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WHITEPAPER

Implementing a successful offshoring programme

for lenders and other CRE players

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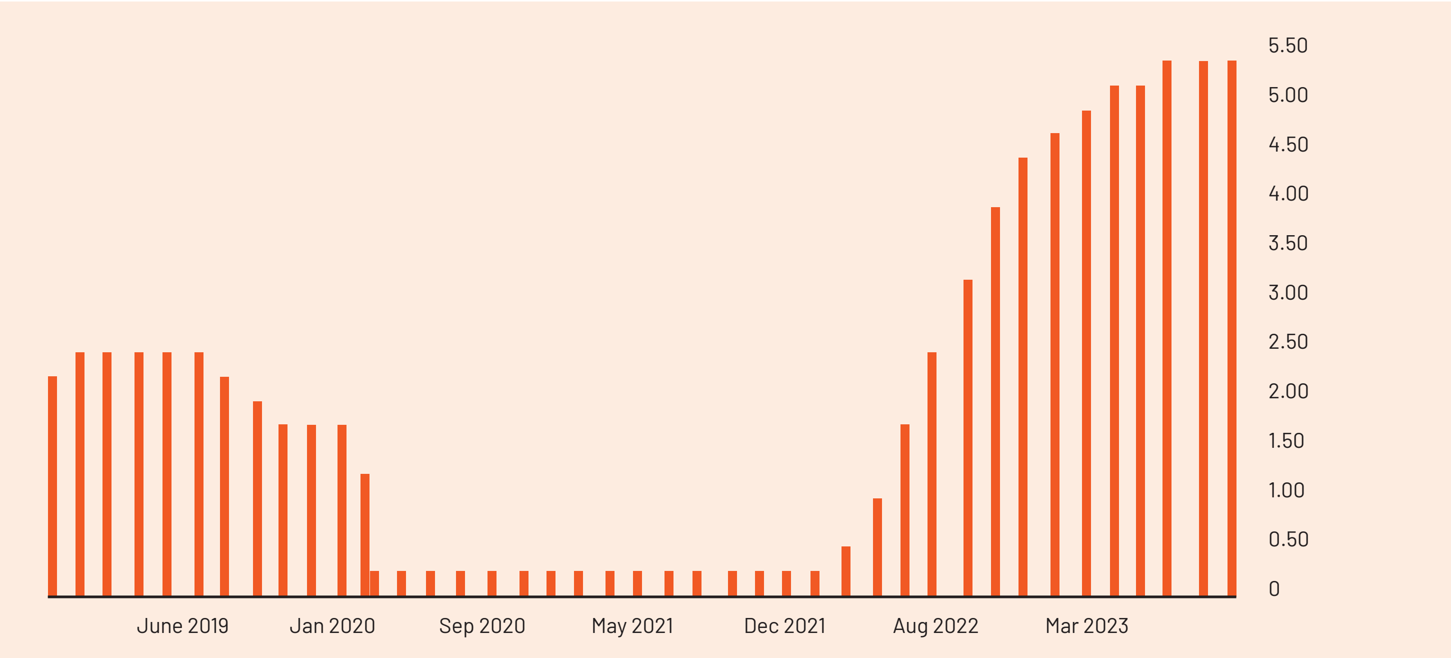
Introduction

Thinking differently in a changing world

Interest rates play a major role in CRE, as they shape investment decisions and the overall dynamics of the market, impacting the price of and demand for real estate. With inflation soaring in 2021 and 2022, the US Federal Reserve (Fed) increased the interest rate at the fastest pace in generations. After 11 increases since March 2022, the benchmark federal funds rate as of November 2023 was between 5.25% and 5.50%, marking an increase of over 500 basis points. The Fed chief stated that it may act further to achieve its 2% inflation target.



Rising mortgage rates mean that fewer qualify for a mortgage, prompting mortgage lenders to reduce staff costs. Most of the largest banks/financial institutions have implemented at least one round of layoffs in 2023. A swift surge in mortgage rates and a substantial drop in origination volume has led to a significant number of job losses in 2022 and 2023.

Stringent credit policies and guidelines need to be implemented to maintain financial stability, and there has been notable implementation of such policies since the pandemic. Banks/financial institutions have heightened their scrutiny and risk assessment measures, aiming to enhance financial stability, ensure prudent lending practices and manage potential risks. Loans are being originated only to those borrowers who have demonstrated creditworthiness. Stringent credit standards reduce the likelihood of bad debts and other credit costs, although they restrict sales and profit margins.

The pandemic made the hybrid working model a normal way of working, with a significant impact on office leasing. Global leasing volumes of office space dropped 18% y/y as of 1Q 2023, according to Jones Lang LaSalle. However, 3Q 2023 brought mixed results for the office market, with considerable progress on return-to-office plans, growing tenant requirements, declining sublease additions and a tightening market for high-end space pointing to stabilisation in 2024.

Such factors have driven banks/financial institutions to explore new ways to add cost-effective scale to their existing due diligence and portfolio-monitoring processes. However, while a number of tactical measures have been implemented to respond to this changing environment, we believe the only effective way to overcome these challenges is by "thinking differently". Many are now prepared to abandon their traditional business models in favour of those offering a renewed strategic focus, not only to improve operating efficiency and effectiveness, but also to control costs.

Many banks/financial institutions are already working closely and successfully with strategic offshore partners, to manage growth both efficiently and cost-effectively. Offshoring not only allows banks/financial institutions to allocate their onshore resources to more critical and value-added tasks, but also provides faster-generated, timely, logically structured and data-driven information on important market opportunities, enabling more efficient and profitable investment decisions.

In this white paper, we provide practical guidance, showcasing how banks/financial institutions implement successful offshoring programmes. The first section focuses on the business case for offshoring by banks/financial institutions, while later sections discuss how to execute and evaluate an offshoring programme. We conclude by sharing our experiences of successfully establishing offshoring programmes for a number of banks/financial institutions. We strongly believe this paper will provide banks/financial institutions with important ideas on how to leverage offshoring not only as a tactical measure to save costs, but also as a strategic partnership for growth.

Why offshore?

Business case for offshoring by banks and other financial institutions

In the current market scenario, commercial banks and financial institutions face multiple challenges at different stages of the loan lifecycle, as highlighted below.

Turnaround time for quote: Given the high competition, borrowers expect quick turnaround of quotes. Do we have the bandwidth to provide quotes on time to retain customers?
Value creation: How can we increase our involvement in driving growth and improving profitability? Can we dedicate more time to focus on critical aspects of the business?
Cost savings: With revenue declining due to a drop in origination volume, how can we achieve cost savings effectively?
Increased volume: Do we currently have the bandwidth to increase origination volume?
Portfolio monitoring: Are we monitoring our portfolio loans as often as we should, and with sufficient detail?

Globally, lending institutions are partnering with offshoring vendors that offer solutions designed to address these questions. Offshoring enables cost-effective scaling of origination, underwriting and portfolio monitoring, and provides access to globally sourced and located talent. Such a configuration enables reallocation of onshore resources for high-value activities, including scaling up of new business, strategic decision-making and maintaining client relationships.

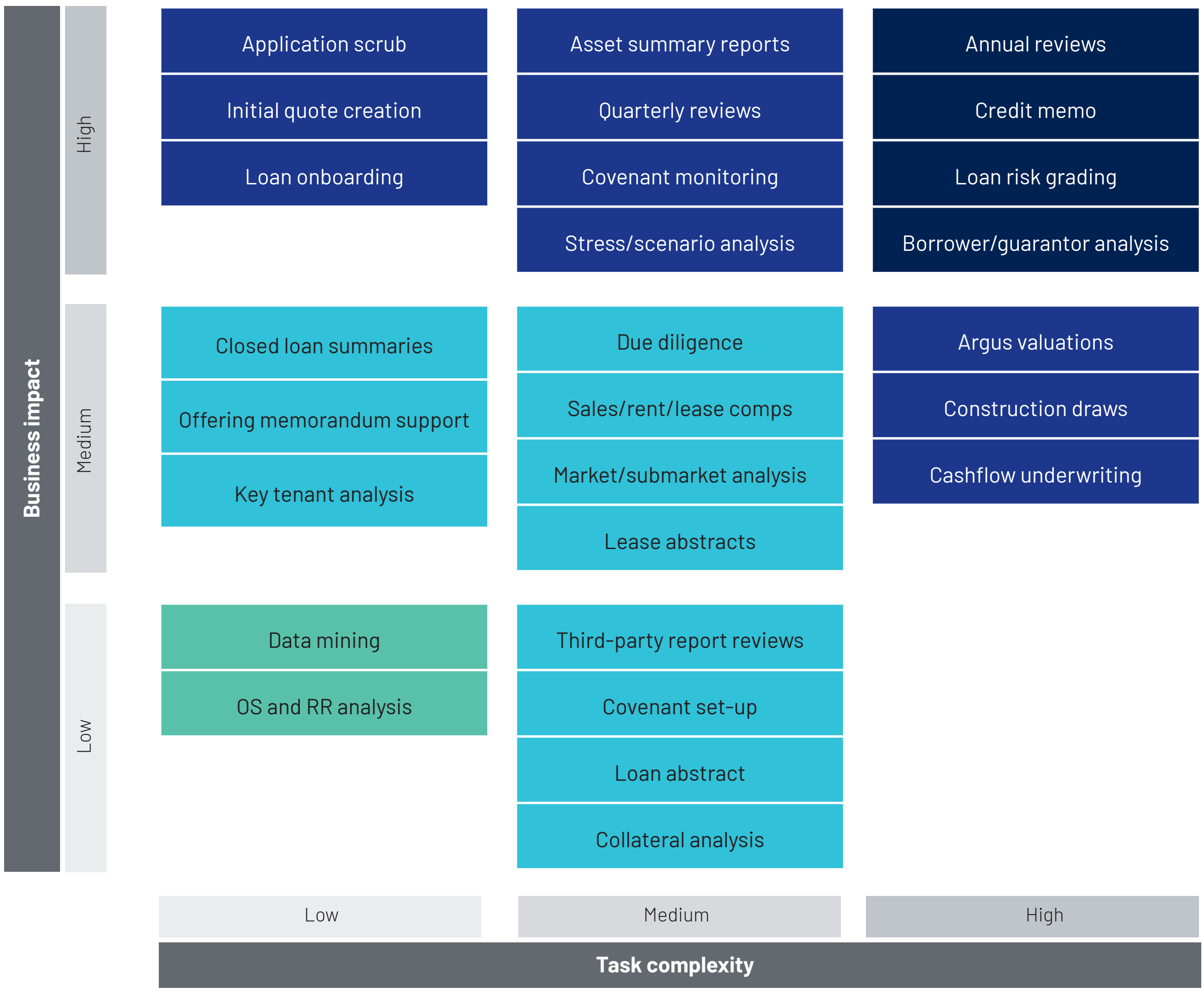
Offshoring is not new to the financial services sector. Several large banks/financial institutions have either set up their own captives or have engaged strategically with third-party vendors to offshore labour-intensive research and analytical tasks. We already see strong and growing interest from a number of banks seeking to realise such advantages.

KEY TAKEAWAYS

- Offshoring provides access to a global talent pool, helps ensure 24x7 up time and, most importantly, enables banks to deploy onshore resources to cover high-value activities.
- Increasing competition in new loan origination is driving lenders to target ways to deliver swift results and cost efficiency on a scalable level.
- Offshoring is a proven concept in the financial services sector, providing cost benefits and flexibility of scaling in line with business requirements.

What to offshore

Offshore lending services teams undertake a variety of tasks across the loan lifecycle, which we classify under origination, underwriting and portfolio monitoring. Origination tasks include loan sizing, preliminary quote creation, deal onboarding, due diligence checks, market research and initial credit memo submissions. Underwriting tasks include cashflow underwriting, third-party reviews, lease reviews, credit memos and system updates to ensure consistency with available due diligence. Portfolio monitoring includes periodic (quarterly/semi-annual/annual) loan review activities such as operating statement and rent roll analysis, lease-up analysis, cash flow underwriting, asset summary report updates, value-add tracking, guarantor analysis and risk grading recommendations. Tasks involving research and analysis are ideal for offshoring, as they are both more structured and measurable, and able to be objectively defined. To ensure the long-term success of any offshoring programme, it is vital that the introduction of these tasks to the project is sequenced while bearing in mind both the learning curve and ramping-up skills of the offshore team.



We suggest that clients devise their own task-segmentation matrix, as their assessment of complexity and the impact of each task on the business may vary according to the situation. They would sometimes need to tactically concentrate on only a limited number of tasks that require offshoring support.

In such cases, we work with clients to define a suitable sequence for offshoring those tasks, consistent with their requirements. We advise clients to ramp up their offshoring programmes as follows:

Low-complexity, repetitive tasks
Begin with relativity low-complexity, repetitive tasks that enable the offshore team to become familiar with client-specific templates and build momentum by delivering high-quality output

Time-critical tasks
Later, add high-impact, time-critical but low-complexity projects that may from time to time require same-day turnaround. Such tasks would enable the offshore team to increase its versatility in performing more sophisticated higher-quality tasks

Judgment-based tasks
Subsequently, incorporate more complex tasks in the project that involve an open-ended problem statement and require judgments to made by the offshore team

High-complexity, critical tasks
Finally, begin to engage the offshore team in more complex and large-impact projects that capitalise on its now well-established ability to leverage continuing improvements in quality, versatility and judgment

KEY TAKEAWAYS

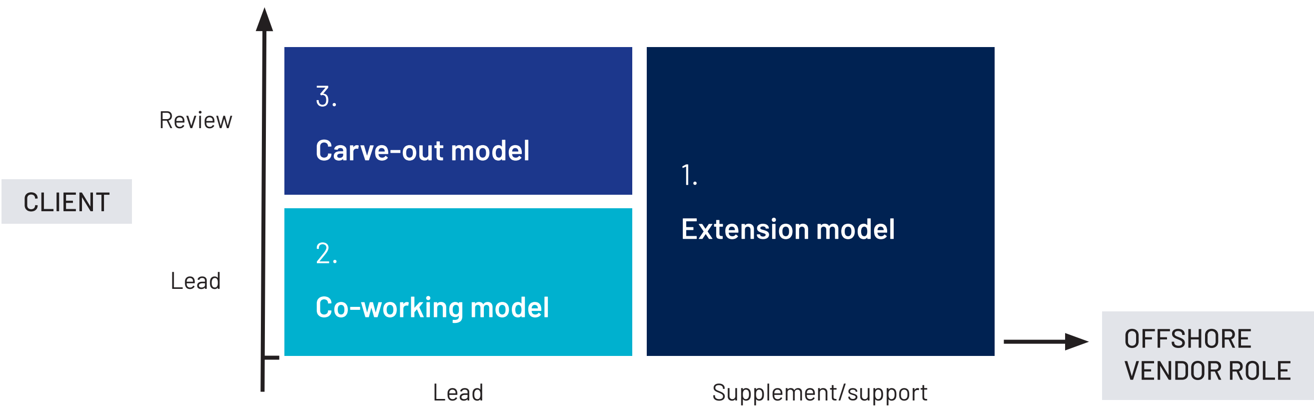
» At each stage of a loan life cycle, there are several time-consuming repetitive tasks that can be offshored.
» Tasks to be offshored can be selected based on complexity, business criticality and the client's commercial requirement.
» Sequencing of tasks for offshoring should also take into account the learning curve of the offshore team.

How to offshore

Choosing the right operating model

Once a decision is made to offshore, and the various tasks to be placed in the programme have been identified, it is necessary to define the roles that the onshore (client) and offshore (vendor) teams will play and how they will work together. Based on our more-than-a-decade-long experience in establishing CRE offshoring projects, we believe such arrangements adopt one or more of three operating models:

Operating models for a CRE offshoring programme



1. Extension model

In this model, the onshore client team retains ownership of a particular master task and engages the offshore team to support specific sub-tasks. These tasks are more structured and objectively defined than the master task.

The principal advantage of this model is that it enables the client to remain focused on core analysis of the master task, and leverage the offshore team to gather, collate and synthesise background material to support this analysis.

For example, a client sought to evaluate a CRE loan proposal for one of its clients. It assigned us the following specific sub-tasks:

» Prepare an initial sizing based on three-year historical, trailing12-month statement and a rent roll

» Prepare a writeup detailing market/submarket and borrower/guarantor analysis

» Compile lease abstracts for a portfolio of retail properties

2. Co-working mode

In this model, the onshore and offshore teams share the task and work together, assuming joint ownership of the project. Responsibilities and areas of work are separated, and periodic meetings are held to review each other's findings and determine further action. The main advantage of this model is that it enables the client and its partner to focus professional resources on core issues and leverage individual experience and expertise to provide effective solutions. The model also allows targets to be met more rapidly, as onshore and offshore teams can capitalise on time-zone differences and work closely.

For example, a client had an urgent requirement to gather data for a large portfolio of over 100 properties at the underwriting stage and had little time to collate and review relevant information. We worked together with the onshore team and were able to deliver the task on time.

It is necessary to clearly define the roles that the onshore (client) and offshore (vendor) teams will play and how they will work together

3. Carve-out model

In this model, the offshore team assumes full ownership of the task and is responsible for end-to-end project planning, conducting research and analysis, and synthesising findings into deliverables for review by the onshore client team.

First, this model enables the client to obtain an independent third-party view on key components of an investment decision. Additionally, it allows the offshore team to progressively build task expertise and deliver greater time and cost savings.

For example, a client recently moved to a new application to manage its c.USD35bn CRE loan portfolio in a more transparent and efficient way. For this platform-migration exercise, we allocated a five-member team for transition of 650 loans. The team worked independently and provided detailed weekly status updates of loans completed and highlighted missing documents, along with gaps between the legacy and new systems. We completed this project within the stipulated timelines.

We work closely with our clients to suggest the most suitable operating model, as each model has its own advantages and different models may be advisable in different circumstances

Factors governing choice of operating model

All the operating models we describe have their own advantages, and different models may be advisable in different circumstances. We work closely with our clients to suggest the most suitable operating model, based on the following factors:

1

Low-complexity tasks are ideal candidates for a carve-out model, while more complicated functions are better suited for either an extension or co-working model.

2

High-criticality tasks are more suited for an extension model or, in a few cases, a co-working model. For low-criticality tasks, clients typically adopt the carve-out model.

3

Newly established client systems without a large number of in- house junior staff usually adopt a carve-out model where the offshore team is fully responsible for screening and initial due diligence.

4

In the early stages of an offshoring relationship, most clients prefer either an extension model or, in a limited number of cases, a carve-out model. Once the initial setup stabilises, the relationship may evolve to include the co-working model as well.

The selection of operating models may evolve during an offshoring relationship as project mix and client priorities change. In large teams, multiple operating models may co-exist, as such teams typically service clients in various business situations, often operating in several countries, using multiple investment strategies and with a range of offshoring requirements.

How to begin

Steps to implementing a CRE offshoring programme

To ensure offshore programmes are implemented in a timely and efficient manner, banks and other financial institutions must first align their internal organisation and resources with the objectives. Subsequently, the selected offshoring partner should be engaged to establish the offshore team, requisite infrastructure and service rollout.

Aligning internal resources and the organisation with the programme's objectives

To ensure the programme's long-term success, banks and financial institutions must internally align all key stakeholders by defining clearly its objectives, structure, participants and roles, and governance model.

Stages in internal preparation for offshoring

1

Define and communicate programme

» The objectives of the offshoring programme should be clearly defined and communicated to all stakeholders

» The nature of the objectives will vary depending on whether the decision to offshore is strategic or tactical

» Strategic offshoring objectives will be linked to business success, e.g., the ability to execute more deals in less time

» Tactical offshoring objectives will be task-oriented, e.g., full transition of portfolio monitoring tasks to offshore team

2

Define programme structure

» The programme structure includes scope of tasks to be offshored, goals and transition timelines

» A multi-year offshoring programme should be structured in phases, each comprising well-defined tasks, goals and timelines

» The core rationale used to select offshored tasks should be properly communicated, to ensure internal organisations are fully aligned

3

Define organisation structure and assign roles

» The offshoring partner should be regarded as an integral part of the organisation structure

» Large banks should consider adjusting their senior staff-to-junior staff ratio over time

» Smaller firms may opt to employ only senior personnel and to assign junior staff roles to the offshore team. Key roles to be defined:

- Programme sponsor
- Onshore coordinator: first point of contact for any operational matters
- Authorised requestors

4

Define governance mode

» The programme structure includes scope of tasks to be offshored, goals and transition timelines

» A multi-year offshoring programme should be structured in phases, each comprising well-defined tasks, goals and timelines

» The core rationale used to select offshored tasks should be properly communicated, to ensure internal organisations are fully aligned

Rolling out the engagement with the offshoring partner

The process of rolling out an offshoring engagement with an identified partner requires a broad-based agreement covering the programme's objectives and defined operating procedures, exchanging templates and task methodologies, establishing the offshore team's infrastructure, and timely and effective team recruitment and training. This process may last 6-12 weeks, depending on the scale of the project and the availability of suitably skilled resources. The following diagram shows the key stages, actions and timetable used to establish an offshoring engagement.

Steps and timetable for rolling out the programme with an offshore partner:

1-2 weeks

Initiation and process setup

- Conduct a kick-off call to clarify and agree programme objectives and requirements
- Finalise key procedures: task allocation and prioritisation, offshore capacity management, feedback frequency, etc.
- Discuss templates to be used and methodologies to be followed for each task

6-8 weeks

Team and infrastructure setup

- Offshore partner defines team structure based on the skill set required to meet all client objectives
- Offshore partner, with client participation, conducts internal and external hiring to appoint resources to the team
- Offshore partner establishes delivery infrastructure, including seating, computing and communication to resources

2-4 weeks

Training and service rollout

- Internal team orientation and training to get accustomed to use of standard task templates and methodologies
- Conduct client-specific team training covering customised templates and methodologies, to include an optional visit to client premises
- Offshore team receives and executes client projects

Our experience

Over the past 15+ years, we have successfully established and upscaled offshoring engagements for several regional banks, brokers and insurance players. We, therefore, understand the differences in underwriting and portfolio-monitoring requirements of major industry players.

CRE case study – Support for construction loans portfolio

In 2023, a leading mid-size US regional bank approached us to design an offshoring solution that freed up its in-house resources for more value-added activities. A key requirement was that the offshore team undertake the responsibilities of drafting construction draw memos and updating the subsequent systems that support the client's CRE credit and portfolio management's team.

We established a dedicated offshore team for the client that consisted of three Acuity analysts with extensive experience in the CRE domain. The offshore team undertook several diligence and portfolio value-enhancement projects apart from compiling regular memos on a tight delivery deadline.

The client, impressed with its offshoring experience with us, introduced us to several of its other business units to expand support. We added three more FTEs to extend our support in streamlining covenants for the client's construction and CRE loan books and conducting quarterly loan reviews. We have also expanded our support in the areas of new loan origination (where the team helps in creating models) and performing extensive market research – we added another two FTEs for this task. Overall, we have eight analysts dedicated to supporting this client.

Client's challenges

» A significant share of the client's resources was allocated to conducting due diligence checks

» The client lacked the bandwidth to meet aggressive pipeline/targets while maintaining detailed portfolio monitoring

» The client was facing high personnel costs and a high level of attrition

Our solutions

» Set up a dedicated offshore team with a mandate to perform due diligence, draft draw memos and update systems accordingly

» Assumed full responsibility for all portfolio performance monitoring and reporting

» Assigned dedicated staff to support the onshore team, reducing costs, and helped build a knowledge base to reduce the risk of attrition

Value delivered

» Turnaround time: Reduced turnaround time, so the onshore team could meet the requirements of target customers and generate more revenue.

» Deeper analysis: Undertook in-depth analysis by performing thorough due diligence and market analysis

» Robust monitoring: Increased capability to closely and actively monitor the client's portfolio on an ongoing basis

» Cost saving and profitability: Cut costs for onshore team significantly versus the fully loaded expenses of in-house resources

Case study: Loan origination and portfolio monitoring, including business analyst support

In 2013, a leading US regional bank approached us to support their two major lines of business: (1) origination underwriting support for off-balance sheet/CMBS loans and (2) portfolio-monitoring support for on-balance-sheet/bridge loans. The key requirements were quick turnaround of origination inquiries and standardisation of the portfolio-monitoring process. As a testament to the work Acuity has delivered, the client was impressed and started engaging us in critical and time-sensitive projects including LIBOR transition, migration to a web-based risk rating platform from conventional 2DRR risk rating methodology. We also successfully transitioned portfolio-monitoring activity for its community lending and investment programme.

In 2015, the client asked for support of a dedicated business analyst (BA) to maintain business-as-usual (BAU) operations of its underwriting platform. This was an exceptional and distinct request that redefined offshore capabilities. We started with one dedicated BA with extensive experience in the CRE domain to support the BAU operations. The individual visited the onshore team for two months to obtain extensive training and understanding of the underwriting platform. The BA handles most of the tasks. We currently have a team of two dedicated BAs supporting a number of activities production support, release support, enhancement request support and other business support.

Impressed with the work delivered, the client now considers our offshore counterparts as an integral part of its operations and involves us in all critical decisions.

Client's challenges

» Delayed responses to initial sizings/quote requests
» A non-standardied portfolio-monitoring process with irregular covenant-monitoring activity
» Needed a dedicated BA to maintain BAU operations of the underwriting platform
» Lacked bandwidth to meet requests on system support, as the system was new to the client
» High personnel costs
» A significant number of the client's resources were allocated to system-support activities, diluting its focus on other critical requirements

Our solutions

» Acuity analysts delivered quotes the next business day
» Structured the portfolio-monitoring process with standardised covenant-monitoring procedure
» Set up two dedicated BAs with extensive experience in the CRE domain and proficiency in Excel and VBA
» Adopted a phased approach and assumed full responsibiilty for as many support activities as possible
» Was directly involved in discussions with the vendor in conveying and reporting requests

Value delivered

» Turnaround time: 24-hour turnaround for all quotes
» Customised memos: Supported all lines of business in creating customised memo reports with the flexibility to make instant changes to the reports based on requirements
» Robust monitoring: Increased capability to closely and actively monitor the client portfolio on an ongoing basis, including covenant setup and monitoring
» Cost saving and profitability: Cut costs significantly for the onshore team versus fully loaded expenses of in-house resources

Conclusion

Banks and other CRE players operate in a very different world to the environment just five years ago. Periodic disruptions in the form of the global financial crisis and the pandemic have presented new challenges for the sector. The extent and pace of change being witnessed have undoubtedly forced decision makers to explore new strategies not only to adapt, but also to succeed in the face of new realities.

We believe banks will benefit significantly by including offshoring in their basket of response strategies. In fact, our experience has shown that partnering with an offshoring vendor enables managers to scale their operations cost-effectively and secure incremental capabilities to increase the breadth and depth of analysis at each stage of the loan lifecycle, while ensuring key personnel remain focused on critical tasks and core analysis.

In this white paper, we present several ideal tasks for offshoring that currently form part of the loan lifecycle of any CRE loan and sequence their potential transition to an offshoring vendor. While our discussion may serve as a baseline for further development, offshoring partners will, in all cases, incorporate client-specific measures when designing any value-added offshoring programme. Given the clear and present industry trends indicating a tight labour market, strict underwriting standards, rising interest rates, liquidity concerns and an economic slowdown, we expect banks to offshore more rapidly going forward, to source sustainable differentiations that deliver long-term competitive advantages.

Having established a number of sustainable and mutually profitable offshoring relationships, Acuity Knowledge Partners has demonstrated its awareness that operating successfully in the CRE sector requires specialist vendors who understand the nature, operations and commercial realities of a client's business and possess demonstrable expertise in managing the offshore business of such firms. We offer a comprehensive range of services to banks and other CRE players, including underwriting and portfolio-monitoring support across all stages of the loan lifecycle.

The macroeconomic climate has been changing rapidly since the pandemic and affecting the CRE sector. Traditional sectors such as retail and office have been severely impacted, while certain non-traditional ones such as data centres, cell towers and industrial space are experiencing a surge in demand. These asset classes are being widely adopted asset classes across geographies and sectors, becoming influential participants in the global economic order.

About our services to banks and other financial institutions

We provide a wide range of services across property and transaction types throughout the loan lifecycle, including initial loan due diligence, comparable and tenant analysis and detailed underwriting support. We also monitor the performance of on-balance-sheet portfolios, helping to identify early warning signals, and assist with loan-risk grading.

Authors

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Hina has been with Acuity since August 2013 and has 14+ years of experience across commercial lending life-cycle: Origination, Underwriting, Portfolio Monitoring and Servicing. Her responsibilities include managing one of the largest CRE and loan ops engagement. In addition to this, she is actively involved in new process transitions, client management, training, and quality control of deliverables. She has also acted as a Business Analyst facilitating conversations and negotiations between business and tech teams, to produce automated and be-spoke solutions, which help our clients transform their internal processes. An active member of the Acuity WIN community, Hina is also a proud ally.

Keerthivarman Balasubramaniam

Assistant Director, Lending Services

Keerthivarman holds a master's in business administration in Finance and Marketing. With more than 15 years in the US Commercial Real Estate sector, Keerthi has extensive experience in initial sizing, detailed underwriting, portfolio monitoring, cashflow modeling, market research, and more. For more than a decade, he has been part of Acuity Knowledge Partners. Prior to this, he gained experience working with BlackRock and Accenture. He is also serving as a Business Analyst, providing technical support for ongoing business requirements to a key client.

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For more details scan the QR code or visit
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Acuity Knowledge Partners (Acuity) is a leading provider of bespoke research, analytics and technology solutions to the financial services sector, including asset managers, corporate and investment banks, private equity and venture capital firms, hedge funds and consulting firms. Its global network of over 6,000 analysts and industry experts, combined with proprietary technology, supports more than 600 financial institutions and consulting companies to operate more efficiently and unlock their human capital, driving revenue higher and transforming operations. Acuity is headquartered in London and operates from 10 locations worldwide.

Acuity was established as a separate business from Moody's Corporation in 2019, following its acquisition by Equistone Partners Europe (Equistone). In January 2023, funds advised by global private equity firm Permira acquired a majority stake in the business from Equistone, which remains invested as a minority shareholder.