inside small-balance

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

A look back, a look ahead

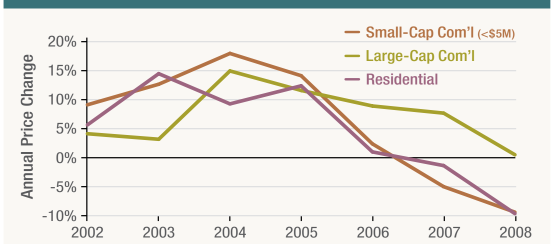
In the past two years of Inside Small-Balance, we've reported on many dimensions of the marketplace for commercial loans of $5 million or less. These include its resilience, underwriting practices, higher incidence of loan delinquencies, and more recently, small-capitalization-rent trends and the increase of lending among small banks.

Perhaps one of the most-fundamental points, though, is recognizing that the small-balance/small-cap market is neither fish nor fowl. By definition, the collateral is commercial real estate, but its performance is inextricably linked to the residential housing market's ups and downs.

When I started this column in 2007 (**scotsmanguide.com/2204**), we had already passed the high-water mark in small-balance originations and property sales. The market was highly splintered, with the top 10 national lenders accounting for a negligible 18-percent market share.

Of course, this extreme market fragmentation was a siren song for new participants who then converged on the field of play. On one hand, residential lenders entered the small-balance-commercial fray, seeking to mitigate declining loan volume in the slowing housing market. On the other, commercial conduits sought respite from heavy competition and piddling spreads.

Commercial and Residential Price Trends



Sources: Boxwood Means Inc., National Association of Realtors, Real Capital Analytics

It was the beginning of the end of the real estate cycle.

As a result, the "golden era" for small-balance lending didn't last long. Most of the new national players folded, deconstructing their origination platforms almost as quickly as they rolled them out. Others felt a squeeze as bank capital became increasingly scarce or as credit lines withered. Meanwhile, the securitization market for small-balance loans — which had shown great promise as an exit strategy — stalled long before the "jury" could return a verdict on its merits.

Moving forward, the structural changes that are under way today — including those in the residential markets — will have a profound impact on the market's shape and profitability.

As the nearby graph shows, small-cap-property prices correlate more closely with the residential market than they do with prices of larger commercial properties. Just as the small-balance and residential markets declined in tandem in mid-2006, the small-balance sector should turn back up as the residential market strengthens.

For those of you who may have found your focus or faith tested in the past year, don't lose sight of the important contributions that small-balance lenders and brokers make in building the country's local communities. These companies and professionals finance the needs of small-business real estate owners and local investors.

With this being the final installment of Inside Small-Balance, I'd like to close by saying that it's been a pleasure working with *Scotsman Guide* staff in bringing this column to you each month.

Randy Fuchs is a principal and co-founder of real estate research and consulting firm Boxwood Means Inc. This is his final installment of Inside Small-Balance for *Scotsman Guide* (archives: scotsmanguide.com/isbalance). Boxwood Means is renewing its commitment to the space with the imminent launch of SmallBalance.com. The new Web site is dedicated to promoting greater transparency for small-balance transactions with new data and analytics for lenders and brokers. E-mail randy.fuchs@boxwoodmeans.com.

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