

BROADWAY FINANCIAL CORP \DE\  
Form 10KSB  
March 31, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-KSB**

(Mark one)

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

For the fiscal year ended December 31, 2007

**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**  
(State or other jurisdiction of  
incorporation or organization)

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

**(323) 634-1700**

(Issuer's Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Act:

**95-4547287**  
(I.R.S. Employer  
Identification No.)

**90010**  
(Zip Code)

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

| <b>Title of Class</b>  | <b>Name of Exchange on Which Registered</b> |
|--|---|
| Common Stock, par value \$0.01 per share<br>(including attached preferred stock purchase rights) | The NASDAQ Stock Market, LLC                |
| Securities registered pursuant to Section 12(g) of the Act: <b>None</b>                          |   |

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  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

State issuer's revenues for its most recent fiscal year: \$22,499,000

State the aggregate market value of the voting and non-voting common equity held by non-affiliates: \$11,859,000, based on the average bid and asked price of such common equity, as of March 17, 2008.

State the number of shares outstanding of each of the issuer's classes of common equity, as of March 17, 2008: 1,759,478 shares of Common Stock

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the Registrant's 2008 Annual Meeting of Shareholders are incorporated by reference in Part III.

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

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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 other 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 commercial 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 those described in Management's Discussion and Analysis or Plan of Operation.

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**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, one banking office located in the nearby City of Inglewood and two loan production offices in the City of Irvine and Torrance. In February 2008, we opened an additional branch in Los Angeles. 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](http://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 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 Deposit Insurance Fund (DIF) of the FDIC. The Bank is also a member of the Federal Home Loan Bank (FHLB) of San Francisco. See Regulation.

At December 31, 2007, 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 than we are and have greater financial resources, 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

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on 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.** Our primary lending activity is the origination of loans secured by first mortgages on multi-family residential properties and commercial real estate properties, including churches. We also make one- to four-family residential loans, construction loans, loans to sports franchises, commercial business loans and consumer 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, 2007, approximately 91% of our mortgage loans had adjustable rates. To a lesser extent, we also originate fixed rate mortgage loans to meet customer demand but we sell the majority of these loans 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, 2007, we had six loans held for sale totaling \$3.6 million.

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.

**Multi-Family and Commercial Real Estate Lending.** We focus our lending efforts primarily on the origination of multi-family and commercial real estate loans. These loans are secured primarily by multi-family dwellings or by properties used for business or religious purposes, such as small office buildings, health care facilities, retail facilities and church buildings located in our primary market area. Recently, several lenders active in the multi-family channel have instituted aggressive marketing and pricing tactics to gain market share. Since part of our strategy is to maintain quality and reasonable returns, our multi-family business declined in 2007. Alternatively, given our long history serving the church community, we found ourselves uniquely positioned to attract and grow this channel of business. Consequently, we focused on growing our church loan business and saw it noticeably increase in 2007.

Multi-family loans amounted to \$113.4 million and \$131.3 million at December 31, 2007 and 2006, respectively. At December 31, 2007, multi-family loans represented 37% of our gross loan portfolio, compared to 52% at December 31, 2006. Of the multi-family residential mortgage loans outstanding at December 31, 2007, 2% were fixed rate loans and 98% were ARMs. Most multi-family loans are originated with maturities of up to 30 years. Our largest multi-family loan at December 31, 2007, had an outstanding balance of \$1.6 million and is secured by a 75-unit property located in Van Nuys, California. Our ten largest multi-family loans at December 31, 2007, aggregated \$13.2 million.

Our commercial real estate loans amounted to \$130.6 million and \$78.1 million at December 31, 2007 and 2006, respectively. At December 31, 2007, commercial real estate lending represented 43% of our gross loan portfolio, compared to 31% at December 31, 2006. Of the commercial real estate loans outstanding at

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December 31, 2007, 14% were fixed rate loans and 86% were ARMs. Most commercial real estate loans are originated with 30 year amortization and due in 15 years. The largest commercial real estate loan in our portfolio at December 31, 2007 had an outstanding balance of \$3.9 million and is secured by a church building located in Los Angeles, California. Our ten largest commercial real estate loans at December 31, 2007, aggregated \$29.2 million.

The interest rate on ARM loans is based on a variety of indices such as the 6-Month London InterBank Offered Rate Index ( 6-Month LIBOR ), the 1-Year Constant Maturity Treasury Index ( 1-Yr CMT ), the 12-Month Treasury Average Index ( 12-MTA ), the 11th District Cost of Funds Index ( COFI ), or the 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.

Loan secured by multi-family and commercial real estate 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.

We believe that the risks associated with multi-family and commercial real estate loans described below are mitigated by our 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 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 a board-approved independent appraiser and 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 estate 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 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 minimize these risks by originating such loans on a selective basis and generally restrict such loans to our general market area.

Originating loans secured by church properties is a market niche in which we have been active since our inception. 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 commercial properties. Nonetheless, adverse economic conditions can result in risks to loan repayment that are similar to those encountered in other types of commercial 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 commercial real estate portfolio totaled \$70.8 million and \$16.7 million at December 31, 2007 and 2006, respectively.

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 loan are based upon the level and history of church member contributions as a repayment source rather than income generated by rents or leases.

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**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. Single-family loans totaled \$35.3 million and \$25.2 million at December 31, 2007 and 2006, respectively. At December 31, 2007, single-family loans represented 12% of our gross loan portfolio, compared to 10% at December 31, 2006. Of the one- to four-family residential mortgage loans outstanding at December 31, 2007, 14% were fixed rate loans and 86% 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. 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 90% of the lower of the appraised value or the selling price of the property securing the loan, however, any loan in excess of 80% of appraised value or selling price of the property securing the loan generally requires private mortgage insurance or the Bank self-insures. Under certain circumstances, we may originate loans 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 single-family 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.

**Commercial Lending.** We originate and purchase non-real estate commercial loans that are secured by business assets, the franchise value of the business, if applicable, and individual assets. Most loans are originated with maturities of up to 5 years. Commercial loans amounted to \$22.6 million and \$12.2 million at December 31, 2007 and 2006, respectively. At December 31, 2007, commercial loans represented 7% of our gross loan portfolio, compared to 5% at December 31, 2006. Of the commercial loans outstanding at December 31, 2007, 1% were fixed rate loans and 99% were ARMs. At December 31, 2007, the largest amount of commercial loans outstanding to one borrower was \$3.6 million to a radio station.

In 2007, management and the Board of Directors changed strategies to focus less on loans to sports franchises, continue participating in nationally syndicated corporate loan facilities, and focus more on financing opportunities within our market area. The Board of Directors approved a sports finance policy that restricts lending to national professional sports franchises. Sports loans are generally perceived to be risky due to the large amount of intangible value of a professional sports franchise. To offset risk, Broadway Federal's policy imposes the following underwriting requirements: 1) maximum loan to franchise value covenants; 2) operating support agreements that require funding of any potential losses by a credit worthy third party (usually an ultra high net worth member of the sports franchise ownership group); 3) 12 months of interest reserve. The interest rate on sports loans is variable and is based on the three-month LIBOR or the Prime Rate.



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We also participate as a direct lender in selected large nationally syndicated credits. These corporate credits are typically rated by a credit rating service and are secured by the assets of the borrowers. These nationally syndicated credits are typically floating rate loans based on three-month LIBOR.

**Construction Lending.** At December 31, 2007, we had \$2.0 million in construction loans, representing 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 Wall Street Journal Prime Rate. Generally, we require a loan-to-value ratio of 75% to 80% on a purchase and a loan-to-cost ratio of 80% to 90% on a refinance.

Construction loans involve risks different from completed project lending because we advance loan funds based upon the security of the completed 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 time, market demand and the accuracy of the value of the completed project.

**Consumer Lending.** Our consumer loans primarily consist of loans secured by savings accounts. At December 31, 2007, loans secured by savings accounts represented \$643,000, or 0.2%, 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 ( CLO ) and four members of the Board of Directors, one of whom is the Chief Executive Officer ( CEO ), 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 the CEO or the CLO; 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 two Loan Committee members; 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 three Loan Committee members, two of which must be Board appointed non-management Loan Committee members; and if the total of existing loans and the loan under consideration is more than \$1.75 million, the new loan must be approved by four Loan Committee members, two of which must be Board appointed non-management Loan Committee members. In the event that the Loan Committee does not have the required four signatures for approval, then the loan may be presented to the Executive Committee of the Board of Directors for approval. 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.

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 disbursements for private mortgage insurance, taxes and hazard and flood insurance as required.

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***Delinquencies and Classified Assets.*** We perform a monthly review of all delinquent loans and reports are made quarterly to the Loan 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 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 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 commercial 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 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.

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 estimated fair value less the costs estimated to be necessary to sell the property.

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.

A financial institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by banking regulators, 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

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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, 2007, no loans, other than a \$34,000 unsecured consumer loan, were classified as Substandard, Doubtful or Loss and four loans were designated as Special Mention. At December 31, 2007, the largest loan designated as Special Mention had a principal balance of \$601,000 and was secured by a 10-unit property located in Los Angeles, California.

### **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 26.

### **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 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

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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, 2007, we had approximately \$30.9 million of brokered deposits. For further information, see Deposits on page 26.

**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, 2007 and 2006, we had \$96.5 million and \$50.0 million, respectively, in outstanding advances from the FHLB. For further information, see Borrowings on page 27.

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. There were no outstanding balances on the line of credit at December 31, 2007.

## **Personnel**

At December 31, 2007, we had 84 employees, which consisted of 73 full-time and 11 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 by the Deposit Insurance Fund of the FDIC to the extent provided by applicable federal law. 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. 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.

Any change in these laws and regulations, whether by the OTS, the FDIC, the SEC, or through legislation, could have a material adverse impact on the Bank and the Company, their operations, and the Company's shareholders.

Certain of the laws and regulations applicable to the Bank and the Company are summarized below. These summaries do not purport to be complete and are qualified in their entirety by reference to such laws and regulations.

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**Deposit Insurance.** The deposit accounts held by customers of the Bank are insured by the FDIC's Deposit Insurance Fund up to a maximum of \$100,000, with coverage of up to \$250,000 for certain self-directed retirement accounts, as provided by law. Insurance on deposits may be terminated by the FDIC if it finds that the Bank has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS as the Bank's primary regulator. The management of the Bank does not know of any practice, condition, or violation that might lead to termination of the Bank's deposit insurance.

The FDIC charges an annual assessment for the insurance of deposits based on the risk a particular institution poses to its deposit insurance fund. 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 enactment in February 2006, of the Federal Deposit Insurance Reform Act of 2005 ( FDIRA ) provided, among other things, changes in the formula and factors to be considered by the FDIC in calculating the FDIC reserve ratio, assessments and dividends, and a one-time aggregate assessment credit for depository institutions in existence on December 31, 1996 (or their successors) that paid assessments prior to that date. As a result, most banks had assessment credits that would initially offset all of their deposit premiums for 2007. In 2007, the Bank received a refund of \$145,000 for premiums paid prior to 1996 which was offset to its deposit insurance premium for 2007.

The Bank, as a former member of the Savings Association Insurance Fund, also pays, in addition to its normal deposit insurance premium, assessments towards the retirement of the Financing Corporation Bonds (known as FICO Bonds) issued in the 1980s to assist in the recovery of the savings and loan industry. These assessments will continue until the FICO Bonds mature in 2017. For the fourth quarter of 2007, this assessment was equal to .0028% of insured deposits.

**Capital Requirements.** The Bank must meet regulatory capital standards to be deemed in compliance with the OTS capital requirements. OTS capital regulations require savings institutions to meet three capital standards: (1) tangible capital equal to 1.5% of total adjusted assets; (2) leverage capital, or core capital, equal to 4.0% of total adjusted assets; and (3) risk-based capital equal to 8.0% of total risk-based assets. In assessing an institution's capital adequacy, the OTS 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 where necessary. At December 31, 2007, the Bank's regulatory capital exceeded all minimum regulatory capital requirements.

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

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debt and, subject to certain limitations, loan and lease general valuation allowances. At December 31, 2007 and 2006, the general valuation allowance included in our supplementary capital was \$2.0 million and \$1.7 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, 2007 and December 31, 2006:

|                                   | As of December 31,  |                             |                                    |                     |                             |                                    |
|-----------------------------------|---------------------|-----------------------------|------------------------------------|---------------------|-----------------------------|------------------------------------|
|                                   | 2007                |                             | 2006                               |                     |                             |                                    |
|                                   | Tangible<br>Capital | Tier 1<br>(Core)<br>Capital | Total<br>Risk-<br>Based<br>Capital | Tangible<br>Capital | Tier 1<br>(Core)<br>Capital | Total<br>Risk-<br>Based<br>Capital |
|                                   | (In thousands)      |                             |                                    |                     |                             |                                    |
| Equity capital-Broadway Federal   | \$ 26,037           | \$ 26,037                   | \$ 26,037                          | \$ 23,930           | \$ 23,930                   | \$ 23,930                          |
| Additional supplementary capital: |                     |                             |                                    |                     |                             |                                    |
| General valuation allowance       | -                   | -                           | 2,015                              | -                   | -                           | 1,696                              |
| Assets required to be added       | -                   | -                           | -                                  | -                   | -                           | -                                  |
| Regulatory capital balances       | 26,037              | 26,037                      | 28,052                             | 23,930              | 23,930                      | 25,626                             |
| Minimum requirement               | 5,353               | 14,275                      | 22,413                             | 4,515               | 12,040                      | 16,957                             |
| Excess over requirement           | \$ 20,681           | \$ 11,762                   | \$ 5,639                           | \$ 19,415           | \$ 11,890                   | \$ 8,669                           |

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, 2007, the Bank was considered well capitalized by the OTS, with a Total risk-based capital ratio of 10.01%, Tier 1 risk-based capital ratio of 9.29% and Core capital ratio of 7.30%.

The current risk-based capital guidelines are based upon the 1988 capital accord of the International Basel Committee on Banking Supervision. A new international accord, referred to as Basel II, which emphasizes internal assessment of credit, market and operational risk, supervisory assessment and market discipline in determining minimum capital requirements, currently becomes mandatory for large international banks outside the U.S. in 2008. In November 2007, the federal banking agencies adopted a final rule to implement Basel II in the United States that requires compliance for U.S. financial institutions with over \$250 billion in assets or total on-balance-sheet foreign exposure of \$10 billion or more (referred to as core banks ). The final rule will be effective as of April 1, 2008. It adopts the most complex regime of risk-based capital referred to by the Basel Committee on Banking Supervision as the advanced measurement approach. Other financial institutions can elect

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to be governed by Basel II. The advanced measurement approach would not apply to the Bank or the Company, and management does not contemplate electing to calculate its risk-based capital based on the Basel II capital framework.

One of the tensions created by the adoption of the advanced measurement approach for core-banks has been the prediction that this approach would lower capital requirements for institutions adopting this approach. This has raised significant concern by other U.S. financial institutions as they may be at a competitive disadvantage under Basel I. To address these concerns and provide more flexibility to U.S. financial institutions that have not adopted the advanced measurement approach, the agencies agreed to proceed promptly to issue a proposed rule that would provide all financial institutions that are not core banks with the option to continue under Basel I standards or to adopt a standardized approach under Basel II. The standardized approach would provide non-core banks with an alternative that affords more risk-sensitive capital requirements and simpler approaches for both credit risk and operational risk. The proposal is also expected to provide greater differentiation across corporate exposures based on borrowers' underlying credit quality and to recognize a broader spectrum of credit-risk mitigation techniques. The agencies intend that the proposed standardized option would be finalized before the core banks begin the first transition period year under Basel II. Neither the Bank nor the Company have made any decision as to whether they will attempt to adopt the standardized approach.

***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, 2007, 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 \$4.2 million. Our internal policy limits loans to one borrower to \$3.3 million. At December 31, 2007, the largest aggregate amount of loans that we had outstanding to any one borrower was \$3.9 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, 2007, 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 (the Act) was enacted after September 11, 2001 to provide the federal government with

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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. There are a number of programs that financial institutions must have in place such as: (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 terrorist or terrorist organizations; and (iii) a program for monitoring for the timely detection and reporting of suspicious activity and reportable transactions.

***Guidance on Nontraditional Mortgage Products.*** In September 2006, the federal banking agencies issued guidance on alternative residential mortgage loan products that allow borrowers to defer repayment of principal and sometimes interest, including interest-only mortgage loans, and payment option adjustable rate mortgage loans where a borrower has flexible payment options, including payments that have the potential for negative amortization. While acknowledging that innovations in mortgage lending can benefit some consumers, the guidance states that management should (1) assess a borrower's ability to repay the loan, including any principal balances added through negative amortization, at the fully indexed rate that would apply after the incentive interest rate period, (2) recognize that certain nontraditional mortgage loans are untested in a stressed environment and warrant strong risk management standards as well as appropriate capital and loan loss reserves, and (3) ensure that borrowers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice. We do not originate or purchase nontraditional residential mortgages and we had no nontraditional residential mortgages represented in our portfolio as of December 31, 2007, except for \$6.5 million of loans that have the potential for negative amortization.

***Guidance on Real Estate Concentrations.*** In December 2006, the federal banking agencies finalized guidance for banks and thrifts with high and increasing concentrations of commercial real estate (CRE) lending. The OTS issued separate CRE guidance which provides that OTS institutions actively engaged in CRE lending should implement sound risk management procedures commensurate with the size and risks of their CRE portfolios and establish concentration thresholds for internal reporting and monitoring. The Bank has established such risk management procedures and internal concentration thresholds. We believe the Bank has sufficient capital levels appropriate for the risk associated with our CRE concentration.

***Guidance on Subprime Mortgage Lending.*** In June 2007, the federal banking agencies issued guidance on subprime mortgage lending to address issues related to adjustable rate mortgage products marketed to subprime borrowers. We do not originate or purchase subprime loans and we had no subprime loans represented in our loan or investment portfolios as of December 31, 2007. However, the Federal banking agencies stated that the principles contained in the guidance are also relevant to adjustable rate mortgages offered to prime borrowers. Consistent with the Guidance on Nontraditional Mortgage Products (discussed above), this guidance continues to encourage financial institutions to evaluate a borrower's repayment capacity. In addition, it emphasizes the need to evaluate a borrower's debt-to-income ratio. The guidance promotes consumer protection principles relevant to the marketing of mortgage loans and states that financial institutions should provide consumers with information about costs, terms, features and risks of the loan to the borrower.

The federal banking agencies also announced their intention to scrutinize more closely underwriting, risk management and consumer compliance processes, policies and procedures of its supervised financial institutions and their intention to take action against institutions that engage in predatory lending practices, violate consumer protection laws or fair lending laws, engage in unfair or deceptive acts or practices or otherwise engage in unsafe or unsound lending practices.

***Economic Stimulus for Home Buyers and Home Owners.*** Congress recently enacted an economic stimulus plan that President Bush signed into law on February 13, 2008. While the main thrust of the plan is to stimulate the economy with a significant infusion of cash to consumers, the plan also addresses the current lack of liquidity in the mortgage market. The plan temporarily increased the maximum size of mortgage loans that Fannie Mae and Freddie Mac purchase (the conforming loan limit) from \$417,000 to a maximum of \$729,750. The plan also temporarily raised the cap on the Federal Housing Administration's conforming loan limit from \$362,000 to



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\$729,750. These changes are intended to, among other purposes, provide more liquidity for originators of larger mortgage loans, make lower interest rates available to homebuyers for such loans and enable homeowners to refinance such loans at lower interest rates.

***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.

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 laws and regulations 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

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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.

**Item 2. Description of Property**

We conduct our business through four branch offices and two loan production 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 Expiration | Net Book Value of Property or Leasehold Improvements at December 31, 2007<br>(In thousands) |
|--|----------------------------------|----------------------------------|--------------------------|---|
| <b>Administrative/Branch Office/Loan Origination Center:</b>                 |                                  |                                  |                          |   |
| 4800 Wilshire Blvd<br>Los Angeles, CA  | Owned                            | 1997                             | -                        | \$ 1,863  |
| <b>Branch Offices:</b>   |                                  |                                  |                          |   |
| 4835 West Venice Blvd.<br>Los Angeles, CA                                    | Building Owned<br>on Leased Land | 1965                             | 2013                     | \$ 113  |
| 170 N. Market Street<br>Inglewood, CA<br>(Branch Office/Loan Service Center) | Owned                            | 1996                             | -                        | \$ 728  |
| 4001 South Figueroa Street<br>Los Angeles, CA                                | Owned                            | 1996                             | -                        | \$ 2,025  |
| 4371 Crenshaw Blvd., Suite C (1)<br>Los Angeles, CA                          | Leased                           | 2007                             | 2012                     | \$ 421  |
| <b>Loan Production Offices:</b>  |                                  |                                  |                          |   |
| 19800 MacArthur Blvd, Suite 300<br>Irvine, CA                                | Leased                           | 2005                             | 2009                     | -   |
| 2400 West Carson Street, Suite 215<br>Torrance, CA                           | Leased                           | 2007                             | 2009                     | -   |

(1) This branch was an approved and unopened branch at December 31, 2007. It was opened in February 2008.

**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. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of stockholders during the fourth quarter of 2007.

**Table of Contents****PART II****Item 5. Market for Common Equity and Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities**

The common stock of the Company is traded in the over-the-counter market and is quoted through the National Association of Securities Dealers Automated Quotation Capital Market ( NASDAQ Capital Market ) under the symbol BYFC. As of March 17, 2008, 1,759,478 shares of Common Stock were outstanding and held by approximately 410 holders of record (not including the number of persons or entities holding stock in nominee or street name through various brokerage firms). The following table sets forth for the end of the fiscal quarters indicated the range of high and low bid prices per share of the common stock of the Company as reported on NASDAQ Capital Market.

|             | <b>1st<br/>Quarter</b> | <b>2nd Quarter</b> | <b>3rd<br/>Quarter</b> | <b>4th<br/>Quarter</b> |
|-------------|------------------------|--------------------|------------------------|------------------------|
| <b>2007</b> |                        |                    |                        |                        |
| High        | \$ 11.20               | \$ 11.20           | \$ 11.29               | \$ 10.49               |
| Low         | \$ 10.25               | \$ 10.80           | \$ 8.99                | \$ 3.50                |
| <b>2006</b> | <b>1st Quarter</b>     | <b>2nd Quarter</b> | <b>3rd Quarter</b>     | <b>4th Quarter</b>     |
| High        | \$ 11.50               | \$ 11.09           | \$ 10.90               | \$ 11.25               |
| Low         | \$ 10.49               | \$ 10.02           | \$ 10.40               | \$ 10.25               |

On November 18, 2007, the Board of Directors of the Company approved a stock repurchase program whereby the Company may repurchase up to \$500,000 of its common stock. The Company may make purchases of its common stock on the open market or in privately negotiated transactions at prices deemed appropriate by the Company. The Company began to repurchase shares under this program in December 2007. The following table provides the specified information about the repurchases of shares by the Company during the fourth quarter of 2007.

| <b>Period</b>          | <b>Total Number<br/>of Shares<br/>Purchased</b> | <b>Average Price<br/>Paid per<br/>Share</b> | <b>Total<br/>Number of<br/>Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Approximate<br/>Dollar<br/>Value<br/>of Shares that<br/>May Yet Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs</b> |
|------------------------|---|---|---|---|
| December 1 to 31, 2007 | 500   | \$ 7.50                                     | 500   | \$ 496,250  |
| Total                  | 500   | \$ 7.50                                     | 500   |   |

At March 28, 2008, \$477,000 of the Company's common stock remains to be repurchased in the stock repurchase program.

The Company paid quarterly dividends on its Common Stock at the rate of \$0.05 per share during 2007 and 2006. The Company may pay dividends out of funds legally available at such times as the Board of Directors determines that dividend payments are appropriate, after considering the Company's net income, capital requirements, financial condition, alternate investment options, prevailing economic conditions, industry practices and other factors deemed to be relevant at the time. There can be no assurance that dividends will in fact be paid on the Company's Common Stock in the future.

Dividends from the Bank are the Company's principal source of income. The payment of dividends and other capital distributions by the Bank to the Company are subject to regulation by the OTS. A 30-day prior notice to the OTS is required before any capital distribution is made.

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In addition to Common Stock, the Company, as part of the Bank's mutual to stock conversion in January 1996, issued 91,073 shares of Series A Preferred Stock. The Series A Preferred Stock has a par value of \$0.01 per share and a liquidation preference of \$10.00 per share. The Series A Preferred Stock was issued to holders of non-withdrawable Pledged Deposits held by the Bank prior to conversion. The holders of the Pledged Deposits were allowed to use them to purchase the maximum amount of Common Stock permitted under the Plan of Conversion, with the remainder of the Pledged Deposits being used to purchase Series A Preferred Stock. On December 30, 2002, the Company issued 100,000 shares of Series B Preferred Stock with a liquidation preference of \$10.00 per share to Fannie Mae for gross proceeds of \$1.0 million. Both Series A and the Series B Preferred Stock have non-cumulative annual dividend rates of 5% of their liquidation preference, are non-voting and non-convertible, and are subordinate to all indebtedness of the Company, including customer accounts. On April 5, 2006, the Company issued 76,950 shares of Series C Preferred Stock at a price of \$13.00 per share. The non-voting non-cumulative Series C Preferred Stock is convertible at a conversion price of \$13.00 per share, subject to certain anti-dilution adjustment provisions. All series of preferred stock were issued without registration with the Securities and Exchange Commission under the Securities Act of 1933 pursuant to the registration exemption provided by Section 4(2) thereof.

### **Item 6. Management's Discussion and Analysis or Plan of Operation**

The following discussion provides information about our results of operations, financial condition, liquidity, and capital resources. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of our operations. This discussion and analysis should be read in conjunction with our Consolidated Financial Statements and the accompanying notes presented elsewhere herein.

#### **Critical Accounting Policies**

We have established various accounting policies that are consistent with generally accepted accounting principles in the United States of America in the preparation of our consolidated financial statements. Our significant accounting policies are described in Note 1 of Notes to Consolidated Financial Statements. Certain of these accounting policies, which we consider to be critical accounting policies, require us to make significant estimates and assumptions which have a material impact on the carrying value of certain assets and liabilities and on our reported results of operations. These policies include our policies for accounting for the allowance for loan losses, which involve significant judgments and assumptions by management as to the value of properties securing our loans, the borrowers' ability and willingness to repay their loans and other factors. The estimates and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Actual results may differ in material respects from these estimates under different assumptions or conditions.

#### **Comparison of Operating Results for the Years Ended December 31, 2007 and 2006**

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 generated from deposits and borrowings (interest-bearing liabilities). Our results of operations are also affected by our provision for loan losses, non-interest income generated from service charges and fees on loan and deposit accounts, gain or loss on the sale of loans and securities, non-interest expenses and income taxes.

**Net Earnings.** We recorded net earnings of \$1.5 million, or \$0.74 per diluted common share, for the year ended December 31, 2007, compared to net earnings of \$1.7 million, or \$0.90 per diluted common share, for the year ended December 31, 2006. Current year net earnings decreased by \$210,000, or 12.63%, primarily due to a substantial increase in our non-interest expense which was partially offset by higher net interest income after provision for loan losses.

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**Net Interest Income.** Net interest income before provision for loan losses totaled \$11.1 million, up \$1.3 million, or 13.00%, from a year ago. This increase reflected a \$29.3 million, or 10.50%, increase in our average interest-earning assets and an 8 basis point improvement in our net interest rate margin.

**Interest Income.** Interest income for 2007 increased \$3.8 million as a result of a \$29.3 million increase in our average interest-earning assets and a 63 basis point increase in our yield on average interest-earning assets. Our net loan portfolio accounted for a substantial portion of the increase in our average interest-earning assets, and increased to \$300.0 million at December 31, 2007 from \$247.7 million at December 31, 2006, as we experienced consistent growth in loan originations. Our loan portfolio yield improved 60 basis points during 2007.

**Interest Expense.** Interest expense for 2007 increased \$2.5 million as a result of a \$29.1 million increase in our average interest-bearing liabilities and a 57 basis point increase in our cost of average interest-bearing liabilities. Our cost of average interest-bearing liabilities increased as we relied heavily on FHLB borrowings to fund the growth in net loans receivable. Another factor that contributed to the increase in our cost of average interest-bearing liabilities was the shift of our deposit mix toward higher costing time deposits.

**Average Balance Sheet and Yield/Rate Analysis.** We analyze our earnings performance using, among other measures, the net interest rate spread and effective net interest rate margin. The interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities. The net interest rate margin is net interest income expressed as a percentage of average interest-earning assets.

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The following table presents for the years indicated the total dollar amount of (1) interest income from average interest-earning assets and the resultant yields; and (2) interest expense on average interest-bearing liabilities and the resultant costs, expressed as annual rates. The table also sets forth our net interest income, net interest rate spread, net interest rate margin and certain additional information. We did not include non-accrual loans in the average interest-earning assets balance. Average balances are derived from average daily balances. The yields and costs include loan prepayment fees and amortization of fees, costs, premiums and discounts which are considered adjustments to interest rates.

|  | 2007               |                  | For the Year Ended December 31,<br>2006 |                    |                  |                       | 2005               |                  | Average<br>Yield/Cost |
|--|--------------------|------------------|---|--------------------|------------------|-----------------------|--------------------|------------------|-----------------------|
|  | Average<br>Balance | Interest         | Average<br>Yield/Cost                   | Average<br>Balance | Interest         | Average<br>Yield/Cost | Average<br>Balance | Interest         |                       |
| (Dollars in Thousands)   |                    |                  |   |                    |                  |                       |                    |                  |                       |
| <b>Assets</b>  |                    |                  |   |                    |                  |                       |                    |                  |                       |
| Interest-earning assets:   |                    |                  |   |                    |                  |                       |                    |                  |                       |
| Interest-earning deposits  | \$ 2,970           | \$ 138           | 4.65%                                   | \$ 2,954           | \$ 128           | 4.33%                 | \$ 3,141           | \$ 88            | 2.81%                 |
| Federal Funds sold and other short-term investments              | 1,368              | 66               | 4.82%                                   | 1,750              | 87               | 4.97%                 | 6,732              | 206              | 3.06%                 |
| Investment securities  | 2,000              | 100              | 5.00%                                   | 2,000              | 82               | 4.10%                 | 2,578              | 90               | 3.49%                 |
| Mortgage-backed securities                                       | 34,709             | 1,601            | 4.61%                                   | 38,846             | 1,693            | 4.36%                 | 37,743             | 1,621            | 4.29%                 |
| Loans receivable (1)(2)  | 264,366            | 19,178           | 7.25%                                   | 230,676            | 15,335           | 6.65%                 | 232,856            | 14,106           | 6.06%                 |
| FHLB stock   | 2,980              | 162              | 5.44%                                   | 2,851              | 152              | 5.33%                 | 3,121              | 137              | 4.39%                 |
| <b>Total interest-earning assets</b>                             | <b>308,393</b>     | <b>\$ 21,245</b> | <b>6.89%</b>                            | <b>279,077</b>     | <b>\$ 17,477</b> | <b>6.26%</b>          | <b>286,171</b>     | <b>\$ 16,248</b> | <b>5.68%</b>          |
| Non-interest-earning assets                                      | 10,512             |                  |   | 8,424              |                  |                       | 8,496              |                  |                       |
| <b>Total assets</b>  | <b>\$ 318,905</b>  |                  |   | <b>\$ 287,501</b>  |                  |                       | <b>\$ 294,667</b>  |                  |                       |
| <b>Liabilities and Stockholders' Equity</b>                      |                    |                  |   |                    |                  |                       |                    |                  |                       |
| Interest-bearing liabilities:                                    |                    |                  |   |                    |                  |                       |                    |                  |                       |
| Money market deposits  | \$ 20,411          | \$ 693           | 3.40%                                   | \$ 13,537          | \$ 369           | 2.73%                 | \$ 15,689          | \$ 229           | 1.46%                 |
| Passbook deposits  | 39,973             | 536              | 1.34%                                   | 51,981             | 763              | 1.47%                 | 55,918             | 762              | 1.36%                 |
| NOW and other demand deposits                                    | 36,281             | 59               | 0.16%                                   | 32,217             | 26               | 0.08%                 | 29,654             | 23               | 0.08%                 |
| Certificate accounts   | 130,164            | 5,770            | 4.43%                                   | 112,456            | 4,294            | 3.82%                 | 106,998            | 3,428            | 3.20%                 |
| <b>Total deposits</b>  | <b>226,829</b>     | <b>7,058</b>     | <b>3.11%</b>                            | <b>210,191</b>     | <b>5,452</b>     | <b>2.59%</b>          | <b>208,259</b>     | <b>4,442</b>     | <b>2.13%</b>          |
| FHLB advances  | 61,350             | 2,590            | 4.22%                                   | 48,932             | 1,728            | 3.53%                 | 60,279             | 1,856            | 3.08%                 |
| Junior subordinated debentures                                   | 6,000              | 485              | 8.08%                                   | 6,000              | 463              | 7.72%                 | 6,000              | 354              | 5.90%                 |
| <b>Total interest-bearing liabilities</b>                        | <b>294,179</b>     | <b>\$ 10,133</b> | <b>3.45%</b>                            | <b>265,123</b>     | <b>\$ 7,643</b>  | <b>2.88%</b>          | <b>274,538</b>     | <b>\$ 6,652</b>  | <b>2.42%</b>          |
| Non-interest-bearing liabilities                                 | 3,735              |                  |   | 3,808              |                  |                       | 4,296              |                  |                       |
| Stockholders' Equity   | 20,991             |                  |   | 18,570             |                  |                       | 15,833             |                  |                       |
| <b>Total liabilities and stockholders' equity</b>                | <b>\$ 318,905</b>  |                  |   | <b>\$ 287,501</b>  |                  |                       | <b>\$ 294,667</b>  |                  |                       |
| Net interest rate spread (3)                                     |                    | \$ 11,112        | 3.44%                                   |                    | \$ 9,834         | 3.38%                 |                    | \$ 9,596         | 3.26%                 |
| Net interest rate margin (4)                                     |                    |                  | 3.60%                                   |                    |                  | 3.52%                 |                    |                  | 3.35%                 |
| Ratio of interest-earning assets to interest-bearing liabilities |                    |                  | 104.83%                                 |                    |                  | 105.26%               |                    |                  | 104.24%               |
| Return on average assets   |                    |                  | 0.46%                                   |                    |                  | 0.58%                 |                    |                  | 0.56%                 |
| Return on average equity   |                    |                  | 6.92%                                   |                    |                  | 8.96%                 |                    |                  | 10.50%                |
| Average equity to average assets ratio                           |                    |                  | 6.58%                                   |                    |                  | 6.46%                 |                    |                  | 5.37%                 |
| Dividend payout ratio (5)  |                    |                  | 25.81%                                  |                    |                  | 20.80%                |                    |                  | 19.13%                |

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

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- (2) Amount excludes non-performing loans.
- (3) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (4) Net interest rate margin represents net interest income as a percentage of average interest-earning assets.
- (5) Percentage is calculated based on cash dividends paid on common stocks divided by net earnings less cash dividends paid on preferred stocks.



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**Rate/Volume Analysis.** 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.

|   | Year ended December 31, 2007               |               |                 | Year ended December 31, 2006               |               |               |
|---|--|---------------|-----------------|--|---------------|---------------|
|   | Compared to                                |               |                 | Compared to                                |               |               |
|   | Year ended December 31, 2006               |               |                 | Year ended December 31, 2005               |               |               |
|   | Increase (Decrease) in Net Interest Income |               |                 | Increase (Decrease) in Net Interest Income |               |               |
|   | Due to Volume                              | Due to Rate   | Total           | Due to Volume                              | Due to Rate   | Total         |
|   | (In thousands)                             |               |                 |  |               |               |
| <b>Interest-earning assets:</b>                     |  |               |                 |  |               |               |
| Interest-earning deposits                           | \$ 1                                       | \$ 9          | \$ 10           | \$ (6)                                     | \$ 46         | \$ 40         |
| Federal funds sold and other short term investments | (18)                                       | (3)           | (21)            | (204)                                      | 85            | (119)         |
| Investment securities, net                          | -  | 18            | 18              | (22)                                       | 14            | (8)           |
| Loans receivable, net                               | 2,365                                      | 1,478         | 3,843           | (133)                                      | 1,362         | 1,229         |
| Mortgage backed securities, net                     | (187)                                      | 95            | (92)            | 48   | 24            | 72            |
| FHLB stock  | 7  | 3             | 10              | (13)                                       | 28            | 15            |
| <b>Total interest-earning assets</b>                | <b>2,168</b>                               | <b>1,600</b>  | <b>3,768</b>    | <b>(330)</b>                               | <b>1,559</b>  | <b>1,229</b>  |
| <b>Interest-bearing liabilities:</b>                |  |               |                 |  |               |               |
| Money market deposits                               | 218  | 106           | 324             | (35)                                       | 175           | 140           |
| Passbook deposits                                   | (165)                                      | (62)          | (227)           | (56)                                       | 57            | 1             |
| NOW and other demand deposits                       | 4  | 29            | 33              | 2  | 1             | 3             |
| Certificate accounts                                | 730  | 746           | 1,476           | 182  | 684           | 866           |
| FHLB advances                                       | 487  | 375           | 862             | (379)                                      | 251           | (128)         |
| Junior subordinated debentures                      | -  | 22            | 22              | -  | 109           | 109           |
| <b>Total interest-bearing liabilities</b>           | <b>1,274</b>                               | <b>1,216</b>  | <b>2,490</b>    | <b>(286)</b>                               | <b>1,277</b>  | <b>991</b>    |
| <b>Change in net interest income</b>                | <b>\$ 894</b>                              | <b>\$ 384</b> | <b>\$ 1,278</b> | <b>\$ (44)</b>                             | <b>\$ 282</b> | <b>\$ 238</b> |

**Provision for Loan Losses.** The provision for loan losses represents the charge against current earnings that is determined by management as the amount needed to maintain an allowance for loan losses that management believes should be sufficient to absorb loan losses inherent in the Bank's loan portfolio. The size of the provision for each year is determined by management based upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of loan portfolio quality, value of collateral and general economic factors.

For the year 2007, the provision for loan losses totaled \$321,000, up \$41,000, or 14.64%, from a year ago. During 2007, our net loan portfolio grew \$52.4 million and, as a result, an increase in the allowance for loan losses was deemed appropriate due to the increase in probable incurred losses associated with growth in our loan portfolio. Despite substantial loan growth during 2007, the provision for loan losses did not significantly increase in 2007 as compared to 2006 primarily due to the lack of any charge-offs and a change in the mix of our loan portfolio resulting from increased church loan originations. There were no net charge-offs experienced in 2007, compared to \$5,000 of net charge-offs in 2006. For further information, see Allowance for Loan Losses on page 23.

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**Non-Interest Income.** Non-interest income totaled \$1.3 million in 2007, up \$131,000, or 11.67%, from a year ago, primarily due to higher loan and deposit related fees and increased gain on sale of loans held for sale. During 2007, loan related fees increased \$44,000 while deposit related fees increased \$75,000.

**Non-Interest Expense.** Non-interest expense totaled \$9.9 million in 2007, up \$1.8 million, or 21.66%, from a year ago, primarily due to higher compensation and benefits expense and other expense. The \$1.3 million increase in compensation and benefits expense primarily reflected a \$185,000 severance payment, higher bonus expense, annual pay increases, staff addition, accrual for the director emeritus liability, increased health insurance costs and payroll taxes. Other expense increased \$0.4 million partially due to \$125,000 of expense recognized during the second quarter to settle a personnel matter. Also contributing to the increase in other expense were increases in donations, sponsorships, promotion, shareholder reporting and printing expenses, and losses on checking accounts.

**Income Taxes.** The provision for income taxes for the year ended December 31, 2007 was \$0.7 million as compared to \$0.9 million in 2006. The effective tax rate was 32.2% for 2007 as compared to 34.5% for 2006. The income tax expense for 2007 was positively impacted by an increase in state tax credits and an increase in the tax exempt income from bank owned life insurance. See Note 1 and Note 10 of the Notes to Consolidated Financial Statements for a further discussion of income taxes and an explanation of the factors that impact our effective tax rate due to adjustments related to our deferred income taxes.

## **Financial Condition**

**Total Assets.** At December 31, 2007, assets totaled \$356.8 million, up \$55.8 million, or 18.54%, from year-end 2006. During 2007, net loans, including loans held for sale, increased \$55.9 million, securities available for sale increased \$4.8 million and FHLB stock increased \$2.0 million, while cash and cash equivalents decreased \$1.0 million and securities held to maturity decreased \$6.6 million.

**Loans.** During 2007, net loans receivable increased \$52.4 million, or 21.14%, as loan originations and loan purchases exceeded loan repayments and loan sales. Loan originations, including purchases, for the year ended December 31, 2007 totaled \$128.7 million, up \$51.2 million, or 66.06%, from \$77.5 million a year ago. Loan repayments, including loan sales, amounted to \$70.8 million for the year ended December 31, 2007 compared to \$55.6 million for the year ended December 31, 2006.

Our loan portfolio consists primarily of first lien mortgage loans not insured or guaranteed by any government agency. At December 31, 2007, our gross loan portfolio totaled \$304.7 million, of which approximately 43% was secured by commercial real estate properties, 37% was secured by multi-family properties, and 12% was secured by one- to four-family residential properties.

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The following table sets forth the composition of our loan portfolio in dollar amounts and as a percentage of the total loan portfolio (held for investment and held for sale) by loan type at the dates indicated.

|  | 2007              |                  | 2006              |                  | December 31,<br>2005 |                  | 2004              |                  | 2003              |                  |
|--|-------------------|------------------|-------------------|------------------|----------------------|------------------|-------------------|------------------|-------------------|------------------|
|  | Amount            | Percent of total | Amount            | Percent of total | Amount               | Percent of total | Amount            | Percent of total | Amount            | Percent of total |
| (Dollars in thousands)                   |                   |                  |                   |                  |                      |                  |                   |                  |                   |                  |
| <b>Real Estate:</b>                      |                   |                  |                   |                  |                      |                  |                   |                  |                   |                  |
| One-to four-units                        | \$ 35,313         | 11.59%           | \$ 25,233         | 10.08%           | \$ 19,467            | 8.52%            | \$ 26,405         | 11.16%           | \$ 33,452         | 17.24%           |
| Five or more units                       | 113,395           | 37.21%           | 131,305           | 52.42%           | 154,170              | 67.46%           | 182,403           | 77.08%           | 140,904           | 72.62%           |
| Construction                             | 2,033             | 0.67%            | 2,090             | 0.83%            | 780                  | 0.34%            | 2,650             | 1.12%            | 1,726             | 0.89%            |
| Commercial                               | 130,590           | 42.85%           | 78,072            | 31.17%           | 53,276               | 23.31%           | 24,290            | 10.26%           | 17,350            | 8.94%            |
| Commercial                               | 22,630            | 7.43%            | 12,247            | 4.89%            | -                    | -                | -                 | -                | -                 | -                |
| <b>Loans secured by deposit accounts</b> |                   |                  |                   |                  |                      |                  |                   |                  |                   |                  |
| Other                                    | 643               | 0.21%            | 718               | 0.29%            | 443                  | 0.20%            | 636               | 0.27%            | 537               | 0.28%            |
| Other                                    | 141               | 0.04%            | 812               | 0.32%            | 388                  | 0.17%            | 250               | 0.11%            | 51                | 0.03%            |
| <b>Gross loans</b>                       | <b>304,745</b>    | <b>100.00%</b>   | <b>250,477</b>    | <b>100.00%</b>   | <b>228,524</b>       | <b>100.00%</b>   | <b>236,634</b>    | <b>100.00%</b>   | <b>194,020</b>    | <b>100.00%</b>   |
| <b>Plus:</b>                             |                   |                  |                   |                  |                      |                  |                   |                  |                   |                  |
| Premiums on loans purchased              | 4                 |                  | 12                |                  | 23                   |                  | 39                |                  | 107               |                  |
| <b>Less:</b>                             |                   |                  |                   |                  |                      |                  |                   |                  |                   |                  |
| Loans in process                         | 2,356             |                  | 872               |                  | 417                  |                  | 1,089             |                  | 255               |                  |
| Deferred loan fees (costs), net          | 258               |                  | 162               |                  | 62                   |                  | (110)             |                  | 305               |                  |
| Unamortized discounts                    | 60                |                  | 68                |                  | 71                   |                  | 78                |                  | 139               |                  |
| Allowance for loan losses                | 2,051             |                  | 1,730             |                  | 1,455                |                  | 1,420             |                  | 1,312             |                  |
| <b>Total loans held for investment</b>   | <b>\$ 300,024</b> |                  | <b>\$ 247,657</b> |                  | <b>\$ 226,542</b>    |                  | <b>\$ 234,196</b> |                  | <b>\$ 192,116</b> |                  |
| Loans held for sale                      | \$ 3,554          |                  | \$ -              |                  | \$ -                 |                  | \$ 1,145          |                  | \$ 1,671          |                  |

The following table sets forth the contractual maturities of our gross loans receivable at December 31, 2007 and does not reflect the effect of prepayments or scheduled principal amortization.

|                                 | December 31, 2007  |                    |              |                        |               |                         |                | Gross loans receivable |
|---------------------------------|--------------------|--------------------|--------------|------------------------|---------------|-------------------------|----------------|------------------------|
|                                 | One-to-four family | Five or more units | Construction | Commercial real estate | Commercial    | Savings secured & other |                |                        |
| (In thousands)                  |                    |                    |              |                        |               |                         |                |                        |
| <b>Amounts Due:</b>             |                    |                    |              |                        |               |                         |                |                        |
| One year or less                | \$ 1,715           | \$ 1,973           | \$ 1,285     | \$ 720                 | \$ 8,053      | \$ 750                  | \$ 14,496      |                        |
| <b>After one year:</b>          |                    |                    |              |                        |               |                         |                |                        |
| One year to five years          | 40                 | 5,322              | 748          | 15,938                 | 10,178        | 34                      | 32,260         |                        |
| After five years                | 33,558             | 106,100            | -            | 113,932                | 4,399         | -                       | 257,989        |                        |
| <b>Total due after one year</b> | <b>33,598</b>      | <b>111,422</b>     | <b>748</b>   | <b>129,870</b>         | <b>14,577</b> | <b>34</b>               | <b>290,249</b> |                        |

|       |           |            |          |            |           |        |            |
|-------|-----------|------------|----------|------------|-----------|--------|------------|
| Total | \$ 35,313 | \$ 113,395 | \$ 2,033 | \$ 130,590 | \$ 22,630 | \$ 784 | \$ 304,745 |
|-------|-----------|------------|----------|------------|-----------|--------|------------|

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The following table sets forth the dollar amount of gross loans receivable, excluding loans held for sale, at December 31, 2007 which are contractually due after December 31, 2008, and whether such loans have fixed interest rates or adjustable interest rates.

|                        | Adjustable | December 31, 2007 |            |
|------------------------|------------|-------------------|------------|
|                        |            | Fixed             | Total      |
| (Dollars in thousands) |            |                   |            |
| Real estate loans:     |            |                   |            |
| One-to four-units      | \$ 29,292  | \$ 4,306          | \$ 33,598  |
| Five or more units     | 109,356    | 2,066             | 111,422    |
| Construction           | 748        | -                 | 748        |
| Commercial             | 111,882    | 17,988            | 129,870    |
| Commercial             | 14,511     | 66                | 14,577     |
| Other                  | -          | 34                | 34         |
| Total                  | \$ 265,789 | \$ 24,460         | \$ 290,249 |
| % of total             | 91.57%     | 8.43%             | 100.00%    |

**Origination, Purchase, Sale and Servicing of Loans.** We originate and purchase loans for investment and for sale. Loan sales are made from the loans held for sale portfolio and from loans originated during the period that are designated as held for sale. It is our current practice to sell most single-family conforming fixed rate mortgage loans that we originate, retaining a limited amount in our portfolio. We also may sell single-family and multi-family ARMs that we originate based upon our investment and liquidity needs and market opportunities. At December 31, 2007, we had six loans held for sale totaling \$3.6 million. We typically retain the servicing rights associated with loans sold. If material, the servicing rights are recorded as assets based upon the relative fair values of the servicing rights and the underlying loans and are amortized over the period of the related loan servicing income stream. At December 31, 2007, we had \$134,000 in mortgage servicing rights.

We receive monthly loan servicing fees on loans sold and serviced for others that are payable by the loan purchaser out of loan collections in an amount equal to an agreed percentage of the monthly loan installments collected, 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, 2007 and 2006, we were servicing \$22.7 million and \$21.3 million, respectively, of loans for others.

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 property and the appraised value of the property. We purchased \$5.4 million of loans during the year ended December 31, 2007 and \$9.5 million during the year ended December 31, 2006.

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The following table provides information concerning our loan origination, purchase, sale and principal repayment activity during the years indicated.

|                                   | 2007              | 2006              | 2005              |
|-----------------------------------|-------------------|-------------------|-------------------|
|                                   | (In thousands)    |                   |                   |
| <b>Gross loans:</b>               |                   |                   |                   |
| Beginning balance (1)             | \$ 250,477        | \$ 228,524        | \$ 237,779        |
| <b>Loans originated:</b>          |                   |                   |                   |
| One-to four-units                 | 14,909            | 5,630             | 1,455             |
| Five or more units                | 9,822             | 8,185             | 25,090            |
| Construction                      | 3,319             | 3,991             | -                 |
| Commercial real estate            | 80,636            | 35,347            | 16,070            |
| Commercial                        | 13,814            | 12,215            | -                 |
| Loans secured by deposit accounts | 244               | 652               | 246               |
| Other                             | 510               | 1,951             | 154               |
| <b>Total loans originated</b>     | <b>123,254</b>    | <b>67,971</b>     | <b>43,015</b>     |
| <b>Loan purchased:</b>            |                   |                   |                   |
| One-to four-units                 | -                 | 4,915             | -                 |
| Five or more units                | -                 | -                 | 1,494             |
| Commercial real estate            | -                 | 4,622             | 18,763            |
| Commercial                        | 5,414             | -                 | -                 |
| <b>Total loans purchased</b>      | <b>5,414</b>      | <b>9,537</b>      | <b>20,257</b>     |
| <b>Less:</b>                      |                   |                   |                   |
| Principal repayments              | 63,273            | 53,902            | 69,475            |
| Sales of loans                    | 7,573             | 1,653             | 3,052             |
| <b>Ending balance (1)</b>         | <b>\$ 308,299</b> | <b>\$ 250,477</b> | <b>\$ 228,524</b> |

(1) Includes loans held for sale

**Allowance for Loan Losses.** Our allowance for loan losses is established through provisions for loan losses charged against income in amounts that are based on management's evaluation of the risks inherent in the loan portfolio and the general economy. We maintain an allowance for loan losses to reflect probable incurred losses in the loan portfolio. The Board of Directors reviews the level and reasonableness of the provision for loan losses, as well as a matrix of loan information that supports the adequacy of the allowance for loan losses. The allowance is based upon a number of factors, including current economic conditions, actual loss experience, industry trends, asset classifications, levels of impaired loans, geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience and our underwriting policies.

We also maintain an allowance for impaired loans as a component of our allowance for loan losses. We review all loans with principal balances of less than \$250,000 for impairment on a collective basis. Loans with balances of \$250,000 and greater are evaluated for impairment on an individual basis as part of our normal internal asset review process. Under U.S. generally accepted accounting principles, measurement of impairment may be based on (1) the present value of the expected future cash flows of the impaired loan discounted at the loan's original effective interest rate, (2) an observed market price of the impaired loan or (3) the fair value of the collateral of a collateral-dependent loan. The amount by which the recorded investment in the loan exceeds the measurement of the impaired loan is recognized by recording a valuation allowance with a corresponding charge to the provision for loan losses. While the measurement method may be selected on a loan-by-loan basis, we measure impairment for all collateral dependent loans at the fair value of the collateral. At December 31, 2007, our total recorded investment in impaired loans was \$34,000 and was fully reserved.

Adjustments to the loan loss allowance are made based upon management's analysis of each category of loans. The provision for loan losses may fluctuate on a monthly basis as changes occur within the loan categories

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as a result of numerous factors, including new loan originations, loan repayments and prepayments, and changes in asset classifications. Loan loss allowances also may be increased if management becomes aware of factors elevating the probable incurred losses in that loan category.

We seek to anticipate problems and take appropriate steps to resolve them through our internal asset review procedures. Our procedures include a review of all loans on which full collectibility may not be reasonably assured, and consideration of, among other factors, debt service coverage ratios, vacancy rates, the estimated value of the underlying collateral, economic conditions, historical loan loss experience and other factors that warrant recognition in providing for an adequate loan loss allowance. We monitor and modify our allowance for loan losses as conditions dictate. Although we maintain our allowance at a level that we consider adequate to provide for probable incurred losses, there can be no assurance that losses will not exceed the estimated amounts. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions based upon judgments of the information available to them at the time of the examination.

For loans transferred to REO, any excess of cost or recorded investment over the estimated fair value of the asset at foreclosure is classified as a loss and is charged off against the allowance for loan losses. REO is initially recorded at the estimated fair value of the related assets at the date of foreclosure, less estimated costs to sell. Thereafter, if there is further deterioration in value, we either write down the REO directly or provide a valuation allowance and charge operations for the diminution in value. At December 31, 2007 and 2006, we had no REO.

The following table sets forth the activity in our allowance for loan losses for the years indicated.

|                                   | 2007           | 2006     | 2005     | 2004     | 2003     |
|-----------------------------------|----------------|----------|----------|----------|----------|
|                                   | (In thousands) |          |          |          |          |
| <b>Allowance for loan losses:</b> |                |          |          |          |          |
| Balance at beginning of year      | \$ 1,730       | \$ 1,455 | \$ 1,420 | \$ 1,312 | \$ 1,429 |
| Charge-offs                       | -              | (5)      | -        | -        | -        |
| Recoveries                        | -              | -        | -        | -        | (117)    |
| Provision charged to earnings     | 321            | 280      | 35       | 108      | -        |
| Balance at end of year            | \$ 2,051       | \$ 1,730 | \$ 1,455 | \$ 1,420 | \$ 1,312 |

The following table sets forth our allocation of the allowance for loan losses to the various categories of loans and the percentage of loans in each category to total loans at the dates indicated. The allocations are for management analytical purposes only. The entire allowance is available for losses on any type of loan.

|                                 | 2007                   |  | 2006     |  | December 31, 2005 |  | 2004     |  | 2003     |  |
|---------------------------------|------------------------|--|----------|--|-------------------|--|----------|--|----------|--|
|                                 | Amount                 | Percent of loans in each category to total loans | Amount   | Percent of loans in each category to total loans | Amount            | Percent of loans in each category to total loans | Amount   | Percent of loans in each category to total loans | Amount   | Percent of loans in each category to total loans |
|                                 | (Dollars in thousands) |  |          |  |                   |  |          |  |          |  |
| One-to four-units               | \$ 89                  | 11.59%   | \$ 71    | 10.08%   | \$ 60             | 8.52%  | \$ 83    | 11.16%   | \$ 73    | 17.24%   |
| Five or more units              | 612                    | 37.21%   | 709      | 52.42%   | 847               | 67.46%   | 1,004    | 77.08%   | 853      | 72.62%   |
| Construction                    | 54                     | 0.67%  | 23       | 0.83%  | 8                 | 0.34%  | 28       | 1.12%  | 17       | 0.89%  |
| Commercial real estate          | 1,004                  | 42.85%   | 750      | 31.17%   | 487               | 23.31%   | 179      | 10.26%   | 249      | 8.94%  |
| Commercial                      | 245                    | 7.43%  | 132      | 4.89%  | -                 | -  | -        | -  | -        | -  |
| Other                           | 47                     | 0.25%  | 45       | 0.61%  | 53                | 0.37%  | 86       | 0.38%  | 57       | 0.31%  |
| Unallocated                     | -                      | -  | -        | -  | -                 | -  | 40       | -  | 63       | -  |
| Total allowance for loan losses | \$ 2,051               | 100.00%  | \$ 1,730 | 100.00%  | \$ 1,455          | 100.00%  | \$ 1,420 | 100.00%  | \$ 1,312 | 100.00%  |





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We periodically evaluate the allocation of the allowance for loan losses to each category of loans. This evaluation takes into consideration quantitative and qualitative factors. Qualitative factors include credit concentration, economic and business conditions, changes in lending programs and lending management and staff, and other risks and uncertainties that impact business.

**Non-Performing Assets.** At December 31, 2007, non-accrual loans totaled \$34,000, or 0.01%, of gross loans as compared to \$34,000, or 0.01% of gross loans, at December 31, 2006. The following table provides information regarding our non-performing assets at the dates indicated. We had no commitments to lend additional funds to borrowers whose loans were on non-accrual status at December 31, 2007. No accruing loans were contractually past due by 90 days or more at December 31, 2007 or 2006.

|  | 2007         | 2006         | December 31,<br>2005   |               | 2004         | 2003 |
|--|--------------|--------------|------------------------|---------------|--------------|------|
|  |              |              | (Dollars in thousands) |               |              |      |
| Non-accrual loans:   |              |              |                        |               |              |      |
| One-to four-family   | \$ -         | \$ -         | \$ -                   | \$ 78         | \$ 80        |      |
| Commercial real estate   | -            | -            | -                      | -             | -            |      |
| Unsecured consumer loan  | 34           | 34           | 35                     | 36            | -            |      |
| <b>Total non-accrual loans</b>   | <b>\$ 34</b> | <b>\$ 34</b> | <b>\$ 35</b>           | <b>\$ 114</b> | <b>\$ 80</b> |      |
| <b>Total non-performing assets</b>                                       | <b>\$ 34</b> | <b>\$ 34</b> | <b>\$ 35</b>           | <b>\$ 114</b> | <b>\$ 80</b> |      |
| Interest income that would have been recognized on non-accrual loans     | \$ 3         | \$ 3         | \$ 8                   | \$ 7          | \$ 4         |      |
| Interest income received and recognized on non-accrual loans             | \$ 4         | \$ 5         | \$ 3                   | \$ 6          | \$ 4         |      |
| Allowance for loan losses as a percentage of gross loans                 | 0.68%        | 0.69%        | 0.64%                  | 0.60%         | 0.68%        |      |
| Allowance for loan losses as a percentage of total non-accrual loans     | 6,032.35%    | 5,088.24%    | 4,157.14%              | 1,245.61%     | 1,640.00%    |      |
| Allowance for loan losses as a percentage of total non-performing assets | 6,032.35%    | 5,088.24%    | 4,157.14%              | 1,245.61%     | 1,640.00%    |      |
| Non-accrual loans as a percentage of gross loans                         | 0.01%        | 0.01%        | 0.02%                  | 0.05%         | 0.04%        |      |
| Non-performing assets as a percentage of total assets                    | 0.01%        | 0.01%        | 0.01%                  | 0.04%         | 0.03%        |      |
| Net charge-offs to average loans   | 0.00%        | 0.00%        | 0.00%                  | 0.00%         | 0.00%        |      |
| Impaired loans as a percentage of gross loans                            | 0.01%        | 0.01%        | 0.02%                  | 0.02%         | 0.00%        |      |

The following table sets forth delinquencies in our loan portfolio as of the dates indicated.

|                                       | December 31, 2007      |                   | December 31, 2006 |                   | December 31, 2005 |                   |
|---------------------------------------|------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|                                       | 60-89 Days             | 90 Days or more   | 60-89 Days        | 90 Days or more   | 60-89 Days        | 90 Days or more   |
|                                       | Principal balance      | Principal balance | Principal balance | Principal balance | Principal balance | Principal balance |
|                                       | Number of loans        | Number of loans   | Number of loans   | Number of loans   | Number of loans   | Number of loans   |
|                                       | (Dollars in thousands) |                   |                   |                   |                   |                   |
| Other                                 | - \$ -                 | 1 \$ 34           | - \$ -            | 1 \$ 34           | - \$ -            | 1 \$ 35           |
| Total                                 | - \$ -                 | 1 \$ 34           | - \$ -            | 1 \$ 34           | - \$ -            | 1 \$ 35           |
| Delinquent loans to total gross loans | 0.00%                  | 0.01%             | 0.00%             | 0.01%             | 0.00%             | 0.02%             |



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**Securities.** At December 31, 2007 and 2006, we held securities in the aggregate amount of \$33.9 million and \$35.8 million, respectively, with fair values of \$33.9 million and \$35.2 million, respectively.

The following table sets forth information regarding the carrying amount and fair values of our securities at the dates indicated.

|                                    | 2007            |                  | December 31,<br>2006 |                  | 2005            |                  |
|------------------------------------|-----------------|------------------|----------------------|------------------|-----------------|------------------|
|                                    | Carrying amount | Fair value       | Carrying amount      | Fair value       | Carrying amount | Fair value       |
| (In thousands)                     |                 |                  |                      |                  |                 |                  |
| <b>Held to maturity:</b>           |                 |                  |                      |                  |                 |                  |
| Mortgage-backed securities         | \$27,184        | \$ 27,104        | \$33,793             | \$ 33,206        | \$43,369        | \$ 42,536        |
| U.S. Government and federal agency | 2,000           | 2,048            | 2,000                | 1,968            | 2,000           | 1,958            |
| <b>Available for sale:</b>         |                 |                  |                      |                  |                 |                  |
| Mortgage-backed securities         | 4,763           | 4,763            | -                    | -                | -               | -                |
| <b>Total</b>                       | <b>\$33,947</b> | <b>\$ 33,915</b> | <b>\$35,793</b>      | <b>\$ 35,174</b> | <b>\$45,369</b> | <b>\$ 44,494</b> |

The table below sets forth certain information regarding the carrying amount, weighted average yields and contractual maturities of our securities as of December 31, 2007. The table reflects stated final maturities and does not reflect scheduled principal payments.

|                                    | One Year or less |                        | More than one<br>year to five years |                        | At December 31, 2007<br>More than five<br>years to ten years |                        | More than ten years |                        | Total           |                        |
|------------------------------------|------------------|------------------------|-------------------------------------|------------------------|--|------------------------|---------------------|------------------------|-----------------|------------------------|
|                                    | Carrying amount  | Weighted average yield | Carrying amount                     | Weighted average yield | Carrying amount  | Weighted average yield | Carrying amount     | Weighted average yield | Carrying amount | Weighted average yield |
| (Dollars in thousands)             |                  |                        |                                     |                        |  |                        |                     |                        |                 |                        |
| <b>Held to maturity:</b>           |                  |                        |                                     |                        |  |                        |                     |                        |                 |                        |
| Mortgage-backed securities         | \$-              | - %                    | \$ -                                | - %                    | \$ -   | - %                    | \$27,184            | 4.77%                  | \$27,184        | 4.77%                  |
| U.S. Government and federal agency | -                | - %                    | 1,000                               | 4.96%                  | 1,000  | 5.00%                  | -                   | - %                    | 2,000           | 4.98%                  |
| <b>Available for sale:</b>         |                  |                        |                                     |                        |  |                        |                     |                        |                 |                        |
| Mortgage-backed securities         | \$-              | - %                    | \$ -                                | - %                    | \$ -   | - %                    | \$4,763             | 5.79%                  | \$4,763         | 5.79%                  |
| <b>Total</b>                       | <b>\$-</b>       | <b>- %</b>             | <b>\$1,000</b>                      | <b>4.96%</b>           | <b>\$1,000</b>   | <b>5.00%</b>           | <b>\$31,947</b>     | <b>4.92%</b>           | <b>\$33,947</b> | <b>4.92%</b>           |

**Deposits.** Deposits totaled \$228.7 million at December 31, 2007, up \$7.3 million, or 3.28%, from year-end 2006. During 2007, our certificates of deposit increased \$14.3 million while our core deposits (NOW, demand, money market and passbook accounts) decreased \$7.0 million. A substantial portion of the increase in certificates of deposit was from brokered deposits, primarily in Certificate of Deposit Account Registry Service (CDARS). At December 31, 2007, core deposits represented 40.61% of total deposits compared to 45.11% at December 31, 2006.

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

|                                  | 2007                   |                     |                             | For the Year Ended December 31,<br>2006 |                     |                             | 2005               |                     |                             |
|----------------------------------|------------------------|---------------------|-----------------------------|---|---------------------|-----------------------------|--------------------|---------------------|-----------------------------|
|                                  | Average<br>balance     | Percent<br>of total | Weighted<br>average<br>rate | Average<br>balance                      | Percent<br>of total | Weighted<br>average<br>rate | Average<br>balance | Percent<br>of total | Weighted<br>average<br>rate |
|                                  | (Dollars in thousands) |                     |                             |   |                     |                             |                    |                     |                             |
| Money market deposits            | \$ 20,411              | 9.00%               | 3.40%                       | \$ 13,537                               | 6.44%               | 2.73%                       | \$ 15,689          | 7.53%               | 1.46%                       |
| Passbook deposits                | 39,973                 | 17.62%              | 1.34%                       | 51,981                                  | 24.73%              | 1.47%                       | 55,918             | 26.85%              | 1.36%                       |
| NOW and other demand<br>deposits | 36,281                 | 16.00%              | 0.16%                       | 32,217                                  | 15.33%              | 0.08%                       | 29,654             | 14.24%              | 0.08%                       |
| Certificates of deposits         | 130,164                | 57.38%              | 4.43%                       | 112,456                                 | 53.50%              | 3.82%                       | 106,998            | 51.38%              | 3.20%                       |
| <b>Total</b>                     | <b>\$ 226,829</b>      | <b>100.00%</b>      | <b>3.11%</b>                | <b>\$ 210,191</b>                       | <b>100.00%</b>      | <b>2.59%</b>                | <b>\$ 208,259</b>  | <b>100.00%</b>      | <b>2.13%</b>                |

The following table sets forth the maturity periods of our certificates of deposit in amounts of \$100,000 or more at December 31, 2007.

|                        | December 31, 2007      |                          |
|------------------------|------------------------|--------------------------|
|                        | Amount                 | Weighted<br>average rate |
|                        | (Dollars in thousands) |                          |
| Certificates maturing: |                        |                          |
| Less than three months | \$ 31,678              | 4.88%                    |
| Three to six months    | 16,453                 | 3.96%                    |
| Six to twelve months   | 11,514                 | 4.72%                    |
| Over twelve months     | 10,795                 | 4.74%                    |
| <b>Total</b>           | <b>\$ 70,440</b>       | <b>4.62%</b>             |

**Borrowings.** At December 31, 2007, borrowings consisted of advances from the FHLB of \$96.5 million and junior subordinated debentures of \$6.0 million. Since the end of 2006, FHLB borrowings increased \$46.5 million, or 93.06%, primarily due to strong loan growth financing needs, which exceeded the increase in our deposits. At December 31, 2007 and 2006, FHLB advances were 27.05% and 16.61%, respectively, of total assets, and the weighted average cost of advances at those dates was 4.16% and 3.76%, respectively.

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

|   | At or For the Year Ended |           |           |
|---|--------------------------|-----------|-----------|
|   | 2007                     | 2006      | 2005      |
|   | (Dollars in thousands)   |           |           |
| FHLB Advances:  |                          |           |           |
| Average balance outstanding during the year                 | \$ 61,350                | \$ 48,932 | \$ 60,279 |
| Maximum amount outstanding at any month-end during the year | \$ 96,500                | \$ 56,131 | \$ 66,407 |
| Balance outstanding at end of year                          | \$ 96,500                | \$ 49,985 | \$ 56,513 |
| Weighted average interest rate during the year              | 4.22%                    | 3.53%     | 3.08%     |
| Weighted average interest rate at end of year               | 4.16%                    | 3.76%     | 3.27%     |

On March 17, 2004, the Company issued \$6.0 million of Floating Rate Junior Subordinated Debentures in a private placement to fund the purchase of shares of the Company's Common Stock from Hot Creek Ventures 1, L.P. and its affiliates. The debentures mature in 10 years and interest is payable quarterly at a rate per annum equal to the 3-month LIBOR plus 2.54%. The interest rate is determined as of each

March 17, June 17, September 17, and December 17, and was 7.53% at December 31, 2007.

**Table of Contents****Liquidity and Capital Resources**

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. Our most liquid assets are cash and cash equivalents, which totaled \$4.3 million at December 31, 2007. Our sources of funds include deposits, advances from the FHLB and other borrowings, proceeds from the sale of loans, mortgage-backed and investment securities, and principal and interest payments from loans and mortgage-backed and investment securities.

Our principal source of liquidity, in addition to deposits, is our ability to utilize FHLB borrowings. We currently are approved by the FHLB to borrow up to 40% of total assets to the extent we provide qualifying collateral and hold sufficient FHLB stock. That approved limit and collateral requirement would have permitted us, as of year-end 2007, to borrow an additional \$13.6 million. To the extent 2008 deposit growth falls short of satisfying ongoing commitments to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans, make investments, and continue branch improvement programs, we may utilize our FHLB borrowing arrangement, within the limits permitted by FHLB policy, or other sources, or we may increase the rates we offer on deposit accounts. As of December 31, 2007, we had commitments to borrowers of \$22.5 million and undisbursed loan funds of \$2.4 million. The Company also has a \$6.0 million unsecured line of credit agreement with First Federal Bank of California. No amounts were outstanding under this line of credit at December 31, 2007. We believe our current sources of funds, including repayments of existing loans, will enable us to meet our obligations while maintaining liquidity at appropriate levels.

On April 5, 2006, the Company completed the sale of 76,950 shares of non-voting Series C Noncumulative Convertible Perpetual Preferred Stock at a price of \$13.00 per share. On May 22, 2006, the Company completed the sale of 145,000 shares of its common stock to Cathay General Bancorp at \$11.51 per share. The Company received a total of \$2.5 million from the issuance of the preferred and common stock. The Company deposited the proceeds into a savings account at the Bank to be available for use by the Company for general corporate purposes, including payment of quarterly interest on the junior subordinated debentures and quarterly dividends to preferred and common stockholders.

**Contractual Obligations**

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following table presents, as of December 31, 2007, significant fixed and determinable contractual obligations to third parties by payment date. Payments for deposits and borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts.

|                                      | Less than<br>one year  | More than<br>one year to<br>three years | More than<br>three years to<br>five years | More than<br>five years | Total             |
|--------------------------------------|------------------------|---|---|-------------------------|-------------------|
|                                      | (Dollars in thousands) |   |   |                         |                   |
| Certificates of deposit              | \$ 118,570             | \$ 15,323                               | \$ 1,887                                  | \$ 65                   | \$ 135,845        |
| FHLB advances                        | 30,000                 | 7,000                                   | -   | 59,500                  | 96,500            |
| Junior subordinated debentures       | -                      | -                                       | -   | 6,000                   | 6,000             |
| Operating lease obligations          | 238                    | 413                                     | 345                                       | 43                      | 1,039             |
| <b>Total contractual obligations</b> | <b>\$ 148,808</b>      | <b>\$ 22,736</b>                        | <b>\$ 2,232</b>                           | <b>\$ 65,608</b>        | <b>\$ 239,384</b> |

**Market Risk**

Market risk is the risk of loss from adverse changes in market prices and rates. For the Company, this risk consists primarily of interest rate risk in its lending and investing activities relating to its interest costs on funding through its deposit and borrowing activities, as further described below. The ongoing monitoring and management of this risk is an important component of the Company's asset/liability management process, which

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is governed by policies established by the Company's Board of Directors. The Board of Directors delegates responsibility for carrying out the asset/liability management policies to the Company's Asset Liability Committee (ALCO). In this capacity, ALCO develops guidelines and strategies for the Company's asset/liability management activities based upon estimated market risk sensitivity, policy limits and overall market interest rate levels/trends.

**Interest Rate Risk.** Banks are affected by interest rate risk to the degree that their interest-bearing liabilities, consisting principally of customer deposits, FHLB advances and other borrowings, mature or reprice on a different basis than their interest-earning assets, which consist of loans and investment securities. Our principal objective is to actively monitor and manage the adverse effects of fluctuations in interest rates on our net interest income. To improve the rate sensitivity and maturity balance of our interest-earning assets and liabilities, we have emphasized the origination for investment of loans with adjustable interest rates. We also emphasize growth in core deposits, which have a lower interest cost and tend not to be volatile deposits.

We do not engage in the use of trading activities, derivatives, synthetic instruments or hedging activities in controlling our interest rate risk. Although such strategies could be used in the future if recommended by our Investment Committee and approved by our Board of Directors, we do not intend to engage in such practices in the immediate future.

**Net Portfolio Value.** Net Portfolio Value (NPV) is the difference between the present value of expected future cash flows of the Bank's assets and liabilities under various interest rate scenarios. The present value of these cash flows is calculated by discounting the cash flows using the assumed interest rates for the various scenarios. Under current OTS regulations and practice, the effect on NPV must be calculated for immediate, parallel, and sustained interest rate changes of plus or minus 100 basis points, and plus 200 and 300 basis points as a test of an institution's exposure to interest rate risk.

The following are the estimated impacts to net interest income and net portfolio value from various instantaneous, parallel shifts in interest rates based upon our asset and liability structure as of year-ends 2007 and 2006. This information is provided solely to illustrate the current application of the above-described regulation to the Bank and is based upon data and assumptions about how interest rate changes may affect the Bank's interest-earning assets and interest-bearing liabilities. Actual results may vary in material respects.

| Change in interest rates<br>(in basis points) | 2007   |  | 2006   |  |
|---|--|--|--|--|
|   | Percentage change in<br>Net interest<br>income (a) | Percentage change in<br>Net portfolio<br>value (b) | Percentage change in<br>Net interest<br>income (a) | Percentage change in<br>Net portfolio<br>value (b) |
| 300   | (9)%   | (25)%  | (1)%   | (5)%   |
| 200   | (5)%   | (14)%  | 0%   | (3)%   |
| 100   | (2)%   | (5)%   | 1%   | (1)%   |
| (100)   | 3%   | (6)%   | 1%   | (1)%   |

(a) The percentage change in this column represents net interest income for 12 months in the base-case interest rate environment versus the net interest income in the various rate scenarios.

(b) The percentage change in this column represents the net portfolio value of the Bank in the base-case interest rate environment versus the net portfolio value in the various rate scenarios.

**Impact of Inflation and Changing Prices**

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with generally accepted accounting principles (GAAP) which require the measurement of financial position and operating results 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 the Company's operations. Unlike industrial companies, nearly all of the assets and liabilities of the Company and



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Broadway Federal are monetary in nature. As a result, interest rates have a greater impact on the Company's 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.

### **Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting standards, and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position ( FSP ) 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and the interim periods within those fiscal years. The impact of the adoption of SFAS 157 was not material to the Company's consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ), which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of the company's choice to use fair value on its earnings. SFAS 159 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. SFAS 159 does not eliminate disclosure requirements of other accounting standards, including fair value measurement disclosures in SFAS 157. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

The Company adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), as of January 1, 2007. 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 adoption had no effect on the Company's consolidated financial statements.

### **Item 7. Financial Statements**

See Index to the Consolidated Financial Statements of Broadway Financial Corporation.

### **Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None

### **Item 8A. Disclosure Controls and Procedures**

As of December 31, 2007, 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, 2007. There have been no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect the Company's controls over financial reporting subsequent to December 31, 2007.

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**Item 8A(T). Controls and Procedures**

(a) Management's annual report on internal control over financial reporting.

The management of Broadway Financial Corporation (the "Company") 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 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, 2007.

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 temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

(b) 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 Company's last fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

/s/ Paul C. Hudson  
 Paul C. Hudson  
  
*Chief Executive Officer*

/s/ Samuel Sarpong  
 Samuel Sarpong  
  
*Chief Financial Officer*

Los Angeles, CA

Los Angeles, CA

March 31, 2008

March 31, 2008

**Item 8B. Other Information**

None



**Table of Contents****PART III****Item 9. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act**

The information required by this Item is incorporated herein by reference to the definitive Proxy Statement, under the captions "Directors and Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance", to be filed with the Securities and Exchange Commission in connection with the Company's 2008 Annual Meeting of Shareholders (the "Company's Proxy Statement").

**Item 10. Executive Compensation**

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

**Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item, other than the following table, is incorporated herein by reference to the Company's Proxy Statement, under the caption "Voting Securities and Principal Holders Thereof".

**Equity Compensation Plan Information**

| Plan category   | Number of securities to<br>be issued upon<br>exercise of outstanding<br>options, warrants<br>and rights<br>(a) | Weighted average<br>exercise price<br>of<br>outstanding options,<br>warrants and<br>rights<br>(b) | Number of securities<br>remaining available<br>for future issuance<br>under equity<br>compensation plans<br>(excluding securities<br>reflected in column (a))<br>(c) |
|---|--|---|--|
| Equity compensation plans approved by security holders:     |  |   |  |
| Recognition and retention plan                              | 161  | \$ 10.49  | 3,482  |
| Performance equity plan                                     | 2,400  | \$ 10.25  | 5,836  |
| Employee stock ownership plan                               | 87,505   | \$ 4.63   |  |
| Long term incentive plan                                    | 79,390   | \$ 8.75   | 68,611   |
| Stock option plan for outside directors                     | 6,282  | \$ 8.13   | 18,628   |
| Equity compensation plans not approved by security holders: |  |   |  |
| None  |  |   |  |
| <b>Total</b>  | <b>175,738</b>   | <b>\$ 6.70</b>  | <b>96,557</b>  |

**Item 12. 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".

**Table of Contents****Item 13. Exhibits**

## (a) Exhibits

| <b>Exhibit</b> |   |
|----------------|---|
| <b>Number*</b> |   |
| 2.1            | Plan of Conversion, including Certificate of Incorporation and Bylaws of the Registrant and Federal Stock Charter and Bylaws of Broadway Federal (Exhibit 2.1 to Amendment No. 2 to Registration Statement on Form S-1, No. 33-96814, filed by Registrant on November 13, 1995) |
| 3.1            | Certificate of Incorporation of Registrant (contained in Exhibit 2.1)   |
| 3.2            | Bylaws of Registrant (contained in Exhibit 2.1)   |
| 4.1            | Form of Common Stock Certificate (Exhibit 4.1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on September 12, 1995)   |
| 4.2            | Form of Series A Preferred Stock Certificate (Exhibit 4.2 to Amendment No. 1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on November 6, 1995)  |
| 4.3            | Form of Certificate of Designation for Series A Preferred Stock (contained in Exhibit 2.1)  |
| 4.4            | Form of Series B Preferred Stock Certificate (Exhibit 4.4 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2003)   |
| 4.5            | Form of Certificate of Designation for Series B Preferred Stock (Exhibit 4.5 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2003)  |
| 4.6            | Form of Series C Preferred Stock Certificate (Exhibit 4.6 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)   |
| 4.7            | Form of Certificate of Designation for Series C Preferred Stock (Exhibit 4.7 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)  |
| 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           | ESOP Loan Commitment Letter and ESOP Loan and Security Agreement (Exhibit 4.1 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on September 12, 1995)   |
| 10.3           | Form of Severance Agreement among Broadway Financial Corporation, Broadway Federal and certain executive officers (Exhibit 10.7 to Amendment No. 2 to Registration Statement on Form S-1, No. 33-96814, filed by the Registrant on November 13, 1995)                           |
| 10.4           | Broadway Financial Corporation Recognition and Retention Plan for Outside Directors dated August 1, 1997, (Exhibit 10.4 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 1997)   |
| 10.5           | Broadway Financial Corporation Performance Equity Program for Officers and Directors, dated August 1, 1997, (Exhibit 10.5 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 1997)   |
| 10.6           | Broadway Financial Corporation Stock Option Plan for Outside Directors (filed by the Registrant as part of Form S-8, No. 333-17331, on December 5, 1996)  |
| 10.7           | Broadway Financial Corporation Long Term Incentive Plan (filed by Registrant as part of Form S-8, No. 333-17331, on December 5, 1996)   |
| 10.9           | Stock Purchase Agreement Among Cathay General Bancorp, Broadway Financial Corporation and Broadway Federal Bank (Exhibit 10.9 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2004)   |

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| <b>Exhibit</b> |  |
|----------------|--|
| <b>Number*</b> |  |
| 10.10          | First Amendment to Stock Purchase Agreement Among Cathay General Bancorp, Broadway Financial Corporation and Broadway Federal Bank (Exhibit 10.10 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2004)  |
| 10.11          | Second Amendment to Stock Purchase Agreement Among Cathay General Bancorp, Broadway Financial Corporation and Broadway Federal Bank (Exhibit 10.11 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2005) |
| 10.12          | Third Amendment to Stock Purchase Agreement Among Cathay General Bancorp, Broadway Financial Corporation and Broadway Federal Bank (Exhibit 10.12 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2005)  |
| 10.13          | Preferred Stock Purchase Agreement Between Broadway Financial Corporation and National Community Investment Fund (Exhibit 10.1 to Form 8-K filed by the Registrant on April 6, 2006)   |
| 10.14          | Deferred Compensation Plan (Exhibit 10.14 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)  |
| 10.15          | Salary Continuation Agreement Between Broadway Federal Bank and Chief Executive Officer Paul C. Hudson (Exhibit 10.15 to Form 10-KSB filed by the Registrant for the fiscal year ended December 31, 2006)                              |
| 21.1           | List of Subsidiaries   |
| 23.1           | Consent of Crowe Chizek and Company LLP  |
| 31.1           | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2           | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 32.1           | Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |

\* Exhibits followed by a parenthetical reference are incorporated by reference herein from the document described therein.

**Table of Contents****Item 14. Principal Accountant Fees and Services**

Before the Company's independent accountants are engaged to render non-audit services for the Company or the Bank, the Audit Committee approves each engagement. The Audit Committee also preapproved all of the audit and audit-related services provided by Crowe Chizek and Company LLP for the year ended December 31, 2007 and 2006. The following table sets forth the aggregate fees billed to us by Crowe Chizek and Company LLP for the years indicated.

|                        | <b>2007</b>           | <b>2006</b> |
|------------------------|-----------------------|-------------|
|                        | <b>(In thousands)</b> |             |
| Audit fees (1)         | \$ 139                | \$ 133      |
| Audit-related fees (2) | 12                    | 14          |
| All other fees (3)     | 6                     | 7           |
| <br>Total fees         | <br>\$ 157            | <br>\$ 154  |

- 
- (1) Aggregate fees billed for professional services rendered for the audit of the Company's consolidated annual financial statements included in the Company's Annual Report on Form 10-KSB and for the reviews of the Company's consolidated financial statements included in the Company's Quarterly Reports on Form 10-QSB.
  - (2) Consultation fees billed for professional services rendered for the 2007 and 2006 Independent Accountant's Report on Management's Assertion About Compliance with Minimum Servicing Standards (USAP) and for professional services rendered for the accounting for the Bank's Director Emeritus Plan.
  - (3) Fees billed for certifications and internal control assessment software and license fees and related training.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BROADWAY FINANCIAL CORPORATION

By: /s/ Paul C. Hudson  
Paul C. Hudson

*Chief Executive Officer*

Date: March 31, 2008

In accordance with the Exchange Act, 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/ Paul C. Hudson  
Paul C. Hudson

Date: March 31, 2008

Chief Executive Officer and Chairman of the Board

(Principal Executive Officer)

/s/ Samuel Sarpong  
Samuel Sarpong

Date: March 31, 2008

Chief Financial Officer

(Principal Financial Officer and

Principal Accounting Officer)

/s/ Kellogg Chan  
Kellogg Chan

Date: March 27, 2008

Director

/s/ Robert C. Davidson, Jr.  
Robert C. Davidson, Jr.

Date: March 28, 2008

Director

/s/ Javier Leon  
Javier Leon

Date: March 31, 2008

Director

/s/ Albert Odell Maddox  
Albert Odell Maddox

Date: March 31, 2008

Director

/s/ Daniel A. Medina  
Daniel A. Medina

Date: March 27, 2008



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Director

/s/ Virgil P. Roberts  
Virgil P. Roberts

Date: March 31, 2008

Director

/s/ Elrick Williams  
Elrick Williams

Date: March 28, 2008

Director

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Index to Consolidated Financial Statements**

**Years ended December 31, 2007 and 2006**

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|---|-----|
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| <u>Consolidated Balance Sheets</u>                                      | F-2 |
| <u>Consolidated Statements of Operations and Comprehensive Earnings</u> | F-3 |
| <u>Consolidated Statements of Changes in Stockholders' Equity</u>       | F-4 |
| <u>Consolidated Statements of Cash Flows</u>                            | F-5 |
| <u>Notes to Consolidated Financial Statements</u>                       | F-7 |

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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 balance sheets of Broadway Financial Corporation and subsidiaries as of December 31, 2007 and 2006 and the related consolidated statements of operations and comprehensive earnings, changes in stockholders' equity and cash flows for the years 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 audits.

We conducted our audits 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. 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 financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Broadway Financial Corporation and subsidiaries as of December 31, 2007 and 2006 and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Chizek and Company LLP

South Bend, Indiana

March 31, 2008

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

|  | December 31,<br>2007                          | December 31,<br>2006 |
|--|---|----------------------|
|  | (In thousands, except share<br>and per share) |                      |
| <b>Assets</b>  |   |                      |
| Cash   | \$ 4,331                                      | \$ 5,310             |
| Securities available for sale, at fair value   | 4,763   | -                    |
| Securities held to maturity (fair value of \$29,152 at December 31, 2007 and \$35,174 at December 31, 2006)  | 29,184  | 35,793               |
| Loans receivable held for sale, at lower of cost or fair value   | 3,554   | -                    |
| Loans receivable, net of allowance of \$2,051 and \$1,730  | 300,024                                       | 247,657              |
| Accrued interest receivable  | 1,867   | 1,476                |
| Federal Home Loan Bank (FHLB) stock, at cost   | 4,536   | 2,490                |
| Office properties and equipment, net   | 5,678   | 5,263                |
| Bank owned life insurance  | 2,227   | 2,138                |
| Other assets   | 643   | 868                  |
| <b>Total assets</b>  | <b>\$ 356,807</b>                             | <b>\$ 300,995</b>    |
| <b>Liabilities and stockholders equity</b>   |   |                      |
| Deposits   | \$ 228,727                                    | \$ 221,467           |
| Federal Home Loan Bank advances  | 96,500  | 49,985               |
| Junior subordinated debentures   | 6,000   | 6,000                |
| Advance payments by borrowers for taxes and insurance  | 512   | 588                  |
| Deferred income taxes  | 926   | 855                  |
| Other liabilities  | 2,093   | 2,075                |
| <b>Total liabilities</b>   | <b>334,758</b>                                | <b>280,970</b>       |
| <b>Commitments and Contingencies (Note 14)</b>   |   |                      |
| <b>Stockholders Equity:</b>  |   |                      |
| Preferred non-cumulative and non-voting stock, \$.01 par value, authorized 1,000,000 shares; issued and outstanding 55,199 shares of Series A, 100,000 shares of Series B and 76,950 shares of Series C at December 31, 2007 and 2006; liquidation preference of \$552 for Series A, \$1,000 for Series B and \$1,000 for Series C at December 31, 2007 and 2006 | 2   | 2                    |
| Common stock, \$.01 par value, authorized 3,000,000 shares; issued 2,013,942 shares at December 31, 2007 and 2006; outstanding 1,761,778 shares at December 31, 2007 and 1,637,415 shares at December 31, 2006   | 20  | 20                   |
| Additional paid-in capital   | 12,212  | 12,829               |
| Accumulated other comprehensive income, net of taxes of \$3 at December 31, 2007   | 6   | -                    |
| Retained earnings-substantially restricted   | 13,152  | 12,169               |
| Treasury stock-at cost, 252,164 shares at December 31, 2007 and 376,527 shares at December 31, 2006  | (3,343)                                       | (4,995)              |
| <b>Total stockholders equity</b>   | <b>22,049</b>                                 | <b>20,025</b>        |
| <b>Total liabilities and stockholders equity</b>   | <b>\$ 356,807</b>                             | <b>\$ 300,995</b>    |

*See accompanying notes to consolidated financial statements.*



**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Operations and Comprehensive Earnings**

|  | Year Ended December 31,          |                 |
|--|----------------------------------|-----------------|
|  | 2007                             | 2006            |
|  | (In thousands, except per share) |                 |
| Interest and fees on loans receivable                      | \$ 19,178                        | \$ 15,335       |
| Interest on mortgage-backed securities                     | 1,601                            | 1,693           |
| Interest on investment securities                          | 100                              | 82              |
| Other interest income                                      | 366                              | 367             |
| <b>Total interest income</b>                               | <b>21,245</b>                    | <b>17,477</b>   |
| Interest on deposits                                       | 7,058                            | 5,452           |
| Interest on borrowings                                     | 3,075                            | 2,191           |
| <b>Total interest expense</b>                              | <b>10,133</b>                    | <b>7,643</b>    |
| Net interest income before provision for loan losses       | 11,112                           | 9,834           |
| Provision for loan losses                                  | 321                              | 280             |
| <b>Net interest income after provision for loan losses</b> | <b>10,791</b>                    | <b>9,554</b>    |
| Non-interest income:                                       |                                  |                 |
| Service charges  | 1,094                            | 975             |
| Gain on sale of loans held for sale                        | 30                               | 8               |
| (Loss) gain on sale of securities                          | (1)                              | 12              |
| Other  | 131                              | 128             |
| <b>Total non-interest income</b>                           | <b>1,254</b>                     | <b>1,123</b>    |
| Non-interest expense:                                      |                                  |                 |
| Compensation and benefits                                  | 5,984                            | 4,639           |
| Occupancy expense, net                                     | 1,144                            | 1,200           |
| Information services                                       | 670                              | 654             |
| Professional services                                      | 573                              | 530             |
| Office services and supplies                               | 507                              | 455             |
| Other  | 1,024                            | 661             |
| <b>Total non-interest expense</b>                          | <b>9,902</b>                     | <b>8,139</b>    |
| Earnings before income taxes                               | 2,143                            | 2,538           |
| Income taxes   | 690                              | 875             |
| <b>Net earnings</b>  | <b>\$ 1,453</b>                  | <b>\$ 1,663</b> |
| Other comprehensive income, net of tax:                    |                                  |                 |
| Unrealized gain on securities available for sale           | \$ 9                             | \$ -            |
| Income tax effect  | (3)                              | -               |
| <b>Other comprehensive income, net of tax</b>              | <b>6</b>                         | <b>-</b>        |

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|   |          |          |
|---|----------|----------|
| Comprehensive earnings                    | \$ 1,459 | \$ 1,663 |
| Net earnings                              | \$ 1,453 | \$ 1,663 |
| Dividends paid on preferred stock         | (128)    | (115)    |
| Earnings available to common shareholders | \$ 1,325 | \$ 1,548 |
| Earnings per share-basic                  | \$ 0.78  | \$ 0.97  |
| Earnings per share-diluted                | \$ 0.74  | \$ 0.90  |

*See accompanying notes to consolidated financial statements.*

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**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Changes in Stockholders' Equity**

(In thousands, except per share)

|   | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income,<br>Net | Retained<br>Earnings<br>(Substantially<br>Restricted) | Treasury<br>Stock | Total<br>Stockholders<br>Equity |
|---|--------------------|-----------------|----------------------------------|---|---|-------------------|---------------------------------|
| Balance at December 31, 2005  | \$ 2               | \$ 19           | \$ 10,296                        | \$ -  | \$ 10,842   | \$ (4,382)        | \$ 16,777                       |
| Cumulative effect of adoption of SFAS<br>No. 156  | -                  | -               | -                                | -   | 101   | -                 | 101                             |
| Net earnings for the year ended<br>December 31, 2006  | -                  | -               | -                                | -   | 1,663   | -                 | 1,663                           |
| Preferred stock issued, net of offering costs   | -                  | -               | 905                              | -   | -   | -                 | 905                             |
| Common stock issued, net of offering costs  | -                  | 1               | 1,643                            | -   | -   | -                 | 1,644                           |
| Treasury stock acquired   | -                  | -               | -                                | -   | -   | (929)             | (929)                           |
| Treasury stock used for vested stock awards   | -                  | -               | (12)                             | -   | -   | 31                | 19                              |
| Cash dividends paid of \$0.20 per common<br>share   | -                  | -               | -                                | -   | (322)   | -                 | (322)                           |
| Cash dividends paid of \$0.50 per preferred<br>share  | -                  | -               | -                                | -   | (115)   | -                 | (115)                           |
| Stock-based compensation expense  | -                  | -               | 115                              | -   | -   | -                 | 115                             |
| Stock options exercised   | -                  | -               | (158)                            | -   | -   | 285               | 127                             |
| Tax benefit on stock options exercised  | -                  | -               | 40                               | -   | -   | -                 | 40                              |
| Balance, at December 31, 2006   | 2                  | 20              | 12,829                           | -   | 12,169  | (4,995)           | 20,025                          |
| Net earnings for the year ended<br>December 31, 2007  | -                  | -               | -                                | -   | 1,453   | -                 | 1,453                           |
| Unrealized gain on securities available for<br>sale, net of tax   | -                  | -               | -                                | 6   | -   | -                 | 6                               |
| Treasury stock acquired   | -                  | -               | -                                | -   | -   | (4)               | (4)                             |
| Treasury stock used for vested stock awards   | -                  | -               | (9)                              | -   | -   | 34                | 25                              |
| Cash dividends paid of \$0.20 per common<br>share   | -                  | -               | -                                | -   | (342)   | -                 | (342)                           |
| Cash dividends paid of \$0.50 per preferred<br>share of Series A, \$0.50 per preferred share<br>of Series B and \$0.65 per preferred share of<br>Series C | -                  | -               | -                                | -   | (128)   | -                 | (128)                           |
| Stock-based compensation expense  | -                  | -               | 70                               | -   | -   | -                 | 70                              |
| Stock options exercised   | -                  | -               | (929)                            | -   | -   | 1,622             | 693                             |
| Tax benefit on stock options exercised  | -                  | -               | 251                              | -   | -   | -                 | 251                             |
| Balance, at December 31, 2007   | \$ 2               | \$ 20           | \$ 12,212                        | \$ 6  | \$ 13,152   | \$ (3,343)        | \$ 22,049                       |

*See accompanying notes to consolidated financial statements.*



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

|   | <b>Year Ended December 31</b> |             |
|---|-------------------------------|-------------|
|   | <b>2007</b>                   | <b>2006</b> |
|   | <b>(In thousands)</b>         |             |
| <b>Cash flows from operating activities:</b>  |                               |             |
| Net earnings  | \$ 1,453                      | \$ 1,663    |
| Adjustments to reconcile net earnings to net cash (used in) provided by operating activities: |                               |             |
| Depreciation  | 311                           | 331         |
| Net amortization of premiums and discounts on loans purchased                                 | 1                             | 8           |
| Net amortization of net deferred loan origination costs                                       | 6                             | 80          |
| Net amortization of premiums on mortgage-backed securities                                    | 58                            | 122         |
| Stock-based compensation expense  | 70                            | 115         |
| Gain on sale of loans held for sale   | (30)                          | (8)         |
| Loss (gain) on sale of securities   | 1                             | (12)        |
| Increase in cash surrender value of bank owned life insurance                                 | (89)                          | (25)        |
| FHLB stock dividends  | (161)                         | (155)       |
| Provision for loan losses   | 321                           | 280         |
| Loans originated for sale   | (11,139)                      | (1,653)     |
| Proceeds from sale of loans held for sale   | 7,615                         | 1,661       |
| Tax benefit on stock options exercised  | 251                           | 40          |
| Changes in operating assets and liabilities:  |                               |             |
| Accrued interest receivable   | (391)                         | (235)       |
| Other assets  | 225                           | (202)       |
| Deferred income taxes   | 67                            | (374)       |
| Other liabilities   | 18                            | 323         |
| Net cash (used in) provided by operating activities   | (1,413)                       | 1,959       |
| <b>Cash flows from investing activities:</b>  |                               |             |
| Net change in loans receivable  | (47,281)                      | (11,946)    |
| Purchase of loans receivable  | (5,414)                       | (9,537)     |
| Purchases of mortgage-backed securities available for sale                                    | (5,161)                       | -           |
| Proceeds from sale of mortgage-backed securities held to maturity                             | 344                           | 451         |
| Principal repayments on mortgage-backed securities held to maturity                           | 6,206                         | 9,015       |
| Principal repayments on mortgage-backed securities available for sale                         | 408                           | -           |
| Purchase of bank owned life insurance   | -                             | (2,113)     |
| Purchase of Federal Home Loan Bank stock  | (1,885)                       | (14)        |
| Proceeds from redemption of Federal Home Loan Bank stock                                      | -                             | 1,011       |
| Capital expenditures for office properties and equipment                                      | (726)                         | (135)       |
| Net cash used in investing activities   | (53,509)                      | (13,268)    |

(continued)

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

|   | <b>Year Ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2007</b>                    | <b>2006</b> |
|   | <b>(In thousands)</b>          |             |
| <b>Cash flows from financing activities:</b>                        |                                |             |
| Net increase in deposits  | \$ 7,260                       | \$ 12,003   |
| Advances from the Federal Home Loan Bank                            | 72,000                         | 127,100     |
| Principal repayments on advances from the Federal Home Loan Bank    | (25,485)                       | (133,628)   |
| Preferred stock issued  | -                              | 905         |
| Common stock issued   | -                              | 1,644       |
| Common and preferred dividends paid                                 | (470)                          | (437)       |
| Purchases of treasury stock   | (4)                            | (929)       |
| Reissuance of treasury stock  | 25                             | 19          |
| Stock options exercised, net of tax benefits                        | 693                            | 127         |
| Net change in advance payments by borrowers for taxes and insurance | (76)                           | 29          |
| <br>  |                                |             |
| Net cash provided by financing activities                           | 53,943                         | 6,833       |
| <br>  |                                |             |
| Net decrease in cash and cash equivalents                           | (979)                          | (4,476)     |
| Cash and cash equivalents at beginning of year                      | 5,310                          | 9,786       |
| <br>  |                                |             |
| Cash and cash equivalents at end of year                            | \$ 4,331                       | \$ 5,310    |
| <br>  |                                |             |
| <b>Supplemental disclosures of cash flow information:</b>           |                                |             |
| Cash paid for interest  | \$ 10,045                      | \$ 7,541    |
| <br>  |                                |             |
| Cash paid for income taxes  | \$ 1,028                       | \$ 1,174    |

*See accompanying notes to consolidated financial statements.*

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**December 31, 2007 and 2006**

**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, 2007, the Bank operated four retail-banking offices and two loan production offices in Southern 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 subsidiaries, Broadway Federal Bank, f.s.b. and Broadway Service Corporation. All significant inter-company transactions and balances have been eliminated in consolidation. The Company liquidated its investment in Broadway Financial Funding, LLC in July 2007 after deciding to terminate its joint venture with Metrocities Mortgage in November 2006.

*Use of Estimates*

To prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, ( U.S. generally accepted accounting principles ) 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. The allowance for loan losses and fair values of financial instruments are particularly subject to change.

*Cash Flows*

Cash and cash equivalents include cash, deposits with other financial institutions under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions.

*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 not classified as held to maturity or trading are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income or loss, net of tax.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts on securities are amortized on the constant-yield method. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Company s ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

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

***Loans Held for Sale***

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Loans held for sale are generally sold with servicing rights retained. The carrying value of loans sold is reduced by the amount allocated to the servicing rights. 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 held for sale are sold, existing deferred loan fees or costs are an adjustment of the gain or loss on sale.

***Loans***

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of allowance for loan losses, loans in process, deferred loan fees and costs and unamortized premiums and discounts. Interest income is accrued on the unpaid principal balance. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized in income using the interest method over the contractual life of the loans, adjusted for prepayments. Premiums and discounts on loans receivable are recognized in income using the interest method over the contractual life of the loans, adjusted for prepayments. Accretion of discounts and amortization of deferred loan fees or costs are discontinued when loans are placed on non-accrual status.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent. 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.

***Loans Purchased***

The Bank purchases or participates in loans originated by other institutions. The determination to purchase loans is based upon the Bank's investment needs and market opportunities. 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 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.

***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 uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and amounts of loans in the portfolio, information about specific borrower situations, estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

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

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

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. 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. Impairment is measured on a loan by loan basis, for loans over \$250,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

***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***

Bank owned life insurance is carried at an amount that could be realized under the insurance contract as of the date of the consolidated balance sheet. The change in cash surrender or contract value is recorded as income.

***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.

The Company adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), as of January 1, 2007. 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 adoption had no effect on the Company's consolidated financial statements.

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

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

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

***Preferred Stock***

The Series A and Series B preferred stock are 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 is 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 is convertible at a conversion price of \$13.00 per share, subject to certain anti-dilution adjustment provisions. All of the series of preferred stock have non-cumulative annual dividend rates of 5% of the liquidation preference.

***Earnings Per Share***

Basic earnings per common share is net income available to common shareholders 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 per common share includes the dilutive effect of additional potential common shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

***Employee Stock Ownership Plan***

The cost of shares issued to the ESOP but not yet allocated to participants is shown as a reduction of shareholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

***Stock-Based Compensation***

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), *Share-based Payment*, using the modified prospective transition method. Accordingly, the Company has recorded stock-based employee compensation cost using the fair value method starting in 2006.

***Comprehensive Income***

Comprehensive income consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available for sale, which are also recognized as separate components of stockholders' 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 there now are any such matters 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. These balances do not earn interest.

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

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to its stockholders. (See Note 13 for more specific disclosure.)

***Fair Values of Financial Instruments***

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. 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.

***Recent Accounting Pronouncements***

**SFAS No. 157** In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting standards, and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position ( FSP ) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and the interim periods within those fiscal years. The impact of the adoption of SFAS 157 was not material to the Company's consolidated financial statements.

**SFAS No. 159** In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ), which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of the company's choice to use fair value on its earnings. SFAS 159 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. SFAS 159 does not eliminate disclosure requirements of other accounting standards, including fair value measurement disclosures in SFAS 157. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

**Note 2 Securities**

The fair value of available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

|                    | <b>Fair<br/>Value</b> | <b>Gross<br/>Unrealized<br/>Gains<br/>(In thousands)</b> | <b>Gross<br/>Unrealized<br/>Losses</b> |
|--------------------|-----------------------|--|--|
| December 31, 2007: |                       |  |  |
| Mortgage-backed    | \$ 4,763              | \$ 10  | \$ (1)                                 |

|       |          |       |        |
|-------|----------|-------|--------|
| Total | \$ 4,763 | \$ 10 | \$ (1) |
|-------|----------|-------|--------|

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

The carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

|                                    | Carrying<br>Amount | Gross<br>Unrecognized<br>Gains | Gross<br>Unrecognized<br>Losses | Fair<br>Value |
|------------------------------------|--------------------|--------------------------------|---------------------------------|---------------|
| (In thousands)                     |                    |                                |                                 |               |
| December 31, 2007:                 |                    |                                |                                 |               |
| Mortgage-backed                    | \$ 27,184          | \$ 28                          | \$ (108)                        | \$ 27,104     |
| U.S. Government and federal agency | 2,000              | 48                             | -                               | 2,048         |
| Total                              | \$ 29,184          | \$ 76                          | \$ (108)                        | \$ 29,152     |

|                                    | Carrying<br>Amount | Gross<br>Unrecognized<br>Gain | Gross<br>Unrecognized<br>Loss | Fair<br>Value |
|------------------------------------|--------------------|-------------------------------|-------------------------------|---------------|
| (In thousands)                     |                    |                               |                               |               |
| December 31, 2006:                 |                    |                               |                               |               |
| Mortgage-backed                    | \$ 33,793          | \$ 6                          | \$ (593)                      | \$ 33,206     |
| U.S. Government and federal agency | 2,000              | -                             | (32)                          | 1,968         |
| Total                              | \$ 35,793          | \$ 6                          | \$ (625)                      | \$ 35,174     |

The fair value of debt securities and carrying amount, if different, at December 31, 2007 by contractual maturity were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

|                            | Available for<br>Sale<br>Fair<br>Value | Held to Maturity<br>Carrying<br>Amount | Fair<br>Value |
|----------------------------|--|--|---------------|
| (In thousands)             |  |  |               |
| Due in one year or less    | \$ -                                   | \$ -                                   | \$ -          |
| Due from one to five years | -                                      | 1,000                                  | 1,001         |
| Due from five to ten years | -                                      | 1,000                                  | 1,047         |
| Due after ten years        | -                                      | -                                      | -             |
| Mortgage-backed            | 4,763                                  | 27,184                                 | 27,104        |
| Total                      | \$ 4,763                               | \$ 29,184                              | \$ 29,152     |

At year-end 2007 and 2006, securities with carrying amounts of \$4.2 million and \$4.9 million were pledged to secure public deposits and \$25.0 million and \$30.9 million were pledged as collateral for FHLB advances. At year-end 2007 and 2006, 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.



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

Securities with unrealized losses at year-end 2007 and 2006, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

|                                     | Less than 12 months  |                         | 12 months or more    |                         | Total                |                         |
|-------------------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|-------------------------|
|                                     | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses |
| (In thousands)                      |                      |                         |                      |                         |                      |                         |
| December 31, 2007:                  |                      |                         |                      |                         |                      |                         |
| Mortgage-backed, available for sale | \$ 2,080             | \$ (1)                  | \$ -                 | \$ -                    | \$ 2,080             | \$ (1)                  |
| Mortgage-backed, held to maturity   | 2,147                | (25)                    | \$ 14,110            | (83)                    | 16,257               | (108)                   |
| Total temporarily impaired          | \$ 4,227             | \$ (26)                 | \$ 14,110            | \$ (83)                 | \$ 18,337            | \$ (109)                |

|                                    | Less than 12 months  |                         | 12 months or more    |                         | Total                |                         |
|------------------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|-------------------------|
|                                    | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses |
| (In thousands)                     |                      |                         |                      |                         |                      |                         |
| December 31, 2006:                 |                      |                         |                      |                         |                      |                         |
| Mortgage-backed                    | \$ -                 | \$ -                    | \$ 32,852            | \$ (593)                | \$ 32,852            | \$ (593)                |
| U.S. Government and federal agency | -                    | -                       | 1,968                | (32)                    | 1,968                | (32)                    |
| Total temporarily impaired         | \$ -                 | \$ -                    | \$ 34,820            | \$ (625)                | \$ 34,820            | \$ (625)                |

Unrealized losses on securities have not been recognized into income because the securities are of high credit quality, management has the intent and ability to hold them for the foreseeable future, and the decline in their fair value is largely due to changes in the interest rates. The fair value is expected to recover as the bonds approach maturity.

During the year ended December 31, 2007, the Company sold \$0.3 million of mortgage-backed securities held to maturity and realized gross losses of \$1,000, which had been included in gain (loss) on sale of securities in the accompanying Consolidated Statements of Operations and Comprehensive Earnings.

During the year ended December 31, 2006, the Company sold \$0.5 million of mortgage-backed securities held to maturity and realized gross gains of \$12,000, which had been included in gain (loss) on sale of securities in the accompanying Consolidated Statements of Operations and Comprehensive Earnings.

During 2007 and 2006, the Company sold certain mortgage-backed securities held to maturity for which the Company had already collected more than 85% of the principal outstanding at acquisition due to repayments of the underlying mortgages. There have been no sales of held to maturity securities for which the Company had not already collected more than 85% of the original principal.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)****Note 3 Loans**

Loans at year-end were as follows:

|                                   | <b>December 31,</b>   |             |
|-----------------------------------|-----------------------|-------------|
|                                   | <b>2007</b>           | <b>2006</b> |
|                                   | <b>(In thousands)</b> |             |
| Loans receivable, held for sale:  |                       |             |
| Commercial                        | \$ 3,554              | \$ -        |
| Loans receivable, net:            |                       |             |
| Real estate:                      |                       |             |
| Residential:                      |                       |             |
| One to four units                 | \$ 35,313             | \$ 25,233   |
| Five or more units                | 113,395               | 131,305     |
| Construction                      | 2,033                 | 2,090       |
| Total residential                 | 150,741               | 158,628     |
| Commercial                        | 130,590               | 78,072      |
| Total real estate                 | 281,331               | 236,700     |
| Commercial                        | 22,630                | 12,247      |
| Loans secured by deposit accounts | 643                   | 718         |
| Other                             | 141                   | 812         |
| Total gross loans receivable      | 304,745               | 250,477     |
| Plus:                             |                       |             |
| Premiums on loans purchased       | 4                     | 12          |
| Less:                             |                       |             |
| Loans in process                  | 2,356                 | 872         |
| Net deferred loan fees            | 258                   | 162         |
| Unamortized discounts             | 60                    | 68          |
| Allowance for loan losses         | 2,051                 | 1,730       |
| Loans receivable, net             | \$ 300,024            | \$ 247,657  |

Activity in the allowance for loan losses was as follows:

|                           | <b>2007</b>           | <b>2006</b> |
|---------------------------|-----------------------|-------------|
|                           | <b>(In thousands)</b> |             |
| Beginning balance         | \$ 1,730              | \$ 1,455    |
| Provision for loan losses | 321                   | 280         |
| Loans charged off         | -                     | (5)         |
| Ending balance            | \$ 2,051              | \$ 1,730    |



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

Individually impaired loans were as follows:

|  | 2007           | 2006         |
|--|----------------|--------------|
|  | (In thousands) |              |
| Year-end loans with no allocated allowance for loan losses | \$ -           | \$ -         |
| Year-end loans with allocated allowance for loan losses    | 34             | 34           |
| <b>Total</b>   | <b>\$ 34</b>   | <b>\$ 34</b> |
| Amount of the allowance for loan losses allocated          | \$ 34          | \$ 34        |
| Average of individually impaired loans during year         | \$ 34          | \$ 35        |
| Interest income recognized during impairment               | 4              | 5            |
| Cash basis interest income recognized                      | 4              | 5            |

The following is a summary of the Bank's non-accrual loans by loan type at December 31, 2007 and 2006:

|                                | December 31,   |              |
|--------------------------------|----------------|--------------|
|                                | 2007           | 2006         |
|                                | (In thousands) |              |
| Other                          | \$ 34          | \$ 34        |
| <b>Total non-accrual loans</b> | <b>\$ 34</b>   | <b>\$ 34</b> |

The Bank had no restructured loans or loans that were contractually past due 90 days or more and were still accruing at December 31, 2007 and 2006.

The Bank serviced loans for others totaling \$22.7 million and \$21.3 million at December 31, 2007 and 2006, respectively. The amount of servicing rights recorded and the amount of custodial escrow balances on serviced loans at December 31, 2007 and 2006 was not material.

**Note 4 Office Properties and Equipment, net**

Year-end office properties and equipment were as follows:

|   | 2007            | 2006            |
|---|-----------------|-----------------|
|   | (In thousands)  |                 |
| Land  | \$ 1,723        | \$ 1,723        |
| Office buildings and improvements           | 4,712           | 4,296           |
| Furniture, fixtures and equipment           | 1,782           | 1,578           |
|   | 8,217           | 7,597           |
| Less accumulated depreciation               | (2,539)         | (2,334)         |
| <b>Office properties and equipment, net</b> | <b>\$ 5,678</b> | <b>\$ 5,263</b> |

During the years ended December 31, 2007 and 2006, depreciation expense totaled \$311,000 and \$331,000, respectively.

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

The Company has operating leases on certain premises and equipment on a long-term basis. Some of these leases require that the Company pay property taxes and insurance. Lease expense was approximately \$253,000 in 2007 and \$216,000 in 2006. Annual minimum lease commitments attributable to long-term leases at December 31, 2007 are as follows:

|                          | Premises | Equipment<br>(In thousands) | Total    |
|--------------------------|----------|-----------------------------|----------|
| Year ending December 31: |          |                             |          |
| 2008                     | \$ 128   | \$ 110                      | \$ 238   |
| 2009                     | 104      | 110                         | 214      |
| 2010                     | 92       | 107                         | 199      |
| 2011                     | 94       | 91                          | 185      |
| 2012                     | 78       | 82                          | 160      |
| Thereafter               | 43       | -                           | 43       |
|                          | \$ 539   | \$ 500                      | \$ 1,039 |

**Note 5 Deposits**

Deposits are summarized as follows:

|                                       | December 31,   |            |
|---------------------------------------|----------------|------------|
|                                       | 2007           | 2006       |
|                                       | (In thousands) |            |
| NOW account and other demand deposits | \$ 15,755      | \$ 23,972  |
| Non-interest bearing demand deposits  | 18,727         | 16,292     |
| Money market deposits                 | 21,880         | 15,763     |
| Passbook                              | 36,520         | 43,883     |
| Certificates of deposit               | 135,845        | 121,557    |
| Total                                 | \$ 228,727     | \$ 221,467 |

The aggregate amount of time deposits equal to or exceeding \$100,000 totaled \$70.4 million at December 31, 2007 and \$63.5 million at December 31, 2006.

During the years ended December 31, 2007 and 2006, the weighted average cost of deposits was 3.11% and 2.59%, respectively.

Scheduled maturities of certificates of deposit were as follows at December 31, 2007:

| Maturity | Amount<br>(In thousands) |
|----------|--------------------------|
| 2008     | \$ 118,570               |
| 2009     | 10,460                   |



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|            |            |
|------------|------------|
| 2010       | 4,863      |
| 2011       | 1,125      |
| 2012       | 762        |
| Thereafter | 65         |
|            | \$ 135,845 |

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**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)****Note 6 Federal Home Loan Bank Advances**

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

|  | <b>Amount<br/>(In thousands)</b> |
|--|----------------------------------|
| <b>December 31, 2007:</b>  |                                  |
| Maturities February 2008 to December 2017, fixed rates at rates from 3.33% to 5.30%, averaging 4.22% | \$ 90,300                        |
| Maturity January 2008 variable rate at 3.28%   | 6,200                            |
|  | \$ 96,500                        |
| <b>December 31, 2006:</b>  |                                  |
| Maturities February 2007 to December 2016, fixed rates at rates from 2.85% to 4.25%, averaging 3.72% | \$ 48,485                        |
| Maturity January 2007 variable rate at 5.25%   | 1,500                            |
|  | \$ 49,985                        |

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by \$86.0 million and \$79.3 million of first mortgage loans and \$25.0 million and \$30.9 million of mortgage-backed securities under a blanket lien arrangement at year-end 2007 and 2006. Based on this collateral, the Company's holdings of FHLB stock and a general borrowing limit of 40% of assets, the Company is eligible to borrow an additional \$13.6 million at year-end 2007.

Required payments are:

|            | <b>Amount<br/>(In thousands)</b> |
|------------|----------------------------------|
| 2008       | \$ 30,000                        |
| 2009       | 3,500                            |
| 2010       | 3,500                            |
| 2011       | -                                |
| 2012       | -                                |
| Thereafter | 59,500                           |
|            | \$ 96,500                        |

**Note 7 Junior Subordinated Debentures**

On March 17, 2004, the Company issued \$6.0 million of Floating Rate Junior Subordinated Debentures in a private placement. The debentures mature in 10 years and interest is payable quarterly at a rate per annum equal to the 3-month LIBOR plus 2.54%. The interest rate is determined as of each March 17, June 17, September 17, and December 17, and was 7.53% at year-end 2007.

**Note 8 Employee Benefit Plans**

***Broadway Federal 401(k) Plan***

A 401(k) benefit plan allows employee contributions for substantially all employees up to \$15,000 of their compensation for 2007 and 2006, which are matched at a rate equal to 50% of the first 6% of the compensation contributed. Expense for 2007 and 2006 was \$72,000 and \$67,000.

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**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)*****Recognition and Retention Plan (RRP)***

A Recognition and Retention Plan ( RRP ) provides for the issuance of shares to non-employee directors. Compensation expense is recognized over the five-year vesting period of the shares for the difference between the exercise price and the market value at issue date. Awards are automatically vested upon a change of control of the Company or the Bank. In the event that, before reaching normal retirement, a non-employee director terminates service with the Company or the Bank, that person's non-vested awards are forfeited. Total shares available and unissued under the plan were 3,482 at December 31, 2007. No shares were issued in 2007 or 2006. Compensation expense was \$4,000 for 2007 and \$5,000 for 2006.

***Performance Equity Program (PEP)***

A Performance Equity Program ( PEP ) provides for the issuance of shares to certain officers and employees. Compensation expense is recognized over the five-year vesting period of the shares for the difference between the exercise price and the market value at issue date provided that any required performance goals have been met. In the event that, before reaching normal retirement, an officer or employee terminates service with the Company or the Bank, that person's non-vested awards are forfeited. Total shares available and unissued under the plan were 5,836 at December 31, 2007. No shares were issued in 2007 and 8,000 shares were issued in 2006. Compensation expense was \$9,000 for 2007 and \$21,000 for 2006.

A summary of changes in the Company's nonvested RRP and PEP shares for the year follows:

|                                | RRP    |  | PEP     |  |
|--------------------------------|--------|--|---------|--|
|                                | Shares | Weighted<br>Average<br>Grant Date<br>Fair<br>Value | Shares  | Weighted<br>Average<br>Grant Date<br>Fair<br>Value |
| Nonvested at January 1, 2007   | 966    | \$ 10.86   | 9,090   | \$ 10.15   |
| Vested                         | (483)  | 10.22  | (2,090) | 9.70   |
| Forfeited                      | (322)  | 11.99  | (4,600) | 10.31  |
| Nonvested at December 31, 2007 | 161    | \$ 10.49   | 2,400   | \$ 10.25   |

As of December 31, 2007, there was \$2,000 and \$25,000 of total unrecognized compensation cost related to nonvested shares granted under the RRP and PEP Plans. The cost is expected to be recognized over a weighted average period of 0.3 years and 3.4 years. The total fair value of shares vested for the RRP and PEP Plans during the years ended December 31, 2007 and 2006 was \$25,000 and \$26,000.

***Deferred Compensation***

The Bank has a deferred compensation agreement with its Chief Executive Officer ( CEO ) whereby a stipulated amount will be paid to the CEO over a period of 15 years upon his retirement. The amount accrued under this agreement was \$212,000 at December 31, 2007 and \$109,000 at December 31, 2006, and is accrued over the period of active employment. Compensation expense was \$103,000 for 2007 and \$109,000 for 2006.

**Note 9 ESOP Plan**

Employees participate in an Employee Stock Option Plan ( ESOP ) after attaining certain age and service requirements. The Company makes discretionary contributions to the ESOP. Dividends on allocated shares increase participant accounts. At the end of employment, participants

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will receive cash or shares at their election for their vested balance. Vesting occurs over seven years. Contributions to the ESOP for the years ended 2007 and 2006 were \$41,000 and \$44,000. Expense was \$55,000 and \$51,000 during 2007 and 2006.

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

Shares held by the ESOP were as follows:

|                           | 2007   | 2006   |
|---------------------------|--------|--------|
| Allocated to participants | 87,505 | 93,401 |
| Total ESOP shares         | 87,505 | 93,401 |

**Note 10 Income Taxes**

Income tax expense (benefit) was as follows:

|                 | 2007           | 2006          |
|-----------------|----------------|---------------|
|                 | (In thousands) |               |
| Current taxes:  |                |               |
| Federal         | \$ 615         | \$ 1,032      |
| State           | 8              | 217           |
|                 | 623            | 1,249         |
| Deferred taxes: |                |               |
| Federal         | 57             | (246)         |
| State           | 10             | (128)         |
|                 | 67             | (374)         |
| <b>Total</b>    | <b>\$ 690</b>  | <b>\$ 875</b> |

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

|   | 2007           | 2006          |
|---|----------------|---------------|
|   | (In thousands) |               |
| Federal statutory rate times financial statement income | \$ 729         | \$ 863        |
| Effect of:  |                |               |
| State taxes, net of federal benefit                     | 7              | 59            |
| Other, net  | (46)           | (47)          |
| <b>Total</b>  | <b>\$ 690</b>  | <b>\$ 875</b> |

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

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

|  | 2007            | 2006            |
|--|-----------------|-----------------|
|  | (In thousands)  |                 |
| Deferred tax assets:                                     |                 |                 |
| Allowance for loan losses                                | \$ 820          | \$ 688          |
| Accrued liabilities                                      | 65              | 65              |
| Lower of cost or market adjustment                       | 7               | 7               |
| State income taxes                                       | 29              | 73              |
| Impairment loss on capital investment                    | 41              | 41              |
| Deferred compensation                                    | 87              | 45              |
| Stock compensation                                       | 70              | 47              |
| <b>Total deferred tax assets</b>                         | <b>1,119</b>    | <b>966</b>      |
| Deferred tax liabilities:                                |                 |                 |
| Basis difference on fixed assets                         | (169)           | (257)           |
| Deferred loan fees/costs                                 | (965)           | (719)           |
| Unrealized appreciation on securities available for sale | (4)             | -               |
| FHLB stock dividends                                     | (791)           | (725)           |
| Mortgage servicing rights                                | (55)            | (50)            |
| Other  | (20)            | (29)            |
| <b>Total deferred tax liabilities</b>                    | <b>(2,004)</b>  | <b>(1,780)</b>  |
| Valuation allowance                                      | (41)            | (41)            |
| <b>Net deferred tax liability</b>                        | <b>\$ (926)</b> | <b>\$ (855)</b> |

A deferred tax asset valuation allowance of \$41,000 has been established at year-end 2007 and 2006 against the deferred tax asset related to the impairment loss on an equity security owned by the Company. A loss realized from the sale of this investment would be capital in nature and would only be deductible as an offset to future capital gains.

In prior years, the Bank had qualified under the provision of the Internal Revenue Code that allowed it to deduct, within limitations, a bad debt deduction computed as a percentage of taxable income before such deductions. Alternatively, the Bank could deduct from taxable income an allowance for bad debts based upon the experience method. Under provisions of the Small Business Job Protection Act of 1996, the Bank lost the use of the method of calculating a bad debt deduction based on a percentage of taxable income. However, the Bank may continue to maintain an allowance for bad debts based on the experience method, and its tax allowance for bad debts has been maintained under such method.

Retained earnings at December 31, 2007 is substantially restricted for tax purposes and includes \$3.0 million in all periods, for which no provision for federal income tax has been made. If in the future, this tax bad debt reserve is used for any purpose other than to absorb bad debt losses, federal income taxes of approximately \$1.0 million may be imposed and expensed at that time.

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

The following table summarizes the activity related to our unrecognized tax benefits:

|  | <b>Amount<br/>(In thousands)</b> |
|--|----------------------------------|
| Balance at January 1, 2007   | \$ 59                            |
| Increase related to current year tax positions                       | 18                               |
| Expiration of the statute of limitations for the assessment of taxes | (12)                             |
| Balance at December 31, 2007   | \$ 65                            |

Included in the unrecognized tax benefits of \$65,000 at December 31, 2007 was \$65,000 of tax benefits that, if recognized, would reduce our annual effective tax rate. We also accrued \$11,000 for potential interest, related to these unrecognized tax benefits as of December 31, 2007. We do not expect our unrecognized tax benefits to change significantly over the next 12 months. The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the State of California. The Company is no longer subject to examination by federal taxing authorities for years before 2004 or by state taxing authorities for years before 2003.

**Note 11 Related Party Transactions**

Loans to principal officers, directors, and their affiliates during 2007 were as follows:

|                   | <b>Amount<br/>(In thousands)</b> |
|-------------------|----------------------------------|
| Beginning balance | \$ 497                           |
| New loans         | -                                |
| Repayments        | (9)                              |
| Ending balance    | \$ 488                           |

Deposits from principal officers, directors, and their affiliates at year-end 2007 and 2006 were \$3.1 million and \$3.2 million.

**Note 12 Stock Options*****Stock Option Plan***

Options to buy stock are granted to directors, officers and employees under the Company's Long-Term Incentive Plan ( LTIP ) and under the Company's 1996 Stock Option Plan ( Stock Option Plan ), which provide for the issuance of up to 403,562 options. The maximum option term is ten years, and options vest over five years.



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

A summary of the activity in the plans for 2007 follows:

|                                  | LTIP                                       |          | Stock Option Plan |          |             | Total    |             | Aggregate |
|----------------------------------|--|----------|-------------------|----------|-------------|----------|-------------|-----------|
|                                  | Number                                     | Weighted | Number            | Weighted | Number      | Weighted | Weighted    | Intrinsic |
|                                  | Outstanding                                | Average  | Outstanding       | Average  | Outstanding | Average  | Contractual | Value     |
|                                  |  | Exercise |                   | Exercise |             | Exercise | Term        |           |
|                                  |  | Price    |                   | Price    |             | Price    |             |           |
|                                  | (In thousands, except share and per share) |          |                   |          |             |          |             |           |
| Outstanding at January 1, 2007   | 249,420                                    | \$ 7.70  | 15,256            | \$ 6.62  | 264,676     | \$ 7.63  |             |           |
| Exercised                        | (114,030)                                  | 5.71     | (8,260)           | 5.01     | (122,290)   | 5.66     |             |           |
| Forfeited or expired             | (56,000)                                   | 10.25    | (714)             | 11.99    | (56,714)    | 10.28    |             |           |
| Outstanding at December 31, 2007 | 79,390                                     | \$ 8.75  | 6,282             | \$ 8.13  | 85,672      | \$ 8.70  | 5.82 years  | \$ 106    |
| Vested or expected to vest       | 79,390                                     | \$ 8.75  | 6,282             | \$ 8.13  | 85,672      | \$ 8.70  | 5.82 years  | \$ 106    |
| Exercisable at December 31, 2007 | 63,390                                     | \$ 8.19  | 5,925             | \$ 7.99  | 69,315      | \$ 8.17  | 5.35 years  | \$ 106    |

No options were granted during 2007 and 75,000 options were granted during 2006. Options available and unissued under the Plans totaled 87,239 at December 31, 2007.

Options outstanding and exercisable at year-end 2007 were as follows:

| Stock Option Plan  | Exercise Price | Number Outstanding | Outstanding | Weighted Average Contractual Life | Weighted Average Exercise Price | Exercisable        | Weighted Average Exercise Price |
|--------------------|----------------|--------------------|-------------|-----------------------------------|---------------------------------|--------------------|---------------------------------|
|                    |                |                    | Remaining   |                                   |                                 | Number Outstanding |                                 |
| December 31, 2007: |                |                    |             |                                   |                                 |                    |                                 |
| LTIP               | \$ 4.34        | 8,472              | 2.87 years  | \$ 4.34                           | 8,472                           | \$ 4.34            |                                 |
|                    | \$ 6.68        | 29,718             | 4.56 years  | \$ 6.68                           | 29,718                          | \$ 6.68            |                                 |
|                    | \$ 10.49       | 4,200              | 5.21 years  | \$ 10.49                          | 4,200                           | \$ 10.49           |                                 |
|                    | \$ 13.11       | 10,000             | 6.30 years  | \$ 13.11                          | 6,000                           | \$ 13.11           |                                 |
|                    | \$ 10.85       | 12,000             | 8.25 years  | \$ 10.85                          | 12,000                          | \$ 10.85           |                                 |
|                    | \$ 10.25       | 15,000             | 8.39 years  | \$ 10.25                          | 3,000                           | \$ 10.25           |                                 |
|                    |                | 79,390             | 5.92 years  | \$ 8.75                           | 63,390                          | \$ 8.19            |                                 |
| Stock Option Plan  | \$ 4.34        | 2,000              | 2.87 years  | \$ 4.34                           | 2,000                           | \$ 4.34            |                                 |
|                    | \$ 8.19        | 1,784              | 4.72 years  | \$ 8.19                           | 1,784                           | \$ 8.19            |                                 |
|                    | \$ 10.49       | 1,428              | 5.21 years  | \$ 10.49                          | 1,071                           | \$ 10.49           |                                 |
|                    | \$ 11.99       | 1,070              | 6.55 years  | \$ 11.99                          | 1,070                           | \$ 11.99           |                                 |

|       |            |         |       |         |
|-------|------------|---------|-------|---------|
| 6,282 | 4.55 years | \$ 8.13 | 5,925 | \$ 7.99 |
|-------|------------|---------|-------|---------|

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option

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

expense and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The fair value of options granted during 2006 was determined using the following weighted average assumptions as of grant date.

|                                 | <b>2006</b> |
|---------------------------------|-------------|
| Risk free interest rate         | 4.91%       |
| Expected term (years)           | 10 years    |
| Expected stock price volatility | 26.77%      |
| Dividend yield                  | 1.86%       |

Information related to the Company's stock option Plans during each year follows:

|  | <b>2007</b>                                 | <b>2006</b> |
|--|---|-------------|
|  | <b>(In thousands,<br/>except per share)</b> |             |
| Intrinsic value of options exercised           | \$ 610                                      | \$ 98       |
| Cash received from options exercised           | 693   | 127         |
| Tax benefit realized from options exercised    | 251   | 40          |
| Weighted average fair value of options granted | N/A   | \$ 3.86     |

As of December 31, 2007, there was \$50,000 of total unrecognized compensation cost related to nonvested stock options granted under the Plans. The cost is expected to be recognized over a weighted average period of 2.8 years.

**Note 13 Regulatory Capital Matters**

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2007 and 2006, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Additionally, Bank management has communicated to the Bank's primary regulator that the Bank intends to keep the Total Risk-based capital ratio above 11%. However, as of December 31, 2007, the Bank's actual Total Risk-based capital ratio was only 10.01%.

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

The Bank's actual and required capital amounts and ratios are presented below at year-end.

|                           | Actual    |        | Minimum For Capital Adequacy Purposes |       | Minimum Amount Required to be Well Capitalized |        |
|---------------------------|-----------|--------|---------------------------------------|-------|--|--------|
|                           | Amount    | Ratio  | Amount                                | Ratio | Amount   | Ratio  |
| <b>December 31, 2007:</b> |           |        |                                       |       |  |        |
| Core Capital Ratio        | \$ 26,037 | 7.30%  | \$ 14,275                             | 4.00% | \$ 17,844                                      | 5.00%  |
| Tier I Risk-based ratio   | \$ 26,037 | 9.29%  | \$ 11,207                             | 4.00% | \$ 16,810                                      | 6.00%  |
| Total Risk-based ratio    | \$ 28,052 | 10.01% | \$ 22,413                             | 8.00% | \$ 28,016                                      | 10.00% |
| <b>December 31, 2006:</b> |           |        |                                       |       |  |        |
| Core Capital Ratio        | \$ 23,930 | 7.95%  | \$ 12,040                             | 4.00% | \$ 15,050                                      | 5.00%  |
| Tier I Risk-based ratio   | \$ 23,930 | 11.29% | \$ 8,478                              | 4.00% | \$ 12,718                                      | 6.00%  |
| Total Risk-based ratio    | \$ 25,626 | 12.09% | \$ 16,957                             | 8.00% | \$ 21,196                                      | 10.00% |

The Company's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2008, the Bank could, without prior approval, declare dividends of approximately \$4.3 million plus any 2008 net profits retained to the date of the dividend declaration.

**Note 14 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 to 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:

|                           | 2007           | 2006   |
|---------------------------|----------------|--------|
|                           | (In thousands) |        |
| Commitments to make loans | \$ 10,875      | \$ 800 |
| Unused lines of credit    | 11,604         | 4,374  |

Commitments to make loans are generally made for periods of 60 days or less. Our loan commitments at year-end 2007 consist primarily of commercial real estate loans with an average interest rate of 7.43%.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)****Note 15 Fair Values of Financial Instruments**

Carrying amount and estimated fair values of financial instruments at year-end were as follows:

|   | 2007            |              | 2006            |              |
|---|-----------------|--------------|-----------------|--------------|
|   | Carrying Amount | Fair Value   | Carrying Amount | Fair Value   |
| (In thousands)  |                 |              |                 |              |
| <b>Assets:</b>  |                 |              |                 |              |
| Cash and cash equivalents                             | \$ 4,331        | \$ 4,331     | \$ 5,310        | \$ 5,310     |
| Securities available for sale                         | 4,763           | 4,763        | -               | -            |
| Securities held to maturity                           | 29,184          | 29,152       | 35,793          | 35,174       |
| Loans receivable held for sale                        | 3,554           | 3,577        | -               | -            |
| Loans receivable, net                                 | 300,024         | 300,024      | 247,657         | 244,125      |
| Federal Home Loan Bank stock                          | 4,536           | N/A          | 2,490           | N/A          |
| Accrued interest receivable                           | 1,867           | 1,867        | 1,476           | 1,476        |
| <b>Liabilities:</b>                                   |                 |              |                 |              |
| Deposits  | \$ (228,727)    | \$ (228,932) | \$ (221,467)    | \$ (210,506) |
| Federal Home Loan Bank advances                       | (96,500)        | (97,379)     | (49,985)        | (49,309)     |
| Junior subordinated debentures                        | (6,000)         | (6,000)      | (6,000)         | (6,000)      |
| Advance payments by borrowers for taxes and insurance | (512)           | (512)        | (588)           | (588)        |
| Accrued interest payable                              | (406)           | (406)        | (318)           | (318)        |

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, demand deposits, short-term debt, advance payments by borrowers for taxes and insurance, and variable rate loans, deposits and borrowings that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. Fair value of loans receivable held for sale is based on market quotes. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values and the allowance for loan losses is considered to be a reasonable estimate of discount for credit quality concerns. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The estimated fair values of other financial instruments and off-balance-sheet loan commitments approximate cost at year-end 2007 and 2006, and are not considered significant to this presentation.

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)****Note 16 Parent Company Only Condensed Financial Information**

Condensed financial information of Broadway Financial Corporation follows:

**Condensed Balance Sheet**

|  | <b>December 31,</b>   |             |
|--|-----------------------|-------------|
|  | <b>2007</b>           | <b>2006</b> |
|  | <b>(In thousands)</b> |             |
| <b>Assets</b>                              |                       |             |
| Cash                                       | \$ 1,522              | \$ 1,584    |
| Investment in bank subsidiary              | 26,044                | 23,930      |
| Investment in non-bank subsidiaries        | -                     | 181         |
| Other assets                               | 671                   | 477         |
|  | \$ 28,237             | \$ 26,172   |
| <b>Liabilities and stockholders equity</b> |                       |             |
| Junior subordinated debentures             | \$ 6,000              | \$ 6,000    |
| Other liabilities                          | 188                   | 147         |
| Stockholders equity                        | 22,049                | 20,025      |
|  | \$ 28,237             | \$ 26,172   |

**Condensed Statements of Operations**

|  | <b>Year Ended December 31,</b> |             |
|--|--------------------------------|-------------|
|  | <b>2007</b>                    | <b>2006</b> |
|  | <b>(In thousands)</b>          |             |
| Interest income  | \$ 6                           | \$ 5        |
| Interest expense   | 485                            | 464         |
| Other expense  | 497                            | 532         |
| Loss before income taxes                                     | (976)                          | (991)       |
| Income taxes benefit   | 391                            | 389         |
| Loss before equity in undistributed earnings of subsidiaries | (585)                          | (602)       |
| Equity in undistributed earnings of bank subsidiary          | 2,038                          | 2,245       |
| Equity in undistributed earnings of non-bank subsidiaries    | -                              | 20          |
| Net earnings   | \$ 1,453                       | \$ 1,663    |

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

| <i>Condensed Statements of Cash Flows</i>                                       | <b>Year Ended December 31,</b> |                 |
|---|--------------------------------|-----------------|
|   | <b>2007</b>                    | <b>2006</b>     |
|   | (In thousands)                 |                 |
| <b>Cash flows from operating activities</b>                                     |                                |                 |
| Net earnings  | \$ 1,453                       | \$ 1,663        |
| Adjustments to reconcile net earnings to net cash used in operating activities: |                                |                 |
| Equity in undistributed earnings of bank subsidiary                             | (2,038)                        | (2,245)         |
| Equity in undistributed earnings of non-bank subsidiaries                       | -                              | (20)            |
| (Increase) decrease in other assets   | (194)                          | 337             |
| Increase in other liabilities   | 41                             | 32              |
| Stock compensation expense  | -                              | 115             |
| <b>Net cash used in operating activities</b>                                    | <b>(738)</b>                   | <b>(118)</b>    |
| <b>Cash flows from investing activities</b>                                     |                                |                 |
| Proceeds from liquidation of non-bank subsidiary                                | 181                            | -               |
| <b>Net cash provided by investing activities</b>                                | <b>181</b>                     | <b>-</b>        |
| <b>Cash flows from financing activities</b>                                     |                                |                 |
| Preferred stock issued  | -                              | 905             |
| Common stock issued   | -                              | 1,644           |
| Stock options exercised, net of tax benefits                                    | 944                            | 167             |
| Purchases of treasury stock   | (4)                            | (929)           |
| Reissuance of treasury stock  | 25                             | 19              |
| Common and preferred dividends paid   | (470)                          | (437)           |
| <b>Net cash provided by financing activities</b>                                | <b>495</b>                     | <b>1,369</b>    |
| <b>Net (decrease) increase in cash and cash equivalents</b>                     | <b>(62)</b>                    | <b>1,251</b>    |
| Cash and cash equivalents, beginning of year                                    | 1,584                          | 333             |
| <b>Cash and cash equivalents, end of year</b>                                   | <b>\$ 1,522</b>                | <b>\$ 1,584</b> |

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements (continued)****Note 17 Earnings Per Share**

The factors used in the earnings per share computations follow:

|  | 2007  | 2006      |
|--|---|-----------|
|  | (Dollars in thousands,<br>except per share) |           |
| <b>Basic</b>   |   |           |
| Net earnings   | \$ 1,453                                    | \$ 1,663  |
| Less: Preferred stock dividends  | (128)                                       | (115)     |
| Earnings available to common stockholders                                      | \$ 1,325                                    | \$ 1,548  |
| <br>   |   |           |
| Weighted average common shares outstanding                                     | 1,691,462                                   | 1,591,364 |
| <br>   |   |           |
| Basic earnings per common share  | \$ 0.78                                     | \$ 0.97   |
| <b>Diluted</b>   |   |           |
| Net earnings   | \$ 1,453                                    | \$ 1,663  |
| Less: Preferred stock dividends  | (128)                                       | (115)     |
| <br>   |   |           |
| Earnings available to common stockholders                                      | \$ 1,325                                    | \$ 1,548  |
| <br>   |   |           |
| Weighted average common shares outstanding for basic earnings per common share | 1,691,462                                   | 1,591,364 |
| Add: dilutive effects of assumed exercises of stock options                    | 104,627                                     | 125,277   |
| <br>   |   |           |
| Average shares and dilutive potential common shares                            | 1,796,089                                   | 1,716,641 |
| <br>   |   |           |
| Diluted earnings per common share  | \$ 0.74                                     | \$ 0.90   |

Stock options for 44,000 and 92,000 shares of common stock were not considered in computing diluted earnings per common share for 2007 and 2006 because they were anti-dilutive.

**Note 18 Capital Transactions**

On April 5, 2006, the Company completed the sale of 76,950 shares of non-voting Series C Noncumulative Convertible Perpetual Preferred Stock to National Community Investment Fund ( NCIF ) at a price of \$13.00 per share. The preferred stock is convertible at a conversion price of \$13.00 per share, subject to certain anti-dilution adjustment provisions.

On May 22, 2006, the Company completed the sale of 145,000 shares of its common stock to Cathay General Bancorp at \$11.51 per share, under the Third Amendment to the Stock Purchase Agreement dated December 31, 2005. The shares sold constituted 8.83% of the number of shares of common stock outstanding, as determined immediately after the sale of the shares.