
THRIFT INDUSTRY HIGHLIGHTS FOURTH QUARTER 2004

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SUMMARY

Record levels of earnings and equity capital, and overall strong credit quality characterized thrift industry results for the year 2004 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 over the course of the year. But the industry's aggregate net interest margin remained relatively stable as loan portfolios grew, and as quarterly changes in interest income and interest expense remained relatively matched. Mortgage origination volume for the year was the industry's second best ever, declining from the record volume of the prior year as slightly higher longer-term interest rates at the beginning of the year and lower refinancing volumes reduced demand.

Thrift industry assets increased by almost 20 percent for the year to \$1.31 trillion. The number of thrifts supervised by OTS stood at 886 at the end of 2004. In addition, at year-end OTS supervised 491 holding company enterprises with approximately \$6.8 trillion in U.S. domiciled consolidated assets. These enterprises owned 461 thrifts with total assets exceeding \$1 trillion, or 80 percent of total thrift industry assets. In December 2004, OTS was determined to be an equivalent consolidated holding company supervisor by the United Kingdom's Financial Services Authority, in consultation with Commission Bancaire of France and BaFin of Germany, for General Electric's financial services arm, GE Capital Services, assuring proper coordination among various financial services regulators overseeing the activities of this diversified multinational financial services company.

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 loan types showing improvement in delinquencies from one year ago. Troubled assets (defined as noncurrent loans and repossessed assets) were at record low rates in the third and fourth quarters. Loans past due by 30- to 89-days as a percentage of assets were lower from one year ago, and unchanged from the third quarter. Although the industry's equity capital reached a new record level at year-end, its equity capital ratio was slightly lower than the record level of the third quarter.

EARNINGS AND PROFITABILITY

Net income reached a record of \$13.96 billion in 2004, up two percent from the previous record of \$13.74 billion in the prior year. For the fourth quarter, the industry earned a record \$3.76 billion, up nine percent from the year ago fourth quarter and up seven percent from the prior quarter. This was the ninth time and eighth consecutive quarter that quarterly income topped the \$3 billion mark. The number of thrifts reporting losses in the fourth quarter

was 82, down from 107 thrifts in the fourth quarter one year ago.

Profitability, as measured by return on average assets (ROA), was 1.17 percent for the year, down from the previous record of 1.29 percent in 2003. Fourth quarter ROA was 1.17 percent, down from 1.26 percent in the comparable year ago quarter, but up two basis points from 1.15 percent in the third quarter. The median ROA declined to 0.71 percent in the fourth quarter from 0.75 percent in the third quarter, but was up from 0.67 percent one year ago.

Return on average equity (ROE) decreased to 12.79 percent for the year from 14.29 percent in 2003. In the fourth quarter, ROE was 12.95 percent, down from 14.07 percent in the fourth quarter one year ago, but up from 12.58 percent in the third quarter.

ANALYSIS OF ROA

Lower net interest margin and other noninterest income, and higher loan loss provisions and noninterest expense contributed to lower ROA for the year. These reductions to ROA more than offset the positives of higher fee income and lower taxes. For the fourth quarter, ROA was slightly higher than in the prior quarter due to an improved net interest margin, higher other noninterest income, and lower noninterest expense.

For the year, NIM decreased to 289 basis points (or 2.89 percent of average assets) from 290 basis points in 2003. In the fourth quarter, NIM averaged 290 basis points, up from 284 basis points in the comparable quarter a year ago.

Loan loss provisions increased to 0.22 percent of average assets for the year from 0.21 percent in 2003. Provisions were 0.26 percent of average assets in the fourth quarter, up from 0.12 percent in the fourth quarter one year ago and from 0.21 percent in the prior quarter. The relatively low level of provisioning in the fourth quarter one year ago was due to some reversals of previously booked loss provisions as economic conditions and credit quality improved over the 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 1.03 percent of average assets for the year from 0.87 percent in 2003. In the fourth quarter, total fee income was 1.18 percent of average assets, down from 1.25 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 a negative 0.01 percent of average assets in 2004, an improvement of six basis points from the prior year. In the fourth quarter, servicing fee income was 0.13 percent of average assets, down from 0.29 percent in the fourth quarter one year ago, but up from 0.10 percent in the prior quarter.

Other fee income was up ten basis points for the year to 1.04 percent of average assets. In the fourth quarter, other fee income was 1.05 percent of average assets, up nine basis points from the fourth quarter one year ago, but down from 1.12 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 22 basis points to 0.65 percent of average

assets, due to lower gains from sales of assets over the year. In the fourth quarter, other noninterest income was 0.54 percent of average assets, up from 0.46 percent in the fourth quarter one year ago and from 0.50 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 increased to 2.55 percent of average assets over the year from 2.43 percent in 2003. In the fourth quarter, noninterest expense increased to 2.55 percent of average assets from 2.47 percent in the fourth quarter one year ago. General and administrative expense, the largest component of noninterest expense, climbed to 2.52 percent of average assets in the fourth quarter from 2.44 percent in the comparable year ago quarter.

Taxes were down eight basis points over the year to 0.64 percent of average assets and were 0.63 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 2004 were \$689.1 billion, the industry's second best originations volume, and down 14 percent from the record of \$805.7 billion in 2003. In the fourth quarter total mortgage originations climbed to \$176.6 billion, up from \$163.9 billion in the fourth quarter one year ago and from \$167.1 billion in the third quarter. Fourth quarter 1-4 family mortgage originations by thrifts were \$154.1 billion, up seven percent from \$143.9 billion in the fourth quarter one year ago and up six percent from the \$145.4 billion originated in the third quarter.

Thrifts accounted for approximately 24 percent of total 1-4 family originations nationwide in the fourth quarter of 2004,¹ up from 23 percent in the comparable year ago quarter and from 21 percent in the third quarter. An estimated 62 percent of thrift originations were ARMs in the fourth quarter, up from 37 percent in the fourth quarter one year ago and from 55 percent in the third quarter. In contrast, the ARM share for all lenders was 36 percent in the fourth quarter, 27 percent in the fourth quarter one year ago, and 38 percent in the third quarter.²

The volume of mortgage refinancing was sharply lower over the year, but up in the fourth quarter as longer-term interest rates eased. Refinancing activity accounted for 36 percent of thrift originations in the fourth quarter, up from 26 percent in the fourth quarter one year ago and from 31 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 over the year for most loan types. Troubled assets, which consist of noncurrent loans and repossessed assets, remained at a record low 0.49 percent of assets first achieved in the prior quarter, and were down from 0.67 percent in the comparable year ago quarter. Repossessed assets were unchanged from the prior quarter at 0.06 percent of assets and down from 0.09 percent of assets one year ago.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) have remained at a record low rate of 0.43 percent of assets for the past three quarters, down from 0.58 percent at the end of 2003. Noncurrent loan rates for multifamily mortgages were unchanged from one year ago, and noncurrent loan rates for other loan types 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 were 0.52 percent of all 1-4 family loans at year-end, down from 0.83 percent one year ago. Noncurrent multifamily loans were unchanged from one year ago at 0.13 percent of all multifamily loans.

Noncurrent nonresidential mortgages fell to 0.79 percent of all nonresidential mortgages from 0.87 percent one year ago. Noncurrent construction and land loans were 0.69 percent of all construction and land loans, down from 0.85 percent one year ago. Noncurrent commercial loans fell to 1.11 percent of all commercial loans at the end of 2004 from 1.21 percent a year ago. Noncurrent consumer loans were lower from one year ago at 0.89 percent of all consumer loans, but up from 0.70 percent at the end of the third quarter.

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 year-end were \$7.4 billion, or 0.57 percent of assets compared to \$7.8 billion, or 0.71 percent of assets, one year ago, and \$7.0 billion, or 0.57 percent of assets, in the third quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased 19.6 percent over the year to \$1.31 trillion from \$1.09 trillion a year ago. Thrifts remain focused on residential mortgage lending, with 55.8 percent of assets invested in 1-4 family mortgage loans at year-end, up from 50.1 percent one year ago. Holdings of consumer loans climbed over the year to 6.0 percent of assets from 5.8 percent a year ago, and multifamily mortgages were down slightly over the year to 4.7 percent of assets from 4.9 percent. Commercial loans decreased over the year to 3.1 percent of assets.

Deposits and escrows grew by 10.2 percent over the year to \$758 billion from \$688 billion a year ago. As a percentage of total assets, deposits and escrows decreased to 58.0 percent from 62.9 percent one year ago. Federal Home Loan Bank advances climbed to 18.7 percent of assets at the end of 2004 from 17.4 percent one year ago.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At year-end, over 99 percent of the industry exceeded well-capitalized standards. Equity capital at the end of 2004 was 9.08 percent of assets, down from 9.09 percent a year ago and from a record 9.27 percent at the end of the third 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 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 – fell by two over the year to six. Assets of problem thrifts were \$709 million at the end of 2004, up from \$636 million a year ago and from \$287 million in the third quarter.

Thrifts with composite ratings of 3 declined to 52 at year-end from 57 one year ago, and were down from 53 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 year-end 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 14 existing institutions coming under OTS supervision during the year and 21 thrifts leaving OTS supervision (14 to commercial bank charters and seven to state-regulated savings bank charters). During the year, 12 OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired 21 thrifts. Three thrifts left through voluntary dissolution. One small thrift failed during the year.

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*.