ORANGE COUNTY'S CREDIT UNION
Santa Ana, California

FINANCIAL STATEMENTS
December 31, 2012 and 2011

TABLE OF CONTENTS

Independent Auditor's Report

Members of the Supervisory Committee and
Board of Directors
Orange County's Credit Union
Santa Ana, California

We have audited the accompanying statements of financial condition of Orange County's Credit Union as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Orange County's Credit Union as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America

CliftonLarsonAllen LLP

Tucson, Arizona
March 18, 2013

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF FINANCIAL CONDITION
December 31, 2012 and 2011

ASSETS

	2012	2011
Cash and cash equivalents	$ 80,865,174	$ 135,438,915
Investment securities:		
Available-for-sale	411,777,332	304,922,423
Other investments	5,060,000	2,705,234
Federal Home Loan Bank stock	5,815,200	4,333,800
Loans held-for-sale	8,311,602	2,033,850
Loans to members, net of allowance for loan losses	491,746,310	493,050,590
Accrued interest receivable	2,527,624	2,622,657
Foreclosed assets	-	1,159,125
Premises and equipment, net	22,467,837	22,850,906
NCUSIF deposit	8,954,804	8,302,416
Life insurance policies	17,399,574	7,496,426
Other assets	4,204,647	3,504,790
TOTAL ASSETS	$ 1,059,130,104	$ 988,421,132

LIABILITIES AND MEMBERS' EQUITY

	2012	2011
LIABILITIES		
Members' share and savings accounts	$ 939,549,438	$ 877,602,791
Borrowed funds	15,750,000	17,250,000
Accrued expenses and other liabilities	4,791,206	3,102,488
Total liabilities	960,090,644	897,955,279
MEMBERS' EQUITY - substantially restricted		
Regular reserve	14,248,147	14,248,147
Undivided earnings	80,729,025	73,262,985
Accumulated other comprehensive income	4,062,288	2,954,721
Total members' equity	99,039,460	90,465,853
TOTAL LIABILITIES AND MEMBERS' EQUITY	$ 1,059,130,104	$ 988,421,132

The accompanying notes are an integral part of the financial statements.

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF INCOME
Years Ended December 31, 2012 and 2011

	2012	2011
INTEREST INCOME		
Interest on loans to members	$ 27,802,045	$ 29,607,901
Interest on investment securities and cash equivalents	5,075,994	4,789,565
Total interest income	32,878,039	34,397,466
INTEREST EXPENSE		
Dividends on members' share and savings accounts	4,077,663	5,586,996
Interest on borrowed funds	550,988	546,158
Total interest expense	4,628,651	6,133,154
Net interest income	28,249,388	28,264,312
PROVISION FOR LOAN LOSSES	2,889,780	3,646,422
Net interest income after provision for loan losses	25,359,608	24,617,890
NON-INTEREST INCOME		
Fees and charges	5,688,020	5,318,172
Gain on sales of loans held-for-sale	2,647,143	821,874
Other non-interest income	8,897,277	7,533,020
Total non-interest income	17,232,440	13,673,066
NON-INTEREST EXPENSE		
Compensation and benefits	18,721,109	16,861,349
Occupancy	2,440,624	2,723,764
Operations	7,838,083	7,302,908
NCUSIF premium assessment	850,706	2,075,604
Professional and outside services	712,669	745,404
Educational and promotional	1,052,277	845,813
Loan servicing	2,194,523	1,427,386
Other expense	1,316,017	1,307,448
Total non-interest expense	35,126,008	33,289,676
NET INCOME	$ 7,466,040	$ 5,001,280

The accompanying notes are an integral part of the financial statements.

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2012 and 2011

	2012	2011
NET INCOME	$ 7,466,040	$ 5,001,280
OTHER COMPREHENSIVE INCOME:		
Change in unrealized gain (loss) on securities available-for-sale	1,107,567	3,158,741
COMPREHENSIVE INCOME	$ 8,573,607	$ 8,160,021

The accompanying notes are an integral part of the financial statements.

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF MEMBERS' EQUITY
Years Ended December 31, 2012 and 2011

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCES, DECEMBER 31, 2010	$ 14,248,147	$ 68,261,705	$ (204,020)	$ 82,305,832
Net income	-	5,001,280	-	5,001,280
Other comprehensive income	-	-	3,158,741	3,158,741
BALANCES, DECEMBER 31, 2011	14,248,147	73,262,985	2,954,721	90,465,853
Net income	-	7,466,040	-	7,466,040
Other comprehensive income	-	-	1,107,567	1,107,567
BALANCES, DECEMBER 31, 2012	$ 14,248,147	$ 80,729,025	$ 4,062,288	$ 99,039,460

The accompanying notes are an integral part of the financial statements.

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 7,466,040	$ 5,001,280
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,703,924	1,586,095
Amortization of premiums and discounts, net	3,720,883	2,294,236
Amortization of deferred loan origination fees and costs, net	(512,582)	(263,339)
Provision for loan losses	2,889,780	3,646,422
Loss on sale of foreclosed assets	64,968	331,356
(Gain) loss on disposal of premises and equipment	145,803	(20,660)
Capitalization of servicing assets	(672,316)	(254,737)
Decrease in fair value of servicing assets	10,782	21,365
Effect of changes in operating assets and liabilities:		
Loans held-for-sale	(6,277,752)	807,312
Accrued interest receivable	95,033	(246,722)
Other assets	(38,323)	(842,463)
Accrued expenses and other liabilities	1,035,570	439,977
Net cash provided by operating activities	9,631,810	12,500,122
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from repayments or maturity of available-for-sale securities	93,805,756	82,748,964
Purchases of available-for-sale securities	(203,273,981)	(228,676,474)
Decrease in deposits in corporate credit union accounts	-	134,000,000
Proceeds from maturity of certificates of deposit	200,000	-
Purchases of certificates of deposit	(2,700,000)	-
Decrease in other investments	145,234	-
Increase in Federal Home Loan Bank stock	(1,481,400)	(876,900)
Loans to members, net of principal collections	(1,072,918)	(15,037,375)
Proceeds from sale of foreclosed assets	1,094,157	2,003,044
Increase in NCUSIF deposit	(652,388)	(144,643)
Purchases of life insurance policies	(9,250,000)	-
Proceeds from sale of premises and equipment	-	507,011
Purchases of premises and equipment	(1,466,658)	(2,538,664)
Net cash used in investing activities	(124,652,198)	(28,015,037)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share and savings accounts	61,946,647	26,398,680
Proceeds received on borrowed funds	-	5,000,000
Payments made on borrowed funds	(1,500,000)	(2,500,000)
Net cash provided by financing activities	60,446,647	28,898,680

ORANGE COUNTY'S CREDIT UNION
STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended December 31, 2012 and 2011

	2012	2011
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ (54,573,741)	$ 13,383,765
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	135,438,915	122,055,150
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 80,865,174	$ 135,438,915
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for interest:		
Dividends on members' share and savings accounts	$ 4,077,663	$ 5,586,996
Interest on borrowed funds	550,988	546,158
Total	$ 4,628,651	$ 6,133,154
Non-cash transactions:		
Transfers from loans to foreclosed assets	$ -	$ 1,821,525
Increase in cash surrender value of life insurance policies	$ 653,148	$ 294,688

The accompanying notes are an integral part of the financial statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations
Orange County's Credit Union is a state chartered credit union organized under the provisions of the California Credit Union Act and administratively responsible to the California Department of Financial Institutions. The primary purpose is to promote thrift among, and create a source of credit for its members. Participation in the Credit Union is limited to those individuals that qualify for membership. The field of membership is defined in the Credit Union's Charter and Bylaws. The Credit Union's primary source of revenue is providing loans to its members.

Use of Estimates in Preparing Financial Statements
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant Group Concentrations of Credit Risk
The Credit Union provides a variety of financial services to its members, most of whom live, work, or worship in Orange County, California and Riverside County, California. The Credit Union may be exposed to credit risk from a regional economic standpoint because of significant concentration of its borrowers work or reside in the state of California. The financial deterioration resulting from the economic conditions in this region have resulted in significant loan losses and declines in fair value of investments for the Credit Union and those with whom it does business, including corporate credit unions. The Credit Union continually monitors the Credit Union's operations, including the loan and investment portfolios, for potential impairment.

However, the loan portfolio is well diversified and the Credit Union does not have any significant concentrations of credit risk except for member business, residential real estate and consumer – auto loans. The Credit Union's policy for repossessing collateral is that when all other collection efforts have been exhausted, the Credit Union enforces its first lien holder status and repossesses the collateral. The Credit Union has full and complete access to repossessed collateral. Repossessed collateral normally consists of vehicles and residential and commercial real estate.

Cash and Cash Equivalents
For purposes of the statements of financial condition and the statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from financial institutions, and highly liquid debt instruments with original maturities of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

Investment Securities
Debt and equity securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost, adjusted for amortization of premiums and accretion of discounts. Securities not classified as held-to-maturity or trading, including debt and equity securities with readily determinable fair values, 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 (loss).

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Securities (Continued)
The Credit Union evaluates debt and equity securities for other-than-temporary impairment (OTTI), at least quarterly. This guidance specifies that (a) if the Credit Union does not have the intent to sell a debt security prior to recovery and (b) it is more-likely-than-not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When the Credit Union does not intend to sell the security and it is more-likely-than-not the Credit Union will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an OTTI of a debt security in earnings and the remaining portion in other comprehensive income (loss). For held-to-maturity debt securities, the amount of OTTI recorded in other comprehensive income (loss) for the noncredit portion of a previous OTTI should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

The Credit Union's statements of income reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Credit Union intends to sell or would more-likely-than-not be required to sell before the expected recovery of the amortized cost basis. The credit component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected on cash flow projections.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. The Credit Union does not maintain a trading or held-to-maturity portfolio. Other investments are classified separately, stated at cost and subject to OTTI evaluation.

Federal Home Loan Bank Stock
The Credit Union, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its membership assets or 4.7% of advances from the FHLB. There is no ready market value for the FHLB stock; therefore, it has no quoted market value and is reported on the statements of financial position at cost. The Credit Union considered the long-term nature of this investment and the intent and ability to hold this investment for a period of time sufficient to recover the recorded investment and determined it was not impaired at December 31, 2012 and 2011.

Loans Held-For-Sale
Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. All sales are made without recourse.

Loans to Members
The Credit Union grants mortgage, member business and consumer loans to members and purchases loan participations. A substantial portion of the loan portfolio is represented by member business, residential real estate and consumer – auto loans to members. A substantial portion of its members' ability to honor their loan agreements is dependent upon the real estate and economic stability of the various groups comprising the Credit Union's field of membership.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans to Members (Continued)

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

The accrual of interest on loans is discontinued at the time a loan is 60 days delinquent. Consumer loans are typically charged-off no later than 180 days past due. Loans may be charged-off at an earlier date if collection of principal or interest is considered doubtful. Past due loan status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if management believes, after considering economic conditions, business conditions, and collection efforts, that collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method (first mortgage loans) and the effective yield method, which approximates the interest method (all other loan types) over the contractual life of the loans, adjusted for estimated prepayments based on the Credit Union's historical prepayment experience.

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 uncollectability of a loan balance is confirmed. 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 collectability 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 any 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses (Continued)
The Credit Union's allowance for loan losses is that 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 distribution of the portfolios, the impact of current internal and external influences on credit loss and the levels of nonperforming loans. 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 in terms of loan type. The qualitative factors associated with the allowances are subjective and require a high degree of management judgment. Specific allowances for loan losses are established for large non-homogeneous impaired loans on an individual basis. The specific allowance established for these loans is based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flow, the loan's estimated market value, or the estimated fair value of the underlying collateral. These factors include the credit quality statistics, recent economic uncertainty, losses incurred from recent events, and lagging data.

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 and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for member business and residential real estate loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Credit Union does not separately identify individual consumer loans for impairment disclosures.

Servicing
Servicing assets are recognized separately when mortgage servicing rights are acquired through purchase or through sale of financial assets. Servicing rights resulting from the sale or securitization of loans originated by the Credit Union are initially measured at fair value at the date of transfer. The Credit Union measures servicing assets at fair value at each reporting date and report changes in fair value of servicing assets in earnings in the period of which the change occurs.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Servicing (Continued)
Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. These variables change from quarter to quarter as the market conditions and projected interest rates change, and may have an adverse impact on the value of the mortgage servicing right and may result in reduction to noninterest income.

Off-Balance Sheet Credit Related Financial Instruments
In the ordinary course of business, the Credit Union has entered into commitments to extend credit. Such financial instruments are recorded when they are funded.

Collateral in Process of Liquidation and Foreclosed Assets
Assets acquired through, or in lieu of, loan repossession or foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of repossession or foreclosure, establishing a new cost basis. Subsequent to repossession or 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 from operations and changes in the valuation allowance are included in net expenses.

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 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 maturity.

Premises and Equipment
Land is carried at cost. Buildings and improvements, furniture and equipment and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Buildings and improvements and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the terms of the related leases or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured.

Impairment of Long-Lived Assets
Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Management reviews all material assets annually for possible impairment. If such assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NCUSIF Deposit
The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with NCUA regulations, which require the maintenance of a deposit by each insured credit union in an amount equal to one percent of its insured shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA Board.

NCUSIF Insurance Premiums
A credit union is required to pay an annual insurance premium based on a percent of its total insured shares as declared by the NCUA Board, unless the payment is waived by the NCUA Board.

Members' Share and Savings Accounts
Members' share and savings accounts are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' share and savings accounts are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Interest rates on members' share and savings accounts are set by Management, based on an evaluation of current and future market conditions.

Members' Equity
The Credit Union is required, by regulation, to maintain a statutory regular reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of interest.

Income Taxes
The Credit Union is exempt, by statute, from federal and state income taxes.

The Credit Union is a tax-exempt entity under Internal Revenue Code 501(c)(14), but may be subject to taxation on income unrelated to the Credit Union's exempt function. State chartered credit unions should pay income tax on certain types of net taxable income from activities that taxing authorities consider unrelated to the purpose for which the Credit Union was granted non-taxable status. The Credit Union has filed UBIT returns (990-T) in the past, which has resulted in no income taxes paid for the years ended December 31, 2012 and 2011. In addition, there were no material uncertain tax positions at December 31, 2012 and 2011.

Pension Plan – 401(k)
The Credit Union has a qualified 401(k) plan covering substantially all of its employees.

Pension Plan – Deferred Compensation Plan
The Credit Union has a non-qualified deferred compensation plans for members of management.

Life Insurance Policies
Life insurance policies held as part of the Credit Union's deferred compensation plan are carried at their cash surrender value.

Advertising Costs
Advertising costs are charged to operations when incurred.

NOTE 1 – 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, are reported as a separate component of the members' equity section of the statements of financial condition. For 2012 and 2011, other comprehensive income (loss) includes no reclassification adjustments.

Fair Value Measurements
Fair value measurement standards provide a comprehensive framework for measuring fair value and expands disclosures for assets and liabilities reported at fair value. Specifically, it sets forth a definition of fair value and establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable value inputs.

Subsequent Events
Management evaluated subsequent events through March 18, 2013, the date the financial statements were available to be issued.

Reclassifications
Certain reclassifications have been made to the 2011 financial statement presentation to correspond to the current year's format. Total members' equity and net income are unchanged due to these reclassifications.

NOTE 2 – INVESTMENT SECURITIES

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

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ 122,060,801	$ 880,374	$ -	$ 122,941,175
Federal agency mortgage-backed securities	124,755,379	1,740,028	(76,956)	126,418,451
Federal agency collateralized mortgage obligations	94,452,552	1,555,489	(58,239)	95,949,802
Mutual funds	65,259,269	31,035	-	65,290,304
Municipal bonds	1,187,043	-	(9,443)	1,177,600
Total	$ 407,715,044	$ 4,206,926	$ (144,638)	$ 411,777,332

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ 142,884,577	$ 967,085	$ (12,019)	$ 143,839,643
Federal agency mortgage-backed securities	57,655,835	1,032,973	(374)	58,688,434
Federal agency collateralized mortgage obligations	91,426,263	1,113,870	(146,814)	92,393,319
Mutual funds	10,001,027	-	-	10,001,027
Total	$ 301,967,702	$ 3,113,928	$ (159,207)	$ 304,922,423

The mutual funds invest exclusively in U.S. government securities and related custodial receipts, repurchase agreements pertaining thereto, and short-term obligations.

At December 31, 2012 and 2011, securities valued at approximately $340,244,000 and $289,845,000, respectively, were pledged as collateral against a line of credit with the Federal Home Loan Bank. At December 31, 2012 and 2011, securities carried at approximately $4,075,000 and $4,208,000, respectively, were pledged as collateral against a line of credit with the Federal Reserve Bank.

The amortized cost and fair values of investment securities available-for-sale at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	$ 66,559,009	$ 66,869,306
Due in one year through five years	55,501,792	56,071,869
Due in five years through ten years	1,187,043	1,177,600
	123,247,844	124,118,775
Federal agency mortgage-backed securities	124,755,379	126,418,451
Federal agency collateralized mortgage obligations	94,452,552	95,949,802
Mutual funds	65,259,269	65,290,304
Total	$407,715,044	$411,777,332

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

Temporarily Impaired Investment Securities
Information pertaining to available-for-sale securities with gross unrealized losses at December 31, 2012, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position, are as follows:

	Less than 12 Months		Greater than 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Federal agency mortgage-backed securities	$ (76,956)	$ 25,161,482	$ -	$ -
Federal agency collateralized mortgage obligations	(33,110)	9,264,586	(25,129)	3,049,544
Municipal bonds	(9,443)	1,177,600	-	-
Total	$ (119,509)	$ 35,603,668	$ (25,129)	$ 3,049,544

Information pertaining to available-for-sale securities with gross unrealized losses at December 31, 2011, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position, are as follows:

	Less than 12 Months		Greater than 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ -	$ -	$ (12,019)	$ 6,125,587
Federal agency mortgage-backed securities	-	-	(374)	2,021,360
Federal agency collateralized mortgage obligations	-	-	(146,814)	21,024,622
Total	$ -	$ -	$ (159,207)	$ 29,171,569

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

Federal agency mortgage-backed securities and collateralized mortgage obligations. At December 31, 2012, the 15 debt securities with unrealized losses have depreciated 0.36% from the Credit Union's amortized cost basis. The unrealized losses are primarily driven by changes in interest rates. The Credit Union assesses for credit impairment using a cash flow model. Based on the assessment of the expected credit losses of the security given the performance of the underlying collateral compared to the credit enhancement, the Credit Union expects to recover the entire amortized cost basis of these securities.

Municipal bonds. At December 31, 2012, the one debt security with an unrealized loss has depreciated 0.80% from the Credit Union's amortized cost basis. The unrealized loss is primarily driven by higher projected collateral losses; wider credit spreads and changes in interest rates. The Credit Union assesses for credit impairment using a cash flow model. Based on the assessment of the expected credit losses of the security given the performance of the underlying collateral compared to the credit enhancement, the Credit Union expects to recover the entire amortized cost basis of this security.

In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

Other-Than-Temporary Impairment

The Credit Union routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an OTTI has occurred. Economic models are used to determine whether an OTTI has occurred on these securities. For each security in the investment portfolio (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine if an OTTI has occurred. Various inputs to the economic model are used to determine if an unrealized loss is other-than-temporary. Based on the assessment of the expected credit losses of the security given the performance of the underlying collateral compared to the credit enhancement, the Credit Union expects to recover the entire amortized cost basis of these securities; therefore, no OTTI is deemed necessary or reported for the years ended December 31, 2012 and 2011.

Investment Risk

Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the amounts reported in the statements of financial condition.

Other Investments

Other investment securities at December 31 are summarized as follows:

	2012	2011
Certificates of deposit	$ 4,700,000	$ 2,200,000
Investment in credit union service organizations	360,000	505,234
Total	$ 5,060,000	$ 2,705,234

NOTE 3 – LOANS TO MEMBERS

The composition of loans to members at December 31 is as follows:

	2012	**2011**
Member Business:		
Real estate	$ 121,208,362	$ 124,331,650
Residential Real Estate:		
1st mortgage	190,943,882	190,283,651
2nd mortgage	46,716,860	54,871,935
Consumer:		
Auto	112,598,260	104,025,332
Unsecured	28,777,689	28,402,030
Other secured	2,578,234	2,852,890
	502,823,287	504,767,488
Net deferred loan origination fees and costs	(273,515)	(231,592)
Allowance for loan losses	(10,803,462)	(11,485,306)
Total	$ 491,746,310	$ 493,050,590

The Credit Union has purchased loan participations originated by various entities that are secured by commercial property and other real estate to members of other credit unions. All of the loan participations were purchased without recourse and the originating entities perform all of the related loan servicing functions on these loans.

The composition of loan participations purchased at December 31 is as follows:

	2012	**2011**
Member business – real estate	$ 17,821,957	$ 22,203,719
Residential real estate – 1st mortgage	276,876	419,954
Total	$ 18,098,833	$ 22,623,673

In 2012, the Credit Union sold loan participations that are secured by commercial property. These loan participations were sold without recourse and the Credit Union performs all loan servicing functions on these loans. Loan participations sold and excluded from the member business – real estate loan segment above, totaled $3,821,041 at December 31, 2012. Servicing assets related to loan participations sold are included in other assets on the statement of financial condition and totaled $50,088 at December 31, 2012.

The Credit Union has non-traditional mortgage loans. These loans include hybrid and variable interest only mortgages. Hybrid loans consist of loans that are fixed for an initial period of three, five or seven years. After this period, the mortgages are converted to variable rates using an indexed rate, which can result in significant payment shock to the borrower. The interest only loans primarily result from troubled debt restructurings and allow the borrower to pay only interest for a specified number of years. These types of loans may result in a lack of principal amortization or even negative amortization, if the minimum payment is less than the interest accruing on the loan.

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Non-traditional 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 the additional risk. Non-traditional mortgage loans, which are included in the member business – real estate and residential real estate – 1st mortgage captions above, totaled approximately $57,248,000 and $62,373,000 at December 31, 2012 and 2011, respectively.

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the year ended December 31, 2012 are as follows:

Allowance for loan losses:	**Member Business**	**Residential Real Estate**	**Consumer**	**Total**
Beginning balance	$ 2,316,864	$ 6,640,371	$ 2,528,071	$ 11,485,306
Provision for loan losses	1,280,687	1,340,635	268,458	2,889,780
Charge-offs	(776,045)	(2,159,416)	(1,620,767)	(4,556,228)
Recoveries	-	474,401	510,203	984,604
Ending balance	$ 2,821,506	$ 6,295,991	$ 1,685,965	$ 10,803,462
Ending balance: Individually evaluated for impairment	$ 2,507,875	$ 2,851,008	$ -	$ 5,358,883
Ending balance: Collectively evaluated for impairment	313,631	3,444,983	1,685,965	5,444,579
Ending balance	$ 2,821,506	$ 6,295,991	$ 1,685,965	$ 10,803,462
Loans to members:				
Ending balance: Individually evaluated for impairment	$ 15,680,147	$ 20,036,459	$ -	$ 35,716,606
Ending balance: Collectively evaluated for impairment	105,528,215	217,624,283	143,954,183	467,106,681
Ending balance	$ 121,208,362	$ 237,660,742	$ 143,954,183	$ 502,823,287

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the year ended December 31, 2011 are as follows:

Allowance for loan losses:	**Member Business**	**Residential Real Estate**	**Consumer**	**Total**
Beginning balance	$ 1,903,728	$ 6,439,202	$ 4,130,933	$ 12,473,863
Provision for loan losses	718,497	2,486,846	441,079	3,646,422
Charge-offs	(305,361)	(2,571,989)	(2,331,441)	(5,208,791)
Recoveries	-	286,312	287,500	573,812
Ending balance	$ 2,316,864	$ 6,640,371	$ 2,528,071	$ 11,485,306
Ending balance: Individually evaluated for impairment	$ 1,966,288	$ 3,258,226	$ -	$ 5,224,514
Ending balance: Collectively evaluated for impairment	350,576	3,382,145	2,528,071	6,260,792
Ending balance	$ 2,316,864	$ 6,640,371	$ 2,528,071	$ 11,485,306
Loans to members:				
Ending balance: Individually evaluated for impairment	$ 17,089,451	$ 26,045,785	$ -	$ 43,135,236
Ending balance: Collectively evaluated for impairment	107,242,199	219,109,801	135,280,252	461,632,252
Ending balance	$ 124,331,650	$ 245,155,586	$ 135,280,252	$ 504,767,488

Member Business Loan Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Credit Union's member business loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk ratings of member business loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans, and (v) the general economic conditions in the market area.

The Credit Union utilizes a risk rating matrix to assign risk ratings to each of its member business loans. Loans are rated on a scale of 1 to 8. A description of the 8 risk ratings is presented in the matrix as follows:

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Rating	Financial Condition	Combined Earnings	Collateral	Management	Industry Outlook
1 Excellent - Pass (minimal risk)	Strong equity and liquidity with low leverage. Exceeds RMA or peer group standards	Strong earnings and cash flow trend. Substantial additional debt service capacity.	Significantly better than policy limits. Government guarantees of 75% or more.	Proven track record with adequate depth. Succession plan in place.	Outstanding performance ratios compared to peers. Industry may have modest cyclical qualities, but is generally stable.
2 Good - Pass (modest risk)	Good equity and liquidity. Consistent with RMA and peer group standards.	Satisfactory earnings and adequate cash flow. DSCR exceeds 1.5X	Better than policy limits with minimal reliance on receivables and inventory.	Satisfactory depth and experience. History of proper decision making.	Outlook is acceptable. May be somewhat vulnerable to sudden economic or technological change.
3 Acceptable - Pass (average risk)	Moderate leverage and adequate liquidity with stable trend.	Acceptable earnings and/or cash flow. Minimum DSCR of 1.25X	At policy limits with acceptable coverage ratios.	Acceptable experience and controls. Previous business decisions not always appropriate.	May be susceptible to unfavorable changes in the economy. Serious financial deterioration is the industry is unlikely.
4 Acceptable with Caution/Watch - Pass (developing risk)	Moderate leverage (debt/worth 3:1 or more) with declining trends. Falling liquidity.	Marginal profitability. Break-even or slightly negative cash flow. Minimum DSCR of 1.1X. Start-up operations.	Coverage below policy limits. Notable reliance on inventory.	Recent management or key person changes. Lack of succession plan.	Intensely competitive industry. Outlook is uncertain. Barriers to entry are declining. Market niche is increasingly competitive.
5 Special Mention (currently protected, but potentially weak, considerable risk)	Marginal liquidity and/or equity. Declining trends. Ratios below RMA and peer group standards. Borrower unwilling to provide info for current evaluation and existing info is outdated by two or more years.	Unstable performance and negative cash flow. Recent loss with modest impact on balance sheet.	Marginal collateral coverage with stale valuation or other uncertainties. Moderate reliance on inventory.	Inexperienced management. Lack of succession plan and potential ownership issues.	Outlook is questionable. Competition is fierce. Industry may be in start-up or long-term decline phase.
6 Substandard (high and well-defined risk of default)	Negative trends. Highly leveraged. Poor liquidity and equity. Significant intangibles and/or poor quality assets.	Material losses. Negative cash flow.	Insufficient coverage. Heavy reliance on inventory.	Management weaknesses. Pattern of poor business decisions.	Industry has problems which may adversely affect majority of participants. Borrower ranks in bottom of industry.
7 Doubtful (extremely high risk of loss)	Negative net worth.	Significant negative cash flow.	Collection in full is highly improbable.	Significant weaknesses. Adversarial bank/borrower relationship.	Severe permanent industry problems exist.
8 Loss	Principal uncollectible.	Principal uncollectible.	Principal uncollectible.	Principal uncollectible.	Principal uncollectible.

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Member Business Credit Exposure:
The member business loan credit risk profile by internally assigned risk ratings by class at December 31 is as follows:

Real Estate	**2012**	**2011**
Pass	$105,528,215	$108,034,457
Special mention	4,962,084	6,036,682
Substandard	8,957,368	10,260,511
Doubtful	1,760,695	-
Loss	-	-
Total	$121,208,362	$124,331,650

Residential Real Estate and Consumer Loan Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Credit Union's residential real estate and consumer loan portfolios, management tracks certain credit quality indicators based on if these loans are performing or non-performing. To differentiate these categories, management tracks the loans performance and when the loan becomes 60 days past due these are classified as non-performing loans.

Residential Real Estate Credit Exposure:
The residential real estate credit risk profile based on payment activity by class at December 31 is as follows:

2012	**1st Mortgage**	**2nd Mortgage**	**Total**
Performing	$ 186,477,452	$ 46,511,419	$ 232,988,871
Non-performing	4,466,430	205,441	4,671,871
Total	$ 190,943,882	$ 46,716,860	$ 237,660,742
2011			
Performing	$ 183,470,446	$ 54,218,565	$ 237,689,011
Non-performing	6,813,205	653,370	7,466,575
Total	$ 190,283,651	$ 54,871,935	$ 245,155,586

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Consumer Credit Exposure:
The consumer loan credit risk profile based on payment activity by class at December 31 is as follows:

2012	**Auto**	**Unsecured**	**Other Secured**	**Total**
Performing	$112,256,670	$ 28,584,399	$ 2,578,234	$143,419,303
Non-performing	341,590	193,290	-	534,880
Total	$112,598,260	$ 28,777,689	$ 2,578,234	$143,954,183
2011				
Performing	$103,871,780	$ 27,467,501	$ 2,852,890	$134,192,171
Non-performing	153,552	934,529	-	1,088,081
Total	$104,025,332	$ 28,402,030	$ 2,852,890	$135,280,252

Information concerning impaired loans by loan class as of December 31, 2012 is as follows:

	Unpaid Principal Balance	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no specific reserve recorded:				
Member Business:				
Real estate	$ 3,802,638	$ -	$ 6,499,720	$ 201,848
Residential Real Estate:				
1st mortgage	5,003,632	-	3,561,719	236,535
2nd mortgage	953,420	-	791,018	25,437
Total	$ 9,759,690	$ -	$ 10,852,457	$ 463,820
With specific reserve recorded:				
Member Business:				
Real estate	$ 11,877,509	$ 2,507,875	$ 9,885,079	$ 471,554
Residential Real Estate:				
1st mortgage	13,137,955	2,571,845	17,493,982	473,753
2nd mortgage	941,452	279,163	1,194,404	19,732
Total	$ 25,956,916	$ 5,358,883	$ 28,573,465	$ 965,039
Member business	$ 15,680,147	$ 2,507,875	$ 16,384,799	$ 673,402
Residential real estate	20,036,459	2,851,008	23,041,123	755,457
Total	$ 35,716,606	$ 5,358,883	$ 39,425,922	$ 1,428,859

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Information concerning impaired loans by loan class as of December 31, 2011 is as follows:

	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded:				
Member Business:				
Real estate	$ 9,196,802	$ -	$ 7,279,199	$ 495,985
Residential Real Estate:				
1st mortgage	2,119,806	-	1,958,428	132,740
2nd mortgage	628,615	-	587,030	26,961
Total	$ 11,945,223	$ -	$ 9,824,657	$ 655,686
With specific reserve recorded:				
Member Business:				
Real estate	$ 7,892,649	$ 1,966,288	$ 7,660,250	$ 349,121
Residential Real Estate:				
1st mortgage	21,850,009	2,929,777	20,700,309	781,190
2nd mortgage	1,447,355	328,449	2,005,759	30,410
Total	$ 31,190,013	$ 5,224,514	$ 30,366,318	$ 1,160,721
Member business	$ 17,089,451	$ 1,966,288	$ 14,939,449	$ 845,106
Residential real estate	26,045,785	3,258,226	25,251,526	971,301
Total	$ 43,135,236	$ 5,224,514	$ 40,190,975	$ 1,816,407

The recorded investment in impaired loans approximates the amount reported as unpaid impaired loan balances as of December 31, 2012 and 2011.

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

A summary of non-accrual loans by class at December 31 is as follows:

	2012	2011
Member Business:		
Real estate	$ 347,372	$ 1,232,625
Residential Real Estate:		
1st mortgage	4,466,430	6,813,205
2nd mortgage	205,441	653,370
Consumer:		
Auto	341,590	153,552
Unsecured	193,290	934,529
Total	$ 5,554,123	$ 9,787,281
Foregone interest on non-accrual loans	$ 288,718	$ 313,122

A summary of past due loans by class as of December 31 is as follows:

2012	30-59 Days	60-90 Days	Greater than 90 Days	Total Past Due	Current	Total Loans to Members
Member Business:						
Real estate	$ -	$ -	$ 347,372	$ 347,372	$ 120,860,990	$ 121,208,362
Residential Real Estate:						
1st mortgage	760,465	111,411	4,355,019	5,226,895	185,716,987	190,943,882
2nd mortgage	271,206	67,155	138,286	476,647	46,240,213	46,716,860
Consumer:						
Auto	967,813	197,174	144,416	1,309,403	111,288,857	112,598,260
Unsecured	282,794	78,808	114,482	476,084	28,301,605	28,777,689
Other secured	-	-	-	-	2,578,234	2,578,234
Total	$ 2,282,278	$ 454,548	$ 5,099,575	$ 7,836,401	$ 494,986,886	$ 502,823,287
2011						
Member Business:						
Real estate	$ -	$ -	$ 1,232,625	$ 1,232,625	$ 123,099,025	$ 124,331,650
Residential Real Estate:						
1st mortgage	749,382	2,960,429	3,852,776	7,562,587	182,721,064	190,283,651
2nd mortgage	299,574	119,726	533,644	952,944	53,918,991	54,871,935
Consumer:						
Auto	1,043,840	153,552	-	1,197,392	102,827,940	104,025,332
Unsecured	554,887	934,529	-	1,489,416	26,912,614	28,402,030
Other secured	-	-	-	-	2,852,890	2,852,890
Total	$ 2,647,683	$ 4,168,236	$ 5,619,045	$12,434,964	$ 492,332,524	$ 504,767,488

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

The Credit Union had no loans that were greater than 60 days past-due for which the loans were accruing interest at December 31, 2012 and 2011.

A summary of loan troubled debt restructurings by class that were granted during the years ended December 31 are as follows:

2012	Number of Contracts	Pre-Modification Outstanding Balance	Post-Modification Outstanding Balance
Troubled Debt Restructurings:			
Member Business:			
Real estate	2	$ 818,118	$ 818,118
Residential Real Estate:			
1st mortgage	6	1,876,986	1,876,986
2nd mortgage	2	114,973	114,973
Consumer:			
Auto	55	587,590	587,590
Total	65	$ 3,397,667	$ 3,397,667

2011	Number of Contracts	Pre-Modification Outstanding Balance	Post-Modification Outstanding Balance
Troubled Debt Restructurings:			
Member Business:			
Real estate	3	$ 4,818,247	$ 4,818,247
Residential Real Estate:			
1st mortgage	9	3,364,491	3,364,491
2nd mortgage	9	579,003	579,003
Consumer:			
Auto	58	570,739	570,739
Unsecured	18	104,923	104,923
Total	97	$ 9,437,403	$ 9,437,403

NOTE 3 – LOANS TO MEMBERS (CONTINUED)

Management has defined that a troubled debt restructured loan is considered in default when it becomes 60 days past due. A summary of loan troubled debt restructurings by class that were granted and subsequently defaulted during the years ended December 31 are as follows:

2012	Number of Contracts	Recorded Investment
Troubled Debt Restructurings that Subsequently Defaulted:		
Consumer:		
Auto	3	$ 22,079

2011	Number of Contracts	Recorded Investment
Troubled Debt Restructurings that Subsequently Defaulted:		
Residential Real Estate:		
1st mortgage	1	$ 404,145
2nd mortgage	3	216,476
Total	4	$ 620,621

NOTE 4 – LOAN SERVICING

The Credit Union sells 1st mortgage residential real estate loans on the secondary market and retains the servicing. Loans serviced for others are not included in the accompanying statements of financial condition. The unpaid principal balances of 1st mortgage residential real estate loans serviced for others were $126,828,531 and $31,232,682 at December 31, 2012 and 2011, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing were $561,346 and $434,308 at December 31, 2012 and 2011, respectively.

Servicing assets are included in other assets on the statements of financial condition and totaled $894,906 and $233,372 at December 31, 2012 and 2011, respectively. At December 31, 2012, the fair value of servicing rights was determined using a discount rate of 7.50%, annual inflation rate of 2.30%, and projected prepayment speeds (PSAs) ranging from 396 to 436, depending upon the stratification of the specific right. At December 31, 2011, the fair value of servicing rights was determined using a discount rate of 7.50%, annual inflation rate of 2.50%, and projected prepayment speeds (PSAs) ranging from 361 to 530, depending upon the stratification of the specific right.

NOTE 4 – LOAN SERVICING (CONTINUED)

Following is an analysis of the changes in servicing assets subsequently measured using the fair value measurement method by class at December 31, 2012:

Statement of Financial Condition Disclosures	**10-year & Balloons Servicing Assets**	**15-year Servicing Assets**	**20-year Servicing Assets**	**30-year Servicing Assets**	**Total**
Fair value as of the beginning of the Period	$ -	$ 81,799	$ 2,835	$ 148,738	$ 233,372
Additions:					
Servicing obligations that result from transfers of financial assets	4,389	91,777	7,945	568,205	672,316
Change in fair value:					
Due to change in valuation inputs or assumptions used in valuation model	792	(497)	481	(11,558)	(10,782)
Fair value as of the end of the period	$ 5,181	$ 173,079	$ 11,261	$ 705,385	$ 894,906

Following is an analysis of the changes in servicing assets subsequently measured using the fair value measurement method by class at December 31, 2011:

Statement of Financial Condition Disclosures	**15-year Servicing Assets**	**20-year Servicing Assets**	**30-year Servicing Assets**	**Total**
Fair value as of the beginning of the period	$ -	$ -	$ -	$ -
Additions:				
Servicing obligations that result from transfers of financial assets	84,028	3,240	167,469	254,737
Change in fair value:				
Due to change in valuation inputs or assumptions used in valuation model	(2,229)	(405)	(18,731)	(21,365)
Fair value as of the end of the period	$ 81,799	$ 2,835	$ 148,738	$ 233,372

NOTE 5 – PREMISES AND EQUIPMENT

Premises and equipment at December 31 is summarized as follows:

	2012	2011
Land	$ 4,853,742	$ 4,853,742
Buildings and improvements	17,955,825	17,938,834
Furniture and equipment	4,459,303	4,439,831
Computer equipment	6,205,871	4,185,044
Leasehold improvements	3,401,961	3,772,005
Projects-in-process	-	1,170,401
	36,876,702	36,359,857
Accumulated depreciation and amortization	(14,408,865)	(13,508,951)
Total	$ 22,467,837	$ 22,850,906

Depreciation and amortization expense amounted to $1,703,924 and $1,586,095 for the years ended December 31, 2012 and 2011, respectively.

NOTE 6 – LEASE COMMITMENTS

The Credit Union leases certain office facilities under noncancelable operating leases expiring in various years through August 2018. Some of the leases contain renewal options for periods from three to five years at their fair rental value at the time of renewal. Future minimum lease payments under these leases are as follows:

Years Ending December 31,	
2013	$ 697,409
2014	553,406
2015	496,437
2016	268,463
2017	183,980
Thereafter	75,320
Future minimum lease payments	$ 2,275,015

Minimum lease payments exclude rentals under renewal options, which, as of December 31, 2012, are not reasonably assured of being exercised.

Rent expense was approximately $735,000 and $825,000 for the years ended December 31, 2012 and 2011, respectively.

NOTE 7 – MEMBERS' SHARE AND SAVINGS ACCOUNTS

Members' share and savings accounts at December 31 are summarized as follows:

	2012	2011
Regular share accounts	$ 236,880,898	$ 197,605,505
Share draft accounts	149,997,755	133,586,202
Money market accounts	301,183,445	274,535,278
IRA share accounts	7,599,628	6,529,243
Total share accounts	695,661,726	612,256,228
Share and IRA certificates		
0.00% to 0.99%	173,188,012	172,314,266
1.00% to 1.99%	30,167,374	39,312,466
2.00% to 2.99%	25,042,411	28,010,702
3.00% to 3.99%	12,848,158	13,464,511
4.00% to 4.99%	2,298,187	3,329,550
5.00% to 5.99%	343,570	8,915,068
Total certificate accounts	243,887,712	265,346,563
Total members' share and savings accounts	$ 939,549,438	$ 877,602,791

Scheduled maturities of share and IRA certificates at December 31, 2012 are as follows:

Years Ending December 31,	
2013	$ 184,326,852
2014	24,840,997
2015	18,154,791
2016	9,780,841
2017	6,784,231
Total certificate accounts	$ 243,887,712

The aggregate amounts of members' share and savings accounts in denominations of $100,000 or more were approximately $435,542,000 and $391,567,000 at December 31, 2012 and 2011, respectively.

Overdrawn share accounts reclassified to other assets totaled $731,150 and $484,664 at December 31, 2012 and 2011, respectively.

The National Credit Union Insurance Fund (NCUSIF) insures members' shares and certain individual retirement accounts up to $250,000 as a result of an amendment approved by the House-Senate conference committee on regulatory overhaul in June 2010. The new law also requires NCUA to use the higher $250,000 standard maximum share insurance amount when making decisions about premiums and administering insurance deposit adjustments. The increase in share insurance coverage includes all account types, such as share drafts, money markets, shares, and certificates of deposit.

NOTE 8 – LINES OF CREDIT

The Credit Union maintains lines of credit (LOC) with the Federal Home Loan Bank of San Francisco (FHLB) and the Federal Reserve Bank of San Francisco (FRB) and formerly maintained a line of credit with Western Bridge Corporate Federal Credit Union (WesCorp) as described below:

December 31, 2012	FHLB	FRB	Total Lines
Total available	$ 506,272,468	$ 3,992,961	$510,265,429
Borrowed	(15,750,000)	-	(15,750,000)
Remaining available	$ 490,522,468	$ 3,992,961	$494,515,429
Term	LOC	LOC	
Weighted average rate	3.17%	N/A	

December 31, 2011	WesCorp Settlement	FHLB	FRB	Total Lines
Total available	$ 20,000,000	$455,121,298	$ 4,117,891	$479,239,189
Borrowed	-	(17,250,000)	-	(17,250,000)
Remaining available	$ 20,000,000	$437,871,298	$ 4,117,891	$461,989,189
Term	LOC	LOC	LOC	
Weighted average rate	N/A	3.30%	N/A	

The FHLB line is collateralized by available-for-sale securities held in safekeeping by the FHLB and certain member business real estate and residential real estate 1st and 2nd mortgage loans. The outstanding principle balance of real estate loans pledged as collateral to the FHLB totaled approximately $297,941,000 and $353,511,000 at December 31, 2012 and 2011, respectively. The FRB line of credit is collateralized by federal agency securities held in safekeeping by the FRB. The WesCorp settlement line was collateralized by substantially all of the Credit Union's assets, excluding assets pledged to secure other lines of credit as described above. This line was discontinued in 2012.

NOTE 9 – BORROWED FUNDS

Borrowed funds at December 31 are as follows:

	2012	2011
FHLB, fixed rate (3.17% and 3.30% weighted average rates at December 31, 2012 and 2011, respectively), secured, with various maturity dates	$ 15,750,000	$ 17,250,000

NOTE 9 – BORROWED FUNDS (CONTINUED)

Scheduled maturities of borrowed funds at December 31, 2012, are as follows:

Years Ending December 31,	
2013	$ 4,000,000
2014	-
2015	3,750,000
2016	2,250,000
2017	750,000
Thereafter	5,000,000
Total	$ 15,750,000

NOTE 10 – ADVERTISING

Advertising expense totaled approximately $1,046,000 and $829,000 for the years ended December 31, 2012 and 2011, respectively.

NOTE 11 – OFF-BALANCE SHEET ACTIVITIES

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

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

At December 31, the following financial instruments were outstanding whose contract amounts represent credit risk:

	2012	**2011**
Commitments to extend credit:		
Home-equity lines of credit	$ 35,230,488	$ 37,979,821
Credit cards	31,714,651	26,685,213
Line-of-credit loans	28,404,381	29,145,231
Overdraft protection program commitments	5,698,931	6,764,255
Member business loan commitments	1,475,665	176,730
Total	$ 102,524,116	$ 100,751,250

NOTE 11 – OFF-BALANCE SHEET ACTIVITIES (CONTINUED)

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Credit Union upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include consumer assets, residential real estate and member share balances.

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

NOTE 12 – CONTINGENCIES AND COMMITMENTS

Legal:
The Credit Union is periodically a party to various legal actions normally associated with financial institutions, the aggregate effect of which, in management's and legal counsel's opinion, would not be material to the Credit Union's financial condition.

Loans sold with recourse:
The Credit Union has implemented a mortgage program whereby some of its mortgage loans are sold on the secondary market. The Credit Union is subject to recourse on the loans sold under certain conditions as disclosed in the loan purchase agreements with the funding corporations.

NOTE 13 – CAPITAL REQUIREMENTS

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy regulations and the regulatory framework for Prompt Corrective Action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance-sheet items as calculated under generally accepted accounting principles. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

NOTE 13 – CAPITAL REQUIREMENTS (CONTINUED)

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the following table) of net worth (as defined in the regulations) to assets and RBNW ratios (as defined). As of December 31, 2012 and 2011, the Credit Union's RBNW requirement was 5.08% and 5.06%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6 percent. Management believes that, as of December 31, 2012, the Credit Union meets all capital adequacy requirements to which it is subject. No conditions or events have occurred since the calculation date that management believes has changed the Credit Union's category.

As of December 31, 2012, the most recent call reporting period, the NCUA has 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%. The Credit Union's actual capital amounts and ratios as of December 31, 2012 and 2011 are also presented in the table.

The Credit Union's actual capital amounts and ratios as of December 31, 2012 are as follows:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Net worth	$ 94,977,172	9.00%	$ 63,340,209	6.0%	$ 73,896,910	7.0%
Risk-based net worth requirement	$ 53,628,043	5.08%	N/A	N/A	N/A	N/A

Because the RBNW ratio of 5.08% is less than the net worth ratio of 9.00%, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the average of the three month-end balances over the calendar quarter option, as permitted by regulation.

The Credit Union's actual capital amounts and ratios as of December 31, 2011 are as follows:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Net worth	$ 87,511,132	8.90%	$ 58,996,553	6.0%	$ 68,829,311	7.0%
Risk-based net worth requirement	$ 49,753,759	5.06%	N/A	N/A	N/A	N/A

NOTE 14 – RELATED PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends credits to members of the Board of Directors, Supervisory Committee members and executive officers. The aggregate loans to related parties at December 31, 2012 and 2011 were approximately $3,762,000 and $3,605,000, respectively. Deposits from related parties at December 31, 2012 and 2011 amounted to approximately $2,060,000 and $1,368,000, respectively.

NOTE 15 – 401(k) RETIREMENT PLAN

The Credit Union provides a 401(k) employee benefit plan covering substantially all employees who have completed at least one year of service and met minimum age requirements. The Credit Union matches a portion of employees' wage reductions. Total pension expense under this plan was $964,702 and $885,914 for the years ended December 31, 2012 and 2011, respectively.

NOTE 16 – DEFERRED COMPENSATION PLANS

The Credit Union has a 457(b) non-qualified deferred compensation plan for members of management. The Credit Union makes discretionary contributions to the plan and employees are allowed to contribute to the plan. The deferred compensation accounts are shown as both assets and liabilities on the Credit Union's financial statements and are available to creditors in the event of the Credit Union's liquidation.

The Credit Union has a 457(f) non-qualified deferred compensation plan for members of management. The Credit Union contributes 100% of the funds to this plan. Under the terms of the plan, the participants are entitled to a specified amount if they remain employed by the Credit Union until a predetermined time. If these employees become fully disabled as defined in the agreement, accrued benefits are immediately payable. The benefits are subject to forfeiture if employment is terminated for cause as defined in the agreements. The deferred compensation accounts are shown as both assets and liabilities on the Credit Union's financial statements and are available to creditors in the event of the Credit Union's liquidation.

Life insurance policies pertaining to these plans were $17,399,574 and $7,496,426 as of December 31, 2012 and 2011, respectively. The deferred compensation payable, included in accrued expenses and other liabilities on the statements of financial condition was $1,051,434 and $522,824 as of December 31, 2012 and 2011, respectively. Deferred compensation expense was $493,571 and $119,389 for the years ended December 31, 2012 and 2011, respectively.

NOTE 17 – FAIR VALUES OF FINANCIAL INSTRUMENTS

Determination of Fair Value

The Credit Union uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Credit Union's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value measurements are to focus on an exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

The Credit Union groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgments or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value estimation.

NOTE 17 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

The following methods and assumptions were used by the Credit Union in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents: The carrying amounts of cash and cash equivalents approximate their fair value.

Available-For-Sale Securities: Market value technique is marked to market on a monthly basis, of which information is performed and provided on a monthly basis by Raymond James. Month end market prices are obtained through the Raymond James report folio investment accounting service. Raymond James obtains their market values from Reuters. Reuters methodology for the valuation of U.S. government and federal agency securities is based on an OAS model, which includes the LIBOR/Swap forward curve, credit spreads and interest rate volatilities. The valuation of seasoned federal agency mortgage-backed securities and collateralized mortgage obligations pools is based on market makers and live trading systems. The valuation of federal agency mortgage-backed securities and collateralized mortgage obligations adjustable rate mortgages are based on the bond equivalent effective margin. These figures are validated by comparing Raymond James results to the primary safekeeper, Federal Home Loan Bank.

Other Investment Securities: The carrying amounts of other investment securities approximate their fair value.

Federal Home Loan Bank Stock: The carrying amount of the FHLB stock approximates the fair value.

Loans Held-for-Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate.

Loans to Members: For variable-rate loans that reprice frequently and have no significant change in the credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one-to-four family residential), credit-card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics; or are based on estimated cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for business real estate and business loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral value, where appropriate.

Accrued Interest Receivable: Accrued interest receivable represents interest on loans and investments. The carrying amounts of accrued interest receivable approximate their fair value.

Foreclosed Assets: The fair value of foreclosed assets is generally based on recent real estate appraisals, less estimated costs to sell. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available.

NOTE 17 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

Members' Share and Savings Accounts: The fair values disclosed for share draft, regular savings and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term share certificates approximate their fair values at the reporting date. Fair values for fixed-rate shares and share certificates are estimated using a discounted cash flow calculation that applies interest rates currently being offered on share certificates to a schedule of aggregated expected monthly maturities on shares and certificates.

Borrowed Funds: The carrying amounts of borrowed funds maturing within 90 days approximate their fair values. Fair values of other borrowed funds are estimated using discounted cash flow analyses based on the Credit Union's current incremental borrowing rates for similar types of borrowing arrangements.

Commitments to Extend Credit: The estimated fair value of the commitments to extend credit represents the potential unfunded commitments under such lines-of-credit.

Assets and Liabilities Measured at Fair Value on a Recurring Basis
Assets and liabilities measured at fair value on a recurring basis at December 31, 2012 and 2011 are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
December 31, 2012	**Total Carrying Value**	**Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. government and federal agency securities	$ 122,941,000	$ -	$ 122,941,000	$ -
Federal agency mortgage-backed securities	126,418,000	-	126,418,000	-
Federal agency collateralized mortgage obligations	95,950,000	-	95,950,000	-
Mutual funds	65,290,000	65,290,000		-
Municipal bonds	1,178,000	-	1,178,000	-

NOTE 17 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

December 31, 2011	Total Carrying Value	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government and federal agency securities	$ 143,840,000	$ -	$ 143,840,000	$ -
Federal agency mortgage-backed securities	58,688,000	-	58,688,000	-
Federal agency collateralized mortgage obligations	92,393,000	-	92,393,000	-
Mutual funds	10,001,000	10,001,000	-	-

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Under certain circumstances the Credit Union makes adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following table presents the financial instruments carried on the statements of financial condition by caption and by level in the fair value hierarchy at December 31, 2012 and 2011 for which a nonrecurring change in fair value has been recorded:

	Carrying Value	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012				
Impaired loans with an allowance, net	$ 20,598,000	$ -	$ -	$ 20,598,000
December 31, 2011				
Impaired loans with an allowance, net	$ 25,965,000	$ -	$ -	$ 25,965,000
Foreclosed assets	1,159,000	-	-	1,159,000

NOTE 17 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

The carrying values and estimated fair values of the Credit Union's financial instruments at December 31 are as follows:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSETS				
Cash and cash equivalents	$ 80,865,174	$ 80,865,000	$ 135,438,915	$ 135,439,000
Investment securities:				
Available-for-sale	411,777,332	411,777,000	304,922,423	304,922,000
Other investments	5,060,000	5,060,000	2,705,234	2,705,000
FHLB stock	5,815,200	5,815,000	4,333,800	4,334,000
Loans held-for-sale	8,311,602	8,312,000	2,033,850	2,034,000
Loans to members, net of allowance for loan losses	491,746,310	500,673,000	493,050,590	516,223,000
Accrued interest receivable	2,527,624	2,528,000	2,622,657	2,623,000
FINANCIAL LIABILITIES				
Members' share and savings accounts:				
Share, drafts, and money market accounts	$ 695,661,726	$ 695,662,000	$ 612,256,228	$ 612,256,000
Certificate accounts	243,887,712	245,615,000	265,346,563	268,198,000
Borrowed funds	15,750,000	16,771,000	17,250,000	18,342,000
UNRECOGNIZED FINANCIAL INSTRUMENTS				
Commitments to extend credit	$ -	$ 102,524,000	$ -	$ 100,751,000