

Operational Risk Assessments News Bulletin

KeyBank Real Estate Capital

Morningstar Assigns KeyBank Real Estate Capital 'MOR CS1/Stable' Rankings as a Primary and Master Servicer and 'MOR CS2/Stable' Ranking as a Special Servicer

Morningstar Credit Ratings, LLC (Morningstar) has assigned KeyBank Real Estate Capital (KBREC) 'MOR CS1' rankings as a commercial mortgage primary and master servicer, and a 'MOR CS2' ranking as a commercial mortgage special servicer. The forecast for all rankings is Stable. The assigned rankings reflect our assessment of KBREC's operational infrastructure and portfolio administration capabilities for its respective duties as a primary, master, and special servicer.

On April 5, 2012, KBREC announced it will transfer sub-servicing rights on approximately \$40 billion (consisting of approximately 4,500 loans) of its CMBS portfolio to Berkadia Commercial Mortgage in exchange for obtaining FHA deposit accounts. While this exchange will significantly shrink KBREC's primary servicing portfolio and cause a corresponding staff reduction, we do not believe the transaction and KBREC's planned workforce reduction will adversely affect or diminish KBREC's servicing capacity or capabilities and therefore we currently view it as a ranking-neutral event. However, we will continue to monitor KBREC's organizational structure and overall performance relative to this announced portfolio sale.

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

- 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. We based our opinion on investor feedback that we obtained and on our review of selected Morningstar's published DealView® CMBS surveillance reports. We found KBREC's reporting and portfolio management performance overall to be highly favorable based on investor feedback and the DealView reports we reviewed. We do note though that some format refinements to KBREC's asset-level commentaries could benefit investors and the ratings surveillance process.
- Our positive opinion of KBREC's CMBS primary and master servicing capabilities and expertise. In our view, KBREC, 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 KBREC 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.
- 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 asset management and reporting application called RECWeb is highly effective for workflow management, tracking loan level covenants and trigger events, and managing specially serviced assets with many customized features to address CMBS and other investor reporting requirements.
- KBREC's overall operational stability and solid levels of industry experience among management and professional staff. While KBREC incurred higher staff turnover during 2011, much of it was attributable to intra-bank transfers related to career advancement. We do note that the respective average years of industry experience for its portfolio management staff and its special servicing asset managers, while solid, is lower than some other master and special servicers. The average for special servicing asset managers also may have been diluted since 2010 as the company hired for its smaller balance and FDIC assets. KBREC does not outsource servicing functions and it centralizes nearly all primary, master and special servicing operations in one location.

- KBREC's independent, well-designed internal audit function that annually 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.
- KBREC's effective practices and procedures for proactive asset-level management and portfolio oversight, which include a number of effective reporting tools managed through a robust proprietary technology application, to monitor collateral performance, track compliance and trigger events, and respond to borrower requests and consents. We also support the company's recent move to contract with a national tax service vendor which we believe strengthens its already very sound real estate tax administration function.
- Our belief that KBREC is an effective special servicer having a diligent and pragmatic approach, sound analytics, and a corresponding successful record. Our ranking does consider that smaller balance and multifamily assets account for much of its loan resolution activity, which may be viewed as moderate compared to many other special servicers, while also recognizing that KBREC has resolved some larger loans of varying complexity and property types with very positive results. We believe that the FDIC's awarding to KBREC one of only two large-scale servicing and asset resolution flow contracts in late 2010 is a further testament to KBREC's problem loan management capabilities, particularly with respect to smaller balance loans.
- 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, 2011, KBREC's total commercial mortgage primary and master serviced portfolio was approximately \$109.4 billion by unpaid principal balance (UPB) and 11,883 by loan count, and it was the named master servicer (or master/primary combined role) on 142 CMBS transactions and a primary servicer only on another 54 CMBS transactions. During 2011, KBREC obtained 12 new assignments as a CMBS primary servicer and four new assignments as a CMBS master servicer. Additionally, the FDIC awarded KBREC with a multi-year servicing and asset management pre-securitization flow contract in late 2010.

As of December 31, 2011, KBREC's total active special servicing portfolio was approximately \$419 million by UPB and 113 by asset count (108 loans and five real estate owned properties), and it was the named special servicer on 28 CMBS transactions (\$14.1 billion by UPB consisting of 2,372 loans). Additionally, the majority of the assets managed for the FDIC involve special servicing loan resolution work, which is not reflected in these numbers.

Forecast

Stable for all rankings.

We expect the assigned primary and special servicer rankings to remain unchanged during the next 12 months. Given its recent announcement to sell a sizable portion of sub-servicing rights, we also believe that commensurately KBREC will be increasing its focus on its already quite effective master servicer oversight duties.

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

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