KEYNOTE INTERVIEW

Early intervention

Identifying problem loans early means the potential for better resolutions, says Trimont's Amber Sefert

The first signs of distress are becoming evident in the commercial real estate market, with property owners starting to feel the impact of maturing loans at a time when interest rates are rising, lending capacity is diminished and valuations are murky.

Amber Sefert, a managing director of credit and asset management for Atlanta-based advisory and credit solutions provider Trimont, says the firm is taking those factors into consideration as it works to hammer out potential solutions to distressed situations and identify potential problems with loans as early as possible.

Still, top of mind for the firm are the near-term challenges the market is facing, particularly in the office and retail sectors. Data from the Mortgage Bankers Association projects about $728 billion of commercial loan maturities in 2023 and another $659 billion of maturities next year. There are significant concentrations of loans in both office and retail, two sectors in which lenders are reluctant to originate new loans, Sefert says.

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Despite sector-specific difficulties, there are several key distinctions between the period immediately following the global financial crisis and what is going on today, Sefert notes. Servicers have become more efficient and proficient in handling situations of distress and there is more communication between the different stakeholders around trouble loans.

Moreover, there is more liquidity available and there has been a greater investment in, and use of, technology since the GFC. "I think this will put us in a better position to manage volume," Sefert says.

As the market heads into the second half of the year, the key factor will be the US inflation rate and how the Federal Reserve is responding to it, Sefert says. While the Federal Reserve opted to keep interest rates unchanged at its June meeting, the expectation is that there will be one to two more increases in rates before year-end as the central bank seeks to meet its 2 percent inflation goal.

Q The commercial real estate market is starting to see more instances of distress. What is Trimont seeing now and what are you expecting down the line?

Since the end of last year, we have started seeing a lot of loans that need some type of modification or extension due

Q What sectors and markets are seeing the most distress?

Our portfolio reflects a lot of the headlines you are reading about in the news right now. We are seeing challenges in some of the major markets: Chicago, Houston, New York, Minneapolis, San Diego. In some markets – San Francisco being a good example – areas that thrived as a result of office and convention-use have seen a slower recovery.

We are seeing a fair amount of distress in the office sector, with some hotels, retail and multifamily distress scattered in. Going forward, office is poised to be a significant challenge, and I expect we will see some smaller amounts distress for other property types as well.

A lot of these property types are interconnected, some hotels and retail feed off busy office areas. The challenges with office will act as a domino effect for other property types. It will be interesting to see what office product falls apart and which properties survive this market restructuring.

San Francisco: hard hit by the decline in the office sector

to market or economic challenges. We have also seen our clients slow down on originating new loans and our underwriting groups are being asked to look at more preferred equity deals.

Going forward, we expect the new origination business to stay slow a while longer and we expect to see an increase in the pace of defaults.

Q How important is surveillance in identifying potential problems early on?

It is critical to understand what loans have challenges early on. It can put a servicer in a better position to ask constructive questions and start having structured conversations earlier.

Q Is there a difference in the way larger and smaller sponsors are handling distress? Are better-capitalized borrowers seeking to buy more time to handle troubled loans as interest rate changes are expected to slow over the next 12-24 months?

Within the industry, we have seen some large investors hand over or default on large debt positions secured by office and hotel assets. Some examples of this are RXR Realty's decision to hand the keys back for 61 Broadway in New York and other, older office buildings in their portfolio. Additionally, Park Hotels and Resorts in June stopped making payments on a CMBS loan that secured two of its hotels in San Francisco.

This could be seen as strategic – a way to cut early and focus on other assets within their portfolio that may not be quite as challenged or have stronger market fundamentals.

We have seen a lot of borrowers continue to support assets financially, and while I expect this to continue, at some point either type of investor will exhaust their efforts if pricing and transaction activity doesn't start to pick up momentum.

Q What are some of the key differences between the

global financial crisis and what is happening today?
The largest difference between the GFC and today is rates were going down in 2008 and are still going up today. It drives a different dynamic. Another key difference is the availability of capital. I've heard it's virtually impossible to get a large bank to finance an office building at the moment. We are seeing smaller regional banks stay active. Debt funds have slowed down but still are demonstrating some activity. I think if a borrower is working with a current lender that is willing to extend another 12 months or so, a lot of borrowers are taking the option to buy some time.

We are now in a standoff between buyers and sellers, both of which have very different ideas about where pricing should be. One question we are asking is if there will be a catalyst that moves market participants to the middle. Both buyers and sellers will have to adjust their expectations, the challenge is trying to predict where that will end up.

Ultimately, they will likely meet somewhere in the middle, but where they will meet is the question. Based on conversations we've had, a lot of borrowers don't see themselves as distressed sellers. However, the offers we hear about coming in on marketed properties sound like the buyers are looking for a distressed sale price.

If you are a borrower who has some time, you can continue to lease up vacant space, continue to white box space, and continue to add amenities. You have the opportunity to increase occupancy. The challenge is going to be once several properties in a market are sold at a loss or a discount, the cost basis for the new owner will lower, creating a competitive advantage for that owner.

"It is critical to understand what loans have challenges early on"

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Q How are you calculating valuations? And how are you working that into calculations around the highest resolution value for an asset?
We typically have appraisals and one or two broker opinions of values. With the slowing of market activity, value is a harder thing to peg. But most of the market professionals we deal with have their fingers on the pulse enough to give us good guidance. In the instance of a loan sale or property sale, you have market exposure and actual offers to place weight on.

Q What are the key metrics you're following these days and how are they affecting commercial real estate?
The key metrics I follow have remained relatively consistent. Interest rates are rising, while unemployment metrics are low. Inflation is still above the Federal Reserve's target of 2 percent and consumer spending, while cooling, remains strong. The car traffic and retail parking lots where I live, for example, are overwhelmingly strong.

I think all of these metrics add up to confusion because parts of the economy are still thriving. But I would expect these parts to slow over time, especially in a rising interest rate environment. We know that we are headed for considerable stress in some industries, and it is slowly starting to show, but not yet to the extent that we expect.

Q What role does technology play for servicers in this cycle?
At Trimont, all our systems are helping to make us more efficient and focused. We have been actively working to leverage technology to help keep turnaround times low.

Q How do you see market conditions developing?
I predict the market will stay slow through at least the end of the year. The expectation is that if the rising interest rates effectively lower inflation to the Federal Reserve's 2 percent target, everyone will get used to the adjustment and activity will – probably reluctantly in some instances – start to pick up. ■