BROADWAY FINANCIAL CORP \DE\
Form 10KSB
March 30, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-KSB

(Mark one)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

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

For the transition period from to

Commission file number **0-27464**

BROADWAY FINANCIAL CORPORATION

(Name of Small Business Issuer in its Charter)

Delaware	**95-4547287**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4800 Wilshire Boulevard, Los Angeles, California	**90010**
(Address of principal executive offices)	(Zip Code)

(323) 634-1700

(Issuer s Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Exchange Act: **None**

Securities registered under Section 12(g) of the Exchange Act:

Common Stock (including attached preferred stock purchase rights),

$0.01 par value per share

(Title of Class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. [ ]

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB [ ].

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

State issuer s revenues for its most recent fiscal year: $17,323,000

State the aggregate market value of the voting and non-voting common equity held by non-affiliates: $15,679,000, based on the average bid and asked price of such common equity, as of February 28, 2006.

State the number of shares outstanding of each of the issuer s classes of common equity, as of February 28, 2006: 1,554,610 shares of Common Stock

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Registrant s 2006 Annual Meeting of Shareholders are incorporated by reference into Part III.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

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Forward-Looking Statements

Certain statements herein, including without limitation, matters discussed under Management s Discussion and Analysis or Plan of Operation in Part II, Item 6 of this Form 10-KSB, 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 oth 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. 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-KSB. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following factors, among others, could cause future results to differ materially from historical results or from those anticipated: (1) the level of demand for mortgage loans, which is affected by such external factors as interest rate levels, tax laws, and demographics of our lending markets; (2) the direction of 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 of loan losses incurred by us, the level of our loss reserves and management s judgments regarding the collectibility of loans; (4) federal and state regulation of the lending and deposit operations or other regulatory actions; (5) the actions undertaken by both current and potential new competitors; (6) the possibility of adverse trends in the residential and non-residential real estate markets; (7) the effect of changes in economic conditions; (8) the effect of geopolitical uncertainties; and (9) other risks and uncertainties detailed in this Form 10-KSB, including Management s Discussion and Analysis or Plan of Operation.

PART I

Item 1. Description of 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.

Broadway Federal is a community-oriented savings institution dedicated to serving the African-American, Hispanic and other communities of Mid-City and South Los Angeles, California. We conduct our business from three banking offices in Los Angeles and one banking office located in the nearby City of Inglewood. Our executive offices are located at 4800 Wilshire Boulevard, Los Angeles, California 90010. The telephone number is (323) 634-1700. Shareholders, analysts and others seeking information about us can visit our website at www.broadwayfederalbank.com.

Our principal business consists of attracting retail 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 multi-family residential and commercial real estate loans. In addition, we invest in securities issued by the federal government and agencies, mortgage-backed securities, mortgage-related mutual funds and other investments.

We originate and purchase loans for investment and for sale. In most instances, we retain the servicing rights with respect to loans sold. Our primary sources of revenue are interest we earn on our mortgage loans and securities. Our principal expenses are interest expense we incur on our interest-bearing liabilities, including deposits and borrowings, together with general and administrative expenses. Our primary sources of funds are deposits, principal and interest payments on our loans and securities, proceeds from sales of our loans and securities, and Federal Home Loan Bank (FHLB) borrowings.

The Bank is regulated by the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS). The Bank s deposits are insured up to applicable limits by the Savings Association Insurance Fund (SAIF) of the FDIC. The Bank is also a member of the Federal Home Loan Bank (FHLB) of San Francisco. See -Regulation.

At December 31, 2005, the Bank was classified as well-capitalized under applicable OTS and FDIC capital regulations.

Market Area and Competition

The Los Angeles metropolitan area is a highly competitive market in which we face significant competition in making loans and in attracting deposits. Although our offices are primarily located in low and 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 a number of financial institutions with branch offices or loan origination capabilities in our market area as well as from institutions with internet-based programs. Most of these financial institutions are significantly larger and have greater financial resources than us, and many have a regional, statewide or national presence. We believe that this competition has increased substantially, particularly with respect to one-to four-family and multi-family residential lending activities. Many larger institutions, able to accept lower returns on

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loans in our market, do so to attract a sufficient volume of such loans in response to the increased emphasis by federal regulators on financial institutions fulfillment of their responsibilities under the Community Reinvestment Act. See Regulation-Community Reinvestment Act.

For much of the period since World War II, the communities of Mid-City and South Los Angeles had a predominately African-American population and, although there is significant variation among communities in South Los Angeles, a substantial portion of the area has historically consisted of low and moderate income neighborhoods and commercial areas. While the area remains predominantly low and moderate income in nature, in more recent years the population has changed, with a rapidly growing Hispanic community, as well as Asian and other ethnic communities.

Lending Activities

General. The Company s loan portfolio primarily consists of mortgage loans. We emphasize the origination of adjustable-rate loans (ARMs) and hybrid ARM loans (ARM loans having an initial fixed rate period) primarily for retention in our portfolio in order to increase the percentage of loans with more frequent repricing, thereby reducing our exposure to interest rate risk. At December 31, 2005, approximately 94% of our mortgage loans had adjustable rates. Although we have continued to originate fixed rate mortgage loans in response to customer demand, and our strategy is to have a portion of our interest earning assets be assets that do not reprice regularly, a large portion of the conforming fixed rate mortgage loans we originate and some of our ARMs and hybrid ARMs are sold in the secondary market, primarily to other financial institutions. The decision as to whether the loans will be retained in our portfolio or sold is generally made at the time of loan origination or purchase. At December 31, 2005, we had no loans held for sale.

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. Federal savings associations and savings banks are not subject to usury or other interest rate limitations.

During 2005, we purchased $20.3 million of loans originated by others. These loans are secured by multi-family residential properties and commercial real estate properties.

Multi-Family Lending. We originate multi-family mortgage loans generally secured by five or more unit apartment buildings primarily located in our market area. In reaching a decision on whether to make a multi-family loan, we consider the qualifications of the borrower as well as the underlying property securing the loan. 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 debt service), and the ratio of the loan amount to the lower of the selling price or the appraised value. Most multi-family loans are originated with maturities of up to 30 years. Multi-family loans amounted to $154.2 million and $183.5 million at December 31, 2005 and 2004, respectively. At December 31, 2005, multi-family loans represented 67% of our gross loan portfolio, compared to 77% at December 31, 2004. All of our multi-family residential mortgage loans outstanding at December 31, 2005 were ARMs.

The interest rates for our multi-family ARMs are indexed to the 11th District Cost of Funds Index (COFI), which is based on the funding cost of the member institutions of the FHLB of San Francisco, the 1-year Treasury Index (Treasury), the 1-year Constant Maturity Treasury Index (1 Yr. CMT), the 12-month average of the Treasury Index (12 MTA) and the six-month London InterBank Offered Rate Index (LIBOR). 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.

Multi-family lending is a significant part of our strategy to focus on loan program offerings in less competitive markets resulting in higher-yielding assets. The small multi-family loan (generally under $500,000) on properties in our market area has been a successful niche for us in the past several years. Most of these multi-family loans have had adjustable rates, with an initial fixed interest rate period. The fixed interest rate period for these loans generally ranges from two to seven years. The adjustable rate portion of these loans is primarily indexed to the LIBOR Index.

We believe that the risks associated with multi-family loans described below are mitigated by our underwriting requirements, which include conservative loan-to-value ratios and debt service coverage ratios. Under our underwriting policies, a multi-family ARM loan may only be made in an amount up to 75% of the lower of the selling price or the appraised value of the underlying property. Subsequent declines in the real estate values in our primary market area, however, may result in increases in the loan-to-value ratios on our existing multi-family mortgage loans. We also generally require minimum debt service ratios of 120%. Properties securing a loan are appraised by an approved independent appraiser and title insurance is required on all loans.

When evaluating the qualifications of the borrower for a multi-family loan, we consider, among other things, the financial resources and income level of the borrower, the borrower s experience in owning or managing similar property, and our lending experience with the borrower, where applicable. Our underwriting policies require that the borrower be able to demonstrate management skills and the ability to maintain the property from current rental income. The borrower is required to present evidence of the ability to repay the mortgage and a history of making mortgage payments on a timely basis. In making our assessment of the creditworthiness of the borrower, we generally review the financial statements, employment and credit history of the borrower, as well as other related documentation.

The largest multi-family loan in our loan portfolio at December 31, 2005 was a loan secured by an 26-unit property located in Van Nuys, California and had an outstanding principal balance of $1.8 million. This loan is currently performing according to its terms. Our second largest multi-family loan, totaling $1.7 million at that date, was secured by a 31-unit property located in Ontario, California. This loan is currently performing according to its terms. At December 31, 2005, we had 24 other multi-family loans with a balance exceeding $1.0 million. These loans are currently performing according to their terms.

Multi-family 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. Repayment of multi-family loans generally is dependent, in large part, on sufficient income from the property to cover operating expenses and debt service. As a result, adverse economic conditions that have severe effects in our primary market areas of Mid-City and South Los Angeles may result in declines in real estate values of multi-family properties that are more pronounced than for single-family residential properties. We attempt to offset the risks associated with multi-family lending through careful application of our underwriting standards and procedures, and by generally making such loans with lower loan-to-value ratios than the maximum ratios permitted for single-family loans. Economic events and government regulations, which are outside the control of the borrower or lender, could impact the value of the security for the loan or the future cash flow of the affected properties.

One-to Four-Family Mortgage Lending. We offer ARMs and fixed rate loans secured by one-to four-family (single-family) residences, with maturities up to 30 years. Substantially all of such 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, existing or past customers, and referrals from members of churches or other organizations in the local communities where we operate. During 2005, we originated $1.5 million of single-family loans, which is 3% of our total originations. Single-family loans totaled $19.5 million and $26.4 million at December 31, 2005 and 2004, respectively. At December 31, 2005, single-family loans represented 9% of our gross loan portfolio, compared to 11% at December 31, 2004. Of the one- to four-family residential mortgage loans outstanding at December 31, 2005, 26% were fixed rate loans and 74% were ARMs.

The interest rates for our single-family ARMs are indexed to COFI 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.

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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. Because of interest rate caps and floors, market rates may exceed and/or go below the respective maximum or minimum rates payable on our ARMs.

Our policy is to originate one- to four-family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property securing the loan and up to 95% (and under certain circumstances up to 97%) of the selling price if private mortgage insurance is obtained. We may originate loans based on other parameters for loans that are originated for committed sales to other investors. Properties securing a loan are appraised by an approved independent appraiser and title insurance is required on all loans.

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 without our consent. Due-on-sale clauses are an important means of adjusting the rates on our fixed rate mortgage loan portfolio.

The majority of our single-family loans are made available through a joint venture between the Company and Metrocities Mortgage, LLC. The Company refers loan customers to the joint venture, which is named Broadway Metro Financial, and Metrocities Mortgage, LLC provides the origination, processing, underwriting, and funding services. This arrangement enables us to offer to customers a full spectrum of single-family loan products at competitive pricing. Profits from the joint venture are split 50/50 in accordance with the terms of its Agreement and amounted to $108,000 in 2005.

Non-Residential Real Estate Lending. We originate non-residential real estate loans that are generally secured by properties used for religious or for business purposes, such as church buildings, small office buildings, health care facilities and retail facilities located in our primary market area. Non-residential real estate loans amounted to $53.3 million and $24.3 million at December 31, 2005 and 2004, respectively. At December 31, 2005, non-residential lending represented 23% of our gross loan portfolio, compared to 10% at December 31, 2004. Of the non-residential real estate loans outstanding at December 31, 2005, 15% were fixed rate loans and 85% were ARMs.

Our non-residential real estate loans are generally made in amounts up to 75% of the lower of the selling price or the appraised value of the property. These loans may have amortization periods and maturity dates of up to 30 years and are ARMs or hybrid ARMs indexed to COFI, Treasury, LIBOR, or the Prime Rate. Our non-residential loan underwriting standards and procedures are similar to those applicable to our multi-family loans. We consider, among other things, the net operating income of the property and the borrower s management expertise, credit history and profitability. We have generally required that the properties securing non-residential real estate loans have debt service coverage ratios of at least 130%. The underwriting standards for non-residential loans secured by church properties are different than for non-church, non-residential real estate in that the ratios used in evaluating the loan are based upon the level and history of church member contributions as a repayment source rather than income generated by rents or leases.

The largest non-residential loan in our portfolio was a loan purchased from Cathay General Bancorp (Cathay) in 2005. The loan is secured by a commercial building located in Tustin, California, and had an outstanding balance at December 31, 2005 of $2.1 million. This loan is currently performing according to its terms. Our second largest non-residential loan was also a loan purchased from Cathay in 2005. The loan is secured by three commercial buildings located in City of Industry, California, and had an outstanding balance at December 31, 2005 of $2.0 million. This loan is currently performing according to its terms. At December 31, 2005, our portfolio contained 13 other non-residential loans with outstanding balances exceeding $1.0 million. These loans are currently performing according to their terms.

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Originating loans secured by church properties is a market niche in which we have been active since our inception. Although we experience delinquencies on some of these loans and have made additions to our allowance for loan losses as a result thereof, this product has produced higher yields than the residential loan portfolio and we have not incurred losses from foreclosures of these loans to date. We believe that the importance of church organizations in the social and economic structure of the communities we serve makes church lending an important aspect of our community orientation. We further believe that the importance of churches in the lives of the individual members of the respective congregations encourages donations even in difficult economic times, thereby providing somewhat greater assurance of financial resources to repay such church loans compared to other types of non-residential properties. Nonetheless, adverse economic conditions can result in risks to loan repayment that are similar to those encountered in other types of non-residential lending, and such church lending is subject to other risks not necessarily directly related to economic factors such as the stability, quality and popularity of church leadership. Church loans included in our portfolio totaled $15.8 million and $13.5 million at December 31, 2005 and 2004, respectively.

Loans secured by non-residential real estate generally involve a greater degree of risk than residential mortgage loans because payment on loans secured by non-residential real estate is typically dependent on the successful operation or management of the properties and is thus subject, to a greater extent than single family residential loans, to adverse conditions in the real estate market or the economy. Additionally, adverse economic conditions in our primary lending market area could result in reduced cash flows on commercial real estate loans, vacancies and reduced rental rates on such properties. We seek to minimize these risks by originating such loans on a selective basis with more restrictive underwriting criteria and generally restrict such loans to our general market area.

Consumer Lending. Our consumer loans primarily consist of loans secured by savings accounts. At December 31, 2005, loans secured by savings accounts represented $443,000, or 0.19%, of our gross loan portfolio. Loans secured by depositors accounts are generally made up to 90% of the current value of the pledged account, at an interest rate between 2% and 4% above the rate paid on the account, depending on the type of account, and for a term expiring the earlier of one year from origination or upon the maturity of the account.

Loan Approval Procedures and Authority. Our Board of Directors establishes our lending policies. The Loan Committee, which is comprised of the Chief Lending Officer and four members of the Board of Directors, one of whom is the Chief Executive Officer, is primarily responsible for establishing and monitoring our lending policies.

The Board of Directors has authorized the following loan approval limits based upon the amount of our total loans to each borrower: if the total of the borrower s existing loans and the loan under consideration is $500,000 or less, the new loan may be approved by either the Senior Vice President/Chief Loan Officer or the President; if the total of the borrower s existing loans and the loan under consideration is from $500,001 to $1,000,000, the new loan must be approved by one Loan Committee member, in addition to the Senior Vice President/Chief Loan Officer; if the total of the borrower s existing loans and the loan under consideration is from $1,000,001 up to $1,750,000, the new loan must be approved by two Board appointed non-management Loan Committee members, in addition to the Senior Vice President/Chief Loan Officer; and if the total of existing loans and the loan under consideration is more than $1.75 million, the loan must have a unanimous Loan Committee approval. If such unanimous approval is not reached, then the loan may be presented to the Executive Committee of the Board of Directors for approval. The Board of Directors approved these limits on February 22, 2006. In addition, it is our practice that all loans approved only by management be reported the following month to the Loan Committee, and be ratified by the Board of Directors.

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 annually reviews our appraisal policy and the independent appraisers that we use.

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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, private mortgage insurance is typically required and the borrower is required to make payments to a mortgage impound account from which we make disbursements for private mortgage insurance, taxes and hazard and flood insurance as required.

Delinquencies and Classified Assets. We perform a monthly review of all delinquent loans and reports are made quarterly to the 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 nature of the loan and the period of delinquency. In the case of residential mortgage loans, we generally send the borrower a written notice of nonpayment promptly after the loan becomes past due. In the event payment is not received promptly thereafter, additional letters 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 against all real property that secures the loan.

We cease to accrue interest on all loans that are 90 days past due. When a loan first becomes 90 days past due, all previously accrued but unpaid interest is deducted from interest income. In the event a non-accrual loan subsequently becomes current, which would require that the borrower pay all past due payments, late charges and any other delinquent fees owed, all income is recognized and the loan is returned to accrual status.

In the case of non-residential real estate loans, we generally contact the borrower by telephone and send a written notice of non-payment upon expiration of the grace period. Decisions as to when to commence foreclosure actions for non-residential 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.

If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan is sold at foreclosure by the trustee named in the deed of trust. Property foreclosed upon and not purchased by a third party at the foreclosure sale is held by us as real estate owned through foreclosure (REO) and is carried in our consolidated financial statements at the lower of estimated fair value less the costs estimated to be necessary to sell the property, or cost.

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 problem assets and potential problem assets as Substandard, Doubtful or Loss assets. 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 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.

We have established an allowance for loan losses in an amount deemed prudent by management. General valuation allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When a federally insured institution classifies one or more assets, or portions thereof, as Loss, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

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A financial institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS, which can order the establishment of additional loss allowances. The OTS, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of valuation guidelines. Generally, the policy statement recommends that financial institutions have effective systems and controls to identify, monitor and address asset quality problems, that management analyze all significant factors that affect the collectibility of the portfolio in a reasonable manner and that management establish acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Although we believe we have established adequate loan loss allowances, actual losses are dependent upon future events. Accordingly, further material additions to the level of loan loss allowances may become necessary. In addition, there can be no assurance that the OTS or the FDIC, in reviewing our loan portfolio in connection with periodic regulatory examinations, will not request us to materially increase our allowance for loan losses based on such agencies evaluation of the facts available to the OTS or the FDIC at that time, thereby negatively affecting our financial condition and earnings.

At December 31, 2005, we had one loan classified as Substandard, which had a principal balance of $73,000 and was secured by a single-family property. At December 31, 2005, no loans were classified as Doubtful and no loans were classified as Loss . As of December 31, 2005, three loans were designated as Special Mention due to delinquencies or other identifiable weaknesses. At December 31, 2005, the largest loan designated as Special Mention had a principal balance of $316,000 and was secured by a multi-family property.

Investment Activities

Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers acceptances, repurchase agreements and federal funds. Subject to various restrictions, federally chartered savings institutions may also invest in commercial paper, investment grade corporate debt securities and mutual funds whose assets are limited to investments that a federally chartered savings institution is authorized to make directly.

Our investment policy is to provide a source of liquidity for deposit contraction, repayment of borrowings and loan fundings, and to generate a favorable return on investments without incurring undue interest rate and credit risk. 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 a fixed interest rate for a period of three to seven years, after which time the loans convert to a one-year or six-month adjustable rate mortgage. For further information, see Securities on page 24.

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 derive funds from loan repayments and prepayments, proceeds from sales of loans and mortgage-backed and investment securities, FHLB borrowings and cash flows generated from operations.

Deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposits principally consist of passbook savings accounts, non-interest bearing checking accounts, NOW and other demand accounts, money market accounts, and fixed-term certificates of deposit. The flow of deposits is

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influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely primarily on customer service and long-standing relationships with customers to attract and retain these deposits. We emphasize our retail core deposit relationships, consisting of customers with passbook accounts, checking accounts, non-interest bearing demand accounts and money market accounts, which we believe tend to be more stable and available at a lower cost than other, longer term types of deposits. However, market interest rates, including rates offered by competing financial institutions, significantly affect our ability to attract and retain deposits. We generally have not solicited deposit accounts by increasing the rates of interest paid as quickly as some of our competitors. We have, from time to time, used brokers to obtain wholesale deposits. Late in 2004, we joined a deposit program called Certificate of Deposit Account Registry Service (CDARS), which increased the amount of deposits. At December 31, 2005, we had approximately $33.1 million of brokered deposits. For further information, see Deposits on page 25.

Borrowings. Besides deposits, we have utilized other sources to fund our loan origination and other business activities, including borrowings from the FHLB of San Francisco. We have also issued junior subordinated debentures as an additional source of funds. Advances from the FHLB are secured primarily 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, including Broadway Federal, for purposes other than meeting withdrawals, changes from time to time in accordance with the policies of the FHLB. At December 31, 2005 and 2004, we had $56.5 million and $55.3 million, respectively, in outstanding advances from the FHLB. For further information, see Borrowings on page 26.

We have an unsecured $6.0 million revolving line of credit agreement with First Federal Bank of California. Interest is at the prime rate if the loan proceeds are used for CRA lending, and at prime plus one percent if the loan proceeds are used for any other purpose. The line of credit is renewable annually, and may be converted to a four-year term loan at the same rate of interest.

Personnel

At December 31, 2005, we had 72 employees, 56 of whom were full-time employees and 16 of whom were part-time employees. We believe that we have good relations with our employees and none are represented by a collective bargaining group.

Regulation

General. We are registered with the OTS as a savings and loan holding company and are subject to regulation and examination in that capacity by the OTS. Broadway Federal is a federally chartered savings bank and a member of the FHLB System. Our customer deposits are insured through the Savings Association Insurance Fund, which is one of two deposit insurance funds currently managed by the FDIC, but which is to be merged with the Bank Insurance fund, which is the FDIC s other insurance Fund, under recent Federal legislation. We are subject to examination and regulation by the OTS with respect to most of our business activities, including, among other things, capital standards, general investment authority, deposit taking and borrowing authority, mergers, establishment of branch offices, and permitted subsidiary investments and activities. We are also subject to regulation by the FDIC. The OTS s operations, including examination activities, are funded by assessments levied on its regulated institutions.

We are further subject to the regulations of the Board of Governors of the Federal Reserve System (the Federal Reserve Board) concerning reserves required to be maintained against deposits, transactions with affiliates, Truth in Lending and other consumer protection requirements and certain other matters.

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Financial institutions, including Broadway Federal, are also subject, under certain circumstances, to potential liability under various statutes and regulations applicable to property owners generally, including statutes and regulations relating to the environmental condition of real property and liability for the remediation of adverse environmental conditions thereof. The potential liabilities under federal and state environmental legislation may affect our decision whether to foreclose on real property that secures our loans and on the actions we may take with respect to our borrowers preceding foreclosure. Liability for environmental remediation costs may be imposed under federal and state laws without regard to whether an entity actually caused the environmental condition and may, under certain circumstances, be imposed on a real property lender if the lender is deemed to exercise control over the borrower that is the owner of the real property. If we foreclose on property containing hazardous substances, we could become subject to additional environmental statutes, regulations and common law relating to such matters as asbestos abatement, lead-based paint abatement, hazardous substance investigation and remediation, waste water discharges, hazardous waste management, and third party claims for personal injury and property damage.

The descriptions of the statutes and regulations applicable to us and the effects thereof set forth below and elsewhere herein do not purport to be a complete description of such statutes and regulations and their effects on us. The descriptions also do not purport to identify every statute and regulation that may apply to us.

Capital Requirements. The Bank must meet regulatory capital standards to be deemed in compliance with the OTS capital requirements. OTS capital regulations (the Capital Regulations) require savings institutions to meet three capital standards: a leverage limit (also referred to as the core capital requirement), a tangible capital requirement and a risk-based capital requirement. In addition to the general standards, the OTS may establish individual minimum capital requirements for a savings institution on a case-by-case basis, which vary from the requirements that would otherwise apply under the Capital Regulations.

A savings institution that fails to meet one or more of the applicable capital requirements is subject to various regulatory limitations and sanctions, including a prohibition on growth and the issuance of a capital directive by the OTS Director requiring one or more of the following: an increase in capital; a reduction of rates paid on savings accounts; cessation of or limitations on operational expenditures; an increase in liquidity; and such other actions as may be deemed necessary or appropriate by the OTS Director. In addition, a conservator or receiver may be appointed under appropriate circumstances.

The core capital requirement generally requires a savings institution to maintain core capital of not less than 4% (3% for certain highly evaluated institutions not experiencing or anticipating significant growth) of adjusted total assets. 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 with generally accepted accounting principles (GAAP), with certain exceptions. Intangible assets must be deducted from core capital, with certain exceptions and limitations, including mortgage servicing rights and certain other intangibles, which may be included on a limited basis.

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 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 classes of 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 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 and, subject to certain limitations, loan and lease general valuation allowances. At December 31, 2005 and

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2004, the general valuation allowance included in our supplementary capital was $1.4 million and $1.4 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.

Following is a reconciliation of our equity capital to the minimum OTS regulatory capital requirements as of December 31, 2005 and December 31, 2004:

	As of December 31,					
	2005			2004		
	Tangible Capital	Core Capital	Risk-Based Capital	Tangible Capital	Core Capital	Risk-Based Capital
	(In thousands)					
Equity capital-Broadway Federal	$ 21,584	$ 21,584	$ 21,584	$ 19,444	$ 19,444	$ 19,444
Additional supplementary capital:						
General valuation allowance	-	-	1,420	-	-	1,383
Assets required to be added	-	-	-	7	7	7
Regulatory capital balances	21,584	21,584	23,004	19,451	19,451	20,834
Minimum requirement	4,384	11,692	15,049	4,143	11,047	15,142
Excess over requirement	$ 17,200	$ 9,892	$ 7,955	$ 15,308	$ 8,404	$ 5,692

The Federal Deposit Insurance Act contains prompt corrective action (PCA) provisions pursuant to which banks and savings institutions are to be classified into one of five categories based primarily upon capital adequacy, ranging from well capitalized to critically undercapitalized and which require, subject to certain exceptions, the appropriate federal banking agency to take prompt corrective action with respect to an institution which becomes undercapitalized and to take additional actions if the institution becomes significantly undercapitalized or critically undercapitalized.

Under the OTS regulations implementing the PCA provisions, an institution is well capitalized if it has a total risk-based capital ratio of 10.00% or greater, has a Tier 1 risk-based capital ratio (Tier 1 capital to total risk-weighted assets) of 6.00% or greater, has a core capital ratio of 5.00% or greater and is not subject to any written capital order or directive to meet and maintain a specific capital level or any capital measure. An institution is adequately capitalized if it has a total risk-based capital ratio of 8.00% or greater, has a Tier 1 risk-based capital ratio of 4.00% or greater and has a core capital ratio of 4.00% or greater (3.00% for certain highly rated institutions). The OTS also has authority, after an opportunity for a hearing, to downgrade an institution from well capitalized to adequately capitalized, or to subject an adequately capitalized or undercapitalized institution to the supervisory actions applicable to the next lower category, for supervisory concerns. At December 31, 2005, the Bank exceeded the capital requirements of a well-capitalized institution under applicable OTS regulations.

The table below presents our capital ratios at December 31, 2005 and 2004:

	Actual		Well Capitalized
	Amount	Ratios	Requirement
	(Dollars in thousands)		
December 31, 2005:			
Leverage/Tangible Ratio	$ 21,584	7.38%	5.00%
Tier 1 Risk based ratio	$ 21,584	11.47%	6.00%
Total Risk based ratio	$ 23,004	12.23%	10.00%
December 31, 2004:			
Leverage/Tangible Ratio	$ 19,451	7.04%	5.00%
Tier I Risk based ratio	$ 19,451	10.28%	6.00%
Total Risk based ratio	$ 20,834	11.01%	10.00%

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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, 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. At December 31, 2005, the maximum amount that the Bank could lend to any one borrower (including related persons and entities) under the current loans to one borrower regulatory limit was $3.2 million. Our internal policy limits loans to one borrower to $2.5 million. At December 31, 2005, the largest aggregate amount of loans that we had outstanding to any one borrower was $2.1 million.

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 OTS to assess the 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 OTS assigns ratings of outstanding, satisfactory, needs to improve or substantial noncompliance. The Bank was rated outstanding in its most recent CRA examination.

Qualified Thrift Lender Test. Savings institutions regulated by the OTS are subject to a qualified thrift lender (QTL) test, which in general requires such an institution to maintain on an average basis at least 65% of its portfolio assets (as defined) in qualified thrift investments. 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 business, 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 conversion of the institution to a bank charter 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, 2005, the Bank was in compliance with the QTL test requirements.

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.

OTS approval must be obtained prior to any person acquiring control of the Company or Broadway Federal. Control is conclusively presumed to exist if, among other things, a person acquires more than 25% of any class of voting stock of the institution or holding company or controls in any manner the election of a majority of the directors of the insured institution or the holding company and may be presumed to exist at lower levels of ownership under certain circumstances.

Restrictions on Dividends and Other Capital Distributions. In general, the prompt corrective action regulations prohibit an OTS-regulated institution 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, OTS regulations limit certain capital distributions by savings associations. Capital distributions are defined to include, among other things, dividends and payments for stock repurchases and cash-out mergers.

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

An application to the OTS 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 OTS regulations to expedited treatment (which is generally available to institutions the OTS 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 institutions by the OTS.

The Bank s ability to pay dividends to the Company is also subject to 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.

Tax Matters

Federal Income Taxes

General. 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 discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company.

Bad Debt Reserves. 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. Under the relevant provisions of the Code as currently in effect, a small bank (a bank with $500 million or less of assets) may continue to utilize a reserve method of accounting for bad debts, under which additions to reserves are based on the institution s six-year average loss experience. Broadway Federal qualifies as a small bank and has utilized the reserve method of accounting for bad debts based on its actual loss experience.

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 tax rate is the rate for general corporations plus 2%. Under California regulations, bad debt deductions are available in computing California franchise taxes using a three or six year average loss experience method.

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Item 2. Description of Property

We conduct our business through four branch offices. 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 4800 Wilshire Boulevard, Los Angeles, which also houses one of our branch offices. 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.

Location	Leased or Owned	Original Date Leased or Acquired	Date of Lease