California Credit Union and Subsidiary

Consolidated Financial Statements

December 31, 2017

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Independent Auditor's Report

Board of Directors and Supervisory Committee
California Credit Union

We have audited the accompanying consolidated financial statements of California Credit Union (the credit union) and subsidiary, which comprise the consolidated statement of financial condition as of December 31, 2017, the consolidated statements of income, comprehensive income, members' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 controls relevant to the credit union's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the credit union's internal controls. 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 California Credit Union and subsidiary as of December 31, 2017, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Turner, Warren, Hwang + Conrad

Burbank, California
April 19, 2018

California Credit Union and Subsidiary

Consolidated Statement of Financial Condition

December 31, 2017

ASSETS	(in thousands)
Cash and cash equivalents	$ 253,191
Investments:	
Trading securities	9,845
Securities available for sale, at fair value	328,605
Securities held to maturity	580
Other	15,879
Loans held for sale	5,357
Loans receivable, net	2,147,551
Accrued interest receivable	8,226
Property and equipment, net of accumulated depreciation	120,355
Note receivable	7,290
National Credit Union Share Insurance Fund (NCUSIF) deposit	22,962
Goodwill	23,115
Other assets	88,338
Total assets	$ 3,031,294

LIABILITIES AND MEMBERS' EQUITY	
Liabilities:	
Members' share accounts	$ 2,517,867
Borrowed funds	140,000
Accrued expenses and other liabilities	70,850
Total liabilities	2,728,717
Members' equity:	
Regular reserve	16,459
Undivided earnings	157,826
Equity acquired in merger	167,986
Accumulated other comprehensive loss	(39,694)
Total members' equity	302,577
Total liabilities and members' equity	$ 3,031,294

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

CALIFORNIA CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF INCOME

YEAR ENDED DECEMBER 31, 2017

INTEREST INCOME		(in thousands)
Cash balances	$	2,289
Loans receivable		82,948
Investments		8,379
Total interest income		93,616
INTEREST EXPENSE		
Members' share accounts		6,649
Borrowed funds		1,467
Total interest expense		8,116
NET INTEREST INCOME		85,500
PROVISION FOR LOAN LOSSES		5,387
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES		80,113
NON-INTEREST INCOME		
Member fees and service charges		14,831
Interchange Income		9,832
Service income and other		3,689
Net gain on sale of loans		3,942
Net gain on sale of investments		69
Net real estate rental income		4,355
Total non-interest income		36,718
NON-INTEREST EXPENSE		
Compensation and benefits		55,732
Office occupancy		10,122
Other		35,565
Total non-interest expense		101,419
NET INCOME	$	15,412

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

CALIFORNIA CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED DECEMBER 31, 2017

	(in thousands)
NET INCOME	$ 15,412
OTHER COMPREHENSIVE LOSS	
Unrealized losses on securities available for sale:	
Unrealized holding losses arising during the year	(29)
Reclassification adjustment for net gain included in net income	(69)
	(98)
Defined benefit plan:	
Net loss recognized during the year	(5,778)
Amortization of periodic service cost and actuarial loss included in net periodic benefit cost	5,445
	(333)
Total other comprehensive loss	(431)
COMPREHENSIVE INCOME	$ 14,981

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

CALIFORNIA CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

YEAR ENDED DECEMBER 31, 2017

	Regular Reserve	Undivided Earnings	Equity Acquired in Merger	Accumulated Other Comprehensive Loss	Total
			(in thousands)		
Balance, December 31, 2016, as previously reported	$ 16,459	$ 143,801	$ -	$ (39,263)	$ 120,997
Prior period adjustment (Note 17)	-	(1,387)	-	-	(1,387)
Balance, December 31, 2016, restated	16,459	142,414	-	(39,263)	119,610
Comprehensive income:					
Net income	-	15,412	-	-	15,412
Other comprehensive loss	-		-	(431)	(431)
Total comprehensive income					14,981
Captial arising from acquisition of North Island Credit Union	-	-	167,986	-	167,986
Balance, December 31, 2017	$ 16,459	$ 157,826	$ 167,986	$ (39,694)	$ 302,577

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

CALIFORNIA CREDIT UNION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2017

	(in thousands)
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	$ 15,412
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	5,387
Gain on sale of loans	(3,942)
Gain on sale of investments	(69)
Gain on trading securities	(934)
Amortization of fair value adjustment of acquired loans	4,592
Amortization of deferred loan costs, net	404
Amortization of securities, net	2,793
Depreciation and amortization	7,456
Amortization of core deposit intangible	5,452
Net change in operating assets and liabilities:	
Loans held for sale	(717)
Accrued interest receivable	(683)
NCUSIF deposit	(1,272)
Other assets	(20,528)
Accrued expenses and other liabilities	6,670
Net cash provided by operating activities	20,021
CASH FLOWS FROM INVESTING ACTIVITIES	
Cash received from merger	137,717
Purchases of trading securities	(29)
Purchases of securities available for sale	(51,240)
Proceeds from sales, maturities and prepayments of securities available for sale	57,649
Proceeds from sales, maturities and prepayments of securities held to maturity	83
Net decrease in other investments	8,959
Net increase in loans receivable	(245,191)
Net decrease in note receivable	442
Proceeds from sale of loans	166,016
Purchases of property and equipment	(6,506)
Net cash provided by investing activities	67,900
CASH FLOWS FROM FINANCING ACTIVITIES	
Net increase in members' share accounts	108,822
Net cash provided by financing activities	108,822
NET INCREASE IN CASH AND CASH EQUIVALENTS	196,743
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	56,448
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 253,191
SUPPLEMENTAL CASH FLOW INFORMATION	
Interest paid on members' share accounts and borrowed funds	$ 8,010
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES	
Fair value of assets acquired in merger	$ 1,143,508
Fair value of liabilities assumed in merger	1,136,355

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization: California Credit Union (the credit union) is a state-chartered credit union organized under the California Credit Union Act. Membership in the credit union is limited to qualified individuals as defined in its charter and bylaws. The credit union's primary source of revenue is providing loans to members. The credit union conducts its operations through 24 branches located in Los Angeles County and San Diego County, California.

Field of Membership and Sponsor: Membership in the credit union is limited to those individuals who qualify under defined terms specified in the bylaws, including any employee of any public or private California school, community college, state college, university or their governing organizations (districts, regions, etc.), or any member of any organization affiliated with and recognized by said entities, and their successor organizations; or any and all persons who live, regularly work, currently attend school or currently worship in San Diego County, California, Orange County, California, or Riverside County, California, as well as any businesses, corporations and other legal entities in those counties.

Principles of Consolidation: The consolidated financial statements include the accounts of the credit union and its wholly owned subsidiary, California Members Title Insurance Company (CMTIC). CMTIC is 100% owner of California Members Title Company (CMTC). CMTC is engaged in the business of preparing title searches, title examinations, title reports, certificates or abstracts of title upon the basis of which a title insurer writes title policies. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Use of Estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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, mortgage servicing rights, the actuarial estimate of the defined benefit obligation and the fair value of financial instruments.

Fair Value: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, provides a framework for measuring fair value that requires an entity to determine fair value based on the exit price in the principal market for the asset or liability being measured. Fair value is defined as the exchange price that would be received on the measurement date to sell an asset or the price paid to transfer a liability in the principal or most advantageous market available to the entity in an orderly transaction between market participants. The guidance also establishes a three-level fair value hierarchy that describes the inputs used to measure assets and liabilities.

- Level 1 asset and liability fair values are based on quoted prices in active markets for identical assets and liabilities.
- Level 2 asset and liability fair values are based on observable inputs that include quoted market prices for similar assets or liabilities, quoted market prices that are not in an active market, or other inputs that are observable in the market and can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 assets and liabilities are financial instruments whose value is calculated by the use of pricing models and/or discounted cash flow methodologies, as well as financial instruments for which the determination of fair value requires significant management judgment or estimation.

The credit union's financial instruments and other accounts subject to fair value measurement and/or disclosure are summarized in Note 9.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents: For purposes of the consolidated statements of financial condition and cash flows, cash and cash equivalents include cash on hand and in banks and all highly liquid debt instruments with original maturities of three months or less.

Investments: Trading securities are measured at fair value as of the consolidated statement of financial condition date as they occur, with changes in fair value recognized in earnings. Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading, including 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.

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 available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the credit union to retain its investments in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date, and the costs of securities sold are determined using the specific-identification method.

Other investments are classified separately and stated at cost.

Federal Home Loan Bank (FHLB) Stock: The credit union, as a member of the FHLB of San Francisco system, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its membership asset value, subject to a cap of $15 million or 2.7% of advances from the FHLB. There is no ready market for the FHLB stock; therefore, it has no quoted market value and is reported on the consolidated statement of financial condition at cost.

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

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the credit union. Gains and losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying amount of the related mortgage loans sold.

Loans Receivable, Net: The credit union grants commercial, residential real estate and consumer loans to members and purchases U.S. government-guaranteed loans. The members' or borrowers' ability to honor their loan agreements is dependent upon the economic stability of the various groups that compose the credit union's field of membership and commercial real estate borrowers. Loans that the credit union has the intent and ability to hold for the foreseeable future are stated at unpaid principal balances, less an allowance for loan losses and net deferred loan origination fees and costs. Interest on loans is recognized over the term of the loan and calculated using the simple-interest method on principal amounts outstanding.

The accrual of interest on loans is discontinued at the time a loan is 90 days delinquent. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if management believes, after considering economic conditions, business conditions and collection efforts, that collection of principal or interest is considered doubtful.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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 commercial and residential real estate and vehicles.

Loan Origination Fees: Nonrefundable loan origination fees and certain direct costs associated with the origination or purchase of real estate loans are deferred and recognized over the seven-year life of the related loans as an adjustment of the loan's yield using the interest method.

Troubled Debt Restructurings (TDRs): In situations where, for economic or legal reasons related to a member's financial difficulties, the credit union grants a concession to a member for other than an insignificant period of time that the credit union would not otherwise consider, the related loan is classified as a TDR. The credit union strives to identify members in financial difficulty early and work with them to modify their loan to more affordable terms before it reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and avoid foreclosure or repossession of the collateral. In cases where the credit union grants a member new terms that provide for a reduction of interest or principal, the credit union measures any impairment on the restructuring using the methodology for individually impaired loans. Loans classified as TDRs are reported as impaired loans.

Allowance for Loan Losses: The credit union maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on ongoing monthly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and decreased by charge-offs when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Management develops and documents its systematic methodology for determining the allowance for loan losses by first dividing its portfolio into four segments: commercial, U.S. government guaranteed, residential real estate and consumer. The credit union further divides the portfolio segments into classes based on initial measurement attributes, risk characteristics or its method of monitoring and assessing credit risk. The commercial segment comprises commercial real estate loans. The classes within the residential real estate portfolio segment are first mortgage and home equity line of credit (HELOC) and other mortgage. The classes within the consumer portfolio segment are automobile, credit card and other consumer.

The allowance for loan losses is evaluated on a regular basis by management and is based on 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, the 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. 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 the information available to them at the time of their examinations.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The allowance for loan losses consists of the specific loan loss allowance for impaired loans and the general loan loss allowance. The credit union evaluates the residential real estate and consumer segments for impairment on a pooled basis, unless they represent TDRs, as part of the general loan loss allowance and evaluates the commercial segment individually. Impaired loans are subject to the specific loan loss allowance. Loans are considered impaired when the individual evaluation of current information regarding the borrower's financial condition, loan collateral and cash flows indicates that the credit union will be unable to collect all amounts due according to the contractual terms of the loan agreement, including interest payments. Impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or, as an expedient, at the loan's observable market price or the fair value of the collateral, less costs to sell, if the loan is collateral dependent.

A general loan loss allowance is provided on loans not specifically identified as impaired. The allowance is determined by pooling residential real estate, consumer and non-impaired commercial loans by portfolio class and applying a historical loss percentage to each class. The credit union's historical loss percentage may be adjusted for significant qualitative and environmental factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

The conditions evaluated for qualitative and environmental factors may include existing general economic and business conditions affecting the key lending areas and products of the credit union, credit quality trends and risk identification, collateral values, loan volumes, underwriting standards and concentrations, specific industry conditions within portfolio segments, recent loss experience in particular classes of the portfolio, and the duration of the current business cycle.

In estimating the allowance for loan losses, significant risk characteristics considered for the residential real estate segment were historical and expected future charge-offs, borrower's credit and property collateral. Significant characteristics considered for the commercial segment were type of property, geographical concentrations and risks, and individual borrower financial condition.

Loans Acquired in Merger: Loans that the credit union has acquired in merger are aggregated into pools with similar risk characteristics. For loans with evidence of credit deterioration, expected cash flows are estimated, and, if they are less than the carrying value, a credit risk discount is established. The credit union calculates the carrying values of the pools, effective yields, impairment and underlying loans based on actual and projected events. The excess of the expected cash flows is considered to be accretable yield and is recognized as interest income over the estimated life of the loans. The accretable yield may fluctuate due to changes in the timing and amounts of expected cash flows.

Property and Equipment: Land is carried at cost. Buildings, leasehold improvements, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the lesser of the useful life of the assets or the expected terms of the related leases.

Estimated useful lives of the assets are as follows:

Buildings	25–45 years
Furniture and equipment	3–5 years
Leasehold improvements	5 years

NCUSIF Deposit: The deposit in the NCUSIF is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each insured credit union in an amount equal to 1% of its insured shares. The deposit will be refunded to the credit union if its insurance coverage is terminated, if it converts insurance coverage to another source, or if the operations of the fund are transferred from the NCUA Board.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NCUSIF Insurance Premium and Temporary Corporate Credit Union Stabilization Fund (TCCUSF) Assessment: The credit union is required to pay an annual insurance premium and/or TCCUSF assessment based on a percentage of its total insured shares as declared by the NCUA Board, unless the payment is waived by the Board. The NCUA did not approve an assessment during the year ended December 31, 2017.

Goodwill: On March 1, 2017, the credit union merged with North Island Credit Union (NICU). The merger resulted in goodwill of $23,114,683. The amount represents the fair value of the acquired entity as a whole in excess of the fair value of the individual assets and liabilities. Goodwill is determined to have an indefinite useful life and is not amortized. Management reviews goodwill for impairment on an annual basis. If impairment is noted, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds its estimated fair value. See Note 16 for a discussion of the merger.

Other Real Estate Owned: Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations (assuming multiple properties are involved) are performed by management and property held for sale is carried at the lower of the new cost basis or fair value less costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less costs to sell. There is no other real estate owned as of December 31, 2017.

Loan Servicing: Servicing assets are recognized as separate assets initially measured at fair value when the credit union sells mortgage loans with servicing retained. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, discount rate, custodial earnings rate, inflation rate, ancillary income, prepayment speeds, and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

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 non-interest income when earned.

Servicing assets are evaluated for impairment based on the fair value of the rights as compared to amortized cost. Impairment is determined through stratifying servicing rights by predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the credit union later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to have been surrendered when (1) the assets have been isolated from the credit union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the credit union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Members' Share Accounts: Members' share accounts are the deposit accounts of the members of the credit union. Share ownership entitles a member to vote in the annual elections of the Board of Directors and on other credit union matters. Irrespective of the amount of shares owned, no member has more than one vote. Members' share accounts are subordinated to all other liabilities of the credit union upon liquidation. Interest on members' share accounts is based on available earnings at the end of an interest period and is not guaranteed by the credit union. Interest rates on members' share accounts are set by the Asset Liability Committee and ratified by the Board of Directors based on an evaluation of current and future market conditions.

Regular Reserve: The credit union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of interest.

Equity Acquired in Merger: Equity acquired in merger represents the aggregated entity value of NICU at acquisition, measured using a weighted approach that emphasizes probable future discounted cash flows (income approach) and takes into consideration guideline transaction and market value approaches.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale and defined benefit plan adjustments, are reported as separate components of the members' equity section on the consolidated statement of financial condition.

Accumulated other comprehensive loss consists of the following:

	(in thousands)
Net unrealized loss on securities available for sale	$ (2,978)
Unrecognized prior service cost of net actuarial loss of defined benefit plan	(36,716)
	$ (39,694)

Income Taxes: The credit union is exempt by statute from federal income taxes under the provisions of Section 501 of the Internal Revenue Code of 1986 and from state income taxes; however, the credit union is subject to taxes on unrelated business income as further discussed in Note 8.

Recent Accounting Pronouncement: On March 30, 2017, the FASB published Accounting Standards Update (ASU) No. 2017-08—*Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. This new guidance shortens the amortization period for certain callable debt securities held at a premium. The amendments in ASU No. 2017-08 require the premium to be amortized to the earliest call date. There is no required change for securities held at a discount, and the discount continues to be amortized to maturity.

For public entities, the amendments in ASU No. 2017-08 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts ASU No. 2017-08 in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes the interim period. The amendments should be applied on a modified retrospective basis through a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption, and an entity should provide disclosures about a change in accounting principle in the period of adoption. The credit union does not anticipate that ASU No. 2017-08 will have a material impact on its consolidated financial statements.

Subsequent Events: Subsequent events have been evaluated through April 19, 2018, which is the date the consolidated financial statements were available to be issued.

NOTE 2 – INVESTMENTS

The estimated fair value of trading securities is as follows:

	(in thousands)
Mutual funds	$ 9,845

The net realized and unrealized gains recognized on trading securities amounted to approximately $934,000 during the year ended December 31, 2017.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
Federal agency securities	$ 119,936	$ 99	$ (1,448)	$ 118,587
Mortgage-backed securities	152,879	77	(1,164)	151,792
Collateralized mortgage obligations	58,523	10	(547)	57,986
Negotiable certificates of deposit	245	-	(5)	240
	$ 331,583	$ 186	$ (3,164)	$ 328,605

The weighted average yield on securities available for sale was 2.21% at December 31, 2017.

The amortized cost and fair value of securities held to maturity are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
Federal agency securities	$ 2	$ -	$ -	$ 2
Mortgage-backed securities	578	2	-	580
	$ 580	$ 2	$ -	$ 582

The weighted average yield on securities held to maturity was 2.22% at December 31, 2017.

Gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2017 are as follows:

	Less Than 12 Months		12 Months or Longer		Total	
Available for Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(in thousands)			
Federal agency securities	$ 43,789	$ (336)	$ 53,008	$ (1,112)	$ 96,797	$ (1,448)
Mortgage-backed securities	103,479	(730)	25,113	(434)	128,592	(1,164)
Collateralized mortgage obligations	47,040	(547)	-	-	47,040	(547)
Negotiable certificates of deposit	-	-	240	(5)	240	(5)
	$ 194,308	$ (1,613)	$ 78,361	$ (1,551)	$ 272,669	$ (3,164)

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the credit union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

NOTE 2 – INVESTMENTS (CONTINUED)

As of December 31, 2017, 12 federal agency securities, 32 mortgage-backed securities and 21 collateralized mortgage obligation have been in a continuous unrealized loss position for less than 12 months; 9 federal agency securities and 9 mortgage-backed securities have been in a continuous unrealized loss position for 12 months or longer. The unrealized losses associated with these investments are considered temporary, as the credit union has both the intent and ability to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value.

Other investments consist of the following:

	(in thousands)
Share certificates at other credit unions	$ 200
Perpetual contributed capital in a corporate credit union	1,500
FHLB stock	14,179
	$ 15,879

Share certificates are generally non-negotiable and non-transferable and may incur substantial penalties for withdrawal prior to maturity.

The weighted average yield on share certificates was 0.10% at December 31, 2017. The weighted average yield on perpetual contributed capital was 0.75% at December 31, 2017.

The amortized cost and fair value of investments by contractual maturity at December 31, 2017 are shown below. Because borrowers may prepay obligations with or without call or prepayment penalties, the expected maturities of mortgage-backed securities and collateralized mortgage obligations may differ from the contractual maturities. Mortgage-backed securities and collateralized mortgage obligations are therefore classified with no specific maturity date.

	Available for Sale		Held to Maturity		
Maturity	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Other
			(in thousands)		
No contractual maturity	$ -	$ -	$ -	$ -	$ 15,679
Less than one year	160	160	2	2	200
Due in one to five years	11,135	11,046	-	-	-
Due in five to ten years	5,929	5,879	-	-	-
Due in more than ten years	102,957	101,742	-	-	-
	120,181	118,827	2	2	15,879
Mortgage-backed securities	152,879	151,792	578	580	-
Collateralized mortgage obligations	58,523	57,986	-	-	-
	$ 331,583	$ 328,605	$ 580	$ 582	$ 15,879

NOTE 3 – LOANS RECEIVABLE, NET

Total loans outstanding by portfolio segment and class of loan are as follows:

	(in thousands)
Commercial:	
Commercial real estate	$ 277,940
U.S. government guaranteed	136,721
Residential real estate:	
First mortgage	896,537
HELOC and other mortgage	329,433
	1,225,970
Consumer:	
Automobile	396,105
Credit card	54,454
Other consumer	80,357
	530,916
Total loans	2,171,547
Interest rate discount	(11,246)
Credit risk discount	(4,606)
Allowance for loan losses	(8,144)
Total loans, net	$ 2,147,551

Loans include the loans acquired in the business combination for which nonaccretable and accretable yields were recorded. The following table provides additional information about these loans and the associated approximate amounts as of December 31, 2017:

	Loans Receivable	Nonaccretable Balance Outstanding	Accretable Yield Outstanding	Carrying Amount of Loans Receivable
		(in thousands)		
Commercial real estate	$ 124,127	$ 394	$ 808	$ 122,925
First mortgage	300,040	1,369	6,679	291,992
HELOC and other mortgage	117,094	361	1,944	114,789
Automobile	145,265	1,085	2,452	141,728
Credit card	19,351	1,132	(553)	18,772
Other consumer	15,160	265	(84)	14,979
	$ 721,037	$ 4,606	$ 11,246	$ 705,185

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

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

	Commercial	U.S. Government Guaranteed	Residential Real Estate	Consumer	Total
			(in thousands)		
Allowance for loan losses:					
Beginning balance	$ 484	$ -	$ 2,814	$ 2,695	$ 5,993
Charge-offs	(85)	-	(60)	(5,075)	(5,220)
Provision (credit) for loan losses	139	-	(2,069)	7,317	5,387
Recoveries	70	-	962	952	1,984
Ending balance	$ 608	$ -	$ 1,647	$ 5,889	$ 8,144
Individually evaluated for impairment	$ 594	$ -	$ 1,584	$ -	$ 2,178
Collectively evaluated for impairment	14	-	63	5,889	5,966
Ending balance	$ 608	$ -	$ 1,647	$ 5,889	$ 8,144
Recorded investment in loans:					
Individually evaluated for impairment	$ 13,029	$ -	$ 19,826	$ 1	$ 32,856
Collectively evaluated for impairment	257,394	136,721	1,124,214	459,780	1,978,109
Loans acquired with deteriorated credit quality	7,517	-	81,930	71,135	160,582
Ending balance	$ 277,940	$ 136,721	$ 1,225,970	$ 530,916	$ 2,171,547

Credit Risk Discount: Loans acquired through a merger with deteriorated credit quality are evaluated and pooled separately from the allowance for loan losses calculation. The following presents activity in the credit risk discount valuation account by portfolio segment, including accretion (reclassifications of nonaccretable discount to accretable yield), amounts of loans charged off and any recoveries:

	Commercial	Residential Real Estate	Consumer	Total
		(in thousands)		
Beginning balance	$ -	$ -	$ -	$ -
Additions	415	1,883	4,742	7,040
Charge-offs	-	-	(1,261)	(1,261)
Accretion	(20)	(153)	(1,000)	(1,173)
	$ 395	$ 1,730	$ 2,481	$ 4,606

Changes in Accounting Methodology: The credit union did not change its allowance for loan losses methodology during the year ended December 31, 2017.

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

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

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

The following table presents the credit quality of commercial loans graded internally based on the commonly used internal classification system:

Internal Grade	(in thousands)
Pass/Excellent	$ 1,743
Pass/Strong	99,173
Pass/Satisfactory	139,547
Pass/Watch	26,249
Special Mention	4,850
Substandard	5,326
Doubtful	1,052
	$ 277,940

Credit Quality Indicators for U.S. Government-Guaranteed Segment: The credit union purchased small business loans that are fully backed by the U.S. government and full repayment is expected; therefore, no allowance was provided for this segment.

Credit Quality Indicators for Residential Real Estate and Consumer Segment: The credit union assesses the credit quality of its residential real estate and consumer loans by recent FICO score and loan-to-value (LTV) ratio.

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

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

The FICO score distribution is as follows:

	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
			(in thousands)			
800 and above	$ 370,414	$ 131,661	$ 109,892	$ 4,760	$ 12,291	$ 629,018
750 to 799	219,656	79,210	98,431	10,185	18,151	425,633
650 to 749	246,697	81,421	150,431	29,536	34,113	542,198
600 to 649	16,967	13,455	20,093	5,194	4,373	60,082
599 and below	11,285	12,416	12,829	3,422	2,670	42,622
Unknown	31,518	11,270	4,429	1,357	8,759	57,333
	$ 896,537	$ 329,433	$ 396,105	$ 54,454	$ 80,357	$ 1,756,886

LTV and Combined LTV (CLTV) Ratios: Residential real estate loans are assessed for credit quality by LTV or CLTV, the ratio of the loan's unpaid principal balance to the value of the collateral securing repayment of the loan. If the credit union is in a junior lien position, only the excess collateral value over the amounts necessary to retire any senior lien positions is considered. LTVs are updated quarterly using a cascade approach that first uses values provided by an automated valuation model (AVM) for a property. If an AVM is not available, the value is estimated using the original appraised value adjusted by the change in Home Price Index (HPI) for the property location. If an HPI is not available, the original appraised value is used.

Although residential real estate markets experienced significant declines in property values several years ago, recent analysis, as shown in the table below, highlights improvement in all mortgage categories. These trends are considered in the way the credit union monitors credit risk and establishes the residential real estate allowance for loan losses. LTV does not necessarily reflect the likelihood of performance of a given loan but does provide an indication of collateral value. In the event of default, any loss to the credit union should be approximately limited to the portion of the loan amount in excess of the net realizable value of the underlying real estate collateral.

The LTV distribution of first mortgage and HELOC and other mortgage loans is as follows:

	Less Than 80%	80%–89%	90%–99%	100% or Greater	Unknown	Total
			(in thousands)			
First mortgage	$ 663,463	$ 147,551	$ 43,315	$ 27,313	$ 14,895	$ 896,537
HELOC and other mortgage	291,544	17,113	9,319	7,689	3,768	329,433
	$ 955,007	$ 164,664	$ 52,634	$ 35,002	$ 18,663	$ 1,225,970

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

Nonaccrual and Past Due Loans: Information relating to the age and nonaccrual status of the loans by class is shown below. There were no loans 90 days or more past due and still accruing interest as of December 31, 2017.

	Current	31–59 Days Past Due	60–179 Days Past Due	180–359 Days Past Due	360 Days or More Past Due	Total	Loans on Nonaccrual Status
				(in thousands)			
Commercial real estate	$ 276,640	$ 616	$ 128	$ -	$ 556	$ 277,940	$ 594
U.S. government guaranteed	136,721	-	-	-	-	136,721	-
First mortgage	880,513	8,246	5,861	1,167	750	896,537	5,061
HELOC and other mortgage	321,021	5,312	2,451	220	429	329,433	1,985
Automobile	393,232	2,099	774	-	-	396,105	375
Credit card	53,180	575	699	-	-	54,454	330
Other consumer	79,461	471	425	-	-	80,357	160
	$ 2,140,768	$ 17,319	$ 10,338	$ 1,387	$ 1,735	$ 2,171,547	$ 8,505

Impaired Loans: Impaired loans individually evaluated for impairment are summarized below. The average balances are calculated based on the month-end balances of the loans for the period reported, and the interest income on impaired loans is recognized on a cash basis when received.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(in thousands)		
With no related allowance recorded:					
Commercial real estate	$ 7,902	$ 7,902	$ -	$ 7,629	$ 472
First mortgage	378	378	-	710	17
HELOC and other mortgage	490	490	-	364	16
Credit card	1	1	-	2	-
	8,771	8,771	-	8,705	505
With an allowance recorded:					
Commercial real estate	5,127	5,127	594	4,286	187
First mortgage	13,469	13,469	919	14,008	546
HELOC and other mortgage	5,489	5,489	665	6,547	147
Credit card	-	-	-	-	-
	24,085	24,085	2,178	24,841	880
Total:					
Commercial real estate	13,029	13,029	594	11,915	659
First mortgage	13,847	13,847	919	14,718	563
HELOC and other mortgage	5,979	5,979	665	6,911	163
Credit card	1	1	-	2	-
	$ 32,856	$ 32,856	$ 2,178	$ 33,546	$ 1,385

NOTE 3 – LOANS RECEIVABLE, NET (CONTINUED)

TDRs: Loans modified as TDRs during the year ended December 31, 2017 and the type of concession granted, presented by class, are as follows:

	Type of Concession				
	Interest Rate	Maturity Date	Principal Reduction	Other	Total
			(in thousands)		
Commercial real estate	$ 924	$ -	$ -	$ -	$ 924
HELOC and other mortgage	220	-	-	-	220
	$ 1,144	$ -	$ -	$ -	$ 1,144

Loans modified as TDRs during the year ended December 31, 2017, presented by class, and those restructurings for which there was a payment default subsequent to the restructuring, but within 12 months of the restructuring, are as follows:

	TDRs			TDRs That Subsequently Defaulted		
	Number of Loans	Principal Balance	Allowance Impact	Number of Loans	Principal Balance	Allowance Impact
			(dollars in thousands)			
Commercial real estate	2	$ 924	$ 5	-	$ -	$ -
HELOC and other mortgage	2	220	63	-	-	-
	4	$ 1,144	$ 68	-	$ -	$ -

NOTE 4 – PROPERTY AND EQUIPMENT

The composition of property and equipment is summarized as follows:

	(in thousands)
Land	$ 43,138
Buildings	75,455
Leasehold improvements	17,369
Furniture and equipment	37,514
	173,476
Accumulated depreciation and amortization	(55,545)
	117,931
Construction in progress	2,424
	$ 120,355

NOTE 4 – PROPERTY AND EQUIPMENT (CONTINUED)

The following is a schedule of minimum future gross rental income on noncancelable operating leases:

Years Ending December 31,	(in thousands)
2018	$ 5,308
2019	4,798
2020	3,958
2021	1,827
2022	1,498
Thereafter	3,001
	$ 20,390

NOTE 5 – MEMBERS' SHARE ACCOUNTS

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

	Weighted Average Cost	(in thousands)
Regular shares	0.08%	$ 1,369,155
Checking	0.03%	137,576
Money market	0.26%	555,705
IRA shares	0.12%	34,286
		2,096,722
Share certificates	1.13%	370,167
IRA certificates	1.05%	50,978
		421,145
		$ 2,517,867

As allowed by the Federal Reserve Bank, the linked savings sub-account portions of checking accounts ($611 million as of December 31, 2017) are classified as regular shares in these consolidated financial statements in order to accurately reflect the deposit structure and reserve requirements of these balances.

The aggregate amount of share and IRA certificates in denominations that met or exceeded the NCUSIF insurance limit was approximately $51 million as of December 31, 2017.

A summary of share and IRA certificates by maturity is as follows:

Years Ending December 31,	(in thousands)
2018	$ 284,922
2019	71,952
2020	33,191
2021	13,163
2022	17,731
Thereafter	186
	$ 421,145

NOTE 5 – MEMBERS' SHARE ACCOUNTS (CONTINUED)

Interest expense on members' share accounts is summarized as follows:

	(in thousands)
Regular shares	$ 604
Checking	402
Money market	1,334
IRA shares	37
Share certificates	3,747
IRA certificates	525
	$ 6,649

NOTE 6 – BORROWED FUNDS AND LINES OF CREDIT

The credit union has a senior line of credit with the FHLB of San Francisco. Collateral under the agreement consists of a priority interest in most one-to-four unit residential real estate loans owned by the credit union plus its capital stock and all deposits as well as pledged securities. At December 31, 2017, the credit union had borrowed $140 million against this line. The credit union has pledged real estate loans and securities with outstanding balances of $671,439,000 and $144,658,000, respectively, as of December 31, 2017. The total remaining borrowing capacity under the agreement, determined as a percentage of available loan collateral, was approximately $544 million at December 31, 2017.

The credit union also has letters of credit with the FHLB worth $8.5 million used as collateral for public deposits.

In addition, the credit union has two open-end loan promissory notes consisting of settlement and term lines of credit with a corporate credit union. Maximum available borrowings on the settlement line were $49.4 million, subject to provision of adequate collateral. The limit on the term line of credit was $12.4 million, subject to provision of adequate collateral for credit requests. Collateral under the settlement line of credit can include share certificates, securities in safekeeping and all the assets of the credit union. The credit union pledged securities in the amount of $71.9 million as of December 31, 2017. Collateral under the term line of credit can include designated loans, corporate credit union share certificates and securities held in safekeeping. Interest is variable or fixed as determined at the time of the credit request. This arrangement is annually reviewed for continuation by the lender and the credit union. As of December 31, 2017, there were no borrowings under the open-end loan promissory notes.

NOTE 7 – COMMITMENTS AND CONTINGENT LIABILITIES

Legal Proceedings: The credit union is periodically a defendant in various legal proceedings involving matters generally incidental to its business. Although it is difficult to predict the outcome of these proceedings, management believes, based on discussions with counsel, that there are no estimable or probable material losses at December 31, 2017.

Lease Commitments: At December 31, 2017, the credit union was obligated under noncancelable operating leases for office space. Certain leases contain escalation clauses providing for increased rent based primarily on increases in real estate taxes or the average consumer price index. Rent expense totaled $3.3 million for the year ended December 31, 2017.

NOTE 7 – COMMITMENTS AND CONTINGENT LIABILITIES (CONTINUED)

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

Years Ending December 31,	(in thousands)
2018	$ 1,775
2019	1,487
2020	1,255
2021	959
2022	740
Thereafter	2,311
	$ 8,527

Loan Commitments: The credit union had outstanding real estate loan commitments of $16 million as of December 31, 2017. The credit union also had unused lines of credit that are not reflected in the accompanying consolidated financial statements as follows:

	(in thousands)
Credit card	$ 166,244
HELOC	331,546
Business	21,121
Overdraft protection	106,761
Other	21,950
	$ 647,622

Financial Instruments with Off-Balance-Sheet Risk: The credit union is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its members. The financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated statement of financial condition. The contractual or notional amounts of these instruments reflect the extent of involvement the credit union has in particular classes of financial instruments. The credit union's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The credit union uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

Financial instruments whose contract amounts represent credit risk at December 31, 2017 are the commitments to extend credit of $648 million in contractual or notional amount per the above table. Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The credit union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the credit union upon extension of credit, is based on management's credit evaluation of the member. Collateral held varies but may include real estate, vehicles and shares.

NOTE 8 – INCOME TAXES

The credit union is a state-chartered credit union as described in Internal Revenue Code (IRC) Section 501(c)(14) and, as such, is exempt from federal taxation of income derived from the performance of activities that are in furtherance of its exempt purposes. However, IRC Section 511 imposes a tax on unrelated business income (as defined in Section 512) derived by state-chartered credit unions. Exemption from California income tax is similar. The specific application of Section 512 to the various activities conducted by state-chartered credit unions has been at issue for many years. During 2007, the Internal Revenue Service (IRS) issued a series of Technical Advice Memoranda (TAMs) to a number of state-chartered credit unions located throughout the country. In these TAMs the IRS ruled certain products and services to be subject to taxation as unrelated business income. In light of the TAMs, the credit union has assessed its activities and any potential federal or state income tax liability. In the opinion of management, any liability arising from federal or state taxation of activities deemed to be unrelated to its exempt purposes is not expected to have a material effect on the credit union's financial position or results of operations.

ASC 740-10-65, *Income Taxes*, provides guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the consolidated financial statements. This requires the evaluation of tax positions taken or expected to be taken in the course of preparing the credit union's tax returns to determine whether the tax positions are "more likely than not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions deemed to not meet the more-likely-than-not threshold should be recorded as a tax expense and liability in the current year. For the year ended December 31, 2017, management has determined that the credit union has no material uncertain tax positions, and accordingly, the credit union has not recorded a liability for the payment of interest or penalties. The credit union is subject to and pays all state and city taxes on goods and services purchased by the credit union. There was no income tax provision for the subsidiaries in 2017.

NOTE 9 – FAIR VALUE

The following methods and assumptions were used to estimate fair value of the credit union's securities available for sale as required by the adoption of ASU No. 2016-01.

Fair values of securities are usually based on quoted market prices. If quoted market prices are not available, fair value is estimated using quoted market prices of similar securities or discounted cash flow models based on the expected payment characteristics of the underlying mortgage instruments.

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

		Fair Value Measurement at Reporting Date Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
Trading securities	$ 9,845	$ 9,845	$ -	$ -
Securities available for sale	328,605	-	328,605	-
	$ 338,450	$ 9,845	$ 328,605	$ -

NOTE 9 – FAIR VALUE (CONTINUED)

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

	Fair Value	Fair Value Measurement at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
Impaired loans	$ 9,315	$ -	$ -	$ 9,315

Impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans.

NOTE 10 – LOAN SERVICING

The credit union's servicing portfolio with capitalized mortgage servicing rights (MSRs) is summarized as follows:

	(in thousands)
Residential loans	$ 496,411
Commercial loans	355,732
	$ 852,143

MSRs as recorded in the consolidated financial statements at amortized cost compared to fair value as determined by an independent third-party valuation company are summarized as follows:

	Cost	Fair Value
	(in thousands)	
Residential loans	$ 3,228	$ 5,444
Commercial loans	4,050	5,290
	$ 7,278	$ 10,734

The fair value of servicing rights was determined using discount rates ranging from 9.7% to 9.9%, depending upon the loan stratification for residential loans, and 10.50% for all commercial loans at December 31, 2017. Current delinquency experience has been assumed to continue for all stratifications. The average prepayment speed for residential loans was 11.04% at December 31, 2017. The average prepayment speed for commercial loans was 9.19% at December 31, 2017.

MSRs are evaluated periodically for possible impairment based on the difference between the carrying amount and current fair value of the MSRs by risk stratification for loan age and interest rate. If a temporary impairment exists, a valuation allowance is established for any excess of amortized cost over the current fair value through a charge to income. A direct write-down is performed when the recoverability of a recorded valuation allowance is determined to be remote. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSRs and the valuation allowance, precluding subsequent reversals.

NOTE 10 – LOAN SERVICING (CONTINUED)

The following summarizes MSR activity, loan servicing income and escrow accounts for collections, taxes and insurance held in a fiduciary capacity and not as assets of the credit union:

	(in thousands)
MSRs, beginning of year	$ 5,964
Capitalized from loan originations	2,309
MSRs aquired from merger	857
Amortization	(1,852)
MSRs, end of year	$ 7,278
Loan servicing income	$ 2,839
Escrow accounts	$ 2,556

NOTE 11 – NOTE RECEIVABLE

The purchase of the West L.A. property was partially financed by the purchaser via a promissory note from the credit union. The note receivable was for $8.7 million, payable monthly for a period of 192 months at an interest rate of 3.75%. At December 31, 2017, the note receivable balance was $7.3 million.

NOTE 12 – CONCENTRATION OF CREDIT RISK

At December 31, 2017, the credit union had cash balances totaling $4,771,000 at financial institutions, which exceeded federally insured limits.

NOTE 13 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the credit union has granted loans to principal officers and directors amounting to $4.7 million at December 31, 2017. Deposits from related parties held by the credit union at December 31, 2017 amounted to $2.1 million. Loans to credit union officials and deposits held by credit union officials were treated the same with regard to rates, terms and requirements as loans and deposits of other members with similar circumstances.

NOTE 14 – EMPLOYEE BENEFIT PLANS

401(k) Plan: The credit union has a salary deferral 401(k) plan. Employees who have completed three months of service are eligible to participate in the plan. For any calendar year, employee contributions may not exceed a specific dollar amount as determined by the IRS. The credit union will contribute a fixed amount of safe harbor matching contributions of 100% on the first 6% of compensation deferred into the plan. For the year ended December 31, 2017, the credit union contributed $1.9 million.

457(f) Plan: The credit union has a nonqualified deferred compensation plan for certain executives under IRC Section 457(f). To support the deferred compensation plan, the credit union has elected to purchase credit union-owned variable life insurance and variable annuities. The surrender value of these investments, included in other assets, was $5.4 million as of December 31, 2017. There was no change in the market value of designated plan assets and benefit expense for the year ended December 31, 2017. The liability for the deferred compensation is included in accrued liabilities and totaled $357,000 as of December 31, 2017.

NOTE 14 – EMPLOYEE BENEFIT PLANS (CONTINUED)

The credit union has another nonqualified deferred compensation plan for a key management employee under Internal Revenue Code (IRC) Section 457(f). The credit union invested in certain mutual funds to partially defray the cost of this agreement. The assets under this arrangement are maintained at fair value amounting to $9 million and are included in trading securities as of December 31, 2017. Changes in fair value of these mutual funds are recorded through earnings.

457(b) Plan: The credit union has an unfunded nonqualified deferred compensation plan for members of management. The plan allows for employees to defer a portion of their compensation. The deferred compensation investments are shown as both assets and liabilities on the credit union's consolidated financial statements and are available to creditors in the event of the credit union's liquidation. The funds were invested into certain mutual funds and are included in trading securities in the consolidated financial statements. Deferred compensation investments and liabilities totaled $493,000 as of December 31, 2017.

Defined Benefit Pension Plan: The credit union sponsors a defined benefit pension plan that covers all regular employees hired before January 1, 2007 who meet certain requirements. The plan calls for benefits to be paid to eligible employees at retirement based primarily on years of service with the credit union and compensation rates. The credit union's funding policy has been to annually contribute an amount in excess of the minimum required by federal regulations. Contributions to the plan reflect benefits attributed to employees' service to date, as well as estimated future benefits.

The following sets forth information regarding the plan:

	(dollars in thousands)
Benefit obligation	$ 86,899
Fair value of plan assets	65,869
Funded status	$ (21,030)
Liability for pension benefits (included in other liabilities)	$ (21,030)
Net actuarial loss (recognized in accumulated other comprehensive loss)	$ 36,716
Accumulated benefit obligation	$ 75,257
Assumptions used to determine benefit obligation:	
Discount rate	4.19%
Rate of compensation increase	3.00%
Net periodic benefit cost:	
Service cost	$ 2,494
Interest cost	3,126
Expected return on plan assets	(4,124)
Amortization of prior service cost	605
Recognized loss	2,181
Additional charges due to curtailment	660
	$ 4,942

NOTE 14 – EMPLOYEE BENEFIT PLANS (CONTINUED)

The amount in accumulated other comprehensive income expected to be recognized as a component of net periodic benefit cost over the next fiscal year is $2,700,000.

	(dollars in thousands)
Employer contributions	$ -
Benefits paid	1,325
Assumptions used to determine net pension cost:	
Discount rate	4.19%
Expected return on plan assets	7.00%
Rate of compensation increase	3.00%

The actuarial loss from the changes in the discount rate at December 31, 2017 was $9.5 million. A discount rate change impacts the actuarial value of the discounted benefit obligation.

The mortality table used for December 31, 2017 was the RP-2014 White-Collar Mortality Table Adjusted to 2006 with Generational Projection (Scale MP-2017) for 2017.

Expected long-term return on plan assets is determined by applying historical average investment returns from published indexes relating to the current allocation of assets in the portfolio.

The fair values of the credit union's pension plan assets are mostly priced at Level 1, quoted prices in active markets for identical assets.

Asset Category	(in thousands)
Equity securities	$ 38,534
Fixed income	26,940
Cash and cash equivalents	395
	$ 65,869

The credit union does not expect to have a required contribution to the plan for 2018.

Pension benefits, which reflect expected future service as appropriate, are expected to be paid as follows:

Years Ending December 31,	(in thousands)
2018	$ 1,392
2019	1,447
2020	1,620
2021	1,653
2022	2,281
2023–2027	14,625
	$ 23,018

NOTE 15 – REGULATORY CAPITAL

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

Quantitative measures established by regulation to ensure capital adequacy require the credit union to maintain minimum amounts and ratios (set forth in the table on the following page) of net worth (as defined) to assets (as defined). The credit union is also required to calculate a risk-based net worth (RBNW) ratio that establishes whether the credit union will be considered "complex" under the regulatory framework. The credit union's RBNW ratio as of December 31, 2017 was 5.75%. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes that, as of December 31, 2017, the credit union meets all capital adequacy requirements to which it is subject.

As of December 31, 2017, the most recent call reporting period, the NCUA categorized the credit union as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the credit union must maintain a minimum net worth ratio of 7% of assets and meet any applicable RBNW requirement. There are no conditions or events since that notification which management believes have changed the credit union's category.

The credit union's actual capital amounts and ratios 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
			(dollars in thousands)			
Net worth	$ 318,457	10.51%	$ 181,878	6.00%	$ 212,191	7.00%
RBNW	174,299	5.75%	N/A	N/A	N/A	N/A

Because the RBNW requirement is less than the net worth ratio, the credit union retains its original category.

NOTE 16 – BUSINESS COMBINATION

The credit union merged with the San Diego-based NICU on March 1, 2017. The merging credit union terminated its charter, and its accounts were merged and accounted for by the acquisition method. The merging credit union's assets as of the merger date totaled approximately $1.3 billion. Through this merger the credit union expanded its footprint into the San Diego metropolitan area, acquiring 11 additional branches. The San Diego area branches continued to be branded as North Island Credit Union – a division of California Credit Union. The acquisition resulted in goodwill at the merger date of $23,114,683, which represented the excess of the entity fair value over the fair value of the acquired credit unions' net assets, calculated as discussed in Note 1.

NOTE 16 – BUSINESS COMBINATION (CONTINUED)

The assumptions used to estimate the fair values related to the merger transactions are reflected below.

Purchased Loans: Purchased loans are evaluated for impairment according to the applicable accounting guidance. Purchased performing loans that do not have evidence of deterioration in credit quality at acquisition are recorded at fair value at the acquisition date. Purchased loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that all contractually required payments will not be collected are deemed as purchased credit impaired (PCI). Revolving loans, including lines of credit and credit card loans, and loans where cash flows cannot be reasonably estimated are excluded from PCI accounting.

For loans secured by residential real estate, the credit union estimated the fair value of each loan by using a discounted cash flow analysis based on the collateral attributes and market-based assumptions for expected prepayment rates, default rates, loss severity and required rates of return. For other consumer loans the credit union grouped loans into cohorts based on similar attributes and interest rates and estimated the fair value of each group based on collateral attributes and market-based assumptions for expected prepayment rates, default rates, loss severity and required rates of return. For member business loans the credit union compared the acquired credit union's estimated credit losses analysis to industry repayment and severity percentages and solved for the default rate needed to derive the acquired credit union's estimated loss percentage. Any premium or discount associated with purchased performing loans is recognized as an expense or income based on the effective-yield method of amortization.

Under the applicable guidance for PCI loans, the excess of cash flows expected to be collected, measured as of the acquisition date, over the estimated fair value is referred to as accretable yield and is recognized in interest income over the remaining life of the loan or cohort using the effective-yield method. The difference between the contractually required principal and interest payments as of the acquisition date and the cash flows expected to be collected is referred to as the nonaccretable difference. The nonaccretable difference, which is not accreted into income, reflects estimated future credit losses and uncollectible contractual payments over the life of the PCI loan. Management monitors actual cash collections to determine if they conform to initial expectations. Revised cash flow expectations are prepared periodically. A decrease in expected cash flows would result in the establishment of an allowance for loan losses by recording a charge to the provision for loan losses. Additional cash flows expected to be collected are reclassified from nonaccretable difference to the accretable yield, and the amount of periodic accretion is adjusted over the remaining life of the PCI loan or pool.

Property and Equipment: The fair value of the various real estate properties acquired was determined by appraisals obtained from a licensed, certified appraiser at the merger date.

Core Deposit Intangible: Core deposit intangible represents the premium a rational buyer is willing to pay to obtain a group of core deposit accounts that are less expensive than the credit union's marginal cost of funds. The credit union estimated the fair value of the core deposit intangible using an income approach discounted at a capital asset pricing model (CAPM) rate determined by an industry-recognized valuation handbook plus a risk premium. The core deposit intangible is amortized using the level-yield method over 70 months.

The core deposit intangible is summarized as follows as of December 31, 2017:

	(in thousands)
Core deposit intangible	$ 20,683
Accumulated amortization	(5,452)
	$ 15,231

Amortization expense was $5,451,664 for the year ended December 31, 2017.

NOTE 16 – BUSINESS COMBINATION (CONTINUED)

Future amortization of the core deposit intangible is scheduled as follows:

Years Ending December 31,	(in thousands)
2018	$ 5,443
2019	4,245
2020	3,046
2021	1,848
2022	649
	$ 15,231

Members' Share Accounts: The fair value of each certificate was estimated based on a discounted cash flow analysis that compared the certificates' amounts, original terms, remaining terms and interest rates with market rates provided by a third-party data analytics firm at the merger date. The combined calculated discount is amortized as a decrease to interest expense over the remaining terms.

Investments: The credit union estimated the fair value of securities available for sale and securities held to maturity by comparing market prices from Bloomberg with the fair values provided by the acquired credit union's investment broker. For all other investments, fair value approximated book value.

Other Assets and Liabilities: The value of mortgage servicing rights was estimated based on a discounted cash flow analysis of the servicing income and expense on the commercial loan servicing portfolio, adjusted for estimated prepayments. Lease assets and liabilities were determined based on a market rate analysis of the credit union's branch and tenant leases. For all other assets and liabilities, fair value approximated book value. Mortgage servicing right liabilities are amortized into loan servicing income. Lease assets and liabilities are amortized over the respective lives against rent expense and rental income, respectively.

Net assets acquired in the merger and the estimated fair value adjustments resulting in goodwill were as follows for the year ended December 31, 2017:

	NICU (in thousands)
Net assets acquired in merger	$ 144,172
Fair value adjustments:	
Securities held to maturity	37
Loans	(18,809)
Property and equipment	1,237
Core deposit intangible	20,683
Other assets	(1,010)
Shares	(337)
Other liabilities	(1,103)
Fair value of net assets of merging credit union	144,870
Less entity value	167,985
Goodwill acquired	$ (23,115)

NOTE 16 – BUSINESS COMBINATION (CONTINUED)

The assets acquired and liabilities assumed at their estimated fair values were as follows for the year ended December 31, 2017:

	NICU (in thousands)
Assets acquired:	
Cash	$ 137,717
Trading securities	8,882
Securities available for sale	114,886
Securities held to maturity	669
Other investments	15,446
Loans held for sale	150
Loans	875,340
Accrued interest	2,667
Property and equipment	57,304
NCUSIF deposit	9,997
Core deposit intangible	20,683
Other assets	37,484
	1,281,225
Liabilities assumed:	
Members' share accounts	1,117,649
Other liabilities	18,706
	1,136,355
Fair value of net assets acquired	$ 144,870

The operations of the merging credit union are included in the credit union's results of operations from March 1, 2017 (the merger date) through December 31, 2017. The results of operations prior to the acquisition are not included. The credit union recognized expenses of $4.6 million related to the merger that occurred during the year ended December 31, 2017. These amounts are included in other non-interest expense.

NOTE 17 – PRIOR PERIOD ADJUSTMENT

Undivided earnings have been restated from the amount previously reported. The acquired credit union incurred merger related expenses aggregating $1,387,326 during the year ended December 31, 2016 and prior to the merger, which were reimbursed by the surviving credit union pursuant to negotiations that were ongoing subsequent to the report issuance date. The undivided earnings have been decreased by $1,387,326 to recognize the liability for merger related expenses during the year incurred.

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