

# Structured Finance Servicer Evaluation

Commercial Finance  
Special Servicer

USA

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## Touchstone Asset Management LLC

### Opinion

<b>RANKING</b>
<b>Commercial Finance Special Servicer: AVERAGE</b>

The commercial finance special servicer ranking for Touchstone Asset Management LLC (TAM), a wholly owned subsidiary of Touchstone Partners LLC, is affirmed at AVERAGE.

Since 1999, TAM's niche has been managing and resolving small and moderate balance performing, nonperforming or underperforming commercial loans, commercial real estate loans, construction loans, bonds, and other types of commercial debt. The company has shifted from acquiring small balance loans toward acquiring somewhat larger loans, due in part to the increased demand for small-balance loans in the market. Accordingly, the company's portfolio includes both moderate and small-balance loans consisting of unsecured and secured loans whose collateral may include commercial and/or residential real estate or various business assets. Approximately 80% of the portfolio consists of loans secured by commercial real estate. TAM's principal flow of business corresponds to its role as the special servicer/asset manager for assets acquired through Touchstone Partners' series of related investment funds, known as the Touchstone Opportunity Funds, and for the fund's co-investors. Since inception, TAM has managed more than 3,600 commercial loans and has publicly issued bonds aggregating to approximately \$659 million in face value. As of June 30, 2007, TAM's portfolio comprised 603 assets totalling \$321 million.

TAM demonstrates a properly experienced management team, detailed and proactive asset recovery procedures, and an acceptable control environment, which includes a sound internal audit process, governing accounting, investor reporting, and asset management tasks. While the company does not have any asset-backed securities (ABS) reporting experience, it is experienced with detailed reporting to a private investor client. As of June 2006, TAM terminated its relationship with Deloitte & Touche. Through this relationship, Deloitte & Touche provided asset management and accounting services within TAM's Toronto office. TAM has subsequently closed its Toronto office and transferred asset management and accounting functions to the company headquarters. TAM maintains a suitable technology platform, revolving principally around the use of the McCracken Strategy commercial mortgage servicing system (formerly called EnableUS and owned by GMAC), which provides an acceptable level of processing efficiency for the company's specialized loan recovery work. A centralized application integrating TAM's general ledger, loan accounting, servicing, and database applications would further strengthen TAM's management and reporting abilities. TAM has acknowledged the need for such a system and is in the process of implementing one.

(continued)

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Also, TAM has implemented changes to its data storage and testing protocols in order to strengthen its disaster recovery and business continuity planning. TAM has also taken measures to strengthen its data storage and testing protocols.

Standard & Poor's realizes that TAM acquires many irregular asset types that may involve extended resolution and disposition times. The company's average hold period is approximately three-and-one-half years for nonperforming specially serviced assets. Standard & Poor's believes that the company's average asset hold times for loans and real estate are acceptable.

### OUTLOOK **STABLE**

The outlook is stable. Standard & Poor's expects TAM to continue performing its asset management duties for its existing investor clients in a fully competent manner. The company also manifests the necessary expertise and reporting capabilities to transition into special servicing for securitized ABS transactions involving similar types of assets as those it handles for its parent's investment funds.

**Table 1** Portfolio Volume And Asset Recovery Summary

End of period	06/30/07	12/31/06	12/31/05	12/31/04
Loan volume (\$)	<b>321,305,758</b>	314,871,666	290,392,823	296,827,939
Loan volume (No.)	<b>603</b>	692	836	985
Loan disposition (\$)	<b>44,512,696</b>	21,486,589	17,869,248	10,331,987
Loan dispositions (No.)	<b>57</b>	50	64	98
REO portfolio (\$)	<b>10,492,640</b>	5,526,340	6,075,656	1,484,821
REO portfolio (No.)	<b>3</b>	3	5	5
REO net sales Proceeds (\$)	<b>0</b>	74,061	162,014	2,024,486
REO sales (No.)	<b>0</b>	1	2	4
Net proceeds/value (%)	<b>0</b>	98.7	90.0	96.2
Total portfolio (\$)	<b>331,798,399</b>	320,398,006	296,468,479	298,312,760
Total portfolio (No.)	<b>606</b>	695	841	990
Average asset size (\$)	<b>547,522</b>	461,004	352,519	301,326

## Management And Organization

### RANKING **AVERAGE**

*The ranking of AVERAGE is affirmed for management and organization.*

The ranking for management and organization is based on:

- Organizational changes to improve asset management efficiencies;
- Solid staffing experience;

- A consistent and thorough internal audit function;
- Improved disaster recovery and business continuity plans, which still need to be tested; and
- An acceptable technology environment; however, it would benefit from a centralized application that integrates TAM's general ledger, loan accounting, servicing, and database applications.

### **Management depth, staffing, and training**

TAM has a five-person senior management team and an 11-person staff, four of which are direct employees of Touchstone Partners, for asset management and collateral administration functions. The company has restructured its core functions since Standard & Poor's last review and no longer uses consultants for systems management, tax accounting, and legal services. TAM hired a systems manager and appointed a dedicated compliance officer/tax accountant. In addition, TAM terminated its relationship with Deloitte & Touche, and has subsequently eliminated the accounting and asset management support positions within its Toronto office. TAM's senior management team has solid depth and industry experience. The staff displays an acceptable level of experience. Management and staff attributes include:

- The company's five senior managers average 24 years of industry experience and more than seven years' tenure with TAM;
- The head of the special servicing department has 29 years of industry experience;
- The three senior-most direct employee asset managers average 18 years of experience;
- The company continues to make progress in centralizing document and collateral tracking. While all documents have not been scanned, the company has begun storing electronic copies of collateral documents on the system as new loan pools are purchased;
- The company continues to combine loan administration with asset management; however, certain loan administration tasks have been taken away from asset managers so they can focus on collections;
- TAM has also improved asset management workload efficiency by further segregating duties so that a separate staff monitors performing or corrected loans; and
- The company has experienced minimal turnover of staff since its inception.

TAM provides an acceptable level of ongoing training for its staff. Training

activities and continuing education consists primarily of various online debt collection tutorials, and periodic training sessions conducted by third-party professionals and TAM senior managers. Policy manuals are also used in training and are available via electronic copy on the company's shared network. Based on its size, TAM is not yet at the point of justifying a dedicated training coordinator. However, the company noted that employees participate in an average of between one and three formal training each month. Given the varied nature of the assets the company services, TAM stresses the importance of FDCPA compliance as an integral part of the training regimen. While TAM's portfolio does not fall under the realm of the FDCPA, Standard & Poor's concurs that TAM's focus on the FDCPA helps foster a professional collection environment and mitigates overall liability risk with respect to customer contact.

### **Technology**

TAM operates within an adequate technology environment. The principal system used for cash management and general loan administration tasks is McCracken's Strategy system through an ASP relationship. However, Standard & Poor's believes the company would benefit from a centralized application that integrates its general ledger, loan accounting, servicing, and database applications. Such an integrated system, which other companies in the industry typically utilize for such purposes, could reduce TAM's dependence on independent spreadsheet applications and enable the company to improve data management and reporting efficiency. TAM acknowledges the potential of such an integrated system and is currently working with both internal staff and external consultants to develop one.

- TAM uses appropriate Web-based software to conduct online banking related to funds transfer, cash disbursements, and payment receipts; and
- The general ledger system provides adequate functionality. Since Standard & Poor's last review, the company has

upgraded to a more robust general ledger system to facilitate the company's accounting function; however, the new system is not directly interfaced with the loan-servicing system.

TAM's data back-up protocols and hot site locations have improved since Standard & Poor's last review. Recognizing certain deficiencies within its existing disaster recovery plan, TAM has taken additional steps to strengthen disaster recovery preparedness. Procedures for annual disaster recovery and business continuity testing are now in place.

- Data is now backed up daily, and backup tapes are sent off site on a weekly basis to a secure facility managed by a third-party vendor. Transferring the data on a daily basis would further improve data disaster recovery controls;
- Business recovery sites are more than 25 miles from primary data centers and the main servicing location;
- The disaster recovery plan includes calling trees; however, it does not provide staff assignments;
- The disaster recovery plan is reviewed at least annually and is modified as required;
- A compliance officer ensures that testing is conducted at least annually, and testing is observed by an outside party; and
- Target recoveries for investor reporting and remaining servicing functions are within 24 hours and 48 hours, respectively.

### Special Servicing Loan Administration

#### **RANKING** AVERAGE

*The ranking of AVERAGE is affirmed for special servicing loan administration.*

#### **Collections and loan recovery process**

TAM's operations for small balance commercial loans are similar to those of a residential or consumer loan servicing operation and follow guidelines established by the FDICPA. For moderate balance commercial loans, TAM follows commercial real estate and commercial business procedures in con-

#### **Internal controls**

- TAM has properly documented policies and procedures covering all core areas of its special servicing functions. All procedures are available online via a shared network drive;
- TAM maintains an acceptable internal audit function, which is performed by its principal investor client. The latest audit report, dated May 15, 2006, did cite a few servicing-oriented exceptions. These exceptions recommended improved check log procedures and related posting/reconciling controls, as well as formalized real estate tax tracking. The company has noted that the audit recommendations have since been cured; and
- TAM's external auditor, Grant Thornton, performs an annual audit of the company's financial statements in accordance with auditing standards established by the auditing standards board of the American Institute of Public Accountants. Accordingly, the audit includes tests of internal controls used for financial reporting. On April 30, 2006, the audit concluded that the company's audited financial statements and operating results fairly present its financial position as of Dec. 31, 2005.

#### **Additional items**

TAM represented that it has no outstanding material defensive lawsuits. The company provided evidence of satisfactory levels of corporate insurance coverage.

nection with its collections, workout, and approval processes. Forbearance plans, modifications, extensions, restructuring, consolidation, and foreclosure are some of the options the company uses in an effort to bring all loan resolutions to a successful close. TAM's operations are similar to those of a commercial bank's loan workout department; however, TAM distinguishes itself in that its workouts are central to its business model, and as such, are not limited to a department. Rather, they are taken on

by the entire organization. Overall, the company displays a properly controlled loan collection and foreclosure management processes.

- Account officers must follow set collection timelines consisting of letters and calls to borrowers;
- While account officers are responsible for determining collateral values and negotiating borrower payments, senior management controls the recovery decision-making process regarding acceptance of offers and tracking net present value recovery estimates;
- Approval delegations are properly controlled: If the recovery value is more than 90% of the net present value (NPV) estimate, a senior manager must approve the transaction. If the recovery value is less than 90% of the estimated NPV, two senior managers must approve the recommended asset resolution;
- During 2006, account officers averaged about 82 loans per person, the majority of which were nonperforming. Assets are typically assigned by collateral type to match account officer expertise;
- Performing and nonperforming loans are monitored for real estate taxes, and tax payments are advanced if the company determines that the collateral value warrants advancing;
- Approximately 50% of the portfolio consists of nonperforming assets. As of Dec. 31, 2006, these assets had an average hold period of five years. However, about half of these assets are deemed to have no collection potential. All collectible assets are monitored for real estate tax payments, and payments are advanced if collateral value warrants cost of advance;
- Given that about 50% of the portfolio is performing in some degree, TAM has reassigned these loans to a dedicated asset manager to improve efficiency;
- Upon boarding of a new portfolio, the company follows a proactive calling and letter issuance campaign in the first 30 days to establish borrower contact and procure promises to pay;
- Collectors are trained to follow a script

for initial borrower contact to emphasize reinstatement within 90 days or at least obtain a partial payment. Such activity is tracked through comments on the main servicing system;

- The special servicing manager also maintains accountability over a portfolio of assets that typically have higher balances and include complex assets. This is acceptable given that other account officers still handle any daily tasks on such assets;
- Periodically, the department head will reassign assets to balance workloads and ensure a fresh collection strategy if no progress has been made;
- Account officers must prepare and obtain management approval of a brief collection strategy documented via the comments fields on the servicing system. Asset values are captured within the text and overall recovery estimates are maintained through a separate system; and
- As noted, combining the asset action plan, valuation process, and rolling recovery projections within a single system would likely improve the company's reporting and performance tracking efficiency. A review of TAM's ongoing NPV and recovery projection procedures indicated a lengthy process using Microsoft Excel macros involving many manual steps.

#### **Legal and subcontractor management**

Overall, TAM's use of external law firms and other contractors is adequately controlled.

- Account officers choose law firms using TAM's approved counsel list and a standard engagement letter. For added efficiency, as the portfolio increases in size, TAM could centralize its legal engagement process;
- The servicing system properly tracks all legal expenses and other subcontractor payables. However, a centralized AM system could help track all legal case activity more efficiently;
- TAM uses approved lists for environmental audits and brokers, with the lists managed on a shared network drive;

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- TAM uses third party environmental consultants as needed; and
- Due to its size, it is not economically feasible for TAM to maintain its own in-house legal function. However, TAM is aware that as the portfolio grows in size an internal legal staff could offer additional support with asset recovery decisions and help control the law firm engagement process more effectively.

### REO management and dispositions

TAM demonstrates a proactive real estate owned (REO) management and sales process. The process begins in advance of taking title with pre- and post-foreclosure checklists to ensure that all key real estate management, accounting, and communication issues are covered. Given the nature of the real estate, which often involves special purpose and smaller properties in tertiary markets, eviction proceedings and cash-for-keys are frequent occurrences.

TAM's commercial REOs often include single-tenanted buildings, which obviates the need for a third-party management company. Instead, TAM is usually able to rely sufficiently on a listing broker. Frequently, TAM's REOs are vacant and require no monthly cash flow accounting. Despite the smaller size of many of the properties, TAM has gained experience managing, leasing, and selling a wide range of property types including restaurants, small retail, mixed-use facilities, warehouses, raw land, multifamily, senior housing, and miscellaneous business machinery and equipment.

- The assigned account officer must prepare an REO marketing and sales plan within 30 days of the REO acquisition date;
- The asset manager procures a real estate broker from TAM's approved vendor list,

or through referrals or interviews of prospective brokers (who are then registered to become approved vendors) to market the REO;

- Broker agreements are limited to 120 days and brokers must submit monthly status reports;
- Valuations are based usually on brokers' opinions of value that are refreshed every six months;
- Initial list prices, list price reductions, capital expenditures outside of the approved budget, and sales offers all require management approvals through TAM's delegated authority policies;
- Average REO hold time is reasonable at about 180 days, which includes eviction time; and
- TAM's net sale proceeds from the sale of its REO properties have averaged about 94% of the REO collateral value since 2004, which is quite good.

### Asset accounting and investor reporting

TAM coordinates all asset and portfolio-level accounting through dedicated staff based at its headquarters office. Job tasks, assignments, and written procedures denote an acceptable segregation of duties relating to handling payment receipts, investor remittances, and monthly investor reporting. TAM also has made certain adjustments to address an internal audit issues calling for improved procedures surrounding check log management, payment posting, and account reconciliation tasks.

TAM demonstrates a sound investor reporting function for monthly reporting to its parent and investment fund participants. However, the company does not yet have any experience with securitized portfolio reporting.

## Financial Position

### **RANKING SUFFICIENT**

*The financial position for TAM is deemed to be SUFFICIENT.*

This assessment is based on Standard & Poor's review of the audited financial statements of TAM and Touchstone Partners, its parent company.

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