TAKING THE PAIN OUT OF BORROWING

WHEN SMALL-BUSINESS owners in New Jersey look for funding, their first choices are often the obvious ones: family, friends, credit cards or banks. But doing business with friends and family comes with strings attached: If the loan goes sour it can tear the relationship apart. And credit cards usually carry double-digit rates.

That doesn't mean banks are the only remaining solution. For some small-business owners, a credit union can work just fine.

"Since credit unions are member-owned, they may be a bit more likely to extend financing to someone that's been turned down by a bank," says Scott Rekant, vice president of government affairs at the New Jersey Credit Union League in Hightstown. He says credit unions might also offer a better rate than a bank.

That's assuming the CU offers business loans. And federal regulations restrict the amount of money that a credit union can lend to a business. Generally, a so-called member business loan (MBL) won't exceed $50,000; and the total amount of a credit union's

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Hard Lessons Learned from Catering to One Industry

United Teletech's narrow focus led to a surge in loan losses

Robin Zielinski

Flanyak says it looked like nothing could go wrong during the heady days of the 1990s.

By Martin C. Daks

WHAT WOULD HAPPEN to your business if you relied upon only a few customers for most of your revenue and these customers hit hard times simultaneously? That's what happened to United Teletech Financial.

For three decades since its 1967 launch, the Tinton Falls-based credit union prospered by drawing members from the lucrative telecommunications industry. But when the dot-com bubble burst at the end of the 1990s and the telecom industry swooned, United's members—and its finances—took a painful hit. The organization's fall and its attempt at a comeback offer lessons that can be applied to just about any industry.

In 1999, the credit union had $185.6 million in assets, 25,046 members and net income of $2.1 million. In 2004, while assets had increased to $258 million, membership had slipped a bit to 24,950 and net income had

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CRANFORD

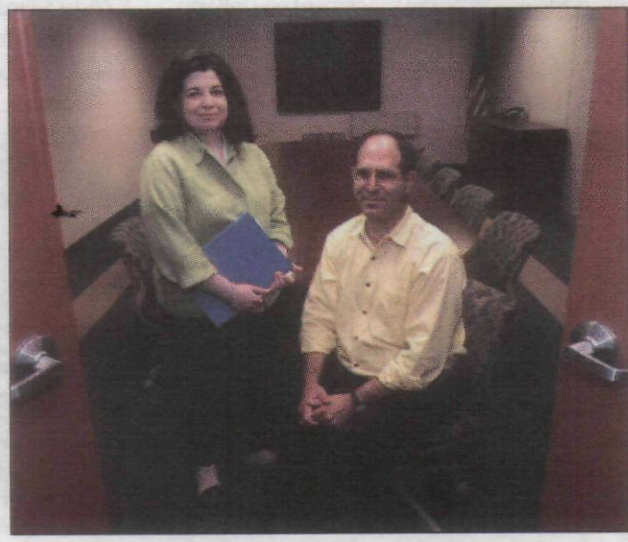
A Level Playing Field Or an Unfair Tilt?

Bankers cry foul over a federal proposal to make credit unions more competitive

By Martin C. Daks

CREDIT UNIONS AND BANKS have long had a testy relationship. Now representatives of the institutions are tussling over a bill introduced this spring in the U.S. House of Representatives. H.R. 2317, the Credit Union Regulatory Improvements Act (CURIA), would relax some of the restrictions that govern credit union operations.

Supporters say it would increase competition in the financial arena, benefiting consumers and small-business borrowers.



Robin Zielinski

Rekant and spokeswoman Sharon Dilling just want an even break.

Bankers say the new rules would give credit unions, which enjoy a privileged status under the federal tax code, the upper hand.

"We vehemently oppose this bill," says Charlotte Birch, a spokeswoman for the American Bankers Association in Washington, D.C. "Credit unions were originally granted tax and other advantages because they were created to serve people

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Hard Lessons Learned

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dropped to $1.6 million. This was primarily due to loan defaults among its members.

"The 1990s were a whirlwind for United Teletech," says Bob Flanyak, vice president of retail delivery. "The telecommunications market and high-tech in general just kept growing, and it looked like nothing could go wrong."

United had a great niche. High telecom-industry salaries meant that a lot of members had household incomes of $100,000 a year or more, a level Flanyak says is significantly higher than that of most credit unions.

At that point United Teletech was doing exactly what credit unions were originally chartered to do: limiting its services to a specific segment of the population and getting to know its members' needs. But United's close alignment with telecom and related high-tech companies meant the credit union would be set up for a fall when the sector stumbled.

"It's tempting to chase the niches that are most profitable, and many service industries have done just that," says Marty Abo, principal of Abo and Associates, a CPA firm based in Voorhees. "But people who are familiar with the principles of risk management will tell you that it's better to diversify."

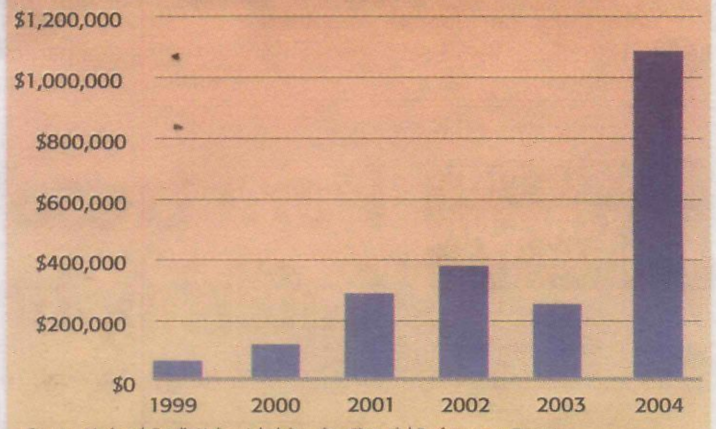
Up until the early 1980s, credit unions didn't have a choice—federal legislation kept their focus on limited, "common bond" member segments. But the rules were loosened in the early 1980s, and 1998 legislation opened the way for federal credit unions to serve just about anyone. But United may have waited too long to do so.

In the wake of the 2000-to-2001 dot-com meltdown and subsequent blows to the telecom industry, many of United Teletech's members lost their jobs; many defaulted on their loans. The credit union tried to soften the blow by letting borrowers opt for short-term interest-only payment plans or by letting them take out additional, short-term bridge loans to cover monthly payments. But eventually some of these loans had to be written off.

A look at the institution's 2004 annual report highlights the impact of the ongoing layoffs at places like AT&T. In 1999, the year before the dot-com meltdown, United's loan-loss provision was only $60,000. By 2003, when United posted $8.1 million of income from loans, it also recorded a provision for loan losses of $248,538. While loan income fell about 1.7% to $8 million in 2004, United's loan losses jumped nearly five times to more than $1 million. The bad debt expense rippled through the company, which posted $4.1 million of income from operations in 2003, but only $3.3 million in 2004.

Burgeoning Problems with the Loan Portfolio

Provision for Loan Losses at United Teletech Financial



Source: National Credit Union Administration Financial Performance Reports

"Most of our $1 million in loan write-offs were due to people going bankrupt," reports Flanyak. "It's sad. Every week at our AT&T Middletown location, for example, we see AT&T employees getting a pink slip."

United wasn't the only organization to face this problem. According to statistics from the Credit Union National Association, the number of credit unions across New Jersey has plunged from a high of 670 in 1979 to 248 by the end of 2004. Industry observers say that many of the smaller groups consolidated in an effort to absorb increasing expenses.

Still, Ethne Swartz, an assistant professor of entrepreneurial studies at Fairleigh Dickinson University in Madison, takes United's management to task for maintaining a narrow focus for so long.

"The accepted wisdom calls for building in resilience by diversifying a business, instead of relying on one or two customers or classes of income streams," Swartz says. "It can be tempting to rely on a limited group of customers or markets, but it's better to build up a broad base."

In late 2004 United Telecom began offering debt-protection policies in a bid to stem the loan losses. Under the program, members can buy an insurance-like policy that will make good on their loan payments for a specified period of time if they lose their job involuntarily as a result of disability, layoff, death or certain other conditions.

"Because we're not looking to make a profit on the policies we have a certain latitude regarding pricing," says Flanyak. "But the program is expected to at least cover its costs."

More important for its long-term health, United has also been working on diversifying its membership base. The credit union has opened its ranks to a variety of nontelecom businesses, and on May 5 federal regulators gave it a green light to accept anyone who lives, works or attends church in the fast-growing counties of Monmouth and Ocean. Other federal credit unions, including First Atlantic in Eatontown, have also become so-called community credit unions that are defined by geography instead of industry.

> *"We thought we were doing the right thing, but our members were simply losing their jobs."*
>
> **Bob Flanyak**
> Vice President, United Teletech

Abo applauds this change. "If I was catering to a particular segment, I'd try to leverage my expertise to additional markets that aren't necessarily on the same cycle," he says. "For example, at one time I had a lot of doctors as clients, so I took my tax and other skills for handling professional services firms and extended it to attorneys. Now if the activity in one group ever dips for some reason, I've got other segments that will likely take up the slack."

Flanyak, who's been with United since 1999, says he sees these and other changes as part of a long-term strategy. "The days of starting a credit union around a plant site, or even an industry are gone," he reports. "When you limit yourself to a small segment you're increasing your risk. We thought we were doing the right thing, but our members were simply losing their jobs."

Even today three out of United's six offices are actually inside buildings owned by AT&T, Lucent and Avaya, its big telecom-industry members. But if the diversification strategy works, maybe next time telecom hits stormy weather, United Telecom won't end up soaked. ◆

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Taking the Pain Out of Borrowing

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MBLs usually can't total more than 12.25% of its assets.

"Each MBL is considered on it's own merits," says Ted Sweeney, vice president of lending at Raritan Bay Federal Credit Union's headquarters in Sayreville. "Annual interest rates on a business loan currently range from 5.25% to 10% depending on collateral, credit history and other factors."

Besides the rates, Sweeney says that credit unions are friendly to borrowers. "We're more accessible than banks," he explains. "Here, for example, a person can walk in and deal directly with a vice president instead of having to first run a gauntlet of other people. Also, because credit unions are limited in the amount of business loans that can be made, we tend to spread out the risk by being willing to make a higher volume of loans for lower amounts. That can be important to a small-business borrower."

Of course bankers are quick to point out their own advantages. "Often, a business owner is looking for more than just rates," says Timothy E. Doherty, vice president of the New Jersey Bankers Association in Princeton. "They would like a complete banking relationship, which is a specialty of commercial banks."

Doherty adds that because banks are highly regulated, a small-business owner can feel comfortable placing his or her assets with a bank as part of an overall relationship.

These days a business has to be prepared to move quickly to take advantage of opportunities—and that can mean being able to scare up extra cash on short notice. If banks, credit unions and other financial institutions are looking to take on new customers, that can only be good news for borrowers. ◆

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