UNIVERSITY FEDERAL CREDIT UNION
70th
70th ANNIVERSARY

2005 Annual Report

Contents:

Chairman's Report

University Federal Credit Union performed exceptionally well in 2005 with respect to financial performance, service to our community, and, most importantly, the manner in which it served its members' financial needs. Your board of directors, executive management team, and staff worked hand-in-hand to achieve several noteworthy milestones:

- *To further improve physical convenience for The University of Texas at Austin, UFCU secured the space formerly occupied by the University Co-Op on Guadalupe Street. In March of 2006, we relocated the former Dobie Mall Branch to this new, more convenient and visible location. Additionally, we purchased property on Ben White Blvd. at South Congress Avenue for eventual construction of a branch facility to better serve the St. Edward's University community.*
- *UFCU eliminated virtually all fees on education loans, making our student loan program one of the most competitive in the country.*
- *We converted all UFCU branch facilities to outlets within the national network of credit union shared facilities. That network, detailed at www.ufcu.org, includes well over 2,000 shared credit union outlets across the country at which UFCU members can transact business at no additional cost.*
- *In an effort to further strengthen our partnership with universities and communities served, UFCU made substantial financial commitments in 2005 to UT libraries, the UT Childcare Center, Neighborhood Longhorns, and UT Elementary School. Additionally, we generously supported construction of St. Edward's University's new science building, the Austin Chamber of Commerce's Opportunity Austin campaign, Goodwill Industries' capital campaign, and Austin Children's Hospital. The Austin Credit Union Chapter, of which UFCU is a member, was nationally recognized as winner of the prestigious Dora Maxwell Social Responsibility Award.*
- *UFCU partnered with ING, Inc. to offer attractive products and services to University of Texas personnel wishing to save for retirement through the (1) Optional Retirement Program, (2) UT Saver Tax-Sheltered Annuity Program, or (3) UT Saver Deferred Compensation Plan. Additionally, we offered educational seminars to guide members through the complex array of available retirement programs.*
- *We reconfigured UFCU's quarterly newsletter into an educational magazine supporting our value-added products and services and emphasis on consumer advocacy. We also instituted onsite seminars at several sponsor organizations, as convenient financial education opportunities for members.*
- *UFCU's website was completely redesigned to better serve our members, and was launched in March 2006.*
- *UFCU, together with six other Austin credit unions, established Credit Union Business Solutions, L.L.C., an organization through which participating credit union members have access to small business loans with extremely attractive terms and conditions. Another local partnership, the Alliance of Austin Credit Unions, allows our members to transact business at more than 200 ATMs owned by Austin credit unions at no cost.*

As a member-owned financial cooperative, our responsibilities extend well beyond simply making loans and generating deposits. Our goal is to live up to our tag line---Live Learn Prosper---by positioning each UFCU member for financial success. We are committed to equipping members with trustworthy, unbiased, consumer financial education and the very best financial products and services available. After all, as a member-owned cooperative, we are successful only when you, our members, are successful.

On behalf of the fine men and women who comprise our volunteer board of directors, I thank you for your membership and business.

Warm regards,

Arthur B. Martinez

Chairman of the Board

2005 Board of Directors & Officers

Board of Directors

Standing from left to right:

George K. Herbert, Ph.D., Director Emeritus
Carl E. Hansen, Ph.D., Vice Chairman
Thomas J. Ardis
Arthur B. Martinez, Chairman
Gilbert O. Gallegos
William T. Guy, Jr., Ph.D.

Seated from left to right:

Cynthia A. Leach, Secretary
Frank J. Peters
Mary A. Seng, Treasurer
Marilla D. Svinicki, Ph.D.

Not pictured:

Jerry Davis, Associate
Barbara White, Ph.D., Associate

Supervisory Committee

Dana M. Malone, Chairman
Ned H. Burns, Ph.D., Secretary
Doris F. Constantine
Chris A. Plonsky
Reagan Y. Sakai
Michael Harris, Ph.D., Associate

Principal Officers

President/CEO:
Tony C. Budet

Senior Vice Presidents:
Steve E. Kubala, Operations/COO
James A. Nastars, Lending and Collections
Yung V. Tran, CPA, Finance/CFO

Vice Presidents:
Michael T. Hintz, Information Technology
Becky M. LeBlanc, Leadership
Sheila Jo Wojcik, Ph.D., Membership

President's Report

As our cooperative approaches its 70th anniversary in May, it's appropriate to reflect upon our heritage and celebrate successes, particularly those accomplishments that reinforce our founders' vision in 1936. During that Great Depression era, several UT faculty and staff members pooled meager financial resources to create the organization we know today as University Federal Credit Union. Dr. George K. Herbert, UFCU director emeritus and former Supervisory Committee member, researched and wrote the following historical account of that event:

On May 6, 1936, twelve University of Texas faculty and staff members gathered at an organizational meeting to sign the charter for a new credit union. The Farm Credit Administration, the regulatory body for credit unions at this time, approved the application and issued an Organizational Certificate to charter members dated May 14, 1936.

In its first decade, University Federal Credit Union was a small but continuously growing entity. As with many fledgling credit unions of that era, operations were handled by volunteers. Business was conducted at the desk of the volunteer in custody of the records at the time. John Stockton, the tenth member to join and a long-serving officer of the credit union, told many times how the credit union did business from a small file box on his desk in the School of Business.

The first loan went bad, but the credit union continued undaunted on its mission to provide low-cost loans to members of the University faculty and staff in need of funds. A basic principle of the credit union movement was, and is, to be a means for people in an organization such as The University to pool funds for low-interest loans to members and a reasonable rate of return on deposits made by members. As its motto stated: "Members helping members." This makes credit available to those who need it and at a rate of interest far below the high, even usurious, rates some members might otherwise have to pay.

Despite the extraordinary changes in the financial services sector over the last 70 years, and the growth of our cooperative to almost 110,000 members and $700 million in assets, much remains unchanged. University Federal Credit Union continues to be a member-owned, not-for-profit cooperative that utilizes finance as a tool to meet human need, one relationship at a time.

We are an organization of stories. Not a week passes that I don't receive multiple notes from members describing how our staff has touched their lives in a meaningful way. I recently shared the following member note with our full staff:

"I'm just back from my first walk in my new house with my new keys. I'm so happy, I wasn't sure whether to laugh or cry, so I did both! I am so thoroughly pleased with the professional, friendly, fast service you provided. You couldn't have been kinder and you made the process completely painless for me. I've told everyone I work with about finding yet another wonderful reason to partner with UFCU. Thank you for your role in making my dream come true!"

As consumers, we don't do business with companies---we do business with people. UFCU is blessed with an exceptional staff, all of whom take great pride in treating you like you own the place… because you do! In fact, credit unions have been ranked No. 1 in customer satisfaction for multiple years in the American Banker Newspaper's annual customer satisfaction survey. Those who frequently interact with our staff are certainly not surprised to hear that. At UFCU, we are passionate about delivering quality service.

I am proud to report the cooperative principles that inspired our founders to create our organization in 1936 remain alive and well today:

- ***First, we are a financial cooperative owned by our 110,000 members, whereas most banks are owned and controlled by a select few investors.***

continued

continued

- *UFCU is a not-for-profit organization through which members pool their financial resources to help one another, whereas a bank's primary objective is to maximize its return to its investor-owners.*
- *UFCU members democratically elect a volunteer board of directors, whereas banks compensate their appointed directors. Our members have a say in who runs their financial institution and how they run it.*
- *UFCU membership is available only to those individuals within its field of membership, whereas banks serve the general public. No one understands and can meet your financial needs better than we.*
- *UFCU pays property and payroll taxes, but is exempt from federal income tax under Section 501(c)(1) of the Internal Revenue Code, whereas a (non-S corporation) bank's income is generally taxed. Our tax-exempt status enables UFCU to pass those tax savings to its members in the form of dividends and very competitive loan rates.*
- *As part-owner of UFCU, you trust us to deliver unbiased consumer educational resources. After all, as a co-op, we're successful only when we position our members for financial success.*

Even though our $700 million in assets make University Federal Credit Union the largest locally-owned financial institution in Austin, we have no Wall Street-types to impress. You, our members, are our only focus. This is your financial cooperative. You own us. We are unique in our structure, unique in our mission, and unique in how we've measured success for 70 years. Thank you for your membership and business!

Warm regards,

Tony C. Budet

President/CEO

Treasurer's Report

The year 2005 was challenging, a period that began with a rising interest rate environment and ended with the Federal Reserve's 13th consecutive rate increase, coupled with soaring energy prices in the wake of arguably the worst natural disaster in the US Gulf Coastal region.

Despite these economic events, University Federal Credit Union recorded exceptional financial performance in 2005. Our success resulted from our basic commitment to deliver unequaled products and services to meet your financial needs. This is evidenced by loan disbursements to members totaling $504 million, boosting total loans outstanding to $574 million, an increase of $86 million, or 18 percent. Member deposits grew by $48 million, or 8 percent, and totaled $623 million at year end. Total assets ended the year at $700 million, representing annual growth of 9 percent. On total revenue of $57 million, UFCU generated net income of $7.2 million, a return of 1.05 percent on average assets. Reserves were strengthened by $6.1 million, an increase of 14 percent.

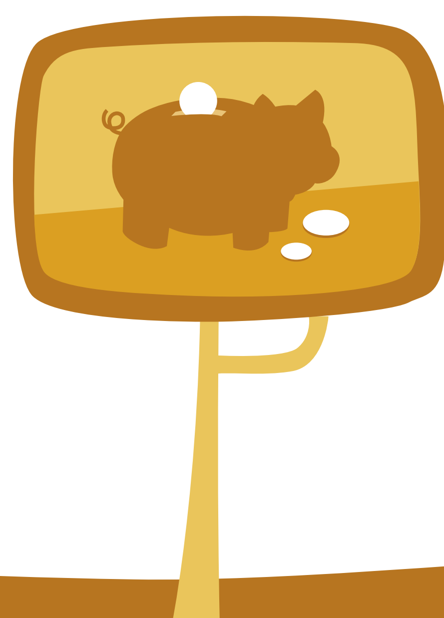
Through our wholly-owned financial subsidiary, UFCU Financial Services, LLC, we continued to help members build and manage their wealth through attractive, nontraditional financial products and services. These include comprehensive financial planning, online brokerage services, a variety of insurance alternatives, and attractive tax preparation services.

The new year will no doubt present new challenges, but UFCU remains financially strong and well-positioned to meet such obstacles. We remain fully committed to further expanding and enhancing our products and services to meet the evolving financial needs of our 110,000 members.

Best regards,

Mary A. Seng

Treasurer



Supervisory Committee Report

The primary responsibility of the Supervisory Committee is to ensure that UFCU's financial statements accurately and fairly report the credit union's financial condition. To accomplish this goal, the committee retained certified public accountants Orth, Chakler, Murnane & Co. to audit the 2005 financial statements. We are pleased to present their unqualified opinion in the independent auditors report as part of this annual report.

In addition to retaining independent auditors, the board-appointed, volunteer members of the Supervisory Committee regularly review management practices to ensure issues of safety and soundness are successfully addressed. We also direct the internal audit activities of UFCU's Assurance Services function, including review and follow-up on all audit issues. Additionally, we meet on a regular basis with management to review regulatory compliance and internal controls issues. The committee gives considerable attention to management's responses to and resolutions of both external and internal audit issues.

We commend management for its responsiveness and commitment to audit and NCUA examination issues, and for the attention given the critical issues of network and information security, member privacy and employee safety.

Throughout the year, committee members attended board meetings, participated in educational events, and reviewed critical governance issues. We are grateful to the board of directors for its support and for our exemplary working relationship.

For their time and effort, I personally thank committee members Dr. Ned H. Burns, Doris Constantine, Chris Plonsky, Reagan Sakai and Associate Dr. Michael Harris.

Best Regards,

Dana Malone

Dana Malone

Supervisory Committee

Chairman

Independent Auditors' Report

February 3, 2006

To the Supervisory Committee of University Federal Credit Union

We have audited the accompanying consolidated statements of financial condition of University Federal Credit Union as of December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, members' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

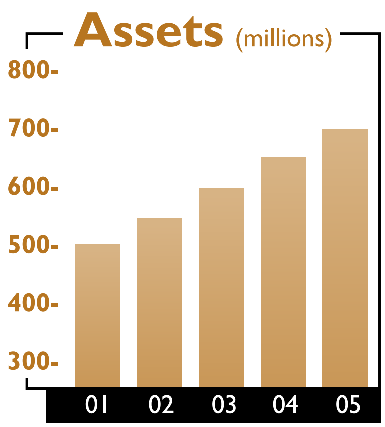
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of University Federal Credit Union as of December 31, 2005 and 2004, and the results of its consolidated operations and its consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

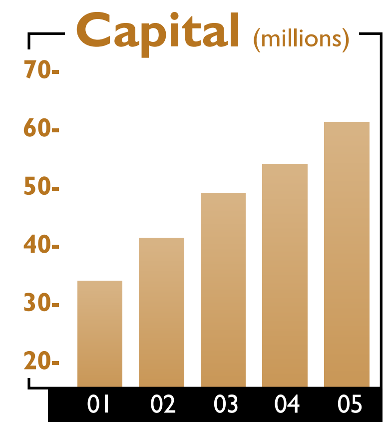
Orth, Chakler, Murnane & Co.

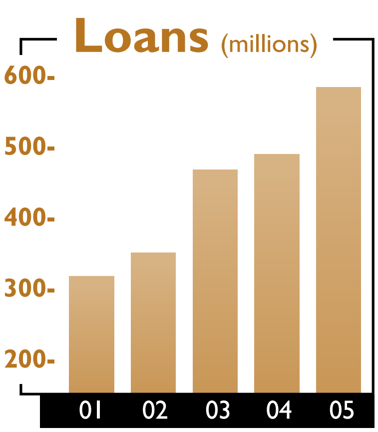
Orth, Chakler, Murnane & Company

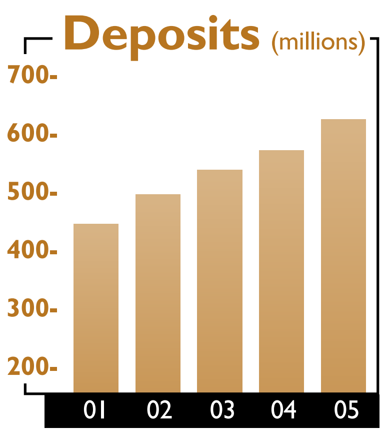
Certified Public Accountants

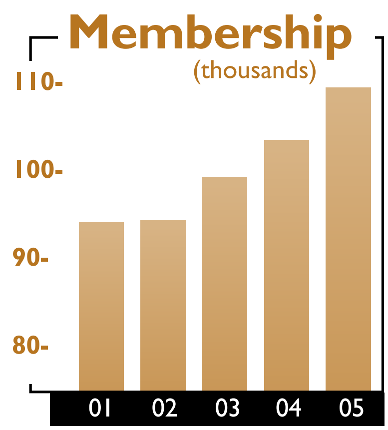
Financial Highlights











2005 Financials

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

ASSETS

	As of December 31, 2005	As of December 31, 2004
Cash and cash equivalents	$ 36,120,336	$ 35,072,455
Investments:		
Available-for-sale	54,977,969	85,296,608
Other	8,068,025	7,521,801
Loans held for sale, student loans	35,537,411	26,385,682
Loans held for sale, real estate	805,548	1,257,163
Loans to members, net of allowance for loan losses	533,648,101	457,472,003
Accrued interest receivable	2,802,750	2,160,792
Prepaid and other assets	6,412,482	4,065,634
Property and equipment	16,606,416	17,102,504
NCUSIF deposit	5,607,272	5,242,414
Total assets	$ 700,586,310	$ 641,577,056

LIABILITIES AND MEMBERS' EQUITY

	As of December 31, 2005	As of December 31, 2004
LIABILITIES:		
Members' share and savings accounts	$ 622,441,157	$ 574,508,255
Borrowed funds	953,770	—
Accrued expenses and other liabilities	16,401,790	13,498,786
Total liabilities	639,796,717	588,007,041
Commitments and contingent liabilities	—	—
MEMBERS' EQUITY:		
Regular reserve	8,004,559	8,004,559
Undivided earnings	53,704,194	46,521,072
Accumulated other comprehensive loss	(919,160)	(955,616)
Total members' equity	60,789,593	53,570,015
Total liabilities and members' equity	$ 700,586,310	$ 641,577,056

The accompanying notes are an integral part of these consolidated financial statements.

2005 Financials

CONSOLIDATED STATEMENTS OF INCOME

	For the years ended December 31, 2005	2004
INTEREST INCOME:		
Loans to members	$ 32,276,083	$ 27,746,568
Investments	3,260,524	2,968,210
Total interest income	35,536,607	30,714,778
INTEREST EXPENSE:		
Members' share and savings accounts	8,357,350	5,605,742
Borrowed funds	59,986	5,075
Total interest expense	8,417,336	5,610,817
Net interest income	27,119,271	25,103,961
PROVISION FOR LOAN LOSSES	4,692,144	2,150,618
Net interest income after provision for loan losses	22,427,127	22,953,343
NON-INTEREST INCOME:		
Fees and service charges	16,407,674	14,445,248
Gain on distribution of membership interest in Pulse EFT Association	3,914,770	—
Gain on sale of student loans	2,296,987	2,346,304
Total non-interest income	22,619,431	16,791,552
	45,046,558	39,744,895
NON-INTEREST EXPENSE:		
Compensation and employee benefits	17,032,070	14,931,446
Office operating	13,522,708	12,339,432
Marketing and business development	2,618,572	2,302,526
Loan servicing	2,276,146	1,961,273
Loss on sale of investments	656,289	—
Professional and outside services	615,092	569,168
Travel and conference	536,681	485,038
Other	438,004	428,545
Loss on sale of real estate loans	167,874	283,512
Total non-interest expense	37,863,436	33,300,940
Net income	$ 7,183,122	$ 6,443,955

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the years ended December 31, 2005	2004
NET INCOME	$ 7,183,122	$ 6,443,955
OTHER COMPREHENSIVE INCOME:		
Net unrealized holding gains/(losses) on available-for-sale investments arising during the period	(619,833)	(608,636)
Reclassification adjustments for losses/(gains) included in net income	656,289	—
Other comprehensive income/(loss)	36,456	(608,636)
Comprehensive income	$ 7,219,578	$ 5,835,319

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY

For the years ended December 31,2005 and 2004

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
Balance, December 31, 2003	$ 8,004,559	$ 40,077,117	$ (346,980)	$ 47,734,696
Net income	—	6,443,955	—	6,443,955
Other comprehensive loss	—	—	(608,636)	(608,636)
Balance, December 31, 2004	8,004,559	46,521,072	(955,616)	53,570,015
Net income	—	7,183,122	—	7,183,122
Other comprehensive income	—	—	36,456	36,456
Balance, December 31, 2005	$ 8,004,559	$ 53,704,194	$ (919,160)	$ 60,789,593

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the years ended December 31, 2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 7,183,122	$ 6,443,955
Adjustments:		
Provision for loan losses	4,692,144	2,150,618
Depreciation and amortization	2,760,062	2,674,399
Amortization/accretion of investment premiums/discounts	173,537	159,325
Amortization of deferred fees and costs	403,913	468,709
Loss on sale of investments	656,289	—
Gain on distribution of membership interest in Pulse EFT Association	(3,914,770)	—
Capitalization of servicing rights	(515,438)	(585,628)
Amortization of servicing rights	170,720	107,249
Gain on sale of student loans	(2,296,987)	(2,346,304)
Loss on sale of real estate loans	683,312	869,140
Changes in operating assets and liabilities:		
Loans held for sale, student loans	(6,854,742)	1,042,679
Loans held for sale, real estate loans	(2,898,935)	(957,930)
Accrued interest receivable	(641,958)	(80,688)
Prepaid and other assets	(2,002,130)	(476,863)
Accrued expenses and other liabilities	2,903,004	2,407,279
Net cash provided by operating activities	501,143	11,875,940
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities, sales, and repayments of available-for-sale securities	34,571,326	29,941,225
Purchase of available-for-sale securities	(5,046,057)	(49,186,269)
Proceeds from distribution of membership interest in Pulse EFT Association	3,914,770	—
Net change in other investments	(546,224)	(1,861,900)
Proceeds from sale of real estate loans	12,713,218	16,811,675
Net change in loans to members, net of charge-offs	(91,472,608)	(50,857,464)
Recoveries on loans charged off	154,473	238,559
Expenditures for property and equipment	(2,263,974)	(4,114,141)
Change in NCUSIF deposit	(364,858)	(180,142)
Net cash used in investing activities	(48,339,934)	(59,208,457)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

	For the years ended December 31, 2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in members' share and savings accounts	47,932,902	38,652,149
Net increase in borrowed funds	953,770	—
Net cash provided by financing activities	48,886,672	38,652,149
Net change in cash and cash equivalents	1,047,881	(8,680,368)
Cash and cash equivalents at beginning of year	35,072,455	43,752,823
Cash and cash equivalents at end of year	$ 36,120,336	$ 35,072,455
SUPPLEMENTAL CASH FLOWS DISCLOSURES:		
Interest paid	$ 8,414,309	$ 5,610,817
SCHEDULE OF NON-CASH TRANSACTIONS:		
Change in unrealized gain/(loss) on investments	$ 36,456	($608,636)
Transfer from loans to members to loans held for sale, real estate	$ 10,045,980	$ 17,380,048

The accompanying notes are an integral part of these consolidated financial statements.

Notes To The Consolidated Financial Statements

Note 1: SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

University Federal Credit Union (the "Credit Union") is a cooperative association organized in accordance with the provisions of the Federal Credit Union Act for the purpose of promoting thrift among, and creating a source of credit for, its members. Participation in the Credit Union is limited to those individuals that qualify for membership. The field of membership is defined in the Credit Union's Charter and Bylaws.

FINANCIAL STATEMENTS

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the dates of the consolidated financial statements and the reported amounts of revenues and expenses for the periods then ended. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, mortgage servicing rights and the fair value of financial instruments. The significant accounting principles and policies used in the preparation of these consolidated financial statements, together with certain related information, are summarized below.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Credit Union and the significant accounts of its wholly owned Credit Union Service Organizations (CUSOs), UFCU Financial Services, LLC and UFCU Real Estate Services, LLC. All significant inter-company accounts and transactions have been eliminated.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, demand deposits and non-term share deposits in Southwest Corporate Federal Credit Union. Amounts due from banks and the corporate credit union may, at times, exceed federally insured limits.

INVESTMENTS

Investments are classified as available-for-sale and other. Investment securities classified as available-for-sale are measured at market value as of the consolidated statement of financial condition date. Unrealized gains and losses for available-for-sale investments are reported as a separate component of members' equity. The Credit Union has elected to classify certain cash equivalents as other investments. This election is available to the Credit Union according to the terms of SFAS No. 95, "Statement of Cash Flows." Realized gains and losses on disposition, if any, are computed using the specific identification method. Investments are adjusted for amortization of premiums and accretion of discounts over the term of the investment by a method which approximates the interest method. Adjustments are recognized to interest income on investments.

FEDERAL HOME LOAN BANK (FHLB) STOCK

As a member of the FHLB, the Credit Union is required to invest in stock of the FHLB. The Credit Union's minimum stock investment is based on a formula developed by the FHLB that considers the Credit Union's total assets and outstanding advances from the FHLB. The FHLB stock is carried at cost within other investments and its disposition is restricted.

LOANS HELD FOR SALE

Loans intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. All sales are made without recourse.

LOANS TO MEMBERS AND ALLOWANCE FOR LOAN LOSSES

Loans to members are stated at the amount of unpaid principal net of certain deferred fees and costs and reduced by an allowance for loan losses. The allowance for loan losses is increased by a provision for loan losses charged to expense and decreased by charge-offs (net of recoveries). Loans are charged against the allowance for loan losses when management believes that collection of the principal is unlikely. Recoveries on loans previously charged off are credited to the allowance for loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for incurred loan losses in the portfolio by applying a historical loan loss rate to consumer loan pools that have similar risk characteristics. Individually significant, non-homogeneous loans are measured for impairment in accordance with SFAS No. 114. These loans are evaluated individually based on an examination of the current financial information of the borrower and an estimate of the value of the collateral, if any. If the carrying value of any of these loans is greater than the estimated net realizable value of the property or of the collateral securing these loans, a reserve is established for the difference.

Interest on loans to members is recognized over the terms of the loans and is calculated on principal amounts outstanding. The accrual of interest is discontinued when a loan exceeds 90 days delinquent or when management believes that collection of interest is doubtful. Generally, loan fees which are charged to members are recognized in income when received and direct loan origination costs on loans to members are recognized in expenses when incurred; however, certain loan origination costs are deferred over the life of the loan as an adjustment to yield on loans using a method that approximates the interest method. This is not materially different from fees and expenses that would have been recognized under the provisions of SFAS No. 91, "Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases."

MORTGAGE SERVICING RIGHTS

Mortgage servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in prepaid and other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost.

Service fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

PROPERTY AND EQUIPMENT

Land is carried at cost. Property and equipment are carried at cost less accumulated depreciation. Buildings, and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the term of the lease, or the estimated life of the asset, whichever is less. The Credit Union reviews property and equipment (long-lived assets) for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

NATIONAL CREDIT UNION SHARE INSURANCE FUND (NCUSIF) DEPOSIT

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each insured credit union. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA Board.

NCUSIF INSURANCE PREMIUMS

Credit unions are required to pay an annual insurance premium equal to one-twelfth of one percent of its total insured shares, unless the payment is waived or reduced by the NCUA Board. The NCUA Board waived the 2005 and 2004 insurance premiums.

MEMBERS' SHARE AND SAVINGS ACCOUNTS

Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' share and savings accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on members' share accounts are set by the Board of Directors, based on an evaluation of current and future market conditions.

REGULAR RESERVE

The Credit Union is required to maintain a statutory reserve (regular reserve) in accordance with the Federal Credit Union Act. This statutory reserve represents a regulatory restriction and is not available for the payment of interest.

FEDERAL AND STATE TAX EXEMPTION

The Credit Union is exempt from most federal, state, and local taxes.

NON-INTEREST INCOME

The Credit Union received a distribution of approximately $3,915,000 in 2005 for its membership interest in Pulse EFT Association. Certain members of Pulse EFT Association were entitled to a distribution as a result of the merger between Pulse EFT Association with a subsidiary of Discover Financial Services, Inc.

Note 2: INVESTMENTS

The amortized cost and estimated market value of investments are as follows:

As of December 31, 2005

AVAILABLE-FOR-SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Mortgage-backed securities	$ 30,932,531	$ 53,898	$ (452,530)	$ 30,533,899
Mutual funds	15,964,816	—	(400,656)	15,564,160
Federal agency securities	8,999,782	—	(119,872)	8,879,910
	$ 55,897,129	$ 53,898	$ (973,058)	$ 54,977,969

As of December 31, 2004

AVAILABLE-FOR-SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Mortgage-backed securities	$ 38,549,382	$ 94,050	$ (260,245)	$ 38,383,187
Mutual funds	35,206,394	—	(746,520)	34,459,874
Federal agency securities	12,496,448	8,773	(51,674)	12,453,547
	$ 86,252,224	$ 102,823	$ (1,058,439)	$ 85,296,608

The following tables show the gross unrealized losses and fair value of investments, aggregated by length of time that individual securities have been in a continuous unrealized loss position.

As of December 31, 2005

AVAILABLE-FOR-SALE:	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Mortgage-backed securities	$ 6,314,960	$ 22,736	$ 18,246,284	$ 429,794	$ 24,561,244	$ 452,530
Mutual funds	—	—	15,564,160	400,656	15,564,160	400,656
Federal agency securities	1,974,680	25,320	6,905,230	94,552	8,879,910	119,872
	$ 8,289,640	$ 48,056	$ 40,715,674	$ 925,002	$ 49,005,314	$ 973,058

As of December 31, 2004

AVAILABLE-FOR-SALE:	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Mortgage-backed securities	$ 22,555,726	$ 170,425	$ 7,459,250	$ 89,820	$ 30,014,976	$ 260,245
Mutual funds	—	—	34,459,874	746,520	34,459,874	746,520
Federal agency securities	8,945,008	51,674	—	—	8,945,008	51,674
	$ 31,500,734	$ 222,099	$ 41,919,124	$ 836,340	$ 73,419,858	$ 1,058,439

Unrealized losses on securities issued by the U.S. Government and its Agencies have not been recognized into income because the principal balances of these securities are guaranteed by the U.S. Government. Additionally, the decline in these fair values is largely due to increases in market interest rates, and the fair values of the securities are expected to be recovered as these securities approach their maturity date and/or market rates decline. Management has the ability to hold these securities for the foreseeable future.

NOTE 2: CONTINUED

OTHER INVESTMENTS:

	As of December 31, 2005	2004
Certificates of deposit	$ 5,438,987	$ 4,985,000
Capital shares in Southwest Corporate Federal Credit Union	1,000,000	1,000,000
Credit union service organizations	830,738	450,001
Federal Home Loan Bank stock	798,300	1,086,800
	$ 8,068,025	$ 7,521,801

The Credit Union maintains deposits at Southwest Corporate Federal Credit Union which normally exceed federally insured limits. Included in the deposits with Southwest Corporate Federal Credit Union is a restricted capital share base which is required for membership. This amount was $1,000,000 as of December 31, 2005 and 2004.

The amortized cost and estimated market value of investments by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay certain obligations without call or prepayment penalties.

	As of December 31, 2005 Available-for-sale	
	Amortized Cost	Market Value
No contractual maturity	$ 15,964,816	$ 15,564,160
1-5 years	8,999,782	8,879,910
	24,964,598	24,444,070
Mortgage-backed securities	30,932,531	30,533,899
	$ 55,897,129	$ 54,977,969

As of December 31, 2005 and 2004, securities having a market value of approximately $39,414,000 and $50,836,000, respectively, were pledged as collateral to secure borrowed funds.

Proceeds from the sale of investments classified as available-for-sale approximated $19,263,000 for the year ended December 31, 2005. Gross losses of approximately $656,000 were realized on the sale of investments classified as available-for-sale during the year ended December 31, 2005. There were no sales of investments classified as available-for-sale during the year ended December 31, 2004.

Note 3: LOANS TO MEMBERS

The composition of loans to members is as follows:

	As of December 31, 2005	2004
Loans outstanding:		
Vehicle	$ 229,300,021	$ 196,492,684
Real estate	197,965,467	172,419,066
Unsecured	79,708,283	66,609,521
Member business loans	19,153,527	12,879,856
Shares and other collateral	10,336,585	10,122,208
	536,463,883	458,523,335
Deferred fees and costs	1,423,618	1,575,176
	537,887,501	460,098,511
Less allowance for loan losses	(4,239,400)	(2,626,508)
	$ 533,648,101	$ 457,472,003

Loans on which the accrual of interest has been discontinued or reduced approximated $2,273,000 and $1,349,000 as of December 31, 2005 and 2004, respectively. If interest on these loans had been accrued, such income would have approximated $137,000 and $73,000 for the years ended December 31, 2005 and 2004, respectively.

NOTE 3: CONTINUED

A summary of the activity in the allowance for loan losses is as follows:

	For the years ended December 31, 2005	2004
Balance, beginning of the year	$ 2,626,508	$ 3,065,591
Provision for loan losses	4,692,144	2,150,618
Recoveries	154,473	238,559
Loans charged off	(3,233,725)	(2,828,260)
Balance, end of year	$ 4,239,400	$ 2,626,508

Note 4: PROPERTY AND EQUIPMENT

A summary of the Credit Union's property and equipment is as follows:

	As of December 31, 2005	2004
Land	$ 1,695,591	$ 1,695,591
Buildings	8,223,658	8,141,624
Furniture and equipment	17,403,270	15,920,118
Leasehold improvements	5,815,425	5,769,625
	33,137,944	31,526,958
Less accumulated depreciation and amortization	(16,531,528)	(14,424,454)
	$ 16,606,416	$ 17,102,504

Note 5: MEMBERS' SHARE AND SAVINGS ACCOUNTS

Members' share and savings accounts are summarized as follows:

	As of December 31, 2005	2004
Share drafts	$ 153,538,918	$ 145,526,513
Shares and equivalents	131,300,323	167,702,114
Money market accounts	197,067,669	143,967,395
IRA shares	19,634,179	21,324,745
Share and IRA certificates	120,900,068	95,987,488
	$ 622,441,157	$ 574,508,255

The aggregate amount of members' time deposit accounts in denominations of $ 100,000 or more was approximately $22,421,000 and $16,203,000 as of December 31, 2005 and 2004, respectively.

SCHEDULED MATURITIES OF CERTIFICATES ARE AS FOLLOWS:

	As of December 31, 2005	2004
Within 1 year	$ 77,476,703	$ 60,054,120
1 to 2 years	18,038,612	18,772,261
2 to 3 years	9,371,280	7,928,901
3 to 4 years	6,738,675	4,119,765
4 to 5 years	9,252,109	5,061,674
Thereafter	22,689	50,767
	$ 120,900,068	$ 95,987,488

SHARE INSURANCE

Members' shares are insured by the NCUSIF to a maximum of $100,000 for each member. Individual Retirement Accounts carry an additional $100,000 coverage.

Note 6: BORROWED FUNDS

The Credit Union has entered into a secured line-of-credit agreement with the Federal Home Loan Bank of Dallas. Amounts borrowed under this line-of-credit agreement are secured by a blanket lien on Credit Union assets and investments safe kept with the Federal Home Loan Bank of Dallas. As of December 31, 2005, the unused line of credit was approximately $175,000,000.

As of December 31, 2005, the Credit Union had borrowed $953,770 under this agreement. The table to the right is a schedule of the amounts borrowed, along with the maturity dates and weighted average interest rates as of December 31, 2005:

Maturity In	Balance Due	Weighted-Average Rate
2006	$ 293,770	4.23%
2007	315,000	4.36%
2008	155,000	4.44%
2009	120,000	4.50%
2010	70,000	4.54%
	$ 953,770	4.36%

Note 7: EMPLOYEE BENEFITS

401(K) PROFIT SHARING PLAN

Participation in the 401(k) profit sharing plan is limited to employees who meet specific age and service year limitations. Employees may contribute up to the maximum limits authorized by the Internal Revenue Service.

During the years ended December 31, 2005 and 2004, the Credit Union made a discretionary contribution of 4% of employees' compensation, which is subject to a five-year vesting schedule at the rate of 20% per year. The 401(k) profit sharing plan is structured to match 100% of employees' elective contributions up to 3% of compensation, and 50% of contributions to the extent that such contributions exceed 3% but do not exceed 5% of compensation. Employee contributions and the employer matching contributions vest immediately. The expense for the plan approximated $955,000 and $837,000 for the years ended December 31, 2005 and 2004, respectively.

Note 8: COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 2005, the Credit Union maintained a $20,000,000 unsecured and unused line-of-credit agreement with Southwest Corporate Federal Credit Union.

As of December 31, 2005, the Credit Union maintained a $6,000,000 unsecured and unused line-of-credit agreement with Bank of America.

The Credit Union has entered into a secured line-of-credit agreement to borrow funds from Southwest Corporate Federal Credit Union. Amounts borrowed under this line-of-credit agreement are secured by investments safe kept at Southwest Corporate Federal Credit Union. The available line-of-credit under this agreement fluctuates based on the amount of investments safe kept at Southwest Corporate Federal Credit Union. As of December 31, 2005, the unused line of credit was $3,580,000.

The Credit Union leases certain office space and equipment. The table to the right reflects the estimated minimum noncancellable lease obligations as of December 31, 2005:

Year ending December 31,	Amount
2006	$ 1,626,000
2007	1,461,000
2008	1,129,000
2009	1,008,000
2010	677,000
Thereafter	1,970,000
	$ 7,871,000

Rental expense under operating leases was approximately $1,794,000 and $1,598,000 for the years ended December 31, 2005, and 2004, respectively.

The Credit Union is a party to various miscellaneous legal actions normally associated with financial institutions, the aggregate effect of which, in management's opinion, would not be material to the Credit Union's consolidated financial statements.

Note 9: OFF-BALANCE -SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

OFF-BALANCE-SHEET RISK

The Credit Union is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its members and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the consolidated statements of financial condition.

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments may expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2005, the unfunded members' total lines of credit approximated $165,562,000. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if any, is based on management's credit evaluation of the member.

CONCENTRATIONS OF CREDIT RISK

The Credit Union may be exposed to credit risk from a regional economic standpoint, since a significant concentration of its borrowers work or reside in the Austin, Texas area. However, the loan portfolio is well diversified and the Credit Union does not have any significant concentrations of credit risk.

Note 10: REGULATORY CAPITAL

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory-and possibly additional discretionary-actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's consolidated financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off balance sheet items as calculated under generally accepted accounting practices. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth (as defined in NCUA's Rules and Regulations) to total assets (as defined in NCUA's Rules and Regulations). Credit unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR) which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNWR as of December 31, 2005 and 2004 was 5.24% and 5.22% respectively. The minimum requirement to be considered complex under the regulatory framework is 6.0%. Management believes, as of December 31, 2005 and 2004, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of December 31, 2005, the most recent call reporting period, the NCUA categorized the Credit Union as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Credit Union must maintain a minimum net worth ratio of 7.0% of assets. There are no conditions or events since that notification that management believes have changed the Credit Union's category.
The Credit Union's actual and required net worth amounts and ratios are as follows:

	As of December 31, 2005		As of December 31, 2004	
	Amount	Ratio/ Requirement	Amount	Ratio/ Requirement
Actual net worth	$ 61,708,753	8.81%	$ 54,525,631	8.50%
Amount needed to be classified as "adequately capitalized"	$ 42,035,179	6.00%	$ 38,494,623	6.00%
Amount needed to be classified as "well capitalized"	$ 49,041,042	7.00%	$ 44,910,394	7.00%

Because the RBNWR is less than the net worth ratio, the Credit Union retains its original net worth category of "well capitalized." In performing its calculation of total assets, the Credit Union used the quarter-end option as of December 31, 2005, as permitted by regulation.

Note 11: LOAN SERVICING

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances and the related custodial escrow balances maintained in connection with the servicing of these loans approximated the following:

	As of December 31, 2005	2004
Mortgage loan portfolio serviced for:		
Federal National Mortgage Association	$ 119,653,000	$ 86,155,000
Custodial escrow balances	$ 443,000	$ 292,000

Note 12: MORTGAGE SERVICING RIGHTS

The components of capitalized mortgage servicing rights, included in prepaid and other assets, are as follows:

	As of December 31, 2005	2004
Mortgage servicing rights:		
Balance, beginning of year	$ 901,923	$ 452,969
Additions	515,438	585,628
Amortization	(170,720)	(107,249)
	1,246,641	931,348
Less allowance for market value impairment	—	(29,425)
Balance, end of year	$ 1,246,641	$ 901,923
Estimated fair value of mortgage servicing rights	$ 1,422,620	$ 901,923

The fair value of mortgage servicing rights was determined by using a discount rate of 9.0% as of December 31, 2005 and 2004 and an average prepayment speed of 10.02% and 11.71% as of December 31, 2005 and 2004, respectively.

Note 13: FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of amounts that could be realized in a market exchange. The use of different assumptions and estimation methodologies may have a material effect on the estimated fair value amounts. The following methods and assumptions were used to estimate fair value of each of the financial instruments for which it was practicable to estimate.

CASH AND CASH EQUIVALENTS

The carrying amount is a reasonable estimation of fair value.

INVESTMENTS

Estimated fair values for investments are obtained from quoted market prices where available.

FHLB STOCK

FHLB stock is valued at cost.

LOANS HELD FOR SALE

The carrying amount of mortgage loans held for sale is a reasonable estimation of fair value. The fair value of student loans held for sale was estimated based on the terms of the contract with North Texas Higher Education Authority, Inc., and the history of past sales.

LOANS TO MEMBERS

The estimated fair value of variable-rate loans is the current carrying amount. For estimation of fair value purposes, credit card loans are considered variable-rate loans since interest rates may be changed by the Credit Union. The fair value of fixed-rate loans were estimated by discounting the estimated cash flows using the current rate at which similar loans would be issued.

ACCRUED INTEREST RECEIVABLE

The carrying amounts for accrued interest receivable approximate fair value.

MORTGAGE SERVICING RIGHTS

Fair values of mortgage servicing rights are obtained from an independent third party evaluation.

MEMBERS' SHARE AND SAVINGS ACCOUNTS

The estimated fair value of demand deposit accounts is the carrying amount. The fair value of fixed-rate share certificates was estimated by discounting the estimated cash flows using the current rate at which similar certificates would be issued.

BORROWED FUNDS

The fair value of borrowings, should be estimated by discounting the estimated future cash flows using current rate at which similar borrowings would be issued; however, management has determined that the fair value of borrowings would not be materially different from the carrying amount. Therefore, the fair value of borrowed funds is the carrying amount.

COMMITMENTS TO EXTEND CREDIT

The fair value of commitments to extend credit is equivalent to the amount of credit extended since the Credit Union does not charge fees to enter into these commitments and the commitments are not stated at fixed rates.

The carrying value and estimated fair value of the Credit Union's financial instruments are as follows:

	As of December 31, 2005		As of December 31, 2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSETS:				
Cash and cash equivalents	$ 36,120,336	$ 36,120,336	$ 35,072,455	$ 35,072,455
Investments:				
Available-for-sale	$ 54,977,969	$ 54,977,969	$ 85,296,608	$ 85,296,608
Other	$ 8,068,025	$ 8,068,025	$ 7,521,801	$ 7,521,801
Loans held for sale	$ 36,342,959	$ 36,858,251	$ 27,642,845	$ 28,764,236
Loans to members, net	$ 533,648,101	$ 531,583,315	$ 457,472,003	$ 458,651,026
Accrued interest receivable	$ 2,802,750	$ 2,802,750	$ 2,160,792	$ 2,160,792
Mortgage servicing rights	$ 1,246,641	$ 1,422,620	$ 901,923	$ 901,923
FINANCIAL LIABILITIES:				
Members' share and savings accounts	$ 622,441,157	$ 622,546,302	$ 574,508,255	$ 574,531,820
Borrowed funds	$ 953,770	$ 953,770	$ —	$ —
UNRECOGNIZED FINANCIAL INSTRUMENTS:				
Commitments to extend credit	$ —	$ 165,562,000	$ —	$ 127,186,000

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