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Downturn Recovery Requires A New Era In Automation

Is now the time for the commercial mortgage industry to finally shed its reputation as a technology laggard?

By Brian McCracken

Commercial real estate lending has been referred to as one of the last frontiers in automation adoption. The current credit crisis, however, is a wake-up call that an era of real estate lending exuberance has ended. Now, portfolio transparency is imperative to valuing underlying assets, access to and integration of data is essential to internal risk management, and free-form - or nontraditional underwriting - is eventually catastrophic.


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Whereas the industry really did not need to connect all the dots from origination through securitization in the prior era, and lenders did not really have to automate to do business, the reality is that these new-era needs can only be solved by the effective and creative use of technology.

In fact, the adoption of technology for lending and risk management will likely be a requirement for a lender's survival when we emerge from the current crisis and lending resumes. Professionals along the entire loan life cycle, from brokers to rating agencies and Wall Street, must be more technologically progressive for the overall well-being of the industry.

It is understandable why so many in the industry are apathetic about technology, given so many failed projects and technology vendors that have come and gone. There are still lingering effects of the dot-com era, when Capital Thinking, MortgageRamp and other firms promised fundamental change in the efficiencies of originating and underwriting loans.

Many lenders, banks and mortgage bankers got burned by some vendors, and those that attempted to build their own technology in-house discovered that doing so was not their core competency, thus failing and wasting millions of dollars.

But past project failures must now be forgotten. The fallout from the credit crisis, including the cessation of commercial mortgage-backed securities (CMBS) lending, has transformed the commercial real estate finance landscape, and it is essentially a new beginning.

New players and merged entities will soon be focusing their attention on gearing up for new business. This is an opportunity for participants to learn from the past, revisit their need for greater technology adoption, and differentiate themselves from those that are slow to adapt to new ways and realize new efficiencies.

Increased regulatory requirements

One of the biggest problems in CRE lending operations is how disconnected the data are. A loan may be screened by one person, underwritten by another in a spreadsheet, approved based on a Word document, documented and closed in legal, re-keyed onto a production report, boarded onto servicing by operations, tracked by servicers and asset managers, inspected and appraised by third parties, and pooled by capital markets groups.

Without automated data flow from one step to the next, there is no way of ensuring data integrity, avoiding redundant data entry, getting real-time reporting, easily trending a loan or measuring performance.

Regulatory compliance now must be anticipated by all financial institutions. The restructuring of the oversight agencies will certainly result in tighter regulation of commercial lending entities. This accentuates the need for ready access to portfolio information and the ability to trend loans and, at any point, benchmark loan and asset performance to the original underwritten projections.

In addition to regulatory compliance, financial institutions will also be faced with conforming to new industry standards for data, such as MISMO or other data-exchange standards mandated by players in the industry such as investors, the government-sponsored enterprises (GSEs) and players in the (reshaped) secondary market when it comes back.

The adoption of standards such as MISMO-formatted rent rolls and operating statements by all participants would serve at least the two immediate needs of internal risk management (making it easier to gauge asset values and trends) and external reporting transparency (by providing a foundation for exchange of information among investors, rating agencies and regulators).

The current financial crisis and the potential for a CRE meltdown could finally be the catalyst for data standards, as there will be more of a need than ever to cooperate and share information. Capturing of point-in-time loan and asset performance, as well as the transparency of those data from origination through securitization, will require industry data-exchange standards.

Freddie Mac and Fannie Mae are currently in the process of updating their loan submission, underwriting and asset management systems, all while undergoing an unprecedented amount of public scrutiny and government direction.

Their role in providing capital to the multifamily market has only grown in volume and importance. The platforms they are developing will enable them to more effectively serve the market, as well as manage the process and institute underwriting rules.

Lenders that are licensed to originate for Fannie and Freddie will eventually need to seamlessly integrate their origination process with the GSEs for maximum efficiency and compliance with the agencies' rules.

We are moving toward a standard set of XML data tags that will define the loan and asset universe. These will be integrated into commercial and internal origination systems.

The core database

All of the items previously mentioned - data access, integration and data standards - start with a true end-to-end, enterprise-accessible database. That is the foundation for any type of lending system. It should encompass customer, origination, underwriting, approval, closing, performance and asset management data, so as to facilitate straight-through processing and automated data flow throughout the process.

Eventually, any operation will only be as good as its database, as it will dictate an institution's ability to capture information and get it to the right people at the right time, as well as its prospects for implementing new adjunct technologies, such as mobile apps and data exchange with other entities.

When origination of new loans and refinancings ramp back up, you can be assured that pro forma, rosy-glasses underwriting will not be tolerated in an environment where underlying risk can no longer be hidden or spread amongst the masses, as was possible with CMBS lending.

Excel spreadsheets that can be manipulated back into acceptable loan-to-values and debt-service coverage ratios by the underwriter on a case-by-case basis will need to be replaced, or at least reined in somehow to ensure that undisciplined underwriting is not taking place, as well as to accomplish the new requirements for transparency and portfolio surveillance.

Excel is not going away anytime soon, but the spreadsheets will have to be under program control or tightly integrated with the loan origination system database and rules engine.

Risk managers within financial institutions must embrace technology and realize that it is the key to making informed and timely decisions. They have traditionally been detached from the field and working in their own silos with data that are incomplete and dated at best.

They need to realize that risk management is all about information, and technology is what facilitates the capture and processing of information, and should be more of a driving factor in its adoption.

Rules engine integration

All of the aforementioned needs related to compliance, portfolio surveillance and more intelligent underwriting point to the need for a rules engine, either integrated into the database or coupled.

This component has been a standard requirement on the residential mortgage side for a long time. Rules need to be triggered during loan submission, underwriting and loan approval, and periodically throughout the life of a loan.

Adoption of technology will dictate how commercial mortgage originators serve current customers, track exposure, scale up the business without adding physical resources, react to changes in the marketplace and, ultimately, how they manage risk. In essence, the adoption of technology will dictate successful execution and these companies' survival in the less-forgiving future of finance.

Too many lenders expect software to work exactly like they need it to right out of the box. Although you want to avoid developing a new system from scratch, you do need to find a base system and vendor to customize - or, at least, fine-tune - the software for you and assist with the implementation.

One other interesting aspect of the current state of the industry as it relates to technology adoption is that now is actually the best time to get a technology platform in place. Most businesses search and try to implement new technologies when business is robust, which is the worst time.

The problem with that approach is that a lot of the same resources that are needed to find, qualify, test and implement a system are too busy to dedicate the time required to do it properly. The best time to do so is actually when volume is down, allowing proper vetting of requirements, involvement of users in the development process, and time to test and accept new technology. **CMI**

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