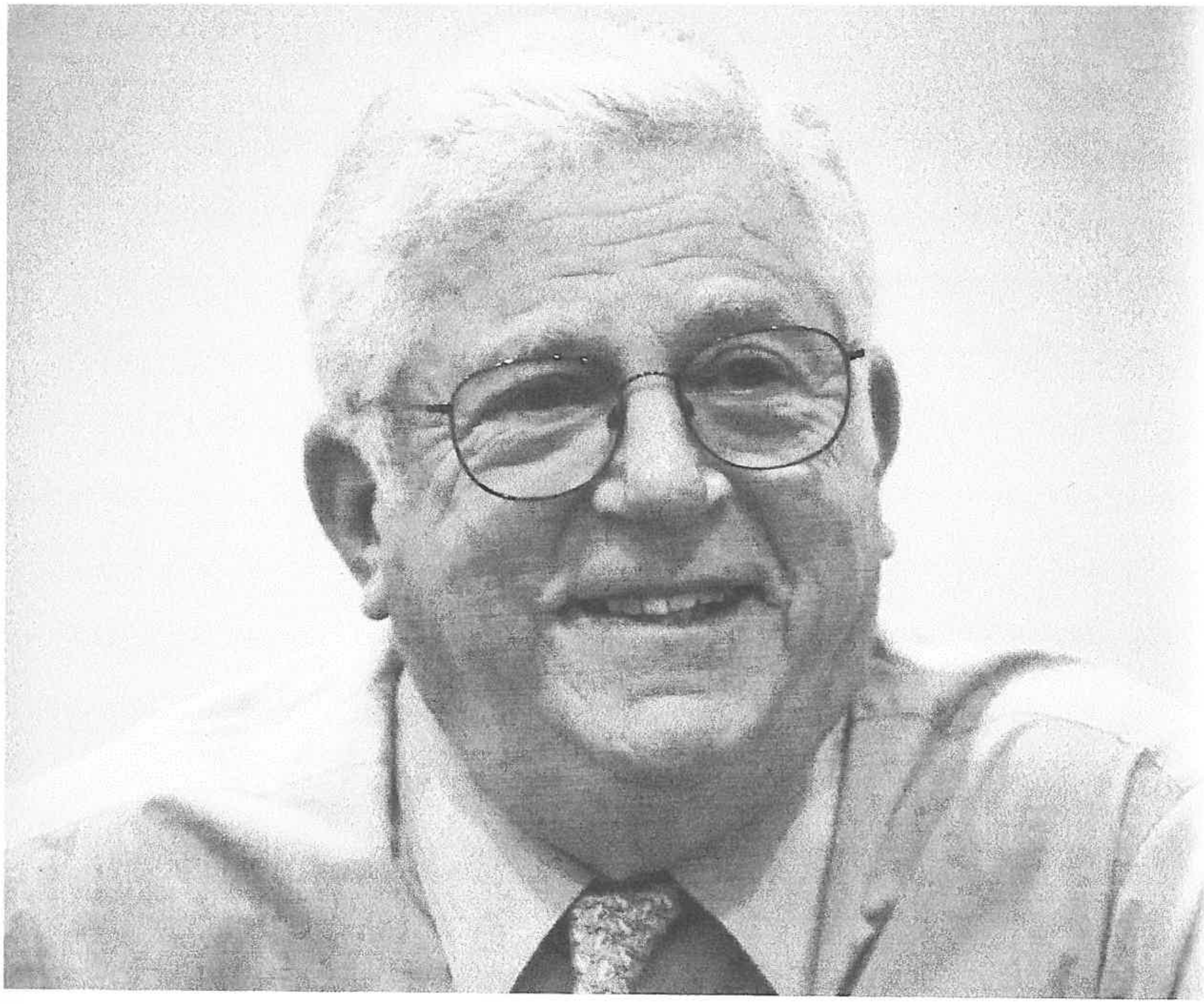

SO MUCH TO DO

A Full Life of Business, Politics, *and* Confronting Fiscal Crises

RICHARD RAVITCH

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On the Public-Private Seesaw

WHEN I FINALLY LEFT THE MTA in November 1983, I was thanked and feted—more than I deserved, as I had just ended the four most exciting years of my life and felt I should be thanking others for the experience. Chief among them were the government employees of the MTA. Thirty years later, the country would be astonished at the speed with which they brought New York City back to life after Hurricane Sandy. Having seen their skill and dedication at close range, I was wholly unsurprised.

But I still thought of myself as a businessman on loan to the government. Indeed, for the next couple of decades, I bounced back and forth between the public and private sectors—embarking on business ventures that I thought were going to be the primary focus of my energies, then being pulled back into public life. Along the way, I got a multifaceted view of the changes taking place in New York's and America's institutions.

AFTER I LEFT the MTA, Nick Brady asked me to join Dillon Read, but I couldn't see myself as an investment banker. Several law firms also offered me partnerships; but for all their talk about their interest in my skills, they were clearly more interested in my contacts. I was looking for something more unusual, but something that would replenish the coffers.

It came along in a phone call from Bud Gravette, chairman of the Bowery Savings Bank. Gravette was one of the last people I'd expected to hear from, because in my previous contacts with the Bowery I had played what was becoming my habitual role with respect to public institutions: Cassandra. The bank had not appreciated me or my dire predictions.

The Bowery, founded in 1834, was one of New York's oldest savings banks. From the Depression until the late 1970s, savings banks played a distinctive role in American finance. They were prohibited from offering commercial banking services, and federal regulations set the rates of interest they could pay their depositors. The savings banks used their depositors' funds primarily to make mortgage loans, performing the very useful function of employing some people's life savings to finance other people's homes.

As nonprofit institutions owned by their depositors—they were also known as mutual banks—savings banks developed a tradition of being civic-minded. Their executives populated the leadership ranks of do-good community organizations. George Bailey, the small-town savings bank president in Frank Capra's 1946 film, *It's a Wonderful Life*, was an idealized version of these executives but one that was widely recognizable to an American audience. When I was asked to join the Bowery's board of trustees in 1977, I readily accepted.

But by 1979 the distinction between savings banks and commercial banks was collapsing. Inflation was soaring. Commercial banks found ways around the interest-rate regulations and were paying higher interest rates on their deposits. As a consequence, money was moving out of the savings banks. The government responded by allowing the savings banks to pay higher rates as well. But that was not enough help for the savings banks, because they had already invested their deposit funds in long-term assets, like mortgages and government bonds, which paid interest to the banks at relatively low interest rates that were fixed in earlier times. The government could permit savings banks to pay higher interest rates to their depositors, but the low rates the banks were earning on their own investments did not allow them to do so.

The savings banks began to lose money. Their depositors were protected against the possibility of bank failure by the Federal Deposit Insurance Corporation, but FDIC protection was limited to $100,000 per account. Many Bowery depositors, including large nonprofit organizations, had accounts far larger than the FDIC-insured amount.

At one 1979 Bowery board meeting, I asked whether the bank should send a letter to these large depositors to warn them that the bank's surplus was being wiped out and there was a limit to their deposit insurance. Most of the board disagreed, on grounds that a warning letter would produce a flood of withdrawals and could push the bank into bankruptcy. I resigned from the board.

That was why it was hard to imagine what Gravette had in mind when he called me in 1984. But it turned out that he wanted me to replace him as chairman. He said the bank was now in serious financial trouble. He was looking for an institution to buy the Bowery, but he hadn't been able to find one that was acceptable to the FDIC, which would have to approve the takeover.

Because one of my primary objectives at the time was to make some money, there wasn't much appeal in the idea of becoming chairman of a semi-insolvent mutual savings bank. But might it be possible to convert the Bowery to a regular for-profit bank owned by stockholders? The combination of the Bowery's importance as a New York institution and the chance at a lucrative financial deal was my kind of challenge.

Don Rice, a lawyer who had worked with me at the Urban Development Corporation, was the first person I asked about the idea. He said it was possible, in theory. But because the Bowery's financial assets were earning interest at rates lower than the rates the bank was paying to its depositors, there was no reason for private investors to put money into the bank, unless the FDIC was ready to absorb the cost of the existing gap between the bank's earnings and its obligations.

The negotiations with the FDIC would be complicated, filled with novel and nonmeasurable risks. But unless private investors could be found for the Bowery, the FDIC would itself have to take over the bank, at a still greater cost to taxpayers. With Dillon Read as financial adviser, I began almost a year of negotiations with the FDIC's professionals.

The FDIC was interested in making a deal if it would cost the government less than a takeover—and if the private investors in the deal contributed $100 million in equity. Dillon Read thought it could, again in theory, raise the money on terms that would leave me with a significant piece of the equity in the bank.

First, however, I had to review the creditworthiness of the assets the bank owned, examine all fourteen of its branches, and determine whether its personnel were capable of running an institution whose nature was about to undergo a fundamental change. As the talks proceeded, the FDIC personnel grew nervous. They had never done a deal like this. The transaction would be highly visible. If the buyers made a fast profit, the government would be criticized for having given away the store. Therefore, the FDIC made clear that any quick returns were off the table. But as the FDIC became more demanding, the job of raising the $100 million became harder.

The discussions went on until March 1985, when the FDIC suddenly indicated possible termination of negotiations because the transaction was going to be too expensive. Bill Isaacs was then the FDIC's chairman. He agreed to let us pay him a final visit before we folded our tent, to try to explain to him why the FDIC's costs were not going to be as high as he feared.

It worked. We persuaded him that the private investors were going to assume more of the risk than the government would. Besides, if interest rates went down, as we thought they would, the deal would cost the public very little indeed.

Then came another kind of crisis. Dillon Read prepared a private placement memo for potential investors. It outlined the transaction's risks and potential benefits. A prominent part of the document was a description of me and how I was said to have saved other major institutions. It made me as uncomfortable as I had been when Ed Logue offered HRH a large amount of money to build something that could not be successfully built. I wasn't going to set out to raise money on the basis of an implied representation that I was a kind of Rumpelstiltskin with an ability to turn straw into gold.

Instead, I called Laurence Tisch to see whether he might be interested in investing the required equity. Larry Tisch was a kind of financial wunderkind. He had earned an MBA from the Wharton School when he was twenty years old and made his first real estate investment at the age of twenty-three. By 1980 he was a billionaire and one of New York's major philanthropists. He was also a friend. It took him just a few hours to understand the transaction and say he was in.

Tisch could not invest more than $25 million in the transaction. Otherwise, his company, Loews, would own more than 25 percent of the private equity in the bank and, thus, become a bank holding company subject to detailed regulation. So Tisch called *his* friend, Warren Buffett, and introduced the two of us. We had a brief meeting, and Buffett agreed to invest $25 million. With those two commitments in hand, it was not hard to get the rest. Nick Brady and the investment banker Lionel Pincus committed $25 million each. The transaction closed.

I moved into what were then the Bowery's splendid headquarters on 42nd Street with Tess Ankis, my secretary since the 1970s, Don Rice as my counsel, and my first major new hire, Ed Grebow. Ed worked for the Morgan Bank, but I knew him as head of the Waterside Tenants' Association. He and I had negotiated many rent increase packages. I was well aware of his brains and energy.

I had promised the investors that I would stay at the Bowery for five years, substantially reduce overhead, and close branches that couldn't make money. The only thing I wasn't going to do was fire

Joe DiMaggio, the bank's spokesman and its biggest advertising expenditure. At the first opportunity, I took him to dinner. The ostensible reason was to offer to extend his contract. The real reason was to tell him about all the times I had gone to see him play at Yankee Stadium. He turned out to be a fairly boring fellow. When you're Joe DiMaggio, I figured, you're entitled.

The Bowery continued to support civic causes, but our major goal was to turn it into a profitable operation. That was tougher than anticipated. Our competitors were offering higher and higher interest rates to depositors in order to accumulate the largest possible pools of deposits. They were accumulating these deposits so they could invest them in assets that provided even greater returns. The high-return assets were often junk bonds and highly leveraged real estate loans. We were unwilling to take those risks. But if the bank had to offer competitively high interest rates to attract depositors without earning the profits provided by the risky investments, it couldn't produce the returns on equity that the investors wanted.

True, the Bowery had depositors to whom it still paid low interest rates, the passbook depositors left over from the bank's time as a mutual savings bank. Periodically, we sent these depositors notices informing them that they could change their passbook accounts to accounts that earned higher interest rates. Many of them did not change their accounts. The reasons, I gradually realized, were inattention and ignorance. The bank was making money off a lot of poor people who didn't know better. This was not a particularly appealing enterprise.

Moreover, even with depositor ignorance, we were not going to be able to increase the value of the bank without taking on risks that we all thought imprudent. Buffett and Tisch were eager to sell. Less eagerly, I went along. We retained Goldman Sachs to find a buyer. In short order, they brought us the Home Savings Bank of California, which wanted the Bowery's depositor base so that it could increase its junk bond acquisitions.

Thus, in 1988, after three years of ownership, we sold the bank for a respectable profit. Cassandra as always, I (along with the FDIC's professionals) predicted that the bubble in which many savings banks were investing was going to burst and that the industry would be in chaos within a few years. The Home Savings Bank of California was later sold to Washington Mutual Savings Bank, which filed for bankruptcy some years after that. The magnificent bank building on 42nd street is now a fancy catering hall.

As I was getting this profitable education in the banking business, New York City was heading toward yet another crisis, this one not fiscal but fundamentally political. Under the city charter in effect since the five boroughs became the City of Greater New York in 1898, the city had an executive branch, a legislative branch, and something in between, a hybrid called the Board of Estimate, which approved the budget and city contracts and had the final say on land use decisions. The board was made up of the mayor, the president of the City Council, and the city comptroller, each with four votes, and the presidents of the five boroughs, each with two votes. The equal voting power held by each borough reflected the view that no borough should be treated prejudicially in the allocation of city funds and facilities.

In 1981, though, certain Brooklyn activists challenged the structure of the Board of Estimate on grounds that Brooklyn, the city's most populous borough, had no more votes on the board than Staten Island, the least populous. In their view, Brooklyn residents were being denied equal protection of the law under the Constitution, in violation of the one-person-one-vote rule. In 1987 the US Court of Appeals for the Second Circuit ruled for the activists and against the Board of Estimate.

Mayor Koch responded by appointing a Charter Revision Commission to propose changes to the structure of city government. He