THRIFT INDUSTRY HIGHLIGHTS FOURTH QUARTER 2008

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SUMMARY

Continued economic weakness combined with uncertainty of an economic recovery in the short-term has necessitated the need for elevated levels of loan loss reserves. Thrifts' responded to this environment and outlook by significantly bolstering their loan loss reserves. In the fourth quarter, thrifts added $8.7 billion to loan loss provisions bringing the total additions to a record $38.7 billion for the year. These substantial loan loss provisions increased thrifts' loss reserve-to-total loans and leases ratio 63 percent to 1.79 percent at the end of 2008 from 1.10 percent one year ago.

But since loan loss reserves are built through charges to earnings, these substantial loss provision expenses continue to drive industry net losses. The large provision for losses of $8.7 billion resulted in a fourth quarter net loss of $3 billion, or an annualized return on average assets (ROA) of negative 1.02 percent. And the record annual provision of $38.7 billion drove the industry's loss to a record $13.4 billion for 2008, or an ROA of negative 1.00 percent.

We expect loss provisioning to continue to dampen industry earnings until footing can be established in home prices, job market losses slow, and the employment outlook begins to brighten.

Despite recent net losses, the industry's financial fundamentals remain solid. The majority of thrifts – 97.2 percent – hold capital exceeding the "well-capitalized" regulatory standards. And these thrifts' combined assets represent 95.3 percent of industry aggregate assets.

To better gauge and assess earnings, many analysts are increasingly focusing attention on "core" or "operating" earnings. Operating earnings measures exclude volatile items and one-time events such as branch sale gains or acquisition charges. And operating earnings measures also exclude charges for provisions for loan losses.

The thrift industry's recent operating earnings remain stable and measured 1.39 percent of average assets, 1.37 percent, and 1.34 percent, for the years 2008, 2007, and 2006, respectively. The combination of solid capital, bolstered loan loss reserves, and solid, stable operating earnings will help the industry weather the economic and housing market distress currently facing the nation.

Recent increases in problem assets are also a direct result of the continued housing market downturn and rising unemployment. Troubled assets (noncurrent loans and repossessed assets) rose to 2.52 percent of assets, up from 1.66 percent a year ago. The current level of troubled assets is the highest since the early 1990s.

However the composition of thrift troubled assets is currently much different than in the early 1990s when the ratio reached 3.74 percent at the end of 1990. Mortgages on 1-4 family properties comprise approximately 72 percent of the industry's current troubled assets, with an additional 20 percent consisting of commercial real estate loans (nonresidential mortgages, multifamily complexes, and construction loans), and eight percent in nonmortgage loans. In contrast, commercial real estate loans comprised the majority, or 68 percent, of thrift troubled assets in 1990, with 1-4 family mortgages (23 percent) and nonmortgage loans (9 percent) comprising the remainder.

The number of private sector thrifts supervised by OTS stood at 810 with assets of $1.20 trillion at the end of 2008. In addition, OTS supervised 463 holding company enterprises with approximately $6.4 trillion in U.S. domiciled consolidated assets. These enterprises owned 431 thrifts with total assets of $865 billion, or 72 percent of total thrift industry assets.

Other highlights include:

EARNINGS AND PROFITABILITY

- Net losses were $13.44 billion for the year, down from net losses of $649 million in 2007. In the fourth quarter, net losses of $2.99 billion were reported, an improvement from net losses of $4.38 billion in the third quarter and from net losses of $8.75 billion in the fourth quarter one year ago. This was the fifth consecutive quarterly loss reported by the thrift industry.

- Profitability, as measured by return on average assets (ROA), was a negative 1.00 percent for the year, down from a negative 0.04 percent in the prior year. In the fourth quarter, ROA was a negative 1.02 percent, down from a negative 2.31 percent in the comparable year ago quarter, but up from a negative 1.48 percent in the prior quarter. The median ROA declined to 0.30 percent in the fourth quarter from 0.39 percent in the fourth quarter one year ago, and was down from 0.35 percent in the prior quarter.

- Return on average equity (ROE) was a negative 11.04 percent in the fourth quarter, down from a negative 23.5 percent in the fourth quarter one year ago, but up from a negative 16.4 percent in the prior quarter.

ANALYSIS OF ROA

- Higher loan loss provisions drove losses for the fourth quarter and year.

- For the year, net interest margin increased to 282 basis points (or 2.82 percent of average assets) from 269 basis points in 2007. In the fourth quarter, net interest margin decreased to 268 basis points from 293 basis points in the third quarter, but was up from 261 basis points in the comparable quarter a year ago.

- For the year, loan loss provisions were 2.87 percent of average assets, up from 0.77 percent in 2007. Loan loss provisions were 2.96 percent of average assets in the fourth quarter, up from 2.80 percent in the third quarter and from 1.44 percent in the fourth quarter one year ago. The recent increases in loss provisions reflect the increase in noncurrent loans stemming from the housing market downturn and the deterioration of loans originated in the past several years. 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.

- Total fee income, including mortgage loan servicing fee income and other fee income, was 1.23 percent of average assets in 2008, up slightly from 1.22 percent in the prior year. In the fourth quarter, total fee income was 1.01 percent of average assets, down from 1.18 percent in the third quarter and from 1.15 percent in the fourth quarter one year ago.

- Other noninterest income was 0.15 percent of average assets in 2008, up from 0.12 percent in 2007. In the fourth quarter, other noninterest income was 0.35 percent of average assets, up from a negative 0.17 percent in the third quarter and from a negative 0.51 percent in the fourth quarter a year ago. 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 decreased to 2.75 percent of average assets in 2008 from 3.13 percent in 2007. In the third quarter, noninterest expense fell to 2.50 percent of average assets from 2.94 percent in the prior quarter and from 4.59 percent in the fourth quarter one year ago. General and administrative expense, the largest component of noninterest expense, was 2.29 percent of average assets in the fourth quarter, down from 2.63 percent in the comparable year ago quarter.

- Taxes were down 59 basis points over the year to a negative 0.43 percent of average assets in 2008 from 0.16 percent in 2007. In the fourth quarter, taxes were a negative 0.41 percent of average assets, down from a negative 0.32 percent in the prior quarter.

MORTGAGE ORIGINATIONS

- Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) in 2008 were $404.9 billion, down 43 percent from $716.2 billion in 2007. In the fourth quarter, total mortgage originations decreased to $63.2 billion from $166.6 billion in the fourth quarter one year ago, and were down from $79.6 billion in the prior quarter. Fourth quarter 1-4 family mortgage originations by thrifts were $52.4 billion, down 64 percent from $143.9 billion in the fourth quarter one year ago, and down 21 percent from the $66.1 billion originated in the prior quarter.

- Thrifts accounted for approximately 20 percent of total 1-4 family originations nationwide in the fourth quarter of 2008,[1] down from 31 percent in the comparable year ago quarter, and from 21 percent in the prior quarter. An estimated less than one percent of thrift originations were ARMs in the fourth quarter, down from nine percent in the comparable year ago quarter, and down from 18 percent in the prior quarter. The ARM share for all lenders was estimated at three percent in the fourth quarter, eight percent in the prior quarter, and nine percent in the fourth quarter one year ago.[2]

- The volume of mortgage refinancing, as a percentage of total originations, was down from the comparable year ago quarter, but up from the prior quarter as borrowers converted adjustable rate mortgages to fixed rate mortgages. Refinancing activity accounted for 42 percent of thrift originations in the fourth quarter, down from 48 percent in the fourth quarter one year ago, but up from 34 percent in the prior quarter.

ASSET QUALITY

- Delinquencies for most loan types were higher over the year and in the fourth quarter.

- Troubled assets, which consist of noncurrent loans and repossessed assets, were up 12 basis points from the prior quarter at 2.52 percent of assets, and were up from 1.66 percent one year ago. Repossessed assets were unchanged from the prior quarter at 0.33 percent of assets, and were up from 0.20 percent one year ago.

- Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) increased by 13 basis points from the prior quarter to 2.20 percent of assets at the end of the fourth quarter, and were up from 1.46 percent one year ago. Noncurrent loan rates for 1-4 family loans were up 135 basis points from one

[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*.

year ago and 31 basis points from the prior quarter to 3.70 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 1.18 percent of all multifamily loans from 0.43 percent one year ago. Noncurrent consumer loans increased from 1.01 percent of all consumer loans one year ago to 1.40 percent at the end of the fourth quarter. Noncurrent nonresidential mortgages increased to 1.36 percent of all nonresidential mortgages from 0.70 percent one year ago. Noncurrent construction and land loans were 8.07 percent of all construction and land loans at the end of the fourth quarter, up from 4.62 percent one year ago. Noncurrent commercial loans increased to 1.84 percent of all commercial loans at the end of the fourth quarter from 1.01 percent a year ago.

- Loans past due by 30 to 89 days were higher over the year. Total loans past due by 30 to 89 days at the end of the fourth quarter were $20.9 billion, or 1.74 percent of assets compared to $20.6 billion, or 1.37 percent of assets, one year ago, and were up from $17.1 billion, or 1.44 percent of assets, in the prior quarter.

ASSETS, LIABILITIES, AND CAPITAL

- Industry assets decreased by 21 percent over the year to $1.20 trillion from $1.51 trillion reflecting the loss of one large thrift that failed in the third quarter. Thrifts remain focused on residential mortgage lending, with 43.5 percent of assets invested in 1-4 family mortgage loans at the end of the year, down from 49.1 percent one year ago. Of these 1-4 family mortgage loans, 5.4 percent are home equity lines of credit, down from 7.7 percent one year ago. Holdings of consumer loans increased to 6.8 percent of assets from 5.8 percent a year ago. Multifamily mortgages decreased over the year from 4.1 percent of assets to 2.8 percent at the end of the year. Commercial loans increased to 5.2 percent of assets at the end of the year from 3.8 percent one year ago.

- Deposits and escrows fell by 18 percent over the year to $732 billion from $892 billion. As a percentage of total assets, deposits and escrows increased to 61.0 percent from 59.1 percent one year ago. Federal Home Loan Bank advances were down from 20.0 percent one year ago to 17.5 percent of total assets.

- Capital measures for the industry continue to be strong, stable, and well in excess of minimum requirements. Equity capital at the end of 2008 was 9.09 percent of assets, down from 9.26 percent one year ago. At the end of the year, over 97 percent of the industry exceeded well-capitalized standards and eight 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 11 thrifts one year ago to 26 thrifts at the end of 2008.

STRUCTURAL CHANGES

- A total of 17 new thrifts were chartered during 2008, including seven “de novo” thrifts, eight conversions from state savings banks, and two conversions from state commercial banks. Six thrifts converted to commercial bank or state savings bank charters over the year. Also during the year, seven OTS-regulated thrifts merged with other OTS-regulated thrifts and non-OTS regulated institutions acquired 13 thrifts. In addition, two thrifts completed voluntary dissolutions and five thrifts failed during the year.