

# inside small-balance

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

## 2007: Not as bad as you'd think

Even as the direction for mortgage originations continues southward, and as a recession scenario looms, our latest research indicates that the market for small-balance commercial loans largely sidestepped the capital-markets debacle.

According to our preliminary statistics, originations of loans less than \$5 million totaled \$29.1 billion in the fourth quarter of 2007, contributing to a total of \$133.8 billion for the year. We anticipate that the final tally will increase modestly above this total and land near the \$140 billion mark recorded in 2006.

Why did the market stay buoyant? The primary reason is that the securitization market — nearly paralyzed since this past summer — has played a minor role in the small-balance market's evolution. Most lenders continue to originate and hold small-balance loans in their portfolios or occasionally create liquidity via portfolio sales.

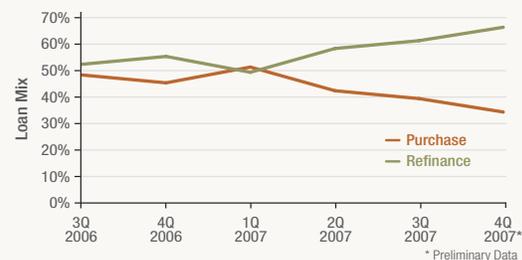
Another factor in the market's resilience has been the vibrant refinance segment. The number of refinance loans was up 0.5 percent from third quarter 2007 and down 4.1 percent from the boom of fourth quarter 2006.

Conversely, acquisition mortgages plummeted 18.8 percent between October and December 2007 and fell 40.3 percent compared to the same period in 2006, as



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## Small-Balance Originations: Purchases Vs. Refinances



Source: Boxwood Means Inc.

mounting uncertainties in the real estate market created a less hospitable climate for property investments.

As the graph notes below, however, refinance activity accounted for 66 percent of total originations in fourth quarter 2007, compared to only 55 percent in fourth quarter 2006.

But major questions linger about the small-balance market's endurance for the rest of this year. One rests with small businesses — a major factor in this market because of their heavy representation in loans for owner-occupied and single-tenant properties. They've felt the effects of the nation's economic slowdown. In fact, small-business confidence is extremely low: National Federation of Independent Business' February *Small-Business Economic Trends Report* ([www.nfib.com/page/sbet](http://www.nfib.com/page/sbet)) reported the lowest small-business-optimism level since January 1991, as inventories contracted and capital-spending plans ratcheted downward. Optimism did show growth in March's report, however.

Another question mark is whether the relatively strong refinance market still has legs. Anecdotal reports indicate that a big portion of the refinance volume is for cash-outs. Signs as to whether this activity is subsidizing business growth and investment — a good thing — or merely financing consumption needs — which could indicate possible future problems — should show in the months ahead.