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Servicer Evaluation: Torchlight Loan Services LLC

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Commercial special	
Overall ranking	ABOVE AVERAGE
Subranking	
Management and organization	STRONG
Loan administration	ABOVE AVERAGE
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Financial position	SUFFICIENT

Key Ranking Factors

- Long track record of resolving commercial real estate loans and real estate-owned (REO) assets in an efficient and timely manner;
- Good use of technology to enhance operations;
- Solid internal control environment, including internal and external audits, and a well-defined committee approval process;
- An employee training program that supplements on-the-job training with more formalized lunch and learn seminars;
- Shrinking portfolio volume as the credit environment has improved over the past few years; and
- Lower employee tenure and higher turnover than peers, despite some staff continuity at the senior management level, primarily due to unstable special servicing operations because of company relocations and planned staff reductions.

Opinion

S&P Global Ratings' ranking on Torchlight Loan Services LLC (Torchlight) is ABOVE AVERAGE as a commercial mortgage special servicer. On March 9, 2017, we affirmed our ranking (see "Torchlight Loan Services LLC Commercial Loan Special Servicer Ranking Affirmed; Outlook Stable").

Despite relocating operations twice in the past three years and reducing employee headcount, we believe that Torchlight maintains an efficient operation with proper internal controls. In our opinion, the company managed the move back to New York from Miami in a controlled manner to limit operations interruptions. While operating from Miami, Torchlight fully implemented a more robust special servicing system and enhanced the internal control environment through more frequent and thorough operational auditing.

Outlook

The outlook for the commercial mortgage special servicer ranking is stable. However, we note that it may be difficult for Torchlight to maintain a STRONG management and organization subranking if the active special servicing portfolio continues to decrease per management's projections and investment in special servicing operations declines.

Key Changes Since Last Review

- Moved special servicing operations back to New York from Miami.
- Appointed a new head of special servicing, who has 21 years of industry experience and six years of experience at Torchlight Investors LLC, the parent company.
- Reduced special servicing staff by approximately 22% from year-end 2015 to year-end 2016 because of decreasing special active special servicing volume.
- Fully implemented Backshop, a new special servicing system.
- Two authorized signatories must now sign important documents.
- An independent third party conducted a thorough internal audit of special servicing operations.
- Instituted a, REO property manager auditing program.

In addition to conducting an on-site meeting with servicing management, our review includes current and historical Servicer Evaluation Analytical Methodology data until Dec. 31, 2016, as well as other supporting documentation provided by the company.

Profile

Servicer Profile	
Servicer name	Torchlight Loan Services LLC
Primary servicing location	New York, NY
Parent holding company	Torchlight Investors LLC
Loan servicing system	Backshop

Torchlight Investors is a limited liability company and an SEC-registered investment advisor located in New York City. It was formed in 1995 to provide commercial real estate investment management services including portfolio management, commercial real estate lending, and distressed debt workouts. As of September 2016, Torchlight Investors had approximately $4.1 billion in commercial real estate assets under management and recently closed its fifth opportunity fund.

Torchlight is the commercial mortgage special servicing arm of Torchlight Investors. It primarily acts as the special servicer on commercial mortgage-backed securities (CMBS) transactions in which Torchlight Investors affiliates are the B-piece investors, though Torchlight occasionally receives third-party special servicing assignments. The servicing operation moved back to New York in the first quarter of 2017 after operating primarily from Miami since May 2014. Special servicing volume has decreased to approximately $998.8 million in unpaid principal balance (UPB) as of Dec. 31, 2016 ($535.7 million in loans and $463.1 million in REO assets) from $1.9 billion as of Dec. 31, 2014 ($1.2 billion in loans and $770.6 in REO). This decline in special servicing volume is largely consistent with the industry trend. As of Dec. 31, 2016, Torchlight's named special servicing volume totaled $16.6 billion in UPB across 36 CMBS transactions compared with 34 transactions totaling $27.5 billion in UPB as of our last review (see "Servicer Evaluation: Torchlight Loan Services LLC," published April 7, 2015).

Table 1

Total Servicing Portfolio

	Unpaid principal balance (mil. $)	YOY change (%)	No. of loans	YOY change (%)	No. of staff	YOY change (%)
Dec. 31, 2016	998.8	(38.2)	51	(53.2)	21	(22.2)
Dec. 31, 2015	1,615.6	(15.8)	109	(24.8)	27	0.0
Dec. 31, 2014	1,919.5	(11.4)	145	(1.4)	27	(18.2)
Dec. 31, 2013	2,167.4	(25.6)	147	(15.5)	33	(8.3)
Dec. 31, 2012	2,911.7		174		36	

YOY--Year-over-year.

Management And Organization

The management and organization subranking is STRONG.

Organizational structure, staff, and turnover

A senior vice president from Torchlight Investors' acquisition group was appointed as the head of special servicing in May 2016, replacing the former head who served in that capacity for less than three years while the company operated in Miami. The managers for the loan asset management group, which is responsible for managing nonperforming loan workouts, the REO asset management/performing loans group, which manages the company's REO portfolio and administers borrower requests for performing loans, and operations, which oversees operational compliance and systems administration among other tasks, all report to the head of special servicing. Additionally, Torchlight receives support from a centralized financial control group, accounting, and compliance. The servicer also has Torchlight Investors representatives on its credit committees. The committee authorizes key special servicing decisions, including special servicing loan resolutions and REO sales.

In January 2017, Torchlight's special servicing operations relocated back to New York after operating primarily from Miami for about three years. Torchlight provided a number of reasons for consolidating operations again with Torchlight Investors in New York, primarily driven by a shrinking portfolio of specially serviced loans following Torchlight Investors' reduced special servicing controlling class-holder assignments and lower-than-expected default rates. According to management, asset managers in Miami created checklists during the transition period to help ensure that asset managers based in New York had a thorough understanding of every asset in the company's special servicing portfolio. Furthermore, Torchlight had some continuity in staff during the transition because some special servicing employees had worked primarily from New York, and some employees decided to relocate to New York.

Partly because of the relocation, Torchlight employees have less company tenure than ranked peers (see table 2). Torchlight employees also have slightly less industry experience than ranked peers, but we believe that employee experience levels are adequate at Torchlight.

Table 2

Industry Experience/Company Tenure(i)

	Senior managers		Middle managers		Asset managers		Staff	
	Industry experience	Company tenure	Industry experience	Company tenure	Industry experience	Company tenure	Industry experience	Company tenure
Special servicing (years)	21	7	15	5	12	3	9	3

(i)As of Dec. 31, 2016.

As of Dec. 31, 2016, Torchlight had 21 full-time employees after reducing its headcount by six from year-end 2015 (see table 1). Torchlight counts three of its 21 employees as special servicing asset managers. The ratio of loans and REO assets per asset manager was 17 to 1 as of Dec. 31, 2016, higher than what we typically see for special servicers. Torchlight does, however, forecast further run-off in its portfolio, which would lead to lower loan and REO per asset manager ratios if staffing levels remain consistent.

After experiencing minimal turnover in 2015, Torchlight experienced an elevated turnover rate of approximately 30% in 2016. The majority of the turnover was involuntary and occurred because of a planned staff reduction.

Training

Overall, in our opinion, Torchlight has an effective employee training program for a company of its size. It supplements on-the-job training with more formalized training, such as company-sponsored lunch and learn sessions, which are led by internal and external subject matter experts to cover both soft skills and topics relevant to the special servicing industry. Topics in 2016 included:

- Pooling and servicing agreement (PSA) and real estate mortgage investment conduit training;
- Backshop, Torchlight's special servicing system;
- Business plans;
- Risk retention;
- Bankruptcy; and
- REO transactions.

Training hours and topics are formally tracked, though Torchlight does not have any dedicated training personnel. Torchlight targets 45 to 50 hours per employee per annum. Actual training hours for full-year 2016 averaged 40 hours per employee, slightly below the company target and a decrease since our last review.

Systems and technology

Torchlight uses the Backshop third-party commercial real estate software as its main special servicing system. Torchlight worked with Backshop's vendor to adapt the system, which was originally only an origination/asset management system, to fit its special servicing needs. The company has contracted with an outside vendor to provide 24-hour information technology support

Asset managers use Backshop as a workflow tool to manage loan workouts once it is transferred to special servicing until resolution. Backshop includes the following useful special servicing features:

- Investor report preparation;

- Business plan creation and maintenance;
- Cash flow analysis;
- Business forecasts and revenue tracking tied to loss expectations;
- Form letter creation; and
- Asset status reports.

The previous system, Microsoft SharePoint, has been largely phased out of use (besides electronic document storage).

Torchlight Investors monitors the disaster recovery protocols and testing performed by Backshop's third-party vendor and a different third-party technology company provides data production monitoring and disaster recovery for the rest of the company's systems and IT infrastructure. The technology company maintains Torchlight's applications and data at a primary data center in Jersey City, N.J. and two disaster recovery data centers in Boston. The data is continually replicated from the production to the disaster recovery environment, and Torchlight indicated that in the event of a disaster, it can restore key servicing functions within one day. Remote access is available to all employees via Citrix. Torchlight tests business continuity annually; the most recent test in December 2016 cited no material exceptions.

Torchlight maintains a cybersecurity policies and procedures (P&Ps) manual. The manual outlines the technical and physical safeguards that Torchlight takes to protect sensitive information. Torchlight employees receive training on the manual, which all employees and contract workers must fully adhere to. Access to sensitive information, including personal information, is limited to only those who need the information to perform legitimate business tasks. In addition, the vendors for Backshop and Torchlight Investor's IT infrastructure have system features that restrict access to sensitive information.

The IT infrastructure vendor maintains updated network firewall protection and operating system security patches. It also hires a third party to conduct a regular security assessment and regular network penetration testing. Backshop's vendor uses encryption to protect borrower data. Furthermore, if Backshop's vendor were to ever receive any kind of network breach, the vendor would notify Torchlight immediately.

Internal controls

Torchlight's special servicing P&Ps are comprehensive and available to all employees via the company intranet. The P&Ps provide both the company's overall policy and a detailed list of the procedural steps to complete important special servicing tasks. The P&Ps are updated frequently, subject to approval by the manager of operations from both Torchlight and Torchlight Investors. The P&Ps and supporting materials are being updated to incorporate Torchlight's full Backshop implementation.

An independent accounting firm currently conducts an internal audit approximately every 12 months for Torchlight The most recent audit report issued in January 2016 focused on risks associated PSA compliance and with the financial close, the investor reporting, and the cash management processes. Several medium-risk recommendations were noted. Management indicated that all recommendations have been implemented, and all issues have been remedied. The 2016 internal audit--covering the same operational risks as 2015 but with more focus on the transition to Backshop and the move to New York--is in progress.

Torchlight has effective controls in place to ensure Regulation AB (Reg AB) and Uniform Signal Audit Program (USAP) compliance, including REO accounting reviews. Torchlight uses an independent accounting firm to perform annual

Reg AB and USAP testing. The reports covering 2016 were satisfactory with no material exceptions noted.

Given that REO has become a larger portion of Torchlight's special servicing portfolio in recent years and is expected to remain a high percentage of the portfolio in the near term, Torchlight engaged a third-party to perform several REO property management agreed-upon procedure audits in 2016.

Corporate insurance and litigation

Torchlight has represented that its directors and officers as well as errors and omissions insurance coverage is in line with the requirements of its portfolio size. As of Dec. 31, 2016, there were no material servicing-related pending litigation items.

Loan Administration

The loan administration subranking is ABOVE AVERAGE.

The active special servicing volume decreased to approximately $1 billion UPB at year-end 2016, represented by $536 million UPB of nonperforming loans and $463.1 million UPB in REO, from $1.6 billon UPB at year-end 2015 (see table 3), primarily because of improving credit conditions. The average age of specially serviced assets increased significantly as of Dec. 31, 2016, from Dec. 31, 2015, because Torchlight worked out many specially serviced loans in 2016, and there were few new transfers into special servicing (see table 3). Also, as of Dec. 31, 2016, Torchlight was the named special servicer on 35 CMBS securitizations with almost 1,100 loans and an outstanding UPB of $16.4 billion and one commercial real estate collateralized debt obligation transaction with 12 loans and a UPB of approximately $193 million.

Table 3

Special Servicing Portfolio

	Dec. 31, 2016			Dec. 31, 2015			Dec. 31, 2014			Dec. 31, 2013			Dec. 31, 2012		
	UPB (mil. $)	No.	Average age (months)(i)	UPB (mil. $)	No.	Average age (months)(i)	UPB (mil. $)	No.	Average age (months)(i)	UPB (mil. $)	No.	Average age (months)(i)	UPB (mil. $)	No.	Average age (months)(i)
Active inventory															
Loans	535.7	21	17.6	1,025.4	60	10.8	1,148.9	79	12.8	1,587.0	97	17.1	2,638.9	137	17.0
Real estate owned	463.1	30	37.1	590.1	49	29.4	770.6	66	25.3	580.4	50	25.0	272.8	37	20.3
Total	998.8	51	29.0	1,615.6	109	17.6	1,919.5	145	17.8	2,167.4	147	19.2	2,911.7	174	17.3

(i)Average age reflects the time in months from date the loan first came specially serviced to the reporting date. UPB--Unpaid principal balance.

Torchlight takes a proactive approach to surveillance for both performing and nonperforming loans. It regularly contacts master servicers and maintains certain performing loans on its watchlist based on conversations with 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
- Other loan issues such as cash management, loan covenants, and significant deferred maintenance and insurance claims.

These surveillance practices facilitate the flow of information, improve reporting, and provide a smooth transition of the loans/borrowers between the master servicers and Torchlight. The special servicing group also works closely with master servicers to perform advance reconciliations as needed to determine advance recoverability.

Loan recovery and foreclosure management

We believe that Torchlight has a well-defined problem loan management process based on the following:

- Upon a loan's transfer to special servicing, the assigned asset manager obtains all of the necessary documents from the master servicer and trustee, if necessary, and completes an initial file review. The operations team sets up the loan in Backshop.
- Asset managers hire an external attorney based on geographical location for consultation shortly after a loan transfers to special servicer. The head of special servicing or other authorized personnel provide dual signatory approval for all legal engagements.
- If necessary, the asset manager may hire a vendor from the preferred vendor list to update inspections, appraisals, broker opinions of value, and environmental condition reports.
- Asset managers complete business plans that recommend a course of resolution primarily based on net present value analysis within 60 days of transfer to special servicing, or sooner, per the transaction documents.
- All major decisions, including workout business plans, must be approved by the special servicing committee. The committee can review business plans in Backshop and provide feedback and approval.
- If Torchlight decides to commence a foreclosure action, the asset manager in consultation with external and Torchlight Investor's legal counsel moves to secure any rent from the property and determines if an updated environmental assessment and appraisal are needed. The special servicing committee must sign foreclosure bid memos.

Table 4

Total Special Servicing Portfolio--Loan Resolutions

	2016			2015			2014			2013			2012		
	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)
Resolutions															
Loans	535.8	47	9.9	392.5	37	20.4	782.0	59	19.5	1,444.2	40	17.7	1,463.3	40	17.7
Foreclosed loans	183.9	16	16.4	342.4	30	34.0	672.3	72	N/A	341.4	35	19.3	252.6	35	19.0
Total	719.7	63	11.6	734.9	67	26.7	1,454.3	131	N/A	1,785.6	75	18.0	1,715.8	75	17.9
Resolution breakdown															
Returned to master	98.8	9	11.9	86.6	6	32.3	147.2	14	17.1	636.0	21	14.4	725.4	28	23.9
Full payoffs	256.8	25	7.3	185.6	21	12.8	169.2	21	11.8	282.0	24	15.3	450.3	24	8.2
DPO or note sale	180.2	13	13.8	120.3	10	23.3	465.6	24	23.0	526.2	28	22.8	287.6	27	17.0
Foreclosed loans	183.9	16	16.4	342.4	30	34.0	672.3	72	N/A	341.4	35	19.3	252.6	35	19.0

Table 4

Total Special Servicing Portfolio--Loan Resolutions (cont.)															
	2016			2015			2014			2013			2012		
	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)	UPB (mil. $)	No.	Average age(i)
Total/average	719.7	63	11.6	734.9	67	26.7	1,454.3	131	N/A	1,785.6	108	18.0	1,715.8	114	17.9

(i)Average age reflects the time in months from the date the loan first became specially serviced to the reporting date. UPB--Unpaid principal balance. DPO--Discounted payoff.

Torchlight tracks its liquidation recovery rates for U.S. CMBS fixed-rate conduit loans, which, it indicated, were above industry averages from January 2014 to June 2016 (excluding liquidations with realized losses of less than 2%). Torchlight reported a 54.0% recovery rate compared with its calculated CMBS industry average of 41.9%.

REO management and dispositions

One fully dedicated asset manager and one hybrid asset manager oversee REO management and dispositions, as well as operations of properties under receivership. During full-year 2016, Torchlight sold 37 REO assets averaging an REO hold period of approximately 19.7 months, which is lower than ranked peers.

Table 5

Total Special Servicing Portfolio--REO Sales															
	2016			2015			2014			2013			2012		
	Amount (mil. $)	No.	Average REO hold period (months)	Amount (mil. $)	No.	Average REO hold period (months)	Amount (mil. $)	No.	Average REO hold period (months)	Amount (mil. $)	No.	Average REO hold period (months)	Amount (mil. $)	No.	Average REO hold period (months)
Estimated market value	212.8	37	19.7	223.0	30	17.3	191.1	26	18.1	113.9	27	14.3	115.4	17	14.7
Net sales	197.1	--	--	225.7	--	--	196.0	--	--	102.9	--	--	123.8	--	--
Sale/market value (%)	92.7	--	--	101.2	--	--	102.6	--	--	90.4	--	--	107.2	--	--

REO--Real estate owned.

Torchlight has REO-specific P&Ps for REO asset management/performing loans asset managers that include:

- Asset managers typically submit REO business plans in Backshop within 60 days of foreclosure. The REO business plans contain an asset disposition plan, a property management strategy, a property budget approval request, and budget assumptions. Special servicing committee members review the plans and provide approval in Backshop.
- Asset managers choose property managers and brokers from approved vendor lists.
- Property managers must prepare annual budgets for each property for REO asset managers to approve. Unbudgeted expenses require approval from the asset manager and his or her supervisor or the head of special servicing.
- Brokers provide monthly reports describing all marketing activities associated with the property. Torchlight does not generally contract brokers for more than 180 days to list the property. This allows for flexibility in relisting the property because of poor broker performance.
- The special servicing manager must give approval before accepting a purchase offer that must fall within

pre-approved parameters as outlined in the REO business plan.

REO accounting and reporting

Torchlight Investors' corporate accounting group sets up separate operating accounts for each REO property with an external bank: one for disbursements and one for rent collection. The disbursement account can only be funded according to the terms of a pre-approved budget and with Torchlight dual signatory approval. The property manager completes monthly bank account reconciliations, which are reviewed and approved by an REO asset manager.

Property managers provide a series of monthly management reports, including a balance sheet, rent roll, and operating statement, which require REO asset manager approval. Brokers submit monthly updates, reviewed by Torchlight, to ensure the property is effectively marketed. Property managers and brokers can only be used if they are on the approved vendor list, which requires a minimum of three competitive proposals.

Subcontracting management

The special servicing asset manager is generally responsible for engaging third-party service providers, monitoring their performance, and authorizing payment. Vendors must meet Torchlight's standards for qualifications (geographic and product expertise, licensing, insurance, and professional designations). Torchlight maintains an extensive approved vendor list and uses standard contracts for the following 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.

Borrower requests

Torchlight's reports of borrower consent activity reflect its role as a special servicer. The REO asset management/performing loans group manages borrower consents. All major borrower consent decisions must be approved by the special servicing committee.

During the full year of 2016, Torchlight reported that it processed 59 borrower requests. Approximately 70% of these were leasing consents, and 27% were assumptions with the remainder falling into the "other" category.

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 P&Ps. Torchlight uses Backshop to provide necessary Commercial Real Estate Finance Council reports to master servicers for its specially serviced loans.

Legal department

Torchlight does not have an in-house legal department to support the special servicing asset managers but can consult with Torchlight Loan Investors' counsel when necessary. Torchlight maintains a list of third-party counsels on its approved vendor list. Only the head of special servicing or another authorized signatory 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 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

- Torchlight Loan Services LLC Commercial Loan Special Servicer Ranking Affirmed; Outlook Stable, March 9, 2017
- Select Servicer List, Feb. 17, 2017
- Servicer Evaluation: Torchlight Loan Services LLC, April 7, 2015