

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED JUNE 30, 2018 AND 2017**

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## INDEPENDENT AUDITORS' REPORT

Members of the Supervisory Committee and Board of Directors  
Local Government Federal Credit Union and Subsidiaries  
Raleigh, North Carolina

### **Report on Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Local Government Federal Credit Union and Subsidiaries (the Credit Union), which comprise the consolidated statements of financial condition as of June 30, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in members' equity, and cash flows for the years then ended and the related notes to the consolidated financial statements.

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

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

### ***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Members of the Supervisory Committee and Board of Directors  
Local Government Federal Credit Union and Subsidiaries

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Local Government Federal Credit Union and Subsidiaries as of June 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*CliftonLarsonAllen LLP*

**CliftonLarsonAllen LLP**

Baltimore, Maryland  
September 13, 2018

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
JUNE 30, 2018 AND 2017**

	2018	2017
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 135,726,744	\$ 174,574,530
Investment Securities:		
Available-for-Sale	66,943,087	82,856,123
Other Investments	1,961,363	1,924,200
Loans Held-for-Sale	4,290,948	2,083,363
Loans to Members, Net of Allowance for Loan Losses	1,679,788,518	1,495,882,366
Accrued Interest Receivable	4,601,618	3,804,411
Due from State Employees' Credit Union, Net	-	1,729,396
Premises and Equipment, Net	60,098,361	58,440,999
Restricted Cash	4,000,000	-
NCUSIF Deposit	16,655,176	15,619,056
Credit Union Owned Life Insurance	22,639,964	22,045,462
Split-Dollar Collateral Assignment Life Insurance	14,512,064	13,476,663
Other Assets	3,564,413	8,421,973
	<b>\$ 2,014,782,256</b>	<b>\$ 1,880,858,542</b>
<b>LIABILITIES AND MEMBERS' EQUITY</b>		
<b>LIABILITIES</b>		
Members' Share and Savings Accounts	\$ 1,797,435,770	\$ 1,697,067,870
Accrued Interest Payable	337,295	437,245
Due to State Employees' Credit Union, Net	8,365,726	-
Accrued Expenses and other Liabilities	24,402,642	18,522,694
Total Liabilities	1,830,541,433	1,716,027,809
<b>MEMBERS' EQUITY</b>		
Regular Reserve	8,568,384	8,568,384
Undivided Earnings	180,031,314	159,037,942
Accumulated other Comprehensive Loss	(4,358,875)	(2,775,593)
Total Members' Equity	184,240,823	164,830,733
	<b>\$ 2,014,782,256</b>	<b>\$ 1,880,858,542</b>

See accompanying Notes to Consolidated Financial Statements.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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CONSOLIDATED STATEMENTS OF INCOME  
YEARS ENDED JUNE 30, 2018 AND 2017**

	2018	2017
<b>INTEREST INCOME</b>		
Loans to Members	\$ 85,068,771	\$ 70,019,811
Investment Securities and Cash Equivalents	3,082,887	2,999,216
Total Interest Income	88,151,658	73,019,027
<b>INTEREST EXPENSE</b>		
Members' Share and Savings Accounts	10,745,669	8,397,821
Net Interest Income before Provision for Loan Losses	77,405,989	64,621,206
<b>PROVISION FOR LOAN LOSSES</b>	19,234,765	16,333,754
Net Interest Income after Provision for Loan Losses	58,171,224	48,287,452
<b>NON-INTEREST INCOME</b>		
Service Charges and Fees	34,627,938	30,967,521
Other Non-Interest Income	5,570,394	4,362,832
Net Gain on Sale of Investment Securities Available-for-Sale	-	2,755
Total Non-Interest Income	40,198,332	35,333,108
<b>NON-INTEREST EXPENSE</b>		
Compensation and Benefits	21,971,366	19,254,991
Occupancy	2,194,030	2,410,358
Operations	39,326,041	34,102,904
Other Non-Interest Expense	13,884,747	18,029,087
Total Non-Interest Expense	77,376,184	73,797,340
Net Income	\$ 20,993,372	\$ 9,823,220

See accompanying Notes to Consolidated Financial Statements.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
YEARS ENDED JUNE 30, 2018 AND 2017**

	2018	2017
<b>NET INCOME</b>	\$ 20,993,372	\$ 9,823,220
<b>OTHER COMPREHENSIVE LOSS:</b>		
Reclassification Adjustment for Net Realized Gains on Sales of Investment Securities Included in Net Income	-	(2,755)
Unrealized Holding Loss on Investment Securities Available-for-Sale Arising During the Period	(1,583,282)	(2,444,324)
Total other Comprehensive Loss	(1,583,282)	(2,447,079)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 19,410,090</b>	<b>\$ 7,376,141</b>

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY  
YEARS ENDED JUNE 30, 2018 AND 2017**

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
<b>BALANCES, JUNE 30, 2016</b>	\$ 8,568,384	\$ 147,138,240	\$ (328,514)	\$ 155,378,110
Net Income	-	9,823,220	-	9,823,220
Other Comprehensive Loss	-	-	(2,447,079)	(2,447,079)
Equity Acquired in Acquisition	-	2,076,482	-	2,076,482
<b>BALANCES, JUNE 30, 2017</b>	8,568,384	159,037,942	(2,775,593)	164,830,733
Net Income	-	20,993,372	-	20,993,372
Other Comprehensive Loss	-	-	(1,583,282)	(1,583,282)
<b>BALANCES, JUNE 30, 2018</b>	<u>\$ 8,568,384</u>	<u>\$ 180,031,314</u>	<u>\$ (4,358,875)</u>	<u>\$ 184,240,823</u>

See accompanying Notes to Consolidated Financial Statements.



**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2018 AND 2017**

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 20,993,372	\$ 9,823,220
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	2,635,493	3,688,445
Amortization of Premiums and Discounts, Net	776,775	939,089
Provision for Loan Losses	19,234,765	16,333,754
Loss on Impairment and Disposition of Premises and Equipment	3,044,515	3,708,049
Gain on Sale of Investment Securities Available-for-Sale, Net	-	(2,755)
Losses (Gains) on Foreclosed Assets	(680,940)	692,277
Effects of Changes in Operating Assets and Liabilities:		
Loans Held-for-Sale	(2,207,585)	(2,083,363)
Accrued Interest Receivable	(797,207)	416,488
Other Assets	1,203,415	(12,152)
Credit Union Owned Life Insurance	(594,502)	(611,394)
Split-Dollar Collateral Assignment Life Insurance	(1,035,401)	(672,794)
Due from State Employees' Credit Union, Net	1,729,396	36,449,531
Due to State Employees' Credit Union, Net	8,365,726	-
Accrued Interest Payable	(99,950)	(54,706)
Accrued Expenses and Other Liabilities	5,879,948	886,811
Net Cash Provided by Operating Activities	<u>58,447,820</u>	<u>69,500,500</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from Maturities and Pay Downs of Investment Securities Available-for-Sale	13,552,979	17,021,712
Proceeds from Sales of Investment Securities Available-for-Sale	-	39,102,960
Net Change in Other Investments	(37,163)	(244,300)
Loans to Members, Net of Principal Collections	(204,904,490)	(267,888,629)
Increase in NCUSIF Deposit	(1,036,120)	(1,417,928)
Net Investments Received in Business Combination	-	12,481,437
Net Cash Received in Business Combination	-	322,844
Proceeds from Sale of Foreclosed Assets	2,098,658	1,074,898
Purchases of Premises and Equipment	(7,337,370)	(3,795,742)
Net Cash Used in Investing Activities	<u>(197,663,506)</u>	<u>(203,342,748)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Increase in Members' Share and Savings Accounts	100,367,900	141,648,238
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	(38,847,786)	7,805,990
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	174,574,530	166,768,540
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 135,726,744</u>	<u>\$ 174,574,530</u>
<b>ADDITIONAL NONCASH AND CASH FLOW INFORMATION</b>		
Interest on Members' Share and Savings Accounts	\$ 10,845,619	\$ 8,452,527
Transfers from Loans to Members to Foreclosed Assets	<u>\$ 1,763,573</u>	<u>\$ 2,857,676</u>

See accompanying Notes to Consolidated Financial Statements.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

Local Government Federal Credit Union (the "Credit Union" or "LGFCU") is a federally chartered credit union organized under the Federal Credit Union Act of 1934 and administratively responsible to the National Credit Union Administration (NCUA). The primary purpose is to promote thrift among, and create a source of credit for its members. The Credit Union's primary source of revenue is providing loans to its members.

The Credit Union serves its members through the State Employees' Credit Union branch network. This network includes 263 offices in 175 communities.

**Membership**

Participation in the Credit Union is limited to those individuals that qualify for membership as defined in the Credit Union's Charter and Bylaws. The primary field of membership consists of local government employees, elected and appointed officials, volunteers, and their families in North Carolina.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Credit Union, Civic Federal Credit Union (Civic), and its wholly-owned Credit Union Service Organization (CUSO) subsidiaries, LGFCU Financial Partners, LLC (LGFCUFP), and LGFCU Trustee, LLC. LGFCUFP and LGFCU Trustee, LLC are engaged in providing business loans to local government entities as well as acting in the capacity of trustee under the deed of trust loans made by LGFCU and LGFCUFP. No significant net income is derived from the Credit Union's CUSOs.

Civic was chartered by the NCUA in December 2017. LGFCU was instrumental in the chartering of Civic by providing the financial support and management structure necessary to obtain a charter. Civic is currently determined to be a variable interest entity (VIE) of LGFCU for the year ended June 30, 2018. Civics' financial statements are included in the consolidated financial statements of the Credit Union. No significant net income was derived from Civic for the year ended June 30, 2018. LGFCU will continue to support Civic financially as well as operationally. The Credit Union will continue to evaluate whether there is a controlling financial interest in Civic. See further discussion regarding specific Civic transactions in Note 11.

All significant intercompany accounts and transactions have been eliminated during consolidation for both the Credit Union's wholly-owned subsidiaries and Civic.

**Use of Estimates in Preparing Consolidated Financial Statements**

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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Use of Estimates in Preparing Consolidated Financial Statements (Continued)**

Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses and the valuation of securities.

**Financial Instruments with Concentrations of Credit Risk**

The Credit Union may be exposed to credit risk from a regional economic standpoint because a significant concentration of its borrowers work or reside within a limited geographical field of membership.

**Cash and Cash Equivalents**

For purposes of the Consolidated Statements of Financial Condition and Consolidated Statements of Cash Flows, cash and cash equivalents include funds due from banks, corporate credit unions, cash in vaults and on hand, and highly-liquid debt instruments with original maturities of three months or less.

The Credit Union maintains cash in deposit accounts at financial institutions approved by the Board of Directors. Accumulated deposits at these institutions, at times, may exceed federally insured limits.

**Restricted Cash**

For purposes of the Consolidated Statements of Financial Condition and Consolidated Statements of Cash Flows, cash and cash equivalents that are restricted as to withdrawal or use under the terms of certain contractual agreements are recorded as restricted cash.

As of June 30, 2018, Restricted Cash totaling \$4,000,000 represented monies that are held in escrow by the Quorum Center's Master Association. These funds are restricted under the North Carolina Condominium Act and are set aside specifically for the rebuild of the Credit Union's Quorum Center building. See Note 4.

**Investment Securities**

Debt securities are classified as available-for-sale and are carried at fair value with unrealized gains and losses reported in Other Comprehensive Loss. Realized gains and losses on securities available-for-sale are included in non-interest income and, when applicable, are reported as a reclassification adjustment in Other Comprehensive Loss. Gains and losses on sales of securities are determined using the specific identification method on the trade date. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Investment Securities (Continued)**

Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The Credit Union monitors the investment security portfolio for impairment on an individual security basis and has a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves analyzing the length of time and the extent to which the fair value has been less than the amortized cost basis, the market liquidity for the security, the financial condition and near-term prospects of the issuer, expected cash flows, and the Credit Union's intent and ability to hold the investment for a period of time sufficient to recover the temporary loss. The ability to hold is determined whether it is more likely than not that the Credit Union will be required to sell the security before its anticipated recovery. A decline in value due to a credit event that is considered other than temporary impairment (OTTI) is recorded as a loss in non-interest income.

Federal Home Loan Bank (FHLB) stock and certificates of deposit are stated at cost, and are subject to OTTI evaluation.

The Credit Union did not record any OTTI during the years ended June 30, 2018 and 2017.

**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 outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized in a valuation allowance by charges to income. Realized gains and losses on sales of loans are recognized at settlement dates and are determined by the difference between the sales proceeds and the carrying value of the loans and are recorded in non-interest income. All sales are made without recourse and are sold without the mortgage servicing rights retained by the Credit Union.

**Loans to Members, Net of Allowance for Loan Losses**

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

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. Interest on loans is recognized over the term of the loan and is generally calculated using the simple-interest method on principal amounts outstanding.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Loans to Members, Net of Allowance for Loan Losses (Continued)**

The accrual of interest on loans is discontinued at the time a loan is 90 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 status or that are 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 status. 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 does not charge fees on certain consumer loans. Fees are charged on mortgage loans; however, such fees are remitted to State Employees' Credit Union as compensation for originating the loans on behalf of the Credit Union. The Credit Union has not capitalized any loan origination costs or fees. The Credit Union does not charge commitment fees.

**Allowance for Loan Losses**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is 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, and 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.

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 and 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. 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.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Allowance for Loan Losses (Continued)**

Specific allowances for loan losses are established for 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, less estimated selling costs, if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are generally collectively evaluated for impairment. Accordingly, the Credit Union does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Under certain circumstances, the Credit Union will provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Credit Union for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of other assets in full or partial satisfaction of the debt. The Credit Union considers all aspects of the restructuring to determine whether it has granted a concession to the borrower. An insignificant delay in payment resulting from a restructuring is not deemed to be a concession and would not be considered to be a TDR.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Allowance for Loan Losses (Continued)**

The Credit Union maintains a separate general valuation allowance for homogeneous loan portfolio segments. These portfolio segments and their risk characteristics are described as follows:

**Consumer:** The consumer loan portfolio is usually comprised of a large number of small loans. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

**Residential Real Estate:** This portfolio consists of residential mortgage loans. The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate, and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than commercial real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

**Commercial:** Typical industry commercial portfolios consist of member business loans secured by real estate generally possessing a higher inherent risk of loss than residential real estate portfolio segments. LGFCU provides loans for apparatus, equipment, real estate and construction for North Carolina Fire, Rescue, and EMS Departments. Historically and currently, losses in this portfolio have been minimal.

The Credit Union assigns a risk rating to commercial loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Credit Union's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into the following major categories, defined as follows:

**Credit Risk Grade 1 – Highest Quality:** Assigned to credits which possess the lowest possible risk; the underlying borrower has established a borrowing relationship with LGFCU; and the loan(s) are 110% collateralized by USD deposits held by LGFCU.

**Credit Risk Grade 2 – Good Quality:** Credit is entirely acceptable and extended to the highest quality borrower and based on audited or reviewed financials as well as the following traits: a business entity in existence for a relatively long period, with many years of consecutive profits; strong equity position, good liquidity, excellent debt service ability, and unblemished past performance; relationships with reasonably strong borrowers supported by: a strong guarantor; and/or fully secured cash deposits held by LGFCU; other collateral with established value that is capable of being liquidated within a reasonable length of time where the maximum original loan-to-value is 80%.

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Allowance for Loan Losses (Continued)**

**Credit Risk Grade 3 – Acceptable:** Credit is acceptable and extended to a borrower not as strong and established as in credit risk grade 2. Financial information must be at minimum compiled financial statements and/or tax returns prepared by an independent accountant and upon analysis must show: no apparent weaknesses, but statement analysis reveals leverage, liquidity, or debt service ability to be less than optimal; credit to a borrower is not strong enough to sustain any major setbacks (typically uncovered during sensitivity analysis) but supported by collateral with established value which is capable of being liquidated.

**Credit Risk Grade 4 – Pass:** The credit risk is acceptable; however, financial statements cannot be relied upon to objectively and accurately provide the Credit Union with a reliable financial position.

**Credit Risk Grade 5 – Watch:** A credit that is currently an acceptable risk; however, trends are developing that are not promising and should be reversed if the borrower is to continue normal operations in the long run as well as the following traits: performance has not met expectations; however, the credit has not deteriorated sufficiently to be criticized or classified; earnings/cash flow problems are likely within the next twelve months; management may have defined weaknesses; the industry may be cyclically vulnerable or relatively unimportant.

**Credit Risk Grade 6 – Other Assets Especially Mentioned (“OAEM”):** Borrower risk rating 6/OAEM is a specific loan classification which is assigned to a credit when the borrower or guarantor has deteriorated or is deteriorating to a level below borrower risk rating 5, but has not reached the level of weakness and/or adverse financial trends that characterize borrower risk rating 7.

***Assets subject to Criticism***

The following credit risk grades are assigned to loan assets which display risk profiles which are deemed higher than is normally acceptable. As a consequence, depending upon the factors specific to the affected credit, it may be necessary to establish a reserve to absorb any loss which may occur.

**Credit Risk Grade 7 – Substandard:** Loans so classified must have a clear and well-defined weakness which jeopardizes the repayment of the underlying obligation(s). Loans possessing this classification are strong candidates for non-accrual.

**Credit Risk Grade 8 – Doubtful:** A loan subject to this classification has all of the weaknesses inherent in an asset classified substandard, with the added provision, that the weaknesses are pronounced to a point where collection or liquidation in full, on the basis of currently existing facts, conditions and values, is highly questionable and improbable.



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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Allowance for Loan Losses (Continued)**

**Credit Risk Grade 9 – Loss:** Loans classified loss are considered uncollectible and of such little value that their continuance as active assets of the Credit Union is not warranted. Assets classified as loss must be charged off.

Each portfolio segment has applicable funding requirements based on the Credit Union's historical loss ratio as determined by the allowance methodology. Net charge-offs are used to calculate historical losses. The Credit Union utilizes a range of 12 to 60 months based on the most applicable charge-off period for the losses present at that date for each portfolio segment, with 60 months being the maximum look-back period. In addition, management considers the impact of current and relevant environmental factors and documents which factors have been used in the analysis and how these factors affect the loss measurements.

**Transfers of Financial Assets**

Transfers of financial assets or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Credit Union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

**Off-Consolidated Statement of Financial Condition 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.

**Foreclosed Assets and Collateral in Process of Liquidation**

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 non-interest expense. As of June 30, 2018 and 2017, the amount of foreclosed assets and collateral in process of liquidation included in Other Assets totaled \$2,084,221 and \$2,820,539, respectively.

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Premises and Equipment, Net**

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

**Impairment of Long-Lived Assets**

The Credit Union tests long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less estimated costs to sell. See Note 4 – Premises and Equipment, Net for additional discussion.

**NCUSIF Deposit and NCUSIF and CCUSF Premium Assessments**

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 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.

In October 2017, the NCUA closed the Temporary Corporate Credit Union Stabilization Fund and transferred the remaining funds into the NCUSIF. The transfer of funds increased the equity level of the NCUSIF above the normal operating equity ratio threshold which was raised to 1.39% of insured shares. In February 2018, a dividend of \$736 million from the NCUSIF was announced by NCUA to lower the equity level to the normal operating ratio. The Credit Union accounted for the distribution by recognizing a receivable in April 2018. The Credit Union received the funds in July 2018, totaling \$1,052,765.

**Members' Share and Savings Accounts**

Members' share and savings accounts are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends and interest on members' share and savings accounts, except for interest on certificates of deposit which are set in advance, 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 the Board of Directors, based on an evaluation of current and future market conditions.

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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 established for the purpose of absorbing losses that exceed undivided earnings and other appropriations of undivided earnings, and is not available for the payment of interest and dividends.

The Credit Union is subject to various regulatory net worth requirements administered by the NCUA.

**Business Combination**

Effective January 1, 2017, City of Raleigh Employees Credit Union, a \$20.3 million state chartered federally insured credit union, was acquired by the Credit Union. This acquisition was accounted for as a purchase acquisition with no payment considerations involved. The acquisition did not have a material impact on the Credit Union's consolidated financial statements. See Note 14 – Business Combination for additional discussion.

**Comprehensive Income**

Comprehensive income consists of net income and other comprehensive loss. Accumulated other comprehensive loss recognized as a separate component of members' equity, includes valuation adjustments for sales of available-for-sale investment securities.

**Income Taxes**

As a federal instrumentality, the Credit Union is exempt from federal and state income taxes. The income from the CUSOs, both organized as an LLC, flows through to the Credit Union, and therefore are not subject to federal and state income taxes.

**Retirement Plan**

The Credit Union provides a 401(k) plan, which covers substantially all of the Credit Union's employees who are eligible as to age and length of service. A participant may elect to make contributions of up to the applicable IRS limitations of the participant's annual compensation. The Credit Union makes discretionary matching contributions as approved by the Board of Directors. The Credit Union's contributions to the plan were \$1,695,402 and \$1,495,781 for the years ended June 30, 2018 and 2017, respectively.

**Credit Union Owned Life Insurance Policies**

The Credit Union is the owner and substantial beneficiary of several life insurance policies on certain key executives. The policies are recorded at their cash surrender value (CSV) and increases or decreases in their CSV are included in Other Non-Interest Income.

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Split Dollar Collateral Assignment Life Insurance**

The Credit Union has made nonrecourse loans to select executives to fund life insurance policy premiums. The executives own the policies death benefit and sole control over listed beneficiaries, but the Credit Union holds a first lien on the policies account as security for repayment of the advanced funds plus compounded interest at the long-term applicable federal rate.

According to policy provision, the executives can borrow from the cash surrender values to supplement retirement income. Policy borrowing is strictly limited so that it never puts the policy at risk of lapsing.

As early as possible after specified dates, the Credit Union is repaid the amount it advanced for policy premiums. At the executive's death, the death benefit proceeds are allocated to (i) repay the insurance carrier for the executive's retirement loans, (ii) pay the Credit Union any premium advances amount not recovered from the policy during the executive's life, (iii) pay the Credit Union the interest on its funding amount, and (iv) provide a death benefit for the executive's beneficiaries.

The total value of the loans was \$14,512,064 and \$13,476,663 at June 30, 2018 and 2017, respectively.

**Advertising Costs**

Advertising and promotion costs which totaled approximately \$7,751,000 and \$2,835,000 for the years ended June 30, 2018 and 2017, respectively, are expensed as incurred and included in operations expense on the Consolidated Statements of Income.

**Fair Value Measurements**

The Credit Union categorizes its assets and liabilities measured at fair value into a three-level hierarchy based on the priority of the inputs to the valuation technique used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement.

Assets and liabilities valued at fair value are categorized based on the inputs to the valuation techniques as follows:

*Level 1* – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Credit Union has the ability to access.

*Level 2* – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

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**NOTE 1      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Fair Value Measurements (Continued)**

*Level 3* – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Subsequent to initial recognition, the Credit Union may remeasure the carrying value of assets and liabilities measured on a nonrecurring basis to fair value. Adjustments to fair value usually result when certain assets are impaired. Such assets are written down from their carrying amounts to their fair value.

Professional standards allow entities the irrevocable option to elect to measure certain financial instruments and other items at fair value for the initial and subsequent measurement on an instrument-by-instrument basis. The Credit Union adopted the policy to value certain financial instruments at fair value. The Credit Union has not elected to measure any existing financial instruments at fair value; however, it may elect to measure newly acquired financial instruments at fair value in the future.

**New Accounting Pronouncements**

In May 2014, the FASB approved ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The guidance requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required regarding customer contracts, significant judgements and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The standard will be effective for the Credit Union for annual reporting periods beginning after December 15, 2018. Early adoption is permitted. Management is evaluating the impact of the amended revenue recognition guidance on the Credit Union's consolidated financial statements.

In February 2016, the FASB approved ASU 2016-02, *Leases (Topic 842)*. The ASU is designed to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the Consolidated Statements of Financial Condition and disclosing key information about leasing arrangements. The ASU is effective for the Credit Union for the fiscal year beginning after December 15, 2019, and interim periods within the fiscal year beginning after December 15, 2020. Early adoption is permitted. Management is currently evaluating the impact of ASU 2016-02 on the consolidated financial statements.

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**New Accounting Pronouncements (Continued)**

In June 2016, the FASB approved ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in the ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The ASU is effective for the Credit Union for the fiscal year beginning after December 15, 2021. Early adoption is permitted for the fiscal year beginning after December 15, 2018, including interim periods within this fiscal year. Management is currently evaluating the impact of ASU 2016-13 on the financial statements.

In March 2017, the FASB approved ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The guidance requires an entity to shorten the amortization period for certain purchased callable debt securities held at a premium to the earliest call date. The standard will be effective for the Credit Union for annual reporting periods beginning after December 15, 2019. Early adoption is permitted. Management believes that this standard will not have a material impact on the Credit Union’s consolidated financial statements.

**Subsequent Events**

In preparing these consolidated financial statements, the Credit Union has evaluated events and transactions for potential recognition or disclosure through September 13, 2018, the date the consolidated financial statements were available to be issued.

**NOTE 2 INVESTMENT SECURITIES**

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Value)
<b>June 30, 2018</b>				
Federal Agency Mortgage Backed Securities	\$ 46,174,389	\$ -	\$ (2,612,643)	\$ 43,561,746
Collateralized Mortgage Obligation Securities	25,127,573	-	(1,746,232)	23,381,341
Total	<u>\$ 71,301,962</u>	<u>\$ -</u>	<u>\$ (4,358,875)</u>	<u>\$ 66,943,087</u>

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**NOTE 2 INVESTMENT SECURITIES (CONTINUED)**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Value)
<b>June 30, 2017</b>				
Federal Agency Mortgage Backed Securities	\$ 55,115,542	\$ -	\$ (1,553,374)	\$ 53,562,168
Collateralized Mortgage Obligation Securities	30,516,174	-	(1,222,219)	29,293,955
Total	<u>\$ 85,631,716</u>	<u>\$ -</u>	<u>\$ (2,775,593)</u>	<u>\$ 82,856,123</u>

There were no sales of securities available-for-sale during the year ended June 30, 2018. Sales of securities resulted in gross gains of approximately \$40,000 and gross losses of approximately \$37,000 during the year ended June 30, 2017.

The amortized cost and fair value of investment securities available-for-sale at June 30, 2018, 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 (Carrying Value)
Federal Agency Mortgage Backed Securities:		
Within Five to Ten years	\$ 16,800,020	\$ 15,837,823
After Ten Years	29,374,369	27,723,923
Collateralized Mortgage Obligation Securities:		
After Ten Years	25,127,573	23,381,341
Total	<u>\$ 71,301,962</u>	<u>\$ 66,943,087</u>

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**NOTE 2 INVESTMENT SECURITIES (CONTINUED)**

*Temporarily Impaired Investment Securities*

Information pertaining to securities with gross unrealized losses at June 30, 2018 and 2017, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position, are as follows:

	2018			
	Continuous Unrealized Losses Existing			
	Less than 12 months		Greater than 12 months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
<b>Securities Available-for-Sale:</b>				
Federal Agency Mortgage backed Securities	\$ -	\$ -	\$ (2,612,643)	\$ 43,561,746
Collateralized Mortgage Obligation Securities	-	-	(1,746,232)	23,381,341
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (4,358,875)</u>	<u>\$ 66,943,087</u>
	2017			
	Continuous Unrealized Losses Existing			
	Less than 12 months		Greater than 12 months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
<b>Securities Available-for-Sale:</b>				
Federal Agency Mortgage backed Securities	\$ (340,121)	\$ 12,575,265	\$ (1,213,253)	\$ 40,986,903
Collateralized Mortgage Obligation Securities	-	-	(1,222,219)	29,293,955
Total	<u>\$ (340,121)</u>	<u>\$ 12,575,265</u>	<u>\$ (2,435,472)</u>	<u>\$ 70,280,858</u>

At June 30, 2018, 15 securities with unrealized losses depreciated 6.11% from the Credit Union's amortized cost basis. All of these securities are either guaranteed by federal insurance, the U.S. Government, and/or secured by mortgage loans. These unrealized losses relate principally to current interest rates for similar types of securities and does not relate to credit risk. 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. As management has the ability to hold securities until maturity or for the foreseeable future for those classified as available-for-sale, no declines are deemed to be other than temporary.

In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility risk. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the investments will occur in the near term and that such changes could be material.



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**NOTE 2 INVESTMENT SECURITIES (CONTINUED)**

Other investments at June 30 are summarized as follows:

	2018	2017
Certificates of Deposit	\$ 145,263	\$ 250,000
FHLB Stock	1,816,100	1,674,200
Total	<u>\$ 1,961,363</u>	<u>\$ 1,924,200</u>

*Certificates of Deposit*

The Credit Union has a certificate of deposit in another financial institution. This is stated at cost. The certificate of deposit matures within one year.

*FHLB Stock*

The Credit Union has an investment in Federal Home Loan Bank of Atlanta (FHLB) stock that allows the Credit Union access to other FHLB financial services. The stock qualifies as a restricted stock and, as such, is not subject to investment security accounting treatment and is therefore reported at cost, subject to impairment.

**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES**

The composition of loans to members, net of allowance for loan losses at June 30 is as follows:

	2018	2017
Commercial:		
Member Business	<u>\$ 94,960,172</u>	<u>\$ 79,795,407</u>
Residential Real Estate:		
First Mortgage	694,791,927	583,031,763
Home Equity Line	90,142,941	76,235,225
Total Residential Real Estate	<u>784,934,868</u>	<u>659,266,988</u>
Consumer:		
New Auto	139,760,170	133,989,324
Used Auto	382,843,892	376,681,892
Credit Card	91,486,816	84,146,612
Other	202,721,963	176,285,170
Total Consumer	<u>816,812,841</u>	<u>771,102,998</u>
Subtotal	1,696,707,881	1,510,165,393
Less Allowance for Loan Losses	<u>(16,919,363)</u>	<u>(14,283,027)</u>
Total	<u>\$ 1,679,788,518</u>	<u>\$ 1,495,882,366</u>

The Credit Union has \$13,720,752 of mortgage loan commitments at June 30, 2018 (\$19,796,687 at June 30, 2017), included in residential real estate loan segment above.

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**NOTE 3    LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the year ended June 30, 2018 are as follows:

	Commercial	Residential Real Estate	Consumer	Total
<b>Allowance for loan losses:</b>				
Beginning Balance	\$ 280,218	\$ 2,259,069	\$ 11,743,740	\$ 14,283,027
Provision (Credit) for Loan Losses	(42,381)	(1,150,991)	20,428,137	19,234,765
Recoveries	-	43,291	1,429,039	1,472,330
Charge-offs	-	(317,451)	(17,753,308)	(18,070,759)
Ending Balance	<u>\$ 237,837</u>	<u>\$ 833,918</u>	<u>\$ 15,847,608</u>	<u>\$ 16,919,363</u>
Ending Balance:				
Individually Evaluated for Impairment	\$ 27,823	\$ 462,966	\$ 501,932	\$ 992,721
Collectively Evaluated for Impairment	<u>210,014</u>	<u>370,952</u>	<u>15,345,676</u>	<u>15,926,642</u>
Total	<u>\$ 237,837</u>	<u>\$ 833,918</u>	<u>\$ 15,847,608</u>	<u>\$ 16,919,363</u>
<b>Loans to Members:</b>				
Ending Balance:				
Individually Evaluated for Impairment	\$ 29,123	\$ 50,891,125	\$ 922,842	\$ 51,843,090
Collectively Evaluated for Impairment	<u>94,931,049</u>	<u>734,043,743</u>	<u>815,889,999</u>	<u>1,644,864,791</u>
Total	<u>\$ 94,960,172</u>	<u>\$ 784,934,868</u>	<u>\$ 816,812,841</u>	<u>\$ 1,696,707,881</u>

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the year ended June 30, 2017 are as follows:

	Commercial	Residential Real Estate	Consumer	Total
<b>Allowance for loan losses:</b>				
Beginning Balance	\$ 102,108	\$ 2,542,942	\$ 7,192,592	\$ 9,837,642
Provision for Loan Losses	178,110	203,892	15,951,752	16,333,754
Recoveries	-	15,196	1,254,755	1,269,951
Charge-offs	-	(502,961)	(12,655,359)	(13,158,320)
Ending Balance	<u>\$ 280,218</u>	<u>\$ 2,259,069</u>	<u>\$ 11,743,740</u>	<u>\$ 14,283,027</u>
Ending Balance:				
Individually Evaluated for Impairment	\$ 42,874	\$ 1,624,950	\$ 542,219	\$ 2,210,043
Collectively Evaluated for Impairment	<u>237,344</u>	<u>634,119</u>	<u>11,201,521</u>	<u>12,072,984</u>
Total	<u>\$ 280,218</u>	<u>\$ 2,259,069</u>	<u>\$ 11,743,740</u>	<u>\$ 14,283,027</u>
<b>Loans to members:</b>				
Ending Balance:				
Individually Evaluated for Impairment	\$ 42,874	\$ 50,610,987	\$ 1,004,350	\$ 51,658,211
Collectively Evaluated for Impairment	<u>79,752,533</u>	<u>608,656,001</u>	<u>770,098,648</u>	<u>1,458,507,182</u>
Total	<u>\$ 79,795,407</u>	<u>\$ 659,266,988</u>	<u>\$ 771,102,998</u>	<u>\$ 1,510,165,393</u>

The following tables show the commercial loan portfolio segment allocated by managements internal risk ratings as of June 30:

<u>Commercial Loan Risk Ratings</u>	<u>2018</u>	<u>2017</u>
Pass (Risk Grade 1 - 4)	\$ 94,378,868	\$ 79,120,397
Watch	552,181	632,136
Other Assets Especially Mentioned	-	-
Substandard	-	-
Doubtful	29,123	42,874
Loss	-	-
<b>Total</b>	<u>\$ 94,960,172</u>	<u>\$ 79,795,407</u>

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

*Commercial, 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 loan portfolio, management tracks the loan's performance and when the loan becomes 90 days past due they are classified as non-performing loans.

The following tables show the classes within the homogenous loan portfolio segments allocated by payment activity. Loans are deemed performing if they are less than 90 days delinquent and still accruing interest.

<b>June 30, 2018</b>	Payment Activity		
	Performing	Non-Performing	Total
<b><u>Commercial:</u></b>			
Member Business	\$ 94,960,172	\$ -	\$ 94,960,172
<b><u>Residential Real Estate:</u></b>			
First Mortgage	687,764,064	7,027,863	694,791,927
Home Equity Line	90,017,168	125,773	90,142,941
<b><u>Consumer:</u></b>			
New Auto	139,095,882	664,288	139,760,170
Used Auto	380,006,798	2,837,094	382,843,892
Credit Card	90,290,388	1,196,428	91,486,816
Other	201,978,397	743,566	202,721,963
Total	<u>\$1,684,112,869</u>	<u>\$ 12,595,012</u>	<u>\$1,696,707,881</u>
<b>June 30, 2017</b>	Payment Activity		
	Performing	Non-Performing	Total
<b><u>Commercial:</u></b>			
Member Business	\$ 79,752,533	\$ 42,874	\$ 79,795,407
<b><u>Residential Real Estate:</u></b>			
First Mortgage	577,123,080	5,908,683	583,031,763
Home Equity Line	75,747,034	488,191	76,235,225
<b><u>Consumer:</u></b>			
New Auto	133,481,575	507,749	133,989,324
Used Auto	374,117,690	2,564,202	376,681,892
Credit Card	83,212,767	933,845	84,146,612
Other	175,656,180	628,990	176,285,170
Total	<u>\$1,499,090,859</u>	<u>\$ 11,074,534</u>	<u>\$1,510,165,393</u>

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

The following tables show an aging analysis of the loan portfolio at June 30, by time past due:

2018	Accruing Interest				Total Loans to Members
	Current	30-59 Days Past Due	60-89 Days Past Due	Nonaccrual 90 Days or More Past Due	
<b><u>Commercial</u></b>	\$ 94,931,049	\$ -	\$ 29,123	\$ -	\$ 94,960,172
<b><u>Residential Real Estate:</u></b>					
First Mortgage	663,810,020	18,113,341	5,840,703	7,027,863	694,791,927
Home Equity Line	89,695,461	225,361	96,346	125,773	90,142,941
<b><u>Consumer:</u></b>					
New Auto	136,900,286	1,791,666	403,930	664,288	139,760,170
Used Auto	370,051,708	7,097,961	2,857,129	2,837,094	382,843,892
Credit Card	82,664,923	6,175,585	1,449,880	1,196,428	91,486,816
Other	199,109,488	2,018,446	850,463	743,566	202,721,963
<b>Total</b>	<b>\$ 1,637,162,935</b>	<b>\$ 35,422,360</b>	<b>\$ 11,527,574</b>	<b>\$ 12,595,012</b>	<b>\$ 1,696,707,881</b>

2017	Accruing Interest				Total Loans to Members
	Current	30-59 Days Past Due	60-89 Days Past Due	Nonaccrual 90 Days or More Past Due	
<b><u>Commercial</u></b>	\$ 79,752,533	\$ -	\$ -	\$ 42,874	\$ 79,795,407
<b><u>Residential Real estate:</u></b>					
First Mortgage	559,869,595	13,657,771	3,595,714	5,908,683	583,031,763
Home Equity Line	75,207,999	372,846	166,189	488,191	76,235,225
<b><u>Consumer:</u></b>					
New Auto	131,408,964	1,483,121	589,490	507,749	133,989,324
Used Auto	364,363,057	7,357,158	2,397,475	2,564,202	376,681,892
Credit Card	76,489,454	5,370,922	1,352,391	933,845	84,146,612
Other	172,596,208	2,004,274	1,055,698	628,990	176,285,170
<b>Total</b>	<b>\$ 1,459,687,810</b>	<b>\$ 30,246,092</b>	<b>\$ 9,156,957</b>	<b>\$ 11,074,534</b>	<b>\$ 1,510,165,393</b>

The Credit Union had no loans that were greater than 90 days past-due for which the loans were accruing interest at June 30, 2018 and 2017, respectively.

Interest income foregone on nonaccrual loans was deemed immaterial by management for the years ended June 30, 2018 and 2017.

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

Information concerning impaired loans by loan class as of June 30, 2018 is as follows:

	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b><i>With No Specific Reserve Recorded:</i></b>			
<b><u>Residential Real Estate:</u></b>			
First Mortgage	\$ 21,188,135	\$ -	\$ 20,328,842
<b><u>Consumer:</u></b>			
Used Auto	\$ 6,047	\$ -	\$ 3,024
Total	<u>\$ 21,194,182</u>	<u>\$ -</u>	<u>\$ 20,331,865</u>
<b><i>With Specific Reserve Recorded:</i></b>			
<b><u>Commercial</u></b>			
Member Business	<u>\$ 29,123</u>	<u>\$ 27,823</u>	<u>\$ 14,562</u>
<b><u>Residential Real Estate:</u></b>			
First Mortgage	<u>\$ 29,702,990</u>	<u>\$ 462,966</u>	<u>\$ 30,422,215</u>
<b><u>Consumer:</u></b>			
New Auto	\$ 207,398	\$ 117,828	\$ 103,699
Used Auto	709,397	384,104	354,699
Total Consumer	<u>\$ 916,795</u>	<u>\$ 501,932</u>	<u>\$ 458,398</u>
Commercial	\$ 29,123	\$ 27,823	\$ 14,562
Residential Real Estate	50,891,125	462,966	50,751,057
Consumer	<u>922,842</u>	<u>501,932</u>	<u>461,421</u>
Total Loans Individually Evaluated for Impairment	<u>\$ 51,843,090</u>	<u>\$ 992,721</u>	<u>\$ 51,227,039</u>

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

Information concerning impaired loans by loan class as of June 30, 2017 is as follows:

	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
<b><i>With No Specific Reserve Recorded:</i></b>			
<b><u>Residential Real Estate:</u></b>			
First Mortgage	\$ 19,469,548	\$ -	\$ 19,850,007
<b><u>Consumer:</u></b>			
Used Auto	\$ 15,318	\$ -	\$ 7,659
Total	\$ 19,484,866	\$ -	\$ 19,857,666
<b><i>With Specific Reserve Recorded:</i></b>			
<b><u>Commercial</u></b>			
Member Business	\$ 42,874	\$ 42,874	\$ 21,437
<b><u>Residential Real Estate:</u></b>			
First Mortgage	\$ 31,141,439	\$ 1,624,950	\$ 31,907,319
<b><u>Consumer:</u></b>			
New Auto	\$ 227,719	\$ 129,787	\$ 113,860
Used Auto	761,313	412,432	380,657
Total Consumer	\$ 989,032	\$ 542,219	\$ 494,517
Commercial	\$ 42,874	\$ 42,874	\$ 21,437
Residential Real Estate	50,610,987	1,624,950	51,757,326
Consumer	1,004,350	542,219	502,176
Total Loans Individually Evaluated for Impairment	\$ 51,658,211	\$ 2,210,043	\$ 52,280,939

Interest collected on impaired loans for the years ended June 30, 2018 and 2017 was not deemed significant as interest is not accrued on non-accrual loans or other loans past-due 90 days or more.

The Credit Union does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are in nonaccrual.

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**NOTE 3 LOANS TO MEMBERS, NET OF ALLOWANCE FOR LOAN LOSSES (CONTINUED)**

A summary of TDRs by class that were granted during the year and those that were granted, and subsequently defaulted (became 90 days or more delinquent) during the years ended June 30, 2018 and 2017, are as follows. The aggregate amount of charge-offs as a result of restructuring are not significant. A summary of loan modifications by class during the years ended June 30 are as follows:

<b>During the Year Ended June 30, 2018</b>	<b>Troubled Debt Restructurings</b>		<b>Troubled Debt Restructurings That Subsequently Defaulted</b>	
	<b>Number of Loans</b>	<b>Post-Modification Outstanding Balance</b>	<b>Number of Loans</b>	<b>Post-Modification Outstanding Balance</b>
First Mortgage	203	\$ 8,823,930	7	\$ 498,645
Home Equity Line	17	615,687	-	-
New Auto	97	1,946,203	1	14,690
Used Auto	369	3,981,187	19	212,610
Other	46	349,178	1	18,092
Total	<u>732</u>	<u>\$ 15,716,185</u>	<u>28</u>	<u>\$ 744,037</u>

  

<b>During the Year Ended June 30, 2017</b>				
First Mortgage	198	\$ 11,190,365	32	\$ 3,143,572
Home Equity Line	18	475,628	1	48,200
New Auto	79	1,444,556	5	105,532
Used Auto	369	3,671,724	23	231,083
Other	63	397,354	6	22,231
Total	<u>727</u>	<u>\$ 17,179,627</u>	<u>67</u>	<u>\$ 3,550,618</u>

The following table shows the types of modifications made during the years ended June 30, 2018 and 2017:

	<b>During the Year Ended June 30, 2018</b>				
	<b>Interest Rate Adjustment</b>	<b>Extended Maturities</b>	<b>Partial Payment</b>	<b>Refinance</b>	<b>Total</b>
First Mortgage	\$ 571,166	\$ 5,182,994	\$ 578,475	\$ 2,491,295	\$ 8,823,930
Home Equity Line	-	615,687	-	-	615,687
New Auto	-	1,946,203	-	-	1,946,203
Used Auto	-	3,981,187	-	-	3,981,187
Other	-	349,178	-	-	349,178
Total	<u>\$ 571,166</u>	<u>\$ 12,075,249</u>	<u>\$ 578,475</u>	<u>\$ 2,491,295</u>	<u>\$ 15,716,185</u>

	<b>During the Year Ended June 30, 2017</b>				
	<b>Interest Rate Adjustment</b>	<b>Extended Maturities</b>	<b>Partial Payment</b>	<b>Refinance</b>	<b>Total</b>
First Mortgage	\$ 2,144,694	\$ 4,141,272	\$ 1,017,206	\$ 3,887,193	\$ 11,190,365
Home Equity Line	-	475,628	-	-	475,628
New Auto	-	1,444,556	-	-	1,444,556
Used Auto	-	3,671,724	-	-	3,671,724
Other	-	397,354	-	-	397,354
Total	<u>\$ 2,144,694</u>	<u>\$ 10,130,534</u>	<u>\$ 1,017,206</u>	<u>\$ 3,887,193</u>	<u>\$ 17,179,627</u>



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**NOTE 4 PREMISES AND EQUIPMENT, NET**

A summary of premises and equipment at June 30 is as follows:

	2018	2017
Land	\$ 2,364,437	\$ 2,364,437
Building	57,126,208	57,090,752
Leasehold Improvements	-	722,839
Furniture and Equipment	3,191,397	4,411,981
Computer Equipment	4,117,305	4,506,677
Automobiles	551,738	693,227
Construction in Process	2,208,004	173,945
	<u>69,559,089</u>	<u>69,963,858</u>
Less Accumulated Depreciation and Amortization	(9,460,728)	(11,522,859)
	<u>\$ 60,098,361</u>	<u>\$ 58,440,999</u>
Total	<u>\$ 60,098,361</u>	<u>\$ 58,440,999</u>

In March 2017, the Credit Union's Headquarters building (Quorum Center), and other property and equipment were damaged in a fire. During 2017, the Credit union evaluated these assets for impairment and subsequently recorded a loss of approximately \$3,708,000, which was included in other non-interest expense on the Consolidated Statements of Income.

As of June 30, 2018, the Quorum Center building had a carrying value of \$11,811,000, acquired value of \$16,336,000 less accumulated depreciation of \$4,525,000. With new information available since the prior year consolidated financial statements were issued, management evaluated the building for impairment, utilizing the fair value, less the carrying value, which resulted in an additional loss totaling approximately \$173,000.

The losses for both the property and equipment, along with the building impairment, were recorded in the Consolidated Statements of Income as other non-interest expense. However, because management submitted insurance claims and received funds of approximately \$3,881,000, which fully offset the previous loss taken, a gain was recognized for approximately \$4,530,000. See further discussion regarding the restricted funds received from the insurance company in the Summary of Significant Accounting Policies, Note 1 – Restricted Cash.

**NOTE 5 LEASE COMMITMENTS**

Tenants are unable to occupy the building space and management has deemed that the contractual amounts are likely to differ from the actual amounts received until such time that the facility is available for use.

Rental income was \$13,367 and \$285,716 for the years ended June 30, 2018 and 2017, respectively. This is included in other non-interest income in the Consolidated Statements of Income. Management submitted insurance claims to recover lost rental income due to the fire which have since been settled.

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**NOTE 6 MEMBERS' SHARE AND SAVINGS ACCOUNTS**

A summary of members' share and savings accounts by type at June 30 are as follows:

	<u>2018</u>	<u>2017</u>
Regular Share Accounts	\$ 476,232,926	\$ 422,682,320
Share Draft Accounts	348,490,979	322,929,039
Money Market Accounts	527,157,744	486,579,617
IRA Share Accounts	178,652,908	181,789,204
Share Term Certificates	<u>266,901,213</u>	<u>283,087,690</u>
 Total Members' Share and Savings Accounts	 <u>\$ 1,797,435,770</u>	 <u>\$ 1,697,067,870</u>

The aggregate amounts of certificates of deposit in denominations of \$250,000 or more was approximately \$19,822,000 and \$21,884,000 at June 30, 2018 and 2017, respectively.

Overdrawn share accounts reclassified to unsecured loans to members totaled approximately \$264,000 and \$216,000 at June 30, 2018 and 2017, respectively.

Scheduled maturities of share term certificates for years ending June 30 are as follows:

2019	\$ 129,897,741
2020	49,342,269
2021	44,106,156
2022	27,974,260
2023	<u>15,580,787</u>
Total	<u>\$ 266,901,213</u>

Member accounts are insured to at least \$250,000 by the National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF is a federal insurance fund backed by the full faith and credit of the U.S. Government.

**NOTE 7 BORROWED FUNDS**

At June 30, 2018 and 2017, the Credit Union had available lines of credit of approximately \$503,565,000 and \$469,400,000 with the FHLB and \$352,228,000 and \$341,314,000 with the Federal Reserve Bank of Richmond (FRB), respectively. The FHLB line is collateralized by mortgage loans and the FRB line is collateralized by auto loans. The interest rates applied on any borrowing are determined on the date of borrowing. The lines have no expiration dates, but are subject to review and change by the issuing institutions. There were no balances outstanding on these lines at June 30, 2018 and 2017.

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**NOTE 7 BORROWED FUNDS (CONTINUED)**

On October 2, 2017, the Credit Union obtained a secondary capital loan totaling \$2 million from the National Federation of Community Development Credit Unions (the "Federation") for the purpose of making loans to promote community development. The funds are committed to the Secondary Capital account for a period of seven (7) years. The secondary capital is a form of subordinated debt and is included in "Accrued Expenses and Other Liabilities" on the Consolidated Statements of Financial Condition. At June 30, 2018, the Credit Union applied \$2,000,000 of subordinated debt towards the net worth calculation.

Interest is payable quarterly in arrears on January 1, April 1, July 1, and October 1 of each year at a rate of 3.75% per annum. Principal payments will be paid on the anniversary of the disbursement of the loan as follows for the years ending June 30:

2019	\$ 400,000
2020	400,000
2021	400,000
2022	400,000
2023	400,000
Total	<u>\$ 2,000,000</u>

**NOTE 8 OFF-STATEMENT OF FINANCIAL CONDITION 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, and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated financial statements.

The Credit Union's exposure to credit loss is represented by the contractual 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 consolidated financial statements.

At June 30, the following financial instruments were outstanding whose contract amounts represent credit risk:

	2018	2017
Commitments to Grant Loans:		
Member Business	\$ 6,600,637	\$ 2,240,335
Home-Equity Lines of Credit	63,122,654	57,179,981
Credit Cards	109,935,463	104,696,333
Other Unfunded Commitments	37,871,728	39,222,963
Total	<u>\$ 217,530,482</u>	<u>\$ 203,339,612</u>

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**NOTE 8 OFF-STATEMENT OF FINANCIAL CONDITION 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. 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 counterparty. Collateral held varies, but may include consumer assets, residential real estate and member share balances.

Unfunded commitments under member business lines-of-credit and revolving credit lines 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 only be drawn upon to the total extent to which the Credit Union is committed.

**NOTE 9 CONTINGENCIES AND COMMITMENTS**

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 consolidated financial condition.

The Credit Union entered into several contracts representing purchase commitments. As of June 30, 2018 and 2017, purchase commitments related to the purchase of a core processing system were estimated to be \$3,515,000 and \$2,560,000, respectively.

At June 30, 2018, the Credit Union estimates the rebuild construction of the Quorum Center will total approximately \$7,724,000. This amount will be paid out of the Quorum Center Master Association funds, which are held by three different brokers and not by the Credit Union directly. See Restricted Cash in Note 1.

**NOTE 10 REGULATORY NET WORTH**

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

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**NOTE 10 REGULATORY NET WORTH (CONTINUED)**

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum ratios (set forth in the table below) of net worth to total assets (as defined by the regulation). Credit unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR) which establishes whether or not the Credit Union will be considered “complex” under the regulatory framework. The Credit Union’s RBNWR ratio as of June 30, 2018, the most recent quarterly regulatory filing date, was 5.12%. The minimum ratio to be considered complex under the regulatory framework is 6.00%. Management believes, as of June 30, 2018, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of June 30, 2018, the most recent call reporting period, the NCUA categorized the Credit Union initially as “well capitalized” under the regulatory frame work for prompt corrective action. To be categorized as “well capitalized,” the Credit Union must maintain a minimum net worth ratio of 7% of assets. There are no conditions or events since that notification that management believes have changed the institution’s category.

The Credit Union’s actual capital amounts and ratios as of June 30 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
<b>2018</b>						
Net worth	\$ 195,600,099	9.97%	\$ 117,634,099	6.00%	\$ 137,239,782	7.00%
Risk-based net worth requirement	103,426,373	5.12%	N/A	N/A	N/A	N/A
<b>2017</b>						
Net worth	\$ 167,606,326	9.29%	\$ 108,306,644	6.00%	\$ 126,357,751	7.00%
Risk-based net worth requirement	96,673,473	5.18%	N/A	N/A	N/A	N/A

Because the RBNW ratio of 5.12% is less than the net worth ratio of 9.97%, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the average of the current and three preceding quarter-end balances option, as permitted by regulation. For purposes of the net worth calculation, net worth includes all undivided earnings, regular reserves, net worth from an acquisition and subordinated debt obtained from the Federation.

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**NOTE 11 RELATED PARTY TRANSACTIONS**

Additionally, in the normal course of business, the Credit Union extends credit to members of the board of directors, supervisory committee members and executive officers. Included in Loans to Members, Net of Allowance for Loan Losses and Split-Dollar Collateral Assignment Life Insurance at June 30, 2018 and 2017, are loans to the Credit Union's board of directors, committee members, and senior executive staff of approximately \$16,231,000 and \$18,333,000, respectively. The aggregate principal advances and principal repayments are not significant.

Members' Shares and Savings Accounts (deposits) from the Credit Union's board of directors, supervisory committee members, and executive officers held by the Credit Union at June 30, 2018 and 2017 are approximately \$2,099,000 and \$4,951,000, respectively.

The Credit Union provided financial support of \$5,000,000 during the year ended June 30, 2018 to Civic Federal Credit Union and treated it as a capital gift. The capital gift was given to Civic with no expectation that the funds would be returned. Therefore, the transaction was treated as an expense to the Credit Union and an equity Civic transaction, respectively. This transaction was eliminated in consolidation. In April, 2018, the Credit Union approved an additional capital gift of up to \$3 million for expenditures needed to reach Civics' launch. Current estimates indicate that \$200 thousand will be need by December 31, 2018.

The Credit Union and Civic currently have common oversight and management. While there are two independent board members for each Credit Union, the remaining Civic board members are also Credit Union board members. The Credit Union will cover expenses on Civics' behalf in return for a service fee outlined in a Support Services Agreement. Had Civic incurred these expenses on a stand-alone basis, the operational support expenses during the fiscal year would have been approximately \$6.9 million and reported in Civics' financial statements. The agreement states that the Credit Union will provide substantially all of Civics' operating services, including property and equipment, system infrastructure and human capital in return for a rate of 25 percent of the gross revenue of Civic. Operational support expenses incurred by LGFCU on Civic's behalf are included in the Credit Union's consolidated financial statements. The Credit Union received \$0 in services fees given that Civic is not yet operational and did not have any gross revenue for the year ended June 30, 2018.

**NOTE 12 RELIANCE ON OTHER PARTIES**

The Credit Union has an agreement with State Employees' Credit Union of North Carolina (SECU) under which SECU provides substantially all of the Credit Union's operating services including member services, branch facilities, and data processing services. SECU is compensated for such services at a rate of twenty five percent of the gross revenue of the Credit Union, which is paid on a monthly basis. During 2018 and 2017, the Credit Union incurred service fees of \$30,933,691 and \$26,495,154, respectively, for services rendered under the agreement with SECU, which is included in operations expense on the Consolidated Statements of Income.

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**NOTE 12 RELIANCE ON OTHER PARTIES (CONTINUED)**

SECU charges the Credit Union a \$.50 processing charge for the usage of SECU automated teller machines (ATM). Total ATM fees paid to SECU were \$2,420,677 and \$2,240,196 for fiscal years ended June 30, 2018 and 2017, respectively. At June 30, 2018 and 2017, the payable to SECU for services rendered under this agreement was \$0 and \$201,979, respectively.

SECU settles daily member transactions on behalf of the Credit Union. The Credit Union records this activity as a net receivable or payable for amounts settled but not received or paid. The Credit Union had a net receivable from SECU of \$0 and \$4,596,174 at June 30, 2018 and 2017, respectively.

**NOTE 13 FAIR VALUE**

**Recurring Basis**

The Credit Union uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how the Credit Union measures fair value refer to Note 1 – Summary of Significant Accounting Policies. The following tables present the balances of the assets and liabilities measured at fair value on a recurring basis as of June 30:

	Balance as of June 30,	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
<b>2018</b>					
Federal Agency Mortgage backed Securities	\$ 43,561,746	\$ -	\$ 43,561,746	\$ -	\$ 43,561,746
Collateralized Mortgage Obligation Securities	23,381,341	-	23,381,341	-	23,381,341
Total	<u>\$ 66,943,087</u>	<u>\$ -</u>	<u>\$ 66,943,087</u>	<u>\$ -</u>	<u>\$ 66,943,087</u>
<b>2017</b>					
Federal Agency Mortgage backed Securities	\$ 53,562,168	\$ -	\$ 53,562,168	\$ -	\$ 53,562,168
Collateralized Mortgage Obligation Securities	29,293,955	-	29,293,955	-	29,293,955
Total	<u>\$ 82,856,123</u>	<u>\$ -</u>	<u>\$ 82,856,123</u>	<u>\$ -</u>	<u>\$ 82,856,123</u>

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**NOTE 13 FAIR VALUE (CONTINUED)**

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

**Investment Securities:** When available, the Credit Union uses quoted market prices to determine the fair value of securities; such items are classified in Level 1 of the fair value hierarchy. For the Credit Union's securities where quoted prices are not available for identical securities in an active market, the Credit Union determines fair value utilizing vendors who apply matrix pricing for similar bonds where no price is observable or may compile prices from various sources. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Fair values from these models are verified, where possible, against quoted market prices for recent trading activity of assets with similar characteristics to the security being valued. Such methods are generally classified as Level 2. However, when prices from independent sources vary, cannot be obtained or cannot be corroborated, a security is generally classified as Level 3.

**Nonrecurring Basis**

Certain assets are measured at fair value on a nonrecurring basis. These assets are not measured at fair value on an ongoing basis; however, they are subject to fair value adjustments in certain circumstances, such as there is evidence of impairment or a change in the amount of previously recognized impairment.

Net impairment losses related to nonrecurring fair value measurements of certain assets for the years ended June 30, 2018 and 2017 consisted of the following:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Impairment Losses
<b>June 30, 2018</b>				
Impaired Loans	\$ -	\$ -	\$ 29,656,187	\$ (992,721)
Foreclosed Assets	-	-	1,663,312	(895,450)
Total Nonrecurring	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,319,499</u>	<u>\$ (1,888,171)</u>
<b>June 30, 2017</b>				
Impaired Loans	\$ -	\$ -	\$ 29,963,302	\$ (2,210,043)
Foreclosed Assets	-	-	2,358,408	(676,578)
Total Nonrecurring	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 32,321,710</u>	<u>\$ (2,886,621)</u>



**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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**NOTE 13 FAIR VALUE (CONTINUED)**

**Impaired Loans:** In accordance with the provisions of the loan impairment guidance, impairment was measured for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. Collateral values are estimated using Level 3 inputs based on customized discounting criteria.

Impairment amounts on impaired loans represent specific valuation allowance and write-downs during the period presented on impaired loans that were individually evaluated for impairment based on the estimated fair value of the collateral less estimated selling costs, excluding impaired loans fully charged-off.

**Foreclosed Assets:** Foreclosed assets are recorded at fair value based on property appraisals, less estimated selling costs, at the date of the transfer with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, foreclosed assets are carried at the lower of cost or fair value, less estimated selling costs with changes in fair value or any impairment amount recorded in other non-interest expense. Values are estimated using Level 3 inputs based on customized discounting criteria. The carrying value of foreclosed assets is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value, less estimated selling costs.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Credit Union has utilized Level 3 inputs to determine fair value:

<b>June 30, 2018</b>				
	Fair Value	Valuation Technique	Unobservable Input	Range (Average)
Impaired Loans	\$ 29,656,187	Appraisals or Discounted Expected Cash Flows	Appraisal Adjustment or Discount Rates	Collateral Discount of 8% or 2.75% to 8.25% Discount Rate
Foreclosed Assets	1,663,312	Appraisal	Appraisal Adjustment	16%

<b>June 30, 2017</b>				
	Fair Value	Valuation Technique	Unobservable Input	Range (Average)
Impaired Loans	\$ 29,963,302	Appraisals or Discounted Expected Cash Flows	Appraisal Adjustment or Discount Rates	Collateral Discount of 8% or 2.75% to 8.25% Discount Rate
Foreclosed Assets	2,358,408	Appraisal	Appraisal Adjustment	16%

**LOCAL GOVERNMENT FEDERAL CREDIT UNION  
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**NOTE 14 BUSINESS COMBINATION**

The Credit Union acquired 100% interest in City of Raleigh Employees (CORE) Credit Union effective beginning of business January 1, 2017. The combination was encouraged to improve and continue financial services to members of the combined credit unions. See Note 1 for additional discussion.

Details on the composition of net assets, liabilities and equity, after fair value adjustments, acquired in the combination and recorded on the consolidated statements of financial condition are as follows as of January 1, 2017:

	Fair Value
<b>Assets</b>	
Cash and Cash Equivalents	\$ 322,844
Investment Securities	12,481,437
Loans to Members, Net of Allowance for Loan Losses	7,295,337
NCUSIF Deposit	189,331
Other Assets	20,530
<b>Total Assets</b>	<b>20,309,479</b>
 <b>Liabilities</b>	
Other Liabilities	\$ 3
Members' Share and Savings Accounts	18,232,994
<b>Total Liabilities</b>	<b>18,232,997</b>
 Acquired Equity	 <b>\$ 2,076,482</b>

The Credit Union is not aware of any assets or liabilities arising from contingencies that have not been recognized as of the date of the acquisition in accordance with GAAP. The Credit Union has determined, based on the valuation of net assets and liabilities, that there were no significant fair value adjustments or intangible assets recognized as a result of the business combination.