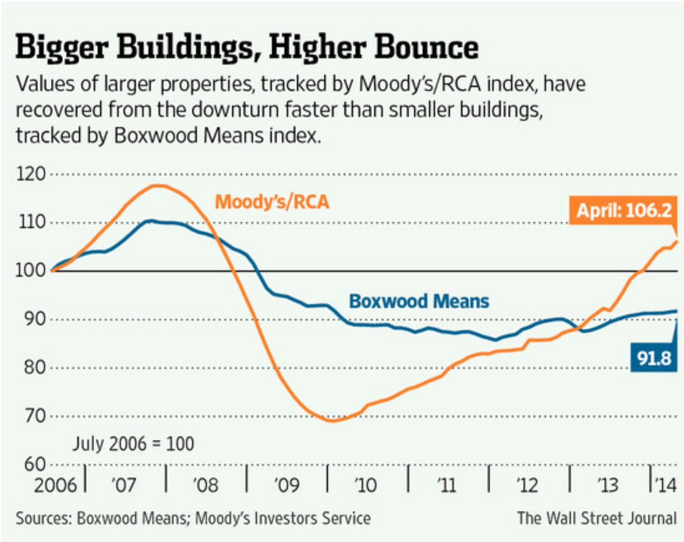
THE WALL STREET JOURNAL.

New Lenders Enter Property Market and Think Small



By
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Updated July 22, 2014 5:10 p.m. ET

A new group of lenders has begun to target properties valued at $10 million and less, and that is good news for mom and pop landlords and small-business owners.

Lenders, including ones controlled by asset managers Waterfall Asset Management, Guggenheim Partners LLC and Sabal Financial Group LLC, have launched new programs this year focusing on loans to smaller properties. Many banks and other lenders have been avoiding smaller deals since the financial crisis because they can be riskier than larger properties, and the underwriting costs are high relative to their size.

But now lenders are paying them more attention as the economy improves and loans are seen as less risky. Also, with less competition among lenders for these deals, interest rates and potential profit can be higher.

After sputtering for years, the commercial-property market for small properties is "starting to percolate," said Randy Fuchs, principal of Boxwood Means Inc., a commercial-property analytics firm.

One beneficiary of this trend is BKM Capital Partners, an Irvine, Calif.-based investment company that turned to ReadyCap Commercial LLC for a $4.6 million loan this year to buy Hayden Island Business Park, a Portland, Ore., industrial property. ReadyCap is a unit of Sutherland Asset Management Corp., a real-estate investment trust managed by Waterfall.

Brett Turner, director of acquisitions for BKM, said ReadyCap was able to offer terms that banks wouldn't, such as limiting lender recourse in case of default. Banks wanted stricter terms, including full recourse to the lender because of the property's worn condition and vacant space, Mr. Turner said.

ReadyCap expects to quintuple volume to $1.25 billion by 2016 by making real-estate loans to investors and small businesses under a U.S. Small Business Administration program, said Tom Capasse, chief executive of Sutherland. The loans are "for the small manufacturer in the Midwest or an eight-unit, multifamily owner in Encino who has been left behind," he said.

Lenders made $176 billion in loans of $5 million or less last year, a 75% rise from 2010, Boxwood said. The pace has slowed to $36 billion in the first three months of this year, but some of the newer entrants expect volume will increase as they address pockets that haven't been able to meet still-tight bank-lending guidelines.

While large deals involving trophy properties get most of the headlines, many real-estate markets depend just as much on debt financing being available for the buying, selling and refinancing of stand-alone doctor offices and restaurants, and cheaper apartment complexes. Loans on small or less expensive properties represent about 15% of the $3.2 trillion in commercial real-estate debt outstanding, according to Mr. Capasse's estimates.

Partly because debt financing has been tight, prices of small commercial properties as of April have climbed 7% from their low in January 2012, according to a Boxwood Means index. In comparison, prices for larger properties have gained more than 27% in the same period and 54% from their bottom two years earlier, according to the Moody's/RCA Core Commercial Property Price Index, which covers transactions averaging $22 million.

Before the financial crisis, most loans to smaller properties were made by commercial banks that held the loans or lenders that packaged the loans into securities that were sold to investors. Commercial banks have been ramping up lending since 2010 but have been mindful of stiffer regulations.

Lenders not overseen by bank regulators, such as ReadyCap and Guggenheim, also are returning to smaller loans. Before 2008, at least a dozen nonbank lenders funded some $26 billion of commercial real-estate debt to small properties by selling asset-backed securities, which typically contained riskier and more customized loans than traditional commercial mortgage bonds. The asset-backed market for newly originated, smaller commercial real-estate loans has been frozen since the crisis, but will likely be revived with a bond backed by ReadyCap loans in coming months, said Mr. Capasse.

Meanwhile, lenders such as Guggenheim and Wells Fargo & Co., which have focused on larger and more standardized loans for commercial mortgage-backed securities, have made a push into smaller properties. Wells Fargo, which started a program for $1 million to $10 million loans in 2011, said its volume has increased, while Guggenheim launched a similar effort this month.

Freedom Mortgage Corp., a residential lender in Mount Laurel, N.J., last year launched a lending division for commercial mortgage-bond loans up to $10 million.

In the market for larger loans, lenders are taking profits of less than 1% to win deals, down from 2% or 3% two years ago, said Chris Haynes, president of Broadacre Financial, a commercial real-estate finance adviser. Smaller loans can still produce more than 2% profit, though lenders must close more in a short period to make them worthwhile, Mr. Haynes said.

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