inside small-balance

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

First-quarter originations tumble

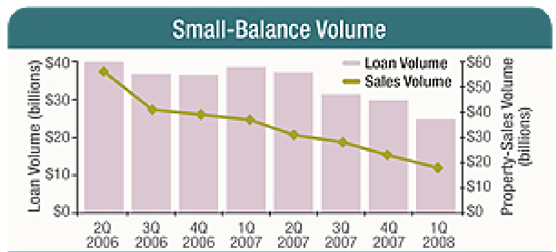
What a difference a year makes.

In 2007, small-balance originations were self-sustaining and relatively untarnished by the emerging capital-markets turmoil. This year's teetering economy and uncertain real estate market, however, have now tripped up the market for loans of $5 million and less.

Originations in the first quarter of this year slowed considerably: Small-balance volume totaled $24.8 billion, a 16.8-percent decline from the previous quarter and a 27.6-percent drop since the first quarter of 2007. This first-quarter output is the smallest sum since Boxwood Means Inc. began reporting small-balance originations in 2006.

The erosion in small-cap-property sales is a major factor in the slowdown. Property acquisitions have plummeted, either because of 1031 exchanges; single- and multitenant deals; or transactions related to small-business owners. After all, with the reverse in small-cap sales prices, buyers are wary of how far property valuations will fall before hitting bottom. Consequently, purchase loans for the first quarter totaled only $7.9 billion, a far cry from the $19.6 billion produced in the first quarter of '07.

Meanwhile, refinance loans, which represent a cash-out opportunity for many borrowers in lieu of a property sale in troubled times, continue to pull their weight. At



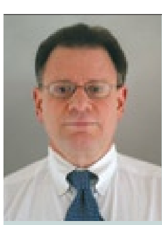
Source: Boxwood Means Inc.

$17 billion, refinances saw only a 9.7-percent decline from first quarter '07 to '08. These loans now represent 68 percent of all originations, up 13 percentage points from the first quarter of '07.

In addition to property-sale declines, small-balance volume also has felt the impact of the supply-side factor. In the past year, direct capital sources have become scarce. Many lenders have either cut back severely on the types of loans they make or have stopped lending entirely.

The departure of some major lenders has created a vacuum of opportunity for other well-capitalized lenders. The small-balance marketplace, like other asset-based lending arenas, allows new investors to fill the funding gap left by lenders with balance-sheet problems. In addition to traditional participants such as insurance firms, nontraditional players like credit unions, private lenders and hedge funds are answering the call for small-balance funding.

It's likely that a year from now, the competitive landscape for small-balance loans will look different and be even more fragmented.


Randy Fuchs, a principal and co-founder of real estate research and consulting firm Boxwood Means Inc., writes a monthly column on small-balance commercial loans for *Scotsman Guide*. Boxwood provides lenders with strategic mortgage reports, direct-mail lists, portfolio analytics and other services based on its proprietary database of small-balance transactions. E-mail randy.fuchs@boxwoodmeans.com.

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