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Community Banks Adjust Playbook as Big Lenders Exit Commercial Real Estate

July 16, 2025

— Categories: Real Estate



Community banks and credit unions are quietly but decisively stepping up in commercial real estate (CRE) lending as larger financial institutions pull back, reshaping the market when stability is needed most. Amid rising refinancing risks, volatile interest rates, and stricter regulatory conditions, these smaller lenders are recalibrating their approach to CRE financing, showing both caution and adaptability.

A new white paper from real estate firm Colliers features a roundtable of industry voices, including Aaron Jodka, Director of Research for U.S. Capital Markets at Colliers, Executive

Director Justin Bakst, and Darling Consulting Group Managing Directors Frank Farone and Jeff Reynolds. Their discussion highlights how community-focused banks are staying in the game and adjusting strategies to manage risk while continuing to support local markets.

One of the more encouraging takeaways from the report is the ability of many community banks to renew or reprice loans without significant issues. Borrowers, even when under pressure, are engaging with lenders, often returning to discuss revised terms or short-term forbearance. This level of dialogue is being viewed as a sign of ongoing trust between lenders and borrowers and a positive indicator of financial stability in an otherwise unpredictable landscape.

Shifting Priorities

One major adjustment in strategy has to do with interest rate sensitivity. While the 10-year U.S. Treasury note and the Secured Overnight Financing Rate (SOFR) often dominate headlines, community banks pay closer attention to the five-year point on the yield curve. This reflects the common three- to five-year loan cycle where borrowers make interest-only payments before refinancing. That part of the curve has experienced more price swings, prompting smaller banks to proceed more cautiously. Many now offer rates tied to a spread over a chosen index, allowing borrowers to decide between floating or fixed rates, sometimes with brief lock-in periods, up-front fees, or swap options.

Banks also report a noticeable rise in loan modification requests, particularly for deals made in 2023 and 2024. This is a sharp shift from the low-rate lending of 2020 through 2022, when five-year Treasury yields sat around just 0.40%. Now, with higher rates and more conservative pricing, lenders are padding their risk buffers in anticipation of continued economic uncertainty and global tensions.

At the same time, improved loan margins are easing the pressure to chase volume aggressively. One institution mentioned in the Colliers report projects a 19% increase in lending margin over the next year, largely because of elevated loan yields. This gives community banks more flexibility and reduces the need to make risky concessions just to land a deal.

Still, there are complex challenges ahead. Jeff Reynolds of Darling Consulting pointed to what he called a “barbell dynamic” affecting loan performance. Loans made during the

pandemic at 4% to 5% are acting very differently from newer loans now priced at 7% to 9%. The contrast is having a big impact on prepayment activity. According to Reynolds, modified loans from 2023 and 2024 are seeing prepayment rates of nearly 30%, while those from earlier periods are closer to 5%. That kind of disparity, he warned, could catch some institutions off guard if they're not carefully modeling for it.

Perhaps most notably, the composition of the CRE lending market is undergoing a real shift. Community banks and credit unions now hold a much larger share of CRE loans than they did a decade ago. While large banks still carry the bulk of upcoming maturities, many are reducing their exposure. That's where smaller lenders are stepping in, ensuring the continuity of financing just as the market faces a wave of upcoming debt rollovers.

As the real estate sector braces for further changes, it may be these smaller institutions, not the financial giants, that play the most critical role in keeping deals alive and properties funded. Their flexibility, attentiveness, and local focus could prove to be the foundation that helps stabilize the CRE market in uncertain times.