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Lender Series:

Managing an Environmental Risk Department Through Uncertain Economic Times

This is Risk-E-Business, the podcast for environmental risk and property due diligence professionals to stay up to date with industry news, the best information, and the best tools.

Dave Colonna:
Hi, and welcome to Risk-E-Business, the Environmental Risk and Due Diligence podcast. I'm Dave Colonna, Director of Lender Services at ERIS. I'm pleased to be your host for today's episode. This is the first in a series of podcasts focusing on lender-specific topics in the environmental due diligence space. Today we're going to be discussing managing an environmental risk department through economic uncertainty. And I think uncertainty is the key word here today. We're in a rising interest rate environment, and that's led to challenging lending conditions. We're still dealing with pandemic-related fallout, and if that wasn't enough, we've also seen a string of recent bank failures. To help us gain some clarity and navigate these choppy waters is a very special guest. John Thomas Rybak has served on the EBA Board dating back to 1997 and is currently serving in the office of Vice President. He's also managed four different environmental risk management departments, including KeyBank, Wachovia, BB&T, and now Truist Financial. He has over 30 years of experience with a Bachelor of Environmental Studies from the University of Buffalo and an MBA from Canisius College. He was honored in 2017 to have received national recognition with the industry influencer award for excellence in his bank's vendor management program. In 2019, he co-founded an industry mentor program and served as co-chairman for the first three years. Welcome John.

John Rybak:
Thanks, Dave. I appreciate being here. I wanted to share something with you before we get started with the q and a. I believe that life is like a circle. People are relational and we're designed for society. Well, this is our society. When you were born, you start off knowing almost nothing. You're mentored by everyone. You meet your parents, your siblings, your teachers. Paradoxically, as you go on in life, you are the one with knowledge, and now you are enlightened by your life experiences. You are the one who is lighting the path for others. I believe that is what we are doing here today. Having said that, I need to share with you a disclaimer. I will be speaking on behalf of the environmental lending industry based on my current lending positions, knowledge and feedback received from various industry and lending connections. These are my views and my views only. They're not of Truist Financial, nor should they be interpreted as Truist views in any way.

Dave Colonna:
Great. So with that, let's jump in. It's hard to ignore all the recession talk these days. So are you seeing banks making plans for a possible recession? What's going on out there today?

John Rybak:
Risk is always on the forefront of lender strategic planning. We have a risk model. We assess the risk, number one. Number two, we implement controls. Number three, we monitor, the residual risk. So that's nothing new. But in the current situation, lenders are starting to focus on portfolio concentrations, both geographically and on industry types. Do you have too much concentration in a state or region? Do you have too much concentration in a certain type of property? Then they're evaluating those impacts, and what a recession might do to their portfolio considering the impacts, the changes they need to make, and closely monitoring the results. So I guess you could say there's a heightened sense of awareness going on.

Dave Colonna:
That monitor piece is important. What steps can be taken right now to address these the slowdowns, the decrease in volumes.

John Rybak:
Well, I like to think of a prepared readiness. Start talking to your workout groups, your special asset groups. Make sure that you're in sync with what they might see coming in, in the default assets and whatnot. We are also seeing and hearing and experiencing controlled expenses in anticipation for lower income and lower profit ratios. Controlling expenses is not unusual. It's always part of a lender's risk model, but I think lenders, like I said, have a heightened sense of concern that a recession might be on the horizon.

Dave Colonna:
It's easy to look at this situation and sort of harken back to previous events. We just dealt with the Covid pandemic in 2020. We had the mortgage crisis in 2008, 2009; and it's easy to draw parallels. But how is this different than those two events?

John Rybak:
Well, first of all, what's different is that we've seen a slowdown, but we've not seen a market crash or a recession yet. COVID was a reaction, a market reaction based on health concerns. It was inevitable that we, the business world would find our way through the health pandemic business would be interrupted, but we would recover. There was nothing unusual going on in the market prior to covid. This was a human condition or concern, a legitimate one that disrupted that market. I say it all the time, that business is made up of people during that time. We temporarily remove the people, and the demand drops for public services are goods like travel, hotels, dining out. They all took a hit, more goods and service as a result took a hit. And the market, once again, reacted to the unknown risk.

John Rybak:
But once the health risk was better, understood, better controlled, demanded, those services began to climb. We are still seeing impacts from covid today in reduced office space. New York City study by Newmark in May of this year, and articles had quoted activities the strongest in pockets near transit hubs or in trophy buildings or in buildings with full amenities. Soft market conditions exist with limited demand and significant headwinds of other non-high demand offices. So, the market is predicting a slowdown in this category. Companies have tried to implement strategies and schedules to get people back to the office to pre covid levels, but that is just tough. It is very tough. You also referenced 2009, the mortgage meltdown, and that one was totally different because that was an over concentration in a certain industry type. That being single family subdivisions, the over concentration led to disastrous results when something happened to the value of that market. When you have a diversification of a bank loan portfolio type in geographical regions plus advanced monitoring and performance indicators, those that are all vital to avoid repeating pitfalls like we saw in 2009. That's why I mentioned that risk model of risk identification controls and monitoring. We have better tools in place than we did 12-14 years ago.

Dave Colonna:
Yeah. And I think that's a good thing. One of the good things that certainly came out of that. We haven't really seen the wave of foreclosures that we saw in 2009. I'm certainly not an economist or a prognosticator, but you must think they're coming. Are you hearing anything on that front?

John Rybak:
I think there's a lot of readiness, and from the bankers I talked to across the industry, no, we've not seen a large influx of foreclosures. It hasn't happened at this point. There are always a few, but the activity is limited.

Dave Colonna:
Well, let's keep our fingers crossed on that front. One sort of natural progression of things, if we do start to see an uptick in foreclosures and, and REO (Real Estate Owned) properties is unfortunately, banks do start to fail - and we've already seen a few. Silicon Valley Bank, First Republic Bank, granted those were kind of different animals. It wasn't real estate related that led to the shuttering of those institutions. But what we do tend to see is whenever banks do close, we see more oversight. We see tighter regulations. Are you hearing anything from the regulatory agencies in terms of changes or just readiness on their end or anything that they're going to be doing as a result?

John Rybak:
As always, I'm sure they're paying attention, but we are not seeing or hearing of regulatory changes yet. It's likely because we have not seen a full recession, or systemic risk. Just like the risk model, they're assessing the risk evaluating controls and they'll monitor the risk through this cycle. Some of those controls, like in 2009 were increased regulations, but in 2009 we had a meltdown. We're not there yet.

Dave Colonna:
I wanted to move to speak for a minute about just environmental risk departments and managing them. Today compared to what it's like during normal times, how is it different? How's your job and your function different today than it was a year ago?

John Rybak:
Well, a lot of banks are experiencing hiring freezes because of a lot of the things we've already gone into. So we're looking at capacity, what do we have capacity to handle right now? You're seeing, if there is a recession to come, you will see a redeployment of lending officers from the front line to supporting special assets and, and distressed assets. We are seeing the candidate pool out there is weak. So right now, Dave, we're kind of in a plan B. Potential hiring freezes. We've got capacity issues, the candidate pools weak, the plan B is outsourcing until we breach capacity for a sustained period and a freeze is lifted and more candidates become available in the market. That's the plan B with hiring or with staffing.

Dave Colonna:
It's certainly tough. And especially when you think of environmental risk departments are typically cost centers. When transaction volumes are low like this, how do you continue to add value to the organization?

John Rybak:
Well, that's a really good question. There are two things that we have control over that one is service and the other is timing. So when volume goes down, it becomes critical to focus even more on service and timing. Service, for example. Always give more, take time to explain your response. Simon Sinek, well-known author 'Start with Why', is one of my favorite books. Two key components are why and what, explain to the banker why you need to do additional due diligence. The what is the phase two, but the why is critical because they must understand the why so that they can carry that message onto their client, to our borrower. So take the time to give them great service, but timing, sometimes a fast 'no' is the best answer, better than a long slow 'no', which can drain resources. With a fast 'no', the banker can either redirect their attention to other opportunities, or at least we have more time to solve this problem, this risk, this concern, say with a phase two.

Dave Colonna:
You mentioned earlier redeployment of loan officers and, and things like that. I'm just wondering is more work being done internally because of that. Or what sort of impact to third party vendors because of that? I must imagine there's more time to do what you must do now.

John Rybak:
Third party vendors are critical to lending organizations. We still need them. But as any business cycle slows down, there are strategies to limit the use of third-party vendors where we can. So, if a lender charges a fee for reviews, they might stop using outsources to do reviews so they could capture a larger percentage of the fee revenue. When volume is low, they might reduce expenses, more work is done in-house to reduce the expense of an outsource third party. It's a normal part of an ebb and flow in business. And when things change and the numbers go up, either foreclosure numbers or new loan origination numbers, we'll be back to the upside of that cycle.

Dave Colonna:
That makes a lot of sense. The relationship between banks' environmental risk departments and their environmental consulting panel is obviously critical. I'm sure you are getting calls and people are looking for work. Consultants that may be used to getting, 10 or 20 deals are getting four or five, whatever the numbers may be. What are some best practices that lenders would like to see from consultants and what's the communication like to have with them?

John Rybak:
If you haven't figured it out by now, I'm a big fan of books. I'm going to quote another one by Jim Collins, 'Good to Great'. Make sure we have the right people on the bus and in the right seats. So for consultants, I'll often tell them, consult to us. Don't default. Firms who just call out a phase two on every situation really aren't that valuable to an educated lender. Firms who can consult to their clients and separate out the de minimus situations from others. They're adding value in the process. Or what if you have a more serious problem onsite beyond a phase two? You need that consultant who can add value back to us by being a partner by being a consultant. Don't just default and tell me I have a risk. Don't just default and tell me I need to do a phase two. You can say that on just about every property if you want to. But also those lenders who are really interested in risk mitigation, they're searching for quality over price. I'm not saying price is not important, but I am saying it's not always the driver and it should not be always the driver.

Dave Colonna:
Any other important takeaways you would like to share with our listeners, John?

John Rybak:
Sure. I'll give you three. One, the cycles are normal. The process of risk management or risk model, it doesn't change. Again, I'll say it again, assess the risk. Two, implement controls. Three, monitor the results, the residual risk. That's very normal and it gets applied to this situation that we're talking about here today. You should have these practical steps and relationships built into your process. And then when you ebb and flow in the normal business cycle, you're prepared. Number two, expectations are critical. They should be developed and shared with our clients, right, on timing and the deliverables we're going to give them. It should be shared with our staff on the standards that we set for ourselves and have a quality control program to measure that. And they also, expectations need to be shared with your consultants. If they're going to be that trusted partner, share with them this scope, the type of things you need to see. Scorecard them on how they're doing and provide them feedback. And then last, number three, consultants are the cornerstone of your risk model. You'll get out of it, what you put into it, the stronger they are, the better risk decisions you can make.

Dave Colonna:
Three great points there. Any other closing thoughts?

John Rybak:
Think about it this way. It's a network. We have to develop it, reach out, use collective knowledge in building out your program and addressing the issues that you're facing. I'd say you're not alone. This is going to be a plug for the value of the Environmental Bankers Association, www.envirobank.org. That's a terrific place to network, learn what other lenders are doing and how they're handling risk assessment. Find consultants who can help your bank through the due diligence process. You need to develop relationships in this industry to be successful, to stay ahead, find a couple of pure banks that you can talk to and discuss risk with. Find a couple of trusted consultants who will be your eyes and ears on the ground while completing due diligence on your projects consultants who are willing to do the extra work and pull the thread. I believe that following that path that others have already walked will with the help of your peers in the lending community and the guided, and being guided by trusted consultants will help us to be successful.

Dave Colonna:
That's great and you're right. And with that, I think we leave it there for today's episode. John, thank you so much for spending the time with us today. Your insights are invaluable.

John Rybak:
You're more than welcome.

Dave Colonna:
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