Credit Unions Reap Benefits of Conservative Investing During Economic Maelstrom

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Arizona's growth and construction-based economy has both benefitted and hurt financial services businesses such as credit unions.Credit unions in Arizona are sailing along under the radar during these turbulent economic times, thanks to conservative and prudent lending and investing practices.

But it doesn't mean they're not hurting. None have gone out of business nor are any clamoring for a bailout. They are not-for-profit institutions, so their executives don't feel the need to take risky steps in an effort to beef up the bottom line and impress stockholders.

The Arizona Credit Union League and Affiliates represents 55 credit unions and 1.6 million members throughout the state. Nationally, credit unions claim 90 million members.

Scott Earl, CEO of Arizona Credit Union League, explains the status of credit unions in Arizona. "We did not get into subprime mortgages," he says. "Basically we avoided the whole subprime mess, but we are feeling the fallout from that mess. When credit union members hurt, credit unions hurt."

Some credit unions are feeling more pain than others and do not have what Earl calls "positive bottom lines," but he adds: "That's what reserves were built up for - an economic downturn."

Though credit unions steered clear of offering subprime mortgages, that doesn't mean their members didn't seek such deals from a bank or other lending institution. Several credit unions are working with their members who are in a financial bind because of a subprime mortgage they cannot afford, and as a result might fall behind on making home equity or auto loan payments to a credit union. Or maybe they lost their job.

If a member can't make payments on a first mortgage, chances are there is no money for a line-of-credit second mortgage either.

"That's where credit unions feel the effect of the economy," Earl says.

Earl emphasizes that no member has ever lost any money in an Arizona credit union. Savings are insured by the National Credit Union Administration (NCUA), a federal agency similar to the Federal Deposit Insurance Corporation (FDIC) that oversees banks. Recently passed legislation by Congress increasing the amount covered by insurance to $250,000 from $100,000 also applies to credit unions, though scant mention was made initially of credit unions when President Bush signed the bill.

No access to federal bailout money

Credit unions have not taken an official position on the federal bailouts that keep emerging.

"Anything that keeps the economy moving is great with us," Earl says. "Who knows if what Congress and the administration have put together will work? It's a little scary from where I'm sitting. I'm not in a position to comment one way or another that it's the best thing for America."

Besides, under current guidelines, credit unions do not have access to bailout dollars, Earl says.

"I'm confident that credit unions are going to weather the storm just fine," he says.

Credit unions are not-for-profit financial cooperatives, which means they are not in business to make a profit, and do not issue stock or pay dividends to outside stockholders. Instead, Earl says, earnings are returned to credit union members in the form of lower loan rates, higher interest on deposits and lower fees, all of which are reasons why people join credit unions.

Credit unions came into existence during the Great Depression, when people didn't have access to credit. They are mutually-owned organizations and each member, regardless of the amount in a savings account, has one vote on policy issues and directors.

Although a majority of credit unions were employer based, that has changed over the years as companies come and go. Today, a credit union may include members from several employer groups, and virtually anyone could join. Because federal law says credit unions cannot serve the general public, people can qualify to join through their employer or organizational affiliations like churches or social groups.

Federal law also prohibits them from investing in stocks and bonds.

Credit unions, therefore, generally limit their investments to offerings by federal agencies, U.S. treasuries and federally insured jumbo certificates of deposit.

Credit unions have something else going for them - an exemption from federal income taxes, which Earl says enables them to offer consumers a better deal. “It’s a major bone of contention between the banking industry and credit unions,” he says. “It was enacted in 1937, and Congress has reaffirmed it because we stay true to our basic principles of one member, one vote. A credit union is a way that the federal government has provided access to credit for the average individual.”

Paul Stull, senior vice president of marketing for Arizona State Credit Union, says the reasons credit unions have avoided the headlines gets back to the profit motive.

“We don’t like to put our members in a loan they can’t afford,” Stull says. “In the subprime crisis, many people were given loans they couldn’t afford to pay back. Credit unions don’t like to sell a product just for the sake of selling a product. Our goal is to help people achieve their financial goals. That’s probably why we didn’t get into subprime lending. We felt it was not in our members’ best interest. Given the evidence, we probably made the right call.”

But Arizona State Credit Union, the largest state-chartered, federally insured credit union in Arizona with 24 locations statewide and 131,000 members, does indeed offer mortgages, mostly standard 30-year fixed interest products. During October, the credit union had its best mortgage origination month since 2005, approving

$20 million in first mortgages, Stull says.

The fact that banks tightened their lending practices could be a factor in renewed interest in the credit union, but Stull says his organization did not change its standards or loan requirements.

“We see it as a reflection that people like dealing with an organization they can reach out and touch,” Stull says. “When the going gets rough and harder financial times arrive, people make choices - they turn to value. They go to McDonald’s rather than Starbucks.”

Robin Romano, CEO of MariSol Federal Credit Union, says her organization, which has 6,900 members, mostly Maricopa County employees, is handling the economic downturn “with a lot of patience.

“We realize our members are hurting, and our attitude is, we try to help them work through the next year or two as best we can,” Romano says. “Our members are affected by the same things that everybody is affected by. Our credit union used a lot of common sense and followed good underwriting principles.”

But Romano adds: “I don’t say we don’t suffer losses, we certainly have. We have seen them increase this year.”

Losses have occurred with some mortgages and equity lines of credit. “We don’t do subprime mortgages or interest-only mortgages,” she says.

“We’re more prudent. Our board of directors felt very strongly that when people borrow money, they should pay back both principal and interest.

“Credit unions are owned by their members. It’s our members’ money, so we need to be pretty conservative in what we choose to do. Credit unions are a well-capitalized group. In general, I think everybody’s handling it pretty well. That’s why we build reserves. Not every year is a good year.”

Rob Swick, president and general manager of Hughes Federal Credit Union in Tucson, says his institution tries to maintain a balancing act. "We basically balance the best job we can do for any individual member versus protecting the credit union as a whole," Swick says. "That philosophy flows into everything we do. We have been able to avoid taking any excessive risks, and that's one difference between us as a credit union and a regular bank."

Hughes Federal, with 49,700 members, has seven locations in Tucson. Its original sponsor was Hughes Aircraft, which is now Raytheon. Swick says it's open to just about anyone living or working in Tucson.

Swick assesses the effect that being located in Arizona has on credit unions. "A minus is where we are geographically," he says. "Arizona is one of the hardest hit with the housing downturn. The plus side of that is that this is a growing area. People are still moving here. The housing market got a little too overheated. So much of the Arizona economy is based on population growth and housing. We have seen what happens when housing comes to a grinding halt. Now we're seeing more effect on retail. Real estate and car sales are down. We have members from all walks of life. Whatever affects our members ultimately affects us, but the bulk of our members are still doing well."

Stull of Arizona State Credit Union agrees that housing drives the economy in many states, including Arizona. "The demand for houses and interest in locating here is one of the biggest advantages Arizona has, he says. "People are still moving to Arizona.

"Local governments and the nation are facing pretty hard times," Stull says. "The challenge for 2009 is unemployment and how it will affect credit unions and the entire community."

Romano of MariSol sees Arizona's economy benefitting from an expected push toward alternative sources of energy. "There is a lot of talk about alternative energy being a cornerstone for revitalizing the national economy," she says. "If that's the case, Arizona is a great place to be, given that we have more than 330 days of sunshine."

Looking down the road, Swick of Hughes Federal wonders how long it will take for the economy to turn around, and what the effect of possibly new regulations will have on the financial community. "You never know what the impact may be, even with well-intentioned regulations," he says.

On the legislative front, Arizona credit unions generally opposed Proposition 200, the payday lending ballot proposal that was soundly defeated by voters last month.

Stull explains: "It's not our view that payday lending is bad. Predatory lending is bad. Look at their rates and it's hard to not categorize them as predatory. There is a role for short-term financing, and it should be provided at a reasonable rate."

One of the goals of credit unions, Stull says, is to increase the financial independence of their members, regardless of their status.

Payday loans that charge people as much as 400 percent interest do not raise anyone's level of financial independence, he says.

Earl of the Credit Union League says his organization encourages credit unions to come up with alternatives to payday loans that have better rates, are better for consumers, and don't "put them into a downward spiral, which payday loans will do."

"The Proposition 200 campaign was misleading the public, saying it would do away with the bad apples and reduce rates, none of which was really true," Earl says. "The closer it got to Election Day, the more that story was embellished by the payday lending industry. Credit union members needed to know the truth."

Austin De Bey, the league's vice president of government affairs, says credit unions opposed Prop 200 was because it was an industry writing a law for itself that would be virtually untouchable by the Legislature.

He says he'll be watchful for any attempts to revive the payday lending issue at the Legislature in 2009.

“Maybe the financial crisis may cause the Legislature to look at the financial services industry,” De Bey says. “We need to emphasize our differences and that we did not play a role in this economic crisis we are in. We’re just as much a victim as any other small business out there.”

But De Bey emphasizes: “We’ve got money to lend to small businesses - they’re the economic driver in our country.”