Hudson City Bancorp: One Bank That Didn't Drink the Kool-Aid

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The Move: Hudson stuck to its conservative lending practices and skipped subprime mortgages, trading short–term windfalls for slow but steady growth.

Hudson City Bancorp now ranks as the largest savings bank in the country — a position that seemed unlikely for the Paramus, N.J.–based thrift just a few years ago. Hudson, which began as a mutual savings institution, embarked on a simple growth strategy in 2005: Gradually open branches in contiguous markets where residents' demographics mirrored those of its affluent New Jersey base, such as the tony suburbs of Fairfield County, Conn., and Westchester, N.Y.

As it expanded, Hudson passed on the subprime mortgage trend, preferring to stick to conservative underwriting standards, says CEO Ronald Hermance. In addition to taking deposits, the bank specializes in writing jumbo prime home mortgages — its average borrower puts down 42 percent of a home's value to get a loan. In 2005, Hudson City converted from a mutual to a bank and raised $3.9 billion in the largest-ever banking IPO.

At the time, shareholders questioned why well-capitalized Hudson shied away from mortgages that carried higher yields. "It wasn't a tough decision," says Hermance. "After you raise capital, it takes about two weeks before investors tell you you're overcapitalized." Hermance says he told shareholders to be patient and that he'd leverage the capital in the same way Hudson has always done business — without changing credit standards for borrowers. Analysts, too, were expecting faster growth. "As the market overheated, Hudson chose not to go into the subprime business, and it got a lot of criticism because people thought they were leaving money on the table," says Morningstar equity analyst James Sinegal. "But there was definitely a sense from management that the risk/reward was skewed, and they saw that they wouldn't get paid for the risk they'd be assuming." Adds David Darst, senior analyst for FTN Midwest, "Hudson was criticized for not changing its business model into a more modern one better suited to the times. Instead of selling mortgages on the secondary market, they stuck to the traditional thrift model, feeling that that was the more competitive model."

In the years following Hudson's $3.9 billion IPO, the thrift grew steadily and deliberately. In 2006, the company paid $265 million to acquire Sound Federal Bancorp, a thrift with 14 branches in wealthy counties of New York and Connecticut. Between 2005 and the third quarter of 2008, Hudson grew from 84 to 125 branches and saw its assets increase by nearly 85 percent, to $51.77 billion. While scores of financial institutions faltered that quarter, Hudson's year-to-year net profit was up 64

percent, and it gave investors a double-digit return on equity. The bank earned a record $121 million. Thanks to customers' wariness of banks after the demise of Washington Mutual and Wachovia, depositors have started flocking to Hudson; it reported an increased deposit market share in 91 percent of its markets between 2007 and 2008. Building on this performance, CEO Hermance uses every media opportunity to highlight Hudson's "plain-vanilla banking" and risk-averse mortgage model.

Hudson now averages $138 million in deposits per branch, compared to the national average of $71 million for FDIC-insured institutions. Just three years after converting from a mutual savings institution, Hudson now ranks among the top 20 banks in the country in terms of market cap. Because Hudson is so well-capitalized and has a steady source of funding from deposits, it can keep writing mortgages and boosting its portfolio at a time when the competitive field continues to narrow. "We didn't let the [IPO] money burn a hole in our pocket," Hermance says.

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