



## **THRIFT INDUSTRY HIGHLIGHTS FOURTH QUARTER 2005**

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### **SUMMARY**

Record levels of earnings and equity capital, and overall strong credit quality characterized thrift industry results for the year 2005 and for the fourth quarter. Profitability was strong and loan growth was solid over the year.

The interest rate environment proved challenging as the yield curve flattened during 2005. Despite solid growth in loan portfolios, the industry's aggregate net interest margin decreased as quarterly changes in interest expense climbed at a faster pace than interest income. Mortgage origination volume for the year was the industry's second best ever, up by nine percent from the prior year, as increased existing and new home sales resulted in strong originations volume.

Thrift industry assets increased by 12 percent during 2005 to \$1.46 trillion. The number of thrifts supervised by OTS stood at 863 at the end of 2005. In addition, OTS supervised 484 holding company enterprises with approximately \$7.0 trillion in U.S. domiciled consolidated assets. These enterprises owned 451 thrifts with total assets of \$1.2 trillion, or 80 percent of total thrift industry assets.

Asset quality remained strong for all loan types over the year and the overall level of credit quality in the thrift industry has remained good, with most noncurrent loan types showing improvement in delinquencies from one year ago. Delinquencies of 1-to-4 family mortgage loans were higher chiefly because changes to accounting and regulatory reporting requirements for banks and thrifts now require loans repurchased, or eligible for repurchase, from Government National Mortgage Association (GNMA) mortgage pools to be included in past due loans<sup>1</sup>. Excluding these repurchased GNMA loans, troubled assets (defined as noncurrent loans and repossessed assets) were lower from one year ago, but up from the record low rate in the second quarter. Loans past due by 30- to 89-days as a percentage of assets reached a record low at the end of the first quarter, but have increased in subsequent quarters and were higher at year-end from one year ago, and from the third quarter. The industry's equity capital level and equity capital ratio reached new records at year-end.

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<sup>1</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.

## **EARNINGS AND PROFITABILITY**

Net income reached a record of \$16.42 billion in 2005, up 18 percent from the previous record of \$13.96 billion in the prior year. For the fourth quarter, the industry earned a record \$4.34 billion, up 15 percent from the year ago fourth quarter and up seven percent from the prior quarter. This was the fourth time and fourth consecutive quarter that quarterly income topped the \$4 billion mark. The number of thrifts reporting losses in the fourth quarter was 102, up from 83 thrifts in the fourth quarter one year ago.

Profitability, as measured by return on average assets (ROA), was 1.19 percent for the year, up from 1.17 percent in 2004. Fourth quarter ROA was 1.20 percent, up from 1.17 percent in the comparable year ago quarter, and up five basis points from 1.15 percent in the third quarter. The median ROA declined to 0.67 percent in the fourth quarter from 0.73 percent in the third quarter, and was down from 0.71 percent one year ago. Median ROA for the year rose to 0.73 percent from 0.71 percent.

Return on average equity (ROE) increased to 12.84 percent for the year from 12.79 percent in 2004. In the fourth quarter, ROE was 12.90 percent, down from 12.96 percent in the fourth quarter one year ago, but up from 12.41 percent in the third quarter.

## **ANALYSIS OF ROA**

Increased fee income and lower overhead expense generally offset lower net interest margin for the year. For the fourth quarter, ROA was up from the prior quarter due to higher fee income and higher other noninterest income.

For the year, NIM decreased to 281 basis points (or 2.81 percent of average assets) from 289 basis points in 2004. In the fourth quarter, NIM averaged 276 basis points, down from 290 basis points in the comparable quarter a year ago.

Loan loss provisions decreased to 0.21 percent of average assets for the year from 0.22 percent in 2004. Provisions were 0.23 percent of average assets in the fourth quarter, down from 0.26 percent in the fourth quarter one year ago, but up from 0.20 percent in the prior quarter. 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, increased to 1.22 percent of average assets for the year from 1.03 percent in 2004. In the fourth quarter, total fee income was 1.38 percent of average assets, up from 1.18 percent in the fourth quarter one year ago and from 1.22 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 0.12 percent of average assets in 2005, an improvement of 13 basis points from the prior year. In the fourth quarter, servicing fee income was 0.10 percent of average assets, down from 0.13 percent in the fourth quarter one year ago, and from 0.16 percent in the prior quarter.

Other fee income was up six basis points for the year to 1.10 percent of average assets. In the fourth quarter, other fee income was 1.28 percent of average assets, up 23 basis points from the fourth quarter one year ago, and up from 1.06 percent in the prior quarter. Growth over the year came from increases in fee income 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 for the year fell by 14 basis points to 0.51 percent of average assets, due to lower gains from sales of assets over the year. In the fourth quarter, other noninterest income was 0.51 percent of average assets, down from 0.53 percent in the fourth quarter one year ago, but up from 0.41 percent in the third 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 decreased to 2.48 percent of average assets over the year from 2.55 percent in 2004. In the fourth quarter, noninterest expense was unchanged from one year ago at 2.54 percent of average assets, but was up 12 basis points from 2.42 percent in the third quarter. General and administrative expense, the largest component of noninterest expense, decreased by one basis point to 2.50 percent of average assets in the fourth quarter from 2.51 percent in the comparable year ago quarter.

Taxes were up two basis points over the year to 0.66 percent of average assets and were 0.67 percent in the fourth quarter. Over the past two years, taxes have averaged 0.67 percent of average assets, or about 35 percent of pretax income.

## **MORTGAGE ORIGINATIONS**

Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) in 2005 were \$744.1 billion, the industry's second best originations volume, and up eight percent from \$689.1 billion in 2004. In the fourth quarter total mortgage originations climbed to \$187.1 billion from \$176.6 billion in the fourth quarter one year ago, but were down from \$204.2 billion in the third quarter. Fourth quarter 1-4 family mortgage originations by thrifts were \$164.0 billion, up six

percent from \$154.1 billion in the fourth quarter one year ago, but down ten percent from the \$181.3 billion originated in the third quarter.

Thriffs accounted for approximately 26 percent of total 1-4 family originations nationwide in the fourth quarter of 2005,<sup>2</sup> up from 23 percent in the comparable year ago quarter and from 24 percent in the third quarter. An estimated 50 percent of thrift originations were ARMs in the fourth quarter, down from 62 percent in the fourth quarter one year ago, but up from 43 percent in the third quarter. In contrast, the ARM share for all lenders was 29 percent in the fourth quarter, 36 percent in the fourth quarter one year ago, and 28 percent in the third quarter.<sup>3</sup>

The volume of mortgage refinancing was lower from the fourth quarter one year ago as longer-term interest rates increased. Refinancing activity accounted for 34 percent of thrift originations in the fourth quarter, down from 36 percent in the fourth quarter one year ago, but up slightly from 33 percent in the prior quarter.

## ASSET QUALITY

Asset quality within the industry remained strong over the year. OTS is closely monitoring thrift 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, increased to 0.64 percent of assets at the end of the year, up from 0.48 percent in the comparable year ago quarter, and from 0.62 percent in the prior quarter. Excluding repurchased GNMA loans, troubled assets were lower from one year ago at 0.44 percent of assets. Repossessed assets decreased to 0.05 percent of assets from 0.06 percent of assets one year ago.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status), excluding repurchased GNMA loans, fell to 0.39 percent of assets at year-end from 0.43 percent one year ago, and were down from 0.41 percent in the prior quarter. Noncurrent loan rates for all loan types but multifamily mortgages improved 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 this sector accounts for its overall strong credit quality. Noncurrent loan rates for 1-4 family loans, excluding repurchased GNMA loans, were down two basis points from one year ago and from the end of the third quarter at 0.50 percent of all 1-4 family. Noncurrent multifamily loans increased to 0.16 percent of all multifamily loans from 0.13 percent one year ago.

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

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

Noncurrent nonresidential mortgages fell to 0.56 percent of all nonresidential mortgages from 0.79 percent one year ago. Noncurrent construction and land loans were 0.41 percent of all construction and land loans, down from 0.71 percent one year ago. Noncurrent commercial loans fell slightly to 1.10 percent of all commercial loans at the end of year from 1.11 percent a year ago. Noncurrent consumer loans decreased from 0.78 percent of all consumer loans one year ago to 0.63 percent at the end of 2005.

In contrast to the year-over-year improvement in most noncurrent loan types, loans past due by 30 to 89 days were higher over the year for most 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 \$8.6 billion, or 0.59 percent of assets compared to \$7.3 billion, or 0.56 percent of assets, one year ago, and \$7.6 billion, or 0.53 percent of assets, in the third quarter.

## **ASSETS, LIABILITIES, AND CAPITAL**

Industry assets increased by 12.0 percent over the year to \$1.46 trillion from \$1.31 trillion. Thrifts remain focused on residential mortgage lending, with 55.7 percent of assets invested in 1-4 family mortgage loans at the end of the year, down slightly from 55.8 percent one year ago. Of these 1-4 family mortgage loans, 11.1 percent are home equity lines of credit, up from 11.0 percent of 1-4 family mortgages in the fourth quarter one year ago. Holdings of consumer loans increased to 6.6 percent of assets from 6.0 percent a year ago, and multifamily mortgages were down over the year to 4.5 percent of assets from 4.7 percent. Commercial loans fell to 3.0 percent of assets at year-end from 3.1 percent one year ago.

Deposits and escrows grew by 10.3 percent over the year to \$836 billion from \$758 billion. As a percentage of total assets, deposits and escrows decreased to 57.1 percent from 58.0 percent one year ago. Federal Home Loan Bank advances were unchanged from one year ago at 18.7 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 2005 was a record 9.45 percent of assets, up from 9.08 percent one year ago. No thrift was less than adequately capitalized at year-end.

## **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 – increased by one over the year to seven. Assets of problem thrifts were unchanged from the third quarter at \$1.9 billion, but were up from \$709 million one year ago.

Thrifts with composite ratings of 3 declined to 45 at year-end from 52 one year ago and from 49 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. All of the 3-rated thrifts at the end of 2005 were well capitalized, providing them with some degree of cushion to work through their problems.

## **STRUCTURAL CHANGES**

Charter choice decisions resulted in 13 institutions choosing a thrift charter during the year – five were “de novo” institutions and eight were existing institutions that converted to a federal thrift charter (one from a national bank, one from a state-chartered commercial bank, and six from state-chartered savings banks). Nine thrifts converted to commercial bank or state-chartered savings bank charters over the year. Also during the year, ten OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired 12 thrifts. Five thrifts left through voluntary dissolution.