

Structured Finance Servicer Evaluation

Capital Servicing Co. Ltd.

Residential Loan Primary Servicer

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Ranking: **ABOVE
AVERAGE**

On Dec. 14, 2007, Standard & Poor's Ratings Services assigned its ABOVE AVERAGE Servicer Evaluation Ranking to Capital Servicing Co. Ltd. (CSC) as a residential loan primary servicer. The outlook on the ranking is stable.

The ranking is mainly based on the following:

- The company's strong track record as a residential loan primary servicer;
- The strong servicing experience of its management team and other employees;
- The clear definition of responsibilities in its administration and servicing departments;
- Its detailed and comprehensive policies and procedures;
- Its solid internal auditing;
- Its efforts towards establishing its internal control framework;
- Its firm internal training programs;
- Its sound backup data system;
- Its appropriately designed disaster recovery plan, and the execution of system recovery tests using a backup site;
- An excellent computer system that boosts its operational efficiency;
- Its experience in servicing securitization transactions recognized in the market;
- Its appropriate cash management methods;
- Its ability to report to investors, trustees, and other relevant parties; and
- The appropriate control and oversight of third parties to which CSC outsources a part of its servicing business.

Outlook: **STABLE**

CSC's main business as a residential loan primary servicer involves the servicing of residential loans arranged by investment banks for securitization. CSC began focusing on residential loan servicing in 2002, and has experienced a significant increase in servicing volume since 2006. CSC has an ample track record

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in the overall servicing of securitization transactions given that the company has participated in 23 securitization transactions as of April 2007, as master, primary, and/or special servicer.

The stable outlook reflects Standard & Poor's expectations that CSC will continue to focus its efforts on expanding its servicing of residential mortgage loans.

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 100% owned by a private company owned by a CSC director, maintains a 75% share in CSC, while a private company holds a 25% share.

Since August 2003, CSC has effectively shared its personnel and technology resources with its group companies, Global Commercial Real Estate (Japan)

Inc. (GCRE) and Capital Realty Inc. (CRI), to avoid duplicating efforts in areas such as corporate accounting, human resources, systems management, and other office administrative support.

CSC's core business lies in the servicing of commercial real estate-backed distressed loans, performing loans, residential loan and apartment loan receivables. In July 2007, Andrew Hughes became the president/representative director of CSC, which has 53 employees. Meanwhile, GCRE has one representative director and 64 employees, who are responsible for the group's IT, finance, and human resources, etc. CRI has nine employees, and is responsible for real estate asset management, including hotels, and REOs. As of June 30, 2007, the group employed 126 workers in total, up from 108 in December 2005. CSC's previous president/representative director, Carl Everett, currently oversees the entire Capital Services Group of companies, and remains a director of CSC.

In addition, Standard & Poor's has affirmed its STRONG Servicer Evaluation Ranking on CSC as a special servicer mainly handling distressed real-estate backed loans.

Performance Data

CSC's figures for residential loan servicing as a primary servicer are shown in Tables 1 and 2.

Table 1: Residential Loan Servicing Volume Serviced By CSC

	September 2004	September 2005	September 2006	September 2007
Number of loans	473	472	1,104	2,845
Total servicing volume (¥ mil.)	6,455	6,535	18,719	51,520
Delinquent amount (¥ mil.) Total 1-180 days overdue	529	399	652	1,566
1-30 days overdue	253	105	240	1,112
31-60 days overdue	67	112	270	166
61-90 days overdue	75	71	66	246
91-120 days overdue	43	14	25	30
121-150 days overdue	55	26	0	12
151-180 days overdue	36	71	51	0
Special servicing (¥ mil.)	416	465	578	1,001

Table 2: Ratios Of Delinquent Loans To Residential Loans Serviced By CSC

		September 2004	September 2005	September 2006	September 2007
Delinquency ratios (%)	Total 1-180 days overdue	8.20	6.11	3.48	3.04
	1-30 days overdue	3.92	1.61	1.28	2.16
	31-60 days overdue	1.04	1.71	1.44	0.32
	61-90 days overdue	1.16	1.09	0.35	0.48
	91-120 days overdue	0.67	0.21	0.13	0.06
	121-150 days overdue	0.85	0.40	0.00	0.02
	151-180 days overdue	0.56	1.09	0.27	0.00
Special servicing (%)		6.44	7.12	3.09	1.94

Management And Organization Ranking: ABOVE AVERAGE

Management and Staff Experience

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

Representative Director Andrew Hughes has been involved in financial accounting for 21 years, and in NPL disposal for five years. Carl Everett has worked in commercial real estate (RE) lending and development for 26 years, and in NPL workouts in the U.S. for 18 years. The company's director/attorney has been in the legal profession for 26 years.

CSC's Loan Administration Department, which includes the Residential Loan team, is led by a director with more than 20 years of experience in the real estate and real estate finance sectors in Japan and the U.S. The Residential Loan team has 13 members.

- Seven employees focus on servicing performing loans, and they have on average seven years of industry experience.
- Three employees are to service delinquent and defaulted loans. They have on average more than 18 years of industry experience.
- There are also two document custodians and one full time staff for investor reporting.

The Loan Administration Department covers all the loan servicing functions as well as reporting, loan boarding, and set up. Overall, the department plays a strategically important role in ensuring more efficient servicing operations, including commercial loan special and primary servicing, and residential loan servicing.

GCRE employees (responsible for Finance, HR, and IT) and CSC employees (responsible for loan administration) have an average of between 10 and 15 years of experience in their respective areas.

Two REO asset managers at CRI have on average 15 years of experience in the real estate-related business.

The wide experience of employees at CSC, CRI, and GCRE enhances CSC's primary and special servicing capabilities. While the number of employees has been increasing from the time it started its business, the staff turnover rate in managerial and other important positions is low.

Business Strategy

In its residential loan primary servicing business, CSC is particularly focusing on expanding its business from third parties. The main points of its strategy are as follows:

- Vigorously explore new markets, using the Sales & Marketing team, established as a separate department in August 2007;

- Secure high-caliber personnel;
- Further boost operational efficiency; and
- Continue in the planning of securitization deals.

Standard & Poor's recognizes CSC as having implemented measures that will be effective in the future development of its businesses such as the development of a system with high functionality, and establishing a framework that consolidates its administrative department.

Policy and Procedures

CSC prepares appropriate policies and procedures for the smooth operation of its daily business. It has prepared the Residential Loan Management Process Manual as a guide to managing residential loan assets. CSC has also created manuals for loan administration and system purposes, including those for Document Custody Process, Cash Posting Process, Servicing System Input, Data Transfer Process, Investor Reporting, and Accounting. Most of them are available in both English and Japanese.

The manuals are updated continuously, and all updates are reviewed and approved by senior management. The latest policies and procedures are accessible online to all employees in the company. Standard & Poor's believes that these online manuals provide an excellent way for all staff to understand functional procedures, and to boost CSC's operational efficiency.

However, Standard & Poor's will scrutinize how these manuals will be adjusted to include other important topics for its residential loan servicing business such as "negotiating with customers over the telephone".

Audit and Inspection Program

CSC employs an intensive internal and external audit and inspection regimen.

1) Quarterly Internal Audit

The audit focuses on all administrative and operational aspects of servicing. A director of internal audit, hired in

October 2006, is responsible for this audit process.

The purpose is to check CSC's overall organizational internal controls and to identify the risk factors in daily administrative and operational activities. After the audit, a detailed report is compiled within 45 days to indicate areas that need alterations or improvements, and presented to CSC's executive management. The management must provide solutions to problems highlighted by the audit director within 30 days. Standard & Poor's confirmed adequate internal audits have been carried out periodically. Reports are presented semi-annually, in the first half of the fiscal year and in the second half.

Most recently, a thorough report and the management's response were compiled for the first half of fiscal 2007, and there were no significant findings reported in that audit.

2) External Audit

External audit through fiscal 2003

External audits were carried out to confirm CSC's compliance with investor-servicing agreements, which required the investor's external auditors to conduct periodic reviews. To ensure that servicing activities were in line with its agreements with CSC, Lehman Brothers had asked for an Agreed Upon Procedure audit. The scope of the review included testing and verifying bank account activity, principal and interest calculations, sweep accounts, petty cash, insurance, servicing fees, and documentation. In 2000 and 2002, Ernst & Young (E&Y) conducted an annual audit during the July-September period of each year. The audit noted that there were no material deficiencies from the procedures outlined in the servicing agreements.

External audit in fiscal 2004 and onward

Since 2004, E&Y has been conducting annual audits on CSC, based on the Sarbanes-Oxley Act, which has replaced the Agreed Upon Procedure audit, upon Lehman Brothers' request. The new E&Y audit is a relatively more comprehensive audit covering all the critical fronts in CSC's internal control, including IT, asset management,

loan administration, finance, and investor reporting.

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

In addition to the above, CSC was subjected to the two external audits listed below:

- An accounting audit by Shin Nihon & Co. found no significant issues to date.
- An inspection was conducted over three days by the Ministry of Justice under the Servicer Law at the end of January 2007. The issues pointed out during the inspection have been addressed.

Expansion and Enhancement of Internal Controls

CSC continues to strengthen its legal and compliance functions, improving its internal control systems and procedures in line with the Sarbanes-Oxley Act, and promoting business risk evaluation. To achieve these goals, Capital Services Holding Corp. established a Risk Management Committee in September 2005. In November 2005, the company employed a director of compliance to further oversee duties relating to compliance. His role includes keeping all employees informed of servicing-related laws, making inquiries to the Ministry of Justice about the interpretation of the related laws, and acting as a contact person for inquiries from external parties. The director of compliance was also responsible for conducting internal audits, although that changed in October 2006 when the company hired a separate director of internal audit to take on this responsibility, as part of CSC's efforts to refine its internal control system and enhance its compliance procedures.

In January 2007, a legal manager was employed and the legal function was moved to a dedicated Legal Department. This has further enhanced legal compliance in areas of

corporate business such as board of directors' meetings, shareholders' meetings, and the handling of agreements.

Standard & Poor's recognizes the increasing importance of the compliance system, and considers CSC's actions as positive factors.

Training Program

CSC's training program had historically emphasized external seminars and on-the-job training. Until 2004, in particular, internal training mainly focused on IT, new servicing systems, and English language skills. In 2005, the company expanded its internal training program significantly. The company introduced a new system that allows each employee to design his/her own training program with support and advice from his/her supervisor. The effectiveness of these custom-made training programs is examined through dialogues between employees and their department managers on a semi-annual basis. The exchanges serve as a platform for drafting training programs for the next term. The custom-made training programs may include courses offered by external sources. For particular courses that many employees wish to attend, managers may give lectures in some cases. Starting fiscal 2006, CSC adopted a timeline for employees to complete their training program, and the company checks that employees are taking courses appropriate to their position in the firm.

Currently, CSC's main training programs conducted include the following courses:

- Corporate training: Corporate governance, internal control, IT security, operating procedure, how to read a contract written in English, new hire orientation, and others.
- Technical business training: Servicing operations and business law-related courses conducted by each business unit.
- Business tools training: To boost employees' capabilities in servicing systems and other computer applications.
- Language training: To raise employees' English and Japanese language skills.

In 2007, key employees undertook more than 40 hours' worth of training programs on average from internal and external sources.

For asset management employees, weekly meetings help improve skills for business practices through discussion of asset recovery issues using actual examples.

In addition, CSC has a summer internship program for college students from overseas and Japan, and at the same time, through its company contribution program, CSC provides aid to the home countries of its employees, and the countries in which its sister companies have branch offices.

Standard & Poor's considers that CSC is undertaking the training of its employees earnestly, and we will scrutinize how the company will further boost the effectiveness of its training to raise the operational efficiency of its residential loan servicing business.

Systems and Disaster Recovery Programs

Since October 2003, CSC's daily residential loan servicing operations have been running on a new system, known as the Servicing Company Operating and Reporting Engine (SCORE; see section: "Operation support system" under "Special Servicing"). There are 17 dedicated IT professionals at GCRE supporting CSC's system.

Data is replicated daily and stored at the company's Osaka disaster recovery center. In addition, important data is saved daily on a backup tape, which is delivered to a secure data repository managed by a professional data maintenance company, Wanbishi Archives Co. Ltd. The daily backup tapes are also stored in a fireproof safe located in the Wanbishi building. The servers have sufficient capacity for all of CSC's data requirements, and can cope with sudden increases in business volume.

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

In the first half of 2001, CSC created a detailed disaster recovery manual. The stringent regulations were designed to protect the company from business interruption associated with natural disasters. Dedicated management and business resumption teams would be appointed to take the necessary actions should a disaster occur. Members in charge of disaster recovery at each department are given a priority-based calling list so that they can maintain efficient lines of communication. Procedures and details are thoroughly reviewed at least once a year, with the last review conducted in February 2006. The members are told to keep copies of the emergency contact list and disaster procedures at home.

In 2005, CSC designated an alternative backup business resumption site in Osaka. Standard & Poor's regards this as a significant improvement to prepare against unexpected disasters. The company implemented disaster recovery and business resumption tests in February 2006, September 2006, and November 2007, respectively, using the Osaka backup site.

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 will verify if the company continues to conduct disaster recovery and business resumption tests every 12 to 18 months.

Insurance Policies

CSC has insurance policies that meet or exceed servicing industry standards, including Directors and Officers, Errors and Omissions, and Fidelity Bond coverage.

Litigation

CSC does not face any litigation at present.

Primary Servicing Ranking: ABOVE AVERAGE

System Support

The introduction of SCORE in October 2003 firmly backs CSC's residential loan servicing system capabilities. The Web-based, multilingual asset management and data warehouse system centralizes CSC's asset data for Japan and all its offices in Asia, maintains detailed property-level information on all portfolios and obligor/guarantor information, payment records, negotiation history with obligors, and litigation records. SCORE effectively carries out schedule management for each loan so that each asset manager efficiently concentrates on core servicing activities. It also serves as a reporting database repository that can produce reports for third parties and the Ministry of Justice. SCORE is easy to operate and is supplemented by comprehensive, easy-to-understand manuals.

In addition, SCORE is designed to accommodate securitization transactions of various asset types, including NPLs, performing loans, commercial loans, and residential loans, in a flexible manner. In fact, the system is used for securitization transactions in which CSC participates as a servicer.

Furthermore, SCORE 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, which ultimately helps the company to boost its operating efficiency.

CSC also introduced a supporting, business intelligence tool for asset management called Servicing Operating and Reporting Analytics (SORA) in 2007. The introduction of this tool and its integration with SCORE, has allowed the company to maximize the use of loan data to efficiently create multiple reports whether the loans are master, primary or special servicing. This is possible even if the asset's status changes repeatedly. This tool has enhanced report preparation by greatly reducing the time involved.

Servicing System for New Loan Assets

CSC's main business activities as a residential loan primary servicer involve servicing residential loans arranged by investment banks for securitization. Below is a description of how CSC handles and verifies its loan data, before loan servicing begins.

- Information on the borrower and property, loan contract details, and other data are sent via a data pipeline from the loan originator and uploaded to the SCORE system.
- A series of logic tests are performed on the data and the Loan Administration Department verifies that certain data fields are accurately reflected in the system.
- SCORE generates a repayment schedule based on the loan data, which is then confirmed by the Loan Administration Department.
- Manual re-verification of the system data and the repayment schedule that have been uploaded into SCORE is completed.

Standard & Poor's regards CSC's procedure as adequately effective. The company accurately inputs the necessary data into its servicing system for the residential loans that it is currently servicing. At the same time, Standard & Poor's will be checking the company's incorporation of future residential loans into its loan data system, and monitoring procedures as CSC expands its servicing of residential loans with more varied conditions originated by third parties.

Payment Process and Cash Management

Cash management is conducted efficiently through automatic withdrawals from bank accounts as listed:

- The Loan Administration Department sends request forms for monthly automatic withdrawals from the borrower's bank account to an agent through a secure digital format.
- The agent compiles the requests according to each bank and sets up an automatic remittance from each of the banks one day before the payment date. The agent then checks the withdrawals, and sends a cash collection report to CSC within four to six business days. (The date for sending data is determined based on the agreement with the agent.)

- The cash from the successfully completed withdrawals are placed into CSC's bank by each contractual due date.
- As for the withdrawals that were not completed successfully, a representative from CSC will contact the borrower directly.
- Reconciliation of accounts is performed daily and monthly.
- Any cash payouts by CSC are made after being verified three times by the Financial Accounting Department, and twice by the Treasury Department.
- The payment instructions are prepared by staff in the Loan Administration Department, and are then reviewed by the departmental manager, director, and CFO. If the amount is over ¥20 million or US\$200 thousand, then approval from the Representative Director is also required.
- Treasury associate inputs payment instruction into SMBC Web21 (online banking), which is then authorized by the treasury manager. If the amount is over ¥2.5 million, an additional authorization from the CFO is required.

Standard & Poor's believes that CSC has excellent protection given that the company is able to monitor its payments and cash management system through electronic banking. Security is also increased because the responsibilities for its cash deposits and withdrawals are separated.

Asset Management

In primary servicing, according to the various deadlines for each loan and each transaction, the representative typically stays in contact with the borrower and sends notices through the use of SCORE.

Delinquent loans are processed according to the specific escalation process of each portfolio by the team in charge of servicing such loans.

- As of Sept. 30, 2007, there were three main representatives appointed to the task of managing and

servicing approximately 140 NPLs or delinquent loans. The three representatives have an average of about 18 years of industry experience.

- The representatives are expected to build good relationships with the borrowers, and be knowledgeable about their respective financial and personal conditions.
- There is a detailed manual on NPL management, which prescribes the procedures for following up in writing and by telephone, and the notification methods for loans that are delinquent for a period of between one and six months.
- Each notification letter drafted is checked by the Compliance Department.

Investor/Trustee Reporting

CSC uses SCORE and/or SORA to compile reports for investors and trustees. SCORE contains all necessary information regarding the assets and loans, including the negotiation and collection histories. From this system, asset managers can retrieve any information that is necessary for their reports on the loans that they are in charge of. Reports are generated in formats agreed upon between investors and CSC.

Currently, reports are provided to trustees through a secure website.

Customer Service

CSC maintains a system that can accommodate accelerated payments of loans by customers, lump-sum repayments, and changes to loan conditions. Through the SCORE system, the company is able to immediately verify the loan's up-to-date payment schedule. Therefore, the company can reply to a customer's inquiry quickly and in a comprehensive manner.

Through its utilization of SCORE's high degree of functionality, S&P considers that CSC is capable of handling the loans within the current staffing levels, even if the numbers of loans are increased several times over.

Financial Position

Ranking: SUFFICIENT

Standard & Poor's currently believes that there are no significant concerns regarding CSC's financial condition.

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