

inside small-balance

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

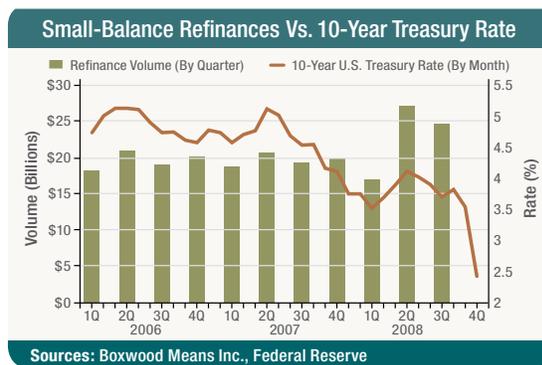
Hanging in there

TO PARAPHRASE MARK TWAIN, REPORTS of small-balance lending's demise may have been greatly exaggerated.

In January's column ("*Inside Small-Balance*," *scotsmanguide.com/3333*), I presented research indicating that small banks grabbed some market share from larger banks in 2008. While liquidity issues have hampered, if not sidelined, a few large banks from issuing new small-balance-loan commitments, credit has flowed from commercial banks, savings and loans, credit unions, and thrifts of all sizes.

Case in point: Originations for loans of \$5 million or less in the third quarter of 2008 totaled \$33.5 billion, a 9.3-percent decline from the previous quarter but 6.4-percent greater than the third quarter of '07. Most action occurs these days in refinances, which represented 74 percent of the total volume. In fact, as shown in the nearby graph, this latest refinance activity is close to that of the second quarter, the high-water mark for these originations since at least 2006.

Coupled with the trend in 10-year Treasury rates, the direction of interest rates has influenced the uptick of refinance business. Granted, the 10-year rate is a limited proxy for the direction of whole-loan commercial



mortgages because portfolio lenders determine their actual lending rates based upon many factors, such as the institution's equity-hurdle rate, cost of funds and credit cost. But bank rates have moderated in response to changes in federal monetary policy and the direction of interest rates. And many small-balance borrowers and brokers are taking advantage of this by refinancing.

Therein lies the disconnect. Wall Street's estimates for commercial mortgages' rate premiums on the secondary market — as illustrated by spread expansion for commercial-mortgage-backed securities and other benchmark rates by 1,000 basis points and more — have dominated discussions and have shaped views about credit scarcity. Meanwhile, most banks — whose rates aren't pegged to the capital markets' worldview — are quietly lending.

Loans may no longer be available to every small-balance borrower with a pulse or an occupied piece of commercial real estate. But the latest origination figures demonstrate that a small-business owner or small-cap investor with good credit, adequate equity, and a cash-flowing property or operation likely can obtain a loan from a local or regional banking institution.



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