

First Republic Woe Shows End of Easy Money That Drove California

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By John Gittelsohn and Karen Breslau

(Bloomberg) -- The worst thing to hit California this week was supposed to be the weather, with drenching rainstorms, flooding and the evacuation of thousands of residents. Then came the sudden collapse of Silicon Valley Bank, a key lender for California's almighty tech industry and the second finance company to fail in the state in days.

While US authorities deployed measures on Sunday to boost confidence in the wider banking system, the turmoil continued to engulf shares in other regional banks on Monday. San Francisco-based First Republic Bank sank by 78% and trading in the shares were halted for volatility, as news that it secured additional financing failed to calm investors. PacWest Bancorp, based in Beverly Hills, plunged by as much as 60%.

In California, politicians and executives scrambled over the weekend to contain the broader fallout for the economy — the fifth-largest in the world — at a time nervousness had already been growing about its outlook. But the damage caused by the collapse of SVB has already spread beyond Silicon Valley, where it counted half of all US venture capital firms as clients, to other important California industries that it catered to, including cleantech companies and wineries.

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The fallout stands to bring a reckoning to the Bay Area's tech-driven economy — a center of the state's recent economic boom — just as California is facing a broader slowdown. Tax collections from high earners that drive revenue are falling as the stock market flounders, with Governor Gavin Newsom projecting a \$22.5 billion budget deficit in the coming fiscal year.

San Francisco itself has been particularly hit hard by tech

layoffs and the slow return of workers and tourists to its downtown after the Covid-19 pandemic. Rising interest rates have roiled the real estate market, with house prices in the city down almost 15% in the past year, according to brokerage Compass Inc. On Friday, Mayor London Breed called the SVB situation “extremely concerning for the local and regional economy.” The Bay Area is now facing a broad correction to the over exuberance of the free-money era that fueled explosive growth in Silicon Valley, the tech sector and speculative investments like cryptocurrency, said Ken Rosen, chair of the real estate department at the University of California, Berkeley. While he expects the problems at SVB and Silvergate Capital Corp.’s bank, the crypto-friendly lender that also closed last week, are isolated, he sees a humbling of the move-fast-and-break-things spirit that drove growth at companies like Facebook. “There’s a contagion effect,” Rosen said. “This could be the beginning of something bigger. It’s all about confidence.”

Those concerns drew together an unlikely alliance of politicians and venture capitalists — from Representative Ro Khanna, a Bernie Sanders acolyte whose Silicon Valley district includes SVB, to Kevin McCarthy, the pro-Trump Republican who leads Congress. They ultimately got what they wanted from the Biden administration: a plan on Sunday night that will enable Silicon Valley Bank customers to get back all their money, easing concerns of a cash crunch rippling through the state. Newsom, for his part, praised the Biden administration for backstopping SVB depositors and said the move will have “profoundly positive impacts” on California as worries about access to cash ease.

The Biden Administration has acted swiftly and decisively to protect the American economy and strengthen public confidence in our banking system. Their actions this weekend have calmed nerves, and had profoundly positive impacts on California.
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Beyond the shakeout for the technology industry, the collapse of Silicon Valley Bank could still have broader ramifications for industries such as real estate, where office landlords are already facing falling demand and property values. In many cases, SVB provided letters of credit as substitutes for renters’ deposits.

Fast-growing tech startups, like typical clients of Silicon

Valley Bank, often rely on these letters to secure leases because they lack the credit of established blue chip companies and don't want to tie up cash security deposits with landlords, said Alain R'bibio, a real estate attorney with Allen Matkins in Los Angeles. Now they'll need new letters of credit, which would require transferring collateral to another bank or solvent institution.

"Having a lease that goes from being secured to having a lease that's now unsecured creates significant exposure for a landlord," R'bibio said.

But landlords may have little inclination to kick renters out at a time it would be hard to find tenants to replace them, said one Bay Area office developer and investor who has at least three tenants with Silicon Valley Bank accounts. Silicon Valley's office vacancy rate climbed to 19% at the end of 2022, according to brokerage Cushman & Wakefield Plc, while it was 24% in San Francisco.

In Northern California's wine country, where Silicon Valley Bank was a major lender, issues such as making payroll were top of mind for vineyards when news of the collapse came Friday, said Daren Shaver, who specializes in wine law as a partner at Hanson Bridgett LLP. Longer term, there stands to be a "big drag on investment and development activities" for investors with funds tied to the bank, though the federal measures may ease that, he said.

Even as SVB's collapse has jolted the region, the economy is still fundamentally strong, said Christopher Thornberg, a founding partner of Beacon Economics. "Silicon's Valley's unemployment rate is 2.1%," he said, citing the latest December jobs data from the San Jose-Sunnyvale-Santa Clara metro area. "For all the hand wringing over tech I don't see see massive layoffs, in the aggregate sense. People who are being let go, are being hired somewhere else."

The state's economic fortunes can turn quickly, kind of like the state's volatile weather: Years of drought are now being followed by one of the wettest winters on record. On Monday, another atmospheric river is in the forecast.

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