



# CERTIFIED AUDIT REPORT



## CONSOLIDATED FINANCIAL STATEMENTS

As of and for the years ended  
December 31, 2016 and 2015



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***AUDITED FINANCIAL STATEMENTS***

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**VyStar**<sup>®</sup>  
Credit Union

**Consolidated Financial  
Statements**

**2016**

FEDERALLY  
INSURED  
BY **NCUA**

## TABLE OF CONTENTS

Independent Auditor's Report	2
Consolidated Statements of Financial Condition	4
Consolidated Statements of Operations	5
Consolidated Statements of Comprehensive Income	6
Consolidated Statements of Members' Equity	7
Consolidated Statements of Cash Flows	8
Notes to Consolidated Financial Statements	9

## **INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors, Audit Committee and Members of VyStar Credit Union:

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of VyStar Credit Union, which comprise the consolidated balance sheet as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, changes in members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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

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

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

### **Basis for Qualified Opinion**

The industry audit guide "Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies" issued by the American Institute of Certified Public Accountants indicates that members' deposits should be classified as liabilities in order to conform to generally accepted accounting principles. As further described in Note 1, VyStar Credit Union considers members' deposits to be equity as defined in the Federal Credit Union Act and so presented the information. The presentation followed by VyStar Credit Union has no effect on the total amount or classification of assets or on the determination of income, expenses or net income.

**Qualified Opinion**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of VyStar Credit Union as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Nearman, Maynard, Vallez, CPAs*

Nearman, Maynard, Vallez, CPAs  
Miami, Florida

March 1, 2017

**VYSTAR CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**DECEMBER 31, 2016 AND 2015**

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 724,139,258	\$ 442,190,006
Investments		
Available-for-sale	1,139,034,086	1,049,250,895
Other	47,652,411	29,768,901
Loans to members, net	4,424,086,051	3,934,365,253
Accrued interest receivable	12,854,273	11,358,127
Property and equipment, net	136,411,011	125,937,592
National Credit Union Share Insurance Fund deposit	46,308,998	41,544,863
Other assets	21,501,082	18,380,811
<b>Total Assets</b>	<b>\$ 6,551,987,170</b>	<b>\$ 5,652,796,448</b>
 <b>LIABILITIES AND MEMBERS' EQUITY</b>		
Liabilities		
Accrued expenses and other liabilities	\$ 102,472,127	\$ 68,064,778
Borrowed funds and interest payable	887,904,912	487,084,760
Total Liabilities	990,377,039	555,149,538
Commitments and contingent liabilities		
Members' Equity		
Members' deposits	4,986,011,351	4,563,455,660
Retained earnings	579,724,644	529,518,775
Merged equity	54,300	-
Accumulated other comprehensive income	(4,180,164)	4,672,475
Total Members' Equity	5,561,610,131	5,097,646,910
<b>Total Liabilities and Members' Equity</b>	<b>\$ 6,551,987,170</b>	<b>\$ 5,652,796,448</b>

**VYSTAR CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>INTEREST INCOME</b>		
Interest on loans to members	\$ 163,573,907	\$ 150,327,673
Interest on investments and cash equivalents	21,839,001	18,362,891
<b>TOTAL INTEREST INCOME</b>	<u>185,412,908</u>	<u>168,690,564</u>
<b>INTEREST EXPENSE</b>		
Dividends on members' deposits	25,062,243	22,836,808
Interest on borrowed funds	14,752,947	14,925,925
<b>TOTAL INTEREST EXPENSE</b>	<u>39,815,190</u>	<u>37,762,733</u>
<b>NET INTEREST INCOME</b>	145,597,718	130,927,831
<b>PROVISION FOR LOAN LOSSES</b>	<u>5,975,101</u>	<u>7,829,957</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<u>139,622,617</u>	<u>123,097,874</u>
<b>NON-INTEREST INCOME</b>		
Commissions	67,089,694	61,044,942
Service charges and other fees	25,132,001	19,910,591
Loan servicing fees	411,294	442,897
Net gains on sales of loans	246,868	1,388,629
<b>TOTAL NON-INTEREST INCOME</b>	<u>92,879,857</u>	<u>82,787,059</u>
<b>NON-INTEREST EXPENSES</b>		
Salaries and benefits	83,831,857	75,981,146
Operations	81,987,462	73,166,911
Occupancy	15,771,749	14,257,905
Other non-interest losses	705,537	1,836,854
<b>TOTAL NON-INTEREST EXPENSES</b>	<u>182,296,605</u>	<u>165,242,816</u>
<b>NET INCOME</b>	<u>\$ 50,205,869</u>	<u>\$ 40,642,117</u>



**VYSTAR CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

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	<u>2016</u>	<u>2015</u>
<b>NET INCOME</b>	\$ 50,205,869	\$ 40,642,117
<b>OTHER COMPREHENSIVE (LOSS) INCOME</b>		
Net unrealized holding losses on securities arising during the year	(8,893,988)	(6,038,218)
Add reclassification adjustment for net losses included in net income	<u>41,349</u>	<u>-</u>
Total other comprehensive loss	<u>(8,852,639)</u>	<u>(6,038,218)</u>
<b>TOTAL COMPREHENSIVE INCOME</b>	<u>\$ 41,353,230</u>	<u>\$ 34,603,899</u>

**VYSTAR CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

	Members' Deposits	Retained Earnings			Accumulated Other Comprehensive Income
		Regular Reserves	Undivided Earnings	Total	
Balance December 31, 2014	\$ 4,179,570,264	\$ 96,605,882	\$ 392,270,776	\$ 488,876,658	\$ 10,710,693
Net income	-	-	40,642,117	40,642,117	-
Net change in unrealized losses on available-for-sale investments	-	-	-	-	(6,038,218)
Net increase in members' deposits	<u>383,885,396</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance December 31, 2015	\$ 4,563,455,660	\$ 96,605,882	\$ 432,912,893	\$ 529,518,775	\$ 4,672,475
Net income	-	-	50,205,869	50,205,869	-
Mergers and acquisitions	-	-	54,300	54,300	-
Net change in unrealized losses on available-for-sale investments	-	-	-	-	(8,852,639)
Net increase in members' deposits	<u>422,555,691</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance December 31, 2016	<u>\$ 4,986,011,351</u>	<u>\$ 96,605,882</u>	<u>\$ 483,173,062</u>	<u>\$ 579,778,944</u>	<u>\$ (4,180,164)</u>

**VYSTAR CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 50,205,869	\$ 40,642,117
Adjustments to reconcile net income to net cash provided by / (used in) operating activities:		
Provision for loan losses	5,975,101	7,829,957
Depreciation and amortization	9,857,410	9,032,588
Premium amortization, net of accretion	7,626,884	7,738,873
(Gain)/loss on sale of property and equipment	(6,952)	860,273
Net realized loss on sale of investments	41,349	-
(Increase) decrease in accrued interest receivable	(1,496,146)	96,710
Increase in other assets	(3,120,272)	(3,449,772)
Increase in accrued expenses and other liabilities	34,407,348	6,691,112
Net cash provided by operating activities	<u>103,490,591</u>	<u>69,441,858</u>
<b>INVESTING ACTIVITIES</b>		
Net proceeds from sale of property and equipment	1,383,287	627,247
Purchases of available-for-sale investments	(387,772,408)	(120,945,571)
Proceeds from maturities, prepayments and calls of available-for-sale investments	273,783,998	260,515,705
Proceeds from sales of available-for-sale investments	7,684,348	-
Net (increase) decrease in other investments	(17,883,509)	2,307,989
Net increase in loans to members	(495,695,899)	(385,106,641)
Merger, net of cash received	54,300	-
Increase in the National Credit Union Share Insurance Fund deposit	(4,764,135)	(2,160,039)
Purchases of property and equipment	(21,707,164)	(22,626,670)
Net cash used in investing activities	<u>(644,917,182)</u>	<u>(267,387,980)</u>
<b>FINANCING ACTIVITIES</b>		
Proceeds from (repayment of) borrowed funds	400,820,152	(38,624,868)
Net increase in members' deposits	422,555,691	383,885,396
Net cash provided by financing activities	<u>823,375,843</u>	<u>345,260,528</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<u>281,949,252</u>	<u>147,314,406</u>
Cash and cash equivalents at the beginning of the year	<u>442,190,006</u>	<u>294,875,600</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 724,139,258</u>	<u>\$ 442,190,006</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Dividends paid on members' deposits & interest paid on borrowed funds	\$ 39,815,190	\$ 37,762,733
Other real estate acquired in settlement of loans	\$ 2,102,427	\$ 911,432

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 1. SIGNIFICANT ACCOUNTING POLICIES

#### **Organization**

VyStar Credit Union (the Credit Union) is a state-chartered credit union organized under the provisions of Florida Statutes.

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of VyStar Credit Union and its wholly-owned subsidiary, VyStar Financial Group, LLC, a credit union service organization that provides insurance brokerage, title insurance and real estate services to Credit Union members as well as non-members. All significant inter-company accounts and transactions have been eliminated.

#### **Nature of Operations**

The Credit Union operates forty-one full service branches, eleven high school branches, two drive-thru branches and one Call Center in Jacksonville, Florida and the surrounding areas. The Credit Union's primary source of revenue is providing loans to members who live or work in a twenty-two-county area in northeastern Florida.

#### **Use of Estimates in the Preparation of Financial Statements**

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

#### **Subsequent Events**

Credit Union Management has evaluated subsequent events through March 1, 2017, the date on which the financial statements were available to be issued.

#### **Cash, Cash Equivalents and Cash Flows**

Cash and cash equivalents consist of cash on hand, demand deposits, and other non-term deposits in other financial institutions. For purposes of reporting cash flows, loans to members, other investments, members' deposits and borrowed funds are reported net.

#### **Investments**

Investments the Credit Union intends to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on investments classified as available-for-sale have been accounted for as accumulated other comprehensive income. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity. Declines in the fair value of individual

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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available-for-sale securities below their costs that are other than temporary, result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer or that management would not have the ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Other investments are classified separately and are stated at cost.

### **Federal Home Loan Bank Stock**

The Credit Union, as a member of the FHLB of Atlanta, is required to maintain a minimum stock investment with the FHLB based on a formula developed by the FHLB that considers the Credit Union's total assets and outstanding advances from the FHLB. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

### **Visa Inc. Stock**

In early 2008, as part of the restructuring of Visa Inc., the Credit Union was issued shares of Class B Common Stock in Visa Inc. The shares represented by this issuance are fully paid and non-assessable. At December 31, 2016, the Credit Union held 80,778 shares of Visa's Class B Common Stock. Currently, there is no readily available fair market value of the stock and therefore, the stock is not reflected in the Credit Union's financial statements. Once a readily available fair market value of the stock is known, the value of the stock will be reflected in the Credit Union's financial statements.

### **Loans**

The Credit Union grants mortgage, business and consumer loans to members. Mortgage loans secured by properties located primarily in northeast Florida comprise about 53% of the loan portfolio at December 31, 2016 and 55% of the loan portfolio at December 31, 2015. The ability of the members to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that the Credit Union has the intent and ability to hold for the foreseeable future are stated at unpaid principal balances, less an allowance for loan losses and net deferred loan origination fees and discounts. Interest on loans is recognized over the term of the loan and is calculated using the simple-interest method on principal amounts outstanding for consumer loans and the amortized-interest method on principal amounts outstanding for most mortgage loans.

The accrual of interest on loans is discontinued at the time the loan is 91 days delinquent. Credit card loans and other personal loans are typically charged-off no later than 180 days past due. Past due status is based on contractual terms of the loan. Loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan fees and certain 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.

### **Troubled Debt Restructurings**

A loan is classified as a troubled debt restructure when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Credit Union grants concessions to the borrower in the restructuring that it would not otherwise consider. The Credit Union strives to identify members in financial difficulty early and works with them to modify to more affordable terms before their loan reaches nonaccrual status. These concessions include but are not limited to interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral.

Troubled debt restructurings are considered impaired loans by their nature. The amount of the impairment is derived based on discounting expected cash flows at the loan's effective rate of interest. Therefore, assumptions must be made as to the amount of the future cash flows, which will consider the borrower's willingness and ability to pay contractual principal and interest payments.

### **Other Real Estate Owned (Foreclosed Property)**

Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, additional expenses related to improvements to the property are capitalized. Valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in operating expenses.

As of December 31, 2016, the Credit Union has approximately \$2.1 million in foreclosed residential and commercial real estate property held for sale. In addition, the Credit Union has approximately \$3.4 million in loans collateralized by residential and commercial real estate in the process of foreclosure.

### **Allowance for Loan Losses**

The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the required allowance for loan losses balance using past loan loss experience, known and inherent risks in the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance for loan losses may be made for specific loans, but the entire allowance is available for any loan that, in Management's judgment, should be charged-off. Loan losses are charged against the allowance for loan losses when Management believes the uncollectibility of a loan balance is confirmed.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

Due to the nature of uncertainties related to an estimation process, Management's estimate of loan losses inherent in the loan portfolio may change in the near term. However, the amount if the change that is reasonably possible cannot be estimated.

A loan is considered impaired when, based on current information and events, full payment under the loan terms is not expected. Impairment is generally evaluated in total for smaller-balance loans of similar nature such as consumer and credit card loans, but may be evaluated on an individual loan basis if deemed necessary. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows or at the fair value of collateral if repayment is expected solely from the collateral.

### **Transfers and Servicing of Financial Assets**

The Credit Union accounts for transfers and servicing of financial assets in accordance with generally accepted accounting principles (GAAP) codified in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) section 860. GAAP requires application of a financial-components approach that focuses on control. Under this approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. The statement also distinguishes transfers of financial assets that are sales from transfers of financial assets that are secured borrowings.

The Credit Union generally retains the right to service mortgage loans sold to others. The cost allocated to the mortgage servicing rights retained has been recognized as a separate asset and is being amortized in proportion to and over the period of estimated net servicing income. Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based on current market rates of interest and current expected future prepayment rates.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

### **Property and Equipment**

Land is carried at cost. Building, leasehold improvements, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings and furniture and 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### **National Credit Union Share Insurance Fund Deposit**

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each federally insured Credit Union in an amount equal to 1% of its insured members' deposits. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, if it converts its insurance coverage to another source or if management of the fund is transferred from the NCUA Board.

### **Members' Deposits**

Members' deposits consist of the savings and other deposit accounts of the owners of the Credit Union. 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 deposits owned, no member has more than one vote. Members' deposits are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members' deposits are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union.

Members' deposits are classified as members' equity in the consolidated statements of financial condition. It is the Credit Union's position that members' deposits represent an ownership interest and are properly classified as equity. Such classification is not in accordance with generally accepted accounting principles. Generally accepted accounting principles require members' deposits to be classified as liabilities. This change has no effect on the consolidated statements of operations.

### **Regular Reserve**

The Credit Union is required by regulation to maintain a statutory reserve, "regular reserve". The regular reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of dividends to members.

### **Equity Acquired in Merger**

Equity acquired in a merger represents equity accounted for in accordance with the acquisition method of accounting. Under this accounting method, regular reserves and undivided earnings of the acquiree are combined on the acquirer's statement of financial condition as a component of equity called merged equity. This component of equity is considered part of net worth as defined by regulations established by the NCUA.

### **Income Taxes**

The Credit Union is exempt, by statute, from federal taxes on income related to the exempt purpose of the Credit Union. However, the Credit Union is subject to taxes on certain "unrelated business income" as further discussed in Note 8.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### **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 available-for-sale securities, are reported as a separate component of the members' equity section of the consolidated statements of financial condition.

### **Reclassifications**

Certain account reclassifications have been made to the 2015 financial statements in order to conform to classifications used in the current year.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. INVESTMENTS**

Investments classified as available-for-sale consist of the following:

	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
<b><u>December 31, 2016</u></b>				
U.S. government obligations and federal agencies securities	\$ 135,081,953	\$ 668,260	\$ (278,219)	\$ 135,471,994
Mortgage-backed securities	268,465,559	2,668,784	(2,068,974)	269,065,369
Corporate bonds	261,095,609	350,213	(3,776,822)	257,669,000
CMOs	478,571,129	469,683	(2,213,089)	476,827,723
	<u>\$ 1,143,214,250</u>	<u>\$ 4,156,940</u>	<u>\$ (8,337,104)</u>	<u>\$ 1,139,034,086</u>

**December 31, 2015**

U.S. government obligations and federal agencies securities	\$ 213,148,812	\$ 1,428,207	\$ (285,654)	\$ 214,291,365
Mortgage-backed securities	219,241,108	4,042,488	(205,428)	223,078,168
Corporate bonds	107,045,388	461,204	(192,894)	107,313,698
CMOs	505,143,112	1,068,924	(1,644,372)	504,567,664
	<u>\$ 1,044,578,420</u>	<u>\$ 7,000,823</u>	<u>\$ (2,328,348)</u>	<u>\$ 1,049,250,895</u>

Gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2016 and 2015 are as follows:

	<b>Fair Value</b>	<b>Continuous Unrealized Losses Existing For:</b>		<b>Total Unrealized Losses</b>
		<b>Less Than 12 Months</b>	<b>More Than 12 Months</b>	
<b><u>Available-for-sale December 31, 2016</u></b>				
U.S. government obligations and federal agencies securities	\$ 28,586,018	\$ 278,219	\$ -	\$ 278,219
Mortgage-backed securities	124,010,772	2,068,974	-	2,068,974
Corporate bonds	197,967,285	3,776,822	-	3,776,822
CMOs	340,892,440	1,364,382	848,707	2,213,089
	<u>\$ 691,456,515</u>	<u>\$ 7,488,397</u>	<u>\$ 848,707</u>	<u>\$ 8,337,104</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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<b>Available-for-sale December 31, 2015</b>	<b>Fair Value</b>	<b>Continuous Unrealized Losses Existing For:</b>		<b>Total Unrealized Losses</b>
		<b>Less Than 12 Months</b>	<b>More Than 12 Months</b>	
U.S. government obligations and federal agencies securities	\$ 41,068,100	\$ 285,654	\$ -	\$ 285,654
Mortgage-backed securities	51,957,047	205,428	-	205,428
Corporate bonds	51,273,162	168,041	24,853	192,894
CMOs	213,005,285	791,022	853,350	1,644,372
	<b>\$ 357,303,594</b>	<b>\$ 1,450,145</b>	<b>\$ 878,203</b>	<b>\$ 2,328,348</b>

There are a total of one hundred fifty-five and seventy-one investments with unrealized losses as of December 31, 2016 and 2015, respectively. The unrealized losses associated with these investments are considered temporary as the Credit Union has the ability to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value.

Gross realized gains on sales of investments available-for-sale were \$29,374 in 2016; gross realized losses were \$70,723 in 2016. There were no sales of investments in 2015. Proceeds from the sales of investments available-for-sale were \$7,684,348 in 2016 and zero in 2015.

Other investments consist of the following:

	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
FHLB stock	\$ 42,805,200	\$ 25,422,100
Credit Union Service Organizations	4,346,801	4,346,801
Other Credit Unions -CDs	500,410	-
	<b>\$ 47,652,411</b>	<b>\$ 29,768,901</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Investments by maturity as of December 31, 2016 are summarized as follows:

	<u>Available-for-sale</u>		<u>Other</u>
	<u>Amortized Cost</u>	<u>Fair Value</u>	
No contractual maturity	\$ -	\$ -	\$ 47,152,001
Less than 1 year maturity	103,078,455	103,542,539	-
1 to 5 years maturity	227,025,961	225,541,243	500,410
5 to 10 years maturity	66,073,146	64,057,212	-
Mortgage-backed securities and CMOs	747,036,688	745,893,092	-
	<u>\$ 1,143,214,250</u>	<u>\$ 1,139,034,086</u>	<u>\$ 47,652,411</u>

Expected maturities of mortgage-backed securities and CMOs may differ from contractual maturities because borrowers may have the right to call or prepay the obligations. Securities not due at a single maturity date, primarily mortgage-backed securities and CMOs, are shown separately. FHLB stock and various other investments have been classified with no contractual maturity.

### 3. LOANS TO MEMBERS

Loans to members are shown below. Included in these loan amounts are approximately \$49.2 million and \$41.1 million of deferred loan origination fees/costs as of December 31, 2016 and 2015, respectively.

	<u>December 31</u>	
	<u>2016</u>	<u>2015</u>
Residential first mortgage real estate loans	\$ 1,932,164,743	\$ 1,782,940,477
Residential second mortgage real estate loans	248,850,156	237,897,108
Consumer secured loans	1,599,124,865	1,331,609,954
Consumer unsecured loans	476,692,553	440,392,282
Business real estate loans	189,946,685	169,911,782
Other business loans	7,569,031	7,907,876
Gross loans to members	<u>4,454,348,033</u>	<u>3,970,659,479</u>
Allowance for loan losses	<u>(30,261,982)</u>	<u>(36,294,226)</u>
Loans to members, net	<u>\$ 4,424,086,051</u>	<u>\$ 3,934,365,253</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The following summarizes the activity by loan categories in the allowance for loan losses account:

	<b>For the Year Ended December 31, 2016</b>			
	<b>Residential Real Estate</b>	<b>Consumer</b>	<b>Business</b>	<b>Total</b>
<b><u>Allowance for Loan Losses:</u></b>				
Beginning balance	\$ 18,360,118	\$ 12,478,043	\$ 5,456,065	\$ 36,294,226
Provision for loan losses	(4,485,868)	11,663,123	(1,202,154)	5,975,101
Recoveries	164,008	1,428,002	190,750	1,782,760
Loans charged off	(1,361,208)	(12,276,494)	(152,403)	(13,790,105)
Ending balance	\$ 12,677,050	\$ 13,292,674	\$ 4,292,258	\$ 30,261,982
Ending allowance for loans individually evaluated for impairment	\$ 524,362	\$ -	\$ 1,812,716	\$ 2,337,078
Ending allowance for loans collectively evaluated for impairment	\$ 12,152,688	\$ 13,292,674	\$ 2,479,542	\$ 27,924,904
<b><u>Loans to Members:</u></b>				
Loans individually evaluated for impairment	\$ 1,921,348	\$ -	\$ 18,594,050	\$ 20,515,398
Loans collectively evaluated for impairment	2,179,093,551	2,075,817,418	178,921,666	4,433,832,635
Ending balance	\$ 2,181,014,899	\$ 2,075,817,418	\$ 197,515,716	\$ 4,454,348,033

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The following summarizes the activity by loan categories in the allowance for loan losses account:

	<b>For the Year Ended December 31, 2015</b>			
	<b>Residential Real Estate</b>	<b>Consumer</b>	<b>Business</b>	<b>Total</b>
<b><u>Allowance for Loan Losses:</u></b>				
Beginning balance	\$ 24,258,713	\$ 11,834,745	\$ 5,730,820	\$ 41,824,278
Provision for loan losses	(3,530,876)	11,527,129	(166,296)	7,829,957
Recoveries	295,173	1,500,814	39,305	1,835,292
Loans charged off	(2,662,892)	(12,384,645)	(147,764)	(15,195,301)
Ending balance	\$ 18,360,118	\$ 12,478,043	\$ 5,456,065	\$ 36,294,226
Ending allowance for loans individually evaluated for impairment	\$ 655,865	\$ -	\$ 2,743,920	\$ 3,399,785
Ending allowance for loans collectively evaluated for impairment	\$ 17,704,253	\$ 12,478,043	\$ 2,712,145	\$ 32,894,441
<b><u>Loans to Members:</u></b>				
Loans individually evaluated for impairment	\$ 1,804,152	\$ -	\$ 19,899,773	\$ 21,703,925
Loans collectively evaluated for impairment	2,019,033,433	1,772,002,236	157,919,885	3,948,955,553
Ending balance	\$ 2,020,837,585	\$ 1,772,002,236	\$ 177,819,658	\$ 3,970,659,479

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The following is a summary of information pertaining to impaired loans at:

	December 31, 2016		
	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
<b>With a related allowance recorded:</b>			
Residential 1 <sup>st</sup> mortgage real estate loans	\$ 64,393,821	\$ 8,842,771	\$ 64,330,165
Residential 2 <sup>nd</sup> mortgage real estate loans	6,155,408	1,291,475	6,181,848
Consumer secured loans	951,846	4,466	959,493
Consumer unsecured loans	1,015,435	19,868	1,017,625
Business real estate loans	18,557,421	1,776,088	18,567,183
Other business loans	36,628	36,628	36,959
<b>With no related allowance recorded:</b>			
Residential 1 <sup>st</sup> mortgage real estate loans	-	-	-
Residential 2 <sup>nd</sup> mortgage real estate loans	-	-	-
Consumer secured loans	-	-	-
Consumer unsecured loans	-	-	-
Business real estate loans	-	-	-
Other business loans	-	-	-
<b>Total impaired loans:</b>			
Residential real estate loans	\$ 70,549,229	\$ 10,134,246	\$ 70,512,013
Consumer loans	\$ 1,967,281	\$ 24,334	\$ 1,977,118
Business loans	\$ 18,594,049	\$ 1,812,716	\$ 18,604,142

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of information pertaining to impaired loans at:

	December 31, 2015		
	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
<b>With a related allowance recorded:</b>			
Residential 1 <sup>st</sup> mortgage real estate loans	\$ 80,820,106	\$ 12,055,539	\$ 80,881,500
Residential 2 <sup>nd</sup> mortgage real estate loans	9,817,743	1,786,075	9,774,133
Consumer secured loans	1,065,594	9,377	1,077,129
Consumer unsecured loans	1,076,991	23,991	1,078,248
Business real estate loans	19,847,445	2,691,592	19,861,594
Other business loans	52,328	52,328	52,913
<b>With no related allowance recorded:</b>			
Residential 1 <sup>st</sup> mortgage real estate loans	-	-	-
Residential 2 <sup>nd</sup> mortgage real estate loans	-	-	-
Consumer secured loans	-	-	-
Consumer unsecured loans	-	-	-
Business real estate loans	-	-	-
Other business loans	-	-	-
<b>Total impaired loans:</b>			
Residential real estate loans	\$ 90,637,849	\$ 13,841,614	\$ 90,655,633
Consumer loans	\$ 2,142,585	\$ 33,368	\$ 2,155,377
Business loans	\$ 19,899,773	\$ 2,743,920	\$ 19,914,507

The following is a summary age analysis of past due loans:

	As of December 31, 2016				
	2 to < 6 Months Past Due	6 to < 12 Months Past Due	Greater than 12 Months Past Due	Total	Nonaccrual Loans
Residential 1 <sup>st</sup> mortgage real estate loans	\$ 4,161,700	\$ 1,674,766	\$ 873,950	\$ 6,710,416	\$ 4,699,690
Residential 2 <sup>nd</sup> mortgage real estate loans	1,212,117	202,794	81,468	1,496,379	835,074
Consumer secured loans	2,782,410	728,408	15,835	3,526,653	1,709,414
Consumer unsecured loans	3,318,163	1,073,484	-	4,391,647	4,044,110
Business real estate loans	987,274	1,190,438	918,616	3,096,328	2,682,309
Other business loans	6,296	-	-	6,296	6,296
<b>Total</b>	\$ 12,467,960	\$ 4,869,890	\$ 1,889,869	\$ 19,227,719	\$ 13,976,893



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary age analysis of past due loans:

	As of December 31, 2015				
	2 to < 6 Months Past Due	6 to < 12 Months Past Due	Greater than 12 Months Past Due	Total	Nonaccrual Loans
Residential 1 <sup>st</sup> mortgage real estate loans	\$ 4,322,943	\$ 1,537,460	\$ 696,091	\$ 6,556,494	\$ 4,283,071
Residential 2 <sup>nd</sup> mortgage real estate loans	1,513,339	135,359	113,377	1,762,075	1,095,785
Consumer secured loans	1,803,595	246,820	10,371	2,060,786	1,079,300
Consumer unsecured loans	2,450,452	698,460	-	3,148,912	2,857,827
Business real estate loans	3,254,765	-	152,228	3,406,993	3,012,664
Other business loans	1,924	-	-	1,924	-
<b>Total</b>	<u>\$ 13,347,018</u>	<u>\$ 2,618,099</u>	<u>\$ 972,067</u>	<u>\$ 16,937,184</u>	<u>\$ 12,328,647</u>

The following table presents a summary of credit exposure based upon payment activity. Internally assigned loan grades are defined as either performing loans or nonperforming loans. A performing loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary. A loan classified as nonperforming is considered potentially uncollectible with a likelihood of charge-off. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it means that charge-off is likely in the near future.

The following is a summary of loans based on credit quality:

	As of December 31, 2016 (Dollars in thousands)					
	Residential Real Estate		Consumer		Business	
	First	Second	Secured	Unsecured	Real Estate	Other
Performing	\$ 1,927,465	\$ 248,015	\$ 1,597,416	\$ 472,648	\$ 187,264	\$ 7,563
Nonperforming	4,700	835	1,709	4,044	2,682	7
<b>Total</b>	<u>\$ 1,932,165</u>	<u>\$ 248,850</u>	<u>\$ 1,599,125</u>	<u>\$ 476,692</u>	<u>\$ 189,946</u>	<u>\$ 7,570</u>

	As of December 31, 2015 (Dollars in thousands)					
	Residential Real Estate		Consumer		Business	
	First	Second	Secured	Unsecured	Real Estate	Other
Performing	\$ 1,778,657	\$ 236,801	\$1,330,531	\$ 437,534	\$ 166,899	\$ 7,908
Nonperforming	4,283	1,096	1,079	2,858	3,013	-
<b>Total</b>	<u>\$ 1,782,940</u>	<u>\$ 237,897</u>	<u>\$1,331,610</u>	<u>\$ 440,392</u>	<u>\$ 169,912</u>	<u>\$ 7,908</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of information pertaining to troubled debt restructurings for the years ending December 31, 2016 and 2015:

For the year ending December 31, 2016			
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
<b>Troubled debt restructurings</b>			
Residential real estate loans	29	\$ 3,658,102	\$ 3,637,414
Consumer loans	81	\$ 672,562	\$ 610,480
Business loans	1	\$ 646,103	\$ 446,013
Year ending December 31, 2016			
<b>Troubled debt restructurings that subsequently defaulted</b>			
Residential real estate loans	9	\$ 388,816	\$ 388,816
Consumer loans	55	\$ 273,997	\$ 273,997
Business loans	1	\$ 142,500	\$ 142,500
For the year ending December 31, 2015			
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
<b>Troubled debt restructurings</b>			
Residential real estate loans	33	\$ 2,669,640	\$ 2,665,427
Consumer loans	59	\$ 380,216	\$ 333,926
Business loans	3	\$ 1,848,609	\$ 1,847,601
Year ending December 31, 2015			
<b>Troubled debt restructurings that subsequently defaulted</b>			
Residential real estate loans	28	\$ 1,079,175	\$ 1,079,175
Consumer loans	54	\$ 381,994	\$ 381,994
Business loans	1	\$ 81,284	\$ 81,284

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 4. LOAN SERVICING

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans at December 31, 2016 and 2015 are summarized as follows:

	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Mortgage loan portfolios serviced for Federal National Mortgage Association (FNMA)	\$ 277,392,023	\$ 315,748,907

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in deposits, were approximately \$2.1 million and \$2.3 million at December 31, 2016 and 2015 respectively.

A summary of the changes in the balance of mortgage servicing rights in 2016 and 2015 were as follows:

	<b>Years Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Balance, beginning of year	\$ 1,178,678	\$ 1,225,907
Servicing assets recognized during the year	43,133	296,712
Amortization of servicing assets	(337,627)	(343,941)
Balance, end of year	\$ 884,184	\$ 1,178,678

### 5. PROPERTY AND EQUIPMENT

Property and equipment are summarized as follows:

	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Land	\$ 60,211,999	\$ 57,163,745
Buildings	80,643,930	77,010,544
Land and leasehold improvements	7,765,640	7,451,787
Furniture and equipment	69,022,886	58,767,760
Construction in progress	8,486,860	7,011,133
Total cost	226,131,315	207,404,969
Accumulated depreciation and amortization	(89,720,304)	(81,467,377)
Total property and equipment, net	\$ 136,411,011	\$ 125,937,592

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The Credit Union leases office and ATM facilities. The operating leases contain renewal options and provisions requiring the Credit Union to pay property taxes and operating expenses over base period amounts. All rental payments are dependent only upon the lapse of time. Minimum rental payments for office and ATM facilities under operating leases with remaining terms of one year or more at December 31, 2016 are as follows:

<u>Years Ending December 31</u>	
2017	\$ 1,139,471
2018	688,050
2019	451,707
Subsequent years	682,902
	<u>\$ 2,962,130</u>

Rental expense for the years ending December 31, 2016 and 2015 for all office facilities leased under operating leases totaled \$471,000 and \$279,000, respectively. Rental expense for the years ending December 31, 2016 and 2015 for all ATM facilities leased under operating leases totaled \$664,000 and \$642,000, respectively.

### 6. MEMBERS' DEPOSITS

Members' deposits are summarized as follows:

	<u>December 31</u>	
	<u>2016</u>	<u>2015</u>
Savings accounts	\$ 1,370,309,799	\$ 1,165,477,570
Checking accounts	952,822,761	836,412,797
Money market accounts	1,227,277,023	1,119,760,541
Individual retirement accounts	187,134,126	172,750,831
Certificates of deposit	1,248,467,642	1,269,053,921
	<u>\$ 4,986,011,351</u>	<u>\$ 4,563,455,660</u>

Certificates of deposit by maturity as of December 31, 2016 are summarized as follows:

0 – 1 year maturity	\$ 659,374,133
1 – 2 years maturity	218,757,158
2 – 3 years maturity	77,858,451
3 – 4 years maturity	145,959,171
4 – 5 years maturity	145,915,883
Over 5 years maturity	602,846
	<u>\$ 1,248,467,642</u>

Savings, checking, money market and individual retirement accounts have no contractual maturity. Certificate accounts have maturities of seventy months or less.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The National Credit Union Share Insurance Fund insures members' shares up to \$250,000. This includes all account types, such as savings, checking, money market and certificates of deposit. Individual Retirement Account coverage is an additional \$250,000. At December 31, 2016, the aggregate amount of members' deposit accounts that are federally insured is \$4.7 billion. Conversely, the aggregate amount of members' deposit accounts that are not federally insured is approximately \$301 million.

### 7. NOTES PAYABLE

The Credit Union utilizes a demand loan agreement with the Federal Home Loan Bank of Atlanta (FHLB). The terms of the agreement call for pledging a portion of the Credit Union's mortgage portfolio. The agreement provides for a maximum borrowing amount of \$2.0 billion. As of December 31, 2016, fixed rate advances total \$887 million and have interest rates ranging from 0.610% to 4.935%.

The outstanding balances by maturity dates are as follows:

	<u>December 31</u>	
	<u>2016</u>	<u>2015</u>
0 to 2 years maturity	\$ 588,116,667	\$ 98,050,000
3 to 5 years maturity	199,404,762	268,357,143
Over 5 years maturity	99,176,703	119,104,939
	<u>886,698,132</u>	<u>485,512,082</u>
Interest payable	1,206,780	1,572,678
	<u>\$ 887,904,912</u>	<u>\$ 487,084,760</u>

### 8. COMMITMENTS AND CONTINGENT LIABILITIES

The Credit Union has an available line of credit with one bank. The terms of the agreement provide for borrowings up to \$594 million with interest payable at a rate determined by the lender on a periodic basis. There are currently no borrowings under this agreement.

The Credit Union is a party to various legal actions normally associated with collections of loans and other business activities of financial institutions, the aggregate effect of which, in management's opinion, would not have a material adverse effect on the financial condition or results of operations of the Credit Union.

The Credit Union has no outstanding commitments to sell loans or investments at December 31, 2016.

#### **Off Balance Sheet Risk:**

The Credit Union is a 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 credit cards, lines of credit and home equity lines that

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Credit Union's exposure to credit loss is represented by the contractual notional amount of these instruments. The Credit Union uses the same credit policies in making commitments as it does for loans recorded in the financial statements.

Unfunded loan commitments under lines of credit are summarized as follows:

	December 31	
	2016	2015
Credit card	\$ 562,847,077	\$ 519,204,554
Other consumer	92,140,143	88,881,815
Home equity	180,974,586	162,943,576
Business	115,000	-
	<u>\$ 836,076,806</u>	<u>\$ 771,029,945</u>

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. Because 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 credit worthiness on a case-by-case basis. The amount of collateral obtained to secure borrowing on the lines of credit is based on management's credit evaluation of the member.

Unfunded commitments under lines-of-credit and revolving credit lines are commitments for possible future extensions of credit to existing members. These lines-of-credit are uncollateralized with the exception of home-equity loans and usually do not contain a specified maturity date and ultimately may not be drawn upon to the total extent to which the Credit Union is committed.

### Unrelated Business Income Tax:

The Internal Revenue Service ("IRS") and certain state taxing authorities continually revisit what products and services provided by state-chartered credit unions may be subject to unrelated business income tax ("UBIT"). There is currently very little guidance in the Internal Revenue Code on what activities should be subject to UBIT. The IRS has indicated that they are studying this area of taxation and may issue additional guidance.

As a result, at this time, there is uncertainty regarding whether state-chartered credit unions should pay income tax on certain types of net taxable income from activities that may be considered by taxing authorities as unrelated to the purpose for which the Credit Union was granted non-taxable status. The Credit Union has determined certain activities to be unrelated to the exempt purpose of its charter and has filed federal tax returns in the past for those potential taxable activities.

The taxing authorities have the ability to assess taxes, penalties and interest for any years for which no tax return was filed. In the opinion of management, any liability resulting from taxing authorities

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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imposing income taxes on the net taxable income from activities deemed to be unrelated to the Credit Union's non-taxable status is not expected to have a material effect on the Credit Union's financial position or results of operations.

### **9. EMPLOYEE BENEFITS**

The Credit Union has a qualified, contributory 401(k) profit sharing plan that allows employees to defer a portion of their salary into the 401(k) plan. The Credit Union matches a portion of employees' wage deferrals. The employer contributions are accrued on a monthly basis and funded on an annual basis. The Credit Union accrued \$1.6 million and \$1.5 million for 401(k) plan years ending December 31, 2016 and 2015, respectively.

### **10. MEMBERS' EQUITY**

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital guidelines that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance-sheet items as calculated under generally accepted accounting principles. The Credit Union's capital amounts and 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 to total assets. Further, credit unions over \$10 million in assets are also required to calculate a Risk-Based Net Worth (RBNW) requirement which establishes whether the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNW requirements as of December 31, 2016 and 2015 were 5.26% and 5.17%, respectively. The minimum ratio to be considered "complex" under the regulatory framework is 6%. Management believes, as of December 31, 2016 and 2015, that the Credit Union meets all capital adequacy requirements to which it is subject.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Key aspects of the Credit Union's minimum capital amounts and ratios are summarized as follows:

<b><u>General Capital Requirements:</u></b>	<b><u>December 31, 2016</u></b>		<b><u>December 31, 2015</u></b>	
	<b><u>Amount</u></b>	<b><u>Ratio</u></b>	<b><u>Amount</u></b>	<b><u>Ratio</u></b>
Amount needed to be classified as “adequately capitalized”	\$ 393,119,230	6.00%	\$ 339,167,787	6.00%
Amount needed to be classified as “well capitalized”	\$ 458,639,102	7.00%	\$ 395,695,751	7.00%
Actual net worth	\$ 579,778,944	8.85%	\$ 529,518,775	9.37%

For December 31, 2016 and December 31, 2015, 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. There are no conditions or events since that notification that management believes have changed the institution's category.

Because the RBNW requirement is less than the net worth ratio, the Credit Union retains its original category of “well capitalized”. Further, in performing its calculation of total assets, the Credit Union used the average of the quarter-end balances of the four most recent quarters, as permitted by regulation.

### **11. RELATED PARTY TRANSACTIONS**

In the normal course of business, the Credit Union extends credit to directors, audit committee members and executive officers. The aggregate loans to related parties were \$2.3 million at December 31, 2016 and 2015, respectively.

### **12. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Credit Union discloses the fair value of assets and liabilities in accordance with the provisions of GAAP which defines fair value and establishes a framework for measuring fair value. The fair value of financial instruments represents the fair value in terms of the price in an orderly transaction between market participants to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

The availability of inputs relevant to the asset or liability and the relative reliability of the inputs might affect the selection of appropriate valuation techniques.

### **Level 1 Inputs**

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. In general, a quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

### **Level 2 Inputs**

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data (market-corroborated inputs). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. An adjustment to a Level 2 input that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

### **Level 3 Inputs**

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Therefore, unobservable inputs shall reflect the reporting Credit Union's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the Credit Union's own data. However, the unobservable inputs shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Available-for-Sale Securities

Fair values for securities 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 instruments.

### Assets Acquired in Liquidation

Fair value is measured based on the appraised value of the collateral or based on the collateral type, through the National Automobile Dealers Association (“NADA”) valuation tables. Collateral may be real estate, vehicles and/or business assets including equipment and value is determined based on appraisals by qualified licensed appraisers hired by the Credit Union for real estate or NADA valuation tables for consumer collateral. Appraised and reported values may be discounted based on management’s historical knowledge, changes in market conditions from the time of valuation, and/or management’s expertise and knowledge of the member and member’s business.

### Fair Value on a Recurring Basis

The following table presents the balances of financial assets that are measured and presented in the statements of financial condition at fair value on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b><u>December 31, 2016</u></b>				
Investments AFS	\$ 1,139,034,086	\$ 1,139,034,086	-	-
<b><u>December 31, 2015</u></b>				
Investments AFS	\$ 1,049,250,895	\$ 1,049,250,895	-	-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### **Fair Value on a Nonrecurring Basis**

Certain assets and liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances. The following table presents assets and liabilities carried on the statements of financial condition for which a nonrecurring change in fair value has been recorded during the year ended:

	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b><u>December 31, 2016</u></b>				
Assets acquired in liquidation	\$ 2,300,744	-	\$ 2,300,744	-
<b><u>December 31, 2015</u></b>				
Assets acquired in liquidation	\$ 1,071,944	-	\$ 1,071,944	-

### **13. MERGED EQUITY**

Effective November 1, 2016, the Credit Union completed the merger of Anchor 7 Federal Credit Union, the acquiree in this business combination. Anchor 7 Federal Credit Union was a federally chartered credit union located in Jacksonville, Florida, founded as a cooperative association for the purposes of promoting thrift among, and creating a source of credit for its members. The reason for the merger is to further promote thrift among its members consistent with purpose when founded. The merger is a business combination of two mutual entities accounted for in accordance with the provisions of acquisition method accounting. The application of acquisition method accounting requires that the acquiree credit union's assets and liabilities be recorded at fair value. The difference between the fair value of assets and liabilities obtained during the merger are reflected in either a bargain purchase gain or goodwill. In addition, the acquirer in a combination of mutual entities recognizes the acquiree's net assets as a direct addition to equity in its statement of financial position, not as an addition to retained earnings. Based on the asset size of Anchor 7 Federal Credit Union, amortized cost is equivalent to its fair market value and is reflected in the attached audited financial statements. In addition, merged equity as a result of the merger is \$54,300.