THRIFT INDUSTRY HIGHLIGHTS FIRST QUARTER 2003

Office of Thrift Supervision / May 20, 2003

SUMMARY

The thrift industry reported very strong results for the first quarter. New records were set for quarterly earnings, return on average assets (ROA), equity capital, and mortgage refinancing volume.

Strength in earnings and profitability continued to be attributable to the favorable interest rate environment. Over the quarter, the yield curve remained steep and lower shorter-term interest rates benefited net interest margins at many larger thrifts. The low interest rate environment continued to fuel the mortgage market boom. Mortgage originations and sales volumes remained strong, although off the prior quarter's record levels. A decline in mortgage interest rates over quarter to the lowest rates in four decades generated record levels of mortgage refinancing.

The industry's equity capital reached a record level at the end of the first quarter and its equity capital ratio was slightly below the record set in the prior quarter. 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 first quarter. Troubled assets (defined as noncurrent loans and repossessed assets) and loans past due by 30- to 89-days as a percentage of total assets were lower over the first quarter. 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 1.30 percent in the first quarter, up from the previous record of 1.24 percent in the first quarter one year ago, and up from 1.20 percent in the prior quarter. Return on average equity (ROE) was 14.23 percent in the first quarter, down from 14.67 percent in the comparable year ago quarter, but up from 13.24 percent in the prior.

Net income reached a record of $3.33 billion in the first quarter; only the second time thrift industry net income has topped the $3 billion mark. First quarter net income was up nine percent from the previous record of $3.05 billion set in the first quarter one year ago, and up eleven percent from $2.98 billion in the prior quarter. The number of thrifts reporting losses in the first quarter was 75, the lowest level in four years and down from 104 thrifts in the first quarter one year ago. Aggregate losses of $35 million for these thrifts were the lowest since the industry began quarterly data reporting in 1984.

ANALYSIS OF ROA

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

In the first quarter, NIM decreased to 300 basis points (or 3.00 percent of average assets) from 318 basis points in the first quarter one year ago, but was up from 294 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 slightly to 0.26 percent of average assets in the first quarter from 0.27 percent in the prior and comparable year ago quarters.

Total fee income, including mortgage loan servicing fee income and other fee income, fell to 0.66 percent of average assets in the first quarter from 0.86 percent in the first quarter one year ago, but was up from 0.64 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 0.24 percent of average assets in the first quarter, 29 basis points lower than in the first quarter one year ago, but an improvement of four basis points from the prior quarter.

On the positive side, other fee income was up nine basis points over the year to 0.90 percent of average assets in the first 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 first quarter climbed to 0.98 percent of average assets from 0.43 percent one year ago and from 0.91 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 2.35 percent of average assets in the first quarter from 2.29 percent in the first quarter a year ago, but was down from 2.39 percent in the prior quarter. General and administrative expense, the largest component of noninterest expense, increased to 2.32 percent of average assets in the first quarter from 2.25 percent in the comparable year ago quarter.

Taxes were higher in the first quarter at 0.73 percent of average assets, up from 0.68 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) in the first quarter reached $161.4 billion, up sharply from $111.0 billion in the first quarter a year ago, but down from a record $177.4 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. First quarter 1-4 family mortgage originations by thrifts were $145.4 billion, up 49 percent from $97.4 billion in the comparable year ago quarter, but down nine percent from a record $159.6 billion originated in the prior quarter.

Thrifts' estimated share of all 1-4 family originations[1] was 20 percent of total 1-4 family originations in the first quarter, unchanged from the first quarter one year ago, but down slightly from 21 percent in the prior quarter. An estimated 26 percent of thrift originations were ARMs in the first quarter, down from 34 percent in the first quarter a year ago and from 29 percent in the prior quarter. In contrast, the ARMs share for all lenders was 16 percent in the first quarter, 17 percent in the first quarter one year ago, and 13 percent in the prior quarter.[2] The lower ARMs shares over the year reflected the decline in long-term mortgage interest rates.

In the first quarter, the volume of mortgage refinancing climbed sharply to a new record for the third consecutive quarter as mortgage interest rates eased further. Refinancing activity (counting only those mortgages refinanced with the same lender) accounted for 55 percent of thrift originations in the first quarter, up from 49 percent in the prior quarter and 39 percent in the first quarter one year ago.

ASSET QUALITY

Asset quality remained strong for all loan types in the first 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 0.72 percent of assets at the end of the first quarter, unchanged from one year ago and down from 0.75 percent in the prior quarter. Repossessed assets were down one basis point from the prior and year ago quarters at 0.09 percent of assets.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) increased slightly to 0.63 percent of assets at the end of the first quarter from 0.62 percent in the comparable year ago quarter, but were down from 0.65 percent in the prior quarter. Noncurrent rates (as a percentage of total loan type) moved higher from a year ago for consumer loans while noncurrent rates moved lower 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 down one basis point from one year ago 0.86 percent of all 1−4 family mortgage loans and were down from 0.93 percent in the prior quarter. Noncurrent multifamily loans were 0.15 percent of all multifamily loans at the end of the first quarter, down from 0.17 percent one year ago.

Noncurrent nonresidential mortgages decreased to 1.26 percent of all nonresidential mortgages from 1.45 percent one year ago. Noncurrent construction and land loans were 1.55 percent of all construction and land loans, down from 1.82 percent one year ago. Noncurrent commercial loans fell to 2.10 percent of all commercial loans at the end of the first quarter from 2.27 percent a year ago. Noncurrent consumer loans were 0.66 percent of all consumer loans at the end of the first quarter, up from 0.55 percent one year ago.

Loans past due by 30 to 89 days were lower over the year for all loan types but consumer loans. 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 first quarter were $7.2 billion, or 0.69 percent of assets, compared to $7.1 billion, or 0.71 percent of assets, one year ago, and down from $7.6 billion, or 0.76 percent of assets, in the fourth quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased at an annualized rate of 17.1 percent during the first quarter to $1.05 trillion from $1.00 trillion at year-end 2002. Thrifts remain focused on residential mortgage lending, with 48.8 percent of total assets invested in 1-4 family mortgage loans at the end of the first quarter, up from 47.8 percent from the prior quarter. Holdings of consumer loans, multifamily loans, and commercial loans decreased slightly over the quarter to 6.0 percent, 4.6 percent and 2.9 percent of total assets, respectively.

Deposits grew at an annualized rate of 10.2 percent over the first quarter to $609 billion, up from $594 billion at year-end 2002. As a percentage of total assets, deposits fell to 58.1 percent from 59.1 percent in the prior quarter. Federal Home Loan Bank advances declined to 16.4 percent of assets in the first quarter from 17.1 percent in the prior quarter.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At the end of the first quarter, over 99 percent of the industry exceeded well-capitalized standards. In the first quarter, the industry's equity capital reached a record $95 billion and the equity capital ratio stood at 9.1 percent of assets, down slightly from the record 9.2 percent at the end of the prior quarter. Capital growth 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 first quarter for the first time 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 well over the first 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 two over the quarter to 12. Assets of problem thrifts declined to $2.4 billion at the end of the first quarter, the lowest level since OTS was founded in 1989. Problem thrift assets were $2.6 billion in the prior quarter and $14.7 billion in the first quarter one year ago.

Thrifts with composite ratings of 3 declined to 71 in the first quarter from 72 in the prior quarter. The number of thrifts rated 3 stood at 71 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, 96 percent were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

During the first quarter, 20 thrifts left OTS supervision, up from 14 thrifts in the prior quarter. Six exits were due to bank acquisitions. Thrift-to-thrift mergers accounted for six exits. There were seven charter conversions and one voluntary dissolution. Four new entrants began operations in the first quarter. Of the new entrants, two were *de novo* charters and two were charter conversions. One of the charter conversions immediately merged into another thrift.

The number of institutions supervised by OTS fell to 958 at the end of the first quarter from 974 in the prior quarter and 1,007 one year ago.

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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*.