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January 13, 2009

# Servicer Evaluation: Midland Loan Services Inc.

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## Servicer Evaluation: Midland Loan Services Inc.

## **Opinion**

This servicer evaluation refers only to the Canadian servicing operations of Midland Loan Services Inc. Standard & Poor's Ratings Services has raised the rankings for Midland Loan Services Inc. (Midland) as a Commercial Mortgage Primary Servicer to STRONG. The ranking for Midland as Commercial Mortgage Master Servicer is affirmed at ABOVE AVERAGE. The ranking for Midland Loan Services Inc. as Special Servicer is affirmed at AVERAGE.

The rankings reflect Midland's extensive U.S. track record in handling a high volume of commercial mortgage-backed securities (CMBS) and other portfolio types. In addition, the rankings reflect Midland's excellent procedures, demonstrated expertise, appropriate controls, the integration of Canadian mortgage loans into its systems, and established additional Canada-specific policies and procedures. Midland has continued to develop a number of technology initiatives and process enhancements designed to improve operating efficiency and effectiveness. Midland has maintained a strong management team that has held a commitment to high-quality servicing practices.

Subservicer oversight practices remain thorough; however, while they could be improved through stronger audit procedures, current Office of the Superintendent of Financial Institutions Canada (OSFI) regulations impede Midland's ability to conduct onsite audits. Excellent mortgage performance in the Canadian market has provided few examples of recovery results and resolution time frames on specially serviced assets. Midland's U.S. track record, however, has been excellent and it is expected that Canadian results will continue to be acceptable. While seasoned, Midland is less experienced with the Canadian mortgage market and has employed asset managers who are more familiar to manage the Canadian portfolio. We expect that the company will continue to deliver an equivalent level of service and expertise as it has done in its home market.

#### Outlook

The outlook is positive. Although Midland has experienced substantial portfolio growth in recent years, it has demonstrated careful management of this growth by adding the necessary staff and system enhancements. Standard & Poor's expects Midland to remain efficient and proactive in meeting its various servicing and special servicing duties given its track record, emphasis on technology, staff experience levels, and proactive servicing practices. Improvements in subservicer oversight either by way of onsite audits and/or the use of a third-party auditor to conduct such audits could be beneficial to the servicer rankings.

#### **Profile**

Midland has been involved in the Canadian CMBS market since 1999.

Table 1

#### Midland Loan Services Inc. -- Total Canadian Servicing Portfolio --Year ended Dec. 31--2007 2006 2005 2004 Vol. (Thou. **Assets** Vol. (Thou. Vol. (Thou. Assets Assets Assets Vol. (Thou. C\$) (No.) (No.) (No.) (No.) CS C\$) C\$) 6,247,142 2,708,449 752 2,299,726 Primary servicing 8,808,350 1,351 1,278 613 32 Master servicing 3,676,483 640 3,062,208 623 1,280,942 181 579,908 12,484,833 9,309,350 3,989,392 933 2,879,634 645 Total servicing 1,991 1,901 N/A Average loan size 6.271 N/A 4,897 N/A 4,276 N/A 4.465 2 1 2 1,904 5 5,641 Active special 10,550 6,887 servicing

N/A--Not applicable.

In early 1998, Midland became a wholly owned subsidiary of PNC Bank N.A., Pittsburgh, PA (PNC Bank), which is a wholly owned subsidiary of the PNC Financial Services Group. Including its predecessor ownership, Midland has a 14-year history in the commercial loan servicing and special servicing business.

In November 2000, Midland acquired Little Rock, Ark.-based Univest Financial Group LLC, and acquired ownership of the Enterprise!® loan servicing system. In 2001, PNC Bank purchased certain lending and servicing assets from TRI Capital Corp. In November of 2001, Midland acquired Zenetics LLC, a Dallas, Texas software company that specialized in origination and risk management software for commercial real estate.

Midland's growth plan is based principally on continued acquisition of purchased and fee CMBS and other third-party servicing rights, retaining servicing on conduit loans originated through PNC Bank and its investment partners, seeking interim servicing assignments, special servicing, and providing real estate advisory services. In late 2006 Midland purchased the master servicing rights in Canada from Capmark Canada, which added about 1,000 loans and C\$5.7 billion of servicing assets. Most recently, in 2008, Midland acquired the servicing rights from GSS Canada, which added 273 loans and C\$2.9 billion to the servicing portfolio.

Another major part of Midland's growth strategy is the continued expansion of its presence as a service provider for insurance companies, agencies, mortgage bankers, and banks that might desire to outsource all or part of their servicing and technology needs. Management seeks to establish a better balance between CMBS servicing revenues and fee service revenues, a good diversification strategy in a very competitive industry. Midland has successfully marketed its technology platform to the U.S. and Canadian markets for a number of years and has signed contracts with major life insurance companies to use Midland's technology for managing their commercial loan portfolios.

As of June 30, 2008, Midland employed 344 people in its primary and master servicing operation and another 21 people were allocated to its special servicing work along with 42 people for IT, and 81 in support departments. To address its portfolio growth, the company relocated in 2002 from Kansas City, Mo. to newer and larger office space in Overland Park, Kan. Midland also maintains offices in Arlington, Texas; Atlanta, Ga.; Bethesda, Md.; Washington D.C.; Dallas; Pittsburgh; and Little Rock, Ark.

Midland manages the Canadian loan portfolio from its headquarters in Overland Park. The Enterprise! loan system includes functionality to enable Midland to accurately manage Canadian dollar loans and account for differences in Canadian mortgage calculations. Midland has incorporated a level of automation such as electronic loan files and

document imaging that, coupled with highly automated payment collection processes, allow the company to manage the loans effectively. Each group has assigned individuals to manage Canadian mortgages, ensuring an acceptable level of service. Midland also maintains a senior representative responsible for all Canadian contact and developments. Furthermore, training for these individuals includes Canada-focused elements to keep a pulse on the Canadian CMBS market and other market developments. This allows Midland to capitalize on efficiencies with respect to scope and size of the servicing operation, while benefiting from global experiences when issues come up in Canada.

## **Management And Organization**

The ranking for Management and Organization is raised to STRONG.

#### Staffing, organizational structure, and training

Midland has a well-designed organizational structure that ensures a proper delineation of functional tasks and portfolio accountability. One of Midland's core strengths is the depth of its management team. Midland's experience in the Canadian market is limited to its involvement since 1999, as it had no Canadian operations before the growth of the Canadian CMBS market.

- Senior managers average 27 years of industry experience and 14 years at Midland. Many managers have been
  with Midland since its inception.
- Middle managers average more than 20 years of industry experience and 12 years' tenure at Midland.
- Loan administration staff averages an acceptable nine years of experience.
- Asset managers for special servicing have a very high average experience level of more than 18 years, and an average of seven years at Midland.
- Midland reported no management turnover in the first half of 2008. Overall employee turnover for that period was a low 4.6%. The overall employee turnover rate for 2007 was a reasonable 7.8%. There has been no turnover within the group of employees that focuses on Canadian transactions.

Midland is committed to ongoing staff training and has allocated sufficient resources for a variety of internally and externally led activities.

- The company's formal professional development training curriculum and schedule is managed by a committee of senior managers within the servicing departments and is tied to employees' overall objectives and performance review.
- Midland formally tracks employee participation (a minimum 20 hours per person for staff and 30 hours for managers has been mandated) and their training hours. Employees averaged 33 training hours as of Sept. 30, 2008, and 36 training hours in the past 12 months.
- Some of the servicing-related programs include onsite industry training, monthly staff meetings in which supervisors present a specific topic, and a business skills program offered by an outside consultant.
- Midland has conducted additional servicing-related training for employees who require a Canadian perspective, including onsite and teleconference sessions.

#### **Technology**

Midland remains a technology-oriented company with a strong commitment to automation and achieving efficiency through ongoing system enhancements.

- The company has fully integrated the Enterprise! loan management system as the central servicing, special servicing, and investor reporting system. The added functionality gained from the system conversion has obviated the need for certain other supplemental system applications. Enterprise! streamlines internal processes by using an electronic loan file that can be created at origination and followed through until final maturity. These files are stored centrally and can easily be accessed, providing ad hoc reporting capabilities to the end user.
- An internally developed bank account reconciliation system, which is integrated with Midland's treasury system and the servicing system, balances bank accounts nightly against servicing system records.
- Investor accounting is integrated into the Enterprise! loan management system along with the servicing, accounting, and asset management functions. The Commercial Mortgage Securities Association (CMSA) Investor Reporting Package (IRP) and other required formats are a standard part of the Enterprise! system, thereby reducing the needs for proprietary side systems.
- Midland recently entered into an agreement with Trepp LLC to provide links on both the Trepp Web site and Midland's investor Web site to link the data that is provided through Midland's Web site, CMBS Investor Insight®.
- From the Enterprise! database, data from all servicing, accounting, and asset management systems feed into
  Midland's investor reporting data repository for the production of standard and ad hoc reports according to
  CMSA and other required formats.
- The Enterprise! database also feeds into Midland's dedicated Web sites for CMBS investors, portfolio investors, and borrowers. The investor sites provide access to portfolio, asset, and property-level information to assess pool and loan performance.
- Midland continues to market Enterprise! as a software solution to Canadian lenders to service their own portfolios.
- The company continues to build on its document management platform, using proprietary software along with vendor products to support the document imaging and workflow management process.
- The company has an up-to-date disaster recovery and business continuity plan, which is tested annually. The foundation for the disaster recovery plan is a separate PNC owned data center for rapid recovery where critical applications and databases are replicated. Results of the last test in April 2008 showed full recovery of critical systems within 24 hours.

#### Internal controls

Midland has well-documented operating procedures for all primary, master, and special servicing functions that promote an efficient and soundly controlled operating environment. All policies and procedures are centrally managed and available online.

Midland's audit program thoroughly reviews compliance and controls across each department. Audits are conducted regularly and range from specific procedural audits such as attestation letters for the Uniform Single Attestation Program to broader audits reviewing the overall adequacy of policies and procedures across departments. Midland also conducts Regulation AB compliance audits annually.

- An external auditing firm completes these audits based on established scopes of review and reports findings to Midland and PNC Bank management.
- Standard & Poor's has reviewed the scope and results from the latest audit reports available from 2007. Overall, the audits were satisfactory.

In addition, since late 2002, Midland has maintained a full-time risk manager to monitor Midland's servicing and

other related procedures for regulatory compliance and other externally imposed internal control requirements. This risk manager performs quarterly business risk reviews and serves as liaison with the PNC Bank audit department.

Midland continually reviews and, when necessary, will re-engineer certain workflow processes to improve efficiencies for various tasks. As part of this initiative, Midland has implemented a series of centralized performance metrics that track processes to monitor ongoing accuracy and efficiency of various servicing tasks. Standard & Poor's believes that Midland's adaptation of such a program enhances servicing effectiveness.

To supplement its existing internal control practices, Midland has expanded its internal audit function to include the SAS 70 examination (Statement on Auditing Standards No. 70). During 2008, Midland conducted its annual SAS 70 audit and found no material deficiencies.

#### Additional items

Midland reports no material lawsuits outstanding. The company maintains acceptable levels of corporate insurance coverage amounts, including mortgage impairment, errors and omissions, and fidelity bonds for its portfolio.

## Loan Administration--Primary Servicing

The ranking for Primary Servicing is raised to STRONG.

The company demonstrates proactive servicing practices across all core functions and proficient management of complex loan and reporting structures. Standard & Poor's expects that Midland's streamlined technology tools, efforts to redesign workflow procedures, and performance metric tracking will produce increased efficiency levels for routine administrative processes. The servicing operation is characterized by an effective use of technology to promote process efficiency for a large portfolio. The Canadian operations are based out of the Kansas office, and although the company does not have an origination operation in Canada, it has been able to obtain primary servicing rights through strong relationships with other Canadian lenders and service loans during the early stages of securitization.

Midland is one of the largest loan servicers in the U.S. and as of June 30, 2008, the company acted as primary servicer for a C\$10.7 billion portfolio. The portfolio is nationwide and included a range of property types.

• As of June 30, 2008, the company's average number of loans serviced per employee was 69. This ratio has remained relatively constant and is commensurate with other high volume CMBS and higher ranked servicers. In addition, Standard & Poor's has observed an industry decline in the loans-per-employee ratio in the past year.

Table 2

Midland Loan Services Inc Total Canadian Primary Servicing							
(as of June 30, 2008)							
Loans UPB vol. (Thou. C\$)	10,692,043						
Properties (No.)	2,341	-					
Deals (No.)	56						
Avg. loan size (Thou. C\$)	6,929						
Delinquencies							
	% by UPB	% by loan count					
31-60 days	0.00	0.00					

Table 2

Midland Loan Services Inc (cont.)	c Total Canadian Primar	y Servicing
61-89 days	0.02	0.06
90-plus days	0.08	0.13
Total	0.10	0.19

UPB--Unpaid principal balance.

#### New loan set-up

Midland maintains a dedicated staff for managing portfolio conversions and new loan set-up. The staff is part of the company's financial data services unit. The entire process is effectively administered with multiple levels of review to protect against data input errors. Midland's stringent loan-boarding function underscores the company's concern for data integrity and achieving smooth servicing transfers.

- For pending transactions, a Midland staff member is assigned to monitor the outgoing servicer and maintain contact throughout the boarding process.
- The file review process is thorough, with each loan file containing more than 500 data points for system entry.
- Data integrity controls include a secondary review by a senior file review specialist.
- All files are imaged as they are boarded.

To facilitate loan boarding, Midland uses a specially designed conversion management system for its quality control process to upload data to the Enterprise! servicing system.

Integral to the portfolio conversion process is Midland's CMBS administration group, which oversees the negotiation, administration, and interpretation of pooling and servicing agreement (PSA) requirements. The group reviews all CMBS servicing agreements and then creates abstracts that detail key items and critical reporting and remittance dates. By delivering these abstracts online, the servicing staff has an efficient means to access and to become familiar with deal-specific PSA requirements.

Table 3

Tubic 0	
Midland Loan Services Inc Total Canadian Master and Primary Servicing Portfolio Volume By Investor Type	
(as of June 30, 2008)	

	Vol.		Vol. (Loan Count)		30 Days		60 Days		90+ Days		Total	
	Thou. C\$	%	No.	%	UPB	No.	UPB	No.	UPB	No.	UPB	No.
Investor												
Insurance cos.	0	0.0	0	0.0	0	0	0	0	0	0	0	0
Banks/Financial institutions	0	0.0	0	0.0	0	0	0	0	0	0	0	0
Other third-party investors	768,945	5.5	103	4.8	0	0	0	0	0	0	0	0
CMBS	12,856,825	91.8	2,020	94.3	0	0	1,852,821	1	8,279,834	2.00	10,132,655	3
CMBS subserviced for others	376,813	2.7	19	0.9	0	0	0	0	0	0	0	0
Overall total	14,002,583	100.0	2,142	100.0	0	0	1,852,821	1	8,279,834	2.00	10,132,655	3

UPB--Unpaid principal balance.

#### Payment processing

The company has developed an effective payment processing function.

- About 99% of all Canadian payments are received and posted electronically (electronic funds transfer), or by wire transfers.
- Midland has procedures in place to ensure an appropriate segregation of duties for the receipt and deposit of funds, batch processing, and the posting of these payments.
- Through online bank account access, Midland is able to balance its clearing account daily and perform a daily reconciliation.

#### Investor reporting and accounting

Midland demonstrates thorough investor reporting and accounting functions. As an organizational improvement, Midland has established greater separation between the accounting and reporting areas with each area respectively managed by dedicated units within the company's investor reporting department.

Midland's cash management and related accounting and reporting procedures are thorough and demonstrate the company's commitment to accurate remittance processing and investor reporting for a high number of complex transactions.

- Trustee remittance, reporting, and account reconciliation tasks are appropriately segregated between a 24-person investor reporting unit and an eight-person investor accounting unit.
- A specialized CMBS reporting team prepares monthly distribution reports according to CMSA formats.
- Report production is highly automated, with a direct interface to the servicing system and a proprietary investor reporting application.
- Midland incurred no material late remitting situations and no late reporting penalties in 2008.
- The installation of automated bank account reconciliation and cash management systems with full online bank activity access enables Midland to oversee a greater number of bank accounts while operating with a slightly smaller staff.

#### Asset Administration - Taxes And Insurance

The servicing operations group includes specialized teams for tax and insurance administration. Midland displays proactive servicing practices for these functions. About 18% of the loans have tax escrows, while 8% has insurance escrow accounts.

- Midland uses a national tax service for the entire portfolio to facilitate tracking and to reduce the risk of
  incurring property tax penalties.
- Upcoming renewals are tracked through the system and a series of system-generated renewal notices are generated with sufficient lead time.
- Great American Insurance Co. (A/Stable/--) is the force-placed carrier. Currently, the company has no Canadian loans with force-placed coverage. Loss draft policies demonstrate appropriate controls.

## Asset Administration -- Collateral Tracking, Floating-Rate Loans, And Payoffs

The servicing staff includes dedicated units for floating-rate loan monitoring, collateral and release tracking, and payoff verification processing.

- This staff also works on resolving document-recording exceptions and tracks the release of documents for payoffs in conjunction with the payoff-processing unit.
- Senior managers review yield maintenance calculations with a one-day turnaround time for CMBS loans.
- The floating-rate and accrual unit includes staff to verify re-stated loan terms for any modified loans and to conduct floating-rate mortgage reviews.

## **Asset Management**

Midland's portfolio management and asset performance monitoring functions are well staffed. Its asset administration department encompasses dedicated teams of analysts for credit analysis and watchlist management, performing loan asset management, reserve account administration, and collections. Midland's organizational structure and the capabilities of the Enterprise! loan management system promote accountability.

- Midland has assigned an asset manager to focus specifically on Canadian CMBS transactions. This manager
  provides a consistent point of contact for Canadian borrower requests. Standard & Poor's experience with loan
  requests through Midland has been favorable, with well-documented files and an appropriate level of background
  materials to enable feedback quickly.
- Midland has a thorough process for responding to asset management issues, such as defaulted loan monitoring, special servicing transfers, reserve account administration, assumptions, defeasances, and partial releases.
- The asset manager is responsible for the analyses and for preparing the written proposals that must be approved through a formal committee process. Midland uses a system tracking report to monitor the resolution and aging of asset management requests.

Table 4

Midland Loan Services Inc Canadian CMBS Primary And Master Servicing Portfolio Only												
(as of June 30, 2008)												
							Loan Deling	uency	(% by UPB an	d Ioan d	count)	
	Vol. (UP	В)	Vol. (L Cou		30 D	ays	60 Days	S	90+ Day	'S	Total	
	Thou. C\$	%	No.	%	UPB	No.	UPB (Thou. C\$)	No.	UPB (Thou. C\$)	No.	UPB (Thou. C\$)	No.
CMBS type												
Primary and master combined (excluding subserviced loans)	9,546,285	72	1,421	70	0	0	1,852,821	1.00	8,279,834	2.00	10,132,655	3.00
Master servicer only (subserviced by others)	3,310,540	25	599	29	0	0	0	0	0	0	0	0
Primary only (subserviced for others)	376,813	3	19	1	0	0	0	0	0	0	0	0
Total	13,233,637	100	2,039	100			1,852,821	1	8,279,834	2	10,132,655	3

UPB--Unpaid principal balance.

#### **CMBS** Surveillance

Midland also has a separate CMBS surveillance group led by a seasoned manager and includes seven analysts. One of the analysts in the surveillance group is dedicated to Canadian accounts.

- Analysts in each group are expected to understand the requirements of the PSA and any nuances in a deal.
- The group's purpose is to analyze the performance of CMBS loans in greater detail and to respond to rating agency and investor inquiries. To date, based on its interaction with Midland's requests for ratings confirmations for loan assumptions, defeasance transactions, and other events that require rating agency confirmation, Standard & Poor's experience has been positive, with all documentation complete and clear, and concise explanations surrounding each request.
- Among its duties, the CMBS surveillance group engages in portfolio performance reviews, participates in the
  watchlist process, and reviews credit administration exception reports for issues that could affect the performance
  of a CMBS transaction.
- Midland has a special servicer liaison position to communicate with CMBS special servicers regarding the status of problem loans, valuation and advancing analysis, and borrower consents requiring special servicer review.
- Midland conducts monthly calls with investors and special servicers to discuss portfolio performance.

Finally, Midland has appropriate procedures and criteria governing the actions to be taken regarding payment advances and recoverability. A CMBS advance credit committee monitors advance activity on a monthly basis and is responsible for all loan level recoverability decisions. Advances are monitored through a series of monthly system-generated advance reports that highlight principal and interest (P&I) advances, property protection expenses, valuations, and the ratio of advances to appraised values and unpaid balances. In the past year, Midland has refined its classification criteria to improve its advancing determination policies and procedures.

## Financial Statement Analysis, Inspections, And Watchlist Management

- The workflow process for collateral and credit analysis is well automated, with sound quality control mechanisms that assist in identifying input errors and property performance problems.
- All financial statements are imaged as received, with procedures that prioritize the review process based on the size and issues surrounding the asset.
- Midland stated that it typically achieves a financial statement collection rate exceeding 89% for the timely receipt of year-end statements.
- Its portfolio and credit analysis teams coordinate the key steps involved in credit analysis (data receipt and input, initial review, and more in-depth review and trend analysis), with assets assigned according to investor type and geographic concentration.
- The tracking of property statements and inspections is properly automated; the credit administration group is also responsible for engaging third-party property inspectors.
- Deferred maintenance and other critical issues are maintained and tracked on the system, and the repair work is monitored monthly to ensure completion within any time frames required by the loan documents.
- Credit analysts use Enterprise! to perform the modeling and analytical work. The system produces a detailed analysis of each operating statement to assist with identifying trends and problems.
- To advance into the asset management unit, credit administration staff must complete an 18-month training

program within their department.

- The Enterprise! system automatically flags loans for the watchlist based on various performance triggers, including delinquency, low DSCR or occupancy, high loan-to-value, and pending maturity, among others. In addition, Midland uses watchlist criteria and reporting based on the latest CMSA standards for all CMBS portfolios.
- The asset manager, or any other servicing staff member, may identify other collateral performance issues based on various other qualitative factors not captured by the system and may recommend watchlist inclusion of a loan to Midland's watchlist committee through a corresponding e-mail box.
- Senior managers present the status of their watchlisted loans to this committee, which meets monthly. The
  committee, which has the sole authority to remove a loan from watchlist status, approves all recommended
  courses of action.
- The internal watchlist filters and prioritizes loans based on the severity of the issues, which is a sound approach
  to watchlist management.
- Midland's proactive stance on early intervention through monthly internal reviews by asset managers and the
  watchlist committee, and through monthly conference calls with special servicers illustrates its proactive efforts to
  mitigate loan loss situations.

#### **Collections**

Midland maintains a two-person servicing staff within the portfolio servicing department to provide payment oversight for Canadian loans. In-place procedures provide for a high level of automation.

- The company uses a customized collection queue and progress tracking system, which downloads all current loan information from the servicing system on a daily basis.
- The portfolio servicing group contacts the borrower to research failed electronic funds transfer to non-sufficient funds or a delayed wiring of funds.
- Higher-risk loans, such as those with large principal balances or chronic delinquency problems, are flagged on the
  system and transferred immediately to a Canadian subservicer for collection and default handling. Midland, in
  accordance with its arrangement with OSFI, uses licensed Canadian servicers who handle all the collection and
  default work under the oversight of Midland.

## Loan Administration: Master Servicing

The ranking for Master Servicing is affirmed at ABOVE AVERAGE.

In its role as master servicer for loans in which Midland is not acting as the primary servicer, the company protects the interests of investors in various CMBS transactions by ensuring that the subservicers are handling their loan administration duties according to the PSA and prudent loan servicing standards.

Midland maintains a well-designed master servicing capability. The company's dedicated subservicer oversight group includes a manager and two administrators to monitor daily subservicer compliance and to coordinate subservicer audits.

Table 5

Midland Loan Services Inc	c Total Canadian I	Master Servicing
(as of June 30, 2008)		
Loans UPB vol. (Thou. C\$)	3,310,540	
Properties (No.)	709	
Deals (no.)	31	
Avg. Ioan size (Thou. C\$)	5,527	
Delinquencies		
Delinquencies	% by UPB	% by loan count
<b>Delinquencies</b> 31-60 days	<b>% by UPB</b> 0.00	% by loan count
•		· · · · · · · · · · · · · · · · · · ·
31-60 days	0.00	0.00

UPB--Unpaid principal balance.

Midland uses its proprietary subservicer administration system to monitor subservicers' reporting requirements. Subservicer agreements are used with approved organizations that are approved by the trust originators.

As of June 30, 2008, in Canada, Midland was the named master servicer for a C\$3.3 billion portfolio representing 709 loans spread among eight subservicers. The portfolio covers nine out of 10 provinces and a range of collateral property types.

#### New loan set-up and conversions

Midland's conversions department sets up master-serviced loans on the servicing system using the same high standard of internal controls as used for primary serviced loans.

The creation of online deal summaries assists in monitoring subservicer activities to ensure that the reporting procedures outlined in pooling and servicing agreements are handled correctly.

## **Subservicer Accounting And Reporting**

Midland effectively performs all loan and subservicer accounting and corresponding trustee remittance and reporting functions. The company is well experienced in overseeing a large number of subservicers on multiple transactions. As with its primary serviced loans, Midland demonstrates a proper segregation between reporting, cash management, and accounting tasks to promote sound controls.

- The accounting staff reconciles all incoming subservicer remittances monthly to ensure accurate trustee remittance and other related reports.
- Each month, Midland provides each subservicer with an expected remittance report that indicates scheduled
  pass-through amounts generated from the servicing system. This process helps Midland resolve any discrepancies
  prior to remittance dates.
- To reduce the potential for late reporting or remittance, Midland's subservicer oversight staff provides subservicers with monthly calendars noting all critical reporting and remittance deadlines.
- To ensure accuracy, Midland verifies investor records against the investor remittance reports from its system. The system calculates the correct distribution of subservicer, master servicer, and trustee fees.

Midland has online access to its bank and the reconciliation process is properly automated.

#### **Asset Administration**

The subservicer control group actively monitors subservicer activity relating to the tracking of real estate taxes, insurance, and reserve account receipts and disbursements.

- To verify that its servicers are tracking these items in an appropriate manner, Midland requires that subservicers e-mail certification forms quarterly.
- Using this data, Midland will update expiration and paid-to dates on its system, with exception reports used to resolve open items with subservicers.
- Each certification includes copies of paid receipts, proof of coverage amounts, and a loan-level status report.
- As an added control, Midland audits a random sample of loans on the subservicer certifications by verifying the status of taxes and insurance directly with taxing authorities and insurance carriers.

Midland's portfolio and credit analysis teams display a thorough process for reviewing subservicer property inspections, financial statement analyses, and monitoring watchlist triggers for master serviced loans.

- The staff compares the subservicer's debt service and cash flow calculations against the borrower's actual property operating statements.
- Computation errors, deferred maintenance issues, and cash flow questions are noted, with follow-up calls made to the subservicer.
- As with primary serviced loans, the system produces a detailed analysis of each operating statement, shows how the numbers were spread, and displays adjusted net operating income and debt service coverage ratios.
- Master serviced loans placed on the watchlist are prioritized by severity following the same criteria as for primary serviced loans.
- Performing loan asset managers also identify performance issues on assigned master serviced loans and discuss
  any watchlisted master serviced loans with the watchlist committee.
- The CMBS surveillance group includes staff dedicated to master serviced loans.

## Portfolio Management

Midland's portfolio management responsibilities include responsibility for defaulted loan transfers/monitoring, special servicing transfers, and approvals relating to assumption, condemnation, defeasance, and partial release requests presented by subservicers.

- The subservicer oversight group or portfolio servicing group coordinates such requests in conjunction with the asset management department, which is responsible for the analysis.
- Midland's subservicers must submit their borrower requests through standard case formats that Midland approves through delegated levels of authority, which may include a credit committee.
- Midland uses a tracking report within its servicing system to monitor the resolution and aging of portfolio management requests.
- Midland's asset managers review subservicers' monthly collection activity and the status of workouts activity from special servicers.

## **Subservicer Audit And Compliance**

The subservicer oversight group conducts desk audit reviews of all subservicers regularly. Audit procedures are adequate; however, due to an OSFI restriction Midland is unable to conduct onsite audits. Audit procedures could be strengthened through a greater proportion of desk audits. Ideally, strengthened procedures through the use of an external auditor to conduct onsite audits on behalf of Midland may provide a better audit solution until Midland is able to conduct its own onsite audits. Midland appropriately prioritizes regular desk audits based on each subservicer's past performance and the volume it services among the eight Canadian subservicers that it oversees.

- As of June 30, 2008, seven desk audits were performed. Collectively, 88% of the total subserviced portfolio was audited in some form during 2007.
- A detailed audit template covers subservicer performance in all core functional areas.
- The subservicer audit procedure consists of both sampling and review of operational procedures.
- Prior to initiating an audit, the subservicer oversight group completes a quality control checklist and the subservicer completes a subservicer compliance questionnaire.
- Midland, through a committee process, reviews the findings of each audit and assigns an overall ranking of either
  acceptable or unacceptable, with each subservicer receiving a letter containing exception items and
  recommendations.
- Between audits, Midland also performs a monthly review of each subservicer's performance for the previous reporting period. The subservicer oversight committee reviews any resulting issues as well.

## **Advancing And Special Servicer Interaction**

Midland has payment advancing responsibility (for both delinquent P&I and property protection expenses) for the majority of its CMBS portfolio. Midland has solid procedures and criteria governing the actions to be taken regarding such payment advances and the determination of their recoverability for the trust.

- A CMBS advance credit committee monitors advance activity on a monthly basis and is responsible for all loan level recoverability decisions.
- Advances are monitored through a series of monthly system-generated advance reports that highlight the advance type, valuations, and the ratio of advances to appraised values and unpaid balances.
- The investor accounting area calculates the servicer fees and any appraisal subordination entitlement reductions (the amount by which the servicer advance is reduced based on an appraisal reduction amount) and enters the calculations into the servicing system to derive the net advance amounts.
- All advances are calculated and reconciled through the servicing system, with the CMBS reporting manager approving any adjustments.
- Midland has refined its advance determination criteria into a four-tiered analysis based on the magnitude of the advance amount, the advance-to-value ratio, and the delinquency aging of the loan payments. Noteworthy in the criteria is that advances exceeding 50% of the appraised value are classified as Level III advances. This level connotes closer scrutiny to determine if a declaration of nonrecoverability might soon be required.
- The CMSA standard loss template is used to report realized losses.
- Weak issuance markets for CMBS and overall difficult credit conditions have created a more difficult lending environment. As a result, some loans have not found refinancing on the scheduled repayment date. Midland has

been effective in determining from the loan documents what grace periods may be extended as well as working with the controlling class representative and the borrowers as they work to secure refinancing.

## **Special Servicing**

The Special Servicing ranking is affirmed at AVERAGE.

In the U.S. market, Midland has a controlled special servicing function that shows a track record of excellent recovery results within very reasonable time frames.

The average experience level for the staff exceeds 18 years, which is at the high end of the range compared with many of Midland's competitors. To address special servicing volume growth in the U.S. market, the department has grown from three senior asset managers to its current 22 asset managers. The Canadian CMBS market has performed very well and to date there have been few specially serviced assets. As such, Midland has little Canadian default experience. In accordance with its arrangement with OSFI, Midland uses a network of licensed Canadian subservicers that are real estate professionals to assist with special servicing activities in Canada. Through this network, it is expected that if the Canadian CMBS market were to deteriorate, Midland will be able to manage specially serviced loans with the same level of proficiency as it has demonstrated in the U.S.. Midland will likely incorporate staff that are familiar with Canadian foreclosure laws and rely on expertise in its Canadian network to ensure it will be able to work with such assets as required.

In the event that there are any Canadian REO properties, an asset manager may handle a portfolio of both troubled loans and REO properties. Should REO volume rise, Midland has indicated that it would likely revert to having a dedicated REO department in order to maintain efficiency and to oversee the Canadian subservicer network.

Table 6

Midland Loan Services Inc Special Servicing Canadian Portfolio							
	2007	2006	2005				
Loan Portfolio							
Total volume beginning of period (Thou. C\$)	10,550.4	5,640.5	5,695.8				
Total loans	1.0	2.0	2.0				
Transfers In:							
Total volume (Thou. C\$)	0	9,245.9	0				
Total loans	0	4.0	0				
Transfers Out:							
Restructured or returned to a master servicer	0	0	0				
Full payoffs	8,620.6	4,166.0	0				
Liquidations	0	0	0				
Power of sale	0	0	0				
Repair and warranty claim settlement	0	0	0				
Other loans transferred out of portfolio	0	0	0				
Add(+)/Deduct(-): Other adjustments (Write-downs, amortization, etc.)	(26.0)	(170.0)	(55.3)				
Total end of period (Thou. C\$)	1,903.9	10,550.4	5,640.5				

### Loan Recovery And Foreclosure Management

Midland has thorough procedures for asset analysis and business plan preparation that it has shared with each of its network partners in Canada.

- Asset-level business plans provide all necessary details along with a proposed resolution strategy.
- The asset managers are required to finalize and present their business plans for committee approval within the first 60-90 days of receiving the asset.
- As an efficiency measure and for better document retrieval, asset managers complete their entire business plans using a standardized format, which is tracked in Midland's Enterprise! and DealFlow® applications.
- Asset managers must regularly update business plans and asset status reports for senior management to review.

Loan enforcement recommendations are made by the asset managers and are reviewed by the department manager before submission to the appropriate delegated authority (which may include Midland's credit committee) for final approval. This process is also used to approve all asset or REO dispositions and power of sale proceedings.

## **REO Management And Dispositions**

In the U.S., Midland has demonstrated proactive REO property oversight procedures, with a track record of producing high recoveries in relation to the corresponding property values.

- The property management and broker selection processes are well controlled through effective policies and
  procedures that guide the engagement process through approved vendor lists, asset manager input, and standard
  contracts. The REO and disposition process is centralized and tracked through Midland's Enterprise! loan
  management system.
- For Canada, asset managers (working with companies in the Canadian network) and accounting staff monitor property managers' adherence to a Midland-issued procedure manual for reporting and compliance.
- Asset managers also must prepare and present an REO business plan and budget within 30 to 60 days of title acquisition. The approval of the plan and budget is similar to the approval process used for loan business plans.
- All sale bids must be submitted to the appropriate delegated authority (which may include Midland's credit committee) for final approval. The asset manager, in conjunction with the Canadian subservicer network and Midland's legal department, coordinate the closing process.

## **REO Accounting And Reporting**

The asset manager and accounting staff monitor property management operating account activity monthly in conjunction with the Canadian subservicer network.

- Midland controls property management income and expenses through separate accounts that are reconciled monthly.
- Property managers electronically submit operating account statements, along with appropriate bank statement reconciliations, in a standardized format each month.
- The asset tracking system performs REO-level accounting management by storing all line item income and expense so that asset managers and accounting staff can readily track budgeted-to-actual activity.

• Midland's investor reporting staff coordinates the Web-based delivery of all required CMSA-formatted reports relating to specially serviced assets.

## **Subcontracting Management**

Through the Enterprise! system, the special servicing department is able to track all contracting bids and work products for appraisals, environmental work, and engineering studies. Midland has a soundly controlled contracting process to monitor the quality and timeliness of services provided from third-party vendors.

- Business references are checked on all vendors and report cards are maintained on each one.
- Active vendor assignments are tracked through Enterprise!.
- For environmental work, the contracting staff uses an external environmental specialist who acts as a liaison with other environmental firms contracted to perform environmental audits. The specialist is responsible for ordering environmental audits from Midland's approved list and for reviewing completed site assessments.

## Legal

The special servicing department has access to Midland's five-person legal staff for both U.S. and Canadian assets. The legal staff controls the engagement process and case management oversight function when external law firms are required. The payment status of nonreimbursed legal billings is tracked through a PNC Bank-developed invoice tracking system. Midland also has begun tracking all incurred asset legal costs within the Enterprise! servicing system to facilitate the monitoring of actual legal costs against budgeted amounts and overall recovery expectations.

#### **Financial Position**

The Financial Position for Midland is deemed to be SUFFICIENT.

This assessment is based on the AA-/Watch Neg/A-1+ counterparty credit rating on PNC Bank, the direct parent company for Midland. For further information on this credit rating, please visit www.ratingsdirect.com.

#### **Contact Information**

Midland's commercial servicing operations are headquartered in Overland Park, Kansas. The company also has a business development office in Bethesda, Md.

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