inside small-balance

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

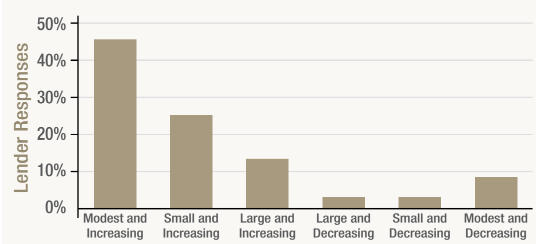
Survey shows shifts

This past March and April, Boxwood Means and Scotsman Guide polled small-balance commercial lenders to gauge market changes since 2006. There were some interesting conclusions from the survey results that could indicate a changing landscape. These include:

- **Some lenders are up, some are down:** Small-balance-origination volume has been healthy, as 63 percent of lenders reported that they were "significantly" or "slightly" ahead of the previous year's pace (see table). A quarter of the lenders, however, indicated that current originations were trailing the previous year's output to some degree. This number increased from the Boxwood Means/Scotsman Guide 2006 Small-Balance Commercial Mortgage Brokers Survey. It also correlates with data reported in my May 2007 Inside Small-Balance column, which suggested that originations of loans of less than $1.5 million may have peaked in the current cycle.

- **Residential-broker relationships thrive:** Commercial lenders have been tapping into the reservoir of residential brokers whose mortgage production has been clipped by the housing sector's downturn. Eighty-five percent of survey respondents said broker contributions were increasing in some fashion. Ramifications of this sourcing trend likely are significant. For instance, these brokers likely will tilt documentation standards toward more residential- or debt-to-income-style approaches.

Residential Brokers' Role in Small-Balance Originations



Source: Boxwood Means/*Scotsman Guide* spring 2007 survey

This assumes, of course, that residential brokers don't exit commercial lending when the housing market bounces back.

- **Conventional commercial underwriting persists:** Cash-flow-driven underwriting still is predominant. Responding lenders indicated that on average, nearly 70 percent of their loans garnered full documentation on the property, while 20 percent received light documentation and 12 percent received no documentation. Moreover, 47 percent of the lenders claimed full documentation on all of their loans, up slightly from the 2006 survey results. And full documentation on the borrower increased modestly as well, from 53 percent to 55 percent of all loans. Increased credit concerns that surfaced in the commercial arena this past spring could have affected these results.

- **Credit opinions are turning negative:** Given the fallout in nonprime lending, lenders were asked if they felt residential loan problems would impact credit availability in the small-balance commercial space. Fifty-six percent of lenders responded that the nonprime situation would have a "significantly negative" or "slightly negative" effect on credit. This survey, however, preceded the changing perception of credit risk that has since emerged in the secondary market.

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