alloya

CAPITAL MARKETS *monthly*

VOL 1 | FEBRUARY 2023

2022: THE YEAR OF THE CRUNCH

GENERAL MARKET OVERVIEW

What a time to be alive! No less than a year ago, credit unions sought outlets for their historically high levels of liquidity. The influx of deposits from governmental relief programs left the industry asking, "What should we do with all this money?!"

As good financial stewards, most credit unions invested their funds and originated loans for their members. But as loan applications continued to roll in, credit unions were generating loans at an unprecedented pace. Naturally, liquidity began to tighten, but there was little cause for concern thanks to the still-solid deposit base… until the unthinkable happened: a liquidity exodus. As fast as liquidity had poured in, it suddenly began to pour out.

The reasons were numerous. Some members were chasing rates on certificates of deposit. Others were paying off bills and accumulated debt, while others were investing in cryptocurrencies (more on this later). Coincident with the deposit outflow, the Federal Reserve elevated its baseline interest rate. This decision halted borrowing demand, a good thing for most credit unions.

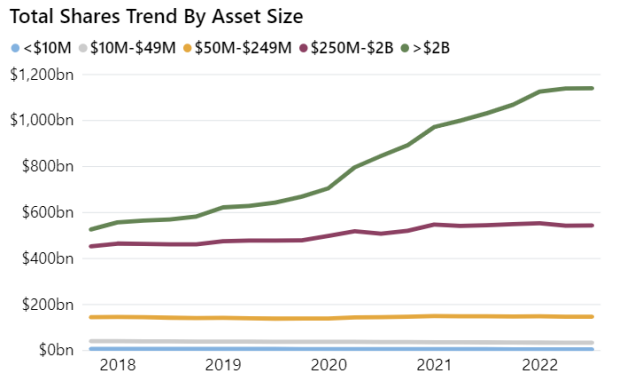
But with the positive came a negative. Investment rates were rising, and those that were held on credit union balance sheets were suddenly underwater. This prompted substantial losses on credit unions' investment portfolios – which are key to most credit unions' liquidity plans. See page two for a visual depiction of where overall liquidity and investment portfolio equity stands.

So, what does this mean? It means we're all feeling the liquidity crunch, and we'll all make it through together – but not without some ingenuity, innovation and patience. *Continued on page 2*

Loans have experienced a sizable uptick over the last five years, and in 2022, outpaced share growth by a considerable margin. While the overall industry numbers in share growth have increased, it's only for credit unions with assets of $250 million and above. In fact, most credit unions have seen a stall or slight decrease in share growth. This change equates to a $9 billion net decrease in deposits for credit unions with assets of $49 million or less. These loan and share growth trends have had a huge impact on credit unions of that size.

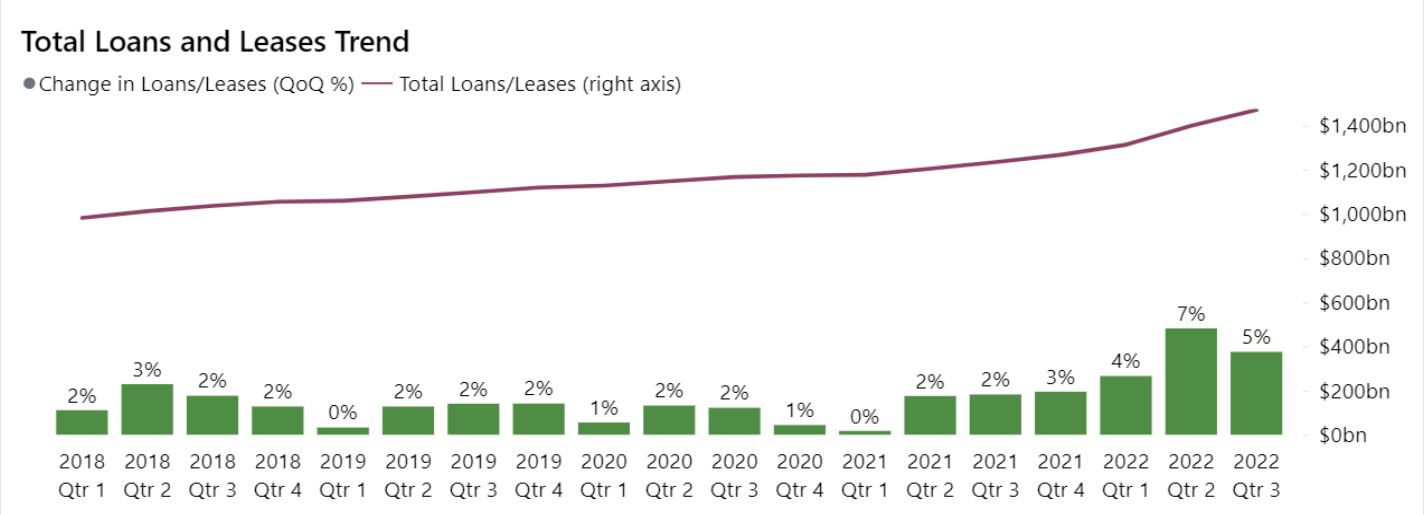
5 Year Change in Total Loans & Leases

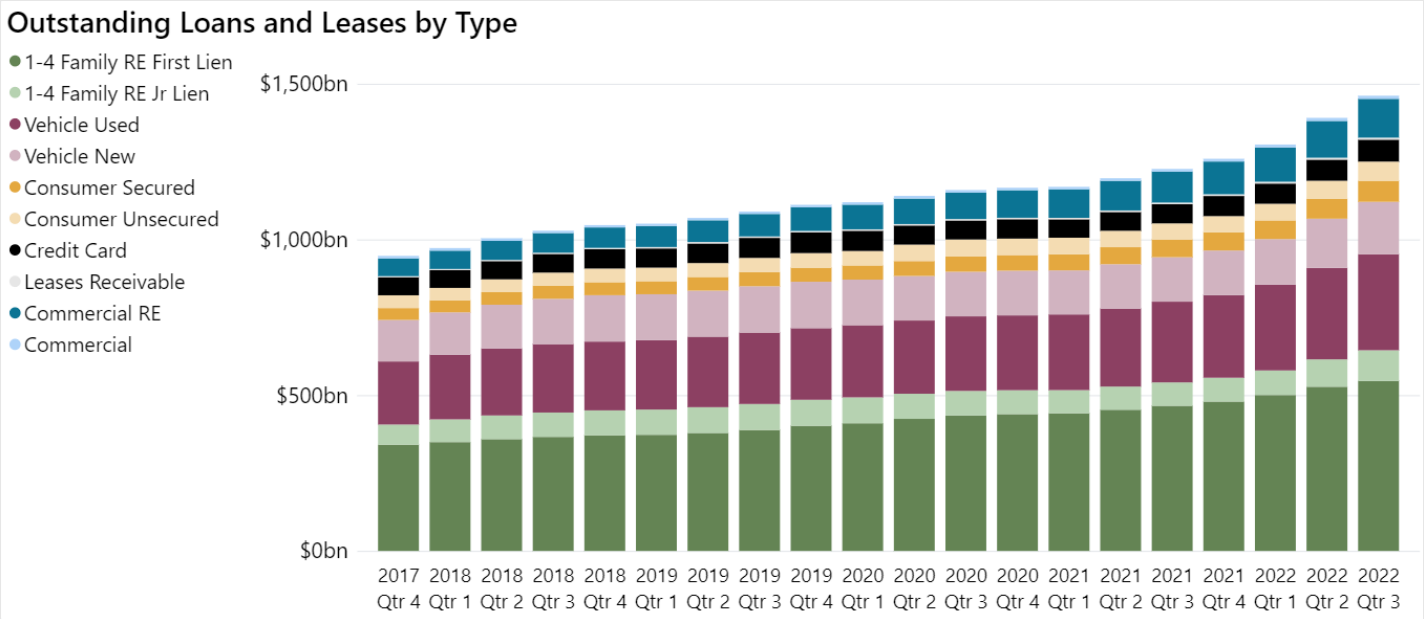
Current Total Loans & Leases	$1,472bn
$ Change	$504bn
% Change	▲ 52%



5 Year Change in Shares by Assets Size

Asset Size	5 Yr $ Change	5 Yr % Change
<$10M	($2bn)	▼ -36%
$10M-$49M	($7bn)	▼ -18%
$50M-$249M	$2bn	▲ 1%
$250M-$2B	$91bn	▲ 20%
>$2B	$614bn	▲ 117%



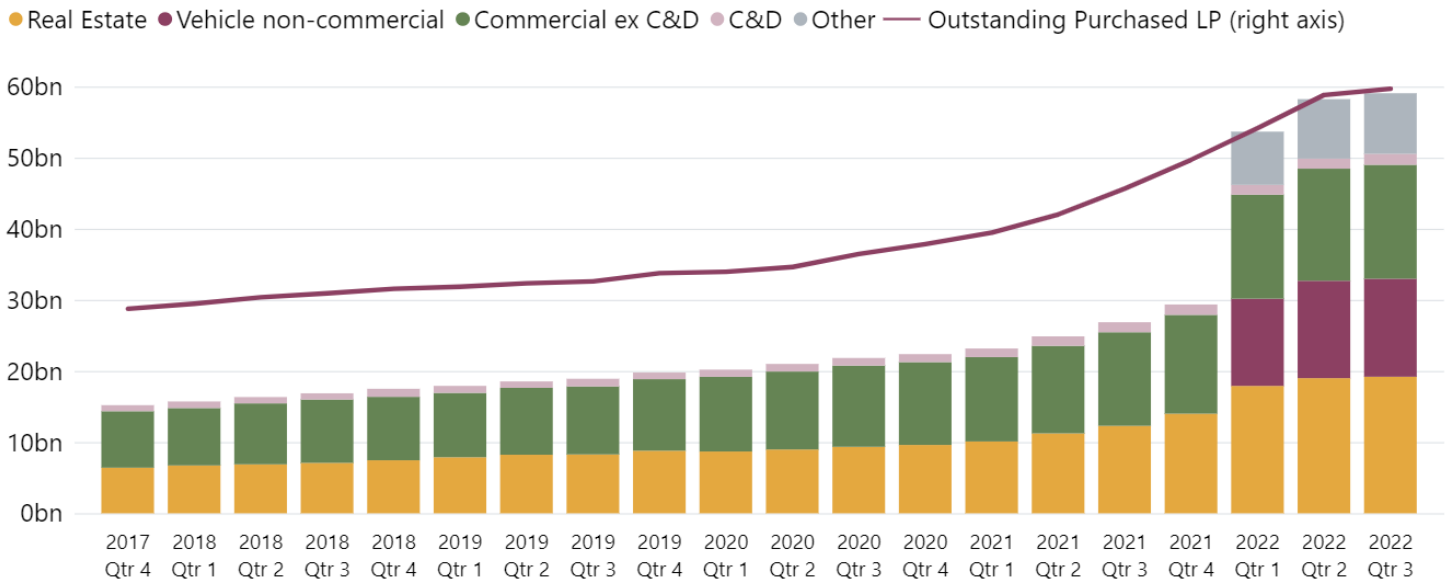


Historically, credit unions have leveraged loan participations to help manage their liquidity levels and balance sheet health. At present, over 2,000 credit unions have loan participations outstanding – a 13% increase from five years ago!

There are over $60 billion in outstanding purchased loan participations as of September 30, 2022. An incredible number by any measure.

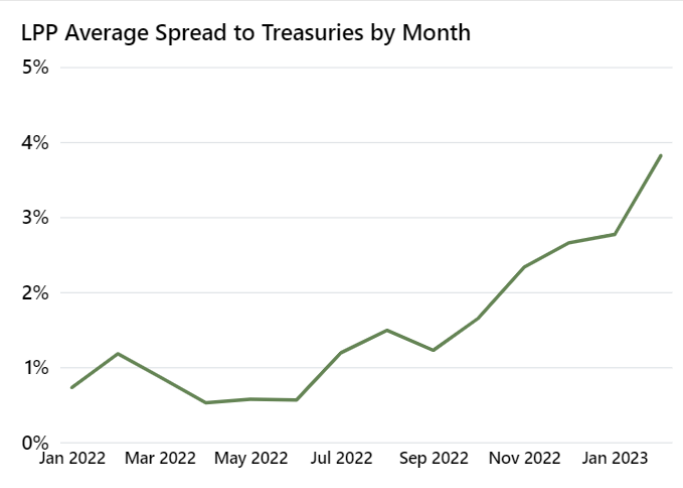
	2022-09
CU's with LP Outstanding	2078
CU's with LP Purchased	1964
CU's with LP Sold	854
5 Yr Change in # of CU's with LP	▲ 240
5 Yr Change in % of CU's with LP	▲ 13%
LP Purchased Outstanding	$60bn
5 Yr $ Change in LP Purchased Outstanding	▲ $31bn
5 Yr % Change in LP Purchased Outstanding	▲ 108%

Total Outstanding Balance of Purchased Loan Participations & Select Type Detail



LP MARKET OVERVIEW

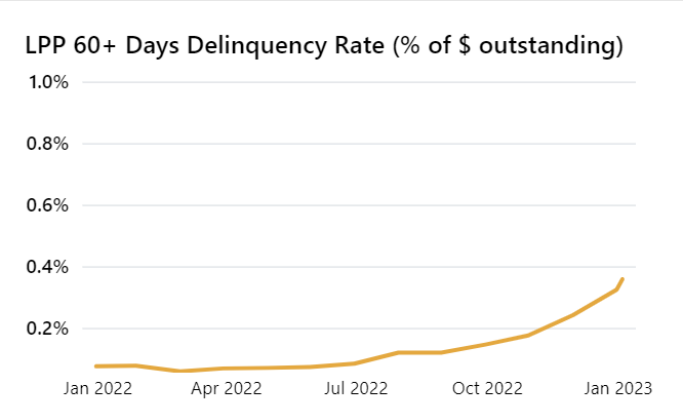
Loan participations are a microcosm of the credit union capital market space in general. A year ago, a credit union could get their hands on practically any type of loan they wanted. As credit unions were making loans at a historic pace, they were selling them just as quickly. Because there was ample cash in the system, investors were happy to purchase those participations at reduced spreads simply to pick up a rate over a comparable investment.

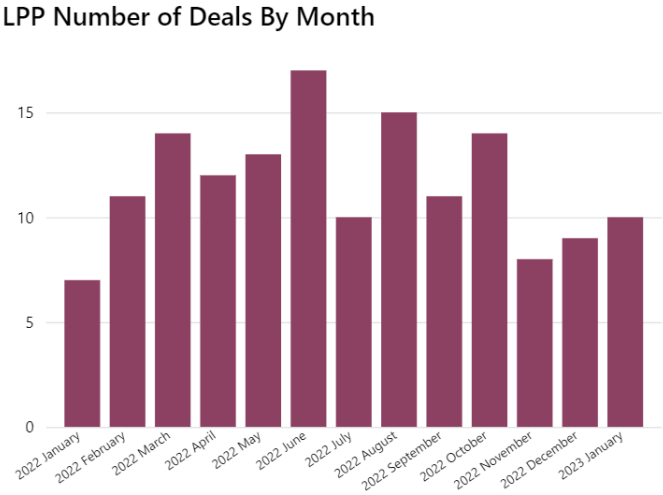


Spreads have widened by almost 300% in just six months!

Then, the tides turned. Investment yields picked up, liquidity left the market, and seemingly overnight, so did every loan participation investor! Sellers started dropping their prices, and yields and spreads widened to levels not seen in a decade.

While many see a recession looming, credit quality has remained strong. Delinquencies and charge-offs for sold loan participations have remained below projections on average. While investors will understandably worry about a decrease in credit quality, historically speaking, credit union loans have performed incredibly well in down economic environments. With that said, you can see below that delinquencies have picked up in the beginning of 2023, although still below 40 basis points in total.



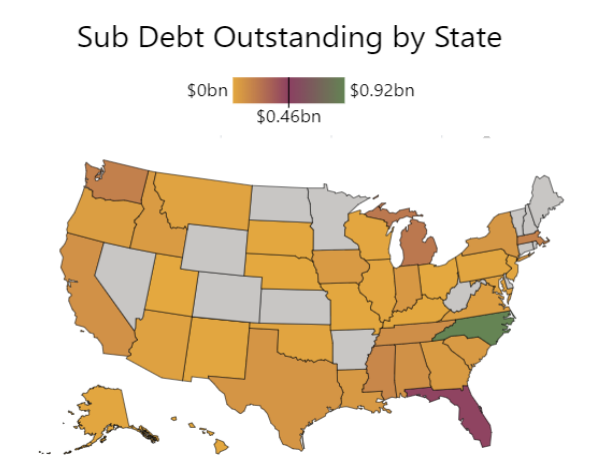


Since yields are widening and more credit unions are utilizing loan participations as a balance sheet tool, Alloya's Loan Participation Platform saw an average of 10 deals per month over the past quarter. This is slightly below our historical numbers, but a solid indicator of credit union interest in loan participations – despite tightened liquidity across the board.

SUB DEBT MARKET OVERVIEW

New to credit unions in 2022 was the increased opportunity to issue and invest in subordinated debt. While credit unions always had the opportunity to issue and invest in secondary capital, new regulation by the NCUA opened new doors in 2022.

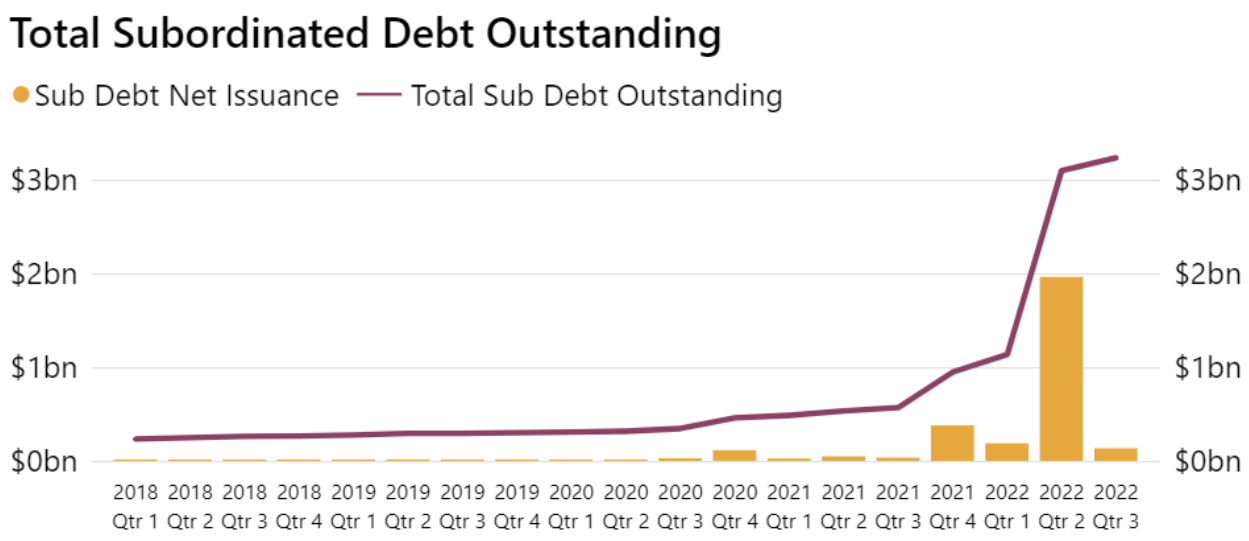
As we know, rates were low in early 2022, which made issuing subordinated debt a relatively cheap endeavor. And because of the excess liquidity at the time, investors were at the ready to pick up great yields compared to alternatives, while also helping out a fellow credit union in the process.



Just as it happened with loan participations, the market turned on a dime. With the Fed raising rates and investment yields picking up, subordinated debt issuers had to adjust to make their offers attractive. This nearly doubled the issuing rate and made capital far more expensive.

In general, credit unions have been slow to invest in credit union-issued subordinated debt. The relatively low level of inventory coupled with burdensome regulatory restrictions left credit unions feeling reluctant.

The current subordinated debt market is slow but starting to reenergize. A couple of credit unions have been approved to issue but are biding their time for other strategic initiatives. Potential investors should utilize this lull to prepare to leverage deals that come available over the next couple of years while rates are still high. *Continued on page 6*



SUB DEBT MARKET OVERVIEW

Recent credit union subordinated debt issuances came in at 7.75% and 8%, respectively. The graph above and chart below show recent rate issuances based on size and ratings for both bank and credit union subordinated debt. Like all other opportunities, spreads have widened considerably over the past 12 months. That said, we believe the sub debt market has started to stabilize and will likely fall soon. Credit union issuances tend to lag the overall market by a couple of months as seen over the past year.

	2017-12	2018-12	2019-12	2020-12	2021-12	2022-09
# of CU's with Sub Debt	70	66	68	80	106	142
Sub Debt Outstanding	$223M	$265M	$301M	$460M	$948M	$3,232M
Combined Sub Debt as % of NW	9.8%	10.1%	9.2%	8.8%	11.9%	20.3%
AVG Assets Size of Issuing CU's	$344M	$400M	$486M	$698M	$757M	$1,033M
AVG Net Worth Ratio of Issuing CU's	10.4%	9.7%	9.8%	9.2%	10.4%	12.4%

Issuance Size	IG Egan Jones	Kroll BBB-	Kroll BBB	Kroll BBB+	Unrated
50MM	7.75% +/-	7.75% +/-	7.75% +/-	7.75% +/-	**7.75%- 8.25% +/-**
50MM-100MM	7.75% +/-	7.75% +/-	7.75% +/-	7.75% +/-	
100MM+	7.75% +/-	7.75% +/-	7.75% +/-	7.75% +/-	

WHERE TO FROM HERE?

We are excited to continue building upon our capital market insights for credit unions. The creation of this new monthly report is a baby step. The capital markets are vast, which makes conveying the information daunting. With that in mind, we will maintain a monthly flow within a quarterly rhythm.

Each month's report will feature discussion about the loan participation and subordinated debt markets. From there, our focus will fluctuate from month to month. This month, we zeroed in on deposit and loan balances. Next month, we will concentrate on wholesale funding and liquidity trends. In April, we will discuss investment trends at credit unions and the relative value of those investments for any credit unions with liquidity. We'll return to deposits and loans come May, hopefully with Q1 data to share!

CONCLUSION

Alloya Corporate Federal Credit Union and Alloya Investment Services, LLC are at the forefront of the capital markets for credit unions. We were quite literally built to help credit unions gain access to liquidity sources that were not previously available, and to provide investment vehicles for credit unions when they have excess liquidity. Our mission remains the same today as it did so many decades ago.