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THRIFT SURVIVAL STRATEGY: *SURPRISE*, IT'S A HOUSING ROLE

By Andrew R. Mandala

The nation's savings and loan associations have begun to establish their strategy for survival: fealty to the residential housing market.

While this might seem a strange turn of events for an industry that has uniformly been recognized as seeking to "go bank-like" during the 1980s, the thrifts are genuinely worried that their industry may be in deep jeopardy of disappearing--and they figure the best way to avoid that is to go back to basics.

What it means is at least lip service to the home mortgage marketplace, although it probably means more than that. The industry's leaders already are talking specifically about pressing for tighter regulation and reduced ability to move afield of housing.

In particular, the always controversial loans to one borrower regulation will likely be offered up for closer scrutiny, as will the ability of thrifts to engage in commercial mortgage loans and commercial real estate; acquisition, development and construction transactions, tighter rules on loan to value ratios and other, similar "high-flier"-associated transactions.

The thrifts are going to wrap themselves around the Cranston-D'Amato National Affordable Housing Act, or a variation of that, and will work to demonstrate they never really were unfaithful to housing.

Whether or not that will "play in Iowa" is conjectural, of course. The thrifts, the vast majority of which are profitable institutions, are going to adopt a philosophy that suggests the nation cannot do without them as specialized housing lenders.

That this in turn suggests increased competition for other mortgage lenders from thrifts who had tilted towards the banking arena is obvious. It also signals the beginning of a political strategy that will intensify in the coming months.

Fact is, the thrift industry's leaders are now saying with increasing emphasis, those institutions that never left the housing finance arena are the ones that today are paying the freight for their more profligate brethren.

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And they say they don't want to do that any longer.

At last week's annual convention of the US League of Savings Institutions, the savings and loan industry's managers sought to drive home the underlying theme of the conference: don't tar the entire industry with the same brush that should be reserved for the few abusers of the privilege.

Theo Pitt, chairman of the League, hammered away at the notion that critics "refuse to acknowledge...that the bulk of the FSLIC's problems are heavily concentrated."

"In fact," Pitt, who also is chairman and president of Pioneer Savings Bank, Rocky Mount, NC, added, "the two dozen worst FSLIC cases, a mere 24 institutions, account for nearly half the negative capital of all troubled institutions. This group of 24 represents a mere 8/10ths of one per cent of all savings institutions, yet it represents 55 per cent of the business' annual losses."

What Pitt was getting at is the emerging strategy that will surface in the 101st Congress that begins next January, and which the thrift industry will attempt to put to the new administration even before then.

That is, those thrifts that have run away from their traditional housing role need to be kept separate and apart when Congress and the administration look at the thrift industry as a whole.

Pitt makes the point that for every dollar they (the "bad" guys) put into residential mortgage investments, they put $2.97 in something that is far and beyond the traditional lending category of a true thrift institution. "They invested three to one in non-traditional assets."

There are going to be a lot of horse laughs over this strategy, as many thrifts and thrift holding companies have pushed Congress hard for broader investment powers and have helped push through state legislation that in some cases allows 100 per cent of capital to be invested in just about anything.

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But a "that was then, this is now" attitude clearly permeated the League's convention in Honolulu (in itself an embarrassment because of the perception of thrift executives basking on Waikiki in the midst of needing federal assistance to help FSLIC out of its mess).

The industry is going to work from a new report of a task force "on the future direction of the business." The major recommendation of the report is that "the role of the nation's savings institutions as a major instrument of national housing policy must be enhanced."

Others include:

- The burden of the FSLIC problem on healthy savings institutions must be reduced.

- The nation's savings institutions must continue to concentrate on residential mortgage finance.

- Savings institutions must focus their efforts, reduce operating costs, and limit their growth.

Beyond those global recommendations, the thrifts are going to make four specific proposals to Congress and the new administration:

- Savings institutions should be authorized to sell REMIC securities over the counter and guarantee related maturities.

- Qualified thrift lenders should be able to use a tax favored interest rate risk reserve.

- Qualified thrift lenders should be able to offer a tax advantaged savings account for homebuyers.

- Homebuyers should be allowed to trade their tax benefits to a qualified thrift lender in exchange for a reduced mortgage interest rate.

The thrift strategy is two-pronged: take care of the FSLIC burden on the one hand and insure that the perception is changed that thrifts want out of their traditional housing role.

The feeling among politically-knowledgeable thrift executives is that with a Democrat-controlled Senate, and particularly with Michigan Senator Donald Riegle as the probable chairman of the Senate Banking Committee, the thrift industry cannot be counted out and, indeed, can be expected to get a sympathetic hearing.

And while the task force on the future direction of the business has completed its work, a separate group is working on determining how to resolve the FSLIC problem.

In that connection, there are few who expect Congress to add billions to the federal budget deficit with a plain vanilla bailout of the thrift industry. The leaders of the savings and loan business have been working on a separate plan that would sidestep the bailout issue and allow a workout to be long term in nature.

Envisioned is a Home Owners' Loan Corporation-type entity that would become a kind of Asset Holding Corporation (AHC) to hold the bad assets of FSLIC and receivership institutions, working out those assets over

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time to minimize the budget deficit "hit" while avoiding the straight bailout.

Key to the development of the plan is that there be a perception it is coming from the industry and not the trade organization, the US League, S&L managers told MORTGAGE COMMENTARY during the conference last week.

"If it is perceived as coming from the US League," said one who is working on the plan, "it will be DOA (dead on arrival)."

The industry officials working on the various plans--and the League itself--are going to attempt to finesse the question about whether or not the thrift industry has remained faithful to housing.

Among other ways this will be done is via statistics that show the business holding 62.2 per cent of its total assets in residential mortgages and mortgage backed securities at the end of August, 1988. While this is down from pre Garn-St Germain Act days, when the thrift assets included 71.8 per cent in residential mortgages and MBS, it still represents a sizable commitment to housing.

At the same time, the thrifts working on the solution are quick to recognize a significant problem in the absence of profitability in the mortgage market.

Two elements are said to be pushing this factor: insolvent thrifts that are offering high savings rates and low mortgage rates are shrinking the spreads in the marketplace, and the increasing prominence of the secondary market entities, Fannie Mae and Freddie Mac, are making it more difficult for thrifts to compete.

A study by Patrick H. Hendershott of Ohio State University found that the mortgage securitization has played a role in reducing mortgage portfolio lender profitability and that the rapidly expanding use of Fannie Mae and Freddie Mac guarantees have had a "significantly negative impact on thrift profitability."

Thrift leaders are also pointing to statements by former Freddie Mac CEO Kenneth Thygerson, who is CEO of Imperial Savings of California, to the effect that under current conditions, thrifts cannot compete effectively with either secondary market entity as portfolio lenders.

The question of why an industry with shrinking profitability in its so-called "core" business would remain 62.2 per cent invested in that business is not discussed--at least not by the thrifts involved in mapping the emerging strategy.

The emerging strategy may find its way to the surface via legislation in the Senate, where officials expect a better reception. They also expect the new president to appoint a Commission to examine the thrift crisis--and that a report from such a commission would emerge from the Treasury Department, and be highly critical of thrifts.

The hope of the thrift strategists is that their "back to basics" approach will survive and a legislative solution be arrived at that would at once deal with the "bad assets" problem of FSLIC and the more focused housing role for thrifts.
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