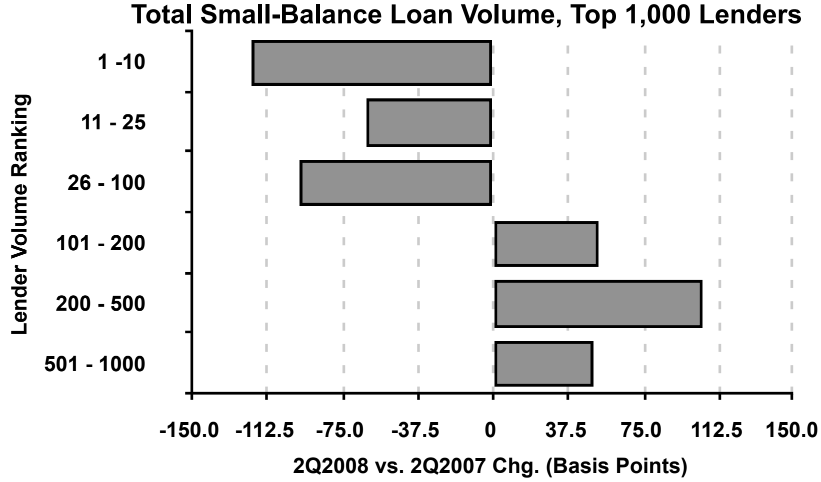
BOXWOOD MEANS, INC

Small Commercial Mortgage Market Shows Signs of Life
Payback for Modest-Sized, Small-Balance Lenders

It's no secret that the credit crisis has sharply curtailed large bank lending. But has all lending to Main Street ground to a halt? Commercial mortgage lending for small business real estate owners and small property investors is a robust $130 billion originations market that is a primary catalyst in fostering growth for America's local businesses and communities. A recent study by the real estate research and consulting firm, Boxwood Means, Inc, indicates that smaller banking institutions are indeed lending and picking up some of the slack for a number of bigger banks that remain sidelined without adequate capital. No doubt this is an irony not lost upon the smaller banks, which have persevered for years against increased competition resulting from mega-bank mergers and acquisitions.

In a study of lender market shares that compared loan volume among the top 1,000 lenders in the second quarter of 2008 versus the same period in 2007, the results demonstrate a clear shift in small-balance loan originations. As shown in *Figure 1* below, the top 10 lenders that traditionally represent the larger national banks lost 119 basis points as their collective market share dipped from 19.31% to 18.12%. Likewise, there were market share losses for lenders ranked 11-25 (-62 bps) and firms in the next tier from 26-100 (-96 bps). While these market-share declines may seem negligible, even minor percentage-point changes in this large originations market can translate into sizable loan production for lenders.

Figure 1: Lender Market Share Shifts
Total Small-Balance Loan Volume, Top 1,000 Lenders

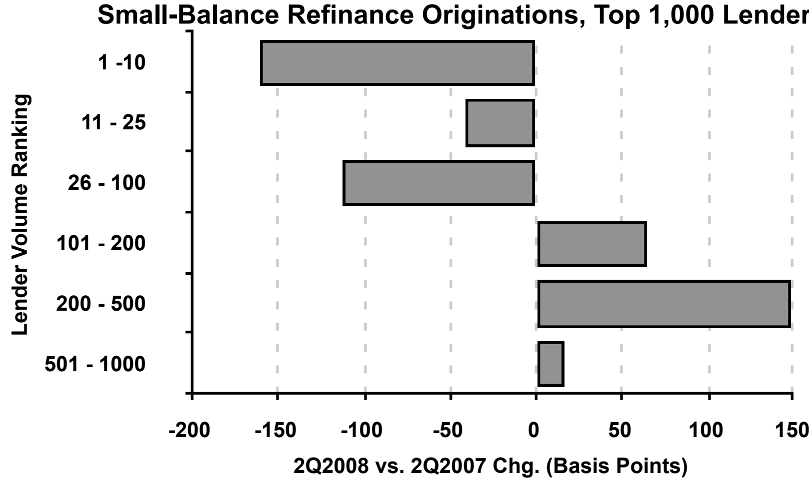


Source: Boxwood Means, Inc.

Of course, some of the top 100 firms with relatively healthy balance sheets actually gained on the competition in the quarterly comparison. Representative banks that increased market share in this segment included Wells Fargo Bank, Regions Bank, Capital One, California Bank and Trust, and Banco Popular. Nevertheless, the top 100 lenders collectively relinquished 277 basis points in market share compared with second quarter, 2007.

As shown in *Figure* 2 below, these same top lenders gave up even more of the refinance loan market, yielding 311 basis points. The top 10 lenders dropped 159 basis points, down to 18.75% of total refinance originations. The next two tiers of top lenders suffered less market share compression.

Table 2: Lender Market Share Shifts
Small-Balance Refinance Originations, Top 1,000 Lenders



Source: Boxwood Means, Inc.

While top lenders were generally originating fewer loans, modest-sized lenders picked up the pace. Lenders ranked between 101 and 1,000 in overall loan volume added 208 basis points in total originations market share as well as 230 basis points in refinance volume.

In particular, these refinance trends are notable since 75% of the $37 billion in total small-balance originations during second quarter 2008 were refinance loans. This high percentage, which during normal market conditions will approximate 50% of new loans with the balance making up purchase loans for property acquisitions, is itself a sign of challenging times on Main Street. However, the market share gains produced by this lender segment composed of mid-sized to small local and regional banks clearly demonstrate that they are out-performing and capturing local business despite the challenging credit environment. Winners in the latest period included geographically diverse institutions such as Pinnacle National Bank (Nashville, TN), Valley National Bank (Wayne, NJ) and Lone Star National Bank (Pharr, TX) among others. Moreover, these shifts in refinance market share underscore a potentially dramatic redirection in future customer relationships, away from some larger banks to smaller and local institutions.

Importantly, this study period ended in June of this year, prior to the escalation of bank liquidity problems and the shutdown of some big lenders. Consequently, we anticipate that these share shifts from larger to smaller lending institutions – and increased market fragmentation – will have accelerated though the second half of 2008 and into 2009.

End Note: This originations trend in favor of smaller banks has current public policy implications as the federal government attempts to simultaneously jump start the credit markets and furnish longer-term solutions. In Congressional testimony in October, Alan Greenspan, former Chairman of the Federal Reserve, admitted to having put “too much faith in the self-correcting power of free markets.” Well, maybe. Now, we risk making the opposite mistake by placing too little trust in markets. In the final analysis, our research on modest-sized bank lending demonstrates that self-correcting, market mechanisms are indeed working. Granted, the scale of this grass-roots effort may be insufficient and the timing too slow for a national economy tilting towards deep recession. But government’s promotion of a level-playing field in the credit markets best serves the interests of all constituents in the long run, not the least of which are the small lenders and their borrowers.

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Boxwood Means, Inc. (http://www.boxwoodmeans.com) is a Stamford, CT-based research firm that furnishes data, forecasting, risk monitoring and other analytical services across commercial and residential real estate sectors for clients in the U.S. and Canada. Harnessing comprehensive real estate transaction and listings data, Boxwood provides independent analyst insight in multiple domains including the small-balance commercial loan origination market, the small commercial property markets and residential AVM validations.