THRIFT INDUSTRY HIGHLIGHTS

FOURTH QUARTER 2003

Office of Thrift Supervision / February 18, 2004

SUMMARY

The thrift industry reported record results for the year 2003 and very strong results for the fourth quarter. New records were set for annual earnings and return on average assets (ROA), equity capital, annual total mortgage originations, and annual 1-4 family mortgage originations.

The sustained strength in earnings and profitability was in part attributable to the favorable interest rate environment. Over the year, the yield curve remained steep, but the industry's aggregate annual net interest margin (NIM) declined as asset portfolios repriced at lower yields, and as noninterest-bearing custodial and escrow accounts declined as refinancing volumes fell. The low interest rate environment continued to fuel the mortgage refinancing boom over the first three quarters of the year, driving annual mortgage originations and sales volumes to record levels. An increase in mortgage interest rates in the third and fourth quarters reduced fourth quarter originations and sales volumes to their lowest levels in five quarters.

Although the industry's level of equity capital reached a new record at year-end, its equity capital ratio was slightly lower from the record level of one year ago. 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, although consumer loan delinquencies were higher from one year ago. Troubled assets (defined as noncurrent loans and repossessed assets) were lower over the year and fourth quarter. Loans past due by 30- to 89-days were lower from one year ago, but up in the fourth quarter.

EARNINGS AND PROFITABILITY

Net income reached a record of $13.7 billion in 2003, up 16 percent from the previous record of $11.8 billion in the prior year. For the fourth quarter, the industry earned $3.45 billion, up 16 percent from the year ago fourth quarter and nearly unchanged from the prior quarter. The number of thrifts reporting losses in the fourth quarter was 105, up from 93 thrifts in the fourth quarter one year ago.

Profitability, as measured by ROA, reached a record 1.29 percent for the year, up from the previous record of 1.21 percent in 2002. Fourth quarter ROA was 1.26 percent, up from 1.20 percent in the comparable year ago quarter, but down slightly from 1.28 percent in the third quarter. The median ROA declined to 0.68 percent in the fourth quarter, down from 0.76 percent in the third quarter and from 0.81 percent one year ago.

Return on average equity (ROE) climbed to 14.30 percent for the year from 13.61 percent in 2002. In the fourth quarter, ROE was 14.09 percent, up from 13.24 percent in the fourth quarter one year ago, but down from 14.17 percent in the third quarter.

ANALYSIS OF ROA

Lower loan loss provisions, lower impairment charges for mortgage servicing rights, and higher fee income, fueled improvement in ROA for the year. These increases more than offset the negatives of lower net interest margin, lower other noninterest income, higher noninterest expense, and higher taxes. For the fourth quarter, ROA was slightly lower due to lower noninterest income, and higher noninterest expense.

For the year, NIM decreased to 290 basis points (or 2.90 percent of average assets) from 306 basis points in 2002. In the fourth quarter, NIM averaged 285 basis points, down from 294 basis points in the comparable quarter a year ago. Over the quarter, interest income as a percentage of average assets fell three basis points while interest expense declined by five basis points.

Provisions decreased to 0.21 percent of average assets for the year from 0.29 percent in 2002. Loss provisions were 0.12 percent of average assets in the fourth quarter, down from 0.27 percent in the fourth quarter one year ago and from 0.20 percent in the prior quarter. The large decline in the fourth quarter was due to some reversal of previously booked loss provisions as economic conditions and credit quality improved over the quarter.

Total fee income, including mortgage loan servicing fee income and other fee income, increased to 0.87 percent of average assets for the year from 0.47 percent in 2002. In the fourth quarter, total fee income was 1.25 percent of average assets, up from 0.64 percent in the fourth quarter one year ago and from 1.01 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 0.07 percent of average assets in 2003, an improvement of 32 basis points from the prior year. In the fourth quarter, servicing fee income was 0.29 percent of average assets, an improvement from a negative 0.28 percent in the fourth quarter one year ago and from 0.05 percent in the prior quarter.

Other fee income was up eight basis points for the year to 0.94 percent of average assets. In the fourth quarter, other fee income was 0.96 percent of average assets, up four basis points from the fourth quarter one year ago and unchanged from the prior quarter. 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 for the year fell by 11 basis points to 0.87 percent of average assets, due to lower gains from sales of assets over the last half of the year. In the fourth quarter, other noninterest income was 0.46 percent of average assets, down from 0.91 percent in the fourth quarter one year ago and from 0.76 percent in the third quarter. Other noninterest income primarily includes gains on sales of assets, dividends on FHLB stock, 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 2.43 percent of average assets over the year from 2.35 percent in 2002. In the fourth quarter, noninterest expense increased to 2.47 percent of average assets from 2.39 percent in the fourth quarter one year ago. General and administrative expense, the largest component of noninterest expense, climbed to 2.44 percent of average assets in the fourth quarter from 2.34 percent in the comparable year ago quarter.

Taxes were up six basis points over the year to 0.72 percent of average assets and were 0.70 percent in the fourth quarter. Over the past two years, taxes have averaged 0.68 percent of average assets, or about 35 percent of pretax income.

MORTGAGE ORIGINATIONS

Total mortgage originations for the thrift industry in 2003 were a record $806 billion, surpassing the previous record of $536 billion in 2002. Home sales and mortgage loan demand remained at or near record levels over the first three quarters of the year as mortgage interest rates remained at four decade lows. Higher mortgage interest rates in the fourth quarter resulted in a decline in total mortgage originations (which include multifamily and nonresidential mortgages) to $163.9 billion, down from $177.4 billion in the fourth quarter one year ago and from a record $250.5 billion in the third quarter. Fourth quarter 1-4 family mortgage originations by thrifts were $143.9 billion, down ten percent from $159.6 billion in the fourth quarter one year ago and down 37 percent from the record $230.0 billion originated in the third quarter.

Thrifts' estimated share of all 1-4 family originations[1] was 23 percent of total 1-4 family originations in the fourth quarter, unchanged from the comparable year ago quarter and up from 19 percent in the third quarter. An estimated 37 percent of thrift originations were ARMs in the fourth quarter, up from 29 percent in the fourth quarter one year ago and from 26 percent in the third quarter. In contrast, the ARM share for all lenders was 27 percent in the fourth quarter, 13 percent in the fourth quarter one year ago, and 18 percent in the third quarter.[2] Thrifts' higher ARM share in the fourth quarter reflected the increase in longer-term mortgage interest rates.

The volume of mortgage refinancing was sharply lower in the fourth quarter as mortgage interest rates climbed. Refinancing activity (counting only those mortgages refinanced with the same lender) accounted for 26 percent of thrift originations in the fourth quarter, down from 49 percent in the fourth quarter one year ago and from 42 percent in the prior quarter.

ASSET QUALITY

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. Troubled assets, which consist of noncurrent loans and repossessed assets, decreased to 0.67 percent of assets from 0.75 percent in the comparable year ago quarter and from 0.68 percent in the prior quarter. Repossessed assets were unchanged from the prior quarter at 0.09 percent of assets and down from 0.10 percent of assets 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*.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) decreased over the year to 0.58 percent of assets at year-end as noncurrent rates (as a percentage of total loan type) were improved for 1-4 family mortgage loans, nonresidential loans, construction and land loans, and commercial loans over the year. Noncurrent loan rates for multifamily mortgages were unchanged from one year ago, and noncurrent consumer loans increased 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 strong credit quality. Noncurrent loan rates for 1-4 family loans were 0.84 percent of all 1-4 family loans at year-end, down from 0.93 percent one year ago. Noncurrent multifamily loans were unchanged from one year ago at 0.13 percent of all multifamily loans.

Noncurrent nonresidential mortgages decreased to 0.87 percent of all nonresidential mortgages from 1.24 percent one year ago. Noncurrent construction and land loans were 0.87 percent of all construction and land loans, down sharply from 1.60 percent one year ago. Noncurrent commercial loans fell sharply to 1.21 percent of all commercial loans at year-end from 2.19 percent a year ago. Noncurrent consumer loans were 0.87 percent of all consumer loans at year-end, up from 0.64 percent one year ago.

Loans past due by 30 to 89 days were lower over the year for all 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 year-end were $7.8 billion, or 0.71 percent of assets compared to $7.6 billion, or 0.76 percent of assets, one year ago, and $7.2 billion, or 0.66 percent of assets, in the third quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased 8.8 percent over the year to $1.09 trillion from $1.00 trillion at year-end 2002. Thrifts remain focused on residential mortgage lending, with 49.4 percent of assets invested in 1-4 family mortgage loans at year-end, up from 47.8 percent one year ago. Holdings of consumer loans increased slightly over the year to 6.5 percent of assets, and multifamily mortgages were slightly higher at 4.9 percent of assets. Commercial loans climbed over the year to 3.6 percent of assets.

Deposits grew by 7.2 percent over the year to $637 billion from $594 billion at year-end 2002. As a percentage of total assets, deposits decreased to 58.3 percent from 59.1 percent one year ago. Federal Home Loan Bank advances rose to 17.4 percent of assets at year-end from 17.1 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. In the fourth quarter, equity capital was 9.1 percent of assets, down slightly from a record 9.2 percent a year ago. Capital growth over the year resulted from growth in retained earnings and new capital brought into the industry. Only one thrift was less than adequately capitalized at year-end and has since been recapitalized.

PROBLEM THRIFTS

The thrift industry continued to perform extremely well over the past year and the number of problem thrifts remained at a low level. Problem thrifts - those with composite examination ratings of 4 or 5 - fell by six over the year to 8. Assets of problem thrifts declined to $636 million at the end of the fourth quarter from $2.6 billion in the fourth quarter one year ago, but were up slightly from $602 million in the prior quarter.

Thrifts with composite ratings of 3 declined to 57 in the fourth quarter from 72 one year ago and from 62 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. Of the 57 thrifts rated 3, 98 percent were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

During 2003, 56 thrifts left OTS supervision, up slightly from 54 thrifts over the prior year. Acquisitions by banks resulted in 16 exits. Thrift-to-thrift mergers accounted for 18 exits. There were 18 charter conversions and four voluntary dissolutions. No thrift failed during 2003. There were ten new entrants for the year, up from nine in the prior year. Of the ten new entrants, nine were *de novo* charters and one was a charter conversion.

In the fourth quarter, 12 thrifts left OTS supervision, unchanged from the third quarter. Exits were due primarily to thrift-to-thrift mergers and bank acquisitions. There were four new entrants in the quarter. All new entrants were *de novo* charters.

The number of institutions supervised by OTS stood at 928 at year-end, down from 936 in the prior quarter and 974 one year ago.