How CU Increased Annual Earnings 147.1%

01/25/2018 07:59 pm

METAIRIE, La.—Thanks largely to an injection of secondary capital, Jefferson Financial FCU last year increased earnings 147.1%—with the majority of the growth occurring in the final quarter.

With support from Atlanta-based CUSO CU Capital Market Solutions, Jefferson Financial raised $12 million in secondary capital. The credit union's earnings increased from $3.5 million in 2016 to $8.6 million in 2017. Total assets increased 82% from $490 million to $890 million, and net worth grew 75% from $48.6 million to $84.9 million.

Mergers were key, completing three ($161 million in total assets) late in the year. Jefferson Financial's membership increased 46%, from 43,175 members at 2016 year-end to more than 63,191 at the close of 2017. The credit union's efficiency ratio improved from 80% to 72%. The low-income designated CU (LICU) also **helped fund** a $112.6-million loan guaranteed through the USDA Rural Development Biorefinery, Renewable Chemical and Bio based Product Manufacturing Assistance Program.

"None of these results could have occurred had it not been for the injection of secondary capital," said Jefferson Financial CEO Mark Rosa. "We always knew we had significant opportunities in our market, and we can now capitalize on them. Access to secondary capital has provided that ability. The combination of secondary capital and non-member funding sources provided by CMS, combined with the pro-growth agenda implemented by the NCUA board of directors, has changed the future landscape for credit unions nationwide."

Rosa emphasized the importance of capital to the future of the movement.

"It goes back to square one, with this industry or any other element of financial services–capital has been your license to kill since there were financial institutions," said Rosa. "If you want to get on steroids, from a bodybuilder's standpoint you know what to do. From a financial services standpoint, we inject capital into our organization. You use that money to ramp up a little, or a lot, and realize the benefits immediately. Banks have had that ability, and while low-income designated credit unions have had the ability for a while, it has not been reached for until late."

3% Of LICUS Using Secondary Capital

Although more than 2,000 low-income designated CUs now have access to secondary capital, only about 3% have taken advantage of it, NCUA noted last year.

Rosa posited that with the results in for Jefferson Financial, and with those results being dramatic given a relatively small amount of capital, that more credit unions need to leverage secondary capital.

"Twelve-million dollars led to $120 million in growth, and more important are the earnings that come off that growth," he said.

Rosa told *CUToday.info* that the addition of secondary capital and non-member deposits placed the CU in a position to accomplish four key objectives:

- Achieve organic growth in its existing market
- Increase asset size to gain operating economies of scale
- Book loans that the CU would otherwise have not been able to book
- Position the institution to complete several mergers

The price for the capital, explained CMS CEO Lewis Lester, is a rate is set by the CU Secondary Capital Fund. The rate on each issuance is fixed and based on a 350 BP spread over the matched funding rate.

"The matched funding rate is the average of the six-10 year FHLB advance rate," he said. "Obviously the rate for each issuance may vary as a result of fluctuating interest rates. However, this rate has typically been lower than the rate for bank sub-debt. The efficiency of this rate is achieved through the diversification of the fund."

CU Capital Market Solutions assisted Jefferson Financial with its secondary capital plan and non-member funding. CMS President and Chief Strategist Robert Colvin said that how Jefferson Financial is growing is right in line with NCUA's guidelines.

"What is happening with Jefferson Financial's efficiency ratio, and growing at a more rapid pace than retained earnings, is specifically what NCUA's best practices guide points to," said Colvin. "That is the purpose of secondary capital, to allow LICUs serving low- and moderate-income families to grow—to make sure that retained earnings does not slow growth."

Economies Of Scale

Colvin also emphasized that the capital infusion leading to growth is driving economies of scale, which is improving the credit union's efficiency.

"In a short amount of time the credit union's cost to make a dollar dropped from 80 cents to 72 cents," noted Colvin. "That is a significant change."

As *CUToday.info* **reported**, CMS in December worked with Notre Dame FCU in Indiana to inject the CU with $12 million in secondary capital. CMS is currently working with more than 20 institutions in 14 states on secondary capital efforts totaling more than $350 million. Colvin said that CMS, which offers a turnkey solution for LICUs seeking secondary capital, expects that total to exceed $1 billion by the end of the year. CMS assists LICUs with the application process, funding through the CU Secondary Capital Fund and assistance with the implementation of the plan.

Colvin pointed to the importance of secondary capital to help LICUs grow and compete.

"Credit unions no longer have the shallow end of the pool where they play alone. Consumers want services, and whoever can provide those services is where they money will flow," he said. "Credit unions have to have the capacity to compete or they won't remain relevant. They have to have the ability to keep pace with other financial institutions."

Lester emphasized that while LICUs have had access to secondary capital since the late 1990's, it's time more leverage the tool to grow.

"Go back to the financial crisis and look what happened. Banks stopped lending. But it was credit unions that stood by their communities, providing people with the loans they needed to get by," said Lester. "No one else did that. Credit unions have earned the right to leverage secondary capital to grow. This is helping the credit union and the membership. Secondary capital has been on the books since 1996, but it's time more LICUs use it so their members can enjoy the benefits."

Full-Year Impact?

Lester pointed again to the impact secondary capital has had on Jefferson Financial in just a short period. "It will be interesting to see the impact of secondary capital on the credit union after one full year," he said.

Colvin said that from 1996 to 2016, secondary capital was largely used by LICUs for only small amounts of money among institutions trying to fix problems.

"What is occurring now is the first time healthy credit unions are using secondary capital to expand," said Colvin. "I know that in the first two decades of credit unions using secondary capital there were some failures among those who used the funding, and bankers like to point to that. But this is a whole new ballgame now. And in those first 20 years you never saw results anything like what Jefferson Financial has experienced."