NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

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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, 2016 and 2015, 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 Consolidated 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 of 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, 2016 and 2015, 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
April 6, 2017

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
Cash and cash equivalents	$ 35,826,156	$ 45,791,808
Investments:		
Securities available for sale	477,733,627	472,357,721
Other	9,484,000	250,000
Loans receivable, net	524,756,739	469,748,482
Accrued interest receivable	3,097,427	3,037,563
Property and equipment	6,144,312	6,260,476
National Credit Union Share Insurance Fund (NCUSIF) deposit	8,802,157	8,377,464
Other assets	7,259,123	7,531,878
Total assets	$ 1,073,103,541	$ 1,013,355,392
LIABILITIES AND MEMBERS' EQUITY		
Liabilities:		
Members' share accounts	$ 946,595,302	$ 895,363,574
Accrued expenses and other liabilities	13,260,862	8,541,250
Total liabilities	959,856,164	903,904,824
Members' equity:		
Regular reserve	3,559,687	3,559,687
Undivided earnings	118,493,187	115,396,908
Accumulated other comprehensive loss	(8,805,497)	(9,506,027)
Total members' equity	113,247,377	109,450,568
Total liabilities and members' equity	$ 1,073,103,541	$ 1,013,355,392

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, 2016 AND 2015

	2016	2015
INTEREST INCOME		
Loans receivable	$ 21,131,294	$ 19,560,556
Investments and interest-bearing accounts	10,918,132	9,115,087
Total interest income	32,049,426	28,675,643
INTEREST EXPENSE		
Members' share accounts	5,748,571	5,436,758
Borrowed funds	932,615	-
Total interest expense	6,681,186	5,436,758
NET INTEREST INCOME	25,368,240	23,238,885
PROVISION FOR LOAN LOSSES	3,091,124	1,571,380
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	22,277,116	21,667,505
NON-INTEREST INCOME		
Fees and charges	2,097,313	2,095,666
Net realized gain on sale of securities available for sale	109,579	65,962
Other income	2,722,596	2,628,103
Total non-interest income	4,929,488	4,789,731
NON-INTEREST EXPENSE		
Compensation and benefits	11,173,314	10,193,475
Operations	11,628,558	10,247,228
Occupancy	1,308,453	1,411,010
Total non-interest expense	24,110,325	21,851,713
NET INCOME	$ 3,096,279	$ 4,605,523

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, 2016 AND 2015

	2016	2015
NET INCOME	$ 3,096,279	$ 4,605,523
OTHER COMPREHENSIVE INCOME		
Net change in unrealized losses on securities available for sale	810,109	1,969,933
Less: reclassification adjustment for realized gains included in net income	(109,579)	(65,962)
Total other comprehensive income	700,530	1,903,971
COMPREHENSIVE INCOME	$ 3,796,809	$ 6,509,494

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, 2016 and 2015

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2014	$ 3,559,687	$ 110,791,385	$ (11,409,998)	$ 102,941,074
Comprehensive income:				
Net income	-	4,605,523	-	4,605,523
Other comprehensive income	-	-	1,903,971	1,903,971
Total comprehensive income				6,509,494
Balance, December 31, 2015	3,559,687	115,396,908	(9,506,027)	109,450,568
Comprehensive income:				
Net income	-	3,096,279	-	3,096,279
Other comprehensive income	-	-	700,530	700,530
Total comprehensive income				3,796,809
Balance, December 31, 2016	$ 3,559,687	$ 118,493,187	$ (8,805,497)	$ 113,247,377

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, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,096,279	$ 4,605,523
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,058,454	1,213,243
Provision for loan losses	3,091,124	1,571,380
Amortization of investments, net	3,215,966	3,588,402
Amortization of deferred loan origination costs, net	118,227	110,814
Net realized gain on sale of securities available for sale	(109,579)	(65,962)
Amortization of mortgage servicing rights	70,075	125,852
Gain on sale of property and equipment	(2,329)	-
Net change in:		
Accrued interest receivable	(59,864)	(12,692)
NCUSIF deposit	(424,693)	(410,953)
Other assets	202,680	(1,232,779)
Accrued expenses and other liabilities	4,021,300	427,834
Net cash provided by operating activities	14,277,640	9,920,662
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available for sale	(171,743,121)	(110,908,206)
Proceeds from sales, maturities and principal payments received on securities available for sale	164,659,670	119,016,834
Net increase in other investments	(9,234,000)	-
Net increase in loans receivable	(58,217,608)	(41,934,233)
Purchases of property and equipment	(955,815)	(465,438)
Proceeds from the sale of property and equipment	15,854	-
Net cash used in investing activities	(75,475,020)	(34,291,043)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share accounts	51,231,728	40,216,635
Net cash provided by financing activities	51,231,728	40,216,635
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(9,965,652)	15,846,254
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	45,791,808	29,945,554
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 35,826,156	$ 45,791,808
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION AND NONCASH INVESTING ACTIVITIES		
Dividends paid on members' share accounts	$ 5,751,315	$ 5,442,122
Purchase of securities available for sale	698,312	-
Interest paid on borrowed funds	932,615	-

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 consists of employees and former employees of Northrop Grumman Corporation.

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the 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 investment values, the allowance for loan losses, and the fair value of financial instruments.

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 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.

The credit union's financial instruments and other accounts subject to fair value measurement and/or disclosure are summarized 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 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. Declines in the fair value of individual securities available for sale below their cost that are deemed to be other than temporary are reflected in (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 other-than-temporary impairment (OTTI) exists, management considers many factors, including (1) the length of time and 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.

Federal Home Loan Bank (FHLB) Stock: The credit union, as a member of the FHLB system, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its Membership Asset Value, subject to a cap of $15 million, or 2.7% of advances from the FHLB. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Receivable, Net: 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 composing 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 a 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 the 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 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 to a member for other than an insignificant period of time 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 their loan to more affordable terms before it 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 a 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 card 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 were 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 costs 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 costs 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 costs 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 have been 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.

Loan Servicing: Servicing assets are recognized as separate assets initially measured at fair value, if practicable, when the credit union sells mortgage loans with servicing retained. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, discount rate, custodial earnings rate, inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in other assets and amortized into non-interest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based on the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the credit union later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Property and Equipment: Land is carried at cost. Building, furniture and equipment, data processing equipment and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Building, 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 will be refunded to the credit union if its insurance coverage is terminated, if it converts insurance coverage to another source, or if the operations of the fund are transferred from the NCUA Board.

NCUSIF Insurance Premium and Temporary Corporate Credit Union Stabilization Fund (TCCUSF) Assessment: The credit union is required to pay an annual insurance premium and/or TCCUSF assessment based on a percentage of its total insured shares as declared by the NCUA Board, unless the payment is waived by the Board. There were no assessments during the years ended December 31, 2016 and 2015.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 December 31, 2016 and 2015.

Recent Accounting Pronouncements: In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01—*Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU requires an entity to measure equity investments at fair value through net income, with certain exceptions; present in other comprehensive income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; present financial assets and financial liabilities by measurement category and form of financial assets; and calculate the fair value of financial instruments for disclosure purposes based on an exit price. ASU No. 2016-01 provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. This ASU also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements.

Entities that are not public business entities will no longer be required to disclose the fair value of financial instruments carried at amortized cost, which the credit union has early adopted.

The classification and measurement guidance will be effective for non-public entities in fiscal years beginning after December 15, 2018. The credit union is currently evaluating the impact of ASU No. 2016-01 on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02—*Leases (Topic 842)*. This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU affects any entity that enters into a lease, with some specified scope exemptions. The guidance in ASU No. 2016-02 supersedes ASC 840, *Leases*.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:

- A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and
- A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term.

Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and ASC 606, *Revenue from Contracts with Customers*.

The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees will no longer be provided with a source of off-balance-sheet financing.

The amendments in ASU No. 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities, specific not-for-profit entities and specific employee benefit plans. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. The credit union is currently evaluating the impact of this ASU on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13—*Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the consolidated financial statements. In addition, ASU No. 2016-13 amends the accounting for credit losses on debt securities available for sale and purchased financial assets with credit deterioration. This ASU is effective for private entities for fiscal years beginning after December 15, 2020 and interim periods beginning after December 15, 2021. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The credit union is currently evaluating the impact of ASU No. 2016-13 on its consolidated financial statements.

On August 26, 2016, the FASB published ASU No. 2016-15—*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)*. This new guidance makes eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows with the intent to reduce diversity in practice in how transactions are classified in the statement of cash flows. ASU No. 2016-15 is effective for private entities for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years a year later. Early application is permitted, including adoption in an interim period, and any adjustments should be reflected as of the beginning of the fiscal year that includes the interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments in this ASU should be applied using a retrospective transition method for each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The credit union is currently evaluating the impact of ASU No. 2016-15 on its consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On December 14, 2016, the FASB published ASU No. 2016-19—*Technical Corrections and Improvements*, with a slate of minor corrections for several parts of GAAP. Most of the updates take effect immediately, although the FASB indicated that some will be effective for reporting periods beginning after December 15, 2016. The credit union is currently evaluating the impact of ASU No. 2016-19 on its consolidated financial statements.

Subsequent Events: Subsequent events have been evaluated through April 6, 2017, 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:

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Federal agency securities	$ 22,824,560	$ -	$ (254,459)	$ 22,570,101
Mortgage-backed securities	463,714,564	551,391	(9,102,429)	455,163,526
	$ 486,539,124	$ 551,391	$ (9,356,888)	$ 477,733,627
2015				
Federal agency securities	$ 83,932,180	$ 34,173	$ (1,684,839)	$ 82,281,514
Mortgage-backed securities	397,931,568	847,121	(8,702,482)	390,076,207
	$ 481,863,748	$ 881,294	$ (10,387,321)	$ 472,357,721

At December 31, 2016, securities with a fair market value totaling $364,723,671 have been pledged as collateral to secure borrowings through the FHLB.

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		
2016	Fair Value	Less Than 12 Months	12 Months or Longer	Total Unrealized Losses
Federal agency securities	$ 22,570,101	$ (254,459)	$ -	$ (254,459)
Mortgage-backed securities	403,328,743	(5,387,379)	(3,715,050)	(9,102,429)
	$ 425,898,844	$ (5,641,838)	$ (3,715,050)	$ (9,356,888)
2015				
Federal agency securities	$ 67,083,211	$ (385,214)	$ (1,299,625)	$ (1,684,839)
Mortgage-backed securities	340,045,284	(833,798)	(7,868,684)	(8,702,482)
	$ 407,128,495	$ (1,219,012)	$ (9,168,309)	$ (10,387,321)

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, 2016, 38 investments have been in a continuous unrealized loss position for less than 12 months and 117 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 OTTI is identified.

There was no OTTI loss recorded for the years ended December 31, 2016 and 2015.

Other investments consisted of the following:

	2016	2015
Contributed capital in a corporate credit union	$ 250,000	$ 250,000
FHLB stock	9,234,000	-
	$ 9,484,000	$ 250,000

The amortized cost and fair value of investments by contractual maturity at December 31, 2016 are as follows:

	Securities Available for Sale		
	Amortized Cost	Fair Value	Other
No contractual maturity	$ -	$ -	$ 9,484,000
Five to ten years	16,750,000	16,658,732	-
More than ten years	6,074,560	5,911,369	-
	22,824,560	22,570,101	9,484,000
Mortgage-backed securities	463,714,564	455,163,526	-
	$ 486,539,124	$ 477,733,627	$ 9,484,000

Because borrowers may prepay obligations with or without call or prepayment penalties, the expected maturities of mortgage-backed securities may differ from the contractual maturities. Mortgage-backed securities are therefore classified separately with no specific maturity date.

NOTE 3 – LOANS RECEIVABLE, NET

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

	2016	2015
Residential real estate:		
First mortgage	$ 233,852,327	$ 207,268,207
HELOC and other mortgage	90,152,715	86,703,755
	324,005,042	293,971,962
Consumer:		
Automobile	122,731,803	108,373,686
Credit card	40,714,255	43,115,184
Other consumer, primarily unsecured	40,434,549	26,350,939
	203,880,607	177,839,809
Total loans	527,885,649	471,811,771
Allowance for loan losses	(3,128,910)	(2,063,289)
Total loans, net	$ 524,756,739	$ 469,748,482

At December 31, 2016 and 2015, HELOC loans with unpaid principal balances totaling $40,173,637 and $22,611,144, respectively, have been pledged as collateral to secure borrowings through the Federal Reserve Bank (FRB) discount window.

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

2016	Residential Real Estate	Consumer	Total
Allowance for loan losses:			
Beginning balance	$ 575,217	$ 1,488,072	$ 2,063,289
Charge-offs	(487,433)	(1,804,973)	(2,292,406)
Provision for loan losses	1,199,903	1,891,221	3,091,124
Recoveries	40,912	225,991	266,903
Ending balance	$ 1,328,599	$ 1,800,311	$ 3,128,910
Individually evaluated for impairment	$ 777,832	$ 121,742	$ 899,574
Collectively evaluated for impairment	550,767	1,678,569	2,229,336
Ending balance	$ 1,328,599	$ 1,800,311	$ 3,128,910
Recorded investment in loans:			
Individually evaluated for impairment	$ 3,757,993	$ 196,513	$ 3,954,506
Collectively evaluated for impairment	320,247,049	203,684,094	523,931,143
Ending balance	$ 324,005,042	$ 203,880,607	$ 527,885,649

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

2015	Residential Real Estate	Consumer	Total
Allowance for loan losses:			
Beginning balance	$ 759,727	$ 1,154,035	$ 1,913,762
Charge-offs	(174,886)	(1,469,784)	(1,644,670)
Provision (credit) for loan losses	(25,956)	1,597,336	1,571,380
Recoveries	16,332	206,485	222,817
Ending balance	$ 575,217	$ 1,488,072	$ 2,063,289
Individually evaluated for impairment	$ 372,176	$ 110,846	$ 483,022
Collectively evaluated for impairment	203,041	1,377,226	1,580,267
Ending balance	$ 575,217	$ 1,488,072	$ 2,063,289
Recorded investment in loans:			
Individually evaluated for impairment	$ 4,237,178	$ 216,215	$ 4,453,393
Collectively evaluated for impairment	289,734,784	177,623,594	467,358,378
Ending balance	$ 293,971,962	$ 177,839,809	$ 471,811,771

Changes in Accounting Methodology: There were no changes in accounting methodology for the allowance for loan losses during the years ended December 31, 2016 and 2015, respectively.

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

FICO Scores: The credit union obtains FICO scores at loan origination, and the scores are updated at least annually with the most recent update as of December 31, 2016. 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:

2016	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
800 and above	$ 80,105,138	$ 19,566,289	$ 17,930,739	$ 2,357,869	$ 1,688,408	$ 121,648,443
720 to 799	117,773,334	44,069,356	57,077,477	19,428,215	17,550,876	255,899,258
680 to 719	18,811,747	11,291,207	18,913,112	8,126,332	9,106,398	66,248,796
640 to 679	8,943,401	6,082,680	12,772,343	5,475,284	5,836,802	39,110,510
580 to 639	4,224,252	4,733,708	8,951,377	3,141,644	3,741,512	24,792,493
579 and below	868,456	2,926,805	6,037,801	1,575,206	2,051,428	13,459,696
Unknown	3,125,999	1,482,670	1,048,954	609,705	459,125	6,726,453
	$ 233,852,327	$ 90,152,715	$ 122,731,803	$ 40,714,255	$ 40,434,549	$ 527,885,649
2015						
800 and above	$ 65,954,216	$ 18,954,363	$ 12,248,761	$ 1,901,619	$ 780,471	$ 99,839,430
720 to 799	105,758,342	40,564,766	48,686,040	20,702,836	9,541,210	225,253,194
680 to 719	19,885,778	12,507,538	17,519,208	8,755,001	5,794,259	64,461,784
640 to 679	8,506,671	6,397,724	12,435,128	6,184,527	4,752,180	38,276,230
580 to 639	3,251,767	4,162,568	9,016,874	3,437,544	2,848,414	22,717,167
579 and below	1,852,904	2,898,669	7,062,209	1,736,003	2,310,027	15,859,812
Unknown	2,058,529	1,218,127	1,405,466	397,654	324,378	5,404,154
	$ 207,268,207	$ 86,703,755	$ 108,373,686	$ 43,115,184	$ 26,350,939	$ 471,811,771

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

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 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.

Trends in LTV migration 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 limited to approximately 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:

2016	Less Than 80%	80%–89%	90%–100%	Greater Than 100%	Unknown	Total
First mortgage	$ 215,657,956	$ 11,432,613	$ 4,701,820	$ 2,059,938	$ -	$ 233,852,327
HELOC and other mortgage	72,305,418	9,290,874	2,876,255	5,266,173	413,995	90,152,715
	$ 287,963,374	$ 20,723,487	$ 7,578,075	$ 7,326,111	$ 413,995	$ 324,005,042
2015						
First mortgage	$ 188,155,399	$ 12,886,516	$ 4,321,649	$ 1,811,181	$ 93,462	$ 207,268,207
HELOC and other mortgage	77,809,220	4,197,908	2,344,335	2,025,428	326,864	86,703,755
	$ 265,964,619	$ 17,084,424	$ 6,665,984	$ 3,836,609	$ 420,326	$ 293,971,962

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

2016	Current	30–59 Days Past Due	60–179 Days Past Due	180–359 Days Past Due	360 Days or More Past Due	Total	Loans on Nonaccrual Status
First mortgage	$ 231,614,686	$ 1,974,869	$ -	$ -	$ 262,772	$ 233,852,327	$ 262,772
HELOC and other mortgage	88,338,969	1,056,236	89,709	46,380	621,421	90,152,715	757,510
Automobile	121,262,419	996,558	313,157	111,463	48,206	122,731,803	472,826
Credit card	40,350,302	-	363,953	-	-	40,714,255	363,953
Other consumer	39,758,829	404,349	269,947	1,424	-	40,434,549	271,371
	$ 521,325,205	$ 4,432,012	$ 1,036,766	$ 159,267	$ 932,399	$ 527,885,649	$ 2,128,432
2015							
First mortgage	$ 206,284,739	$ 570,944	$ -	$ 69,249	$ 343,275	$ 207,268,207	$ 412,524
HELOC and other mortgage	84,858,574	241,547	465,112	328,823	809,699	86,703,755	1,603,634
Automobile	106,324,554	1,038,345	772,508	109,767	128,512	108,373,686	1,010,787
Credit card	42,792,989	197,985	124,210	-	-	43,115,184	124,210
Other consumer	25,834,155	314,207	190,861	11,716	-	26,350,939	202,577
	$ 466,095,011	$ 2,363,028	$ 1,552,691	$ 519,555	$ 1,281,486	$ 471,811,771	$ 3,353,732

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

There were no loans 60 days or more past due and still accruing interest as of December 31, 2016 and 2015.

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

2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
First mortgage	$ 785,765	$ 781,568	$ -	$ 812,052	$ 17,210
HELOC and other mortgage	1,352,947	1,349,745	-	1,514,336	34,747
Automobile	20,373	20,373	-	27,374	406
	2,159,085	2,151,686	-	2,353,762	52,363
With an allowance recorded:					
First mortgage	876,571	877,316	294,449	983,466	17,806
HELOC and other mortgage	750,830	749,364	483,383	687,435	9,276
Automobile	174,717	174,717	120,319	157,724	895
Other consumer	1,423	1,423	1,423	21,266	-
	1,803,541	1,802,820	899,574	1,849,891	27,977
Total:					
First mortgage	1,662,336	1,658,884	294,449	1,795,518	35,016
HELOC and other mortgage	2,103,777	2,099,109	483,383	2,201,771	44,023
Automobile	195,090	195,090	120,319	185,098	1,301
Other consumer	1,423	1,423	1,423	21,266	-
	$ 3,962,626	$ 3,954,506	$ 899,574	$ 4,203,653	$ 80,340
2015					
With no related allowance recorded:					
First mortgage	$ 838,338	$ 840,386	$ -	$ 1,185,407	$ 30,364
HELOC and other mortgage	1,675,725	1,676,304	-	1,495,988	24,767
Automobile	34,375	34,375	-	34,375	1,374
	2,548,438	2,551,065	-	2,715,770	56,505
With an allowance recorded:					
First mortgage	1,099,360	1,096,449	257,268	1,217,233	18,804
HELOC and other mortgage	624,039	624,039	114,908	791,468	6,136
Automobile	140,731	140,731	69,737	192,237	1,950
Other consumer	41,109	41,109	41,109	41,109	-
	1,905,239	1,902,328	483,022	2,242,047	26,890
Total:					
First mortgage	1,937,698	1,936,835	257,268	2,402,640	49,168
HELOC and other mortgage	2,299,764	2,300,343	114,908	2,287,456	30,903
Automobile	175,106	175,106	69,737	226,612	3,324
Other consumer	41,109	41,109	41,109	41,109	-
	$ 4,453,677	$ 4,453,393	$ 483,022	$ 4,957,817	$ 83,395

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

TDRs: There were no loans modified as TDRs during the year ended December 31, 2016 and no restructurings for which there was a payment default subsequent to the restructuring, but within 12 months of the restructuring, during the year ended December 31, 2016.

Loans modified as TDRs during the year ended December 31, 2015 included one first mortgage loan in the amount of $220,148 that was granted an interest rate concession with an allowance impact of $13,800. There was one other consumer modification with a principal balance of $14,856 for which there was a payment default within 12 months of the restructuring date during the year ended December 31, 2015.

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 $51,125,865 and $59,789,550 at December 31, 2016 and 2015, respectively. Mortgage servicing rights totaled $250,517 and $320,592 as of December 31, 2016 and 2015, respectively.

NOTE 5 – PROPERTY AND EQUIPMENT

The composition of property and equipment is summarized as follows:

	2016	2015
Land	$ 1,110,140	$ 1,110,140
Building	3,958,345	3,958,345
Furniture and equipment	4,563,633	4,426,926
Data processing equipment	11,185,975	10,525,696
Leasehold improvements	3,062,781	2,942,591
	23,880,874	22,963,698
Accumulated depreciation and amortization	(17,736,562)	(16,703,222)
	$ 6,144,312	$ 6,260,476

NOTE 6 – MEMBERS' SHARE ACCOUNTS

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

	2016	2015
Regular share	$ 226,515,538	$ 208,087,400
Share draft	126,943,872	118,355,062
Money market	290,490,862	278,939,043
Individual retirement account	12,659,474	12,022,875
Certificates of deposit	289,985,556	277,959,194
	$ 946,595,302	$ 895,363,574

Dividend rates are set by the Board of Directors, and dividends are charged to operations. The aggregate amounts of time deposits in denominations that met or exceeded the NCUSIF insurance limit were $38,773,259 and $35,654,502 at December 31, 2016 and 2015, respectively.

NOTE 6 – MEMBERS' SHARE ACCOUNTS (CONTINUED)

A summary of share certificate accounts by maturity at December 31, 2016 is as follows:

Years Ending December 31,	
2017	$ 165,582,199
2018	50,714,581
2019	20,857,974
2020	17,954,706
2021	26,964,460
Thereafter	7,911,636
	$ 289,985,556

NOTE 7 – BORROWED FUNDS

Corporate Credit Union: The credit union utilizes a demand loan agreement with Vizo Financial Corporate Credit Union (formed from the merger of Mid-Atlantic Corporate Federal Credit Union and First Carolina Corporate 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 agreement provides 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, 2016 and 2015, there were no borrowings under this agreement, which is annually reviewed for continuation by the lender and the credit union.

FHLB Advances: During the year ended December 31, 2016, the credit union established a line-of-credit arrangement with the FHLB under the Securities-Backed Credit Program. At December 31, 2016, the credit union had pledged securities with a market value of $364,723,671 as collateral under the program. The credit union's borrowing capacity is determined as a percentage of the fair value of the pledged securities, less outstanding advances, subject to a cap of 35% of total assets. As of December 31, 2016, the credit union had a borrowing capacity of $342,184,679 with no outstanding borrowings.

FRB Discount Window: The credit union also has a secured borrowing arrangement through the FRB discount window. The credit union has pledged certain HELOC loans as collateral for any and all obligations of the credit union. The borrowing capacity is determined as a percentage of pledged collateral. As of December 31, 2016 and 2015, the credit union pledged HELOC loans with a collateral value of $40,173,637 and $22,611,144, respectively, as collateral for this borrowing arrangement. As of December 31, 2016 and 2015, there were no borrowings under this arrangement.

Repurchase Agreement: The credit union has a $50,000,000 repurchase agreement line of credit with Raymond James & Associates. As of December 31, 2016 and 2015, the credit union did not have any securities repurchased and did not have any outstanding borrowings.

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.

The required future minimum annual lease payments under the terms of the leases are as follows:

Years Ending December 31,	
2017	$ 915,888
2018	974,343
2019	971,714
2020	1,005,808
2021	1,035,982
Thereafter	2,179,636
	$ 7,083,371

Rent expense totaled approximately $1,093,000 and $1,168,000 for the years ended December 31, 2016 and 2015, 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 the loans recorded in the consolidated financial statements.

The credit union had approximately $695,000 and $745,000 in outstanding first mortgage loan commitments at December 31, 2016 and 2015, respectively.

The following financial instruments were outstanding whose contract amounts represent credit risk:

	2016	2015
HELOC	$ 107,622,108	$ 99,285,136
Lines of credit	50,770,629	50,995,517
Credit card	63,585,914	57,417,983
Courtesy pay program	1,110,712	1,054,010
	$ 223,089,363	$ 208,752,646

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 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, 2016, the credit union had no account balances 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 $2,189,753 and $2,360,784 at December 31, 2016 and 2015, 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, 2016 and 2015 totaled approximately $493,000 and $454,000, respectively.

Deferred Compensation Plan: In March 2012, the credit union established a nonqualified deferred compensation plan for certain executives under Internal Revenue Code 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 approximately $2,336,000 and $2,273,000 as of December 31, 2016 and 2015, respectively. The accrued liability for the deferred compensation included in accrued expenses and other liabilities was approximately $159,000 and $120,000 as of December 31, 2016 and 2015, respectively.

NOTE 14 – FAIR VALUE

The following methods and assumptions were used to estimate fair value of the credit union's securities available for sale as required by the adoption of ASU No. 2016-01.

Fair values of securities available for sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or on discounted cash flow models based on the expected payment characteristics of the underlying mortgage instruments.

Fair values of assets measured on a recurring basis are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
2016	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Federal agency securities	$ 22,570,101	$ -	$ 22,570,101	$ -
Mortgage-backed securities:				
U.S. agency	453,513,670	-	453,513,670	-
Non-U.S. agency	1,649,856	-	1,649,856	-
	455,163,526	-	455,163,526	-
	$ 477,733,627	$ -	$ 477,733,627	$ -
2015				
Federal agency securities	$ 82,281,514	$ -	$ 82,281,514	$ -
Mortgage-backed securities:				
U.S. agency	388,081,761	-	388,081,761	-
Non-U.S. agency	1,994,446	-	1,994,446	-
	390,076,207	-	390,076,207	-
	$ 472,357,721	$ -	$ 472,357,721	$ -

Fair values of assets measured on a nonrecurring basis are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
2016	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 2,308,120	$ -	$ -	$ 2,308,120
2015				
Impaired loans	$ 3,383,127	$ -	$ -	$ 3,383,127

Impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans.

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, 2016 and 2015 was 6.27% and 7.24%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes, as of December 31, 2016, that the credit union meets all capital adequacy requirements to which it is subject.

As of December 31, 2016, 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	
2016	Amount	Ratio	Amount	Ratio	Amount	Ratio
Net worth	$ 122,052,874	11.37%	$ 64,386,212	6.00%	$ 75,117,248	7.00%
RBNW requirement	67,283,592	6.27%	N/A	N/A	N/A	N/A
2015						
Net worth	$ 118,956,595	11.74%	$ 60,801,324	6.00%	$ 70,934,877	7.00%
RBNW requirement	73,366,930	7.24%	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.

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