

Downey Gets Big Investor; Loan Woes Could Be Issue

Finance: Ford eyes control, sale; McAlister remains deciding factor

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Could it be for real this time for Downey Financial Corp.?

As California's fourth largest savings and loan operator, Newport Beach-based Downey is a constant source of buyout speculation.

Earlier this year, Jim Cramer of TV's "Mad Money" called Downey "the next Golden West," referring to Oakland-based Golden West Financial Corp., which Wachovia Corp. bought for \$25 billion in late 2006.

The latest round of speculation stems from a move by Texas billionaire Gerald J. Ford, who said last month he's acquired a 6.8% stake in Downey.

His investment could lead to an acquisition of Downey or the sale of the company to another buyer, Ford said in a Securities and Exchange Commission filing.

Past acquisition speculation about Downey didn't come to pass largely because of cofounder and Chairman Maurice "Mac" McAlister, who owns 20% of the company.

In Ford's filing, he said he met with the 82-year-old McAlister and other Downey officials about his investment and Downey's "long-term strategies, including a potential business combination."

Ford, who sold Golden State Bancorp of San Francisco to Citigroup Inc. in 2002 for \$5.8 billion, made the Downey investment through his Hilltop Holdings Inc.

Dallas-based Hilltop, a property and casualty insurer for "low value" homes, paid \$63.4 million for nearly 2 million shares of Downey, according to the filing.

As of last week, Downey had a market value of about \$1 billion, down 45% from a year ago amid a rise in bad mortgages at the company and the overall meltdown in home lending.

Since word of Ford's investment broke on Nov. 19, Downey's shares were up about 30% last week.

McAlister has held the company closely since founding it in 1957 with the late Gerald McQuarrie.

Downey is mum about any succession plans and declined to comment on Ford's investment and plans.

McAlister's daughter, Cheryl Olson, is Downey's vice chairman. Daniel Rosenthal, McAlister's former son-in-law, is chief executive.

In a September speech at the University of California, Irvine, McAlister was sharp as he talked about six decades in mortgages and real estate investing.

He called the current downturn minor.

“We have a little bit of a problem, but not very much,” McAlister said.

Like McAlister, Ford has a history in thrifts.

In the 1990s, he bought First Nationwide Bank, Glendale Federal Savings and California Federal Bank, which he rolled up into Golden State Bancorp, the second largest thrift after Washington Mutual Inc. in 2002.

Ford bought his first bank in 1975 for \$1.2 million and later sold it for \$80 million.

Downey’s 170 branches and \$10 billion in deposits could be a considerable prize for Ford. He’s also buying into the company at a time when its shares are worth half as much as they were a year earlier.

The thorny side is Downey’s mortgages, which brought the company a \$23 million loss in the third quarter because of borrowers who’ve failed to make payments.

The quarterly loss was the first since 1996 for Downey, which boomed earlier this decade during the heyday of mortgages.

The majority of Downey’s \$14 billion in loans are adjustable-rate mortgages that were made to people with less than great credit, but better than the riskiest subprime borrowers.

The loans, known as option ARMs, allow borrowers to pay credit card-style minimum payments with the difference tacked onto the balance of the loan.

The loans also switch to a higher rate after two years, putting payments out of reach for some borrowers.

Rates on option ARMs generally go up a couple of points, or by about 30%.

About a third of Downey’s option ARM loans were made in 2005, about a quarter in 2006 and 11% in 2007, according to Amit Chokshi, managing member of Stamford, Conn.-based Kinnaras Capital Management LLC, a hedge fund manager.

With the bulk of Downey’s option ARMs starting to reset, Chokshi said he expects more turmoil at the company. Downey could have to boost its cash to offset loan defaults, he said.

“I think once Ford takes a closer look at the company he’ll back out,” Chokshi said.

Chokshi, a Downey skeptic, shorted the stock earlier this year in a bet it would fall with mounting trouble in mortgages.

Many think Downey’s shares could fall further. As of October, 41% of Downey’s shares were sold short, up from 38% in September.

In October, Ford walked away from a potential buy of Santa Monica-based Fremont General Corp., a beaten down subprime lender with operations in Brea.

Raised in west Texas, Ford graduated from Southern Methodist University where he earned a

bachelor's in economics and a law degree.

He is a member of the school's board of trustees and has a stadium named after him.

Ford's other investments include Texas auto financier AmeriCredit Corp., which earlier this year bought Orange-based ACC Capital Holdings Corp.'s Long Beach Acceptance Corp. for \$283 million, as well as a 120,000-acre New Mexico ranch.