

# Operational Risk Assessments News Bulletin

## RAIT Financial Trust

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### **Morningstar Affirms RAIT Financial Trust 'MOR CS3' Rankings as a Commercial Mortgage Primary and Special Servicer; Forecast for Both Rankings is Stable.**

Morningstar Credit Ratings, LLC (Morningstar) has affirmed its 'MOR CS3' rankings on RAIT Financial Trust (RAIT) as a commercial mortgage primary servicer and commercial mortgage special servicer. The assigned rankings reflect our assessment of RAIT's operational infrastructure and portfolio administration capabilities for its respective duties as a primary and special servicer. In particular, the assessment and affirmed rankings are based on the following composite factors:

- *Established CRE CDO servicing expertise* - RAIT has approximately six years of servicing experience primarily gained through loans contained in its two commercial real estate collateralized debt obligation (CRE CDO) portfolios. While RAIT has originated and sold some loans into commercial mortgage-backed securities (CMBS) transactions in the past two years, it has not yet retained any of the associated primary servicing. However, Morningstar believes that RAIT has the operational capability to serve as a competent CMBS sub-servicer.
- *Experienced professional staff and management* - In our view, the company has a well-experienced staff and management team, and has had a low staff turnover rate in the past year. Additionally, we believe that RAIT's organizational structure suitably addresses the company's current portfolio administration requirements along with the ability and capacity to accommodate moderate portfolio growth.
- *Proactive asset administration* - We believe that RAIT, overall, has proactive and sound loan administration and asset management practices to address its current portfolio characteristics and associated servicing requirements. While it services a relatively small portfolio (approximately 250 loans), RAIT, in our view, has experience servicing some large and complex loan structures that include mezzanine and preferred equity positions in addition to first lien whole loans. Additionally, we believe that RAIT possesses expertise administering loans with active cash management agreements (albeit with some manual elements still involved in the process), which comprise the majority of its serviced portfolio.
- *An effective internal audit function* - RAIT maintains an independent audit program which consists of quarterly reviews that examine various loan administration and reporting controls. The program is designed to match the scope of a Regulation AB attestation. It also undergoes an annual USAP (Uniform Single Attestation Program) examination. Based on our review, we believe that recently completed audit reports have been overall satisfactory.
- *Sound and strengthening technology environment* - RAIT uses the Enterprise! loan servicing system for loan accounting and administration. It also uses a non-interfaced, customized Microsoft Access database for certain special servicing tracking and asset management tasks. We believe that RAIT's current technology provides the automation, data management, and reporting functionality to address its current servicing and reporting requirements, handle a modest amount of special servicing work, and should enable it to handle CMBS loans as a sub-servicer. The company noted that it soon expects to purchase a front-end system and integrate it with the servicing system to facilitate its growing loan origination activities and related new loan boarding process. RAIT also expects to decommission its stand-alone database and instead leverage the functionality of the new front-end system for certain asset analysis and portfolio management work.

- *Modest, but overall successful special servicing track record*- RAIT currently and historically has managed a relatively small volume of assets requiring special servicing. However, Morningstar believes that the company has an experienced loan workout staff, proactive resolution practices, sound asset recovery analytics, and, overall, has achieved solid resolution results through different methods -- although primarily through loan modifications. Many of RAIT's specially serviced asset resolutions have involved subordinate notes or mezzanine loans in which RAIT has had to negotiate with senior secured lenders and, in some cases, assume the borrower's position in the collateral property. Based on our positive view of RAIT's personnel resources and its record of resolving troubled loans in its CRE CDO pools, we believe that the company is adequately positioned for other third party special servicing assignments.
- *Controlled conflicts of interest management*- Based on RAIT's stated practices, Morningstar believes that the company is acceptably managing any potential conflicts of interest in its position as the servicer, special servicer, and principal investor for its two CRE CDOs and particularly with respect to using its affiliated property management companies.

RAIT's servicing and corporate offices are headquartered in Philadelphia, PA. As of June 30, 2012, RAIT had more than 350 employees across all business lines, with approximately 21 employees directly involved in loan servicing and accounting, special servicing, and related portfolio management. As of June 30, 2012, RAIT had approximately \$3.6 billion of assets under management. The direct servicing portfolio was approximately \$1.9 billion based on unpaid principal balances (UPB) and comprised 255 loans. The company currently serves as a special servicer only for its primary serviced loans. As of June 30, 2012, the active special servicing portfolio totaled approximately \$181.2 million by UPB comprising 23 loans and no REO properties.

## Forecast

*Stable* for both the primary and special servicer rankings.

We expect the assigned rankings to remain unchanged during the next 12 months. We believe that RAIT maintains the operational qualifications to meet all of its current servicing and special servicing duties for its two CRE CDO transactions and has the capability to engage in some additional third party assignments.

Our full assessment report on RAIT is forthcoming and will be made available on our website.

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