

Operational Risk Assessments News Bulletin

KeyBank Real Estate Capital

Morningstar Affirms Its 'MOR SBC1/Stable' Small Balance Commercial Mortgage Primary Servicer and Special Servicer Rankings on KeyBank Real Estate Capital

Morningstar Credit Ratings, LLC (Morningstar) has affirmed its 'MOR SBC1' small balance commercial mortgage primary servicer and small balance commercial mortgage special servicer rankings on KeyBank Real Estate Capital (KBREC), a subsidiary business unit of KeyBank, N.A. The forecast for each ranking is Stable. The affirmed rankings reflect our assessment of KBREC's operational infrastructure and portfolio administration capabilities for its respective duties as a primary and special servicer of small balance commercial mortgage loans and real estate assets. (Additionally, please refer to Morningstar's April 23, 2013 operational risk assessment News Bulletin on KBREC, which covers the company's rankings as a primary, master, and special servicer for large CMBS and other large loans.)

Note: On May 10, 2013, KBREC announced that it was acquiring substantially all of BofA Merrill Lynch's CMBS servicing and special servicing rights, with the transaction to include certain other BofA Merrill Lynch portfolios subject to investors' consent. Morningstar's rankings on KBREC are unchanged by this transaction. (Please refer to our May 13, 2013 BofA Merrill Lynch/KBREC News Bulletin.)

For classification purposes, Morningstar defines small balance commercial mortgage assets as those loans and REO properties having unpaid principal balances (UPB) of \$3 million or less. Although small balance servicers and special servicers may have some larger assets under management, our expectation is that their average asset sizes are generally well below our \$3 million threshold and that their small balance portfolios will typically be concentrated with assets in the \$500,000 to \$1.5 million range.

Unlike some residential mortgage servicers that have expanded their operations into small balance commercial mortgage loans, KBREC operates solely within a commercial real estate credit and servicing environment. Additionally, in our view, KBREC's small balance portfolio has a higher average loan size in relative terms compared to the portfolios held by some of these other servicers and overall has characteristics more akin to commercial and not residential mortgage loans. We believe that KBREC effectively leverages its operational infrastructure and practices to serve as a proactive and diligent small balance commercial mortgage servicer and special servicer, which we consider to be niche businesses.

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

Small Balance Primary Servicing

- Investor Reporting Expertise - Our view of KBREC's capabilities to provide accurate and timely reporting, its responsiveness to information requests, the overall quality of its asset-level reporting content, and its website functionality, which addresses both CMBS and non-CMBS client requirements.
- Excellent Technology - KBREC's excellent technology tools, sound data security and disaster preparedness protocols, high level of automation, and centralized data management to accommodate a diverse and large servicing portfolio while also yielding a high degree of operating efficiency. In particular, we believe the company's proprietary, integrated asset management and reporting application, called RECWeb, is highly effective for workflow management, tracking loan-level covenants and trigger events, and handling many other core functions with customized features to address CMBS and other investor reporting requirements in tandem with its main servicing system, which KBREC is upgrading this year.
- Strong Management and Professional Depth - KBREC's overall operational stability and its retention of a highly experienced management and professional staff. We view KBREC's managers and staff as being quite adept with smaller

balance loan administration and asset management. While KBREC incurred a sharply higher staff turnover rate in the first half of 2012, almost all of it involved lower-level staff and was associated with the shared servicing agreement that KBREC entered into with Berkadia Commercial Mortgage, LLC (Berkadia) in March 2012. Through this agreement, KBREC transferred nearly all primary servicing duties on approximately \$40 billion (about 4,500 loans) of its CMBS servicing portfolio to Berkadia. KBREC does not outsource servicing functions and it centralizes nearly all servicing operations in one location. We also believe that KBREC has a well-designed organizational structure that addresses its myriad servicing requirements efficiently.

- Robust Internal Audit Program - KBREC's multi-faceted internal audit program that encompasses annual Regulation AB and USAP attestations, annual operational audits conducted by the parent bank, and an annual Service Organization Control 1 Report (SOC 1) that collectively examine a broad range of loan administration and portfolio management processes. KBREC supplements its audit function with various performance tracking activities embedded in the company's technology applications and daily workflow practices. KBREC's dedicated compliance unit monitors these tracking activities. The 2012 Regulation AB and USAP attestations did not cite any exceptions. In our view, neither the parent bank's December 2012 audit report, which assigned KBREC its highest rating, nor the 2012 SOC 1 cited any major exceptions.
- Diligent Portfolio Management - Our view that KBREC has very diligent, thorough practices and procedures for proactive asset-level management and portfolio oversight for smaller balance loans. In particular, the company continues to achieve a very high collection rate of annual property operating statements and has a policy of pursuing annual property inspections for all of its small balance loans. KBREC uses a number of reporting tools managed through its proprietary technology application to monitor collateral performance, track loan covenant compliance and trigger events, and manage borrower relationships for small balance loans.

Small Balance Special Servicing

- Excellent Asset Resolution Record - Our belief that KBREC is an effective special servicer for small balance assets based on its pragmatic and sound analytics, and a corresponding successful asset resolution record based on recovery proceeds and overall timeframes. Although KBREC has successfully resolved a number of large, complex loans, we view KBREC's experience and record with small balance special servicing as a particular organizational strength.
- Expanding Client Base - Our view that the FDIC's recent renewal of its asset resolution contract with KBREC and KBREC's procurement in late 2012 of a separate servicing and asset management assignment with another government sector client are both testaments to KBREC's capabilities. We also acknowledge KBREC's additional special servicer appointments from Freddie Mac and KBREC's appointment as the replacement special servicer on a 2007-vintage CMBS during 2012 as further indications of investor confidence.
- Effective, Well-Designed Technology - In our view, KBREC's RECWeb application also serves as a highly effective and thorough asset management and reporting tool for all of the company's specially serviced assets.
- No Discernible Conflict of Interest - Our belief that KBREC has effective policies and procedures to manage conflicts of interest. Overall, we generally view KBREC 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. KBREC's business model is to act as an independent, third party special servicer without any investment in subordinate CMBS. In addition, KBREC does not have or use affiliates to purchase or sell assets within securitization trusts.

As of December 31, 2012, KBREC's small balance primary servicing portfolio was approximately \$5.5 billion by UPB and 5,609 by loan count (6% and 57% of its total primary servicing portfolio by UPB and loan count, respectively). As of December 31, 2012, KBREC's total active small balance special servicing portfolio was approximately \$319.6 million by UPB and 547 by asset count (543 loans and 4 real estate owned properties), with an average asset balance of approximately \$584,000. The CMBS component comprised 80 assets with a total UPB of \$61.3 million.

Forecast

Stable for both rankings

We expect KBREC to continue serving as a highly effective servicer and special servicer of smaller balance commercial mortgage loans and REO properties during the next 12 months.

Our full assessment report on KBREC's small balance commercial servicer and special servicer rankings is forthcoming and will be made available on our website.

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