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Carrie L. Birkhofer



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2009 Annual Report



A Letter from the Chairperson and the President and Chief Executive Officer

Bay Federal Credit Union has seen many changes in our community over the past 52 years. Still, 2009 stands out as a year to be remembered – both for the economic challenges facing the community and the opportunities to assist those in need. Bay Federal was not immune to the financial impact of the recession and we took quick action to minimize losses, while at the same time focusing on the needs of our members.

The economic environment required the Management Team and the Board of Directors to quickly adapt to the rapidly changing market and closely manage expenses. The results paid off – the Credit Union was profitable by approximately \$9 million at an operational level for the year. However, due to high unemployment and declining home values, it was necessary to set aside just over \$15 million in loan loss reserves as well as absorb over \$3.5 million in expenses due to corporate credit union losses and federal share insurance premiums.

As a result, the Credit Union posted a net loss of \$9.9 million. Unlike banks, credit unions did not receive any capital from bailout packages from the Federal government. Fortunately, we had sufficient reserves to absorb the net loss and we closed the year adequately capitalized at 6.11%.

Although the downturn in the economy and its impacts to financial institutions made 2009 a challenging year, we continued to hold fast to our mission to make a real difference in the lives of those we serve. We worked diligently to soften the turbulent economy's impact on our members and the Credit Union.

Our dedicated team members adapted to a constantly changing economic environment and upheld our mission through every point of contact. Each and every day, we focused on assisting members who were struggling to make ends meet. We explored financial options based on an individual's situation, encouraged members to take advantage of our free and confidential financial counseling service, explained how to maximize deposit insurance coverage, helped our members roll over their retirement plans and continued to support the community by working at not-for-profit events.

The following highlights some of our accomplishments in 2009:

- We provided over 400 members with loan modifications and financial counseling to help them keep their homes and vehicles during their time of need.
- For the seventh consecutive year, 100% of Bay Federal employees volunteered their time and financial resources to assist local non-profit organizations.
- Our Youth Financial Education Program reached over 1,250 students throughout the county.
- Our Balance Financial Education program provided complimentary, personalized financial counseling and assistance to nearly 500 members through our toll-free hotline.

- Our free adult financial education seminars reached over 230 community members about the benefits of budgeting and understanding credit.
- Our website now features self-paced education modules to help members take charge of their financial future.
- Bay Federal received the following awards in 2009:
 - Community Outreach Award by the California Nevada Credit Union League
 - "Be the Difference" Award from the Volunteer Centers of Santa Cruz County
 - Business of the Year by the Aptos Chamber of Commerce
 - Exceptional Employer designation during National Disability Employment Awareness Month
 - Woman of the Year recognition awarded to our CEO by the Mid-County Post

The community also voted Bay Federal as the "Best Local Financial Institution" through reader polls in regional newspapers, including the Press Banner, Good Times and Santa Cruz Weekly.

We are optimistic about the opportunities that 2010 will bring, and yet will remain diligent in our fiscal responsibilities toward the safety and soundness of member assets. Bay Federal has been serving Santa Cruz County since 1957, and we plan to continue serving the community for generations to come.

In 2010, we have launched plans to expand loans and enhance products and services. Our staff will continue to work in our community to make it a better place, and we will live our mission of "making a real difference in the financial lives of the people in the communities we serve".

We are honored to serve an organization that exhibits integrity, care, compassion and a real commitment to our community. Please accept our sincere appreciation for your generous and continued support of Bay Federal Credit Union.

Sincerely,

Dana M. Sales
Chairperson

Carrie L. Birkhofer
President and Chief Executive Officer



Supervisory Committee and Treasurer's Report

The Supervisory Committee's role is to oversee the system of internal controls to ensure the safety and soundness of our Credit Union and to protect the assets of our membership. In 2009, the Supervisory Committee secured the services of Clifton Gunderson, LLP, to perform a certified financial audit of the Credit Union. The CPAs stated that, based on the Credit Union continuing as a going concern, the financial statements present fairly the financial position of the Credit Union as of June 30, 2009. The CPAs also conducted a verification of member accounts with no exceptions noted.

The economic crisis of 2009 brought many challenges to our local, state, national and global markets. The Central Coast was hit hard by the recession, with 12.5% of our community members unemployed or underemployed during the year, resulting in delinquencies as members struggled with individual financial hardships. The California State budget crisis left many local organizations and companies scrambling for funding. Lending activities across the nation nearly ground to a halt as a result of federal regulators becoming overly conservative due to the alarming delinquency rate.

Despite our best efforts to work with members on an individual basis with our Home and Consumer Loan Preservation Programs, the burden of debt proved too great for some. Bay Federal was conservative in accruing for potential loan losses during this challenging year and set aside over \$15 million in Provision for Loan Losses.

During 2009, the United States government put plans in place to assist banks with the Troubled Asset Relief Program (TARP). Without receiving TARP assistance, credit unions across the nation shouldered the burden to repair the National Credit Union Share Insurance Fund upon the conservatorship of two corporate credit unions. Bay Federal Credit Union's portion of the expense was \$3.5 million dollars. While this was an unexpected expense, our reserves were sufficient to absorb this loss.

These challenges required your Credit Union Board of Directors and Management Team to make tough decisions. In order to offset rising loan losses and industry-related expenses, the Management team enacted a series of difficult but necessary expense reductions.

The reduction in expenses softened the blow of the recession-induced losses. Although the Credit Union posted a \$9.9 million loss for the year, the capital ratio ended the year at 6.11%, classified as adequately capitalized.

Assets ended the year at \$585.9 million. Although membership remained flat for the year, deposits decreased by 5%. The reduction in deposits was almost solely due to maturing Certificates; our core deposits, Checking and Savings accounts, increased by 18% during the same time period.

Despite the challenges in 2009, Bay Federal Credit Union strives to offer exceptional and affordable services to you, our member. We have been solidly committed to serving our community since 1957 and Bay Federal Credit Union remains steadfast in serving our community in the years ahead. Through risk management assessments, significant improvements in efficiencies and process enhancements, and careful management of expenses, the Credit Union returned to profitability in September 2009.

We are grateful to the Board, the Management Team and the employees of Bay Federal for their commitment to a strong set of core values and a commendable worth ethic that they demonstrated every day. We would like to extend our warm appreciation to our membership, on behalf of the entire organization, for making Bay Federal Credit Union your financial institution of choice.

Statement of Income

for the year ending December 31, 2009 (unaudited)

INTEREST INCOME	
Interest on Loans	\$ 34,233,716
Interest on Investments	319,853
Total Interest Income	\$ 34,553,569
INTEREST EXPENSE	
Dividends and Interest	\$ 6,740,139
Interest on Borrowed Money	4,961,287
Total Interest Expense	\$ 11,701,426
Net Interest Income	\$ 22,852,143
Provision for Loan Losses	15,279,000
Interest Income Net of Provision	\$ 7,573,143
Non-Interest Income	7,814,888
OPERATING EXPENSES	
Compensation and Benefits	\$ 12,262,339
Operations	8,038,642
Occupancy	2,561,119
Other Expenses	2,473,499
Total Operating Expenses	\$ 25,335,599
Net Loss	\$ (9,947,568)

Statement of Financial Condition

as of December 31, 2009 (unaudited)

ASSETS	
Member Loans (net)	\$ 478,004,889
Cash	7,166,404
Investments	72,843,192
Land, Building and Equipment	23,110,326
Share Insurance Deposit	4,846,498
Total Assets	\$ 585,971,309
LIABILITIES, DEPOSITS AND EQUITY	
Notes Payable	\$ 81,000,000
Other Liabilities	224,286
Member Deposits	468,941,253
Equity	35,805,770
Total Liabilities, Deposits and Equity	\$ 585,971,309

