Methodology

# North American Commercial Mortgage Servicer Rankings

**DBRS Morningstar**
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## Related Research

For a list of the Structured Finance-related methodologies for our principal Structured Finance asset class methodologies that may be used during the rating process, please see the *DBRS Morningstar Global Structured Finance Related Methodologies* document on www.dbrsmorningstar.com. Please note that not every related methodology listed under a principal Structured Finance asset class methodology may be used to rate or monitor an individual structured finance or debt obligation.

## Key Updates in This Methodology

For key updates in this methodology, please refer to the press release titled “DBRS Morningstar Publishes Updated Methodology for North American Commercial Mortgage Servicer Rankings” dated August 23, 2023.

## Scope and Limitations

A methodology sets forth the key analytical considerations and applicable analytics used when DBRS Morningstar assigns or monitors credit ratings or other opinions. DBRS Morningstar applies approved methodologies in the evaluation of a structured finance transaction or debt obligation. Quantitative and qualitative factors set forth in a methodology or in a combination of methodologies are evaluated by a DBRS Morningstar rating committee or discussion group that exercises analytical judgment and considers the regulatory environment, market standards and customary practices in addition to other factors deemed relevant to the analysis.

In cases when an applicable methodology does not address one or more elements of a structured finance transaction or obligation, or such element(s) differs from the expectations contemplated when an applicable methodology was approved, DBRS Morningstar may apply analytical judgment in the determination of any related analytical factor, assumption, rating, or other opinion.

DBRS Morningstar North American (NA) commercial mortgage servicer rankings are not credit ratings. Instead, they are designed to evaluate the quality of the parties that service or conduct master servicing on commercial mortgage loans. Although the servicer’s financial condition contributes to the applicable ranking, its relative importance is such that a servicer’s ranking should never be considered as a proxy of its creditworthiness.

## NA Commercial Mortgage Servicer Rankings

### Introduction

When rating a commercial mortgage-backed securities (CMBS) transaction, the capacity of the servicer is a key analytical consideration as servicing quality can affect the performance of the trust assets from a delinquency, default, and recovery perspective and, consequently, may affect the timely and ultimate repayment of rated securities. Because of the servicing role's importance, DBRS Morningstar conducts servicer reviews prior to rating a new transaction as well as over the life of an existing transaction.

NA commercial mortgage servicers that participate in rated securitizations may request DBRS Morningstar to issue a public servicer ranking on their companies.

DBRS Morningstar NA commercial mortgage servicer rankings are designed to evaluate the quality of the parties that service or conduct primary, master, or special servicing on the commercial mortgage loans that are securitized. DBRS Morningstar typically begins the servicer review process by sending a questionnaire and information request to the company that outlines the topics to be covered during discussions with management and includes a list of documents to be provided, such as organizational charts, policies and procedures, operational audits, financial statements, report samples, and servicing portfolio data. DBRS Morningstar relies on the factual accuracy of the servicer's information submission and the servicer's own representations about its operations, practices, and business. Accordingly, the servicer ranking itself is not an audit as it does not entail examining individual asset files, testing procedures and technology applications, or conducting any other testing that may be construed as an audit.

In addition to assessing servicers involved in CMBS transactions, DBRS Morningstar may assess servicers that participate in nonsecuritized transactions, such as servicing commercial mortgage loan portfolios on behalf of a parent company or other third-party investors. Accordingly, these assessments and assigned rankings take into consideration a servicer's abilities and duties acting in such capacities.

*Servicer Ranking Scale*

MOR CS1: **Superior Servicing Quality**—Exceeds prudent loan servicing standards. Unlikely to be significantly vulnerable to future credit events.

MOR CS2: **Good Servicing Quality**—Demonstrates proficiency in loan servicing standards. May be vulnerable to future credit events, but qualifying negative factors are considered manageable.

MOR CS3: **Adequate Servicing Quality**—Demonstrates satisfactory loan servicing standards. May be vulnerable to future credit events.

MOR CS4: **Weak Servicing Quality**—Demonstrates lack of compliance with one or more key areas of risk. Vulnerable to future credit events.

Servicer rankings are calculated by scoring the quantitative and qualitative data obtained through the review process. DBRS Morningstar typically monitors an evaluated servicer through periodic review meetings and discussions with management, usually on an annual basis, in addition to interactions with the servicer through ongoing surveillance activities.

In instances where DBRS Morningstar determines that the servicer ranks as a MOR CS4, issuers may incorporate certain structural enhancements into a proposed transaction, such as additional credit support or dynamic triggers, in order for DBRS Morningstar to be able to rate the transaction. In cases where there is a potential risk that the servicing may need to be transferred at a future date, issuers may incorporate a warm or hot backup servicer as a transaction party. If DBRS Morningstar determines that a servicer is ranked MOR CS4 or is otherwise unacceptable, it may also refuse to rate the deal.

DBRS Morningstar performs surveillance of the servicer and, as a result, may place a servicer ranking Under Review with the appropriate Implications designation: Positive, Negative, or Developing. DBRS Morningstar expects servicers to supply certain information over the life of the ranking(s). The maintenance of a ranking is conditional upon the ongoing timely receipt of this data and/or information, which may be obtained from reasonably reliable sources as part of the surveillance process. DBRS Morningstar does not audit the information it receives in connection with the ranking process, and it does not and cannot independently verify that information in every instance.

## Roles of Servicers in CMBS Transactions

The servicer functions as a conduit between the obligors and investors; therefore, the quality of the servicer’s capabilities is a key analytical consideration when assigning ratings to CMBS transactions. A servicer protects the investors’ interest in the securitized collateral and is a third party that can be relied on to make decisions on behalf of the noteholders. Servicers function in various capacities, including primary, master, special, and backup servicer. Below is a summary of each of these roles.

### Primary Servicer

The primary servicer is the main contact for the borrower and is responsible for administering the borrower’s loan payments and enforcing the loan documents, including loan covenants and triggers. The obligation of the servicer to respond to borrower requests, such as loan balance inquiries, payoff requests, reserve disbursements, tax payments, or escrow analysis, remains the same, regardless of asset ownership. As the main contact for the borrower, the primary servicer collects and applies payments and enforces reporting requirements. The primary servicer also administers escrow accounts, monitors collateral insurance coverage, performs loan accounting, and is generally responsible for property inspections and operating statement analysis. The primary servicer is often the first to identify potential loan performance problems. Therefore, a proactive primary servicer can help mitigate losses in a CMBS transaction. In all its duties, the primary servicer must adhere to the standards set out in the servicing agreement to enforce the terms of the loan agreement with the borrower.

### Master Servicer

In CMBS transactions, the assets are pledged to the trust and are generally administered by a master servicer on behalf of the investors. Accordingly, the master servicer may be called upon to maintain and enforce the trust's security interest in the assets. In doing so, the master servicer is contractually bound to operate within an agreed-upon servicing standard that stipulates it will service the loans in accordance with the pooling and servicing agreement and according to the same standard as other prudent lenders or as if it were servicing the assets for its own portfolio.

Another role of the master servicer is to track the performance of the asset pool and communicate its findings to the trustee, rating agencies, and, ultimately, the investors. Information on payments that the servicer receives is accounted for in aggregate, disseminated to the trustee, and published in the monthly investor reporting package and remittance reports. In addition to reporting on the aggregate flow of funds, CMBS master servicers typically report specific performance metrics, such as delinquencies, defaults, losses, portfolio stratifications, individual loan details, and (property) financial statements.

Servicers in a strictly master-servicing role typically do not have direct borrower contact. They monitor the activities of primary servicers acting in a subservicing capacity and monitor the overall performance of the subserviced portfolios. The master servicer and subservicer relationship is largely associated with CMBS transactions in which the master servicer is the named servicer to the transaction and is responsible for overseeing the quality of information provided by subservicers to ensure accurate investor reporting and compliance with servicing agreements. CMBS master servicers are also responsible for advancing scheduled payments to the trust and determining the recoverability of advances.

A pooling and servicing agreement for a CMBS transaction may generally label the named servicer as the transaction's master servicer regardless of whether that servicer may oversee subservicers in the transaction. Accordingly, a named CMBS master servicer, in addition to having advancing and trustee reporting responsibilities, may have primary servicing duties for some or all loans in the transaction.

### Special Servicer

The special servicer is named to the trust specifically to handle the workout, resolution, and disposition of defaulted loans. A special servicer generally assumes responsibility for managing a loan when the loan becomes 60 days delinquent. A loan may also transfer to special servicing without an actual monetary default based on the master servicer's or special servicer's determination that the loan's default is imminent. The special servicer contacts delinquent borrowers to establish payment plans to bring them current. At the same time, the special servicer often pursues foreclosure and other workout alternatives, such as forbearance and modifications, and manages and sells foreclosed assets, with the goal of minimizing losses to the trust. The CMBS special servicer works for all bondholders but it is appointed by the holder of the controlling class—typically, the first-loss class. Special servicers also may have responsibility for reviewing and approving certain borrower consent requests involving performing loans.

## Servicer Ranking Process

The servicer review process typically involves a review and analysis of the following components:

1. Company Management
2. Financial Condition
3. Staffing and Training
4. Controls and Compliance
5. Technology
6. Portfolio Administration (Primary, Master, Special)

The assessment process involves a review and analysis of the servicer in each area of the criteria. The relative applicability of each area varies depending on the servicing role as primary, master, or special.

### Operational Infrastructure

*Company and Management*

DBRS Morningstar examines a servicer's operating history and business position, management experience and tenure, employee turnover, and the effectiveness of the organizational structure to support current servicing assignments and planned growth. DBRS Morningstar believes that a seasoned management team and professional staff with expertise in the product(s) they are servicing, along with a soundly designed organizational and reporting structure, are essential for successful servicing.

A servicer that maintains a management team made up of highly experienced and tenured individuals generally experiences operating efficiencies that are gained when people work together over a longer period. As a result, DBRS Morningstar favorably views those servicers whose management team averages more than 10 years of industry experience.

Additionally, DBRS Morningstar believes that in order to appropriately evaluate a servicer, the servicer should have enough loans in its portfolio to represent the particular asset type and have been servicing those loans for a minimum of one year.

*Financial Condition*

DBRS Morningstar reviews a servicer's financial condition or considers compensating factors. To the extent that no public or private rating is maintained on the originator, the review may include an internal assessment consistent with DBRS Morningstar's Internal Assessments Global Policy located on www.dbrsmorningstar.com.

Some reviewed items may include the following:

- Company ownership structure
- Business lines
- Corporate rating of any parent company (if applicable)
- Industry competitive landscape and company position
- Financial statements, costs to service, and related audit results
- Revenue sources and lines of credit

- Litigation (past, present, and expected)
- Corporate insurance adequacy
- Existing business strategy and strategic initiatives
- Recent or planned mergers or acquisitions
- Recent or planned portfolio transfers
- Securitization history and plans

*Staffing and Training*

DBRS Morningstar expects servicers to have the appropriate staff in place to maintain requisite service levels. Furthermore, adequate capacity and resources to handle fluctuations in loan volume are also important. For assessing special servicers, asset managers' experience levels and workloads are key considerations as well.

Providing employees with updated and relevant training, knowledge, and career planning generally contributes to higher productivity and hence better servicing results. Consequently, DBRS Morningstar reviews the servicer's training program framework in terms of subject matter, volume (number of courses), and employee participation (average hours per employee per year), both for new hires and existing staff. Well-rounded training programs provide a mix of commercial real estate finance, technology, and general skills. DBRS Morningstar views favorably servicers that have a manager responsible for training initiatives.

*Controls and Compliance*

DBRS Morningstar believes internal assessments and quality control reviews are important in recognizing procedural errors that may not be easily detectable. These reviews can be used to identify trends, training opportunities, and exception practices. Frequent checks can assist management in quickly instituting changes to areas needing improvement as well as benchmarking those results to performance. In addition, a monitoring process, along with a dedicated compliance function, can assist servicers in complying with all applicable laws, rules, and regulations.

DBRS Morningstar considers properly documented policies and procedures a key factor in ensuring a consistent quality of servicing. The content, timeliness, usefulness, and accessibility of documentation related to policies and procedures can provide employees with operating guidelines and reduce uncertainty and errors in the event of staff turnover or the departure of key persons. Quality control programs, including approval requirements, delegations of authority and management reports, such as key indicator reports, are also considered. Servicers that measure servicing performance against internally established benchmarks demonstrate dedication to process improvements, which DBRS Morningstar views favorably.

Finally, DBRS Morningstar expects servicers to participate in regularly scheduled audits, which may include a Uniform Single Attestation Program or Regulation AB audits, service organization control (SOC 1) reports, and any other applicable internal or client-commissioned examinations and reviews. DBRS

Morningstar expects that the servicer will address any deficiencies discovered during the audit process in a timely manner.

*Technology*

Technology resources are an integral component of the servicer review process. DBRS Morningstar does not subscribe to specific systems architecture, but adequate system controls and backup procedures, including disaster recovery and business continuity plans, are considered critical processes and should be in place. As a result, DBRS Morningstar expects servicers to have the appropriate staff and controls in place to ensure website availability, account maintenance, and enhancements. DBRS Morningstar views favorably sophisticated technology with robust functionality and safeguards for data protection as it often brings large efficiencies to the servicing (or special servicing) operation and more predictability in terms of loan performance.

**Portfolio Administration: Primary and Master Servicers**

DBRS Morningstar reviews the servicer's framework for servicing processes and controls throughout the life of the loan from new loan boarding through loan payoff and release. DBRS Morningstar views favorably those servicers that have strong automation and controls in place to maintain efficiencies.

Areas addressed in this section of the evaluation include the following:

- Loan boarding for new and modified loans
- Payment processing and cash management
- Customer service/borrower relationship management
- Escrow management, including tax, insurance, and reserves
- Managing uniform commercial code filing statements
- Investor reporting, remitting, and accounting
- Loan surveillance, including financial statement analysis and reporting, property inspections, watchlist management, and document covenant/trigger-event compliance
- Asset management: loan delinquency and loss management
- Asset management: performing-loan borrower requests (such as loan assumptions, lease approvals, and property releases)
- Loan payoffs and mortgage releases
- Master servicer advancing practices
- Master servicer oversight/audit practices for subservicers
- Outsourcing/offshoring oversight and vendor arrangements

Some of these areas can be considered high-volume, process-oriented tasks (e.g., new loan boarding and payment processing), while others require more credit analysis (e.g., asset management and covenant compliance). As a result, DBRS Morningstar typically reviews performance metrics, such as

- Time to board new loans to the servicing system,
- Payment processing efficiency: percentage of payments automatically processed,
- Account reconciliation timeliness,
- Amount of real estate tax penalties as a percentage of taxes paid,

- Timeliness and accuracy of investor reporting and remitting,
- Financial statement collection and reporting timeliness, and
- Property inspection completion timeliness.

Loss management is not limited to the special servicer of the transaction. The effectiveness of a servicer's operation has a direct impact on a transaction's performance and, ultimately, losses to the CMBS investor. As the borrower's primary contact, servicers are on the forefront when it comes to detecting loan performance issues.

DBRS Morningstar considers the role played by CMBS primary and/or master servicers in loss management in terms of detecting the early warning signs of a troubled loan. A servicer's portfolio surveillance practice, including the administration of its loan watchlist, is a key component of loss management. Proactive servicers maintain solid lines of communication with special servicers (whether internal or external) and keep them informed of potential problem loans, as early detection often leads to lower loan losses or more amicable solutions.

DBRS Morningstar believes it can sometimes be prudent to outsource or offshore certain servicing functions, such as escrow reviews, financial statement spreading, and rent roll reviews, among others, as part of volume management or to handle work overflow. DBRS Morningstar reviews outsourcing and offshoring arrangements to determine if appropriate supervision and controls are maintained, in addition to having a backup plan in place should the outsourcer or offshore operations lose the ability to operate.

### Portfolio Administration: Special Servicers

DBRS Morningstar's review process examines the special servicer's practices for determining recovery strategies on newly received assets, executing those strategies, and managing nonperforming assets through their final disposition. DBRS Morningstar reviews how recommended resolution strategies and specific actions are documented and approved, and the analytical quality of those processes.

Successful CMBS special servicers typically maintain experienced staff trained in all aspects of default management, loan resolution, and commercial real estate management and disposition. Credit decisions made by committee or according to an established delegation of authority generally lead to stronger plans of action. Standardized asset status reports and business plans provide consistent investor reporting while maintaining quality control.

As part of its review, DBRS Morningstar reviews the special servicer's asset-review and recovery procedures, real estate reporting and accounting procedures, and disposition results such as time-to-resolution and net recovery proceeds-to-collateral value. DBRS Morningstar considers vintage, property type, and other asset-level and portfolio characteristics when examining a special servicer's overall performance results.

Special servicers often rely on third parties with specialized expertise, such as attorneys, receivers, appraisers, commercial real estate brokers, and property managers. Therefore, prudent servicers typically develop strong relationships with third-party vendors and maintain stringent vendor management oversight and approval processes.

Additionally, DBRS Morningstar reviews special servicers' capabilities and procedures to deliver their required reports and communicate information in a timely and accurate manner to their investors, master servicers, and rating agencies as applicable. For CMBS special servicers, the timely delivery of updated asset values and asset status reports to master servicers is critically important so that master servicers can effectively make prudent advancing decisions and accurately report realized losses. The assessment also examines a CMBS special servicer's ability to review and respond in a timely manner to borrower consent requests on performing loans that it may receive from a master or primary servicer.

# Appendix A—Sample Score Adjustment Reasons

**Instances Under Which a Ranking Score May Be Adjusted Upward**

- New owner with significant financial wherewithal and experience purchased the firm.
- Proof received that a significant financial or audit issue has been resolved.

**Instances Under Which a Ranking Score May Be Adjusted Downward**

- Significant management or staff changes that have not yet seasoned.
- Large-scale organizational restructuring.
- Paucity of information provided for the review.
- Significant increase/decrease in servicing portfolio.
- Ongoing concern of substance in the audited financial statements.
- Pending merger/acquisition of substance.
- Outsourcing practices that are overly broad or newly implemented.
- Multiple audit issues where resolution is underway but not yet completed.
- Outstanding regulatory investigations of substance.
- Material outstanding litigation.
- Significant technology conversion in process and not seasoned.
- Broad market/social disruptions that may affect ongoing performance.
- Numerous investor-reporting issues.
- Performance feedback from the DBRS Morningstar CMBS surveillance team.
- Failure to advance in a timely manner.
- Failure to properly manage escrowed accounts.
- Significant amounts of unpaid taxes/insurance.
- Significant instances of fraud.
- Lack of default management experience (i.e., no real estate owned or foreclosure experience with current portfolio).

# Appendix B—Servicer Information Request

As part of the servicer assessment process, DBRS Morningstar submits to the servicer an information request and an agenda of discussion topics to be addressed by the servicer as part of the servicer review. An example of a servicer information request can be accessed at the link below.

Operational Risk Assessments: Commercial Mortgage Primary, Master, and Special Servicers Document and Information Submission Request

**About DBRS Morningstar**

DBRS Morningstar is a full-service global credit ratings business with approximately 700 employees around the world. We're a market leader in Canada, and in multiple asset classes across the U.S. and Europe.

We rate more than 4,000 issuers and nearly 60,000 securities worldwide, providing independent credit ratings for financial institutions, corporate and sovereign entities, and structured finance products and instruments. Market innovators choose to work with us because of our agility, transparency, and tech-forward approach.

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