NASB FINANCIAL INC
Form 10-Q
February 11, 2013

Securities and Exchange Commission

Washington, DC 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the period ended December 31, 2012

or

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _________ to _________

Commission File Number 0-24033

NASB Financial, Inc.

(Exact name of registrant as specified in its charter)

Missouri	**43-1805201**

(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
12498 South 71 Highway,	
Grandview, Missouri	**64030**
(Address of principal executive offices)	**(Zip Code)**

(816) 765-2200

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer, or a small reporting company. See definition of accelerated filer , large accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Small reporting Company ¨

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

The number of shares of Common Stock of the Registrant outstanding as of February 4, 2013, was 7,867,614.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Balance Sheets

	December 31, 2012 (Unaudited)	September 30, 2012
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents	$ 11,908	8,716
Securities:		
Available for sale, at fair value	266,326	214,190
Stock in Federal Home Loan Bank, at cost	8,097	7,073
Mortgage-backed securities:		
Available for sale, at fair value	524	554
Held to maturity, at cost	23,669	25,921
Loans receivable:		
Held for sale, at fair value	164,635	163,834
Held for investment, net	722,654	766,601
Allowance for loan losses	(27,853)	(31,829)
Total loans receivable, net	859,436	898,606
Accrued interest receivable	4,169	4,402
Foreclosed assets held for sale, net	15,314	17,040
Premises and equipment, net	15,248	15,272
Investment in LLCs	17,137	17,222
Deferred income tax asset, net	15,523	17,199
Other assets	15,173	14,631
	$ 1,252,524	1,240,826
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer deposit accounts	$ 864,827	870,946
Brokered deposit accounts	9,997	21,367
Advances from Federal Home Loan Bank	150,000	127,000
Subordinated debentures	25,774	25,774
Escrows	4,330	8,760
Income taxes payable	4,953	3,490
Accrued expenses and other liabilities	12,783	11,986
Total liabilities	1,072,664	1,069,323
Stockholders equity:		
Common stock of $0.15 par value: 20,000,000 shares authorized; 9,857,112 shares issued	1,479	1,479
Additional paid-in capital	16,657	16,657
Retained earnings	197,833	189,516
Treasury stock, at cost; 1,989,498 shares	(38,418)	(38,418)
Accumulated other comprehensive loss	2,309	2,269
Total stockholders equity	179,860	171,503

	$ 1,252,524	1,240,826

See accompanying notes to condensed consolidated financial statements**.**

1

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Operations (Unaudited)

	Three months ended December 31,	
	2012	2011
	(Dollars in thousands, except share data)	
Interest on loans receivable	$ 12,334	15,893
Interest on mortgage-backed securities	294	499
Interest and dividends on securities	963	968
Other interest income	2	2
Total interest income	13,593	17,362
Interest on customer and brokered deposit accounts	1,749	2,479
Interest on advances from Federal Home Loan Bank	531	635
Interest on subordinated debentures	129	129
Other interest expense	3	
Total interest expense	2,412	3,243
Net interest income	11,181	14,119
Provision for loan losses	(4,000)	2,500
Net interest income after provision for loan losses	15,181	11,619
Other income (expense):		
Loan servicing fees, net	26	47
Customer service fees and charges	1,474	1,410
Provision for loss on real estate owned	(575)	(1,354)
Loss on sale of securities available for sale		(343)
Gain from loans receivable held for sale	16,106	11,271
Other expense	(534)	(482)
Total other income	16,497	10,549
General and administrative expenses:		
Compensation and fringe benefits	6,356	5,348
Commission-based mortgage banking compensation	5,813	3,701
Premises and equipment	1,322	1,191
Advertising and business promotion	1,163	1,011
Federal deposit insurance premiums	586	387
Other	2,915	2,499
Total general and administrative expenses	18,155	14,137
Income before income tax expense	13,523	8,031
Income tax expense	5,206	3,092
Net income	$ 8,317	4,939
Basic earnings per share	$ 1.06	0.63
Diluted earnings per share	$ 1.06	0.63

Basic weighted average shares outstanding	7,867,614	7,867,614

See accompanying notes to condensed consolidated financial statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three months ended December 31,	
	2012	2011
	(Dollars in thousands)	
Net income	$ 8,317	4,939
Other comprehensive income (loss):		
Unrealized gain (loss) loss on available for sale securities, net of income taxes of $25 and $(113) at December 31, 2012 and 2011, respectively	40	(181)
Reclassification adjustment for loss included in net income, net of income taxes of $132 at December 31, 2011		211
Change in unrealized gain on available for sale securities, net of income taxes of $25 and $19 at December 31, 2012 and 2011, respectively	40	30
Comprehensive income	$ 8,357	4,969

See accompanying notes to condensed consolidated financial statements**.**

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statement of Stockholders Equity (Unaudited)

	Common stock	Additional paid-in capital	Retained Earnings	Treasury stock	Accumulated other comprehensive Income	Total stockholders equity
			(Dollars in thousands)			
Balance at October 1, 2012	$ 1,479	16,657	189,516	(38,418)	2,269	171,503
Comprehensive income:						
Net income			8,317			8,317
Other comprehensive income, net of tax:						
Unrealized gain on securities available for sale					40	40
Total comprehensive income						8,357
Balance at December 31, 2012	$ 1,479	16,657	197,833	(38,418)	2,309	179,860

See accompanying notes to condensed consolidated financial statements**.**

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three months ended December 31, 2012	2011
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$ 8,317	4,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	522	482
Amortization and accretion, net	212	(440)
Loss on sale of securities available for sale		343
Loss from investment in LLCs	90	13
Gain from loans receivable held for sale	(16,106)	(11,271)
Provision for loan losses	(4,000)	2,500
Provision for loss on real estate owned	575	1,354
Origination of loans receivable held for sale	(542,797)	(413,503)
Sale of loans receivable held for sale	558,103	424,076
Stock based compensation stock options		2
Changes in:		
Net fair value of loan-related commitments	300	635
Accrued interest receivable	233	288
Prepaid and accrued expenses, other liabilities, and income taxes payable	2,940	1,531
Net cash provided by operating activities	8,389	10,949
Cash flows from investing activities:		
Principal repayments of mortgage-backed securities:		
Held to maturity	2,248	3,366
Available for sale	28	53
Principal repayments of mortgage loans receivable held for investment	68,138	54,486
Principal repayments of other loans receivable	659	759
Principal repayments of investment securities available for sale		25,103
Loan origination - mortgage loans receivable held for investment	(24,930)	(19,019)
Loan origination - other loans receivable	(588)	(941)
Purchase of mortgage loans receivable held for investment	(647)	(378)
Proceeds from sale (purchase) of Federal Home Loan Bank stock	(1,024)	5,246
Purchase of investment securities available for sale	(52,525)	(5,468)
Proceeds from sale of investment securities available for sale		19,678
Proceeds from sale of real estate owned	2,772	2,506
Purchases of premises and equipment, net	(499)	(889)
Investment in LLCs	(5)	(3)
Other	(319)	(380)
Net cash provided by (used in) investing activities	(6,692)	84,119

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three months ended December 31,	
	2012	2011
	(Dollars in thousands)	
Cash flows from financing activities:		
Net increase (decrease) in customer and brokered deposit accounts	(17,496)	72,895
Proceeds from advances from Federal Home Loan Bank	25,000	
Repayment on advances from Federal Home Loan Bank	(2,000)	(122,000)
Change in escrows	(4,431)	(5,297)
Proceeds from other borrowings	422	
Net cash provided by (used in) financing activities	1,495	(54,402)
Net increase in cash and cash equivalents	3,192	40,666
Cash and cash equivalents at beginning of the period	8,716	5,030
Cash and cash equivalents at end of period	$ 11,908	45,696
Supplemental disclosure of cash flow information:		
Cash paid for income taxes (net of refunds)	$ 2,093	
Cash paid for interest	2,378	3,332
Supplemental schedule of non-cash investing and financing activities:		
Conversion of loans receivable to real estate owned, net of specific reserves	$ 1,826	6,483
Conversion of real estate owned to loans receivable		42

See accompanying notes to condensed consolidated financial statements.

NASB Financial, Inc.

(1) BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of NASB Financial, Inc. (the Company), its wholly-owned subsidiary, North American Savings Bank, F.S.B. (North American or the Bank), and the Bank s wholly-owned subsidiary, Nor-Am Service Corporation. All significant inter-company transactions have been eliminated in consolidation. The consolidated financial statements do not include the accounts of our wholly-owned statutory trust, NASB Preferred Trust I (the Trust). The Trust qualifies as a special purpose entity that is not required to be consolidated in the financial statements of NASB Financial, Inc. The Trust Preferred Securities issued by the Trust are included in Tier I capital for regulatory capital purposes. See Footnote 8, Subordinated Debentures.

The accompanying unaudited condensed consolidated financial statements are prepared in accordance with instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. All adjustments are of a normal and recurring nature, and, in the opinion of management, the statements include all adjustments considered necessary for fair presentation. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended September 30, 2012, filed with the Securities and Exchange Commission on December 14, 2012. Operating results for the three month period ended December 31, 2012, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2013. The condensed consolidated balance sheet of the Company as of September 30, 2012, has been derived from the audited balance sheet of the Company as of that date.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowances for losses on loans, valuation of foreclosed assets held for sale, accruals for loan recourse provisions, and fair values of financial instruments, among other items. Management believes that these estimates are adequate; however, future additions to the allowance or changes in the estimates may be necessary based on changes in economic conditions.

The Company s critical accounting policies involving the more significant judgments and assumptions used in the preparation of the condensed consolidated financial statements as of December 31, 2012, have remained unchanged from September 30, 2012. These policies relate to the allowance for loan losses, the valuation of foreclosed assets held for sale, the valuation of derivative instruments, and the valuation of equity method investments. Disclosure of these critical accounting policies is incorporated by reference under Item 8 Financial Statements and Supplementary Data in the Company s Annual Report on Form 10-K for the Company s year ended September 30, 2012.

Certain quarterly amounts for previous periods have been reclassified to conform to the current quarter s presentation.

(2) RECONCILIATION OF BASIC EARNINGS PER SHARE TO DILUTED EARNINGS PER SHARE

The following table presents a reconciliation of basic earnings per share to diluted earnings per share for the periods indicated.

	Three months ended	
	12/31/12	12/31/11
Net income (in thousands)	$ 8,317	4,939
Average common shares outstanding	7,867,614	7,867,614
Average common share stock options outstanding		
Average diluted common shares	7,867,614	7,867,614
Earnings per share:		
Basic	$ 1.06	0.63
Diluted	1.06	0.63

At December 31, 2012 and 2011, options to purchase 47,538 shares of the Company s stock were outstanding. These options were not included in the calculation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares for the period, thus making the options anti-dilutive.

(3) SECURITIES AVAILABLE FOR SALE

The following table presents a summary of securities available for sale at December 31, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 69,464	3,310		72,774
U.S. government sponsored agency securities	192,710	580	166	193,124
Municipal securities	428			428
Total	$ 262,602	3,890	166	266,326

The following table presents a summary of securities available for sale at September 30, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross Unrealized Losses	Estimated fair value
Corporate debt securities	$ 57,983	3,035		61,018
U.S. government sponsored agency securities	152,546	624	4	153,166
Municipal securities	6			6
Total	$ 210,535	3,659	4	214,190

There were no sales of securities available for sale during the three month period ended December 31, 2012. During the three month period ended December 31, 2011, the Company realized gross gains of $227,000 and gross losses of $570,000 on the sale of securities available for sale.

The following table presents a summary of the fair value and gross unrealized losses of those securities available for sale which had unrealized losses at December 31, 2012. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated fair value	Gross unrealized Losses	Estimated fair value	Gross unrealized losses
U.S. government sponsored agency securities	$ 60,307	166	$	
Total	$ 60,307	166	$	

The scheduled maturities of securities available for sale at December 31, 2012 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due in less than one year	$ 11,734	13		11,747
Due from one to five years	164,484	3,706	1	168,189
Due from five to ten years	35,095	147		35,242
Due after ten years	51,289	24	165	51,148
Total	$ 262,602	3,890	166	266,326

(4) MORTGAGE-BACKED SECURITIES AVAILABLE FOR SALE

The following table presents a summary of mortgage-backed securities available for sale at December 31, 2012. Dollar amounts are expressed in thousands.

		Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Pass-through certificates guaranteed by GNMA	fixed rate	$ 76	2		78
Pass-through certificates guaranteed by FNMA	adjustable rate	137	7		144
FHLMC participation certificates:					
Fixed rate		161	13		174
Adjustable rate		120	8		128
Total		$ 494	30		524

The following table presents a summary of mortgage-backed securities available for sale at September 30, 2012. Dollar amounts are expressed in thousands.

		Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Pass-through certificates guaranteed by GNMA	fixed rate	$ 78	3		81
Pass-through certificates guaranteed by FNMA	adjustable rate	143	9		152
FHLMC participation certificates:					
Fixed rate		176	14		190
Adjustable rate		123	8		131
Total		$ 520	34		554

There were no sales of mortgage-backed securities available for sale during the three month periods ended December 31, 2012 and 2011.

The scheduled maturities of mortgage-backed securities available for sale at December 31, 2012 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from five to ten years	$ 161	13		174
Due after ten years	333	17		350
Total	$ 494	30		524

Actual maturities and pay-downs of mortgage-backed securities available for sale will differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments, on which borrowers have the right to prepay certain obligations.

(5) MORTGAGE-BACKED SECURITIES HELD TO MATURITY

The following table presents a summary of mortgage-backed securities held to maturity at December 31, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 35	3		38
FNMA pass-through certificates:				
Fixed rate	3			3
Balloon maturity and adjustable rate	23	1		24
Collateralized mortgage obligations	23,608	370	327	23,651
Total	$ 23,669	374	327	23,716

The following table presents a summary of mortgage-backed securities held to maturity at September 30, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 37	3		40
FNMA pass-through certificates:				
Fixed rate	3			3
Balloon maturity and adjustable rate	24	1		25
Collateralized mortgage obligations	25,857	390	198	26,049
Total	$ 25,921	394	198	26,117

There were no sales of mortgage-backed securities held to maturity during the three month periods ended December 31, 2012 and 2011.

The following table presents a summary of the fair value and gross unrealized losses of those mortgage-backed securities held to maturity which had unrealized losses at December 31, 2012. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses
Collateralized mortgage obligations	$ 9,587	197	$ 1,345	130
Total	$ 9,587	197	$ 1,345	130

Management monitors the securities portfolio for impairment on an ongoing basis by evaluating market conditions and other relevant information, including external credit ratings, to determine whether or not a decline in value is other-than-temporary. When the fair value of a security is less than its amortized cost, an other-than-temporary impairment is considered to have occurred if the present value of expected cash flows is not sufficient to recover the entire amortized cost, or if the Company intends to, or will be required to, sell the security prior to the recovery of its amortized cost. The unrealized losses at December 31, 2012, are primarily the result of changes in market yields from the time of purchase. Management generally views changes in fair value caused by changes in interest rates as temporary. In addition, all scheduled payments for securities with unrealized losses at December 31, 2012, have been made, and it is anticipated that the Company will hold such securities to maturity and that the entire principal balance will be collected.

The scheduled maturities of mortgage-backed securities held to maturity at December 31, 2012, are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from one to five years	$ 26	2		28
Due from five to ten years	1,115	2	28	1,089
Due after ten years	22,528	370	299	22,599
Total	$ 23,669	374	327	23,716

Actual maturities and pay-downs of mortgage-backed securities held to maturity will differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments, on which borrowers have the right to prepay certain obligations.

(6) LOANS RECEIVABLE

The Bank has traditionally concentrated its lending activities on mortgage loans secured by residential and business property and, to a lesser extent, development lending. Residential mortgage loans have either long-term fixed or adjustable rates. The Bank also has a portfolio of mortgage loans that are secured by multifamily, construction, development, and commercial real estate properties. The remaining part of North American s loan portfolio consists of non-mortgage commercial loans and installment loans.

The following table presents the Bank s total loans receivable. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
HELD FOR INVESTMENT		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 329,436	331,310
Business properties	291,487	321,559
Partially guaranteed by VA or insured by FHA	4,447	3,950
Construction and development	97,684	110,718
Total mortgage loans	723,054	767,537
Commercial loans	14,986	17,570
Installment loans and lease financing to individuals	7,591	7,753
Total loans receivable held for investment	745,631	792,860
Less:		
Undisbursed loan funds	(18,013)	(21,014)
Unearned discounts and fees on loans, net of deferred costs	(4,964)	(5,245)
Net loans receivable held for investment	$ 722,654	766,601
HELD FOR SALE		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 164,635	163,834

Included in the loans receivable balances at December 31, 2012, are participating interests in mortgage loans and wholly-owned mortgage loans serviced by other institutions in the amount of $1.2 million. Loans and participations serviced for others amounted to approximately $27.4 million at December 31, 2012. Loans serviced for others are not included in the accompanying condensed consolidated balance sheets.

Lending Practices and Underwriting Standards

Residential real estate loans - The Bank offers a range of residential loan programs, including programs offering loans guaranteed by the Veterans Administration (VA) and loans insured by the Federal Housing Administration (FHA). The Bank s residential loans come from several sources. The loans that the Bank originates are generally a result of direct solicitations of real estate brokers, builders, developers, or potential borrowers via the internet. North American periodically purchases real estate loans from other financial institutions or mortgage bankers.

The Bank s residential real estate loan underwriters are grouped into three different levels, based upon each underwriter s experience and proficiency. Underwriters within each level are authorized to approve loans up to prescribed dollar amounts. Any loan over $1 million must also be approved by either the CEO or the EVP/Chief Credit Officer. Conventional residential real estate loans are underwritten using FNMA s Desktop Underwriter or FHLMC s Loan Prospector automated underwriting systems, which analyze credit history, employment and income information, qualifying ratios, asset reserves, and loan-to-value ratios. If a loan does not meet the automated underwriting standards, it is underwritten manually. Full documentation to support each applicant s credit history, income, and sufficient funds for closing is required on all loans. An appraisal report, performed in conformity with the Uniform Standards of Professional Appraisers Practice by an outside licensed appraiser, is required for all loans. Typically, the Bank requires borrowers to purchase private mortgage insurance when the loan-to-value ratio exceeds 80%.

NASB originates Adjustable Rate Mortgages (ARMs), which fully amortize and typically have initial rates that are fixed for one to seven years before becoming adjustable. Such loans are underwritten based on the initial interest rate and the borrower s ability to repay based on the maximum first adjustment rate. Each underwriting decision takes into account the type of loan and the borrower s ability to pay at higher rates. While lifetime rate caps are taken into consideration, qualifying ratios may not be calculated at this level due to an extended number of years required to reach the fully-indexed rate. NASB does not originate any hybrid loans, such as payment option ARMs, nor does the Bank originate any subprime loans, generally defined as high risk or loans of substantially impaired quality.

12

At the time a potential borrower applies for a residential mortgage loan, it is designated as either a portfolio loan, which is held for investment and carried at amortized cost, or a loan held-for-sale in the secondary market and carried at fair value. All the loans on single family property that the Bank holds for sale conform to secondary market underwriting criteria established by various institutional investors. All loans originated, whether held for sale or held for investment, conform to internal underwriting guidelines, which consider, among other things, a property s value and the borrower s ability to repay the loan.

Construction and development loans Construction and land development loans are made primarily to builders/developers, who construct properties for resale. The Bank s requirements for a construction loan are similar to those of a mortgage on an existing residence. In addition, the borrower must submit accurate plans, specifications, and cost projections of the property to be constructed. All construction and development loans are manually underwritten using NASB s internal underwriting standards. All construction and development loans must be approved by the CEO and either the EVP/ Chief Credit Officer or SVP/Construction Lending. Prior approval is required from the Bank s Board of Directors for newly originated construction and development loans with a proposed balance of $2.5 million or greater. The bank has adopted internal loan-to-value limits consistent with regulations, which are 65% for raw land, 75% for land development, and 85% for residential and non-residential construction. An appraisal report performed in conformity with the Uniform Standards of Professional Appraisers Practice by an outside licensed appraiser is required on all loans in excess of $250,000. Generally, the Bank will commit to an initial term of 12 to 18 months on construction loans, and an initial term of 24 to 48 months on land acquisition and development loans, with six month renewals thereafter. Interest rates on construction loans typically adjust daily and are tied to a predetermined index. NASB s staff regularly performs inspections of each property during its construction phase to help ensure adequate progress is achieved before making scheduled loan disbursements.

When construction and development loans mature, the Bank typically considers extensions for short, six-month term periods. This allows the Bank to more frequently evaluate the loan, including creditworthiness and current market conditions and, if management believes it s in the best interest of the Company, to modify the terms accordingly. This portfolio consists primarily of assets with rates tied to the prime rate and, in most cases, the conditions for loan renewal include an interest rate floor in accordance with the market conditions that exist at the time of renewal.

During the three month period ended December 31, 2012, the Bank renewed nineteen loans within its construction and land development portfolio due to slower home and lot sales in the current economic environment. Such extensions were accounted for as Troubled Debt Restructurings (TDRs) if the restructuring was related to the borrower s financial difficulty, and if the Bank made concessions that it would not otherwise consider. In order to determine whether or not a renewal should be accounted for as a TDR, management reviewed the borrower s current financial information, including an analysis of income and liquidity in relation to debt service requirements. The large majority of these modifications did not result in a reduction in the contractual interest rate or a write-off of the principal balance (although the Bank does commonly require the borrower to make a principal reduction at renewal).

Commercial real estate loans - The Bank purchases and originates several different types of commercial real estate loans. Permanent multifamily mortgage loans on properties of 5 to 36 dwelling units have a 50% risk-weight for risk-based capital requirements if they have an initial loan-to-value ratio of not more than 80% and if their annual average occupancy rate exceeds 80%. All other performing commercial real estate loans have 100% risk-weights.

The Bank s commercial real estate loans are secured primarily by multi-family and nonresidential properties. Such loans are manually underwritten using NASB s internal underwriting standards, which evaluate the sources of repayment, including the ability of income producing property to generate sufficient cash flow to service the debt, the capacity of the borrower or guarantors to cover any shortfalls in operating income, and, as a last resort, the ability to liquidate the collateral in such a manner as to completely protect the Bank s investment. All commercial real estate loans must be approved by the CEO and either the EVP/ Chief Credit Officer or SVP/Commercial Lending. Prior approval is required from the Bank s Board of Directors for newly originated commercial loans with a proposed balance of $2.5 million or greater. Typically, loan-to-value ratios do not exceed 80%; however, exceptions may be made when it is determined that the safety of the loan is not compromised, and the rationale for exceeding this limit is clearly documented. An appraisal report performed in conformity with the Uniform Standards of Professional Appraisers Practice by an outside licensed appraiser is required on all loans in excess of $250,000. Interest rates on commercial loans may be either fixed or tied to a predetermined index and adjusted daily.

The Bank typically obtains full personal guarantees from the primary individuals involved in the transaction. Guarantor financial statements and tax returns are reviewed annually to determine their continuing ability to perform under such guarantees. The Bank typically pursues repayment from guarantors when the primary source of repayment is not sufficient to service the debt. However, the Bank may decide not to pursue a guarantor if, given the guarantor s financial condition, it is likely that the estimated legal fees would exceed the probable amount of any recovery. Although the Bank does not typically release guarantors from their obligation, the Bank may decide to delay the decision to pursue civil enforcement of a deficiency judgment.

At least once during each calendar year, a review is prepared for each borrower relationship in excess of $5 million and for each individual loan over $1 million. Collateral inspections are obtained on an annual basis for each loan over $1 million, and on a triennial basis for each loan between $500,000 and $1 million. Financial information, such as tax returns, is requested annually for all commercial real estate loans over $500,000, which is consistent with industry practice, and the Bank believes it has sufficient monitoring procedures in place to identify potential problem loans. A loan is deemed impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement. Any loans deemed impaired, regardless of their balance, are reviewed by management at the time of the impairment determination, and monitored on a quarterly basis thereafter, including calculation of specific valuation allowances, if applicable.

Installment Loans - These loans consist primarily of loans on savings accounts and consumer lines of credit that are secured by a customer s equity in their primary residence.

Allowance for Loan Losses

The Allowance for Loan and Lease Losses (ALLL) recognizes the inherent risks associated with lending activities for individually identified problem assets as well as the entire homogenous and non-homogenous loan portfolios. ALLLs are established by charges to the provision for loan losses and carried as contra assets. Management analyzes the adequacy of the allowance on a quarterly basis and appropriate provisions are made to maintain the ALLLs at adequate levels. At any given time, the ALLL should be sufficient to absorb at least all estimated credit losses on outstanding balances over the next twelve months. While management uses information currently available to determine these allowances, they can fluctuate based on changes in economic conditions and changes in the information available to management. Also, regulatory agencies review the Bank s allowances for loan loss as part of their examination, and they may require the Bank to recognize additional loss provisions, within their regulatory filings, based on the information available at the time of their examinations.

The ALLL is determined based upon two components. The first is made up of specific reserves for loans which have been deemed impaired in accordance with GAAP. The second component is made up of general reserves for loans that are not impaired. A loan becomes impaired when management believes it will be unable to collect all principal and interest due according to the contractual terms of the loan. Once a loan has been deemed impaired, the impairment must be measured by comparing the recorded investment in the loan to the present value of the estimated future cash flows discounted at the loan s effective rate, or to the fair value of the loan based on the loan s observable market price, or to the fair value of the collateral if the loan is collateral dependent. Prior to the quarter ended March 31, 2012, the Bank recorded a specific allowance equal to the amount of measured impairment.

In July 2011, the Office of Thrift Supervision (OTS) merged with and into the Office of the Comptroller of the Currency (OCC), and the OCC became the Bank s primary regulator. Beginning with the quarter ended March 31, 2012, the Bank was required to file a Consolidated Report of Condition and Income (Call Report) instead of the previously required Thrift Financial Report (TFR). With the adoption of the Call Report, the Bank was required to discontinue using specific valuation allowances on loans deemed impaired. The TFR had allowed any measured impairments to be carried as specific valuation allowances, whereas the Call Report required any measured impairments that are deemed confirmed losses to be charged-off and netted from their respective loan balances. For impaired loans that are collateral dependent, a confirmed loss is generally the amount by which the loan s recorded investment exceeds the fair value of its collateral. If a loan is considered uncollectible, the entire balance is deemed a confirmed loss and is fully charged-off. During the quarter ended March 31, 2012, the Bank charged-off against ALLL the aggregate confirmed losses that were carried as specific valuation allowances in prior periods, and netted them against their respective loan balances for reporting purposes. This change had no impact on net loans receivable as presented in the consolidated balance sheet. In addition, this change did not materially impact the analysis of ALLL, which is described in more detail in the following paragraph, as specific valuation allowances were previously considered in the determination of historical loss ratios.

Loans that are not impaired are evaluated based upon the Bank s historical loss experience, as well as various subjective factors, to estimate potential unidentified losses within the various loan portfolios. These loans are categorized into pools based upon certain characteristics such as loan type, collateral type and repayment source. In addition to analyzing historical losses, the Bank also evaluates the following subjective factors for each loan pool to estimate future losses: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in management and other relevant staff, changes in the volume and severity of past due loans, changes in the quality of the Bank s loan review system, changes in the value of the underlying collateral for collateral dependent loans, changes in the level of lending concentrations, and changes in other external factors such as competition and legal and regulatory requirements. Historical loss ratios are adjusted accordingly, based upon the effect that the subjective factors have in estimated future losses. These adjusted ratios are applied to the balances of the loan pools to determine the adequacy of the ALLL each quarter. For purposes of calculating historical loss ratios, specific valuation allowances established prior to March 31, 2012, are considered charge-offs during the periods in which they are established.

The Bank does not routinely obtain updated appraisals for their collateral dependent loans that are not adversely classified. However, when analyzing the adequacy of its allowance for loan losses, the Bank considers potential changes in the value of the underlying collateral for such loans as one of the subjective factors used to estimate future losses in the various loan pools.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method at December 31, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Allowance for loan losses:							
Balance at October 1, 2012	$ 6,941		7,086	16,590	513	699	31,829
Provision for loan losses	1,956		166	(5,698)	(448)	24	(4,000)
Losses charged off	(464)		(69)	(40)		(86)	(659)
Recoveries	60		246	353		24	683
Balance at December 31, 2012	$ 8,493		7,429	11,205	65	661	27,853
Ending balance of allowance for loan losses related to loans at December 31, 2012:							
Individually evaluated for Impairment	$ 605		25	191			821
Collectively evaluated for Impairment	$ 7,888		7,404	11,014	65	661	27,032
Acquired with deteriorated credit quality	$ 21						21
Loans:							
Balance at December 31, 2012	$ 331,640	164,635	289,359	79,078	14,986	7,591	887,289
Ending balance:							
Loans individually evaluated for impairment	$ 23,398		19,806	39,560	13,751	62	96,577
Loans collectively evaluated for impairment	$ 308,242	164,635	269,553	39,518	1,235	7,529	790,712
Loans acquired with deteriorated credit quality	$ 3,956						3,956

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method at December 31, 2011. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Allowance for loan losses:							
Balance at October 1, 2011	$ 6,663	12	13,201	41,863	7,682	845	70,266
Provision for loan losses	(731)	6	9,640	(3,967)	(2,577)	129	2,500
Losses charged off	(587)		(1,437)	(10,246)	(2,569)	(19)	(14,858)
Recoveries	37						37
Balance at December 31, 2011	$ 5,382	18	21,404	27,650	2,536	955	57,945
Ending balance of allowance for loan losses related to loans at December 31, 2011:							
Individually evaluated for Impairment	$ 1,742	18	7,011	16,927	335	660	26,693
Collectively evaluated for Impairment	$ 3,640		14,393	10,723	2,201	295	31,252
Acquired with deteriorated credit quality	$ 51						51
Loans:							
Balance at December 31, 2011	$ 325,417	116,133	378,585	144,434	73,970	9,185	1,047,724
Ending balance:							
Loans individually evaluated for impairment	$ 13,614	18	33,771	89,244	800	722	138,169
Loans collectively evaluated for impairment	$ 311,803	116,115	344,814	55,190	73,170	8,463	909,555
Loans acquired with deteriorated credit quality	$ 2,504						2,504

Classified Assets, Delinquencies, and Non-accrual Loans

Classified assets **-** In accordance with the Bank s asset classification system, problem assets are classified with risk ratings of either substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the borrower s ability to repay, or the value of collateral. Substandard assets include those characterized by a possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have the same weaknesses of those classified as substandard with the added characteristic that the weaknesses present 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 considered uncollectible and of little value. Prior to the quarter ended March 31, 2012, the Bank established a specific valuation allowance for such assets. In conjunction with the adoption of the Call Report during the quarter ended March 31, 2012, such assets are charged-off against the ALLL at the time they are deemed to be a confirmed loss.

In addition to the risk rating categories for problem assets noted above, loans may be assigned a risk rating of pass, pass-watch, or special mention. The pass category includes loans with borrowers and/or collateral that is of average quality or better. Loans in this category are considered average risk and satisfactory repayment is expected. Assets classified as pass-watch are those in which the borrower has the capacity to perform according to the terms and repayment is expected. However, one or more elements of uncertainty exist. Assets classified as special mention have a potential weakness that deserves management s close attention. If left undetected, the potential weakness may result in deterioration of repayment prospects.

Each quarter, management reviews the problem loans in its portfolio to determine whether changes to the asset classifications or allowances are needed. The following table presents the credit risk profile of the Company s loan portfolio based on risk rating category as of December 31, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Rating:							
Pass	$ 272,947	164,635	203,228	12,893		7,529	661,232
Pass Watch	24,253		57,868	20,048	1,235		103,404
Special Mention	229		4,749				4,978
Substandard	33,820		23,514	45,953	13,751	62	117,100
Doubtful	391			184			575
Loss							
Total	$ 331,640	164,635	289,359	79,078	14,986	7,591	887,289

The following table presents the credit risk profile of the Company s loan portfolio based on risk rating category as of September 30, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Rating:							
Pass	$ 283,771	163,834	256,158	14,370	1,318	7,621	727,072
Pass Watch	11,076		28,439	19,054			58,569
Special Mention	4,689		323				5,012
Substandard	32,011		34,352	56,261	16,249	132	139,005
Doubtful	773			4			777
Loss							
Total	$ 332,320	163,834	319,272	89,689	17,567	7,753	930,435

The following table presents the Company s loan portfolio aging analysis as of December 31, 2012. Dollar amounts are expressed in thousands.

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Residential	$ 2,064	1,131	7,738	10,933	320,707	331,640	156
Residential held for sale					164,635	164,635	
Commercial real estate	536		6,008	6,544	282,815	289,359	213
Construction & development		962	4,167	5,129	73,949	79,078	566
Commercial					14,986	14,986	
Installment	15		75	90	7,501	7,591	11
Total	$ 2,615	2,093	17,988	22,696	864,593	887,289	946

The following table presents the Company s loan portfolio aging analysis as of September 30, 2012. Dollar amounts are expressed in thousands.

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Residential	$ 1,727	1,439	16,430	19,596	312,724	332,320	5,183
Residential held for sale					163,834	163,834	
Commercial real estate	217	714	6,082	7,013	312,259	319,272	
Construction & development	567	633	5,487	6,687	83,002	89,689	1,931
Commercial					17,567	17,567	
Installment	181	67	64	312	7,441	7,753	
Total	$ 2,692	2,853	28,063	33,608	896,827	930,435	7,114

When a loan becomes 90 days past due, or when full payment of interest and principal is not expected, the Bank stops accruing interest and establishes a reserve for the unpaid interest accrued-to-date. In some instances, a loan may become 90 days past due if it has exceeded its maturity date but the Bank and borrower are still negotiating the terms of an extension agreement. In those instances, the Bank typically continues to accrue interest, provided the borrower has continued making interest payments after the maturity date and full payment of interest and principal is expected.

The following table presents the Company s loans meeting the regulatory definition of nonaccrual, which includes certain loans that are current and paying as agreed. This table does not include purchased impaired loans or troubled debt restructurings that are performing. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Residential	$ 23,083	23,147
Residential held for sale		
Commercial real estate	14,711	20,952
Construction & development	23,220	30,606
Commercial		
Installment	62	62
Total	$ 61,076	74,767

As of December 31, 2012, $50.0 million (81.9%) of the loans classified as nonaccrual were current and paying as agreed.

During the quarter ended March 31, 2012, the Company s nonaccrual loans increased $41.4 million. This increase resulted from management s decision to move certain impaired collateral dependent loans secured by land development properties to nonaccrual, even though the majority of such loans were current and paying in accordance with their contractual terms. Due to the continued deterioration in the real estate markets, further declines in the value of collateral securing these loans are possible. In accordance with GAAP, such loans have been charged-down to the fair value of their underlying collateral, and therefore, the recorded investment in the loan is deemed fully collectable at December 31, 2012. Interest income is recognized on a cash-basis as payments are received.

A loan becomes impaired when management believes it will be unable to collect all principal and interest due according to the contractual terms of the loan. A restructuring of debt is considered a TDR if, because of a debtor s financial difficulty, a creditor grants concessions that it would not otherwise consider. Loans modified in troubled debt restructurings are also considered impaired. Concessions granted in a TDR could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Once a loan has been deemed impaired, the impairment must be measured by comparing the recorded investment in the loan to the present value of the estimated future cash flows discounted at the loan s effective rate, or to the fair value of the loan based on the loan s observable market price, or to the fair value of the collateral if the loan is collateral dependent.

During the quarter ended December 31, 2012, the Company modified five residential loans to a single borrower with a recorded investment of $2.8 million prior to modification, which were deemed to be TDRs. These modifications extended the maturity date for four years and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. The loans were deemed collateral dependent, and the modification did not result in any measured impairment or specific allowances. In addition, the Company modified three residential loans to a single borrower with a total recorded investment of $421,000 prior to modification, which were deemed to be TDRs. These modifications, which required a combined $39,000 principal payment, extended the maturity date for three years and did not result in a reduction in the contractual interest rate. Prior to modification, the loans were deemed impaired and collateral dependent. Therefore, they were being carried at the fair value of the underlying collateral and no additional impairment of specific valuation allowances were required.

During the quarter ended December 31, 2012, the Company modified five construction and land development loans with a recorded investment of $3.7 million prior to modification which had previously been deemed TDRs and continued to be TDRs following the current modification. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Such loans are considered collateral dependent and were being carried at the fair value of the underlying collateral prior to modification. In addition, the Company modified three construction and land development loans with a recorded investment of $2.3 million prior to modification, which were deemed to be TDRs during the current period. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. The loans were deemed collateral dependent, and the modification did not result in any measured impairment or specific allowances, based upon the fair value of the underlying collateral.

During the quarter ended December 31, 2012, the Company modified two commercial real estate loans with a recorded investment of $746,000 prior to modification, which were deemed to be TDRs. The modifications restructured the payment terms and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Prior to modification, such loans were considered impaired and collateral dependent. Therefore, they were being carried at the fair value of the underlying collateral and no additional impairment or specific valuation allowances were required. In addition, the Company agreed to modify one commercial loan with a recorded investment of $16.3 million prior to modification, which was deemed to be a TDR. The modification extended the maturity date by eighteen months and required a $2.5 million principal payment. The modification resulted in a measured impairment of $25,000, based upon the present value of the estimated future cash flows discounted at the loan s effective rate.

TDRs secured by residential properties with a recorded investment of $3.7 million, TDRs secured by commercial properties with a recorded investment of $698,000, and TDRs secured by land development properties with a recorded investment of $1.7 million defaulted during the period ended December 31, 2012. Management considers the level of defaults within the various portfolios when evaluating qualitative adjustments used to determine the adequacy of the Allowance for Loan and Lease Losses.

During the period ended December 31, 2011, the Company modified five land development loans, with a recorded investment of $3.2 million prior to modification, which had previously been deemed TDRs and continued to be TDRs following the current modification. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Such loans are considered collateral dependent, and the modifications resulted in specific loss allowances of $418,000, based upon the fair value of the collateral. Specific loss allowances are included in the calculation of estimated future loss ratios, which are applied to the various loan portfolios for purposes of estimating future losses.

TDRs secured by residential properties with a recorded investment of $3.1 million, TDRs secured by commercial properties with a recorded investment of $3.8 million, and TDRs secured by land development properties with a recorded investment of $4.7 million defaulted during the period ended December 31, 2011.

The following table presents the recorded balance of troubled debt restructurings. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Troubled debt restructurings:		
Residential	$ 9,084	6,156
Residential held for sale		
Commercial real estate	14,168	17,384
Construction & development	38,303	39,844
Commercial	13,751	
Installment		
Total	$ 75,306	63,384
Performing troubled debt restructurings:		
Residential	$ 825	593
Residential held for sale		
Commercial real estate	3,553	3,812
Construction & development	16,340	11,521
Commercial	13,751	
Installment		
Total	$ 34,469	15,926

At December 31, 2012, the Bank had outstanding commitments of $235,000 to be advanced in connection with TDRs.

The following table presents impaired loans, including troubled debt restructurings, as of December 31, 2012. Dollar amounts are expressed in thousands.

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	YTD Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Residential	$ 17,689	19,184		17,742	216
Residential held for sale					
Commercial real estate	19,806	28,384		20,023	462
Construction & development	35,988	40,109		37,170	553
Commercial					
Installment	62	519		70	5
Loans with a specific valuation allowance:					
Residential	$ 5,709	6,670	605	5,725	89
Residential held for sale					
Commercial real estate					
Construction & development	3,572	3,988	191	3,577	59
Commercial	13,751	13,751	25	15,417	280
Installment					
Total:					
Residential	$ 23,398	25,854	605	23,467	305
Residential held for sale					
Commercial real estate	19,806	28,384		20,023	462
Construction & development	39,560	44,097	191	40,747	612
Commercial	13,751	13,751	25	15,417	280
Installment	62	519		70	5

20

The following table presents impaired loans, including troubled debt restructurings, as of September 30, 2012. Dollar amounts are expressed in thousands.

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	YTD Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Residential	$ 16,849	19,394		18,252	776
Residential held for sale					
Commercial real estate	21,574	30,652		24,961	1,796
Construction & development	40,633	45,873		46,820	2,658
Commercial					
Installment	68	570		69	17
Loans with a specific valuation allowance:					
Residential	$ 4,836	4,910	974	4,836	260
Residential held for sale					
Commercial real estate	3,322	3,955	7	3,949	215
Construction & development	1,634	1,668	42	1,698	100
Commercial					
Installment					
Total:					
Residential	$ 21,685	24,304	974	23,088	1,036
Residential held for sale					
Commercial real estate	24,896	34,607	7	28,910	2,011
Construction & development	42,267	47,541	42	48,518	2,758
Commercial					
Installment	68	570		69	17

(7) FORECLOSED ASSETS HELD FOR SALE

The following table presents real estate owned and other repossessed property. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Real estate acquired through (or deed in lieu of) foreclosure	$ 15,314	17,040
Less: allowance for losses		
Total	$ 15,314	17,040

Foreclosed assets held for sale are initially recorded at fair value as of the date of foreclosure less any estimated selling costs (the new basis) and are subsequently carried at the lower of the new basis or fair value less selling costs on the current measurement date. When foreclosed assets are acquired, any excess of the loan balance over the new basis of the foreclosed asset is charged to the allowance for loan losses. Subsequent adjustments for estimated losses are charged to operations when the fair value declines to an amount less than the carrying value. Costs and expenses related to major additions and improvements are capitalized, while maintenance and repairs that do not improve or extend the lives of the respective assets are expensed. Applicable gains and losses on the sale of real estate owned are realized when the asset is disposed of, depending on the adequacy of the down payment and other requirements.

With the adoption of the Call Report during the quarter ended March 31, 2012, the Bank was required to begin following regulatory guidance related to the Call Report requirements. One such requirement resulted in a change in the treatment of specific loss reserves for foreclosed assets held for sale. Previous Thrift Financial Report guidance allowed banks to reduce an asset s carrying value through a specific allowance when the fair value declined to an amount less than its carrying value. Call Report guidance requires that the carrying value of foreclosed assets held for sale be written down to fair value through a charge to earnings. During the quarter ended March 31, 2012, the Bank charged-off the previously established specific allowances on such assets of $9.4 million. This change had no impact on net foreclosed assets held for sale as presented in the consolidated balance sheet.

(8) SUBORDINATED DEBENTURES

On December 13, 2006, the Company, through its wholly-owned statutory trust, NASB Preferred Trust I (the Trust), issued $25 million of pooled Trust Preferred Securities. The Trust used the proceeds from the offering to purchase a like amount of the Company s subordinated debentures. The debentures, which have a variable rate of 1.65% over the 3-month LIBOR and a 30-year term, are the sole assets of the Trust. In exchange for the capital contributions made to the Trust by the Company upon formation, the Company owns all the common securities of the Trust.

In accordance with Financial Accounting Standards Board ASC 810-10, the Trust qualifies as a special purpose entity that is not required to be consolidated in the financial statements of the Company. The $25.0 million Trust Preferred Securities issued by the Trust will remain on the records of the Trust. The Trust Preferred Securities are included in Tier I capital for regulatory capital purposes.

The Trust Preferred Securities have a variable interest rate of 1.65% over the 3-month LIBOR, and are mandatorily redeemable upon the 30-year term of the debentures, or upon earlier redemption as provided in the Indenture. The debentures are callable, in whole or in part, after five years of the issuance date. The Company did not incur a placement or annual trustee fee related to the issuance. The securities are subordinate to all other debt of the Company and interest may be deferred up to five years.

On July 11, 2012, the Company notified security holders that it was exercising its right to defer the payment of interest on its Trust Preferred Securities for a period of up to five years.

(9) INCOME TAXES

The Company s federal and state income tax returns for fiscal years 2009 through 2011 remain subject to examination by the Internal Revenue Service and various state jurisdictions, based on the statute of limitations.

(10) SEGMENT INFORMATION

The Company has identified two principal operating segments for purposes of financial reporting: Banking and Mortgage Banking. These segments were determined based on the Company s internal financial accounting and reporting processes and are consistent with the information that is used to make operating decisions and to assess the Company s performance by the Company s key decision makers.

The Mortgage Banking segment originates mortgage loans for sale to investors and for the portfolio of the Banking segment. The Banking segment provides a full range of banking services through the Bank s branch network, exclusive of mortgage loan originations. A portion of the income presented in the Mortgage Banking segment is derived from sales of loans to the Banking segment based on a transfer pricing methodology that is designed to approximate economic reality. The Other and Eliminations segment includes financial information from the parent company plus inter-segment eliminations.

The following table presents financial information from the Company s operating segments for the periods indicated. Dollar amounts are expressed in thousands.

Three months ended December 31, 2012	Banking	Mortgage Banking	Other and Eliminations	Consolidated
Net interest income	$ 11,310		(129)	11,181
Provision for loan losses	(4,000)			(4,000)
Other income	50	17,021	(574)	16,497
General and administrative expenses	6,750	11,688	(283)	18,155
Income tax expense	3,315	2,053	(162)	5,206
Net income	$ 5,295	3,280	(258)	8,317

Three months ended December 31, 2011	Banking	Mortgage Banking	Other and Eliminations	Consolidated
Net interest income	$ 14,248		(129)	14,119
Provision for loan losses	2,500			2,500
Other income	(771)	11,685	(365)	10,549
General and administrative expenses	6,031	8,264	(158)	14,137
Income tax benefit	1,904	1,317	(129)	3,092
Net loss	$ 3,042	2,104	(207)	4,939

(11) DERIVATIVE INSTRUMENTS

The Company has commitments outstanding to extend credit that have not closed prior to the end of the period. As the Company enters into commitments to originate loans, it also enters into commitments to sell the loans in the secondary market on a best-efforts basis. Such commitments to originate loans held for sale are considered derivative instruments in accordance with GAAP, which requires the Company to recognize all derivative instruments in the balance sheet and to measure those instruments at fair value. As a result of marking to market commitments to originate loans, the Company recorded a decrease in other assets of $2.2 million, an increase in other liabilities of $623,000, and a decrease in other income of $2.9 million for the three month period ended December 31, 2012. The Company recorded a decrease in other assets of $662,000, a decrease in other liabilities of $535,000, and a decrease in other income of $127,000 for the three month period ended December 31, 2011.

Additionally, the Company has commitments to sell loans that have closed prior to the end of the period. Due to the mark to market adjustment on commitments to sell loans held for sale, the Company recorded an increase in other assets of $2.4 million, a decrease in other liabilities of $117,000, and an increase in other income of $2.6 million during the three month period ended December 31, 2012. The Company recorded a decrease in other assets of $669,000, a decrease in other liabilities of $161,000, and a decrease in other income of $508,000 during the three month period ended December 31, 2011.

The balance of derivative instruments related to commitments to originate and sell loans at December 31, 2012, is disclosed in Footnote 12, Fair Value Measurements.

(12) FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would likely be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. GAAP identifies three primary measurement techniques: the market approach, the income approach, and the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach uses valuations or techniques to convert future amounts, such as cash flows or earnings, to a single present amount. The cost approach is based on the amount that currently would be required to replace the service capability of an asset.

23

GAAP establishes a fair value hierarchy and prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to observable inputs such as quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The maximization of observable inputs and the minimization of the use of unobservable inputs are required. Classification within the fair value hierarchy is based upon the objectivity of the inputs that are significant to the valuation of an asset or liability as of the measurement date. The three levels within the fair value hierarchy are characterized as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 Inputs other than quoted prices included with Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

Level 3 Unobservable inputs for the asset or liability for which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs reflect the Company s own assumptions about what market participants would use to price the asset or liability. These inputs may include internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment.

The Company measures certain financial assets and liabilities at fair value in accordance with GAAP. These measurements involve various valuation techniques and assume that the transactions would occur between market participants in the most advantageous market for the Company.

The following is a summary of valuation techniques utilized by the Company for its significant financial assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy:

Available for sale securities

Securities available for sale consist of corporate debt, trust preferred, U. S. government sponsored agency, and municipal securities. Such securities are valued using market prices in an active market, if available. This measurement is classified as Level 1 within the hierarchy. Less frequently traded securities are valued using industry standard models which utilize various assumptions such as historical prices of the same or similar securities, and observation of market prices of securities of the same issuer, market prices of same-sector issuers, and fixed income indexes. Substantially all of these assumptions are observable in the marketplace or can be derived from observable data. These measurements are classified as Level 2 within the hierarchy.

At December 31, 2011, mortgage-backed securities available for sale, which consist of agency pass-through and participation certificates issued by GNMA, FNMA, and FHLMC, were valued by using broker-dealer quotes for similar assets in markets that are not active. Although the Company did not validate these quotes, they were reviewed by management for reasonableness in relation to current market conditions. Additionally, they were obtained from experienced brokers who had an established relationship with the Bank and deal regularly with these types of securities. The Company did not make any adjustment to the quotes received from broker-dealers. These measurements are classified as Level 2. At December 31, 2012, mortgage-backed securities available for sale were valued by using industry standard models which utilize various inputs and assumptions such as historical prices of benchmark securities, prepayment estimates, loan type, and year of origination. Substantially all of these assumptions are observable in the marketplace or can be derived from observable data. These measurements are classified as Level 2 within the hierarchy.

Loans held for sale

Loans held for sale are valued using quoted market prices for loans with similar characteristics. This measurement is classified as Level 2 within the hierarchy.

Commitments to Originate Loans and Forward Sales Commitments

Commitments to originate loans and forward sales commitments are valued using a valuation model which considers differences between current market interest rates and committed rates. The model also includes assumptions, which estimate fall-out percentages, for commitments to originate loans, and average lives. Fall-out percentages, which range from ten to forty percent, are estimated based upon the difference between current market rates and committed rates. Average lives are based upon estimates for similar types of loans. These measurements use significant unobservable inputs and are classified as Level 3 within the hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall at December 31, 2012 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities, available for sale				
U.S. government sponsored agency securities	$ 193,124	156,850	36,274	
Corporate debt securities	72,774		72,774	
Municipal securities	428		428	
Mortgage-backed securities, available for sale				
Pass through certificates guaranteed by GNMA fixed rate	78		78	
Pass through certificates guaranteed by FNMA adjustable rate	144		144	
FHLMC participation certificates:				
Fixed rate	174		174	
Adjustable rate	128		128	
Loans held for sale	164,635		164,635	
Commitments to originate loans	323			323
Forward sales commitments	4,636			4,636
Total assets	$ 436,444	156,850	274,635	4,959
Liabilities:				
Commitments to originate loans	$ 1,135			1,135
Forward sales commitments	16			16
Total liabilities	$ 1,151			1,151

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall at September 30, 2012 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities, available for sale				
U.S. government sponsored agency securities	$ 153,166	142,359	10,807	
Corporate debt securities	%			

Allowance for loan losses as a percentage of total loans outstanding	2.71 %	2.88 %

The following summarizes the amount of impaired loans (in thousands):

	December 31, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential real estate	$—	$ —	$ —	$194	$ 217	$ —
Commercial real estate	2,259	2,259	—	231	231	—
Commercial	1,114	1,114	—	—	—	—
With an allowance recorded -						
Residential real estate	954	954	268	978	978	330
Commercial real estate	1,602	1,602	162	744	744	83
Commercial	814	814	814	—	—	—
Total:						
Residential real estate	$954	$ 954	$ 268	$1,172	$ 1,195	$ 330
Commercial real estate	$3,861	$ 3,861	$ 162	$975	$ 975	$ 83
Commercial	$1,928	$ 1,928	$ 814	$—	$ —	$ —
Total	$6,743	$ 6,743	$ 1,244	$2,147	$ 2,170	$ 413

During 2018, 2017, and 2016, the average net investment in impaired loans and interest income recognized and received on impaired loans is as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Average investment in impaired loans	$3,296	$1,801	$2,957
Interest income recognized on impaired loans	$187	$278	$124
Interest income received on a cash basis on impaired loans	$187	$173	$182

Liquidity and Capital Resources

Liquidity represents an institution's ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. The Bank's ability to respond to the needs of depositors and borrowers and to benefit from investment opportunities is facilitated through liquidity management.

The Bank's primary sources of cash during the year ended December 31, 2018, were from principal repayments of securities available for sale and held-to-maturity of $1.7 million, proceeds from Federal Home Loan Bank Advances of $4.1 million, proceeds from federal funds of $0.6 million, and proceeds from sale of common stock of $0.5 million. Cash was used primarily to fund loans. The Bank will adjust rates on its deposits to attract or retain deposits as needed. The Bank obtains funds primarily from depositors in its market area.

In addition to obtaining funds from depositors, the Bank may borrow funds from other financial institutions. OptimumBank is a member of the Federal Home Loan Bank of Atlanta, which allows it to borrow funds under a pre-arranged line of credit equal to $26.6 million. As of December 31, 2018, the Bank had $24.6 million in borrowings outstanding from the Federal Home Loan Bank of Atlanta to facilitate loan fundings and manage its asset and liability structure. The Bank has established a line of credit for $3.0 million with Center State Bank, $2.5 million with State Bank, $2.1 million with First National Bankers Bank, $0.8 million with Servis First Bank, and $0.4 million with the Federal Reserve.

Securities

The Bank's securities portfolio is comprised primarily of SBA Pool Securities and Collateralized mortgage obligations. The securities portfolio is categorized as either "held-to-maturity" or "available for sale." Securities held-to-maturity

represent those securities which the Company has the positive intent and ability to hold to maturity. These securities are carried at amortized cost. Securities available for sale represent those investments which may be sold for various reasons including changes in interest rates and liquidity considerations. These securities are reported at fair market value and unrealized gains and losses are excluded from earnings and reported in other comprehensive loss.

The following table sets forth the amortized cost and fair value of the Bank's securities portfolio (in thousands):

	Amortized Cost	**Fair Value**
At December 31, 2018:		
Held-to-maturity-		
Collateralized mortgage obligations	$ 7,139	$7,175
Securities available for sale-		
SBA Pool Securities	2,423	2,359
	$ 9,562	$9,534
At December 31, 2017:		
Securities available for sale:		
Collateralized mortgage obligations	$ 8,806	$8,466
SBA Pool Securities	2,965	2,971
	$ 11,771	$11,437

The following table sets forth, by maturity distribution, certain information pertaining to the securities portfolio (dollars in thousands):

	After One Year Through Five Years	After Ten Years	Total	Yield
At December 31, 2018:				
Collateralized mortgage obligation	$ 7,139	$—	$7,139	2.09 %
SBA Pool Securities	—	2,423	2,423	2.67 %
	$ 7,139	$2,423	$9,562	
At December 31, 2017:				
Collateralized mortgage obligation	$ 8,806	$—	$8,806	1.93 %
SBA Pool Securities	—	2,965	2,965	2.50 %
	$ 8,806	$2,965	$11,771	

Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Bank's market risk arises primarily from interest-rate risk inherent in its lending and deposit-taking activities. The Bank does not engage in securities trading or hedging activities and does not invest in interest-rate derivatives or enter into interest rate swaps.

The Bank may utilize financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. The measurement of market risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance-sheet transactions are aggregated, and the resulting net positions are identified. Disclosures about the fair value of financial instruments, which reflect changes in market prices and rates, can be found in Note 7 of Notes to Consolidated Financial Statements.

The Bank's primary objective in managing interest-rate risk is to minimize the potential adverse impact of changes in interest rates on its net interest income and capital, while adjusting its asset-liability structure to obtain the maximum yield-cost spread on that structure. The Bank actively monitors and manages its interest-rate risk exposure by managing its asset and liability structure. However, a sudden and substantial increase in interest rates may adversely impact its earnings, to the extent that the interest-earning assets and interest-bearing liabilities do not change or reprice at the same speed, to the same extent, or on the same basis.

The Bank uses modeling techniques to simulate changes in net interest income under various rate scenarios. Important elements of these techniques include the mix of floating versus fixed-rate assets and liabilities, and the scheduled, as well as expected, repricing and maturing volumes and rates of the existing balance sheet.

Asset Liability Management

As part of its asset and liability management, the Bank has emphasized establishing and implementing internal asset-liability decision processes, as well as control procedures to aid in managing its earnings. Management believes that these processes and procedures provide us with better capital planning, asset mix and volume controls, loan-pricing guidelines, and deposit interest-rate guidelines, which should result in tighter controls and less exposure to interest-rate risk.

The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring an institution's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest-rate

sensitivity gap is defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. The gap ratio is computed as the amount of rate sensitive assets less the amount of rate sensitive liabilities divided by total assets. A gap is considered positive when the amount of interest-rate sensitive assets exceeds interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would adversely affect net interest income, while a positive gap would result in an increase in net interest income. During a period of falling interest rates, a negative gap would result in an increase in net interest income, while a positive gap would adversely affect net interest income.

In order to minimize the potential for adverse effects of material and prolonged increases in interest rates on the results of operations, the Bank’s management continues to monitor its assets and liabilities to better match the maturities and repricing terms of its interest-earning assets and interest-bearing liabilities. The Bank’s policies emphasize the origination of adjustable-rate loans, building a stable core deposit base and, to the extent possible, matching deposit maturities with loan repricing timeframes or maturities.

The following table sets forth certain information related to the Bank's interest-earning assets and interest-bearing liabilities at December 31, 2018, that are estimated to mature or are scheduled to reprice within the period shown (dollars in thousands):

Gap Maturity / Repricing Schedule

	One Year or Less	More than One Year and Less than Five Years	More than Five Years and Less than Fifteen Years	Over Fifteen Years	Total
Loans (1):					
Residential real estate loans	$8,309	$14,712	$3,058	$1,125	$27,204
Multi-family real estate loans	349	7,776	70	—	8,195
Commercial real estate loans	11,198	24,620	816	—	36,634
Land and construction	1,998	—	—	—	1,998
Commercial	3,193	1,804	—	—	4,997
Consumer	260	—	—	—	260
Total loans	25,307	48,912	3,944	1,125	79,288
Securities (2)	2,359	—	—	7,175	9,534
Interest-bearing deposits in banks	6,049	—	—	—	6,049
Federal Home Loan Bank stock	1,132	—	—	—	1,132
Total rate-sensitive assets	34,847	48,912	3,944	8,300	96,003
Deposit accounts (3):					
Money-market deposits	20,450	—	—	—	20,450
Interest-bearing checking deposits	5,675	—	—	—	5,675
Savings deposits	557	—	—	—	557
Time deposits	20,413	5,645	—	—	26,058
Total deposits	47,095	5,645	—	—	52,740
Federal Home Loan Bank advances	19,600	5,000	—	—	24,600
Junior subordinated debenture	—	—	—	5,155	5,155
Federal funds purchased	560	—	—	—	560
Total rate-sensitive liabilities	67,255	10,645	—	5,155	83,055

GAP (repricing differences)	$(32,408)	$38,267	$3,944	$3,145	$12,948
Cumulative GAP	$(32,408)	$5,859	$9,803	$12,948	$12,948
Cumulative GAP/total assets	(32.29)%	5.84%	9.77%	12.90%	

(1) In preparing the table above, adjustable-rate loans are included in the period in which the interest rates are next scheduled to adjust rather than in the period in which the loans mature. Fixed-rate loans are scheduled, including repayment, according to their maturities.

(2) Securities are scheduled through the repricing date.

(3) Money-market, interest-bearing checking and savings deposits are regarded as readily accessible withdrawable accounts. All other time deposits are scheduled through the maturity dates.

The following table sets forth loan maturities by type of loan at December 31, 2018 (in thousands):

	One Year or Less	**After One But Within Five Years**	**After Five Years**	**Total**
Residential real estate	$—	$1,593	$25,611	$27,204
Multi-family real estate	—	518	7,677	8,195
Commercial real estate	6,024	5,188	25,422	36,634
Land and construction	1,998	—	—	1,998
Commercial	94	4,181	722	4,997
Consumer	5	255	—	260
Total	$8,121	$11,735	$59,432	$79,288

21

The following table sets forth the maturity or repricing of loans by interest type at December 31, 2018 (in thousands):

	One Year or Less	**After One But Within Five Years**	**After Five Years**	**Total**
Fixed interest rate	$8,038	$7,442	$2,012	$17,492
Variable interest rate	17,269	41,470	3,057	61,796
Total	$25,307	$48,912	$5,069	$79,288

Scheduled contractual principal repayments of loans do not reflect the actual life of such assets. The average life of loans is substantially less than their average contractual terms due to prepayments. In addition, due-on-sale clauses on loans generally give us the right to declare a conventional loan immediately due and payable in the event, among other things, that the borrower sells real property subject to a mortgage and the loan is not repaid. The average life of mortgage loans tends to increase, however, when current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when rates on existing mortgages are substantially higher than current mortgage rates.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the consolidated balance sheet. The contractual amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed-expiration dates or other termination clauses and may require payment of a fee. Since certain commitments expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a

case-by-case basis. The amount of collateral obtained, if deemed necessary in order to extend credit, is based on management's credit evaluation of the counterparty.

A summary of the contractual amounts of the Company's off-balance sheet risk at December 31, 2018 follows (in thousands):

Commitments to extend credit	$1,820
Unused lines of credit	$2,735
Standby letters of credit	$-

The following is a summary of the Company's contractual obligations, including certain on-balance sheet obligations, at December 31, 2018 (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Federal Home Loan Bank advances	$24,600	$19,600	$5,000	$ —	$—
Junior subordinated debenture	5,155	—	—	—	5,155
Other borrowings	560	560	—	—	—
Operating leases	378	92	193	93	—
Total	$30,693	$20,252	$5,193	$ 93	$5,155

Deposits

Deposits traditionally are the primary source of funds for the Company's use in lending, making investments and meeting liquidity demands. The Company has focused on raising time deposits primarily within its market area, which is the tri-county area of Broward, Miami-Dade and Palm Beach counties. However, the Company offers a variety of deposit products, which are promoted within its market area. Net deposits decreased $2.9 million in 2018.

The following table displays the distribution of the Company's deposits at December 31, 2018, 2017 and 2016 (dollars in thousands):

	2018		2017		2016	
	Amount	% of Deposits	Amount	% of Deposits	Amount	% of Deposits
Noninterest-bearing demand deposits	$9,638	15.45 %	$12,632	19.36 %	$7,209	8.37 %
Interest-bearing demand deposits	20,450	32.79	4,782	7.33	3,604	4.19
Money-market deposits	5,675	9.10	16,498	25.28	17,743	20.61
Savings	557	0.89	765	1.17	806	0.94
Subtotal	$36,320	58.23 %	$34,677	53.14 %	$29,362	34.11 %
Time deposits:						
0.00% – 0.99%	$2,669	4.20 %	$6,849	10.50 %	$14,891	17.30 %
1.00% – 1.99%	10,113	16.21	23,582	36.14	41,695	48.43
2.00% – 2.99%	13,276	21.28	143	0.22	139	0.16
Total time deposits (1)	26,058	41.77	30,574	46.86	56,725	65.89
Total deposits	$62,378	100.00 %	$65,251	100.00 %	$86,087	100.00 %

(1) Included are Individual Retirement Accounts (IRA's) totaling $1,922,000 and $2,451,000 at December 31, 2018 and 2017, respectively, all of which are in the form of time deposits.

Time Deposits of $250,000 or more, or Jumbo Time Deposits, are generally considered a more unpredictable source of funds. The following table sets forth the Company's maturity distribution of time deposits of $250,000 or more at December 31, 2018 and 2017 (in thousands):

	At December 31,	
	2018	2017
Due three months or less	$666	$303
Due more than three months to six months	324	—
More than six months to one year	909	302
One to five years	760	673
Total	$2,659	$1,278

Analysis of Results of Operations

The Company’s profitability depends to a large extent on net interest income, which is the difference between the interest received on earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Net interest income is determined by the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities (“interest-rate spread”) and the relative amounts of interest-earning assets and interest-bearing liabilities. The Company’s interest-rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand, and deposit flows. The Company’s results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and noninterest income such as loan prepayment fees.

The following table sets forth, for the periods indicated, information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yield; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average cost; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin. Average balances are based on average daily balances (dollars in thousands):

	Years Ended December 31,										
	2018			2017			2016			2015	
	Average Balance	Interest And Dividends	Average Yield/ Rate	Average Balance	Interest And Dividends	Average Yield/ Rate	Average Balance	Interest and Dividends	Average Yield/ Rate	Average Balance	Int and Div
Interest-earning assets:											
Loans	$ 74,598	$ 3,912	5.24 %	$75,894	$ 4,126	5.44 %	$83,574	$4,200	5.03%	$80,691	3,
Securities	10,494	232	2.21	18,054	366	2.03	22,686	459	2.02	26,490	59
Other interest-earning assets (1)	4,811	148	3.08	16,536	224	1.35	11,996	105	0.88	1,273	72
Total interest-earning assets/interest income	89,903	4,292	4.78 %	110,484	4,716	4.27 %	118,256	4,764	4.03%	108,454	4,
Cash and due from banks	1,676			1,171			953			9,483	
Premises and equipment	2,676			2,618			2,687			3,744	
Other assets	(1,985)			(3,480)			(747)			3,278	
Total assets	$ 92,270			$110,793			$121,149			$124,959	
Interest-bearing liabilities:											
Savings, NOW and money-market deposits	$ 22,000	175	.80	$22,062	112	.51	$23,360	117	0.50	$19,314	12
Time deposits	23,032	335	1.45	50,367	562	1.11	60,813	611	1.00	59,158	52
Borrowings (4)	29,213	736	2.52	25,672	522	2.03	24,416	351	1.44	23,158	23
Total interest-bearing liabilities/interest expense	74,245	1,246	1.68	98,101	1,196	1.22	108,589	1,079	.99	101,630	88
Noninterest-bearing demand deposits	11,893			6,551			5,870			8,497	

Other liabilities	2,105	3,380	3,526	11,771
Stockholders' equity	4,027	2,761	3,164	3,061
Total liabilities and stockholders' equity	$ 92,270	$110,793	$121,149	$124,959
Net interest income	$3,046	$3,520	$3,685	$3,
Interest rate spread (2)	3.10	3.05	3.04	
Net interest margin (3)	3.39	3.19	3.12	
Ratio of average interest-earning assets to average interest- bearing liabilities	1.21	1.13	1.09	

(1) Includes interest-earning deposits with banks, Federal funds sold and Federal Home Loan Bank stock dividends.

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

(3) Net interest margin is net interest income divided by average interest-earning assets.

(4) Includes Federal Home Loan Bank advances, junior subordinated debenture and securities sold under an agreement to repurchase.

Rate/Volume Analysis

The following tables set forth certain information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (change in rate multiplied by prior volume), (2) changes in volume (change in volume multiplied by prior rate) and (3) changes in rate-volume (change in rate multiplied by change in volume) (in thousands):

	Year Ended December 31, 2018 versus 2017 Increases (Decreases) Due to Change In:			
	Rate	Volume	Rate/ Volume	Total
Interest-earning assets:				
Loans	$(146)	$ (70)	$ 2	$(214)
Securities	33	(153)	(14)	(134)
Other interest-earning assets	285	(159)	(202)	(76)
Total interest-earning assets	172	(382)	(214)	(424)
Interest-bearing liabilities:				
Savings, NOW and money-market	63	0	0	63
Time deposits	171	(305)	(93)	(227)
Other	125	72	17	214
Total interest-bearing liabilities	359	(233)	(76)	50
Net interest income	$(187)	$ (149)	$ (138)	$(474)

	Year Ended December 31, 2017 versus 2016 Increases (Decreases) Due to Change In:			
	Rate	Volume	Rate/ Volume	Total
Interest-earning assets:				
Loans	$299	$ (386)	$ (27)	$(114)
Securities	1	(94)	—	(93)
Other interest-earning assets	58	40	21	119
Total interest-earning assets	358	(440)	(6)	(88)

Interest-bearing liabilities:				
Savings, NOW and money-market	2	(7)	—	(5)
Time deposits	68	(105)	(12)	(49)
Other	145	18	7	170
Total interest-bearing liabilities	215	(94)	(5)	116
Net interest income	$143	$ (346)	$ (1)	$(204)

25

Financial Condition as of December 31, 2018 Compared to December 31, 2017

The Company's total assets increased by $4.5 million at December 31, 2018, to $100.4 million.

At December 31, 2018, the Bank had a Tier 1 leverage ratio of 11.68%, and a total risk-based capital ratio of 15.86%. The Company's capital was enhanced during 2018 through the sale of $525,000 of common stock, the issuance of common stock for compensation of $615,000, and common stock issued in exchange for Trust Preferred Securities, with fair value of $694,000 plus accrued interest of $211,000, which resulted in $905,000 increase in Company's capital.

Junior Subordinated Debenture. The Company is in default with respect to its $5,155,000 Junior Subordinated Debenture (the "Debenture") due to its failure to make certain required interest payments under the Debenture. The Debenture was issued to Optimum Bank Holdings Capital Trust I, a Delaware statutory trust formed by the Company for the purpose of issuing and selling certain securities (the "Trust Preferred Securities") representing undivided beneficial interests in the Debenture. The trust issued a total of 5,000 Trust Preferred Securities.

The Trustee, Wells Fargo Bank, for the Debenture (the "Trustee") and the beneficial owners of the Debenture are entitled to accelerate the payment of the $5,155,000 principal balance plus accrued and unpaid interest totaling $1,686,350 at December 31, 2018. To date, neither the Trustee nor the holders have accelerated the outstanding balance of the Debenture. No adjustments to the accompanying consolidated financial statements have been made as a result of this uncertainty.

In May 2018, a company affiliated with a director of the Company (the "New Holder") purchased all 5,000 Trust Preferred Securities from a third party. During the third quarter of 2018, the New Holder sold its rights in approximately 694 of the Trust Preferred Securities to several unaffiliated third parties, who subsequently exchanged these Trust Preferred Securities for 301,778 shares of the Company's common stock. Due to regulatory agreement the exchange of Trust Preferred Securities for the Company's common stock cannot reduce the principal amount of the Debenture collateralizing the Trust Preferred Securities. Accordingly it is recorded as an increase in the Company's equity interest in the unconsolidated subsidiary trust, presented in "Other Assets" in the accompanying consolidated balance sheets.

Although the Company and the New Holder have not executed a formal, definitive bilateral agreement, the New Holder has provided the Company with written representations that the New Holder will not accelerate and demand payment of any of the remaining 4,306 Trust Preferred Securities principal or accrued interest within the next twelve months from the date this Annual Report, Form 10-K as of and for the year ended December 31, 2018, is filed with the Securities and Exchange Commission.

Results of Operations for Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

General. Net earnings of $796,000 or $.53 earnings per basic and diluted share for the year ended December 31, 2018 compared to net loss for the year ended December 31, 2017 of $589,000 or $.53 loss per basic and diluted share.

Interest income. Interest income decreased to $4.3 million for the year ended December 31, 2018 compared to $4.7 million for the year ended December 31, 2017. Interest on loans decreased by $214,000 due to a decrease in average balance of loans in 2018 compared to 2017. Interest on securities decreased by $134,000 due to a decrease in average balance of securities in 2018 compared to 2017. Other interest income decreased by $76,000 as the bank's average deposits decreased, resulting in a decrease in cash available for other interest-earning assets.

Interest expense. Interest expense on deposits was $510,000 during the year ended December 31, 2018 compared to $674,000 during the year ended December 31, 2017. Interest expense on borrowings was $736,000 in the year ended December 31, 2018 compared to $522,000 during the year ended December 31, 2017.

Provision for Loan Losses. In June 2018, the Bank reversed $2.1 million of the allowance for loan losses into income, which was later offset by a $0.3 million provision for loan losses during the fourth quarter of 2018. There was no provision or credit for losses during the year ended December 31, 2017. The provision or credit for loan losses is charged to operations as losses are estimated to have occurred in order to bring the total allowance for loan losses to a level deemed appropriate by management to absorb losses inherent in the portfolio at December 31, 2018. Management's periodic evaluation of the adequacy of the allowance is based upon historical experience, the volume and type of lending conducted by us, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral, loans identified as impaired, general economic conditions, particularly as they relate to our market areas, and other factors related to the estimated collectability of our loan portfolio. The allowance for loan losses totaled $2.2 million or 2.8% of loans outstanding at December 31, 2018, as compared to $4.0 million or 5.5% of loans outstanding at December 31, 2017. Management believes the balance in the allowance for loan losses at December 31, 2018 is adequate. The Company determined that it was appropriate to decrease in the amount of the Company's allowance for loan losses due to the continued improvement in the performance and credit quality of the loan portfolio.

Noninterest Income. Total noninterest income increased to $84,000 for the year ended December 31, 2018, from $52,000 for the year ended December 31, 2017 primarily due to loss on sale of securities during 2017 and an increase in service charges and fees in 2018.

Noninterest Expenses. Total noninterest expenses decreased by $73,000 for the year ended December 31, 2018, from $4,161,000 for the year ended December 31, 2017 to $4,088,000 for the year ended December 31, 2018, primarily due to an accrual related to a BSA look back project.

Income Taxes. There were no income taxes during the years ended December 31, 2018 and 2017.

Impact of Inflation and Changing Prices

The consolidated financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, substantially all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on its performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services, since such prices are affected by inflation to a larger extent than interest rates.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors

OptimumBank Holdings, Inc.

Fort Lauderdale, Florida:

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of OptimumBank Holdings, Inc. and Subsidiary (the "Company"), as of December 31, 2018 and 2017 and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for the years then ended and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, the Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ HACKER, JOHNSON & SMITH PA
We have served as the Company's auditor since 2000.
Fort Lauderdale, Florida
March 25, 2019

28

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)

	December 31, 2018	**December 31, 2017**
Assets:		
Cash and due from banks	$ 1,934	$ 1,224
Interest-bearing deposits with banks	6,049	10,441
Total cash and cash equivalents	7,983	11,665
Securities available for sale	2,359	11,437
Securities held-to-maturity (fair value of $7,175)	7,139	—
Loans, net of allowance for loan losses of $2,243 and $3,991	77,200	68,220
Federal Home Loan Bank stock	1,132	979
Premises and equipment, net	2,668	2,593
Accrued interest receivable	314	316
Other assets	1,573	656
Total assets	$ 100,368	$ 95,866
Liabilities and Stockholders' Equity:		
Liabilities:		
Noninterest-bearing demand deposits	9,638	12,632
Savings, NOW and money-market deposits	26,682	22,045
Time deposits	26,058	30,574
Total deposits	62,378	65,251
Federal Home Loan Bank advances	24,600	20,500
Junior subordinated debenture	5,155	5,155
Federal funds purchased	560	—
Official checks	274	46
Other liabilities	2,095	2,369
Total liabilities	95,062	93,321
Commitments and contingencies (Notes 4, 7 and 13)		
Stockholders' equity:		
Preferred stock, no par value; 6,000,000 shares authorized: Designated Series A, no par value, $25,000 liquidation value per share, none issued or outstanding in 2018 and 7 shares issued and outstanding in 2017	—	—
	18	11

Common stock, $.01 par value; 5,000,000 shares authorized, 1,858,020 shares issued and outstanding in 2018 and 1,120,947 shares issued and outstanding in 2017		
Additional paid-in capital	36,128	34,090
Accumulated deficit	(30,510)	(31,306)
Accumulated other comprehensive loss	(330)	(250)
Total stockholders' equity	5,306	2,545
Total liabilities and stockholders' equity	$ 100,368	$ 95,866

See accompanying notes to Consolidated Financial Statements

29

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Operations
(In thousands, except share amounts)

	Year Ended December 31,	
	2018	**2017**
Interest income:		
Loans	$3,912	$4,126
Securities	232	366
Other	148	224
Total interest income	4,292	4,716
Interest expense:		
Deposits	510	674
Borrowings	736	522
Total interest expense	1,246	1,196
Net interest income	3,046	3,520
Credit for loan losses	1,754	—
Net interest income after credit for loan losses	4,800	3,520
Noninterest income:		
Service charges and fees	49	26
Other	35	15
Gain on sale of securities available for sale	—	11
Total noninterest income	84	52
Noninterest expenses:		
Salaries and employee benefits	1,864	1,770
Occupancy and equipment	437	415
Data processing	407	342
Professional fees	558	784
Insurance	95	95
Regulatory assessments	114	202
Other	613	553
Total noninterest expenses	4,088	4,161

Net earnings (loss)	$796	$(589)
Net earnings (loss) per share:		
Basic and diluted	$.53	$(.53)

See Accompanying Notes to Consolidated Financial Statements.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income (Loss)
(In thousands)

	Year Ended December 31,	
	2018	2017
Net earnings (loss)	$796	$(589)
Other comprehensive (loss) income:		
Change in unrealized loss on securities:		
Unrealized gain arising during the year	270	82
Amortization of unrealized loss on securities transferred to held-to-maturity	55	—
Reclassification adjustment for unrealized loss on securities transferred to held-to-maturity	(432)	—
Reclassification adjustment for realized gain on sale of securities available for sale	—	(11)
Other comprehensive (loss) income before income tax benefit (expense)	(107)	71
Deferred income tax benefit (expense) on above change	27	(69)
Total other comprehensive (loss) income	(80)	2
Comprehensive income (loss)	$716	$(587)

See Accompanying Notes to Consolidated Financial Statements.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2018 and 2017
(Dollars in thousands)

	Preferred Stock Series A		Common Stock		Additional		Accumulated Other	Total
	Shares	Amount	Shares	Amount	Paid-In Capital	Accumulated Deficit	Comprehensive Loss	Stockholders' Equity
Balance at December 31, 2016	7	$ —	1,103,447	$ 11	$ 34,039	$ (30,717)	$ (252)	$ 3,081
Proceeds from sale of common stock	—	—	10,000	—	30	—	—	30
Common stock issued for services	—	—	7,500	—	21	—	—	21
Net change in unrealized loss on securities available for sale, net of income taxes	—	—	—	—	—	—	2	2
Net loss	—	—	—	—	—	(589)	—	(589)
Balance at December 31, 2017	7	$ —	1,120,947	$ 11	$ 34,090	$ (31,306)	$ (250)	$ 2,545
Proceeds from sale of common stock	—	—	211,367	2	523	—	—	525
Common stock issued as compensation to directors	—	—	144,742	2	613	—	—	615
Common stock issued in exchange for Preferred Stock	(7)	—	79,186	—	—	—	—	—
Common stock issued in exchange for Trust Preferred Securities	—	—	301,778	3	902	—	—	905
Net change in unrealized loss on securities available for sale, net of income taxes	—	—	—	—	—	—	200	200
Amortization of unrealized loss on securities transferred to held-to-maturity	—	—	—	—	—	—	44	44
Unrealized loss on securities transferred to held-to-maturity, net of income tax benefit	—	—	—	—	—	—	(324)	(324)
Net earnings	—	—	—	—	—	796	—	796
Balance at December 31, 2018	—	$ —	1,858,020	$ 18	$ 36,128	$ (30,510)	$ (330)	$ 5,306

See Accompanying Notes to Consolidated Financial Statements.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows
(In thousands)

	Year Ended December 31,	
	2018	**2017**
Cash flows from operating activities:		
Net earnings (loss)	$796	$(589)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:		
Depreciation and amortization	159	149
Common stock issued as compensation for services	—	21
Net amortization of fees, premiums and discounts	237	211
Credit for loan losses	(1,754)	—
Gain from sale of securities available for sale	—	(11)
Decrease in accrued interest receivable	2	64
Decrease (increase) in other assets	15	(24)
Increase in official checks and other liabilities	569	749
Net cash provided by operating activities	24	570
Cash flows from investing activities:		
Principal repayments of securities available for sale	906	2,189
Proceeds from sale of securities available for sale	—	6,448
Principal repayments of securities held-to-maturity	814	—
Net (increase) decrease in loans	(7,351)	8,798
Purchase of premises and equipment, net	(234)	(94)
(Purchase) redemption of Federal Home Loan Bank stock	(153)	134
Net cash (used in) provided by investing activities	(6,018)	17,475
Cash flows from financing activities:		
Net decrease in deposits	(2,873)	(20,836)
Purchase (repayments) of Federal Home Loan Bank advances, net	4,100	(3,000)
Net decrease in advanced payment by borrowers for taxes and insurance	—	(214)
Proceeds from sale of common stock	525	30
Increase in federal funds purchased	560	—
Net cash provided by (used in) financing activities	2,312	(24,020)
Decrease in cash and cash equivalents	(3,682)	(5,975)
Cash and cash equivalents at beginning of the year	11,665	17,640
Cash and cash equivalents at end of the year	$7,983	$11,665

(continued)

33

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows, Continued
(In thousands)

	Year Ended December 31,	
	2018	2017
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$931	$980
Income taxes	$—	$—
Noncash transactions:		
Change in accumulated other comprehensive loss, net change in unrealized loss on securities available for sale, net of income taxes	$(80)	$2
Transfer of securities from available for sale to held-to-maturity	$7,945	$—
Reclassification of stock compensation from other liabilities to common stock	$615	$—
Issuance of common stock in exchange for Trust Preferred Securities	$905	$—
Amortization of unrealized loss on securities transferred to held-to-maturity	$55	$—

See Accompanying Notes to Consolidated Financial Statements.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

At December 31, 2018 and 2017 and for the Years Then Ended

(1) Summary of Significant Accounting Policies

Organization. OptimumBank Holdings, Inc. (the “Holding Company”) is a one-bank holding company and owns 100% of OptimumBank (the “Bank”), a Florida-chartered commercial bank. The Holding Company’s only business is the operation of the Bank and its subsidiaries (collectively, the “Company”). The Bank’s deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation (“FDIC”). The Bank offers a variety of community banking services to individual and corporate customers through its three banking offices located in Broward County, Florida.

Basis of Presentation. The accompanying consolidated financial statements include the accounts of the Holding Company, the Bank and the Real Estate Subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting practices of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and to general practices within the banking industry. The following summarizes the more significant of these policies and practices.

Junior Subordinated Debenture. The Company is in default with respect to its $5,155,000 Junior Subordinated Debenture (the “Debenture”) due to its failure to make certain required interest payments under the Debenture. The Debenture was issued to Optimum Bank Holdings Capital Trust I, a Delaware statutory trust formed by the Company for the purpose of issuing and selling certain securities (the “Trust Preferred Securities”) representing undivided beneficial interests in the Debenture. The trust issued a total of 5,000 Trust Preferred Securities.

The Trustee, Wells Fargo Bank, for the Debenture (the “Trustee”) and the beneficial owners of the Debenture are entitled to accelerate the payment of the $5,155,000 principal balance plus accrued and unpaid interest totaling $1,686,350 at December 31, 2018. To date, neither the Trustee nor the holders have accelerated the outstanding balance of the Debenture. No adjustments to the accompanying consolidated financial statements have been made as a result of this uncertainty.

In May 2018, a company affiliated with a director of the Company (the “New Holder”) purchased all 5,000 Trust Preferred Securities from a third party. During the third quarter of 2018, the New Holder sold its rights in approximately 694 of the Trust Preferred Securities to several unaffiliated third parties, who subsequently exchanged these Trust Preferred Securities for 301,778 shares of the Company’s common stock. Due to regulatory agreement the exchange of Trust Preferred Securities for the Company’s common stock cannot reduce the principal amount of the Debenture collateralizing the Trust Preferred Securities. Accordingly is recorded as an increase in the Company’s equity interest in the unconsolidated subsidiary trust, presented in “Other Assets” in the accompanying consolidated balance sheets.

Although the Company and the New Holder have not executed a formal, definitive bilateral agreement, the New Holder has provided the Company with written representations that the New Holder will not accelerate and demand payment of any of the remaining 4,306 Trust Preferred Securities principal or accrued interest within the next twelve months from the date this Annual Report, Form 10-K as of and for the year ended December 31, 2018, is filed with the Securities and Exchange Commission.

Use of Estimates. In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of the deferred tax asset.

Cash and Cash Equivalents. For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks and interest-bearing deposits with banks, all of which have original maturities of ninety days or less.

The Company may be required by law or regulation to maintain cash reserves in the form of vault cash or deposit with Federal Reserve Banks or in Pass-through accounts with other banks. At December 31, 2018 and 2017, there were no required cash reserves.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Securities. Securities may be classified as trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in operations. Held-to-maturity securities are those which management has the positive intent and ability to hold to maturity and are reported at amortized cost. Available for sale securities consist of securities not classified as trading securities nor as held to maturity securities. Unrealized holding gains and losses on available for sale securities are reported as a net amount in accumulated other comprehensive loss in stockholders' equity until realized. Gains and losses on the sale of available for sale securities are determined using the specific-identification method. Premiums and discounts on securities are recognized in interest income using the interest method over the period to maturity.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. A security is impaired if the fair value is less than its carrying value at the financial statement date. When a security is impaired, the Company determines whether this impairment is temporary or other-than-temporary. In estimating other-than-temporary impairment ("OTTI") losses, management assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in operations. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in operations is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. Management utilizes cash flow models to segregate impairments to distinguish between impairment related to credit losses and impairment related to other factors. To assess for OTTI, management considers, among other things, (i) the severity and duration of the impairment; (ii) the ratings of the security; (iii) the overall transaction structure (the Company's position within the structure, the aggregate, near-term financial performance of the underlying collateral, delinquencies, defaults, loss severities, recoveries, prepayments, cumulative loss projections, and discounted cash flows); and (iv) the timing and magnitude of a break in modeled cash flows.

Loans. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Commitment fees and loan origination fees are deferred and certain direct origination costs are capitalized. Both are recognized as an adjustment of the yield of the related loan.

The accrual of interest on loans is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these 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.

Allowance for Loan Losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to operations. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. There were no changes in the Company’s accounting policies or methodology during the years ended December 31, 2018 and 2017.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Allowance for Loan Losses, Continued

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loans are lower than the carrying value of those loans. The general component covers all other loans and is based on historical loss experience adjusted for qualitative factors.

The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding three years. The historical loss experience is adjusted for the risks by each portfolio segment. Risk factors impacting loans in each of the portfolio segments include: economic trends and conditions; experience, ability and depth of lending management; national and local political environment; industry conditions and trends in charge-offs; and other trends or uncertainties that could affect management's estimate of probable losses.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due. 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, 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.

Premises and Equipment. Land is stated at cost. Buildings and improvements, furniture, fixtures, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization expense are computed using the straight-line method over the estimated useful life of each type of asset or lease term, if shorter.

Preferred Securities of Unconsolidated Subsidiary Trust. The Company owns all of the common stock of OptimumBank Holdings Capital Trust I ("Issuer Trust"), an unconsolidated subsidiary trust. The Issuer Trust used the proceeds from the issuance of $5,000,000 of its preferred securities to third-party investors and common stock to acquire a $5,155,000 debenture issued by the Company. This debenture and certain capitalized costs associated with the issuance of the securities comprise the Issuer Trust's only assets and the interest payments from the debentures finance the distributions paid on the preferred securities. The Company recorded the debenture in "Junior Subordinated Debenture" and its equity interest in the business trust in "Other Assets" in the accompanying consolidated balance sheets (See Note 6).

The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the preferred securities of the Issuer Trust subject to the terms of the guarantee.

Transfer of Financial Assets. Transfers of financial assets or a participating interest in an entire financial asset are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder, (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Income Taxes. There are two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods.

Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management’s judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company provides reserves for potential payments of tax related to uncertain tax positions. These reserves are based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized following resolution of any potential contingencies present related to the tax benefit. Potential interest and penalties associated with such uncertain tax positions are recorded as a component of income tax expense. See Note 9 for additional details.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Holding Company and the Bank file a consolidated income tax return. Income taxes are allocated proportionately to the Holding Company and the Bank as though separate income tax returns were filed.

On December 22, 2017, the "Tax Cuts and Jobs Act of 2017," or the Tax Act, was signed into law. The Tax Act, among other things, reduced the maximum statutory federal corporate income tax rate from 35% to 21% effective January 1, 2018. As a result of enactment of the Tax Act, the Bank revalued its net deferred tax asset. This revaluation of the deferred tax asset had no effect on the income tax provision due to the valuation allowance on the deferred tax asset.

Advertising. The Company expenses all media advertising as incurred. Media advertising expense included in other noninterest expenses in the accompanying consolidated statements of operations was approximately $40,000 and $69,000 during the years ended December 31, 2018 and 2017, respectively.

Stock Compensation Plan. The Company has adopted the fair value recognition method and expenses the fair value of any stock options as they vest. Under the fair value recognition method, the Company recognizes stock-based compensation in the accompanying consolidated statements of operations.

Earnings (loss) Per Share. Basic earnings (loss) per share is computed on the basis of the weighted-average number of common shares outstanding. In 2018, basic and diluted earnings per share is the same as there were no outstanding potentially dilutive securities. In 2017, basic and diluted loss per share is the same due to the net loss incurred by the Company. Earnings (loss) per common share has been computed based on the following:

	Year Ended December 31,	
	2018	**2017**
Weighted-average number of common shares outstanding used to calculate basic and diluted earnings (loss) per common share	1,493,303	1,104,995

38

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Off-Balance-Sheet Financial Instruments. In the ordinary course of business, the Company may enter into off-balance-sheet financial instruments consisting of commitments to extend credit, unused lines of credit, and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Fair Value Measurements. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets measured at fair value:

Securities Available for Sale. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain mortgage-backed securities and U.S. Government and agency securities.

Impaired Loans. The Company's impaired loans are normally collateral dependent and, as such, are carried at the lower of the Company's net recorded investment in the loan or fair market value of the collateral less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Fair Values of Financial Instruments. The following methods and assumptions were used by the Company in estimating fair values of financial instruments disclosed herein:

Cash and Cash Equivalents. The carrying amounts of cash and cash equivalents approximate their fair value (Level 1).

Securities. Fair values for securities are based on the framework for measuring fair value established by GAAP (Level 2).

Loans. For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans, including fixed-rate residential and commercial real estate and commercial loans, are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality (Level 3).

Federal Home Loan Bank Stock. Fair value of the Company’s investment in Federal Home Loan Bank stock is based on its redemption value, which is its cost of $100 per share (Level 3).

Accrued Interest Receivable. The carrying amount of accrued interest approximates its fair value (Level 3).

Deposit Liabilities. The fair values disclosed for demand, NOW, money-market and savings deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities of time deposits (Level 3).

Federal Home Loan Bank Advances. Fair values of Federal Home Loan Bank advances are estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowings (Level 3).

Federal Funds Purchased. The carrying amount of federal funds purchased approximates its fair value (Level 1).

Off-Balance-Sheet Financial Instruments. Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing (Level 3).

Comprehensive income (loss). GAAP generally requires that recognized revenue, expenses, gains and losses be included in net earnings (loss). Although certain changes in consolidated assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items along with net earnings (loss), are components of comprehensive income (loss).

Accumulated other comprehensive loss consists of the following (in thousands):

	December 31, 2018	**December 31, 2017**
Unrealized loss on securities available for sale	$ (64)	$ (334)
Unamortized portion of unrealized loss related to securities available for sale transferred to securities held-to-maturity	(377)	—
Income tax benefit	111	84
	$ (330)	$ (250)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies, continued

Recent Pronouncements. In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-2, Leases (Topic 842) which will require lessees to recognize on the consolidated balance sheet the assets and liabilities for the rights and obligations created by those leases with a term of more than twelve months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The new ASU will require both types of leases to be recognized on the consolidated balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the consolidated financial statements. The ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018. The Company estimates that the effect of the ASU will increase assets by $276,000, liabilities by $280,000 and accumulated deficit by $4,000.

In June 2016, the FASB issued ASU No. 2016-13 *Financial Instruments-Credit Losses (Topic 326)*. The ASU improves financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by the Company. The ASU requires the Company to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. The Company will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the condensed consolidated financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU will take effect for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted. The Company is in the process of determining the effect of the ASU on its consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedge Activities*. The ASU better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging

relationships and the presentation of hedge results. To meet that objective, the ASU expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The ASU is effective for fiscal years beginning after December 15, 2018. The adoption of guidance will not have a material impact on the Company's consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, Stock Compensation *(Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. The ASU is intended to reduce the cost and complexity and to improve financial reporting for nonemployee share-based payments. The ASU expands the scope of Topic 718. Compensation Stock Compensation (which currently only includes share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, *Equity-Equity-Based payments to Non-Employees*. The ASU is effective for the Company for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. The adoption of this guidance will not have a material impact on the company's consolidated financial statements.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(2) **Securities.** Securities have been classified according to management's intent. The carrying amount of securities and approximate fair values are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2018:				
Held-to-maturity –				
Collateralized mortgage obligations	$ 7,139	$ 40	$ (4)	$7,175
Available for sale –				
SBA Pool Securities	$ 2,423	$ —	$ (64)	$2,359
At December 31, 2017 –				
Securities Available for Sale:				
Collateralized mortgage obligations	$ 8,806	$ —	$ (340)	$8,466
SBA Pool Securities	2,965	10	(4)	2,971
Total	$ 11,771	$ 10	$ (344)	$11,437

In April 2018, the bank transferred securities of $7,945,000 from the available-for-sale category to the held-to-maturity category at their then fair values resulting in unrealized losses of $432,000. The unrealized loss which is recorded in the stockholders' equity net of amortization and net of tax is being amortized over the remaining term of the securities. At December 31, 2018, $55,000 has been amortized.

There were no sales of securities available for sale during the year ended December 31, 2018.

The following summarizes the sale of securities available for sale during the year ended December 31, 2017 (in thousands):

Proceeds from sales	$6,448

Gross gains from sales	11
Gross loss from sales	-
Net gain from sales	$11

Securities with gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	At December 31, 2018			
	Over Twelve Months		Less Than Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Held-to-maturity —				
Collateralized mortgage obligations	$4	$1,361	$ —	$—
Available for Sale —				
SBA Pool Securities	$24	$829	$40	$1,530

	At December 31, 2017			
	Over Twelve Months		**Less Than Twelve Months**	
	Gross Unrealized Losses	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**
Securities Available for Sale:				
Collateralized mortgage obligations	$340	8,466	—	—
SBA Pools Securities	$3	$539	$1	$ 540
	343	9,005	$1	$ 540

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(2) ***Securities, Continued.*** Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2018 and 2017, the unrealized losses on seven and eight investment securities, respectively were caused by market conditions. It is expected that the securities would not be settled at a price less than the book value of the investments. Because the decline in fair value is attributable to market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Available-for-sale securities measured at fair value on a recurring basis are summarized below (in thousands):

		Fair Value Measurements Using		
	Fair Value	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
At December 31, 2018 –				
SBA Pool Securities	$2,359	$—	$ 2,359	$ —
At December 31, 2017:				
Collateralized mortgage obligations	$8,466	$—	$ 8,466	$ —
SBA Pool Securities	2,971	—	2,971	—

$11,437	$—	$ 11,437	$ —

During the years ended December 31, 2018 and 2017, no securities were transferred in or out of Level 1, 2 or 3.

As of December 31, 2018, the Company had pledged Securities with a market value of $453,000 as collateral for the Federal Reserve Bank Discount Window.

The Company’s available-for-sale and held-to-maturity securities all have contractual maturity dates which are greater than ten years after December 31, 2018. Expected maturities of these securities will differ from contractual maturities because borrowers have the right to call or repay obligations with or without call or prepayment penalties.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans.*** The components of loans are as follows (in thousands):

	At December 31, 2018	**At December 31, 2017**
Residential real estate	$ 27,204	$ 26,054
Multi-family real estate	8,195	7,356
Commercial real estate	36,634	32,152
Land and construction	1,998	1,051
Commercial	4,997	4,522
Consumer	260	794
Total loans	79,288	71,929
Add (deduct):		
Net deferred loan fees, costs and premiums	155	282
Allowance for loan losses	(2,243)	(3,991)
Loans, net	$ 77,200	$ 68,220

The Company grants the majority of its loans to borrowers throughout Broward County, Florida and portions of Palm Beach and Miami-Dade Counties, Florida. Although the Company has a diversified loan portfolio, a significant portion of its borrowers' ability to repay their loans and meet their contractual obligations to the Company is dependent upon the economy in Broward, Palm Beach and Miami-Dade Counties, Florida.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, Continued.*** An analysis of the change in the allowance for loan losses for the years ended December 31, 2018 and 2017 follows (in thousands):

	Residential Real Estate	Multi-Family Real Estate	Commercial Real Estate	Land and Construction	Commercial	Consumer	Unallocated	Total
Year Ended December 31, 2018:								
Beginning balance	$ 641	$ 59	$ 759	$ 22	$ 55	$ 86	$ 2,369	$ 3,991
(Credit) provision for loan losses	(97)	29	(192)	(26)	795	(44)	(2,219)	(1,754)
Charge-offs	—	—	—	—	—	(25)	—	(25)
Recoveries	—	—	—	23	—	8	—	31
Ending balance	$ 544	$ 88	$ 567	$ 19	$ 850	$ 25	$ 150	$ 2,243
Year Ended December 31, 2017:								
Beginning balance	$ 310	$ 58	$ 787	$ 120	$ 188	$ 165	$ 2,287	$ 3,915
Provision (credit) for loan losses	229	1	(28)	(122)	(133)	(29)	82	—
Charge-offs	—	—	—	—	—	(67)	—	(67)
Recoveries	102	—	—	24	—	17	—	143
Ending balance	$ 641	$ 59	$ 759	$ 22	$ 55	$ 86	$ 2,369	$ 3,991

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, continued.***

The balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2018 and 2017 follows (in thousands):

	Residential Real Estate	**Multi-Family Real Estate**	**Commercial Real Estate**	**Land and Construction**	**Commercial**	**Consumer**	**Unallocated**	**Total**
At December 31, 2018:								
Individually evaluated for impairment:								
Recorded investment	$ 954	$ —	$ 3,861	$ —	$ 1,928	$ —	$ —	$ 6,743
Balance in allowance for loan losses	$ 268	$ —	$ 162	$ —	$ 814	$ —	$ —	$ 1,244
Collectively evaluated for impairment:								
Recorded investment	$ 26,250	$ 8,195	$ 32,773	$ 1,998	$ 3,069	$ 260	$ —	$ 72,545
Balance in allowance for loan losses	$ 276	$ 88	$ 405	$ 19	$ 36	$ 25	$ 150	$ 999
At December 31, 2017:								
Individually evaluated for impairment:								
Recorded investment	$ 1,172	$ —	$ 975	$ —	$ —	$ —	$ —	$ 2,147
Balance in allowance for loan losses	$ 330	$ —	$ 83	$ —	$ —	$ —	$ —	$ 413
Collectively evaluated for impairment:								
Recorded investment	$ 24,882	$ 7,356	$ 31,177	$ 1,051	$ 4,522	$ 794	$ —	$ 69,782
Balance in allowance for loan losses	$ 311	$ 59	$ 676	$ 22	$ 55	$ 86	$ 2,369	$ 3,578

On January 6, 2016, the Bank completed a sale of a judgement on a defaulted credit that resulted in a $1.8 million recovery of previously charged-off amounts to the Allowance for Loan and Lease Losses (“ALLL”). That increased the

balance of the ALLL to approximately $4.2 million. On February 12, 2016, and amended May 6, 2016, pursuant to the terms and requirements of the Consent Order, Management submitted a Second written request to the FDIC for a partial reversal of the ALLL. During the second quarter of 2018, the FDIC approved management's request. In June 2018, the Bank reversed $2.1 million of the ALLL into income.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, Continued.***

Residential Real Estate, Multi-Family Real Estate, Commercial Real Estate, Land and Construction. All loans are underwritten in accordance with policies set forth and approved by the Board of Directors (the "Board"), including repayment capacity and source, value of the underlying property, credit history and stability. Residential real estate loans are underwritten based on repayment capacity and source, value of the underlying property, credit history and stability. Multi-family and commercial real estate loans are secured by the subject property and are underwritten based upon standards set forth in the policies approved by the Company's Board. Such standards include, among other factors, loan to value limits, cash flow coverage and general creditworthiness of the obligors. Construction loans to borrowers finance the construction of owner occupied and leased properties. These loans are categorized as construction loans during the construction period, later converting to commercial or residential real estate loans after the construction is complete and amortization of the loan begins. Real estate development and construction loans are approved based on an analysis of the borrower and guarantor, the viability of the project and on an acceptable percentage of the appraised value of the property securing the loan. Real estate development and construction loan funds are disbursed periodically based on the percentage of construction completed. The Company carefully monitors these loans with on-site inspections and requires the receipt of lien waivers on funds advanced. Development and construction loans are typically secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely on the value of the underlying property, the Company considers the market conditions and feasibility of proposed projects, the financial condition and reputation of the borrower and guarantors, the amount of the borrower's equity in the project, independent appraisals, cost estimates and pre-construction sales information. The Company also makes loans on occasion for the purchase of land for future development by the borrower. Land loans are extended for future development for either commercial or residential use by the borrower. The Company carefully analyzes the intended use of the property and the viability thereof.

Commercial. Commercial business loans and lines of credit consist of loans to small- and medium-sized companies in the Company's market area. Commercial loans are generally used for working capital purposes or for acquiring equipment, inventory or furniture. Primarily all of the Company's commercial loans are secured loans, along with a small amount of unsecured loans. The Company's underwriting analysis consists of a review of the financial statements of the borrower, the lending history of the borrower, the debt service capabilities of the borrower, the projected cash flows of the business, the value of the collateral, if any, and whether the loan is guaranteed by the principals of the borrower. These loans are generally secured by accounts receivable, inventory and equipment. Commercial loans are typically made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business, which makes them of higher risk than residential loans and the collateral securing loans may be difficult to appraise and may fluctuate in value based on the success of the business. The Company seeks to minimize these risks through its underwriting standards.

Consumer. Consumer loans are extended for various purposes, including purchases of automobiles, recreational vehicles, and boats. Also offered are home improvement loans, lines of credit, personal loans, and deposit account collateralized loans. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Loans to consumers are extended after a credit evaluation, including the creditworthiness of the borrower(s), the purpose of the credit, and the secondary source of repayment. Consumer loans are made at fixed and variable interest rates. Risk is mitigated by the fact that the loans are of smaller individual amounts.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, Continued.*** The following summarizes the loan credit quality (in thousands):

	Pass	OLEM (Other Loans Especially Mentioned)	Sub-standard	Doubtful	Loss	Total
At December 31, 2018:						
Residential real estate	$26,250	$ —	$ 954	$ —	$ —	$27,204
Multi-family real estate	8,195	—	—	—	—	8,195
Commercial real estate	31,050	1,723	3,861	—	—	36,634
Land and construction	1,998	—	—	—	—	1,998
Commercial	2,362	707	1,928	—	—	4,997
Consumer	260	—	—	—	—	260
Total	$70,115	$ 2,430	$ 6,743	$ —	$ —	$79,288
At December 31, 2017:						
Residential real estate	$22,315	$ 2,494	$ 1,245	$ —	$ —	$26,054
Multi-family real estate	7,356	—	—	—	—	7,356
Commercial real estate	24,704	6,473	975	—	—	32,152
Land and construction	1,051	—	—	—	—	1,051
Commercial	2,304	2,218	—	—	—	4,522
Consumer	794	—	—	—	—	794
Total	$58,524	$ 11,185	$ 2,220	$ —	$ —	$71,929

Internally assigned loan grades are defined as follows:

Pass – a Pass loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary. These are loans that conform in all aspects to bank policy and regulatory requirements, and no repayment risk has been identified.

OLEM (Other Loans Especially Mentioned) – an Other Loan Especially Mentioned has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or the Company's credit position at some future date.

Substandard – a Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Included in this category are loans that are current on their payments, but the Bank is unable to document the source of repayment. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – a loan classified as Doubtful has all the weaknesses inherent in one classified as Substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. The Company charges off any loan classified as Doubtful.

Loss – a loan classified as Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. The Company fully charges off any loan classified as Loss.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, Continued.*** Age analysis of past due loans at December 31, 2018 is as follows (in thousands):

	Accruing Loans						
	30-59 Days Past Due	**60-89 Days Past Due**	**Greater Than 90 Days Past Due**	**Total Past Due**	**Current**	**Nonaccrual Loans**	**Total Loans**
At December 31, 2018:							
Residential real estate	$—	$—	$ —	$ —	$27,204	$ —	$27,204
Multi-family real estate	—	—	—	—	8,195	—	8,195
Commercial real estate	—	—	—	—	35,254	1,380	36,634
Land and construction	—	—	—	—	1,998	—	1,998
Commercial	—	—	—	—	4,997	—	4,997
Consumer	—	—	—	—	260	—	260
Total	$ —	$ —	$—	$ —	$77,908	$ 1,380	$79,288

At December 31, 2017, no loans were past due, more than thirty days and no loans were on nonaccrual.

The following summarizes the amount of impaired loans (in thousands):

	At December 31, 2018			**At December 31, 2017**		
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance recorded:						
Residential real estate	$—	$—	$—	$194	$217	$—
Commercial real estate	2,259	2,259	—	231	231	—
Commercial	1,114	1,114	—	—	—	—

With related allowance recorded:						
Residential real estate	954	954	268	978	978	330
Commercial real estate	1,602	1,602	162	744	744	83
Commercial	814	814	814	—	—	—
Total						
Residential real estate	$954	$954	$268	$1,172	$1,195	$330
Commercial real estate	$3,861	$3,861	$162	$975	$975	$83
Commercial	$1,928	$1,928	$814	$—	$—	$—
Total	$6,743	$6,743	$1,244	$2,147	$2,170	$413

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(3) ***Loans, Continued.*** The average net investment in impaired loans and interest income recognized and received on impaired loans are as follows (in thousands):

	For the Year Ended December 31,					
	2018			2017		
	Average Recorded Investment	Interest Income Recognized	Interest Income Received	Average Recorded Investment	Interest Income Recognized	Interest Income Received
Residential real estate	$981	$ 76	$ 76	$817	$ 226	$ 121
Commercial real estate	$677	$ 25	$ 25	$984	$ 52	$ 52
Commercial	$1,638	$ 86	$ 86	$—	$ —	$ —
Total	$3,296	$ 187	$ 187	$1,801	$ 278	$ 173

There were no loans modified and determined to be troubled debt restructurings during the years ended December 31, 2018 and 2017.

(4) Premises and Equipment

A summary of premises and equipment follows (in thousands):

	At December 31,	
	2018	2017
Land	$1,171	$1,171
Buildings and improvements	2,123	2,105
Furniture, fixtures and equipment	684	1,308
Leasehold improvements	127	131
Total, at cost	4,105	4,715
Less accumulated depreciation and amortization	(1,437)	(2,122)

Premises and equipment, net	$2,668	$2,593

The Company currently leases one branch facility under an operating lease. The lease contains renewal options and requires the Company to pay an allowable share of common area maintenance and real estate taxes. Rent expense under the operating lease during the years ended December 31, 2018 and 2017 was $90,000 and $73,000, respectively. At December 31, 2018, the future minimum lease payments are approximately as follows (in thousands):

Year Ending December 31,	**Amount**
2019	$92
2020	95
2021	98
2022	93
Total	$378

(continued)

50

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(5) Deposits

The aggregate amount of time deposits with a minimum denomination of $250,000 was approximately $2.7 and $1.3 million at December 31, 2018 and 2017, respectively.

A schedule of maturities of time deposits at December 31, 2018 follows (in thousands):

Year Ending December 31,	Amount
2019	$20,413
2020	3,914
2021	334
2022	1,095
2023	302
	$26,058

(6) Federal Home Loan Bank Advances, Other Available Credit and Junior Subordinated Debenture

The maturities and interest rates on the Federal Home Loan Bank ("FHLB") advances were as follows (dollars in thousands)

Maturity Year Ending	Interest	At December 31,	
December 31,	Rate	2018	2017
2018	1.53%	$—	$5,000
2019	1.60 - 2.65%	19,600	10,500
2021	1.68%	5,000	5,000
		$24,600	$20,500

At December 31, 2018, all FHLB advances had fixed interest rates, with the exception of one advance in the amount of $9.1 million which is a daily rate credit and matures in 2019.

At December 31, 2018, the FHLB advances were collateralized by a blanket lien requiring the Company to maintain certain first mortgage loans as pledged collateral. The Company has remaining credit availability of $2.0 million which can be used if additional collateral is pledged. At December 31, 2018, the Company had loans pledged with a carrying value of $39.5 million as collateral for FHLB advances.

At December 31, 2018, the Company also had lines of credit amounting to $8.4 million with four correspondent banks to purchase federal funds. The Company also has a line of credit with the Federal Reserve Bank under which the Company may draw up to $0.4 million. The line is secured by $0.5 million in securities. There were $560,000 of federal funds purchased outstanding with one of the correspondent banks at December 31, 2018. There were no federal funds purchased outstanding at December 31, 2017.

Junior Subordinated Debenture. On September 30, 2004, the Company issued a $5,155,000 Junior Subordinated Debenture (the “Debenture”) to Optimum Bank Holdings Capital Trust I, a Delaware statutory trust formed by the Company for the purpose of issuing and selling certain securities (the “Trust Preferred Securities”) representing undivided beneficial interests in the Debenture. The trust issued a total of 5,000 Trust Preferred Securities. The Debenture has a term of thirty years. The interest rate was fixed at 6.40% for the first five years, and thereafter, the coupon rate floats quarterly at the three-month LIBOR rate plus 2.45% (5.25% at December 31, 2018). The Debenture is redeemable in certain circumstances. The terms of the Debenture allow the Company to defer payments of interest on the Debenture by extending the interest payment period at any time during the term of the Debenture for up to twenty consecutive quarterly periods.

Beginning in 2010, the Company exercised its right to defer payment of interest on the Debenture. Interest payments deferred as of December 31, 2018 totaled $1,686,350. The Company has deferred interest payments with respect to the Debenture for the maximum allowable twenty consecutive quarterly payments. The Trustee for the Debenture and the beneficial owners of the Debenture can accelerate the $5,155,000 principal balance plus accrued and unpaid interest, as a result of this default. To date, neither the Trustee nor the holders have accelerated the outstanding balance of the Debenture. No adjustments to the accompanying consolidated financial statements have been made as a result of this uncertainty. Under the Written Agreement, the Company is not able to make any interest or principal payments without the prior approval of the Federal Reserve Bank of Atlanta.

In May 2018, a company affiliated with a director of the Company (the “New Holder”) purchased all 5,000 Trust Preferred Securities from a third party. During the third quarter of 2018, the New Holder sold its rights in approximately 694 of the Trust Preferred Securities to several unaffiliated third parties, who subsequently exchanged these Trust Preferred Securities for 301,778 shares of the Company’s common stock. Due to regulatory agreement the exchange of Trust Preferred Securities for the Company’s common stock cannot reduce the prinicipal amount of the Debenture collateralizing the Trust Preferred Securities. Accordingly is recorded as an increase in the Company’s

equity interest in the unconsolidated subsidiary trust, presented in “Other Assets” in the accompanying consolidated balance sheets.

Although the Company and the New Holder have not executed a formal, definitive bilateral agreement, the New Holder has provided the Company with written representations that the New Holder will not accelerate and demand payment of any of the remaining 4,306 Trust Preferred Securities principal or accrued interest within the next twelve months from the date this Annual Report, Form 10-K as of and for the year ended December 31, 2018, is filed with the Securities and Exchange Commission.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(7) Financial Instruments

The estimated fair values of the Company's financial instruments were as follows (in thousands):

	At December 31, 2018			**At December 31, 2017**		
	Carrying Amount	**Fair Value**	**Level**	**Carrying Amount**	**Fair Value**	**Level**
Financial assets:						
Cash and cash equivalents	$7,983	$7,983	1	$11,665	$11,665	1
Securities available for sale	2,359	2,359	2	11,437	11,437	2
Securities held-to-maturity	7,139	7,175	2	—	—	2
Loans	77,200	77,062	3	68,220	68,079	3
Federal Home Loan Bank stock	1,132	1,132	3	979	979	3
Accrued interest receivable	314	314	3	316	316	3
Financial liabilities:						
Deposit liabilities	62,378	62,243	3	65,251	65,475	3
Federal Home Loan Bank advances	24,600	24,437	3	20,500	20,394	3
Junior subordinated debenture	5,155	N/A (1)	3	5,155	N/A (1)	3
Federal funds purchased	560	560	3	—	—	3
Off-balance sheet financial instruments	—	—	3	—	—	3

(1) The Company is unable to determine value based on significant unobservable inputs required in the calculation. Refer to Note 6 for further information.

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit, unused lines of credit, and standby letters of credit and may involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments reflect the extent of involvement the Company has in these financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses

the same credit policies in making commitments as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit, is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit to customers is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments. Standby letters of credit generally have expiration dates within one year.

Commitments to extend credit, unused lines of credit, and standby letters of credit typically result in loans with a market interest rate when funded. A summary of the contractual amounts of the Company's financial instruments with off-balance-sheet risk at December 31, 2018 follows (in thousands):

Commitments to extend credit	$1,820
Unused lines of credit	$2,735
Standby letters of credit	$-

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(8) Income Taxes

Income tax benefit consisted of the following (in thousands):

	Year Ended December 31, 2018	2017
Current:		
Federal	$—	$—
State	—	—
Total Current	—	—
Deferred:		
Federal	182	1,633
State	38	(32)
Change in Valuation Allowance	(220)	(1,601)
Total Deferred	—	—
Total	$—	$—

The reasons for the differences between the statutory Federal income tax rate and the effective tax rate are summarized as follows (dollars in thousands):

	Year Ended December 31, 2018		2017	
	Amount	% of Pretax Loss	Amount	% of Pretax Loss
Income tax benefit at statutory rate	$167	21.00%	$(200)	(34.0)%
Increase (decrease) resulting from:				
State taxes, net of Federal tax benefit	38	4.77%	(21)	(3.6)%

Other permanent differences	15	1.88 %	—	— %
Reduction in Federal income-tax rate	(220)	(27.65)%	1,822	309.3 %
Change in valuation allowance	—	—	(1,601)	(271.7)%
	$—	—	$—	—

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below (in thousands):

	At December 31,	
	2018	**2017**
Deferred tax assets:		
Net operating loss carryforwards	$3,926	$3,547
Premises and equipment	70	66
Accrued expenses	—	104
Nonaccrual loan interest	77	122
Unrealized loss on available for sale securities	111	84
Other	54	56
Gross deferred tax assets	4,238	3,979
Less: Valuation allowance	3,572	3,792
Net deferred tax assets	666	187
Deferred tax liabilities:		
Allowance for loan losses	(521)	(77)
Loan costs	(34)	(26)
Total deferred tax liabilities	(555)	(103)
Net deferred tax asset	$111	$84

During the years ended December 31, 2018 and 2017, the Company assessed its earnings history and trend over the past year and its estimate of future earnings, and determined that it was more likely than not that the deferred tax assets would not be realized in the near term. Accordingly, a valuation allowance was recorded and maintained against the net deferred tax asset for the amount not expected to be realized in the future.

At December 31, 2018, the Company had net operating loss carryforwards of approximately $15.1 million for Federal tax purposes and $15.1 million for Florida tax purposes available to offset future taxable income. These carryforwards will begin to expire in 2029. A portion of the Federal and Florida net operating losses are subject to Internal Revenue Code Section 382 limitations.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(8) Income Taxes, Continued

The Company files U.S. and Florida income tax returns. The Company is no longer subject to U.S. Federal or state income tax examinations by taxing authorities for years before 2015.

The Company regularly reviews its tax positions in each significant taxing jurisdiction in the process of evaluating its unrecognized tax benefits. The Company makes adjustments to its unrecognized tax benefits when: (i) facts and circumstances regarding a tax position change, causing a change in management's judgment regarding that tax position; (ii) a tax position is effectively settled with a tax authority at a differing amount; and/or (iii) the statute of limitations expires regarding a tax position. The Company does not expect a change in unrecognized tax benefits in the next year.

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(9) Related Party Transactions

The Company has entered into transactions with its executive officers, directors and their affiliates in the ordinary course of business. There were no loans to related parties at December 31, 2018 or 2017. During 2018, the Company incurred approximately $99,000 in legal fees related to a law firm owned by a director. At December 31, 2018 and 2017, related parties had approximately $1,147,000 and $229,000, respectively, on deposit with the Company. At December 31, 2018, all 4,306 Trust Preferred Securities are owned by a company affiliated with a director of the Company.

(10) Stock-Based Compensation

The Company is authorized to grant stock options, stock grants and other forms of equity-based compensation under its 2011 Equity Incentive Plan as amended (the "2011 Plan") and its 2018 Equity Incentive Plan (the "2018 Plan"). Both plans have been approved by shareholders. The Company is authorized to issue up to 210,000 shares of common stock under the 2011 Plan as amended, of which 208,881 have been issued, and 1,119 shares remain available for grant, and up to 250,000 shares of common stock under the 2018 Plan, of which 100,000 have been issued, and 150,000 shares remain available for grant.

The Company's only grants under the 2011 Plan as amended have been the issuance of shares of common stock to directors for director's fees and compensation for services rendered. As of April 1, 2017, the Company discontinued the issuance of common stock as a method of payment of director's fees.

During 2018, the sale of 20,814 shares of common stock to a director of the Company, and the issuance of 79,186 shares of common stock in exchange for 7 shares of the Company's preferred stock held by a director in April 2018, were treated as grants under the 2018 Plan. Please refer to the Company's Forms 8-K filed with the Securities and Exchange Commission on November 16, 2018 and January 10, 2019 for further details.

During year ended December 31, 2017, the Company accrued compensation expense of $8,858 with respect to 2,821 shares to be issued to directors at a value of $3.14 per share on account of director's fees accrued during the first quarter of 2017. These shares were issued in 2018.

During the year ended December 31, 2018, the Company accrued compensation expense of $200,000 with respect to 36,101 shares issued to a director for services performed in 2018. The Company had previously agreed to issue 105,820 shares to this director for services performed in 2016 and 2017. These shares were issued in 2018.

(11) Regulatory Matters. The Bank is subject to various regulatory capital requirements administered by the bank regulatory agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(11) Regulatory Matters, Continued

Effective January 1, 2015, the Bank became subject to the new Basel III capital level threshold requirements under the Prompt Corrective Action regulations with full compliance with all of the final rule's requirements phased in over a multi-year schedule. These new regulations were designed to ensure that banks maintain strong capital positions even in the event of severe economic downturns or unforeseen losses.

Changes that could affect the Bank going forward include additional constraints on the inclusion of deferred tax assets in capital and increased risk weightings for nonperforming loans and acquisition/development loans in regulatory capital. Beginning on January 1, 2016, the Bank became subject to the capital conservation buffer rules which places limitations on distributions, including dividend payments, and certain discretionary bonus payments to executive officers. In order to avoid these limitations, an institution must hold a capital conservation buffer above its minimum risk-based capital requirements. As of December 31, 2018 and 2017, the Bank's capital conservation buffer exceeds the minimum requirements of 1.875% and 1.250%, respectively. The required conservation buffer of 2.50% is effective January 1, 2019.

The following table shows the Bank's capital amounts and ratios and regulatory thresholds at December 31, 2018 and 2017 (dollars in thousands):

	Actual		**For Capital Adequacy Purposes**		**Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
As of December 31, 2018:						
Total Capital to Risk-Weighted Assets	$12,155	15.86%	$6,132	8.00%	$7,665	10.00%
Tier I Capital to Risk-Weighted Assets	11,181	14.59	4,599	6.00	6,132	8.00
Common equity Tier I capital to Risk-Weighted Assets	11,181	14.59	3,449	4.50	4,983	6.50
Tier I Capital to Total Assets	11,181	11.68	3,828	4.00	4,785	5.00

As of December 31, 2017:						
Total Capital to Risk-Weighted Assets	$10,484	15.08%	$5,561	8.00%	$6,951	10.00%
Tier I Capital to Risk-Weighted Assets	9,577	13.78	4,170	6.00	5,561	8.00
Common equity Tier I capital to Risk-Weighted Assets	9,577	13.78	3,128	4.50	4,518	6.50
Tier I Capital to Total Assets	9,577	8.89	4,307	4.00	5,383	5.00

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(11) Regulatory Matters, Continued

Regulatory Enforcement Actions

Memorandum of Understanding. On August 28, 2018, the Bank agreed to the issuance of a Memorandum of Understanding (the "MOU"), with the FDIC and OFR which requires the Bank to take certain measures to improve its safety and soundness. By agreeing to the MOU, the Bank was released from the Consent Order that became effective in 2016, including the restrictions on the interest rates paid on deposits.

Pursuant to the MOU, the Bank is required to take certain measures to maintain qualified management, improve its strategic planning and budgeting process, strengthen the interest rate management practices, limit its asset growth and provide for the ongoing organization, monitoring and operational administration of the Bank Secrecy Act Program. The MOU prohibits the payment of dividends by the Bank.

Company Written Agreement with Reserve Bank. On June 22, 2010, the Company and the Reserve Bank entered into a Written Agreement with respect to certain aspects of the operation and management of the Company. The Written Agreement prohibits, without the prior approval of the Reserve Bank, the payment of cash dividends, taking dividends or payments from the Bank, making any interest, principal or other distributions on account of the Debenture, incurring, increasing or guaranteeing any debt, purchasing or redeeming any shares of stock, or appointing any new director or senior executive officer. Management believes that the Company is in substantial compliance with the requirements of the Written Agreement.

(12) ***Dividends.***

The Company is limited in the amount of cash dividends that may be paid. Banking regulations place certain restrictions on dividends and loans or advances made by the Bank to the Holding Company. The amount of cash dividends that may be paid by the Bank to the Holding Company is based on the Bank's net earnings of the current year combined with the Bank's retained earnings of the preceding two years, as defined by state banking regulations. However, for any dividend declaration, the Company must consider additional factors such as the amount of current period net earnings, liquidity, asset quality, capital adequacy and economic conditions. It is likely that these factors would further limit the amount of dividends which the Company could declare. In addition, bank regulators have the authority to prohibit banks from paying dividends if they deem such payment to be an unsafe or unsound practice. At December 31, 2018, the Bank and Holding Company could not pay cash dividends (See Note 11).

(13) ***Contingencies*****.**

Various claims also arise from time to time in the normal course of business. In the opinion of management, none have occurred that will have a material effect on the Company's consolidated financial statements.

(14) ***Retirement Plans*****.**

The Company has a 401(k) Profit Sharing plan covering all eligible employees who are over the age of twenty-one and have completed one year of service. The Company may make a matching contribution each year. The Company did not make any matching contributions in connection with this plan during the years ended December 31, 2018 or 2017.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(15) Fair Value Measurement

Impaired collateral-dependent loans are carried at fair value when the current collateral value is lower than the carrying value of the loan. Those impaired collateral-dependent loans which are measured at fair value on a nonrecurring basis are as follows (in thousands):

	At December 31, 2018					
	Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total Losses**	**Losses Recorded in Operations For the Year Ended December 31, 2018**
Residential real estate	$686	$ —	$ —	$686	$ 268	$ —
Commercial real estate	1,312	—	—	1,312	71	—
	1,998	—	—	1,998	339	—

	At December 31, 2017					
	Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total Losses**	**Losses Recorded in Operations For the Year Ended December 31, 2017**
Residential real estate	$648	$ —	$ —	$648	$ 330	$ —

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(16) Holding Company Financial Information

The Holding Company's unconsolidated financial information as of December 31, 2018 and 2017 and for the years then ended follows (in thousands):

Condensed Balance Sheets

	At December 31,	
	2018	**2017**
Assets		
Cash	$245	$51
Investment in subsidiary	10,851	9,327
Other assets	1,103	200
Total assets	$12,199	$9,578
Liabilities and Stockholders' Equity		
Other liabilities	$1,738	$1,878
Junior subordinated debenture	5,155	5,155
Stockholders' equity	5,306	2,545
Total liabilities and stockholders' equity	$12,199	$9,578

Condensed Statements of Operations

	Year Ended December 31,	
	2018	**2017**

Earnings of subsidiary	$1,604	$79
Interest expense	(298)	(227)
Other expense	(510)	(441)
Net earnings (loss)	$796	$(589)

Condensed Statements of Cash Flows

	Year Ended December 31,	
	2018	**2017**
Cash flows from operating activities:		
Net earnings (loss)	$796	$(589)
Adjustments to reconcile net earnings (loss) to net cash used in operating activities:		
Stock compensation for services	—	21
Equity in undistributed earnings of subsidiary	(1,604)	(79)
Increase in other liabilities	475	525
Decrease (increase) in other assets	2	(19)
Net cash used in operating activities	(331)	(141)
Cash flow from investing activities-		
Investment in subsidiary	—	(2)
Cash flow from financing activities –		
Proceeds from sale of common stock	525	30
Net increase (decrease) in cash	194	(113)
Cash at beginning of the year	51	164
Cash at end of year	$245	$51
Noncash transactions:		
Change in accumulated other comprehensive loss of subsidiary, net change in unrealized loss on securities available for sale, net of income taxes	$(80)	$2
Reclassification of stock compensation from other liabilities to common stock	615	—
Issuance of common stock in exchange for Trust Preferred Securities	905	—

(17) Preferred Stock

Prior to 2016, the Company issued 7 shares of Series A Preferred Stock (the "Series A Preferred") at a price of $25,000 per share to a director. Each share of the Series A Preferred had an initial liquidation preference of $25,000 per share and was entitled to cumulative dividends at the rate of 10% per annum, provided that no dividends would be declared, paid or set aside for payment to the extent such act would cause the Company to fail to comply with any applicable regulatory requirements. In April 2018, the Company issued 79,186 shares of Common Stock in exchange for the 7 outstanding shares of the Series A Preferred.

(18) Bank Secrecy Act ("BSA") Lookback Review.

The Bank is required to perform a BSA lookback review. The Bank expects the cost of the BSA lookback review to be $235,000 based on an independent firm's proposal for services. The proposal and ultimate agreement is subject to FDIC review and approval. Until the approval is received, these BSA services cannot be rendered. Once the BSA lookback review begins, the independent firm has 120 days to complete the work. At December 31, 2018, the Bank has accrued $235,000 for the proposed services.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon management's evaluation of those controls and procedures performed within the 90 days preceding the filing of this Report, its Principal Executive Officer and Chief Financial Officer concluded that, subject to the limitations noted below, the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms.

(b) Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Such internal controls over financial reporting were designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In making this assessment, the Company used the criteria set forth in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based upon its evaluation under the framework in Internal Control-Integrated Framework, the Company's management concluded that its internal control over financial reporting was effective as of December 31, 2018.

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

(c) Changes in Internal Controls

The Company has made no significant changes in its internal controls over financial reporting during the year ended December 31, 2018 that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

(d) Limitations on the Effectiveness of Controls

The Company's management, including its Principal Executive Officer and Principal Financial Officer, does not expect that its disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers, and Corporate Governance

The Company has a Code of Ethics that applies to its chief executive officer, chief operating officer, chief financial officer (who is also its chief accounting officer) and controller. This Code of Ethics is also posted on its website at www.optimumbank.com/corpgovernance.html.

A list of the Company's executive officers and biographical information about them and its directors will be included in the definitive Proxy Statement for its 2019 Annual Meeting of Stockholders, which will be filed within 120 days of the end of its fiscal year ended December 31, 2018 (the "2019 Proxy Statement") and is incorporated herein by reference. Information about its Audit Committee may be found in the Proxy Statement. That information is incorporated herein by reference.

Item 11. Executive Compensation

Information relating to the Company's executive officer and director compensation and the compensation committee of its board of directors will be included in the 2019 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information relating to security ownership of certain beneficial owners of its common stock and information relating to the security ownership of its management will be included in the 2019 Proxy Statement and is incorporated herein by reference.

The Company had two compensation plans under which shares of its common stock were issuable at December 31, 2018. The plans are the 2011 Equity Compensation Plan, as amended, and the 2018 Equity Compensation Plan, previously approved by its stockholders. The following table sets forth information as of December 31, 2018 with respect to the number of shares of the Company's common stock issuable pursuant to these plans.

Equity Compensation Plan Information

The following table provides information generally as of December 31, 2018, regarding securities to be issued on exercise of stock options, and securities remaining available for issuance under the Company's equity compensation plans that were in effect during fiscal year 2018.

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance under the equity compensation plans
Equity compensation plans approved by stockholders	—	$ —	151,119
Equity compensation plans not approved by stockholders	—	—	—
Total	—	$ —	151,119

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions and director independence will be included in the 2019 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

Information regarding principal accounting fees and services will be included in the 2019 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

3.1	Articles of Incorporation (incorporated by reference from Current Report on Form 8-K filed with the Securities and Exchange Commission ("SEC") on May 11, 2004)
3.2	Articles of Amendment to the Articles of Incorporation, effective as of January 7, 2009 (incorporated by reference to Exhibit 3.2 to Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 31, 2009)
3.3	Articles of Amendment to the Articles of Incorporation, effective as of November 5, 2010 (incorporated by reference to Exhibit 3.3 to the Current Report on Form 8-K, filed with the SEC on November 5, 2010)
3.4	Articles of Amendment to the Articles of Incorporation, effective as of September 29, 2011 (incorporated by reference from Current Report on Form 8-K, filed with the SEC on October 4, 2011)
4.3	Bylaws (incorporated by reference from Current Report on Form 8-K filed with the SEC on May 11, 2004)
4.1	Form of stock certificate (incorporated by reference from Quarterly Report on Form 10-QSB filed with the SEC on August 12, 2004)
10.1	Amended and Restated Stock Option Plan (incorporated by reference from Annual Report on Form 10-KSB filed with the SEC on March 31, 2006)
10.2	OptimumBank Holdings, Inc. 2011 Equity Incentive Plan (incorporated by reference from Current Report on Form 8-K filed with the SEC on January 3, 2012)
10.3	OptimumBank Holdings, Inc. Director Compensation Plan (incorporated by reference from Annual Report on Form 10-K filed with the SEC on March 30, 2012)
10.4	Written Agreement by and between OptimumBank Holdings, Inc. and Federal Reserve Bank of Atlanta dated June 22, 2010 (incorporated by reference from Quarterly Report on Form 10-Q filed with the SEC on November 15, 2010)
10.5	Amended and Restated Stock Purchase Agreement, dated as of December 5, 2011, between OptimumBank Holdings, Inc. and Moishe Gubin (incorporated by reference from Current Report on Form 8-K filed with the SEC on December 9, 2011)
10.6	Amended and Restated Stock Purchase Agreement, dated as of March 22, 2013, between OptimumBank Holdings, Inc. and Moishe Gubin (incorporated by reference from Current Report on Form 8-K filed with the SEC on March 28, 2013)

10.98	Form of Registration Rights Agreement between OptimumBank Holdings, Inc. and Moishe Gubin (incorporated by reference from Current Report on Form 8-K filed with the SEC on October 31, 2011)
10.9	Form of Registration Rights Agreement between OptimumBank Holdings, Inc. and Investors (incorporated by reference from Current Report on Form 8-K filed with the SEC on October 31, 2011)
14.1	Code of Ethics for Chief Executive Officer and Senior Financial Officers (incorporated by reference from Annual Report on Form 10-K filed with the SEC on March 31, 2010)
31.1	Certification of Principal Executive Officer required by Rule 13a-14(a)/15d-14(a) under the Exchange Act
31.2	Certification of Principal Financial Officer required by Rule 13a-14(a)/15d-14(a) under the Exchange Act
32.1	Certification of Principal Executive Officer under 18 U.S.C. Section 1350
32.2	Certification of Principal Financial Officer under 18 U.S.C. Section 1350

63

EXHIBIT INDEX

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this 10-K report to be duly signed on its behalf by the undersigned, thereunto duly authorized, in the City of Fort Lauderdale, State of Florida, on the 27 day of March, 2019.

OPTIMUMBANK HOLDINGS, INC.

/s/ Timothy Terry
Timothy Terry
Principal Executive Officer

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 indicated on March 27, 2019.

Signature	Title
/s/ Timothy Terry Timothy Terry	Principal Executive Officer
/s/ David L. Edgar David L. Edgar	Principal Financial Officer
/s/ H Fai Chan H Fai Chan	Director
/s/ Moishe Gubin Moishe Gubin	Director
/s/ Martin Schmidt Martin Schmidt	Director
/s/ Joel Klein Joel Klein	Director
/s/ Avi M. Zwelling Avi M. Zwelling	Director
/s/ Jeffry Wagner Jeffry Wagner	Director