Callahan's
CREDIT UNION REPORT
At the Leading Edge of Credit Unions

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CALLAHAN & ASSOCIATES
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BUILDING A NEW FUTURE FOR HOUSING FINANCE

THE INDUSTRY HAS HIT A NEW ALL-TIME HIGH FOR MORTGAGE MARKET SHARE. NOW IT'S TIME TO RAISE OUR COLLECTIVE AMBITIONS.

THE NATION'S HOUSING MARKET HAS CHANGED TREMENDOUSLY SINCE THE CREDIT CRISIS OF 2008 AND 2009, BUT THE CHANGE IS NOT OVER. Three of the largest lenders—Countrywide, Washington Mutual and IndyMac—are gone. Bank of America is retreating from the mortgage market, and Citi has significantly tightened its correspondent channel. The future of Fannie Mae and Freddie Mac is uncertain—if they survive, they are likely to look starkly different. Meanwhile, credit union market share of the nation's first mortgages has risen from 2% to an all–time high of more than 8%.

Credit union momentum comes as the nation is struggling with housing finance policy. November's national elections will stimulate proposals from both political parties that might aim to appease voters rather than create sustainable, long–term policy. The nation needs an informed discussion on housing finance reform. Credit unions have the chance to play a role in this discussion and help shape policy. The industry's record lending, including mortgage lending, since 2007 validates the important role cooperatives play in local economies. Given the uncertainty surrounding the future of mortgage finance, credit unions have the opportunity to assert their place at the table.

Credit unions need to be a strong voice

in this discussion for many reasons. Credit unions are resolute in their communities. Collectively they form a tapestry of insight and action that is woven into their communities. They are not a network imposed from a home office in San Francisco, New York, or Charlotte. This locally informed approach is the antithesis of the nationwide banks', who manage from a remote board room. Credit unions choose bettering communities and members' lives over simple profit and cash flow. And they're winning with this strategy, emerging as a leader in the national mortgage market while quadrupling their market share in only five years. It's an extraordinary gain that makes the case for our active participation in a thoughtful discussion of a new national housing finance strategy.

MARKET SHARE: PRESENT AND FUTURE

In 2006, when credit unions held just 2% of the mortgage market, the CU Housing Roundtable devised an ambitious BHAG (Big, Hairy, Audacious Goal) to achieve 10% by 2016, termed "2 to 10 in 10." The 8.2% share in the first quarter of 2012 is close to the 10% goal, which is imminently attainable given the market dynamics. Credit unions taken together are the third–largest mortgage lender after Wells Fargo, which has more than one-third of the market, and JPMorgan Chase.

It's time to raise our ambitions. Perhaps the goal should now be "8-20-20," meaning we should aspire to move from 8% market share to 20% by 2020. Is it possible? In 17 metropolitan statistical areas credit unions already originate in excess of 20% of all mortgages.

Now for the tougher questions: Is that goal desirable? Will meeting it make a difference to American families? If so, how can we achieve it?

FINDING POSITIVES IN A CRISIS

First, achieving 8-20-20 is possible. Credit unions' rise in mortgage market share has a number of sources. In the late 2000's, Bank of America and JPMorgan Chase absorbed Countrywide and Washington Mutual. Digesting these mortgage giants proved problematic for both institutions, which have since been reducing mortgage lending because of balance sheet constraints, legal liabilities, and delinquencies. Mortgage brokers went out of business. Some community banks and S&Ls suffered from lofty delinquency, liquidity issues, and a changing regulatory landscape. Their reaction — like that of the megabanks — has been to write fewer mortgages.

All the while credit unions have pressed ahead. They're serving their communities by educating, advising, and providing sensible mortgages to responsible borrowers. This ethos is reflected in a mortgage delinquency rate that peaked at 2.3% in 2010, one–fifth of the 10.6% peak for FDIC-insured institutions.

Although the mortgage market turmoil that played a role in credit unions' 8% market share has eased, the market is still in flux and more change is on the way, including continuing aftershocks from the 2008 economic calamity, unpredictable Congressional action, uncertain regulatory direction, and struggling megabanks.

But these are not the only changes in the mortgage market. Americans are increasingly discontent with banks and are moving to credit unions. The missteps of banks and the relative clean operation of credit unions have raised credit unions' reputations and visibility to new heights. Credit union membership growth is accelerating as a result, with more than 1.1 million members added in the past two quarters.

If credit unions do nothing, likely increases in mortgage market share will correspond with membership growth — but nothing more. If they seize the moment, however, credit unions can ensure mortgages uplift families rather than weigh them down. But it's going to take imagination, industry collaboration, and significant sacrifice before credit unions achieve that meaty 20% market share.

CHANGE IS UNDERWAY

Many facets of mortgage lending are uncertain, including the long-term roles of Fannie and Freddie. We can say with fair confidence, however, that the GSEs' role in the national mortgage market will be significantly diminished, if not terminated, in the coming years. Some in the public dialog have called for the unwinding of Fannie and Freddie, which would likely end the 30-year mortgage in this country. Others call for a redesign that limits the government role to insuring a tightly targeted segment of FHA, USDA and VA borrowers only and to providing general assurance only for catastrophic losses. Such insurance would sit behind a massive infusion of private capital that creditors would claim ahead of any government intervention.

The GSEs' role and support in the mortgage market will change. They will likely reduce their current 90+% market share to a more historic norm in the 60% range. The question is: What will fill the void?

If new non–agency alternatives do not emerge, the remainder of the nation's mortgages is likely to go to an effective oligopoly of the largest banks. Interest rate risk concerns at credit unions and NCUA would likely quash the option of retaining mortgages on the underwriters' balance sheets, especially for fixed rate, 30–year loans. The large banks will likely demand, and secure, the servicing. If credit unions lose this piece, will service released be service denied to credit union members?

Or maybe a new mechanism will arise for a secondary market and securitization, with one or more options rooted in the cooperative model. With competitors holding back and with more people turning to credit unions, now is the time to vigorously seize the market opportunity, starting with intra-industry mortgage sales. Credit unions have the capacity and liquidity right now to buy and sell mortgages among themselves. However, if they want to write 20%, or even 30%, of the nation's mortgages, they must eventually develop an outlet to outside investors.

Moving in that direction is going to take

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an industry-wide, conscious, cooperative effort. Growing market share organically and in traditional ways will likely leave credit unions short of an ambitious 20% market share goal.

CREDIT UNION ADVANTAGES

Credit unions can reach 20% market share by 2020—believe it!

Credit unions have a great story to tell. Aside from the growing discontent with banks, increasing credit union membership, rising market share, and strong balance sheets, potential investors will find several good qualities in credit union mortgages. They will like the strong relationship members have with their credit unions, the solid credit quality of credit union members, the low rate of credit union delinquencies and charge–offs, the reputation of credit unions for innovative products, and the ability of credit unions to sustain their communities such as through effective modification programs.

With regard to superior credit quality, rating agencies have lately been conducting 100% loan inspections in the wake of the subprime debacle and investors are following suit. More scrutiny will work to credit unions' advantage as the private secondary market is rebuilt from scratch, one loan at a time.

THE COOPERATIVE RESPONSE

What steps can credit unions take and what questions can they ask to get to 8–20–20? Here are a few starting points:

- Track market share in local communities as well as nationally. Where are credit unions succeeding? How can others replicate their marketplace success? What can we learn from the 17 communities in the U.S. where credit unions already originate at least 20% of mortgages?
- Understand how individual credit unions have successfully raised their profile in the mortgage market since 2008. Conclusions might lead to better courting realtors, being more aggressive in pursuit of purchase mortgages, and partnering with mortgage CUSOs and the like.
- In the first quarter, 4.4% (by number) of credit unions processed 80% of the industry's first mortgage originations. Which small credit unions have had success in mortgage lending? How can smaller institutions get involved with mortgage lending?
- Are there product innovations that are both balance sheet– and member-friendly that credit unions can develop? Are there lessons the industry can learn from markets outside the U.S.?
- What role will demographics play in the coming years? Housing affordability—tied to interest rates, home prices, and median income—is near its peak. Developing strong first–time home-buyer programs will not only capture a larger share of the purchase market but attract younger members.
- Begin a dialogue with potential outside investors such as insurance companies, pension funds, and Wall Street firms.
- Evaluate options such as participations, securitizations, credit union mutual funds, and credit union real estate investment trusts.
- Look at involving NCUA. For example, could NCUA guarantee mortgages the way it is now guaranteeing bonds? Spur NCUA to stimulate a national policy debate on housing finance.
- Follow, and influence if possible, changes in the structures of the secondary market through legislation and regulation.

This list sounds ambitious, but undertaking just a few of these moves will jump-start the industry. The window of opportunity is not going to stay open indefinitely. We should set our minds to our new goal and take the first steps now.

To that end, Callahan & Associates has been working with a group of credit unions that wish to explore the industry's role in creating a new paradigm for a secondary mortgage market. If you are interested in participating, please contact Michael Emancipator at (800) 446-7453 ext. 239.

—The Callahan Leadership Team

IN PERSON

WHERE YOU'LL FIND CALLAHAN IN JULY

JULY 10 -13
CUFSLP PARTNERS MEETING SEATTLE, WA

Seattle serves as the perfect backdrop for the CUFSLP Partner meeting, themed "How Cooperatives Create Value by Being More Cooperative." Many of Seattle's most successful businesses have been built upon a cooperative mindset. It is home to four of the most established co-ops in the country: REI, Group Health, PCC Natural Markets, and, one of our very own, BECU. Partners come prepared to share your biggest challenges and identify opportunities for collaborative solutions.

JULY 10
ACUMA REGIONAL WORKSHOP, BOSTON, MA

Lydia Cole, director of industry analysis, finishes a four-stop tour of the country showcasing the power of Callahan's latest software, MortgageAnalyzer, at ACUMA's regional workshop in Boston. In "Using Local Mortgage Data to Improve Market Share," Lydia helps credit unions understand how to measure their mortgage lending activity against their local credit union and bank competitors.

JULY 17
NCUMA'S SUMMER CONFERENCE,
PARADISE ISLAND, BAHAMAS

Scott Patterson, vice president of new business innovation, is presenting two sessions at this year's NCUMA conference:

- Credit Unions in 2012: A New Era for Members
- Four Issues to Jump-Start Your Executive Leadership's Strategic Thinking

JULY 24
CALLAHAN'S CLO ROUNDTABLE, DENVER, CO

Credit unions' collective market share is topping 8% for mortgages and 15% for auto loans, but there is still plenty of opportunity to grow your loan portfolio. In this open and off-the-record discussion, credit unions are encouraged to share the secrets of their success and discuss the challenges they face in growing their loan portfolio. Jay Johnson, executive vice president, will moderate the event and focus the discussion around "The Power of Local: Strategies to Win in Your Marketplace."

Call Victoria Neeb at (800) 446-7453
to register for either roundtable.

Interview By Brooke C. Stoddard

TALES OF A CREDIT UNION WITH 27% MORTGAGE MARKET SHARE

GREYLOCK FEDERAL CREDIT UNION SAYS SERVICE IS MOST IMPORTANT IN ACHIEVING AND SUSTAINING SUPERIOR MARKET SHARE.

GREYLOCK FEDERAL CREDIT UNION ($1.2B, PITTSFIELD, MA) BEGAN AS THE CREDIT UNION FOR THE PITTSFIELD, MA, GENERAL ELECTRIC CO. PLANT. When GE ceased operation in Pittsfield in the 1990s, Greylock—which is named for a local mountain—converted to a community charter in 1997. It now serves those who live, work, worship, attend school, or regularly conduct business in Berkshire County, which is the westernmost county in the state and has a population of 132,000.

According to the credit union, its loan portfolio is approximately 65% real estate, 25% auto, and 10% commercial. It holds $640 million in real estate loans on its books, $25 million of which is in fixed mortgages. It has sold $350 million of fixed mortgages to Fannie Mae, though retaining the servicing.

Lisa Trybus is the head of real estate lending and Marilyn Sperling is the CEO. Together they answered questions about Greylock's real estate lending. Greylock has captured 27% of the real estate market, and *The Callahan Report* wanted to learn how a credit union achieved an almost 30% mortgage market share.

WHAT ARE THE MAIN FACTORS IN YOUR SUCCESS AS A REAL ESTATE LENDER?

LISA TRYBUS & MARILYN SPERLING: Credit unions need to make sure they offer the mortgage products that meet the needs of the borrowers in their marketplace. When setting up our mortgage lending programs, it was important we had the appropriate mortgage options available to accommodate Berkshire County home buyers.

To grow market share, credit unions have to establish and foster relationships with those involved in the real estate mortgage process to earn their trust. Providing responsive and attentive service throughout the mortgage process is crucial to a successful operation. Realtors and attorneys have to believe, as we feel they do, that Greylock can handle a mortgage better than any financial institution in Berkshire County. We have been successful in earning their confidence. We hear from those in the community, realtors and attorneys, on just how pleased they are with our mortgage staff and the timeliness and simplicity of the mortgage process—evidence that people and relationships make a difference.

Equally important are experienced, well-rounded originators and underwriters. We have been fortunate in having a committed loan originator who is sought out by the local realtors and attorneys. She interacts with them regularly and follows up quickly. There is so much third–party involvement that takes place in putting a mortgage together and someone has to make sure everything and everyone is working toward a timely closing of the loan. Our loan originator is available to the realtors and attorneys just about 24/7, and they appreciate that.

DOES THE LOAN ORIGINATOR WORK UNDER AN INCENTIVE SYSTEM?

LT&MS: She does. She earns commissions. Return to the notion of service.

HOW DO YOU SEE IT? HOW IS IT IMPORTANT?

LT&MS: Realtors and attorneys want to complete mortgages quickly and easily. Some institutions are easier to deal with than others. We work hard to streamline the process from loan origination to closing, and we believe this increases referrals to us from realtors and attorneys.

There is another aspect to the loan originator here. She does an excellent job of visiting parts of the community and presenting extensive seminars for first–time homeowners. These seminars receive publicity in our newsletters and elsewhere and repeatedly draw sizeable audiences. The loan originator brings in third parties to talk about various aspects of the mortgage process. The seminars take place at various locations and are not mere one-hour events; each is a course that takes six hours to complete.

DID YOU MAKE A CONSCIOUS EFFORT TO EXPAND REAL ESTATE LENDING?

LT&MS: When we converted to a community charter we were very aggressive about getting the word out that anyone was eligible to join Greylock if he or she lived or worked in Berkshire County, that we were no longer an exclusive club. Mainly the marketing was through newspaper and radio, a little off–beat with some humor. We promoted attractive rates. At that time fixed rates were higher and it was common to have discounted adjustable rate mortgages.

We have been the leading real estate lender in Berkshire County for at least 15 years. When we decided to grow and expand our loan portfolio, we were not doing member business loans, so our options, at that time, for loan growth were consumer loans and real estate loans. Today, we have 27% of the Berkshire County mortgage market share and 90% of the auto loan market share.

Our best advertising, though, is word of mouth. Our rates are competitive, though

> "We have never gotten to a closing and not closed the mortgage. Some of the competition gets close to settlement and then the closing doesn't happen because something was not done correctly."
>
> *Greylock Federal Credit Union*

not always the lowest. It is the member-centric culture and outstanding service that makes us successful. That's what brings people here.

WHAT WAS THE COMPETITION AT THAT TIME?

LT&MS: Mainly it was local banks. The megabanks have never been considered competition in our market area. Some consumers go online to see what kind of rates they can get, but mainly the competition has been and continues to be local banks. We are a pretty parochial community—the community, the chamber of commerce, and the residents promote buying in the Berkshires, and supporting local institutions is very much a part of that effort.

WHAT IS YOUR MIX OF REFIS AND PURCHASE MORTGAGES?

LT&MS: In the past five years, not surprisingly, most of our loans have been refis. But a key factor in our success at market share has been not losing sight of the purchase market. We never want purchase mortgages to get lost in the shuffle. We meet all the dates and we close them promptly. We believe this is what sets us apart from the rest of the competition.

SO YOUR EDGE HAS LESS TO DO WITH THE FACT THAT YOU KEEP EXPENSES LOW THAN IT HAS WITH GOOD SERVICE?

LT&MS: Yes. As noted, our rates have not always been the lowest, so we feel our edge is in service. We have never gotten to a closing and not closed the mortgage. Some of the competition gets close to settlement and then the closing doesn't happen because something was not done correctly.

WHAT HAS HAPPENED TO YOUR LOAN PORTFOLIO SINCE THE CREDIT CRUNCH OF 2008?

LT&MS: We lost a little bit of market share. Fannie Mae tightened credit standards. What we lost was to a broker who wrote FHA loans. FHA has broader underwriting standards and some competitors jumped in to do them. We choose not to offer FHA programs. If we feel a member cannot fit into one of our products but might qualify for an FHA loan, we send that member to a local broker with whom we have a relationship. Conversely, if that broker is talking with a person he feels would be better in one of our loan programs rather than with an FHA loan, he refers that person to us. It's all about fitting the member into a product that works for the member.

HOW IS DELINQUENCY?

LT&MS: The current economy has created challenges for borrowers and financial institutions. We are having more tough conversations with members about the affordability of owning a home. Although we work hard with borrowers, sometimes the best solution is to sell the home. We work through each borrower situation one at a time.

HOW DOES THE STRUCTURE OF YOUR LENDING MANAGEMENT TEAM WORK?

LT&MS: We have a chief lending officer who is responsible for asset quality and our overall loan programs. Lisa manages the retail portion of lending—the consumer loans and mortgages—while another manager is responsible for member business loans. Our loan review officer reports to risk management. The CFO is responsible for the allowance for loan loss. There is a great deal of staff interaction among departments; this is very important.

WHAT'S IN YOUR CRYSTAL BALL FOR GREYLOCK AND FOR CREDIT UNION MORTGAGE LENDING ACROSS THE COUNTRY?

LT&MS: We're anticipating minimal growth in lending. Our portfolio is amortizing as quickly as we're putting on new loans. This is primarily due to the fixed rate mortgage activity and the subsequent sale of those loans.

The recession changed the way consumers think about debt. They are more careful about borrowing. Financial institutions are adjusting their strategies to accommodate this environment.

DO YOU USE A CUSO?

LT&MS: Yes. We have a CUSO for property and casualty insurance. It fits well in our business model. As the largest provider of home and auto loans, we can offer competitively priced insurance all under one roof. It's one more way to deepen the member relationship.

MIGHT THERE BE A FUTURE FOR A SECONDARY MARKET IN CREDIT UNION MORTGAGES?

LT&MS: If there was a secondary market for credit union mortgages, and the premium paid for credit union mortgages was more than Fannie was paying, we'd certainly look at it.

NOTES FROM THE ROAD

WHAT WE'VE LEARNED
FROM WHERE WE'VE BEEN.

ANATOMY ROAD TRIP: SPOKANE, WA

DAY 1

We started bright and early at Spokane Teachers. Our first interview (at 8 a.m.) was with the VP of lending. We also talked with the VP of operations, finance, marketing, and the CEO. We got some great insight into how Spokane Teachers views the role of credit unions in Spokane and the role of Spokane Teachers in the local credit union mix.

The interview that stands out the most to me is Tom Johnson, the CEO. He articulated very clearly why Spokane is a special market for credit unions: It is a large enough city to allow a lot of competition but it is too small for the national banks to heavily focus on it. This place is definitely NOT unbanked, there is practically a bank or credit union on every street corner.

DAY 2

Today we visited two credit unions, Spokane Media and Numerica. Spokane Media is a $10 million, SEG-based institution that serves Spokane's media market. Despite its size, it offers a range of products and has a robust relationship with its members. Numerica is a $1 billion, community credit union. Despite its size, it wants to treat every member as an individual.

Then we drove to Idaho because it was there. It. Was. Beautiful. And we saw a camel.

DAY 3

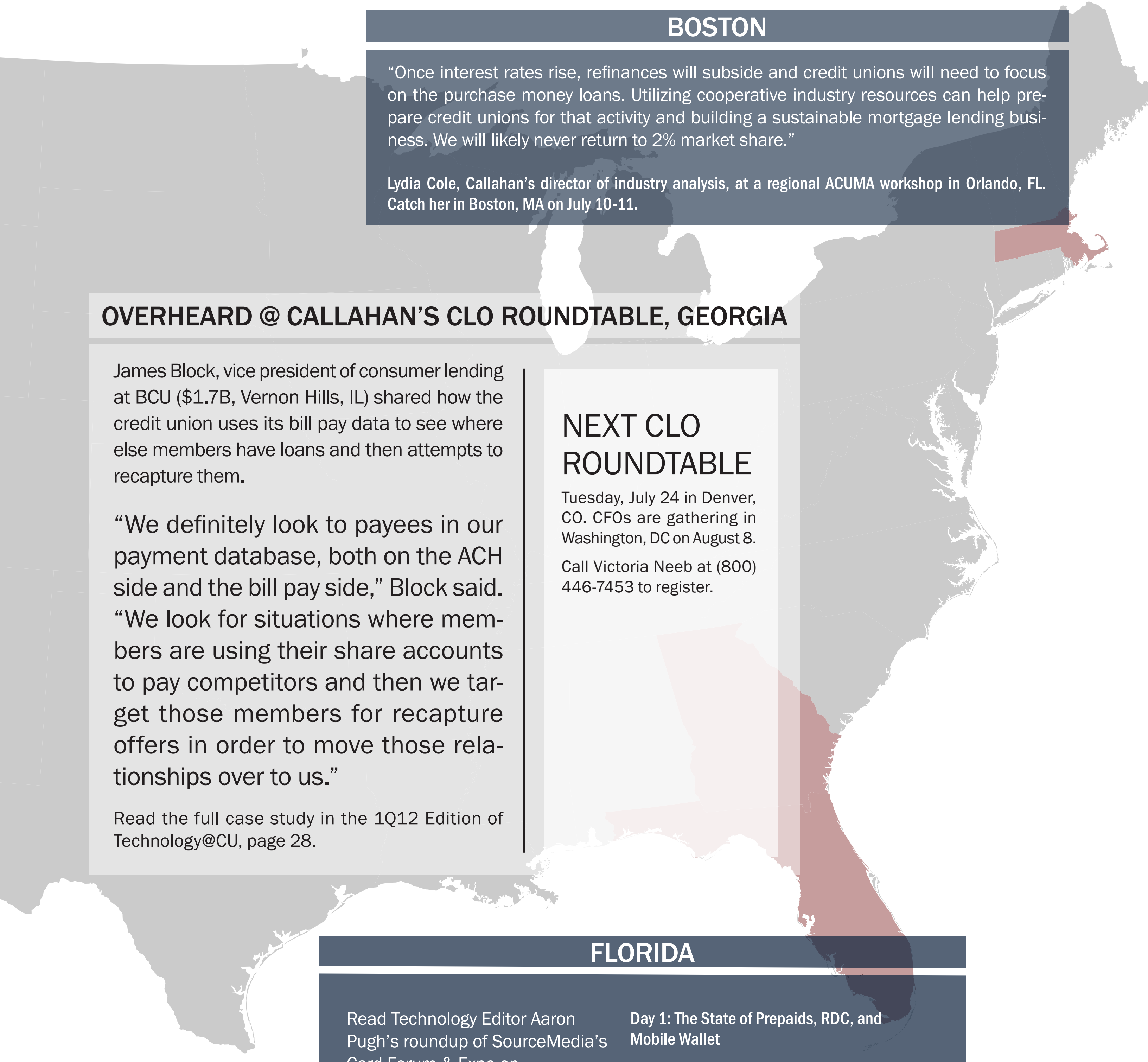
Camel sightings: 0
Gondola rides over Spokane Falls: 1

We bid Spokane adieu today. There was some rain, some sunshine, and an exciting ride over a flood-level Spokane Falls. We started the day at PrimeSource Credit Union ($48 million in assets) where we conducted a round-table style interview with the CEO and three senior officers. They are all enthusiastic about coming in to work and working with one another and it shows in the staff culture. After wrapping up with PrimeSource, we drove around Spokane for some b-roll.

In the afternoon, we headed to Numerica to interview the CFO. The way she talked about finances and performance was totally approachable. We got a glimpse into how Numerica benchmarks its performance and the way it looks at other credit unions and financial institutions in its market. Her thoughts on what makes Spokane special is right along what we've been hearing; it's just the right size market for credit unions.

Rebecca Wessler, Senior Editor and Melissa Forsyth, Video Producer

Read & Watch the entire on Anatomy of a Market: Spokane, WA in 1Q12 CUSP and on CreditUnions.com.



BOSTON

"Once interest rates rise, refinances will subside and credit unions will need to focus on the purchase money loans. Utilizing cooperative industry resources can help prepare credit unions for that activity and building a sustainable mortgage lending business. We will likely never return to 2% market share."

Lydia Cole, Callahan's director of industry analysis, at a regional ACUMA workshop in Orlando, FL. Catch her in Boston, MA on July 10-11.

OVERHEARD @ CALLAHAN'S CLO ROUNDTABLE, GEORGIA

James Block, vice president of consumer lending at BCU ($1.7B, Vernon Hills, IL) shared how the credit union uses its bill pay data to see where else members have loans and then attempts to recapture them.

"We definitely look to payees in our payment database, both on the ACH side and the bill pay side," Block said. "We look for situations where members are using their share accounts to pay competitors and then we target those members for recapture offers in order to move those relationships over to us."

Read the full case study in the 1Q12 Edition of Technology@CU, page 28.

NEXT CLO ROUNDTABLE

Tuesday, July 24 in Denver, CO. CFOs are gathering in Washington, DC on August 8.

Call Victoria Neeb at (800) 446-7453 to register.

FLORIDA

Read Technology Editor Aaron Pugh's roundup of SourceMedia's Card Forum & Expo on CreditUnions.com:

Day 1: The State of Prepaids, RDC, and Mobile Wallet

Day 2: EMV Tips From Canada; Competition From Wal-Mart

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