HOT TOPICS FOR SERVICERS

WELCOME

TO THIS FREE WEBINAR
FROM 1:00pm – 2:00pm CST

1ST SERVICE SOLUTIONS®

ANDREWS KURTH LLP ATTORNEYS

MORTGAGE BANKERS ASSOCIATION®

MORNINGSTAR

Speakers

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CMBS MARKET OVERVIEW

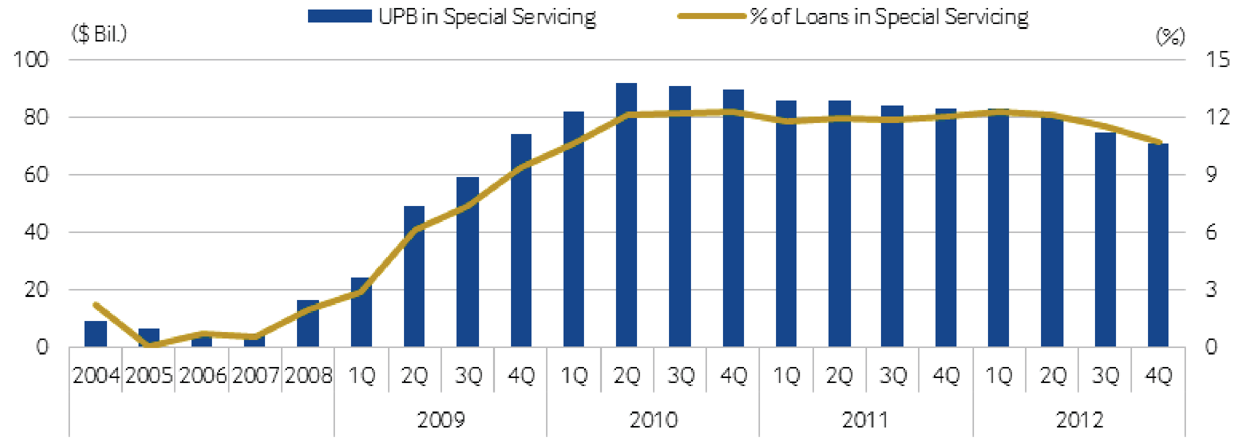
Speaking:

Ann Hambly, 1st Service Solutions

Ann Hambly created 1st Service Solutions in 2005 recognizing the need for a borrower advocate in commercial real estate. Hambly has over 30 years of commercial real estate servicing experience and has served as the CEO of servicing for Prudential, Bank of New York, Nomura, and Bank of America. In 2011 she was recognized as one of the most influential woman in commercial real estate by National Real Estate Investor. She has also been recognized as one of the top 25 CEOs across all industries in a book called True Leaders. She has been at the forefront of setting industry standards for commercial real estate and has led many initiatives for industry groups that included attorneys, rating agencies, master and special servicers, trustees, and bondholders.

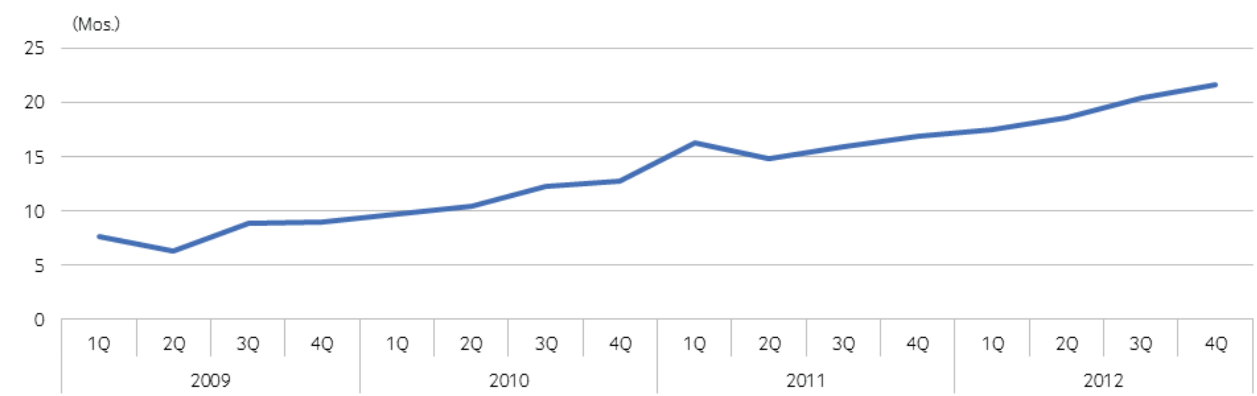
Defaults

Special Servicing Universe



Source: Fitch.

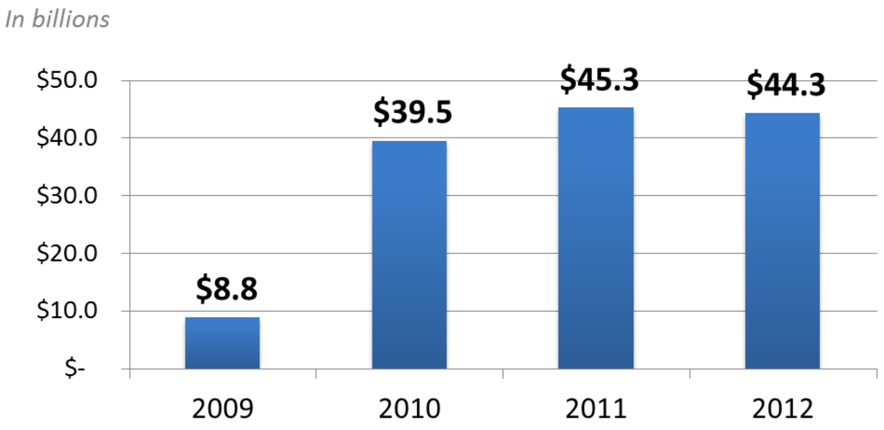
Average Time in Special Servicing

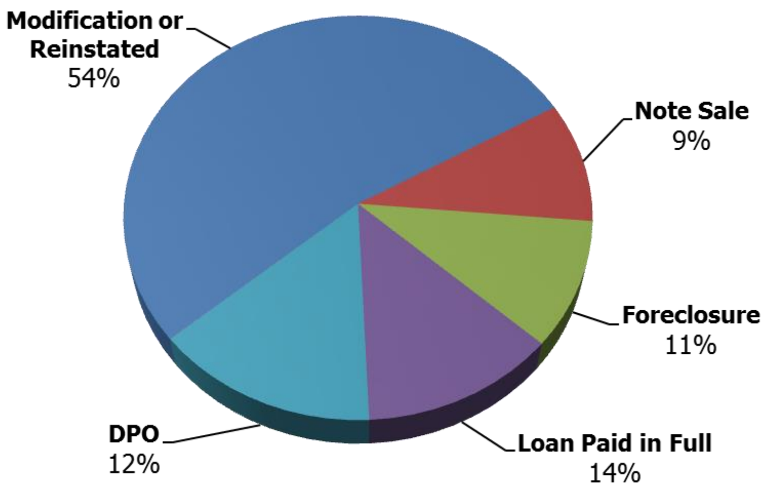


Source: Fitch.

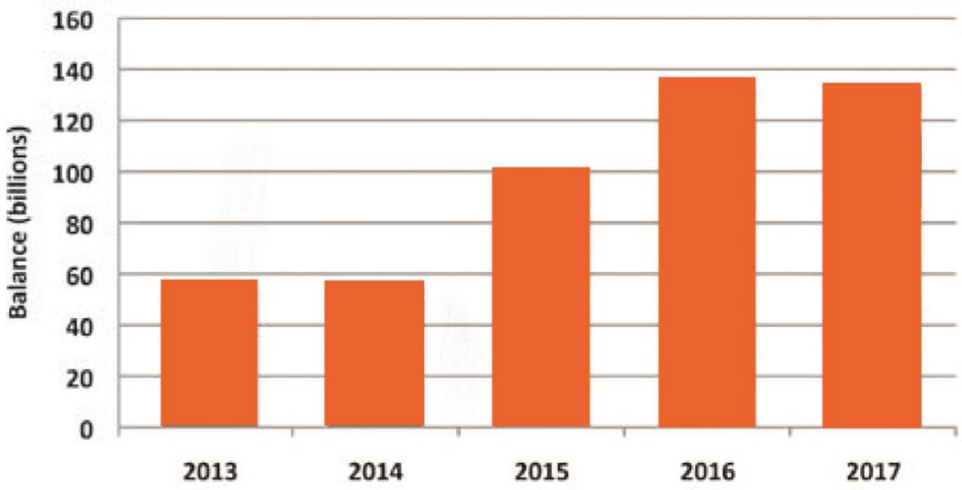
Resolutions

History of CMBS Default Resolutions and How They Were Resolved





Maturities



Balance (billions)
160
140
120
100
80
60
40
20
0
2013
2014
2015
2016
2017

REGULATORY CHANGES

Speaking:

Pat Sargent, Andrews Kurth LLP

Mr. Sargent is a Partner with Andrews Kurth LLP and a member of the Commercial Real Estate and Securitization and Structured Finance Practice Groups in the firm's Dallas office. He has represented participants in every facet of U.S. and international securitization and structured finance transactions, including commercial mortgage loan originators and loan sellers, issuers, investment banks, servicers, borrowers, investors, and rating agencies. He is also past President of the Commercial Real Estate Finance Council, and served on the Board of Governors of the Mortgage Bankers Association and the Board of Governors of the Chartered Realty Investor Society. Mr. Sargent is a frequent speaker and author on commercial real estate finance issues.

PSA

Legacy

CMBS 2.0

CMBS 3.0

Dodd Frank Act

Passed by congress in 2010

Most sweeping regulatory and supervisory reform in the history of the US

Very much still a “work in progress”

Sweeping effects on Banks

How it effects CMBS and servicers specifically:

- Conflicts of interest
- Affiliations
- Operating Advisor
- Transparency and the IRP

Unintended consequences

Limits on Servicer Compensation

Master servicer

Special servicer

- Permitted special servicer/affiliate fees
- Workout and liquidation fees

Other fees and commissions

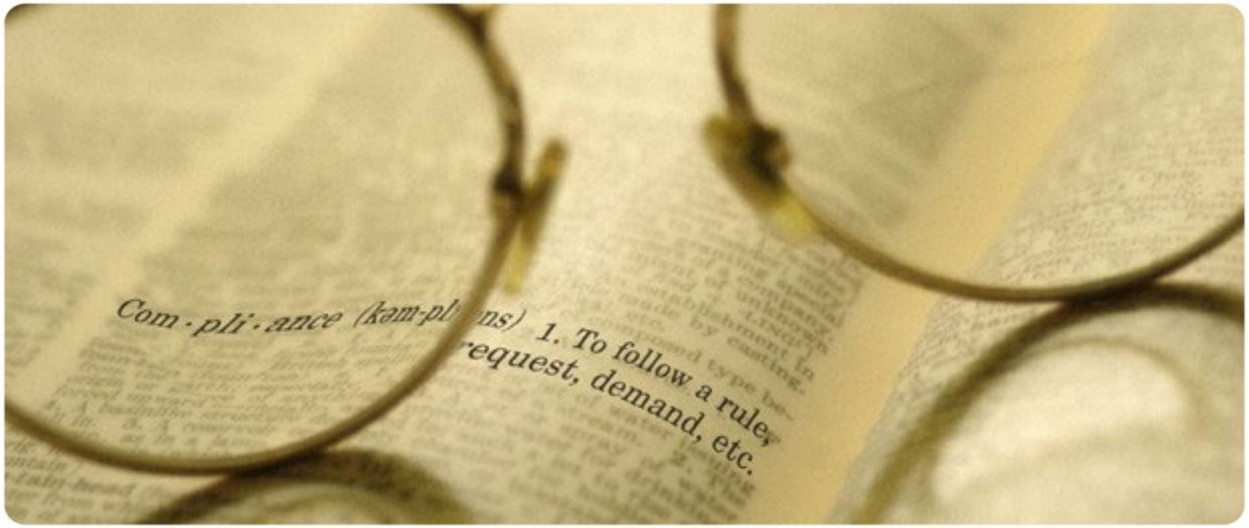
Reg AB

Sub servicer agreement criteria

Sub servicer filing requirements

Annual reports required for each SERVICING FUNCTION PARTICIPANT

COMPLIANCE PROGRAM



Speaking:

Mary Chamberlain, Morningstar

Bio Here

Key Risk Areas:
Operational Infrastructure and Portfolio Administration

Operational Infrastructure

- The factors we consider in our review of a servicer's Operational Infrastructure, and the weight we assign to each factor are as follows:
  - Organizational Structure and Business Strategy (30%)
  - Audit, Compliance, and Procedural Completeness (40%)
  - Technology and Disaster Recovery (30%)

Portfolio Administration

- This key area examines and weights these factors (the elements associated with each factor cover primary servicers and master servicers, as applicable):
  - Loan Administration (30%)
  - Investor Reporting, Accounting, and Advancing (35%)
  - Portfolio Management (35%)

Audit, Compliance, and Procedural Completeness

We place particular weight on the servicer's audit function along with the completeness of the servicer's policies and procedures.

A robust audit function promotes accountability and accuracy, which in turn, mitigates risk.

We review the servicer's audit and any related quality assurance reports to assess how any exceptions to policies and procedures or regulatory and industry-mandated requirements are identified and corrected.

To be ranked 'MOR3', we expect a servicer to have:

- A formalized and independent audit function that governs the scope and frequency of audits, the process and timing for corrective actions, and the personnel resources involved; and
- An audit process that examines cash and investor reporting controls at least every 12 to 18 months

Best Practices Governing Audits, Compliance, Procedures

Well designed policies and procedures serve as a useful training reference tool, offer a resource for experienced staff, promote consistent practices, and facilitate auditing. Best practices include:

- Developing and updating policies and procedures in a centralized and controlled manner involving senior management review, and preferably including compliance or legal review, for adherence to regulatory requirements, pooling and servicing agreements, inter-creditor agreements, and other servicing agreements.

- Combining statements of policy with clear procedures on how to perform a particular task and include the requisite forms, exhibits and computer screen captures.

Compliance: Portfolio Administration

Servicers must have comprehensive portfolio administration procedures and practices to address loan and portfolio-level responsibilities in order to guard against errors and oversights, and to protect the interests of their investor clients, but with sensitivity to borrowers' needs as well.

We believe that compliance with portfolio administration procedures means that lien priorities are maintained, loan-level and investor-level requirements are followed, borrowers' needs are handled in a reasonable manner, and that potential problem loans are proactively addressed so that investors' rights and their investment positions are protected

Loan Administration

Compliance should test loan administration procedures and practices for:

- Boarding new loans,
- Tracking loan file and collateral documentation,
- Processing payment receipts and disbursements,
- Loan accounting,
- Uniform Commercial Code (UCC) re-filings,
- Real estate tax administration,
- Property insurance administration, and
- Capital expenditure reserve account disbursements.

For all these functions, compliance should test whether the servicer has proactive and overall effective control practices in place.

Compliance with Insurance Administration

A compliance program should also test whether the servicer uses best practices for insurance administration such as:

- Tracking requirements, premium payments, carrier ratings
- Obtaining renewals that shows appropriate loss payees
- Monitoring exceptions for timely resolution
- Having controlled procedures for loss draft processing
- Maintaining a lender's force-placed insurance policy for prompt activation and with a provision for retroactive coverage

Compliance: Real Estate Tax Payments

Compliance testing also should address the servicer's procedures and practices for monitoring real estate tax payments to protect collateral and lien priority.

Audits should address tax penalties and test whether procedures facilitate incurring minimal late tax payment penalties for escrowed loans.

Compliance examines whether servicer has standardized processes for conducting annual tax escrow analyses and any whether the servicing system can accurately calculate revised escrow payments.

Compliance: Investor Reporting, Accounting, and Advancing

An effective compliance program examines a servicer's investor reporting and accounting abilities and should test whether:

- Reports conform with investor and CREFC requirements.
- Investor bank account reconciliation practices match to Reg AB timelines and requirements.
- Procedures and systems address the reconciling of unpaid principal balances to scheduled security balances in a controlled manner.
- Duties among investor reporting, remitting, and account reconciling functions, are properly segregated, with these functions executed through a controlled approval process.

Compliance programs should also consider the extent to which the servicer has incurred any remittance or reporting errors, the servicer's explanation for such errors, and if the servicer filed any re-stated investor reports as a result.

Policies and procedures should reflect effective controls related to receiving and validating sub-servicer remittances, remittance reports, and reconciling sub-servicers' remittances to required pool-level trustee remittance amounts.

Compliance: Advancing

Compliance reviews should examine whether the servicer has clearly stated policies and approval procedures for prudently determining the recoverability of making a monthly debt service payment advance on a delinquent loan.

Compliance programs test controls for advancing to ensure that servicers recover their advances in a manner that can best avoid, if at all possible, interest shortfalls to the CMBS trust.

Compliance: Portfolio Management

A compliance program should also test controls related to portfolio management by examining whether the servicer:

- Tracks borrower compliance and loan covenant triggers events
- Collects and analyzes financial statements and property inspections,
- Manages a watchlist of potential problem loans
- Engages in early stage collection efforts on delinquent loans
- Analyzes and responds to borrower consent requests
- Releases reserves to cover capital expenditures

INSURANCE

Speaking:

Kathy Marquardt, Mortgage Bankers Association

Kathryn (Kathy) Marquardt, is the Associate Vice President of Commercial Servicing and Council Coordination with the Mortgage Bankers Association. She represents the association with its commercial/multifamily servicing members and coordinates interests and activities across the constituent Councils. Prior to joining MBA, Marquardt spent 17 years at GMAC Commercial Mortgage Corporation where she served as a senior manager in global servicing. During her tenure in global servicing, she was responsible for the acquisition of nearly $100million in loan servicing rights, operations management and industry relations.

Prior to joining the commercial/multifamily arm of GMAC Mortgage of PA, Marquardt held a variety of roles in 1-4 family mortgage finance including underwriting, branch management and secondary marketing. Marquardt has been an active member of the MBA Servicer Committee, servicing as Vice Chair of the Servicer Committee and Chair of the 2005 Reg AB Task Force. She has authored multiple articles relating to commercial/multifamily loan servicing.

Terrorism Insurance

The Terrorism Risk Insurance Act was passed in the aftermath of the September 11 attacks

- Following the attacks, insurers began excluding terrorism from all risks coverage
- For lenders and servicers ensuring that properties were insured against acts of terrorism became a labor intensive and extremely contentious endeavor with capacity, cost and forced placement concerns and litigation

TRIA 2002

Passage of TRIA in 2002 provided relief to the commercial property markets

- Passed as a temporary program to allow insurers and reinsurers time to develop pricing models
- A key component was the “make available” provision

Other key provisions were included that were meant to limit taxpayer liability while ensuring that terrorism coverage was available:

- Certified event
- Annual Cap
- Loss Sharing
- Recoupment
- Insurer Deductible

TRIREA 2005

Modeling applications to forecast terrorist activity were hindered by a fortunate lack of events to model as well as the ability of terrorists to adapt to assumptions utilized in the models

- Extended for another two years
- Instituted a loss amount to be absorbed by private insurers prior to the federal program being triggered
- Made modifications to the loss sharing and recoupment provisions to require that a larger burden of losses would fall on the private market

TRIPRA 2007 - Current Law

Recognition of the value of the program as well as limits to modeling resulted in a seven year extension of the program

- The law was expanded to include acts of domestic terrorism
- Eliminated provisions aimed at allowing Congress to delay recoupment

What's Next

Without Congressional action the program will expire December 31, 2014

Coalition to Insure Against Terrorism (CIAT) is advocating for extension of the program in 2013 to avoid disruption in the 2014 insurance markets

Bill introduced in the House of Representatives earlier this year that would extend the program for an additional five years

Industry Concerns

Expiration of the federal loss sharing program would create additional uncertainty in the CRE finance markets

Where available, pricing would rise significantly

Trophy market capacity would be reduced

Lack of clear direction would impact existing properties

Government Concerns

Philosophical disagreement that the government should be insuring private property – taxpayer liability versus owner liability

Government is standing in the way of innovation in the private insurance market for terrorism insurance

Skepticism about the insurance industry's lack of ability to model losses

Expectations?

Flood Insurance

Biggert-Waters Flood Insurance Reform Act of 2012

- BW12 attempts to provide solvency to the National Flood Insurance Program by reducing or eliminating subsidies and phasing-in actuarially sound premiums

- Key provisions relative to CRE:
  - FEMA is able to increase coverage on 5+ unit properties up to the coverage provided for commercial properties
  - Increased penalties for systemic non-compliance
  - Expanded escrow requirements
  - Privatization study due January 2014
- Coalition Letter and Technical Correction
  - Expansion of the escrow provision concerned lenders and servicers
  - Technical correction constricted provision to residential properties

2012 Reform – C/MF impacts

- Potential for increased coverage for multifamily properties
  - Migration of 5+ unit properties to 'commercial' coverage
- Escrow requirements
  - Expanded
  - Technical correction and legislative intent

Evidence of Insurance

The issue:

- Delivery of property and casualty policies remains spotty at best
- Until 2006 ACORD Evidence of Insurance forms were a primary method of evidencing coverage
- Market practice has developed a variety of methods to evidence that compliant property and casualty insurance is in place on a loan

Current Action:

- State Legislative and Regulatory actions
- Lender Coalition
- National Conference of Insurance Legislators

QUESTIONS

Contact Information

Thank You
for attending

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