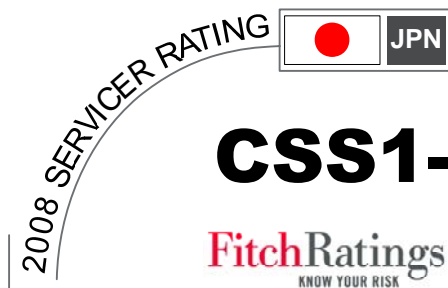


CMBS/Japan
Servicer Report

Capital Servicing Co., Ltd.



Rating
Special Servicer CSS1- (JPN)^a
^a Japan

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■ Summary

Fitch Ratings has upgraded the commercial mortgage special servicer rating of Capital Servicing Co., Ltd. (CSC) to 'CSS1-(JPN)' from 'CSS2+(JPN)'. The upgrade reflects the company's flexible and well-integrated asset management system, and well-established comprehensive risk management infrastructure. The rating also takes into account CSC's stable and experienced asset managers as well as its solid collection performance.

CSC received a servicer license, issued by the Ministry of Justice, in September 1999 and started its servicing operation in December 1999 for collateralised loans. Since then, the company has serviced approximately 6,200 loans, the unpaid principal balance of which amounted to JPY3,640bn as at July 2007. In recent years, the company has also been actively pursuing opportunities to act as the primary servicer for many CMBS and RMBS securitised loan assets.

CSC is one of the Capital Services Group (CSG) companies. On 31st March 2007 One Chome LLC (One Chome) acquired a 90% share of Capital Services Holding Corporation (CSHC) from TriMont and as a result, One Chome became the sole owner of CSHC which is the parent of ten of the Capital Services Group companies throughout Asia, including CSC.

CSG had 126 employees in its Japan operations as of June 2007, an increase of 12 from the last review. Of the 126 employees, 53 are specifically identified as CSC staff.

■ Rating Highlights

Strengths

- Flexible and well-integrated IT system (SCORE).
- Comprehensive, company wide risk management infrastructure.
- Highly experienced and stable asset managers.
- Well designed and managed training programmes.
- Solid collection performance.

Concerns

- Relatively high turn over of department managers.
- Maintaining a satisfactory business volume and asset diversification in a highly competitive market.

Mitigating Factors

- Stable senior management and new managers have long industry experience.
- Long-standing partnership with Lehman Brothers which has an extensive business network in Japan.

■ Company Overview

CSC was licensed by the Ministry of Justice (“MoJ”), Japan in September 1999, as the country’s 23rd servicer, and commenced servicing operations in December that year. On 31st March 2007 One Chome LLC (One Chome) acquired a 90% share of CSHC from TriMont (Fitch servicer ratings of ‘CSS2’ and ‘CPS2’) and as a result, One Chome became the sole owner of CSHC. CSHC is the parent of ten Capital Group companies throughout Asia. CSC is the largest subsidiary of CSHC which conducts real estate and servicing businesses.

In August 2003, the Japanese operations of CSG were reorganised into three entities: CSC, Capital Realty Inc. (CRI), and Global Commercial Real Estate (Japan) Inc. (GCRE). CRI manages real estate, while GCRE deals with due diligence, IT, underwriting and the group’s administration.

CSC has maintained a strong vendor-client relationship with Lehman Brothers, mainly servicing the non-performing and performing loan investments of Lehman Brothers. This arrangement currently contributes 75% of CSC’s revenue. However, the servicer has indicated that it is working to diversify its client base.

CSG has continued to improve its internal organization in order to accomplish its new business initiatives, specifically an increased emphasis on RMBS primary servicing, and to improve its internal control functions. Since the last review year, CSG has introduced the following new internal functions:

- Internal Audit
- Legal
- Sales & Marketing

■ Financial Overview

CSC’s financial performance continues to grow. For the year ended December 2006, the servicer reported significant increases in total revenue (consisting of servicing and management fees) and net income over the previous year. Fitch is of the opinion that CSC has sufficient financial resources to fulfil the needs of its servicing operations. CSC had been financially consolidated with Lehman Brothers since September 2005, but was de-consolidated at the end of May 2007.

Portfolio Statistics (For NPL Only)

From inception to July 2007

| Total loans serviced ^a | |
|-----------------------------------|-------------------------------|
| (JPYm in UPB) | No. of borrowers ^a |
| 3,645,047 | 6,286 |

Disposal amount (JPYm)

| From inception to July 2007 | Annual figure in 2006 |
|-----------------------------|-----------------------|
| 251,074 | 40,931 |

Types of resolution by disposal amount, left) Inception to July 2007^a, right) Jan–July 2007^a (%)

| | | |
|-----------------|------|------|
| Voluntary sales | 38.3 | 12.6 |
| Foreclosure | 14.6 | 5.2 |
| DPO | 12.7 | 19.9 |
| Loan-sold | 20.9 | 39.6 |
| REO | 2.1 | 1.3 |
| Other | 11.4 | 21.4 |

^a "High Yield Assets" are not included
Source: Capital Servicing Co., Ltd.

■ Staffing and Training

As of June 2007, CSG employed 126 employees in Japan representing an increase of 12 from the last review. Staff distribution was as follows:

CSG Organisation

| | |
|--------------------------------------|---------------|
| CSC | 53(38) |
| Management | 2(2) |
| Asset management (special servicing) | 21(15) |
| Loan administration | 30(21) |
| GCRE | 64(63) |
| IT | 17(19) |
| Finance | 12(12) |
| Corporate administration | 9(8) |
| Investor reporting | 8(7) |
| Others | 18(17) |
| CRI | 9(13) |

Source: Capital Servicing Co. Ltd.

The increase in staff of CSC is mainly in the area of Loan Administration (primary servicing) and in the Osaka based Asset Managers, where CSC opened a new office in February 2007.

CSC’s top executives, including the president, have, on average, 25 years’ relevant industry experience and over five year’s tenure with the group companies. There are eleven departments in CSG of which two (Internal Audit and Legal) are newly established. Since the last review three staff members have left the company. Two of these vacated positions were filled with experienced new hires, and the other was filled by a promotion from within the group. Fitch has observed no negative effects from these changes, but will continue to monitor the situation. On the other hand, CSC employs highly experienced asset managers whose working experience in the industry

averages 25 years and NPL workout experience of 12 years on average. There have been no asset manager departures in three years.

CSG offers well-designed and managed training programmes to its employees and targets employees to have 40 hours (20 hours for exempt employees) of training per year. Each department manager will assist individual staff to determine their training plan, including job knowledge and skill and assist the employee to achieve the target. The HR Department organizes internal and external training programmes, which includes focusing on upgrading the knowledge and skill of an employee's specific job and servicing system expertise, English and compliance. Each employee must choose and apply for courses based on the department's plan. As a result, most of the departments achieved their target of an average of 40.1 hours in 2006 and 40.8 in 2005. Training for asset managers is in excess of the company's annual average hours, as CSG believes constant updating is necessary in order to adapt to market and regulatory changes.

CSG has continued its commitment to summer intern programmes to U.S. and Japanese universities, and some graduates are hired and promoted to key positions. It also applies a self-nominated intra company transfer system. All these initiatives are believed to have resulted in a lowering of turnover.

CSG has recently experienced a substantial increase in the number of staff, mainly in the loan administration, IT, compliance, and internal control areas. As a result, CSG's average employee's tenure became relatively shorter and the agency will monitor the potential effect. However, the stable top management and comprehensive and appropriate training programmes should facilitate effective assimilation of new employees.

■ Procedures and Controls

Since the last review, CSG has further enhanced its internal control function by hiring an Internal Audit Director and Legal Manager and increasing staff in the Compliance Department. In Sept. 2005, to establish a company-level control framework, CSG established a Risk Management Committee (RMC). Meetings are held on a monthly basis to discuss the assessment of risk to promote responsible business practices and strong corporate governance. The committee is composed of 12 senior and middle management members, including the managers of Compliance, Internal Audit, Operations, Asset Management, and others.

Based on the COSO model, from 2005 to 2006, the RMC conducted a risk assessment, utilizing its

control-matrix, to identify, prioritize, analyze and initiate mitigation strategies for risks that could potentially have a significant adverse impact on the operations of CSG. Based on this framework, CSG has been conducting a comprehensive revision of its policy and procedure (P&P) manuals since summer 2006. This initiative is intended to add to and update the basic policy, changes in procedure, expansion of business (primary servicing) and reviews by the new Loan Administration manager. The revision has been completed in most areas, including asset management, loan administration, finance, IT, HR and compliance.

CSG's policy is to review P&Ps annually or more often, if necessary. The Director of Compliance is responsible for training and giving instruction to employees when the related laws are changed. Manuals are available online to all staff. With timely updates, Fitch believes CSG's P&Ps are comprehensive and appropriate.

Fitch views CSG as having one of the most advanced company-wide risk management infrastructures among servicers by its timely efforts to strengthen its risk management platform in order to accommodate the various regulatory and market changes.

Internal Audit

Since the hiring of a Director of Internal Audit, internal audits have been held quarterly for each CSHC group company based on the result of the RMC's risk assessment. The audits are focused on company-level control framework, client and corporate operations and fraud risk mitigation. Any control deficiencies identified by internal audits are remedied as soon as possible and no later than the next audit.

Fitch believes CSG's internal audit to be effective and based on a well structured group risk control system and, based on the focus of the company, expects that CSG will continue to expand its group internal audit coverage.

External Audit

Lehman Brothers and a leading auditing firm conducted an audit in November 2006 but did not find any irregularities. No other external audits were conducted since Fitch's last review.

Statutory Audit

One of Japan's leading auditors performs annual audits for CSC. No irregularities were found in the audited financial statement as of 31 December 2006.

Inspection by the Ministry of Justice

The third MOJ inspection was carried out in January 2007. Three minor irregularities were found and remedied.

■ Technology

Since 2003, CSC has utilized a self-developed asset management system, the Servicing Company Operating and Reporting Engine (SCORE). Fitch observes SCORE to be a highly integrated and versatile tool and that it is one of the most advanced IT systems among servicers in the market.

The SCORE system handles loans, obligors, guarantors, collateral and hard assets, as well as information on negotiations etc, with obligors and court records. Additionally, SCORE functions well when preparing reports to the MOJ and others. The system is also useful in selecting loans requiring legal procedures and managing due dates efficiently through the use of a Watch List. Above all, SCORE is valued for its flexibility, which allows availability to a combination of data to prepare various reports that meet the requirements of investors, the management and its regulator.

The first release of the system was completed in 2003 as a non-performing loan management system and, in response to increasing performing loans a performing loan management function was developed and added in 2005. SCORE is also equipped with the capability to function in a multi-lingual, multi-currency environment for use not only Japan but in each CSG company and many countries around the world.

One of the distinctive functions of SCORE is integrating master, primary, and special servicing functionality into one system using the Internet. Since the last review, new software has been added to enhance reporting and special servicing functions, such as balance adjustments, surveillance and management reports and watch list modules were implemented. CSC has indicated it hopes to significantly improve its service to investors by the use of this highly sophisticated system. CSC believes that SCORE is considered by many in the IT field to be cutting-edge technology and has been licensed to third parties since early 2007. CSC has indicated that it intends to promote this licensing business further.

The security of SCORE is protected by limiting access to information or areas of the system, with Management determining access levels for individual users. CSG's systems security provisions satisfy the requirements of the SOX Act.

Currently, the system's capacity appears sufficient since the servers' usage rate is at 40% to 60%. As indicated in the previous review, each server is backed up daily onto tapes, which are then stored at the data centre and carried to a store-room in the suburbs of Tokyo twice weekly. In addition, data is replicated daily to the company's Osaka disaster recovery center for further security.

The Osaka office of CSC is used as an alternative for any contingency. It is equipped with 30 intranet PCs and IP telephone lines and is connected to the company's Tokyo office and data centre through a VPN link. CSC completed a disaster recovery drill, as planned, in November 2007, following relocation of the Osaka office in October.

The IT section of GCRE is responsible for the maintenance of the company's systems. The IT department consists of a department head, with over 30 years of professional experience, and 17 staff with ten years of industry experience. Of these, five are engaged in application development and work closely with external vendors. CSC has a maintenance agreement with an outside systems company.

The IT staff of GCRE is experienced and effective disaster recovery plans are in place. Fitch recognizes that SCORE is designed to provide global investors with highly reliable services and CSC has continued to enhance its efficiency.

■ Special Servicing

Loan Administration

The loan setup process, cash management and reporting at CSC have not changed since the last review. Fitch continues to consider it efficient and supported by SCORE.

The loan setup process is automated and procedures are clearly explained in the company's manuals. When the servicer receives all the necessary data on newly assigned loans from an entrustor, the data are re-formatted using a standard template and uploaded into SCORE.

The information on borrower repayment is obtained on a daily basis from the bank where it has been deposited. The Asset Management Department receives the printed repayment record several times a day from the Finance Department. The next business day, repayment information is uploaded into SCORE by the Finance Department and an asset manager is responsible for confirming the collection amount in SCORE.

The upgrade of SCORE significantly improved CSC's ability to service securitizations, including investor reporting. The application automatically calculates cash flow distributions and monitors the compliance of covenants stipulated by the securitization agreement. Furthermore, the application is able to generate customized investor reports and investors have access to portfolio performance data on a real time basis.

For the collateralized property management, when the entrusted collateral properties are worth in excess of JPY500 million the asset manager visits the site and completes a property inspection report which is attached to the original business plan. For larger collateralized property, an annual inspection and update of the property inspection report is conducted by the asset manager.

Special Servicing

From inception to July 2007, CSC has serviced non-performing commercial mortgage loans with a cumulative UPB of JPY3,645bn, on 6,286 borrowers, and had collected JPY251bn. While the amount of NPL outstanding (in terms of UPB) has fluctuated over the years because of secondary sales, the annually collected amount has increased steadily.

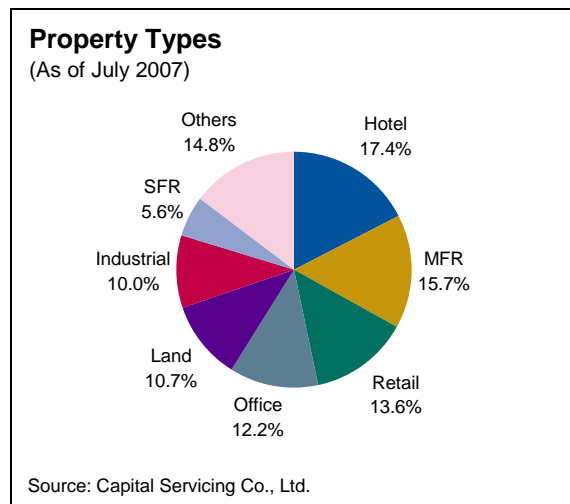
All servicing portfolios are entrusted to CSC by securitizing trusts, Lehman Brothers or other investors. Prior to 2002, NPLs accounted for almost 100% of the commercial mortgage loans. However, performing loans have gradually increased. At FYE 2006, the percentage of non-performing commercial mortgage loans was only approximately 18% of the total mortgage portfolio. It should be noted that CSC's performance on primary loan servicing is outside the scope of this rating and report.

In the opinion of Fitch the company operates a highly efficient special servicing operation and, since inception, has consistently met the NPL collection targets imposed by its entrustor. Fitch believes the collection performance of CSC is equal to or better when compared to other peer players. This strong performance is attributed mainly to its highly experienced asset managers, with an average of 12 years of NPL workout experience, an extensive network of disposition channels, and carefully constructed business plans.

There have been only minor changes to the mix of NPLs serviced by CSC since the last review. The percentage of retail declined to 13.6% of the total from 20.4%, whereas that of industrial increased to 10% from 5.9% and land to 10.7% from 6.7%.

On the other hand, as for the pattern of NPL resolutions at CSC (Portfolio statistics table on page

2), the percentage of voluntary sales and foreclosure has recently declined and loan-sales have increased. This reflects, backed by the current CRE market rise after the cash-flow collection and disposition of collateral, that there are increasing cases of final resolution by sale of loans. However, Fitch determined that there has been no material change in CSC's resolution policy which is that voluntary sale always takes priority in negotiations.



The volume of so-called sub-performing loans (SPLs), defaulted loans for which borrowers are still able to make partial payment, is clearly on the increase, with approximately 25 % UPB of outstanding as of July 2007. However, approximately 90% of NPL investment in 2006 was categorized as sub-performing.

CSC maintains a two-tier approach to its business plan depending on the level of the target collection amount:

- Tier 1 Assets: Assets with a Target Amount above JPY100mln: Each individual asset requires a resolution plan to be completed within 120 days of receipt of the underwriting package. The business plan is reviewed annually or as necessary.
- Tier 2 Assets: Assets with a Target Amount below JPY10mln: These assets are grouped by portfolio and each group is assigned a business plan within 120 days of receipt of the underwriting package. The business plan is reviewed annually, or as necessary.

As of July 2007, each asset manager is responsible for, on average, 95 assets, an increase of 30 compared with the last review. Although SPL assets, which cannot be resolved in a short time, are increasing, CSC transfers these assets when

substantial collections are made to a special team to maintain efficient collections, with SCORE providing sufficient support. As a result, Fitch considers the asset managers' workloads are manageable.

CSC has only used REO sales as a measure of loss mitigation infrequently. In 2006, proceeds from REO disposition amounted to only 2.9% of total resolution. As of July 2007, CSG has no outstanding REO's.

CSC expects to aggressively continue its work in the area of securitizations. CSC is a leading participant in the CMBS market in Japan and since November 2002, has participated in the issuance of 23 CMBS/RMBS including five with the Resolution and Collection Corporation. CSC services all of these issues as the special servicer as well as primary or master servicer. Fitch views favourably CSC's extensive experience in securitization.

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