KEYNOTE INTERVIEW

Better outcomes, better markets

Trimont is using traditional and new methods to help lenders and borrowers re-align their portfolios, says Christina Brodeur

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Servicing loans has been a critical component of the modern commercial real estate finance market since the end of the savings and loan crisis.

But loan servicing has evolved as the lending markets have become more sophisticated, with servicers like Atlanta-based Trimont combining traditional functions with technology to produce what it believes are better outcomes, says Christina Brodeur, senior managing director of client services for the Americas.

"As we have evolved as an industry, so too has the complexity and sophistication of both borrowers and lenders," Brodeur says.

"Once solely thought of as 'guardians of the money,' the role of servicer has expanded to surveillance, asset management and now partner and adviser."

As lenders are faced with increased regulatory oversight and requirements, as well as changing credit appetite and budgetary constraints, they are looking more and more to servicers to bridge the gap between their staffing and capabilities and the growing demands of their portfolios, Brodeur adds.

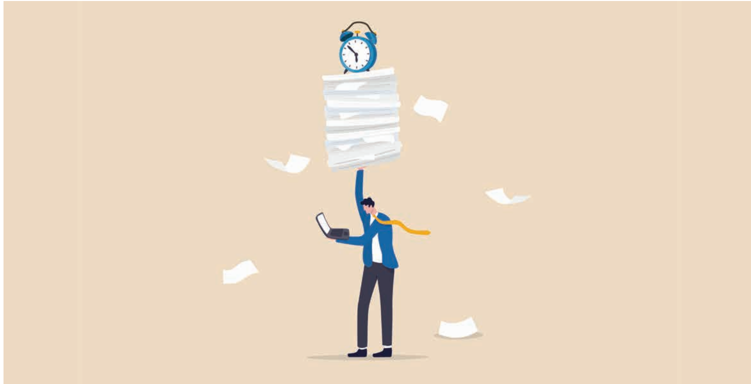
Post covid-19, Trimont has tracked an increased need for servicers and asset managers to do much more than provide accounting of funds and summary of portfolio and borrower performance, Brodeur says. "The need has grown to performing a higher level of analysis and presenting recommendations on resolutions, business plans, insurance coverages and how to restructure deals for modifications or extensions," Brodeur notes.

"More complex and sophisticated reporting is required for regulators, auditors and investors as a result of more complex and novel deal and/or fund structuring. Our teams have had to adapt to, and keep up with, the evolving nature of lending to do our jobs properly, which has in turn led to an increase in the scope of services beyond our original contracts."

Q One key difference between the GFC and today is a more hawkish Federal Reserve outlook which has kept rates high. How is this affecting the way in which servicers work with lenders and borrowers?

Rates will play a large part in spurring lending activity, but that alone will not solve the existing problem deals that were made when rates were lower. Some of the deals where we have seen continued extensions and modifications were structured perhaps more aggressively than they should have been and would likely have been problematic regardless of the increased interest rate environment. Rate hikes only accelerated and exacerbated the issues.

As more deals continue to underperform, balance sheet lenders continue to have capital tied up in reserves and CLO issuers are reaching the threshold for deals that they can buy out. A critical mass will be reached, and while these deals will start to trade at lower than desired returns, that may free up much needed liquidity that will start to make its way back into the markets.



Q There have been many widely quoted metrics around loan maturities this year and into 2025. How are servicers grappling with that load?

With $1.08 trillion of $5.54 trillion commercial real estate loans maturing in 2024, and 2025 we have certainly all seen an increase in modifications and extensions. This translates to lenders – and by extension, servicers – having transactions on their books for longer than anticipated for these types of deals.

In turn, the requirements for reporting and surveillance have also increased. This is in addition to the new originations volume that we are seeing. So, in that respect, we are seeing an increase not just in the portfolios that we manage but also with the scope of services that we are being asked to provide. But this has been a compounding issue since the onset of covid-19 and will take more than a year or two to see the 'maturity wall' get back to stabilized levels.

Q What will help restart activity?

Some lenders and borrowers are sitting on capital waiting for the 'right deal.' With even some of the more straightforward transactions requiring more complex deal structuring in the capital stack, or credit enhancements such as interest reserves in lieu of interest rate caps or higher insurance deductibles and self-insuring rather than a traditional policy, there are a lot of moving parts to get a deal done in this environment.

For these types of transactions to work, borrowers need to have sufficient funds and the financial wherewithal to enter into the deal, and lenders need to have enough capital to deploy.

Given that the inflationary pressures do not show any signs of easing, some lenders are now willing to take losses on underperforming assets. They are divesting these assets to free up capital and ease the burden of reserve requirements for those transactions which have been sitting on the books longer than intended thanks to additional modifications and extensions. As a result, lenders can redeploy those funds on better quality transactions at a higher rate, yielding better returns.

Q Is technology a part of the solution?

At Trimont we are increasingly leveraging technology, as well as offshore resources, to augment our existing staff to support the increasing workload. From partnering with our platform providers for our day-to-day work to bring the technology current to accommodate all of the changes in lending vehicles and structures, to increasing the capabilities of our own homegrown systems, we are working to make sure that we stay ahead of the rapid industry shifts. Of course, we also use productivity tools more frequently to track and manage KPIs.

But this is all secondary to the work that our teams are doing and how we continue to partner with clients to advise them on how to maximize recovery on their assets that they have held for longer than anticipated.

There are many loans made to strong borrowers and sponsors on what would otherwise be performing assets were it not for the increased interest rate environment, and factors beyond their control such as tax assessments and rising insurance premiums.

Our proximity to the intricate

details of these transactions has required us to think outside of the box when it comes to making recommendations for modifications and extensions. How we leverage the data and the tools available to us to turn these deals around and keep them from going into default and/or special servicing is what will make the difference between "returning to normal" and another financial crisis.

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Q What factors determine the final outcomes for loans – is it valuations, debt service, the ability to refinance, or line up more equity?

It is all of the above – and then some. There is no one-size-fits-all solution or magic bullet to making a 'good deal' or guaranteeing a positive outcome. Now more than ever, there are several variables beyond a borrower's control that now adversely impact a deal's DSCR: increased costs of labor and materials, rising insurance and cost prohibitive rate cap premiums, and higher property tax obligations for starters.

All of these also factor into a lender's assessment as to whether there are any risks to refinancing at maturity and may dictate their credit appetite for lending on certain types of transactions, property types and in geographic locations.

A large factor going forward will be the borrower or sponsor's track record. Are they experienced? Do they continue to have a good relationship with their lender even if their deals experienced some distress during covid-19 and beyond? Were they willing to work with the lenders, put equity back into the deal to right size, and turn it around in time?

The risk appetite for lenders in lending to new, unestablished relationships is certainly curbed given some of the turmoil in their portfolios in the past four years. This isn't to say that new deals to new borrowers won't happen, but the deal has to have tremendous upside to be considered.

Q How are you using AI to model potential outcomes?

While more and more firms are adopting AI, the way in which we are all using it varies. Many firms are just dipping their toe in the water and exploring all the possible uses.

One thing that has perhaps slowed adoption, and rightfully so, are developing policies and governance around the use of AI before implementing it for day-to-day use. Particularly with the sensitive nature of the data that we have access to, and the importance of the analysis we perform with that data, lenders and third-party service providers are implementing AI use incrementally and learning along the way.

There are myriad ways in which to use AI before getting to the point of using it for predictive modeling. Perhaps the most straightforward use case is data collection and aggregation for the purposes of reporting, studying demand trends and analyzing historical patterns. This is the kind of work that would typically fall to analysts and require hours of searching various systems of record, underlying documentation, Excel spreadsheets, reconciliation and then validation by more senior members of the team before reporting to boards, committees, auditors, regulators or investors. This was prone to human error, whether it was transposing numbers, overlooked data sources or incorrect classification of data.

With AI, research that could take a week or more can now be done within minutes and move straight into the data validation. Given that much of the subjectivity and human error is removed from the equation, this yields faster results with a higher degree of accuracy. And the introduction of AI has also allowed us to add many more sources of data, such as third-party data subscriptions, to our analysis. But this is only as good as the underlying data and infrastructure for housing data from multiple sources with the use of data lakes and data warehouses.

Q How does using AI change the equation?

These uses create tremendous time and cost savings throughout any organization. However, the technology is not quite at the point where we are ready for widespread predictive modeling.

Many firms are beginning to implement AI for predictive modeling but since that type of work is subjective, it requires exhaustive review and calibration, not unlike the existing non-AI predictive models. Regardless, we are hurtling towards a future where predictive modeling through AI will be as commonplace as any other technologies we use, at a speed unseen in our industry.

The adoption of AI in all facets of our work is happening much faster than we have seen in any technology that has preceded it. And all facets of the industry will need to adapt to AI in some way, shape or form to remain relevant and competitive. ■