NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION

NATIONAL CREDIT UNION SHARE INSURANCE FUND

LETTER NO. 177

DATE: September 1995

DEAR BOARD OF DIRECTORS:

Enclosed is a report highlighting credit union financial trends during the first half of 1995. The analyses are based on data compiled from the midyear 1995 call reports submitted by all federally insured credit unions. We are providing this information to keep you informed of current conditions and trends in the credit union industry.

For the National Credit Union Administration Board,

NORMAN E. D'AMOURS
Chairman

Enclosures FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS January 1, 1995 to June 30, 1995

*** ENDNOTES/FOOTNOTES WILL SHOW AS [1], [2], [3], ETC. & ARE AT THE END OF THE REPORT.

HIGHLIGHTS

The financial trends for the first half of 1995 are very favorable. Federally insured credit unions experienced well-balanced share and loan growth, while maintaining profitability, continuing capital growth, improving liquidity and declining delinquency. Specifically:

* Assets of federally insured credit unions increased 3.7% in the first half of 1995.

* Capital accumulation continued, increasing 6.3%. The capital to asset ratio at midyear 1995 equals 10.6%.

* Loans increased 4.4%, beginning the third year of revitalized loan growth.

* Shares expanded 4.1%, a balanced counterpoint to the growth in loans. The loan to share ratio now stands at 69.1%.

* Investments increased only 1.9%.

* Profitability declined very slightly, as measured by the net income (before reserve transfers) to average assets ratio, which moved from 1.2% at the middle of last year to 1.1%.

* Liquidity improved, after tightening last year as a result of accelerated loan growth. Borrowings declined 64.3% as of midyear 1995.

* Delinquency again edged slightly lower, and is now 0.8%, compared to 0.9% during 1994.

CAPITAL

Capital [1] increased 6.3% in the first half of 1995 and now totals $31.8 billion. At the same time, assets grew at a slower pace increasing 3.7%. Capital now equates to 10.6% of total assets, compared to 9.8% for the same period one year ago. The net capital [2] to asset ratio is 9.9%, compared to 9.1% at midyear 1994.

The full implementation of SFAS 115 [3] this year has had only a slight impact on overall capital levels. The new equity account for accumulated unrealized gains and losses on available for sale securities has become an additional component of capital, which for midyear 1995 was -$190 million, representing 0.6% of total capital. Exclusion of this account from the capital to asset ratio would bring the ratio up slightly, from 10.6% to 10.7%.

ASSET QUALITY

LOAN TRENDS:

In the first half of 1995, loans expanded 4.4%, compared to 6.1% in the first half of last year. During all of 1994, loan growth expanded 15.6%, the fastest rate since 1988. Because of the disparity between loan growth and share growth during 1994 (15.6% and 3.3%, respectively), liquidity tightened, and borrowed funds increased 325%. In the first half of 1995, however, loan growth and share growth were more balanced, with loans increasing 4.4% and shares expanding 4.1%. As a result, borrowing is down significantly, -64.3%.

The ratio of loans to shares is increasing. At midyear 1995 the loan to share ratio was 69.1%, compared to 62.6% at midyear 1994, and 69.0% at the end of 1994.

Loans are also increasing as a percentage of total assets. Loans currently comprise 61.2% of total assets, compared to 55.7% at midyear 1994 and 60.8% at yearend 1994.

New auto loans contributed the most significantly to loan growth in the first half of this year, both in dollar volume and percentage increases. Of the $7.8 billion added to total loans outstanding, $3.5 billion were in new auto loans, an 8.5% increase. The second largest increase was in used auto loans, which expanded 8.0%, or $2.1 billion.

While real estate loans outstanding continued to increase, their relative contribution to the total loan portfolio is declining slowly but steadily. Real estate loans as a percentage of total loans has declined from 33.9% at yearend 1993, to 32.8% at yearend 1994, to 32.4% at midyear 1995. First mortgage loan originations have slowed considerably, although other real estate loan originations have held steady. Overall market rates on thirty-year, fixed-rate mortgages have declined over 120 basis points since December 1994. However, the resulting refinancing activity has not yet been significant. During this time, first mortgage real estate loans outstanding increased only 1.5%. In addition, fewer loans are being sold on the secondary market.

Real Estate Loans Granted and Secondary Market Activity

Biannually in Billions of Dollars June 1994 Dec. 1994 June 1995

1st Mortgage Loans Granted $8.1 $4.9 $3.8

Other Real Estate Loans Granted $3.4 $3.6 $3.5

1st Mortgages Sold on Scndry Mkt $2.8 $1.0 $1.2

DELINQUENCY TRENDS:

The ratio of delinquent loans to total loans edged down again in the first half of this year. Delinquency currently equals 0.8%, compared to 0.9% during 1994. The net charge-off ratio remained unchanged at 0.4%.

INVESTMENT TRENDS:

Total investments increased only 1.9% in the first half of 1995. This increase follows a 2.4% increase in the first six months of last year, and a 12.1% decline in the second half of 1994. Investments as a percentage of assets declined from 39.8% at midyear 1994 to 34.4% at midyear 1995. The decline of investments as a percentage of total assets is primarily attributable to the acceleration in loan growth. Loans as a percentage of total assets increased from 55.7% at the middle of last year to 61.2%.

Of the individual types of investments making up the investment portfolio, deposits in corporate credit unions registered the largest increase in dollar volume and percentage increases. Deposits in corporate credit unions increased $2.4 billion, or 10.0%, in the first half of this year. The increase in corporate credit union deposits is indicative of the perceived need for liquid investments in anticipation of continuing loan growth, and of the continued confidence in the corporate system.

The overall composition of the investment portfolio is shifting toward investments with shorter maturities and repricing intervals:

Investment Maturity% of Ttl Investments % of Ttl Invstmnts or Repricing Interval June 1994June 1995

Less than 1 year 53.1% 58.8%

1 to 3 years30.3% 26.7%

3 or more years 16.6% 14.5%

Credit unions are investing more in the short term for two reasons. First, they are anticipating liquidity needs in the near future to sustain loan growth. Secondly, the yield curve has flattened, narrowing the interest margins between longer and shorter term investments.

For the first time, all credit unions were required to report their investments according to the classification system set forth under SFAS 115. The following pie chart shows the break out of investments according to this new classification system for midyear 1995.

EARNINGS

Gross income increased as a percentage of average assets in the first half of this year. The ratio registered 7.3% in the middle of last year, compared with the current measurement of 7.9%. The increase was driven by an increase in interest income from loans, a result of accelerated loan growth during 1994. This is a favorable trend because yields on loans are generally higher than those earned on investments.

Although credit unions were able to maintain a fairly stable ratio of operating expenses to average assets, an increase in the cost of funds exerted a downward pressure on the bottom line. Net operating expenses as a percentage of average assets increased slightly, from 2.5% for the midpoint of last year to 2.6%. Before adjusting for the cost of funds, net income increased 11.6% in the first half of this year. However, in an effort to remain competitive, credit unions raised dividend rates. As a result, the cost of funds to average assets ratio increased from 2.9% at midyear 1994 to 3.4%, and the net income to average assets ratio [4] moved down slightly, from 1.2% to 1.1%.

LIQUIDITY

LONG TERM ASSET TRENDS:

The percentage of assets with maturities exceeding three years declined in the first half of this year. At midyear, 18.2% of total assets are considered long term, compared to 19.7% at the end of last year, and 19.3% at midyear 1994. Contributing to this shift is the trend favoring shorter term investments, as mentioned earlier, and the trend in shorter term lending.

SHARE TRENDS:

Shares increased 4.1% in the first six months of 1995. Growth in share certificates contributed the most significantly to total share growth, expanding by nearly $13.8 billion, or 37.0%. Growth rates for the various share categories are as follows:

Share drafts, +4.6%

Regular shares, -3.6%

Money market shares, -4.9%

Share certificates, +37.0%

IRA/Keogh accounts, +1.6%

All other shares and deposits, +21.2 %

Shares maturing between one and three years posted the largest increases in the first half of 1995, expanding 41.0%, and representing a $5.4 billion change. Share maturing in under one year increased $3.8 billion, or 1.6%, and shares maturing in more than three years increased $1.3 billion, or 29.4%.

OVERALL LIQUIDITY TRENDS:

During the second half of 1994, share growth stagnated while loan growth accelerated, raising concerns about a near term liquidity crunch. Credit unions did not have sufficient liquidity to meet loan demand, resulting in an increase in borrowed funds of $1.4 billion, or 325%.

The figures for the first half of 1995 indicate that loan growth moderated, while share growth gained momentum. The result is a more balanced level of loan and share growth.

ENDNOTES/FOOTNOTES

[1] Capital is defined as the sum of regular reserves, accumulated unrealized gains and losses on available

for sale securities, other reserves, undivided earnings, allowance for loan losses, allowance for investment losses, and the net income of credit unions which did not close their books.

[2] Net capital is defined as capital less classified assets. Classified assets are estimated by summing the allowance for investment losses, allowance for loan losses, and the investment valuation reserve for state chartered credit unions.

[3] Statement of Financial Accounting Standard (SFAS) 115, Accounting for Certain Investments in Debt and Equity Securities.

[4] The ratio of net income to average assets measures the return on assets after operating expenses, non-operating expenses or income, and cost of funds, but before transfers to reserves.