MONEY & BANKING

An S&L with the Midas touch

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The Sandlers have posted 25% earnings growth at Golden West every year since 1963.

As their costs of raising new funds soared above the fixed rates on their home mortgages, the nation's 4,600 savings and loan associations took a financial beating in the first quarter of 1980 that made it easily their worst period on record. About 1,200 associations suffered first-quarter losses, and some analysts suspect that the industry will post $3 billion in losses for the year. Yet, the results are anything but even. A few S&Ls, such as Golden West Financial Corp., of Oakland, Calif., reacted quickly to the threat of high rates and did surprisingly well. For Gibraltar Financial Corp. and others that projected rates incorrectly, there were also surprises—the kind their managers would rather not talk about.

While most of its competitors were coping with degrees of financial crisis, Golden West was having yet another banner first quarter. Earnings per share rose by 3%, the S&L's 53rd consecutive quarterly increase. "Such a record is nothing short of phenomenal," says Maurice Mann, former president of the San Francisco Federal Home Loan Bank. Even more phenomenal is the fact that Golden West has achieved a 25% compounded annual growth rate in earnings ever since attorney Herbert Sandler and his securities analyst wife, Marion, acquired the company in 1963. The S&L has been so successful for so long because it has avoided the industry's biggest problem: borrowing short to fund long-term, fixed-rate mortgages.

Last year, for example, most of its competitors, gambling that interest rates would soon peak, locked in as many long-term mortgage loans as possible. Golden West, by contrast, built up liquidity by investing in short-term money market instruments, mostly federal funds and certificates of deposit. As a result, the rate of loan growth dropped 30% from 1978 levels. Moreover, by the end of March, Golden West had $753 million invested in cash and U. S. government obligations, earning an average of 15.5%. This represents 26% of its savings deposits, more than twice the industry's average level.

"All S&Ls deal with the same ingredients," says Marion Sandler, who serves as Golden West's vice-chairman. "But our recipe is different." Above all, the S&L wants to avoid the fluctuating earnings pattern typical of the industry.

Soaring rates. Unfortunately, the industry's cyclicality has been increased dramatically by the creation of the six-month money market certificates, which carry a floating rate pegged to the Treasury-bill rate. Since they were created in June, 1978, the certificates have attracted $160 billion and protected the industry from disintermediation. But during the first quarter of this year, rates on the certificates soared to about 16%, far above the yields on existing mortgage portfolios, and that has helped plunge the industry into deep financial trouble.

"Money market certificates have made the S&Ls their own worst enemies," says Vice-President Allan G. Bortel of Shearson Loeb Rhoades Inc. "Today a highly liquid asset structure dominated by short-term investments—instead of long-term mortgage loans—is the only savior of margins."

The Sandlers were among the first to recognize this, and they opposed the new instrument because it introduced interest-rate sensitivity to the liability side of the balance sheet without giving similar flexibility to the asset side. Nevertheless, Golden West, like its competitors, aggressively marketed the certificates because the only alternative was to lose savings to other institutions. In fact, in 1979, Golden West increased its savings accounts—including certificates—by 18%, some 50% higher than the California industry average. Currently, it has 40% of its $2.9 billion savings deposits in six-month certificates.

Fewer mortgages. What Golden West did differently from the rest of the industry was to put the new funds into short-term investments that were as interest-rate sensitive as the certificates. Explains Marion Sandler: "We got a very strong message from the money market certificates, which is: If you haven't taken care of yourself up to now, you damn well better in the future."

Golden West is not only parking new savings in short-term investments but is also doing the same with nearly $400 million in "advances" it borrowed from the Federal Home Loan Bank over the past two years. The average interest rate on these funds is 9%, while the yield on Golden West's earning assets is nearly 11%.

Of course, pursuing this course has meant that Golden West has pulled back from the principal arena for S&Ls—the home mortgage market. Last year some of its California competitors, such as Gibraltar S&L, increased mortgage lending by a third. By contrast, Golden West cut back its mortgage lending 30.5%, from $863 million in 1978 to $599 million in 1979. As a result, the S&L preserved comfortable spreads between its cost of funds and what it earns on them, while the industry as a whole has seen such spreads nearly vanish.

'Sour grapes' response. Although some observers suggest that Golden West's performance is attributable to looking in mirrors, Jerry Gitt, an S&L analyst with Dean Witter Reynolds Inc., claims: "There is no way they've gotten through three credit crunches on luck." Adds Richard H. Deihl, president of H. F. Ahmanson & Co., the largest S&L holding company: Golden West is now "far and away the most profitable S&L."

But its unorthodox style has come under fire. A top officer of one S&L, for

example, charges that the Sandlers went against an "unspoken rule" that FHLB advances should bolster liquidity and the housing market rather than be used as an arbitrage ploy. But former FHLB official Mann notes, "If I had been running an S&L in that environment, I would have been pleased to have done what Golden West did."

Still, the Sandlers' record in building Golden West from $38 million in assets and two branches in 1963 to $4 billion in assets and 139 offices today has caused a "sour grapes" response by some competitors, perhaps because of Golden West's maverick style. In an industry where the vast majority of branch managers are men who focus on marketing, more than 80% of Golden West's managers are females who pay more attention to numbers than to what Marion Sandler calls "glad handing."

In the 1974 slump, for example, Golden West maintained its earnings record by quickly building liquidity through selling mortgages to the secondary market and slashing expenses. In the wake of that downturn, the Sandlers vowed to avoid future surprises and completely ignored variable-rate mortgages (VRMs) despite their sudden popularity among other California S&Ls and despite, as Chairman Herbert Sandler puts it, "their sizzle on Wall Street."

Although many California S&Ls have put 40% of their loan portfolios into VRMs since 1975, Golden West has zero. Because VRMs are restricted to half a percentage point annual rate increases and have limited marketability, Golden West's chairman pronounces them "an imperfect instrument." Similarly, Golden West has been far more cautious than competitors in issuing $100,000 "jumbo" certificates of deposit because of the potential refunding problem involved when they are rolled over to catch higher interest rates. "We'd love to use new weapons if they would make weapons that would work," sighs the S&L's chief.

Workable instruments. Herbert Sandler is also not enamored of the newest method for keeping money available from housing in an unstable interest environment—the renegotiable rate mortgage (RRM) recently authorized by the Federal Home Loan Bank Board. Borrowed from plans used in Canada, it would provide three- to five-year loans at fixed rates, secured by a long-term mortgage of up to 30 years. Deihl says the RRM is "a giant step in the right direction," but Herbert Sandler feels that the half percentage point annual allowable increase or decrease (five percentage points over the life of the mortgage) makes it little more than "an improved VRM."

In short, S&Ls need "broader access to the capital markets as well as mortgage instruments that work," Herbert Sandler contends. "Insurance companies are saying they will not make long-term loans anymore. Do you think we're going to be the only long-term lender left?" For the industry, the response may be uncertain, but if it follows the lead of Golden West, the answer is a resounding "No." ■

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