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inside small-balance

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

Stability reigns

Wall Street attracted most of the attention this past summer when the liquidity squeeze and increasing volatility forced many investors to the sidelines. Meanwhile, Main Street — home to single investors, small-business real estate owners and "mom and pops" — kept cruising, albeit slightly slower.

Research from the second quarter of this year indicates that small-balance originations totaled $34.1 billion, 0.7 percent lower than volume in the previous quarter.

This indicates market stability, which is good news. It also points to the prevailing confidence among Main Street's small-property investors that the market for commercial loans of less than $5 million is generally healthy and sufficiently insulated from the larger commercial mortgage space — as well as from the issues in the single-family-housing market.

That said, growth in small-balance originations declined 16.6 percent for the second quarter of 2007 compared to second quarter '06. Property sales are largely to blame, as small-cap buyers and sellers wrestled with changing asset valuations and rising cap rates. Lenders also imposed more-stringent underwriting standards for acquisitions. As a result, sales volume for small-balance commercial and multifamily properties declined 16.1 percent between the first and second quarters of '07 to $30.8 billion.

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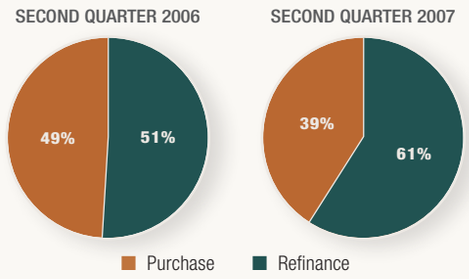
Purchase Volume Vs. Refinance Volume



Source: Boxwood Means Inc.

Further, property-trade volume shrunk 36.5 percent between second quarter '06 and '07. Small-cap buyers have been re-evaluating investment opportunities in light of changing credit requirements.

Lest we forget, however, that property investments reached record heights in the middle of 2006. Some moderation in capital flows can be expected.

Meanwhile, loan refinances, at $20.7 billion in the second quarter, are holding their own. Total refinances for the same quarter in 2006 were nearly the same — $20.9 billion — and represented 51 percent of total originations. In second quarter '07, as shown in the graphs above, refinances ballooned to 61 percent as purchase-mortgage volume retreated.

Credit-tightening and higher cap rates have altered the topography of the commercial real estate world for the first time in several years. Despite these cross-currents, small-balance commercial business remains solid and a relative shelter from the recent squalls on Wall Street.

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