



Operational Risk Assessments News Bulletin

Situs Asset Management, LLC and Situs Holdings, LLC

Morningstar Assigns 'MOR CS2/Stable' Ranking to Situs Asset Management, LLC as a Commercial Mortgage Primary Servicer and 'MOR CS2/Stable' Ranking to Situs Holdings, LLC as a Commercial Mortgage Special Servicer

Morningstar Credit Ratings, LLC (Morningstar) has assigned its 'MOR CS2' ranking to Situs Asset Management, LLC as a commercial mortgage primary servicer and its 'MOR CS2' ranking to Situs Holdings, LLC as a commercial mortgage special servicer. The forecast for both rankings is Stable. Situs Asset Management is one of the wholly owned operating units of The Situs Companies, LLC, whose parent is Situs Holdings, LLC. In October 2011, CMBS special servicer Helios AMC, LLC, a Ranieri Partners-sponsored company, acquired The Situs Companies but retained the Situs name. As a result, Situs Asset Management and Situs Holdings (collectively "Situs") now represent the consolidated operations of the two merged companies.

The assigned rankings reflect our assessment of the company's operational infrastructure and portfolio administration capabilities for its respective duties as a primary and special servicer. Our special servicer ranking acknowledges the company's solid performance and capabilities as a CMBS special servicer principally through the merged Helios operation. Our primary servicer ranking largely reflects our view of Situs as a boutique operation experienced with non-CMBS assets, distressed portfolios, and other specialized portfolio assignments. Although CMBS primary servicing has not been the company's focus, we believe that Situs has the operational capabilities to serve as a fully competent CMBS sub-servicer. In particular, Morningstar's assessment and assigned rankings are based on the following factors:

Primary Servicing:

- Effective and Strengthened Technology - Morningstar believes that Situs has effective technology tools to support portfolio growth. In our view, the company's July 2012 conversion to the *Enterprise!* loan servicing system, along with other planned and in-progress technology enhancements, such as the rollout of borrower and investor websites in 2013, should provide increased operating efficiency and improve the company's servicing capabilities, especially as the company continues to rebuild portfolio volume. We also understand that Situs is currently revising and enhancing its documented policies and procedures based on the implementation of the new servicing system.
- Sound Operational Structure/Re-Positioned Platform - Along with the system conversion, Situs has been re-tooling and re-positioning the servicing operation this year. Between July 2011 and September 2012, Situs reduced its servicing staff by approximately 60% to match substantially reduced portfolio volume and to account for projected automation gains from the new system. Situs stated that the staff reduction and related reorganization primarily reflected the transfer in 2011 of its FDIC portfolio out of the company and its subsequent decision in February 2012, driven by economic considerations and a re-directed growth strategy, to resign as the servicer on a \$3 billion Colony Capital portfolio. In connection with the portfolio transfers, system conversion, and the Helios merger, Situs has been redesigning aspects of its organizational structure, re-deploying certain staff, conducting extensive system training, and revising procedures. The company also noted that it is developing a metrics tool using the performance tracking features of the new servicing system to optimize staffing levels and efficiency. Morningstar believes that these initiatives collectively should strengthen Situs's operational effectiveness as it pursues new client relationships and third party business opportunities.

- Solid Management Depth/Well-Experienced Staff - After examining the company's current staffing levels and structure, we believe that Situs is well-positioned to handle growth and provide customized, proactive servicing. In our view, the company: (i) has retained experienced managers and professionals (although we observed the average years of experience among middle managers declined this year), (ii) currently operates with some excess capacity, and (iii) maintains an organizational structure that leverages individuals' acquired expertise and promotes portfolio management accountability. We also observe that Situs has an effective training function.
- Expanded Internal Audit Program - Situs recently enhanced its primary servicing audit regimen by engaging an external firm to perform semi-annual operational audits to supplement the annual Uniform Single Attestation Program (USAP). The first such audit is currently in process. Situs also has had a succession of clean USAP letters and had an exception-free Service Organization Control (SOC) report issued in early 2012 that tested cash controls, technology security, and various other operational processes. Based on our review, the scope of the SOC appears to have many similarities to that of a SSAE 16 (Statement on Standards for Attestation Engagements No. 16). Situs also indicated that it plans to establish a formal compliance unit for servicing that may involve expanding the company's existing compliance function which currently supports special servicing.
- Effective Portfolio Management - In our view, Situs has diligent practices for proactive asset-level management and portfolio oversight to monitor collateral performance, track compliance and trigger events, and handle borrower requests. We recognize that the company is experienced servicing highly structured assets and distressed portfolios that are prone to documentation defects. Furthermore, we recognize that certain investors have placed their confidence in Situs's capabilities to perform enhanced surveillance, shadow servicing, and reporting to supplement or, for some tasks, supplant the servicers named on their respective transactions, which may include CMBS positions, mezzanine debt, and warehouse loans. We believe the company's recent servicing system conversion strengthens its portfolio management function.
- Proven Client Reporting Capabilities - In our view, Situs has a successful record of delivering customized investor reporting for a range of institutional clients and private investors. The company also has experience with FDIC reporting. While it has not served or is actively pursuing work as a GSE or CMBS servicer, Situs currently services one securitized portfolio of smaller balance assets and has other assignments that require detailed remittance and portfolio management client reporting. Some investors, including those invested in CMBS, have engaged Situs to provide supplemental reporting and to produce their quarterly investment fund portfolio performance reports.
- Sound Loan Administration - We believe that Situs has sound practices to perform effective loan administration related to such functions as payment receipts and disbursement processing, real estate tax and insurance administration, and loan boarding. We expect that during 2013, Situs will steadily gain higher levels of loan administration and data management efficiency through the new servicing system.

Special Servicing:

- Positively Trending Performance Record - Morningstar recognizes Situs, particularly through the former Helios platform which began resolving assets in 2009, for its steadily increasing performance record of successful asset management and resolution results for a range of asset types and complex structures nationwide. We consider Situs, through the legacy Helios group, to be very adept as a CMBS special servicer. We also found the company's portfolio performance reporting to be thorough based on our review of selected Morningstar published DealView® CMBS surveillance reports. We found only one cited instance where more information was desired on a particular asset.

- Well-Experienced Professional Team - Senior managers and asset managers, overall, have a high degree of industry experience, and many have worked together for 10 years or more based on their positions at Helios and predecessor companies.
- Excellent Technology - Situs executes its special servicer duties using what we consider to be a very effective, highly functional proprietary asset management system, which the company continues to enhance.
- Well-Controlled, Efficient Asset Management - In our view, Situs has a tightly controlled approval process and a thorough asset analysis process which is well documented and principally managed through the asset management system. However, we will monitor the company's REO workload ratios, which appear to be slightly higher than the ratios we have observed at some other special servicers. The company also does not routinely conduct property manager audits in contrast to some other special servicers. However, we note that Situs has dedicated staff and defined procedures to review property managers' monthly reporting and monitor property-level performance.
- Sound Internal Audit and Compliance - Situs's special servicing platform is subject to annual audits through a Regulation AB examination and a supplemental audit process. Additionally, the special servicing operation has its own compliance function to monitor adherence to servicing agreement and loan-level requirements.
- Enhanced Platform - In our view, the special servicing platform, largely representing the former Helios operation, is steadily expanding its capabilities to resolve diverse and complex portfolios. We believe the special servicing unit will increasingly benefit from its ability to leverage the internal resources available through its parent and its related due diligence, advisory, and other business lines. It is also our opinion that Situs, particularly through its recently formed operating unit called Hanover Street Capital to exclusively manage certain Deutsche Bank assets, is demonstrating its ability to handle assets and reporting requirements other than those associated with CMBS pools.
- Effective Conflicts of Interest Management - Situs is the special servicer on CMBS transactions in which Ranieri Partners, the principal owner of Situs, and another affiliated investor respectively hold first loss positions and serve as the controlling class representative (CCR). Accordingly, we reviewed Situs's stated asset management practices, use of affiliates, and resolution results in this context. In our view, Situs has sound practices to manage conflicts of interest in its asset resolution work and maintain the servicing standard in its asset recovery decision-making process.

As of June 30, 2012, Situs's servicing portfolio consisted of 760 loans with an unpaid principal balance (UPB) of approximately \$8 billion. The portfolio included one securitized transaction, 'Velocity 2011-1', which contained 178 smaller balance commercial mortgage loans having a total UPB of approximately \$67.7 million. Situs serves as a primary servicer on three commercial real estate collateralized debt obligation (CRE CDO) transactions that had a total UPB of approximately \$1.9 billion and 62 remaining loans as of June 30, 2012. Situs expects to add approximately 600 new loans, with an aggregate UPB in excess of \$4 billion, to the servicing portfolio in 2012.

As of June 30, 2012, Situs was the named special servicer on 2,439 loans with an approximate UPB of \$28.7 billion covering 29 transactions, inclusive of 13 CMBS transactions, its Hanover Street Capital portfolio, and certain assets in the current Situs servicing portfolio. The company's total active special servicing portfolio, inclusive of CMBS and non-CMBS, contained 658 assets consisting of 585 loans and 73 REO properties with a combined UPB of approximately \$5.3 billion. The CMBS portion of the active special servicing portfolio consisted of 150 loans and 36 REO with a combined UPB of approximately \$2.8 billion.

Forecast

Stable for both Primary and Special Servicer Rankings.

The Stable forecast for primary servicing reflects our view that Situs has sound and proactive practices across all core functions, experienced personnel, and improved technology and reporting tools to continue providing quality, customized servicing during the coming year. Its recent servicing system conversion and other pending technology, procedural, and organizational enhancements should steadily strengthen the company's overall level of operational effectiveness to meet increased duties and performance expectations as it grows the portfolio.

The Stable forecast for the special servicer ranking reflects our view that the company, largely representing the former Helios operation, has the practices and expertise to serve as an effective special servicer for CMBS and a range of other clients. In our view, Situs has been steadily broadening its capabilities and building a record of successful asset management and resolution achievement involving a range of complex loan structures. We believe the special servicing platform also will increasingly benefit from its ability to leverage the internal resources from other Situs business lines as it further integrates and aligns its operations with the primary servicing platform.

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

Analysts:

Michael S. Merriam, michael.merriam@morningstar.com, 646-560-4518

Mary Chamberlain, mary.chamberlain@morningstar.com, 646-560-4520

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