THRIFT INDUSTRY HIGHLIGHTS

THIRD QUARTER 2004

Office of Thrift Supervision / November 17, 2004

SUMMARY

Strong earnings and profitability, solid loan growth, and healthy asset quality characterized third quarter results for the thrift industry. The interest rate yield curve flattened over the quarter and the industry's aggregate net interest margin declined. Higher yields on longer-term maturities at the beginning of the quarter resulted in lower volumes of new and refinanced mortgages over the quarter.

Equity capital and the industry's equity capital ratio set new records at the end of the third quarter. Asset quality remained excellent as troubled assets for the industry reached a record low.

EARNINGS AND PROFITABILITY

Net income in the third quarter was $3.50 billion, up two percent from $3.44 billion earned in the third quarter one year ago, and four percent from $3.37 billion in the prior quarter. This was the second highest net income for the industry and the eighth quarter that quarterly income topped the $3 billion mark. There were 74 thrifts reporting losses in the third quarter, down from 89 thrifts in the third quarter one year ago, and from 86 thrifts in the prior quarter.

Profitability, as measured by return on average assets (ROA), was 1.15 percent in the third quarter, down from 1.16 percent in the prior quarter and from 1.28 percent in the third quarter one year ago. The median ROA was up one basis point from the prior quarter at 0.74 percent, but down from 0.76 percent in the comparable year ago quarter.

Return on average equity (ROE) fell to 12.59 percent in the third quarter from 14.17 percent in the third quarter a year ago and from 12.63 percent in the prior quarter.

ANALYSIS OF ROA

Industry ROA in the third quarter was down one basis point from the prior quarter as net interest margin and other noninterest income were lower, and noninterest expense was higher. Partially offsetting these decreases to ROA in the third quarter were higher fee income (including lower impairment charges on mortgage servicing portfolios and higher income on other fees and charges), and lower taxes.

NIM was lower by three basis points in the third quarter at 288 basis points (or 2.88 percent of average assets), but up from 284 basis points in the third quarter a year ago. The decline in NIM in the third quarter was chiefly due to a flatter yield curve over the quarter that resulted in interest

income increasing at a slower rate than interest expense. Over the quarter, interest income as a percentage of average assets increased by 11 basis points while interest expense climbed by 14 basis points.

Loss provisions on interest-bearing assets were unchanged from the prior quarter at 0.21 percent of average assets, but were up slightly from 0.20 percent in the third quarter a year ago. 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, climbed to 1.22 percent of average assets in the third quarter from 1.01 percent in the third quarter a year ago and from 1.06 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 0.10 percent of average assets in the third quarter, improved from 0.05 percent in the third quarter one year ago and from negative 0.02 percent in the prior quarter.

Other fee income was up from the third quarter a year ago at 1.12 percent of average assets, and from 1.08 percent in the prior quarter. Other fee income includes 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 fell by 26 basis points from the third quarter a year ago to 0.50 percent of average assets, and was down from 0.62 percent in the prior 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 2.62 percent of average assets from 2.43 percent in the third quarter a year ago, and from 2.59 percent in the second quarter. General and administrative expense, the largest component of noninterest expense, climbed to 2.59 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 a year ago to 0.62 percent of average assets, and were down from 0.64 percent in the prior quarter. Over the past two years, taxes have averaged 0.68 percent of average assets, or about 35 percent of pretax income.

MORTGAGE ORIGINATIONS

Total thrift industry mortgage originations[1] (which include multifamily and nonresidential mortgages) in the third quarter were $167.1 billion, down from a record $250.5 billion in the comparable year ago quarter, and from $196.5 billion in the second quarter. Mortgage loan demand, and particularly refinancing activity, was lower in the third quarter as mortgage interest rates were higher at the beginning of the quarter. Third quarter 1-4 family mortgage originations

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1 Mortgage originations data include only new amounts disbursed.

by thrifts were $145.4 billion, down 37 percent from a record $230.0 billion in the third quarter one year ago, and down 16 percent from $173.5 billion originated in the second quarter.

Thrifts' estimated share of all 1-4 family originations[2] was 22 percent of total 1-4 family originations in the third quarter, up from 19 percent in the comparable year ago quarter, and from 20 percent in the second quarter. An estimated 56 percent of thrift originations were ARMs in the third quarter, up from 26 percent in the third quarter one year ago and from 50 percent in the second quarter. In contrast, the ARM share for all lenders was estimated at 38 percent in the third quarter, up from 18 percent in the third quarter one year ago and from 36 percent in the prior quarter.[3] Thrifts' higher ARM share in the third quarter reflected the increase in longer-term mortgage interest rates in the second quarter.

The volume of mortgage refinancing was lower in the third quarter, reflecting higher mortgage interest rates at the beginning of the quarter. Refinancing activity accounted for 31 percent of thrift originations in the third quarter, down from 42 percent in the third quarter one year ago, and from 37 percent 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 for most loan types and remained strong for all loan types over the year and the overall level of credit quality in the thrift industry has remained good. Asset quality remains strong to a large extent because of the high volume of new loans in thrift portfolios. As these new loans season over time, delinquencies are expected to increase. Troubled assets, which consist of noncurrent loans and repossessed assets, decreased to a record low 0.49 percent of assets from 0.68 percent in the comparable year ago quarter and from 0.50 percent in the prior quarter. Repossessed assets stood at 0.06 percent of assets, down three basis points from the third quarter a year ago quarter and one basis point from the prior quarter.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) decreased over the year to a record low 0.43 percent of assets at the end of the second quarter and remained at that level in the third quarter as noncurrent rates (as a percentage of total loan type) improved for all loan types 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 residential mortgage lending accounts for its strong credit quality. Noncurrent loan rates for 1-4 family loans were 0.52 percent of all 1-4 family loans at the end of the third quarter, down from 0.84 percent one year ago. Noncurrent multifamily loans decreased from one year ago to 0.15 percent of all multifamily loans.

Noncurrent nonresidential mortgages fell to 0.81 percent of all nonresidential mortgages from 1.03 percent one year ago. Noncurrent construction and land loans were 0.77 percent of all construction and land loans, down sharply from 1.14 percent one year ago. Noncurrent commercial loans fell to 1.29 percent of all commercial loans at the end of the third quarter from 1.51 percent a year ago. Noncurrent consumer loans were lower from one year ago at 0.70 percent of all consumer loans.

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

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

Loans past due by 30 to 89 days were lower over the year for all loan types but 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 third quarter were $6.9 billion, or 0.57 percent of assets compared to $7.2 billion, or 0.66 percent of assets, one year ago, and $6.7 billion, or 0.56 percent of assets, in the second quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased 12.2 percent to $1.23 trillion at the end of the third quarter from $1.09 trillion in the third quarter a year ago. 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, up from 49.0 percent one year ago. Holdings of consumer loans climbed over the year to 6.2 percent of assets from 5.4 percent a year ago, and multifamily mortgages were unchanged over the year at 4.8 percent of assets. Commercial loans decreased over the year to 3.2 percent of assets.

Deposits and escrows grew by 0.9 percent over the year to $720 billion from $714 billion in the third quarter a year ago. As a percentage of total assets, deposits and escrows decreased to 58.7 percent from 65.2 percent one year ago. Federal Home Loan Bank advances climbed to 18.3 percent of assets at the end of the third quarter from 16.0 percent one year ago.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At the end of the third quarter, over 99 percent of the industry exceeded well-capitalized standards. Equity capital at the end of the third quarter was a record 9.27 percent of assets, up from 8.89 percent a year ago and from 9.19 percent at the end of the second quarter. 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 third quarter.

PROBLEM THRIFTS

The thrift industry continued to perform extremely well over the past year and the number of problem thrifts remained at a low level. Problem thrifts - those with composite examination ratings of 4 or 5 - fell by two over the year to five. Assets of problem thrifts declined to $294 million at the end of the third quarter from $602 million in the third quarter one year ago and from $493 million in the prior quarter.

Thrifts with composite ratings of 3 declined to 53 in the third quarter from 62 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. Of the 53 thrifts rated 3, 98 percent 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 three existing institutions coming under OTS supervision in the third quarter and six thrifts leaving OTS supervision (three to commercial bank charters and three to state-regulated savings bank charters). During the third quarter, four OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired six thrifts. One thrift left through a voluntary dissolution.

The number of institutions supervised by OTS stood at 896 at the end of the third quarter, down from 910 in the prior quarter and 936 one year ago.