

# Logix Federal Credit Union and Subsidiaries

Consolidated Financial Report  
December 31, 2018

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## Independent Auditor's Report

RSM US LLP

Supervisory Committee  
Logix Federal Credit Union and Subsidiaries

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Logix Federal Credit Union (a federally chartered credit union) and its subsidiaries, which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP); 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 Logix Federal Credit Union and its subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. GAAP.

*RSM US LLP*

San Francisco, California  
April 15, 2019

**Logix Federal Credit Union and Subsidiaries**

**Consolidated Statements of Financial Condition  
December 31, 2018 and 2017**

	2018	2017
<b>Assets</b>		
Cash and cash equivalents	\$ 305,415,759	\$ 199,066,700
Available-for-sale investments	155,811,235	224,571,090
Other investments	17,250,000	41,040,000
Loans held for sale	7,112,168	26,691,412
Loans, net	5,358,564,477	4,754,887,008
Accrued interest receivable	16,503,172	15,067,437
Premises and equipment, net	78,392,473	51,326,576
National Credit Union Share Insurance Fund (NCUSIF) deposit	37,661,758	36,375,579
Other assets	42,351,345	34,836,489
	<u>5,111,673,825</u>	<u>4,552,487,773</u>
<b>Total assets</b>	<b>\$ 6,019,062,387</b>	<b>\$ 5,383,862,291</b>
<b>Liabilities and Members' Equity</b>		
Liabilities:		
Members' shares	\$ 4,476,910,089	\$ 4,165,252,964
Dividends payable	4,929,104	2,248,429
Accrued expenses and other liabilities	78,366,477	74,986,380
Borrowed funds	548,622,193	310,000,000
Notes payable	2,845,962	-
	<u>5,111,673,825</u>	<u>4,552,487,773</u>
<b>Total liabilities</b>	<b>5,111,673,825</b>	<b>4,552,487,773</b>
Commitments and contingencies (Notes 5, 8 and 9)		
Members' equity:		
Retained earnings, substantially restricted	933,491,953	854,879,962
Accumulated other comprehensive loss	(26,103,391)	(23,505,444)
	<u>907,388,562</u>	<u>831,374,518</u>
<b>Total members' equity</b>	<b>907,388,562</b>	<b>831,374,518</b>
	<u>5,111,673,825</u>	<u>4,552,487,773</u>
<b>Total liabilities and members' equity</b>	<b>\$ 6,019,062,387</b>	<b>\$ 5,383,862,291</b>

See notes to consolidated financial statements.

**Logix Federal Credit Union and Subsidiaries**

**Consolidated Statements of Income**  
**Years Ended December 31, 2018 and 2017**

	2018	2017
Interest income:		
Loans	\$ 209,596,293	\$ 179,745,971
Investments and cash equivalents	10,879,335	22,637,116
<b>Total interest income</b>	<b>220,475,628</b>	<b>202,383,087</b>
Interest expense:		
Members' shares	39,758,817	25,629,795
Borrowed funds	9,920,126	13,646,400
<b>Total interest expense</b>	<b>49,678,943</b>	<b>39,276,195</b>
<b>Net interest income</b>	<b>170,796,685</b>	<b>163,106,892</b>
Provision for loan losses	20,000,000	18,600,000
<b>Net interest income after provision for loan losses</b>	<b>150,796,685</b>	<b>144,506,892</b>
Noninterest income:		
Service charges and other fees	12,847,704	14,346,308
Interchange income	17,115,029	15,026,496
Commissions	10,432,449	9,706,520
Gains on sales of loans	6,124,557	7,690,691
Gains on sales of securities	118,263	419,811
Other noninterest income	7,247,623	2,800,410
<b>Total noninterest income</b>	<b>53,885,625</b>	<b>49,990,236</b>
Noninterest expense:		
Salaries and benefits	73,067,943	70,517,476
Operations and occupancy	53,002,376	47,997,799
Member loyalty reward	-	115,175
<b>Total noninterest expense</b>	<b>126,070,319</b>	<b>118,630,450</b>
<b>Net income</b>	<b>\$ 78,611,991</b>	<b>\$ 75,866,678</b>

See notes to consolidated financial statements.

**Logix Federal Credit Union and Subsidiaries**

**Consolidated Statements of Comprehensive Income  
Years Ended December 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
Net income	<b>\$ 78,611,991</b>	<b>\$ 75,866,678</b>
Other comprehensive loss:		
Adjustment to defined benefit pension plan	<b>409,437</b>	951,942
Adjustment to postretirement benefit plan	<b>57,070</b>	(178,304)
Adjustment to supplemental executive retirement plan	<b>(1,174,164)</b>	(574,346)
Unrealized holding losses on available-for-sale securities, net of realized gains on sale of available-for-sale securities of approximately \$118,000 and \$420,000 for the years ended December 31, 2018 and 2017, respectively	<b>(1,890,290)</b>	(2,868,917)
<b>Other comprehensive loss</b>	<b>(2,597,947)</b>	(2,669,625)
<b>Comprehensive income</b>	<b>\$ 76,014,044</b>	<b>\$ 73,197,053</b>

See notes to consolidated financial statements.

**Logix Federal Credit Union and Subsidiaries**

**Consolidated Statements of Members' Equity  
Years Ended December 31, 2018 and 2017**

	Retained Earnings				Accumulated	Total
	Regular Reserve	Other Appropriated	Unappropriated	Total	Other Comprehensive Loss	
Balance, December 31, 2016	\$ 31,302,181	\$ 716,099,289	\$ 31,611,814	\$ 779,013,284	\$ (20,835,819)	\$ 758,177,465
Net income	-	-	75,866,678	75,866,678	-	75,866,678
Other comprehensive loss	-	-	-	-	(2,669,625)	(2,669,625)
Appropriations	-	69,671,395	(69,671,395)	-	-	-
Balance, December 31, 2017	31,302,181	785,770,684	37,807,097	854,879,962	(23,505,444)	831,374,518
Net income	-	-	78,611,991	78,611,991	-	78,611,991
Other comprehensive loss	-	-	-	-	(2,597,947)	(2,597,947)
Appropriations	-	73,926,730	(73,926,730)	-	-	-
<b>Balance, December 31, 2018</b>	<b>\$ 31,302,181</b>	<b>\$ 859,697,414</b>	<b>\$ 42,492,358</b>	<b>\$ 933,491,953</b>	<b>\$ (26,103,391)</b>	<b>\$ 907,388,562</b>

See notes to consolidated financial statements.

## Logix Federal Credit Union and Subsidiaries

### Consolidated Statements of Cash Flows Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Net income	\$ 78,611,991	\$ 75,866,678
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium on securities, net	973,649	1,738,184
Amortization of mortgage servicing rights	1,794,177	1,656,593
Capitalization of servicing rights	(5,318,365)	(3,169,761)
Provision for loan losses	20,000,000	18,600,000
Capitalization of deferred net loan origination costs, net	(3,602,250)	(4,257,197)
Depreciation and amortization of premises and equipment	5,281,707	5,790,557
Losses on disposal of premises and equipment	7,952	167,659
Gains on sales of real estate owned	(8,113)	(181,298)
Gains on sales of securities	(118,263)	(419,811)
Originations of loans to be sold	(169,847,241)	(294,753,398)
Proceeds from sales of loans originated for sale	195,551,042	302,444,089
Gains on sales of loans	(6,124,557)	(7,690,691)
Net change in:		
Accrued interest receivable	(1,435,735)	(2,472,691)
Other assets	(4,387,618)	(1,535,691)
Accrued expenses and other liabilities	5,353,115	1,764,430
<b>Net cash provided by operating activities</b>	<b>116,731,491</b>	<b>93,547,652</b>
Cash flows from investing activities:		
Purchases of available-for-sale investments	(10,641,102)	(21,392,693)
Proceeds from sales of available-for-sale investments	10,748,000	21,892,874
Proceeds from principal pay-downs on available-for-sale investments	65,907,283	83,513,520
Proceeds from sales of other real estate owned	405,063	919,347
Net change in other investments	23,790,000	(18,630,000)
Net increase in loans as a result of originations and principal repayments	(620,075,217)	(593,120,509)
Increase in the NCUSIF deposit	(1,286,180)	(3,276,208)
Purchase of premises and equipment	(32,355,556)	(21,415,264)
<b>Net cash used in investing activities</b>	<b>(563,507,709)</b>	<b>(551,508,933)</b>
Cash flows from financing activities:		
Net increase in members' shares	311,657,125	291,837,662
Net proceeds from borrowed funds	238,622,193	230,000,000
Proceeds from notes payable	4,268,940	-
Repayments of notes payable	(1,422,981)	-
<b>Net cash provided by financing activities</b>	<b>553,125,277</b>	<b>521,837,662</b>
<b>Increase in cash and cash equivalents</b>	<b>106,349,059</b>	<b>63,876,381</b>
Cash and cash equivalents, beginning of year	199,066,700	135,190,319
Cash and cash equivalents, end of year	\$ 305,415,759	\$ 199,066,700
Supplemental disclosure of cash flow information:		
Dividends paid on members' shares and interest paid on borrowed funds	\$ 47,332,198	\$ 39,374,498
Supplemental disclosure of noncash investing activities:		
Transfers of loans to foreclosed property	\$ -	\$ 1,078,678

See notes to consolidated financial statements.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies

**Nature of operations:** Logix Federal Credit Union (the Credit Union) is a cooperative association holding a charter under the provisions of the Federal Credit Union Act. Membership is open to anyone who is part of the Credit Union's select employer groups or associations listed in the Credit Union's charter, or if they are related to an existing member. The field of membership is defined in the Credit Union's Charter and Bylaws.

A summary of the Credit Union's significant accounting policies is as follows:

**Significant accounting policies:** The Credit Union follows the accounting standards set by the Financial Accounting Standards Board (FASB). The FASB establishes U.S. generally accepted accounting principles (U.S. GAAP) that are followed to ensure consistent reporting of the financial condition, results of operations and cash flows of the Credit Union. References to U.S. GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification, commonly referred to as the Codification or ASC.

**Principles of consolidation:** The accompanying consolidated financial statements include the accounts of the Credit Union and its wholly owned subsidiaries, one of which is inactive. The other subsidiary is Logix Employment Services, Inc. (LESI), which leases employees to the Credit Union. All material intercompany balances and transactions have been eliminated in consolidation.

**Use of estimates:** The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses; the fair value of financial instruments and nonfinancial assets for measurement and disclosure, including, but not limited to, available-for-sale securities, loans held for sale, impaired loans, foreclosed property, and loan servicing rights; and defined benefit, postretirement benefit and supplemental executive retirement plans.

**Subsequent events:** The Credit Union has evaluated subsequent events through April 15, 2019, the date on which the consolidated financial statements were available to be issued.

**Concentrations of credit risk:** Most of the Credit Union's business activity is with its members, many of whom reside in Southern California. The loan portfolio is diversified as a result of the Credit Union's membership. However, the Credit Union's loan portfolio has significant balances that are collateralized by residential and commercial real estate and may be exposed to credit risk resulting from this geographic concentration. In addition, the Credit Union's loan portfolio includes certain nontraditional loans (as described in Note 3), as well as unsecured loans, which by their nature increase the risk of loss compared to those loans that are collateralized. The Credit Union's policy for repossessing collateral is that when all other collection efforts have been exhausted, the Credit Union enforces its first lienholder status and repossesses the collateral. Repossessed collateral normally consists of vehicles, residential and commercial real estate.

**Fair value:** The Codification defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurement. Fair value is a market-based measurement, not an entity-specific measurement, and the hierarchy gives the highest priority to quoted prices in active markets. Fair value measurements are disclosed by level within the fair value hierarchy.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### **Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

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 or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the fair value hierarchy establishes valuation inputs that give the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

**Level 1:** Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date

**Level 2:** Significant other 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

**Level 3:** Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability

A summary of the Credit Union's financial instruments and other accounts subject to fair value measurement and/or disclosure, including methodologies and resulting values, is presented in Note 13.

**Cash and cash equivalents:** For the purpose of the consolidated statements of financial condition and cash flows, cash and cash equivalents include cash on hand, amounts due from financial institutions and highly liquid debt instruments classified as cash that were purchased with maturities of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

**Investments:** Debt securities are classified as available-for-sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of individual available-for-sale securities below their cost that are deemed to be other than temporary are allocated to either (1) credit losses (which are reflected in earnings as realized losses) or (2) noncredit losses (which are recorded in other comprehensive income). In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the current liquidity and volatility of the market for each of the individual security categories, (4) the projected cash flows from the specific security type, (5) the financial guarantee and financial rating of the issuer, and (6) the intent and ability of the Credit Union to retain its investment in the issue for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

**Federal Home Loan Bank stock:** The Credit Union became a member of the Federal Home Loan Bank (FHLB) of San Francisco in 2012 and is required to maintain an investment in capital stock of the FHLB in an amount equal to 1 percent of its membership asset value, which comprises substantially all commercial and residential mortgage loans and investment securities. No ready market exists for the FHLB stock and it has no quoted market value. FHLB stock is included in other investments on the consolidated statements of financial condition and is stated at cost.

**Loans held for sale:** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated market value. All sales are made without recourse subject to the customary representations and warranties.

**Loans, net:** The Credit Union grants mortgage and consumer loans to members. The portfolio also includes commercial loans. The loan portfolio comprises three segments, with further disaggregation into classes of loans, as follows: residential real estate (first mortgages, second mortgages and equity lines), commercial (commercial real estate and Small Business Administration (SBA)) and consumer (vehicles, credit cards and other). The relevant risk characteristics for these classes of loans are as follows:

**First mortgages:** This portfolio class consists of wholly owned loans for which the Credit Union possesses a senior lien on the underlying collateral. Changes in real property values and the financial stability status of borrowers are key risk factors that may impact the collectibility of these loans, along with the condition of the collateral if foreclosed.

**Second mortgages:** This portfolio class consists of wholly owned loans for which the Credit Union possesses a junior lien on the underlying collateral. Changes in real property values and the financial stability status of borrowers are key risk factors that may impact the collectibility of these loans, along with the condition of the collateral if foreclosed.

**Equity lines:** This portfolio class consists of wholly owned loans for which the Credit Union possesses a junior lien on the underlying collateral. Changes in real property values and the financial stability status of borrowers are key risk factors that may impact the collectibility of these loans, along with the condition of the collateral if foreclosed.

**Commercial real estate:** This portfolio class consists of commercial real estate loans secured by the underlying collateral. Changes in commercial property values and the financial stability status of borrowers are key risk factors that may impact the collectibility of these loans, along with the condition of the collateral if foreclosed.

**SBA:** This portfolio class consists of small business loans secured by the underlying collateral. Changes in commercial property values and the financial stability status of borrowers are key risk factors that may impact the collectibility of these loans, along with the condition of the collateral if foreclosed.

**Vehicles:** This portfolio class primarily consists of loans that are secured by underlying collateral, which are primarily vehicles. The financial stability status of borrowers is a key risk factor that may impact the collectibility of these loans, along with the nature, value and condition of the collateral if foreclosed.

**Credit cards:** This portfolio class primarily consists of loans that are unsecured, which are primarily personal lines of credit. The financial stability status of borrowers is a key risk factor that may impact the collectibility of these loans due to the absence of collateral.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

**Other consumer:** This portfolio class primarily consists of other consumer loans that are secured and unsecured. For other secured loans, the financial stability status of borrowers is a key risk factor that may impact the collectibility of these loans, along with the nature, value and condition of the collateral if foreclosed. For other unsecured loans, the financial stability status of borrowers is a key risk factor that may impact the collectibility of these loans due to the absence of collateral.

Loans that the Credit Union has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are stated at their outstanding unpaid principal balances, less an allowance for loan losses and net deferred origination fees and costs. Interest income on loans is recognized over the term of the loan and is calculated using the simple interest method on principal amounts outstanding.

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans, adjusted for estimated prepayments.

**Impaired loans:** A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

**Troubled debt restructurings:** Included in impaired loans are troubled debt restructurings (TDR). A loan is classified as a TDR when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Credit Union grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include rate reductions, extension of maturity date, principal forgiveness and other actions intended to minimize potential losses.

**Nonaccrual loans:** The accrual of interest income on loans is discontinued at the time the loan is 90 days or more past due. Past-due status is based on the contractual terms of the loan. Loans are placed on nonaccrual status at an earlier date if the collection of principal and interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans, other than member business loans, are returned to accrual status when all of the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Member business loans are returned to accrual status when the member demonstrates a sustained period of payments (typically six consecutive payments).

**Allowance for loan losses:** The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is likely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Credit Union's allowance for loan losses and may require the Credit Union to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

The Credit Union's allowance for loan losses is an amount considered adequate to absorb probable losses in the portfolio based on management's evaluations of the size and current risk characteristics of the loan portfolio. Such evaluations consider prior loss experience, the risk rating and the levels of nonperforming loans. Specific allowances for loan losses are established for impaired loans, including TDRs, on an individual basis as required. The specific allowances established for these loans are based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows, the loan's estimated market value or the estimated fair value of the underlying collateral. General allowances are established for loans that can be grouped into pools based on similar characteristics. In this process, general allowance factors are based on an analysis of historical charge-off experience and expected losses given default derived from the Credit Union's internal risk rating process. These factors are developed and applied to the portfolio by loan type. The qualitative factors associated with the allowances are subjective and require a high degree of management judgment. These factors include credit quality statistics, market values, economic uncertainty, losses incurred from recent events and other relevant data.

**Charge-off policies for loans:** The Credit Union's policies provide for charge-off of a loan when the balance of the loan is considered uncollectible. Specific timing and actions taken are generally based upon whether the account is identified as bankrupt or non-bankrupt. Bankruptcy accounts are evaluated for collectibility using information from the chapter filing and bankruptcy court decisions; non-bankruptcy accounts are evaluated for collectibility primarily based upon payment delinquency. Charge-off amounts are determined from the expected cash flows or the value of any available collateral, less costs to sell. While circumstances may require other terms of charge-off, unsecured loans are generally charged off no later than three months past due and secured loans no later than six months past due. A modified loan may exceed these typical past-due limits and not be charged off as long as the loan continues to perform as expected under the modified arrangements.

**Transfers of financial assets:** Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Credit Union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. In addition, for transfers of a portion of financial assets (for example, participations of loans receivable), the transfer must meet the definition of "participating interest" in order to account for the transfer as a sale. Following are the characteristics of a participating interest:

- Pro rata ownership of an entire financial asset.
- From the date of transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership.
- The rights of each participating interest holder have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder.
- No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

**Loan servicing:** Servicing assets are recognized as separate assets based on fair value when rights are acquired through the purchase or sale of financial assets. Fair value is based on market prices for comparable servicing contracts, when available, or on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Capitalized servicing rights are reported in other assets and are subsequently accounted for using either the amortization method or fair value method as determined by the Credit Union at the initiation of the servicing arrangement. Under the amortization method, amounts are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. The amortization of loan servicing rights is netted against loan servicing fee income. For servicing assets accounted for using the fair value method, adjustments to fair value are included in servicing fee income.

Servicing assets accounted for under the amortization method are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Fair value changes most commonly are the result of changes in expected cash flows (i.e., prepayments, defaults or similar events) or changes in the valuation model inputs or assumptions. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as loan type, origination date and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Credit Union later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned.

**Foreclosed property:** The Credit Union has foreclosed property consisting of other real estate owned and repossessed automobiles. Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses associated with foreclosed assets, as well as the changes in the corresponding valuation allowance, are included in the consolidated statements of income as noninterest expense. As of December 31, 2018 and 2017, the Credit Union had approximately \$563,000 and \$832,000, respectively, of foreclosed property, which is included in other assets on the consolidated statements of financial condition.

**Premises and equipment, net:** Land is carried at cost. Buildings, leasehold improvements, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings, furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the terms of the related leases. Management reviews premises and equipment for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

**National Credit Union Share Insurance Fund deposit and insurance premium:** The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which in prior years required the maintenance of a deposit by each federally insured credit union in an amount equal to 1 percent of its insured members' shares. The deposit would be refunded to the Credit Union if its insurance coverage was terminated, if it converted its insurance coverage to another source, or if management of the fund was transferred from the NCUA Board.

**Other assets:** Other assets consist primarily of prepaid expenses, other receivables, foreclosed properties, and loan servicing rights.

**Members' shares:** Members' shares are the deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in the annual elections of the Board of Directors and on other corporate matters. Irrespective of the amount of shares owned, no member has more than one vote. Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation.

Dividends on members' shares are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Dividend rates are set by the Asset Liability Committee.

**Advertising costs:** Advertising costs are expensed as incurred.

**Noninterest income:** The Credit Union's noninterest income consists primarily of gains/losses on loan sales, loan servicing rights fair value adjustments, gains/losses on sales of securities, interchange income, service charges, other fees and commissions, which consist of investment brokerage commissions recorded on the settlement date. Commission income from the sale of insurance products is recognized as of the effective date of the insurance policy or the initial billing date for the policy, if later.

**Income taxes:** The Credit Union is exempt, by statute, from federal and state income taxes. The Credit Union's wholly owned subsidiary, LESI, is subject to federal and state income taxes. Operations of the wholly owned subsidiaries resulted in an insignificant amount of income taxes for the years ended December 31, 2018 and 2017.

FASB ASC Topic 740, Income Taxes, provides guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the financial statements. This requires the evaluation of tax positions taken or expected to be taken by the Credit Union, which must determine whether the tax positions are more likely than not to be sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense and liability in the current year. As of and for the years ended December 31, 2018 and 2017, management has determined that there are no material uncertain tax positions requiring recognition in the consolidated financial statements.

**Pension plan:** The Credit Union, through its subsidiary, LESI, has a qualified, noncontributory defined benefit pension plan. The Credit Union's policy is to fund the minimum amount required under the Employee Retirement Income Security Act of 1974. To the extent the Credit Union determines it is in its best interest, based on the availability of cash, cost of funds and internal return on capital, an amount in excess of the minimum amount required will be made.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

**Comprehensive income:** Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, the defined benefit pension plan, postretirement benefit plan and the supplemental executive retirement plan (SERP), are reported as a separate component of the members' equity section of the consolidated statements of financial condition. For 2018 and 2017, other comprehensive loss includes reclassification adjustments related to realized gains on sales of available-for-sale securities.

Accumulated other comprehensive loss consists of the following as of December 31:

	2018	2017
Unrealized gains on available-for-sale securities	\$ 520,142	\$ 2,410,431
Minimum pension liability, postretirement benefit plan and SERP adjustments	(26,623,533)	(25,915,875)
	<u>\$ (26,103,391)</u>	<u>\$ (23,505,444)</u>

**Reclassifications:** Certain account reclassifications have been made to the prior year's consolidated financial statements in order to conform to classifications used in the current year, with no impact to previously reported members' equity or net income.

**Recent accounting pronouncements:** In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue From Contracts With Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods and services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. With the subsequent issuance of ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*, the updated standard will be effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Because the Credit Union recognizes revenue in a manner consistent with this ASU, the adoption of this standard is not expected to have a material impact on its consolidated financial statements or disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial condition for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The FASB has issued ASU amendments to improve certain aspects of Topic 842, including practical expedients, which are available to the Credit Union. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The most significant expected impact of this ASU relates to the Credit Union's operating leases of its branch locations, and the Credit Union is currently evaluating the potential impact of the adoption of the standard on its consolidated financial statements.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU applies to entities holding financial assets and net investment in leases that are not accounted for at fair value through income including trade and other receivables as well as loans and debt securities. The amendments in this ASU require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances.

Credit losses on available-for-sale debt securities should be measured in a manner similar to current U.S. GAAP. However, the amendments in this ASU require that credit losses be presented as an allowance rather than as a write-down. In addition, the ASU provides for reversals of credit losses in future period net income when the estimate of loss declines.

The FASB has issued ASU amendments intended to clarify and improve Topic 326, including the clarification that entities that are not public business entities will be required to adopt the ASU in fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. All entities will be permitted to early adopt the ASU as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Credit Union is assessing data and system needs in order to evaluate the impact of adopting the new guidance. The Credit Union expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. The Credit Union continues to evaluate the potential impact of the adoption of the standard on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost*. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit costs are required to be presented in the income statement, if one is presented. The amendments allow only the service cost component to be eligible for capitalization.

The amendments are effective for nonpublic business entities for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. The adoption of this standard will not impact the Credit Union's consolidated financial statements as nonpublic entities are not required to separately disclose components of net periodic benefit costs.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

In March 2017, the FASB issued ASU 2017-08, *Receivables (Topic 310-20): Premium Amortization on Purchased Callable Debt Securities*. ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium. The amendment requires the premium to be amortized to the earliest call date. The guidance is effective for annual periods beginning after December 15, 2019, and interim periods beginning after December 15, 2020. Early adoption is permitted. This standard will not have a material impact on the Credit Union's results of operations or financial position.

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*. The amendments in this update modify the disclosure requirements primarily related to Level 3 fair value measurements of the fair value hierarchy. This amendment is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. Because this ASU primarily relates to disclosure requirements that have not previously been a significant part of the Credit Union's operations, the Credit Union does not expect its adoption of the ASU to have a material impact on its consolidated financial statements and disclosures.

In August 2018, the FASB issued ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans General (Subtopic 715-20)—Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*. The amendments in this update modify the disclosure requirements on defined benefit plans, including requiring disclosures about significant gains and losses related to changes in the benefit obligation. This amendment is effective for fiscal years ending after December 15, 2021. Early adoption is permitted. Because this ASU primarily relates to disclosure requirements that have not previously been significant for its defined benefit plans, the Credit Union does not expect its adoption of the ASU to have a material impact on its consolidated financial statements and disclosures.

In November 2018, the FASB issued ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*. ASU 2018-19 clarifies that receivables from operating leases are accounted for using the lease guidance and not as financial instruments. The ASU is effective for fiscal years beginning after December 15, 2021. ASU 2016-13 and ASU 2018-19 are effective for the Credit Union as of December 31, 2021. The Credit Union is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

#### Note 2. Investments

Investments classified as available-for-sale consist of the following at December 31:

	2018			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Collateralized mortgage obligations (CMO), agency residential	\$ 14,721,469	\$ 44,310	\$ (213,339)	\$ 14,552,440
CMOs, private residential	13,315,550	1,100	(519,162)	12,797,488
Mortgage-backed securities (MBS), agency residential	127,254,075	1,831,393	(624,161)	128,461,307
	<u>\$ 155,291,094</u>	<u>\$ 1,876,803</u>	<u>\$ (1,356,662)</u>	<u>\$ 155,811,235</u>

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 2. Investments (Continued)

	2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
CMOs, agency residential	\$ 20,698,366	\$ 114,522	\$ (208,834)	\$ 20,604,054
CMOs, private residential	16,006,200	20,238	(290,273)	15,736,165
MBSs, agency residential	185,456,093	3,138,707	(363,929)	188,230,871
	<u>\$ 222,160,659</u>	<u>\$ 3,273,467</u>	<u>\$ (863,036)</u>	<u>\$ 224,571,090</u>

The Credit Union's MBSs consist of residential real estate mortgage obligations and residential real estate CMO securities. Gross realized gains on sales of investments available for sale were approximately \$118,000 and \$420,000 in 2018 and 2017, respectively. There were no realized losses on sales of investments available for sale in 2018 or 2017.

As of December 31, 2018 and 2017, securities with a fair value totaling approximately \$47,931,000 and \$75,214,000, respectively, have been pledged as collateral to secure FHLB advances, as more fully disclosed in Note 7.

Expected maturities of MBSs and CMOs may differ from contractual maturities because borrowers or issuers may have the right to call or prepay the obligations, and are therefore classified separately with no specific maturity date.

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

	2018				
	Fair Value Associated With Unrealized Losses Existing for		Continuous Unrealized Losses Existing for		Total Unrealized Losses
	Less Than 12 Months	More Than 12 Months	Less Than 12 Months	More Than 12 Months	
Available for Sale					
CMOs, agency residential	\$ 332,914	\$ 10,304,586	\$ (1,139)	\$ (212,200)	\$ (213,339)
CMOs, private residential	1,838,571	10,666,543	(32,807)	(486,355)	(519,162)
MBSs, agency residential	11,835,717	42,488,657	(90,866)	(533,295)	(624,161)
	<u>\$ 14,007,202</u>	<u>\$ 63,459,786</u>	<u>\$ (124,812)</u>	<u>\$ (1,231,850)</u>	<u>\$ (1,356,662)</u>

	2017				
	Fair Value Associated With Unrealized Losses Existing for		Continuous Unrealized Losses Existing for		Total Unrealized Losses
	Less Than 12 Months	More Than 12 Months	Less Than 12 Months	More Than 12 Months	
Available for Sale					
CMOs, agency residential	\$ -	\$ 14,398,252	\$ -	\$ (208,834)	\$ (208,834)
CMOs, private residential	3,007,495	9,982,621	(24,779)	(265,494)	(290,273)
MBSs, agency residential	50,028,289	10,876,803	(158,286)	(205,643)	(363,929)
	<u>\$ 53,035,784</u>	<u>\$ 35,257,676</u>	<u>\$ (183,065)</u>	<u>\$ (679,971)</u>	<u>\$ (863,036)</u>

At December 31, 2018 and 2017, the investment portfolio included five and 11 securities, respectively, with unrealized losses that have existed for less than one year. In addition, the investment portfolio included 19 and 10 securities, respectively, with unrealized losses that had existed for longer than one year.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 2. Investments (Continued)

Based upon an evaluation of the available evidence, including recent changes in market rates, credit rating information and information obtained from regulatory filings, management believes the decline in fair value for these securities is temporary, resulting primarily due to changes in interest rates and market illiquidity rather than credit deterioration of the investments. In addition, management of the Credit Union does not intend to sell, nor will the Credit Union be required to sell, these investment securities prior to the recovery of the amortized cost basis. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period in which the other-than-temporary impairment is identified.

Other investments consist of FHLB stock in the amount of approximately \$17,250,000 and \$41,040,000 at December 31, 2018 and 2017, respectively. FHLB stock has been classified with no contractual maturity.

#### Note 3. Loans, Net

Loans, net, consist of the following, presented by portfolio segment, at December 31:

	2018	2017
Residential real estate:		
First mortgages, fixed rate	\$ 1,896,254,864	\$ 1,757,605,274
First mortgages, variable rate	1,397,135,513	1,137,478,207
	<u>3,293,390,377</u>	<u>2,895,083,481</u>
Second mortgages, fixed rate	88,137,870	68,347,591
Equity lines, variable rate	346,302,163	315,257,037
Total residential real estate	<u>3,727,830,410</u>	<u>3,278,688,109</u>
Commercial:		
Real estate, fixed rate	125,949,380	103,520,869
Real estate, variable rate	238,967,515	229,743,311
	<u>364,916,895</u>	<u>333,264,180</u>
SBA	38,699	49,451
Total commercial	<u>364,955,594</u>	<u>333,313,631</u>
Consumer:		
Vehicle loans	986,560,468	886,626,500
Credit card loans, unsecured	241,662,134	232,811,711
Other consumer loans, primarily unsecured	77,456,143	63,176,298
Total consumer	<u>1,305,678,745</u>	<u>1,182,614,509</u>
Total loans receivable	<u>5,398,464,749</u>	<u>4,794,616,249</u>
Deferred net loan origination costs	20,655,689	17,053,439
Allowance for loan losses	(60,555,961)	(56,782,680)
	<u>\$ 5,358,564,477</u>	<u>\$ 4,754,887,008</u>

Commercial loans primarily consist of loans that are secured by office, industrial, apartment and retail business property. The Credit Union has purchased commercial participation loans originated by various other credit unions to faith-based organizations and other businesses. All of these loan participations were purchased without recourse and are secured by real property. The originating credit unions perform all servicing functions on these loans.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

The Credit Union has nontraditional mortgage loans. These loans include hybrid adjustable rate mortgage (ARM), balloon and interest-only loans. Hybrid ARMs are loans that are fixed for an initial period of three, five, seven or 10 years. After this period, the mortgages are converted to a variable rate using the fully indexed rate, annually or every five years, which can result in payment shock for the borrower. Balloon loans do not fully amortize over their term and have a final payment for the nonamortized balance upon maturity. Interest-only loans allow the borrower to pay only interest for a specified number of years, after which the principal becomes due or the loan amortizes principal over its remaining term. The nontraditional mortgage loans amounted to approximately \$1,422,567,000 and \$1,159,262,000 at December 31, 2018 and 2017, respectively.

Nontraditional mortgage loans may have significantly different credit risk characteristics than traditional fixed- and variable-rate mortgages. However, the Credit Union believes it has established prudent underwriting standards as well as adequate risk management functions to monitor these additional risks. The Credit Union has discontinued offering certain nontraditional mortgage products.

Included in mortgage loans are first trust deeds in the amount of approximately \$2,356,960,000 and \$2,204,950,000 at December 31, 2018 and 2017, respectively, which have been pledged as collateral to secure FHLB advances, as more fully disclosed in Note 7.

The allowance for loan losses is considered by the Credit Union as adequate to cover probable losses inherent in the loan portfolio. However, no assurance can be given that the Credit Union, in any particular period, will not sustain loan losses that exceed the allowance, or that subsequent evaluation of the loan portfolio, in light of then-prevailing factors, including economic conditions, credit quality of the assets comprising the portfolio and the ongoing evaluation process, will not require significant changes in the allowance for loan losses.

The following tables present, by loan portfolio segment, the activity in the allowance for loan losses and the recorded investments in loans and the associated allowance amounts according to the two methods of impairment (collectively evaluated and individually evaluated):

	December 31, 2018			
	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Beginning balance	\$ 28,044,376	\$ 5,475,432	\$ 23,262,872	\$ 56,782,680
Provision	1,385,125	177,340	18,437,535	20,000,000
Charge-offs	(20,518)	-	(19,317,592)	(19,338,110)
Recoveries	377,312	52,187	2,681,892	3,111,391
Ending balance	<u>\$ 29,786,295</u>	<u>\$ 5,704,959</u>	<u>\$ 25,064,707</u>	<u>\$ 60,555,961</u>
Ending balance: individually evaluated for impairment	\$ 2,161,892	\$ 95,976	\$ 1,690,759	\$ 3,948,627
Ending balance: collectively evaluated for impairment	27,624,403	5,608,983	23,373,948	56,607,334
	<u>\$ 29,786,295</u>	<u>\$ 5,704,959</u>	<u>\$ 25,064,707</u>	<u>\$ 60,555,961</u>
Total loans:				
Ending balance: individually evaluated for impairment	\$ 23,683,496	\$ 14,452,021	\$ 12,235,707	\$ 50,371,224
Ending balance: collectively evaluated for impairment	3,704,146,914	350,503,573	1,293,443,038	5,348,093,525
	<u>\$ 3,727,830,410</u>	<u>\$ 364,955,594</u>	<u>\$ 1,305,678,745</u>	<u>\$ 5,398,464,749</u>

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

	December 31, 2017			
	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Beginning balance	\$ 30,429,367	\$ 7,876,318	\$ 15,726,919	\$ 54,032,604
Provision	(2,667,648)	(2,472,662)	23,740,310	18,600,000
Charge-offs	(174,014)	-	(17,527,719)	(17,701,733)
Recoveries	456,671	71,776	1,323,362	1,851,809
Ending balance	<u>\$ 28,044,376</u>	<u>\$ 5,475,432</u>	<u>\$ 23,262,872</u>	<u>\$ 56,782,680</u>
Ending balance: individually evaluated for impairment	\$ 3,749,503	\$ 215,379	\$ 3,488,641	\$ 7,453,523
Ending balance: collectively evaluated for impairment	24,294,873	5,260,053	19,774,231	49,329,157
	<u>\$ 28,044,376</u>	<u>\$ 5,475,432</u>	<u>\$ 23,262,872</u>	<u>\$ 56,782,680</u>
Total loans:				
Ending balance: individually evaluated for impairment	\$ 28,552,896	\$ 4,004,806	\$ 17,943,642	\$ 50,501,344
Ending balance: collectively evaluated for impairment	3,250,135,213	329,308,825	1,164,670,867	4,744,114,905
	<u>\$ 3,278,688,109</u>	<u>\$ 333,313,631</u>	<u>\$ 1,182,614,509</u>	<u>\$ 4,794,616,249</u>

Credit quality indicators represent loan attributes and information used by the Credit Union to evaluate the adequacy of the allowance for loan losses. "Pass" loans are performing loans that are collectively evaluated for impairment. The other categories reflect the following credit quality indicators that are then used to establish loan ratings for each loan segment as follows:

**Commercial:** Delinquency status, financial condition and collateral value are monitored to determine whether repayment weakness exists. Accordingly, management regularly reviews and risk grades commercial loans in the Credit Union's portfolio. The risk grading system allows management to classify assets by credit quality in accordance with the Credit Union's policy. The Credit Union's internal risk-grading definition is as follows:

**Pass:** The loan is either risk rated as highest grade, excellent, satisfactory, acceptable or pass/watch and contains no well-defined deficiencies or weaknesses.

**Special Mention:** The loan has credit deficiencies or potential weaknesses that deserve management's close attention and warrant more frequent monitoring; usually current but show some sign of potential problems that, if not addressed, may affect future credit risk.

**Substandard:** The loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loan classified as "substandard" must have a well-defined weakness that jeopardizes the full recovery of the debt.

**Doubtful:** The loan has all the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions and values, highly improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the loans, its classification as an estimated loss is deferred until its more exact status may be determined.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

**Loss:** The loan is considered uncollectible and of such little value that continuing to carry it as an asset on the statement of financial condition is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical to defer writing off the asset, even though the partial recovery may be affected in the future.

The following presents, by credit quality indicator, the commercial portfolio:

	December 31, 2018				
	Pass	Special Mention	Substandard	Loss	Total Loans
Commercial:					
Real estate	\$ 350,501,843	\$ 4,357,728	\$ 10,057,324	\$ -	\$ 364,916,895
SBA	1,730	-	-	36,969	38,699
Total commercial	<u>\$ 350,503,573</u>	<u>\$ 4,357,728</u>	<u>\$ 10,057,324</u>	<u>\$ 36,969</u>	<u>\$ 364,955,594</u>

  

	December 31, 2017				
	Pass	Special Mention	Substandard	Loss	Total Loans
Commercial:					
Real estate	\$ 321,685,350	\$ 6,974,118	\$ 4,604,712	\$ -	\$ 333,264,180
SBA	952	-	11,529	36,970	49,451
Total commercial	<u>\$ 321,686,302</u>	<u>\$ 6,974,118</u>	<u>\$ 4,616,241</u>	<u>\$ 36,970</u>	<u>\$ 333,313,631</u>

**Residential real estate:** Delinquency status serves as the initial indicator for loan rating purposes, with collateral value and repayment considerations then evaluated to determine if the loan is to be categorized as performing or nonperforming.

**Consumer:** Delinquency status is the primary factor considered with further analysis performed at the loan level to determine if the loan is to be categorized as performing or nonperforming.

The following tables present the residential real estate and consumer loans portfolio based on the Credit Union's credit quality categories:

	December 31, 2018		
	Performing	Nonperforming	Total Loans
Residential real estate:			
First mortgages	\$ 3,272,350,804	\$ 21,039,573	\$ 3,293,390,377
Second mortgages	87,391,993	745,877	88,137,870
Equity lines	344,404,117	1,898,046	346,302,163
Total residential real estate	<u>3,704,146,914</u>	<u>23,683,496</u>	<u>3,727,830,410</u>
Consumer:			
Vehicles	976,197,405	10,363,063	986,560,468
Credit cards	240,226,592	1,435,542	241,662,134
Other	77,019,041	437,102	77,456,143
Total consumer	<u>1,293,443,038</u>	<u>12,235,707</u>	<u>1,305,678,745</u>
Total	<u>\$ 4,997,589,952</u>	<u>\$ 35,919,203</u>	<u>\$ 5,033,509,155</u>

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

	December 31, 2017		
	Performing	Nonperforming	Total Loans
Residential real estate:			
First mortgages	\$ 2,870,139,458	\$ 24,944,023	\$ 2,895,083,481
Second mortgages	67,151,841	1,195,750	68,347,591
Equity lines	312,843,914	2,413,123	315,257,037
Total residential real estate	3,250,135,213	28,552,896	3,278,688,109
Consumer:			
Vehicles	870,915,203	15,711,297	886,626,500
Credit cards	231,077,670	1,734,041	232,811,711
Other	62,677,994	498,304	63,176,298
Total consumer	1,164,670,867	17,943,642	1,182,614,509
Total	\$ 4,414,806,080	\$ 46,496,538	\$ 4,461,302,618

Impaired loans consist primarily of TDRs and nonaccrual loans. The following table includes information for impaired loans by class, with additional segregation of balances and allowances by those loans requiring a specific allowance and those that do not require a specific allowance:

	December 31, 2018			December 31, 2017		
	Unpaid Principal Balance	Associated Allowance	Average Balance	Unpaid Principal Balance	Associated Allowance	Average Balance
Allowance recorded:						
Residential real estate:						
First mortgages	\$ 10,507,033	\$ 1,549,576	\$ 12,097,955	\$ 13,688,877	\$ 2,962,205	\$ 16,983,640
Second mortgages	486,269	197,763	609,342	732,414	235,484	905,872
Equity lines	804,514	414,553	904,651	1,004,787	551,814	1,291,655
Total residential real estate	11,797,816	2,161,892	13,611,948	15,426,078	3,749,503	19,181,167
Commercial:						
Real estate	1,072,934	59,007	1,319,696	1,566,458	176,681	3,315,274
SBA	36,969	36,969	37,834	38,698	38,698	39,095
Total commercial	1,109,903	95,976	1,357,530	1,605,156	215,379	3,354,369
Consumer:						
Vehicles	10,363,063	792,458	13,037,180	15,711,297	2,435,911	11,762,002
Credit cards	1,435,542	733,928	1,584,792	1,734,041	821,401	1,812,710
Other	437,102	164,373	467,703	498,304	231,329	429,450
Total consumer	12,235,707	1,690,759	15,089,675	17,943,642	3,488,641	14,004,162
Subtotal	25,143,426	3,948,627	30,059,152	34,974,876	7,453,523	36,539,698
No allowance recorded:						
Residential real estate:						
First mortgages	10,532,540	-	10,893,843	11,255,146	-	10,258,848
Second mortgages	259,608	-	361,472	463,336	-	367,248
Equity lines	1,093,532	-	1,250,934	1,408,336	-	1,308,308
Total residential real estate	11,885,680	-	12,506,249	13,126,818	-	11,934,404
Commercial:						
Real estate	13,342,118	-	7,870,884	2,399,650	-	2,920,744
SBA	-	-	-	-	-	445
Total commercial	13,342,118	-	7,870,884	2,399,650	-	2,921,189
Subtotal	25,227,798	-	20,377,133	15,526,468	-	14,855,593
Total	\$ 50,371,224	\$ 3,948,627	\$ 50,436,285	\$ 50,501,344	\$ 7,453,523	\$ 51,395,291

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

For the years ended December 31, 2018 and 2017, residential real estate and commercial loan interest income of approximately \$2,081,000 and \$1,446,000, respectively, was recognized on impaired loans. No significant amount of interest income was recognized on impaired consumer loans in 2018 or 2017. There were no loans more than three months past due and still accruing interest at December 31, 2018 or 2017.

Nonaccrual loans at December 31 are presented by class as follows:

	2018	2017
Residential real estate:		
First mortgages	\$ 9,810,596	\$ 9,240,327
Second mortgages	242,836	408,000
Equity lines	785,453	916,277
Total residential real estate	<u>10,838,885</u>	<u>10,564,604</u>
Commercial:		
SBA	149,605	159,404
Total commercial	<u>149,605</u>	<u>159,404</u>
Consumer:		
Vehicles	2,814,077	6,098,390
Credit cards	958,211	875,162
Other	162,197	212,328
Total consumer	<u>3,934,485</u>	<u>7,185,880</u>
Total	<u>\$ 14,922,975</u>	<u>\$ 17,909,888</u>

The Credit Union monitors loans using the delinquency categories presented in the following tables. The tables include TDRs for which delinquency is reported consistent with the modified loans' contractual terms.

	December 31, 2018						Total Reportable	Total Loans
	Reportable Delinquency							
	Current	1 to < 2 Months	2 to < 6 Months	6 to 12 Months	> 12 Months			
Residential real estate:								
First mortgages	\$ 3,243,382,832	\$ 36,943,650	\$ 9,587,029	\$ 1,972,425	\$ 1,504,441	\$ 13,063,895	\$ 3,293,390,377	
Second mortgages	86,929,098	814,437	176,560	54,121	163,654	394,335	88,137,870	
Equity lines	343,166,104	1,777,048	1,181,824	132,219	44,968	1,359,011	346,302,163	
Total residential real estate	<u>3,673,478,034</u>	<u>39,535,135</u>	<u>10,945,413</u>	<u>2,158,765</u>	<u>1,713,063</u>	<u>14,817,241</u>	<u>3,727,830,410</u>	
Commercial:								
Real estate	364,916,895	-	-	-	-	-	364,916,895	
SBA	-	-	-	1,730	36,969	38,699	38,699	
Total commercial	<u>364,916,895</u>	<u>-</u>	<u>-</u>	<u>1,730</u>	<u>36,969</u>	<u>38,699</u>	<u>364,955,594</u>	
Consumer:								
Vehicles	975,624,578	7,976,535	2,893,147	51,208	15,000	2,959,355	986,560,468	
Credit cards	237,215,909	2,322,396	2,123,829	-	-	2,123,829	241,662,134	
Other	76,661,475	421,996	370,995	1,677	-	372,672	77,456,143	
Total consumer	<u>1,289,501,962</u>	<u>10,720,927</u>	<u>5,387,971</u>	<u>52,885</u>	<u>15,000</u>	<u>5,455,856</u>	<u>1,305,678,745</u>	
Total	<u>\$ 5,327,896,891</u>	<u>\$ 50,256,062</u>	<u>\$ 16,333,384</u>	<u>\$ 2,213,380</u>	<u>\$ 1,765,032</u>	<u>\$ 20,311,796</u>	<u>\$ 5,398,464,749</u>	

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3. Loans, Net (Continued)

	December 31, 2017						Total Reportable	Total Loans
	Reportable Delinquency							
	Current	1 to < 2 Months	2 to < 6 Months	6 to 12 Months	> 12 Months			
Residential real estate:								
First mortgages	\$ 2,859,839,667	\$ 19,595,623	\$ 10,932,226	\$ 1,979,930	\$ 2,736,035	\$ 15,648,191	\$ 2,895,083,481	
Second mortgages	67,354,350	504,263	161,188	58,800	268,990	488,978	68,347,591	
Equity lines	311,966,659	1,491,648	1,349,030	336,725	112,975	1,798,730	315,257,037	
Total residential real estate	3,239,160,676	21,591,534	12,442,444	2,375,455	3,118,000	17,935,899	3,278,688,109	
Commercial:								
Real estate	333,264,180	-	-	-	-	-	333,264,180	
SBA	953	-	11,529	-	36,969	48,498	49,451	
Total commercial	333,265,133	-	11,529	-	36,969	48,498	333,313,631	
Consumer:								
Vehicles	872,136,021	7,759,871	5,502,317	993,177	235,114	6,730,608	886,626,500	
Credit cards	228,842,891	1,965,278	1,990,707	12,835	-	2,003,542	232,811,711	
Other	62,174,136	576,536	403,010	22,616	-	425,626	63,176,298	
Total consumer	1,163,153,048	10,301,685	7,896,034	1,028,628	235,114	9,159,776	1,182,614,509	
Total	\$ 4,735,578,857	\$ 31,893,219	\$ 20,350,007	\$ 3,404,083	\$ 3,390,083	\$ 27,144,173	\$ 4,794,616,249	

The Credit Union has modified loans to assist members who are expected to perform according to the modified loan terms. Modifications generally provide the member with lower payments through either the reduction of the interest rate and/or the extension of the maturity date. Principal amounts are rarely forgiven. Because of the nature of the allowable TDR terms granted by the Credit Union, the financial effects of such modifications are considered insignificant to the Credit Union. TDRs are summarized as follows:

	December 31, 2018			
	Number of Contracts	Balance	Associated Allowance	Net Balance
Outstanding as of end of year:				
Residential real estate	66	\$ 13,865,398	\$ 1,744,485	\$ 12,120,913
Commercial	5	3,393,211	95,976	3,297,235
Consumer	1,031	11,331,788	688,741	10,643,047
Total	1,102	\$ 28,590,397	\$ 2,529,202	\$ 26,061,195

	December 31, 2017			
	Number of Contracts	Balance	Associated Allowance	Net Balance
Outstanding as of end of year:				
Residential real estate	88	\$ 18,497,851	\$ 3,205,154	\$ 15,292,697
Commercial	5	3,464,499	213,650	3,250,849
Consumer	1,335	15,905,445	1,189,801	14,715,644
Total	1,428	\$ 37,867,795	\$ 4,608,605	\$ 33,259,190

**Logix Federal Credit Union and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Note 3. Loans, Net (Continued)**

	December 31, 2018		December 31, 2017	
	Number of Contracts	Post-Modification Balance	Number of Contracts	Post-Modification Balance
Loans modified during the year:				
Residential real estate:				
First mortgages	4	\$ 1,148,289	4	\$ 1,751,916
Commercial:				
Real estate	-	-	-	-
Consumer:				
Vehicles	115	1,944,690	674	10,504,525
Credit cards	15	144,464	31	188,001
Other	21	182,426	23	167,753
Total consumer	151	2,271,580	728	10,860,279
Total	155	\$ 3,419,869	732	\$ 12,612,195

	December 31, 2018		December 31, 2017	
	Number of Contracts	Post-Modification Balance	Number of Contracts	Post-Modification Balance
Modified loans for which payment default occurred (re-defaults):				
Residential real estate:				
First mortgages	2	\$ 1,001,578	2	\$ 764,796
Consumer:				
Vehicles	8	126,373	40	572,844
Credit cards	-	-	2	22,121
Other	2	25,538	-	-
Total consumer	10	151,911	42	594,965
Total	12	\$ 1,153,489	44	\$ 1,359,761

As of December 31, 2018 and 2017, there are no commitments to lend additional funds to members whose loans have been modified as TDRs.

**Note 4. Loan Servicing**

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

	2018	2017
Residential loans serviced for:		
Federal National Mortgage Association (FNMA)	\$ 1,231,677,058	\$ 1,229,185,052
FHLB	140,333,975	111,709,948
Other investors	18,215,163	4,855,973
	1,390,226,196	1,345,750,973
Commercial loans serviced	264,188,153	218,614,909
	<u>\$ 1,654,414,349</u>	<u>\$ 1,564,365,882</u>

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 4. Loan Servicing (Continued)

A summary of the changes in the balance of loan servicing rights for the years ended December 31 is as follows:

	2018	2017
Balance, beginning of year	\$ 11,148,182	\$ 9,634,960
Servicing assets recognized during the year	5,318,365	3,169,761
Amortization of servicing assets	(1,794,177)	(1,656,539)
Balance, end of year	<u>\$ 14,672,370</u>	<u>\$ 11,148,182</u>

**Residential mortgage loan servicing rights assumptions:** Significant assumptions made in the calculations of servicing assets include discount rates ranging from 9.5 percent to 12.5 percent for the years ended December 31, 2018 and 2017, respectively, and weighted prepayment speeds of 130 and 158 for the years ended December 31, 2018 and 2017, respectively, utilizing the Public Securities Association factors. Expected life of the loan portfolio associated with servicing assets was approximately 7.27 years and 6.61 years as of December 31, 2018 and 2017, respectively.

**Commercial mortgage loan servicing rights assumptions:** Significant assumptions made in the calculations of servicing assets include discount rate of 10 percent for the year ended December 31, 2018, and conditional prepayment rate of 15 percent for the year ended December 31, 2018, which has been benchmarked to the SBA 7(a) historic data, updated in Bloomberg as of December 2018 with prepayment rates ranging from 3.27 percent in year one to a peak at 14.55 percent in year four. Expected life of the loan portfolio associated with servicing assets was approximately 30 months as of December 31, 2018.

The Credit Union has an existing master agreement with FNMA whereby sales of fixed-interest residential mortgage loans may be securitized and retained by the Credit Union in the form of Logix Federal Credit Union agency residential MBSs (see Note 2). Consistent with other loans sold, these sales are made without recourse, are subject to customary representations and warranties, and are guaranteed by FNMA.

In May 2016, the Credit Union became a member of the FHLB Original Mortgage Partnership Finance program to sell loans to the FHLB. The program calls for credit risk sharing with the FHLB up to a maximum of 8 percent of the loan amount, referred to as the credit enhancement (CE) obligation. A CE fee of 10 basis points of the outstanding master commitment balances is paid to the Credit Union by the FHLB on a monthly basis. The Credit Union entered into an agreement with the FHLB providing for a mandatory commitment of \$50 million in loans and a maximum CE amount of \$4 million. In the event of underdelivery, the Credit Union is subject to a pair-off or price-adjustment fee for any portion of the delivery commitment that is under or over the tolerance limit of 1 percent.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 5. Premises and Equipment, Net

Premises and equipment, net are summarized as follows at December 31:

	2018	2017
Land	\$ 19,607,618	\$ 19,607,618
Building	14,587,854	14,358,174
Furniture and equipment	39,860,059	35,179,773
Leasehold improvements	8,852,783	8,338,214
	<u>82,908,314</u>	<u>77,483,779</u>
Accumulated depreciation and amortization	(49,315,795)	(45,643,761)
	<u>33,592,519</u>	<u>31,840,018</u>
Construction in progress	44,799,954	19,486,558
	<u>\$ 78,392,473</u>	<u>\$ 51,326,576</u>

In June 2015, the Credit Union executed a purchase and sale agreement for the acquisition of a 12-acre parcel of land located in Santa Clarita, California, for approximately \$15.6 million. This acquired property is intended to be the site of the Credit Union's new headquarters. At December 31, 2018 and 2017, the Credit Union incurred approximately \$25,465,000 and \$16,849,000, respectively, for the ongoing construction of its new headquarters, which is inclusive of the total capitalized interest expense. For the years ended December 31, 2018 and 2017, the Credit Union capitalized interest expense totaling approximately \$482,000 and \$307,000, respectively. The Credit Union currently anticipates completion of this new headquarters by March 2020.

The Credit Union leases 18 offices. The operating leases contain renewal options and provisions requiring the Credit Union to pay property taxes and operating expenses over base period amounts. All rental payments are dependent only upon the lapse of time. Minimum rental payments under operating leases with initial or remaining terms of one year or more at December 31, 2018, are as follows:

Years ending December 31:	
2019	\$ 2,826,000
2020	2,294,000
2021	2,104,000
2022	1,603,000
2023	1,357,000
Subsequent years	3,549,000
	<u>\$ 13,733,000</u>

Rental expense for both of the years ended December 31, 2018 and 2017, for all facilities leased under operating leases, totaled approximately \$3,669,000, which is included in noninterest expense in the consolidated statements of income.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 6. Members' Shares

Members' shares are summarized as follows at December 31:

	2018	2017
Regular shares	\$ 619,515,158	\$ 612,771,888
Share draft accounts	514,780,955	518,232,407
Money market accounts	2,215,350,345	2,145,476,694
Individual Retirement Account (IRA) shares	107,221,949	96,906,283
Certificates	1,020,041,682	791,865,692
	<u>\$ 4,476,910,089</u>	<u>\$ 4,165,252,964</u>

Shares by maturity as of December 31, 2018, are summarized as follows:

No contractual maturity	<u>\$ 3,456,868,407</u>
Zero to one year maturity	737,679,556
One to two years maturity	135,200,969
Two to three years maturity	94,876,417
Three to four years maturity	28,148,479
Four to five years maturity	24,136,261
	<u>1,020,041,682</u>
	<u>\$ 4,476,910,089</u>

Regular shares, share draft accounts, money market accounts and IRA shares have no contractual maturity. Certificate accounts have maturities of five years or less.

The NCUSIF insures members' shares and certain IRAs and Keogh accounts up to a maximum federal deposit insurance level of \$250,000. This includes all account types, such as regular share, share draft, money market and certificates of deposit. IRA and Keogh account coverage remains at up to \$250,000 separate from other types of accounts owned.

The aggregate amount of certificates in denominations of \$250,000 or more at December 31, 2018 and 2017, is approximately \$197,296,000 and \$149,456,000, respectively.

#### Note 7. Borrowed Funds and Note Payable

**Borrowed funds:** The Credit Union utilizes a demand loan agreement with the FHLB under a Securities-Backed Credit Program. The terms of the agreement call for pledging of certain investments held in safekeeping by the FHLB of approximately \$47,931,000 and \$75,214,000 at December 31, 2018 and 2017, respectively, as more fully described in Note 2. This current agreement provides for a maximum borrowing amount of approximately \$46,419,000.

The Credit Union also has a demand loan agreement with the FHLB under the Standard Credit Program. Any and all advances under this agreement are secured by certain first trust deeds of approximately \$2,356,964,000 and \$2,204,950,000 at December 31, 2018 and 2017, respectively, as more fully described in Note 3. This current agreement provides for a maximum borrowing amount of approximately \$1,949,231,000. There is an overall maximum financing availability of approximately \$1,211,360,000 at the FHLB.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 7. Borrowed Funds and Note Payable (Continued)

At December 31, 2018, total borrowings under the above agreements were approximately \$548,622,000 with interest rates ranging from 2.39 percent and 2.64 percent. All outstanding borrowings mature on various dates in January 2019, March 2019 and May 2019. At December 31, 2017, total borrowings under the above agreements were \$310,000,000, with interest rates ranging from 1.37 percent and 1.41 percent. All outstanding borrowings did mature on January 2, 2018.

The following is other pertinent data with respect to short-term borrowings with the FHLB for the years ended December 31:

	2018	2017
Average borrowings during the year	\$ 125,934,000	\$ 501,883,721
Maximum amount outstanding during the year	1,485,000,000	1,449,000,000
Weighted-average monthly interest on borrowings:		
During the year	1.8%	1.0%
At year-end	2.5%	1.4%

The Credit Union also has a borrowing agreement with the Federal Reserve Bank's Discount Window. The total borrowing limit under this agreement is based on any amount that can be pledged as collateral to cover any such advances. At December 31, 2018 and 2017, there were no borrowings under this agreement. In May 2018, for ease of financing, the Credit Union's borrowing agreement with the Federal Reserve Bank's Discount Window was amended to pledge \$400,011,000 of consumer auto loans as collateral to cover any advances.

**Note payable:** During 2018, the Credit Union entered into a note payable agreement totaling approximately \$4,269,000 for the purchase of technology equipment, software and services. The note payable bears interest at 0.80 percent and is collateralized by the financed assets and is due in three annual installments beginning in April 2018. As of December 31, 2018, the remaining balance is \$2,845,962 with \$1,422,981 due in 2019 and \$1,422,981 due in 2020.

#### Note 8. Off-Balance-Sheet Activities

The Credit Union is party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its members. These commitments represent financial instruments to extend credit, which include lines of credit, credit cards and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated financial statements.

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

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. However, if all commitments were to be drawn upon, it would result in significant liquidity pressure for the Credit Union. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained to secure borrowings on the lines of credit is based on management's credit evaluation of the member.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 8. Off-Balance-Sheet Activities (Continued)

Unfunded commitments under revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date and ultimately may not be drawn upon to the total extent to which the Credit Union is committed.

Outstanding commitments to fund mortgage loans at December 31, 2018 and 2017, total approximately \$51,486,000 and \$73,796,000, respectively.

Unfunded loan commitments under lines of credit are summarized as follows at December 31:

	2018	2017
Credit card	\$ 564,190,000	\$ 544,364,000
Home equity	480,665,000	404,402,000
Other	19,167,000	19,919,000
	<u>\$ 1,064,022,000</u>	<u>\$ 968,685,000</u>

#### Note 9. Commitments and Contingent Liabilities

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

The Credit Union had approximately \$6,350,000 and \$27,000,000 in outstanding commitments to sell loans to the secondary market or for investment purposes at December 31, 2018 and 2017, respectively.

#### Note 10. Employee Benefits

**Defined benefit pension plan:** The Credit Union, through its subsidiary, sponsors a defined benefit pension plan for the benefit of its employees. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Credit Union and compensation levels at retirement. Contributions to the plan reflect benefits attributed to employees' services to date, as well as services expected to be earned in the future.

Effective December 31, 2006, the plan was amended to freeze the benefit accrual for salaried employees who are under the age of 40 with less than five years of service as of December 31, 2006.

The Codification requires the Credit Union to recognize the funding status of its defined benefit pension plan in its consolidated statements of financial condition, with a corresponding adjustment to accumulated other comprehensive income. Net unrecognized actuarial losses and unrecognized prior service costs are recognized as net periodic pension plan cost pursuant to the Credit Union's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that are not recognized as net periodic pension cost in the same period will be recognized as a component of other comprehensive income. Those amounts will be subsequently recognized as a component of net periodic pension plan cost on the same basis as the amounts recognized in accumulated other comprehensive income.

**Logix Federal Credit Union and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Note 10. Employee Benefits (Continued)**

	<u>2018</u>	<u>2017</u>
Benefit obligation	\$ (74,262,845)	\$ (77,889,940)
Fair value of plan assets	57,886,148	60,997,717
Funded status	<u>\$ (16,376,697)</u>	<u>\$ (16,892,223)</u>

Amounts recognized in the consolidated statements of financial condition pension liability \$ (16,376,697) \$ (16,892,223)

Accumulated benefit obligation \$ (67,066,522) \$ (68,187,937)

	<u>2018</u>	<u>2017</u>
Net pension cost	\$ 2,793,911	\$ 3,383,351
Employer contribution	2,900,000	4,670,000
Plan participants' contribution	-	-
Benefit payments	2,012,197	1,425,050

Amounts recognized in accumulated other comprehensive loss at December 31 consist of the following:

	<u>2018</u>	<u>2017</u>
Loss	\$ 22,707,694	\$ 23,093,780
Prior service cost	1,505,770	1,529,121
	<u>\$ 24,213,464</u>	<u>\$ 24,622,901</u>

The following are the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic pension cost over the year ending December 31, 2019:

Loss	\$ 1,663,261
Prior service cost	202,562

	<u>2018</u>	<u>2017</u>
Assumptions used to determine benefit obligation:		
Discount rate	4.4%	3.7%
Rate of compensation increase	4.0%	4.0%

	<u>2018</u>	<u>2017</u>
Assumptions used to determine net pension cost:		
Discount rate	3.4%-3.8%	3.8%-4.3%
Expected long-term return on plan assets	6.6%	6.6%
Rate of compensation increase	4.0%	4.0%

Expected long-term return on plan assets is determined by using industry averages from other institutions with similar plan asset allocations.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 10. Employee Benefits (Continued)

The Credit Union's pension plan weighted-average asset allocations by asset category are as follows at December 31:

	2018	2017
Equity securities (including common collective trust funds)	69.8%	71.8%
Fixed-income securities	26.2%	24.7%
Money market funds	4.0%	3.5%
	<u>100.0%</u>	<u>100.0%</u>

The Credit Union has developed asset allocation and diversification guidelines, which are monitored for compliance by the Investment Committee on a quarterly basis. The guidelines were established to optimize the pension plan's expected return based on the Credit Union's risk tolerance.

The fair values of the Credit Union's pension plan assets by asset category are as follows:

Asset Category	Total	Fair Value Measurements at December 31, 2018		
		Level 1	Level 2	Level 3
Money market funds	\$ 2,377,874	\$ 2,377,874	\$ -	\$ -
Mutual funds:				
Fixed-income funds	15,158,121	15,158,121	-	-
Equity funds	9,828,718	9,828,718	-	-
Other equity funds	29,376,105	29,376,105	-	-
Balance funds	1,145,330	1,145,330	-	-
	<u>\$ 57,886,148</u>	<u>\$ 57,886,148</u>	<u>\$ -</u>	<u>\$ -</u>

Asset Category	Total	Fair Value Measurements at December 31, 2017		
		Level 1	Level 2	Level 3
Money market funds	\$ 2,167,058	\$ 2,167,058	\$ -	\$ -
Mutual funds:				
Fixed-income funds	15,051,061	15,051,061	-	-
Equity funds	4,766,482	4,766,482	-	-
Other equity funds	33,067,472	33,067,472	-	-
Balance funds	5,945,644	5,945,644	-	-
	<u>\$ 60,997,717</u>	<u>\$ 60,997,717</u>	<u>\$ -</u>	<u>\$ -</u>

The Credit Union expects to contribute \$2,900,000 to the plan for the year ending December 31, 2019.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 10. Employee Benefits (Continued)

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Years ending December 31:	
2019	\$ 2,271,485
2020	2,611,232
2021	2,955,905
2022	3,252,835
2023	3,526,024
2024 and thereafter	22,707,103
	<u>\$ 37,324,584</u>

**Other postretirement benefits plan:** The Credit Union, through its subsidiary, sponsors a healthcare plan that provides postretirement medical and life insurance benefits to full-time employees who meet minimum age and service requirements. The plan is contributory with retiree contributions adjusted annually, and contains other cost-sharing features such as deductibles and co-insurance. The accounting for the plan anticipates future cost-sharing changes to the written plan that are consistent with the Credit Union's expressed interest to increase the retiree contribution rate annually for the expected general inflation rate for that year. The Credit Union's policy is to fund the cost of medical benefits in amounts determined at the discretion of management. There are no assets set aside to prefund the liability associated with the plan.

	2018	2017
Benefit obligation	\$ (1,730,679)	\$ (1,938,629)
Fair value of plan assets	-	-
Funded status	<u>\$ (1,730,679)</u>	<u>\$ (1,938,629)</u>

Accrued benefit cost recognized in the consolidated statements of financial condition	<u>\$ (1,730,679)</u>	<u>\$ (1,938,629)</u>
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	2018	2017
Net periodic postretirement benefit cost	\$ (66,200)	\$ (71,547)
Employer contribution	84,680	57,048
Benefit payments	84,680	57,048

Amounts recognized in accumulated other comprehensive loss at December 31 consist of the following:

	2018	2017
Gain	\$ (1,769,942)	\$ (1,730,828)
Prior service cost	54,949	72,905
	<u>\$ (1,714,993)</u>	<u>\$ (1,657,923)</u>

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 10. Employee Benefits (Continued)

The following are the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic postretirement benefit cost over the year ending December 31, 2019:

Gain	\$ (214,058)
Prior service cost	17,956

	2018	2017
Assumptions used to determine benefit obligation:		
Discount rate	4.4%	3.7%
Increase in health insurance premiums:		
Initial increase	7.3%	7.5%
Ultimate increase	4.3%	4.3%
Year ultimate reached	2033	2032

	2018	2017
Assumptions used to determine net postretirement benefit cost:		
Discount rate	3.7%	4.2%
Expected long-term return on plan assets	NA	NA
Rate of compensation increase	NA	NA

The plan is unfunded, so the Credit Union makes benefit payments as they become due. The benefit payments are made from the general assets of the Credit Union.

The Credit Union expects to contribute approximately \$73,710 to the plan for the year ending December 31, 2019.

The following postretirement benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Years ending December 31:	
2019	\$ 162,733
2020	164,362
2021	173,662
2022	197,773
2023	218,665
2024 and thereafter	846,550
	\$ 1,763,745

**Supplemental executive retirement plan:** The Credit Union, through its subsidiary, also sponsors a defined benefit supplemental executive retirement plan for selected employees. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Credit Union and compensation levels at retirement. No contributions, except to fund benefit payments, have been made to the plan since inception. Therefore, there are no plan assets.

**Logix Federal Credit Union and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Note 10. Employee Benefits (Continued)**

	<u>2018</u>	<u>2017</u>
Benefit obligation	\$ (8,755,625)	\$ (7,006,239)
Fair value of plan assets	-	-
Funded status	<u>\$ (8,755,625)</u>	<u>\$ (7,006,239)</u>
Accrued benefit cost recognized in the consolidated statements of financial condition	<u>\$ (8,755,625)</u>	<u>\$ (7,006,239)</u>

	<u>2018</u>	<u>2017</u>
Net periodic postretirement benefit cost	\$ (916,066)	\$ (787,742)

Amounts recognized in accumulated other comprehensive loss at December 31 consist of the following:

	<u>2018</u>	<u>2017</u>
Loss	\$ 3,937,294	\$ 2,829,074
Prior service cost	187,768	121,824
	<u>\$ 4,125,062</u>	<u>\$ 2,950,898</u>

The following are the amounts in accumulated other comprehensive income expected to be recognized as components of net period postretirement benefit cost over the year ending December 31, 2019:

Loss	\$ 347,513
Prior service cost	49,491

	<u>2018</u>	<u>2017</u>
Assumptions used to determine benefit obligation:		
Discount rate	4.4%	3.7%
Rate of compensation increase	4.5%	4.5%
Pension increases for in-payment and deferred benefits	0.0%	0.0%

	<u>2018</u>	<u>2017</u>
Assumptions used to determine net postretirement benefit cost:		
Discount rate	3.7%	4.2%
Expected long-term return on plan assets	NA	NA
Rate of compensation increase	4.5%	4.5%

The plan is unfunded, so the Credit Union makes benefit payments as they become due. The benefit payments are made from the general assets of the Credit Union.

The Credit Union does not expect to contribute to the plan for the year ending December 31, 2019.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 10. Employee Benefits (Continued)

The following postretirement benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Years ending December 31:	
2019	\$ 399,471
2020	422,207
2021	442,717
2022	445,483
2023	449,097
2024 and thereafter	2,374,913
	<u>\$ 4,533,888</u>

**401(k) plan:** The Credit Union has a 401(k) defined contribution plan that allows eligible employees to defer a portion of their salary into the 401(k) plan. There is no minimum age or minimum service requirement for eligibility. The Credit Union matches a portion of employees' wage reductions. Plan costs are accrued and funded on a current basis. The Credit Union contributed approximately \$2,173,000 and \$1,895,000 to the plan for the years ended December 31, 2018 and 2017, respectively, which is included in noninterest expense in the consolidated statements of income.

**Supplemental savings plan:** The Credit Union has a supplemental savings plan for eligible executives that allows them to contribute in excess of their maximum 401(k) plan contribution. The Credit Union provides a corresponding matching amount for these executives at the Credit Union's discretion. The liability associated with this supplemental savings plan is approximately \$5,237,000 and \$5,187,000 at December 31, 2018 and 2017, respectively.

#### Note 11. Members' Equity

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital guidelines that involve quantitative measures of the Credit Union's assets, liabilities and certain off-balance-sheet items as calculated under U.S. GAAP. The Credit Union's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth to total assets. Further, credit unions over \$10,000,000 in assets are also required to calculate a Risk-Based Net Worth (RBNW) requirement that establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNW requirements were 6.49 percent and 5.63 percent as of December 31, 2018 and 2017, respectively. The minimum requirement to be considered "complex" under the regulatory framework is 6 percent. Management believes, as of December 31, 2018 and 2017, that the Credit Union meets all capital adequacy requirements to which it is subject.

Other appropriated retained earnings represent a restriction of retained earnings as established by the Board of Directors.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 11. Members' Equity (Continued)

Key aspects of the Credit Union's minimum capital amounts and ratios at December 31 are summarized as follows:

	2018		2017	
	Amount	Ratio/ Requirement	Amount	Ratio/ Requirement
Amount needed to be classified as "adequately capitalized"	\$ 390,637,149	6.49%	\$ 323,031,737	6.00%
Amount needed to be classified as "well-capitalized"	421,334,367	7.00%	376,870,360	7.00%
Actual net worth	933,491,953	15.5%	854,879,962	15.9%

As of December 31, 2018 and 2017, the NCUA categorized the Credit Union as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized," the Credit Union must maintain a minimum net worth ratio of 7 percent of assets. There are no conditions or events since that notification that management believes have changed the institution's category.

Because the RBNW requirement is less than the net worth ratio, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the quarter-end balance option, as permitted by regulation.

#### Note 12. Related-Party Transactions

The Credit Union has had, and may be expected to have in the future, transactions in the ordinary course of business with directors, supervisory committee members and executive officers (commonly referred to as related parties). In management's opinion, these loans and transactions were on the same terms as those for comparable loans and transactions with non-related parties.

Aggregate loan transactions with related parties for the years ended December 31 were as follows:

	2018	2017
Balance, beginning of year	\$ 3,309,000	\$ 3,398,000
New loans	2,416,429	289,000
Repayments	(969,429)	(378,000)
Balance, end of year	<u>\$ 4,756,000</u>	<u>\$ 3,309,000</u>

None of the loans are past due, nonaccrual or restructured to provide a reduction or deferral of interest or principal because of deteriorations in the financial position of the borrower. There were no loans to a related party that were considered classified loans at December 31, 2018 or 2017.

Total undisbursed loan commitments outstanding with related parties were approximately \$549,000 at December 31, 2018.

Deposits from related parties at December 31, 2018 and 2017, amounted to approximately \$2,455,000 and \$2,121,000, respectively.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 13. Fair Value

The following methods and assumptions were used by the Credit Union in estimating fair values as disclosed herein:

**Financial instruments:** Fair value represents management's best estimates based on a range of methodologies and assumptions. The carrying value of short-term financial instruments (such as cash and cash equivalents), other investments, as well as receivables and payables arising in the ordinary course of business (such as accrued interest receivable and dividends payable) approximates fair value because of the relatively short period of time between the origination and expected realization. The fair value of the Credit Union's off-balance-sheet commitments are estimated using fees charged to others to enter into similar agreements, taking into account the remaining terms of the agreements and credit standing of the members. The estimated fair value of these commitments is not significant.

The Credit Union's policies for the determination of fair value of other financial instruments for disclosure or measurement are described below:

**Investment securities:** The Credit Union considers the inputs utilized to fair value the U.S. agency and U.S.-sponsored agency issued debt securities (callable and noncallable notes), private label securities, MBSs guaranteed by those agencies and CMOs issued by those agencies within Level 2 of the valuation hierarchy, which are derived from readily available pricing sources and third-party pricing services for identical or comparable instruments, respectively. However, the fair value reported may not be indicative of the amounts that could be realized in an actual market exchange.

**Impaired loans, net, and loans held for sale:** When quoted market prices are not available, the fair value of loans receivable is generally based upon observable market prices of similar instruments, including loans with similar characteristics. If observable market prices are not available, fair value is based upon estimated cash flows adjusted for credit risk that are discounted using an interest rate appropriate for the maturity of the applicable loans or the unfunded commitments.

The inputs for the determination of the fair value of loans are generally classified within Level 2 of the valuation hierarchy. However, certain of the Credit Union's loans, including nonperforming loans, are classified within Level 3 due to the lack of observable pricing data. The fair value of these Level 3 loans is calculated with a discounted cash flows model using market-based credit spreads of comparable debt instruments or credit derivatives of the specific borrower or comparable borrowers. Results of discounted cash flow calculations may be adjusted, as appropriate, to reflect other market conditions or the perceived credit risk of the borrower.

Loans held for sale are required to be measured at the lower of cost or fair value. The market value represents fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions, which is a Level 2 input. Premiums received or to be received on the quotes or bids are indicative of the fact that cost is lower than fair value.

**Loan servicing rights:** Loan servicing rights do not trade in an active, open market with readily observable prices. While sales of loan servicing rights do occur, the precise terms and conditions typically are not readily available. Accordingly, the Credit Union estimates the fair value of loan servicing rights and certain other retained interests in securitizations using discounted cash flow models incorporating numerous assumptions from the perspective of market participants, including servicing income, servicing costs, market discount rates, prepayment speeds and default rates. Due to the nature of the valuation inputs, loan servicing rights are classified within Level 3 of the valuation hierarchy.

**Nonfinancial assets:** The Credit Union's primary nonfinancial assets subject to fair value measurement include foreclosed property.

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 13. Fair Value (Continued)

**Fair value on a recurring basis:** The tables below present the balances of assets measured at fair value on a recurring basis:

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
CMOs, agency residential	\$ 14,552,000	\$ -	\$ 14,552,000	\$ -
CMOs, private residential	12,797,000	-	12,797,000	-
MBSs, agency residential	128,461,000	-	128,461,000	-
Loan servicing rights, commercial	3,670,000	-	3,670,000	-
	<u>\$ 159,480,000</u>	<u>\$ -</u>	<u>\$ 159,480,000</u>	<u>\$ -</u>

  

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
CMOs, agency residential	\$ 20,604,000	\$ -	\$ 20,604,000	\$ -
CMOs, private residential	15,736,000	-	15,736,000	-
MBSs, agency residential	188,231,000	-	188,231,000	-
	<u>\$ 224,571,000</u>	<u>\$ -</u>	<u>\$ 224,571,000</u>	<u>\$ -</u>

**Fair value on a nonrecurring basis:** Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following tables present those assets, by caption and by level within the valuation hierarchy, and any nonrecurring change in fair value:

	Fair Value at December 31, 2018			
	Total	Level 1	Level 2	Level 3
Loans held for sale	\$ 7,112,000	\$ -	\$ 7,112,000	\$ -
Impaired loans, other than TDRs	20,362,000	-	-	20,362,000
TDRs	26,061,000	-	-	26,061,000
Foreclosed property	563,000	-	-	563,000

  

	Fair Value at December 31, 2017			
	Total	Level 1	Level 2	Level 3
Loans held for sale	\$ 26,691,000	\$ -	\$ 26,691,000	\$ -
Impaired loans, other than TDRs	9,789,000	-	-	9,789,000
TDRs	33,259,000	-	-	33,259,000
Foreclosed property	832,000	-	-	832,000

## Logix Federal Credit Union and Subsidiaries

### Notes to Consolidated Financial Statements

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#### **Note 13. Fair Value (Continued)**

Nonrecurring basis fair value measurement instruments include certain impaired loans as described in Note 3. The tables above reflect the loan receivable amounts for impaired loans and TDRs after the application of valuation allowances and the expected cash flows model using the payment terms from loan modification agreements and the discount rates. The specific reserves for collateral-dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of collateral was determined based on appraisals or discounted cash flow models. In some cases, adjustments were made to the appraised values for various factors, including age of the appraisal, age of comparable included in the appraisal, and known changes in the market and in the collateral. When significant adjustments were based on unobservable inputs, the resulting fair value measurement has been categorized as a Level 3 measurement.

Foreclosed property consists of other real estate owned and repossessed automobiles. Note 1 describes the accounting policy applied to such assets. In accordance with U.S. GAAP, for fair value measurement purposes, the Credit Union excludes transaction costs such as costs to sell or dispose of the property.

The fair value for loan servicing rights is based on a discounted cash flow model that calculates the present value of estimated future net servicing income, as more fully described in Note 1.