



THRIFT INDUSTRY HIGHLIGHTS FOURTH QUARTER 2006

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SUMMARY

Annual results for the nation's thrift industry were historically strong in 2006 even as earnings, profitability, and asset quality measures decreased in the fourth quarter as industry data began to reflect the slowdown in the housing markets and the changing credit cycle for residential mortgage lending and consumer loans. Earnings and profitability, especially for smaller thrifts, continued to be stressed by the flat to inverted yield curve throughout the year.

The industry's aggregate net interest margin, while lower for the year, improved from the prior quarter. Total mortgage origination volume for the year was down 14 percent from 2005, and in the fourth quarter was down 22 percent from the third quarter as existing and new home sales and refinance volumes declined.

Thrift industry assets decreased by four percent over the year to \$1.41 trillion, reflecting the exits of two large, affiliated thrifts in the fourth quarter. The number of thrifts supervised by OTS stood at 845 at the end of 2006. In addition, OTS supervised 475 holding company enterprises with approximately \$8.0 trillion in U.S. domiciled consolidated assets. These enterprises owned 448 thrifts with total assets of \$1.3 trillion, or 91 percent of total thrift industry assets.

Asset quality remained strong by historical levels, but delinquencies have increased from recent record low levels. Despite the sustained strength in industry asset quality, delinquencies of 1-4 family and multifamily mortgages, consumer loans, and construction and land loans were up from recent record low rates. Loans past due 30- to 89-days as a percentage of assets rose in the fourth quarter and were higher from one year ago at the end of 2006. The industry's equity capital level and ratio, as a percentage of assets, set new records at the end of the year.

EARNINGS AND PROFITABILITY

Net income was \$15.89 billion for the year, down three percent from a record \$16.40 billion earned in 2005. In the fourth quarter, thrifts earned \$3.19 billion, down 26 percent from record quarterly earnings of \$4.32 billion in the fourth quarter one year

ago, and down 26 percent from \$4.29 billion in the prior quarter. The number of thrifts reporting losses in the fourth quarter was 132, up from 102 thrifts in the fourth quarter one year ago.

Profitability, as measured by return on average assets (ROA), was 1.06 percent for the year, down from 1.19 percent in 2005. In the fourth quarter, ROA was 0.91 percent, down from 1.19 percent in the comparable year ago quarter, and from 1.08 percent in the third quarter. The median ROA declined to 0.53 percent in the fourth quarter from 0.67 percent in the fourth quarter one year ago, and was down from 0.62 in the prior quarter.

Return on average equity (ROE) was 9.02 percent in the fourth quarter, down from 12.86 percent in the fourth quarter one year ago, and from 11.72 percent in the third quarter.

ANALYSIS OF ROA

Lower net interest margin and fee income and higher loan loss provisions and noninterest expense drove the ROA decline for the year compared to 2005. Partially offsetting these negative impacts to profitability were higher other noninterest income, and lower taxes. For the fourth quarter, ROA was lower from the prior quarter due to higher loan loss provisions and noninterest expense and lower noninterest income.

For the year, NIM decreased to 273 basis points (or 2.73 percent of average assets) from 281 basis points in 2005. In the fourth quarter, NIM averaged 271 basis points, down from 276 basis points in the comparable quarter a year ago, but up from 265 basis points in the prior quarter.

Loan loss provisions increased to 0.25 percent of average assets for the year from 0.21 percent in 2005. Provisions were 0.45 percent of average assets in the fourth quarter, up from 0.26 percent in the fourth quarter one year ago, and up from 0.22 percent in the prior quarter. The recent rise in loss provisions reflects the increase in noncurrent loans as discussed later in more detail. 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, decreased to 1.15 percent of average assets for the year from 1.22 percent in 2005. In the fourth quarter, total fee income was 1.26 percent of average assets, down from 1.38 percent in the fourth quarter one year ago, but up from 0.91 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 0.07 percent of average assets in 2006, down from 0.12

percent in the prior year. In the fourth quarter, servicing fee income was 0.04 percent of average assets, down from 0.10 percent in the fourth quarter one year ago, but up from a negative 0.05 percent in the prior quarter. Other fee income was down two basis points for the year to 1.08 percent of average assets. In the fourth quarter, other fee income was 1.22 percent of average assets, down six basis points from the fourth quarter one year ago, but up from 0.96 percent in the prior quarter.

Other noninterest income for the year was up five basis points to 0.56 percent of average assets, due to larger gains from sales of assets over the year. In the fourth quarter, other noninterest income was 0.43 percent of average assets, down from 0.53 percent in the fourth quarter one year ago, and down from 0.81 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 2.58 percent of average assets over the year from 2.48 percent in 2005. In the fourth quarter, noninterest expense was up five basis points to 2.59 percent of average assets from the prior and comparable year ago quarters. General and administrative expense, the largest component of noninterest expense, increased by two basis points to 2.52 percent of average assets in the fourth quarter from 2.50 percent in the comparable year ago quarter.

Taxes were down 11 basis points over the year to 0.55 percent of average assets and were 0.45 percent in the fourth quarter. Over the past two years, taxes have averaged 0.61 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 2006 were \$642.2 billion, down 14 percent from \$744.1 billion in 2005, the industry's second best volume. Total mortgage originations reached a record \$805.6 billion in 2003. In the fourth quarter total mortgage originations fell to \$134.3 billion from \$187.1 billion in the fourth quarter one year ago, and were down from \$172.1 billion in the prior quarter. Fourth quarter 1-4 family mortgage originations by thrifts were \$112.1 billion, down 32 percent from \$163.9 billion in the fourth quarter one year ago, and down 25 percent from the \$149.9 billion originated in the third quarter.

Thrifts accounted for approximately 20 percent of total 1-4 family originations nationwide in the fourth quarter of 2006,¹ down from 23 percent in the comparable year ago quarter, and down from 24 percent in the prior quarter. An estimated 12 percent of thrift originations were ARMs in the fourth quarter, down from 26 percent in the prior quarter, and from 50 percent in the comparable year ago quarter. In contrast, the ARM

¹ Total 1-4 family mortgage originations estimated by the Mortgage Bankers Association of America.

share for all lenders was estimated at 14 percent in the fourth quarter, 19 percent in the prior quarter, and 28 percent in the fourth quarter one year ago.²

The volume of mortgage refinancing, as a percentage of total originations, was up from the prior and comparable year ago quarters as borrowers converted adjustable rate mortgages to fixed rate mortgages. Refinancing activity accounted for 39 percent of thrift originations in the fourth quarter, up from 34 percent in the fourth quarter one year ago, and from 27 percent in the prior quarter.

ASSET QUALITY

Asset quality within the industry remained strong over the year and fourth quarter, but delinquencies were up from recent record low levels. OTS is closely monitoring thrift loan performance and asset quality since a significant proportion of thrift loan portfolios are recently originated, or unseasoned, loans. Moreover, newer loan types such as interest-only mortgages and the significant rise in home equity lines-of-credit are receiving additional supervisory scrutiny since these loans have not been stressed through different economic cycles. There are emerging signs of weakening credit quality in certain loan portfolios and geographic areas. OTS is closely watching construction loans made in previously “hot” markets, and residential mortgage loans made to investors. The agency is also closely monitoring recently originated or “unseasoned” loans made to first-time homebuyers. Troubled assets, which consist of noncurrent loans and repossessed assets, were up six basis points from the prior and comparable year ago quarters at 0.70 percent of assets. Excluding repurchased GNMA³ loans, troubled assets were up ten basis points from the prior quarter at 0.63 percent of assets, and up from 0.44 percent one year ago. Repossessed assets were up one basis point from the third quarter at 0.09 percent of assets, and were up from 0.05 percent one year ago.

Noncurrent loan rates (loans over 89 days past due or in nonaccrual status), excluding repurchased GNMA loans, climbed nine basis points from the third quarter to 0.54 percent of assets at the end of 2006, and were up from 0.39 percent one year ago. Noncurrent loan rates for 1-4 family and multifamily mortgages, consumer loans, and construction and land loans were higher 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 overall strong credit quality. Noncurrent loan rates for 1-4 family loans, excluding repurchased GNMA loans, were up 26 basis points from one year ago and 17 basis points from the prior quarter to 0.76 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 0.21 percent of all multifamily loans from 0.16 percent one year ago. Noncurrent consumer loans increased from 0.63 percent of all consumer

² Data are from the Federal Housing Finance Board’s monthly *Mortgage Interest Rate Survey*.

³ GNMA mortgage-backed securities are fully guaranteed by the U.S. Government. Individual loans repurchased from GNMA pools are fully or partially guaranteed or insured by agencies of the U.S. Government.

loans one year ago to 0.91 percent at the end of 2006. Noncurrent construction and land loans were 0.91 percent of all construction and land loans at the end of the year, up from 0.41 percent one year ago.

Noncurrent nonresidential mortgages fell to 0.53 percent of all nonresidential mortgages from 0.57 percent one year ago. Noncurrent commercial loans fell to 0.90 percent of all commercial loans at the end of 2006 from 1.10 percent a year ago.

Loans past due by 30 to 89 days were higher over the year for 1-4 family loans, consumer loans, and construction and land loans. Past due loan rates were lower from one year ago for nonresidential mortgages and commercial loans. 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 the end of 2006, excluding repurchased GNMA loans, were \$10.6 billion, or 0.75 percent of assets compared to \$8.6 billion, or 0.59 percent of assets, one year ago, and \$10.7 billion, or 0.66 percent of assets, in the third quarter.

ASSETS, LIABILITIES, AND CAPITAL

Industry assets decreased by four percent over the year to \$1.41 trillion from \$1.46 trillion due to the exits of two large, affiliated thrifts in the fourth quarter. Thrifts remain focused on residential mortgage lending, with 51.5 percent of assets invested in 1-4 family mortgage loans at the end of the year, down from 55.6 percent one year ago. Of these 1-4 family mortgage loans, 5.7 percent are home equity lines of credit, down from 6.2 percent of 1-4 family mortgages one year ago. Holdings of consumer loans decreased to 5.8 percent of assets from 6.6 percent a year ago, and multifamily mortgages increased slightly over the year from 4.5 percent of assets to 4.7 percent at the end of 2006. Commercial loans increased to 3.6 percent of assets at the end of the year from 3.0 percent one year ago.

Deposits and escrows grew by five percent over the year to \$876 billion from \$836 billion. As a percentage of total assets, deposits and escrows increased to 62.1 percent from 57.1 percent one year ago. Federal Home Loan Bank advances were down from one year ago at 15.2 percent of total assets.

Capital measures for the industry continue to be strong, stable, and well in excess of minimum requirements. Equity capital at year-end was a record 10.71 percent of assets, up from 9.45 percent one year ago. At the end of 2006, 99 percent of the industry exceeded well-capitalized standards and the remaining thrifts exceeded adequately capitalized standards. No thrift was less than adequately capitalized at the end of 2006.

PROBLEM THRIFTS

As the thrift industry continued to perform at or near record levels over the past year, the number of problem thrifts remained at a low level. Problem thrifts – those with composite examination ratings of 4 or 5 – decreased by one over the year to six. Assets of problem thrifts were higher at the end of 2006 at \$3.9 billion, up from \$1.9 billion at the end of 2005, and up from \$180 million at the end of the prior quarter.

Thrifts with composite ratings of 3 increased to 57 at the end of 2006 from 45 at the end of 2005 and from 52 at the end of the third 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 but three of the 3-rated thrifts at the end of 2006 were well capitalized, providing them with some degree of cushion to work through their problems.

STRUCTURAL CHANGES

Charter choice decisions resulted in 18 institutions choosing a thrift charter during 2006 – 12 were “de novo” institutions and six were existing institutions that converted to a federal thrift charter (two from credit unions, and four from state savings banks). Seven thrifts converted to commercial bank or state-chartered savings bank charters over the year. Also during the year, 13 OTS-regulated thrifts merged with other OTS-regulated thrifts, and non-OTS regulated institutions acquired 16 thrifts.