NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION

NATIONAL CREDIT UNION SHARE INSURANCE FUND

LETTER NO. 156
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DEAR BOARD OF DIRECTORS:

Enclosed is a report highlighting credit unions' financial trends during the first half of 1994. The analysis is based on data compiled from the midyear 1994 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 (2)

**** FOOTNOTES WILL APPEAR AS (1), (2), (3), ETC. AND WILL APPEAR AT THE END OF THIS LETTER AS FOOTNOTES\ENDNOTES

Enclosure #1

Financial Trends in Federally insured Credit Unions January 1, 1994 to June 30, 1994

HIGHLIGHTS

During the first half of 1994, total assets of federally insured credit unions increased 4.6%. Capital accumulated at the rate of 5.8%. Loans increased 6.1%, continuing the trend of revitalized loan growth which began last year. Loan growth exceeded share growth (4.5%), in the first half of 1994, a continuation of the trend which began last year. The loan to share ratio now stands at 62.6%, versus 61.7% at the end of 1993. Delinquency continues its steady decline, as it has since 1987, and currently measures 0.9% of total loans. Investments increased 2.4% during the first six months of this year, compared to 5.0% for the first half of 1993. This is a significantly slower rate of growth in comparison to the first halves of 1992 and 1991 when investments grew 19.2% and 49.8%, respectively. Profitability in federally insured credit unions declined slightly, because growth in operating expenses (3.6% annualized) continues to exceed growth in income (-0.6% annualized).

CAPITAL

From January to June 1994, capital(1) increased 5.8%, beginning the ninth consecutive year of capital accumulation in federally insured credit unions. The ratio of capital to total assets currently is 9.8%, compared to 9.7% at the end of 1993. The net capital(2) to total assets ratio is 9.1%, compared to 9.0% at the end of last year.

During the period of 1989 through 1993, capital growth significantly and consistently outpaced loan growth. However, the ratio of capital to total loans has remained unchanged from the yearend 1993 level of 17.7%.

ASSET QUALITY

LOAN TRENDS: In the first half of this year, loans increased 6.1%. If loans continue to expand at this rate for all of 1994, the annual rate of increase will be the largest percentage increase since 1988. From 1989 until last year, share growth consistently exceeded loan growth. The reversal of this trend has continued into the first half of 1994, and the resulting loan to share ratio has increased to 62.6%, compared to 61.7% at yearend.

In terms of dollar volume, loan growth was concentrated in vehicle loans, which contributed $6.1 billion of the $9.2 billion increase in the total loan portfolio for midyear 1994. New vehicle loans exhibited the largest increase in terms of dollar volume growth, $3.5 billion (10.9%). Used vehicle loans increased $2.6 billion (11.9%). First mortgage real estate loans also increased $2.6 billion (8.1%) during the first six months of 1994. Real estate loans, other than first mortgages, increased a slight 1.3%. Unsecured loans remained essentially unchanged from yearend 1993, and no longer comprise the single largest loan category within the total loan portfolio. New auto loans, followed very closely by first mortgage real estate loans, currently account for the greatest portion of the total loan portfolio.

While real estate loans continue to contribute significantly to the total loan portfolio, their percentage of total loans has dropped slightly in recent years. Total real estate loans currently comprise 33.7% of total loans, compared to 34.0% at yearend 1993 and 35.3% at the end of 1992.

First mortgage real estate loan originations dropped sharply, compared to the second half of 1993. However, as the following table illustrates, the second half of 1993 exhibited an unusually high level of first mortgage loan originations. The level of first mortgage loan originations in the first half of 1994 merely adjusted downward to resume levels commensurate with new loans granted in the past several years3. This pattern is also apparent in the levels of activity in the secondary market, although the amount of first mortgage loans sold in the first six months of this year dropped below levels of activity demonstrated in the earlier periods. As a result, credit unions are currently holding more first mortgage loans in their portfolios, and this has contributed to the increase in the amount of real estate loans outstanding on the balance sheet.

First Mortgage Loan Activity(3)

Originations * Sold in Secondary * Outstanding Market Balance

6/92 $7.575 $3.471 $27.581

12/92 $8.459 $3.333 $29.223

6/93 $8.017 $3.631 $30.817

12/93 $11.231 $5.453 $32.789

6/94 $8.137 $2.750 $35.435

It should be noted that much of the patterns exhibited by first mortgage loan originations, secondary market activity and outstanding balances have been significantly influenced by refinancing in response to declining interest rates. However, because of limitations in the data, it is not possible to quantify the effect that refinancing has had on mortgage lending.

Other noteworthy items regarding real estate lending are:

* Of the nearly $54.4 billion in real estate loans outstanding at midyear 1994, $23.6 billion, or 43.3% of all real estate loans, will either refinance, reprice or mature within 3 years.

* Of the $52.9 billion in loans granted during the first half of 1994, $11.5 billion were in real estate loans. Approximately 21.7% of new loans, therefore, were real estate secured.

DELINQUENCY TRENDS: The ratio of delinquent loans to total loans declined again during the first six months of 1994. Loan delinquency has been gradually and consistently edging downward since 1987. The ratio of delinquent loans to total loans currently stands at 0.9%, compared to 1.0% at yearend 1993, and 1.2% at yearend 1992. The total dollar volume of delinquent loans has actually been declining since 1990, and the most recent decline during the first half of 1994 (-6.2%), brings the total amount of delinquent loans down to $1.5 billion. From yearend 1993 to midyear 1994, loans delinquent 2 to 6 months declined 6.6%; loans delinquent 6 to 12 months declined 4.3%; and loans delinquent 12 months or more declined 7.3%.

While delinquency has been on the decline, the net charge-off to average loan ratio has also edged slightly lower. At midyear 1994, the net charge-offs to average loans ratio is 0.4%, compared to 0.5% at yearend 1993, 0.6% at yearend 1992 and 0.7% at yearend 1991.

INVESTMENT TRENDS: Total investments increased only 2.4% during the first half of 1994 and only 5.0% during all of 1993, a dramatic slowdown when compared with investment growth during 1992 and 1991 which registered 28.3% and 34.8%, respectively. The significantly lower rate of investment growth is primarily due to the acceleration in loan growth during 1993 and the first half of 1994.

Of the individual types of investments making up the portfolio, investments in federal agency securities (including mortgage-backed securities) registered the largest increase in terms of dollar volume ($4.7 billion) and the second largest percentage growth (15.0%). Dollar volume increases were also significant in U.S. government obligations which added $1.4 billion to the midyear 1994 investment portfolio, an increase of 7.9%. Deposits in corporate credit unions declined 4.3%, representing an outflow of $1.3 billion.

The overall composition of the investment portfolio is shifting toward investments with longer maturities and repricing intervals. In the first half of 1994, investments maturing or repricing in less than 1 year declined 4.1%, and currently represent 53.0% of the total investment portfolio, compared to 56.6% at the end of 1993. Investments maturing or repricing in 1 to 3 years increased $2.7 billion, or 8.5%, while investments maturing or repricing in more than 3 years increased $2.6 billion (15.9%).

Losses, both unrealized and realized, due to market value decline and to sales or trades at below amortized cost, have occurred primarily as a result of rising interest rates. Significant indicators are:

* an increase of 307% in the allowance for investment loss account (from $60.8 million at the end of 1993 to $247.6 million at midyear 1994),

* a reported net loss of $14.8 million (annualized) as of June 30, 1994 in the income from trading account as opposed to a net gain of $58.4 million reported at yearend 1993, and finally,

* a net loss on investments in the non-operating gain or loss category of $9.9 million (annualized) compared to a net gain of $71.8 million at the end of 1993.

Due to the variety of accounting treatments currently followed by credit unions, it is not possible to tell if these losses involve available-for-sale or trading accounts, and the extent to which they are realized or unrealized. Full implementation of Statement of Financial Accounting Standard 115 would ultimately clarify these accounting distinctions.

EARNINGS

During the first half of 1994, the profitability of federally insured credit unions declined, as measured by the ratio of net income to average assets(4). Operating expenses increased 3.6% (annualized), while gross income declined 0.6% (annualized). As a result of declining asset yield, gross income as a percentage of average assets declined in the first six months of this year. The ratio of operating expenses to average assets remained stable. Consequently, the net income to average assets ratio declined from yearend 1993 (1.4%) to midyear 1994 (1.2%). Although loans outstanding at midyear 1994 increased (6.1%), interest income declined (-1.4%). These circumstances are a result of a loan turnover with newly issued loans being written at lower interest rates than those maturing. Although credit unions reduced their cost of funds, the savings were not enough to sustain previous levels of profitability. This condition will be further exacerbated if market interest rates continue their steady rate of increase and credit unions increase their cost of funds without a corresponding increase in asset yield.

LIQUIDITY

The percentage of assets with maturities exceeding 3 years increased from yearend 1993 to midyear 1994. Currently, 19.4% of total assets are long-term, compared to 18.3% at the end of last year. As mentioned before, real estate loans, which are generally longer term than other types of loans, contributed significantly to asset growth during the first half of 1994, and are partially responsible for the change evidenced in the long-term asset ratio. Also contributing to the upward shift in long-term assets is the increasing maturity of the investment portfolio. Investments with maturities or repricing intervals exceeding 3 years increased $2.6 billion, or 15.9%.

SHARE TRENDS: Total shares increased 4.5% during the first six months of this year, the slowest rate of growth since 1989. In terms of dollar volume, regular shares contributed the most significantly to total share growth, increasing nearly $6.7 billion. Growth rates for the various share categories are as follows:

Share drafts, +4.3%

Regular shares, +5.2%

Money market shares, +3.2%

Share certificates, +4.8%

IRA/Keogh accounts, +0.1%

All other shares and deposits, +23.3%

Short-term shares, or shares maturing or repricing in less than 1 year, accounted for the majority of the growth in total shares. Shares maturing or repricing in less than 1 year increased $9.8 billion during the first half of 1994 (4.2%). Shares categorized as maturing or repricing in 1 to 3 years increased 6.4% (an increase of approximately $680 million) and shares in the exceeding 3 year category grew 15.6% (about $556 million).

Enclosure #2

REGIONAL COMPARISONS

The following table and the graphic presentation attached to this report show regional comparisons of key ratios and trends.

JUNE 1994 RATIOS							
	RG I *	**RG II ***	**RG III ***	**RG IV ***	**RG V ***	**RG VI ***	**NATIONAL AVERAGE**
Capital to Assets	10.4%	9.1%	10.3%	9.9%	9.7%	9.7%	9.8%
Net Cap. to Assets	9.3%	8.4%	9.5%	9.1%	9.0%	9.0%	9.1%
Dlnquency	1.6%	0.9%	0.8%	0.9%	0.8%	0.8%	0.9%
Net Charge- Offs	0.6%	0.4%	0.4%	0.3%	0.3%	0.5%	0.4%
Fixed Assets & OREOs	1.5%	1.3%	1.8%	1.8%	1.9%	1.9%	1.7%
Net Op. Exp. to Average Assets	2.5%	2.4%	2.4%	2.8%	2.6%	2.5%	2.5%
Net Income Before Transfers	1.2%	1.2%	1.4%	1.1%	1.2%	1.1%	1.2%
Net Income After Transfers	1.2%	1.1%	1.3%	1.0%	1.1%	1.0%	1.1%
Long-Term Assets	37.9%	29.0%	25.8%	25.9%	21.2%	28.7%	27.5%
Net Long- Term Assets	27.1%	22.1%	16.4%	18.1%	16.8%	18.8%	19.4%

FOOTNOTES\ENDNOTES

(1) Capital is defined as the sum of the following accounts: regular reserves, other reserves, undivided earnings, allowance for loan losses, allowance for investment losses, and the net income of credit unions who did not close their books.

(2) Net capital is defined as capital less classified assets. Classified assets are estimated by summing the following accounts: allowance for loan losses, allowance for investment losses, and the investment valuation reserve for state-chartered credit unions.

(3) The figures in this table are in billions of dollars. Loan originations and secondary market data reflect activity during the six month period identified (i.e., the figures are neither annual nor annualized).

(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.