STATE DEPARTMENT FEDERAL CREDIT UNION

FINANCIAL STATEMENTS

DECEMBER 31, 2017 AND 2016

(With Independent Auditor's Report Thereon)

STATE DEPARTMENT FEDERAL CREDIT UNION

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Independent Auditor's Report

March 27, 2018

To the Supervisory Committee and Board of Directors
of State Department Federal Credit Union

Report on the Financial Statements

We have audited the accompanying financial statements of State Department Federal Credit Union, which comprise the statements of financial condition as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of State Department Federal Credit Union as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Doeren Mayhew

Doeren Mayhew
Miami, FL

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF FINANCIAL CONDITION
AS OF DECEMBER 31, 2017 AND 2016

Assets	**2017**	**2016**
Cash and cash equivalents	$43,214,721	$49,722,767
Certificates of deposit in other financial institutions	250,000	250,000
Investments:		
Available-for-sale	659,721,045	708,668,982
Loans to members, net of allowance for loan losses	1,027,582,189	898,362,397
Accrued interest receivable	4,851,791	4,547,644
Other receivables	33,235,520	31,083,379
Property and equipment	21,778,570	21,366,779
Prepaid and other assets	31,112,842	29,731,708
Institution-owned life insurance	40,987,266	29,936,213
Defined benefit plan	24,393,441	20,820,835
NCUSIF deposit	13,028,275	12,560,645
Total assets	$1,900,155,660	$1,807,051,349
Liabilities and Members' Equity		
Liabilities:		
Members' shares and savings accounts	$1,527,519,647	$1,469,299,381
Borrowings	183,100,339	165,000,000
Accrued expenses and other liabilities	16,477,406	13,589,200
Total liabilities	1,727,097,392	1,647,888,581
Commitments and contingent liabilities		
Members' equity:		
Regular reserve	6,315,918	6,315,918
Undivided earnings	181,587,259	167,524,824
Accumulated other comprehensive loss	(14,844,909)	(14,677,974)
Total members' equity	173,058,268	159,162,768
Total liabilities and members' equity	$1,900,155,660	$1,807,051,349

See accompanying notes to the financial statements.

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Interest income:		
Loans to members	$42,491,434	$37,641,419
Investment securities	10,957,063	9,898,063
Total interest income	53,448,497	47,539,482
Interest expense:		
Members' shares and savings accounts	7,752,560	6,753,621
Borrowings	2,670,830	2,371,620
Total interest expense	10,423,390	9,125,241
Net interest income	43,025,107	38,414,241
Provision for loan losses	3,677,220	1,823,705
Net interest income after provision for loan losses	39,347,887	36,590,536
Non-interest income:		
Fees and charges	2,522,120	2,306,337
Interchange income	5,960,961	5,638,151
Rental income	1,700,720	1,629,999
Other miscellaneous income	3,192,688	3,260,531
Gain on sale of investments	95,869	644,511
Total non-interest income	13,472,358	13,479,529
Non-interest expense:		
Compensation and benefits	18,831,375	17,730,436
Office operations	11,317,206	10,367,316
Office occupancy	2,138,706	2,160,235
Loan servicing	4,319,412	4,293,638
Other	2,151,111	3,700,457
Total non-interest expense	38,757,810	38,252,082
Net income	$14,062,435	$11,817,983

See accompanying notes to the financial statements.

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Net income	$14,062,435	$11,817,983
Other comprehensive income/(loss):		
Net pension gains	2,247,400	2,774,780
Net unrealized holding (losses)/gains on available-for-sale investments	(2,318,466)	987,452
Reclassification adjustment for net investment gains included in net income	(95,869)	(644,511)
Other comprehensive (loss)/income	(166,935)	3,117,721
Comprehensive income	$13,895,500	$14,935,704

See accompanying notes to the financial statements.

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF MEMBERS' EQUITY
YEARS ENDED DECEMBER 31, 2017 AND 2016

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2015	$6,315,918	$155,706,841	($17,795,695)	$144,227,064
Net income	—	11,817,983	—	11,817,983
Other comprehensive income	—	—	3,117,721	3,117,721
Balance, December 31, 2016	6,315,918	167,524,824	(14,677,974)	159,162,768
Net income	—	14,062,435	—	14,062,435
Other comprehensive loss	—	—	(166,935)	(166,935)
Balance, December 31, 2017	$6,315,918	$181,587,259	($14,844,909)	$173,058,268

See accompanying notes to the financial statements.

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Cash flows from operating activities:		
Net income	$14,062,435	$11,817,983
Adjustments to net cash provided from operating activities:		
Provision for loan losses	3,677,220	1,823,705
Depreciation and amortization	2,136,625	2,038,234
Gain on sale of investments	(95,869)	(644,511)
Net amortization and accretion on available-for-sale investments	10,135,119	11,559,720
Changes in assets and liabilities:		
Accrued interest receivable	(304,147)	(318,210)
Other receivables	(2,152,141)	(2,617,751)
Prepaid and other assets	(1,381,134)	600,872
Defined benefit plan	(1,325,206)	(806,545)
Institution-owned life insurance	(1,051,053)	(813,717)
Accrued expenses and other liabilities	2,888,206	2,687,026
Total adjustments	12,527,620	13,508,823
Net cash provided by operating activities	26,590,055	25,326,806

See accompanying notes to the financial statements.

STATE DEPARTMENT FEDERAL CREDIT UNION

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 AND 2016

Cash Flows (Continued)

	2017	2016
Cash flows from investing activities:		
Net change in loans to members	(132,897,012)	(162,941,234)
Proceeds from the sale of loans	—	11,261,404
Proceeds from the sale or maturity of available-for-sale investments	197,903,840	185,861,769
Purchase of available-for-sale investments	(161,409,488)	(144,289,819)
Purchase of institution-owned life insurance	(10,000,000)	—
Increase in NCUSIF deposit	(467,630)	(402,482)
Purchases of property and equipment	(2,548,416)	(1,985,329)
Net cash used in investing activities	(109,418,706)	(112,495,691)
Cash flows from financing activities:		
Net change in members' shares and savings accounts	58,220,266	67,185,191
Proceeds from borrowings	105,000,000	75,000,000
Payments on borrowings	(86,899,661)	(55,000,000)
Net cash provided from financing activities	76,320,605	87,185,191
Net change in cash and cash equivalents	(6,508,046)	16,306
Cash and cash equivalents - beginning	49,722,767	49,706,461
Cash and cash equivalents - ending	$43,214,721	$49,722,767

Supplemental Information

Interest paid	$10,440,373	$8,887,245

See accompanying notes to the financial statements.

Note 1 - Nature of Business and Significant Accounting Policies

<u>Organization</u>

State Department Federal Credit Union (the "Credit Union") is a cooperative association organized in accordance with the provisions of the Federal Credit Union Act for the purpose of promoting thrift among, and creating a source of credit for, its members. Participation in the Credit Union is limited to those individuals who qualify for membership. The field of membership is defined by the Credit Union's Charter and Bylaws.

<u>Use of Estimates</u>

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses for the periods then ended. Actual results could differ from those estimates. Estimates that are particularly susceptible to change include the determination of the allowance for loan losses, the fair value of securities classified as available-for-sale, the fair value of loan servicing assets, the estimate of the defined benefit plan's projected benefit obligation and the determination of fair value accounts evaluated for impairment or disclosure. The significant accounting principles and policies used in the preparation of these financial statements, together with certain related information, are summarized below.

<u>Concentrations of Credit Risk</u>

A significant amount of the Credit Union's business activity is with members who are employees or former employees of the U.S. Department of State who work and/or reside in the Washington, D.C. area. Therefore, the Credit Union may be exposed to credit risk by the economic climate of the overall geographical region in which borrowers reside.

<u>Comprehensive Income</u>

Accounting principles generally require the recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities are reported in a separate component of comprehensive income. Other comprehensive income/(loss) relates to the change in the unrealized gain/loss on available-for-sale securities and unrealized gains and losses from changes in actuarial assumptions and amortization related to the defined benefit pension plan. When available-for-sale securities are sold, the gain or loss realized on the sale is reclassified from accumulated other comprehensive loss to the gain/loss on sale of investment securities reported on the statements of income. Amortization of the unrealized gain or loss related to the defined benefit pension plan are reclassified from accumulated other comprehensive loss to compensation and benefits expense on the statements of income.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in the process of clearing) and interest-bearing deposits in banks with an original maturity of 90 days or less including overnight deposits. Amounts due from banks and corporate credit unions may, at times, exceed federally insured limits.

Certificates of Deposit in Other Financial Institutions

Certificates of deposits in other financial institutions are time deposits with financial institutions with an original maturity in excess of 90 days. These deposits are all 100% insured as no deposit to one individual institution exceeds $250,000.

Investment Securities

Investments are classified as available-for-sale and are measured at fair value as of the statement of financial condition date. Unrealized gains and losses on available-for-sale investments are reported as a separate component of members' equity. Realized gains and losses on disposition, if any, are computed using the specific identification method. Investments are adjusted for the amortization of premiums and accretion of discounts as an adjustment to interest income on investments over the term of the investment.

Unrealized gains and losses on securities available-for-sale are recognized as direct increases or decreases in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment (OTTI) losses, management considers (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 Credit Union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and the costs of securities sold are determined using the specific identification method. No OTTI was recorded during the years ended December 31, 2017 or 2016.

Federal Home Loan Bank (FHLB) Stock

As a member of the FHLB, the Credit Union is required to invest in stock of the FHLB. The FHLB stock is carried at cost and its disposition is restricted. Based on its restricted nature, no ready market exists for this investment and it has no quoted market value. The carrying value of FHLB stock approximates $9,406,000 and $8,545,000 as of December 31, 2017 and 2016, respectively, and is included in prepaid and other assets.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Loans to Members

Loans that the Credit Union has the intent and ability to hold for the foreseeable future are stated at unpaid principal balances, less an allowance for loan losses and net deferred loan origination fees and costs. Loans that the Credit Union has acquired through mergers and acquisitions are stated at fair value. Interest on loans to members is recognized over the terms of the loans and is calculated on principal amounts outstanding.

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

All interest accrued but not collected for loans that are placed on non-accrual 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.

Certain direct loan origination fees and costs are deferred and recognized as an adjustment to interest income over the contractual life of the loans. Other loan origination fees are recognized in income when received and other direct loan origination costs are recognized as a charge to expense when incurred.

Allowance for Loan Losses

The allowance for loan losses (allowance) is an estimate of loan losses inherent in the Credit Union's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Loan losses are charged off against the allowance when the Credit Union determines the loan balance to be uncollectible. Cash received on previously charged-off amounts is recorded as a recovery to the allowance.

The allowance is evaluated on a regular basis by management and is based upon management's periodic assessment 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.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

For purposes of determining the allowance, the Credit Union has segmented certain loans in the portfolio by product type. Loans are divided into the following segments: Consumer, Real Estate and Commercial. The Credit Union further disaggregates the consumer and real estate segments into classes based on the associated risks within those segments. Consumer loans are divided into six classes: Auto, Credit cards, Personal, Moneyline, Share secured and Student. Real estate loans are divided into two classes: First mortgage and Home equity.

The allowance consists of specific, and general components. The specific component covers impaired loans and the specific allowances are established for these loans based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows, the loan's estimated market value, or the estimated fair value of the underlying collateral. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment or class of loans. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment. The Credit Union maintains a separate general valuation allowance for each portfolio segment.

Consumer and Real Estate Segment Allowance Methodology

For consumer and real estate loans not individually evaluated for impairment, the Credit Union determines the allowance on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses existing at the measurement date. Loans are pooled, generally by loan types with similar risk characteristics. As of December 31, 2017 and 2016, the historical loss time frame used for each class was 24 months.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Commercial Segment Allowance Methodology

Commercial loans are specifically reviewed by management for impairment. Based on management's credit quality risk assessment and analysis of leading predictors of losses existing as of the measurement date, loan losses are estimated. These loss estimates are adjusted, as appropriate, based on additional analysis of long-term average loss experience compared to previously forecasted losses, external loss data, or other risks identified from current economic conditions and credit quality trends. For loans where the specific review process resulted in no estimated losses, the credit union utilizes a peer group loss factor to estimate loan losses within the commercial loan portfolio.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral.

Troubled Debt Restructurings

Under certain circumstances, the Credit Union will provide borrowers relief through loan restructurings. A loan restructuring represents a troubled debt restructuring (TDR) if for economic or legal reasons related to the borrower's financial difficulties the Credit Union grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Consumer and Real Estate Credit Quality Indicators

The majority of the Credit Union's consumer and residential loan portfolio comprises secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Credit Union's collections department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts, and actual losses incurred.

The Credit Union evaluates the credit quality of loans in the consumer and real estate loan portfolios based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans are considered to be in a nonperforming status for purposes of credit quality evaluation.

Commercial Credit Quality Indicators

The Credit Union categorizes commercial loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, and current economic trends among other factors. These credit quality indicators are used to assign a risk rating to each individual credit. The risk ratings can be grouped into eight major categories, defined as follows:

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Rating	Description
1	Secured loan with no identified risk.
2	Strongest credit - a strong credit with no existing or known potential weaknesses deserving management's close attention.
3	Average risk - borrower is a reasonable credit risk and demonstrates the ability to repay the debt from normal business operations. Risk factors may include reliability of margins and cash flows, liquidity, dependence on a single product or industry, cyclical trends, depth of management, or limited access to alternative financing sources. Historic financial information may indicate erratic performance, but current trends are positive.
4	Pass but watch - a loan that otherwise meets the definition of a standard or minimum acceptable quality loan, but which requires more than normal attention due to any of the following items: deterioration of borrower financial condition less severe than those warranting more adverse grading, deterioration of repayment ability and/or collateral value, increased leverage, adverse effects from a downturn in the economy, local market or industry, adverse changes in local or regional employer, management changes (including illness, disability, and death), and adverse legal action. Payments are current per the terms of the agreement. If conditions persist or worsen, a more severe risk grade may be warranted.
5	Special mention (weaknesses noted) - a loan that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Credit Union's position at some future date. Special mention loans are not adversely classified and do not expose the Credit Union to sufficient risk to warrant adverse classification.
6	Substandard (probable loss) - a loan that is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well-defined weaknesses include a lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or a project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Credit Union will sustain some loss if the deficiencies are not corrected.
7	Doubtful - a loan that has all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.
8	Loss - Charge-off.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Loan Charge-off Policies

The Credit Union's quality control process includes preparing lists to monitor and track delinquent loans and special mention loans. Tracking the loans on these lists enables management to assess the performance of the loan portfolio and act to mitigate risk therein through necessary changes in policy and procedures. The quality control process also serves as a tool to assist the Credit Union in identifying loans for charge-off on a timely basis. The following is a description of the Credit Union's loan charge-off policies:

Loans are generally charged off when the loan is deemed to be uncollectible. Factors considered when assessing collectability include:

- aging of delinquent non-performing loans;
- estimated deficiency in the value of the underlying collateral for non-performing loans determined to be collateral dependent;
- additional collection efforts are expected to be non-productive;
- classification as loss as the result of either the Credit Union's internal review process or by external examiners.

Mortgage Servicing Rights

Mortgage servicing assets are recognized when rights are acquired through the sale of financial assets. Fair value is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses.

Capitalized servicing rights are reported in other assets and are amortized to non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Service fee income is calculated based on a contractual percentage of the outstanding principal balance of the loans being serviced. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Other Receivables

Included in other receivables is approximately $28,000,000 in ACH receivables related to member payroll direct deposits as of December 31, 2017 and 2016.

Prepaid and Other Assets

Included in prepaid and other assets is approximately $17,000,000 and $16,000,000 in loan balances related to split dollar insurance agreements between the Credit Union and key employees as of December 31, 2017 and 2016, respectively.

Property and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation. Depreciation is computed principally by the straight-line method based upon the useful lives of the related assets. The cost of leased assets and leasehold improvements is amortized using the straight-line method over the term of the lease, or the estimated life of the asset, whichever is less. The Credit Union reviews property and equipment (long-lived assets) for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Maintenance, repairs, and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

NCUSIF Deposit

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each insured credit union in an amount equal to one percent of its insured shares. The deposit would be refunded to the credit union if its insurance coverage is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA Board. The NCUSIF deposit is required to be periodically reviewed for impairment.

Members' Shares and Savings Accounts

Members' shares are the savings deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in annual elections of the Board of Directors. Irrespective of the amount of shares owned, no member has more than one vote.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Members' Shares and Savings Accounts (Continued)

Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' shares and savings accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on members' share accounts are set by the Board of Directors, based on an evaluation of current and future market conditions.

Borrowed Funds

The Credit Union maintained borrowed funds outstanding from the FHLB as of December 31, 2017 and 2016. All borrowings are collateralized by certain securities owned by the Credit Union.

Regular Reserve

The Credit Union is required to maintain a statutory reserve (regular reserve) in accordance with the Federal Credit Union Act. This statutory reserve represents a regulatory restriction and is not available for the payment of interest.

Income Taxes

The Credit Union is exempt from most federal, state, and local taxes under the provisions of the Internal Revenue Code (IRC) and state tax laws. The Income Taxes Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) clarifies accounting for uncertainty in income taxes reported in the financial statements. The interpretation provides criteria for assessment of individual tax positions and a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the "more likely than not" standard for sustainability on examination by tax authorities. Federal credit unions are tax-exempt under IRC sections 501(c)(14)(a) and 501(c)(1)(a)(I). As such, the Credit Union has no uncertain tax positions that qualify for either recognition or disclosure in the financial statements. Additionally, no interest or penalties related to uncertain tax positions have been recorded in the accompanying financial statements.

Reclassification

Certain amounts reported in the 2016 financial statements have been reclassified to conform with the 2017 presentation. Total equity and net income are unchanged due to these reclassifications.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Recent Accounting Pronouncements

Accounting for Financial Instruments - Overall

In January 2016, the FASB issued Accounting Standards Update (ASU) 2016-01, *Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The changes to the current model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The classification and measurement guidance will be effective for non-public business entities in fiscal years beginning after December 15, 2018, or they may early adopt for periods after December 15, 2017. The Credit Union is currently evaluating the impact of this ASU.

Accounting for Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses*. The ASU introduces a new accounting model, the Current Expected Credit Losses (CECL) model, which requires earlier recognition of credit losses. The FASB's CECL model utilizes a lifetime "expected credit loss" measurement objective for the recognition of credit losses for loans, held-to-maturity securities and other receivables at the time the financial asset is originated or acquired. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. For available-for-sale securities where fair value is less than cost, credit-related impairment, if any, will be recognized in an allowance for credit losses and adjusted each period for changes in expected credit risk. This model replaces the multiple existing impairment models, which generally require that a loss be incurred before it is recognized.

The CECL model represents a significant change from existing models, and may result in material changes to the Credit Union's accounting for loans. The Credit Union has not determined the effect this ASU will have on its financial statements and its related disclosures. This ASU will be effective for the Credit Union on December 31, 2021. Early application is permitted for annual periods beginning January 1, 2019.

Lease Accounting

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which is intended to increase transparency and comparability of accounting for lease transactions. The ASU will require lessees to recognize most leases on the balance sheet as lease assets and lease liabilities and will require both quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting is largely unchanged. The guidance is effective December 31, 2020 with an option to early adopt. The Credit Union is evaluating whether to early adopt and the effect this ASU will have on its financial statements, regulatory capital and related disclosures.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Subsequent Events

Management has evaluated subsequent events through March 27, 2018, the date the financial statements were available to be issued. No significant such events or transactions were identified.

Note 2 - Investments

The following table presents the amortized cost and estimated fair value of investments as of December 31, 2017:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Mortgage-backed securities	$551,774,234	$478,981	($7,374,015)	$544,879,200
Small business administration	34,839,653	258,335	(86,551)	35,011,437
Taxable municipal bonds	79,494,593	55,729	(746,343)	78,803,979
Mutual funds	808,241	218,188	—	1,026,429
Total	$666,916,721	$1,011,233	($8,206,909)	$659,721,045

The following table presents the amortized cost and estimated fair value of investments as of December 31, 2016:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Mortgage-backed securities	$605,359,958	$1,475,513	($5,994,142)	$600,841,329
Small business administration	39,346,833	110,117	(84,049)	39,372,901
Taxable municipal bonds	68,162,718	151,341	(662,993)	67,651,066
Mutual funds	580,814	222,872	—	803,686
Total	$713,450,323	$1,959,843	($6,741,184)	$708,668,982

Note 2 - Investment (Continued)

The amortized cost and estimated fair value of debt securities as of December 31, 2017, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale	
	Amortized Cost	**Fair Value**
1 to 5 years	$51,820,020	$51,493,161
5 to 10 years	27,674,573	27,310,818
Mortgage-backed securities	551,774,234	544,879,200
Small business administration	34,839,653	35,011,437
Mutual funds	808,241	1,026,429
Total	$666,916,721	$659,721,045

Information pertaining to investments with gross unrealized losses as of December 31, 2017, aggregated by investment category and length of time that individual investments have been in a continuous loss position follows:

	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Available-for-sale:						
Mortgage-backed securities	$194,317,248	$2,352,433	$264,412,092	$5,021,582	$458,729,340	$7,374,015
Small business administration	19,438,969	86,551	—	—	19,438,969	86,551
Taxable municipal bonds	51,522,296	382,119	13,749,299	364,224	65,271,595	746,343
Total	$265,278,513	$2,821,103	$278,161,391	$5,385,806	$543,439,904	$8,206,909

Note 2 - Investment (Continued)

Information pertaining to investments with gross unrealized losses as of December 31, 2016, aggregated by investment category and length of time that individual investments have been in a continuous loss position follows:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available-for-sale:						
Mortgage-backed securities	$175,997,417	$2,830,321	$260,132,418	$3,163,821	$436,129,835	$5,994,142
Small business administration	12,084,191	32,004	10,427,064	52,045	22,511,255	84,049
Taxable municipal bonds	41,544,580	662,993	—	—	41,544,580	662,993
Total	$229,626,188	$3,525,318	$270,559,482	$3,215,866	$500,185,670	$6,741,184

Unrealized losses on securities issued by the U.S. Government and its Agencies have not been recognized into income because the implicit guarantee of the principal balances of these securities by the U.S. Government and its Agencies. The decline in fair value is primarily due to differences between security yields and market interest rates. Additionally, the decline in fair value is expected to be recovered as securities approach their maturity date and/or market rates decline. Management has the ability and intent to hold these securities through to recovery of fair value, which may be maturity.

Proceeds from the sales of investments classified as available-for-sale approximated $60,483,000 and $49,370,000 during the years ended December 31, 2017 and 2016, respectively. Gross gains of approximately $308,000 and $646,000 were realized from these sales during the years ended December 31, 2017 and 2016, respectively. Gross losses of approximately $212,000 and $1,000 were realized during the years ended December 31, 2017 and 2016, respectively.

Securities with a fair value of approximately $200,072,000 and $186,151,000 have been pledged as collateral to secure advances from the FHLB December 31, 2017 and 2016, respectively.

Note 3 - Loans to Members

The composition of loans to members as of December 31, 2017 and 2016 is as follows:

	2017	2016
Consumer:		
Auto	$211,567,026	$157,497,011
Credit cards	83,166,982	76,320,310
Personal	43,481,181	39,191,721
Moneyline	9,546,600	9,917,109
Share secured	1,164,425	1,293,325
Student	495,323	631,439
	349,421,537	284,850,915
Real Estate:		
First mortgage	579,320,395	525,256,209
Home equity	85,736,868	72,965,927
	665,057,263	598,222,136
Commercial:		
Real estate	15,087,627	17,186,468
	15,087,627	17,186,468
	1,029,566,427	900,259,519
Net deferred fees and costs	2,932,844	1,709,795
	1,032,499,271	901,969,314
Less: Allowance for loan losses	(4,917,082)	(3,606,917)
Loans to members, net	$1,027,582,189	$898,362,397

Note 3 - Loans to Members (Continued)

Allowance for Loan Losses

The following table presents the activity in the allowance and a summary of the allowance by portfolio segment as of and for the year ended December 31, 2017:

	Consumer	Real Estate	Commercial	Total
Allowance for loan losses:				
Beginning allowance	$2,128,567	$1,250,211	$228,139	$3,606,917
Charge-offs	(3,437,655)	(263,452)	(7,697)	(3,708,804)
Recoveries	1,198,763	135,607	7,379	1,341,749
Provision for loan losses	3,611,212	144,401	(78,393)	3,677,220
Ending allowance	$3,500,887	$1,266,767	$149,428	$4,917,082
Ending balance, individually evaluated for impairment	$—	$—	$—	$—
Ending balance, collectively evaluated for impairment	3,500,887	1,266,767	149,428	4,917,082
Ending allowance	$3,500,887	$1,266,767	$149,428	$4,917,082

The following table presents a summary of the recorded investment in loans by portfolio segment as of December 31, 2017:

	Consumer	Real Estate	Commercial	Total
Loans:				
Ending balance, individually evaluated for impairment	$—	$—	$—	$—
Ending balance, collectively evaluated for impairment	353,859,909	663,551,735	15,087,627	1,032,499,271
Total loans	$353,859,909	$663,551,735	$15,087,627	$1,032,499,271

Note 3 - Loans to Members (Continued)

Allowance for Loan Losses

The following table presents the activity in the allowance and a summary of the allowance by portfolio segment as of and for the year ended December 31, 2016:

	Consumer	Real Estate	Commercial	Total
Allowance for loan losses:				
Beginning allowance	$2,026,582	$1,023,877	$293,149	$3,343,608
Charge-offs	(3,030,751)	(58,490)	(27,030)	(3,116,271)
Recoveries	1,272,647	273,363	9,865	1,555,875
Provision for loan losses	1,860,089	11,461	(47,845)	1,823,705
Ending allowance	$2,128,567	$1,250,211	$228,139	$3,606,917
Ending balance, individually evaluated for impairment	$—	$—	$—	$—
Ending balance, collectively evaluated for impairment	2,128,567	1,250,211	228,139	3,606,917
Ending allowance	$2,128,567	$1,250,211	$228,139	$3,606,917

The following table presents a summary of the recorded investment in loans by portfolio segment as of December 31, 2016:

	Consumer	Real Estate	Commercial	Total
Loans:				
Ending balance, individually evaluated for impairment	$—	$—	$—	$—
Ending balance, collectively evaluated for impairment	287,839,279	596,943,567	17,186,468	901,969,314
Total loans	$287,839,279	$596,943,567	$17,186,468	$901,969,314

Note 3 - Loans to Members (Continued)

Age Analysis of Past Due Loans

The following table presents the aging of the recorded investment in past due loans and loans on non-accrual as of December 31, 2017:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans
Consumer:						
Auto	$2,432,541	$456,504	$683,051	$3,572,096	$212,433,302	$216,005,398
Credit cards	378,444	185,095	541,505	1,105,044	82,061,938	83,166,982
Personal	413,953	176,117	398,859	988,929	42,492,252	43,481,181
Moneyline	100,342	66,632	86,896	253,870	9,292,730	9,546,600
Share secured	—	—	2,711	2,711	1,161,714	1,164,425
Student	—	—	33,785	33,785	461,538	495,323
	3,325,280	884,348	1,746,807	5,956,435	347,903,474	353,859,909
Real Estate:						
First mortgage	3,348,417	923,448	1,754,811	6,026,676	571,788,191	577,814,867
Home equity	589,544	359,507	460,641	1,409,692	84,327,176	85,736,868
	3,937,961	1,282,955	2,215,452	7,436,368	656,115,367	663,551,735
Commercial:						
Real estate	—	—	—	—	15,087,627	15,087,627
	—	—	—	—	15,087,627	15,087,627
Total	$7,263,241	$2,167,303	$3,962,259	$13,392,803	$1,019,106,468	$1,032,499,271

Loans on which the accrual of interest has been discontinued or reduced approximated $3,962,000 as of December 31, 2017. There were no loans 90 days or more past due and still accruing interest as of December 31, 2017.

Note 3 - Loans to Members (Continued)

Age Analysis of Past Due Loans (Continued)

The following table presents the aging of the recorded investment in past due loans and loans on non-accrual as of December 31, 2016:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans
Consumer:						
Auto	$2,115,240	$469,951	$424,470	$3,009,661	$157,475,714	$160,485,375
Credit cards	560,360	152,724	278,741	991,825	75,328,485	76,320,310
Personal	458,108	87,549	196,417	742,074	38,449,647	39,191,721
Moneyline	154,157	39,718	66,387	260,262	9,656,847	9,917,109
Share secured	88	27	—	115	1,293,210	1,293,325
Student	49,549	—	—	49,549	581,890	631,439
	3,337,502	749,969	966,015	5,053,486	282,785,793	287,839,279
Real Estate:						
First mortgage	3,022,319	713,189	1,237,544	4,973,052	519,004,588	523,977,640
Home equity	627,860	464,881	32,965	1,125,706	71,840,221	72,965,927
	3,650,179	1,178,070	1,270,509	6,098,758	590,844,809	596,943,567
Commercial:						
Real estate	—	—	—	—	17,186,468	17,186,468
	—	—	—	—	17,186,468	17,186,468
Total	$6,987,681	$1,928,039	$2,236,524	$11,152,244	$890,817,070	$901,969,314

Loans on which the accrual of interest has been discontinued or reduced approximated $2,237,000 as of December 31, 2016. There were no loans 90 days or more past due and still accruing interest as of December 31, 2016.

Note 3 - Loans to Members (Continued)

Consumer and Real Estate Credit Quality

The Credit Union considers the performance of the loan portfolio and its impact on the allowance for loan losses. For real estate and consumer loan classes, the Credit Union evaluates credit quality based on the aging status of the loan and payment activity. Accordingly, nonaccrual loans are considered to be in a nonperforming status for purposes of credit quality evaluation.

The following tables present the recorded investment based on performance indication as of December 31, 2017 and 2016:

	As of December 31, 2017		As of December 31, 2016	
	Performing Loans	**Nonperforming Loans**	**Performing Loans**	**Nonperforming Loans**
Consumer:				
Auto	$215,322,347	$683,051	$160,060,905	$424,470
Credit cards	82,625,477	541,505	76,041,569	278,741
Personal	43,082,322	398,859	38,995,304	196,417
Moneyline	9,459,704	86,896	9,850,722	66,387
Share secured	1,161,714	2,711	1,293,325	—
Student	461,538	33,785	631,439	—
	352,113,102	1,746,807	286,873,264	966,015
Real Estate:				
First mortgage	576,060,056	1,754,811	522,740,096	1,237,544
Home equity	85,276,227	460,641	72,932,962	32,965
	661,336,283	2,215,452	595,673,058	1,270,509
Total	$1,013,449,385	$3,962,259	$882,546,322	$2,236,524

Note 3 - Loans to Members (Continued)

Commercial Credit Quality

The Credit Union considers the performance of the loan portfolio and its impact on the allowance for loan losses. For commercial loan classes, the Credit Union evaluates credit quality based on risk ratings assign to each loan as described in Note 1.

The following table presents the recorded investments based on risk rating as of December 31, 2017:

Risk Rating		Real Estate
1	Secured loan with no risk	$—
2	Strongest credit	—
3	Average risk	13,935,534
4	Pass, but watch	1,152,093
5	Special mention	—
6	Substandard	—
7	Doubtful	—
8	Loss	—
	Total	$15,087,627

The following table presents the recorded investments based on risk rating as of December 31, 2016:

Risk Rating		Real Estate
1	Secured loan with no risk	$—
2	Strongest credit	—
3	Average risk	16,008,092
4	Pass, but watch	1,178,376
5	Special mention	—
6	Substandard	—
7	Doubtful	—
8	Loss	—
	Total	$17,186,468

Note 4 - Property and Equipment

Property and equipment is carried at cost, less accumulated depreciation and amortization, and is summarized as of December 31, 2017 and 2016 by major classification as follows:

	2017	2016
Land	$3,476,686	$3,476,686
Buildings	23,762,419	23,652,419
Furniture and equipment	3,494,203	3,294,461
Data processing equipment	12,088,997	12,169,773
Leasehold improvements	1,447,737	1,407,151
Leased assets	110,340	110,340
Construction-in-process	2,253,545	718,054
	46,633,927	44,828,884
Less accumulated depreciation and amortization	(24,855,357)	(23,462,105)
	$21,778,570	$21,366,779

Note 5 - Members' Shares and Savings Accounts

Members' shares and savings accounts are summarized as follows as of December 31, 2017 and 2016:

	2017	2016
Share accounts	$296,328,512	$284,609,011
Share draft accounts	324,433,152	311,539,314
Money market accounts	588,856,050	569,985,195
Individual retirement accounts	32,673,440	34,121,903
Share and IRA certificates	285,228,493	269,043,958
	$1,527,519,647	$1,469,299,381

Note 5 - Members' Shares and Savings Accounts (Continued)

As of December 31, 2017, scheduled maturities of share and IRA certificates are as follows:

	2017
Within one year	$158,357,858
1 to 2 years	62,294,950
2 to 3 years	23,481,071
3 to 4 years	22,725,234
4 to 5 years	18,369,380
	$285,228,493

The aggregate amount of members' time deposit accounts in denominations of $250,000 or more as of December 31, 2017 was approximately $39,980,000.

Note 6 - Borrowed Funds

FHLB Atlanta

The Credit Union is a member of the FHLB of Atlanta. As of December 31, 2017, the Credit Union had access to a pre-approved secured line of credit with the capacity to borrow up to a certain percentage of the value of its qualified collateral, as defined in the FHLB Statement of Credit Policy. As of December 31, 2017, the unused credit available under this line-of-credit agreement was approximately $287,487,000. In order to access the unused portion of the line of credit, the Credit Union would need to pledge additional qualifying collateral in accordance with the terms of the agreement.

M&T Bank

As of December 31, 2017, the Credit Union maintained a $15,000,000 unused secure line of credit with M&T Bank. In order to access the unused portion of the line of credit, the Credit Union would need to pledge qualifying collateral in accordance with the terms of the agreement.

Federal Reserve Discount Window

As of December 31, 2017, the Credit Union has appropriate agreements on file to access liquidity from the Federal Reserve Discount Window. In order to access the borrowings, the Credit Union would need to pledge qualifying collateral in accordance with the terms of the agreement.

Note 6 - Borrowed Funds (Continued)

Federal Home Loan Bank

The Credit Union maintained outstanding borrowings from the Federal Home Loan Bank of Atlanta (FHLB). These borrowings are collateralized by certain securities owned by the Credit Union. The borrowings outstanding as of December 31, 2017 and 2016 are as follows:

Interest Type	Interest Rate	Final Maturity Date	Payment Type	2017	2016
Fixed Credit	0.544%	January 3, 2017	Monthly	$—	$20,000,000
Fixed Credit	0.660%	January 5, 2017	Monthly	—	15,000,000
Fixed Credit	0.700%	March 14, 2017	Monthly	—	15,000,000
Fixed Hybrid	1.085%	December 14, 2017	Quarterly	—	30,000,000
Fixed Credit	1.300%	January 31, 2018	Monthly	20,000,000	—
Fixed Credit	1.440%	February 14, 2018	Monthly	15,000,000	—
Fixed Credit	1.376%	December 5, 2018	Monthly	20,000,000	—
PRC Hybrid	0.975%	February 26, 2019	Monthly	10,049,767	15,000,000
Fixed Credit	2.028%	December 18, 2019	Monthly	30,000,000	—
Fixed Credit	2.059%	December 19, 2019	Monthly	20,000,000	—
PRC Hybrid	1.263%	February 26, 2021	Monthly	8,050,572	10,000,000
Fixed Hybrid	2.509%	July 15, 2021	Quarterly	30,000,000	30,000,000
Fixed Hybrid	2.497%	July 21, 2021	Quarterly	30,000,000	30,000,000
				$183,100,339	$165,000,000

The outstanding balances by maturity dates as of December 31, 2017 are as follows:

	2017
Within 1 year	$55,000,000
1 to 2 years	60,049,767
2 to 3 years	—
3 to 4 years	68,050,572
	$183,100,339

Note 7 - Commitments and Contingent Liabilities

Off Balance-Sheet Risk

The Credit Union is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its members and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the statements of financial condition.

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments may expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2017, the total unfunded commitments under such lines of credit was approximately $432,771,000. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if any, is based on management's credit evaluation of the member.

Note 8 - Regulatory Capital

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. 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 Credit Union's financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance-sheet items as calculated under generally accepted accounting practices. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth (as defined in *NCUA Regulations*) to total assets (as defined in *NCUA Regulations*). Credit unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR) which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNWR as of December 31, 2017 and 2016 was 6.06% and 5.85% respectively. The minimum requirement to be considered complex under the regulatory framework is 6.00%. Management believes, as of December 31, 2017 and 2016, that the Credit Union meets all capital adequacy requirements to which it is subject.

Note 8 - Regulatory Capital (Continued)

As of December 31, 2017, the most recent call reporting period, the NCUA categorized the Credit Union as *"well capitalized"* under the regulatory framework for prompt corrective action. To be categorized as *"well capitalized"* the Credit Union must maintain a minimum net worth ratio of 7.00% of assets. There are no conditions or events since that notification that management believes have changed the Credit Union's category.

The Credit Union's actual and required net worth amounts and ratios are as follows:

	As of December 31, 2017		As of December 31, 2016	
	Amount	**Ratio/ Requirement**	**Amount**	**Ratio/ Requirement**
Actual net worth	$187,903,177	9.89%	$173,840,742	9.62%
Amount needed to be classified as "adequately capitalized"	$114,009,340	6.00%	$108,423,081	6.00%
Amount needed to meet RBNWR	$115,149,433	6.06%	$105,712,504	5.85%
Amount needed to be classified as "well capitalized"	$133,010,896	7.00%	$126,493,594	7.00%

Because the RBNWR is less than the net worth ratio, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the quarter end option, as permitted by regulation.

Note 9 - Fair Value Measurements

Accounting standards establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under this guidance are described below.

Basis of Fair Value Measurements

Level 1 - Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Note 9 - Fair Value Measurements (Continued)

Level 2 - Valuation is based on inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is generated from model-based techniques use at least one significant assumption not observable in the market. Level 3 assets and liabilities include financial instruments whose value is determined by using pricing models, discounted cash flow methodologies, or similar techniques.

Assets Measured at Fair Value on a Recurring Basis

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

	Assets at Fair Value as of December 31, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Available-for-sale:				
Mortgage-backed securities	$—	$544,879,200	$—	$544,879,200
Small business administration	—	35,011,437	—	35,011,437
Taxable municipal bonds	—	78,803,979	—	78,803,979
Mutual funds	—	1,026,429	—	1,026,429
	$—	$659,721,045	$—	$659,721,045

	Assets at Fair Value as of December 31, 2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Available-for-sale:				
Mortgage-backed securities	$—	$600,841,329	$—	$600,841,329
Small business administration	—	39,372,901	—	39,372,901
Taxable municipal bonds	—	67,651,066	—	67,651,066
Mutual funds	—	803,686	—	803,686
	$—	$708,668,982	$—	$708,668,982

Note 10 - Loan Servicing

Mortgage loans serviced for others are not included in the accompanying statements of financial condition. The unpaid principal balances of these loans and the related custodial escrow balances approximate the following as of December 31, 2017 and 2016:

	2017	2016
Mortgage loan portfolio serviced for:		
Federal National Mortgage Association (FNMA)	$149,713,000	$173,652,000
Custodial escrow balances	$1,064,000	$1,112,000

The following table presents mortgage servicing rights activity and fair value as of and for the years ended December 31, 2017 and 2016:

	2017	2016
Mortgage servicing rights:		
Balance, beginning of year	$1,865,585	$2,385,043
Capitalization	—	109,879
Amortization	(447,408)	(629,337)
	1,418,177	1,865,585
Market value adjustment	—	—
Balance, end of year	$1,418,177	$1,865,585

	2017	2016
Fair value of mortgage servicing rights	$1,419,000	$1,866,000

As of December 31, 2017 and 2016, the fair value of mortgage servicing rights was determined by an internal valuation model using market value discount rates based on the specific characteristics of each pool of loans. The fair value of servicing rights was determined using average discount rates ranging from 2.5% to 5.0% as of December 31, 2017 and 2016 and prepayment speed ranging from 7.0% to 18.1% as of December 31, 2017 and from 7.0% to 23.5% as of December 31, 2016.

Note 11 - Employee Benefits

401(k) Retirement Plan

Credit Union employees who are at least 20 years old and have completed at least one month of service at the Credit Union are eligible to join a 401(k) retirement plan the first of the month following satisfaction of eligibility requirements. The Credit Union contributes a 3% safe-harbor contribution as well a matching contribution equal to 100% of employee deferral contribution up to a maximum of 3%. Employees are eligible for employer contributions upon joining the plan. Employees are immediately vested in the Credit Union's safe-harbor contributions, while the matching contributions vest 20% annually and are fully vested after 5 years of qualifying service. The total expense related to the Credit Union's 401(k) plan contributions was approximately $997,000 and $814,000 for the years ended December 31, 2017 and 2016, respectively.

Split Dollar Life Insurance

The Credit Union entered into a split dollar insurance agreement which is a collateral assignment arrangement between the Credit Union and key employees. The agreement involves a method of paying for insurance coverage for the executives by splitting the elements of a life insurance policy. Under the agreement, the executives are the owner of the policies and make a collateral assignment to the Credit Union in return for a loan equal to the amount of premiums to be paid on behalf of the executives plus accrued interest at a specific rate. At the time of death, the Credit Union will be paid the loan amount plus accrued interest and the balance of the insurance benefits will be paid to the executives' designated beneficiaries. The loan balance under this agreement approximated $17,000,000 and $16,000,000 as of December 31, 2017 and 2016, respectively.

Institution-Owned Life Insurance

The Credit Union has purchased a series of Credit Union owned life insurance policies intended to help fund employee benefit costs and provide insurance benefits to the related employees. The policies carry a minimum guaranteed interest rate that could increase in a rising interest rate environment, or strong equity market performance. NCUA Regulation §701.19 permits the investment in otherwise impermissible investments (assets) if the Credit Union can support that the investment is directly related to its obligation under an employee benefit plan obligation and only intends to hold the investment for as long as it has an actual or potential obligation under the employee benefit plan. The assets are carried at the cash surrender value of the policies which approximated $41,000,000 and $30,000,000 as of December 31, 2017 and 2016, respectively.

Note 11 - Employee Benefits (Continued)

Defined Benefit Plan

The Credit Union sponsors a defined benefit pension plan that covers substantially all eligible employees. The Plan was frozen effective August 1, 2006. As a result, participants will not accrue any further benefits based on service or changes in compensation occurring after the effective date of the election to freeze the plan and participants are 100% vested in the frozen benefit accruals.

The following sets forth the funded status of the plan included in the accompanying statements of financial condition and other key information as of December 31, 2017 and 2016:

	2017	2016
Net pension asset:		
Market value of assets	$63,041,251	$56,242,944
Projected benefit obligation	(38,647,810)	(35,422,111)
Funded status	$24,393,441	$20,820,833

	2017	2016
Accumulated benefit obligation	($38,647,810)	($35,422,111)

	2017	2016
Components of net periodic pension credit:		
Interest cost	$1,411,060	$1,495,072
Expected return on plan assets	(3,339,708)	(3,189,224)
Amortization of unrecognized net loss	603,440	887,608
Net periodic pension credit	($1,325,208)	($806,544)

	2017	2016
Recognized in accumulated other comprehensive loss:		
Unrecognized net gain	$7,649,233	$9,896,633
Unrecognized prior service cost	—	—
	$7,649,233	$9,896,633

Note 11 - Employee Benefits (Continued)

Defined Benefit Plan (Continued)

The assumptions used to develop the net period pension cost for the year ended December 31, 2017 and 2016 were as follows:

	2017	**2016**
Discount rate	4.05%	4.24%
Expected long-term rate of return on plan assets	n/a - frozen	n/a - frozen
Weighted-average rate of compensation increases	6.00%	6.00%
Amortization method	Straight-Line	Straight-Line

The assumptions used to develop the periodic benefit obligation as of December 31, 2017 and 2016 were as follows:

	2017	**2016**
Discount rate	3.52%	4.05%
Weighted-average rate of compensation increases	n/a - frozen	n/a - frozen

The discount rate is determined annually by Credit Union management based on historical data provided by its actuary.

The long-term rate of return on assets is determined by applying historical average investment returns from published indexes relating to the current allocation of assets in the portfolio.

Plan assets are invested in a broadly diversified combination of equity and bond commingled trust index funds, each with its own investment objectives, investment strategy and risks. The Plan Sponsor retains discretion to determine the appropriate strategic asset allocation versus plan liabilities, as governed by the Plan's Statement of Investment Policy.

The long-term investment objectives are to maintain plan assets at a level that will sufficiently cover long-term obligations and to generate a return on plan assets that will meet or exceed the rate at which long-term obligations will grow. A broadly diversified combination of equity and fixed income portfolios and various risk management techniques are used to help achieve these objectives. In addition, consideration is paid to each Plan's funding levels and the Plan Sponsor's risk tolerance when determining the overall asset allocation. Asset rebalancing normally occurs when the equity and fixed income allocations vary by more than 10% from their respective targets.

Note 11 - Employee Benefits (Continued)

Defined Benefit Plan (Continued)

The following table sets forth the expected benefit payments as of December 31, 2017:

Year ending December 31,	Amount
2018	$1,305,916
2019	$1,332,718
2020	$1,401,156
2021	$1,435,443
2022	$1,465,062
Five years Thereafter	$8,474,872

The Credit Union has not determined the amount of contribution, if any, to be contributed for the plan year beginning January 1, 2018.

The Credit Union's weighted-average asset allocations as of December 31, 2017 and 2016 by asset category are as follows:

	2017	2016
Asset category:		
Common/collective trust – equity	61.2%	57.5%
Common/collective trust – fixed income	32.1%	34.7%
Mutual funds – fixed income	5.8%	6.5%
Cash equivalents	0.9%	1.3%
	100.0%	100.0%

The fair value of the Credit Union's pension plan assets by asset class are as follows: (the three levels of input used to measure fair value are more fully described in Note 9: Fair Value Measurements):

	Assets at Fair Value as of December 31, 2017			
	Level 1	Level 2	Level 3	Total
Common/collective trust:				
equity	$—	$38,555,665	$—	$38,555,665
fixed income	—	20,223,258	—	20,223,258
Mutual funds – fixed income	3,647,148	—	—	3,647,148
Cash equivalents	615,180	—	—	615,180
	$4,262,328	$58,778,923	$—	$63,041,251

Note 11 - Employee Benefits (Continued)

Defined Benefit Plan (Continued)

	Assets at Fair Value as of December 31, 2016			
	Level 1	Level 2	Level 3	Total
Common/collective trust:				
equity	$—	$32,352,572	$—	$32,352,572
fixed income	—	19,493,404	—	19,493,404
Mutual funds – fixed income	3,640,790	—	—	3,640,790
Cash equivalents	756,178	—	—	756,178
	$4,396,968	$51,845,976	$—	$56,242,944

Note 12 - Changes in Accumulated Other Comprehensive Loss

	For the years ended December 31, 2017 and 2016		
	Unrealized Gains/(Losses) on Available-for-Sale Investments	Defined Benefit Plan Items	Total
Balance, December 31, 2015	($5,124,282)	($12,671,413)	($17,795,695)
Other comprehensive income before reclassifications	987,452	2,774,780	3,762,232
Amounts reclassified from other comprehensive loss	(644,511)	—	(644,511)
Net other comprehensive income	342,941	2,774,780	3,117,721
Balance, December 31, 2016	(4,781,341)	(9,896,633)	(14,677,974)
Other comprehensive (Loss)/income before reclassifications	(2,318,466)	2,247,400	(71,066)
Amounts reclassified from other comprehensive income	(95,869)	—	(95,869)
Net other comprehensive (loss)/income	(2,414,335)	2,247,400	(166,935)
Balance, December 31, 2017	($7,195,676)	($7,649,233)	($14,844,909)

Note 12 - Changes in Accumulated Other Comprehensive Loss (Continued)

When available-for-sale investments are sold, the gain or loss realized on the sale is reclassified from accumulated other comprehensive income to the gain/(loss) on sale of available-for-sale investments reported on the statements of income. Amortization of the unrealized loss related to the defined benefit pension plan is reclassified from accumulated other comprehensive loss to compensation and benefits expense on the statements of income.

* * * End of Notes * * *