



## **THRIFT INDUSTRY HIGHLIGHTS FIRST QUARTER 2011**

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### **SUMMARY**

The nation's thrift industry again – for the seventh consecutive quarter – posted positive earnings. All other indicators of financial condition and performance also show some stability. Though stabilization in condition and performance is a positive step to the industry's full recovery from the nation's economic and housing downturn, we are mindful that the recovery – to date – has been uneven and fragile for many markets throughout the country.

The thrift industry reported a profit of \$1.40 billion, or 0.60 percent of average assets for the first quarter. First quarter profits were down from \$1.61 billion in the prior quarter and from \$1.72 billion in the first quarter one year earlier. The decline in first quarter earnings was attributable to significant restructuring charges of approximately \$649 million taken by one large thrift. Absent these restructuring charges, first quarter industry earnings would have increased from the prior quarter and comparable quarter one year ago.

Loss provision expense continues to trend downward from very high levels in 2008. The industry added \$1.68 billion (0.73 percent of average assets) to loan loss provisions in the first quarter. Provisions measured 1.05 percent of average assets in the prior quarter and 1.19 percent in the first quarter one year earlier. Still, the level of loss provision expense is higher than the period of 2001-2006 when loss provisions averaged 0.24 percent.

While loss provisions dampen earnings, they also bolster loan loss reserves. And the industry's loss reserve ratios – loss reserves as a percent of total loans and leases (reserve ratio), and the ratio of reserves plus capital-to-total loans and leases (loss coverage ratio) have been bolstered to record or near record levels. As of the end of the first quarter, the industry's reserve ratio stood at 1.87 percent. This reserve has remained in the 1.8 percent-to-2.1 percent range since mid-2008. The loss coverage ratio rose slightly to a new record of 21.51 percent from the previous record of 21.41 percent set in the prior quarter.

Like the industry's loss reserve ratios, all of the industry's capital measures remain solid and stable. The majority of thrifts – 91.2 percent – reported capital exceeding the “well-capitalized” regulatory standards. And these thrifts' combined assets represented 95.8 percent of industry aggregate assets.

The thrift industry's operating earnings<sup>1</sup> for the first quarter of 2011 were 1.63 percent of average assets, compared with the 2001-2010 ten year average of 1.42 percent. The combination of solid capital, bolstered loan loss reserves and solid, stable operating earnings will help the industry weather the persistent economic and housing market weakness currently facing the nation.

The level of problem assets has stabilized over the past two years. The industry's troubled assets (noncurrent loans and repossessed assets) declined to 3.09 percent of assets from 3.26 percent in the prior quarter, and from 3.28 percent one year earlier. Despite the stability in troubled assets, current levels are much above pre-recession levels when thrifts' troubled assets ratios were below one percent.

The number of private sector thrifts supervised by OTS stood at 724 with assets of \$930.2 billion at the end of the first quarter. In addition, OTS supervised 440 holding company enterprises with approximately \$4.2 trillion in U.S. domiciled consolidated assets. These enterprises owned 402 thrifts with total assets of \$720 billion, or 77 percent of total thrift industry assets.

Other highlights include:

## **EARNINGS AND PROFITABILITY**

- Net income was \$1.40 billion in the first quarter of 2011, down from \$1.72 billion in the first quarter one year earlier and down from \$1.61 billion in the prior quarter. However, one large thrift had a significant restructuring charge during the quarter. Absent these restructuring charges, industry net income would have increased from the prior quarter and comparable quarter one year ago.
- Profitability, as measured by return on average assets (ROA), was 0.60 percent in the first quarter, down from 0.73 percent in the first quarter one year earlier and down from 0.69 percent in the prior quarter. As mentioned previously, ROA would have increased from last quarter and from one year ago absent the significant restructuring charges of one large thrift. The median ROA in the first quarter was 0.42 percent, up from 0.40 percent in the first quarter one year earlier and up from 0.39 percent in the prior quarter.
- Return on average equity (ROE) was 5.16 percent in the first quarter, down from 6.73 percent in the first quarter one year earlier, and down from 5.90 percent in the prior quarter.

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<sup>1</sup> Operating earnings exclude volatile items and one-time events such as branch sale gains, acquisition and restructuring charges. Operating earnings measures also exclude charges for provisions for loan losses.

## **ANALYSIS OF ROA**

- Earnings decline during the first quarter was primarily due to lower fee income and higher noninterest expense. These declines were partially offset by lower loan loss provisions. As previously mentioned, a major restructuring charge reported by one thrift contributed to the increase in noninterest expense.
- Net interest margin for the first quarter increased to 317 basis points from 305 basis points in the first quarter one year earlier, and was up from 316 basis points in the prior quarter.
- Total fee income in the first quarter, including mortgage loan servicing fee income and other fee income, was 1.50 percent of average assets, up from 1.30 percent in the comparable quarter one year earlier, and down from 1.59 percent in the prior quarter.
- Lower loan loss provisions in the first quarter had a positive impact on thrift earnings. In the first quarter, thrifts added \$1.68 billion, or 0.73 percent of average assets, to loan loss provisions. Provisions measured 1.05 percent of average assets in the previous quarter and 1.19 percent in the first quarter one year earlier. 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.
- Other noninterest income in the first quarter declined to 0.28 percent of average assets from 0.63 percent in the first quarter of 2010, and was down from 0.30 percent in the prior quarter. 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 in the first quarter increased to 3.35 percent of average assets from 2.67 percent in the first quarter one year earlier, and was up from 2.92 percent in the prior quarter. However, as mentioned previously, one large thrift had a significant restructuring charge during the quarter. Absent these restructuring charges, noninterest expense would have been 3.08 percent of average assets in the first quarter.
- Taxes in the fourth quarter were 0.31 percent of average assets, down from 0.42 percent in the first quarter one year earlier, and down from 0.40 percent in the prior quarter.

## MORTGAGE ORIGINATIONS

- Total thrift industry mortgage originations in the first quarter, were \$32.1 billion, down slightly from \$32.2 billion in the first quarter one year earlier, and down 35 percent from \$49.4 billion in the prior quarter. The first quarter decline in originations was primary due to a drop in refinancing caused by a rise in interest rates during the first quarter.
- In the first quarter, 1-4 family mortgage originations were \$26.5 billion, down 2.2 percent from \$27.1 billion in the first quarter one year earlier, and down 37.2 percent from the \$42.2 billion originated in the prior quarter. Much of thrifts' current 1-4 family mortgage production is being sold into the secondary markets. Sales of 1-4 family mortgages measured 99.6 percent of 1-4 family originations in the first quarter, up from 98 percent in the prior quarter.
- Refinancing activity accounted for 56 percent of thrift originations in the first quarter, down from 60 percent in the prior quarter, but up from 52 percent in the first quarter one year earlier. Refinancing activity was attributable to historically low mortgage interest rates.

## ASSET QUALITY

- Delinquencies for most loan types were lower over the year.
- Troubled assets, which consist of noncurrent loans and repossessed assets, were 3.09 percent of assets at the end of the first quarter, down from 3.28 percent one year earlier, and down from 3.26 percent at the end of the prior quarter. Repossessed assets were down three basis points over the year from 0.52 percent of assets to 0.49 percent, and were down two basis points from the prior quarter. Repossessed assets as a percent of assets has been stable over the past six quarters but more than double the level of 0.20 percent in the fourth quarter of 2007.
- Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) fell to 2.60 percent of assets at the end of the first quarter from 2.76 percent at the end of the first quarter one year earlier, and were down from 2.75 percent at the end of the prior quarter. Noncurrent loan rates for 1-4 family loans decreased to 5.19 percent of all 1-4 family loans from 5.31 percent in the prior quarter, but up slightly from 5.17 percent one year earlier. Noncurrent multifamily loans decreased to 2.83 percent of all multifamily loans from 3.46 percent one year earlier. Noncurrent consumer loans decreased to 1.02 percent of all consumer loans in the first quarter from 1.41 percent at the end of first quarter one year earlier. Noncurrent nonresidential mortgages increased to 4.01 percent of all nonresidential mortgages from 3.50 percent one year earlier. Noncurrent construction and land loans were 16.23 percent of all construction and land loans at the end of the first quarter, up from 14.65 percent one year earlier. Noncurrent

commercial loans decreased to 2.48 percent of all commercial loans at the end of the first quarter from 2.68 percent a year earlier. Noncurrent loan rates have trended down from a high of 3.17 percent in the third quarter of 2009.

- Loans past due by 30 to 89 days relative to total assets were lower over the year and from the prior quarter. Total loans past due by 30 to 89 days at the end of the quarter were \$9.0 billion, or 0.96 percent of assets, compared to \$11.6 billion, or 1.22 percent of assets, one year earlier, and were down from 1.07 percent of assets, in the prior quarter.

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

- Industry assets declined 2.1 percent over the year to \$930 billion from \$950 billion. Thrifts remain focused on residential mortgage lending, with 50.4 percent of assets invested in 1-4 family mortgage loans and mortgage-backed securities at the end of the first quarter, up from 50.1 percent one year earlier. Of total 1-4 family mortgage loans, 4.6 percent were home equity lines of credit, down from 4.8 percent one year earlier. Holdings of consumer loans decreased to 8.9 percent of assets from 7.8 percent a year earlier. Multifamily mortgages increased over the year from 3.3 percent of assets to 3.5 percent at the end of the first quarter. Commercial loans decreased from 5.4 percent of assets one year earlier to 5.3 percent.
- Deposits and escrows increased 2.6 percent over the year to \$684 billion from \$667 billion. As a percentage of total assets, deposits and escrows increased to 73.6 percent from 70.2 percent one year earlier. Federal Home Loan Bank advances were down from 9.0 percent one year earlier to 7.7 percent of total assets at the end of the first quarter.
- Capital measures for the industry continue to be strong, stable and well in excess of minimum requirements. Equity capital at the end of the first quarter was 11.58 percent of assets, up from 11.02 percent one year earlier. At the end of the first quarter, 91.2 percent of the industry exceeded well-capitalized standards and 11 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 50 thrifts one year earlier to 60 thrifts at the end of the first quarter, and was up from 58 thrifts at the end of the prior quarter.

## **STRUCTURAL CHANGES**

- A total of 8 thrifts left OTS regulation over the first quarter. One thrift converted to a bank charter, three were acquired by banks, one thrift merged into another OTS-regulated thrift, and one thrift completed a voluntary dissolution. In addition, two thrifts failed during the first quarter. One thrift entered OTS regulation during the quarter.