**18-July 2014**

**Story**

## Blackstone mulls one-off financings for small-balance commercial loan originators

Blackstone is considering financing portfolios of small-balance commercial loans, according to a source familiar with the firm's strategy, who emphasized any such investment is expected to be minimal and carried out on a one-off basis.

Clients would likely be small private lenders that access markets in which Blackstone typically doesn't play, the source said. “It would be pushing the inefficiency of the [small-balance commercial lending model] back to [the origination] shop,” the source familiar said.

The firm would consider financing portfolios of loans in the range of USD 10m to USD 20m with coupons in the L+ 700bps–800bps range.

Portfolios would ideally contain loans at 70%–80% LTV, he said. Blackstone would give the lender a 70% advance against their loan, or 50 cents on the value, the source said. The firm would likely price its loans at L+ 500bps–600bps, he said.

Such a strategy could be implemented in roughly 15 markets, he said. Those could include the gateway markets of New York and Washington, DC, in addition to what the source described as “large deals in small markets." “There would be a higher burden of proof on those deals,” he said.

Blackstone has yet to do a deal in the space. Players currently in the sector include investment banks like Credit Suisse, a mortgage broker said. A spokesman for Credit Suisse was not able to comment by press time.

### Dearth of financing?

“The market is not that deep because the strategy is a little more complicated. You’re not lending on real estate, but a note — it’s a hypothecated note. If you’re a conservative bank, then it’s not your cup of tea,” the mortgage broker said.

Pre-crisis, the wider note-on-note space was largely dominated by international banks like Lehman Brothers and Belgian bank Fortis, according to the mortgage broker. For example, Fortis provided loans to New Jersey-based hard-money lender Kennedy Funding, which lent money to real estate developers. “[Fortis] would close a loan in two weeks. Their rates were really high: around 10%–12% to their borrowers,” said the broker. Fortis was acquired by BNP Paribas in 2009. A spokesperson for BNP Paribas Fortis declined to comment.

The strategy is more effective now because interest rates are at such a low level, the mortgage broker said. “Pre-crisis, note-on-note financing was very limited and very expensive. Firms were buying notes at such a huge discount, and they were getting a pretty huge yield, but at a double-digit interest rate cost — around 15%,” he said.

Though yields associated with cross-collateralized financing on such portfolios are enticing — at an estimated risk-adjusted return of 5% — the strategy carries some risk. “When you’re doing loan on loans, you’re not in the driver’s seat, and you can’t really do anything if things go bad. That’s why you go in at a lower leverage,” the broker said. “But if there are other [better performing] properties in the portfolio, you can get your money back. That’s the benefit of cross-collateralization,” he said.

**Growing volume**

The small balance commercial loan space was hit particularly hard as the market fell, thanks to the nature of the collateral and the rate of failure of local banks. “A disproportionate amount of the small loan space under USD 10m was related to land or construction, and a disproportionate amount of that lending was by local banks, rather than major international banks,” said Spencer Levy, executive managing director at CBRE Capital Markets.

“A lot of the slack has been picked up in the bridge lending space by private, smaller institutions. The bridge space has been vibrant over the last two years, and we’ve seen pricing come in substantially over the last 18 months,” he said.

That said, Randy Fuchs, principal at Boxwood Means, which tracks US small commercial loan markets, said that regional and local banks are still contenders in the small-balance commercial lending arena. “They’re a lot more competitive now,” he said.

In 2013, Boxwood Means tracked USD 176bn in commercial and multifamily mortgages under USD 5m — the highest level since 2006.

Such small-balance commercial loan originators do not have low-cost access to capital because of the high-risk nature of the loan-on-loan sector. “Banks don’t want that stuff. They need cash flow, and it’s too risky,” the loan broker said.

**By Eleanor Duncan**

**Source: Debtwire**