REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

# REDSTONE FEDERAL CREDIT UNION AND SUBSIDIARIES

June 30, 2020 and 2019

MOSSADAMS

Federally Insured by NCUA

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# Report of Independent Auditors

To the Board of Directors and Supervisory Committee
Redstone Federal Credit Union and Subsidiaries

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Redstone Federal Credit Union and Subsidiaries, which comprise the consolidated statements of financial condition as of June 30, 2020 and 2019, and the related consolidated statements of income, comprehensive income, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

### *Auditor's Responsibility*

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

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

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

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Redstone Federal Credit Union and Subsidiaries as of June 30, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Spokane, Washington
September 29, 2020

**Consolidated Statements of Financial Condition (in thousands)**

## ASSETS

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Cash and cash equivalents | $ 307,927 | $ 246,022 |
| Investments in available-for-sale debt securities | 3,008,207 | 2,556,021 |
| Loans held for sale | 455 | 5,881 |
| Loans, net | 2,516,671 | 2,152,372 |
| Accrued interest receivable | 14,448 | 13,811 |
| Property and equipment, net | 143,513 | 113,200 |
| National Credit Union Share Insurance Fund (NCUSIF) deposit | 44,966 | 41,170 |
| Equity investments | 40,101 | 79,583 |
| Other investments | 11,866 | 4,429 |
| Other assets | 15,728 | 14,831 |
| Total assets | $ 6,103,882 | $ 5,227,320 |

## LIABILITIES AND MEMBERS' EQUITY

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Liabilities | | |
| Members' shares | $ 5,355,080 | $ 4,545,762 |
| Borrowed funds | 42,242 | - |
| Accrued expenses and other liabilities | 58,484 | 108,287 |
| Total liabilities | 5,455,806 | 4,654,049 |
| Contingent liabilities (Note 11) | | |
| Members' equity | | |
| Retained earnings | 623,820 | 589,749 |
| Accumulated other comprehensive gain/(loss) | 24,256 | (16,478) |
| Total members' equity | 648,076 | 573,271 |
| Total liabilities and members' equity | $ 6,103,882 | $ 5,227,320 |

See accompanying notes.

## Redstone Federal Credit Union and Subsidiaries
### Consolidated Statements of Income (in thousands)

| | Years Ended June 30, 2020 | Years Ended June 30, 2019 |
|---|---|---|
| Interest income | | |
| Interest on loans | $ 135,997 | $ 118,164 |
| Interest on investments and cash equivalents | 65,742 | 66,169 |
| | 201,739 | 184,333 |
| Interest expense | | |
| Dividends on members' shares | 36,629 | 42,448 |
| Interest on borrowed funds | 820 | - |
| | 37,449 | 42,448 |
| Net interest income | 164,290 | 141,885 |
| Provision for loan losses | 28,212 | 20,322 |
| Net interest income after provision for loan losses | 136,078 | 121,563 |
| Noninterest income | | |
| Loan late and over limit fees | 3,876 | 3,195 |
| Loan servicing | 1,962 | 1,871 |
| Mortgage banking revenue | 8,294 | 2,953 |
| Nonsufficient fund and overdraft fees | 16,580 | 17,398 |
| Debit card interchange | 31,732 | 29,416 |
| Credit card interchange | 15,315 | 13,152 |
| Insurance and investment commissions | 9,941 | 9,406 |
| Other noninterest income | 11,556 | 8,612 |
| | 99,256 | 86,003 |
| Noninterest expenses | | |
| Salaries and benefits | 96,814 | 84,819 |
| Occupancy | 18,045 | 15,261 |
| Data processing | 16,336 | 15,104 |
| Debit card processing | 8,410 | 7,715 |
| Credit card processing | 6,960 | 5,403 |
| Cash back rebate on credit and debit cards | 12,720 | 13,596 |
| Loan processing and servicing | 7,778 | 6,413 |
| Member education and promotion | 5,267 | 6,429 |
| Professional and outside services | 7,351 | 6,354 |
| Federal supervision and insurance | 683 | 637 |
| Uncollectible accounts | 5,081 | 5,296 |
| Net (gain) loss on sale of securities | 4,062 | (8,166) |
| Unrealized loss on equity securities | 1,483 | - |
| Other operating expense | 11,622 | 9,904 |
| | 202,612 | 168,765 |
| Net income | $ 32,722 | $ 38,801 |



See accompanying notes.

# Redstone Federal Credit Union and Subsidiaries
## Consolidated Statements of Comprehensive Income (in thousands)

| | Years Ended June 30, 2020 | Years Ended June 30, 2019 |
|---|---|---|
| Net income | $ 32,722 | $ 38,801 |
| Other comprehensive income (loss) | | |
| Net change in defined benefit plan obligations | (24,873) | (17,128) |
| Net change in postretirement benefit plan obligations | (1,580) | (1,107) |
| Net change in unrealized holding gains on investments in securities | 64,474 | 84,849 |
| Reclassification adjustment for net gain (loss) realized in income from sale of investments in securities | 4,062 | (8,166) |
| Other comprehensive income | 42,083 | 58,448 |
| Comprehensive income | $ 74,805 | $ 97,249 |

# Redstone Federal Credit Union and Subsidiaries
## Consolidated Statements of Members' Equity (in thousands)

| | Retained Earnings | | | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|
| | Regular Reserve | Unappropriated | Total | |
| Balance, June 30, 2018 | $ 24,833 | $ 526,115 | $ 550,948 | $ (74,926) |
| Net income | - | 38,801 | 38,801 | - |
| Other comprehensive income | - | - | - | 58,448 |
| Balance, June 30, 2019 | 24,833 | 564,916 | 589,749 | (16,478) |
| Net income | - | 32,722 | 32,722 | - |
| Other comprehensive income | - | - | - | 42,083 |
| Reclassification related to the adoption of ASU 2116-01 | - | 1,349 | 1,349 | (1,349) |
| Balance, June 30, 2020 | $ 24,833 | $ 598,987 | $ 623,820 | $ 24,256 |

 See accompanying notes.

## Redstone Federal Credit Union and Subsidiaries
### Consolidated Statements of Cash Flows (in thousands)

| | Years Ended June 30, 2020 | 2019 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 32,722 | $ 38,801 |
| Adjustments to reconcile net income to net cash from operating activities | | |
| Capitalization of mortgage servicing rights | (1,245) | (936) |
| Amortization of mortgage servicing rights | 1,198 | 729 |
| Amortization of premiums and discounts on investments in debt securities, net | 15,689 | 9,656 |
| Provision for loan losses | 28,212 | 20,322 |
| Depreciation and amortization | 11,612 | 9,645 |
| Lease right-of-use operating expense | 653 | - |
| Mortgage banking revenue | (8,294) | (2,953) |
| Proceeds from sales of loans held for sale | 188,100 | 141,148 |
| Origination of loans held for sale | (175,625) | (117,291) |
| Net loss on derivatives | - | 77 |
| Net (gain) loss on sale of securities | 4,062 | (8,166) |
| Net unrealized loss on equity securities | 1,483 | - |
| Net gain on disposition of property and equipment | (154) | (3) |
| Net change in | | |
| Accrued interest receivable | (637) | (1,570) |
| Defined benefit pension liability | (34,829) | 15,516 |
| Other assets | 527 | 2,094 |
| Accrued expenses and other liabilities | (41,427) | (2,242) |
| Net cash from operating activities | 22,047 | 104,827 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of available for sale investment in debt securities | (1,082,800) | (568,142) |
| Proceeds from maturities of investments in debt securities | 653,831 | 480,102 |
| Proceeds from sales of investments in debt securities | 29,439 | 1,619 |
| Purchase of equity investments | (26,193) | (70,152) |
| Proceeds from sales of equity investments | 60,322 | 68,482 |
| Proceeds from sales of other investments | - | 120 |
| Purchase of other investments | (7,437) | - |
| Net change in loans to members | (392,644) | (219,192) |
| Increase in the NCUSIF deposit | (3,796) | (3,585) |
| Proceeds from disposition of property and equipment | 306 | 23 |
| Purchases of property and equipment | (42,730) | (29,163) |
| Net cash from investing activities | (811,702) | (339,888) |

**Consolidated Statements of Cash Flows (in thousands)**

| | Years Ended June 30, 2020 | 2019 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net increase in members' shares | $ 809,318 | $ 320,685 |
| Proceeds from borrowed funds | 69,874 | - |
| Repayment of borrowed funds | (27,632) | (4) |
| Net cash from financing activities | 851,560 | 320,681 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 61,905 | 85,620 |
| CASH AND CASH EQUIVALENTS, beginning of year | 246,022 | 160,402 |
| CASH AND CASH EQUIVALENTS, end of year | $ 307,927 | $ 246,022 |
| SUPPLEMENTAL CASH FLOWS INFORMATION | | |
| Dividends paid on members' shares and interest paid on borrowed funds | $ 37,408 | $ 42,775 |
| NONCASH INVESTING AND FINANCING ACTIVITIES | | |
| Transfer of loans into other real estate owned | $ 133 | $ 261 |

### Note 1 – Nature of Operations and Significant Accounting Policies

**Principles of consolidation** – The accompanying consolidated financial statements include the accounts of Redstone Federal Credit Union (Credit Union) and its wholly owned subsidiaries, Redstone Services Group, LLC (RSG), Redstone Consulting Group, LLC (RCG), Redstone Title Services, LLC (RTS), and Redstone Family Realty, LLC (RFR). All significant intercompany balances and transactions have been eliminated in consolidation.

**Nature of operations** – The Credit Union is a cooperative association holding a corporate charter under the provisions of the Federal Credit Union Act. Participation in the Credit Union is limited to those individuals who qualify for membership. The field of membership is defined in the Credit Union's Charter and Bylaws.

RSG is engaged primarily in selling insurance products to nonmember customers and servicing student loans. RCG specializes in the development and support of software technology products, process improvements, and best practices for other credit unions and community banks. RTS provides title insurance and settlement services to members and nonmember customers. RFR provides real estate brokerage services to members and nonmember customers.

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

**Use of estimates** – The preparation of consolidated financial statements in accordance with 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 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, fair value of investment securities, and the defined benefit pension plan obligation.

**Subsequent events** – Subsequent events are events or transactions that occur after the date of the consolidated statement of financial condition but before the consolidated financial statements are available to be issued. The Credit Union recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated statement of financial condition, including the estimates inherent in the process of preparing the consolidated financial statements. The Credit Union's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated statement of financial condition but arose after the date of the consolidated statement of financial condition and before the consolidated financial statements are issued.

Management of the Credit Union has evaluated subsequent events through September 29, 2020, which is the date the consolidated financial statements were available to be issued.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

On July 28, 2020, the Credit Union entered into collateral assignment split-dollar insurance agreements that are between the Credit Union and members of the executive management. Under the agreements, the employees own the life insurance policies and assign the policy benefits to the Credit Union. The Credit Union pays the premiums on behalf of the executives and in turn receives the right to death benefits of the underlying policy. The loans to the executives to cover the premium totaled $9,240,500 with interest of 1.17%. Upon the death of an executive, the Credit Union shall have the unqualified right to receive a lump sum death benefit equal to 100% of the loan plus interest.

**Concentrations of credit risk** – Historically, most of the Credit Union's business activity was with members who reside in the north Alabama and middle Tennessee areas. The Credit Union was exposed to credit risk from a regional economic standpoint, since a significant concentration of its borrowers work or reside in Alabama and Tennessee. During 2020, the Rural King program expanded significantly, spreading credit risk across fourteen additional states.

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

**Investments** – 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. Debt securities not classified as held to maturity or trading 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. Equity securities with readily determinable fair values are recorded at fair value, with unrealized gains and losses included in earnings. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment. Gains and losses on the sale of investment securities are recognized on the trade date and determined using the specific identification method. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

**ASU 2016-01** – On July 1, 2019, the Credit Union adopted ASU 2016-01 – *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which changes the accounting for certain equity securities to record at fair value with unrealized gains or losses reflected in earnings. Upon adoption the Credit Union recorded a cumulative-effect adjustment that increased retained earnings by $1,349. Prior to adoption, such unrealized gains and losses were reflected in other comprehensive income. In connection with adoption, the Credit Union has modified the balance sheet and income statement presentations to report equity securities separately and labeled "Equity securities" in both financial statements.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

Declines in the fair value of held to maturity and 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 the extent to which the fair value has been less than the amortized cost basis, (2) adverse conditions specifically related to the security, an industry, or a geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement), (3) the intent of the Credit Union to sell a security, and (4) whether it is more likely than not the Credit Union will have to sell the security before recovery of its cost basis.

If the Credit Union does not have the intent to sell a security prior to recovery and it is more likely than not that it will not have to sell the security prior to recovery, the security would not be considered other than temporarily impaired unless there is a credit loss. If in this case there is a credit loss, the Credit Union will recognize the credit component of an other than temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

**Charitable donation account** – The Credit Union holds investments in a segregated custodial charitable donation account. A charitable donation account is a hybrid charitable and investment vehicle that is funded as a means to provide charitable contributions to qualified charities. The value of the charitable donation account cannot exceed 5% of the Credit Union's net worth and the Credit Union is required to distribute a minimum of 51% of the total return on assets no less frequently than every five years or upon termination of the charitable donation account. The charitable donation account has no stated maturity date, is owned by the Credit Union, and may be terminated at the sole discretion of the Credit Union. Charitable donation account assets are measured at fair value on a recurring basis. In the accompanying consolidated statements of income for the year ended June 30, 2020 and 2019, loss of $957 and gain of $1,292, respectively, is included as a component of noninterest expense and noninterest income and $862 and $838, respectively, is included as a component of interest on investments. Distributions to qualified charities recognized as charitable contribution expense for the years ended June 30, 2020 and 2019, were $500 and $730, respectively.

**Employee benefit funding account** – The Credit Union holds investments in a segregated benefit investment account for the Credit Union's medical employee benefit obligations. The Credit Union funds the investment account with amounts sufficient to result in actual investment returns not to exceed the respective underlying medical benefit obligations. The account has no stated maturity date and may be terminated at the sole discretion of the Credit Union. Benefits funding assets are measured at fair value on a recurring basis. In the accompanying consolidated statements of income for the year ended June 30, 2020 and 2019, loss of $4,475 and gain of $5,926, respectively, is included as a component of noninterest expense and noninterest income and income of $4,284 and $4,173, respectively, is included as a component of interest on investments. The assets are owned by the Credit Union, and are revocable at any time at the discretion of the Credit Union.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

**Supplemental Executive Retirement Plan (SERP) account** – The Credit Union held investments in a segregated investment account for the Credit Union's supplemental executive retirement plan obligations. The Credit Union funded the investment account with amounts expected to result in actual investment returns sufficient to fund the plan obligations. The account had no stated maturity date and was closed by the Credit Union in June 2020, with all assets being liquidated. Assets were measured at fair value on a recurring basis. In the accompanying consolidated statements of income for the years ended June 30, 2020 and 2019, loss of $113 and gain of $947, respectively, is included as a component of noninterest expense and noninterest income and $778 and $841, respectively, is included as a component of interest on investments.

**Federal Home Loan Bank (FHLB) stock** – The Credit Union is a member of the FHLB system. Members are required to own a certain amount of stock based on the Credit Union’s total assets plus a percentage of outstanding advances, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. FHLB stock is reported on the consolidated statement of financial condition as a component of other investments.

**Loans held for sale** – Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Prior to January 2019, the Credit Union carried these loans at fair value due to the Credit Union’s practice of using derivative instruments to hedge the risk associated with interest rate lock commitments on these loans. This practice was discontinued in January 2019. Most mortgage loans held for sale are sold with the mortgage service rights retained by the Credit Union. Gains or losses on sales of residential mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. All sales are made without recourse.

**Accounting for derivative instruments** – The Credit Union discontinued the practice of holding derivative instruments as of January 1, 2019. Prior to that date, interest rate lock commitments on loans to be sold into the secondary market, forward commitments for the future delivery of these mortgage loans and forward commitments for the future sale of mortgage-backed securities in the TBA (to-be-announced) market, were accounted for as free-standing derivatives. The fair value of the interest rate lock was recorded at the time the commitment to fund the mortgage loan was executed and was adjusted for the expected exercise of the commitments to fund the loans. The Credit Union entered into forward commitments for the future delivery of mortgage loans and forward commitments for the future sales of mortgage-backed securities when interest rate locks were entered into. Fair values of these mortgage derivatives were estimated based on changes in mortgage interest rates from the date the interest on the loan was locked or the date the forward commitment was entered into. Changes in the fair values of these derivatives are included in “mortgage banking revenue”.

**Loans, net** – The Credit Union grants residential mortgage, business, and consumer loans to members. The ability of the members to honor their contracts is dependent upon the real estate and general economic conditions of the area.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

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

The accrual of interest income on loans is discontinued at the time the loan is 91 days past due, unless the credit is well secured and in the process of collection. 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 the collection of principal and interest is considered doubtful.

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

Certain direct loan origination costs and related fees are deferred and are recognized as an adjustment to interest income using the interest method over the contractual life of the loans.

**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 collectability of a loan balance is unlikely. Subsequent recoveries, if any, are credited to the allowance.

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

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

The Credit Union's allowance for loan losses is that amount considered adequate to absorb probable losses in the portfolio based on management's evaluations of the size and current risk characteristics of the loan portfolio. Such evaluations consider prior loss experience, the risk rating, and the levels of nonperforming loans. A loan is considered impaired when, based on current information and events, it is probable the Credit Union will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement or when the loan is subject to a troubled debt restructuring. Specific allowances for loan losses are established for large impaired loans on an individual basis as required by the Codification. The specific allowances established for these loans are based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flow, the loan's estimated market value, or the estimated fair value of the underlying collateral. General allowances are established for loans that can be grouped into pools based on similar characteristics as described in the Codification. In this process, general allowance factors are based on an analysis of historical charge-off experience and expected losses given default derived from the Credit Union's internal risk rating process. These factors are developed and applied to the portfolio by loan type. The qualitative factors associated with the allowances are subjective and require a high degree of management judgment. These factors include the credit quality statistics, recent economic uncertainty, losses incurred from recent events, and lagging data.

**Transfers of financial assets** – Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset, are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Credit Union, the transferee obtains the right to pledge or exchange the transferred assets, and the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Loan servicing** – Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or, alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into noninterest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk 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.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

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

**Property and equipment** – Land is carried at cost. Land improvements, buildings, building improvements, leasehold improvements, and furniture and equipment are carried at cost less accumulated depreciation and amortization. Land improvements, buildings and building improvements, and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, ranging from 2 to 40 years. 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. Expected terms include lease option periods to the extent the exercise of such options is reasonably assured. Management reviews premises and equipment for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

**Leases** – For all leases (with the exception of short-term leases), the Credit Union, as the lessee, recognizes the following at the commencement date; a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under Codification Topic 842 Leases, the Credit Union elected certain relief options for practical expedients: the option to not separate lease and nonlease components and instead to account for them as a single lease component, and the option to not recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e. lease terms of 12 months or less). As of June 30, 2020 and 2019, the Credit Union recorded a $1,813 and $1,334, respectively, right-of-use asset in property and equipment and a $1,634 and $1,335, respectively, lease liability on its consolidated statements of financial condition.

**National Credit Union Share Insurance Fund (NCUSIF) deposit and insurance premium** – The deposit in the NCUSIF is in accordance with National Credit Union Administration (NCUA) regulations, which requires the maintenance of a deposit by each federally insured Credit Union in an amount equal to 1% of its insured members’ shares. The deposit would be refunded to the Credit Union if its insurance coverage was terminated, if it converted its insurance coverage to another source, or if management of the fund was transferred from the NCUA Board. The Credit Union is also required to pay an annual insurance premium as assessed by the NCUA Board.

**Other real estate owned** – Real estate and other property acquired in full or partial settlement of loan obligations is referred to as other real estate owned. Other real estate owned is originally recorded in the Credit Union’s consolidated financial statements at fair value less any estimated costs to sell. When property is acquired through foreclosure or surrendered in lieu of foreclosure, the Credit Union measures the fair value of the property acquired against its recorded investment in the loan. If the fair value of the property at the time of acquisition is less than the recorded investment in the loan, the difference is charged to the allowance for loan losses. Any subsequent fluctuations in the fair value of other real estate owned are charged to noninterest expense. All related operating or maintenance costs are charged to noninterest expense as incurred. Any subsequent gains or losses on the sale of other real estate owned are recorded in other income or expense as incurred.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

**Members' shares** – Members' shares are the savings deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in the annual elections of the Board of Directors and on other corporate matters. Irrespective of the number of shares owned, no member has more than one vote. Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members' shares are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Dividend rates are set by the Credit Union's Board of Directors.

**Advertising costs** – Advertising costs are expensed as incurred. Total advertising costs for the years ended June 30, 2020 and 2019, were $3,501 and $4,681, respectively.

**Income taxes** – The Credit Union is exempt, by statute, from federal and state income taxes. The Credit Union Service Organizations, RSG, RCG, RTS, and RFR, are limited liability corporations and are not subject to federal and state income taxes.

**Defined benefit plans** – The Credit Union has a qualified, noncontributory defined benefit pension plan and a postretirement benefit plan covering certain employees as more fully disclosed in Note 12. The Credit Union's policy is to fund an amount in excess of the minimum amount required under the Employee Retirement Income Security Act (ERISA).

**Comprehensive income (loss)** – Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available for sale debt securities, are reported as a separate component of the members' equity section of the consolidated statements of financial condition.

**Fair value of financial instruments** – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

**Collaborative arrangement** – Effective March 15, 2019, the Credit Union entered into a contract with RK Family, Inc., Rural King Holdings, LLP, and RK Finance, LLC (collectively referred to as Rural King) under which the Credit Union will provide financial services to Rural King customers. Rural King is a retail provider of farm equipment and other home products. The program includes loans for equipment purchases, credit cards, and in-store branches. Rural King customers who obtain a loan or credit card are required to become members of the Credit Union, thereby expanding and diversifying the Credit Union's membership. The Credit Union and Rural King share equally in all revenues and expenses of the loan and credit card programs. Revenues and expenses related to the in-store branch program belong entirely to the Credit Union.

**Note 1 – Nature of Operations and Significant Accounting Policies (continued)**

This program is accounted for as a collaborative arrangement as outlined in ASC 808 – C*ollaborative Arrangements*. Both the Credit Union and Rural King are active participants in the program and both are exposed to risk or reward depending on the success of the program activities. The Credit Union will originate and service loans, as well as provide limited branch services to Rural King customers. Loan origination will be provided through an online portal in store or on Rural King's website. Rural King will assist customers in the store with loan and credit card applications, as well as market the loan and credit card products within their stores and on their website. Rural King will provide dedicated space within selected stores for in-store branches operated by the Credit Union.

Revenue generated and costs incurred from transactions with members are recorded at their gross amount in the appropriate category in the consolidated statement of income. Any gain or loss resulting from these transactions will be shared equally with Rural King with the shared amount recorded in other non-interest income or other operating expense. All other program expenses from transactions with other third parties that are incurred by the Credit Union and Rural King will be combined and shared equally. The net amount of these expenses after payment to or from Rural King will be included by the credit union in the appropriate expense category on the consolidated statement of income.

For the years ended June 30, 2020 and 2019, the Credit Union incurred a net loss after reimbursement by Rural King of $6,265 and $220, respectively, from the program. Net income (loss) is included in the consolidated statement of income. See footnote 17 for additional financial information attributed to this collaborative arrangement.

**Reclassifications** – Certain account reclassifications have been made to the 2019 consolidated financial statements in order to be in accordance with classifications used in the current year with no impact on prior year reported net income or members' equity.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

## Note 2 – Investments

Investments classified as available for sale debt securities consist of the following at June 30:

| | 2020 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| **Operating investments** | | | | |
| Federal agency debt securities | $ 88,987 | $ 753 | $ - | $ 89,740 |
| Collateralized debt obligations | 77,845 | 4,530 | - | 82,375 |
| Residential mortgage-backed securities | 1,126,439 | 37,033 | (604) | 1,162,868 |
| Commercial mortgage-backed securities | 1,508,353 | 45,186 | (1,336) | 1,552,203 |
| **Charitable donation account** | | | | |
| Fixed income bonds | 19,688 | 658 | (218) | 20,128 |
| **Employee benefit funding account** | | | | |
| Fixed income bonds | 99,122 | 3,141 | (1,370) | 100,893 |
| | $ 2,920,434 | $ 91,301 | $ (3,528) | $ 3,008,207 |

| | 2019 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| **Operating investments** | | | | |
| Federal agency debt securities | $ 215,940 | $ 309 | $ (427) | $ 215,822 |
| Collateralized debt obligations | 90,101 | 1,320 | (215) | 91,206 |
| Residential mortgage-backed securities | 1,011,555 | 10,633 | (4,722) | 1,017,466 |
| Commercial mortgage-backed securities | 1,121,323 | 14,395 | (3,772) | 1,131,946 |
| **Charitable donation account** | | | | |
| Fixed income bonds | 13,436 | 318 | (92) | 13,662 |
| **Employee benefit funding account** | | | | |
| Fixed income bonds | 66,590 | 1,611 | (484) | 67,717 |
| **Supplemental executive retirement plan account** | | | | |
| Fixed income bonds | 17,839 | 476 | (113) | 18,202 |
| | $ 2,536,784 | $ 29,062 | $ (9,825) | $ 2,556,021 |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 2 – Investments (continued)**

Sales of investments in available for sale debt securities resulted in the following:

| | 2020 | | | |
|---|---|---|---|---|
| | Proceeds from sales | Gross realized gains | Gross realized losses | Net realized gain/(loss) |
| Charitable donation account | $ 1,845 | $ 132 | $ 237 | $ (105) |
| Employee benefit funding account | 8,513 | 662 | 1,161 | (499) |
| Supplemental executive retirement plan account | 19,081 | 891 | 479 | 412 |
| | $ 29,439 | $ 1,685 | $ 1,877 | $ (192) |

| | 2019 | | | |
|---|---|---|---|---|
| | Proceeds from sales | Gross realized gains | Gross realized losses | Net realized gain/(loss) |
| Charitable donation account | $ 358 | $ 47 | $ 70 | $ (23) |
| Employee benefit funding account | 770 | 90 | 339 | (249) |
| Supplemental executive retirement plan account | 491 | 43 | 105 | (62) |
| | $ 1,619 | $ 180 | $ 514 | $ (334) |

Debt securities with fair value of $107,796 and $144,080 have been pledged as collateral to secure advances from the Federal Reserve Bank discount window as of June 30, 2020 and 2019, respectively, as more fully disclosed in Note 8. Securities with fair value of $8,219 and $88,162 have been pledged as collateral to secure advances from the Federal Home Loan Bank as of June 30, 2020 and 2019, respectively.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 2 – Investments (continued)**

Investments in debt securities by contractual maturity as of June 30, 2020, are summarized as follows:

| | Available for Sale | |
|---|---|---|
| | Amortized Cost | Fair Value |
| **Operating investments** | | |
| Less than 1 year maturity | $ 88,987 | $ 89,740 |
| Collateralized debt obligations | 77,845 | 82,375 |
| Residential mortgage-backed securities | 1,126,439 | 1,162,868 |
| Commercial mortgage-backed securities | 1,508,353 | 1,552,203 |
| **Charitable donation account** | | |
| Less than 1 year maturity | 772 | 779 |
| 1-5 years maturity | 9,481 | 9,584 |
| 5-10 years maturity | 9,038 | 9,366 |
| Over 10 years maturity | 397 | 399 |
| **Employee benefit funding account** | | |
| Less than 1 year maturity | 5,465 | 5,522 |
| 1-5 years maturity | 48,986 | 49,211 |
| 5-10 years maturity | 42,733 | 44,219 |
| Over 10 years maturity | 1,938 | 1,941 |
| | $ 2,920,434 | $ 3,008,207 |

Expected maturities of collateralized debt obligations and mortgage-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay the obligations and are, therefore, classified separately with no specific maturity date.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 2 – Investments (continued)**

Gross unrealized losses and fair value by length of time the individual debt securities have been in a continuous unrealized loss position at June 30 are as follows:

| | 2020 | | | | |
|---|---|---|---|---|---|
| | Fair Value Associated with Unrealized Losses Existing for | | Continuous Unrealized Losses Existing For | | Total Unrealized Losses |
| | Less Than 12 Months | More Than 12 Months | Less Than 12 Months | More Than 12 Months | |
| **Available for Sale** | | | | | |
| **Operating investments** | | | | | |
| Residential mortgage-backed securities | $ 128,651 | $ 23,048 | $ 428 | $ 176 | $ 604 |
| Commercial mortgage-backed securities | 74,936 | 121,164 | 483 | 853 | 1,336 |
| **Charitable donation account** | | | | | |
| Fixed income bonds | 2,810 | 434 | 123 | 95 | 218 |
| **Employee benefit funding account** | | | | | |
| Fixed income bonds | 15,266 | 2,681 | 635 | 735 | 1,370 |
| | $ 221,663 | $ 147,327 | $ 1,669 | $ 1,859 | $ 3,528 |

| | 2019 | | | | |
|---|---|---|---|---|---|
| | Fair Value Associated with Unrealized Losses Existing for | | Continuous Unrealized Losses Existing For | | Total Unrealized Losses |
| | Less Than 12 Months | More Than 12 Months | Less Than 12 Months | More Than 12 Months | |
| **Available for Sale** | | | | | |
| **Operating investments** | | | | | |
| Federal agency debt securities | $ - | $ 176,519 | $ - | $ 427 | $ 427 |
| Collateralized debt obligations | - | 18,907 | - | 215 | 215 |
| Residential mortgage-backed securities | 9,588 | 413,512 | 113 | 4,609 | 4,722 |
| Commercial mortgage-backed securities | 95,667 | 384,996 | 614 | 3,158 | 3,772 |
| **Charitable donation account** | | | | | |
| Fixed income bonds | 593 | 3,291 | 12 | 80 | 92 |
| **Employee benefit funding account** | | | | | |
| Fixed income bonds | 3,513 | 16,936 | 73 | 411 | 484 |
| **Supplemental executive retirement plan account** | | | | | |
| Fixed income bonds | 672 | 2,617 | 37 | 76 | 113 |
| | $ 110,033 | $ 1,016,778 | $ 849 | $ 8,976 | $ 9,825 |

At June 30, 2020 and 2019, the investment portfolio included 128 and 272 available for sale debt securities, respectively, with unrealized losses.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 2 – Investments (continued)**

As of June 30, 2020, unrealized losses on the Credit Union's investment portfolio were primarily attributable to market interest rate volatility, rather than to credit risk. Current characteristics of each security owned, such as delinquency rates, foreclosure levels, credit enhancements, and projected losses, are reviewed periodically by management. Accordingly, it is expected these securities would not be settled at a price less than the amortized cost of the Credit Union's investment.

Because the Credit Union does not have the intent to sell these investments and it is not likely the Credit Union will be required to sell these investments before anticipated recovery of fair value, which may be at maturity, the Credit Union did not consider any of its investments to be other-than-temporarily impaired as of June 30, 2020 or 2019.

The gain (loss) recognized on equity securities in the Consolidated Statement of Income was composed of the following for the years ended June 30:

| | 2020 | 2019 |
|---|---|---|
| Net gain/(loss) recognized on equity securities | $ (5,353) | $ 8,500 |
| Less net gain/(loss) recognized on equity securities sold | (3,870) | 8,500 |
| Unrealized gain/(loss) recognized on equity securities held | $ (1,483) | $ - |

Other investments consist of the following as of June 30:

| | 2020 | 2019 |
|---|---|---|
| FHLB of Atlanta stock | $ 6,702 | $ 4,409 |
| Certificate of deposit | 5,144 | - |
| Co-Op Stock | 20 | 20 |
| | $ 11,866 | $ 4,429 |

The Credit Union views its investment in FHLB of Atlanta stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recoverability of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by factors such as 1) the significance of the decline in net assets of the institution as compared to the investment amount and length of time a decline has persisted, 2) impact of legislative and regulatory changes on the institution, and 3) the liquidity position of the institution. The Credit Union does not believe that its investment in the FHLB of Atlanta stock is impaired as of June 30, 2020.

The certificate of deposit is held at All In Credit Union, accrues dividends at 3% and matures July 22, 2022.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 3 – Loans, Net**

Loans consist of the following at June 30:

| | 2020 | | |
|---|---|---|---|
| | Loans Individually Evaluated for Impairment | Loans Collectively Evaluated for Impairment | Total |
| Member business loans | $ 3,316 | $ 171,177 | $ 174,493 |
| Residential real estate and home equity | 7,231 | 714,941 | 722,172 |
| Consumer loans | 8,848 | 1,646,115 | 1,654,963 |
| Total loans | $ 19,395 | $ 2,532,233 | 2,551,628 |
| Less allowance for loan losses | | | (34,957) |
| | | | $ 2,516,671 |

| | 2019 | | |
|---|---|---|---|
| | Loans Individually Evaluated for Impairment | Loans Collectively Evaluated for Impairment | Total |
| Member business loans | $ 3,226 | $ 151,850 | $ 155,076 |
| Residential real estate and home equity | 5,806 | 582,604 | 588,410 |
| Consumer loans | 7,371 | 1,427,064 | 1,434,435 |
| Total loans | $ 16,403 | $ 2,161,518 | 2,177,921 |
| Less allowance for loan losses | | | (25,549) |
| | | | $ 2,152,372 |

The Credit Union had net deferred loan origination costs included in the above loan balances of $11,378 and $9,822 as of June 30, 2020 and 2019, respectively.

The total loan amount includes $112,351 and $1,305 in loans originated through the Rural King program as of June 30, 2020 and 2019, respectively.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 3 – Loans, Net (continued)**

A summary of the activity in the allowance for loan losses is as follows for the years ended June 30:

| | 2020 | | | |
|---|---|---|---|---|
| | Member Business | Residential Real Estate and Home Equity | Consumer | Total |
| Balance at beginning of year | $ 1,377 | $ 4,124 | $ 20,048 | $ 25,549 |
| Provision for loan losses | 713 | 2,316 | 25,183 | 28,212 |
| Loans charged off | (187) | (742) | (23,091) | (24,020) |
| Recoveries of loans | 17 | 355 | 4,844 | 5,216 |
| Balance at end of year | $ 1,920 | $ 6,053 | $ 26,984 | $ 34,957 |

| | 2019 | | | |
|---|---|---|---|---|
| | Member Business | Residential Real Estate and Home Equity | Consumer | Total |
| Balance at beginning of year | $ 659 | $ 4,053 | $ 15,427 | $ 20,139 |
| Provision for loan losses | 850 | 366 | 19,106 | 20,322 |
| Loans charged off | (143) | (565) | (18,685) | (19,393) |
| Recoveries of loans | 11 | 270 | 4,200 | 4,481 |
| Balance at end of year | $ 1,377 | $ 4,124 | $ 20,048 | $ 25,549 |

The Credit Union offers nontraditional mortgage loans to its members. These loans include hybrid/balloon, which consist of loans that are fixed for an initial period of three, five, seven, or ten years. After this period, the mortgages are converted to a variable rate using the fully indexed rate, which can result in significant payment adjustment to the borrower.

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

The allowance for loan losses is considered by the Credit Union as adequate to cover probable losses inherent in the loan portfolio at June 30, 2020. However, no assurance can be given the Credit Union will not sustain loan losses that exceed the allowance, or that subsequent evaluation of the loan portfolio, in light of the prevailing factors, including economic conditions, credit quality of the assets comprising the portfolio and the ongoing evaluation process, will not require significant changes in the allowance for loan losses.

**Note 3 – Loans, Net (continued)**

Management considers a loan to be impaired when, based on current information and events, it is determined the Credit Union will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan to be impaired, the impairment is measured based on the present value of expected future cash flows, and discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs, is utilized instead of discounted cash flows. If management determines the value of the impaired loan is less than the recorded investment in the loan, net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount, impairment is recognized through an allowance or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is in nonaccrual status, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received under the cash basis method.

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount. Also presented are the average recorded investments in the impaired loans. The average balances are calculated based on the month end balances of the loans receivable of the period reported.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

## Note 3 – Loans, Net (continued)

Information about impaired loans is as follows as of and for the years ended June 30:

| | 2020 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| **With an allowance recorded** | | | | | |
| Member business loans | | | | | |
| Real estate secured | $ 2,528 | $ 2,528 | $ 631 | $ 2,568 | $ 8 |
| SBA guaranteed | 169 | 169 | 34 | 171 | - |
| Other unsecured | 33 | 33 | 33 | 34 | - |
| Total member business loans | 2,730 | 2,730 | 698 | 2,773 | 8 |
| Residential real estate and home equity | | | | | |
| First mortgage | 4,461 | 4,461 | 2,577 | 4,574 | 14 |
| Second mortgage | 45 | 45 | 45 | 46 | - |
| Home equity lines of credit | 1,603 | 1,603 | 1,599 | 1,662 | 7 |
| Total real estate and home equity | 6,109 | 6,109 | 4,221 | 6,282 | 21 |
| Consumer loans - collateralized | | | | | |
| Automobile | 2,331 | 2,331 | 1,034 | 2,504 | 7 |
| Indirect automobile | 4,272 | 4,186 | 2,127 | 4,572 | 11 |
| Other secured | 574 | 572 | 269 | 591 | 2 |
| Total consumer loans - collateralized | 7,177 | 7,089 | 3,430 | 7,667 | 20 |
| Consumer loans - unsecured | | | | | |
| Unsecured | 264 | 264 | 264 | 304 | 1 |
| Credit cards | 523 | 523 | 523 | 369 | - |
| Total consumer loans - unsecured | 787 | 787 | 787 | 673 | 1 |
| Total impaired loans with an allowance recorded | 16,803 | 16,715 | 9,136 | 17,395 | 50 |
| **Without an allowance recorded** | | | | | |
| Member business loans | | | | | |
| Real estate secured | 574 | 574 | - | 588 | - |
| SBA guaranteed | 6 | 6 | - | 7 | - |
| Other unsecured | 6 | 6 | - | 11 | - |
| Total member business loans | 586 | 586 | - | 606 | - |
| Residential real estate and home equity | | | | | |
| First mortgage | 1,071 | 1,071 | - | 1,094 | 4 |
| Second mortgage | 4 | 4 | - | 7 | - |
| Home equity lines of credit | 47 | 47 | - | 50 | - |
| Total real estate and home equity | 1,122 | 1,122 | - | 1,151 | 4 |
| Consumer loans - collateralized | | | | | |
| Automobile | 372 | 372 | - | 481 | 1 |
| Indirect automobile | 207 | 200 | - | 302 | - |
| Other secured | 305 | 304 | - | 334 | - |
| Total consumer loans - collateralized | 884 | 876 | - | 1,117 | 1 |
| Total impaired loans without an allowance recorded | 2,592 | 2,584 | - | 2,874 | 5 |
| Total | $ 19,395 | $ 19,299 | $ 9,136 | $ 20,269 | $ 55 |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 3 – Loans, Net (continued)

| | 2019 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| **With an allowance recorded** | | | | | |
| Member business loans | | | | | |
| Real estate secured | $ 2,595 | $ 2,595 | $ 630 | $ 2,618 | $ 9 |
| Residential real estate and home equity | | | | | |
| First mortgage | 3,347 | 3,347 | 1,628 | 3,391 | 9 |
| Second mortgage | 22 | 22 | 22 | 22 | - |
| Home equity lines of credit | 1,429 | 1,429 | 1,396 | 1,495 | 7 |
| Total real estate and home equity | 4,798 | 4,798 | 3,046 | 4,908 | 16 |
| Consumer loans - collateralized | | | | | |
| Automobile | 2,262 | 2,262 | 920 | 2,437 | 7 |
| Indirect automobile | 3,241 | 3,185 | 1,486 | 3,427 | 10 |
| Other secured | 651 | 648 | 306 | 667 | 4 |
| Total consumer loans - collateralized | 6,154 | 6,095 | 2,712 | 6,531 | 21 |
| Consumer loans - unsecured | | | | | |
| Unsecured | 288 | 288 | 288 | 303 | 1 |
| Credit cards | 206 | 206 | 207 | 185 | - |
| Total consumer loans - unsecured | 494 | 494 | 495 | 488 | 1 |
| Total impaired loans with an allowance recorded | 14,041 | 13,982 | 6,883 | 14,545 | 47 |
| **Without an allowance recorded** | | | | | |
| Member business loans | | | | | |
| Real estate secured | 606 | 606 | - | 625 | 10 |
| SBA guaranteed | 9 | 9 | - | 27 | - |
| Other unsecured | 16 | 16 | - | 19 | - |
| Total member business loans | 631 | 631 | - | 671 | 10 |
| Residential real estate and home equity | | | | | |
| First mortgage | 954 | 954 | - | 974 | 5 |
| Second mortgage | 13 | 13 | - | 15 | - |
| Home equity lines of credit | 42 | 42 | - | 44 | - |
| Total real estate and home equity | 1,009 | 1,009 | - | 1,033 | 5 |
| Consumer loans - collateralized | | | | | |
| Automobile | 423 | 423 | - | 611 | 2 |
| Indirect automobile | 128 | 125 | - | 200 | - |
| Other secured | 171 | 169 | - | 191 | - |
| Total consumer loans - collateralized | 722 | 717 | - | 1,002 | 2 |
| Total impaired loans without an allowance recorded | 2,362 | 2,357 | - | 2,706 | 17 |
| Total | $ 16,403 | $ 16,339 | $ 6,883 | $ 17,251 | $ 64 |

**Note 3 – Loans, Net (continued)**

**Credit quality indicators** – The Credit Union utilizes internal risk ratings for its credit quality indicators. The internal risk ratings (1) provide a basis for evaluating, monitoring, and reporting the overall quality of the loan portfolio, (2) promptly identify deterioration of loan quality and the need for remedial action, and (3) emphasize areas requiring upgrading of policies, procedures, or documentation.

The internal risk ratings are as follows:

For member business loans, management's judgment about the quality of each individual loan is made at the time the loan is granted and the collectability of each loan is reviewed periodically and changed when warranted, based on the status of the loan or business. Loans are classified on a nine-point system ranging from Excellent to Probable Loss. Loans classified as Excellent are fully secured by marketable collateral such as deposit accounts pledged to the Credit Union or government backed securities. Strong loans are secured by pledged liquid collateral such as publicly traded stocks or corporate bonds with an adequate margin of safety. Satisfactory loans have sound credit quality overall but may indicate a slight potential weakness in the financial analysis. Loans classified as Acceptable have sound credit quality overall but may indicate several moderate trends toward weakness in the financial analysis or may be a startup business with less than 12 months of financial history. Pass with Caution loans have strained liquidity, unfavorable payment trends, management weakness or erratic profitability and financial performance. Loans classified as Other Loans Especially Mentioned (OLEM) have been downgraded at first 30 days past due and placed on the watch list. Substandard loans are problem loans and likely to deteriorate over the near term. Loans classified as Doubtful have deteriorated and there is no defined source of repayment, identified deficiencies cannot be corrected, and loan loss is expected. Probable Loss loans have no repayment ability and loan loss is near certain.

Real estate loans, home equity, and consumer loans are generally risk based priced at the time the loan is made based on the borrower's or co-borrower's beacon score. Loans are classified as A, B, C, D, E, or Not Rated. Loans classified as A are the highest quality and the borrow current beacon score is in the highest desirable range. E loans are generally loans with a beacon score below 620. Loans that are classified as Not Rated were either made prior to risk based pricing implementation or the borrower has no established credit score available. Real estate loans in the Not Rated category are loans granted prior to April 2011 and were generally approved based on strict underwriting guidelines. Loan classifications are performed at the time of origination.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 3 – Loans, Net (continued)

The following table presents the credit exposure of the loan classes as of June 30:

| | 2020 | | | | |
|---|---|---|---|---|---|
| Member business loans | Real estate secured | Unsecured | SBA Guaranteed | Other secured | Total |
| 1 Excellent | $ - | $ - | $ 30,044 | $ 180 | $ 30,224 |
| 2 Strong | 897 | 20 | - | - | 917 |
| 3 Satisfactory | 30,167 | 39 | 73 | 508 | 30,787 |
| 4 Acceptable | 48,153 | 6,051 | 3,223 | 4,799 | 62,226 |
| 5 Pass with Caution | 45,728 | 356 | 46 | 1,114 | 47,244 |
| 6 Other Especially Mentioned | - | 211 | 69 | 4 | 284 |
| 7 Substandard | 2,137 | 90 | - | 6 | 2,233 |
| 8 Doubtful | 325 | 32 | 169 | 52 | 578 |
| 9 Probable Loss | - | - | - | - | - |
| Total | $ 127,407 | $ 6,799 | $ 33,624 | $ 6,663 | $ 174,493 |

| Residential real estate and home equity | First mortgage | Second mortgage | Home equity lines of credit | Total |
|---|---|---|---|---|
| Not Rated | $ 36,598 | $ 93 | $ 23,661 | $ 60,352 |
| A | 270,082 | 5,338 | 92,596 | 368,016 |
| B | 93,652 | 4,596 | 39,656 | 137,904 |
| C | 89,393 | 4,601 | 13,249 | 107,243 |
| D | 23,884 | 1,067 | 4,346 | 29,297 |
| E | 18,158 | 575 | 627 | 19,360 |
| Total | $ 531,767 | $ 16,270 | $ 174,135 | $ 722,172 |

| Consumer loans - collateralized | Automobile | Indirect automobile | Other secured | Total |
|---|---|---|---|---|
| Not Rated | $ 1 | $ - | $ 4,862 | $ 4,863 |
| A | 219,837 | 297,157 | 103,313 | 620,307 |
| B | 112,981 | 214,555 | 53,301 | 380,837 |
| C | 42,252 | 63,788 | 17,589 | 123,629 |
| D | 20,354 | 23,687 | 7,605 | 51,646 |
| E | 10,097 | 7,572 | 839 | 18,508 |
| Total | $ 405,522 | $ 606,759 | $ 187,509 | $ 1,199,790 |

| Consumer loans - unsecured | Unsecured | Credit cards | Total |
|---|---|---|---|
| Not Rated | $ 7,187 | $ 810 | $ 7,997 |
| A | 80,302 | 125,979 | 206,281 |
| B | 56,891 | 89,957 | 146,848 |
| C | 19,819 | 33,861 | 53,680 |
| D | 6,008 | 14,300 | 20,308 |
| E | 2,384 | 17,675 | 20,059 |
| Total | $ 172,591 | $ 282,582 | $ 455,173 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

## Note 3 – Loans, Net (continued)

| | 2019 | | | | |
|---|---|---|---|---|---|
| Member business loans | Real estate secured | Unsecured | SBA Guaranteed | Other secured | Total |
| 1 Excellent | $ - | $ - | $ - | $ 59 | $ 59 |
| 2 Strong | - | - | - | - | - |
| 3 Satisfactory | 31,375 | 17 | 214 | 1,087 | 32,693 |
| 4 Acceptable | 103,763 | 5,784 | 3,811 | 4,448 | 117,806 |
| 5 Pass with Caution | 1,207 | 84 | 188 | 8 | 1,487 |
| 6 Other Especially Mentioned | 2,331 | 73 | 115 | 5 | 2,524 |
| 7 Substandard | 49 | 34 | - | - | 83 |
| 8 Doubtful | 328 | 4 | 16 | 76 | 424 |
| 9 Probable Loss | - | - | - | - | - |
| Total | $ 139,053 | $ 5,996 | $ 4,344 | $ 5,683 | $ 155,076 |

| Residential real estate and home equity | First mortgage | Second mortgage | Home equity lines of credit | Total |
|---|---|---|---|---|
| Not Rated | $ 45,986 | $ 173 | $ 30,685 | $ 76,844 |
| A | 169,855 | 4,730 | 94,787 | 269,372 |
| B | 68,921 | 3,302 | 40,242 | 112,465 |
| C | 67,701 | 4,052 | 13,637 | 85,390 |
| D | 19,128 | 839 | 4,381 | 24,348 |
| E | 18,682 | 489 | 820 | 19,991 |
| Total | $ 390,273 | $ 13,585 | $ 184,552 | $ 588,410 |

| Consumer loans - collateralized | Automobile | Indirect automobile | Other secured | Total |
|---|---|---|---|---|
| Not Rated | $ 1 | $ - | $ 5,940 | $ 5,941 |
| A | 198,643 | 250,483 | 66,550 | 515,676 |
| B | 108,763 | 174,533 | 32,791 | 316,087 |
| C | 42,501 | 56,103 | 9,607 | 108,211 |
| D | 22,251 | 22,371 | 3,042 | 47,664 |
| E | 12,452 | 8,838 | 1,053 | 22,343 |
| Total | $ 384,611 | $ 512,328 | $ 118,983 | $ 1,015,922 |

| Consumer loans - unsecured | Unsecured | Credit cards | Total |
|---|---|---|---|
| Not Rated | $ 8,771 | $ 365 | $ 9,136 |
| A | 80,422 | 114,103 | 194,525 |
| B | 54,972 | 74,220 | 129,192 |
| C | 20,131 | 24,836 | 44,967 |
| D | 6,799 | 13,036 | 19,835 |
| E | 3,194 | 17,664 | 20,858 |
| Total | $ 174,289 | $ 244,224 | $ 418,513 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

## Note 3 – Loans, Net (continued)

The following table is an aging analysis of loans receivable as of June 30:

| | 2020 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days and Greater | Total Past Due | Current | Total Loans | Recorded Investment > 90 Days and Accruing |
| Member business loans | | | | | | | |
| Real estate secured | $ - | $ - | $ 325 | $ 325 | $ 127,082 | $ 127,407 | $ - |
| Unsecured | 48 | 46 | 97 | 191 | 6,608 | 6,799 | - |
| SBA guaranteed | - | - | 169 | 169 | 33,455 | 33,624 | - |
| Other secured | - | - | - | - | 6,663 | 6,663 | - |
| Residential real estate and home equity | | | | | | | |
| First mortgage | 25 | 692 | 1,819 | 2,536 | 529,231 | 531,767 | - |
| Second mortgage | - | - | 45 | 45 | 16,225 | 16,270 | - |
| Home equity lines of credit | 371 | 78 | 613 | 1,062 | 173,073 | 174,135 | - |
| Consumer loans - collateralized | | | | | | | |
| Automobile | 1,864 | 496 | 790 | 3,150 | 402,372 | 405,522 | - |
| Indirect automobile | 5,609 | 1,257 | 1,761 | 8,627 | 598,132 | 606,759 | - |
| Other secured | 670 | 154 | 419 | 1,243 | 186,266 | 187,509 | - |
| Consumer loans | | | | | | | |
| Unsecured | 851 | 186 | 55 | 1,092 | 171,499 | 172,591 | - |
| Credit cards | 2,169 | 852 | 366 | 3,387 | 279,195 | 282,582 | - |
| Total | $ 11,607 | $ 3,761 | $ 6,459 | $ 21,827 | $ 2,529,801 | $ 2,551,628 | $ - |

| | 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days and Greater | Total Past Due | Current | Total Loans | Recorded Investment > 90 Days and Accruing |
| Member business loans | | | | | | | |
| Real estate secured | $ 49 | $ - | $ 150 | $ 199 | $ 138,854 | $ 139,053 | $ - |
| Unsecured | 45 | - | - | 45 | 5,951 | 5,996 | - |
| SBA guaranteed | - | - | - | - | 4,344 | 4,344 | - |
| Other secured | - | - | - | - | 5,683 | 5,683 | - |
| Residential real estate and home equity | | | | | | | |
| First mortgage | - | 333 | 1,051 | 1,384 | 388,889 | 390,273 | - |
| Second mortgage | - | - | 22 | 22 | 13,563 | 13,585 | - |
| Home equity lines of credit | 455 | 51 | 273 | 779 | 183,773 | 184,552 | - |
| Consumer loans - collateralized | | | | | | | |
| Automobile | 3,474 | 857 | 691 | 5,022 | 379,589 | 384,611 | - |
| Indirect automobile | 6,153 | 982 | 1,235 | 8,370 | 503,958 | 512,328 | - |
| Other secured | 827 | 132 | 390 | 1,349 | 117,634 | 118,983 | - |
| Consumer loans | | | | | | | |
| Unsecured | 1,485 | 451 | 42 | 1,978 | 172,311 | 174,289 | - |
| Credit cards | 2,041 | 395 | 78 | 2,514 | 241,710 | 244,224 | - |
| Total | $ 14,529 | $ 3,201 | $ 3,932 | $ 21,662 | $ 2,156,259 | $ 2,177,921 | $ - |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 3 – Loans, Net (continued)**

The following table presents nonaccrual loans by asset class as of June 30:

| | 2020 | 2019 |
|---|---|---|
| Member business loans | | |
| Real estate secured | $ 325 | $ 150 |
| Unsecured | 97 | - |
| SBA guaranteed | 169 | - |
| Total member business loans | 591 | 150 |
| Residential real estate and home equity | | |
| First mortgage | 1,819 | 1,051 |
| Second mortgage | 45 | 22 |
| Home equity lines of credit | 613 | 273 |
| Total residential real estate and home equity loans | 2,477 | 1,346 |
| Consumer loans - collateralized | | |
| Automobile | 790 | 691 |
| Indirect automobile | 1,761 | 1,235 |
| Other secured | 419 | 390 |
| Total collateralized consumer loans | 2,970 | 2,316 |
| Consumer loans - unsecured | | |
| Unsecured | 55 | 42 |
| Credit cards | 366 | 78 |
| Total unsecured consumer loans | 421 | 120 |
| Total loans | $ 6,459 | $ 3,932 |
| Forgone interest on nonaccrual loans | $ 145 | $ 83 |

**Troubled debt restructurings** – At June 30, 2020 and 2019, impaired loans of $8,221 and $6,689, respectively, were classified as troubled debt restructurings. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 3 – Loans, Net (continued)**

The types of modifications offered can generally be described in the following categories:

**Rate modification** – A modification in which the interest rate is modified.

**Term modification** – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

**Payment modification** – A modification in which the payment amount is changed.

**Combination modification** – Any other type of modification, including the use of multiple types of modifications.

In the tables below, member business loan modifications were mostly payment modifications and residential real estate and home equity and consumer loan modifications were combination modifications.

The following table presents loans identified as restructured during the years ended June 30:

| | 2020 | | |
|---|---|---|---|
| | Number of Loans | Pre-Modification Outstanding Balance | Modification Outstanding Balance |
| Residential real estate and home equity | | | |
| First mortgage | 7 | $ 925 | $ 928 |
| Second mortgage | 1 | 45 | 45 |
| Home equity lines of credit | 6 | 265 | 265 |
| Total residential real estate and home equity loans | 14 | 1,235 | 1,238 |
| Consumer loans - collateralized | | | |
| Automobile | 51 | 630 | 629 |
| Indirect automobile | 43 | 758 | 754 |
| Other secured | 3 | 64 | 64 |
| Total collateralized consumer loans | 97 | 1,452 | 1,447 |
| Total loans | 111 | $ 2,687 | $ 2,685 |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 3 – Loans, Net (continued)**

| | 2019 | | |
|---|---|---|---|
| | Number of Loans | Pre-Modification Outstanding Balance | Modification Outstanding Balance |
| Member business loans | | | |
| Real estate secured | 4 | $ 2,468 | $ 2,468 |
| Total member business loans | 4 | 2,468 | 2,468 |
| Residential real estate and home equity | | | |
| First mortgage | 4 | 268 | 268 |
| Second mortgage | 1 | 22 | 22 |
| Home equity lines of credit | 4 | 74 | 74 |
| Total residential real estate and home equity loans | 9 | 364 | 364 |
| Consumer loans - collateralized | | | |
| Automobile | 41 | 452 | 434 |
| Indirect automobile | 33 | 564 | 564 |
| Other secured | 4 | 62 | 62 |
| Total collateralized consumer loans | 78 | 1,078 | 1,060 |
| Total loans | 91 | $ 3,910 | $ 3,892 |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 3 – Loans, Net (continued)

The Credit Union defines default as loans that went 91 days or more past due after the modification, loans that were charged off during the year, or loans that encounter a subsequent modification. The following table presents subsequent defaults within 12 months of the modification date on troubled debt restructurings during the years ended June 30:

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Number of Loans | Total Balance | Number of Loans | Total Balance |
| Member business loans | | | | |
| Real estate secured | 1 | $ 325 | 1 | $ 150 |
| Total member business loans | 1 | 325 | 1 | 150 |
| Residential real estate and home equity | | | | |
| First mortgage | 1 | 63 | 3 | 212 |
| Second mortgage | 1 | 45 | 1 | 22 |
| Home equity lines of credit | 2 | 18 | 2 | 31 |
| Total residential real estate and home equity loans | 4 | 126 | 6 | 265 |
| Consumer loans - collateralized | | | | |
| Automobile | 31 | 240 | 41 | 381 |
| Indirect automobile | 10 | 108 | 27 | 414 |
| Other secured | - | - | 2 | 4 |
| Total collateralized consumer loans | 41 | 348 | 70 | 799 |
| Total loans | 46 | $ 799 | 77 | $ 1,214 |

### Note 4 – Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans at June 30 are summarized as follows:

| | 2020 | 2019 |
|---|---|---|
| Mortgage loan portfolio serviced for Fannie Mae | $ 701,775 | $ 690,347 |
| Mortgage loan portfolio serviced for Freddie Mac | 14 | 16 |
| Mortgage loan portfolio serviced for City of Huntsville | 272 | 354 |
| | $ 702,061 | $ 690,717 |

Mortgage servicing rights, net of impairment, in the amounts of $2,632 and $2,585 at June 30, 2020 and 2019, respectively, are classified as other assets in the consolidated statements of financial condition.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 4 – Loan Servicing (continued)**

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in members' shares in the consolidated statements of financial condition, were $6,491 and $6,508 at June 30, 2020 and 2019, respectively.

The activities in capitalized mortgage servicing rights for the years ended June 30 are summarized as follows:

| | 2020 | 2019 |
|---|---|---|
| Mortgage servicing rights | | |
| Balance, beginning of year | $ 2,586 | $ 2,379 |
| Additions | 1,245 | 936 |
| Amortization | (967) | (729) |
| Balance, end of year | 2,864 | 2,586 |
| Reserve for impairment of mortgage servicing rights | | |
| Balance, beginning of year | 1 | - |
| Additions | 231 | 1 |
| Balance, end of year | 232 | 1 |
| Net book value | $ 2,632 | $ 2,585 |
| Fair value | $ 2,908 | $ 4,678 |

The key market assumptions used in determining the fair value of mortgage servicing rights at June 30 were as follows:

| | 2020 | 2019 |
|---|---|---|
| Prepayment speed per year | 19.74 CPR | 12.00 CPR |
| Weighted-average discount rate | 11.50% | 10.43% |

## Notes to Consolidated Financial Statements (dollar amounts in thousands)

### Note 5 – Property and Equipment

Property and equipment are summarized as follows at June 30:

| | 2020 | 2019 |
|---|---|---|
| Land | $ 22,863 | $ 21,888 |
| Land improvements | 10,185 | 9,026 |
| Building and building improvements | 139,051 | 110,696 |
| Leasehold improvements | 5,467 | 5,139 |
| Furniture and equipment | 58,180 | 52,986 |
| Lease right-of-use asset | 1,813 | 1,334 |
| | 237,559 | 201,069 |
| Accumulated depreciation and amortization | (94,046) | (87,869) |
| | $ 143,513 | $ 113,200 |

Depreciation and amortization expense totaled $11,612 and $9,645 for the years ended June 30, 2020 and 2019, respectively.

Imputed interest of $459 and $323 for the years ended June 30, 2020 and 2019, respectively, is included in the cost of buildings.

### Note 6 – Leases

The Credit Union adopted the provisions of ASC 842 effective July 1, 2018, on a modified retrospective basis. Refer to Note 1, Nature of Operations and Significant Accounting Policies.

The Credit Union leases 17 buildings and offices and 13 automobiles under non-cancelable operating leases. Substantially all of the leases provide the Credit Union with the option to extend the lease term one or more times following expiration of the initial term.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 6 – Leases (continued)**

**Lease position**

The table below presents the lease right-of-use assets and lease liabilities recorded on the consolidated statement of financial condition as of June 30:

| | Classification on the Consolidated Statements of Financial Condition | 2020 | 2019 |
|---|---|---|---|
| Assets | | | |
| Operating right-of-use lease assets | Property and equipment | $ 1,813 | $ 1,334 |
| Liabilities | | | |
| Operating lease liabilities | Accrued expenses and liabilities | $ 1,634 | $ 1,335 |
| Weighted-average remaining lease term | | | |
| Operating leases | | 3.99 years | 3.87 years |
| Weighted-average discount rate | | | |
| Operating leases | | 1.93% | 2.49% |

The lease right-of-use assets and lease liabilities recorded were based on 30 leases with a term beginning prior to June 30, 2020. All other leases held by the Credit Union were not considered material for purposes of reporting the right-of-use assets and liabilities and therefore were not included in these amounts.

**Lease costs** – All right-of-use leases were classified as operating leases. The table below presents lease costs for years ended June 30:

| | 2020 | 2019 |
|---|---|---|
| Operating lease cost | | |
| Buildings and offices | $ 764 | $ 424 |
| Automobiles | 91 | 54 |
| Total lease cost | $ 855 | $ 478 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 6 – Leases (continued)**

**Undiscounted cash flows** – The table below presents the undiscounted cash flows remaining on all lease liabilities recorded on the consolidated statements of financial position:

| | Operating Leases |
|---|---|
| Years ending June 30, | |
| 2021 | $ 564 |
| 2022 | 531 |
| 2023 | 367 |
| 2024 | 31 |
| Thereafter | 239 |
| Total minimum lease payments | 1,732 |
| Less amount of lease payments representing interest | (98) |
| Lease obligations | $ 1,634 |

**Note 7 – Members' Shares**

Members' shares are summarized as follows at June 30:

| | 2020 | 2019 |
|---|---|---|
| Regular shares | $ 2,284,022 | $ 1,866,378 |
| Share draft accounts | 984,549 | 809,651 |
| Money market accounts | 1,260,086 | 1,115,771 |
| Individual retirement accounts | 45,059 | 45,202 |
| Other savings | 29,434 | 24,493 |
| Certificates | 751,930 | 684,267 |
| | $ 5,355,080 | $ 4,545,762 |

Certificates by contractual maturity as of June 30 are summarized as follows:

| | |
|---|---|
| 2021 | $ 372,640 |
| 2022 | 95,246 |
| 2023 | 96,475 |
| 2024 | 51,519 |
| 2025 | 21,824 |
| Thereafter | 114,226 |
| | $ 751,930 |

**Note 7 – Members' Shares (continued)**

Regular shares, share draft accounts, money market accounts, and individual retirement account shares, and other savings have no contractual maturity. The NCUSIF insures members' shares and certain individual retirement and Keogh accounts. As of July 21, 2010, Congress permanently applied the minimum NCUSIF coverage to $250,000 on member share accounts. This includes all account types, such as regular share, share draft, money market, and certificates of deposit. Individual retirement account and Keogh account coverage remains at up to $250,000 separate from other types of accounts owned.

The aggregate amount of certificates in denominations of $250,000 or more was $87,494 and $78,164 at June 30, 2020 and 2019, respectively.

Overdraft demand shares reclassified to loans totaled $1,472 and $1,922 at June 30, 2020 and 2019, respectively.

**Note 8 – Borrowed Funds**

The Credit Union utilizes a demand loan agreement with the FHLB of Atlanta. The advances are collateralized by FHLB of Atlanta stock and pledged mortgage loan collateral, which includes residential first mortgages, home equity lines of credit, and second mortgages, under an Advances and Security Agreement between the FHLB and the Credit Union. The amount of loans pledged as collateral at June 30, 2020, is $538,019. Based on the qualifying collateral, the agreement provides for a maximum borrowing amount of approximately $377,688. Borrowings outstanding as of June 30, 2020 and 2019, were $42,242 and $0. The maturity for the borrowings outstanding as of June 30, 2020, is May 1, 2023 and the weighted average rate is 0.59%.

The Credit Union has available lines of credit with the Federal Reserve Bank of Atlanta, and the Federal Home Loan Bank of Atlanta, which are secured by pledged investments from the Credit Union's investment portfolio. The terms of the agreements provide for primary credit up to the market value of the securities pledged. There were no borrowings under these agreements as of June 30, 2020 or 2019.

**Note 9 – Derivatives**

The Credit Union is engaged in providing first mortgage permanent financing for residential property. Residential home mortgages are originated for sale into the secondary market and were previously hedged against interest rate fluctuations with mandatory forward sales commitments and commitments for forward sales of mortgage-backed securities in the TBA market from the time of an interest rate lock loan commitment until the loans are sold (typically 30 to 90 days). These hedging activities were discontinued during the year ended June 30, 2019.

There were no interest rate lock loan commitments or open forward commitments as of June 30, 2020 or 2019. There were no derivative assets or liabilities on the consolidated statements of financial condition of June 30, 2020 or 2019.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 9 – Derivatives (continued)

The following table summarizes the types of derivatives, their locations within the consolidated statements of income, and the gains (losses) recorded for the year ended June 30:

| Derivatives | Statement of Income Location | 2020 | 2019 |
|---|---|---|---|
| Interest rate lock commitments | Mortgage banking revenue | $ - | $ (210) |
| Forward sales of mortgage-backed securities commitments | Mortgage banking revenue | - | 128 |
| Mandatory forward loan sales commitments | Mortgage banking revenue | - | 80 |

### Note 10 – Off-Balance Sheet Activities

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

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

Outstanding loan commitments total $73,736 and $63,780 at June 30, 2020 and 2019, respectively. Letters of credit outstanding totaled $77 and $87 as of June 30, 2020 and 2019, respectively.

ACH origination limits for business customers outstanding totaled approximately $7,109 and $7,375 as of June 30, 2020 and 2019, respectively.

Unfunded loan commitments under lines of credit are summarized as follows at June 30:

| | 2020 | 2019 |
|---|---|---|
| Credit card | $ 1,103,707 | $ 519,925 |
| Home equity line of credit | 204,313 | 188,132 |
| Overdraft line of credit | 48,227 | 46,409 |
| Member business | 20,307 | 10,993 |
| Other consumer | 11,412 | 10,262 |
| | $ 1,387,966 | $ 775,721 |

**Note 10 – Off-Balance Sheet Activities (continued)**

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

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

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

**Note 11 – Contingent Liabilities**

In the ordinary course of business, the Credit Union sells loans that may have to be subsequently repurchased due to defects that occurred during the origination of the loan. The defects are categorized as documentation errors, underwriting errors, early payment defaults, and fraud. When a loan sold to an investor without recourse fails to perform, the investor will typically review the loan file to determine whether defects in the origination process occurred. If a defect is identified, the Credit Union may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no defects, the Credit Union has no commitment to repurchase the loan.

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 12 – Employee Benefits

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

| | As of and for the Years Ended June 30, | |
|---|---|---|
| | 2020 | 2019 |
| Projected benefit obligation | $ (134,454) | $ (103,776) |
| Fair value of plan assets | 131,832 | 66,325 |
| Funded status | $ (2,622) | $ (37,451) |
| Accumulated benefit obligation | $ 92,704 | $ 72,615 |
| Net pension cost | $ 5,698 | $ 3,428 |
| Employer contribution | 65,400 | 5,400 |
| Benefit payments | 1,246 | 1,065 |

The components of pension expense are as follows:

| | Years Ended June 30, | |
|---|---|---|
| | 2020 | 2019 |
| Service cost | $ 4,667 | $ 3,322 |
| Interest cost | 3,649 | 3,297 |
| Expected return on Plan assets | (4,783) | (4,189) |
| Amortization of loss | 2,165 | 998 |
| Net periodic pension cost | $ 5,698 | $ 3,428 |

The change in fair value of Plan assets is as follows:

| | June 30, | |
|---|---|---|
| | 2020 | 2019 |
| Fair value of Plan assets at beginning of year | $ 66,325 | $ 57,747 |
| Actual return on Plan assets | 1,353 | 4,243 |
| Employer contributions | 65,400 | 5,400 |
| Benefits paid | (1,246) | (1,065) |
| Fair value of Plan assets at end of year | $ 131,832 | $ 66,325 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 12 – Employee Benefits (continued)**

The change in projected benefit obligation is as follows:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Projected benefit obligation at beginning of year | $ 103,776 | $ 80,042 |
| Service cost | 4,667 | 3,322 |
| Interest cost | 3,649 | 3,297 |
| Benefits paid | (1,246) | (1,065) |
| Actuarial loss | 23,608 | 18,180 |
| Projected benefit obligation at end of year | $ 134,454 | $ 103,776 |

Amounts recognized in the consolidated statements of financial condition consist of:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Defined pension liability | $ 2,622 | $ 37,451 |
| Total recognized | $ 2,622 | $ 37,451 |

Amounts recognized in accumulated other comprehensive loss consist of:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Unrealized losses | $ 62,118 | $ 37,245 |

Components of net periodic pension cost over the next fiscal year ending June 30, 2021:

| | |
|---|---|
| Amortization of loss | $ 3,973 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 12 – Employee Benefits (continued)**

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 Plan seeks to beat inflation, meet actuarial assumptions, meet or exceed benchmark returns, and fund Plan operating needs. The goal is to control risk through portfolio diversification and to reflect, among other possible factors, the previously stated objectives in conjunction with current and anticipated funding levels and economic and industry trends. Plan assets are primarily invested in funds with a high degree of liquidity and/or marketability. Quantitative and qualitative determinants will establish the appropriate asset allocation on a periodic, but not less than annual basis.

| | 2020 | 2019 |
|---|---|---|
| Assumptions used to determine benefit obligation | | |
| Discount rate | 2.72% | 3.54% |
| Rate of compensation increase | 5.00% | 5.00% |
| Assumptions used to determine net pension cost | | |
| Discount rate | 2.72% | 3.54% |
| Expected long-term return on Plan assets | 7.00% | 7.00% |
| Rate of compensation increase | 5.00% | 5.00% |

The Credit Union made a special one-time contribution to the plan in June of 2020 of $60,000 therefore does not expect to contribute to the Plan in fiscal year 2021.

The Credit Union’s pension plan weighted average asset allocations by asset category are as follows as of June 30:

| | 2020 | 2019 |
|---|---|---|
| Equity securities | 43.8% | 78.0% |
| Fixed income | 9.9% | 20.4% |
| Money market funds and cash | 46.3% | 1.6% |

The following pension benefits, which reflected expected future service, as appropriate, are expected to be paid as follows:

| | |
|---|---|
| Years ending June 30, | |
| 2021 | $ 1,575 |
| 2022 | 1,838 |
| 2023 | 2,148 |
| 2024 | 2,508 |
| 2025 | 2,872 |
| 2026-2030 | 19,696 |
| | $ 30,637 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 12 – Employee Benefits (continued)**

The following table discloses the fair value of Pension Plan assets by level:

| June 30, 2020 | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market fund | $ 61,068 | $ 61,068 | $ - | $ - |
| Mutual funds | | | | |
| Domestic equity | | | | |
| Blended funds | 40,252 | 40,252 | - | - |
| International equity | 13,945 | 13,945 | - | - |
| Specialty funds | 3,524 | 3,524 | - | - |
| Fixed income | 13,043 | 13,043 | - | - |
| | $ 131,832 | $ 131,832 | $ - | $ - |

| June 30, 2019 | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market fund | $ 1,127 | $ 1,127 | $ - | $ - |
| Mutual funds | | | | |
| Domestic equity | | | | |
| Blended funds | 35,883 | 35,883 | - | - |
| International equity | 12,437 | 12,437 | - | - |
| Specialty funds | 3,379 | 3,379 | - | - |
| Fixed income | 13,499 | 13,499 | - | - |
| | $ 66,325 | $ 66,325 | $ - | $ - |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 12 – Employee Benefits (continued)**

**Postretirement benefit plan** – The Credit Union provides certain health care benefits for all retired employees who meet eligibility requirements. The Credit Union's share of the benefits that will be paid after retirement is being accrued by charges to expense over each employee's service period to the dates they are fully eligible for benefits.

The status of the Plan is as follows:

| | Years Ended June 30, 2020 | Years Ended June 30, 2019 |
|---|---|---|
| Projected benefit obligation | $ (16,427) | $ (14,118) |
| Funded status | $ (16,427) | $ (14,118) |
| Benefit cost | $ 852 | $ 836 |
| Employer contribution | 123 | 102 |
| Participant contribution | 8 | 9 |
| Benefit payments | 131 | 111 |

The components of postretirement benefit expense are as follows:

| | Years Ended June 30, 2020 | Years Ended June 30, 2019 |
|---|---|---|
| Service cost | $ 375 | $ 346 |
| Interest cost | 477 | 496 |
| Amortization of loss | - | (6) |
| Net periodic pension cost | $ 852 | $ 836 |

The Credit Union expects to contribute $402 to the Plan in fiscal year 2021.

Amounts recognized in the consolidated statements of financial condition consist of:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Accrued expenses and other liabilities | $ 16,427 | $ (14,118) |
| Total recognized | $ 16,427 | $ (14,118) |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

**Note 12 – Employee Benefits (continued)**

Amounts recognized in accumulated other comprehensive (gain) loss consist of the following:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Unrealized (gains) losses | $ 1,399 | $ (181) |

The following are assumptions used to determine net periodic benefit cost for the Plan at June 30:

| . | 2020 | 2019 |
|---|---|---|
| Weighted-average assumptions as of June 30, | | |
| Discount rate | 2.56% | 3.42% |
| Healthcare cost trend | | |
| Current | 5.30% | 5.50% |
| Ultimate | 3.84% | 3.84% |

The following benefits are expected to be paid as follows:

| | |
|---|---|
| Years ending June 30, | |
| 2021 | $ 402 |
| 2022 | 480 |
| 2023 | 554 |
| 2024 | 628 |
| 2025 | 642 |
| 2026-2030 | 3,867 |
| | $ 6,573 |

**Defined contribution retirement savings plan** – The Credit Union has a 401(k) defined contribution plan (Plan) that allows employees to defer a portion of their salary into the Plan. The Credit Union matches a portion of employees' wage reductions. The Credit Union contributed $2,990 and $2,664 in matching contributions to the Plan for the years ended June 30, 2020 and 2019, respectively.

**Deferred compensation plans** – The Credit Union has a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457(b). The Plan permits the eligible employees to defer a portion of their salary until future years. The recorded obligation of approximately $345 and $296 as of June 30, 2020 and 2019, respectively, was included in other liabilities.

The Credit Union had a Plan created in accordance with IRC Section 457(f) that allowed the Credit Union to contribute to a segregated investment account (see SERP account in Note 1). The investment returns are intended to fund obligations to eligible employees when they retire. This SERP account was closed and the assets liquidated in 2020. The recorded obligation of $1,094 and $1,388 as of June 30, 2020 and 2019, respectively, was recorded in other liabilities.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 13 – Members' Equity**

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

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth to total assets. Further, credit unions over $10,000,000 in assets are also required to calculate a Risk-Based Net Worth (RBNW) requirement that establishes whether or not the Credit Union will be considered complex under the regulatory framework. The Credit Union's RBNW requirement was 6.38% and 7.04% as of June 30, 2020 and 2019, respectively. The minimum requirement to be considered complex under the regulatory framework is 6.00%. Management believes, as of June 30, 2020 and 2019, the Credit Union meets all capital adequacy requirements to which it is subject.

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

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| Amount needed to be classified as well capitalized for RBNW | $ 389,428 | 6.38% | $ 368,003 | 7.04% |
| Amount needed to be classified as well capitalized | 427,272 | 7.00% | 365,912 | 7.00% |
| Actual net worth | 623,820 | 10.22% | 589,749 | 11.28% |

As of June 30, 2020 and 2019, 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 7.00% of assets. There are no conditions or events since that notification that management believes have changed the Credit Union's category. In performing its calculation of total assets, the Credit Union used the quarter end balance option, as permitted by regulation.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

## Note 14 – Changes in Accumulated Other Comprehensive Income (Loss) Balances

The changes in the balances of each component of accumulated other comprehensive income (loss) are as follows:

| | Net Change in (Losses) Gains, Prior Service Cost, and Transition Obligation on Defined Benefit Pension Plan | Net Change in Losses and Prior Service Cost on Postretirement Benefit Plan | Net Unrealized (Losses) Gains on Investments in Available-for-Sale Debt Securities | Net Unrealized (Losses) Gains on Equity Investments | Total |
|---|---|---|---|---|---|
| Balance as of June 30, 2018 | $ (20,117) | $ 1,288 | $ (55,768) | $ (329) | $ (74,926) |
| Other comprehensive income (loss) before reclassifications | (17,128) | (1,107) | 74,671 | 10,178 | 66,614 |
| Amounts reclassified from accumulated other comprehensive (income) loss | - | - | 334 | (8,500) | (8,166) |
| Net current period other comprehensive income (loss) | (17,128) | (1,107) | 75,005 | 1,678 | 58,448 |
| Balance as of June 30, 2019 | (37,245) | 181 | 19,237 | 1,349 | (16,478) |
| Other comprehensive income (loss) before reclassifications | (24,873) | (1,580) | 64,474 | - | 38,021 |
| Amounts reclassified from accumulated other comprehensive loss | - | - | 4,062 | - | 4,062 |
| Net current period other comprehensive income (loss) | (24,873) | (1,580) | 68,536 | - | 42,083 |
| Reclassification related to the adoption of ASU 2016-01 | - | - | - | (1,349) | (1,349) |
| Balance as of June 30, 2020 | $ (62,118) | $ (1,399) | $ 87,773 | $ - | $ 24,256 |

## Note 15 – Related Party Transactions

In the normal course of business, the Credit Union extends credit to directors, committee members, and executive officers. The aggregate loans to related parties are $274 and $244 at June 30, 2020 and 2019, respectively. Deposits from related parties amounted to $6,347 and $3,647 at June 30, 2020 and 2019, respectively.

### Note 16 – Fair Value Measurements

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

Fair value measurements are disclosed by level within the fair value hierarchy. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Valuation techniques are to be consistent with the market approach, the income approach, and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity’s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the fair value hierarchy establishes valuation inputs that give the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

The fair value hierarchy is as follows:

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

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

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

A summary of the Credit Union’s financial instruments and other accounts subject to fair value, including methodologies and resulting values follows:

**Cash and cash equivalents** – The carrying amounts of cash and cash equivalents approximate their fair value.

**Money market account** – The money market deposit accounts are public investment vehicles valued using $1 for the net asset value. The money market deposit accounts are classified within Level 2 of the valuation hierarchy.

**Note 16 – Fair Value Measurements (continued)**

**Investments** – Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities would include U.S. agency debentures and agency issued mortgage-backed securities. In certain cases, where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

U.S. agency and agency issued mortgage-backed securities are generally based upon a matrix pricing model from an investment reporting and valuation service. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Fixed income bonds in the Charitable donation account, Employee benefit funding account, and Supplemental executive retirement account are valued using pricing models maximizing the use of observable inputs for similar securities, which includes basing value on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, those corporate bonds are valued under a discounted cash flow approach that maximizes observable inputs, such as current yields or similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

Equity securities in the Charitable donation account, Employee benefit funding account, and Supplemental executive retirement account are valued at the closing price reported on the active market on which the individual securities are traded.

**Loans held for sale** – Loans held for sale are valued at the lower of cost or market value as determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis. Loans that are committed with firm investor pricing are classified as Level 1. In the absence of a commitment, these are classified as Level 2.

**Loans, net** – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one-to-four family residential), credit card loans, and other consumer loans are estimated using a discounted cash flow calculation that applies interest rates currently being offered similar loans to a schedule of aggregated expected monthly maturities of these loans. Fair values for business real estate and business loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

**Note 16 – Fair Value Measurements (continued)**

**Impaired loans** – The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and 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. At June 30, 2020 and 2019, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with Accounting Standards Codification Topic 820, 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. For a majority of impaired real estate loans, the Credit Union obtains a current external appraisal. Other valuation techniques are used as well, including internal valuations, comparable property analysis, and contractual sales information.

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

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 16 – Fair Value Measurements (continued)**

**Fair value on a recurring basis** – The table below presents the balances of assets and liabilities measured and presented in the consolidated statement of financial condition at fair value on a recurring basis:

| June 30, 2020 | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market accounts | | | | |
| Charitable Donation Account | $ 491 | $ - | $ 491 | $ - |
| Employee Benefit Funding Account | 2,588 | - | 2,588 | - |
| Available-for-sale debt securities | | | | |
| Operating Investments | | | | |
| Federal agency debt securities | 89,740 | - | 89,740 | - |
| Collateralized debt obligation | 82,375 | - | 82,375 | - |
| Residential Mortgage-backed securities | 1,162,868 | - | 1,162,868 | - |
| Commercial Mortgage-backed securities | 1,552,203 | - | 1,552,203 | - |
| Charitable Donation Account - fixed income bonds | 20,128 | - | 20,128 | - |
| Employee Benefit Funding Account - fixed income bonds | 100,893 | - | 100,893 | - |
| Equity securities | | | | |
| Charitable Donation Account | 6,684 | 6,684 | - | - |
| Employee Benefit Funding Account | 33,417 | 33,417 | - | - |
| Other Investments | | | | |
| FHLB of Atlanta stock | 6,702 | - | 6,702 | - |
| Co-op stock | 20 | - | 20 | - |
| Certificate of deposit | 5,144 | - | 5,144 | - |
| | $ 3,063,253 | $ 40,101 | $ 3,023,152 | $ - |

**Notes to Consolidated Financial Statements (dollar amounts in thousands)**

### Note 16 – Fair Value Measurements (continued)

| June 30, 2019 | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market accounts | | | | |
| Charitable Donation Account | $ 649 | $ - | $ 649 | $ - |
| Employee Benefit Funding Account | 2,891 | - | 2,891 | - |
| Supplemental executive retirement plan account | 1,180 | - | 1,180 | - |
| Available-for-sale debt securities | | | | |
| Operating Investments | | | | |
| Federal agency debt securities | 215,822 | - | 215,822 | - |
| Collateralized debt obligation | 91,206 | - | 91,206 | - |
| Residential Mortgage-backed securities | 1,017,466 | - | 1,017,466 | - |
| Commercial Mortgage-backed securities | 1,131,946 | - | 1,131,946 | - |
| Charitable Donation Account - fixed income bonds | 13,662 | - | 13,662 | - |
| Employee Benefit Funding Account - fixed income bonds | 67,717 | - | 67,717 | - |
| Supplemental executive retirement plan account - fixed income bonds | 18,202 | - | 18,202 | - |
| Equity securities | | | | |
| Charitable Donation Account | 12,233 | 12,233 | - | - |
| Employee Benefit Funding Account | 60,492 | 60,492 | - | - |
| Supplemental executive retirement plan account | 6,858 | 6,858 | - | - |
| Other Investments | | | | |
| FHLB of Atlanta stock | 4,409 | - | 4,409 | - |
| Co-op stock | 20 | - | 20 | - |
| Loans Held for Sale | 5,881 | - | 5,881 | - |
| | $ 2,650,634 | $ 79,583 | $ 2,571,051 | $ - |

**Fair value on a nonrecurring basis** – Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the statements of financial condition by caption and by level within the valuation hierarchy (as described above) for which a nonrecurring change in fair value has been recorded.

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| June 30, 2020 | | | | |
| Restructured and impaired loans | $ 7,667 | $ - | $ - | $ 7,667 |
| June 30, 2019 | | | | |
| Restructured and impaired loans | $ 7,158 | $ - | $ - | $ 7,158 |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 16 – Fair Value Measurements (continued)**

**Quantitative information about Level 3 fair value measurements** – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ended June 30 along with the valuation techniques used, are shown in the following table:

| | Fair Value at June 30, 2020 | Valuation Technique | Unobservable Input | Range (Weighted-Average) |
|---|---|---|---|---|
| Restructured loans | $ 2,024 | Present value | Discount rate | 4% - 78% (24%)[1] |
| Impaired loans | 5,643 | Fair market value | Collateral value | 1% - 92% (46%)[2] |

[1] Discount to the present value of the expected cash flows based on the revised loan terms.
[2] Discount to the estimated value of the collateral that secures the loan. Various methods of valuation are used.

| | Fair Value at June 30, 2019 | Valuation Technique | Unobservable Input | Range (Weighted-Average) |
|---|---|---|---|---|
| Restructured loans | $ 2,098 | Present value | Discount rate | 1% - 79% (24%)[1] |
| Impaired loans | 5,060 | Fair market value | Collateral value | 8% - 83% (55%)[2] |

[1] Discount to the present value of the expected cash flows based on the revised loan terms.
[2] Discount to the estimated value of the collateral that secures the loan. Various methods of valuation are used.

**Note 17 – Collaborative Arrangement with Rural King**

As noted in Note 1, effective March 15, 2019, the Credit Union entered into a contract with RK Family, Inc., Rural King Holdings, LLP, and RK Finance, LLC (collectively referred to as Rural King) under which the Credit Union will provide financial services to Rural King customers. Revenue and expenses are included in the consolidated statement of income, net of reimbursements provided by Rural King as described in Note 1.

Notes to Consolidated Financial Statements (dollar amounts in thousands)

### Note 17 – Collaborative Arrangement with Rural King (continued)

Results for the years ended June 30, 2020, were as presented below. Net loss attributable to the program for 2019 was immaterial to the financial statements and therefore no detail is disclosed.

| | Year ended June 30, 2020 |
|---|---|
| Interest income | |
| Loans | $ 4,335 |
| Interest expense | |
| Borrowed funds | 608 |
| Net interest income | 3,727 |
| Provision for loan losses | 3,353 |
| Net interest income after provision for loan losses | 374 |
| Other income | |
| Credit card and interchange income | 2,044 |
| Loan fees | 483 |
| Total other income | 2,527 |
| Other expense | |
| Salary and benefits | 1,832 |
| Office occupancy | 186 |
| Data processing | 445 |
| Credit card processing | 1,688 |
| Cash back rebate on credit and debit cards | 1,769 |
| Member education and promotion | 353 |
| Loan servicing expense | 1,241 |
| Professional and outside | 28 |
| Uncollectible accounts | 1,330 |
| Other operating expense | 6,559 |
| Total other income | 15,431 |
| Net program income/(loss) | (12,530) |
| Profit sharing income/(loss) | (6,265) |
| Redstone FCU net program income/(loss) | $ (6,265) |

Notes to Consolidated Financial Statements (dollar amounts in thousands)

**Note 18 – Other Non-Interest Income and Operating Expense**

Other non-interest income is composed of the following for the year ended June 30:

| | 2020 | 2019 |
|---|---|---|
| Account fees | $ 3,293 | $ 3,080 |
| Marketing incentives | 3,343 | 2,836 |
| Subsidiary income | 2,992 | 848 |
| Other non-interest income | 1,782 | 1,848 |
| Gain on other assets | 146 | - |
| | $ 11,556 | $ 8,612 |

Other operating expense is composed of the following for the year ended June 30:

| | 2020 | 2019 |
|---|---|---|
| Communications (telephone and postage) | $ 3,000 | $ 2,712 |
| Armored car service | 2,826 | 2,236 |
| Subsidiary expenses | 1,065 | - |
| Maintenance of equipment and vehicles | 1,008 | 886 |
| Insurance | 809 | 769 |
| Supplies | 623 | 575 |
| Other operating expenses | 2,291 | 2,691 |
| Loss on other assets | - | 35 |
| | $ 11,622 | $ 9,904 |

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