



**SACRAMENTO**

**CREDIT UNION**

*Invest in Sacramento*

**2006**

**ANNUAL REPORT**

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## Board of Directors' and President's Report

Sacramento Credit Union completed its 71<sup>st</sup> year of business with strong performance on many levels. This success stems from member stakeholder support, the Board of Directors' and management's clear vision for the credit union and the efforts of an outstanding staff. Sacramento Credit Union continues to evolve as a distinctive, innovative, full service financial institution.

Despite market fluctuations and changes in the business environment, we have reached another rung on the ladder in our continuing journey for financial growth. At the same time, we have managed to a safety and soundness platform to withstand the unprecedented interest rate risk environment of recent years. In this enduring quest for financial success, equal emphasis is placed on building a Sales and Service Culture that is measured by member feedback obtained via independent surveys. We are extremely pleased that these surveys reported further improvement in member satisfaction throughout the year.

Products and services not reflected on the balance sheet are offered through business partners selected for their volume and service standards for improving the financial well being of members. In 2006 the credit union funded first mortgage home loans totaling \$50.6 million and assisted members with their financial planning via alternative investment products totaling \$9.3 million.

Simultaneously behind the scenes, the Board of Directors and management were taking actions to further the strength of the organization. The merger of a local credit union having assets of \$20 million was successfully negotiated in the fall. The Department of Financial Institutions approved the expansion of the field of membership into four additional counties.

Faced with the prevailing threat of fraud that jeopardizes consumer confidence, proactive steps were taken to enhance prevention, early detection and alert programs to protect the membership. Sentry 7 is the multi-layered, sophisticated networking system implemented to bridge security concerns with user friendliness, while maintaining 24/7 uninterrupted service. Examples include a neural network applicable to plastic cards that protects the membership from merchants that do not comply with VISA procedures. E-alerts were rolled out to allow individual member customization for online account activity. SCU was the first credit union in Sacramento to integrate standards for electronic settlement established by the Federal Reserve Bank, otherwise known as Check 21.

As our tagline *Invest in Sacramento* suggests, the volunteers, management and staff of the credit union are committed to making a visible contribution to the community with the support and assistance of the membership. During the course of 2006, monetary and in kind donations were made to the Sacramento Children's Home, Children's Miracle Network, United Way, Salvation Army, Volunteers of America and the Susan B. Komen Foundation. In partnership with Volunteers of America, the first steps were taken toward a future housing project for low to very low income Sacramento County residents. Although small contributions toward major concerns, this is part of our commitment to enrich the community we serve.

Submitted by: Les Brown  
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 2006 are \$3,214,430 or 103 basis points, down slightly compared to \$3,519,410 or 118 basis points for fiscal year ended September 2005. Net worth increased nearly 9%, similarly down compared to the 10% growth achieved during the prior 12 month period. However, the ratio of net worth to assets increased substantially to 12.0% compared to the 11.3% recorded effective September 30, 2005. This ratio continues its ascent in response to a decade long trend where growth in net worth has outpaced growth in assets.

Sluggish growth continues to pose a huge challenge, not only to Sacramento Credit Union, but also to the credit union industry. SCU deposit growth for fiscal 2005 – 2006 ended slightly positive as a result of the successful certificate program.

Compressed interest margins present another perplexing challenge to financial institutions in general. At SCU during fiscal 2005 – 2006, cost of funds increased \$1,808,358, while interest income increased only \$1,755,202. As a result, net interest margin slipped to 317 basis points, down 18 basis points from 335 basis points recorded during the prior fiscal year. SCU's higher than industry standard capital position more than compensates for the change in this area.

Slow growth and receding margins put pressure on the other components of net earnings. That is, credit unions must look to other income, operating expenses and loan quality to take up the slack in net earnings. Sacramento Credit Union has managed the first two components well and has markedly outperformed peers in the third component, provision for bad debt.

Rigorous underwriting standards and collection procedures have delivered very high credit quality with the resultant diminished requirement for loan loss reserves. Thus, 60 day delinquency has been reduced by half from 0.27% for fiscal 2004 – 2005 to 0.13% for fiscal 2005 – 2006. Charged off loans, respectively, have been reduced from 0.66% to 0.31%. Together, these impressive improvements in credit quality have reduced fiscal year provision for bad debt an astonishing 97% from \$544,138 to a mere \$15,402.

In summary, despite the challenge of shrinking margins in a very competitive, slow growth environment, net capital and liquidity risk position are sound. Since the year 2000, rolling 12 month net earnings have equaled or exceeded 100 basis points. In anticipation of an elevated interest rate risk environment, management forecasted accordingly and analyzed quarterly for potential course corrections. Plans are underway to expand products and services to benefit the members and maintain future growth.

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



## Lending Report

Sacramento Credit Union experienced moderate loan growth in its operation during fiscal year 2006. During this period, the credit union funded \$102 million in consumer loans and \$60 million in residential first mortgage loans, a decrease of 24% and 14% respectively from the prior year. This decrease in production resulted from lower consumer demand for new vehicle loans and the increase in mortgage interest rates.

The credit union's Residential Lending Department and Consumer Loan Department have enhanced marketing efforts to attract new borrowers. Outside sales representatives have been added to the staff to market SCU mortgage loan products to realtors. An indirect lending relationship has been established to attract swimming pool and other home improvement second mortgage borrowers. To manage the interest rate risk associated with holding fixed rate first mortgage loans, the credit union routinely sells these mortgages to a number of investors, including Indy Mac Bank, PHH Mortgage, Country Wide Mortgage Company and the Federal National Mortgage Association.

While loan volume increased during the period, the overall quality of the loan portfolio continued to remain strong. Loan charge-offs net of recovery were 0.24%, a reduction from the previous year.

<u>Loan Type</u>	<u>Percent of Portfolio Mix</u>	<u>September 2006</u>	<u>September 2005</u>	<u>Variance</u>
Automobiles	54.3%	\$142,346,405	\$143,875,913	( 1.06%)
VISA & All Other	3.4%	\$ 8,799,648	\$ 8,080,342	8.90%
Commercial	0.5%	\$ 1,294,703	\$ 449,382	188.11%
Mortgage*	41.8%	\$109,678,567	\$ 93,452,333	17.36%
Total	100.0%	\$262,119,323	\$245,857,970	6.61%

\*Does not include loans sold to investors.

Submitted by: Jim Kelly  
Vice President, Lending and Retail Operations



## Supervisory Committee Report

McGladrey & Pullen, LLP, Certified Public Accountants, were retained to perform the 2006 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, 2006, are as follow:

### Key Financial Performance Comparison Fiscal Year Ending September 30, 2006

<u>Performance Category</u>	<u>September 2006</u>	<u>September 2005</u>	<u>Variance</u>	
Assets	327,169,201	319,109,780	8,059,421	2.53%
Net Loans	261,993,135	245,244,027	16,749,108	6.83%
Member Deposits	285,539,026	281,213,131	4,325,895	1.54%
Net Capital	39,287,218	36,072,788	3,214,430	8.91%
Interest Income	15,717,828	13,962,626	1,755,202	12.57%
Less Cost of Funds	5,793,571	3,985,213	1,808,358	45.38%
Net Interest Margin	9,924,257	9,977,413	( 53,156)	( 0.53%)
Less Provision for Bad Debt	15,402	544,138	( 528,736)	(97.17%)
Add Non-Interest Income	4,205,703	4,561,068	( 355,365)	( 7.79%)
Less Operating Expenses	10,900,128	10,474,933	425,195	4.06%
Net Income	\$ 3,214,430	\$ 3,519,410	(\$ 304,980)	( 8.67%)

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: Patricia Wilcox  
Chairperson, Supervisory Committee



## LOCATIONS

**Elk Grove**

**9160 East Stockton Boulevard, #120**

**Fair Oaks**

**8100 Madison Avenue**

**Sacramento**

**3660 Bradshaw Road**

**800 H Street**

**2255 Watt Avenue, #10, (ATM Only)**

**3441 Arden Way**

**Kaiser Hospital, 6600 Bruceville Road**