Whitepaper

Syndication evolves as the rules of money expand—and AI excels at following rules

Tamarack™

Overview

Syndication has been a central process for both risk management and access to capital in enterprise operations for over two centuries. Recently it has received elevated attention in commercial and equipment financing as high inflation has driven prices up and increased the demand for financing of capital equipment while high interest rates simultaneously compressed lender margins, reducing their profitability.

This executive whitepaper explores the evolving syndication funding ecosystem, highlighting the shift from traditional banking relationships to private capital sources. At the same time, digital technology — particularly AI — is introducing new capabilities that enhance both the efficiency and effectiveness of syndication workflows. These advancements position market participants to capitalize on the anticipated rise in borrower demand and available capital.

Canonically, syndication is defined as an agreement wherein the risk of an endeavor is shared by a group of individuals or enterprises. Early examples of a syndicate in action are the funding of the Suez Canal by a syndicate of European nations and the construction of the U.S. transcontinental railroad by a coalition of railroad companies, banks and the U.S. government.

1. “Why syndicate?” is not new
2. New buyers are changing the rules
3. New tools exist for capital markets teams
4. Data will close the gap between syndication and securitization

Every risk also has an opportunity for reward, which for many participants, e.g., early railroad companies, is their true motivation – a share of profits from an investment. The management/sharing of risk and reward is the engine of syndication. It's a road well-traveled, particularly in the financial domain. But two trends – one economic and one technological – are poised to significantly change and increase the importance of syndication in equipment finance.

The economic trend is the emergence of private capital as a principal buying partner for capital markets teams, as the more highly regulated and risk-averse banking partners have pulled back. "'Money has rules' is a well-known fact to capital markets teams," said John Gauger, president of Compass Capital Solutions. "But the makeup of private capital is much more diverse and complex than that of banks who are homogenous by comparison." As a result, following the rules requires a more analytic approach for sellers because the rules are multiplying and the parameters are changing.

The syndication of the transcontinental railroad was a pioneering example of how large-scale infrastructure projects could be financed and managed through the distribution of risk among multiple parties.

The technological trend is the adoption of consolidated and structured data warehousing by financing companies, supporting faster, more accurate and more precise workflows as well as enabling the deployment of AI prediction for both buyer-matching and risk management with higher accuracy and efficiency.

While the economic trend changes the buyer profiles and complicates the rules, the technology trend provides the most efficient and effective rule-following engine ever for sellers.

When economic and technology trends align in a way such that each supports the other, the result can be an innovative overhaul of daily life. An example: Moore's Law supplying lower cost consumer electronics driven by the development of Internet and GPS (satellites), with mobile networks (towers and phones) providing precision location for e-commerce logistics. The opportunity with the emergence of private capital and AI is the proliferation and acceleration of credit funding, driving unprecedented growth in the asset-based financing industry.

“Why syndicate?” is not new

This discussion will use the Equipment Leasing and Finance Foundation’s (ELFF) definition of syndication as a capital markets activity that bundles and sells the payment stream of a group of leases to a funder based on a portfolio or business strategy. In this definition, syndications are sold to private buyers and can include discounting and portfolio sales but are separate from securitization which is defined as pooling leases to create a marketable, interest-bearing security sold in the public markets. As a fundamental capital markets activity of the equipment finance space, syndication (and its ***whys***) remains durable: An ELFF-sanctioned study by the Alta Group in 2022 summarizes the whys for both sellers and buyers.

According to the ELFF study, the *sell-side* has five primary reasons to syndicate:

Profit	Increase profit/return
Risk	Reduce portfolio risk – credit or exposure
Expand market access	Access bigger deals in marketplace – beyond balance sheet
Growth	Recapitalize the business – move beyond discounting
Brand	Validate market acceptance of credit profile and do what you say you will do – close deals

The sell-side whys support two functions: access to more capital and risk management. But the specifics described above can vary in focus and combination to define different strategies for the sellers. A lessor engaging higher risk credits, for example, could bypass bank funders altogether by using risk-based pricing and data aggregation to access a lower cost of capital via less risk averse investors looking for higher returns. An independent with a bank line of credit could use the same investors to offload deals that do not meet the credit requirements of the line and recover capital for reuse. These are different strategies, but both sellers use syndication for risk management and access to capital.

The top *buy-side* reasons to syndicate are defined as:

Growth	Source of origination and market access
Profit	Access higher returns of EF space
Strategy	Flexibility and speed of EF space for investor strategy
Risk	Easy implementation of risk policy for funds

In any syndication, the buyers are investors whose focus is maximizing the risk-reward return of their investments. In equipment finance, buyers typically are looking for the higher spreads of leases compared to conventional loans, and they appreciate the flexibility lessors have using structure to get deals done within a given risk policy, particularly in the riskier credit tiers. The diversity of risk engaged in equipment finance attracts buyers who use quantified investment strategies integrating assets of different risk levels. Investors of this type in the equipment finance space tend to be very demanding of data on deal pools to support the design of their investment portfolios. An irony of the reasons buyers engage in the equipment finance industry for investment is that banks, the traditional buyers, often avoid the same characteristics: high growth, riskier investments and flexibility in deal types.

"Money has rules" is a well-known fact to capital market teams. But the makeup of private capital is much more diverse and complex than that of banks who are homogenous by comparison.

-John Gauger, president of Compass Capital Solutions

New buyers are changing the rules

Gauger's "Money has rules" statement describes the matching problem of any finance company looking to acquire more capital. The common moniker for the rules is "credit box." But while the sources of capital all have rules, the nature and diversity of the legacy rules are relatively uniform because banks are highly regulated. Regulation is like a standard that simplifies the rules and makes them similar or identical for all parties. The data tapes that the bank buyers request tend to be similar because they do their analyses against the regulations of the industry – fair lending, expected loss, and spreads. Often the only difference in the "credit boxes" of community banks is the geography within which they will lend.

Regulations haven't changed much since the 2007 bank crisis and resulting Dodd-Frank legislation, but in 2023 the Silicon Valley Bank failure demonstrated a new technology-based risk to the bank deposits required for lending. Rather than stabilize the market, in this case regulations became a source of change because, during the recent period of high inflation, they forced banks to pull back or exit altogether from the higher-risk markets as the spreads naturally shrank. The result has been that [banks are leaving the SMB-driven equipment finance marketplace].

But equipment finance is a growing, resilient, asset-diverse, and highly profitable market for investors. As some banks pulled back, those more comfortable pursuing the higher returns associated with higher risk and more sophisticated in their investment portfolio strategies have entered. This is the domain of private equity and venture capital – private capital – and brings two new requirements relative to bank buyers.

As a less regulated group, private capital presents a much more fragmented and diverse collection of risk policies. Private equity firms often specialize and engage specific markets or industries for which they have experience or domain knowledge that gives them an edge with their investments, e.g., agriculture, manufacturing, software, IT services, medical services, etc. Consequently, the nature, number and shape of credit boxes proliferate with private capital.

As a result, private capital buyers also tend to bring a more analytic approach to their decisions; they are much more data-centric investors. They believe data gives them an edge and use it aggressively.

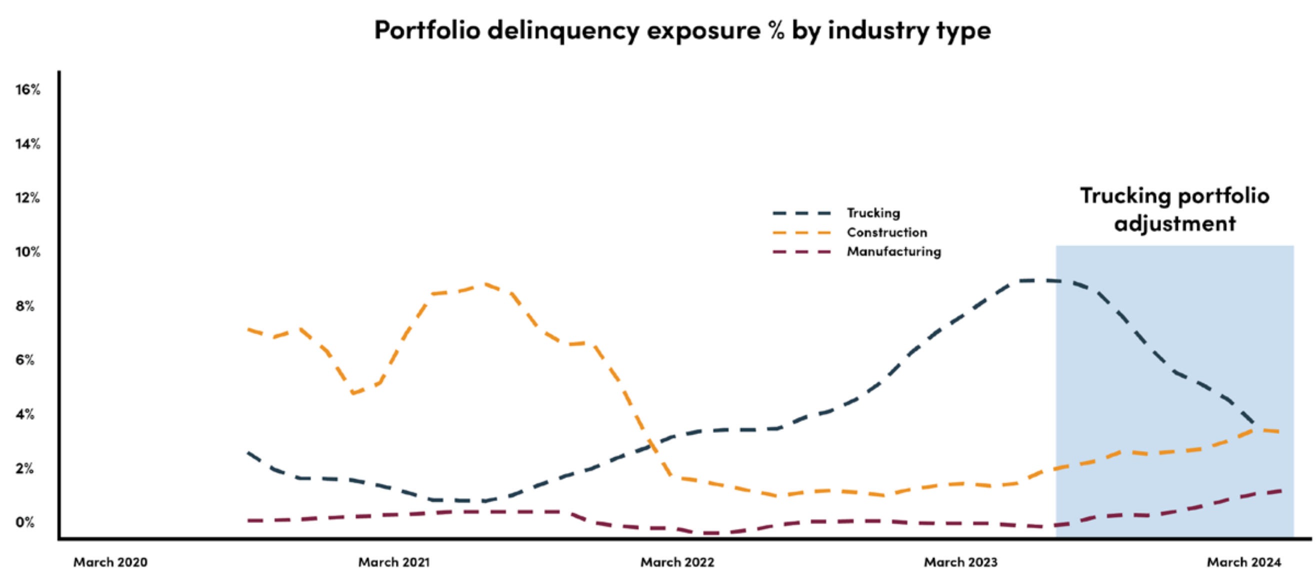

Figure 1 Delinquency varied widely by industry over the four-year pandemic period and in some cases required adjustments to origination efforts by industry as shown in the late 2023 period.

Fortunately, equipment finance businesses are rich in data: asset types, NAICS codes, geographies and the full range of financial measures and metrics are part of typical credit analyses. The figure on the previous page shows how an equipment finance portfolio management team can dovetail with this thinking as they monitor delinquency in the portfolio as a function of industry. The business adapted to the rising delinquency by reducing originations in a particular trucking segment, in this case local delivery trucks.

The capital markets team responded with a portfolio risk adjustment via a syndication of deals that no longer fit their risk profile; see figure below. The important point of this example is that a portfolio of deals that represented too much risk to one lender, a bank-owned leasing company, fit the risk profile of another lender. The wide diversity of risk acceptance in the private capital markets is an opportunity for leasing companies to leverage their data generated by the technology stack during servicing operations.

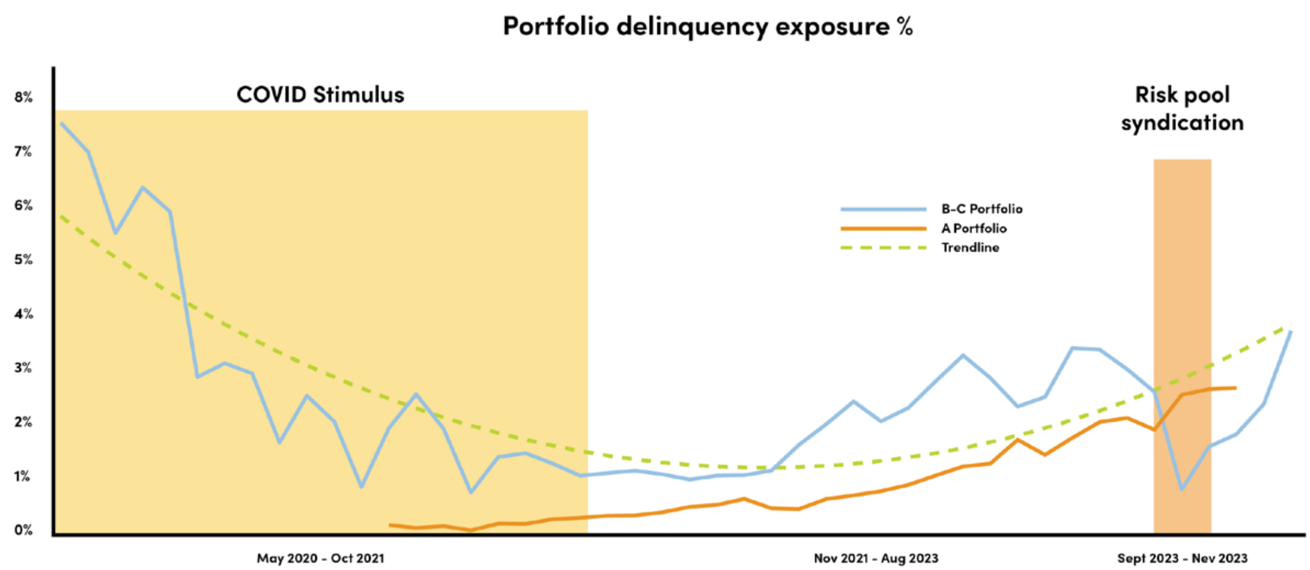

Figure 2 Quantitative easing during COVID reduced delinquency risk, but a later economic change in delinquency required a risk reduction syndication sale to a different funder to bring the overall portfolio back within risk parameters of the originating group.

Equipment finance and private capital are well matched for multiple reasons, but data will be language of the engagement. The 2022 ELFF report summarizes the wishes, i.e., requirements, of both buyers and sellers in the syndication ecosystem. The table below shows how properly captured and organized data can make those wishes a reality for capital markets teams and private capital buyers alike.

Capital markets wish list from 2022 ELFF funding study

Wish	Data-driven reality
Access to average buy spreads based on credit quality metrics (i.e., public debt rating). List of buyers of equipment on foreign soil (Mexico, Canada, etc.).	Increasing availability of data and the diversity of data combined via AI to create better matching and better risk measurements for management.
Current sale prices/spreads (over average-life or full-term SWAPS based on credit and/or collateral).	Centralized serving data, data collaboration and data analytics make this table stakes for capital markets transactions.
Market clearing prices by credit rating and/or collateral type.	Access bigger deals in marketplace – beyond balance sheet.
Ratings of buyers and sellers by syndicated volume.	Private capital markets using centralized data will, like stock exchanges, make risk measurement and pricing more of a standard operating procedure (SOP).
Industry standard, secure web-based 'e-SAFE' or 'e-VAULT' for document retention and retrieval.	This too now exists. All web service providers – MS Azure, AWS, Google GCP – make secure, SOC 2-level security exchanges an SOP.

Consolidated data makes these wishes the new reality while simultaneously increasing the granularity and precision with which credit is analyzed and policies are implemented. The "wish" for standards – spreads vs. credit quality, buyer/seller ratings, market pricing – is far from a reality, but the breadth and diversity of the private capital space combined with consolidated data solutions will begin to define standards for syndication in the same way PayNet did for credit risk.

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New tools exist for capital markets teams

Timothy Appleget, director of SaaS products at Tamarack, has commented that during his time helping finance businesses with technology support, the capital markets teams were always underserved. Appleget said the business tended to focus the technology investments on origination, underwriting and portfolio management. The team managing capital had to take data from other systems of record – the contract management system (CMS), customer relationship management (CRM) / loan origination system (LOS) and general ledger (GL) – to build spreadsheets and data tapes that allowed them to leverage their relationships with buyers/funders. Capital markets teams are traditionally viewed more as relationship managers than technology users, which has left them with manual tools.

Indeed, the 2022 ELFF funding report found that over 60 percent of respondents said they used manual processes and spreadsheets to do syndications. This can work when there are very few funding partners, e.g., bank-owned or captive financing, or when the credit and data tape requirements are more uniform as is the case with bank lenders. But private capital requires more data, more speed and more sophisticated data analysis in order for capital markets teams to make the most of both their financial insights and relationship skills.

Several service providers have stepped up to address this emerging gap in the tech stack. Tamarack has released SyndicationBuilder, which leverages a consolidated system of record built from the CMS, CRM/LOS and GL to provide multi-parametric analyses for the construction of lease pools along with automated pool summaries and data tape generation. Syndifi now provides a seller-buyer platform that leverages standard data tape definitions to provide secure, transparent and uniform visibility to both sides of the transaction. PrivateCap was recently launched by industry veterans Barry Ripes and Bill Phelan to provide institutional private investors with access to the equipment finance market in a familiar and easy-to-use format. Each of these new tools is specifically designed to support capital markets teams as they adapt to and strive to meet requirements of the changing buyer market.

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Data will close the gap between syndication and securitization

These new data-based tools will rapidly generate more data, outcome data, that will enable sellers to apply machine learning and AI to the workflow. AI predictors of lender matches have already been in use on the Tamarack AI platform for several years. AI predictors that match buyers to deals are called classifiers and have high accuracy relative to numeric forecasters. When properly deployed and with enough data, they can reverse-engineer the credit box of a buyer.

The extension of the buyer market from primarily banks to the full gambit of private equity and institutional investors will add significant value to consolidated data platforms as they provide access to the data necessary to build machine learning models and AI predictors that provide faster, more accurate and more precise matches between deal pools and the investment parameters of the buyers. AI is a software technology and inherently good at following rules. As the rules of all the buyers proliferate, AI will learn these new rules, match deals to buyers, and can accelerate the learning through automation of the deal making.

AI workflows can also reduce the effort to move from syndication to securitization as the data consolidation and analytics grow to fill the needs of the more data-centric securitization process. The volume of originations has typically been a hurdle to entering securitization because of the fixed costs associated with aggregating the data for risk assessment and management. Consolidated data systems dramatically reduce the costs of providing that data thereby reducing the scale necessary to provide returns on a securitization effort. The result will be smaller securitizations supported by more data per deal and automated servicing reports completed by smaller originators in search of lower costs of capital.

More is coming.

When macro-economic and technology trends align, the future becomes very bright. Such is the situation today for capital markets teams in equipment finance. The intrinsic risk diversity, economic reliability and higher returns of equipment finance are attracting a much broader and varied investor group. But consolidated data, more sophisticated analytics, and AI-based workflows are already addressing the expectations and opportunity of the new buyer market. As the number of lessors doing syndications grows and more transaction data becomes available, syndication workflows will become even more efficient and precise. Data analytics will generate more data and more efficiency. The resulting capital markets perpetual-motion-machines will drive growth for the entire industry.

Tamarack would like to extend our sincere thanks to John Gauger for his inspirational quote — Money has Rules — which served as a guiding theme throughout this project. We are also grateful to our fellow ELFA webinar contributors— Barry Ripes, Kayla Perlinger, and Spencer Thomas — for sharing their insights and experiences that helped shape the direction of this whitepaper.

A special thank you goes to Bob Rinaldi for his ongoing mentorship and invaluable contributions to our understanding of Equipment Finance.

Guiding financial innovation™

As the equipment finance industry continues to evolve, Tamarack will be here at every turn to help lessors embrace change and explore risk in order to meet the changing business requirements needed for success.

Contact us today to get started.

About Tamarack Technology, Inc.

Tamarack Technology is the leading provider of AI-based automation and risk management software along with professional technology services specifically for the equipment finance industry. For more than 20 years, Tamarack has been helping lessors protect their investments, improve business performance, and provide customers with access to solutions that enhance operations and financial performance. Tamarack's suite of AI products connect and integrate key ecosystem applications using historical and real-time data to automate burdensome manual processes, drive operational efficiency with better, faster decision-making, and improve organizational productivity. The company provides professional services including integration, implementation, and data migration services for the leading industry portfolio management platforms.

In 2020, Tamarack identified the need to help customers improve their operational and financial performance through the integration of equipment finance software platforms with emerging digital technologies. To support its vision, Tamarack developed a suite of artificial intelligence (AI) products that leverage a lessor's historical and operational data to predict financial outcomes and improve operational performance. The benefit: automation of the burdensome and often manual processes that weigh down workflows and slow financial decision-making. Through AI, Tamarack is further helping lessors protect their investments, improve business performance, and provide customers with access to solutions that enhance operations and financial results.

For more information, please email us at discover@tamarack.ai or visit [Tamarack.ai](https://tamarack.ai) to learn more.

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