

# THE PROLONGED RESOLUTION OF TROUBLED REAL ESTATE LENDERS DURING THE 1930S

Jonathan D. Rose

October 2, 2011

—Preliminary—Please do not cite—

## **Abstract**

Building and loan associations (B&Ls) in Newark, New Jersey collectively suffered a set of severe balance sheet shocks to their mortgage lending businesses during the Great Depression. Resolution was postponed as regulators were unwilling to take large-scale action, and as laws were revised to allow for indefinite withdrawal restrictions. Many associations were frozen for nearly a decade, suffering from illiquidity but reluctant to raise cash by selling assets at a loss. In the medium run, a market-based resolution mechanism developed in the form of a secondary market for B&L equity share liabilities. Shareholders barred from withdrawal incurred large losses on this market. At the same time, B&Ls used the market to avoid realizing some losses by exchanging foreclosed real estate for their second-hand share liabilities. More formal resolution ultimately took place from 1938 to 1943, first consisting heavily of closures, and then of reorganizations. Reorganizations were spurred by a large scale federal intervention arranging for liquidity injection and liability insurance, and by higher real estate prices during the run up to World War II.

## 1. Introduction

Building and loan associations (B&Ls) were the largest institutional residential real estate lenders of the interwar period. This paper studies how one group of particularly troubled B&Ls, in Newark, New Jersey, responded to a set of shocks during the Great Depression, including damaged balance sheets, broken contractual relationships, and ultimately the loss of public confidence. The focus on B&Ls in the mid-Atlantic region 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 (see Ewalt (1962) and Snowden and James (2001) and Snowden (2003)).<sup>1</sup>

This paper has two parts. First, I describe the endogenous emergence of a secondary market for B&L liabilities in the mid-to-late 1930s. This was a market-based resolution mechanism that allowed shareholders to exit their associations, though at steep losses, and also gave management an incentive to dispose of foreclosed real estate. Similar markets existed in many major cities and were an important feature of the Depression B&L experience. Second, I describe the formal resolution process during 1938-1943. This timing significantly lagged the pattern characterizing commercial banks and even most other B&Ls outside the mid-Atlantic. The federal role was large, as loans from the Reconstruction Finance Corporation (RFC) provided the first large source of new liquidity in a decade, and the Federal Savings and Loan Insurance Corporation (FSLIC) provided share insurance, helping restoring confidence of shareholders. However, many of the most troubled associations simply liquidated instead of reorganizing.

Liquidity shortages are a common theme between the secondary share market and the RFC-aided reorganizations. B&Ls' core liabilities were equity shares that involved commitments to invest additional funds over several years as a form of systemized thrift.<sup>2</sup> Though

---

<sup>1</sup>Of an estimated 12-13 thousand 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 sub-focus on Newark is due to the rich history of the 499 B&Ls, most very small, that operated in that city. 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.

<sup>2</sup>Much of the country's B&Ls operated mainly with this funding source. However, some states, including

this funding source ostensibly reduced maturity mismatch between assets and liabilities, the Depression prompted widespread moves by Newark's shareholders to access their savings by converting shares into cash. At the same time, illiquid foreclosed real estate (all in New Jersey, by law) dominated B&L assets. Many associations simply "froze," as they were persistently unwilling to pay withdrawals by liquidating their real estate in a depressed market. Correspondingly, associations were unable to attract what would have been highly dubious new investments. Their illiquidity shackled them even as it protected their solvency, at least according to book value.

The frozen nature of some Depression B&Ls may be partly attributable to shortcomings in their underlying institutional framework comprised of a set of contracts that gave individuals withdrawal rights at odds with the mutual principle that losses (and profits) should be shared by all members. In the name of these mutual ideals, legal changes significantly altered withdrawal rights (or perhaps clarified them) in the early 1930s: New Jersey legislators and jurists revised statutes and issued new legal interpretations to allow B&Ls to more or less indefinitely restrict withdrawals. With contractually based mechanisms for forcing action nullified, there was no clear path for resolution. In a distinctly non-mutual eventuality, members came to persistently disagree over the value of withdrawal liquidity (or the willingness to take losses) as well as how to apportion losses. Associations struggled for a decade to find methods to proceed, and without consensus over sharing realized losses on real estate, the default outcome was to do nothing.

As delayed withdrawals stretched into the late 1930s and early 1940s, public confidence was lost. Such was the despair of Newark B&L shareholders that some resorted to selling their shares for steep discounts from book value via a fairly well-organized secondary market. The endogenous development of this market is notable inasmuch as it was a market-based resolution mechanism, although ultimately an imperfect substitute for more formal resolatory actions. With data on these secondary market prices in 1939 and 1940 for about two-thirds of Newark's active B&Ls, I find the median trading price of a share to be about 40 percent of book value. The pattern of market prices across associations is consistent with a decade-long

---

Ohio most prominently, allowed B&Ls to accept deposits, though equity shares or similar vehicles known as certificates were still an important funding source in those areas.

liquidity shortage, with the more illiquid associations on average having the lowest prices.

This secondary share market was credited for helping clear the housing market. Mechanically, buyers of discounted shares subsequently used those shares to purchase real estate from B&Ls at the nominal (much higher) par value of the shares. B&Ls often preferred these transactions to cash sales if the book value of the shares exceeded the cash value of the property, as this allowed them to avoid realizing some losses on their books. At the same time, these transactions helped clear the market as they lowered prices since shares were obtainable at large discounts. Altogether, it was possible for both the buyer and seller of real estate to be better off by bartering real estate for shares rather than using cash.

The secondary market began to fade in the second half of 1940 as more formal resolutions picked up. By 1945, the 499 B&Ls that were active in Newark in 1930 had executed 239 voluntary liquidations, 50 bulk transfers of assets, 103 reorganizations, 41 state seizures, 27 mergers, and other more minor structural actions. The industry was reduced to 55 associations in 1945.

Broadly speaking, the major structural events came in two waves. The first wave, roughly from 1938 to 1940, consisted most heavily of voluntary liquidations, bulk sales (more similar to liquidations than mergers), and state seizures. The associations exiting were largely the ones with the weakest balance sheets; they 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. These were hopeless cases that had effectively been liquidating informally during the 1930s but finally opted for more formal action possibly due to a push by state authorities.

Reorganizations were the most important development during the second wave of resolutions primarily in 1942 and 1943. After years of experimentation, Newark B&L managers were aided by Federal Home Loan Bank officials in coalescing around a reorganization strategy, ironed out sometime during 1939 and implemented on a wide scale soon thereafter. The 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 immediate pent-up withdrawals upon reorganization, and qualifying for coverage by the Federal Savings and Loan Insurance Corporation. Feder-

ally insured associations formed the core of the post-war savings and loan industry in New Jersey, following the national thrift association pattern but at a lag. This reorganization strategy was able to provide the intangible asset of public confidence that Newark B&Ls had lost during the 1930s. The RFC money was critical to addressing the persistent maturity mismatch, and the war-time economic expansion also contributed to the liquidation.

The next section gives background on the real estate market in the 1930s and the experience of B&Ls, with particular focus on Newark. The paper then proceeds chronologically, focusing first on the secondary share market in Section 3, and then turning to the waves of liquidations and reorganization in Section 4. Section 5 concludes.

## 2. Background

### *2.1 General B&L background*

Building and loan associations, the predecessors of savings and loan associations, were mutually owned thrift organizations that invested almost wholly in real estate assets.<sup>3</sup> 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, even relative to other community lending institutions. For example, the median number of borrowing members was 104. State law put some limit on B&L size with restrictions such as prohibitions against branching, the use of agents, or the granting of mortgage loans on properties located outside of the state of New Jersey. These restrictions should not be overstated, though, because large associations did exist: the largest five associations in Newark had over 11,000 borrowing members combined in 1930, and the largest association in Newark, the West End B&L, was at one time the second largest B&L in the country.

---

<sup>3</sup>The transition to *savings* and loan terminology occurred during the 1930s and 1940s. It was partly a re-branding, but it also reflected a set of institutional changes away from the more unsuccessful business practices central to the old B&L industry.

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.<sup>4</sup> All things considered, though, the large number of associations in Newark, a city at the time of about 400-450 thousand people, was a bit unusual. This extreme preponderance of associations was a feature shared by neighboring cities in New Jersey, Pennsylvania, and Maryland. Roughly half of the country's estimated 12-13 thousand B&Ls were located in these three states. Free entry appears to have played a role: the state regulator in New Jersey, for example, had no authority during the 1920s to deny a charter based on the saturation of a community by existing B&Ls, whereas such an assessment was required in the chartering of commercial and savings banks.<sup>5</sup>

Holdings of non-real estate assets were fairly negligible prior to the Depression, as shown by Table 1, which displays the aggregate balance sheet of Newark B&Ls in 1930 and 1937.<sup>6</sup> Newark B&L assets were heavily concentrated in residential real estate loans, but it should be noted that some also invested in commercial properties in the 1920s, particularly apartment buildings and some small business properties such as store-fronts or parking garages. 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 mortgage collateral.<sup>7</sup>

---

<sup>4</sup>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 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 19th century but many failed in a large wave during the 1890s.

<sup>5</sup>Entry was even more free in Maryland, which had no state regulation of B&Ls whatsoever until the 1940s.

<sup>6</sup>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.

<sup>7</sup>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 1-4 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 non-residential 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 paper, 15 of 18 real estate parcels were 1-4 family residences, and the other 3 were mixed-use properties.

Table 1: Aggregate balance sheet, 1930 and 1937, Newark B&amp;Ls

Assets			Liabilities		
	<u>1930</u>	<u>1937</u>		<u>1930</u>	<u>1937</u>
Cash	1.1	1.3	Installment Shares	63.1	42.5
Liquid Investment Fund	0.3	0.9	Income Shares	14.6	19.3
Mortgage Loans - Pledged Shares	85.6	31.4	Other Shares	0.5	1.9
Mortgage Loans - Other	2.0	5.5	Balance Due Borrowers	0.3	0.0
Share Loans	2.5	0.8	Borrowed Money	5.7	2.4
Real Estate	6.7	54.0	Apportioned Profits	14.0	5.1
Arrears	1.2	3.9	Reserves and Unapportioned Profits	1.1	22.8
Other	0.7	2.2	Other	0.7	5.9
Total	100.0	100.0	Total	100.0	100.0

*Notes:* The total balance sheets are each normalized to 100. Total assets were \$480 million in 1930 and \$298 million in 1937.

The liability structure of Newark B&Ls is probably quite foreign to modern readers. Some states had introduced deposits or other deposit-like liabilities as legal funding mechanisms for B&Ls, but many states, including New Jersey, maintained the traditional equity dominated liability structure shown in Table 1. The resulting ownership structure was quite diffuse, motivated by mutual ideals. In the same spirit, management usually served part time and were often unpaid.

## ***2.2 The Depression Housing Crisis***

The nation as a whole experienced a severe housing and mortgage finance crisis in the early and mid 1930s. Wheelock (2008), White (2010), Courtemanche and Snowden (2010), Fishback, Lagunes, Horrace, Kantor, and Treber (2011), and Rose (2011) provide background on this. While it is difficult to fully quantify, Newark's housing market appears to have had a particularly difficult recovery after 1933. Ongoing suburbanization out of Newark appears to have contributed to the weakness, and home-buyers in the 1930s were less interested in the old and large houses that were common in parts of Newark but becoming obsolete. High property taxes were a persistent burden as well, in the context of a municipal fiscal crisis.<sup>8</sup>

<sup>8</sup>Beito (1989), p. 112.

The median value of owner-occupied housing in Newark, according to the decennial census, 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.”<sup>9</sup> New construction was depressed. According to the 1940 census, only 5 percent of Newark’s dwelling units in 1940 were built during the 1930s. This is lower than the 26 percent of the Newark housing stock from the 1920s, and 16 percent of the national housing stock from the 1930s.

In such an environment, foreclosures mounted, and correspondingly there were very large increases in holdings of foreclosed real estate at Newark B&Ls. Statistics collected by the Home Owners’ Loan Corporation indicate that the flow of foreclosures in Newark did not materially decrease from their 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.”<sup>10</sup>

### ***2.3 Restricted Withdrawals***

At the beginning of the 1930s, Newark B&Ls generally had little liquidity, small capacity to absorb losses, and their assets were wholly undiversified in real estate loans. This model had led the growth of the industry in the 1920s, yielding relatively high returns to shareholders which attracted further funds and new entry.

Low asset liquidity is appropriate only if liabilities cannot run off quickly. Ostensibly, this was the case, as New Jersey B&Ls were thrift institutions that were not designed to engage in maturity transformation: their main liabilities were equity shares purchased through installment savings contracts. In an “installment” share, a shareholder committed to monthly payments, and the share would mature when those payments, combined with apportioned

---

<sup>9</sup>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.

<sup>10</sup>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.

profits (retained earnings), reached a prefixed maturity value, typically \$200 in about 11-12 years.<sup>11</sup>

Share withdrawals picked up as shareholders desired access to their savings during the Depression and as they lost confidence in their B&Ls.<sup>12</sup> At this point, the legal history becomes complicated. B&L bylaws sometimes maintained two restrictions on withdrawals. The first was a waiting period, typically 30 days. However, many contemporary sources note that these waiting periods were not enforced during the 1920s, 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, as little principal payments had accumulated, this was not much of a deterrent.

The relevant statutory requirements turn out to be more important, holding 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:

- In mid-1932, the New Jersey Supreme Court ruled that even after six months, withdrawals could still be restricted. In general, the ruling considered withdrawal to be a statutory privilege accorded to members rather than a contractual right. Two reasons were given. First, it was held that 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.” Further, “the statute should not apply where the exercise of the right granted thereunder would disturb the financial stability of the associations or materially depreciate the value of the shares of the remaining members.” Mutuality

---

<sup>11</sup>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.

<sup>12</sup>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.

was invoked in this sense.

- Asserting “emergency” powers during 1933, a new law allowed the Commissioner of Banking and Insurance virtually complete discretion in restricting withdrawals. This authority was repeatedly extended until September 1940, and though the original law and its extensions were challenged many times on constitutional grounds, the law was never struck down.<sup>13</sup>

Withdrawal restrictions lasted for years at many Newark B&Ls and were terrible 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 report noted that the “majority of the associations are still on a restricted withdrawal basis.”<sup>14</sup> 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.”<sup>15</sup> In 1940, the largest association in Newark, the West End, had “an unpaid withdrawal list reaching several millions which hadn’t been materially reduced since about 1933.” Prior to reorganization, “many of the shareholders thought that it was frozen tighter than any concrete that was ever poured.”<sup>16</sup> 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 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.

In 1935, an HOLC report stated B&Ls had “completely destroyed public confidence by restrictions on withdrawals and recapture of dividends.”<sup>17</sup> In 1939, the same characteri-

---

<sup>13</sup>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.

<sup>14</sup>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.

<sup>15</sup>*Building and Loan Guide and Bulletin*, July 1940, p. 56.

<sup>16</sup>*Building and Loan Guide and Bulletin*, February 1940, p. 49

<sup>17</sup>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.

zation 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.”<sup>18</sup>

State regulators required withdrawal restrictions until adequate loss reserves had been assembled. This is in line with the judicial ruling noted above, as without adequate loss reserves the withdrawing members would be transferring a loss to other members. Newark B&Ls had entered the Depression with loan loss reserves constituting less than 1 percent of liabilities. Augmenting these reserves was costly. The reserves were first taken from unapportioned profits, then by reclassifying previously apportioned profits (kept on books until shares matured), then from earnings.<sup>19</sup>

Reclassification of apportioned profits was common. In 1935, one out of every three associations had zero apportioned profits, meaning all had been captured to establish 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 by liquidating real estate at a loss. As an example, Table 7, discussed below, itemizes the loss reserves held by the Enterprise B&L in 1941; 40 percent of the loss reserves had been established by recapture of apportioned profits.<sup>20</sup>

By 1937 real estate constituted an incredible 54 percent of Newark B&L assets. It is

---

<sup>18</sup>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.

<sup>19</sup>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 laws was originally set to expire within one year, but was repeatedly renewed, with the last renewal that I can find preserving it until 1940.

<sup>20</sup>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, 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 non-interest 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.

important to note, though, that real estate was kept on books at the cost of acquisition. In the mid-1930s, while still building loss reserves, most B&Ls would likely have been immediately insolvent if their real estate had been marked to market. Newark B&Ls faced the classic problem of disposing large amounts of foreclosed real estate in a severely depressed market. Without the discipline of meeting withdrawal demands, modern accounting standards, or 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.”<sup>21</sup>

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.”<sup>22</sup> (Of course, in the new millennium, we have our own foreclosed real estate problems.)

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.

### 3. Secondary market

This paper analyzes the secondary market in B&L shares for two reasons. First, though I focus on the Newark market, similar markets in other cities existed and were a defining feature of the Depression experience for many B&L shareholders. Some markets arose in a panic during 1933, others persisted for years as shareholders were persistently unable to

---

<sup>21</sup>George Bliss, *Newark Sunday Call*, 21 April 1940, part IV p. 10.

<sup>22</sup>*Building and Loan Guide and Bulletin*, August 1936, p. 25.

withdraw and had the option of converting their investments to cash but at a loss. Second, the market turns out to get at the heart of the resolution of B&Ls burdened by poor credit quality in the form of foreclosed real estate. This market was widely credit with helping clear the housing market, but this is confusing since presumably the way to clear the market was to lower prices, and these B&Ls resisted that for years. Below, I detail why it was nevertheless in the interest of B&Ls to exchange their real estate for second-hand shares. Before that, though, I first provide detail on who participated in the market and how the market developed during the 1930s.

### ***3.1 Market Participants***

By the late 1930s, it became common practice for Newark B&Ls to sell their real estate in exchange for their own share liabilities.<sup>23</sup> Correspondingly, the demand side of the second-hand share market largely consisted of people purchasing shares in order to use them as a means of payment for real estate. 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.<sup>24</sup>

The supply side participants were, naturally, those shareholders that wished to liquidate their shares immediately, at a loss.<sup>25</sup> Presumably, these shareholders were restricted from withdrawing their funds, as described in Section 2.

Two other sets of actors also operated in this market. Market functioning was aided by so-called speculators, who helped provide liquidity, and by brokers, who intermediated between buyers and sellers.<sup>26</sup> Not much can be said about the speculators, but regarding brokers there is evidence of a fairly competitive market; in 1939, at least 9 brokerage firms regularly advertised their services in the *Sunday Call*. Examples of such advertisements are reproduced in Figure 1.

---

<sup>23</sup>Real estate sales were reported as “one of the most important factors” for the “increased activity” during 1939 in this share market.

<sup>24</sup>The *Sunday Call* describe these transactions as “not nearly as frequent as real estate sales” but nevertheless there was “little doubt that they have been a contributing factor in creating a market for shares of many associations” (9 July 9 1939, part III p. 6).

<sup>25</sup>For a contemporary description, see, for example, *Sunday Call* 5 January 1941, part V p. 3.

<sup>26</sup>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).

3.2 Development of the market

Figure 1: Advertisements for broker services for B&L share sales



Notes: Source: *Newark Sunday Call*, 1 January 1939, part III p. 5.

The earliest hints of the B&L share market start in 1933, when the first advertisements for broker services appeared, such as in Figure 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.<sup>27</sup> 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,

<sup>27</sup>(*BLGB*, July 1938, p. 71)

and why it existed.<sup>28</sup>

The market appears to have been at its most active from 1938 to 1940. Trading activity then declined in latter 1940 and especially 1941. These declines were 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.<sup>29</sup> Advertisements for broker services became more common in the late 1930s, peaking at about 9 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.

### ***3.3 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 second-hand 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 depicted on the left side of Figure 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. The \$20 figure is picked somewhat at random, but the point is that it is higher than the cash price, which is what generates the incentive for the B&L, while still entailing a lower cash

---

<sup>28</sup>*Sunday Call*, 9 July 1939, part III page 6.

<sup>29</sup>*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).

outlay, which is what generates the incentive for the real estate purchaser. At the 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.

Figure 2: Stylized balance sheet implications of real estate sales

<b>Initial position</b>			
Assets		Liabilities	
Cash	1	Shares	75
Mortgage loans	39	Apportioned Profits	5
Real Estate	60	Loss Reserves	20
<b>Total</b>	<b>100</b>	<b>Total</b>	<b>100</b>

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

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

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 benefitted 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 the its book value or worth to them.”

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 second-hand 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 at 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.<sup>30</sup>

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.<sup>31</sup> 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.

---

<sup>30</sup>*Building and Loan Guide and Bulletin*, June 1939, p. 58.

<sup>31</sup>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 which gave each parcel a grade from A to D, they were able to unload the “C”s and “D”s 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.

This helps articulate the sense in which the secondary share market helped associations liquidate real estate and clear the housing market. The New 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.<sup>32</sup>

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.<sup>33</sup>

While lower prices helped B&Ls sell their real estate, this was not necessarily a positive development for the housing market. On the one hand, working through the overhang of real estate may have boosted expectations, 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 HOLC reports:

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

---

<sup>32</sup>*Building and Loan Guide and Bulletin*, December 1938, p. 30.

<sup>33</sup>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.

finding levels at which business can be done.<sup>34</sup>

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 had large amounts of its owned foreclosed real estate awaiting liquidation.

In some sense, B&Ls' remaining shareholders gained at the expense of the shareholders that sold their shares. While the second-hand share sales were 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 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 that interpretation, though, the share market would be establishing 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.<sup>35</sup>

### ***3.4 Share price data***

As of this draft, data on share prices are available from January 1939 to December 1940. The source is detailed in the appendix; prices may be available in 1938 but I have not yet been able to obtain them. This period from 1938 to 1940 is roughly the period when historical sources indicate trading volume was at its most active. 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

---

<sup>34</sup>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.

<sup>35</sup>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 95 associations that exited during those years and that had quotes available before their exits. After their exits, prices were only quoted for 50, 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.

1939, 60 percent have quotes available. Figure 3 contains a reproduction of one of the share price listings.

Figure 3: Share price listing excerpt

<b>Building and Loan Share Quotations</b>	
Furnished by Elsele, 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>	
	Bid
Manor .....	27
Manufacturers .....	60
Masonic .....	42
Mavflower .....	38
McKinley .....	47
Mechanics .....	37
Metropolitan .....	37
Modern .....	35
Montiflora .....	33
Monitor .....	20
Mt. Prospect .....	53
Mutual .....	48
Mt. Sinai-New Deal .....	30
Nelson .....	40
Newark .....	45
New Empire .....	53
Newstead .....	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 .....	56
Realty .....	30
Reliable .....	35
Renowned .....	29
Rex .....	40
Rialto .....	33
Roseville .....	33
Sanford .....	45
Savings .....	49
Select .....	48
Seymour .....	40
A-1 .....	34
Abington .....	47
Able Old Hickory .....	25
Acme .....	54
Acropolis .....	38
Action .....	39
Adamant .....	43
Aggressive .....	40
Alert .....	45
Almanac .....	30
Amalgamated .....	15
American .....	60
Annexed District .....	40
Arrow .....	50
Assembly .....	38
Bankers .....	23
Barringer .....	43
Big Brother .....	30
Rigelow New .....	59
Rigelow Trust Shares .....	28
Bonded .....	35
Branch Brook .....	50
Broad and Market .....	40
Broad Street .....	40
Buildmore .....	40
Bulwark .....	45
Capital .....	47
Casino .....	40
Cedars .....	50
Central .....	38
Century .....	53
Charter Oak .....	38

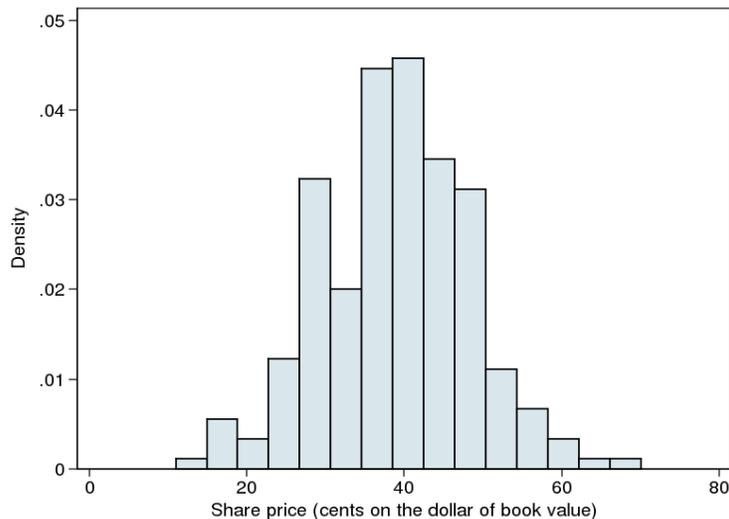
Notes: Source: Newark Sunday Call, 23 June 1940, part IV p. 6.

In January 1939, the median bid quote for the shares of active Newark B&Ls was 39 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 39 cents would represent a large loss for any shareholder selling at the time. Figure 4 displays the distribution of share prices across associations. Some sold for as little as 20 cents on the dollar, and few exceeded 60 cents.

### 3.5 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

Figure 4: Distribution of share prices for B&Ls active at the beginning of 1939



*Notes:* Data are the first quotes available for each association in the first quarter of 1939

extent to which would the book value would 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.

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 nice 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 2. 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 pre-paid income shares (supposedly a relatively “hot” funding source), the extent of borrowed money, and the extent of reserves. Asset side characteristics include the portions of assets held in real estate, arrears, and 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 (I believe) shareholder obligated payments that have not been made, rather than arrears on, say, loans.<sup>36</sup> 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 non-serial plans (with the serial plan associations as the excluded group).<sup>37</sup>

Table 3 reports the results of two simple 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.

The apportioned profits variables dominate the results. The magnitude is about a 3-4 cent change in the share price for a one standard deviation change in apportioned profits, along with an additional 3 cent drop in the presence of zero apportioned profits. These are reasonably strong changes given that the share prices range from about 20 to 60 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 5 plots share prices in early 1939 against apportioned profits per share at the end of 1938, showing the correlation.

---

<sup>36</sup>Since the B&L loan contract used installment shares as sinking funds, arrears on loans may have been characterized in this manner as well.

<sup>37</sup>Serial plan associations were the most traditional form, with new share investments only opening up at specified points in time, typically once a quarter. Non-serial 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 2: Summary Statistics

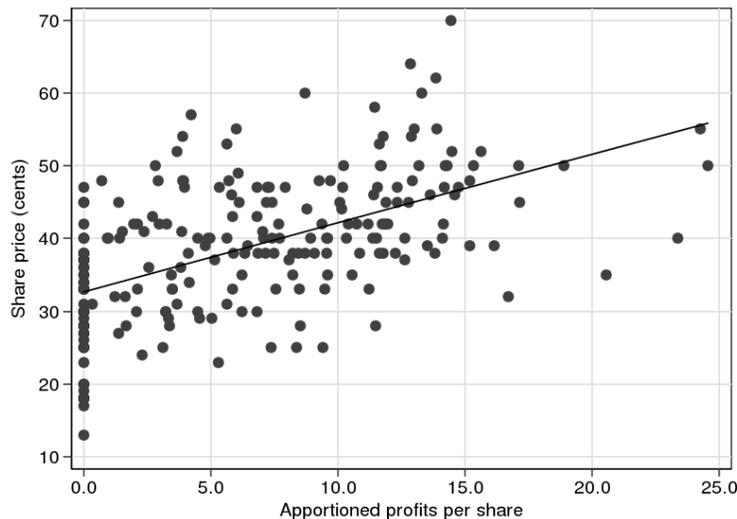
	1939		
	Median	Mean	Standard Deviation
<i><u>Liability Characteristics</u></i>			
Apportioned profits / shares	6.20	6.40	4.60
1(Apportioned profits = 0)		0.15	
Value of income shares / value of all shares	0.33	0.32	0.15
Borrowed money / liabilities	0.000	0.014	0.029
Reserves / liabilities	0.27	0.28	0.09
<i><u>Asset characteristics</u></i>			
Real Estate / Assets	0.482	0.479	0.183
Arrears / Assets	0.013	0.040	0.069
Share of mortgages unpledged	0.430	0.441	0.275
Liquid Assets / Assets	0.026	0.042	0.048
Log(assets)	12.74	12.80	0.71
<i><u>Lagged characteristics from 1930</u></i>			
Real Estate / Assets	0.033	0.047	0.052
log(assets1930)	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><u>Other characteristics</u></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(Non-serial plan)		0.20	

Table 3: 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			-0.50	(5.61)
Borrowed money / liabilities			-29.7	(25.5)
Reserves / liabilities			0.58	(7.17)
<i>Asset characteristics</i>				
Real Estate / assets			-6.81	(4.24)
Arrears / assets			-30.0***	(9.20)
Share of mortgages unpledged			3.22	(2.18)
Liquid assets / assets			22.0	(16.8)
Log(assets)			-0.77	(1.84)
<i>Lagged characteristics from 1930</i>				
Real Estate / Assets			-3.48	(11.2)
Log(assets)			1.48	(1.83)
Income shares / all shares			-3.25	(9.52)
Borrowed Money / liabilities			-0.90	(13.6)
Reserves / liabilities			-36.7	(68.5)
<i>Other characteristics</i>				
1(Received RFC Loan before 1935)			-0.048	(0.058)
1(Member of FHLB by 1936)			-0.99	(1.46)
Year established			2.18	(2.20)
1(Optional plan)			-4.51***	(1.49)
1(Non-serial plan)			-5.01***	(1.49)
Constant	36.9***	(1.11)	125	(113)
Observations		202		202
R-squared		0.35		0.45

*Notes:* The symbols \*\*\*, \*\*, and \* indicate significance at the 10%, 5%, and 1% with robust standard errors. The share price is scaled between 1 and 100, i.e. 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 are excluded that underwent reorganizations in late 1938, 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.

Figure 5: Share prices plotted against apportioned profits per share



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 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 39 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 4, and indicates that apportioned profits are capturing something else, arguably the withdrawal situation.

Table 4: 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 symbols \*\*\*, \*\*, and \* indicate significance at the 10%, 5%, and 1% with robust standard errors. The share price is scaled between 1 and 100, i.e. 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.

Returning to Table 3, 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 3, even though this would seem naturally related to the ability to pay withdrawals. However, more flexible nonlinear specifications do indicate that very low levels of asset liquidity are associated with lower share prices. For example, when when a dummy for very low asset liquidity term is included (not shown, measured as less than 2.5 percents of assets in cash or liquid investments), B&Ls with near zero liquid assets had lower share prices on the order of about 1 to 2 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 3, 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 re-organized associations be considered insolvent, but their share prices were still trading between 37 and 53 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 4, below.

### ***3.6 Secondary markets in the rest of the country***

A set of HOLC surveys regarding housing and mortgage finance conditions in the late 1930s, stored at the National Archives, reveal that secondary B&L liability markets were quite common in the 1930s, though they certainly did not exist everywhere. Importantly, none of these markets existed before the Depression. Large cities with active liability markets included Philadelphia, New Orleans, Baltimore, Indianapolis, Milwaukee, Columbus and Cleveland. The surveys indicate that liability trading also occurred in a host of other smaller cities in Alabama, Mississippi, Florida, North Carolina, Missouri, Indiana, elsewhere in New Jersey, Colorado, Texas, and California. Notably missing from this list, though, are all of the

cities in New England, and some major cities with large amounts of owner-occupied housing such as Chicago, Los Angeles, Pittsburgh, and St. Louis.

In the existing Depression literature I am aware of two references to secondary 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 96 associations. The average bid quote among those associations was about 67 cents on the dollar—a substantial loss to the shareholder, but materially smaller than the average loss to a Newark shareholder. Rockoff (1993) mentions that a secondary market for B&L liabilities existed in Youngstown, Ohio as well. A short search uncovers share price quotes in a Youngstown newspaper from 1933 to 1936; the median bid for 7 institutions was 49 cents on the dollar, closer to but still above the median Newark price. In other cities, HOLC reports indicate that trading in the range that Newark associations were trading, about 40 cents on the dollar, was quite common.

Altogether, 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. All of this is the basis for ongoing and future work into the resolution of B&Ls more broadly across the country during the 1930s.

#### **4. 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, 55 associations were still active in the city. 37 associations had avoided any changes, and the other 18 associations were all that were left of the 462 that had undergone some major structural event, including liquidation, state action, reorganization, and merger. Table 5 tabulates the exit process by year and type of exit.

This section examines these events, grouping them into two large waves. Relatively few

Table 5: Major structural events of Newark B&amp;Ls

Type of action	1931- 1936	1937	1938	1939	1940	1941	1942	1943	1944	Total
<u>Liquidations and bulk transfers</u>										
Voluntary liquidation	3	14	38	32	66	34	39	11	2	239
Bulk transfers	0	0	0	1	10	8	9	18	4	50
<u>State actions</u>										
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
<u>Reorganizations</u>										
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
<u>Other</u>										
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	
<hr/>										
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 18 charters indicated, but 4 of those (all formed in the early 1930s) exited before 1945.

structural events occurred in the early and mid 1930s, especially on a per-year basis. Rather, the first large wave of resolution actions started in 1937 or 1938, and consisted mainly of closures of the most heavily burdened institutions. The second wave, particularly in 1942 and 1943, was dominated more heavily by reorganizations, made possible by a large-scale federal intervention.

#### ***4.1 First wave of exit: liquidations and other closures***

In the first wave of exits, primarily during 1938, 1939, and 1940, exits were dominated by liquidations and appear to have been driven by severe balance sheet distress, and pressure from depositors for withdrawals as measured by share prices in the secondary market. Of 428 B&Ls that existed at the end of 1937, 155 voluntarily liquidated or were taken over by the state, while only 31 engaged in some form of reorganization.

Voluntary liquidation closed a B&L to new capital and asset investments, but liquidation itself often took years as real estate was gradually sold off. A bulk transfer involved an association selling all of its sound assets to one of the reorganized and insured associations, shareholders receiving an immediate cash dividend, and then the remaining bad assets being gradually liquidated. Both voluntary liquidations and bulk transfers were exercised by B&Ls whose shareholders did not wish to have any interest in ongoing associations, or did not have enough good assets for reorganization to be a viable option, or that exited before reorganization became practical as will be discussed below. Discussions among B&L leaders in the late 1930s makes clear that a bulk transfer was considered a close substitute to voluntary liquidation. Voluntary liquidation was more common, particularly before 1940, partly since at that point there were only a few reorganized associations capable of purchasing assets in a bulk transfer (and willing to do so).

Actions by the state regulator, the Department of Banking and Insurance, were less common than liquidations. Once withdrawal restrictions were put in place in 1933, illiquidity was ruled out for years as grounds for the Department to seize an association. Otherwise, officials in the Department appear to have been more willing to seize associations if the managers were incompetent than if the associations were insolvent. In a remarkable statement, Deputy Commissioner (in charge of B&Ls) J. McNish declared in 1932:

[T]his question is asked, “How many building and loan associations in the State of New Jersey have failed during these last twelve months?” We say, “Zero!” (Applause) Our policy at the present moment points to one and one goal only, and that is this: That there shall be no fatalities among the building and loan associations of this State...<sup>38</sup>

---

<sup>38</sup>*Building and Loan Guide and Bulletin*, January 1932, p. 32.

Instead, B&Ls were left to build capital by slowly retaining earnings and taking back apportioned profits.

The Department had only 74 total B&L examiners on staff in 1930 to cover the 1,500 associations in the state. A revolving door was in operation among the top officials, as, for example, McNish's successor left to become president of the West End B&L (Newark's largest) in 1939. Furthermore, the Department of Banking and Insurance opposed actions by others, particularly shareholders, to force B&Ls into receivership or other closure. Shareholders of the Warranty B&L tried (and failed) to force it into federal receivership, and the state Department argued against the move in court. Similarly, the Department helped defend the authority to restrict withdrawals.

After 20 B&Ls were closed by the state in the early 1930s, 1 more was seized in 1938, and then 20 more in one day in April, 1940. The last batch was 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."<sup>39</sup> These moves may help explain the increase in voluntary liquidations later that year. Even these small number of actions at the late date of 1940 met with criticism from the state legislature, which opened an investigation into the Department.

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 3.4, with the addition of each association's share price.

---

<sup>39</sup>*Building and Loan Guide and Bulletin*, July 1940, p. 25.

Table 6: Closures from 1938 to 1940

Dependent variable:	Closure in 1938-1940		-----Closure in 1940-----		Liquidate in 1940	Closure in 1941
	All	All	Subset with share prices	Subset with share prices	Subset without seizures (and with share prices)	Subset with share prices
B&Ls included:	1937	1939	1939	1939	1939	1940
Vintage of Data:	(1)	(2)	(3)	(4)	(5)	(6)
Share price			-0.018*** (0.0066)		-0.016*** (0.0061)	0.0052 (0.0044)
<i>Asset side:</i> Real Estate / Assets	1.13*** (0.24)	0.76*** (0.23)	0.84** (0.39)	0.87** (0.37)	0.65* (0.38)	0.34 (0.26)
Arrears / Assets	1.76*** (0.51)	1.53*** (0.59)	1.04 (0.95)	1.57* (0.87)	0.19 (0.90)	-0.85 (1.20)
Share of mortgages unpledged	-0.064 (0.16)	-0.17 (0.11)	-0.21 (0.19)	-0.23 (0.20)	-0.064 (0.18)	-0.24* (0.14)
Liquid Assets / Assets	-0.36 (0.94)	1.15* (0.62)	0.65 (1.04)	0.56 (1.05)	1.10 (0.94)	0.82** (0.41)
Log(assets)	-0.52*** (0.14)	-0.29*** (0.11)	-0.20 (0.17)	-0.16 (0.16)	-0.15 (0.16)	-0.13 (0.11)
<i>Liability side:</i> Apportioned profits / shares	0.012* (0.0069)	0.012 (0.0079)	0.013 (0.014)	0.0031 (0.014)	0.018 (0.013)	-0.0078 (0.010)
1(Apportioned profits = 0)	0.40*** (0.082)	0.39*** (0.12)	0.40*** (0.15)	0.41*** (0.15)	0.51*** (0.16)	-0.061 (0.11)
Portion of shares in income shares	-0.12 (0.31)	0.062 (0.25)	-0.29 (0.39)	-0.33 (0.38)	-0.26 (0.41)	-0.53 (0.33)
Borrowed money / liabilities	1.34 (1.12)	1.38 (1.06)	2.91 (2.07)	3.46* (1.86)	2.30 (1.78)	2.97* (1.62)
Reserves / liabilities	0.61 (0.55)	0.86** (0.40)	0.25 (0.61)	0.30 (0.61)	0.19 (0.54)	0.28 (0.44)
<i>Lagged from 1930</i> Real Estate / Assets	1.07* (0.56)	1.06* (0.60)	1.72* (0.95)	1.50* (0.90)	1.54 (0.95)	-0.0018 (0.83)
Log(assets)	0.37*** (0.13)	0.25** (0.10)	0.19 (0.17)	0.13 (0.17)	0.11 (0.15)	0.0068 (0.10)
Income shares / all shares	0.60 (0.46)	0.71** (0.36)	1.44** (0.66)	1.55** (0.64)	1.51** (0.61)	0.36 (0.47)
Borrowed Money / liabilities	0.013 (0.76)	0.25 (0.71)	-0.25 (1.25)	-0.081 (1.27)	0.64 (1.23)	0.43 (0.87)
Reserves / liabilities	2.43 (4.06)	0.30 (5.09)	-15.0** (6.72)	-12.3* (6.30)	-12.9* (7.22)	-5.14 (5.65)
Observations	427	338	169	169	154	131
Number with LHS = 1	168	96	63	63	48	27
Pseudo R-squared	0.24	0.30	0.34	0.31	0.35	0.23

Notes: Probit estimation with marginal effects displayed. The symbols \*\*\*, \*\*, and \* indicate significance at the 10%, 5%, and 1% with robust standard errors. The five "other characteristics" from Table 2 are also included but not displayed here to save space. Closure includes voluntary liquidation, bulk transfer, and regulatory seizure.

The marginal effects and standard errors are reported in Table 6. I first report results using data from 1937, predicting closure from 1938 to 1940 in the 1st column, and then using data from 1939 predicting closure in 1940 in the 2nd column. The 1939 data are helpful because, among other reasons, 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, the 3rd and 4th columns report results using the subset of associations with share prices, first including share prices as an explanatory variable, and second not including it.

The results are generally unsurprising insofar as they indicate that important 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 10 percentage point increase in real estate over assets in 1939 increases the probability of closure in 1940 by 8 percentage points. At the extreme, at the end of 1939 there were 17 associations that had more than 75 percent of their assets in real estate, and 14 of those closed the following year.

Share prices have strong predictive power over closures as well, and when included the magnitude of the coefficient on arrears declines moderately. Associations with lower share prices were strongly more likely to close in 1940. The magnitude is roughly that every 2 cent reduction in 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 fifth column replicates the analysis of the third column but excludes associations that were seized by the state regulators. The only noticeable differences are that magnitude of the coefficient

on real estate decreases moderately, and the coefficient on arrears drops to nearly zero. Otherwise the results are fairly similar, particularly with respect to the share prices and the dummy for zero apportioned profits. 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 proximate function of viability in the sense of the ability to return profits to shareholders and to allow them to sell their shares at less sacrificial prices.

Finally, the sixth column examines closures in 1941. It is striking how different the characteristics are that predict the 1941 closures, and this anticipates some of the results in the next section. Credit quality, share 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 weren't embracing the new world of mortgage lending.

Two developments may help explain the 1941 closures. First, the build-up 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.

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 impending 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 surely have been different.

#### ***4.2 Second wave of exit: reorganizations***

In the second wave of structural events at Newark B&Ls, primarily during 1942 and 1943, reorganizations became a much more dominant trend. 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, i.e. 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 corporation and shares in the new association which together would have face value equal to the old shares.<sup>40</sup>
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 above set of procedures. Those procedures were not fully formulated until 1939, and they were implemented most heavily in 1942 and 1943, with 68 associations reorganizing in those

---

<sup>40</sup>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

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 which required careful planning and some legislative accommodation.<sup>41</sup> 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.<sup>42</sup> Uniquely dysfunctional was the state of New Jersey, though, with 20 separate community programs of its own.<sup>43</sup>

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 59 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 post-war savings and loan industry in Newark belonged to 14 consolidated associations that emerged from this reorganization process. All but 2 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 14 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 14 had controlled only 42 percent of Newark B&L assets in 1930.

Asset segregation and liquidity infusions were both critical. Table 7 helps to elucidate this, by showing the reorganization plan of the Enterprise B&L. According to RFC loan files,

---

<sup>41</sup>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.

<sup>42</sup>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 1938-9 (p. 107), 1939-40 (also p. 107), and 1940-41 (p. 120).

<sup>43</sup>See *Federal Home Loan Bank Review*, November 1943, p. 33.

Table 7: Example of asset segregation

	Old Association	New Association	Liquidating Association
<u>Assets</u>			
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
<b>Total</b>	<b>\$314,741</b>	<b>\$131,559</b>	<b>\$256,183</b>
<u>Capital and Liabilities</u>			
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
<b>Total</b>	<b>\$314,741</b>	<b>\$131,559</b>	<b>\$256,183</b>

*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.

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 10 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). 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.<sup>44</sup> Indeed, the RFC loan file notes that Enterprise's withdrawals were still restricted, and outstanding withdrawal requests totalled 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

<sup>44</sup>*Building and Loan Guide and Bulletin*, February 1940, p. 15.

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 15 Newark associations that experimented with asset segregation in 1933, but the 3 consolidated associations that resulted had difficulty gaining traction because their liquidity positions were essentially unchanged.<sup>45</sup> 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 50 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?”<sup>46</sup>

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.

---

<sup>45</sup> 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.

<sup>46</sup> *Building and Loan Guide and Bulletin*, August 1937, p. 15.

Table 8: 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)
Share price			-0.0036 (0.0092)	
<i>Asset side:</i>				
Real Estate / Assets	1.47*** (0.34)	1.58*** (0.40)	2.13*** (0.70)	2.15*** (0.68)
Arrears / Assets	-3.56 (2.31)	-3.59 (2.64)	-5.31* (2.85)	-5.22* (2.85)
Share of mortgages unpledged	0.81*** (0.22)	0.92*** (0.30)	1.62*** (0.52)	1.60*** (0.53)
Liquid Assets / Assets	3.15*** (0.71)	3.69*** (0.85)	5.12*** (1.12)	5.08*** (1.12)
Log(assets)	0.38*** (0.084)	0.47*** (0.12)	0.81*** (0.19)	0.81*** (0.19)
Apportioned profits / shares	-0.015 (0.012)	-0.018 (0.016)	-0.016 (0.021)	-0.017 (0.021)
<i>Liability side:</i>				
1(Apportioned profits = 0)	-0.19** (0.096)	-0.082 (0.21)	-0.15 (0.20)	-0.18 (0.18)
Portion of shares in income shares	-0.12 (0.37)	-0.14 (0.52)	-1.28 (0.79)	-1.30* (0.77)
Borrowed money / liabilities	-2.51 (2.54)	-0.14 (3.08)	-3.93 (4.01)	-4.06 (3.89)
Reserves / liabilities	-1.03* (0.55)	-1.17 (0.72)	-2.70*** (1.00)	-2.70*** (1.00)
<i>Lagged from 1930</i>				
Real Estate / Assets	-0.67 (1.18)	-1.29 (1.47)	-1.05 (1.78)	-1.14 (1.74)
Income shares / all shares	-0.31 (0.53)	-0.18 (0.74)	0.94 (1.11)	0.95 (1.09)
Borrowed Money / Liabilities	-0.36 (1.01)	-0.48 (1.41)	1.19 (2.02)	1.21 (2.00)
Reserves / liabilities	-7.24 (7.86)	-5.88 (10.8)	-1.36 (11.5)	-0.35 (11.5)
<i>Other characteristics</i>				
1(Received RFC Loan before 1935)	0.24 (0.23)	0.17 (0.22)	0.20 (0.22)	0.21 (0.22)
1(Member of FHLB by 1936)	-0.068 (0.12)	-0.21 (0.14)	-0.39*** (0.12)	-0.38*** (0.13)
Year established	0.010*** (0.0040)	0.016*** (0.0059)	0.027*** (0.0096)	0.027*** (0.0096)
1(Optional plan)	-0.15 (0.099)	-0.19 (0.14)	-0.63*** (0.15)	-0.62*** (0.14)
1(Non-serial plan)	-0.059 (0.10)	-0.058 (0.14)	-0.41** (0.16)	-0.40** (0.17)
Observations	191	150	103	103
Pseudo R-squared	0.49	0.47	0.57	0.57

Notes: Probit estimation with marginal effects displayed. The symbols \*\*\*, \*\*, and \* indicate significance at the 10%, 5%, and 1% with robust standard errors.

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 8. The estimation reported in the first column includes all associations active at the end of 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.

## **5. Lessons and Conclusions**

Today, we are again learning over time that mortgage crises can have legacies that live with lenders and the housing market for years after the peak of the crisis. For example, the resolution of representation and warranty issues related to securitization transactions continue to weigh on mortgage lenders today. This is a very different type of unresolved pressure than the pressure affecting Newark B&Ls in the 1930s, but both problems arguably stem from contractual agreements made during boom times that proved difficult to work through during post-crisis macroeconomic environments. B&Ls effectively made representations during the 1920s that no institution would have made with perfect foresight: they promised that shareholders would be able to withdraw their funds relatively quickly. Sim-

ilarly, modern mortgage lenders made representations and warranties about underwriting standards, and if the mortgages had not later defaulted, there would have been less incentive for investors to challenge the veracity of those promises. 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. In other words, incomplete contracts generally left lawsuits as the only remediating mechanism for B&L shareholders in the 1930s and for mortgage backed security investors today.

These incomplete contracts contributed to the frozen nature of Newark B&Ls in the 1930s and complicated their resolution. Consider, for example, the question of whether New Jersey B&L regulators should simply have seized the large majority of Newark B&Ls by 1935 on grounds of illiquidity, insolvency, or poor management. Modern accounting and regulatory standards likely would have required just that, short of a plan for large state-led recapitalization, which was a non-starter for the entire decade. Of course, closing Newark's B&Ls would have effectively annihilated a large part of Newark's mortgage lending industry. More to the point of the previous paragraph, in a world without federal share insurance, shareholders would still have not received any of their funds unless the state was prepared to cut a very large check (at a time when finances were quite strained and writing a check for recapitalization had already been rejected) or to immediately liquidate real estate and mortgages. If the latter, the state would have been responsible for dumping an enormous quantity of real estate on a deeply dysfunctional real estate market. If instead the state had slowly liquidated the real estate, while also only slowly paying shareholders, this would have mimicked several aspects of the actual course of history.

Resolution was postponed as B&Ls 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. From this perspective, the RFC intervention is notable by finally matching a patient funding source to the real estate

assets and by creating a substantial amount of new liquidity for the first time in a decade.

The slow resolution of these institutions 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), Kaugman and Seelig (2002)). Of course, B&L liabilities have not historically been considered part of the core money aggregates, and quite appropriately as they appear to have become less money-like during the height of B&L troubles. This paper emphasizes, for example, the bartering of shares for real estate assets. Lack of access to B&L investments was a fact of life across the country during the Depression, as secondary markets for B&L liabilities developed in many cities. In contrast, though liquidation was not immediate for commercial banks either, the discounting of share liabilities is something that would be complicated and difficult to replicate in the commercial banking world, where deposits must necessarily be paid at par except when in receivership.

The federal government's role stands out as particularly helpful in resolving Newark B&Ls' issues. In fact, this paper 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 in the federally created paradigm, consisting of FHA-insured direct reduction mortgage loans made by federally-chartered associations (or at least FHLB member associations) with share insurance from the FSLIC—all innovations of the 1930s. 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. The participation of the Reconstruction Finance Corporation was particularly important, as the RFC was alone in its willingness to lend on collateral of foreclosed real estate for long periods.

Not all federal programs had equally lasting impacts. This paper has not discussed much the discount facilities of the Federal Home Loan Bank System or the troubled asset relief available through the Home Owner's 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.<sup>47</sup> 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.

---

<sup>47</sup> 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&L's 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.

## 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 record 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 continue 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, 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 59 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**, “Bank Asset Liquidation and the Propagation of the U.S. Great Depression,” *Journal of Money, Credit, and Banking*, 2005, 37 (4), 753–773.

**Beito, David T.**, *Taxpayers in Revolt: Tax Resistance During the Great Depression*, Chapel Hill: North Carolina University Press, 1989.

**Bodfish, H. Morton**, *History of Building and Loan in the United States*, Chicago: United States Building and Loan League, 1931.

—, “The Depression Experience of Savings and Loan Associations in the United States,” September 1935.

- and **A.D. Theobald**, *Savings and Loan Principles*, New York: Prentice-Hall, 1938.
- Carlson, Mark, Kris J. Mitchener, and Gary Richardson**, “Arresting Banking Panics: Fed Liquidity Provision and the Forgotten Panic of 1929,” *NBER Working Paper*, 2010, (16460).
- Clark, Horace F. and Frank A. Chase**, *Elements of the Modern Building and Loan Associations*, New York: The Macmillan company, 1925.
- Courtemanche, Charles and Kenneth Snowden**, “Repairing a Mortgage Crisis: HOLC Lending and its Impact on Local Housing Markets.”
- Ewalt, Josephine H.**, *A Business Reborn: The Savings and Loan Story, 1930-1960*, Chicago: American Savings and Loan Institute Press, 1962.
- Fishback, Price, Alfonso Flores Lagunes, William C. Horracc, Shawn Kantor, and Jaret Treber**, “The Influence of the Home Owners’ Loan Corporation in Housing Markets During the 1930s,” *Review of Financial Studies*, 2011, (24), 278–307.
- Kendall, Leon T.**, *The Savings and Loan Business*, Englewood Cliffs, NJ: Prentice-Hall, 1962.
- New Jersey**, *Annual Report of the Commissioner of Banking and Insurance*, various years.
- Piquet, Howard S.**, *Building and Loan Associations in New Jersey*, Princeton: Princeton University Press, 1930.
- Rockoff, Hugh**, “The Meaning of Money in the Great Depression,” *NBER Historical Paper*, 1993, (53).
- Snowden, Kenneth A.**, “Building and Loan Associations in the U.S., 1880-1893: the Origins of Localization in the Residential Mortgage Market,” *Research in Economics*, 1997, 51, 227–250.
- , “The Transition from Building and Loan to Savings and Loan, 1890-1940,” in Stanley L. Engerman, Phillip T. Hoffman, Jean-Laurent Rosenthal, and Kenneth L. Sokoloff, eds., *Finance, Intermediaries, and Economic Development*, Cambridge, UK: Cambridge University Press, 2003, chapter 6.
- and **Joshua James**, “The Federalization of Building and Loans, 1927-1940: The North Carolina Experience,” 2001. Manuscript, University of North Carolina, Greensboro.
- Wheelock, David C.**, “The Federal Response to Home Mortgage Distress: Lessons from the Great Depression,” *Federal Reserve Bank of St. Louis Review*, May/June 2008, 90 (3), 133–48.
- White, Eugene**, “Lessons from the Great American Real Estate Boom and Bust of the 1920s,” *NBER Working Paper No. 15634*, 2010.