# IMBs face ripple effect from recent bank failures

The threat of warehouse-line contractions and margin calls is real for independent mortgage bankers, but not a foregone conclusion, industry experts say

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March came in like a lion for the banking industry with a trio of bank failures, including the nation's 16th largest bank, **Silicon Valley Bank** (SVB), with assets of $212 billion.

The other banks laid to rest in early March were crypto-friendly lenders **Silvergate Capital Corp.** ($11.4 billion in assets) and **Signature Bank** ($110 billion in assets). The bank failures set off panic in markets globally and prompted a flight to safe investments, like U.S. Treasuries, which has helped to fuel a recent precipitous decline in interest rates.

The impact of the failures is still being assessed by the markets. Experts who spoke with **HousingWire** about the banking-industry woes point out that it's still too early to know how everything will shake out. For now, however, they say lenders in the adjacent mortgage banking market should take some prudent steps to guard against the worst of the downside risk — zeroing in on bank-sponsored warehouse lines utilized by independent mortgage banks (IMBs).

Among the commonalities for all three failed banks was a concentration of customers in a narrow industry segment — crypto-focused for Silvergate and Signature and tech-focused for SVB — and a high volume of "hot deposits" that were prone to flight in search of the best return on their money.

For SVB, the most significant bank failure of the three — and the largest since 2008 and the crash of **Washington Mutual** — the customer concentration and short-term deposit risk it carried was set against a longer-term investment portfolio that had been clobbered by the doubling of interest rates over the course of 2022 in the wake of the Federal Reserve's monetary tightening policies.

"I have trouble understanding how this can happen, that you're taking in a lot of the short-term deposits and making a lot of long-term investments," said **Community Home Lenders Association** (CHLA) Executive Director Scott Olson during a webinar this week focused on assessing SVB's failure and its consequences. CHLA serves small and mid-sized independent mortgage banks.

"I'm sure it seemed like a good idea at the time," Olson added, "but how many times do we have to see this before we learn that it's a very, very risky strategy."

In fact, the rate environment that spurred the liquidity crisis at SVB also has wreaked havoc on bank bond portfolios generally.

"As a result of the higher interest rates, longer-term maturity assets acquired by banks when interest rates were lower are now worth less than their face values," said Martin Gruenberg, chairman of the **Federal Insurance Deposit Corp**. (FDIC) in recent speech at the **Institute of International Bankers**. "The result is that most banks have some amount of unrealized losses on securities.

"The total of these unrealized losses, including securities that are available for sale or held to maturity, was about $620 billion at yearend 2022. Unrealized losses on securities have meaningfully reduced the reported equity capital of the banking industry."

As of Dec. 31, 2022, SVB had a total a securities-investment portfolio of $120.1 billion, including more than $16 billion in Treasury securities and some $64 billion in agency-issued mortgage-backed securities, according to the bank's filings with the **U.S. Securities and Exchange Commission**. Much of that MBS

portfolio involves mortgages originated prior to the Fed-induced rate run-up, when 30-year fixed mortgage rates were at 3% or less, versus now, when they are more than twice that mark.

The bulk of SVB's investment portfolio, some $91.3 billion, including $57.7 billion in MBS, is marked as being "held to maturity." The balance of the SVB portfolio ($26.1 billion) was listed as "available for sale" (AFS), per the SEC filings. The bank also listed some $2.7 billion in non-marketable equity securities.

In early March, the bank sold roughly $21 billion of its AFS portfolio, recording a $1.8 billion loss due to the volatile rate environment. The bond sale was required, in part, to compensate for a large exodus of deposits in 2022 as the tech industry faltered, which created liquidity issues for the lender.

In the wake of that bond-sale loss, SVB announced it would seek to raise capital to replenish its equity, which spooked the markets, icing the fundraising plan. The bank's customers, already dealing with a downturn in their high-flying industry, also were alarmed by the exposure of SVB's precarious finances — which led to a social media-amplified run on the bank and its subsequent collapse.

"They [SVB] had immense concentration risk in the tech space [in terms of customers]," said Brian Hale, founder and CEO of consulting firm **Mortgage Advisory Partners.** "And they completely mismanaged, in my opinion, the duration risk [of their investment portfolio]."

"When you have long-term assets [MBS] that are financed with short-term deposits, if the deposits begin to get repriced [upward, and you've locked in your asset yield [too low] because your deposit costs were [low at the time], when those short-term deposits get repriced [higher], that's the definition of disintermediation."

IMBs don't face a disintermediation challenge because they don't deal with deposits or maintain long-term investment portfolios. They do, however, utilize bank warehouse lines of credit to help fund mortgage originations.

“This is purely a lend long borrow short problem that these guys [SVB ] got themselves into,” said Dave Stevens, CEO of **Mountain Lake Consulting** and past president and CEO of the **Mortgage Bankers Association**, who also spoke about SVB’s failure during the recent webinar. “IMBs don’t retain much risk. They are primarily pass-through entities … with an outstanding pipeline of loans that are locked until they close and get sold.”

## Warehouse lines

Stevens added, however, that the big threat with the recent bank failures is the potential for a “contagion” effect.

“How do you control the potential spread of this to other banks around the country that are behaving the same way?” he asked. “That’s the other shoe to drop.

“For IMBs, what you need to be thinking about is where are your warehouse lines, and do have enough diversified options for warehouse lines should one of the banks that you do business with potentially be at risk?”

Stevens stressed that, in his opinion, the recent bank failures are not likely to have a contagion effect. He estimated that there are no more than a dozen banks nationwide that have an “overconcentration in long, underwater investments in the Treasury markets and the mortgage-backed securities (MBS) market.”

Rob Nunziata, co-CEO of independent mortgage lender **FBC Mortgage**, said FBC works with a number of warehouse lenders, small and large, including **Texas Capital Bank**, **Western Alliance**, **Bank of America** and **Veritex Community Bank**.

“I’ve talked to all of our warehouse lenders,” he said. “They’ve all said the same think, ‘It’s business as usual.’

“What they’re seeing is that it is a very regional situation [with the bank failures]. … Basically, they are saying that they’ve got strong balance sheets

and don’t anticipate anything to change … based on what’s currently happening.”

Nunziata added that the optimistic outlook from warehouse lenders could change in the future, of course, “but as of now, it’s really that same message from all the warehouse banks we work with.”

Nunziata’s assessment of the warehouse-lending space is echoed in a recent posting on Texas Capital Bank’s **LinkedIn** page, which states the following:

“We have purposefully built Texas Capital Bank to operate from a position of financial strength and stability and to serve our clients through market and rate driven cycles. Thanks to our actions in 2021 and 2022, we have peer-leading balance-sheet strength, with 18% of our total assets in cash and 30% in liquid assets, along with 13% common equity Tier 1 capitalization. Each of these metrics puts us among the best-capitalized banks in the United States, including in comparison to the largest U.S. firms.”

Still, CHLA President Taylor Stork, who also is chief operating officer at **Developer’s Mortgage Co.**, said IMBs should be in close communications with their warehouse lenders at this time. Stork spoke during the same webinar that Stevens and Olson participated in this week.

“In the warehouse space right now, every single IMB operator needs to be on the phone with their warehouse provider having a very, very open honest two-way conversation,” he said. “Here’s where I am. Here’s my cash position. Here’s my liquidity position. What’s yours? How do you look? How do we make sure that we work well together?”

## Bank failures and fears of margin calls

The 2-year Treasury yield on Monday, March 13, recorded its biggest drop since the stock market crash of 1987, though it rebounded a bit on Tuesday. Likewise, the 10-year Treasury rebounded some on Tuesday, after hitting a five-week low of 3.51% on Monday.

The sudden rate plunge in recent days prompted both Davis and Hale to raise the prospect of mortgage banks being hit with potential margin calls.

“You’ll remember at the beginning March and April of 2020, at the beginning of [the pandemic], rates dropped precipitously,” Hale said. “Well, a lot of mortgage companies got nailed.

“I hope the industry learned from that to some degree, but I talked to some people today that are nervous about margin calls around the interest rate move.”

Stevens added during the SVB-focused webinar: “I think anybody who’s hedging the pipeline right now knows that they’re going to get margin calls. I think it’s a given unless the bond market just reverts back, which I don’t think is going to happen right away.”

John Toohig, head of whole-loan trading **Raymond James**, said if there was a margin-call rush, he did not see signs of it on his trading desk as of Monday, March 13.

“I had plenty of buyers calling me, more bottom-feeders, saying they were available and looking for an opportunistic [asset] pool, but I didn’t have any sellers calling me, looking for an exit,” Toohig said. “I did not see forced sellers [a sign of margin calls], so If it happened, I didn’t have vision into that, but that’s not to say what other desks or sellers experienced.”

Spencer Kallick, a partner focused on real estate transactions and land-use entitlement at the law firm of **Allen Matkins**, said he remains an optimist about the real estate market and the longer-term outlook for the U.S. economy. Assuming he’s correct, then maybe March for the mortgage industry will leave as a lamb. We’ll have to all ride it out and see.

When it comes to people’s “common sense,” however, Kallick is less sanguine, saying it sometimes seems in short supply today.

“I think sometimes in this in this very high-stakes, fast-paced world, some of the common sense goes out the window, and some of the best practices go

out the window," he said. "That was the case here [with SVB's failure], on the bank side, but also on the borrower side, and on the on the business side of things.

"But I don't think that this [the fallout from the recent bank failure] is going to spread like wildfire for two reasons: One, because I think that it's a case of several banks failing that are very heavily concentrated in one area, and I think most banks are much more diversified. I also think the other thing, quite candidly, is that the Biden administration [via its recent expansion of liquidity options for banks and its action to make whole all depositors at SVB and Signature Bank] has shown a strong willingness to step in and make sure that this doesn't happen again."

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