Wither Commercial Mortgage Technology?

The commercial mortgage space is very different from its residential counterpart, so it shouldn't be too surprising that the technology used also differs. As is the case with the residential market, however, some commercial lenders have made strategic use of technology, while most others have not. Also—as with residential—commercial mortgage volumes will be down this year and the market is changing dramatically.

But unlike the residential space, commercial lending is not moving back toward a "vanilla" market. Instead, the commercial market is not even chocolate; it is more like tutti-frutti. This market complexity has distinct implications for the technology that serves it.

There are many types of institutions that serve as commercial mortgage lenders, ranging from community banks to insurance companies to large banks and specialized commercial lenders. What these commercial mortgage lenders have in common with—and part of what sets them apart from—residential mortgage lenders is that commercial lenders originate fewer loans but with significantly higher loan balances. And then the complexity comes in.

By definition, a commercial property is expected to generate revenue, typically through lease payments coming from tenants. The lending decision must evaluate the income potential for the property over the life of the loan. This requires not only considering the property itself, but the surrounding neighborhood, the state of the local economy and perceived trends. Similarly, a commercial property borrower is typically a corporate entity, not an individual, which means judging creditworthiness requires more than a FICO® score and a couple of pay stubs.

In the commercial market, there are often multiple exit strategies possible for loans, which may not be known at the time of origination (whereas with residential mortgages, it is usually known at the outset whether the loan will be securitized or placed in portfolio). Lenders that originate loans with $25-million-dollar-plus balances have different requirements (low volume and high flexibility, because loans are fairly unique) than lenders that originate small or microbalance loans. Lenders specializing in smaller-balance loans typically have higher volume and a somewhat standardized line of business, so a residential style of automation makes sense.

The multifamily business is different than other kinds of commercial lending because of the agency presence. This has led to more variation and specialization in the space.

Because of the complexity of the loans and the differences in requirements among types of lenders, size of deals and market niches, relatively few vendor solutions have succeeded in providing core technologies for commercial origination. Those that have survived have done so with relatively small market shares. As with the residential market, there are a few systems for commercial mortgage servicing that do have large market shares.

With this variety of requirements and dearth of systems to choose from, lenders largely have chosen to devise their own solutions for commercial origination technology, and to integrate around core systems for commercial mortgage servicing.

Technology in the commercial mortgage space

Technology has never really been perceived as the differentiator in commercial lending the way it has in residential. However, the lack of technology or the use of very poor technology has at times been an inhibitor to the business.

Lenders have typically taken one of two routes—viewed technology as a necessary evil, and done as little as possible with it; or viewed technology strategically. Most have opted for the former, and have ended up originating each deal in a stand-alone spreadsheet. In fact, the willingness of lenders to simply use Microsoft® Excel™ to model their deals has served to inhibit the success of new vendor entrants into the commercial origination market.

Spreadsheets do provide the ultimate in flexibility. Each deal can be modeled based off of a previous, similar deal, updated for this specific loan. However, as common as this has been, the approach may not provide enough controls or reporting information in today's age. For example, we found a $3 billion spreadsheet error at a client, measuring its counterparty exposure. There is just too much at risk not to have better controls and reporting.

Some lenders have built state-of-the-art solutions

Some lenders have taken a strategic view of commercial lending technology and have been able to derive significant value from their approach. They have taken a core system—either a vendor package or one custom-developed to their specifications—and wrapped it with supplemental systems to better support their specific needs.

Some have also developed a data warehouse into their systems architecture as a key component for reporting and risk management. But for most, the key is they have also integrated imaging and workflow around their solution.

Imaging and workflow allow these commercial originators to process remotely. For some, this means local origination with centralized approval. For others, it allows offshoring certain processes for greater cost efficiency. And for some, it enables them to originate internationally. In fact, one of the first uses of eSign technology was for international commercial loan approvals at GMAC Commercial Mortgage (now CapMark), Horsham, Pennsylvania.

In order to build this type of solution—a core origination system wrapped with supplemental systems and a core servicing system wrapped with supplemental systems, both feeding a data warehouse and both using the same imaging and workflow system—a commercial mortgage entity needs the vision to see how technology can support its business and the desire to operate differently than most of its peers.

Such a lender needs to craft a strategic vision for how it wants to leverage technology, and build a roadmap for how to get there. The company's ability to execute on the projects that support its strategic plan will be greatly dependent on having the right resources available, with prior experience in imaging, workflow and integration. But the results can be well worth the effort.

Most lenders should concentrate on building flexibility into their systems.

What commercial lenders should do in 2009

Few companies are in a position to drive the market—most are not. If you are one of those companies that can drive the market, then you probably already know what you need to do to have your technology support your business vision. But what about the rest of the lenders trying to compete?

Most lenders should concentrate on building flexibility into their systems. Most of us realize we don't really know what business will be like this year, except that it will be different than in 2008 and 2007. And you should assume that 2010 also will be different than 2009. Such is the nature of the times. As a result, it is important to emphasize short projects that can realize business benefits quickly by increasing your flexibility and ability to adapt and change.

If you use stand-alone spreadsheets to originate, and you originate more than a few loans per month, hook them to a database. It is not difficult, and the automated pipeline reporting will greatly increase your risk-management efforts. If you do only a few loans, at least add basic controls such as cross-footing (adding in a cell that compares the sum of the rows with the sum of the columns and flags the error if they don't match) to your spreadsheets.

If you don't already have a data warehouse, start building one. Data warehouses are a journey, not a destination, meaning they are never done—so starting is important. Their reporting functionality provides a great risk-management tool.

And finally, all companies should be working to improve their data quality. Build data integrity into your process and into your systems. Correct any weaknesses in your data model. Make sure your people are being smart about the business and are not spending their smarts trying to outsmart their technology.

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