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inside small-balance

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

The concentration game

Fragmentation in the small-balance commercial loan market means different things to participants in the space.

For some lenders, diversity in market-share represents a major tactical challenge in deal-sourcing and aggregation. For others, fragmentation means that low entry barriers exist and opportunities abound.

For brokers, information on market structure and competition can help when developing strategies to excel in loans of less than $5 million.

Nationally, fragmentation was prevalent during the first quarter of the year. According to market research, the top small-balance lender commanded merely a 4-percent share of total small-balance commercial loan production, and the top three lenders combined accounted for only 8 percent of these originations. The leading 10 lenders grabbed just 16 percent of total volume.

Think about that: Based on $130 billion in annual originations, the top 10 small-balance lenders control roughly $21 billion; the remaining $110 billion is split among thousands of other players. This attenuated market structure is a primary reason I've called the small-balance space the last frontier in commercial mortgage originations.

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On the other hand, lender concentration reaches larger levels in regional markets. Among the top 50 U.S. metropolitan statistical areas (MSAs) in the first quarter, for instance, the top lender averaged 16 percent in local production. The top three lenders per area averaged a total of 30-percent control of local-market volume. The top 10 reached an enviable 55 percent.

Largest Market Concentration for Top 10 Lenders

Metropolitan Statistical Area	Percent
Richmond, Va.	82%
Sacramento, Calif.	79%
Honolulu	77%
Raleigh-Durham, N.C.	77%
Minneapolis	76%
Norfolk, Va.	75%
Indianapolis	74%
Salt Lake City	71%

Source: Boxwood Means Inc.

The variation in lender concentration in these markets can be significant. For example, as shown in the table above, the top 10 lenders accounted for 70 percent of small-balance production in eight MSAs.

MSAs that exhibit high levels of concentration tend to require substantial marketing efforts to capture reasonable market share. So it makes sense that lenders might find less-competitive markets to be most productive.

On the other hand, that also could make the more-concentrated markets — which are likely to be profitable for the dominant players — equally attractive to new entrants. Top lenders there could accrue potential pricing advantages in the form of larger fees and rates.

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