



## **THRIFT INDUSTRY HIGHLIGHTS THIRD QUARTER 2008**

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### **SUMMARY<sup>1</sup>**

The nation's economic crisis continued to impact institutions focused on home mortgage financing in the third quarter. In reaction to the current housing market distress, thrifts continued taking necessary steps to bolster cushions for potential loan losses by significantly adding to loan loss provisions.

The industry has added \$23.4 billion to loan loss reserves in the most recent four quarters. But since additions to loan loss reserves are direct charges to earnings, earnings over the past year have been weak and, recently, net losses have been incurred. During the third quarter, thrifts set aside \$7.9 billion in loan loss provisions. The provisions increased the industry's loan loss reserve ratio to 1.93 percent from 1.89 percent in the prior quarter. These large provisions resulted in a quarterly net loss of \$4.0 billion, or negative 1.35 percent relative to average assets.

Recent increases in problem assets are also a direct result of the continued housing market downturn. Troubled assets (noncurrent loans and repossessed assets) rose to 2.40 percent of assets, up from 2.27 percent in the prior quarter and 1.00 percent a year ago. The current level of troubled assets is the highest since the early 1990s. However the composition of thrift troubled assets is currently much different than in the early 1990s when the ratio reached 3.74 percent at the end of 1990. Mortgages on 1-4 family properties comprise approximately 69 percent of the industry's current troubled assets, with an additional 19 percent consisting of commercial real estate loans (nonresidential mortgages, multifamily complexes, and construction loans), and 12 percent in nonmortgage loans. In contrast, commercial real estate loans comprised the majority, or 68 percent, of thrift troubled assets in 1990, with 1-4 family mortgages (23 percent) and nonmortgage loans (9 percent) comprising the remainder.

The industry's capital position remains solid, but down from record levels. Thrifts' capital rose to record or near record levels in advance of the housing market downturn, and generally peaked in mid-2007. But recent net losses have reduced current capital ratios to pre-mid-2007 levels. Nevertheless, current regulatory capital measures remain solid. The combination of solid capital and bolstered loan loss reserves will help the industry weather the housing market distress currently facing the nation.

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<sup>1</sup> To improve comparisons of current data with prior periods, the data for prior periods exclude two large thrifts that failed in the third quarter 2008.

Regulatory capital measures were mixed in the third quarter from the prior quarter. Thrifts' tier 1 core capital ratio increased to 8.67 percent in the third quarter from 8.59 percent in the prior quarter. Thrifts' tier 1 risk-based capital ratio declined to 13.48 percent from 13.58 percent in the prior quarter. Total risk-based capital declined to 14.77 percent from 14.85 percent in the prior quarter.

The number of private sector thrifts supervised by OTS stood at 818 with assets of \$1.18 trillion at the end of the third quarter. In addition, OTS supervised 469 holding company enterprises with approximately \$8.1 trillion in U.S. domiciled consolidated assets. These enterprises owned 435 thrifts with total assets of \$960 billion, or 81 percent of total thrift industry assets.

Other highlights include:

## **EARNINGS AND PROFITABILITY**

- Net losses in the third quarter were \$4.0 billion compared to a loss of \$1.7 billion in the prior quarter and net income of \$598 million in the third quarter one year ago.
- Profitability, as measured by return on average assets (ROA), was a negative 1.35 percent in the third quarter compared to negative 0.57 in the second quarter. One year ago the industry ROA was 0.20 percent.
- Return on average equity (ROE) was a negative 14.88 percent in the third quarter, down from a negative 6.16 percent in the second quarter, and from 1.85 percent in the third quarter a year ago.

## **ANALYSIS OF ROA**

- Higher loan loss provisions drove the third and prior quarter losses.
- In the third quarter, net interest margin increased to 293 basis points (or 2.93 percent of average assets) from 289 basis points in the second quarter and from 258 basis points in the comparable quarter a year ago.
- Loan loss provisions were 2.67 percent of average assets in the third quarter, unchanged from the second quarter, and up from 0.84 percent in the third one year ago. The recent increases in loss provisions reflect the increase in noncurrent loans stemming from the housing market downturn and the deterioration of loans originated in the past several years. Loan loss provisions averaged 0.26 percent of average assets between 2001 and 2003 and generally

trended lower from the beginning of 2003 through the first half of 2006, reflecting historically low levels of problem assets.

- Total fee income, including mortgage loan servicing fee income and other fee income, was 1.18 percent of average assets in the third quarter, down from 1.39 percent in the prior quarter, but up from 1.10 percent in the third quarter one year ago.
- Other noninterest income was a negative 0.18 percent of average assets in the third quarter, down from 0.26 percent in the second quarter and from 0.04 percent in the third quarter a year ago. Other noninterest income is typically volatile since it includes realized gains or losses on assets held for sale and the results of balance sheet restructuring activities.
- Noninterest expense increased to 2.93 percent of average assets in the third quarter from 2.69 percent in the prior quarter, and from 2.60 percent in the third quarter one year ago. General and administrative expense, the largest component of noninterest expense, was 2.55 percent of average assets in the third quarter, up from 2.27 percent in the comparable year ago quarter.
- Taxes were down 40 basis points over the year to a negative 0.32 percent of average assets in the third quarter, and were down from a negative 0.29 percent in the prior quarter.

## MORTGAGE ORIGINATIONS

- Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) were \$79.5 billion in the third quarter, down 45 percent from \$145.3 billion in the third quarter a year ago and down 26 percent from \$107.8 billion in the prior quarter.
- An estimated 18 percent of thrift originations were ARMs in the third quarter, up from 11 percent in the prior quarter and from 13 percent in the comparable year ago quarter. The ARM share for all lenders was estimated at nine percent in the third quarter, eight percent in the prior quarter, and 12 percent in the third quarter one year ago.<sup>2</sup>
- The volume of mortgage refinancing, as a percentage of total originations, remained strong in the third quarter as borrowers converted adjustable rate mortgages to fixed rate mortgages. Refinancing activity accounted for 34 percent of thrift originations in the third quarter, down from 41 percent in the prior quarter, and from 44 percent in the third quarter a year ago.

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

## ASSET QUALITY

- Delinquencies for most loan types were higher over the year and in the third quarter.
- Troubled assets, which consist of noncurrent loans and repossessed assets, were up 13 basis points from the prior quarter at 2.40 percent of assets, and were up from 1.00 percent one year ago. Repossessed assets were up six basis points from the prior quarter at 0.33 percent of assets, and were up from 0.12 percent one year ago.
- Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) increased by eight basis points from the prior quarter to 2.08 percent of assets at the end of the third quarter, and were up from 0.88 percent one year ago. Noncurrent loan rates for 1-4 family loans were up 205 basis points from one year ago and 11 basis points from the prior quarter to 3.39 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 1.00 percent of all multifamily loans from 0.40 percent one year ago. Noncurrent consumer loans increased from 0.83 percent of all consumer loans one year ago to 1.16 percent at the end of the third quarter. Noncurrent nonresidential mortgages increased to 1.04 percent of all nonresidential mortgages from 0.73 percent one year ago. Noncurrent construction and land loans were 7.80 percent of all construction and land loans at the end of the third quarter, up from 2.69 percent one year ago. Noncurrent commercial loans increased to 1.32 percent of all commercial loans at the end of the third quarter from 0.81 percent a year ago.
- Loans past due by 30 to 89 days were higher over the year. Total loans past due by 30 to 89 days at the end of the third quarter were \$17.1 billion, or 1.44 percent of assets compared to \$14.0 billion, or 1.16 percent of assets, one year ago, and were up from \$15.0 billion, or 1.28 percent of assets, in the prior quarter.

## ASSETS, LIABILITIES, AND CAPITAL

- Industry assets decreased by two percent over the year to \$1.18 trillion from \$1.21 trillion. Thrifts remain focused on residential mortgage lending, with 45.8 percent of assets invested in 1-4 family mortgage loans at the end of the third quarter, down from 48.6 percent one year ago. Of these 1-4 family mortgage loans, 5.3 percent are home equity lines of credit, up from 5.0 percent one year ago. Holdings of consumer loans increased to 6.4 percent of assets from 6.0 percent a year ago, and multifamily mortgages increased over the year from 2.8 percent of assets to 2.9 percent at the end of the third quarter. Commercial loans increased to 4.8 percent of assets at the end of the third quarter from 4.4 percent one year ago.

- Deposits and escrows fell by two percent over the year to \$727 billion from \$741 billion. As a percentage of total assets, deposits and escrows increased to 61.5 percent from 61.3 percent one year ago. Federal Home Loan Bank advances were up from 18.8 percent one year ago to 20.5 percent of total assets.
- Capital measures for the industry continue to be strong, stable, and well in excess of minimum requirements. Equity capital at the end of the third quarter was 9.24 percent of assets, down from 10.74 percent one year ago, but up from 8.97 percent in the prior quarter. At the end of the third quarter, over 98 percent of the industry exceeded well-capitalized standards and six thrifts were less than adequately capitalized.

## **PROBLEM THRIFTS**

- The number of problem thrifts – those with composite examination ratings of 4 or 5 – was up from 12 thrifts one year ago to 23 thrifts at the end of the third quarter.
- Four thrifts failed during the third quarter<sup>3</sup>.

## **STRUCTURAL CHANGES**

- During the third quarter, one “de novo” institution came into OTS regulation. In addition, two thrifts converted to bank charters, two thrifts were acquired by banks, two thrifts were acquired by thrifts, and one thrift completed a voluntary dissolution.

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<sup>3</sup> One thrift included in failures was a wholly-owned subsidiary of another thrift that failed.