Heartland
Credit Union Association

Date: August 13, 2020

To: Chairwoman Julia Lynn & Committee Members
Special Committee on Economic Recovery

From: Stephanie Mullholland
Heartland Credit Union Association

Chairwoman Lynn and Members of the Committee,

Thank you for the opportunity to provide the committee with an overview of how COVID is impacting the financial sector and what your local credit unions have been doing to assist Kansans and small businesses in this economic recovery.

Heartland Credit Union Association represents 78 credit unions across the state, ranging from the smallest - Norwesco Credit Union, which is part of the ag co-op in St. Francis, Kansas - to the state's largest credit union - Meritrust in Wichita, which serves the employees of Spirit Aerosystems. More than 678,000 Kansans rely on a local credit union for not-for-profit financial services and loans.

Credit unions are not-for-profit cooperatives, created out of economic hard times.

Credit unions were formed on the verge of the Great Depression. When low- and middle-income Kansans were unable to find lending opportunities, they pooled their resources to form credit unions in order to lend to each other. As not-for-profit co-ops, credit unions are structured differently than for-profit institutions. Among those differences, credit unions:

- Return the earnings back to the consumers, instead of stockholders. Last year, credit unions returned more than $132 million to Kansans.
- Member-owned with each member, regardless of their economic status, having an equal vote.
- Managed by a volunteer board of directors that is elected by and from the membership. Board members are not paid and do not derive personal financial gain from serving.
- Prohibited from having outside investors or raising outside capital.
- Remain locally owned and operated, keeping Kansas money right here at home to be recirculated in the local economy.

Credit unions are working hard to help their members through this recovery.

Credit unions have effectively served Kansans through many economic downturns, ranging from recessions to the mortgage crisis to local industry layoffs. Some of the resources Kansas credit unions offer, and have continued to offer to aid their members in this recovery, include:

- **Paycheck Protection Program (PPP) loans.** While some credit unions are unable to offer business lending due to their asset size and/or federal barriers that keep them out of the commercial market, eligible credit unions quickly positioned themselves to assist borrowers with PPP loan applications. PPP loans underwritten by Kansas credit unions were primarily focused on small and locally-owned businesses, with the average loan amount at $30,532. Overall, the PPP has resulted in $5.01 billion in loans for 53,700 Kansas businesses, protecting a total of 521,000 Kansas jobs.

- **Low-cost lending options & Skip-A-Pay.** This has included 0% and low-interest hardship loans to assist Kansans who may have gone without a paycheck during the stay-at-home order. Many credit unions also offer Skip-a-Pay options, allowing Kansans to temporarily skip payments on auto, home and personal loans in order to preserve household resources during a layoff or job loss; and skip-a-pay options on business loans to help owners protect their working capital during the stay-at-home order.

- **Financing for those with less-than-perfect credit scores.** The small dollar loans and credit-builder loans that credit unions traditionally offer will have an increased purpose during the economic recovery. Kansas credit unions currently hold 86,614 loans for Kansans with credit scores of 640 or less, in addition to 26,984 small dollar loans, which are low-cost short-term alternatives to high-cost predatory loans.

- **Community support for local businesses.** Kansas credit unions donated marketing resources and created social media campaigns to encourage consumers to continue to support local businesses and restaurants throughout the stay-at-home order. Credit unions also worked to provide meals and other relief for first responders and their fellow essential businesses.

- **Financial counseling.** Credit unions place a strong emphasis on financial counseling and improving financial literacy. This includes household budgeting assistance, not-for-profit debt reduction/consolidation for members, and teaching financial workshops in K-12 schools. Last year, 35,361 families relied on their credit union for financial counseling. Kansas credit unions are reporting an increased demand for these services this year as families and small business owners work to adjust their budgets due to COVID and aircraft industry layoffs. Credit unions have also adapted classroom training to be available online so students can continue to receive financial literacy training if they are participating in virtual learning this coming school year.

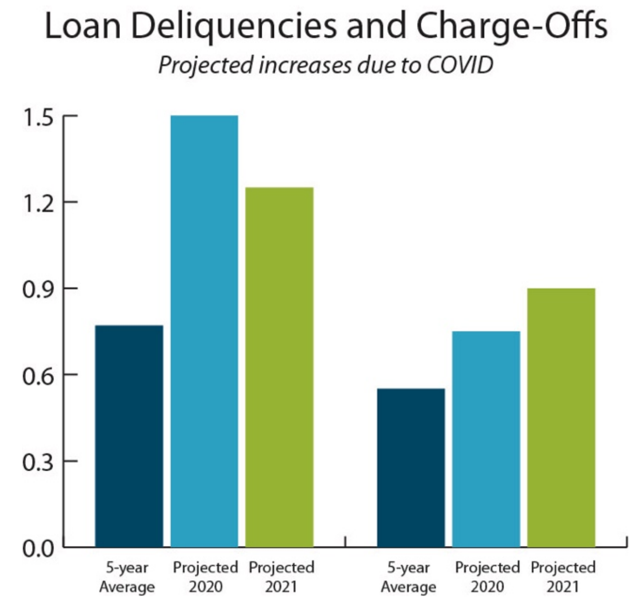
COVID has created short-term and future challenges for financial institutions.

As essential businesses, credit unions have remained open throughout the pandemic with lobbies open by appointment, and a greater focus on drive-thru, online, mobile and ATM services. Like most every business in the state, credit unions have faced increased costs associated with PPE equipment, lobby adaptions, mobile banking upgrades, more frequent stocking of ATMs, and cleaning supplies in order to protect their employees and consumers during this time. Smaller credit unions in particular, just like smaller businesses, have felt the impact of these additional costs. As cooperatives, credit unions of all sizes have been working together to share resources and obtain the needed supplies & equipment.

Moving forward, credit union economists are predicting a number of challenges for financial institutions for the remainder of 2020 and 2021:

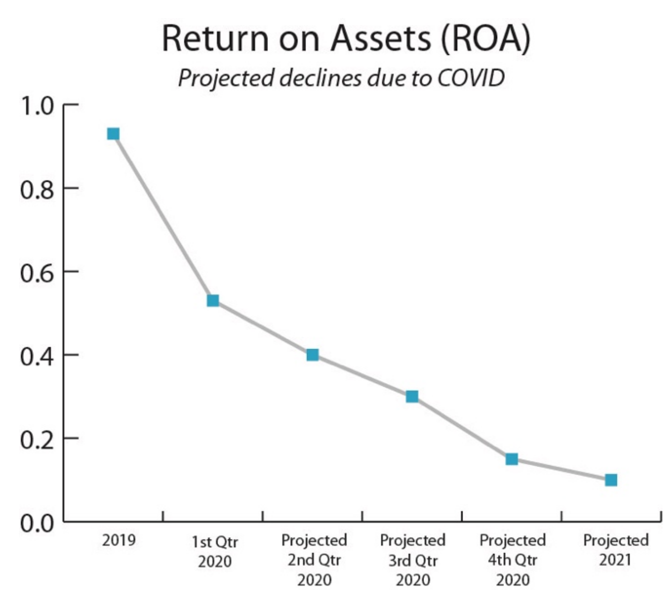
- **Increased loan delinquencies and charge-offs.** Credit unions anticipate loan delinquencies will increase to 1.50% in 2020 before falling slightly to 1.25% in 2021; and they expect charge-offs to increase to 0.75% in 2020, then to 0.90% in 2021. This is compared to what has been a 5-year average delinquency rate of 0.77% and average net charge-off rate of 0.55%. However, portfolio quality is not expected to deteriorate to the extent that it did during the Great Recession for several reasons:

  First, many credit unions are allowing Skip-a-Pays, debt restructuring, forbearance, and other means to provide repayment flexibility. Recent NCUA guidance makes it clear that many of these activities will not result in credit unions automatically categorizing loan modifications as Troubled Debt Restructurings (TDRs) and that will help to keep both delinquency and net charge-off rates lower than they would otherwise be. Second, very low interest rates and strong mortgage & housing markets should prevent significant deterioration in mortgage portfolios. Third, federal stimulus - including direct checks to consumers, expanded unemployment benefits, and PPP loans to small businesses - have helped Kansans remain current on their bills up to this point. Financial institutions may experience a significantly greater deterioration in portfolio quality than what is predicted if stimulus resources are discontinued.



- **Loan growth in some areas, but not in most.** In this low interest rate environment, people are buying and refinancing homes, creating a boom in mortgages. Continued mortgage lending is expected to support modest credit union loan growth in the immediate future. However, besides used auto loans, all other loan categories fell during the first five months of 2020 according to national monthly credit union estimates, including: credit cards (-9.2%), new auto loans (-3.0%), adjustable-rate mortgages (-3.0%), HELOCs (-1.7%) and other/commercial loans (-2.3%). New auto loans may see a boost in the third quarter when new model year cars are released as low interest rates have historically encouraged spending on big-ticket items.

- **Declining Return on Assets (ROA).** The combination of near-zero market interest rates and a shift to fast growth in low-yielding investments has translated into a decline in net interest income to 0.53%, according to NCUA's first-quarter credit union results. As many credit unions are waiving fees and offering emergency loans with significantly reduced interest rates, these efforts to benefit members do decrease earnings. However, earnings will be supported



slightly by strong mortgage refinancing and an increase in fees from mortgage sales to the secondary market. National credit union forecasts show ROA falling to 0.35% for 2020, a significant decline from a 0.93% ROA in 2019, but well above the Great Recession low of 0.18% in 2009. In 2021, earnings are expected to fall to 0.10% as losses mount and interest rate margins remain extremely tight, limiting returns on loan portfolios and investments. As member-owned cooperatives, a declining ROA means a decline in earnings for members.

While no credit union is immune, smaller credit unions and credit unions that serve members employed by heavily-impacted industries (aircraft, healthcare) will likely be most affected. However, credit unions overall are prepared for a significant slowdown in economic growth. Kansans tend to manage their credit unions conservatively and, therefore, have maintained strong balance sheets and are well-capitalized.

For most Kansas credit unions, the chosen course of action will be to remain even keel and let their capital do its work. Credit unions in general are taking the same approach they have carefully taken in prior economic downturns: “if there was ever a need to allow capital ratios to fall in order to meet members’ needs, this is it.”

Potential actions to assist in the economic recovery process.

Potential Federal-Level Solutions

Credit unions are working with other financial institutions on solutions at the federal level, including:

- **Simplify PPP Forgiveness Process for Small Businesses.** Legislation introduced at the federal level (HR 7777 and S 4117) would simplify the forgiveness process for businesses with PPP loans less than $150,000 and would remove burdensome regulatory hurdles for local business owners and their local lenders.

- **HEALS Act.** The Senate Republican COVID legislation, known as the HEALS Act, contains protections for local lenders who, in good faith, relied on documentation submitted by a borrower for a covered PPP loan. The Act also allows eligible businesses in need to take a second PPP loan if funds remain available, and creates a limited payroll tax credit (50%) for employers’ costs related to protecting employees from COVID.

- **Greater Flexibility to Help Consumers.** This includes extending the deadline for Troubled Debt Restructurings (TDRs) through the end of 2021 so that credit unions can continue to assist members with loan workouts and flexible restructuring. The deadline is currently scheduled to end Dec. 31, 2020, or within 60 days after the end of the national emergency.

Potential State-Level Solutions

State-level solutions this committee may wish to consider:

- **Evaluate demand for the new Small Business Working Capital grants.** The State Finance Council and SPARK committee recently approved use of $32.5 million of the state’s federal stimulus dollars for Small Business Working Capital grants. These grants are to be targeted toward Kansas businesses that have experienced a loss of revenue due to COVID, but did not qualify for or have not received other federal/state funding. While affordable lending options exist for many businesses that are struggling due to COVID, businesses that were already struggling prior to the onset of COVID may have more difficulty accessing financing. The Small Business Working Capital grants should provide some much-needed resources for these businesses. The committee may wish to monitor the demand for these grants and determine whether additional dollars could be invested in the program.

- **Remove barriers for consumers.** Projections indicate that hair salons, local retail shops, restaurants and bars are among those expected to be hit the hardest over the next several months. The committee may wish to evaluate barriers that limit consumer choice and access, particularly for small businesses and sole proprietorships.
    - Kansas law (KSA 17-2205) currently restricts which consumers can access lending from a not-for-profit credit union. In House Bill 2619, the Legislature sought to remove this arbitrary barrier. Though vetoed, we believe value remains in amending the state's Field of Membership restrictions, allowing consumers and small businesses the freedom to choose which type of financial institution best fits their needs.
    - There is an ongoing opportunity to ensure varied business types (LLCs, sole proprietorships, etc.) are eligible for new and existing programs. Recent regulatory guidance granting access for sole proprietorships to the Community Development Block Grant-CV program is to be commended. This ensures that the smallest of businesses and entrepreneurs are not left out.

- **Revisit creation of a low-interest loan program.** Earlier this year, the Legislature approved creation of an Economic Recovery Linked-Deposit Loan program (contained in House Bill 2619) that would make unused state idle funds available for small businesses and ag producers. HCUA worked with the Kansas Bankers Association and Farm Credit in supporting creation of this loan program. Though HB 2619 was ultimately vetoed, we believe a loan program of this kind or a loan guarantee program could be one more way to make low-interest financing available to struggling small business owners and ag producers.

Thank you for the opportunity to provide an overview to your committee. Credit unions look forward to being a resource to you, and partner with you, in assisting Kansas families and local businesses through this economic recovery.