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Servicer Evaluation: Capital Servicing Co. Ltd.

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Ranking Overview

Servicer category	Overall ranking	--Subrankings--		
		Management and organization	Loan administration	Outlook
Commercial loan special servicer	STRONG	STRONG	STRONG	Stable
Financial position	Sufficient			

Major Ranking Factors

Strengths:

- Capital Servicing has a significant track record in special servicing for commercial loans.
- The company has established and is set to uphold a suitable framework for internal controls.
- Its management team and collection staff have ample servicing experience.

Opinion

On Jan. 20, 2017, S&P Global Ratings affirmed its STRONG servicer ranking on Capital Servicing Co. Ltd. (CSC) as a commercial loan special servicer. The outlook on the ranking is stable.

We base the ranking mainly on our views of:

- The ample servicing experience of its management team and staff;
- Its detailed and easy-to-understand internal policies and procedures;
- Its solid internal auditing;
- Its established framework for internal controls;
- Its excellent computer systems, which allow it to streamline operations;
- Its sound data backup system and data recovery procedures;
- Its aptly designed disaster recovery plan, and the execution of routine system recovery tests using a backup site;
- Its significant track record in special servicing for commercial loans;
- Its appropriate method for preparing collection plans;
- Its suitable loan boarding and verification processes;
- Its appropriate cash management methods;
- The appropriate number of loans assigned to each asset manager; and
- Its suitable reporting to investors and other relevant parties.

Outlook

The outlook is stable. CSC's main business activity as a commercial loan special servicer is the servicing of nonperforming loans (NPLs) that investors purchased and that are mostly backed by real estate. CSC began operations in December 1999 and has a proven track record managing specially serviced loans. CSC's management focuses on boosting efficiency and productivity in servicing operations and enhancing internal controls. At the same time, it works

to enhance its computer system functions. The company has a significant track record in overall servicing for securitization transactions: Since its establishment, CSC has acted as a master, primary, or special servicer for securitization transactions involving commercial real estate-backed loans, real estate-backed distressed loans, apartment construction loans, and residential housing loans. In 2015, CSC expanded its business portfolio by accepting entrusted residential loans and relevant staff from other servicers.

Despite difficult business conditions due to declining servicing volume in the industry, we expect CSC to secure a certain level of servicing volume and sustain its high-quality servicing and collection of receivables, given its extensive track record as a commercial loan special servicer.

Profile

CSC was established in September 1998. The Ministry of Justice (MOJ) licensed the company as Japan's 23rd servicer a year later to conduct servicing operations as allowed under Japan's Act on Special Measures Concerning Claim Management and Collection Businesses (the Servicer Law), which came into effect in February 1999. In December 1999, the company actually started operations as a special servicer.

Capital Services Holding Corp. (CSHC) maintains a 75% share in CSC. A private company owned by CSC's former managing director/representative director, Mr. Carl Everett, holds the remaining 25% share. Meanwhile, this private company owns 100% of CSHC.

CSC's core business is the servicing of distressed and performing loans backed by commercial real estate, residential loans, apartment construction loans, and consumer finance loans. The current managing director/representative director of CSC is Mr. Andrew Hughes. Including him, the company had 54 employees as of July 31, 2016.

In addition to CSC, Capital Services Group's offices in Japan also house Capital Advisory Japan Inc., which provides due diligence and other real estate-related services.

Capital Services Group also manages real estate assets and services loans in Thailand and the U.S. with offices in each country. The entire group had a total of 75 employees as of July 31, 2016.

Mr. Everett, CSC's previous managing director/representative director, currently oversees the entire Capital Services Group as CEO.

Management And Organization

Our management and organization subranking for CSC's commercial loan special servicing is **STRONG**.

Organization and staff of servicing departments

CSC had 54 employees in the below departments as of July 31, 2016. Although headcount fell by five from the previous year, no particular department saw a material change in the number of employees.

Internal Control Group. This group consists of the chief operating officer and six professionals of the Legal and Compliance Department (hereafter, the Compliance Department), comprising three members engaged in legal compliance and three members in charge of management operations. These members establish, maintain, and enhance CSC's internal control system and draft and review all contracts that CSC concludes. They also handle various legal operations, report to regulatory authorities, and provide employees with compliance training.

Asset Management Department. This department mainly conducts special servicing for commercial loans, with a staff of nine, two of whom belong to the Osaka Branch.

Loan Administration Department. This department was newly established in 2016 by integrating the former Retail Loan Department and the former Loan Administration Department. The department has 26 employees and mainly comprises the following four teams:

- The Retail Loan (residential loan) Team, whose nine staff members service residential loans;
- The Asset Administration Team, whose three administrators close transactions of all entrusted loans and manage documents;
- The Investor Reporting Team, whose five members handle reporting to relevant parties; and
- The Collection Team, whose eight members service nonperforming residential loans.

Finance Department. This department comprises four members that formulate budgets and handle accounting, tax, insurance, and cash management (cash-in/out) operations.

Information Technology (IT) Department. This department consists of four IT professionals in charge of overall support for the company's asset management and loan servicing system, companywide IT planning, and IT-related operations.

Human Resources Department. This department comprises one member who is responsible for human resources management, staff training, management of training data, and employee benefit programs.

Corporate Communications Department. This department comprises four members that plan marketing activities, make promotional materials, and manage office facilities.

Management and staff experience

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

Mr. Hughes, CSC's managing director/representative director, has 28 years of financial accounting and corporate governance experience and 13 years of experience in loan servicing. Mr. Everett, the CEO of Capital Services Group, has worked in commercial real estate lending for more than 30 years and in NPL workouts for 29 years. CSC's director-attorney has been in the legal profession for 35 years and has worked for the company since March 2000.

The key employees that conduct special servicing of commercial loans average about 27 years of industry experience. Key members of other departments including the Finance, IT, Human Resources, and Compliance departments have roughly 15 to 30 years of experience in their respective areas.

Business strategy

In its business strategy, CSC mainly aims to:

- Provide a wide range of independent services;
- Tailor fee structures to client needs to boost competitiveness, while trying to maintain profitability;
- Provide high-quality servicing with strong reporting capabilities in Japanese and English;

- Continuously strive to enhance corporate governance while working to maintain the confidence of clients; and
- Retain high-caliber personnel.

Policies and procedures

CSC prepares policies and procedures to facilitate smooth operations. For special servicing, the company has prepared distinct sets of manuals including the Asset Management Guide, Asset Management Approval Process, NPL Transfer Process, Loan Management Process (NPL Portfolio), Selection and Approval of Brokers, Cash Allocation (NPL Portfolio), and Collection Plan (Business Plan). For compliance, CSC has established procedures for handling complaints and consultations from debtors, determining eligible loans, and confirming closed transactions. CSC has also prescribed rules for professional conduct, as well as rules for the treatment of noneligible servicing claims and the confirmation of transferees of loans. In addition, the company has prepared manuals for creating a variety of legal ledgers, issuing and controlling various kinds of receipts, and creating internal reports.

CSC has also produced manuals for loan administration and system-related procedures including those relating to document custody, cash posting, data input into the servicing system, data transfers, investor reporting, and accounting.

CSC also prepares some rules and manuals in both English and Japanese as necessary. The company updates these rules and manuals continually, and senior management reviews and approves all updates. The latest policies and procedures are accessible online to all employees. We believe these online manuals are very useful for all staff to understand functional procedures and to conduct their duties in compliance with various laws and regulations including the Servicer Law.

Audit and inspection program

CSC conducts an internal audit every six months. The audit focuses on administrative and operational aspects of servicing. An internal auditor is responsible for this process.

The purpose is to examine CSC's overall internal administration and identify risks in daily administrative and operational activities. After the audit, the internal auditor promptly compiles a report that indicates areas in need of improvements and presents the report to CSC's executive management. Management must promptly provide solutions to problems that the internal auditor highlighted.

The reports covering the first and second halves of 2015 had no significant findings, in our view.

In addition to the above, CSC underwent:

- A statutory financial audit by KPMG AZSA LLC., and
- An inspection under the Servicer Law by the MOJ.

Internal control system

CSC focuses on enhancing internal controls mainly through cooperation among the below entities, committees, and departments, as well as the director-attorney.

Board of Directors (BOD) meeting. CSC traditionally promotes internal controls based on the framework that the U.S.-based Committee of Sponsoring Organizations of the Treadway Commission (COSO) publicly disclosed. At BOD meetings, directors confirm that CSC maintains its internal control system in line with the COSO model. In addition,

the directors also confirm that:

- CSC follows instructions from the MOJ;
- The company adequately carries out voluntary rules that the Loan Servicers Association of Japan (LSAJ) has instructed servicers in Japan to apply through the "plan-do-check-act (PDCA)" framework for internal controls;
- The in-house policies and measures regarding protection of personal information function properly; and
- The company has taken adequate, timely measures after directors found issues in past reviews.

Risk Management Committee. The Director of Operations chairs this quarterly committee and members include managers of the Compliance Department and other operational departments. The committee aims to identify risks that might significantly harm business operations and mitigate these risks as much as possible.

Compliance Committee. The representative director chairs this committee and members include the director-attorney, Director of Operations, internal auditor, director of the Compliance Department, and managers of the IT and servicing departments. The committee aims to promote compliance with relevant laws and advancement of the entire company's corporate ethics. The committee has focused on protecting personal information and has established a subcommittee, called the Personal Information Protection Committee, to further pursue the Compliance Committee's role in this regard. The Compliance Committee met six times in 2015.

Compliance Department. This department monitors the company's progress in resolving issues that the MOJ pointed out in its inspections, inspects and manages detailed contents of legal ledgers, and reports to regulatory authorities. The department director, jointly with other in-charge staff, verifies all contracts that CSC concluded, maintains and administers internal documents, and provides employees with training on relevant regulations.

Internal Auditor. The internal auditor prepares internal audit programs and conducts the companywide audit annually and the operations-based audits semiannually (see the above Audit and inspection program subsection for details). The annual organizational audit confirms whether CSC's internal controls function appropriately across departments. The operations-based audits examine whether employees implement all administrative and operational work related to the servicing business in line with in-house procedures.

Training program

CSC has encouraged employees to tailor their training programs to their own professional needs, with support and advice from supervisors. The company examines the effectiveness of these customized training programs through dialogue between employees and their supervisors on a semiannual basis. The exchanges serve as a platform for drafting training programs for the next term. The customized training programs may include courses that external sources offer, as well as internal training courses that managers lead. CSC has adopted a timeline for employees to complete their training programs and checks whether employees are generally taking courses appropriate for their positions.

Currently, CSC's main training programs include:

- Technical business training: Servicing operations and business law-related courses, communications training, and various management courses, as well as a study course to pass the licensing exam that the LSAJ administers for loan servicing asset managers.
- Corporate training: Courses for internal controls including compliance and personal information protection, and courses that provide employees with general knowledge of the industry.
- Business tools training: Courses that heighten employees' capabilities in servicing systems and other computer applications.

- Language training: Courses that improve employees' English- and Japanese-language skills.

CSC has set annual training targets of 25 hours for full-time employees and 12 hours for part-time employees. The average amount of training for all employees in 2015 was about 29 hours.

Operation support system

SCORE--CSC's Web-based, multilingual asset management and data warehouse system, introduced in October 2003--centralizes the company's asset data and maintains detailed property-level information on all portfolios and information on obligors and guarantors. The system also keeps records of payments, negotiations with obligors, and litigations. SCORE effectively manages the schedule for each loan so asset managers can concentrate on core servicing activities. It also serves as a reporting database repository that can produce reports for third parties and the MOJ. SCORE is easy to operate and is supplemented by comprehensive, easy-to-understand manuals.

In addition, SCORE is designed to flexibly accommodate securitization transactions backed by various asset types including NPLs, performing loans, commercial loans, and residential loans. Employees use the system for securitizations that CSC services.

Furthermore, SCORE reflects CSC's policies and procedures. It strengthens internal controls and spreads overall knowledge of various parts of the business to all its employees. Based on this, we believe SCORE ultimately helps the company streamline its operations. We note that SCORE can flexibly accommodate changes to workflows as well as new requirements that arise when the company undertakes servicing for new loan portfolios.

Systems and disaster recovery programs

CSC stores servicing data on its main server and simultaneously replicates and transmits the data on a daily basis to the company's business resumption center in Osaka to ensure safety. In addition, the company saves important data daily on a backup tape and delivers the tape to a secure data repository that the professional data maintenance company Mitsui-Soko Co. Ltd. manages. Mitsui-Soko also stores copies of the daily backup tapes in one of its fireproof safes. In our view, the servers have sufficient capacity for all of CSC's data needs and can cope with sudden increases in business volume.

CSC also has a backup server in its Tokyo office that the company's IT Department manages. CSC stores its servicing data on the server on a daily basis and keeps an updated backup copy of the data on an external recording device.

CSC's disaster recovery manual prescribes rules to protect the company from business interruptions associated with natural disasters. Dedicated management and business resumption teams would be appointed to take necessary actions should a disaster occur. CSC has enhanced its system to communicate with employees in the event of a disaster by implementing the SECOM Safety Confirmation system. CSC reviews disaster recovery procedures at least once a year. Managers of each department are instructed to keep the disaster recovery manual at home.

CSC has designated an alternative backup business resumption site at the Osaka office. We regard this as a significant improvement in the company's preparedness for an unexpected disaster. Currently, the company maintains a structure where its employees can pursue their business activities should an emergency arise: Twenty network PCs are available and employees can access the company's network remotely. The company implements disaster recovery and business continuity tests by using this backup site once a year.

We believe CSC is taking appropriate measures to prepare for possible disasters.

Insurance policies

CSC's insurance policies cover compensation claims against directors and officers, specialists' liabilities related to servicing operations, financial losses arising from employee fraud, and losses stemming from accidents during the transport of cash and checks.

Litigation

CSC does not currently face any litigation as a defendant.

Loan Administration

Special servicing

Our loan administration subbanking for CSC's commercial loan special servicing is STRONG.

Track record

CSC's annual figures for the special servicing of commercial loans follow (see the table below).

Capital Servicing Co. Ltd. -- Special Servicing Portfolio Volume					
	--As of Dec. 31--				Seven-month period to July 31
	2012	2013	2014	2015	2016
Amount of receivables (face value; mil. ¥)*	927,889	857,358	631,297	625,022	607,030
No. of properties*	2,849	2,652	2,154	2,168	2,092
Collection proceeds (mil. ¥)§	31,140	63,685	25,504	11,782	9,233
No. of claims resolved	348	387	749	228	140
	--As of Dec. 31--				Seven-month period to July 31
Breakdown of collections	2012	2013	2014	2015	2016
Auctions					
Collection proceeds (mil. ¥)	488	881	869	496	1,099
No. of claims disposed	18	27	38	23	6
Voluntary sales					
Collection proceeds (mil. ¥)	1,651	9,676	4,064	3,465	3,226
No. of claims disposed	36	51	36	23	20
Discounted payoffs					
Collection proceeds (mil. ¥)	5,191	1,738	1,120	1,944	2,697
No. of claims disposed	90	63	42	44	31
Loan sales					
Collection proceeds (mil. ¥)	15,356	43,132	15,444	3,583	1,832
No. of claims disposed	91	116	484	56	44
Others					
Collection proceeds (mil. ¥)	8,454	8,258	4,006	2,294	379
No. of claims disposed	113	130	149	82	39

Capital Servicing Co. Ltd. -- Special Servicing Portfolio Volume (cont.)

*Remaining balance as of end of each year. §Excludes collections through refinancing.

CSC's special servicing portfolio consists of a wide array of property types including office buildings, multifamily residential properties, hotels, and retail buildings. Geographically, the portfolio is relatively concentrated in the Kanto region (Tokyo and surrounding prefectures).

Establishment of collection strategies

Asset managers analyze newly assigned loans and the obligors and then devise appropriate management and collection plans. The procedure includes detailed analysis of collateral assets and cash flows. The asset managers also consider each obligor's payment history and other issues related to specific loans and prepare alternative collection methods if needed. Following this procedure, the asset managers present the plans to the designated portfolio managers, who review them prior to finalizing them with investors. Generally, portfolio managers and asset managers decide on a collection plan for all assets within 120 days of CSC assuming the servicing duties for a distressed loan. The same employees prepare more detailed plans within the same time frame for assets with expected collection amounts that exceed ¥100 million or in cases where a client requests such a plan. Collection actions for any assets require the representative director's approval of an outline of the collection status and strategy.

The asset managers implement the plans following approval from the designated portfolio managers, the representative director, and investors. Asset managers and portfolio managers review the plans annually or as necessary.

Loan boarding and verification processes

The usual procedure for loan boarding is:

- CSC receives the data from clients in Excel format so that employees can upload the data electronically to SCORE.
- The Investor Reporting Team of the Loan Administration Department reconciles the uploaded data through a quality control check, referring to the servicing agreement and other related reference documents. As long as related documents are properly provided, the team usually finishes this check within several hours.
- After the data are loaded, each asset manager performs a detailed review of the information on their respective assets when analyzing the related documents.

We believe CSC's loan boarding process is well streamlined.

Cash management

Confirmation and reconciliation are made by the end of the next day when the obligor makes a payment. Employees in the Treasury section of the Finance Department print out payment statements several times a day and forward them to asset managers. On the day of payment, the Treasury section uploads the payment information to SCORE. The asset managers identify the individual collections and compare collection amounts with the agreed payment schedules. When a discrepancy arises between the expected amount and the amount actually received, the asset manager in charge will contact the obligor to reconcile the difference.

When an obligor makes a relatively large payment following, for example, the sale of a property, the designated asset manager first tries to persuade the borrower to remit payments via bank transfers. The next most preferable option is

for the borrower to make payments in person, with the asset manager and the borrower meeting at CSC's offices or at the bank. Failing that and if the payment amount exceeds a certain level, CSC uses a two-person collection team consisting of the asset manager and someone outside the Asset Management Department. The proceeds are then paid into the investors' accounts.

Designated employees in the Asset Management Department prepare payment requests, obtain approval for the requests from the department head, and then forward the requests to the Finance Department. If the total amount requested equals or exceeds ¥1,000,000, the designated employee must obtain the Director of Operations' approval for the request.

The Accounting section of the Finance Department prepares a payment instruction form based on the approved payment request, obtains necessary approvals depending on the payment amount, and forwards the form to the Treasury section of the Finance Department, which actually executes the payment. An associate of the Treasury section applies the payment through an online banking application and forwards the set of necessary documents including the forwarded payment instruction form to the Treasury manager for his or her approval.

The manager then checks the payment instruction form and online payment application, approves them, and makes the payment. If the manager is to make a payment of ¥2,500,000 or more through Sumitomo Mitsui Banking Corp.'s (SMBC) online banking platform, the manager must obtain approval for the form and online payment application from one additional approver in a senior position before making the payment.

S&P Global Ratings believes that the multiple review and approval stages of this payment and cash management system provide excellent protection against the risk of misconduct.

Asset managers' workloads

The portfolio manager assigns individual assets to asset managers based on each asset manager's area of expertise and workload. Each asset manager handles about 30-60 difficult assets that require significant effort to resolve. S&P Global Ratings views CSC's assignment volume per asset manager as appropriate, given the asset managers' ample experience in servicing loans.

The asset managers' primary goal is to attain the highest net present value recovery for each asset, heeding the specific handling requirements in each servicing agreement. They accomplish this goal through foreclosure liquidations, voluntary sales, discounted payoffs (DPOs), and loan sales.

Reporting to relevant parties

CSC uses SCORE to compile reports for investors and clients. SCORE contains all necessary information regarding the assets and loans, including negotiation and collection histories. Asset managers can retrieve any information necessary for reporting in a timely manner from this system.

The system generates reports in both Japanese and English, as well as in formats agreed upon between investors, clients, and CSC. CSC typically submits reports to clients through a file transfer system that has an added security function. Asset managers are responsible for summarizing the report and also use SCORE to keep statutory books.

Use of brokers

CSC requires any real estate brokers that it uses to submit a comprehensive sales strategy that includes timing and a target price. Regarding the sales price, CSC obtains comparisons from several brokers to determine a reasonable price.

Third-party vendors

CSC employs third-party vendors such as property managers, real estate appraisers, and warehouse companies. CSC's selection criteria include a vendor's financial stability, conflicts of interest, and its lack of links to organized crime and other anti-social forces.

Financial Position

S&P Global Ratings currently views CSC's financial position as sufficient.

Related Criteria And Research

Related Criteria

- Revised Criteria For Including RMBS, CMBS, And ABS Servicers On Standard & Poor's Select Servicer List, April 16, 2009
- Servicer Evaluation Ranking Criteria: U.S., Sept. 21, 2004

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