

inside small-balance

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

Just what is a 'small' loan these days?

There is consensus that the small-balance commercial lending market is large, with approximately \$130 billion in volume tracked in 2006. But it's a little more difficult to find agreement on what exactly constitutes a "small" loan.

Many define the small-balance market as commercial and multifamily loans of less than \$5 million. Some lenders lower the bar to loans less than \$3 million, while others actually raise it to \$10 million.

The small-balance market is composed of a diverse population of loans supported by a heterogeneous mix of collateral types. The velocity of recent originations differs by loan size, too. That is, production of sub-\$5 million loans is not uniform across the board.

Although small-balance originations for the first three quarters of 2006 were nearly matched those in the same period in '05 — about \$100 billion — loan volume varied widely among different loan brackets.

Of note:

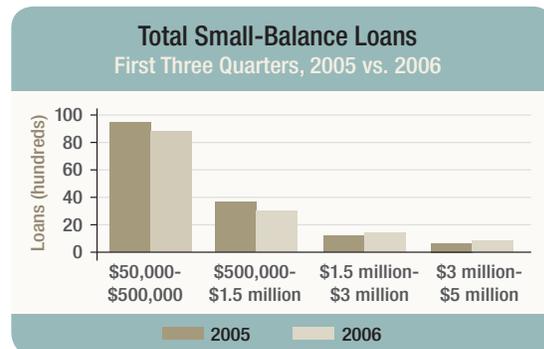
- **Loan volume increased in the two largest loan ranges.** Volume was up 7 percent for loans of \$1.5 million to \$3 million and increased 10 percent for loans between \$3 million and \$5 million.
- **Originations of smaller loans declined** — by 12 percent for loans less than \$500,000 and by 3 percent for loans of \$500,000 to \$1.5 million



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- **The sweet spot continues to be the \$500,000-to-\$1.5 million range**, which accounted for one-third of total originations through the third quarter of 2006.

This bifurcation is important. First, it underscores the fact that the definition of "small loans" means different things to different people. It also suggests that this sector's potential varies by loan size over time and in different real estate and economic conditions.



The larger loans appear to track the still-strong trend of conduit-type loans in the institutional or commercial mortgage-backed securities market. Conversely, smaller loan volume is contracting and is more closely tracing the descent in the residential mortgage sector. This suggests that smaller single investors, "mom and pops" and owner-users are pulling in the reigns on commercial investments, to a degree, in reaction to home-value and interest-rate fluctuations.

This market structure and recent origination trends have important implications for lenders and brokers. Small-balance originators should be mindful of their loan-product mix to sidestep a downdraft in originations in the smaller loan ranges. In addition, lenders should monitor regional variations in small-balance loan volume, which likely will be more volatile in the months ahead.