3,779 | 9,024 |  |
| Church |  | 151 |  |
| Real estate owned: | 2,082 | 1,933 |  |
| Commercial real estate | F-31 |  |  |
| Church |  |  |  |
|  |  |  |  |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

The following tables present quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014 and 2013:

|  | Fair Value | December 31, 2014 |  | Range (Weighted Average) |
| :---: | :---: | :---: | :---: | :---: |
|  |  | Valuation <br> Technique(s) | Unobservable Input(s) |  |
|  | (Dollars in thousands) |  |  |  |
| Impaired loans single family | \$ 549 | Sales comparison approach | Adjustment for differences between the comparable sales | $\begin{aligned} & 1 \% \text { to } 9 \% \\ & (4 \%) \end{aligned}$ |
| Impaired loans multi-family | 323 | Sales comparison approach | Adjustment for differences between the comparable sales | 18\% |
|  |  | Income approach | Capitalization rate | 7\% |
| Impaired loans commercial real estate | 1,177 | Sales comparison approach | Adjustment for differences between the comparable sales | $\begin{gathered} 0 \% \text { to } 1 \% \\ (0 \%) \end{gathered}$ |
|  |  | Income approach | Capitalization rate | $\begin{gathered} 5 \% \text { to } 7.25 \% \\ (6.64 \%) \end{gathered}$ |
| Impaired loans church | 3,779 | Sales comparison approach | Adjustment for differences between the comparable sales | $\begin{gathered} 12 \% \text { to } 18 \% \\ (5 \%) \end{gathered}$ |
|  |  | Income approach | Capitalization rate | 6\% |
| Real estate owned church | 2,082 | Sales comparison approach -32 | Adjustment for differences between the comparable sales | $\begin{aligned} & 1 \% \text { to } 2 \% \\ & (0 \%) \end{aligned}$ |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

December 31, 2013


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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Fair Values of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at December 31, 2014 and December 31, 2013 were as follows:

|  | Carrying Value |  | Fair Value Measurements at December 31, 2014 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | (In thousands) |  |  |  | Level 3 |  | Total |  |
| Financial Assets: |  |  |  |  |  |  |  |  |  |  |
| Cash and cash equivalents | \$ | 20,790 | \$ | 20,790 | \$ |  | \$ |  | \$ | 20,790 |
| Securities available-for-sale |  | 17,075 |  | 1,957 |  | 15,118 |  |  |  | 17,075 |
| Loans receivable held for sale |  | 19,481 |  |  |  |  |  | 19,679 |  | 19,679 |
| Loans receivable held for investment |  | 276,643 |  |  |  |  |  | 277,000 |  | 277,000 |
| Federal Home Loan Bank stock |  | 4,254 |  |  |  |  |  |  |  | N/A |
| Accrued interest receivable |  | 1,216 |  |  |  | 45 |  | 1,171 |  | 1,216 |
| Financial Liabilities: |  |  |  |  |  |  |  |  |  |  |
| Deposits | \$ | 217,867 | \$ |  | \$ | 210,181 | \$ |  | \$ | 210,181 |
| Federal Home Loan Bank advances |  | 86,000 |  |  |  | 88,246 |  |  |  | 88,246 |
| Junior subordinated debentures |  | 5,100 |  |  |  |  |  | 2,034 |  | 2,034 |


|  | Carrying <br> Value |  | Fair Value Measurements at December 31, 2013 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Level 1 |  | Level 2(In thousands) |  | Level 3 |  | Total |  |
| Financial Assets: |  |  |  |  |  |  |  |  |  |  |
| Cash and cash equivalents | \$ | 58,196 | \$ | 58,196 | \$ |  | \$ |  | \$ | 58,196 |
| Securities available-for-sale |  | 9,397 |  |  |  | 9,397 |  |  |  | 9,397 |
| Loans receivable held for investment |  | 247,847 |  |  |  |  |  | 8,167 |  | 248,167 |
| Federal Home Loan Bank stock |  | 3,737 |  |  |  |  |  |  |  | N/A |
| Accrued interest receivable |  | 1,107 |  |  |  | 27 |  | 1,080 |  | 1,107 |
| Financial Liabilities: |  |  |  |  |  |  |  |  |  |  |
| Deposits | \$ | 214,405 | \$ |  | \$ | 209,656 | \$ |  | \$ | 209,656 |
| Federal Home Loan Bank advances |  | 79,500 |  |  |  | 82,840 |  |  |  | 82,840 |
| Junior subordinated debentures |  | 6,000 |  |  |  |  |  | 2,167 |  | 2,167 |
| Senior debt |  | 2,923 |  |  |  |  |  | 1,429 |  | 1,429 |

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

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The fair value of loans receivable held for sale is estimated based upon binding contracts and quotes from third party investors or appraisal reports adjusted by sales commission assumptions resulting in a Level 3 classification.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013
(c)

## Loans receivable held for investment

Fair values of loans, excluding loans receivable 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)

Junior Subordinated Debentures and Senior Debt

The fair values of the Company's junior subordinated debentures and senior debt 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

The carrying amounts of accrued interest receivable approximate their fair value and are classified the same as the related asset.

## Note 8 Office Properties and Equipment, net

Year-end office properties and equipment were as follows:

|  | $\mathbf{2 0 1 4}$ |  | $\mathbf{2 0 1 3}$ |  |
| :--- | ---: | ---: | ---: | ---: |
|  |  | (In thousands) |  |  |
| Land | $\$$ | 572 | $\$$ | 572 |
| Office buildings and improvements |  | 3,231 | 3,126 |  |


| Furniture, fixtures and equipment |  | 1,655 | 2,140 |
| :--- | :---: | :---: | :---: |
|  |  | 5,458 | 5,838 |
| Less accumulated depreciation |  | $(2,761)$ | $(3,113)$ |
| Office properties and equipment, net | $\$$ | 2,697 | $\$$ |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

Depreciation expense was $\$ 241$ thousand and $\$ 214$ thousand for 2014 and 2013.

At December 31, 2014, the Company was obligated through 2021 under various non-cancelable operating leases on buildings and land used for office space and banking purposes. These operating leases contain escalation clauses which provide for increased rental expense, based primarily on increases in real estate taxes and cost-of-living-indices. The Company also leases certain office equipment. Rent expense under the operating leases was $\$ 478$ thousand for 2014 and $\$ 458$ thousand for 2013.

Rent commitments, before considering renewal options that generally are present, are as follows:

|  | Premises | Equipment <br> (In thousands) | Total |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Year ending December 31: |  |  |  |  |  |
| 2015 | $\$$ | 386 | $\$$ | 39 | $\$$ |
| 2016 |  | 404 | 35 | 425 |  |
| 2017 | 416 | 34 | 439 |  |  |
| 2018 | 467 | 17 | 450 |  |  |
| 2019 | 481 |  | 484 |  |  |
| Thereafter | 661 |  | 481 |  |  |
| Total |  |  |  |  |  |

## Note 9 Deposits

Deposits are summarized as follows:

|  | December 31, |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
|  |  | $\mathbf{2 0 1 4}$ | 2013 |  |
|  | (In thousands) |  |  |  |
| NOW account and other demand deposits | $\$$ | 8,576 | $\$$ | 12,006 |
| Non-interest bearing demand deposits |  | 20,937 | 18,951 |  |
| Money market deposits | 16,266 | 15,494 |  |  |
| Passbook | 36,970 | 37,900 |  |  |
| Certificates of deposit |  | 135,118 | 130,054 |  |
| Total | $\$$ | 217,867 | $\$$ | 214,405 |

There were no brokered deposits at December 31, 2014. Brokered deposits totaled $\$ 1.5$ million at December 31, 2013.

Certificates of deposit of $\$ 250$ thousand or more were $\$ 26.1$ million and $\$ 23.7$ million at year end 2014 and 2013.

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

Scheduled maturities of certificates of deposit for the next five years are as follows:

| Maturity | Amount <br> (In thousands) |  |
| :--- | :---: | ---: |
| 2015 | $\$$ | 99,411 |
| 2016 |  | 22,684 |
| 2017 |  | 10,434 |
| 2018 |  | 1,207 |
| 2019 |  | 1,221 |
| Thereafter |  |  |
|  | $\$$ | 135,118 |

Deposits from principal officers, directors, and their affiliates totaled $\$ 1.7$ million and $\$ 2.0$ million at year-end 2014 and 2013.

## Note 10 Federal Home Loan Bank Advances

At year-end, advances from the Federal Home Loan Bank were as follows:

|  | Amount <br> (In thousands) |  |
| :---: | :---: | :---: |
| December 31, 2014 |  |  |
| Maturities January 2015 to February 2019, fixed rates at rates from 0.27\% to 3.95\%, averaging 2.31\% | \$ | 86,000 |
| December 31, 2013 |  |  |
| Maturities October 2014 to December 2017, fixed rates at rates from 0.54\% to 4.70\%, averaging 2.49\% | \$ | 79,500 |

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $\$ 193.6$ million of first mortgage loans at year-end 2014 and $\$ 159.6$ million of first mortgage loans and $\$ 8.1$ million of residential mortgage-backed securities at year-end 2013 under a blanket lien arrangement. Based on this collateral, the Company's holdings of FHLB stock and a general borrowing limit of $\$ 100.0$ million, the Company is eligible to borrow up to an additional $\$ 14.0$ million at year-end 2014.

Required payments over the next five years are as follows:

|  | Amount <br> (In thousands) |  |
| :---: | ---: | ---: |
| 2015 | $\$$ | 35,000 |
| 2016 | 7,000 |  |
| 2017 | 36,000 |  |
| 2018 |  |  |
| 2019 |  | 8,000 |

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Note 11 Junior Subordinated Debentures and Senior Debt

On March 17, 2004, the Company issued $\$ 6.0$ million of Debentures in a private placement to a trust that was capitalized to purchase subordinated debt and preferred stock of multiple community banks. Interest on the Debentures 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 $2.78 \%$ at December 31, 2014. The Company stopped paying interest on the Debentures in September 2010 and was not able to pay the principal or accrued interest on the Debentures at their March 17, 2014 maturity date. Under the Cease and Desist Order applicable to the Company, 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 FRB. In addition, under the terms of the Debentures, the Company is not allowed to make payments on the Debentures if the Company is in default on any of its senior indebtedness, which term includes the senior debt described below. As described in Note 2, the Company completed the modification of the Debentures and related transactions on October 16, 2014, on which date the Company concurrently consummated private placements of $8,829,549$ shares of common stock, including $6,973,320$ shares of non-voting common stock, for gross proceeds of $\$ 9.7$ million, made payments of $\$ 900$ thousand of principal and approximately $\$ 805$ thousand of accrued interest on Debentures, executed a Supplemental Indenture for the Debentures that extended the maturity of the Debentures to March 17, 2024, and modified the payment terms of the remaining $\$ 5.1$ million principal amount thereof and repaid the outstanding defaulted senior debt of $\$ 2.4$ million, together with all accrued interest thereon. The modified terms of the Debentures require quarterly payments of interest only for the next five years at the original rate of 3-Month LIBOR plus $2.54 \%$. Starting in June 2019, the Company will be required to make quarterly payments of equal amounts of principal, plus interest, until the Debentures are fully amortized on March 17, 2024. The Debentures may be called for redemption at any time by the Company.

As described in Note 2, on August 22, 2013, the Company completed the Recapitalization, pursuant to which the Company exchanged shares of common stock in settlement of $\$ 2.6$ million of the principal amount of its $\$ 5.0$ million senior debt, and modified the terms for the remaining $\$ 2.4$ million principal amount of the senior debt to include, among others items, an extension of the maturity of the senior debt to February 22, 2019, and elimination of the default rate. In addition, the interest rate on the remaining loan was increased to the Wall Street Journal Prime Rate plus $2 \%$, with a floor (minimum) rate of $6 \%$, from the original loan interest rate of the Wall Street Journal Prime Rate plus 1\%, with a floor rate of $6 \%$. The repayment schedule specified six quarterly payments of interest only beginning three months following the closing of the Recapitalization, followed by 48 monthly payments of principal and interest on the loan beginning 19 months after the closing of the Recapitalization; provided, that each payment on the loan must receive prior approval from the FRB. The Company obtained approval from the FRB and paid the interest payments due in November 2013, February 2014, May 2014 and August 2014. In October 2014, the Company repaid the full amount of the outstanding senior debt and related accrued interest using proceeds from the private placement described above.

## Note 12 Employee Benefit Plans

## Broadway Federal 401(k) Plan

A 401(k) benefit plan allows employee contributions for substantially all employees up to $15 \%$ of their compensation, which are matched at a rate equal to $50 \%$ of the first $6 \%$ of the compensation contributed. Expense totaled $\$ 105$ thousand and $\$ 84$ thousand for 2014 and 2013.

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## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## ESOP Plan

Employees participate in an Employee Stock Ownership Plan ("ESOP") after attaining certain age and service requirements. Upon termination of their employment with the Bank, participants will receive shares in accordance with their vested balance. Vesting occurs over seven years. The number of shares held by the ESOP and allocated to participants were 360,235 at December 31, 2014 and 87,505 at December 31, 2013. There were no shares unallocated as of December 31, 2014 and 2013. Dividends on allocated shares increase participant accounts. Compensation expense related to the ESOP was $\$ 69$ thousand for 2014 and $\$ 49$ thousand for 2013.

## Deferred Compensation Plan

The Bank has a deferred compensation agreement with its former Chief Executive Officer ("Former CEO") whereby a stipulated amount will be paid to the Former CEO over a period of 15 years beginning on his retirement date in May 2013. Pursuant to the Order applicable to the Company, the Company is not permitted to make payments under this deferred compensation agreement. The amount accrued under this agreement was $\$ 1.0$ million at December 31, 2014 and $\$ 992$ thousand at December 31, 2013, and was accrued over the period of the Former CEO's active employment. Compensation expense was $\$ 58$ thousand for 2014 and $\$ 71$ thousand for 2013.

## Note 13 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.

Income tax expense (benefit) was as follows:

|  | $\mathbf{2 0 1 4}$ <br> (In thousands) | $\mathbf{2 0 1 3}$ <br> Current | $\$$ |
| :--- | :---: | :---: | :---: |
|  | $\$$ |  |  |
| Federal |  | 3 | 4 |
| State |  | 530 | $(286)$ |
| Deferred | 324 | $(267)$ |  |
| Federal |  | $(854)$ | 553 |
| State | $\$$ | 3 | $\$$ |
| Change in valuation allowance |  | 4 |  |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

Effective tax rates differ from the federal statutory rate of $34 \%$ applied to income before income taxes due to the following:

|  | 2014 <br> (In thousands) |  |  |
| :--- | ---: | ---: | ---: |
|  | $\mathbf{2 0 1 3}$ |  |  |
| Federal statutory rate times financial statement net income (loss) | $\$$ | 861 | $\$$ |
| Effect of: |  | $(101)$ |  |
| State taxes, net of federal benefit | 183 | $(19)$ |  |
| Enterprise zone net interest deduction |  | $(285)$ |  |
| Earnings from bank owned life insurance | $(27)$ | $(28)$ |  |
| Low income housing credits | $(212)$ | $(211)$ |  |
| Change in valuation allowance | $(854)$ | 553 |  |
| Other, net | 52 | 95 |  |
|  |  |  |  |
| Total | $\$$ | 3 | $\$$ |

Year-end deferred tax assets and liabilities were due to the following:

|  | $\mathbf{2 0 1 4}$ <br> (In thousands) |  |  |
| :--- | ---: | ---: | ---: |
| Deferred tax assets: | $\mathbf{2 0 1 3}$ |  |  |
| Allowance for loan losses | 1,833 | $\$, 040$ |  |
| Accrued liabilities | 286 | 120 |  |
| State income taxes | 44 | 42 |  |
| Deferred compensation | 513 | 407 |  |
| Stock compensation | 275 | 270 |  |
| Real estate owned | 7,341 | 6,752 |  |
| Net operating loss carryforward | 58 | 485 |  |
| Non-accrual loan interest |  | 109 |  |
| Basis difference on fixed assets | 60 | 27 |  |
| Partnership investment | 938 | 725 |  |
| General business credit | 113 | 113 |  |
| Alternative minimum tax credit | 33 | 28 |  |
| Other |  |  |  |
|  | 11,494 | 12,275 |  |
| Total deferred tax assets |  |  |  |
|  | $(1,633)$ | $(1,699)$ |  |
| Deferred tax liabilities: | $(86)$ |  |  |
| Deferred loan fees/costs | $(80)$ |  |  |
| Real estate owned | $(222)$ | $(198)$ |  |
| Basis difference on fixed assets | $(574)$ | $(574)$ |  |
| Net unrealized appreciation on available-for-sale securities | $(26)$ | $(50)$ |  |
| FHLB stock dividends | $(67)$ | $(69)$ |  |
| Mortgage servicing rights |  |  |  |
| Prepaid expenses | $(2,688)$ | $(2,590)$ |  |
|  | $(8,806)$ | $(9,685)$ |  |
| Total deferred tax liabilities |  |  |  |
| Valuation allowance |  |  |  |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

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 $\$ 8.8$ million was required as of December 31, 2014, resulting in $\$ 0$ net deferred tax assets. The Company had recorded a valuation allowance of $\$ 9.7$ million and $\$ 0$ net deferred tax assets as of December 31, 2013.

As of December 31, 2014, the Company had federal net operating loss carryforwards of $\$ 14.8$ million, expiring beginning in 2032 through 2034 and California net operating loss carryforwards of $\$ 32.1$ million, expiring beginning in 2030 through 2034. The Company also had federal general business credits of $\$ 938$ thousand, expiring beginning in 2031 through 2034, and alternative minimum tax credit carryforwards of $\$ 113$ thousand, which can be carried forward indefinitely.

Federal income tax laws previously allowed the Company additional bad debt deductions based on the reserve method of computing the federal bad debt deduction. This method of computing the Company's federal bad debt deduction was permitted to be used by the Company until the end of 1987. As of December 31, 1987, the tax bad debt reserve balance totaled $\$ 3.0$ million. Accounting standards do not require a deferred tax liability to be recorded on this amount, which otherwise would total $\$ 1.0$ million at year end 2014 and 2013. If the Bank were liquidated, or otherwise ceases to be a bank, the $\$ 3.0$ million tax bad debt reserve may need to be recaptured into taxable income and income tax expense would need to be provided.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|  |  | (In thousands) |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Balance at beginning of year | \$ | 488 | \$ | 431 |
| Additions based on tax positions related to the current year |  |  |  | 86 |
| Additions for tax positions of prior year |  |  |  |  |
| Reductions for tax positions of prior years |  | (13) |  | (29) |
| Settlements |  |  |  |  |
| Balance at end of year | \$ | 475 | \$ | 488 |

The $\$ 475$ thousand balance at December 31, 2014 represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the income tax provision in future periods. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. Prior to 2013, the Company recognized interest and/or penalties related to income tax matters in income tax expense. Beginning in 2013, interest related to income tax matters is recorded as interest expense. During 2014 and 2013, $\$ 3$ thousand was accrued during each period for potential interest related to these unrecognized tax benefits.

Federal tax years 2011 through 2014 remain open for the assessment of Federal income tax. California tax years 2009 through 2014 remain open for the assessment of California income tax. The Company is currently under examination by the Internal Revenue Service ("IRS") for the 2010 tax year and California Franchise Tax Board ("FTB") for the 2009, 2010, and 2011 tax years. The IRS and FTB have issued and the Company has responded to the standard Information Documentation Requests.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Note 14 Stock-Based Compensation

In 2008, the Company adopted the 2008 Long-Term Incentive Plan ("2008 LTIP"), which was approved by the Company's stockholders. 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 directors, certain officers, employees and consultants for up to $2,000,000$ 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 and may have vesting periods ranging from immediate vesting to 5 years and have 10-year contractual terms.

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

There were no options granted during 2014 and 2013. The Company recorded $\$ 11$ thousand and $\$ 45$ thousand of stock-based compensation expense for 2014 and 2013, respectively.

A summary of the activity in the plans for the years ended December 31, 2014 and 2013 follow:

|  | 2008 LTIP <br> Number <br> Outstanding <br> Weighted Average <br> Exercise Price |  |  |
| :--- | ---: | :--- | :---: |
| Outstanding at January 1, 2014 | 93,750 | $\$$ | 4.94 |
| Forfeited or expired during 2014 |  |  |  |
| Outstanding at December 31, 2014 | 93,750 | $\$$ | 4.94 |
| Vested or expected to vest at December 31, 2014 | 93,750 | $\$$ | 4.94 |



| Outstanding at <br> December 31, 2013 | 93,750 | \$ | 4.94 | \$ | 93,750 | \$ | 4.94 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Vested or expected to vest | 93,750 | \$ | 4.94 | \$ | 93,750 | \$ | 4.94 |
| Exercisable at <br> December 31, 2013 | 78,750 | \$ | 4.94 | \$ | 78,750 | \$ | 4.94 |

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## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

There were no options exercised during 2014 and 2013. As of December 31, 2014, there was no unrecognized compensation cost related to nonvested stock options granted under the plan. Options outstanding and options exercisable had no intrinsic value and had a weighted average remaining contractual term of 4.1 years at December 31, 2014.

## Note 15 Regulatory Capital Matters

Effective September 9, 2010, the Company and the Bank agreed to the issuance of cease and desist orders (the "Orders") by the Office of Thrift Supervision, which was the regulatory predecessor of the OCC. The Order applicable to the Company prohibits the Company from paying dividends to its stockholders without the prior written approval of the FRB, which is now the federal regulator for savings and loan holding companies. 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.

Effective October 30, 2013, the Bank entered into a Consent Order with the OCC, which superseded the Order applicable to the Bank. The Bank's capital requirements are administered by the OCC and 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.

As part of the Consent Order, the Bank is required to maintain a Tier 1 (Core) Capital to Adjusted Total Assets ratio of at least $9 \%$ and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least 13\%, both of which ratios are greater than the respective $4 \%$ and $8 \%$ levels for such ratios that are generally required under OCC regulations.

The Bank met the minimum capital requirements under the Consent Order at December 31, 2014 and 2013. Actual and required capital amounts and ratios at December 31, 2014 and 2013, together with the higher capital requirements that the Bank is required to meet under the Consent Order applicable to it, are presented below.


The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III") as well as requirements contemplated by the Dodd-Frank Act.

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# BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY 

## Notes to Consolidated Financial Statements (Continued)

## December 31, 2014 and 2013

Under the new capital rules, the Bank will be required to meet certain minimum capital requirements that differ from current capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of retained earnings and common stock (subject to certain adjustments) as well as accumulated other comprehensive income ("AOCI"), except to the extent that the Bank exercises a one-time irrevocable option to exclude certain components of AOCI as of March 31, 2015. The Bank will also be required to establish a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to $2.5 \%$ of risk-weighted assets to be phased in by 2019. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for the various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the rules will be a $5.0 \%$ leverage ratio, a $6.5 \%$ common equity Tier 1 capital ratio, an $8.0 \%$ Tier 1 capital ratio, and a $10.0 \%$ total capital ratio. To be adequately capitalized, those ratios are $4.0 \%, 4.5 \%, 6.0 \%$, and $8.0 \%$, respectively.

The rules modify the manner in which certain capital elements are determined. The rules make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets, including commercial real estate loans, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credit that are 90 days past due or are nonaccrual, securitization exposures, and in certain cases mortgage servicing rights and deferred tax assets.

The Bank is required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015. The conservation buffer will be phased-in beginning in 2016, and will take full effect on January 1, 2019. Certain calculations under the rules will also have phase-in periods.

## Note 16 Loan Commitments and Other Related Activities

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk for credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance-sheet risk at year-end were as follows:

|  | $\mathbf{2 0 1 4}$ <br> (In thousands) |  | $\mathbf{2 0 1 3}$ |
| :--- | :---: | :---: | :---: |
| Commitments to make loans | $\$$ | 1,000 | $\$$ |

Commitments to make loans are generally made for periods of 60 days or less. At year-end 2014, loan commitments consisted of one multi-family residential loan with an initial five year interest rate of $3.375 \%$.

## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

Note 17 Parent Company Only Condensed Financial Information
Condensed financial information of Broadway Financial Corporation follows:

|  | Condensed Balance Shee December 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  |
|  | (In thousands) |  |  |  |
| Assets |  |  |  |  |
| Cash and cash equivalents | \$ | 2,880 | \$ | 1,231 |
| Investment in bank subsidiary |  | 39,944 |  | 34,127 |
| Other assets |  |  |  | 2 |
| Total assets | \$ | 42,824 | \$ | 35,360 |
| Liabilities and stockholders' equity |  |  |  |  |
| Senior debt | \$ |  | \$ | 2,923 |
| Junior subordinated debentures |  | 5,100 |  | 6,000 |
| Accrued expenses and other liabilities |  | 466 |  | 847 |
| Stockholders' equity |  | 37,258 |  | 25,590 |
| Total liabilities and stockholders' equity | \$ | 42,824 | \$ | 35,360 |

## Condensed Statements of Operations

 Years ended December 31,|  | (In thousands) |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Interest income | \$ |  | \$ |  |
| Interest expense |  | (180) |  | (557) |
| Gain on restructuring of debt |  | 365 |  | 1,221 |
| Other expense |  | (875) |  | (815) |
| Loss before income tax and undistributed subsidiary income (loss) |  | (690) |  | (151) |
| Income taxes expense |  | (2) |  | (2) |
| Equity in undistributed subsidiary income (loss) |  | 3,221 |  | (148) |
| Net income (loss) | \$ | 2,529 | \$ | (301) |

## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Condensed Statements of Cash Flows

## Years ended December 31,

|  | 2014 |  | 2013 |  |
| :---: | :---: | :---: | :---: | :---: |
|  | (In thousands) |  |  |  |
| Cash flows from operating activities |  |  |  |  |
| Net income (loss) | \$ | 2,529 | \$ | (301) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |  |  |  |  |
| Equity in undistributed subsidiary (income) loss |  | $(3,221)$ |  | 148 |
| Gain on restructuring of debt |  | (365) |  | $(1,221)$ |
| Amortization of deferred gain on debt restructuring |  | (133) |  | (37) |
| Stock-based compensation non-employee |  | 25 |  |  |
| Change in other assets |  | 2 |  | 338 |
| Change in accrued expenses and other liabilities |  | (381) |  | 507 |
| Net cash used in operating activities |  | $(1,544)$ |  | (566) |
| Cash flows from investing activities |  |  |  |  |
| Investment in bank subsidiary |  | $(2,500)$ |  | $(1,200)$ |
| Net cash used in investing activities |  | $(2,500)$ |  | $(1,200)$ |
| Cash flows from financing activities |  |  |  |  |
| Reduction in amount due to bank subsidiary |  |  |  | (521) |
| Net proceeds from issuance of common stock and Recapitalization |  | 9,018 |  | 3,398 |
| Repayments on senior debt |  | $(2,425)$ |  |  |
| Repayments on junior subordinated debentures |  | (900) |  |  |
| Net cash provided by financing activities |  | 5,693 |  | 2,877 |
| Net change in cash and cash equivalents |  | 1,649 |  | 1,111 |
| Beginning cash and cash equivalents |  | 1,231 |  | 120 |
| Ending cash and cash equivalents | \$ | 2,880 | \$ | 1,231 |

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## BROADWAY FINANCIAL CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements (Continued)

December 31, 2014 and 2013

## Note 18 Earnings (Loss) Per Common Share

The factors used in the earnings (loss) per common share computation follow:

|  | 2014 <br> (Dollars in thousands, except share <br> and per share) |
| :--- | :--- | :--- | :--- | :--- |
| Basic $\$$ 2,529 $\$$ $(301)$ <br> Net income (loss)   $(779)$  <br> Less: Preferred stock dividends and accretion $\$$ 2,529 $\$$ $(1,080)$ |  |
| Income (loss) available to common stockholders |  |


| Weighted average common shares outstanding | $2,511,610$ |
| :--- | :--- |

Earnings (loss) per common share basic
\$ 0.11 \$

Diluted

| Net income (loss) | $\$$ | 2,529 | $\$$ | $(301)$ |
| :--- | :--- | :--- | :--- | :--- |
| Less: Preferred stock dividends and accretion |  |  |  |  |
| Income (loss) available to common stockholders | $\$$ | 2,529 | $\$$ | $(1,080)$ |


| Weighted average common shares outstanding for basic earnings per common share |  | $22,103,488$ | $8,511,610$ |
| :--- | :--- | :--- | :--- |
| Add: dilutive effects of assumed exercises of stock options |  |  |  |
| Average shares and dilutive potential common shares | $22,103,488$ | $8,511,610$ |  |

Stock options for 93,750 shares of common stock for the years December 31, 2014 and 2013 were not considered in computing diluted earnings (loss) per common share because they were anti-dilutive.

