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to withstand such pressures when compared to the larger institutional banks. Some of the issues come from the banking rules and regulations inherent in the system. Since 2010, Banks are not forced to use mark-to-market accounting principles because of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Mark-to-market (MTM) is an accounting method that is based on measuring the value of assets based on their current price. Because of these accounting rules changes, banks don't have to report market losses that would show up using MTM, which results in the banks not having to show negative equity on their balance sheets.

Using the recent example of Silicon Valley Bank (SVB) their balance sheet showed a positive amount of \$12 Billion. Under the current accounting rules, they did not need to count against an unrealized \$15 Billion loss. If they would have Marked to Market, they were not +\$12B, they were -\$3B. Making things worse for SVB, some of the pundits in the media, like Jim Cramer from *Mad Money* on CNBC, shined a light on their stock price as it was going down by claiming that the stock was still cheap at \$320 a share. As a result, smart investors and money managers began taking a deeper look at SVB and discovered this \$15B in unrealized losses. This caused some investors to short SVB stock, betting on further declines in the stock price, which drew more attention to SVB, in a bad way.

The result is a run on the bank, which doesn't have the liquidity to pay back its depositors all at once. SVB needs to borrow money to meet the demand of its depositors but cannot borrow enough to meet the demand. This forces them to sell their assets that are underwater and realize a \$2B loss, which causes them to file for bankruptcy protection.

All of this volatility is good for mortgage rates as investors start running to the safe haven of the bond market. In addition, the February CPI and PPI inflation numbers were lower than anticipated, adding more demand to the bond market, and continuing the push down on mortgage rates. The real estate markets in my area are turning from a buyer's market to a seller's market. Combine that with historically low inventory and we are going to start to see home prices push back up again, which we are already experiencing.

*As always, your mortgage guy,
Viral (Vic) Joshi
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Vic's Mortgage Report

"Home of REAL Mortgage Advice®"



Vic Joshi
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MORTGAGE

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My mission is to help buyers qualify for the best loan available for their circumstance. I spend a generous amount of time with each client to educate them about how the mortgage industry works, through free "Mortgage 101" consultations, so they can make good decisions and get the best loan possible. I've revamped my website to give clients the best resources to supplement my consultations.

When I'm not doing loans, I'm an avid scuba diver and certified Rescue Diver. Eventually I'd like to become a dive instructor, so I can share the joys of this ocean sport with others.

I give back to the Monterey Bay Aquarium, Divers Alert Network (DAN), and the National Outdoor Leadership School (NOLS).

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Another Bank Bailout?

Hi Friends,

March was a volatile month in the markets. The headlines were full of news that reminded us of the Great Recession of 2008 with multiple banks facing major liquidity issues. The Federal Reserve's steep increase of the Fed Funds interest rate, increasing the Fed Funds by 4.5% in less than one calendar year, is not only slowing the economy, but it is putting pressure on smaller, regional banks like Silicon Valley Bank, Signature Bank, and First Republic Bank.

The basic way that banks make money is to take your deposits, pay you a small amount of interest, and then either lend that money out or invest it at a higher rate than what they paid their depositors, making the spread between the two. Typically, a bank will only keep a small percentage of the overall deposits as liquid, say 10% of the deposits, and then lend or invest the remaining balance to earn interest on the spread. When the markets perceive weakness in the banks and the banks' depositors try to pull out their money all at once, the banks don't have the liquidity to pay out their depositors and they are forced to sell their assets and/or borrow money to meet their depositor obligations.

With the huge increase in the Fed Funds rate, which is the rate of interest that banks charge each other for overnight or short-term loans, a bank that is facing a run on deposits will have to borrow at a higher rate than what they are earning from the loans and investments that the majority of their assets are invested in. In



addition, banks that were lending at 3% or less during 2020 and 2021 suddenly have to pay their depositors more than that due to the Fed rate hikes. This inverts the spread and causes losses for the banks that they cannot recover unless they sell off their assets at a loss. This can force the banks to collapse and file for bankruptcy or be bailed out by the Federal Government, as happened during the Great Recession.

The recent depositor run on Silicon Valley Bank, Signature Bank, and First Republic Bank, when depositors try to withdraw their deposits all at once, highlights the fragility of the banking industry where many of the smaller, regional banks don't have the huge amount of capital, required

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