

Caribe Federal Credit Union

**CONSOLIDATED AUDITED FINANCIAL STATEMENTS AND
SUPPLEMENTAL INFORMATION**

For the years ended
December 31, 2017 and 2016



Caribe Federal Credit Union

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Caribe Federal Credit Union
San Juan, Puerto Rico

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of the Caribe Federal Credit Union (“the credit union”) which comprise the consolidated statements of financial condition as of December 31, 2017 and 2016, and the related statements of income and expenses, changes in members’ equity, comprehensive net income, and cash flows for the years then ended, and the corresponding 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 the 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

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

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

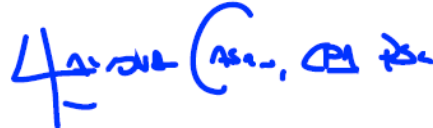
OPINION ON ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Caribe Federal Credit Union, as of December 31, 2017 and 2016, and the results of its operations, changes in member’s equity, comprehensive net income and cash flows for the years then ended, in accordance with generally accepted accounting principles in the United States of America.

SUPPLEMENTAL INFORMATION

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in pages 39, 40, and 41 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such supplemental information is the responsibility of management and was derived from and relates directly to, the underlying accounting and other records used to prepare the consolidated financial statements. The supplemental information has been subject to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental information is fairly stated in all material respects in relation to the consolidated financial statements taken as whole.

San Juan, Puerto Rico
April 20, 2018

A handwritten signature in blue ink, appearing to read "Llavona Casas, CPA PSC".

Stamp No. E-306196
was affixed to the original.

LLAVONA - CASAS, CPA PSC
License Number 226
Expires on December 1, 2018

Caribe Federal Credit Union
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
December 31, 2017 and 2016

Assets	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 9,345,373	\$ 7,142,296
Certificates of deposits	36,799,270	24,161,200
Investment securities	30,894,050	60,306,309
Loans to members, net	265,494,847	228,163,203
Accrued interest receivable	1,460,975	640,787
Accounts receivable, net	37,500	367,584
Prepaid expenses	125,327	131,457
Property and equipment, net	11,183,917	11,827,632
NCUSIF deposit	2,815,866	2,686,175
Art Collections	77,619	77,619
Other assets	824,139	750,848
Total assets	<u>\$ 359,058,883</u>	<u>\$ 336,255,110</u>
 Liabilities and Members' Equity		
Members' shares and savings accounts	303,785,748	286,973,339
Accounts payable and accrued liabilities	2,626,509	1,792,539
Accounts payable to auto dealers	7,095,436	3,011,240
Total liabilities	<u>313,507,693</u>	<u>291,777,118</u>
 Members' Equity		
Appropriated regular reserve	3,811,746	3,811,746
Unappropriated earnings	41,897,281	40,713,114
Accumulated other comprehensive loss	(157,837)	(46,868)
Total members' equity	<u>45,551,190</u>	<u>44,477,992</u>
Total liabilities and members' equity	<u>\$ 359,058,883</u>	<u>\$ 336,255,110</u>

Caribe Federal Credit Union

CONSOLIDATED STATEMENTS OF INCOME AND EXPENSES

For the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Interest Income:		
Interest and fees on loans	\$ 11,849,898	\$ 10,817,571
Interest on investments	886,470	797,793
Total interest income	<u>12,736,368</u>	<u>11,615,364</u>
Interest expense:		
Interest and dividends on members' shares and savings accounts	<u>1,989,172</u>	<u>1,951,646</u>
Net interest income	10,747,196	9,663,718
Provision for loan losses	<u>(2,735,265)</u>	<u>(1,147,454)</u>
Net interest income after provision for loan losses	<u>8,011,931</u>	<u>8,516,264</u>
Service fee and non-interest income	<u>693,765</u>	<u>771,902</u>
Non-Interest expenses:		
Compensation and benefits	3,665,686	3,406,786
Occupancy and related	2,044,781	2,093,305
Other	1,811,062	1,781,148
Total non-interest expenses	<u>7,521,529</u>	<u>7,281,239</u>
Net Income	<u><u>\$ 1,184,167</u></u>	<u><u>\$ 2,006,927</u></u>

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

Caribe Federal Credit Union

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

For the years ended on December 31, 2017 and 2016

	Appropriated Regular Reserve	Unappropriated Earnings	Accumulated Other Comprehensive loss	Total
Balance, December 31, 2015	\$ 3,811,746	\$ 38,706,187	\$ (22,637)	\$ 42,495,296
Comprehensive income	-	2,006,927	(24,231)	1,982,696
Balance, December 31, 2016	3,811,746	40,713,114	(46,868)	\$ 44,477,992
Comprehensive income		1,184,167	(110,969)	1,073,198
Balance, December 31, 2017	<u>\$ 3,811,746</u>	<u>\$ 41,897,281</u>	<u>\$ (157,837)</u>	<u>\$ 45,551,190</u>

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

Caribe Federal Credit Union

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended on December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net Income	\$ 1,184,167	\$ 2,006,927
Changes in unrealized gain (loss) on investment securities available for sale	(110,969)	(24,231)
Total comprehensive income	<u>\$ 1,073,198</u>	<u>\$ 1,982,696</u>

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

Caribe Federal Credit Union
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended on December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Net income	\$ 1,184,167	\$ 2,006,927
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	864,984	900,624
Loss (gain) on disposition of repossessed assets	23,539	(233)
Capitalized interest on certificate of deposit	(70)	(70)
Provision for possible loan losses	2,735,265	1,147,454
Dividends credited on members' shares accounts	1,993,957	1,959,462
Premium amortization and discount accretion, net	2,690	4,225
Recoveries on charged-off loans	314,877	298,494
(Increase)/decrease in assets:		
Accrued interest receivable	(820,188)	1,048
Insurance claim receivable	-	64,358
Accounts receivable, net	330,084	(340,363)
Prepaid expenses	6,130	(1,687)
Other assets	(96,830)	(31,662)
(Decrease)/increase in assets:		
Accrued and other liabilities	833,970	(121,668)
Accounts payable to auto dealers	4,084,196	551,849
Total adjustments	<u>10,272,604</u>	<u>4,431,831</u>
Net cash provided by operating activities	<u>11,456,771</u>	<u>6,438,758</u>

Caribe Federal Credit Union
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended on December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from investing activities:		
Cash proceeds from maturities, disposition and return on principal over investments	39,798,600	28,900,000
Acquisition of certificates of deposit	(12,638,000)	(7,241,000)
Acquisition of investment securities available for sale	(10,500,000)	(36,000,000)
Net increases in loans to members	(40,381,786)	(16,222,374)
Acquisitions of property and equipment	(221,269)	(568,974)
Deposit in NCUSIF	(129,691)	(224,161)
Net cash provided by investing activities	<u>(24,072,146)</u>	<u>(31,356,509)</u>
Cash flows from financing activities:		
Net increase in shares accounts	14,818,452	19,969,634
Net cash provided by financing activities	<u>14,818,452</u>	<u>19,969,634</u>
Net decrease in cash and cash equivalents	2,203,077	(4,948,117)
Cash and cash equivalents at beginning of year	<u>7,142,296</u>	<u>63,117,502</u>
Cash and cash equivalents at end of year	<u>\$ 9,345,373</u>	<u>\$ 58,169,385</u>

Supplemental Disclosures of Cash Flow Information

Interest and dividend paid for the years ended December 31, 2017 and 2016 was \$1,993,957 and \$1,959,462, respectively.

Also, during the years ended December 31, 2017 and 2016, unrealized loss on securities available for sale were recognized for (\$110,969) and (\$24,231), respectively, representing a non-cash item. Those charges are not reported as part of the net income for those years since they represent other comprehensive income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

1. ORGANIZATION

Caribe federal Credit Union (“Credit Union”) is a nonprofit organization established in 1951 organized and chartered under the Federal Credit Union Act. The Credit Union serves federal employees in Puerto Rico and the U.S. Virgin Islands, members of the *Liga de Estudiantes de Arte de San Juan*, select employee groups in Puerto Rico and immediate family members. Its purpose is to promote thrift among its members by affording them an opportunity to accumulate their savings and create for them a source of credit for productive purposes.

Business Consortium Alliance, Inc. (BCA) is a wholly-owned subsidiary of Caribe Federal Credit Union (Parent Company). It is a credit union service organization (“CUSO”) under the United States Credit Union Act. It was engaged in the development of its lines of business and in providing services to the Credit Union.

During the year ended December 31, 2008, Business Alliance Insurance Agency (BAIA) was incorporated and began operations in 2009. The Company was created to conduct and operate a general insurance agency business for insurance companies organized or admitted to do business in the Commonwealth of Puerto Rico. It is a subsidiary of BCA.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The most significant accounting policies followed the Credit Union are in conformity he accounting principles generally accepted in the United States of America. The most significant policies are as follows:

Principles of Consolidation

The consolidated financial statements include the accounts of Caribe Federal Credit Union and its wholly-owned subsidiary Business Consortium Alliance, Inc. (BCA), which was consolidated with Business Alliance Agency (BAIA). All significant intercompany balances and transactions between the Credit Union and the subsidiary have been eliminated in the preparation of the consolidated financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications

In the accompanying financial statements, certain 2016 figures were reclassified to conform to the 2017 presentation.

Concentrations of Credit Risk

Financial instruments that potentially subject the Credit Union to credit risk include cash balances and certificate of deposits with several financial institutions located in Puerto Rico and the United States; which were insured for up to \$250,000 by the U.S. Federal Deposit Insurance Corporation (FDIC). The balances may exceed amounts insured by the FDIC.

Credit risk for loans receivable and share accounts are also concentrated since most of the Credit Union's members are located in the Puerto Rico geographical area.

Bank deposits are insured by the Federal Deposit Insurance Corporation (FDIC) and National Credit Union Association (NCUA) up to \$250,000 per institution. The bank balance of deposits in commercial banks amounting to approximately \$8,840,000 exceeded the amounts covered by federal depository insurance limits. There was no bank balance of deposits exceeding the NCUA depository insurance limits at December 31, 2017 and the balance of deposits in *Banco Cooperativo* amounting to approximately \$1,212,000 were uninsured at that date.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Credit Union consider all highly liquid investment securities acquired with an original or remaining maturity of three months or less to be cash equivalents.

Investment Securities

Investment securities consist mainly of obligations issued by the Government of the United States and its political subdivisions. The Credit Union records the investments in securities in accordance with *Accounting for Certain Investments in Debts and Equity Securities*. The Credit Union classifies investments in debt instruments as securities available for sale and held to maturity.

Investments are made in accordance with the Credit Union's policies, which incorporate the regulations of National Credit Union Administration (NCUA), hence they are

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

principally in federally sponsored and guaranteed instruments. Gains or losses on disposition are based on the net proceeds and the adjustment carrying amount of the securities sold, using the specific identification method. Interest income is recorded on an accrual basis.

Securities held-to-maturity

Securities held-to-maturity are those which the management has the intent to hold to maturity. These investments are reported at cost, adjusted for amortization of premiums or accretion of discounts, which are recognized in investment interest income using the effective interest method over the period of maturity.

Securities available-for-sale

Securities available-for-sale are presented at fair market value. Unrealized gains and losses on securities available for sale are excluded from earnings and recognized as a direct or decrease in other comprehensive income. Investment securities in this classification could be sold any time in response to economic and strategic factors.

Other than temporary decline in the fair market value

Declines in the fair value of held to maturity and available for sale securities below their cost that are other than temporary are reflected as realized losses. In estimating other than temporary impairment, management considers: (1) the credit union intent to sell the debt security prior to recovery and, (2) whether it is more likely than not that it will not have to sell the debt prior to recovery, the security would not be considered other than temporarily impaired unless there is a credit loss. When the Credit union does not intend to sell a security, and its more likely than not, the Credit Union will not have to sell the security before recovery of its cost basis, it will recognize the credit component of other than temporary impairment of a debt security in earnings and the remaining portion in accumulated other comprehensive income (loss).

Loans to Members and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and net origination fees. Interest on loans is recognized over the term of the loan and is calculated using the simple-interest method on principal amounts outstanding. The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance is an amount that

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of collectability of loans and prior loan loss experience.

The evaluations take into consideration such factors as changes in the nature and volume of loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. Accrual of interest is discontinued on a loan when management believes, after considering economics, business conditions and collection efforts that the borrowers' financial condition is such that collection of interest is doubtful. Regularly, this is applied to loans with the delinquency greater than 89 days. The revenue for such interests not accrued is recognized when collected.

Loan Origination Fees

Loan origination fees are deferred and recognized over the life of the loan as an adjustment of yield. The unamortized balance of the net origination fees is reported as part of the loan balance to which it relates. The periodic amortization is reported on the income statement as interest income.

Accounts Receivable

Accounts receivable are stated at their net realizable value.

Property and Equipment

Land is carried at cost. Property and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line- method over the estimated useful lives of the assets. Leasehold improvements are stated at cost, less accumulated amortization. Assets classified as construction in process are not depreciated until the asset has been completed and placed into service.

Impairment of Long Lived Assets

The Credit Union periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No indications of impairment are evident at December 31, 2017 and 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Art Collection

Art collections are capitalized at their cost at the date of purchase or, if the items were contributed, at their fair or appraised value at the contribution date.

NCUSIF Deposit

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

Assets Acquired in Liquidation of Loans

Assets acquired in liquidation of loans represent collateral used to secure members loans that have been acquired by the Credit Union in an effort to settle the members' loan and are recorded at the lower of cost or market less costs of sale. Upon acquisition, The Credit Union determines fair value of the collateral and any losses are charged-off through the allowance for loan losses. The Credit union continues to review the properties for subsequent impairment and any subsequent declines in fair value are recorded through current period earnings.

Members' Shares Accounts

The dividend rates are set by the Board of Directors based on an evaluation of current and future market conditions. Dividends on members' shares accounts are based on available earnings at the end of the corresponding period and are not guaranteed by the Credit Union. Dividends are credited to the members' share accounts on the last day of the month for which dividends are declared. Members share accounts are subordinated to all other liabilities of the Credit Union upon liquidation.

Members' Equity

Caribe Federal Credit Union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of retained earnings, is not for the payment of dividends. The statutory reserve consists of \$3,811,746 for 2017 and 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available for sale securities.

Advertising and Promotional Costs

Advertising and promotional costs are expensed as incurred.

Federal and State Income Taxes

The Credit Unions is exempt, by statute, from federal and state income taxes.

3. CASH AND CASH EQUIVALENTS

As of December 31 2017 and 2016, the balance of cash and cash equivalents consisted of the following:

	<u>2017</u>	<u>2016</u>
Cash in banks	\$ 8,255,976	\$ 6,116,705
Petty cash	200	200
Change Fund	1,089,197	1,025,391
Total cash and cash equivalents	<u>\$ 9,345,373</u>	<u>\$ 7,142,296</u>

4. CERTIFICATES OF DEPOSITS

As of December 31, 2017, and 2016, the Credit Union maintains certificates of deposits mostly in denominations of \$250,000 and \$100,000. The schedules maturities are as follows:

	<u>2017</u>	<u>2016</u>
Due in one year or less	\$ 13,911,000	\$ 6,741,000
Due after one year through three years	22,638,270	17,420,200
Due in three years or more	250,000	
Total certificates of deposits	<u>\$ 36,799,270</u>	<u>\$ 24,161,200</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

5. INVESTMENT SECURITIES

At December 31, 2017 and 2016 the investment securities were as follows:

	<u>2017</u>	<u>2016</u>
Investment securities:		
Available for Sale	\$ 20,592,163	\$ 10,203,133
Held to maturity	10,301,887	50,103,176
Total investment securities	<u>\$ 30,894,050</u>	<u>\$ 60,306,309</u>

As of December 31, 2017 and 2016, the amortized cost and the estimate fair market value of investment securities available for sale and held to maturity are as follows:

		<u>2017</u>		
<u>Available for sale:</u>				
<u>Type of Investment</u>	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Unrealized Loss</u>	<u>Market Value</u>
Federal Home Loan Bank (FHLB)	\$ 3,000,000		\$ (18,170)	\$ 2,981,830
Federal Home Loan Mortgage Corporation (FHLMC)	8,000,000		(66,924)	7,933,076
Federal National Mortgage Association (FNMA)	6,750,000		(57,663)	6,692,337
Federal Farm Credit Bank (FFCB)	3,000,000		(15,080)	2,984,920
Total	<u>\$ 20,750,000</u>	<u>\$ -</u>	<u>\$ (157,837)</u>	<u>\$ 20,592,163</u>

<u>Held to maturity:</u>				
<u>Type of Investment</u>	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Unrealized Loss</u>	<u>Market Value</u>
Federal Home Loan Bank (FHLB)	\$ 10,301,887	\$ 174	\$ (82)	\$ 10,301,979
Total	<u>\$ 10,301,887</u>	<u>\$ 174</u>	<u>\$ (82)</u>	<u>\$ 10,301,979</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

5. INVESTMENT SECURITIES (CONTINUED)

<u>2016</u>				
<u>Available for sale:</u>				
<u>Type of Investment</u>	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Unrealized Loss</u>	<u>Market Value</u>
Federal Home Loan Bank (FHLB)	\$ 1,000,000	\$ -	\$ (1,190)	\$ 998,810
Federal Home Loan Mortgage Corporation (FHLMC)	4,000,000	-	(20,710)	3,979,290
Federal National Mortgage Association (FNMA)	3,250,000	520	(24,048)	3,226,473
Federal Farm Credit Bank (FFCB)	2,000,000	-	(1,440)	1,998,560
Total	<u>\$ 10,250,000</u>	<u>\$ 520</u>	<u>\$ (47,388)</u>	<u>\$ 10,203,133</u>

<u>Held to maturity:</u>				
<u>Type of Investment</u>	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Unrealized Loss</u>	<u>Market Value</u>
Federal Home Loan Bank (FHLB)	\$ 50,103,176	\$ 2,760	\$ -	\$ 50,105,936
Total	<u>\$ 50,103,176</u>	<u>\$ 2,760</u>	<u>\$ -</u>	<u>\$ 50,105,936</u>

The amortized cost and estimated fair value of investment securities, at December 31, 2017 and 2016, by contractual maturity, are shown below. Investment expected maturities may differ from original contractual maturities because of borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<u>Due Date</u>	<u>2017</u>		<u>2016</u>	
	<u>Amortized Cost</u>	<u>Market Value</u>	<u>Amortized Cost</u>	<u>Market Value</u>
Due in one year or less	\$ 15,301,887	\$ 15,282,620	\$ 50,103,176	\$ 50,105,936
Due after one year through five years	15,750,000	15,611,922	10,250,000	10,203,133
Total	<u>\$ 31,051,887</u>	<u>\$ 30,894,542</u>	<u>\$ 60,353,176</u>	<u>\$ 60,309,069</u>

Unrealized losses as of December 31, 2017 have not been recognized into income because they are not considered to be other-than temporary. Management considers the unrealized losses to be market driven, rather than credit driven and no loss will be realized unless the securities are sold.

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

5. INVESTMENT SECURITIES (CONTINUED)

Description of Securities	As of December 31, 2017					
	Continuing Unrealized Losses for Less Than 12 months		Continuing Unrealized Losses for 12 months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal Home Loan Bank (FHLB)	\$ 1,984,300	(15,700)	\$ 997,130	(2,870)	\$ 2,981,430	\$ (18,570)
Federal Home Loan Mortgage Corporation (FHLMC)	4,961,755	(38,245)	2,971,720	(28,280)	\$ 7,933,475	\$ (66,525)
Federal Farm Credit Bank (FFCB)	1,991,420	(8,580)	993,500	(6,500)	2,984,920	(15,080)
Federal National Mortgage Association (FNMA)	3,472,955	(27,045)	3,219,383	(30,617)	6,692,338	(57,662)
Total	\$ 12,410,430	\$ (89,570)	\$ 8,181,733	\$ (68,267)	\$ 20,592,163	\$ (157,837)

Description of Securities	As of December 31, 2016					
	Continuing Unrealized Losses for Less Than 12 months		Continuing Unrealized Losses for 12 months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal Home Loan Bank (FHLB)	\$ -	-	\$ 998,810	(1,190)	\$ 998,810	\$ (1,190)
Federal Home Loan Mortgage Corporation (FHLMC)	3,979,290	(20,710)	-	-	3,979,290	(20,710)
Federal National Mortgage Association (FNMA)	2,225,953	(24,048)	-	-	2,225,953	(24,048)
Federal Farm Credit Bank (FFCB)	1,998,560	(1,440)	-	-	1,998,560	(1,440)
Total	\$ 8,203,803	\$ (46,198)	\$ 998,810	\$ (1,190)	\$ 9,202,613	\$ (47,388)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

6. LOANS

As of December 31, 2017, and 2016, the portfolio of loans to members of the Credit Union by type is as follows:

	<u>2017</u>	<u>2016</u>
<u>Commercial:</u>		
Corporations and individuals	\$ 23,149,103	\$ 19,257,185
Total commercial	<u>23,149,103</u>	<u>19,257,185</u>
<u>Consumer:</u>		
Unsecured	58,835,571	47,158,674
Mortgage	30,492,872	27,738,872
Auto	136,260,423	115,168,752
Share secured loans	7,339,551	7,310,254
Credit cards	13,260,682	13,839,901
Lines of credit	534,705	581,767
Total consumer	<u>246,723,804</u>	<u>211,798,220</u>
Total loans	<u>\$ 269,872,907</u>	<u>\$ 231,055,405</u>
Less: Allowance for loan losses	(3,769,704)	(2,304,679)
Plus: Net unamortized deferred origination fees	(608,356)	(587,523)
Total loans to members, net	<u>\$ 265,494,847</u>	<u>\$ 228,163,203</u>

Allowance for loan Losses

The allowance for loan losses reflects management judgement of probable loan losses inherent in the portfolio at balance sheet date. The Credit Union uses a disciplined methodology to establish the allowance for loan losses each quarter. A minimum of 1.40% of the outstanding loans portfolio is required by policy. To determine the total allowance for loan losses, management estimates the provision needed for each segment of the portfolio, including loans analyzed individually and loans analyzed on a collectively basis. The allowance for loan losses consists of amounts applicable to: (1) consumer loans (personal auto, mortgage, line of credit and credit card) and (2) commercial loans portfolios.

The establishment of the allowance for loan relies on a consistent process that requires multiple layers of management review and judgment and responds to changes in economic conditions, member behavior, and collateral value, among other influences. From time to time, events or economic factors may affect the loan portfolio, causing management to provide additional amounts to or release balances from the allowance for loan losses.

6. LOANS (CONTINUED)

The Credit Union's allowance for loan losses is sensitive to individually evaluated loans, economic conditions and delinquency trends. Individually loans are evaluated based on each situation by experienced collection officers and reviewed by management.

Additions to the allowance for loan losses are made by charges to the provision for loan losses. Credit exposures deemed to be uncollectible are charged ("charge -off") against the allowance for loan losses. Recoveries of previously charged off amounts are credited to the allowance for loan losses.

Loan Charge-Offs

Loans recommended for charge-off must meet at least one of the following standards:

- A non-performing loan more than six month past due without a payment of at least 75 percent of a regular monthly installment within the last 90 days. In cases of non-performing loans, transfers from shares and proceeds from the sale of collateral generally do not constitute "payments";
- A loan in bankruptcy, within 60 days of receipt of notification of filing from the bankruptcy court, unless the credit union can clearly demonstrate and document that repayment is likely to occur. Loans with collateral may be written down to the value of the collateral, less cost to sell. However, in Chapters 11 and 13 bankruptcy proceedings, if the court lowers the amount that the borrower must pay, the credit union should immediately charge off that portion of the debt discharged by the court;
- A fraudulent loan, no later than 90 days of discovery or when the loss is determined, whichever is shorter;
- On the death of the debtor, there appears to be little hope that there are sufficient assets available from the estate or from insurance to recover the debt;
- On liquidation of the collateral, a deficiency balance exists, and the borrower(s) has indicated that no further payments are forthcoming;
- Where CFCU has foreclosed an estimate loan loss, but has not yet sold the collateral on hand, CFCU may transfer the loan balance into the Collateral in Process of Liquidation account. It should charge-off any outstanding loan balance in excess of the property, less the cost to sell;

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

6. LOANS (CONTINUED)

- Where CFCU has foreclosed an estimate loan loss, but has not yet sold the property securing the real estate loan at the fair value of the property, CFCU may transfer the loan balance into the Other Real Estate Owned (OREO) account and should charge-off any outstanding loan balance in excess of the value of property, less cost to sell;
- A delinquent loan in the hands of an attorney or collection agency, unless there are extenuating circumstances to indicate CFCU will collect the loan;
- A loan deemed uncollectible, where additional collection efforts are non-productive regardless of the number of months delinquent;
- A “skip” where the credit union has had no contact for 90 days.

When a loan meeting of the above criteria is not recommended for charge-off, the collections department will report that fact to the board of directors in a separate written report. The report will include an explanation as to why the loan should be kept open and not assigned to nonperforming asset status (e.g., the debtor has agreed to and is making regular periodic payments). A summary of the changes in the allowance for loan losses, by portfolio segment, is as follows:

	<u>2017</u>		
	Commercial	Consumer	Total
Beginning balance	\$ 251,016	\$ 2,053,663	\$ 2,304,679
Provision during the year	198,418	2,536,847	2,735,265
Recoveries of loans previously reserved		314,877	314,877
Loans charge-offs		(1,585,117)	(1,585,117)
Ending balance	<u>\$ 449,434</u>	<u>\$ 3,320,270</u>	<u>\$ 3,769,704</u>
Evaluation of Allowance:			
Allowance evaluated individually	\$ 378,202	\$ 546,656	\$ 924,858
Allowance evaluated collectively	<u>71,232</u>	<u>2,773,614</u>	<u>2,844,846</u>
Total	<u>\$ 449,434</u>	<u>\$ 3,320,270</u>	<u>\$ 3,769,704</u>
Loan Ending Balance:			
Evaluated individually for impairment	\$ 2,097,263	1,988,583.00	\$ 4,085,846
Evaluated collectively for impairment	<u>21,051,840</u>	<u>244,735,221</u>	<u>265,787,061</u>
Total	<u>\$ 23,149,103</u>	<u>\$ 246,723,804</u>	<u>\$ 269,872,907</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

6. LOANS (CONTINUED)

	<u>2016</u>		
	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Beginning balance	\$ 318,318	\$ 1,832,303	\$ 2,150,621
Provision during the year	7,796	1,139,658	1,147,454
Recoveries of loans previously reserved	-	298,494	298,494
Loans charge-offs	(75,098)	(1,216,792)	(1,291,890)
Ending balance	<u>\$ 251,016</u>	<u>\$ 2,053,663</u>	<u>\$ 2,304,679</u>
Evaluation of Allowance:			
Allowance evaluated individually	\$ 112,099	\$ 388,916	\$ 501,015
Allowance evaluated collectively	138,917	1,664,747	1,803,664
Total	<u>\$ 251,016</u>	<u>\$ 2,053,663</u>	<u>\$ 2,304,679</u>
Loan Ending Balance:			
Evaluated individually for impairment	\$ 1,425,738	1,554,305	\$ 2,980,043
Evaluated collectively for impairment	17,831,447	210,243,915	228,075,362
Total	<u>\$ 19,257,185</u>	<u>\$ 211,798,220</u>	<u>\$ 231,055,405</u>

Non-Accruing Loans

The Credit Union generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach over 89 days past due.

Loans to members in which the accrual of interest has been discontinued or reduced amounted to \$1,616,201 and \$1,235,391, at December 31, 2017 and 2016, respectively. If interest on those had been accrued, such income would have approximately \$112,893 and \$96,075, respectively.

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

6. LOANS (CONTINUED)

The following table summarizes the aging of the loans to members' receivable portfolio:

Age Analysis of Loan to members Receivables by Category as of December 31, 2017					
December 31, 2017	Current or 0-59	60-89	Over 90	Total	Over 90 Non Accruing
Personal	58,785,402	\$ 26,555	\$ 23,614	\$ 58,835,571	\$ 23,614
Mortgage	29,347,369	308,344	837,159	30,492,872	837,159
Auto	136,147,582	59,017	53,824	136,260,423	53,824
Secured	7,339,504	47		7,339,551	-
Credit cards	13,239,024	21,074	584	13,260,682	584
Lines of credit	534,705			534,705	-
Total consumer loans	<u>\$ 245,393,586</u>	<u>\$ 415,037</u>	<u>\$ 915,181</u>	<u>\$ 246,723,804</u>	<u>\$ 915,181</u>
Commercial	22,448,083		701,020	23,149,103	701,020
Total loans to members	<u><u>\$ 267,841,669</u></u>	<u><u>\$ 415,037</u></u>	<u><u>\$ 1,616,201</u></u>	<u><u>\$ 269,872,907</u></u>	<u><u>\$ 1,616,201</u></u>

Age Analysis of Loan to members Receivables by Category as of December 31, 2016					
December 31, 2016	Current or 0-59	60-89	Over 90	Total	Over 90 Non Accruing
Personal	47,084,110	\$ 41,198	\$ 33,366	\$ 47,158,674	\$ 33,366
Mortgage	26,882,749	-	856,123	27,738,872	856,123
Auto	115,079,334	22,753	66,665	115,168,752	66,665
Secured	7,300,971	9,283	-	7,310,254	-
Credit cards	13,790,412	21,548	27,941	13,839,901	27,941
Lines of credit	566,773	-	14,994	581,767	14,994
Total consumer loans	<u>\$ 210,704,349</u>	<u>\$ 94,782</u>	<u>\$ 999,089</u>	<u>\$ 211,798,220</u>	<u>\$ 999,089</u>
Commercial	19,020,883	-	236,302	19,257,185	236,302
Total loans to members	<u><u>\$ 229,725,232</u></u>	<u><u>\$ 94,782</u></u>	<u><u>\$ 1,235,391</u></u>	<u><u>\$ 231,055,405</u></u>	<u><u>\$ 1,235,391</u></u>

6. LOANS (CONTINUED)

Credit Quality Information

Consumer Loans - The use of risk classifications in consumer loans allows management to estimate their exposure to different types of risk. The Credit Union has established policies to evaluate application for loans using FICO credit scores, among other information, provided by major credit reporting agencies. A FICO score is a credit score developed by a third party that take information and analyze it to predict consumer behavior, such as how likely someone is to pay their bills on time or not, or whether they are able to handle a larger credit line. Generally, the FICO score range is 300 to 850, with the higher number representing less risk to the lender.

Credit Quality Levels, Credit Score and Loans to Members' Risk Exposure

The different levels of risk of loss established internally by the Credit Union according to the FICO credit scores are as follows:

Upper Level - 700 or more, member has little or no additional risk.

Middle Level - 660 to 699, member represents a nominal risk of loss.

Lower Level - 659 or less, member is experiencing some degree of financial difficulty, and represents a potential risk of loss.

These levels are reviewed periodically, as well as other statistics and external factors, to monitor the performance of the portfolio.

The following table represents the recorded investment in consumer loans based on different levels of risk of loss for the years ended December 31, 2017 and 2016.

Credit Quality Levels	December 31, 2017		December 31, 2016	
	Loans Balance	%	Loans Balance	%
Upper Level	\$ 193,415,543	74%	\$ 198,912,706	93%
Middle Level	60,350,560	23%	10,828,526	5%
Lower Level	8,552,974	3%	4,581,609	2%
	\$ 262,319,077	<u>100%</u>	\$ 214,322,841	<u>100%</u>
Credit score not available	7,553,830		16,732,564	
Total Consumer loans	<u>\$ 269,872,907</u>		<u>\$ 231,055,405</u>	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

6. LOANS (CONTINUED)

Commercial Loans - The Credit Union categorizes member business loans into risk categories based on relevant information about the ability of the borrower to service their debts such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Credit Union analyzes member business loans individually by classifying the loans as to credit risk. This analysis is limited to member business loans. The Credit Union uses the following definitions for classified risk rating:

Pass - The debtor has adequate capital and the ability to repay the debt in the normal course of operations.

Special Mention - The loan has the potential weakness, such as negative financial trends, a limited financial history, a serious documentation flaws, or inadequate control on the part of the financial institution. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset. However, a loan rated “special mention” is considered fully collectible.

Substandard - A loan is “substandard” if there is the potential for loss. Such loans have well-defined weakness and are not fully protected either by the paying capacity of the borrower or the value of the secondary source of repayment. These loans are characterized by the distinct possibility that your financial institution could sustain some loss if the deficiencies are not corrected.

Doubtful and loss - The lowest risk ratings of “doubtful” and “loss” indicate increased loss potential. Such loans should have been already recognized and, more than likely, charged off.

At December 31, 2017 and based on the most recent analysis performed, the risk category of loans is as follows:

	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful or Loss	Total
Commercial	\$ 21,051,840		\$ 1,396,243	\$ 701,020	\$ 23,149,103
Total commercial	<u>\$ 21,051,840</u>	<u>\$ -</u>	<u>\$ 1,396,243</u>	<u>\$ 701,020</u>	<u>\$ 23,149,103</u>

6. LOANS (CONTINUED)

Impaired Loans

The following table includes the recorded investment and unpaid principal for impaired loans receivables with associated allowance amount. The Credit Union determined the specific allowance based on the net charge-off experience for the last two years, the specific losses estimated on an individual basis, the present net value of future cash flows, discontinued at the loan's effective rate for troubled restructuring (TDR) and in cases of collateral depended loans, the fair value of the collateral less selling costs.

	Impaired Loans by Category for the year ended December 31, 2017		Impaired Loans by Category for the year ended December 31, 2016	
	Unpaid Principal of Impaired Loans (cases)	Specific Associated Allowance for the Impaired Loan (Cases)	Unpaid Principal of Impaired Loans (cases)	Specific Associated Allowance for the Impaired Loan (Cases)
Consumer:				
Personal	\$ 143,058	\$ 65,992	\$ 182,003	\$ 65,095
Mortgage	1,634,822	351,219	1,177,391	225,696
Auto	180,309	120,316	111,313	45,880
Credit cards	30,394	9,129	68,605	37,251
Lines of credit	-	-	14,993	14,994
Total consumer	<u>\$ 1,988,583</u>	<u>\$ 546,656</u>	<u>\$ 1,554,305</u>	<u>\$ 388,916</u>
Commercial	<u>2,097,263</u>	<u>378,202</u>	<u>1,425,738</u>	<u>112,099</u>
Total	<u><u>\$ 4,085,846</u></u>	<u><u>\$ 924,858</u></u>	<u><u>\$ 2,980,043</u></u>	<u><u>\$ 501,015</u></u>

Loans to members secured by collateral consist of \$196,537,768 and \$168,955,411 for 2017 and 2016, respectively. The remaining balance represents loans partially secured and unsecured. The collections from most of the members' loans are by direct deposit through payroll deduction.

Troubled Debt Restructuring (TDR)

In situations where, for economic or legal reasons related to a member's financial difficulties, the Credit Union grants a concession for the other than an insignificant period of time to the member that the Credit Union would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Credit Union strives to identify members in financial difficulty early and work with them to modify to more affordable

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

6. LOANS (CONTINUED)

terms before their loan reaches nonaccrual status. In cases where the Credit Union grants to the member new terms that provide for a reduction of either interest or principal (on non-collateral dependent loans) measures any impairment based on the present value of expected future cash flows at the loan effective interest rate.

The following table presents the restructured loans by category:

	For the year ended December 31, 2017					
	Restructured Loans			Delinquent Loans		
	Loans Count	Principal Balance	Assigned Allowance	Loans Count	Principal Balance	Assigned Allowance
Consumer:						
Master card	1	\$ 1,734	\$ 173	-	\$ -	\$ -
Personal	9	43,361	4,336	-	-	-
Mortgage	3	398,083	42,034	-	-	-
Auto	3	30,177	3,018	-	-	-
Total consumer loans	16	473,355	49,561	-	-	-
Commercial	7	1,396,243	70,636	-	-	-
Total	23	\$ 1,869,598	\$ 120,197	-	\$ -	\$ -

	For the year ended December 31, 2016					
	Restructured Loans			Delinquent Loans		
	Loans Count	Principal Balance	Assigned Allowance	Loans Count	Principal Balance	Assigned Allowance
Consumer:						
Master card	1	\$ 2,338	\$ 234	-	\$ -	\$ -
Personal	10	60,525	7,538	1	9,902	2,476
Mortgage	2	321,267	29,036	-	-	-
Auto	3	44,647	7,878	1	22,753	5,688
Total consumer loans	16	428,777	44,686	2	32,655	8,164
Commercial	6	1,266,250	68,667	1	159,487	-
Total	22	\$ 1,695,027	\$ 113,353	3	\$ 192,142	\$ 8,164

Loans to Related Parties

Certain officers, directors, and employees of the Credit union had loans and also share accounts with the Credit Union during 2017 and 2016. Such loans were in the ordinary course of business at normal credit terms including interest rates and collateralization and do not represent more than a normal risk of collection. Total loans outstanding to these related parties at December 31, 2017 and 2016, amounted to \$2,076,145 and \$1,689,200,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

respectively. Share accounts to these related parties at December 31, 2017 and 2016 amounted to \$4,202,656 and \$4,168,075, respectively.

7. ACCRUED INTEREST RECEIVABLE

At December 31, 2017 and 2016, the following are the components of accrued interest receivable:

	<u>2017</u>	<u>2016</u>
Accrued interests on loans	\$ 1,337,253	\$ 583,105
Accrued interests on investments	<u>123,722</u>	<u>57,682</u>
Total accrued interest receivable	<u>\$ 1,460,975</u>	<u>\$ 640,787</u>

8. PROPERTY AND EQUIPMENT

As of December 31, 2017, and 2016, the property and equipment were composed of the following:

	Useful Life (in Years)	<u>2017</u>	<u>2016</u>
Buildings	40	\$ 10,876,022	\$ 10,831,222
Furniture and fixtures	1-5	1,062,577	1,006,525
Office equipment, principally			
Information systems	1-5	<u>3,199,719</u>	<u>3,079,301</u>
		15,138,318	14,917,048
Less accumulated depreciation and amortization		<u>(6,340,896)</u>	<u>(5,475,911)</u>
		8,797,422	9,441,137
Land		<u>2,386,495</u>	<u>2,386,495</u>
Total property and equipment		<u>\$ 11,183,917</u>	<u>\$ 11,827,632</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

9. OTHER ASSETS

As of December 31, 2017, and 2016, the other assets were composed of the following:

	<u>2017</u>	<u>2016</u>
Acquired on liquidation of loans - real estate	\$ 512,241	\$ 468,950
Acquired on liquidation of loans - auto	17,160	25,126
Deposits for the acquisition of property and equipment	12,105	-
Deposits in Banco Cooperativo	108,099	108,099
Investment in FHLB NY	54,200	64,500
Deposits for annual meeting	15,000	40,000
Others	105,334	44,173
Total other assets	<u>\$ 824,139</u>	<u>\$ 750,848</u>

10. MEMBERS' SHARES ACCOUNTS

Members' shares accounts are summarized as follows:

	Weighted-Average Dividend Rate at December 31,	<u>2017</u>	<u>2016</u>
Shares drafts	0.16%	\$ 18,497,251	\$ 14,727,064
Regular shares (excluding escrow shares)	0.58%	<u>220,545,276</u>	<u>207,538,582</u>
Share certificates:	1.11%		
0.00% - 2.00%		64,148,364	61,215,024
2.01% - 3.00%		594,857	3,492,669
		<u>64,743,221</u>	<u>64,707,693</u>
Total members shares accounts		<u>\$ 303,785,748</u>	<u>\$ 286,973,339</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

10. MEMBERS' SHARES ACCOUNTS (CONTINUED)

As of December 31, 2017 and 2016, the NCUA insured and Credit Union shares members' accounts up to \$250,000.

The composition of insured and uninsured members' shares and deposits balances follows:

<u>Type</u>	<u>2017</u>	<u>2016</u>
Uninsured member shares and deposits	\$ 15,647,644	\$ 14,498,343
Insured member shares and deposits	288,538,668	272,821,269
Insured escrow	(400,564)	(346,273)
Total share and share certificates accounts	<u>\$ 303,785,748</u>	<u>\$ 286,973,339</u>

At December 31, 2017, scheduled maturities of share certificates are as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
2018	\$ 40,104,804
2019	8,936,172
2020	6,488,478
2021	5,539,140
2022	3,674,627
	<u>\$ 64,743,221</u>

Dividends expense on members' shares accounts is summarized as follows:

<u>Type</u>	<u>2017</u>	<u>2016</u>
Regular shares	\$ 1,241,456	\$ 1,165,106
Share drafts	27,974	23,665
Share certificates	719,742	762,875
Total dividends expense	<u>\$ 1,989,172</u>	<u>\$ 1,951,646</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

11. ACCRUALS AND OTHER LIABILITIES

As of December 31, 2017, and 2016 the composition of accruals and other liabilities is as follows:

	<u>2017</u>	<u>2016</u>
Dividends payable	\$ 31,131	\$ 35,916
Accrued payroll and related	243,818	214,698
Annual members' meeting	100,000	100,000
Accounts payable - trade	96,188	75,342
Accounts payable - ATM	368,738	248,039
Escrow accounts	400,564	346,273
Other accruals	1,386,070	772,271
Total accruals and other liabilities	<u>\$ 2,626,509</u>	<u>\$ 1,792,539</u>

12. SERVICE FEE AND NON-INTEREST INCOME

Service fee and non-interest income for the years ended December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
ATM card fees and charges, net	\$ 139,636	\$ 156,124
Master card fees and charges, net	(208,278)	(142,058)
Other fees, charges and expenses	450,585	488,091
Sponsorships other	68,330	53,620
Annual meeting	12,240	11,585
	<u>\$ 462,513</u>	<u>\$ 567,362</u>
Non-interest income from BCA	231,252	204,540
Total service fee and non-interest income	<u>\$ 693,765</u>	<u>\$ 771,902</u>

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

13. NON-INTEREST EXPENSES

The detail of non-interest expenses for the years ended December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Compensation and benefits	\$ 3,665,686	\$ 3,406,786
Occupancy and related:		
Depreciation and amortization	864,984	900,624
Occupancy and utilities	277,903	293,167
Communications	289,002	263,830
Insurance	236,713	232,898
Rent	14,219	15,399
Repairs and maintenance	236,352	266,000
Security	125,608	121,387
	<u>2,044,781</u>	<u>2,093,305</u>
Other operating expenses:		
Professional services and contracted services	560,660	525,568
Education and promotional	260,831	297,478
Loan servicing and collection	205,741	176,523
Annual meeting	156,918	158,437
Monthly statements	126,243	138,716
Bank service charges	80,332	84,830
Federal operating	76,763	57,583
Office supplies	61,460	57,530
Commission and fees	64,800	65,745
Travel and conferences	78,196	88,248
Employees activities	24,818	22,165
Loss (gain) on disposition of assets	5,872	16,930
Dues and subscriptions	11,069	10,344
Other miscellaneous	97,359	81,051
Total other operating expenses	<u>1,811,062</u>	<u>1,781,148</u>
Total non-interest expenses	<u>\$ 7,521,529</u>	<u>\$ 7,281,239</u>

14. DEFERRED COMPENSATION PLAN

The employees of Caribe Federal Credit Union participate in a group deferred compensation plan through contributions to a life annuity accumulation contract administered by an insurance company. The plan was effective on October 1, 1993. Caribe Federal Credit Union matches the participant's contribution up to a 5% of the employee compensation. All participants contribute at least 3% of their total gross compensation. The participants' annual deposit should not exceed \$15,000 from the gross compensation or \$16,500 for participants over 50 years old.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

14. DEFERRED COMPENSATION PLAN (CONTINUED)

Employees are eligible to enter the plan if they have attained eighteen (18) years old and completed twelve months of service. The normal retirement date is the first day of the month after the participants 62nd birthday and after completing twenty (20) years of service.

The plan also provides for early retirement. A participant may elect to retire at any time after attaining fifty-five (55) years old and completing seven (7) years of service. Vesting is accumulated after the second year on the plan for a period of five years at 20% per year. At termination of employment, the vested portion of a participant's account will be paid following the next annual benefit payment date.

During the years ended December 31, 2017 and 2016, Caribe Federal Credit Union contributed \$94,128 and \$91,051, respectively, to the pension plan.

15. UNCERTAINTIES, COMMITMENTS AND CONTINGENCIES

Economic Conditions

The Commonwealth of Puerto Rico and its instrumentalities (Commonwealth) is currently experiencing a severe fiscal, economic and liquidity crisis. On June 30, 2017, the President of the United States signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). Consequently, there is no assurance that the federally appointed oversight board of PROMESA will be successful in achieving budgetary and fiscal balance through a debt restructuring and a multi-year fiscal plan. The Credit Union continues to take steps to mitigate the possible effect in payment of loans by increasing the reserve for bad debt expenses from 1% to 1.40% of total loans as of December 31, 2017.

Litigation

The Credit Union maintains several claims against third parties, mainly demands payment of money and repossessions of assets, as part of its ordinary operations as a financial institution. Based upon counsel and management's opinion the outcome of such matters is not expected to have a material adverse effect on the Credit Union's financial condition.

15. UNCERTAINTIES, COMMITMENTS AND CONTINGENCIES (CONTINUED)

Loan Commitments

At December 31, 2017 and 2016, Caribe Federal Credit Union had outstanding the following commitments to extended credit with its members:

<u>Lines of Credit</u>	<u>2017</u>	<u>2016</u>
Commercial	\$ 2,295,820	\$ 2,480,349
Consumer	1,176,986	1,147,238
Credit Cards	20,120,647	18,604,132
	<u>\$ 23,593,453</u>	<u>\$ 22,231,719</u>

In addition, the Credit Union had pending to deliver certain payments to auto dealers subject to the presentation of required documents. As of December 31, 2017, and 2016, payments amounted to \$7,095,436 and \$3,011,239, respectively, and are recorded as accounts payable to dealers in the accompanying financial statements.

Caribe Federal Credit Union is a party to financial statements with off- balance sheet risk in the normal course of business to meet the financing needs of its members. These financial statements include commitments to extend credit and involve, to varying degrees, elements of credit and interest risk in excess of the amount recognized in the statement of financial position. The contractual notional amounts of those instruments reflect the extent of involvement Caribe Federal Credit Union has in particular classes of financial instruments.

Caribe Federal Credit Union's exposure to credit loss in the event of nonperformance by the other party to the financial statements for commitments to extend credit is represented by the contractual notional amount of those instruments. Caribe Federal Credit Union uses the same credit policies in making commitments as it does for on-balance-sheet instruments. Unless noted otherwise, Caribe Federal Credit Union does not require collateral or other security to support financial instruments with 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 and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Caribe Federal Credit Union evaluates each member's credit worthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by Caribe Federal Credit Union upon extension of credit, is based on management's credit evaluation of the counterpart.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

15. UNCERTAINTIES, COMMITMENTS AND CONTINGENCIES (CONTINUED)

Line of Credit

Caribe Federal Credit Union has a line of credit facility with a financial institution. As of December 31, 2017, and 2016 there are not outstanding balances in the subject line of credit. With certain exceptions, substantially all assets of the Credit Union serve as collateral for the line of credit facility. The unused amount was \$5,000,000 as of December 31, 2017 and 2016. Interest is charged when applicable based on the advance term, usually below prime rate.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

The estimated fair values of the Credit Union's financial statements, none of which are held for trading purposes, are as follows:

Caribe Federal Credit Union
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended on December 31, 2017 and 2016

16. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

	December 31, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 9,345,373	\$ 9,345,373	\$ 7,142,296	\$ 7,142,296
Certificates of deposits	36,799,270	36,799,270	24,161,200	24,161,200
Investment securities	30,894,050	30,894,142	60,306,309	60,309,069
Loans receivable (net of unamortized deferred origination fees)	265,494,847	257,681,542	228,163,203	203,427,104
Accrued interest receivable	1,460,975	1,460,975	640,787	640,787
Assets acquired in liquidation of loans	529,401	529,401	494,076	494,076
	<u>\$ 343,994,515</u>	<u>\$ 336,710,703</u>	<u>\$ 320,413,795</u>	<u>\$ 296,174,532</u>
Financial Liabilities				
Members' shares accounts	<u>\$ 303,785,748</u>	<u>303,785,748</u>	<u>\$ 286,973,339</u>	<u>\$ 286,973,339</u>
Off- Balance Sheet Financial:				
Commitments to extend credit	<u>\$ 23,593,453</u>	<u>\$ 23,593,453</u>	<u>\$ 22,231,719</u>	<u>\$ 22,231,719</u>

The carrying amounts in the preceding table that is included in the statement of financial condition under the applicable captions.

The Credit Union has no financial instruments that are held or issued for trading purposes.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

- Cash and cash equivalents- The carrying amount approximates fair value due to the short-term nature of these instruments.
- Certificates of Deposit- For long-term certificates of deposit, fair value has been determined discounting the principal and interest to be received at rates currently offered by other financial institutions for certificates with similar terms and characteristics.
- Investment securities - Fair values have been determined using quoted market prices for all investment securities.
- Accrued Interest Receivable - The fair value of the accrued interest receivable approximates the carrying amount in the financial statements.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

- Members' shares accounts:
 - (a) Regular shares and share drafts accounts - The fair value of members' regular shares and share drafts having no fixed maturity is the amount payable on demand at the reporting date.
 - (b) Share certificates - The fair value of fixed maturity members' share certificates is estimated using the rates currently offered for deposits with similar remaining maturities.
- Commitments to extend credit - The estimated fair value of the commitments to extend credit represents the Credit Union are potentially unfunded under such lines of credit.

Lease Commitments

BAIA operates on leased premises under a month-to-month agreement with an entity related with a director, at a monthly charge of \$1,000. During the years ended December 31, 2017 and 2016, the total rent expenses amounted to \$14,219 and \$15,399, respectively.

Fair Value of Financial Instruments Measured on a Recurring Basis

The fair values of assets and liabilities measured on a recurring basis at December 31, 2017 and 2016 are as follows:

Asset Class	Fair Value	Fair Value Measurement At Reporting Date Using:		
		Level 1	Level 2	Level 3
December 31, 2017				
Available for sale securities	\$ 20,592,163	\$ 20,592,163	-	-
Held-to-maturity securities	\$ 10,301,979	\$ 10,301,979	-	-
Assets acquired in liquidation of loans	\$ 529,401	-	-	\$ 529,401
December 31, 2016				
Available for sale securities	\$ 10,203,133	\$ 10,203,133	-	-
Held-to-maturity securities	\$ 50,105,936	\$ 50,105,936	-	-
Assets acquired in liquidation of loans	\$ 494,076	-	-	\$ 494,076

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended on December 31, 2017 and 2016

17. REGULATORY CAPITAL

As of December 31, 2017, and 2016, the Credit Union's net worth to total assets ratio is categorized as "well capitalized" as per the most recent call report. To be categorized as "well capitalized", the Credit Union must maintain a minimum net worth ratio of 7% as defined under the regulatory framework provisions of Section 38 of the FDI Act. Credit Unions whose net worth ratio falls below 7% will be subject to Prompt Corrective Actions requirements.

The Credit Union net worth ratio at December 31, 2017 and 2016 follows:

Period	CFCU Actual		
	Net Worth Amount	Net Worth to Total Assets Ratio (1)	CFCU Category (2)
2017	\$ 45,709,027	12.73%	Well Capitalized
2016	\$ 44,524,860	13.24%	Well Capitalized

- (1) In performing its calculation of total assets, the credit union used the monthly average over the quarter option, as permitted by regulation.
- (2) There are no conditions or events since the most recent Call Report that management believes have changed the Credit Union's category.

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.

Risk Based Net Worth (RBNW) Ratio

The RBNW requirement only applies to complex Credit Unions (CU) as defined by the National Credit Administration (NCA). A complex CU is one with more than \$50 million in assets and with a risk based net worth requirement of more than 6%. The RBNW is based on risk weighting formulas on specific assets, liabilities, and off-balance sheet items which qualify under the regulations. The Credit Union RBNW ratio for 2017 and 2016 was 4.62% and 4.74%, respectively, based on most recent CALL Report.

18. SUBSEQUENT EVENTS

The consolidated financial statements and related disclosures include evaluation of events up to and including April 20, 2018, which is the date the consolidated financial statements were available to be issued.

Caribe Federal Credit Union
CONSOLIDATING STATEMENT OF FINANCIAL CONDITION
At December 31, 2017

Assets	CFCU	BCA	Eliminations	2017
Cash and cash equivalents	\$ 9,108,160	\$ 237,213	\$ -	\$ 9,345,373
Certificates of deposits	36,789,000	10,270	-	36,799,270
Investment securities	30,894,050	-	-	30,894,050
Loans to members, net	265,494,847	-	-	265,494,847
Accrued interest receivable	1,460,975	-	-	1,460,975
Accounts receivable, net	12,415	25,085	-	37,500
Prepaid expenses	123,047	2,280	-	125,327
Property and equipment, net	11,183,340	577	-	11,183,917
NCUSIF deposit	2,815,866	-	-	2,815,866
Art Collections	77,619	-	-	77,619
Investment in unconsolidated subsidiary, net	238,775	-	(238,775)	-
Other assets	824,139	-	-	824,139
Total assets	\$ 359,022,233	\$ 275,425	\$ (238,775)	\$ 359,058,883
Liabilities and Members' Equity				
Members' shares accounts	\$ 303,785,748	\$ -	\$ -	\$ 303,785,748
Accruals and other liabilities	2,589,859	36,650	-	2,626,509
Accounts payable to auto dealers	7,095,436	-	-	7,095,436
Total liabilities	313,471,043	36,650	-	313,507,693
Members' Equity				
Capital stock - authorized 10,000 shares with a par value of \$100, issued and outstanding 5,000 shares	-	500,000	(500,000)	-
Additional paid-in capital	-	1,000,000	(1,000,000)	-
Appropriated regular reserve	3,811,746	-	-	3,811,746
Unappropriated earnings	41,897,281	-	-	41,897,281
Accumulated deficit	-	(1,261,225)	1,261,225	-
Accumulated other comprehensive income	(157,837)	-	-	(157,837)
Total members' equity	45,551,190	238,775	(238,775)	45,551,190
Total liabilities and members' equity	\$ 359,022,233	\$ 275,425	\$ (238,775)	\$ 359,058,883

Caribe Federal Credit Union
CONSOLIDATING STATEMENT OF INCOME AND EXPENSES
For the year ended on December 31, 2017

	<u>CFCU</u>	<u>BCA</u>	<u>Eliminations</u>	<u>2017</u>
Interest Income:				
Interest and fees on loans	\$ 11,849,898	\$ -	\$ -	\$ 11,849,898
Interest on investments	886,470	-	-	886,470
	<hr/>	<hr/>	<hr/>	<hr/>
Total interest income	12,736,368	-	-	12,736,368
Interest expense:				
Dividends on members' shares accounts	1,989,172	-	-	1,989,172
	<hr/>	<hr/>	<hr/>	<hr/>
Net interest income	10,747,196	-	-	10,747,196
Provision for loan losses	(2,735,265)	-	-	(2,735,265)
	<hr/>	<hr/>	<hr/>	<hr/>
Net interest income after provision for loan losses	8,011,931	-	-	8,011,931
Service fee and non-interest income	462,513	231,252	-	693,765
	<hr/>	<hr/>	<hr/>	<hr/>
Compensation and benefits	3,664,486	1,200	-	3,665,686
Occupancy and related	2,026,456	18,325	-	2,044,781
Other	1,654,711	156,351	-	1,811,062
	<hr/>	<hr/>	<hr/>	<hr/>
Total non-interest expenses	7,345,653	175,876	-	7,521,529
Income/(loss) before participation in losses of unconsolidated subsidiary and regulatory charges	1,128,791	55,376	-	1,184,167
	<hr/>	<hr/>	<hr/>	<hr/>
Participation in profit of unconsolidated subsidiary	55,376	-	(55,376)	-
	<hr/>	<hr/>	<hr/>	<hr/>
Net Income	\$ 1,184,167	55,376	(55,376)	\$ 1,184,167
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Caribe Federal Credit Union
CONSOLIDATING SCHEDULE OF NON-INTEREST EXPENSES
For the year ended on December 31, 2017

	<u>CFCU</u>	<u>BCA</u>	<u>Eliminations</u>	<u>2017</u>
Compensation and benefits	\$ 3,664,486	\$ 1,200	\$ -	\$ 3,665,686
Occupancy and related:				
Depreciation and amortization	863,648	1,336	-	864,984
Occupancy and utilities	276,769	1,134	-	277,903
Communications	287,130	1,872	-	289,002
Insurance	233,302	3,411	-	236,713
Rent	3,719	10,500	-	14,219
Repairs and maintenance	236,280	72	-	236,352
Security	125,608	-	-	125,608
	<u>2,026,456</u>	<u>18,325</u>	<u>-</u>	<u>2,044,781</u>
Other operating expenses:				
Professional services and contracted services	499,573	61,087	-	560,660
Education and promotional	258,253	2,578	-	260,831
Loan servicing and collection	205,741	-	-	205,741
Annual meeting	156,918	-	-	156,918
Monthly statements	126,243	-	-	126,243
Bank service charges	79,787	545	-	80,332
Federal operating	76,763	-	-	76,763
Office supplies	58,293	3,167	-	61,460
Commission and fees	-	64,800	-	64,800
Travel and conferences	78,196	-	-	78,196
Employees activities	24,818	-	-	24,818
Loss (gain) on disposition of assets	5,872	-	-	5,872
Dues and subscriptions	11,069	-	-	11,069
Other miscellaneous	73,185	24,174	-	97,359
Total other operating expenses	<u>1,654,711</u>	<u>156,351</u>	<u>-</u>	<u>1,811,062</u>
Total non-interest expenses	<u>\$ 7,345,653</u>	<u>\$ 175,876</u>	<u>\$ -</u>	<u>\$ 7,521,529</u>