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Executive Summary

- Loan growth for all federally insured credit unions (FICUs) during the first half of 2004 was approximately 5 percent. The majority of the loan growth came from first mortgage loans, which contributed 38 percent, followed by other real estate loans, which contributed 27 percent. Loan growth exceeded the national average in only two regions.
- Most credit unions expect elevated new and used auto loan demand over the next 12 months. Several regions seem to be less optimistic about real estate lending, given the likelihood that long-term interest rates will increase over the next year.
- Share growth for all FICUs was 4 percent during the first half of 2004, with strong growth in every region being concentrated in non-maturity share accounts.
- Credit unions as a whole are uncertain whether share growth will continue to decrease or remain about at current levels over the next twelve months. Institutions in NCUA Region 3 (Southeast) seem to feel strongest about a possible up-tick in share growth, citing expectations that banks will move slowly in increasing deposit rates.
- The return on average assets (ROA) for all FICUs at the end of the first half of 2003 was 0.92 percent. Most credit union management teams believe that earnings over the next twelve months will remain about the same or move slightly higher.
- General economic conditions in each of the NCUA regions tend to mirror the national picture, but within each region, economic activity is under performing or outperforming the nation as a whole. Housing affordability and labor market performance remain of concern in several regions. However, strong manufacturing output (Region 1, Northeast) and home sales (Region 6, West) are examples of improving sectors.
- Most of the credit union leadership throughout the country were not concerned about liquidity at this time. However, if interest rates increase quickly, than liquidity pressures may emerge. Credit union managers expect continued margin pressure over the near-term. Although general economic conditions remain mixed, asset quality at most credit unions continues to be strong.

NCUA Region One

NCUA's Region 1 (Northeast) consists of eight states.[1] As of June 2004, there were 1,595 federally insured credit unions in the region, with total assets of $104.9 billion and a total membership of 8.7 million.

Lending

Region 1's loan growth during the first half of 2004 was 4.7 percent, compared to 5.0 percent for all federally insured credit unions (FICUs). During the first six months of the year, loan growth was concentrated in real estate products, and to a lesser extent, light vehicle loan products. The steady mortgage "refi" activity that swept the nation during the first half of 2004 was evident in Region 1. First mortgage lending expanded by 4.5 percent, while home equity loan demand grew at the brisk pace of 10.3 percent. Despite the continuation of auto maker/dealer incentives, new auto lending expanded by nearly 4 percent, supported by indirect lending programs, member education, and Internet sales. Used auto loan demand rose by over 2.6 percent during the first half of 2004. Credit card and unsecured lending reversed the gains of the previous year, declining by 3.5 percent and 0.8 percent respectively. Finally, the region's credit unions experienced an elevated demand for member business loans, with lending expanding at an 18 percent pace.

According to the NAFCU's October *Flash Report*, near-term expectations for loan growth in Region 1 were slightly more negative than during the previous month. The responding credit unions felt that both new and used light vehicle loan growth would be somewhat weaker during the fourth quarter than they predicted in September. However, the credit unions in Region 1 were more optimistic about the near-term prospects for unsecured lending. Regarding real estate loan demand, the responding credit unions were marginally more positive than they were during the previous month.

Member Shares

Region 1's share growth was 3.7 percent during the first six months of the year, slightly below the 4 percent for all FICUs. As with many FICUs, the region's share growth during the first half of 2004 was concentrated in money market shares, share drafts, and regular shares (which rose by 3.6 percent, 4.4 percent, and 5.5 percent respectively). During the first half of the year, IRA/KEOGH accounts grew by 2 percent, while there was only a 0.2 expansion of share certificates as members chose to keep their assets as liquid as possible. Many of Region 1's credit unions expect share growth to continue to decline during the fourth quarter of 2004. However, according to the October *Flash Report*, some of the responding credit unions indicated that they believe share growth will pick up modestly over the near term. Because loan demand remains strong at many of the region's credit unions, liquidity has been an issue. As a result, corporate credit unions have been increasing their lending activity to their member credit unions, while experiencing a net outflow of overnight and most other investments.

[1] The eight states are Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island and Vermont.

Earnings and Asset Quality

During the first half of 2004, the credit unions in Region 1 had an ROA of 0.84 percent, compared to an ROA of 0.92 percent for all FICUs. The lower cost of funds, limiting expenses, and higher non-interest income helped offset the lower net margins. For example, the net margin over average assets declined to 4.09 percent in June 2004 from 4.25 percent at the end of 2003. During the same time period, the cost of funds over average assets fell 30 basis points to 1.34 percent. Assuming a gradually rising interest rate environment over the next year, the region's credit unions expect a moderate increase in earnings and ROA. The asset quality in the region was somewhat better than the asset quality of all FICUs during the first half of this year. The delinquent loans-to-total loans ratio in the region was 0.64 percent compared to 0.67 percent for all FICUs, while the net charge-off rate in Region 1 of 0.39 percent was much lower than the overall FICU charge-off rate of 0.53 percent. While bankruptcy remains a problem in Region 1, both the number of members filing for bankruptcy and the loan amounts subject to bankruptcy declined during the first half of 2004. As a result, the Region's credit unions did not indicate that bankruptcy was a principal concern for moving into 2005.

Competition and Credit Union Operational Concerns for 2004

Region 1's credit unions are closely watching three bank consolidations: Bank of America with Fleet, Citizens Bank with Charter One, and First Niagara with Hudson River Bank and Trust. These merger activities have created uncertainty among the Region's credit unions as the "behavior" of these new financial entities has yet to be seen. Liquidity has become an operational concern in Region 1 as loan demand remains robust at most institutions, while share growth has slowed significantly. As a result, credit unions are borrowing from their corporate credit unions, the Federal Home Loan Banks, and/or engaging in loan participations. The other principal operational concern is how and when to re-price loan rates and share rates in line with the expected rise in interest rates.

Member Concerns and Economic Conditions in 2004

When asked to assess their member's confidence/sentiment, the majority of the region's credit unions indicated that their members were cautiously optimistic about 2005. Many members cited geopolitical uncertainty as a major concern, while others cited the rising interest rate environment, the low share rates, and the condition of the labor market. While most members felt the economy would continue to grow at a decent pace, there was concern that both consumer spending and business investment could easily be disrupted by an act of terrorism.

The economic and financial conditions throughout Region 1 were positive overall during the first half of 2004. In New York, the manufacturing sectors around Buffalo and Rochester have finally recovered, while employment generation in Connecticut was above the nation's average. In Maine, credit unions experienced very strong non-maturity deposit demand, while in Massachusetts credit unions experienced strong home equity loan demand during the first six months of the year. In both New Hampshire and

Vermont, credit unions reported an increase in commercial loan activity, while Rhode Island credit unions indicated that employment generation was still slow and that loan demand had decreased somewhat.

NCUA Region Two

NCUA Region 2 (Mid-Atlantic) consists of six states[2] plus the District of Columbia. The region's credit unions[3] have about 15.3 percent of the total assets of the nation, up by 11.6 percent for the year. There are roughly 12.4 million members in this region, up by 199,000 (1.6 percent) over the past year. These percentages mirror the regional economy where the gross state product is about 13.5 percent of the U.S. gross domestic product. The regional production is more concentrated in government, services, finances, insurance, and real estate industries than the average concentrations found nationwide.

Lending

Region 2 credit unions generated a loan growth of 5.2 percent, slightly more than the national average of 5.1 percent. Over the course of the first half of 2004, other real estate supplied 40.6 percent of loan portfolio growth, closely followed by first mortgages at 37.2 percent. Combined real estate secured lending (first mortgages and home equity lines of credit - HELOCs) accounted for 77.8 percent of the gain.

Looking forward into 2005, Region 2 CUs anticipate higher loan growth for new auto loans than other regions do. Conversely, Region 2 CUs expect real estate loans to moderate somewhat over the next 12-month period. Other loan expectations are similar to those among all credit unions, except for used autos, where a less positive outlook is indicated nationwide.

Total auto loans in Region 2 advanced by 4.1 percent during the first half of 2004, the same rate as for all credit unions. Region 2 used auto loans led the way, rising 4.7 percent for the year, while the new auto loan portfolio increased 3.5 percent.

Unsecured loans (excluding credit cards) represent 8.5 percent of all credit union loans in the region. This portfolio segment decreased 0.5 percent during the first half of 2004. Credit card loans declined 2.9 percent during the first half of 2004, representing 8.5 percent of all credit union loans in the region. The credit union leadership in the region does believe unsecured loans will be a source of loan growth in 2005, but is more optimistic than most other regions in the country.

Member Shares

Member share deposits reached $83.4 billion in June 2004, up $4.3 billion (5.5 percent) during the first half of the year. Regular shares contributed 45.5 percent of the increase during the first half of the year, with money market shares at 10.6 percent. Add in share drafts at 11.3 percent and the number comes to 67.4 percent of 2004's increase from highly liquid deposit accounts. In addition, share certificates contributed 22.7 percent of the regional savings growth, reflecting members' concerns regarding low interest rates.

For 2005, Region 2 credit unions foresee a slight decrease in share growth, similar to the nationwide share growth expectation for 2005.

[2] The six states are Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia..
[3] Credit unions are federally insured credit unions.

Region 2 credit unions share drafts (12.4 percent of Region 2 credit union shares) increased at a lower rate (5.0 percent) than during the same period last year (the 2003 regional average was 12.0 percent growth). Regular shares (40.6 percent of Region 2 credit union shares) grew 6.2 percent during the first half of 2004. Money market share accounts (15.4 percent of credit union shares) reached $12.9 billion in June 2004, up by 3.7 percent. Credit union share certificates (21.9 percent of credit union shares) experienced a 6.0 percent increase during the first half of 2004.

IRA accounts (9.4 percent of credit union shares) were a safe haven for members' precious retirement funds in 2004. This deposit segment advanced 9.0 percent for the year compared to a national average of 1.1 percent.

Return on Average Assets (ROA), Spreads and Asset Quality

With deposits re-pricing faster than loans in 2004, credit unions experienced a slight decline in Region 2's consolidated ROA. At 1.06 percent (average ROA for all credit unions was 0.92 percent), this profitability measure decreased 6 basis points over 2003 for the region's credit unions. Some credit union management teams expect a slight decrease in ROA as a result of the reduction in yields on loans.

Gross spreads declined by 12 basis points from 3.35 percent in 2003 to 3.23 percent this year. The ROA declined among Region 2 credit unions despite the 7 basis point decline in operating expenses and no change in the provision for loan loss expense.

Loan Loss Trends in 2004

Several Region 2 credit unions indicated that their delinquency rate had risen, especially in the area of repossessing auto loans. In June 2004 Region 2 credit unions have a slightly lower delinquency ratio and charge-off ratio than credit unions nationwide. The trend in bankruptcy is about the same among Region 2 credit unions as last year. In June 2004, the bankruptcies-to-total loans ratio decreased by 7 basis points to 0.51 percent, while the ratio nationwide remained about the same at 0.59 percent.

The primary operational concerns for 2004, cited by our regional credit unions, were share growth, interest rate risk, loan growth, and delinquency ratios. Higher car loans, not material concern about bankruptcies, were mentioned as examples of positive future performance.

Member Concerns and Region 2 Economic Conditions in 2003

Credit union leadership in Region 2 viewed the financially distressed state governments as a primary economic concern in their states. Except for West Virginia, their assessments of employment conditions were improving in the region. On the negative side, concerns about a possible decline in real estate values were cited. Mutual funds/stocks were viewed as primary competition for savings, while banks and auto dealerships were viewed as primary competitors for loans—a similar view is held nationwide.

NCUA Region Three

At mid-year 2003, there were 1,950 credit unions in NCUA Region 3 (Southeast), consisting of ten states and two territories[4]. The June count represents a loss of 68 credit unions over the past year and a net loss of 31 credit unions through the first half of 2004. Total assets in Region 3 are up a solid 4.2 percent year-to-date (YTD) and 6.0 percent over the past year. The number of credit union members climbed by over a half million since June 2003 to 18.8 million. The 25 largest credit unions in Region 3 hold 37 percent of all assets and 26 percent of the membership in the region.

While individual credit union member attitudes vary by the primary employer(s) in their fields of membership, overall we would characterize members in Region 3 as cautiously optimistic. Their primary use of credit has moved from refinances to new vehicle loans. Increased consumer short-term borrowing and a reduced rate of deposit inflows support our observations.

From a credit union perspective, rising consumer loan portfolios are boosting earning asset yields (especially, when compared to investment returns), but as short-term interest rates rise, overall spreads will be squeezed and place additional downward pressure on ROAs (return on average assets). Increasing loan demand, combined with slower deposit inflows may drive up liquidity concerns over the next year. Since many credit unions still have excessive liquidity from the high level of deposit growth that occurred the past few years, this liquidity issue should not be a major concern for most credit unions.

Lending

The credit unions in Region 3 increased their loan portfolios by 4.5 percent YTD and by a very healthy 11.0 percent over June 2003. Region 3 loan growth performance trails the total U.S. credit union marketplace on both a year-to-date and an annual basis. North Carolina had the strongest gains, at 19.5 percent over the past year, followed by Florida with 14.0 percent growth. Vehicle loans accounted for 45.6 percent of all loan growth YTD and 40.8 percent over the past year. First mortgage portfolio growth contributed 43.0 percent of the annual gain, despite loan sales of almost $3.2 billion. At 71.0 percent, the key loan-to-share ratio for the region is up 3.1 percentage points from last year. Since loan growth is expected to remain solid for the next year and deposits are expected to grow at a slower rate than loans, the average loan-to-share ratio should continue to increase over this time period.

We have seen an exceptional recovery in new vehicle lending with annual growth of 13.1 percent. This is more than double the rate of increase for all of 2003. If we combine these results with the gains in home equity lending (a tax-preferential vehicle loan substitute), the region's credit unions new vehicle financing appears not to be

[4] The ten states include Alabama, Florida, Georgia, Indiana, Kentucky, Mississippi, North Carolina, Ohio, South Carolina, Tennessee, and the territories of Puerto Rico and the U.S. Virgin Islands. This review excludes 106 credit unions with a state charter and private share insurance. Their total assets were $3.7 billion.

suffering from manufacturers' financing incentives. North Carolina had annual new vehicle portfolio gains of almost 31 percent; Florida's annual gains were about 18 percent.

During the first half of 2004, 826 credit unions reported originating first mortgage loans. The dollar amount originated totaled $4.5 billion. This was down $2.3 billion (34 percent) from the record pace in 2003. The steepest declines in origination volumes occurred in fixed-rate first mortgages. Origination activity continues to slow primarily due to declining refinance potential. Currently, adjustable-rate first mortgages are experiencing rising member demand for both purchases and refinancing activity. One popular adjustable-rate mortgage loan is the 3/1 ARM product, which provides a low rate that is fixed for the first three years of the loan and then adjusts annually thereafter subject to certain limitations as to the rate adjustment each year and over the life of the loan. Since adjustable-rate first mortgage rates remain fairly low, many members are finding them to be an attractive alternative to fixed-rate mortgage loan products.

Credit cards and other unsecured loans are down 3.1 percent YTD and fractionally below June 2003 levels. Credit card portfolio sales by some credit unions and an overall decline in other unsecured lending are driving this trend. Some credit unions are reporting that a number of members are paying off their credit card debt with the proceeds from home equity loans.

Member Shares

Total savings are up 4.5 percent YTD to $111.3 billion. The strongest growth was recorded in low cost funds such as checking, money market accounts and regular shares. This helped lower the cost of funds to 1.45 percent. Annual growth results came in at 6.2 percent. This is a significant slowdown from the 10.9 percent gain generated between June 2002 and June 2003. The major sources of growth were essentially the same as the YTD results. This has translated into a 38 basis point reduction in the cost of funds since June 2003. It should be highlighted that all results discussed above were compiled prior to the combined 75 basis point hike in the FED Funds target rate during the third quarter of this year. Credit unions will try to hold off on deposit account rate increases for as long as possible, but eventually the marketplace will slowly force their cost of funds to rise. One positive factor is that we expect many banks to wait as long as possible before raising their deposit rates. Moving too slowly with rate adjustments in a climbing yield environment may trigger some liquidity pressures. The key will be for each credit union to look at its own liquidity picture and determine how aggressively deposit rates should be increased.

Return on Average Assets (ROA), Spreads and Asset Quality

On a consolidated basis, Region 3 credit unions posted a mid-year (annualized) return on average assets (ROA) of 85 basis points. This was down 8 basis points from year-end 2003 and 14 basis points from a year ago. In total, 84 percent of all credit unions reported a positive ROA, but just 42 percent of the region's credit unions produced an improvement in their ROA between year-end 2003 and mid-year 2004. There were 474 credit unions (24 percent) that generated ROAs of 100 basis points or better. With interest rates projected to continue trending up during the next year, it is essential for credit unions to understand their ALM position and the impact on their ROA and net interest margin from various rising rate scenarios.

Asset quality as measured by the ratio of delinquent loans to total loans (0.69 percent) and net charge-offs to total loans (0.53 percent) have both improved over the past year. Looking at one measure of operating efficiency (operating expenses to assets), we see this measure is stable at 3.3 percent. The overall health of Region 3 credit unions remains solid with a slight improvement in the capital-to-asset ratio to 10.9 percent over the past year. If deposits continue to grow in a range of 6 percent to 7 percent, then this capital-to-asset ratio will continue to improve during the rest of 2004 and into 2005.

NCUA Region Four

NCUA Region 4 (Central) consists of thirteen states.[5] The regional credit unions have about 44.9 percent of total credit union assets, up 4.4 percent for the last twelve months. There are roughly 18.8 million members in this region, up 268,000 (1.5 percent) over the past year. These percentages mirror the regional economy where the regional gross state product is concentrated more in transportation, public utilities, and manufacturing industries than the average concentrations found nationwide.

Lending

Loans grew by roughly 4.4 percent during the first half of 2004 with total loans for Region 4 ending the period at $82.3 billion. Most loan categories experienced positive growth for the last six months. Exceptions included modest drops in both the credit card and unsecured loan categories. Significant gains were made in fixed-rate first mortgages (up 19.8 percent from December, 2003) and other real estate loans (up 7.8 percent). Alternatively, adjustable-rate first mortgages fell by 34 percent, to $3.4 billion. Despite heavy competition, credit unions were able to grow auto loans by 5 percent during the first half of the year. Region 4's loan-to-share ratio improved modestly to 75.1 percent from 74.2 percent in December.

While the pace of improvement in mortgage lending has moderated somewhat during the first half of 2004, rising rates have not had as significant an impact as previously projected. With monetary policy now in the early stages of a tightening cycle, the refinancing boom will not likely repeat itself anytime soon. The mortgage purchase business is expected to be above historical averages for credit unions, but volumes will fall far short of the robust refinancing of 2002 - 2003. There continues to be optimism concerning home equity lending for the balance of 2004 as households continue to restructure their balance sheets while rates begin to rise from 45-year lows. Auto lending should deviate little from last year's performance.

Finally, activity in loan participations continued its strong growth, following up the second half 2003 growth of 74 percent with a solid 42.2 percent growth rate during the first half of 2004, to $1.03 billion as of June 30, 2004.

Member Shares

Shares and deposits grew by 3.1 percent during the first half of 2004, up from flat growth in the second half of 2003. Total shares and deposits stood at $109.5 billion at the end of June 2004. Most of the growth occurred in two categories: regular shares (up 5.4 percent) and money market shares (up 3.4 percent). Share certificate growth was essentially flat, growing by only 0.2 percent.

Prospects for continued share and deposit growth for the second half of 2004 will depend in large part on the relative performance of the stock market as an alternative to

[5] The thirteen states are Arkansas, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas and Wisconsin.

members' excess funds. Job and income growth continues to be sluggish, and will not likely add much to the credit union deposit base in Region 4. Gaining market share from competitors will be the other major defining factor in 2004 share and deposit growth success stories.

Loan Quality

In the face of continued sluggish employment growth and a difficult manufacturing environment, Region 4 credit unions continue to do a good job managing credit risk. Total delinquent loans as a percentage of net worth declined to 5.02 percent from 5.57 percent in December, 2003. The annualized net charge-off ratio was steady at 0.52 percent of total loans for the first half of 2004.

Investments

Intuitively, with loan growth still relatively strong, investments increased only modestly, up 4.6 percent from December 2003. Region 4 credit unions ended June 2004 with $31.6 billion in total investments. Totals in cash and cash-equivalent instruments added another $8.4 billion, down sharply from the $12.6 billion only one year ago. The largest category of gain was investments in corporate credit unions, adding 15.3 percent to $3.9 billion. There continues to be ample liquidity to fund future loan growth.

Earnings

The annualized return on average assets slipped to 0.90 percent as of June 30, 2004 from 0.92 percent at year-end 2003. Spread compression easily explains the drop. Versus December 2003, the annualized yield on average loans fell 54 basis points to 6.25 percent, exceeding the impact of the 13 basis points drop in yield on average investments (to 2.35 percent).

Mitigating the effects of spread compression, Region 4 credit unions lowered their cost of funds/average assets by 28 basis points, to 1.41 percent during the same time frame. These factors brought the net interest margin down to 3.33 percent from 3.41 percent. Margin compression was further countered by a 5.4 percent increase in annualized non-interest income. With interest rates expected to continue to rise from 45-year lows, margin compression should have a lessening impact in future reporting periods.

Credit unions in Region 4 raised their average net worth ratio by 9 basis points to 10.90 percent.

General Economic Conditions

Heavier reliance on the manufacturing sector has produced greater job losses and a tougher recovery. Economic conditions in the Midwest appear to be less favorable than in the nation as a whole. Based on employment and industrial production, it can still be said that Michigan and Ohio are in a recession. State and local governments carefully manage their expense budgets to keep deficits from reaching the alarming levels seen in other regions of the country.

Still, positive signs are evident. Even though manufacturing continues to be a key economic component, other sectors such as finance, healthcare, and technology have grown in importance and impact. Several of these sectors are starting to show signs of recovery. Thus, while we have likely seen the worst of this recent economic slowdown, the Midwest will probably lag much of the nation in posting the positive statistics to demonstrate that recovery is underway.

NCUA Region Five

Region 5 consists of 13 states and two territories[6]. As of June 30, 2004, the region's 1,476 credit unions comprised 15.6 percent of all federally insured credit unions and held some $178 billion in total assets, 27 percent of the nation's total credit union assets. Credit unions across the country continue to attract new members and the credit unions in Region 5 saw membership increase by 227,000 since year-end 2003, ending the period by topping the 20 million mark in members. For the first six months of 2004, total assets grew by 4 percent and reserves and undivided earnings increased 3.3 percent to a total of $18 billion. Shares grew $5.6 billion (3.7 percent) over the six-month period, while loans increased $6.2 billion (5.8 percent). At June 30, 2004 share balances totaled $155.6 billion while outstanding loans came in at $113.6 billion. The loan-to-share ratio rose from 71.5 percent in December 2003 to 73.0 percent in June 2004.

Lending

Loan growth in Region 5 for 2004 to date was 5.8 percent, resulting in total loans for Region 5 of $113.6 billion – making up 63.6 percent of total assets. Loans comprised 60.1 percent of assets one year ago in the period ending June 2003.

Growth in real estate loans continued to outpace loan growth in all other categories. Residential first mortgage loans grew by 7.9 percent and other real estate loans grew by 12.2 percent. While overall real estate loans grew, new first mortgage loans granted actually fell by $6.8 billion (28 percent decline) from the pace in the first half of 2003. Secondary market sales also fell by $5.0 billion (49 percent decline). (This is due to a change in the call report classifications.) Other mortgage loans, predominately home equity lines of credit (HELOCs), grew by $1.7 billion (up 19.4 percent) in the first half of 2004. For the region, real estate loans made up 45.1 percent of total loans, an increase from the 30.9 percent level recorded at the end of 2003.

Auto loans grew $2.1 billion (4.6 percent increase) in 2004, and surprisingly new auto lending growth outpaced used car lending. Total auto loans grew from $45.2 billion to $47.3 billion. Growth in indirect auto lending has provided the lion's share of this growth and indirect loans now comprise more than 39.8 percent of the total auto loan portfolio. Among WesCorp's members, credit unions in the indirect market grew their portfolios by more than twice as much as credit unions with only a direct origination channel.

While still modest in the context of aggregate loan activity, member business lending activity continues to grow as credit unions start to assist members in this area. Originations increased sharply to $2.1 billion in the first six months of 2004 to bring total member business loans outstanding to $6.3 billion. Two hundred ninety credit unions in

[6] The thirteen states and two territories are Alaska, American Samoa, Arizona, California, Colorado, Guam, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming.

the Region 5 added loans to their portfolio in 2004 and 473 credit unions have current outstanding balances.

Credit unions have mixed views on the outlook for loan growth for the rest of 2004 and into 2005. Refinancing activity has declined sharply in the last few months and further declines are predicted. However, reasonably low interest rates and more aggressive marketing of Hybrid ARMs should help support purchase activity for credit unions with competitive mortgage lending programs. Some credit unions, especially in Hawaii and California, are becoming concerned that affordability is becoming a significant factor for members seeking to buy that first home or trade up. Credit unions in those areas are concerned that real estate lending could slow due to that factor. They expect to see continued growth in indirect auto lending as existing players increase their activity and new credit unions enter the market. Member business lending is another bright spot. The outlook for unsecured lending remains very weak.

Loan Quality

Credit unions continue to do a good job in managing credit risk and generally remain very positive about the outlook for 2005. The delinquency/total loans ratio was at 0.56 percent by June 2004, an improvement over the 0.68 percent year-end 2003 rate. The net charge-offs/average loans ratio also showed improvement from 0.64 percent to 0.60 percent.

Member Shares

In the first six months of 2004, shares grew $5.6 billion (3.7 percent) to $155.6 billion. The growth in shares in 2004 was largely concentrated in regular share accounts ($2.7 billon), money market shares ($1.4 billion) and share drafts ($1.3 billion). The six-month growth rates in these categories were 5.5 percent, 4.2 percent and 6.9 percent respectively. Share certificate balances changed modestly from year-end 2003 levels decreasing only $38 million (0.1 percent). As of June 30, 2004, regular share accounts (33.0 percent), share certificates (22.5 percent) and money market accounts (22.3 percent) made up the major portion of share accounts. The current low rate environment makes it very difficult for credit unions to interest members in long-term certificates. We are hearing some concern from credit unions about the need to match funding for some of their fixed-rate residential mortgage loans, and we have seen growth in borrowing for that purpose. For the region as whole, match-funding borrowing remains low. Although liquidity is not a big issue for most credit unions, we are seeing an increase in borrowing for liquidity. This demand is generally coming from credit unions that have been aggressive in mortgage lending and indirect auto lending. Borrowings increased $577 million (21.9 percent) in the first six months of this year, but total borrowing outstanding is still a modest $3.2 billion. Several credit unions are looking to the derivatives market to hedge the cost of share balances and short-term certificate issuance. Region 5 credit unions expect share growth to be relatively weak in 2005.

Investments

Total excess liquidity in the region grew $349 million (up 0.6 percent) in the first half of 2004 and at June 30, 2004, stood at $58.4 billion or 32.7 percent of total assets. Cash and overnight balances declined $874 million (7.2 percent drop) while term investments increased $1,223 million (2.7 percent rise). Holdings of Treasury and federal agency notes declined by $391 million (1.6 percent drop) while mortgage backed security holdings decreased $0.6 million (0.01 percent). Total agency securities declined from $23.5 billion to $23.0 billion during the first half of 2004. In the same period, holdings of corporate credit union certificates grew by $1.4 billion (12.6 percent) to a total of $12.8 billion. Other investment categories were fairly flat. The growth in investments was concentrated in the one- to three-year category. The average yield on investments declined from 2.76 percent to 2.52 percent.

Earnings

Credit unions continue to be concerned about shrinking net interest margins. The average return on assets in 2004 to date was 0.95 percent, a decline from the 1.01 percent rate for 2003. The average yield on loans declined from 6.74 percent in 2003 to 6.17 percent. The cost of funds/average assets ratio declined from 1.59 percent in 2003 to 1.27 percent. The overall net interest margin declined from 3.54 percent to 3.44 percent. Operating expense/gross income was at 55.8 percent, up from 52.6 percent. Non-interest income came in at $1,958 million in the first half of 2004 compared to $1,868 million during the same period in 2003.

General Economic Conditions and Credit Union Concerns

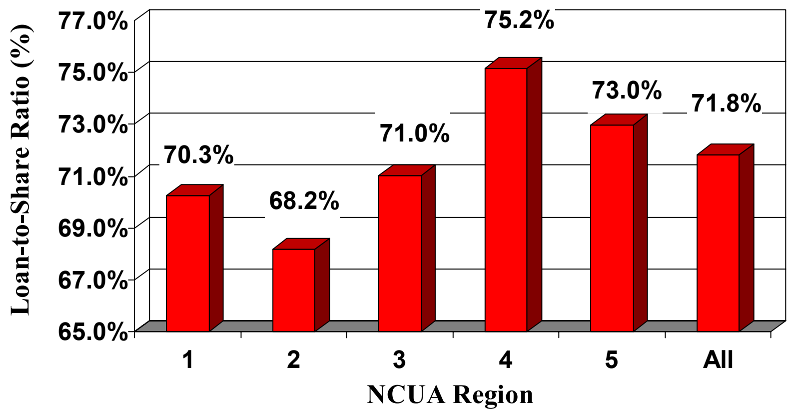
Economic conditions in the Western Region generally improved in the first six months of 2004. Recent data shows improvements in the labor market, consumer spending, commercial real estate, information technology, service, and manufacturing industries. The most critical factor, the labor market, did show a marked improvement over 2003, but recent national data indicates some slowing could be expected in the region. Household spending was driven by gains in services, travel and home furnishings.

Home sales were strong throughout the region in the first half of 2004, but the housing market has recently shown signs of cooling. Affordability is becoming a particular issue in the states of California and Hawaii.

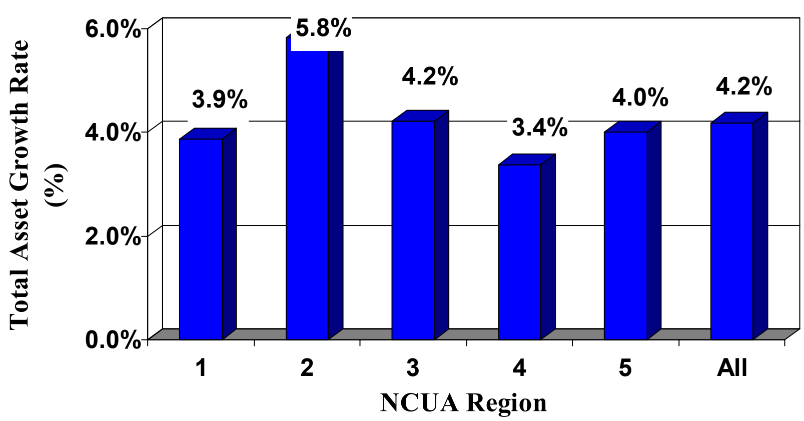
The number one concern expressed by credit union executives is the squeeze on net interest margins. The speed of compression will be primarily driven by the pace at which the Fed raises short-term interest rates. To offset this problem, many credit unions are seeking ways to increase fee income, enter new lending sectors, and/or become more competitive in the mortgage lending area. Most credit unions are wary of putting longer-term higher yielding assets on the books in the current low yield environment due to the impact on risk measurements.

Although most credit unions do not currently have liquidity concerns, they are considering how to maintain member share balances in a rising rate environment. This will vary widely depending on how the stock market performs and on local market competition. Nevertheless, to the extent that credit unions are forced to aggressively follow market rates higher, there is concern that margins could decline more sharply and quickly than expected.

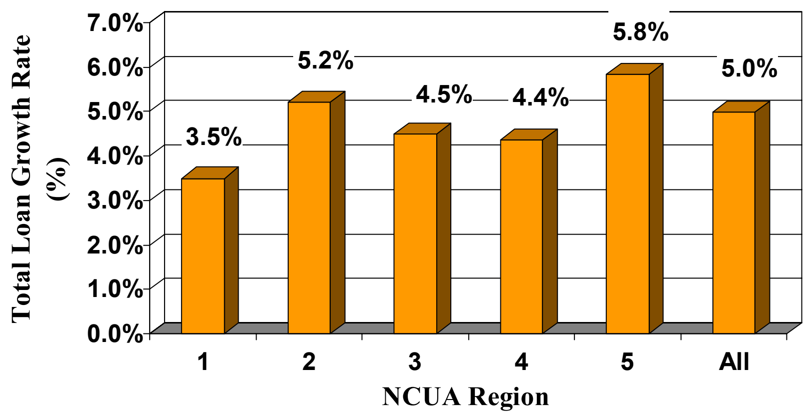
Loan-to-Share Ratio
Federally Insured Credit Unions
by NCUA Region
June 2004



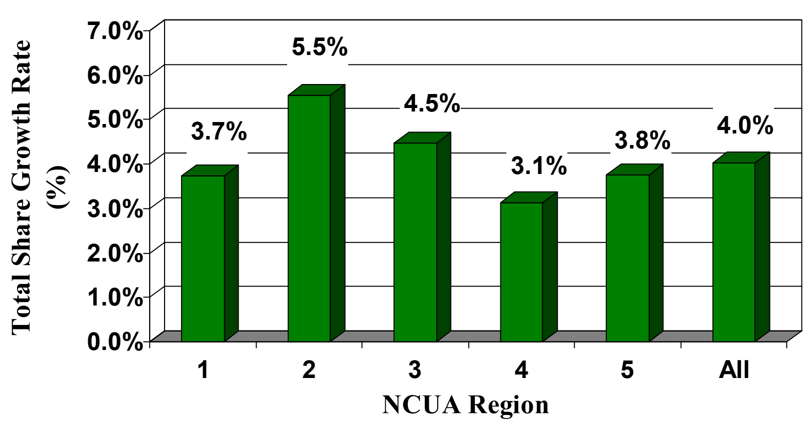
Total Asset Growth
Federally Insured Credit Unions
by NCUA Region
June 2004



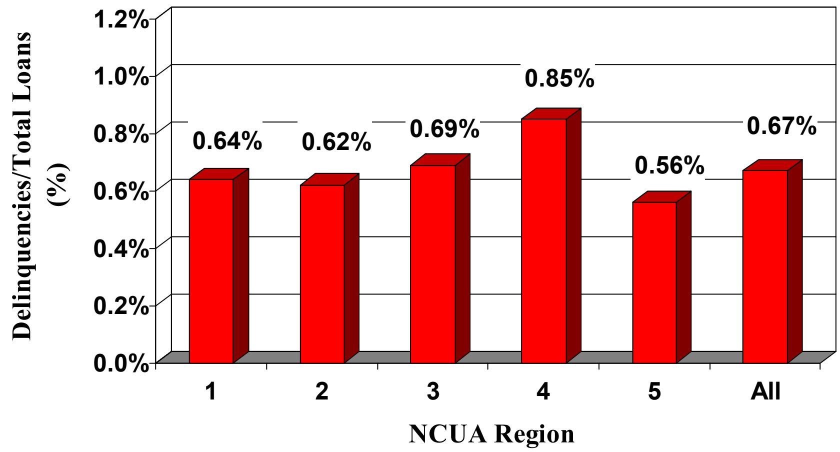
Total Loan Growth
Federally Insured Credit Unions
by NCUA Region
June 2004



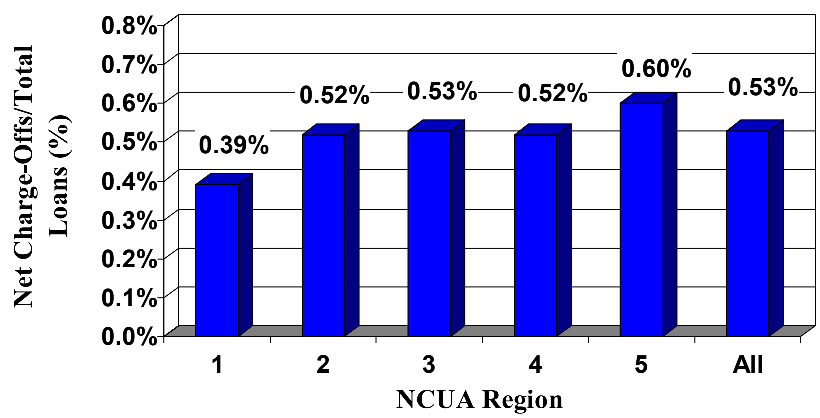
Total Share Growth
Federally Insured Credit Unions
by NCUA Region
June 2004



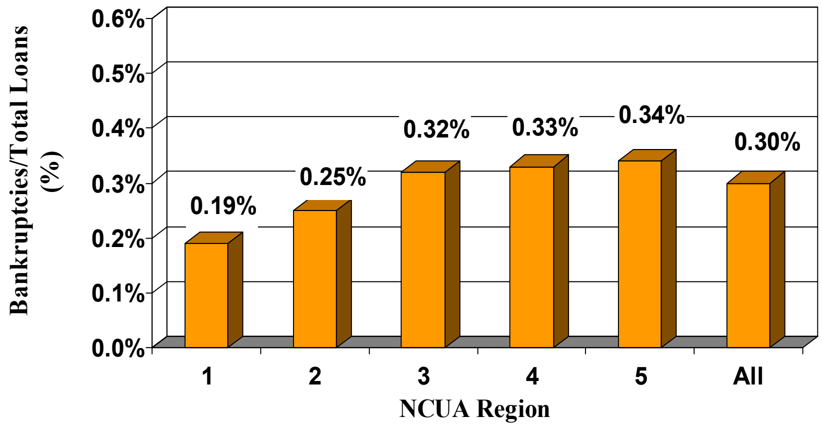
Delinquency Ratio
Federally Insured Credit Unions
by NCUA Region
June 2004



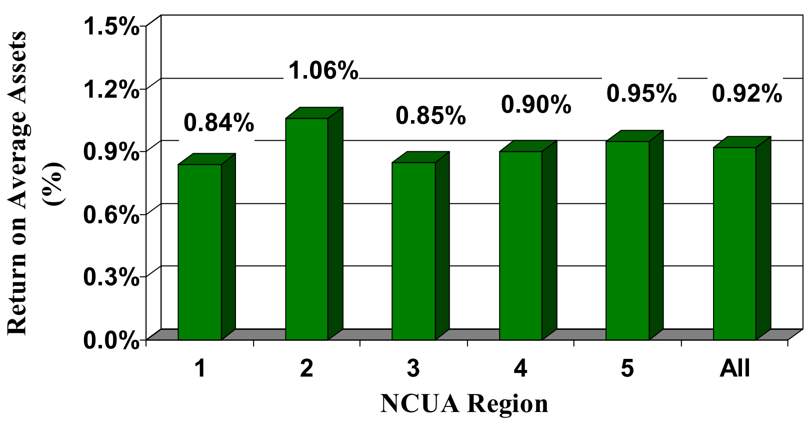
Net Charge-Offs/Total Loans
Federally Insured Credit Unions
by NCUA Region
June 2004



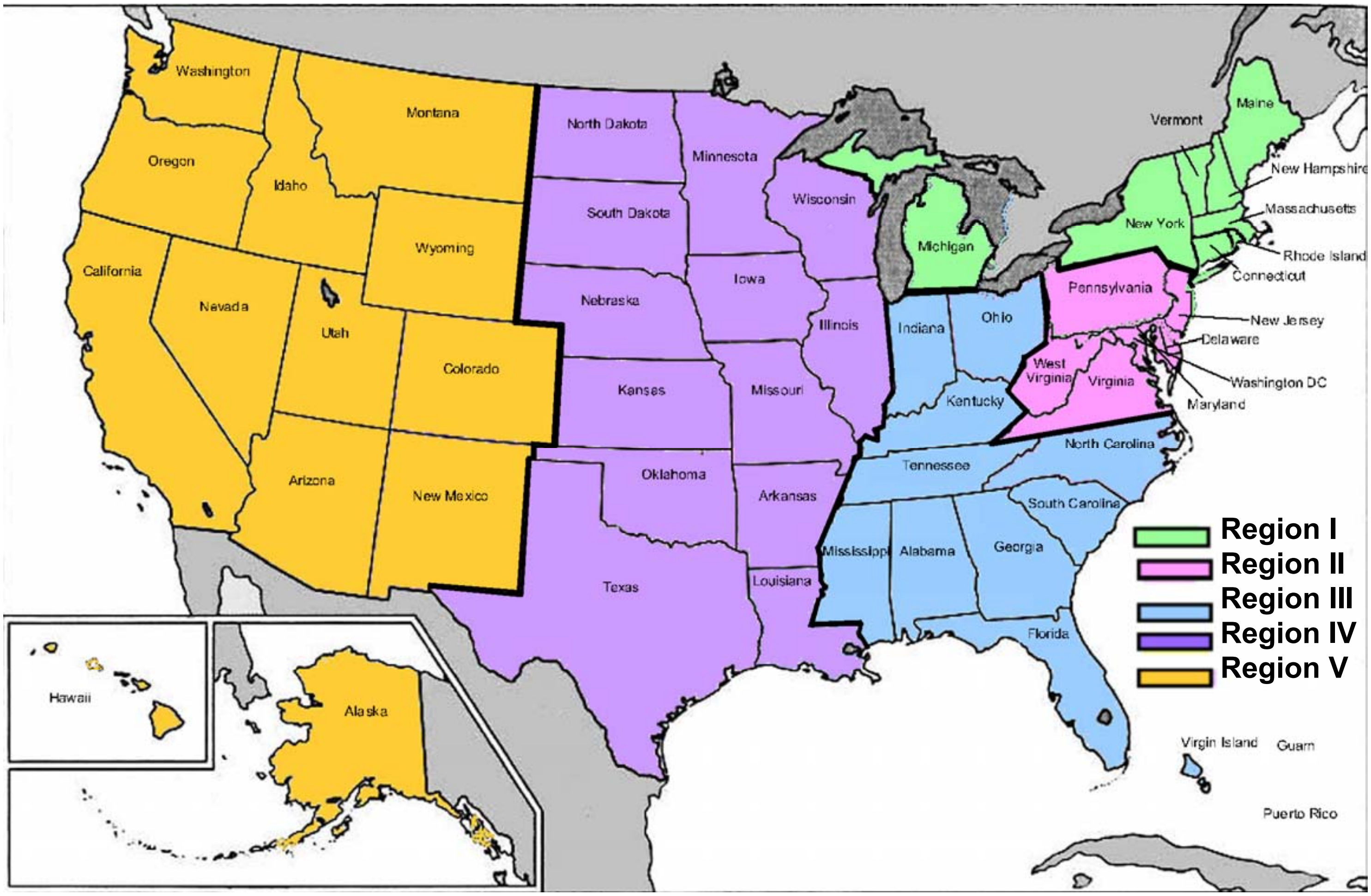
Bankruptcies/Total Loans
Federally Insured Credit Unions
by NCUA Region
June 2004



Return on Average Assets (ROA)
Federally Insured Credit Unions
by NCUA Region
June 2004



NCUA REGIONAL BREAKDOWN



Source: NCUA Web site