

# THE CALLAHAN REPORT

AUGUST 2013

At the Leading Edge of Credit Unions

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## A BOLD APPROACH TO STRATEGIC PLANNING

It's time for credit unions to build on the momentum gained during the economic downturn and make long-term plans for the future.

BY JAY JOHNSON

**NEWS COVERAGE OF** the United States' macro economy is growing increasingly positive. It seems we have climbed out of the crater the 2007 to 2009 fiscal crisis created and are now embarking on a new growth phase. To wit:

- The United States economy added more than 1.2 million jobs in the first half of 2013. Those jobs helped lower national unemployment to 7.6%. Each month this year, the U.S. Department of Labor has revised the figures upward from initial reports.
- Consumer confidence is at a five-year high and has risen for three consecutive months.
- Despite higher Social Security taxes and a sequestration that forced furloughs and dampened government spending, consumer spending rose in four of the first five months of the year.
- The Dow-Jones Industrial Average crossed 15,000 for the first time in May 2013. As of July 12, it is up 18% since January.
- Car and truck sales are posting their strongest results in six years. Analysts are saying 2013 new vehicle sales will top 15 million, the highest since before the credit crisis.
- Twelve-month growth for the S&P/Case-Shiller 20-City Composite Home Price Index was 12.1 % as of April, with all 20 cities posting year-over-year increases for at least four consecutive months. This is the largest rise since 2006. Three of the states hit hardest by the real estate downturn — Nevada, California, and Arizona — are now posting some of the biggest gains.

Credit union reports have also been encouraging.

- Credit unions originated \$83 billion in loans during the first three months of the year; up more than 12% from 2012's record pace. All lending categories posted their best first quarter ever.

- Loans outstanding are growing at the fastest pace since 2009.
- At nearly \$15,600, the average member relationship — which is composed of both loan and savings balances — has reached its highest level ever.
- Credit union member-ownership increased by 2.3 million Americans over the past year.
- Members have opened more than 2.3 million new checking accounts over the past 12 months.

### A FOUNDATION FOR GROWTH

These results indicate credit unions have momentum amid an economy that is returning to normal. Now is not the time to sit back and ride up the growth curve; now is the time to make investments that will improve the value credit unions deliver to members and strengthen the market impact of credit unions.

This is a critical time for the industry. Credit unions have momentum, but their competition is healthier, too. Banks reported their highest ever quarterly earnings in the first quarter. Competitors are pressing aggressively in markets like auto lending, especially among the most desirable consumers.

Credit unions have diligently served members for more than 100 years. The resurgence in popularity of cooperative financial services during the downturn has put them in a market position that is stronger than ever before. Now is the time to turn being a key financial services provider during times of crisis to being a key financial services provider all the time.

The uncertainty of the economy has forced many credit unions to focus on near-term initiatives over the past few

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Q&A

Pete Sainato

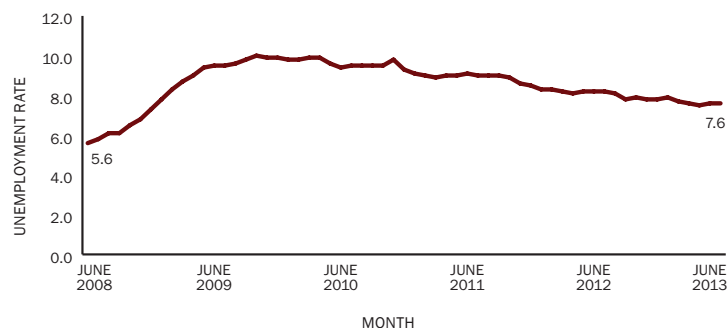
CEO, Justice Federal Credit Union

## A NEW GROWTH PHASE IN THE UNITED STATES ECONOMY

Improvements in the macro economy shows we have climbed out of the crater created by the 2007 to 2009 fiscal crisis.

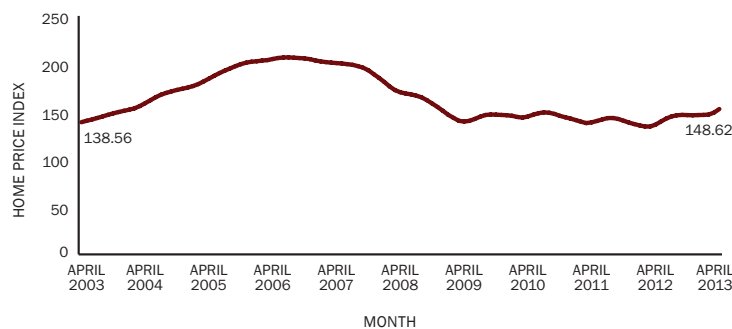
### U.S. UNEMPLOYMENT RATE

The more than 1.2 million jobs added in the first half of 2013 helped lower national unemployment to 7.6%. SOURCE: BUREAU OF LABOR STATISTICS



### S&P/CASE-SHILLER 20-CITY COMPOSITE HOME PRICE INDEX

In the past 12 months, all 20 cities included in the composite posted year-over-year increases for at least four consecutive months. SOURCE: S&P



years. They've held off on technological investments or have refrained from devoting significant resources to potential opportunities. With the economy stabilizing and credit union performance reaching new highs, it is time to reinvest in the business.

### BOLD PLANS

In this year's planning season, credit union leaders should challenge themselves to think beyond 2014. Management teams and board members need to think about where they want the organization to be in 2016, 2019, or 2024. Without regard to the constraints they face from available resources, management and the board needs to think about what they want the credit union to be. Then, they need to answer some major questions, such as:

- What will our credit union be known for?

- What capabilities will we have?
- What impact will we have on the communities we serve?
- What will our vision mean for the members and their interaction with the credit union?
- What will our vision mean for the credit union's employees?
- What key investments should we make to realize our vision?

The responses to these questions can open up the credit union to new possibilities and ensure it is looking for and pursuing opportunities.

### OPPORTUNITIES FOR CREDIT UNIONS

Credit unions have a positive, growing reputation. This is a period of golden opportunities, and here are just a few to consider:

**Mortgage Lending:** The structure of the mortgage lending market changed significantly during the downturn. The two largest mortgage lenders prior to the downturn — Countrywide and Washington Mutual — were absorbed into Bank of America and JPMorgan Chase, respectively. Additionally, new licensing requirements forced many mortgage brokers to exit the market. As a result, realtors are now looking for dependable, trustworthy lenders.

Credit unions have already expanded their presence in the mortgage market and have more than tripled their national share of the mortgage market since the downturn. So how can they further change mortgage lending? By expanding the value they provide to members.

Many credit unions offer home buying seminars geared toward first-time homebuyers or members who want to be more knowledgeable consumers. Wright-Patt Credit Union (\$2.6B, Fairborn, OH) now offers a seminar called "Home Staging" that it customizes to sellers. Pentagon Federal Credit Union (\$16.0B, Alexandria, VA) and TDECU (\$2.0B, Lake Jackson, TX) have acquired real estate brokerages to help members buy and sell their homes. Other credit unions are redoubling their efforts to work with area realtors by becoming active in the local board of realtors. And it is becoming more common for a credit union to set up a title company to support the closing process.

Actions such as these enhance the visibility of credit unions in the market. Such strategies also help credit unions expand their internal mortgage lending capabilities. With this kind of proactive approach, it is not out of reach to one day develop a mortgage banking operation that originates, sells, and services loans.

**Small Business Lending:** Credit unions have an even greater opportunity in small business lending than they do in mortgage lending. NCUA has granted a waiver from the MBL cap to many credit unions through the low income charter designation. But more important and applicable to all credit unions are the opportunities afforded by the retreat from local community banks that traditionally served local small businesses. Bank mergers have resulted in closed branches. The remaining institutions are driven to be more efficient, which has led them to expand their market regions and lose contact with

local businesses. And increased regulatory burdens coupled with earnings pressures have resulted in larger institutions raising their minimum loan amounts to generate a sufficient return. All of these developments play to credit unions' advantage.

**Community Partnerships:** Credit unions are increasingly viewed as the leading local financial institutions that are committed to and entrenched in the communities they serve. They are active in their chambers of commerce and other business and economic development groups. This is opening doors to new partnership possibilities with high schools, community colleges, universities, and municipalities. It is also leading to new relationships with leading private companies and non-profits. This has implications for not only for credit unions' reputation and visibility but also business opportunities.

## THE DIFFERENTIATOR

Opportunities are there. Credit unions need to think boldly while at the same time ensuring the core values that have provided the foundation of their success do not waiver.

Credit unions have a proven strength in, and should stay focused on, putting members in the right loan based on their circumstances. A credit union might take a different route than other lending institutions in order to say "yes" to a member, but members are better off with the cooperative option. It is up to the credit union to show them why. It is up to credit unions to demonstrate how they help, not hurt, a member's financial well-being.

The mission of Wright-Patt Credit Union includes helping members to "borrow smarter and learn a lot." The credit union does this in part with its lending seminar series, which educates members on how to use credit to the benefit of their entire financial picture. Helping consumers learn as well as borrow is one way credit unions can differentiate themselves from those lenders who are more concerned about volume and the value of assets loaned out rather than the welfare of the borrower.

Keeping the welfare of the member always in the forefront is how credit unions will continue to build, and enhance, their reputation. And in building a positive reputation, credit unions can make the best use of the opportunities available in this new era of possibilities. ✕

## IN PERSON & ONLINE WHERE YOU'LL FIND CALLAHAN

### CHAPTER MEETING OF THE SABINE CHAPTER OF CREDIT UNIONS

Aug 16 | Beaumont, TX

Callahan analyst Andrew Bolton will present data on credit union performance and trends with a group of Southeastern Texas credit unions at a meeting for the Sabine Chapter of Credit Unions.

### MAKE THE MOST OF YOUR MEDIA SUITE SUBSCRIPTION

Aug 20 & 21 | Online

Callahan & Associates offers resources in print and online that help busy decision makers evaluate a credit union's performance. Learn how to identify industry leaders, pull ratios, build peer groups, analyze performance data, and benchmark goals with the help of the Callahan Media Suite. *Learn more or register online for this webinar at [www.creditunions.com/connect/calendar](http://www.creditunions.com/connect/calendar).*

### LEADERSHIP PROGRAM CFO ROUNDTABLE

Aug 21 | Seattle, WA

Join Jay Johnson, executive vice president of Callahan & Associates, for a discussion on "Evolving Credit Union Business Model Strategies For 2013 And Beyond." Topics will include: What does the economic and consumer outlook mean for loan and share growth? How is the regulatory environment influencing balance sheet management? What investment strategies are credit unions using to accommodate high liquidity? What steps are credit unions taking to mitigate margin compression?

Roundtable discussions evolve organically as participants contribute and suggest topics most relevant to themselves and their peers. *Contact [vneeb@callahan.com](mailto:vneeb@callahan.com) to register or for more information.*

### TRENDWATCH 2Q 2013

Aug 22 & 23 | Online

Join hundreds of credit union employees who want to identify the areas of focus that will drive a successful 2014 strategic plan. Learn about second quarter performance data and trends through credit union case studies and Callahan executive analysis. *Visit [www.creditunions.com/connect/calendar](http://www.creditunions.com/connect/calendar) to learn more or to register for this free webinar.*

### BUILDING A SUCCESSFUL & RESPONSIBLE SMALL BUSINESS LENDING PROGRAM

Aug 28 | Online

Members Choice Credit Union seized the opportunity to lend to local businesses when banks began to pull out of the market in 2009. The credit union is now the ninth-largest SBA lender in the Houston market, which is the fourth-largest district in the nation. Learn first-hand from Members Choice about the steps it took to build a responsible business lending program and become a top 10 SBA lender. *Visit [www.creditunions.com/connect/calendar](http://www.creditunions.com/connect/calendar) to learn more or to register for this one-hour webinar.*

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# BUILDING A STRONG CREDIT UNION

Good practices make for a positive future.

**JUSTICE FEDERAL CREDIT** Union (\$596.5M, Chantilly, VA) was chartered in 1935 to serve the U.S. Department of Justice. Now, it also serves employees and family members of Homeland Security, U.S. and District of Columbia courts, the Georgia Department of Public Safety, 11 law enforcement groups — such as the National Sheriffs’ Association — and many private contractors who serve the national law enforcement community. It has 58,000 members, 22 full-service and boutique branches, and nearly \$600 million in assets.

Here, CEO Pete Sainato reflects on the opportunities Justice FCU has taken advantage of over the past few years and how the credit union plans to proceed to retain its positive momentum.

## HOW ARE THINGS AT JUSTICE FEDERAL CREDIT UNION?

**Pete Sainato:** We see a great future at Justice FCU. We have a firm foundation and strong momentum. The years 2010 to 2012 were the best years in our history. We planned cautiously during the years before the credit crisis. When the credit crisis hit the economy, it was much harsher than we anticipated; however, we were more prepared. We proceeded with cuts, as did nearly all credit unions, but we never trimmed back on efforts to retain the closeness and support of our members.

## SO THE DARK YEARS OF 2008 AND 2009 OFFERED YOU SOME OPPORTUNITIES?

**PS:** Some Fortune 500 companies trimmed back on what they were doing to support law enforcement during the recession. We kept up with our sponsorships and remained visible to the national law enforcement community.

In addition, while other large financial service providers raised fees and showed they were not as welcoming, we showed we cared and worked diligently to assist our membership. We demonstrated not only that we had been around a long time

but also that we were strong enough to stay the course. Our members are smart, skeptical, examining people, and we believe they saw firsthand the value in what Justice FCU has to offer.

## YOU’VE ALSO BEEN EXPANDING? SOME OF THAT BY MERGER?

**PS:** Yes. Lately we have had as much business — or more — as we can handle. We acquired the former Georgia Department of Public Safety Credit Union through a merger last year. That provided exposure in Atlanta. We’ve also expanded our reach in Chicago, San Diego, and West Virginia.

## HOW DOES THE REST OF THE YEAR LOOK?

**PS:** For the remainder of this calendar year we anticipate earnings to be slightly lower due to the interest margin squeeze. However, we continue to work our ALM strategies and be proactive. For example, when mortgage interest rates first rose in May, we quickly hedged our exposure so we could continue to make profitable mortgages.

We expect mortgage lending to continue to increase. We are seeing more people anxious about rising mortgage interest rates, and they have begun to take ac-



Pete Sainato

CEO, Justice Federal Credit Union

### CU QUICK FACTS

#### **JUSTICE FEDERAL CREDIT UNION**

HQ: Chantilly, VA  
Assets: \$596.5M  
Members: 55,932  
12-MO Share Growth: 8.90%  
12-MO Loan Growth: 10.00%  
ROA: 0.61%

tion. This is a positive sign for Justice FCU and the economy. We want to be ready to welcome this stream of business.

We are also closing more business loans than we have in the past and expect this to continue. Compared to previous years, we are seeing larger companies coming to us for member business loans. With interest rates at a historic low, we anticipate healthy lending in this area.

Auto lending is solid, though this year might not be as strong for us as last year when our auto loan growth rate was more than 20%.

One of our most popular loans on the consumer side is the consolidation loan. Members are unhappy with paying high interest credit cards elsewhere and have been coming to us to switch out of them.

“We are seeing more people anxious about rising mortgage interest rates and they have since begun to take action.”

— Pete Sainato, CEO, Justice Federal Credit Union

### WHAT STRUGGLES DO YOU EXPECT AHEAD?

**PS:** Justice FCU’s loan-to-share ratio has been 80%, and we work hard to maintain this healthy ratio. It is a daily struggle, but we expect to hold it, for one, by increasing our wallet share from our members’ eligible family.

We have also experienced a sizeable increase in loan pay-downs, which shows there is anxiety about the future of the economy among members. We believe this unrest might be due to their worries about the sequestration of federal funds and expected furloughs.

### SO WHAT POSITIVE SIGNS DO YOU SEE FOR JUSTICE FCU IN THIS ECONOMY?

**PS:** Our member satisfaction rankings have been rising since 2008. In fact, they have risen to levels we had not imagined — 2012 was an all-time historic record for us. We believe through the rough economic times, members experienced the value we provide and always have provided. Members have demonstratively acknowledged this in our service satisfaction rankings.

### YOUR 12-MONTH MEMBER GROWTH AS OF MARCH 31, 2013, WAS 9.02%. WHERE ARE NEW MEMBERS COMING FROM?

**PS:** We believe a high percentage of new growth will come from people giving up their existing bank relationships. We realize it’s tough for people to surrender relationships built over years. People seem to have to go through five or six bad experiences before switching. However, as noted

earlier, our potential members are from the law enforcement community, people who recognize value. They realize we have a growing presence at their conferences and elsewhere. This growing presence demonstrates we are increasingly the tested and trustworthy financial service provider for the law enforcement community and their families.

### HOW DO YOU RETAIN NEW MEMBERS?

**PS:** We concentrate on service. We understand people who come to us from other financial service institutions could leave us if we do not seal the relationship. That is just one reason we pay so much attention to our member satisfaction rankings. When service testimonial letters arrive — and we normally receive one a week — we post them on our intranet so all staff can read about the excellent level of service. I make a point of personally reaching out to each of these employees and thanking them for their exemplary service.

### HOW ARE YOU GOING TO “FACE THE PUBLIC” FOR THE REST OF THE YEAR?

**PS:** We will continue to market heavily to our affiliates. We have learned that marketing within our affinity groups is an efficient way of reaching potential members. Our marketing efforts consist of direct mail, email, and national media campaigns consisting of radio, online, print, and posters in transit systems such as the Washington, DC, metro. Our newsletter, Justice for You, is popular with our members; in fact, it is one of the most-read products we distribute. And we will continue to have a high profile

presence at law enforcement conferences through sponsorships and interactive display booths.

### WHAT ABOUT NEW TECHNOLOGY?

**PS:** We’ll be investing in our branches in the future. We’ll be moving away from the traditional branch to a more concierge-like environment; there will be biometrics, more support for mobile devices and the like — more high-tech, high touch, services.

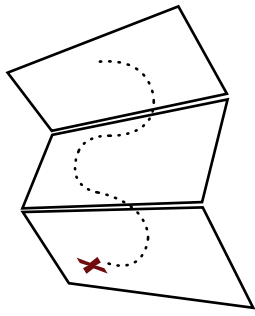
### DO YOU HAVE ADVICE FOR OTHER CREDIT UNIONS FOR THE REMAINDER OF THE YEAR?

**PS:** To be a strong credit union these days, it’s simple — take care of your members and take care of your employees. If you have to ask for sacrifices from employees — as we did during economic tough times — pay them back. We made 2012 the “Year of the Employee” to recognize the sacrifices our employees made to bring us through the toughest years in our history. We gave back in numerous ways and paid the highest employee incentive payout in our history.

Lastly, don’t be so cautious that you miss opportunities as the economy is improving. Look at rising interest rates for the opportunities they will afford. ✕

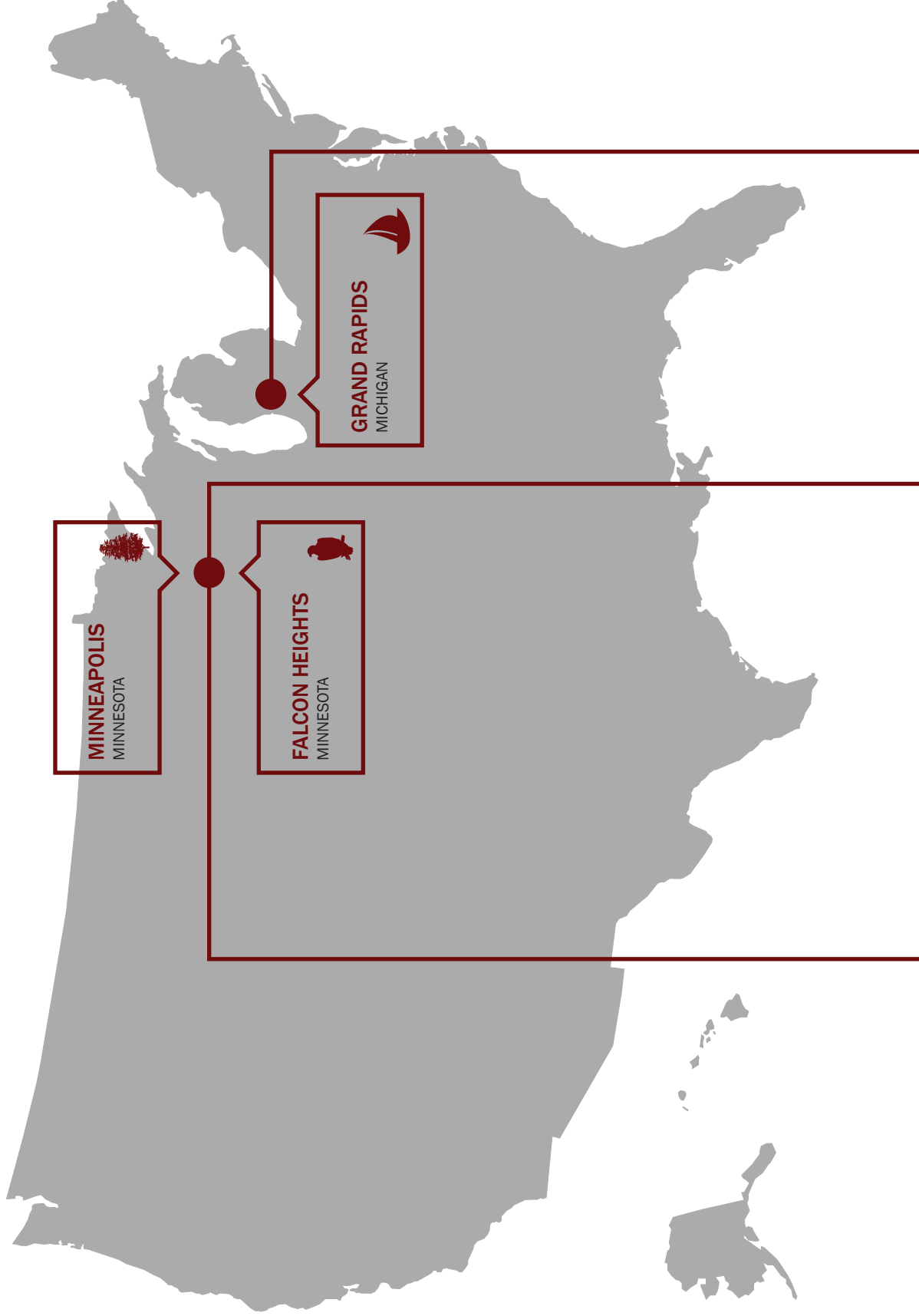
“We’ll be investing in our branches in the future.”

— Pete Sainato, CEO,  
Justice Federal Credit Union



# NOTES FROM THE ROAD

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



## CALLAHAN'S CFO ROUNDTABLE



### MINNEAPOLIS MINNESOTA

*Callahan's Roundtable Series for leadership clients provides an open forum for credit union leaders to discuss the challenges and opportunities facing their roles. In July, the Callahan team escaped the DC humidity to host a geographically diverse roundtable with representation from credit unions ranging in assets from \$153 million to \$5 billion. Callahan EVP Jay Johnson moderated the discussion.*

After a hearty dinner at Manny's Steakhouse the night before the roundtable, we were ready to solve the industry's problems. A number of trends have emerged from this year's roundtables. How to manage expenses, enhance productivity, and improve profitability in today's rate environment has been a popular area of discussion. So has sharing new investment strategies and how to devote the necessary resources to compliance and risk management roles. And because this was a CFO roundtable, attendees discussed their evolving — and sometimes changing — roles.

The final CFO Roundtable for 2013 will take place on August 21 in Seattle. Contact Victoria Neeb at [vneeb@callahan.com](mailto:vneeb@callahan.com) or (202) 223-3920 x248 for additional information.

## SPIRE FEDERAL CREDIT UNION



### FALCON HEIGHTS MINNESOTA

*Callahan writers Aaron Pugh and Drew Grossman traveled north to Minnesota for two days of on-site interviews and filming of the next installment of CUSP's ANATOMY series. Although the duo was momentarily distracted by the Mall of America's abundant roller coasters, such amusement did not distract the team from reaching their ultimate destination: SPIRE Federal Credit Union (\$603.6M, Falcon Heights, MN).*

SPIRE Federal Credit Union was founded in 1934 as Twin City Oil Co-Ops Credit Union. In 2008, the credit union transitioned from its original moniker to the name SPIRE, meaning the highest point or summit of something. The great recession has ensured the new brand's climb to the top of the market would not be easy, but SPIRE's story is a testament to the benefits that perseverance and a dedicated vision can unlock.

The credit union posted a notable first quarter 2013 performance: 1.24% ROA, 2.59% annual loan growth, and 2.5% annual membership growth. It also has achieved back-to-back record net income (prior to corporate assessments) the past three years. Such success is the result of strategic shifts and enhancements to its operation, culture, and community partnerships. Read more about SPIRE in the second quarter 2013 issue of CUSP.

## XTEND ANNUAL CONFERENCE

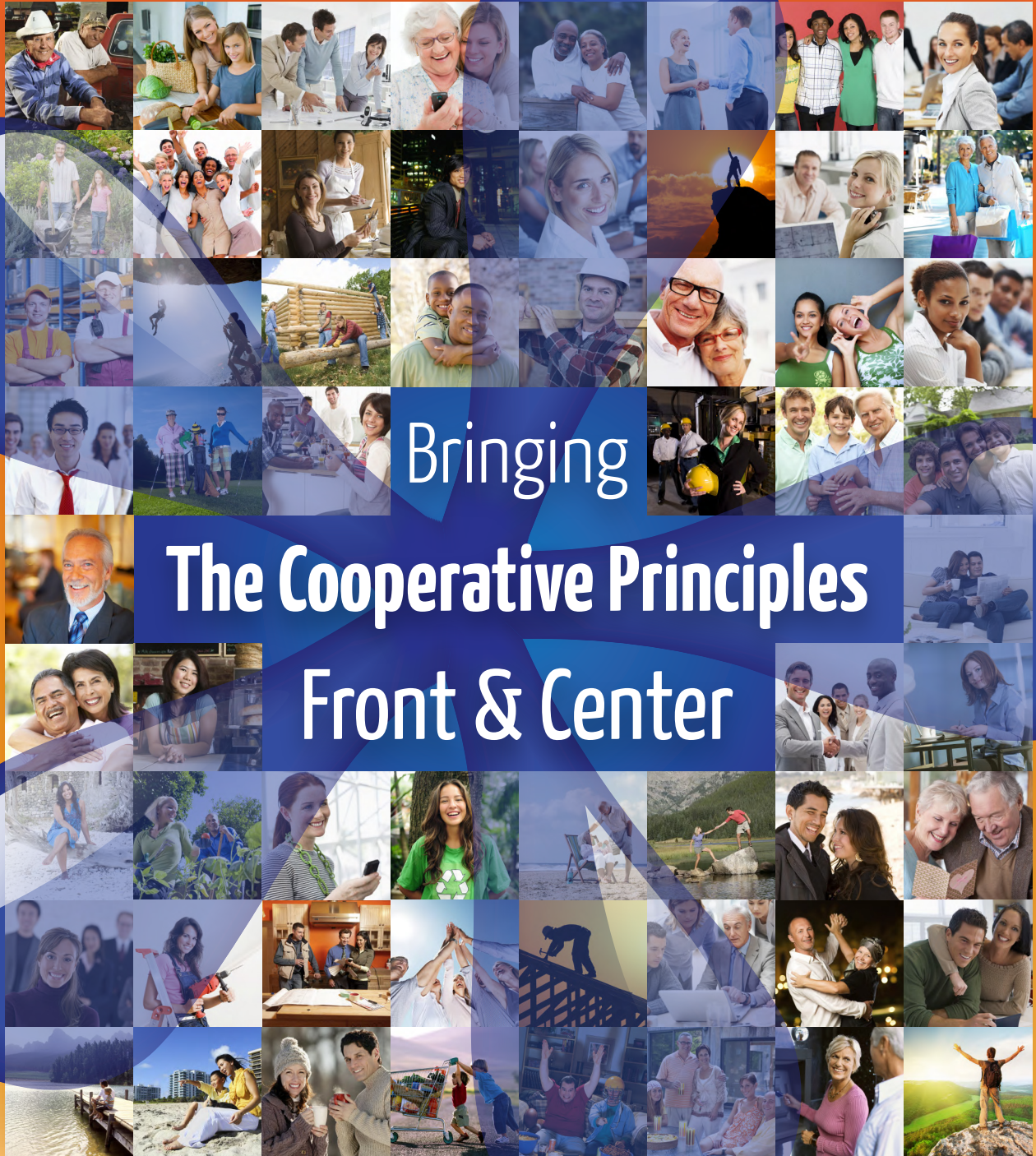


### GRAND RAPIDS MICHIGAN

*Kevin Heal, vice president of sales and business development for CUFSLP, traveled to Michigan in June for the XTEND stockholders' meeting and leadership conference. There, attendees networked with peers and learned what's on the horizon for 2013. XTEND is a distribution partner of the Trust for Credit Unions' mutual funds.*

XTEND CEO Scott Collins highlighted the Trust for Credit Unions (TCU) funds numerous times in his speech to the Xtend partners. We signed a distribution agreement with the CUSO in February, so we had a booth alongside CU Student Choice. We received some decent traffic and had insightful conversations with potential investors.

The credit unions that visited with us were familiar with the TCU funds and wanted more information, so we gave them informational packets for their boards and management. It typically takes smaller credit unions approximately six to nine months before the board and executive management approves and gets comfortable with the funds. On-site visits, seminars, and conferences in conjunction with our distribution partners all provide an important way to reach credit unions and tell them about this investment strategy.



# Bringing The Cooperative Principles Front & Center

We live it **every day.**



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