Turning Brick and Mortar into Gold

The New, Improved Value of Sale-Leasebacks for Credit Unions

An Industry White Paper from

CUinfluential℠

Capital is King. There can never be enough of it. In an unpredictable operating environment, credit unions need reliable access to capital without the long-drawn-out time required to organically grow deposits and increase loans and investments to generate more net income and raise capital. Alternatively, credit unions can't always meet the restrictions and repayment requirements associated with raising secondary capital, a formerly attractive option that has become increasingly expensive and cumbersome. So, where can credit unions find needed capital and quickly? For those credit unions that own operational real estate, the answer lies in a sale-leaseback of those assets with CU Capital Management's CUSO Network.

Key Takeaways

- Sale-leasebacks provide credit unions with capital to reinvest in core business operations and growth initiatives.
- Sale-leasebacks provide credit unions with the ability to retain operational control of real estate with no disruption to day-to-day operations.
- Recent changes in accounting rules around sale-leasebacks now provide credit unions with the ability to immediately realize the net income and capital from a sale-leaseback.
- While there are multiple sources for arranging sale-leaseback transactions, there is only one source that keeps the entire transaction – real property, sales proceeds, commercial real estate loans and investment dollars - **within the credit union industry**.
- **CU Capital Management's Sale-Leaseback CUSO Network** provides credit unions with opportunities for raising capital and liquidity, opportunities for permissible CUSO investments, and opportunities for direct lending and loan participations. This alignment of interests also provides selling credit unions with a much more comfortable landlord/tenant relationship.

Prologue: Unconventional Fiction Meets Unconventional Fact

The highest grossing film worldwide in 1985 was "Back to the Future" a critical and commercial success that earned $381 million in which eccentric scientist Doc Brown broke through the barriers of time in a highly unconventional DeLorean.

That same year, the most unconventional business transaction in recent history was "boy wonder" Sam Armacost's sale-leaseback of BankAmerica's world headquarters which netted the bank $660 million and sent shockwaves throughout the worldwide financial community.

In September 1985, Sam Armacost, then the 40-something year old president of BankAmerica Corporation, entered into a $660 million sale-leaseback arrangement for Bank of America's iconic headquarters. Towering above the San Francisco financial district at 52 stories, the building was the bold embodiment of Bank of America's strength and security. Like so many other financial institution headquarters that are designed to be representations of success, the building symbolized BofA's superiority. Opened in 1969, 555 California Street was meant to display the wealth, power, and importance of Bank of America and the building's sale in 1985 sent shockwaves through the financial services industry sparking rumors of the Bank's failure. Although his strategy was highly criticized in 1985, Armacost was 40 years ahead of his time. While retaining long-term occupancy of the headquarters building, Armacost brilliantly monetized a nearly-20-year-old, high-maintenance 52-story structure, and significantly strengthened the bank's balance sheet during times of significant financial challenges and a historic period of bank and thrift failures. With assets of $2.6 trillion at the end of the second quarter of 2024, Bank of America is now the second largest US bank by asset size, only behind JPMorgan Chase at $3.5 trillion.

Fast forward to 2024: While times have changed, the continuing hurdles facing the financial services operating environment - including increased capital requirements, rising efficiency ratios, escalating compliance and operating expenses, mounting liquidity pressure, net interest margin compression, and loss of once-reliable fee income sources - have refocused the spotlight on sale-leaseback transactions which can provide credit unions with the immediate access to capital and liquidity through the sale and leaseback of their appreciated real estate assets such as headquarters buildings, operations centers and branch networks.

Today, across all industries, properly structured sale-leaseback transactions are positively looked upon as sound financial strategies that allow businesses to re-focus on their financial health and core growth opportunities for better long-term success. Sale-leasebacks enable credit unions to raise capital, improve net worth, grow net income by expanding lending and investing capabilities, and enable further investments in technology, employees, branches, CUSOs, and more. Unlike the 1985 sale-leaseback transaction that sent shockwaves through the financial system, sale-leaseback transactions are considered routine in today's business world and have gained in popularity. Simply put, sale-leaseback transactions unlock immediate capital and liquidity.

Why does a credit union, even a well-capitalized credit union, need more capital?

The Need for Capital for Regulatory Reasons. The definition of "well-capitalized" is evolving upward. NCUA's risk-based capital rule will require that credit unions have a minimum risk-based capital ratio of 10% as well as a net worth to assets ratio of 7%. If the credit union engages in certain activity as set forth in the NCUA matrix, additional risk-based capital may be needed. Credit unions were required to adopt the new Current Expected Credit Loss (CECL) accounting rules beginning in 2023 which also resulted in increased capital requirements. Additionally, the NCUA continues to communicate to credit unions, even well-capitalized ones, that more capital is better. If a credit union has a ret worth ratio of 7%, there is pressure to get to 8%. If a credit union is at 8% there is pressure to get to 9% and so on and so forth. The future is clear. Credit unions will face increased capital requirements from the NCUA.

The Need for Capital to Offset Risk in Challenging Times. We have recently undergone a rapidly rising interest rate environment that had not been seen in decades. Assets and liability management for credit unions will continue to present difficulties going forward. Member shares have swung wildly for credit unions since the onset of Covid-19. Loan demand is declining. Non-interest income from once reliable interchange fees and overdraft fees is declining or disappearing. Borrowers are taking on much higher mortgage loan obligations due to the rapid increase in real estate prices. Credit card and auto loan balances and delinquencies have increased. Inflation adversely impacts the ability of borrowers to make loan payments. Recession or not, there will be loan and revenue contractions or losses that credit unions will have to absorb. Additional capital gives credit unions the opportunity to better weather and emerge from these changing times.

Capital is central to a credit union's ability to absorb unexpected losses and to continue to lend to creditworthy consumers. Capital serves as the first line of defense against losses, protecting the National Credit Union Share Insurance Fund (NCUSIF) – Principles of Capital Policy and Capital Planning – Office of National Examinations and Supervision

The Need for Capital to Fund Investments in People and Technology Resources. In order to remain relevant to their members, credit unions have to keep pace with consumer expectations, full stop. Big banks and fintechs continue to create ever higher service expectations, especially from a technology standpoint. This is particularly relevant for online and mobile app capabilities which might now include things like applying for an unsecured loan on a mobile phone and having it underwritten and funded within a minute. In addition to the consumer-facing side of necessary technology investments, credit unions also face increasing pressure to invest in back-office technologies including core systems; cybersecurity protections; and fraud and regulatory compliance related software, as well as all of the systems that their employees must use on a regular basis such as loan underwriting and monitoring technology; customer service platforms; and other software that allows employees to do their jobs and serve members better. Credit unions have no choice but to continue to invest in both people and technology to be competitive in the 21st century if they are going to survive. Providing attractive salaries and benefits along with everything necessary to allow employees to do their jobs and serve members in the best way possible. This is critical to attracting and retaining talented employees which in turn allows credit unions to provide better services and experiences to members and enables the asset and income growth that all credit unions need in this increasingly uncertain and challenging economic and regulatory environment.

How Sale-Leasebacks Unlock Capital for Credit Unions

What is a Sale-Leaseback Transaction in the World of Credit Unions? In a sale-leaseback transaction, a credit union sells some or all of its operational real estate, including its headquarters building, operations center, call center, and/or branch network, to an investor. The credit union remains in place as a lessee with no interruption in day-to-day operations. The investor acquires the asset(s) while the selling credit union receives a significant cash infusion that can be used for immediate growth without disruption to its employees or operating environment.

While it is owned, the full market value of a credit union's real estate is not able to be recognized as capital or as an asset under accounting rules. In fact, credit unions must use the depreciated cost basis for their accounting which means that real estate is carried on balance sheets at even less than it cost in the past. The market value of the real estate, which quite often significantly exceeds the depreciated cost basis, is only recognized, accessible and realized if the real estate is sold. Sale-leaseback transactions offer access to undiluted capital, free from the complexities of traditional financing. This capital can be strategically deployed for any needs or initiatives the credit union desires, ensuring institutions can adapt to market dynamics, allocate resources wisely, and seize opportunities for long-term sustainability.

Importantly, sale leasebacks are structured with long-term, triple-net leases. This structure allows the selling credit union to receive the highest possible market value for the properties while allowing the credit union to maintain operational control of the real estate as they did before the sale leaseback and eliminate any interruption in day-to-day activities for members and employees. This structure also offers credit unions the most long-term control over their future, with leases usually around 15-20 years plus multiple tenant extension options.

As credit unions navigate the complexities of a volatile market, embracing innovative strategies like sale-leaseback transactions becomes imperative. Unlocking appreciated value, enhancing capital ratios, and boosting financial flexibility are strategic maneuvers positioning financial institutions for resilience and success in the face of economic uncertainties. It is becoming more well known that the strategic use of real estate assets through sale-leaseback transactions can usher in a new era of financial strength and adaptability.

If the sale is to a CUSO, the impact of a sale-leaseback transaction is synergistic. The recipients of the rental income stream and appreciation of value of the real estate are other credit unions. A credit union that sells its real estate to a CUSO has the ability to invest and earn income in other CUSO funded sale-leaseback transactions. Additionally, a selling credit union can serve as a lead lender or loan participant on other credit union sale leasebacks. Regulations even allow for a selling credit union to participate in the credit union loan taken out by the CUSO as part the funding of their own sale leaseback. There are accounting, legal and regulatory issues that require the credit union's attention, but they are readily manageable.

Selling to a CUSO provides for alignment of interest between the credit union seller/lessee and CUSO owner/landlord. Private investors have traditionally dominated sale-leasebacks and credit unions are justified in being wary of outside firms that have a primary obligation to maximize returns to their investors, usually at the expense of their tenants. Most private investors need to sell assets in order to generate necessary returns for their investors and themselves. This means that a selling credit union may have to deal with multiple different landlords over the course of their lease, some of whom may be problematic to work with. A CUSO landlord means the selling credit union can feel comfortable that the landlord they sold to will remain their landlord as long as the lease is in place and that the CUSO landlord will always be an honorable and trustworthy partner that understands the importance of overall health and growth of the credit union movement. Importantly, if a credit union ever desires to explore repurchasing some or all of the real estate that was sold as part of a sale-leaseback, doing so with a CUSO provides the highest likelihood of that occurring. Account regulations prohibit guaranteed repurchase options in a sale-leaseback, but with a CUSO landlord the credit union owners understand the needs of fellow credit unions and are committed to working with their fellow credit unions on the desired outcome.

A credit union that sells its operational real estate can immediately book as net income and as capital the difference between the market value sale price and the depreciated carrying value of the real estate. Unlike with secondary capital, there is no obligation to pay back the capital; there is no long, expensive and cumbersome process to apply for approval from the NCUA; and there is no strict business plan that must be followed as a condition of regulatory approval. A credit union can also raise capital organically through net income, but this is a slower process that may take years to replicate the amount of capital that can be raised in one sale-leaseback transaction. With a sale-leaseback transaction, a credit union has access to the related capital and liquidity immediately and can use it any way it deems most effective without restrictions or an obligation to pay it back.

The New and Favorable Change in Accounting Treatment of Sale-Leaseback Transactions through *ASC Topic 842: Lease Accounting*. The recent changes in lease accounting guidance, which were implemented at the beginning of 2022, changed how and when the gain in a sale-leaseback transaction could be recognized in a way that is now much more favorable to credit unions. Under the new standard, ASC Topic 842, the seller can now recognize the full and complete gain-on-sale in the current period in which the transaction closes. Under the old accounting standard, ASC 840, the gain-on-sale was required to be recognized proportionally over the lease term. Obviously, only recognizing one-tenth or one-fifteenth of the gain-on-sale as net income and capital each year following a sale-leaseback was not particularly attractive for a credit union from a financial standpoint. The new standard provides the highest possible benefit from a sale-leaseback to credit unions as compared to all other industries due to their non-profit structure (thus avoiding taxes on the income windfall) and ability to leverage that new capital for asset growth to further drive increases in net income.

An immediate benefit for credit unions:

The old accounting rules requiring sale-leaseback generated capital to be recognized over the term of the lease have been changed.

Under the new rules, the gain on sale from a sale-leaseback transaction can be recognized "at the time of the sale-leaseback arrangement."

ASC Topic 842: Lease Accounting

Before the issuance of ASC Topic 842, US GAAP contained very prescriptive and detailed rules around sale-leaseback accounting. In most cases, these rules precluded the immediate recognition of gain on the sale of assets subject to a sale-leaseback arrangement. In many other situations, particularly those involving real estate, US GAAP required the seller/lessee to treat the transaction as a financing transaction rather than as a true sale transaction with a related operating lease. *The new leasing guidance indicates the presence of the leaseback doesn't, in isolation, preclude the seller/lessee from concluding it sold the underlying asset to the buyer-lessor. Instead, a seller/lessee can recognize a gain on sale at the time of the sale-leaseback arrangement.*[1] In other words, the credit union realizes and enjoys immediate access to the capital and liquidity.

[1] Moss-Adams: Lease Accounting / Additional Considerations in Applying ASC Topic 842

Breaking the Emotional Tie to Iconic Brick and Mortar. Many credit unions have built very attractive headquarters buildings and branches and are justifiably proud of them. These locations serve as the face of the credit union's brand to their members, their employees and their community, and are a point of pride. Management and board members often have an emotional attachment to owning real estate. By owning the real estate, there is a comfort knowing that the credit union has more control over its long-term future in a community and that the value of the real estate will be there if needed one day. In many situations, that one day has arrived. Commercial real estate values remain at elevated levels, which may not always be the case given the uncertainty that remote work and interest rate increases have wrought over the past few years and now is an opportune time for credit unions to capitalize on the value of their long-owned real estate. The highest value of that real estate is realized through a sale-leaseback which provides credit unions with immediate capital along with ongoing operational continuity and the ability to continue to evaluate their real estate needs going forward by leaving room for lease extensions or the ability to sublease unnecessary space.

There is nothing safe about keeping a capital source locked-up while the credit union has a need for that capital to grow the credit union today. As financial institution competitors are growing rapidly, the financial institutions that do not find a way to keep up are not going to survive in the long term. Owning real estate does not advance the financial health of a credit union. Credit unions are in the business of serving their members and communities, not in the business of real estate speculation. A well-run credit union can and should generate higher returns and growth by investing in their employees, members and communities than they can through holding on to real estate with phantom growth.

More credit unions are making the strategic choice to sell and lease back headquarters buildings, operation centers, call centers and branches. The benefits are many:

- Opportunity to grow Net Worth and improve Net Worth Ratio
- Capitalize on appreciated market value of real estate
- Enhance reserves and liquidity to prepare for uncertainty or downturns
- Increase earning assets by expanding lending and investing capacity
- Reinvest in technology, employees, CUSOs, and other initiatives to benefit members
- Improve flexibility to navigate a post-COVID world and new regulatory requirements such as CECL, Risk-Based Capital, etc.

Introducing the Elephant in the Room

Q: Why should credit unions sell to, and then lease back their headquarters, operations centers or branches from outside investors such as real estate investment trusts, private investment funds, pension funds and other third parties outside the Credit Union Industry? Why shouldn't those assets "stay in the family?"

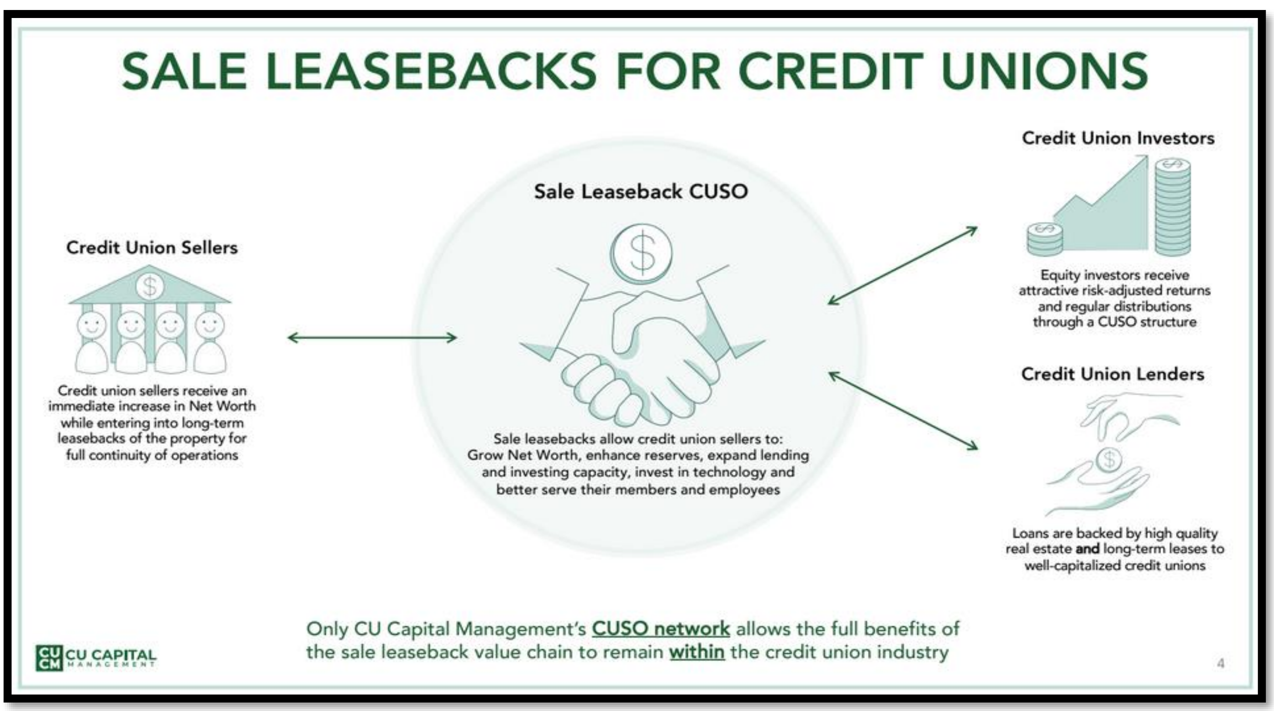
A: CU Capital Management, a CUSO, manages a network of CUSOs focused exclusively on sale-leasebacks for credit unions including opportunities for credit unions to participate as sellers/lessees, as investors, and/or as lenders. In other words, the entire sale-leaseback transaction can now remain entirely within the Credit Union Ecosystem. Importantly, the landlord

CUSO that a credit union may sell to is 100% owned by fellow credit unions, solidifying alignment of interests between the selling credit union and the purchasing CUSO, both for negotiating the initial transaction itself and throughout the duration of the lease.

Introducing CU Capital Management, managing CUSO of a network of CUSOs focused exclusively on sale-leasebacks while providing opportunities for credit unions to participate as sellers/lessees, investors and/or lenders.

CU Capital Management ("CUCM") is a CUSO that was created alongside credit unions and credit union industry experts to bring unique capital and asset opportunities to credit unions. A member and Platinum Partner of NACUSO, and the first Promotion Partner of NACUSO Business Services, CU Capital Management oversees a sale-leaseback network for credit unions that provides credit unions with a turnkey opportunity to raise capital through the sale and long-term leaseback of operational real estate (headquarters buildings, operations centers, call centers and/or branch networks).

Keeping it in the Family. CU Capital Management has created a unique model that eliminates the dilution of value by keeping the generation of capital and retention of assets exclusively within the credit union ecosystem. Outside parties looking to execute sale-leasebacks with credit unions have a primary



duty to themselves and their investors which has a higher potential for a credit union seller to feel "burned" in a sale leaseback. A CUSO landlord alleviates this concern by keeping all of the benefits of a sale-leaseback and the major decision-making points within the credit union industry.

Benefits to the Credit Union Seller/Lessee

The credit union seller/lesse receives the immediate increases in capital and liquidity discussed above, but why is selling to a CUSO such a signficant benefit? If you attended college and were assigned a roommate freshman year, it was a matter of luck as to whether you got along with the roommate. It was either a good year or a trying ordeal that had an impact on all aspects of your life, and one you wanted to forget. Such is the situtation if a credit union sells to a private investment fund that is not a CUSO nor backed by other credit unions. Maybe the relationship will be good, maybe it won't be. Since the private fund is likely to sell the lease after a few years to maximize their return to their investors, there is yet another unknown party to deal with. Some years ago, there was a situation where a credit union seller made the decision to buy back their property at a premium because of the contentious realtionship with the private fund landlord. By selling to a CUSO, a credit union tenant is dealing with credit union owners who are friends and colleagues with a each credit union in the CUSO network a first or second degree connection away. This situation is a much better predictor of a good long-term landlord-tenant relationship.

The initial lease terms are typically 15-20 years with multiple tenant extension options. This provides sustained operational continuity, while fixed annual increases in the lease rate mitigates inflation concerns. If a credit union's needs for the real estate change over time, subletting a minority portion of the total space with permission of the CUSO owner is also permissible. The lease is an absolute triple net structure so the seller/lessee continues to operate and maintain the building with responsibility for all maintenance, insurance, taxes and other costs. The assumption of these tenant obligations is considered in establishing the rental payment amounts which are set lower to account for this. The other benefit of this is that the selling credit union is best equipped to operate and maintain the building with their designated employees, desired contractors and other desired building vendor relationships. This beats having to deal with an out-of-state landlord, even a well-intentioned CUSO one every time something needs to be done to a property, especially because these properties are the face of the credit union to their members, employees and community.

CUCM works with seller/lessee credit unions to find the best solution for the credit union. Does the credit union want to maximize its captial and liquidity gain? If so, the initial lease rate will be higher than if the credit union wants minimize lease payments. If the credit union wants a lower initial lease rate and increases, the purchase price will be less. CUCM will work direclty with the selling credit union to make sure your Board of Directors and your independent auditors are comfortable with all aspects of the proposed sale-leaseback transaction. Working with a CUSO buyer in an off-market sale-leaseback transaction allows a selling credit union to keep the entire proceeds for themselves and avoid the approximately 5% broker fee that most commercial real estate brokers will charge for marketing and selling a property to private investors. CUCM does a comprehensive survey of comparable sale prices and lease rates in that market to determine the real estate values and lease rates for a proposal. CUCM always strongly encourages the credit union seller to obtain their own appraisals of the properties from an independent apprisal firm so they know that they know the proposal is fair and can make an informed decision along with helping their Board of Directors and independent auditor also get comfortable with the sale-leaseback.

Benefits to CUSO Investors and Lenders

Credit unions can invest in sale-leaseback transactions by *other* credit unions through a permissible CUSO investment. Selling credit unions have priority in participating as investors in CUSOs that buy other credit union properties and as originators or loan participants in loans funding the purchase of other credit union properties.

Credit union investors that fund CUSO buyers can earn annual returns that are generally projected to be between 5% and 8% which is well above other investment instruments permitted under the investment rules. These investment returns are paid in the form of a quarterly dividend with an annual true-up. CU Capital Management has also structured the CUSO Network in a way that provides reasonable liquidity to all CUSO investors should there be a need for a credit union to sell its ownership in the CUSO. Returns to CUSO investors are projected to grow over time as lease rates across the CUSO portfolio increase annually. Best of all, this is a very hands-off CUSO investment where the CUSO owners need only to evaluate and vote on approving or denying newly proposed sale-leasebacks and other major decisions. Outside of that, CUSO owners simply receive their regular dividend distributions. CUCM does all of the other work to source and evaluate new credit union sale-leasebacks; manage all of the ongoing leases and other administrative responsibilities in the CUSO's capacity as a landlord; and ensure completion of all compliance and ongoing operating requirements for the CUSO.

As this is a permissible CUSO investment, the limitations in the investment rules do not apply. Lending opportunities to well-capitalized credit unions are also very attractive. The CUSO investments and loans in the CU Capital Management Sale-Leaseback Network are all backed by high-quality real estate <u>and</u> long-term leases to well-capitalized credit unions. In the CU Capital Management Sale-Leaseback Network, credit unions can be sellers/tenants, investors, and/or lenders. The purchasing CUSOs are solely owned by credit union investors, thereby keeping all the benefits within the credit union industry.

Depending on size of the sale-leaseback as well as the current interest rate and economic environment, CUCM will arrange for a credit union loan to partially fund the sale-leaseback transaction. In those cases, the initial loan-to-value will range from 50% - 65% and credit unions that are part of the CUSO Network as sellers or investors will have priority to be a lead lender and purchase loan participations before that opportunity is opened to other credit unions. It can be reasonably argued that there is no safer loan for a credit union to make than one to a CUSO that is backed by well-located real estate with a long-term triple net lease to a well-capitalized credit union.

Which credit unions are the best candidates to sell and lease back their property?

Credit unions that have owned some or all of their property for a decent period of time are the best candidates to sell and lease back their properties. This is because these properties have the benefit of being partially or substantially depreciated on the credit union's balance sheet along with having experienced appreciation in fair market value over time as well. These credit unions will have the most "gain-on-sale" which translates directly to net income and capital and increases in Net Worth Ratio. However, even credit unions that own relatively recently built, acquired or substantially renovated properties can see an attractive and beneficial gain due to the value that a sale-leaseback lends to a proposed transaction over the value of the property when vacant.

To maximize the capital gain on the sale of real estate, a credit union is well advised to sell it in a sale-leaseback transaction and lease back 100% of the space. Remember that the value of the property to a buyer in a sale-leaseback transaction includes both (1) the fair market value of the property and (2) the value attributed to the long-term lease. We have seen that the value of the long-term lease often bumps the fair market value anywhere from 20% to 100% depending on the individual market and the structure of the leaseback. Thus, if a credit union buys a property for $10 million and then sells it in a sale-leaseback the next day, the sales price may be $12 to $13 million depending on the terms of the lease and location of the property, resulting in $2 million to $3 million in new capital to the selling credit union. By agreeing to lease back 100% of the space, a selling credit union can maximize the amount that properties will sell for while maintaining flexibility to use the space as they need through the opportunity to sublet extra space. This is often more beneficial than selling an office property or branch and then incurring all of the costs of locating, acquiring renovating/updating and moving into a new property.

Over two-thirds of credit unions own some real estate used for their operations. That real estate is carried at a collective depreciated book value of over $31 billion. It is conservatively estimated that the market value of the property owned and used by credit unions is worth two or even three times that depreciated book value if sold in sale-leaseback transactions. That value is currently inaccessible to credit unions while it sits at a depreciated cost basis on balance sheets and sale-leasebacks, especially when other credit unions are the investors and lenders, allow the entire credit union industry to leverage this real estate into prosperity and growth to better compete with banks in serving their communities.

Credit unions who have an immediate need for the capital generated from a sale-leaseback for regulatory cushion purposes and/or those who have a plan for how to put the capital to work for the credit union's growth are the ones that can benefit most from a sale-leaseback. As stated above, some uses for the capital include offsetting losses from restructuring an underwater investment portfolio, whole bank or bank branch acquisitions, branch expansion, employee hiring and retention, major front-end or back-end technology investments, CUSO investments, loan/investment growth or launching of new business lines. These are the types of credit unions that are best positioned to not only survive but to thrive in an increasingly competitive environment.

Case Studies

In addition to immediately boosting liquidity and permanent capital, each of the following sale-leasebacks allowed the credit unions to enhance income from the immediate gain-on-sale, from ongoing increased net interest income related to the additional lending/investment capacity created and from other longer-term net income drivers derived from strategic use of the capital to fund growth initiatives for the credit union. The credit unions below all maintained uninterrupted operations and control for lease terms ranging from 15 years all the way up to 30 years, including extension options.

Wescom Central Credit Union, Pasadena, CA (Total Assets $6.2B)

- Sold their headquarters building to the CUSO for $59M
- Had owned and occupied the property since 1985
- Depreciated carrying value of just over $10M
- Leased back the fully property for initial 15-year term with three 5-year extensions
- Market rate lease with 2.5% annual increases
- Wescom continues to occupy, operate and maintain the property
- Wescom realized an increase in Net Worth of $50M and Net Worth Ratio of 0.75%
- The CUSO was able to out-compete all outside proposals

Affinity Federal Credit Union, Basking Ridge, NJ. (Total Assets $4.2B)

- Sold their headquarters building to the CUSO for $51.7M
- Had owned and occupied the property since 2008
- Depreciated carrying value of just over $25M
- Leased back the full property for initial 20-year term with one 10-year extension
- Market rate lease with 2.5% annual increases
- Affinity continues to occupy, operate and maintain the property
- Affinity realized an increase in Net Worth of $25M and Net Worth Ratio of 0.63%
- Specifically only interested in working with a CUSO buyer/landlord

Mission City Federal Credit Union, Santa Clara, CA (Total Assets $153.2M)

- Sold their headquarters building and flagship branch to the CUSO for $5.0M
- Had owned and occupied the property since 1995
- Depreciated carrying value of just under $1.5M
- Leased back the full property for initial 20-year term with one 10-year extension
- Market rate lease with 3.0% annual increases
- Mission City continues to occupy, operate and maintain the property
- Mission City realized an increase in Net Worth of nearly $3.5M and Net Worth Ratio of 1.90%

Conclusion: CU Capital Management Provides Credit Unions Multiple Opportunities and a Superior Sale-Leaseback Solution Over Private Investors

CU Capital Management is a CUSO that was created alongside credit unions and credit union industry experts to bring unique capital and asset opportunities to credit unions. As CUSO Network Manager, CU Capital Management oversees a network of CUSOs focused exclusively on sale-leasebacks for credit unions including opportunities for credit unions to participate as sellers/lessees, as investors and/or as lenders. Specific functions include the formation of the CUSO entities, the purchases of the real estate, the leases and collection of rents, the property loans, the investments by credit unions, the distributions to investor credit unions, and the ongoing oversight of each lease/property. As NACUSO Business Services' first Promotion Partner, CU Capital Management, has developed three opportunities for credit unions to participate in its Sale-Leaseback Network.

1. **CAPITAL ACQUISITION OPPORTUNITIES**. The first is the ability for a credit union to sell its appreciated operational real estate (headquarters building, operations center and/or branch network) and lease back the real estate. The new accounting rules enable the credit union to book all the gain-on-sale in the period a transaction closes, so there is an immediate, and often substantial, capital bump. Capital and liquidity are made available for growing loans and investments, improving member services, acquisition/expansion of new branch locations, technology investment and development, and more. The operations of the credit union are not interrupted. The buyers and lessors of the real property are CUSOs ("Lessor CUSOs"). Each Lessor CUSO will own and lease the real estate from one credit union seller/lessee. A Lessor CUSO is owned by an Investor CUSO as described below. The Board of Managers of a Lessor CUSO consists of three credit union representatives elected by the Investor CUSO.

2. **INVESTMENT OPPORTUNITIES.** The second opportunity is for credit unions to invest directly in CUSOs ("Investor CUSOs"). The Investor CUSOs will, in turn, invest in a number of Lessor CUSOs so that the risk for the Investor CUSOs is diversified among multiple credit union leased properties. The expected returns are very attractive compared to other permitted investment opportunities available to credit unions and dividends are paid on a quarterly basis. The Investor CUSOs are managed by representatives from the investing credit unions. The Board of Managers of an Investor CUSO consists of one representative from each of the credit union investors.

3. **LENDING AND LOAN PARTICIPATION OPPORTUNITIES.** The third opportunity is for credit unions to lend to the Lessor CUSOs, either as the original lead lender or as a purchaser of a loan participation interest. Credit unions can lend under both their Member Business Lending and CUSO lending powers. A diverse array of lending opportunities exists including variable and fixed rate loans with a range of term lengths. Selling credit unions are permitted to put some of their capital to work by lending on sale-leasebacks by other credit unions or even immediately on their own transaction.

EPILOGUE

Credit unions monetizing real estate holdings can grow capital, enhance reserves, expand lending and investment capacity, and invest back in the credit union to better serve their mission and their members. CU Capital Management's unique sale-leaseback model utilizes a network of CUSOs to allow credit unions the opportunity to receive attractive, risk-adjusted returns through participation in the equity and/or debt components of sale-leaseback transactions by other credit unions and keeps all of the benefits of sale-leasebacks within the credit union industry. A CUSO landlord helps alleviate all of the concerns that credit unions rightfully have when considering a sale-leaseback with private investors coming from outside of the credit union industry.

CU Capital Management looked "back to the future" to develop a CUSO model that benefits credit unions, CUSOs and the entire credit union industry. By providing the tools and the network to unlock capital that can be used to strengthen the balance sheets of participating credit unions and thereby eliminating the need for involvement with real estate investment trusts, banks, pension funds and other outside third parties, all real estate assets, loans and investments stay within and help to fortify the entire credit union ecosystem. Credit unions have achieved growth and success by always looking out for one another through cooperation and resource/idea sharing. However, in an increasingly competitive economic environment, credit unions will **need to collaborate** in order to ensure their collective survival and growth. The opportunity to do so with sale-leasebacks and the utilization of CUSOs should be no exception.

Please reach out to CU Capital Management at info@cucapitalmanagement.com if you would like to discuss sale-leasebacks for credit unions in more detail or would like a no-obligation estimate of what your credit union's properties may be worth as part of a sale-leaseback, including an approximation of your increase in capital and boost to Net Worth Ratio.

For additional information, including answers to Frequently Asked Questions, please visit www.cucapitalmanagement.com or email info@cucapitalmanagement.com.

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About CU*influential*sm

CU*influential*sm is a corporate communications firm dedicated to enhancing the strength of the credit union industry by accelerating collaborative growth among credit unions, CUSOs and small business.

Founder Mike Hales served the National Association of Credit Union Service Organizations (NACUSO) as a board member, and during his 18-year tenure he chaired the NACUSO Governance, Membership Growth, and Business Services Committees. He has been president of two Credit Union Service Organizations, and a veteran bank and credit union consultant with Moss Adams, LLP, Counter Intelligence Associates, and the Rochdale Group where he oversaw the development and launch of 16 multiple credit union-owned CUSOs. Prior to his credit union career, Mike was a community bank president and served as chair of the California Bankers Association Sales and Marketing Committee.

Mike is a graduate of the *ABA School of Bank Marketing Management and Strategic Planning* at the University of Georgia, and the *NACUSO/Pepperdine University Graziadio School of Business and Management Designing and Implementing Collaboration and Business Networks* certificate program. He is also a graduate of the Lincoln University School of Law and author of "*The Handbook of Consumer Banking Law*" © Prentice Hall and "*The Language of Banking*" © MacFarland & Company.