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# UK Commercial Real Estate Special Servicing: Strategies, Data Requirements, and AI Opportunities

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## Overview

This report provides an analysis of the strategies, decision-making processes, and operational requirements involved in managing distressed commercial real estate loans in the UK. It defines special servicing as the management of defaulted or high-risk CRE loans, distinct from routine master servicing. Transfer to a special servicer is triggered by events like payment defaults, covenant breaches (LTV, DSCR), maturity defaults, or borrower insolvency. A range of workout strategies are investigated, broadly categorized as consensual or enforcement. We discuss how banks and debt funds often approach workouts differently. Workout strategies differ for stabilised income-generating properties versus higher-risk development projects. We discuss the operational needs of effective special servicing with robust data management, comprehensive reporting, and specialized software with capabilities for workflow management, financial modelling (including ECL/RWA), compliance tracking, and audit trails. Finally, we explore the use of generative AI in the context of CRE special servicing of workout.

## 1. Introduction to UK CRE Special Servicing

### 1.1 Defining Special Servicing in the UK Context

Special servicing within the United Kingdom's commercial real estate (CRE) finance market refers to the specialised management and resolution of CRE loans that are distressed, typically meaning they are in default or at high risk of default. These loans are secured against various types of commercial property located within the UK. The primary objective of the special servicer is twofold: either to work with the borrower to return the loan to a performing status or, if that is not feasible, to mitigate financial losses for the ultimate debt holders (such as investors in Commercial Mortgage-Backed Securities (CMBS) or

Limited Partners in a debt fund) through strategies involving loan liquidation or enforcement against the underlying property asset.

This function is distinct from that of primary or master servicers, who manage the day-to-day administration of loans that are performing according to their contractual terms.<sup>1</sup> The transfer of a loan from a master/primary servicer to a special servicer is a significant event, triggered by specific occurrences defined within the loan's governing documents, indicating that the loan has entered a state of distress.

## 1.2 Triggers for Special Servicing Transfer

A loan is typically transferred to a special servicer upon the occurrence of a Servicing Transfer Event as defined in the governing loan documentation, such as a Pooling and Servicing Agreement (PSA) for CMBS loans or a specific Loan Agreement or Servicing Agreement for bilateral or portfolio loans.<sup>4</sup> Common triggers include:

- Monetary Default: Failure to make scheduled payments of principal or interest beyond any applicable grace period.

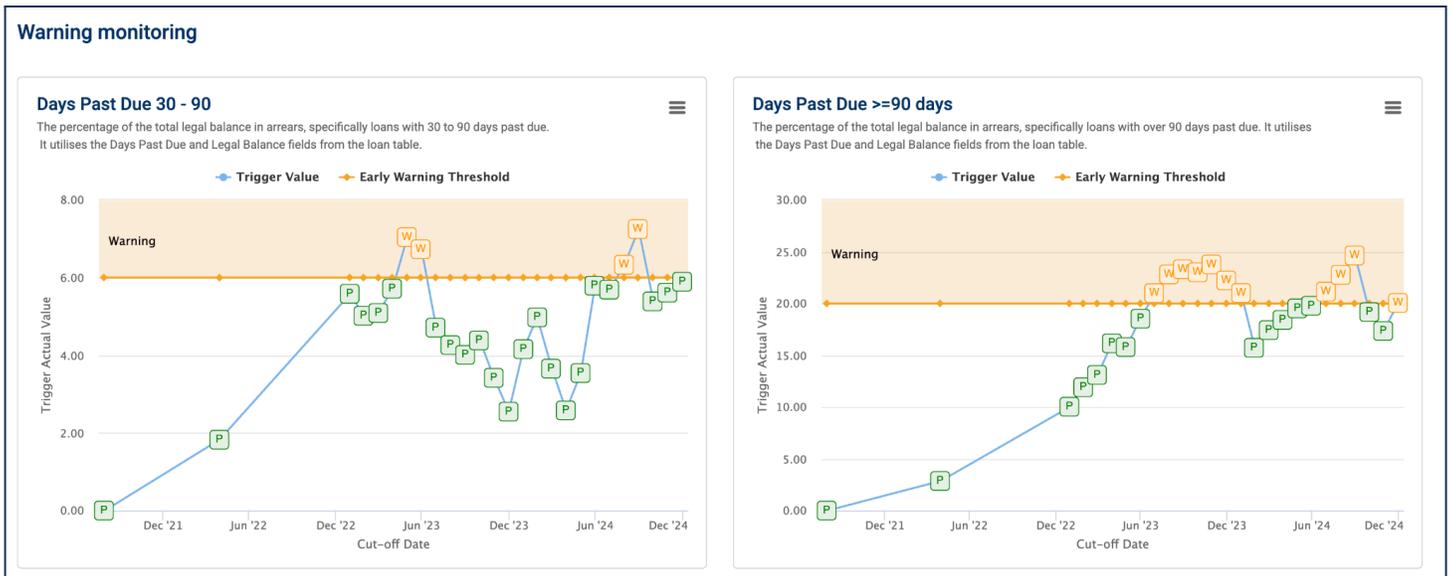


Figure 1: Monitoring of loan performance, covenants and key performance indicators. Source: Accuria Platform

- Covenant Breaches: Violation of specific financial covenants, such as the Loan-to-Value (LTV) ratio exceeding a threshold or the Debt Service Coverage Ratio (DSCR) falling below a minimum level.
- Maturity Default: Failure to repay the loan principal in full on its scheduled maturity date.<sup>3</sup>
- Borrower Insolvency: The borrower filing for bankruptcy, administration, liquidation, or other insolvency proceedings.
- Imminent Default: A determination (based on criteria in the governing agreement) that the borrower

is likely to default in the near future, even if currently making payments.<sup>1</sup>

- **Material Adverse Changes:** Significant negative events impacting the property's value or operating performance, or the borrower's financial standing.

The mechanism triggering the transfer is itself a critical operational element. Effective loan portfolio management requires **IT systems** capable of continuously monitoring loan performance against payment schedules and financial covenants documented in the governing agreements. Automating the detection of these triggers allows the servicer (whether master or special) to identify distress signals early. This proactive identification is crucial because it enables quicker intervention, potentially preserving more value for investors compared to reactive management initiated only after significant deterioration or prolonged default (Figures 1 and 2).

Cut-Off Date	Early Warning	Description	Threshold	Direction	Status At Last Cut-Off Date	Actions
2024-12-31	Days Past Due 30 - 90	The percentage of the total legal balance in arrears, specifically loans with 30 to 90 days past due. It utilises the Days Past Due and Legal Balance fields from the loan table.	6.00	<	Pass	
2024-12-31	Days Past Due >=90 days	The percentage of the total legal balance in arrears, specifically loans with over 90 days past due. It utilises the Days Past Due and Legal Balance fields from the loan table.	20.00	<	Warning	
2024-12-31	Defaults/NPL	The percentage of the total legal balance that is classified as non-performing. It utilises the Loan Status and Legal Balance fields from the loan table.	32.89	<	Warning	
2024-12-31	IFRS Stage 3	The percentage of the loans that is classified as IFRS Stage 3 under the accounting stages. It utilises the Accounting Stages of Asset Quality and Legal Balance fields from the Loan table.	22.19	<	Pass	
2024-12-31	Days from Claim Submitted to Claim Payment	The average time in days between the date the claim was submitted and the date the claim was paid. It uses the fields Date of Guarantee Claim Payment and Date of Guarantee Claim Submitted from the Guarantee Loan table.	270.00	<	Pass	
2024-12-31	Days from Default to Claim Payment	The average time in days between the date of default and the date the claim was paid. It uses the fields Date of Guarantee Claim Payment from the Guarantee Loan table and the Date of Default from the Loan table.	252.76	<	Warning	

Figure 2: Extracting, calculating and validating KPIs and covenants. Source: Accuria Platform.

### 1.3 Roles: Special Servicer vs. Master/Primary Servicer

Understanding the distinct roles and responsibilities of master/primary servicers and special servicers is fundamental.

- **Master/Primary Servicer:** This entity handles the routine administration of performing loans. Key responsibilities include collecting payments from borrowers, managing escrow accounts for taxes and insurance, handling standard borrower communications and requests, conducting routine property inspections and financial statement reviews, and distributing funds and reports to investors or the trustee. In the early stages of delinquency, the master servicer might undertake initial collection efforts.
- **Special Servicer:** This entity becomes involved only when a loan experiences a servicing transfer event. The special servicer takes over all communication with the borrower regarding the default

and its resolution. Their expertise lies in managing distressed assets, formulating and executing workout strategies (like modifications or forbearance), pursuing enforcement actions (such as foreclosure or appointing receivers), and managing properties that become Real Estate Owned (REO) following foreclosure. Special servicers typically possess greater discretionary authority than master servicers when dealing with non-performing loans.<sup>5</sup>

A critical distinction lies in their primary duty. While master servicers focus on efficient administration, special servicers owe their primary fiduciary duty to the investors (e.g., the CMBS trust or fund investors).<sup>3</sup> Their mandate is to maximize the recovery on the distressed loan for the benefit of these investors, acting in accordance with a defined Servicing Standard stipulated in the PSA or servicing agreement.<sup>8</sup> This standard generally requires the special servicer to act prudently and consistently with accepted industry practices, often measured against how they would manage their own assets or comparable assets for other third parties.<sup>9</sup> Adherence to this standard is paramount and subject to scrutiny.

Table 1: Comparison of Master/Primary vs. Special Servicer Roles in UK CRE

Feature	Master/Primary Servicer	Special Servicer
Role Focus	Administration of Performing Loans	Resolution of Distressed/Defaulted Loans
Key Responsibilities	Payment collection, Escrow management, Routine communication, Basic monitoring, Investor reporting distribution	Workout negotiation, Loan modification, Enforcement actions (Foreclosure/Receivership), REO management, Distressed asset analysis <sup>1</sup>
Primary Duty Owed To	Typically the Securitisation Trust/Lender (for administration)	Noteholders/Investors (to maximize recovery)
Typical Compensation	Basis points on outstanding loan balance	Fees during default, Workout fees, Disposition fees, Incentive fees <sup>3</sup>
Key Decision Authority	Limited (operational decisions)	Significant (loan modifications, enforcement) <sup>2</sup>

The clear separation of roles necessitates robust protocols for the handover process when a loan is transferred to special servicing. A seamless transition is vital to prevent delays or information loss during a critical workout or enforcement phase. The special servicer requires immediate access to all pertinent loan, property, borrower, and historical communication data. Furthermore, the special servicer

must meticulously document all actions, analyses, and decisions taken, demonstrating compliance with the Servicing Standard for investor reporting and potential audits.

It is also important to recognise potential conflicts of interest inherent in the special servicer role. Compensation structures often include fees earned only while a loan is in default, workout fees tied to successful restructurings, and disposition fees upon property sale.<sup>3</sup> Some agreements may even grant the special servicer the right to purchase REO assets, potentially at a discount.<sup>4</sup> These factors can create a conflict between the special servicer's financial incentives and the borrower's desire to retain the property or achieve the fastest possible return to performing status. This dynamic shapes negotiations, making it crucial for borrowers to understand that the special servicer's objective (maximizing investor recovery under the Servicing Standard) may diverge from their own. The Servicing Standard acts as a crucial, albeit partial, constraint on the special servicer's actions in navigating these conflicts.

## 2. Special Servicing Strategies and Decision-Making

### 2.1 Overview of Workout Strategies

Once a loan transfers, the special servicer evaluates the situation and determines the optimal strategy to maximize recovery for the investors, always operating within the bounds of the applicable Servicing Standard. A range of workout and resolution strategies are available:

1. **Forbearance Agreements:** Providing temporary relief by allowing the borrower to delay or reduce payments for a defined period. This gives the borrower breathing room to address short-term issues (e.g., re-tenanting space, completing minor works). It is often a precursor to a more permanent modification and requires a credible plan for the loan to return to performance. These agreements are formally documented.<sup>12</sup>
2. **Loan Modification/Restructuring:** Altering the original loan terms to make them more manageable for the borrower. Common modifications include extending the maturity date, changing the interest rate (fixed/floating, margin), altering the amortization schedule (e.g., interest-only period), deferring or capitalising interest or principal, or, less commonly, forgiving a portion of the principal. Modifications are often contingent on the borrower injecting fresh equity, providing enhanced guarantees, or meeting specific performance milestones. A thorough analysis of the borrower's revised business plan and capacity to meet the modified terms is essential.<sup>10</sup>
3. **Consensual Property Sale:** An agreement where the borrower sells the underlying property, with proceeds used to repay the debt. The special servicer may oversee or approve the sale process.
4. **Deed-in-Lieu of Foreclosure:** The borrower voluntarily transfers title of the property to the lender (or the CMBS trust) to satisfy the debt and avoid the formal foreclosure process. This requires the lender to be comfortable taking ownership and requires clear title and due diligence on property liabilities (e.g., environmental).
5. **Note Sale:** The special servicer facilitates the sale of the defaulted loan itself to a third-party investor, typically one specializing in distressed debt.<sup>7</sup> This allows the original investors to achieve a

potentially quicker recovery, albeit likely at a discount.

6. **Enforcement:** When consensual workouts fail or are deemed unlikely to maximize recovery, the special servicer will pursue enforcement remedies under the loan security. In the UK, this primarily involves appointing an LPA Receiver or seeking the appointment of an Administrator.

The selection and implementation of these strategies are rarely linear. Special servicers often employ a dual-tracking approach, simultaneously negotiating a potential workout (like a modification) while progressing the necessary steps for enforcement.<sup>6</sup> This maintains pressure on the borrower during negotiations and ensures the servicer can pivot quickly to enforcement if discussions break down, minimizing delays in the recovery process. This necessity for managing parallel paths highlights the need for sophisticated case management capabilities in supporting software.

Market conditions significantly influence strategy selection and success rates. Recent analysis (comparing H2 2023 to H1 2024 in a US CMBS context) indicated a potential increase in modifications, extensions (sometimes termed *extend and pretend*), and foreclosures, alongside a decrease in successful resolutions and REO (Real Estate Owned) strategies.<sup>7</sup> Furthermore, different special servicing entities may exhibit distinct strategic preferences, influenced by their internal capabilities, compensation structures, and potentially relationships with specific investor groups.<sup>14</sup> This variability underscores that the optimal strategy is highly context-dependent, influenced by the specific loan, property characteristics, borrower situation, prevailing market conditions, and the servicer's own operational model.

Table 2: Summary of UK CRE Workout Strategies

Strategy	Description	Key Considerations	Typical Use Case
Forbearance	Temporary suspension or reduction of payments. <sup>3</sup>	Borrower's issues deemed temporary; credible recovery plan; formal agreement needed. <sup>10</sup>	Short-term cash flow disruption (e.g., tenant vacancy, minor delay).
Loan Modification	Permanent change to loan terms (rate, term, amortization, etc.). <sup>1</sup>	Borrower deemed creditworthy; viable business plan; often requires borrower equity/guarantees. <sup>6</sup>	Long-term affordability issues but viable asset/borrower; maturity default resolution.
Consensual Property Sale	Borrower agrees to sell the property to repay debt. <sup>3</sup>	Market conditions permit sale at acceptable value; borrower cooperation.	Borrower accepts inability to hold assets; faster than foreclosure if buyer is found.
Deed-in-Lieu	Borrower voluntarily transfers	Clear title; lender accepts	Borrower cooperative but

of Foreclosure	property title to lender. <sup>1</sup>	ownership risks (environmental, operational); avoids foreclosure costs/delays.	unable to repay/sell; lender willing to take ownership.
Note Sale	Selling the defaulted loan to a third party. <sup>7</sup>	Market for distressed debt exists; allows original lender/investors quicker exit, likely at a discount.	Lenders/investors seek accelerated exit; complex workout anticipated.
Enforcement (UK Specific)	Appointing LPA Receiver or Administrator to take control.	Workout attempts failed or deemed inappropriate; necessary legal grounds exist under security/law.	Non-cooperative borrower; severe default; maximizing recovery through asset control/sale deemed optimal.

## 2.2 Enforcement Mechanisms: Administration vs. LPA Receivership in the UK

When consensual workouts are not viable, UK lenders typically resort to appointing either an LPA Receiver (also known as a Fixed Charge Receiver) or an Administrator. The choice depends on the nature of the security held and the strategic objectives.

- **LPA Receiver / Fixed Charge Receiver:**

- Appointment: Appointed by a lender holding a *fixed charge* over specific assets, most commonly property. The power to appoint usually stems directly from the mortgage deed or charge document, which often grants wider powers than the basic statutory rights under the Law of Property Act 1925 (LPA). Appointment can be very swift following a default as defined in the security document, and borrower insolvency is not a prerequisite.<sup>15</sup>
- Focus & Powers: The receiver takes control of the *specific assets* subject to the fixed charge. Their powers, primarily defined in the charge document, typically include managing the property (collecting rent, insuring, repairing) and, crucially, selling it to recover the secured debt. The statutory power of sale under the LPA itself is more limited, hence the reliance on contractual powers.<sup>19</sup>
- Duty: The receiver's primary duty is to the *appointing secured creditor* – to take custody of the asset and realise it to repay their debt.<sup>15</sup> While technically acting as agent of the borrower (unless the borrower enters winding up/bankruptcy), they owe the borrower only a duty to act in good faith, not necessarily to achieve the absolute best price beyond what's needed to cover the secured debt and costs.
- Suitability: Generally preferred for straightforward enforcement against a specific property asset, especially when the lender wants direct control focused solely on their recovery. It is typically quicker and less expensive than administration.<sup>17</sup>

- **Administrator:**

- Appointment: Appointed over the *entire company*, not just specific assets, under the Insolvency Act 1986. Appointment can be by the court, the company's directors, or a qualifying floating charge holder (QFCH) – often the lender holding security over all or substantially all of the company's assets.
- Focus & Powers: The administrator takes control of the company's business, affairs, and all its property. They have broad statutory powers, including the ability to continue trading the business, sell assets, or propose a restructuring plan (like a Company Voluntary Arrangement).<sup>16</sup>
- Duty: The administrator has a statutory duty to act in the interests of *all creditors* as a whole, pursuing a hierarchy of objectives: (1) rescuing the company as a going concern; if not possible, (2) achieving a better outcome for creditors collectively than in a winding-up; and only if neither (1) nor (2) is reasonably practicable, (3) realising property to pay secured or preferential creditors.
- Moratorium: Appointment triggers an automatic statutory moratorium, which freezes most legal actions and enforcement steps against the company by creditors, providing breathing space for the administrator to formulate proposals.<sup>16</sup>
- Suitability: Favoured when a company rescue might be possible, when dealing with complex business operations rather than just passive property assets, or when a moratorium is needed to prevent disruptive actions by other creditors. It provides control over the entire company entity. However, it is generally more costly and potentially slower than receivership, and the administrator's duties extend beyond the appointing lender. An administrator also has the power to require a previously appointed LPA receiver to vacate office.<sup>17</sup>

The strategic decision between these routes is critical. LPA Receivership offers a targeted, lender-focused tool for asset realisation, while Administration provides a broader, company-focused approach with potential for rescue and protection via moratorium. The specific security package held by the lender (fixed charge over property vs. qualifying floating charge over the company) is a key determinant of the available options. Software systems supporting special servicing must be able to differentiate between these UK-specific enforcement routes, track the relevant security structures, and manage the distinct legal procedures, timelines, and reporting obligations associated with each.

It is worth noting that while Administrative Receivership (appointed under older floating charges) technically still exists, its use has been heavily restricted since the Enterprise Act 2002, making Administration the predominant company-wide insolvency procedure initiated by secured lenders holding qualifying floating charges.<sup>16</sup> LPA/Fixed Charge Receivership remains a common and vital tool for enforcing security over specific property assets.

### 2.3 The Decision Framework: Key Criteria and Influencing Factors

The special servicer's decision on which strategy to pursue involves a complex analysis of multiple

quantitative and qualitative factors:

- Core Financial Metrics:
  - Loan-to-Value (LTV): Comparing the outstanding loan balance to the current market value of the property is fundamental.<sup>6</sup> A high LTV suggests limited equity cushion, increasing the risk of loss upon sale and potentially making modification less attractive without significant borrower equity injection. Accurate, up-to-date valuations are critical in special servicing.
  - Debt Service Coverage Ratio (DSCR): Assessing the property's ability to generate sufficient Net Operating Income (NOI) to cover its debt payments (principal and interest) is crucial. A DSCR below 1.0x signifies a cash flow shortfall. Persistently low DSCR indicates an unsustainable debt structure. Lenders typically underwrite loans with DSCRs comfortably above 1.0x (e.g., 1.25x or higher)<sup>22</sup>, so a decline towards or below 1.0x is a major red flag.
- Property/Asset Viability: The analysis goes beyond headline metrics to assess the underlying asset's quality and prospects. This includes its physical condition, location, position within its specific market segment (office, retail, industrial, etc.), the stability and quality of the existing rent roll (tenant mix, lease expiry profile), potential for value enhancement through refurbishment or repositioning, and the capital expenditure required.<sup>10</sup> Understanding whether the distress is due to property-specific issues or broader market downturns is key.
- Borrower Analysis: Evaluating the borrower's financial capacity, track record, and willingness to cooperate is vital.<sup>6</sup> Can and will the borrower inject new equity? Do they have credible guarantors? Is their proposed business plan for recovery realistic? A cooperative borrower with a viable plan is more likely to achieve a consensual workout than an uncooperative one. The assessment of the borrower's creditworthiness is central to determining if a workout is a prudent option, even if it results in a modified loan with initially weaker metrics.<sup>10</sup> Regulatory guidance often encourages working with borrowers deemed creditworthy despite temporary difficulties.
- Loan Structure & Documentation: The specific terms of the loan agreement, any intercreditor agreements (if mezzanine or other debt exists), and the security package dictate the lender's rights and options. This includes understanding the exact triggers for default and enforcement, the priority of payments, and any specific rights granted to junior lenders (like cure rights).<sup>23</sup>
- Market Conditions: The prevailing CRE market climate heavily influences strategy. Is there sufficient liquidity for refinancing? What is the investor appetite for assets of this type and location? Are cap rates compressing or expanding? Can a sale achieve a reasonable price in the current market?<sup>7</sup>
- Servicing Standard & Investor Directives: All decisions must comply with the overarching Servicing Standard, aimed at maximizing net present value recovery for the investors. In CMBS structures, the Controlling Class Representative (representing the most subordinate bondholders) often has rights to approve or direct certain major servicing decisions.<sup>9</sup>

The analysis highlights that special servicing decisions are not driven by simple thresholds. Quantitative data provides the foundation, but qualitative judgment regarding the property's potential, the borrower's reliability, and market trajectory is essential. Effective decision-making requires sophisticated analytical tools capable of modeling different scenarios (e.g., the impact of varying interest rates on DSCR, the projected value uplift from capital expenditure, Figure 3) and comparing the estimated financial

outcomes of alternative strategies (e.g., modification vs. immediate sale vs. enforcement). Documenting the rationale for the chosen strategy, referencing these multiple factors, is crucial for demonstrating compliance with the Servicing Standard to investors and regulators.

## 2.4 Illustrative Quantitative Examples

The interplay between quantitative metrics and qualitative factors determines the chosen strategy:

### **Scenario 1 (Modification - Consensual Workout):**

- *Asset:* A multi-let office building in a secondary UK city.
- *Trigger:* DSCR covenant breach (fell to 1.10x vs. 1.25x required) due to a major tenant vacating at lease expiry. LTV is currently 70% based on a recent valuation reflecting the vacancy. Loan matures in 18 months.
- *Borrower Situation:* Experienced sponsor with other assets, cooperative, has identified a potential replacement tenant but requires funds for fit-out and letting incentives. Proposes injecting 50% of required capex as new equity.
- *Decision Basis:* Asset remains fundamentally sound in a stable, albeit not prime, market. The borrower is cooperative and willing to inject equity. The prospect of re-leasing and restoring DSCR above covenant level within 6-9 months is credible. LTV remains acceptable. Modification avoids enforcement costs and potential value loss in a forced sale.
- *Strategy & Metrics:* Agree to modify the loan: extend maturity by 2 years, provide short-term interest-only period (6 months), potentially capitalise a portion of interest shortfall during lease-up, conditional on borrower equity injection and achieving leasing milestones. Monitor DSCR recovery closely.

### **Scenario 2 (LPA Receivership - Enforcement):**

- *Asset:* A portfolio of three regional industrial units.
- *Trigger:* 90+ days monetary default. DSCR consistently below 0.8x for 12 months. LTV estimated at 90% based on a recent distressed valuation. The loan matured 3 months ago (maturity default).
- *Borrower Situation:* Borrower has failed to engage meaningfully, provided unrealistic refinancing promises, and lacks funds to cure defaults or support the assets. Communication has broken down.
- *Decision Basis:* Loan is non-performing with significant cash flow shortfall and high leverage. Borrower is uncooperative and lacks capacity for a workout. Consensual sale unlikely given borrower behaviour. Enforcement via LPA Receivership over the properties (assuming fixed charges exist) is deemed the most efficient route to secure the assets, manage them professionally, and proceed to sale to maximize recovery for the lender under the Servicing Standard.
- *Strategy & Metrics:* Appoint LPA Receiver under powers in the charge documents. Receiver takes control, secures properties, ensures insurance/maintenance, collects any rent, appoints agents, and markets properties for sale. Recovery analysis based on estimated sale prices less costs vs. outstanding debt.

Predefined cluster options, click to select

Corporate/Retail Date of Default (year) Guarantee Type Legal Balance (Buckets) Mortgage Rank

Settings Clusters Download

Name Of Insolvency Or Restructuring Proceedings CP	# Loans	C.Bal (Mn)	C.Bal (%)	Avg. Loan Size	# Borrowers	Default Years	Number Of Property Collateral	Value Of Property Collateral (Mn)	Value Of Property Collateral (%)
<b>Total</b>	1,100	168.86	100.00	153,506	1,097	7.41	1,101	23.71	100.00
Bankruptcy or insolvency proceedings	7	1.12	0.66	159,316	7	6.48	7		
Composition plan with creditors	1	0.12	0.07	123,261	1	3.57	1		
Debt restructuring, rescue, or rehabilitation plan...	21	2.92	1.73	139,056	21	5.52	21	0.37	1.55
Mortgage foreclosure or secured creditor enforcement...	747	119.40	70.71	159,838	745	8.12	748	19.77	83.39
Other	91	11.75	6.96	129,168	91	3.94	92	0.17	0.74

Figure 3: Monitoring voluntary and in-court workout scenarios. Source: Accuria Platform.

### Scenario 3 (Administration - Enforcement/Restructuring):

- **Asset:** A group of companies owning and operating several hotels, financed by senior and mezzanine debt.
- **Trigger:** Operating company faces severe liquidity issues due to market downturn, triggering defaults under both senior and mezzanine loans. Cross-defaults triggered across the group. Impending risk of winding-up petitions from unsecured trade creditors.
- **Borrower Situation:** Management is overwhelmed; complex group structure; potential value exists in the brand and operating platform if stabilized. Mezzanine lenders are concerned about their position.
- **Decision Basis:** Need to control the entire operating group, not just the property assets. Administration provides a moratorium protecting against actions by unsecured creditors and allows time to assess rescue/sale options for the business as a whole. It offers broader powers than LPA Receivership to manage the ongoing business. Senior lender (as QFCH) decides administration is the best route to achieve a better outcome for creditors overall (Objective 2 of administration) compared to immediate liquidation or piecemeal asset sales.
- **Strategy & Metrics:** Appoint Administrators. Administrators assess viability, potentially trade the hotels while seeking a buyer for the group as a going concern, or implement an orderly sale of assets/hotels. Financial analysis compares estimated outcomes from going concern sale vs. breakup liquidation, considering all creditor claims according to statutory priorities.

These examples illustrate that while LTV, DSCR, and arrears are critical inputs, the final strategy depends heavily on the context – asset type, borrower engagement, market conditions, and the specific legal tools available under the security package and UK law.

### 3. Lender-Specific Considerations

The identity and nature of the lender significantly influence the approach taken during special servicing. Banks and debt funds, the two primary categories of CRE lenders, operate under different constraints and motivations.

#### 3.1 Bank Approaches to Senior CRE Loan Workouts

Traditional banks typically hold senior positions in the capital stack, often retaining these loans on their balance sheets. Their approach to workouts is heavily influenced by:

- **Regulation:** Banks in the UK are subject to stringent prudential regulation by the PRA. Capital adequacy rules mean that non-performing or forborne loans attract significantly higher risk-weightings (RWAs), requiring the bank to hold more capital against them<sup>24</sup>. Furthermore, the IFRS 9 accounting standard mandates substantial expected credit loss (ECL) provisions against distressed loans, impacting profitability.<sup>11</sup> This regulatory burden creates a strong incentive for banks to resolve troubled loans efficiently to minimize capital strain and provision charges.
- **Relationship Management:** Banks often have broader relationships with borrowers beyond a single loan. Maintaining long-term client relationships can be a factor, potentially making banks more inclined towards consensual workouts with cooperative, creditworthy borrowers, provided the workout plan is sound.<sup>10</sup>
- **Internal Processes:** Decision-making typically involves internal credit committees and established procedures, which can sometimes lead to slower response times compared to more agile debt funds.
- **Strategic Intent:** The bank's strategy for the loan (hold-to-maturity vs. potential syndication/securitisation) can influence its workout appetite.

Overall, while banks are focused on recovery, regulatory pressures and relationship considerations may lead them to favour structured workouts and modifications where feasible, rather than immediate enforcement, especially if the borrower demonstrates creditworthiness and cooperation.<sup>10</sup>

#### 3.2 Debt Fund Strategies and Objectives

Debt funds, including private real estate debt funds, often operate differently:

- **Capital Stack Position:** They may hold senior debt but are also active in providing mezzanine finance or whole loans, sometimes taking on higher leverage or risk profiles than traditional banks. They are also significant buyers of NPL portfolios.
- **Regulation:** Debt funds are generally subject to less direct prudential regulation regarding capital and provisioning compared to banks, although they are regulated as fund managers. This can

afford them greater flexibility in structuring deals and managing workouts.

- **Primary Driver:** The key objective for a debt fund is typically to achieve a target Internal Rate of Return (IRR) for its investors (Limited Partners) within a defined fund life. Decisions are primarily driven by maximizing this return.
- **Workout Approach:** While seeking to maximize recovery, their focus on IRR and potentially shorter investment horizons might lead them to pursue enforcement or loan sales more readily if a workout appears protracted or unlikely to meet return hurdles. Opportunistic strategies, such as "loan-to-own" (acquiring the property through enforcement of debt), may be more common.
- **Operational Model:** Debt funds frequently utilize experienced third-party special servicers to handle the complexities of workouts and enforcement, leveraging external expertise.
- **Governing Documents:** Decisions are guided by the fund's governing documents (Limited Partnership Agreement, Investment Management Agreement) and investor mandates.

The fundamental difference in drivers – regulatory capital and balance sheet stability for banks versus IRR maximization for funds – often results in differing risk appetites and preferred resolution paths. A bank might accept a workout delivering slightly lower recovery if it avoids the significant capital impact and operational burden of taking ownership (REO), whereas a fund might pursue enforcement more aggressively if that path is projected to yield the highest IRR, even if it means acquiring the asset.

Table 3: Comparing Bank vs. Debt Fund Approaches to UK CRE Workouts

Factor	Banks	Debt Funds
Regulation	High (PRA capital, IFRS 9 provisioning) <sup>24</sup>	Lower (Fund manager regulation, fewer capital constraints)
Primary Driver	Balance sheet stability, Regulatory compliance, Profitability	IRR maximization for investors, Fund life cycle
Risk Appetite	Generally more conservative, influenced by RWAs	Often higher, driven by return targets
Typical Position	Often Senior Debt	Senior, Mezzanine, Whole Loans, NPLs
Decision Speed	Potentially slower (internal committees)	Potentially faster (more agile structures)
Preferred Strategies	May favour consensual workouts/modifications if viable <sup>10</sup>	Flexible; potentially quicker to enforcement/loan sale if IRR driven

## 4. Forbearance and Intercreditor Dynamics

### 4.1 Considerations for Granting Forbearance

Forbearance represents a temporary concession granted by a lender to a borrower facing financial difficulty. Key considerations include:

- **Purpose:** It provides short-term relief, typically involving delayed or reduced payments, to allow the borrower time to overcome temporary issues.<sup>3</sup> It is not usually a permanent solution.
- **Borrower Assessment:** Granting forbearance generally requires an assessment that the borrower's financial difficulties are temporary and that there is a reasonable prospect of them resuming full payments after the forbearance period.<sup>10</sup>
- **Formal Agreement:** Forbearance arrangements are typically documented in a formal Forbearance Agreement, specifying the terms of the relief, the duration, conditions, and the lender's rights if the borrower breaches the agreement.<sup>12</sup>
- **Interest Accrual:** Interest typically continues to accrue during the forbearance period, meaning the total amount owed increases.<sup>11</sup>
- **Credit Reporting:** While agreed forbearance periods may not be reported as missed payments to credit reference agencies, the underlying financial distress might still be noted, and lenders need to be clear about the reporting implications.<sup>28</sup>
- **Lender's Perspective:** The lender must weigh whether forbearance genuinely enhances the likelihood of maximizing recovery compared to simply delaying necessary enforcement action.<sup>10</sup>
- **Regulatory Treatment (IFRS 9 & CRR):** Granting forbearance does not automatically trigger a Significant Increase in Credit Risk (SICR) under IFRS 9 or a default classification under the Capital Requirements Regulation (CRR), particularly if the issues are deemed temporary (as seen in Covid-19 guidance). However, concessions granted due to longer-term financial difficulties typically constitute forbearance under CRR definitions and impact staging under IFRS 9.<sup>11</sup>

### 4.2 Payment Holidays with Senior/Mezzanine Debt: The Role of the Intercreditor Agreement (ICA)

When a property is financed with multiple layers of debt (e.g., senior and mezzanine loans), the relationship between the lenders is governed by an Intercreditor Agreement (ICA). This document is critical in determining how forbearance or payment holidays are handled:

- **Payment Priority (Waterfall):** The ICA strictly defines the order in which property income is applied to debt service. Typically, all senior loan interest, principal, fees, and costs must be paid in full before any funds can flow to the mezzanine lender.
- **Senior Lender Control:** The senior lender (or the servicer/special servicer acting on their behalf) almost invariably controls decisions regarding the senior loan, including whether to grant waivers, modifications, or forbearance that affects the cash flow available for senior debt service. The ICA grants the senior lender consent rights over such actions.
- **Mezzanine Lender Standstill:** ICAs contain standstill provisions that restrict the mezzanine lender's ability to take enforcement action (e.g., enforcing its own security or calling guarantees) for a

specified period following certain defaults (either senior or mezzanine defaults, depending on the negotiation).<sup>23</sup> This prevents the mezzanine lender from disrupting the senior lender's workout strategy.

- **Decision on Payment Holidays:** The decision to grant a payment holiday on the senior debt rests solely with the senior lender (or their appointed servicer/special servicer). The mezzanine lender cannot compel the senior lender to grant such relief. If the senior lender grants a payment holiday, it does not automatically mean funds flow to the mezzanine lender; this depends entirely on the property's cash flow generation relative to senior obligations and the specific terms of the ICA waterfall. Often, the underlying issue causing the need for a senior payment holiday means insufficient cash flow exists for mezzanine payments anyway.
- **Mezzanine Forbearance:** The mezzanine lender can typically grant forbearance on its *own* loan (e.g., deferring its own interest), but only to the extent permitted by the ICA and provided it does not adversely affect the senior lender's position or security.
- **Mezzanine Rights:** While direct control is limited, mezzanine lenders often negotiate specific rights in the ICA, such as the right to *cure* defaults on the senior loan (by making the payment themselves) to prevent senior enforcement, or the right to *purchase* the senior loan at par plus accrued interest and costs upon certain trigger events. These rights provide strategic leverage or exit options for the mezzanine lender.

The ICA is therefore the controlling document in multi-layered debt structures. It establishes the hierarchy, control rights, and restrictions governing lender actions during periods of distress. Any software system managing such loans must have the capability to accurately model the specific payment waterfall, consent requirements, standstill provisions, cure rights, and purchase options defined within the deal-specific ICA.

## 5. UK Regulatory Landscape for Special Servicing

The actions of special servicers, particularly those working for regulated banks, are significantly influenced by the UK regulatory environment.

### 5.1 Prudential Regulation Authority (PRA) Rules and Implications

The PRA, part of the Bank of England, oversees the prudential soundness of UK banks and large investment firms. Its regulations directly impact how banks manage distressed CRE loans:

- **Capital Requirements:** The PRA sets minimum capital requirements (Pillar 1) and firm-specific add-ons (Pillar 2A) based on its assessment of a firm's risks.<sup>26</sup> These requirements mandate that banks hold sufficient capital against their Risk-Weighted Assets (RWAs).
- **Risk-Weighted Assets (RWAs):** Loans classified as non-performing or subject to forbearance measures typically attract higher risk weights under both the Standardised Approach (SA) and Internal Ratings-Based (IRB) approaches to credit risk. This increase in RWAs directly translates

into higher capital requirements for the bank holding the loan. The PRA may also impose specific risk-weight floors for certain asset classes, such as the potential 100% floor for CRE exposures under the SA mentioned in consultation papers.<sup>27</sup>

- Incentive to Resolve: The increased capital cost associated with holding distressed assets creates a strong regulatory incentive for banks to actively manage and resolve these exposures, either through successful workouts or through enforcement and disposal.
- Definitions and Guidance: The PRA Rulebook, incorporating elements of the EU Capital Requirements Regulation (CRR) and EBA standards, provides the definitions of default and forbearance that determine regulatory classification and capital treatment.<sup>11</sup> The PRA also issues guidance on specific situations, such as the treatment of COVID-19 related payment deferrals.<sup>11</sup>

The PRA's framework ensures that the capital cost of holding distressed loans is a significant factor in a bank's economic assessment of different workout and enforcement strategies.

## 5.2 Impact of IFRS 9 on Expected Credit Loss (ECL) Provisions and Capital

The introduction of International Financial Reporting Standard 9 (IFRS 9) fundamentally changed how banks provision for credit losses, moving from an incurred loss model (IAS 39) to an expected credit loss (ECL) model.<sup>25</sup> Key impacts include:

- Staging Approach: IFRS 9 uses a three-stage approach. Stage 1 assets (performing) require provisions for 12-month ECL. Stage 2 assets (those that have experienced a Significant Increase in Credit Risk (SICR) since origination) require provisions for lifetime ECL. Stage 3 assets (credit-impaired, typically defaulted) also require lifetime ECL provisions.<sup>11</sup>
- Earlier Recognition: The critical trigger is the move to Stage 2 (SICR), which often occurs *before* a formal default or transfer to special servicing. This results in earlier recognition of potentially significant lifetime ECL provisions compared to the previous incurred loss model.<sup>25</sup> SICR assessment is complex, involving forward-looking information, model outputs, and backstops like being 30 days past due.<sup>11</sup>
- Complexity and Procyclicality: ECL calculations are complex, often relying on sophisticated models incorporating multiple forward-looking macroeconomic scenarios (base, upside, downside). This complexity adds operational burden. The forward-looking nature can also lead to procyclicality, potentially overestimating losses during sharp downturns, although the COVID-19 pandemic's impact was somewhat masked by government support measures.<sup>25</sup>
- Capital Impact: The introduction of IFRS 9 generally led to an increase in overall provisions. Transitional arrangements allowing banks to phase in the impact on regulatory capital have now largely expired in the UK, meaning the full capital effect of ECL provisions is typically recognised.

IFRS 9's requirement to provision for lifetime expected losses upon a significant increase in credit risk (Stage 2) means that the financial impact of deterioration is felt earlier by banks, influencing the economics and timing of intervention and workout strategies. The complexity of ECL calculations

necessitates robust data infrastructure and modelling capabilities.

### 5.3 Treatment of Non-Performing and Forborne Loans (RWAs)

Under the PRA's implementation of the Basel framework (via the PRA Rulebook/CRR), loans classified as non-performing (NPLs – typically defined as >90 days past due or where repayment in full is considered unlikely without recourse to security) or forborne (where concessions like modified terms are granted due to the borrower's financial difficulty) receive specific regulatory treatment.<sup>11</sup> This generally involves applying higher risk weights compared to performing loans, whether under the Standardised Approach or IRB models. This higher RWA directly increases the amount of regulatory capital a bank must hold against that exposure, reinforcing the incentive for timely resolution. The precise definitions and criteria for classifying loans as NPL or forborne are detailed in regulatory standards (originating from EBA technical standards and CRR) and are crucial for determining the correct capital treatment.

Software supporting bank special servicing operations must accurately classify loans according to these regulatory definitions and calculate the corresponding RWAs and ECL provisions under IFRS 9, enabling accurate capital reporting and the modelling of capital implications for different resolution scenarios.

## 6. Asset-Specific Considerations

The nature of the underlying CRE asset significantly shapes the special servicing strategy.

### 6.1 Strategies for Income-Generating Properties (e.g., Office, Retail, Industrial, Multifamily)

For properties that derive their value primarily from rental income streams, special servicing focuses on:

- **Stabilising Operations:** The immediate goal is often to stabilise the property's Net Operating Income (NOI) and occupancy levels.
- **Leasing and Tenant Management:** Strategies frequently involve negotiating with existing tenants (lease restructuring, rent concessions in exchange for longer terms), marketing vacant space, and securing new tenants. Tenant credit quality becomes a key focus.
- **Capital Expenditure (Capex):** Investment in refurbishment, upgrades, or repositioning may be necessary to attract or retain tenants and maintain or enhance the property's market competitiveness and value. The special servicer must assess the viability and funding of such Capex.
- **Valuation Drivers:** Property value is heavily influenced by the current and projected income stream, tenant covenant strength, lease lengths, and prevailing market yields (capitalisation rates).
- **Workout Structures:** Modifications or forbearance may be linked to achieving specific leasing targets or NOI milestones. DSCR is a primary metric for monitoring performance and covenant compliance.<sup>22</sup>
- **Challenges:** These assets face headwinds from broader market shifts (e.g., the impact of remote

working on office demand, the rise of e-commerce affecting retail), fluctuations in tenant demand, and potentially rising operating expenses (Figure 4).

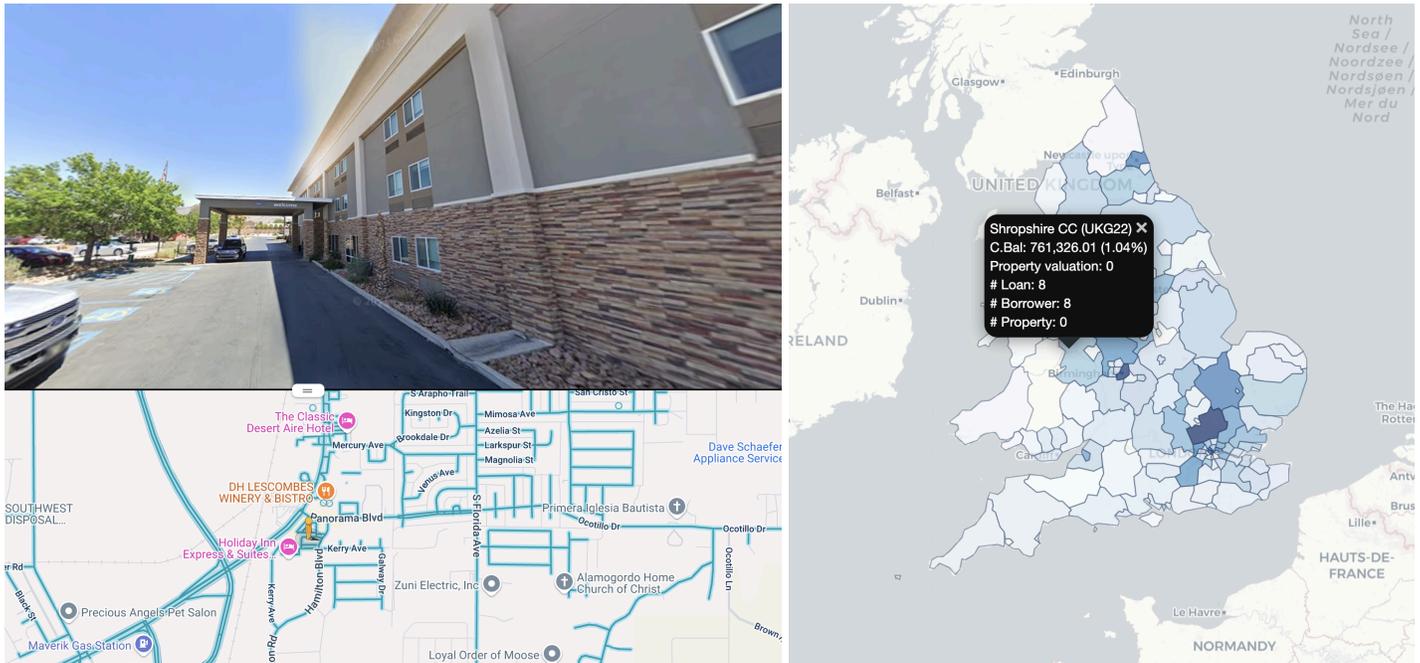


Figure 4: Monitoring regional trends, local developments and property specific risk factors. Source: Accuria Platform.

## 6.2 Strategies for Development Projects

Development projects present a different and often higher risk profile during special servicing:

- **Inherent Risks:** Distress often arises from factors beyond typical property operations, including construction cost overruns, planning permission issues, delays in completion, failure to meet pre-leasing or pre-sales targets required for funding drawdowns, or an inability to secure take-out financing upon completion.
- **Complex Workouts:** Resolution is often more complex than for stabilised assets. It may involve:
  - **Assessing Viability:** Re-evaluating the entire project's feasibility in current market conditions.
  - **Securing Funding:** Determining if further funding is needed to complete construction and, if so, whether the existing lender is willing/able to provide it or if new equity partners are required.
  - **Exit Strategy Revision:** Reassessing the optimal exit – hold and lease upon completion, sell the completed project, sell individual units/phases, or even sell the partially completed site.
- **Security and Control:** Loan security often includes step-in rights, allowing the lender to take control of the project. Appointing an LPA Receiver or Administrator with development expertise may be necessary to manage completion or sale.
- **Valuation:** Valuation is typically based on a residual methodology (estimated completed value less

remaining costs to complete and associated risks) or, if development is halted, the existing use value of the site.

The significant differences in risk profile and resolution pathways between stabilised income-producing assets and development projects necessitate distinct approaches and expertise within special servicing. Software systems need to accommodate these differences, capturing development-specific data points (e.g., construction budgets, timelines, planning status, sales rates) and supporting the unique analysis required for development workouts.

## 7. Data, Reporting, and Software Requirements

Effective special servicing is heavily reliant on robust data management, analytical capabilities, and reporting functionalities, underpinned by appropriate software systems.

### 7.1 Critical Data Elements for Effective Special Servicing

A comprehensive and accurate dataset is essential for analysis, decision-making, and reporting. Key data elements span multiple categories:

- **Loan Level:** Core contractual terms (original/current balance, interest rate details, maturity, payment schedule), performance data (payment history, arrears status, days past due), covenant compliance tracking (LTV, DSCR, ICR tests and results), detailed security information (collateral type, priority, location), guarantor details and financials, regulatory/accounting classifications (IFRS 9 stage, ECL amount, RWA), and pointers to governing legal documents (Loan Agreement, PSA, ICA).<sup>1</sup>
- **Property Level:** Asset details (type, location, size, age, condition), historical and current valuations (using multiple bases like Market Value, Investment Value), detailed tenancy information (rent roll, lease terms, expiry dates, tenant financials/covenant strength), historical and projected operating statements (NOI, Net Rental Income), occupancy data, capital expenditure history and future requirements, and relevant reports (environmental, condition surveys).
- **Borrower Level:** Borrower legal structure, financial statements (historical and projected), credit history, details of related entities or sponsors, records of all communications, and any submitted business or workout plans.
- **Workout/Enforcement Process:** Chosen resolution strategy, key dates, task tracking, legal proceedings status, third-party appointments (lawyers, receivers, agents), costs incurred, updated recovery estimates, records of approvals, and detailed communication logs.
- **Market Data:** Relevant property market data (yields/cap rates, comparable transactions, leasing data for the specific submarket and property type), and broader economic forecasts influencing forward-looking assessments.<sup>22</sup>

The sheer volume and variety of data required underscore the need for a centralised, well-structured

data management system. While industry standards like the CREFC Investor Reporting Package (IRP) provide standardised formats for many data points, particularly in the CMBS market <sup>31</sup>, bespoke requirements for portfolio loans and internal management reporting necessitate flexible data architectures. Ensuring data accuracy, completeness, and timeliness is paramount, often requiring integration capabilities with disparate source systems (e.g., loan origination, property management, accounting systems).

Table 4: Key Data Categories for CRE Special Servicing

Data Category	Key Data Points Examples	Importance/Use Case
Loan Data	Balance, Rate, Maturity, Covenants, Payment History, Arrears, Security Details, IFRS 9 Stage, ECL, RWA <sup>30</sup>	Core loan tracking, Performance monitoring, Covenant compliance, Risk assessment, Regulatory & Investor Reporting
Property Data	Type, Location, Valuation, Rent Roll, Occupancy, NOI, Capex, Condition Reports <sup>22</sup>	Asset underwriting, Performance analysis, Valuation, Workout strategy formulation (hold, sell, invest)
Borrower Data	Financials, Credit History, Structure, Communication Logs, Business Plans <sup>1</sup>	Assessing borrower viability & cooperation, Guarantor strength analysis, Workout negotiation support
Process/Workout Data	Strategy, Milestones, Legal Actions, Costs, Recovery Estimates, Approvals, Communications <sup>1</sup>	Managing the resolution process, Tracking progress & costs, Reporting on workout status, Audit trail
Market Data	Cap Rates, Comparables (Sales/Leasing), Economic Forecasts <sup>22</sup>	Valuation inputs, Benchmarking asset performance, Informing forward-looking assumptions (ECL, strategy)

## 7.2 Essential Reporting Capabilities

Special servicing software must generate a variety of reports for different stakeholders:

- **Investor Reporting:** Particularly crucial for CMBS, requiring regular, detailed updates on loan status, workout activities, cash flow applications (waterfall calculations), recovery projections, and adherence to the Servicing Standard. Standardised formats like the CREFC IRP are often mandated.<sup>1</sup> Examples include Delinquent Loan Status Reports, REO Status Reports, Operating Statement Analysis Reports (OSARs), and various reconciliation reports.<sup>31</sup>
- **Regulatory Reporting:** Generating data required by regulators like the PRA, including capital

adequacy calculations (showing RWAs based on loan status), reports on NPL and forbearance levels, and detailed IFRS 9 ECL provisioning data.<sup>24</sup>

- Internal Management Reporting: Providing portfolio-level dashboards, tracking key risk indicators (KRIs) across distressed assets, monitoring servicer performance against targets, tracking workflow progress, and highlighting exceptions or delays.
- Ad-hoc Reporting & Analytics: Enabling users to perform custom queries, generate bespoke reports, and conduct scenario analysis to support decision-making (e.g., comparing potential outcomes of different workout strategies, stress testing assumptions).<sup>6</sup>

The reporting function needs to be accurate, automated where possible, flexible to accommodate different requirements, and ideally offer strong data visualization capabilities to aid comprehension.

### 7.3 Core Software Functionalities

To meet the data and reporting needs and effectively manage the special servicing process, software solutions should possess the following core functionalities:

- Centralised Data Management: A robust database serving as a single source of truth for all loan, property, borrower, and process data, with capabilities for data validation and integration with external systems.
- Workflow and Case Management: Tools to define, execute, and monitor special servicing workflows (e.g., modification process, foreclosure process), assign tasks, track deadlines, manage approvals, and support dual-tracking of strategies.
- Document Management: Integrated system for storing, indexing, and retrieving all relevant documents associated with each loan and property.
- Financial Analysis & Modelling: Built-in calculators and modelling tools for key CRE metrics (LTV, DSCR, ICR), cash flow projections under various scenarios, IFRS 9 ECL calculations (including staging and scenario weighting), regulatory RWA calculations, and sensitivity/stress testing.<sup>6</sup>
- Reporting Engine: Capability to generate standardised industry reports (e.g., CREFC IRP), regulatory reports, and flexible custom reports with dashboards and data visualization.
- Compliance Management & Audit Trail: Features to track and document adherence to the Servicing Standard, regulatory rules (PRA, IFRS 9), and internal policies. A comprehensive, immutable audit trail logging all significant actions, decisions, and data changes is essential.<sup>8</sup>
- Communication Logging: A facility to systematically record all interactions (calls, emails, meetings) with borrowers, legal counsel, valuers, agents, and other third parties.
- Security & Access Control: Robust security measures to protect sensitive data, with granular user access controls based on roles and responsibilities.

These functionalities collectively provide the necessary infrastructure to manage the complexities of CRE special servicing, moving beyond simple data storage to offer active process management, sophisticated analysis, and robust compliance oversight.

Table 5: Core Software Functionalities for CRE Special Servicing

Functionality Area	Key Features/Capabilities	Business Need Addressed
Data Management	Central repository, Data validation, Integration APIs, Support for standards (e.g., CREFC IRP) <sup>31</sup>	Single source of truth, Data accuracy & consistency, Efficiency
Workflow/Case Management	Configurable workflows, Task assignment & tracking, Deadline monitoring, Approval chains, Dual-tracking support <sup>6</sup>	Process standardisation & control, Efficiency, Task management, Auditability
Document Management	Secure storage, Indexing, Version control, Search capabilities	Centralised access to critical documents, Compliance, Efficiency
Financial Analysis	Metric calculation (LTV, DSCR), Cash flow modelling, Scenario analysis, IFRS 9 ECL engine, RWA calculation <sup>6</sup>	Risk assessment, Workout strategy evaluation, Provisioning & Capital calculation, Decision support
Reporting Engine	Standard report templates (Investor, Regulatory), Custom report builder, Dashboards, Data visualization <sup>31</sup>	Meeting stakeholder requirements, Management oversight, Performance monitoring, Transparency
Compliance & Audit	Servicing Standard checks, Policy adherence tracking, Regulatory rule integration, Immutable audit logs <sup>8</sup>	Ensuring compliance, Risk mitigation, Transparency, Defensibility of actions
Communication Log	Structured logging of interactions (calls, emails, meetings)	Record keeping, Dispute resolution support, Audit trail
Security & Access Control	User authentication, Role-based permissions, Data encryption, Secure hosting	Data protection, Preventing unauthorised access/actions, Compliance (GDPR)

## 8. The Role of Generative AI in CRE Special Servicing

Generative Artificial Intelligence (GenAI) presents potential opportunities and significant risks for the CRE special servicing sector.<sup>35</sup>

## 8.1 Potential Applications Across the Servicing Lifecycle

GenAI's core strength lies in its ability to process, understand, and generate human-like text and summarise vast amounts of information. This capability could augment human expertise in several areas of special servicing:

- **Document Review & Summarization:** Accelerating the review of complex and lengthy documents such as loan agreements, PSAs, intercreditor agreements, valuation reports, and legal filings by generating summaries, extracting key clauses (e.g., covenants, default triggers), and identifying potential risks.
- **Communication Assistance:** Drafting initial versions of standardised communications, such as default notices, reservation of rights letters, forbearance proposals, or routine borrower updates, which would then be reviewed and finalised by human staff.
- **Data Extraction:** Potentially extracting specific data points from unstructured documents like leases, operating statements, or invoices to populate structured data fields within the servicing system. However, this requires high accuracy and robust validation processes.
- **Market Intelligence:** Assisting analysts by gathering, filtering, and summarizing relevant news articles, market reports, and economic data pertaining to specific property types, locations, or market trends. In <https://accuria.com/private-debt-ai-driven-qualitative-overlays-in-credit-risk/> we discuss the use of qualitative overlays for private debt cash flow models to capture, for instance, macro events like global trade tariffs or exposure to local environmental risks.
- **Reporting Support:** Generating narrative summaries or commentary for sections of investor or management reports based on structured data inputs and predefined templates.
- **Internal Knowledge Management:** Powering internal chatbots or search tools that allow staff to quickly find answers to procedural questions or locate specific information within internal policy documents or historical loan files.

The primary benefit lies in automating or accelerating time-consuming, text-intensive tasks, thereby freeing up experienced special servicing professionals to concentrate on higher-value activities such as complex analysis, strategic decision-making, negotiation, and relationship management.

## 8.2 Implementation Challenges and Risks

Despite the potential benefits, the adoption of GenAI in the high-stakes environment of special servicing faces significant hurdles and risks:

- **Accuracy and Reliability:** GenAI models are known to hallucinate – generating plausible-sounding but factually incorrect or nonsensical information.<sup>34</sup> Relying on inaccurate AI-generated summaries of legal terms or extracted financial data could lead to serious errors in decision-making or compliance breaches. Rigorous human validation of all critical outputs is non-negotiable.
- **Data Privacy and Security:** Feeding sensitive or confidential information (loan details, borrower financials, internal strategies) into publicly accessible or inadequately secured GenAI tools poses a major data breach risk.<sup>34</sup> Use in government and regulated industries necessitates secure, private

instances of models and strict data governance protocols to ensure compliance with regulations like GDPR.<sup>37</sup> It's crucial to understand where data is processed and stored and ensure it is not used for retraining models without consent.

- Bias: AI models trained on historical data can inherit and perpetuate biases present in that data, potentially leading to unfair or discriminatory outcomes in risk assessment or even biased language in communications.<sup>34</sup> Bias detection and mitigation strategies are essential.<sup>38</sup>
- Lack of Context and Nuance: Current GenAI may struggle to fully grasp the complex interplay of legal clauses, specific market dynamics, or the subtleties of borrower negotiations.<sup>34</sup> Human judgment and domain expertise remain indispensable.
- Over-Reliance and Deskilling: There is a risk that users may become complacent, accepting AI outputs without sufficient critical scrutiny, potentially leading to errors and an erosion of specialist skills over time.
- Integration and Cost: Integrating GenAI tools effectively into existing servicing platforms and workflows can be technically challenging and expensive.<sup>38</sup> The significant energy consumption of large models also presents environmental considerations.
- Regulatory Landscape: The regulatory framework governing the use of AI in financial services is still developing, creating uncertainty for implementation.
- Human Oversight: Maintaining meaningful human control at appropriate stages of the process is vital to ensure accountability, ethical use, and the ability to override AI suggestions when necessary.<sup>34</sup>

Given the potential for significant financial consequences arising from errors in special servicing, the adoption of GenAI must be approached cautiously, prioritizing safety, security, accuracy, and robust human oversight, in line with principles outlined in UK government guidance for AI use.

### 8.3 Future Outlook

The integration of GenAI into UK CRE special servicing is likely to be gradual and focus initially on applications that enhance efficiency in lower-risk areas.

- Initial Adoption: Likely focus on internal tasks like summarising research, drafting internal memos, assisting with initial drafts of standard external communications (subject to rigorous review), and potentially powering internal knowledge management tools.
- Maturation: As the technology improves, trust builds, and secure, domain-specific models become available, applications could expand to assist with more complex tasks like preliminary scenario analysis, identification of relevant clauses across large document sets, or generating more sophisticated components of reports.
- Human Element: Despite advancements, GenAI is unlikely to replace the core skills of experienced special servicing professionals. Negotiation, strategic thinking, complex problem-solving, relationship management, and ultimate decision-making authority will remain human responsibilities. AI will serve as a tool to augment, not replace, these capabilities.
- Success Factors: Successful adoption will depend on developing or accessing secure GenAI

platforms, fine-tuning models with high-quality, relevant CRE finance and legal data, establishing strong governance frameworks, implementing rigorous validation processes, and ensuring seamless integration with core servicing systems.

Table 6: Potential GenAI Applications & Challenges in CRE Special Servicing. For more AI use cases in credit portfolio management see [accuria.com/insights](https://accuria.com/insights)

Application Area	Potential Benefit	Key Challenges/ Risks	Required Safeguards
Document Summarization	Faster review of agreements, reports, legal docs <sup>35</sup>	Accuracy/Hallucination, Misinterpretation of legal nuance <sup>34</sup>	Rigorous human validation by legal/domain experts, Use of domain-specific models
Communication Drafting	Increased efficiency in drafting standard notices, letters <sup>35</sup>	Inappropriate tone, Inaccuracy, Bias <sup>34</sup>	Human review and approval, Templates, Tone guidelines
Data Extraction	Automate data entry from unstructured sources (leases, invoices)	Accuracy crucial, Potential for errors in critical data	High validation requirements, Confidence scoring, Human oversight
Market Research & Analysis	Quickly gather and summarise market trends, news, data <sup>37</sup>	Information may be outdated, biased, or inaccurate <sup>34</sup>	Cross-referencing with trusted sources, Human analysis overlay
Reporting Assistance	Generate narrative summaries for reports <sup>35</sup>	Risk of generic or inaccurate summaries, Lack of nuanced insight	Human editing and contextualisation, Clear prompts, Data validation
Internal Knowledge Chatbot	Quick answers to procedural/policy questions <sup>35</sup>	Inaccurate answers based on training data, Security of knowledge base <sup>34</sup>	Regular updates to knowledge base, Secure internal deployment, User feedback mechanisms
General (All Applications)	---	Data Privacy/Security (GDPR) <sup>34</sup> , Bias <sup>34</sup> , Over-reliance, Cost <sup>38</sup> , Regulatory uncertainty	Secure private instances, Data governance, Bias testing, Human oversight <sup>34</sup> , Ongoing training, Clear policies

## 9. Conclusion

The landscape of UK commercial real estate special servicing is complex, involving a range of strategies from consensual workouts like forbearance and loan modifications to enforcement actions such as LPA Receivership and Administration. The choice of strategy is driven by a multi-faceted analysis encompassing financial metrics (LTV, DSCR), property viability, borrower cooperation and capacity, loan structure, market conditions, and the overarching Servicing Standard owed to investors.

Lender type significantly influences the approach, with banks navigating stringent PRA capital and IFRS 9 provisioning requirements, while debt funds are primarily driven by IRR targets and fund mandates. In multi-lender structures, the Intercreditor Agreement is paramount, dictating control rights and payment priorities, typically favouring the senior lender.

Effective special servicing hinges on comprehensive, accurate, and timely data covering the loan, property, borrower, and the workout process itself. Robust software is essential not merely as a data repository but as an active tool for workflow management, complex financial analysis (including IFRS 9 ECL and RWA calculations), scenario modelling, compliance tracking, and generating diverse reports for investors, regulators, and internal management.

Generative AI presents potential efficiencies, particularly in processing and summarizing large volumes of text inherent in legal documents and reports, and assisting with communications. However, significant risks related to accuracy, data security, bias, and the need for human oversight necessitate a cautious and well-governed approach to its adoption. While AI can augment capabilities, human expertise remains critical for the strategic decision-making, negotiation, and complex judgments required in resolving distressed CRE situations.

Developing software to support UK CRE special servicing requires a deep understanding of these interconnected elements: the specific workout and enforcement tools available under UK law, the regulatory and accounting frameworks (PRA, IFRS 9), the differing motivations of lenders, the criticality of intercreditor dynamics, the comprehensive data requirements, and the potential and pitfalls of emerging technologies like AI. Addressing these requirements is key to building a platform that can effectively support the demanding process of managing and resolving distressed commercial real estate loans in the UK market.

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## About Accuria

Accuria is a cutting-edge credit portfolio management platform that helps clients trade and monitor loan portfolios using a series of domain expert AI agents to automate the processing of data, documents and transactions. Accuria offers automated due diligence, data migration, valuation and reporting services for performing and non performing assets across 28 jurisdictions.

With the help of its proprietary data mapping and transformation tool Accuria helps financial institutions to map their data to a variety of data formats such as those defined by EBA for NPL transactions, EBA for the valuation in resolution, and by ESMA for securitisation disclosures. Once standardised and validated, the loan-level data can be uploaded to the Accuria valuation tool to conduct a detailed discounted cash flow analysis using pre-populated pricing parameters in different macroeconomic scenarios across all major asset classes.

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