

Seeking Alpha

Seeking Alpha  $\alpha$

## Hudson City Bancorp Prime Delinquencies: Q3 2009 Sees Portfolio Stress [3 comments](#)

by: Sold At The Top

October 22, 2009 | about: [FNM](#) / [HCBK](#)

Hudson City Bancorp (NYSE:[HCBK](#)), fully recognized as the poster child for “safe” prime-only mortgage lending and whose CEO’s frequent media appearances (particularly on [Jim Cramer’s “Mad Money”](#)) usually come with heaping portions of high praise and accolades, appears now to be fully experiencing portfolio stress driven by the vicious combination of rising unemployment and falling home values.

Though CEO Ronald Hermance appears to have succeeded in his goal of increasing basic confidence in his bank, its non-performing loan ratio, which has exploded dramatically jumping from .5% in Q3 2008 to 1.66% in Q3 2009, tells a different story.

So much for the “pristine” portfolio with “hardly any bad loans”...

Hudson City now holds over \$517 million in delinquent loans forcing them to increase their loan loss provisions to \$92.5 million, a stunning 781% annual increase for the nine months ended September 30.

Further, over the same period, net-charge offs jumped to \$27.5 million, a 958% increase over the \$2.6 million reported for the first nine months of 2008.

I’ve been arguing for the better part of two years that although the traditional media and apparently general consensus has focused on subprime and other “toxic” mortgage products as the source for the credit tumult, the historic deterioration would by no means be limited to these “bleeding edge” products.

Before this massive housing and general economic contraction is complete, I expect to see new records set for prime defaults, be they prime-Jumbo ARM loans, prime-Jumbo fixed rate loans, prime-conforming ARM loans or prime-conforming fixed rate loans... we will see historic defaults across the entire spectrum of mortgage products.

Although there is significant debate about the true drivers of mortgage default, most individuals in default cite unemployment as the cause while other key instigators are: risky or insufficient household financial planning (high consumer debt and low/no savings), low-equity stake and housing depreciation, and simply general recession.

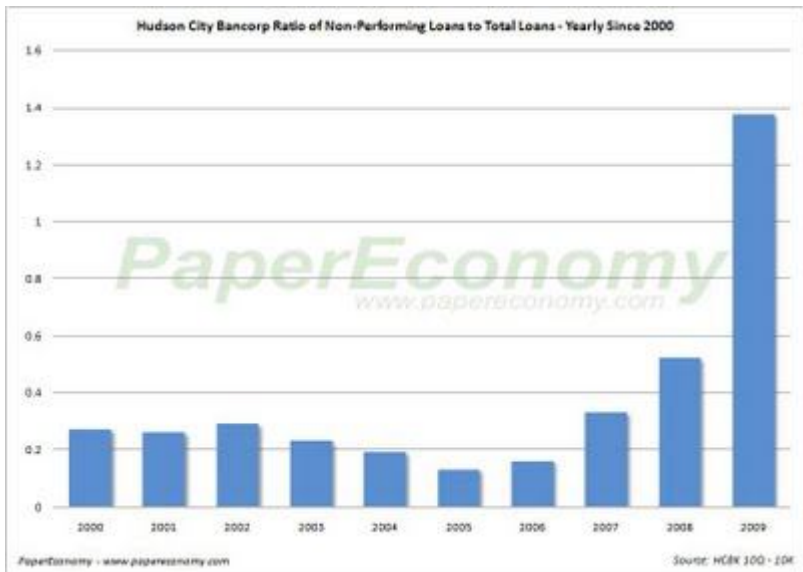
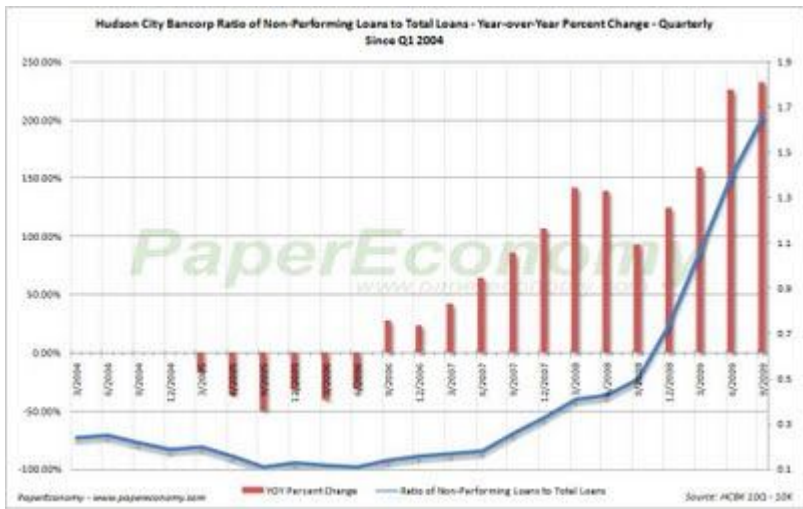
The key point to consider though is that while all of these factors have contributed to creating environments of high mortgage default in the past, our current circumstances make these past periods look like walks in the park.

It’s important to understand that although Hudson City’s total first mortgage loan portfolio has a reasonable average loan-to-value ratio of 61.8%, the bank is still seeing a precipitous increase in loan defaults.

In fact, currently the average LTV of their non-performing loans (defaulted loans) is 71.5% so “prime” borrowers with roughly 30% equity at the time of origination are now defaulting in steadily increasing numbers.

The following chart plots Hudson City Bancorp’s Non-Performing Loan Ratio (defaulted loans to total loan portfolio) since Q1 2004.

Notice that defaults have been on the rise since Q2 2006 while in Q2 2007 things really started to heat up.

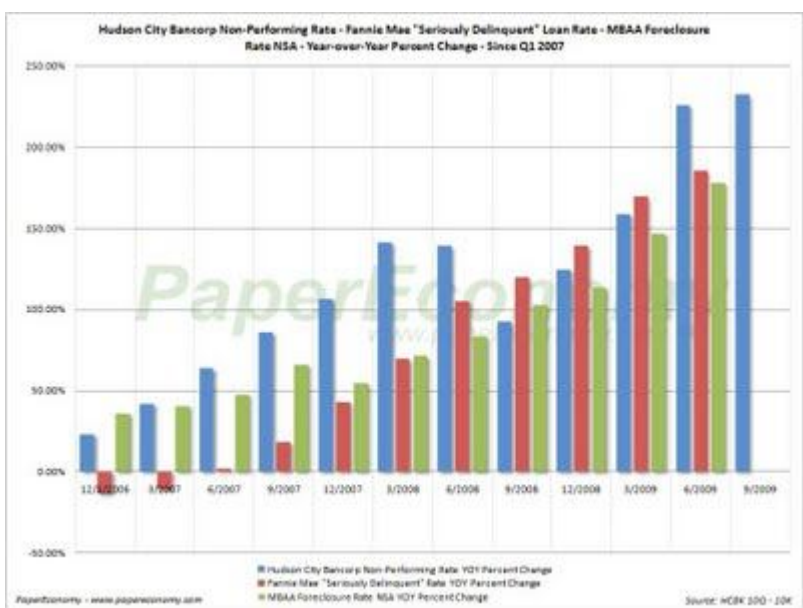
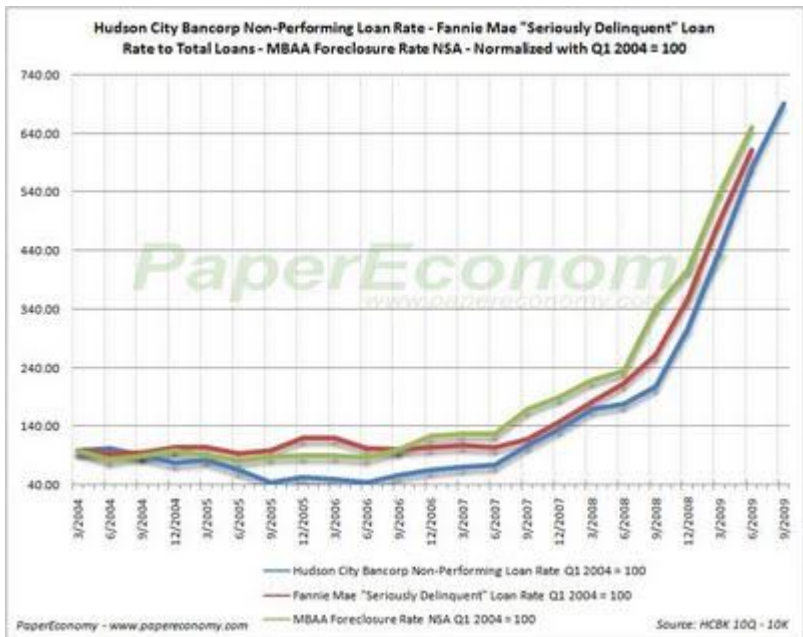


But how does the growth in defaults of the Hudson City Bancorp “prime” portfolio stack up compared to other well know default rates?

The Following charts compare the Hudson City default rate to that of Fannie Mae (FNM) and the MBAA foreclosure rate.

The top chart compares the normalized default rates since Q1 2004 while the lower two compare the same data since Q1 2007 in order to get a sense of the respective growth over these periods.

It’s important to keep in mind that although Hudson City is not experiencing the same ratio of defaults (Fannie Mae and the general MBAA rates are worse) the growth of prime defaults is comparable and, since Q1 2007, has even been substantially higher.



As for Hudson City loan loss provisions, as you can see from the following chart, the capital cushion is dwindling.

