JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

- I. Other Presentations In Which Either The Date And / Or Sponsoring Organization Is Missing
  - 6. Real Estate Finance/Mortgage Banking/Mortgage Guaranty Insurance
    - r. "Savings and Loans - Some Thoughts", no date

Index

Savings and Loans - Some Thoughts

I. Savings and loans in Wisconsin tied to German-Scandinavian origins where cooperative thrift and insurance groups were common in Europe. Some historical notes are useful to understand current dilemma of savings and loan industry.

A. State statutes permitted S & L's in 1850 and Platteville Loan & Building Association was the first, organized in April of 1876. By 1893 there were 34 groups, responsible to the state banking dept., with 1/3 of them in Milwaukee.

B. All began on a terminating plan, i.e., members subscribe to purchase so many shares on a planned savings program with weekly or monthly collections. As funds were accumulated sufficient to buy a home, the opportunity was auctioned among members. When original group each had a home and had fully paid for their stock, loan and stock were offset, books closed and association liquidated. This was beginning of amortized loan.

C. To permit continuity and sharing of administering skills, a serial plan of operation was developed whre administrators started new groups at regular intervals.

1. No investment problem as long as everyone needed a house.
2. Saving habit continued after shares were paid for and funds might accumulate more rapidly than home loans were made.
3. First solution was a lottery to force some lucky winner to borrow money.
4. Eventually associations began to develop saving member accounts as distinct from borrowing member accounts.
5. Shift in pooling concept from those interested in buyihg their own house, to local community building, to currently a regional shift of funds from say a mature area like New England to a growth area like the southeast or California.
6. Permanent plan then began to permit one lump investments and subscription accounts which could be opened any time and applied at anytime to the balance on the mortgage.

D. By 1920 the State Banking Commission brought about standardized charters, by-laws, accounting systems, and lending practices. In 1915 there was a rash of branch offices which were closed by the Commission.

1. Dichotomy of savers and borrowers led to creation of contingency reserves from earnings.
2. Growth in Wisconsin cities required mortgage financing in advance of savings so that S & L's often borrowed cash at the bank to do it.
3. Cash flow from savings kept associations liquid but by 1928 mortgages averaged more than 98% total assets and cash was less than 1%.

E. In the forty months following the crash in October 1929, Wisconsin factory employment fell to 58% of the summer of 1929 payrolls to 40% agricultural to 45% and dollar volume of construction dropped 85% to less than 25 million $.

1. Banks closed in March 1933, 930 banks at beginning of 1930 and 279 reopened by 1936. S & L's had depended on banks for liquidity

2. S & L's at first were untouched and during 1930 total assets increased because of local confidence in this form of savings, many people shifting from banks. Cash flow merely postponed inevitable. Between 1930 and '39 Wisconsin Association declined only 50% in total assets, savings capital and membership.
3. In 1930 Wisconsin was first in terms of savings per capita, percentage of home ownership, and percent of savings in S & L's. S & L's had financed 1/3 of these homes.

F. By 1932 associations had gone on "notice" - that is, a member had to file a written request for the association to repurchase his shares and the association was obliged to do that according to some planned liquidation.

1. By 1936 state associations were once again off notice, but Milwaukee County association were on notice the rest of the decade.
2. Speculators bought pass books at a fraction of par value.
3. Savings and loans liquidated properties by trading pass books at par for value of foreclosed property.
4. HOLC saved many S & L's and home owners.
5. In Milwaukee by 1938 half of S & L's assets represent real estate loans, indeed one of every 5 houses and by 1939 Milwaukee associations had still failed to liquidate their real estate holdings so that rental income exceeded interest income by nearly 20%.
6. State Banking Commission forced associations to liquidate beginning in 1939 with significant profits being taken on sales during the early part of Wrold War II. These profits became retained earnings which later provided additional lending power and leverage income which fed the rapid growth of some of the older Milw S & L's.

G. To correct for some of the structural flaws of the S & L industry the federal government created:

1. HLB (Home Loan Bank) to provide liquidity to member savings and loan.
2. FSLDIC (Federal Savings and Loan Deposit Insurance Corporation)
3. Savings deposit interest controls which favored S & L deposits over banks by a 1/2 %.
4. World War II which provided a tremendous flow of savings in the absence of new housing and consumer durables.

II. Since 1960 the savings and loans have continued to grow in between a variety of crises in the money market made worse by their structural characteristics which remained from their days as kitchen table co-ops.

A. There are many problems, as developed by your reading on the Friend Report which can be summarized as:

1. Refine the methods by which they attract savings.
2. Develop alternatives to home loans for investment for better yields and liquidity.
3. Develop techniques for greater liquidity
4. Clarify their institutional objectives
5. Improve executive development and recruitment
6. Find an effective response to threat of inflation.

B. Attracting the savings dollar, finding higher yield investments, and maintaining liquidity are inter-related problems of increasing significance as investors become more sensitized to yield and sophisticated in their investment choices.

1. Disintramediation the shift of fund flows from one intermediary institution to another. (Citicorp variable interest bond issue)
2. Disintermediation--tendency of investor to bypass intermediary institutions to purchase securities directly in the market (purchase of small denomination government bonds greatly damaged liquidity of individual S & L).

C. In recent years S & L has created a variety of rates which encourage longer term commitment of money and larger size accounts. The rate game advertises the high but qualifies you for the lower return. Some have said a truth in savings law is needed.

1. Controls on maximum rates payable by banks now only favors the small accounts .
2. Some advocate removal of all differentials and interest controls
3. Savings and loans were qualified as depositories for Self Employed Retirement Pension Trust Accounts.

D. Withdrawals in excess of deposits threatens liquidity of S & L if trend continues so that S & L must retain interest and mortgage payments collected in near cash rather than make new mortgage loans. Thus a small change in liquidity causes sharp changes in their willingness to or ability to make loans.

E. In 72-73 disintermediation reached a point that had taken S & L's out of the mortgage market. The HLB was given authority to borrow money in the bond market, say at 8%, and then lend it for 3-5 years to its members at 6% or that rate which would maintain a 2 point spread between the cost of money and the mortgage rate which could be obtained by the local S & L.

1. The reverse leverage to the HLB was subsidized by the US Treasury as an outright grant to the HLB.
2. The unseen result was a subsidy to the middle class American family buying a home and the building industry of more than $2 billion

III. To generate net income which can pay dividends which will attract savings otherwise going directly into the market, S & L's must find outlets for money whibh yield desired dividend plus required spread and at the same time permit turnover so they can reinvest more rapidly during a period of rising interest rates.

A. Higher yield investments imply:

1. Consumer financing of mobile homes, furniture, and cars for their depositers.
2. Consumer finance has the additional appeal of higher turnover for reinvestment policy changes to react to the money markets.
3. Higher risk or larger scale mortgages such as development loans, construction loans, etc. for a larger proportion of their assets.

4. More altermatives in mortgage investment such as convertible bonds, etc.
5. Ownership of real estate equity (via the service corporation).

B. Turnover can be achieved by artificially accelerating maturity or sale at paar.

1. Mortgages may provide lender with options to call the loan due to sale, other encumbrance, loss of prime tenant, or strict enforcement of the covenants.
2. An alternative is to switch from prepayment penaltied to prepayment bonuses.
3. Encourage refinancing by trading a stretch out of principal payments for a higher interest rate
4. Persuading the government via GNMA to buy old loans at lower rates at paar to free ~~dash~~ cash for new loans

C. Expand service revenue sources for the savings and loan by means of:

1. Full banking services for depositers
2, Loan origination fees
3. Stand-by fees
4. Mortgage servicing for other investors
5. Ownership of real estate service organizations providing appraisal, computer, and printing supplies
6. Provision of property management and counseling services
7, Provision of insurance services
8. Actual development of land, low rent housing, etc. (via service corporatio

D. Liquidity is the ability to produce cash in any and all circumstances. The S& L is borrowing short from depositers and lending long with the right to go on call to protect ultimate solvency.

1. Check S & L handbook and relate proportion of total assets in mortgages to proportion of liabilities in savings accounts
2. FSLDIC serves to discourage the depositer from testing liquidity

E. HLB Provides liquidity for individual members but cannot do so for the entire system. Unlike the FRB, FHLB cannot create money but depends on the bond market and deposits of its members for its cash. It must pay interest on its members deposits by taking an override on monies taken from the bond market and loans to members.

F. The practice of FHLB of making cash advances on demand has encouraged S & L association management to minimize planning for future cash requirements. Continual growth meant it was possible to pay-off FHLB with savings deposits increases in the future

G. Loss reserves and retained earnings represent one source of funds on which np dividends have to be payed paid but:

1. If reserves are offset by a strong liquidity position earnings drop
2. Drop in earnings makes it difficult to accumulate more retained earnings
3. Loss reserves would permit write-off of mortgages or properties sold below paar, maintaining solvency but not liquidity
4. Older savings and loan gains advantage from reserves accumulated when dividend rates were artificially lower

H. The squeeze between mortgage rates and rising dividend rates (cost of deposits) forces the S & L to depend on loan fees and closing charges which tends to make their loans cost more than those from the bank or even the insurance company

1. To justify extra cost S & L's m8st make more generous loans in tetms of loan ratio, prepayment, or other conditions
2. They compete for commitments from the builders who can pass along extra cost directly or indirectly in the cost of the house

I. S & L management walk tight rope betwhen dividend rate, mortgage rate, liquidity ratio, and retained earnings.

IV. Management issues which confront the S & L industry are inherent in where they came from and where they want to go. Promotion of thrift and family home ownership are both splendid objectives but are somewhat inconsistent.

A. If thrift is paramount, then the S & L should be permitted to seek the highest yields and inflation hedges appropriate for savings, and during long periods of inflation , home mortgages provide a poor yield and mo inflation hedge.

B. Promotion of home ownership in effect makes the local S & L a community development bank. If it paid modest dividends it could provide lower than market interest rates which would give it great power locally to support priorities for low income housing , remodeling, or other community facilities.

C. S & L objectives are further confused in regard to profits. Mutual co-ops aren't supposed to have any and to the degree they are chartered institutions they have some elements of monopoly. Still things are managed best when they are managed to self interest but when is self interest the public interest?

D. The small ethnic neighborhood S & L is finding it difficult to attract good management, new savings, or even good loans. The large one has lost all semblance of a co-op.

E. In 1974 Congress failed to take action on a bill called The Financial Institutions Reform Act which would have converted savings and loans into consumer banks. That possibility is better understood after looking at the banks.