

This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: Housing and Mortgage Markets in Historical Perspective

Volume Author/Editor: Eugene N. White, Kenneth Snowden, and Price Fishback, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-07384-X (cloth); 978-0-226-07384-2 (cloth); 978-0-226-09328-4 (EISBN)

Volume URL: <http://www.nber.org/books/fish12-2>

Conference Date: September 23-24, 2011

Publication Date: July 2014

Chapter Title: The Prolonged Resolution of Troubled Real Estate Lenders during the 1930s

Chapter Author(s): Jonathan D. Rose

Chapter URL: <http://www.nber.org/chapters/c12799>

Chapter pages in book: (p. 245 - 284)

The Prolonged Resolution of Troubled Real Estate Lenders during the 1930s

Jonathan D. Rose

7.1 Introduction

Building and loan associations (B&Ls) were an important source of residential real estate loan funds during the interwar period. This chapter studies how one set of particularly troubled B&Ls in Newark, New Jersey, slowly unwound their obligations over the late 1930s and 1940s, following financial shocks which included credit losses on foreclosed real estate and demands for withdrawals from investors.¹

Key to this story is the absence of contractual or statutory mechanisms that could have forced resolution more quickly. To prevent some B&L investors from withdrawing at 100 cents on the dollar while leaving losses for

Jonathan D. Rose is an economist in the Division of Monetary Affairs at the Board of Governors of the Federal Reserve System.

The views expressed here are solely the responsibility of the author and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or of anyone else associated with the Federal Reserve System. I thank Price Fishback, Andra Ghent, Ken Snowden, Eugene White, and seminar participants at the NBER Conference on Housing and Mortgage Markets in Historical Perspective and at Yale University. For acknowledgments, sources of research support, and disclosure of the author's material financial relationships, if any, please see <http://www.nber.org/chapters/c12799.ack>.

1. The focus on B&Ls in the mid-Atlantic region in this chapter is deliberate, as B&Ls were unusually numerous prior to the Depression in this region, with roughly 500 based in Newark alone, and the 1930s recovery of these institutions was remarkably prolonged compared to the national pattern. Of an estimated 12,000–13,000 B&Ls active across the country in 1930, more than 4,000 were located in Pennsylvania and about 1,500 in New Jersey. The activity in Maryland is not well documented as B&Ls were wholly unregulated in that state until the 1940s, but crude estimates suggest around 1,000 to 1,500 associations. The focus on New Jersey is due to its superior data, and the subfocus on Newark is due to the rich history of the 499 B&Ls, most very small, that operated in that city. The B&Ls in this region lagged the pattern of recovery typical for B&Ls in most of the country, where closures and reorganizations were largely finished by 1939.

remaining investors, New Jersey legislators and jurists revised statutes and issued new legal interpretations that allowed B&Ls to restrict withdrawals until loss reserves were established. However, establishing such reserves often took years, and in the interim B&Ls had no clear path for achieving consensus over whether to realize losses and how to allocate losses once realized. These associations struggled for a decade to find such consensus and unwind their obligations.

In response, a secondary market for B&L liabilities, known as shares, emerged in the mid to late 1930s.² This was a market-based resolution mechanism that allowed shareholders to exit their associations, though at steep losses. Similar markets existed in many major cities and were an important feature of the Depression experience for those who accumulated savings through B&Ls.

Importantly, this secondary market was also credited for helping clear the housing market. Buyers of discounted shares subsequently used those shares to purchase real estate from B&Ls at the much higher book value of the shares. The B&Ls preferred these transactions to cash sales if the book value of the shares exceeded the cash price a property could command, as this allowed the association to avoid realizing some losses on its books. Therefore, it was possible for both the buyer and seller of real estate to be better off by exchanging real estate for shares rather than cash because of the loss previously borne by the original holder of the shares.

The median trading price of B&L shares in Newark was low, about forty cents on the dollar of book value during 1939 and 1940. The pattern of market prices across associations is consistent with the primacy of withdrawal considerations, as investors took the largest discounts on shares of associations that were least able to pay withdrawals. In contrast, solvency characteristics have less explanatory power.

The secondary market began to fade in the second half of 1940 as more formal resolutions picked up. The Newark industry was reduced from 499 associations in 1930 to 55 associations in 1945. From 1938 to 1940, a wave of associations exited heavily through voluntary liquidations and state seizures. These associations tended to have larger holdings of foreclosed real estate, to be less profitable, and to have relatively heavier discounts of their shares on the secondary market. In 1942 and 1943 another wave of associations went through reorganization. The main reorganization strategy involved spinning off bad assets (foreclosed real estate, delinquent loans) into separate bad banks, receiving a liquidity infusion from the Reconstruction Finance Corporation (secured by the bad assets) to satisfy unpaid withdrawals, and qualifying for insurance by the Federal Savings and Loan Insurance Cor-

2. Much of the country's B&Ls operated mainly with equity shares. Despite being equity, these shares were subject to withdrawal like deposits. Some states, including Ohio and California, allowed B&Ls to explicitly accept deposits or instruments similar to certificates of deposit.

poration. The RFC cash was critical to addressing the persistent maturity mismatch, and the wartime economic expansion also contributed to the liquidation through higher real estate prices.

The late timing of these resolutions significantly lags the pattern characterizing commercial banks and some (but not all) B&Ls in other parts of the country (See Richardson [2007] for commercial banks and Ewalt [1962] and Snowden [2003] for B&Ls). The slow resolution of these institutions also relates to a literature, traditionally in the context of commercial banks, regarding depositors' access to funds during downturns (Anari, Kolari, and Mason 2005; Rockoff 1993; Kaufman and Seelig 2002). B&L liabilities have not historically been considered part of the core money aggregates and, in fact, appear to have become less money-like during the height of B&L troubles. Lack of access to savings in B&L was a fact of life across the country during the 1930s.

7.2 Background

7.2.1 General B&L Background

Building and loan associations, the predecessors of savings and loan associations, were generally mutually owned thrift organizations that invested almost wholly in real estate loans.³ Here I focus largely on the industry as it existed in New Jersey. There was a certain amount of diversity in B&L practices across the country, and so readers interested in a more thorough and geographically generalized discussion would find useful the information in Snowden (1997, 2003), Snowden and James (2001), Bodfish (1931, 1935), Bodfish and Theobald (1938), Clark and Chase (1925), and Ewalt (1962).

The 499 B&Ls in Newark at the end of 1930 were generally quite small, as the median number of investors was about 450 people. State law put some limit on B&L size through prohibitions against branching or the use of agents, and against loans on properties outside of New Jersey. These restrictions should not be overstated, though, because large associations did exist in the state. The West End B&L, for example, had 33,000 investors and was one of the largest B&Ls in the country.

Snowden (1997) suggests that the small traditional size of B&Ls (not just in Newark but across the country) was a choice of the associations' management (e.g., local builders) who had little desire to manage associations larger than what was necessary to provide financing for their other businesses.⁴

3. The transition to *savings* and loan terminology occurred during the 1930s and 1940s. It was partly a rebranding, but it also reflected a set of important institutional changes.

4. Along these lines, Piquet (1930) tabulates the occupations of New Jersey B&L presidents and secretaries, and finds they were most commonly builders, realtors, and insurance brokers, as well as merchants, clerks, and accountants. In this sense, the growth of the B&L industry was a development endogenous to the relative immaturity of institutional mortgage markets

Table 7.1 Aggregate balance sheet, 1930 and 1937, Newark B&Ls

	Assets		Liabilities		
	1930	1937	1930	1937	
Cash	1.1	1.3	Shares-installment payments	63.1	42.5
Liquid investments	0.3	0.9	Shares-one payment	14.6	19.3
Mortgage loans-B&L contracts	85.6	31.4	Shares-other	0.5	1.9
Mortgage loans-other	2.0	5.5	Borrowed money	5.7	2.4
Loans on shares	2.5	0.8	Accrued dividends	14.0	5.1
Real estate owned	6.7	54.0	Reserves and unapportioned profits	1.1	22.8
Late share payments	1.2	3.9	Other	1.0	5.9
Other	0.7	2.2			
Total	100.0	100.0	Total	100.0	100.0

Notes: The balance sheets are expressed as percentage points out of 100. Total assets were \$480 million in 1930 and \$298 million in 1937.

All things considered, though, the extreme preponderance of associations in Newark was a bit unusual, though shared by neighboring cities in New Jersey, Pennsylvania, and Maryland. Members held a total of about 425,000 accounts at Newark B&Ls in 1930, in a city with 444,000 people.

Table 7.1 displays the aggregate balance sheet of Newark B&Ls in 1930 and 1937.⁵ Most assets were in real estate loans, primarily residential, though some associations also invested in commercial properties in the 1920s, particularly apartment buildings and some small mixed-use properties. This expansion into non-owner-occupied lending was criticized, at least in retrospect, but its extent is difficult to quantify as the published balance sheets do not separate out different types of real estate.⁶ Holdings of non-real estate assets were fairly negligible prior to the Depression but became quite important by 1937.

On the liability side, New Jersey B&Ls were funded mainly by traditional

in late 1800s and early 1900s. Snowden (2003) rejects an alternate hypothesis that the small size of most B&Ls was chosen in order to ease peer monitoring. Larger and more geographically diverse associations had been more numerous during the late nineteenth century but many failed in a large wave during the 1890s.

5. I use data from 1930 in this example because 1930 is the first year in which reserves and unapportioned profits are reported separately from apportioned profits.

6. Some measure is available in RFC loan files, which are careful to characterize the collateral available. For example, at the West End B&L, the largest association in Newark, the majority of owned real estate parcels were traditional one-to-four family residential properties, but by value apartment buildings constituted about two-thirds of the available collateral. From a small sample of RFC loan files, apartment building loans and real estate appear to be more common at the larger associations, while the nonresidential properties held by smaller associations were mixed-use properties such as a store combined with a dwelling. At the Enterprise B&L, which is discussed later in this chapter, fifteen of eighteen real estate parcels were one-to-four family residences, and the other three were mixed-use properties.

equity shares. The resulting ownership structure was quite diffuse, motivated traditionally by mutual ideals. In an “installment” share, a shareholder committed to monthly payments, and the share would mature when those payments, combined with apportioned profits (retained earnings), reached a prefixed maturity value, typically \$200 in about eleven to twelve years (roughly \$2,700 today adjusted for inflation). These liabilities were meant to reduce maturity mismatch with assets, but in practice withdrawal privileges undermined the long-term nature of these shares. Other funding was also obtained with “income” shares, which were similar to certificates of deposits, as the full maturity value of an income share was paid up front and cash dividends were then paid out instead of accumulated.

7.2.2 The Depression Foreclosure Crisis

The nation as a whole experienced a severe foreclosure crisis in the early and mid-1930s. Wheelock (2008), White (2010), Courtemanche and Snowden (2010), Fishback et al. (2011), and Rose (2011) provide background on this. In general, the “double trigger” theory of borrower default emphasizes the importance of negative income shocks combined with lower property prices.⁷ Both triggers were present in the 1930s. In Newark, unemployment was still about 16 percent in 1940 according to the census, and another 4 percent of the labor force was in emergency relief programs. The median value of owner-occupied housing in Newark fell to 52 percent of its 1930 level by 1940, compared to 61 percent in the country as a whole. Much of the decline likely occurred in the first few years of the decade, but even in 1939 a federal survey described real estate prices in Newark as “still shrinking from the high levels of the late 1920s.”⁸

In such an environment, foreclosures mounted, and correspondingly there were very large increases in holdings of foreclosed real estate at Newark B&Ls. Table 7.1 indicates that real estate accounted for 54 percent of Newark B&L assets in 1937. The annual flow of foreclosures in Newark did not materially decrease from its peak until 1937, and were still quite elevated in 1939. Prodigious quantities of institutionally owned real estate had a persistently depressive effect on prices in the market. In 1938, a federal agency noted that, in northern New Jersey, “At least until such time as this liquidation by the B&L associations is farther advanced, there would appear to be little prospect of any improvement in prices; possibly even the contrary.”⁹

7. See Foote, Gerardi, and Willen (2008) for a discussion of the double trigger.

8. The HOLC officials were in good position to observe these trends since they were in charge of selling their own foreclosed properties. Source: field report titled “Survey of Economic, Real Estate, and Mortgage Finance Conditions in Five Counties in Northern New Jersey,” p. 11, September 30, 1939, box 48, City Survey File, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

9. Report on Newark, NJ, p. E111, box 4, City Survey Files, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

7.2.3 Imposition of Withdrawal Restrictions

During the 1930s, withdrawals picked up as shareholders desired access to their savings amid the weakened economy. Withdrawals gained urgency as shareholders lost confidence in their B&Ls.¹⁰ However, many B&L members were reluctant to liquidate foreclosed real estate in order to meet other members' withdrawals, given the depressed real estate market. In addition, since B&Ls in New Jersey carried real estate at cost of acquisition rather than market value, realizing losses on real estate could possibly lead to insolvency.

These problems were without much recent precedent, as B&Ls had rarely if ever been subjected to such large withdrawals, certainly not during the prosperous 1920s. The B&L bylaws sometimes maintained two restrictions on withdrawals. The first was a requirement for advance notice, typically thirty days. Many contemporary sources note that these requirements were not enforced during the 1920s as they were unnecessary, and the subsequent enforcement during the 1930s took shareholders by surprise. The second was some sacrifice of apportioned profits. Apportioned profits typically vested at 20 percent a year, so that by the sixth year of the savings contract, no sacrifice occurred. Since apportioned profits were fairly small during the first five years, this was not much of a deterrent.

Statutory withdrawal restrictions turned out to be more important in practice. Up to the 1930s, New Jersey law held that no withdrawals could be delayed for more than six months. During that six months, withdrawals were to be paid in the order received, and no more than one half of revenue was required to be paid out. Two major changes occurred in the early 1930s, as the six-month limit threatened to send much of the industry into the hands of the court as investors sued under the six-month rule.

First, in mid-1932, the New Jersey Supreme Court ruled that even after six months, withdrawals could still be restricted, on the basis that withdrawal was a statutory privilege rather than a contractual right. The court held that the statutory privilege could be rescinded for two reasons. First, withdrawals would cause "forced sales in these times when there is no market for real estate and association mortgage assets, repayable in shares, are unsalable." Second, "the statute should not apply where the exercise of the right granted there under would disturb the financial stability of the associations or materially depreciate the value of the shares of the remaining members."¹¹

A second development occurred in the legislature which, under "emergency" powers first asserted during 1933, passed a new law that allowed the B&Ls' regulator (the commissioner of banking and insurance) to restrict

10. As an interesting historical note, Piquet (1930) states that the 1929 stock market crash led to a small crisis of confidence in New Jersey B&Ls, sparking withdrawals and freezing up some institutions. This episode would be in line with the idea that the stock market crash was important for the uncertainty it created.

11. *Building and Loan Guide and Bulletin*, July 1932, p. 3–4.

withdrawals at his discretion. This authority was repeatedly extended until September 1940, and though the original law and its extensions were challenged many times on constitutional grounds, it appears to have never been struck down.¹²

These developments could be interpreted either as altering the rights of shareholders, or as clarifying those rights. These withdrawal restrictions were quite consistent with the preexisting idea that both profits and losses should be mutually shared across all B&L members. Shareholders would have been familiar with the concept since mutuality was a central selling point for B&Ls to their investors, a central ethos of those associations, and a key legal foundation that allowed B&Ls to avoid federal taxation. Nevertheless, no law during the 1920s allowed withdrawals to be delayed for years. Also, it was largely unanticipated that associations would be unable to agree on whether to realize losses and how to allocate those losses. That discord was a decidedly nonmutual eventuality, and obviously some shareholders were more willing to realize losses than others, as evidenced by those who sold their shares on the secondary market.

7.2.4 Fallout from Withdrawal Restrictions

Withdrawal restrictions lasted for years at many Newark B&Ls and were a disaster for shareholder relations. Comprehensive data on withdrawal restrictions are not available, but reports and examples from the period abound. As late as 1939, a Federal Home Loan Bank Board (FHLB) report noted that the “majority of the associations are still on a restricted withdrawal basis.”¹³ In 1940 the secretary of the New Jersey B&L League similarly stated that, prior to many reorganizations, “shareholders were being paid little or nothing, perhaps \$25 a month as a necessitous case.”¹⁴

The largest association in Newark, the West End, fits this pattern. In 1940, it had “an unpaid withdrawal list reaching several millions which hadn’t been materially reduced since about 1933.” Before it was reorganized, “many of the shareholders thought that it was frozen tighter than any concrete that was ever poured.”¹⁵ The RFC, considering a loan to the West End for reorganization, noted that the West End’s “frozen nature has caused many shareholders to withhold their monthly payments and not reinvest their maturities, as well as to react against new shareholder investments.” Of five

12. Eventually this was modified to stipulate that, if in each month an association used one-third of its net receipts to pay maturities or add to maturity reserves and another one-third to pay withdrawals, then shareholders were categorically barred from suing that association to seek a withdrawal.

13. Report titled “Comparison of HOLC Activities and the Building and Loan Situation with Economic, Real Estate, and Mortgage Finance Conditions in Northern New Jersey,” p. 5, box 52, City Survey Files, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

14. *Building and Loan Guide and Bulletin*, July 1940, p. 56.

15. *Building and Loan Guide and Bulletin*, February 1940, p. 49.

associations with RFC loan files between 1938 and 1941 that I have viewed, all were still restricting payment on withdrawals, and some on maturing shares.

The result was that B&Ls had “completely destroyed public confidence by restrictions on withdrawals and recapture of dividends” already by 1935.¹⁶ In 1939, the same characterization remained: “Building and loan associations in the Northern New Jersey Area, once having resources per capita ranking among the highest in the country, today, excepting a comparatively few, are in a generally frozen condition and lack public confidence.”¹⁷

The only solution offered by supervisors was the establishment of loss reserves. Loss reserves were important because, if inadequate, members withdrawing at 100 percent of book value would avoid incurring their share of their associations’ losses. Therefore, under the new emergency powers, the state B&L regulator required strong withdrawal restrictions until adequate loss reserves were assembled. Accumulating these reserves was costly. Newark B&Ls had entered the Depression with loan loss reserves constituting less than 1 percent of liabilities. To establish new reserves, associations were required to first convert unapportioned profits, then to reclassify previously apportioned profits (kept on books until shares matured), then to further accumulate through new earnings.¹⁸

To establish loss reserves, associations commonly reclassified another liability item, apportioned profits, into general loss reserves. In 1935, one out of every three associations had zero apportioned profits, meaning all had been converted into reserves. Reclassification of apportioned profits was subject to return to shareholders if reserves ultimately exceeded losses, which contributed to the unwillingness of B&L managers to actually tap the loss reserves so created. As an example, table 7.9, discussed later, itemizes the loss reserves held by the Enterprise B&L in 1941; 40 percent of the loss reserves were still kept in a separate account and had not been used, having been established by recapture of apportioned profits half a decade earlier.¹⁹

16. Field Report titled “Summary, Survey of Essex County New Jersey,” p. 1, October 30, 1935, box 48, City Survey File, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

17. Report titled “Comparison of HOLC Activities and the Building and Loan Situation with Economic, Real Estate, and Mortgage Finance Conditions in Northern New Jersey,” p. 5, box 52, City Survey Files, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

18. This reserve building was required by order of the state regulator and was probably the most significant state-level intervention. Of course, modern accounting rules would have required even larger provisioning at earlier dates. The set of policies governing reserve building were implemented as Orders 1 and 1A, on March 14, 1933, authorized by emergency legislation passed in the preceding days. These orders were modified by Orders 3 and 3A, dating to May 23, 1933. This law was originally set to expire within one year, but was repeatedly renewed, with the last renewal that I can find preserving it until 1940.

19. The reclassification of apportioned profits was a serious blow to borrowers as well. In the traditional “pledged share” B&L loan, a borrower accumulated shares just as an investor did; when the shares matured they would be used to extinguish the full principal debts. Admittedly,

Without the discipline of meeting withdrawal demands, complying with modern accounting standards, or the guidance of an effective regulatory resolution regime, real estate liquidation and loss realization was repeatedly put off. As late as 1940, the president of the Federal Home Loan Bank of New York described Newark's B&L managers as hoping for a miracle:

In far too many cases, the directorates of financial institutions substantially burdened with foreclosed real estate, rather than facing the facts and marketing their steadily depreciating properties at current values (writing off whatever loss may be necessary in the process) are, unconsciously perhaps, engaging in one of the biggest real estate speculations of all time. For in such cases managements are refusing to sell at current levels solely in the hope that at some future and undeterminable date they will be able to get higher prices.²⁰

One B&L manager described some colleagues as “apparently waiting for the millennium to come before selling their properties. They have their eyes only on the cost.”²¹ These delays in loss realizations helped lead to the creation of the secondary share market, in which shareholders realized losses that associations as a whole refused to. This market is examined in the next section.

7.3 Secondary Market

In response to withdrawal restrictions, by the late 1930s it became common practice for B&L shareholders in Newark to liquidate their shares on a secondary market, though at a loss.²²

The demand side of the share market largely consisted of people purchasing shares in order to use them as a means of payment for real estate, as Newark B&Ls sold their real estate in exchange for their own share liabilities.²³ In this section, I sketch the economics of why these transactions were

the mixing of a share contract on the liability side with a mortgage on the asset side is confusing. One way to think about this is to imagine a fully amortized mortgage in which a bank, rather than using the noninterest portion of the monthly payment to extinguish part of the principal debt, instead invested it in equity shares of the bank. The term of such a loan would not be fixed but rather would depend on the profitability of the institution itself; highly profitable institutions would return greater profits, allowing shares to mature faster. The opposite can happen as well, though. When apportioned profits were taken back and new profits were limited, if they existed at all, borrowers were forced to make payments for longer periods than they had anticipated. Some frustrated borrowers defaulted or moved their loans to other institutions, further depriving B&Ls of needed income.

20. George Bliss, *Newark Sunday Call*, 21 April 1940, part IV p. 10.

21. *Building and Loan Guide and Bulletin*, August 1936, p. 25.

22. For a contemporary description, see, for example, *Sunday Call* 5 January 1941, part V p. 3.

23. Real estate sales were reported as “one of the most important factors” for the “increased activity” during 1939 in this share market. Some demand for shares also came from mortgage borrowers who were able to pay some of their outstanding debts with shares in the association from which they had borrowed, but this type of exchange appears to have been clearly secondary in importance to the real estate transactions. The *Sunday Call* describe these transactions as “not nearly as frequent as real estate sales” but nevertheless there was “little doubt that they

in the interests of each party, and give special attention to how this was a market-based resolution mechanism to unwind the obligations of B&Ls.

7.3.1 Development of the Market

Market functioning was aided by so-called speculators, who helped provide liquidity, and by brokers, who intermediated between buyers and sellers.²⁴ Not much can be said about the speculators, but regarding brokers there is evidence of a fairly competitive market; in 1939, at least nine brokerage firms regularly advertised their services in a Newark newspaper, the *Sunday Call*. Examples of such advertisements are reproduced in figure 7.1.

The earliest hints of the B&L share market start in 1933, when the first advertisements for broker services appeared, such as in figure 7.1. It was not until 1938 that the market appears to have really matured. In 1938, managers were still uncertain how their shareholders would react to the maturing market, and whether they would have even more difficulty recruiting additional shareholders if such prospective shareholders saw their shares trading for twenty-five or fifty cents on the dollar.²⁵ Meanwhile, state regulators and leaders of the B&L movement saw the share market as an opportunity to liquidate the industry's real estate, and so consistently exhorted associations to exchange real estate for shares. These efforts succeeded. Over 1939, trading activity spread to the shares of more and more associations. By the end of 1939, most shareholders had become familiar with the market, how it worked, and why it existed.²⁶

The market appears to have been at its most active from 1938 to 1940. Trading activity then declined in latter 1940 and especially 1941. For example, advertisements for broker services became more common in the late 1930s, peaking at about nine or more in each issue of the *Sunday Call* in 1939. Advertisements then fell to three by 1941, two in 1943, and zero in 1946. The decline in activity was generally attributed to years of real estate liquidation, which left the stock of remaining properties reduced, and to a decline in the number of shares for sale at low prices, perhaps as the most desperate shareholders had by 1941 generally sold their shares.²⁷

have been a contributing factor in creating a market for shares of many associations" (9 July 1939, part III, p. 6).

24. The *Sunday Call* described speculators as key to maintaining liquidity for some shares with infrequent real estate sales (9 July 1939, part III, p. 6).

25. *Building and Loan Guide and Bulletin*, July 1938, p. 71.

26. *Sunday Call*, 9 July 1939, part III, page 6.

27. *Sunday Call*, 4 January 1942, part IV, p. 9. Along the same lines, in April 1941 a Federal Home Loan Bank Board document noted that "share sales are fast drying up due to absorption of cheap certificates." "Report on Newark, New Jersey" p. 7; April, 1941, box 47, City Survey File, Records of the Home Owners' Loan Corporation, record group 195.3, National Archives II, College Park, MD.

OUR CASH PRICES
 are **USUALLY HIGHER** for
BUILDING & LOAN SHARES
"See Us" Before You Sell
 NO COMMISSIONS CHARGED

NEWARK B. & L. SHARE EXCHANGE
 786 Broad St. (Broad & Market Bldg.) Newark, N. J.
 6th Floor (Formerly Firemen's Bldg), Broad & Market Sts.
 Market 2-7567, 2-7568, 2-7569

EISELE, KING & STUDDIFORD
 Members New York Stock Exchange
 9 CLINTON ST., NEWARK, N. J. MARKET 2-3820

BUILDING AND LOAN SHARES
 BANK AND INSURANCE STOCKS
 OVER-THE-COUNTER SECURITIES
 UNLISTED AND MUNICIPAL BONDS

Branch Offices
 Trenton, New Brunswick, Red Bank, Ellensburg, Plainfield

ELEVENTH WARD
BUILDING & LOAN SHARES
Bought and Sold—Immediate Cash Paid
C. T. MELANDER & CO.
 3 NO. ARLINGTON AVE., OR 3-8371
 EAST ORANGE, N. J.
 Opposite East Orange City Hall

Fig. 7.1 Advertisements for broker services for B&L share sales
 Source: Newark Sunday Call, 1 January 1939, part III, p. 5.

7.3.2 Why Did the Share Market Help Clear the Housing Market?

The share market was widely credited with helping clear the housing market. It is not immediately apparent why such a market was necessary for this purpose: clearing the housing market would presumably require prices to drop, but B&Ls always had the option of lowering their prices, and had long resisted doing so. In order for the share market to clear the housing market, it would have to provide B&Ls some benefit over a cash sale, while still lowering real estate prices for those on the demand side of the housing market.

A simple balance sheet exercise has a way of clarifying how this was possible. Suppose that an association had the simple stylized balance sheet

Initial Position			
Assets		Liabilities	
Cash	1	Shares	75
Mortgage loans	39	Apportioned Profits	5
Real Estate	60	Loss Reserve	20
Total	100	Total	100

Result if \$20 of real estate sold for \$12 cash			
Assets		Liabilities	
Cash	13	Shares	75
Mortgage loans	39	Apportioned Profits	5
Real Estate	40	Loss Reserves	12
Total	92	Total	92

Result if \$20 of real estate sold for \$20 of shares (book value)			
Assets		Liabilities	
Cash	1	Shares	55
Mortgage loans	39	Apportioned Profits	5
Real Estate	40	Loss Reserves	20
Total	80	Total	80

Fig. 7.2 Stylized balance sheet implications of real estate sales

depicted on the left side of figure 7.2, and it was trying to sell a piece of real estate valued on its books at \$20, though the cash market price was \$12. If sold for \$12 in cash, loss reserves would be depleted by \$8 and the association's coverage for future losses would look a bit doubtful. Alternatively, suppose that the association's shares were trading at forty cents on the dollar. A real estate purchaser might be willing to purchase, say, \$20 worth of shares for \$8 in cash and exchange those shares for the same parcel. Loss reserves would not need to decline at all, but it is important to realize that a loss did occur: some shareholder realized \$12 in losses on their shares. At an upper limit, the real estate purchaser might be willing to exchange up to \$30 of shares, since those shares could be purchased at \$12, the cash market value of the property. At the lower limit, the B&L would have no incentive to accept shares with book value of less than \$12.

In essence, there were two prices. The nominal price was the book value of the shares, which determined the amount of liabilities the B&L could retire. The effective price was the price of obtaining those shares, which is what really matters to the real estate purchaser. This helped clear the housing market because the effective price dropped. This is an interesting situation in which both the supply and demand sides to the real estate transactions benefited by the use of shares; the key is that these benefits originated in the loss taken by the shareholder who sold shares. By realizing a loss via the secondary share market, a shareholder essentially created a surplus that was available to two parties: the other shareholders of their B&L, and the real estate purchasers.

Contemporary sources support the idea that prices worked in this fashion. A summary of the Atlantic City share market stated this idea most starkly:

The customary method is to mark up the value of the property to a point where the discount price of the shares will result in a present day, fair cash value. For example, take the case of a piece of real estate worth \$5,000 in today's market. If the shares are selling at fifty cents on the dollar, in an all share sale, the association promptly fixes the price at \$10,000 irrespective of its book value or worth to them.²⁸

I suspect this quote overstates the case a bit; it seems more likely that the parcel mentioned would sell for a bit less than \$10,000 in the presence of transaction costs to obtain secondhand shares and some bargaining power on the side of the real estate purchaser. Other examples fit this pattern, including a case study that was discussed at length in a conference of B&L managers in mid-1938. An association was willing to sell a piece of real estate for \$1,000 in cash and a \$5,200 mortgage, but a second offer was made for \$800 in cash and \$6,700 in shares. The second offer is attractive to the real estate purchaser, since the shares were more than likely obtained for half price or less—about \$3,350. The second offer is also attractive to the B&L on the supply side, since, with a nominal price of \$1,300 more than the first offer, fewer losses would have to be realized by the B&L's remaining shareholders.

Another example fits the same pattern. A B&L manager described how his association had acquired a property with book value of \$10,000, expected a loss on the property, and had two offers for its sale. The first was for \$8,500 in cash and a mortgage, the second for \$6,000 in cash and \$5,000 in shares. The second offer actually gave the association the rare opportunity to record a gain on a piece of foreclosed real estate, and still involved a smaller outlay to the purchaser than the pure cash offer.²⁹

As in the preceding examples, payment for real estate typically consisted of some combination of a cash down payment combined with a mortgage or with shares.³⁰ To be clear, if the shares were part of the transaction, they would be applied to the nominal transaction price at book value, and subsequently cancelled as liabilities. Associations considered both types of offers.

This helps articulate the sense in which the secondary share market helped associations liquidate real estate and clear the housing market. The New

28. Report on Atlantic City, pp. 28–29, box 51 City Survey Files, Records of the Home Owners' Loan Corporation, record group 195.3, National Archives II, College Park, MD.

29. *Building and Loan Guide and Bulletin*, June 1939, p. 58.

30. Some sources from the period note that these transactions were subject to the approval of the state regulator. However, the reality was that *every* real estate transaction required the approval of the state regulator—with one major caveat. The caveat is that if associations adopted a real estate classification plan that gave each parcel a grade from A to D, they were able to unload the Cs and Ds without seeking regulatory approval. It appears that regulatory approval was either easily obtained or that associations made use of this classification scheme, since the market for shares was so widespread. See *Building and Loan Guide and Bulletin*, June 1939, p. 56.

Jersey state regulator, for example, described the competitive edge of B&Ls in this manner:

A considerable volume of sales is resulting from the use of shares in exchange for real estate. Many associations are able to secure a competitive advantage in the real estate market by this means and have thus been able to create a real estate activity which otherwise would not have existed. This has resulted in returning a considerable amount of property back to private owners thus reducing the overhang of institutionally owned real estate.³¹

This quote indicates that the cash market value of real estate was low enough that B&Ls chose not to transact; the share market helped “create” these transactions by lowering the effective prices. After all, by 1938, the real estate market was not as dysfunctional as it was in 1933; at a low enough price, a B&L would have been able to sell its real estate for cash and a mortgage, albeit at a realized loss.³²

While lower prices helped B&Ls sell their real estate, this was not necessarily a positive development for the housing market. Working through the overhang of real estate may have boosted expectations for recovery, but in the short run this effect could easily be dominated by the cheap effective prices of B&L real estate. When households are deleveraging, fire sales of real estate can damage the ability of owner-occupants to engage in transactions of their own that might increase economic efficiency. Along these lines, B&Ls faced criticism for their sales’ negative effect on market prices, as described by this Home Owners’ Loan Corporation (HOLC) report:

Building and loan associations as a whole are being charged with “dumping” of acquired properties due to their acceptance of shares at par toward purchase price of real estate, when such shares could be purchased at substantial discounts. . . . It is open to question whether it is really dumping or whether it is not merely finding levels at which business can be done.³³

Other HOLC documents note that the HOLC was at a competitive disadvantage against B&Ls because of the low effective prices via the use of shares. The HOLC was very much in a position to know this, since it owned large amounts of foreclosed real estate and sought to liquidate those holdings.

In some sense, B&Ls’ remaining shareholders gained at the expense of the shareholders that sold their shares. While the secondhand share sales were

31. *Building and Loan Guide and Bulletin*, December 1938, p. 30.

32. As a side note, the discussion highlights the difficulty of defining a singularly meaningful market price of real estate in a depressed market. Given two offers with the same nominal prices, B&Ls valued the offer with shares differently than the offer without shares. Likewise, given the same two offers, the actual cost to the purchaser changed when shares were involved.

33. Field Report titled “Survey of Economic, Real Estate, and Mortgage Finance Conditions in Five Counties in Northern New Jersey,” p. 15, September 30, 1939, box 48, City Survey File, Records of the Home Owners’ Loan Corporation, record group 195.3, National Archives II, College Park, MD.

voluntary and presumably Pareto improving, B&Ls used the share market to push an extra portion of their real estate losses onto the set of shareholders who had sold their shares, rather than distributing those losses equally across all shareholders. This could be interpreted as a reward for patience. Alternately, it could be interpreted as compensating the rest of the association for the cost of early withdrawals, but this is less compelling considering that withdrawal restrictions were often still in place in 1939 or 1940. In any case, the share market established a price of liquidity, which many years of history have shown can be mispriced during financial crises. Alternatively, B&L managers may have just preferred that their paper losses be realized not by the association but by shareholders on the open market.³⁴

7.3.3 Secondary Markets in the Rest of the Country

Secondary B&L liability markets were common in the 1930s, though they certainly did not exist in every major city. Importantly, none of these markets existed before the Depression. Survey reports of urban real estate markets, conducted by the HOLC during the second half of the 1930s, indicate that several large cities had active B&L liability markets, including Cleveland, Columbus, Indianapolis, Milwaukee, New Orleans, and Philadelphia. The surveys indicate that liability trading also occurred in a number of other smaller cities in Alabama, Mississippi, Florida, North Carolina, Missouri, Indiana, elsewhere in New Jersey, Colorado, Texas, and California. Notably missing from these lists are all cities in New England, and some major cities with large amounts of B&L activity such as Chicago, Cincinnati, Louisville, Omaha, Pittsburgh, and St. Louis.

The share markets were a common but not uniformly prevalent feature of the Depression B&L experience. These markets generally worked to help associations dispose of real estate, but the exact mechanics differed from city to city, and few persisted into the late 1930s as Newark's did. State laws regarding withdrawals differed, as did the take-up rate of federal aid and the structure of B&L liabilities. For example, a twist in some markets was the competing interests of depositors against shareholders. Allegations of corruption seem to have been not uncommon as well, with B&L management accused of manipulating the share markets in various ways.

In the existing Depression literature I am aware of two references to sec-

34. As a final note, there is some indirect evidence that the secondary market was, to a degree, a substitute for more formal resolution. After associations exited, trading in their shares reportedly fell, but was not eliminated. Trading was noted as sometimes occurring in the shares both of associations in liquidation and of the various "bad bank" entities that held defaulted mortgages and real estate loans spun off during reorganizations. (See a discussion in the *Sunday Call*, 4 January 1942, part IV, p. 9.) In this data set spanning price quotes in 1939 and 1940, there were ninety-five associations that exited during those years and that had quotes available before their exits. After their exits, prices were only quoted for fifty, a bit more than half. In contrast, of the associations with share prices available and that survived to the end of 1940, about 85 percent continued to have prices quoted up until the end of 1940.

Table 7.2 Share markets in other cities

City	Date	Median	25th percentile	75th percentile	Number of quotes
Newark	Jan-39	38	30	44	164
Oklahoma City	Jan-34	40	36	50	42
New Orleans	Jan-34	40	35	48	37
San Francisco	Feb-34	51	30	60	36
Cleveland	Jan-34	52	45	57	49
Columbus	Jan-34	62	54	68	20
Milwaukee	Jan-35	78	72	83	40

Sources: Quotes are from the following sources: *Daily Oklahoman*, 7 January 1934; *New Orleans Time-Picayune*, 13 January 1934, p. 22; *San Francisco Examiner*, 6 January 1935; *Cleveland Plain Dealer*, 6 January 1934, p. 11; *Columbus Dispatch*, 7 January 1934; *Milwaukee Journal-Sentinel*, 16 January 1935, p. F1.

ondary B&L share markets. Kendall (1962) briefly notes that “some” cities developed such markets, and specifically mentions Milwaukee, reproducing an offering sheet from a brokerage in that city containing approximate market prices for the shares of ninety-six associations. Rockoff (1993) mentions that a secondary market for B&L liabilities existed in Youngstown, Ohio, as well.

Table 7.2 gives a simple comparison between shares prices of Newark B&Ls and the prices of B&Ls in a limited sample of six other cities with B&L share markets. Newark B&L quotes are roughly in the same range as those in Oklahoma City and New Orleans, but below the median prices in San Francisco, Cleveland, Columbus, and Milwaukee. Newark is somewhat of an anomaly as the first quotes available are from 1939, whereas in most other cities (except Milwaukee) the markets were at their height in the mid-1930s and no longer operating by 1939. Altogether, more research is warranted on the timing of these markets across cities, the variation in share prices across and within cities, and the existence of markets in some cities but not others.

7.4 Examining Share Prices

7.4.1 Share Price Data

Data on share prices are available from January 1939 to December 1940. The source is detailed in the appendix. Information on prices in 1938 may exist but I have not been able to obtain them. The period from 1938 to 1940 is roughly the period when historical sources indicate trading volume was at its most active. Over time, the quotes were published weekly, but short-term volatility was quite limited: most shares do not change more than a few cents over the two-year period. Of the 384 associations still active at the beginning of 1939, 60 percent have quotes available. Figure 7.3 contains a reproduction of one of the share price listings.

Building and Loan Share Quotations

Furnished by Eitel, King & Studdiford.

<p>These quotations are for Newark associations, unless otherwise specified. All quotations are subject to confirmation.</p> <p>The quotations should not be taken to represent the book value of the shares listed. They are merely approximate bid prices at which shares are currently quoted in the local market. In some cases associations expect to pay liquidating dividends in excess of the amount quoted. A bid is not an appraisal.—Editor.</p>	<table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 5%;"></td> <td style="width: 55%;"></td> <td style="width: 40%; text-align: right;">Bid</td> </tr> <tr><td>Manor</td><td></td><td style="text-align: right;">27</td></tr> <tr><td>Manufacturers</td><td></td><td style="text-align: right;">60</td></tr> <tr><td>Masonic</td><td></td><td style="text-align: right;">42</td></tr> <tr><td>Mayflower</td><td></td><td style="text-align: right;">38</td></tr> <tr><td>McKinley</td><td></td><td style="text-align: right;">47</td></tr> <tr><td>Mechanics</td><td></td><td style="text-align: right;">37</td></tr> <tr><td>Metropolitan</td><td></td><td style="text-align: right;">37</td></tr> <tr><td>Modern</td><td></td><td style="text-align: right;">35</td></tr> <tr><td>Montiflore</td><td></td><td style="text-align: right;">33</td></tr> <tr><td>Monitor</td><td></td><td style="text-align: right;">20</td></tr> <tr><td>Mt. Prospect</td><td></td><td style="text-align: right;">53</td></tr> <tr><td>Mutual</td><td></td><td style="text-align: right;">48</td></tr> <tr><td>Mt. Sinai-New Deal</td><td></td><td style="text-align: right;">30</td></tr> <tr><td>Nelson</td><td></td><td style="text-align: right;">40</td></tr> <tr><td>Newark</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>New Empire</td><td></td><td style="text-align: right;">53</td></tr> <tr><td>Newslead</td><td></td><td style="text-align: right;">25</td></tr> <tr><td>Normal</td><td></td><td style="text-align: right;">38</td></tr> <tr><td>North American</td><td></td><td style="text-align: right;">38</td></tr> <tr><td>Novel</td><td></td><td style="text-align: right;">12</td></tr> <tr><td>O. K.</td><td></td><td style="text-align: right;">42</td></tr> <tr><td>Opportunity</td><td></td><td style="text-align: right;">52</td></tr> <tr><td>Ordway</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>Outlook</td><td></td><td style="text-align: right;">54</td></tr> <tr><td>Owl</td><td></td><td style="text-align: right;">25</td></tr> <tr><td>Oxford</td><td></td><td style="text-align: right;">38</td></tr> <tr><td>Pacific</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>Paramount</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>Parker</td><td></td><td style="text-align: right;">35</td></tr> <tr><td>Parkview</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>Paywell</td><td></td><td style="text-align: right;">70</td></tr> <tr><td>Perfection</td><td></td><td style="text-align: right;">60</td></tr> <tr><td>Pilgrim</td><td></td><td style="text-align: right;">46</td></tr> <tr><td>Popular</td><td></td><td style="text-align: right;">27</td></tr> <tr><td>Postoffice Cfts</td><td></td><td style="text-align: right;">37</td></tr> <tr><td>Precise</td><td></td><td style="text-align: right;">38</td></tr> <tr><td>Producers</td><td></td><td style="text-align: right;">37</td></tr> <tr><td>Provident</td><td></td><td style="text-align: right;">42</td></tr> <tr><td>Public</td><td></td><td style="text-align: right;">58</td></tr> <tr><td>Real'y</td><td></td><td style="text-align: right;">30</td></tr> <tr><td>Reliable</td><td></td><td style="text-align: right;">31</td></tr> <tr><td>Renowned</td><td></td><td style="text-align: right;">29</td></tr> <tr><td>Rex</td><td></td><td style="text-align: right;">40</td></tr> <tr><td>Rialto</td><td></td><td style="text-align: right;">33</td></tr> <tr><td>Roseville</td><td></td><td style="text-align: right;">34</td></tr> <tr><td>Sanford</td><td></td><td style="text-align: right;">45</td></tr> <tr><td>Savings</td><td></td><td style="text-align: right;">49</td></tr> <tr><td>Select</td><td></td><td style="text-align: right;">48</td></tr> <tr><td>Severnur</td><td></td><td style="text-align: right;">40</td></tr> </table>			Bid	Manor		27	Manufacturers		60	Masonic		42	Mayflower		38	McKinley		47	Mechanics		37	Metropolitan		37	Modern		35	Montiflore		33	Monitor		20	Mt. Prospect		53	Mutual		48	Mt. Sinai-New Deal		30	Nelson		40	Newark		45	New Empire		53	Newslead		25	Normal		38	North American		38	Novel		12	O. K.		42	Opportunity		52	Ordway		45	Outlook		54	Owl		25	Oxford		38	Pacific		45	Paramount		45	Parker		35	Parkview		45	Paywell		70	Perfection		60	Pilgrim		46	Popular		27	Postoffice Cfts		37	Precise		38	Producers		37	Provident		42	Public		58	Real'y		30	Reliable		31	Renowned		29	Rex		40	Rialto		33	Roseville		34	Sanford		45	Savings		49	Select		48	Severnur		40
		Bid																																																																																																																																																					
Manor		27																																																																																																																																																					
Manufacturers		60																																																																																																																																																					
Masonic		42																																																																																																																																																					
Mayflower		38																																																																																																																																																					
McKinley		47																																																																																																																																																					
Mechanics		37																																																																																																																																																					
Metropolitan		37																																																																																																																																																					
Modern		35																																																																																																																																																					
Montiflore		33																																																																																																																																																					
Monitor		20																																																																																																																																																					
Mt. Prospect		53																																																																																																																																																					
Mutual		48																																																																																																																																																					
Mt. Sinai-New Deal		30																																																																																																																																																					
Nelson		40																																																																																																																																																					
Newark		45																																																																																																																																																					
New Empire		53																																																																																																																																																					
Newslead		25																																																																																																																																																					
Normal		38																																																																																																																																																					
North American		38																																																																																																																																																					
Novel		12																																																																																																																																																					
O. K.		42																																																																																																																																																					
Opportunity		52																																																																																																																																																					
Ordway		45																																																																																																																																																					
Outlook		54																																																																																																																																																					
Owl		25																																																																																																																																																					
Oxford		38																																																																																																																																																					
Pacific		45																																																																																																																																																					
Paramount		45																																																																																																																																																					
Parker		35																																																																																																																																																					
Parkview		45																																																																																																																																																					
Paywell		70																																																																																																																																																					
Perfection		60																																																																																																																																																					
Pilgrim		46																																																																																																																																																					
Popular		27																																																																																																																																																					
Postoffice Cfts		37																																																																																																																																																					
Precise		38																																																																																																																																																					
Producers		37																																																																																																																																																					
Provident		42																																																																																																																																																					
Public		58																																																																																																																																																					
Real'y		30																																																																																																																																																					
Reliable		31																																																																																																																																																					
Renowned		29																																																																																																																																																					
Rex		40																																																																																																																																																					
Rialto		33																																																																																																																																																					
Roseville		34																																																																																																																																																					
Sanford		45																																																																																																																																																					
Savings		49																																																																																																																																																					
Select		48																																																																																																																																																					
Severnur		40																																																																																																																																																					

Fig. 7.3 Share price listing excerpt
 Source: Newark Sunday Call, 23 June 1940, part IV, p. 6.

In January 1939, the median bid quote for the shares of active Newark B&Ls was thirty-nine cents. For now, the median price is noted in order to gauge the scale of losses being realized by shareholders who sold their shares. A discount to thirty-nine cents would represent a large loss for any shareholder selling at the time. Figure 7.4 displays the distribution of share prices across associations. Some sold for as little as twenty cents on the dollar, and few exceeded sixty cents.

7.4.2 Cross-Sectional Characteristics of Share Prices

On the secondary market, what should determine the discount of B&L liabilities from their book value? On the one hand, the basic solvency of the association would affect the extent to which would the book value would

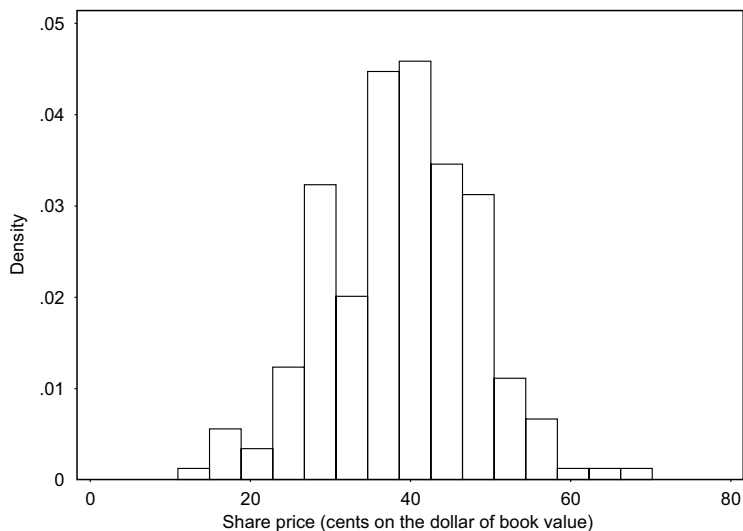


Fig. 7.4 Distribution of share prices for B&Ls active at the beginning of 1939

ever be fully paid out. On the other hand, the earnings capacity and liquidity position of an association would affect how soon those payments would come. Of course, liquidity and solvency are not wholly distinct concepts (see Carlson, Mitchener, and Richardson [2011] for example). Nevertheless, here I use those two terms in the sense of separating out the probability of being paid full book value from the timing of those payments. In general, the liquidity aspect appears to be more important for share prices.

No perfect measures of solvency or liquidity are available. Assets held in real estate and loss reserves on the liability side are the best measures of general solvency, although it would be even better to know the expected losses on the real estate assets. In terms of liquidity, one useful measure might be the size of a B&L's withdrawal list or the expected duration of a withdrawal request. These are not available in New Jersey, but they may be problematic even if they were available, since shareholders were known to not bother with requesting withdrawal if it were a fruitless exercise.

Summary statistics of available balance sheet characteristics are given in table 7.3. Some of these characteristics I will describe as being more associated with solvency, and others with liquidity. These variables essentially exhaust all available balance sheet information. Liability-side characteristics include apportioned profits per share, a dummy indicating if apportioned profits were zero, the extent of reliance on prepaid "income" shares (supposedly a relatively "hot" funding source compared to installment shares), the extent of borrowed money, and the extent of loss reserves. Asset-side characteristics include the portions of assets held in real estate, arrears, and

Table 7.3 Summary statistics

	1939		
	Median	Mean	Standard deviation
<i>Liability characteristics</i>			
Apportioned profits/shares	6.20	6.40	4.60
1(Apportioned profits = 0)		0.15	
Value of income shares/value of all shares	0.33	0.32	0.15
Borrowed money/liabilities	0.000	0.014	0.029
Reserves/liabilities	0.27	0.28	0.09
<i>Asset characteristics</i>			
Real estate/assets	0.48	0.48	0.18
Arrears/assets	0.013	0.040	0.069
Share of mortgages unpledged	0.43	0.44	0.28
Liquid assets/assets	0.026	0.042	0.048
Log(assets)	12.74	12.80	0.71
<i>Lagged characteristics from 1930</i>			
Apportioned profits/shares	12.7	12.2	4.0
Real estate/assets	0.033	0.047	0.052
log(assets)	13.39	13.41	0.73
Income shares/all shares	0.17	0.18	0.09
Borrowed money/liabilities	0.062	0.060	0.039
Reserves/liabilities	0.0056	0.0078	0.0073
<i>Other characteristics</i>			
Year established	1912	1911	12
1(Received RFC loan before 1935)		0.14	
1(Member of FHLB by 1936)		0.07	
1(Optional plan)		0.28	
1(Nonserial plan)		0.20	

liquid assets, respectively, the log of total assets, and the share of mortgages that are unpledged, a measure of transition away from the old B&L mortgage. Note that arrears are shareholders' obligated payments that have not been made, rather than arrears on, say, loans.³⁵ Lagged values of some of these liability and asset characteristics, from 1930, are also included. Finally, the year of establishment is included, as are dummy variables for whether the B&L received an RFC loan before 1935, whether it was a member of the FHLB, and whether it operated on the optional or nonserial plans (with the serial plan associations as the excluded group).³⁶

35. Since the B&L loan contract used installment shares as sinking funds, arrears on loans may have been characterized in this manner as well.

36. Serial plan associations were the most traditional form, with new share investments only opening up at specified points in time, typically once a quarter. Nonserial plans allowed them to be opened at any time. Optional plan associations still used installment shares but the payments were optional (at the discretion of the shareholder) rather than required every month.

Table 7.4 Predictors of share prices

Dependent variable: share price				
	Coeff.	SE	Coeff.	SE
<i>Liability characteristics</i>				
Apportioned profits/shares	0.78*	(0.15)	0.62*	(0.19)
1(Apportioned profits = 0)	-6.34*	(1.62)	-3.26***	(1.77)
Value of income shares/value of all shares		-0.54	(5.83)	
Borrowed money/liabilities			-29.8	(25.8)
Reserves/liabilities			0.55	(7.37)
<i>Asset characteristics</i>				
Real estate/assets			-6.80	(4.29)
Arrears/assets			-30.0*	(9.23)
Share of mortgages unpledged			3.24	(2.21)
Liquid assets/assets			22.1	(17.0)
Log/assets)			-0.76	(1.84)
<i>Lagged characteristics from 1930</i>				
Apportioned profits/shares			0.0066	(0.23)
Real estate/assets			-3.47	(11.2)
Log/assets)			1.46	(1.87)
Income shares/all shares			-3.16	(9.91)
Borrowed money/liabilities			-0.85	(14.0)
Reserves/liabilities			-36.5	(68.9)
<i>Other characteristics</i>				
1(Received RFC loan before 1935)			-0.047	(0.063)
1(Member of FHLB by 1936)			-0.99	(1.47)
Year established			2.19	(2.21)
1(Optional plan)			-4.50*	(1.51)
1(Nonserial plan)			-5.01*	(1.50)
Constant	36.9*	(1.11)	123	(123)
Observations	202		202	
R-squared	0.35		0.45	

Notes: The share price is scaled between 1 and 100; that is, one unit is one cent on the dollar. Balance sheet data are from 1938. The share price is the median price quoted over 1939 and 1940 for each association. Two B&Ls that underwent reorganizations in late 1938 are excluded, as their balance sheets were highly unusual immediately after the reorganizations, with large amounts of cash that were quickly drawn down in the following months. Robust standard errors.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7.4 reports the results of two simple ordinary least squares (OLS) regressions of the share price on these characteristics. In practice, the variables I would associate with the liquidity effect appear to dominate, but the data are not perfect and so these conclusions should be taken with that hedge.

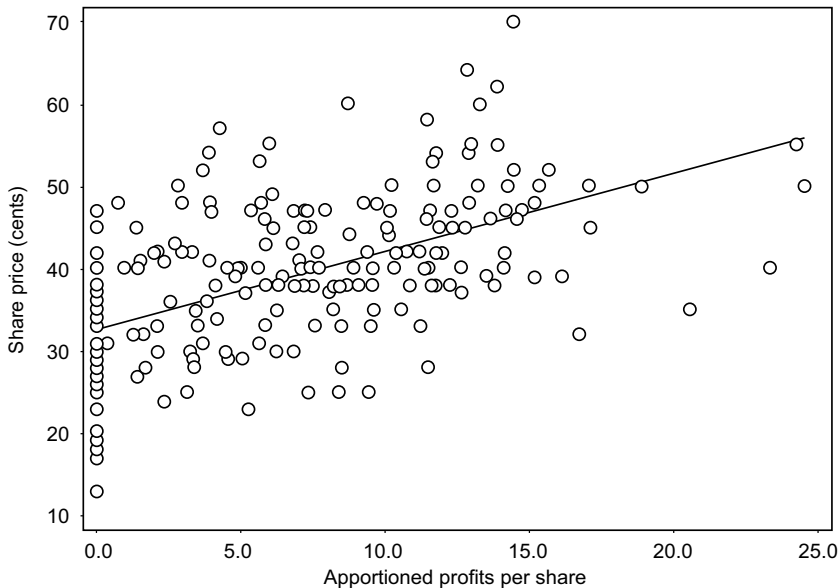


Fig. 7.5 Share prices plotted against apportioned profits per share

The apportioned profits variables dominate the results. The magnitude is about a three to four cent change in the share price for a one standard deviation change in apportioned profits, along with an additional three-cent drop in the presence of zero apportioned profits. These are reasonably strong changes given that the share prices range from about twenty to sixty cents on the dollar. The simple regression of share prices on the two apportioned profits variables itself has an R -squared of 35 percent, reported in the first column. Figure 7.5 plots share prices in early 1939 against apportioned profits per share at the end of 1938, showing the correlation.

What do apportioned profits reflect? Arguably, they are more associated with liquidity than solvency, for the following reasons. Recall that apportioned profits are dividends applied to installment shares but not distributed until those shares reach maturity value. New apportionment was severely constrained during the mid-1930s as associations were forced to build loss reserves, and existing apportionments were very often partly or wholly reclassified into loss reserves. By 1938, higher levels of apportioned profits characterized associations that no longer needed to build more loss reserves. In turn, the important point here is that withdrawals were restricted by order of the state regulator until these loss reserves were established. Consequently, associations with more apportioned profits in 1938 were quite likely to be paying larger amounts of withdrawals.

Another interpretation of the apportioned profits variables might focus on the fact that associations with more apportioned profits likely had higher

Table 7.5 Importance of dividend rates

Dependent variable: share price		
	Coeff.	SE
Apportioned profits/shares	0.61**	(0.30)
1(Apportioned profits = 0)	1.6	(7.52)
Dividend rate	2.1	(1.45)
Constant	32.6	(3.5)
Observations	39	
R-squared	0.29	

Notes: The share price is scaled between 1 and 100; that is, one unit is one cent on the dollar. Balance sheet data are from 1938. The share price is the median price quoted over 1939 and 1940 for each association. The dividend rate is set to zero if no dividend had been paid in either 1937 or 1938, as the survey was done in late 1938 or early 1939. Robust standard errors.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

dividend rates. If shares were fixed maturity bonds, then associations with lower dividend rates would likely exhibit larger discounts from par value. Of course, installment shares were distinct from bonds inasmuch as their dividends were retained rather than paid out and the maturity value was fixed rather than the maturity date, and payouts at maturity were also restricted in the 1930s. Nevertheless, it is worth trying to distinguish this yield effect from the withdrawal effect emphasized in the previous paragraph. To that end, I have a limited amount of data on dividends from a special HOLC survey of Newark B&Ls in 1938. Unfortunately, there are only thirty-nine observations in which I observe this dividend information and have share prices. There is a strong 64 percent correlation between apportioned profits per share and the dividend rate, which ranges from 0 to 5 percent. When the share price is regressed on both variables, only apportioned profits retain significance. That simple regression is reported in table 7.5, and indicates that apportioned profits are capturing something else, arguably the withdrawal situation.

Returning to table 7.4, another liquidity measure is the extent of asset holdings in cash and liquid investments. This measure of asset liquidity shows little predictive power in table 6.4, even though this would seem naturally related to the ability to pay withdrawals. However, more flexible non-linear specifications do indicate that very low levels of asset liquidity are associated with lower share prices. For example, when a dummy for very low asset liquidity term is included (not shown, measured as less than 2.5 percent of assets in cash or liquid investments), B&Ls with near zero liquid assets had lower share prices on the order of about one to two cents, while the relationship fades for moderate and higher levels of liquidity.

It is also worth noting that large amounts of arrears were associated with lower share prices, although the magnitude is a moderate 1.5 cent change in the share price for a one standard deviation change in arrears over assets. Recall that arrears are obligated payments that shareholders have not made. This is quite an intangible and dubious asset that would have done little to improve liquidity, but likely reflects both liquidity and solvency issues.

Few other variables have much predictive power, including some variables that would seem strongly related to solvency issues. Real estate holdings do not have any conditional statistical relationship with share prices, and the result is not dependent on the linearity imposed in table 7.4, as more flexible quadratic and cubic specifications also have little predictive power (not shown). The size of loss reserves does not have predictive power, nor does the ratio of loss reserves to real estate holdings.

Altogether this evidence is consistent with a liquidity-centric story, though it is not fully able to rule out alternative stories. As one final piece of history, though, the experience of three B&Ls that experimented with real estate segregation in 1933 (discussed more in the next section regarding reorganization) is relevant. By 1938, each had zero real estate or delinquent loans, since those assets had been placed in separate bad banks, with shareholders receiving certificates of participation in those bad banks. In no way could these reorganized associations be considered insolvent, but their share prices were still trading between thirty-seven and fifty-three cents on the dollar in 1939. The real estate segregation by itself did little to solve liquidity issues, which continued to weigh on shareholders who wanted access to their investments. This anticipates one of the key features of most of the successful reorganizations of the late 1930s and early 1940s: cash loans secured by real estate, which were then used to pay withdrawals that had been restricted since 1933. This is discussed at more length in section 7.5.

These results help us understand the share market, but do not tell us much about the root of B&Ls' credit problems and why they varied across associations. Such an analysis is handicapped by a lack of data on issues such as associations' management competency, underwriting standards, types of real estate collateral and their locations, or borrower characteristics.

7.5 Formal Resolution in the Late 1930s and Early 1940s

At the end of 1930, 499 associations were operating in Newark. By the end of 1944, fifty-five associations were still active in the city. Thirty-seven associations had avoided any changes, and the other eighteen associations were all that were left of the 462 that had undergone some major structural event, including liquidation, state action, reorganization, and merger. Table 7.6 tabulates the exit process by year and type of exit.

This section examines these events, grouping them into two large waves. Relatively few structural events occurred in the early and mid-1930s,

Table 7.6 Major structural events of Newark B&Ls

Type of action	1931–1936	1937	1938	1939	1940	1941	1942	1943	1944	Total
<i>Liquidations and bulk transfers</i>										
Voluntary liquidation	3	14	38	32	66	34	39	11	2	239
Bulk transfers	0	0	0	1	10	8	9	18	4	50
<i>State actions</i>										
Conservatorship	7	0	0	0	0	0	0	0	0	7
Liquidation	5	0	0	0	0	0	0	0	0	5
Possession	8	0	1	0	20	0	0	0	0	29
<i>Reorganizations</i>										
With new charter	4	0	0	7	1	2	34	34	1	83
Without new charter	12	1	6	1	0	0	0	0	0	20
New or retained charters	4	0	2	3	0	0	4	5	0	18
<i>Other</i>										
Merged	19	0	2	2	3	1	0	0	0	27
Moved out of Newark	2	0	0	0	0	0	0	0	0	2
Total (excluding new or retained charters)	58	15	47	43	100	45	82	63	7	
Associations at end of 1930	499									
Total actions taken, above	462									
New or retained charters	18									
Associations at start of 1945	55									

Notes: The table refers to the years in which the actions were initiated. Voluntary liquidation was known to take several years, as was the liquidation of real estate spun off into bad banks during reorganization. The reorganizations took different forms, as discussed in the text. Many reorganizations also involved mergers, but I avoid double counting here: the 103 associations that reorganized consolidated into the eighteen charters indicated, but four of those (all formed in the early 1930s) exited before 1945.

especially on a per-year basis. The first large wave of resolution actions started in 1937 or 1938, and consisted mainly of closures of the institutions in the poorest condition. The second wave, particularly in 1942 and 1943, was dominated more heavily by reorganizations, made possible by a large-scale federal intervention.

7.5.1 First Wave of Exit: Liquidations and Other Closures

In the first wave, primarily during 1938, 1939, and 1940, exits were dominated by liquidations and appear to have been driven by conventional factors stemming from poor balance sheets, as well as pressure from shareholders for withdrawals as measured by share prices.

Voluntary liquidation and bulk transfer were each a voluntary choice to end the operations of an association. Discussions among B&L leaders in the late 1930s make clear that the two were considered close substitutes. In a voluntary liquidation, an association placed all of its assets into a liquidating corporation. In a bulk transfer, an association sold off some of its assets to another association, and placed the rest in a liquidating corporation. In either case, liquidation itself was not immediate but depended on the pace of real estate sales. Voluntary liquidation was far more common, particularly before 1940. After 1940, more reorganized associations were able and willing to purchase assets in bulk.

Actions by the state regulator, the Department of Banking and Insurance, were less common than liquidations. After twenty B&Ls were closed by the state in the early 1930s, one more was seized in 1938, and then twenty more in one day in April 1940. Incompetence or manifest insolvency appear to have motivated most of these actions. The seizures in 1940 were a long overdue effort to spur deeply frozen associations into formal liquidation. The commissioner of banking and insurance stated the rationale: "The problem associations, for the most part, remained apathetic . . . As time went on, it became increasingly evident that in the absence of any voluntary correction or dissolution by a substantial number of these associations, the department would be obliged to take action."³⁷ Nevertheless, in most cases of poor condition, B&Ls were left to build capital by slowly retaining earnings and taking back apportioned profits. Illiquidity was not countered with seizure but rather addressed through withdrawal restrictions.

To understand which characteristics were associated with the closures from 1938 to 1940, I use a probit framework in which the dependent variable is a dummy for closure, defined as voluntary liquidation, bulk transfer, or state seizure. The set of characteristics is the same set as used in section 7.4, with the addition of each association's share price.

The marginal effects and standard errors are reported in table 7.7. I first report results using data from 1937, predicting closure from 1938 to 1940 in

37. *Building and Loan Guide and Bulletin*, July 1940, p. 25.

Table 7.7 Closures from 1938 to 1940

Dependent variable:	Closure in 1938–1940		Closure in 1940		
	All	1937	All	1939	1939
B&Ls included:					
Vintage of data:	(1)	(2)	(3)	(4)	(5)
Share price			-0.024*	-0.018*	
			(0.0049)	(0.0066)	
Real estate/assets	1.13*	0.76*		0.83**	0.87**
	(0.24)	(0.23)		(0.39)	-0.36
Arrears/assets	1.75*	1.53**		0.85	1.45***
	(0.51)	(0.60)		(0.92)	-0.84
Share of mortgages unpledged	-0.063	-0.16		-0.15	-0.18
	(0.16)	(0.11)		(0.20)	-0.2
Liquid assets/assets	-0.34	1.15***		0.73	0.67
	(0.95)	(0.63)		(1.05)	-1.04
Log(assets)	-0.51*	-0.29*		-0.16	-0.12
	(0.14)	(0.11)		(0.16)	-0.16
Apportioned profits/shares	0.012***	0.012		0.014	0.0035
	(0.0070)	(0.0079)		(0.015)	-0.014
l(Apportioned profits = 0)	0.40*	0.39*		0.42*	0.43*
	(0.082)	(0.12)		(0.14)	-0.14

Liability side:

Portion of shares in income shares	-0.13 (0.33)	0.060 (0.27)	-0.42 (0.41)	-0.44 (0.39)
Borrowed money/liabilities	1.34 (1.12)	1.37 (1.05)	2.76 (2.07)	3.36*** (1.88)
Reserves/liabilities	0.60 (0.56)	0.86** (0.40)	0.16 (0.60)	0.2 (-0.6)
Apportioned profits/shares	0.0013 (0.0097)	0.0027 (0.0096)	0.026 (0.017)	0.023 (-0.016)
Real estate/assets	1.07*** (0.56)	1.06*** (0.60)	1.93*** (1.02)	1.66*** (-0.96)
Log(assets)	0.36* (0.13)	0.25** (0.10)	0.12 (0.17)	0.07 (-0.16)
Income shares/all shares	0.61 (0.49)	0.72*** (0.41)	1.91* (0.73)	1.93* (-0.69)
Borrowed money/liabilities	0.029 (0.77)	0.25 (0.72)	-0.014 (1.26)	0.17 (-1.26)
Reserves/liabilities	2.55 (4.19)	0.32 (5.09)	-15.4** (6.99)	-12.4*** (-6.52)
Observations	427	338	169	169
Number with LHS = 1	168	96	63	63
Pseudo <i>R</i> -squared	0.24	0.30	0.34	0.31

Notes: Probit estimation with marginal effects displayed. The five “other characteristics” from table 7.4 are also included but not displayed here to save space. Closure includes voluntary liquidation, bulk transfer, and regulatory seizure. Robust standard errors.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

the first column, and then using data from 1939 predicting closure in 1940 in the second column. The 1939 data are helpful for many reasons, including that the data on share prices are first available in 1939. Since share prices are not available for every association and selection may be an issue, columns (3), (4), and (5) report results using the subset of associations with share prices, first including share prices as an explanatory variable by itself, then adding the other controls, and finally without the share price.

The results are generally unsurprising insofar as they indicate that measures of balance sheet distress predict closures in this period. These results will contrast, though, with those in the next subsection in which reorganizations in 1942 and 1943 are studied instead of these closures.

In terms of credit quality, associations with relatively large amounts of real estate were strongly more likely to close in these years. A B&L with a 10 percentage point greater share of assets held as real estate in 1939 had a roughly 8 percentage point higher probability of closure in 1940. For example, at the extreme, at the end of 1939 there were seventeen associations that had more than 75 percent of their assets in real estate, and fourteen of those closed the following year.

Share prices have strong predictive power over closures as well, as associations with lower share prices were strongly more likely to close in 1940. The magnitude is roughly that every two-cent level change in the 1939 share price is associated with a 1 percentage point increase in the probability of closure. Interpreting this relationship is not necessarily straightforward. Associations with very low share prices could have had shareholders clamoring for serious action such as liquidation. However, share prices are still observed for some institutions after their closures in this period, and the prices rarely changed afterward. This indicates that the incentives of shareholders to seek liquidation to satisfy their withdrawal requests were limited, as liquidation was still protracted. Another possibility is that share prices capture a range of other unobserved characteristics that are related to viability.

As a check that the regulatory seizures are not completely driving the results, the first column of table 7.8 replicates this analysis but excludes associations that were seized by the state regulators. The coefficient on real estate decreases moderately, and the coefficient on arrears drops to nearly zero, suggesting perhaps that the state officials targeted associations with extreme values of each. A look at the data confirms that the associations seized by regulators were those at the very upper end of the distribution of real estate burdens. This indicates that the voluntary liquidations and bulk transfers were less a direct function of real estate burdens and more a function of the ability to return profits to shareholders and to allow them to sell their shares at less sacrificial prices.

Finally, the second column of table 7.8 examines closures in 1941. The characteristics that predict the 1941 closures are quite different, and this anticipates some of the results in the next section. Credit quality, share

Table 7.8 Closures from 1938 to 1940, continued

Dependent variable:		Liquidation in 1940	Closure in 1941
B&Ls included:		Subset without seizures (and with share prices)	Subset with share prices
Vintage of data:		1939	1940
		(5)	(6)
	Share price	-0.016*	
<i>Asset side:</i>	Real Estate/assets	(0.0060) 0.63***	0.36 (0.26)
	Arrears/assets	0.022 (0.86)	-0.76 (1.21)
	Share of mortgages unpledged	-0.016 (0.18)	-0.26*** (0.14)
	Liquid assets/assets	1.13 (0.94)	0.89** (0.42)
	Log(assets)	-0.12 (0.15)	-0.16 (0.11)
	<i>Liability side:</i>	Apportioned profits/shares	0.018 (0.013)
1(Apportioned profits = 0)		0.52* (0.16)	-0.042 (0.12)
Portion of shares in income shares		-0.34 (0.41)	-0.40 (0.33)
Borrowed money/liabilities		2.15 (1.74)	3.40** (1.62)
Reserves/liabilities		0.13 (0.53)	0.32 (0.43)
<i>Lagged from 1930</i>		Apportioned profits/shares	0.018 (0.016)
	Real estate/assets	1.73*** (0.99)	-0.13 (0.84)
	Log(assets)	0.058 (0.14)	0.052 (0.10)
	Income shares/all shares	1.84* (0.66)	0.12 (0.50)
	Borrowed money/liabilities	0.79 (1.23)	0.45 (0.87)
	Reserves/liabilities	-13.0*** (7.28)	-6.25 (5.79)
	Observations	154	131
	Number with LHS = 1	48	27
	Pseudo R-squared	0.35	0.23

Notes: Probit estimation with marginal effects displayed. The five “other characteristics” from table 7.4 are also included but not displayed here to save space. Closure includes voluntary liquidation, bulk transfer, and regulatory seizure. Robust standard errors.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

prices, and profitability all have little predictive power. Instead, the liquidations are generally more difficult to predict. Liquidity of assets is important, reflecting the ability to make a short-term payout during liquidation, and to some extent associations with more old style mortgages were more likely to liquidate, suggesting they were not embracing the new world of mortgage lending.

Two developments may help explain the 1941 closures. First, the buildup to World War II changed the return to liquidation, making it more attractive to all associations. A special report written by HOLC officials in August 1941 noted the remarkable changes in conditions:

In the four month period, since the rendering of the original report covering Newark, conditions have changed materially . . . The combination of [defense orders and war contracts] has greatly stimulated employment and brought many new residents to Newark. This has had a noticeable effect upon occupancy, rents, and the sales market.³⁸

These sentiments were echoed at around the same time in all of the key primary sources, including the *Sunday Call* and the *Building and Loan Guide and Bulletin*. The second development is the ongoing reorganization program. Many of the associations that reorganized in 1942 began preparations in 1941, for example, by applying for loans from the RFC. Had economic conditions not changed and had the reorganization program not developed, the fate of those associations would likely have been different.

7.5.2 Second Wave of Exit: Reorganizations

In the second wave of structural events at Newark B&Ls, primarily during 1942 and 1943, reorganization became a much more dominant choice. Of the 201 associations still active at the beginning of 1941, 145 either closed or reorganized during the subsequent two years. As a result, generally speaking, the choice for these associations was not whether to have a major structural event, but whether that event would be a complete exit or some form of reorganization.

By about 1940, the strategy for reorganization coalesced into a set of procedures with three main features:

1. An association's assets were split in two, with the good assets placed in a new association and the bad assets placed into an association whose only purpose was liquidation; that is, a "bad bank" in modern vernacular. This usually involved some form of consolidation of multiple associations in order to ensure the new association was large enough to be viable. Shareholders would be issued participation certificates in the liquidating corpora-

38. Report on Newark, NJ, April 1941, special addenda dated August 1941, box 47, City Survey Files, Records of the Home Owners' Loan Corporation, record group 195.3, National Archives II, College Park, MD.

tion and shares in the new association, which together would have face value equal to the old shares.³⁹

2. Most of the new associations required infusions of liquidity in order to meet pent-up demand for payments on withdrawals or matured shares. This liquidity came in the form of a loan from the Reconstruction Finance Corporation (RFC), or possibly an investment in shares by the Home Owners' Loan Corporation (HOLC). The RFC loan was secured first by the real estate held in the liquidating association and second by a general lien on all of [both] associations assets; the RFC cash would be placed in the new association.

3. The new association qualifies for insurance from the Federal Savings and Loan Insurance Corporation.

Altogether, 103 associations went through reorganization, though not all using the exact set of the aforementioned procedures. Those procedures were not fully formulated until 1939, and they were implemented most heavily in 1942 and 1943, with sixty-eight associations reorganizing in those years. The hiatus during 1940 and 1941 was largely due to demands by the federal agencies involved that any further reorganizations be part of a comprehensive program for the closure or rehabilitation of *all* troubled B&Ls in Newark, a large task that required careful planning and some legislative accommodation.⁴⁰ Newark was joined by several other cities in requiring this "community program." Similar community programs were conducted in Philadelphia, New Orleans, Milwaukee, Baltimore, Chicago, and Altoona, PA.⁴¹ Uniquely dysfunctional was the state of New Jersey, though, with twenty separate community programs of its own.⁴²

According to data on RFC activities available at the National Archives, the large majority of loans were approved in 1941 and 1942 and dispensed in the subsequent year. The records indicate fifty-nine loans were approved by the RFC to Newark B&Ls between 1938 and 1943, totaling \$13.7 million. In comparison, all Newark B&Ls had \$51 million in assets at the end of 1943.

The core of the postwar savings and loan industry in Newark belonged to fourteen consolidated associations that emerged from this reorganization

39. Associations also had the option of writing down shareholder's capital during the reorganization. It is unclear how many or if any associations in Newark exercised the option.

40. The FSLIC also insisted on having the ability to be a joint receiver with the state regulator in case of an insured association's failure, and the FHLB insisted on having a law allowing for easier conversion into federal charters. Both of these required legislative fixes, and those actions are actually somewhat remarkable given the extreme resistance to the federal program demonstrated in New Jersey during the 1930s.

41. These programs were partly done for the sake of the industry itself. Federal officials, however, emphasized their necessity so that the reorganized and insured institutions would not be put at risk by the continued presence of frozen institutions. See the annual reports of the Federal Home Loan Bank Board in 1938-1939 (p. 107), 1939-1940 (p. 107), and 1940-1941 (p. 120).

42. See *Federal Home Loan Bank Review*, November 1943, p. 33.

Table 7.9 Example of asset segregation

	Old association	New association	Liquidating association
<i>Assets</i>			
Mortgage loans	\$96,181	\$23,506	\$72,676
Real estate	179,007	0	179,007
HOLC bonds	4,525	4,525	0
Cash on hand and in banks	35,028	103,528	4,500
Total	\$314,741	\$131,559	\$256,183
<i>Capital and Liabilities</i>			
Shares	\$178,336	\$124,835	\$53,501
RFC loan	0	0	73,000
Reserves—established prior to recapture of profits	25,341	0	25,341
Reserves—established by recapture of profits	54,761	0	54,761
Reserves—established after recapture of profits	55,957	6,693	49,263
Other	347	30	317
Total	\$314,741	\$131,559	\$256,183

Notes: This is the asset segregation plan adopted by the Enterprise B&L of Newark, which received a \$73,000 loan from the RFC for reorganization. The data reflect Enterprise's condition in April 1940 when it first approached the RFC. Reorganization was ultimately executed in early 1942.

process. All but two were formed by associations that were approved for loans by the RFC. After resisting this outcome for nearly a decade, the core of Newark's thrift industry now offered accounts that were insured by the Federal Savings and Loan Insurance Corporation, were free of the burden of foreclosed real estate, and were relatively large, professionally managed, with permanent offices. In 1950, when the troubles of the 1930s were finally just memories, the fourteen reorganized associations held 92 percent of Newark B&L assets. In comparison, the 103 associations that, through reorganizations and asset transfers, were consolidated into these fourteen had controlled only 42 percent of Newark B&L assets in 1930.

Asset segregation and liquidity infusions were both critical. Table 7.9 helps to elucidate this, by showing the reorganization plan of the Enterprise B&L. According to RFC loan files, Enterprise sent 80 percent of its assets to the liquidating association. Altogether, Enterprise did not have a very large core business worth preserving, which is why ten other Newark associations simultaneously reorganized with Enterprise in the same manner, forming the Penn Savings and Loan Association.

With a large RFC loan to fund Enterprise's liquidating association, 70 percent of the share liabilities were put in the new association (a bit more than typical). The B&L managers learned to expect withdrawals of about 30 percent of new associations' share liabilities in the first few months, which would be met with the RFC cash.⁴³ Indeed, the RFC loan file notes that

43. *Building and Loan Guide and Bulletin*, February 1940, p. 15.

Enterprise's withdrawals were still restricted, and outstanding withdrawal requests totaled about 12 percent of share capital in 1941. In addition, while Enterprise's reserves were quite large relative to real estate, 40 percent of those reserves had been created in 1933 by recapture of profits, and so were specially earmarked for return to shareholders if managers could avoid tapping them.

Without the RFC loan, Enterprise would not have been well positioned to solve its withdrawal problem. As an illustration, there were fifteen Newark associations that experimented with asset segregation in 1933, but the three consolidated associations that resulted had difficulty gaining traction because their liquidity positions were essentially unchanged.⁴⁴ Their balance sheets indicate they were chronically short on liquid assets post-reorganization; two of three never had more than 2.5 percent of their assets in cash or securities. Two eventually voluntarily liquidated, and the third liquidated via bulk transfer of assets to one of the new federally insured associations. As noted in the previous section, their shares were still traded in the secondary market in 1939, at around fifty cents on the dollar. With this experience in mind, after the first version of the new reorganization strategy was presented at the state B&L convention in 1937, the most important question involved liquidity:

What of these liabilities which are our real headaches, our unpaid maturity list? . . . Where do we get the money to pay off the withdrawals and the maturities? How can we continue as a going concern, simply by the bookkeeping operation of transferring some bad assets from one association to another, or from one account to another in the same association?⁴⁵

Asset segregation was not a panacea, but it did accomplish at least two things. First, it clarified to existing shareholders the extent of their maximum potential exposure to losses on the bad assets. Second, and probably more importantly, it allowed new investors to have their capital invested wholly in good assets. It had been difficult to attract new capital into a B&L that had, say, 50 percent real estate on its books, since that capital's return would be lower than the return on the new mortgage investments it allowed.

To conclude this section, it is informative to repeat the type of analysis used in the previous section with a probit framework in which the dependent variable is a dummy for reorganization after 1941. The set of right-hand-side variables is the same. The results are reported in table 7.10. The estimation reported in the first column includes all associations active at the end of

44. Authority for asset segregation was always implicitly available, and was made explicit in two pieces of state legislation in the early 1930s, and then in a 1937 reorganization act, and again modified in 1939 and later. The method of segregation used in 1933 was slightly more cumbersome, as these associations were required to set up trust entities, which were liquidated by special trustees under the supervision of the state regulator. Nevertheless the mechanics were essentially identical and it is difficult to believe that the distinction between trust accounts and liquidating corporations can alone explain the long delay in asset segregation.

45. *Building and Loan Guide and Bulletin*, August 1937, p. 15.

Table 7.10 Reorganizations in the 1940s

		Dependent variable: reorganization after 1941			
B&Ls included:		All	Subset that closed or reorganized	Subset with share prices	Subset with share prices
Vintage of data		1941	1941	1941	1941
		(1)	(2)	(3)	(4)
<i>Asset side:</i>					
Share price				-0.0018 (0.0090)	
Real estate/assets		1.48* (0.34)	1.63* (0.41)	2.40* (0.76)	2.41* (0.75)
Arrears/assets		-3.57 (2.31)	-3.52 (2.65)	-6.49*** (3.36)	-6.46*** (3.35)
Share of mortgages unpledged		0.79* (0.23)	0.91* (0.31)	1.49* (0.57)	1.48** (0.57)
Liquid assets/assets		3.16* (0.70)	3.85* (0.86)	5.57* (1.11)	5.56* (1.10)
Log(assets)		0.39* (0.084)	0.51* (0.12)	0.89* (0.21)	0.89* (0.21)
Apportioned profits/shares		-0.014 (0.012)	-0.015 (0.016)	-0.016 (0.023)	-0.017 (0.024)
1(Apportioned profits = 0)		-0.19** (0.096)	-0.069 (0.21)	-0.17 (0.20)	-0.19 (0.18)
Portion of shares in income shares		-0.029 (0.40)	0.088 (0.58)	-1.36*** (0.80)	-1.36*** (0.79)
Borrowed money/liabilities		-2.94 (2.52)	-0.97 (3.01)	-3.65 (4.08)	-3.70 (4.01)
Reserves/liabilities		-1.03*** (0.56)	-1.17 (0.72)	-2.93* (1.09)	-2.93* (1.09)
<i>Liability side:</i>					

Lagged from 1930:

Apportioned profits/shares	-0.012 (0.014)	-0.030 (0.019)	-0.036 (0.028)	-0.037 (0.028)
Real estate/assets	-0.69 (1.19)	-1.51 (1.50)	-1.37 (1.82)	-1.42 (1.79)
Income shares/all shares	-0.56 (0.60)	-0.83 (0.90)	0.38 (1.28)	0.38 (1.28)
Borrowed money/liabilities	-0.54 (1.06)	-0.85 (1.48)	1.09 (2.12)	1.11 (2.11)
Reserves/liabilities	-7.90 (7.90)	-7.36 (11.0)	-3.62 (11.8)	-3.17 (11.8)
1(Received RFC loan before 1935)	0.24 (0.23)	0.17 (0.22)	0.25 (0.21)	0.25 (0.21)
1(Member of FHLB by 1936)	-0.074 (0.12)	-0.23*** (0.13)	-0.38* (0.15)	-0.38** (0.15)
Year established	0.0085*** (0.0044)	0.012** (0.0060)	0.025** (0.0099)	0.025** (0.0098)
1(Optional plan)	-0.17*** (0.100)	-0.24*** (0.14)	-0.70* (0.14)	-0.70* (0.14)
1(Nonserial plan)	-0.066 (0.10)	-0.096 (0.14)	-0.46* (0.17)	-0.46* (0.16)
Observations	191	150	103	103
Pseudo <i>R</i> -squared	0.49	0.47	0.57	0.57

Notes: Probit estimation with marginal effects displayed. Robust standard errors.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

1941, while the second includes just those that closed or reorganized, setting aside those that survived.

Naturally, associations reorganizing had large amounts of real estate, but it is interesting that they had even larger amounts than associations that liquidated during the same time period. One way to think about this is that, by the end of 1941, the associations with large amounts of real estate that had not yet liquidated were clearly looking for some way to avoid that fate. After all, the large majority of associations either closed or reorganized after 1941, so the decision for most was not whether to take some major action but the form of that action.

Larger associations were more likely to reorganize. As troubled as some of the larger associations were, their size ensured that they still had enough good assets to form the core of a new association. Smaller associations that reorganized tended to do so while merging their good assets with many other associations. Reorganizing associations also had converted almost all of their mortgages away from pledge mortgages into direct reduction mortgages, a sign that they were taking steps to embrace the modern mortgage industry.

7.6 Modern Parallels

The trading of B&L shares on secondary markets resembles practices that characterize modern closed-end mutual funds. Funds of this sort have a fixed amount of shares outstanding at any given time and do not offer to pay out withdrawals. This is advantageous to the extent that these funds are able to hold less liquid assets. In place of withdrawals, investors can trade their shares on a secondary market, typically at some discount to the net asset value of the shares. Since there is no specific withdrawal value, these funds do not “break the buck” in the same sense as money market mutual funds or B&Ls for that matter. As a thought experiment, Newark B&Ls could be thought of as having operated in a manner similar to money market mutual funds that abruptly converted into closed-end mutual funds. Ignoring the profound regulatory barriers that make such a conversion purely a thought experiment, such a move would dramatically alter the nature of investors’ claims in a way that captures the important part of B&L investors’ 1930s experience.

The imposition of withdrawal restrictions at B&Ls also has some parallels to developments in the auction-rate securities (ARS) market during the 2007 to 2009 financial crisis. Holders of ARS were accustomed to the option of selling their holdings if desired at periodic auctions, but became unable to do so as demand at auctions decreased in early 2008 and investment banks declined to provide backstops against auction failure. The aftermath was litigious and involved basic questions of what investors were promised, much like the questions over the obligations of B&Ls to their investors. Ultimately,

after litigation by state attorneys general and federal and state regulators, some investment banks agreed to buy back ARS.⁴⁶

Finally, focusing on the nature of financial crises at intermediaries more broadly, what these episodes have in common is the inability of these institutions, during periods of macroeconomic or financial distress, to fulfill promises that were made either explicitly or implicitly during stronger economic times. Such unfulfilled promises can create particularly persistent problems when they involve real estate assets with long durations. For example, today the resolution of representation and warranty issues related to securitization transactions continue to weigh on mortgage lenders. These issues stem from contractual agreements made during boom times that proved difficult to fulfill or unwind during postcrisis macroeconomic environments. The problem in each case is not necessarily the promise itself but rather the lack of clear provision for what to do when the promise breaks down.

7.7 Conclusion

This chapter has studied how B&Ls unwound their obligations after taking on large amounts of foreclosed real estate during the 1930s. Resolution among Newark, NJ, B&Ls was postponed as those institutions exploited the gray area between illiquidity and insolvency. After a large balance sheet shock, insolvency was given a temporal dimension, as the persistent reality of lower real estate prices was downplayed. The time horizon of a B&L as a whole did not always reflect the short-term needs of some shareholders to access their savings during the Depression. The secondary share market reflects this most starkly; illiquidity only protected the solvency of those with long time horizons, while those shareholders who sold their shares realized the steep losses others would not.

The federal government's role stands out as particularly helpful in resolving Newark B&Ls' issues. The intervention by the Reconstruction Finance Corporation starting in 1939 is notable for finally matching a patient funding source to real estate assets, and for creating a substantial amount of new liquidity for the first time in a decade. In fact, this chapter adds a new dimension to the set of federal programs described by Snowden (2003) as transforming the thrift industry during the 1930s. Snowden shows that, nationally, the future of the thrift industry lay within a new federally designed system of national charters, FHLB membership, and FSLIC insurance. New Jersey thrift leaders at first rejected each of these innovations. In 1945 there were still no federally chartered S&Ls in Newark, an anomaly. By that time, though, B&L managers and shareholders had capitulated to the comprehensive overhaul carefully designed in the late 1930s by federal authorities.

Not all federal programs had equally lasting impacts. This chapter has

46. See Austin (2010) for more background on the ARS market.

not discussed much the discount facilities of the Federal Home Loan Bank System or the troubled asset relief available through the Home Owners' Loan Corporation. Not many Newark associations were able to qualify for FHLB membership, and FHLB collateral requirements were stricter than those of the RFC program as those two institutions had very different structures. The Home Owners' Loan Corporation was likely more helpful with its purchases of distressed mortgage loans. However, the HOLC did not purchase the most distressed mortgages possible; rather, it purchased those that were creditworthy given restructuring.⁴⁷

In a previous study I have suggested that the HOLC was in many ways a lenders' program, purchasing mortgages from lenders at generous terms, and I have no reason not to believe that was the case in Newark. In fact, it is sobering that, even as ambitious, large, and generous as the HOLC was, it was still insufficient to deal with problems on the scale of those at Newark B&Ls.

Appendix

Data and Textual Sources

New Jersey B&L balance sheet data were published each year in the *Annual Report of the Commissioner of Banking and Insurance*. Until 1939, these data recorded the condition as of the fiscal year-end of each association. Starting in 1939, the reports recorded the condition of each B&L on December 31st of each year. The post-1938 vintage data are preferred whenever possible for the purposes of comparability, even though most balance sheets did not change much over the course of a year as many of these associations were quite frozen.

Prices for shares on the secondary share market were published in a weekly Newark newspaper, the *Sunday Call*, as early as January 1939, and continued to be published until December 1940. Quotes may have been published in 1937 or 1938 as well, but I have not yet been able to view the newspaper in those years.

Throughout the text I make references to loans from the Reconstruction Finance Corporation to Newark B&Ls. All of this information is from the Records of the Reconstruction Finance Corporation, record group 234,

47. The B&Ls in Essex county held about \$325 million in mortgage loans as of the end of 1933, and the HOLC purchased \$45 million in mortgages from all the mortgage lenders in the county from 1933 to 1936, but it is impossible to know how much of that came from B&Ls, and Newark is most of Essex county but not all of it. While there were sizable declines in mortgage loans outstanding at B&Ls during the years in which the HOLC purchased mortgages, there were similarly sized declines before and after those years as well. As far as I know, there is no comprehensive data on the amount of loans the HOLC purchased from B&Ls specifically on a city, county or state basis.

stored at the National Archives in College Park, Maryland. Basic information on the number and size of loans approved to Newark B&Ls was gathered from the “Index to Loans Made to Banks and Railroads,” boxes 1–27, which is alphabetically ordered. I also make references to some loan files with more detailed information. The archives have many thousands of boxes of loan files to various types of entities, and so in practice, I have had time to view only a limited number of files. Loan files for the West End and Warranty B&L associations are stored in box 42 of the “Records of Declined and Cancelled Loans, 1932–1946” as both loans were eventually cancelled; Warranty ultimately executed a bulk transfer, whereas the West End arranged for a liquidity infusion from a source other than the RFC. Altogether, these are two of the four RFC loans to Newark B&Ls that were cancelled, out of the fifty-nine that were approved. The loan files for the Enterprise, Outlook, and Woodside B&L associations are stored, respectively, in boxes 57, 139, and 193 of the “Paid Loan Case Files, compiled 1932–1942.” Note that those records are arranged in two groups, those paid before 1942 and those paid during 1942, and the box numbering restarts at 1 for loans paid during 1942. These three loans were paid during 1942.

References

- Anari, A., J. Kolari, and J. Mason. 2005. “Bank Asset Liquidation and the Propagation of the U.S. Great Depression.” *Journal of Money, Credit, and Banking* 37 (4): 753–73.
- Austin, D. Andrew. 2010. “Auction-Rate Securities.” Congressional Research Service RL34672.
- Bodfish, H. Morton. 1931. *History of Building and Loan in the United States*. Chicago: United States Building and Loan League.
- . 1935. *The Depression Experience of Savings and Loan Associations in the United States*.
- Bodfish, H. Morton and A. D. Theobald. 1938. *Savings and Loan Principles*. New York: Prentice-Hall.
- Carlson, Mark, Kris J. Mitchener, and Gary Richardson. 2011. “Arresting Banking Panics: Fed Liquidity Provision and the Forgotten Panic of 1929.” *Journal of Political Economy* 119 (5): 889–924.
- Clark, Horace F., and Frank A. Chase. 1925. *Elements of the Modern Building and Loan Associations*. New York: The Macmillan Company.
- Courtemanche, Charles, and Kenneth Snowden. 2010. “Repairing a Mortgage Crisis: HOLC Lending and its Impact on Local Housing Markets.” *Journal of Economic History* 71 (2): 307–37.
- Ewalt, Josephine H. 1962. *A Business Reborn: The Savings and Loan Story, 1930–1960*. Chicago: American Savings and Loan Institute Press.
- Fishback, Price, Alfonso Flores Lagunes, William C. Horrace, Shawn Kantor, and Jaret Treber. 2011. “The Influence of the Home Owners’ Loan Corporation in Housing Markets During the 1930s.” *Review of Financial Studies* 24 (6): 278–307.
- Foote, Christopher, Kristopher Gerardi, and Paul Willen. 2008. “Negative Equity and Foreclosure: Theory and Evidence.” *Journal of Urban Economics* 64 (2): 234–45.

- Kaufman, George G., and Steven A. Seelig. 2002. "Post-Resolution Treatment of Depositors at Failed Banks: Implications for the Severity of Banking Crises, Systemic Risk, and Too Big to Fail." *Economic Perspectives* (2):27–41.
- Kendall, Leon T. 1962. *The Savings and Loan Business*. Englewood Cliffs, NJ: Prentice-Hall.
- Piquet, Howard S. 1930. *Building and Loan Associations in New Jersey*. Princeton, NJ: Princeton University Press.
- Richardson, Gary. 2007. "Quarterly Data on the Categories and Causes of Bank Distress during the Great Depression." *Research in Economic History* 25:37–115.
- Rockoff, Hugh. 1993. "The Meaning of Money in the Great Depression." NBER Historical Paper no. 53. Cambridge, MA: National Bureau of Economic Research.
- Rose, Jonathan. 2011. "The Incredible HOLC? Mortgage Modification During the Great Depression." *Journal of Money, Credit and Banking* 43 (6): 1073–1108.
- Snowden, Kenneth A. 1997. "Building and Loan Associations in the U.S., 1880–1893: The Origins of Localization in the Residential Mortgage Market." *Research in Economics* 51 (3): 227–50.
- . 2003. "The Transition from Building and Loan to Savings and Loan, 1890–1940." In *Finance, Intermediaries, and Economic Development*, edited by Stanley L. Engerman, Phillip T. Hoffman, Jean-Laurent Rosenthal, and Kenneth L. Sokoloff. Cambridge: Cambridge University Press.
- Snowden, Kenneth A., and Joshua James. 2001. "The Federalization of Building and Loans, 1927–1940: The North Carolina Experience." University of North Carolina, Greensboro. Unpublished Manuscript.
- State of New Jersey Department of Banking and Insurance. Various Years. *Annual Report of the Commissioner of Banking and Insurance*.
- Wheelock, David C. 2008. "The Federal Response to Home Mortgage Distress: Lessons from the Great Depression." *Federal Reserve Bank of St. Louis Review* 90 (3): 133–48.
- White, Eugene. 2010. "Lessons from the Great American Real Estate Boom and Bust of the 1920s." NBER Working Paper no. 15634, Cambridge, MA.