

inside small-balance

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

Gauging delinquencies

Questions about the performance of small-balance commercial loans surfaced at the “Small Loans” concurrent session at February’s Mortgage Bankers Association Commercial Real Estate Finance/Multifamily Housing Conference and Expo (*Wrapup: scotsmanguide.com/cref08blog#small*). The perception is growing that small-balance delinquencies and defaults are worse than those experienced in the larger commercial mortgage market.

Of course, suspicions about credit health surround all types of debt these days. But the uncertainty about the risks involved in loans of less than \$5 million stems directly from the scarcity of comprehensive loan performance data. Research also shows a connection between small-balance performance and that of the residential housing market (*Inside Small-Balance, Scotsman Guide commercial edition, February 2008*).

There’s a gap between this perception and the reality. In the nearby graph, you can see that delinquencies of small-balance, commercial-mortgage-backed-securities (CMBS) loans have tracked closely to the performance of all conduit CMBS loans since 1998. The delinquency rate of small-balance loans was 0.86 percent as of this past January, compared to 0.46 percent for all CMBS loans.

This relatively narrow spread has widened of late. But delinquencies are near historical lows. Loan defaults also are at a cyclical low.



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Small-Balance and Conduit Delinquencies



Source: Trepp LLC

Note that this data set only reflects small-balance performance among pools of CMBS deals. It does not include the far-larger population of loans on the balance sheets of local, regional and national banks. Moreover, delinquencies represent payments that are only 30 days late; borrowers can miss one payment but become current in the next month.

Ultimately, delinquencies alone likely are not a solid measure of ongoing loan performance. Instead, they likely are an early warning signal of potential problems with collateral performance.

Is the perception of heightened risk among all small-balance loans warranted? Generally, no. Size also matters — recently, the performance of commercial loans of less than \$1 million has not been as solid as that of larger loans — and could bear watching in coming months.