



Bank & Thrift - Industry

M&A: A dying breed: In metro New York, thrifts should continue to fall by the wayside

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EXCLUSIVE

The metropolitan New York City thrift market has changed drastically over the past decade, with many players either converting or selling out amid an increasingly competitive and more difficult operating environment. And with no near-term end to those trends in sight, industry experts believe that all of the notable thrifts in metro New York will most likely hand over the reins before another decade passes.

"Timing might be a bit of an issue, but I can say with a straight face that every thrift in the metro New York market will at some point become a seller," RBC Capital Markets analyst Jim Ackor told SNL Financial.

The landscape recently underwent another step in that direction when Brooklyn, N.Y.-based [Independence Community Bank Corp.](#) agreed to hand over control to Philadelphia-based [Sovereign Bancorp Inc.](#) in the year's most hotly [contested deal](#). The transaction follows 50 other transactions since Jan. 1, 1994, in which public metro New York thrifts gave up their independence and 48 instances in which thrifts engaged in some form of stock conversion, according to the SNL DataSource.

Competition has increased significantly over the same period, with new commercial banks entering the market and existing banks competing more aggressively. More recently, augmented by the flattening yield curve, competitive activity has risen another notch, according to many management teams.

To take one example, [Flushing Financial Corp.](#) CEO John Buran told SNL that some of the dynamics in the market have changed significantly. Specifically, margins are increasingly squeezed in the one- to four-family business as competition picks up, the GSEs have increased their involvement in the thrifts' lending areas, and customers have become more sophisticated on the deposit side of the business.

According to Ackor, this increased competition is the main difference in the market today versus five to 10 years ago. However, Ackor, who has covered the New York thrift market for nearly 10 years, said that most thrifts have not meaningfully changed their operating strategies.

Indeed, [New York Community Bancorp Inc.](#) Chairman and CEO Joe Ficalora told SNL that the company's strategy today is the same as it was when it decided to go public in 1993.

"Our strategy is exactly the strategy that we had in mind when we became a public company. It hasn't changed," Ficalora told SNL at a recent investor conference. "That decision was made back in '93 and holds right to this day, that as a focused lender on our particular niche, we create a distinguishable advantage for our stock, our currency to be better positioned against others during a period of adversity."

Rick Weiss, an analyst with Janney Montgomery Scott, said that the changes that have transpired in the metro New York thrift market are not really that different than those experienced in any other highly desired markets.

"There are not really a lot of big thrifts. I think what's happening in the New York area is really no different than other really top markets," Weiss told SNL.

Ryan Beck Chairman and CEO Ben Plotkin agreed, though he believes more companies now recognize how attractive a market it is.

"The reason it's such a great market is that historically it was dominated by two very large commercial banks, [Citigroup Inc.](#) and [JPMorgan Chase & Co.](#), who did not do a very good job on the service side," Plotkin told SNL.

Donald Musso, the founder of FinPro, a financial adviser based in northern New Jersey, does not believe that an "imminent demise" of the thrift charter in the market is in the works. However, he noted that many large thrifts are selling, and few are formed in their place.

"We've got a couple of de novos being formed that are going into OTS format. I will tell you of the 27 de novos that we're currently working on, new startups we're working on, only three or four are OTS chartered, though. They're clearly not getting their share," Musso told SNL.

According to Musso, many bankers do not want to operate as a thrift because of the required limit on commercial lending, a business which is even more desirable as spreads on single-family residential mortgage and multi-family mortgage lending compress. Ackor said that both of these lending areas have become commoditized over the past decade, making scale matter even more as larger players influence pricing more than in the past. For instance, the analyst said, spreads on multifamily loans averaged 250 basis points over the five-year Treasury in the mid- to late 1990s, but now, because of competitive factors, they average 100 to 150 basis points over the five-year Treasury.

While those lending areas have a lower rate of default, giving the companies a safeguard against a turning credit cycle, the declining spreads kept some executives on the sidelines in certain cases.

"Crazy pricing continues, maybe a little less crazy than it was a while ago, but it's still pretty tough," [Astoria Financial Corp.](#) Chairman and CEO George Engelke Jr. said in a Nov. 17 conference presentation. "We're losing some loans because of that."

[Dime Community Bancshares Inc.](#) Chairman and CEO Vincent Palagiano echoed that sentiment at the same conference, adding that the metro New York market is also "very competitive" for high-cost deposits.

"I think we've taken a very defensive position," Palagiano said at the conference. "We've taken the opportunity to keep our powder dry."

With the operating environment remaining difficult, Musso believes that planning will become more important, especially for thrifts located in "high de novo propensity markets," which face an even higher risk from fierce competition.

"What you can't do is be complacent. You've got to do what they do," Musso said of competing with de novos. "But it's going to take a significant change in persona of a lot of these older thrifts."

Musso said these changes would likely entail more active boards, diversifying into the commercial sector, more aggressive marketing, more sophistication on product pricing and better asset/liability management.

According to Plotkin, thrifts must also maintain low expenses to remain viable.

"A thrift has to have a lower expense base by a pretty material factor, then they can live with a lower margin. They're going to have less credit risk," Plotkin said. "And they have historically done well."

Buran told SNL that companies are responding with different approaches to dealing with the pressure, acquiring companies, restructuring to look more like a commercial bank and developing lending niches.

Such a mutation to a more banklike model makes sense, given the influx of commercial banks in the market and their impact on competitive dynamics.

Musso noted that [Bank of America Corp.](#) is a better retail operator than the Fleet franchise it acquired, and fellow Charlotte, N.C.-based [Wachovia Corp.](#) — which recently [ramped](#) up its [efforts](#) in metro New York — is a strong competitor.

"[\[Washington Mutual Inc.\]](#) is a good retailer, so the competition is getting worse and worse," Musso said.

Competition is particularly tough for smaller thrifts that do not necessarily have the "marketing muscle to battle" with Citi, JPMorgan, Bank of America, [Commerce Bancorp Inc.](#) and Wachovia, who continued to ramp up their retail focus in the market, Ackor said.

"These competitors are bigger, getting better and aren't going away. So, to me, that spells ongoing pressure from now until the time they're sold for the thrifts. And all of them will be sold eventually," Ackor said.

Weiss also believes that the industry will see more consolidation in metro New York — especially considering that the quickest way for a thrift to become more commercial bank-like is just to sell to one.

"There's just not many left, and I think three years from now there's going to be even fewer in metro New York. Astoria, Flushing, Dime Community, NYB — they're not going to be all there. [Provident New York \[Bancorp Inc.\]](#), [Sound Federal \[Bancorp Inc.\]](#), [Provident Financial \[Services Inc.\]](#): Do you really think in five years they're all going to be independent? Probably not. And I don't see anybody who's going to take their place," Weiss told SNL.

Potential buyers abound. Analysts recently speculated that Wachovia could be an [acquirer](#) in the metro New York market, and [TD Banknorth Inc.](#) at a Nov. 29

conference [expressed](#) an interest in gobbling up players in New York City.

Much of the consolidating activity may be driven by the thrifts themselves. Musso noted that a number of players in metro New York have recently raised capital, with [Hudson City Bancorp Inc.](#) [raising](#) several billion dollars in its second-stage conversion and [Investors Bancorp Inc. MHC](#) and [Kearny Financial Corp. MHC](#) each raising a couple hundred million dollars. Those players will either have to start massive repurchase programs, engage in organic strategies in the already difficult environment or serve as the acquirers in the market, the investment banker said.

"We've got people with all kinds of capital, and there are just not enough places to deploy the capital today," Musso said. "There's going to be a war on the acquisition front, and we're already seeing it on the organic front."

In the short term, the disappearance of at least one player, with Independence Community's pending sale to Sovereign, could benefit thrifts gaining from fallout from the transaction, executives said.

Buran, for instance, said that Flushing generally picks up some business whenever disruption from a larger institution occurs in the market.

"I think it will be interesting, and that's primarily on the deposit side of the business, but also on the business relationship side as well," Buran said of the transaction.

The executive also noted that two other players are exiting the market, with New York Community's purchases of [Atlantic Bank of New York](#) and [Long Island Financial Corp.](#)

New York Community CEO Ficalora said at a Nov. 7 conference that the Independence deal could be [very good](#) for his company in many respects, "because whenever there is change, you have the potential for a different focus and certainly this represents that kind of an opportunity."

There is no clear consensus that extinction by acquisition is the likely endgame for thrifts in New York. Plotkin, among others, expects thrifts to remain a feature of the market.

However, he acknowledged that further consolidation will most likely continue.

"Consolidation in this business will continue. At the end of the day ... community banking is a consolidating business because it has to be, since revenues are being squeezed and expenses, especially regulatory expenses, are going up. Inevitably, the way that any industry solves for that is through consolidation," he said.

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