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Servicer Evaluation: Torchlight Loan Services LLC

Servicer Analyst:

Andrew Foster, New York (1) 212-438-2759; andrew.foster@standardandpoors.com

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Ranking Overview

	--Subrankings--			
	Overall ranking	Management and organization	Loan administration	Outlook
Special	ABOVE AVERAGE	STRONG	ABOVE AVERAGE	Stable
Financial condition	Sufficient			
Corporate insurance	Sufficient			

Major Ranking Factors

The ABOVE AVERAGE ranking reflects the following strengths and weaknesses:

Strengths

- A highly experienced senior management team;
- A successful track record of resolving nonperforming commercial real estate loans in a timely manner; and
- A solid control environment, including policies and procedures, internal/external audits, and a two level approval committee process.

Weaknesses

- High turnover rate at the staff level for the first half of 2013.

Opinion

Standard & Poor's Ratings Services' overall commercial special servicer ranking for Torchlight Loan Services LLC is ABOVE AVERAGE. The outlook is stable.

Torchlight has a skilled management team with significant industry experience. The servicing staff members have broad commercial real estate backgrounds with expertise in loan workouts and real estate owned (REO) asset management. They also have strong knowledge and understanding of various asset types and geographic markets. Procedures are comprehensive and approvals for major decisions are subject to a well-defined committee review process. Torchlight has a solid oversight and control framework as evidenced by recent internal and external audits that were completed with no cited exceptions.

Key Changes Since Last Review

- Added new assignments and an active pipeline by making new loans and/or acquiring 'b' pieces or second-loss position securities in the new issue/secondary market since our last review;
- A drop in number of defaulted loan transfers in existing portfolio year to date 2013; and
- Improved turnover rate since last review; however, continues to be above average for first half of 2013 (although rate amongst management staff is minimal).

Outlook

Our outlook for the ranking is stable. We believe that, with its managerial expertise and well-executed asset management approach, Torchlight will remain an effective commercial mortgage special servicer. Since our last review, Torchlight is in a better position to increase or maintain its special servicing business with more assignments and a bigger pipeline.

Profile

Servicer Profile					
Servicer name	Torchlight Loan Services LLC				
Primary servicing location	New York, N.Y.				
Parent holding company	Torchlight Investors				
Servicer affiliates	None				
Loan servicing system	Sharepoint				
Total servicing portfolio					
	Unpaid principal balance (mil. \$)	Year-over-year change (%)	Number of assets	Year-over-year change (%)	
June 30, 2013	3,039.0	4	170	(2)	
Dec. 31, 2012	2,911.7	(11)	174	(3)	
Dec. 31, 2011	3,277.9	10	179	2	
Dec. 31, 2010	2,979.1	--	175	--	

Torchlight Investors LLC is a New York limited liability company and a registered investment advisor. It was formed in 1995 to provide commercial real estate debt investment management services, primarily in commercial mortgage-backed securities (CMBS) and other forms of commercial real estate debt. Torchlight specializes in investment management, commercial real estate lending, and distressed debt workouts. Torchlight Investors was formerly known as ING Clarion Capital LLC (ING) and its special servicing business was known as ING Clarion Capital Loan Services LLC. In July 2010, management repurchased a minority interest held by ING's parent, ING Group NV, and rebranded the company as Torchlight Investors.

Torchlight Loan Services LLC is the commercial mortgage special servicing division of Torchlight Investors. We have ranked Torchlight and its predecessors since 1999.

Management And Organization

The ranking for management and organization is STRONG.

Staffing depth and organizational effectiveness

Torchlight Investors' business is concentrated on investment management, commercial real estate lending, and distressed loan special servicing. It takes a fundamental approach by focusing on credit-driven underwriting, downside protection, and continuous surveillance. Investment Advisory and Special Servicing are the two main divisions within Torchlight Investors LLC, and they are each supported by centralized financial control, accounting, compliance, and operations groups; it currently has over 50 professionals on staff (see table 1).

Table 1

Torchlight Loan Services LLC--Industry Experience/Company Tenure*								
	--Senior managers--		--Middle managers--		--Asset managers--		--Staff--	
	Experience	Tenure	Experience	Tenure	Experience	Tenure	Experience	Tenure
Special	26	9	18	6	7	2	13	2

*As of June 30, 2013.

Torchlight is responsible for the special servicing activities and had 36 full-time employees supporting the group as of June 30, 2013. The special servicing business is organized into three functional areas: loan workout, REO, and investor reporting and operations. Senior managers average 26 years' experience; middle level managers have 18 years' experience. Asset managers directly involved with loan workouts and REO management have an average of 13 years' experience. As noted, the loan workout and REO asset management functions are separate, but are a highly collaborative. The ratio of loans to REO assets per asset manager was 18 to 1 at June 30, 2013, relatively flat since our last review. While this ratio is at the high end of the range for its peer group, it partly is mitigated by Torchlight's large number of performing loans in special servicing (about 25%), which generally require less attention than severely distressed loans.

Training

Overall, Torchlight has an adequate employee training program, consistent with similarly ranked special servicers. Training hours and topics are formally tracked, but there are no dedicated training personnel, because of its size. Senior and middle managers work with each employee to define training needs as part of their professional development plan.

Torchlight's minimum annual training requirement is 24 hours, which is 20% above our criteria of 20 hours per employee per year allocated to mortgage banking education. Employees receive training through a variety of channels, including Web-based, in-house seminars, industry conferences, and on-the-job training. Internal and external subject matter experts present the material, and content covers both soft skills and topics that are particularly relevant to the special servicing role. Topics include:

- Anatomy of a Loan Purchase Agreement;
- Ins and Outs of Intercreditor Agreements and Mezzanine Debt;
- Foreclosure: Judicial/Nonjudicial; Receiverships; Bankruptcy; and
- Fraudulent Conveyance and Carve Out Guaranty Issues.

Analysts are paired with asset managers and team leaders, providing regular training/performance feedback and constant supervision.

Technology

Torchlight makes good use of technology to manage its portfolio of distressed loans, and many functions are automated and the platform is efficient and reliable. It uses a proprietary system (developed using Microsoft SharePoint) to track all special servicing activity, which also provides work flow, document management, critical timelines, and pooling and servicing agreement (PSA) requirements. For REO management, analysis, and reporting, Torchlight uses a third-party system designed by MRI Software, and its website features properties for sale. Sound controls are in place to ensure peak system performance at all times. The special servicing department uses Argus software to complete cash flow projections and property-level modeling.

Historically, Torchlight relied on the shared resources of its former parent company, ING, for IT support, but engaged a third-party vendor in mid-2011. The vendor has over 300 employees worldwide, with approximately 10 service team members specifically designated to assist Torchlight. This team is composed of help desk assistance, field engineer assistance, senior level engineer assistance, and technology management.

Data is backed up daily, and stored off site. In case of a business interruption, the vendor maintains Torchlight's applications and data at a primary data center in Jersey City, N.J. and a disaster recovery data center in Boston. Remote access is available. Torchlight tests business continuity annually; the most recent test (December 2012) cited no material exceptions.

Internal controls

Torchlight has a robust control environment to mitigate operational risk and maximize recoveries for its investor clients.

Policies and procedures

Torchlight's special servicing policy and procedures manual is detailed, comprehensive, and available to all employees via the company intranet. The procedures contain several convenient features that assist the special servicing team in managing defaulted loans and REO:

- PSA requirements;
- REMIC guidelines;
- Approved vendor lists;
- Committee meeting minutes and schedules;
- Property insurance guidelines; and
- Links to additional policy resources, forms and templates.

The procedures emphasize the importance of controlling cash as soon as possible when dealing with sub/nonperforming loans. They are proactive and facilitate quick action in order to preserve loan and collateral value.

All major actions require committee approval. There are two committee levels: one for loans equal to or greater than \$10 million, and one for loans of less than \$10 million. In both cases, the committee has mid- to senior-level managers with deep and broad commercial real estate backgrounds. A staff member updates the policy and procedures manual semiannually, and the head of special servicing must approve any changes.

Audits

The company maintains a robust compliance and control environment, as evidenced by:

- Comprehensive policies and procedures;
- No material exceptions for the 2012 USAP issued in March 2013;
- No material exceptions for the 2012 Regulation AB attestation issued in March 2013;
- No material findings during an internal cash control audit completed March 2013; and
- Torchlight's finances were independently audited in April 2013.

Prior to its divestiture and rebranding, Torchlight relied on the shared resources of its former parent company, ING, for internal audits. Since the cash control audit completed in November 2010, Torchlight has used its own internal operations group to perform audits on a 24-month cycle. This is slightly less frequent than some servicers in its peer group; however, the company now conducts cash control audits on an annual basis.

Additional items

Torchlight has applicable and acceptable corporate insurance coverage (Fidelity Bond and E&O). As of June 30 2013, there were no material servicing-related pending litigation items.

Loan Administration

Special Servicing

The ranking for loan administration is ABOVE AVERAGE.

Torchlight's named special servicing volume has been relatively steady over the past few years. It currently is the named special servicer on 28 CMBS securitizations with approximately 2,400 loans, and an outstanding balance of \$30 billion (see table 2). Because of market conditions, active special servicing volume increased dramatically in 2008 and 2009. As of June 30, 2013, Torchlight actively managed 170 assets totaling \$3.0 billion with an average asset size of \$18.0 million.

Table 2

Torchlight Loan Services LLC--Total Servicing Portfolio By Property Type And Location*				
Property type	Unpaid principal balance (mil \$)	No. of loans	% of unpaid principal balance	% of loans
Retail	841.8	63.0	27.7	37.1
Mixed-use	90.6	8.0	3.0	4.7
Industrial	152.9	10.0	5.0	5.9
Office	1,072.3	46.0	35.3	27.1
Multifamily	288.2	21.0	9.5	12.4
Warehouse	0.0	0.0	0.0	0.0
Lodging	515.0	12.0	16.9	7.1
All other	78.2	10.0	2.6	5.9
Total	3,039.0	170.0	100.0	100.0

*As of June 30, 2013.

	Unpaid principal balance (mil \$)	No. of loans	% of unpaid principal balance	% of properties
California	420.1	21	14	12

Table 2

Torchlight Loan Services LLC--Total Servicing Portfolio By Property Type And Location* (cont.)				
New York	301.8	8	10	5
Florida	257.4	16	8	9
New Jersey	236.6	8	8	5
Georgia	217.0	14	7	8
Michigan	144.2	7	5	4
Arizona	99.4	6	3	4
All other	1,362.4	90	45	53
Total	3,039.0	170	100	100

Torchlight takes a proactive approach to surveillance. It monitors loan and collateral performance continuously and maintains close relationships with CMBS master servicers. Monthly conference calls with the master servicers cover topics:

- Watchlists, delinquency reports, and maturing loans;
- Potential loan transfers;
- Performing loan borrower consents;
- Important information on specially serviced loans needed by the master servicer; and
- Advancing requirements and recoverability.

These surveillance practices facilitate the flow of information, improve reporting, and provide a smooth transition of the loans/borrowers between Torchlight and the master servicers it works with. The special servicing group works with master servicers to perform advance reconciliations as needed to determine advance recoverability; however, we believe the two parties can sometimes do a better job of communicating updated valuations (which can be an issue when values drop precipitously and/or appraisals and broker's opinions of value differ materially). Without up-to-date discussions on workout expectations and realistic expected sales prices, CMBS trusts could over-advance on a given loan, which can ultimately hurt the recovery.

Loan recovery and foreclosure management

Torchlight has a well-defined problem loan management process. Immediately following a loan transfer to special servicing, the head of special servicing assigns it to a team leader and asset manager. All necessary documentation is obtained, an initial file review is completed, and the loan is uploaded to the special servicing system. Legal counsel is engaged as needed, and the asset manager conducts a thorough analysis of the borrower, loan, and collateral.

Depending on circumstances, this may include updating property inspections, appraisals, environmental condition reports, and a brokers' opinion of value. Detailed procedures exist to guide the asset manager on how to assess the viability of each resolution strategy. Torchlight also accounts for legal, tax, and servicing agreement compliance requirements. Asset status reports are to be completed and distributed within 60 days of transfer, or sooner, as prescribed in the transaction documents. As noted, all major actions are subject to committee approval. Resolution activity increased significantly in 2008 and 2009 and has remained at elevated levels. Torchlight's resolution times and recovery rates compare favorably with industry norms, because of its highly experienced team and thorough approach to loan recovery and foreclosure management.

Torchlight's active inventory of specially serviced loans and REO properties stayed relatively flat between 2009 and mid-year 2013 in terms of both the number of loans as well as outstanding principal balance; however it has active resolution activity (see tables 3 and 4). While it continues to see a decrease in the number of newly defaulted loan transfers from its existing portfolio, it added 12 new special servicing assignments in 2012 and 2013, year to date. These new assignments are \$14 billion in outstanding principal balance (\$1.1 billion/76 loans actively special serviced). Torchlight expects further migration in control rights to offer future growth opportunities for its special servicing division.

Table 3

Torchlight Loan Services LLC -- Special Servicing Portfolio												
Active inventory	--June 30, 2013--			--Dec. 31, 2012--			--Dec. 31, 2011--			--Dec. 31, 2010--		
	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)
Loans	2,519.3	121	17	2,638.9	137	17	3,108.2	152	16	2,903.0	165	12
Real estate owned	519.7	49	25	272.8	37	20	169.7	22	27	76.1	10	25
Total special servicing portfolio	3,039.0	170	19	2,911.7	174	18	3,277.9	174	17	2,979.1	175	13

Table 4

Torchlight Loan Services LLC -- Special Servicing Loan Resolutions												
Resolution breakdown	--June 30, 2013--			--Dec. 31, 2012--			--Dec. 31, 2012--			--Dec. 31, 2010--		
	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)	Unpaid principal balance (mil. \$)	No.	Average age (months)
Returned to master	68.2	9	12	725.4	28	24	792.2	51	20	1,025.6	26	13
Full payoffs	183.0	13	16	450.3	24	9	144.9	12	9	117.4	3	3
DPO and/or note sale	192.9	14	21	287.6	27	17	186.7	24	16	178.2	40	10
Foreclosed loans	192.7	20	23	252.6	35	19	98.7	10	16	37.6	6	18
Other loans transferred out	0.0			419.7			0.0			0.0		
Adjustments	0.0			0.0			0.0			0.0		
Total	636.8	56	19	1,715.8	114	18	1,222.6	97	17	1,358.8	75	11

*The number of restructured loans may be lower if some are recognized as single loans.

Torchlight tracks its liquidation recovery rates for U.S. CMBS fixed-rate conduit loans, which have been above industry averages from January 2010-July 2013 (excluding liquidations with realized losses of less than 2%), and says it has a recovery rate of 57.4%, compare with the industry average of 45.2%. Torchlight also tracks recovery rates for the balance sheet loans, but does not have an index against which to compare. Torchlight's special servicing committee

receives an aging schedule of its specially serviced assets monthly; the committee compares that schedule to the broader CMBS market to determine resolution strategies, specifically for seasoned specially serviced assets. We believe this is a proactive approach to ensuring that assets are resolved in a timely manner.

REO management and dispositions

As of June 30, 2013, Torchlight managed 49 REO assets with an unpaid principal balance of \$519.7 million (see table 5). There are four asset managers dedicated to REO asset management, who also oversee the operations of properties under receivership. We believe this is an effective structure that allows asset managers in the group to handle property-related workload, while others focus on the defaulted loan portfolio, where the borrower maintains control of the collateral.

Table 5

Torchlight Loan Services LLC--Real Estate Owned Sales												
	--June 30, 2013--			--Dec. 31, 2012--			--Dec. 31, 2011--			--Dec. 31, 2010--		
	Unpaid principal balance (mil. \$)	No.	Months	Unpaid principal balance (mil. \$)	No.	Months	Unpaid principal balance (mil. \$)	No.	Months	Unpaid principal balance (mil. \$)	No.	Months
Estimated market value	24.3	8		129.4	22		13.6	4		15.5	9	
Gross sales proceeds	20.4			125.9			14.0			16.1		
Net sales proceeds	20.4			124.2			13.6			15.0		
Net sales /market value (%)	83.8			96.0			100.5			96.5		
Average time in real estate owned			15			4			19			6
Average time with special			28			29			30			21

Torchlight's primary goal regarding REO assets is to manage, conserve, protect, and operate each REO for the investors to obtain a prompt disposition and sale, while maximizing recoveries for the benefit of the certificateholders. The policies and procedures manual provides detailed guidance for asset managers, and all major decisions regarding REO assets are subject to committee approval. Torchlight typically completes REO business plans within 90 days of foreclosure.

REO accounting and reporting

A minimum of two accounts are set up for each REO asset. One is used for rent collections, and the property manager is granted view-only access to process rent payments. The second is for expense disbursements, funded according to a preapproved budget. The property manager completes monthly account reconciliations, reviewed and approved by the asset manager.

Third-party property managers and brokers are engaged to assist with foreclosed properties. They must be on

Torchlight's approved vendor list, and it uses a competitive bid process. Property managers deliver monthly operating reports, reviewed by Torchlight; brokers submit monthly updates, reviewed by Torchlight to ensure the property is effectively marketed.

Subcontracting management

The special servicing asset manager is generally responsible for engaging third-party service providers and monitoring performance and authorizing payment. Vendors must meet Torchlight's standards for qualifications (geographic and product expertise, licensing, insurance, professional designations), and the company uses standard contracts for engagement. Torchlight also maintains approved vendor lists for professional services, which include geographic and product specialties where applicable to ensure the use of appropriate vendors:

- Lawyers;
- Appraisers;
- Site inspections;
- Environmental consultants;
- Property managers;
- Receivers;
- REO brokers; and
- Loan sale advisors.

Torchlight says it does not use affiliates as vendors.

Investor reporting

We believe Torchlight has the technology and expertise to meet required CMBS and other third-party investor reporting duties for nonperforming commercial assets. It adequately documents investor reporting requirements and procedures in its policy and procedures manual. Senior management demonstrates a full awareness of CMBS reporting requirements, and says its systems are capable of producing all required CREFC-formatted reports.

Legal department

Torchlight does not have an in-house legal department to support the special servicing asset managers, but maintains an approved list of third-party counsel, and only the head of special servicing may execute a legal engagement letter. Further, appropriate asset managers review and approve all legal invoices prior to payment.

Financial Position

The financial position for Torchlight is deemed to be Sufficient. This is based on our review of the audited financial statements for Torchlight Investors LLC.

Related Criteria And Research

Related Criteria

- Revised Criteria For Including RMBS, CMBS, And ABS Servicers On Standard & Poor's Select Servicer List, April 16, 2009
- Servicer Evaluation Ranking Criteria: U.S., Sept. 21, 2004

Related Research

- Torchlight Loan Services ABOVE AVERAGE Ranking Affirmed As Commercial Mortgage Special Servicer, Nov. 23, 2011

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