

CAPITAL PARTNERS

Expanding Horizons in U.S. Nonbank Lending

Charting the Nonbank Lending Landscape

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The U.S. has the most dynamic financial system and capital markets in the developed world. Borrowers and lenders can access and extend credit through plentiful bank and capital market channels. The Global Financial Crisis (GFC) and its legislative repercussions curtailed banks' risk-taking activities. Nonbank lenders (NBL) stepped into the vacuum, growing and evolving to maintain the credit creation vital to consumer and economic health. Yet as its economic importance grows, much of the NBL sector remains poorly understood and sparsely invested, offering investors attractive compensation amidst some unfamiliar risks.

In a series of whitepapers, Partner Neil Hohmann dives into the NBL sector and its opportunities. In a previous article, we reviewed the vast landscape of U.S. lending and how the complex sector of NBL fits into it. Now, we look at the history and dynamics behind the NBL landscape in order to explain the rise and evolution of this \$17 trillion sector over the past two decades.

Why is the NBL landscape so varied?

The primary catalyst for the varied NBL landscape is the federal government, through legislation and regulation. Implied government support for the government-sponsored enterprises (GSEs) and consequent low financing costs explain the dominance of the agency mortgage-backed securitization trusts (agency mortgage-backed securities [MBS]) in single-family and multifamily residential mortgages. Real estate investment trusts (REIT) and business development companies (BDC) legislation also encouraged the

growth of tax-efficient public vehicles for mortgage and commercial loans, respectively – you now find the bulk of nonagency multifamily mortgages in levered REIT vehicles and more than half of direct loans in BDCs.

Dodd-Frank legislation, interagency guidance on leveraged lending, required capital boosts, and liquidity requirements have all shifted banks away from lending to leveraged and smaller companies and below-super-prime borrowers. Hence the prominence and growth of independent finance companies, and their

related BDC, collateralized loan obligations (CLO), and asset-backed securities (ABS) financing sources, over the last 15 years.

Another change agent is the dynamism and vast capital of the private equity (PE) and private credit ecosystem, which finances not just the borrowers marginalized by the banks but also competes directly for the larger loans and prime borrowers that banks target. The pace of business and structural development in privates is far more rapid than at the utility-like banks, suggesting privates' outsized growth and competitive pressure may continue, particularly as investors discover value in direct private opportunities.

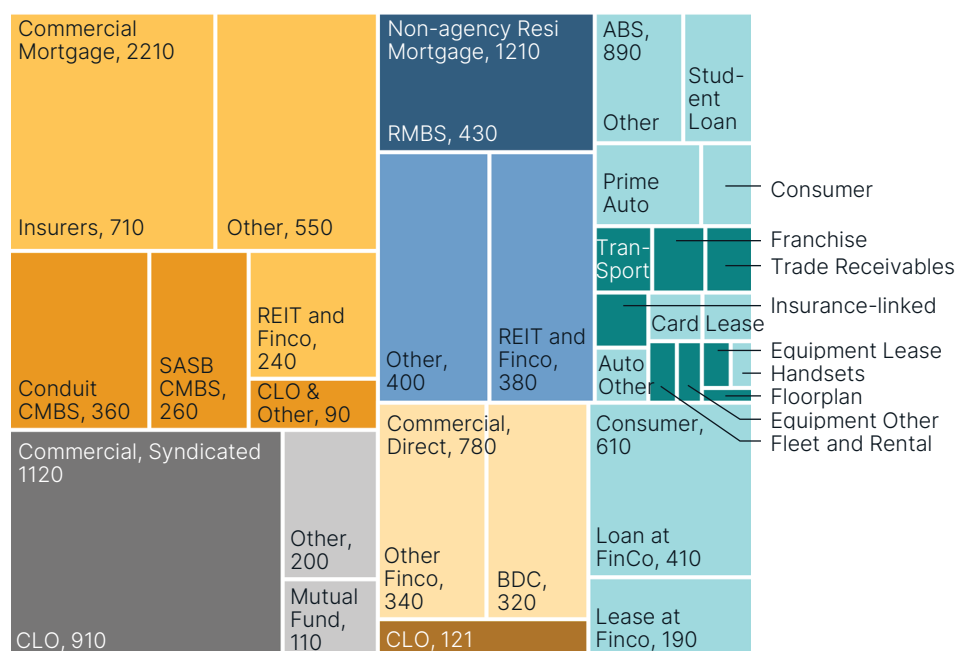
A final force is the continued evolution of securitization as both financing source and investment, along with its supporting legal framework. Like any technology, the structural safeguards and flexibility afforded by securitizations have evolved and improved through successive market tests like the GFC and the COVID-19 pandemic. The bankruptcy-remoteness of securitization trusts continues to be definitively affirmed by U.S. courts. Application of ABS, commercial mortgage-backed securities (CMBS), CLOs, and other securitizations should continue to outpace broader lending market growth.

The evolution of the nonbank ecosystem

It's useful to chart not just the current landscape of NBL but also its evolution over the last 20 years. Oddly, annual growth in the "dynamic" nonbank sector (2% annual) has trailed bank lending (3%) since the GFC. Hence, each sector is about the same size as it was at the end of 2008, adjusting for inflation.

The stall in bank lending growth is understandable. Since the early 1990s, consolidation has magnified

Exhibit 1: U.S. private lending by holder (\$ billion) – total \$7 trillion



Source: Federal Reserve, SIFMA, J.P. Morgan
Data as of December 31, 2023

* Excludes government, U.S. depository, GSE, and broker/dealer lending.

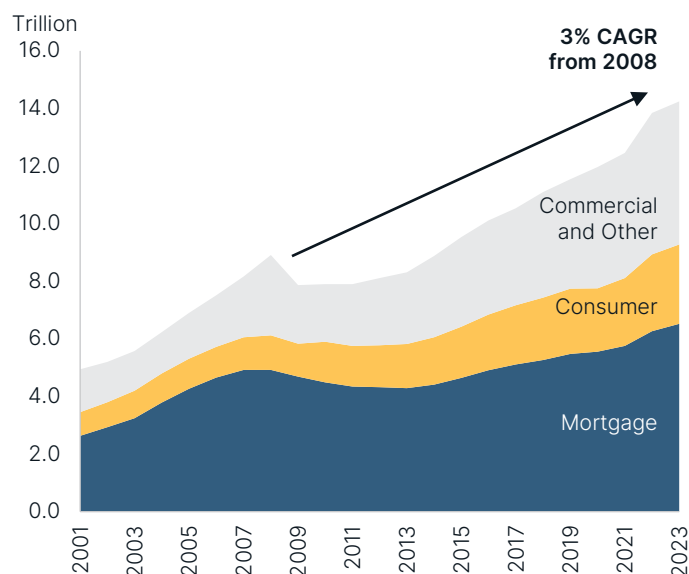
average bank size. A greater share of a typical bank's business is focused today on large commercial customers and higher quality consumer borrowers than in the past. Post-GFC regulation forced banks to de-lever, exit their higher leverage loans, and hold more liquid securities at the expense of loans. Large systemically important banks are capped in size, while the deposit stability advantage of regional and smaller banks has recently come into question.

The slower growth of NBL since the GFC is more surprising. It's a compositional effect from the burst of the early 2000s bubble in nonagency mortgage lending, which had reached \$3 trillion in size by 2008. As housing prices declined, mortgage performance deteriorated, new origination shut down, and the sector cratered to its \$1 trillion size today.

Remove residential mortgages and one finds that the other segments of NBL have grown like or faster than bank loans. NBL growth has hastened particularly in the last five years: agency pools by 6% annually, nonagency commercial mortgages by 6%, syndicated commercial lending by 7%, direct commercial lending

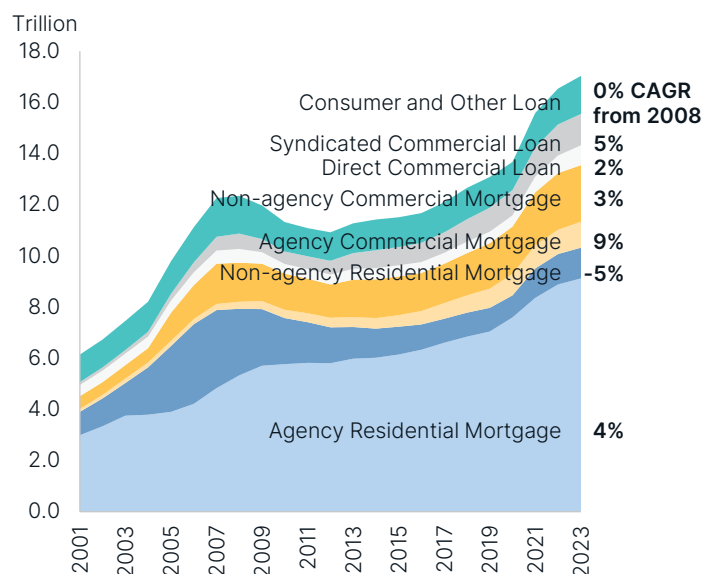
Exhibit 2: Growth of U.S. bank and agency lending, 2001-2024

(a) Bank Lending (U.S. Depositories)



Source: Federal Reserve

(b) Nonbank Lending



Source: Federal Reserve, SIFMA, J.P. Morgan, BBH Research

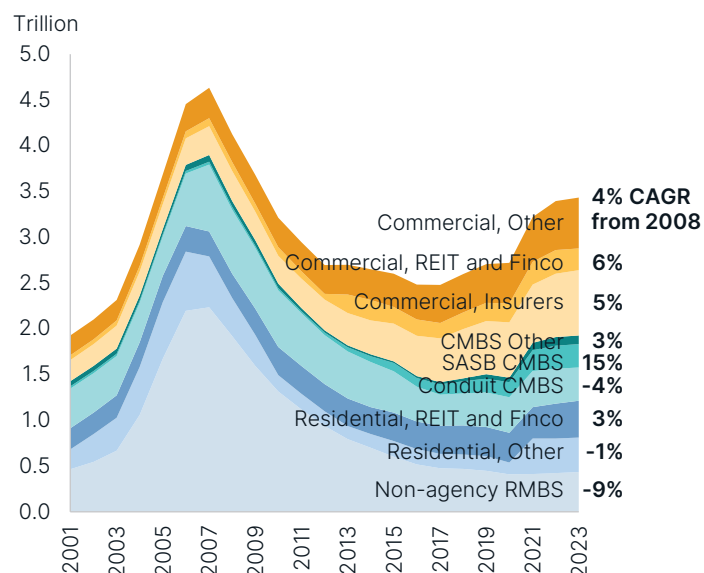
by 11%, and by 10% or more in many specialized lending segments commonly financed with ABS (e.g., consumer installment, auto and equipment lease, franchise, data centers and fiber, venture and recurring revenue debt, rental and fleet, and other specialized segments).

NBLs have stepped in where banks have retreated, particularly in middle-market commercial lending, personal lending to below-super-prime borrowers, and specialized lending. New required disclosures have shrunk the number of U.S. exchange-listed companies. In reaction, new lending models are being pioneered by private lenders to be more flexible in underwriting. PE and credit providers are filling the gap left by the banks and exchanges.

Charting the evolution of NBL over the last two decades offers additional insight. Exhibit 2(a) underscores the flat growth of bank lending, with a meagre nominal CAGR of just 3% since the GFC. In contrast, as seen in Exhibit 2(b), much of the NBL sector has grown at swifter annualized rates. These very broad NBL categories conceal even more dynamic growth in certain segments of the NBL market, which we explore below.

Nonagency residential mortgage lending is a shadow

Exhibit 3: Growth and subsequent decline of nonagency mortgage lending, 2001-2024



Source: Federal Reserve, SIFMA, J.P. Morgan, BBH Research

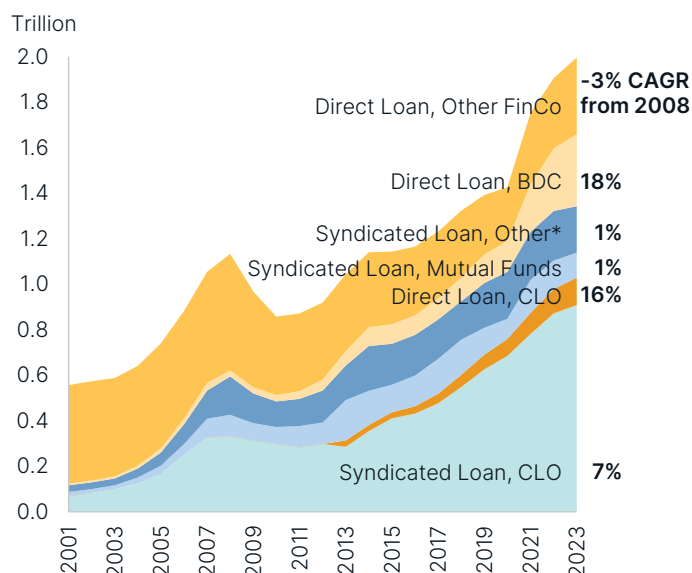
of its former size (see blue in Exhibit 3), but some new supply has been available in less-traditional investments, such as agency risk transfer, single family rental

debt, and nonqualifying mortgages. Swifter growth is evident in nontraditional commercial mortgage investments, such as single-asset, single-borrower (SASB) CMBS and commercial mortgage REITs issuing commercial real estate (CRE) CLOs.

In commercial lending (see Exhibit 4), the swift 11% growth of direct commercial lending over the last five years has been financed primarily through BDCs – which have grown at a remarkable 25% rate – as well as through middle-market CLOs (MM CLOs), with 18% growth. Funds and finance companies have basically been static over that period. Syndicated loan market growth has also been swift and absorbed almost entirely in CLOs, as mutual fund holdings have declined.

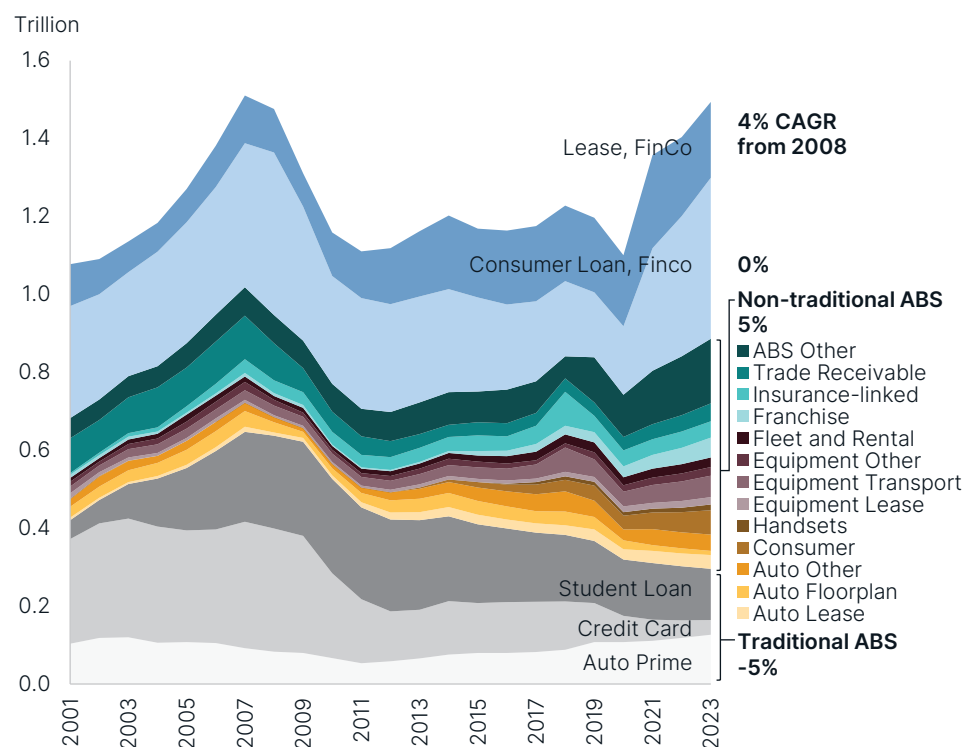
Moderate overall growth in U.S. consumer and other lending (see Exhibit 5) masks the rapid rise of more specialized lending segments against the decline of traditional lending channels. Bank accounting rule changes have effectively eliminated the large credit card ABS market. Direct federal lending to students has

Exhibit 4: Growth of nonbank commercial lending, 2001-2024



Source: Federal Reserve, SIFMA, J.P. Morgan, BBH Research
* Holdings of nonprofits, brokers and dealers, insurers, and others, excludes offshore institutions.

Exhibit 5: Growth of nonbank consumer and other lending, 2001-2024



Source: Federal Reserve, SIFMA, J.P. Morgan, BBH Research

similarly diminished student loan ABS. Growth has been dynamic in the rest: ABS segments catering to nontraditional asset types including triple net lease, transportation, data centers and fiber, auto and equipment lease, smartphone handset financing, venture and recurring revenue debt, fund financing, and many others.

The balance sheet growth of these same specialized lenders outpaced the moderate overall growth and supported further ABS financings.

Conclusion

Over the past two decades, NBLs have rapidly expanded to fill gaps left by traditional

banks, especially in specialized and middle-market lending. Driven by regulatory shifts, private capital, and evolving securitization structures, NBLs now play a vital role in credit creation across diverse sectors. Their continued growth underscores both the resilience and complexity of the U.S. financial ecosystem.

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