



## **THRIFT INDUSTRY HIGHLIGHTS SECOND QUARTER 2008**

---

*Office of Thrift Supervision / August 27, 2008*

---

### **SUMMARY**

The economic distress currently facing the nation is primarily focused on housing. As a result, entities engaged in home mortgage financing are feeling the brunt of the economic distress – and the thrift industry is no exception. In reaction to the current housing market distress, thrifts are taking necessary steps to bolster cushions for potential loan losses by significantly adding to loan loss provisions. The industry has added \$30.6 billion to loan loss reserves in the most recent four quarters. But since additions to loan loss reserves are direct charges to earnings, earnings over the past year have been weak and, recently, net losses have been incurred.

During the second quarter, thrifts set aside a record \$14.0 billion in loan loss provisions, substantially increasing their reserve for potential loan losses. The record provisions increased the industry's loan loss reserve ratio over 50 percent to an all-time high of 2.27 percent from 1.51 percent in the prior quarter. These large provisions resulted in a quarterly net loss of \$5.4 billion, or negative 1.41 percent relative to average assets.

This was the second largest industry net loss on record – the largest was the \$8.8 billion loss in the fourth quarter 2007. The industry had a loss of \$627 million in the first quarter 2008.

Recent increases in problem assets are also a direct result of the continued housing market downturn. Troubled assets (noncurrent loans and repossessed assets) rose to 2.68 percent of assets, up from 2.06 percent in the prior quarter and 0.95 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 3.80 percent at the end of 1990. Mortgages on 1-4 family properties comprise approximately 81 percent of the industry's current troubled assets, with an additional 13 percent consisting of commercial real estate loans (nonresidential mortgages, multifamily complexes, and construction loans), and six 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 industry's capital position remains solid, but down from record levels. Thrifts' capital rose to record or near record levels in advance of the housing market downturn,

and generally peaked in mid-2007. But recent net losses have reduced current capital ratios to pre-mid-2007 levels. Nevertheless, current regulatory capital measures remain solid. The combination of solid capital and bolstered loan loss reserves will help the industry weather the housing market distress currently facing the nation.

Regulatory capital measures declined in the second quarter from the prior quarter, but were generally level with measures in 2006 and 2005. Thrifts' tier 1 core capital ratio declined to 8.18 percent in the second quarter from 8.53 percent in the prior quarter and from the peak of 8.85 percent in June 2007. The industry's tier 1 core capital ratios were 8.16 percent and 8.07 percent in the second quarters of 2006 and 2005, respectively. Thrifts' tier 1 risk-based capital ratio declined to 12.13 percent from 12.60 percent in the prior quarter. The industry's tier 1 risk-based capital ratios were 12.37 percent and 12.67 percent in the second quarters of 2006 and 2005, respectively. The trends for total risk-based capital ratios were similar and declined to 14.11 percent from 14.56 percent in the prior quarter. The industry's total risk-based capital ratios were 13.94 percent and 14.14 percent in the second quarters of 2006 and 2005, respectively.

The number of private sector thrifts supervised by OTS stood at 829 with assets of \$1.51 trillion at the end of the second quarter. In addition, OTS supervised 479 holding company enterprises with approximately \$8.4 trillion in U.S. domiciled consolidated assets. These enterprises owned 445 thrifts with total assets of \$1.32 trillion, or 87 percent of total thrift industry assets.

Other highlights include:

## **EARNINGS AND PROFITABILITY**

- Net losses in the second quarter were \$5.4 billion compared to a loss of \$627 million in the prior quarter and net income of \$3.8 billion in the second quarter one year ago. The second quarter loss was the second highest in history for the thrift industry – the loss of \$8.8 billion in the fourth quarter of 2007 was the highest.
- Profitability, as measured by return on average assets (ROA), was a negative 1.41 percent in the second quarter compared to negative 0.17 in the first quarter. One year ago the industry ROA was 1.02 percent.
- Return on average equity (ROE) was a negative 16.05 percent in the second quarter, down from a negative 1.83 percent in the first quarter, and from 9.54 percent in the second quarter a year ago.

## **ANALYSIS OF ROA**

- Higher loan loss provisions drove the second quarter loss.
- In the second quarter, net interest margin increased to 291 basis points (or 2.91 percent of average assets) from 277 basis points in the first quarter, and from 276 basis points in the comparable quarter a year ago.
- Loan loss provisions increased to 3.68 percent of average assets in the second quarter from 2.02 percent in the first quarter and from 0.38 percent in the second quarter a 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 1.56 percent of average assets in the second quarter, up from 1.11 percent in the prior quarter, and from 1.42 percent in the second quarter one year ago.
- Other noninterest income was a negative 0.19 percent of average assets in the second quarter, down from 0.60 percent in the first quarter and from 0.48 percent in the second 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 increased to 2.79 percent of average assets in the second quarter from 2.77 percent in the prior quarter, and from 2.72 percent in the second quarter one year ago. General and administrative expense, the largest component of noninterest expense, was 2.68 percent of average assets in the second quarter, up from 2.63 percent in the comparable year ago quarter.
- Taxes were down 135 basis points over the year to a negative 0.80 percent of average assets in the second quarter, and were down from a negative 0.14 percent in the prior quarter.

## **MORTGAGE ORIGINATIONS**

- Total thrift industry mortgage originations (which include multifamily and nonresidential mortgages) were \$128.3 billion in the second quarter, down 34 percent from \$194.6 billion in the second quarter a year ago and down four percent from \$133.8 billion in the prior quarter.
- An estimated nine percent of thrift originations were ARMs in the second quarter, down from 11 percent in the prior and comparable year ago quarters. The ARM share for all lenders was estimated at eight percent in the first quarter, eight

percent in the current and prior quarters, and 11 percent in the second quarter one year ago.<sup>1</sup>

- The volume of mortgage refinancing, as a percentage of total originations, remained strong in the second quarter as borrowers converted adjustable rate mortgages to fixed rate mortgages. Refinancing activity accounted for 41 percent of thrift originations in the second quarter, down from 50 percent in the prior quarter, and from 48 percent in the second quarter a year ago.

## ASSET QUALITY

- Delinquencies for most loan types were higher over the year and in the second quarter.
- Troubled assets, which consist of noncurrent loans and repossessed assets, were up 62 basis points from the prior quarter at 2.68 percent of assets, and were up from 0.95 percent one year ago. Repossessed assets were up six basis points from the prior quarter at 0.33 percent of assets, and were up from 0.13 percent one year ago.
- Noncurrent loan rates (loans over 89 days past due or in nonaccrual status) increased by 56 basis points from the prior quarter to 2.34 percent of assets at the end of the second quarter, and were up from 0.83 percent one year ago. Noncurrent loan rates for 1-4 family loans were up 256 basis points from one year ago and 97 basis points from the prior quarter to 3.82 percent of all 1-4 family loans. Noncurrent multifamily loans increased to 0.66 percent of all multifamily loans from 0.29 percent one year ago. Noncurrent consumer loans increased from 0.83 percent of all consumer loans one year ago to 1.28 percent at the end of the second quarter. Noncurrent nonresidential mortgages increased to 0.90 percent of all nonresidential mortgages from 0.68 percent one year ago. Noncurrent construction and land loans were 7.18 percent of all construction and land loans at the end of the second quarter, up from 1.77 percent one year ago. Noncurrent commercial loans increased to 1.40 percent of all commercial loans at the end of the second quarter from 0.86 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 second quarter were \$21.3 billion, or 1.41 percent of assets compared to \$14.1 billion, or 0.94 percent of assets, one year ago, and were up from \$20.2 billion, or 1.33 percent of assets, in the prior quarter.

---

<sup>1</sup> Data are from the Federal Housing Finance Board's monthly *Mortgage Interest Rate Survey*.

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

- Industry assets increased by less than one percent over the year to \$1.51 trillion from \$1.50 trillion. Thrifts remain focused on residential mortgage lending, with 49.5 percent of assets invested in 1-4 family mortgage loans at the end of the second quarter, down from 50.9 percent one year ago. Of these 1-4 family mortgage loans, 7.9 percent are home equity lines of credit, up from 7.1 percent one year ago. Holdings of consumer loans decreased to 5.8 percent of assets from 6.1 percent a year ago, and multifamily mortgages increased over the year from 4.2 percent of assets to 4.3 percent at the end of the second quarter. Commercial loans increased to 3.9 percent of assets at the end of the second quarter from 3.8 percent one year ago.
- Deposits and escrows fell by two percent over the year to \$929 billion from \$949 billion. As a percentage of total assets, deposits and escrows decreased to 61.5 percent from 63.1 percent one year ago. Federal Home Loan Bank advances were up from 14.3 percent one year ago to 19.7 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 the second quarter was 8.66 percent of assets, down from 10.80 percent one year ago, and from 9.05 percent in the prior quarter. At the end of the second quarter, over 98 percent of the industry exceeded well-capitalized standards and seven 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 ten thrifts one year ago to 17 thrifts at the end of the second quarter.

## **STRUCTURAL CHANGES**

- During the second quarter, two “de novo” institutions and one state-chartered institution came into OTS regulation. In addition, two banks were brought into OTS supervision as a result of acquisitions by OTS institutions. Two thrifts converted to bank charters over the second quarter. Also during the second quarter, non-OTS regulated institutions acquired three thrifts.