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The Rise of Debt Funds

The number of debt funds and non-traditional lending sources has grown throughout this cycle. Is that a reflection of temporary market forces or have they become a permanently larger part of the commercial mortgage landscape?

Debt funds originated about $67 billion in mortgages in 2018, up from $52 billion in 2017 and $32 billion in 2016, according to Jamie Woodwell, vice president of Commercial-Multifamily Research at the Mortgage Bankers Association. The MBA estimates that debt funds originated roughly 10 percent of all commercial mortgages in 2018.

Debt funds have been around for a long time. In the cycle leading up to the global financial crisis, vehicles that financed highly leveraged tranches of mezzanine debt proliferated, though many were wiped out by the downturn. In recent years, debt funds have filled a void left by commercial banks in the construction and transitional loan space. Reforms passed in the wake of the banking crisis required banks to put up more capital for construction and redevelopment loans, making those products less profitable. Not every bank has cut back, but large banks in particular are facing increased scrutiny from regulators on the amount of commercial mortgage holdings on their books.