vocality

Community Credit Union

2023

Annual Report

Board Chair Report

Dear Fellow Members,

My report for this year looks much like the one from last year, because our efforts to help our members remain a top priority, even as our environment continues to strain our local economy and community. Our focus in 2022 was on helping our members survive the effects of the lingering pandemic, and the ramifications of the legalization of cannabis. Throughout 2023 and now into 2024, we are still helping our members through these ongoing problems, and most recently, through the refusal of several major insurance companies to insure homes in our communities, while others charge premiums that are draining our community members of the funds they need to maintain their homes. A credit union is its members. We are you. When you thrive, so do we; when you struggle, so do we. To understand the financial hit our communities have taken from all of these issues, all we have to do is look around: at our personal budgets, our neighbors' situations, and the state of our business and social districts.

A credit union is not a bank. Banks have customers and must focus on profits to serve their shareholders. Credit unions have members, and do not sell stock. We make our money through loans to other members. That money is what pays our employees, maintains our buildings and pays for services that our members want and need. If you don't understand those differences, please look at the lending report on this page to see just how many members our lending department helped in the last year, and at what cost to our bottom line. This is neighbors helping neighbors. And while reducing the interest we received from loans lessens our income, you, our members, are our top priority, and we continue to do everything we can, safely and legally, to keep our members in their homes and vehicles. We've continued our attempts to do this, even as we work to maintain mandated reserves for emergencies, such as we're all experiencing these days.

This is also why we increased our field of membership to the counties to our south, who are less dependent on one industry than Southern Humboldt is and opened our branch in Ukiah. We are gaining new members, with new deposits and new loans, as a result, and thank every one of you who have joined our credit union. We also thank our long-time, loyal members for their confidence in us. Our expansion and our increased membership in that area has helped us in our efforts to help all of our members during this tough time, helping to diversify our deposit and loan portfolios and reduce risk. Diversity is a key to community strength and success.

We are still sponsoring many community events, and supporting organizations that serve our members and communities, such as the Healy Senior Center, Heart of the Redwoods Hospice, KMUD, the Mateel Community Center, the Boys and Girls Club of Ukiah, the local Economic Development Corporations supporting our local small businesses, the Rodeo, our local Chamber of Commerce, SHBVB, Children's Services in Mendocino County, our local volunteer fire departments, and "fire-safe/fire-wise" groups, South Fork High School, Redway Elementary School, Family Resource Center food Backpack Program, and many more. We remain committed to being a socially responsible community partner, with over $36,000 directly contributed to our non-profit organizations and tens of thousands of additional advertising sponsorship dollars that provide income to our local charities serving our members and communities. You will often see members of our staff at these events, as well, adding their volunteer presence to our financial support.

I am proud of our staff, who have worked so hard through this long, difficult time to provide services to our members, without once closing our doors, even though many on the staff were hit by COVID, just as many of you were. Many of our staff have also studied to pass bilingual tests in order to better serve our growing Spanish-speaking membership.   They continue to work to bring you the services you have told us you want, some of which are available only at much larger credit unions and banks.

I am also proud of our board of directors, who have all volunteered so much time to study credit union policies and strategic planning, and worked to make our credit union as successful as it can be. Our board has worked diligently to keep us safe and sound.

What can you do to keep your credit union strong?   Put your money into your credit union. We have competitive account rates.   We need deposits to make loans, and that loan income is what pays our employees and bills, and the interest on your accounts.   If you're already doing that, thank you! If you have money in other financial institutions, please consider moving it to your credit union, so we can remain strong. If you know people who aren't credit union members, please consider recommending us to them.

If you have a loan and you're able to make your payments, thank you! If you're having trouble, please be proactive in calling our lending department to see if they can help you. Communication from you before you fall behind is the most important thing you can do, not only for the safety of your home or vehicle, but for your credit rating.

We are all in this together, both personally and as a community. I believe that all of our communities will return to, and I hope exceed, their former vibrancy, but it will take all of us working together to do that...and isn't that exactly what a credit union is?   This is, by far, the toughest economy we have had to work and live through. We appreciate your membership and everything you do to keep our credit union strong. It is my honor and privilege to serve you.

Marcia Mendels, Chair,

on behalf of the Board of Directors

President / CEO Report

We remain vigilant in our efforts to support the financial wellness of our members and our communities. We are grateful for the continued loyalty of our members, and we hope our commitment to you and your continued success is also reflected in the program/product offerings, savings and earnings opportunities, face to face and heart to heart support we provide to the communities we serve.

As a Community Development Credit Union (CDCU) we take our social responsibility very seriously; especially in these extended times of financial difficulty for so many. We welcome opportunities to support our local charitable and civic organizations, providing a broad scope of support contributions and activities for various groups.

You're seeing a recurring theme in our officer's reports for 2023 – Your credit union management and staff have worked diligently to assist members wherever and however we can, with credit counseling, budget counseling, loan extensions, deferments or modifications to get members to the other side of their financial challenges... We've experienced a period of stagnation of deposit totals even as we have gained members and deposits in our new area of service. We are glad to have these new deposits to continue to spin the flywheel of opportunity and stability for our members even as we've seen deterioration of deposits from our northern area due to the extended economic stressors in the north that are depleting member savings over time. And as you can see, those efforts are reflected in our overall financial figures after this extended need for response to economic, natural disaster and health-related challenges we've faced together for the last four years. These strains on our members and our reserves are also affected by a long-awaited and unwelcome accounting process change associated with loan loss reserves we were required to make in 2023. Please see the Treasurer's report for further detail on that adjustment to our regulatory reserves-moving it to our loan loss reserves under the new accounting rule. We are glad we've had the chance to gain ground on the bottom line reserve totals over prior years to help prepare us for this large bottom line adjustment. This item was a one-time entry; however, it did make a substantial difference in our overall rainy day, bottom line reserve total. Your management team continues to seek ways to reduce expenses and maintain income to allow us to serve you and the communities we love.

I'm personally grateful for our staff, the valued and loyal members we serve each day, and for the opportunity to do what we can to support and sustain our towns and our regional economy as part of our mission for their benefit.

Yours, in cooperation and in service,

Pat Neighbors
President/CEO

Lending Report

Your credit union staff worked hard in lending to our members and servicing their loans in 2023.
The credit union provided 446 loans to our members in 2023 for a total of $14,186,701 and closed the year with loans totaling $125,926,607 before allowance for loan losses.
Loans amounting to $2,320,154 were charged off in 2023. Due to diligent collection efforts, $399,976 was recovered in that same time period for a net loss of $1,920,178 associated with those charge offs.

In addition to the periodic charge offs throughout the year, 2023 marked a substantial and material adjustment for Vocality and all credit unions to a new accounting requirement of projected losses in our loan portfolio over time, rather than a "look back" model. For decades, the credit union has followed approved accounting procedures that referred to a historical "look back" varying from 12 to 36 months of actual losses to determine a loss factor, coupled with losses in the given period, to establish what was needed in our loan loss reserve fund.

Please refer to the Treasurer's report for details related to an additional $2.9 million set aside in 2023 for future potential loan losses in the portfolio, directly associated with this change in accounting rules and driven by current loss ratios within various areas of the loan portfolio.

The last year has continued to show many of our members are experiencing stress on their ability to meet their obligations for payments to the credit union and others. Over the last four years, we have seen a substantial need for a large number of members to seek loan extensions (payment deferment for greater than 30 days) for their loans with the credit union to help them re-establish regular periodic payments throughout their budget, catch up on other debts or monthly costs due, or react to an unexpected expense that their savings couldn't support.

Our credit solutions team has worked diligently in 2023 to provide these payment deferments whenever possible, to assist our members in their efforts to reset their ability to meet monthly obligations as they faced financial difficulty.

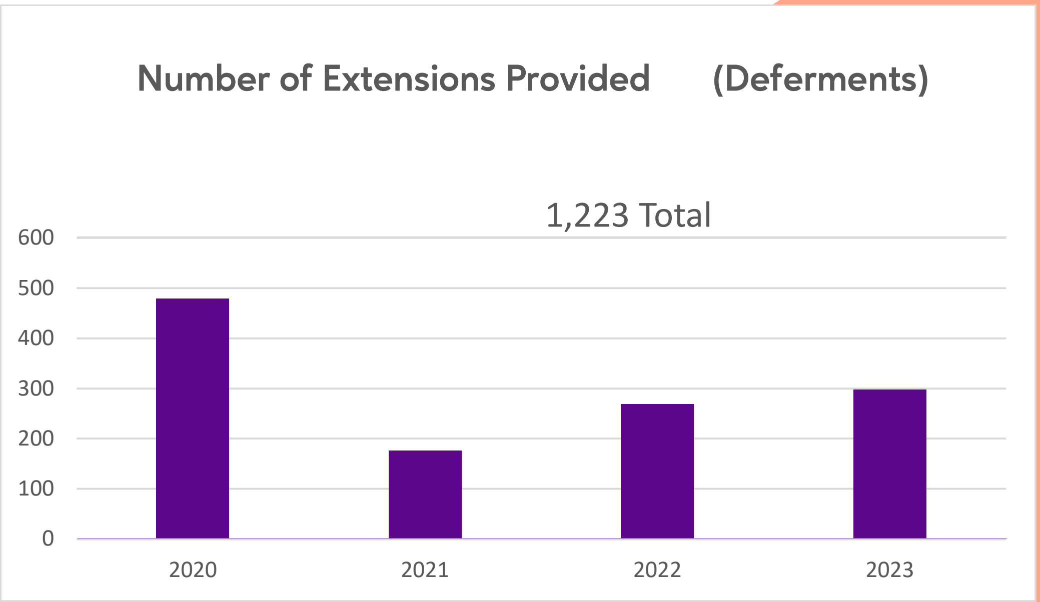
The number of deferments, and the total affected loans within the portfolio:

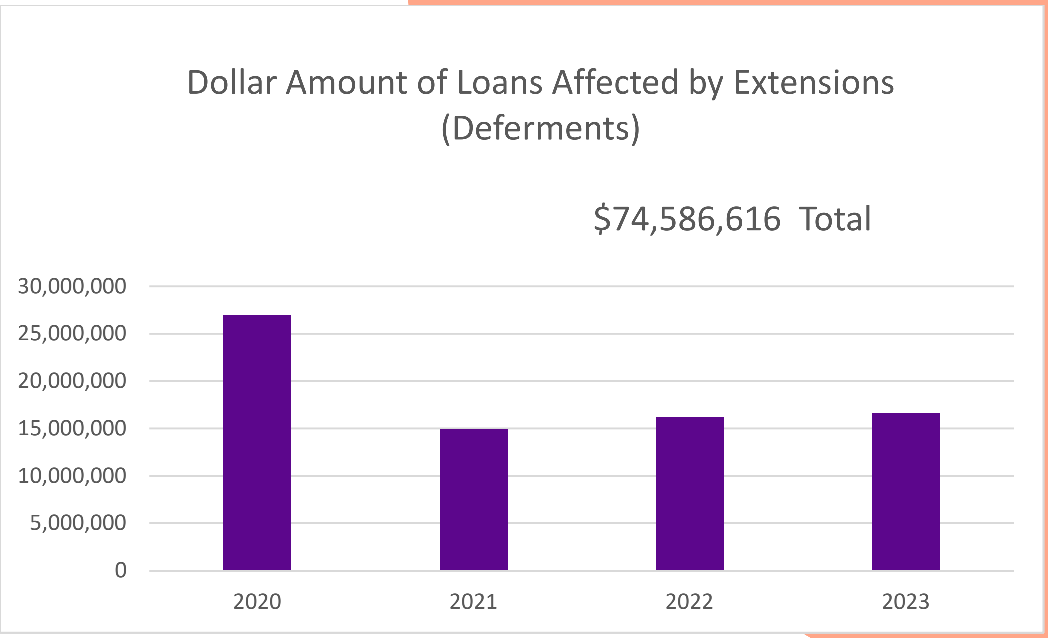
- 298 members with deferments for $16,567,315 in 2023
- 269 members with deferments for $16,186,864 in 2022
- 177 members for $14,906,903 in 2021
- 479 members for $26,925,534 in 2020

We also provided seventeen (17) home loan modifications for $5,457,832 to assist members and referred several others to the CMRP (California Mortgage Relief Program) to help them keep their homes. Unfortunately, we couldn't help everyone, in spite of our best efforts. We added a total of $1,093,004 in foreclosures of real property in 2023, bringing our total to 8 credit union owned properties, totaling $1,428,869 to close out the year, which now reside on our books until we can find buyers for those properties. To date, we have one property sold and another in escrow... with six (6) remaining. Our region is currently experiencing a severe reduction in real estate prices, making it difficult to sell the properties. We are working with local realtors to attempt to sell these properties and mitigate losses associated with them.

Your Loan Department continues to seek new ways to meet your borrowing needs, while keeping safety and soundness in the forefront of their decision-making process. We are committed to working with our members to keep them in their homes and their vehicles. Please don't wait to contact us if you're struggling!

Tom Farmer
SVP Lending





Treasurer Report

The last several years have been challenging for us all, and we know our members are reeling from things that are affecting our local communities, our general region and our nation. Many of our members continue to deplete their savings in their attempts to make ends meet, and the continuing effects of the local economic crash has resulted in an extended period of need within our region. Your credit union is doing all we can to assist where we can – including providing loan extensions and modifications to assist over 1,200 members in keeping their vehicles and homes over the last four (4) years, with 298 of those in 2023. We have also maintained our efforts to provide support to our local community service and charitable organizations in the communities we serve.

Loan interest revenue (approximately 71% of all income for the credit union in 2023) is the greatest contributing item to our bottom line, along with other non-interest and investment income making up the additional 29%. Reduced income, increasing expenses and increasing loan losses have reduced the credit union's reserves. Regarding loan loss reserves, and of particular note, the credit union has taken a total of eight (8) properties into foreclosure and has only been able to sell one of the properties as of the date of this report. Another is currently in escrow. These properties currently sit on the credit union's balance sheet as non-earning assets with a balance of $1,336,089.74 as of December 31, 2023. Refer to the Lending Report for total number and dollar amounts of loan extensions and modifications provided to our membership over the last four years and specifically, 2023.

Of greatest affect to our credit union regarding our income and balance sheet totals for 2023, was an adjustment to the loan loss reserve total due to a required change in accounting rules for loan losses. This change in accounting requirements took effect on January 1, 2023. This new rule, ("CECL" -Current Expected Credit Losses) is a complete change from our prior method of reserve calculations. Rather than managing the reserve based on historical losses and charge offs each month, the new rules require reserves to be set aside <u>immediately for potential losses within the loan portfolio, over the full life of the loans.</u> It is a "look ahead and forecast" model rather than the "historical look back" model we and others have used for decades. I'll apologize for the detail here but based on the extreme adjustment to our bottom line reserves, I believe the membership should understand why its such a difference and how it has affected our total balance sheet and income for 2023.

- The new CECL model reserve method records the current loss ratio and loan balances as a starting point.
- That loss calculation is projected forward for the expected payoff terms of various loan pools (example: credit cards, auto loans, real estate, unsecured loans, commercial loans) all have different amounts of time they might take to pay off or refinance or otherwise close out.
- Also considered and recorded separately, are individual loans identified as highly probable for loss, due to severe delinquency.
- It also must take "environmental factors" into consideration based on (economic stress, ((local, regional, state, national)), stable, declining or escalating delinquency, unemployment rates, inflation in the area, etc.) which add additional "points" to the loss factor of each pool… with unsecured and longer term loan pools having higher potential for losses, based on their inherent higher risks as unsecured or long-term remaining balances.

All of these factors contribute to the total reserve needed to create a "life of loan loss" total for each category, which changes each month as the loan balances go up or down over time and charge offs increase or decrease within the portfolio. These figures are reviewed periodically and adjusted for future reserve totals needed based on the effect of these changes.

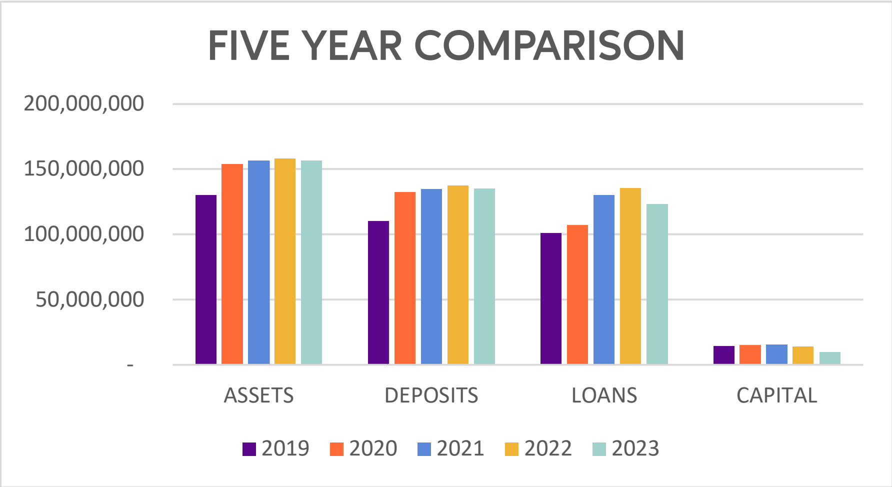
Why is our required reserve so high as we start this new method? The implementation of this new accounting rule is taking place at a time when our membership is struggling --- we have high delinquency in many areas of the portfolio, and we have taken several properties back in foreclosure in 2022 and 2023. The foreclosures and slow payments within the real estate portfolio specifically; along with low recoveries at auction on repossessed autos and increasing charge offs on unsecured loans resulted in a necessary adjustment of approximately $2,886,000 taken from the general reserve to the loan loss reserve as the baseline figure; resulting in a final net (loss) of -$3,167,685.24 for 2023.

We ended the year with a -2.01% Return on Average Assets (ROAA) and a net Capital to Asset ratio of 6.16%, which, thanks to our strong reserves over time, sustains us in an adequately capitalized position according to regulatory requirements. It is important to have sufficient reserves in order to weather financial storms and our future success depends on our communities' support, as we support you. Please refer to our financials and the five year comparison graph for key points below.

We appreciate your membership, business, trust and support and wish you well. It is an honor to serve you.

Respectfully,
Janet Fitzgerald

ASSETS	
Loans/Visa (Net)	123,088,637.63
Cash/Investments	24,567,072.37
Fixed Assets (Net)	2,965,990.08
NCUA Insurance Fund Cap	1,217,864.77
Other Assets	4,598,132.55
TOTAL ASSETS	**156,437,697.40**
LIABILITIES	
Accounts Payable and Accruals	11,638,593.94
Member Shares	135,164,815.99
TOTAL LIABILITIES	**146,803,409.93**
CAPITAL	
Regular Reserves	635,707.58
Undivided Earnings (net)	8,998,579.89
TOTAL CAPITAL	9,634,287.47
TOTAL LIABILITIES & CAPITAL	**156,437,697.40**



Audit Committee Report

The Audit Committee continues to work with a CPA firm to conduct our annual financial and member verification audits. Thank you to all that returned member verification letters. Additionally, our internal auditor and compliance officer keep an eye on safety and security risks with monthly and other periodic reviews in accordance with state and federal compliance regulations. Their efforts have saved our members $73,108 in attempted fraud activities.

Fraud attempts are up across the nation and the credit union staff continues to work diligently to protect our members. We encourage you to also remain vigilant with all of your account information and urge you not to share passwords, PIN numbers or other account access points with others, for your own protection. Our compliance and internal audit staff continue to help us manage ever-changing and increasingly complex compliance and security requirements in today's electronic-based world.

Although our bottom line incurred some hits this year due to new federal regulations regarding assumed losses to come, Vocality Community Credit Union staff continue to work with state and federal examiners to ensure we strive for the safety and soundness of Vocality's continued operations in these challenging financial times.

I continue to enjoy serving as a volunteer board member at VCCU.

Respectfully submitted,

Erica Boyd
Audit Committee Chairperson