

Federal Reserve Bank of Atlanta 2007 Annual Report

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# The Southeast Economy: A Larger Perspective



The Federal Reserve Bank of Atlanta is one of twelve regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., make up the Federal Reserve System—the nation’s central bank. Since its establishment by an act of Congress in 1913, the Federal Reserve System’s primary role has been to foster a sound financial system and a healthy economy.

To advance this goal, the Atlanta Fed helps formulate monetary policy, supervises banks and bank and financial holding companies, and provides payment services to depository institutions and the federal government.

Through its six offices in Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans, the Federal Reserve Bank of Atlanta serves the Sixth Federal Reserve District, which comprises Alabama, Florida, Georgia, and parts of Louisiana, Mississippi, and Tennessee.

Federal Reserve Bank of Atlanta 2007 Annual Report  
**The Southeast Economy: A Larger Perspective**

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Dennis P. Lockhart,  
president and chief  
executive officer,  
and Patrick K.  
Barron, first vice  
president and chief  
operating officer

## A Message from the President

In March 2007, not long after I came to the Federal Reserve Bank of Atlanta as its new president and chief executive officer, I was greeted with question after question about the performance of the Southeast economy and its prospects for future growth.

My experience in the region dates back to 1978, when I was transferred from overseas to Atlanta to work as senior corporate officer of a major national bank. During my eight years in Atlanta, I traveled widely in the region and made many enduring friendships. Along the way, I enjoyed personal involvement in a regional economy that was becoming increasingly outward looking and growing more rapidly than the nation as a whole.

Then I left the region for more than twenty years. While I was away, the Southeast continued to grow in population, income, and economic output. The industrial base of the region became more diverse. In 2007 these trends were evident and continued to influence my thinking about national economic and monetary policy in my new position at the Atlanta Fed.

As one of twelve Federal Reserve Banks, the Atlanta Fed has threefold responsibilities: to help formulate monetary policy, to supervise certain types of financial institutions, and, through direct market participation, to foster reliability and efficiency in the payment system. All these duties are elements of the Fed's broad mission to promote long-term, stable economic growth. During the extensive immersion process I went through upon joining the bank in 2007, I gained a new appreciation for how the on-the-ground presence of the Reserve Banks supports these roles.

In its monetary policy role, the Atlanta Fed, like the other Reserve Banks, has an implied mandate to monitor and understand the economy of its region. A key part of this mandate is to gather and analyze information about our region. Insights are challenged and refined and then shared with colleagues in the Fed System through various channels, including the Federal Open Market Committee meetings.

An understanding of the Southeast adds to the nation's monetary policy process in many ways. One way is the early identification of trends in the region that may have national relevance. Because the economic composition of the Sixth District resembles the nation as a whole, I believe the Southeast can serve as a microcosm of the total economy.

Since the Federal Reserve Bank of Atlanta is a part of the region we serve, we are concerned about the continuing economic success of the Southeast. Tracking day-to-day and month-to-month changes in the region's economy and financial sector helps us accomplish our mission, but I believe it's also important to achieve a larger, longer-term perspective. To do so, we must evaluate the region's macroeconomic trends over different time horizons. I believe it's appropriate, therefore, to focus the Bank's 2007 annual report on longer-term growth prospects for the Southeast and the associated challenges.

My sense is that the economic evolution that progressed during my twenty years away from the region will persist. These trends include population and income growth, the loss of jobs in low value-added industries, job creation in technologically intensive industries, the development of vital transportation and logistics facilities such as ports and airports, and continued investment flows to the region. The region will also continue to grapple with formidable challenges in the areas of natural resource stewardship, prekindergarten through twelfth-grade education, and worker retraining for transition to newly created jobs.

What follows is a deeper exploration of these themes. I hope this annual report—the first under my leadership as president of the Atlanta Fed—adds materially to the reader's understanding of our diverse and dynamic region.



Dennis P. Lockhart

# The Atlanta Fed's Place in the Southeast Economy

The Atlanta Fed has a tradition of engagement with the Southeast through its economic research, financial institution services and supervision, and public outreach.

On many issues in 2007—from the dynamics affecting the present and future workforce to the rapid rise of electronic payment methods to helping consumers avoid home foreclosures—the Atlanta Fed, both at its headquarters and its branches, continued to deepen its active involvement with its varied constituencies in the region.

One of the bank's core responsibilities is to contribute to monetary policy deliberations. In pursuit of this goal, nearly two dozen Ph.D. economists dissect the regional, national, and global economies both to help inform the nation's monetary policy and to advance knowledge of our ever-changing economy and the methods used to study it. That work not only sheds light on current conditions but also analyzes underlying dynamics and longer-term trends significant to the region, nation, and world.

For instance, Atlanta Fed research economists—along with experts in the Retail Payments Office, under the auspices of the bank's Americas Center—have taken a leading role in studying monetary remittances that Latin American immigrants send from the United States to their native countries. Since 2000, remittances have grown into a multibillion-dollar annual phenomenon.

## At the center of the payments evolution

The Atlanta Fed benefits not only from robust economic research but also from the perspective it gains as the seat of the Federal Reserve System's Retail Payments Office (RPO). The Federal Reserve manages large parts of the nation's payments system, and the RPO directs the System's retail payment activities.

The RPO's mission, among other initiatives, includes payments research. In recent years, that research has focused on a fundamental shift by American consumers and businesses away from writing paper checks and toward electronic payment methods.

## An Economic Timeline of the Southeast: Poor to Prosperous

**1938:** President Franklin Roosevelt declares the South to be America's "economic problem No. 1."

**1946:** An Atlanta Fed economist writes that the Southeast region suffers from "an adherence to an agricultural economy built on . . . cotton, corn, and tobacco."

**1947:** Two major automakers open plants in the Atlanta area—Ford, in Hapeville, and General Motors, in Doraville.

The Fed's most recent study of noncash payments revealed that from 2003 to 2006, the period covered by the study, all types of electronic payments grew while check payments decreased. By 2006 more than two-thirds of all U.S. noncash payments were made electronically—a significant shift from 2003, when the number of electronic payments and check payments was roughly equal.

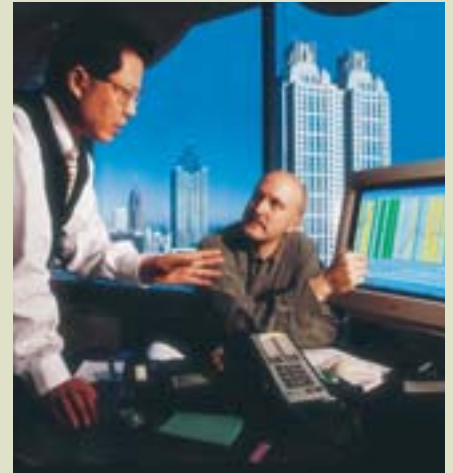
With the ongoing declines in check writing and the rising use of electronic payments, the Atlanta Fed continued in 2007 to consolidate paper check processing operations. At the end of 2007, only the Jacksonville and Atlanta offices maintained a check processing unit, and the Jacksonville operation is scheduled to move to Atlanta in 2008.

On the cash front, the Sixth Federal Reserve District's Miami Branch serves as the Southeast's currency gateway to the world. Miami processes U.S. currency—counting it, destroying worn bills, and keeping accounts for customers in about forty countries. The highest volume of foreign-originated currency comes from Mexico, Panama, Ecuador, and Europe. Nearly half of the cash processed by the Miami Branch comes from outside the United States, and that figure will likely exceed 50 percent by the end of 2008. Among thirty-one Federal Reserve System cash processing centers nationwide, Miami handles the fourth-largest volume.

#### **Taking a closer look at banks**

Different components of the Atlanta Fed are engaged in various aspects of the region's and nation's economy and financial system. For instance, the bank's Supervision and Regulation Division (S&R) is charged with ensuring that the region's commercial banking organizations operate safely and soundly and treat consumers fairly and equitably.

During the past year, S&R focused much of its attention on the widely discussed downturn in housing markets. For many banks in the Southeast, residential real estate development lending is a substantial business. Concerns in the real estate sector are therefore of significant interest to Atlanta Fed examiners, who monitor the safety and soundness of financial institutions.



Atlanta Fed Research Economist and Senior Policy Adviser Tao Zha and Vice President John Robertson use forecasting models to inform monetary policy.

**“One of the bank’s core responsibilities is to contribute to monetary policy deliberations.”**

**1950:** Homeownership rates in the six southeastern states average 51.4 percent versus 55 percent in the country as a whole.

**1960:** The combined six-state Southeast region's population is 24 million.

**1970:** Farm workers make up 5.6 percent of the Southeast's labor force.

**1973:** The number of textile and apparel jobs in the United States reaches a peak of 2.4 million; 46 percent of these jobs are in the Southeast.



Developments in the real estate sector in 2007 were sufficiently important that the Atlanta Fed focused considerable energy on real estate analysis to deepen understanding of how that industry's dynamics affect lending institutions and borrowers.

S&R's Community Affairs unit faced new challenges across the Sixth Federal Reserve District, particularly in Florida and Georgia, with rising foreclosure volume, which threatens progress in raising homeownership rates. One bright spot in the midst of the foreclosure crisis has been the resilience of families who sought reputable prepurchase counseling before buying a home and, therefore, made better-informed choices. But foreclosures in general remain serious because of not only their damaging effects on families and communities but also their potential systemic effects on the financial system.

Community Affairs continues to direct significant resources toward early intervention of preventable foreclosures and, in the process, works with many groups that share this goal.

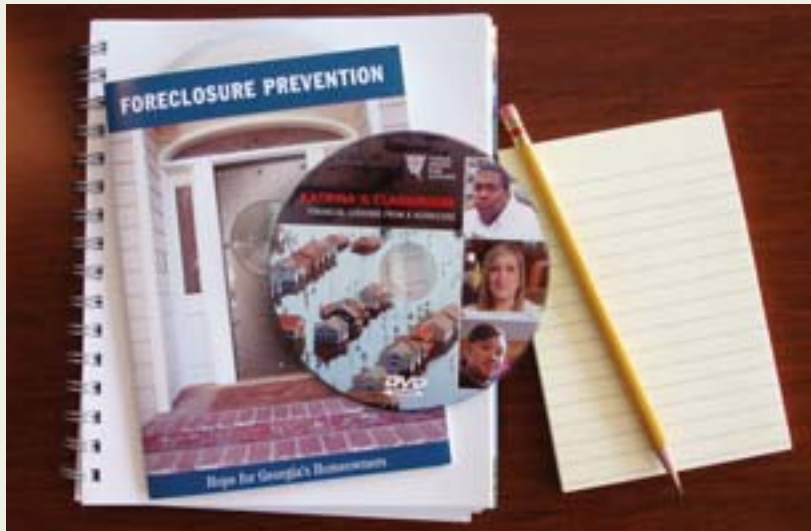
Finally, the Miami Branch of the Atlanta Fed is also the nexus of the Sixth Federal Reserve District's international banking supervision operations. A team of more than two dozen examiners in Miami has primary oversight responsibility for some sixty foreign banking operations doing business in the Southeast. The international supervision team monitors these foreign banks' financial condition, corporate governance, and activities, including compliance with the Sarbanes-Oxley Act and anti-money-laundering regulations.

Atlanta Fed bank supervision also assesses the strength of the parent financial institutions, which are located outside the United States. Those parent organizations include many financial entities based in Latin America as well as others headquartered across the globe. In recent years, an increasing number of Spanish banks, in particular, have expanded into the southeastern United States by establishing agencies and branches and acquiring U.S.-based institutions. Overseas banking firms are drawn to the United States because of its large economy and stable political, legal, and regulatory climate.

**FACT:**

Gulf Coast oil extraction off the shores of Louisiana, Alabama, and Mississippi could bring a potential 1.3 billion barrels of oil to market, more than four times 2006 production.





To meet the needs of its wide audiences, the Atlanta Fed has developed DVD-based materials covering topics that range from assistance with foreclosure prevention to personal finance.

### **On the economic education front**

The Atlanta Fed in 2007 continued to expand its economic and financial education offerings. This program's primary focus is helping the region's middle and high school educators to teach economics and personal finance. The bank's regionwide economic education team offers numerous services for educators and students, including hosting frequent teacher workshops throughout the Southeast and providing publications and other materials such as the DVD-based curriculum about the financial lessons Gulf Coast teenagers learned in the wake of Hurricane Katrina.

The Atlanta Fed is not only offering more economic education but is also formulating tools to analyze and measure the effectiveness of its economic education efforts. The objective is to sharpen the outreach to best serve the region's teachers, students, and citizens.

### **Improving information gathering**

Another economic research initiative is the newly launched Local Economic Analysis and Research Network (LEARN). An online marketplace of ideas and

### **Research is wide-ranging**

In 2007 the Atlanta Fed produced economic and financial research covering a diverse array of issues, including

- creating a single indicator to track the southeastern economy;
- the economic significance of financial market frictions, such as transaction costs, taxes, regulations, and agency and information problems;
- the consequences of a public perception that monetary policy could at times relax its stance on inflation fighting to accommodate other economic concerns;
- the role of Federal Home Loan Bank advances in stabilizing their member banks' residential mortgage lending activities;
- small businesses' access to credit;
- how much of the gender differential in wages can be explained by the tendency of women to intermittently enter and leave the workforce; and
- how much smoking affects whether low-income families can afford proper nutrition.



Part of the Atlanta Fed's grassroots economic intelligence comes from its directors, who provide insight into local businesses, such as this carpet manufacturer.

information for academics and researchers with intimate knowledge of the region's local economies, LEARN's data bank and research network are vehicles for information sharing.

LEARN's fundamental objective is to enhance the bank economists' and analysts' understanding of the region's economy by helping to inform the bank's economic analysis and expand professional relationships. Simply put, more information leads to greater insights.

Ultimately, all the bank's research and intelligence-gathering and -sharing initiatives provide rich raw materials for the economic analysis from which monetary policy is formulated. The bank's research analysts, for instance, track important industries in the region—from auto manufacturing to residential real estate to high-tech medical research. The analysts' work is to assess those businesses' contributions to the regional economy.

In addition to economists, the Atlanta Fed's directors of the boards at the head office and the branches are another critical component of the bank's

information-gathering network. Directors play a crucial monetary policy role by contributing anecdotal, grassroots economic intelligence they learn from their own industries and from other local contacts. In order to present a comprehensive and nuanced view of local and regional economies, directors and other Atlanta Fed advisers are drawn from a range of industries including commercial banking, real estate, agriculture, labor, retail, health care, and logistics.

Thus, in contributing to the nation's monetary policy, the Atlanta Fed blends hard data and econometric modeling with knowledge gathered from firsthand accounts of southeastern businesspeople. These efforts—like those of the staff in Community Affairs, Supervision and Regulation, and other areas of Federal Reserve Bank of Atlanta—are continuous. But they assume particular prominence amid a challenging economic climate like the one the region and nation began to experience during 2007.

**“In contributing to the nation’s monetary policy, the Atlanta Fed blends hard data and econometric modeling with knowledge gathered from firsthand accounts of southeastern businesspeople.”**

## Factors That Tested the Southeast Economy in 2007

Like most of the nation, the Southeast confronted an array of negative economic forces during 2007.

These forces included the downturn in Florida's residential real estate market, a slowing in property markets elsewhere, high energy costs, weaker consumer spending, and a prolonged drought. All of these factors combined to apply the brakes to the region's previously robust economic growth.

Signs of a slowing economy were numerous: Employment growth decelerated, banks saw profits and lending growth decline, retail sales began to slacken, and real estate activity fell on virtually all fronts.

In the second half of 2007, the Southeast created the fewest jobs it had produced in a six-month period since the first half of 2003. The rate of job growth for the year decelerated to 1.1 percent, down from 1.7 percent in 2006.

Florida, the region's economic driver, which accounts for 40 percent of the six-state region's workforce, saw employment growth decelerate in each quarter of 2007 when compared to the year-earlier period.

The Sunshine State had been among the nation's most dynamic jobs creators for several years (see chart 1). From the fourth quarter of 2003 through the fourth quarter of 2006, Florida added jobs at twice the national rate. Only California added more jobs over those three years, and only five states created jobs at a faster rate. Unfortunately, that momentum has slowed. The average rate at which Florida added jobs during each quarter of 2007 slowed to less than a third of a percentage point and to a meager 0.1 percent in the fourth quarter. That performance matched the overall region's fourth quarter job growth.

Florida's slowdown in payroll employment growth is spread across metropolitan areas and economic sectors. Construction employment growth, not surprisingly, has slowed most. From the start of 1998, more people worked construction jobs in Florida in each successive quarter in thirty-three of thirty-four quarters. But construction employment declined for six consecutive quarters

### An Economic Timeline of the Southeast: Highs and Lows

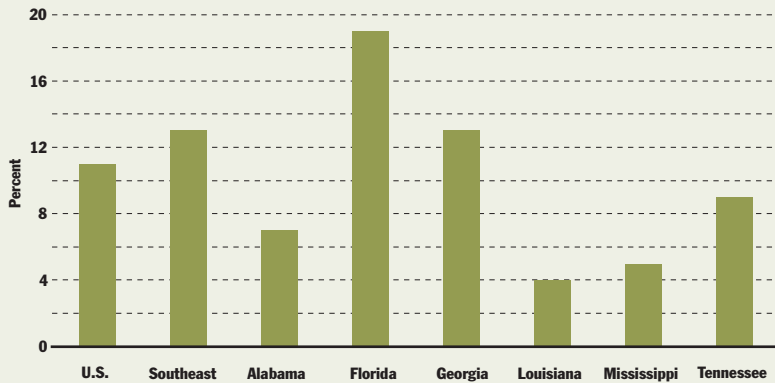
**1980:** The population of the six southeastern states grows to 30.4 million.

**1983:** Nissan opens the first foreign-owned auto plant in the region in Smyrna, Tennessee.

**1984:** Median household income is \$41,430 (in 2006 dollars) for the United States but only \$33,343 for the six southeastern states.

Chart 1

### U.S. and Southeast employment growth, 1997 to 2007



Source: U.S. Bureau of Labor Statistics

from mid-2006 through the end of 2007, according to figures from the U.S. Bureau of Labor Statistics.

Across all industries in the region, the unemployment rate climbed to 4.5 percent in the fourth quarter of 2007, up from 4.1 percent in the same period the year before.

#### Consumer spending slows

Slowing employment growth and declining home values could eventually begin to constrain consumption. But for much of 2007, consumer spending in the region held up reasonably well. Consumer spending tends to mirror personal income, and personal income has remained healthy in the Southeast, though some slowing of growth has been evident, notably in Florida.

Retail sales throughout most of the region remained healthy through the first half of 2007. But early in the year consumer spending growth stalled in Florida and showed signs of slowing elsewhere as the year progressed. As measured by sales tax collections, retail sales began to decline in Florida, Georgia, and Mississippi late in 2007. Regionwide, sales growth has slowed from robust increases in 2005 and 2006.



Retail sales began to slow as the housing downturn worsened in 2007.

**“In the second half of 2007, the Southeast created the fewest jobs it had produced in a six-month period since the first half of 2003.”**

**1985:** Employment in the apparel industry has fallen 11 percent since 1980 while textile employment has dropped 15 percent.

**1990:** Buoyed by Florida, homeownership in the six southeastern states averages 68 percent, surpassing the nation's 64.2 percent.

**1992:** Construction employment payroll in Florida, Georgia, and Tennessee hits \$12 billion.

**1996:** Tourists visiting Florida spend more than \$48 billion.

**1997:** Daimler Chrysler's Mercedes plant opens in Vance, Alabama.



Like the rest of the nation, the Southeast experienced rising numbers of home foreclosures during the past year.

In particular, the retail automotive market in 2007 signaled that troubles in the housing market, along with higher gasoline prices, could be causing consumers to close their wallets. Strapped automobile owners often repair their vehicles rather than buy new ones. And as measured by new vehicle registrations, vehicle sales fell significantly in the Southeast during 2007, down 8.8 percent, compared to a national dip of just 3.3 percent. While Florida led the regional decline, all southeastern states except Tennessee posted fewer registrations than in 2006.

Florida remains the nation's second-largest car market behind California. But this state that had been an economic powerhouse for many years slowed markedly on several fronts in 2007.

#### **Housing woes spread gloom through the economy**

Much of that slowing is linked to the end of a residential real estate and construction boom. Evidence of housing market problems was widespread throughout the Southeast. For example, fewer existing homes sold in every state in the region in 2007 than in 2006, with sales down 18 percent for the region as a whole.

#### **FACT:**

Existing home sales were down 18 percent for the Southeast as a whole in 2007.



Like the rest of the nation, the Southeast experienced rising numbers of mortgage delinquencies and home foreclosures during the past year (see map 1). The increase was primarily driven by a lack of house price appreciation (see map 2). For owner-occupied homes with little equity, delinquency and foreclosure generally arose from adverse life events, like a job loss or divorce. For investor-owned properties, particularly in Florida, the combination of little initial equity, coupled with falling house prices, was a significant cause of mortgage distress.

Exiting a long boom, Florida's residential real estate market slowed most. The Sunshine State's existing home sales were off 27 percent for the year, the result of a blend of fast-rising homeowner insurance premiums, higher taxes, and general economic weakness. But Florida was not the only state with a deteriorating housing market during 2007.

The housing slowdown worsened in late 2007. Florida home sales slackened most in the fourth quarter, while Georgia and Louisiana sales fell off substantially, and every state experienced lower sales than in the previous quarter and the year-earlier period.

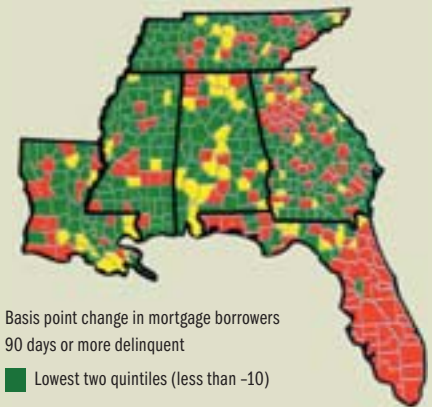
Weakening demand for homes, due in part to tighter credit standards, led builders to plan fewer new builds, which meant fewer construction jobs and lower sales of building materials and home furnishings. Again, slowing was most pronounced in Florida.

In 2007, Florida single-family home builders secured 52 percent fewer permits than the year before, while permits for condominiums were down substantially as well. For the region as a whole, single-family permits fell 40 percent in 2007 from 2006, declining in all six states, according to the U.S. Census Bureau. This drop followed a smaller decline in 2006, which was also attributable mainly to a dip in Florida. Prior to the housing downturn, Florida had been the only southeastern state in which the number of single-family residential building permits issued had climbed in every year from 2000 through 2005.

Map 1

**Change in mortgage delinquency by county in the Southeast**

(Q4 2004 to Q4 2007)



Basis point change in mortgage borrowers 90 days or more delinquent

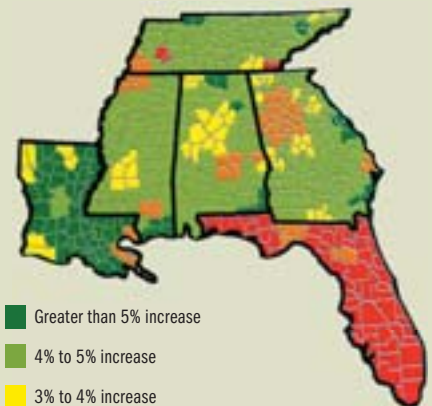
- Lowest two quintiles (less than -10)
- Middle quintile (-10 to 30)
- Highest two quintiles (greater than 30)

Source: TrenData from TransUnion LLC

Map 2

**Change in house price index by county in the Southeast**

(Q4 2006 to Q4 2007)



- Greater than 5% increase
- 4% to 5% increase
- 3% to 4% increase
- 1% to 2% increase
- Any decrease

Source: House Price Index from the Office of Federal Housing Enterprise Oversight



### **Banks' challenges rooted in real estate**

Housing woes profoundly affected the Southeast banking industry in 2007. As the year progressed, banking conditions began to deteriorate; earnings declined amid worsening loan quality and lower revenue. Eroding asset quality was most apparent in real estate–related lending, according to Bank Call Report data and Atlanta Fed analysis. Nevertheless, the region's banks remained well-capitalized, a fact that should help them weather these challenges.

Cumulative earnings for the region's banks declined markedly in the second half of 2007. Fourth-quarter profits decreased 50 percent from a year earlier after falling 24 percent year-over-year in the third quarter.

Slimmer profits were brought about mainly by lower revenue and higher loan-loss provisions—funds banks set aside to cover bad loans. Loan-loss provisions more than tripled in the last three months of 2007 from a year earlier.

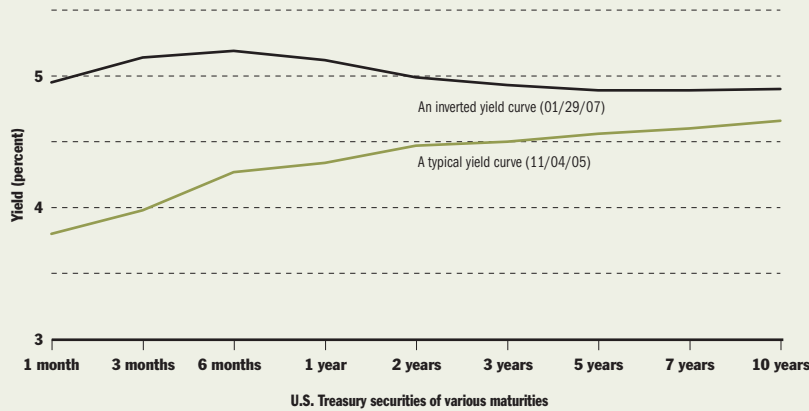
Across the region, loan-loss provisions consumed more than 20 percent of net operating revenue, surpassing the previous cyclical peak of 9.5 percent during the 2001 recession, according to Atlanta Fed analysts. Meanwhile, the volume of loans charged off by banks climbed, providing warning signals of trouble to come, particularly in residential mortgage loans and loans to builders and real estate developers.

The volatility of the yield curve, with its periodic inversions in 2007, put additional stress on banks. The shape of the yield curve determines the difference between the interest banks earn from long-term loans and the interest they pay for short-term deposits. Typically, when the yield curve flattens, bank profits are squeezed, especially when the curve is “inverted,” meaning that banks are paying more for deposits than they are earning on long-term loans (see chart 2).

Meanwhile, lending growth remained modest late in 2007. Sixth Federal Reserve District banks reported slight increases in commercial lending and construction and development lending, with an uptick in credit card lending. But tighter underwriting and continued slow home sales led to a 7 percent,

Chart 2

### The yield curve



or \$9 billion, year-over-year decline in residential mortgage lending in the fourth quarter.

The banking industry saw both some fundamental changes and shrinking profits in 2007, and 2008 is likely to be another difficult year as more adjustable rate mortgages are scheduled to reset. On balance, banks in the Southeast did not have as much direct exposure to subprime mortgage defaults as financial institutions in some parts of the country did. Upcoming mortgage resets, though, could mean additional delinquencies and foreclosures, pushing banks to increase loan-loss reserves and thereby squeezing profit margins further. This outcome may be mitigated, however, by lower current mortgage rates as a result of the Fed's rate cuts.

Most of the region's financial institutions may be well positioned to withstand these challenges. At the end of 2007, more than 99 percent of the Southeast's banks were classified by regulatory capital standards as being sufficiently capitalized.

#### Rising energy costs hurt most, help some

Along with problems in real estate markets, energy costs were another force constraining the region's economy in 2007. Retail gasoline prices, on average,



As 2007 progressed, banking conditions began to deteriorate.

**“In the fourth quarter of 2007, banks charged off consumer loans at a rate of 2.61 percent compared to 1.80 percent in the first quarter of 2006.”**



Deepwater drilling continued to increase off the Gulf Coast through 2007.

rose 8 percent nationwide from the year before. Increased demand and a significant decline in domestic gasoline stocks drove the record gasoline prices, and that momentum seems likely to continue into 2008.

Oil prices are high and volatile, geopolitical tensions continue to threaten the oil supply, consumers are facing higher costs at the pump and at home, and businesses face higher fuel expenses. Still, a glimmer of good news might be the increased deepwater exploration for oil off the coasts of Louisiana, Mississippi, and Alabama.

Made practical by higher oil prices, deepwater drilling continued to increase off the Gulf Coast through 2007. The number of rigs in ultradeep water—at least 5,000 feet—in the Gulf of Mexico hit a record high in August 2007, according to the Louisiana Department of Natural Resources.

Gulf Coast oil extraction potential was further enhanced in October 2007, when the federal Central Gulf of Mexico Lease Sale generated the second-highest total bids in U.S. leasing history.

### **Drought parches much of the region**

Back on land, the worst drought in decades took its toll on the Southeast in 2007. In a region that has grown rapidly in recent years, rising demand for water and a constrained supply are squeezing some local economies. While it is difficult as yet to judge the economic impact of the drought, media reports detailed job cuts and lost revenue in industries that depend heavily on rain, such as landscaping and commercial nurseries. The implications of water shortages on future growth in the region are still to be assessed.

In the longer term, areas with persistent water supply concerns could be less likely to attract manufacturers and other businesses that depend on a consistent water source. In reaction to the drought, certain parts of the Southeast, such as metropolitan Atlanta, are considering stronger water conservation and planning efforts to ensure long-term supplies. In late 2007 and early 2008, some municipalities had begun increasing water rates, partly to encourage conservation.

### **Still recovering from Katrina**

Nature continued to exert influence of a different sort in southern Mississippi and Louisiana in 2007 as the area sustained its post-Hurricane Katrina rebuilding efforts throughout the year. In Louisiana, insurance availability and higher costs put a damper on redevelopment efforts. The recovery of the 177,000 jobs Katrina carried away in the state also remains slow.

On the other hand, the state's critical tourism industry improved rapidly. To the east, after being nearly destroyed by the hurricane, the gaming industry in Mississippi has rebounded powerfully and is contributing to the state's coffers. By the end of 2007, the Mississippi Gulf Coast had regained all but 1,500 of the 25,000 jobs lost because of Katrina.



Tree stumps now sit on the sun-baked shores of Lake Lanier, north of Atlanta, as drought takes its toll.

**“The implications of water shortages on future growth in the region are still to be assessed.”**

### **FACT:**

Crude oil inventories began to decline in July 2007 and reached a two-year low in October.

# The Southeast Economy: A Historical Context

The Southeast's economy in 2007 was buffeted by the same forces as the national economy. That similarity represents progress, in a sense, because it signals the region's long ascension from economic laggard into the nation's economic mainstream.

Only in recent decades has the Southeast moved to the center of the national economy in terms of industry composition, productivity, and population. Boosted by an influx of people of varying backgrounds and an infusion of diversified industries, the economy of the Southeast, more than any other region, is now a microcosm of the nation.

The population of the six states served by the Sixth Federal Reserve District has more than doubled since 1960, to about 46 million, far outpacing growth in the country as a whole. Florida's population in that period nearly quadrupled, to 18.25 million, and Georgia's more than doubled. During the same period, the nation's population grew by 68 percent.

## Migration spurs growth

Much of the Southeast's population growth has come via migration from other parts of the country, notably the Northeast and Midwest. From 2000 to 2007, three of the six southeastern states—Florida (first), Georgia (fifth), and Tennessee (eighth)—ranked among the top ten for in-migration from within the United States as the region experienced net domestic in-migration of 1.68 million people (or 2.05 million excluding the post-Hurricane Katrina outflow from Louisiana and Mississippi), according to the U.S. Census Bureau.

A steady flow of newcomers has streamed into the Southeast for much of the past fifty years. In each decade starting with the 1960s, the six-state region's population grew at a rate greater than the nation's. In the 1970s the Southeast's growth doubled the nation's, and in the 1980s it was 50 percent higher.

In recent years, the region's immigrant population has grown particularly fast, helping to make the region more like the rest of the country demographically as well as economically. From 2000 to 2006, Georgia, Tennessee, and Alabama

**An Economic Timeline of  
the Southeast: Entering  
the 21st Century**

**2000:** The combined population of the Southeast reaches 41.6 million.

**2001:** Honda opens an auto plant in Lincoln, Alabama.

**2003:** One thousand people a day move to Florida.

Table 1

**Per capita personal income (PCPI) (in 2007 dollars)**

	2006 (revised)	Percent of U.S. PCPI	2007 (preliminary)	Percent of U.S. PCPI	1977	Percent of U.S. PCPI
United States	\$36,714		\$38,611		\$26,092	
Alabama	30,894	84	32,404	84	20,412	78
Florida	36,720	100	38,444	100	24,602	94
Georgia	32,095	87	33,457	87	21,850	84
Louisiana	31,821	87	34,756	90	21,550	83
Mississippi	27,028	74	28,845	75	18,435	71
Tennessee	32,172	88	33,280	86	21,448	82

Note: According to the U.S. Bureau of Economic Analysis, Louisiana and Mississippi experienced large jumps in personal income from 2006 to 2007 primarily because of the Road Home subsidies (Louisiana) and housing subsidies (Mississippi) granted to Hurricane Katrina victims.

Source: U.S. Bureau of Economic Analysis

ranked fourth, fifth, and sixth, respectively, among states in the percentage growth in foreign-born residents, according to the U.S. Census Bureau. The foreign-born segment of each of the three states' population grew by more than 40 percent in that period. In the entire region, the foreign-born population increased by 32 percent, triple the region's overall population growth and far surpassing the nationwide growth in the foreign-born population.

In 2006, 11 percent of the Southeast's population was foreign-born, a figure that is likely below the actual percentage because of difficulties in counting undocumented immigrants.

**Moving toward prosperity**

This influx of people has both spurred job growth and helped to satisfy demand for workers. In turn, per capita personal income has come much closer to that in the United States as a whole in the six Southeast states: \$33,531 on average in preliminary 2007 data versus \$21,382 on average (in today's dollars) in 1977, according to the U. S. Bureau of Economic Analysis (see table 1 and charts 1 and 2).



A sign of the times in Chamblee, Georgia: The foreign-born population in the Southeast grew by nearly one-third from 2000 to 2006.

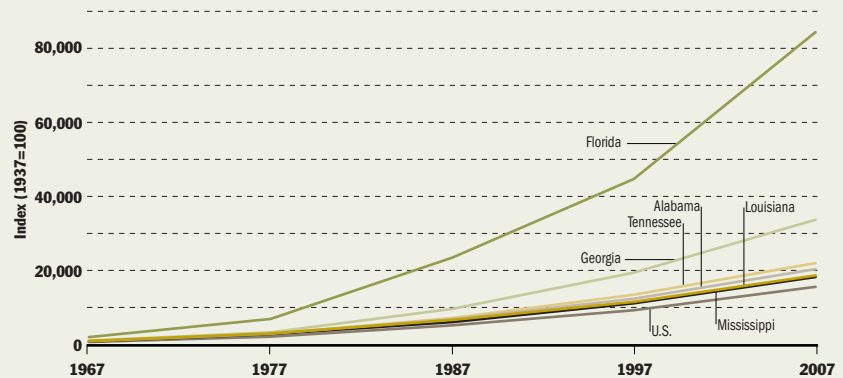
**“The population of the states served by the Sixth Federal Reserve District more than doubled from 1960 to 2000, to about 46 million.”**

**2004:** Florida ranks first nationally in the impact of international travel on state economies (\$14.45 billion).

**2004:** Hyundai opens an auto plant in Montgomery, Alabama.

Chart 1

**Nominal personal income growth in the United States and the six southeastern states**



Source: U.S. Bureau of Economic Analysis

This virtuous circle has been evident in, among other sectors, construction and services—from schools to hospitals to restaurants to golf courses to elder care homes—demanded by the millions of new residents.

The building industry, in particular, has boomed in the Southeast. From 1992 to 2002, construction employment in the region’s three biggest states—Florida, Georgia, and Tennessee—increased by 58 percent, to 770,132 jobs, and construction payrolls more than doubled, to about \$24 billion, according to the Economic Census from the U.S. Census Bureau.

Service industries have also been expanding. In 2007 the service sector employed more than eight of ten workers in the Southeast, up from two-thirds in 1970.

Today, the six southeastern states’ annual economic output is roughly \$1.7 trillion. By comparison, the gross domestic product of the nation is about \$13 trillion. If the Southeast were a country, its economy would rank as the world’s eighth-largest, between Italy and Canada.

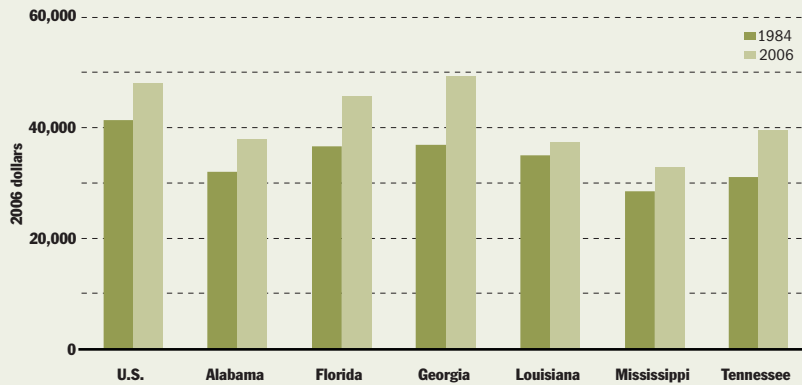
**FACT:**

In 2007, for the first time in decades, more people left Florida than moved in.



Chart 2

### Median household income in the United States and the six southeastern states



Source: U.S. Census Bureau

The large, multifaceted regional economy is the product of a gradual but profound change. Around the middle of the twentieth century, the Southeast lagged the nation in almost every measure of economic health. The region was so far behind the nation that in 1938 President Franklin D. Roosevelt famously declared it America's "economic problem No. 1."

In the years before World War II, the region's economy suffered from an "adherence to an agricultural economy built on a few staples—cotton, corn and tobacco," Atlanta Fed economist C.H. Donovan wrote in 1946.

#### **Agrarian society receded after World War II**

That agrarian Southeast, romanticized by some, bemoaned by others, gradually receded in the years following World War II as a result of mechanization and agricultural industry consolidation. Vestiges of the old farm-dominated economy have disappeared rapidly in recent decades.

That is not to say agriculture is no longer important. In fact, the dollar value of the region's farm output has risen substantially even as agricultural employment



Vestiges of the region's old farm-dominated economy have disappeared rapidly in recent decades.

**"If the Southeast were a country, its economy would rank as the world's eighth largest, between Italy and Canada."**

#### **FACT:**

The percentage of the region's workers who make their living on farms fell to just 1.5 percent in 2006.

dropped by 36 percent from 1970 to 2006 from more than 600,000 jobs to 387,000, according to the U.S. Bureau of Economic Analysis.

Contraction of farm employment has been even more pronounced in the Southeast than in the United States as a whole. The percentage of the region's workers who make their living on farms fell from 5.6 percent in 1970 to just 1.5 percent in 2006. Today, agricultural jobs account for a smaller portion of the region's total employment than they do for the nation as a whole, a stark reversal from most of the twentieth century.

As the number of farm jobs dwindled in the latter half of the century, manufacturing of nondurable goods such as textiles and apparel helped to fill the employment void. In 1970, one of four employees in the Southeast held a factory job. Like agriculture before it, however, manufacturing's share of total regional employment has steadily shrunk, mainly because of global competition from lower-cost manufacturers abroad. By 2007, only about one in ten southeastern workers was employed in manufacturing. Data from the U.S. Census Bureau for the United States as a whole show a similar pattern.

#### **Manufacturing shifts gears, services gain ground**

While manufacturing no longer provides the significant number of jobs it once did, it remains a vital part of the region's economy through the ascendance of higher-tech, higher-skilled industries. Like its farms, the Southeast's factories have over time produced more product with fewer workers. The region's manufacturing output grew tenfold between 1970 and 2005, to nearly \$200 billion. This gain in output also reflects relocation of higher value-added industries from other parts of the United States and elsewhere to the Southeast. The impressive growth of the transportation equipment industry, notably in Alabama, exemplifies this trend. In 2006, the Southeast boasted 119,000 auto manufacturing jobs, a 13 percent increase since 2001. By contrast, auto employment nationally declined over the same period.

As the number of manufacturing jobs declined, the services sector emerged as an employment growth engine in the Southeast. This sector encompasses a broad range of jobs, from white-collar positions in accounting, advertising,

#### **FACT:**

In 2006 there were 119,000 auto manufacturing jobs in the Southeast, a 13 percent increase since 2001.



Employment in the Southeast’s service sector is similar to the profile in the nation.

communications, computer software, and law to less skilled jobs such as retail sales, hospitality, pest control, security services, building maintenance, and telemarketing. Service sector jobs jumped from 67 percent of the Southeast’s total employment in 1970 to just short of 84 percent by 2007. Like the decline in manufacturing and agricultural jobs, the growth in services also reflects similar trends in the United States.

According to the U.S. Census Bureau, employment in the Southeast’s service sector in high-, medium-, and low-paying service occupations is similar to the profile in the country as a whole (see table 2). For the United States, 96 percent of the total number of people employed in high-paying jobs are in managerial, professional, and related occupations. That figure compares to 97 percent in the Southeast. All of the low-paying jobs for both the nation and the Southeast are in what the U.S. Census Bureau classifies as service occupations—for example, food preparation, health care support, and maintenance.

### **Education and training are keys to the future**

Because both the population and industrial composition of the Southeast have shifted over time, so has the demand for differently and higher-skilled labor.

### **FACT:**

In spring 2007 the GM Saturn plant in Spring Hill, Tennessee, laid off 2,400 workers for eighteen months as the plant phased out production of the Saturn brand.

Table 2

### **Service sector occupations in 2006 by pay category (percent)**

Occupations*	United States	Southeastern states
High-paying	31.8	30.4
Medium-paying	49.3	51.1
Low-paying	18.9	18.5

\* For this table, high-paying jobs are defined as those falling 0.5 standard deviation above median pay and low-paying jobs as those falling 0.5 standard deviation below median.

Source: FRB Atlanta analysis using data from the U.S. Census Bureau 2006 American Community Survey



Attracted by a skilled and educated workforce, Scripps Research Institute, a leading biomedical research organization, opened a lab in Florida in 2004.

That shift has increased demands on higher education in Florida, Georgia, and other southeastern states and boosted the need for postsecondary technical education and worker training.

When sophisticated manufacturing plants in industries including steel, automobiles, and aerospace locate in the region, the Southeast appears to be making strides toward meeting the challenge of preparing its citizens for these jobs. According to a June 2007 *Expansion Management* magazine poll of corporate site consultants, the top three, as well as four of the top ten, state-sponsored workforce training programs are in the Southeast: Georgia, Alabama, and Florida were the top three, and Tennessee ranked seventh.

Job training programs were part of the incentives packages that helped to attract global manufacturers to the region, including Kia Motors to Georgia and ThyssenKrupp and Airbus to Alabama. Florida's ability to provide

educated and skilled employees has helped to bring Scripps Florida, the Max Planck Society, and other biomedical research centers to the state in recent years.

Clearly, as lower-skilled jobs move overseas and higher-skilled work demands greater, more specialized training and knowledge, future economic prosperity will depend on educated, talented people. Hopeful signs can be found throughout the Southeast. In all six southeastern states, the proportion of eighteen- to twenty-four-year-olds enrolled in college or graduate school climbed steadily from 2000 to 2006. Still, none of the six matched the national percentage of 39.7 percent in 2006, up from 34 percent in 2000 (see table 3).

Table 3

**Percent of 18- to 24-year-olds enrolled in college or graduate school**

	2000	2006
United States	34.0	39.7
Alabama	33.3	37.3
Florida	31.7	35.2
Georgia	27.9	34.9
Louisiana	32.3	34.7
Mississippi	31.3	36.9
Tennessee	30.0	36.3

Source: U.S. Census Bureau

**“Future economic prosperity in the Southeast will depend on educated, talented people.”**

## Challenges Ahead

The primary challenge facing the Southeast is elevating the education level of the region's people to meet the demands of the present and future job market. Even as the region has prospered on many fronts and university enrollments continue to climb, the overall quality of kindergarten through twelfth grade education remains below national norms.

The news from university campuses around the Southeast, however, is mostly good. Over several decades, the Southeast's institutions of higher education have expanded and diversified. One of Georgia's major metropolitan institutions, Atlanta-based Georgia State University (GSU), has become a model for quality growth and development. (See the sidebar on GSU, page 28.)

Florida alone is home to four schools that did not exist in 1960 but have blossomed into major research universities: the University of Central Florida, the nation's sixth-largest university based on fall 2007 enrollment of 48,497; the University of South Florida, the nation's ninth-largest university, with an enrollment of 45,244; Florida International University, with 38,000 students; and Florida Atlantic, with an enrollment of 26,000.

In Tennessee, the state's premier research institution, the University of Tennessee, Knoxville, is comanager with Battelle of the Oak Ridge National Laboratory, the U.S. Department of Energy's largest science and energy laboratory.

Regionwide, the number of undergraduate, graduate, and professional students is growing. That number increased 17 percent from 2000 to 2006, to 2.73 million, according to the U.S. Census Bureau. That rate of increase is nearly twice the rate of increase in the overall population of the Southeast during that period.

Despite that impressive growth in college enrollment, every state in the region remains below the national average in the proportion of citizens eighteen to twenty-four years old who are college or graduate school students.

The Southeast also continues to lag the nation in the percentage of adults with at least a bachelor's degree. Among the six states in the region, Georgia—

### An Economic Timeline of the Southeast: Opportunities and Challenges

**2006:** Median household income grows to \$48,201 (in 2006 dollars) for the nation but averages only \$40,414 for the six southeastern states. Only Georgia surpasses the nation's median with \$49,344.

**2007:** The estimated six-state Southeast population hits 45.8 million, nearly double the 1960 population; the U.S. population in total grows at a much slower rate of 39 percent during the same period.



Founded after 1960, the University of Central Florida is now the nation's sixth-largest university based on enrollment.

where 26.6 percent of adults twenty-five and older hold a degree—comes closest to the national rate of 27 percent. But the region is moving closer to the national standard. Between 1990 and 2006, the proportion of citizens twenty-five and older with degrees increased more in five of the six southeastern states than it did nationally (see table 1).

### Competitive workforce a critical goal

The Southern Growth Policies Board (SGPB), a nonpartisan public policy think tank formed by the region's governors, in 2007 identified the task of building a competitive workforce as a critical issue for the region. In meetings conducted by SGPB with government, economic development, and business leaders across Georgia last year, common discussion threads emerged focusing on a need for greater emphasis on the importance of education, hard work, and lifelong learning among young people. In particular, the current workforce and younger people need to improve “hard skills” such as reading, writing, math, problem-solving, and science; “soft skills” like work ethic and integrity; and “life skills” such as how to dress appropriately, manage households, and take care of themselves. (See the sidebar on working smart, page 30.)

Table 1  
Percent of adults 25 and older with a bachelor's degree or higher

	1990	2000	2006
United States	20.3	24.4	27.0
Alabama	15.7	19.0	21.1
Florida	18.3	22.3	25.3
Georgia	19.3	24.3	26.6
Louisiana	16.1	18.7	20.3
Mississippi	14.7	16.9	21.4
Tennessee	16.0	19.6	21.7

Source: U.S. Census Bureau

**“The Southern Growth Policies Board in 2007 identified the task of building a competitive workforce as a critical issue for the region.”**

**2007:** Service sector jobs in the Southeast represent 84 percent of total jobs.

**2007:** In Florida out-migration exceeds in-migration for the first time.

**2007:** German steelmaker ThyssenKrupp broke ground on a \$3.7 billion plant north of Mobile, Alabama.



## IN DEPTH: GSU exemplifies Southeast's new breed of universities



GSU students cross Peachtree Street in Atlanta as they navigate the sprawling urban campus.

Through the past few decades, the Southeast has nurtured several young urban universities that have grown into major research institutions. While these schools lack some of the amenities of traditional universities, they are dynamic institutions serving diverse student bodies.

Florida boasts a handful of these universities—Central Florida, South Florida, Florida Atlantic, and Florida International (see the essay). To the north, Georgia State University (GSU) in Atlanta has, perhaps as much as any school in the country, grown and prospered alongside its home city.

Founded in 1913 as Georgia Tech's Evening School of Commerce, GSU was later dubbed "the Atlanta Division" of the University of Georgia. The state Board of Regents granted the school independence in 1955, and in 1969 it officially became Georgia State University.

GSU's evolution from a commuter school received a major boost in 1995, when the state Board of Regents, which oversees Georgia's thirty-four public colleges and universities, changed the school's status from regional university to research institution. That move placed GSU in the same category as the University of Georgia, Georgia Tech, and the Medical College of Georgia.

"Our students come from every county in Georgia, every state in the nation, and from

160 other countries," notes GSU President Carl V. Patton.

Befitting its origins, Georgia State boasts a highly regarded business school, including the nation's No. 5 part-time MBA program, as ranked by *U.S. News and World Report*. The former night business school now offers 250 fields of study through fifty-two accredited degree programs. The Carnegie Foundation for the Advancement of Teaching rates GSU a "research intensive university," one of five in Georgia.

In 2006, GSU announced a \$1 billion dollar campus expansion that will add more than a dozen new buildings. As part of that sweeping plan, GSU in August 2007 opened a \$165 million complex that houses about 2,000 students downtown. The university plans to ultimately accommodate 20 percent of its enrollment, now at more than 27,000, in housing near the downtown campus.

Just over a decade ago, GSU had no campus housing. But "Georgia State has worked hard to be a part of the community, not apart from it," states Patton. The university acquired the complex that housed athletes during the 1996 Olympic Games. (That complex has subsequently been sold to Georgia Tech.) Since the dawn of the 1990s, GSU has purchased several buildings in downtown Atlanta, including the historic C&S Bank Building, the Rialto Theater, and the former Wachovia Bank building. ■

Meanwhile, education throughout the Southeast remains a persistent economic development challenge.

At the K–12 level, no single measure of education is comprehensive. But the Southeast consistently lags national benchmarks in, among other indicators, per pupil public school spending and public high school graduation rates. All six states in the region ranked among the lower half of states in average K–12 education spending per pupil from 1992 through 2005, in constant 2005 dollars, according to a June 2007 report from the Nelson A. Rockefeller Institute of Government at the State University of New York. Florida ranked twenty-ninth, Georgia thirtieth, and the other four southeastern states ranked between forty-fourth and forty-ninth.

In public high school graduation rates in 2005, none of the region's states matched the national average of 68.8 percent, according to the National Information Center for Higher Education Policymaking and Analysis. In that study, Tennessee ranked highest, at fortieth, with a graduation rate of 64.5 percent. All six southeastern states except Louisiana posted a lower rate in 2005 than in 1990, reflecting the national trend in the overall U.S. high school graduation rate, which also slid from 71.2 percent.

Part of the problem may lie at the pre-K level. Studies conducted by the National Institute for Early Childhood Research suggest that states in the Southeast and across the nation have made progress in expanding participation in pre-K education, but there remains variation in teacher educational qualifications, which are a key factor in student achievement.

The impact of poor education on the economy is stated plainly by the National Center for Public Policy and Higher Education, an independent California-based organization. That group issues a National Report Card on Higher Education that includes reports on each state. The 2006 report, the most recent, noted that in each of the six Southeast states poor educational performance “could limit the state’s access to a competitive workforce and weaken its economy over time.” In particular, the reports faulted the states for poor high school graduation rates and for low numbers of high school graduates enrolling in college.



Part of the Southeast’s educational challenges lie at the pre-K level.

**“The overall quality of kindergarten through twelfth grade education in the Southeast remains below national norms.”**



Several southeastern states operate highly regarded worker training programs.

## IN DEPTH: Working smart

As globalization and technology continue to transform the workplace, a prosperous Southeast needs a workforce with the skills, education, and training to adapt to fast-changing jobs and careers.

For example, Atlanta Fed research has shown that information technology workers in Georgia who lost jobs during the technology industry downturn of 2000–01 found higher-paying new jobs than workers in other fields who had lost jobs. That finding suggests that people with skills that are transferable across industries are better prepared for industry-specific shocks than those who rely on skills valuable to only one industry. Virtually all enterprises need people with information technology skills, while few, if any, other businesses require someone trained strictly as an apparel plant sewing machine operator.

Across the Southeast, forecasts suggest that the most abundant new jobs through 2014 are expected to include network systems and data communications analysts, software engineers, network and computer systems administrators, database administrators, and physician assistants. These fields require education and specialized skills. In Louisiana, the state-sponsored 2007 Occupational Forecasting Conference found that 95 percent of 400 “top demand occupations” through 2009 require training beyond a high school diploma.

All the southeastern states operate worker training programs, which are often used to retrain citizens who are changing jobs. Many of the programs are tailored for specific industries or employers. Georgia, for instance, established a training center to provide preemployment assessment training and job-specific training for Kia Motors’ \$1 billion assembly plant, which is scheduled to begin production in 2009. The state of Alabama has committed to supply National Steel Car with 1,500 trained welders for its plant near Muscle Shoals.

In Florida, a consortium of public-private workforce development organizations is retraining aerospace workers. The goal is to prepare the state’s workforce as NASA discontinues the space shuttle program and launches its first Crew Exploration Vehicle mission in 2014. Retiring the shuttle is expected to reduce the workforce at Kennedy Space Center at Cape Canaveral by up to 80 percent, or 6,400 jobs, according to a NASA forecast.

Finally, it should be underscored that some job training programs geared toward a single employer or industry might not best serve a population. If that employer or industry leaves, then those trained to work for that company or in that industry might again find themselves with skills that are not easily transferable. ■

In improving the region's workforce, not only universities and K-12 education but also community colleges and technology-based worker training programs will likely play a critical role. In these areas, the region stacks up reasonably well. Several southeastern states operate highly regarded worker training programs.

Alabama's training initiative, for example, has been instrumental in the state's successful recruitment of several major manufacturing plants in recent years, including ThyssenKrupp and National Steel Car rail car facility, according to state officials.

Florida also boasts one of the nation's leading community college systems, which enrolled 797,000 students in the 2006-07 academic year. The system is designed to help students get the training they need and to boost the state's economy, according to the Florida Department of Education. (See the sidebar on Florida's community colleges, pages 33.)

### **Growing pains**

The Southeast's explosive population growth has been central to the region's economic success in recent decades. At the same time, that expansion presents its own set of challenges that the region must master if it is to continue to prosper.

In 2007, after decades of huge in-flows, more people left Florida than moved in. Pricier housing, rising property taxes, skyrocketing homeowners' insurance rates, and general economic weakness made the state less attractive to newcomers and second-home buyers. If slowing population growth persists, it will have significant consequences for the Sunshine State's once-booming construction industry, among other sectors.

In metropolitan areas throughout the region, infrastructure concerns such as water supplies, traffic congestion, and air quality present additional potential growth constraints. Georgia and Florida rank sixth and tenth among states in the longest average commute time, according to the Census Bureau's 2006 American Community Survey, while all six southeastern states rank among the top twenty-five.



Technology-based worker training programs will likely play a critical role in the region's workforce.

### **FACT:**

According to the Atlanta Chamber of Commerce, traffic congestion is the greatest threat to Atlanta's continued economic prosperity.



Declining auto sales affected production at southeastern assembly plants in 2007.

Photo: Nissan

In addition, the region relies more on coal-fired electricity plants than most of the nation, meaning it could be disproportionately affected by any measures to curb carbon emissions. Similarly, the settlement pattern of southeastern cities—spread out and dependent on the automobile—makes the region more vulnerable to volatility in gas prices.

The region's growing automotive industry also stands to feel the effects of rising gas prices. That industry embodies the reality that, as the region's overall economy becomes more like the nation's economy as a whole, it also becomes more cyclical and thus more vulnerable to downturns. For example, declining auto sales in 2007, mainly a sign of general weakness in consumer spending, affected production at southeastern assembly plants.

#### **A firm foundation for the future**

Although the region confronts both short-term cyclical stresses and challenges to its long-term economic vitality, it has a firm foundation for prosperity (see table 2). The Southeast has done well in building on its historic strengths: a positive business environment, a favorable climate and attractive destinations,



## IN DEPTH: Community and technical colleges are vital to region's largest economy

Florida's system of community colleges is the primary point of entry to higher education for many citizens of the Southeast's largest state, particularly for African-Americans and Latinos, according to the Florida Department of Education (DOE).

The system, comprising 28 colleges and 61 campuses at 177 sites from the northwest corner of the state to the Keys, serves about 800,000 students a year.

Workforce development is part of the system's mission. In fact, during economic downturns more students enroll to "retool and retrain," the Florida DOE says. During the 2005-06 school year, the continuing workforce education program was the system's second most popular offering, with 159,316 students enrolled, behind only the associate in arts degree curriculum.

Florida's community colleges also play a key role in Workforce Florida Inc., the state's public-private effort to continually improve the Sunshine State's workforce. Community colleges host most Workforce Florida programs that create and provide up-to-date training for workers in industries deemed critical to sustaining and expanding the state's economy.

The aviation/aerospace training center is at Florida Community College at Jacksonville and Brevard Community College in Jacksonville and Coco; digital media training is based at Seminole Community College in Sanford; health sciences at Valencia Community College in Orlando; and logistics and distribution at Lake City Community College in Lake City.

To try to increase the number of women in the information technology industry, the Florida DOE and Cisco Systems' Cisco Networking Academy established the Girls Get IT Initiative, with sites on several community college campuses.

Some Florida community colleges also offer specialized degrees designed to prepare students for work in important local industries. For example, Florida Keys Community College, the southernmost college in the United States, offers programs in marine technology and the diving business.

The system has begun to feel the effects of a slowing economy. During 2007 and 2008, Florida community colleges faced the challenge of serving rising enrollments, due in part to the state's slowing economy, in the face of state funding cuts. ■



A student studies between classes at Seminole Community College in Sanford, part of Florida's large network of community colleges.

Table 2

**Real gross domestic product in the United States and the Southeast in 2006**

	GDP (\$millions) <sup>a</sup>	Percent change from 2005	Rank in U.S.
United States	11,291,375	3.4	—
Southeast (Sixth FR District) <sup>b</sup>	1,496,119	2.9	—
Southeast without LA and MS	1,284,920	3.4	—
Alabama	136,576	3.1	23
Florida	609,958	4.2	12
Georgia	331,129	3.4	20
Louisiana <sup>b</sup>	141,167	1.7	45
Mississippi <sup>b</sup>	70,032	2.5	35
Tennessee	207,257	3.0	25

<sup>a</sup> GDP is shown in year 2000 dollars.

<sup>b</sup> Post-Hurricane Katrina data

Source: U.S. Bureau of Economic Analysis advance estimates

in-migration from other areas of the country, low taxes and business costs, and hitherto abundant natural resources. Additionally, the region has been adept at developing promising new industries—from biotechnology and medical research to high-end manufacturing, accounting, and management services to computer and network engineering. These industries offer the types of jobs in which technology tends to complement performance, adding value instead of acting as a labor substitute.

The region's industrial mix is diverse and resilient as evidenced by industries such as defense-related manufacturing and shipbuilding, which help to offset recent weakness in consumer products manufacturing. In addition, the Southeast's proximity to other national markets is an advantage in the competitive race to attract industry and capital from around the world. In fact, nearly 665,000 jobs in the Southeast are at nonbank, foreign-owned businesses. And in the next few years, European and Asian aerospace, automobile, and steel concerns plan to open large factories in the region, adding to this pool of jobs.

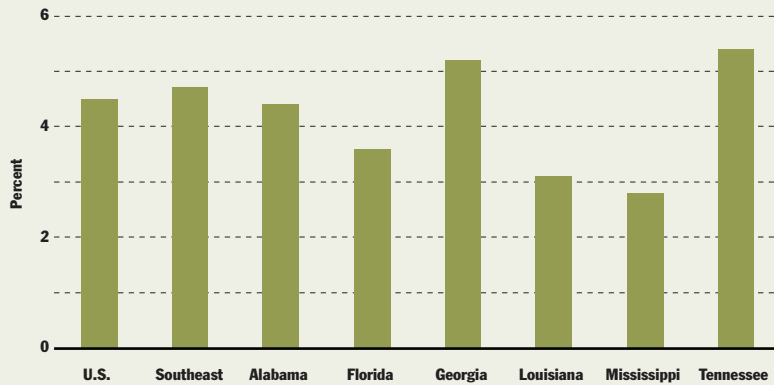
**FACT:**

Of the nation's fifty largest ports for international trade, fifteen are located in the Southeast.



Chart

**Percent of nonfarm employment for U.S. affiliates of nonbank foreign-owned firms, 2004**



Source: U.S. Bureau of Economic Analysis

According to the latest data available, employment by nonbank foreign-owned firms represents 4.5 percent of U.S. nonfarm employment, or about 5.1 million jobs, and 4.9 percent in the Southeast (see the chart).

As world economies grow increasingly interdependent, the Southeast is well positioned to benefit from international trade. Of the nation's fifty largest ports in terms of total international trade, fifteen are in the Southeast. Strong world demand for regional exports such as industrial machinery, electrical equipment, and transportation equipment, including motor vehicles and auto parts, has bolstered export growth even as other economic sectors weakened.

Finally, the region's favorable climate and business environment bode well for continued in-migration of residents and jobs. To be sure, the Southeast faces challenges, some unique to the region, others typical of the nation and world. But the Southeast has in its history overcome large obstacles to forge a new prosperity and quality of life. The coming years should be no different.



In 2007, export shipments through the region's ports grew significantly.

**“The region’s industrial mix is diverse and resilient as evidenced by industries such as defense-related manufacturing and shipbuilding, which help to offset recent weakness in consumer products manufacturing.”**

## 2007 Highlights

### Federal Reserve Bank of Atlanta Year in Review

#### **Bank names Lockhart president and CEO**

Dennis P. Lockhart became the Atlanta Fed's fourteenth president and chief executive officer March 1, succeeding Jack Gynn, who retired in October 2006. Lockhart came to the bank after a long career in senior-level positions in the banking and finance industry with Citicorp/Citibank (now Citigroup), Heller Financial, and Zephyr Management, L.P. From 2003 to 2007, Lockhart was a faculty member of Georgetown University's Walsh School of Foreign Service, serving as chair of the school's programs in international business–government relations and global economics and finance. He also served as an adjunct professor in the economics department at Johns Hopkins University's Nitze School of Advanced International Studies.

#### **Mexican president endorses FedACH service**

The president of Mexico, Felipe Calderón Hinojosa, in February officially endorsed the Federal Reserve's remittance service, Directo a México, as the best tool to reduce the cost of money transfers to Mexico. Staff from the Atlanta-based Federal Reserve Retail Payments Office attended a ceremony and media event, featuring a live funds transfer, in Jalpa, a small city in central Mexico.

#### **Atlanta Fed launches podcasts**

The Atlanta Fed's Web site, [frbatlanta.org](http://frbatlanta.org), debuted a new feature in February—podcasts. Eighteen of these recorded interviews with Atlanta Fed executives, economists, researchers, banking analysts, and others were posted on the site in 2007. Five different podcast series, two of them tied to the content of quarterly publications, focus on a broad range of timely economic and financial topics.

#### **Eagle Estates moves on**

In March the last of a dozen FEMA trailers once parked in the Atlanta Fed's New Orleans Branch parking lot were removed as the three staff members still living there located to alternative housing. The trailers had housed a number of bank staff members for more than a year after their homes had been destroyed or damaged by Hurricane Katrina in 2005.

**Personal finance lessons from *Katrina's Classroom***

Using lessons Gulf Coast residents learned before, during, and after Hurricane Katrina, the Atlanta Fed produced *Katrina's Classroom: Financial Lessons from a Hurricane*. The four-part, DVD-based curriculum, released in May, is designed to teach middle and high school students about financial readiness during an emergency and in day-to-day life.

**Exploring the risks and rewards of credit derivatives**

The Atlanta Fed's annual Financial Markets Conference in May examined the evolving use of credit derivatives. Conference participants included academics, financial practitioners, regulators, and policymakers, who focused on how these financial instruments affect the allocation and transmission of risk across global financial markets.

**Conference explores bank monitoring of suspicious activities**

The programs banks use to identify and report questionable transactions, which may be linked to criminal activity, are an increasingly important part of the work of bank examiners. This work was the focus of the Suspicious Activity Report Conference held in Atlanta in June. The conference was named for the reports banks file with the Financial Crimes Enforcement Network when they discover transactions that appear questionable. Speakers from law enforcement agencies discussed topics including drug financing, identity theft, and Internal Revenue Code violations.

**The chairman pays a visit**

Ben Bernanke paid his first visit to the Atlanta Fed's headquarters as Federal Reserve chairman to speak at a monetary policy conference in June. In his keynote address, "The Credit Channel of Monetary Policy in the 21st Century," Bernanke discussed the ways in which monetary policy and lending dynamics affect the larger economy and the activities of businesses and consumers.

#### **Altig named research director**

David E. Altig, formerly associate director of research at the Cleveland Fed, was named senior vice president and director of research for the Atlanta Fed in July. Before joining the Cleveland Fed in 1991, Altig taught at Indiana University. In addition to his Fed work, he is an adjunct professor in the graduate school of business at the University of Chicago and in the Chinese Executive MBA program sponsored by the University of Minnesota and Lingnan College of Sun Yat-Sen University.

#### **Check processing consolidation**

As consumers increasingly use electronic payment methods and write fewer paper checks, the Federal Reserve Banks are scaling back their check processing operations and consolidating processing to four regional sites. In a June announcement, the Atlanta Fed was named one of the sites (with the Cleveland, Philadelphia, and Dallas Reserve Banks) that are expected to provide a full range of check processing services through at least mid-2011.

#### **Nashville checks shut down**

The Nashville Branch's check processing center closed in July, and its processing operations shifted to Atlanta. This move, originally planned for 2006, had been delayed when the New Orleans Branch's check processing operation moved to Atlanta following Hurricane Katrina in 2005. The Sixth Federal Reserve District maintains a strong presence in Nashville via a cash processing operation and local board of directors as well as other functions, including community development and economic and financial education.

#### **DVD on foreclosure prevention**

Amid rising foreclosures and low consumer awareness about the foreclosure process, the Federal Reserve Bank of Atlanta and several contributing partners developed *Foreclosure Prevention: Hope for Georgia's Homeowners*, a video that sheds light on Georgia's judicial process concerning foreclosures. The video was released in October.

## **SIXTH FEDERAL RESERVE DISTRICT DIRECTORS**

Federal Reserve Banks each have a board of nine directors. Directors provide economic information, have broad oversight responsibility for their bank's operations, and, with Board of Governors approval, appoint the bank's president and first vice president.

Six directors—three class A, representing the banking industry, and three class B—are elected by banks that are members of the Federal Reserve System. Three class C directors (including the chairman and deputy chairman) are appointed by the Board of Governors. Class B and C directors represent agriculture, commerce, industry, labor, and consumers in the district; they cannot be officers, directors, or employees of a bank; class C directors cannot be bank stockholders.

Fed branch office boards have five or seven directors; the majority are appointed by head-office directors and the rest by the Board of Governors.

## Atlanta Board of Directors

**V. LARKIN MARTIN**

CHAIRMAN  
Managing Partner  
Martin Farm  
Courtland, Alabama

**D. SCOTT DAVIS**

DEPUTY CHAIRMAN  
Chief Financial Officer and  
Vice Chairman  
United Parcel Service  
Atlanta, Georgia

**JAMES F. BEALL**

Chairman, President, and  
Chief Executive Officer  
Farmers & Merchants Bank  
Centre, Alabama

**TERI G. FONTENOT**

President and  
Chief Executive Officer  
Woman's Hospital  
Baton Rouge, Louisiana

**L. PHILLIP HUMANN**

Executive Chairman  
SunTrust Banks Inc.  
Atlanta, Georgia

**EGBERT L.J. PERRY**

Chairman and  
Chief Executive Officer  
The Integral Group LLC  
Atlanta, Georgia

**DAVID M. RATCLIFFE**

Chairman, President, and  
Chief Executive Officer  
Southern Company  
Atlanta, Georgia

**RUDY E. SCHUPP**

President and  
Chief Executive Officer  
1st United Bank  
Boca Raton, Florida

**LEE M. THOMAS**

Chairman, President, and  
Chief Executive Officer  
Rayonier  
Jacksonville, Florida

**Federal Advisory Council Member**

**FREDERICK L. GREEN III**

President and  
Chief Operating Officer  
Synovus Financial Corporation  
Columbus, Georgia





**Martin**



**Davis**



**Beall**



**Ratcliffe**



**Fontenot**



**Schupp**



**Humann**



**Thomas**



**Perry**

Not pictured: Green

## Birmingham Branch Directors

**MARYAM B. HEAD**

CHAIRMAN

President

Ram Tool and Supply Company Inc.

Birmingham, Alabama

**JOHN B. BARNETT III**

Monroeville President

BankTrust

Monroeville, Alabama

**BOBBY A. BRADLEY**

Managing Partner

Lewis Properties LLC and

Anderson Investments LLC

Huntsville, Alabama

**SAMUEL F. DODSON**

Consultant

International Union of

Operating Engineers Local 312

Birmingham, Alabama

**JOHN H. HOLCOMB III**

Chairman and

Chief Executive Officer

Alabama National Bancorporation

Birmingham, Alabama

**F. MICHAEL REILLY**

President and

Chief Executive Officer

Randall-Reilly Publishing Company

Tuscaloosa, Alabama

**JAMES H. SANFORD**

Chairman of the Board

HOME Place Farms Inc.

Prattville, Alabama



**Holcomb**



**Sanford**



**Head**



**Bradley**



**Dodson**

Not pictured: Barnett, Reilly

## Jacksonville Branch Directors

**H. BRITT LANDRUM JR.**

CHAIRMAN  
President and  
Chief Executive Officer  
Landrum Human Resource  
Companies Inc.  
Pensacola, Florida

**FASSIL GABREMARIAM**

President and Founder  
U.S.-Africa Free Enterprise  
Education Foundation  
Tampa, Florida

**WENDELL A. SEBASTIAN**

President and  
Chief Executive Officer  
GTE Federal Credit Union  
Tampa, Florida

**JACK B. HEALAN JR.**

President  
Amelia Island Plantation Company  
Amelia Island, Florida

**LINDA H. SHERRER**

President and  
Chief Executive Officer  
Prudential Network Realty  
Jacksonville, Florida

**ALAN ROWE**

President and  
Chief Executive Officer  
First Commercial Bank of Florida  
Orlando, Florida

**ELLEN S. TITEN**

President  
E.T. Consultants  
Winter Park, Florida



**Landrum**



**Sebastian**



**Gabremariam**



**Sherrer**



**Healan**



**Titen**



**Rowe**

## Miami Branch Directors

**GAY REBEL THOMPSON**

CHAIRMAN

President and  
Chief Executive Officer  
Cement Industries Inc.  
Fort Myers, Florida

**LEONARD L. ABESS**

Chairman, President, and  
Chief Executive Officer  
City National Bank of Florida  
Miami, Florida

**EDWIN A. JONES JR.**

President  
Angus Investments Inc.  
Port St. Lucie, Florida

**WALTER BANKS**

President  
Lago Mar Resort and Club  
Fort Lauderdale, Florida

**MARVIN O'QUINN**

President and  
Chief Executive Officer  
Jackson Health System  
Miami, Florida

**DENNIS S. HUDSON III**

Chairman and  
Chief Executive Officer  
Seacoast Banking Corporation  
of Florida  
Stuart, Florida

**THOMAS H. SHEA**

Regional Chief Executive  
Officer—Florida/Caribbean  
Right Management  
Fort Lauderdale, Florida





**Thompson**



**Banks**



**Jones**



**Hudson**



**O'Quinn**



**Shea**

Not pictured: Abess

## Nashville Branch Directors

**DEBRA K. LONDON**

CHAIRMAN  
President and  
Chief Executive Officer  
St. Mary's Health System  
Knoxville, Tennessee

**RICH FORD**

President and  
Chief Executive Officer  
The Sage Group  
Brentwood, Tennessee

**MICHAEL B. SWAIN**

Chairman  
First National Bank  
Oneida, Tennessee

**M. TERRY TURNER**

(RESIGNED)  
President and  
Chief Executive Officer  
Pinnacle Financial Partners  
Nashville, Tennessee

**DANIEL A. GAUDETTE**

Retired Senior Vice President  
North American Manufacturing  
and Supply Chain Management  
Nissan North America Inc.  
Smyrna, Tennessee

**DAVID WILLIAMS II**

Vice Chancellor and  
General Counsel  
Vanderbilt University  
Nashville, Tennessee

**CORDIA W. HARRINGTON**

President and  
Chief Executive Officer  
Tennessee Bun Company  
Nashville, Tennessee

**PAUL G. WILLSON**

Chairman and  
Chief Executive Officer  
Citizens National Bank  
Athens, Tennessee



**Ford**



**Gaudette**



**London**



**Harrington**



**Swain**



**Willson**

Not pictured: Turner, Williams

## New Orleans Branch Directors

**DAVE DENNIS**

CHAIRMAN  
President and  
Chief Executive Officer  
Specialty Contractors and  
Associates Inc.  
Gulfport, Mississippi

**ROBERT S. BOH**

President and  
Chief Executive Officer  
Boh Bros. Construction Company LLC  
New Orleans, Louisiana

**J. HERBERT BOYDSTUN**

(RESIGNED)  
President and  
Chief Executive Officer  
Capital One N.A.  
New Orleans, Louisiana

**DAVID E. JOHNSON**

Chairman and  
Chief Executive Officer  
The First Bancshares Inc.  
and The First, A National  
Banking Association  
Hattiesburg, Mississippi

**LAWRENCE E. KURZIUS**

(RESIGNED)  
President  
U.S. Consumer Foods  
McCormick and Company Inc.  
Baltimore, Maryland

**R. KING MILLING**

Vice Chairman  
Whitney Holding Corporation and  
Whitney National Bank  
New Orleans, Louisiana

**EARL L. SHIPP**

President—Dow India,  
Middle East, and Africa  
Global Vice President for  
Oxides and Glycols  
The Dow Chemical Company  
Dubai, United Arab Emirates

**CHRISTEL C. SLAUGHTER**

Partner  
SSA Consultants LLC  
Baton Rouge, Louisiana

**MATTHEW G. STULLER SR.**

Chairman and  
Chief Executive Officer  
Stuller Inc.  
Lafayette, Louisiana



**Milling**



**Dennis**



**Boh**



**Shipp**



**Johnson**



**Slaughter**



**Stuller**

Not pictured: Boydston, Kurzius

## **SMALL BUSINESS, AGRICULTURE, AND LABOR ADVISORY COUNCIL**

### **KEVIN BERKEN**

Owner  
KMB Farms  
KMB Properties LLC  
Lake Arthur, Louisiana

### **BOB CARVER**

President and Chief Executive Officer  
Florida Professional Firefighters  
Tallahassee, Florida

### **STEVE COLE**

President  
Robert Bowden Inc.  
Marietta, Georgia

### **JOYCE I. COOK**

Chief Executive Officer  
International CyberTrans  
Brentwood, Tennessee

### **SANDRA RHODES DUNCAN**

Owner  
Duplain W. Rhodes Funeral  
Home—Family of Businesses  
Gretna, Louisiana

### **KARL “BUBBA” GUIDRY**

Vice President/Secretary-Treasurer  
Advanced Agriculture Inc.  
Lafayette, Louisiana

### **SUSAN L. HARTLEY**

President  
Coffee Perks  
Jacksonville, Florida

### **JIMMY HAYNES**

President  
J.H. Haynes Electric Company Inc.  
Gulfport, Mississippi

### **LESTER H. KILLEBREW SR.**

Chairman of SunSouth  
Chief Executive Officer of  
ValCom Business Centers  
Abbeville, Alabama

### **JACQUES KLEMPF**

Chairman/President  
Foodonics International Inc.  
Jacksonville, Florida

### **CYNTHIA JONES PARKS**

President and Chief Executive Officer  
Jones Worley Communications  
Atlanta, Georgia

### **RONALD L. TANNER**

Manager, Business Development  
Ohio Valley and Southern States  
Laborers-Employers Cooperation  
and Education Trust  
Chattanooga, Tennessee

### **GUY TIPTON**

President  
Alabama District Council Ohio Valley  
and Southern States Region  
Hoover, Alabama

### **EVETTE WHITE**

Chief Executive Officer  
White/Thompson/Cunningham/Regen  
Nashville, Tennessee

### **GARY WISHNATZKI**

President and Chief Executive Officer  
Wishnatzki Inc. d/b/a  
Wishnatzki Farms  
Plant City, Florida



**Berken**



**Parks**



**Carver**



**Tanner**



**Cole**



**Hartley**



**Tipton**



**Cook**



**Haynes**



**White**



**Duncan**



**Killebrew**



**Wishnatzki**

Not pictured: Guidry, Klempf



## SIXTH FEDERAL RESERVE DISTRICT OFFICERS Management Committee

**DENNIS P. LOCKHART**  
President and  
Chief Executive Officer

**PATRICK K. BARRON**  
First Vice President and  
Chief Operating Officer

**DAVID E. ALTIG**  
Senior Vice President and  
Director of Research  
Research Division

**CHRISTOPHER G. BROWN**  
Senior Vice President and  
Chief Financial Officer  
Corporate Services Division

**ANNE M. DeBEER**  
Senior Vice President  
Corporate Services/  
Financial Services Division

**ROBERT A. EISENBEIS**  
(RETIRED)  
Executive Vice President and  
Director of Research  
Research Division

**WILLIAM B. ESTES III**  
Senior Vice President  
Supervision and  
Regulation Division

**MARIE C. GOODING**  
Senior Vice President and  
Director of Human Resources  
Human Resources Department

**FREDERICK R. HERR**  
Senior Vice President  
System Retail Payments Office

**RICHARD R. OLIVER**  
Executive Vice President  
System Retail Payments Office

**LOIS C. BERTHAUME**  
ADVISER  
Senior Vice President and  
General Auditor  
Auditing Department

**RICHARD A. JONES**  
ADVISER  
Senior Vice President and  
General Counsel  
Legal Department



**Altig**



**Gooding**



**Lockhart**



**Brown**



**Herr**



**Barron**



**DeBeer**



**Oliver**



**Estes**



**Berthaume**



**Jones**

Not pictured: Eisenbeis

## Other Corporate Officers

### SENIOR VICE PRESIDENTS

#### HENRY BOURGAUX

(RETIRED)

System Retail Payments Office

#### SCOTT H. DAKE

System Retail Payments Office

#### JAMES M. McKEE

System Retail Payments Office

#### DONALD E. NELSON

System Retail Payments Office

#### WILLIAM J. TIGNANELLI

System Retail Payments Office

### VICE PRESIDENTS

#### ANDRE T. ANDERSON

Supervision and Regulation Division

#### JOHN S. BRANIGIN

System Retail Payments Office

#### SUZANNA J. COSTELLO

Supervision and Regulation Division

#### THOMAS J. CUNNINGHAM

Associate Director of Research  
Research Division

#### LEAH DAVENPORT

Check Function Office/  
Atlanta Financial Services

#### GERALD P. DWYER JR.

Research Department

#### BRIAN D. EGAN

System Retail Payments Office

#### J. STEPHEN FOLEY

Supervision and Regulation Division

#### CYNTHIA C. GOODWIN

Supervision and Regulation Division

#### MARY M. KEPLER

Financial Management  
and Planning

#### ROBERT A. LOVE

System Retail Payments Office

#### MARY M. MANDEL

Executive Support Office

#### BOBBIE H. McCRACKIN

Public Affairs Officer  
Public Affairs Department

#### JOHN C. ROBERTSON

Research Department

#### MELINDA J. RUSHING

System Retail Payments Office

#### ROBERT M. SCHENCK

Supervision and Regulation Division

#### ELLIS W. TALLMAN

Research Department

#### DAVID E. TATUM

Supervision and Regulation Division

#### ADRIENNE M. WELLS

System Retail Payments Office

#### RONALD N. ZIMMERMAN

(RETIRED)

Supervision and Regulation Division

### ASSISTANT VICE PRESIDENTS

#### CHRISTOPHER N. ALEXANDER

ACH Operations

#### JOHN H. ATKINSON

Supervision and Regulation Division

#### ROBERT LEE BAGOSY

Law Enforcement

#### WILLIAM B. BOWLING

Supervision and Regulation Division

#### JOAN H. BUCHANAN

Supervision and Regulation Division

#### ANNELLA D. CAMPBELL-DRAKE

System Retail Payments Office

#### DAVID J. CHRISTERSON

System Retail Payments Office

#### CHAPELLE D. DAVIS

Supervision and Regulation Division

#### W. JEFFREY DEVINE

Check Function Office/  
Business Development

#### ANGELA H. DIRR

Legal Department

#### GREGORY S. FULLER

Financial Statistics and  
Structure Analysis

#### JENNIFER GIBILTERRA

(RESIGNED)

Check Function Office  
Atlanta Office

#### PAUL GRAHAM

Check Function Office  
Jacksonville Office

#### ROBERT D. HAWKINS

Supervision and Regulation Division

#### CAROLYN ANN HEALY

Supervision and Regulation Division

#### JANET A. HERRING

Financial Management  
and Planning

**SUSAN HOY**

Legal Department

**BRADLEY M. JOINER**

Information Security/Systems

**EVETTE H. JONES**

Business Development/Atlanta Cash

**JACQUELYN H. LEE**

Automation Operations

**STEPHEN A. LEVY**

Financial Management  
and Planning

**MARGARET DARLENE MARTIN**

System Retail Payments Office

**MARIE E. McNALLY**

Facilities Management

**ELIZABETH McQUERRY**

System Retail Payments Office

**D. PIERCE NELSON**

Public Information Officer  
Public Affairs Department

**ALVIN L. PILKINTON JR.**

(RETIRED)  
Auditing Department

**DORIS QUIROS**

Assistant General Auditor  
Auditing Department

**SUSAN L. ROBERTSON**

System Retail Payments Office

**JUAN C. SANCHEZ**

Supervision and Regulation Division

**DAVID W. SMITH**

Supervision and Regulation Division

**MARIA SMITH**

Supervision and Regulation Division

**TIMOTHY R. SMITH**

Community Relations Officer  
Public Affairs Department

**ARUNA SRINIVASAN**

(RESIGNED)  
Credit and Risk Management/  
Enterprise Risk Management

**CLIFFORD S. STANFORD**

Human Resources Department

**ALLEN D. STANLEY**

Supervision and Regulation Division

**JOEL E. WARREN**

Check Function Office  
Jacksonville Office

**CHARLES L. WEEMS**

Check Function Office  
Atlanta Office

**JULIUS G. WEYMAN**

System Retail Payments Office

**KENNETH WILCOX**

Check Function Office  
Atlanta Office

**STEPHEN W. WISE**

Supervision and Regulation Division

## Branch Officers

### BIRMINGHAM

**LEE C. JONES**

Vice President and  
Branch Manager/  
Atlanta Law Enforcement

### JACKSONVILLE

**CHRISTOPHER L. OAKLEY**

Vice President and  
Branch Manager

**CHRISTINA M. WILSON**

Assistant Vice President

### MIAMI

**JUAN DEL BUSTO**

Vice President and  
Branch Manager

**ROBERT A. DE ZAYAS**

Assistant Vice President

### NASHVILLE

**MELVYN K. PURCELL**

Senior Vice President and  
Branch Manager

**ANNITA T. MOORE**

Assistant Vice President and  
Assistant Branch Manager

### NEW ORLEANS

**ROBERT J. MUSSO**

Senior Vice President and  
Branch Manager

**AMY S. GOODMAN**

Vice President and  
Assistant Branch Manager

## **FINANCIAL REPORTS**

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2007 was Deloitte & Touche LLP (D&T). Fees for these services totaled \$4.7 million. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2007, the Bank did not engage D&T for any material advisory services.

## MANAGEMENT'S ASSERTION

To the Board of Directors of the Federal Reserve Bank of Atlanta:

The management of the Federal Reserve Bank of Atlanta ("FRB Atlanta") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31, 2007 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the *Financial Accounting Manual for the Federal Reserve Banks* ("Manual") and, as such, include amounts, some of which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies, and practices documented in the Manual and include all disclosures necessary for such fair presentation.

The management of the FRB Atlanta is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of the Financial Statements in accordance with the Manual. Internal control contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

Even effective internal control, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The management of the FRB Atlanta assessed its internal control over financial reporting reflected in the Financial Statements, based upon the criteria established in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the FRB Atlanta maintained effective internal control over financial reporting as it relates to the Financial Statements.

Federal Reserve Bank of Atlanta



Dennis P. Lockhart  
President and Chief Executive Officer



Patrick K. Barron  
First Vice President and Chief Operating Officer



Christopher G. Brown  
Senior Vice President and Chief Financial Officer

March 20, 2008

## REPORT OF INDEPENDENT AUDITORS

To the Board of Governors of the Federal Reserve System  
and the Board of Directors of the Federal Reserve Bank of Atlanta:

We have audited the accompanying statement of condition of the Federal Reserve Bank of Atlanta (“FRB Atlanta”) as of December 31, 2007, and the related statements of income and comprehensive income and changes in capital for the year then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB Atlanta as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB Atlanta’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Assertion. Our responsibility is to express an opinion on these financial statements and an opinion on FRB Atlanta’s internal control over financial reporting based on our audit. The financial statements of FRB Atlanta for the year ended December 31, 2006, were audited by other auditors whose report, dated March 12, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

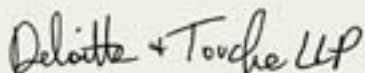
FRB Atlanta’s internal control over financial reporting is a process designed by, or under the supervision of, FRB Atlanta’s principal executive and principal financial officers, or persons performing similar functions, and effected by FRB Atlanta’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. FRB Atlanta’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of FRB Atlanta; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System and that receipts and expenditures of FRB Atlanta are being made only in accordance with authorizations of management and directors of FRB Atlanta; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FRB Atlanta’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.



As described in Note 3 to the financial statements, FRB Atlanta has prepared these financial statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such financial statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 3.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FRB Atlanta as of December 31, 2007, and the results of its operations for the year then ended, on the basis of accounting described in Note 3. Also, in our opinion, FRB Atlanta maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

Deloitte & Touche LLP

March 20, 2008  
Atlanta, Georgia

## REPORT OF INDEPENDENT AUDITORS

To the Board of Governors of the Federal Reserve System  
and the Board of Directors of the Federal Reserve Bank of Atlanta:

We have audited the accompanying statement of condition of the Federal Reserve Bank of Atlanta (the "Bank") as of December 31, 2006, and the related statements of income and changes in capital for the year then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 3, these financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2006, and the results of its operations for the year then ended, on the basis of accounting described in Note 3.



PricewaterhouseCoopers LLP

March 12, 2007

## STATEMENTS OF CONDITION

(in millions)	December 31, 2007	December 31, 2006
<b>Assets</b>		
Gold certificates	\$ 1,117	\$ 1,023
Special drawing rights certificates	166	166
Coin	153	93
Items in process of collection	229	324
Loans to depository institutions	25	3
Securities purchased under agreements to resell	4,313	—
U.S. government securities, net	69,155	65,602
Investments denominated in foreign currencies	3,939	1,382
Accrued interest receivable	590	563
Interdistrict settlement account	3,909	12,403
Bank premises and equipment, net	269	278
Other assets	76	82
<b>Total assets</b>	<b>\$ 83,941</b>	<b>\$ 81,919</b>
<b>Liabilities and Capital</b>		
<b>Liabilities</b>		
Federal Reserve notes outstanding, net	\$ 75,609	\$ 74,237
Securities sold under agreements to repurchase	4,080	2,479
Deposits		
Depository institutions	975	1,980
Other deposits	3	3
Deferred credit items	143	474
Interest on Federal Reserve notes due to U.S. Treasury	140	53
Accrued benefit costs	123	121
Other liabilities	18	20
<b>Total liabilities</b>	<b>81,091</b>	<b>79,367</b>
<b>Capital</b>		
Capital paid-in	1,425	1,276
Surplus (including accumulated other comprehensive loss of \$21 million and \$27 million at December 31, 2007 and 2006, respectively)	1,425	1,276
<b>Total capital</b>	<b>2,850</b>	<b>2,552</b>
<b>Total liabilities and capital</b>	<b>\$ 83,941</b>	<b>\$ 81,919</b>

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

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

(in millions)	For the year ended December 31, 2007	For the year ended December 31, 2006
<b>Interest income</b>		
Interest on U.S. government securities	\$ 3,489	\$ 2,888
Interest on securities purchased under agreements to resell	130	—
Interest on investments denominated in foreign currencies	47	24
<b>Total interest income</b>	<b>3,666</b>	<b>2,912</b>
<b>Interest expense</b>		
Interest expense on securities sold under agreements to repurchase	152	110
<b>Net interest income</b>	<b>3,514</b>	<b>2,802</b>
<b>Other operating income</b>		
Income from services	754	788
Reimbursable services to government agencies	12	15
Foreign currency gains, net	162	79
Other income	10	7
<b>Total other operating income</b>	<b>938</b>	<b>889</b>
<b>Operating expenses</b>		
Salaries and other benefits	182	172
Occupancy expense	21	21
Equipment expense	20	21
Compensation paid for services costs incurred	597	543
Assessments by the Board of Governors	104	86
Other expenses	115	121
<b>Total operating expenses</b>	<b>1,039</b>	<b>964</b>
<b>Net income prior to distribution</b>	<b>3,413</b>	<b>2,727</b>
<b>Change in funded status of benefit plans</b>	<b>6</b>	<b>—</b>
<b>Comprehensive income prior to distribution</b>	<b>\$ 3,419</b>	<b>\$ 2,727</b>
<b>Distribution of comprehensive income</b>		
Dividends paid to member banks	\$ 78	\$ 64
Transferred to surplus and change in accumulated other comprehensive loss	149	411
Payments to U.S. Treasury as interest on Federal Reserve notes	3,192	2,252
<b>Total distribution</b>	<b>\$ 3,419</b>	<b>\$ 2,727</b>

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

## STATEMENTS OF CHANGES IN CAPITAL

(in millions)	For the years ended December 31, 2007, and December 31, 2006				
	Capital Paid-In	Surplus		Total Surplus	Total Capital
Net Income Retained		Accumulated Other Comprehensive Loss			
<b>Balance at January 1, 2006</b> (17.8 million shares)	\$ 892	\$ 892	\$ —	\$ 892	\$ 1,784
Net change in capital stock issued (7.7 million shares)	384	—	—	—	384
Transferred to surplus	—	411	—	411	411
Adjustment to initially apply SFAS No. 158	—	—	(27)	(27)	(27)
<b>Balance at December 31, 2006</b> (25.5 million shares)	\$ 1,276	\$ 1,303	\$ (27)	\$ 1,276	\$ 2,552
Net change in capital stock issued (3 million shares)	149	—	—	—	149
Transferred to surplus and change in accumulated other comprehensive loss	—	143	6	149	149
<b>Balance at December 31, 2007</b> (28.5 million shares)	\$ 1,425	\$ 1,446	\$ (21)	\$ 1,425	\$ 2,850

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

## NOTES TO FINANCIAL STATEMENTS

### 1. STRUCTURE

The Federal Reserve Bank of Atlanta (“Bank”) is part of the Federal Reserve System (“System”) and one of the twelve Reserve Banks (“Reserve Banks”) created by Congress under the Federal Reserve Act of 1913 (“Federal Reserve Act”), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank and its branches in Birmingham, Alabama; Jacksonville, Florida; Nashville, Tennessee; New Orleans, Louisiana; and Miami, Florida, serve the Sixth Federal Reserve District, which includes Georgia, Florida, Alabama, and portions of Louisiana, Tennessee, and Mississippi.

In accordance with the Federal Reserve Act, supervision and control of the Bank is exercised by a board of directors. The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as chairman and deputy chairman, are appointed by the Board of Governors of the Federal Reserve System (“Board of Governors”) to represent the public, and six directors are elected by member banks. Banks that are members of the System include all national banks and any state-chartered banks that apply and are approved for membership in the System. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

The System also consists, in part, of the Board of Governors and the Federal Open Market Committee (“FOMC”). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (“FRBNY”), and on a rotating basis four other Reserve Bank presidents.

### 2. OPERATIONS AND SERVICES

The Reserve Banks perform a variety of services and operations. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse (“ACH”) operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government’s bank; provision of short-term loans to depository institutions; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY for its execution of transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of U.S. government securities, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY executes these open market transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account (“SOMA”).

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System’s central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange (“FX”) and securities contracts for, nine foreign currencies and to invest such foreign currency holdings ensuring adequate liquidity is maintained. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements (“FX swaps”) with four central banks and “warehouse” foreign currencies for the U.S. Treasury and Exchange Stabilization Fund (“ESF”) through the Reserve Banks. In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that results from their future settlement and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

Although the Reserve Banks are separate legal entities, in the interests of greater efficiency and effectiveness they collaborate in the delivery of certain operations and services. The collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Bank providing the service and the other eleven Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are billed for services provided to them by another Reserve Bank.

Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include Retail Payments Office, Retail Check-Related Projects, Accounting-Related Projects, Audit Services, and Special Check-Related Projects.

### 3. SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank, which differ significantly from those of the private sector. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* ("Financial Accounting Manual"), which is issued by the Board of Governors. All of the Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual and the financial statements have been prepared in accordance with the Financial Accounting Manual.

Differences exist between the accounting principles and practices in the Financial Accounting Manual and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all securities holdings at amortized cost, rather than using the fair value presentation required by GAAP. U.S. government securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Bank has elected not to present a Statement of Cash Flows because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities. A Statement of Cash Flows, therefore, would not provide additional meaningful information. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

#### a. Gold and Special Drawing Rights Certificates

The Secretary of the U.S. Treasury is authorized to issue gold and special drawing rights ("SDR") certificates to the Reserve Banks.

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time, and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at \$42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2007 or 2006.

#### b. Loans to Depository Institutions

Depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Bank. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. The Bank offers three discount window programs to depository institutions: primary credit, secondary credit, and



seasonal credit, each with its own interest rate. Interest is accrued using the applicable discount rate established at least every fourteen days by the board of directors of the Reserve Bank, subject to review and determination by the Board of Governors.

In addition, depository institutions that are eligible to borrow under the Reserve Bank's primary credit program are also eligible to participate in the temporary Term Auction Facility ("TAF") program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. All advances under the TAF must be fully collateralized.

Outstanding loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established.

**c. U.S. Government Securities and Investments Denominated in Foreign Currencies**

Interest income on U.S. government securities and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains (losses), net" in the Statements of Income and Comprehensive Income.

Activity related to U.S. government securities, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

**d. Securities Purchased under Agreements to Resell, Securities Sold under Agreements to Repurchase, and Securities Lending**

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities, pass-through mortgage securities of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association, STRIP securities of the U.S. Government, and "stripped" securities of other government agencies. The tri-party agreements are accounted for as financing transactions, with the associated interest income accrued over the life of the agreement.

Securities sold under agreements to repurchase are accounted for as financing transactions and the associated interest expense is recognized over the life of the transaction. These transactions are reported in the Statements of Condition at their contractual amounts and the related accrued interest payable is reported as a component of "Other liabilities."

U.S. government securities held in the SOMA are lent to U.S. government securities dealers in order to facilitate the effective functioning of the domestic securities market. Securities-lending transactions are fully collateralized by other U.S. government securities and the collateral taken is in excess of the market value of the securities loaned. The FRBNY charges the dealer a fee for borrowing securities, and the fees are reported as a component of "Other income."

Activity related to securities sold under agreements to repurchase and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account. On February 15, 2007, the FRBNY began allocating to the other Reserve Banks the activity related to securities purchased under agreements to resell.

**e. FX Swap Arrangements and Warehousing Agreements**

FX swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to support its international operations and give the authorized foreign central bank temporary access to dollars. Drawings under the FX swap arrangements can be initiated by either party and must be agreed to by the other party. The FX swap arrangements are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. Foreign currencies received pursuant to these agreements are reported as a component of "Investments denominated in foreign currencies" in the Statements of Condition.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the U.S. Treasury, U.S. dollars for foreign currencies held by the U.S. Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the U.S. Treasury and ESF for financing purchases of foreign currencies and related international operations.

FX swap arrangements and warehousing agreements are revalued daily at current market exchange rates. Activity related to these agreements, with the exception of the unrealized gains and losses resulting from the daily revaluation, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Unrealized gains and losses resulting from the daily revaluation are recorded by FRBNY and not allocated to the other Reserve Banks.

**f. Bank Premises, Equipment, and Software**

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

Costs incurred for software during the application development stage, either developed internally or acquired for internal use, are capitalized based on the cost of direct services and materials associated with designing, coding, installing, or testing software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from two to five years. Maintenance costs related to software are charged to expense in the year incurred.

Capitalized assets including software, buildings, leasehold improvements, furniture, and equipment are impaired when events or changes in circumstances indicate that the carrying amount of assets or asset groups is not recoverable and significantly exceeds their fair value.

**g. Interdistrict Settlement Account**

At the close of business each day, each Reserve Bank assembles the payments due to or from other Reserve Banks. These payments result from transactions between Reserve Banks and transactions that involve depository institution accounts held by other Reserve Banks, such as Fedwire funds and securities transfers, and check and ACH transactions. The cumulative net amount due to or from the other Reserve Banks is reflected in the "Interdistrict settlement account" in the Statements of Condition.

**h. Federal Reserve Notes**

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the chairman of the board of directors of each Reserve Bank and their designees) to the Reserve Banks upon deposit with such agents of specified classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be at least equal to the sum of the notes applied for by such Reserve Bank.

Assets eligible to be pledged as collateral security include all of the Bank's assets. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, for which the collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. At December 31, 2007, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of \$36,017 million and \$23,938 million at December 31, 2007 and 2006, respectively.

**i. Items in Process of Collection and Deferred Credit Items**

Items in process of collection in the Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet date, have not yet been presented to the paying bank. Deferred credit items are the counterpart liability to items in process of collection, and the amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

**j. Capital Paid-in**

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of \$100 and may not be transferred or hypothecated. As a member bank's capital and surplus change, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

By law, each Reserve Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To reflect the Federal Reserve Act requirement that annual dividends are deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Statements of Income and Comprehensive Income.

**k. Surplus**

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to defined benefit pension plans and other postretirement benefit plans that, under accounting standards, are included in other comprehensive income but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 9 and 10.

The Bank initially applied the provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Statements of Condition and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006, is recorded as "Adjustment to initially apply SFAS No. 158" in the Statements of Changes in Capital.

**l. Interest on Federal Reserve Notes**

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. Treasury as interest on Federal Reserve notes, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

In the event of losses or an increase in capital paid-in at a Reserve Bank, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in.

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the U.S. Treasury in the following year.

**m. Income and Costs Related to U.S. Treasury Services**

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. During the years ended December 31, 2006 and 2007, the Bank was reimbursed for all services provided to the Department of Treasury.

**n. Compensation Received for Services Provided and Compensation Paid for Services Costs Incurred**

The Bank has overall responsibility for managing the Reserve Banks' provision of check and ACH services to depository institutions and, as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. Similarly, the FRBNY manages the Reserve Banks' provision of Fedwire funds and securities transfer services and recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. The Bank and FRBNY compensate the other Reserve Banks for the costs incurred to provide these services. Compensation paid by the Bank for check and ACH services is reported as "Compensation paid for services costs incurred" in the Statements of Income and Comprehensive Income.

**o. Assessments by the Board of Governors**

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to prepare and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

**p. Taxes**

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were \$3 million for each of the years ended December 31, 2007 and 2006, and are reported as a component of "Occupancy expense."

**q. Restructuring Charges**

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 11 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Bank's assets are discussed in Note 6. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY.

**r. Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. SFAS No. 157 is generally effective for the Bank on January 1, 2008, though the effective date of some provisions is January 1, 2009. The provisions of SFAS No. 157 will be applied prospectively and are not expected to have a material effect on the Bank's financial statements.

**4. U.S. GOVERNMENT SECURITIES, SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL, SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE, AND SECURITIES LENDING**

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 9.275 percent and 8.372 percent at December 31, 2007 and 2006, respectively.

The Bank's allocated share of U.S. Government securities, net, held in the SOMA at December 31, was as follows (in millions):

	2007		2006
Par value			
U.S. government:			
Bills	\$ 21,132	\$	23,191
Notes	37,264		33,685
Bonds	10,294		8,332
Total par value	68,690		65,208
Unamortized premiums	740		729
Unaccreted discounts	(275)		(335)
Total allocated to the Bank	\$ 69,155	\$	65,602

At December 31, 2007 and 2006, the fair value of the U.S. government securities allocated to the Bank, excluding accrued interest, was \$72,078 million and \$66,630 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government securities, net, held in the SOMA was \$745,629 million and \$783,619 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the U.S. government securities held in the SOMA, excluding accrued interest, was \$777,141 million and \$795,900 million, respectively, as determined by reference to quoted prices for identical securities.

Although the fair value of security holdings can be substantially greater or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as central bank, to meet their financial obligations and responsibilities, and should not be misunderstood as representing a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

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Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the year ended December 31, 2007, was as follows (in millions):

	Securities Purchased under Agreements to Resell	Securities Sold under Agreements to Repurchase
Allocated to the Bank		
Contract amount outstanding, end of year	\$ 4,313	\$ 4,080
Weighted average amount outstanding, during the year	3,253	3,232
Maximum month-end balance outstanding, during the year	4,777	4,080
Securities pledged, end of year	—	4,085
System total		
Contract amount outstanding, end of year	\$ 46,500	\$ 43,985
Weighted average amount outstanding, during the year	35,073	34,846
Maximum month-end balance outstanding, during the year	51,500	43,985
Securities pledged, end of year	—	44,048

At December 31, 2006, the total contract amount of securities sold under agreements to repurchase was \$29,615 million, of which \$2,479 million was allocated to the Bank. The total par value of SOMA securities that were pledged for securities sold under agreements to repurchase at December 31, 2006, was \$29,676 million, of which \$2,484 million was allocated to the Bank.

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

The maturity distribution of U.S. government securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2007, was as follows (in millions):

	U.S. Government Securities (Par Value)	Securities Purchased under Agreements to Resell (Contract Amount)	Securities Sold under Agreements to Repurchase (Contract Amount)
Within 15 days	\$ 2,531	\$ 4,313	\$ 4,080
16 days to 90 days	13,887		
91 days to 1 year	14,123		
Over 1 year to 5 years	22,312		
Over 5 years to 10 years	7,600		
Over 10 years	8,237		
Total allocated to the Bank	\$ 68,690	\$ 4,313	\$ 4,080

At December 31, 2007 and 2006, U.S. government securities with par values of \$16,649 million and \$6,855 million, respectively, were loaned from the SOMA, of which \$1,544 million and \$574 million, respectively, were allocated to the Bank.

##### 5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities purchased under agreements to resell. These investments are guaranteed as to principal and interest by the issuing foreign governments.

The Bank's allocated share of investments denominated in foreign currencies was approximately 8.328 percent and 6.746 percent at December 31, 2007 and 2006, respectively.

The Bank's allocated share of investments denominated in foreign currencies, including accrued interest, valued at foreign currency market exchange rates at December 31, was as follows (in millions):

	2007	2006
Euro		
Foreign currency deposits	\$ 2,289	\$ 421
Securities purchased under agreements to resell	212	149
Government debt instruments	389	275
Japanese Yen		
Foreign currency deposits	234	176
Government debt instruments	476	361
Swiss Franc		
Foreign currency deposits	339	—
 Total allocated to the Bank	 \$ 3,939	 \$ 1,382

At December 31, 2007, the total amount of foreign currency deposits held under FX contracts was \$24,381 million, of which \$2,031 million was allocated to the Bank. At December 31, 2006, there were no open foreign exchange contracts.

At December 31, 2007 and 2006, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was \$3,937 million and \$1,378 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government securities discussed in Note 4, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were \$47,295 million and \$20,482 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was \$47,274 million and \$20,434 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2007, was as follows (in millions):

	European Euro	Japanese Yen	Swiss Franc	Total
Within 15 days	\$ 416	\$ 249	\$ —	\$ 665
16 days to 90 days	1,924	34	339	2,297
91 days to 1 year	230	167	—	397
Over 1 year to 5 years	320	260	—	580
 Total allocated to the Bank	 \$ 2,890	 \$ 710	 \$ 339	 \$ 3,939

At December 31, 2007 and 2006, the authorized warehousing facility was \$5,000 million, with no balance outstanding.

**6. BANK PREMISES, EQUIPMENT, AND SOFTWARE**

Bank premises and equipment at December 31 was as follows (in millions):

	2007	2006
Bank premises and equipment		
Land	\$ 39	\$ 39
Buildings	221	216
Building machinery and equipment	36	35
Construction in progress	2	3
Furniture and equipment	102	109
Subtotal	400	402
Accumulated depreciation	(131)	(124)
Bank premises and equipment, net	<u>\$ 269</u>	<u>\$ 278</u>
Depreciation expense, for the year ended December 31	<u>\$ 17</u>	<u>\$ 18</u>

The Bank leases space to outside tenants with remaining lease terms ranging from 1 to 8 years. Rental income from such leases was \$2 million and \$1 million for the years ended December 31, 2007 and 2006, respectively, and is reported as a component of "Other income." Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2007, are as follows (in millions):

2008	\$ 2.4
2009	1.3
2010	1.0
2011	0.6
2012	0.3
Thereafter	0.3
Total	<u>\$ 5.9</u>

The Bank has capitalized software assets, net of amortization, of \$468 thousand and \$1 million at December 31, 2007 and 2006, respectively. Amortization expense was \$1 million for each of the years ended December 31, 2007 and 2006. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 11, include check equipment, cash equipment, and software. Asset impairment losses of \$1 million for each of the periods ending December 31, 2007 and 2006, were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses."

**7. COMMITMENTS AND CONTINGENCIES**

At December 31, 2007, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 2 to approximately 3 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$1 million for each of the years ended December 31, 2007 and 2006.



Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2007, are as follows (in thousands):

	<u>Operating</u>
2008	\$ 401
2009	262
2010	<u>60</u>
Future minimum rental payments	<u>\$ 723</u>

At December 31, 2007, there were no material unrecorded unconditional purchase commitments or long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2007 or 2006.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

## **8. RETIREMENT AND THRIFT PLANS**

### **Retirement Plans**

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP"), and certain Reserve Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2007 and 2006, and for the years then ended, were not material.

### **Thrift Plan**

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled \$6 million for each of the years ended December 31, 2007 and 2006, and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2007 and 2006, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

## **9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS**

### **Postretirement Benefits Other Than Pensions**

In addition to the Bank's retirement plans, employees who have met certain age and length-of-service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets.

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Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2007	2006
Accumulated postretirement benefit obligation at January 1	\$ 105.2	\$ 83.5
Service cost-benefits earned during the period	4.5	2.7
Interest cost on accumulated benefit obligation	6.6	4.5
Net actuarial (gain) loss	(3.1)	12.0
Contributions by plan participants	1.1	1.3
Benefits paid	(5.3)	(4.6)
Medicare Part D subsidies	0.3	0.3
Plan amendments	—	5.5
Accumulated postretirement benefit obligation at December 31	<u>\$ 109.3</u>	<u>\$ 105.2</u>

At December 31, 2007 and 2006, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.25 percent and 5.75 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due.

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit costs (in millions):

	2007	2006
Fair value of plan assets at January 1	\$ —	\$ —
Contributions by the employer	3.9	3.0
Contributions by plan participants	1.1	1.3
Benefits paid, net of Medicare Part D subsidies	(5.0)	(4.3)
Fair value of plan assets at December 31	<u>\$ —</u>	<u>\$ —</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 109.3</u>	<u>\$ 105.2</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 4.0	\$ 5.2
Net actuarial loss	(24.8)	(31.7)
Total accumulated other comprehensive loss	<u>\$ (20.8)</u>	<u>\$ (26.5)</u>

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Statements of Condition.

For measurement purposes, the assumed health care cost trend rates at December 31 are as follows:

	2007	2006
Health care cost trend rate assumed for next year	8.00%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2013	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2007 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 1.9	\$ (1.5)
Effect on accumulated postretirement benefit obligation	14.5	(12.0)

The following is a summary of the components of net periodic postretirement benefit expense for the years ended December 31 (in millions):

	2007	2006
Service cost-benefits earned during the period	\$ 4.5	\$ 2.7
Interest cost on accumulated benefit obligation	6.6	4.5
Amortization of prior service cost	(1.2)	(2.2)
Amortization of net actuarial loss	3.8	1.0
Net periodic postretirement benefit expense	\$ 13.7	\$ 6.0
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2008 are shown below:		
Prior service cost	\$ (1.2)	
Net actuarial loss	2.0	
Total	\$ 0.8	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2007 and 2006, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 5.50 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided under the Bank's plan to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

There were no receipts of federal Medicare Part D subsidies in the year ended December 31, 2006. Receipts in the year ending December 31, 2007, related to benefits paid in the years ended December 31, 2006 and 2007, were \$0.3 million and \$0.2 million, respectively. Expected receipts in 2008, related to benefits paid in the year ended December 31, 2007, are \$0.1 million.

Following is a summary of expected postretirement benefit payments (in millions):

	Without Subsidy	With Subsidy
2008	\$ 5.5	\$ 5.1
2009	6.1	5.7
2010	6.9	6.4
2011	7.5	7.0
2012	8.0	7.4
2013–2017	47.9	43.3
Total	<u>\$ 81.9</u>	<u>\$ 74.9</u>

#### Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2007 and 2006, were \$11 million and \$13 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit (credit) expense included in 2007 and 2006 operating expenses were (\$577 thousand) and \$3 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

#### 10. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive loss (in millions):

	Amount Related to Postretirement Benefits Other Than Pensions
Balance at January 1, 2006	\$ —
Adjustment to initially apply SFAS No. 158	<u>(27)</u>
Balance at December 31, 2006	\$ (27)
Change in funded status of benefit plans:	
Net actuarial gain arising during the year	\$ 3
Amortization of prior service cost	(1)
Amortization of net actuarial loss	<u>4</u>
Change in funded status of benefit plans— other comprehensive income	<u>6</u>
Balance at December 31, 2007	<u>\$ (21)</u>

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 9.

## 11. BUSINESS RESTRUCTURING CHARGES

### 2007 Restructuring Plans

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure will involve consolidation of operations into four regional Reserve Bank processing sites in Philadelphia, Cleveland, Atlanta, and Dallas.

### 2005 and Prior Restructuring Costs

The Bank incurred various restructuring charges prior to 2006 related to the restructuring of checks and cash operations.

Following is a summary of financial information related to the restructuring plans (in millions):

	2005 and Prior Restructuring Plans	2007 Restructuring Plans	Total
Information related to restructuring plans as of December 31, 2007:			
Total expected costs related to restructuring activity	\$ 5.0	\$ 2.6	\$ 7.6
Expected completion date	2008	2010	
Reconciliation of liability balances:			
Balance at January 1, 2006	\$ 5.0	\$ —	\$ 5.0
Employee separation costs Payments	2.0 (2.0)	— —	2.0 (2.0)
Balance at December 31, 2006	\$ 5.0	\$ —	\$ 5.0
Employee separation costs Adjustments Payments	— (2.6) (2.3)	2.6 — —	2.6 (2.6) (2.3)
Balance at December 31, 2007	<u>\$ 0.1</u>	<u>\$ 2.6</u>	<u>\$ 2.7</u>

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

Restructuring costs associated with the impairment of certain Bank assets, including software and equipment, are discussed in Note 6. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8.

## 12. SUBSEQUENT EVENTS

In March 2008, the Board of Governors announced several initiatives to address liquidity pressures in funding markets and promote financial stability, including increasing the Term Auction Facility (see Note 3b) to \$100 billion and initiating a series of term repurchase transactions (see Notes 3d and 4) that may cumulate to \$100 billion. In addition, the Reserve Banks' securities lending program (see Notes 3d and 4) was expanded to lend up to \$200 billion of Treasury securities to primary dealers for a term of 28 days, secured by federal agency debt, federal agency residential mortgage-backed securities, agency collateralized mortgage obligations, non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and AAA/Aaa-rated commercial mortgage-backed securities. The FOMC also authorized increases in its existing temporary reciprocal currency arrangements (see Notes 3e and 5) with specific foreign central banks. These initiatives will affect 2008 activity related to loans to depository institutions, securities purchased under agreements to resell, U.S. government securities, net, and investments denominated in foreign currencies, as well as income and expenses. The effects of the initiatives do not require adjustment to the amounts recorded as of December 31, 2007.

**CREDITS**

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**Vice President and Public Affairs Officer**

Bobbie H. McCrackin

**Assistant Vice President and Public Information Officer**

Pierce Nelson

**Publications Director**

Lynne Anservitz

**Graphic Designer and****Art Director**

Peter Hamilton

**Writers**

Charles Davidson

William Smith

**Editor**

Lynn Foley

**Photographers**

Flip Chalfant, represented by Will Sumpter and Associates

Brad Newton

**Printing**

BennettGraphics

Head Office and Atlanta Branch  
1000 Peachtree Street, N.E.  
Atlanta, Georgia 30309-4470

Birmingham Branch  
524 Liberty Parkway  
Birmingham, Alabama 35242-7531

Jacksonville Branch  
800 West Water Street  
Jacksonville, Florida 32204-1616

Miami Branch  
9100 N.W. 36th Street  
Miami, Florida 33178-2425

Nashville Branch  
301 Rosa L. Parks Avenue  
Nashville, Tennessee 37203-4407

New Orleans Branch  
525 St. Charles Avenue  
New Orleans, Louisiana 70130-3480

For additional copies contact  
Public Affairs Department  
Federal Reserve Bank of Atlanta  
1000 Peachtree Street, N.E.  
Atlanta, Georgia 30309-4470  
404.498.8020  
[www.frbatlanta.org](http://www.frbatlanta.org)





