

Servicer Evaluation: Superior Loan Servicing

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| Small balance commercial mortgage primary servicer | AVERAGE | AVERAGE | AVERAGE | Stable |
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| SUFFICIENT | | | | |

Rationale

S&P Global Ratings' ranking on Superior Loan Servicing is AVERAGE as a small balance commercial mortgage primary servicer. On April 17, 2023, we assigned the ranking (please see "Superior Loan Servicing AVERAGE Small Balance Commercial Mortgage Primary Servicer Ranking Assigned; Rnkg Outlook Stable," published April 17, 2023). The ranking outlook is stable.

Our ranking reflects SLS's:

- Investments in technology including its servicing system, call management system, and proprietary investor portal to support servicing operations;
- Learning management system that is used to facilitate and track required learning courses;
- Year-over-year growth of its servicing portfolio;
- Geographic concentration in its portfolio with properties primarily located in New York, California, and New Jersey;
- Limited internal control environment, which is not segregated from operations, relies on operational processes and quality control/compliance reviews, and has no internal audit program, but is mitigated somewhat by annual SOC-2 and uniform single attestation program (USAP) reports;
- Manual loan boarding process and limited connectivity between the core servicing application and the general ledger, which results in multiple manual reconciliations and data transfer processes; and
- Lack of asset administration processes such as property financial statement reviews, periodic property inspections outside of default, or Uniform Commercial Code (UCC) filing management, which are not required by its investors but are typically performed by small balance commercial servicers.

The ranking outlook is stable. SLS has support from its experienced senior leadership team and adequate systems and technology. The company continues to invest in systems automation and enhancements to further its scalability, which supports its growing servicing portfolio. We note that accelerated growth without commensurate investments in staff and a strong control environment increases risk. We believe SLS will remain a capable and effective servicer of business purpose loans. If SLS changes its product or portfolio mix without also implementing appropriate operational controls and processes, we could lower our ranking. This risk is heightened if the mix shifts toward longer term loans

or loans with delegated authority.

In addition to conducting a meeting with servicing management, our review includes current and historical Servicer Evaluation Analytical Methodology data through Dec. 31, 2022, as well as other supporting documentation provided by the company.

Profile

| Servicer Profile | |
|----------------------------|---------------------------|
| Servicer name | Superior Loan Servicing |
| Primary servicing location | Canoga Park, Calif. |
| Parent holding company | n/a |
| Servicer affiliates | n/a |
| Loan servicing system | The Mortgage Office (TMO) |

SLS was founded in 2009 to provide loan servicing for private lenders. It does not originate or purchase loans but rather provides third party servicing of business purpose loans to private lenders, brokers, institutions, and hedge funds. SLS's 49-person staff are in its Canoga Park, Calif. and Las Vegas offices and manage servicing assets of just under \$3.2 billion (see table 1).

Table 1

| Total Servicing Portfolio | | | | | | |
|---------------------------|---------------|----------------|--------------|----------------|--------------|----------------|
| | UPB (mil. \$) | YOY change (%) | No. of loans | YOY change (%) | No. of staff | YOY change (%) |
| Primary servicing | | | | | | |
| Dec. 31, 2022 | 3,169.3 | 41.8 | 7,524 | 25.9 | 49 | 22.5 |
| Dec. 31, 2021 | 2,235.3 | 38.8 | 5,974 | 26.8 | 40 | 21.2 |
| Dec. 31, 2020 | 1,610.8 | 5.0 | 4,710 | 0.4 | 33 | 22.2 |
| Dec. 31, 2019 | 1,533.5 | 51.5 | 4,692 | 39.3 | 27 | 8.0 |
| Dec. 31, 2018 | 1,012.5 | | 3,369 | | 25 | |

SLS's portfolio is predominantly comprised of short-term loans with terms between 12 and 48 months. The loans are primarily used as bridge loans and for financing property rehabilitation. A small portion, approximately 8%, of the portfolio includes non-consumer loans with terms between five and 30 years.

The portfolio under review is made up of single-family rental properties and has a high concentration geographically in three states (see table 2). SLS is in the process of expanding its licensing which they anticipate will mitigate the risk of geographic concentration going forward.

Table 2

| Portfolio By State | | | | |
|--------------------|---------------|---------|-------------------|----------------|
| | UPB (mil. \$) | UPB (%) | No. of properties | Properties (%) |
| State | | | | |
| NY | 650.7 | 20.5 | 1,415 | 14.5 |
| NJ | 604.4 | 19.1 | 1,851 | 19.0 |

Table 2

| Portfolio By State (cont.) | | | | |
|-----------------------------------|----------------------|----------------|--------------------------|-----------------------|
| | UPB (mil. \$) | UPB (%) | No. of properties | Properties (%) |
| CA | 598.5 | 18.9 | 1,375 | 14.1 |
| FL | 196.6 | 6.2 | 505 | 5.2 |
| TX | 156.8 | 5.9 | 501 | 5.1 |
| All other | 962.3 | 30.4 | 4,106 | 42.1 |
| Total | 3,169.3 | 100.0 | 9,753 | 100.0 |

Management And Organization

The management and organization subranking is AVERAGE for small balance commercial mortgage primary servicing.

Organizational structure, staff, and turnover

SLS has an executive management team with experience in private lending and servicing. The company founder and majority stockholder is the CEO. The minority owner is the COO. The director of servicing and human resources has extensive experience in mortgage servicing, originations, secondary marketing, and capital markets.

Reporting into the director of servicing is the vice president of servicing. In addition to the servicing operational departments, SLS's office of the president includes the compliance manager, who reports to the director of servicing. We typically view the reporting of compliance to operational leadership as a potential conflict of interest and consider the separation of compliance functions from operations as a best practice.

At seven, five, and two years the tenure of SLS's senior and middle management and staff is lower than we see with other servicers we rank. SLS does not track industry experience for management or staff. Total turnover of 19% was higher than peers though management believes changes to the benefit package will help reduce the higher turnover experienced in 2022.

Training

SLS does not have a separate training department which is not unusual for a servicer of its size. Instead, it uses a third party web-based platform to facilitate its core training courses which are supplemented by ad hoc training conducted by management. Required courses for the various job functions are managed and tracked through the platform. Knowledge checks are mandatory for some courses and are graded on a pass/fail basis. If an employee fails the knowledge check, they must retake the course. Cybersecurity and information security training is provided to all new hires and annually to all staff.

New hires meet with all department heads to understand the end-to-end loan lifecycle. For the first 30 days of employment, new employees check-in weekly with managers who provide feedback on their progress with the onboarding and training process. SLS' target training hours per employee per year of 20 is less than we see targeted by peers.

Systems and technology

SLS's chief information security officer, who also acts as its chief technology officer, joined the company in early 2022. A managed service provider handles the company's computer maintenance, cloud computing, and IT resources.

SLS performs an annual IT risk assessment where risks are identified, rated based on likelihood and consequence, and mitigation strategies are developed.

We believe SLS has effective technology to meet its primary servicing requirements and adequate data backup routines and disaster recovery preparedness are in place. Systems and tools to address information security risks are maintained.

Servicing system applications

Key technology applications include the following:

- The Mortgage Office, a cloud-based loan servicing platform;
- GoTo call center application;
- Metasource for document management and workflow; and
- LoanLinq a secure web portal used by clients to access their loan portfolio, submit loans, and view reports and documents.

SLS launched an initiative to transition to a different servicing system, McCracken Strategy, with a planned rollout by the end of 2023. The management team anticipates increased scalability and more granular data analytics from the new system.

Business continuity (BC) and disaster recovery (DR)

The business continuity plan relies on the ability to remotely access all systems. In the event one or both SLS offices are unavailable, employees can log into an Azure cloud environment via virtual private network to access the systems via a virtual desktop.

We considered the following features of SLS's BC and DR plans:

- Backups are hosted on a Datto server at the Los Angeles office and on the Datto Cloud.
- Full and incremental backups, which are synched to the cloud, are performed multiple times a day.
- Backups are stored in the Azure Cloud.
- Target recovery time for the servicing system is 24 hours.
- DR testing is performed annually with the most recently completed test performed Oct. 12, 2022. SLS indicated no material issues were identified.

Cybersecurity

We believe the company has a well-developed system to detect and respond to information security threats. SLS uses a vendor to perform penetration testing annually. The last test was performed between Sept. 14 and Sept. 16, 2022,

with no material exceptions noted. Furthermore:

- SLS maintains a formal incident response plan.
- A NIST information security program ensures best practices are followed.
- A managed service provider performs network monitoring and audits.
- There is endpoint protection on all devices.
- SLS performs quarterly phishing simulation exercises and training.
- SLS maintains a cyber insurance policy.

Internal controls

SLS relies on in-line business process reviews, QC/compliance reviews, and third party SOC and USAP reports as its risk management program. It does not have an internal audit program which we would typically see at larger or higher ranked servicers. Its portfolio is comprised of business purpose loans that, along with the annual SOC and USAP attestation, mitigate some risk associated with not having internal audits performed.

Policies and procedures

SLS maintains policies and procedures manuals (P&Ps), which are in a consistent and detailed format. Changes and updates are prompted at a department level and submitted to compliance for update. If a change is deemed material by compliance, it is sent to the senior management committee for review. There is no policy around the periodic review of P&P's and while all final updates are made by compliance, the processes surrounding the updates and maintenance of them are less formalized than those we see with other servicers.

Quality assurance (QA)

The first line of defense is comprised of limited quality monitoring measures within some of the servicing business units although SLS uses a vendor to review 100% of loan boarding.

The customer service manager performs call monitoring daily, typically reviewing and assessing five to seven calls per agent per day. A checklist is used to document whether items were followed during the call. All incoming and outgoing calls from the call center phone system are recorded. The system has functionality to flag calls based on the tone of the conversation. These calls are also reviewed with the staff.

Compliance and quality control

SLS's QC/compliance manager and the QC/compliance officer report to the director of servicing, which we consider a conflict of interest. Transactional testing is completed to monitor compliance with regulatory, investor, and SLS P&P requirements. Features of the review and testing process include:

- There is an annual schedule with testing areas covered once during the year.
- While there is not a formal risk rating process, areas considered to be higher risk are prioritized;
- A 10% random sample pulled from monthly quality control reports is used for testing;

- The QC reports, which outline the preparatory process, the review process, and the findings, are distributed to the director and VP of servicing along with the business unit manager but not to independent control groups or senior management; and
- Any findings require the business units to submit proof of correction to QC/compliance and subsequent reports are issued to show the corrective action status.

Internal and external audits

SLS does not have an internal audit group nor does it engage an outside firm to perform internal audits. They engage an external vendor to perform a System and Organization Controls (SOC) 1 Type 2 assessment and complete a USAP examination. The most recent published reports covered the period from Feb. 1, 2021 through Jan. 31, 2022. There were no exceptions noted in the SOC1 and no areas of non-compliance in the USAP report.

Vendor management

SLS does not have a centralized vendor management group, which we see at comparably sized servicers. Management will identify options for new vendors and solicit feedback from other industry parties prior to engagement. A vendor assessment questionnaire focused on information and cybersecurity controls is required of new vendors. Generally, meetings are held with vendors monthly or bi-weekly to review performance and the current pipeline. Performance metrics are based on contract and statement of work requirements.

Insurance and legal proceedings

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

Loan Administration

The loan administration subranking is AVERAGE for small balance commercial mortgage primary servicing.

SLS's portfolio loan count has increased by almost 60% since December 2020 (see table 4). The portfolio is comprised predominantly of newly originated private money investor loans secured by single family rental properties (see table 2).

Table 3

| Primary Servicing Portfolio | | | | | | | | | |
|-----------------------------|------------|---------------|---------------|----------------------------|----------------------------|---------------------------|-----------------------|-----------------|----------------|
| | Loan count | UPB (\$ Mil.) | Avg loan size | 30-59 days delinquency (%) | 60-89 days delinquency (%) | 90 days + delinquency (%) | Total delinquency (%) | Foreclosure (%) | Bankruptcy (%) |
| Dec. 31, 2022 | 7,524 | 3,169.3 | 421,222 | 1.98 | 1.15 | 5.77 | 8.90 | 3.20 | 0.70 |
| Dec. 31, 2021 | 5,974 | 2,235.4 | 374,179 | 2.52 | 0.83 | 4.64 | 7.99 | 0.24 | 0.18 |
| Dec. 31, 2020 | 4,710 | 1,610.8 | 342,002 | 2.02 | 1.74 | 6.27 | 10.03 | 2.40 | 1.81 |

Table 3

| Primary Servicing Portfolio (cont.) | | | | | | | | | |
|-------------------------------------|------------|---------------|---------------|----------------------------|----------------------------|---------------------------|-----------------------|-----------------|----------------|
| | Loan count | UPB (\$ Mil.) | Avg loan size | 30-59 days delinquency (%) | 60-89 days delinquency (%) | 90 days + delinquency (%) | Total delinquency (%) | Foreclosure (%) | Bankruptcy (%) |
| Dec. 31, 2019 | 4,692 | 1,533.5 | 326,837 | 1.93 | 1.18 | 6.28 | 9.39 | 3.85 | 1.57 |
| Dec. 31, 2018 | 3,408 | 1,017.5 | 298,574 | 1.85 | 1.31 | 4.83 | 7.99 | 3.37 | 1.04 |

UPB- Unpaid principal balance.

New-loan boarding

SLS boards loans manually to their system. While we understand that the company was originally started to service loans for private lenders where the origination automation may not be as robust, the manual entry of loan information is a risk due to the potential for data input errors and the lack of scalability. SLS uses a vendor to perform a data to document review for 100% of the loans boarded with SLS QC/compliance reviewing 10%. This post board review mitigates some risk within the loan boarding process.

The bulk of loans boarded to the SLS system for servicing are newly originated, although SLS has limited experience boarding seasoned loans. SLS boarded just over 3,200 loans during the second half of 2022.

Payment processing

SLS processes all payments internally by four staff members who are part of the trust accounting team. Highlights of payment processing include that:

- The electronic payment capture rate is 87.48% including lockbox and Automated Clearing House payments.
- Bank accounts are reconciled daily.
- Payments returned for non-sufficient funds are processed daily.
- Unprocessed checks are kept in a fireproof lockbox.
- There were minimal items in suspense.
- A utility is used to pull in daily indices for rate and payment changes on adjustable rate mortgages. The updated indices and loan level rate changes are audited by a manager.
- They have minimal exposure to Libor based loans with systems capable of handling index changes.

Investor reporting

Similar to payment processing, investor reporting has four staff members and is part of the trust accounting team. Investors have access to their reports, including customized reports created by SLS, through the SLS portal.

Other highlights include the following:

- The servicer has 100% electronic reporting and a 92% electronic remitting rate to investors.
- Remittances are made daily and remittance reports are reviewed and approved by a manager.

- Custodial accounts are reconciled daily.
- There were no aged unidentified items in custodial accounts.

Escrow administration

The percentage of the loans in the SLS portfolio where taxes and insurance are escrowed is low at approximately 5%, primarily due to the short-term loan maturities. Nevertheless, it has two dedicated escrow personnel and a vendor monitoring the portfolio for tax payment status. Highlights and controls of the process include the following:

- The servicing system provides tracking for escrowed and non-escrowed tax and insurance items;
- The tax vendor remits payments to the taxing authority in addition to monitoring property tax status;
- SLS performs the escrow analysis and produces the notices for the borrowers;
- For loans with delinquent taxes, the investor determines if it wants to advance payment;
- SLS does not track the amount of tax penalties incurred due to the low percentage of loans escrowed;
- SLS sends notices 30 days in advance of insurance expiration via email or regular mail;
- A vendor is used to force place insurance but they do not provide tracking services; and
- Loss drafts are managed by SLS.

Asset and portfolio administration

SLS does not conduct some of the typical commercial mortgage loan monitoring we see with other servicers, including property financial statement reviews, periodic property inspections outside of default, or UCC filing management because they are not required by their investors. SLS also does not manage or perform oversight for any construction associated with the rehabilitation loans, which is managed by the lender who then requests reserve draws from SLS rather than those requests coming directly from the borrower. With the types of loans SLS services we do not currently see the lack of asset administration processes as a risk but with a change to the composition of the portfolio, including longer term loans and loans with delegated authority, the risk level could change.

Customer care/borrower requests

SLS has a combined customer service and early stage collection team headed by two managers. Call center software was implemented in 2022 and is used for workforce management, call retrieval, and reporting. SLS's telephone technology also has callback functionality, an IVR, and the ability for borrowers to make payments by phone.

In addition to incoming calls, customer service is responsible for:

- Handling incoming mail;
- Managing a general email box by acknowledging receipt of the email and forwarding it to the appropriate person for handling; and
- Creating and mailing balloon notices for loans nearing maturity.

Early-stage collections

SLS's customer service team is responsible for managing early-stage collections. Outbound calls are made after a loan becomes 30-days delinquent. Processes and metrics relating to collections include the following:

- Late notices are sent on the 15th, 30th, and 43rd days of delinquency.
- A delinquent loan report identifies accounts for collection.
- A minimum of three call attempts, made at different times to all non-work numbers listed on the account, is made until the borrower is reached.
- An email is sent to the borrower after each call.
- Upon borrower contact, agents determine if the borrower is able to pay, in which case a promise is taken and noted in the servicing system, or they need financial assistance where a financial assistance application will be emailed to them.
- Delinquency rates for its 30-day bucket are better than averages of peers.

Financial Position

The financial position is SUFFICIENT.

Related Research

- Superior Loan Servicing AVERAGE Small Balance Commercial Mortgage Primary Servicer Ranking Assigned; Rnkg Outlook Stable, April 17, 2023
- Servicer Category Descriptions Expanded and Revised, Feb. 28, 2022
- Select Servicer List, Feb. 14, 2023
- Servicer Evaluation Spotlight Report™: Environmental, Social, And Governance Factors Have Consistently Powered Our Servicer Evaluation Rankings, Nov. 16, 2020
- Analytical Approach: Global Servicer Evaluations Rankings, Jan. 7, 2019

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