NCUA LETTER TO CREDIT UNIONS

DATE: March 1999 LETTER NO.: 99-CU-04

DEAR BOARD OF DIRECTORS:

Enclosed is a report highlighting credit union financial trends during 1998. The analysis is based on data compiled from the yearend 1998 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.

I thank you for your cooperation in providing this data and look forward to any comments you may have.

For the National Credit Union Administration Board,

/S/
NORMAN E. D'AMOURS
Chairman

Enclosure

FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1, 1998 to December 31, 1998

HIGHLIGHTS

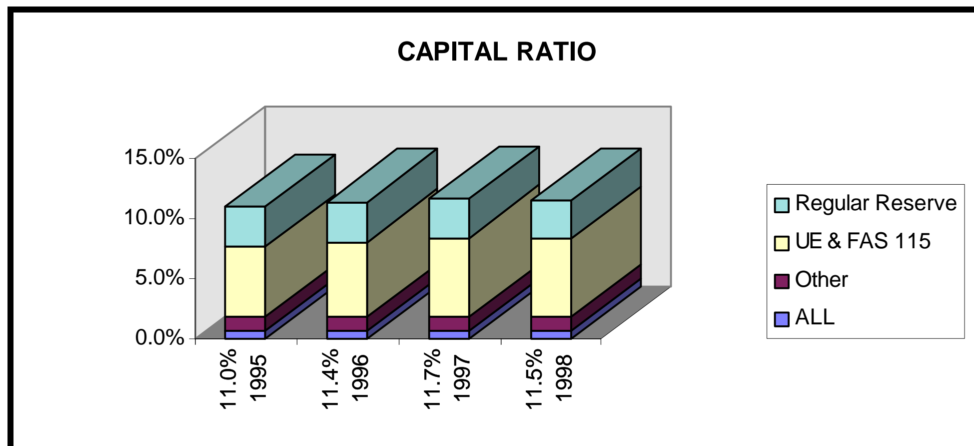
This report summarizes the trends of all federally insured credit unions which reported as of December 31, 1998. The trends discussed for all federally insured credit unions do not necessarily reflect the trends in smaller credit unions.

- **Assets** increased $37.5 billion or 10.7%.
- **Capital increased, but at a slower rate,** 8.8% ($3.7 billion increase), and the capital to assets ratio declined to 11.5%.
- **Loans** increased $13.5 billion, or 5.8%.
- **Shares** increased $32.8 billion or 10.7%. The loan to share ratio decreased to 72.3%.
- **Investments** increased $21.9 billion or 21.3%.
- **Profitability** declined slightly with a 0.95% return on average assets ratio.
- **Delinquent** loans as a percentage of total loans decreased from the yearend 1997 level of 1.01 to 0.88%.

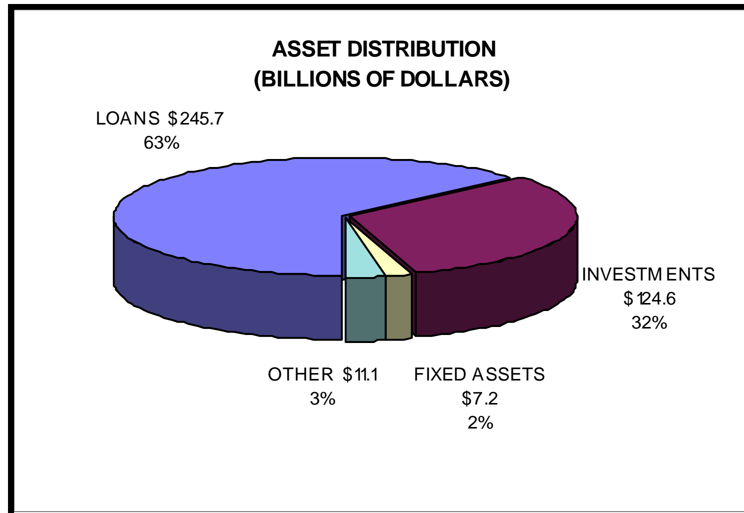
CAPITAL

Total capital increased $3.7 billion or 8.8% during 1998, compared to a 10.3% increase during 1997. The capital to total assets ratio declined from 11.7% at the end of 1997 to 11.5% at the end of 1998 due to asset growth outpacing capital growth.

The net capital to total assets ratio, which measures capital after estimated losses, also declined from 11.1% to 10.9%.



ASSET QUALITY



LOAN TRENDS: Total loans increased $13.5 billion or 5.8% during 1998. Two loan categories accounted for the increase:

- First mortgage real estate loans increased $9.5 billion (18.3% increase);
- Used auto loans increased $4.9 billion (11.4% increase);

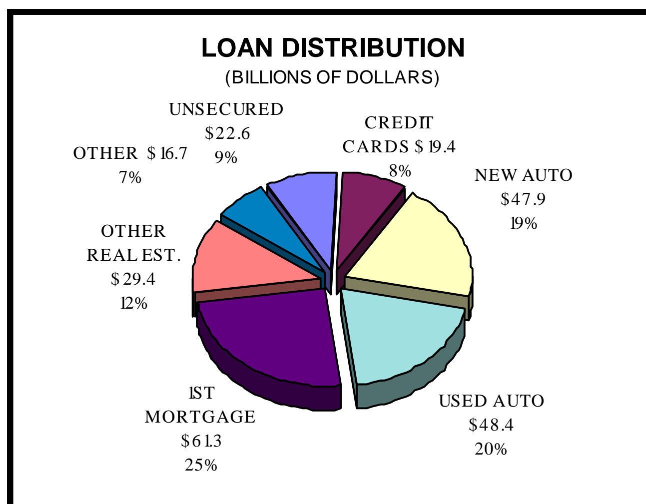
New auto loans and other unsecured loans (excluding credit cards and other lines of credit) declined $1.5 billion (3.1%) and $0.9 billion (3.7%), respectively.

First mortgage real estate loans ($61.3 billion) account for 25% of all loans, with $43.9 billion or nearly 72% reported to be fixed rate. For the first time in more than 10 years, outstanding adjustable rate first mortgage real estate loans declined, although by a small amount (3.8%).

Federally insured credit unions granted $27.1 billion in fixed rate first mortgage real estate loans in 1998 – more than double the amount granted in 1997. During this same period, $4.5 billion adjustable rate first mortgages were granted, nearly equal to the amount granted in 1997.

Credit unions also report dramatic increases in the amount of first mortgages sold: $10.8 billion in 1998 compared to $4.5 billion in 1997 (includes both fixed and adjustable rates).

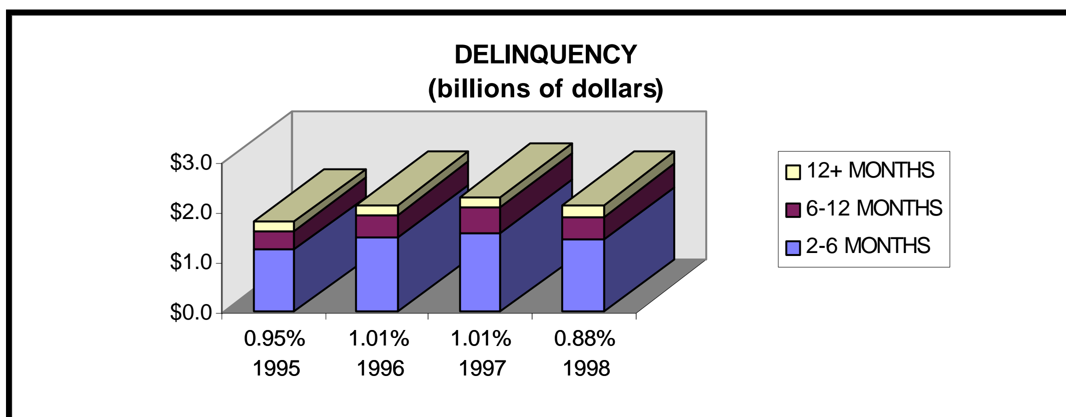
The slower rate of loan growth (5.8%) ended a 5-year trend of loan growth exceeding the rate of share growth (10.7% for 1998). As a result, the loan to share ratio decreased to 72.3%, the lowest level since 1995.

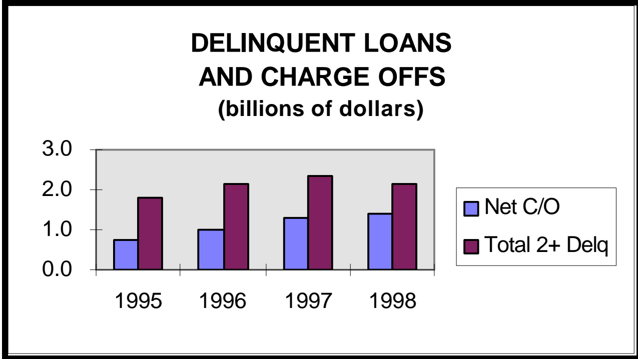


DELINQUENCY TRENDS: Delinquent loans decreased $179 million or 7.7%, and the delinquent loans to total loans ratio decreased from 1.01% at the end of 1997 to 0.88% at the end of 1998. This represents the lowest delinquency rate since 1994.

While the delinquency ratio declined, the net charged off loans to average loans ratio remained unchanged at 0.6% for 1998. Although the ratio did not change, loan dollars charged off increased $122 million or 8% over 1997's charge offs. Recoveries on charged off loans increased 12.0%. The net charge off ratio remained unchanged because the rate of loan growth was similar to the rate of growth in net charge offs.

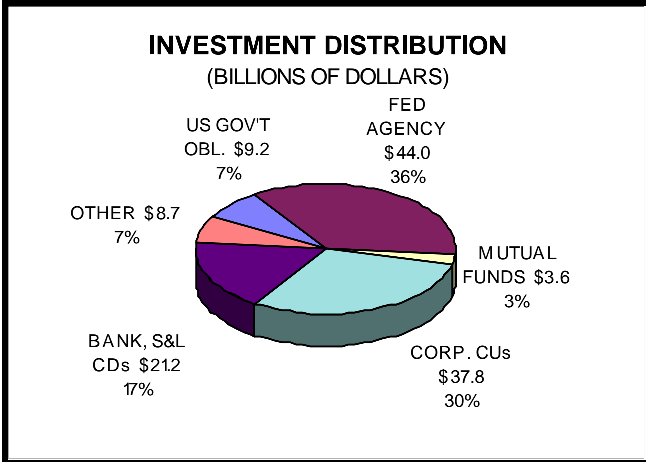
Bankruptcies continue to increase. Credit unions reported nearly $1 billion in outstanding loans subject to bankruptcies, and another $781 million charged off in 1998 as a result of bankruptcies. Nearly 250,000 credit union members filed for bankruptcy in 1998 (approximately the same number as reported for 1997), representing 0.3% of all members.





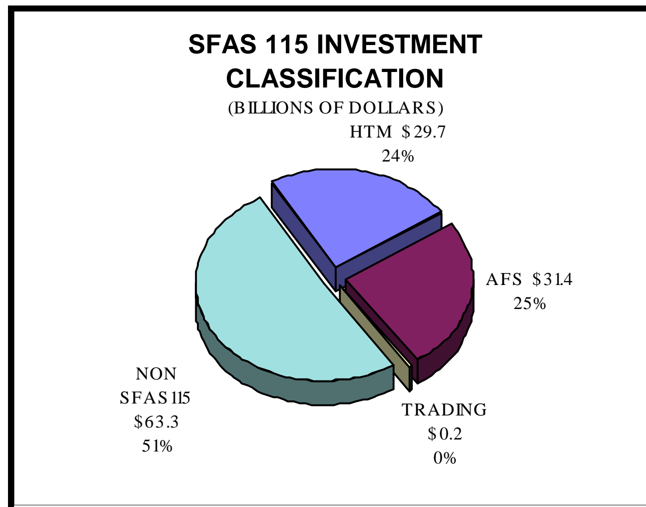
INVESTMENT TRENDS: Investments increased $21.9 billion (21.3%) during 1998, and represent 32.0% of total assets. This is a large increase from the 1997 level of 29.2% of assets.

The investment mix also changed, with significant increases noted in corporate credit union investments ($11.8 billion or 45.3%), certificates of deposit at banks ($4.7 billion or 28.4%), and federal agency securities ($4.7 billion or 11.9%). The only decline was in U.S. Government obligations, which decreased $2.5 billion or 21.2%.



During 1998, investments with maturities or repricing periods less than 1 year increased $15.6 billion or 25.2%, which is consistent with the growth noted in corporate credit union investments and certificates of deposit.

The investment portfolio continues to shift from *held to maturity* and *available for sale* investments into *non-SFAS 115* investments. At the end of 1997, *held to maturity* and *available for sale* investments made up 54.8% of the investment portfolio (30.1% and 24.7%, respectively), while *non-SFAS 115* investments accounted for 44.9% of the portfolio (the remainder was classified as trading). As noted on the graph below, *non-SFAS 115* investments now account for 50.8% of the portfolio. Again, this is due to an increase in investments in corporate credit unions and certificates of deposit.



Investments in the 3 to 10 years maturity category increased consistent with the increase in federal agency securities. The following table compares the changes in the maturity structure of the investment portfolio during 1998.

Investment Maturity or Repricing Interval	% of Total Investments Dec. 1997	% of Total Investments Dec. 1998
Less than 1 year	60.2%	62.2%
1 to 3 years	25.2%	21.3%
3 to 10 years	10.1%	12.5%
Greater than 10 yrs	4.5%	4.0%

EARNINGS

The earnings ratios declined in 1998. At 8.23%, the gross income to average assets ratio (yield) declined to its lowest level since 1995. The decline can be attributed to placing a larger percentage of assets in investments rather than in higher-yielding loans.

The decline in yield was somewhat offset by small declines in the cost of funds, operating expense, and Provision for Loan Loss expense ratios. However, these small declines were not sufficient to avoid a decline in the Return on Average Assets ratio (see table).

Ratio	As of 12/97	As of 12/98
Gross Income	8.41%	8.23%
Cost of Funds	3.64%	3.57%
Operating Expenses	3.32%	3.31%
PLL	0.44%	0.42%
ROA	1.03%	0.95%

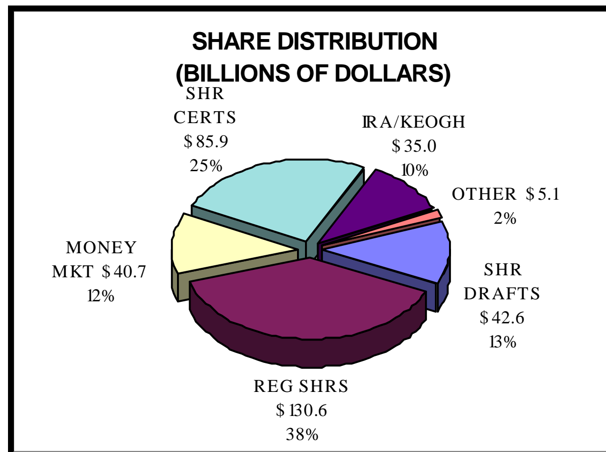
ASSET/LIABILITY MANAGEMENT

LONG TERM ASSET TRENDS: Long term assets continue to increase as a percentage of total assets. These assets, which have maturities or repricing intervals greater than 3 years, equaled 22.3% of total assets at the end of 1998, compared to 20.2% at the end of 1997. This increase is the result of growth in first mortgage real estate loans and increased investments in federal agency securities discussed earlier.

SHARE TRENDS: Total shares increased $32.8 billion or 10.7% in 1998, compared to 7.1% in 1997. Share dollars in all categories increased in 1998, as noted below:

- Share drafts -- ↑ $6.7 billion, 18.8%;
- Regular shares -- ↑ $7.2 billion, 5.8%;
- Money market shares -- ↑ $7.4 billion, 22.4% (this represents the largest percentage increase);
- Share certificates -- ↑ $9.9 billion, 13.0% (this represents the largest dollar increase);
- IRA/Keogh accounts -- ↑ $0.7 billion, 2.0%;
- Other shares -- ↑ $0.7 billion, 21.3%; and
- Nonmember deposits -- ↑ $106 million, 13.8%.

Large increases in short term share accounts such as share drafts and money market accounts may indicate members' uncertainty about the financial markets in general, and a desire to keep funds liquid.

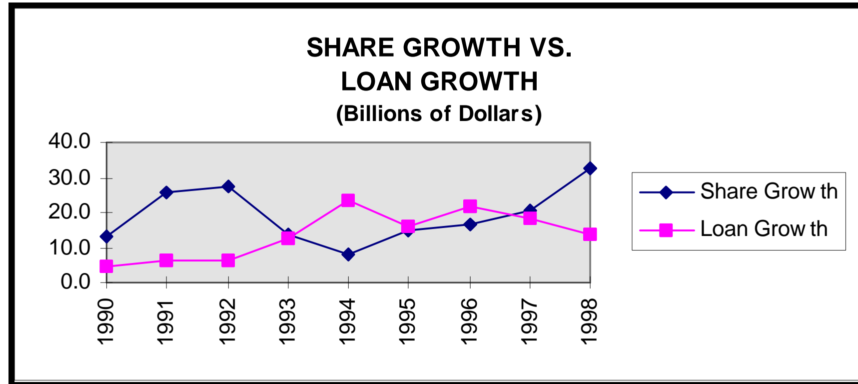


Consistent with the large increases in share drafts, regular shares, and money market accounts, share growth during 1998 was concentrated in shares with maturities less than 1 year. These shares increased $30.4 billion (11%) and represented 93% of all share growth. Share maturities for the past two years are as follows:

Share Maturity or Repricing Interval	% of Total Shares Dec. 1997	% of Total Shares Dec. 1998
Less than 1 year	89.9%	90.2%
1 to 3 years	8.3%	7.9%
3 or more years	1.8%	1.9%

OVERALL LIQUIDITY TRENDS: As previously noted, a five-year trend of the

rate of loan growth exceeding the rate of share growth ended in 1998. The trends of loan growth versus share growth over the past nine years are illustrated in the following graph.



Since the beginning of 1990, share growth has exceeded loan growth by $49.6 billion in total. During the periods when share growth exceeds loan growth, excess funds are placed in investments. For all years, liquid assets (cash and investments with maturities less than 1 year) remained relatively constant at about 23% of assets.

At the end of 1998, cash and short-term investments made up about 22% of total assets, allowing credit unions ample liquidity to meet daily cash needs.

Total unused commitments equaled $68.0 billion, up $8.0 billion or 13.3% since the end of 1997. Unused credit card lines equaled $40.5 billion (60% of the total), increasing $3.7 billion or 10%, and unused home equity lines of credit increase $2.5 billion or 23.7%. In light of the need for prudent management of liquidity and contingency funding arrangements, credit union managers are encouraged to consider unused commitments when evaluating their overall funds management strategies.