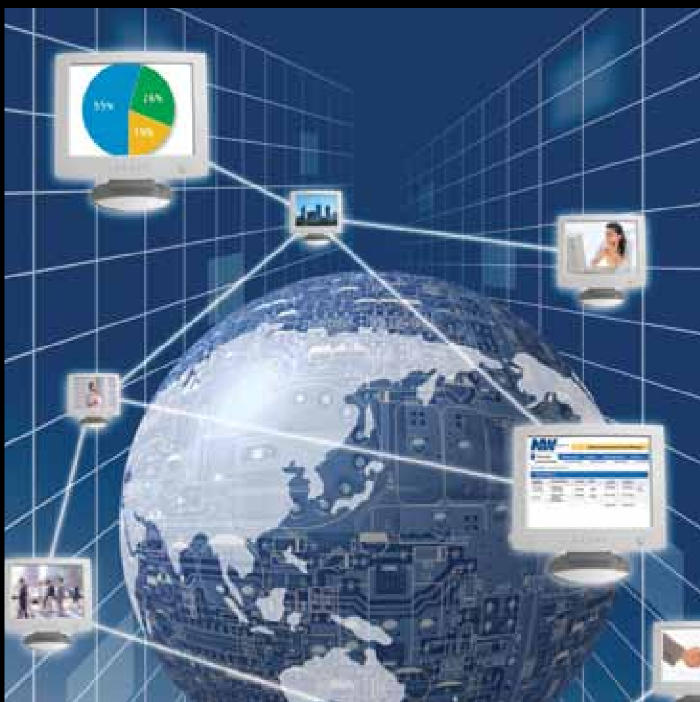
INVESTING IN YOUR FUTURE

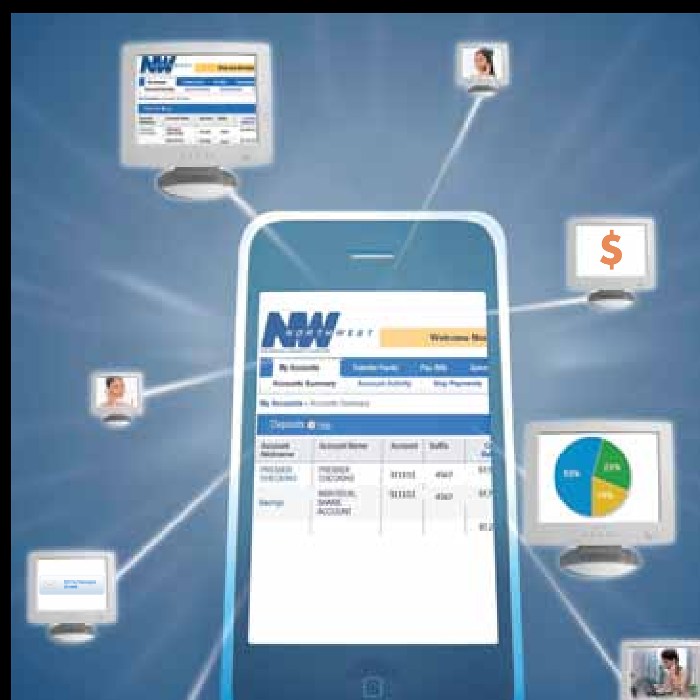
NORTHWEST FEDERAL CREDIT UNION 2011 ANNUAL REPORT



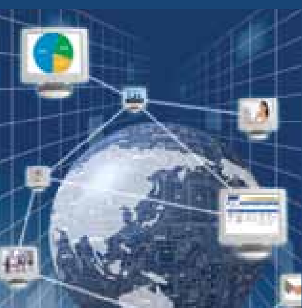
TECHNOLOGY

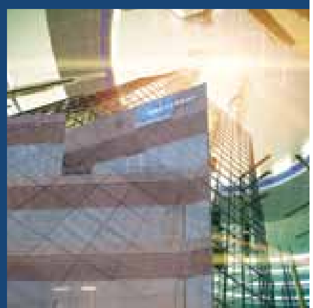
EXPANSION

COMMUNITY



CONVENIENCE



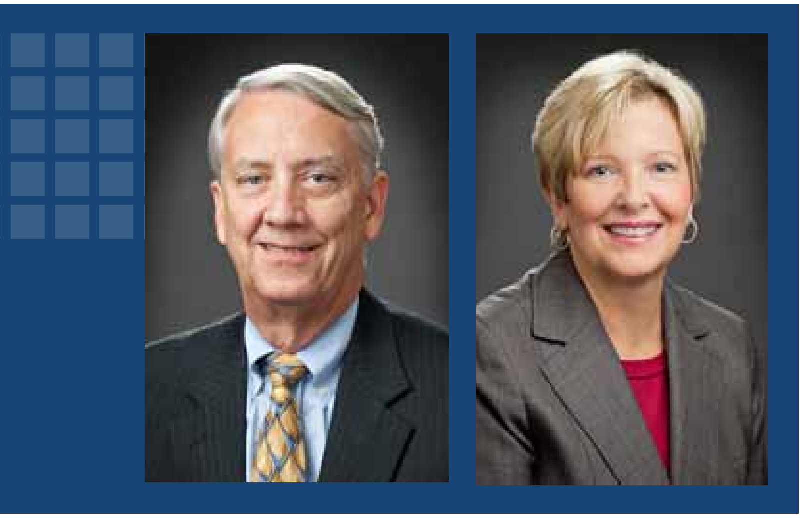


INVESTING
IN YOUR
FUTURE

Contents

Chairman & President Report	2
Board of Directors & Executive Staff	4
Treasurer & Financial Management Committee Report	5
Supervisory Committee Report	6
Independent Auditor's Report	7
Consolidated Statements of Financial Condition	8
Consolidated Statements of Income	9
Consolidated Statements of Comprehensive Income	9
Consolidated Statements of Members' Equity	10
Consolidated Statements of Cash Flows	11
Notes to Consolidated Financial Statements	12

NORTHWEST
FEDERAL CREDIT UNION



Thomas Conroy
Gerrianne Burks

Investing in Your Future

It is again a pleasure to report to you that this past year was very successful for your Credit Union. Even though significant challenges have remained in the domestic economy as we slowly recover from the dramatic recession of the past several years, Northwest Federal has continued to thrive. During 2011, we grew by more than $57 million, increased convenience for members, introduced new products and services and initiated several projects targeted toward the delivery of significantly enhanced technologies. These undertakings were launched while maintaining a focus on efficiency, earnings and capital formation, and our commitment to safety and soundness. We are gratified to report to you that your Credit Union was strengthened significantly in 2011 as net income for the year exceeded $20 million for the first time in Northwest Federal's history. As a result of the year's superior earnings, our capital position was further enhanced with the institution's net worth ratio increasing to 9.55%. This is well above the 7% threshold required by our regulator to be considered well capitalized and is an indication that your Credit Union remains safe, sound and sustainable for years to come.

Investing in Our Members

In the past four years, Northwest Federal formulated a vision of becoming the premier financial institution in the country. We have refined this vision over the past two years and are developing a culture throughout the organization that is driven to provide a consistent experience for our members that is second to none: simply put, to provide an extraordinary experience to each member every day. We recognize that this is a monumental undertaking and an ongoing process rather than a single event. But we have embarked on this goal and believe we have made significant strides toward the realization of this vision as evidenced in the feedback received from you, our members. The Board, management and staff of NWFCU know we work for a very special membership and that you deserve the level of extraordinary service and experience we are building. We understand you have choices for financial services and we want your first choice to continue to be Northwest Federal.

A number of investments made for our members were evident in 2011, as we opened a new office in Leesburg, Virginia, in May and commenced construction of another new branch location in Gainesville, Virginia, which will open in the spring of 2012. Not only will these offices provide additional convenience to existing members in these areas, but it will also introduce Northwest Federal's style of banking to new communities. We believe the addition of the Leesburg and Gainesville communities offer us excellent opportunities for the Credit Union's future growth. In response to frequent requests for enhancements to our online banking system, Northwest Federal has made a sizeable investment in new software, which will become operational in the spring of 2012. This new online banking provides a number of service enhancements. Another long-term investment that is providing valuable services to many members is Northwest Financial LLC, our wholly owned subsidiary. NWFLLC offers members brokerage and investment services, real estate title and escrow services, a wide array of insurance products and income tax preparation and advisory services. Northwest Financial had another very successful year in 2011, posting a record $1.5 million in net income.

Over the past several years, we have observed significant growth in the demand for business banking products and we expect the need for these services to expand exponentially over the coming years. Therefore, we have invested in resources to enhance the menu of products and services that we offer for small businesses. This investment is positioning us to become a valuable and trusted resource for member business owners. In 2012, we will continue to develop our business service offerings with our launch of an online business banking platform.

Investing in Sustainability

Northwest Federal has a long-standing legacy of stability, safety and soundness. One of the primary financial strengths of NWFCU is its capital base, which at the close of 2011 surpassed $200 million for the first time in the organization's history. Maintaining and growing our capital base is essential as it is the primary mechanism by which the rate of our overall growth is dictated. And, in turn, our capital is strengthened as the Credit Union generates and retains earnings.

The past four years have been some of the most tumultuous and challenging in generations for financial institutions, and many challenges remain. However, as noted above, we are pleased to report to you that your Credit Union recorded another profitable year in 2011. In fact, in a year when nearly one third of all credit unions remained unprofitable, the strong earnings performance achieved by NWFCU underscores our focus on continuing to strengthen the institution and ensure its growth and sustainability far into the future.

As pleased as we are with the financial performance of the organization, we know full well that superior earnings performance is not our primary goal but is a means to an end. Our goal is to invest in strengthening an already strong organization and to continue its growth so we may provide more members with greater convenience and positively impact their lives.

Investing in Our Communities

We continue to have a visible and meaningful presence in our communities by sponsoring events and furthering our financial education efforts. To address the financial education needs of the individuals within our communities, we continued our tradition of offering a full line of free seminars. We conducted over 33 seminars in 2011, with topics including information on How to Prepare, Pay & Stay in College, Managing Your Debt, Staging Your Home to Sell and many more. Working hand in hand with Northwest Federal Credit Union Foundation, our staff invested more than 1,200 hours of volunteer time in our local schools and local charitable organizations during 2011. We also reinforced our commitment to our flagship charity, Children's Miracle Network, through our participation in the Credit Union Cherry Blossom Ten Mile Run in April. Through our fundraising events and member donations, we raised $25,000 for Children's Miracle Network.

Outlook for the Future

The past four years of economic uncertainty and turbulence have demonstrated a number of very relevant facts that inform and guide our strategic planning for the future. The world has changed dramatically over the past several years and will continue to change at an unprecedented pace. To maintain our solid foundation, financial strength and relevance to our members, we must plan proactively to address their needs and continue to develop our competitive advantages in the markets we serve. We are diligently pursuing this mission. It is equally evident that the regulatory burden on all financial institutions will continue to mount. We have seen new regulations and the associated costs of compliance grow dramatically. This will necessitate our continued growth so we may distribute the economic impact of such compliance over a larger base of business and thereby remain efficient and cost effective in our operations. To accomplish this, we believe we must continue to develop new markets as well as deepen our relationships with existing members.

While still viewed as challenging, our macro-economic outlook for the future is notably more favorable than has been the case for the past several years. Despite lingering uncertainties for the general economy, our outlook for Northwest Federal is overwhelmingly positive and we remain decidedly optimistic. We believe that Northwest Federal is well positioned to prosper over the coming years. As we continue to enhance and improve our members' experiences by providing consistent value, we view the future as exceptionally bright for your Credit Union.

In many respects, 2011 was a watershed year for your Credit Union. During the year, several significant issues were deliberated and addressed by your Board of Directors, which resulted in significant strategic decisions. Consequently, plans for a number of initiatives have been developed, many of which will come to fruition in 2012 and beyond. Upon completion, we expect these initiatives to be transformational in many respects for Northwest Federal over the coming years, but particularly in our ability to efficiently and effectively serve our members' needs.

On a personal note, as President and CEO, I want to make you aware of another change that will occur in the organization's leadership over the coming year. As has been my plan for some time, I have decided to retire at the end of 2012. After more than 40 years serving NWFCU, it is with both tremendous gratitude and a touch of sadness that I will end my day-to-day involvement in this great organization. While my day-to-day involvement in NWFCU will be ending, rest assured I cannot leave Northwest Federal completely as it will forever be in my heart. It has been an honor and a privilege to serve you over these years and I wish to thank the Board of Directors for their continual support as well as the entire Northwest Federal team whom I consider not only friends and colleagues but family. I am confident that I will be leaving a strong and vibrant institution with a clear vision for the future and the means and dedication to achieve that vision.

Thomas Conroy

Thomas Conroy
Chairman, Board of Directors

Gerrianne D. Burks

Gerrianne D. Burks
President/Chief Executive Officer

Seated:
Thomas Conroy
Chairman

Standing, left to right:

Dawn Eilenberger
Secretary

Joel Ticknor
Director

David Eldred
Vice Chairman

Mary Corrado
Director

Leo Cardillo
Director

Cynthia Strand
Director

Chuck Molina
Treasurer

Jeannette Moore
Director

Seated:
Gerrianne Burks
President/Chief Executive Officer

Standing, left to right:

Greg Gibson
Senior Vice President/ Chief Operating Officer/ Chief Financial Officer

Colleen Daly
Senior Vice President, Lending

Chris Meese
Senior Vice President/ Chief Information Officer

Bill Cook
Senior Vice President, Planning & Support Services

Phyllis Ziakas
Senior Vice President, Human Resources & Organizational Development

Chuck Molina

Economic turmoil in the U.S. and around the world continued to dominate the headlines throughout 2011. While the U.S. economy seemed to move toward a slow and relatively weak recovery, the Washington, D.C., metro area fared considerably better than virtually any other region in the country. We are pleased to again report that during 2011, the performance of your Credit Union continued to excel. Many of the actions your Board and management have taken over the past several years have begun to be reflected fully in the financial performance of the institution. We remain pleased in the overall positioning Northwest Federal has accomplished during these years of monumental economic challenge. We believe the strength of our financial performance places us in a favorable posture as we prepare to enter a very exciting and progressive period of time for our organization.

During 2011, the credit union movement as a whole remained saddled with costs associated with the collapse of the corporate credit union system in 2009 and 2010. Our regulator continued to pass along these costs to all credit unions via assessments, which during 2011 amounted to over $2 billion. Northwest Federal was assessed over $4 million during the year as its pro-rata portion of these expenses; however, even with this substantial assessment expense, NWFCU recorded net income of more than $20.1 million, which is by far the best earnings performance in the institution's 64-year history.

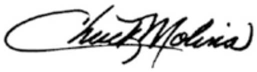
The substantial improvement in NWFCU's earnings resulted in large part from the ongoing restructuring of the Credit Union's balance sheet, which also produced the additional benefit of reducing exposure to rising interest rates. As a result of the strong earnings performance accomplished during the year, Northwest Federal's capital base was further strengthened. At December 31, 2011, Northwest Federal had increased its net worth ratio to 9.55% as compared to 9.01% on December 31, 2010. This is nearly 40% above the regulatory threshold of 7.0% required to be considered a well-capitalized institution and is evidence of the importance and commitment that your Board and management place on NWFCU continuing its long running history as a safe, sound and relevant institution.

From December 31, 2010, to year end 2011, Northwest Federal's balance sheet grew $57.8 million, or nearly 3%. However, continued retrenchment of consumers who have been reducing debt for the past two to three years has resulted in an environment in which it has been challenging in which to generate loan volume. As a result, the outstanding balance of Northwest Federal's loan portfolio fell approximately $77 million, or 6%, during 2011 and has been reduced by over $140 million, or nearly 10.5%, in the past two years. A number of new opportunities for originating loans were explored and undertaken during 2011.

We believe these actions, along with other new endeavors and a slowly recovering domestic economy, will provide favorable conditions to allow for renewed expansion of our loan portfolio in the coming months. Additionally, during 2011, Northwest Federal's total deposits increased by 2%. Most notably, core transaction accounts (shares, share drafts and money market accounts) increased by more than $115 million and at December 31, 2011, comprised nearly 69% of total deposits. Our focus on growing these transaction accounts was a key factor in this increase and also in further enhancing lasting relationships with our members.

Over the past three years of the financial crisis, Northwest Federal's asset quality and credit loss experience has been very favorable, often two to three times less than peer institutions. However, with the residual impact of the "Great Recession" expected to last for many more years, the institution's credit "safety net," its allowance for loan losses, has been increased to ensure adequate coverage. In the past two years, the credit allowance has been increased by 62%, from 0.77% of outstanding loans to 1.25% of loans at December 31, 2011. Again, we consider the increasing of this ratio both a prudent measure and an additional strength of the institution's balance sheet. With that stated, we remained pleased with Northwest Federal's asset quality metrics during the year. At December 31, 2011, delinquent loans represented less than 1% of total loans and credit losses for the year amounted to 0.59% of total loans.

We are pleased to present this report to you, our member/owners, and consider it indicative of the Board and management's dedication to the building of your institution into an increasingly positive influence on our members' financial lives. Thank you for your continued patronage and for choosing to be a vital part of Northwest Federal Credit Union.



Chuck Molina
Treasurer, Board of Directors
Chairman, Financial Management Committee

David McCue

The Supervisory Committee is a volunteer organization appointed by the Board and is responsible for engaging the annual audit, overseeing compliance with audit and regulatory exam findings, validating and testing internal controls and procedures, member account verification, and other activities to prevent and detect fraud. The Committee meets regularly to review and discuss internal controls as well as auditing matters. The Supervisory Committee executes its responsibilities through the following key mechanisms:

- **Internal Audit** – The Committee regularly meets with the Internal Audit executive to review ongoing and completed audits, progress against the annual audit plan, management's responsiveness in addressing internal audit recommendations, and the adequacy of the resources, executive support and training the Internal Audit function needs to execute its mission.

- **External Audits** – The Supervisory Committee engaged an independent audit firm, Orth, Chakler, Murnane and Company, CPAs, to conduct an annual audit of the Credit Union's financial statements. In addition, the National Credit Union Administration (NCUA) conducts regular examinations of Credit Union activities. The most recent external audit activities and NCUA's last examination completed during December 2011 confirm the outstanding financial health of the Credit Union and the strong internal control environment that is in place.

- **Special Focus Areas** – The Supervisory Committee continuously meets with the Board and management to identify emerging initiatives, issues and challenges that could impact the Credit Union's internal control environment and warrant ongoing Supervisory Committee attention and monitoring.

- **Continuous Learning** – In order to maintain and improve the effectiveness of the Supervisory Committee, Committee members regularly participate in Credit Union-related training opportunities. In addition, the Supervisory Committee receives regular briefings from management to better learn about and understand the various operations and activities within the Credit Union.

The Supervisory Committee would like to thank the membership for its outstanding support of the Credit Union. Likewise, we commend the Credit Union's volunteer Board of Directors for their diligence and guidance in the oversight of the Credit Union as well as their support of the Supervisory Committee and its activities. I would like to personally thank Maureen Wingfield, our prior Supervisory Committee Chair, for her leadership and guidance of our Supervisory Committee activities during the past two years.

The Supervisory Committee is working for the best interest of all Credit Union members. If you have a question relating to the financial soundness or management of this organization, please do not hesitate to contact us.

Dave McCue
Chairman, Supervisory Committee

Orth, Chakler, Murnane and Company, CPAs
A Professional Association

12060 S.W. 129th Court, Suite 201, Miami, Florida 33186-4582
Telephone 305-232-8272 Fax 305-232-8388
Website: www.ocmcpa.com

Douglas J. Orth, CPA, CFE, Managing Partner
Hugh S. Chackler, CPA, CISA, CITP, CFE
John J. Murnane, CPA
James A. Griner, CPA
Lori J. Carmichael, CPA
Daniel C. Moulton, CPA

March 30, 2012

To the Supervisory Committee of
Northwest Federal Credit Union

We have audited the accompanying consolidated statements of financial condition of Northwest Federal Credit Union, as of December 31, 2011 and 2010, and the related consolidated statements of income, comprehensive income, members' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northwest Federal Credit Union as of December 31, 2011 and 2010, and the results of its consolidated operations and its consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Orth, Chakler, Murnane and Co.

Orth, Chakler, Murnane and Company
Certified Public Accountants

Consolidated Statements of Financial Condition

(dollars in thousands)

	As of December 31,	
	2011	2010
ASSETS		
Cash and cash equivalents	$50,098	$96,999
Investments:		
Available-for-sale	747,165	597,804
Other	3,518	6,466
Loans held for sale	27,871	1,482
Loans to members, net of allowance for loan losses	1,190,932	1,268,692
Accrued interest receivable	7,731	6,863
Prepaid and other assets	18,970	16,025
Property and equipment	42,431	37,585
NCUSIF deposit	16,022	15,055
Total assets	$2,104,738	$2,046,971
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES:		
Members' share and savings accounts	$1,874,485	$1,837,012
Accrued expenses and other liabilities	27,067	22,281
Interest payable	2,286	3,198
Total liabilities	1,903,838	1,862,491
Commitments and contingent liabilities	—	—
MEMBERS' EQUITY:		
Regular reserve	18,008	18,008
Undivided earnings	185,502	165,371
Accumulated other comprehensive (loss)/income	(2,610)	1,101
Total members' equity	200,900	184,480
Total liabilities and members' equity	$2,104,738	$2,046,971

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

Consolidated Statements of Income & Comprehensive Income

(dollars in thousands)

For the years ended December 31,

CONSOLIDATED STATEMENTS OF INCOME	2011	2010
INTEREST INCOME:		
Loans to members	$67,089	$73,198
Investments	13,923	10,893
Total interest income	81,012	84,091
INTEREST EXPENSE:		
Members' accounts and savings accounts	18,784	26,289
Patronage dividend	—	4,446
Interest on borrowed funds	6	163
Total interest expense	18,790	30,898
Net interest income	62,222	53,193
PROVISION FOR LOAN LOSSES	8,143	12,866
Net interest income after provision for loan losses	54,079	40,327
NON-INTEREST INCOME:		
Fees and service charges	19,133	18,370
Gain on sale of mortgage loans, net	2,442	4,875
Other non-operating income	1,627	2,307
Gain on sale of investments	1,965	942
Total non-interest income	25,167	26,494
	79,246	66,821
NON-INTEREST EXPENSE:		
Compensation and employee benefits	28,756	30,920
Other expenses	14,807	11,689
Operating and occupancy expenses	11,547	10,091
NCUA insurance premium assessments	4,005	3,935
Total non-interest expense	59,115	56,635
Net income	$20,131	$10,186
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME		
NET INCOME	$20,131	$10,186
OTHER COMPREHENSIVE INCOME/(LOSS):		
Unrealized holding (losses)/gains on available-for-sale investments arising during the period	(1,746)	943
Reclassification adjustments for gains included in net income	(1,965)	(942)
Other comprehensive (loss)/income	(3,711)	1
Comprehensive income	$16,420	$10,187

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

Consolidated Statements of Members' Equity

(dollars in thousands)

For the years ended December 31, 2011 and 2010

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
Balance, December 31, 2009	$18,008	$155,185	$1,100	$174,293
Net income	—	10,186	—	10,186
Other comprehensive income	—	—	1	1
Balance, December 31, 2010	18,008	165,371	1,101	184,480
Net income	—	20,131	—	20,131
Other comprehensive loss	—	—	(3,711)	(3,711)
Balance, December 31, 2011	$18,008	$185,502	($2,610)	$200,900

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

Consolidated Statements of Cash Flows

(dollars in thousands)

For the years ended December 31,

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$20,131	$10,186
Adjustments:		
Provision for loan losses	8,143	12,866
Depreciation and amortization	3,868	3,211
Amortization of premiums and discounts	6,762	1,570
Amortization of servicing rights	1,891	1,696
Capitalization of servicing rights	(1,868)	(2,176)
Gain on sale of investments	(1,965)	(942)
Changes in operating assets and liabilities:		
Loans held for sale	(26,389)	(934)
Accrued interest receivable	(868)	(515)
Prepaid and other assets	(2,968)	(1,070)
Interest payable	(912)	(1,266)
Accrued expenses and other liabilities	4,786	1,950
Net cash provided by operating activities	10,611	24,576
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities, sales and repayment of available-for-sale investments	331,882	412,883
Purchase of available-for-sale investments	(489,751)	(642,539)
Change in other investments	2,948	18,621
Net change in loans, net of charge-offs	68,954	54,096
Recoveries on loans charged off	663	482
Expenditures for property and equipment	(8,714)	(6,420)
Change in NCUSIF deposit	(967)	(1,125)
Net cash used in investing activities	(94,985)	(164,002)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in members' share and savings accounts	37,473	139,842
Repayment of borrowings	—	(54,000)
Net cash provided by financing activities	37,473	85,842
Net change in cash and cash equivalents	(46,901)	(53,584)
Cash and cash equivalents at beginning of year	96,999	150,583
Cash and cash equivalents at end of year	$50,098	$96,999
SUPPLEMENTAL CASH FLOWS DISCLOSURES:		
Interest paid	$19,702	$32,164
SCHEDULE OF NON-CASH TRANSACTIONS:		
Other comprehensive (loss)/income	($3,711)	$1

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

(dollars in thousands)

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND NATURE OF OPERATIONS

Northwest Federal Credit Union (the Credit Union) is a cooperative association organized in accordance with the provisions of the Federal Credit Union Act for the purpose of promoting thrift among, and creating a source of credit for, its members. The principal operations of the Credit Union are located in the Washington, D.C., metropolitan area. 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.

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 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 allowance for loan losses and 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 consolidated financial statements include the accounts of the Credit Union and the accounts of its wholly owned Credit Union Service Organization (CUSO), Northwest Financial, LLC. The CUSO provides insurance and financial services to Credit Union members. All significant intercompany accounts and transactions have been eliminated.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, due from banks, due from corporate credit unions and federal funds sold. Amounts due from banks and corporate credit unions may, at times, exceed federally insured limits.

INVESTMENTS

Investments are classified into the following categories: available-for-sale and other. Investment securities classified as available-for-sale are measured at fair value as of the consolidated statement of financial condition date. Unrealized gains and losses for available-for-sale investments are reported as a separate component of members' equity. The Credit Union has elected to classify certain cash equivalents as other investments. This election is available to the Credit Union according to the terms of the Statement of Cash Flows Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Realized gains and losses on disposition, if any, are computed using the specific identification method. Investments are adjusted for amortization of premiums and accretion of discounts over the terms of the investments by a method which approximates the interest method. Adjustments are recognized to interest income on investments.

FEDERAL HOME LOAN BANK (FHLB) STOCK

As a member of the FHLB of Atlanta, the Credit Union is required to invest in stock of the FHLB. The Credit Union's minimum stock investment is based on a formula developed by the FHLB that considers the Credit Union's total assets and outstanding advances from the FHLB. The FHLB stock is carried at cost within other investments and its disposition is restricted. No ready market exists for the FHLB stock, and it has no quoted market value.

LOANS HELD FOR SALE

Loans originated and intended for sale in the secondary market are carried at the lower of cost of estimated market value in aggregate. All sales are made without recourse.

LOANS TO MEMBERS AND ALLOWANCE FOR LOAN LOSSES

Loans to members are stated at the amount of unpaid principal, net of an allowance for loan losses (ALL) and certain deferred loan origination fees. The ALL is increased by a provision for loan losses charged to expense and decreased by charge-offs (net of recoveries). The ALL is maintained at a level considered adequate to provide for incurred loan losses in the loan portfolio by applying a historical loan loss rate to loan pools which have similar risk characteristics. Management's periodic evaluation of the adequacy of the ALL also considers such factors as changes in the nature and volume of the loan portfolio, review of specific problem loans and current economic conditions that may affect the borrower's ability to repay. Loans are charged against the ALL when management believes that collection of principal is unlikely.

Interest on loans to members is recognized over the terms of the loans and is calculated on principal amounts outstanding. The accrual of interest is discontinued when a loan exceeds 90 days delinquent or when management believes that collection of interest is doubtful. Direct loan origination costs are recognized in expense when incurred; however, real estate loan origination fees are deferred over the average life of the loan as an adjustment to loan yield using a method that approximates the interest method. Credit card fees are recognized as fee income when assessed. This is not materially different from fees and expenses that would have been recognized under the provisions of the Nonrefundable Fees and Other Costs Topic of the FASB ASC.

Allowance for Loan Losses

Management has an established methodology to determine the adequacy of the ALL that assesses the risks and losses inherent in the loan portfolio under varying economic scenarios by which to establish a range of potential outcomes for each criterion applied to the ALL calculation. Management applies judgment to develop its own view of loss probability within that range, using both external and internal parameters, with the objective of establishing an ALL inherent within the portfolio as of the reporting date. Reflected in the Credit Union's methodology is an amount for imprecision or uncertainty that incorporates the range of likely outcomes inherent in estimates used for the ALL, which may change from period to period. This amount is the result of the Credit Union's judgment of risks inherent in the portfolio, economic uncertainties, historical loss experience and other subjective factors, including industry trends, general trends of real estate values, the trends of existing borrower's FICO scores and other data incorporated into the Credit Union's judgment of the adequacy of the ALL which is intended to better reflect management's view of risk in each loan portfolio. No single statistic or measurement determines the adequacy of the ALL. Changes in the ALL and the related provision expense can materially affect net income.

For purposes of determining the ALL, the Credit Union has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: consumer, real estate and commercial. The Credit Union also sub-segments these segments into classes based on the associated risks within those segments. Consumer loans are divided into five classes: New Auto, Used Auto, Unsecured, Credit Cards and Other Secured. Real estate loans are divided into three classes: First Mortgages, Second Mortgages and Home Equity Loans. Commercial loans are divided into the following four classes: Commercial Real Estate, Industrial and Other, Commercial Construction and SBA/USDA Loans. Each class of loans requires significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment. The Credit Union uses an internally developed model in the process. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the ALL are independently validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices and end-user controls are appropriate and properly documented.

The following is how management determines the balance of the ALL for each segment or class of loans.

Consumer Portfolio Segment ALL Methodology

For consumer loans not identified as impaired, the Credit Union determines the ALL on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses at the measurement date. Loans are pooled, generally by loan types with similar risk characteristics. As of December 31, 2011, the Credit Union used industry standard loss factors for each loan class.

As appropriate, to achieve greater accuracy, further stratification of a selected portfolio may occur such as by year of origination, geographic location and other predictive characteristics. The consumer ALL model primarily uses historic delinquency and default experience, loss severity, unemployment trends and other key economic variables that may influence the frequency and severity of losses for each class of loan within the consumer segment. The consumer ALL also includes an amount for the estimated losses on individually evaluated impaired loans.

Real Estate Portfolio Segment ALL Methodology

For real estate loans not identified as impaired, the Credit Union determines the ALL on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses at the measurement date. Loans are pooled, generally by loan types with similar risk characteristics. As of December 31, 2011, the Credit Union used industry standard loss factors for each loan class.

As appropriate, to achieve greater accuracy, further stratification of a selected portfolio may occur such as by year of origination, geographic location and other predictive characteristics. The real estate ALL model primarily uses historic delinquency and default experience, loss severity, home price trends, unemployment trends and other key economic variables that may influence the frequency and severity of losses for each class of loan within the real estate segment. The real estate ALL also includes an amount for the estimated losses on individually evaluated impaired loans.

Commercial Portfolio Segment ALL Methodology

Upon being originated, or in the case of loan participations when they are purchased, commercial loans are evaluated assessed and graded based on their estimated risk of potential loss. Periodically, the evaluation of these loans is updated and the loan's grade is affirmed or changed as dictated by current information analyzed in the periodic review.

Based on credit risk assessment and management's analysis of leading predictors of losses, additional loss multipliers are applied to loan balances. These loss estimates are adjusted as appropriate based on additional analysis of long-term average loss experience compared to previously forecasted losses, external loss data or other risks identified from current economic conditions and credit quality trends. The commercial ALL also includes an amount for the estimated losses on individually evaluated impaired loans.

Loan Charge-Off Policies

The Credit Union's quality control process includes preparing lists to monitor and track delinquent loans and special mention loans. Tracking the loans on these lists enables management to assess the performance of the loan portfolio and act to mitigate risk therein through necessary changes in policy and procedures. The quality control process also serves as a tool to assist the credit union in identifying loans for charge-off on a timely basis. The following is a description of the Credit Union's loan charge-off policies:

Consumer, real estate and commercial loans are generally charged off when:

- A loan is deemed uncollectible, where additional collection efforts are non-productive regardless of the number of days delinquent;
- A non-performing loan is more than 180 days past due;
- Management judges the asset to be uncollectible;
- A "skip" where the Credit Union has had no contact for 90 days;
- An estimated loan loss, where the Credit Union has repossessed, but not yet sold, collateral on hand;
- A loan of a deceased person where the loss is determined;
- The asset has been classified as a loss by either the internal loan review process or external examiners.

MORTGAGE SERVICING RIGHTS

Servicing assets are recognized as separate assets when rights are acquired through the 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 non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Service fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

PROPERTY AND EQUIPMENT

Land is carried at cost. Property and equipment are carried at cost less accumulated depreciation. Buildings, furniture and equipment, and computer 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.

NATIONAL CREDIT UNION SHARE INSURANCE FUND (NCUSIF) DEPOSIT

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each insured credit union. 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.

(dollars in thousands)

NCUA INSURANCE PREMIUM ASSESSMENTS

During 2010, the NCUA Board assessed a 13.4 basis point insurance premium on insured deposits as of March 31, 2010, and a 12.42 basis point insurance premium on insured deposits as of June 30, 2010. During 2011, the NCUA Board assessed a 25 basis point insurance premium on insured deposits as of June 30, 2011.

MEMBERS' SHARE AND SAVINGS ACCOUNTS

Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' share and savings accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on members' share accounts are set by the Board of Directors, based on an evaluation of current and future market conditions.

REGULAR RESERVE

The Credit Union is required to maintain a statutory reserve (regular reserve) in accordance with the Federal Credit Union Act. This statutory reserve represents a regulatory restriction and is not available for the payment of interest.

FEDERAL AND STATE TAX EXEMPTION

The Credit Union is exempt from most federal, state and local taxes. The FASB ASC 740-10-25 clarifies accounting for uncertainty in income taxes reported in the 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 financial statements. Additionally, no interest or penalties have been recorded in the accompanying financial statements related to uncertain tax positions.

SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 30, 2012, the date the financial statements were available to be issued. Management had not identified any items requiring recognition or disclosure.

NOTE 2: INVESTMENTS

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

	As of December 31, 2011			
Available-for-sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SBA pools	$666,905	$791	($2,501)	$665,195
Federal agency securities	55,929	469	(315)	56,083
Mutual fund	26,941	85	(1,139)	25,887
	$749,775	$1,345	($3,955)	$747,165

	As of December 31, 2010			
Available-for-sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SBA pools	$322,166	$1,603	($2,386)	$321,383
Federal agency securities	248,764	2,793	(448)	251,109
Mutual fund	25,774	67	(529)	25,312
	$596,704	$4,463	($3,363)	$597,804

Other investments:	As of December 31, 2011	2010
Certificates of deposit	$—	$2,100
FHLB stock	3,518	4,366
	$3,518	$6,466

The amortized cost and estimated fair value of investments 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.

	As of December 31, 2011	
Available-for-sale	Amortized Cost	Fair Value
No maturity	$26,941	$25,887
Within 1 year	1,976	2,047
1-5 years	—	—
Mortgage-backed securities	53,953	54,036
SBA pools	666,905	665,195
	$749,775	$747,165

The proceeds from the sale of investments classified as available-for-sale approximated $196,800,000 during the year ended December 31, 2011. Gross gains of approximately $1,965,000 were realized from these sales during the year ended December 31, 2011.

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

	As of December 31, 2011 *Available-for-sale*					
	Less than 12 Months		*12 Months or Longer*		*Total*	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
SBA pools	$394,944	$2,000	$71,242	$501	$466,186	$2,501
Federal agency securities	7,872	103	18,595	212	26,467	315
Mutual fund	2,847	259	20,067	880	22,914	1,139
	$405,663	$2,362	$109,904	$1,593	$515,567	$3,955

	As of December 31, 2010 *Available-for-sale*					
	Less than 12 Months		*12 Months or Longer*		*Total*	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
SBA pools	$166,891	$2,386	$—	$—	$166,891	$2,386
Federal agency securities	40,525	448	—	—	40,525	448
Mutual fund	16,957	529	—	—	16,957	529
	$224,373	$3,363	$—	$—	$224,373	$3,363

Unrealized losses on securities issued by the U.S. Government and its Agencies have not been recognized into income because the principal balances of these securities are guaranteed by the U.S. Government. In addition, management has the ability and intent to hold these securities to recovery of fair value, which may be maturity.

NOTE 3: LOANS TO MEMBERS

The composition of loans to members is as follows:

	As of December 31, 2011	2010
Consumer:		
New vehicle	$74,555	$102,087
Used vehicle	133,962	102,771
Unsecured	77,210	77,566
Credit cards	90,353	88,011
Other secured	7,598	3,519
Total consumer	383,678	373,954
Real estate:		
First mortgage	503,763	597,998
Second mortgage	82,369	103,980
Home equity	95,924	102,480
Total real estate	682,056	804,458
Commercial:		
Real estate	34,951	49,189
Industrial and other	23,265	—
Construction	6,555	—
SBA and USDA	75,502	55,319
Total commercial	140,273	104,508
Total loans	1,206,007	1,282,920
Less allowance for loan losses	(15,075)	(14,228)
	$1,190,932	$1,268,692

A summary of the activity in the allowance for loan losses by portfolio segment is as follows:

	For the year ended December 31, 2011			
	Consumer	Real Estate	Commercial	Total
Balance, beginning of year	$6,303	$2,762	$5,163	$14,228
Provision for loan losses	3,432	2,461	2,250	8,143
Recoveries	453	210	—	663
Loans charged off	(3,678)	(2,341)	(1,940)	(7,959)
Balance, end of year	$6,510	$3,092	$5,473	$15,075
Ending balance:				
Individually evaluated for impairment	$1,534	$2,160	$624	$4,318
Collectively evaluated for impairment	$4,975	$932	$4,850	$10,757

A summary of the activity in the allowance for loan losses is as follows:

	For the year ended December 31, 2010
Balance, beginning of year	$10,387
Provision for loan losses	12,866
Recoveries	482
Loans charged off	(9,507)
Balance, end of year	$14,228

A summary of the recorded investment in loans by portfolio segment is as follows:

	As of December 31, 2011			
	Consumer	Real Estate	Commercial	Total
Ending balance	$383,678	$682,056	$140,273	$1,206,007
Individually evaluated for impairment	$3,068	$4,842	$7,874	$15,784
Collectively evaluated for impairment	$380,610	$677,214	$132,399	$1,190,223

Impaired Loans

Management considers a loan to be impaired when, based on current information and events, it is determined likely that 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 as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the primary (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determined that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees and unamortized premium or discount), impairment is recognized through a specific allowance or a charge to the ALL. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on non-accrual 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 non-accrual status, contractual interest is credited to interest income when received, under the cash basis method.

(dollars in thousands)

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired. Interest is credited to interest income when received, under the cash basis method. The average balances are calculated based on the month-end balances of the loans of the period reported. Payments received on impaired loans are recorded as a reduction of principal or as interest income depending on management's assessment of the ultimate collectability of the loan principal. Generally, interest income on an impaired loan is recorded on a cash basis when the outstanding principal is brought current. Interest income recorded on impaired loans for all periods presented was recorded on a cash basis.

The table below summarizes key information for impaired loans:

	As of December 31, 2011			For the Year Ended December 31, 2011	
	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded:					
Consumer:					
New auto	$251	$251	$125	$251	$4
Used auto	$847	$847	$423	$847	$13
Unsecured	$1,970	$1,970	$986	$1,970	$30
Real estate:					
First mortgage	$4,414	$4,414	$1,969	$4,414	$77
Second mortgage	$383	$383	$171	$383	$7
Home equity	$45	$45	$20	$45	$—
Commercial:					
Real estate	$7,826	$7,826	$614	$7,826	$—
Construction	$48	$48	$10	$48	$—
Totals:					
Consumer	$3,068	$3,068	$1,534	$3,068	$47
Real estate	$4,842	$4,842	$2,160	$4,842	$84
Commercial	$7,874	$624	$624	$7,874	$—
	$15,784	$8,534	$4,318	$15,784	$131

The table below provides an age analysis of past due loans by class:

	As of December 31, 2011					
	Days Delinquent			Total Delinquent Loans	Total Current Loans	Total Loans
	30 - 59	60 - 89	90 or more			
Consumer:						
New auto	$740	$251	$141	$1,132	$73,423	$74,555
Used auto	1,334	484	456	2,274	131,688	133,962
Unsecured	276	450	418	1,144	76,066	77,210
Credit cards	—	441	1,831	2,272	88,081	90,353
Other secured	—	—	—	—	7,598	7,598
Real estate:						
First mortgage	16,806	8,513	6,380	31,699	472,064	503,763
Second mortgage	3,282	1,075	603	4,960	77,409	82,369
Home equity	1,931	542	402	2,875	93,049	95,924
Commercial:						
Real estate	—	—	2,900	2,900	32,051	34,951
Industrial and other	—	—	—	—	23,265	23,265
Construction	—	—	—	—	6,555	6,555
SBA and USDA	2,421	—	—	2,421	73,081	75,502
Total	$26,790	$11,756	$13,131	$51,677	$1,154,330	$1,206,007

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. Loans on which the accrual of interest has been discontinued or reduced approximated $13,131,000 and $9,914,000 as of December 31, 2011 and 2010, respectively. There were no loans 90 days or more past due and still accruing interest as of December 31, 2011 or 2010.

The Credit Union's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Credit Union's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are classified as non-accrual at the time of restructure and are returned to accrual status after receiving on time payments for six consecutive months.

When the Credit Union modifies a loan, management evaluates impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement. Or in certain cases, management uses the current fair value of the collateral, less selling costs. The loan is further analyzed for consideration of the risk of re-default. If management determines that the value of the modified 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 by segment or class of loan, as applicable, through the allowance estimate. Segment and class status is determined by the loan's classification at origination.

The following table includes the recorded financial impact of TDRs originated or charged off during the previous 12 months. Management has also disclosed the recorded investment for TDRs within the last year where a concession has been made, that then defaulted in the current reporting period. Management defines a TDR as subsequently defaulted when the TDR is 90 days past due.

The following table presents the activity on TDRs.

	For the year ended December 31, 2011	
	TDRs Approved During the Period	TDRs which Subsequently Defaulted
Consumer:		
New auto	$335	$—
Used auto	847	—
Unsecured	1,886	—
Credit cards	—	—
Other secured	—	—
Real estate:		
First mortgage	926	—
Second mortgage	—	181
Home equity	168	—
Commercial:		
Real estate	—	—
Industrial and other	—	—
Construction	48	—
SBA and USDA	—	—
Total	$4,210	$181

Consumer Credit Quality Indicators

Consumer credit quality is measured, assessed and quantified through analysis of current delinquencies and credit losses within each segment of the consumer loan portfolio as well as on the portfolio as a whole. Additionally, historical loss trends are factored into management's evaluation of credit performance along with local and regional economic trends and other external variables that may impact portfolio performance. The adequacy of the ALL allocated to the consumer loan portfolio is then evaluated on these various sets of data.

Real Estate Credit Quality Indicators

The following table represents consumer credit exposures by credit score as of December 31, 2011. The use of creditworthiness categories to grade loans permits management to estimate a portion of credit risk. Category ratings are reviewed each quarter, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track loan performance. Loans that trend upward toward higher levels generally have a lower risk factor associated, whereas loans that migrate toward lower ratings generally will result in a higher risk factor being applied to those related loan balances.

The Credit Union's internal risk ratings are as follows:

- 800 and above - Member poses little to no risk.
- 750 to 799 - Member poses a nominal risk of loss.
- 650 to 749 - Composed of the Credit Union's average member profile.
- 600 to 649 - Member is experiencing some degree of financial difficulty.
- 599 and below - Member is showing above average risk.

The table below summarizes key information for consumer credit quality:

Real Estate Credit Quality Indicators
As of December 31, 2011
Real Estate Credit Exposure

	Credit Risk Profile by Creditworthiness Category by Class of Loan			
	First mortgage	Second	Home Equity	Total
800 and above	$226,895	$24,511	$37,391	$288,797
750 to 799	133,998	19,617	25,942	179,557
650 to 749	106,731	27,456	24,187	158,374
600 to 649	16,730	4,503	3,934	25,167
599 and below	19,409	6,282	4,470	30,161
	$503,763	$82,369	$95,924	$682,056

Commercial Credit Quality Indicators

The Credit Union categorizes commercial loans into risk categories based on relevant information about the ability of the borrowers to service their debt, such as: current financial information, historical payment experience, credit documentation and current economic trends, among other factors. These credit quality indicators are used to assign a risk rating to each individual credit. The risk ratings can be grouped into six major categories, defined as follows:

Pass. A pass loan is a strong credit with no existing or known potential weaknesses deserving management's close attention.

Watch. A watch credit is a loan that otherwise meets the definition of a standard or minimum acceptable quality loan, but which requires more than normal attention due to any of the following items: deterioration of borrower financial condition less severe than those warranting more adverse grading, deterioration of repayment ability and/or collateral value, increased leverage, adverse effects from a downturn in the economy, local market or industry, adverse changes in local or regional employer, management changes (including illness, disability, and death), and adverse legal action. Payments are current per the terms of the agreement. If conditions persist or worsen, a more severe risk grade may be warranted.

Special Mention. A special mention credit is a loan that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit or in the Credit Union's position at some future date. Special Mention credits are not adversely classified and do not expose the Credit Union to sufficient risk to warrant adverse classification.

Substandard. A substandard credit is a loan that is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Credits classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or a project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Credit Union will sustain some loss if the deficiencies are not corrected.

Doubtful. Credits classified as doubtful are loans that have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss. Credits classified as loss are loans considered uncollectible and charged off immediately.

(dollars in thousands)

The following table summarizes the credit risk profile of the commercial loan portfolio by class as of December 31, 2011:

Credit	Real	Industrial and Other	Construction	SBA and USDA	Total
Pass	$27,125	$23,265	$6,555	$73,081	$130,026
Watch	3,363	—	—	2,421	5,784
Special mention	1,563	—	—	—	1,563
Substandard	—	—	—	—	—
Doubtful	2,900	—	—	—	2,900
Loss	—	—	—	—	—
Total	$34,951	$23,265	$6,555	$75,502	$140,273

Methodology Changes

The Credit Union has implemented changes to its ALL methodology in the current period. In prior years, management used a historical loss period of 12 months for all segments when estimating the historical charge-off rates. In 2011, management changed its ALL calculation from using historical loss rates to industry rates related to each individual segment or class of loans. The following is a list of the changes made to each segment:

The following table represents the effects of changes to methodology from the prior period on the current period provision.

	Calculated Provision based on Prior Year Methodology	Calculated Provision based on Current Year Methodology	Difference
Portfolio Segment:			
Consumer	$3,086,810	$4,691,770	$1,604,960
Real estate	1,911,175	1,987,007	75,832
Commercial	—	—	—
Total	$4,997,985	$6,678,777	$1,680,792

NOTE 4: PROPERTY AND EQUIPMENT

A summary of the Credit Union's property and equipment is as follows:

	As of December 31, 2011	2010
Land	$4,271	$4,271
Buildings	38,184	32,730
Computer equipment	16,713	14,268
Furniture and equipment	5,340	5,012
Leasehold improvements	8,527	8,806
Construction in progress	4,481	4,384
	77,516	69,471
Less accumulated depreciation and amortization	(35,085)	(31,886)
	$42,431	$37,585

NOTE 5: MEMBERS' SHARE AND SAVINGS ACCOUNTS

Members' share and savings accounts are summarized as follows:

	As of December 31, 2011	2010
Share drafts	$228,764	$203,309
Shares and equivalents	328,920	309,106
Money market	730,842	660,682
IRA shares	61,669	60,347
Share and IRA certificates	524,290	603,568
	$1,874,485	$1,837,012

The aggregate amount of members' individual time deposit accounts in denominations of $100,000 or more was approximately $299,626,000 and $355,500,000 as of December 31, 2011 and 2010, respectively. The aggregate amount of overdraft accounts reclassified to loans to members was approximately $171,000 and $127,000 as of December 31, 2011 and 2010, respectively.

Scheduled maturities of certificates are as follows:

	As of December 31, 2011
Within 1 year	$271,857
1 to 2 years	86,225
2 to 3 years	67,783
3 to 4 years	41,993
4 to 5 years	56,432
	$524,290

SHARE INSURANCE

Members' shares are generally insured by the NCUSIF to a maximum of $250,000 for each member. Individual Retirement Accounts are insured by the NCUSIF to a maximum of $250,000.

NOTE 6: EMPLOYEE BENEFITS

401(K) PROFIT SHARING PLAN

Participation in the 401(k) profit sharing plan is available to all employees who are 21 years of age. Employee contributions to the plan are subject to certain limits established by the Internal Revenue Service. Participants are always 100% vested in their voluntary contributions. The Credit Union may make a discretionary matching contribution equal to a uniform percentage of an employee's salary deferral and/or a discretionary profit sharing contribution. Credit Union contributions vest at 33% after one year of service, 67% after two years of service and 100% after three years of service. During the years ended December 31, 2011 and 2010, the Credit Union contributed a matching contribution equal to 4% of employee contributions. During the year ended December 31, 2010, the Credit Union also made a profit sharing contribution; however, no profit sharing contribution was made during the year ended December 31, 2011. The Credit Union's expense for the 401(k) profit sharing plan approximated $821,000 and $1,026,000 for the years ended December 31, 2011 and 2010, respectively.

POST-RETIREMENT BENEFIT PLAN

The Credit Union has a post-retirement benefit plan which pays for certain medical benefits for employees retiring after age 55 with at least 20 years of service. Participation in the plan is limited to those full-time employees who have participated in the Credit Union's health insurance plan for a minimum of five years prior to retirement. The Credit Union is not required to and has not funded the plan. Management has determined that the accrued benefits related to this post-retirement benefit plan are not material to the Credit Union's consolidated financial condition as of December 31, 2011 and 2010; therefore, no amounts have been recognized in the accompanying consolidated financial statements.

DEFERRED COMPENSATION

The Credit Union maintains a deferred compensation plan which will be payable in accordance with terms of the underlying agreement. The liability as of December 31, 2011 and 2010, was approximately $858,000 and $719,000, respectively, and is included in accrued liabilities. The plan is funded via the earnings from investments made by the Credit Union specifically related to this plan.

NOTE 7: COMMITMENTS AND CONTINGENT LIABILITIES

LEASE COMMITMENTS:

The Credit Union leases several branch offices. The minimum noncancellable lease obligations approximate the following as of December 31, 2011:

Year ending December 31,	Amount
2012	$596
2013	609
2014	596
2015	552
2016	333
Thereafter	658
	$3,344

Rental expense under operating leases was approximately $711,000 and $703,000 for the years ended December 31, 2011 and 2010, respectively.

LINES OF CREDIT:

In aggregate, the Credit Union maintained $60,000,000 in unsecured line-of-credit agreements with SunTrust, Wells Fargo and PNC Bank as of December 31, 2011. No amounts were outstanding on these line-of-credit agreements as of December 31, 2011.

The Credit Union also maintains a $100,000,000 secured line of credit with SunTrust Robinson Humphrey as of December 31, 2011. This line of credit is secured by a blanket security interest in the Credit Union's investment portfolio. No amount was outstanding on this line-of-credit agreement as of December 31, 2011.

As of December 31, 2011, the Credit Union had access to a pre-approved line-of-credit from the FHLB, secured by eligible 1– 4 family first mortgage loans, as defined in the FHLB Statement of Credit Policy. The aggregate line of credit under this agreement was approximately $18,353,000 as of December 31, 2011. No amount was outstanding on this line-of-credit agreement as of December 31, 2011.

MISCELLANEOUS LITIGATION:

The Credit Union is a party to various miscellaneous legal actions normally associated with financial institutions, the aggregate effect of which, in management's opinion, would not be material to the Credit Union's consolidated financial statements.

NOTE 8: 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 financial statements.

CONCENTRATIONS OF CREDIT RISK: 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, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2011, the total unfunded commitments under such lines of credit approximated $334,495,000. The Credit Union may be exposed to credit risk from a regional economic standpoint, since a significant concentration of its borrowers work or reside in the Washington, D.C. area. However, the loan portfolio is well diversified and the Credit Union does not have any significant concentrations of credit risk.

NOTE 9: 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 actions and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's consolidated financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities and certain off-balance-sheet items as calculated under generally accepted accounting principles. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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 (as defined in NCUA's Regulations) to total assets (as defined in NCUA's Regulations). Credit unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR), which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNWR as of December 31, 2011 and 2010, was 4.63% and 4.79%, respectively. The minimum requirement to be considered complex under the regulatory framework is 6.0%. Management believes, as of December 31, 2011 and 2010, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of December 31, 2011, the most recent call reporting period, the NCUA categorized the Credit Union as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Credit Union must maintain a minimum net worth ratio of 7.0% of assets. There are no conditions or events since that notification that management believes have changed the Credit Union's category.

(dollars in thousands)

The Credit Union's actual and required net worth amounts and ratios are as follows:

	As of December 31, 2011		As of December 31, 2010	
	Amount	Ratio/ Requirement	Amount	Ratio/ Requirement
Actual net worth	$203,510	9.67%	$183,379	8.96%
Amount needed to be classified as "adequately capitalized"	$126,284	6.00%	$122,818	6.00%
Amount needed to be classified as "well capitalized"	$147,332	7.00%	$143,288	7.00%

Because the RBNWR is less than the net worth ratio, the Credit Union retains it original category. Further, in performing its calculation of total assets, the Credit Union used the quarter end option, as permitted by regulation.

NOTE 10: 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 are summarized as follows:

	As of December 31, 2011	2010
Mortgage loan portfolio serviced for:		
Federal National Mortgage Association	$1,028,461	$955,460
Charlie Mac	$7,200	$8,914
Custodial escrow balances:		
Federal National Mortgage Association	$4,378	$3,673
Charlie Mac	$15	$19

NOTE 11: MORTGAGE SERVICING RIGHTS

The components of capitalized mortgage servicing rights, included in prepaid and other assets are as follows:

	As of December 31, 2011	2010
Mortgage servicing rights:		
Balance, beginning of year	$4,516	$4,036
Additions	1,868	2,176
Amortization	(1,891)	(1,696)
Balance, end of year	$4,493	$4,516

As of December 31, 2011 and 2010, the fair value of servicing rights was determined by an independent third party using market value discount rates and prepayment speeds based on the specific characteristics of each pool of loans to be approximately $5,726,000 and $8,021,000, respectively.

NOTE 12: FAIR VALUES OF FINANCIAL INSTRUMENTS

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) and the lowest priority to unobservable inputs (Level 3) as further described below:

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.

The following tables set forth by level, within the fair value hierarchy, the Credit Union's financial instruments at fair value:

	Assets at Fair Value as of December 31, 2011			
	Quoted Prices Active Markets Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets:				
Available-for-sale securities:				
SBA pools	$660,807	$4,388	$—	$665,195
Federal agency securities	2,396	53,687	—	56,083
Mutual fund	25,887	—	—	25,887
	$689,090	$58,075	$—	$747,165

	Assets at Fair Value as of December 31, 2010			
	Quoted Prices Active Markets Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets:				
Available-for-sale securities:				
SBA pools	$309,941	$11,442	$—	$321,383
Federal agency securities	3,260	247,849	—	251,109
Mutual fund	25,312	—	—	25,312
	$338,513	$259,291	$—	$597,804

The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of amounts that could be realized in a market exchange. The use of different assumptions and estimation methodologies may have a material effect on the estimated fair value amounts. The following methods and assumptions were used to estimate fair value of each of the financial instruments for which it was practicable to estimate.

CASH AND CASH EQUIVALENTS

The carrying amount is a reasonable estimation of fair value.

INVESTMENTS

Estimated fair values for investments are obtained from quoted market prices where available.

LOANS TO MEMBERS

The fair value of loans to members was estimated by discounting the estimated cash flows using the current rate at which similar loans would be issued. The impact of delinquent loans on the estimation of the fair value is not considered to have a material effect and, accordingly, delinquent loans have been disregarded in the valuation methodologies used.

LOANS HELD FOR SALE

The carrying amount is a reasonable estimation of fair value.

ACCRUED INTEREST RECEIVABLE

The carrying of accrued interest receivable approximates fair value.

MORTGAGE SERVICING RIGHTS

Fair values of mortgage servicing rights are obtained from an independent third party evaluation.

MEMBERS' SHARE AND SAVINGS ACCOUNTS

The estimated fair value of demand deposit accounts is the carrying amount. The fair value of fixed-rate certificates was estimated by discounting the estimated cash flows using the current rate at which similar certificates would be issued.

COMMITMENTS TO EXTEND CREDIT

The fair value of commitments to extend credit is equivalent to the amount of credit extended since the Credit Union does not charge fees to enter into these commitments and the commitments are not stated at fixed rates.

The carrying value and estimated fair value of the Credit Union's financial instruments are as follows:

	As of December 31, 2011		As of December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash	$50,098	$50,098	$96,999	$96,999
Investments:				
Available-for-sale	$747,165	$747,165	$597,804	$597,804
Other	$3,518	$3,518	$6,466	$6,466
Loans held for sale	$27,871	$27,871	$1,482	$1,482
Loans to members, net	$1,190,932	$1,211,405	$1,268,692	$1,300,442
Accrued interest receivable	$7,731	$7,731	$6,863	$6,863
Mortgage servicing rights	$4,493	$5,726	$4,516	$8,021
Financial liabilities:				
Members' share and savings accounts	$1,874,485	$1,880,954	$1,837,012	$1,845,791
Unrecognized financial instruments:				
Commitments to extend credit	$—	$334,495	$—	$332,713

NOTE 13: INDUSTRY EVENTS

In January 2009, the NCUA informed federally-insured credit unions that it was taking actions to enhance and support the corporate credit union system as well as the NCUSIF. In addition to placing U.S. Central Federal Credit Union into conservatorship, the NCUA established the Temporary Corporate Credit Union Share Guarantee Program, whereby all deposits in excess of insurable limits maintained at corporate credit unions, other than membership capital shares and paid-in capital, will be guaranteed through December 31, 2012.

During June 2009, legislation was created to establish a Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) to absorb the corporate stabilization costs by borrowing money from the U.S. Treasury. During September 2010, the NCUA received approval from the U.S. Treasury to extend the life of the Stabilization Fund to June 2021.

The funds borrowed from the U.S. Treasury will be repaid from assessments authorized by the NCUA Board. The NCUA Board has levied assessments during 2010 and 2011 to repay borrowed funds to the U.S. Treasury. It is anticipated that the NCUA Board will be making annual assessments over at least the next five years to cover costs associated with the corporate credit union system.

TECHNOLOGY
EXPANSION
COMMUNITY
CONVENIENCE

NORTHWEST
FEDERAL CREDIT UNION

Your Lifetime Financial Partner

200 Spring Street, Herndon, VA 20170
703-709-8901 • 1-866-709-8901
www.nwfcu.org