

# Operational Risk Assessments News Bulletin

## iStar Asset Services, Inc.

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### **Morningstar Assigns iStar Asset Services 'MOR CS1' Ranking as a Commercial Mortgage Primary Servicer and 'MOR CS2' Ranking as a Commercial Mortgage Special Servicer; Forecast for Both Rankings is Stable.**

Morningstar Credit Ratings, LLC (Morningstar) has assigned its 'MOR CS1' commercial mortgage primary servicer ranking and its 'MOR CS2' commercial mortgage special servicer ranking to iStar Asset Services, Inc. (iSAS), a subsidiary business unit of iStar Financial Inc. (iStar). The assigned rankings reflect our assessment of iSAS' operational infrastructure and portfolio administration capabilities as a primary and special servicer.

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

#### Primary Servicing

- Retention of Strong Management and Professional Depth - Our belief that iSAS has retained overall operational soundness and a highly experienced management and professional staff with strong backgrounds in commercial real estate credit analysis, real estate development, and loan administration to address complex assets and reporting. We believe that the company's inter-disciplinary team-based organizational structure has proved to be an effective approach to asset servicing. Although the company's staff-level turnover rate spiked in the second half of 2011, it was mainly due to involuntary departures reflecting the company's contracting portfolio volume from general runoff, asset resolutions, and iStar's suspension of new lending activity during the 2008 to 2011 period.
- Highly Diligent, Customized Portfolio Management - Our view that iSAS is a boutique servicer with thorough performance monitoring and portfolio management practices designed to address very intricate and large-scale assets. We consider its real estate analytics and highly proactive credit culture, as reflected in its experienced personnel, diligent procedures, and comprehensive asset tracking methods, to be core operational strengths. Although our assigned rankings do not formally opine on iSAS as a construction loan servicer, we acknowledge the company's substantial history with construction loan administration and project development. We also believe the company's construction loan management experience has strengthened its asset management capabilities as a primary servicer of permanent mortgage loans.
- Excellent Technology - iSAS' well integrated and robust technology tools provide centralized data management and substantial process automation, which enable the company to manage a very complex portfolio of debt and equity assets with a high degree of operating efficiency and control. We believe the company's proprietary, integrated asset management application, combined with PNC/Midland's *Enterprise!* servicing system, provides very effective workflow management and broad functionality to track loan-level covenants, triggers, and essential asset data including the ability to address CMBS and other reporting requirements.
- Investor Reporting Expertise - Our positive view of the company's capabilities to provide accurate and timely investor reports and remittances, the thoroughness and quality of its asset-level and portfolio-level reporting, and its ability to meet monthly securitization requirements on its four legacy securitizations secured by automotive dealership real estate loans. Its portfolio reporting and responsibilities for these securitizations are quite similar to those required for CMBS. The company also formally checks the accuracy of the master servicer's remittances to the trustee and the trustee's payments to the bondholder classes. iSAS also is well-experienced with reporting to investors on syndicated loans.
- Sound, Ongoing Internal Audit Program - The company's annual cycle of independently issued audit reports based on quarterly field work to monitor internal controls and established procedures across all operational processes. iSAS supplements its audit function with various performance tracking routines embedded in the company's technology applications and daily workflow practices. iSAS also has a quality control group to monitor the accuracy and timeliness of many loan administration tasks, especially those related to cash processing and new loan boarding. The company also

provides an annual USAP attestation for its existing securitizations, which pre-date Regulation AB. The results of its last internal audit report and USAP attestation revealed no material exceptions.

#### Special Servicing

- Solid Analytics and Performance History Resolving Complex Assets - Our belief that iSAS can serve as an effective third party special servicer based on its thorough and controlled analytical practices, sound vendor oversight, effective reporting tools, and overall successful disposition record with some very challenging debt and real estate assets. The company's procedures indicate proactive practices with particular attention given to the REO transition and management processes. In many cases, iSAS has re-classified foreclosed projects to full equity real estate positions to complete development, sales, and leasing. Based on the nature of its special servicing portfolio, which is largely balance sheet-owned and characterized by longer asset holding periods than typically expected in CMBS transactions, the company's performance, which we view very positively in its own right, is principally driven by its own investment return targets and not easily comparable to that of CMBS special servicers.
- Professional Expertise - iSAS' well experienced asset management team of senior-level real estate development and workout professionals who retain life-of-asset responsibilities - from performing loan management through workout and REO liquidation. We believe this organizational approach, albeit unconventional, has worked well for the company.
- Moderate, Yet Successful Record with Securitization Special Servicing - iSAS' moderate, yet successful amount of asset resolution history for third party investors, which principally involves its legacy auto dealership asset-backed securitizations (ABS) and some participation loans. The company's special servicing work has predominantly centered on its parent's investment portfolio. As a result, iSAS has not coordinated and managed troubled asset transfers from other servicers within the current CMBS framework.
- No Discernible or Material Conflicts of Interest - Our belief that iSAS effectively manages any potential conflicts of interest. Currently, iStar has a 51% interest of a small remaining first loss investment position in one of its legacy asset backed auto dealership securitizations. iSAS is otherwise not a subordinate tranche holder and special servicer in any commercial mortgage backed securitizations (CMBS). It also does not have or use affiliates to purchase or sell assets in any loan pools it manages. Accordingly, we view iSAS as a company that essentially operates without the usual potential conflicts of interest arising from using affiliates or serving as both first-loss position investor and special servicer in CMBS.

As of June 30, 2013, the company's total servicing portfolio had an unpaid principal balance (UPB) of approximately \$1.9 billion and comprised 82 loans corresponding to 156 underlying properties. The servicing portfolio comprised 52 permanent mortgage loans with an approximate UPB of \$762 million, and 30 construction loans with an approximate UPB of \$1.2 billion. As of June 30, 2013, the company's active special servicing portfolio of non-construction assets was approximately \$696 million by UPB and comprised 40 assets (8 loans and 32 real estate owned properties). Inclusive of its specially serviced portfolio of construction loans, REO properties, and certain other former REO properties (classified as equity real estate that also included some land development assets), iSAS had 98 specially serviced assets with a total UPB of \$2.7 billion. Combined, iSAS and iStar had total assets under management of approximately \$5.9 billion by UPB, which comprised 453 debt and equity positions.

#### Forecast

*Stable* for Both Rankings. We expect the company's operational quality levels and our assigned rankings to remain unchanged during the next 12 months. We believe that iSAS remains firmly positioned to serve as a highly diligent servicer and capable special servicer for large-scale commercial mortgage loans and real estate requiring a high level of customized asset management and reporting. Although iStar's legacy portfolio continues to paydown, the company stated that its loan origination business is gaining momentum with a number of loans in the current production pipeline.

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

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