THE CALLAHAN REPORT

At the Leading Edge of Credit Unions

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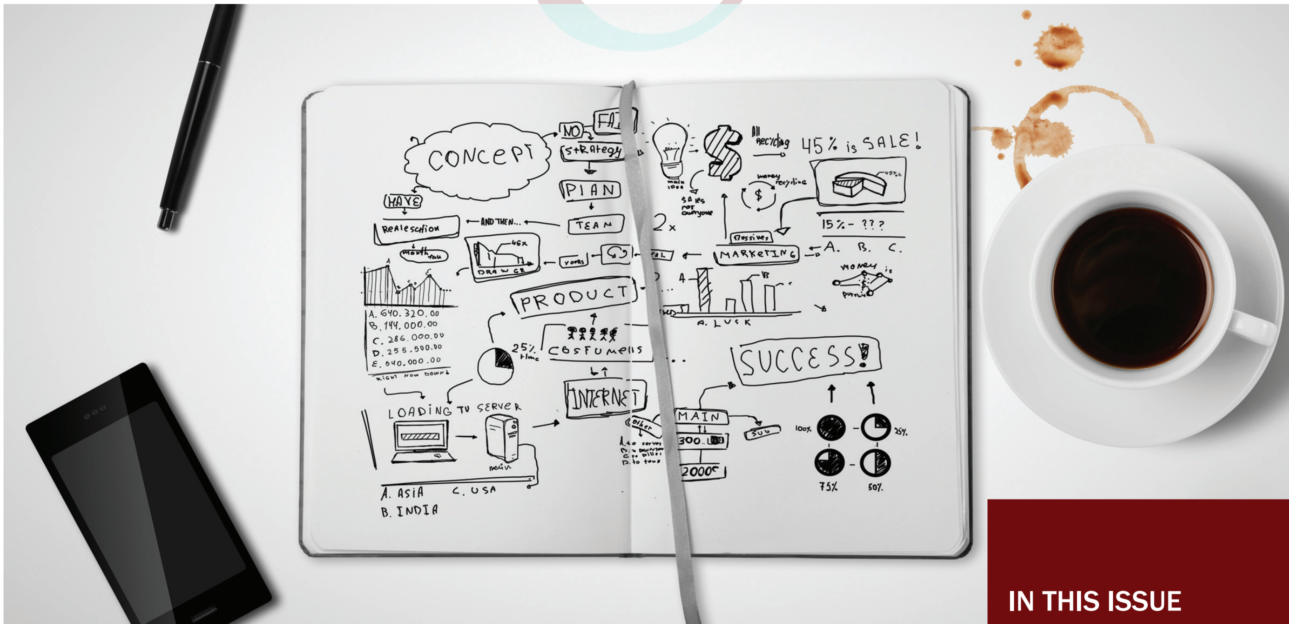

BY JAY JOHNSON

3 WAYS TO ACHIEVE SUCCESS IN 2013

Credit unions' strategic plans should focus on lending, recruitment, and data usage in the coming year.

CREDIT UNIONS HAVE terrific momentum coming into the new year. The industry's $245 billion in loans originated during the first nine months of 2012 set a new record. Credit unions set two additional records as well: Year over year, the industry added 2.5 million new members and 2.9 million new checking accounts.

Now is the time for credit unions to invest in three key strategic areas to drive success in 2013 and beyond. Those areas include mortgage lending, younger member recruitment, and sophisticated data usage.

A POST-REFI MORTGAGE JUGGERNAUT

Credit unions have become major mortgage lenders and must continue to press that advantage. At the end of third quarter 2012, real estate comprised 54% of credit union loan portfolios. As an industry, credit unions grew national real estate lending market share from 2.5% in 2007 to 7.2% in 2012. In 25 of the nation's Metropolitan Statistical Areas (MSAs), credit unions have captured at least 20% of first mortgage loans, and in each of the top five MSAs by credit union market share, the industry has captured more than 30%.

Increasing gains on sales of mortgages to the secondary market is fueling a rise in non-interest income, and such sales are now a vital source of credit union non-interest income. In 2011, non-interest income comprised 1.28% of average assets; that jumped to 1.38% in 2012.

Years ago, the most successful credit union mortgage lenders realized they had to court local realtors in order to get in on the ground floor of the house-buying process. In

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>
> *Tim Mislansky, president, myCUmortgage*

2008, Community First Credit Union ($1.7B, Appleton, WI) made itself the go-to funding source for realtors by putting qualified buyers into homes when the banks refused to lend. Pentagon Federal Credit Union ($15.2B, Alexandria, VA) and other credit unions have taken realtor relationships one step further by purchasing real estate agencies. PenFed's subsidiary CUSO, PenFed Realty, acquired three Prudential real estate agencies in 2012. It now owns agencies in Florida, Kansas, Tennessee, Texas, and Washington, DC. With 1,400 agents and 47 offices across five states, the CUSO posts annual sales of $1.7 billion.

Credit unions have many ways to ramp up the real estate segment of their portfolio. For example, CUSOs offer easy access to efficient mortgage lending as well as established infrastructure, scale, and expertise. Wright-Patt Credit Union ($2.5B, Fairborn, OH) extended its mortgage-lending prowess through the launch of myCUmortgage. Now, more than 130 credit unions leverage the CUSO's lending platform.

Wright-Patt understands the dynamics of the real estate market and acknowledges the cyclicality of the refinance boom. That's why this summer the credit union formed a partnership with a local realty company to operate Southern Ohio Mortgage out of six realtors' offices.

"Eventually interest rates will rise and the refinance business will die down," says Tim Mislansky, president of myCUmortgage. "Credit unions need to start planning now for how they will succeed in a purchase money market. It's about more than great service and good rates and fees; it includes outreach to nonprofits, actively engaging with realtors, and using our balance sheets to create niche products for first-time home buyers. I'm hopeful we can use our cooperative approach to bring even greater success to credit union mortgage lending. As we aim to control a larger share of the mortgage market, we will bring financial success to our cooperatives and our members."

COURT FUTURE MEMBERS

In the long term, of course, the strength of the credit union movement depends on the younger generation. Their embrace of the credit union system and philosophy — or lack thereof — will determine whether credit unions 30 years from now will flourish or flail.

But credit unions need younger members for the shorter term as well. It's the younger members who borrow and reach out for new products and services. Younger members need financing for college, cars, homes, and home improvements. They also need access to credit cards so they can build their own credit histories and habits. With credit, they need financial education that teaches them how to be responsible stewards of credit. This is a core strength of credit unions; indeed, it is part of the reason credit unions receive a tax exemption.

Unfortunately, credit union deposits nationally are growing faster than loans. The industry's loan-to-share ratio stood at 68% as of September 2012, and credit unions are holding $383 billion in liquidity. It's going to take the involvement of younger members to convert that liquidity into loans, raise the loan-to-share ratio, and kick-start the engines of credit union growth.

Currently, the average credit union member is 47 years old. Nearly all credit unions need to devote resources to present the credit union story to the rising generation. But making the credit union philosophy front-and-center is only part of the effort. Credit unions need to focus on developing products that respond to younger consumers' needs and messaging that connects with them. This includes embracing emerging services that allow young members to conduct remote financial transactions — such as new websites and mobile banking — as well as offering more traditional products that help young people develop responsible spending habits — such as debit and pre-paid cards.

"I know credit unions that are sitting on 18% or 20% capital and they have websites that are not going to attract Gen Y," says Jim Kasch, CEO of Darden Employees Credit Union. "You have to make sure you have the products and services and delivery channels that are going to appeal to Gen Y. You need to be able to walk into a SEG's HR department and say, 'Here's what we can do for your employees.'"

Tonya Voltolina, chief financial officer at Darden, agrees.

"If you're sitting on 13% capital, take some of that and invest it into a robust website and mobile application," she says. "We have one branch, but to our members we look like Bank of America. If you can look big and have a good product offering, then you can attract members."

As important as it is to cultivate a relationship with the next generation of credit union members, credit unions must also take care to not alienate those older members that are known for saving. In today's cash-rich environment it might be hard to imagine a future in which credit unions need more deposits, but the economy is cyclical and that day will come. Plus, older members wield strong influence over their younger counterparts. Credit unions rely on parental referrals to introduce younger members to a credit union "banking" relationship. The importance of having the proper balance of older and younger members cannot be understated.

DATA-MINING THAT DELIVERS RESULTS

Statistician, author, and New York Times FiveThirtyEight blogger Nate Silver accurately predicted how 49 of 50 states would tilt in the 2008 presidential election. He improved that record to 50 of 50 states in the 2012 presidential election. In 2012 he also accurately predicted 31 of 33 U.S. Senate races. How did he do this? He analyzed the data and in doing so has created an interest among decision makers of all ilk regarding how they can mine data to anticipate the future.

Analyzing data works, and credit unions have a wealth of it to draw on. Credit unions maintain member demographic data via marketing customer information files (MCIF). They also capture data on everyday member activity such as ATM usage, debit and credit card transactions, and call center, website, and branch inquiries.

This data provides not only insight into members' lives but also better risk management and fraud prevention. Armed with such data, credit unions can offer members the right product at the right time. They can also use the data to determine the depth of a member's relationship and make better pricing decisions. Finally, such data helps credit unions identify discrepancies in member behavior, which might indicate a larger identity theft issue.

These kinds of capabilities derived from data analysis are a strategic advantage in today's interest rate environment. But to maximize the value of data, management must focus on the right issues and credit unions must dedicate resources to identify and mine existing as well as new sources of data for greater insight into members' lives.

ONWARD AND UPWARD

Credit unions did many things right in 2012, and by any number of measures it was an outstanding year. Credit unions must now use this momentum, the likes of which does not come often, to make 2013 an even better, break-through year. Consumers are embracing the cooperative model of people helping people, of customer rather than stockholder ownership. Use the coming year to press forward and help more people reach a higher plane of life. Bring it on! ×

IN PERSON & ONLINE

WHERE YOU'LL FIND CALLAHAN IN JANUARY

WHAT CREDIT UNIONS NEED TO KNOW ABOUT THE ALLOWANCE FOR LOAN LOSS

January 16 I Online

Join us for the fourth annual webinar on issues related to the allowance for loan losses, co-hosted by Callahan & Associates and Sacher Consulting. This event will review the latest data on credit union asset quality trends given the recent changes in regulatory reporting. Then we'll look ahead to 2013 and highlight what credit unions need to consider for the coming year.

ARE YOU MAKING THE MOST OUT OF YOUR CALLAHAN MEDIA SUITE SUBSCRIPTION?

January 17 I Online

Looking to get more from Callahan & Associates? Let us show you how. Our new Media Suite has many components including our topic-tailored print publications, our Read & Watch content and Search & Analyze performance analysis on creditunions.com, and much more.

Join Alix Patterson, chief operating officer of Callahan & Associates, for this complimentary 30 minute training session and tap into all the resources our Media Suite can offer.

GAINING NEW PERSPECTIVE FROM COLLEGE INTERNS

January 23 I Online

Jersey Shore Federal Credit Union ($120M, Northfield, NJ) developed a win-win relationship with a local college to attract and nurture young talent while broadening its own cultural make-up. Find out how this program and others like it can help promote the credit union industry among students and reap big benefits for your organization.

NATIONAL INVESTMENT FORUM

January 28-January 30 I San Diego, CA

Join Callahan & Associates, the Trust for Credit Unions, and a wealth of investment experts as they discuss the economic outlook for 2013 and share best practices with credit union executives and investment managers.

In the current low-rate environment, it's more important than ever to share new thoughts and strategies on how to remain competitive while continuing to offer the products and services members expect from a cooperative institution.

MICHIGAN COUNCIL OF CUES – ECONOMIC SUMMIT 2013

January 25, 2013

Alix Patterson, chief operating officer of Callahan & Associates will be presenting on The Next Generation of Credit Unions to 185 credit union executives in Ypsilanti, Michigan. She'll be discussing what's in store for the next generation of credit unions and their leaders through a cooperative framework.

EXECUTIVE TEAM

CALLAHAN & ASSOCIATES

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INTERVIEW BY BROOKE C. STODDARD

DESERT SCHOOLS FEDERAL CREDIT UNION RAMPS UP REAL ESTATE LENDING

The Arizona-based credit union expands its back office and looks past HARP and refinances.

DESERT SCHOOLS FEDERAL Credit Union ($3B, Phoenix, AZ) serves anyone who lives, works, worships, or attends school in Gila, Maricopa, or Pinal counties in Arizona. It has slightly more than $3.0 billion in assets, 320,000 members, and 50 branches. Although it sells the majority of the first mortgages it originates to Fannie Mae, it retains loan servicing. Here, Jeff Meshey, executive vice president, and Gary Sneed, chief lending officer, discuss the credit union's plans for mortgage lending in 2013.

Q&A

Jeff Meshey
EVP of Desert Schools FCU (*left*)

Gary Sneed
CLO of Desert Schools FCU (*right*)

WHAT WILL DESERT SCHOOLS BE DOING WITH REAL ESTATE LENDING IN 2013?

JM&GS: We saw HARP2 as a tremendous opportunity and planned for it. We did something we don't normally do, which was double our staff in the mortgage processing area but not the retail sales staff. We began this expansion in March 2012 and took about four months to complete the hiring. We felt otherwise we could not do a good job dealing with the volume of loans we expected to attract. Indeed, we have seen a huge increase in mortgage lending. In 2011, we were closing first mortgage loans at a rate of about $20 million a month, but that's currently expanded to more like $50-$60 million a month. In order to do this, we have to process a lot more units. Before the market decline in home prices our average mortgage loan amount was $200,000-$240,000; now it is more like $145,000.

CU QUICK FACTS

DESERT SCHOOLS FEDERAL CREDIT UNION

HQ: Phoenix, AZ
Assets: $3.0B
Members: 320,000
ROA: 1.73%

DESCRIBE YOUR NEW LOANS.

JM&GS: We are seeing an approximate 50-50 split between refis for our own mortgages and those made by competitor lenders. Principally these are the big three banks in our market area: Wells Fargo, Chase, and Bank of America. We have been quite successful at bringing these mortgages over to Desert Schools and are happy to write mortgages for these families, many of whom who are members of Desert Schools but do not have their mortgages here. HARP2 is scheduled to end in 2013, and we need to take advantage of the opportunities that it has brought us.

HOW DO BORROWERS FIND OUT ABOUT YOUR MORTGAGE PROGRAM?

JM&GS: Mainly through word-of-mouth and our website, where we post information about our HARP program. We have not done much outward-facing marketing. We also post rates in the branches, which attract interest. In addition, we encourage our retail staff to discuss the program with members and prospective members — there is good retail awareness at the branches.

WHAT'S YOUR COMPETITIVE ENVIRONMENT LIKE?

JM&GS: The big three banks have a large presence here and most of the market. The rest of the market is fragmented among Desert Schools, the other financial institutions, and the independent mortgage bankers and brokers.

HOW DO YOU COMPETE?

JM&GS: The big three were relatively slow at underwriting — taking 120 to 180 days to close a loan — and Bank of America had even suspended new mortgage applications for a period of time. We were closing refinanced mortgages in 60 to 90 days, so speed has been a competitive advantage for us.

ARE YOU OFFERING BETTER RATES?

JM&GS: Not necessarily. We generally don't have the best rate, but we never have the worst rate. We try to stay in the best half for rates. Mortgage rates have become commoditized, most with no more than an eighth of a point difference between them on any given day.

SO YOU ARE COMPETING ON …

JM&GS: Speed and service for the most part. We are known for taking care of members on their other loans — especially auto loans — and members believe we can take good care of them with their mortgages. We retain the servicing for our mortgages, something we feel is important to the member in building and maintaining relationships.

> "HARP one day will go away; interest rates will rise; and most mortgage holders who could have refinanced will have done so. We want to be ahead of the curve."
>
> *Jeff Meshey, EVP, & Gary Sneed, CLO, Desert Schools FCU*

YOU ARE ALSO DOING SOME NON-HARP LENDING?

JM&GS: Yes, though most of our lending right now is HARP2, which is scheduled to sunset at the end of 2013. There might be some sort of extension, some sort of HARP3, but that is just conjecture at this point.

HOW IS YOUR MARKET DOING?

JM&GS: We were beneficiaries during the real estate boom and one of the early victims of the bust. But as we expected, values are coming back quicker here than in other places — Phoenix is currently the No. 1 MSA [metropolitan statistical area] in market appreciation according to Case Schiller reports over the past 12 months.

YOU DOUBLED YOUR PROCESSING STAFF IN ANTICIPATION OF HARP ACTIVITY. WHAT HAPPENS WHEN HARP ENDS?

JM&GS: We had to plan for it, and we have. HARP one day will go away; interest rates will rise; and most mortgage holders who could have refinanced will have done so. We want to be ahead of the curve for keeping and properly using the people we have hired. Our goal is to create demand for the purchase mortgage business. We plan to do this through the realtor community, and we will ramp up our outward-facing traditional marketing with television and the Internet. We are looking to hire more sales people this year, namely mortgage loan officers like the mortgage companies have who are on the street and can solicit business from real estate agents and the general public. We think we can attract the right sales people to join our team and assist us with this strategy.

DESCRIBE THE BACK-OFFICE GROUP THAT COMPRISED THE BULK OF YOUR EXPANSION.

JM&GS: It is a centralized processing group in our main office. The sales staff takes applications over the Internet, by phone, and in person. The system is tied to Fannie Mae's desktop underwriting system and gives us our loan decisioning. Once we have an approval, central processing assembles the documentation to verify the application information and present it to Fannie Mae. It's a detail-intensive process and where the bulk of the operating costs lie. There are now more questions and more paperwork than three years ago. Some people complain about it, but to be conforming we have to go through more than we used to — Fannie Mae is pickier and wants more information. As a lender we have to be careful, too. Fannie will make lenders repurchase a mortgage in default if they didn't properly underwrite the loan, even if an "i" wasn't dotted or a "t" crossed. You undo a lot of profitable months fast if you end up with some repurchases.

So we caution others: Do your research. Make sure you are doing everything to the letter — this is no area to be trying for shortcuts.

HOW DO YOU DEAL WITH MEMBER ANNOYANCE?

JM&GS: We work with the sales team to help it prepare members for what they are going to face. We tell members we don't ask for anything more than is required.

DESCRIBE THE STRUCTURE OF YOUR LENDING OPERATION.

JM: Previously, we had segregated the sales side from the processing side. The sales team reported up through retail, which reported to the vice president managing all the branches. Since Gary joined us three years ago, we have brought the sales and processing functions together and both report to him. This has been successful. Under the old system, each group looked to its own goals. Under the combined system, though, there is greater accountability and teamwork. We've had sales people help the processing staff when there is a backlog. The quality of loans is also better, which is a critical part of the business these days.

HOW DO YOU SEE YOUR FUTURE UNFOLDING?

JM&GS: With such a small percentage of the mortgage market, we have a tremendous opportunity. The challenge is how to get people to think of us as a mortgage lender, not just an auto lender. The big three banks have done a good job here. They have put a lot of effort into mortgage lending, but we feel we can successfully compete with them. So much comes down to service, and we have an advantage there. We believe we will expand market share at the expense of the independents as well as a bit of the big three.

The anxiety people feel over where their mortgage will end up is an advantage for us. We tell them right away that Fannie will own the mortgage but Desert Schools will always do the servicing.

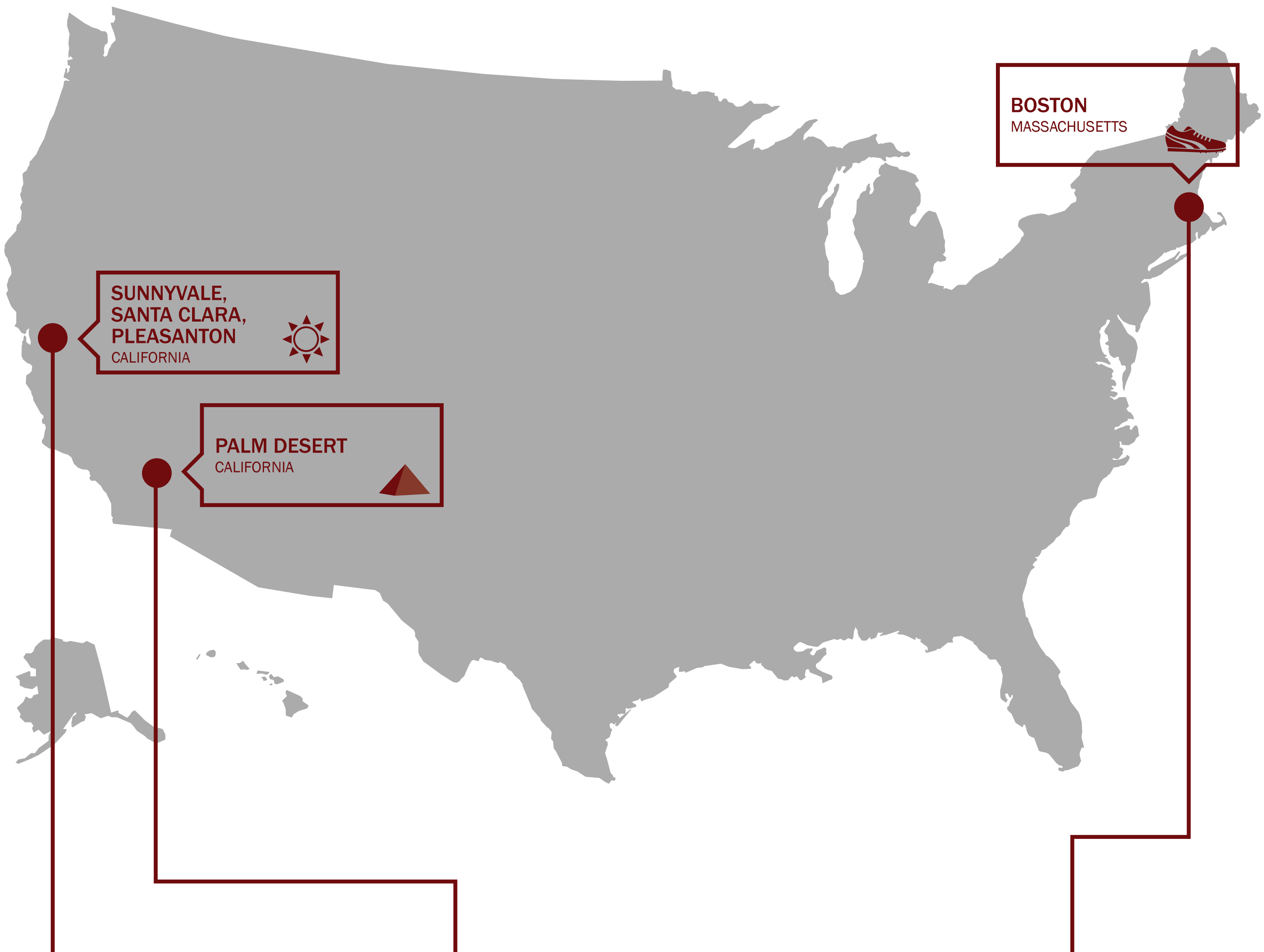
DO YOU HAVE ADVICE FOR OTHER CREDIT UNIONS?

JM&GS: Prepare for volume before it comes. Beef up staff before volume because the last thing you want to do is bring in business you cannot handle. Close loans in a timely manner or you'll turn people off.

If you are going to significantly ramp up for extra volume, examine your other segments to make sure they are ready also. Servicing, secondary marketing, and quality review are areas that might be stressed; be ready in advance. If you are ready, you can contribute to your bottom line and gain market share. ×

NOTES FROM THE ROAD

What we've learned from where we've been.



INVEST IN THE WEST

SUNNYVALE, SANTA CLARA, PLEASANTON
CALIFORNIA

Kevin Heal, vice president of sales and business development for Callahan Financial Services spent two days discussing evolving investment opportunities with some of the West Coast's largest cooperative power players.

This December, Kevin looped the lower part of the San Francisco Bay, answering portfolio questions and highlighting various investment options for Trust for Credit Union partners and new cooperative faces alike.

His ability to provide the quick, insightful answers credit unions are looking for — while supported by accurate and measurable underlying data — is a valuable asset and something credit unions across the nation will thoroughly benefit from in the months ahead.

CHIP FILSON SHARES INDUSTRY EXPERTISE AND IS INITIATED INTO THE CUES HALL OF FAME

PALM DESERT
CALIFORNIA

Callahan & Associates Co-Founder and Chairman of The Board of Directors Chip Filson recently shared his knowledge with approximately 400 volunteer directors at a CUES Conference in the beautiful Coachella Valley.

At the CUES conference, Chip discussed how the private sector engine is waiting for firmer economic trends before picking up hiring, leaving the credit union cooperative model to fill the void and help members through individual and collective upturns. Coming off a record breaking year with roughly $1 trillion in assets, $330 billion in loan originations, and 3.71% membership growth as of 3Q 2012, credit unions are in the perfect position to continue the pro-consumer era kicked off by the Consumer Financial Protection Bureau and Bank Transfer Day. Long-term member ownership is the key to mitigating a growing tide of concern with capital market driven solutions, he says.

In November, Chip was also nominated by the institution's Board of Directors into the CUES Hall of Fame in recognition for his lifetime achievement and his many contributions to the credit union movement throughout his career.

"CUES is setting an example of celebrating our most important resource, our people, and the lifelong commitments they have made to the financial cooperative system's ever expanding role in this country," Chip says.

"We have all inherited a legacy of trust, assets, and opportunities from earlier generations—it is only fitting that CUES provide a platform to let us, in a small way, pay it forward with this recognition."

RUNNING FOR BOSTON CHILDREN'S HOSPITAL

BOSTON
MASSACHUSETTS

Jay Johnson, executive vice president of Callahan & Associates, is excited to be a part of one of the great charitable programs that credit unions lead — the Credit Union Kids at Heart 2013 Boston Marathon Team.

Since 1996 credit unions through the CU Kids at Heart program have donated more than $3.5 million, including over $200,000 raised in 2012, to Boston Children's Hospital. Organized by EasCorp, there are currently 36 credit union sponsors of the program.

The program pairs each runner with a patient, personalizing the event and creating a unique and wonderful bond among the participants. An experienced marathon runner in the past, Jay found new motivation from his patient partner, Davis.

Davis was one of the approximately 6,000 children born annually in the U.S. with Down syndrome and had a very tough first two weeks of his life. His family's pediatrician did not have the background to understand the effects that Down syndrome could have on him and so the gastrointestinal issues that Davis was experiencing were not treated appropriately. Fortunately, the doctor referred the family to Boston Children's Hospital after 10 days of symptoms and the team at the Hospital was able to determine the treatment and literally save Davis' life.

Jay was able to meet Davis and his family at the CU Kids at Heart Kick-Off Party along with his two brothers, Palmer and Carter. Davis is not only excited for the marathon. He's in the race to win and will provide a constant source for motivation for Jay to give it his all.

Callahan has already kicked off Jay's participation with a generous donation towards his participation in the CU Kids at Heart program. We invite anyone who would like to make a tax deductible donation so that the Children's Hospital can continue its amazing, life saving work to visit this site: www.milesformiracles.org/boston/JayJohnson.

Do you know which members will purchase a home this year?

We do.

We know more than just mortgage insurance. Our analytical tools can identify which of your members are most likely to buy a home in 2013. We're experts at helping credit unions retain current members and add new members. And we can help you, too.

Add MGIC to your purchase money strategy to drive the results you're looking for in 2013. Visit our website or give us a call to see real-life results from other credit unions.

Results so amazing you'll think it's magic. But it's not. It's MGIC.

For more information,
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Or go to
www.cu.mgic.com/2013

MGIC

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