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Servicer Evaluation: Torchlight Loan Services LLC

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Ranking Overview

Ranking	
Special	
Overall ranking	ABOVE AVERAGE
Subranking	
Management and organization	STRONG
Loan administration	ABOVE AVERAGE
Outlook	Stable
Financial condition	Sufficient

Key Ranking Factors

- Highly experienced senior management team;
- Successful track record of resolving nonperforming commercial real estate loans in a timely manner;
- Solid control environment, including policies and procedures, internal/external audits, and a well-defined committee approval process; and
- High staff turnover rate for the first half of 2014 due to a strategic decision to relocate to a lower-cost center for their operations.

Opinion

Standard & Poor's Ratings Services' overall commercial special servicer ranking for Torchlight Loan Services LLC (Torchlight) 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 recently completed internal and external audits, which did not cite exceptions.

Outlook

Our outlook for the ranking is stable. We believe that Torchlight will remain an effective commercial mortgage special servicer with its managerial expertise and well-executed asset management approach. Since our last review, we believe Torchlight may be more likely to achieve long-term stability after relocating to a more conducive region for ongoing business continuity. They hired asset managers and staff with significant industry expertise in their new location. Regarding our longer-term outlook, 80% of Torchlight's special servicing portfolio will mature by 2018, which

represents a potentially active pipeline for special servicer activity.

Key Changes

- Relocated special servicing operations to Miami, Fla. from New York City in May 2014.
- Increase in turnover rates since our last review, largely due to the relocation.
- Currently incorporating an enhanced servicing system known as Backshop to assist with multiple special servicing tasks.
- Became an approved Freddie Mac special servicer in December 2014.

Profile

Servicer Profile	
Servicer Name:	Torchlight Loan Services LLC
Primary servicing location	Miami, Fla.
Parent holding company	Torchlight Investors
Servicer affiliates:	None
Loan servicing systems	Backshop and Sharepoint

Torchlight Investors LLC is a New York limited liability company with headquarters in New York City and is an SEC-registered investment advisor. Torchlight Investors LLC was formed in 1995 to provide commercial real estate investment management services, primarily in commercial mortgage-backed securities (CMBS) and other forms of commercial real estate debt. Torchlight Investors LLC 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, which is owned 100% by management.

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

Management And Organization

The management and organization ranking 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. Torchlight Loan Services LLC is the servicing entity, while Torchlight Investors LLC handles investment advisory. They are each supported by centralized financial control, accounting, compliance, and operations groups; combined, they currently have over 40 professionals on staff.

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(i)	20	6	14	4	11	1	8	1
Special(ii)	27	9	16	5	13	2	3	3

(i)As of Dec. 31, 2014. (ii)As of Dec. 31, 2013.

Torchlight is responsible for the special servicing activities and had 27 full-time employees supporting the group as of Dec. 31, 2014. The special servicing business is organized into three functional areas: loan workout, REO, and investor reporting/operations/surveillance. We believe Torchlight's industry experience levels remain strong, especially at the senior and middle manager levels. Senior managers average 20 years' experience, and middle level managers average 14 years' experience. Asset managers directly involved with loan workouts and REO management have an average of 11 years' experience.

As noted above, the loan workout and REO asset management functions are separate, but are highly collaborative. Due to their smaller portfolio volume, Torchlight now utilizes a hybrid pool of analysts that support both REO and loan workouts. The ratio of loans to REO assets per asset manager was 16 to 1 as of Dec. 31, 2014, slightly less since our last review.

We noted above the high turnover rates since our most recent review, largely due to the relocation to Miami, in which numerous New York City employees were replaced with experienced hires residing in Florida. Many of the recent hires worked together under separate firms, mitigating the low tenure numbers for new employees of the firm. However, despite the high turnover last year, we believe Torchlight's staffing situation should stabilize in the near future and that the relocation may continue to provide access to a larger supply of potential employees with special servicing experience, as the need arises.

Training

Overall, Torchlight has an effective 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.

Torchlight's minimum annual training requirement is 59 hours, which is up considerably since our previous review. Actual training hours for the year ending Dec. 31, 2014, averaged 65 hours per employee. Employees receive training through a series of lunch-and-learns and other on-the-job training programs. Training hours per employee are formally tracked by Torchlight. 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:

- Pooling and servicing agreement (PSA) and compliance training;
- Collateralized debt obligations, collateralized loan obligations, and other securitized structures;
- Business plan;
- Bankruptcy; and
- Foreclosures vs. deed-in-lieu.

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

Technology

Torchlight currently utilizes Microsoft SharePoint to track all special servicing activity. Through this system, each loan possesses its own site, and borrower requests are available. Since early 2014, Torchlight has been working with a third-party vendor to migrate over to a new asset management system known as Backshop. Although this system has not been previously utilized by any other special servicer, Torchlight has implemented a three-phase rollout program and plans to continue running Microsoft SharePoint in parallel until the transition to Backshop as the primary servicing system is completed. Management indicated that once Backshop is fully implemented by mid-2015, SharePoint will be phased out of use. Backshop contains numerous capabilities, including:

- Deal locator;
- Filters portfolios;
- Investor Reporting Package data;
- Cash flow analysis;
- Creates form letters; and
- Asset status reports.

Torchlight is directly involved with the developing vendor to continually make improvements and to request additional features to tailor the system to their needs. Training is given regularly to all staff regarding the use of the new system. Relevant external information within the system is currently updated on a monthly basis. We believe Torchlight is transitioning systems in a reasonable and controlled manner, causing minimal operational disruption.

Regarding disaster recovery, data is replicated asynchronously and stored off-site. If business is interrupted, 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, Mass. Remote access is available via Citrix. Due to the move to Miami and as a response to Hurricane Sandy, a hurricane plan was added to business continuity. Torchlight tests business continuity annually; the most recent test (November 2014) 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 materials are detailed, comprehensive, and available to all employees via the company intranet. The procedures contain several convenient features that assist and guide the special servicing team in managing defaulted loans and REO:

- PSA requirements;
- Problem Loan Strategy Overview;
- Approved vendor lists;
- Communication with the master servicer;
- Various loan resolution checklists; and
- Links to additional policy resources, forms, and templates.

The procedures emphasize the importance of effectively addressing problem loans with careful analysis and diligence. A detailed list of steps clarifying the company-wide processes is provided.

Updates are made to the policy and procedures manual frequently, and the head of special servicing must approve any changes. The policy and procedures manual and supporting materials are currently undergoing revision in conjunction with the Backshop rollout and the new organizational structure. Any changes are regularly communicated to staff.

Audits

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

- Comprehensive policies and procedures;
- No material exceptions for the 2014 Uniform Single Audit Program issued in March 2015;
- No material exceptions for the 2014 Regulation AB attestation issued in March 2015; and
- Torchlight's finances were independently audited in April 2013.

Torchlight's most recent cash control audit was completed in 2013. Management indicated it intends to conduct another later in 2015. Torchlight utilizes 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, although it was noted that no issues were uncovered during the previous review.

Given that REO has become a larger portion of Torchlight's special servicing portfolio in recent years and is expected to continue to grow in the near future, Torchlight has decided to engage Cohn Reznick to perform REO property management audits on approximately 15%-20% of its REO portfolio in 2015. The audits will commence in late April. In addition, Torchlight recently hired a compliance officer to assist with a variety of compliance matters.

Additional items

Torchlight has applicable and acceptable corporate insurance coverage (Fidelity Bond and E&O). As of Dec. 31, 2014, there were no material servicing-related pending litigation items.

Loan Administration – Special Servicing

The loan administration ranking is ABOVE AVERAGE.

Torchlight's named special servicing volume has been relatively steady since our most recent review. It currently is the named special servicer on 34 CMBS securitizations with approximately 2,100 loans and an outstanding balance of \$27.5 billion. Because of market conditions, active special servicing volume have been gradually decreasing since 2012. As of Dec. 31, 2014, Torchlight actively managed 145 assets totaling \$1.9 billion with an average asset size of \$13.0 million (see table 2).

Table 2

Torchlight Loan Services LLC - Special Servicing Portfolio			
As of	Unpaid principal balance (mil. \$)	Year-over-year change (%)	Staff (no.)
Dec. 31, 2014	1,919.55	(11.4)	27
Dec. 31, 2013	2,167.40	(25.6)	33
Dec. 31, 2012	2,911.73	(11.2)	36

Table 2

Torchlight Loan Services LLC - Special Servicing Portfolio (cont.)			
Dec. 31, 2011	3,277.86	10.0	40
Dec. 31, 2010	2,979.10		36

During the six-month period ending Dec. 31, 2014, more than half of the 66 resolved loans transferred from another servicer. We believe the increased special servicing transfers occurring over the past several years has created a challenging environment for special servicers, but Torchlight has effectively managed the process and issues that arose with these challenges.

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

- Current watchlists, delinquency reports, and upcoming maturities;
- Current specially serviced loans transferred from the master servicer;
- Performing loan borrower consents;
- Important information on specially serviced loans needed by the master servicer; and
- Changes in processes and procedures.

Policies and procedures define specific standard practices for each individual master servicer with whom Torchlight does business. 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. The special servicing group works with master servicers to perform advance reconciliations as needed to determine advance recoverability.

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 broker's 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. Torchlight reached 156 loan resolutions in 2014; of those, 72 were a completed foreclosure or deed-in-lieu and converted to an REO.

Torchlight's active inventory of specially serviced loans and REO properties has declined between 2012 and year-end 2014 in terms of both the number of loans as well as outstanding principal balance (see tables 2 and 3). While the number of newly defaulted loan transfers from its existing portfolio continues to decrease, it added 15 new special servicing assignments between 2013 and year-end 2014. These new assignments are \$16 billion in outstanding principal balance (\$1.2 billion/110 loans actively special serviced).

Table 3

Torchlight Loan Services LLC - Special Servicing Portfolio (Active Inventory)			
	Loans	Real estate owned	Total
Dec. 31, 2014			
Unpaid principal balance (mil. \$)	1,148.92	770.63	1,919.55
Asset count (no.)	79	66	145
Avg. age (mos.)(i)	13	25	18
Dec. 31, 2013			
Unpaid principal balance (mil. \$)	1,587.03	580.37	2,167.40
Asset count (no.)	97	50	147
Avg. age (mos.)(i)	17	25	19
Dec. 31, 2012			
Unpaid principal balance (mil. \$)	2,638.92	272.82	2,911.73
Asset count (no.)	137	37	174
Avg. age (mos.)(i)	17	20	17
Dec. 31, 2011			
Unpaid principal balance (mil. \$)	3,108.20	169.66	3,277.86
Asset count (no.)	152	22	174
Avg. age (mos.)(i)	16	27	16
Dec. 31, 2010			
Unpaid principal balance (mil. \$)	2,903.03	76.07	2,979.10
Asset count (no.)	165	10	175
Avg. age (mos.)(i)	12	25	13

(i) Average age reflects time in months from date loan first became specially serviced to reporting date.

Table 4

Torchlight Loan Services LLC - Special Servicing (Loan Resolutions)						
	Modified/returned to servicer	Full payoff	Discounted payoff/note sale	Foreclosure/deed-in-lieu	Other transfers out	Total
2014						
Unpaid principal balance (mil. \$)	147.15	169.24	465.58	672.29	267.65	1,721.91
Asset count (no.)	14	21	24	72	25	156
Avg. age (mos.)(i)	17	12	23	18		
2013						
Unpaid principal balance (mil. \$)	636.00	282.01	526.19	341.44	119.16	1,904.80
Asset count (no.)	21	24	28	35	10	118
Avg. age (mos.)(i)	14	15	23	19		

Table 4

Torchlight Loan Services LLC - Special Servicing (Loan Resolutions) (cont.)

2012						
Unpaid principal balance (mil. \$)	725.39	450.26	287.60	252.59	419.74	2,135.59
Asset count (no.)	28	24	27	35	12	126
Avg. age (mos.)(i)	24	8	17	19		
2011						
Unpaid principal balance (mil. \$)	792.22	144.93	186.66	98.74	0.00	1,222.55
Asset count (no.)	51	12	24	10	0	97
Avg. age (mos.)(i)	20	9	16	16		
2010						
Unpaid principal balance (mil. \$)	0.00	0.00	0.00	0.00	0.00	0.00
Asset count (no.)	0	0	0	0	0	0
Avg. age (mos.)(i)	0	0	0	0		

(i) Average age reflects time in months from date loan first became specially serviced to loan resolution date.

Torchlight tracks its liquidation recovery rates for U.S. CMBS fixed-rate conduit loans, which they indicated have been above industry averages from January 2010-December 2014 (excluding liquidations with realized losses of less than 2%). They reported a recovery rate of 55.71%, compared with their calculated CMBS industry average of 52.36%.

REO management and dispositions

As of Dec. 31, 2014, Torchlight managed 66 REO assets with a \$770.6 million unpaid principal balance (see table 5). There are two primary asset manager and four "hybrid" 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 a property-related workload, while possessing the ability to assist with loan asset management during times of changing workloads. Given declining special servicing volume, this type of structure is becoming more common among Standard & Poor's-ranked servicers.

Table 5

Torchlight Loan Services LLC - Special Servicing Portfolio (REO Sales)

	Estimated market value (mil. \$)	Net sales proceeds (mil. \$)	Sales/market value (%)	Asset count (no.)	Avg. time (mos.)
2014	204.90	204.10	100	59	16
2013	114.60	102.91	90	28	14
2012	129.39	124.19	96	22	4
2011	13.56	13.62	100	4	19
2010	15.50	14.96	96	9	6

REO--Real estate owned.

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 guidance with specific business plans for asset managers, and all major decisions regarding REO assets are subject to committee approval. An REO business plan is typically submitted to the Special Servicing Committee within 60 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, which uses a minimum of three competitive proposals 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:

- Legal services;
- Property inspectors;
- Appraisers;
- Environmental consultants;
- Property managers, receivers, and leasing agents; and
- Investment sales brokers.

Torchlight stated it does not use affiliates as vendors. All approved vendors must sign a confidentiality agreement.

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 indicated its systems are capable of producing all required CRE Finance Council-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 before payment.

Financial Position

Torchlight's financial position is deemed to be sufficient.

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

- Select Servicer List, April 1, 2015
- Torchlight Loan Services LLC ABOVE AVERAGE Commercial Special Servicer Ranking Affirmed, March 20, 2015

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