

July 26, 2010

Dear Valued Member/Owner,

During June we recorded an additional investment impairment, which impacted earnings and retained earnings, but did not impact your membership capital. This communication serves as an overview of our June results and provides additional insight on our other than temporary impairment (OTTI) process, the results of the OTTI analysis and commentary on future impairments. [Click here](#) for our June 30, 2010 financial statements.

June 2010 Earnings and Capital

We recorded \$173,794 in earnings prior to recording additional OTTI on one investment during June 2010. Additional OTTI for the investment totaled \$795,662, which resulted in a net loss for June of \$621,868. Despite the additional OTTI recorded in June, our year-to-date earnings total \$767,164. This amount has been transferred to retained earnings and serves as first loss protection for your membership capital, which currently totals \$59.9 million at June 30, 2010.

The \$795,662 additional OTTI was recorded on one investment that we had previously impaired by \$7.4 million. Projected losses on this investment have remained flat since the fall of 2009. However, due to a trustee reporting error that understated our book value at year-end 2009, additional OTTI on this security was warranted as of June 30th based on the actual book value. This security is expected to mature in early 2011 and, as a result, the window for recording additional impairment is closing. Therefore, the additional impairment was taken after we had analyzed it with the same measure of scrutiny as described more fully below.

Our OTTI Process

For reporting purposes, we use a series of investment watch lists in order to report potential credit issues to the Credit Risk Committee and ALCO. Investments reported on the ALCO watch list present an increased probability of negative rating migration and thus a higher potential for loss. In order to determine probable investment losses, the investments included on the ALCO watch list, and other investments at the discretion of the Credit Risk department, are periodically analyzed by two separate third party analytics firms. The analytics firms analyze our investments and provide projected cash flows and losses, if applicable, for the remaining life of those investments. The cash flow projections are based on subjective assumptions using macro economic data, characteristics of the underlying mortgages and the current collateral performance. However, the two main drivers of projected cash flows and losses are the level of loans currently delinquent and loss severities on liquidated collateral.

The most recent analysis performed as of May 31, 2010 was our tenth analysis obtained by third party analytics firms for one or more securities. Although somewhat counterintuitive based on the long-term horizon of the cash flow projections, we have discovered a significant correlation between the level of current delinquencies at the time the analysis is performed and the projected losses for that investment. As delinquency rates escalated from 2006 until late 2009, projected losses continually increased on a number of securities. Therefore, the amount of historical OTTI was based on these analyses and our internal procedures. However, recent trends (improvements) in collateral performance during 2010 have led to materially different projected losses on certain investments.

While we expected the OTTI analysis to become more facile over time, declining loss projections on previously impaired securities has led us to constantly scrutinize our impairment procedures in order to most accurately define the 'probable' amount of losses. As a reminder, GAAP requires that OTTI be recorded on a bond-by-bond basis based on the 'probable' amount of losses, some of which could be years into the future. However, with improving collateral performance and lower loss projections the losses deemed probable several months ago have now contracted by a significant margin on some investments.

In the end, our ultimate goal is to provide the most accurate account of our financial position while striving to protect your remaining capital.

Cumulative OTTI & Results of the Recent OTTI Analysis

To date, Southeast has recorded \$41.9 million of OTTI on twenty-one mortgage related securities, which includes the \$795,662 of OTTI discussed previously. During the most recent third-party analysis, the consolidated results showed an over-impairment of \$186,226 for the entire portfolio. However, GAAP currently requires that OTTI be recorded on a bond-by-bond basis and the avenues for recapturing previous losses are very narrow.

Cash flow projections for nine previously impaired investments resulted in \$2.2 million of additional projected losses. Based on our operating procedures, the additional \$2.2 million was not deemed probable and thus not recorded in earnings for June. The additional projected impairments on the individual investments did not reach the materiality threshold of 10% that is set forth in procedures.

For the remaining eleven previously impaired investments, loss projections improved during the recent analysis which resulted in improvements in OTTI projections of \$4.8 million. The improved loss projections largely stem from stable or lower delinquency rates from the previous analytical period. Unfortunately, GAAP does not provide for immediate recapture of over-impairments. As a result, we have extensively analyzed the over-impairments to redefine the probable amount of the current projected losses. This revised methodology was employed to determine the current impairment amount and this revised methodology will be subject to review by our external auditor.

Three additional investments not currently impaired reported \$2.4 million in losses. Again, the projected OTTI on these three investments does not satisfy the materiality or timing criteria set forth in procedures. In addition, the loss projections for these three securities have flattened or declined since the third-quarter 2009 analysis. We continue to hold three investments that are insured by Ambac Assurance that project \$2.5 million in losses. The \$2.5 million in projected losses assume that we receive no further claims payments from the insurer and we do not deem that scenario probable at this time. We continue to receive principal and interest on the Ambac insured investments and we maintain the position that we will receive all accruing and future claims expected from Ambac Assurance. Therefore, no investment impairments have been recorded on the Ambac insured investments.

Looking Ahead

Because of these unstable economic times, future investment impairments may occur. As I have detailed, approximately \$4.6 million (\$2.2 million on the nine investments plus \$2.4 million on the three investments) in projected losses have not been recorded since the amounts and/or timing of the losses on the individual investments do not meet the guidelines set forth in procedures that guide us in determining “probable losses.” This amount will undoubtedly differ in future analyses based on the dynamics of the underlying collateral performance for each investment and the general economic conditions which drive model assumptions. Additionally, we continue to monitor the Ambac insured investments as their plan of rehabilitation becomes more settled.

As previously stated, our ultimate goal is to provide the most accurate account of our financial position while striving to protect your remaining capital. The timing and amount of future losses will ultimately determine the impact to retained earnings and your membership capital. While current loss projections for our investment portfolio appear very manageable, many factors that we cannot predict at this time, such as the economy, future delinquencies, and NCUA’s new corporate rule and legacy asset plan, may have a significant impact on our future earnings and capital level.

Thank you for your continued support of Southeast Corporate. If you have any questions regarding our OTTI process, please contact me at 1-800-342-0203 ext. 4043.

Sincerely,



Robert F. Schleiter
Executive Vice President