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Credit Union Asset Quality In 3Q 2024

Higher interest rates have forced members to pick and choose which debts to repay and which to postpone, which doesn't fare well for revolving products.

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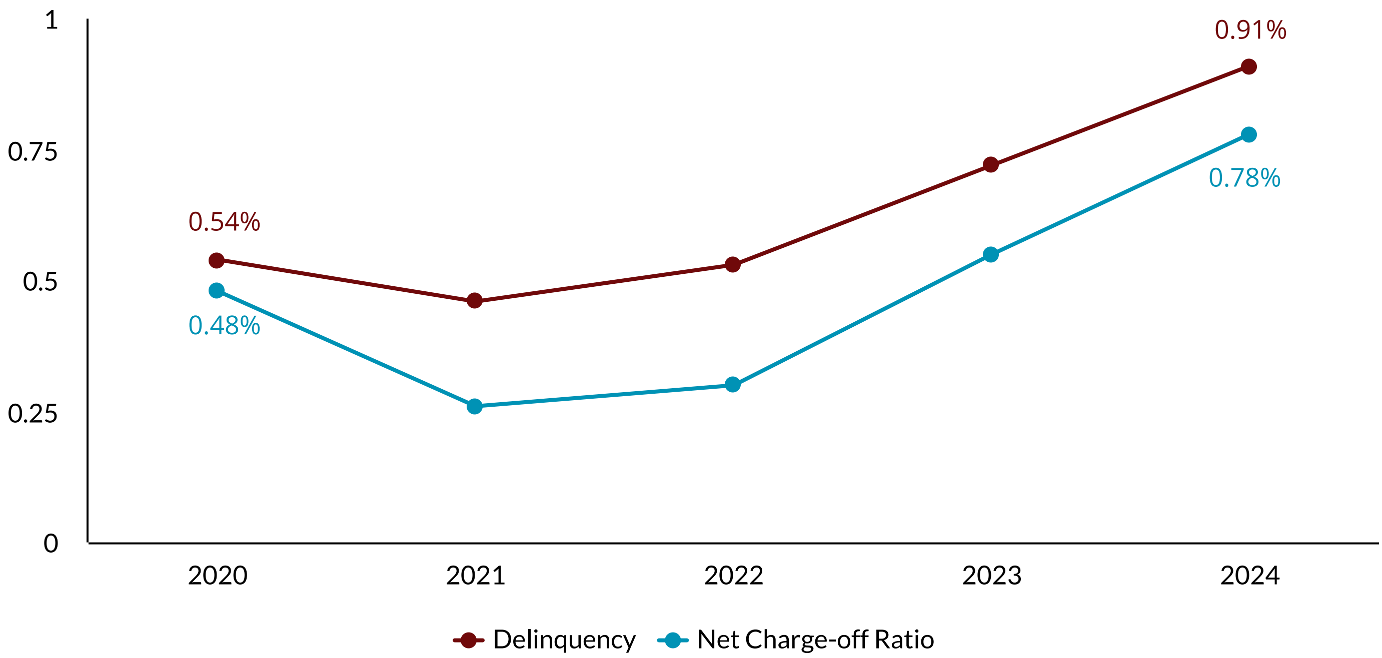
ASSET QUALITY RATIO: DELINQUENCY AND NET CHARGE-OFF RATIO

FOR U.S. CREDIT UNIONS | DATA AS OF 09.30.2024
SOURCE: CALLAHAN & ASSOCIATES



Delinquency at U.S. credit unions increased 19 basis points year-over-year to 0.91% as of Sept. 30. During this time period, the net charge-off ratio jumped 23 basis points to 0.78%. This is a stark contrast from two years ago, when credit union members were flush with cash from COVID-19 relief and delinquency and charge-offs fell to historic lows. Back then, members had excess savings to pay down their loans and even put a dent in their principal.

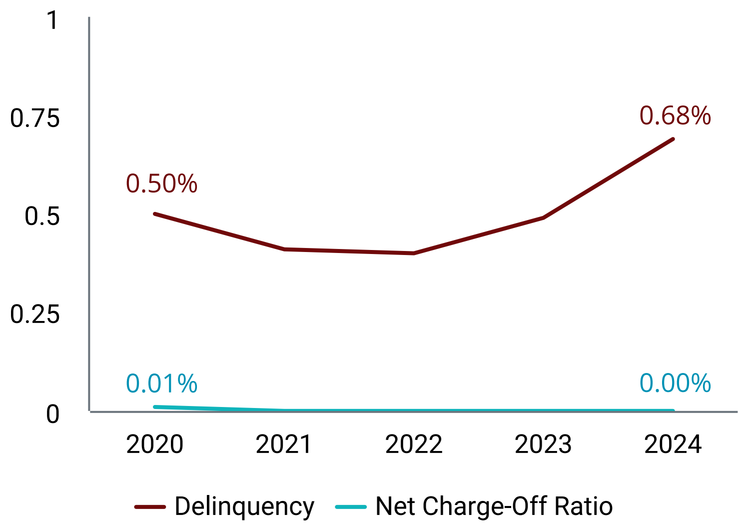
Since the pandemic, however, inflation has forced members to pick and choose which debts to repay and which to postpone. Higher interest rates — the proscribed medicine for inflation — have made credit card loans and adjustable rate mortgages more expensive. Cars, too, have become more difficult to finance and their monthly payments harder to afford. In the loan portfolio, high interest rates have hit revolving products particularly hard.

Economists predict the Federal Reserve will make multiple rate cuts in the year ahead, which will offer credit union members some reprieve. The cost of living, however, is unlikely to improve. To bring asset quality back down to historical norms, credit unions will likely need to tighten lending standards. Member wages, too, need to catch up with the cost of living.

First Mortgage Asset Quality

Credit unions reported a somewhat dramatic increase in first mortgage delinquency, which was up 19 basis points year-over-year. Higher interest rates and living costs have interfered with members' ability to repay these loans.

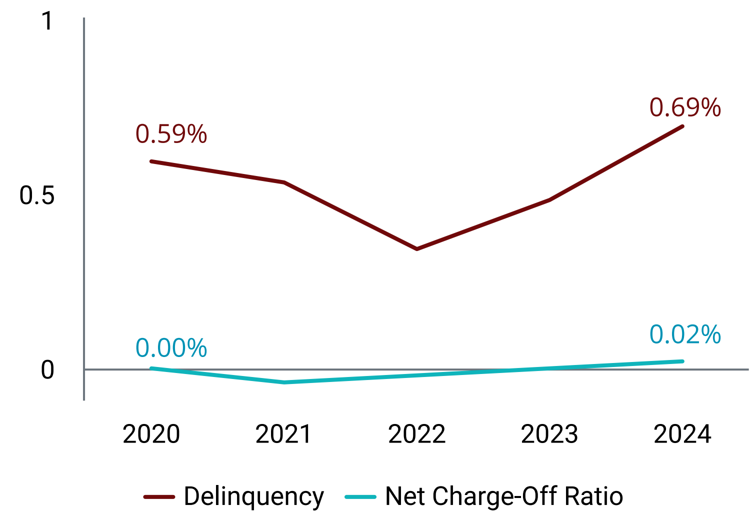
Credit unions have been reluctant to charge-off first mortgages, however. Considering the high-dollar value of a mortgage and the importance of shelter to members, credit unions typically reserve charging off these loans as a last resort.



Other Real Estate Asset Quality

Similar to first mortgages, other real estate deteriorated year-over-year. These loans comprise revolving products — such as home equity lines of credit (HELOC) — that credit union members can tap for purchases, large and small.

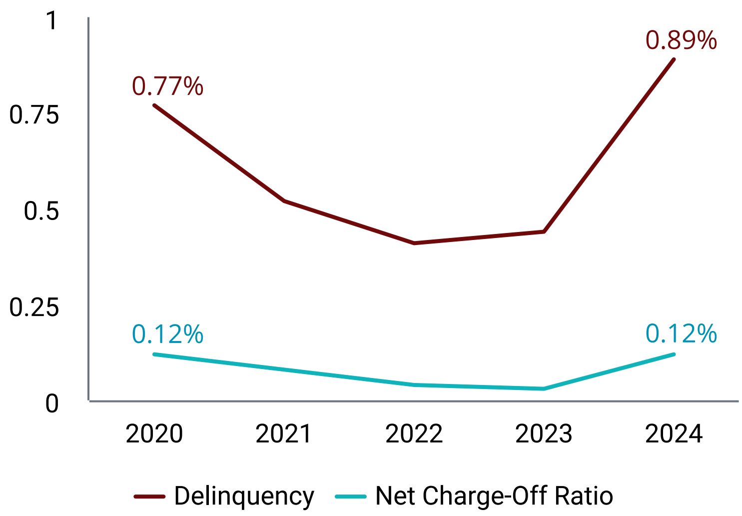
The nature of the collateral — the borrower's home — makes these loans difficult to charge-off; thus, the charge-off rate is extremely low. Further, because these borrowers own their home, they are generally more financially stable than other consumer loan borrowers and might be on a shorter path to repayment.



Commercial Asset Quality

Many credit unions have recently zeroed in on commercial lending as an area of growth. Unfortunately, delinquency in this part of the loan portfolio more than doubled year-over-year to 0.89%.

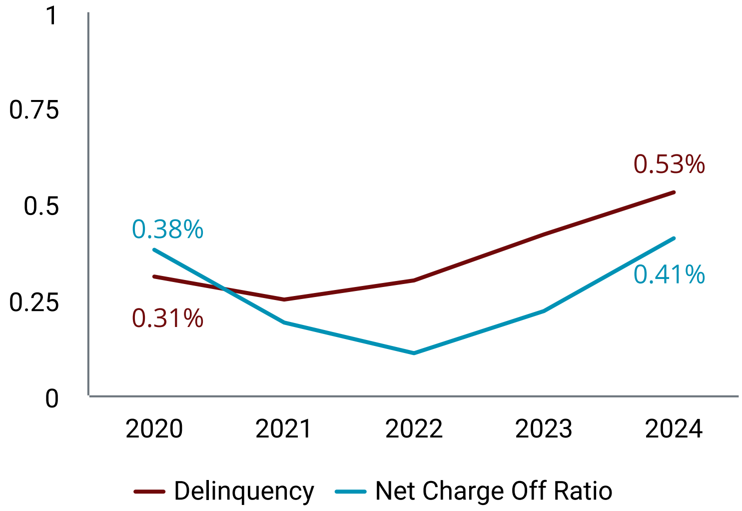
Commercial lending accounts for only 10.40% of total lending at credit unions. Still, this burgeoning business line shows signs of struggle as businesses face repricing loans and investment securities purchased during and prior to the pandemic. Charge-offs remain low, but credit unions must look for ways to support these businesses, which often reflect the health of their communities.



New Auto Asset Quality

New auto loan delinquency has gradually risen in line with interest rate increases the past few years. Auto lending is a cornerstone of most credit union lending, and although new auto loans comprised only 10.2% of the loan portfolio as of the third quarter, degradation in this area often speaks to the financial health of members.

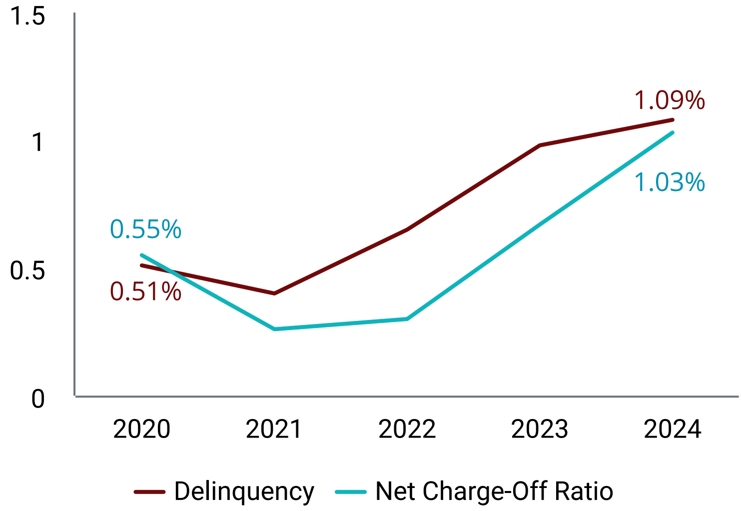
Alongside delinquency, net charge-offs have increased, too. Auto loans — especially indirect ones — are often easier to charge-off given their smaller balances, shorter terms, and collateral backing.



Used Auto Asset Quality

Like in new auto loans, asset quality for used auto loans has worsened, too. Delinquency ticked up 11 basis points to 1.09%. Used auto loans made up 19.6% of total loan balances for credit unions. A jump in delinquency here might impact the asset quality of the entire portfolio more so than in other loan types.

The net charge-off ratio for used auto loans increased 36 basis points year-over-year. The fact the net charge-off ratio is catching up to the delinquency rate implies credit unions don't expect payments to resume.



Credit Card Asset Quality

Credit card lending is a higher-risk product, and quality degradation was worse here than for any other loan type. Still, its popularity cannot be denied. Although credit cards comprised only 5.1% of total loan balances in the third quarter of 2024, their penetration rate was 17.9% and accounted for 28.3% of the total number of loans at credit unions.

Given that credit card loans are both low in dollar value and unlikely to recover, credit unions are often quicker to charge them off. This results in a dynamic wherein the net charge-off ratio exceeds the delinquency rate.