THRIFT INDUSTRY HIGHLIGHTS

SECOND QUARTER 2003

Office of Thrift Supervision / August 20, 2003

SUMMARY

The thrift industry reported very strong results for the second quarter. New records were set for quarterly earnings, return on average assets (ROA), equity capital, and mortgage originations, refinancings, and sales volumes.

Strength in earnings and profitability continued to be attributable to the favorable interest rate environment. Over the quarter, the yield curve remained steep, but lower longer-term interest rates reduced net interest margins at many thrifts. The low interest rate environment continued to fuel the mortgage market boom. A decline in mortgage interest rates over the quarter to the lowest rates in four decades generated record levels of mortgage originations, refinancings, and sales. Since the end of the second quarter, longer-term interest rates, including mortgage interest rates, have jumped sharply. As a result, demand for mortgages, including refinancing activity, has fallen to the lowest level of the year. Institutions will need to carefully manage their portfolios and operations as mortgage volumes are forecast to decline in the coming quarters.

The industry's equity capital reached a record level at the end of the second quarter and its equity capital ratio was slightly below the record set in the fourth quarter 2002. Asset quality remained strong for all loan types over the quarter and the overall level of credit quality in the thrift industry has remained good, although delinquencies were higher for some loan types in the second quarter. Troubled assets (defined as noncurrent loans and repossessed assets) as a percentage of total assets were lower at the end of the second quarter, and loans past due by 30- to 89-days were higher. The strength in thrift portfolios is due, in part, to the industry's concentration in residential lending and its limited exposure to commercial lending and nonmortgage consumer lending.

EARNINGS AND PROFITABILITY

Profitability, as measured by ROA, reached a record 1.34 percent in the second quarter, up from 1.18 percent in the second quarter a year ago, and up from the previous record of 1.30 percent in the prior quarter. Median ROA also reached a record 0.82 percent in the second quarter, up one basis point over the comparable year ago and prior quarters. Return on average equity (ROE) was 14.72 percent in the second quarter, up from 13.16 percent in the comparable year ago quarter, and from 14.70 percent in the prior quarter.

Net income reached a record of $3.54 billion in the second quarter; only the third time thrift industry net income has topped the $3 billion mark. Second quarter net income was up 25 percent from $2.84 billion in the second quarter one year ago, and up six percent from the previous record of $3.33 billion in the prior quarter. The number of thrifts reporting losses in the second quarter was 61, the lowest level in five years and down from 96 thrifts in the second quarter one year ago. Aggregate losses of $60 million for those thrifts reporting losses in the second quarter were up from $35 million in the prior quarter, the lowest losses since the industry began quarterly data reporting in 1984.

ANALYSIS OF ROA

Improvement in second quarter ROA from the comparable year ago quarter came chiefly from lower loan loss provisions, lower impairment charges for mortgage servicing rights, higher fee income, and higher other noninterest income. Partially offsetting this improvement were a lower net interest margin, higher noninterest expense, and higher taxes.

In the second quarter, NIM decreased to 294 basis points (or 2.94 percent of average assets) from 311 basis points in the second quarter one year ago, and from 299 basis points in the prior quarter. The decline in NIM from one year ago resulted from the repricing of and investment in assets at lower yields.

Loss provisions on interest-bearing assets were down to 0.25 percent of average assets in the second quarter from 0.35 percent in the second quarter one year ago, and from 0.26 percent in the prior quarter.

Total fee income, including mortgage loan servicing fee income and other fee income, increased to 0.55 percent of average assets in the second quarter from 0.37 percent in the second quarter one year ago, but was down from 0.66 percent in the prior 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 portfolios 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 was a negative 0.39 percent of average assets in the second quarter, an improvement of eight basis points from the second quarter one year ago, but down 15 basis points from the prior quarter.

On the positive side, other fee income was up ten basis points over the year to 0.94 percent of average assets in the second quarter. This growth came from increases in fees 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 second quarter climbed to 1.30 percent of average assets from 1.07 percent one year ago, and from 0.98 percent in the prior quarter due to gains from sales of assets over the quarter. Other noninterest income primarily includes gains on sales of assets, dividends on FHLB stock, and income from leasing office space. Other noninterest income can be 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 2.45 percent of average assets in the second quarter from 2.38 percent in the second quarter a year ago, and from 2.35 percent in the prior quarter. General and administrative expense, the largest component of noninterest expense, increased to 2.40 percent of average assets in the second quarter from 2.32 percent in the comparable year ago quarter.

Taxes were higher in the second quarter at 0.75 percent of average assets, up from 0.63 percent in the comparable year ago quarter. Over the past two years, taxes have averaged 0.63 percent of average assets, or about 36 percent of pretax income.

MORTGAGE ORIGINATIONS

Total mortgage originations (which include multifamily and nonresidential mortgages) topped the $200 billion mark for the first time in the second quarter, reaching a record $215.1 billion. This was up sharply from $109.2 billion in the second quarter a year ago, and from $176.2 billion in the prior quarter. Home sales and mortgage loan demand remained at or near record levels over the quarter as mortgage interest rates remained at four decade lows. Second quarter 1-4 family mortgage originations by thrifts were a record $195.7 billion, up 111 percent from $92.8 billion in the comparable year ago quarter, and up 22 percent from $160.2 billion originated in the prior quarter.

Thrifts' estimated share of all 1-4 family originations[1] was 21 percent of total 1-4 family originations in the second quarter, up from 19 percent in the comparable year ago quarter. An estimated 21 percent of thrift originations were ARMs in the second quarter, down from 43 percent in the second quarter a year ago and from 26 percent in the prior quarter. In contrast, the ARMs share for all lenders was 15 percent in the second quarter, 20 percent in the second quarter one year ago, and 16 percent in the prior quarter.[2] The lower ARMs shares over the year reflected the decline in longer-term mortgage interest rates.

In the second quarter, the volume of mortgage refinancing climbed sharply to a new record for the fourth consecutive quarter as mortgage interest rates eased further. Refinancing activity (counting only those mortgages refinanced with the same lender) accounted for 54 percent of thrift originations in the second quarter, up from 30 percent in the second quarter one year ago, but down from 59 percent in the prior quarter.

ASSET QUALITY

Asset quality remained strong for all loan types in the second quarter and the overall level of credit quality in the thrift industry has remained good. Troubled assets, which consist of noncurrent loans and repossessed assets, were 0.69 percent of assets at the end of the second quarter, down from 0.70 percent one year ago, and from 0.72 percent in the prior quarter. Repossessed assets were down one basis point over the year, and unchanged from the prior quarter at 0.09 percent of assets.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) were unchanged from a year ago at 0.60 percent of assets, and down from 0.63 percent in the prior quarter. Noncurrent rates (as a percentage of total loan type) moved higher from a year ago for 1-4 family mortgage loans and consumer loans while noncurrent rates moved lower for other loan types. 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 strong credit quality. Noncurrent loan rates on 1-4 family mortgages were

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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*.

up two basis points from one year ago to 0.84 percent of all 1-4 family mortgage loans, but down two basis points from 0.86 percent in the prior quarter. Noncurrent multifamily loans were 0.19 percent of all multifamily loans at the end of the second quarter, down from 0.21 percent one year ago.

Noncurrent nonresidential mortgages decreased to 1.14 percent of all nonresidential mortgages from 1.35 percent one year ago. Noncurrent construction and land loans were 1.15 percent of all construction and land loans, down from 1.66 percent one year ago. Noncurrent commercial loans fell to 1.96 percent of all commercial loans at the end of the second quarter from 2.52 percent a year ago. Noncurrent consumer loans were 0.66 percent of all consumer loans at the end of the second quarter, up from 0.50 percent one year ago.

Loans past due by 30 to 89 days were higher for 1-4 family mortgages and consumer loans, unchanged for multifamily mortgages, and improved for other loan types. Rising delinquencies of loans 30 to 89 days past due are worrisome because they may signal higher levels of troubled assets going forward. The highest past due rates occurred in the consumer, commercial, and construction and land loan sectors. Total loans past due by 30 to 89 days at the end of the second quarter were $7.8 billion, or 0.73 percent of assets, compared to $6.2 billion, or 0.64 percent of assets, one year ago, and to $7.2 billion, or 0.69 percent of assets, in the prior quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased at a 10.4 percent rate over the year to $1.06 trillion from $964 billion in the comparable year ago quarter. Thrifts remain focused on residential mortgage lending, with 48.5 percent of total assets invested in 1-4 family mortgage loans at the end of the second quarter, up from 46.6 percent a year ago. Multifamily mortgages stood at 4.8 percent of total assets at the end of the second quarter, unchanged from one year ago. Holdings of construction and land loans and consumer loans declined slightly over the year to 2.7 percent and 6.3 percent of total assets, respectively.

Deposits grew over the year by 9.3 percent to $617 billion, up from $565 billion one year ago. As a percentage of total assets, deposits fell to 58.0 percent from 58.5 percent in the second quarter a year ago. Federal Home Loan Bank advances declined to 15.4 percent of assets in the second quarter from 18.6 percent a year ago.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At the end of the second quarter, over 99 percent of the industry exceeded well-capitalized standards. In the second quarter, the industry's equity capital reached a record $97 billion and the equity capital ratio stood at 9.2 percent of assets, unchanged from the second quarter a year ago. Growth in capital levels over the year resulted from additional retained earnings, new capital brought into the industry, and unrealized gains on securities available-for-sale. No thrifts were less than adequately capitalized at the end of the second quarter for the second consecutive quarter. Last quarter was the first time that no thrifts were less than adequately capitalized since thrifts began reporting capital under the prompt corrective action provisions of FDICIA in 1992.

PROBLEM THRIFTS

Despite the slow economy and concerns about credit quality in the financial services industry, the thrift industry continued to perform extremely well over the second quarter, and the number of problem thrifts remained at a low level. Problem thrifts - those with composite examination ratings of 4 or 5 - fell by ten over the year to eight, and were down by four over the quarter. Assets of problem thrifts declined to $720 million at the end of the second quarter from $3.5

billion in the second quarter a year ago, and from $2.4 billion in the prior quarter. Both the number and assets of problem thrifts were the lowest since OTS was founded in 1989.

The number of thrifts with composite ratings of 3 was unchanged from the prior quarter at 71, and down from 74 one year ago. 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. Of the 71 thrifts rated 3, 97 percent were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

During the second quarter, 13 thrifts left OTS supervision, down from 14 thrifts in the prior quarter. Eight exits were due to bank acquisitions. There were three charter conversions, one thrift-to-thrift merger, and one voluntary dissolution. Two new entrants began operations in the second quarter. Both new entrants were charter conversions.

The number of institutions supervised by OTS fell to 947 at the end of the second quarter from 958 in the prior quarter and 995 one year ago.