Credit Union Economics Group Regional Report Spring 2007

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Bruce Beaudette: Bruce Beaudette is the President/CEO of Sunmark Federal Credit Union. Bruce has been working in credit union management for 26 years and has been in his current position for 20 years. Bruce was also a Senior Accountant for 1st Maryland Bancorp. Bruce is a current Board member of Members United Corporate FCU in Chicago, IL (formerly Empire Corp.) where he has served for the past 16 years and is a former chairman. Bruce has a Bachelors Degree in Business Administration from Siena College and an MBA from Russell Sage College.

Steve Brewer: Steve Brewer has been the Chief Financial Officer for Macomb Schools and Government Credit Union in Clinton Township, Michigan since 2002. Prior to joining MSGCU, Steve held finance and accounting positions with two credit unions, a savings and loan and a cruise line. Steve earned a Bachelors degree in Finance and Real Estate from the University of Texas, an M.B.A. from Texas A&M Corpus Christi and is a licensed Texas CPA.

Bob Burrell: Bob Burrell is the Executive Vice President and Chief Investment Officer of Western Corporate Federal Credit Union (WesCorp) in San Dimas, California. Prior to joining WesCorp in 1997, Mr. Burrell was Senior Vice President and group manager of capital markets and portfolio management at Boatmen’s Bancshares, Inc., in St. Louis. He also serves on the board of Corporate Exchange, LLC. Mr. Burrell was educated in England where he attended the University of Leeds and earned a Bachelor’s degree in Electrical Engineering.

David Colby: Dave Colby is the Assistant Vice President & Corporate Economist for the CUNA Mutual Group in Madison, Wisconsin. Mr. Colby joined CUNA Mutual in 1977 as a Corporate Research Specialist and has progressed through the organization holding various corporate, operational and financial planning positions. Mr. Colby is a graduate of the University of Wisconsin - LaCrosse where he received his Bachelor of Science degree in Economics. He holds the designation of Fellow, Life Office Management Institute.

David Dickens: David Dickens joined U.S. Central Credit Union in Lenexa, Kansas as Senior Vice President,Asset/Liability Management in December 1997. Prior to joining U.S. Central, Mr. Dickens served in the same role at Corporate One Federal Credit Union in Columbus, Ohio. Mr. Dickens, a Chartered Financial Analyst (CFA), also previously served as Senior Vice President of Corporate Network Brokerage Services, Inc. (CNBS). He earned a Bachelor’s degree in business administration from the University of Missouri.

Bruce Fox: Bruce M. Fox is the Senior Vice President and Chief Investment Officer of Southwest Corporate Federal Credit Union. Mr. Fox joined Southwest in January 1991 as an investment adviser. Mr. Fox is a member of Southwest’s asset-liability committee and chairman of the loan committee. Prior to that, he was an investment portfolio manager at the Members Insurance Companies of the Texas Credit Union League. Mr. Fox has Bachelor’s and Master's degrees in Finance from East Texas State University.

Kendrick Smith: Kendrick Smith is Vice President & Chief Investment Officer of Eastern Financial Florida Credit Union. Mr. Smith joined the credit union in May 1988 as a general ledger accountant and has held the positions of cost accountant, cash management accountant, Manager of Treasury, and Chief Financial Officer. Mr. Smith earned his Chartered Financial Analyst (CFA) designation in 1995 and a Masters in Business Administration from Nova Southeastern University in 2001. Mr. Smith has been managing Eastern’s investment portfolio since 1991.

Tun Wai: Dr. Tun A. Wai is in his twenty-first year as NAFCU's Director of Research and Chief Economist in Arlington, Virginia. Prior to joining NAFCU, Dr. Wai held research positions with the World Bank, the Federal Reserve Board of Governors, and the Brookings Institution, an independent research group. Dr. Wai has a Bachelor of Science in Business Administration in Management and a Ph.D. in Economics from Georgetown University, as well as an M.B.A. in finance from New York University.

Executive Summary

- FICU loan growth is expected to outpace share growth for the seventh consecutive year in 2007, however, by a smaller margin than in 2006.

- Unsecured credit card loans expanded by 11 percent for all of 2006 for FICUs, with Regions II and V (17.5 and 13.5 percent, respectively) leading the way.

- ROA for FICUs in Region II was 1.03 percent for 2006, well above the 0.82 percent figure for the nation as a whole.

- Share certificates were the principal factor driving share growth the over the course of 2006, growing 23.8 percent and accounting for 154 percent of total share growth. Share certificates in Regions II and V expanded the fastest, growing by 28.0 percent and 25.9 percent, respectively.

- New auto lending increased at a 5.4 percent pace in 2006. Regions II and V led the way (11.3 and 8.4 percent, respectively), but Region IV saw only a marginal uptick (0.8 percent) in their new auto lending.

- First mortgage real estate loans grew by 10.1 percent for all regions in 2006, outpaced by other real estate loans, which expanded by 15.0 percent. First mortgages continued to be the bulk of the share of FICU loan growth, although the weakened housing market has seen a slight decline in overall real estate loan growth.

- Anticipated rising energy costs are likely to place a constraint throughout the country, but particularly in Region I, where energy costs are higher overall. Coupled with weakened consumer spending, home depreciation and high debt burdens are causes for a precipitous economic outlook. Region IV also cites rising crop prices due to the drought as a source of concern.

- The number of FICU members declaring bankruptcy was down 65.2 percent in 2006 to 119,087, from 342,681 at year-end 2005. Loans charged off due to bankruptcy were down 38.8 percent. These decreases are largely explained by the bankruptcy legislation passed in October 2005 with a rush of filings to get in under the old law.

- Asset quality increased in 2006 as the delinquency ratio for all FICUs dropped from 0.73 percent at year-end 2005 to 0.68 at the end of 2006. The charge-off ratio also experienced a similar drop, falling 0.09 percent to 0.45 percent. Much of this can be explained by the extreme decrease in bankruptcy filings and loans charged-off due to bankruptcies.

NCUA Region One

NCUA Region I (Northeast) consists of the states of Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island, and Vermont. As of December 31, 2006, there were 1,422 federally insured credit unions in the Region, with total assets of $112.9 billion and a total membership of 13.5 million.

Lending

Loans in Region I during 2006 grew 3.0 percent to $76.4 billion, nearly 2 percent less than the pace for all federally insured credit unions (FICUs). During 2006, loan growth was concentrated in real estate products, and to a lesser extent, light vehicle loan products. While the Region's credit unions experienced a relatively strong demand for first mortgage loan products, home equity lending expanded by double digits once again. In 2006, first mortgage lending expanded by 6.9 percent, while other real estate loan demand (home equity/second mortgage) grew by 12.0 percent. At the end of December, real estate loans comprised 60.2 percent of all loans in the Region. Light vehicle loan portfolio growth slowed sharply in 2006. New light vehicle lending expanded by 4.4 percent after growing by over 17 percent in 2005. Uncertainty in interest rates, forward buying, and aggressive financing and incentives from the vehicle makers have constrained loan growth in 2006. Used light vehicle loan demand rose by less than 1 percent during 2006.

Unlike all FICUs, credit unions in Region I did not experience as strong of a demand for unsecured lending. Credit card lending rose by 5.6 percent, while non-credit card unsecured lending expanded by 3.8 percent. Finally, the Region's credit unions experienced strong demand for member business loans during the first half of this year. Member business loans outstanding grew by 22.9 percent to over $3.3 billion.

According to NAFCU's April 2007 *Flash* Report, near term expectations for loan demand in Region I were slightly more favorable for all four loan categories. The responding credit unions felt that new and used light vehicle loan growth would be sluggish, including indirect vehicle lending. There was also anticipation of an acceleration in member business loan demand, but unsecured lending is expected to remain flat in 2007. As expected, the near-term prospects for real estate lending were less favorable, especially in home equity lines of credit as housing prices have stalled or even dropped in some areas.

Member Shares (Savings)

In 2006, share growth in Region I was 3.1 percent, 1 percent lower than the share growth experienced by all FICUs. As with many FICUs, the Region's share growth during 2006 was concentrated in share certificates and IRA/KEOGH accounts, which rose by 24.7 percent and 6.8 percent respectively. As many credit unions have chosen not to significantly increase the dividend rates of share drafts and money market shares, there was a net outflow of 7.8 percent and 5.4 percent respectively during 2006. Regular shares also saw a decline of 6.9 percent last year. Many credit unions promoted CDs with maturities of one to five years to help fund loan demand. Other credit unions increased their borrowings from the FHLB and/or their corporate credit unions, and other credit unions chose to sell a portion of their first mortgage loan portfolio. In addition, some credit unions engaged in loan participations, while others promoted Web-based share accounts similar to those offered by ING financial corporation. In 2006, non-member deposits increased by 17.5 percent, well above the growth rate of all FICUs, but remain a very small part of total savings. Many of the Region's credit unions expect share growth to continue to remain weak over the near-term. However, according to the April *Flash* Report, the responding credit unions indicated that they believe share growth in 2007 will increase modestly from the pace in 2006. During this year, the strong loan demand, coupled with weak share growth, caused the loan-to-share ratio to increase to 80.8 percent from 78.5 percent in 2005 and 73.1 percent in 2004. The loan-to-asset ratio at the end of 2006 was 67.7 percent compared to 65.8 percent in 2005 and 62.1 percent in 2004.

Earnings and Asset Quality

During 2006, the credit unions in Region I had an ROA of 0.69 percent, down from 0.79 percent in 2005. This is significantly less than the December 2006 ROA of 0.82 percent and a 2005 ROA of 0.85 percent figure for all FICUs. While the Region's credit unions' loan and investment yields were on par with the average for all FICUs, the Region's cost of funds was lower than all FICUs. However, the credit unions in Region I generated substantially less non-interest income than the average for all FICUs and, as a result, had a lower ROA compared to all FICUs.

The asset quality in the Region was mixed in comparison to the asset quality of all FICUs during the first half of this year. The delinquent loans-to-total-loans ratio in the Region was 0.75 percent compared to 0.68 percent for all FICUs, while the net charge-offs/average loans rate of 0.42 percent in the Region was lower than the overall FICU net charge-off ratio of 0.45 percent. During 2006, member bankruptcies were not a problem in Region I, as both the number of members filing for bankruptcy and the loan amounts subject to bankruptcy decreased significantly. Total number of bankruptcy filings in the Region declined 60.1 percent to 17,966, while loan amounts subject to bankruptcy fell to $143.8 million compared with $360.6 million as of the end of 2005. In addition, more and more of the Region's credit unions are engaging in member business lending which adds risk to their balance sheets. While credit unions tend to be risk-averse and tend to conservatively manage their balance sheets, overall asset quality could deteriorate modestly as the yield curve becomes more normal.

Competition and Credit Union Operational Concerns for 2007

In Region I, credit unions are seeing tough competition from regional banks, particularly for member business and indirect light vehicle loans. Bank of America, Citizens and Berkshire Bank are formidable competitors now for loans, while Flagstar Bank, People's Bank, and TFC Bank have been very aggressive in pricing deposits. Because of this, the competition for credit unions is very stiff for savings, particularly share certificates. This, and rising short-term interest rates, has increased the costs of funds for many of the Region's credit unions. However, many of the credit unions in Region I are focusing on operational efficiencies and growing non-interest income in order to counterbalance this and the margin compression as of lately.

Member Concerns and Economic Conditions in 2007

When asked to assess their members' confidence/sentiment, the majority of the Region's credit unions indicated that their members were cautiously optimistic about 2007. Many members cited intense competition for new money, while others cited the tight rate spread as a major concern, the slowing real estate market, low share rates, and tight local labor market conditions. Various regulatory and legislative concerns are also on the minds of credit unions in Region I, namely increasing the member business lending cap. While most members felt the economy will continue to grow at a decent pace, there are concerns that consumer spending could weaken due to the slowdown in home appreciation and the debt burden of some members.

The overall economic and financial conditions throughout Region I remained steady at the end of 2006. However, pockets of weakness remain, particularly where manufacturing makes up a large portion of the local economy. In addition, the Region's economies are suffering from high energy costs. In Michigan, the economy continues to suffer from the financial troubles of the light vehicle and parts manufacturers. In Connecticut, Maine, Rhode Island, and Vermont, the economies are in relatively 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, revenue generation on Wall Street is solid and in upstate the high tech corridors are buoying the economic weaknesses of the manufacturing centers.

NCUA Region Two

NCUA Region II (Mid-Atlantic) consists of six states (Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia) plus the District of Columbia. The Region's federally insured credit unions (FICUs) have about 15.4 percent of the total assets of the nation, up by 0.1 percent from 2005. There were 13.0 million members in this Region at the end of 2006, up by 296,388 (2.3 percent) from the end of 2005. These percentages mirror the regional economy where the gross state product is about 13.7 percent of the U.S. gross domestic product. Regional production is more concentrated in government, professional services, and healthcare industries than the average concentrations found nationwide.

Lending

Region II FICUs generated loan growth of 12.8 percent during 2006, more than the national average of 7.9 percent. Over the course of 2006, other real estate loans supplied 37.0 percent of loan portfolio growth, closely followed by first mortgage real estate loans at 30.5 percent. Combined real estate secured lending (first mortgages and HELOCs) accounted for over two thirds of the gain.

Looking forward to 2007, Region II FICUs anticipate higher loan growth for new vehicle loans than do FICUs in other regions. Conversely, Region II FICUs expect used vehicle lending to moderate somewhat over the next 12-month period. Real estate loan expectations are slightly more negative than other FICUs nationwide.

Total auto loans in Region II advanced by 7.7 percent during 2006, compared to the rate of all FICUs of 3.2 percent. Region II new auto loans led the way, rising 11.3 percent last year, while used auto loan portfolios increased 4.0 percent.

Unsecured loans (excluding credit cards) represent 3.4 percent of all FICU loans in the Region. This portfolio segment increased 6.0 percent during 2006. Credit card loans increased 17.5 percent during the same period, representing 12.0 percent of all FICU loans in the Region. The credit union leadership in the Region believes that unsecured loan growth will be about the same for 2007, and this neutral view is shared by credit unions in other regions of the country.

Member Shares

Total savings/deposits reached $91.6 billion in December 2006, up $4.4 billion (5.1 percent) from 2005. Share certificates grew 28.0 percent during this year, but this was offset by a decrease in share drafts, which declined 26.4 percent. Money market shares also rose (9.1 percent). Combined, these highly liquid accounts contributed 95.9 percent of the increase in savings growth for 2006. In contrast, regular shares contributed a negative 14.6 percent of the regional savings growth, reflecting members' preference for higher returns.

For the next six months, Region II FICUs foresee a significant increase in share growth, and somewhat more than the share growth expectation found in most other regions.

During the 2006 year, Region II FICUs share drafts (9.0 percent of Region II FICU shares) decreased substantially (26.4 percent) since year-end 2005. Regular shares (34.0 percent of Region II FICU shares) declined 2.0 percent during 2006. Money market share accounts (16.0 percent of FICU shares) reached $14.6 billion as of December 2006, up by $1.2 billion (9.1 percent growth). FICU share certificates (30.0 percent of FICU shares) experienced a 28.0 percent increase during 2006.

IRA accounts (10.1 percent of FICU shares) were a safe haven for members' precious retirement funds in 2006. This savings segment advanced 10.1 percent for this year compared to a national average of 7.8 percent.

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

With an increase in the gross income mainly assisted by higher interest rates during 2006, Region II's credit unions experienced a slight increase in consolidated ROA. At 1.03 percent (average ROA for all FICUs was 0.82 percent), this profitability measure increased 8 basis points since 2005 for the Region's credit unions. This is mainly due to the increase in yield on average loans (up 30 basis points) and yield on average investments (up 73 basis points). Some FICU management teams, however, expect a slight decrease on ROA this year due to a higher cost of funds. Gross spreads increased by 62 basis points from 6.18 percent in 2005 to 6.80 percent in 2006. The ROA increased among Region II FICUs despite the 57 basis point increase in cost of funds/average assets, and a 14 basis point increase in the operating expense. Changes in the provision for loan losses/average assets (down 20 basis points) also helped improve the ROA.

Loan Loss Trends in 2006

Several FICUs in Region II indicated that their lending growth had not risen as strongly as the regional average for the last several months, especially in the areas of auto loans. In the area of loan quality, the 2006 Region II FICUs had a slightly lower delinquency ratio and slightly higher charge-off ratio than credit unions nationwide. The trend in bankruptcy among Region II FICUs follows a similar pattern as credit unions nationwide. In 2006, loans subject to bankruptcies decreased by 40.2 percent in Region II FICUs, while nationwide the growth was a negative 61.1 percent.

The primary operational concerns for 2006, cited by our regional credit unions, included attracting savings, rising compliance costs, and attracting new members. Higher loan revenue (especially from indirect auto sales) and a sanguine liquidity situation were mentioned as positives for future performance.

Member Concerns and Region II Economic Conditions in 2007

Credit union leadership in Region II viewed competition for loans from other credit unions and auto dealers more competitive than credit unions in other parts of the country. For saving accounts, banks and other credit unions were viewed as the primary competition. Several credit unions have initiated odd-month share certificates as a means of attracting more savings. Low unemployment, strong retail sales, and high company profits were mentioned as the general economic conditions of the Region. In addition, several credit unions cited concerns about problems with indirect auto lending where large growth rates were matched with rising delinquencies.

NCUA Region Three

At year-end 2006, there were 1,734 federally insured credit unions (FICUs) in Region III (Southeast). This Region consists of ten states which 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. The year-end count represents a net decline of 88 FICUs in 2006, of which 50 occurred in the second half of the year. Region III now holds 21 percent of all FICUs, 20 percent of all assets and 23 percent of all members. At $142 billion, total assets rose 3.9 percent, roughly 70 basis points below the national average. Total membership in the Region rose 1.2 percent to 19.4 million. Region III trailed the national average gain of 1.5 percent in 2006. Total employment (full and part-time employees) increased by 1,804 to just over 54,200. All the gains were in full-time employment. The 50 largest CUs in the Region hold 52 percent of all assets and 40 percent of the total membership.

Once again, two important considerations must be noted for this report. First, Region III covers a wide expanse of geography ranging from the north end of Indiana to the southern tip of Florida. Thus, economic and employment conditions vary significantly. Taking a high level view of borrowing and savings trends, we can generalize that members are growing increasingly cautious as the economy slows, especially in the housing and automotive sectors. Additionally, hurricane Katrina and Rita continue to have lingering effects on results. Five states in Region III were impacted by the 2005 hurricane season. In some cases, savings in these states remain inflated as rebuilding is not finished due to the lack of construction resources. Insurance settlements remain on deposit, waiting for repairs to be completed.

At year-end, Region III FICUs collectively remain in good health as they improved their net worth ratio to 11.7 percent by generating an ROA (return on average assets) of 80 basis points. At the same time, loan delinquencies and charge-offs fell as did the allowance for loan losses. Going forward, re-igniting savings while controlling ROA erosion, as the cost of funds climb and a possible reduction in loan quality, are the primary concerns of Region III FICUs leadership.

Lending

Loan growth within the Region and nationally continues to slow. The FICUs in Region III generated a 6.2 percent loan growth in 2006. This was significantly below the 9.6 percent gain posted in 2005 and 1.7 percentage points below the national average. Over the course of 2006, a total of 661 FICUs (15 percent of assets) in the Region reported declines in loans outstanding while 396 FICUs (35 percent of assets) expanded their loan portfolios by 10 percent or more. In total, Region III FICUs finished the year with a loan-to-share ratio of 79.3 percent. While this key measure was up roughly 200 basis points from year-end 2005, it was 290 basis points below the national average. South Carolina had reported the highest loan-to-share ratio at 81.6 percent and Ohio was the lowest in the Region at 70.6 percent.

The 181 Georgia FICUs reported the highest growth in 2006. They expanded their loan portfolios by 11.6 percent, but the 206 Florida FICUs, who hold 28 percent of all loans in the Region, accounted for 39 percent of all growth.

In 2006, real estate secured loans (first mortgages, second mortgages and home equity loans) accounted for over 74 percent of all loan growth, despite an annual increase one percentage point below 2005 results. Leading the way were first mortgages, up 9.5 percent for the year and supplying 51 percent of all Region III's lending gain. A total of 813 FICUs in the Region reported originating first mortgages in 2006. The dollar amount of Region III originations were only down 2.8 percent versus a national average decline of 10.2 percent.

Looking at other real estate loans (second mortgages and home equity loans), we see member preference has switched to fixed-rate products. Fixed-rate other real estate loan originations were up 38 percent in 2006 and the portfolio grew 39 percent while adjustable-rate loan products declined.

Fifty percent of leaders anticipate reduced first mortgage volumes this year. In contrast, 60 percent see other real estate new loan volumes and portfolios improving. This is being offset by a growing concern about what a decrease in the value of housing might mean for future loan losses. It should be noted that the housing market is not uniformly weak across Region III. Ohio, due to its relatively high unemployment rate, is experiencing home price depreciation as is Florida, due to the value of homes appreciating faster than median incomes for the past few years. Meanwhile, Georgia and South Carolina are experiencing home price appreciation.

In 2005, vehicle loans increased 9.9 percent and supplied 42 percent of all loan growth. During 2006, new and used vehicle loan portfolio expansion dropped to 1.8 percent and accounted for just 12 percent of Region III's lending gain. Region III auto dealers report sharply lower showroom traffic, weak new vehicle sales and extremely depressed used vehicle sales opportunities. Both nationally and within Region III, few FICU leaders are optimistic about resurgence in vehicle lending in the near-term. Many anticipate a slight improvement in vehicle lending results, but believe it will continue to be a drag on overall loan growth. They continue to cite very stiff competition from manufacturers discounted financing, at the point-of-purchase, as the primary reason for this weak performance.

Indirect lending is still driving vehicle loan growth, but portfolio expansion has slowed significantly. In 2005, indirect loans grew 26 percent and their gain equaled 75 percent of the change in total vehicle loans outstanding. During 2006, the indirect portfolio segment was up just 3.5 percent and accounted for 63 percent of vehicle gains. This much weaker performance occurred despite the number of indirect programs increasing by 27 to 344. We see this as a reflection of overall weakness in vehicle sales in the Region and nationally.

Total Shares

Total shares in Region III FICUs increased 3.5 percent in 2006. Share growth continues to slow and the gain in 2006 was just 110 basis points above the cost of funds (a proxy for internal yield accumulation), and thus it appears new savings inflow was minimal. In addition to weak savings inflows, the source of growth has moved to higher cost funds. During 2006, regular shares declined 11.6 percent and share certificates (CDs) increased by 21.5 percent. The year-end average yield on regular shares is estimated at 1.41 percent, versus 3.51 percent on one-year share certificates. This likely understates the yield differential given the popularity of "odd maturity" share certificates. The net effect of this change in savings structure is a 63 basis point increase in the cost of funds during the year, to 2.4 percent.

The 206 FICUs in Florida held 28 percent of Region III's total shares and generated a 4.9 percent annual growth rate. Tennessee FICUs had the strongest growth rate, up 7.2 percent for the year. A total of 1,024 FICUs reported share declines in 2006. These institutions held over 22 percent of the Region's assets. Two states (Georgia and Mississippi) reported declines in total shares. While four out of five surveyed credit union leaders see stronger savings growth in 2007, discussions with many credit union leaders suggest savings growth, or the lack of it, remains their primary concern.

Asset Quality and Operational Results

At year-end 2006, asset quality, as measured by delinquent loans to total loans (0.74 percent), had improved over 2005 results and was near record lows for the Region. The ratio of net charge-offs to average loans (0.46 percent) also showed improvement over 2005. It should be noted that both measures rose slightly from third quarter 2006 results. We believe FICUs in the Region will see minimal spillover from the major deterioration in sub-prime real estate lending which is occurring nationwide. Because real estate loans make up a relatively high percentage of loan portfolios, delinquency ratios should remain well contained. However, credit unions have been growing their Home equity loan portfolios and those in states where home prices are declining are now exposed to larger potential losses.

The consolidated results for the 1,734 Region III FICUs show a return on average assets (ROA) of 80 basis points, just below the national average (82 basis points). Like the national trend, ROA in Region III continues to erode as net interest margins tighten and expenses rise. A closer look at the data shows 533 FICUs (holding 33 percent of the Region's assets) had an ROA of 100 basis points or better. Not all institutions were successful in 2006, as 188 reported an ROA of zero or less. These FICUs held just 2 percent of the Region's assets at year-end. Our survey indicates most believe spreads will be the same or lower, with 60 percent anticipating lower ROAs this year.

Looking forward, we continue to see a difficult environment for credit union savings growth and the potential for rising loan delinquency and charge offs, albeit from near record low levels.

NCUA Region Four

NCUA Region IV (Midwest) consists of 2,468 federally insured credit unions in the states of Arkansas, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, and Wisconsin as of December 31, 2006. The credit unions in this Region represent 29.5 percent of all federally insured credit unions (FICUs) and held $139 billion in total assets or 19.6 percent of the country's total credit union assets. There are approximately 18.8 million members in this Region, up 218,238 (1.2 percent) since year-end 2005. Since 2005, total assets have grown 2.4 percent through 2006 and reserves and undivided earnings increased 2.3 percent to a total of $16.1 billion. Shares grew $4.9 billion (2.6 percent) during the 12-month period, while loan balances increased $4.6 billion (1.2 percent). As of December 31, 2006 share balances totaled $117.2 billion while outstanding loan balances were $96.2 billion.

Lending

Loan growth in Region IV accelerated in the second half of 2006, finishing the year with a year-over-year growth rate of 5.0 percent. Down from last year's 6.7 percent pace, regional loan growth was also somewhat slower than the national average growth rate of 7.9 percent. Total loans outstanding for Region IV at December 31 totaled $96.2 billion, up $4.5 billion since year-end 2005. Loans outstanding grew in virtually every category, with mortgage lending again leading the way. Specifically, first mortgage real estate loans grew by 11.2 percent (or $2.62 billion) and other real estate loans grew 9.4 percent (or $1.12 billion). Under heavy market competition, new auto loan growth was flat at $20.63 billion while used auto loans actually fell by 0.6 percent to $20.6 billion. Despite this modest loan growth, the Region IV loan-to-share ratio actually improved to 82.06 percent, up significantly from 74.2 percent just three years ago, continuing the recent trend toward increased asset concentration in loans.

Several notable trends were revealed with a closer look inside the broader total real estate loan asset category. Most notable was the divergence in the type of first mortgages granted during 2006. Fixed-rate first mortgage production contracted by 6.8 percent versus 2005 levels, with Region IV credit unions granting $5.5 billion in 2006. That is down substantially from the $12.9 billion granted in 2003 during the height of the refinancing boom. Alternatively, adjustable rate first mortgage production grew at a brisk 16.5 percent pace, totaling $1.8 billion in new production. That said, of first mortgage loans outstanding on Region IV credit unions books, fixed rate loans continue to comprise the majority at 53.1 percent of the total. Balloons and hybrids make up another 27.5 percent, while adjustable-rate first mortgages comprise only 7.8 percent of the category total. Consistent with history, the other real estate loans category (home equity loans and HELOCs) made up 33 percent of total real estate loans outstanding.

While the pace of improvement in first mortgage lending moderated somewhat in 2006, rising rates have not had as significant an impact as previously projected. The purchase money mortgage business has traditionally been more difficult business for credit unions to attract than the refinancing business. Even so, total first mortgage loans outstanding were up nearly 36 percent over the past 36 months.

Finally, activity in member business lending continued its strong growth, albeit from modest historical levels. total business loans outstanding grew by 24.7 percent, comparable to the 25.7 percent national average pace. Year-end outstandings totaled $5.19 billion, up from $4.16 billion one year earlier.

Member Shares

Shares and deposits grew slightly faster than the national average in 2006, up 4.3 percent year-over-year. Total shares and deposits stood at $117.2 billion on December 31, 2006. Virtually all of the growth occurred in the higher-cost share certificate category, up 19.0 percent to $35.0 billion. Regular shares contracted 3.1 percent (to $35 billion), while share draft growth was virtually flat, posting a 0.2 percent volume loss (to $14.3 billion).

Prospects for share and deposit growth for 2007 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, which certainly could add to the credit union savings base in Region IV. However, overall savings growth is likely to lag loan growth, putting further upward pressure on the loan-to-share ratio.

Loan Quality

The steadily improving economic environment, coupled with sound loan underwriting, has continued to improve the asset quality picture in Region IV. Total delinquent loans as a percentage of total loans outstanding declined to 0.89 percent from 1.00 percent year-over-year. The net charge-offs /average loans ratio at year end 2006 was slightly improved at 0.51 percent versus 0.55 percent for the same period last year.

Investments

With loan growth continued to outpace share growth, total investments were nearly flat at $26.7 billion versus $26.9 billion at year end 2005. However, total cash and cash equivalents added another $10.0 billion to the total, and were 15.4 percent higher than the $8.7 billion held on December 31, 2005. This increased level of short term investment holdings is consistent with the increase seen in the national statistics, and is also consistent with historical behavior as loan-to-share ratios rise. The largest category of gain within the investments asset category, both in dollar amount and percentage, was investments in corporate credit unions, adding 24.3 percent to $5.2 billion. Similarly, deposits in corporate credit unions make up an additional $6.1 billion of the cash and cash equivalents category, growing by 30.5 percent year-over-year. Added together, corporate credit unions hold 31 percent of Region IV credit union investments and cash equivalents.

Finally, even with the lack of growth in total investments, there continues to be ample liquidity to fund future loan growth.

Earnings

Return on average assets (ROA) fell slightly in 2006, to 0.69 percent from the 0.71 percent recorded during all of 2005. This is well below the national average of 0.82 percent. Spread compression readily explains the persistently low ROA. Versus December 2005, the yield on average loans increased only 37 basis points to 6.46 percent and the yield on average investments increased 112 basis points to 4.23 percent. At the same time, the cost of funds/average assets increased by a full 62 basis points to 2.39 percent. Operating expense and fee income metrics were virtually unchanged versus December 2005 levels.

These factors combined to hold Region IV net interest margin/average asset ratio steady at 3.16 percent, down fractionally from 3.20 percent at December 31, 2005. Interest rates rising steadily from the 45 year lows experienced several years ago have not helped net income as much as predicted, with more members shifting their savings from less interest rate sensitive regular shares to higher yielding share certificates, as discussed earlier. The positive impact of rising rates most benefited those credit unions with low concentrations of fixed rate assets in their loan and investment portfolios.

Finally, capital adequacy remained strong among Region IV credit unions. The average net worth/total assets ratio increased significantly, to 11.63 percent versus 11.36 percent at year-end 2005. The national average stood at 11.54 percent. Total delinquent loans as a percent of net worth fell sharply to 5.31 percent from 6.09 percent on December 31, 2005.

General Economic Conditions

Economic conditions in the Midwest continue to expand at a moderate pace, consistent with the nation as a whole. Manufacturing activity remains solid, with increases broadly reported in production, shipments and orders. Employment increased steadily during 2006, and is yet to show 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. While housing conditions continue to soften in most of the Midwest, impact to consumers versus coastal regions should be muted. Thus, the Midwest will likely continue to post positive statistics that demonstrate that the economic expansion continues on solid footing.

NCUA Region Five

Region V consists of 13 states and two territories: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, Wyoming, and the Territories of Guam and American Samoa. As of December 31, 2006, the Region's 1,360 federally insured credit unions comprised 16 percent of all federally insured credit unions and held $207 billion in total assets, 29 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 V saw membership increase by 279 thousand since year-end 2005, ending December 2006 with 20.9 million members. However, over half this growth can be attributed to indirect auto lending activity. These relationships have not traditionally led to the credit union becoming the primary financial provider for the borrower or provided much in the way of cross-selling opportunities for other products. Total assets grew by 5.3 percent in 2006 and reserves and undivided earnings increased 9.0 percent to a total of $22.4 billion. Shares grew $7.3 billion (4.4 percent) over the year, while loans increased $13 billion (9.4 percent). At December 31, 2006 share balances totaled $176 billion, while outstanding loans came in at $149 billion. The loan-to-share ratio rose from 80.7 in December 2005 to 84.6 in December 2006.

Loan Growth

As mentioned above, loan growth in Region V for 2006 was 9.4 percent, quite a significant decline from the 2005 growth rate of 13.9 percent. This lower percentage puts 2006 a little over one percent below the 10-year average annual pace. Total loans for Region V were $149 billion at December 31, 2006, or 72.2 percent of total assets, compared to 69.4 percent at the end of 2005.

Real estate lending continued to be the primary driver of loan growth, but at a slower pace than recent years. Residential first mortgage loans grew by 10.4 percent and other real estate loans grew by 17.1 percent for the year, primarily driven by real estate collateralized member business loans. While these are relatively strong numbers, they are down from the 2005 growth rates of 13.9 percent in first mortgage loans and 24.6 percent in other real estate lending.

The volume of new real estate loans granted last year actually fell by 13 percent from the 2005 figure. Total first mortgage loans stood at $48.1 billion as of December 31, 2006. The growth rate in fixed rate loans held on the balance sheet of credit unions grew by 7.7 percent in 2006; total new adjustable rate loans held on the balance sheet grew by 8.9 percent. Hybrid loans grew at a rate of 16.0 percent. At year-end 2006, ARMs and hybrids comprised 42 percent of the first mortgage category held by credit unions. HELOCs grew by only 0.9 percent, bringing the regional total value of HELOCS to $12.6 billion. This growth rate is down sharply from the 19.7 percent rate for 2005. For the Region, real estate loans made up 49 percent of total loans, which is slightly higher from the figure at the end of 2005.

Auto loans only grew 5.0 percent during 2006, a sharp decline from prior years and growth still continues to be dominated by the expansion of indirect lending activities. The growth in indirect loans exceeded the total auto loan growth, continuing a trend of declining direct originations. New auto loan balances increased 8.4 percent, while used auto loans balances rose by only 2.0 percent. The rate of growth in new auto lending was considerably slower than the 26.2 percent growth rate in 2005. Many credit unions in Region V, who aggressively built market share in 2005 by offering attractive auto lending rates through indirect lending programs, appeared to have experienced reduced demand in 2006. However, indirect auto lending remains the primary avenue for increasing auto lending in some areas of Region V.

Member business lending activity continues to grow as credit unions expand their assistance to members in this area. Member business loan balances, dominated by real estate secured loans, increased to $9.2 billion from $7.4 billion at year-end 2005. While this sector still represents less than 8 percent of total loans at credit unions, it is growing at the fastest pace of any loan sector.

Another bright spot came in credit card receivables, where outstanding balances grew by nearly $500 million, representing a growth rate of 13 percent. This was by far the strongest performance in over 10 years.

Credit unions have lower expectations overall on the outlook for loan growth for 2007. Refinancing activity has declined sharply in the last few months and further declines are possible. 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.

Credit unions are hoping to capitalize on refinancing opportunities as some borrowers who are in rapidly adjusting mortgage products attempt to lock in a fixed rate for a period of time. Anecdotally, some credit unions have reported a surge in refinancing applications from borrowers who are facing significant rate resets but are unable to refinance with the original lender. Unfortunately, these credit unions are discovering that a majority of these applicants have either very poor credit or are in homes with an unfavorable loan-to-value ratio.

Despite the cooling in the housing market, some credit unions, especially in Hawaii and California, are seeing that affordability has become 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 further due to that factor. Higher short-term rates are expected to continue to curtail growth in HELOCs.

Auto lending for new autos is expected to continue at a healthy but slower pace in 2007, and credit unions expect to see continued growth in indirect auto lending as existing players increase their activity and new credit unions enter the market. Credit unions are hopeful that the Big Three strategy of focusing on pricing as opposed to financing incentives will continue.

Loan Quality

Credit unions continue to do an excellent job in managing credit risk and generally remain positive about the outlook for the rest of 2007. The delinquency/total loans ratio held steady at 0.51 percent in 2006. Net charge-offs/average loans ratio showed improvement from 0.52 percent to 0.41 percent. For those credit unions with heavy concentrations of mortgage loans, there are concerns that a decline in home prices would increase delinquencies and charge-offs, especially in the home equity lending area. But those concerns are now minor.

Share Growth

Shares grew at a 4.4 percent growth rate to $176 billion. However, balances in all transaction and money market categories declined. Regular share accounts declined by 8.8 percent, while share drafts declined by 4.1 percent, the first decline in ten years Money market share balances declined by 0.8 percent. With rising interest rates, share certificate balances grew by a strong 25.9 percent, as higher interest rates enticed members to lock in longer-term rates. With many credit unions facing liquidity and competitive pressures for savings, most credit unions have adopted the strategy of competing aggressively for certificates while pushing back on increasing transaction accounts. The picture is much more mixed for money market accounts where some credit unions have been fairly aggressive on pricing the upper tiers while other credit unions have resisted the move to higher rates.

The growth in certificates was evenly split between maturities of one year to three years and maturities greater than three years. As of December 31, 2006, share certificates represented 32.0 percent of total balances, compared to 27.3 percent at the end of 2005. After the initial seasonal surge in liquidity in the first quarter, liquidity issues surfaced at some credit unions. However, the liquidity of most credit unions in Region V was not a big issue. The demand generally came from credit unions that were aggressive in the indirect lending programs. However, in the last quarter of 2006, the slowdown in loan demand, coupled with the emphasis on attracting term savings, alleviated any nascent liquidity pressures.

Borrowings

Borrowings increased sharply in 2005 but increased by a relatively small amount (9 percent) in 2006. Several credit unions are looking to the derivatives market to hedge the cost of share balances and short-term certificate issuance, although the rate increase in 2006 so far this year has caused those credit unions to refrain from taking action. Region V credit unions generally expect share growth will be relatively weak for the balance of 2007.

Investments

Investments declined in 2006, with total investments declining from $41.5 billion in 2005 to $36.3 billion at the end of 2006. This represented 17 percent of total assets. Holdings of federal agency securities declined by 17 percent in 2006 to a total of $18.8 billion. Holdings of corporate certificates fell by 3.0 percent from $12.26 billion to $11.90 billion. Investments maturing less than one-year constituted 56 percent of total investments, while investments between one and three years comprised 31 percent of the total. The average yield on investments increased 3.23 percent to 3.92 percent as low yielding investments purchased in 2003, 2004 and 2005 matured and were replaced by higher yielding investments. Credit unions should continue to see increases in investment portfolio yields as the portfolios turn over and re-price at current market yields. At the current time credit unions are keeping the maturities of new investments short. Security investments are being allowed to run off and new funds are being left in cash and short-term money market investments. This benefits corporate credit unions because of the lack of credit unions alternatives in the securities markets.

Earnings

Regional return on average assets (ROA) in 2006 slipped to 0.90 percent from the 0.93 percent figure in 2005. This continues a long-term trend and we see no relief in the near future. The average yield on loans increased from 6.02 percent to 6.40 percent. The cost of funds/average assets ratio rose from 1.65 to 2.30. The overall net interest margin declined from 3.31 to 3.19. Operating expense/gross income was at 48.70 percent, down from 52.52. Fee income rose at an annualized pace of 5.4 percent.

General Economic Conditions and Credit Union Concerns

Economic conditions in the Western Region were generally stable in 2006. The slowing in the housing market is of concern to credit unions, but as of yet that slowdown in housing has not fed into any significant slowdown in the general economy of the Region. 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, improved in 2006 but significant gains are not being reported, as was the case in 2005. Increased household spending, driven by the rise in home prices, resulted in gains in services, travel and home furnishings.

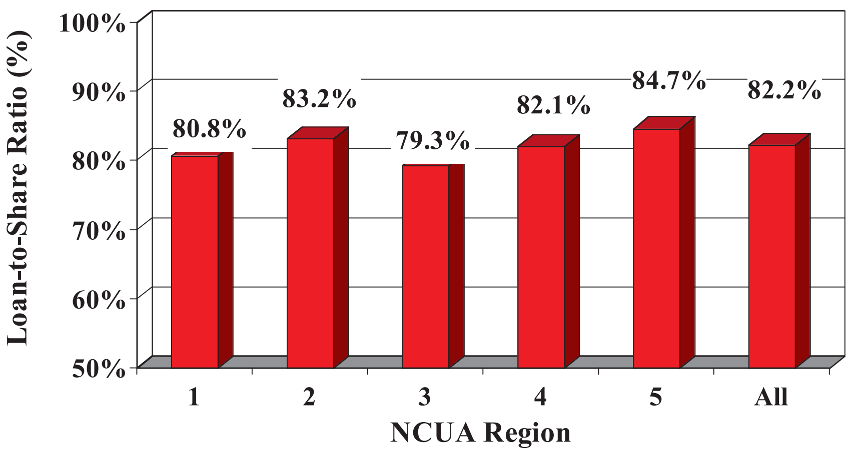
Home sales fell noticeably throughout the Region in 2006. Many areas are reporting home sales that are 25 percent or more below last year. Home price increases have all but disappeared, and a few areas are reporting declines. The central California area seems to have been hit particularly hard. Some credit unions are concerned about the outlook for real estate values and the credit implications, but most credit unions have maintained a conservative lending profile and should weather any downturn without great difficulties. There is some apprehension, however, that a sharp fall in housing activity might result in a general economic slowdown.

The number one concern expressed by credit union executives is the squeeze on net interest margins. While the string of Federal Reserve increases in the Fed Funds rate has ceased for the time being, the inverted yield curve continues to drive compression of spreads. The full impact of higher rates has yet to be felt because retail savings rates at credit unions are dramatically lagging changes in the wholesale market. Credit unions are finding that a more competitive funding landscape is impeding progress on lessening the impact of margin compression. To offset declining margins, many credit unions are seeking ways to increase fee income, enter new lending sectors, and/or become more competitive in the mortgage lending area.

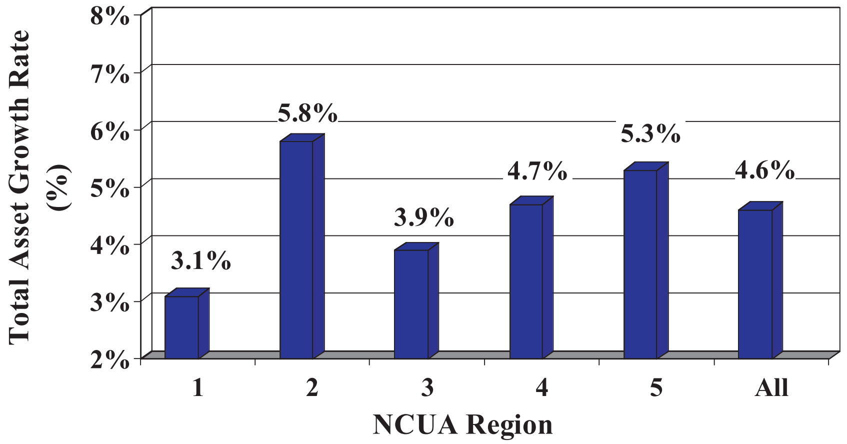
Through the first three months of 2007, there has been a surge in liquidity at credit unions. While this is the usual seasonal trend, it seems more pronounced this year as loan growth has slowed. Additionally, some of the surge in liquidity could also be due to the fact that many credit unions are allowing maturing investments in agencies and other securities to remain in overnight investments. Most credit unions remain wary of putting long-term assets on their books at a time when longer-term yields are lower than shorter-term and when the outlook for loan growth remains uncertain.

Appendix A:
NCUA Regional Financial Ratio Analysis

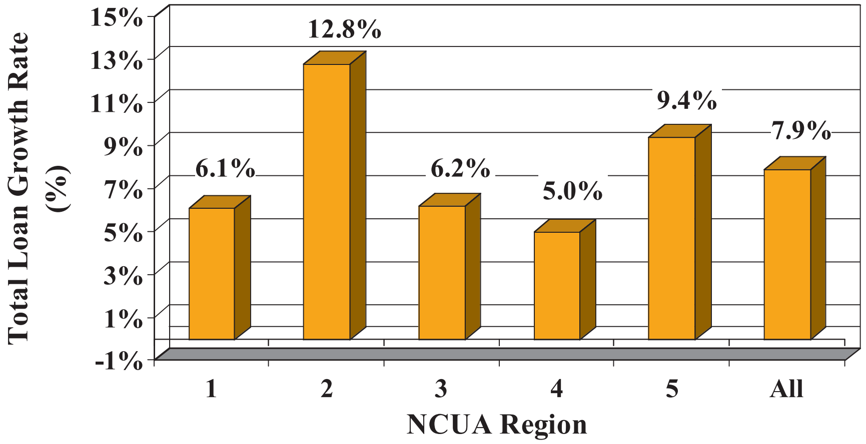
Loan-to-Share Ratio
Federally Insured Credit Unions by NCUA Region
Dec 2006



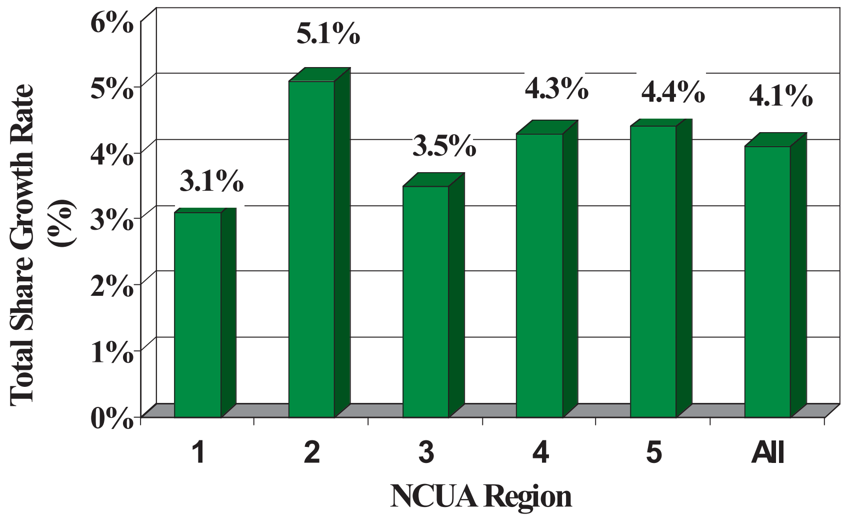
Total Asset Growth
Federally Insured Credit Unions by NCUA Region
Dec 2006



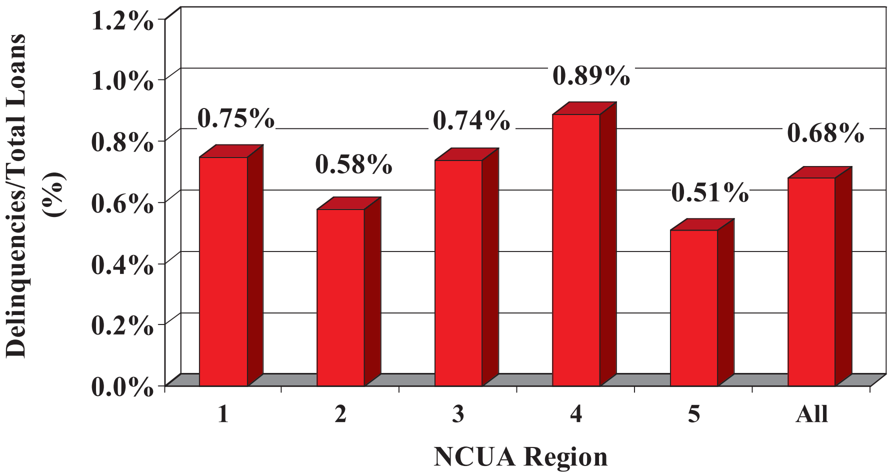
Total Loan Growth
Federally Insured Credit Unions by NCUA Region
Dec 2006



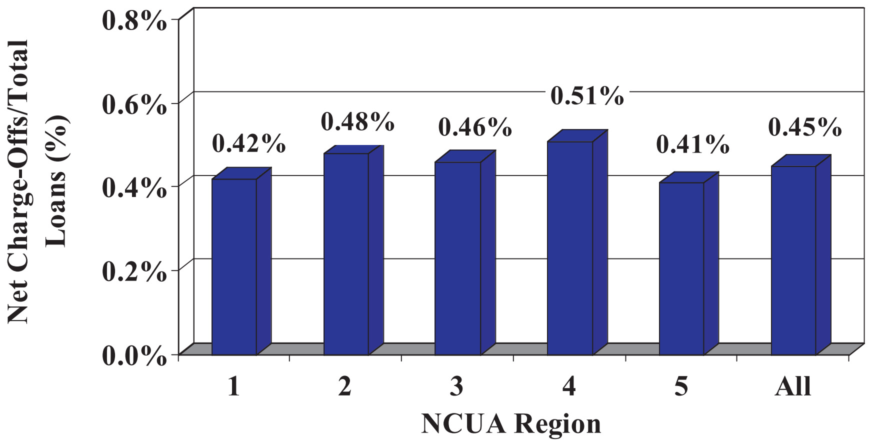
Total Share Growth
Federally Insured Credit Unions by NCUA Region
Dec 2006



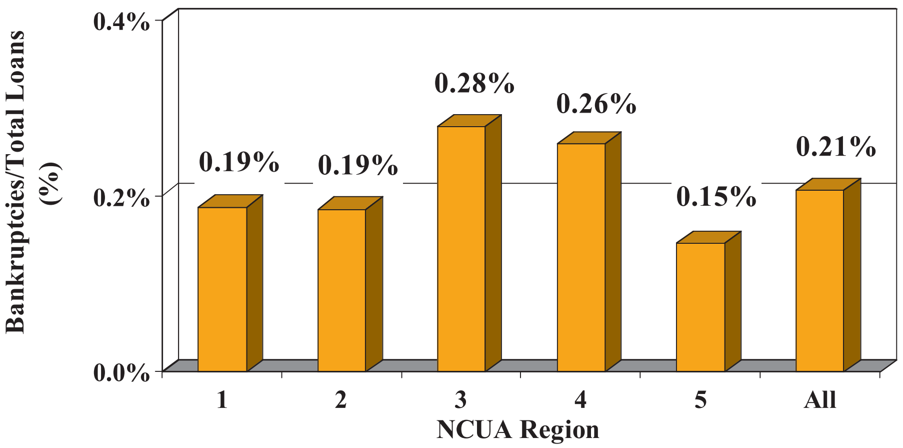
Delinquency Ratio
Federally Insured Credit Unions by NCUA Region
Dec 2006



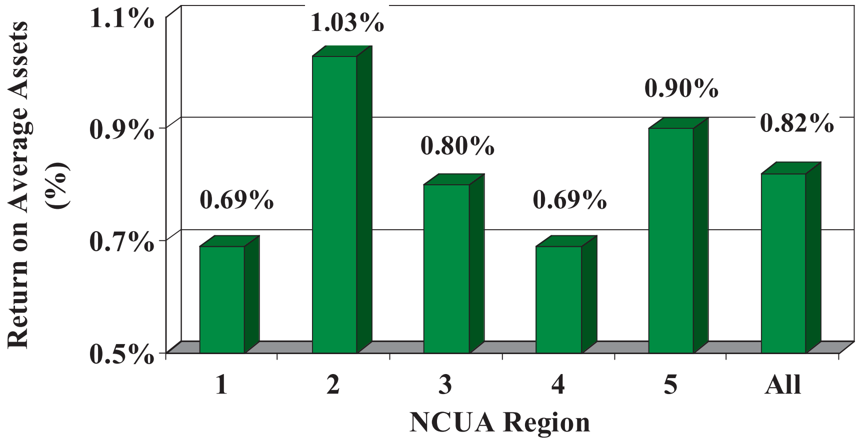
Net Charge-Offs/Average Loans
Federally Insured Credit Unions by NCUA Region
Dec 2006



Bankruptcies/Total Loans
Federally Insured Credit Unions by NCUA Region
Dec 2006

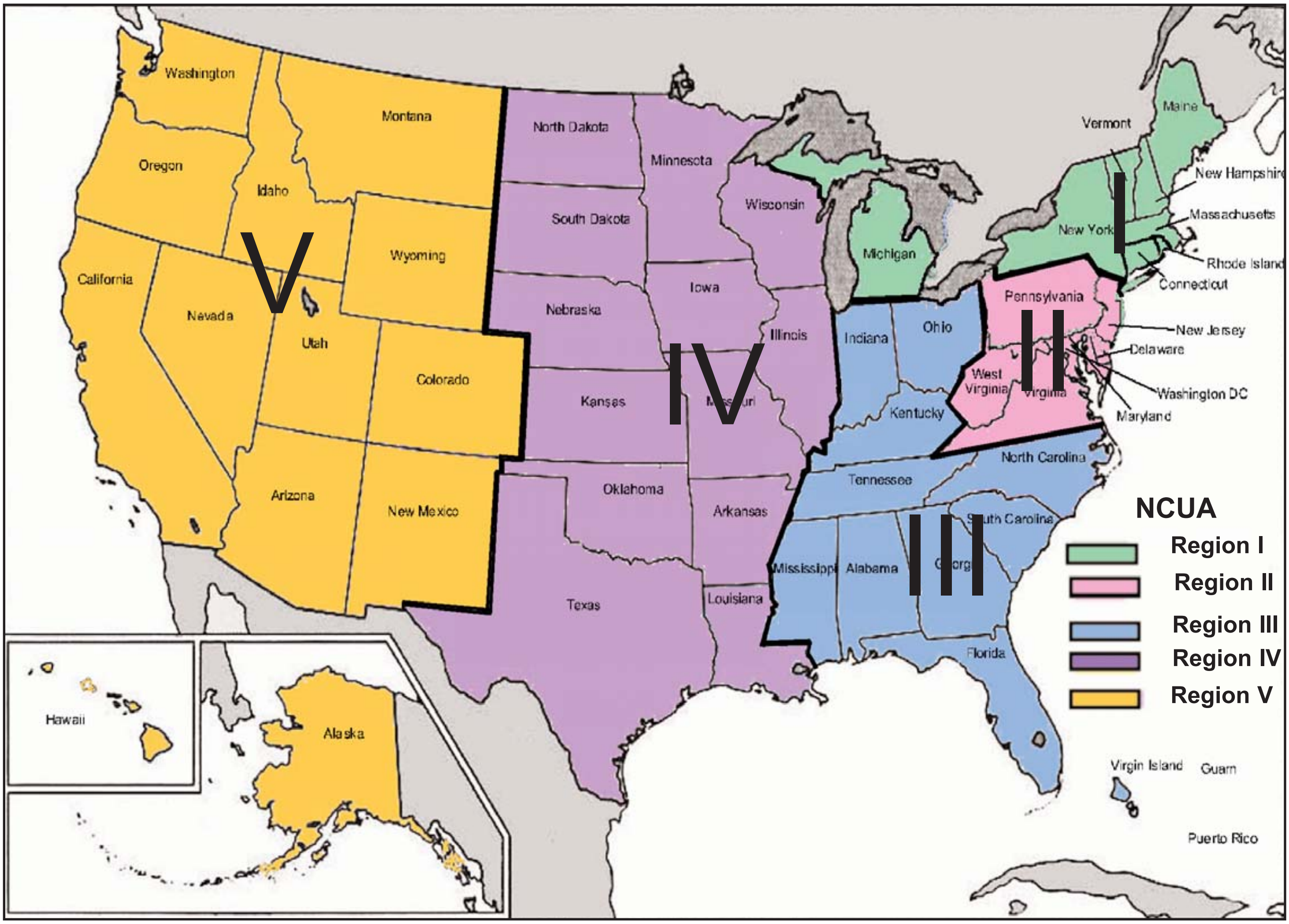


Return on Average Assets (ROA)
Federally Insured Credit Unions by NCUA Region
Dec 2006



Appendix B: NCUA Regions

NCUA Regional Breakdown



Source: NCUA