Our Changing Economy

S & Ls Growing; Why Should They?

By Philip Stoddard Brown

SAVINGS and loan associations have grown, and also changed a lot in character, in the postwar period. In Washington, the net increase in assets of the 28 associations that comprise the District League was $157 million in 1958. Their combined assets at the year-end were $1167 million as against $305 million in mid-1947. They have nearly 400,000 savings accounts.

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Many associations were formed by real estate people with personal advantage in view. Often the advantage turned out to be mutual: An association found an outlet for its funds and the real estate man, credit for his customers. It was a case of "one hand washing the other," as the Pennsylvania Dutch say.

Some associations have long outgrown this close relationship with particular real estate firms. Some never had it. In the case of Perpetual, the founders were a group of card players who "clubbed together" to help one member finance the building of a house.

Some are so careful to avoid self-dealing that they shy away from loans to persons doing business with an officer or director. But, the relationship is still close, and highly valued, in a few associations.

In Maryland, on the other hand, where there is as little state regulation as anywhere in the country, some associations not Federally insured are used for the personal advantage of the real estate interests which run them. Many of these pay high dividend rates—higher than Federally insured associations pay. But they do this, at considerable risk to savers, by pledging their mortgages against bank loans and pyramiding their holdings, with little equity or reserve protection.

What Savers Should Consider

Among the 28 member associations of the District League, which includes three in Maryland and one in Virginia, reserve ratios differ greatly—from less than 3 per cent to more than 12 per cent of savings. The composition of assets also differs, and management ability varies.

But is all this of any concern to savers, so long as their savings are Federally insured and so long as they can be withdrawn at any time without loss of principal? Isn't convenience of location the principal consideration?

The answer is that the average dividend over a period of five, 10 or 15 years differs from one association to another and that the return on a $10,000 account may be sizable.

- An association with a high reserve ratio has more assets per dollar of savings on which it can earn income.
- If reserves are large and the association is stable, or slow-growing, only a small fraction of net income needs to be allocated to reserves; a large fraction is available for dividends.
- The expense ratio of some local associations is twice as high as for others. For members of the D. C. League, expenses range from about 20 to 40 per cent of gross earnings—or, in terms of assets, from less than 1 to more than 2 per cent. (In some years, expenses of some have been equal to nearly 50 per cent of gross income, or 3 per cent of assets.)
- Expenses may be high if an association pays a big rent or spends a lot for promotion. Bookkeeping expenses tend to be high when there is a big turnover of accounts and the average account is small. In a few associations, accounts average nearly $5000 and the withdrawal rate is low.
- The gross earnings of some associations have averaged well below 5 per cent in recent years. Others have averaged more than 6 per cent. Some associations, by making loans to builders and doing a brokerage business in mortgages receive fees, premiums and above-average rates of interest.

Growth is Expensive

Growth tends "to depreciate the assets" of an association. The reserve ratio falls unless a large fraction of income is allocated to reserves.

Rapid growth is costly also in terms of current expenditures. Opening a new office, advertising heavily, training new employes and processing a lot of small accounts can be expensive.

A big give-away promotion by a downtown association may add 2000 accounts and increase assets considerably—even though most of these will be very small and one in five will be closed within a year. But, the greater the success, the more difficult it usually is to pay a high dividend and the more necessary it becomes "to take a vacation from growth."

Why grow? Why don't members of an association vote to refuse new accounts, so as not to dilute their assets by having to share their reserves with new members? If membership drops, so much the better for the remaining members.

Officials are hard put to answer this query. Some say the expense ratio goes down as associations grow in size. But statistics for all United States show that expenses of 794 Federally insured associations with assets of $2.5 million averaged 23.8 per cent of gross operating income in 1957, the same as that of 1924 associations with assets of $5 million to $100 million.

Most officials stress their duty to promote thrift and serve the mortgage needs of their communities. Some demur when asked if this requires the luring of savings by door prizes, giveaways and other gimmicks.

Controlled By Management

Savings and loan officials are not alone in their Rotarian identification of the "urge to serve" with the "urge to get big." Growth usually justifies higher salaries for top officials, just as it does in other businesses, but it would be wrong to attribute either "urge" solely to this detail of business life.

What is significant, I think, is that these associations are typical of a growing number of private and public institutions controlled solely by management. There are no profit-minded stockholders, no rank-and-file members asking questions and debating policy.

The owners, just as in the case of mutual insurance companies, don't realize they have proprietary rights, in most cases. And if they did, they wouldn't be bothered to exercise them. They simply rely on the Government to police the activities of management.

Perhaps it's just as well that members are apathetic and that the associations are run as they are—free of the pressures of strict self-interest and responsive instead to the community's need for mortgage funds.