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Executive Summary

- Loan growth for all FICUs[1] during 2004 was approximately 10 percent. The majority of the loan growth came from first mortgage loans (31 percent of total loans), followed by used vehicle loans (20 percent of total loans). Only the Western and Mid-Atlantic regions exceeded the loan growth national average.
- Mortgage refinancing slowed as member demand migrated to adjustable rate mortgages (ARMs) and home equity lines of credit (HELOCs).
- Other real estate loans grew at a brisk 23.8 percent, mostly due to growth in HELOCs. The Northeast and Central regions experienced HELOC growth of 23 percent in 2004, while the Western region posted a 40.8 percent gain in HELOCs. This strong growth is largely attributed to a combination of members using their home equity to pay off unsecured loans or vehicle loans and members taking advantage of low interest rates before they go up.
- Most credit unions expect elevated new and used vehicle 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 5.3 percent during 2004, with strong growth in every region being concentrated in non-maturity share accounts. The Northeast and Central regions posted relatively weak share growth at 4.0 percent each. While there is an overall expectation of positive share growth in 2005, the Mid-Atlantic region foresees a significant decrease in share growth.
- Share growth lagged significantly behind loan growth in 2004. To help assuage liquidity concerns, many credit unions are promoting various term CDs. The Southeast region expects odd maturity CDs to be a key source of savings growth in 2005.
- While liquidity is not a big concern for most FICUs at this time, if interest rates increase quickly, then liquidity pressures may emerge. With continued margin pressure, generating adequate spread earnings while managing overall liquidity will be significantly more difficult in 2005.
- The return on average assets (ROA) for all FICUs at the end of 2004 was 0.92 percent, with the Mid-Atlantic region posting an ROA of 1.08 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 housing affordability remains of concern in several regions.

[1] An FICU is a federally insured credit union.

NCUA Region One

NCUA Region 1 (Northeast) consists of eight states.[2] As of December 2004, there were 1,558 federally insured credit unions in the region, with total assets of $105.9 billion and a total membership of 13.3 million.

Lending

Region 1's loan growth during 2004 was 9.2 percent, compared to 10.1 percent for all FICUs. During last year, loan growth was concentrated in real estate products, and to a lesser extent, vehicle loan products. Over the course of 2004, the region experienced a slowdown in mortgage refinancing activity. Credit union member demand migrated principally to adjustable-rate first mortgage and home equity loans over the second half of 2004. Over the course of 2004, first mortgage lending expanded by 7.3 percent, while home equity loan demand grew at the brisk pace of 23.2 percent. Despite the continuation of vehicle maker/dealer incentives, new vehicle lending expanded by 7.0 percent, supported by indirect lending programs, member education about the true "costs" of dealer incentives, and Internet sales. Used vehicle loan demand rose by 3.7 percent during 2004. FICUs experienced a rebound in unsecured loan demand in 2004. Credit card and non-credit card unsecured lending rose by 3.7 percent and 2.7 percent respectively, after increasing less than 1 percent in 2003. Finally, the region's credit unions experienced an elevated demand for member business loans last year, with FICUs granting $2.3 billion in loans.

According to NAFCU's March 2005 *Flash Report*, near term expectations for loan growth in Region 1 were somewhat more positive than during the previous month. The responding credit unions felt that both new and used vehicle loan growth would be stronger during the second quarter of this year as compared to the first quarter. In addition, the credit unions in Region 1 are more optimistic about the near-term prospects for unsecured lending. Regarding the prospects for real estate loan demand, the responding credit unions were marginally less positive than they were during the previous month.

Member Shares (Savings)

Region 1's share growth was 4.0 percent during 2004, much lower than the 5.3 percent share growth for all FICUs. Further, last year's share growth was well below the 8.4 percent 10-year average between 1993 and 2003. As with many FICUs, the region's share growth during 2004 was concentrated in share drafts and money market shares, which rose by 8.8 percent and 2.3 percent respectively. Last year, the region's credit unions were able to reverse the 2003 net outflow of share certificates, with share certificates expanding by over 8 percent. As a means to fund their longer term lending activities, many credit unions are promoting CDs within maturities of one to five years.

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

In 2004, IRA/KEOGH accounts declined by 1.2 percent while all shares grew by 46.3 percent. Many credit unions expect share growth to continue to be weak over the first half of 2005. However, according to the March *Flash Report*, responding credit unions in Region 1 indicated that they believe share growth will pick up modestly during the first six months of this year. Because loan demand remains strong at many of the region's credit unions, liquidity became an issue despite the fact that the region's loan-to-share ratio of 73.1 percent is lower than the 74.5 percent for all FICUs. As a result, corporate credit unions increased their lending activity to their member credit unions, the region's credit unions engaged in numerous loan participations, and expanded their borrowings from the Federal Home Loan Bank.

Earnings and Asset Quality

During 2004, the credit unions in Region 1 had an ROA of 0.85 percent compared to an ROA of 0.92 percent for all FICUs. While the region's credit unions' loan and investment yields and cost of funds were on par with the average for all FICUs, their relatively high net operating expense and lower net margins resulted in a lower ROA compared to all FICUs. The asset quality in the region was somewhat better than the asset quality of all FICUs during last year. The delinquent loans-to-total-loans ratio in the region was 0.68 percent compared to 0.72 percent for all FICUs, while the net charge-off rate of 0.40 percent in the region was much lower than the overall FICU charge-off rate of 0.51 percent. Bankruptcy remains a problem in Region 1, as both the number of members filing for bankruptcy and the loan amounts subject to bankruptcy increased during 2004. However, the bankrupt loans-to-total loans ratio was only 0.31 percent compared to 0.55 percent for all FICUs. As a result, the Region's credit unions did not indicate that bankruptcy was a principal concern for 2005.

Competition and Credit Union Operational Concerns for 2005

Many of the credit unions in the region feel that non-traditional financial entities are now their major competitors. While banks, credit unions, and thrifts are viewed as competition, mutual funds and insurance companies were cited as the greatest source of competition across Region 1. Further, check cashers/payday lenders were cited as competition in some parts of the region. In Michigan, Standard Federal Bank is changing its name to LaSalle Bank. While Standard Bank has stated it is only changing its name, credit unions in Michigan remain unsure of the bank's future market behavior. Credit unions in Region 1 are closely watching the operational behavior of Bank America since its merger with Fleet Bank; Citizens Bank since its merger with Charter One; and First Niagara since its merger with Hudson River Trust. Many credit unions feel they can gain new members due to their more personalized service. In addition, the region's credit unions are seeking additional business accounts as membership growth has slowed over the past year. The region's credit unions mentioned liquidity constrains, rising interest rates, and low loan-to-share ratios as principal operational concerns during this year.

Member Concerns and Economic Conditions in 2005

When asked to assess their members' confidence/sentiment, the majority of the region's credit unions indicated that their members were cautiously optimistic about 2005. Many credit unions cited geopolitical uncertainty as a major concern, while others cited the rising interest rate environment, the low share rates, and the condition of the local labor market and/or the local government fiscal balance. While most credit unions 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 or a major problem in Iraq.

The overall economic and financial conditions throughout Region 1 improved over the course of 2004. However, pockets of weakness remain, particularly where manufacturing and high tech industries make up a large portion of the local economy. In Michigan, the economy as a whole has rebounded, but the financial troubles of the vehicle makers and the city of Detroit's fiscal imbalance continue to be problems. In Connecticut, Maine, Rhode Island, and Vermont, the economies are in good shape. In Massachusetts and New Hampshire, the economic situations have improved, but the reliance on high tech and defense industries continues to create volatility. Finally, in New York, the tourism industry has recovered, yet economic weakness remains in the manufacturing centers of upstate New York.

NCUA Region Two

NCUA Region 2 (Mid-Atlantic) consists of six states[3] plus the District of Columbia. The region's credit unions (FICUs) have about 15.3 percent of the total assets of the nation, up by 7.7 percent for the year. There are roughly 12.5 million members in this region, up by 177,000 (1.4 percent) over the past year. These percentages mirror the regional economy where the gross state product is about 13.9 percent of the U.S. gross domestic product. Regional production is more concentrated in government, services, finances, insurance, and real estate industries than the average concentrations found nationwide.

Lending

Region 2 FICUs generated loan growth of 11.1 percent during 2004, slightly more than the national average of 10.1 percent. Over the course of 2004, other real estate supplied 41.2 percent of loan portfolio growth, closely followed by first mortgages at 31.3 percent. Combined real estate secured lending (first mortgages and home equity lines of credits) accounted for 72.5 percent of the gain.

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

Total vehicle loans in Region 2 advanced by 7.4 percent during 2004, compared to the rate of all FICUs at 7.5 percent. Region 2 new vehicle loans led the way, rising 8.1 percent for the year, while the used vehicle loan portfolio increased 6.7 percent.

Unsecured loans (excluding credit cards) represent 8.2 percent of all FICU loans in the region. This portfolio segment decreased 0.9 percent during 2004. Credit card loans increased 7.4 percent during 2004, representing 8.8 percent of all FICU loans in the region. The credit union leadership in the region does believe unsecured loans will not be a source of loan growth in 2005, and is more pessimistic in this regard than most other regions in the country.

Member Shares

Member shares reached $84.1 billion in December 2004, up $5.1 billion (6.4 percent) during the year. Regular shares contributed 26.1 percent of the increase during last year, with money market shares at 13.8 percent. Add in share drafts at 21.2 percent and the number comes to 61.1 percent of 2004's increase from highly liquid savings accounts. In addition, share certificates contributed 30.0 percent of the regional savings growth, reflecting members' concerns regarding low interest rates. For 2005, Region 2 FICUs foresee a significant decrease in share growth, which is different from the slight positive share growth expectation nationwide for 2005. Region 2 FICUs' share drafts (13.0 percent of Region 2 FICU shares) increased at a lower rate (4.2 percent lower) than during the same period last year. (The 2004 regional average was 11.0 percent growth.)

[3] The six states are Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia.

Regular shares (39.5 percent of Region 2 FICU shares) grew 4.2 percent during 2004. Money market share accounts (15.6 percent of FICU shares) reached $13.1 billion in December 2004, up by 5.7 percent. FICU share certificates (21.6 percent of FICU shares) experienced a 9.2 percent increase during 2004.

IRA accounts (9.5 percent of FICU shares) were a safe haven for members' precious retirement funds in 2004. This share segment advanced 5.8 percent for the year compared to a national average of 1.7 percent.

Earnings

With savings re-pricing faster than loans in 2004, credit unions experienced a slight decline in Region 2's consolidated ROA. At 1.08 percent (average ROA for all FICUs was 0.92 percent) this profitability measure decreased 7 basis points over 2003 for the region's credit unions. Some FICU management teams expect a slight decrease on ROA as a result of the reduction of yields on loans.

Gross spreads declined by 9 basis points from 4.39 percent in 2003 to 4.30 percent last year. The ROA declined among Region 2 FICUs despite the 22 basis points decline in cost of funds and little change in the operating expense and the net charge-off expense.

Asset Quality

Several Region 2 FICUs indicated that their lending growth had risen in the last several months, especially in the areas of indirect vehicle loans, home equity, and personal loans secured by retirement funds. In the area of loan quality the December 2004 Region 2 FICUs have a slightly lower delinquency ratio and slightly higher charge-off ratio than credit unions nationwide. The trend in bankruptcy is much lower among Region 2 FICUs than among credit unions nationwide. In December 2004, loans subjected to bankruptcies increased by 2.4 percent in Region 2 FICUs while nationwide the growth was 19.2 percent.

The primary operational concerns for 2004, cited by our regional credit unions, were savings growth, interest rate risk, managing credit card loans, and satisfying members in a community chartered credit union. Higher loan revenue and increasing memberships were mentioned as examples of positive future performance.

Member Concerns and Economic Conditions in 2005

Credit union leadership in Region 2 viewed competition with non-traditional financial institutions as a primary concern for the region. Except for D.C. and Delaware, 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. Non-traditional financial institutions (e.g., AIG and brokerage firms) were viewed as primary competition for savings, while banks and finance companies were viewed as primary competitors for loans. A similar view is held nationwide.

NCUA Region 3 (Southeast), consisting of ten states and two territories,[4] finished the year with 1,903 credit unions (FICUs). This represents a net decline of 78 FICUs in 2004. Over the past three years, the Region 3 FICU count has fallen by 217 FICUs or 10.2 percent. Total assets in the region rose to $130.4 billion. This translates into an annual growth rate of 6.4 percent, which was marginally better than the 6.0 percent reading for the nation as a whole. The number of FICU members in Region 3 reached 18.8 million by year-end. The 2.0 percent or 360,400 member increase was significantly better than the national average. Total employment (full and part-time FICU employees) is now in excess of 51,000. The 25 largest FICUs in the region hold 37.0 percent of all regional assets and 27.0 percent of regional membership.

Region 3 covers a wide expanse of geography ranging from northern Indiana to the southern tip of Florida. Thus, economic and employment conditions vary significantly. Taking a high-level view of savings and borrowing trends, we can generalize that members remain mildly optimistic about current conditions, but are less enthusiastic about their longer term outlook. Credit union members impacted by hurricane activity during late 2004 are beginning to recover and are beginning to focus on their financial situation once again.

From a FICU perspective, 2004 was, on average, a good year. Credit Unions improved Region 3 key net worth ratio to over 11 percent despite a drop in their ROA (return on average assets). The rising interest rate environment has not fully impacted Region 3 FICUs as they reported a declining cost of funds in 2004. Generating adequate spread earnings, while managing overall liquidity, will be significantly more difficult in 2005. Credit unions are generally well-positioned for this higher rate environment since many of them have been preparing for this situation for the past two years.

Lending

The region's FICUs generated 9.7 percent annual loan growth last year, up fractionally from the 9.5 percent gain in 2003, but solidly above the 5.5 percent increase posted in 2002. North Carolina reported the largest increase at 14.2 percent, followed closely by Florida at 13.9 percent. Overall, Region 3's loan growth results were slightly below the national average. During 2004, the loan-to-share ratio climbed 243 basis points to a healthy 73.4 percent. The lowest average loan-to-share ratio in the region was reported by Georgia at 58.2 percent, and North Carolina reported the highest at 84.8 percent. First mortgages contributed over 34.0 percent of the 2004 gain despite loan

[4] The ten states include Alabama, Florida, Georgia, Indiana, Kentucky, Mississippi, Ohio, North Carolina, South Carolina, and Tennessee, and the territories of Puerto Rico and the U.S. Virgin Islands. This review excludes 104 credit unions with a state charter and private share insurance. Their total assets were $3.7 billion.

sales totaling $2.1 billion. New vehicles added 24.0 percent and when combined with used, total vehicle loan growth accounted for almost 40.0 percent of 2004's gain.

Overall, Region 3's vehicle loan results were good with the total portfolio increase coming in at 9.6 percent. This compares favorably to a national average of 7.3 percent in 2004. Both new and used vehicle loan growth outperformed the national averages. We believe a large share of this increase was attributable to member point-of-purchase borrowing. Limited NCUA data now shows that 28.0 percent of all vehicle loans outstanding were generated through indirect channels. FICU leadership feels confident in their ability to grow vehicle loans, although the spreads on high quality paper are razor thin at best. Some of the credit unions reporting the strongest level of vehicle loan growth are doing so through indirect vehicle lending or aggressive pricing of direct vehicle lending.

A total of 880 FICUs reported originating first mortgage loans in 2004, down 16 from 2003. The dollar value of originations totaled $8.7 billion, down almost 38 percent from the refinance driven volumes in 2003. Approximately 85,000 first mortgages were granted by Region 3 FICUs during 2004. In total, FICUs in the region grew their real estate secured loan portfolios by 12.0 percent in 2004. This was achieved with annual gains in excess of 20.0 percent for home equity loans and 16.0 percent growth in adjustable rate mortgages (ARMs). Currently, real estate secured loans equal 44.0 percent of all loans at Region 3 FICUs.

Although the overall housing market is cooling due to rising interest rates, FICU leadership in the region sees adequate loan demand in the near-term and no softening in home (collateral) values. Home equity loans and ARM loans should continue to remain solid for 2005 despite the higher interest rate environment. Many members are using the equity in their homes to pay off their unsecured loans or vehicle loans.

Member Shares

Member savings reached $113 billion at year-end, up 6.1 percent for the year. Region 3's annual growth topped results for the rest of the nation by a healthy margin. Florida FICUs hold 27.0 percent of all savings in the region and generated the strongest annual growth at 10.5 percent. Nearly 70.0 percent of all savings gains in 2004 came from highly liquid accounts (regular shares, share drafts and money market savings accounts).

Although the Region 3 average cost of funds fell 27 basis points to 1.5 percent in 2004, we see market conditions where FICUs will be forced to raise share yields or risk liquidity problems or worse, losing savers. Look for odd maturity CDs to be a key source of savings growth in 2005. Since many credit unions still have excess liquidity from solid share growth trends in recent years, most will not aggressively raise their savings rates in the months ahead.

Asset Quality and Operational Results

The consolidated ROA for Region 3 FICUs was 0.86 percent, down 7 basis points from 2003 and 19 basis points below the return achieved in 2002. A total of 1,624 FICUs (85 percent of the region's FICUs) reported positive ROAs, while 261 FICUs reported losses. The FICUs with negative ROAs represented just 2.8 percent of the region's assets. There were 445 FICUs in the region (41 percent of all assets) reporting an ROA of 1.0 percent or better.

Asset quality as measured by the ratio of delinquent loans to total loans (0.78 percent) and net charge-offs to total loans (0.55 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 FICUs remains solid, although we are anticipating a more challenging operating environment in 2005 and beyond. Credit unions will have to focus on operating in a rising interest rate environment and a very competitive lending environment, which will continue to place downward pressure on net interest margins and ROA ratios.

NCUA Region Four

NCUA Region 4 (Central) consists of thirteen states.[5] The regional credit unions have about 20.0 percent of total credit union assets, down 0.2 percent for the last twelve months. There are roughly 18.8 million members in this region, up 199,467 (1.1 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

Loan growth in Region 4 was strong in 2004, growing 8.8 percent. Total loans for Region 4 ended the year at $85.9 billion, up nearly $7 billion from 2003. All loan categories experienced positive growth for the year. Particularly strong were the gains in mortgage lending. Specifically, first mortgage loans grew by 10.6 percent (or $2 billion) and other real estate loans grew 16.8 percent (or $1.6 billion). Despite heavy competition, credit unions were also able to grow new vehicle loans by 9.3 percent to $18.7 billion. Region 4 loan-to-share ratio improved to 77.7 percent, the highest year-end ratio since December 2000.

Several notable trends were revealed with a closer look inside the broad real estate loan category. Most significant was the divergence in the type of first mortgages granted during 2004. Fixed-rate first mortgage production actually fell 49.6 percent to only $6.5 billion in 2004 while adjustable first mortgage production increased 22.3 percent to $3.4 billion. Similarly, of first mortgage loans outstanding on Region 4 credit unions books, fixed rates decreased 2.7 percent to $13.5 billion while adjustable rates increased 46.4 percent to $7.6 billion. Also of note was the growth in holdings of adjustable home equity lines of credit loans, increasing by 23.3 percent to $4.6 billion during 2004.

While the pace of improvement in mortgage lending moderated somewhat in 2004, rising rates have not had as significant an impact as previously projected. With monetary policy now in the mid stage of a tightening cycle, the refinancing boom will not likely repeat itself anytime soon. And while purchase mortgage business is expected to be above historical averages for credit unions, volumes will fall short of the robust refinancing of 2002 - 2003. However, there continues to be optimism for home equity lending in 2005 while households continue to restructure their balance sheets as rates continue to rise from 45 year lows. Vehicle lending should remain stable, deviating little from the last several years.

Finally, activity in loan participations continued its strong growth, albeit from modest 2003 levels. Growth of 91.0 percent during 2004 brings total participation loans outstanding to $1.4 billion.

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

Member Shares

Shares grew modestly during 2004, up 4.0 percent from December 2003 levels. Total shares stood at $110.5 billion as of December 2004. Most of the growth occurred in three categories: Regular shares, up $1.1 billion to $42 billion (2.8 percent growth in 2004); share drafts, up $1.2 billion to $14.2 billion (9.4 percent growth in 2004); and share certificates, up $1.4 billion to $25.3 billion (6.0 percent growth in 2004).

Prospects for share growth in 2005 will depend in large part on the relative performance of the stock market as an alternative for members' excess funds. Job and income growth continues to improve, and could add to the credit union share base in Region 4. However, overall savings growth is likely to lag loan growth, putting further upward pressure on the loan-to-share ratio.

Asset Quality

As the Region 4 economic environment has continued to improve, its credit unions continue to do a good job managing credit risk. Total delinquent loans as a percentage of net worth declined to 5.50 percent from 5.57 percent in December, 2003. The net charge-offs-to-average loans ratio for 2004 was steady at 0.53 percent versus 0.52 percent for 2003.

Investments

With loan growth strong relative to share growth, total investments actually decreased modestly, down 2.0 percent for 2004. Region 4 credit unions ended 2004 with $29.6 billion in total investments. Total cash and cash equivalents added another $8.7 billion to the total, but were also down 7.4 percent during 2004 from the $9.4 billion figure at year-end 2003. The largest category of gain within the investments category, both in dollar amount and percentage, was investments in corporate credit unions, adding 12.5 percent to $4.5 billion. Even with these reductions in total investments, there continues to be ample liquidity to fund future loan growth.

Earnings

Return on average assets as of year-end 2004 slipped to 0.86 percent from 0.92 percent in the prior 12 months. Spread compression quickly explains the drop. During 2004, the yield on average loans fell 59 basis points to 6.20 percent and the yield on average investments fell 1 basis point (to 2.47 percent). However, the cost of funds-to-average-assets ratio declined by only 24 basis points to 1.45 percent, and operating expenses-to-average-assets ratio was steady at 3.38 percent.

These factors combined to bring average Region 4 net interest margin-to-average-assets ratio down to 3.33 percent from 3.41 percent. Since interest rates are expected to continue to rise from 45-year lows, margin compression pressures should subside. The positive impact of rising rates will be more pronounced for credit unions with low concentrations of fixed-rate assets in their loan and investment portfolios.

Finally, capital accumulation was strong among Region 4 credit unions. The average net worth-to-total assets ratio increased by 31 basis points to 11.12 percent, compared to 10.81 percent in the year prior.

General Economic Conditions

Economic conditions in the Midwest now appear to be improving at a rate similar to those of the nation as a whole. Concentration of employment in the manufacturing sector produced greater job losses in the most recent economic slowdown, and a slower recovery initially. Manufacturing activity continues to expand solidly, with increases broadly reported in production, shipments and orders. Employment increased steadily during 2004, although it is now showing signs of leveling off. Hiring announcements continue to outpace layoffs.

Even though manufacturing is still a key economic component to the region's economic health, other sectors such as finance, healthcare, and technology have grown in importance and impact. And the outlook for agriculture, another key sector, remains generally solid, although concerns linger over rising energy costs, crop prices and whether the drought is finally over.

And finally, consumer spending posted solid improvement in 2004. Retailers and mall managers reported meaningful increases in sales and traffic. Hotel occupancy rates are improved during 2004, and airport traffic is up from year-ago levels in most Region 4 cities. Thus, the Midwest will likely continue to post positive statistics to demonstrate that the economic expansion is on solid footing.

NCUA Region Five

Region 5 (Western) consists of 13 states and two territories[6]. As of December 31, 2004, the region's 1,453 FICUs comprised 16.1 percent of all FICUs and held some $183 billion in total assets, 28 percent of the nation's total credit union assets. FICUs across the country continue to attract new members and the FICUs in Region 5 saw membership increase by 200,000 since year-end 2003, ending the period with 20.2 million members. Total assets grew by 6.4 percent and reserves and undivided earnings increased 8.6 percent to a total of $18.9 billion. Shares grew $8.4 billion (5.6 percent) over the twelve-month period, while loans increased $12.2 billion (11.4 percent). At December 31, 2004 share balances totaled $158.5 billion while outstanding loans came in at $119.5 billion. The loan-to-share ratio rose from 71.5 in December 2003 to 75.4 in December 2004.

Loan Growth

Loan growth in Region 5 for 2004 was 11.4 percent, pushing total loans for Region 5 up to $119.5 billion at December 31, 2004, or 65.5 percent of total assets. Loans comprised 62.6 percent of assets one year ago.

Growth in real estate loans continued to outpace loan growth of all other categories. Residential first mortgage loans grew by 11.9 percent and other real estate loans grew by 31.8 percent.

While overall real estate portfolio loan balances grew, the volume of new loans granted actually fell by 14.7 percent from the 2003 pace. This was primarily due to a decrease in refinancing activity as long-term interest rates moved off their cyclical lows. Total first mortgage loans stood at $38 billion as of December 31, 2004. There was also a noticeable increase in the origination of adjustable rate mortgages (ARMs). At year-end 2003, ARM's comprised 25 percent of the first mortgage category held by FICUs. On December 31, 2004, ARM's comprised 32.8 percent of first mortgages. HELOCs grew by 40.8 percent, bringing the total value of HELOCs to $10.5 billion. For the region, real estate loans made up 46.2 percent of total loans, which is slightly higher from the end of 2003.

Vehicle loans grew 7.7 percent in 2004, and surprisingly new vehicle lending growth outpaced used vehicle lending. New vehicle lending grew by 15.8 percent, while the used vehicle total grew by a mere 1.9 percent. Total vehicle loans grew from $45.2 billion to $48.7 billion. Growth in indirect vehicle lending has been the primary factor fueling portfolio growth.

Member business lending activity continues to grow as FICUs start to assist members in this area. Originations increased sharply in 2004 to a total of $5.9 billion. FICUs in Region 5 have mixed views on the outlook for loan growth for the rest of 2005.

Refinancing activity has declined sharply in the last few months and further declines are predicted. However, reasonably low interest rates and more aggressive

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

marketing of ARMs should help support purchase activity for FICUs with competitive mortgage lending programs. HELOCs are expected to continue to grow sharply and replace some of the shortfall in refinancing activity. Some FICUs, 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. FICUs in those areas are concerned that real estate lending could slow due to that factor. FICUs expect to see continued growth in indirect vehicle lending as existing players increase their activity and new FICUs enter the market. Member business lending is another bright spot for some FICUs. The outlook for unsecured lending continues to be very weak.

Loan Quality

FICUs continue to do a good job in managing credit risk and generally remain very positive about the outlook for 2005. The delinquency-to-total loans ratio was at 0.57 percent on December 2004, an improvement over the 0.68 percent year-end 2003 rate. The net charge-offs-to-average-loans ratio also showed improvement from 0.64 percent to 0.59 percent.

Share Growth

Shares grew at a 5.6 percent growth rate to $158.5 billion. Regular share accounts grew by 5.1 percent and share drafts by 12.4 percent. Share certificate balances grew less than 1 percent, after declining in both 2002 and 2003. Most of the growth is coming in certificates with maturities between 1 year and 3 years. As of December 31, 2004 regular share accounts (32.3 percent), share certificates (23.3 percent) and money market accounts (21.8 percent) made up the major portion of share accounts. The growth in certificates is likely a result of the increase in longer-term rates. We are hearing some concern from FICUs about the need to match fund some of their fixed-rate residential mortgage loans, and we have seen growth in borrowing for that purpose. For the region as whole though, match-funding borrowing remains low. Although liquidity is not a big issue for most FICUs, we are seeing an increase in borrowing for liquidity. This demand is generally coming from FICUs that have been aggressive in the indirect lending programs. Borrowings increased $1 billion (39.1 percent) in 2004 but remain a modest $3.7 billion. Several FICUs are looking to the derivative market to hedge the cost of share balances and short-term certificate issuance. Region 5 FICUs generally expect share growth will be relatively weak in 2005.

Investments

In 2004, FICUs reported a 2.9 percent decline in investments and ended the period at $44.6 billion or 24.4 percent of total assets. Holdings of federal agency securities declined by 7.9 percent from $23.57 billion at year-end 2003 to $21.8 billion. Holdings of corporate certificates grew by 10.1 percent, from $11.3 billion to $12.5 billion. Investments maturing in less than one year were 44.8 percent of total investments, while investments between one and three years comprised 37.0 percent of the total. The average yield on investments declined from 2.8 percent to 2.6 percent.

Portfolio yields, however, seem to have bottomed out and are expected to rise fairly quickly.

Earnings

Average return on assets in 2004 was 0.97 percent, a decline from the 1.01 percent rate at the end of 2003. The average yield on loans declined from 6.74 percent to 6.11 percent. The cost of funds-to-average-assets ratio declined from 1.59 percent to 1.31 percent. The overall net interest margin declined from 3.54 percent to 3.44 percent. Operating-expense-to-gross-income was at 55.2 percent, up from 52.6 percent. Fee income rose modestly from $1.2 billion to $1.4 billion.

General Economic Conditions and Credit Union Concerns

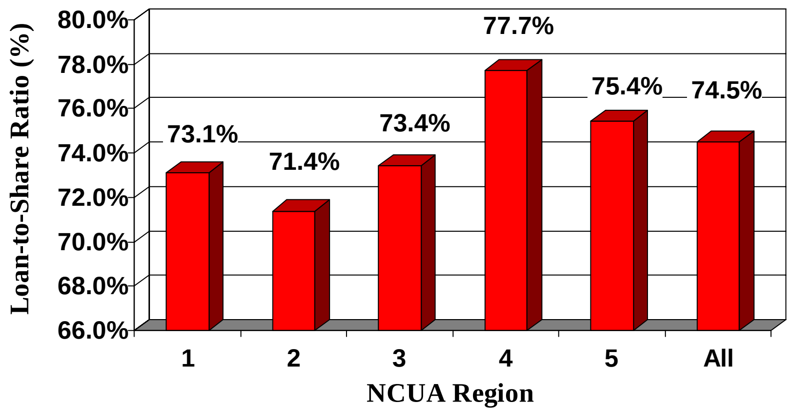
Economic conditions in the Western Region generally improved in 2004. Recent data shows improvements in the labor market, consumer spending, commercial real estate, information technology, service, and manufacturing industries. The most critical factor, the labor market, did show a marked improvement over 2003. Household spending was driven by gains in services, travel and home furnishings.

Home sales were strong throughout the region in 2004, but the housing market has recently shown signs that it might be "cooling off." Affordability is becoming a particular issue in the states of California and Hawaii.

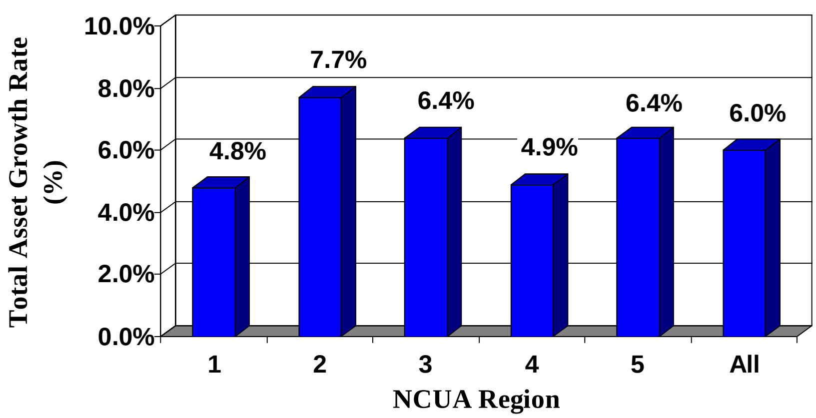
The number one concern expressed by FICU executives is the squeeze on net interest margins. The speed of compression will be primarily driven by the pace at which the Fed raises short-term interest rates. The full impact of higher rates has yet to be felt because retail savings rates at all financial institutions are dramatically lagging changes in the wholesale market. To offset declining margins, many FICUs are seeking ways to increase fee income, enter new lending sectors, and/or become more competitive in the mortgage lending area. Most FICUs remain wary of putting long-term assets on their books in the current environment because they do not want to increase their interest rate sensitivity as rates continue to increase.

Although most FICUs do not currently have immediate liquidity concerns, they are concerned about potential share outflows and the continuing trend of loan growth outpacing share growth. The prospects in this area are still uncertain and will depend on how the stock market performs as well as on local competition. Nevertheless, to the extent that FICUs are forced to aggressively follow market rates higher, there is concern that margins could decline more sharply and quickly than expected.

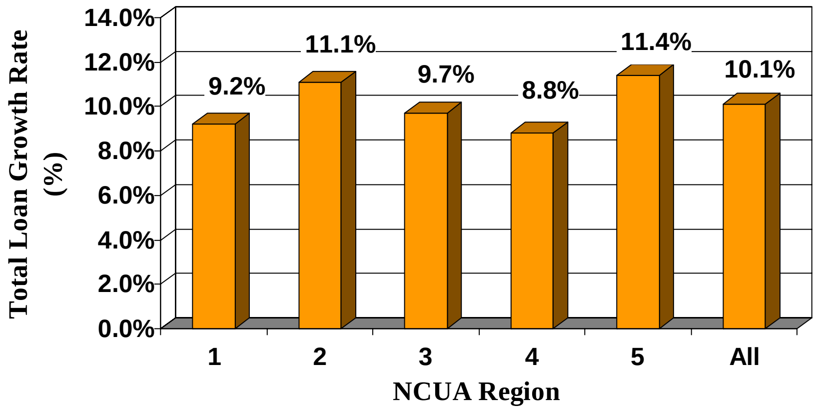
Loan-to-Share Ratio
Federally Insured Credit Unions
by NCUA Region
December 2004



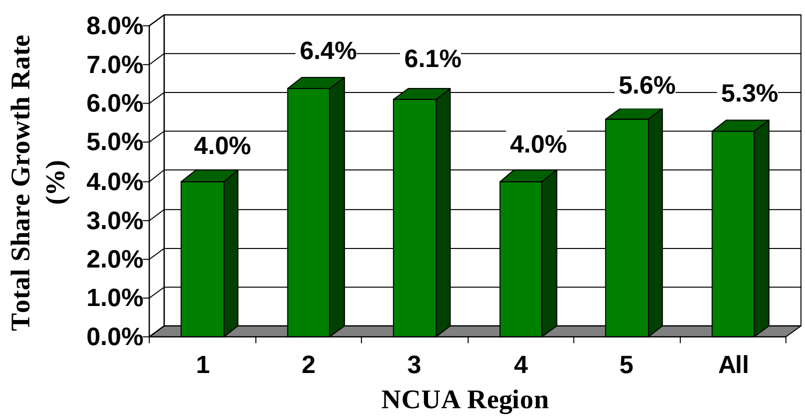
Total Asset Growth
Federally Insured Credit Unions
by NCUA Region
December 2004



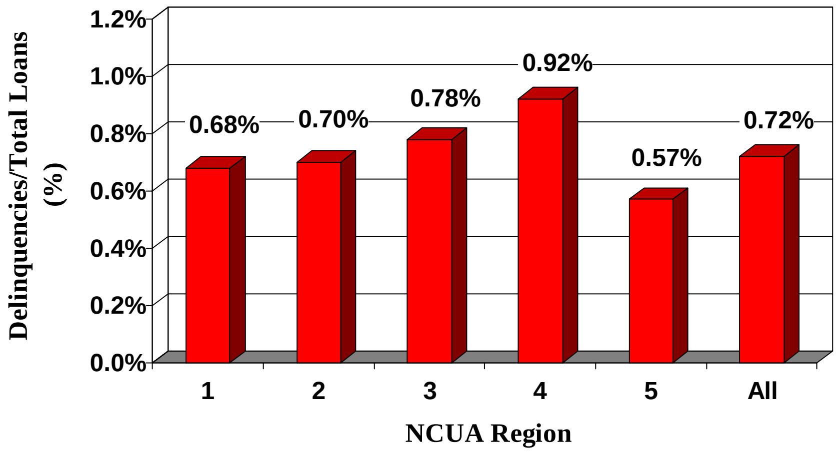
Total Loan Growth
Federally Insured Credit Unions
by NCUA Region
December 2004



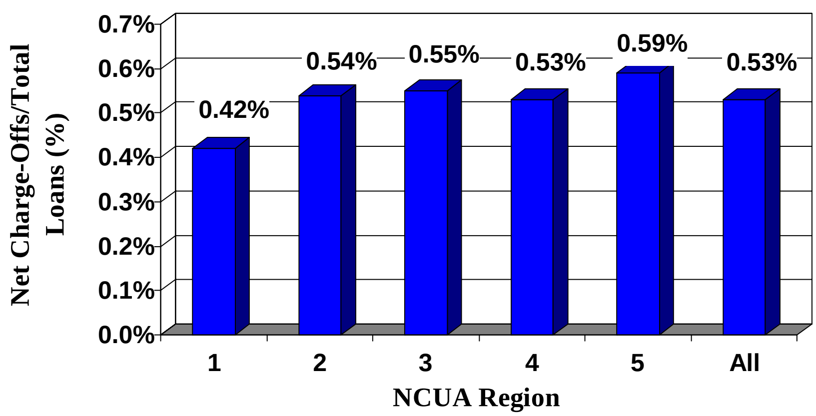
Total Share Growth
Federally Insured Credit Unions
by NCUA Region
December 2004



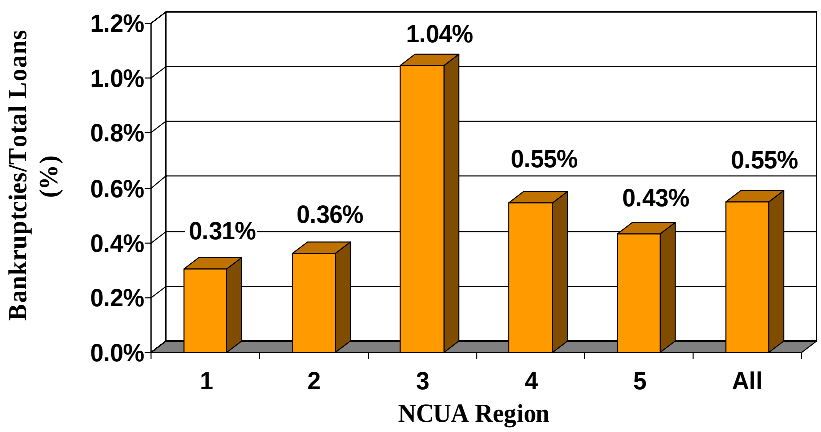
Delinquency Ratio
Federally Insured Credit Unions
by NCUA Region
December 2004



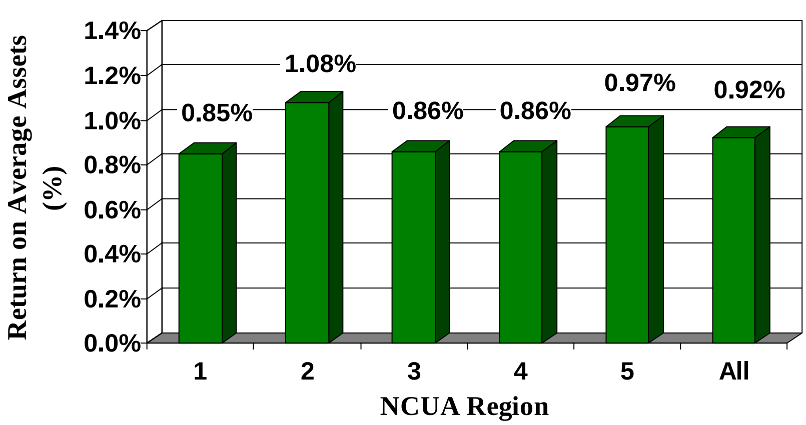
Net Charge-Offs/Total Loans
Federally Insured Credit Unions
by NCUA Region
December 2004



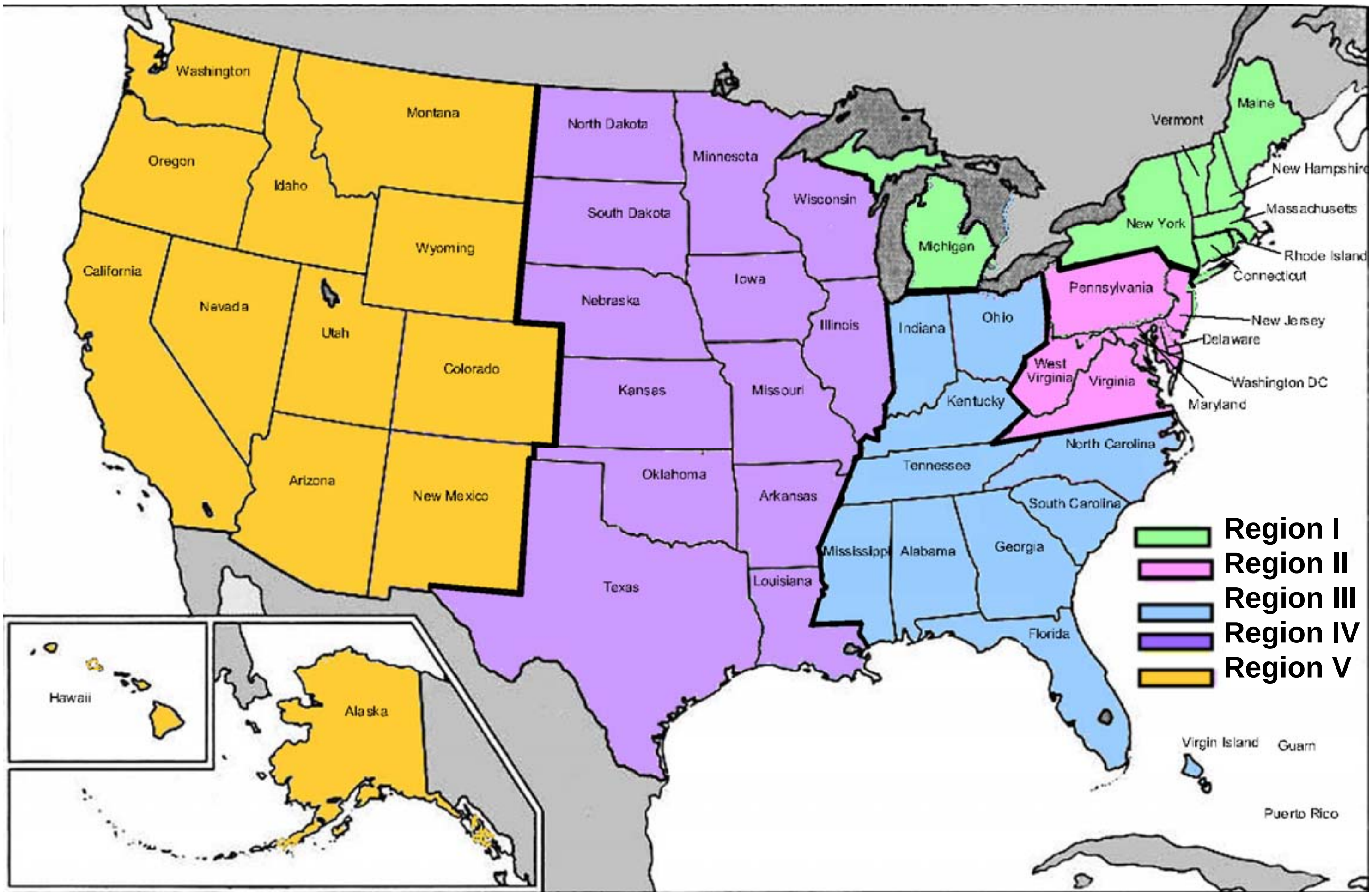
Bankruptcies/Total Loans
Federally Insured Credit Unions
by NCUA Region
December 2004



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



NCUA REGIONAL BREAKDOWN



Source: NCUA Web site