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"And out of the ground the Lord God formed every beast of the field, and every fowl of the air; and brought them unto Adam to see what he would call them: and whatsoever Adam called every living creature, that was the name thereof."

Genesis 2:19, KJV

Whether or not **you've** spent much time reading the Book of Genesis, you likely are familiar with the general gist of the above passage. Indeed, the Creation of Man is one of the most ubiquitous narratives of all time. God creates Man, says to him not to eat the fruit of the Tree of the Knowledge of Good and Evil, and brings all of the creatures to Adam to be named. It is that last that has always been the most intriguing to me; how odd it is, that it is God's nature to create, and yet for Man to name all the creatures of His creation.

Appropriate indeed, for there are few more human instincts than the one to categorize, and while it typically aids in communication, it does not do so always. Indeed, at times, words can obfuscate the nature of something, and oftentimes, they are words that loom large in the public consciousness.

One of those nasty words is "bank."

This is what I'd like to talk about today, in the context of a different sort of creature. This one, however, is a creature of Man's design.

The creature, of course, is the modern bank.

But what, exactly, is a bank in the first place?

It seems a silly question, but can you succinctly (say in a short sentence) sufficiently describe what the word "bank" means these days?

You might say that a bank is an institution that takes deposits and makes loans, and in the traditional sense, that is perfectly correct.

"Ahh," you might say, "that's all well and good. But there are institutions that make loans that are not a bank, and there are institutions that are banks that don't take deposits or make loans."

You would, confusingly, be equally correct.

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What gives?

The creature that is SVB

I say all of this to make a simple point- that what we mean when we use the term “bank” has little inherent meaning, and two “banking” institutions can have very different, sometimes completely unrelated, business models.

Despite the comparison to a famous creature of fiction, however, the upshot today is that this particular monster known as Silicon Valley Bank had little resemblance to the biggest institutions that we typically worry about failing (the so-called “too big to fail” banks). While risks are weighed to the downside, and some further bank failures are certainly possible, there don’t seem to be the ingredients for anything so spectacular as the Great Financial Crisis, at least not yet.

Especially in the case of SVB, there are several factors that make it unique. It had a highly concentrated book of business (tech workers in Northern California). As the sector expanded rapidly, so too did the bank, at least from the perspective of its deposit business, which tripled from 2020-2022. However, the generally wealthy clients of SVB had little need to borrow, and the bank instead put the capital to work by investing in long dated treasuries, an ill-fated wager that interest rates would normalize or come down. The opposite of course happened, sticking SVB with massive unrealized losses, and as word spread amongst depositors quickly online, there was a rush to pull deposits, a frighteningly high proportion of which were uninsured. This forced SVB to sell bonds to meet the demands of depositors, realizing losses on the bonds. This created a vicious cycle and a bank run.

As such, the conditions that led to the demise of SVB were mostly peculiar to it, and are unlikely to be repeated in similar fashion soon.

A different monster entirely

With that being said, do recall the ominous creature of the title. There are indeed monsters of different sorts, all known as banks, yes, but all beings of intrinsically different natures. A problem that has increasingly occupied my attention is the $1.5 trillion wall of commercial mortgages backed by office buildings coming due in the next several years. While many other areas of the real estate world have recovered since the pandemic, there are swathes of unoccupied offices in those geographies where the work from home phenomenon has been embraced. The structures of those loans makes them doubly troublesome as well.

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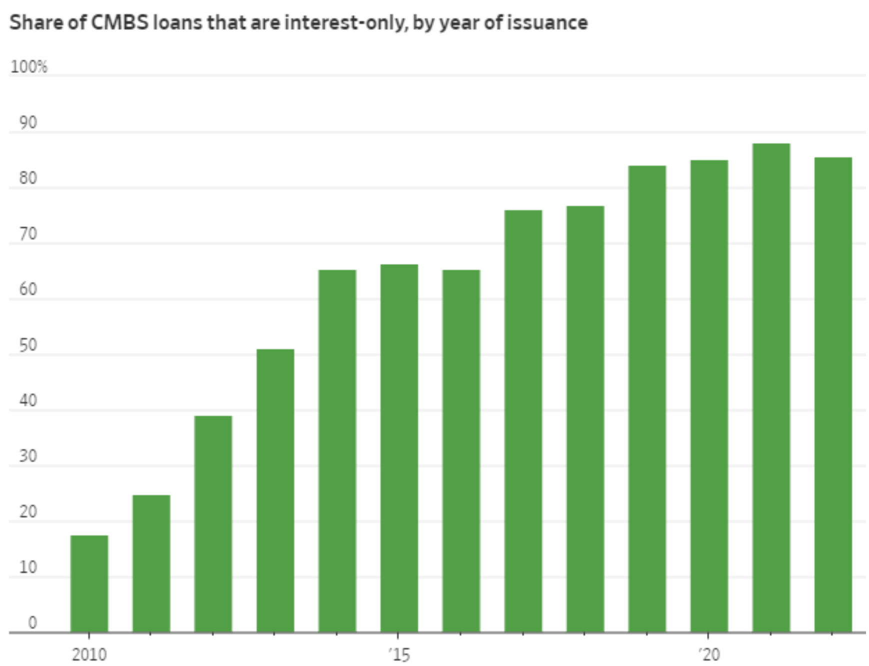

Interest-only loans have exploded as a proportion of the loan books of banks since 2013, and the plans of many landlords to favorably sell or refinance their offices may very well not materialize. The reason is quite simple. As the name implies, interest-only mortgagors pay only the interest over the life of the loan, and the entire principal balance is paid at the end of the life of the loan (when the landlord sells or refinances). However, the explosive growth in the space, as can be seen above, is going to be a major area of concern for bank regulators and investors going forward.

Not to end on too dark of a note, but the true trouble is that it's extremely difficult to say just how big of an issue this will be. The reality is that the financial statements of banks are deeply opaque, to the degree that investors of far greater skill than I avoid them. It's enormously difficult for all but the most sophisticated to parse their statements for meaningful indicators of financial health, and there is no telling which bank will have been exposed to the wrong sector or wrong geography at the wrong time.

This is not to say avoid owning banks entirely.

Simply that, when approaching these monsters, exercise caution- their nature is mercurial at best, and one can be deeply difficult to differentiate from another.

Caveat emptor, folks.