

# Catching the Digital Wave

Commercial real estate finance needs to standardize in the wake of the pandemic

By David Brooks

**A**s the U.S. economy emerges from the specter of the COVID-19 pandemic, the commercial mortgage market will need to change. The traditional mechanics of a commercial real estate deal tend to leverage a 20th century approach to the evaluation of project funding.

In many cases, commercial real estate funding relies on highly inefficient and labor-intensive manual processes that are dependent on local market data — indicative of a proprietary approach to doing business versus a standardized one. Because of its fractured nature, commercial real estate finance simply lags behind other industries in efficiency, which lowers profitability.

In healthier and more profitable economic times, commercial mortgage brokers and lenders were content to accept this, but the pandemic has created an urgent need for improvement. The commercial mortgage industry needs to catch up to the strides in digital transformation that have been made in sectors such as retail banking and residential mortgages.

## Follow the leader

One only has to look at today's residential mortgage industry to witness the tangible, positive impact of a standardized approach to funding that leverages the best of new technologies. The transformation within residential lending began in earnest in 1999 when the Mortgage Bankers Association founded the Mortgage Industry Standards Maintenance Organization (MISMO), which was organized to develop standards for the residential and commercial mortgage industries.

This standardization effort has included mortgage lenders, the government-sponsored enterprises Fannie Mae and Freddie Mac, the Federal Housing Administration and other government agencies. The result has been a significant reduction in clerical errors, closing times and loan processing costs through an increase in automation. MISMO has revolutionized how residential borrowers, brokers and lenders interact, as well as how residential mortgages are funded in the U.S.

Within the commercial mortgage industry, however, the adoption of a similar strategy has been tepid at best. MISMO developed a commercial model about 15 years ago with the aim



of bringing a similar level of standardization to commercial real estate. The contributions are welcome, but the pace of its introduction and adoption needs to accelerate considerably given the circumstances of the current market.

## Front-line opportunity

Commercial mortgage brokers stand at the front lines in terms of opportunity for digital transformation. Commercial borrowers have become accustomed to managing all aspects of their daily lives through their mobile devices, yet their banking relationships are not delivering on these same expectations.

A disconnect exists between expectation and reality when it comes to a digital funding experience — something that commercial real estate professionals are well aware of. A recent survey conducted by Deloitte of 200 industry executives found that most believed their companies were unprepared in certain important areas and that the industry continues to struggle to adapt to their long-term strategies.

Most notably, only one-third of respondents agreed that they have the resources and skills required to operate a digitally transformed business. Less than half of those surveyed considered a digital tenant experience a core competency of their organization. And slightly more than 40% indicated that their organization has stepped up efforts to redefine business processes, job roles and skill requirements to include the use of technology and tools. Herein lies the problem — and the opportunity — for the industry to evolve.

## Managing the surge

Some sectors of commercial real estate (such as data centers and warehouse distribution facilities) have been positively impacted by a consumer shift toward remote working, home schooling and social distancing. Meanwhile, other asset types, such as hotels, restaurants and mixed-used retail, have experienced significant negative effects. This will almost certainly lead to more loan defaults and distressed-asset sales in 2021 — something that the industry may not be equipped to handle.

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So far, the full effects of the pandemic have yet to be realized as forbearance and relief programs have delayed an inevitable surge in commercial mortgage defaults. Although there is still some debate about what percentage of the market will be impacted, what we do know is that mortgage brokers will likely need to manage a wave of asset sales within a compressed period of time.

This is where new technologies and automation can have the most impact. By shifting manual, paper-based processes to cloud-based, secure alternatives, brokers can work more quickly and effectively in a number of areas. You can use technology to more efficiently assess risk appetites and rate sensitivities by collateral type. This makes it easier to compete against other financial institutions and fintech-savvy companies that specialize in specific asset types, such as hotels, multifamily and health care.

By moving to a centralized digital platform, brokers will be able to more quickly secure the required documentation and financial details from developers and investors. They'll also be better positioned to help lenders expedite the disposal of distressed and toxic assets. Ultimately, they will close more deals and complete them more quickly.

### Much-needed catalyst

When considering the remainder of 2021, the general consensus is that the U.S. economy

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and commercial real estate market should experience some level of recovery during the third and fourth quarters. Exactly what this recovery will look like is still being debated by experts and prognosticators. This further complicates matters for developers, investors, lenders and brokers as they develop their business strategies.

As the industry continues to emerge from the unprecedented cycle brought on by the pandemic and looks toward a future rebound, commercial mortgage professionals find themselves in a unique position to affect meaningful change. By adopting greater levels of standardization and technological innovation, brokers will be much better positioned to weather down-market conditions and thrive in a growing market.

For many industries, the past year has served as a much-needed catalyst for the move toward digital transformation. Lockdowns and quarantines have forced companies to become more innovative as they embrace new ways of communicating and doing business with their customers. It is time for the commercial mortgage industry to keep this digital momentum rolling. ●

## KEY POINTS

### Standardizing the commercial mortgage market

- ▶ Because of its fractured nature, the commercial real estate finance industry lags behind others in terms of efficiency.
- ▶ Standardization efforts in the residential mortgage market serve as a good model for its commercial counterpart.
- ▶ Commercial mortgage brokers are prime candidates in terms of opportunity for a digital transformation.
- ▶ This year will be one of recovery for commercial real estate, but there will likely be more defaults and sales of distressed assets.
- ▶ By adopting greater levels of standardization and technological innovation, brokers will be better positioned to manage declining market conditions.

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