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Bruce Beaudette: Bruce Beaudette has been the President/CEO of Sunmark FCU in Schenectady, NY for the past seventeen years. He has also been a board member of Empire Corporate FCU for twelve years and is currently their Chairman of the Board. Mr. Beaudette additionally is the President of Sunmark Financial Services, LLC and sits on the Board of Member Trade Financial Group, LLC and Member Trade Advisory Services, LLC. He is the former Senior Accountant for First Maryland Bancorp and has a Bachelor's Degree in Accounting from Siena College.

Bob Burrell: Bob Burrell is the Executive Vice President and Chief Investment Officer of Western Corporate Federal Credit Union (WesCorp) in San Dimas, California. Prior to joining WesCorp in 1997, Mr. Burrell was Senior Vice President and group manager of capital markets and portfolio management at Boatmen's Bancshares, Inc., in St. Louis. He also serves on the board of Corporate Exchange, LLC. Mr. Burrell was educated in England where he attended the University of Leeds and earned a Bachelor's degree in Electrical Engineering.

David Colby: Dave Colby is the Assistant Vice President & Corporate Economist for the CUNA Mutual Group in Madison, Wisconsin. Mr. Colby joined CUNA Mutual in 1977 as a Corporate Research Specialist and has progressed through the organization holding various corporate, operational and financial planning positions. Mr. Colby is a graduate of the University of Wisconsin - LaCrosse where he received his Bachelor of Science degree in Economics. He holds the designation of Fellow, Life Office Management Institute.

David Dickens: David Dickens joined U.S. Central Credit Union in Lenexa, Kansas as Senior Vice President, Asset/Liability Management in December 1997. Prior to joining U.S. Central, Mr. Dickens served in the same role at Corporate One Federal Credit Union in Columbus, Ohio. Mr. Dickens, a Chartered Financial Analyst (CFA), also previously served as Senior Vice President of Corporate Network Brokerage Services, Inc. (CNBS). He earned a Bachelor's degree in business administration from the University of Missouri.

Bruce Fox: Bruce M. Fox is the Senior Vice President and Chief Investment Officer of Southwest Corporate Federal Credit Union. Mr. Fox joined Southwest in January 1991 as an investment adviser. Mr. Fox is a member of Southwest's asset-liability committee and chairman of the loan committee. Prior to that, he was an investment portfolio manager at the Members Insurance Companies of the Texas Credit Union League. Mr. Fox has Bachelor and Master's degrees in Finance from East Texas State University.

Scott Mainwaring: Scott R. Mainwaring joined VyStar Credit Union in Jacksonville, Florida as the Executive Vice President & Chief Financial Officer in 1991. In addition, Mr. Mainwaring is the President of VyStar Financial Group, LLC, a wholly owned subsidiary of VyStar Credit Union, and is also a CPA. He worked for the public accounting firm of Coopers & Lybrand for five years before joining Vystar. Mr. Mainwaring graduated with a Bachelor's degree in Accounting from Furman University in Greenville, South Carolina.

Brian McVeigh: Brian McVeigh is the Senior Vice President and Chief Financial Officer for State Employees Credit Union (SECU) in Lansing, Michigan and has been there since 1995. Prior to joining SECU, Mr. McVeigh spent eight years with First of America Corporation and three years with Michigan National Corporation. Mr. McVeigh has spent the majority of his nineteen year career specializing in asset and liability management, investments, and accounting after earning a Bachelor's degree in Accounting from Michigan State University.

Jeff Taylor: Jeff Taylor joined NAFCU in 2000 as the Senior Staff Economist in the Research and Analysis Division. Prior to joining NAFCU, Mr. Taylor worked as a financial consultant and Senior Economist and Investment Strategist at Bear Stearns and NatWest Securities, and as a Senior Country Risk Analyst at the U.S. Export Import Bank. Mr. Taylor received a Masters Degree in International Economics from George Washington University and Bachelor's Degrees in Latin American political economy and Spanish from Denison University.

Tun Wai: Dr. Tun A. Wai is in his seventeenth year as NAFCU's Director of Research and Chief Economist in Arlington, Virginia. Prior to joining NAFCU, Dr. Wai held research positions with the World Bank, the Federal Reserve Board of Governors, and the Brookings Institution, an independent research group. Dr. Wai has a Bachelor of Science in Business Administration in Management and a Ph.D. in economics from Georgetown University, as well as an M.B.A. in finance from New York University.

Executive Summary

- Loan growth for all federally insured credit unions (FICUs) in 2003 (YTD) was approximately 6.4 percent, annualized, the majority of the growth being in first mortgage loans, followed by used auto lending. Overall lending within Regions 1, 2, 3, and 5 grew at even higher individual rates.
- Most credit unions have expectations of elevated new and used auto lending and unsecured lending for the remainder of 2003. Several regions revealed less than stellar growth in new auto lending, through June 2003, as volumes continued to be constrained by dealer finance company incentives.
- Credit unions as a whole are mixed about whether growth in shares will increase, decrease, or remain roughly the same throughout the latter half of 2003. Institutions in Regions 5 and 6 seem to feel strongest about a possible up tick in share growth in 2004.
- Share growth for all FICUs was 15.8 percent, annualized, through the first half of 2003, with growth in every region being concentrated in non-share certificates, particularly share drafts, regular and money market shares. IRA accounts were also a noticeable safe haven for credit union members' savings this year.
- The average return on average assets (ROA) for all FICUs in 2002 was roughly 1.04 percent. Most credit union management teams seem to believe that the prospects for earnings this year remain about the same or slightly lower.
- General economic conditions in each of the NCUA regions tend to mirror the national picture, as the primary issue remains the fallout from unemployment. Continued weak labor markets, layoff concerns, and higher levels of loan delinquencies and losses are likely to dominate the economic radar screen for the remainder of 2003.
- What appears to be most on the minds of credit union leadership throughout the U.S. were concerns about the low interest rate environment and the resulting margin pressure institutions have felt throughout the first half of this year. Although general economic indicators have shown moderate signs of improvement, loan quality issues related to economic conditions remains a major concern over the near term.

NCUA Region One

NCUA Region 1 (Northeast) consists of six states[1]. As of June 2003, there were 1,222 credit unions in the region, with total assets of $69.9 billion and a total membership of 8.7 million.

Lending

Region 1's loan growth during the first half of 2003 was 7.2 percent, compared to an annualized 6.4 percent for all federally insured credit unions (FICUs). Loan growth in 2002 was concentrated in real estate products, and to a lesser extent used light vehicle products. The mortgage "refi" wave that swept the nation in 2001/2002 was very evident in Region 1 during the first half of 2003 as well. Home equity loan demand grew at a brisk pace too well. Over the first half of 2003, new light vehicle lending continued to be constrained by the dealer and finance company incentives, while many credit unions experienced an elevated demand for member business loans. Expectations for loan demand during the fourth quarter of 2003 are mixed, yet most credit unions remain cautiously optimistic. However, the weak labor market conditions, coupled with a slow recovery in the information technology and financial services sectors, continue to pressure many credit unions. Credit unions in Region 1 are expecting stronger new light vehicle loan demand, and slightly stronger used light vehicle loan demand during the fourth quarter. Unsecured lending is expected to pick-up during the holiday season, yet real estate loan demand expectations are declining as interest rates move higher.

Member Shares

Region 1's share growth was 17 percent during the first six months of 2003, compared to 15.2 for all FICUs (annualized). Share growth during the first half of the year was concentrated in non-share certificates, particularly regular and money market shares. During the fourth quarter of 2003, share growth in Region 1 is expected slow somewhat in line with the recovery of the economy and the capital markets. Seasonal factors, such as holiday spending, should curb share growth as well. The majority of the NAFCU-member credit unions expect that most of the growth in shares during the latter stages of 2003 will remain in liquid accounts, particularly regular share accounts. While most credit unions in the region are reporting a slowdown in share expansion, the majority are not experiencing a noticeable outflow of shares. The credit unions in Region 1 that have extremely strong loan demand are raising their share rates moderately to capture or maintain the share levels necessary to fund their loan pipeline.

Return on Average Assets, Spreads and Asset Quality

During the first half of 2003, the credit unions in Region 1 had a Return on Assets (ROA) of 1.01 percent compared to a ROA of 1.04 percent for all FICUs. A lower cost of funds, effective cost containment, and higher fee income all allowed for solid earnings. During the fourth quarter of 2003, the prospects for earnings remain positive for most of

[1] The six states are Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island and Vermont.

the region's credit unions, with the majority of institutions expecting an ROA in line with that of the first six months of 2003. However, due to the relatively wide-spread unemployment and the likelihood of rising interest rates later this year and into early 2004, many of the responding credit unions believe that their ROA will contract modestly over the near-term. As usual, the asset quality of Region 1 credit unions was much better than the asset quality of all FICUs. During the first half of 2003, the delinquent loan to total loan rate in the region was 0.61 percent compared to 0.75 percent for all FICUs. Through June, the net charge-off rate of 0.34 percent was much lower than the overall FICU charge-off rate of 0.53 percent. While Region 1 has experienced a large number of bankruptcies during 2003, the number of cases and its effects on the credit unions was less significant than on many FICUs. Last year, Region 1 had the fewest bankruptcies of any of the six NCUA regions, and its bankrupt loans to total loan ration of 0.30 percent was half of the FICU ratio of 0.60 percent. As a result, very few of the credit unions indicated that bankruptcy is a principal concern over the near-term.

Economic Conditions in 2003

Employment declined sharply in the Region during 2003; however, the rate of job loss has moderated and is now tracking national trends. Since March 2001, the Region has lost about 2 percent of its employment base, virtually the same as the nation. However, employment has declined more severely in New York and Massachusetts, where unemployment reached almost 5 percent, more than double the national average.

Several of the Region's key industries have been hard hit by the economic slowdown. Compensation has declined significantly in the securities industry. Wall Street bonuses have been down sharply for two years, and layoffs since December 2001 in New York City and the surrounding area (about 20 percent of the nation's employment in this sector) total approximately 40,000, or 19 percent of the industry's workforce. In addition, the Region's telecommunications, hotel and hospitality, and advertising industries remain sluggish. Both Boston and southern New Hampshire, which each benefited from the high-tech boom of the 1990s, have experienced significant layoffs in this sector. In addition, employment declines have occurred in the Region's manufacturing sector where 14 percent of jobs have been lost, a slightly higher level than that of the nation.

A Rebound in Several Industry Sectors Will Benefit Parts of Region 1

Like that of the nation, the Region's economic outlook appears encouraging in the second half of 2003. Region 1 has benefited from increased federal spending and expanded employment related to homeland security. In addition, population growth among the "echo boom" generation in some of the Region's larger metropolitan areas has increased demand for teachers and other education professionals. An aging baby boomer generation, in turn, has stimulated demand for health care services.

A capital market rebound is critical to any sustained economic recovery in the Region. The market generates substantial compensation for Wall Street employees and affects the business services sector, including accounting, legal, and printing services. Moreover, stock market activity correlates strongly with the Region's overall employment growth; the Region's, as well as the nation's, employment has expanded with the positive performance of the capital markets during the past decade. Evidence suggests that conditions on Wall Street are turning around, a trend that would be expected to benefit the economies of the greater New York City and Boston areas. In fact, some analysts are anticipating a pickup in equity underwriting and mergers and acquisition activity over the next 12 months, although not to the record level of the late 1990s. Profitability in the securities industry significantly improved during the second and third quarters of 2003, and industry compensation and employment are expected to increase during early 2004

Despite some positive signs, the Region's employment growth in the near term may lag that of the nation. A relatively higher cost of doing business in some of the Region's larger cities has resulted in the continued emigration of certain business sectors to the western and southern United States and overseas. In addition, several of the Region's states and cities face serious budget constraints that could hinder a recovery further.

NCUA Region Two

NCUA Region 2 (Mid-Atlantic) consists of five states[2] and the District of Columbia. The regional credit unions (CUs)[3] have about 14.7 percent of the total assets, up 17.9 percent for the year. There are roughly 11.8 million members in this region, up 270,000 (2.4 percent) over the past year. These percentages mirror the regional economy where the regional gross state product is about 14 percent of the US gross domestic product. The regional production is concentrated more in government, services, finances, insurance, and real estate industries than the national average.

Lending

Region 2 CUs generated annual loan growth of just 8.1 percent, well above the national average of 6.4 percent (annualized). Over the course of 2003, 1st mortgages supplied 67 percent of loan portfolio growth, followed by new auto loans at 34 percent. Combined real estate secured lending (1st mortgages and HELOCs) accounted for 82 percent of the gain.

Going forward into 2004, Region 2 CUs do not anticipate higher loan growth, except for new auto loans. Region 2 CUs expect real estate loans to decline significantly over the next 12-month period. Among all CUs these loan expectations are similar to Region 2 CUs, except for used autos where a more positive outlook is indicated nationwide.

Total auto loans in Region 2 advanced by 7.6 percent in 2003 versus 7.4 percent for all CUs. Region 2 used auto loans lead the way, up 17.5 percent for the year while the new auto loan portfolio declined by 0.6 percent.

Unsecured loans (excluding credit cards) represent 9 percent of all CU loans in the region. This portfolio segment declined 2.3 percent in 2003. One factor may be that the average unsecured loan rate nationwide was 12 percent, down just 20 basis points from 2002. CU leadership in the region does not see this portfolio segment as a source of growth in 2004.

Member Shares

Member savings deposits reached $76.0 billion in 2003, up $6.2 billion (17.8 percent) during the year. Regular shares contributed 49.2 percent of the increase last year, followed by money market accounts at 16.1 percent. Add in share drafts at 16.1 percent and you get 81.4 percent of 2003's increase from highly liquid deposit accounts. Bucking the trend were IRA deposits, up 14.7 percent for the year, reflecting member concern for safety of principal.

For 2004, Region 2 CUs see a similar share growth to this year. In contrast, the nationwide expectation on savings is a slightly slower growth rate for 2004.

[2] The five states are Delaware, Maryland, New Jersey, Pennsylvania, and Virginia.
[3] Credit unions (CUs) are federally insured credit unions except for the surveyed figures are from federally-chartered credit unions.

Region 2 CUs share drafts (12.3 percent of Region 2 CU shares) increased at a higher rate (24.9 percent) than last year (2002 regional average was 9.9 percent growth). Regular shares (40.4 percent of Region 2 CU shares) grew an exceptional 22.1 percent in 2003. Money market accounts (15.3 percent of CU shares) reached $11.7 billion in 2003, up 18.8 percent. CU share certificates (21.3 percent of CU shares) experienced a 6.6 percent increase in 2003.

IRA accounts (9.5 percent of CU shares) were a safe haven for members' precious retirement funds in 2003. This deposit segment advanced 14.7 percent for the year compared to a national average of 11.6 percent.

Return on Average Assets (ROA), Spreads and Asset Quality

With deposits re-pricing faster than loans in 2003, Region 2's credit unions experienced a healthy improvement in consolidated ROA. At 1.19 percent (average ROA for all CUs was 1.04 percent), this profitability measure increased 12 basis points over 2002 for the regional credit unions. Some CU management teams expect a slight decrease in ROA as a result of the reduction in interchange income from debit card transactions.

Gross spreads declined by 17 basis points from 3.49 percent in 2002 to 3.32 percent this year. The strong ROA among Region 2 CUs was partly due to the 28 basis point decline in operating expenses while maintaining a constant net charge-off ratio of 33 basis points.

Loan Loss Trends in 2003

Several Region 2 CUs indicated that their delinquency rate has risen due to the recent conversions to community charter. In 2003 Region 2 CUs have a slightly lower delinquency rate and a slightly higher charge-off ratio than credit unions nationwide. The trend in bankruptcy is still increasing among Region 2 CUs. In 2003 the bankruptcies-to-total loans ratio increased by 20 basis points while nationwide saw a 17 basis point rise.

The primary operational concerns for 2003, cited by our regional credit unions, were indirect lending, real estate refinance and potential costs associated with community conversion. Low delinquencies, not material concern about bankruptcies and stable interest margins, were mentioned as examples of positive future performance.

Member Concerns and Region 2 Economic Conditions in 2003

Credit union leadership in Region 2 viewed the potential for negative employment fallout, and financially distressed state governments as a primary economic concern in their states. Low corporate profits and weaknesses across the retail sector were also cited in their assessments of economic conditions in the region. Continued weak labor markets and layoff concerns will dominate Region 2's economic radar screen.

NCUA Region Three

At mid-year 2003, there were 1,695 credit unions (CUs) in NCUA Region 3 (Southeast) consisting of ten states and two territories[4]. June's count represents a net decline of 48 CUs over the past year. Total assets are up 8.3 percent year-to-date (YTD) and 11.9 percent from June of 2002 to $101 billion. Roughly 350,000 additional members brought total membership up to 15.3 million. The 25 largest CUs in Region 3 hold 42 percent of all assets and 30 percent of the membership in the region.

Lending

Region 3 CUs grew their loan portfolios 3.5% YTD and 5.5% over the past year. YTD results show Region 3 CUs outperforming the total US market. Used vehicle loan growth has accounted for 51 percent of the total loan portfolio gain over the past year and 57 percent on a YTD basis. First mortgage portfolio growth contributed 38 percent of the annual gain despite total 1st mortgage loan sales in excess of $2 billion (115 percent above YTD 2002 results). The Region 3 loan-to-share ratio was 67.1 percent at the end of June, down from 70.8 percent in June 2002. Much of the decline was due to the denominator effect, in that shares grew 11.3% over the same period.

During the first six months of 2003, 706 CUs reported granting first mortgages with total YTD first mortgage originations at $5.4 billion. This volume puts the Region's CUs 51 percent ahead of last year's record performance.

Other Real Estate (HELOCs and second mortgages) was up 7.8 percent over the past year. Six hundred and eighty-eight CUs reported they have granted these loans during YTD 2003 and total originations are up 53 percent from the same period in 2002.

During 2003, mortgage loan refinancing activity has been strong throughout Region 3 CUs. However, with the recent rise in interest rates and the large number of consumers that have already refinanced their mortgage loans, refinancing activity has started to slow down, and this trend is expected to continue for the foreseeable future.

Used vehicle lending dominated total vehicle portfolio gains. Used vehicle loans were up a healthy 13.8 percent and accounted for 112 percent of the total vehicle increase as the new vehicle portfolio was off 1.6 percent over the past year. In total, Region 3 CUs achieved 6.3 percent annual vehicle loan growth, topping total U.S. results by a full percentage point.

The dollar amount of unsecured loans held by Region 3 CUs continues to fall. Over the past year this portfolio is down 3.2 percent. This is a marginally faster rate of decline than the total U.S. market, which is off 2.3 percent. The average rate charged on unsecured loans was 12.8 percent, down just 45 basis points from last year.

Although loan growth has improved during 2003, share growth is expected to grow at a faster rate than loan growth in Region 3. For 2003, we expect loan growth of 6% to

[4] The ten states include Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee, and the territories of Puerto Rico and the U.S. Virgin Islands.

8% and share growth of 8% to 10%. As outlined above, the loan areas that have performed the best during 2003 in Region 3 are mortgage loans and used auto loans. In addition, a number of credit unions have reported positive results in the other secured loan area, which would include boats, motorcycles, and RVs, and in the business loan area (for those credit unions that are offering business loans).

Member Shares

Total savings reached $88.1 billion at mid-year, up 11.3 percent over the past year and 8.3 percent YTD. Over the past year, 76 percent of all savings increases came from liquid deposit accounts. Share drafts contributed 9 percent, regular shares 42 percent and money market deposit accounts 26 percent. With 66 percent of all savings in low cost liquid accounts, the cost of funds to average assets declined to 1.84 percent, a reduction of 61 basis points from last year. Members at Region 3 CUs increased their IRA/KEOGH account balances12.4 percent over the past year reflecting continued concerns over equity market performance for retirement funds.

The mid-year (annualized) return on average assets (ROA) slipped to 104 basis points from 107 basis points in June 2002. A total of 842 of the Region's CUs saw their ROAs decline. Fifteen of the 25 largest CUs in the region experienced ROA declines, but collectively these 25 large CUs achieved a 120 basis point result.

At the end of June 2002, gross spreads in the region averaged 390 basis points. As of June 2003, the gross spread average had eroded to 365 basis points. We expect further gross spread compression as interest rates rise and deposits re-price faster than loans.

With the equity market performing much better in 2003, we would expect credit union funds to begin moving into equity investments during the remainder of 2003 and beyond. For those credit unions (or CUSOs) offering alternative investments, we would anticipate the flow of funds into these alternative investments to improve during this time. Since a number of members are still nervous of the equity market and are concerned with the low deposit rates currently being offered, many members are keeping their funds in liquid accounts and short-term certificate accounts.

Credit Union Issues and Economic Factors Impacting Credit Unions

Since interest rates are low and credit unions are facing smaller gross spreads, several challenges are currently being faced by credit unions around the nation, including Region 3. For example, the prevailing interest rates on fixed income investments are presently low. As a result, Region 3 CUs are faced with the decision of whether to invest in short-term fixed income securities (one to five years) or in long-term securities (longer than five years). While the higher yield on long-term fixed income securities may seem attractive, a higher level of interest rate risk does exist if these long-term securities are bought and held. At present, most Region 3 CUs are continuing to buy the majority of their fixed income securities in the short-term category.

Various economic issues have impacted credit unions around the nation, including Region 3. One of the bigger economic issues is unemployment. As outlined above, some credit unions in Region 3 are reporting a higher savings activity and less loan activity, as consumers are worried about spending too much during the tough job market conditions. In addition, a more important issue has been a higher level of loan delinquency and loan losses, which has been caused by job loss factors, various family crises and other factors. Although the economy is showing moderate signs of improvement, loan quality issues related to these economic issues and other factors is a concern during the remainder of 2003 and 2004. The level of loan losses is expected to be similar in 2003 and 2004 unless the economy experiences a significant level of weakness from its current pace of growth, which is not being forecasted at present.

NCUA Region Four

NCUA Region 4 (North Central) consists of seven states.[5] The regional credit unions have about 16.3 percent of total credit union assets, up 10.0 percent for the last twelve months. There are roughly 14.7 million members in this region, up 117,000 (0.8 percent) over the past year. These percentages mirror the regional economy where the regional gross state product is concentrated more in manufacturing than the national average.

Lending

Region 4 CU's generated loan growth of just 5.0% for the first half of 2003. On average, first mortgages now comprise 33.4% of region loans, while auto loans account for 35.2%.

Except for a sudden rush shortly after the June FOMC meeting, mortgage activity has slowed from the peaks. Home prices appear to have stabilized and existing homes seem to be taking slightly longer to sell. Recent declines in Treasury bond rates may push another wave of buying and refinancing but prices will likely remain flat.

The biggest economic issue for the region is definitely job security. This is the most likely culprit in the below average loan growth. Continued news of manufacturing layoffs and government downsizing has the consumer borrower on edge. Midwest consumers have traditionally been some of the most prudent with borrowings (see below average charge-offs) and this round of unease will not be an exception.

We should not expect to see robust loan growth in the region until the job security picture improves.

Loan Quality

Ironically, the region's net charge off ratio (0.49%) was the second lowest in the nation while the delinquency ratio was the highest (0.92%). Perhaps this is a timing issue with larger charge-offs yet to come.

Again, the unemployment picture will have a huge impact on loan quality. Other than working with unemployment issues for existing loans, underwriting standards are not changing.

Deposits

Region 4 generated deposit growth of 15.5% for the first six months of this year. This was slightly below the national average of 16.4%. Much of the growth occurred in regular shares and draft accounts. Since the first of the year, regular shares grew from 32.2% to 37.9% of total deposits in the region. In the same timeframe, draft accounts grew from 11.8% to 12.1% of total deposits.

Low rates of return and uncertainty in the job market seem to have depositors in a 'wait and see' mode. Many certificate of deposit holders are opting to roll maturities into

[5] The seven states are Illinois, Indiana, Michigan, Missouri, Ohio, West Virginia, and Wisconsin.

regular shares or money market accounts for both liquidity and interest rate concerns. There have been signs of deposit growth slowing since June but empirical evidence is not yet available.

Credit Union Concerns

The rise in loan delinquencies is a very real and current issue. A swifter rebound in the national economy could help this situation but is far from a sure thing. The good news is that even region 4 credit unions have lower delinquency ratios than many banks.

Margin pressure from the low rate environment has definitely hit credit unions in 2003. So far, spreads and ROAs are lower than last year. According to Peer-to-Peer, half of the credit unions in region 4 produced annualized ROAs of less than 0.55% for the first half of 2003. This continues to raise significant questions as to deposit and service pricing and/or the costs of operating on so many smaller scales.

NCUA Region Five

NCUA Region 5 (Central) consists of eleven states[6] and 1,718 credit unions as of June 30, 2003. The credit unions in this region represent approximately 16.7 percent of the total assets of all federally insured credit unions (FICUs), up 10.6 percent since June 2002. There are an estimated 15 million members in this region, up 354,000 (2.4 percent) over the past 12 months. These percentages mirror the regional economy where the regional gross state product is about 16.8 percent of the US gross domestic product. The regional production is concentrated more in transportation, public utilities, farms, forestry, fisheries and retail trade than the national average.

Lending

Region 5 credit unions (CUs) generated annual loan growth of just 6.9 percent, slightly above the national average for all FICUs. Loan growth during the twelve-month period ending June 2003 was concentrated in used automobile loans and real estate lending. During the period, used auto loans accounted for 48 percent of loan growth, followed by first mortgages at 43 percent. New automobile lending grew only 9 percent as volumes continued to be constrained by dealer finance company incentives. Combined new and used auto loans accounted for 57 percent of the gain. The loan-to-share ratio in Region 5 was 71.1 percent as of June 2003.

Going forward into 2004, 45 percent of Region 5 CUs anticipate higher or equal overall loan growth when compared to their 2003 results. About 55 percent believe they will see their loan-to share ratio improve, and 36 percent expect a lower result for this key measure.

Credit unions seem to be generally optimistic regarding new and used automobile lending activity in 2004. Only 18 percent of our survey respondents believe 2004 new and used automobile loan growth will be lower than during 2003. A full 82 percent anticipate better or equal results.

Looking forward, credit unions generally view the prospects for real estate lending as remaining somewhat positive, although there is an overwhelming expectation that mortgage refinancing activity will slow dramatically. Sixty-four percent of CUs believe first lien mortgage lending will be the loan product in most demand for 2004. Survey results also show 82 percent of Region 5 CUs are counting on lower mortgage refinancing activity in 2004. Early indications of the third quarter activity confirm that mortgage refinancing is already slowing among Region 5 CUs.

Unsecured loans represent 9.5 percent of all credit union loans in Region 5. This portfolio segment declined approximately 1 percent since June 2002. Almost none of the credit union leadership in the region sees this portfolio segment as a source of growth in

[6] The eleven states are Arizona, Colorado, Iowa, Kansas, Minnesota, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, and Texas.

2004. In fact, about 82 percent of credit union mangers expect unsecured loan growth to be about the same this year as in 2002.

Credit unions in Region 5 continue to do a good job in managing credit risk and the outlook for 2004 remains very positive. The region's delinquency rate was .87 percent, slightly higher than the national average of .74 percent. Ninety-one percent of credit unions surveyed in the region expect loan quality to be the same or better in 2004.

Member Shares

Member savings deposits reached $87 billion as of mid-year 2003, up $7.9 billion (10 percent) during the past twelve months. Regular shares contributed 32.5 percent of the increase since June 2002, followed by money market accounts at 27.3 percent. Additionally, if we consider the 6.9 percent growth in share drafts, then 66.7 percent of the total increase is in highly liquid deposit accounts. IRA deposits were also up 9 percent for the survey period, reflecting member concerns for safety of principal. Longer-term maturity accounts did see some strong gains. Share certificate deposits increased 20.4 percent as members extended their deposit maturity in search of higher returns.

Uncertainty related to the economy and the job market is the primary reasons credit unions expect share growth to remain relatively strong in 2004. Twenty-seven percent of Region 5 respondents expect a higher share growth in 2004 while 36 percent anticipate a decline. About 60 percent believe their deposit liquidity structure will be "about the same." The other 40 percent are evenly split between "more liquid" and "less liquid." Most of the growth is expected to come in regular share and money market accounts.

Investments

With share growth outpacing loan growth, investments grew by 17.1 percent for the twelve month period ending June 2003. Credit unions continued to keep the majority of their investment maturities short term. Approximately 89 percent of investments will mature or reprise within three years and over 58 percent will mature or reprise within 12 months. Ninety-one percent of the credit unions that responded to the survey indicated that the maturity structure or the investment portfolio is not expected to change in 2004.

Earnings

Return on average assets (ROA) in Region 5 declined from 1.04 percent to .98 percent during the twelve-month period ending June 2003. This compares to an ROA of 1.04 percent for all FICUs. In 2004, the prospect for earnings remains a concern for most credit unions, with only 36 percent of those surveyed expecting an improvement in this key performance measurement.

CU Operational Concerns

When credit unions were asked to identify the principal concern for 2004, about 27 percent cited loan growth and asset growth. The second most cited concern was pressure on net interest margins. These credit union managers are concerned about gross margin pressure increasing if the current low interest rate environment persists throughout 2004.

Other issues mentioned in our survey included membership growth concerns, operating expenses, loan credit quality, unemployment and low interest rates.

Region 5 credit unions view their principal competition for lending as banks, followed by other credit unions. Only a small percentage viewed finance companies as competitive concerns in 2003.

Member Concerns

Credit union members are primarily concerned with the low interest rates currently available on their share/savings accounts. Members cited low interest rates 70 percent of the time when asked about their primary concern for 2004. The overall economy, employment and further budget cuts were also cited but far less often than concerns about low rates.

NCUA Region Six

Region 6 (Western) is comprised of ten states and two territories[7]. As of June 30, 2003, the region's 1,249 credit unions comprised 13 percent of all federally insured credit unions and held some $143 billion in total assets, nearly 24 percent of the nation's total credit union assets. In the first six-months of 2003, assets grew some 14.6 percent annualized while net worth increased 11.0 percent to $14.2 billion. Share growth (15.3 percent) outpaced loan growth (6.04 percent) and consequently investments grew at an annualized pace of nearly 32 percent. A large part of these excess funds remain in short-term investments and cash equivalents. There was a significant shift between quarters, as second quarter loan growth accelerated sharply while share growth moderated. Loan demand had been particularly weak in the first quarter.

Lending

In the first six months of 2003, loan growth grew by roughly 6.0% with total loans for Region 6 ending the period at $85 billion – making up just fewer than 59 percent of assets. Loans comprised 62 percent of assets in 2002 and 65 percent in 2001. The only areas of significant strength were in residential mortgage loans and pre-owned automobile loans. There is significant variation in lending activity by state. California, which dominates the group in size, came in just slightly above the average (6.9%) while Idaho and Utah had much stronger loan growth, (9.4% and 9.8%, respectively). The economy in Hawaii remains very subdued and loans actually fell 3.8% in the period. Washington, Wyoming and Nevada also experienced sub-par loan growth.

Real estate loans grew at an annualized pace of 9 percent. In line with the low-rate environment, fixed-rate loans showed the highest growth, increasing by 19% to $20.3 billion. Credit unions did report a decline in home equity loans. For the region as a whole, real estate loans made up 44.3 percent of total loans, the identical percentage as of year-end 2002. Surprisingly, ARMs grew 8.2%, however, most of these loans are hybrids with fairly long fixed rate periods (3-7 years) up front.

Auto loans grew 7.3 percent on an annualized basis, but new car lending effectively stalled due to competition from automakers. Increasing activity in indirect lending has helped maintain portfolio balances. Credit unions are generally optimistic about future prospects, particularly in the used car market.

Elsewhere, loan prospects are not so bright. In fact, home equity lines of credit fell during the period, the first such decline since 1988. There is little expectation for any major strength in unsecured lending which continues its cyclical decline, falling some 11 percent in the period.

Credit unions are generally split on the outlook for loan growth. In our October survey, 41% of the 96 respondents thought prospects would be better in 2004 while 35% feared that prospects would be worse and the remaining 24% thought they would be the

[7] The ten states include Alaska, California, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington, Wyoming, and the territories are Guam and American Samoa.

same. Mortgage lending is expected to decline sharply in 2004 with 68% of respondents expecting refinancing activity to decline and 44% expecting purchase activity to decline as well. There is some mild optimism on new car financing with 45% of respondents looking for improvement while 49% thought things would stay the same. Similar percentages apply to the outlook for pre-owned vehicle financing.

Member Shares

Thus far in 2003, shares and deposits have grown 15.3 percent to $125.5 billion. All member savings account types had positive growth in the first half of the year. Share drafts, regular shares and money market accounts grew at the most rapid pace. However, certificates only grew modestly at a 1% annualized rate. The current low rate environment makes it very difficult for credit unions to issue long-term certificates. We are hearing some concern from credit unions about the need to match-fund some of their fixed-rate residential mortgage loans. Consequently, we expect to see some growth in long-term fixed rate borrowings in the coming months. Other credit unions are looking to the derivatives market to hedge the cost of share and money market balances.

In our survey, credit unions generally felt that share growth would remain strong in 2004. Sixty-eight percent expected growth to remain steady or even improve while 31% thought growth would soften. There are, however, varying expectations at the product level. Share drafts are generally expected to grow while there are clearly some concerns about outflows in regular and money market shares.

Loan Quality

Credit unions continue to do a good job in managing credit risk and generally remain very positive about the outlook for 2004. Delinquency rates fell to 0.62% from 0.67% in the first six months of 2003. The net loan loss ratio increased from .55 to .63 percent in the same period. These results for Region Six mirror results nationally. Within the region, Nevada and Utah experienced the highest levels of delinquencies and losses.

Bankruptcy filings by members did show increases for the period. Region VI credit unions are on pace to charge-off $198 million in loans due to bankruptcy this year compared to $187 million last year. Bankruptcies accounted for 33 percent of total loan losses in the region and 37 percent nationwide. The bankruptcy percentage is significantly higher in Utah, Washington, Idaho, Oregon and Wyoming. California has the lowest percentage at 27%.

Credit unions seem comfortable with the current trends and less than 10 percent of our survey respondents believed that credit quality would deteriorate in 2004.

Investments

With share growth continuing to outpace loan growth, investments grew at an annualized rate of almost 32 percent and ended the period at $51.5 billion or 36 percent of total assets. This represents an increase from last year’s ending balances of $44.5 billion. Credit unions continue to keep the majority of their investments short term. Over 50 percent of investments will mature or re-price within 1-year while another 33 percent will mature or re-price in less than 3 years. Credit unions continue to hold ample liquidity in case funds start to flow out of the system. Liquidity is not a major concern at this time with over 80% of the respondents in our survey projecting liquidity to remain the same or even improve in 2004.

Earnings

The average return on assets declined by five basis points in the period to 1.09 percent mostly due to compression in net interest margins. The yield on average loans declined from 7.5 percent to 6.97 percent while the yield on average investments declined from 3.54 percent to 2.81 percent. Credit unions were able to reduce their cost of funds from 2.22 percent to 1.72 percent, however, there is not much room left on this front. Consequently, the net margin declined by twelve basis points to 4.57 percent. Fee income remained unchanged at 67 basis points while the provision for loan losses declined one basis point to 0.35 percent. Operating expenses declined by 4 basis points to 3.19 percent, however, this was entirely due to the significant increase in assets, and the actual dollars spent on operating expenses continues to increase at a 10% clip. There are some major concerns about continued spread compression and 41% of the respondents in our survey expect their spreads to decline in 2004.

Region 6 credit unions reported annualized net worth growth of 10.8% and asset growth of 14.6 percent. As a result, net worth ratio declined from 10.14 percent to 9.96 percent. Only Alaska and Washington reported an increase in net worth ratios.

General Economic Conditions

Economic conditions in the Western States generally mirrored the rest of the U.S. during the first nine months of 2003. Oregon and Washington continue to face the greatest challenges with unemployment levels rising above the national average. Despite some early setbacks for Hawaii due to the Iraq war and SARS, the economy finally seems to be turning around. The state is highly dependant upon tourism and developments in Asia will remain a key issue. New construction is especially strong in the state and is expected to remain a major source of growth. The U.S. government is also beginning a major construction effort for housing on the bases in Hawaii. Recent surveys of businesses in Western states reflected a growing optimism on the economic outlook, but respondents are still uncertain regarding future employment increases. In summary, cautious optimism has replaced cautious pessimism since the first of the year.

The Federal Reserve Bank of San Francisco reported modest improvement in overall economic activity in the last few months. With the notable exceptions of health care services and energy, contacts noted little upward pressure on prices and wages. Retailers reported that sales were generally up and that discounting was less pervasive than in past survey periods. Reports indicated that manufacturing activity continued to rise. Orders strengthened for manufacturers of semiconductors, machine tools and basic metals. Conditions for District agricultural and resource-related businesses remained solid. Respondents indicated that demand for homes continued to be strong, while commercial real estate generally remained in the doldrums.

Reports from District retailers indicated improved sales during the most recent survey period. Contacts reported solid automobile sales (spurred in part by generous incentives), especially for foreign brands. Favorable financing terms and strong home sales helped prompt sales of large appliances. Discounting among retailers reportedly was less pervasive than in previous survey periods.

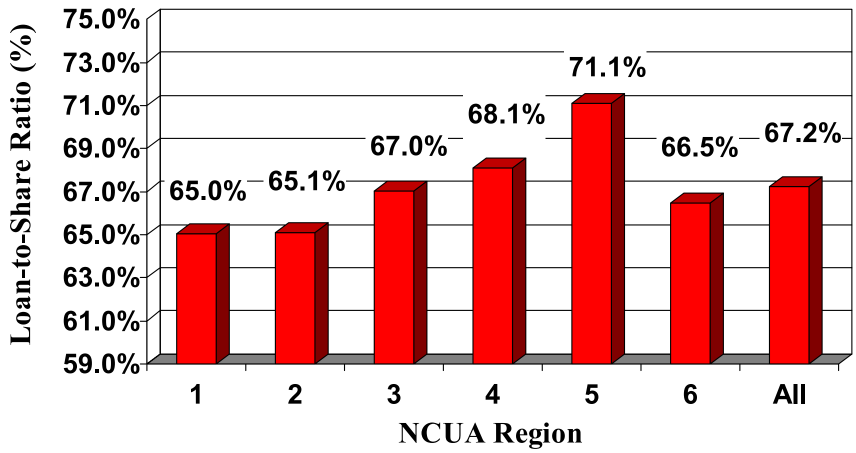
Reports indicated that conditions in the District's travel and tourism sectors improved slightly in late July and August. In Hawaii, increases in domestic visitor counts largely offset declines by international visitors. Hotel occupancy rates inched up in Hawaii, California, and other areas. However, the restaurant industry continued to face below-normal demand in some markets.

Overall District manufacturing activity picked up in late July and August. Demand for semiconductors improved and capacity utilization, particularly for leading-edge products, reportedly remained high. Consistent with improved conditions, a majority of manufacturing respondents indicated plans to increase total capital spending and spending on IT in the next several months.

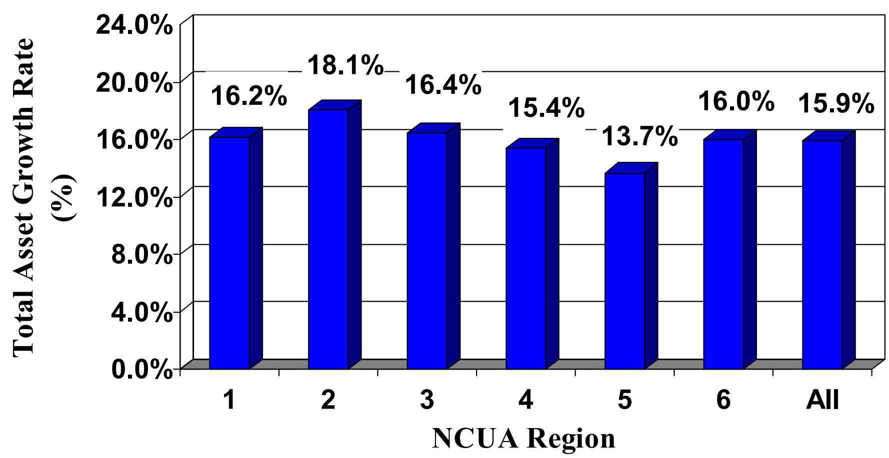
Housing demand remained a bright spot in the District's economy. New home construction continued at a brisk pace across the District, particularly in areas where demand exceeded supplies, namely Hawaii and Southern California. Several respondents believed that housing demand increased as some homebuyers rushed into the market fearing that interest rates may escalate further.

On the commercial side, high vacancy rates continued to characterize many District markets, including the San Francisco Bay Area and Las Vegas. Contacts reported very little commercial construction activity outside of Hawaii and Southern California.

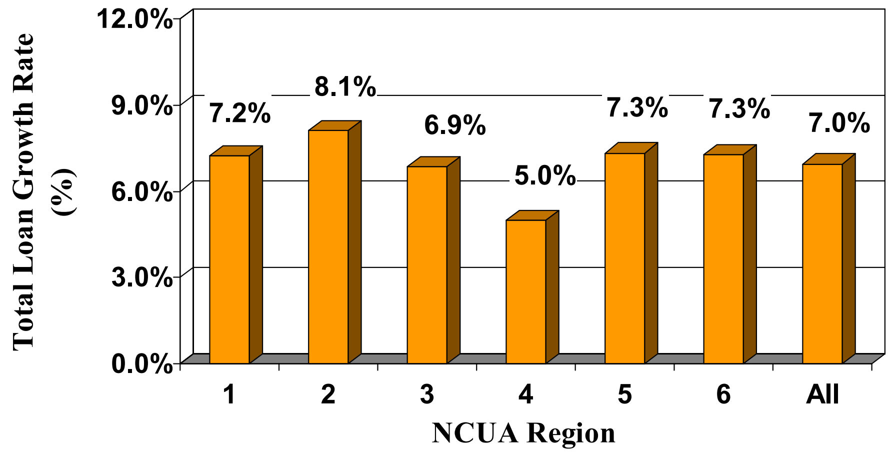
Loan-to-Share Ratio
Federally Insured Credit Unions
by NCUA Region
June 2003



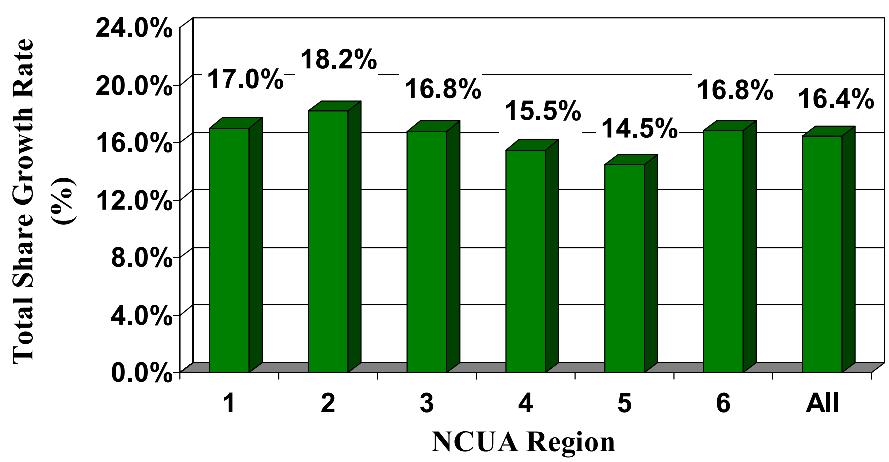
Total Asset Growth
Federally Insured Credit Unions
by NCUA Region
June 2003



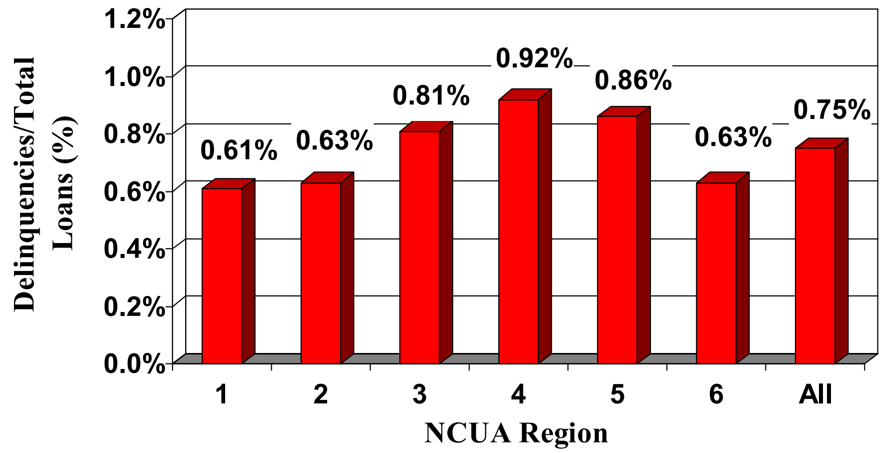
Total Loan Growth
Federally Insured Credit Unions
by NCUA Region
June 2003



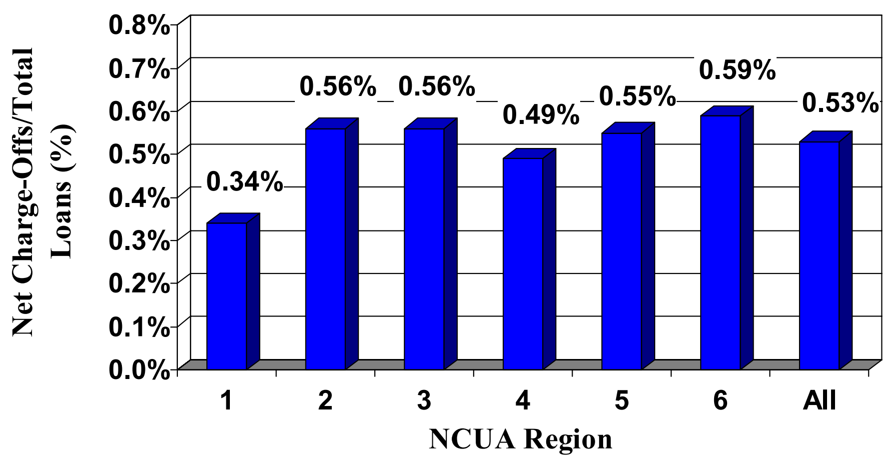
Total Share Growth
Federally Insured Credit Unions
by NCUA Region
June 2003



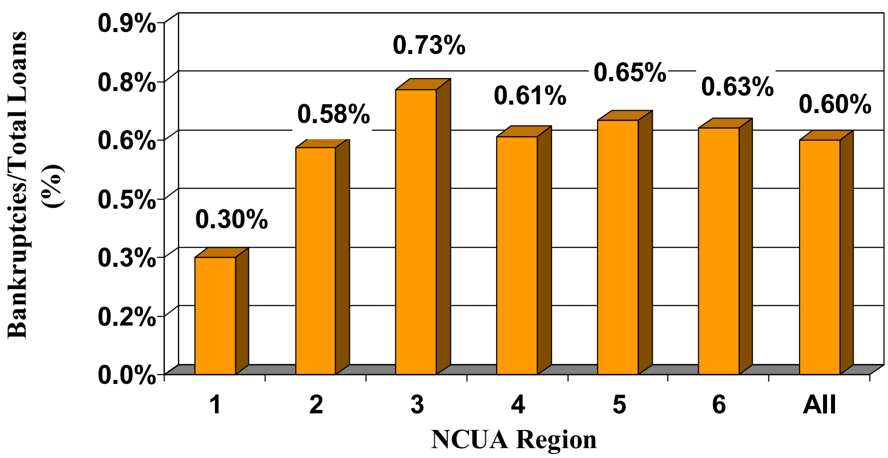
Delinquency Ratio
Federally Insured Credit Unions
by NCUA Region
June 2003



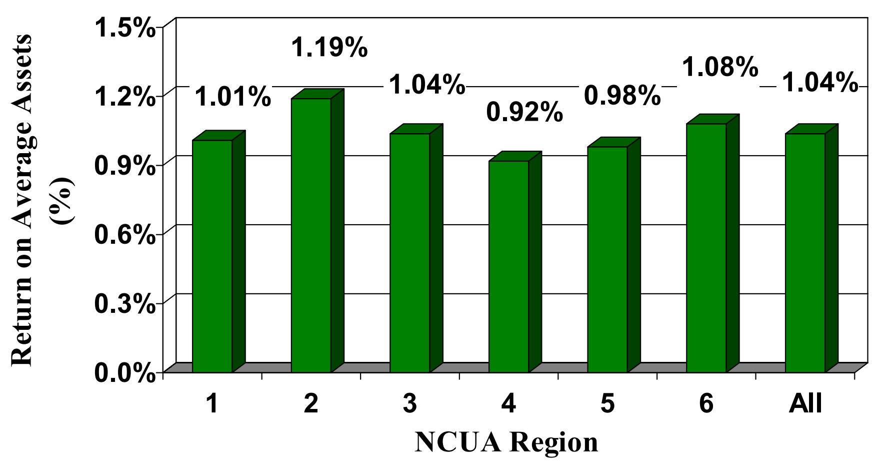
Net Charge-Offs/Total Loans
Federally Insured Credit Unions
by NCUA Region
June 2003



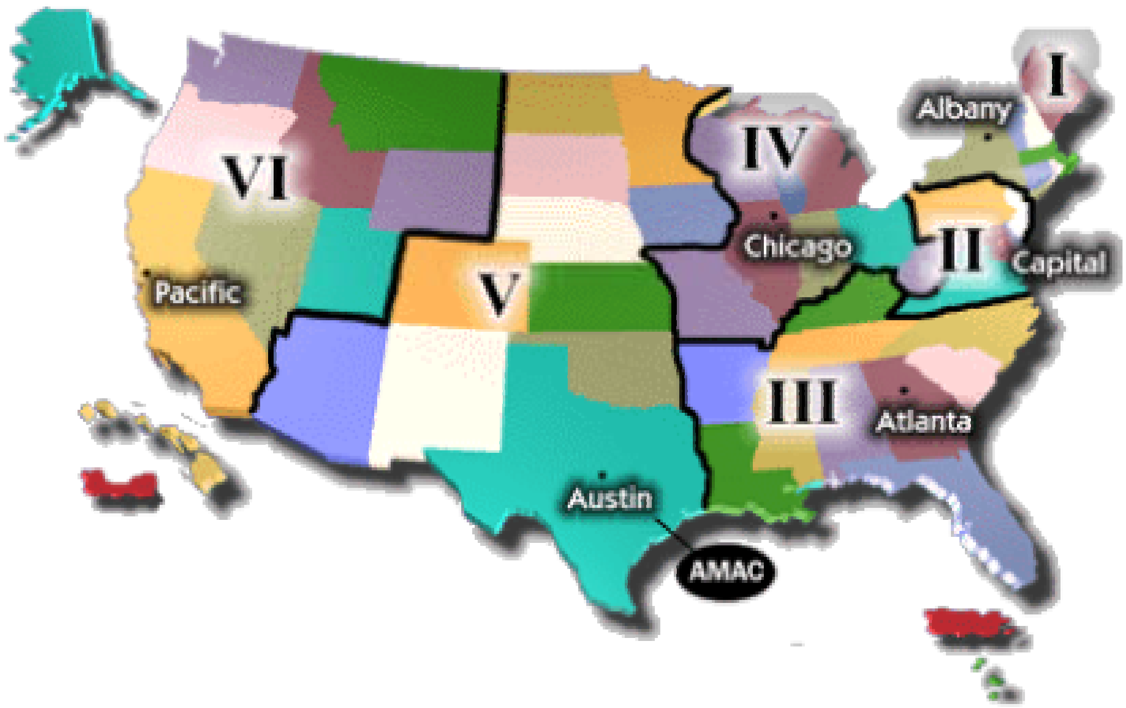
Bankruptcies/Total Loans
Federally Insured Credit Unions
by NCUA Region
June 2003



Return on Average Assets (ROA)
Federally Insured Credit Unions
by NCUA Region
June 2003



NCUA REGIONAL BREAKDOWN



Source: NCUA Web site - http://www.ncua.gov/org/regionalmap.html