NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

TWHC | TURNER, WARREN, HWANG & CONRAD AC
Certified Public Accountants & Consultants

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
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, 2012 and 2011, and the related 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 audit 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, 2012 and 2011, 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, CA
March 7, 2013

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2012 AND 2011

	2012	2011
ASSETS		
Cash and cash equivalents	$ 52,713,695	$ 70,582,559
Investments:		
Securities available for sale	411,218,715	363,377,105
Other	250,000	5,250,000
Loans to members	427,469,377	420,315,464
Accrued interest receivable	3,006,221	2,923,285
Property and equipment	6,955,626	7,268,404
NCUSIF deposit	7,521,621	7,237,351
Other assets	6,086,651	2,244,351
Total assets	$ 915,221,906	$ 879,198,519
LIABILITIES AND MEMBERS' EQUITY		
Liabilities:		
Members' share accounts	$ 797,994,945	$ 767,766,848
Borrowed funds	4,000,000	8,000,000
Accrued expenses and other liabilities	6,069,417	6,161,036
Total liabilities	808,064,362	781,927,884
Members' equity:		
Regular reserve	3,559,687	3,559,687
Undivided earnings	99,145,938	91,182,789
Accumulated other comprehensive income	4,451,919	2,528,159
Total members' equity	107,157,544	97,270,635
Total liabilities and members' equity	$ 915,221,906	$ 879,198,519

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, 2012 and 2011

	2012	2011
INTEREST INCOME		
Loans to members	$ 20,104,454	$ 21,346,339
Investments and interest bearing accounts	8,771,788	10,602,704
Total interest income	28,876,242	31,949,043
INTEREST EXPENSE		
Members' share accounts	6,077,837	7,307,976
Borrowed funds	309,391	484,349
Total interest expense	6,387,228	7,792,325
NET INTEREST INCOME	22,489,014	24,156,718
PROVISION FOR LOAN LOSSES	1,614,525	1,514,903
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	20,874,489	22,641,815
NON-INTEREST INCOME		
Fees and charges	2,248,651	2,353,545
Other-than-temporary impairment (OTTI) losses on securities available for sale:		
Total OTTI losses	(776,158)	(1,819,244)
Less portion of OTTI losses recognized in other comprehensive income	546,523	1,193,132
Net impairment losses recognized in earnings	(229,635)	(626,112)
Net realized gain on sale of securities available for sale	1,325,677	1,776,232
Other income	2,580,670	2,093,032
Total non-interest income	5,925,363	5,596,697
NON-INTEREST EXPENSE		
Compensation and benefits	8,311,715	8,139,543
Operations	8,361,434	7,842,676
Occupancy	1,449,000	1,452,875
NCUSIF premium assessment	714,554	1,809,338
Total non-interest expense	18,836,703	19,244,432
NET INCOME	$ 7,963,149	$ 8,994,080

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, 2012 AND 2011

	2012	2011
NET INCOME	$ 7,963,149	$ 8,994,080
OTHER COMPREHENSIVE INCOME		
Net change in unrealized gains on securities available for sale	3,019,802	6,922,280
Less: reclassification adjustment for net gain recognized in net income	(1,096,042)	(1,150,120)
Other comprehensive income	1,923,760	5,772,160
COMPREHENSIVE INCOME	$ 9,886,909	$ 14,766,240

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, 2012 and 2011

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	$ 3,559,687	$ 82,188,709	$ (3,244,001)	$ 82,504,395
Comprehensive income:				
Net income	-	8,994,080	-	8,994,080
Other comprehensive income	-	-	5,772,160	5,772,160
Total comprehensive income				14,766,240
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

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, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 7,963,149	$ 8,994,080
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,086,147	1,107,095
Provision for loan losses	1,614,525	1,514,903
Net amortization of investments	16,052,053	7,137,664
Amortization of deferred loan origination costs, net	208,945	189,171
OTTI losses recognized on securities available for sale	229,635	626,112
Gain on sale of securities available for sale	(1,325,677)	(1,776,232)
Net change in:		
Accrued interest receivable	(82,936)	(231,989)
NCUSIF deposit	(284,270)	(61,153)
Other assets	(3,842,300)	1,509,260
Accrued expenses and other liabilities	(91,619)	451,441
Net cash provided by operating activities	21,527,652	19,460,352
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available for sale	(423,415,547)	(320,770,682)
Proceeds from sales, maturities and principal payments received on securities available for sale	362,541,686	291,696,169
Net (increase) decrease in other investments	5,000,000	(5,250,000)
Net increase in loans to members	(8,977,383)	(3,864,805)
Purchases of property and equipment	(773,369)	(1,155,967)
Net cash used in investing activities	(65,624,613)	(39,345,285)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share accounts	$ 30,228,097	17,230,949
Net decrease in borrowed funds	(4,000,000)	(4,000,000)
Net cash provided by financing activities	26,228,097	13,230,949
NET DECREASE IN CASH AND CASH EQUIVALENTS	(17,868,864)	(6,653,984)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	70,582,559	77,236,543
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 52,713,695	$ 70,582,559
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Dividends paid on members' share accounts	$ 6,137,294	$ 7,501,736
Interest paid on borrowed funds	309,391	484,349
Transfer of loans to foreclosed assets	-	395,746

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 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 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 troubled debt restructuring. 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 either 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 quarterly 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 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 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 2012 and 2011.

Reclassifications: Certain account reclassifications have been made to the consolidated financial statements of the prior year in order to conform to classifications used in the current year.

Recent Accounting Pronouncements: In April 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-02—*Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. This update provides additional guidance relating to when creditors should classify loan modifications as TDRs. The ASU also ends the deferral issued in January 2010 of the disclosures about TDRs required by ASU No. 2010-20. The provisions of ASU No. 2011-02 and the related disclosure requirements of ASU No. 2010-20 are effective for the credit union's reporting periods ending on or after December 15, 2012. The adoption of this ASU did not have a material impact on the credit union's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-04—*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This update amends existing guidance regarding the highest and best use and valuation premise by clarifying that these concepts are only applicable to measuring the fair value of nonfinancial assets. The update also clarifies that the fair value measurement of financial assets and financial liabilities with offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position.

Additional disclosures about Level 3 fair value measurements are required, including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs. The provisions of ASU No. 2011-04 will be effective for the credit union's reporting period beginning after December 15, 2011 and should be applied prospectively. The adoption of this ASU did not have a material impact on the credit union's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05—*Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. This update amends current guidance to allow an entity the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 are effective for the credit union's reporting period ending after December 15, 2012 and should be applied retrospectively. Early adoption is permitted, and there are no required transition disclosures. The adoption of this ASU did not have a material impact on the credit union's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12—*Comprehensive Income (Topic 220): Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This guidance defers certain disclosure requirements of ASU No. 2011-05 pertaining to reclassifications of items out of accumulated other comprehensive income. The provisions of ASU No. 2011-12 are effective for the credit union's reporting period ending after December 15, 2012. The adoption of this ASU is not expected to have a material impact on the credit union's consolidated financial statements.

Subsequent Events: Subsequent events have been evaluated through March 7, 2013, 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:

2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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
2011				
Federal agency securities	$149,333,524	$ 1,328,618	$ (360,190)	$150,301,952
Mortgage-backed securities	211,515,422	3,430,254	(1,870,523)	213,075,153
	$360,848,946	$ 4,758,872	$ (2,230,713)	$363,377,105

Gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011 are as follows:

2012	Fair Value	Continuous Unrealized Losses Existing for Less Than 12 Months	Continuous Unrealized Losses Existing for More Than 12 Months	Total
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)
2011				
Federal agency securities	$ 59,648,330	$ (360,190)	$ -	$ (360,190)
Mortgage-backed securities	80,444,135	(468,303)	(1,402,220)	(1,870,523)
	$140,092,465	$ (828,493)	$ (1,402,220)	$ (2,230,713)

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.

There are 26 investments that have been in a continuous unrealized loss position for less than 12 months and four investments that have been in a continuous unrealized loss position for 12 months or longer as of December 31, 2012. 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.

NOTE 2 – INVESTMENTS (CONTINUED)

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 $229,635 and $626,112 has been recognized in net income for the years ended December 31, 2012 and 2011, respectively, due to a significant deterioration in the credit quality of the underlying loans comprising these securities.

Other investments consist of the following:

	2012	2011
Contributed capital in a corporate credit union	$ 250,000	$ 250,000
Certificate of deposit in a corporate credit union	-	5,000,000
	$ 250,000	$ 5,250,000

The certificate of deposit is generally non-negotiable and non-transferable and may incur substantial penalties for withdrawal prior to maturity.

The amortized cost and fair value of investments by contractual maturity at December 31, 2012 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	51,320,728	51,565,825	-
Over ten years	127,924,705	130,322,017	-
	179,245,433	181,887,842	250,000
Mortgage-backed securities	227,521,363	229,330,873	-
	$ 406,766,796	$ 411,218,715	$ 250,000

NOTE 3 – LOANS TO MEMBERS

The following table presents total loans outstanding by portfolio segment and class of loan:

	2012	2011
Residential real estate:		
First mortgage	$ 231,549,920	$ 224,784,833
HELOC and other mortgage	76,020,243	87,834,828
Total residential real estate	307,570,163	312,619,661
Consumer:		
Automobile	77,612,329	73,360,011
Credit card	22,755,613	15,671,548
Other consumer, primarily unsecured	23,358,126	22,700,298
Total consumer	123,726,068	111,731,857
Total loans	431,296,231	424,351,518
Allowance for loan losses	(3,826,854)	(4,036,054)
Total loans, net	$ 427,469,377	$ 420,315,464

The allowance for loan losses and recorded investment in loans, by portfolio segment, for the year ended December 31, 2012 is as follows:

	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	$ 6,800,920	$ 74,418	$ 6,875,338
Ending balance: collectively evaluated for impairment	$ 300,769,243	$ 123,651,650	$ 424,420,893

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

The allowance for loan losses and recorded investment in loans, by portfolio segment, for the year ended December 31, 2011 is as follows:

	2011		
	Residential Real Estate	Consumer	Total
Allowance for loan losses:			
Beginning balance	$ 3,314,540	$ 1,134,481	$ 4,449,021
Charge-offs	(1,042,590)	(1,021,460)	(2,064,050)
Provision	731,405	783,498	1,514,903
Recoveries	6,316	129,864	136,180
Ending balance	$ 3,009,671	$ 1,026,383	$ 4,036,054
Ending balance: individually evaluated for impairment	$ 1,289,830	$ 27,391	$ 1,317,221
Ending balance: collectively evaluated for impairment	$ 1,719,841	$ 998,992	$ 2,718,833
Recorded loan balance:			
Ending balance	$ 312,619,661	$ 111,731,857	$ 424,351,518
Ending balance: individually evaluated for impairment	$ 5,157,558	$ 41,015	$ 5,198,573
Ending balance: collectively evaluated for impairment	$ 307,462,103	$ 111,690,842	$ 419,152,945

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 upward 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.

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

FICO score distribution is as follows:

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

2011	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
800 and above	$ 71,200,174	$ 14,977,677	$ 6,136,395	$ 1,163,949	$ 819,482	$ 94,297,677
720 to 799	105,394,386	44,071,557	34,658,462	8,583,794	8,884,345	201,592,544
680 to 719	24,864,488	11,903,685	12,260,709	3,181,469	5,105,678	57,316,029
640 to 679	11,220,889	7,407,518	9,871,616	1,613,982	3,364,828	33,478,833
580 to 639	4,014,556	4,123,551	6,118,847	746,442	2,468,388	17,471,784
579 and below	5,312,907	3,995,886	3,647,157	233,294	1,900,057	15,089,301
Unknown	2,777,433	1,354,954	666,825	148,618	157,520	5,105,350
	$ 224,784,833	$ 87,834,828	$ 73,360,011	$ 15,671,548	$ 22,700,298	$ 424,351,518

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.

The following table presents the LTV distribution of first mortgage and HELOC and other mortgage loans as of December 31, 2012. 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.

	Less Than 80%	80%–89%	90%–100%	Greater Than 100%	Unknown	Total
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:

	2012						
	Current	2–5 Months Past Due	6–11 Months Past due	12 or More Months Past Due	Total	Loans on Nonaccrual Status	60 Days or More Past Due and Still Accruing
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	$ -

	2011						
	Current	2–5 Months Past Due	6–11 Months Past due	12 or More Months Past Due	Total	Loans on Nonaccrual Status	60 Days or More Past Due and Still Accruing
First mortgage	$223,797,522	$ 645,976	$ 341,335	$ -	$224,784,833	$ 353,708	$ 633,603
HELOC and other mortgage	87,081,730	513,759	239,339	-	87,834,828	308,718	444,381
Automobile	72,845,647	422,058	85,678	6,628	73,360,011	175,510	321,966
Credit card	15,653,298	18,250	-	-	15,671,548	18,249	-
Other consumer	22,446,478	231,000	22,820	-	22,700,298	156,660	114,048
	$421,824,675	$ 1,831,043	$ 689,172	$ 6,628	$424,351,518	$ 1,012,845	$ 1,513,998

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Impaired Loans: The following table presents impaired loans individually evaluated for impairment as of December 31, 2012 and 2011 and the related amounts of interest income recognized during the period the loans were impaired. The average balances were calculated based on the year-end balances of the loans for the period reported.

	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

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

	December 31, 2011			Year Ended December 31, 2011	
	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
With no specific allowance recorded:					
First mortgage	$ 554,003	$ 547,256	$ -	$ 555,910	$ 19,717
HELOC and other mortgage	532,253	531,692	-	537,255	16,996
Automobile	-	-	-	-	-
Credit card	-	-	-	-	-
Other consumer	-	-	-	-	-
With an allowance recorded:					
First mortgage	2,926,829	2,923,059	674,081	2,947,403	62,933
HELOC and other mortgage	1,156,719	1,155,551	615,749	1,150,340	26,835
Automobile	21,348	21,348	10,674	21,502	245
Credit card	-	-	-	-	-
Other consumer	19,725	19,667	16,717	19,696	-
Total:					
First mortgage	3,480,832	3,470,315	674,081	3,503,313	82,650
HELOC and other mortgage	1,688,972	1,687,243	615,749	1,687,595	43,831
Automobile	21,348	21,348	10,674	21,502	245
Credit card	-	-	-	-	-
Other consumer	19,725	19,667	16,717	19,696	-
	$ 5,210,877	$ 5,198,573	$ 1,317,221	$ 5,232,106	$ 126,726

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

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

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

A summary of loans and type of concession granted, presented by class, that were modified as TDRs during the year ended December 31, 2011 is as follows:

	2011				
	Type of Concession				
	Interest Rate	Maturity Date	Principal Reduction	Other	Total
First mortgage	$ 640,196	$ -	$ -	$ -	$ 640,196
HELOC and other mortgage	120,473	-	-	659,011	779,484
Automobile	-	638,874	-	-	638,874
Other consumer	-	74,143	-	78,920	153,063
	$ 760,669	$ 713,017	$ -	$ 737,931	$ 2,211,617

A summary of loans, presented by class, that were modified as TDRs during the years ended December 31, 2012 and 2011, and those restructurings for which there was a payment default subsequent to the restructuring, but within 12 months of the restructuring, are as follows:

	2012				
	TDRs			TDRs That Subsequently Defaulted	
	Number of Loans	Principal Balance	Allowance Impact	Number of Loans	Principal Balance
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

	2011				
	TDRs			TDRs That Subsequently Defaulted	
	Number of Loans	Principal Balance	Allowance Impact	Number of Loans	Principal Balance
First mortgage	2	$ 640,196	$ 108,923	-	$ -
HELOC and other mortgage	12	779,484	9,662	5	329,068
Automobile	45	638,874	-	42	561,864
Other consumer	18	153,063	-	11	106,396
	77	$ 2,211,617	$ 118,585	58	$ 997,328

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 totalled $4,079,000 and $6,477,000 at December 31, 2012 and 2011, respectively.

NOTE 5 – PROPERTY AND EQUIPMENT

The composition of property and equipment is summarized as follows:

	2012	2011
Land	$ 1,110,140	$ 1,110,140
Building and improvements	3,958,345	3,958,345
Furniture and equipment	4,136,323	3,928,447
Data processing equipment	8,087,889	7,541,282
Leasehold improvements	2,931,073	2,924,680
	20,223,770	19,462,894
Accumulated depreciation and amortization	(13,268,144)	(12,194,490)
	$ 6,955,626	$ 7,268,404

NOTE 6 – MEMBERS' SHARE ACCOUNTS

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

	2012	2011
Regular shares	$ 168,746,849	$ 153,818,870
Share drafts	89,234,746	82,846,120
Money market	258,522,517	243,894,104
Individual retirement accounts	11,106,145	9,923,322
Certificates of deposit	270,384,688	277,284,432
	$ 797,994,945	$ 767,766,848

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 $119,529,000 and $121,215,000 at December 31, 2012 and 2011, respectively.

A summary of share certificate accounts by maturity at December 31, 2012 is as follows:

Years Ending December 31,	
2013	$ 174,683,982
2014	40,734,331
2015	26,376,863
2016	16,128,720
2017	7,771,485
2018	-
2019	4,689,307
	$ 270,384,688

NOTE 7 – BORROWED FUNDS

On July 7, 2012, Western Bridge Federal Credit Union (Western Bridge) was dissolved and acquired by Catalyst Corporate Federal Credit Union (Catalyst). Catalyst revised the lines of credit previously under Western Bridge with new terms and credit limits. The revised lines of credit included a standard settlement line of credit with an available credit limit of $4,200,000. The term of the line of credit require the pledging of all share certificates and investments held by Catalyst, as well as auto loans and first lien mortgage loans for any and all obligations taken by the credit union under this agreement. This arrangement is annually reviewed for continuation by the lender and the credit union. The credit union had no outstanding borrowings against this line of credit as of December 31, 2012.

The credit union is also a borrower under a Master Loan and Security Agreement (Master Agreement) with Catalyst. Fixed rate loan advances currently outstanding under the Master Agreement bear interest at an average rate of 4.73% and are collateralized by all consumer loans plus four specified investment securities held in safekeeping at Catalyst. As of December 31, 2012, fixed rate loan under the agreement totaled $4,000,000.

In addition to the agreement described above, the credit union utilizes 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, 2012 and 2011, there were no borrowings under these agreements. The agreement is annually reviewed for continuation by the lender and the credit union.

NOTE 8 – LEASE COMMITMENTS

The credit union leases four 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, 2012 are as follows:

Years Ending December 31,	
2013	$ 1,181,941
2014	1,215,906
2015	1,246,742
2016	1,237,148
2017	1,214,280
Thereafter	1,614,432
	$ 7,710,449

Rent expense totaled $1,175,000 and $1,165,000 for the years ended December 31, 2012 and 2011, 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.

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

The credit union had $951,000 and $999,000 in outstanding loan commitments at December 31, 2012 and 2011, respectively. The following financial instruments were outstanding whose contract amounts represent credit risk as of December 31:

	2012	2011
HELOC	$ 76,980,026	$ 83,352,192
Lines of credit	61,321,575	62,334,865
Credit card	36,496,795	29,366,297
Courtesy pay program	9,546,645	9,698,558
	$ 184,345,041	$ 184,751,912

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.

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 management's and legal counsel's opinion, would not be material to the financial condition of the credit union.

NOTE 11 – CONCENTRATION OF CREDIT RISK

At December 31, 2012, the credit union had no cash at any financial institution that exceeded federally insured limits.

The NCUA approved the Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP) on January 28, 2009, effective March 1, 2009 and updated on August 31, 2010. The program provides a temporary guarantee by the NCUSIF of all shares (excluding paid-in capital and membership capital accounts) at participating corporate credit unions through December 31, 2012 with the option for quarterly extensions of the expiration date and a maximum maturity of two years. Upon expiration of the TCCUSGP, NCUA coverage on deposits in corporate credit unions will be limited to the standard maximum share insurance amount of $250,000. At December 31, 2012, the credit union did not have term certificates with any participating corporate credit unions.

NOTE 11 – CONCENTRATION OF CREDIT RISK (CONTINUED)

The Federal Deposit Insurance Corporation (FDIC) announced the Temporary Liquidity Guarantee Program on October 14, 2008 to strengthen confidence and encourage liquidity in the banking system. The program included a (1) guarantee of newly issued senior unsecured debt of eligible institutions, including FDIC-insured banks and thrifts, as well as certain holding companies, and (2) provided full deposit insurance coverage for non-interest bearing deposit transaction accounts in FDIC-insured institutions, regardless of the dollar amount. From December 31, 2010 through December 31, 2012, all noninterest-bearing transaction accounts are fully insured, regardless of the balance of the account and the ownership capacity of the funds. This coverage is available to all depositors, including consumers, businesses, and government entities. The unlimited coverage is separate from, and in addition to, the insurance coverage provided for a depositor's other accounts held at an FDIC-insured bank.

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 $1,920,000 and $1,588,000 at December 31, 2012 and 2011, respectively.

NOTE 13 – EMPLOYEE BENEFIT PLANS

Multi-Employer Pension Plan: The credit union participates in a multiemployer 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 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, 2012 and 2011 amounted to $410,000 in both years.

Deferred Compensation Plan: In March 2012, the credit union established a nonqualified deferred compensation plan for certain executive 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 values of these investments included in other assets was $2,062,000 as of December 31, 2012. The accrued liability for the deferred compensation included in accrued expenses and other liabilities was $22,000 as of December 31, 2012.

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.

NOTE 14 – FAIR VALUE (CONTINUED)

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 amounts 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.

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

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 52,714,000	$ 52,714,000	$ 70,583,000	$ 70,583,000
Securities available for sale	411,219,000	411,219,000	363,377,000	363,377,000
Other investments	250,000	250,000	5,250,000	5,250,000
Loans to members	427,469,000	437,480,000	420,315,000	427,253,000
Financial liabilities:				
Members' share accounts	797,995,000	801,006,000	767,767,000	771,053,000
Borrowed funds	4,000,000	4,000,000	8,000,000	8,003,000

NOTE 14 – FAIR VALUE (CONTINUED)

The fair value of assets and liabilities measured on a recurring basis at December 31, 2012 and 2011 is as follows:

		Fair Value Measurements at Reporting Date Using		
2012	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	$ 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	$ -
2011				
Securities available for sale:				
Federal agency securities	$ 150,301,952	$ 16,755,214	$ 133,546,738	$ -
Mortgage-backed securities:				
NCUA guaranteed notes	1,739,517	-	1,739,517	-
U.S. agency	208,826,124	3,172,500	205,653,624	-
Non U.S. agency	2,509,512	-	2,509,512	-
Total mortgage backed securities	213,075,153	3,172,500	209,902,653	-
	$ 363,377,105	$ 19,927,714	$ 343,449,391	$ -

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). Credit unions are 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, 2012 and 2011 was 8.48% and 6.78%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes, as of December 31, 2012, that the credit union meets all capital adequacy requirements to which it is subject.

As of December 31, 2012, 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	
2012	Amount	Ratio	Amount	Ratio	Amount	Ratio
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
2011						
Net worth	$ 94,742,476	10.78%	$ 52,751,911	6.00%	$ 61,543,896	7.00%
RBNW requirement	59,609,660	6.78%	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 March 20, 2009, 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.

In September 2010, the NCUA announced the Corporate System Resolution Plan, creating a "good bank/bad bank" structure. The plan isolates and funds legacy assets and allows the costs of resolution to be funded over ten years. The plan also establishes bridge corporate credit unions to conduct essential activities of the conserved corporate credit unions with no interruption in member services. The funding of legacy assets is being handled by securitizing the assets in the form of senior debt instruments called NCUA Guaranteed Notes that are backed by the full faith and credit of the U.S. government.

NOTE 16 – CORPORATE STABILIZATION PROGRAM (CONTINUED)

On August 29, 2011, the NCUA approved an assessment of 0.25% of the credit union's insured shares as of June 30, 2011. The credit union paid a premium assessment expense of $1,809,338 in September 2011.

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.

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