CMBS/Japan
Servicer Report

Nissin Servicer Co., Ltd.

2005 SERVICER RATING JPN
CSS3+
FitchRatings

Rating

Special Servicer .... CSS3+$_{\text{(JPN)}}$*

* Japan

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Summary

Fitch Ratings has assigned a commercial-mortgage special servicer rating of 'CSS3+$_{\text{(JPN)}}$' to Nissin Servicer, Co., Ltd. ("Nissin Servicer"), reflecting ability to service non-performing loans secured by commercial real estate as well as to meet investors' reporting requirements.

Nissin Servicer was founded in July 2001 by Nissin Co., Ltd. ("Nissin"), a major finance company in Japan, and became operational in October 2001 having obtained a servicer license from the Ministry of Justice ("MoJ"). The servicer handles both secured and unsecured loans. Between inception and March 2004, Nissin Servicer had serviced 13,589 loans with a combined unpaid principal balance ("UPB") of JPY1,121 billion. The servicer was listed on the MOTHERS (Market of the High-growth and Emerging Stocks) on the Tokyo Stock Exchange ("TSE") in September 2004.

Nissin Servicer has dealt primarily with unsecured loans and secured loans with no residual collateral value. In 2003, it increased its staff by hiring a manager and various other employees with real estate finance and asset management experience. This has placed the servicer in a good position to continue towards its goal of greater participation and profits in the distressed commercial mortgage market. Fitch will continue to monitor the servicer's performance measures and strategy in this regard.

Committee Highlights

Strengths

- Seasoned management and highly motivated staff
- Comprehensive Policies & Procedures
- Various forms of support from the parent company
- Stable funding sources

Concerns

- Limited performance due to relatively short history
- Lack of systemized training programs
- Increasing market risk in accordance with rapid growth in purchased loans
- Tendency towards longer collection periods and higher loan asset purchase price

Mitigating Factors

- Hiring of staff with significant experience in real estate has enhanced servicing capability and mitigated the lack of training
- Adequate due diligence of real estate collateral and borrower status, with appropriate provisions for potential loan losses
- Improved accuracy of purchase price with experienced staff hired, and timely review of business plans

Company Overview

In July 2001, Nissin, a major finance company in Japan and listed on the first section of the TSE and the New York Stock Exchange, founded Nissin Servicer. The servicer became operational in October of that year, having obtained its license from the MoJ. Since its inception through March 2004, Nissin Servicer had serviced 13,589 loans with a combined UPB of JPY1,121bn, split third party loans 4% by UPB and purchased own loans 96% respectively. At FYE04 (the financial year ending March 2004), Nissin reported a loan book totalling JPY175bn and operating profit of JPY1.07bn. In September of 2004, the servicer was listed on the MOTHERS (Market of the High-growth and Emerging Stocks) on the TSE.

Immediately following its founding, Nissin Servicer primarily dealt with unsecured corporate loans. More recently it has increased its volume of commercial mortgage loans and has taken on additional staff with real estate expertise.

Nissin Servicer has stated that its main strategy is to focus on purchasing non-performing commercial mortgage loans and real estate for its own account. The servicer does not undertake servicing for third parties except where these are partners in joint investments.

Financial Overview

The servicer posted losses in its first fiscal year (five months on an actual basis), but moved into profit in its second fiscal year and has since cleared any accumulated losses. For FYE04, the servicer reported revenues of JPY4.6bn (a 61% increase yoy), operating profit of JPY0.9bn (+164%), and net income of JPY0.4bn (+95%).

In its first and second fiscal years, collections on purchased loans accounted for 100% of revenues, and in its third fiscal year, Nissin posted marginal servicing fee income.

At FYE04 the servicer had doubled total assets yoy to JPY6.7bn, of which purchased loans totalled JPY5.1bn (+64%).

At FYE04 serviced loans totalled JPY575.4bn by UPB. Purchased loans accounted for 99% of this and entrusted loans the remaining 1%. Approximately 90% of the entrusted loans for servicing were from partners of joint investments. At FYE04, Nissin Servicer had purchased loans of about JPY4.5bn, virtually stable on the prior fiscal year. The servicer participated in bidding on assets offered by all the Japanese mega banks and an expanding network with Japanese regional banks. At that date, more than half of the 10 largest purchases were from mega banks.

In 2003, in addition to borrowings from financial institutions, Nissin Servicer launched a JPY300 million debenture and a JPY500m share issue allocated to third parties. Moreover, the servicer raised about JPY2.3bn by listing its shares on the MOTHERS of TSE. At end-March 2004, borrowings totalled JPY4.2bn, a 77% increase from the previous year. At FYE04 the servicer had no outstanding obligations owed to its parent company, nor had any new borrowings for other sources been guaranteed by the parent company.

In FYE04, Nissin Servicer carried out a thorough review of its reserving mechanism for expected loan losses. In addition, it made its reserve position more conservative by, for example, making a 100% provision for loans uncollected for two years. Therefore, as of end-March 2004, loss provisions were JPY700m, five times the figure at the previous financial year-end.

Nissin Servicer has expanded its business by purchasing loans on its own account. Since trends in the loan market have a direct bearing on the servicer's financial position, Fitch will continue to monitor management of loan portfolios with these developments in mind.

Staffing and Training

As of end-August 2004, the total number of management and employees was 76: five directors, three auditors, 49 full-time employees, six contractors and 13 temporary staff.

The five-member management team consists of three alumni from Nissin, the parent company, one from the real estate finance industry and one lawyer. Management has adequate experience of corporate finance as well as real estate and property finance, supporting the servicer's capacity to engage in a wide-range of servicing operations. The average experience in related industry was 28 years and the average tenure with the company two years at FYE04, while Nissin's alumni have, on average, more than 30 years of tenure at the parent.

The asset management department is responsible for servicing commercial mortgage loans, handles due diligence of purchasing loans and communicates with joint investors. As of end-August 2004, the department had a staff of 19 including the director who serves as its general manager. In addition, there is also a manager, two deputy managers, eight full-time staff, four contractors and three temporary employees. Staff have, on average, about 15 years of related industry experience with 0.7 years at the servicer. The manager and their deputies have, on average, about 18 years of related experience and 1.5 years at the servicer. There are four asset mangers in the department, having, on average, about 22 years' experience and 0.5 years at the servicer.

Nissin Servicer has an annual salary system for all employees that consists of guaranteed salaries and performance bonuses. The guaranteed element, varying according to individual skills, is based on a matrix. The guaranteed salary is divided into 12 equal amounts and provided as monthly pay. Performance bonuses are determined by personal and corporate performance in a particular calendar year and are awarded the following April.

The servicer undertakes personnel performance reviews semi-annually. The process includes an interactive communication form on which the individual to be appraised completes details of semi-annual goals, performance, self-valuation, transfer requests and other requests. Following completion of the form, an interview takes place with a reviewer. In addition, the performance of each individual in a collection role is monitored daily.

Nissin Servicer provides two training programs. One is company-wide and based on the training courses provided by the Servicers' Association of Japan, and the other is organized by the Management Department. New hires are given a very brief orientation session explaining the company's outline and working rules since, as a rule, it only employs individuals with relevant experience.

Training Program Based on Courses Provided by the Servicers' Association Japan

Training sessions are presented by employees who have participated in the regular training programs held by the Servicers' Association. This training is presented to all staff in the relevant sections. During the 12 months from August 2003, five one-hour training sessions of this type were held by the servicer.

Training Program within the Management Department

This program includes all department staff and takes place during regular Monday meetings, lasting for about 30 minutes. In the six months to end-September 2004, 14 such sessions were conducted.

Although the servicer's employee training system is not comprehensive, there currently does not appear to be any specific problems with the function. This is primarily because the servicer employs staff with experience from the parent company or industry. However, the training programs need to be extended as the volume and variety of serviced loans increase. Fitch will continue to monitor developments.

■ Procedures and Controls

Nissin Servicer strengthened internal controls substantially by developing its policies/manuals and an internal audit system before listing in 2004.

Its company regulations are divided into rules and procedural manuals. Rules, which are prepared by the general administration department, cover company-wide issues. These are stored in a shared folder on the LAN and are accessible by all staff. Procedural manuals, which are created and managed by each department, are stored in each department's folder on the LAN and accessible by all staff. Hard copies of regulations and procedural manuals are also distributed.

Internal Audit

The business planning department is responsible for internal audits, which are based on the internal audit rule. At the start of each fiscal year, the general manager of the business planning department prepares an annual audit program containing audit policies, dates, departments and names of the auditors for approval by the company president. Based on the annual audit program, the general manager of the business planning department produces monthly audit plans, which the president will also approve. In addition to regular audits, ad hoc audits are carried out if necessary. In March 2004, the company appointed an individual with six years' auditing experience at a major credit company.

The general manager of the business planning department, as a rule, prepares audit reports containing date, purpose, items, summary of results, and irregularities and guidance within three weeks of each audit and submits this to the company's president. At the same time, the general manager also creates an "instruction for improvement" to highlight any irregularities, which must also be approved by the president. After approval is received, the general manager submits the request to the head of the audited department for the improvements by handing over the "instruction for improvement". Subsequently, the relevant head prepares a report containing items to be improved and a schedule for completion, which again is submitted to the president.

In addition to internal audits, each quarter a full-time auditor reviews various reports, minutes of the pricing committee, rules and manuals, as well as other documentation. Cash balances are checked twice a day.

External Audit

In May 2003, the servicer received its first on-site MoJ inspection. Although there were a couple of irregularities pointed out, the servicer took prompt action to remedy these.

In February 2004, the parent company audited Nissin Servicer. There were some requests for improvements in the area of clerical errors, management of important items and development of manuals. Again, the servicer took prompt action to improve all noted items.

As the servicer was listed, audits by the parent company have been suspended. However, since the parent company is listed on the New York Stock Exchange, it will review the results of the servicer's internal audits under the requirements of the Sarbanes-Oxley Act. Sanyu, an independent auditing firm, audited the servicer for FYE04; it found no specific irregularities.

■ Technology

Nissin Servicer uses three independent systems; asset management, collateral management and accounting.

In August 2004, the servicer replaced its previous asset management system with the Total Collection System ("TCS"), which became fully operational in October 2004. TCS is a popular system among various Japanese servicers. As a part of the system migration, staff responsible for data transfer received training sessions from the vendor. The introduction of TCS resulted in flexible handling of various reporting forms, quicker cost accounting for purchased loans, strengthened security, and streamlined loan data registration. The servicer also uses its proprietary File Maker-based system for managing collateralized real estate.

Access to the systems is limited to authorized users and protected by IDs and passwords. In September 2004, a temperature-controlled server room was set up. Important documents, including original copies of agreements and notices of loan transfers, are scanned and stored electronically; the originals are held in an outside warehouse.

As for all the systems, data back-ups are run daily. The tapes are stored in a fire-proof safe in the office for a week, and then, the weekly data is transferred to an outside specialty warehouse. The server is also equipped with a UPS (Uninterrupted Power Supply) - emergency back-up battery. However, specific disaster recovery plans, while in preparation, have not been completed or implemented/tested.

Two full-time general administration department staff are responsible for IT system maintenance. They have, on average, about six years of related experience. The servicer has a maintenance agreement with a vendor for regular inspections of the TCS server, and with another vendor for the scanner servers and the File Maker system. Servers currently operate at an average of 45% of capacity, and current capacity is considered sufficient.

The asset and collateral management systems are currently independent platforms. However, if the volume of commercial mortgage loans increases, integration of the two would enhance operational efficiency.

■ Special Servicing

At FYE04 the portfolio balance totalled JPY1,043.2bn by UPB, which was broken down into unsecured loans (90%) and secured loans (10%). The breakdown of purchased loans on a purchase price basis was: unsecured (72%) and secured (28%). The average purchase price per loan was about JPY0.5m for unsecured loans and about JPY2.5m for secured. The servicer primarily purchases loans from mega banks, regional banks and foreign investors.

As of end-July 2004, the breakdown of collateralized property was: single family residence (26%), land (26%) and multi family residences (14%); the remaining (34%) was in various other asset types. Geographically, Kanto (excluding Tokyo) accounted for 23%, Tokyo 20%, Kinki (excluding Osaka) 13% and Osaka 12%, with 32% in various other locations.

Portfolio Statistics

(Secured Loans Only)

Loan Balance (JPYm in UPB)

	March 31, 2004	March 31, 2003
	107,381	2,096

Disposition Amount* (JPYm) Since Inception Through

	Mar 31, 2004	March 31, 2003
	915	609

Types of Resolution by Disposition Amount* (%)

Voluntary Sale	57.4
Foreclosure	15.1
DPO	27.5

* Including real estate disposition and DPO only
Source: Nissin Servicer Co., Ltd.

Due Diligence/Acquisition

Prior to purchasing a commercial mortgage loan, the servicer conducts due diligence of the collateralized real estate and evaluates the asset value based on an assumed business plan. Following this evaluation, a purchase price is set by the Pricing Committee, consisting of all the directors and the general manager of the asset management department. Within 90 days of the purchase of a loan, the servicer reviews the business plan prepared at the time of pricing, based on more current information gained through contacts with the borrower, and the status of the collateralized property. The business plan, which is reviewed annually as a rule, is revised whenever warranted.

Nissin Servicer makes reasonable provisions for possible loan losses on purchased commercial mortgage loans based on collateral value and the obligor's financial situation.

New Loan Set-Up

Nissin Servicer's new loan set-up procedures are as follows: (note: "clients" refers to loan sellers or third parties that entrust loans for servicing):

1. The asset management department creates an Excel spreadsheet based on DIP - Detailed Information Package (loan/asset information) - data is then input into the asset management system.
2. The asset management department prepares basic client data before registration (bank account, pool name, pool details, purchase price, etc).
3. The general administration department staff member responsible for the system inputs the above data into the asset management system.
4. The management department receives loan transfer agreements and original loan documents, which it scans and then stores in an offsite warehouse.
5. The management department reconciles data in the loan transfer agreement against that entered into the asset management system and the client registration card.
6. According to loan type, the management department divides the loans between the asset management and management departments.
7. The asset management department and the management department, respectively, prepare and mail transfer notices of purchased loans as well as servicing notices for third party loans.

Cash Management/Reporting

Multiple bank accounts are opened for each client. The servicer confirms notice of payment by facsimile, answering service or electronic banking service. Expenses relating to collections are controlled by the authorization rule, which prescribes who can authorize payment according to the nature and amount of payment.

Since Nissin Servicer is entrusted for collection only by joint investment partners; the number of investors, to whom the servicer has to provide reports is also limited. Monthly investor reports contain general information; collection activities, balance details, loan balance, disposal of collateral, auction developments, collection plans and yield calculations. Reports are detailed and well organized. Reporting capabilities were substantially improved with the upgrade to the asset management system in 2004.

Asset Management Staff

Each asset manager is responsible for about 150 commercial mortgage loans; as only a half to a third will require constant maintenance, this level is considered manageable.

Within the asset management department, a three-member team is responsible for all legal issues. The head of this team spent eight years as a legal clerk; the two other team members have experience at a bank and a leasing company, respectively. At end-March 2004, cumulative collected amounts through legal procedures, including bankruptcy cases, totalled JPY230m or only about 3% of the total collected during the same period.

Workout/Resolution

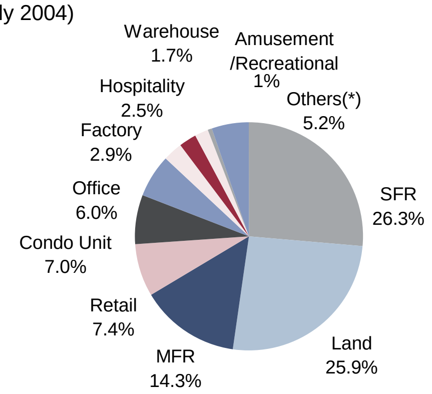
In FYE04 cumulative collections through workout/resolution totalled about JPY7.4bn, of which secured loans accounted for 66%. Payments by borrowers or guarantors accounted for 72% of collections on secured loans, and disposal of collateral, such as foreclosure or voluntary sale, 24% versus 61% and 36% respectively in FYE03. This indicates that, even for secured loans, the majority of collections are made through obligors' payments, and its weight is increasing. One of the reasons for this is an increase in sub-performing loans in the market that still have current cash flows.

As there were insufficient cases where collection was completed through the disposal of collateralized real estate during the period from inception through to end-March 2004, it is difficult to accurately assess the servicer's full performance in collecting on commercial mortgage loans. However, for the cases that were completed, the recovery rates (collected amount/purchase price) were generally in line with the market. The servicer has sufficient capacity in collecting on commercial mortgage loans. However, due to the increase in sub-performing commercial mortgage loans against current cash flow, on which instalments are initially paid regularly, the disposal time for collateral property through liquidation will tend to be a more lengthy process than just a few years earlier.

In cases where collections have been completed from the inception to March 2004, collection methods are broken down such that voluntary sale of collateralized property accounts for 57% of total collections, followed by auction and then DPO (discounted pay-off). The highest recovery rates are attained by DPO, followed by voluntary sale then auction.

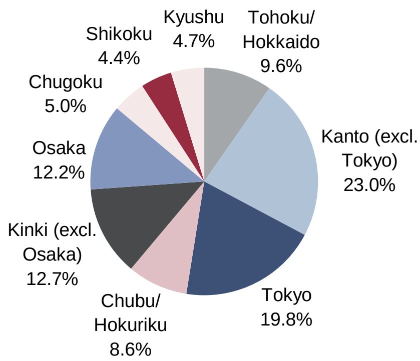
Nissin Servicer takes a positive stance on REO (real estate owned). Although it has no property under management at present, the servicer does own a consolidated subsidiary managing real estate that is a licensed property agent. The company is also aggressively engaged in purchasing loans for corporate revitalization. Although there are various avenues to corporate revitalization, the servicer targets those cases where borrowers' surplus property can be disposed of.

Breakdown of Collateral
(July 2004)



Source: Nissin Servicer, Co., Ltd.

Geographic Breakdown of Collateral
(July 2004)



Source: Nissin Servicer, Co., Ltd.

Confidentiality agreements are signed with all property agents once market standing has been studied. The servicer will also monitor any differences between scenario and performance, ability to collect information and negotiating power, and check for any illegal activities.

Nissin Servicer's asset management operations function effectively on current volumes. Fitch will continue to monitor efforts to increase ratio of loans secured by commercial real estate and effectiveness of recoveries on these assets.