Feasibility Study for the Creation of a Latino Credit Union in Minnesota

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Feasibility Study for the Creation of a Latino Credit Union in Minnesota.
Summary of results and recommendations
for Latino Economic Development Center Board of Directors

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Content

I. Summary of market analysis[1]

- A credit union is a cooperative society, incorporated for the twofold purpose of promoting thrift among its members and crating a source of credit for them at legitimate rates of interest for provident purposes.
- For the case of the Latino Credit Union the demand is measured based on the following elements: demand for bank accounts. Demand for credit cards. Demand for money transfer services. Demand for loans and credits. The demand for these services is determined by: Population growth. Number of formal jobs held by Latinos. Demand for credits for new houses. Expenditures patters related to tastes, needs, and cultural characteristics.
- From the analysis of these factors we reached the conclusions that: There exists a sufficient potential demand for banking services directed to the Latino population in Minnesota.
- There is not a single credit union in Minnesota devoted to serve the Latino population in the state.
- Finally, we conclude that there exist a sufficient market for a Latino Credit Union in Minnesota and that the feasibility of an institution o this nature will depend on its own marketing efforts to capture the potential market.
- However, the Hispanic population has low average balance in bank accounts, and also low average amount in loans. Therefore, the potential income for the credit union will depend on the capacity of the organizers to attract a high number of members.

[1] This is a summary of the results from the market study conducted in the first stage of the project.

II. Estimated Financial Results

The estimated financial results are summarized in the following tables. They include assumptions about operating, and financial costs, membership levels, other necessary assumptions, Statement of Financial Condition and the Statement of Income and Expenses for the first 6 years of operation of the credit union.

Cost Assumptions

Operational Costs	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Number of Members	**1,000**	**7,000**	**14,000**	**25,000**	**25,000**	**25,000**
Number of Full Time employees	3	16	32	27	27	27
Compensation: (Average Compens./FT employee) x No. Employees	$ 72,647.22	$388,254.49	$ 768,103.27	$ 648,000.00	$ 658,232.18	$ 658,232.18
Estimated operation expenses	$ 53,184.92	$351,006.80	$ 544,184.23	$ 770,841.10	$ 791,929.82	$ 791,929.82
TOTAL OPERATIVE EXPENSES	**$125,832.14**	**$739,261.28**	**$1,312,287.50**	**$1,418,841.10**	**$1,450,161.99**	**$1,450,161.99**
Average compensation per FT employee	$ 24,000.00	$ 24,000.00	$ 24,000.00	$ 24,000.00	$ 24,000.00	$ 24,000.00
Average operative cost by member	$ 53.18	$ 50.14	$ 38.87	$ 30.83	$ 31.68	$ 31.68

Other Assumptions

Average aggregate net worth in checking account for renters and home owners	***$ 1,037.86***
Average aggregate net worth in checking account for renters and home owners	$ 1,037.86
Potential market	57,000
Ration FT employees / Number of Members	0.005
Average amount per loan (5)	$ 6,650.78
Ratio Number of Loans/Members	0.1
Loan income rate	0.063
Investment Rate	0.04
Dividend Rate	0.005
Provision for loan losses	0.01
Fees % members	$ 10.5

Estimated Statement of Financial Condition. First 6 years of Operation. Basic Assumptions.

Line Item	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	Amount	Amount	Amount	Amount	Amount	Amount
ASSETS:						
Cash & Equivalents	275,863.00	409,269.01	531,860.65	8,528,497.34	8,497,176.44	8,497,176.44
Invest	100,000.00	1,807,180.00	3,981,824.00	100,000.00	100,000.00	100,000.00
TOTAL LOANS	**665,077.62**	**4,655,543.33**	**9,311,086.67**	**16,626,940.48**	**16,626,940.48**	**16,626,940.48**
(Allow. Ln & Lease Losses) (3)	16,626.94	116,388.58	232,777.17	415,673.51	415,673.51	415,673.51
Other Fixed Assets						
NCUSIF Deposit	10,378.60	72,650.18	145,300.35	259,464.91	259,464.91	259,464.91
All Other Assets						
TOTAL ASSETS	5,189.30	36,325.09	72,650.18	129,732.46	129,732.46	129,732.46
LIABILITIES & CAPITAL:						
Dividends Payable	**5,189.30**	**36,325.09**	**72,650.18**	**129,732.46**	**129,732.46**	**129,732.46**
Accts. Pay. & Other Liab.	**1,037,859.65**	**7,265,017.54**	**14,530,035.09**	**25,946,491.23**	**25,946,491.23**	**25,946,491.23**
TOTAL LIABILITIES	-	-	-	-	-	-
TOTAL SHARES & Dep.	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00
Regular Reserve	(75,102.79)	(340,311.53)	(499,836.42)	(245,647.44)	(276,968.34)	(276,968.34)
Other Reserves	**24,897.21**	**(240,311.53)**	**(399,836.42)**	**(145,647.44)**	**(176,968.34)**	**(176,968.34)**
Undivided Earnings	**1,067,946.15**	**7,061,031.10**	**14,202,848.84**	**25,930,576.24**	**25,899,255.34**	**25,899,255.34**
TOTAL EQUITY	5,189.30	36,325.09	72,650.18	129,732.46	129,732.46	129,732.46
TOTAL LIAB. & EQUITY						

Statement of Income and Expenses. First 6 years of operation under basic assumptions.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
INTEREST INCOME						
Loan Income	41,899.89	293,299.23	586,598.46	1,047,497.25	1,047,497.25	1,047,497.25
Investment Income	4,000.00	72,287.20	159,272.96	4,000.00	4,000.00	4,000.00
TOTAL INTEREST INCOME	**45,899.89**	**365,586.43**	**745,871.42**	**1,051,497.25**	**1,051,497.25**	**1,051,497.25**
INTEREST EXPENSE						
Dividend Expenses	5,189.30	36,325.09	72,650.18	129,732.46	129,732.46	129,732.46
Interests on deposits						
TOTAL INTEREST EXPENSE	**5,189.30**	**36,325.09**	**72,650.18**	**129,732.46**	**129,732.46**	**129,732.46**
Provision for Loan Losses	459.00	3,655.86	7,458.71	10,514.97	10,514.97	10,514.97
GAIN/LOSSES	**40,251.59**	**325,605.48**	**665,762.53**	**911,249.82**	**911,249.82**	**911,249.82**
NON-INTEREST INCOME						
Fees	10,477.75	73,344.27	146,688.55	261,943.83	261,943.83	261,943.83
Other operating income						
Other Income						
OPERATING EXPENSES (non-interest)	-	-	-	-	-	-
Salaries & Benefits	72,647.22	388,254.49	768,103.27	648,000.00	658,232.18	658,232.18
Other operation expenses	53,184.92	351,006.80	544,184.23	770,841.10	791,929.82	791,929.82
Other expenses						
TOTAL OPERATING EXPENSES	**125,832.14**	**739,261.28**	**1,312,287.50**	**1,418,841.10**	**1,450,161.99**	**1,450,161.99**
NET INCOME (6)	**(75,102.79)**	**(340,311.53)**	**(499,836.42)**	**(245,647.44)**	**(276,968.34)**	**(276,968.34)**

Notes:

(1) Loans = Average amount per loan x Estimated Number of Loans. The number of loans = ratio loans/Members x Estimated Number of Members.
(2) Potential market is defined as those Hispanic individuals 15 years old or older, residents of the Twin Cities that do not have a bank account in 2005.
(3) Allowance for losses: 2.5% of total loans.
(4) Estimated shares and deposits = (Estimated number of members) x (average net worth in checking accounts).
(5) Data from Latino Community Credit Union - Durham, North Carolina.
(6) These are year by year estimations not including accumulated loss or gains.

III. Financial Analysis

- According to the assumed market conditions (number of potential members, and historic average balances of bank accounts and loans), the estimated financial statements show an increasing operational deficit over the first six years of operations.

- As mentioned in market study conclusions, the two main factors causing the operational deficit are the **low average balances of bank accounts and loans of the Hispanic population (Approximately $1,000 for checking accounts and $4,000 for loans).** As a comparison, members of St. Paul FCU had an average balance of $6,000 and borrowed in average $14,000 in 2004.

- Latinos also have a low relative demand for loans. For example, only 1 of 10 members of the North Carolina Credit Union has a loan. On the other hand about 6 of every 10 members of the St. Paul Credit Union have loans.

- **Under the above conditions the Latino Credit Union is <u>not feasible</u>.**

IV. Conditions and requirements for the feasibility of the Latino Credit Union.

- The operation of a credit union is costly; furthermore, because of the low average balances in bank accounts and loans of Hispanics **the gap between the income from interest, which is the regular source of income of a banking operation, does not grow as fast as the operational costs of the credit union, generating a deficit that makes difficult the feasibility of the credit union.**

- This situation **will required from the credit union leaders to look for sources of funds other than the regular financial lending operations** in order to overcome the operational deficit.

The feasibility of a Latino Credit Union will depend on the following factors:

1. **Collection of funds for initial investments.** Possible sources: partner credit union and external grants. The approximate amount of these funds would depend on the conditions of the partnership with a larger credit union. The funds may range from at least $100,000 for the first year (assuming an advantageous partnership) to a sequence of funds for the first 3 years of approximately $450,000.

2. **The establishment of a partnership with a larger credit union**. This partnership will assure the reduction of the operational costs of the Latino Credit Union, through the provision of infrastructure, facilities, technology, training, personnel, and other resources.

3. **The Latino credit union must generate financial funds through financial operations such as investment in bonds and other assets.**

4. **An aggressive educational and communication plan to enhance financial education and create trust on the financial system**. The leaders of the Latino credit union need to be aware that average Hispanic are not familiar with financial tools and services. Also, this group shows the lowest levels of income among all minorities. Furthermore, many Latino immigrants show hesitation to access the formal financial system because of their legal status or barriers imposed by regular banks.

5. **Recruitment and training of qualified leadership and managerial team.** The formation of a credit union requires significant effort, time. It is also needed a sufficiently qualified team of leaders who are knowledgeable in financial matters or willing to educate themselves about the processes of the credit union operations. The project organizers would need to develop a strong recruitment strategy so that the Latino Credit Union could count with the necessary human capital to operate efficiently. It is worth to mention that recruitment of qualified personnel requires offering competitive salaries since skilled Latinos are usually attracted by high salary offers from the private business sectors.

V. Examples of scenarios.

Scenario A

- The partnership allows the Latino Credit Union to pay only $100,000 of its operational expenses.
- $250,000 initial grant (first year).
- Then the Latino Credit Union will produce positive accumulated net income by its 4th year.

Scenario B

- The partnership allows the Latino Credit Union to pay only $100,000 of its operational expenses.
- $250,000 grant (first year).
- $150,000 grant (Second year).
- $100,000 grant (Third year).
- Then the Latino Credit Union will produce positive accumulated net income since its 1st year and net losses for its 2nd and 3rd years only.

Scenario A

Statement of Income and Expenses. First 6 years of operation under scenario A.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
INCOME						
INTEREST INCOME						
Loan Income	41,899.89	293,299.23	586,598.46	1,047,497.25	1,047,497.25	1,047,497.25
Investment Income	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00
TOTAL INTEREST INCOME	**45,899.89**	**297,299.23**	**590,598.46**	**1,051,497.25**	**1,051,497.25**	**1,051,497.25**
INTEREST EXPENSE						
Dividend Expenses	5,000.00	35,000.00	70,000.00	125,000.00	125,000.00	125,000.00
Interests on deposits						
TOTAL INTEREST EXPENSE	**5,000.00**	**35,000.00**	**70,000.00**	**125,000.00**	**125,000.00**	**125,000.00**
Provision for Loan Losses	459.00	2,972.99	5,905.98	10,514.97	10,514.97	10,514.97
GAIN/LOSSES	**40,440.89**	**259,326.24**	**514,692.48**	**915,982.28**	**915,982.28**	**915,982.28**
NON-INTEREST INCOME						
Fees	10,477.75	73,344.27	146,688.55	261,943.83	261,943.83	261,943.83
Other operating income						
Other Income	250,000.00					
OPERATING (Non-income) EXPENSES						
Salaries & Benefits	72,647.22	388,254.49	768,103.27	648,000.00	658,232.18	658,232.18
Other operation expenses	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00
Other expenses						
TOTAL OPERATING EXPENSES	**172,647.22**	**488,254.49**	**868,103.27**	**748,000.00**	**758,232.18**	**758,232.18**
NET INCOME	**128,271.42**	**(155,583.98)**	**(206,722.25)**	**429,926.11**	**419,693.93**	**419,693.93**
ACCUMULATED NET INCOME	**128,271.42**	**(27,312.55)**	**(234,034.80)**	**195,891.31**	**615,585.24**	**1,035,279.17**
Regular reserves	14,109.86	-	-	47,291.87	46,166.33	46,166.33

Notes:

(1) Assume constant operational costs of $100,000 resulting from strategic partnership and a $250,000 initial grant.

Scenario B

Statement of Income and Expenses. First 6 years of operation under scenario B.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
INCOME						
INTEREST INCOME						
Loan Income	41,899.89	293,299.23	586,598.46	1,047,497.25	1,047,497.25	1,047,497.25
Investment Income	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00
TOTAL INTEREST INCOME	**45,899.89**	**297,299.23**	**590,598.46**	**1,051,497.25**	**1,051,497.25**	**1,051,497.25**
INTEREST EXPENSE						
Dividend Expenses	5,000.00	35,000.00	70,000.00	125,000.00	125,000.00	125,000.00
Interests on deposits						
TOTAL INTEREST EXPENSE	**5,000.00**	**35,000.00**	**70,000.00**	**125,000.00**	**125,000.00**	**125,000.00**
Provision for Loan Losses	459.00	2,972.99	5,905.98	10,514.97	10,514.97	10,514.97
GAIN/LOSSES	**40,440.89**	**259,326.24**	**514,692.48**	**915,982.28**	**915,982.28**	**915,982.28**
NON-INTEREST INCOME						
Fees	10,477.75	73,344.27	146,688.55	261,943.83	261,943.83	261,943.83
Other operating income						
Other Income	250,000.00	150,000.00	100,000.00			
OPERATING (Non-income) EXPENSES						
Salaries & Benefits	72,647.22	388,254.49	768,103.27	648,000.00	658,232.18	658,232.18
Other operation expenses	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00	100,000.00
Other expenses						
TOTAL OPERATING EXPENSES	**172,647.22**	**488,254.49**	**868,103.27**	**748,000.00**	**758,232.18**	**758,232.18**
NET INCOME	**128,271.42**	**(5,583.98)**	**(106,722.25)**	**429,926.11**	**419,693.93**	**419,693.93**
ACCUMULATED NET INCOME	**128,271.42**	**122,687.45**	**15,965.20**	**445,891.31**	**865,585.24**	**1,285,279.17**
Regular reserves	14,109.86	-	-	47,291.87	46,166.33	46,166.33

Notes:

(1) Assume constant operational costs of $100,000 resulting from strategic partnership and an aggregate amount of external funds of $500,000 for the first 3 years.

References

National Credit Union Administration. Financial data retrieved for benchmarking analysis on November 4, 2006 from: http://www.ncua.gov/IndexCUQuery.htm. Other materials also retrieved from NCUA webpage.