

CREDIT UNION ECONOMICS GROUP (CUEG) PANEL DISCUSSION

**National Association of
Federal Credit Unions
Annual Conference
Las Vegas, Nevada
July 14, 2005**

For more information on CUEG:

www.cueg.org

CUEG DISCUSSION TOPICS

- **IS THERE A HOUSING “BUBBLE?”**
 - Tun Wai, NAFCU
- **WILL THERE BE A CREDIT UNION “LIQUIDITY CRUNCH?”**
 - Not a Major Concern
 - Bob Burrell, WesCorp
 - A Growing Concern
 - Dave Colby, CUNA Mutual Group
- **LENDING OPTIONS: INDIRECT LENDING**
 - Bruce Beaudette, Sunmark FCU
 - Steve Brewer, Macomb Schools and Government CU

Bubble?



Housing Prices

IS THERE A HOUSING “BUBBLE?”

Tun A. Wai, NAFCU
Director of Research/Chief Economist

DEFINITION OF AN ASSET “BUBBLE:”

“A bubble may be defined loosely as a sharp **rise in the price** of an asset or a range of assets in a continuous process, with the initial rise generating expectations of further rises and attracting new buyers – generally **speculators** interested in profits from trading in the asset rather than its use or earnings capacity.”

Charles Kindleberger, *The New Palgrave, A Dictionary of Economics*

Although a "bubble" in home prices for the nation as a whole does not appear likely, there do appear to be, at a minimum, signs of **froth in some local markets where home prices seem to have risen to unsustainable levels.**

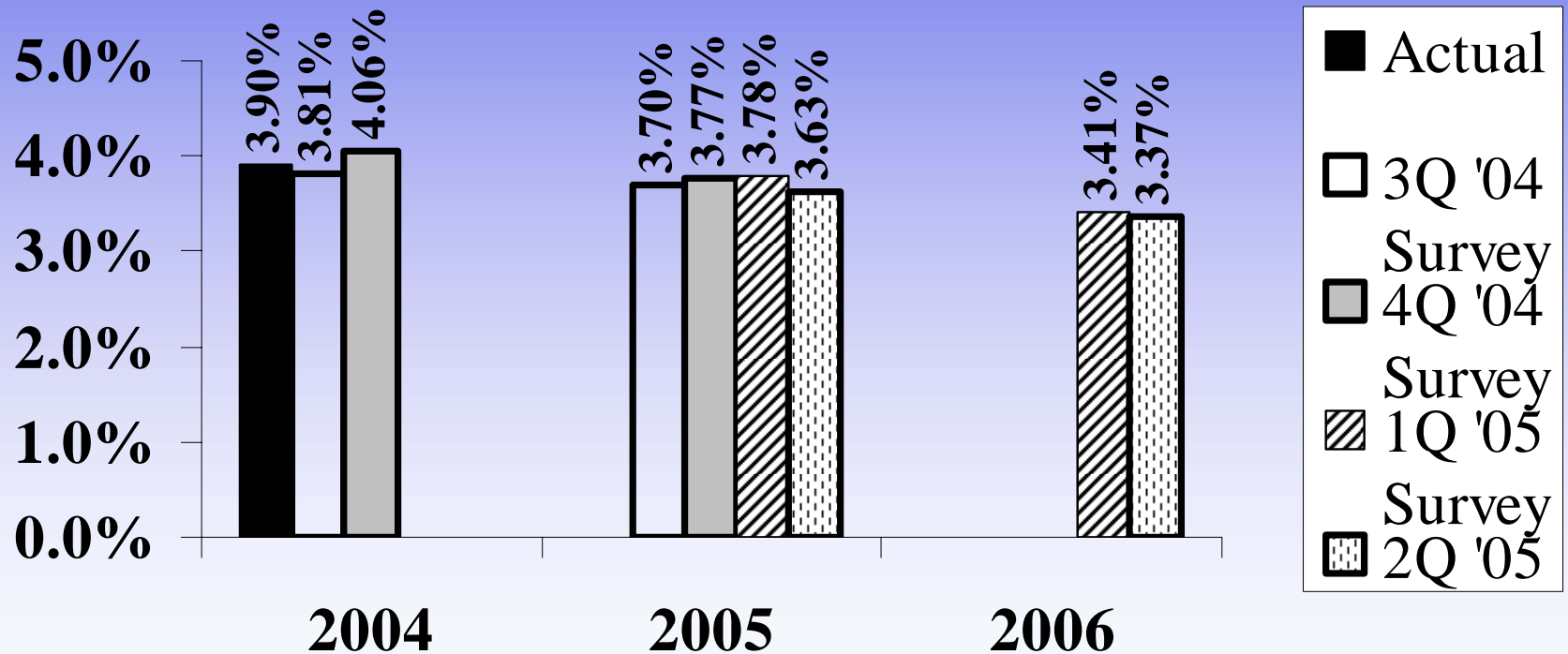
Chairman Alan Greenspan

The economic outlook

Before the Joint Economic Committee

U.S. Congress, June 9, 2005

CHANGES IN CUEG* GDP FORECASTS (Mean Reported)

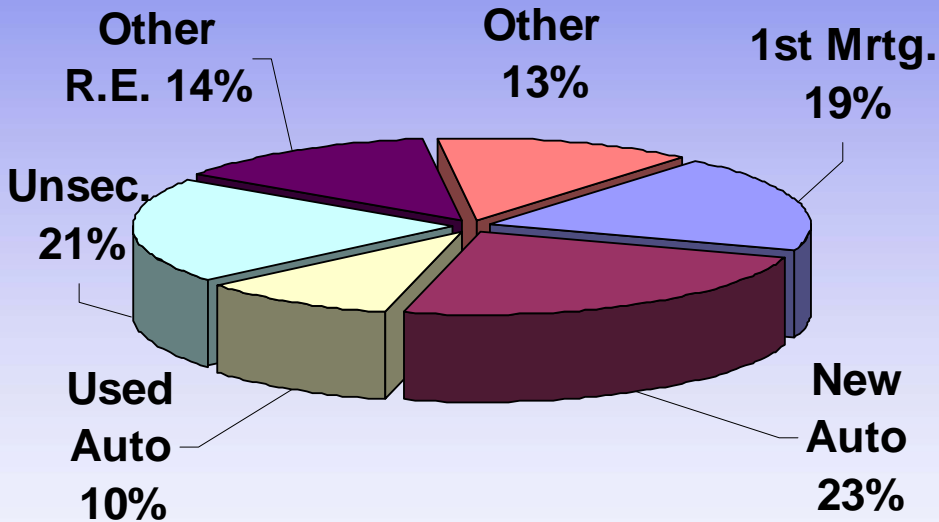


Source: www.cueg.org

* Credit Union Economics Group

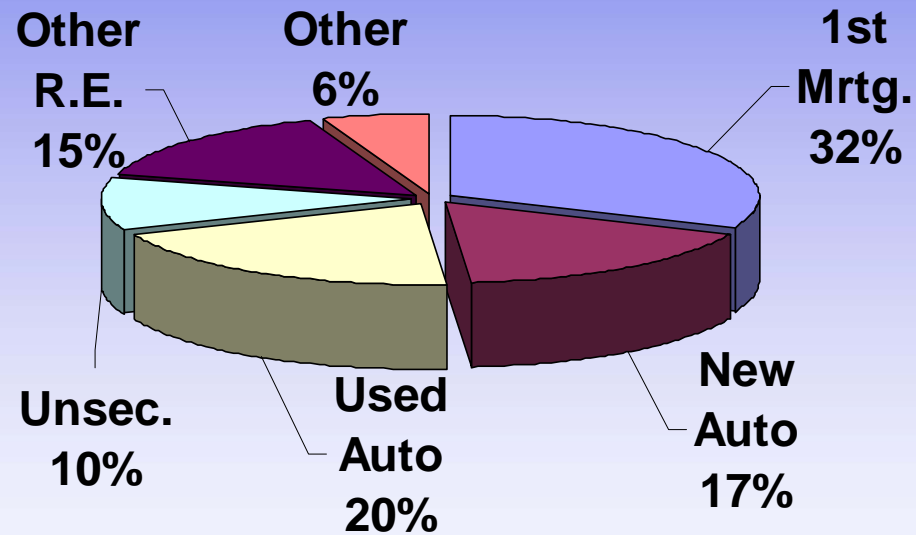
WHY THE CONCERN? IMPORTANCE OF REAL ESTATE LOANS

1989



34% Real Estate Loans

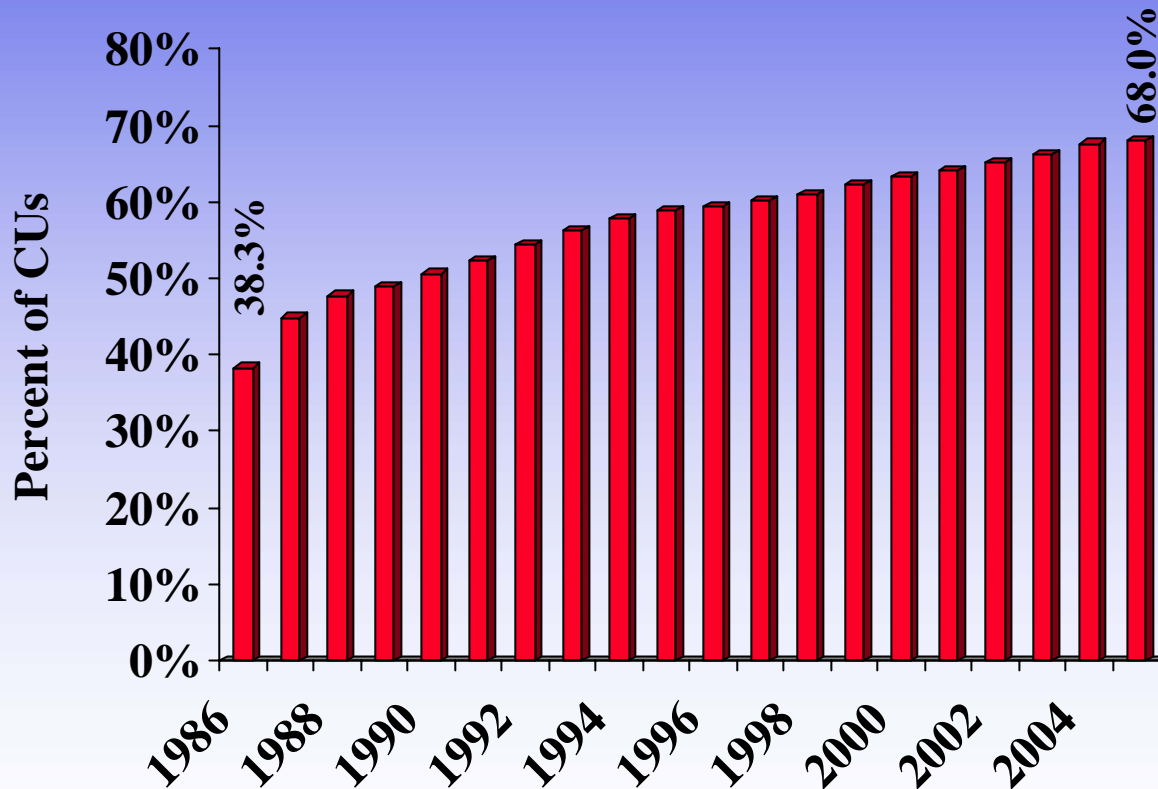
2004



47 % Real Estate Loans

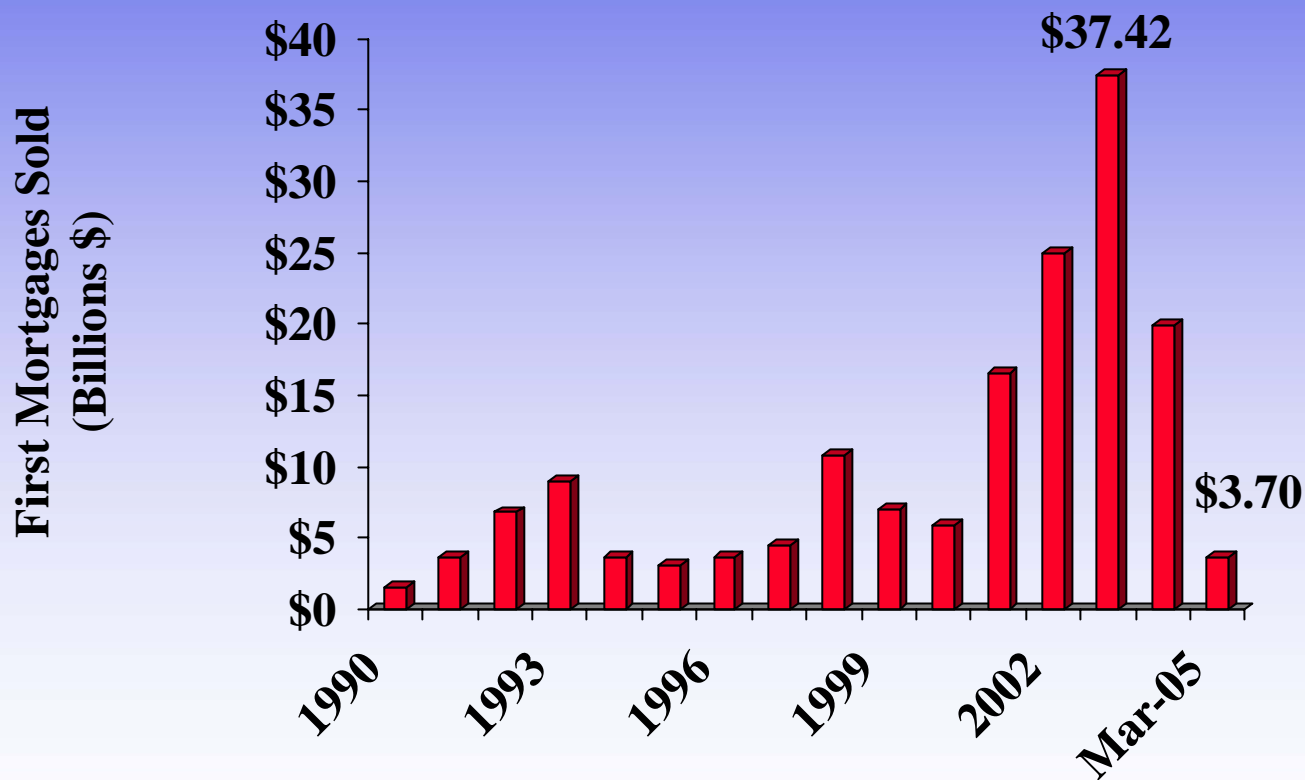
Source:
NCUA Call Reports

PERCENTAGE OF CREDIT UNIONS WITH REAL ESTATE LOANS



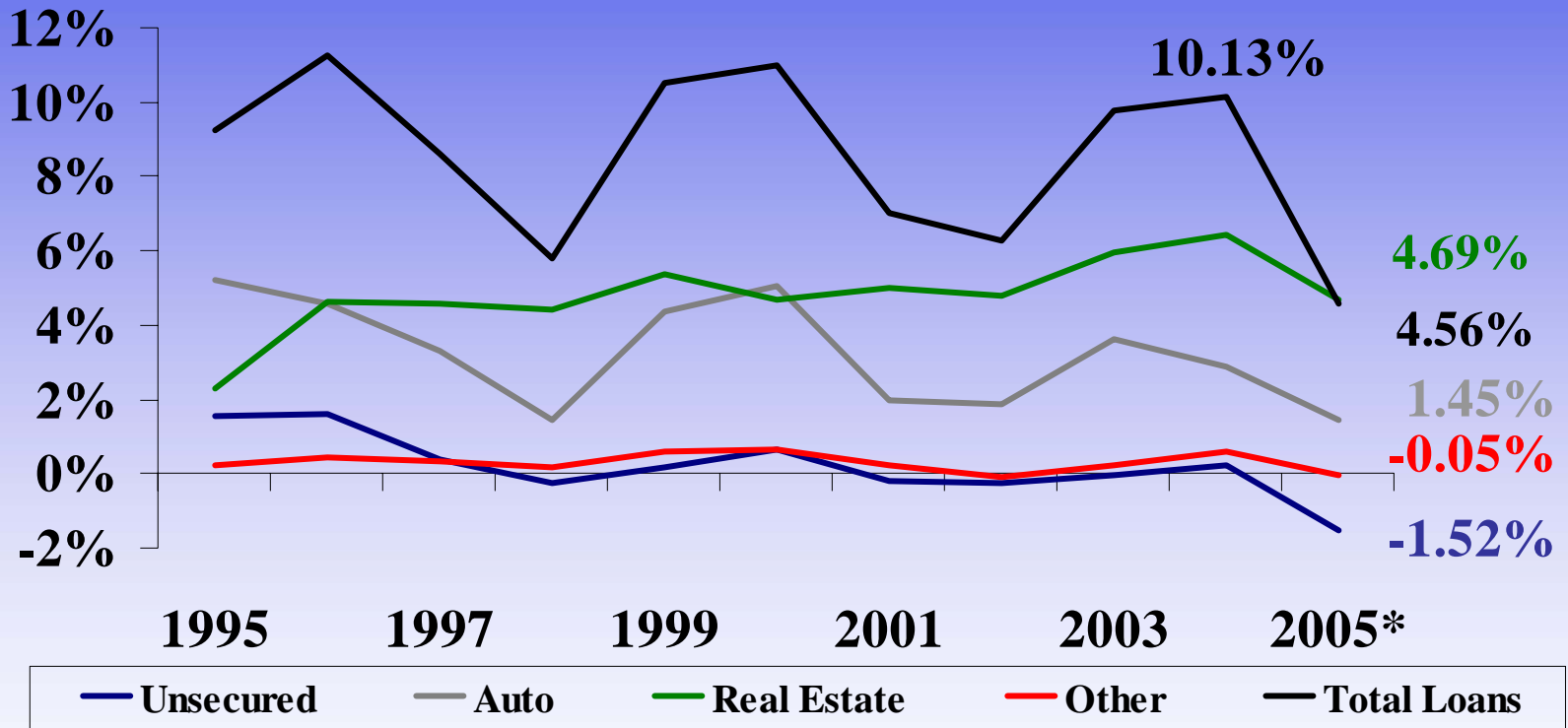
Source:
NCUA Call Reports

FIRST MORTGAGE LOANS SOLD (in Billions \$)



Source:
NCUA Call Reports

SOURCE OF LOAN GROWTH



Source:

NCUA Call Reports

* 2005 Figure is Annualized from March Data.

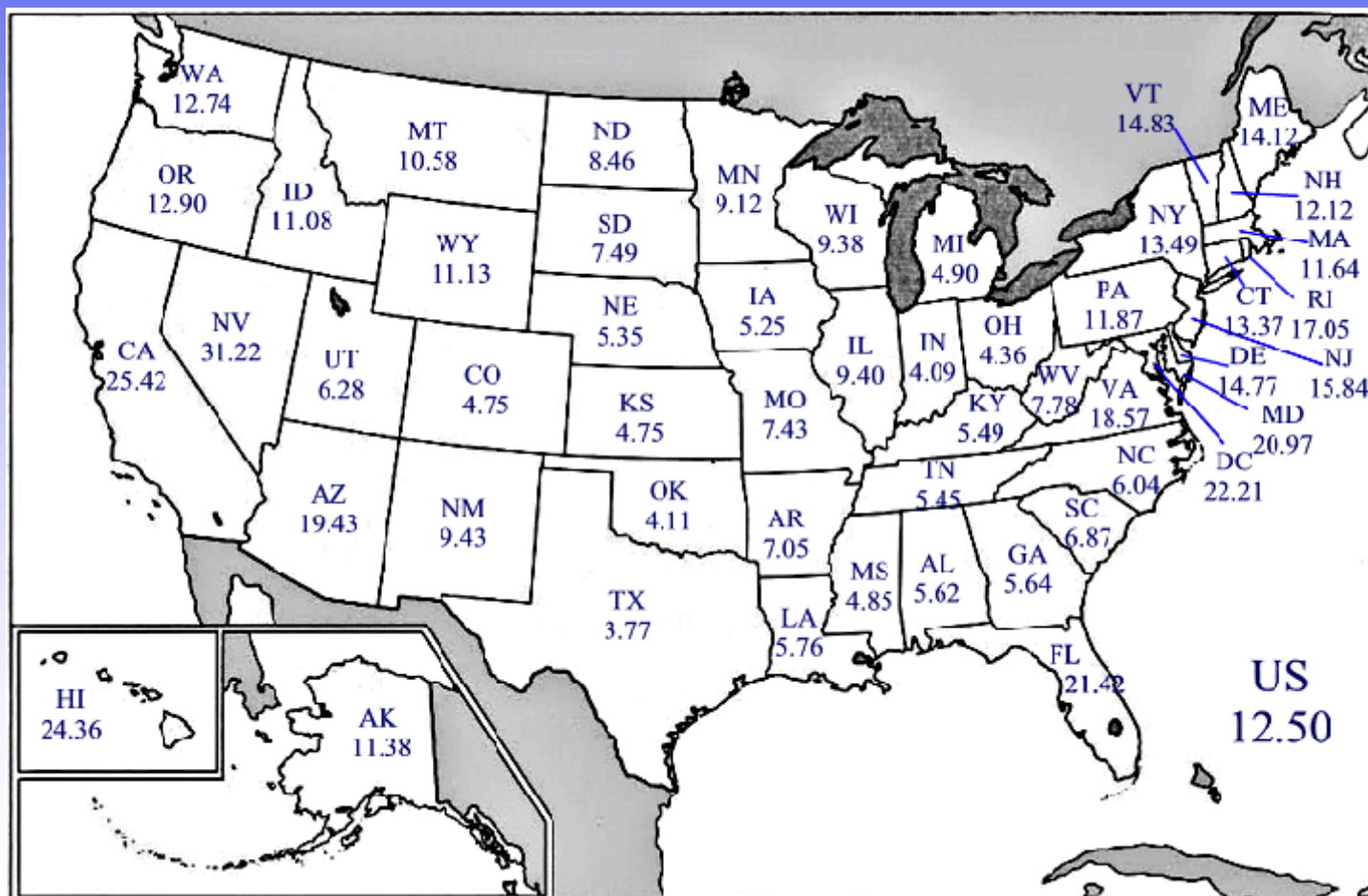
HAVE THE POTENTIAL INDICATORS OF A HOUSING BUBBLE INTENSIFIED?

National home price growth reached an all-time high versus both inflation and income growth in 2004, and 25 out of 100 of the top MSAs had home price appreciation of 20% or more last year – the highest percentage since 1979, when CPI inflation was 13%.

CHANGE IN HOUSE PRICES

First Quarter 2004 to First Quarter 2005

Average U.S. Annual Appreciation = 12.50

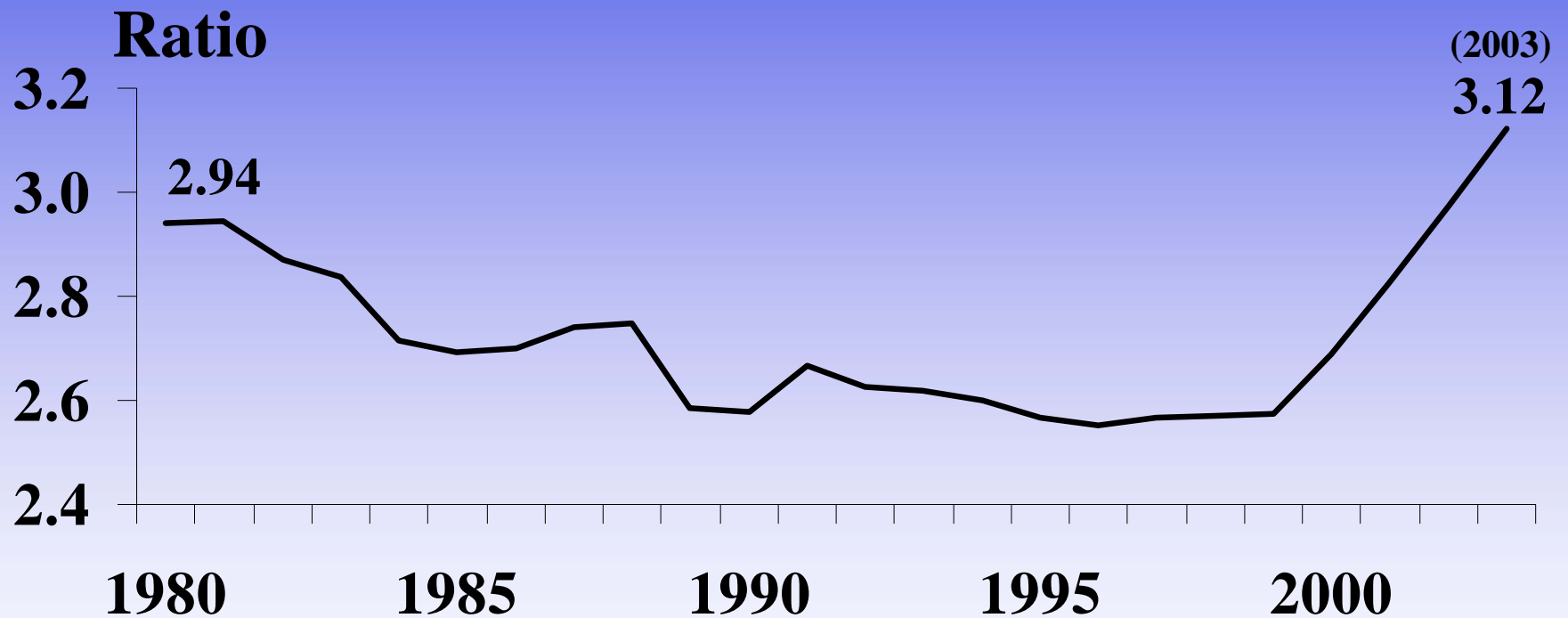


Source:

Office of Federal Housing Enterprise Oversight (OFHEO)

CUEG

MEDIAN HOUSE PRICE-TO-MEDIAN FAMILY INCOME

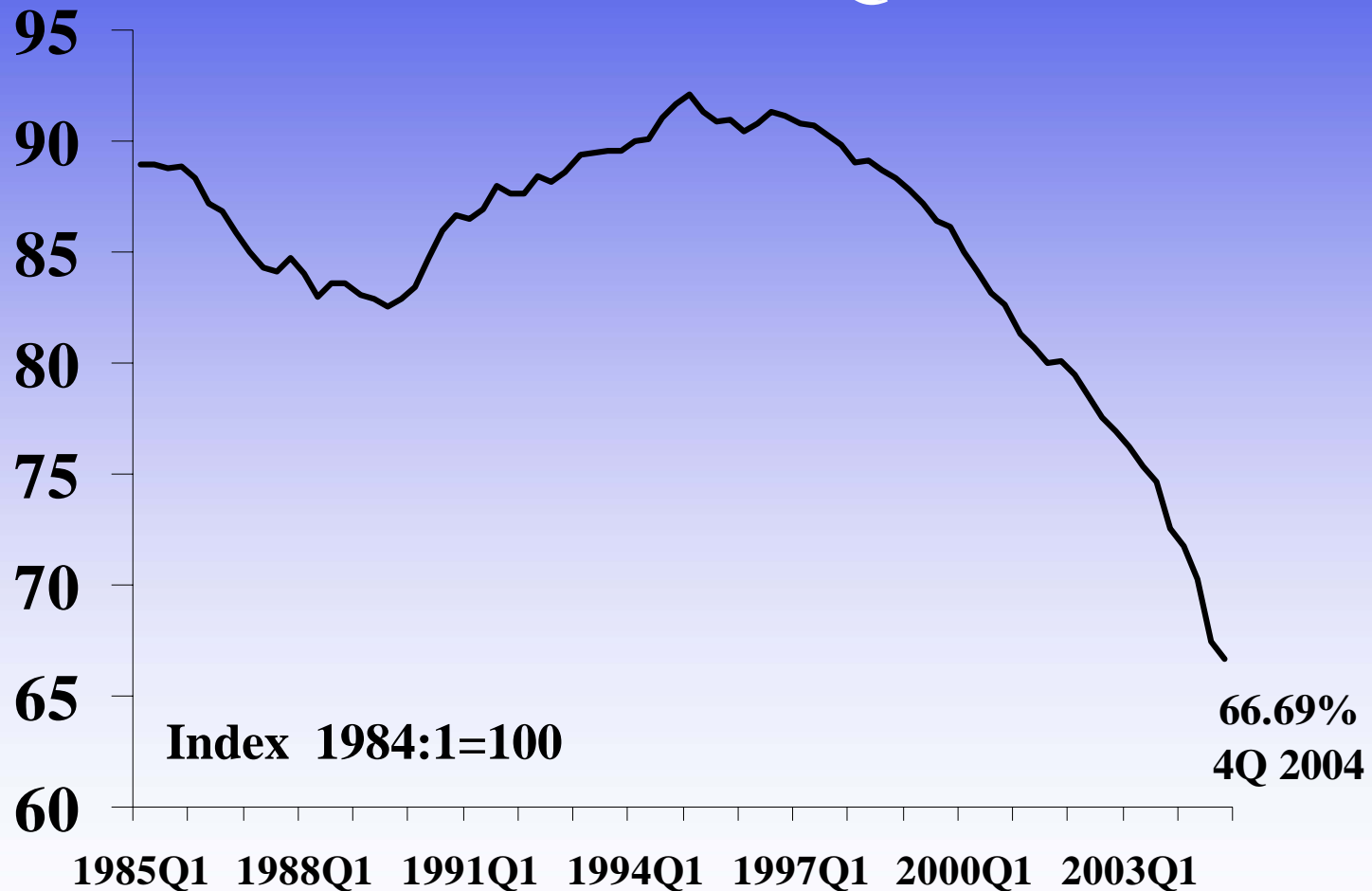


Sources:

National Association of Realtors;

US Department of Commerce, Bureau of Economic Analysis

OFHEO HOUSE PRICE INDEX-TO-OWNERS' RENTAL EQUIVALENCE



Index 1984:1=100

66.69%
4Q 2004

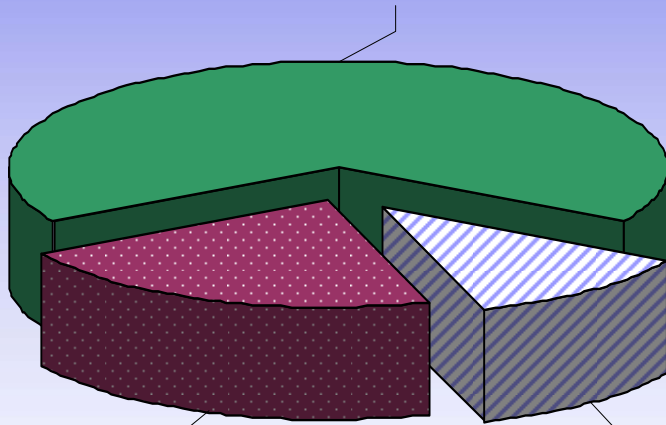
Sources:

Office of Federal Housing Enterprise Oversight (OFHEO);
US Department of Labor, Bureau of Labor Statistics

SHARE OF RECENT SALES BY INTENDED USE

2003

66.7%



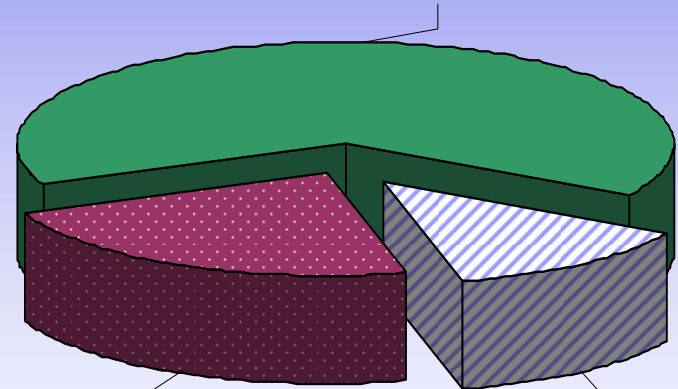
21.6%

11.7%

Vacation Investment Primary Residence

2004

64.6%



22.6%

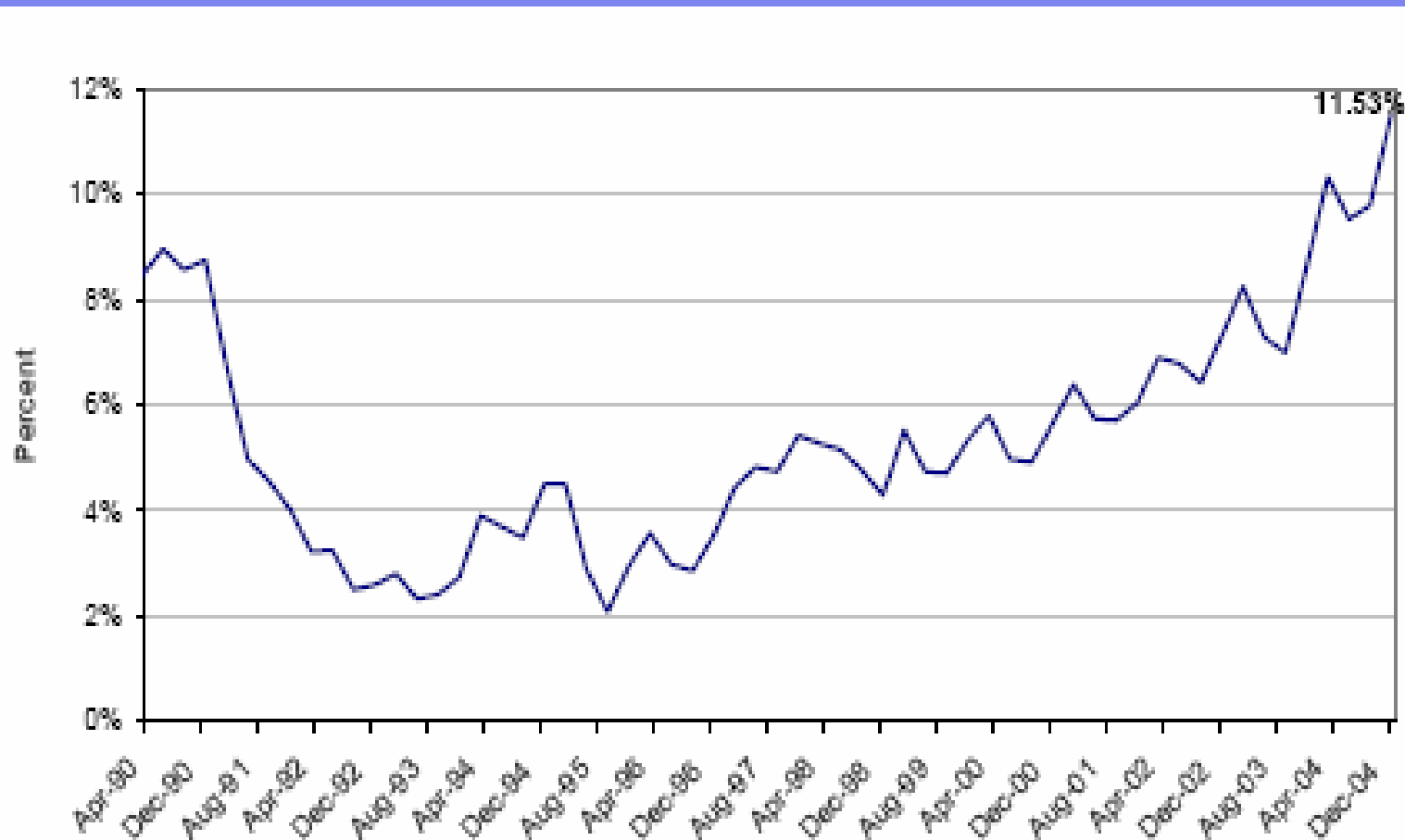
12.8%

Vacation Investment Primary Residence

Source:

National Association of Realtors

INVESTOR SHARE FOR PRIME CONVENTIONAL CONFORMING PURCHASE LOANS



Source: Fannie Mae

RESEARCH RESULTS

Our analysis of the U.S. housing market in recent years finds **little evidence** to support the existence of a national home price bubble. Rather, it appears that home prices have risen in line with increases in **personal income** and declines in nominal **interest rates**.

Jonathan McCarthy and Richard W. Peach

Are Home Prices the Next “Bubble?”

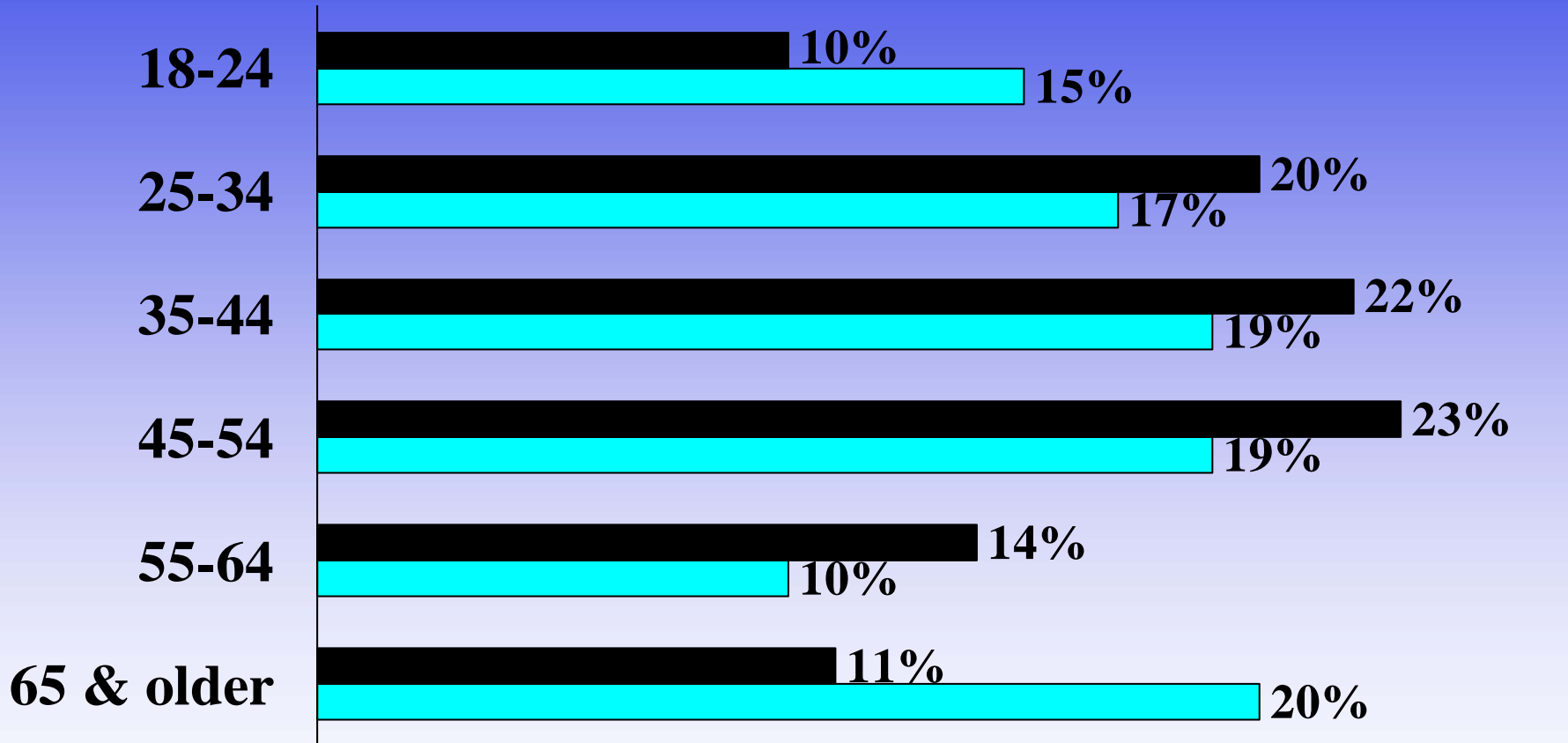
FRBNY Economic Policy Review

December 2004

HAS THE RISK PREFERENCE OF BORROWERS CHANGED?

- **Fannie Mae/Freddie Mac conforming loan limit is now \$359,650**
- **40 year mortgage loans**
- **Interest only real estate loans**
- **Hybrid loans**
- **Zero or low down payments**

AGE DISTRIBUTION OF MEMBERS & NONMEMBERS



0%

5%

10%

15%

20%

25%

Source: *CUNA & Affiliates*

 **Nonmembers**  **Members**

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HOUSING
BUBBLE



IT WON'T BURST...
IT'LL JUST
FLATTEN OUT A BIT...



Wicholson
8 OCT '02

...Credit Union Liquidity Issues



Rising Interest Rates...

CREDIT UNION LIQUIDITY

Not a Major Concern

Bob Burrell, WesCorp

Executive Vice President & Chief Investment Officer

A Growing Concern

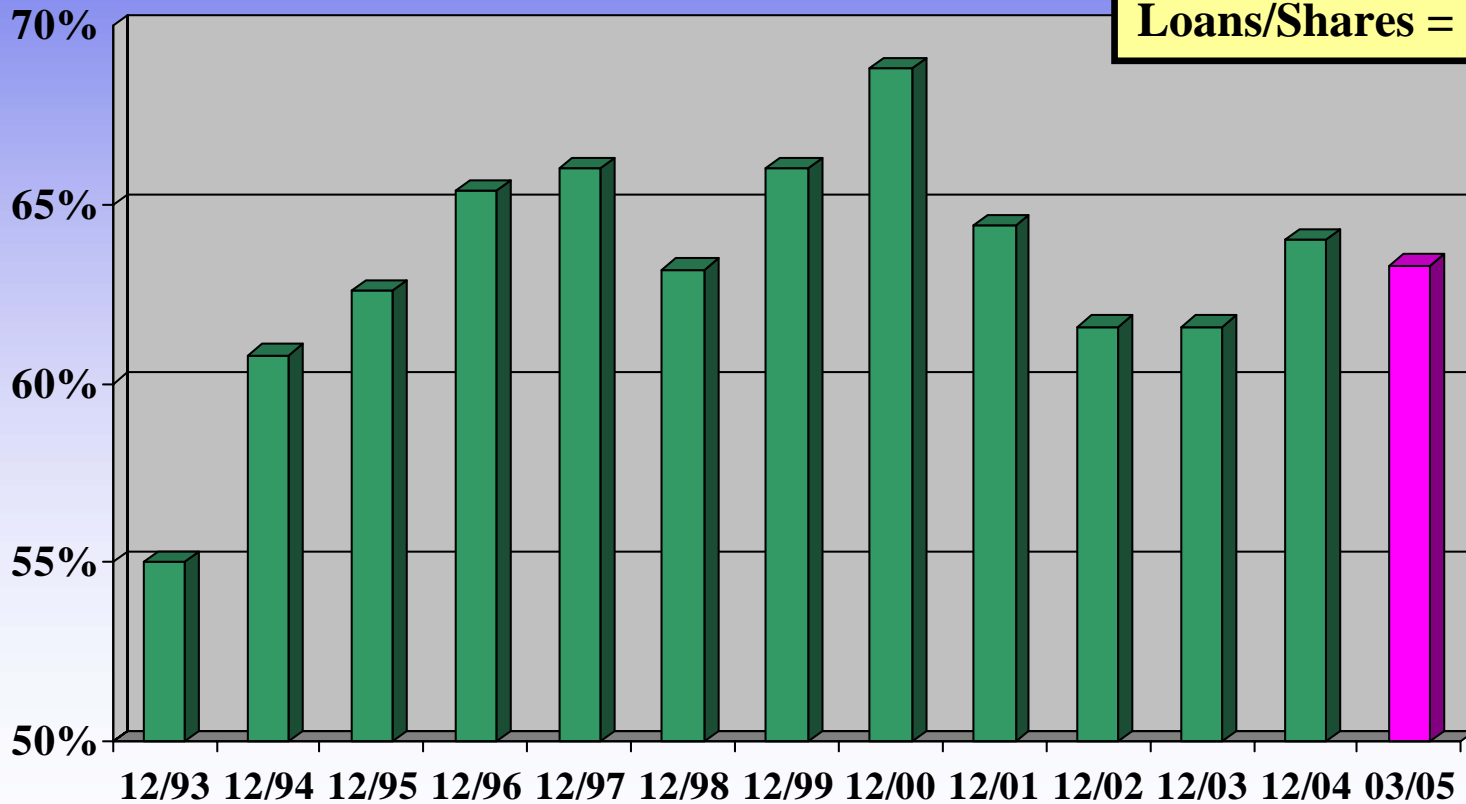
Dave Colby, CUNA Mutual Group

Chief Economist

LOANS ARE STILL LESS THAN TWO THIRDS OF TOTAL ASSETS!

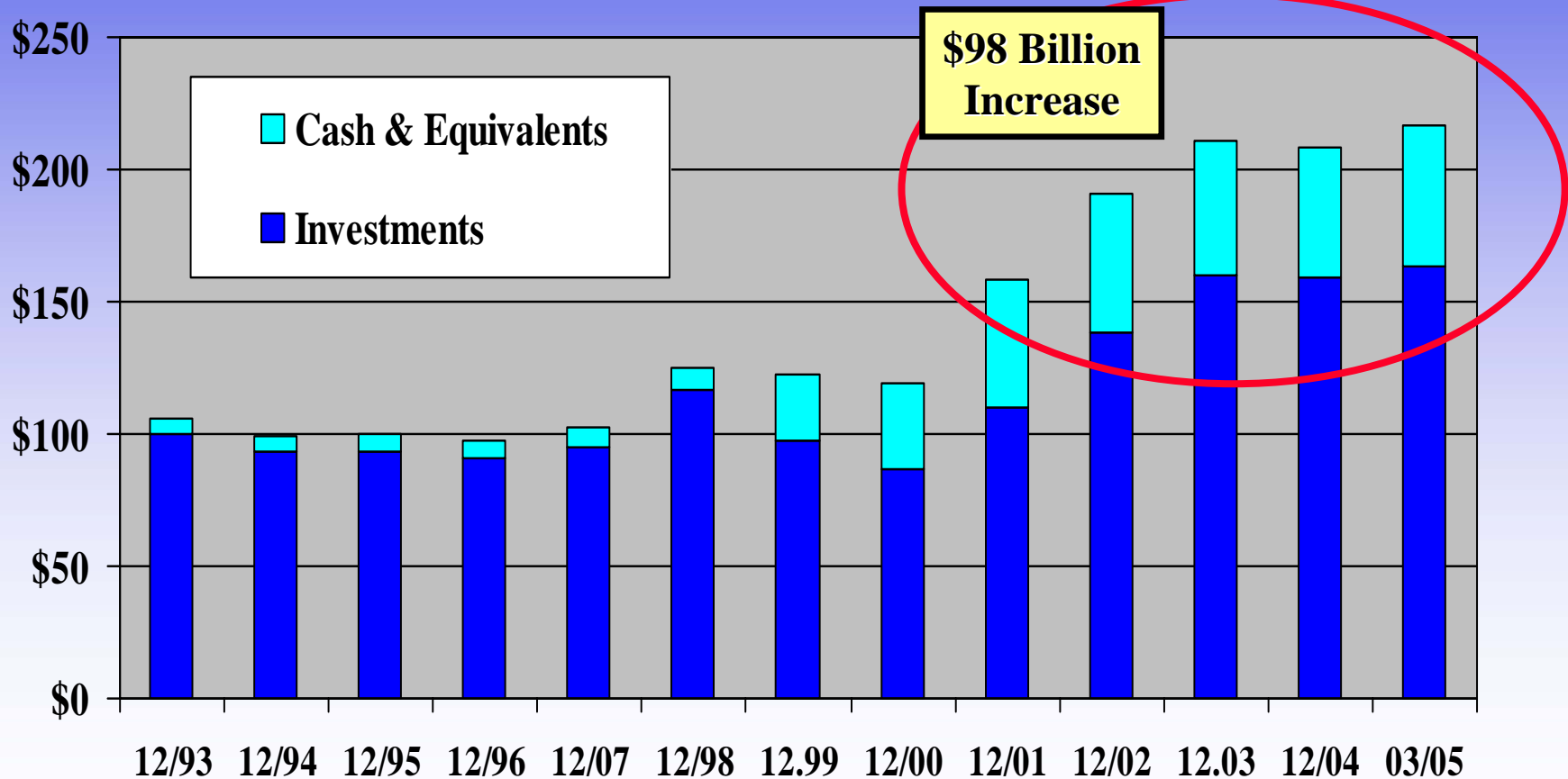
All FICU's

Loans/Assets



WE HAVE BUILT UP HUGE RESERVES OF SURPLUS FUNDS OVER LAST 4 YEARS !

All FICU's



INVESTMENT PORTFOLIOS REMAIN VERY LIQUID

All FICU's

	<1 Year	1-3 Years	>3 Years	Total
Non FAS Investments	\$82.8 Bln	\$25.6 Bln	\$0.2 Bln	\$108.6 Bln
Securities	\$43.7 Bln	\$47.2 Bln	\$11.1 Bln	\$102.0 Bln
Total	\$126.5 Bln	\$72.8 Bln	\$11.3 Bln	\$210.6 Bln

As of 3/31/2005

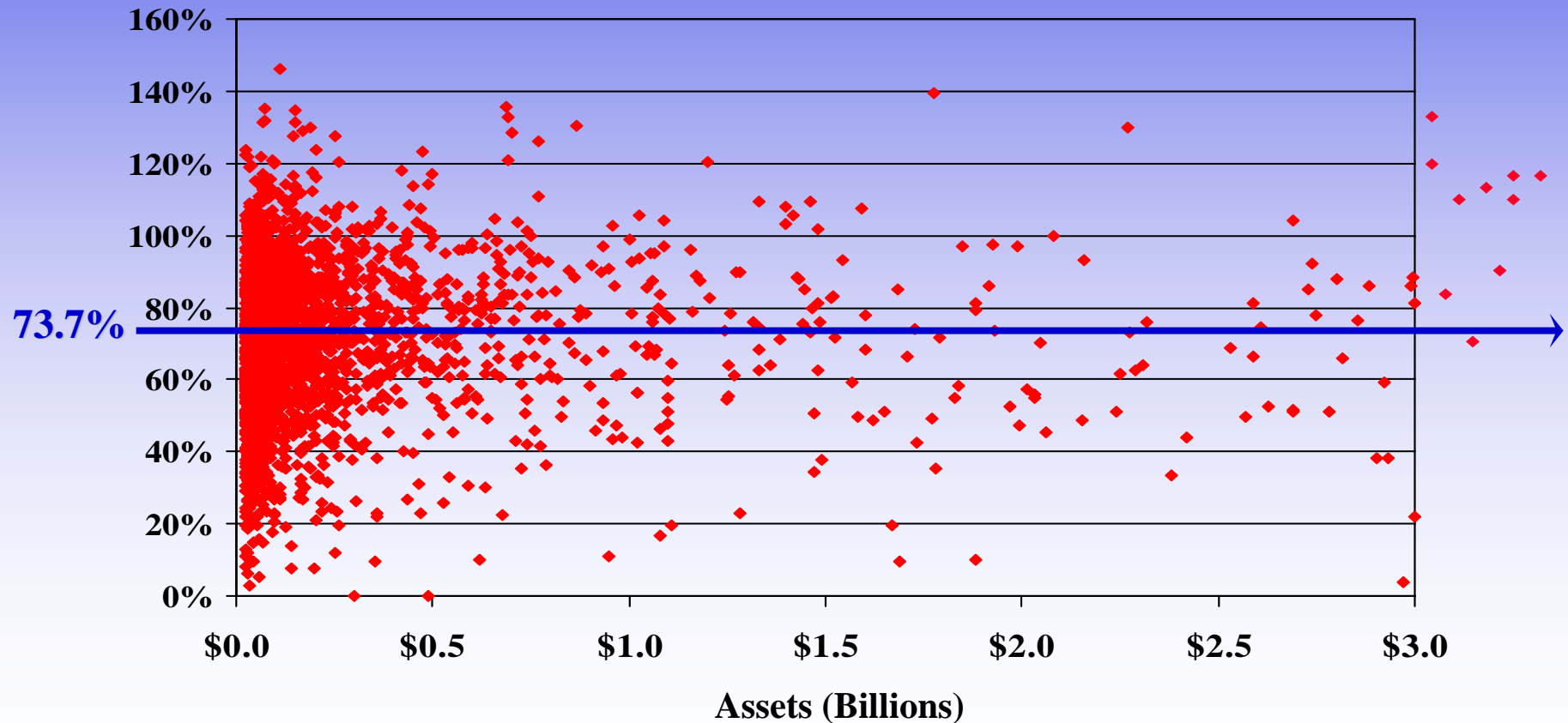
\$36.1 Billion Overnight

CUEG

THE AVERAGE LOAN-TO-SHARE RATIO IS NOT VERY MEANINGFUL

All FICU's \geq \$25 Million Assets

Loans/Shares



As of 3/31/2005

WE NOW HAVE MORE TOOLS TO MANAGE LIQUIDITY

➤ Borrowings

❖ Corporate Credit Unions

- ✓ Extended range of products & terms

❖ FHLB

- ✓ Increased CU membership (958 FICU's)

➤ Loan Sales

❖ Secondary Mortgage Markets

- ✓ Residential mortgages now 32% of total loans

❖ Loan Participations

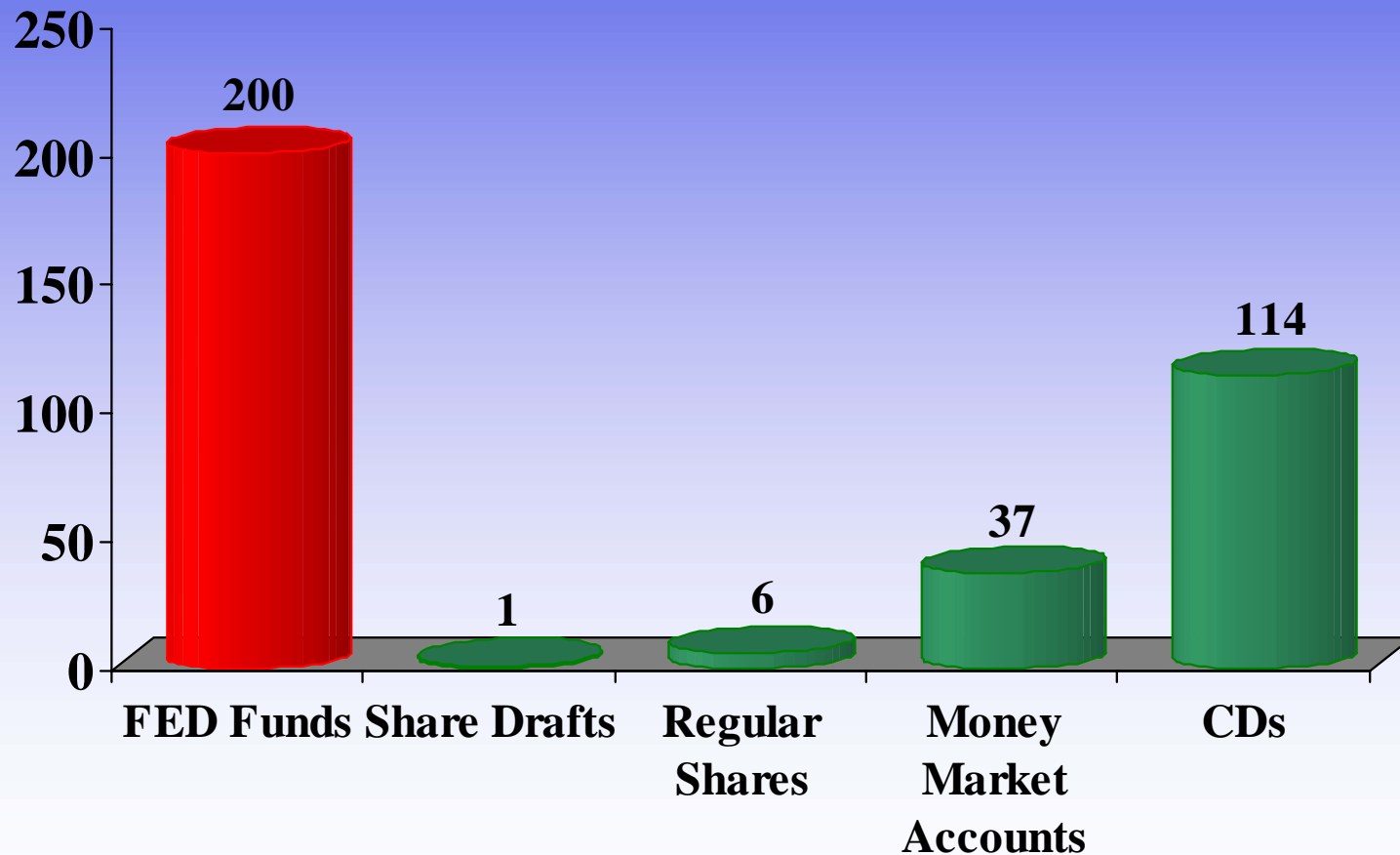
- ✓ Well established markets for Autos & MBL (\$2-3 Bln)

❖ Asset Securitization

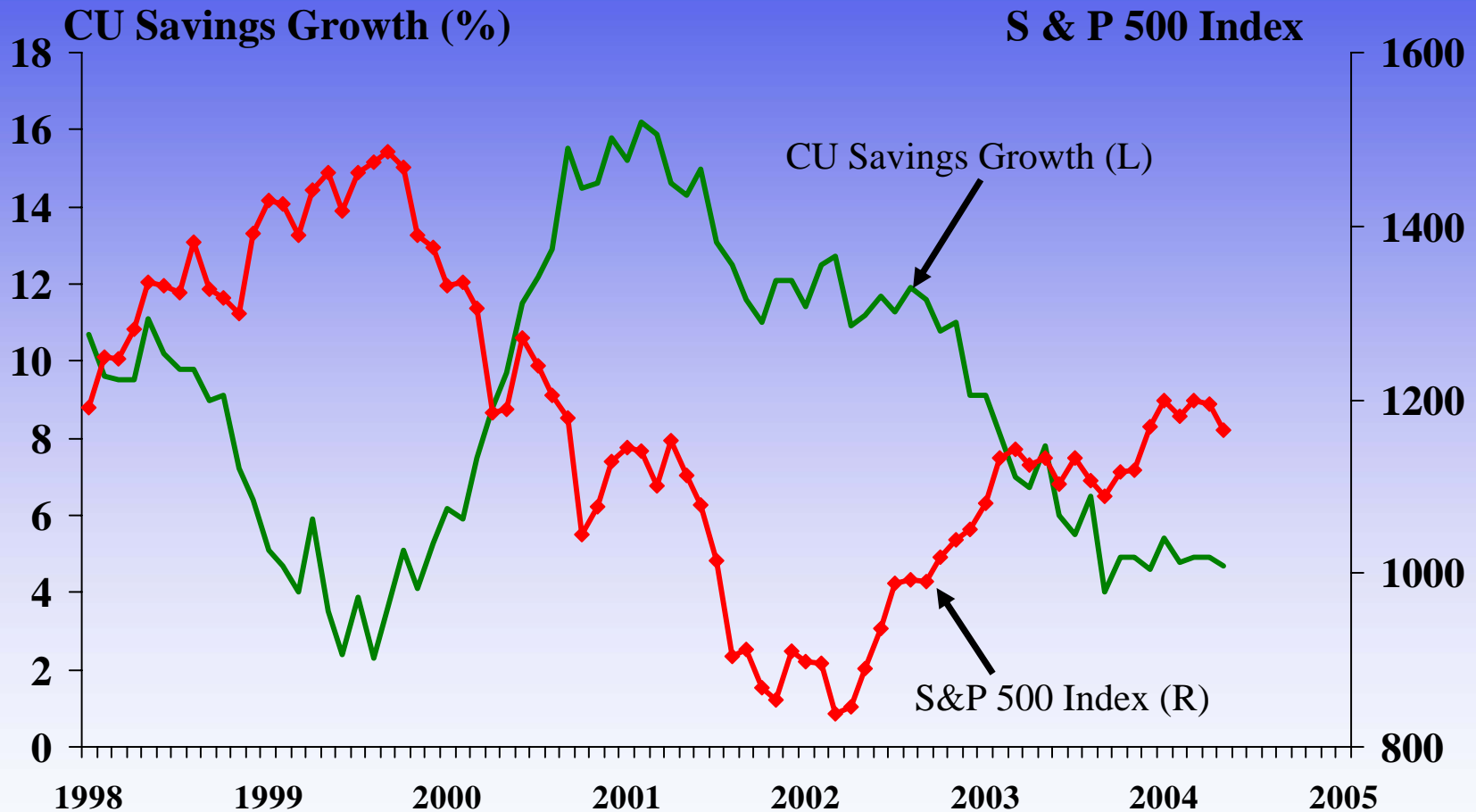
- ✓ First CU securitizations have been completed

DEPOSIT YIELDS LAG MARKET

Rate Change in Basis Points (June – April 2005)



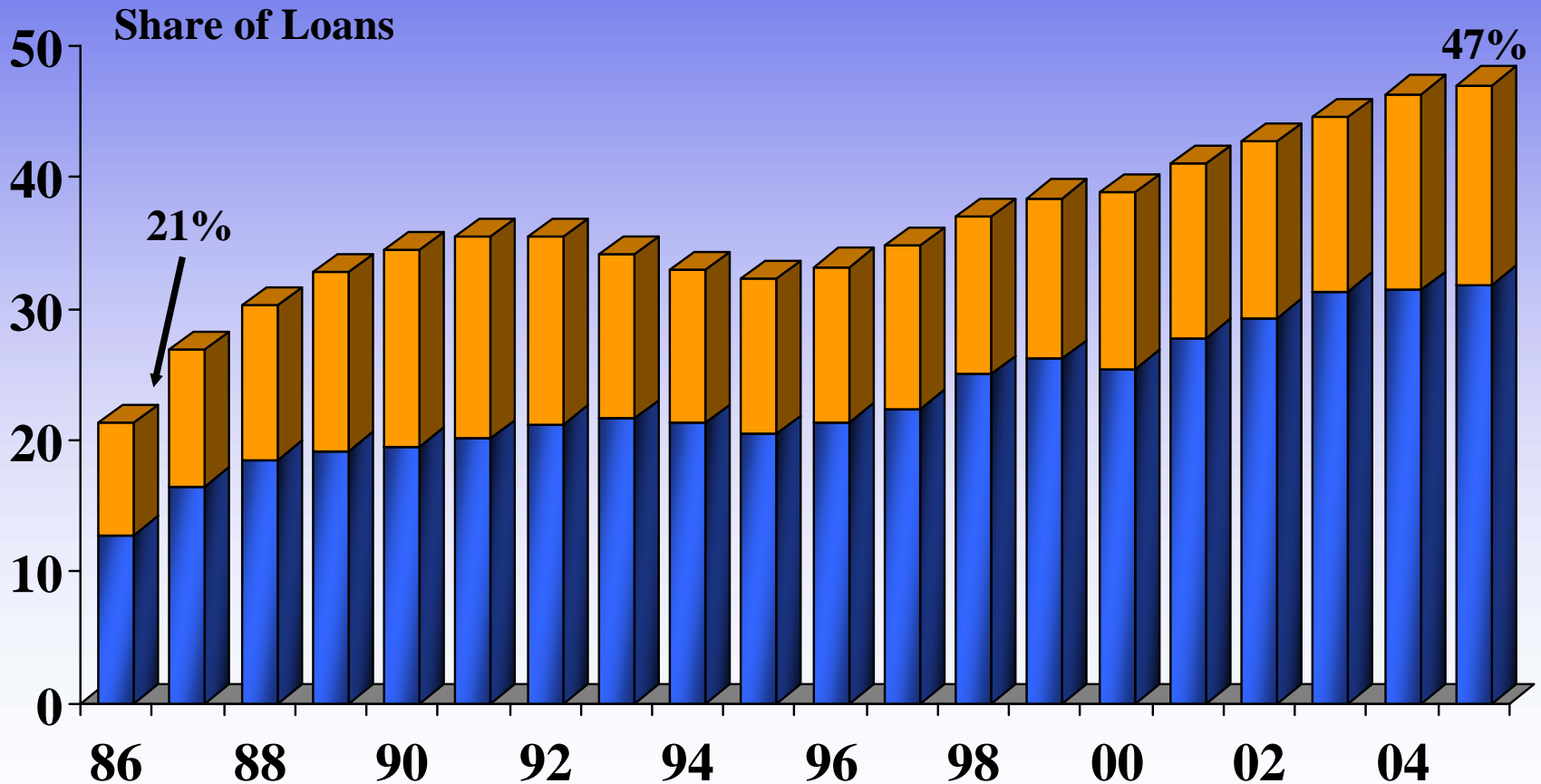
MODEST SAVINGS GROWTH AHEAD?



Source: Standard & Poor's and CUNA Economics & Statistics

CHANGING LOAN PORTFOLIOS

■ 1st Mortgages ■ Other Real Estate



GROWING CONCERNS

- Deposits too expensive
- Deposits not competitive
- Loanable liquidity

IN SUMMARY

...Indirect Lending



Lending Options...

LENDING OPTIONS: INDIRECT LENDING

**Bruce Beaudette, Sunmark FCU
President/CEO**

**Steve Brewer, Macomb Schools & Government CU
Chief Financial Officer**

WHY CONSIDER INDIRECT?

- **Direct auto lending market is shrinking**
- **Balance off longer term asset growth**
- **If you can't beat them- join them
(dealers)**
- **Most banking competitors are doing it**
- **Improve asset yields**

WHY DO INDIRECT IN-HOUSE?

- **Works best with established dealer relationships**
- **You control the process**
- **Maximize yields- no middleman**
- **Promote *your* Brand**

IN-HOUSE REQUIREMENTS

- **Knowledgeable & experienced staff**
- **Constant oversight of dealers**
- **Adequate reports**
- **Tolerance for higher losses**

WHY USE THIRD PARTY?

- **Turnkey- ease of start up**
- **No need to develop dealer relationships**
- **Economies of scale**
- **Established expertise**
- **No dealer pressure**

THIRD PARTY ISSUES

- **Retain right to refuse any deal**
- **Don't pay upfront fees**
- **Know your vendor**

INCOME TO DEALERS IN-HOUSE

- **Flat fees**
- **% over buy rate**

RESERVE PLANS

- **100% upfront**
- **75%/25% (70%/30%)**

CROSS-SELLING INDIRECT MEMBERS

- **Challenging- new member doesn't know you (or care)**
- **Education is key**
- **Outbound calling**

QUALITY CONTROL IN-HOUSE

- **Track losses by dealer**
- **Eliminate bad dealers**
- **Exercise discipline**
- **Monitor your staff**

DEALER RELATIONSHIPS IN-HOUSE

- **Overcome negative attitude- partners not enemies**
- **Build *close* relationships**
- **Be consistent with them**
- **Provide flexibility**
- **Turnaround time is important**
- **Service!**

ALTERNATIVE OPTION

- **Participations**
 - **Diversify geographic risk**
 - **Diversify default risk**
 - **Earn yields without “headaches”**
 - **Lengthen weighted average life**

OTHER ISSUES

- **Manage “back door”**
- **Risk based pricing**
- **Monitor competition**
- **Long term commitment- “ups and downs”**
- **Member issues on dealer rates**
- **Liquidity**
- **Examiner scrutiny**
- **Sale of related products at dealer**

SUMMARY



- **Housing prices in certain regions may fall.**
- **Current economics patterns suggests a future credit union “liquidity crunch” as likely.**
- **Indirect lending option must be evaluated carefully.**

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