Banks Likely To 'Keep Retreating' From CRE Lending 6 Months After Silicon Valley Bank Failure

By Dees Stribling

In the six months since the market-rocking failure of Silicon Valley Bank, commercial property lending has receded into the rearview mirror for many small and regional banks, while nonbank lenders stepped in to fill the void when they or their borrowers can afford it.

The change in the marketplace is a far cry from the Global Financial Crisis-informed alarm that sounded through the financial world after Silicon Valley Bank, followed swiftly by Signature Bank, was closed by regulators in mid-March. Still, the divots left in the terrain of regional banking combined with interest rate hikes have broadened in the intervening months to change the way CRE gets money — at least for now.

“The bad news for borrowers is that a major source of funding, regional banks, will likely need to keep retreating from the sector,” said Gavriel Kahane, managing partner of Arkhouse, a private equity investor that specializes in opportunistic properties. “The good news is that there is an unprecedented amount of private capital looking to get into real estate lending, and if banks create a vacuum, private lenders will fill it.”

Commercial and multifamily mortgage loan originations were 53% lower in the second quarter, just after SVB’s closure, compared to a year ago, the Mortgage Bankers Association reports. Depository institutions like banks dropped 69% in that one-year period, according to MBA data.

Since the SVB and Signature failures, lending totals ticked up by a barely perceptible 0.01% to $2.9T in March, according to Federal Reserve data.

The last time lending leveled off to this kind of whisper-thin growth rate was during the first pandemic year of 2020. In the years of low interest rates following the Global Financial Crisis but before the pandemic, total lending growth was much stronger.

Though SVB was a shock to the system, any conversation about the overall decrease in lending seen in the market can’t ignore the massive impact interest rates have had. The environment has drawn a clear line between those that have pockets deep enough to put down an adequate stack of cash to get a loan and those that don’t.

“Liquidity in the financial sector is being constrained as depositories are finding themselves not being able to pay virtually nothing for deposits any longer,” Alliant Credit Union Chief Capital Markets Officer Charles Krawitz said.

That leaves them with less money to lend and a borrowing pool being slowly drained by the cost of capital.

“From what I understand, some lenders are requiring significant deposits to the point of absurdity,” Krawitz added. “A mortgage broker I know told me that lenders don't want to say they're out of the market, but to do a new loan, they would require 30% of the balance on deposit. And generally speaking, that does not work.”

Those with existing relationships are positioned better.

“If you're a master of the universe and you have these massive deposits already at these lenders, your deals seem to be getting financed,” Anax Real Estate Partners principal Eric Brody said.

He characterized the borrowing situation as worse than six months ago.

“But there are pockets of capital,” Brody said. “That capital is much more expensive because [nonbanks] know how valuable it is. And their biggest issue for them is, is it the bottom yet? Is it time to strike?”

The void left by SVB, a bank popular with tech companies in Silicon Valley, has also rattled the confidence of entrepreneurs and potential borrowers working in a region in many ways still hobbling away from the pandemic.

“We miss Silicon Valley Bank because that was a one-stop shop for many services,” said Haydar Haba, managing partner of Andra Capital, a Silicon Valley-based investment firm.

“We had two companies in our portfolio that were exposed on the last day [of SVB's existence],” he said. “It was pretty frightening that they could lose all their investments overnight, though in the end, the government bailed the depositors out. Still, nobody wants to deal with smaller banks anymore.”

More than 50% of regional bank customer respondents to an American Banker survey released earlier this month reported at least some concern about the stability of their bank in the wake of SVB and Signature's collapses. A fifth of the respondents said they had "strong concern" about their bank. Almost all of the 40 banks included in the survey experienced a falling reputation among noncustomer respondents, and more than half saw their reputation fall among customer respondents.

The failures of SVB and Signature also drastically upped nervousness about the financial industry in general. A survey by the Federal Reserve conducted shortly after the collapses found that 52% of professionals at broker-dealers, investment funds, research and advisory organizations, and universities thought that commercial and residential real estate now posed a “salient risk to financial stability.” Twelve percent said the same in late 2022.

Ratings agencies Moody’s and S&P Global have also downgraded regional banks, citing interest rates and other factors, but also “particular risks in some banks’ commercial real estate (CRE) portfolios.”

“Moody's downgrades combine concerns about lingering funding strains for regional banks, with concerns about commercial real estate exposures, which tend to be higher for the downgraded banks,” Trepp research analyst Emily Yue wrote.

Meanwhile, many regional banks are considered overexposed to the sector as it is, and there are questions about new regulations in SVB’s wake, similar to the slew of rules that banks had to learn to navigate in the years after the Global Financial Crisis.

Out of about 4,760 banks studied by Trepp, 763 had a CRE or construction loan ratio in excess of the liquidity thresholds recommended by regulators. Some 149 banks have both construction concentration and CRE concentration exceeding guidance thresholds.

In August, bank regulators, including the Federal Deposit Insurance Corp. and the Fed, proposed new rules for larger banks, aimed at preventing the sort of cash flow issues that helped sink SVB. Banks with more than $100B in assets would be required to issue $70B in long-term debt. The rule would have applied to SVB, which had about $209B in assets at the beginning of 2023.