KEYNOTE INTERVIEW

Managing risk in a volatile market

Managing risk across cycles is both about following trends and analyzing how macro and micro issues affect individual properties and markets, says Ted Wright, an executive managing director at Trimont

Recognizing and bifurcating market risk from collateral and sponsor risk at a time when there are a number of interrelated trends that include values resetting, fluctuating cap rates and unpredictable interest rates is key. As a risk manager with a track record of 35 years, Trimont has learned how to cut through the noise.

"Once we determine the baseline on a macro level, we're able to stress test each asset and identify potential risks in the future performance of the asset. At the end of the day, we're trying to determine if an asset's income stream is dependable and sustainable," Wright says.

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The firm has seen first-hand how fluctuating interest rates affect cap rates and subsequently property values over multiple commercial real estate cycles.

"However, macro market changes don't happen in a vacuum and affect individual properties differently based on local market dynamics and changing demographics. We're cutting through the noise by having a clear understanding of how each piece is interrelated – setting that new baseline, overlaying our analysis with local market dynamics and then stress testing the individual asset based on its unique characteristics," he adds.

Q The financial markets, specifically the banking sector, are showing signs of stress due to the rapid increase in interest rates. How does that impact the servicing industry?
At Trimont, our principal role is to protect our clients' assets and collateral. This includes securely collecting, depositing and moving funds. As a servicer we are not in the business of taking risks with our clients' assets, and

over many years have developed successful, integrated and secure relationships with our top-tier banking partners. At the end of the day, we're in the risk management business – assessing risk, developing strategies to minimize risk and executing those strategies on behalf of our clients.

The recent turmoil in the US banking sector is a great example. As certain institutions started to experience challenges in liquidity, we were monitoring the situation hourly and moved to protect our clients' cash collateral prior to any bank closure – again assessing risk, developing strategies and, most importantly, executing those strategies.

Q A downturn was expected prior to 2020. However, no one expected the last cycle to end the way it did. How did you prepare for the storm?

The key to preparation is the collection and analysis of data, which in our case stretches over the past 35 years, to identify market trends and potential anomalies. From this data, we're able to analyze each assets' historical performance and compare it against the market. The more robust our dataset, the more accurate we're able to project future performance, even in a rapidly changing economic environment. This in turn provides the guidance our clients need to make informed credit decisions.

Q As the special servicing rate ticks upward, what trends are playing out in real-time as the market readjusts?

As a special servicer, it's imperative to determine temporary market dislocations from permanent demographic shifts. For example, at the beginning of the pandemic, hospitality assets suffered from travel restrictions due to safety concerns. However, those restrictions were temporary, and as anticipated the majority of the hospitality industry eventually recovered.

Contrarily, the societal change in how we work and where we work is viewed by many as a permanent shift and will impact suburban office properties which changes our approach to any potential workout.

Q How do you access and navigate risks in a market where there is no playbook?

For us, risks fall into two main categories – controllable and uncontrollable. Controllable risks are those that are quantifiable where each "data point" is a puzzle piece and as these pieces are collected and analyzed, they start to paint a picture of an asset's performance.

By fully understanding an asset's strengths and weaknesses, we can develop and implement a risk management strategy. Also, by better understanding an asset and its corresponding market, we are better prepared to defend against uncontrollable risks (eg, unforeseen macroeconomic movements).

For example, the rapidly rising interest rate environment in the US had a direct impact on our clients' ability to finance or refinance assets, especially for short term, floating rate bridge loans. Again, by having comprehensive asset level data and comparing that data with an asset's corresponding market, we can formulate multiple strategies to help our clients minimize risk.

Q The value of data has become increasingly important in the CRE market. How are you incorporating that into your work?

We were the first to market with a real-time data platform, Triview. Triview provides clients with an up-to-the-minute dashboard of their portfolios' performance. Triview is accessible on any device, at any time to allow our clients the visibility they need to make more informed decisions. In these fast-moving times, speed of decision can make the difference and having the data immediately to hand is essential.

Q What are the biggest questions you're hearing right now?

Outside of the current banking crisis and associated questions around the security of cash deposits, the biggest questions we're hearing concern the impact on valuations from rapidly rising finance costs. As borrowers refinance, additional equity will be required as values erode.

This cash infusion can come in multiple forms – borrower equity, preferred equity, subordinate debt, etc. As a global platform, we understand the driving forces and unique nuances for CRE financing in the various regions.

However, unrecognized asset value erosion has become a significant issue in the market, as evidenced by the current turmoil in the banking sector. Subsequently, many clients in the Americas region are performing mark to market analysis to better understand current valuations.

Understanding these regional differences and leveraging best practices from all regions allow us to better assist our clients in managing risk around the globe.

Q How is the role of ESG playing out both for Trimont and for your clients?

As a market leader in the management of construction debt, and having been selected as the servicer on new ESG impact funds in the US in 2022, Trimont is at the forefront of sustainable lending, working with clients and investors on the appropriate identification and tracking of ESG related development data points.

Our clients are not only asking about our ESG policies at Trimont, but also seeking guidance on what to look for and require with their investments. We have been focused on both aspects of ESG for several years, as ESG has been a priority for many of our international clients for a long time. We can apply much of that experience to our Americas business. ■