inside small-balance

By Randy Fuchs, principal and co-founder, Boxwood Means Inc.

Metro ups and downs

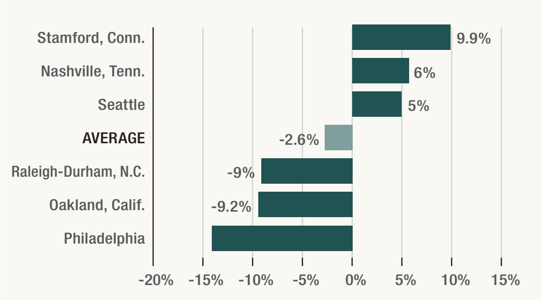
Uncertainties about the short-term prospects for the small-balance commercial space abound. The still-icy capital markets show little signs of thawing, and the residential housing downturn is going from bad to worse.

It's not that we expect a meltdown in the market for commercial loans of less than $5 million, which totaled $140 billion in the 12 months ending with second-quarter 2007. After all, this is a huge marketplace that reflects the character and durability of local economies across the nation and of the small-business real estate owners and investors who help support them.

But amid headlines about residential foreclosures, bloated inventories of unsold homes, historic markdowns in loan portfolios and sudden layoffs on Wall Street, it's clear that the strength and diversity of local economies will become more visible with important consequences for small-balance originators.

The rising tide of small-balance originations that crested in 2006 is receding unevenly across the metropolitan landscape, and winners and losers have emerged. As shown in the adjoining graph, top performers include Stamford, Conn.; Nashville, Tenn.; and Seattle — places where financial services, health and education, and tech-related industries have thrived recently.

Loan Origination: 1st Quarter '07 Vs. July '06-'07



Source: Boxwood Means Inc.

Laggards are beset with various ills such as depending on the contracting housing and mortgage sectors or on traditionally slow-growth industries.

Some areas have slowed considerably. For instance, small-balance-origination growth in all of the major California markets except for San Diego has ebbed. This includes Los Angeles (-6.8 percent), Sacramento (-6.2 percent) and the Inland Empire (-5.9 percent). Larger Florida metropolitan areas have experienced slowdowns in production velocity, as well.

In fact, origination growth is tepid across many metro areas. The increase among the top-fifth of all metro areas in terms of loan growth is only 1.6 percent, while loan growth for the middle fifth is down 3.2 percent.

Clearly, we have passed the peak in the small-cap real estate cycle. Market selection and market risk are important factors for loan originators. That said, small-balance-transaction volume isn't likely to fall out of bed in 2008, and solid underwriting and execution will be a winning combination in any part of the country.

Randy Fuchs, a principal and co-founder of real estate research and consulting firm Boxwood Means Inc., writes a monthly column on small-balance commercial loans for *Scotsman Guide*. Boxwood provides lenders with strategic mortgage reports, direct-mail lists, portfolio analytics and other services based on its proprietary database of small-balance transactions. E-mail randy.fuchs@boxwoodmeans.com.

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