

Structured Finance Servicer Evaluation

November 2003

Capital Servicing Co., Ltd. Special Servicer

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Ranking:
ABOVE AVERAGE

Capital Servicing Co., Ltd. (CSC) has been assigned the ranking of ABOVE AVERAGE as a commercial loan special servicer.

The ranking is mainly based on the following:

- Solid servicing track record;
- A management team and staff with strong experience in the servicing business;
- A low staff turnover rate;
- Well drafted policies and procedures;
- An excellent computer system that boosts operational efficiency;
- Appropriate internal auditing;
- Satisfactory internal training programs;
- A sound backup data system; and
- An appropriately designed disaster recovery plan, and the execution of a system recovery test.

Outlook: **STABLE**

CSC's primary business is to provide special servicing to Lehman Brothers Japan Inc.'s (Lehman Brothers) NPL and real estate portfolios. CSC has been steadily building up its servicing volume, including REOs, since it commenced operations in December 1999. The company has also acted as the master and special servicer for two Lehman Brothers-arranged apartment loan securitization transactions. Standard & Poor's believes CSC will maintain its strong relationship with Lehman Brothers and continue to develop its special servicing business in Japan.

Performance data:

CSC's yearly figures for servicing volume are described in the table below.

Company Profile

CSC was established in September 1998. The company was licensed by Japan's Ministry of Justice as the 23rd servicer in Japan a year later, and was allowed to conduct servicing operations as regulated under Japan's Law Concerning Special Measures for Servicing Business (Servicer Law), which came into effect in February 1999. In December 1999, the company actually commenced its special servicing business.

Capital Services Holding Corp., which is 90% owned by TriMont Real Estate Advisors, Inc. (formerly Hatfield Philips, Inc.), maintains a 75% share of CSC, while a private company owned by a CSC director holds a 25% share. Standard & Poor's has assigned a ranking of Above Average to TriMont as a special servicer. TriMont has an exclusive relationship with Lehman Brothers Holdings for the management of Lehman Brothers' U.S. real estate assets.

CSC is led by Mr. Carl Everett, Representative Director. With two other executive board members, the company employed 52 staff as of June 2003, up from 36 in November 2002 and 24 in August 2001. Of the staff members, 16 are in

| | Jul 2003 | Feb 2003 | Nov 2002 | Nov 2001 | Nov 2000 |
|---|-----------|----------|-----------|----------|----------|
| Receivable amount (face value/ ¥ mil.) | 1,127,544 | 977,243 | 1,035,205 | 946,524 | 867,168 |
| Number of properties | 3,186 | 2,929 | 2,966 | 2,731 | 1,156 |
| <i>Collection proceeds (¥ mil.)</i> | | | | | |
| (1) | 25,887 | 11,101 | 12,322 | 15,945 | 12,718 |
| (2) | 25,766 | 11,187 | 9,953 | 11,863 | 11,480 |
| Number of assets resolved (2) | 396 | 77 | 345 | 389 | 208 |
| <i>Auctions (Keibai)</i> | | | | | |
| Collection proceeds (¥ mil.) | 2,026 | 262 | 3,372 | 5,762 | 6,952 |
| # of properties disposed of | 86 | 18 | 146 | 173 | 121 |
| <i>Voluntary sales</i> | | | | | |
| Collection proceeds (¥ mil.) | 3,454 | 630 | 3,421 | 3,699 | 1,638 |
| # of properties disposed of | 86 | 28 | 73 | 80 | 23 |
| <i>DPO</i> | | | | | |
| Collection proceeds (¥ mil.) | 1,456 | 189 | 1,466 | 1,968 | 2,415 |
| # of properties disposed of | 90 | 18 | 59 | 79 | 28 |
| <i>Loan sale</i> | | | | | |
| Collection proceeds (¥ mil.) | 17,518 | 10,037 | 401 | 70 | 2 |
| # of properties disposed of | 107 | 7 | 8 | 4 | 1 |
| <i>Others</i> | | | | | |
| Collection proceeds (¥ mil.) | 1,312 | 69 | 1,294 | 365 | 474 |
| # of properties disposed of | 27 | 6 | 59 | 53 | 35 |
| <i>REO</i> | | | | | |
| Receivable amount (Mark Price/ ¥ mil.) | 654 | 654 | 654 | 1,086 | 1,077 |
| Number of properties | 3 | 3 | 3 | 4 | 3 |
| <i>Collections</i> | | | | | |
| Market price ① | - | - | 702 | 761 | |
| Sales price ② | - | - | 740 | 885 | |
| ②/① | - | - | 105% | 116% | |
| Number of properties disposed | 0 | 0 | 3 | 1 | |
| (1) Total collections include partial/incomplete resolutions. | | | | | |
| (2) Assets with final resolutions in referenced time frame. | | | | | |

Asset Management, eight in Finance and Accounting, seven in Loan Administration, seven in IT, seven in Office Administration, five in Real Estate and REO, and two in Legal.

As a Special Servicer, CSC manages and collects distressed real estate-backed loans and unsecured loans. As of February 2003, the company had collected a total of approximately ¥52.1 billion by resolving 1,019 assets, and approximately ¥3.27 billion from unsecured loans. The company has disposed of four properties through REO.

Management and Organization

Ranking: ABOVE AVERAGE

Management and staff experience.

CSC's management and staff have extensive experience in servicing operations.

There are three executives in the company. Mr. Carl Everett, Representative Director has 25 years experience in commercial real estate (RE) lending and development, and 13 years in NPL workouts. Mr. Glenn Grossman, the CFO, has 16 years industry experience and 11 years in NPL servicing experience. Ms. Takako Ohtsuka, the company attorney, has 25 years experience.

The Asset Management division is led by Mr. Taiei Sato, who has 23 years industry experience, including nine years in NPL workouts. This division has 16 members.

- Eight senior asset managers have on average 21 years industry experience, including eight years in NPL workouts.
- Two asset managers have an average of 12 years industry experience, including three years in NPL workouts.
- Two valuation associates with five years of industry experience, and four asset management assistants provide support in this division.

There are four REO asset managers in the REO/RE division, with an average of 11 years in RE-related business.

In the Legal division, the legal process manager has 20 years of industry experience, including eight years in NPL workouts.

Professional staff in the Finance/Accounting, IT, and Loan Administration divisions have about 10-15 years relevant work experience.

The wide experience of CSC's staff enhances the company's special servicing capabilities. While the number of staff employed has been increasing since the start of business, the staff turnover rate has decreased. The company lost seven staff members in fiscal 2000, seven in 2001, five in 2002, and three in 2003.

Business Strategy

CSC plans to maintain its strong relationship with Lehman Brothers and to continue to develop its NPL servicing business in Japan. In addition, the company is considering expanding its non-Lehman Brothers-related business. As of July 31, 2003, non-Lehman Brothers-related revenue accounted for 8.2% of total revenue for the first four months of fiscal 2003. CSC's target is to increase its non-Lehman Brothers revenue to the range of 15% -20% in the future. In terms of its cash collection methodology, CSC is placing more focus on DPOs, voluntary sales, loan sales, REOs, and bankruptcy proceedings rather than simple auction foreclosures. These measures should contribute more effectively to investors' target collections, although they require asset managers to exercise greater special servicing skills, involving knowledge of professional negotiation and legal matters. Standard & Poor's believes that this policy should enhance the special servicing capability of the company.

Policy and Procedures

CSC prepares appropriate policies and procedures for the smooth operation of its daily business. For asset management purposes, there are three distinct sets of documents: Asset Management Process-NPL Portfolios, Foreclosure Process, and REO Management Process. For Loan administration and Systems, there are six sets; NPL Acquisition Process, Document Custody Process, Data Transfer Pro-

cess, CMA Database (servicing system input manual), Investor Reporting, and Accounting and Property Accounting. These are written both in English and Japanese.

Manuals are well written, with some actual examples and cover all aspects of daily business activities. They are updated on a continuous basis, with all updates reviewed and approved by senior management. The policies and procedures are accessible online to all employees in the company. Standard & Poor's believes these online manuals provide an excellent way for all staff to understand the logic behind functional procedures, and help boost CSC's operational efficiency.

Internal Audit and Inspection Program

CSC employs an intensive internal audit and inspection regimen.

1) Internal audit: conducted every quarter.

The two-week audit focuses on all administrative and operational aspects of servicing. CSC's controller is responsible for coordinating internal audits. A full-time compliance officer is responsible for the audit.

The purpose of this procedure is to check overall organizational internal controls and to identify the risk factors in daily administrative and operational activities. After the auditing, a detailed report is compiled to indicate areas that need alterations or improvements within one week and presented to CSC's executive management. The management must provide solutions to the points highlighted by the auditor within 30 days. Standard & Poor's confirmed that the quarterly internal auditings have been carried out adequately so far. A thorough report and management response to the report were compiled for the first quarter of 2003 and there were no significant findings reported in that audit.

2) External investor audit.

In case investor-servicing agreements call for the investor's external auditors to conduct periodic reviews to ensure CSC is acting in compliance with the agreements, external audits

are conducted. Lehman Brothers requires the conducting of an Agreed Upon Procedure audit to ensure that servicing activities proceed normally based on the agreements. The scope of the review includes testing and verification of bank account activity, principal and interest calculations, sweep accounts, petty cash, insurance, servicing fees, and documentation. In 2000 and 2002, Ernst & Young completed an audit covering the period from July through September in each year. The audit noted that there were no material diversions from the procedures regulated in the servicing agreements.

Standard & Poor's believes that the internal audits are well managed and thoroughly conducted to attain their purpose. The external investor audit, which is not normally practiced by servicers in Japan, provides additional comfort to investors.

In addition to the above, CSC is subject to the following two external audits. Once again, no significant findings have been reported to date:

- 1) Accounting audit by Shin Nihon & Co.
- 2) Audit and/or inspection by Ministry of Justice (Under the Servicer Law).

Training Program

CSC's training program has historically emphasized external seminars and on-the-job training. Internal training, especially until 2002, was mainly related to IT and system utilization and English language training. Asset managers attended a total of 10 hours internal and external training focusing on legal issues in servicing, bankruptcy, and workouts, as well as business plan templates and investment analysis.

CSC is enhancing the quality and quantity of its internal training, under the coordination of a director in the HR department. The training schedule for 2003 includes:

- Asset Management Training Course: legal issues related to NPL workouts and servicing, and topics related to real estate, such as valuation, will be covered by an internal

attorney and external lecturers. This course is scheduled seven times a year and each course takes about two hours.

- IT Training Course: Every member of staff must take a minimum of three credits with a passing grade.
- Companywide meetings: Held periodically to inform employees of major business events and provide instruction on topics related to servicing and other company activities.
- Weekly English Lesson: CSC pays tuition for participants.

There are additional opportunities for asset management staff to receive training through weekly meetings to discuss asset recovery issues using actual examples. CSC also encourages its staff to participate in external seminars. As of August 2003, CSC staff had attended 24 external seminars, mainly related to servicing practices and real estate business.

Overall, CSC's current internal training programs are regarded as satisfactory. However, it will be necessary for the company to provide its employees with additional training programs as the laws governing the servicing industry change, and the company's business develops and expands. Standard & Poor's will closely monitor the development of this situation.

Systems and disaster recovery programs

CSC's daily special servicing operations currently run on two systems. One is the Japan Capital Market Access (CMA) database developed by the company and the other is the ITFOR Total Collection System (TCS) (see Operation Support System, under Special Servicing). There are seven dedicated professional IT staff at CSC. If needed, CSC can obtain support from an outside vendor who can come to the office within two hours.

Important data is saved daily in a back-up tape loader system located in the same building. The daily backup tapes are also stored in a fireproof safe located in the building. On a weekly and monthly basis, one set of full backup tapes are

stored at an offsite location managed by a professional data maintenance company. The servers have sufficient capacity for all CSC's data requirements, and can also cope with sudden increases in business volume.

Currently, CSC has backup servers in a professional data center operated by NTT located in Tokyo. Servicing data is also saved in the backup servers on a daily basis.

CSC has also developed a new Web-based multilanguage Asset Management and Data Warehouse system, which will be implemented in November. This new application will replace CMA and ITFOR, and centralize CSC's asset data for Japan and all its regional offices. The new system seamlessly integrates CSC's Policies and Procedures into the application, strengthening internal controls and spreading overall knowledge of various parts of the business to all its employees.

CSC drew up a detailed disaster recovery manual in the first half of 2001. The stringent regulations are designed to protect the company from natural disasters. Dedicated management and business resumption teams would be appointed to take the necessary actions should a disaster occur. Staff members in all departments are given a calling tree so they can maintain efficient lines of communication. Procedures and details are thoroughly reviewed at least once a year, with the last review conducted in March 2003. Each employee is told to keep a copy of the emergency calling tree and disaster procedures at home, and is expected to know their individual responsibilities during a crisis. CSC performed a disaster recovery and business continuity test this July and confirmed that business could restart in 14 staff-hours after a disruption to the system.

Standard & Poor's expects that CSC would be able to resume its important business activities within a relatively short period even when faced with a disaster. Standard & Poor's recommends that CSC test this disaster recovery plan annually and designate an alternate backup business resumption site other than the current office premises in the near future.

Compensation for Staff

CSC maintains a clear compensation program, which offers effective incentives for each asset manager. When the company attains its group collection and profit targets, each asset manager is eligible for performance-based incentive bonuses. Standard & Poor's believes that so far, this compensation program is working effectively to offer good incentives to asset managers.

Litigation

CSC does not face any litigation at present.

Special Servicing Ranking: ABOVE AVERAGE

Track Record

CSC's special servicing portfolio consists of a wide range of property types, including office properties, multifamily residential properties, hotels, and industrials. Geographically, the portfolio is concentrated in the Kanto region (comprising Tokyo and surrounding areas).

A comparison of recoveries with "Mark" prices (investors' minimum expected proceeds) is shown below:

System Support

CSC enhanced its special servicing system capabilities through the introduction of ITFOR TCS in September 2002. The TCS servicing system maintains detailed property-level information on all portfolios and obligor information, as well as payment records. Moreover, it serves as a reporting database repository that can produce reports for third parties, such as investors. TCS is easy to operate and is supplemented by comprehensive, easy-to-understand

manuals. Staff can easily and quickly access necessary information in the system, which ultimately helps the company to boost its operating efficiency.

Assignment of Loans to Asset Managers

The portfolio manager, Mr. Sato, assigns individual assets to asset managers based on each employee's area of expertise and workload. Each asset manager handles on average 50 assets.

The asset managers are highly experienced. The goal of the asset managers is to attain the highest net present value recovery for each asset, paying close attention to the specific handling requirements within each servicing agreement. This goal is accomplished through foreclosure liquidations, voluntary sales, DPOs, and the sale of loans.

Establishment of Collection Strategies

Asset managers analyze newly assigned loans and the obligors to which they were granted, and then devise management and collection plans as appropriate. The procedure includes detailed analysis of collateral assets and cash flow generation. Individual obligor payment history and other issues related to specific loans are taken into account as well, and if necessary, asset managers prepare alternative collection methods. Following this procedure, the plan is presented to the portfolio managers, who review it prior to finalization. Generally, a collection plan for assets with marks of more than ¥10 million is decided upon within 60 days of CSC assuming the servicing duties for a distressed loan. Any collection actions against assets marked under ¥10 million require an approval memorandum, which outlines the collection status and strategy.

| Year | Total Mark | Total Resolution (¥ mil.) | % over Mark |
|---------------------|------------|------------------------------|-------------|
| 2000 | 9,606 | 11,481 | 19.52% |
| 2001 | 10,387 | 11,863 | 14.21% |
| 2002 | 9,623 | 9,954 | 3.43% |
| As of Feb. 28, 2003 | 9,816 | 11,188 | 13.98% |
| Grand Total | 39,432 | 44,486 | 12.82% |

The plan is implemented after receiving the approval of the portfolio manager and the representative director. It may be changed later if the designated asset manager and the portfolio manager conclude that alterations are required. The plan is reviewed quarterly.

Standard & Poor's believes that the process of approving all business plans, resolution proposals, and foreclosure actions through a formal process encourages open discussion of critical issues surrounding each asset, which in turn reduces the potential for hasty and improper decision-making.

Loan Boarding Process

The usual methodologies for loan boarding are:

CSC receives the data in excel format so that it can be uploaded electronically to ITFOR TCS. The uploaded data is reconciled through a two-level quality control check conducted by the IT data/report analyst and the Finance department staff, referring to the servicing agreement and other related reference documents. As long as related documents are properly provided, this double-checking of the input data is usually concluded within several hours. After the data is loaded, each asset manager performs a detailed review of the information on their respective assets during their analysis of the related documents.

Standard & Poor's regards the loan boarding process as well streamlined, and incorporated it as a positive factor.

REO

To date, CSC's portfolio has included seven REO properties. CSC will adopt an REO strategy if the REO asset managers and the representative director, through consultation with a company lawyer, decide that this would be appropriate. The REO manager will be responsible for finding a potential buyer for the asset, while at the same time maintaining and improving the property's price. During this process, CSC will select and assign a property manager to maintain the property under the supervision of the REO manager.

The property manager will submit income and expense budget estimates and a property maintenance plan within 30 days of the appointment.

The REO manager and the property manager will then further scrutinize the condition of the REO property and will finalize the budget and property maintenance plan within another two weeks, subject to approval from the investors.

The property manager will submit a monthly report using a format specified by CSC. The report will include an executive summary, variance report, receipt schedule, delinquent report, rolling budget, rent roll, bank reconciliation, management fee schedule, stacking plan, and vendor summary.

To date, CSC has resolved four properties acquired as REO. The properties had a total market price of ¥1.46 billion, and were disposed of realizing a total sales price of ¥1.63 billion. The property managers are well supervised by the REO manager, which enhances the REO procedure.

Standard & Poor's believes that CSC's REO managers are effectively conducting business utilizing and controlling external property managers in a proper manner. At the same time, Standard & Poor's recommends that CSC establish developed criteria for selecting property managers for further efficiencies in REO and securitization-related business.

Utilization of Brokers

If CSC decides to use real estate brokers, the company will require them to submit a comprehensive sales strategy that includes timing and a target price. Regarding the sales price, CSC obtains sales price comparisons from several brokers to confirm the reasonableness of the prices.

Payment Process and Cash Management

Confirmation and reconciliation are made on the same day that an obligor makes payments. Cash collection reports are processed several times a day in the finance and accounting department and then forwarded to the asset managers to identify the individual collections and compare the expected

collection amount to the agreed payment schedule. When there is a discrepancy between the amount actually received and expected, the asset manager in charge will contact the obligor in an attempt to reconcile the difference.

When an obligor makes a relatively large payment following, for example, the sale of a property, each asset manager first tries to persuade the borrower to remit payments via bank transfer. The next most preferable option is for the borrower to make payments in person, with the asset manager and a senior member of the finance and accounting department attending the borrower meeting in the office. Failing that, CSC proceeds to a policy of using a two-man collection team consisting of the asset manager and someone outside of the asset management department. The proceeds are sent to CSC's finance and accounting department and then paid into the investors' account.

Payment responsibilities fall under the finance and accounting department. A member of staff in charge of accounts payable prepares payment instructions with the original supporting documents. The instructions are forwarded to the assistant controller for review. The reviewed and approved payment instructions (including the necessary signatures depending on the amount of the payment) are forwarded to the financial controller for final review and approval. Then, the instructions are forwarded to the treasury section where actual payment operations are conducted. Before the payment is made, a printout of the amounts to be disbursed is made and checked by the treasury. This is presented to the financial controller who checks it against the details before executing payments.

Standard & Poor's believes this payment and cash management system provides excellent protection against the risk of misconduct, by having several review and approval stages.

Reporting to relevant parties

CSC uses CMA and TCS to compile reports for investors and trustees. This system contains all necessary information regarding the assets and loans, including the negotiation and collection histories. From this system, asset managers can retrieve any information necessary for reporting. Reports are generated in formats agreed upon between investors and CSC. Typically, the first page of the report provides a summary of the collection during the designated period (normally one month), and subsequent pages provide detailed property-by-property collection reports. Asset managers are responsible for summarizing the report.

Third Party Vendors

In addition to the property managers and brokers, CSC will employ outside lawyers if required. The company is able to acquire the services of about four outside attorneys that have a good understanding of CSC's daily operations.

Financial Position

Ranking: Sufficient. Standard & Poor's currently believes that there are no significant concerns regarding CSC's financial conditions.

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