

Mortgage Banking

A Challenging **Servicing** **Environment**



Commercial real estate servicers gathered this past June in San Antonio, Texas. The venue was a fitting one for commercial and multifamily servicers today. San Antonio is probably best known as the site of the Alamo, where a small band of men fought heroically in the face of impossible odds. While today's commercial servicing business environment is not quite that hostile, it does present some rather stiff challenges. ■ The industry gathered in San Antonio for the Mortgage Bankers Association's (MBA's) Commercial Asset Administration and Technology Conference. As president and chief executive officer of National Tax Search, a tax administration and reporting partner for commercial servicers, I attended and met with a group of our commercial lender and servicing clients. We asked these commercial real estate professionals to tell us about the challenges that most concern them – not only in the area of tax administration but in the overall servicing of commercial portfolios. ■ The topics that were most on their minds included changes in regulations, standardization, loan complexity and data security – all tough issues. ■

BY LORI ESHOO

Commercial mortgage servicers and their vendor partners met in San Antonio recently to discuss some of the many new challenges they face. Growing loan complexity and Reg AB were high on their list.

SEC's Regulation AB

Commercial mortgage-backed securities (CMBS) servicers concluded their first year of reporting under the Security and Exchange Commission's (SEC's) Regulation AB. Concerns about significant issues in complying with Reg AB – specifically 1122 Attestation reporting – have surfaced and now need to be addressed for 2007.

Commercial servicers are feeling the financial effects of this first year of reporting, including the cost of updating their processes and systems, and implementing the staff training required to ensure their firms pass the audit. In a May 24, 2007, *MBA Newslink* article titled "Reg AB Auditors Generally Pleased With Compliance,"

Van Vorhis, associate legal counsel at Minneapolis-based NorthMarq Capital, Inc., was quoted as saying, "Implementation of Reg AB procedures costs two to three times the amount of a typical Uniform Single Attestation Program [USAP] audit."

In addition to the cost impact on servicers, there are many unanswered questions about other firms that might be required to

participate in 1122 attestation. Servicers and their vendor partners are scrambling to determine whether companies that perform only certain pieces of the servicing function on behalf of a servicer must also go through the audit process. If so, vendors and business partners are likely to experience added costs to comply with Reg AB, raising the overall cost of compliance for the industry even higher.

Other concerns about Reg AB compliance include differences of opinion over the interpretation of its provisions. This has led to potential variations in the compliance evaluations. Servicers say these areas of ambiguity need be addressed by the MBA Regulation AB Working Group.

It is also critically important that each company forced to comply with Reg AB be clear about its provisions, and that all auditors involved in determining servicer compliance are on the same page. Audit results can have huge ramifications for commercial servicers, especially in the way ratings agencies view their portfolios. Thus it is imperative that everyone have the time they need to comply, and be evaluated by the same fair and balanced approach to the audit process in 2007.

Standardization and MISMO

Commercial servicers are also concerned about the significant variability that exists in the way organizations across the commercial mortgage spectrum handle data. Standardization issues remain problematic for the Industry, especially when portfolios move among institutions. Because legal descriptions and other critical

data sets are not standardized, an enormous amount of manpower and time is required to reconcile data as they move from one servicing system to the next.

There is, however, some good news on the standardization front, according to John McCarthy, chief information officer of National Tax Search, and a long-standing member of the MISMO® Commercial Working Group and co-chair of its Commercial Architecture Workgroup. The good news comes from the fact that MISMO has now issued four data-transfer standards.

The first Servicing Transfer Standard was issued in February 2006, and on June 11, 2007, the release of three more standards was announced. These include data-transfer standards for environmental survey assessments and work order requests, as well as document classification standards for document-naming conventions. Other standards due in the coming year include a core servicing transfer standard, property condition synopsis, lease abstract, financial statements and appraisal synopsis standards.

According to McCarthy, MISMO came of age at the conference in San Antonio, in that organizations are now eager to adopt MISMO and want their vendors and trading partners to adopt MISMO standards to help make exchanges between servicers and originators more efficient. Institutions that have gone through the process have found the ease of implementation is good from a technical architecture standpoint, though organizations must invest the time to match information within the MISMO structure to their own systems.

MISMO is also working with other standards organizations to ensure the usability of its standards across all sectors of the real estate finance industry. For example, it has established a strategic alliance with the Commercial Mortgage Securitization Association (CMSA), New York. The CMSA is currently making some incremental modifications of its Investor Reporting Package (IRP) Version 5.0, and the next version will be in extensible markup language (XML) format and "MISMOized," as some are calling it. This version is scheduled to be released in the second quarter of 2008, according to McCarthy.

"MISMO for commercial loans is out and here to stay," says McCarthy. "The standards that have been issued so far have been widely examined throughout the industry, and live production environments are up and running," he adds.

However, it may be a matter of getting the word out to companies that MISMO is ready for implementation. Commercial lenders and servicers can assist in the effort by asking their vendors and business partners to adopt the standards. Yes, there is a time factor and a financial consideration – but the long-term gain is advantageous for the entire industry.

Loan complexity

Another significant challenge for commercial loan servicers is the wide range of diversity and complexity of the loans

Other concerns about Reg AB compliance include differences of opinion over the interpretation of its provisions.

currently on the market. Tracking and reporting for complex loans requires a tremendous amount of attention and specialized servicing structures from loan to loan.

Discussing her concerns about the significant loan complexity in the commercial real estate sector, Sharon Shackelford, vice president of loan administration for The Situs Companies, Houston, says, "While there are many basic commercial loans, they quickly diverge into loans that can be both costly and challenging to service on many levels."

The following are a few examples of the kinds of complex loans commercial servicers are faced with every day:

■ Construction loans with development incentives or exemptions from local or regional governmental agencies that require ongoing tracking as the provisions evolve over time.

■ Development projects that span multiple years with multiple phases that include land combinations and divisions. This scenario creates the challenge of tracking and paying property taxes on parcels that may no longer be active.

■ Loans with tax incremental financing, or TIF, are each unique and require special tax payments. Often times the documents outlining these programs are difficult to find and interpret

■ When loan collateral is simply the building or structure that resides on land owned by a third-party, whether private or public, servicing complexity can skyrocket. These types of loans can involve railroad right-of-ways, county- or city-owned land and waterfront properties. Legal descriptions for these properties often do not indicate the ownership relationships, and if the separate parcels for buildings or right-of-ways are not identified, tax penalties can result.

The list of challenging commercial servicing portfolios goes on to include shopping centers that are generally built in phases, with multiple deeds and ownerships over the course of the development; multi-phase condo or apartment developments with legal description dimensions that "bleed" onto land owned by others; and so on.

As lenders strive to be more competitive, these complex loans will continue to be challenging to service and difficult to efficiently manage.

International investments

While the complexity of loans on real estate property in the United States has increased, problems with international loans have also continued to grow. Many countries still lack the transparency measures needed to allow investors to create global strategies and expand their businesses. Complicating matters further, the language barrier can make the task of obtaining even the most basic real estate information nearly impossible for owners, investors and servicers.

Certainly, language and cultural barriers create some of the most frustrating and time-consuming issues when dealing with foreign agencies. For example, both English and French are official languages in Canada, and loan documents – including legal descriptions – are often in

French. In addition, all fees and taxes must be paid in Canadian dollars, requiring the need to factor in exchange rates that may change from payment to payment. And because tax offices in Canada are very strict on privacy, they may charge anyone other than the property owner huge fees for information.

Fortunately, some of the larger tax offices in Canada have recognized that others in addition to property owners need access to legal descriptions and tax data. As a result, these agencies are slowly moving in the direction of delivering information electronically, via Web site or data rolls. However, they are still about five years behind many US agencies, and the whole concept of third parties setting up escrow accounts and handling property-related financial matters on behalf of owners is relatively new, especially in the area of taxes.

To help facilitate these transactions, some servicers have established offices in Canada to comply with Canadian laws and regulations, or hired third parties to help with translation so these issues can be mitigated or resolved.

Given these significant issues in neighboring Canada, one can image how servicing complexities grow even more challenging in other parts of the world. The inability to communicate with local officials because of language barriers, the struggle to obtain legal descriptions and tax information, and the huge costs that can be required to obtain this critical information will continue to make international servicing a challenge for the foreseeable future. Only as countries adopt policies that support greater transparency, and data become more readily available electronically, will these difficulties be lessened.

Data security

Data security (or lack thereof) has become the target of intense criminal activity, especially in the financial services industry. Thus many financial institutions have

heavily invested in methods or tools that effectively prevent or reduce fraudulent activities. However, data security still remains a challenge as criminal strategies tend to evolve. Financial institutions must also continue to evolve and develop tighter security measures.

Several commercial servicers talked about the

fact that their firms have very strict protocols for data protection, and that security is extremely important – especially when processes, clearances and systems change. Commercial servicers must continually fight the battle that is required to safeguard the personal information of their customers, or suffer the prospect of damaging their reputation, incurring possible penalties, yielding the cost of counter-measures and experiencing other negative consequences.

There is still a long way to go to make commercial servicing more streamlined, efficient and cost-effective.

Final thoughts

While commercial servicers have made impressive strides with the wide deployment of Web services and other enabling technology, there is still a long way to go to make commercial servicing more streamlined, efficient and cost effective. As the industry continues to forge ahead with process improvements and with the adoption of MISMO standards, commercial servicers will make a quantum leap in their ability to move data and loans more efficiently, boost productivity and reduce operating costs.

Perseverance and innovation are both essential for commercial servicers to reach these important goals, but the commercial servicing professionals I know are certainly up to the task. In fact, they're tackling these challenges with very promising results. **MB**

Lori Eshoo is president and chief executive officer of National Tax Search LLC, Chicago. She can be reached at lori.Eshoo@nationaltaxsearch.com.