Credit Union Economics Group Regional Report Spring 2006

April 18, 2006

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Executive Summary

- Liquidity continues to challenge credit unions, with Regions 1, 2 and 4 citing it as a major concern. FICU Loan growth exceeded share growth for the fifth consecutive year in 2005.

- Member business lending grew 33.5 percent for all FICUs with Regions 3 and 5 (41.1 and 36.8 percent, respectively) leading the way.

- Region 2's ROA was 0.95 percent, 10 basis points higher than for all FICUs, and 23 basis points higher than Region 4's 0.72 percent.

- The number of FICU members declaring bankruptcy was up 34.2 percent, to 342,634, in 2005. Loans charged off due to bankruptcy were up 21.0 percent. These increases are largely explained by the bankruptcy legislation passed in October 2005, and are expected to fall back below previous levels in 2006.

- Share certificates were the principal factor driving share growth in 2005, growing 20.4 percent. Share certificates in Regions 2 and 3 accounted for 108.9 and 107.7 percent, respectively, of their total share growth.

- New auto lending growth was strong in Regions 1, 2 and 3 (17.4, 16.1 and 16.6 percent, respectively) and especially in Region 5 (26.2 percent). Indirect lending was cited as the leading factor supporting this rapid growth. This trend is expected to fall off as dealer incentives are reduced or eliminated.

- Given the near-term challenges of the operating environment, Region 3 sees the pace of credit union consolidation continuing. High regulatory compliance costs for BSA and OFAC, along with tightening margins, could accelerate this pace further.

- First mortgage real estate loans grew by 10.2 percent in Region 4, with other real estate loans trailing just behind at 9.6 percent growth. Lower mortgage origination and slower new vehicle sales are expected in Region 4 in 2006. Regions 2 and 5 expressed special concern that the housing "bubble" will slowly deflate in some local housing markets.

- Two major local areas and competition from non-traditional financial firms are also cited. concerns cited for the coming year are a squeeze on net interest margins and a flattening yield curve caused by the current rising interest rate environment. Regions 3, 4 and 5 cited their number one concern was the net interest margin squeeze. Liquidity continues to be a problem with softening housing markets in some

NCUA Region One

NCUA Region 1 (Northeast) consists of the states of Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island, and Vermont. As of December 2005, there were 1,494 federally insured credit unions in the region, with total assets of $109.4 billion and a total membership of 13.4 million.

Lending

Region 1's loan growth during 2005 was 9.5 percent, compared to 10.6 percent for all federally insured credit unions (FICUs). During last year, loan growth was concentrated in real estate products, and to a lesser extent, light vehicle loan products. While the region's credit unions experienced a relatively strong demand for first mortgage loan products, home equity lending continued to expand by double digits. Over the course of 2005, first mortgage lending expanded by 8.7 percent, while "other" real estate loan demand (home equity/second mortgage) grew at over 16 percent. Despite the continuation of light vehicle maker/dealer finance incentives, new light vehicle lending for FICUs expanded by 17.4 percent, supported by indirect lending programs, member education about the true "costs" of dealer incentives, and increased Internet sales. However, almost half of credit union new vehicle lending came during the third quarter when the automakers rolled out their "buy like an employee programs." Used light vehicle loan demand rose by 4.8 percent during 2005. FICUs in Region 1 experienced modest pick-up in unsecured loan demand last year compared to 2004. Credit card and non-credit card unsecured lending expanded by 4.4 percent and 3.1 percent respectively, after increasing by 3.7 percent and 2.8 percent, respectively, in 2004. Finally, the region's credit unions experienced strong demand for member business loans during 2005, with outstanding loans increasing nearly 27 percent to $2.9 billion.

According to NAFCU's March 2006 Flash Report, near-term expectations for loan growth in Region 1 were more positive for three of the four loan categories. The responding credit unions felt that new light vehicle loan growth would be more robust, while there was anticipation of a modest decrease in used light vehicle loan demand. The credit unions in Region 1 are projecting continued growth in unsecured lending after a strong fourth quarter last year. Not surprisingly, the credit unions in Region 1 are slightly pessimistic about the near-term prospects for real estate lending. However, high inventory levels are likely to force home builders to offer incentives and limit pricing, and that should allow for a moderate demand for first mortgage loans.

Member Shares (Savings)

In 2005, Region 1's share growth was 2.0 percent, about 50 percent less than the 3.8 percent share growth for all FICUs. As with many FICUs, the region's share growth during 2004 was concentrated in share certificates and share drafts, which rose by 23.1 percent and 6.4 percent respectively. As many credit unions have chosen not to significantly increase the dividend rates of regular shares and money market shares, there was a net outflow of 6.4 percent and 7.7 percent respectively last year. With loan growth remaining strong in the region, some credit unions experienced a liquidity squeeze. As a result, many credit unions promoted CDs with maturities of one to five years to help fund loan demand. Other credit unions increased their borrowings from the FHLB and/or their corporate credit unions, and other credit unions chose to sell their portion of their first mortgage loan portfolio. In addition, some credit unions engaged in loan participations, while others promoted internet only share accounts similar to those offered by ING financial corporation. In the first half of the year, IRA/KEOGH accounts increased by 3 percent, while other shares/nonmember shares declined by approximately 25 percent. Many of the region's credit unions expect share growth to continue to remain weak during the first half of this year. According to the April Flash Report, the responding credit unions indicated that they believe share growth will increase moderately over the next several months. Last year, the strong loan demand coupled with the paucity of share growth resulted in the loan-to-share ratio increasing to 78.5 percent from 73.1 percent in 2004. The loan-to-asset ratio ended 2005 at 65.8 percent compared to 62.1 percent the previous year. Both ratios are at levels not experienced since the 1980s.

Earnings and Asset Quality

During 2005, the credit unions in Region 1 had an ROA of 0.80 percent compared to an ROA of 0.85 percent for all FICUs. While the region's credit union loan and investment yields and cost of funds were on par with the average for all FICUs, their relatively high net operating expense and lower net margins resulted in a lower ROA compared to all FICUs. The asset quality in the region was in line with the asset quality of all FICUs during last year. The delinquent loans-to-total-loans ratio in the region was 0.74 percent compared to 0.73 percent for all FICUs, while the net charge-off rate of 0.49 percent in the region was exactly the same as the overall FICU charge-off rate. However, bankruptcy was a problem in Region 1, as both the number of members filing for bankruptcy and the loan amounts subject to bankruptcy increased significantly last year. Total bankruptcy filings in the region increased 36.4 percent to 44,971, while loan charge-offs due to bankruptcy were $152.2 million compared to $111.8 million the previous year. The amount of loans subject to bankruptcy stood at $360.6 million as of the end of 2005. In addition, more and more of the region's credit unions are engaging in member business lending and indirect lending which add risk to their balance sheet. While credit unions tend to be risk-averse and tend to properly manage their balance sheets, overall asset quality could deteriorate a little as the portfolios mature.

Competition and Credit Union Operational Concerns for 2006

In Region 1, credit unions are seeing tough competition from large banks moving into the area via mergers. Bank of America and Fifth Third Bank are formidable competitors now, while Flagstar Bank and Citizens Bank have been very aggressive in attracting shares. Because liquidity is so tight right now, the competition is very keen for share certificates and money market shares. "If you want to get into the 'hot money' game, it can be very expensive" report the region's credit unions. Other financial institutions are being very creative by, for example, having high yield money market specials only for new money. In this way they prevent existing deposits from moving into the more expensive accounts. Region 1's credit unions have in general resisted this approach as it is not member friendly. Further, credit unions are also watching closely what happens with the Wal-Mart application for a bank charter as it could be a formidable new competitor. The region's credit unions mentioned liquidity, the flattening/inversion of the yield curve, and in some instances, local housing market conditions as the major operational concerns during this year.

Member Concerns and Economic Conditions in 2006

When asked to assess their members' confidence/sentiment, the majority of the region's credit unions indicated that their members were cautiously optimistic about 2006. Many members cited geopolitical uncertainty as a major concern, while others cited the rising interest rate environment, high energy costs, the low share rates, and the condition of the local labor market and/or the local government fiscal balance. Most members feel the economy will continue to grow at a decent pace, although there are concerns that consumer spending will weaken due to the slowdown in home appreciation and the debt burden of some members.

The overall economic and financial conditions throughout Region 1 improved over the course of 2005. However, pockets of weakness remain, particularly where manufacturing and high tech industries make up a large portion of the local economy. In addition, the region's economies are suffering from high energy costs. In Michigan, the economy continues to suffer from the financial troubles of the light vehicle manufacturers and parts manufacturers. In Connecticut, Maine, Rhode Island, and Vermont, the economies are in good shape. In Massachusetts and New Hampshire, the economic situations have improved, but the reliance on high tech and defense industries continues to create volatility. Finally, in New York, the tourism industry and Wall Street have recovered, yet economic weakness remains in the manufacturing centers of upstate New York.

NCUA Region Two

NCUA Region 2 (Mid-Atlantic) consists of the states of Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia, plus the District of Columbia. The region's federally insured credit unions (FICUs) have about 15.2 percent of the total assets of the nation, down by 0.1 percent from 2004. There are 13.0 million members in this region, up by 519,000 (4.2 percent) during last year. These percentages mirror the regional economy where the gross state product is about 13.8 percent of the U.S. gross domestic product. Regional production is more concentrated in government, professional services, and healthcare industries than the average concentrations found nationwide.

Lending

Region 2 FICUs generated loan growth of 12.4 percent during 2005, slightly more than the national average of 10.6 percent. Over the course of 2005, other real estate (primarily HELOCs and second mortgages) supplied 35.0 percent of loan portfolio growth, closely followed by first mortgage real estate loans at 34.8 percent. Combined real estate secured lending (first mortgages and HELOCs) accounted for 69.8 percent of the gain.

Looking forward to 2006, Region 2 FICUs anticipate higher loan growth for used vehicle loans and unsecured loans than do other regions' FICUs. Conversely, Region 2 FICUs expect real estate to moderate somewhat over the next 12-month period. New vehicle loan expectations are slightly less negative than FICUs nationwide.

Total auto loans in Region 2 advanced by 9.2 percent during 2005, compared to the rate of all FICUs at 9.4 percent. Region 2 new auto loans led the way, rising 16.1 percent for last year, while the used auto loan portfolio increased 3.0 percent.

Unsecured loans (excluding credit cards) represent 7.2 percent of all FICU loans in the region. This portfolio segment decreased 0.3 percent during 2005. Credit card loans increased 12.0 percent during the same period, representing 8.8 percent of all FICU loans in the region. The credit union leadership in the region does believe used vehicle loans will be a source of loan growth in 2006, and is more optimistic in this regard than some other regions in the country.

Member Shares

Member share deposits reached $87.2 billion in December 2005, up $3.0 billion (3.6 percent) from 2004. Share certificates contributed 108.9 percent of the increase during last year, followed by share drafts, which contributed 25.5 percent. Add in money market shares at a negative 4.2 percent and the number comes to 130.2 percent of 2005's increase from highly liquid accounts. In contrast, regular shares contributed a negative 48.8 percent of the regional savings growth, reflecting members' preference for higher returns.

For the next six months, Region 2 FICUs foresee some increase in share growth, but somewhat less positive than the share growth expectation found in most other regions.

During the 2005 year Region 2 FICUs share drafts (13.4 percent of Region 2 FICU shares) increased at a lower rate (7.0 percent) than during the same period in the previous year. (The 2004 region average was 10.6 percent growth.) Regular shares (36.5 percent of Region 2 FICU shares) grew a negative 4.4 percent during 2005. Money market share accounts (14.9 percent of FICU shares) reached $13.0 billion in December 2005, down by 1.0 percent. FICU share certificates (24.6 percent of FICU shares) experienced an 18.1 percent increase during 2005.

IRA accounts (9.6 percent of FICU shares) were a safe haven for members' precious retirement funds in 2005. This deposit segment advanced 5.5 percent last year compared to a national average of 3.4 percent.

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

With an increase in the provision for loan losses mainly due to increased bankruptcy during 2005, Region 2 credit unions experienced a slight decrease in consolidated ROA. At 0.95 percent (average ROA for all FICUs was 0.85 percent), this profitability measure decreased 9 basis points over 2004 for the region's credit unions. This is mainly due to the provision for loan losses which increased by 14 basis points over the same period. Some FICU management teams, however, expect a slight increase in ROA this year as a result of an expected increase in yields on loans.

Gross spreads increased by 38 basis points from 5.80 percent in 2004 to 6.18 percent in 2005. The ROA decreased among Region 2 FICUs despite the 31 basis points increase in cost of funds, and little change in the operating expense. Again, the change in the provision for loan losses accounts for most of the change in ROA.

Loan Loss Trends in 2005

Several Region 2 FICUs indicated that their lending growth had risen in the last several months, especially in the areas of unsecured loans. In the area of loan quality the 2005 Region 2 FICUs have a slightly lower delinquency ratio and slightly higher charge-off ratio than credit unions nationwide. The trend in bankruptcy is much lower among Region 2 FICUs than among credit unions nationwide. In 2005, loans subjected to bankruptcies increased by 9.1 percent in Region 2 FICUs, while nationwide the growth was 15.8 percent.

The primary operational concerns for 2006, cited by our regional credit unions, were savings growth and attracting new members. Some credit unions are noticing that members are moving savings out of credit unions to higher yielding accounts such as Internet banks like ING. Higher loan revenue (especially from auto sales) and a sanguine liquidity situation were mentioned as positives for future performance.

Member Concerns and Region 2 Economic Conditions in 2006

Credit union leadership in Region 2 viewed competition with non-traditional financial institutions as a primary concern for the region. Except for New Jersey, Pennsylvania, and Virginia their assessments of employment conditions were not improving in the region. Another concern cited was a possible decline in real estate values. Non-traditional financial institutions (e.g., ING and brokerage firms) were viewed as primary competition for savings, while banks and finance companies were viewed as primary competitors for loans. A similar view is held nationwide.

NCUA Region Three

NCUA Region 3 (Southeast) consists of Alabama, Florida, Georgia, Indiana, Kentucky, Mississippi, Ohio, North Carolina, South Carolina, and Tennessee, and the territories of Puerto Rico and the U.S. Virgin Islands. Region 3 finished the year with 1,822 federally insured credit unions (FICUs). This represents a net decline of 81 FICUs in 2005. Over the past three years, the Region 3 FICU count has fallen by 234 FICUs or 11.4 percent. Total assets in the region rose to almost $137 billion. This translates into an annual growth rate of 5.0 percent, which was marginally better than the 4.9 percent reading for the nation as a whole. The number of FICU members in Region 3 reached 19.1 million at year-end. The 322,200 member increase (1.7 percent), was solidly above the national average, but represents a growth slowdown from the 2.0 percent average over the previous three years. Total employment (full and part-time CU employees) is now in excess of 52,400. The 25 largest FICUs in the region hold 38 percent of all assets and 27 percent of the total membership.

Region 3 covers a wide expanse of geography ranging from the north end of Indiana to the southern tip of Florida. Thus, economic and employment conditions vary significantly. Additionally, three of the states in the region were significantly impacted by the 2005 hurricane season. Taking a high level view of savings and borrowing trends we can generalize that members remained somewhat upbeat for most of 2005. They are cautiously optimistic regarding 2006 based on employment gains and hurricane recovery spending in the southern part of the region. Longer-term, quality of employment and job certainty remain big issues. Region 3 has a significant manufacturing and agricultural employment base, and it is likely these sectors will continue to be squeezed.

Despite significant pressures from external events (rising interest rates, hurricanes and their aftermath, etc.), Region 3 FICUs were able to manage a very modest decline in their collective return on average assets (ROA). An ROA of 85 basis points is down just one basis point from 2004 results, but is the continuation of a declining trend both nationally and in Region 3. With the cost of funds rising faster than the yield on assets, margins have been squeezed. Going forward, this will continue to be a key challenge for all FICUs, but especially those with tight liquidity. The overall health of Region 3 FICUs, as measured by capital adequacy, remains very solid. During 2005, the net worth ratio climbed to 11.4 percent.

In an attempt to preserve their net interest margins, many credit unions have not moved up their checking and savings rates from their 2004 lows. Those credit unions that were able to rely on vehicle loans to grow will get almost fifty percent of their principal back eighteen months after they made the loans; thus, they may have the opportunity to increase their net interest margins shortly after the Fed stops increasing the Fed Funds rate. Those credit unions that relied on first mortgage loan growth may not be able to increase their margins if they kept those loans on their balance sheets.

Lending

The region's FICUs generated 9.6 percent annual loan growth in 2005. Gains in Region 3 reflect a growth slowdown, unlike the national trend which shows improving loan growth with a 2005 gain of 10.6 percent. During 2005, the loan-to-share ratio increased to 77.3 percent, a 388 basis point increase over year-end 2004. Despite the gain, Region 3 still trails the national average of 79.4 percent.

The 13.6 percent loan growth in Florida was top for the region and Georgia posts the slowest growth at 6.0 percent. Over the past six months, the annualized loan growth rate in Region 3 remained strong.

The $2.6 billion gain in first mortgages accounted for 32.5 percent of all Region 3 loan growth in 2005. When combined with home equity and second mortgage loans, the share of growth climbs to 51.6 percent. New vehicle loans accounted for 31.3 percent of the 2005 loan gain in Region 3 and used vehicles added another 10.3 percent. The share of 2005 loan growth accounted for by total vehicle lending was almost 42 percent in Region 3, this was significantly above results for all FICUs.

Overall, Region 3's vehicle loan results were good with the total portfolio increase coming in at 9.9 percent. This compares favorably to a national average of 9.4 percent in 2005. We believe a large share of this increase was attributable to member point-of-purchase borrowing (indirect loans). NCUA data shows that roughly 71 percent of the change in total vehicle loans outstanding can be explained by the change in indirect loans outstanding in Region 3. At the end of 2005, indirect loans equaled 32 percent of all vehicle loans; this was up from 28 percent at the end of 2004.

For the first quarter of 2006, vehicle lending growth was flat to negative for many of the large credit unions in the region. This is especially true for credit unions with mature indirect programs. The rising cost of a vehicle loan is reducing the volume of vehicle sales and the captive finance companies seem to be winning more of the business.

A total of 860 Region 3 FICUs reported originating first mortgage loans in 2005, up 61 from 2004. The dollar value of originations totaled $9.5 billion, up almost 10 percent from volumes in 2004. Approximately 84,000 first mortgages were granted by Region 3 FICUs during 2005 for an average mortgage loan of $113,200. Adjustable-rate first mortgages (ARMs) accounted for 29 percent of all first mortgage originations in 2005, down from 32 percent the prior year. In total, FICUs in the region grew their real estate secured loan portfolios by 11.1 percent in 2005. This included a 16 percent annual gain in non-first mortgage real estate secured loans. Currently, real estate secured loans account for 45 percent of all loans at Region 3 FICUs.

Mortgage lending remained relatively steady in the first quarter of 2006. Most credit unions continue to grow their volume of loans serviced. However, homes that were selling quickly last year are now staying on the market for much longer periods of time and some sellers are starting to reduce their prices. While power in the market has shifted from sellers to buyers, there are no indications that housing prices are about to sink precipitously. Most experienced observers seem to feel that prices will stagnate or decline a modest amount over a lengthy period of time before housing affordability improves enough for prices to begin to rise again.

Total Member Shares

Member savings deposits reached $117.6 billion at year-end, up just 4.1 percent for the year. Region 3's annual growth results were slightly ahead of the rest of the nation. Florida CUs hold 28 percent of all deposits in the region, but Mississippi generated the strongest annual growth at 26.8 percent. In Mississippi's case, it appears hurricane related insurance settlements are deposited at the credit union, but finding materials and/or contractors to rebuild is very difficult. Reconstruction of hurricane damage in the south will take quite some time.

Looking at the source of 2005's savings gains we see that almost 108 percent of the total gain came from share certificates which were up 19.4 percent for the year. FICUs in Region 3 actually lost regular share deposits as this savings portfolio segment was down 3.7 percent for 2005. With regular shares falling and certificates climbing, FICUs in the region saw a 30 basis point increase in their cost of funds. Based on discussions in the region, we believe a large portion of the certificate increase came from "odd maturity certificates," and in some cases members traded low yielding regular shares for these certificates. Given the widening spread between regular savings rates and certificate rates, savings deposits are likely to continue to move into higher yielding certificates of deposit.

Asset Quality and Operational Results

It is unlikely that we have seen the full impact of the hurricane season on asset quality results at this time. Asset quality as measured by the ratio of delinquent loans to total loans (0.80 percent) was up fractionally, but below the long-term average rate. The ratio of charge-offs to average loans actually fell in 2005 to 0.53 percent. While charge-offs and delinquencies have probably troughed for this economic cycle, a large increase does not appear likely in 2006.

As mentioned previously, the consolidated ROA for Region 3 CUs was 85 basis points, down just one basis point from 2004, but off 20 basis points from 2002. In 2005, 88 percent of Region 3 FICUs reported a positive ROA. FICUs experiencing a loss in 2005 represented just 1.8 percent of the region's assets. It should be noted that 523 FICUs (35 percent of all assets in the region) reported an ROA of 1.0 percent or better.

The overall health of Region 3 CUs remains solid although we are anticipating a more challenging operating environment in 2006 and going forward. Almost 70 percent of Region 3 FICUs had a capital-to-asset ratio of 12 percent or better. These FICUs represented 39 percent of the region's assets. Just 13 Region 3 FICUs report a capital-to-asset ratio below 7.0 percent, and these institutions represents only 0.1 percent of the assets in Region 3.

Given the outlook for a continued challenging operating environment in the foreseeable future, it would not be surprising to see the pace of credit union consolidation continue in 2006. The high cost of complying with the Bank Secrecy Act and the Office of Foriegn Asset Control, coupled with tightening margins, may further accelerate the pace of mergers.

NCUA Region Four

NCUA Region 4 (Midwest) consists of 2,545 credit unions in the states of Arkansas, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, and Wisconsin as of December 31, 2005. The credit unions in this region represent 29.3 percent of all federally insured credit unions (FICUs) and hold some $133 billion in total assets or 19.6 percent of the country's total credit union assets. There are approximately 18.6 million members in this region, down 182,000 (1 percent) over the past 12 months. During 2005, total assets grew by 2.7 percent and reserves and undivided earnings increased 4.9 percent to a total of $15 billion. Shares grew $1.9 billion (1.7 percent) during the twelve-month period while loan balances increased $5.7 billion (4.8 percent). As of December 31, 2005 share balances totaled $112.4 billion while outstanding loan balances were $91.6 billion. Region 4 FICUs' loan-to-share ratio increased from 77.7 percent in December 2004 to 81.5 percent in December 2005.

Lending

Loan growth in Region 4 was relatively strong in 2005, at 6.7 percent. Total outstanding loans for Region 4 were $91.6 billion, up nearly $5.8 billion from December 2004. Most loan categories experienced positive growth in 2005. Particularly strong were gains in mortgage lending and in new auto loans. Specifically, first mortgage loans grew by 10.2 percent (or $2.2 billion) and other real estate loans grew 9.6 percent (or $1.1 billion). Credit unions were able to grow new auto loans by 9.6 percent to $20.5 billion. Credit card and unsecured loans increased 5.3 percent and 0.2 percent respectively. Other loans grew 6.8 percent to $6.5 billion. The Region 4 loan-to-share ratio improved to 81.5 percent -- the highest year-end ratio since December, 2000.

Fixed-rate first mortgage loans grew 7.3 percent and adjustable-rate first mortgage loans rose 15.2 percent in 2005. Other fixed-rate real estate loans increased 13.0 percent while adjustable-rate HELOC loans rose 4.5 percent. Adjustable-rate mortgage loans as a percent of total mortgage loans outstanding increased to 38 percent.

Mortgage originations activity increased 1.2 percent from year-end 2005. The growth was most evident in other fixed-rate real estate loans and adjustable-rate first mortgage loans. During 2005, other fixed-rate real estate loans increased 9.3 percent and first mortgage adjustable-rate loans grew 3.0 percent. Loan participations continued on a strong growth trend increasing 17.2 percent while indirect loans outstanding improved 14.4 percent.

Credit unions have mixed views on the outlook for loan growth in 2006. Higher long-term interest rates and a slower housing market should result in lower mortgage loan origination activity in 2006. Additionally, new vehicle sales are expected to slow as auto manufacturers cut production and reduce incentives.

Asset Quality

Credit unions in Region 4 continue to do a good job in managing credit risk and the outlook for loan quality remains very positive. The region's average delinquency rate was 1.00 percent, slightly higher than the national average of 0.73 percent. Total delinquent loans as a percentage of net worth increased to 6.08 percent from 5.51 percent in December, 2004.

Investments

With loan growth strong relative to share growth, total cash and investments decreased moderately, down 9.2 percent in 2005. Total investments declined $2.73 billion, while total cash fell 0.9 percent or 83 million in 2005. Credit unions continued to keep the majority of their investment maturities short term. Approximately 89 percent of all cash and investments are expected to mature or reprice within three years and over 60 percent are expected to mature or reprice within 12 months. The largest category of gain in dollar amount within the investments category was investments in corporate credit unions, adding 9.7 percent or $370 million. Numerous investment categories experienced declines in 2005 including U.S. Government obligations, Federal Agencies, mutual funds, and bank and S&L certificates of deposit.

Member Shares and Liabilities

Shares grew slightly during 2005, up 1.7 percent from December 2004 levels. Total shares stood at $112.4 billion as of December 2005. Most of the growth occurred in three categories: share certificates, up $4.07 billion to $29.4 billion (16 percent growth); share drafts, up $496 million to $14.7 billion (3.5 percent growth); and IRA/KEOGH accounts, up $161 million to $9.2 billion (1.8 percent growth). Regular shares decreased $1.42 billion or 3.4 percent while money market shares fell $1.44 billion or 8.1 percent.

Prospects for share growth will depend on the relative performance of the stock market and short-term money market accounts as an alternative for members' excess funds. The employment market and relatively strong income growth could add to the credit union share base in Region 4. In general, share growth is expected to lag loan growth, putting further upward pressure on loan-to-share ratios.

Credit unions in Region 4 were less reliant on borrowed funds as a liquidity source in December 2005. Notes payable declined 22.8 percent to $2.5 billion.

Earnings

The return on average assets decreased to 0.72 percent as of December 31, 2005 from 0.85 percent at year-end 2004. During 2005, the yield on average loans fell 10 basis points to 6.10 percent and the yield on average investments increased 65 basis points to 3.12 percent. However, the cost of funds-to-average assets ratio increased by 32 basis points to 1.77 percent and the operating

expenses-to-average assets ratio increased 3 basis points to 3.42 percent.
These factors combined to bring average Region 4's net interest margin-to-average-assets ratio down to 3.21 percent from 3.33 percent.

Member Concerns for 2006

When managers are asked to assess their primary concerns, the majority of the region's credit unions are cautiously optimistic about 2006. However, most credit unions express concern over declining net interest margins and liquidity as major challenges in the foreseeable future, while others cited low share rates and the rising interest rate environment. Most credit unions believe that overall economic and financial conditions will remain healthy in 2006. However some executives expressed concerns about inflation, consumer spending, declining loan demand and a softer housing market.

General Economic Conditions

Economic activity in the Midwest continued to expand at a moderate pace in the second half of 2005. Consumer spending continued to increase gradually supported by strong income and employment gains, but high energy prices have some concerned about the economic outlook. Business spending and hiring expanded at a modest growth rate while construction related activity remained brisk. Additionally, manufacturing activity continued at a solid pace while activity in the service sector was also expanding moderately and agricultural conditions declined slightly. Price pressures remain modest outside the energy-related sectors.

NCUA Region Five

Region 5 consists of 13 states and two territories: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, Wyoming, and the Territories of Guam and American Samoa. As of December 31, 2005, the region's 1,408 federally insured credit unions comprised 15.0 percent of all federally insured credit unions and held some $196 billion in total assets, 28.9 percent of the nation's total credit union assets. Credit unions across the country continue to attract new members and the credit unions in Region 5 saw membership increase by 444,000 in 2005 to 20.6 million members. Total assets grew by 7.5 percent and reserves and undivided earnings increased 8.4 percent to a total of $20.6 billion. Shares grew $10 billion (6.3 percent) over the year period, while loans increased $16.6 (13.9 percent). On December 31, 2005 share balances totaled $168.5 billion while outstanding loans came in at $136 billion. The loan-to-share ratio rose from 75.4 in December 2004 to 80.8 in December 2005.

Loan Growth

Loan growth in Region 5 for 2005 was a very strong 13.9 percent, pushing total loans up to $136 billion at December 31, 2005, or 69.5 percent of total assets. Loans comprised 65.5 percent of assets at the end of 2004.

Growth in real estate loans continued at a strong pace. Residential first mortgage loans grew by 13.8 percent and other real estate loans grew by 25.5 percent.

The volume of new real estate loans granted grew by 17 percent from year-end 2004. The growth was most evident in fixed-rate first mortgages, secondary mortgages, and HELOCs. Total first mortgage loans stood at $43.5 billion as of December 31, 2005. While total first mortgage adjustable-rate loans held on the balance sheet of credit unions grew by 11 percent in 2005, total new adjustable-rate loans granted in 2005 fell by 10 percent. At year-end 2004, ARMs comprised 32.8 percent of the first mortgage category held by credit unions. On December 31, 2005, ARMs comprised 32.0 percent of first mortgages. HELOCs grew by 19.8 percent, bringing the total value of HELOCs to $12.5 billion. For the region, real estate loans made up 47.8 percent of total loans, which is slightly higher than the end of 2004.

Auto loans grew 12.9 percent during 2005. New auto lending surged by 26.2 percent, while used auto lending rose by only 1.5 percent. With the Big Three automakers turning toward price incentives instead of financing incentives to move autos, the new car lending market opened to credit unions. Many credit unions in Region 5 have been aggressive in building market share by offering attractive auto lending rates. Growth in indirect auto lending has been the primary factor fueling portfolio growth.

Member business lending activity continues to grow as credit unions start to assist members in this area. Originations increased sharply to $8.1 billion from $5.9 billion at year-end 2004.

Credit unions have mixed views on the outlook for loan growth for 2006. Refinancing activity has declined sharply in the last few months and further declines are predicted. However, reasonably low interest rates and more aggressive marketing of hybrid ARMs should help support purchase activity for credit unions with competitive mortgage lending programs. Some credit unions, especially in Hawaii and California, are becoming concerned that affordability is becoming a significant factor for members seeking to buy that first home or trade up. Credit unions in those areas are concerned that real estate lending could slow due to that factor. Higher short-term rates are expected to severely curtail growth in HELOCs.

Auto lending for new autos is expected to cool from the rapid pace in 2005, but credit unions expect to see continued growth in indirect auto lending as existing players increase their activity and new credit unions enter the market. Member business lending is another bright spot for some credit unions. The outlook for unsecured lending continues to be very weak.

Loan Quality

Credit unions continue to do a good job in managing credit risk and generally remain positive about the outlook for 2006. The delinquency/total loans ratio declined to 0.52 percent from 0.57 percent in December 2004. The net charge-offs/average loans ratio also showed improvement from 0.59 to 0.52. For those credit unions with heavy concentrations of mortgage loans, there are concerns that a decline in home prices will increase delinquencies and charge-offs, especially in the home equity lending area. But those concerns are now minor.

Share Growth

Shares grew at a 6.3 percent growth rate to $168.5 billion. Regular share accounts declined by 1.9 percent, while share drafts grew 10.1 percent. Money Market Share balances declined by 1.6 percent. With rising interest rates, share certificate balances grew by a strong 23.8 percent, as higher interest rates enticed members to lock in longer-term rates. The growth in certificates was evenly split between maturities of one year to three years and maturities greater than three years. As of December 31, 2005, share certificates represented 27.3 percent of total balances, compared to 23.3 percent at the end of 2004. Although liquidity is not a big issue for most credit unions, we are seeing an increase in borrowing for liquidity. This demand is generally coming from credit unions that have been aggressive in the indirect lending programs. Borrowing increased for most of 2005 but declined in the fourth quarter to a modest $4.5 billion. Several credit unions are looking to the derivatives market to hedge the cost of share balances and short-term certificate issuance. Region 5 credit unions generally expect share growth will be relatively weak for 2006.

Investments

Investments declined in 2005, with the balance at $41.4 billion or 21.1 percent of total assets at the end of the year. Holdings of federal agency securities declined by 5.9 percent, to a total of $20.5 billion. Holdings of corporate certificates fell by 1.7 percent from $12.5 billion to $12.3 billion. Investments maturing in less than one-year were 50 percent of total investments, while investments between one and three years comprised 37 percent of the total. The average yield on investments increased 2.64 percent to 3.23 percent as low yielding investments purchased in 2003 and 2004 matured and were replaced by higher yielding investments. Credit unions should continue to see increases in portfolio yields.

Earnings

Average return on assets in 2005 was 0.93 percent, which is a decline from 0.96 percent at the end of 2004. The average yield on loans declined from 6.11 percent to 6.02 percent. The cost of funds/average assets ratio rose from 1.31 to 1.65. The overall net interest margin declined from 3.44 to 3.32. Operating expense/gross income was at 52.6 percent, down from 55.2. Fee income rose from $1.34 billion to $1.49 billion, a gain of 11.5 percent.

General Economic Conditions and Credit Union Concerns

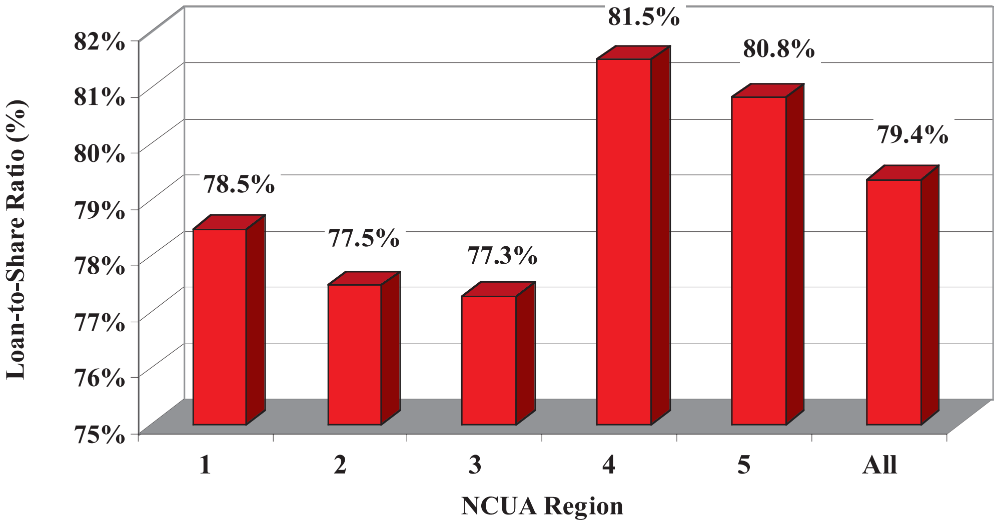
Economic conditions in the Western Region generally improved in 2005, fueled by the growth in the housing market and rising home prices. Recent data shows improvements in the labor market, consumer spending, commercial real estate, information technology, service, and manufacturing industries. The most critical factor, the labor market, has shown marked improvement in 2005 with job growth becoming more consistent and less sporadic. Increased household spending, driven by the rise in home prices, resulted in gains in services, travel and home furnishings.

Home sales were strong throughout the region in 2005, but the housing market has recently shown signs that it might be "cooling off." Affordability is becoming a particular issue in the states of California and Hawaii.

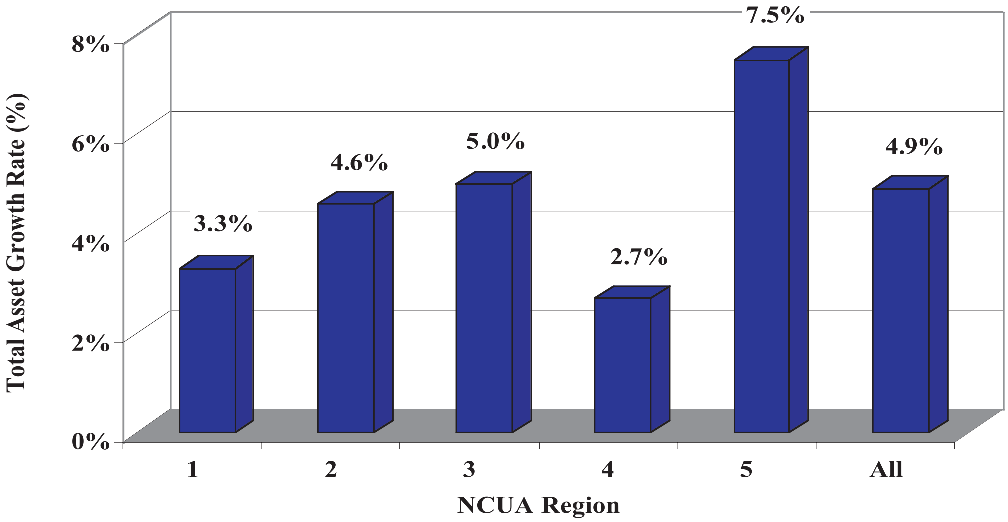
The number one concern expressed by credit union executives is the squeeze on net interest margins. The pace at which the Fed raises short-term interest rates as well as the shape of the yield curve will primarily drive the speed of compression. The full impact of higher rates has yet to be felt because retail deposit rates at credit unions are dramatically lagging changes in the wholesale market. Early in 2005 most financial institutions were lagging the market, but that seems to be shifting. Credit unions may find that a more competitive deposit landscape will speed margin compression. To offset declining margins, many credit unions are seeking ways to increase fee income, enter new lending sectors, and/or become more competitive in the mortgage lending area. Most credit unions remain wary of putting long-term assets on their books in the current environment because they do not want to increase their interest rate sensitivity as rates continue to increase. Additionally, the flat yield curve does not offer an attractive risk/reward ratio for extending investments and other assets.

Appendix A:
NCUA Regional Financial Ratio Analysis

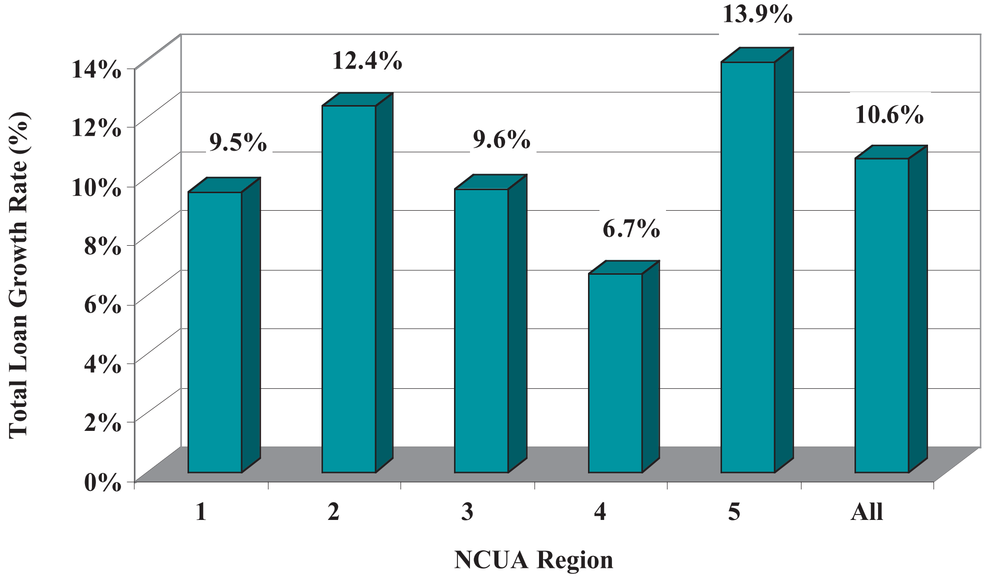
Loan-to-Share Ratios
Federally Insured Credit Unions By NCUA Regions
December 2005



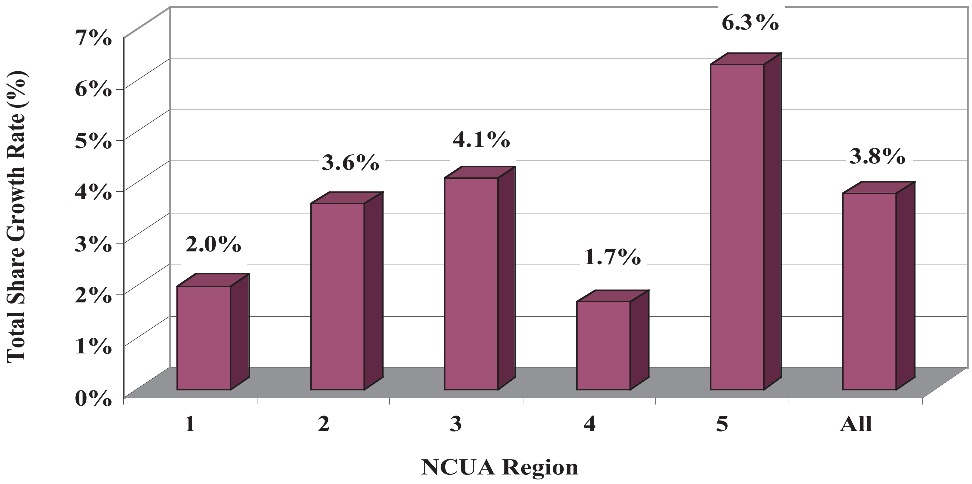
Total Asset Growth
Federally Insured Credit Unions By NCUA Region
December 2005



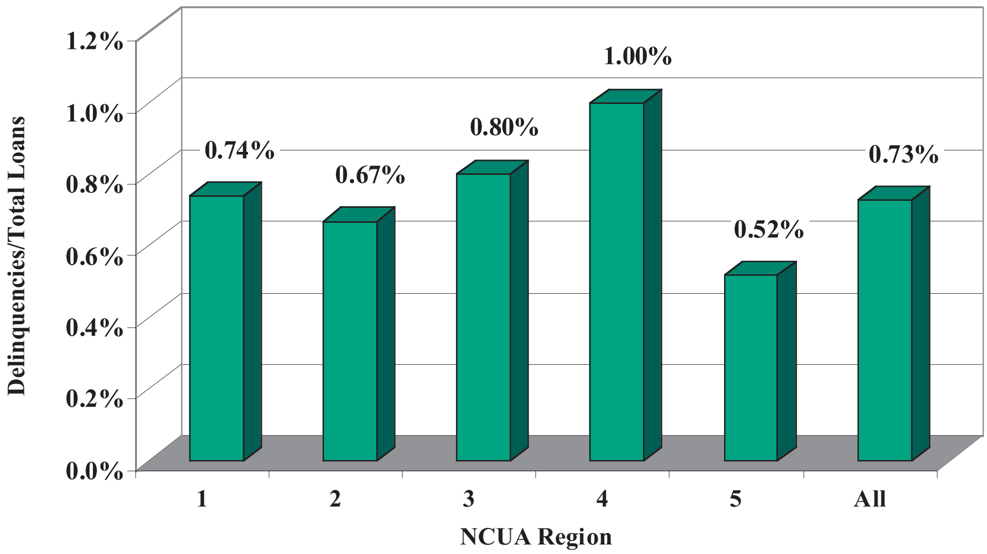
Total Loan Growth
Federally Insured Credit Unions By NCUA Region
December 2005



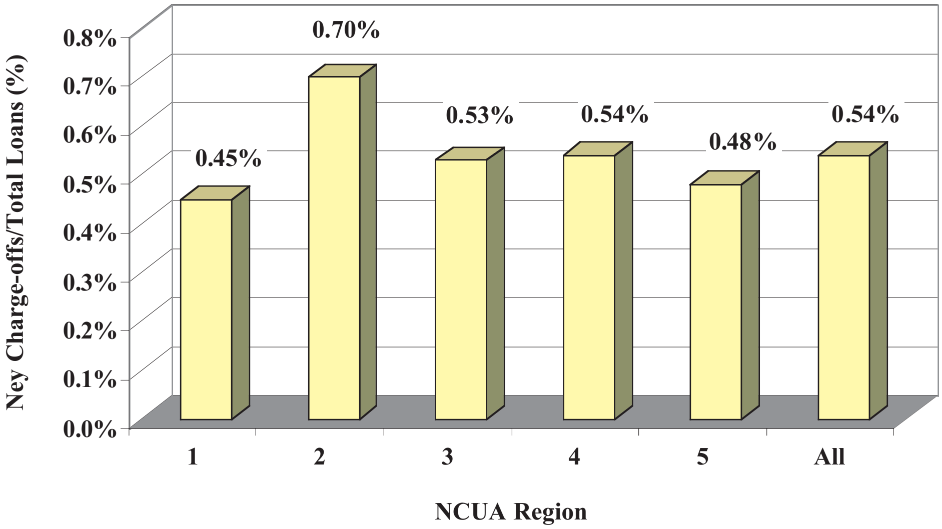
Total Share Growth
Federally Insured Credit Unions By NCUA Regions
December 2005



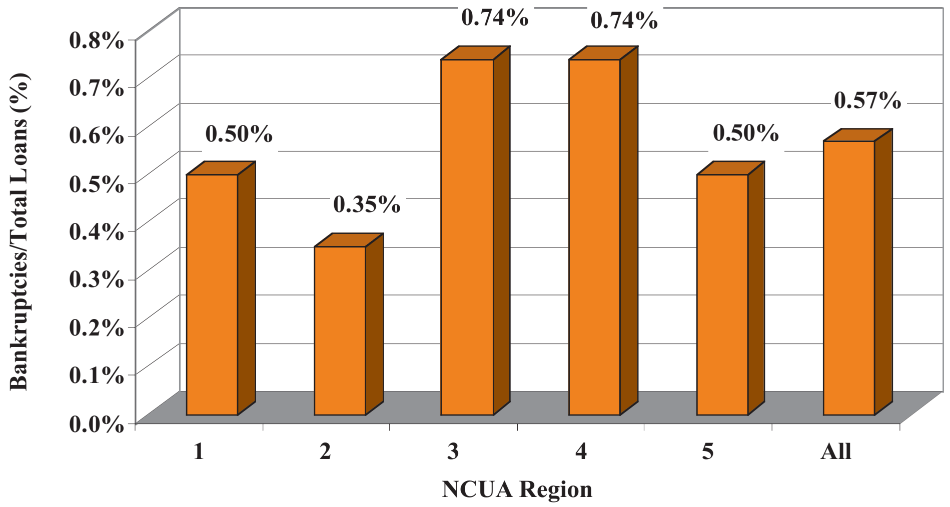
Delinquency Ratio
Federally Insured Credit Unions By NCUA Region
December 2005



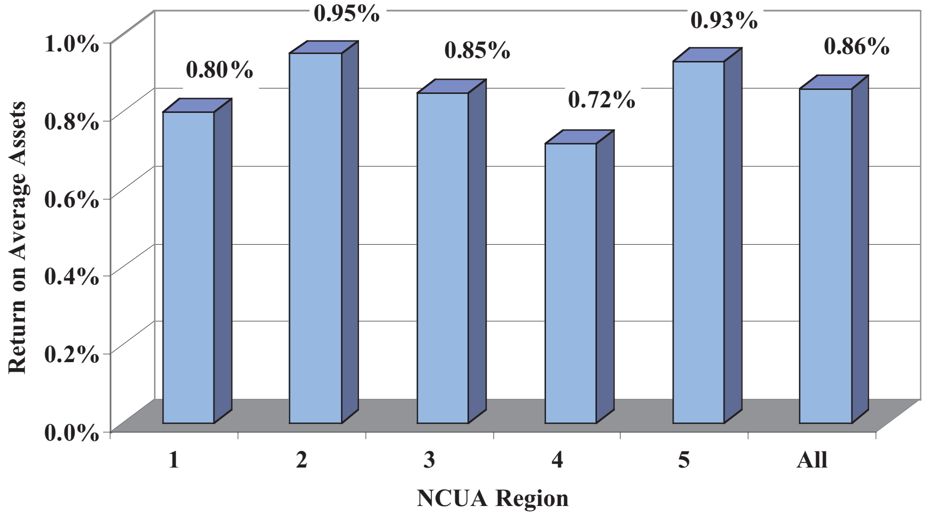
Net Charge-Offs/Average Loans
Federally Insured Credit Unions By NCUA Region
December 2005



Bankruptcies/Total Loans
Federally Insured Credit Unions By NCUA Region
December 2005

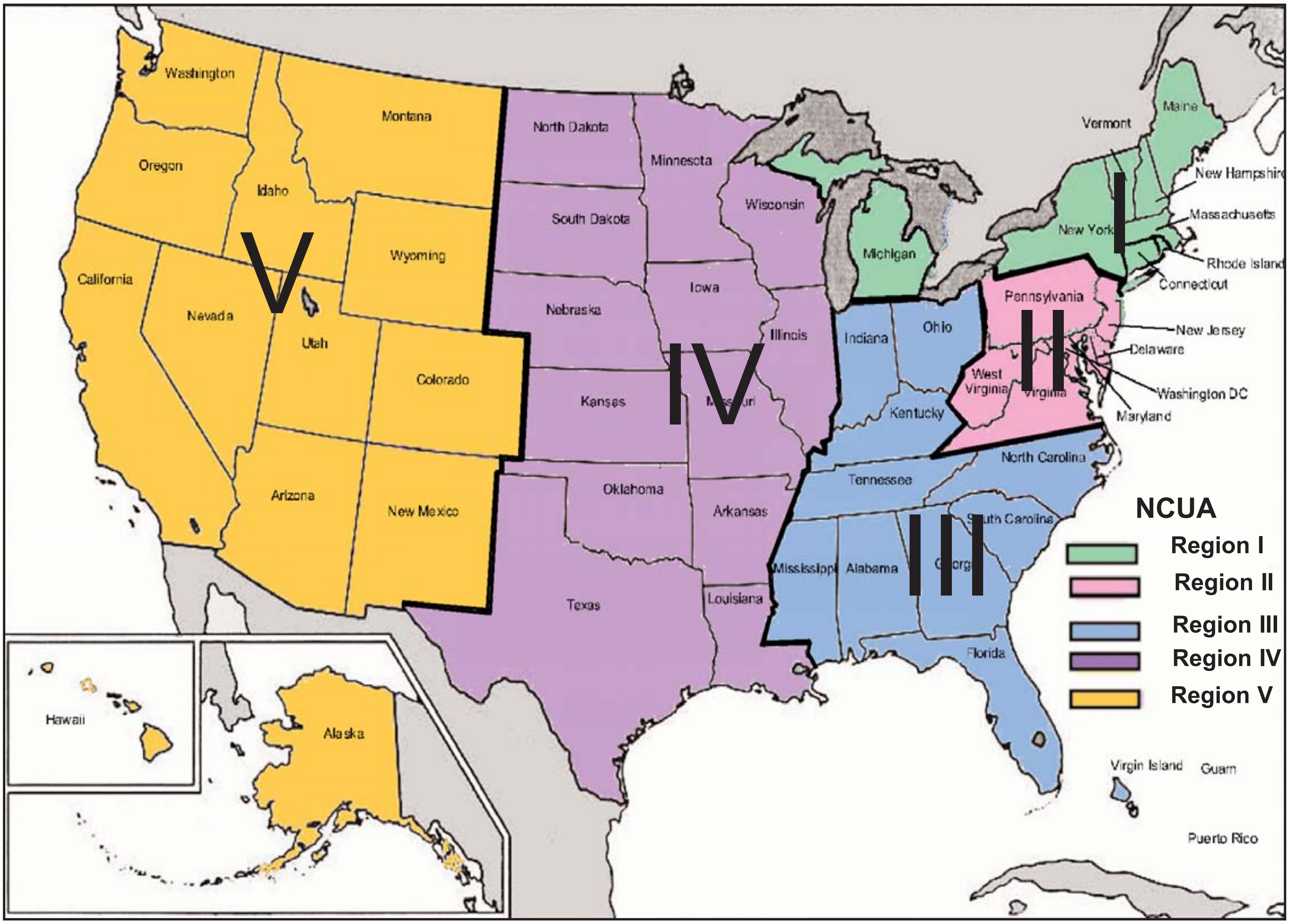


Return on Average Assets
Federally Insured Credit Unions By NCUA Region
December 2005



Appendix B: NCUA Regions

NCUA Regional Breakdown



Source: NCUA