TRENDWATCH 1Q23

May 17, 2023

PEER BETA

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1Q 2023 Credit Union Results

- **Jay Johnson**, Chief Collaboration Officer, Callahan & Associates
- **Alix Patterson**, Chief Experience Officer, Callahan & Associates

Guest Speakers

- **Jason Haley**, Chief Investment Officer, Investment Management Group, ALM First
- **Seth Rudd**, Chief Financial Officer, Leaders Credit Union

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May 17, 2023

ALM First Market Update

Callahan Trendwatch

Speaker

Jason Haley

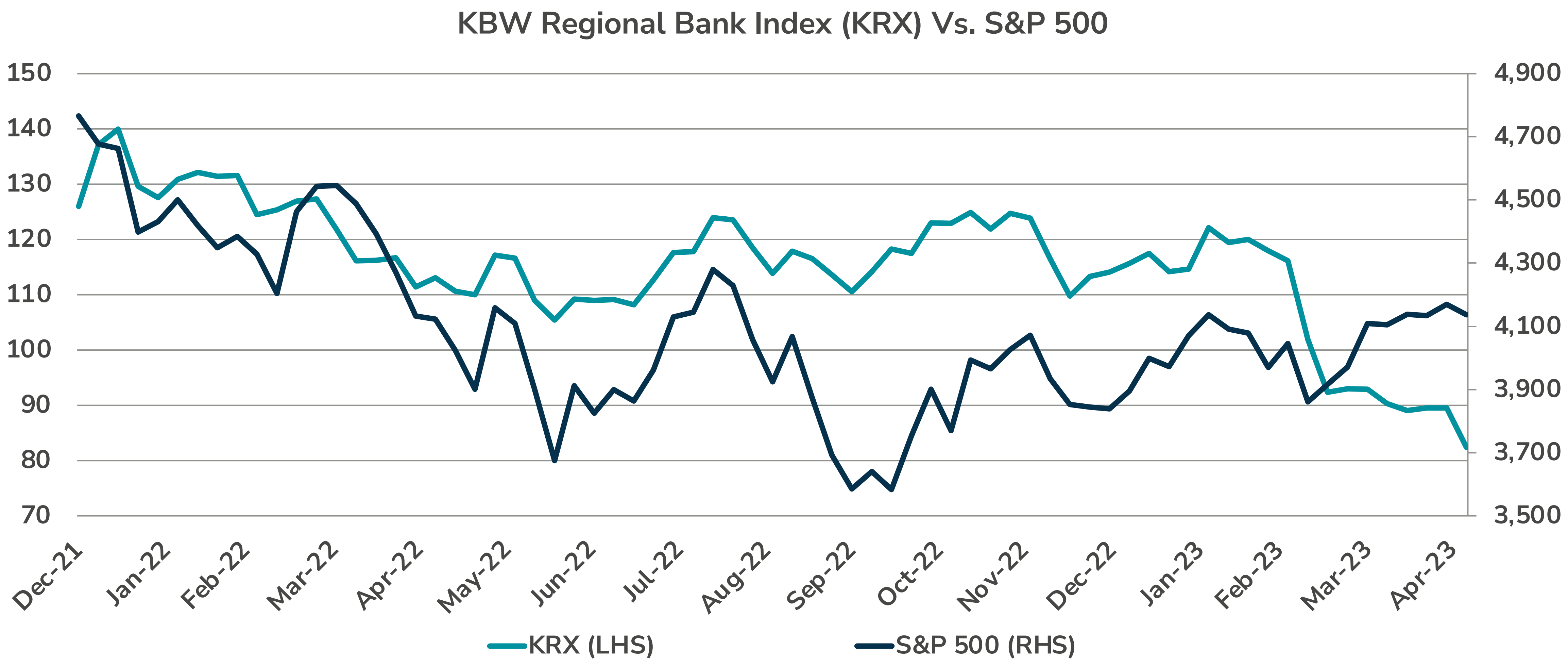
Chief Investment Officer

Current Economic Themes

- **A market in limbo**
  - Banking fears have eased, but certainly not eliminated
    - Following First Republic failure, other regional banks came under fire
  - The debt ceiling x-date looms in the coming weeks, and commercial real estate risks are in the crosshairs as well
  - Is the Fed done with rate hikes?
    - How will banking troubles impact forward economic growth (i.e., tighter credit), and what will be actual or collateral damage of debt ceiling drama?
  - Will the Bank of Japan shift from ultra-accommodative to restrictive monetary policy?

- **Recent economic data continue to surpass expectations, but some signs of cracks**
  - April job growth was 253k (185k expected), and the headline unemployment rate dipped to a new cycle low of 3.394%
  - Headline Q1 GDP growth was weaker than expected, due primarily to a reduction in business inventories
    - Personal consumption remained strong and suggests the consumer isn't dead just yet
  - April CPI was largely in line with expectations, but ex-shelters services inflation was the weakest since last July
  - Weekly jobless claims are up 70k since late January to the highest level since October 2021

Regional Bank Stocks Still Under Pressure



Source: Bloomberg

Summary of FDIC Proposals For Deposit Insurance Reform

- **Three Options to reform the deposit insurance system**
  - **Limited Coverage**: maintains the current structure of deposit insurance in which there is a finite deposit insurance limit that applies across depositors and types of accounts
    - Does not address the run risk associated with high concentrations of uninsured deposits
  - **Unlimited Coverage**: provided unlimited deposit insurance
    - Removes bank run risk but may have large effects on bank risk-taking
  - **Targeted Coverage**: allows for different levels of deposit insurance coverage across different types of accounts (business payment accounts)
    - Business accounts for making payments would get higher coverage compared to personal accounts
    - Helps reduce the risk that non-interest-bearing commercial transaction accounts exit

- **"Targeted Coverage has the greatest potential to meet many of the objectives of the deposit insurance system while mitigating many of the undesirable consequences of raising the limit more broadly"**

Debt Ceiling Drama Update

- **Underwhelming tax inflows have moved x-date estimates forward**
  - The date at which the Treasury will exhaust extraordinary measures and run out of cash was earlier thought to be in July or August
  - Recent tax data has come in below expectations, leading the Treasury and the Congressional Budget Office (CBO) to suggest the x-date could come as soon as June 1
- **House passes initial bill; President Biden meets with congressional leaders**
  - House bill passed by only a 2-vote majority and included significant spending cuts
  - Legislation is essentially dead-on-arrival in the Democrat-controlled Senate
  - White House position has been to raise debt ceiling with no strings attached and handle spending cuts during normal budget negotiations
- **Market anxiety is as high as ever regarding risk of U.S. default**
  - While unprecedented (default), various anticipated outcomes are not pleasant
  - Even if a deal is struck at the last minute, the U.S. credit rating is likely at high risk of downgrade by another rating agency (likely Fitch)

Surge in Perceived U.S. Credit Risk

Rising Cost of Default Insurance For U.S. Debt

U.S. Credit Default Swap 1-year Term Euro Denominated (in bps)

Source: Bloomberg

Looking Ahead

- **Inflation still high, but economy showing signs of slowing**
  - Conference Board Leading Economic Indicators Index has declined for 12 straight months to lowest level since November 2020
  - Fed survey of senior loan officers has shown steady contraction in both supply of and demand for credit since Q2 2022
    - Recent banking turmoil expected to exacerbate this trend and weigh on overall economic growth

- **Regulatory changes are coming, but how severe and broad will they be?**
  - Whatever is implemented will ultimately impact industry profitability and overall economic growth
  - Some former Fed leaders have suggested much higher capital requirements, with less focus on risk-based capital and more on tangible equity (leverage)
    - One (Tarullo) suggested mark-to-market treatment for larger AFS (and even HTM) portfolios

- **Opportunities exist for institutions with strong capital and liquidity profiles**
  - Risk-adjusted asset pricing models more critical than ever, particularly ahead of a potential business cycle shift
  - Risk-adjusted spreads in high credit quality fixed income remain historically attractive with larger regional banks mostly sidelined amid recent deposit outflow concerns
  - Derivatives use in the CU industry has increased notably in the last 1-2 years

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3800 Maple Avenue, Suite 600
Dallas, TX 75219
Phone: 800.752.4628
Fax: 214.987.1052

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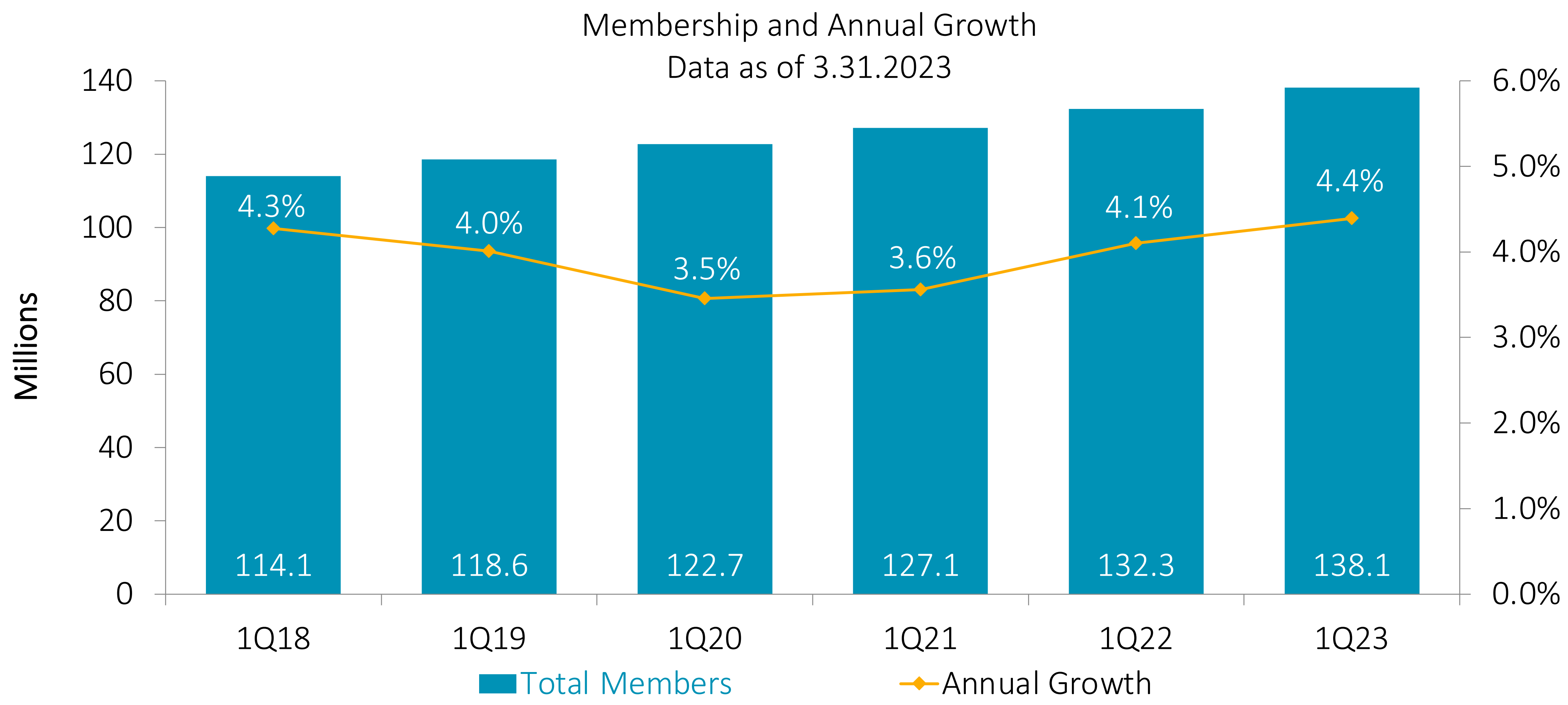
Loan growth significantly outpaces share growth over the past year

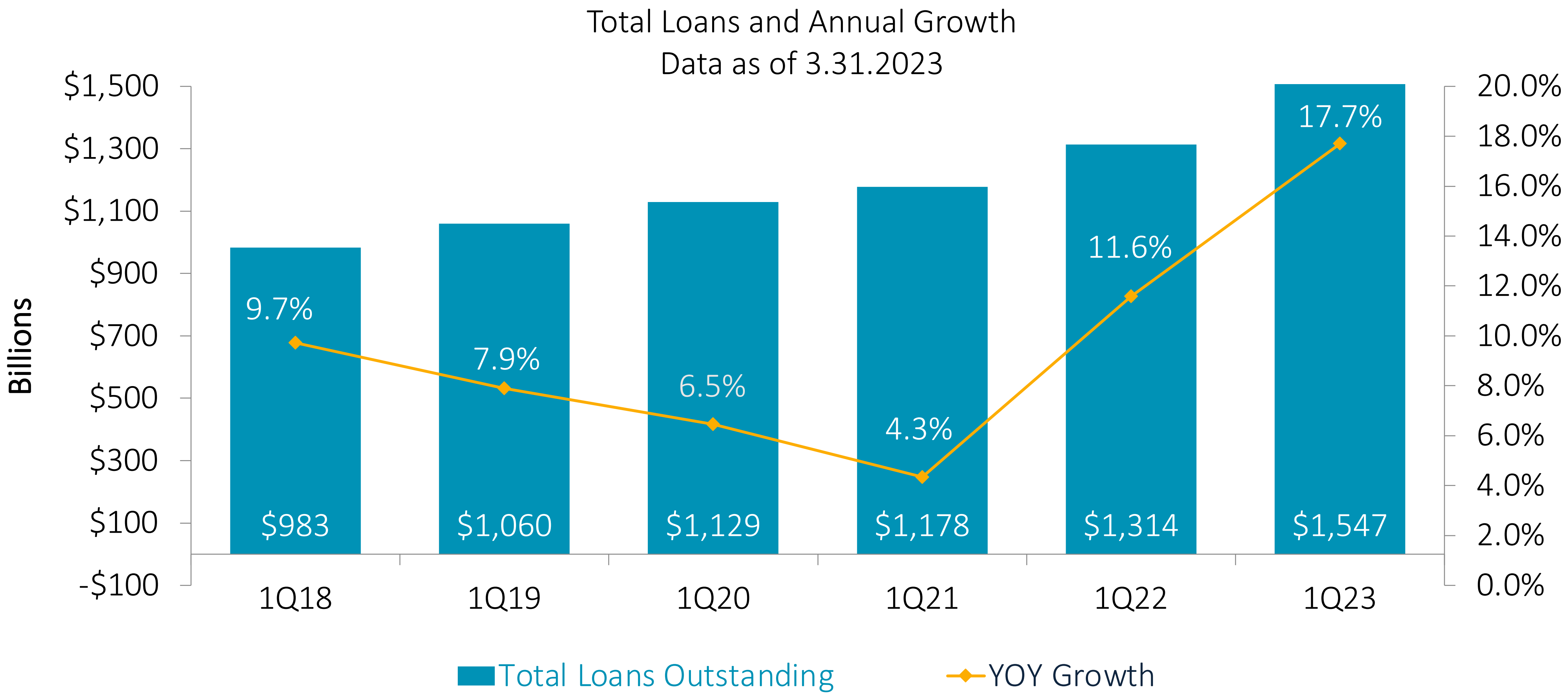
	3/31/2023	12-Mo. Growth	3/31/2022	12-Mo. Growth
Assets	$2,237.1B	4.5%	$2,140.5B	8.6%
Loans	$1,546.8B	17.7%	$1,314.2B	11.6%
Shares	$1,911.9B	2.2%	$1,871.6B	9.2%
Investments	$599.5B	-17.2%	$724.0B	3.0%
Capital	$220.4B	5.3%	$209.4B	1.0%
Members	138.1M	4.4%	132.3M	4.1%

Source: Callahan's Peer-to-Peer Analytics

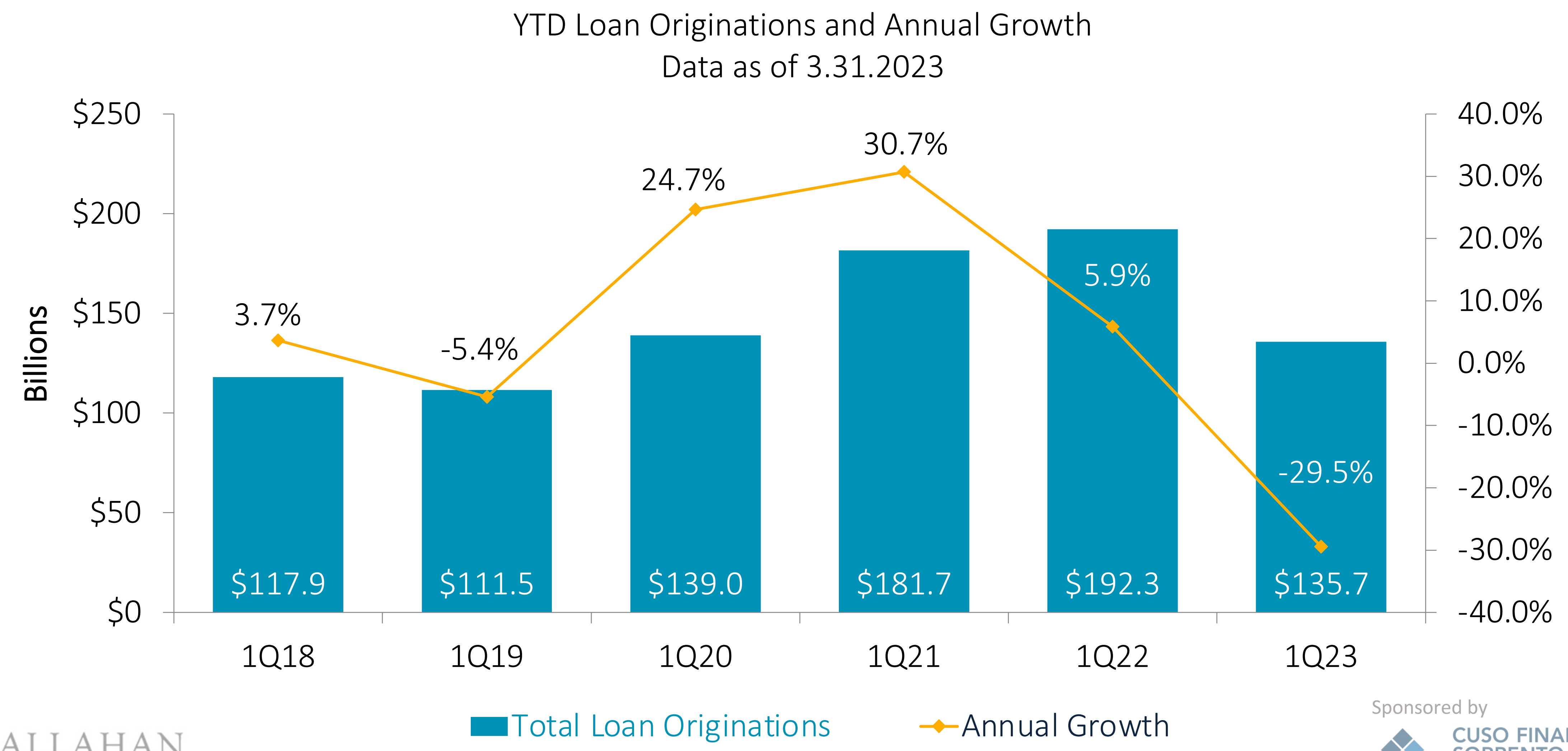
5.8 million consumers joined a credit union over the past 12 months



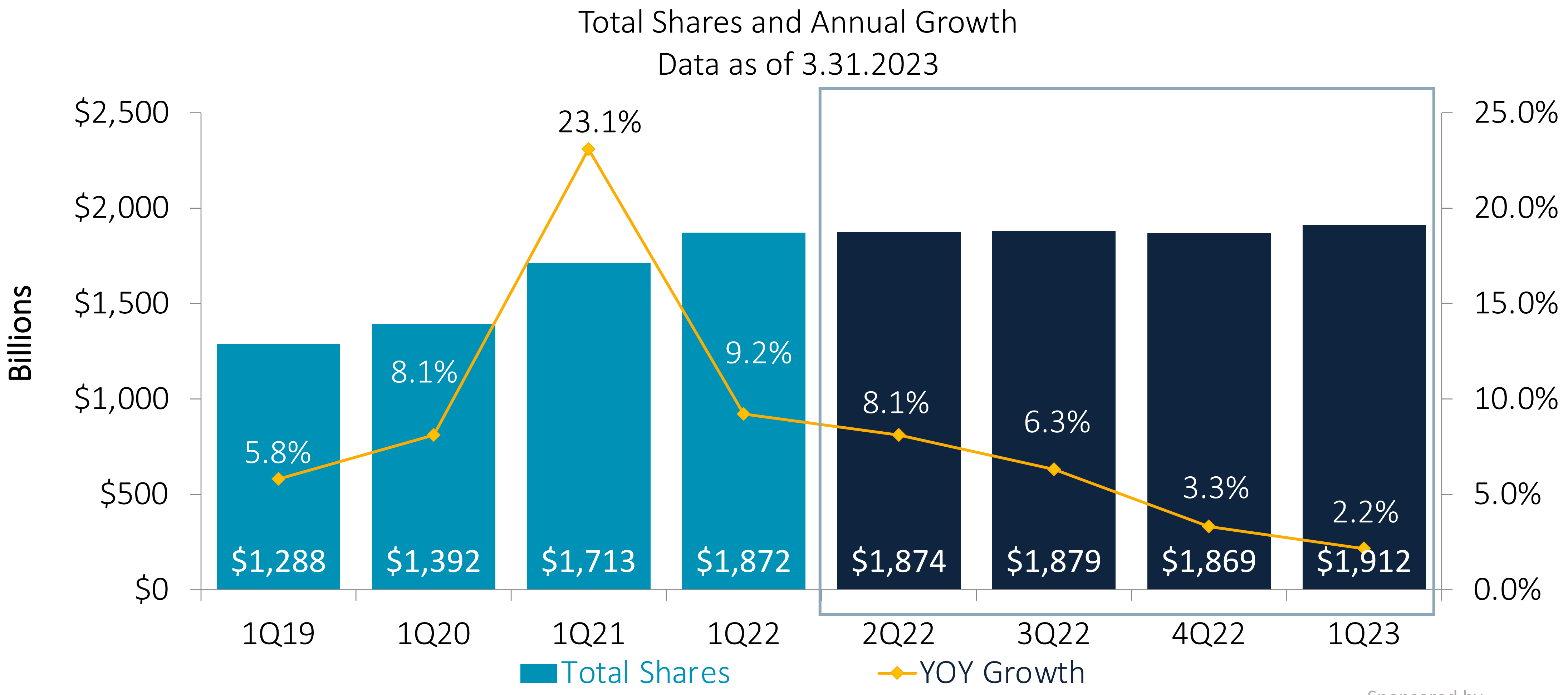
Loan growth remains strong through the first quarter



1Q loan originations decline at fastest pace on record

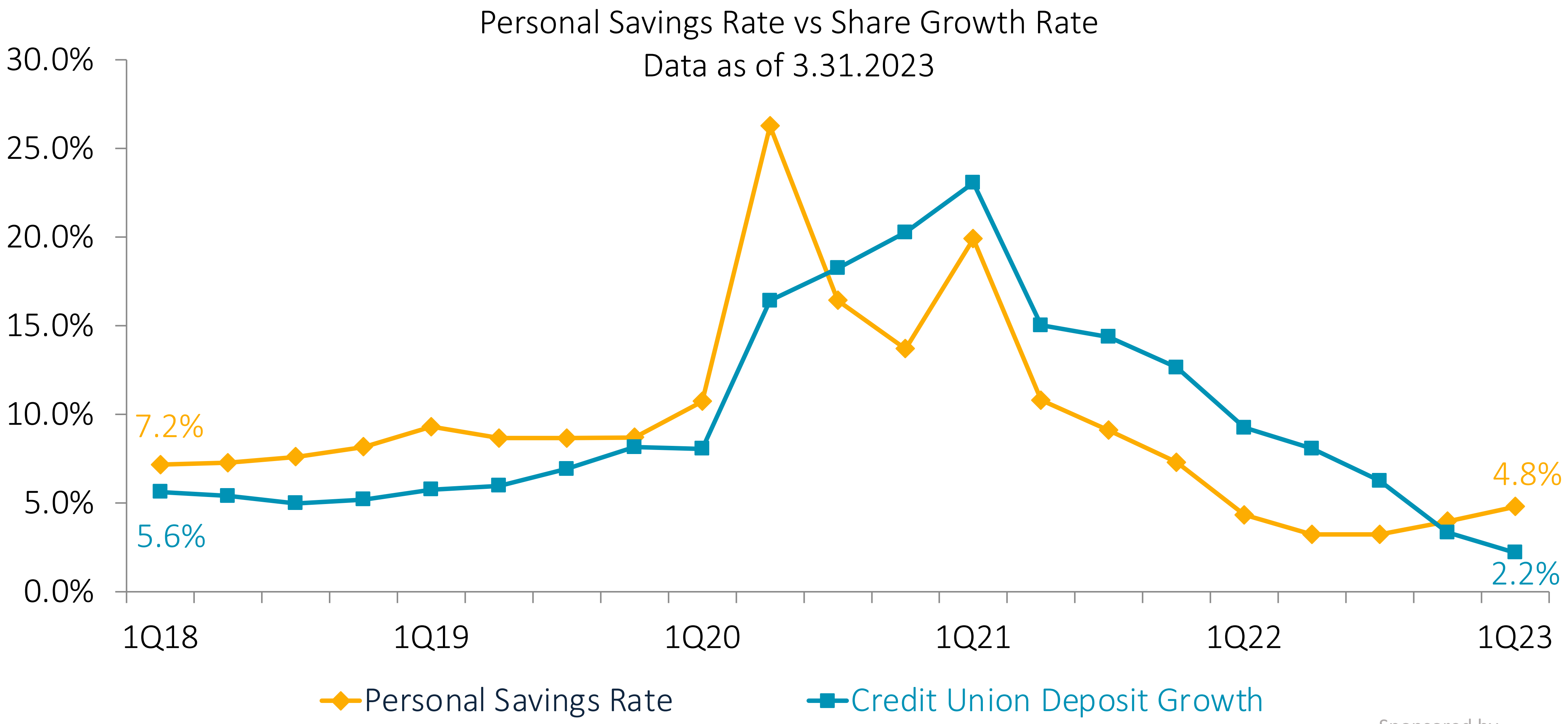


Annual share growth hits record low

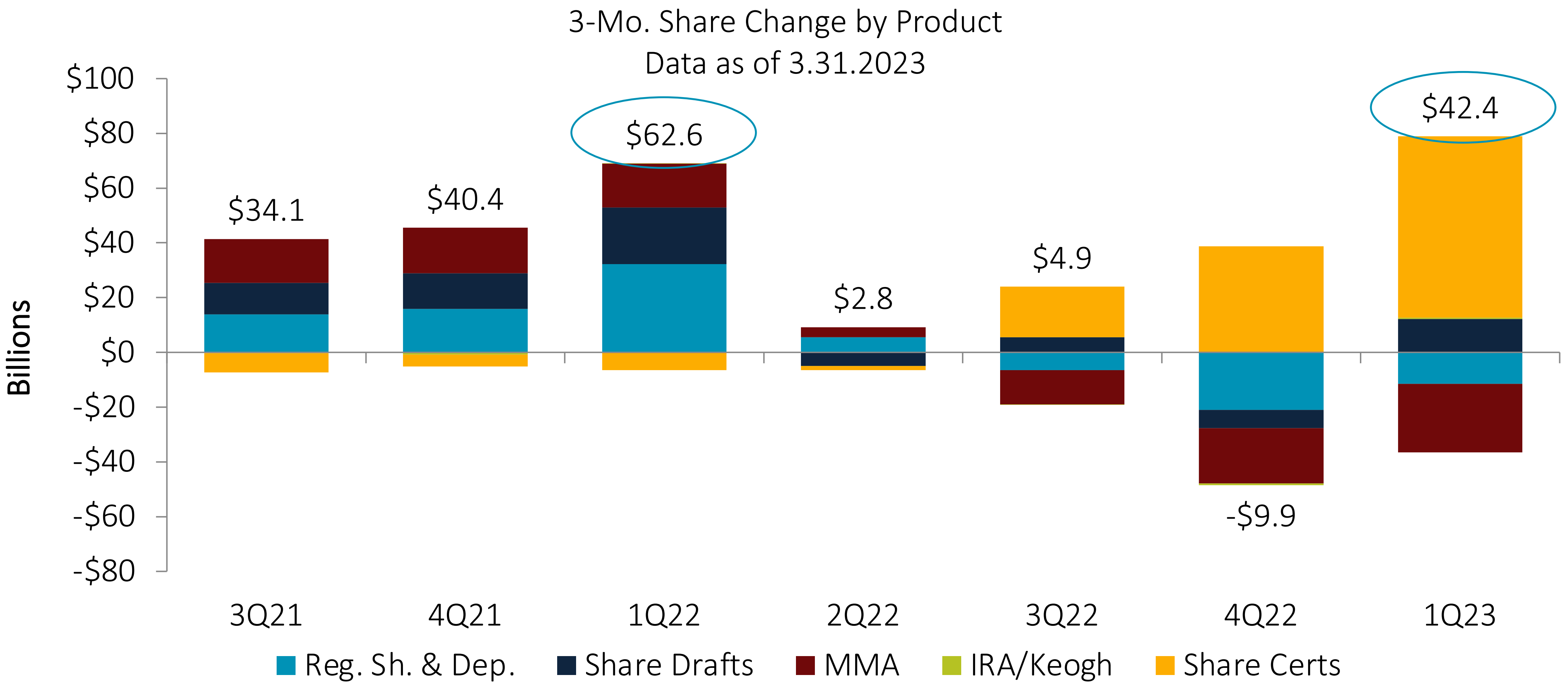


Savings

Deposit growth at credit unions falls despite uptick in personal savings rate



Share certificates rise $66.2 billion in 1Q, offsetting declines in regular savings and money market accounts



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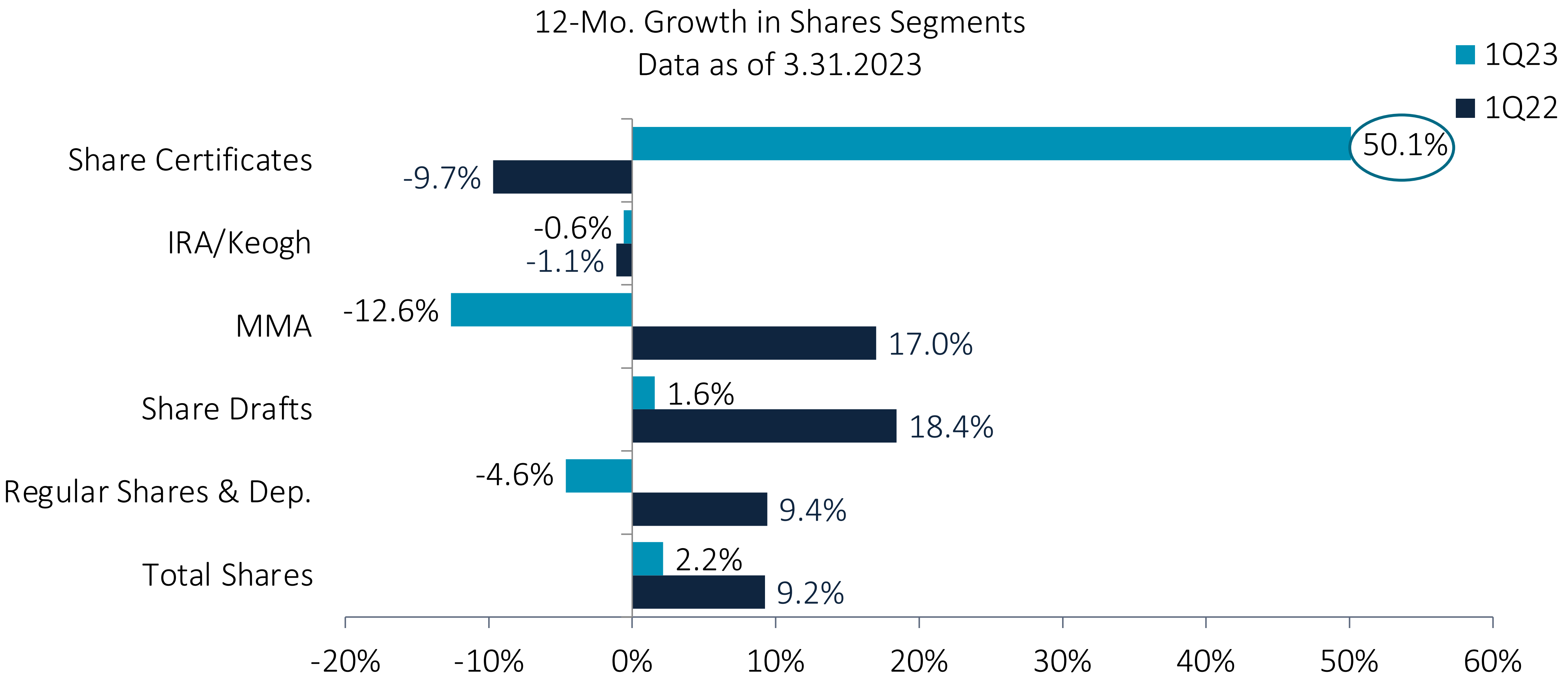
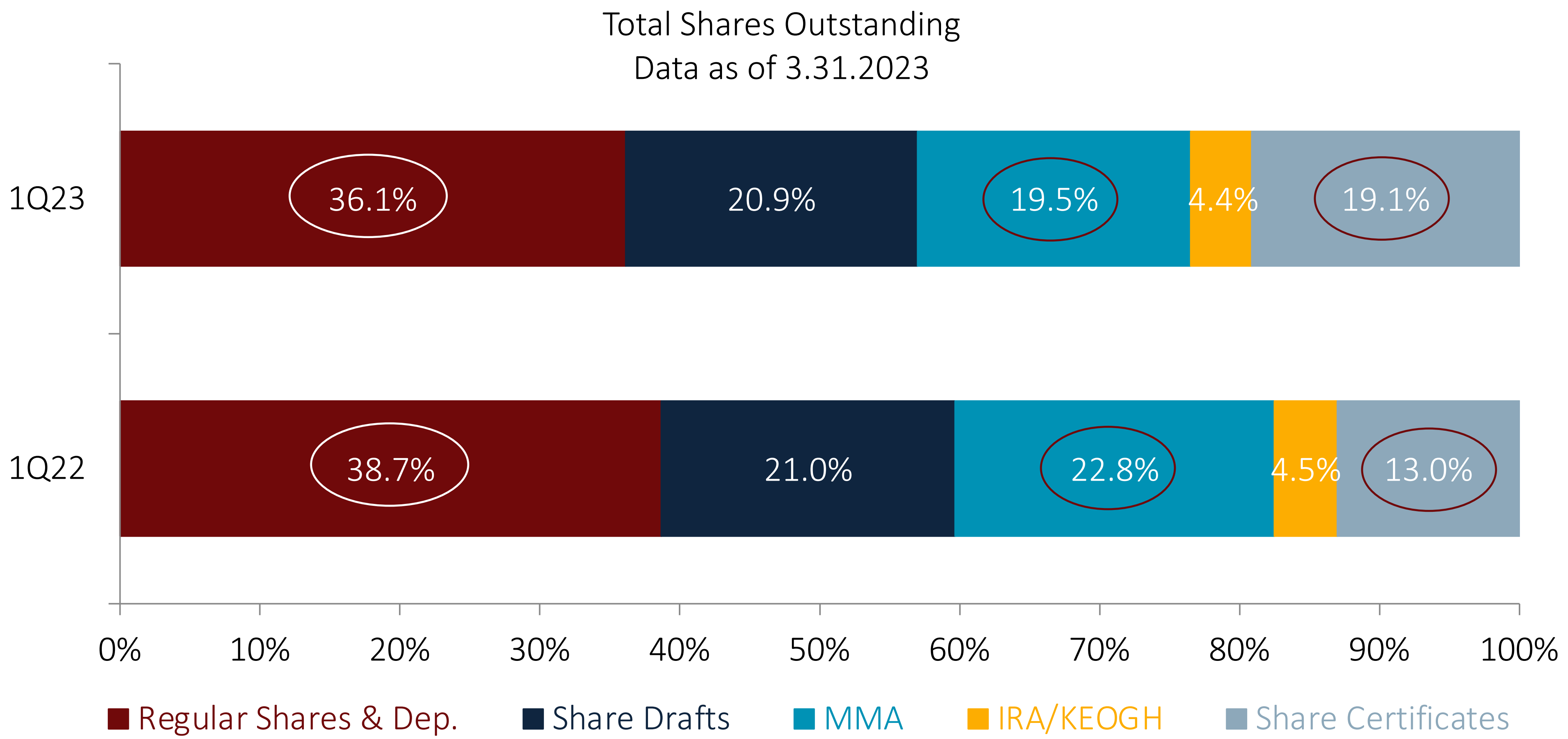
Share certificate balances jump 50% year-over-year

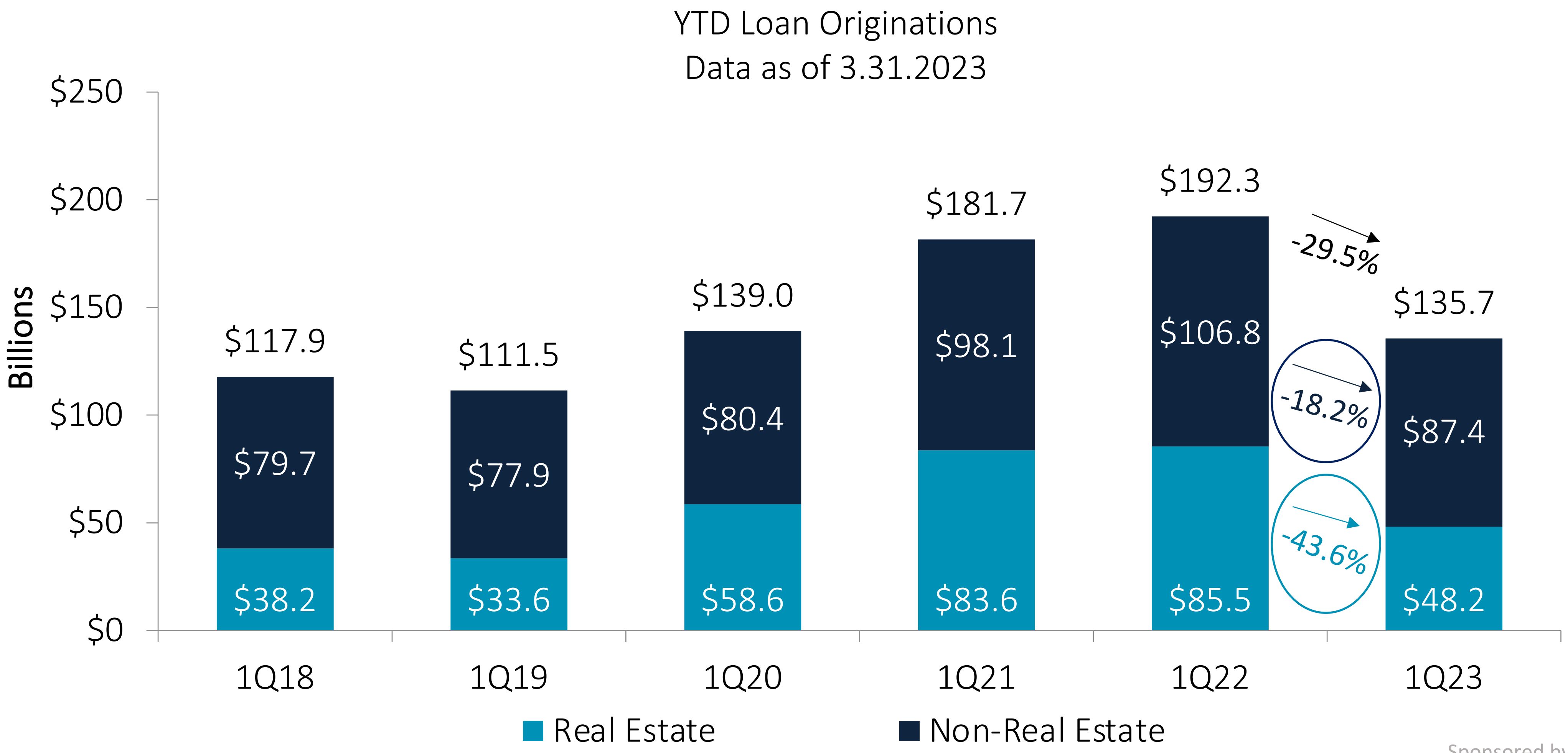


Share certificates increase their portion of the portfolio by over 6 percentage points

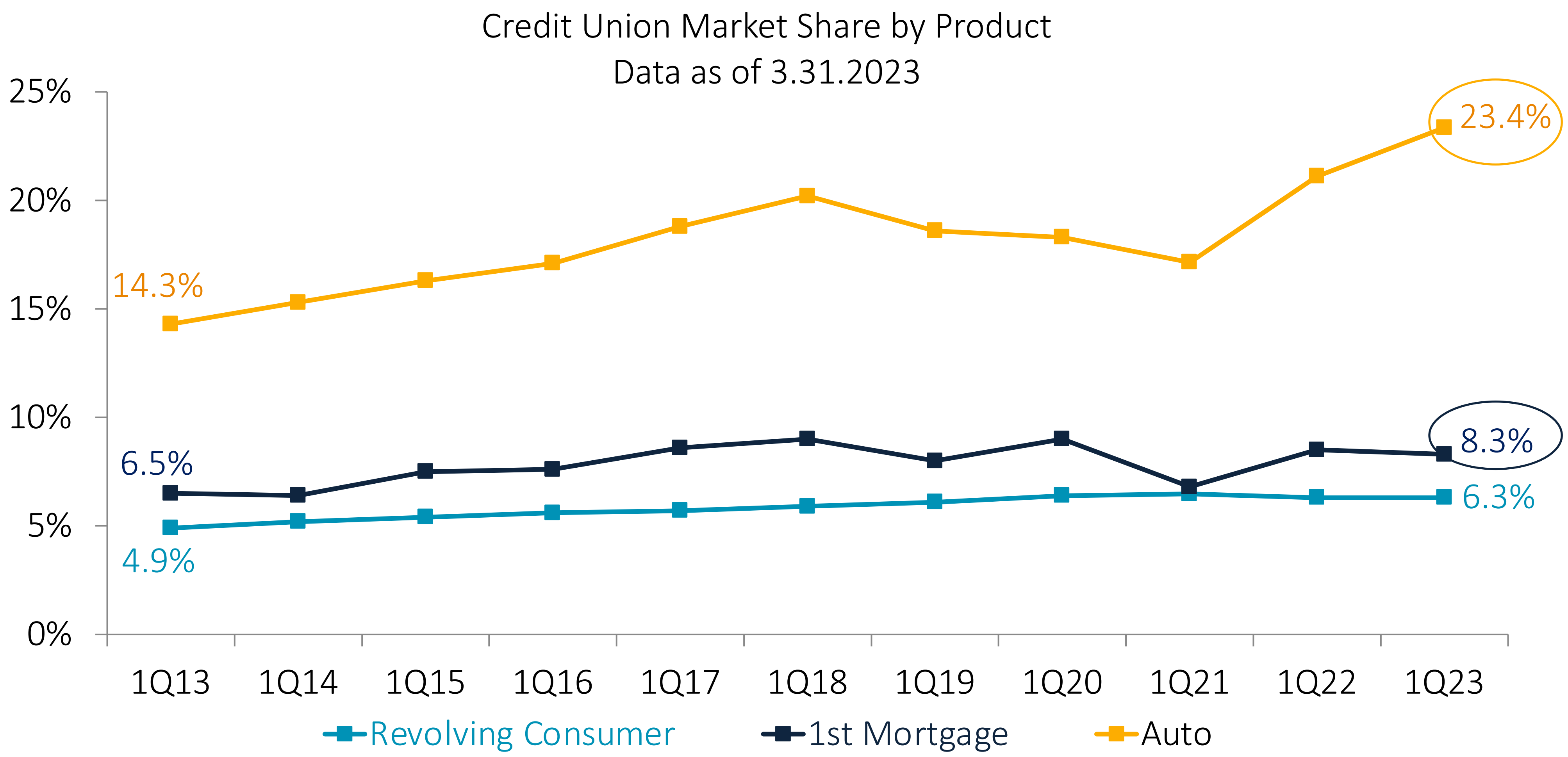


Lending

Contraction in both real estate and consumer lending lead to a 29.5% decline in origination dollars



Auto market shares increases 2.3 percentage points



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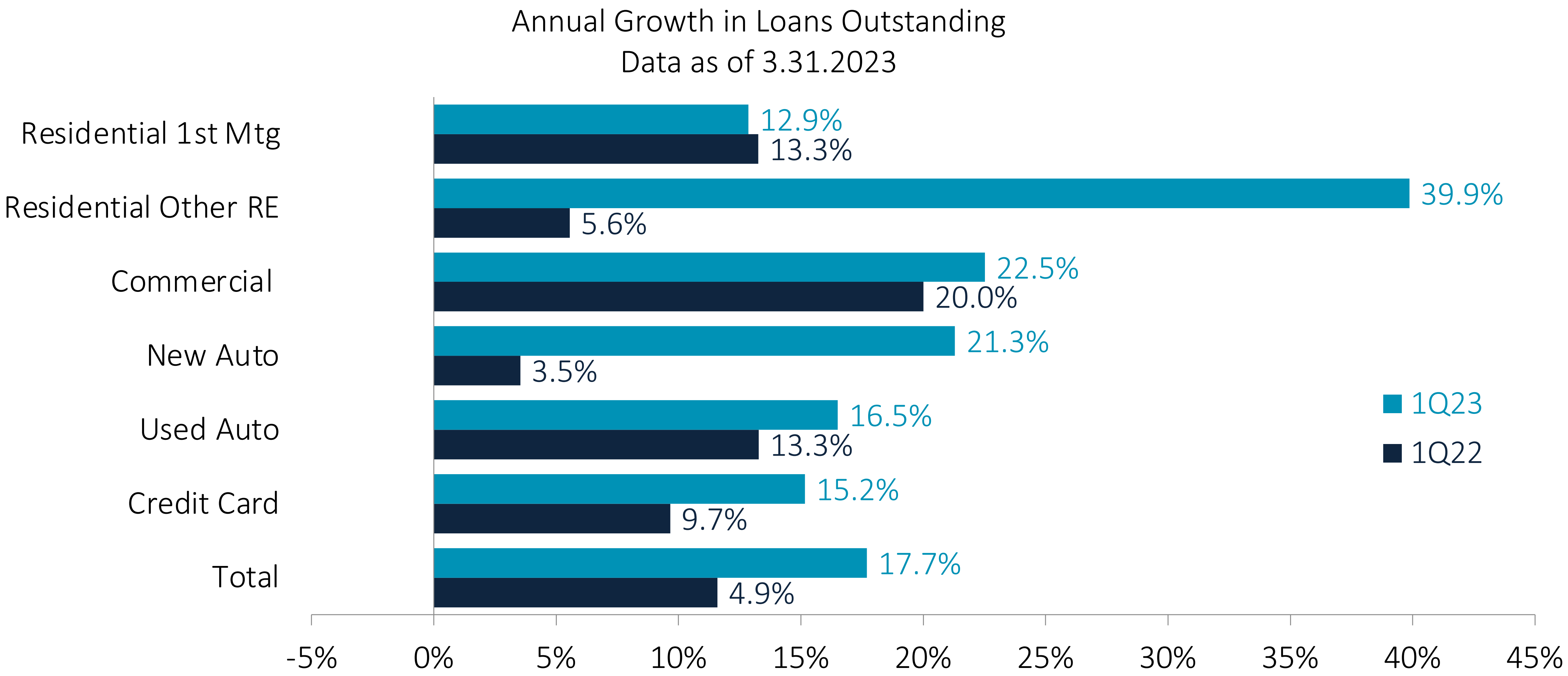
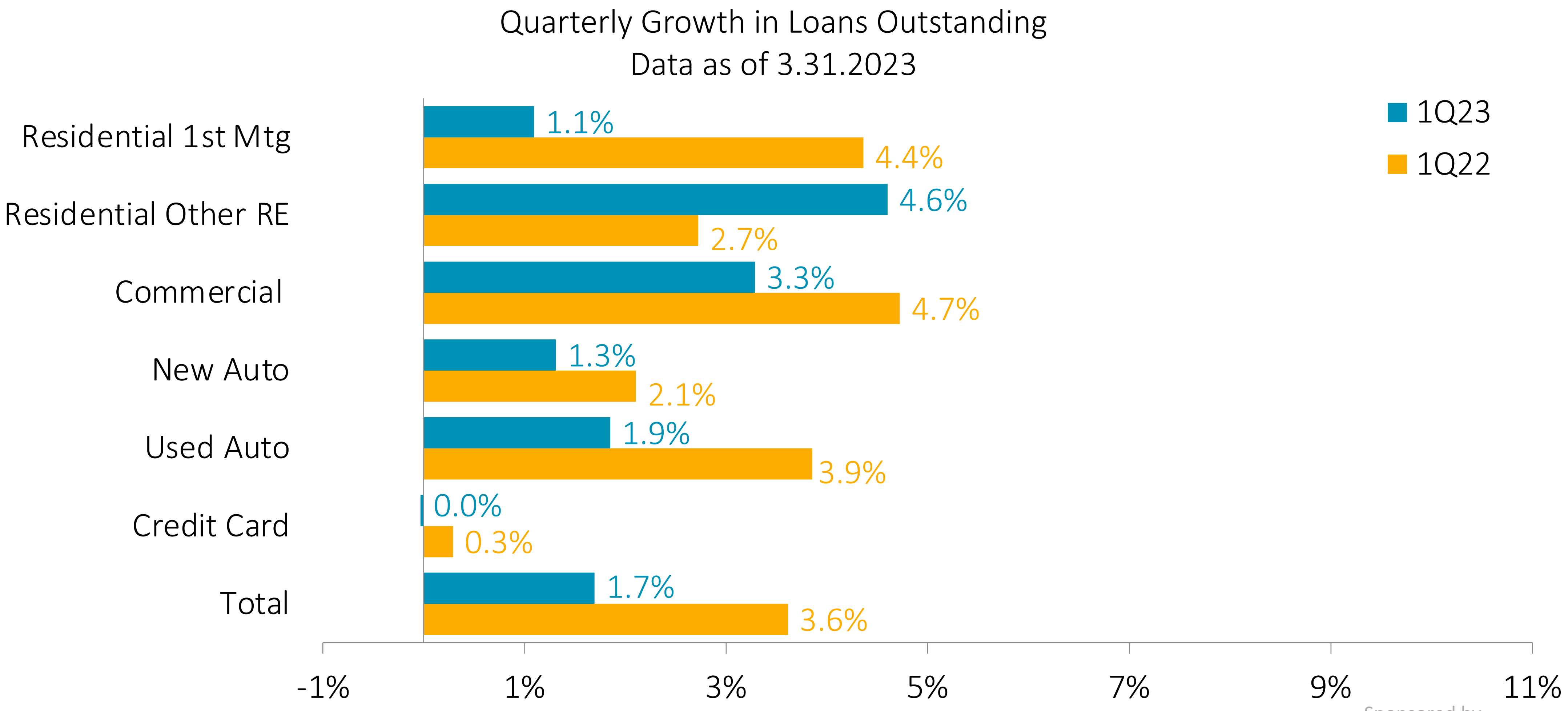
Loan balances across the portfolio grow at a double-digit pace over the last year



First quarter loan growth slows from 2022's pace



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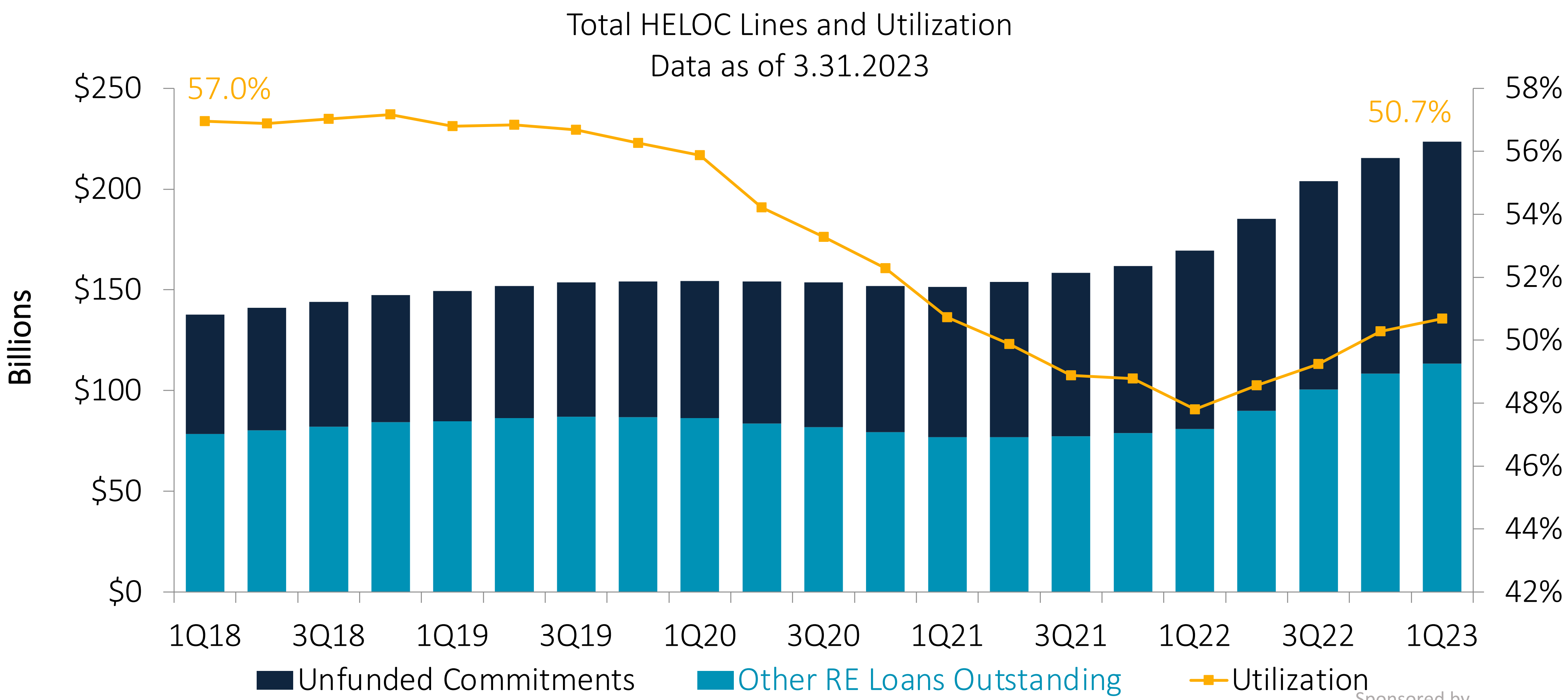
HELOC utilization continues to rise



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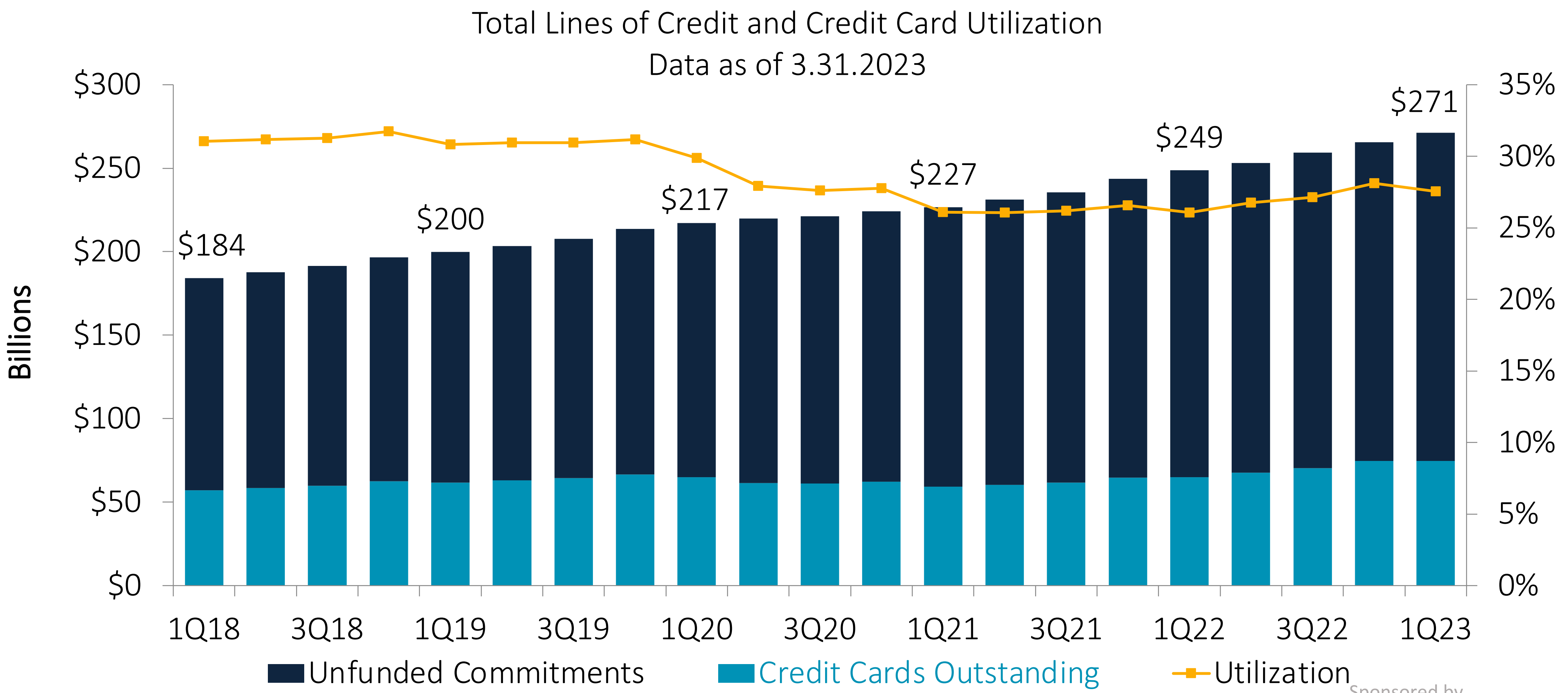
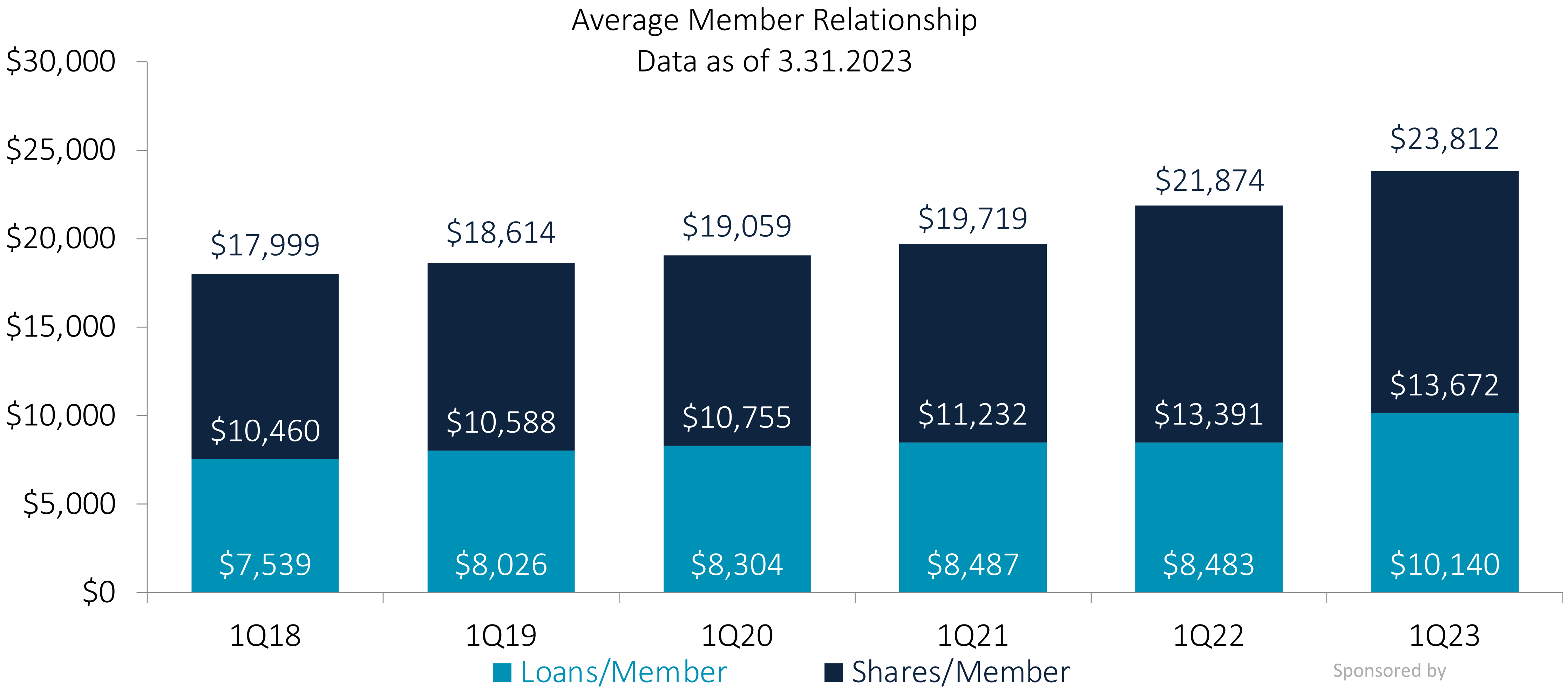
Credit card utilization remains below pre-pandemic levels

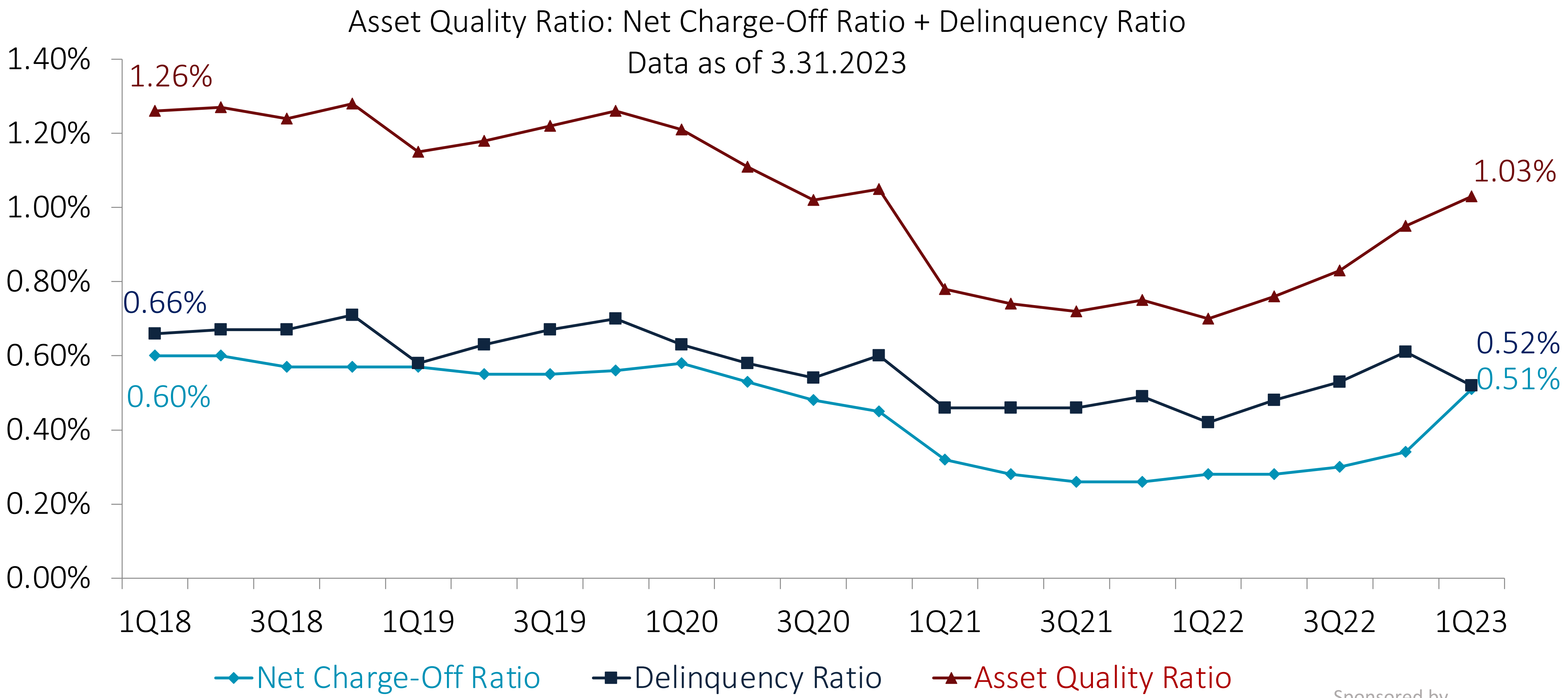


Average member relationship reaches all-time high with both share and loan balances rising



Asset Quality

Net charge-offs rise in 1Q, delinquency declines



Credit cards and auto loans are driving the increase in delinquency…

Annual Change in Delinquency
Data as of 3.31.2023

Total
0.52%
↑ 0.11%

Residential 1st Mortgage
0.29%
↓ 0.01%

Auto
0.58%
↑ 0.19%

Residential Other RE
0.36%
↓ 0.02%

Credit Card
1.47%
↑ 0.41%

Commercial
0.34%
↓ 0.08%

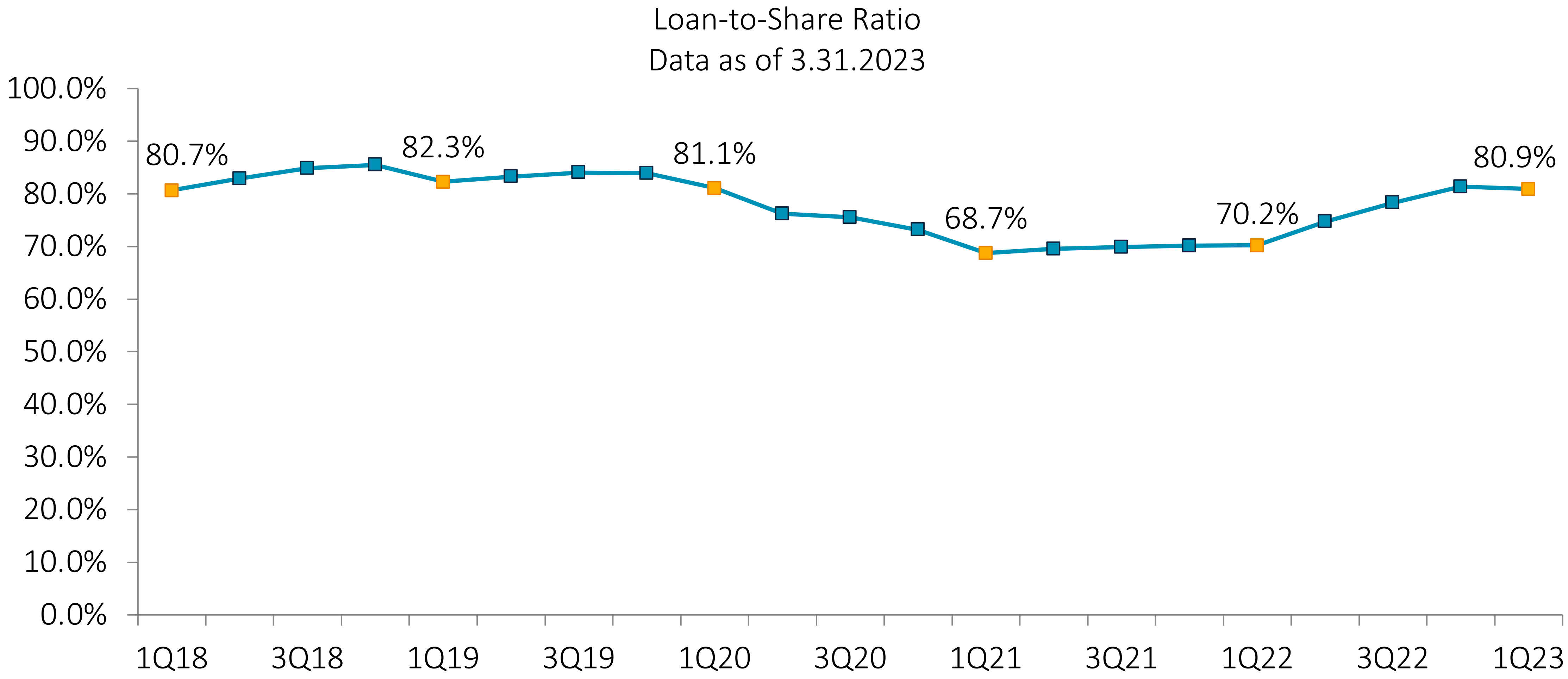
As well as in net charge-offs

Annual Change in Net Charge-Offs
Data as of 3.31.2023

Total	0.52%	↑ 0.24%
Residential 1st Mortgage	0.00%	↓ 0.00%
Auto	0.48%	↑ 0.28%
Residential Other RE	0.00%	↑ 0.04%
Credit Card	3.34%	↑ 1.30%
Commercial	0.07%	↓ 0.05%

Liquidity

The loan-to-share ratio declines slightly in 1Q23 but is up 10.7 percentage points since 1Q22



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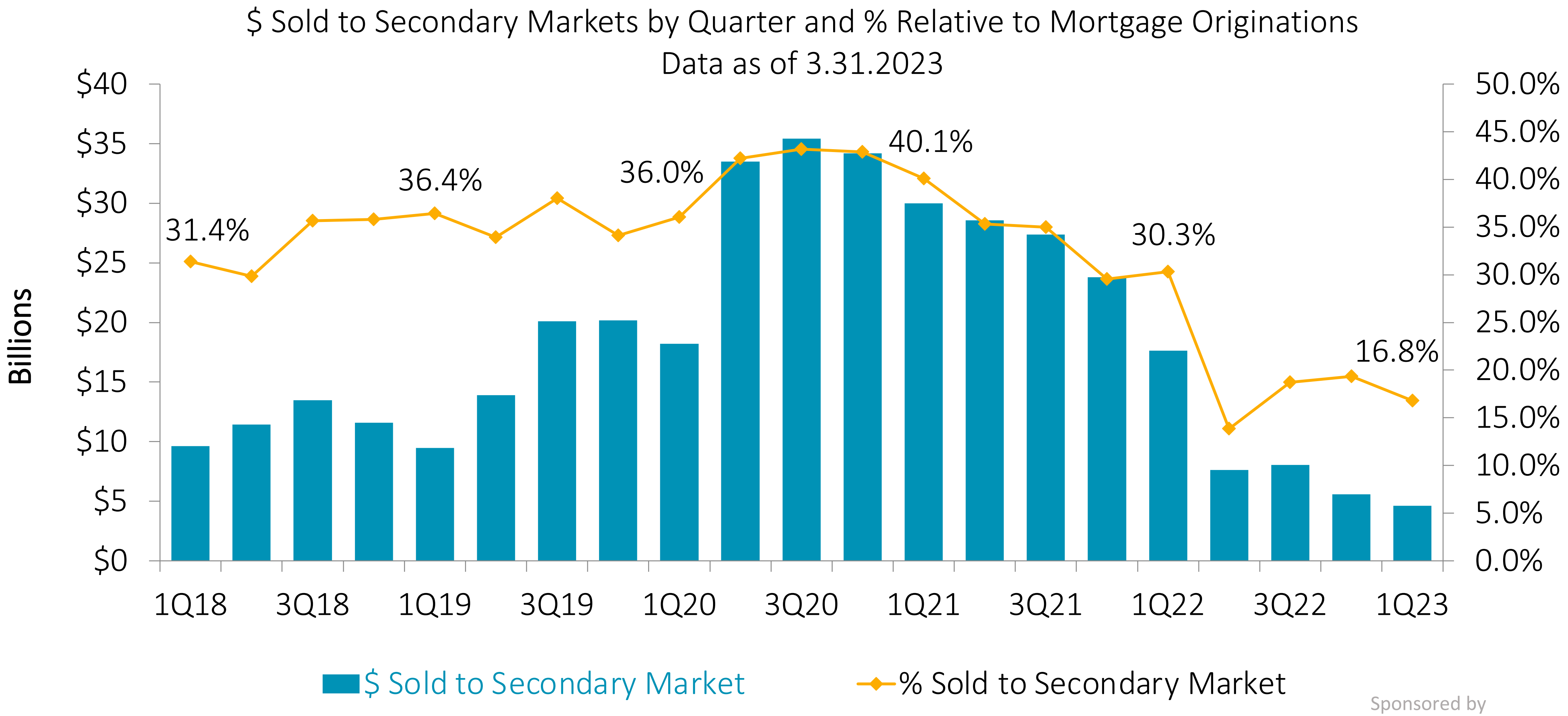
Mortgages sold on secondary market continue to decline



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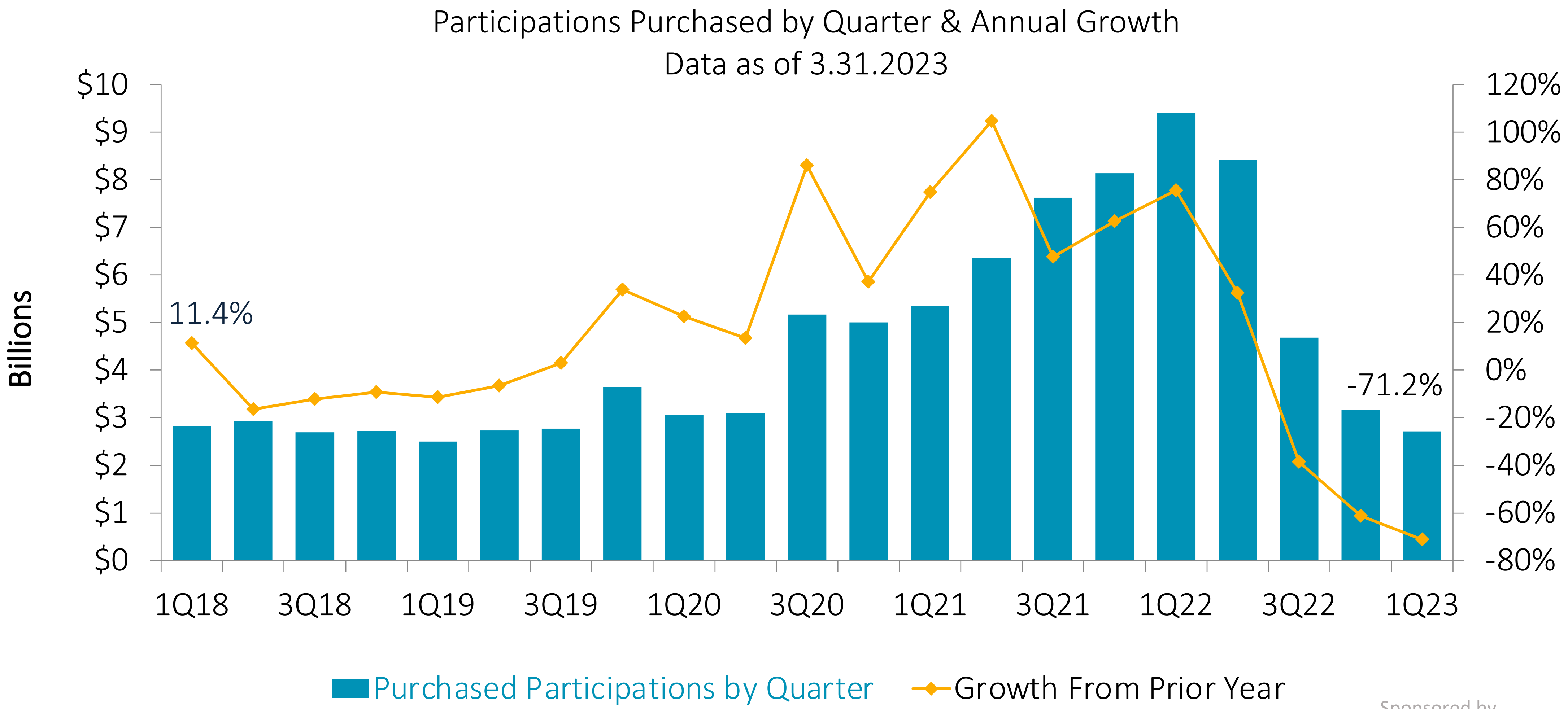
Loan participation activity is also slower



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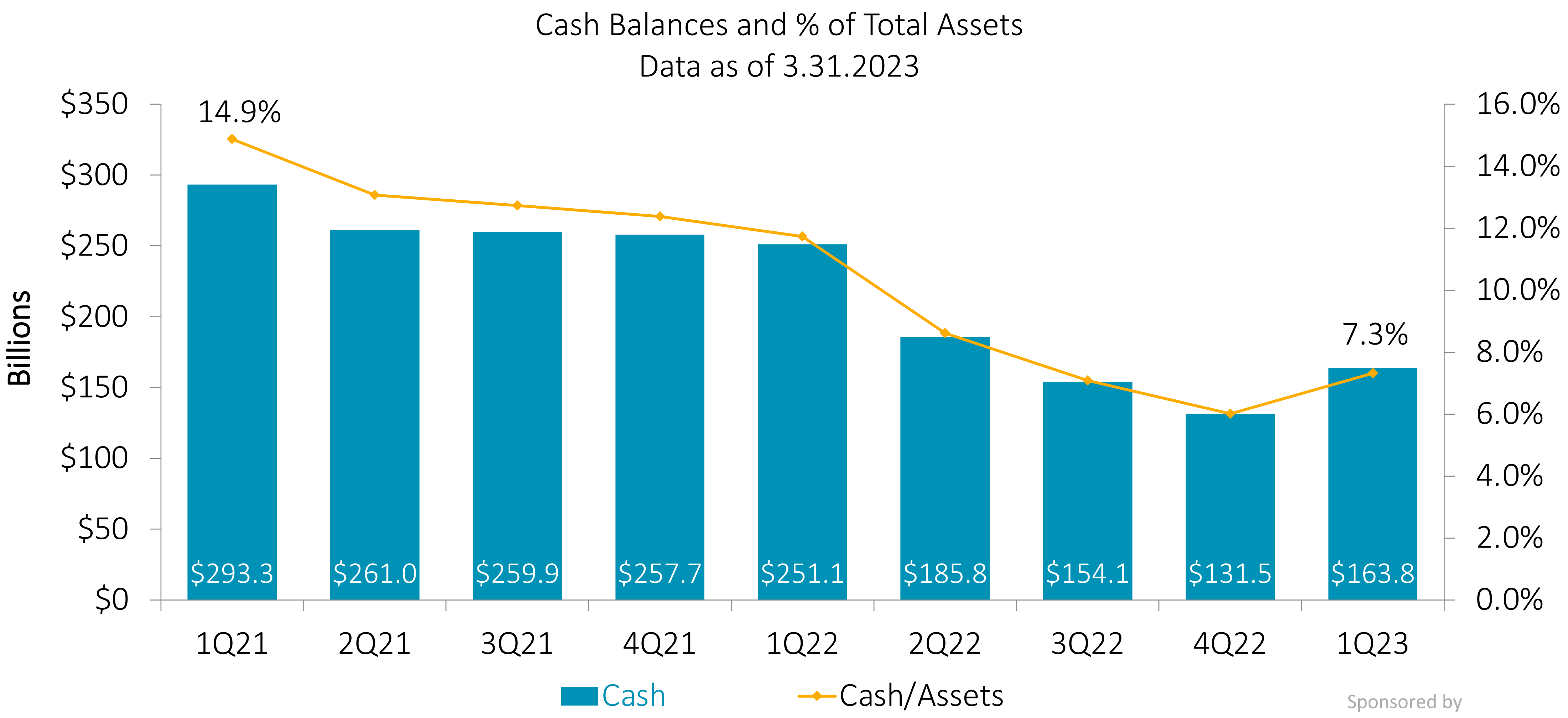
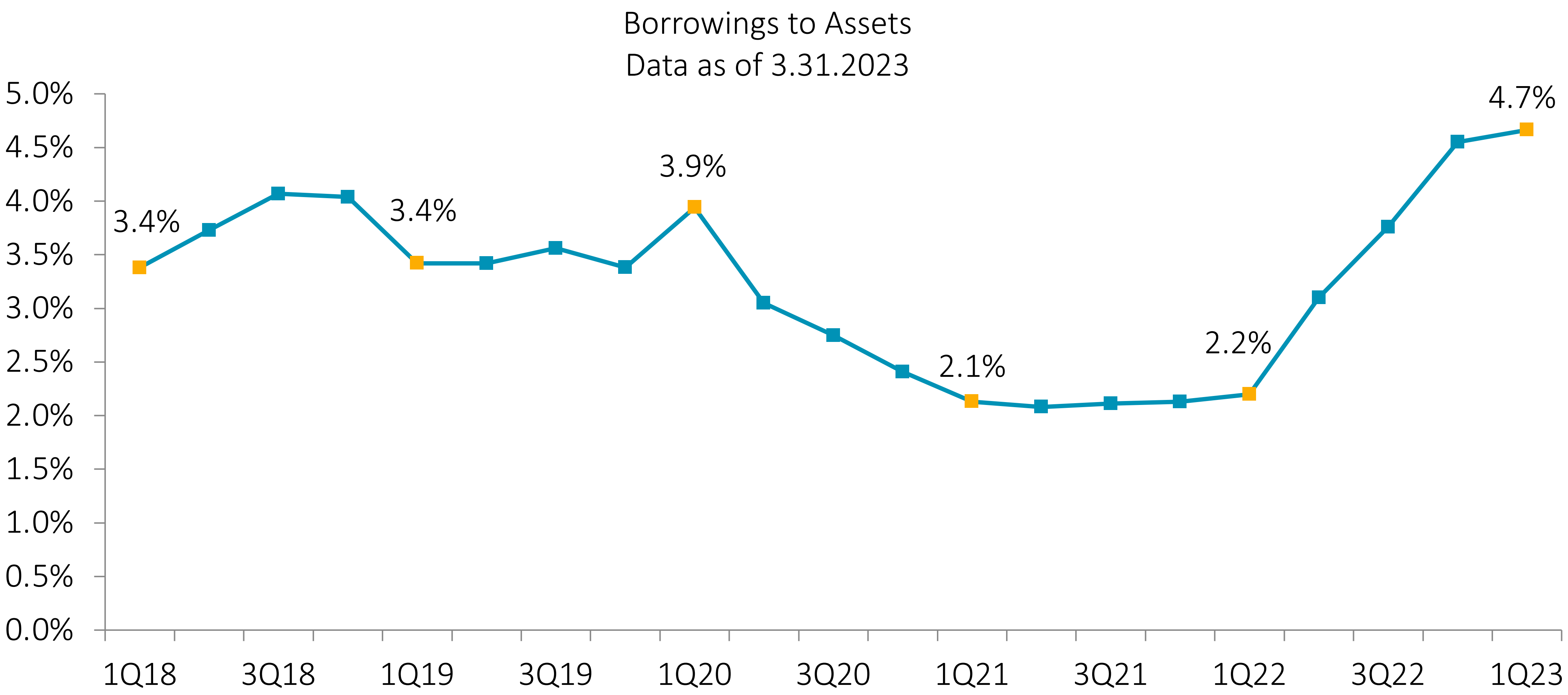
Cash relative to assets bounces rises from year-end low point



Borrowings relative to assets tick up slightly



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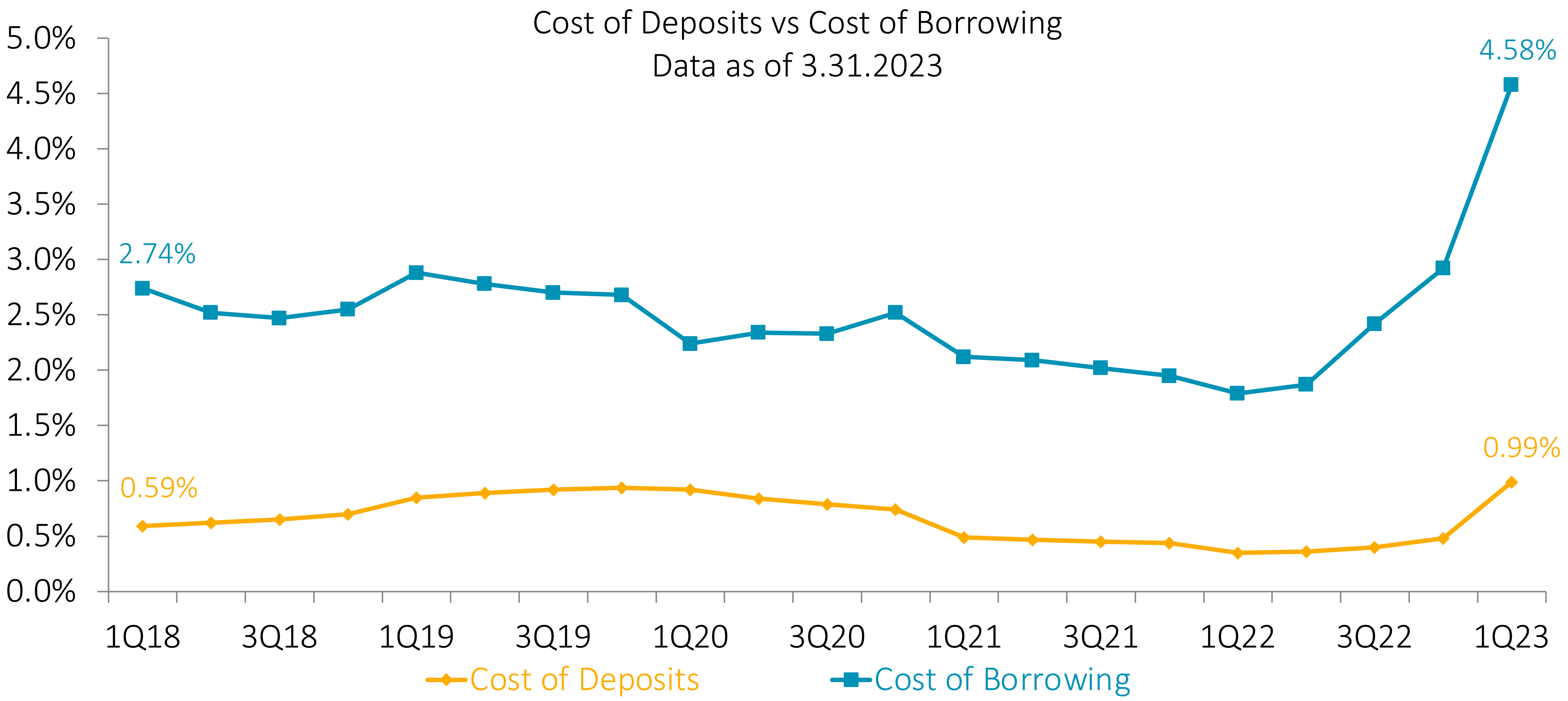
Borrowing costs are up 279 basis points since 1Q22



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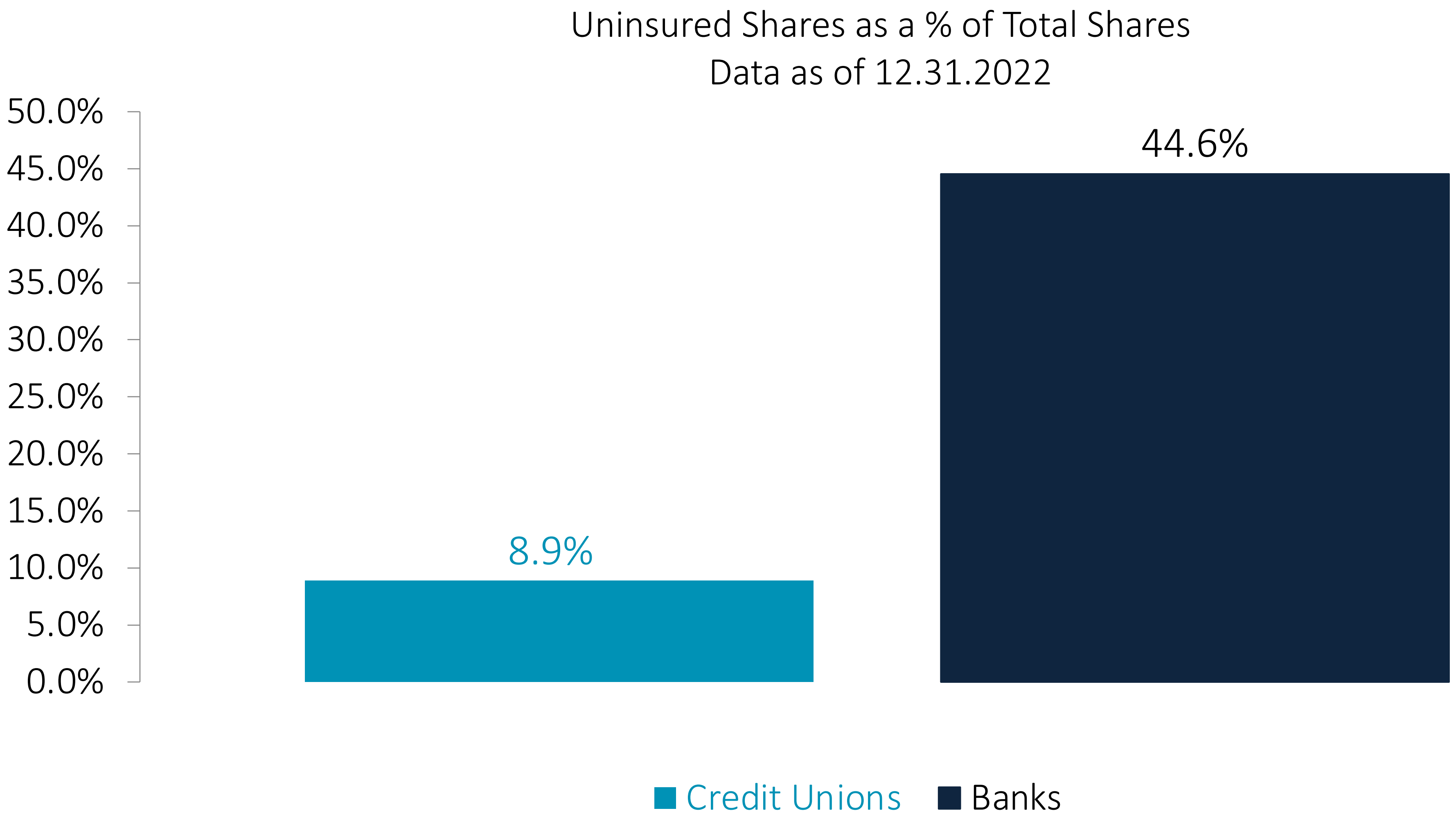
Uninsured shares a small portion of industry balance sheets compared to banks



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Financial Strategy for 2023

Seth Rudd, Chief Financial Officer
Leaders Credit Union

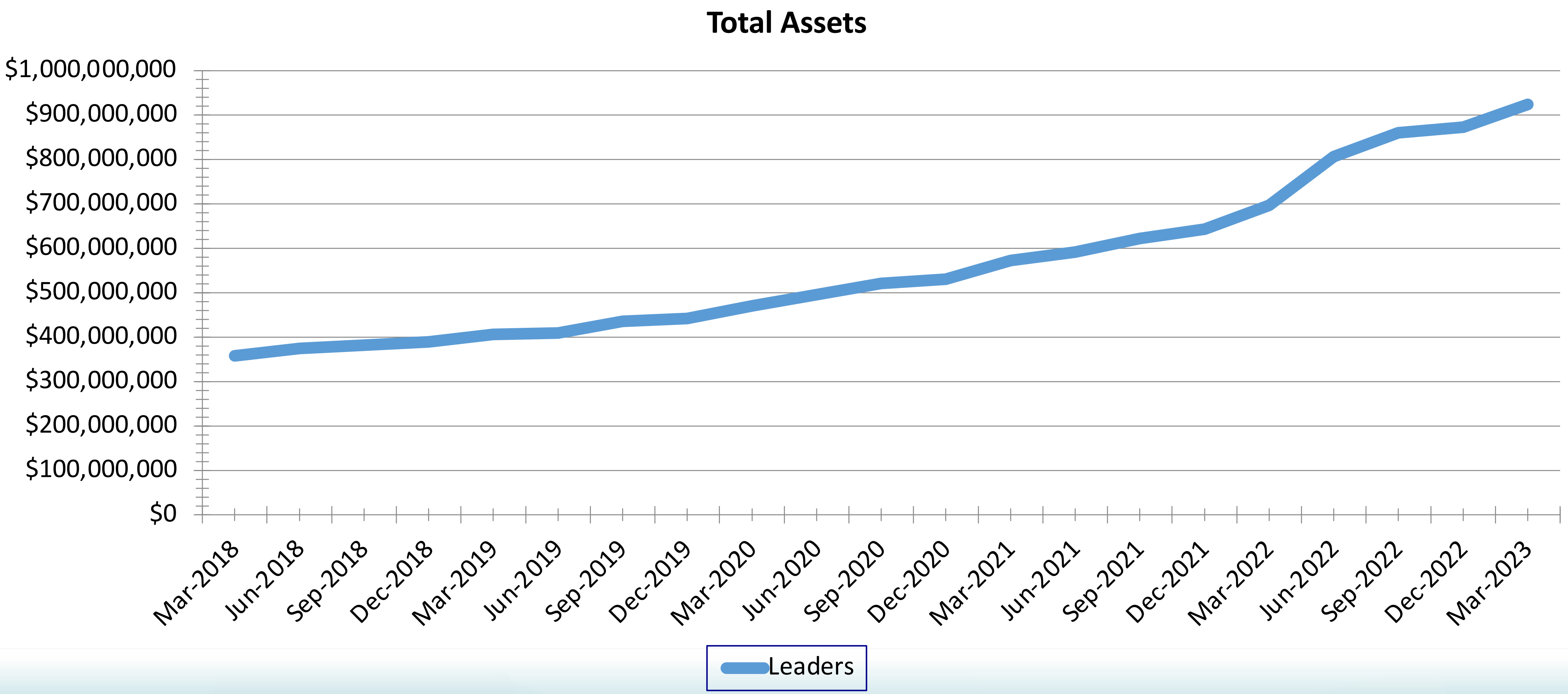
Financial Strategy

Objective 1: Background on Leaders

Objective 2: Industry and Economic Concerns

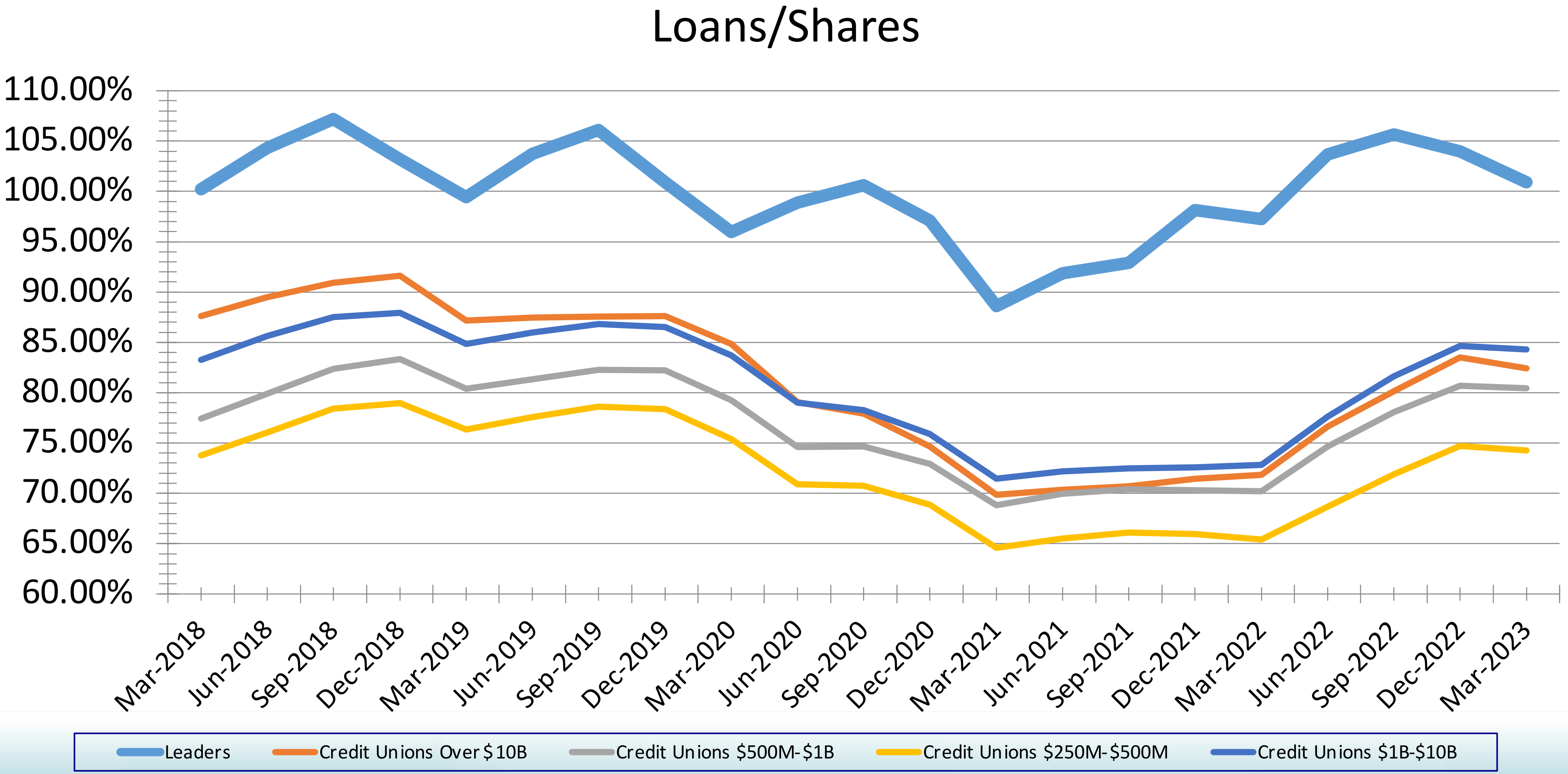
Objective 3: Strategy for 2023 & 2024

Background on Leaders



LEADERS CREDIT UNION

Background on Leaders



LEADERS CREDIT UNION

Background on Leaders

	2020			2021			2022	
KEY RATIOS:	**LCU**	**Peer**		**LCU**	**Peer**		**LCU**	**Peer**
NII to Assets	4.15%	1.48%		4.16%	1.50%		2.84%	1.38%
NIE to Assets	-5.41%	-3.43%		-5.00%	-3.22%		-4.33%	-3.27%
NOE to Assets	-1.26%	-1.95%		-0.84%	-1.72%		-1.49%	-1.89%
Return on Average Assets	1.74%	0.59%		2.10%	0.85%		1.73%	0.82%

LEADERS CREDIT UNION

Industry and Economic Concerns

Concern 1: Liquidity risk is not over.

Concern 2: Credit risk has not started.

Concern 3: ”Capital isn't king”

Industry and Economic Concerns

Concern 1: Liquidity risk is not over.

Response: Increased monitoring.

Response: Re-evaluated lines of credit.

Response: Accept rising cost of funds.

Response: Adjust growth expectations.

Industry and Economic Concerns

Concern 1: Liquidity risk is not over.

Concern 2: Credit risk has not started.

- **Response:** Adjusted underwriting parameters.
- **Response:** Continue to raise rates.
- **Response:** Improve resources in collections.
- **Response:** Maintain a higher allowance.

LEADERS CREDIT UNION

Industry and Economic Concerns

Concern 1: Liquidity risk is not over.

Concern 2: Credit risk has not started.

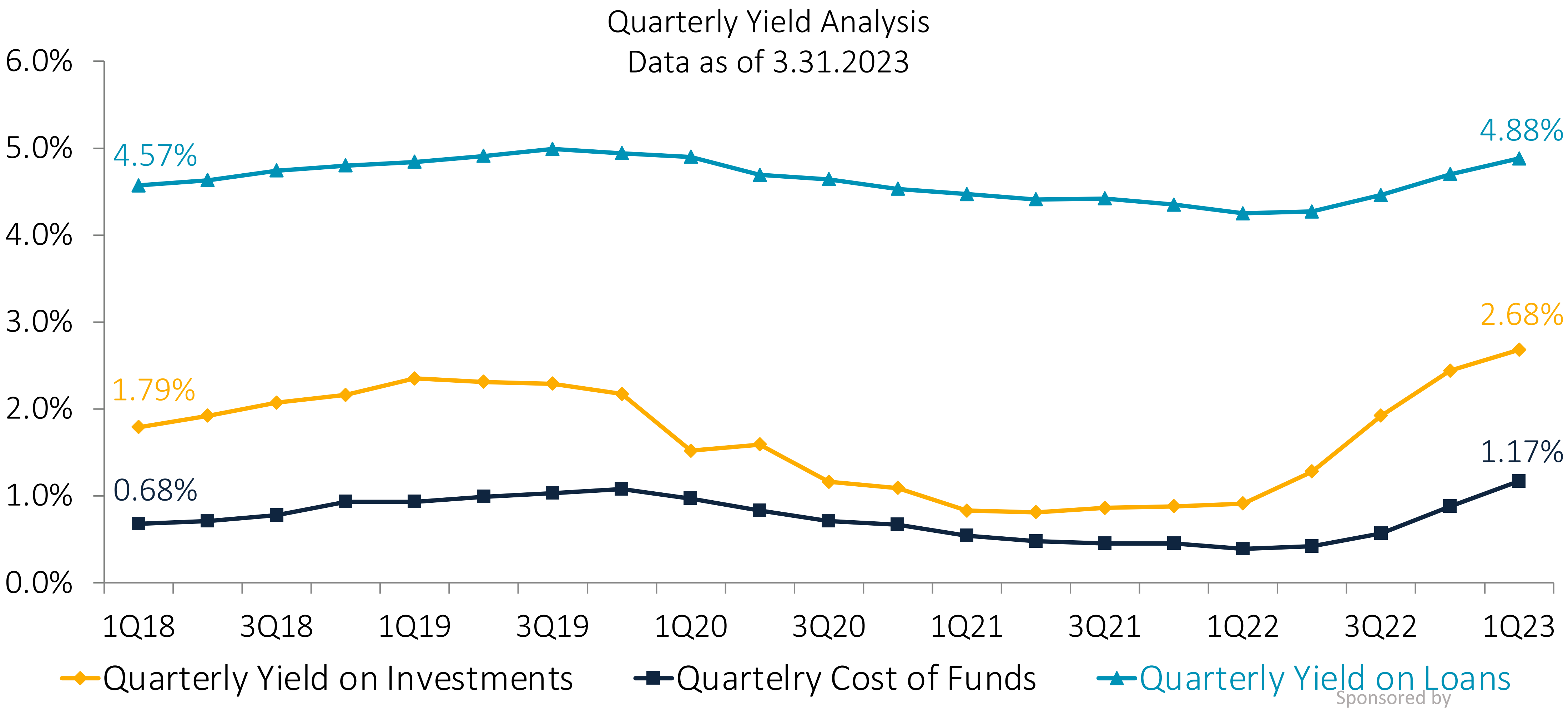
Concern 3: ”Capital isn't king”

Response: Communicate confidence.

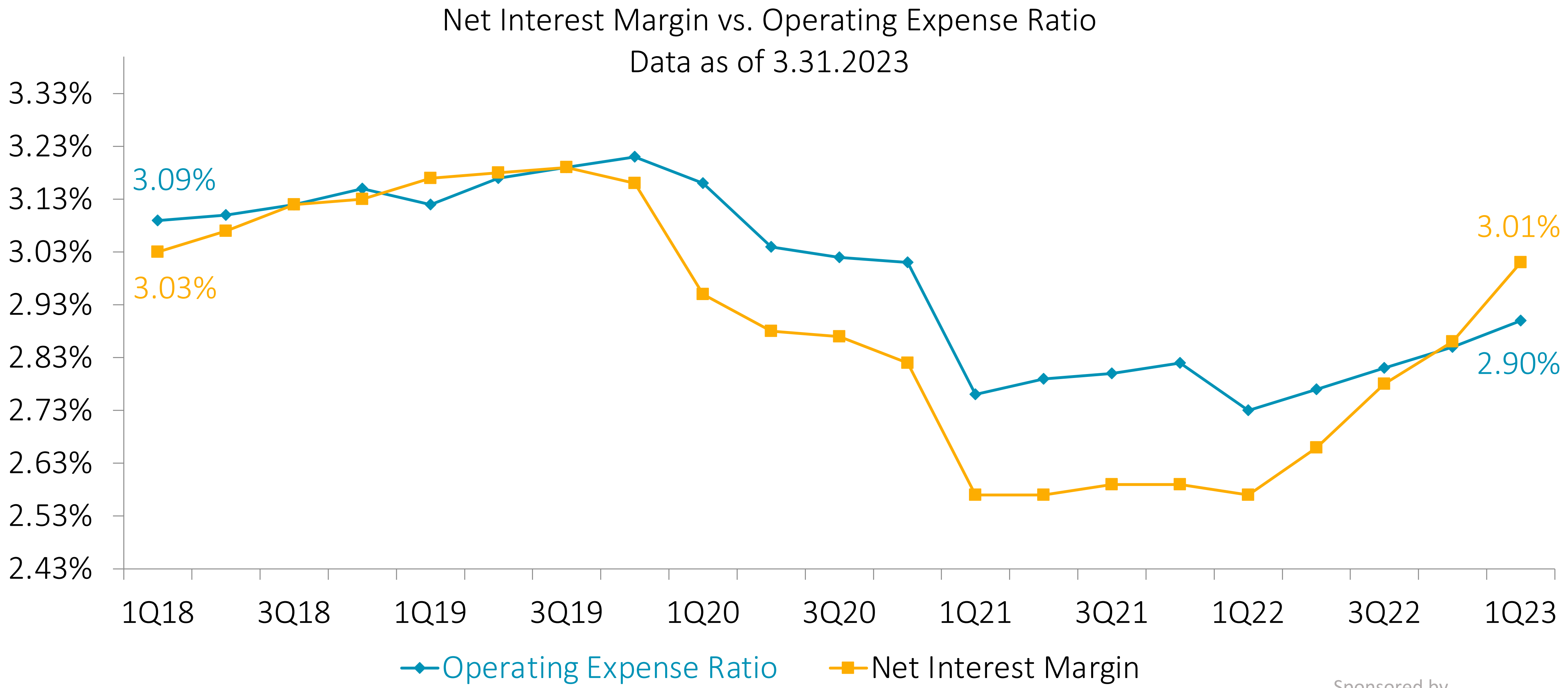
LEADERS
CREDIT UNION

Earnings & Capital

Rising interest rates are reflected in balance sheet yields



Net interest margin is higher than operating expense ratio for the second straight quarter



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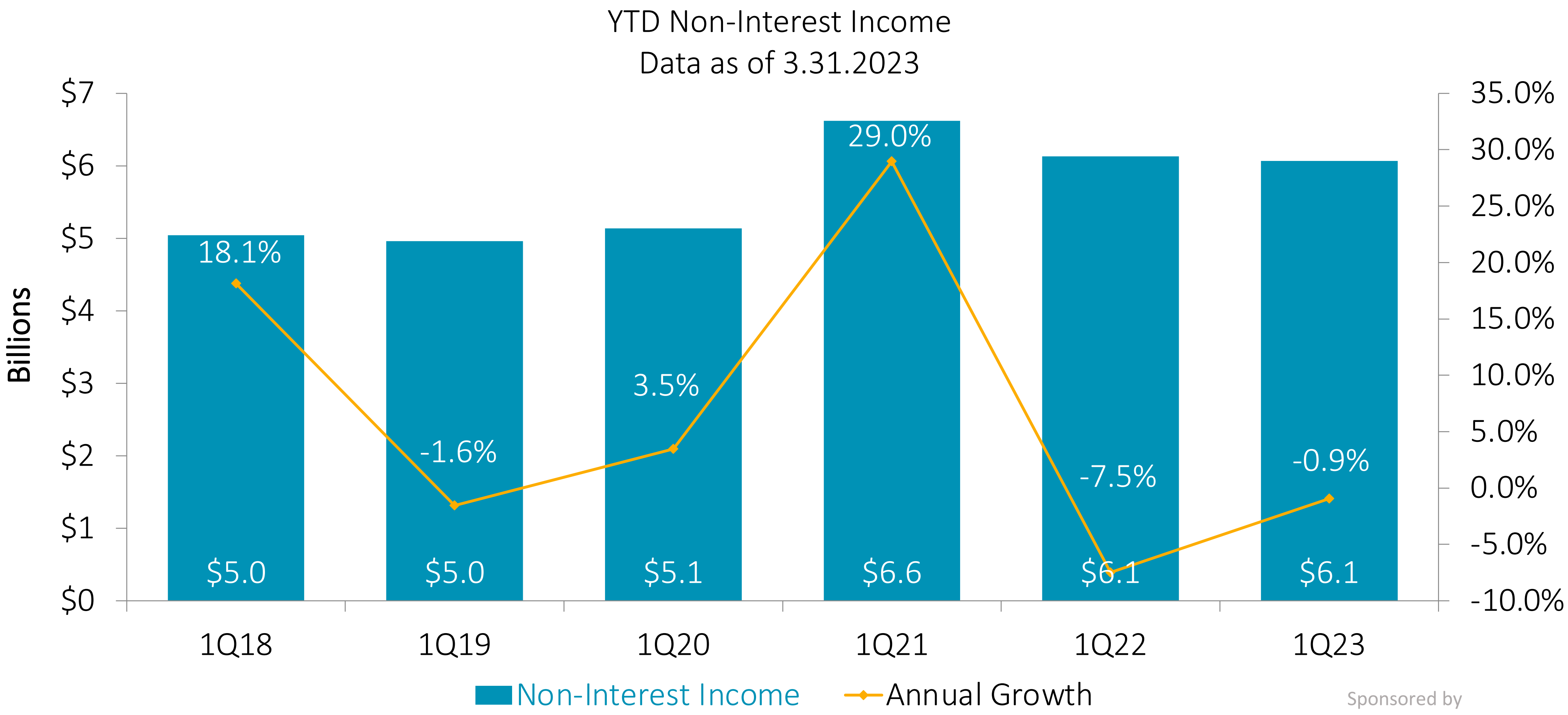
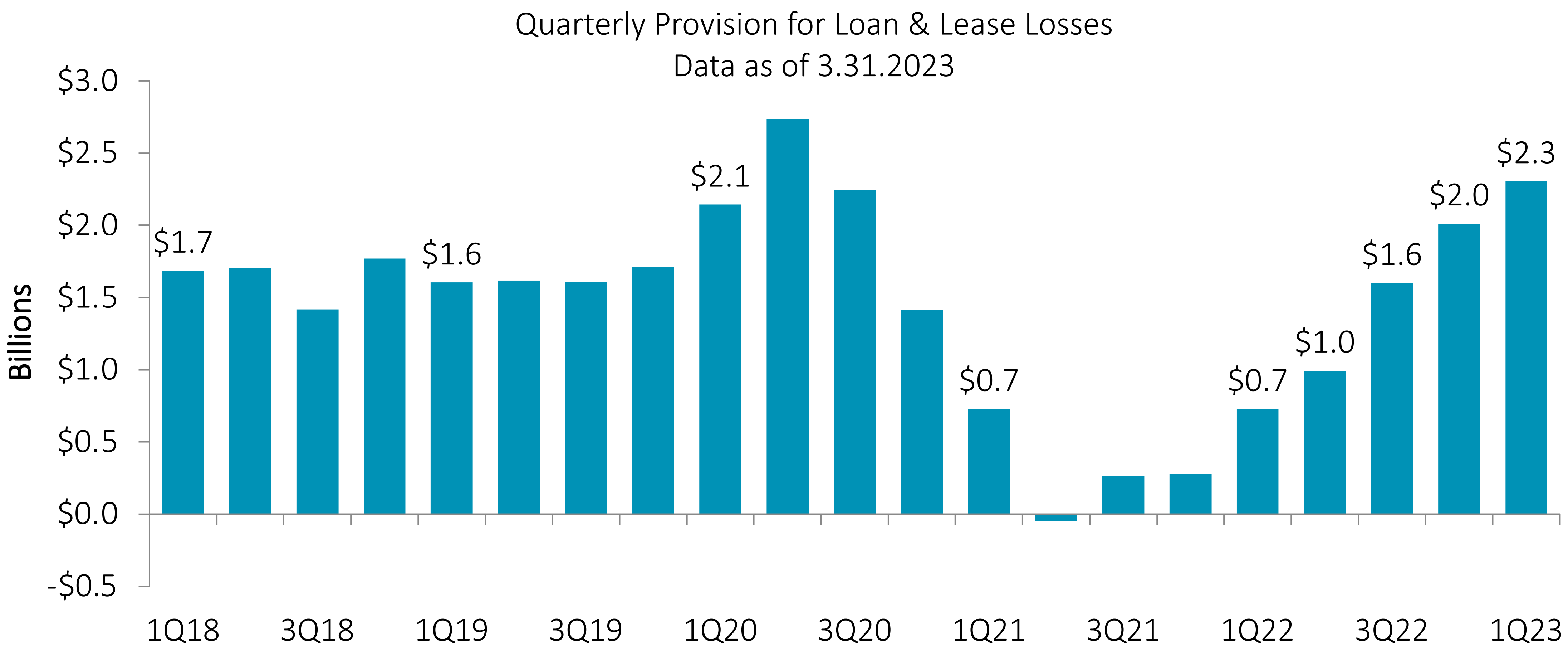
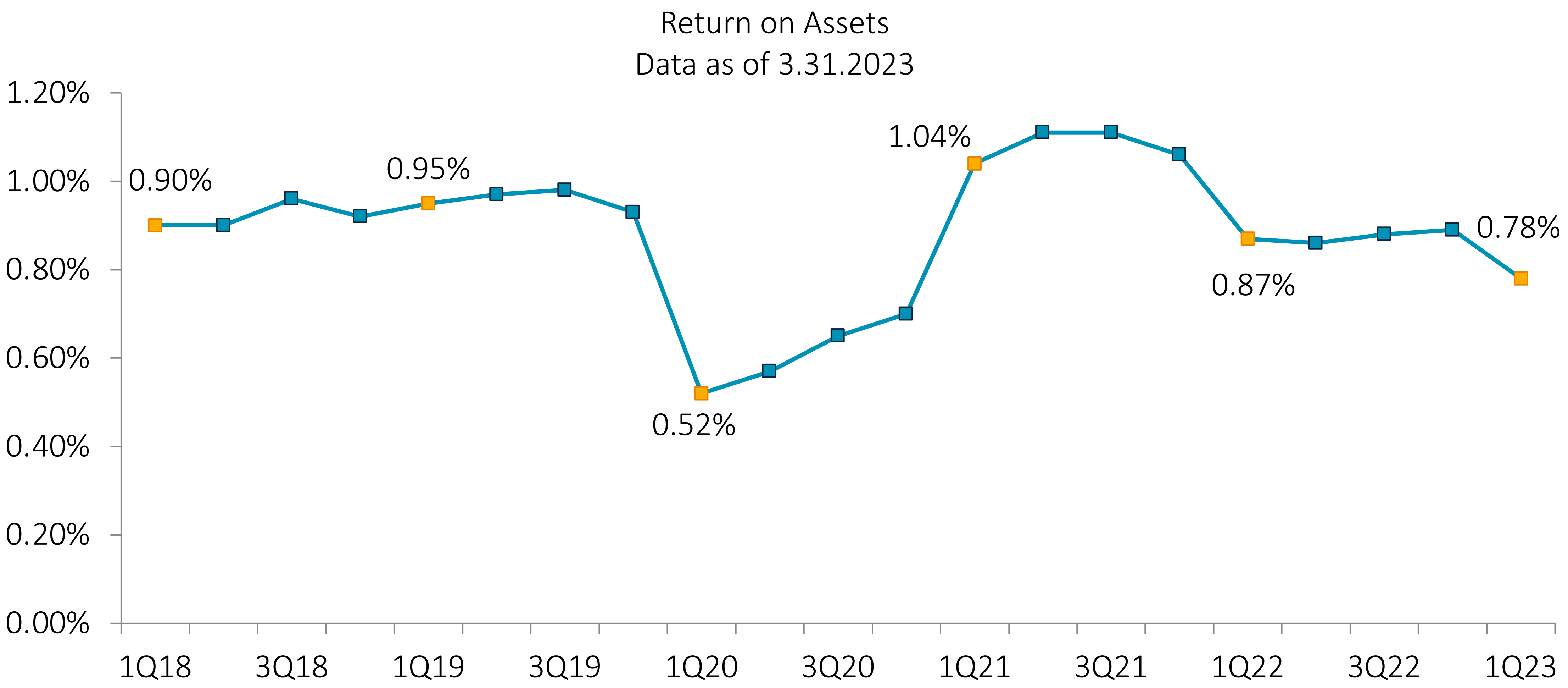
Non-interest income declines almost 1%



Credit unions increase provisions as charge-offs rise



ROA declines from pandemic highs as cost of funds rises

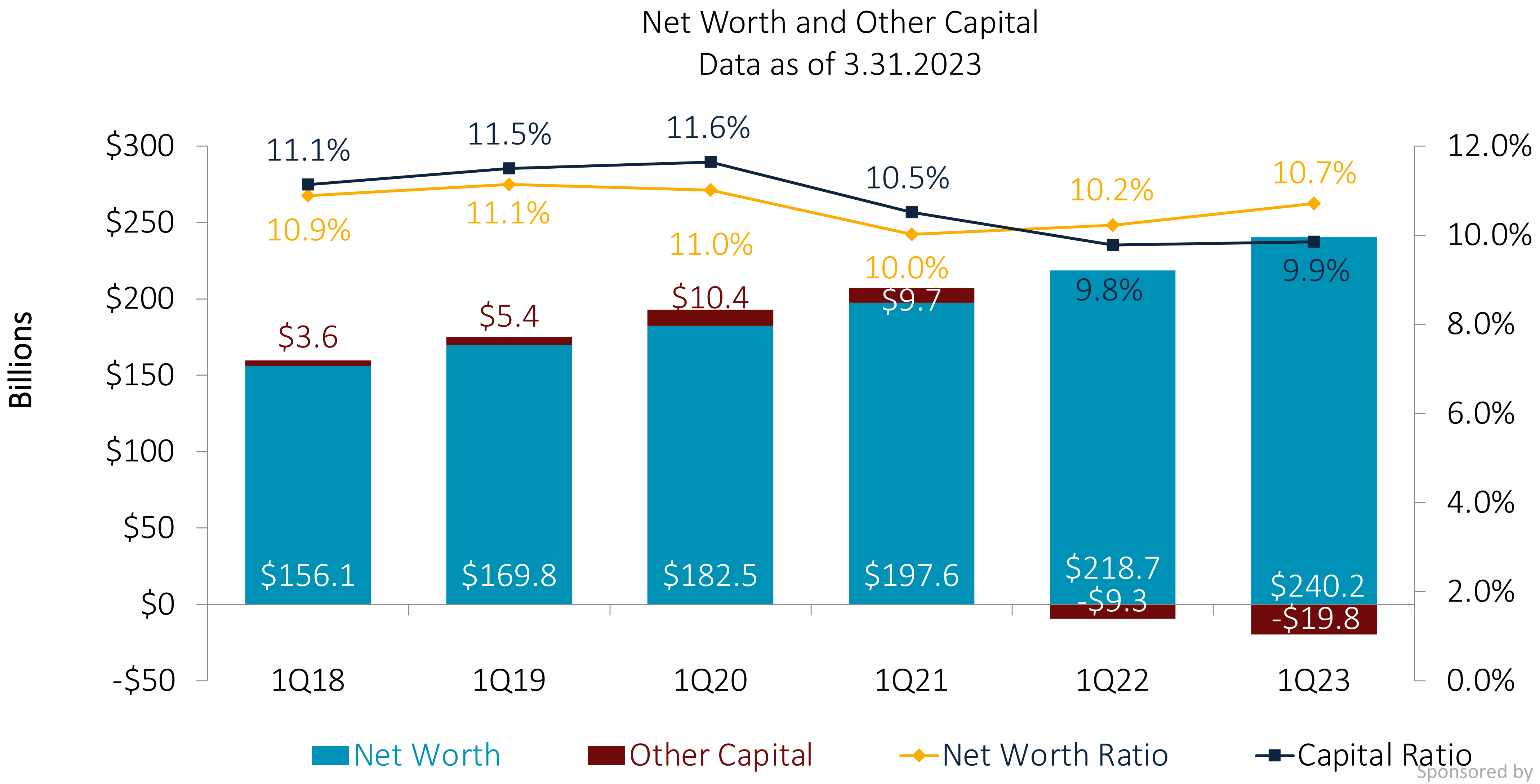


Change in Earnings Components: 1Q23 vs 1Q22

	3/31/2023	3/31/2022	Impact of Change on ROA
Interest Income	4.06%	2.92%	+1.14%
Interest Expense	1.05%	0.35%	(0.70%)
Net Interest Margin	3.01%	2.57%	+0.44%
Non-interest Income	1.09%	1.16%	(0.07%)
Operating Expenses	2.90%	2.73%	(0.17%)
Provision for Loan Losses	0.42%	0.14%	(0.28%)
ROA	0.78%	0.87%	(0.09%)

Expressed as a % of Avg. Assets
May not sum due to rounding

Capital levels off after previous declines



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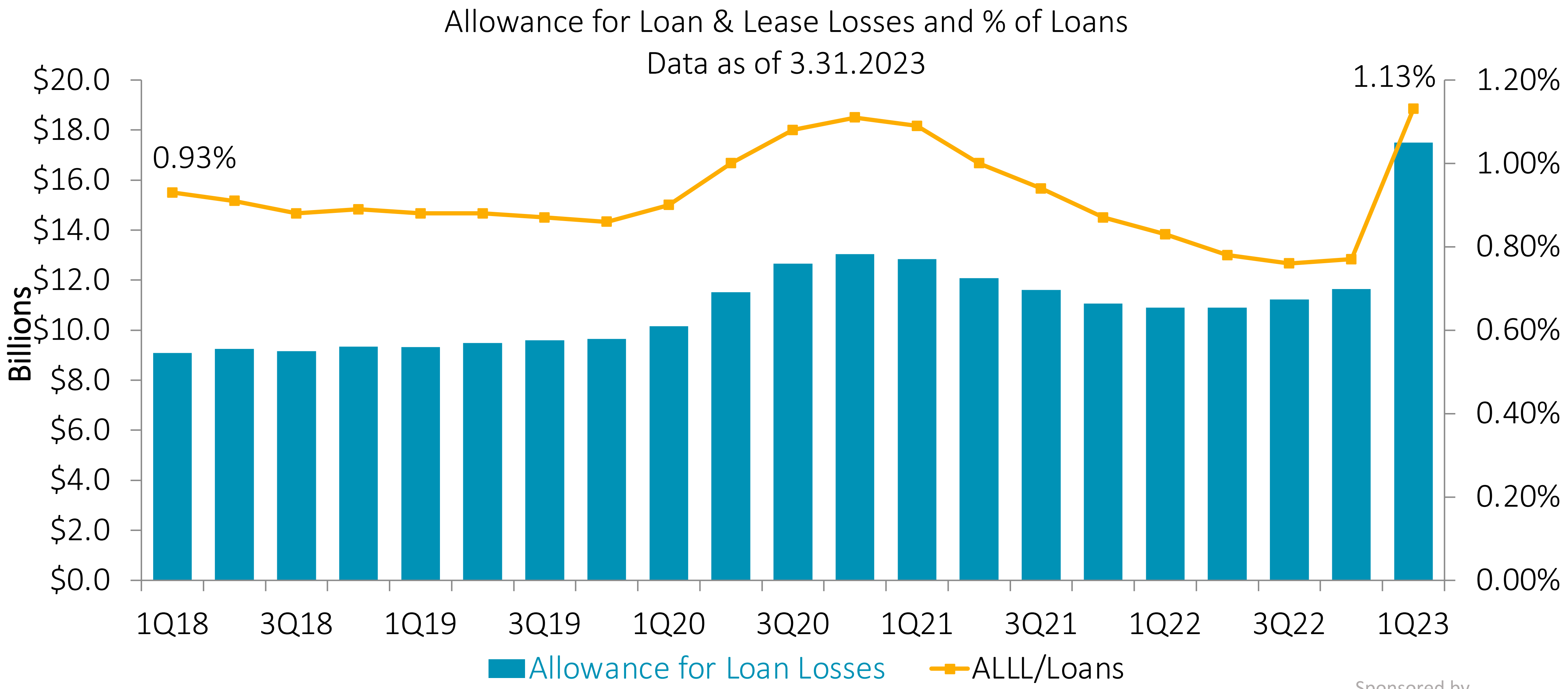
Allowance for loan losses jumps in first quarter …



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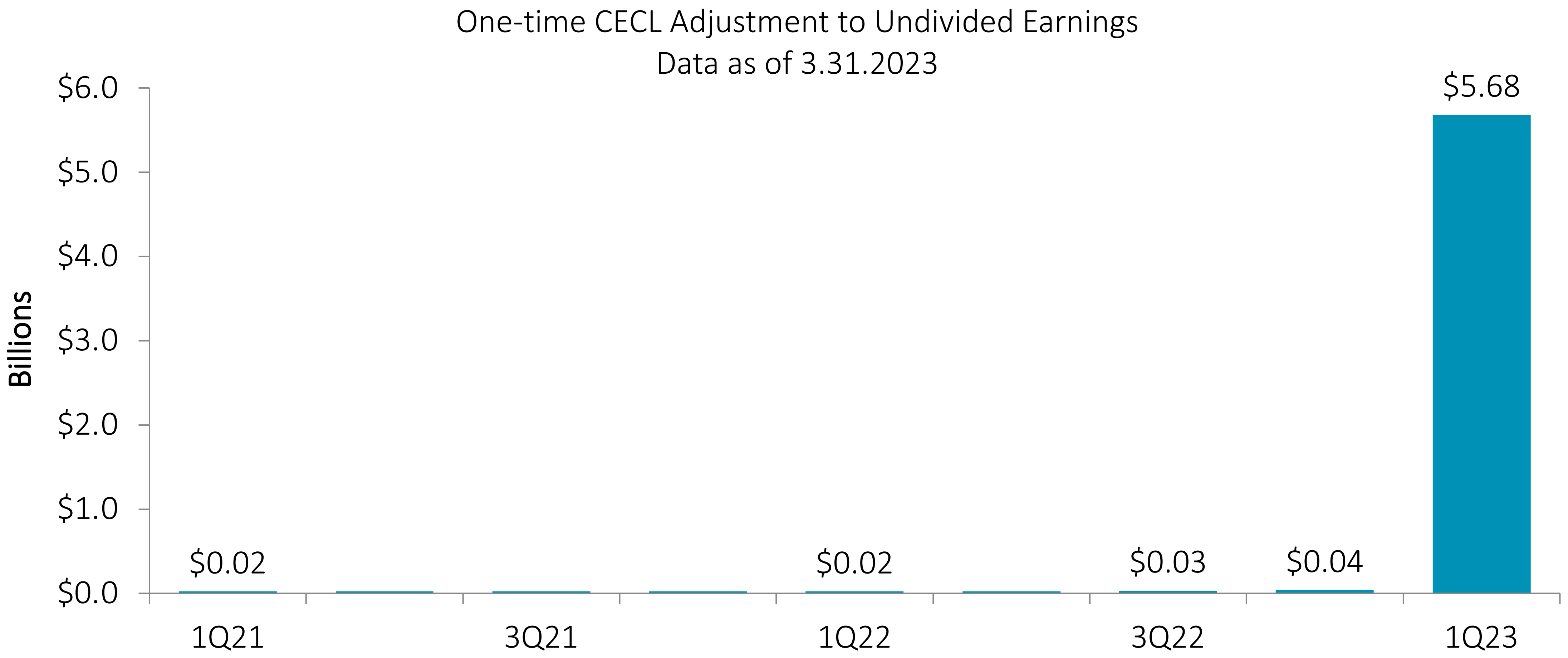
…due to one-time CECL adjustment



Lessons & Looking Forward

Summary

- Credit unions remain financially sound – growing membership and relationships, positive earnings, strong capital base.
- While there are emerging signs of members under financial stress, credit unions are well positioned to support members in need.
- In challenging economic times, credit unions move toward opportunities rather than pulling back.

THANK YOU
FOR WATCHING

1001 Connecticut Ave NW
Ste. 1001
Washington, DC 20036

support@callahan.com
www.callahan.com

800-446-7453

Credit Union Trends: Average vs Median

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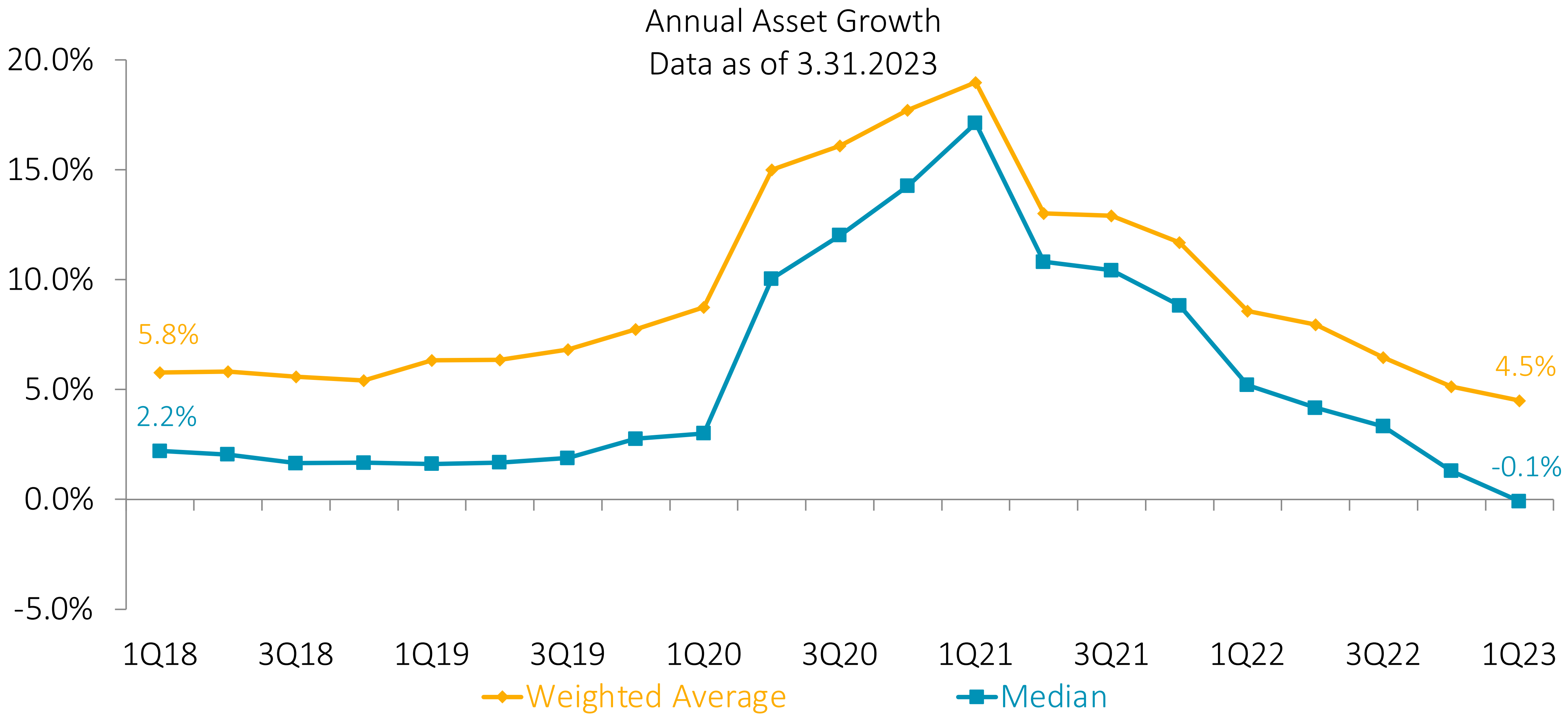
Median asset growth turns negative



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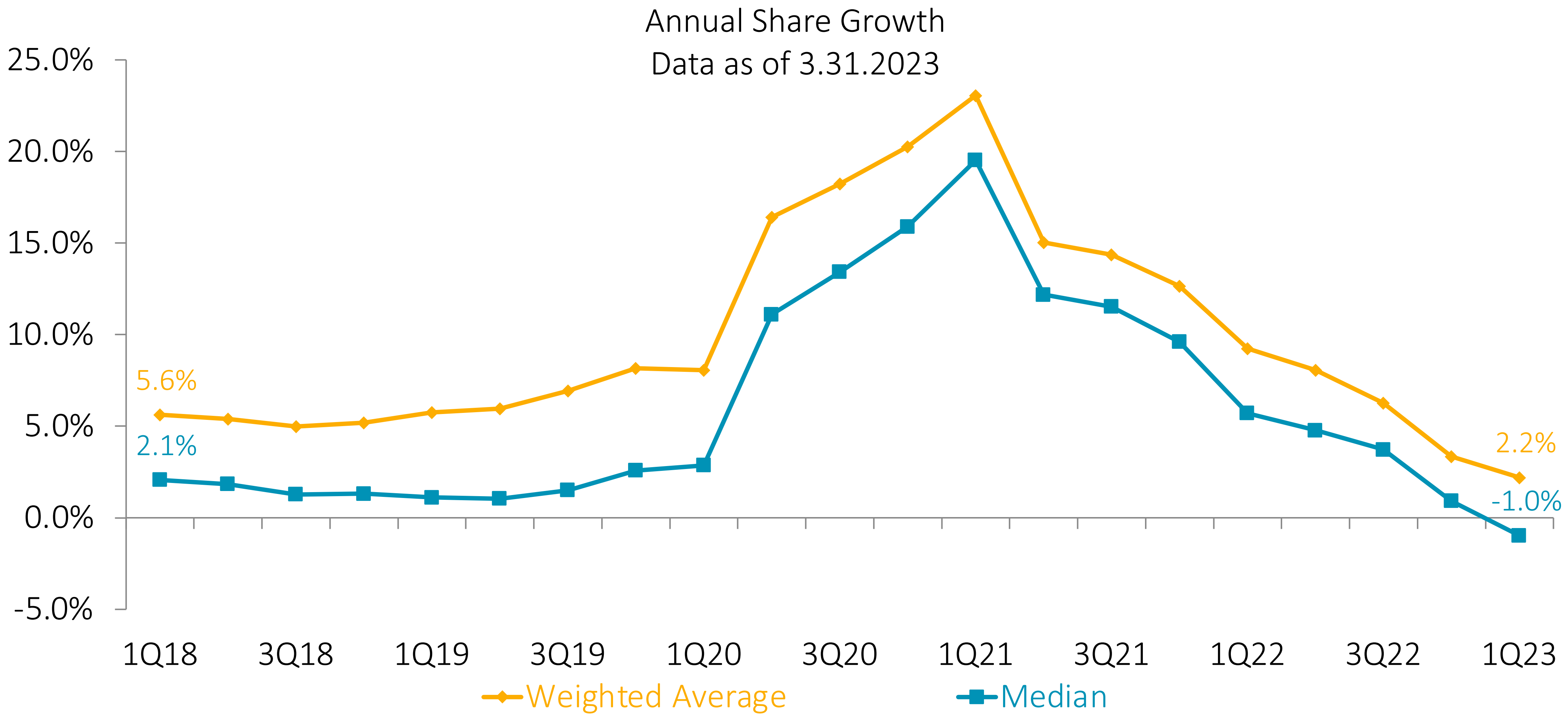
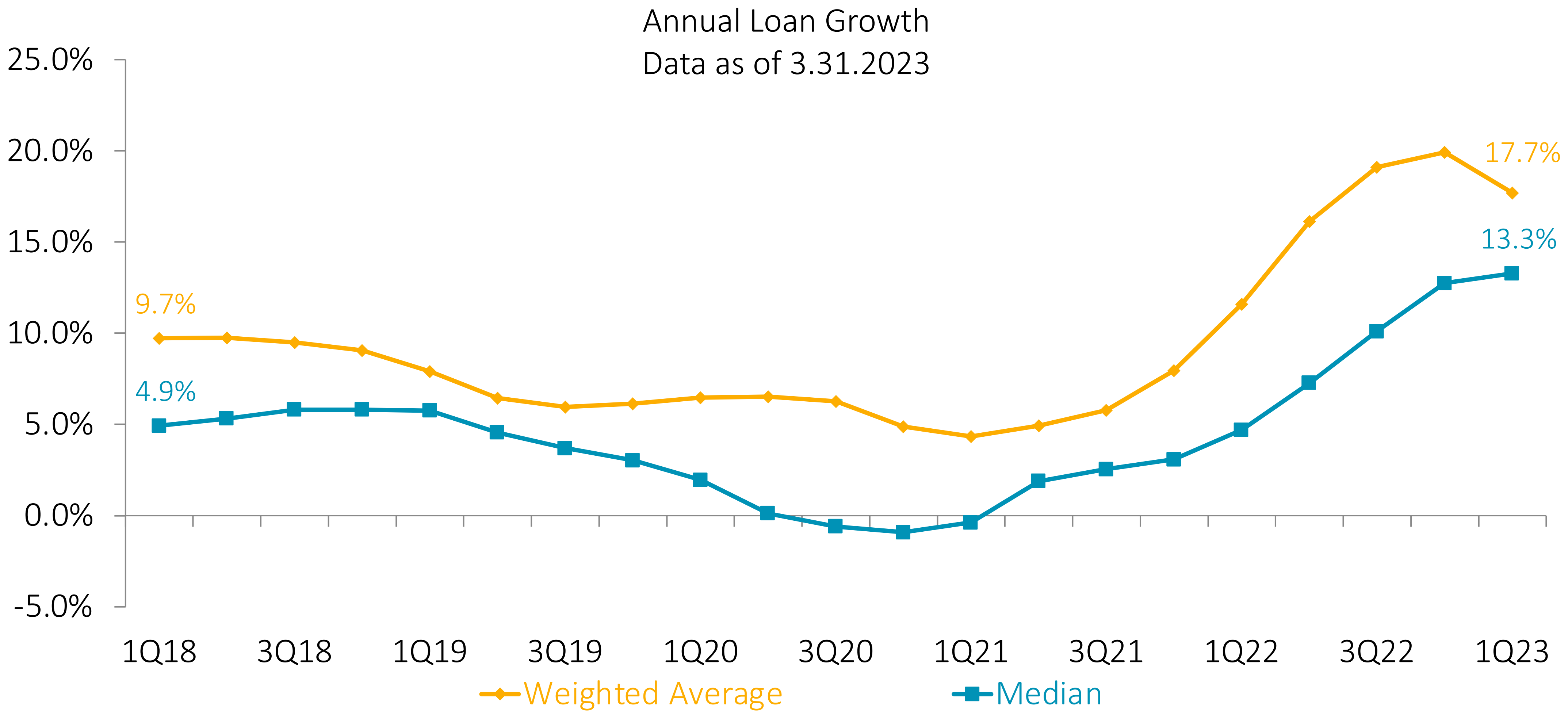
As does median share growth



Median loan growth accelerates



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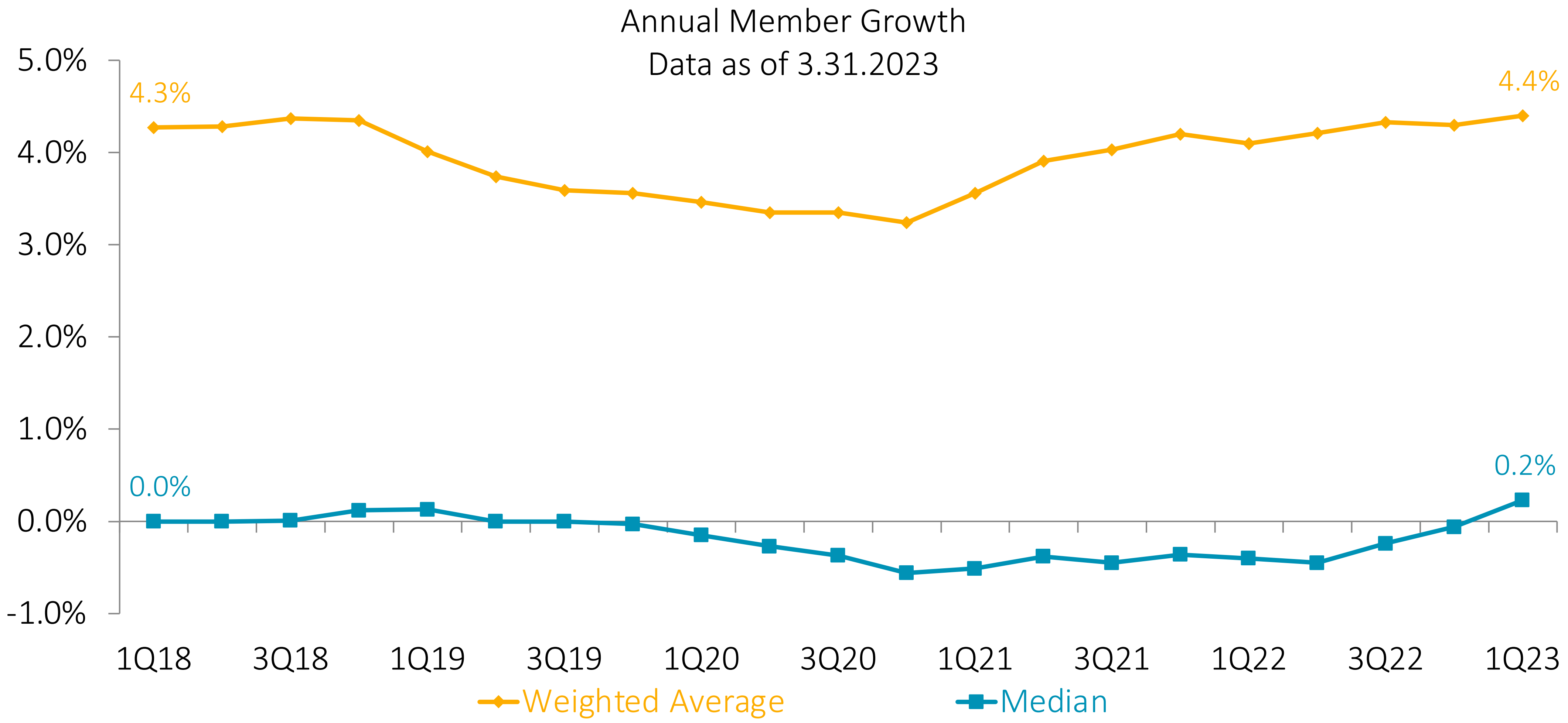
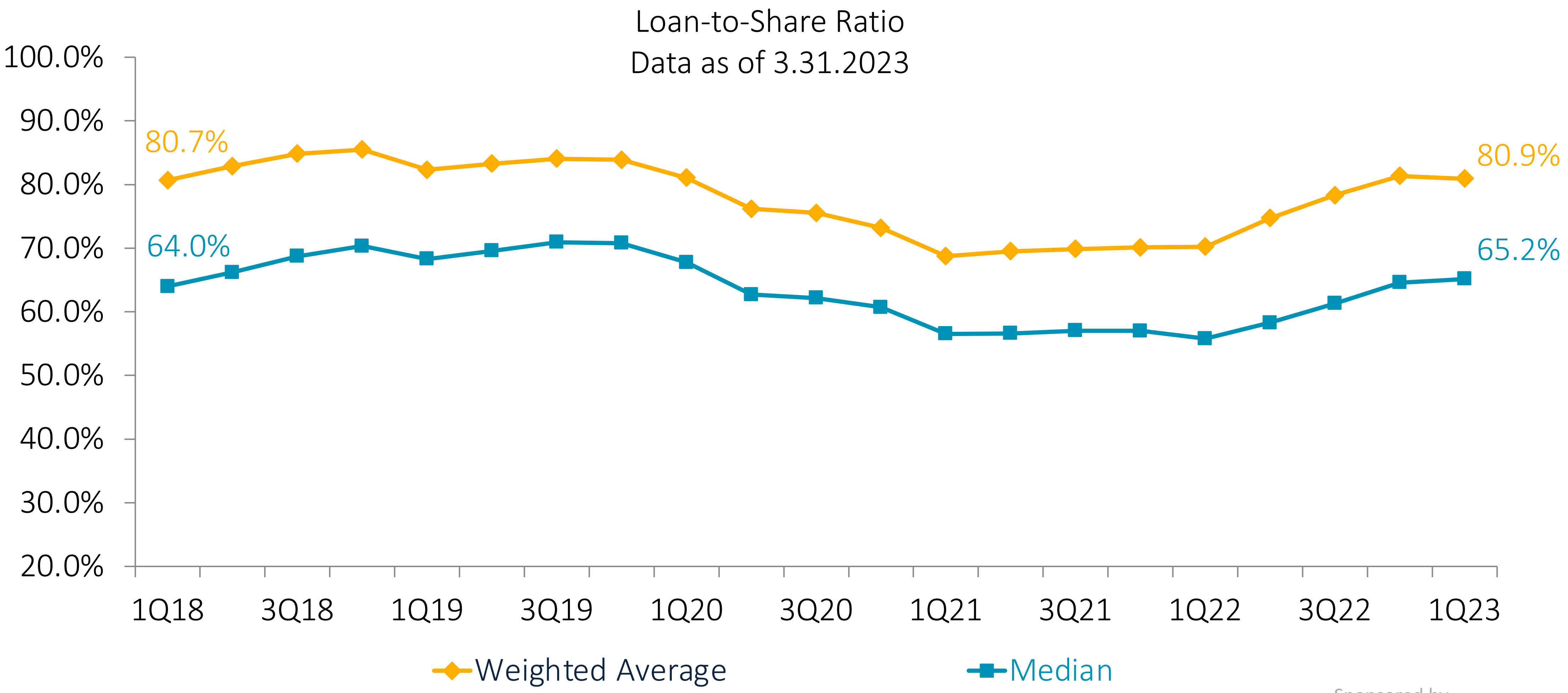
Median member growth turns positive for first time in 4 years



Liquidity is tighter for larger credit unions



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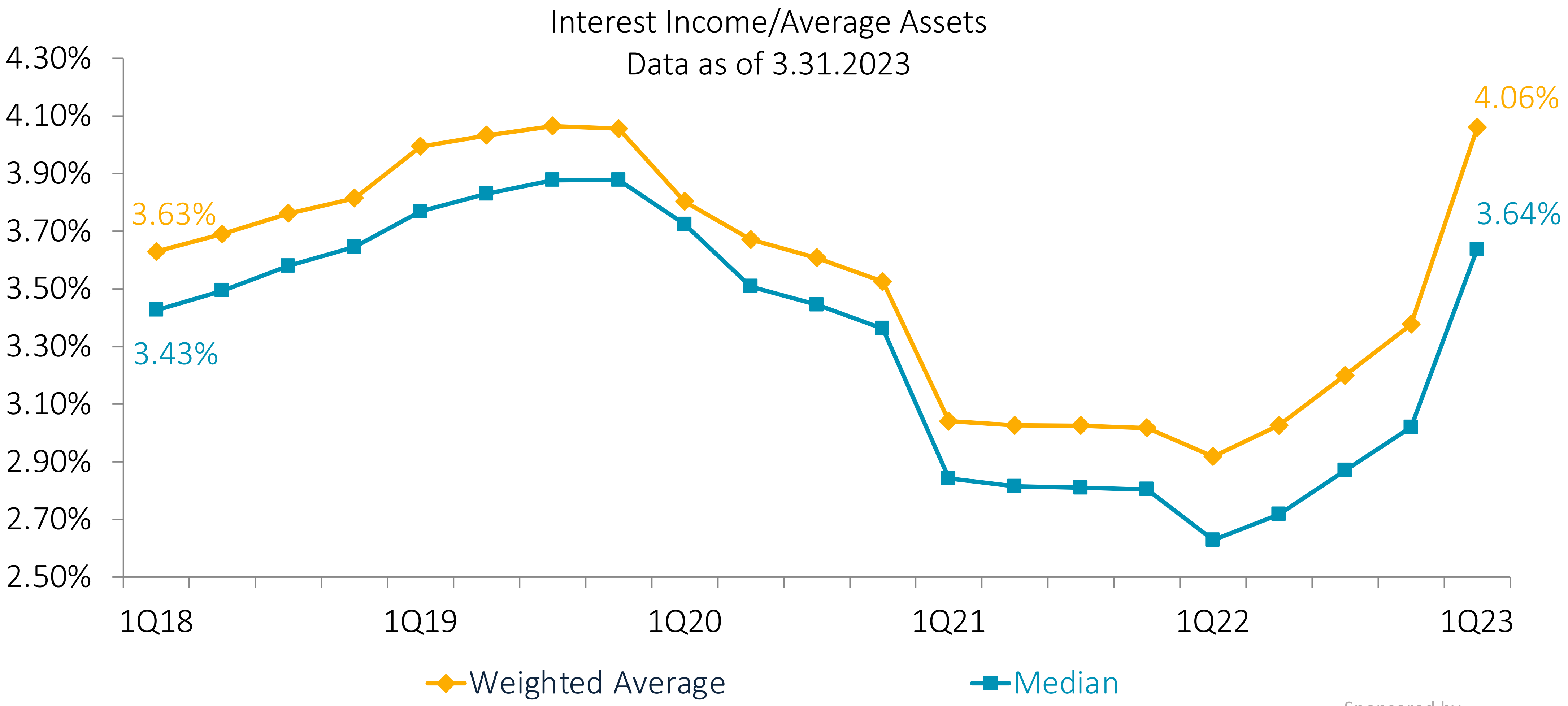
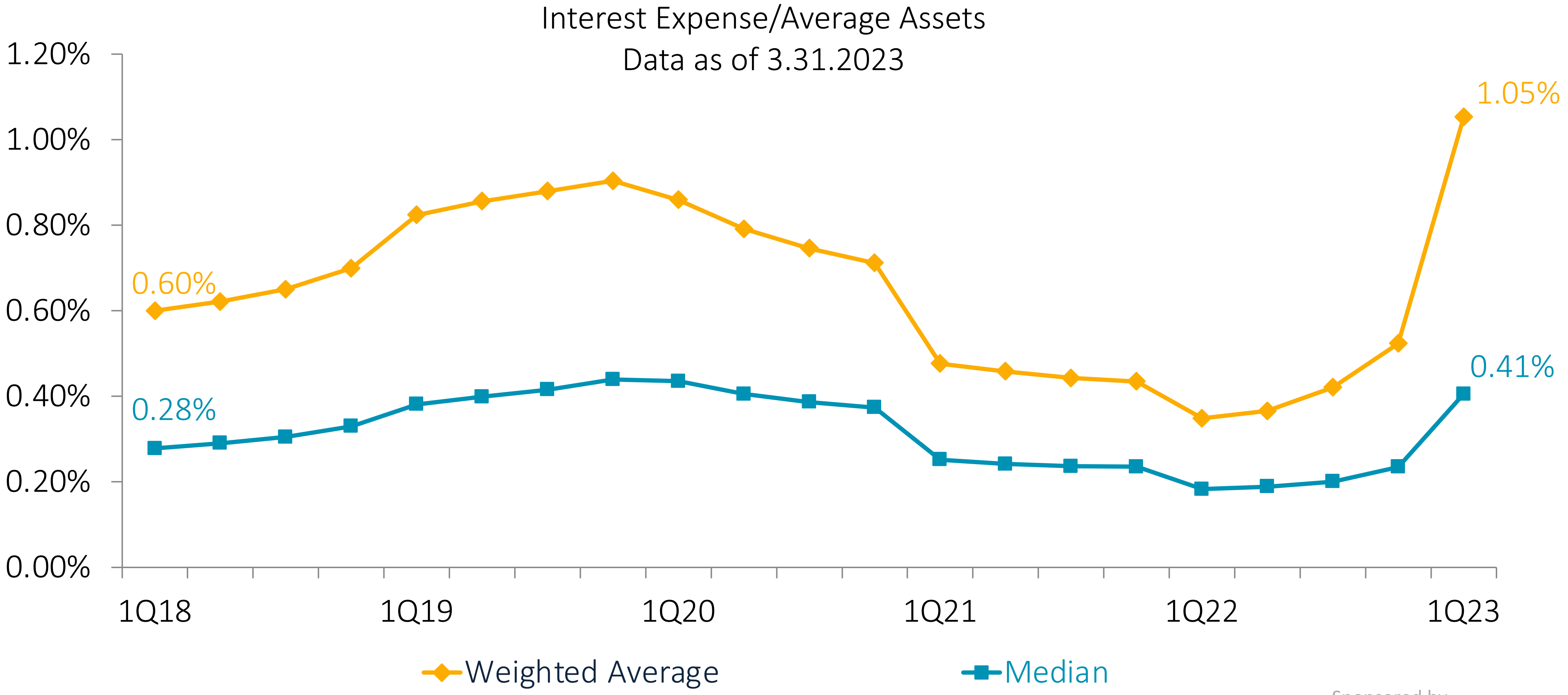
Interest income soars across the board as portfolios reprice



Larger credit unions face tighter liquidity profiles, and are thus paying more to source funds



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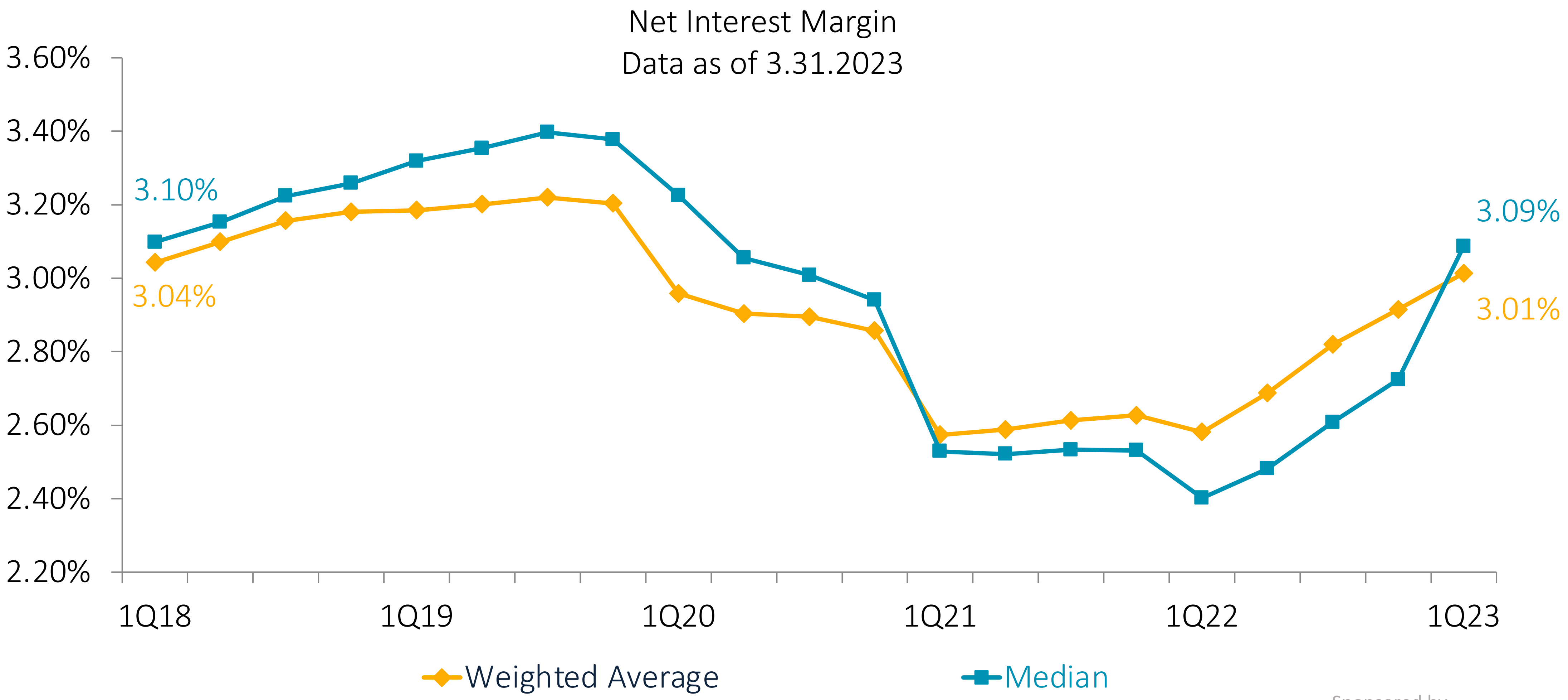
Higher interest expense at larger credit unions place headwinds on industry spreads



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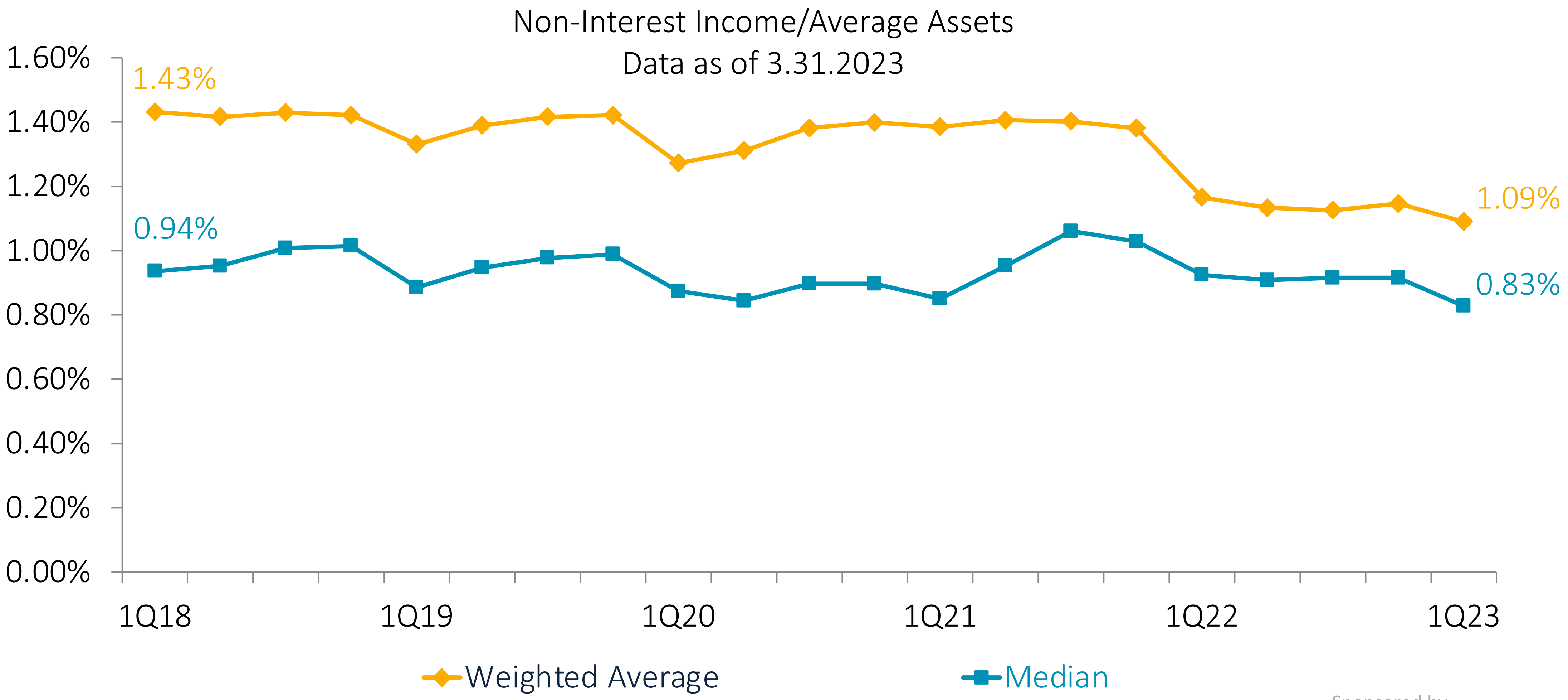
The industry is less reliant on NII as interest revenue grows and secondary market sales slow



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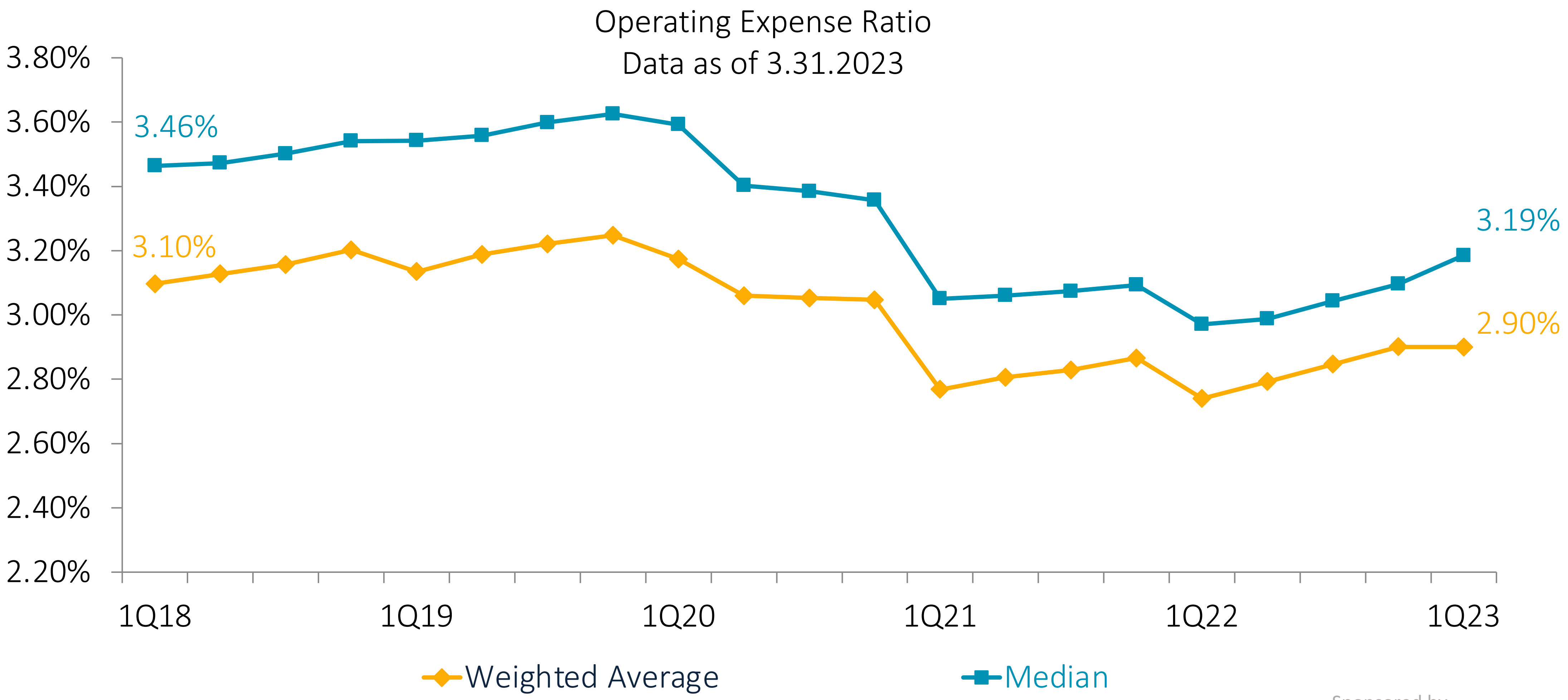
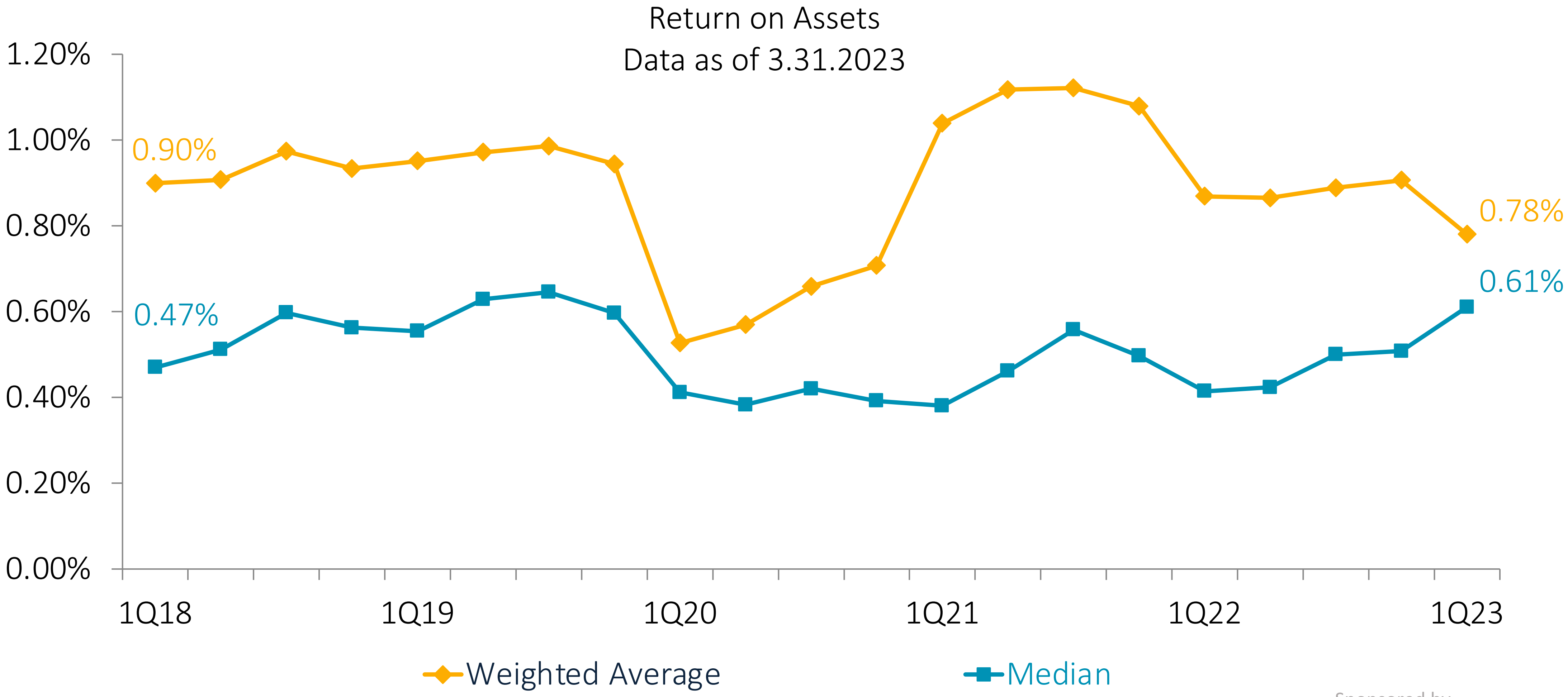
Larger credit unions are more operationally efficient thanks to economies of scale



High interest expense and provisions take a cut out of earnings at larger credit unions, even as interest income grows



Industry net worth remains healthy, though CECL accounting changes have a short-term impact