CUEG

Credit Union Economics Group
Regional Report
Spring 2008

April 2008

Credit Union Economics Group
www.cueg.org

Credit Union Economics Group

Bruce Beaudette: Bruce Beaudette is the President/CEO of Sunmark Federal Credit Union. Bruce has been working in credit union management for 27 years and has been in his current position for 21 years. Bruce was also a Senior Accountant for 1st Maryland Bancorp. Bruce is a current Board member of Members United Corporate FCU in Chicago, IL (formerly Empire Corp.) where he has served for the past 17 years and is a former chairman. Bruce has a Bachelors Degree in Business Administration from Siena College and an MBA from Russell Sage College.

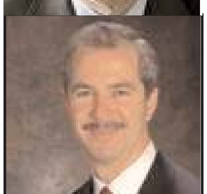
Steve Brewer: Steve Brewer has been the Chief Financial Officer for Michigan Schools and Government Credit Union in Clinton Township, Michigan since 2002. Prior to joining MSGCU, Steve held finance and accounting positions with two credit unions, a savings and loan and a cruise line. Steve earned a Bachelors degree in Finance and Real Estate from the University of Texas, an M.B.A. from Texas A&M Corpus Christi and is a licensed Texas CPA.

David Colby: Dave Colby is the Chief 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 Federal Credit Union in Lenexa, Kansas as Executive 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's and Master's degrees in Finance from East Texas State University.

Dwight Johnston: Dwight Johnston is the Vice President of Economic and Market Research for Western Corporate Federal Credit Union (WesCorp). Mr. Johnston has more than 30 years' experience in the investment business. Before joining WesCorp in 1998, he spent 13 years as manager of the Capital Markets Division at the Bank of the Southwest in Houston and 11 years at the brokerage firm Rauscher Pierce in Dallas. Mr. Johnston has a Bachelor's degree in Finance and Economics from the University of Texas at Austin.



Eli Vazquez: Eli Vazquez is Senior Vice President and Chief Financial Officer of American Airlines Federal Credit Union in Fort Worth, Texas, a position he's held since 2006. Vazquez joined AA Credit Union in 2005 as SVP of Financial Services. Prior to American Airlines CU, Vazquez worked for American Airlines in several capacities. Vasquez holds a bachelor's degree in chemical engineering from Tulane University and a master's degree in business administration from the University of California at Berkeley.

Tun Wai: Dr. Tun A. Wai is the Director of Research and Chief Economist for NAFCU in Arlington, Virginia and is in his twenty-first year there. Dr. Wai is responsible for creating many products and services for NAFCU member credit unions. 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. Prior to NAFCU, he held research positions with the World Bank, the Federal Reserve, and the Brookings Institution.

Executive Summary

- As of Dec. 2007, federally insured credit unions' (FICU) asset growth was 6.1 percent, up 1.5 percent points from Dec. 2006. Region II showed the greatest results with a 10.45 percent growth in total assets compared with just 5 percent in Region III.

- Return on Average Assets (ROA) for Region II was 0.76 percent during 2007, 11 basis points above the 0.65 percent figure for all FICUs and 16 basis points higher than Region I's 0.60 percent. Compared to Dec. 2006, ROA for all FICUs experienced its biggest decline in four years falling 17 basis points to Dec. 2007.

- After declining in 2006 by 6.8 percent, share drafts saw a slight increase of 1.9 percent for all FICUs in 2007. This is only attributed to Region II, which saw the only increase out of all Regions with a share draft growth rate of 34.5 percent. Region III saw a decline in growth by 6.2 percent. Overall, share growth was up 5.19 percent. Share certificates were the principal factor driving share growth in 2007, growing 14.4 percent and accounting for 87.26 percent of total share growth.

- New auto lending declined by 1.8 percent in 2007 on the national level, with Regions III and V reporting the strongest declines (2.3 and 3.6 percent, respectively). Only Region II saw an increase of 4.3 percent as of Dec. 2007.

- First-mortgage real estate loans grew by 12.3 percent during 2007, which is the highest growth rate in four years. Other real estate loans had 8.7 percent growth, though total growth in 2007 was 620 basis points down from 2006. First mortgages continued to be the lion's share of FICU loan growth (60.30 percent), although the weakened housing market has seen a slight decline in overall real estate loan growth.

- The delinquency ratio was up in 2007 by 25 basis points to .93 percent for all FICUs. Across the country, the delinquency ratio was as low as .75 percent in Region II and as high as 1.09 percent in Region IV. After being down by nearly 65 percent in 2006, the number of members bankrupt increased 35 percent at the end of 2007.

- Most regions cited the increase in competition with banks as a challenge for the upcoming year. In addition, many noted that their outlook for the future is a cautious one as they anticipate a further increase in the bankruptcy rate and more people defaulting on their loans. Due to declining credit quality and collateral values, they look for this trend to continue throughout 2008 and possibly into 2009.

- Despite economic concerns and downfalls, credit unions are still financially sound and showing strong asset quality. The net charge-off ratio is up by 5 basis points in 2007, however, compared to years prior to 2006, it is still relatively low. While other financial institutions tighten their credit standards, credit unions will continue to serve their members that are in need. Many credit unions have taken steps to educate their members about financial topics.

NCUA Region One

NCUA Region I (Northeast) consists of the states of Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island, and Vermont. As of December 2007, there were 1,378 federally insured credit unions in the region, with total assets of $118.8 billion and a total membership of 13.6 million.

Lending

Loans in Region I during 2007 grew 3.9 percent to $79.5 billion, nearly 2.7 percent less than the pace for all federally insured credit unions (FICUs) nationwide. During 2007 loan growth was concentrated in first-mortgage real estate loans, and to a lesser extent, other real estate loans. The region's credit unions experienced a relatively strong demand for first-mortgage loan products, while home equity lending did not expand as much as it did in 2006. During 2007, first-mortgage lending expanded by 6.6 percent, while "other" real estate loan demand (home equity/second mortgage) grew by 4.4 percent. At the end of last year, real estate loans comprised 61.3 percent of all loans in the region. Light-vehicle loan portfolio growth slowed sharply during 2007. New light-vehicle loans declined 1.9 percent during 2007 after growing 4.4 percent in 2006. Uncertainty in interest rates, rising energy costs, and aggressive financing and incentives from the vehicle makers have constrained loan growth during 2007. Used light-vehicle loan demand slowed from 0.9 percent in 2006 to 0.1 percent during 2007.

Unlike all FICUs that experienced a strong increase in unsecured loans, credit unions in Region I experienced a slower growth in unsecured lending. Credit card lending increased in 2007 by 6.9 percent, while non-credit card unsecured lending increased by 5 percent. Finally, the region's credit unions experienced strong demand for member business loans during last year. Member business loans outstanding grew by 12.6 percent to over $4.2 billion.

According to NAFCU's March 2008 Flash Report, near-term expectations for loan demand in Region I were less favorable for three out of the four loan categories than for all credit unions. The responding credit unions felt that light-vehicle loan growth, especially new light vehicles, would be sluggish. There was also anticipation of unsecured lending remaining flat in 2008. However, the near-term prospects for real estate lending were more favorable than other parts of the country, especially the category of fixed rate mortgages with maturities greater than 15 years.

Member Shares (Savings)

In 2007 share growth in Region I was 4.2 percent, slightly lower than the share growth experienced by all FICUs. Unlike many FICUs which saw share growth dominated by share certificates and money market shares, the region's share growth during 2007 was concentrated in share certificate, IRA/KEOGH accounts, and money market shares which rose by 11.6 percent, 8.3 percent, and 5.1 percent respectively. As many regional credit unions have chosen to decrease their interest rates on regular shares and share drafts, there was a net outflow of 2 percent, and 2.7 percent respectively during 2007. "Other" shares also saw a decrease of 10.7 percent this year. Many credit unions are still promoting CDs by maintaining competitive rates. Some credit unions, however, are allowing the "hot" money to leave since loan demand is not as strong. In 2007, nonmember deposits decreased by 12 percent, similar to the negative growth rate among all FICUs of 12.1 percent. Many of the region's credit unions do not expect share growth to continue to remain strong over the near term. During last year, the weak loan demand, coupled with strong share growth, caused the region's credit unions' loan-to-share ratio to decrease from 80.8 percent in 2006 to 80.6 percent in 2007. The loan-to-asset ratio among all credit unions was 83.3 percent compared to 82.2 percent at the end of 2006.

Earnings and Asset Quality

During 2007, the credit unions in Region I had an Return on Average Assets (ROA) of 0.60 percent, down from 0.68 percent in 2006. This is less than the 2007 ROA of 0.65 percent and a 2006 ROA of 0.82 percent for all FICUs. While the region's credit unions' loan yields were on par with the average for all FICUs, the region's investment yields were lower than for all FICUs. In addition, the region's cost of funds were slightly lower than for the universe of FICUs; however, credit unions in Region I generated substantially less non-interest income than the average for all FICUs. This lower non-interest income is the main reason for the lower ROA compared to all FICUs.

The asset quality in the region was mixed in comparison to the asset quality of all FICUs during the first half of this year. The delinquent loans-to-total-loans ratio in the region was 0.94 percent compared to 0.93 percent for all FICUs, while the net charge-offs/average loans rate of 0.44 percent in the region was lower than the overall FICU charge-offs/average loans rate of 0.50 percent. During 2007 member bankruptcies were an increasing problem in Region I, as the annualized number of members filing for bankruptcy increased significantly while the loan amounts subject to bankruptcy decreased. The total number of bankruptcy filings in the region increased 29.8 percent to 23,312, while the loan amounts subject to bankruptcy decreased to $252.3 million. The latter number was up from $144.2 million as of the end of 2006. In addition, more and more of the region's credit unions are engaging in member business lending because banks have curtailed lending to smaller business loans. The overall asset quality of these loans remains positive despite the fact that the turmoil in the housing and financial markets have impacted local economies.

Competition and Credit Union Operational Concerns for 2008

In Region I, credit unions are still seeing tough competition from regional banks, particularly for member business, indirect light-vehicle loans and especially share certificates on the deposit side. Because of this, the competition for credit unions is very keen in all key areas. The cost of funds remains very high and margins are still tight for most of the region's credit unions. The reasons for a rising cost of funds are a greater reliance on share certificates and less reliance on traditional sources (such as regular shares and share drafts). This has made credit unions in Region I continue to focus on operational efficiencies and a growing reliance on non-interest income in order to counterbalance this trend and the margin compression of late.

Member Concerns and Economic Conditions in 2008

Credit unions in Region I remain cautiously optimistic about the remainder of 2008 and into 2009. There is some new optimism since the Fed moved to lower interest rates and with the assumption that further loosening may occur this year. There is hope that their cost of funds will decline and compressed margins will thus be alleviated to some degree. Intense competition from the large regional banks is still a big concern but credit unions here are doing their best to deal with it as it is not going away.

Most credit unions have seen overall lending extremely slow in the first quarter this year, especially in March which tends to be more robust. Possibly due to cold/bad weather, new auto loans/sales have been very slow. Home equity loans are equally slow. Used autos have grown moderately. Most credit unions are seeing their delinquency rates rise steadily with charge-offs lagging (rising but at a slower pace). Bankruptcies appear to be rising as well. There has been some growth in loan losses in real estate portfolios, especially on home equity loans, but nothing alarming at this point. Deposit growth appears to be flat overall, depending on how much a credit union wants to chase the hot CD money. Members may be paying off debt with their income tax refunds since the usual rise in deposits this time of year is not being seen.
Domestic manufacturers are feeling competition from foreign manufacturers such that domestic auto dealers are assuming that consumers who purchase with cash do not exist. Domestic manufacturers still have difficulty in convincing consumers that their vehicle products are equal or better in quality than their foreign competitors. Plant closing and lack of vehicle sales have impacted not only local economies, but also local governments staff levels.

NCUA Region Two

NCUA Region II (Mid-Atlantic) consists of the states Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia, plus the District of Columbia. The region's federally insured credit unions (FICUs) have about 16.2 percent of the total assets of the nation, up by 0.8 percent from December 2006. There are 13.4 million members in this region as of December 2007, up by 330,821 (2.5 percent) from the end of 2006. These percentages mirror the regional economy where the gross state product is about 13.6 percent of the U.S. gross domestic product. Regional production is more concentrated in professional services, government and healthcare industries than the average concentrations found nationwide.

Lending

Region II FICUs generated loan growth of 13.7 percent during 2007, more than twice the national average of 6.6 percent. Over the course of 2007, first-mortgage real estate loans supplied 48.9 percent of loan portfolio growth, closely followed by other real estate loans at 23.3 percent. Combined real estate-secured lending (first mortgages and HELOCs) accounted for almost three quarters of the gain.

Looking forward to 2008, Region II FICUs anticipate higher loan growth for used vehicle loans than do FICUs in other regions. Conversely, Region II FICUs expect new vehicle lending to moderate somewhat over the next 12-month period. Real estate loan expectations are slightly more positive than those of other FICUs nationwide.

Total auto loans in Region II increased by 5.2 percent during 2007, compared to the rate of all FICUs at negative 0.1 percent. In Region II the used auto loans led the way, rising 6.2 percent during last year, while new auto loan portfolios increased 4.3 percent.

Unsecured loans (excluding credit cards) represent 9.6 percent of all FICU loans in the region. This portfolio segment increased 18.8 percent during 2007. Credit card loans increased 8.6 percent during the same period, representing 6.5 percent of all FICU loans in the region. The credit union leadership in the region believes that unsecured loans will be a positive source for loan growth for the near term, and at a slightly more optimistic level than that found among all credit unions across the country.

Member Shares

Total savings/deposits reached $99 billion in December 2007, up $7.4 billion (8.1 percent growth) from December 2006. Share drafts contributed 38.6 percent to the overall savings growth during this year, while share certificates contributed 83.3 percent. Add in money market shares at 33.2 percent contribution and the number comes to 155 percent of 2007's increase came from highly liquid accounts. In contrast, regular shares had a negative contribution of 71 percent, reflecting members' preference for higher returns.

For the next six months, Region II FICUs foresee a significant increase in share growth, much more than the other credit union share growth expectations found in most other regions.

During 2007, Region II FICUs share drafts (11.3 percent of Region II FICU shares) increased 34.5 percent since year-end 2006. Regular shares (26.1 percent of Region II FICU shares) decreased 16.9 percent during 2007. Money market share accounts (17.3 percent of FICU shares) reached $17.1 billion as of December 2007, up by $2.5 billion (16.4 percent growth) from December 2006. FICU share certificates (33.9 percent of FICU shares) experienced a 22.5 percent increase during 2007.

IRA accounts (10.5 percent of FICU shares) were a safe haven for members' precious retirement funds in 2007. This deposit segment advanced 12.6 percent for last year compared to a national average of 9.3 percent.

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

With an increase in the cost of funds mainly assisted by higher dividend rates during 2007, Region II's credit unions experienced a decrease in consolidated ROA. At 0.76 percent (average ROA for all FICUs was 0.65 percent) this profitability measure decreased 27 basis points since 2006 for the region's credit unions. This is mainly due to the increase in cost of funds (up 49 basis points), provision for loan losses (up 17 basis points) and operating expenses (up 6 basis points). Some FICU management teams, however, expect further decreases on ROA this year due to the length of time for any Federal Reserve actions to impact their cost of funds and the hesitancy of some credit unions to decrease their dividend rates.

Gross spreads increased by 45 basis points from 6.8 percent in 2006 to 7.25 percent in 2007. The ROA decreased among Region II FICUs despite the 19-basis-point increase in yield on average loans, and a 77-basis-point increase in the yield on average investments. Fee income and other operating income/average assets (up 4 basis points) did slightly help the ROA level for the regional credit unions.

Loan Loss Trends in 2008

Several FICUs in Region II indicated that their lending growth had not risen as strongly as the regional average for the last several months, despite lowering lending rates. In the area of loan quality, the 2007 Region II FICUs had a slightly lower delinquency ratio and slightly higher charge-off ratio than credit unions nationwide. However, some credit unions have experienced a rise in charge-offs for the first time. The trend in bankruptcy among Region II FICUs saw a lower percentage when compared to the pattern found among credit unions nationwide. In 2007, the loans subject to bankruptcies as a percentage of total loans was 0.27 percent among Region II FICUs, while nationwide the ratio was 0.32 percent.

The primary operational concerns for 2007, cited by our regional credit unions, included attracting loans (with greater concern on loan quality), risk mitigations, rising compliance costs, and attracting new members. Lower cost of funds and non-interest income were mentioned as positives for future performance.

Member Concerns and Region II Economic Conditions in 2008

Credit union leadership in Region II state concern about the performance of some loan products because members are using them to save their houses. Because of turmoil in the real estate markets and because credit unions do not issue subprime real estate loans, increases in the delinquency rate are noted among home equity loans, auto loans and credit cards. Furthermore, the number of bankruptcies has increased in the past several months. Some credit unions have indicated that the trend of members resolving such problems may continue this year as well as next year.

NCUA Region Three

At year-end 2007, there were 1,681 federally insured credit unions (FICUs) in NCUA Region III (Southeast). This region consists of ten states which include 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. The year-end count represents a net decline of 53 FICUs in 2007, of which 25 occurred in the second half of the year. Consolidation within the region was significantly slower in 2007, very similar to national results. Region III now holds 21 percent of all FICUs, 20 percent of all assets and 23 percent of all members. At $149 billion, total asset growth improved to 5 percent, but this was 115 basis points slower than the national average. Total membership in the region rose 1.1 percent to 19.6 million. Region III trailed the national average gain of 1.3 percent in 2007. Total employment (full and part-time employees) increased by 1,575 to just over 55,800. All of the gains were in full-time employment. The 50 largest FICUs in the region increased their market share and now hold 53 percent of the region's assets and 41 percent of total membership.

Two key considerations must be highlighted for this report. First, Region III 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. The northern half of the region is heavily influenced by economic weakness in the manufacturing sector and job losses. Some states in the southern portion of the region are critically impacted by the bursting of the speculative housing bubble. Taking a high level view, we see escalating levels of employment uncertainty, loss of wealth due to the housing crisis and declining access to reasonably priced credit. Members and all residents of the region are very concerned and becoming increasingly cautious with spending and borrowing plans. Despite this uneasiness, we haven't seen a precautionary build-up in deposits. Anecdotal evidence suggests many in the region are bracing for an extended period of economic, employment and housing market weakness.

Despite significant economic headwinds, collectively Region III FICUs finished the year with a very healthy 11.65 percent net-worth-to-asset ratio. Even with an return on average assets (ROA) of 61 basis points (19 basis points below 2006 results), most of the region's FICUs remained financially strong. Leaders in the region are anticipating that 2008 will be an even more challenging year. Declining credit quality and collateral values, combined with rising expenses and asset growth, imply lower ROAs and net worth ratios through year-end and into 2009.

Lending

Total loan growth of 5.2 percent was roughly a full percentage point below 2006 results, although 72 percent of the gain occurred in the second half of the year. Over the course of 2007, about 89 percent of all loan growth was attributable to real estate secured loans, while total vehicle loans actually declined. Contributing positively to 2007 results were the 303 FICUs with loan growth of 10 percent or more. These FICUs held 35 percent of the region's assets. On the opposite end of the spectrum were the 771 FICUs in the region, representing 18 percent of assets, reporting loan portfolio declines in 2007.

The 178 FICUs in Georgia posted the strongest loan growth for the year at 9.4 percent, while Ohio's 365 FICUs had the lowest gain at just 3.7 percent. Florida's 195 FICUs hold almost 29 percent of all loans outstanding in Region III and accounted for 32 percent of all growth. The 117 FICUs in North Carolina hold 18 percent of all loans in the region and accounted for 12 percent of 2007 loan growth.

In total, Region III FICUs finished the year with a loan-to-share (L/S) ratio of 79.7 percent. This key measure was up 36 basis points from year-end 2006, but was 364 basis points below the national average. Collectively, South Carolina FICUs reported the highest L/S ratio at 88.3 percent and Alabama had the lowest in the region at 65 percent.

In 2007, real estate secured loans (first mortgages, second mortgages and home equity loans) accounted for almost 89 percent of all loan growth, despite an annual increase slightly below 2006 results. Leading the way were first mortgages, up 11 percent for the year and supplying over 71 percent of all Region III lending gains. A total of 810 FICUs in the region reported originating first mortgages in 2007. The dollar amount of Region III originations were up 9.5 percent versus a national average increase of 10.6 percent. The combination of higher originations and fewer first mortgage loans sold, produced these strong growth results.

Looking at the "other" real estate loan category (second mortgages and home equity loans), we see member demand has declined as originations were down 6.7 percent. Both fixed and adjustable-rate loan originations declined in 2007.

Overall, demand for real estate loans is expected to be strong in 2008 as other lenders have exited the market. Higher credit and collateral standards will limit growth potential in the near-term, as will available funds to lend. Region III FICUs have seen real estate secured loans move from 44 percent of total loans in 2003 to 49 percent at the end of 2007.

A 0.6 percent gain in the used vehicle loan portfolio was not enough to overcome the 2.3 percent decline in new vehicle loans outstanding, thus Region III total vehicle loans contracted by almost one percent in 2007. Over half of all FICUs in the region (representing 49 percent of the region's assets) reported declines in total vehicle loans outstanding. Vehicle loans are now less than 37 percent of the region's total loans. In the past, indirect lending arrangements were a source of growth, but this channel is also down slightly for the year. Auto dealers in the region are reporting lower showroom traffic, even from last year's reduced levels. Few credit union leaders are optimistic about generating strong vehicle loan growth over the next 12 to 18 months. At this point, most would be pleased with positive results.

Total Shares

Total shares at Region III FICUs increased 4.7 percent in 2007, a slight improvement from the 3.5 percent gain posted in 2006. A third of the growth improvement can be explained by the higher cost-of-funds, a proxy for internal yield accumulations. Thus, new deposit inflows are not robust given overall economic uncertainty. During 2007 FICUs in Region III reported a decline of 6.6 percent in regular shares and this follows declines in 2005 and 2006. This source of low cost funds peaked in 2004 at 37 percent of deposits. Over the past three years, regular shares have declined by 20 percent and now equal just 26 percent of all deposits.
The primary source of deposit growth over the past three years is share certificates (CDs). This portfolio segment was up 14.2 percent in 2007 and almost 66 percent since the end of 2004. This change in deposit distribution is one reason Region III FICUs cost-of-funds rose 17.9 percent in 2007 to 283 basis points.

The 195 FICUs in Florida held 27 percent of Region III total shares (deposits) and generated 4.7 percent annual growth. Kentucky FICUs had the strongest growth with deposits up 9 percent for the year. A total of 743 FICUs reported share declines in 2007. These institutions held about 16 percent of the region's assets. Mississippi FICUs reported the slowest growth with deposits up just 1.7 percent for the year. Over 75 percent of credit union leaders are planning on stronger deposit growth in 2008.

Asset Quality and Operational Results

At year-end 2007, asset quality, as measured by delinquent loans to total loans, stood at 1.03 percent, up 28 basis points from 2006 results with all of the adverse increase coming in the second half of 2007. Delinquency rates for all types of loans rose in 2007. CFOs in Region III and throughout the country see credit quality issues getting worse in the first half of 2008 before some improvement by year-end. Most are confident that capital levels are more than adequate to manage through this unusual market.

Consolidated results for the 1,681 Region III FICUs show a return on average assets (ROA) of 61 basis points, just below the national average (65 basis points). The Region III ROA is down 19 basis points from 2006 results, but looking at performance for only the second half of 2007, we see an annualized ROA of just 46 basis points. Like the national trend, the ROA in Region III continues to erode as net interest margins tighten, loan loss provisions increase and expenses rise. A closer look at the data shows 455 FICUs (holding 21 percent of the region's assets) had an ROA of 100 basis points or better. Not all institutions were successful in 2007 as 231 reported an ROA of zero or less. These FICUs held just 4.8 percent of the region's assets at year-end. Credit union leaders and forecasters see 2008 with the lowest ROA in memory, possibly less than 40 basis points.

NCUA Region Four

NCUA Region IV (Midwest) consists of 2,393 federally insured credit unions (FICUs) in the states of Arkansas, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, and Wisconsin as of Dec. 31, 2007. The credit unions in this region represent 29.5 percent of all FICUs and held $146.4 billion, or 19.4 percent, of total assets held by all FICUs. There are approximately 18.9 million members in this region, up 113,564 (0.6 percent) since year-end 2006. Since 2006, total assets have grown 5.3 percent through year-end 2007 while reserves and undivided earnings increased 5.3 percent to $16.9 billion. Savings growth exceeded 2006 growth rates. Loan growth rebounded during the second half of 2007, resulting in an annual growth rate approaching 2006 growth rates. Shares grew nearly $5.8 billion (4.9 percent) during 2007, while loan balances increased $4.3 billion (4.5 percent). As of year-end 2007, share balances totaled $123 billion, while outstanding loan balances were $100.5 billion. The loan-to-share ratio was 81.7 percent, slightly lower than the year-end 2006 ratio of 82.1 percent.

Loan Growth

Loan growth in Region IV was modest in the first half of 2007 and increased in the second half of the year, for a full-year increase of $4.3 billion, or 4.5 percent. This growth rate was somewhat slower than the national average growth rate of 6.1 percent. Total loans outstanding for Region IV at year-end 2007 totaled $100.5 billion, representing 68.7 percent of total assets versus 69.2 percent at year-end 2006.

During 2007, the largest component of loan growth in Region IV was in first-mortgage real estate loans and other real estate loans, which accounted for 85 percent of the growth in loan balances. Total first mortgage loan balances outstanding were $28.8 billion and other real estate loans outstanding were $13.8 billion. First mortgage loans increased 11.0 percent ($2.8 billion) and other real estate loans grew 6.3 percent ($0.8 billion).

Real estate lending in the region rose at a pace near 2006 levels. Fixed-rate first-mortgage real estate loans granted represent 63.3 percent of the total first mortgage loans granted during 2007. At year-end 2007, the $28.8 billion of first-mortgage balances were comprised of 53.5 percent in fixed-rate loans ($15.4 billion), 20.1 percent in adjustable-rate loans ($5.8 billion), and 26.4 percent in balloon/hybrid loans ($7.6 billion). Adjustable-rate first-mortgage loans grew 14.8 percent from year-end 2006, slightly less than half the 2006 growth rate of 28.6 percent. Given the volatility in long-term interest rates and the drop in rates during the second half of 2007, it is not surprising that fixed-rate mortgage loans grew by a strong 11.9 percent for 2007, a significant increase when compared to the 8.6 percent growth rate for 2006.

Closed-end fixed-rate loans increased by a rate of 12 percent to $8.6 billion, while open-end adjustable HELOC loans continued the downward trend of 2006 by declining 5.6 percent to $4.2 billion. The “other” real estate loans category represents almost 32.5 percent of total real estate loans outstanding.

Declining U.S. vehicle sales were reflected in the 2.1 percent decline in new auto loan balances to $20.2 billion in 2007. Used auto loan balances increased 1.8 percent to $21.0 billion, reversing the 2006 decline. The weak performance in the regional auto lending sector follows national trends.

Of the total loans outstanding ($100.5 billion) in Region IV, total real estate loans and total auto loans are almost equal in portfolio representation. Total real estate loans ($42.6 billion) comprise 42.4 percent of total loans outstanding, while total auto loans ($41.2 billion) comprise 41 percent. These figures are in contrast to all FICUs in the nation in that total real estate loans outstanding are significantly ahead of auto loans. That is, total real estate loans represent 51.5 percent of total loans outstanding while total auto loans represent 33.4 percent.

The volume of member business loans increased $0.8 billion or 14.4 percent, to $6 billion at year-end 2007. This growth is off the 2006 pace of 27 percent. However, Region IV's member business loan volume is only slightly below the national FICU growth rate of 15.8 percent for year-end 2007, and total member business loans for the region represented 22.9 percent of total FICU member business loans outstanding at year-end 2007.

Participation loans outstanding at year-end 2007 were $2.1 billion, an increase of 8.8 percent since year-end 2006. Participation loans purchased declined from the 2006 pace by 11.2 percent. The 38.9 percent decline in participation loans sold in 2006 moderated to only a 4.3 percent decline in loans sold in by regional credit unions. The ratio of loan participations outstanding to total loans outstanding is 2.04 percent, up slightly from 1.96 percent at year-end 2006.

Member Shares

Shares and deposits experienced fairly strong growth in 2007, increasing 4.9 percent, up $5.8 billion. The growth rate for 2007 exceeds slightly the growth rate for 2006 and if volatility in the stock markets continues, stronger share growth can be anticipated. Total share balances outstanding at year-end 2007 were $123 billion. For 2007, the growth of shares and deposits in Region IV is slightly below the national FICU growth rate of 5.2 percent. Share certificates followed by money market shares, essentially account for the net growth in share balances in 2007. Net 2007 share growth of $5.8 billion was due to $4.8 billion growth in share certificates and $1.9 billion growth in money market shares, offset by declines in other balances, primarily regular shares.

Share certificate growth in 2007 slowed to 13.6 percent from the 2006 pace of 18.9 percent, while growth in money market account balances increased to 11.6 percent from a 2006 decline of 0.2 percent.

Regular share balances declined $1.5 billion, or 4 percent, and share draft balances declined marginally by 1.9 percent, or $0.1 billion. Regular shares and share draft accounts represented approximately 42.7 percent of the funding for credit unions in Region IV.

Loan Quality

The quality of the loan portfolios of FICUs in Region IV has deteriorated as reflected in a rapid rise in delinquencies. For the first half of 2007, the ratio of delinquent loans to total loans rose by 20.7 percent from 0.90 percent in December 2006 to 1.09 percent in December 2007. Loan delinquency ratios (2 months or greater) increased 72 percent to 0.72 for first mortgage fixed rate/hybrid/balloon loans and 166 percent to 1 for first mortgage adjustable rate loans. The delinquency ratio for other real estate fixed rate/hybrid/balloon loans increased 64 percent to 0.58. Conversely, the year-end 2007 ratio of net charge-offs to average loans was slightly improved at 0.49 percent versus 0.52 percent for December 2006.

Investments

Strong share growth in 2007 ($5.8 billion) helped fund healthy growth of $4.3 billion in loans outstanding, resulting in a $2.6 billion growth in investment balances. As of year-end 2007, total investment balances were $29.4 billion reflecting a robust growth rate of 9.7 percent, up $2.6 billion. This represents a significant change when compared to the previous three-year pattern of investments decline.

Total 2007 cash and cash equivalents grew by a more modest 0.5 percent or by $48.3 million to a year-end 2007 balance of $10.0 billion. This level of liquid investment holdings, though higher than the past five years, is consistent with historical norms. Additionally, Region IV FICU portfolios are comprised of relatively short-term investments in that 62.2 percent of all investments have remaining maturities of less than one year.

Collateralized mortgage obligations was the category with the largest balance increase from year-end 2006, increasing $1.5 billion or 51.3 percent. Corporate credit unions continue to be an important component of Region IV FICU investments. Total deposits and investments in corporate credit unions climbed to $7.3 billion, an increase of $1.3 billion or 22.8 percent.

Earnings

Region IV full-year 2007 return on average assts (ROA) remained steady with 2006 at 0.69. Region IV ROA exceeded the national average of 0.65.

Regional net interest margin (NIM) for 2007 was 3.13 percent; marginally lower than the year-end 2006 level of 3.15 percent. Region IV NIM exceeded the national average NIM of 3.11 percent. The region's yield on assets (gross income/average assets) increased 40 basis points. This gain in yield was driven by increases in the yield on average loans (+30 basis points) and the yield on average investments (+61 basis points). The regional credit unions returned value to members through high dividends as reflected in an increase in the cost of funds of 38 basis points.

Finally, capital adequacy remained strong for FICUs in Region IV. Although net worth to total assets ratio for year-end 2007 declined 5 basis points from year-end 2006, it remained at a healthy 11.58 percent. The net worth to total assets ratio for all FICUs nationwide was 11.44 percent at year-end 2007. Total delinquent loans as a percent of net worth grew by 109 basis points to 6.43 percent in comparison to 5.35 percent at year-end 2006. At a national level, FICUs saw a similar rise of 160 basis points in this ratio to 5.71 at year-end 2007.

General Economic Conditions

The pace of economic activity in the Midwest Region weakened as reflected by national trends. The following excerpts from the Federal Reserve beige book are indicative of regional economic trends:

- Reports indicate that holiday sales were generally disappointing.
- Most Districts reported that vehicle sales for late 2007 were below year-ago levels.
- Dallas indicated that conditions continued to soften.
- Kansas City reported that manufacturing was expanding and that manufacturers were relatively upbeat.
- Conditions in most housing markets remained quite weak through year-end. The pace of sales continued to be sluggish, and inventories persisted at historically high levels according to most Districts.
- Reports suggest that labor markets remained relatively tight overall, and especially for skilled workers, whereas housing-related industries continued to trim payrolls.

Rising oil prices, declining home values and rising variable rate mortgage payments had a negative impact on consumers' disposable income. The effect of these forces can be seen in rising delinquency trends, nationally and within credit unions.

Credit unions, however, are generally well positioned with solid balance sheets, strong capital ratios and generally good liquidity. As other financial institutions tighten credit standards and limit credit availability, credit unions are well positioned to serve their members.

NCUA Region Five

Region V 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 Dec. 31, 2007, the region's 1,305 federally insured credit unions comprised 16 percent of all federally insured credit unions and held some $218 billion in total assets, 28 percent of the nation's total credit union assets. All FICUs continue to attract new members and Region V FICUs were no different with membership increasing by 416,000 since year-end 2006, ending in December 2007 with 21.45 million members. Total assets grew by 5.6 percent in 2007, while reserves and undivided earnings increased 6 percent to a total of $23.7 billion. Shares grew $8.3 billion (4.7 percent) over the year, while loans increased $9.8 billion (6.6 percent). On December 31, 2007 share balances totaled $184 billion while outstanding loans came in at $159 billion. The loan-to-share ratio rose from 84.6 in December 2006 to 86.1 in December 2007.

Loan Growth

As mentioned above, loan growth in Region V FICUs for 2007 was 6.6 percent, a decline from the 2006 growth rate of 9.4 percent. This lower percentage puts 2007 below the 10-year average pace by roughly 3 percent. Total loans for Region V FICUs was $159 billion as of Dec. 31, 2007, or 72.77 percent of total assets. Loans comprised 72.23 percent of assets at the end of 2006.

Real estate lending continued to be the primary driver of loan growth. Residential first mortgage loans grew by 12.6 percent and other real estate loans grew by 10 percent for the year, primarily driven by real estate collateralized member business loans. The growth rate for first mortgages was higher than the 2006 growth rate of 10.6 percent, while the growth rate for other real estate lending was lower than the 17 percent growth rate for 2006

The volume of new real estate loans granted rose by 3.9 percent from year-end 2006. Total first mortgage loans stood at $54.2 billion as of Dec. 31, 2007. The growth rate in fixed rate loans held on the balance sheet of credit unions grew by 12.3 percent in 2007; total new adjustable rate loans held on the balance sheet fell by 10.2 percent. Hybrid loans grew at a rate of 20.2 percent. At year-end 2007, ARMs and hybrids comprised 43 percent of the first mortgage category held by credit unions. HELOCs fell by 9 percent, bringing the total value of HELOCS to $7 billion. For the region, real estate loans made up 50 percent of total loans, which is slightly higher from the end of 2006.

Auto loans were down slightly for 2007. Prior to 2007, growth in indirect auto lending was largely responsible for stronger growth in auto lending. This type of lending, however, flattened in 2007. Several credit unions ceased or sharply curtailed participation in indirect lending due to poor results in establishing new member relationships. New auto loan balances decreased 3.6 percent, while used auto loans balances rose by 1.5 percent.

Member business lending activity continues to grow as credit unions expand their assistance to members in this area. Member business loan balances, dominated by real estate-secured loans, increased to $11.6 billion from $9.1 billion at year-end 2006 for a growth rate of 16.4 percent. While this sector still represents only 7 percent of total loans at credit unions, it is growing at a faster pace of any loan sector.

Another bright spot came in credit card receivables, where outstanding balances grew by over $1 billion, representing a growth rate of 16.4 percent. This was by far the strongest performance in over 10 years.

Credit unions have generally lowered expectations on the outlook for loan growth for 2008. While some credit unions are reporting much stronger refinancing activity, purchase mortgage volume is declining. Additionally, many credit unions are reporting a sharper, higher turndown rate on applicants seeking to refinance due to lower home values. Many credit unions are eager to ramp up mortgage lending activities to help consumers dealing with refinancing issues, but deteriorating home values in the Western states are limiting the ability of some credit unions to provide alternatives to stressed homeowners. Credit unions are also reporting that auto lending is slowing appreciably.

Loan Quality

Credit unions continue to do an excellent job in managing credit risk, but credit conditions deteriorated toward the end of 2007. The delinquency/total loans rate rose from 0.51 percent in 2006 to .88 percent at year-end 2007. The net charge-offs/average loans rate grew from .41 percent to .51 percent. For those credit unions with heavy concentrations of mortgage loans, there are concerns that a decline in home prices will continue to increase delinquencies and charge-offs.

Share Growth

Shares grew at a 4.7 percent growth rate to $184.3 billion. However, balances in all transaction and regular share accounts declined by 4.5 percent. Money market accounts grew by 8.4 percent. The strongest growth came in the share certificate category with a growth rate of 12.8 percent.

With many credit unions facing liquidity and competitive pressures for deposits, most credit unions have adopted the strategy of competing aggressively for certificates while pushing back on increasing transaction accounts. The picture is much more mixed for money market accounts where some credit unions have been fairly aggressive on pricing the upper tiers while other credit unions have resisted the move to higher rates.

The growth in certificates was evenly split between maturities with one to three years and maturities greater than three years. As of Dec. 31, 2007, share certificates represented 35 percent of total balances, compared to 32 percent at the end of 2006. Liquidity of most credit unions in Region V was not a major issue. With loan growth rates falling short of expected and budgeted plans, credit unions faced much less pressure on liquidity than in 2006.

Borrowings

Borrowings increased sharply in 2007 by 39 percent, leaving a relatively small balance of 7.9 billion. However, the annual growth rate is somewhat misleading. Most of the surge in borrowing came in the fourth quarter. Several large credit unions borrowed from the Federal Home Loan Bank and placed those funds with matching maturities at their corporate credit unions. The significant rate spread between those credit unions and other Region V FICUs presented those borrowers with an attractive arbitrage opportunity. Anecdotally, in 2008 we have seen most of those borrowings repaid as the spreads have narrowed.

Investments

Investments rose in 2007, with total investments increasing from $36.3 billion in 2006 to $37.1 billion at the end of 2007. This represented 17 percent of total assets. Holdings of federal agency securities declined by 7.2 percent in 2007 to a total of $14.9 billion. Holdings of corporate certificates rose 8.7 percent from $11.9 billion to $12.90 billion. Investments maturing in less than one-year accounted for 57 percent of total investments, while investments between one and three years comprised 26 percent of the total. The average yield on investments increased 3.92 percent to 4.70 percent as low yielding investments purchased in 2004, 2005 and 2006 matured and were replaced by higher yielding investments. After a substantial increase in investment yields in 2007, credit unions should now expect a decline in the overall portfolio yield in 2008 as the portfolios turn over and are re-priced at current market yields. Currently, credit unions are keeping the maturities of new investments short. Security investments are being allowed to run off and new funds are being left in cash and short-term money market investments. This benefits corporate credit unions because of the lack of alternatives in the securities markets.

Earnings

Average return on average assets (ROA) in 2007 fell .61 percent on an annualized basis from .89 percent at the end of 2006. This continues a long-term trend but is a sharp one-year deterioration. We should see some relief in 2008 as credit unions reprice short-term liabilities. The average yield on loans increased from 6.40 percent to 6.69 percent. The cost of funds/average assets ratio rose from 2.30 to 2.79. The overall net interest margin declined from 3.19 to 3.11. Operating expense/gross income was at 46.4 percent, down from 48.70. Fee income rose at an annualized pace of 12.6 percent.

General Economic Conditions and Credit Union Concerns

Economic conditions in the Western Region deteriorated in the second half of 2007. The slowing in the housing market is of concern to credit unions. Some states such as Idaho and Utah that were seemingly unscathed by the housing slowdown reported softness in local economies as 2007 came to an end.

Home sales fell noticeably throughout the region in 2007. Even those states not hit hard by by declining home prices are experiencing declining home sales. Home price increases have all but disappeared, and most areas are reporting declines. The central California area seems to have been hit particularly hard and that weakness appears to be spreading. Some credit unions are concerned about the outlook for real estate values and the credit implications. To counteract, most credit unions have maintained a conservative lending profile and should weather any downturn without great difficulties. There is some apprehension, however, that a sharp fall in housing activity and the ongoing credit market concerns might result in a general economic slowdown.

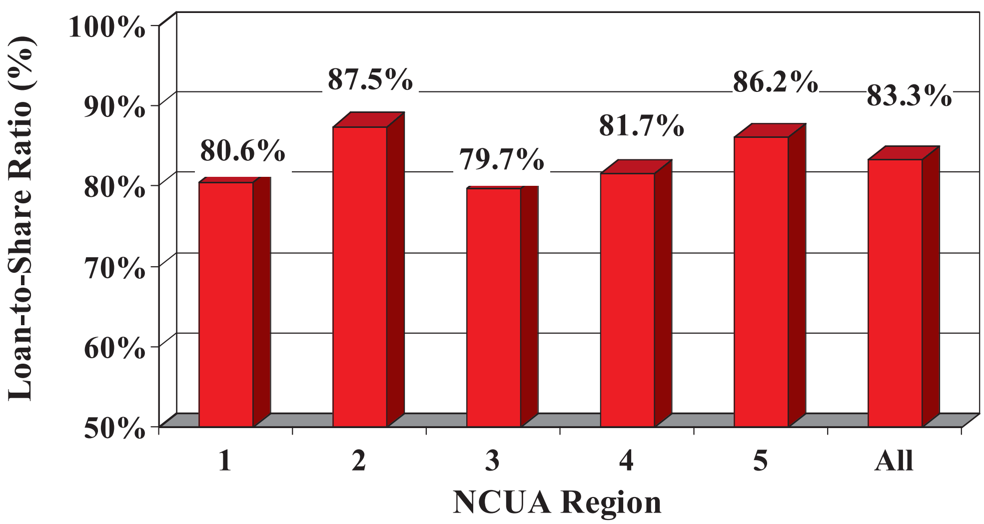
One area of concern expressed by credit union executives continues to be the squeeze on net interest margins. While the Fed's aggressive easing will help as liabilities reprice, many credit unions are concerned about investment returns as assets reprice. The very short-term nature of credit union investment portfolios will cause a shortfall in projected earnings at some high liquid credit unions. As mentioned earlier, credit unions are finding that a more competitive deposit landscape is impeding progress on lessening the impact of margin compression. Prior to the second half of 2007, credit unions were relatively successful in competing on share certificates. Many of their local major bank branch competitors were not in that market. However, the scramble to grow retail deposits at the big banks has changed the landscape once again.

Over the past 15 months, since the beginning of 2007, we have observed several changes in the attitudes of credit unions. Through the first six months of 2007, optimism that strong loan growth would continue buoyed the attitude of most credit union executives. In the second half of 2007, especially toward the end of the year, credit union executives were disappointed in loan growth but still optimistic about gaining market share as credit conditions tightened at competitor institutions. There has been a noticeable change in tone just since the end of 2007. While credit unions are still eager to find ways to assist members, the optimism that 2008 could be a very good and important building year for credit unions has waned. Much of the attitude shift has come as credit unions have experienced sharp increases in delinquencies. While the delinquency and loan loss numbers are still very manageable, especially given the strong capital positions of most credit unions, many credit unions are simply not accustomed to the loan loss experience. This comes after years of conservative lending practices, and no change in those practices in recent history. Very few credit unions competed in the mortgage frenzy. Yet they are seeing their members who did get the riskier types of loans elsewhere fall behind on their loans through their credit union.

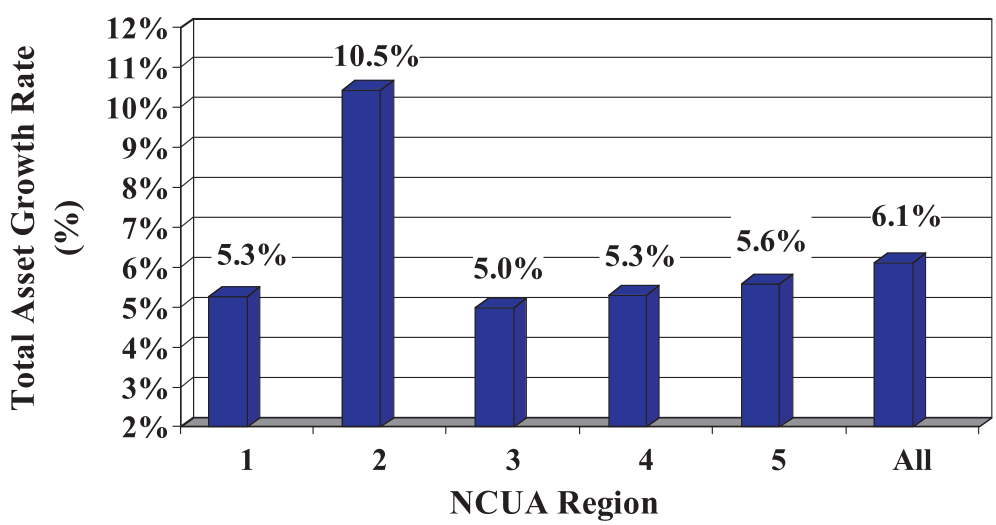
While credit union executives have been reflecting a more downbeat attitude, we also sense they will continue their efforts to assist members with difficulties in a responsible manner. At a recent conference sponsored by WesCorp and Callahan Associates, the most popular session was a panel discussion of credit union executives who were leading efforts at their credit unions to ramp up both mortgage lending and financial education of members. Credit unions clearly see a need to help members and will not shy away from that responsibility.

Appendix A:
NCUA Regional Financial Ratio Analysis

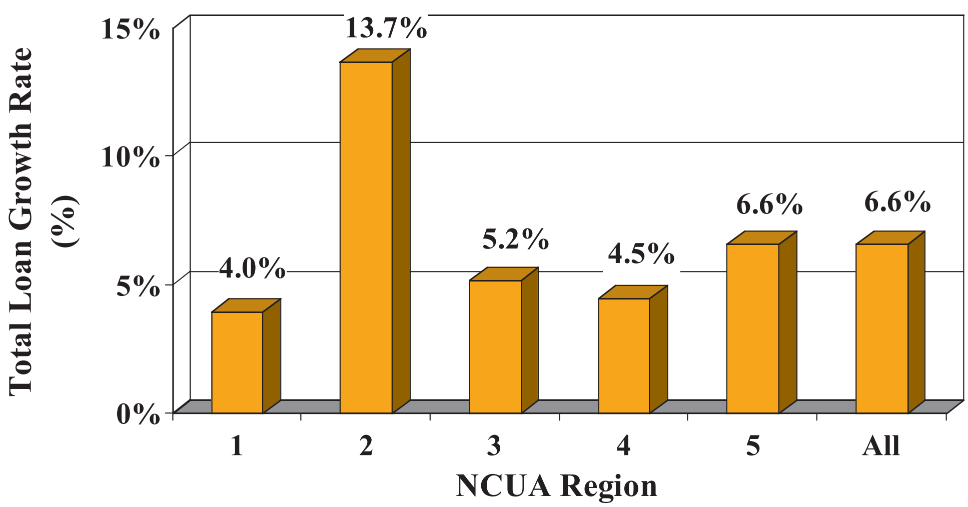
Loan-to-Share Ratio
Federally Insured Credit Unions by NCUA Region
December 2007



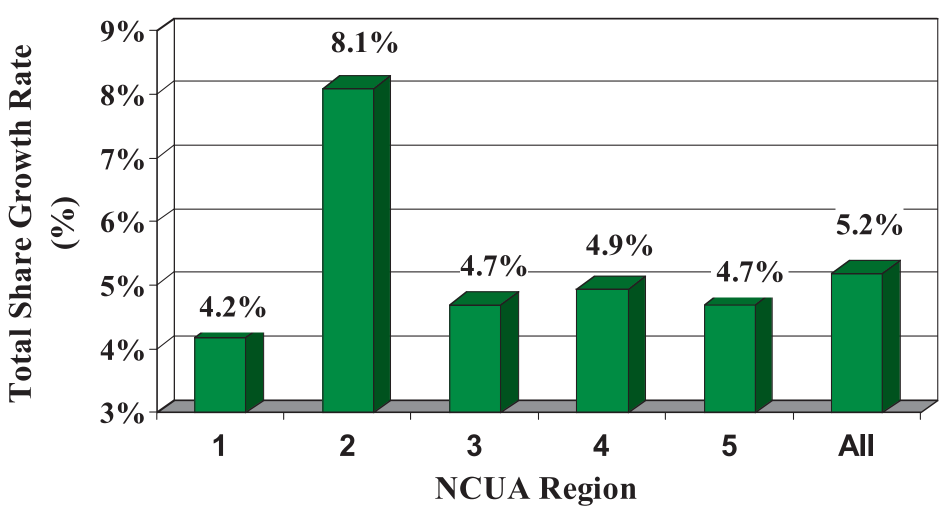
Total Asset Growth
Federally Insured Credit Unions by NCUA Region
December 2007



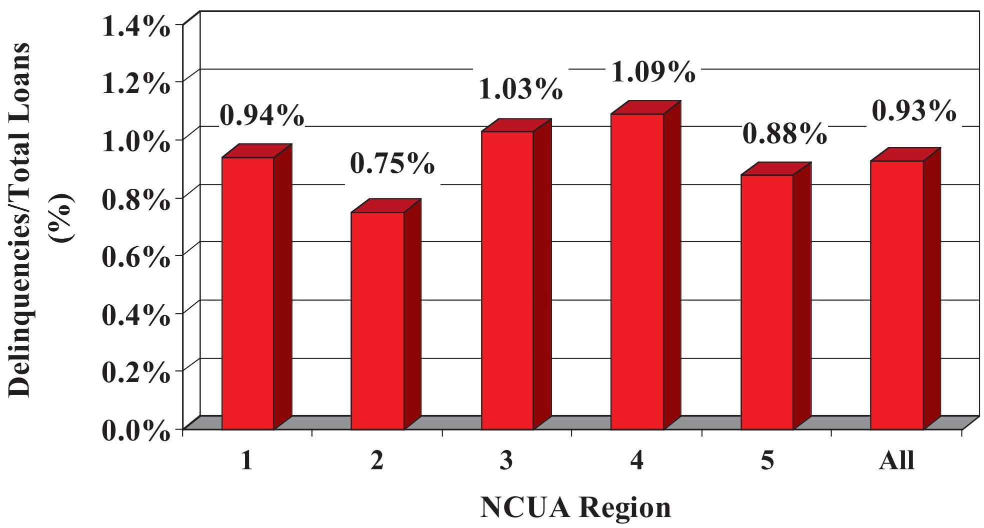
Total Loan Growth
Federally Insured Credit Unions by NCUA Region
December 2007



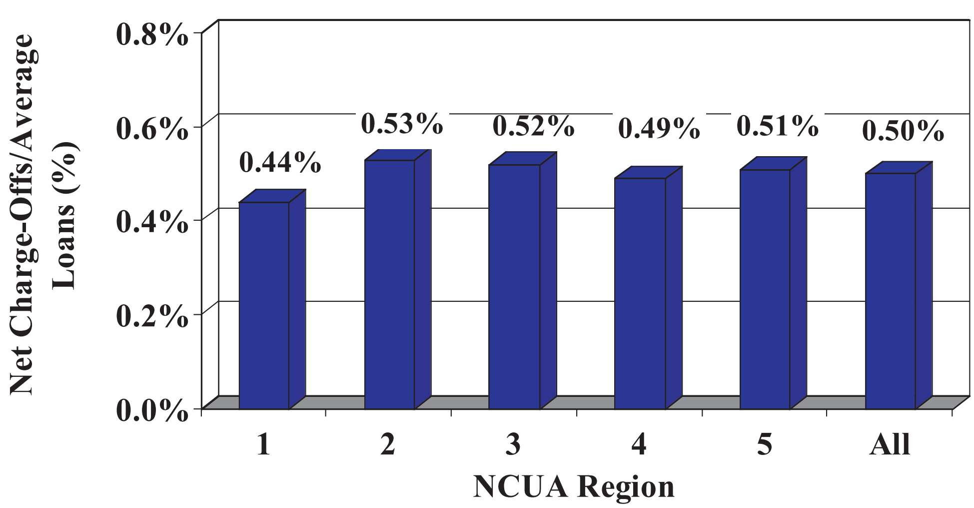
Total Share Growth
Federally Insured Credit Unions by NCUA Region
December 2007



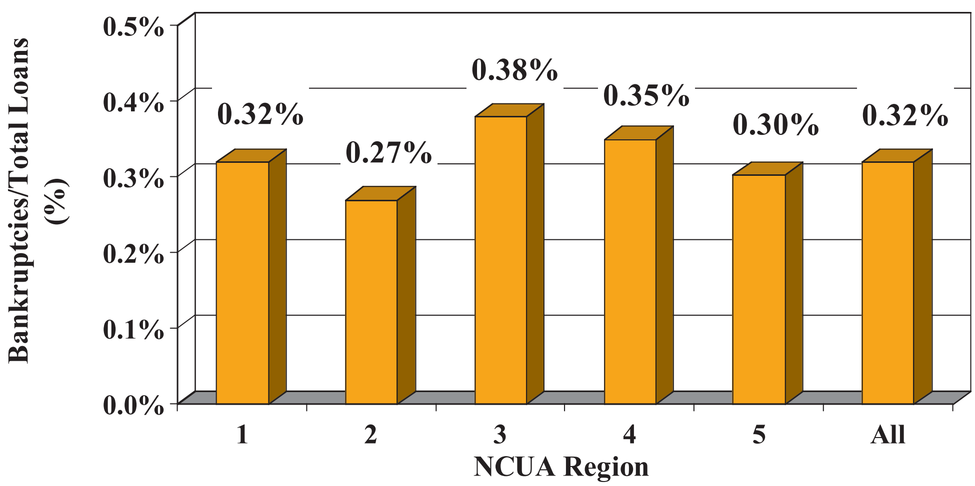
Delinquency Ratio
Federally Insured Credit Unions by NCUA Region
December 2007



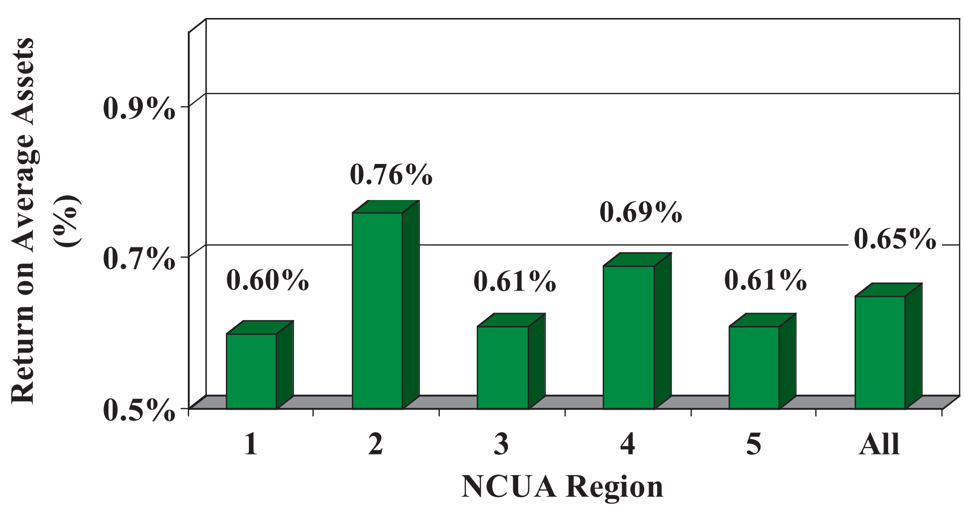
Net Charge-Offs/Average Loans
Federally Insured Credit Unions by NCUA Region
December 2007



Bankruptcies/Total Loans
Federally Insured Credit Unions by NCUA Region
December 2007

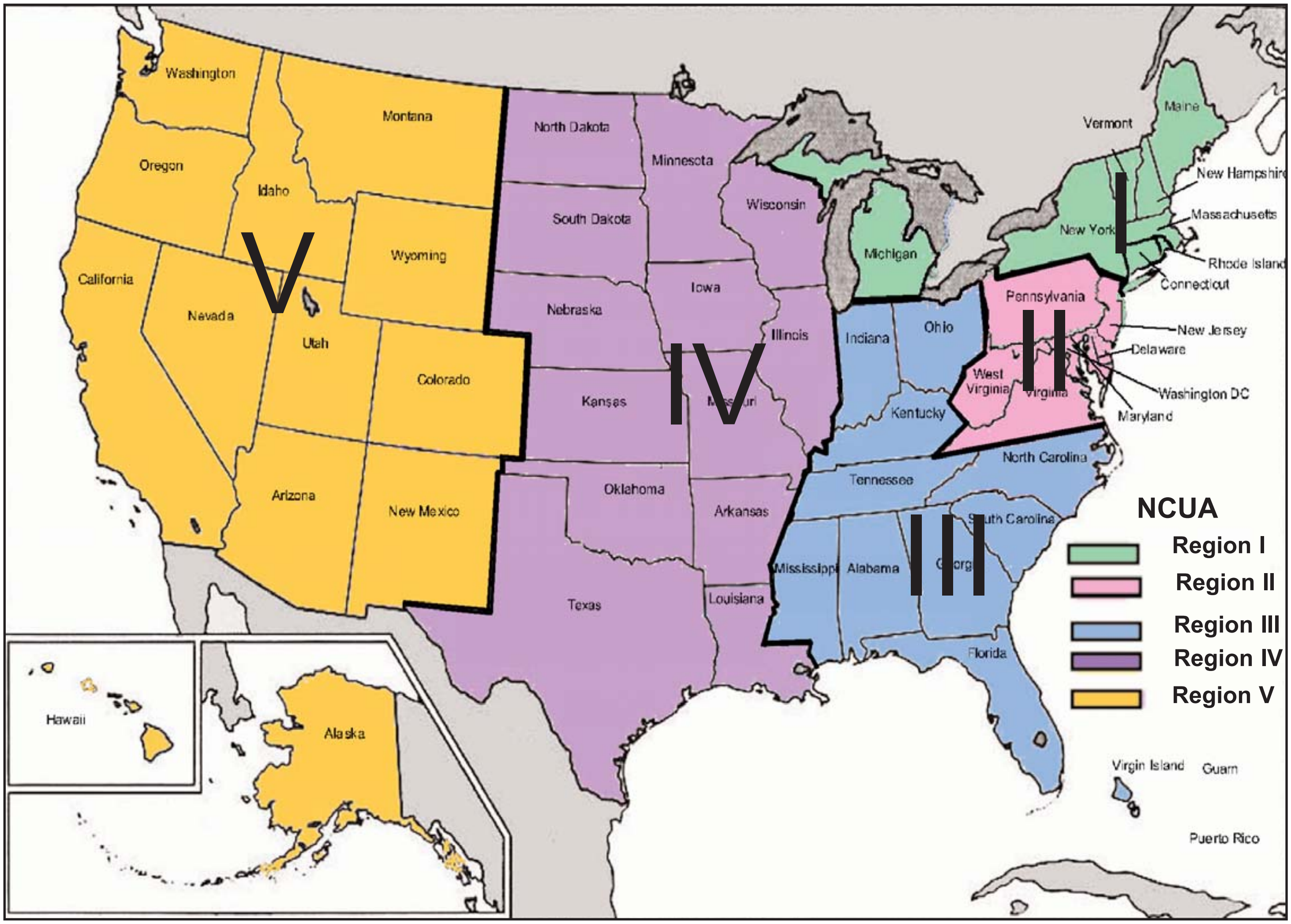


Return on Average Assets (ROA)
Federally Insured Credit Unions by NCUA Region
December 2007



Appendix B: NCUA Regions

NCUA Regional Breakdown



Source: NCUA