# NCUA LETTER TO CREDIT UNIONS

**NATIONAL CREDIT UNION ADMINISTRATION**
**1775 Duke Street, Alexandria, VA 22314**

**DATE:** **March 2005** **LETTER NO.: 05-CU-04**

**TO:** **Federally Insured Credit Unions**

**SUBJ:** **State of the Credit Union Industry as of December 31, 2004**

**ENCL:** **Financial Trends in Federally Insured Credit Unions**
**January 1 - December 31, 2004**

**Dear Board of Directors:**

Enclosed is a report highlighting credit union financial trends for 2004. The analysis is based on data compiled from the year-end 2004 call reports submitted by all federally insured credit unions.

The financial strength of the credit union industry remains strong despite a decline in the return on average assets. The 2004 performance in lending, delinquency and overall net worth accumulation reflects the strength of credit unions while a decline in the net interest margin indicates the challenges credit unions face.

Success in 2005 will depend on how well the individual credit unions have positioned their balance sheets. Credit unions are encouraged to assess their net worth level as it relates to their risk profile and business needs, and recognize lower levels of profitability may occur for those credit unions taking action to reduce interest rate or other types of risk.

I want to thank you for your diligence and cooperation in submitting your financial and statistical data in a timely manner.

Sincerely,

/s/

JoAnn Johnson
Chairman

Enclosure

## FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS
January 1 - December 31, 2004

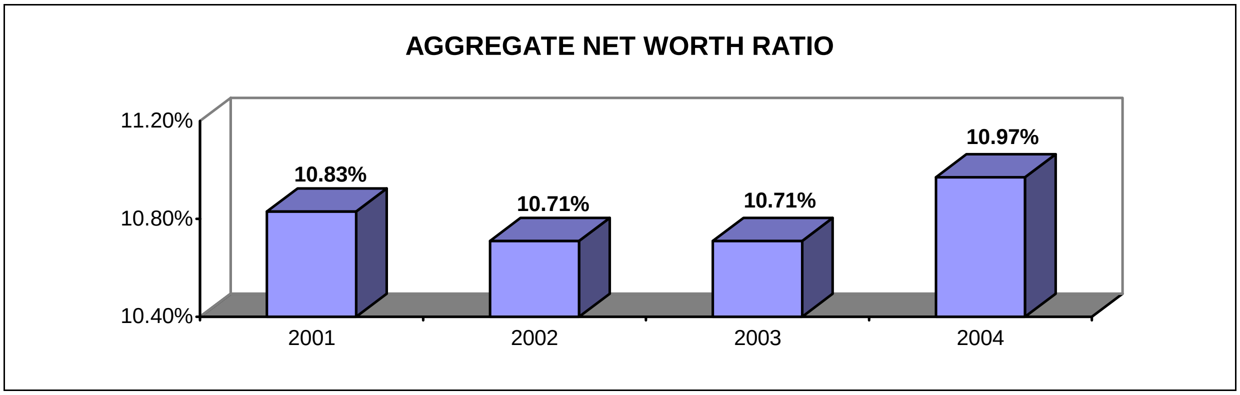
### HIGHLIGHTS

This report summarizes the trends of all federally insured credit unions that reported as of December 31, 2004. Change is measured from the prior year-end (December 31, 2003).

- **Assets** increased $36.9 billion, or 6.04%.
- **Net Worth** increased 8.56%, or $5.6 billion. The Net Worth to assets ratio increased from 10.71% to 10.97%.
- **Loans** increased $38.1 billion, or 10.13%. The loan to share ratio increased from 71.19% to 74.49%.
- **Shares** increased $27.8 billion, or 5.26%.
- ***Cash on hand*, *cash on deposit*, *cash equivalents*, plus short-term investments (less than 1 year)** increased $0.32 billion, or 0.31%.
- **Long-term investments (over 1 year)** decreased $3.7 billion, or 3.43%.
- **Profitability,** as measured by return on average assets, decreased from .99% to .92%, but remains strong.
- **Delinquent** loans as a percentage of total loans decreased from 0.76% to 0.72%.

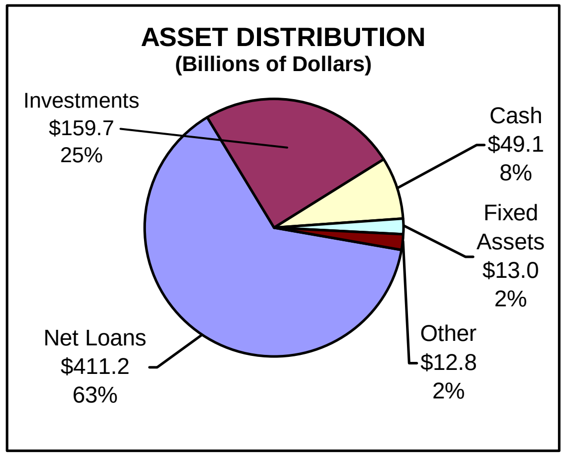
### CAPITAL

Total Net Worth increased $5.6 billion (8.56%) during 2004 due to strong profitability and low loan losses. The aggregate Net Worth to total assets ratio increased to 10.97%. The average (non dollar-weighted) net worth ratio for credit unions is 13.60%.



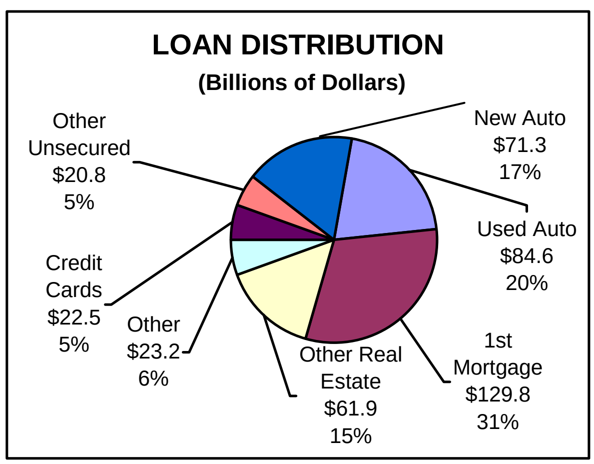
## ASSET QUALITY

*LOAN TRENDS:* All loan categories experienced growth. Loan growth of 10.13%, the highest growth level since 2000, resulted in an increase in total loans of $38.1 billion. Total real estate loan growth accounted for $24.2 billion and 63.37% of the total loan growth. Shares grew slower than loans, causing the loan to share ratio to increase from 71.19% in 2003 to 74.49% in 2004. Growth in the various loan categories is as follows:

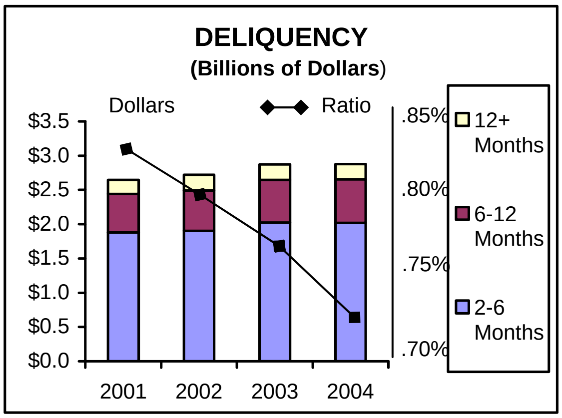



| Loan Category | 2003 Balance In Billions | 2004 Balance In Billions | Growth In Billions | Growth Rate |
|---|---|---|---|---|
| Unsecured Credit Card | $21.7 | $22.5 | $0.8 | 3.5% |
| All Other Unsecured | $20.8 | $20.9 | $0.1 | 0.30% |
| New Vehicle | $63.8 | $71.3 | $7.5 | 11.8% |
| Used Vehicle | $81.2 | $84.6 | $3.4 | 4.2% |
| First Mortgage Real Estate | $117.5 | $129.8 | $12.3 | 10.4% |
| Other Real Estate | $50.1 | $61.9 | $11.9 | 23.8% |
| Leases Receivable | $1.5 | $1.6 | $0.06 | 4.0% |
| All Other | $19.5 | $21.7 | $2.2 | 11.3% |

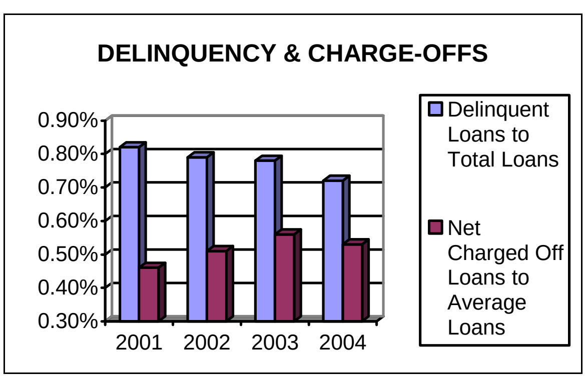
First mortgage real estate loans account for 31.33% ($129.8 billion) of all loans, with 67.19% ($87.2 billion) being fixed rate. Federally insured credit unions granted $36.9 billion in fixed rate first mortgages, a 47.7% decline from the $70.8 billion in fixed rate first mortgages granted in 2003. There were $18.9 billion in adjustable rate first mortgage real estate loans granted in 2004, a 19.2% growth rate. Credit unions sold $19.9 billion first mortgages in 2004 (includes both fixed and adjustable rate loans), reflecting a 46.8% decline.



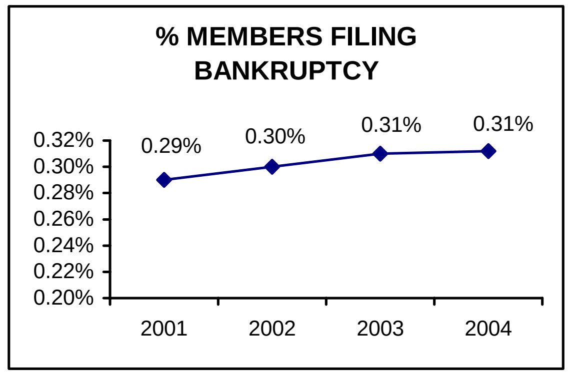
*DELINQUENCY TRENDS:* Delinquent loans increased 3.90% ($110.9 million). However, the delinquent loans to total loans ratio decreased slightly from 0.76% in 2003 to 0.72% in 2004. The decline in the delinquency ratio was the result of the increase in total loans exceeding the increase in delinquent loans.



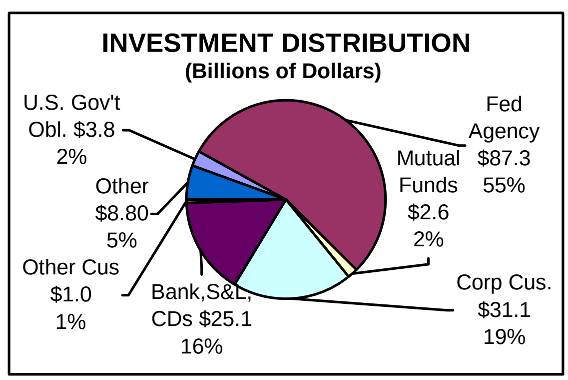

Loan dollars charged off increased 7.10% ($165.0 million), whereas recoveries on charged-off loans increased 19.70% ($63.4 million). This resulted in net charged-off loans increasing by 5.10% ($101.60 million). However, loan growth of 10.13% outpaced net charged-off loans resulting in a decrease in the net charged-off to average loans ratio from 0.56% in 2003 to 0.53% during 2004.




Federally insured credit unions reported an increase in members filing for bankruptcy; however, the percentage of members filing bankruptcy stayed at 0.31%. Outstanding loans subject to bankruptcy total $2.3 billion. Bankruptcies accounted for 34.0% ($849 million) of the loans charged off in 2004.




*INVESTMENT TRENDS:* Federal Agency Securities, Mutual Funds*, and Banks/S&Ls* investment categories decreased by 1.50%, 25.70%, and 4.40% in 2004. This resulted in a 0.70% ($1.10 billion) decline in total investments.



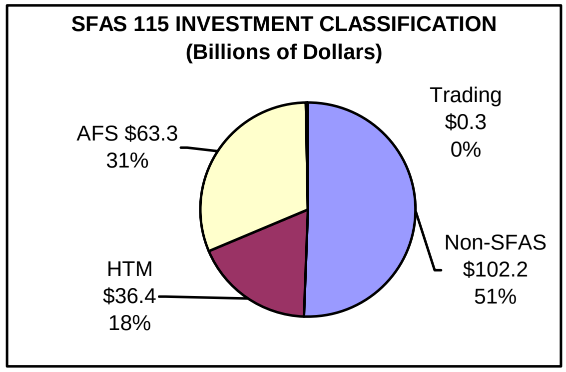

*Cash on hand*, *cash on deposit*, and *cash equivalents* decreased 4.50% ($2.3 billion). These combined categories, along with investments with maturities of less than one year, decreased 0.31% ($0.32 billion).

Investments with maturities greater than a year decreased 3.43% ($3.7 billion).

Non-SFAS 115 investments (including cash on deposit and cash equivalents) decreased 0.90% ($0.97 billion) to $102.2 billion.

Held-to-maturity investments decreased 0.40% ($0.16 billion). Available-for-sale investments decreased 3.30% ($2.16 billion). Trading securities increased 30.90% ($80.4 million).

At the end of 2004, SFAS 115 investments made up 49.48% of the investment portfolio. Non-SFAS 115 investments, cash on deposit, and cash equivalents accounted for 50.52% of the portfolio.




The following table compares the changes in the maturity structure of the investment portfolio over the past year:

| Investment Maturity or Repricing Interval | % of Total Investments 2003 | % of Total Investments 2004 |
|---|---|---|
| **Less than 1 year** | 47.27% | 48.27% |
| **1 to 3 years** | 34.22% | 35.26% |
| **3 to 10 years** | 16.99% | 15.28% |
| **Greater than 10 yrs** | 1.51% | 1.20% |

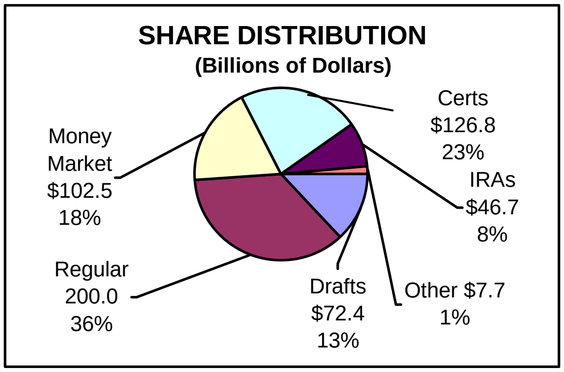
## EARNINGS

Total net income increased 0.70% ($38.4 million). The return on average assets decreased from 0.99% to 0.92%. The net interest margin declined to 3.32%. Fee and other income increased slightly, reducing the impact of the lower net interest margin. Total operating expenses increased at a slower pace of 7.0% and operating expenses to average assets declined by two basis points to 3.21%. The Provision for Loan Loss Expense and non-operating income levels remained stable.

| Ratio (% Ave. Assets) | As of 2003 | As of 2004 | Effect on ROA |
|---|---|---|---|
| **Net Interest Margin** | 3.41% | 3.32% | - 9bp |
| **+ Fee & Other Inc.** | 1.12% | 1.13% | + 1bp |
| **- Operating Expenses** | 3.23% | 3.21% | + 2bp |
| **- PLL** | 0.35% | 0.35% | 0bp |
| **+ Non-Opr. Income** | 0.04% | 0.03% | -1bp |
| **= ROA** | .99% | 0.92% | - 7bp |

## ASSET/LIABILITY MANAGEMENT

*SHARE TRENDS:* Total shares increased 5.26% ($27.8 billion) in 2004, compared to 9.11% in 2003. Money market and share certificate accounts represent 41.23% of total shares.




Growth rates for the various share categories are as follows:

| Type of Share Account | Change ($M) | Change Rate |
|---|---|---|
| Share Drafts | $7,128 | 10.90% |
| Regular Shares | $7,903 | 4.10% |
| Money Market | $3,255 | 3.30% |
| Certificates | $8,085 | 6.80% |
| IRA/Keogh | $782 | 1.70% |
| Other Shares | $296 | 5.10% |
| Non-member Deposits | $333 | 25.90% |
| Total | $27,781 | 5.30% |

Shares extended slightly as the following chart indicates.

| Share Maturity or Repricing Interval | % of Total Shares Dec. 2003 | % of Total Shares Dec. 2004 |
|---|---|---|
| Less than 1 year | 89.44% | 88.50% |
| 1 to 3 years | 7.33% | 8.07% |
| 3 or more years | 3.23% | 3.43% |

*OVERALL LIQUIDITY TRENDS:* At the end of 2004, credit unions had approximately 16.09% of total assets in cash and short-term investments, compared to 17.01% at the end of 2003. Net long-term assets (defined as assets with maturities or repricing intervals greater than 3 years for investments and greater than 5 years for real estate loans), equaled 25.19% of total assets at the end of 2004, compared to 25.35% at the end of 2003.

## CONCLUSION

The financial strength of the credit union industry remains strong despite a decline in the return on average assets. The 2004 performance in lending, delinquency and overall net worth accumulation reflects the strength of credit unions while a decline in the net interest margin indicates the challenges credit unions face.

Success in 2005 will depend on how well the individual credit unions have positioned their balance sheets. Credit unions are encouraged to assess their net worth level as it relates to their risk profile and business needs, and recognize lower levels of profitability may occur for those credit unions taking action to reduce interest rate or other types of risk.