



**SACRAMENTO**  

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**CREDIT UNION**  
*Invest in Sacramento*

**2008**

**ANNUAL REPORT**

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## Board of Directors' and President's Report

Consumer confidence plunged in the wake of the economic turbulence of 2008. As a government employment hub and an area hard hit by declining property values, the Sacramento Region's financial outlook has been significantly challenged. The commitment to improve the financial well being of Sacramento Credit Union members is of even greater importance in such times. The Board of Directors and management team took actions throughout the year to support this pledge.

Financial indicators were monitored even more closely to assure business decisions would uphold the credit union's integrity. Through diligent asset liability management and with the recommendation of the credit union's CPA firm, the Board authorized a \$1.2 million entry to fortify the allowance for loan and lease losses, leaving the capital position in excess of 13%. Lending standards served well in these unprecedented times, and there was no need to restrict or alter lending practices. The credit union's cost control program was revisited to bring expenses in line with revenue streams. This campaign led to a \$500,000, or 5.00%, reduction in operating expense, including employee compensation and benefits, while maintaining the work force. Both state and federal regulatory agencies audited Sacramento Credit Union in 2008. Neither found any material weaknesses, a testament to the safety and soundness of your credit union.

Sacramento Credit Union serves as a member advocate to accommodate a broad spectrum of financial needs not only during times of prosperity, but also during household financial disruptions. The mortgage industry decline and job losses have posed a threat to home ownership. The credit union has aided members to preserve home ownership by working out loans to accommodate their short term and long term outlooks. Financial planners were made available free of charge to help members achieve a successful monetary plan, including making calls on their behalf to their first mortgage holders. Members employed by the State of California were offered assistance during the state budget impasse. Sustaining the financial stability of the membership is as important as building the member relationship.

In addition, technology and product enhancements were realized in 2008. The credit union's web site was redesigned to improve functionality and fulfill the online commitment. Online account opening and funding were introduced for member convenience. These online activities satisfy Bank Secrecy Act requirements in accordance with U.S. government regulations. Management embarked upon a card conversion project to reduce cost, forge a strategic vendor relationship and improve fraud detection. The conversion will take place in first quarter 2009. Free Music Checking was added to the credit union's suite of free checking products. Business checking is in the final exploratory phase as the credit union prepares to expand services to small businesses.

It is our ongoing goal to add value by saving you time, saving you money, earning you money, providing convenience and giving you peace of mind. Through our Sales and Service Culture, we strive to bring these attributes to every member household.

Submitted by: Terry Tice, Chairperson, Board of Directors

Jerrold A. Kinlock, President/CEO



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## Secretary-Treasurer's Report

Audited net earnings for fiscal year ended September 2008 were negative \$537,789, equivalent to negative 18 basis points on average assets of \$305 million. Reflecting the economic downturn that commenced in late fall 2007, these figures are down markedly compared to prior fiscal year figures of \$2,300,816 and 71 basis points on average assets of \$323 million.

Of the 89 basis point unfavorable variance in net earnings, 20 pertain to net interest margin and 69 to net operating expenses including provision for bad debt. Closer inspection of the change in net interest margin reflects the fact that loan balances contracted 23% on the heels of a 17% drop across the prior fiscal year. With the resulting surplus funds deployed in lower yielding investments, the yield on assets plummeted 65 basis points. Conversely, cost of funds could only be trimmed 45 basis points, resulting in the net 20 basis point drop in net interest margin.

The credit union did, however, record less operating expense and more non-interest income. Compared to 2006 - 2007, the former contributed 20 additional basis points to ROA and the latter a more moderate three additional basis points. This leaves provision for bad debt to explain the remainder of the 2007 - 2008 net earnings loss. In terms of basis points, the provision went up 92 basis points from 27 to 119, as explained below.

During fiscal 2007 - 2008, \$2.5 million in loans were charged off, up significantly from the \$1.1 million incurred in 2006 - 2007. Contributing to this increase was the economic malaise. It should be noted that around 40% of loan losses are traceable to loans acquired via the March 2007 merger of Golden State Federal Credit Union. As a result of weakened loan quality, provision for loan loss increased \$2.76 million from the \$0.88 million recognized in 2006 - 2007.

Despite the 2007 - 2008 net earnings loss, the all important ratio of net worth to average assets remained at 14% throughout the year. Maintaining the ratio was largely possible because the \$537,000 contraction in net worth was offset commensurately by contraction in total assets.

Growth remains a formidable challenge for Sacramento Credit Union. In the 17 months since the Golden State merger, average assets have contracted 14 months and loans have contracted 17 months.

Submitted by: Janet Reeves, Secretary-Treasurer, Board of Directors



## Lending Report

During fiscal year 2008, Sacramento Credit Union funded \$45 million in consumer loans and \$28 million in residential first mortgage loans, decreases of 13.25% and 33.39%, respectively, from the prior year. This drop in loan production is a result of low consumer demand for auto loans and the challenges associated with the deterioration of the residential real estate sector.

Consumer loan originations are expected to remain challenging in 2009 because of continued low consumer demand for auto loans. However, there is potential to increase refinance and purchase originations of residential first mortgage loans with the recent lowering of interest rates and of home prices. It is always the credit union's goal to offer members the most comprehensive selection of mortgage options. As a Federal Housing Administration (FHA) approved originator, a CalHFA participant, and a long term associate of the Federal National Mortgage Association (FNMA), SCU will continue to have access to the most complete loan programs available during these turbulent times.

For the fiscal year ending September 31, 2008, net charge-offs as a percentage of average loans were 1.23%, a 96 basis point increase from the prior year. Increased losses resulted from charge-offs in the second mortgage loan portfolio directly related to the deterioration of property values and higher than anticipated losses associated with the loans acquired as part of the March 2007 Golden State Federal Credit Union merger. With an increasing unemployment rate that is projected to reach ten percent in the Sacramento Metropolitan Area and continuing deterioration of property values caused by the large inventory of unsold foreclosed homes, increases in delinquency and charge-offs are expected in both the real estate and auto loan portfolios through the end of 2009.

<u>Loan Type</u>	<u>Percent of Portfolio Mix</u>	<u>September 2008</u>	<u>September 2007</u>	<u>Variance</u>
Automobiles	42.1%	\$ 70,760,713	\$109,334,616	(35.28%)
VISA & All Other	6.2%	\$ 10,341,202	\$ 9,952,695	3.90%
Commercial	0.9%	\$ 1,568,476	\$ 2,029,109	(22.70%)
Mortgage*	50.8%	\$ 85,357,574	\$ 95,283,230	(10.42%)
Total	100.0%	\$168,027,965	\$216,599,650	(22.42%)

\*Does not include loans sold to investors.



## Supervisory Committee Report

McGladrey & Pullen, LLP, Certified Public Accountants, were retained to perform the 2008 annual audit of the credit union's financial statements. Their examination included a study and evaluation of Sacramento Credit Union's accounting systems, procedures, internal controls and other auditing procedures sufficient to provide assurance that the financial statements are accurate.

The comparative highlights from the credit union's audited financial statements for the 12 month period ending September 30, 2008, are as follow:

### Key Financial Performance Comparison Fiscal Year Ending September 30, 2008

<u>Performance Category</u>	<u>September 2008</u>	<u>September 2007</u>	<u>Variance</u>	
Assets	306,797,180	317,111,018	( 10,313,838)	( 3.25%)
Net Loans	165,517,382	215,535,879	( 50,018,497)	( 23.21%)
Member Deposits	261,227,877	271,307,915	( 10,080,038)	( 3.72%)
Net Capital	42,411,963	42,949,751	( 537,788)	( 1.25%)
Interest Income	15,327,050	18,327,401	( 3,000,351)	( 16.37%)
Less Cost of Funds	5,988,846	7,804,659	( 1,815,813)	( 23.27%)
Net Interest Margin	9,338,204	10,522,742	( 1,184,538)	( 11.26%)
Less Provision for Bad Debt	3,642,460	877,959	2,764,501	314.88%
Add Non-Interest Income	4,478,094	4,626,978	( 148,884)	( 3.22%)
Less Operating Expenses	10,711,627	11,970,945	( 1,259,318)	( 10.52%)
Net Income	(\$ 537,789)	\$ 2,300,816	(\$ 2,838,605)	(123.37%)

The Supervisory Committee meets periodically with management and independent accountants to review the work of each and to satisfy itself that each person properly discharges his or her responsibilities.

Additionally, the Committee has reviewed and examined various internal credit union policies and procedures throughout the year. It is the opinion of the Committee that Sacramento Credit Union properly discharges its financial responsibilities and that it has continued its growth and development as a solid financial institution.

Submitted by: Beverly Skeaton, Chairperson, Supervisory Committee



## LOCATIONS

**Elk Grove**

**9160 East Stockton Boulevard, #120**

**Fair Oaks**

**8100 Madison Avenue**

**Sacramento**

**3660 Bradshaw Road**

**800 H Street**

**3045 Arden Way, Suite 200**

**6121 Franklin Boulevard**

**Kaiser Hospital, 6600 Bruceville Road**