



## **THRIFT INDUSTRY HIGHLIGHTS SECOND QUARTER 2007**

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### **SUMMARY**

The thrift industry reported solid earnings and profitability in the second quarter of 2007 despite continued weakness in housing markets and a flat-to-inverted yield curve. Levels of problems assets rose again in the second quarter reflecting the slowing housing sector and the current credit cycle.

Although asset quality remained strong by historical standards, delinquencies continued to rise in the quarter after increasing for most type of loans over the past year from recent record low levels. Thrifts have responded to the current environment by maintaining strong capital and increasing provisions for loan losses. The combination of solid earnings, strong capital, and increasing loan loss provisions will permit thrifts to withstand any further weakening in the housing markets.

The industry's aggregate net interest margin was unchanged from the prior quarter and down slightly from the comparable quarter a year ago. Strong refinancing volumes augmented total mortgage origination volume during the quarter. Originations were up 14 percent from the second quarter one year ago and up 15 percent from the prior quarter.

Thrift industry assets climbed one percent from the prior quarter to \$1.50 trillion. The number of thrifts supervised by OTS stood at 836 at the end of the second quarter. In addition, OTS supervised 472 holding company enterprises with approximately \$8.5 trillion in U.S. domiciled consolidated assets. These enterprises owned 442 thrifts with total assets of \$1.24 trillion, or 82 percent of total thrift industry assets.

Delinquencies for most loan types have increased over the past year and continued to rise in the second quarter. The largest increases in delinquency rates were in 1-4 family mortgages and construction loans, and these increases reflect the continued weakness in the housing sector. The industry last experienced similar levels of delinquencies during the late 1990s – before the extended housing boom that lasted through 2005. The industry's equity capital ratio reached a record 10.81 percent at the end of the second quarter, up from 10.70 percent in the prior quarter.

Other highlights include:

## EARNINGS AND PROFITABILITY

- Net income was \$3.84 billion in the second quarter, down 8.6 percent from \$4.21 billion in the second quarter one year ago, but up 6.3 percent from \$3.61 billion in the prior quarter.
- Profitability, as measured by return on average assets (ROA), was 1.02 percent in the second quarter, down from 1.11 percent in the comparable year ago quarter, but up from 0.97 percent in the prior quarter. The median ROA declined to 0.53 percent in the second quarter from 0.64 percent in the second quarter one year ago, but up from 0.51 percent in the prior quarter.
- Return on average equity (ROE) was 9.57 percent in the second quarter, down from 11.93 percent in the second quarter one year ago, but up from 9.35 percent in the prior quarter.

## ANALYSIS OF ROA

- Higher fee income and other noninterest income drove the increase in second quarter ROA from the prior quarter. Partially offsetting these positive impacts to quarterly profitability were higher loan loss provisions, noninterest expense, and taxes.
- In the second quarter, NIM was unchanged from the prior quarter at 277 basis points (or 2.77 percent of average assets), and was down from 280 basis points in the second quarter one year ago.
- Loan loss provisions increased to 0.38 percent of average assets in the second quarter from 0.20 percent in the second quarter one year ago, and from 0.33 percent in the prior quarter. The recent rise in loss provisions is reflective of the increase in noncurrent loans stemming from the slower housing market and the seasoning 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, increased to 1.42 percent of average assets in the second quarter compared to 1.18 percent in the second quarter one year ago, and 1.11 percent in the prior quarter. Servicing fee income was 0.23 percent of average assets in the second quarter, up from 0.10 percent in the second quarter one year ago, and 0.05 percent in the prior quarter. Other fee income rose 11 basis points from the comparable year ago quarter to 1.19 percent of average assets, and 1.06 percent in the prior quarter.

- Other noninterest income was 0.46 percent of average assets in the second quarter, down from 0.55 percent in the second quarter one year ago, but up from 0.39 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 or losses on assets held for sale and the results of balance sheet restructuring activities.
- Noninterest expense increased to 2.70 percent of average assets in the second quarter as compared to 2.63 percent in the comparable year ago quarter and 2.46 percent in the prior quarter. General and administrative expense, the largest component of noninterest expense, increased three basis points to 2.61 percent of average assets in the second quarter from 2.58 percent in the comparable year ago quarter.
- Taxes were down five basis points over the year to 0.55 percent of average assets, but were up from 0.52 percent in the first quarter. Over the past two years, taxes have averaged 0.58 percent of average assets, or about 35 percent of pretax income.

## MORTGAGE ORIGINATIONS

- Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) were \$194.6 billion in the second quarter, up 14 percent from \$171.1 billion in the second quarter one year ago, and 15 percent from \$169.2 billion in the prior quarter. Second quarter 1-4 family mortgage originations by thrfts were \$173.3 billion, up 17 percent from \$148.5 billion in the second quarter one year ago, and 16 percent from the \$149.6 billion originated in the prior quarter.
- Thrfts accounted for approximately 23.7 percent of total 1-4 family originations nationwide in the second quarter of 2007,<sup>1</sup> up from 19.7 percent in the comparable year ago quarter, and 22.8 percent in the prior quarter. An estimated 10 percent of thrift originations were ARMs in the second quarter, down from 13 percent in the prior quarter and 37 percent in the comparable year ago quarter. The ARM share for all lenders was estimated at 10 percent in the second quarter, 11 percent in the prior quarter, and 28 percent in the second quarter one year ago.<sup>2</sup>
- The volume of mortgage refinancing, as a percentage of total originations, was up from the prior quarter and comparable year ago quarter as borrowers converted adjustable rate mortgages to fixed rate mortgages. Refinancing activity accounted for 48 percent of thrift originations in the second quarter, up

<sup>1</sup> Total 1-4 family mortgage originations estimated by the Mortgage Bankers Association of America.

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

from 31 percent in the second quarter one year ago, and 47 percent in the prior quarter.

## ASSET QUALITY

- Asset quality within the industry remained strong over the second quarter, but delinquencies were up from recent record low levels.
- Troubled assets, which consist of noncurrent loans and repossessed assets, were up 15 basis points from the prior quarter at 0.95 percent of assets, and 0.62 percent one year ago. Excluding repurchased GNMA<sup>3</sup> loans, troubled assets were up 16 basis points from the prior quarter at 0.90 percent of assets, and 0.47 percent one year ago. Repossessed assets were up three basis points from the prior quarter at 0.13 percent of assets, and 0.07 percent one year ago.
- Noncurrent loan rates (loans over 89 days past due or in nonaccrual status), excluding repurchased GNMA loans, climbed 13 basis points from the prior quarter to 0.77 percent of assets at the end of the second quarter, and 0.40 percent one year ago. Noncurrent loan rates for 1-4 family loans, excluding repurchased GNMA loans, were up 57 basis points from one year ago and 24 basis points from the prior quarter to 1.16 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 0.29 percent of all multifamily loans from 0.16 percent one year ago. Noncurrent consumer loans increased from 0.68 percent of all consumer loans one year ago to 0.83 percent at the end of the second quarter. Noncurrent nonresidential mortgages increased to 0.67 percent of all nonresidential mortgages from 0.45 percent one year ago. Noncurrent construction and land loans were 1.61 percent of all construction and land loans at the end of the second quarter, up from 0.47 percent one year ago. Noncurrent commercial loans fell to 0.86 percent of all commercial loans at the end of the second quarter from 1.11 percent a year ago.
- Loans past due by 30 to 89 days were higher over the year for 1-4 and multifamily mortgage loans, consumer, nonresidential, and construction and land loans. Past due loan rates were lower from one year ago for commercial loans. Total loans past due by 30 to 89 days at the end of the second quarter, excluding repurchased GNMA loans, were \$13.6 billion, or 0.91 percent of assets compared to \$8.7 billion, or 0.57 percent of assets, one year ago, and \$11.6 billion, or 0.78 percent of assets, in the prior quarter.

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<sup>3</sup> 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 one percent in the second quarter to \$1.50 trillion from \$1.49 trillion in the first quarter. Thrifts remain focused on residential mortgage lending, with 50.9 percent of assets invested in 1-4 family mortgage loans at the end of the second quarter, down from 56.4 percent one year ago. Of these 1-4 family mortgage loans, 7.1 percent are home equity lines of credit, up from 6.1 percent one year ago. Holdings of consumer loans increased to 6.1 percent of assets from 5.9 percent a year ago, and multifamily mortgages decreased slightly over the year from 4.4 percent of assets to 4.2 percent at the end of the second quarter. Commercial loans increased to 3.8 percent of assets at the end of the second quarter from 3.0 percent one year ago.
- Deposits and escrows grew by 7.4 percent over the year to \$949 billion from \$883 billion. As a percentage of total assets, deposits and escrows increased to 63.1 percent from 57.6 percent one year ago. Federal Home Loan Bank advances were down from 17.7 percent one year ago to 14.3 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 second quarter was a record 10.81 percent of assets, up from 9.25 percent one year ago. At the end of the second quarter, 99 percent of the industry exceeded well-capitalized standards and four 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 four thrifts one year ago to ten thrifts at the end of the second quarter. Assets of problem thrifts were \$3.2 billion at the end of the second quarter, up from \$209 million one year ago, but down from \$3.4 billion at the end of the prior quarter.

## STRUCTURAL CHANGES

- Charter choice decisions resulted in seven institutions choosing a thrift charter during the second quarter – three were “de novo” institutions and four were existing institutions that converted from state savings banks. One thrift converted to a commercial bank over the quarter and one thrift completed a voluntary dissolution. Also during the quarter, four OTS-regulated thrifts merged with other OTS-regulated thrifts and non-OTS regulated institutions acquired three thrifts.