alloya®

Corporate Federal Credit Union

2018 Audited Financials

Chair's Comments

As I look back on 2018, I am pleased to report that Alloya continues to fulfill its mission to support credit union success. This past year, Alloya paid $36.6 million in cash dividends to members, representing an increase of 67% over the $21.8 million paid in 2017. Alloya's 2018 net income of $17.9 million boosted retained earnings and other equity to $95.9 million and advanced our long-range capital accumulation plans.

Alloya continues to make advancements towards increasing the value that it provides to members. Throughout 2018, and for the foreseeable future, Alloya has a roadmap that builds out the Premier View technology to simplify members' operational lives and improve member communication. In 2018, Premier Portfolio was launched within the Premier View system, providing members access to an online trading and comprehensive investment management portal. Members can expect to see even more advancements to Premier View as we head into 2019.

When I think about the value of Alloya, there are many examples that come to mind: Alloya's efficient and affordable Line of Credit, efficient transaction processing, account access via Premier View, and education provided to members by Alloya's professionals. However, the element that stands out above all is Alloya's people; the staff at Alloya give this corporate incomparable value.

Member Service is of the utmost importance to Alloya. At the Corporate, there are no automated response systems. Real people pick up the phone within seconds and to support each credit union's unique needs. For the fifth year in a row, the member survey score continued to reinforce that Alloya is meeting members' expectations as they once again received a 4.7 out of 5.0.

As you know, the Board of Directors consists of credit union leaders from throughout the country working together to evolve Alloya's long-range strategic plan. I am grateful to be working with these talented leaders throughout the country as we help to provide strategic direction to a growing and vibrant organization such as Alloya.

On behalf of Alloya's Board of Directors, thank you for your continued support and engagement.

Floyd Rummel, III
March 11, 2019

Chief Executive Officer's Comments

For the past several years, Alloya's strategic goals have focused on advancing People/Culture, Member Service, Financial Performance and Compliance. I am pleased to report that we made progress against these goals during 2018 and a few highlights are provided below. For more details on how Alloya supports credit union success, I encourage you to also review the *2018 Report to Membership* that is available on our website.

People/Culture

One of our strategic goals is to maintain a team of professionals that are engaged and view themselves as an extension of the credit unions we serve. On a daily basis staff are solving problems, performing adjustments, sharing expertise and planning for the future. I believe our team goes above and beyond to ensure that members have the best experience possible. But how do our staff feel? When asked about their job satisfaction, Alloya received a high score of 96 (out of 100) based on the results of our 2018 Gallup staff engagement survey. Alloya is considered a top tier employer of choice and its engaged professionals are proud to be a part of the credit union community.

Member Service

Alloya's mission is to support credit union success and we continue to ask ourselves, "What is in the best interest of the members we serve and how can we simplify their back-office lives?" In response, we have increased dividends, met all loan requests and have improved upon our leading Premier View technology. As one example, in 2018, Premier Portfolio was added so that credit unions can now perform on-line investment trading and easily access related services such as free investment accounting, pre-purchase analytics and weekly economic updates. Just one year earlier, a new check processing and check deposit platform was launched. Premier View now offers a full menu of payment, investment and liquidity solutions through a single and efficient on-line technology that is supported by a team of professionals ready to answer the phone when members call.

Financial Performance and Compliance

From a financial performance standpoint, Alloya once again exceeded its financial goals for 2018 and remained in compliance with all applicable rules and regulations. Highlights include: net income of $17.9 million, retained earnings and other equity of $95.9 million, total assets of $3.0 billion, EBA balances of $1.9 billion and a leverage ratio of 10.3%.

On behalf of the Alloya team, I want to thank you for your continued support.

Todd M. Adams

March 11, 2019

Doeren Mayhew
CPAs AND ADVISORS

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Independent Auditor's Report

March 11, 2019

To the Board of Directors and the Supervisory Committee of
Alloya Corporate Federal Credit Union

We have audited the accompanying consolidated financial statements of Alloya Corporate Federal Credit Union and its subsidiary (the Credit Union), which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, 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 Consolidated Financial Statements

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

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. 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 consolidated financial position of Alloya Corporate Federal Credit Union and its subsidiary, as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

We have also audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants, Alloya Corporate Federal Credit Union's assertion concerning the effectiveness of the Credit Union's internal control and procedures over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2019, expressed an unmodified opinion.

Doeren Mayhew

Doeren Mayhew
Miami, FL

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
AS OF DECEMBER 31, 2018 AND 2017

Assets	**2018**	**2017**
Cash and cash equivalents	$781,468,091	$1,157,174,775
Investments securities:		
Available-for-sale	1,673,914,863	1,404,660,680
Loans to members	477,444,724	501,263,685
Reverse repurchase agreements	-	100,000,000
Split-dollar life insurance	12,052,495	22,914,817
Prepaid and other assets	11,084,497	12,428,410
Property and equipment	5,482,053	5,432,840
Accrued interest receivable	5,514,915	3,222,505
Goodwill and other intangible assets	5,957,654	5,957,654
National Credit Union Share Insurance Fund (NCUSIF)	3,266,809	3,460,209
Total assets	$2,976,186,101	$3,216,515,575
Liabilities and Members' Equity		
Liabilities:		
Members' shares and certificates	$2,604,481,770	$2,863,284,448
Borrowed funds	-	30,500,000
Deposits in collection	18,930,534	930,500
Accounts payable and other accrued liabilities	18,777,394	13,172,321
Accrued interest payable	1,200,604	824,035
Total liabilities	2,643,390,302	2,908,711,304
Commitments and contingent liabilities		
Members' equity:		
Perpetual contributed capital	237,937,317	226,451,102
Retained earnings and other equity	95,906,396	81,490,509
Accumulated other comprehensive loss	(1,047,914)	(137,340)
Total members' equity	332,795,799	307,804,271
Total liabilities and members' equity	$2,976,186,101	$3,216,515,575

See accompanying notes to the consolidated financial statements.

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Interest income:		
Investments	$54,150,547	$37,671,267
Loans to members	14,351,623	9,967,239
Total interest income	68,502,170	47,638,506
Interest expense:		
Members' shares and certificates	33,181,208	20,308,792
Borrowings	1,937,698	314,292
Total interest expense	35,118,906	20,623,084
Net interest income	33,383,264	27,015,422
Non-interest income:		
Fee income, net of correspondent banking expenses	11,689,156	9,429,091
Balance Sheet Solutions fee income	6,986,283	7,148,770
Agent income from Excess Balance Account Program	3,391,065	3,172,508
Information technology services	598,481	1,249,050
Other income	556,498	549,888
Gain on sale of available-for-sale investments	513,890	158,660
(Loss)/gains on financial instruments	(95,651)	32,176
Total non-interest income	23,639,722	21,740,143
Non-interest expense:		
Compensation and benefits	25,108,037	25,910,122
Professional and outside services	4,278,640	2,861,249
Office operations	2,348,095	2,439,348
Training, travel and communications	3,160,917	2,807,507
Office occupancy	1,967,034	1,859,877
Miscellaneous	2,278,663	906,862
Total non-interest expenses	39,141,386	36,784,965
Net income	$17,881,600	$11,970,600

See accompanying notes to the consolidated financial statements.

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Net income	$17,881,600	$11,970,600
Other comprehensive income:		
Net unrealized gains recorded for derivatives designated as cash flow hedges	571,523	-
Net unrealized holding (losses)/gains on investments classified as available-for-sale	(968,207)	4,094,428
Reclassification adjustments for gains included in net income	(513,890)	(158,660)
Other comprehensive (loss)/income	(910,574)	3,935,768
Comprehensive income	$16,971,026	$15,906,368

See accompanying notes to the consolidated financial statements.

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY
YEARS ENDED DECEMBER 31, 2018 AND 2017

	Perpetual Contributed Capital	Retained Earnings and Other Equity	Accumulated Other Comprehensive Income/(Loss)	Total
Balance, December 31, 2016	$223,244,500	$71,098,906	($4,073,108)	$290,270,298
Net income	-	11,970,600	-	11,970,600
Perpetual contributed capital acquired from members - net	3,206,602	-	-	3,206,602
Dividends on perpetual contributed capital	-	(1,578,997)	-	(1,578,997)
Other comprehensive income	-	-	3,935,768	3,935,768
Balance, December 31, 2017	226,451,102	81,490,509	(137,340)	307,804,271
Net income	-	17,881,600	-	17,881,600
Perpetual contributed capital acquired from members - net	11,486,215	-	-	11,486,215
Dividends on perpetual contributed capital	-	(3,465,713)	-	(3,465,713)
Other comprehensive loss	-	-	(910,574)	(910,574)
Balance, December 31, 2018	$237,937,317	$95,906,396	($1,047,914)	$332,795,799

See accompanying notes to the consolidated financial statements.

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Cash flows from operating activities:		
Net income	$17,881,600	$11,970,600
Adjustments:		
Depreciation and amortization	1,624,427	1,409,319
Gain on sale of available-for-sale investments	(513,890)	(158,660)
Loss/(gain) on financial instruments	95,651	(32,176)
Change in cash surrender value of life insurance contracts	-	(221,008)
Amortization/accretion on investment premiums and discounts	(1,319,588)	1,153,979
Amortization of premiums on loans	-	108,681
Amortization of premiums on members' certificates	-	(33,515)
Amortization of premium paid on derivatives contracts	222,758	-
Changes in operating assets and liabilities:		
Prepaid and other assets	1,597,027	4,902,177
Accrued interest receivable	(2,292,410)	(269,544)
Accrued interest payable	376,569	400,840
Accounts payable and other accrued liabilities	5,605,073	(344,074)
Total adjustments	5,395,617	6,916,019
Net cash provided from operating activities	23,277,217	18,886,619

See accompanying notes to the consolidated financial statements.

ALLOYA CORPORATE FEDERAL CREDIT UNION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017

Cash Flows (Continued)

	2018	2017
Cash flows from investing activities:		
Proceeds from maturities, sales and repayments of available-for-sale investments	1,038,289,813	1,093,280,327
Purchase of available-for-sale investments	(1,307,192,615)	(830,888,131)
Net change in loans to members	23,818,961	(65,627,968)
Expenditures for property and equipment	(1,673,640)	(871,876)
Purchase of repurchase agreements	-	(150,000,000)
Proceeds from maturity of repurchase agreement	100,000,000	50,000,000
Proceeds from sale of insurance contracts	14,922,745	-
Purchase of insurance contracts	(4,060,423)	(7,992,072)
Decrease in NCUSIF deposit	193,400	13,099
Net cash (used in)/provided from investing activities	(135,701,759)	87,913,379
Cash flows from financing activities:		
Net change in members' shares and certificates	(258,802,678)	(223,033,275)
Change in deposits in collection	18,000,034	(19,213,101)
Proceeds from borrowings	140,000,000	30,500,000
Payments on borrowings	(170,500,000)	(30,500,000)
Perpetual contributed capital raised	11,486,215	3,206,602
Dividends on perpetual contributed capital	(3,465,713)	(1,578,997)
Net cash used in from financing activities	(263,282,142)	(240,618,771)
Net change in cash and cash equivalents	(375,706,684)	(133,818,773)
Cash and cash equivalents, beginning of year	1,157,174,775	1,290,993,548
Cash and cash equivalents, end of year	$781,468,091	$1,157,174,775

Supplemental Cash Flows Disclosures

Interest paid	$34,742,338	$20,255,759

See accompanying notes to the consolidated financial statements.

Note 1 - Significant Accounting Policies

Organization

Alloya Corporate Federal Credit Union (the Credit Union) was chartered in October 2011 and provides liquidity, correspondent transaction and investment services to credit unions and their affiliated organizations through a national field of membership. The Credit Union is a "business to business" provider and is used by its member credit unions as their primary point of cash settlement and as a source for operational and term liquidity through an advised line of credit program. The Credit Union also offers a back office technology solution referred to as Premier View which represents an efficient and secure solution for member credit unions to process transactions such as wires, ACH, checks, international payments and coin and currency delivery to their branches and ATMs. The Credit Union further supports member credit unions by providing clearing, research, adjustment and compliance functions related to these transactions.

Balance Sheet Solutions, LLC (BSS) is a wholly-owned subsidiary of the Credit Union. BSS is registered as an investment advisor with the Securities and Exchange Commission (SEC). BSS offers services through CU Investment Solutions, LLC. CU Investment Solutions, LLC, is registered with the Securities and Exchange Commission as a broker-dealer under the Securities Exchange Act of 1934. BSS offers securities transactions and nondiscretionary investment advisory services to its customers, principally credit unions and credit union service organizations.

Consolidated Financial Statements/Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP/USA) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the dates of the consolidated financial statements and the reported amounts of revenues and expenses for the periods then ended. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the determination of the fair value of financial instruments. The significant accounting principles and policies used in the preparation of these consolidated financial statements, together with certain related information, are summarized below.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Credit Union and its wholly owned subsidiary, BSS. All significant intercompany balances and transactions have been eliminated in consolidation.

Note 1 - Significant Accounting Policies (Continued)

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from the Federal Reserve Bank and other depository institutions as well as coin and currency maintained at various courier warehouses. Amounts due from banks may, at times, exceed federally insured limits.

Federal Reserve Bank (FRB) – Excess Balance Account (EBA) Program

The Credit Union, as agent, entered into an EBA agreement with participating member credit unions and the FRB, whereby the FRB opened EBA accounts for the benefit of the participants at the request of the agent. As such, the balances in the EBA accounts are not reflected in the Credit Union's consolidated financial statements. These balances totaled approximately $1,896,430,000 and $2,018,997,000 as of December 31, 2018 and 2017, respectively. Neither the participating member credit unions nor the agent may use the EBA for general payments or other activities. The aggregate balance in the EBA represents a deposit liability of the FRB solely to the participants. The agent is solely responsible for calculating and distributing the interest payable to each participant on the participant's excess balance and for damages owed to participants for any inaccuracy in calculating the participant's excess balance and interest.

Available-for-Sale Investments

Asset-backed securities, collateralized-mortgage obligations, agency securities and corporate notes are classified as available-for-sale when the Credit Union anticipates that the securities could be sold in response to rate changes, prepayment risk, liquidity, availability of and the yield on alternative investments and other market and economic factors. These securities are reported at fair value.

Unrealized gains and losses on securities available-for-sale are recognized as direct increases or decreases in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of 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 (OTTI) losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Credit Union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and the costs of securities sold are determined using the specific identification method.

Note 1 - Significant Accounting Policies (Continued)

Derivative Instruments

The Credit Union has agreements with JP Morgan Chase Bank and PNC for the purpose of effecting derivative transactions. A derivative contract is a financial instrument whose value depends on, or is derived from, the value of an underlying asset, reference rate or index.

The Credit Union enters into derivative financial instruments in the form of interest rate swap and floor agreements. The interest rate swap derivatives are recorded at fair value in the consolidated statements of financial condition and the instruments are designated as being used to hedge changes in fair value (See Note 11). The Credit Union uses the fair value option for interest rate swap derivatives. Assets are recorded for realized gains and liabilities are recorded for realized losses. The interest rate floor derivatives are designated as cash flow hedges and are recorded on the balance sheet at fair value with the offsetting changes recorded in other comprehensive income. The Credit Union uses derivative instruments primarily to minimize the effects of interest rate volatility on net interest income. Derivatives are closely matched with on-balance sheet risks.

The Credit Union uses interest rate swap agreements to offset the changes in fair value of certain member loans that occur during periods of interest rate volatility. Changes in fair value of derivatives and matched member loans are recorded in earnings and are included in gain on financial instruments in the consolidated statements of income. If changes in the fair value of derivatives do not completely offset changes in the fair value of matched member loans, the difference represents ineffectiveness and such ineffectiveness is recorded in earnings. Upon termination, realized gains or losses on derivatives designated in fair value hedging relationships are recorded in earnings.

The Credit Union uses interest rate floor agreements to mitigate the potential risk associated with the volatility on the London Interbank Offered Rate (LIBOR) based assets that could result from declining interest rates. These derivative instruments are cash flow designated hedges and will be recorded on the balance sheet at fair value with the offsetting changes recorded in other comprehensive income (OCI). The Credit Union shall discontinue hedge accounting prospectively for an existing hedge if the derivative expires or is sold, terminated, or exercised, if the Credit Union removes the designation of the cash flow hedge, if the hedged item is no longer probable or if the hedging relationship fails to be highly effective. The net gain or loss through the effective date of the actions above remains in OCI until the hedged item impacts earnings unless hedged asset levels fall permanently below hedge levels. When hedge accounting is discontinued, the net gain or loss in OCI will be reclassified to interest income based on the cash flows modeled in the most recent effective derivative/hypothetical derivative relationship.

The derivatives are included with prepaid and other assets in the consolidated statements of financial condition. The accrual of interest income or expense on derivative instruments is reported as a component of interest income or expense.

Note 1 - Significant Accounting Policies (Continued)

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities are reported in a separate component of comprehensive income/(loss). Other comprehensive income/(loss) is limited to the changes in unrealized gains/(losses) on available-for-sale investments and offsetting changes of interest rate floor derivatives designated as cash flow hedges. When available-for-sale investments are sold, the gain/(loss) realized on the sale is reclassified from accumulated other comprehensive income/(loss) to the net gain/(loss) on sale of available-for-sale investments reported in the consolidated statements of income. Net gains/(losses) on derivative instruments that are designated as cash flow hedges are reclassified into earnings over the term of the instrument.

Reverse Repurchase Agreements

In 2017, the Credit Union entered into reverse repurchase agreements accounted for as secured borrowings at amortized cost. As the buyer-lender, the Credit Union bought the securities with an agreement to resell them to the seller-borrower at a stated price plus interest at a specified date. There were no outstanding reverse repurchase agreements as of December 31, 2018.

Split-Dollar Life Insurance

The Credit Union entered into collateral assignment split-dollar agreements with certain Credit Union executives under Treasury Regulation 1.7872-15(e)(5)(ii). The agreements involve a method of paying for insurance coverage for the executive by splitting the elements of the life insurance policies. Under these agreements, the executive is the owner of the policy and makes a collateral assignment to the Credit Union in return for a loan equal to the amount of premiums paid on behalf of the executive plus accrued interest at a specified rate. However, the executive is not personally responsible for any repayment of the loan. Thus, such agreements are recorded at their cash surrender value. Income recognized under these agreements is included in non-interest income in the consolidated statements of income. At the time of death, the Credit Union will be paid the loan amount plus accrued interest and the balance of the insurance benefit will be paid to the executives' designated beneficiary.

The Credit Union maintains life insurance policies purchased on the lives of current and former members of management. In the event of death of one of these individuals, the Credit Union, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the consolidated statement of financial condition date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in non-interest income. The Credit Union terminated these life insurance contracts as of December 31, 2018.

Note 1 - Significant Accounting Policies (Continued)

Loans to Members

Loans to members are stated at the amount of unpaid principal. Interest on loans is calculated using the simple-interest method on principal amounts outstanding. The accrual of interest is discontinued when management believes that collection of interest is doubtful. The Credit Union reviews the loan portfolio for impairment on a regular basis. No allowance for loan losses (allowance) has been established as the Credit Union has never experienced a loss on a member credit union loan and none of the loans were delinquent.

Allowance Methodology

The Credit Union's loan portfolio consists only of loans made to member credit unions and credit union service organizations. The Credit Union has divided the portfolio into two classes of loans (settlement loans and fixed-rate term loans) based on the risk characteristics of each type. Each class of loans requires significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment.

The following methodology is used by management to evaluate each class of loans.

Commercial Credit Quality Indicators

Settlement loans and fixed-rate term loans are evaluated on a loan-by-loan basis. Loans to members and credit union service organizations (CUSOs) are generally secured by a blanket lien against the assets of the member credit union or CUSO. In addition, the Credit Union may also require the member to pledge specific assets and/or certificate accounts before extending loan advances. Loans to members can be offset against the members' share accounts, if necessary.

If management determines that a loan is impaired, an impairment is recognized through an allowance. There were no impaired loans as of December 31, 2018 or 2017. Additionally, none of the loans were past due or modified as of December 31, 2018 or 2017. The Credit Union places loans on non-accrual status when the loan reaches 90 days past due or when the collection of interest or principal becomes uncertain.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the term of the lease, or the estimated life of the asset, whichever is less. The Credit Union reviews property and equipment (long-lived assets) for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Note 1 - Significant Accounting Policies (Continued)

Goodwill and Other Intangible Assets

Goodwill and intangible assets acquired in a purchase business combination that are determined to have an indefinite life are not amortized, but tested for impairment at least annually, or more frequently if events and circumstances exist that indicate that an impairment test should be performed. The Credit Union has selected December 31 as the date to perform the annual impairment test, and any impairment is recognized in the period identified. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. The Credit Union has no intangible assets with definite useful lives as of December 31, 2018 or 2017. Goodwill is the only intangible asset with an indefinite life in the Credit Union's consolidated statements of financial condition. Based on the annual impairment test performed December 31, 2018, there is no impairment on goodwill.

NCUSIF Deposit

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

Members' Shares and Certificates

Members' shares are subordinated to all other liabilities of the Credit Union other than non-perpetual contributed capital deposits upon liquidation. Interest rates on members' shares and certificates are set by management based on a daily assessment of available earnings and are not guaranteed by the Credit Union.

Non-Perpetual Contributed Capital (NPC) Shares

NPC shares require a notification term of five years prior to their withdrawal from the Credit Union. In the event of the Credit Union's liquidation, NPC shares are payable only after satisfaction of all liabilities of the Credit Union, including uninsured share obligations to members and the NCUSIF.

Note 1 - Significant Accounting Policies (Continued)

Perpetual Contributed Capital (PCC)

PCC is a secondary capital instrument that is classified as equity in the consolidated statements of financial condition. PCC is not negotiable or assignable but may be transferred to another eligible member credit union under certain provisions. PCC may not be pledged or used as security for borrowing. PCC dividends are determined based on net earnings and the overall capital needs of the Credit Union. Additionally, PCC dividends are not guaranteed and may be suspended if earnings are negative and/or capital levels fall below regulatory and/or policy minimum levels.

Borrowed Funds

The Credit Union maintains the ability to borrow from the Federal Home Loan Bank of Chicago (FHLBC). The FHLB borrowings are secured by pledges of qualified collateral, as defined in the FHLB Advance, Pledge and Security Agreement. There were no outstanding FHLB borrowings as of December 31, 2018.

Deposits in Collection

Deposits in collection represent deposits the Credit Union received on December 31 that will be credited to member share accounts the following business day.

Federal and State Tax Exemption

The Credit Union is exempt from most federal, state, and local taxes under the provisions of the Internal Revenue Code and state tax laws. The Income Taxes Topic of the FASB ASC clarifies accounting for uncertainty in income taxes reported in the consolidated financial statements. The interpretation provides criteria for assessment of individual tax positions and a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the “more likely than not” standard for sustainability on examination by tax authorities. Federal credit unions are tax-exempt under Internal Revenue Code sections 501(c)(14)(a) and 501(c)(1)(a)(I). As such, the Credit Union has no uncertain tax positions that qualify for either recognition or disclosure in the consolidated financial statements. Additionally, no interest or penalties have been recorded in the accompanying consolidated financial statements related to uncertain tax positions.

Reclassification

Certain amounts reported in the 2017 consolidated financial statements have been reclassified to conform with the 2018 presentation.

Note 1 - Significant Accounting Policies (Continued)

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases, which is intended to increase transparency and comparability of accounting for lease transactions. The ASU will require lessees to recognize most leases on the balance sheet as lease assets and lease liabilities and will require both quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting is largely unchanged. The guidance is effective December 31, 2020 with an option to early adopt. The Credit Union is evaluating whether to early adopt and the effect that ASU 2016-02 will have on its consolidated financial statements, regulatory capital and related disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses. The ASU introduces a new accounting model, the Current Expected Credit Losses model (CECL), which requires earlier recognition of credit losses. The FASB's CECL model utilizes a lifetime "expected credit loss" measurement objective for the recognition of credit losses for loans, held-to-maturity securities and other receivables at the time the financial asset is originated or acquired. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. For available-for-sale securities where fair value is less than cost, credit-related impairment, if any, will be recognized in an allowance for credit losses and adjusted each period for changes in expected credit risk. This model replaces the multiple existing impairment models in current GAAP, which generally require that a loss be incurred before it is recognized. The ASU will be effective for credit unions on January 1, 2022. Early application is permitted for annual periods beginning January 1, 2019.

Subsequent Events

Management has evaluated subsequent events through March 11, 2019, the date the consolidated financial statements were available to be issued. During December 2018, Balance Sheet Solutions and Alloya announced intentions to sell the ALM risk modeling and investment advisory services provided by Balance Sheet Solutions, LLC. As a result, the Credit Union has provided notice of its intent to terminate the West Covina lease. The Credit Union has accrued the estimated cost associated with the lease termination of approximately $1,100,000. Additionally, the Credit Union has accrued for other expenses such as the write off of leasehold improvements and build out costs as well as the broker commission totaling approximately $700,000. The accruals were recorded as miscellaneous expense on the consolidated statements of income.

Note 2 - Investment Securities

The amortized cost and estimated fair value of investments are as follows:

	As of December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Asset-backed securities	$1,201,286,940	$833,244	($1,214,209)	$1,200,905,975
Collateralized-mortgage obligations	450,231,082	1,108,589	(2,325,692)	449,013,979
Corporate notes	20,000,000	850	(10,750)	19,990,100
Agency securities	4,016,278	-	(11,469)	4,004,809
Total	$1,675,534,300	$1,942,683	($3,562,120)	$1,673,914,863

	As of December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Asset-backed securities	$826,053,737	$3,168,576	($1,692,580)	$827,529,733
Collateralized-mortgage obligations	558,744,283	1,707,902	(3,369,888)	557,082,297
Corporate notes	20,000,000	48,650	-	20,048,650
Total	$1,404,798,020	$4,925,128	($5,062,468)	$1,404,660,680

As of December 31, 2017, the Credit Union held certain investments classified as asset-backed securities or collateralized-mortgage obligations that were acquired through mergers totaling approximately $69,449,000 that were no longer permissible under NCUA Regulations. The Credit Union had a temporary waiver from the NCUA to hold these securities for a time period not to exceed November 30, 2018. These investments were sold in 2018 for a gain of approximately $4,376,000. Proceeds from the sales of investments classified as available-for-sale approximated $252,076,000 and $13,226,000 during the years ended December 31, 2018 and 2017, respectively. Gross gains and losses of approximately $4,587,000 and $4,073,000, respectively, were recognized from these sales during the year ended December 31, 2018. Gross gains and losses of approximately $190,000 and $31,000, respectively, were realized from sales during the year ended December 31, 2017.

Note 2 - Investment Securities (Continued)

The amortized cost and estimated fair value of investments as of December 31, 2018, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay certain obligations without call or prepayment penalties.

	Available-for-sale	
	Amortized Cost	**Fair Value**
Within 1 year	$15,000,000	$15,000,850
1 to 5 years	5,000,000	4,989,250
Asset-backed securities	1,201,286,940	1,200,905,975
Collateralized-mortgage obligations	450,231,082	449,013,979
Agency securities	4,016,278	4,004,809
Total	$1,675,534,300	$1,673,914,863

The following tables represent concentration limits on investments based on parameters established on *NCUA Regulation 704.5*.

	As of December 31, 2018		
	Fair Value	**Capital Based Limit**	**Asset Based Limit**
By Security Type:			
Auto loan/lease ABS	$449,130,877	$1,642,670,015	$744,046,525
Credit card ABS	407,723,207	1,642,670,015	744,046,525
Commercial MBS	278,480,154	985,602,009	446,427,915
FFELP student loan ABS	243,579,645	3,285,340,030	1,488,093,050
Mortgage-backed securities (not including commercial MBS)	170,533,825	3,285,340,030	1,488,093,050
Other ABS	100,472,247	1,642,670,015	744,046,525
Corporate debt obligations	19,990,100	3,285,340,030	1,488,093,050
All other investments	4,004,808	328,534,003	148,809,305

Note 2 - Investment Securities (Continued)

	As of December 31, 2018	
	Fair Value	Regulatory Limit
By Issuer:		
CCCIT	$123,216,144	$164,267,000
COMET	82,738,312	164,267,000
Chase Issuance Trust	71,943,139	164,267,000
AMXCA	66,471,369	164,267,000
FORDF	56,622,954	82,133,500
BACCT	44,373,943	164,267,000
COELT 2005-A	41,172,551	82,133,500
COELT 2004-4 A4	29,078,054	82,133,500
WSLT 2006-1 A6	27,190,734	82,133,500
VALET 2018-2	23,245,704	82,133,500
MBALT 2018-B A1	22,558,183	82,133,500
HART 2018-B	22,507,050	82,133,500
GEDFT 2015-2 A	22,045,760	82,133,500

The following tables show the gross unrealized losses and fair value of investments, aggregated by the length of time the individual securities have been in continuous unrealized loss position.

	As of December 31, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available-for-sale:						
Asset-backed securities	$699,015,739	($1,138,101)	$23,238,750	($76,108)	$722,254,489	($1,214,209)
Collateralized-mortgage obligations	115,828,580	(253,093)	161,344,008	(2,072,599)	277,172,588	(2,325,692)
Corporate notes	4,989,250	(10,750)	-	-	4.989,250	(10,750)
Agency securities	4,004,809	(11,469)	-	-	4,004,809	(11,469)
Total	$823,838,378	($1,413,413)	$184,582,758	($2,148,707)	$1,008,421,136	($3,562,120)

Note 2 - Investment Securities (Continued)

	As of December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available-for-sale:						
Asset-backed securities	$317,797,539	($739,926)	$98,801,699	($952,654)	$416,599,238	($1,692,580)
Collateralized-mortgage obligations	217,906,435	(2,003,027)	103,539,861	(1,366,861)	321,446,296	(3,369,888)
Total	$535,703,974	($2,742,953)	$202,341,560	($2,319,515)	$738,045,534	($5,062,468)

Unrealized losses on securities issued by the U.S. Government and its Agencies have not been recognized into income because the implicit guarantee of the principal balances of these securities by the U.S. Government and its Agencies. The decline in fair value is primarily due to differences between security yields and market interest rates. Additionally, the decline in fair value is expected to be recovered as securities approach their maturity date and/or market rates decline. Management has the ability and intent to hold these securities through to recovery of fair value, which may be maturity.

The Credit Union evaluates each asset-backed security, collateralized-mortgage obligations, and corporate notes for other-than-temporary impairment by considering the credit rating of each security as well as the tranche and underlying collateral in evaluating each security for other-than-temporary impairment. Management has the intent and ability to hold these securities to recovery of fair value, which may be maturity. There was no other-than-temporary impairment recognized on asset-backed securities, collateralized-mortgage obligations or corporate notes during the years ended December 31, 2018 and 2017.

Note 3 - Loans to Members

The composition of loans to members is as follows:

	2018	2017
Commercial:		
Term loans	$340,336,038	$449,827,490
Settlement loans	137,108,686	51,436,195
Total	$477,444,724	$501,263,685

The Credit Union reviews all lines of credit on an annual basis by reviewing the member credit unions' financial condition and key ratios. A watch list is created of member credit unions that represent a credit risk or a concentration risk to the Credit Union. The following criteria are used to determine whether a loan will be placed on the watch list:

Credit Quality Indicator:

- Capital ratio below 6%
- Negative earnings as of the prior year end and most recent quarter end as well as a capital ratio below 9%
- Negative earnings as of the prior year end and most recent quarter end as well as a delinquency ratio above 4% and a capital ratio below 10%

Concentration Risk Indicator:

- Line of credit in excess of 30% of the Credit Union's total members' equity
- Outstanding loan balance in excess of 10% of the Credit Union's total outstanding loan balance

Member credit unions placed on the watch list have lines of credit of approximately $1,644,039,000 and $1,703,234,000 and outstanding loan balances of approximately $212,327,000 and $320,937,000 as of December 31, 2018 and 2017, respectively. Primarily due to a strong collateral position, the Credit Union has never experienced a loss on a loan to a member credit union.

Note 4 - Property and Equipment

Property and equipment is carried at cost, less accumulated depreciation and amortization, and is summarized as of December 31, 2018 and 2017, by major classification as follows:

	2018	2017
Computer equipment	$2,223,575	$1,983,717
Software	4,403,689	3,716,238
Furniture and equipment	4,393,112	3,725,464
Leasehold improvements	1,837,939	1,754,499
Software development in process	-	31,800
	12,858,315	11,211,718
Less accumulated depreciation	(7,376,262)	(5,778,878)
Total	$5,482,053	$5,432,840

Depreciation and amortization charged to office operations and office occupancy expenses was approximately $1,625,000 and $1,409,000 for the years ended December 31, 2018 and 2017, respectively.

Note 5 - Members' Shares and Certificates

Members' shares and certificates are summarized as follows:

	2018	2017
Daily shares	$2,191,823,944	$2,401,770,51
Share certificates	412,348,200	457,789,300
NPC shares	309,626	3,724,637
Total	$2,604,481,770	$2,863,284,448

The aggregate balance of members' certificates in denominations that meet or exceed $250,000 was approximately $349,770,000 as of December 31, 2018.

Note 5 - Members' Shares and Certificates (Continued)

Scheduled maturities of certificates are as follows:

	2018
Within one year	$261,113,200
1 to 2 years	110,763,000
2 to 3 years	30,333,000
3 to 4 years	9,339,000
4 to 5 years	800,000
Total	$412,348,200

Note 6 - Borrowed Funds

The Credit Union is a member of the FHLBC and has access to a pre-approved secured line of credit with the capacity to borrow up to the fair value of all unencumbered assets, as defined in the FHLB Advance, Pledge and Security Agreement.

Outstanding borrowed funds from the FHLBC are summarized as follows:

Interest Type	Interest Rate	Final Maturity Date	Payment Description	2018	2017
Fixed	1.41 %	1/31/2018	Balloon	$-	$30,500,000

Note 7 - Employee Benefit Plans

<u>401(k) and Profit Sharing Plan</u>

The Credit Union sponsors a defined contribution plan (Plan) established under Section 401(k) of the Internal Revenue Code. This Plan allows employees to contribute up to the Internal Revenue Service maximum allowable percentage of their compensation. The Credit Union matches 100% of the first 4% contributed by employees. Matching contributions approximated $642,000 and $658,000 for the years ended December 31, 2018 and 2017, respectively. In addition, the Credit Union may elect to make a discretionary contribution to the Plan annually. This election requires approval by the Board of Directors. The Credit Union made discretionary contributions of approximately $308,000 and $298,000 for the years ended December 31, 2018 and 2017, respectively.

Note 7 - Employee Benefit Plans (Continued)

Split-Dollar Life Insurance

The Credit Union has entered into split-dollar insurance agreements which are collateral assignment arrangements between the Credit Union and key employees. These agreements involve methods of paying for insurance coverage for the executives by splitting the elements of life insurance policies. Under the agreements, the executives are the owner of the policies and make collateral assignments to the Credit Union in return for loans equal to the amount of premiums to be paid on behalf of the executives plus accrued interest at a specific rate. At the time of death, the Credit Union will be paid the loan amounts plus accrued interest and the balance of the insurance benefits will be paid to the executives' designated beneficiaries. As of December 31, 2018, the balance of the loans approximated $12,052,000, and is disclosed as split-dollar life insurance in the Credit Union's consolidated statements of financial condition.

Investment in Life Insurance Contracts

As of December 31, 2017, the Credit Union held life insurance policies purchased on the lives of key members of management. In the event of death of one of these individuals, the Credit Union, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies were recorded at their cash surrender value, or the amount that could be currently realized as of the statement of financial condition date. These contracts were sold in September 2018 at their cash surrender value and therefore no gain or loss was realized on the sale.

Note 8 - Lease Commitments

The Credit Union leases several branch locations. The minimum non-cancellable lease obligations approximate the following as of December 31, 2018:

Year ending December 31,	Amount
2019	$1,302,000
2020	1,335,000
2021	1,358,000
2022	1,083,000
2023	898,000
Thereafter	2,362,000
	$8,338,000

Rental expense under operating leases was approximately $1,458,000 and $1,355,000 for the years ended December 31, 2018 and 2017, respectively.

Note 9 - Off-Balance-Sheet Risk and Concentrations of Credit Risk

Off-Balance-Sheet Risk

The Credit Union is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its members and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated statements of financial condition. The Credit Union's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments.

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. Since many of the commitments may expire without being fully drawn upon and are extended as advised lines of credit, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2018, the members' unused lines of credit approximated $9,155,205,000. The Credit Union evaluates each member credit unions' creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the member.

Note 10 - Regulatory Capital

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's consolidated financial statements. Failure to meet a minimum capital requirement would require the Credit Union to submit a plan of action to correct the shortfall. Additionally, NCUA could require an increase in capital to specific levels, reduction of interest, and ceasing or limiting the Credit Union's ability to accept deposits.

Regulations for corporate credit unions that became effective in October 2011 required corporate credit unions to build minimum retained earnings by October 2013, 2016, and 2020 as well as established requirements to meet a leverage ratio (retained earnings and PCC adjusted for various items divided by the 12-month average of daily net assets), Tier 1 Risk-Based ratio (retained earnings and PCC adjusted for various items divided by the 12-month moving average of net risk-weighted assets), and a Total Risk-Based Capital ratio (retained earnings and PCC adjusted for various items and unamortized non-perpetual capital divided by the 12-month moving average of net risk-weighted assets).

Note 10 - Regulatory Capital (Continued)

Effective December 22, 2017, several changes were made to the capital regulations pertaining to corporate credit unions. The revised regulations provide incentives to build retained earnings to at least 250 basis points by providing the following incentive if this is achieved:

- All PCC will be included in Tier 1 capital. If not, PCC in excess of retained earnings minus 200 basis points of daily average net assets, will be excluded from Tier 1 capital.
- Expanded authorities for corporate credit unions to engage in the following activities:
    - Engage in short sales
    - Purchase principal only stripped MBS securities
    - Enter into dollar roll transactions
    - Invest in certain foreign investments
    - Derivative transactions
    - Loan participations with natural person credit unions

The Credit Union's retained earnings and other equity ratio is 3.01% as of December 31, 2018, therefore, by regulation Alloya exceeds the regulatory minimum of 2.50% allowing it to include all PCC as regulatory Tier 1 capital.

The Credit Union's capital amounts used in the calculations for regulatory capital as of December 31, 2018, are as follows:

	2018
Retained earnings	$71,337,762
Retained earnings from merged credit unions	24,568,634
Total regulatory retained earnings	95,906,396
Perpetual contributed capital	237,937,317
Investments in unconsolidated CUSOs	(5,619,335)
Tier 1 capital before PCC exclusion	328,224,378
PCC exclusion – effective December 2017	-
Tier 1 capital	$328,224,378
Tier 1 capital before PCC exclusion	$328,224,378
Non-perpetual capital	309,626
Total capital	$328,534,004
Daily average net assets	$3,190,980,069
Monthly moving average net risk-weighted assets	$1,054,194,324

Note 10 - Regulatory Capital (Continued)

The Credit Union's capital amounts used in the calculations for regulatory capital as of December 31, 2017, are as follows:

	2017
Retained earnings	$56,921,875
Retained earnings from merged credit unions	24,568,634
Total regulatory retained earnings	81,490,509
Perpetual contributed capital	226,451,102
Investments in unconsolidated CUSOs	(5,711,974)
Tier 1 capital before PCC exclusion	302,229,637
PCC exclusion – effective October 2016	(78,601,488)
Tier 1 capital	$223,628,149
Tier 1 capital before PCC exclusion	$302,229,637
Non-perpetual capital	3,724,637
Total capital	$305,954,274
Daily average net assets (taking into account PCC deduction)	$3,239,353,879
Monthly moving average net risk-weighted assets	$1,155,779,402

Capital ratio	2018	2017	Minimum level to be classified as adequately capitalized	Minimum level to be classified as well capitalized
Leverage ratio (1)	10.29%	6.90%	4.00%	5.00%
Tier 1 risk based capital ratio (2)	31.14%	19.35%	4.00%	6.00%
Total risk based capital ratio (3)	31.16%	26.47%	8.00%	10.00%
Retained earnings ratio (4)	3.01%	2.46%	N/A	N/A

Calculations (Capital/Denominator):
(1) = T1C/DANA
(2) = T1C/MMANRA
(3) = TC/MMANRA
(4) = Retained earnings/DANA

T1C = Tier 1 capital DANA = Daily average net assets
TC = Total capital MMANRA = Moving monthly average net risk-weighted assets

As of December 31, 2018 and 2017, the Credit Union met all capital requirements under Section 704.3 of the NCUA Regulations.

Note 11 - Derivatives

Interest Rate Swaps

At December 31, 2018, and 2017 two interest rate swaps were outstanding as follows:

- February 2016, interest rate swap, ten year pay fixed, receive floating (1 Month LIBOR) with a $5,000,000 notional amount
- September 2015, interest rate swap, ten year pay fixed, receive floating (1 Month LIBOR) with a $10,000,000 notional amount

In 2018 the following additional interest rate swap was outstanding:

- January 2018, interest rate swap, ten year pay fixed, receive floating (1 Month LIBOR) with a $20,000,000 notional amount

The Credit Union's strategy is to hedge the interest rate risk associated with three fixed-rate loans. This strategy effectively swaps the fixed-rate interest income with variable-rate interest income thereby reducing the Credit Union's exposure to interest rate fluctuations. The Credit Union has elected to use Fair Value accounting for these interest rate derivatives. The following tables present the interest rate swaps that are reflected in the Credit Union's consolidated statements of financial condition:

As of December 31, 2018

Swap counterparty (Notional Amount)	Pay Fixed Rate	Consolidated Balance Sheet Classification	Fair Value
JP Morgan Chase ($5,000,000)	1.42%	Prepaid and other assets	$355,101
JP Morgan Chase ($10,000,000)	2.08%	Prepaid and other assets	258,562
JP Morgan Chase ($20,000,000)	2.63%	Prepaid and other assets	(88,461)
			$525,202

As of December 31, 2017

Swap counterparty (Notional Amount)	Pay Fixed Rate	Consolidated Balance Sheet Classification	Fair Value
JP Morgan Chase ($5,000,000)	1.42%	Prepaid and other assets	$311,094
JP Morgan Chase ($10,000,000)	2.08%	Prepaid and other assets	116,689
			$427,783

Note 11 - Derivatives (Continued)

Fair Value Option

The Credit Union has elected to carry at fair value certain loans that are being hedged with interest rate swap derivatives. The Credit Union has elected fair value treatment for these loans in order to align the accounting for these loans with the accounting for the derivatives without having to account for the transactions under hedge accounting.

The following tables present the amount of losses from changes in fair value for loans measured at fair value pursuant to the fair value option election:

	For the year ended December 31, 2018	
Asset	**Loss**	**Consolidated Income Statement Classification**
Fixed-rate loans	($193,071)	Loss on financial instruments

	For the year ended December 31, 2017	
Asset	**Loss**	**Consolidated Income Statement Classification**
Fixed-rate loans	($25,203)	Loss on financial instruments

The following tables present gains/(losses) recorded in the consolidated statements of income for the interest rate swaps:

	For the year ended December 31, 2018	
Derivative Type	**Gain/(Losses) on Derivatives**	**Consolidated Income Statement Classification**
Interest rate swap	$97,420	Gain on hedging instruments
Loan – fair value	(193,071)	Loss on market value of loans
	($95,651)	Loss on financial instruments

	For the year ended December 31, 2017	
Derivative Type	**Gain/(Losses) on Derivatives**	**Consolidated Income Statement Classification**
Interest rate swap	$57,379	Gain on hedging instruments
Loan – fair value	(25,203)	Loss on market value of loans
	$32,176	Gain on financial instruments

Note 11 - Derivatives (Continued)

The following tables present the book value and fair value for loans measured at fair value pursuant to the fair value election option:

	As of December 31, 2018	
Asset	**Book Value**	**Fair Value**
Fixed-rate loans	$35,000,000	$34,334,244

	As of December 31, 2017	
Asset	**Book Value**	**Fair Value**
Fixed-rate loans	$15,000,000	$14,527,314

Interest Rate Floors

At December 31, 2018, four interest rate floors were outstanding as follows:

- April 2018, interest rate floor, four year, 1 month LIBOR, strike rate 1.50%, with a $100,000,000 notional amount
- April 2018, interest rate floor, four year, 1 month LIBOR, strike rate 1.50%, with a $100,000,000 notional amount
- April 2018, interest rate floor, four year, 1 month LIBOR, strike rate 1.50%, with a $100,000,000 notional amount
- April 2018, interest rate floor, four year, 1 month LIBOR, strike rate 1.50%, with a $100,000,000 notional amount

The Credit Union's strategy for the interest rate floor transactions is to offset the variable rate interest income on LIBOR indexed assets. The strategy places a floor under variable rate interest income, thereby reducing the Credit Union's exposure to interest rate fluctuations. The Credit Union has elected to use hedge accounting for the interest rate floor derivatives. The following tables present the interest rate floors that are reflected in the Credit Union's consolidated statements of financial condition:

As of December 31, 2018

Swap counterparty (Notional Amount)	Strike Rate	Consolidated Balance Sheet Classification	Fair Value
PNC Bank ($100,000,000)	1.50%	Prepaid and other assets	$385,598
JP Morgan Chase ($100,000,000)	1.50%	Prepaid and other assets	385,553
JP Morgan Chase ($100,000,000)	1.50%	Prepaid and other assets	385,553
PNC Bank ($100,000,000)	1.50%	Prepaid and other assets	402,362
			$1,559,066

Note 11 - Derivatives (Continued)

During the next 12 months, net gains(losses) in AOCI of approximately $211,000 on derivative instruments that qualify as cash flow hedges are expected to be reclassified into earnings. For open cash flow hedges, the maximum length of time over which forecasted transactions are hedged is approximately 4 years. The gains recorded in Other Comprehensive income for the interest rate floors were approximately $572,000.

Derivative Collateral

The Credit Union has interest rate hedges (swaps) with JP Morgan Chase and PNC Bank. These hedges required the initial and ongoing position of margin collateral. At December 31, 2018, the Credit Union had cash collateral requirements with JP Morgan Chase and PNC Bank for approximately $1,870,000.

Note 12 - Reverse Repurchase Agreements

During the year ended December 31, 2017, the Credit Union established two reverse repurchase agreements with JP Morgan Securities, LLC (JPMS). The reverse repurchase agreements were collateralized by securities held by JPMS. As of December 31, 2017, the two reverse repurchase agreements were each $50,000,000 and set to mature on January 5, 2018 and February 16, 2018, respectively. The fair value of the collateralized securities was approximately $105,000,000 as of December 31, 2017. There were no repurchase agreements outstanding as of December 31, 2018.

Note 13 - Fair Value Measurements

The Fair Value Measurements and Disclosures Topic of the FASB ASC provides a framework for measuring fair value that requires an entity to derive fair value from the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date within its principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability. To increase consistency and comparability in fair value measurements and related disclosures, a three-level hierarchy prioritizes the inputs to valuation techniques used to measure fair value with the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1), inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly (Level 2), and the lowest priority to unobservable inputs (Level 3).

Note 13 - Fair Value Measurements (Continued)

Level 1

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are inactive; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3

Level 3 inputs are unobservable inputs for the asset or liability which reflect the Credit Union's own assumptions about the assumptions that market participants would use in pricing the asset or liability. Assumptions about risk include risk inherent in a particular valuation technique used to measure fair value, typically pricing models and/or discounted cash flow methodologies.

The methodologies and associated inputs used may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While the Credit Union believes its valuation methods and associated inputs are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 13 - Fair Value Measurements (Continued)

Recurring Basis

Available-for-sale Securities
The following is a description of the valuation methodologies used for these securities:

Asset-backed securities - These securities are classified as Level 2 in the fair value hierarchy. Asset-backed securities are valued based on quoted market prices on similar assets in the marketplace and the vintage of the underlying collateral.

Collateralized-mortgage obligations - These securities are classified as Level 2 in the fair value hierarchy. Collateralized-mortgage obligations are valued based on quoted market prices on similar assets in the marketplace and the vintage of the underlying collateral.

Federal Agency Securities and Corporate Notes - These securities are classified as Level 2 in the fair value hierarchy. Federal agency securities and corporate notes are valued based on quoted market prices on similar assets in the marketplace and the vintage of the underlying collateral.

Interest Rate Swaps and Fixed-Rate Loans (Fair Value Option) - Receive-fixed, pay variable interest rate swaps are based on LIBOR swap rate.

Interest Rate Floors - These contracts are classified as Level 2 in the fair value hierarchy and are valued based on movements in LIBOR indexed assets.

The following tables set forth by level, within the fair value hierarchy, the Credit Union's financial instruments at fair value on a recurring basis.

	Assets at Fair Value as of December 31, 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Available-for-sale:				
Asset-backed securities	$-	$1,200,905,975	$-	$1,200,905,975
Collateralized mortgage obligations	-	449,013,979	-	449,013,979
Corporate notes	-	19,990,100	-	19,990,100
Agency securities	-	4,004,809	-	4,004,809
Fixed-rate loans	-	34,334,244	-	34,334,244
Interest rate swap	-	525,202	-	525,202
Interest rate floor	-	1,559,066	-	1,559,066
	$-	$1,710,333,375	$-	$1,710,333,375

Note 13 - Fair Value Measurements (Continued)

	Assets at Fair Value as of December 31, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Available-for-sale:				
Asset-backed securities	$-	$796,898,043	$30,631,690	$827,529,733
Collateralized mortgage obligations	-	540,121,184	16,961,113	557,082,297
Corporate notes	-	20,048,650	-	20,048,650
Fixed-rate loans	-	14,527,314	-	14,527,314
Interest rate swap	-	427,783	-	427,783
	$-	$1,372,022,974	$47,592,803	$1,419,615,777

The following table represents a reconciliation for all recurring Level 3 assets and liabilities:

	For the years ended December 31,	
	2018	**2017**
Balance, beginning of year	$47,592,803	$57,369,759
Proceeds from sales	(42,427,344)	(3,055,175)
Proceeds from repayments	(3,367,725)	(10,300,000)
Change in unrealized gains/(losses)	(1,797,734)	3,578,219
Balance, end of year	$-	$47,592,803

* * * End of Notes * * *

DoerenMayhew
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Independent Auditor's Report

March 11, 2019

To the Board of Directors and the Supervisory Committee of
Alloya Corporate Federal Credit Union

We have audited Alloya Corporate Federal Credit Union's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Management's Responsibility for Internal Control over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Annual Report 2018.

Auditor's Responsibility

Our responsibility is to express an opinion on the institution's internal control over financial reporting based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting involves performing procedures to obtain audit evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risks that a material weakness exists. An audit includes obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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

DoerenMayhew

To the Board of Directors and Supervisory Committee of
Alloya Corporate Federal Credit Union

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 704.15 of the NCUA Regulations, our audit of Alloya Corporate Federal Credit Union's internal control over financial reporting included controls over the preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and with the NCUA 5310 Call Report instructions. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion

In our opinion, Alloya Corporate Federal Credit Union maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Report on Financial Statements

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated statement of financial condition and the related consolidated statements of income, comprehensive income, members' equity, and cash flows of Alloya Corporate Federal Credit Union and our report dated March 11, 2019, expressed an unmodified opinion.

Doeren Mayhew

Doeren Mayhew
Miami, FL

alloya®
Corporate Federal Credit Union

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Alloya Corporate Federal Credit Union
Management Report on Annual Report
2018

We, the undersigned, certify that:

1. We have reviewed the annual report (2018 audited financial statements) of Alloya Corporate Federal Credit Union (Alloya);

2. Based on our knowledge, the financial statements fairly present in all material respects the financial condition, results of operations and cash flows of Alloya as of, and for, the periods presented in the report;

3. We, the certifying officers, are responsible for preparing Alloya's annual financial statements, including reports filed in accordance with regulatory reporting (based on the 5310 Corporate Credit Union Call Report Instructions), for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with the laws and regulations relating to safety and soundness in the following areas: affiliate transactions, legal lending limits, loans to insiders, restrictions on capital and share dividends, and regulatory reporting that meets full and fair disclosure and have:

    a. Designed such internal controls over financial reporting, or caused such internal controls to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and regulatory purposes in accordance with the 5310 Corporate Credit Union Call Report Instructions, utilizing the COSO internal control framework;

    b. Evaluated the effectiveness of such internal controls and procedures; and

    c. Concluded that there were no material changes or weaknesses in financial reporting, including reports filed in accordance with regulatory reporting (based on the 5310 Corporate Credit Union Call Report Instructions), and internal controls that materially affected, or are reasonably likely to materially affect, the internal controls over financial reporting in 2018, and, based on our knowledge, that Alloya is in compliance with the above designated safety and soundness laws and regulations during 2018.

Date: March 11, 2019

Todd M Adams　　　　Tracy J. Lafferty

Todd M. Adams, CEO　　　　Tracy Lafferty, CFO