

## Small Business Real Estate Lending: How the Bluestone Model is Unlocking Opportunities for Growth

As the markets remain uncertain and traditional lenders retreat from smaller balance loans, the role of real estate lending in supporting the growth and success of small businesses is crucial. Small businesses have emerged from the COVID-19 pandemic needing more brick-and-mortar locations as customers are returning to stores and workers return to the office. The unique challenges faced by small businesses in acquiring and financing real estate are often not addressed by banks, forcing alternative lenders to fill the void. Lenders like Bluestone provide a pathway to growth by extending real estate credit to small business owners, creating opportunity for underserved borrowers like women and minority-owned businesses. By understanding how small business real estate lending helps to drive the growth of the economy, lenders and small business owners can collaborate to foster economic development, create jobs, and drive innovation.

**The Importance of Real Estate for Small Businesses.** Real estate is a vital asset for small businesses, enabling them to establish a physical presence, expand operations, and build long-term value. Small businesses benefit from owning real estate through stability, potential appreciation, and the ability to leverage their assets to secure financing. It not only serves as a space to operate the owner's business, but it can also serve as their most valuable asset. However, despite the popularity of owner occupied commercial real estate, acquiring and financing real estate can be a complex and daunting process for small businesses due to limited financial resources, lack of collateral, and stringent lending requirements. The existing model of real estate lending was created for large corporate owners of office buildings, apartment complexes and shopping centers. Billions of dollars of capital flow into this model and massive secondary markets cater to its borrowers and lenders. Due to their size, small business owners can't access this market. Banks would prefer to originate a \$5,000,000 loan instead of a \$500,000 loan. Seeing this gap in the market, alternative lenders like Bluestone have chosen to focus exclusively on small balance loans.

**Challenges in Small Business Real Estate Lending.** Small businesses encounter various challenges when seeking real estate financing. These include lack of financial history, insufficient collateral, high interest rates, and tightened credit policies. Furthermore, lenders struggle with the "informational opacity" of small business borrowers. Because small businesses are often younger businesses that lack the resources and personnel of larger firms, it becomes difficult to supply traditional banks with adequate information required to originate a loan. Borrowers seeking small balance loans may not have the legal, accounting, and sales staff to assist in obtaining financing. This will often place the burden of submitting a loan package on the business owner, who also has the responsibility of running the day-to-day business. The concentrated duties of small business owners impede their ability to effectively deal with lenders, sometimes preventing them from requesting financing altogether.

Certain groups, like women and minority-owned businesses, are more severely impacted by these obstacles. Data from the most recent U.S. Small Business Administration's 7(a) and

594 Summary Report shows that only 28.40% of approved small business loan dollars went to female-owned businesses. Furthermore, roughly 30% of approved small business loan dollars went to black, Hispanic, Asian American or American Indian Borrowers.

**Small Balance Lenders in Decline.** A driving obstacle small business owners face when seeking real estate financing is the lack of lenders. According to data from the Federal Reserve, 31 financial institutions control more than 60% of the total money held in US Banks. This market concentration in larger banks is the result of a steady decline in community banks, defined as those with less than \$10 billion in assets. Community banks serve specific communities, including small businesses that provide the goods and services within those communities. *While larger banks have grown by nearly 50% over the last two decades, the number of community banks has declined by nearly half over the same period.* These community banks were historically the primary source of financing for small business owners seeking credit. Due in part to bank acquisitions and increased regulations, small business owners lack the financing options and have difficulty accessing much needed credit for expansion, working capital, acquisitions, partnership buyouts, etc.

**Enter the Private Small Balance Real Estate Lender.** While traditional small balance lending options have continued to shrink over the past 20 years, private and more specialized lenders like Bluestone have emerged as a viable alternative. More flexibility, faster turnaround times, certainty of execution and common-sense underwriting have allowed private real estate lenders to help underserved small businesses acquire additional real estate or unlock the equity in existing holdings. By focusing on collateral evaluation, loan-to-value ratios, borrower operations and understanding the local real estate market, private lenders have shown the ability to employ prudent lending practices while quickly deploying capital to small business owners. Borrowers benefit by communicating directly with decision makers who demonstrate transparent underwriting

policies, thereby avoiding prolonged closings caused by infrequent loan committee meetings. At the same time, lenders are mitigating risk by using a more hands-on approach with borrowers and securing loans by hard assets that are used by the business. Because both borrower and lender benefit from the relationship, it's no surprise private real estate credit has grown dramatically over the past 15 years.

Bluestone's role as a non-bank community lender is to ensure small business borrowers retain access to funding despite the decline of traditional credit sources. Our balance sheet capital and in-house servicing arm provide a reliable and convenient framework that has efficiently originated loans to the businesses that need it most. And by focusing exclusively on loans backed by real estate, Bluestone has effectively mitigated risk by avoiding losses and keeping defaults to a minimum.

**What's Next?** While the political environment surrounding financial regulation is uncertain, we envision continued tightening of credit policies by banks and a reluctance to lend to underserved business owners. Small balance private real estate lenders are well-positioned to originate loans to borrowers that otherwise lack access to capital. In order to foster economic growth, all small businesses must be able to access appropriate credit. A collaboration between lenders, small business owners, and government agencies is essential to afford equal lending opportunity to all borrowers and make real estate financing accessible and efficient for small businesses. This can be accomplished through streamlined loan applications, transparent pricing and fair lending practices. Small business real estate lending holds significant potential for driving growth and empowering entrepreneurs. By understanding the challenges, benefits, and risk mitigation strategies associated with this type of lending, lenders can provide better support to small businesses, unlock new opportunities for success and contribute to the overall economic well-being of local communities.