Northrop Grumman Federal Credit Union and Subsidiary

Consolidated Financial Statements

December 31, 2013 and 2012

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Supervisory Committee
Northrop Grumman Federal Credit Union

We have audited the accompanying consolidated financial statements of Northrop Grumman Federal Credit Union (the credit union) and subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2013 and 2012, the consolidated statements of income, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 the consolidated 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 consolidated 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 consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the credit union's preparation and fair presentation of the consolidated 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 credit union'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northrop Grumman Federal Credit Union and subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Turner, Warren, Hwang + Conrad

Burbank, California
March 12, 2014

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
Cash and cash equivalents	$ 118,307,342	$ 52,713,695
Investments:		
Securities available for sale	367,931,914	411,218,715
Other	250,000	250,000
Loans to members	397,281,514	427,469,377
Accrued interest receivable	2,383,055	3,006,221
Property and equipment	6,594,464	6,955,626
National Credit Union Share Insurance Fund (NCUSIF) deposit	7,764,285	7,521,621
Other assets	6,368,023	6,086,651
Total assets	$ 906,880,597	$ 915,221,906
LIABILITIES AND MEMBERS' EQUITY		
Liabilities:		
Members' share accounts	$ 820,970,893	$ 797,994,945
Accrued expenses and other liabilities	5,969,026	6,069,417
Borrowed funds	-	4,000,000
Total liabilities	826,939,919	808,064,362
Members' equity:		
Regular reserve	3,559,687	3,559,687
Undivided earnings	104,194,166	99,145,938
Accumulated other comprehensive income (loss)	(27,813,175)	4,451,919
Total members' equity	79,940,678	107,157,544
Total liabilities and members' equity	$ 906,880,597	$ 915,221,906

The accompanying notes are an integral part of these consolidated financial statements.

Northrop Grumman Federal Credit Union and Subsidiary

Consolidated Statements of Income

Years Ended December 31, 2013 and 2012

	2013	2012
INTEREST INCOME		
Loans to members	$ 20,076,524	$ 20,104,454
Investments and interest-bearing accounts	8,999,583	8,771,788
Total interest income	29,076,107	28,876,242
INTEREST EXPENSE		
Members' share accounts	5,411,583	6,077,837
Borrowed funds	123,889	309,391
Total interest expense	5,535,472	6,387,228
NET INTEREST INCOME	23,540,635	22,489,014
PROVISION (CREDIT) FOR LOAN LOSSES	(487,014)	1,614,525
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	24,027,649	20,874,489
NON-INTEREST INCOME		
Fees and charges	2,174,402	2,248,651
Other-than-temporary impairment (OTTI) losses on securities available for sale:		
Total OTTI losses	(112,303)	(776,158)
Less portion of OTTI losses recognized in other comprehensive income	6,377	546,523
Net impairment losses recognized in earnings	(105,926)	(229,635)
Net realized gain on sale of securities available for sale	(651,551)	1,325,677
Loss on sale of loans	(3,073,221)	-
Other income	2,699,591	2,580,670
Total non-interest income	1,043,295	5,925,363
NON-INTEREST EXPENSE		
Compensation and benefits	9,200,792	8,311,715
Operations	8,761,746	8,361,434
Occupancy	1,439,035	1,449,000
NCUSIF premium assessment	621,143	714,554
Total non-interest expense	20,022,716	18,836,703
NET INCOME	$ 5,048,228	$ 7,963,149

The accompanying notes are an integral part of these consolidated financial statements.

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
NET INCOME	$ 5,048,228	$ 7,963,149
OTHER COMPREHENSIVE INCOME (LOSS)		
Net change in unrealized gains (losses) on securities available for sale	(33,022,571)	3,019,802
Less: reclassification adjustment for net (gain) loss recognized in net income	757,477	(1,096,042)
Other comprehensive income (loss)	(32,265,094)	1,923,760
COMPREHENSIVE INCOME (LOSS)	$ (27,216,866)	$ 9,886,909

The accompanying notes are an integral part of these consolidated financial statements.

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY

YEARS ENDED DECEMBER 31, 2013 AND 2012

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2011	$ 3,559,687	$ 91,182,789	$ 2,528,159	$ 97,270,635
Comprehensive income:				
Net income	-	7,963,149	-	7,963,149
Other comprehensive income	-	-	1,923,760	1,923,760
Total comprehensive income				9,886,909
Balance, December 31, 2012	3,559,687	99,145,938	4,451,919	107,157,544
Comprehensive loss:				
Net income	-	5,048,228	-	5,048,228
Other comprehensive loss	-	-	(32,265,094)	(32,265,094)
Total comprehensive loss				(27,216,866)
Balance, December 31, 2013	$ 3,559,687	$ 104,194,166	$ (27,813,175)	$ 79,940,678

The accompanying notes are an integral part of these consolidated financial statements.

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 5,048,228	$ 7,963,149
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,069,435	1,086,147
Provision (credit) for loan losses	(487,014)	1,614,525
Amortization of investments, net	5,829,570	16,052,053
Amortization of deferred loan origination costs, net	215,606	208,945
OTTI losses recognized on securities available for sale	105,926	229,635
Net (gain) loss on sale of securities available for sale	651,551	(1,325,677)
Capitalization of mortgage servicing rights	(636,692)	-
Loss on sale of loans	3,073,221	-
Net change in:		
Accrued interest receivable	623,166	(82,936)
NCUSIF deposit	(242,664)	(284,270)
Other assets	355,320	(3,842,300)
Accrued expenses and other liabilities	(100,391)	(91,619)
Net cash provided by operating activities	15,505,262	21,527,652
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available for sale	(203,020,668)	(423,415,547)
Proceeds from sales, maturities and principal payments received on securities available for sale	207,455,328	362,541,686
Net decrease in other investments	-	5,000,000
Net increase in loans to members	(40,881,638)	(8,977,383)
Purchases of property and equipment	(708,273)	(773,369)
Proceeds from sale of loans	68,267,688	-
Net cash provided by (used in) investing activities	31,112,437	(65,624,613)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share accounts	22,975,948	30,228,097
Net decrease in borrowed funds	(4,000,000)	(4,000,000)
Net cash provided by financing activities	18,975,948	26,228,097
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	65,593,647	(17,868,864)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	52,713,695	70,582,559
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 118,307,342	$ 52,713,695
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Dividends paid on member's share accounts	$ 5,459,666	$ 6,137,294
Interest paid on borrowed funds	123,889	309,391

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business: Northrop Grumman Federal Credit Union (the credit union) is a cooperative association holding a corporate charter under the provisions of the Federal Credit Union Act. The credit union provides a variety of financial services to its members. Participation in the credit union is limited to those individuals who qualify for membership as defined in its charter and bylaws. The credit union's primary deposit products are share accounts, and its primary lending products are real estate, automobile and unsecured loans.

The credit union's wholly owned subsidiary, Flight Plan Financial Services, Inc., provides insurance and investment services for members.

Field of Membership and Sponsor: Participation in the credit union is limited to those individuals who qualify for membership as defined in its charter and bylaws. The primary field of membership of the credit union is employees and former employees of Northrop Grumman Corporation.

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Northrop Grumman Federal Credit Union and its wholly owned subsidiary, Flight Plan Financial Services, Inc. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

Fair Value: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, provides a framework for measuring fair value that requires an entity to determine fair value based on the exit price in the principal market for the asset or liability being measured. Fair value is defined as the exchange price that would be received on the measurement date to sell an asset or the price paid to transfer a liability in the principal or most advantageous market available to the entity in an orderly transaction between market participants. The guidance also establishes a three-level fair value hierarchy that describes the inputs that are used to measure assets and liabilities.

- Level 1 asset and liability fair values are based on quoted prices in active markets for identical assets and liabilities.
- Level 2 asset and liability fair values are based on observable inputs that include: quoted market prices for similar assets or liabilities; quoted market prices that are not in an active market; or other inputs that are observable in the market and can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 assets and liabilities are financial instruments whose value is calculated by the use of pricing models and/or discounted cash flow methodologies, as well as financial instruments for which the determination of fair value requires significant management judgment or estimation.

A summary of the credit union's financial instruments and other accounts subject to fair value measurement and/or disclosure is presented in Note 14.

Cash and Cash Equivalents: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand and in financial institutions and all highly liquid debt instruments with original maturities of three months or less.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments: Investments that the credit union intends to hold for an indefinite period of time, but not necessarily to maturity, are classified as "available for sale" and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and determined using the specific-identification method.

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 individual securities available for sale below their cost that are deemed to be other than temporary are reflected to (1) credit losses, which are reflected in earnings as realized losses, and (2) noncredit losses, which are recorded in other comprehensive income. In determining whether OTTI exists, management considers many factors, including (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, (3) the current liquidity and volatility of the market for each of the individual security categories, (4) the projected cash flows from the specific security type, (5) the financial guarantee and financial rating of the issuer, and (6) the intent and ability of the credit union to retain its investments 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.

Other investments are classified separately and stated at cost.

Loans to Members: The credit union grants mortgage and consumer loans to members. A substantial portion of the loan portfolio is represented by automobile and mortgage loans to members. Members' ability to honor their loan agreements is dependent upon the economic stability of the various groups comprising the credit union's field of membership.

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 costs. Interest on loans is recognized over the term of the loan and calculated using the simple-interest method on principal amounts outstanding.

The accrual of interest on loans is discontinued at the time the loan is 60 days delinquent. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if management believes, after considering economic conditions, business conditions and collection efforts, that 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 the associated loans qualify 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 loan fees and direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans, adjusted for estimated prepayments based on the credit union's historical prepayment experience.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Troubled Debt Restructurings (TDRs): In situations where, for economic or legal reasons related to a member's financial difficulties, the credit union grants a concession for other than an insignificant period of time to the member that the credit union would not otherwise consider, the related loan is classified as a TDR. The credit union strives to identify members in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the credit union grants the member new terms that provide for a reduction of interest or principal, the credit union measures any impairment on the restructuring using the methodology for individually impaired loans. Loans classified as TDRs are reported as impaired loans.

Allowance for Loan Losses: The credit union maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on ongoing monthly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and decreased by charge-offs when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Management develops and documents its systematic methodology for determining the allowance for loan losses by first dividing its portfolio into two segments: residential real estate and consumer. The credit union further divides the portfolio segments into classes based on initial measurement attributes, risk characteristics or its method of monitoring and assessing credit risk. The classes within the residential real estate portfolio segment are first mortgage and home equity line of credit (HELOC) and other mortgage. The classes within the consumer portfolio segment are automobile, credit cards, and other consumer.

The allowance for loan losses consists of the specific loan loss allowance for impaired loans and the general loan loss allowance. The credit union evaluates the residential real estate and consumer segments for impairment on a pooled basis, unless they represent TDRs, as part of the general loan loss allowance. Impaired loans are subject to the specific loan loss allowance. Loans are considered impaired when the individual evaluation of current information regarding the borrower's financial condition, loan collateral and cash flows indicates that the credit union will be unable to collect all amounts due according to the contractual terms of the loan agreement, including interest payments. Impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or, as an expedient, at the loan's observable market price or the fair value of the collateral, less costs to sell, if the loan is collateral dependent.

A general loan loss allowance is provided on loans not specifically identified as impaired. The allowance is determined by pooling residential real estate and consumer loans by portfolio class and applying a historical loss percentage to each class. The credit union's historical loss percentage may be adjusted for significant qualitative and environmental factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. The conditions evaluated for qualitative and environmental factors may include existing general economic and business conditions affecting the key lending areas and products of the credit union, credit quality trends and risk identification, collateral values, loan volumes, underwriting standards and concentrations, specific industry conditions within portfolio segments, recent loss experience in particular classes of the portfolio, and duration of the current business cycle.

In estimating the allowance for loan losses, significant risk characteristics considered for the residential real estate segments are historical and expected future charge-offs, borrower's credit, and property collateral.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Other Real Estate Owned: Real estate properties acquired through or in lieu of loan foreclosure are held for sale and initially recorded at fair value less estimated selling cost at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

Transfers of Financial Assets: Transfers of financial assets 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 credit union, (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 credit union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Property and Equipment: Land is carried at cost. Building and improvements, furniture and equipment, data processing equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Furniture and equipment and data processing equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the terms of the related leases.

NCUSIF Deposit: The deposit in the 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 1% of its insured shares. The deposit would be refunded to the credit union if its insurance coverage is terminated, it converts insurance coverage to another source, or the operations of the fund are transferred from the NCUA Board.

NCUSIF Insurance Premium: The credit union is required to pay an annual insurance premium based on a percentage of its total insured shares as declared by the NCUA Board, unless the payment is waived by the Board. See Note 16 for the NCUA's special insurance premium assessments.

Members' Share Accounts: Members' share accounts are the savings deposit accounts of the owners of the credit union. Share ownership entitles the members to vote in the annual elections of the Board of Directors and on other corporate matters. Irrespective of the amount of shares owned, no member has more than one vote. Members' share accounts are subordinated to all other liabilities of the credit union upon liquidation.

Dividends on members' share accounts are based on available earnings at the end of a dividend period and are not guaranteed by the credit union. Dividend rates on members' share accounts are set by the Board of Directors based on an evaluation of current and future market conditions.

Members' Equity: The credit union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of dividends.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, are reported as a separate component of the members' equity section in the accompanying consolidated statements of financial condition.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes: The credit union is exempt from federal and California taxes on income. The credit union's wholly owned subsidiary, however, is subject to federal and state income taxes. The operations of the subsidiary resulted in immaterial income taxes for the years ended 2013 and 2012.

Recent Accounting Pronouncements: In February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02—*Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, to improve the transparency of reporting these reclassifications. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in the financial statements. All of the information that this ASU requires is already required to be disclosed elsewhere in the financial statements under GAAP.

The new amendments will require an entity to present (either on the face of the statement where net income is presented or in the notes) the effects on net income line items of significant amounts reclassified out of accumulated other comprehensive income, but only if the item reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period, and to cross-reference to other disclosures currently required under GAAP for other reclassification items (that are not required under GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account instead of directly to income or expense.

The amendments apply to all public and private companies that report items of other comprehensive income. A public company is required to meet the reporting requirements of the amended paragraphs about the roll-forward of accumulated other comprehensive income for both interim and annual reporting periods. However, private companies are only required to provide the information about the effect of reclassification on net income line items for annual reporting periods. The amendments are effective for reporting periods beginning after December 15, 2013 for private companies. The credit union is currently evaluating the impact of this ASU on the credit union's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-03—*Financial Instruments (Topic 825): Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities.* This guidance clarifies the scope and applicability of a disclosure exemption that is specific to private companies and not-for-profit organizations that resulted from the issuance of Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*

The ASU clarifies that the requirement to disclose "the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)" does not apply to private companies and nonpublic not-for-profit organizations for items that are not measured at fair value in the statement of financial position, but for which fair value is disclosed. The ASU is effective upon issuance. The adoption of this ASU did not have a material impact on the credit union's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04—*Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. ASU No. 2014-04 is intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The amendments clarify that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy such loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additional disclosures are required.

These amendments are effective for public business entities for annual periods and interim periods within those annual periods beginning after December 15, 2014. For all other entities, it is effective for annual periods beginning after December 15, 2014 and interim periods within annual periods beginning after December 15, 2015. The credit union is currently evaluating the impact of ASU No. 2014-04 on its consolidated financial statements.

Subsequent Events: Subsequent events have been evaluated through March 12, 2014, which is the date the consolidated financial statements were available to be issued.

NOTE 2 – INVESTMENTS

The amortized cost and fair value of securities available for sale are as follows:

	Amortized	Gross Unrealized		Fair
2013	Cost	Gains	Losses	Value
Federal agency securities	$123,945,957	$ 900	$ (10,988,506)	$112,958,351
Mortgage-backed securities	271,799,132	753,195	(17,578,764)	254,973,563
	$395,745,089	$ 754,095	$ (28,567,270)	$367,931,914
2012				
Federal agency securities	$179,245,433	$ 2,994,025	$ (351,616)	$181,887,842
Mortgage-backed securities	227,521,363	3,874,393	(2,064,883)	229,330,873
	$406,766,796	$ 6,868,418	$ (2,416,499)	$411,218,715

Gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position are as follows:

		Continuous Unrealized Losses Existing for		
		Less Than	More Than	
2013	Fair Value	12 Months	12 Months	Total
Federal agency securities	$110,759,465	$ (4,368,447)	$ (6,620,059)	$ (10,988,506)
Mortgage-backed securities	209,972,167	(13,724,867)	(3,853,897)	(17,578,764)
	$320,731,632	$ (18,093,314)	$ (10,473,956)	$ (28,567,270)
2012				
Federal agency securities	$ 50,695,219	$ (351,616)	$ -	$ (351,616)
Mortgage-backed securities	95,150,117	(1,404,130)	(660,753)	(2,064,883)
	$145,845,336	$ (1,755,746)	$ (660,753)	$ (2,416,499)

NOTE 2 – INVESTMENTS (CONTINUED)

Management evaluates securities for OTTI on at least 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 credit union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2013, 53 investments have been in a continuous unrealized loss position for less than 12 months and 25 have been in a continuous unrealized loss position for 12 months or longer. The unrealized losses associated with these investments are considered temporary, as the credit union has both the intent and ability to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period in which the other-than-temporary impairment is identified.

A loss for OTTI of available-for-sale non-government-backed mortgage-backed securities totaling $105,926 and $229,635 has been recognized in net income for the years ended December 31, 2013 and 2012, respectively, due to a significant deterioration in the credit quality of the underlying loans comprising these securities.

Other investments consisted of the following:

	2013	2012
Contributed capital in a corporate credit union	$ 250,000	$ 250,000

The amortized cost and fair value of investments by contractual maturity at December 31, 2013 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available for Sale		
	Amortized Cost	Fair Value	Other
No contractual maturity	$ -	$ -	$ 250,000
Five to ten years	49,394,409	46,252,078	-
Over ten years	74,551,548	66,706,273	-
	123,945,957	112,958,351	250,000
Mortgage-backed securities	271,799,132	254,973,563	-
	$ 395,745,089	$ 367,931,914	$ 250,000

NOTE 3 – LOANS TO MEMBERS

Loans outstanding by portfolio segment and class of loan are as follows:

	2013	2012
Residential real estate:		
First mortgage	$ 171,952,338	$ 231,549,920
HELOC and other mortgage	72,665,314	76,020,243
Total residential real estate	244,617,652	307,570,163
Consumer:		
Automobile	93,970,638	77,612,329
Credit card	36,147,526	22,755,613
Other consumer, primarily unsecured	24,879,122	23,358,126
Total consumer	154,997,286	123,726,068
Total loans	399,614,938	431,296,231
Allowance for loan losses	(2,333,424)	(3,826,854)
Total loans, net	$ 397,281,514	$ 427,469,377

The allowance for loan losses and recorded investment in loans, by portfolio segment, is as follows:

2013	Residential Real Estate	Consumer	Total
Allowance for loan losses:			
Beginning balance	$ 2,911,948	$ 914,906	$ 3,826,854
Charge-offs	(331,135)	(997,647)	(1,328,782)
Provision (credit)	(1,232,313)	745,299	(487,014)
Recoveries	32,805	289,561	322,366
Ending balance	$ 1,381,305	$ 952,119	$ 2,333,424
Ending balance: individually evaluated for impairment	$ 1,072,440	$ 86,222	$ 1,158,662
Ending balance: collectively evaluated for impairment	$ 308,865	$ 865,897	$ 1,174,762
Recorded loan balance:			
Ending balance	$ 244,617,652	$ 154,997,286	$ 399,614,938
Ending balance: individually evaluated for impairment	$ 6,417,575	$ 140,375	$ 6,557,950
Ending balance: collectively evaluated for impairment	$ 238,200,077	$ 154,856,911	$ 393,056,988

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

2012	Residential Real Estate	Consumer	Total
Allowance for loan losses:			
Beginning balance	$ 3,009,671	$ 1,026,383	$ 4,036,054
Charge-offs	(1,044,834)	(963,351)	(2,008,185)
Provision	937,094	677,431	1,614,525
Recoveries	10,017	174,443	184,460
Ending balance	$ 2,911,948	$ 914,906	$ 3,826,854
Ending balance: individually evaluated for impairment	$ 1,653,804	$ 46,706	$ 1,700,510
Ending balance: collectively evaluated for impairment	$ 1,258,144	$ 868,200	$ 2,126,344
Recorded loan balance:			
Ending balance	$ 307,570,163	$ 123,726,068	$ 431,296,231
Ending balance: individually evaluated for impairment	$ 6,801,460	$ 74,418	$ 6,875,878
Ending balance: collectively evaluated for impairment	$ 300,768,703	$ 123,651,650	$ 424,420,353

Credit Quality Indicators: The credit union assesses the credit quality of its residential real estate and consumer loans by FICO score and loan-to-value (LTV) ratio.

FICO Score: Residential real estate and consumer loans are assessed for credit quality by recent FICO score. The credit union obtains FICO scores at loan origination, and the scores are updated at least semi-annually. Loans that trend toward higher levels are generally associated with a lower risk factor, whereas loans that migrate toward lower ratings will generally result in a higher risk factor being applied to the related loan balances.

The FICO score distribution is as follows:

2013	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
800 and above	$ 54,618,754	$ 13,472,485	$ 8,603,574	$ 1,649,716	$ 742,219	$ 79,086,748
720 to 799	80,047,718	35,801,838	38,977,420	16,972,856	8,998,681	180,798,513
680 to 719	18,111,047	8,891,205	15,116,432	7,135,095	4,963,343	54,217,122
640 to 679	8,059,685	5,304,222	13,133,141	4,880,711	4,593,063	35,970,822
580 to 639	4,529,728	3,732,545	7,858,446	2,220,143	2,939,096	21,279,958
579 and below	2,174,368	3,139,651	4,492,731	747,566	1,633,194	12,187,510
Unknown	4,411,038	2,323,368	5,788,894	2,541,439	1,009,526	16,074,265
	$ 171,952,338	$ 72,665,314	$ 93,970,638	$ 36,147,526	$ 24,879,122	$ 399,614,938

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

2012	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
800 and above	$ 73,183,916	$ 16,056,846	$ 7,557,953	$ 1,446,514	$ 784,994	$ 99,030,223
720 to 799	114,037,512	36,198,223	34,167,492	11,680,131	8,592,509	204,675,867
680 to 719	20,463,327	10,338,388	13,540,562	4,448,743	5,115,581	53,906,601
640 to 679	11,170,301	5,292,759	11,134,285	2,939,463	3,961,327	34,498,135
580 to 639	5,411,538	4,188,657	6,224,237	1,272,100	2,641,211	19,737,743
579 and below	2,827,865	2,486,604	3,667,448	632,471	1,942,791	11,557,179
Unknown	4,455,461	1,458,766	1,320,352	336,191	319,713	7,890,483
	$ 231,549,920	$ 76,020,243	$ 77,612,329	$ 22,755,613	$ 23,358,126	$ 431,296,231

LTV and Combined LTV (CLTV) Ratios: Residential real estate loans are assessed for credit quality by LTV or CLTV, the ratio of the loan's unpaid principal balance to the value of the collateral securing repayment of the loan. If the credit union is in a junior lien position, only the excess collateral value over the amounts necessary to retire any senior lien positions is considered. LTVs are updated semi-annually using a cascade approach that first uses values provided by an automated valuation model (AVM) for a property. If an AVM is not available, the value is estimated using the original appraised value adjusted by the change in Home Price Index (HPI) for the property location. If an HPI is not available, the original appraised value is used.

In recent years, the residential real estate markets have experienced a significant decline in property values. These trends are considered in the way the credit union monitors credit risk and establishes the residential real estate allowance for loan losses. LTV does not necessarily reflect the likelihood of performance of a given loan but does provide an indication of collateral value. In the event of default, any loss to the credit union should be approximately limited to the portion of the loan amount in excess of the net realizable value of the underlying real estate collateral.

The LTV distribution of first mortgage and HELOC and other mortgage loans is as follows:

2013	Less Than 80%	80%–89%	90%–100%	Greater Than 100%	Unknown	Total
First mortgage	$ 148,113,381	$ 12,757,173	$ 6,928,104	$ 4,153,680	$ -	$ 171,952,338
HELOC and other mortgage	52,874,712	6,708,768	5,039,986	7,987,415	54,433	72,665,314
	$ 200,988,093	$ 19,465,941	$ 11,968,090	$ 12,141,095	$ 54,433	$ 244,617,652
2012						
First mortgage	$ 164,877,456	$ 30,275,299	$ 13,144,425	$ 17,559,202	$ 5,693,538	$ 231,549,920
HELOC and other mortgage	38,451,988	8,109,223	7,917,420	21,541,612	-	76,020,243
	$ 203,329,444	$ 38,384,522	$ 21,061,845	$ 39,100,814	$ 5,693,538	$ 307,570,163

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Nonaccrual and Past Due Loans: Information relating to the age and nonaccrual status of the loans by class is as follows:

2013	Current	2–5 Months Past Due	6–11 Months Past Due	12 or More Months Past Due	Total	Loans on Nonaccrual Status
First mortgage	$ 171,656,170	$ 296,168	$ -	$ -	$ 171,952,338	$ 296,168
HELOC and other mortgage	71,854,514	523,501	188,200	99,099	72,665,314	810,800
Automobile	93,575,452	286,467	83,289	25,430	93,970,638	395,186
Credit card	36,092,094	55,432	-	-	36,147,526	55,432
Other consumer	24,750,789	128,333	-	-	24,879,122	128,333
	$ 397,929,019	$ 1,289,901	$ 271,489	$ 124,529	$ 399,614,938	$ 1,685,919
2012						
First mortgage	$ 230,601,557	$ 514,609	$ 433,754	$ -	$ 231,549,920	$ 948,363
HELOC and other mortgage	75,283,488	482,348	178,192	76,215	76,020,243	736,755
Automobile	77,409,444	144,591	58,294	-	77,612,329	202,885
Credit card	22,692,957	62,656	-	-	22,755,613	62,656
Other consumer	23,212,071	143,000	3,055	-	23,358,126	146,055
	$ 429,199,517	$ 1,347,204	$ 673,295	$ 76,215	$ 431,296,231	$ 2,096,714

The credit union did not have any loans over 60 days delinquent that were still accruing interest as of December 31, 2013 and 2012.

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Impaired Loans: Impaired loans individually evaluated for impairment and the related amounts of interest income recognized during the period the loans were impaired are as follows. The average balances were calculated based on the year-end balances of the loans for the period reported.

	December 31, 2013			Year Ended December 31, 2013	
	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
With no specific allowance recorded:					
First mortgage	$ 1,431,366	$ 1,429,206	$ -	$ 1,123,422	$ 41,629
HELOC and other mortgage	1,177,304	1,176,214	-	964,214	21,620
Automobile	-	-	-	-	-
Credit card	-	-	-	-	-
Other consumer	-	-	-	-	-
With an allowance recorded:					
First mortgage	2,422,669	2,426,148	416,594	2,931,102	81,230
HELOC and other mortgage	1,386,236	1,386,236	655,846	1,590,780	30,065
Automobile	89,992	89,992	59,665	74,399	922
Credit card	-	-	-	-	-
Other consumer	50,383	50,383	26,557	32,998	393
Total:					
First mortgage	3,854,035	3,855,354	416,594	4,054,524	122,859
HELOC and other mortgage	2,563,540	2,562,450	655,846	2,554,994	51,685
Automobile	89,992	89,992	59,665	74,399	922
Credit card	-	-	-	-	-
Other consumer	50,383	50,383	26,557	32,998	393
	$ 6,557,950	$ 6,558,179	$ 1,158,662	$ 6,716,915	$ 175,859

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

	December 31, 2012			Year Ended December 31, 2012	
	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
With no specific allowance recorded:					
First mortgage	$ 815,478	$ 814,604	$ -	$ 820,557	$ 28,466
HELOC and other mortgage	751,124	750,938	-	758,718	16,256
Automobile	-	-	-	-	-
Credit card	-	-	-	-	-
Other consumer	-	-	-	-	-
With an allowance recorded:					
First mortgage	3,439,535	3,440,311	830,842	3,470,802	93,851
HELOC and other mortgage	1,795,323	1,795,067	822,962	1,813,929	34,678
Automobile	58,805	58,805	32,976	58,805	-
Credit card	-	-	-	-	-
Other consumer	15,613	15,613	13,730	15,613	-
Total:					
First mortgage	4,255,013	4,254,915	830,842	4,291,359	122,317
HELOC and other mortgage	2,546,447	2,546,005	822,962	2,572,647	50,934
Automobile	58,805	58,805	32,976	58,805	-
Credit card	-	-	-	-	-
Other consumer	15,613	15,613	13,730	15,613	-
	$ 6,875,878	$ 6,875,338	$ 1,700,510	$ 6,938,424	$ 173,251

TDRs: A summary of loans modified as TDRs and type of concession granted during the years ended December 31, 2013 and 2012, presented by class is as follows:

	Type of Concession				
2013	Interest Rate	Maturity Date	Principal Reduction	Other	Total
First mortgage	$ -	$ 236,403	$ -	$ 597,954	$ 834,357
HELOC and other mortgage	-	50,184	-	180,197	230,381
Other consumer		9,071	-	7,963	17,034
	$ -	$ 295,658	$ -	$ 786,114	$ 1,081,772

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

2012	Type of Concession: Interest Rate	Maturity Date	Principal Reduction	Other	Total
HELOC and other mortgage	$ -	$ 234,536	$ -	$ -	$ 234,536
Automobile	-	37,102	-	-	37,102
	$ -	$ 271,638	$ -	$ -	$ 271,638

A summary of loans, presented by class that were modified as TDRs during the years ended December 31, 2013 and 2012 and those restructurings for which there was a payment default subsequent to the restructuring, but within 12 months of the restructuring, are as follows:

	TDRs			TDRs That Subsequently Defaulted	
2013	Number of Loans	Principal Balance	Allowance Impact	Number of Loans	Principal Balance
First mortgage	3	$ 834,357	$ -	1	$ 236,403
HELOC and other mortgage	3	230,381	44,638	-	-
Other consumer	2	17,034	-	1	9,071
	8	$ 1,081,772	$ 44,638	2	$ 245,474
2012					
HELOC and other mortgage	2	$ 234,536	$ 89,973	1	$ 90,128
Automobile	3	37,102	-	1	13,450
	5	$ 271,638	$ 89,973	2	$ 103,578

NOTE 4 – LOAN SERVICING

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balance of loans serviced for Fannie Mae totaled $75,012,000 and $4,079,000 at December 31, 2013 and 2012, respectively. Starting December 2013, the credit union capitalized $636,692 in mortgage servicing rights.

NOTE 5 – PROPERTY AND EQUIPMENT

The composition of property and equipment is summarized as follows:

	2013	2012
Land	$ 1,110,140	$ 1,110,140
Building and improvements	3,958,345	3,958,345
Furniture and equipment	4,242,109	4,136,323
Data processing equipment	8,623,943	8,087,889
Leasehold improvements	2,941,491	2,931,073
	20,876,028	20,223,770
Accumulated depreciation and amortization	(14,281,564)	(13,268,144)
	$ 6,594,464	$ 6,955,626

NOTE 6 – MEMBERS' SHARE ACCOUNTS

A summary of members' share accounts by type is as follows:

	2013	2012
Regular shares	$ 182,180,130	$ 168,746,849
Share drafts	94,415,429	89,234,746
Money market	267,208,061	258,522,517
Individual retirement accounts	12,093,057	11,106,145
Certificates of deposit	265,074,216	270,384,688
	$ 820,970,893	$ 797,994,945

Dividend rates are set by the Board of Directors, and dividends are charged to operations. The aggregate amount of certificates in denominations of $100,000 or more was $120,663,000 and $119,529,000 at December 31, 2013 and 2012, respectively.

A summary of share certificate accounts by maturity at December 31, 2013 is as follows:

Years Ending December 31,	
2014	$ 162,461,828
2015	50,842,588
2016	26,920,177
2017	9,266,741
2018	6,312,795
2019	4,533,968
2020	4,736,119
	$ 265,074,216

NOTE 7 – BORROWED FUNDS

The credit union utilizes a demand loan agreement with Mid-Atlantic Corporate Federal Credit Union. The terms of this agreement call for the pledging of all assets not already pledged as collateral under other borrowing agreements as security for any and all obligations taken by the credit union. The agreements provide for a credit limit of $5,000,000 with interest charged at a rate determined by the lender on a periodic basis. At December 31, 2013 and 2012, there were no borrowings under these agreements. The agreement is annually reviewed for continuation by the lender and the credit union.

The credit union also has a secured borrowing arrangement through the FRB discount window. At December 31, 2013, the FRB held approximately $20,523,166 of credit union securities as collateral. There were no outstanding borrowings as of December 31, 2013 under this borrowing arrangement.

In addition, the credit union has a repurchase agreement with Raymond James & Associates for a line of $50,000,000. As of December 31, 2013, the credit union did not have any securities repurchased.

NOTE 8 – LEASE COMMITMENTS

The credit union leases three offices. The operating leases contain renewal options and provisions requiring the credit union to pay property taxes and operating expenses over base period amounts. All rental payments are dependent only upon the lapse of time. Minimum rental payments under operating leases with initial or remaining terms of one year or more at December 31, 2013 are as follows:

Years Ending December 31,	
2014	$ 1,177,830
2015	1,234,858
2016	1,270,892
2017	1,248,024
2018	1,238,795
Thereafter	406,568
	$ 6,576,967

Rent expense totaled $1,180,000 and $1,175,000 for the years ended December 31, 2013 and 2012, respectively.

NOTE 9 – OFF-BALANCE-SHEET ACTIVITIES

The credit union is party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its members. These commitments represent financial instruments to extend credit, which include first mortgage and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated financial statements. The credit union's exposure to credit loss is represented by the contractual notional amount of these instruments. The credit union uses the same credit policies in making commitments as it does for loans recorded in the consolidated financial statements.

The credit union had $1,191,000 and $951,000 in outstanding loan commitments at December 31, 2013 and 2012, respectively. The following financial instruments were outstanding whose contract amounts represent credit risk as of December 31:

	2013	2012
HELOC	$ 78,903,907	$ 76,980,026
Lines of credit	54,902,224	61,321,575
Credit card	47,924,314	36,496,795
Courtesy pay program	9,598,553	9,546,645
	$ 191,328,998	$ 184,345,041

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 and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The credit union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the credit union upon extension of credit, is based on management's credit evaluation of the member. Collateral held generally consists of certificates of deposit, share accounts, automobiles and real estate.

NOTE 9 – OFF-BALANCE-SHEET ACTIVITIES (CONTINUED)

Unfunded commitments under revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing members. These lines of credit are uncollateralized, usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the credit union is committed.

NOTE 10 – LEGAL CONTINGENCIES

The credit union is party to various legal actions normally associated with financial institutions, the aggregate effect of which, in the opinion of management and legal counsel, would not be material to the financial condition of the credit union.

NOTE 11 – CONCENTRATION OF CREDIT RISK

At December 31, 2013, the credit union had $2,147,000 at a financial institution that exceeded federally insured limits.

NOTE 12 – RELATED PARTY TRANSACTIONS

Loans to credit union officials and deposits held by credit union officials were treated the same with regard to rates, terms and requirements as loans and deposits of other members with similar circumstances. Loans to officials totaled $931,000 and $1,920,000 at December 31, 2013 and 2012, respectively.

NOTE 13 – EMPLOYEE BENEFIT PLANS

Multiple Employer Pension Plan: The credit union participates in a multiple employer retirement plan. Employees age 21 and older who have been employed by the credit union for three consecutive months are eligible to participate in the plan. The profit sharing portion of the plan is discretionary and non-contributory. The credit union makes a 3% profit sharing contribution to all eligible employees for each payroll period. All amounts contributed to the plan are deposited into a trust fund administered by independent trustees.

The 401(k) portion of the plan allows eligible employees to defer a portion of their salary into the plan. The employer match for the 401(k) plan is $1 for every $1 deferred up to 5% of the eligible employee's compensation. All matching contributions to the 401(k) plan are 100% vested. The contribution to the profit sharing and 401(k) plan for the years ended December 31, 2013 and 2012 totaled $439,000 and $410,000, respectively.

Deferred Compensation Plan: In March 2012, the credit union established a nonqualified deferred compensation plan for certain executives under IRC Section 457(f). To support the deferred compensation plan, the credit union has elected to purchase credit union-owned variable life insurance. The surrender value of these investments included in other assets was $2,139,000 and $2,062,000 as of December 31, 2013 and 2012, respectively. The accrued liability for the deferred compensation included in accrued expenses and other liabilities was $51,000 and $22,000 as of December 31, 2013 and 2012, respectively.

NOTE 14 – FAIR VALUE

GAAP requires the disclosure of fair value information about financial instruments, whether or not recognized in the statement of financial condition. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based on quoted market prices. However, in many instances, there are no quoted market prices for the credit union's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. GAAP excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the credit union.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value:

Cash and Cash Equivalents: The carrying amount is a reasonable estimate of fair value based on the current availability of funds.

Securities Available for Sale: Fair values of marketable securities are based on quoted market prices, where available. If quoted market prices were not available, fair value are based on quoted market prices of comparable instruments or on discounted cash flow models on the expected payment characteristics of underlying mortgage instruments.

Other Investments: The carrying amount is a reasonable estimate of fair value based on current interest rate and maturities.

Loans to Members: Fair value is estimated by discounting the future cash flows using the current average rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Members' Share Accounts: The fair value of regular shares, share draft and money market accounts is the carrying amount. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowed Funds: The carrying amounts of borrowed funds maturing within 90 days approximate their fair value. The fair value of other borrowed funds is estimated using discounted cash flow analyses based on the credit union's current incremental borrowing rates for similar types of borrowing arrangements.

Off-Balance-Sheet Instruments: The fair value of off-balance-sheet commitments is estimated based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the members. The estimated value of these commitments is not significant.

NOTE 14 – FAIR VALUE (CONTINUED)

The estimated fair values of the credit union's financial instruments are as follows:

	2013		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$118,307,000	$118,307,000	$ 52,714,000	$ 52,714,000
Securities available for sale	367,932,000	367,932,000	411,219,000	411,219,000
Other investments	250,000	250,000	250,000	250,000
Loans to members	397,282,000	397,283,000	427,469,000	437,480,000
Financial liabilities:				
Members' share accounts	820,971,000	822,411,000	797,995,000	801,006,000
Borrowed funds	-	-	4,000,000	4,000,000

The fair value of assets and liabilities measured on a recurring basis is as follows:

		Fair Value Measurements at Reporting Date Using		
2013	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:				
Federal agency securities	$ 112,958,351	$ -	$ 112,958,351	$ -
Mortgage-backed securities:				
NCUA guaranteed notes	822,878	-	822,878	-
U.S. agency	251,449,634	-	251,449,634	-
Non U.S. agency	2,701,051	-	2,701,051	-
Total mortgage-backed securities	254,973,563	-	254,973,563	-
	$ 367,931,914	$ -	$ 367,931,914	$ -
2012				
Securities available for sale:				
Federal agency securities	$ 181,887,842	$ -	$ 181,887,842	$ -
Mortgage-backed securities:				
NCUA guaranteed notes	1,536,229	-	1,536,229	-
U.S. agency	225,208,561	-	225,208,561	-
Non U.S. agency	2,586,083	-	2,586,083	-
Total mortgage-backed securities	229,330,873	-	229,330,873	-
	$ 411,218,715	$ -	$ 411,218,715	$ -

NOTE 15 – 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 consolidated 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 GAAP. 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) to assets (as defined). The credit union is also required to calculate a risk-based net worth (RBNW) ratio that establishes whether the credit union will be considered "complex" under the regulatory framework. The credit union's RBNW ratio as of December 31, 2013 and 2012 was 8.69% and 8.48%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes, as of December 31, 2013, that the credit union meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, 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% of assets and meet any applicable RBNW requirement. There are no conditions or events since that notification which management believes have changed the credit union's category.

	Actual		To Be Adequately Capitalized under Prompt Corrective Action Provisions		To Be Well Capitalized under Prompt Corrective action Provisions	
2013	Amount	Ratio	Amount	Ratio	Amount	Ratio
Net worth	$107,753,853	11.88%	$54,412,836	6.00%	$63,481,642	7.00%
RBNW requirement	78,807,924	8.69%	N/A	N/A	N/A	N/A
2012						
Net worth	$102,705,625	11.22%	$54,913,314	6.00%	$64,065,533	7.00%
RBNW requirement	77,610,818	8.48%	N/A	N/A	N/A	N/A

Because the RBNW requirement is less than the net worth ratio, the credit union retains its original category.

NOTE 16 – CORPORATE STABILIZATION PROGRAM

From late January 2009 to October 2010, the NCUA Board approved a series of actions under its Corporate Stabilization Program designed to enhance and support a corporate credit union system facing unprecedented strains on liquidity and capital due to extraordinary market disruptions and the current economic climate.

On July 24, 2012, the NCUA approved an assessment of 0.095% of the credit union's insured shares as of June 30, 2012 to help cover corporate credit union stabilization costs. The credit union paid a premium assessment of $714,554 in October 2012.

On July 25, 2013, the NCUA approved an assessment of 0.08% of the credit union's insured shares as of June 30, 2013 to fund repayment of corporate credit union liabilities. The credit union paid a premium assessment of $621,143 in September 2013.