



THRIFT INDUSTRY HIGHLIGHTS THIRD QUARTER 2006

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SUMMARY

The nation's thrift industry reported generally stable earnings and profitability for the third quarter 2006. Earnings and profitability, while strong by historical standards, were down from recent highs and continued to be stressed by an interest rate environment characterized by a flat to inverted yield curve. Loan and retail deposit growth were strong in the third quarter and contributed to solid asset growth. Asset quality also remained strong, but delinquencies have increased from recent record low levels. The industry's aggregate net interest margin decreased by 15 basis points from the prior quarter. Total mortgage origination volume for the quarter was down 16 percent from the third quarter one year ago, and up less than one percent from the prior quarter as existing and new home sales volumes declined.

Thrift industry assets increased by 14 percent from the third quarter one year ago to \$1.63 trillion. The number of thrifts supervised by OTS stood at 853 at the end of the third quarter. In addition, OTS supervised 481 holding company enterprises with approximately \$7.7 trillion in U.S. domiciled consolidated assets. These enterprises owned 453 thrifts with total assets of \$1.3 trillion, or 78 percent of total thrift industry assets.

Asset quality remained strong for all loan types over the third quarter and the overall level of credit quality in the thrift industry has remained good. Despite the sustained strength in industry asset quality, delinquencies of most major loan types were up from the record low rates of one year ago. Loans past due by 30- to 89-days as a percentage of assets reached a record low at the end of the first quarter 2005, but have increased in subsequent quarters and were higher from one year ago at the end of the third quarter 2006. The industry's equity capital level reached a record level at the end of the third quarter and, as a percentage of assets, its equity capital ratio was up from the third quarter one year ago, but down slightly from the prior quarter.

EARNINGS AND PROFITABILITY

Net income was \$4.29 billion in the third quarter, up six percent from \$4.04 billion in the year ago third quarter, and up two percent from \$4.21 billion in the prior quarter.

This was the seventh time and seventh consecutive quarter that quarterly income topped the \$4 billion mark. The number of thrifts reporting losses in the third quarter was 93, up from 80 thrifts in the third quarter one year ago.

Profitability, as measured by return on average assets (ROA), was 1.08 percent in the third quarter, down from 1.15 percent in the comparable year ago quarter, and from 1.11 percent in the second quarter. The median ROA declined to 0.62 percent in the third quarter from 0.73 percent in the third quarter one year ago, and was down from 0.64 in the prior quarter.

Return on average equity (ROE) was 11.73 percent in the third quarter, down from 12.41 percent in the third quarter one year ago, and from 11.93 percent in the second quarter.

ANALYSIS OF ROA

Lower net interest margin and fee income and higher loan loss provisions drove the decrease in third quarter ROA from the prior quarter. Partially offsetting these negative impacts to quarterly profitability were higher other noninterest income, and lower noninterest expense and taxes.

In the third quarter, NIM decreased to 265 basis points (or 2.65 percent of average assets) from 276 basis points in the comparable quarter a year ago, and was down from 280 basis points in the prior quarter.

Loan loss provisions were 0.22 percent of average assets in the third quarter, up from 0.20 percent in the prior and comparable year ago quarters. Loan loss provisions averaged 0.26 percent of average assets between 2001 and 2003, but have generally trended lower since the beginning of 2003 reflecting improved economic conditions.

Total fee income, including mortgage loan servicing fee income and other fee income, decreased to 0.91 percent of average assets in the third quarter from 1.22 in the third quarter one year ago, and from 1.18 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 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 was a negative 0.05 percent of average assets in the third quarter, down from 0.16 percent in the third quarter one year ago, and from 0.10 percent in the prior quarter. Other fee income was down ten basis points from the third quarter one year ago to 0.96 percent of average assets, and was down from 1.08 percent in the prior quarter.

Other noninterest income in the third quarter climbed to 0.81 percent of average assets from 0.41 percent in the third quarter one year ago, and was up from 0.55 percent in the second 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 2.54 percent of average assets over the third quarter from 2.42 percent in the third quarter one year ago, but was down from 2.63 percent in the prior quarter. General and administrative expense, the largest component of noninterest expense, increased by ten basis points to 2.49 percent of average assets in the third quarter from 2.39 percent in the comparable year ago quarter.

Taxes were down nine basis points from the third quarter one year ago to 0.53 percent of average assets, and were down from 0.60 percent in the second quarter. Over the past two years, taxes have averaged 0.64 percent of average assets, or about 36 percent of pretax income.

MORTGAGE ORIGINATIONS

Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) in the third quarter fell to \$172.1 billion from \$204.2 billion in the third quarter one year ago, but were up slightly from \$171.1 billion in the prior quarter. Third quarter 1-4 family mortgage originations by thrifts were \$149.9 billion, down 17 percent from \$181.3 billion in the third quarter one year ago, but up one percent from the \$148.5 billion originated in the second quarter.

Thrifts accounted for approximately 24 percent of total 1-4 family originations nationwide in the third quarter of 2006,¹ up from 21 percent the prior and comparable year ago quarters. An estimated 26 percent of thrift originations were ARMs in the third quarter, down from 37 percent in the prior quarter, and from 43 percent in the comparable year ago quarter. In contrast, the ARM share for all lenders was estimated at 18 percent in the third quarter, 25 percent in the prior quarter, and 28 percent in the third quarter one year ago.²

The volume of mortgage refinancing was lower from the third quarter one year ago and from the prior quarter. Refinancing activity accounted for 27 percent of thrift originations in the third quarter, down from 33 percent in the third quarter one year ago, and from 31 percent in the prior quarter.

ASSET QUALITY

Asset quality within the industry remained strong over the third quarter, but delinquencies were up from recent record low levels. OTS is closely monitoring thrift

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*.

loan performance and asset quality since a significant proportion of thrift loan portfolios are 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 receiving additional supervisory scrutiny since these loans have not been stressed through different economic cycles. Troubled assets, which consist of noncurrent loans and repossessed assets, were up two basis points from the prior quarter at 0.64 percent of assets. Excluding repurchased GNMA³ loans, troubled assets were up six basis points from the prior quarter at 0.53 percent of assets, and up from 0.46 percent at the end of the third quarter one year ago. Repossessed assets were up one basis point from the prior quarter at 0.08 percent of assets, and were up from 0.05 percent one year ago.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status), excluding repurchased GNMA loans, climbed five basis points from the prior quarter to 0.45 percent of assets, and were up from 0.41 percent one year ago. Noncurrent loan rates for 1-4 family and multifamily mortgages, consumer loans, and construction and land loans were higher from one year ago. 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, excluding repurchased GNMA loans, were up seven basis points from one year ago and eight basis points from the prior quarter to 0.59 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 0.16 percent of all multifamily loans from 0.14 percent one year ago. Noncurrent consumer loans increased from 0.61 percent of all consumer loans one year ago to 0.78 percent at the end of the third quarter. Noncurrent construction and land loans were 0.68 percent of all construction and land loans at the end of the third quarter, up from 0.51 percent one year ago.

Noncurrent nonresidential mortgages fell to 0.46 percent of all nonresidential mortgages from 0.54 percent one year ago. Noncurrent commercial loans fell to 1.17 percent of all commercial loans at the end of the third quarter from 1.21 percent a year ago.

Loans past due by 30 to 89 days were higher over the year for all major loan types. 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 third quarter, excluding repurchased GNMA loans, were \$10.7 billion, or 0.66 percent of assets compared to \$7.6 billion, or 0.53 percent of assets, one year ago, and \$8.7 billion, or 0.57 percent of assets, in the second quarter.

³ GNMA mortgage-backed securities are fully guaranteed by the U.S. Government. Individual loans repurchased from GNMA pools are fully or partially guaranteed or insured by agencies of the U.S. Government.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased by 14.3 percent over the year to \$1.63 trillion from \$1.43 trillion. Thrifts remain focused on residential mortgage lending, with 54.6 percent of assets invested in 1-4 family mortgage loans at the end of the third quarter, down slightly from 56.7 percent one year ago. Of these 1-4 family mortgage loans, 6.0 percent are home equity lines of credit, down from 6.2 percent of 1-4 family mortgages in the third quarter one year ago. Holdings of consumer loans decreased to 5.7 percent of assets from 6.0 percent a year ago, and multifamily mortgages were unchanged over the year at 4.6 percent of assets. Commercial loans increased to 3.1 percent of assets at the end of the third quarter from 3.0 percent one year ago.

Deposits and escrows grew by 13.6 percent over the year to \$934 billion from \$822 billion. As a percentage of total assets, deposits and escrows decreased to 57.2 percent from 57.5 percent one year ago. Federal Home Loan Bank advances were down from one year ago at 17.5 percent of total assets.

Capital measures for the industry continue to be strong, stable, and well in excess of minimum requirements. At quarter-end, over 99 percent of the industry exceeded well-capitalized standards. Equity capital at the end of the third quarter was 9.23 percent of assets, up from 9.19 percent one year ago. One thrift was less than adequately capitalized at the end of the third 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 – decreased by one over the year to five. Assets of problem thrifts were lower at the end of the third quarter at \$180 million, down from \$1.9 billion at the end of the comparable year ago quarter, and down from \$209 million at the end of the prior quarter.

Thrifts with composite ratings of 3 were up by three from the prior and comparable year ago quarters at 52. 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 but one of the 3-rated thrifts at the end of the third quarter were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

Charter choice decisions resulted in five institutions choosing a thrift charter during the third quarter – three were “de novo” institutions and two were existing state

savings banks that converted to federal thrift charters. One thrift converted to a state savings bank charter over the third quarter. Also during the third quarter, three OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired two thrifts.