

Whoever Knew That Flat Lines Could Have Such an Impact on Bottom Lines?

By Tom Manley, CFA
Managing Director

Lines of one sort or another have been on my mind a lot lately. The yield curve has given way to more than a year of a flat line. This flat line has dramatic importance to your bottom line, and your bottom line has led to the warming up of our telephone line. Then together we pontificate about the possibility of an increase in length of the Nation's unemployment line. So, yes, lines have inundated the thinking around ALM First, and to keep the trend going, I am dropping you a line about what is going on and coming up with your partners at ALM First.

What Has Been Going on?

In February, ALM First produced the third ALM First Financial Institute. For those uninitiated to "The Institute," it is a two-day seminar that the staff of ALM First conducts which gets down to the bottom line of risk, investment and economic analysis. There are two tracks, one of which is for advanced students of these disciplines. The Institute is designed to be a hands-on course for those that do the finance work at your shop. By all accounts, the 2007 Institute was a great success, and I believe we have found a permanent home for it at The Gaylord Texan on Lake Grapevine, just north of DFW Airport. We look forward to seeing you, or members of your team, January 29 – 31, 2008.

Also in February, Emily and I attended the GAC in Washington D.C. We sat down for an interview with Lisa Freeman, managing editor of the *Credit Union Journal* for a story about our firm and our outlook on what will happen in credit union land. That interview appeared in the May 7th issue. When you have a moment, please check out this nice article.

During the first quarter, ALM First was selected as the recipient of the "Business Partnership Excellence Award" for our service to Digital FCU of Marlborough, Massachusetts. The title of the award is quite apt, as we strive to be *strategic partners* with all of our clients. Our warmest gratitude goes out to our friends at Digital FCU and highest accolades to my partner, Emily Hollis, as she is first in line for our team that works with Digital FCU.

Also during the first quarter, Angela Calvert spoke at the WesCorp Financial Strategies Conference. Her topic was "Yield Curve Dynamics"...you know that flat-line thing. The presentation was well received (as it should have been because it was a good topic, presented by a great speaker, in the beautiful setting of the Hawaiian Islands).

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As many of you know, Emily Hollis drives a lot of the product development here at ALM First. That was certainly the case with our Loan Analysis service, which she initially developed on the request of one of our clients – who are often the genesis for new ideas on products. She recently made a presentation on Loan Analysis at the CUNA CFO Council meeting in May. There, she discussed the nuances of actually determining the true profitability of loan offerings.

What Is Coming Up?

The really big event on the horizon is our annual ALM First Financial Forum to be held July 25 – 27 at The Ritz-Carlton, Bachelor Gulch on Beaver Creek Mountain, Colorado. For those that have never been to the Rocky Mountains, this is truly God's country. It is a grand stage for what will be our best agenda yet. The agenda is full of timely topics on credit union valuations and mergers, and features NCUA Chairman Rodney Hood coupled with Wall Street economists. In traditional ALM First fashion, a good amount of fun will be had too. For golfing, we have secured one of the best golf courses in America and we have arranged adventures in fly fishing, white water rafting and four-wheel-drive touring. Angela, Emily and I would love to see you there so, if you have not done so, please visit www.almfirst.com and register.

In closing, I know that I speak for all of the employees of ALM First in thanking you for your business and your relationship. We are blessed with the opportunity to work with you.

DCU Excellence Award

Digital Federal Credit Union, based in Marlborough, Mass., presented ALM First with a Business Partnership Excellence Award for service during 2006.

ALM First is always professional and personable," says Rich Hayward of DCU. "Nominating them for the Business Partnership Excellence Award was an easy decision, as they are always willing to discuss what will work best for DCU and then quickly deliver what we need."

The award is in recognition of businesses that provide service to DCU in a fashion that supports its mission and vision and helps make a difference in the lives of DCU members.

Welcome to ALM First!

ALM First would like to welcome the following clients from the 1st quarter:

Universal 1 Credit Union
Dayton, Ohio
Loren Rush, President/CEO
\$274 Million in assets

Boeing Employees
Credit Union
Tukwila, Washington
Gary Oakland,
President/CEO
\$7.5 Billion in assets

Elevations Credit Union
Boulder, Colorado
Bill Sterner, President/CEO
\$736.5 Million in assets

Tyco Federal Credit Union
Redwood City, California
Christine Brown,
President/CEO
\$77 Million in assets

Join Us for the 2007 Annual ALM First Financial Forum in Colorado



Ritz Bachelor Gulch

On July 25-27, the magnificent Rocky Mountains will play host to the 2007 ALM First Annual Financial Forum. Attendees will have access to the finest outdoor adventures and mountain traditions at The Ritz-Carlton, Bachelor Gulch on Beaver Creek Mountain. The Ritz-Carlton is a year-round destination resort, featuring Colorado's highest rated golf courses, white water rafting, 4x4 expeditions, fly fishing, kayaking, hiking, horseback riding and more.

When you aren't playing golf or hiking the mountain trails, there is an impressive agenda of workshops and breakout sessions. Several notable speakers have been lined up to discuss topics ranging from the overall economic outlook to capturing the financial power of Generation Y. Some of the speakers include:



Ritz Bachelor Great Room

Dr. John Shin, Ph.D, economist for Lehman Brothers in the Global Economics Department. Shin holds a Ph.D in economics from Harvard University where he was a National Science Foundation Research Fellow. He previously worked in the Macroeconomic and Quantitative Studies Section at the Federal Reserve Board in Washington D.C. and was a Postdoctoral Research Fellow at the National Bureau of Economic Research in Cambridge, Mass.

Bryan Sims, chief executive officer and founder of brass|MEDIA which reaches 300,000 readers of the up-and-coming Generation Y. Sims will give you a case for serving Gen Y and show you how.

Paula Edwards-Noise, former president and CEO of Nationwide Federal Credit Union. With a career spanning more than 30 years, Edwards-Noise was highly active in the credit union industry. She served on the board of NAFCU, Corporate One FCU, the Filene Research Institute Council and the PSCU Financial Services Strategic Advisory Group.

Rodney Hood, vice chairman for NCUA. Appointed in November 2005 by President George W. Bush to a seat on the Board of the National Credit Union Administration (NCUA), Hood was then elected to serve as the vice chairman of the Board. Prior to joining NCUA, Hood served in the Bush Administration at the U.S. Department of Agriculture as the associate administrator

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Allie's Cabin

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Allie's View Off Deck

of the Rural Housing Service. As the associate administrator, Hood addressed the housing needs of rural America and helped administer a \$43 billion loan portfolio.

Chris Low, chief economist for FTN Financial. Low joined the investment arm of First Tennessee Bank National Association in 1998 after spending 11 years as an

economist and money manager at HSBC in New York. A frequent and popular speaker at conferences and forums, he has a reputation for taking the most complicated concepts and making them simple. Regularly seen on Bloomberg TV and CNBC, Low also contributes to Bloomberg Radio and NPR's Marketplace. He is a member of the Bond Market Association's Economic Committee.

Pre-conference workshops and concurrent breakout sessions begin at 1:00 p.m. on Wednesday, July 25. Conference registration will be from noon to 4:00 p.m. on July 25 with a welcome reception from 6 to 9:00 p.m. The full agenda for the ALM First Financial Forum can be found on our Website – www.almfirst.com.

Registration for the Annual Financial Forum is underway. To access the online registration form visit our Website – www.almfirst.com. Room reservations must be made directly with The Ritz-Carlton, Bachelor Gulch by calling 800-241-3333 and referencing the group as **ALM First Financial Advisors**. Room rates are \$245 per night, single/double occupancy, plus tax (currently 9.62%). Room rates are guaranteed from July 21 through July 31, 2007. Reservations made after June 25 are not guaranteed to receive the group rate. Contact Paula Beamis with questions at pbeamis@almfirst.com or 800.752.4628, extension 105.



Ritz Bachelor Gulch Spa



13th CUNA CFO Council Conference & Roundtable May 20-23, 2007 • Phoenix, Arizona

ALM First golf team captain and client M.J. Coon, senior vice president/CFO for Ent FCU is seen here at the CUNA CFO council golf outing with the other members of her "pink" foursome which include: Peggy Lamb, CFO at Capital Community CU; Pamela Finch, vice president of administration/CFO for Mid Minnesota FCU and Erin Mendez, senior vice president - finance/information systems for Orange County Teacher's FCU.

Ask Emily

What do you think about all the news of subprime loans and how will this affect credit unions?

We normally do not see credit unions issuing loans to subprime borrowers. Although the possibility does exist, the ramification of the subprime debacle will most likely affect credit unions by a potential slowing of the economy rather than industry defaults.

Regulators have been turning up the heat on financial institutions for more than a year and ultimately, credit standards in banks tightened late last year. The federal financial regulatory agencies (Fed, FDIC, NCUA, OCC, OTS) issued guidance on managing “potential heightened risk” from interest-only loans in December 2005 and more recently issued a “Proposed Statement on Subprime Mortgage Lending.” NCUA has issued several guidance letters to aid credit unions in the issuance of mortgage loans and specifically subprime lending.¹ Grabbing media attention is the fact that 20 percent of the industry that focuses on subprime has been shut down. Customers of these firms will indeed be displaced to other companies, but those lenders that remain in the business have announced tighter new rules and the rejection rate for loans is climbing.

The focus should really then be on loans issued in 2005 and 2006. The credit problems are concentrated not only in subprime but in a small category of “Alt-B” loans. Alt-A is also a concern; however, the default rate is only about one-tenth of the subprime default rates.²

Subprime loans make up about 15 percent of the outstanding mortgage debt market. Subprime mortgages are foreclosing at a rate of approximately 12 percent, which also means that 82 percent are performing! If this figures doubles, only 1 percent of the stock of homes (800,000 homes) will be foreclosed.

Only 0.07 percent of outstanding federally insured credit union mortgages were in the foreclosure process as of December 31, 2006, so there is not much affect to the credit union industry, outside of a potential slow-down in the economy. Given the tougher credit standards on new loans, economists are deducing that as much as 10 percent of mortgage originations are taken out of the market which will have some impact on slowing the economy. The natural lag in the market should cause foreclosures to occur in 2008 through 2010. Most economists are predicting that the subprime market debacle will result in a longer period of weakness rather than a recession. Given the strong growth in exports and business investment and trend-like growth in government spending, the economy should remain solid.

¹ NCUA letter to credit unions 174, 99-CU-05, 04-CU-13, 05-CU-15, 06-CU-16.

² Alt A loans usually have a strong FICO score, but little documentation of income or assets. It is designed for self-employed and other individuals who are willing to pay a premium to avoid verification of income. Alt B loans are Alt A loans with lower credit scores; the lowest sector of the prime market.



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Loan Analysis

As lending continues to be the foundation of our industry's product offering, financial institutions are seeing a lackluster loan demand as the economy slows and consumer spending moderates. Loans in general are not expected to perform as well this year – perhaps driving down profitability. To analyze, many credit unions aggregate data to determine the value of a loan, but this does not enable you to see the true picture. Underperforming loan pools may go undetected, and bad loans may be masked by the addition of newer, more profitable loans.

A better method to consider when reviewing your loan portfolio is through periodic loan analysis. Giving you the capability to measure profitability at the individual loan and loan-pool levels, loan analysis helps you identify profitability within certain categories. This analysis relates the information to specific deal structures and loan performance.

ALM First can provide the loan analysis service to you grouped by loan pools in a variety of ways, and in a manner that is meaningful to your credit union. All that is required is a single data file that contains closed, charged-off and active loans. The profitability of a loan is then measured by the internal rate of return — which avoids distortions due to accounting treatment.

The benefits of loan analysis are many including:

- Determining profitability by a number of criteria and across multiple origination periods.
- Avoiding distorting profitability with heterogeneous pools.
- Defining variables more accurately by assigning them at the loan level.

Ideally, loan analysis is performed on a quarterly schedule. To learn more about loan analysis for your credit union, or to begin the process, please contact your financial advisor.

Employee spotlight



Jie Meng, Senior Financial Analyst

In September 2004 I joined ALM First, and honestly, I enjoy every minute of my job and have lots of fun. It is a great experience working with the most talented people in the industry, as well as seeing the company become more and more successful.

As a senior financial analyst, I am responsible for providing quality ALM analysis that meets and exceeds the client's needs. In addition, I help design and implement new products such as the liquidity forecast model and the loan analysis service. My experience in statistics allows me to provide the quality of service that our clients deserve.

I graduated from the University of Arkansas in 2003 with a master's degree in statistics. My bachelor's degree is in accounting, and I worked as an accountant for four years.

In my spare time, I love spending time with my family, especially, playing with my little princess, Emma. Also, I enjoy home decorating and reading.

On the Calendar

Financial Managers Society

The Finance & Accounting Forum
June 24-26, 2007
Gaylord Texan
Grapevine, Texas
Emily Hollis' Topic is: "Emerging Investment Structures"

ALM First Financial Forum

July 25-27, 2007
Ritz-Carlton Bachelor Gulch,
Beavercreek, Colorado

29th Annual National Directors' Convention

August 7-9, 2007
Las Vegas, Nevada
Emily Hollis' Topic is: "Volatile rate environment: Strike the right balance of loans and investments"

VACORP FCU Financial Strategies Conference

September 13, 2007
Richmond, Virginia
Emily Hollis' Topic is: "ALM and Investment Options"

AICPA National Conference on Credit Unions

October 24-26, 2007
Tempe, Arizona
Emily Hollis' Topic is: "ALM Best Practices in Reporting" and "ALM Managing the Balance Sheet, ROA and Risk Tolerance."