THRIFT INDUSTRY HIGHLIGHTS

FIRST QUARTER 2005

Office of Thrift Supervision / May 18, 2005

SUMMARY

Thrift industry results in the first quarter 2005 continued to be characterized by record levels of earnings and equity capital, and overall strong credit quality. Profitability was strong and loan growth was solid over the quarter.

The interest rate environment proved challenging as the yield curve flattened further over the course of the first quarter. The industry's aggregate net interest margin declined despite loan portfolio growth as interest expense climbed at a faster pace than interest income. Mortgage originations continued at a solid pace over the first quarter, but were down from the prior quarter as higher mortgage interest rates over the quarter reduced mortgage origination and refinancing volumes.

Thrift industry assets increased by 16 percent for the year to $1.34 trillion. The number of thrifts supervised by OTS stood at 880 at the end of the first quarter and OTS supervised 492 U.S. domiciled holding company enterprises with approximately $6.9 trillion in consolidated assets. These enterprises owned 457 thrifts with total assets exceeding $1 trillion, or 80 percent of total thrift industry assets. In December 2004, OTS was determined to be an equivalent consolidated holding company supervisor by the United Kingdom's Financial Services Authority, in consultation with Commission Bancaire of France and BaFin of Germany, for General Electric's financial services arm, GE Capital Services, assuring proper coordination among various financial services regulators overseeing the activities of this diversified multinational financial services company.

Asset quality remained strong for all loan types over the first quarter and the overall level of credit quality in the thrift industry has remained good, with most loan types showing improvement in delinquencies from one year ago. Troubled assets (defined as noncurrent loans and repossessed assets) reached a record low rate in the first quarter. Loans past due by 30- to 89-days as a percentage of assets were lower from one year ago, and down from the fourth quarter. The industry's equity capital reached a new record level at the end of the first quarter and its equity capital ratio was unchanged from one year ago, but improved from the fourth quarter.

EARNINGS AND PROFITABILITY

Net income reached a record of $4.00 billion in the first quarter, up 20 percent from the year ago first quarter and up six percent from the prior quarter. This was the first time that quarterly income reached the $4 billion mark. The number of thrifts reporting losses in the first quarter was 69, down from 82 thrifts in the first quarter one year ago.

Profitability, as measured by return on average assets (ROA), was 1.22 percent in the first quarter, up from 1.19 percent in the comparable year ago quarter, and up five basis points from 1.17 percent in the fourth quarter. The median ROA declined to 0.72 percent in the first quarter from 0.73 percent in the first quarter one year ago, but was up from 0.71 percent in the prior quarter.

Return on average equity (ROE) climbed to 13.29 percent in the first quarter from 13.01 percent in the first quarter one year ago, and was up from 12.96 percent in the fourth quarter.

ANALYSIS OF ROA

Lower loan loss provisions and noninterest expense, and higher mortgage loan servicing fee income drove the first quarter improvement in ROA from the prior quarter. Partially offsetting the improvement in quarterly income were lower net interest margin, other fee income, and other noninterest income, and higher taxes.

In the first quarter, NIM was 286 basis points (or 2.86 percent of average assets), down two basis points from the comparable year ago quarter and four basis points from the prior quarter.

Loan loss provisions were 0.19 percent of average assets in the first quarter, up from 0.18 percent in the first quarter one year ago, but down from 0.26 percent in the prior quarter. The relatively low level of provisioning in the first quarter one year ago was due to some reversals of previously booked loss provisions as economic conditions and credit quality improved over the quarter. Loan loss provisions averaged 0.26 percent of average assets between 2001 and 2003, but have averaged 0.21 percent of average assets since the beginning of 2003, reflecting improved economic conditions and credit quality over the past two years.

Total fee income, including mortgage loan servicing fee income and other fee income, increased to 1.22 percent of average assets in the first quarter from 0.64 in the comparable year ago quarter, and was up from 1.18 percent in the fourth quarter. Since 2001, total fee income has been depressed by lower mortgage loan servicing fee income as a consequence of impairment charges on mortgage servicing assets by a number of thrifts. These impairment charges resulted from higher mortgage prepayments, which decreased the duration and cash flow of servicing assets. Servicing fee income improved to 0.23 percent of average assets in the first quarter, up from negative 0.26 percent in the first quarter one year ago, and from 0.13 percent in the prior quarter.

Other fee income was up nine basis points from the first quarter a year ago at 0.99 percent of average assets, but down from 1.05 percent in the prior quarter. Growth over the year came from increases in fee income from retail banking, trust activities, the sale of mutual funds and annuities, and loan servicing income from nonmortgage loans. Retail banking fees are generated from lending (activity fees, origination fees, insurance premiums, and penalty fees), and deposit taking (ATM charges, transaction account fees, and penalty fees).

Other noninterest income in the first quarter fell to 0.47 percent of average assets from 0.96 percent in the first quarter one year ago, and from 0.53 percent in the prior quarter. The decline in other noninterest income was due to lower gains from sales of assets over the quarter. Other noninterest income primarily includes gains on sales of assets and income from leasing office space. Other noninterest income is typically volatile since it includes realized gains and losses on assets held for sale and the results of balance sheet restructuring activities.

Noninterest expense increased to 2.46 percent of average assets in the first quarter from 2.44 percent in the first quarter a year ago, but was down from 2.54 percent in the prior quarter. General and administrative expense, the largest component of noninterest expense, climbed to 2.42 percent of average assets in the first quarter from 2.40 percent in the comparable year ago quarter.

Taxes were up two basis points from the comparable year ago quarter at 0.68 percent of average assets, and were up from 0.63 percent in the fourth quarter. Over the past two years, taxes have averaged 0.67 percent of average assets, or about 35 percent of pretax income.

MORTGAGE ORIGINATIONS

Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) in the first quarter total mortgage originations climbed to $161.0 billion from $148.8 billion in the first quarter one year ago, but were down from $176.6 billion in the prior quarter. First quarter 1-4 family mortgage originations by thrifts were $141.5 billion, up nine percent from $130.3 billion in the first quarter one year ago, but down eight percent from $154.1 billion in the prior quarter.

Thrifts accounted for approximately 24 percent of total 1-4 family originations nationwide in the first quarter of 2005,[1] up from 22 percent in the comparable year ago quarter. An estimated 50 percent of thrift originations were adjustable rate mortgages (ARMs) in the first quarter, up from 44 percent in the first quarter one year ago, but down from 62 percent in the prior quarter. In contrast, the ARM share for all lenders was 33 percent in the first quarter, 27 percent in the first quarter one year ago, and 34 percent in the fourth quarter.[2]

The volume of mortgage refinancing increased from the first quarter a year ago, but was down from the prior quarter as longer-term interest rates were higher in the first quarter. Refinancing activity accounted for 37 percent of thrift originations in the first quarter, up from 36 percent in the first quarter one year ago and in the prior quarter. Prior to 2004, Thrift Financial Report refinancing data included only loans where the reporting institution held the original mortgage. Thrifts now report mortgages refinanced from any original lender.

ASSET QUALITY

Asset quality improved over the year for most loan types. OTS is closely monitoring thrift loan performance and asset quality since a significant proportion of thrift loan portfolios are now recently originated - or "unseasoned" - loans. Moreover, newer loan types such as interest-only mortgages and the significant rise in home equity lines-of-credit are being given supervisory scrutiny since these loans have not been stressed through different economic cycles. Troubled assets, which consist of noncurrent loans and repossessed assets, reached a record low 0.46

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1 Total 1-4 family mortgage originations estimated by the Mortgage Bankers Association of America.

2 Data are from the Federal Housing Finance Board's monthly *Mortgage Interest Rate Survey*.

percent of assets at the end of the first quarter, down from 0.56 percent in the comparable year ago quarter. Repossessed assets decreased to 0.05 percent of assets from 0.08 percent of assets one year ago.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) fell to a record low rate of 0.41 percent of assets in the first quarter, down from 0.48 percent at the end the first quarter one year ago. Noncurrent loan rates for all loan types but consumer loans improved over the year. Mortgages on 1-4 family dwellings and multifamily mortgages are the mainstay of the thrift industry and together make up over half of thrift assets. The industry's concentration in this sector accounts for its overall strong credit quality. Noncurrent loan rates for 1-4 family loans were 0.49 percent of all 1-4 family loans at the end of the first quarter, down from 0.63 percent one year ago. Noncurrent multifamily loans decreased to 0.08 percent of all multifamily loans from 0.21 percent one year ago.

Noncurrent nonresidential mortgages fell to 0.68 percent of all nonresidential mortgages from 0.93 percent one year ago. Noncurrent construction and land loans were 0.70 percent of all construction and land loans, down from 0.94 percent one year ago. Noncurrent commercial loans fell to 1.30 percent of all commercial loans at the end of the first quarter from 1.43 percent a year ago. Noncurrent consumer loans increased from 0.70 percent of all consumer loans one year ago to 0.75 percent at the end of the first quarter.

Loans past due by 30 to 89 days were lower over the year for all loan types but consumer and commercial loans. Rising delinquencies of loans 30 to 89 days past due can signal that thrifts may experience higher levels of troubled assets in the future. The highest past due rates occurred in consumer loans. Total loans past due by 30 to 89 days at the end of the first quarter were $7.1 billion, or 0.53 percent of assets compared to $6.4 billion, or 0.56 percent of assets, one year ago, and $7.3 billion, or 0.56 percent of assets, in the fourth quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased by 15.8 percent over the year to $1.34 trillion from $1.16 trillion a year ago. Thrifts remain focused on residential mortgage lending, with 56.3 percent of assets invested in 1-4 family mortgage loans at the end of the first quarter, up from 52.1 percent one year ago. Of these 1-4 family mortgage loans, 11 percent are home equity lines of credit, up from nine percent of 1-4 family mortgages in the first quarter one yea ago. Holdings of consumer loans fell slightly over the year to 5.8 percent of assets from 5.9 percent a year ago, and multifamily mortgages were down over the year to 4.7 percent of assets from 4.9 percent. Commercial loans increased over the year to 3.0 percent of assets.

Deposits and escrows grew by 13.2 percent over the year to $785 billion from $693 billion a year ago. As a percentage of total assets, deposits and escrows decreased to 58.5 percent from 59.9 percent one year ago. Federal Home Loan Bank advances fell to 18.0 percent of assets at the end of the first quarter from 18.2 percent one year ago.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At year-end, over 99 percent of the industry exceeded well-capitalized standards. Equity capital at the end of the first quarter was 9.18 percent of assets, unchanged from the first quarter one year ago. Capital growth over the year resulted from growth in retained earnings and new capital brought into the industry. One thrift was less than adequately capitalized at the end of the first quarter.

PROBLEM THRIFTS

As the thrift industry continued to perform at or near record levels over the past year, the number of problem thrifts has remained at a low level. Problem thrifts - those with composite examination ratings of 4 or 5 - increased by one over the year to eight. Assets of problem thrifts were $1.6 billion at the end of the first quarter, up from $585 million a year ago and from $709 million in the fourth quarter.

Thrifts with composite ratings of 3 declined to 53 at the end of the first quarter from 55 one year ago, but were up from 52 in the prior quarter. Thrifts with composite ratings of 3 exhibit some weaknesses that may range from moderate to severe in one or more of the ratings components. These institutions are more vulnerable to adverse conditions and require more supervisory attention. All of the 3-rated thrifts at the end of the first quarter were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

Mergers and acquisitions continued to reduce the number of thrifts. Financial institutions' charter choice decisions resulted in two existing institutions coming under OTS supervision in the first quarter, two new institutions choosing a thrift charter, and one thrift leaving OTS supervision converting to a state savings bank. During the quarter, three OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired five thrifts. One thrift left through voluntary dissolution.