NCUA LETTER TO CREDIT UNIONS

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FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1, 1994 to December 31, 1994

{1}, {2}, {3} -- Denotes an endnote.

HIGHLIGHTS

Total assets of federally insured credit unions increased 4.5%, the smallest rate of growth since 1948. In the last six months of the year there was actually a slight contraction in total assets, from $289.7 billion dollars at midyear to $289.5 billion at yearend.

Capital accumulated at the rate of 11.3%.

Loans increased 15.6%, continuing the trend of revitalized loan growth which began last year. For the second consecutive year, loan growth exceed share growth (3.3%). The loan to share ratio now stands at 69.0%, compared to 61.7% at the end of 1993.

Delinquency continued its steady decline, as it has since 1987, and currently measures 0.9% of total loans.

Total investments declined by 10.0%, despite registering an increase of 2.4% during the first six months of the year.

Profitability declined slightly, as measured by the net income (before transfers) to average assets ratio, which fell from 1.4% to 1.2%.

Liquidity tightened during the year, with an increase in long-term assets, and a 325% increase in borrowed funds.

CAPITAL

Capital{1} increased 11.3%, marking the ninth consecutive year of capital accumulation in federally insured credit unions. The ratio of capital to total assets currently is 10.4%, compared to 9.7% at the end of 1993. The net capital{2} to total assets ratio is 9.5%, compared to 9.0% at the end of last year.

During the period of 1989 through 1993, capital growth outpaced loan growth. During 1994, however, loan growth (15.6%) exceeded capital growth (11.3%), and as a result, the ratio of capital to total loans declined slightly from the yearend 1993 level of 17.7% to 17.1%.

ASSET QUALITY

LOAN TRENDS: Loans expanded at the rate of 15.6% during 1994, the largest percentage increase since 1988. From 1989 until last year, share growth consistently exceeded loan growth. The reversal of this trend in 1994 resulted in a significant change in the loan to share ratio. The ratio currently measures 69.0%, compared to 62.6% at midyear 1994, and 61.7% at the end of 1993.

While all categories of loans to members increased during 1994, in terms of dollar volume, loan growth was concentrated in vehicle loans, which contributed $14.0 billion of the $23.7 billion increase in the total loan portfolio. New vehicle loans exhibited the largest increase in terms of dollar volume growth, $9.2 billion (28.6%). First mortgage real estate loans increased $4.5 billion (13.8%). Real estate loans, other than first mortgages, increased 8.7%, or $1.6 billion. Unsecured loans increased $2.9 billion, or 8.7%. New auto loans currently account for the greatest portion of the total loan portfolio (23.5%), followed very closely by first mortgage real estate loans (21.2%).

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 32.8% of total loans, compared to 33.9% at yearend 1993 and 35.2% at the end of 1992.

Real estate loan originations during 1994 dropped sharply, to $20.0 billion, compared to $25.5 billion during 1993. The largest decrease was in first mortgage fixed rate loans which declined 44.7%. Much of decreased level in real estate loan originations was caused by the rising interest rate market during 1994 which diminished refinancing activity.

The amount of first mortgage loans sold in the secondary market declined even more sharply in 1994, from $9.1 billion during 1993 to $3.7 billion, a decrease of 59.3%. 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.

Another noteworthy item regarding real estate lending is that of the nearly $57.8 billion in real estate loans outstanding at yearend 1994, $24.7 billion, or 42.7% of all real estate loans, will either refinance, reprice or mature within 3 years.

DELINQUENCY TRENDS: The ratio of delinquent loans to total loans declined again during 1994. Loan delinquency has been gradually 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 1994 brings the total amount of delinquent loans down to $1.552 billion. From yearend 1993 to yearend 1994, loans delinquent 2 to 6 months increased 4.7%; loans delinquent 6 to 12 months declined 7.1%; and loans delinquent 12 months or more declined 18.9%.

While delinquency has been on the decline, the net charge-off to average loan ratio has also edged lower. At yearend 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 declined 10.0% during 1994 versus a 5.0% increase during 1993. This is a dramatic change when compared with investment growth during 1992 and 1991 which registered 28.3% and 34.8%, respectively. The significantly lower rate of investment growth during 1993 and the significant decline during 1994 is primarily due to the acceleration in loan growth. This change is also the result of credit unions' accounting recognition of declining market values.

Of the individual types of investments making up the portfolio, investments in federal agency securities (including mortgage-backed securities) registered the only significant increase, up $3.6 billion, or 11.5%. As credit unions withdrew their deposits in corporate credit unions, banks and S&Ls, they reinvested the funds in federal agency securities. The largest dollar volume decrease was in deposits in corporate credit unions, which declined 24.2%, representing an outflow of $7.7 billion. The second largest dollar volume decline was in deposits in banks and S&Ls which decreased 24.9%, or $5.3 billion.

The overall composition of the investment portfolio is shifting toward investments with longer maturities and repricing intervals. During 1994, investments maturing or repricing in less than 1 year declined 17.2%, and currently represent 52.2% of the total investment portfolio, compared to 56.7% at the end of 1993. Investments maturing or repricing in 1 to 3 years decreased $1.5 billion (-4.8%), while investments maturing or repricing in more than 3 years increased $1.3 billion (7.7%).

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 447% in the allowance for investment loss account (from $60.8 million at the end of 1993 to $332.1 million at the end of 1994),

* a reported net loss of $8.0 million as of yearend 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 $62.0 million compared to a net gain of $71.8 million at the end of 1993.

Due to the variety of accounting treatments followed by credit unions during 1994, 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 during 1995 will ultimately clarify these accounting distinctions.

EARNINGS

During 1994, the profitability of federally insured credit unions declined, as measured by the ratio of net income to average assets{3}. Operating expenses increased 6.3%, while gross income increased 3.1%. As a result of declining asset yield, gross income as a percentage of average assets declined this year, from 7.8% at the end of 1993 to 7.6%. The ratio of net operating expenses to average assets remained fairly stable, 2.5% at yearend 1993, compared to 2.6% at yearend 1994. Consequently, the net income to average assets ratio declined from yearend 1993 (1.4%) to yearend 1994 (1.2%). In contrast with prevailing market interest rates, credit unions reduced their cost of funds slightly (from 3.1% at yearend 1993 to 3.0%), but the resultant marginal savings were not enough to sustain previous levels of profitability, and is attributable to some liquidity issues. This condition will be further exacerbated if market interest rates continue their steady rate of increase and credit unions are forced to raise their cost of funds.

There were 588 credit unions reporting a net loss at yearend 1994. They reported a total negative net income figure (after statutory reserve transfers) of $55.6 million. These figures represent an increase of 58 credit unions and $25.8 million in losses over the comparable yearend 1993 data.

LIQUIDITY

LONG TERM ASSET TRENDS: The percentage of assets with maturities exceeding 3 years increased from yearend 1993 to yearend 1994. Currently, 19.7% of total assets are long-term, compared to 18.2% 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 loan growth during 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 $1.3 billion (7.7%).

SHARE TRENDS: Total shares increased 3.3% during the year, the slowest rate of growth since 1943. In terms of dollar volume, share certificates contributed the most significantly to total share growth, increasing nearly $6.9 billion. Growth rates for the various share categories are as follows:

Share drafts, +7.9%

Regular shares, -0.5%

Money market shares, -0.6%

Share certificates, +22.7%

IRA/Keogh accounts, 0.0% (no change)

All other shares and deposits, +0.3%

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 $4.8 billion during 1994 (2.0%). Shares categorized as maturing or repricing in 1 to 3 years increased 23.8% (an increase of approximately $2.5 billion) and shares in the exceeding 3 year category grew 26.8% (about $952 million).

OVERALL LIQUIDITY TRENDS: The increase of $23.7 billion in outstanding loans during 1994 was partially funded by the disposition of investments and the increases in member savings and net income (after all reserve transfers). However, these sources did not provide sufficient funds to meet member loan demand. Credit unions made up the difference by borrowing. Borrowings (exclusive of reverse repurchase agreements) increased $1.4 billion, or 325%, during 1994, which was approximately the shortfall between funds readily available for lending and the demand for loans.

Lengthening asset maturities and borrowing to meet loan demand may indicate that more emphasis on asset/liability management is needed. Credit unions may need to competitively raise their cost of funds to attract additional member savings, and may also need to adjust lending rates upward. Savings only increased 3.3% during 1994, the lowest rate of increase on record in fifty years. The cost of funds during 1994 actually dropped slightly, from 3.1% to 3.0%, which was in contrast to prevailing market interest rates which rose steadily throughout the year.

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 ratio of net income to average assets measures the return on assets after operating expenses, non-operating expenses (or income) and cost of funds.