alterDomus*

"We have proactively and rapidly shifted our team's priority back to special assets, scaling up to meet current demand."

DISTRESSED LOANS ACCELERATE, REQUIRING AN EQUALLY RAPID RESPONSE

To say the COVID-19 global health crisis has upended financial markets would be an understatement. In terms of distressed debt alone, the change is staggering.

According to Bloomberg, in the two weeks ending March 19th, distressed debt in the U.S. doubled to $500 billion; one week later, it was nearing $1 trillion. Except for utilities, no sector is immune. Although the oil and gas industry seems to be taking the biggest hit, retail, travel, and entertainment are close behind. As the pandemic continues, it's expected that more and more highly leveraged borrowers will be forced into default.

The virus may have been unexpected, but the financial fall-out from it is not unprecedented, even in recent history. Distressed debt soared in 2008 prior to the Great Recession, with banks, credit unions, private equity funds, and even the FDIC requiring support to manage non-performing loans. Many organizations created dedicated special asset departments to deal with distressed loan portfolios but dissolved them when the economy recovered. As a result, we're seeing a growing gap between the need for workouts and the in-house expertise or capacity required to plan and execute them. One thing widening that gap is the speed with which the bottom fell out this year.

Compare and Contrast: 2008 and Now

Although none of us has a crystal ball, experts have been predicting the imminent end of our protracted, post-recovery bull market for some time. Their assumptions, which pre-dated the emergence of the coronavirus, were based on historical business cycles.

Did you know...

Within a single week during March 2020, distressed debt in the U.S. doubled to nearly $1 trillion.

The problem is, no one could have anticipated how abruptly things would come to a standstill. Where we might have braced for a slowdown in cash flow, what actually happened was a full stop, with businesses shutting down overnight. Given how long the economic growth and expansion had gone on, it's understandable that lending institutions, credit funds, or banks might not have given as much thought to a recession-like round of problem loans, much less the tsunami they're seeing now.

Compare this to the period from 2008 to 2014. Any institution that originated debt, purchased debt, or did both was stressed, yet they had more time to fully staff a special assets team as the credit problems grew. They generally engaged people who understood different industries, different types of collateral, and even different borrowers—distinguishing those who were cooperative or otherwise able to assist in some sort of resolution strategy from those who were just trying to buy time or move assets around in an effort to avoid fraudulent conveyance.

Once that recession ended and everything was litigated or worked out, those teams were a thing of the past. That's not surprising; it no longer made sense to carry hundreds of thousands of dollars in payroll for people whose work had been completed and the pipeline of distressed debt dried up. Some businesses may have retained a person or two from their former special assets department. Those employees have mostly spent the last five years or so in different roles, in many cases originating new loans or making other deals creating paths to recovery, not dealing with distress—especially the kind that's developed virtually overnight. That suggests that there may be a general lack in experience, agility, or capacity that the current environment demands.

Lean staffing is, of course, the key reason that lending institutions facing debt turmoil are outsourcing their special asset needs. More and more, they're seeking partner companies that can develop appropriate workout strategies, mitigate reputational risk, and move rapidly to resolve tough issues.

Sustainable Solutions for Clients and Their Borrowers

If you're considering partnering with a special assets servicing team, here are some things to look for:

- Broad workout experience, including expertise in restructuring, settlements, litigation, and liquidation services.
- Professionals who understand different types of loans, collateral, borrowers, and regulatory requirements, and can quickly grasp your capital situation.
- Problem solvers who can quickly assess risk and formulate options that will result in the best economic outcome.
- Ability to onboard clients within days.

The Alter Domus special asset servicing team was established in 2008 as part of the broader credit services department, and it's never gone away. Skilled in managing distressed loans and assets, they have furthered their credit experience over the past five years in areas such as underwriting, covenant monitoring and credit reviews.

According to John Budyak, Managing Director, "We have proactively and rapidly shifted their priority back to special assets, scaling up to meet current demand. Our team delivers prompt, sustainable solutions that the borrower can perform on and you can live with."

The economy turned off like a light switch and there's no telling when it will flip back on, or respond more like a dimmer switch, gradually improving—or result in a deeper slowdown or even a recession. Whatever the future holds, working with an experienced special asset team now can lead to better economic results and in less time.

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