

# Operational Risk Assessments News Bulletin

## Berkadia Commercial Mortgage, LLC

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### **Morningstar Raises Berkadia Commercial Mortgage, LLC Rankings as a Commercial Mortgage Primary and Master Servicer to 'MOR CS1/Stable' from 'MOR CS2/Favorable' and Affirms the Company's 'MOR CS1/Stable' Ranking as a Commercial Mortgage Special Servicer**

Morningstar Credit Ratings, LLC (Morningstar) has raised Berkadia Commercial Mortgage, LLC's (Berkadia) commercial mortgage primary servicer and commercial mortgage master servicer rankings to 'MOR CS1' from 'MOR CS2', and changed the forecast for both rankings to Stable from Favorable. Concurrently, Morningstar has affirmed its 'MOR CS1' ranking and its Stable forecast on Berkadia as a commercial mortgage special servicer. The rankings reflect our assessment of Berkadia's operational infrastructure and portfolio administration capabilities for its respective duties as a commercial mortgage primary, master, and special servicer.

Our assessment and assigned rankings are based on the following composite factors:

- On March 30, 2012, Berkadia entered into a subservicing agreement involving the transfer of approximately \$37 billion (4,456 loans) of KeyBank Real Estate Capital's (KeyBank) CMBS primary servicing portfolio to Berkadia in exchange for obtaining FHA deposit accounts. Berkadia reported that KeyBank's deposits began to transfer on March 30, 2012 and that servicing transferred on June 25, 2012. KeyBank remains the named master, primary, and special servicer, respectively, on these CMBS. While this transaction significantly increased Berkadia's primary servicing portfolio, we believe that Berkadia responded very effectively with a commensurate staffing increase and other organizational changes enabling it to absorb this new portfolio in a seamless manner overall.
- Our very favorable view of Berkadia's capabilities to provide accurate and timely reporting, its responsiveness to information requests, the quality of its asset-level reporting content, and its web site functionality. We found Berkadia's reporting and portfolio management performance to be highly favorable based on our review of selected Morningstar published CMBS DealView® reports. Additionally, we believe that investors and our surveillance analysts generally maintain an overall highly favorable view of Berkadia.
- Our positive opinion of Berkadia's CMBS primary and master servicing capabilities and expertise. In our view, Berkadia, as a master servicer, has the capacity to meet its ongoing advancing responsibilities based on the company's representations regarding its financial resources. In addition, we believe that Berkadia has a high degree of experience and an overall successful performance record as a CMBS master servicer with respect to its trustee reporting, controlled advance determination procedures, proactive sub-servicer oversight and audit practices, and handling of master servicing duties for a range of large and complex transactions. The company did not incur any material reporting errors or restatements during 2011 or first half of 2012.
- Our positive opinion of organizational changes controlling the company's reliance on off-shore personnel with respect to borrower interaction. The company no longer relies on its vendor in Manila, Philippines to handle direct borrower contact involving portfolio management tasks. It has instead reassigned this function to its Salt Lake City, Utah location. Consequently, personnel within the Salt Lake City office now serve as single points of contact for all borrower interactions. Although Berkadia indicated that personnel in its Hyderabad, India location interact with borrowers concerning financial statement analysis, the company reported that the India-based personnel who perform this function have at least 10 years of industry related experience. Consequently, we believe they demonstrate the requisite level of experience to interact with borrowers with respect to financial statement analysis. While the India-based staff also communicates with borrowers regarding many other servicing functions, communication is largely coordinated through email that involves U.S.-based management oversight. Approximately 80% of the communication between India personnel and borrowers is via email and 20% is via telephone contact.
- Overall operational stability and high levels of industry experience among management and professional staff. Berkadia experienced minimal staff turnover during 2011 and first half of 2012, and actually increased staffing to accommodate the KeyBank transfer of CMBS assets. The company continues to leverage offshore personnel in India for a significant portion of administrative servicing functions, while subject matter experts within its U.S. operations still directly handle larger and more complex assets, and provide quality control over any work conducted by offshore personnel. We also believe that the company has benefitted from the second shift in operating hours provided

by its offshore operations to address the large volume of information requests from borrowers, investors, and rating agencies. (Our forthcoming full assessment report on Berkadia will include an Appendix providing additional information regarding the company's India operation and the servicing work it performs).

- An independent and highly proactive internal audit function that quarterly examines a broad range of loan administration and portfolio management processes, and is supplemented with a number of performance monitoring activities and compliance routines embedded in the company's daily workflow practices. Audits encompass USAP and Regulation AB attestations, and a Statement on Standards for Attestation Engagements No. 16.
- Effective practices and procedures for proactive asset-level management and portfolio oversight, which include a number of reporting tools managed through a proprietary technology application, which monitors collateral performance, tracks compliance and trigger events, and responds to borrower requests and consents.
- Overall very effective technology tools that provide a high level of automation and centralized data management. Berkadia currently uses a highly customized version of McCracken Financial Solutions Corp.'s Strategy servicing system, and reported that it intends to upgrade to version 17 of the Strategy system. For special servicing, Berkadia uses a proprietary application that we believe offers a substantial amount of functionality.
- Our belief that Berkadia is a very effective special servicer having a diligent and pragmatic approach, sound analytics, highly experienced asset managers, and a continually successful track record of asset resolution results for CMBS and other investors.
- Additionally, we believe that Berkadia has effective policies and procedures to manage conflicts of interest. Overall, we view Berkadia as a special servicer that operates without the potential conflicts of interest inherent in transactions in which the special servicer has a close affiliation with the CMBS B-piece investor. Berkadia's business model is to act as an independent, third party special servicer without any investment in subordinate CMBS.

As of June 30, 2012, Berkadia's combined primary and master servicing portfolio was approximately \$206 billion based on unpaid principal balances (UPB) and 26,918 by loan count, representing a 13% increase by UPB and a 9% increase by loan count compared to June 30, 2011 and in contrast to prior periods of portfolio contraction. During the first half of 2012, Berkadia resolved approximately 58% of its beginning-year inventory of specially serviced loans and REO assets compared to 32% as of June 30, 2011.

### Forecast

*Stable* for all three rankings. We expect the assigned primary, master, and special servicer rankings to remain unchanged during the next 12 months. We expect Berkadia to continue serving as a very effective servicer and special servicer for a range of investor clients based on its performance to date and realized operational efficiencies, including its well-managed use of offshore personnel.

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

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