NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

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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, 2018 and 2017, 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, 2018 and 2017, 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 15, 2019

NORTHROP GRUMMAN FEDERAL CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2018 AND 2017

	2018	2017
ASSETS		
Cash and cash equivalents	$ 11,138,710	$ 27,495,439
Investments:		
Securities available for sale	372,334,938	412,272,943
Other	8,227,900	10,780,000
Loans receivable, net	720,238,578	625,333,246
Accrued interest receivable	3,382,023	3,247,122
Property and equipment	7,079,239	7,478,876
National Credit Union Share Insurance Fund (NCUSIF) deposit	9,864,576	9,436,408
Other assets	6,842,985	8,179,746
Total assets	$ 1,139,108,949	$ 1,104,223,780
LIABILITIES AND MEMBERS' EQUITY		
Liabilities:		
Members' share accounts	$ 1,008,719,083	$ 976,281,706
Accrued expenses and other liabilities	13,839,425	12,683,560
Total liabilities	1,022,558,508	988,965,266
Members' equity:		
Regular reserve	3,559,687	3,559,687
Undivided earnings	122,675,065	119,741,682
Accumulated other comprehensive loss	(9,684,311)	(8,042,855)
Total members' equity	116,550,441	115,258,514
Total liabilities and members' equity	$ 1,139,108,949	$ 1,104,223,780

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, 2018 AND 2017

	2018	2017
INTEREST INCOME		
Loans receivable	$ 28,524,394	$ 23,826,080
Interest-bearing accounts and investments	10,837,517	13,425,013
Total interest income	39,361,911	37,251,093
INTEREST EXPENSE		
Members' share accounts	7,873,035	6,226,022
Borrowed funds	909,406	3,542,528
Total interest expense	8,782,441	9,768,550
NET INTEREST INCOME	30,579,470	27,482,543
PROVISION FOR LOAN LOSSES	2,968,271	3,173,232
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	27,611,199	24,309,311
NON-INTEREST INCOME		
Fees and charges	1,774,705	1,626,737
Interchange income	1,791,626	1,483,343
Loss on sale of securities available for sale	-	(156,224)
Other income	2,570,558	1,715,965
Total non-interest income	6,136,889	4,669,821
NON-INTEREST EXPENSE		
Compensation and benefits	16,448,061	14,160,229
Operations	12,777,328	12,184,420
Occupancy	1,589,316	1,385,988
Total non-interest expense	30,814,705	27,730,637
NET INCOME	$ 2,933,383	$ 1,248,495

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, 2018 AND 2017

	2018	2017
NET INCOME	$ 2,933,383	$ 1,248,495
OTHER COMPREHENSIVE INCOME (LOSS)		
Net change in unrealized losses on securities available for sale	(1,641,456)	606,418
Less: reclassification adjustment for realized losses included in net income	-	156,224
Total other comprehensive income (loss)	(1,641,456)	762,642
COMPREHENSIVE INCOME	$ 1,291,927	$ 2,011,137

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, 2018 AND 2017

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2016	$ 3,559,687	$ 118,493,187	$ (8,805,497)	$ 113,247,377
Comprehensive income:				
Net income	-	1,248,495	-	1,248,495
Other comprehensive income	-	-	762,642	762,642
Total comprehensive income				2,011,137
Balance, December 31, 2017	3,559,687	119,741,682	(8,042,855)	115,258,514
Comprehensive income:				
Net income	-	2,933,383	-	2,933,383
Other comprehensive loss	-	-	(1,641,456)	(1,641,456)
Total comprehensive income				1,291,927
Balance, December 31, 2018	$ 3,559,687	$ 122,675,065	$ (9,684,311)	$ 116,550,441

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, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,933,383	$ 1,248,495
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,409,180	1,068,475
Provision for loan losses	2,968,271	3,173,232
Amortization of investments, net	2,339,438	3,083,894
Amortization of deferred loan origination fees, net	139,269	73,353
Loss on sale of securities available for sale	-	156,224
Amortization of mortgage servicing rights	18,360	53,615
Net change in:		
Accrued interest receivable	(134,901)	(149,695)
NCUSIF deposit	(428,168)	(634,251)
Other assets	1,318,401	(974,238)
Accrued expenses and other liabilities	1,155,865	(577,302)
Net cash provided by operating activities	11,719,098	6,521,802
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available for sale	(47,236,789)	(34,647,341)
Proceeds from sales, maturities and principal payments received on securities available for sale	83,193,900	97,630,549
Net (increase) decrease in other investments	2,552,100	(1,296,000)
Net increase in loans receivable	(98,012,872)	(103,823,092)
Purchases of property and equipment	(1,009,543)	(2,403,039)
Net cash used in investing activities	(60,513,204)	(44,538,923)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share accounts	32,437,377	29,686,404
Net cash provided by financing activities	32,437,377	29,686,404
NET DECREASE IN CASH AND CASH EQUIVALENTS	(16,356,729)	(8,330,717)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	27,495,439	35,826,156
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 11,138,710	$ 27,495,439
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION AND NONCASH INVESTING ACTIVITIES		
Dividends paid on members' share accounts	$ 7,350,959	$ 6,229,384
Interest paid on borrowed funds	909,406	3,542,528

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 the fair value of investments and 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 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 that are 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 and purchases commercial real estate participations. 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 fees. 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 dividing its portfolio into classes based on initial measurement attributes, risk characteristics, or its method of monitoring and assessing credit risk. Management first divides its portfolio into three segments: commercial, 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 commercial portfolio segment comprises commercial real estate loans. The classes within the residential real estate portfolio segment are first mortgage, 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 and evaluates the commercial loans individually. 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, consumer and non-impaired commercial 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. The significant characteristics considered for the commercial segment include payment history, borrower cash flow, collateral value, and market conditions and trends.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Foreclosed and Repossessed Assets: Assets 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. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are performed periodically by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses associated with foreclosed assets, as well as the changes in the corresponding valuation allowance, are included in non-interest expense in the consolidated statements of income.

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 NCUSIF is a revolving fund in the Treasury of the United States under the management of the NCUA. 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: 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.

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, 2018 and 2017.

Advertising Costs: Advertising costs are expensed as incurred.

Reclassification: Certain 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 February 2018, the FASB issued Accounting Standards Update (ASU) 2018-03—*Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU clarifies that an entity measuring equity securities using the measurement alternative may change its measurement approach to fair value in accordance with Topic 820, *Fair Value Measurement*, through an irrevocable election that applies to the securities and all identical or similar investments of the same issuer.

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 2018-03 on its consolidated financial statements.

In July 2018, the FASB issued ASU 2018-10—*Codification Improvements to Topic 842, Leases.* This is an amendment to ASU 2016-02—*Leases (Topic 842)* issued in February 2016 to make improvements to clarify the Codification or to correct unintended application of the guidance. Those items are not expected to have a significant impact on current accounting practice. The amendments in ASU 2018-10 affect narrow aspects of the guidance such as residual value, rate implicit in lease, lease reassessment of lease classification, variable lease payments that depend on an index or a rate and various other areas needing clarification. The amendments in ASU 2018-10 affect the amendments in ASU 2016-02, which are not yet effective but for which early adoption upon issuance is permitted. For entities that early adopted Topic 842, the amendments are effective upon the issuance of ASU 2018-10, and the transition requirements are the same as those in Topic 842. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. The credit union is currently evaluating the impact of ASU 2018-10 on its consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In July 2018, the FASB issued ASU 2018-11—*Leases (Topic 842): Targeted Improvements*. This ASU addresses two requirements in the new leases standard:

1) Comparative reporting requirements for initial adoption (transition-comparative reporting at adoption). The amendment provides an additional transition method to the existing modified retrospective transition method. Under the modified retrospective transition method, an entity initially applies the new leases standard at the earliest period presented in the consolidated financial statements. The FASB decided to allow entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.
2) For lessors only, separating lease and nonlease components in a contract and allocating the consideration in the contract to the separate components (separating components of a contract). The amendment provides lessors a practical expedient to not separate nonlease components from the associated lease component if certain requirements are met.

For entities that have not adopted Topic 842 before the issuance of ASU 2018-11, the effective date and transition requirements for the amendments in ASU 2018-11 related to separating components of a contract are the same as the effective date and transition requirements in ASU 2016-02. For entities that have adopted Topic 842 before the issuance of ASU 2018-11, the transition and effective date of the amendments related to separating components of a contract in ASU 2018-11 are as follows:

1) The practical expedient may be elected either in the first reporting period following the issuance of ASU 2018-11 or at the original effective date of Topic 842 for that entity.
2) The practical expedient may be applied either retrospectively or prospectively.

The credit union is considering the effects of ASU 2018-11 on its consolidated financial statements.

Subsequent Events: Subsequent events have been evaluated through April 15, 2019, which is the date the consolidated financial statements were available to be issued.

NOTE 2 – INVESTMENTS

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

	Amortized	Gross Unrealized		Fair
2018	Cost	Gains	Losses	Value
Federal agency securities	$ 19,260,298	$ -	$ (384,697)	$ 18,875,601
Mortgage-backed securities	362,758,951	467,116	(9,766,730)	353,459,337
	$ 382,019,249	$ 467,116	$ (10,151,427)	$ 372,334,938
2017				
Federal agency securities	$ 25,504,872	$ -	$ (335,345)	$ 25,169,527
Mortgage-backed securities	394,810,926	566,176	(8,273,686)	387,103,416
	$ 420,315,798	$ 566,176	$ (8,609,031)	$ 412,272,943

NOTE 2 – INVESTMENTS (CONTINUED)

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		
2018	Fair Value	Less Than 12 Months	12 Months or Longer	Total Unrealized Losses
Federal agency securities	$ 18,875,601	$ -	$ (384,697)	$ (384,697)
Mortgage-backed securities	296,558,864	(325,924)	(9,440,806)	(9,766,730)
	$ 315,434,465	$ (325,924)	$ (9,825,503)	$ (10,151,427)
2017				
Federal agency securities	$ 25,169,527	$ (21,106)	$ (314,239)	$ (335,345)
Mortgage-backed securities	297,488,637	(499,854)	(7,773,832)	(8,273,686)
	$ 322,658,164	$ (520,960)	$ (8,088,071)	$ (8,609,031)

Management evaluates securities for OTTI on at least an annual 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, 2018, a total of 26 investments have been in a continuous unrealized loss position for less than 12 months and 127 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, 2018 and 2017.

Other investments consist of the following:

	2018	2017
Contributed capital in a corporate credit union	$ 250,000	$ 250,000
FHLB stock	7,977,900	10,530,000
	$ 8,227,900	$ 10,780,000

NOTE 2 – INVESTMENTS (CONTINUED)

The amortized cost and fair value of investments by contractual maturity at December 31, 2018 are as follows:

	Securities Available for Sale		
Maturity	Amortized Cost	Fair Value	Other
No contractual maturity	$ -	$ -	$ 8,277,900
Less than one year	5,175,000	5,132,048	-
One to five years	9,116,279	8,965,498	-
Five to ten years	4,969,019	4,778,055	-
	19,260,298	18,875,601	8,277,900
Mortgage-backed securities	362,758,951	353,459,337	-
	$ 382,019,249	$ 372,334,938	$ 8,277,900

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:

	2018	2017
Commercial:		
Commercial real estate	$ 46,816,623	$ 19,268,737
Residential real estate:		
First mortgage	291,466,130	270,635,260
HELOC and other mortgage	110,363,960	99,924,354
	401,830,090	370,559,614
Consumer:		
Automobile	178,395,218	151,179,308
Credit card	31,928,136	36,006,415
Other consumer, primarily unsecured	66,340,473	52,684,613
	276,663,827	239,870,336
Total loans	725,310,540	629,698,687
Net deferred loan origination fees	(780,464)	(470,055)
Allowance for loan losses	(4,291,498)	(3,895,386)
Total loans, net	$ 720,238,578	$ 625,333,246

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

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

2018	Commercial	Residential Real Estate	Consumer	Total
Allowance for loan losses:				
Beginning balance	$ -	$ 809,365	$ 3,086,021	$ 3,895,386
Charge-offs	-	(28,273)	(2,949,541)	(2,977,814)
Provision (credit) for loan losses	-	(259,029)	3,227,300	2,968,271
Recoveries	-	6,670	398,985	405,655
Ending balance	$ -	$ 528,733	$ 3,762,765	$ 4,291,498
Individually evaluated for impairment	$ -	$ 449,803	$ 1,018,936	$ 1,468,739
Collectively evaluated for impairment	-	78,930	2,743,829	2,822,759
Ending balance	$ -	$ 528,733	$ 3,762,765	$ 4,291,498
Recorded investment in loans:				
Individually evaluated for impairment	$ -	$ 2,816,976	$ 1,214,247	$ 4,031,223
Collectively evaluated for impairment	46,816,623	399,013,114	275,449,580	721,279,317
Ending balance	$ 46,816,623	$ 401,830,090	$ 276,663,827	$ 725,310,540
2017				
Allowance for loan losses:				
Beginning balance	$ -	$ 1,328,599	$ 1,800,311	$ 3,128,910
Charge-offs	-	(215,033)	(2,602,752)	(2,817,785)
Provision (credit) for loan losses	-	(319,456)	3,492,688	3,173,232
Recoveries	-	15,255	395,774	411,029
Ending balance	$ -	$ 809,365	$ 3,086,021	$ 3,895,386
Individually evaluated for impairment	$ -	$ 540,094	$ 937,249	$ 1,477,343
Collectively evaluated for impairment	-	269,271	2,148,772	2,418,043
Ending balance	$ -	$ 809,365	$ 3,086,021	$ 3,895,386
Recorded investment in loans:				
Individually evaluated for impairment	$ -	$ 4,152,635	$ 1,145,163	$ 5,297,798
Collectively evaluated for impairment	19,268,737	366,406,979	238,725,173	624,400,889
Ending balance	$ 19,268,737	$ 370,559,614	$ 239,870,336	$ 629,698,687

Changes in Accounting Methodology: There were no changes in accounting methodology for the allowance for loan losses during the years ended December 31, 2018 and 2017, respectively.

Credit Quality Indicators: The credit union assesses the credit quality of its commercial real estate loans with a nine-grade risk rating system whereby a higher grade represents a higher level of credit risk. The nine-grade risk rating system can generally be classified in the following categories: pass or watch, special mention, substandard, doubtful and loss. The risk ratings reflect the relative strength of the sources of repayment.

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

Pass or watch loans are generally considered to have sufficient sources of repayment in order to pay the loan in full in accordance with all terms and conditions. These borrowers may have some credit risk that requires monitoring, but full repayment is expected. Special mention loans are considered to have potential weaknesses that warrant close attention by management. Special mention loans are considered a transitory grade, and generally, the credit union has not had a loan remain categorized as special mention for longer than six months. If any potential weaknesses are resolved, the loan is upgraded to a pass or watch grade. If negative trends in the borrower's financial status or other information is presented indicating that the repayment sources may become inadequate, the loan is downgraded to substandard. Substandard loans are considered to have well-defined weaknesses that jeopardize the full and timely repayment of the loan. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. Additionally, when management has assessed a potential for loss but a distinct possibility of loss is not recognizable, the loan is still classified as substandard. Doubtful loans have insufficient sources of repayment and a high probability of loss. Loss loans are considered to be uncollectible and are therefore charged off. These internal risk ratings are reviewed continuously and adjusted for changes in borrower status and the likelihood of loan repayment.

The credit quality of the commercial real estate loans, which amounted to $46,816,623 and $19,268,737 as of December 31, 2018 and 2017, respectively, was evaluated as pass or watch based on the internal risk grading system.

The credit union assesses the credit quality of its residential real estate and consumer loans by recent FICO score.

FICO Scores: The credit union obtains FICO scores at loan origination, and the scores are updated at least annually. Loans that trend toward higher levels are generally associated with a lower risk factor, whereas loans that migrate toward lower ratings will generally result in a higher risk factor being applied to the related loan balances.

The FICO score distribution is as follows:

2018	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
800 and above	$ 84,630,266	$ 22,394,615	$ 24,126,331	$ 1,801,977	$ 2,499,323	$ 135,452,512
720 to 799	158,404,902	52,780,322	88,820,847	14,924,416	30,447,196	345,377,683
680 to 719	27,213,684	14,146,306	24,578,822	6,126,858	13,193,041	85,258,711
640 to 679	8,556,314	8,892,704	15,491,934	4,089,651	8,566,129	45,596,732
580 to 639	6,464,745	6,967,035	12,478,856	2,974,250	6,137,915	35,022,801
579 and below	1,353,604	3,598,579	8,269,071	1,621,213	3,306,058	18,148,525
Unknown	4,842,615	1,584,399	4,629,357	389,771	2,190,811	13,636,953
	$ 291,466,130	$ 110,363,960	$ 178,395,218	$ 31,928,136	$ 66,340,473	$ 678,493,917
2017						
800 and above	$ 76,645,690	$ 19,842,091	$ 17,821,960	$ 2,247,610	$ 2,190,039	$ 118,747,390
720 to 799	151,589,725	50,351,904	73,454,979	17,177,906	25,006,032	317,580,546
680 to 719	22,110,098	12,455,246	21,429,935	6,633,384	10,221,942	72,850,605
640 to 679	9,882,810	6,840,074	13,590,172	4,861,295	6,624,524	41,798,875
580 to 639	4,065,809	5,052,534	10,988,448	3,044,059	4,389,922	27,540,772
579 and below	1,483,539	3,477,170	7,586,808	1,693,294	2,684,719	16,925,530
Unknown	4,857,589	1,905,335	6,307,006	348,867	1,567,435	14,986,232
	$ 270,635,260	$ 99,924,354	$ 151,179,308	$ 36,006,415	$ 52,684,613	$ 610,429,950

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

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

2018	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
Commercial real estate	$ 46,816,623	$ -	$ -	$ -	$ -	$ 46,816,623	$ -
First mortgage	290,219,714	1,044,944	7,949	-	193,523	291,466,130	201,472
HELOC and other mortgage	108,319,777	1,508,176	334,422	26,905	174,680	110,363,960	536,007
Automobile	176,450,535	1,249,332	433,091	180,936	81,324	178,395,218	695,351
Credit card	31,544,152	128,091	255,893	-	-	31,928,136	255,893
Other consumer	65,280,735	602,820	456,918	-	-	66,340,473	456,918
	$ 718,631,536	$ 4,533,363	$ 1,488,273	$ 207,841	$ 449,527	$ 725,310,540	$ 2,145,641
2017							
Commercial real estate	$ 19,268,737	$ -	$ -	$ -	$ -	$ 19,268,737	$ -
First mortgage	269,418,837	1,022,900	-	-	193,523	270,635,260	193,523
HELOC and other mortgage	98,805,870	769,816	173,989	27,656	147,023	99,924,354	348,668
Automobile	149,582,542	1,021,734	279,276	271,347	24,409	151,179,308	575,032
Credit card	35,563,205	205,754	237,456	-	-	36,006,415	237,456
Other consumer	51,697,780	435,921	390,932	159,980	-	52,684,613	550,912
	$ 624,336,971	$ 3,456,125	$ 1,081,653	$ 458,983	$ 364,955	$ 629,698,687	$ 1,905,591

There were no loans 60 days or more past due and still accruing interest as of December 31, 2018 and 2017.

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.

2018	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
First mortgage	$ 770,398	$ -	$ 946,915	$ 33,421
HELOC and other mortgage	1,033,747	-	1,273,565	42,460
	1,804,145	-	2,220,480	75,881
With an allowance recorded:				
First mortgage	614,773	183,169	829,966	12,469
HELOC and other mortgage	398,058	266,634	434,360	9,663
Automobile	521,973	326,662	520,879	-
Credit card	255,893	255,893	246,675	-
Other consumer	436,381	436,381	412,152	-
	2,227,078	1,468,739	2,444,032	22,132
Total:				
First mortgage	1,385,171	183,169	1,776,881	45,890
HELOC and other mortgage	1,431,805	266,634	1,707,925	52,123
Automobile	521,973	326,662	520,879	-
Credit card	255,893	255,893	246,675	-
Other consumer	436,381	436,381	412,152	-
	$ 4,031,223	$ 1,468,739	$ 4,664,512	$ 98,013

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

2017	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
First mortgage	$ 1,123,432	$ -	$ 954,599	$ 44,816
HELOC and other mortgage	1,513,383	-	1,433,165	57,872
	2,636,815	-	2,387,764	102,688
With an allowance recorded:				
First mortgage	1,045,159	289,668	960,865	23,501
HELOC and other mortgage	470,661	250,426	610,746	11,203
Automobile	519,785	311,871	347,251	649
Credit card	237,456	237,456	237,456	-
Other consumer	387,922	387,922	194,673	-
	2,660,983	1,477,343	2,350,991	35,353
Total:				
First mortgage	2,168,591	289,668	1,915,464	68,317
HELOC and other mortgage	1,984,044	250,426	2,043,911	69,075
Automobile	519,785	311,871	347,251	649
Credit card	237,456	237,456	237,456	-
Other consumer	387,922	387,922	194,673	-
	$ 5,297,798	$ 1,477,343	$ 4,738,755	$ 138,041

TDRs: There were no loans modified as TDRs during the years ended December 31, 2018 and 2017 and no restructurings for which there was a payment default subsequent to the restructuring, but within 12 months of the restructuring, during the years ended December 31, 2018 and 2017.

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 $38,813,452 and $44,750,349 at December 31, 2018 and 2017, respectively. Mortgage servicing rights totaled $178,542 and $196,902 as of December 31, 2018 and 2017, respectively.

NOTE 5 – PROPERTY AND EQUIPMENT

The composition of property and equipment is summarized as follows:

	2018	2017
Land	$ 1,110,140	$ 1,110,140
Building	3,988,345	3,958,345
Furniture and equipment	5,312,709	5,177,966
Data processing equipment	12,729,070	12,164,048
Leasehold improvements	4,153,191	3,873,413
	27,293,455	26,283,912
Accumulated depreciation and amortization	(20,214,216)	(18,805,036)
	$ 7,079,239	$ 7,478,876

NOTE 6 – MEMBERS' SHARE ACCOUNTS

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

	2018	2017
Regular share	$ 254,725,842	$ 239,482,609
Share draft	141,108,299	135,612,549
Money market	286,312,886	296,303,299
Individual retirement account	11,473,656	13,185,141
Nonmember certificate of deposit	25,000,000	-
Certificates of deposit	290,098,400	291,698,108
	$ 1,008,719,083	$ 976,281,706

Dividend rates are set by the Board of Directors, and dividends are charged to operations. Excluding the State of California certificate described in the next paragraph, the aggregate amounts of time deposits in denominations that met or exceeded the NCUSIF insurance limit were $41,315,939 and $40,993,598 at December 31, 2018 and 2017, respectively.

Included in share certificates is a nonmember certificate of deposit placed by the State of California amounting to $25,000,000 as of December 31, 2018. The certificate is scheduled to mature in February 2019 with an interest rate of 2.37%.

A summary of share certificate accounts by maturity at December 31, 2018 is as follows:

Years Ending December 31,	
2019	$ 191,108,585
2020	57,251,171
2021	35,154,858
2022	16,604,232
2023	10,531,620
Thereafter	4,447,934
	$ 315,098,400

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, 2018 and 2017, 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 Standard Credit Program and Securities-Backed Credit Program. At December 31, 2018, the credit union had pledged securities and real estate loans with a market value of $331,841,017 and $248,975,156, respectively, as collateral under the programs. The credit union's borrowing capacity is determined as a percentage of the fair value of the pledged securities and real estate loans, less outstanding advances, subject to a cap of 35% of total assets. As of December 31, 2018 and 2017, the credit union had a borrowing capacity of $398,020,380 and $390,088,839, respectively, with no outstanding borrowings.

NOTE 7 – BORROWED FUNDS (CONTINUED)

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, 2018 and 2017, the credit union pledged HELOC loans with a collateral value of $50,097,229 and $40,538,887, respectively, as collateral for this borrowing arrangement. As of December 31, 2018 and 2017, 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, 2018 and 2017, the credit union did not have any securities repurchased and did not have any outstanding borrowings.

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.

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

Years Ending December 31,	
2019	$ 1,150,114
2020	1,183,969
2021	1,218,823
2022	1,254,707
2023	1,236,827
Thereafter	1,231,654
	$ 7,276,094

Rent expense totaled approximately $1,140,000 and $1,118,000 for the years ended December 31, 2018 and 2017, 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 outstanding first mortgage loan commitments of $208,800 at December 31, 2018. The credit union had no outstanding first mortgage loan commitments at December 31. 2017.

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

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

	2018	2017
HELOC	$ 129,830,003	$ 118,585,939
Lines of credit	49,198,017	49,584,326
Credit card	82,418,683	66,864,784
Courtesy pay program	1,196,455	1,126,099
	$ 262,643,158	$ 236,161,148

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.

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, 2018, 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 $1,349,202 and $2,090,414 at December 31, 2018 and 2017, 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.

NOTE 13 – EMPLOYEE BENEFIT PLANS (CONTINUED)

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, 2018 and 2017 totaled approximately $710,000 and $625,000, 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 $2,453,143 and $2,396,000 as of December 31, 2018 and 2017, respectively. The accrued liability for the deferred compensation, included in accrued expenses and other liabilities, was approximately $252,809 and $203,000 as of December 31, 2018 and 2017, 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.

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 using the expected payment characteristics of the underlying mortgage instruments.

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

2018	Fair Value	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Federal agency securities	$ 18,875,601	$ -	$ 18,875,601	$ -
Mortgage-backed securities:				
U.S. agency	352,411,794	-	352,411,794	-
Non-U.S. agency	1,047,543	-	1,047,543	-
	353,459,337	-	353,459,337	-
	$ 372,334,938	$ -	$ 372,334,938	$ -

NOTE 14 – FAIR VALUE (CONTINUED)

2017	Fair Value	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Federal agency securities	$ 25,169,527	$ -	$ 25,169,527	$ -
Mortgage-backed securities:				
U.S. agency	385,801,839	-	385,801,839	-
Non-U.S. agency	1,301,577	-	1,301,577	-
	387,103,416	-	387,103,416	-
	$ 412,272,943	$ -	$ 412,272,943	$ -

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

2018	Fair Value	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 177,262	$ -	$ -	$ 177,262
2017				
Impaired loans	$ 140,447	$ -	$ -	$ 140,447

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.

NOTE 15 – REGULATORY CAPITAL (CONTINUED)

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, 2018 and 2017 was 6.54%% and 6.20%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes, as of December 31, 2018, that the credit union meets all capital adequacy requirements to which it is subject.

As of December 31, 2018, 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	
2018	Amount	Ratio	Amount	Ratio	Amount	Ratio
Net worth	$ 126,234,752	11.08%	$ 68,346,537	6.00%	$ 79,737,626	7.00%
RBNW requirement	74,497,725	6.54%	N/A	N/A	N/A	N/A
2017						
Net worth	$ 123,301,369	11.17%	$ 66,253,427	6.00%	$ 77,295,665	7.00%
RBNW requirement	68,461,874	6.20%	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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