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## N.J. Banks Expect New Competition

By Shankar P.

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New Jersey banks are expecting to see competition increase for home mortgages, at least in the short term, as a result of last week's government takeover of **Fannie Mae** and **Freddie Mac**. But bankers worry that the secondary market for mortgages could shrink in the long run and are concerned about the write-downs some banks face because they own stock in Fannie Mae or Freddie Mac.

**Domenick Cama**, chief operating officer of **Investors Savings Bank** in Short Hills, is one that sees the bailout's "immediate impact" as lenders get more active. "There will be some more competitors in the market as Fannie Mae and Freddie Mac step in to buy more loans," he says. He explains that with the immediately increased appetite of Fannie Mae and Freddie Mac for mortgage portfolios, "other banks can go out and sell loans with a little more ease and more confidence."

Fannie Mae and Freddie Mac operate a secondary market for the home loans of banks and other lenders. Last week, the federal government shifted management control of the two once-independent companies to their regulator, the Federal Housing Finance Agency. The government also promised to give up to \$200 billion to help Fannie Mae and Freddie Mac handle their expected mortgage-related losses.

"The implicit government guarantee has become an explicit government guarantee," says **David Hanrahan**, president of the Vineland-based **Capital Bank of New Jersey**.

Constrained by liquidity before the bailout, Fannie Mae and Freddie Mac had found fewer takers for their securities that are backed by the mortgage loan portfolios they buy from banks. Now that the government has taken them over, there is no more uncertainty surrounding the securities they issue, according to Hanrahan.

He sees the government's guarantee lowering rates for securities because they are backed by more liquid home mortgage portfolios. The lower rates will be passed along to home buyers, he predicts.

**Chris Martin**, president and chief operating officer at **Provident Bank** in Jersey City, says, "Competition has been so much on the sidelines [so far], but it has to increase" with the government bailout. However, he says his bank is comfortable in its niche and doesn't expect to see any problems arising out of such competition. Provident Bank has \$6.4 billion in assets; home equity and residential mortgages account for about 55 percent of its \$4.2 billion loan portfolio, he adds.

The government's move "may slow the decline [in the housing markets] or hopefully start bringing back some semblance of order in the markets," says **James Silkensen**, president of the New Jersey League of Community Bankers in Cranford, which has 71 member banks.

"It's good news for the mortgage market, and it should help in lowering mortgage rates on home loans," he says.

But it is too soon to rejoice, warns Hanrahan. He says he is not sure how much new competition banks would face for housing loans, pointing out that the secondary markets for them could get progressively smaller. "They [the government] want Fannie Mae and Freddie Mac to reduce their loan portfolios by 10 percent a year," Hanrahan says. Capital Bank of New Jersey has assets of \$70 million and deposits of \$53 million at its lone branch, which is in Vineland.

Those holding Fannie Mae or Freddie Mac stock will take hits as their values plummet. **Valley National Bank** in Wayne is the only publicly held bank in the state that has disclosed the impact of such holdings, according to experts. The bank said last week in a regulatory filing that it has Fannie Mae or Freddie Mac preferred stock valued at \$79 million, and that it would have to take a \$25.7 million after-tax impairment loss.

Over the past year, Fannie Mae common stock (NYSE: FMN) has fallen from \$63 to 99 cents, while its preferred stock has dropped from \$43 to \$3.15. Freddie Mac's common stock (NYSE: FRE) has fallen from \$59 to 88 cents; its preferred stock fell from \$48 to \$2 last week.

Such exposure is uppermost in the mind of the state's banking regulator. **Steven Goldman**, commissioner in the state's Department of Banking and Insurance, says, "The main thing we are concerned about is the balance sheets of our regulated institutions insofar as they consist of Fannie Mae or Freddie Mac stock."

Goldman says he is in constant touch with federal regulatory agencies to ensure that banks in the state transition smoothly to a newly energized secondary market. He indicates that there might be respite on the way for banks facing significant write-downs because of their Fannie Mae or Freddie Mac preferred stock holdings.

Goldman says he has been told "that the FDIC [**Federal Deposit Insurance Corp.**] is going to explore ways to work with them to find ways to restore that aspect of lost value in their balance sheets." He declined to elaborate.

Some say they saw the risks ahead in holding Fannie Mae and Freddie Mac stock. "We moved our clients out of those well over a year ago," says **Don Musso**, president of **FinPro, Inc.**, a bank consulting firm in Basking Ridge.

Investors Savings Bank had "less than \$100 million" invested in Fannie Mae/Freddie Mac stock but sold it in 2005, says Cama.

Hanrahan says his bank does not own any stock in Fannie Mae or Freddie Mac. **Team Capital Bank** of Flemington and Somerville also doesn't hold any Fannie Mae or Freddie Mac stock, according to its CEO **Jim Deutsch**.

Other dangers lurk, too. "There is a possibility that underwriting standards could decline, but not in the next six months," says Deutsch, adding that mistakes could happen in the longer term. Team Capital's two banks in the state have \$150 million in deposits and a like amount in assets, he says.

Goldman agrees that his department would have to ensure "that we don't fall back" to the looser underwriting standards that fueled the subprime crisis.

Hanrahan points to the downside of a government bailout. "People who were taking risk by buying such stock would have enjoyed the upside. If they don't suffer the downside, there is a moral hazard," he says.

Musso, too, worries about the impact of Fannie Mae and Freddie Mac shrinking over time and reducing their ability to buy mortgage portfolios. The government's action also "diminishes the value of the secondary market because it takes it out of entrepreneurial hands and puts it into bureaucratic hands," he adds.

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