2019 Annual Report

PENFED CREDIT UNION

PenFed Mission, Purpose & Core Values

Our Mission

To empower the members of our community to achieve their financial well-being.

Our Core Values

Service – We serve our members and the communities in which we live and work.

Innovation – We provide market-leading products, with a best-in-class experience.

Collaboration – We believe everyone has unique expertise and skills. Teamwork allows us to achieve more.

Respect – We respect our teammates by being kind, with no surprises. We listen to each other. We appreciate our diversity of ideas and opinions.

Integrity – We always strive to do the right thing. We choose the harder right over the easier wrong.

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Chairman's Letter

Dear Fellow Members,

I am happy to report that PenFed had another successful year. Our assets grew by nearly $300 million to $24.8 billion, and we added 150,000 new members to reach a high of 1.9 million people.

Building Strength

This year, we specifically focused on building capital to provide an even greater position of strength and resilience.

Member Service Improvements

In 2019, we added new branches in Puerto Rico and New Jersey, streamlined our mortgage application and approval process and expanded our Regional Financial Service Centers as we began staffing our newest Service Center in San Antonio, Texas. Perhaps the greatest improvements came with enhancements to PenFed online (www.penfed.org) and the PenFed mobile app, empowering members to complete virtually any transaction anytime, anywhere.

New Mortgages

During 2019, we helped 5,196 families obtain mortgages. Concurrently, we processed over $1 billion in home equity loans. Our Real Estate Rewards program is proving to be a great member benefit, as it saved members about $4.9 million during the year.

Serving the Community

Our dedicated volunteers and employees have an unwavering commitment to serving our communities. In 2019, our credit union donated over $1.4 million to charities supporting military families and our local communities.

The PenFed Foundation

I am pleased to report that our PenFed Foundation's accomplishments continue to be impressive.

In 2019, the PenFed Foundation:

- Raised more than $3 million through our partners to help military families.
- Helped 201 military families achieve home ownership through Dream Makers grants (15 more than the year before).
- Supported more than 1,200 beneficiaries with emergency financial assistance and caregiver support (a 27% increase).
- Supported five veteran-owned businesses with nearly $1 million in planned investments.

No matter what challenges we face in the coming years, PenFed has the financial strength, focused strategy and dedicated staff to continue providing best-in-class member services and supporting our communities across America and around the world.

Respectfully yours,

Edward B. Cody
Chairman, Board Of Directors

Financial Highlights

Total Members

2017	1.62M
2018	1.71M
2019	1.86M

Total Assets

2017	$22.9B
2018	$24.5B
2019	$24.7B

Net income

$169M	$179M	$156M	$151M
2016	2017	2018	2019

Net Worth Ratio

2017	10.33%
2018	10.32%
2019	10.88%

Board of Directors

Mr. Edward B. Cody,
Chairman

Your board members and supervisory committee members are volunteers who serve without compensation. In addition to their service to the credit union, they spend hundreds of hours from their personal lives on credit union business and activities in the interest of our esteemed members.

Mr. Walter P. Fairbanks,
Vice Chairman

Ms. Sandra L.
(Sam) Patricola,
Treasurer

Lt Col (USAF Ret.)
John A. Rolando,
Secretary

Col (Ret.)
Ronald P. Hudak

The Honorable
Frederick F.Y. Pang

Col (Ret.) James F. Quinn

COL (USAR)
Philip F. Romanelli

Mr. Alfred E. Rudolph

Col (Ret.)
Robert W. Siegert, III

LTC (Ret.) Ron Spear

LTC (Ret.) Bill R. Vinson,
Director Emeritus

The Honorable
Douglas W. Webster,
Director Emeritus

President's Report

PenFed Credit Union has been delivering financial services to members like you for over 84 years. I am honored to have had the opportunity to lead our credit union for what is now approaching six years.

What Makes PenFed Great

Maybe you joined PenFed for our great rates. But what truly makes PenFed great is our people — from our Board of Directors to our employees and from our members to our partners.

Five Core Values / Four Key Constituents

At PenFed, we live by five core values: Respect, Collaboration, Integrity, Innovation and Service. These core values empower us to deliver world-class service to our four key constituents:

Members

We serve our members by offering market-leading products with best-in-class pricing, personal service and state-of-the-art technology.

Employees

We serve our employees by providing competitive pay, modern facilities and an open-door work environment where team players can thrive.

Institution

We serve our institution by building net worth to keep our credit union safe and sound.

Community

We serve every community in which we live and work by donating our money, time and talents, and we are inspired by the shared motto of America's credit unions: "People helping people."

You Can Be Proud

In his message, our Chairman highlighted the outstanding numbers you will find in this Annual Report. Join us in being proud that PenFed has grown to become one of the premier financial institutions in America. It is not just our fiscal achievements, you can also be proud that PenFed makes a real difference in the communities we serve.

In 2019, in addition to a historic year of growth in membership and net worth of your institution, PenFed Credit Union provided material support to the PenFed Foundation and over 80 community organizations across America. Our donations touched millions of lives and earned three heartwarming awards.

Making such a positive impact in our communities truly reflects our pride in your credit union. It's an amazing honor to work with credit union employees and volunteers who give more of themselves than they ever ask in return.

At the end of each year, it is rewarding to know that PenFed made a real difference in the lives of millions of Americans.

Respectfully yours,

James R. Schenck
President & CEO

2019
Awards

Canine Companions for Independence recognized PenFed at the Hearts & Heroes Gala for our work raising puppies who train to become service dogs — assisting disabled US military veterans and other people with disabilities.

The National Military Family Association presented PenFed with the Military Family Champion Award for supporting job creation for military spouses and education for military children.

Habitat for Humanity of Washington, DC honored PenFed for revitalizing our nation's capital. Over the past seven years, more than 50 PenFed volunteers have spent nearly 400 hours volunteering at DC Habitat build sites.

2019 Supervisory Committee Report

Dear Fellow Members,

As a matter of introduction, my name is Brad Honkus, and I am a longtime member of PenFed. I currently serve as the Chairman of PenFed's Supervisory Committee.

Under the Federal Credit Union Act, your Supervisory Committee — appointed by PenFed's Board of Directors — is given the responsibility of providing assurances that the operations of the credit union are carried out per the Act, the regulations of the National Credit Union Administration (NCUA) and otherwise in a safe, sound and compliant manner.

The Supervisory Committee is represented at all Board of Directors' meetings and attends key meetings with Board and executive team members — including PenFed's Chief Executive Officer and Executive Vice Presidents. In addition, we meet regularly with PenFed's Audit Services Department, federal regulators and the external auditors of PenFed's financial statements. We do this to monitor and evaluate internal controls that help ensure that your assets remain safeguarded and that PenFed operates effectively and efficiently.

Importantly, the chair of the Supervisory Committee meets quarterly with PenFed's Chairman of the Board, Chief Compliance Officer, Chief Risk Officer, Chief Information Security Officer and Chief Audit Executive.

This is done to receive firsthand updates from the front lines on how PenFed is taking action to protect its members and safeguard their assets and information. It is also done to see how how PenFed ensures unwavering support for efforts to protect the nation's financial system and deter and detect any terrorist or criminal activities.

This year, the Committee engaged the services of the independent public accounting firm of BDO USA, LLP, to audit the financial statements of the credit union. As noted in this report, BDO issued its opinion that the credit union's financial statements as of and for the year ended December 31, 2019, are presented fairly in all material respects.

A critical note here: PenFed was found to have no weaknesses or deficiencies in its controls over financial reporting. In other words, PenFed's members can rest assured that the Board of Directors, Supervisory Committee and Executive Team are fulfilling their fiduciary responsibilities for sound fiscal stewardship of PenFed.

Based on the activity of our external and internal auditors and examiners, as well as our own observations, we can report that

PenFed continues to maintain a high level of financial safety, soundness and compliance with laws and regulations.

PenFed continues to provide outstanding financial services to its members and to serve our core – including the national defense community and all who support them. We, on the Supervisory Committee, are proud to volunteer our time, serving members of PenFed by acting as liaisons between you and your credit union.

If ever you need assistance or experience difficulties that cannot be resolved through normal channels, I encourage you to contact us.

We are always available to answer questions or review your comments regarding PenFed's activities. The Supervisory Committee is made up of members just like you. We exist for your benefit.

Brad Honkus
Chairman, Supervisory Committee

Executive
Team

Left to Right:
Winston Wilkinson, *Executive Vice President & President, Mortgage Banking –* ***John Kelly,*** *Executive Vice President & Chief Administration Officer –* ***Jamie Gayton,*** *Executive Vice President, Member Operations & Global Fixed Assets –* ***Ricardo Chamorro,*** *Executive Vice President, Consumer Banking & Strategy –* ***Lisa Jennings****, First Senior Executive Vice President –* **James Schenck,** *President & CEO –* ***Shashi Vohra,*** *Senior Executive Vice President & President, Affiliated Businesses –* ***Jill Streit,*** *Executive Vice President & Chief Financial Officer –* ***Scott Lind,*** *Executive Vice President & General Counsel –* ***Joseph Thomas,*** *Executive Vice President & Chief Information Officer –* ***Russell Rau,*** *Chief Audit Executive*

2019 Audited
Financial Statements

PENFED®
CREDIT UNION

PENTAGON FEDERAL CREDIT UNION AND SUBSIDIARIES

FINANCIAL STATEMENTS AND REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Years Ended December 31, 2019 and 2018

PENFED CREDIT UNION

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REPORT OF INDEPENDENT REGISTERED ACCOUNTING FIRM

BDO

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1801 Market Street, Suite 1700
Philadelphia, PA 19103

Independent Auditor's Report

Supervisory Committee and Management of
Pentagon Federal Credit Union
McLean, Virginia

We have audited the accompanying consolidated financial statements of Pentagon Federal Credit Union and its subsidiaries, which comprise the consolidated statements of financial condition as of December 31, 2019 and 2018, and the related consolidated statements of income and comprehensive income, changes in 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from 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 entity'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 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 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 Pentagon Federal Credit Union and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

Philadelphia, Pennsylvania
April 6, 2020

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	As of December 31,	
(dollars in thosands)	2019	2018
ASSETS		
Cash and cash equivalents	$ 646,060	$ 1,179,875
Investment securities available-for-sale (cost $2,136,774 and $1,837,984)	2,135,469	1,797,348
Federal Home Loan Bank stock and other	199,197	171,887
Loans, net of allowance of $155,228 and $118,975	19,815,489	19,868,271
Loans held for sale, at fair value	182,302	80,378
Accrued interest receivable	73,101	69,692
NCUSIF deposit	162,939	160,824
Credit Union Life Insurance (COLI)	328,292	305,106
Charitable Donation Account (CDA)	127,297	121,610
Other intangible assets, net	124,057	12,813
Property and equipment, net	524,633	442,295
Other assets	455,525	274,652
Total assets	**$ 24,774,361**	**$ 24,484,751**
LIABILITIES AND MEMBERS' EQUITY		
Members' accounts	$ 17,965,636	$ 18,882,586
Borrowed funds	3,723,996	2,681,000
Accrued interest on members' accounts	12,952	12,052
Other liabilities	409,375	452,484
Total liabilities	**22,111,959**	**22,028,122**
Members' equity:		
Regular reserves	90,900	90,900
Undivided earnings	2,605,023	2,435,035
Accumulated other comprehensive loss	(33,521)	(69,306)
Total members' equity	**2,662,402**	**2,456,629**
Total liabilities and members' equity	**$ 24,774,361**	**$ 24,484,751**

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

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,	
(dollars in thousands)	2019	2018
Interest income		
Loans	$ 949,538	$ 877,804
Investment securities	76,998	57,819
Total interest income	**1,026,536**	**935,623**
Interest expense		
Members' accounts	309,259	264,623
Borrowed funds	80,485	75,239
Total interest expense	**389,744**	**339,862**
Net interest income	**636,792**	**595,761**
Provision for loan losses	199,314	157,441
Net interest income after provision for loan losses	**437,478**	**438,320**
Non-interest income		
Fees and charges	56,188	56,661
Credit card and debit card interchange	26,610	25,879
Gains on sales of loans	15,018	22,263
Gains on sales of investment securities	4,204	87
Other	136,404	57,370
Total non-interest income	**238,424**	**162,260**
Non-interest expense		
Compensation and benefits	260,794	227,096
Office operations	102,418	80,885
Loan servicing	43,458	32,160
Occupancy	28,385	23,802
Education and promotional	27,858	27,115
Professional and outside services	29,582	20,954
Other	31,576	32,540
Total non-interest expense	**524,071**	**444,552**
Net income	**$ 151,831**	**$ 156,028**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)	Years Ended December 31,	
	2019	**2018**
Net income	**$ 151,831**	**$ 156,028**
Other comprehensive income(loss):		
Change in net unrealized gains (losses) on investment securities during the year	35,127	(11,512)
Adjustment for realized gains on investment securities included in consolidated statements of income	4,204	87
Change in unrealized net gains on cash flow hedges	8,521	4,453
Amounts reclassified into interest expense on the consolidated statement of income	(5,954)	(4,219)
Change in unrealized pension and postretirement liabilities recorded to compensation and benefits on the consolidated statements of income	5,941	7,654
Adjustment for realized pension and postretirement costs	(12,054)	3,339
Other comprehensive (loss) income, net of reclassification adjustments	**35,785**	**(198)**
Comprehensive income	**$ 187,616**	**$ 155,830**

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

(dollars in thousands)	Regular Reserves	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
Balance, January 31, 2018	**$ 90,900**	**$ 2,270,770**	**$ (69,108)**	**$ 2,292,562**
Net income	-	156,028	-	156,028
Equity from Credit Union mergers	-	8,237	-	8,237
Other comprehensive income, net of reclassification adjustments	-	-	(198)	(198)
Balance, December 31, 2018	**$ 90,900**	**2,435,035**	**(69,306)**	**2,456,629**
Net income	-	151,831	-	151,831
Equity from Credit Union mergers	-	18,157	-	18,157
Other comprehensive loss, net of reclassification adjustments	-	-	35,785	35,785
Balance, December 31, 2019	**$ 90,900**	**$ 2,605,023**	**$ (33,521)**	**$ 2,662,402**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
(dollars in thousands)	**2019**	**2018**
Cash flows from operating activities:		
Net income	**$ 151,831**	**$ 156,028**
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	199,314	157,441
Depreciation	59,541	42,052
Amortization, net	31,821	38,932
Amortization of intangibles	2,740	2,030
Increase in cash surrender value of Credit Union Owned Life Insurance	(10,776)	(9,743)
Gains on sales of loans	(15,018)	(22,263)
Gains on sales of investment securities	(4,204)	(87)
Gains on sales of foreclosed assets	(79)	(326)
Gains on valuation of taxi medallion loans	(7,241)	-
Losses on valuation of mortgage servicing rights	15,908	6,404
Loan originations	(1,268,510)	(925,599)
Proceeds from sales of loans held for sale	1,372,187	1,130,798
Bargain gains from mergers	(74,176)	(3,038)
Changes in:		
Accrued interest receivable	(1,833)	(5,620)
Other assets	(290,532)	(200,457)
Other liabilities	(40,523)	85,418
Net cash provided by operating activities	**120,450**	**451,970**
Cash flows from investing activities:		
Proceeds from maturities of investment securities	434,706	245,664
Purchases of investment securities	(1,258,924)	(573,820)
(Increase) decrease in Federal Home Loan Bank stock and other	(27,310)	84,673
Investment in Credit Union Owned Life Insurance	(8,523)	(14,922)
Proceeds from sales of investment securities	547,587	60,740
Proceeds from sales of foreclosed assets	5,451	3,836
Net decrease (increase) in loans	244,182	(601,699)
Purchase of property and equipment	(130,451)	(79,145)
Cash from mergers	76,846	56,976
Entity value equity from mergers	(18,157)	(8,237)
Decrease (increase) in NCUSIF deposit	3,929	(3,081)
Net cash (used in) investing activities	**(130,664)**	**(829,015)**
Cash flows from financing activities:		
Repayment of borrowings	(2,495,100)	(8,765,000)
Proceeds from borrowings	3,538,096	9,085,000
(Decrease) increase in members' accounts, net	(1,566,597)	895,214
Net cash (used in) provided by financing activities	**(523,601)**	**1,215,214**
Net (decrease) increase in cash and cash equivalents	(533,815)	838,169
Cash and cash equivalents at beginning of year	**1,179,875**	**341,706**
Cash and cash equivalents at end of year	**$ 646,660**	**$ 1,179,875**
Additional cash flow information:		
Interest paid	$ 384,873	$ 336,528
Noncash investing activities:		
Transfers of loans, net to other real estate owned	$ 3,093	$ 4,063
Fair value of assets acquired in mergers	843,809	191,916
Fair value of liabilities assumed in mergers	751,476	180,641

1 – See Note 7 for details of assets acquired and liabilities assumed
The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2019 and 2018
(dollars in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business and Organization

Pentagon Federal Credit Union (the "Credit Union") is headquartered in McLean, Virginia and was organized and chartered on March 25, 1935 as a federal credit union under the provisions of the Federal Credit Union Act of 1934 for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes. Participation in the Credit Union is limited to those individuals who qualify for membership as defined in its charter and bylaws.

Pentagon Federal Credit Union wholly owns the following subsidiaries, PenFed Realty, LLC, which provides real estate brokerage services to the Credit Union's members and the general public, PenFed Title, LLC, which provides real estate settlement title services to the Credit Union's members and DigMed, LLC – which provides advertising services to the Credit Union and the general public.

Income Taxes

The Credit Union is exempt from federal and state income taxes in accordance with Section 122 of the Federal Credit Union Act.

Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and predominant practices within the banking industry. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on information available at the time the consolidated financial statements are prepared. Actual amounts or results could differ from these estimates.

Principals of Consolidation

The consolidated financial statements include the accounts of Pentagon Federal Credit Union and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified to conform to current year presentation.

Business Combinations

The Credit Union accounts for mergers under the applicable provisions of Accounting Standards Codification ("ASC") 805, "Business Combinations" and the operations of the merged entities are included with the Credit Union's consolidated balances as of the effective dates of each acquisition. Under this guidance, the assets acquired and liabilities assumed for each credit union merger are recorded at their respective fair values at the effective date of the merger. If the fair value of the acquired liabilities exceeds the fair value of the acquired assets, then goodwill is recorded; however, if fair value of assets acquired exceeds the fair value of liabilities assumed and entity value acquired, then the difference is recognized in the Credit Union's statements of income in other non-interest income as a bargain purchase gain.

Goodwill and Intangibles

Goodwill represents the excess of purchase price over the fair value of assets acquired and liabilities assumed in business combinations. In accordance with ASC 350-20, Intangibles—Goodwill and Other, intangible assets with finite useful lives are amortized and goodwill and intangible assets with indefinite lives are evaluated at least annually for impairment. The Credit Union evaluates goodwill and the indefinite lived intangible asset for impairment annually as of October 31 using a Step 0 approach incorporating qualitative factors including, but not limited to, the general economic environment, industry factors, market considerations and overall financial performance of the Credit Union. If necessary, the Credit Union will proceed to a Step 1 approach to identify any potential impairment in which impairment exists when the carrying amount of goodwill exceeds its implied fair value. The Credit Union's Step 0 approach concluded no impairment exists as of October 31 and therefore a Step 1 analysis was not required.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, shares in other credit unions, and demand deposits in other financial institutions. Amounts due from financial institutions may, at times, exceed federally insured limits. Cash and cash equivalents include restricted cash of $14,529 in 2019 and $2,715 in 2018.

Investment Securities

The Credit Union's investments in debt securities are classified as available-for-sale (AFS) or held-to-maturity (HTM). Debt securities classified as AFS are measured at fair value, with an unrealized gains and losses recorded in accumulated other comprehensive income (AOCI). Debt securities where management has the ability and intent to hold these securities until maturity are classified as HTM and are carried at cost, adjusted for the amortization of premiums and accretion of discounts.

Purchase premiums and discounts are recognized in interest income using the effective interest method over the term of the securities purchased. Gains and losses on dispositions of investment securities are computed using the specific identification method.

The Credit Union management evaluates its debt securities in an unrealized position for other-than-temporary impairment. Through this process, consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer as well as the intent to sell and more likely than not it will be required to sell in addition to the 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. Declines in fair value that are other-than temporary (i.e. credit related) are recognized in earnings whereas declines attributed to the interest rate environment are recognized in AOCI.

The Credit Union has stock in the Federal Home Loan Bank (FHLB) of Atlanta. The carrying value represents an appropriate measure of fair value due to the nature of the asset. FHLB of Atlanta stock totaled approximately $173,270 and $128,943 at year-end 2019 and 2018, respectively.

The Credit Union holds investment certificates of deposits with various banks and credit unions held at cost as they are non-marketable, thus an appropriate measure of fair value. Investment certificates of deposits totaled $23,882 and $36,680 at year-end 2019 and 2018, respectively.

The Credit Union utilizes a Charitable Donation Account, in which any revenues and/or gains are used to support charities as allowed under credit union regulations. The Charitable Donation Account totaled approximately $127,297 and $121,610 at year-end 2019 and 2018, respectively. During 2019 and 2018, Federal Home Loan Bank stock and other securities were not impaired.

Loans

The Credit Union's segments its loan portfolio into the following; real estate, credit card, vehicle, secured and other unsecured loans. Real estate loans consist of the following classes; 1st and 2nd trust loans collateralized by real estate. Secured loans consist of the following classes; commercial real estate and taxi medallion loans. Unsecured loans consist of the following classes, unsecured lines of credits to members and student loans. Mortgage loans are classified as either held for investment or held for sale based on management's intent and ability to hold until maturity or sell.

ASC 825, Financial Instruments, permits entities to irrevocably elect to measure financial instruments and certain other items at fair value and thus excluded from the allowance. The Credit Union elected the Fair Value Option for taxi medallion loans, and recognizes changes in fair value as adjustments to gains on sales of loans in Other Income.

Held for investment loans are reported at the amount of unpaid principal, net of deferred loan origination costs/fees and the allowance for loan losses, while loans that management has a strategic intent to sell are designated as Loans Held for Sale (see below). Interest on loans is recognized over the loan term using the effective interest method, whereas interest for credit cards is calculated by applying the periodic rate to the average balance outstanding detailed in the member's monthly statement.

Loan fees and certain direct loan origination costs are deferred, and the net fee/cost is recognized as an adjustment to interest income over the term of the loans using the effective interest method, except for credit cards, which are amortized on a straight-line basis over twelve months.

Interest accrued is discontinued on loans when management believes, after considering economic factors, business conditions, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful, or after three months of nonpayment, whichever occurs first. Credit Card loans that are contractually past due 90 days or more have not been put on nonaccrual status, as they are typically charged off at 180 days which is consistent with industry practice and regulatory guidelines. Uncollectible interest previously accrued is reversed against interest income. The Credit Union generally places impaired loans in nonaccrual status and recognizes interest income on a cash basis as payments are received. Income is subsequently recognized when cash payments are received and, in management's judgment, the borrower's ability to make periodic payments is resumed, in which case the loan is returned to an accrual status.

Allowance for Loan Losses

The Credit Union accrues estimated losses in accordance with ASC 450, Contingencies and ASC 310, Receivables. The allowance for loan losses is a reserve against loans established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectability of the loan amount is unlikely. Recoveries on previously charged-off loans are credited to the allowance.

The allowance is increased by a provision for loan losses (charged to expense) and the allowance is reduced by loan related charge-offs, net of recoveries. Changes in the estimated allowance are charged to the provision for loan losses.

The allowance is sensitive to changes in the economic environment (e.g., unemployment rates), delinquency rates, the realizable value of collateral (e.g., housing prices), regulatory risk and other risk factors. While all of these factors are important determinants of overall allowance levels, changes in the various factors may not occur at the same time or at the same rate, and changes in these factors would not necessarily be consistent across all product types. Finally, it is difficult to predict the extent to which changes in these factors would ultimately affect the frequency of losses, the severity of losses or both.

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

The allowance for loan losses includes a general component and an asset-specific component.

General Component

The allowance for credit losses is calculated by applying statistical credit loss factors based on our own historical losses to loans over a loss emergence period to arrive at an estimate of incurred credit losses. Estimated loss emergence periods may vary by product.

Management evaluates the estimate based on historical factors on a quarterly basis and may apply qualitative adjustment after taking into account uncertainties associated with current macroeconomic and political conditions, quality of underwriting standards, credit administration, portfolio factors, and other relevant internal and external factors affecting the credit quality of the portfolio.

Specific Component

A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect all amounts due from the borrower in accordance with the original contractual term.

The asset-specific component of the allowance relates to loans considered to be impaired, which includes loans that have been modified in troubled debt restructurings as well as certain loans that have been placed on nonaccrual status displaying certain impairment indicators such as documented member hardships, initiation of foreclosure activities, etc.

To determine the asset-specific component of the allowance, the Credit Union generally measures the asset-specific allowance as the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected, discounted at the loan's original effective interest rate. Subsequent changes in impairment are reported as an adjustment to the allowance for loan losses. In certain cases, the asset-specific allowance is determined using an observable market price, and the allowance is measured as the difference between the recorded investment in the loan and the loan's fair value. Collateral-dependent loans are charged down to the fair value of collateral less costs to sell. For any of these impaired loans, the amount of the asset-specific allowance required to be recorded, if any, is dependent upon the recorded investment in the loan (including prior charge-offs), and either the expected cash flows or fair value of the loan's underlying collateral.

Troubled Debt Restructurings

A troubled debt restructuring ("TDR") is a loan for which the Credit Union has granted a concession it would not have otherwise considered because a member is experiencing financial difficulty. The types of concessions the Credit Union grants in a TDR primarily include term extensions and/or interest rate reductions. These TDRs are identified and measured individually for impairment as discussed above.

Loans Held for Sale

At origination, loans are classified as either mortgage loans held for investment or loans held for sale, based on management's strategy, intent, and ability to hold or sell these loans. Interest income on loans held for sale is recognized in loan interest income as earned. The Credit Union elected the Fair Value Option for loans held for sale, and recognizes changes in fair value as adjustments to gains on sales of loans in Other Income. Loans held for sale are sold with the mortgage servicing rights retained by the Credit Union, and are generally sold without recourse, subject to customary representations and warranties. In accordance with ASC 860, Transfers and Servicing, the Credit Union recognizes the sale of loans or other financial assets when the transferred assets are legally isolated from the Credit Union's creditors, the Credit Union has relinquished control over the financial assets, and the appropriate other accounting criteria are met for recognition of a sale of an asset.

Mortgage Servicing Rights

Mortgage servicing rights (MSR) are recognized as separate assets when mortgage loans are sold in the secondary market and the right to service these loans is retained for a fee. The Credit Union records and holds the MSR at fair value. The valuation model used to estimate MSR fair value utilizes assumptions that market participants would use in estimating future net servicing income, such as contractual servicing fee income, costs to service, discount rates, ancillary income, prepayment speeds, and default rates. This model is highly sensitive to changes in certain assumptions. If actual experience differs from the anticipated rates used in the Credit Union's model, this difference could result in a material change in the value of mortgage servicing rights.

Foreclosed Assets

Other Real Estate Owned

The Credit Union records real estate acquired through foreclosure ("real estate owned") at fair value on the date of acquisition, plus certain capitalized costs, net of estimated disposal costs, resulting in a new cost basis. Carrying costs such as maintenance are expensed as incurred. After foreclosure, updated fair values are obtained, after which the real estate owned is carried at the lower of its carrying value or its fair value less estimated costs to sell. The balances of such assets are included in other assets in the consolidated statements of financial condition. Due to changing market conditions (and the fair value and disposal cost assumptions for real estate owned), the amounts ultimately realized from the sale of real estate owned may differ from the amounts reflected in the consolidated financial statements.

Taxi Medallion Collateral

The Credit Union elected the Fair Value Option for taxi medallion loans, and recognizes changes in fair value as adjustments to gains on sales of loans in Other Income. Medallions acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated costs to sell.

Property and Equipment

Property and equipment (excluding land) are stated at cost, including interest capitalized during the period of construction, less accumulated depreciation and amortization. Purchased software, as well as internally developed software for the Credit Union's internal-use, is capitalized when the software is placed in service. Depreciation and amortization are recognized using the straight-line method over the estimated useful lives of the assets. Land is stated at cost. Expenditures for maintenance and repairs are charged to operations as incurred. The cost and related accumulated depreciation are eliminated from the accounts when assets are disposed. Any resulting gain or loss is reflected in the results of operations. Leasehold improvements are amortized over the lesser of the estimated economic life of the improvements or the remaining term of the lease. The Credit Union purchases, as well as internally develops and customizes, certain software to enhance or perform internal business functions. Qualifying software development costs are expensed, and other costs are capitalized and amortized using the straight-line method over its useful life.

The Credit Union uses the straight-line method to account for its operating leases. Under this method, the Credit Union divides the total contractual rent by the total term of the lease. The average monthly rent is recorded as rent expense, and the remaining rent amount is deferred.

National Credit Union Share Insurance Fund ("NCUSIF") Deposit

The NCUSIF deposit is in accordance with National Credit Union Administration ("NCUA") regulations, requiring the maintenance of a deposit by each insured credit union in an amount equal to one percent of its insured shares. The deposit would be refunded to the Credit Union if: (1) the insurance coverage is terminated; (2) the Credit Union converts to insurance coverage from another source; or (3) the operations of the fund are transferred from the NCUA Board.

Advertising Costs

Advertising costs are included in education and promotional expense and are expensed as incurred. Advertising expense for 2019 and 2018 was $27,858 and $27,115, respectively, of which $13,556 and $16,705 in 2019 and 2018, respectively, was paid to a related party.

Comprehensive (Loss)/Income

Accounting principles generally require revenue, expenses, gains, and losses to be included in Net Income. Certain changes in assets and liabilities, such as unrealized gains and losses on investment securities, gains and losses on cash flow hedge derivatives, and pension related adjustments are reported as a separate component of members' equity in the consolidated statements of financial condition.

Revenue Recognition

ASC Topic 606, Revenue from Contracts with Customers, establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied. The majority of our revenue-generating transactions are not subject to ASC Topic 606, including revenue generated from financial instruments, such as our loans, investment securities and mortgage lending income, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of our significant revenue-generating activities that are within the scope of ASC Topic 606, which are presented in our income statements as components of non-interest income are as follows:

Commissions – The Credit Union receives brokerage commission for Realty Services in selling, buying, or leasing a property. Each service is considered a distinct, stand-alone performance obligation, representing the bundled services that culminate when the sales (or lease) agreement is executed, representing the point in time when payment and title change hands, allowing the customer to obtain control.

Interchange Fees – These fees are charged to the merchant for participation in the Credit Union's card network ecosystem. The Credit Union is the principal in providing this service and interchange revenue will be recognized at a point in time on a gross basis as PenFed approves the transactions and transfers funds, while fees paid will be classified as an expense. Credit card rewards and rebate costs are consideration paid to the cardholder, not a Merchant Bank, and are considered separate expenses not recorded net of Interchange Fees.

Core Service Charges – This represents fee revenue from membership services as a series where the Credit Union's only performance obligation is to serve as custodian, providing access to funds as necessary. This performance obligation is satisfied over time, utilizing the time based output method.

Insurance Placement Fee – The Credit Union engages with insurance companies to place its members in insurance products for which it receives a commission from the insurance policy issuer. The Credit Union does not recognize any revenue pertaining to renewal as commissions arising from member renewals is deemed to be fully constrained until uncertainty is resolved (i.e. member renews for ongoing commission income).

Sales of OREO and Other assets – The Credit Union defines an accounting sale with full gain or loss recognition and related asset derecognition if the transaction meets certain requirements. This eliminates the prescriptive criteria and methods surrounding previous gain recognition (i.e. Installment Sale, Cost Recovery, etc.).

Fair Value of Assets and Liabilities

Fair value is a market-based measurement, not an entity-specific measurement. Fair value measurements are disclosed by level within a fair value hierarchy that gives the highest priority to quoted prices in active markets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

Valuation techniques are to be consistent with the market approach, the income approach, and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset/liability or unobservable, meaning those that reflect the entity's own assumptions developed based on the best information available in the circumstances.

The fair value hierarchy is as follows:

Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations have certain assumptions and projections, which require significant management judgment or estimation in determining the fair value assigned to such assets or liabilities.

Derivative Instruments

A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index, or referenced interest rate. These instruments include interest rate swaps, caps, floors, collars, financial forwards and futures contracts, and when-issued securities, as examples. The Credit Union can use derivatives to manage economic risk related to securities, mortgage servicing rights and mortgage banking operations, share deposits, debt, and other funding sources.

Economic Hedges

Derivatives not designated as an accounting hedge are considered an economic hedge transferring economic risk away from the investor. The Credit Union enters into interest rate lock commitments (IRLCs), in connection with the funding of residential mortgage loans in the future. The IRLCs expose the Credit Union to the risk that the price of the loans underlying the commitment may decline between the inception of the IRLC and funding of the loan. In order to mitigate the pricing risk for loans that we have intent to sell, the Credit Union enters into forward sales contracts with various counterparties. The changes in fair value of economic hedges are included in other income.

The Credit Union has netting agreements within its TBA hedge and thus presents the assets and liabilities net in the consolidated statements of financial condition.

Accounting Hedges

Derivative financial instruments are classified primarily as either fair value hedges or cash flow hedges.

Fair value hedges are used to protect against exposure to changes in the fair value of a recorded asset or liability. Changes in the fair value of fair value hedges are recorded in the same line item as the hedged item.

Cash flow hedges are used to protect an exposure to changes in the cash flows of a recognized asset, liability or forecasted transaction. Changes in fair value of cash flow hedges are reported as a component of Accumulated Comprehensive Income or Loss. For a cash flow hedge, changes in the fair value of the derivatives that have been highly effective are recognized in accumulated other comprehensive income or loss until the related cash flows from the hedged item are recognized in earnings. If the cash flow hedge ceases to be highly effective, the Credit Union discontinues hedge accounting and recognizes the changes in fair value in current period earnings.

The Credit Union has netting agreements within its derivatives agreements, but presents gross assets and liabilities in the consolidated statements of financial condition. At inception and at least quarterly during the life of the hedge, the Credit Union documents its analysis of actual and expected hedge effectiveness. This analysis includes techniques such as regression analysis and hypothetical derivatives to demonstrate that the hedge has been, and is expected to be, highly effective in offsetting corresponding changes in the fair value or cash flows of the hedged item.

If a derivative that qualifies as a fair value or cash flow hedge is terminated or de-designated, the realized or then unrealized gain or loss is recognized in income over the life of the hedged item (fair value hedge) or in the period in which the hedged item affects earnings (cash flow hedge). Immediate recognition in earnings is required upon sale or extinguishment of the hedged item (fair value hedge) or if it is probable that the hedged cash flows will not occur (cash flow hedge).

Pension Accounting and Retirement Benefit Plans

The Credit Union has a defined benefit pension plan, 401(K) deferred contribution, postretirement medical plan, and non-qualified supplemental retirement plan.

In accordance with ASC 715, “Compensation-Retirement Benefits” the funding status of each benefit plan is reflected as an asset or liability in the consolidated statements of financial position. ASC 715 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement plans, measured solely as the difference between the fair value of plan assets and the benefit obligation, as an asset or liability on the balance sheet. Unrecognized actuarial gains and losses, unrecognized prior service costs, and unrecognized transition obligation remaining from the adoption of earlier pronouncements in ASC 715 are included as a component of accumulated other comprehensive income or loss.

Actuarial gains and losses and prior service costs and credits that arise during a period, are included in other comprehensive income to the extent they are not included in net periodic pension cost (a component of compensation and benefits expense).

New Accounting Pronouncements adopted in current period

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606) which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods and services.

The following ASUs are integral to Topic 606:

- ASU 2015-14, *Deferral of the Effective Date*
- ASU 2016-08, *Principle versus Agent Considerations*
- ASU 2016-10, *Identifying Performance Obligations and Licensing*
- ASU 2016-12, *Narrow-Scope Improvements and Practical Expedients*
- ASU 2016-20, *Technical Corrections and Improvements to Topic 606*

The Credit Union evaluated revenue streams aligned with the classifications reported on the consolidated statements of income. For those revenue streams subject to the provisions of Topic 606, the Credit Union evaluated those revenue streams which include fees and charges, credit card and debit card interchange, and other non-interest income. The Credit Union adopted the new standard and related ASUs effective January 1, 2019, using the modified retrospective method.

The majority of the Credit Union's non-interest income subject to ASC 606 is recognized at a point in time based on the transfer of control. The Non-Interest Income recognized over time primarily consists of series-type performance obligations such as core service charges. Based on the Company's evaluation process and review of its contracts with customers, the timing and amount of revenue recognized previously is consistent with how revenue is recognized under the new standard. As such, the adoption of this ASU did not have a significant impact on the Credit Union's financial statements.

In January 2016, the FASB issued ASU 2016-01, amends Sub-Topic 825-10 *Financial Instruments- Overall*. This update amends certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, among other amendments, this update eliminates the disclosure of fair value of financial instruments that are at amortized cost, while requiring separate presentation of financial assets and liabilities by measurement category on the balance sheet or in the notes to financial statements. These amendments are effective for the annual periods beginning after December 15, 2018. The Credit Union adopted the new standard on January 1, 2019. The implementation of Sub-topic 825-10 did not have a material effect on the Credit Union's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Clarifying the Definition of a Business, effective for annual reporting periods beginning after December 15, 2018. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similarly identifiable assets; if so, the set of transferred assets and activities is not a business. The Credit Union adopted the new standard on January 1, 2019. The adoption of ASU 2017-01 did not have a material effect on the Credit Union's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation- Retirement Benefits* (Topic 715). This guidance requires the Credit Union records its retirement related service cost components as compensation expense, while all other components of retirement related costs are required to be separately presented in the consolidated statements of income (in other income or other expenses) from the compensation expense, among other requirements. This guidance is effective for fiscal years beginning after December 15, 2018. The Credit Union adopted the new standard on January 1, 2019. The adoption of Topic 715 did not have a material effect on the Credit Union's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments* (Topic 230). The guidance addresses how certain cash receipts and cash payments are presented and classified in the statements of cash flows. This guidance is effective for fiscal years beginning after December 15, 2018. The Credit Union adopted the new standard on January 1, 2019. The adoption of this standard did not have a material effect on the Credit Union's consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The ASU requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Entities will also be required to reconcile such total to amounts on the balance sheet and disclose the nature of the restrictions. The Credit Union adopted the new standard on January 1, 2019. The adoption of this standard did not have a material effect on the Credit Union's consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities (Topic 815). This derivatives and hedging guidance simplifies certain documentation required for hedging activities while also simplifying assessment requirements. This guidance also expands the risk management activities that qualify for hedge accounting. Additionally, the guidance eliminates the concept of separately recording hedge ineffectiveness, and expands disclosure requirements of the impact of hedging relationships. This guidance is effective for fiscal years beginning after December 15, 2019 and early adoption is permitted. The Credit Union elected early adoption of this ASU effective January 1, 2018, which has expanded the Credit Union's use of fair value hedging to include the last-of-layer method. The last-of-layer method permits reporting entities to designate the portion of a closed portfolio of prepayable financial assets as the hedged item in a fair value hedge. Upon adoption, recorded amounts using the last-of-layer method are not material to the consolidated financial statements. The Credit Union has modified the notes to the consolidated financial statements in accordance to the new guidance.

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other* (Topic 350). The new guidance simplifies the subsequent measurement of goodwill which eliminates Step 2 from the goodwill impairment test. Instead, under the amendments in this ASU, an entity should perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This guidance is effective for annual goodwill impairment tests in fiscal years beginning after December 15, 2021. Early adoption is permitted for annual goodwill impairment tests performed on testing dates after January 1, 2017. The Credit Union adopted the new standard on January 1, 2019 and revised its process accordingly.

New Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires a lessee to recognize assets and liabilities on financing and operating leases with terms exceeding 12 months. This is a change from current GAAP, which requires only capital leases to be recognized on the balance sheet. The ASU will also require additional disclosures to help financial statement readers better understand the amount, timing and uncertainty of cash flows arising from leases. The following ASUs comprise Topic 842, which collectively allow entities to elect a simplified transition approach:

- ASU 2018-01, *Practical Expedient for Transition to Topic 842*
- ASU 2018-10, *Codification Improvements to Topic 842, Leases*
- ASU 2018-11, *Leases (Topic 842): Targeted Improvements*
- ASU 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*
- ASU 2019-01, *Leases (Topic 842): Codification Improvements*

These ASUs are effective for the annual reporting periods beginning after December 15, 2020. The Credit Union is currently evaluating these ASUs to determine the impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement* (Topic 820): *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, effective for annual reporting periods beginning after December 15, 2019. The amendments in this ASU either removed or modified disclosure requirements related to fair value measurements in accordance with Topic 820. The Credit Union is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software* (Subtopic 350-40) which helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license. The update applies to entities that are customers in a hosting arrangement that is a service contract. This guidance is effective for annual reporting periods beginning after December 15, 2020. The Credit Union is evaluating the impact from the adoption of the new standard.

In June 2016, the FASB issued new guidance for *Credit Losses* (Topic 326, ASU 2016-13). The new guidance replaces the incurred loss impairment methodology with an expected credit loss methodology. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit deteriorated loans will receive an allowance account for expected credit losses at the acquisition date that represents a component of the purchase price allocation. Credit losses relating to AFS securities will be recorded through an allowance for expected credit losses, with such allowance limited to the amount by which fair value is below amortized cost. An allowance will be established for estimated credit losses on HTM securities. The following ASUs comprise Topic 326, which collectively allow entities to elect a simplified transition approach:

- ASU 2018-19, *Codification Improvements to Topic 326*
- ASU 2019-05, *Targeted Transition Relief to Topic 326*
- ASU 2019-04, *Codification Improvements to Topic 326,*

This guidance is effective for fiscal years beginning after December 15, 2021. The Credit Union is evaluating the effect of this ASU will have on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General* (Subtopic 715-20) which modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The ASU removes disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. The guidance is effective for fiscal years beginning after December 15, 2021 with early adoption permitted. The Credit Union is currently evaluating the effect of the disclosures required by the ASU.

In October 2018, the FASB issued ASU 2018-16, *Derivatives and Hedging* (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes, effective for annual reporting periods ending after December 15, 2019. This ASU permits the use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815. This will provide entities more lead time to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. The Credit Union is currently evaluating this guidance to determine the impact on its consolidated financial statements.

NOTE 2 – INVESTMENT SECURITIES

The Credit Union's AFS debt securities as of December 31, 2019 and 2018 were as follows:

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale debt securities				
Federal agency securities-bonds	$ 121,478	$ 27	$ (297)	$ 121,208
Government agency bonds	208,241	187	(2,074)	206,354
Mortgage backed securities	1,677,533	5,239	(4,842)	1,677,930
Other	129,522	783	(328)	129,977
Total available-for-sale debt securities	**$ 2,136,774**	**$ 6,236**	**$ (7,541)**	**$ 2,135,469**

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale debt securities				
Federal agency securities-bonds	$ 115,980	$ -	$ (3,943)	$ 112,037
Government agency bonds	244,541	575	(8,530)	236,586
Mortgage backed securities	1,411,883	1,055	(27,895)	1,385,043
Other	65,580	-	(1,898)	63,682
Total available-for-sale debt securities	**$ 1,837,984**	**$ 1,630**	**$ (42,266)**	**$ 1,797,348**

The Credit Union sold AFS debt securities for cash proceeds of $547,587 and $60,740 for the years ended December 31, 2019 and 2018, respectively. Gross realized gains of $5,729 and gross realized losses of $1,525 were included in earnings for the year ended December 31, 2019. Gross realized gains of $115 and gross realized losses of $28 were included in earnings for the year ended December 31, 2018.

The contractual maturities at December 31, 2019 and 2018 are detailed in the following table (actual maturities may differ from contractual maturities as certain security issuers have the right to prepay obligations without penalty):

	December 31, 2019	
Available-for-sale debt securities	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 8,243	$ 8,281
Due after one year through five years	247,653	247,845
Due after five years through ten years	320,221	319,567
Due after ten years	1,560,657	1,559,776
Total available-for-sale debt securities	**$ 2,136,774**	**$ 2,135,469**

	December 31, 2019	
Available-for-sale debt securities	**Amortized Cost**	**Fair Value**
Due in one year or less	$ -	$ -
Due after one year through five years	216,570	209,646
Due after five years through ten years	435,315	425,488
Due after ten years	1,186,099	1,162,214
Total available-for-sale debt securities	**$ 1,837,984**	**$ 1,797,348**

All securities in an unrealized loss position were reviewed individually to determine whether those losses were caused by an other-than-temporary decline in fair value. The Credit Union makes a determination of whether unrealized losses are other-than-temporary based on the following factors: whether the Credit Union intends, or would be required, to sell or hold the security until its costs can be recovered, the nature of the security, the portion of unrealized losses that are attributable to credit losses and the financial condition of the issuer of the security. The Credit Union does not intend to sell nor would the Credit Union be, more likely than not, required to sell these securities before recovering their amortized cost basis. The unrealized losses associated with these investments are not a result of changes in the credit quality of the issuers; rather, the losses are reflective of changing market interest rates. The Credit Union expects to recover the entire cost basis of these securities as there were no declines in the fair value that were considered other-than-temporary during the years ended December 31, 2019 and 2018.

The table below presents available-for-sale securities in a gross unrealized loss position, and whether such securities have been in a gross unrealized loss position for less than 12 months, or 12 months or greater.

	December 31, 2019					
	Less than 12 Months			12 Months or Greater		
	Number of Investments	Fair Value	Gross Unrealized Losses	Number of Investments	Fair Value	Gross Unrealized Losses
Securities Available for Sale						
Federal agency securities-bonds	3	$ 44,886	$ (115)	1	$ 14,816	$ (182)
Government agency bonds	10	99,792	(948)	11	75,101	(1,126)
Mortgage backed securities	71	580,833	(2,529)	35	264,678	(2,313)
Other	-	-	-	3	26,789	(328)
Total securities available for sale in a gross unrealized loss position	**84**	**$ 725,511**	**$ (3,592)**	**50**	**$ 381,384**	**$ (3,949)**

	December 31, 2018					
	Less than 12 Months			12 Months or Greater		
	Number of Investments	Fair Value	Gross Unrealized Losses	Number of Investments	Fair Value	Gross Unrealized Losses
Securities Available for Sale						
Federal agency securities-bonds	-	$ -	$ -	9	$ 112,037	$ (3,943)
Government agency bonds	2	31,338	(470)	20	155,772	(8,060)
Mortgage backed securities	28	227,056	(1,628)	116	929,002	(26,267)
Other	1	9,915	(23)	5	53,768	(1,875)
Total securities available for sale in a gross unrealized loss position	**31**	**$ 268,309**	**$ (2,121)**	**150**	**$ 1,250,579**	**$ (40,145)**

NOTE 3 – LOANS, NET

The composition of the Credit Union's loans by portfolio and delinquency status is as follows:

December 31, 2019	Current	30-89 days Past Due	Non-Accrual	>89 days Still Accruing	Total Delinquent Loans	Deferred Fees	Total
First trust mortgages	$ 9,523,820	$ 11,266	$ 13,996	$ -	$ 25,262	$ 82,726	$ 9,631,808
Term home equity	687,257	2,100	1,872	-	3,972	1,901	693,130
Equity lines of credit	1,758,117	7,238	8,961	-	16,199	26,230	1,800,546
Credit card loans	1,648,337	25,881	-	33,264	59,145	(2,895)	1,704,587
Vehicle loans	3,431,054	55,041	36,041	-	91,082	13,566	3,535,702
Other secured loans	257,729	10,016	19,080	-	29,096	(7,288)	279,537
Unsecured consumer/ other	2,279,898	17,502	18,376	-	35,878	9,631	2,325,407
Total loans	**$ 19,586,212**	**$ 129,044**	**$ 98,326**	**$ 33,264**	**$ 260,634**	**$ 123,871**	**$ 19,970,717**

December 31, 2018	Current	30-89 days Past Due	Non-Accrual	>89 days Still Accruing	Total Delinquent Loans	Deferred Fees	Total
First trust mortgages	$ 11,137,025	$ 6,395	$ 10,177	$ -	$ 16,572	$ 83,710	$ 11,237,307
Term home equity	732,889	2,044	1,899	-	3,943	2,437	739,269
Equity lines of credit	1,493,360	4,321	2,577	-	6,898	21,449	1,521,707
Credit card loans	1,665,328	24,924	-	34,416	59,340	(2,249)	1,722,419
Vehicle loans	3,302,012	48,586	33,034	-	81,620	13,135	3,396,767
Other secured loans	37,510	118	2,076	-	2,194	(146)	39,558
Unsecured consumer/ other	1,289,331	14,903	16,019	-	30,922	9,965	1,330,218
Total loans	**$ 19,657,455**	**$ 101,291**	**$ 65,782**	**$ 34,416**	**$ 201,489**	**$ 128,301**	**$ 19,987,245**

Credit Quality

The Credit Union closely monitors the credit quality of its loan portfolio based on economic conditions, loan performance trends and other risk attributes. The Credit Union assesses the credit risk in the following classes:

Real Estate Loans

The risks that may affect the default experience on the Credit Union's loans portfolio include changes in home prices in various geographic locations, which are monitored in conjunction with various loan attributes such as vintage, product type and property type.

The overall risk within the real estate portfolios is supported by the collateral held and thus these values are monitored within current market trends for real estate. The Credit Union holds deeds of trust/mortgages on underlying real estate to collateralize all first trust mortgage, term home equity, and equity line of credit loans. Approximately 30% of real estate loans at December 31, 2019 and 2018 are collateralized by residential real estate located in the District of Columbia metropolitan area.

Vehicle and Other Secured Loans

Value is driven by the borrower's ability to generate cash flows. Delinquency rates are a primary credit quality indicator for secured loans. Loans that are more than 30 days past due provide an early warning of borrowers who may be experiencing financial difficulties and/or who may be unable or unwilling to repay the loan. As the loan continues to age, it becomes more clear whether the borrower is likely either unable or unwilling to pay. Late-stage delinquencies are a strong indicator of loans that will ultimately result in a liquidation transaction. Lastly, the Credit Union monitors debt-to-income and loan-to-value ratios in addition to credit score on an ongoing basis.

Credit Card and Other Unsecured Loans

The risks within consumer and credit card loans correlate broad economic trends such as unemployment, examined in conjunction with borrower risk attributes such as credit score which is a general indicator of credit quality trends within the portfolio.

The Credit Union monitors performance of these portfolios against these trends and adjusts its lending strategies within established risk tolerance strategies. This information is utilized to evaluate the appropriateness of the allowance for loan losses.

Changes in the allowance for loan losses for 2019 and 2018 were as follows:

December 31, 2019	1st Trust Mortgages	Term Home Equity	Equity Lines	Credit Cards	Vehicle Loans	Other Secured Loans	Unsecured and Other	Total
Balance, beg of year	$ 3,351	$ 1,807	$ 3,437	$ 43,839	$ 22,114	$ 88	$ 44,339	$ 118,975
Provision for loan loss	(923)	(566)	525	92,643	27,788	1,039	77,865	198,371
Charge-offs	(20)	(333)	(1,101)	(101,071)	(31,433)	-	(50,314)	(184,272)
Recoveries	32	263	481	11,125	1,786	-	8,467	22,154
Balance, end of year	**$ 2,440**	**$ 1,171**	**$ 3,342**	**$ 46,536**	**$ 20,255**	**$ 1,127**	**$ 80,357**	**$ 155,228**
Ending balance: Loans individually evaluated for impairment	2,291	535	1,025	-	-	-	691	4,542
Ending balance: Loans collectively evaluated for impairment	149	636	2,317	46,536	20,255	1,127	79,666	150,686
Loan amount (excluding ALL):								
Ending balance: Impaired loans with allowance	16,544	1,885	2,706	-	41	-	2,565	23,741
Ending balance: Impaired loans without allowance	11,016	2,528	2,825	-	134	-	2,862	19,365
Ending balance: Loans collectively evaluated for impairment	$ 9,604,248	$ 688,717	$ 1,795,015	$ 1,704,587	$ 3,535,527	$ 279,537	$ 2,319,980	$ 19,927,611

December 31, 2018	1st Trust Mortgages	Term Home Equity	Equity Lines	Credit Cards	Vehicle Loans	Other Secured Loans	Unsecured and Other	Total
Balance, beg of year	$ 3,578	$ 2,149	$ 3,513	$ 40,570	$ 19,856	$ -	$ 28,722	$ 98,388
Provision for loan loss	896	(132)	737	80,615	25,704	88	49,642	157,441
Charge-offs	(1,154)	(575)	(965)	(91,989)	(24,875)	-	(39,010)	(158,568)
Recoveries	31	365	152	14,642	1,429	-	5,073	21,694
Balance, end of year	**$ 3,351**	**$ 1,807**	**$ 3,437**	**$ 43,839**	**$ 22,115**	**$ 88**	**$ 44,427**	**$ 118,975**
Ending balance: Loans individually evaluated for impairment	2,642	920	785	-	-	-	284	4,631
Ending balance: Loans collectively evaluated for impairment	1,241	677	2,614	43,839	12,314	88	53,571	114,344
Loan amount (excluding ALL):								
Ending balance: Impaired loans with allowance	17,405	2,679	3,010	-	30	-	1,636	24,760
End balance: Impaired loans without allowance	12,243	2,615	3,622	-	149	-	2,816	21,445
Ending balance: Loans collectively evaluated for impairment	$ 11,207,660	$ 733,975	$ 1,515,075	$ 1,722,420	$ 3,396,588	$ 39,556	$ 1,325,766	$ 19,941,040

Troubled Debt Restructurings

TDRs are individually evaluated for impairment beginning in the month of restructuring. Impairment is measured as the difference between the net carrying amount of the loan and the modified future expected cash flows discounted at the loan's original effective interest rate. For real estate loans that are collateral dependent, impairment is measured by the difference between the recorded investment and the collateral value, net of costs to sell.

Subsequent to designation as a TDR, interest income is recognized based on a loan's modified expected cash flows and revised effective interest rate. Additional impairment is recognized for TDRs that exhibit further credit deterioration after modification.

In 2019, the Credit Union newly modified 230 TDR loans recorded at $8,864. In 2018, the Credit Union newly modified 62 TDR loans recorded at $7,237, involving mostly concessions in rate and/or extension of maturity to members experiencing financial difficulties.

The following table provides a summary of TDR loans outstanding in accruing and nonaccrual status:

	December 31,	
	2019	**2018**
TDRs		
First trust mortgages	$ 24,543	$ 26,561
Term home equity	3,503	5,163
Equity lines of credit	3,185	3,683
Credit card loans	-	-
Vehicle loans	175	179
* Other Secured loans	16,639	-
Unsecured consumer/other	5,234	4,314
Total TDRs - Current	**$ 53,279**	**$ 39,900**
TDRs - nonaccural		
First trust mortgages	$ 1,163	$ 744
Term home equity	77	-
Equity lines of credit	421	362
Credit card loans	-	-
Vehicle loans	-	-
* Other Secured loans	22,336	-
Unsecured consumer/other	193	138
Total TDRs - Current	**$ 24,190**	**$ 1,244**
Total TDRs	**$ 77,469**	**$ 41,144**

** Comprised of Taxi Medallion loans which are held at Fair Value and therefore excluded from the allowance*

Impaired Loans

The Credit Union's allowance for loan loss evaluation is predominately based on a collective review for impairment, except for loans reviewed individually for impairment on a monthly basis- such as nonaccrual real estate loans and restructured loans. Factors considered in the review for impairment included (but are not limited to) the review of payment history, updated credit status, collateral value, and economic factors, among others. The average total outstanding impaired loan balance in 2019 and 2018 was $44,655 and $46,244.

Interest income was not recognized on loans that remained impaired and did not return to performing status during the years ended December 31, 2019 and 2018. Interest income on impaired loans in non-accrual status is recognized on a cash basis.

NOTE 4 – LOAN SALES

In the normal course of business, the credit union may originate and transfer qualifying residential mortgage loans in a sales transactions in which it has continuing involvement through retained loan servicing. Loans are sold to Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, collectively Government Sponsored Enterprises (GSEs), and Government National Mortgage Association (GNMA). The GSEs and GNMA generally securitize loans into mortgage-backed securities that are sold to third-party investors in the secondary market. The Credit Union may also sell whole loans that were previously retained to private third-party investors.

At December 31, 2019 and 2018, the Credit Union had $182,302 and $80,378, respectively, of loans held for sale, which were committed for sale prior to the respective year-end periods. During 2019 and 2018, the Credit Union sold loans with proceeds from sales of loans totaling $1,372,187 and $1,130,798, respectively, and recognized net gains on sales of loans totaling $15,018 and $22,263, respectively, which were reported in non-interest income. At December 31, 2019 and 2018, the mortgage servicing rights balance was $64,482 and $67,548, respectively, which is reported in Other Assets.

The Credit Union's continuing involvement in loans transferred includes ongoing servicing, repurchasing previously transferred loans under obligations related to standard representations and warranties. The Credit Union repurchased $2,326 and $2,309 of previously transferred loans in 2019 and 2018, respectively and are included in our loan portfolio to date.

Representation and Warranties

For mortgage loans transferred in sale transactions or securitizations to the GSEs, GNMA and other investors, the Credit Union has made representations and warranties that the loans meet specified requirements. These requirements typically relate to collateral, underwriting standards, validation of certain borrower representations in connection with the loan and the use of standard legal documentation. In connection with the sale of loans to the GSEs, GNMA and other investors, the Credit Union may be required to repurchase the loan or indemnify the respective entity for losses due to breaches of these representations and warranties. The Credit Union does not currently recognize a liability for estimated losses related to these representations and warranties due to significantly low repurchase history.

Servicing

The Credit Union retains Mortgage Servicing Rights (MSR) on loans transferred in sale transactions. MSR assets are recognized at fair value on the date of sale and thereafter. Actual and expected loan constant prepayment rates (CPR), discount rates, servicing costs and other economic factors are considered in determining the MSR fair value. The MSR valuation is sensitive to interest rate and prepayment risk. The sensitivity analysis of the hypothetical effect on fair value of MSR as a result of a 100-200 basis point decline/increase in the 10 year US Treasury.

	Weighted-Average Mortgage Servicing Rights Assumptions	
	December 31, 2019	**December 31, 2018**
Prepayment Speed (CPR)	11.9	10.0
Projected Life (Years)	5.4	6.1
*Discount Rate	8.52%	10.10%

**In 2019, the Credit Union revised its MSR valuation methodology from using a static to dynamic option adjusted spread which conforms to best valuation practices.*

	Hypothetical Effect on Mortgage Servicing Rights Fair Value	
	2019	**2018**
Dec. 31 Mortgage Servicing Rights Fair Value	$ 64,482	$ 67,548
Change in Fair Value from:		
-100 bp decline in 10 year US Treasury	(7,314)	(5,189)
-200 bp decline in 10 year US Treasury	(13,889)	(10,275)
+100 bp decline in 10 year US Treasury	6,393	4,858
+200 bp decline in 10 year US Treasury	11,207	7,486

The Credit Union earns servicing and other ancillary fees for its role as servicer. The Credit Union's servicing revenue is included in Fees and Charges in the Consolidated Statements of Income. During the years ended December 31, 2019 and 2018, the Credit Union received $3,830 and $3,109, respectively, of late charges, which are included in Fees and Charges in the Consolidated Statements of Income.

The Credit Union's responsibilities as servicer typically include collecting and remitting monthly principal and interest payments, maintaining escrow deposits, performing loss mitigation and foreclosure activities, and in certain instances, funding servicing advances that have not yet been collected from the borrower. The Credit Union recognizes servicing advances in Other Assets on the Consolidated Statements of Financial Condition. Servicing advances as of December 31, 2019 and 2018 totaled $3,364 and $2,998, respectively.

The following table provides the outstanding and delinquent loan balances of transferred loans for which the Credit Union retains servicing rights. These amounts are excluded from the Consolidated Statements of Financial Condition as they meet the definition of a sale under ASC 860, Transfers and Servicing.

	December 31,	
	2019	**2018**
Principal balances of loans serviced	$ 5,457,860	$ 5,640,786
Principal balances of delinquent loans*	$ 6,405	$ 11,007

**Delinquency within the above table is identified as 60 days and above*

NOTE 5 – FORECLOSED ASSETS

Real Estate Owned

The Credit Union acquires REO assets through foreclosure proceedings or when a delinquent borrower chooses to transfer a mortgaged property in lieu of foreclosure. REO assets represent held-for-sale assets carried at the lower of cost or fair value less costs to sell. The Credit Union generally expects to dispose of REO assets held within one year or less. Holding costs such as insurance, maintenance, taxes and utility are expensed as incurred.

As of December 31, 2019 and 2018, REO assets, which are recognized in Other Assets on the Consolidated Statements of Financial Condition, had carrying values totaling $3,824 and $3,138, net of valuation allowances of $317 and $487, respectively. Additions to the valuation allowance were $455 and $524 for 2019 and 2018, respectively.

Taxi Medallions

The Credit Union acquires Medallions through, or in lieu of, foreclosure proceeds. The Credit Union elected the Fair Value Option for Medallions and as such are carried at fair value less estimated costs to sell. As of December 31, 2019 and 2018, Medallions, which are recognized in Other Assets on the Consolidated Statements of Financial Condition, had value of $4,454 and $0, respectively.

NOTE 6 – GOODWILL AND OTHER INTANGIBLES

The Credit Union completed its annual impairment assessment and concluded the fair value of goodwill was not below its carrying amount. As a result, the Credit Union did not recognize any impairment charges for the years ended December 31, 2019 and 2018.

Total Goodwill was approximately $24,226 and $23,156 at December 31, 2019 and 2018, respectively, and is a component of Other Assets.

	Carrying Value Goodwill	
	December 31, 2019	**December 31, 2018**
Goodwill at beginning of year	**$ 23,156**	**$ 18,707**
Goodwill additions during the year	1,070	4,449
Adjustments	-	-
Goodwill at end of year	**$ 24,226**	**$ 23,156**

The Credit Union has total intangibles from acquisitions at December 31, 2019 and 2018, of $124,057 and $12,813, respectively. Net additions to acquisition intangibles were related to the mergers, which had total additions of $113,985 and $2,787 for 2019 and 2018, respectively. The acquisition intangibles in 2019 include an indefinite lived intangible of $108,942 that removes limitations on the Credit Union's field of membership and core deposit intangibles. In 2018, acquisition intangibles relate mostly to core deposit intangibles, which represent the estimated fair value of the relationships within the members' share deposits acquired.

	Carrying Value Intangibles	
	December 31, 2019	**December 31, 2018**
Intangibles at beginning of year	**$ 12,813**	**$ 12,056**
Intangible additions during the year	113,985	2,787
Amortization and adjustments	(2,741)	(2,030)
Intangibles at end of year	**$ 124,057**	**$ 12,813**

NOTE 7 – ACQUISITIONS

Progressive Credit Union

On January 1, 2019 the Credit Union acquired 100% of Progressive Credit Union, a New York state charted credit union in accordance with the acquisition method of accounting. The merger was approved by NCUA as an emergency merger on November 29, 2018 whereby the Credit Union, upon merger assumed the assets and liabilities of Progressive and in consideration for the assets acquired and liabilities assumed, obtained Progressive's open field of membership charter for its exclusive use.

The fair value of the identifiable assets acquired and liabilities assumed of $48,302 exceeded the fair value of the consideration transferred $0. As a result, the Credit Union reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. Accordingly, the acquisition has been accounted for as a bargain purchase and, as a result, the Credit Union recognized a gain of $48,302 associated with the acquisition. The gain is included in Other within Non-Interest Income in the Consolidated Statement of Income. The measurement period, where an acquirer may adjust the valuation, is deemed closed as of December 31, 2019.

The following table summarizes the assets acquired and liabilities assumed recognized at the acquisition date:

Fair Value of Assets Acquired	**Progressive**
Cash	$ 37,119
Investment securities	1,671
Loans	202,349
Property & equipment	4,618
NCUSIF	2,103
Retirement plan	18,363
Foreclosed assets	5,761
Indefinite lived intangible	108,942
Other	876
Total Assets Acquired	**$ 381,802**
Fair Value of Liabilities Assumed	
Other liabilities	$ 95,141
Member accounts	238,359
Total Liabilities Assumed	**$ 333,500**
Net Equity Acquired from Mergers	**$ 48,302**
Entity Value	$ -
Residual Bargain Gain	48,302
Total	**$ 48,302**

McGraw Hill

On May 1, 2019 the Credit Union acquired 100% of McGraw Hill Federal Credit Union, a New Jersey federally chartered credit union in accordance with the acquisition method of accounting. The merger was approved by NCUA whereby the Credit Union, upon merger assumed the assets and liabilities of McGraw Hill.

The fair value of the identifiable assets acquired and liabilities assumed of $35,888 exceeded the fair value of the consideration transferred $0. As a result, the Credit Union reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. Accordingly, the acquisition has been accounted for as a bargain purchase and, as a result, the Credit Union recognized a gain of $22,748 associated with the acquisition which includes an entity value of $13,140. The gain is included in Other within Non-Interest Income in the Consolidated Statement of Income. The Credit Union is still in the process of assessing the measurement period.

The following table summarizes the assets acquired and liabilities assumed recognized at the acquisition date:

Fair Value of Assets Acquired	**McGraw Hill**
Cash	$ 36,665
Investment securities	619
Loans	329,702
Property & equipment	595
NCSIF	3,300
Accrued income	1,361
COLI	3,980
Identified intangibles	4,145
Other	3,015
Total Assets Acquired	**$ 383,382**
Fair Value of Liabilities Assumed	
Other liabilities	$ 916
Member accounts	346,578
Total Liabilities Assumed	**$ 347,494**
Net Equity Acquired from Mergers	**$ 35,888**
Entity Value	$ 13,140
Residual Bargain Gain	22,748
Total	**$ 35,888**

Magnify

On December 1, 2019 the Credit Union completed a merger with Magnify Federal Credit Union, a Florida federally chartered credit union whereby the fair value of the identifiable assets acquired of $78,626 and liabilities assumed of $70,482 which exceeded the fair value of consideration transferred of $0. Accordingly, the acquisition has been accounted for as a bargain purchase and, as a result, the Company recognized a gain of $3,126 associated with the acquisition which includes an entity value of $5,017. The gain is included in Other within Non-Interest Income in the Consolidated Statement of Income.

2018 Mergers

In 2018, the Credit Union acquired 100% of Fremont and Texas Partner in accordance with the acquisition method of accounting. The two mergers in 2018 had aggregate total assets of approximately $191,916, with total liabilities of approximately $180,641, and a resulting addition to equity of approximately $8,237 and a bargain purchase gain recognized in non-interest income - other of $3,038.

The following table summarizes the assets acquired and liabilities assumed recognized at the respective acquisition date:

Fair Value of Assets Acquired	**Merger A**	**Merger B**	**2018 Total**
Cash	$ 3,154	$ 53,822	$ 56,976
Investment securities	19,333	17,183	36,516
Loans	16,155	68,973	85,128
Property & equipment	300	8,768	9,068
Other	907	3,321	4,228
Total Assets Acquired	**$ 39,849**	**$ 152,067**	**$ 191,916**
Fair Value of Liabilities Assumed			
Other liabilities	$ 1,000	$ 2,000	$ 3,000
Member accounts	35,589	142,052	177,641
Total Liabilities Assumed	**$ 36,589**	**$ 144,052**	**$ 180,641**
Net Equity Acquired from Mergers	**$ 3,260**	**$ 8,015**	**$ 11,275**
Entity Value	$ 2,142	$ 6,095	$ 8,237
Residual Bargain Gain	1,118	1,920	3,038
Total	**$ 3,260**	**$ 8,015**	**$ 11,275**

NOTE 8 – PROPERTY AND EQUIPMENT, NET

Property and equipment are summarized as follows:

		December 31,	
	Estimated useful life	2019	2018
Land		$ 44,926	$ 41,680
Buildings and improvements	5 to 50 years	329,306	264,821
Furniture and fixtures	3 to 8 years	51,577	44,898
Computer equipment	3 to 5 years	77,746	70,643
Computer software	3 to 10 years	268,213	217,244
Leasehold improvements	1 to 5 years	14,838	12,932
		786,606	652,218
Accumulated depreciation		(261,973)	(209,923)
Property and equipment, net		**$ 524,633**	**$ 442,295**

Depreciation expense for the years ended December 31, 2019 and 2018, was approximately $59,541 and $42,052, respectively, and is included in occupancy expense.

Future minimum rental commitments within non-cancelable leases as of December 31, 2019 were as follows:

2020	$ 6,862
2021	5,788
2022	4,952
2023	3,725
2024	2,096
Thereafter	1,576
Total	**$ 24,999**

Rent expense was $9,252 and $7,000 for 2019 and 2018, respectively, and was recorded in the Consolidated Statements of Income as occupancy expense within non-interest expense.

NOTE 9 – MEMBERS' ACCOUNTS

Share and deposit amounts up to $250 per ownership interest are federally insured through the National Credit Union Share Insurance Fund. Individual deposit account balances exceeding $250 at December 31, 2019 and 2018, totaled $2,094,951 and $2,206,999, respectively.

At December 31, 2019, scheduled maturities of IRA certificates and certificates of deposit on members' accounts are as follows:

2020	$ 5,009,648
2021	1,675,696
2022	882,176
2023	938,370
2024	1,124,924
Thereafter	363,036
Total	**$ 9,993,851**

Interest rates on member's accounts are set by the Board of Directors and based on an evaluation of market conditions. Interest expense is based on available earnings for each interest period. Interest expense on members' accounts for the 2019 and 2018 year end are as follows:

	December 31,			
	2019		**2018**	
	Balances	**Interest Expense**	**Balances**	**Interest Expense**
Regular shares	$ 3,847,105	$ 17,099	$ 2,498,377	$ 2,714
Pencheck	1,309,715	2,722	1,149,795	2,356
Money market shares	2,612,319	11,989	3,922,649	30,586
Share certificates	8,236,263	231,237	9,162,893	184,039
IRA shares	202,646	116	218,018	114
IRA certificates	1,757,588	46,096	1,930,854	44,814
Total	**$ 17,965,636**	**$ 309,259**	**$ 18,882,586**	**$ 264,623**

NOTE 10 – BORROWED FUNDS

Borrowed funds are summarized as follows:

	December 31,			
	2019		2018	
Federal Home Loan Bank advances	$	3,723,996	$	2,681,000
Other borrowings		-		-
Total	**$**	**3,723,996**	**$**	**2,681,000**

	December 31, 2019					
	Outstanding Balance		Coupon	Fixed/ Variable	Payment	Maturities
FHLB Borrowing	$	2,467,996	1.52% - 4.97%	Fixed	Quarterly	2021 - 2026
FHLB Borrowing		66,000	5.8% - 6.05%	Fixed	Monthly	2024
FHLB Borrowing		1,190,000	1.88% - 2.14%	Variable	Quarterly	2020
Total FHLB Borrowings	**$**	**3,723,996**				
Other Borrowings		-				
Total Borrowed Funds	**$**	**3,723,996**				

	December 31, 2018					
	Outstanding Balance		Coupon	Fixed/ Variable	Payment	Maturities
FHLB Borrowing	$	2,465,000	1.51% - 4.94%	Fixed	Quarterly	2020 - 2031
FHLB Borrowing		216,000	2.62- 6.05%	Fixed	Monthly	2019-2024
Total FHLB Borrowings	**$**	**2,681,000**				
Other Borrowings		-				
Total Borrowed Funds	**$**	**2,681,000**				

The Credit Union borrowed funds from the Federal Home Loan Bank of Atlanta ("FHLB") secured by a blanket lien on the Credit Union's first trust mortgage portfolio. Accrued interest payable on borrowings was $12,751 and $8,781 for year-end 2019 and 2018, respectively.

The Credit Union had the following unused lines of credit as of December 31:

	December 31,			
	2019		2018	
Unused lines of Credit				
Federal Reserve Bank of Richmond	$	2,964,270	$	2,920,355
Federal Home Loan Bank		3,466,774		4,187,045
SunTrust Bank		25,000		25,000
JPMorgan Chase Bank		50,000		50,000
Wells Fargo Bank		125,000		125,000
PNC Bank		50,000		50,000
Alloya Corporate CU		1,500		4,000
Total	**$**	**6,682,544**	**$**	**7,361,400**

The following table displays the amount of borrowed funds by maturity for each of the next five years and thereafter as of December 31, 2019:

2020	$	1,190,000
2021		100,000
2022		100,000
2023		131,996
2024		2,102,000
Thereafter		100,000
Total	**$**	**3,723,996**

As of December 31, 2019, the Credit Union had $7,326,591 of loans pledged as collateral for FHLB borrowings. As of December 31, 2018, the Credit Union had $8,814,747 of loans pledged as collateral for FHLB borrowings.

NOTE 11 – EMPLOYEE BENEFIT PLANS

The Credit Union Employee Pension Plan

The Credit Union sponsors a trustee, noncontributory, defined-benefit pension plan (the "Plan") covering eligible employees. Benefits under the Plan are primarily based on years of service and the employees' compensation during the last five years of employment. The Credit Union's policy is to make annual contributions to the Plan equal to the amount required to maintain the Plan in sound condition and to satisfy minimum funding requirements. Eligibility requirements of the Plan were modified in December 2006 to exclude employees hired or rehired after December 31, 2006 from participating in the Plan.

Retiree Medical Plan

The Credit Union also sponsors a defined benefit postretirement plan. Eligibility requirements of the defined benefit postretirement plan were modified in December 2012 to exclude employees hired or rehired on or after December 1, 2012 from participating. The plan covers eligible employees providing medical, life insurance and sick leave benefits. The plan is contributory for retirees who retired after January 1, 1995. For these retirees, effective April 1, 2006, retiree medical contributions were set at 70% for retirees age 65 or above, and 90% for retirees age 55 to 65. Effective April 1, 2007, the plan includes an increase in the contribution level for retirees age 65 and above to 90% of the premium. The 70% and 90% contribution provisions do not apply to employees who retired before January 1, 1995, for whom the Credit Union pays 100% of the premiums.

401K Plan

The Credit Union has a 401(k) plan that provides for contributions by employees and the employer, with the employer contributions consisting of a 100% matching of the employees' contributions up to the first 4% of the employees' salaries, subject to federal limitations. The Plan is available to substantially all employees of the Credit Union. The expense related to this plan for 2019 and 2018 was $5,983 and $5,605, respectively.

The following table provides key balances and transaction amount of the pension and retiree medical plans:

	Retirement Plan		Postretirement Benefits	
	2019	**2018**	**2019**	**2018**
Key Balances and Transaction Amounts				
Accumulated benefit obligation at year end	$ 132,602	$ 111,002	$ N/A	$ N/A
Projected benefit obligation at year end	162,126	132,564	4,384	3,430
Fair value of plan assets at year end	125,587	102,132	-	-
Over/(under) funded	(36,539)	(30,433)	(4,384)	(3,430)
Employer contributions	10,000	10,000	431	325
Plan participants' contributions	-	-	282	323
Benefits paid	(1,009)	(7,456)	(713)	(649)
Settlements	(11,582)	-	-	-
Net periodic benefit cost	10,975	8,527	404	236

The weighted-average assumptions used to determine the projected benefit obligation and net periodic benefit costs for the pension and retiree medical benefit plans were as follows:

	Retirement Plan		Postretirement Benefits	
	2019	**2018**	**2019**	**2018**
Weighted Average Assumptions				
Discount rate				
Projected benefit obligation	3.00%	4.05%	3.25%	4.20%
Net periodic benefit cost	4.05%	3.45%	4.20%	3.45%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Expected long-term rate of return	5.00%	5.50%	N/A	N/A
Current year healthcare cost trend rate	N/A	N/A	7.50%	8.00%

The long-term rate of return assumption represents the expected average rate to be earned on plan assets and future plan contributions to meet benefit obligations. The assumption is based on several factors, including the anticipated long-term asset allocation of plan assets, historical market index and plan returns and a forecast of future expected asset returns.

The amounts in AOCI that have not yet been recognized as components of net periodic benefit cost as of December 31 are:

	Retirement Plan		Postretirement Benefits	
	2019	**2018**	**2019**	**2018**
Amounts in Accumulated Other Comprehensive Income				
Net prior service cost	$ -	$ -	$ 1,269	$ 1,372
Net loss/(gain)	43,155	38,024	(1,873)	(2,957)
Other comprehensive loss/(income)	**$ 43,155**	**$ 38,024**	**$ (604)**	**$ (1,585)**

The amounts recognized in AOCI for the years ended December 31, 2019 and 2018 consist of:

	Retirement Plan		Postretirement Benefits	
	2019	**2018**	**2019**	**2018**
Amounts Recognized in Accumulated Other Comprehensive Income				
Amounts amortized during the year				
Net prior service cost	$ -	$ 22	$ (102)	$ (102)
Net gain/(loss)	(5,913)	(3,408)	74	149
Amounts arising during the year				
Net prior service cost	-	-	-	2,049
Net loss/(gain)	11,044	(8,631)	1,010	(1,072)
Total recognized in other comprehensive income	**$ 5,131**	**$ (12,017)**	**$ 982**	**$ 1,024**

The amounts in AOCI expected to be recognized as components of net periodic benefit cost in the coming year.

	Retirement Plan		Postretirement Benefits	
	2019	**2018**	**2019**	**2018**
Amounts in AOCI Expected to be Recognized into Net Periodic Benefit Cost in the Coming Year				
Net loss/(gain)	$ 2,990	$ 2,880	$ (107)	$ (196)
Prior service cost	-	-	102	102
Total expected amortization	**$ 2,990**	**$ 2,880**	**$ (5)**	**$ (94)**

The following table discloses the benefits expected to be paid in the next 10 years:

Estimated Future Benefit Payments	**Retirement Plan**	**Postretirement Benefits**
2020	$ 9,029	$ 173
2021	7,969	158
2022	8,642	157
2023	9,579	163
2024	9,910	161
2025-2028	53,686	713
Estimated Contributions for 2019	**$ -**	**$ 173**

The Credit Union estimates that it will not make any contributions to the retirement plan in 2019. For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for the 2019 year. The rate is assumed to decrease annually until it reaches 4.5% in 2024 and remains at that level thereafter. Assumptions for health care cost trend rates have a significant effect on the amounts reported for the postretirement benefits plan.

Percentage of the fair value of total plan assets held in each major category	**Retirement Plan**		**Postretirement Benefits**	
	2019	**2018**	**2019**	**2018**
Equity securities	57%	58%	N/A	N/A
Debt securities	43%	42%	N/A	N/A
Other securities	0%	0%	N/A	N/A

The Credit Union's target asset allocation at December 31, 2019 and 2018 was 60% for debt securities (Level 1 and Level 2) and 40% for equity securities (Level 1). The valuation methodologies used for the Plan's financial instruments are similar to those detailed in Note 15. The Credit Union's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions. Central to the policy are target allocation ranges (as shown above) by major asset categories. The objectives of the target allocation are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the Plan's actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies. The investment policy is reviewed and administered by the Pension Committee (the "Committee") appointed by the Board of Directors of the Credit Union. The Committee's responsibilities include, but are not limited to, oversight of the investment management's decisions. The investment policy is established and administered in a manner to comply at all times with applicable government regulations.

The Credit Union's expected long-term return on plan assets assumption is based on a periodic review and modeling of the plan's asset allocation and liability structure over a long-term horizon. Expectations of returns for each asset class are the most important assumptions used in the review and modeling and are based on comprehensive reviews of the historical data and economic/financial market theory. The expected long-term rate of return on assets was selected from within the reasonable range of rates determined by (a) historical real returns, net of inflation, for the asset classes covered by investment policy, and (b) projections of inflation over the long-term period during which benefits are payable to plan participants.

NOTE 12 – REGULATORY MATTERS

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 generally accepted accounting principles. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth (as defined in the regulations) to total assets (as defined). Credit unions are also required to calculate a Risk-Based Net Worth ("RBNW") requirement, which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNW ratio was 5.44% and 5.67% at December 31, 2019 and 2018, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes at December 31, 2019 and 2018, the Credit Union meets all capital adequacy requirements to which it is subject. At December 31, 2019, the most recent call reporting period, NCUA categorized the Credit Union as "well capitalized" under the prompt corrective action regulatory framework. 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. Management believes that there are no conditions or events since that notification that would change the Credit Union's category.

The Credit Union's actual capital amounts and ratios are presented below:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
December 31, 2019						
Net Worth to Total Assets	$ 2,695,923	10.9%	≥ $ 1,486,462	≥ 6.0%	≥ $ 1,734,205	≥ 7.0%
December 31, 2018						
Net Worth to Total Assets	$ 2,525,936	10.3%	≥ $ 1,469,085	≥ 6.0%	≥ $ 1,713,933	≥ 7.0%

In performing its calculation of total assets, the Credit Union used the quarter-end balance option, as permitted by regulation. Because the RBNW requirement for the Credit Union is less than the actual net worth ratio, the Credit Union is not considered "complex" under the RBNW requirements.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

Commitments

In the normal course of business, the Credit Union is party to financial instruments with off-balance-sheet risk to meet the financing needs of its members and to reduce its own exposure to fluctuations in interest rates. These commitments include financial instruments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated financial statements.

The Credit Union's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Credit Union uses the same credit policies in making commitments as it does for on-balance-sheet instruments and as such, credit risk related to these commitments could be similar to existing loans, if they became funded.

A summary of the Credit Union's commitments at December 31, 2019 is as follows:

	Fixed Rate	Variable Rate	Total Contract or Notional Amount
Thrifty credit services lines of credit	$ 550,425	$ -	$ 550,425
Second trust mortgages	55	3,564,306	3,564,361
Credit cards	-	8,403,063	8,403,063
First trust mortgages	902,117	109,911	1,012,028
Commercial Real Estate	7,093	184,700	191,793
Total	**$ 1,459,690**	**$ 12,261,980**	**$ 13,721,670**

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.

Contingencies

The Credit Union is party to various legal and regulatory actions normally associated with financial institutions, the outcome of which is neither probable nor estimable and thus not disclosed in the Credit Union's financial statements.

NOTE 14 – RELATED PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends loans and receives deposits from Members of the Board of Directors ("the Board"), Supervisory Committee, and executive officers.

At December 31, 2019, the aggregate balances included 108 loans totaling $7,040 and member account balances (deposits) totaling $11,610 for 26 individuals. At December 31, 2018, the aggregate balances included 133 loans totaling $7,963 and member account balances (deposits) totaling $11,389 for 30 individuals.

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The Credit Union measures certain financial assets and liabilities at fair value in accordance with ASC 820, Fair Value Measurement, through various valuation approaches as described in Note 2 – Fair Value of Assets and Liabilities.

Fair Value on a Recurring Basis- The following is a discussion of the valuation and inputs used by the Credit Union in estimating the fair value of assets and liabilities measured on a recurring basis.

Available for Sale Debt Securities

The Credit Union receives pricing for AFS debt securities from a third-party pricing provider. The following methodologies are used for those securities classified as level 2 in the fair value hierarchy.

Federal Agency Securities, Government Agency Securities, Mortgage-Backed Securities and other Securities such as Bank Notes and Corporate Bonds – These financial instruments are valued based on similar assets in the marketplace or derived from model based valuation techniques for which all significant assumptions are observable.

Mortgage Loans Held for Sale

The Credit Union elects the fair value option for select HFS loans. The fair value of HFS loans is determined based on an evaluation of best execution forward sales contract prices sourced from the TBA market by government sponsored mortgage agency. As such, HFS loans are classified as level 2 in the fair value hierarchy.

Taxi Medallion Loans

The Credit Union elects the fair value option for taxi medallion loans. The fair value of taxi medallion loans is based on discounting expected cash flows that consider the term of the loan, expected charge-offs and losses. The discount rates used reflect the Credit Union's required return on the taxi medallion loan investment. As the taxi medallion loans valuation is based on unobservable inputs, taxi medallion loans are classified as level 3 in the fair value hierarchy.

Taxi Medallion Collateral

The Credit Union elects the fair value option for medallions. Medallions acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated costs to sell. Fair value is based upon the estimated discounted cash flows generated by the collateral of the underlying medallions. These assets are included in Level 3 of the fair value hierarchy upon the lowest level of input that is significant to the fair value measurement.

Mortgage Servicing Rights

MSR assets do not trade in an active, open market with readily observable prices. The fair value of MSR is determined by discounting projected net servicing cash flows. Actual and expected loan prepayment, discount rate, servicing costs and other factors are considered in measurement. As the MSR valuation is based on unobservable inputs, MSR assets are classified as level 3 in the fair value hierarchy.

Derivative Instruments

Fair values of interest rate swaps designated as cash flow and fair value hedges are determined based on third party models that calculate the net present value of future cash flows discount using the Overnight Index Swap (OIS) rate adjusted for credit quality. As the inputs utilized in the valuation are observable, swaps are classified as level 2 in the fair value hierarchy.

The fair value of forward sales contracts are determined based on an evaluation of contract prices sourced from the TBA market by government sponsored mortgage agency. As such, forward sales contracts are classified as level 2 in the fair value hierarchy.

The fair value of Interest Rate Lock Commitments (IRLC) are determined based on forward contract prices sourced from the TBA market, adjusted by the probability it will settle and become a loan. As there are unobservable inputs, IRLCs are classified as level 3 in the fair value hierarchy.

The following table summarizes financial assets measured at fair value on a recurring basis as of December 31, 2019 and 2018, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2019			
	Total	(Level 1)	(Level 2)	(Level 3)
Federal agency securities-bonds	$ 121,208	$ -	$ 121,208	$ -
Government agency bonds	206,354	-	206,354	-
Mortgage backed securities	1,677,930	-	1,677,930	-
Other securities	129,977	-	129,977	-
Loans held for sale	182,302	-	182,302	-
Mortgage servicing rights	64,482	-	-	64,482
Taxi Medallion Loans	102,473	-	-	102,473
Medallion Foreclosed Asset	4,454	-	-	4,454
Interest Rate Lock Commitments	371	-	-	371
Interest Rate Swaps	13,135	-	13,135	
Total Assets	**$ 2,502,686**	**$ -**	**$ 2,330,906**	**$ 171,780**
Forward Loan Commitments	$ 595	$ -	$ 595	$ -
Interest Rate Swaps	18,180	-	18,180	-
Total Liability	**$ 18,775**	**$ -**	**$ 18,775**	**$ -**

	December 31, 2018			
	Total	(Level 1)	(Level 2)	(Level 3)
Federal agency securities-bonds	$ 112,037	$ -	$ 112,037	$ -
Government agency bonds	236,586	-	236,586	-
Mortgage backed securities	1,385,043	-	1,385,043	-
Other securities	63,682	-	63,682	-
Loans held for sale	80,378	-	80,378	-
Mortgage servicing rights	67,548	-	-	67,548
Interest Rate Swaps	9,548	-	9,548	-
Total Assets	**$ 1,954,822**	**$ -**	**$ 1,887,274**	**$ 67,548**
Forward Loan Commitments	$ 757	$ -	$ 757	$ -
Interest Rate Swaps	4,816	-	4,816	-
Interest Rate Lock Commitments	477	-		477
Total Liability	**$ 6,050**	**$ -**	**$ 5,573**	**$ 477**

There were no transfers between levels.

The table below presents the reconciliation for the years ended December 31, 2019 and 2018, for all Level 3 assets that are measured at fair value on a recurring basis.

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2019	**December 31, 2018**
Mortgage servicing rights at beginning of year	$ 67,548	$ 64,398
Fair value adjustment	(15,908)	(6,404)
Issuances	12,842	9,554
Mortgage servicing rights at end of year	**$ 64,482**	**$ 67,548**

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2019	**December 31, 2018**
Taxi Medallion Loans at beginning of year	$ -	$ -
Taxi medallion acquired loans	111,071	-
Fair value adjustment	7,241	-
Principal Paydown	(15,839)	-
Taxi Medallion Loans at end of year	**$ 102,473**	**$ -**

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2019	**December 31, 2018**
Medallion Foreclosed Asset at beginning of year	$ -	$ -
Taxi medallions acquired	5,761	-
Fair value adjustment	(105)	-
Additions	3,193	-
Disposals	(4,395)	-
Medallion Foreclosed Asset at end of year	**$ 4,454**	**$ -**

Transfers into or out of Level 3 are made if the significant inputs used in the pricing models measuring the fair values of the assets and liabilities became unobservable or observable, respectively. There were no transfers into or out of Level 3 for the years ended December 31, 2019 and 2018.

Fair Value on a Non-Recurring Basis- certain assets and liabilities are measured at fair value on a non-recurring basis that are subject to fair value adjustments resulting from the application of the lower of cost or market accounting or the write-down of individual assets due to impairment.

Real Estate Owned and Impaired Loans

REO assets are recorded at the lower of cost or fair value less costs to sell. If an expectation of cash flows exist, impaired loans are recorded at the modified future expected cash flows discounted at the loan's original effective interest rate. Impaired loans that are collateral dependent, are recorded at the collateral value, net of costs to sell.

The Credit Union utilizes appraised values less estimated selling expenses (approximately 8%) to estimate the fair market value of the collateral. During the holding period, updated appraisals are obtained periodically to reflect changes in fair value. A home appraisal involves a certified, state-licensed professional determining the value of the property through an inspection and comparison to other home sales. As certain assumptions and unobservable inputs are currently being used by the appraisers, the REO assets and impaired loans are classified as level 3 in the fair value hierarchy.

During 2019 and 2018, there were no transfers between levels. The following table presents the assets and liabilities carried on the Consolidated Statements of Financial Condition by caption and by level within the valuation hierarchy as described above for which a non-recurring change in fair value has been recorded.

	December 31, 2019			
	Total	**Level 1**	**Level 2**	**Level 3**
Loans, net- identified as impaired	$ 19,199	$ -	$ -	$ 19,199
Other real estate owned, net	3,093	-	-	3,093
Total	**$ 22,292**	**$ -**	**$ -**	**$ 22,292**

	December 31, 2018			
	Total	**Level 1**	**Level 2**	**Level 3**
Loans, net- identified as impaired	$ 20,128	$ -	$ -	$ 20,128
Other real estate owned, net	4,063	-	-	4,063
Total	**$ 24,191**	**$ -**	**$ -**	**$ 24,191**

NOTE 16 – DERIVATIVE INSTRUMENTS

The Credit Union utilizes derivative instruments to manage interest rate risk that affects its ongoing business operations. Interest rate swaps are used to hedge the variability in interest cash flows due to changes in a benchmark interest rate associated with floating rate assets and liabilities. Similarly, interest rate caps are used to manage the maximum exposure to variable rate obligations that are tied to a benchmark interest rate.

ASC 815-10 requires that an entity recognize all derivative instruments as either assets or liabilities at fair value in the consolidated statements of financial condition. In accordance with ASC 815-10, the Credit Union designates derivatives into either cash flow hedges, a hedge of an exposure to changes in cash flows or a recognized asset, liability or forecasted transaction, or fair value hedges, a hedge of an exposure to changes in the fair value of a recorded asset or liability.

Cash Flow Hedges

Interest rate swaps with a total notional amount of $1,250,000 and $500,000 as of December 31, 2019 and 2018, respectively are designated as cash flow hedges of certain share deposit accounts and are highly effective. Interest rate caps with a total notional amount of $100,000 as of December 31, 2019 and 2018, are designated as cash flow hedges of certain share deposit accounts and are highly effective. The Credit Union expects the interest rate swaps and interest rate caps to remain highly effective during their remaining terms.

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	
	2019	**2018**
Interest Rate Swaps	$ 8,521	$ 4,453
Total	**$ 8,521**	**$ 4,453**

Location of Gain or (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income	
	2019	**2018**
Interest Expense	$ 5,954	$ 4,219
Total	**$ 5,954**	**$ 4,219**

Fair Value Hedges

Interest rate swaps are used as fair value hedges on designated closed mortgage portfolios under a last-of-layer expected to be remaining at the end of the hedging relationship. Gain and losses on these interest rate swaps as well as the offsetting loss or gain on the hedged closed mortgage portfolio are recognized in current earnings. The Credit Union includes the gain or loss on the closed loan portfolio in the same consolidated financial statements line item – interest income, loans - as the offsetting loss or gain on the related interest rate swaps.

The following amounts were recorded on the Consolidated Statement of Financial Condition related to cumulative basis adjustments for fair value hedges as of December 31:

Line Item in the Statement of Financial Position in Which the Hedged Item Is Included	Carrying Amount of the Hedged Assets/(Liabilities)		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)	
	2019	2018	2019	2018
Loans receivable - (a)	$ 1,687,063	$ 709,913	$ 13,797	$ 4,813
Total	**$ 1,687,063**	**$ 709,913**	**$ 13,797**	**$ 4,813**
Amortized cost basis of closed portfolios used in the last of layer designation	$ 1,673,266	$ 705,100		
Cumulative basis adjustments associated with last of layer relationships			$ 13,797	$ 4,813
Amount of the designated hedged items	$ 224,000	$ 225,000		

Mortgage Banking Derivatives

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. The Credit Union's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from commitments to fund the loans. These mortgage banking derivatives are not designated in hedge relationships. At December 31, 2019, the Credit Union had approximately $119,500 of interest rate lock commitments and $190,163 of forward commitments for the future delivery of residential mortgage loans. At December 31, 2018, the Credit Union had approximately $66,569 of interest rate lock commitments and $118,325 of forward commitments for the future delivery of residential mortgage loans. Changes in the fair value of these mortgage banking derivatives are included in gains on sales of loans.

Changes to the fair value of our mortgage servicing rights arise from changes in interest rates and are economically hedged using interest rate floors, swaps, and forward commitments. The Credit Union had notional amounts outstanding of $350,000 and $270,000 as of December 31, 2019 and 2018, respectively, to hedge the fair value of mortgage servicing rights. Changes in the fair value of these hedges are recognized in current earnings.

The following table displays the fair value and the location of derivative instruments as of December 31:

	Asset Derivatives				Liability Derivatives			
	2019		2018		2019		2018	
	Consolidated Statement of Financial Condition	**Fair Value**	**Consolidated Statement of Financial Condition**	**Fair Value**	**Consolidated Statement of Financial Condition**	**Fair Value**	**Consolidated Statement of Financial Condition**	**Fair Value**
Derivatives designated as hedging instruments under ASC 815								
Interest rate swaps	Other assets	$ 13,135	Other assets	$ 7,767	Other liabilities	$ (17,043)	Other liabilities	$ (4,816)
Total derivatives designated as hedging instruments under ASC 815		$ 13,135		$ 7,767		$ (17,043)		$ (4,816)
Derivatives not designated as hedging instruments under ASC 815								
Interest rate commitments	Other assets	$ 371	Other assets	$			Other liabilities	$ (477)
Forward loan commitments					Other liabilities	$ (595)	Other liabilities	$ (757)
Interest rate swaps			Other assets	1,781	Other liabilities	$ (1,137)	Other liabilities	-
Total derivatives not designated as hedging instruments under ASC 815		$ 371		$ 1,781		$ (1,733)		$ (1,234)
Total derivatives		**$ 13,506**		**$ 9,548**		**$ (18,775)**		**$ (6,050)**

NOTE 17 – SUBSEQUENT EVENTS

The following subsequent events took place after the balance sheet date, but before April 6, 2020, the date these consolidated financial statements were issued.

On January 30, 2020, the World Health Organization ("WHO") announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the coronavirus as a pandemic, based on the rapid increase in exposure globally.

The coronavirus and the related global responses to curb its spread create uncertainty with the duration, magnitude and velocity of the macroeconomic impacts to the industry in which we operate. The Credit Union continues to evaluate the disruption caused by the pandemic and the related global response. Collectively, we currently are unable to estimate the effects however, these events may have a negative effect on the results of future operations, financial condition, capital and liquidity for fiscal year 2020. Management is actively monitoring the impact of the global situation on its financial condition, operations, industry and workforce.