THRIFT INDUSTRY HIGHLIGHTS

FOURTH QUARTER 2002

Office of Thrift Supervision / February 19, 2003

SUMMARY

The thrift industry reported very strong results for the year 2002 and for the fourth quarter. New records were set for annual earnings and return on average assets (ROA), equity capital, annual and quarterly total mortgage originations, and annual and quarterly 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, benefiting net interest margins, which were higher for the year. But as longer-term interest rates declined slightly during the year and thrift assets repriced or were added to portfolios at these lower yields, the industry's aggregate net interest margin (NIM) fell in each of the last three quarters. The low interest rate environment continued to fuel the mortgage refinancing boom, driving mortgage originations and sales volumes to record levels. A decline in mortgage interest rates over the third and fourth quarters to the lowest rates in four decades generated record levels of mortgage refinancing.

The industry's equity capital ratio set a record at year-end. 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 delinquencies were higher in the fourth quarter. Troubled assets (defined as noncurrent loans and repossessed assets) were higher over the year and fourth quarter. Loans past due by 30- to 89-days, after falling over the first half of the year, were higher in the third and fourth quarters. The strength in thrift portfolios is due, in part, to the industry's concentration in residential lending and its limited exposure to commercial lending and nonmortgage consumer lending.

EARNINGS AND PROFITABILITY

Net income reached a yearly record of $11.8 billion in 2002, up 16 percent from the previous record of $10.2 billion in the prior year. For the fourth quarter, the industry earned $3.0 billion, up two percent from the year ago fourth quarter, and just under the record profits in the first quarter 2002. The number of thrifts reporting losses in the fourth quarter was 86, down from 133 thrifts in the fourth quarter one year ago.

Profitability, as measured by ROA, reached a record 1.21 percent for the year, up from 1.07 percent in 2001, and the best annual ROA in 56 years. Fourth quarter ROA was 1.20 percent, down slightly from 1.22 percent in the prior and comparable year ago quarters.

Return on average equity (ROE) climbed to 13.6 percent for the year from 13.1 percent in 2001. In the fourth quarter, ROE was 13.2 percent, down from 13.4 percent in the third quarter and 14.8 percent in the fourth quarter one year ago.

ANALYSIS OF ROA

Improvement in ROA for the year was fueled by expansion of NIM and growth in other noninterest income, up 17 and 24 basis points, respectively. These increases more than offset the negatives of higher loan loss provisions, additional impairment charges for mortgage servicing rights, and higher taxes. For the fourth quarter, ROA was slightly lower due chiefly to a decline in NIM, lower noninterest income, and higher general and administrative expenses.

For the year, NIM improved to 306 basis points (or 3.06 percent of average assets) from 289 basis points in 2001. In the fourth quarter, NIM averaged 294 basis points, down from 312 basis points in the comparable quarter a year ago. The decline in NIM over the fourth quarter resulted from the repricing of and investment in assets at lower yields. Over the quarter, interest income as a percentage of average assets fell 30 basis points while interest expense declined by only 22 basis points.

Against a backdrop of slower economic activity, rising loan delinquencies, and higher net charge-offs, thrifts increased loss provisions on interest-bearing assets. Provisions rose to 0.29 percent of average assets for the year from 0.27 percent in 2001. Loss provisions were 0.27 percent of average assets in the fourth quarter, up from 0.22 percent in the fourth quarter one year ago, but down from 0.28 percent in the prior quarter. The small decline in fourth quarter provisions was due to one thrift's sale of a portfolio of assets that resulted in a reversal of previously booked loss provisions.

Total fee income, including mortgage loan servicing fee income and other fee income, fell to 0.46 percent of average assets for the year from 0.64 percent in 2001. In the fourth quarter, total fee income was 0.62 percent of average assets, up from a negative 0.03 percent in the prior quarter and from 0.46 percent in the fourth quarter one year ago. Throughout 2001 and 2002, total fee income was depressed by lower mortgage loan servicing fee income as a consequence of impairment charges on mortgage servicing portfolios 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 0.40 percent of average assets in 2002, 24 basis points lower than in the prior year. In the fourth quarter, servicing fee income was negative 0.30 percent of average assets, an improvement from a negative 0.89 percent in the prior quarter and from a negative 0.40 percent in the fourth quarter one year ago.

On the positive side, other fee income was up six basis points for the year to 0.86 percent of average assets. In the fourth quarter, other fee income was 0.92 percent of average assets, up six basis points from the third quarter and from the fourth quarter one year ago. This 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 climbed 24 basis points to 0.98 percent of average assets, due to gains from sales of assets over the year. In the fourth quarter, other noninterest income was 0.92 percent of average assets, down from 1.53 percent in the third quarter, but up from 0.84 percent in the fourth quarter one year ago. 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 decreased to 2.35 percent of average assets over the year from 2.37 percent in 2001. In the fourth quarter, noninterest expense decreased to 2.39 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, fell to 2.34 percent of average assets in the fourth quarter from 2.38 percent in the comparable year ago quarter.

Taxes were higher over the year at 0.66 percent of average assets and were 0.64 percent in the fourth quarter. Over the past two years, taxes have averaged 0.54 percent of average assets, or about 36 percent of pretax income.

MORTGAGE ORIGINATIONS

Total mortgage originations for the thrift industry in 2002 were a record $536 billion, surpassing the previous record of $456 billion in 2001. Home sales and mortgage loan demand remained at or near record levels over the year as mortgage interest rates fell to four decade lows. Total mortgage originations (which include multifamily and nonresidential mortgages) were a record $177.4 billion in the fourth quarter, up from $138.3 billion in the third quarter and $124.2 billion in the fourth quarter one year ago. Fourth quarter 1-4 family mortgage originations by thrifts reached a record $159.6 billion, up 30 percent from $122.4 billion in the third quarter, and up 45 percent from the $110.4 billion originated in the fourth quarter one year ago.

Thrifts' estimated share of all 1-4 family originations[1] was 23 percent of total 1-4 family originations in the fourth quarter, up from 19 percent in the third quarter and from 17 percent in the fourth quarter one year ago. An estimated 29 percent of thrift originations were ARMs in the fourth quarter, down from 46 percent in the third quarter and 30 percent in the fourth quarter one year ago. In contrast, the ARMs share for all lenders was 13 percent in the fourth quarter, 18 percent in the third quarter, and 12 percent in the fourth quarter one year ago.[2] The lower ARMs shares over the year reflected the decline in long-term mortgage interest rates.

The volume of mortgage refinancing climbed sharply to record levels in the fourth quarter as mortgage interest rates eased further. Refinancing activity (counting only those mortgages refinanced with the same lender) accounted for 55 percent of thrift originations in the fourth quarter, up from 45 percent in the prior quarter and 46 percent in the fourth quarter one year ago.

ASSET QUALITY

Despite higher delinquencies in the fourth quarter, 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, climbed to 0.75 percent of assets from 0.70 percent in the prior and comparable year ago quarters. Repossessed assets were unchanged from the prior quarter and one year ago at 0.10 percent of assets.

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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) increased over the year to 0.65 percent of assets at year-end as noncurrent rates (as a percentage of total loan type) moved higher for 1-4 family mortgage loans, consumer loans, construction and land loans, and commercial loans over the year. Noncurrent loan rates for multifamily mortgages and nonresidential mortgages were lower from one year ago. 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 0.93 percent of all 1-4 family loans at year-end, up from 0.81 percent one year ago. Noncurrent multifamily loans were 0.13 percent of all multifamily loans, down from 0.16 percent one year ago.

Noncurrent nonresidential mortgages decreased to 1.22 percent of all nonresidential mortgages from 1.46 percent one year ago. Noncurrent construction and land loans were 1.60 percent of all construction and land loans, up from 1.57 percent one year ago. Noncurrent commercial loans jumped to 2.17 percent of all commercial loans at year-end from 1.99 percent a year ago. Noncurrent consumer loans were 0.64 percent of all consumer loans at year-end, up from 0.60 percent one year ago.

Loans past due by 30 to 89 days were lower over the year for all loan types but 1-4 family mortgages. Rising delinquencies of loans 30 to 89 days past due are worrisome because they may signal higher levels of troubled assets going forward. The highest past due rates occurred in the consumer, commercial, and construction and land loan sectors. Total loans past due by 30 to 89 days at year-end were $7.6 billion, or 0.76 percent of assets, unchanged from $7.6 billion, or 0.77 percent of assets, one year ago, but up from $7.0 billion, or 0.71 percent of assets, in the third quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets increased 2.7 percent during the year to $1 trillion from $978 billion at year-end 2001. Industry assets were last above $1 trillion at the end of 1990. Thrifts remain focused on residential mortgage lending, with 47.7 percent of assets invested in 1-4 family mortgage loans at year-end, up slightly from 47.6 percent one year ago. Holdings of consumer loans decreased slightly over the year to 6.3 percent of assets, while multifamily mortgages were higher at 4.7 percent of assets. Commercial loans were unchanged from one year ago at 3.0 percent of assets.

Deposits grew by 6.9 percent over the year to $594 billion from $555 billion at year-end 2001. As a percentage of total assets, deposits rose to 59.1 percent from 56.8 percent one year ago. Federal Home Loan Bank advances declined to 17.1 percent of assets at year-end from 21.2 percent one year ago.

Capital measures for the industry are strong, stable, and well in excess of minimum requirements. At year-end, 99 percent of the industry exceeded well-capitalized standards. In the fourth quarter, equity capital was a record 9.2 percent of assets, up from 8.1 percent a year ago. Capital growth over the year resulted from growth in retained earnings, larger unrealized gains on available for sale securities, and new capital brought into the industry. Only two thrifts were less than adequately capitalized at year-end.

PROBLEM THRIFTS

Despite the slowing economy and concerns about credit quality in the financial services industry, the thrift industry performed 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 two over the year to 14. Assets of problem thrifts declined to $2.6 billion at the end of the fourth quarter from $3.6 billion in the prior quarter and from $3.3 billion in the fourth quarter one year ago.

Thrifts with composite ratings of 3 declined to 72 in the fourth quarter from 75 in the prior quarter. The number of thrifts rated 3 stood at 72 one year ago. 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 72 thrifts rated 3, 96 percent were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

During 2002, 54 thrifts left OTS supervision, down from 72 thrifts over the prior year. Twenty-six exits were due to bank acquisitions. Thrift-to-thrift mergers accounted for 14 exits. There were nine charter conversions and four voluntary dissolutions. One small thrift with $51.6 million in assets failed in 2002. There were nine new entrants for the year, down from 23 in the prior year. Of the new entrants, three were *de novo* charters and six were charter conversions.

In the fourth quarter, 14 thrifts left OTS supervisions, compared with 12 in the third quarter. Exits were due primarily to bank acquisitions and thrift-to-thrift mergers. There were five new entrants for the quarter. Of the new entrants, two were *de novo* charters and three were charter conversions.

The number of institutions supervised by OTS fell to 974 at year-end from 983 in the prior quarter and 1,019 one year ago.