

CMBS/RMBS/Italy
Servicer Report

Credito Fondiario e
Industriale SpA (Fonspa)



Ratings

Residential Primary Servicer
Italy.....RPS2-(minus)_{IT}

Commercial Primary Servicer
Italy.....CPS2-(minus)_{IT}

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Servicer Rating Criteria

This report provides a description of the findings from Fitch Ratings' review of Fonspa, performed in the context of the criteria set out in Fitch's reports "Rating European Residential and Commercial Mortgage Loan Servicers - 2005", dated 14 March 2005, and "Rating European Mortgage Loan Servicers – Italian Market Addendum", dated 30 May 2006, both of which are available at www.fitchratings.com.

■ Summary

Fitch Ratings has affirmed the commercial primary and residential primary servicer ratings of Credito Fondiario e Industriale SpA ("Fonspa" or "the company") at 'CPS2-(minus)_{IT}' and 'RPS2-(minus)_{IT}'. The ratings address Fonspa's continued ability to effectively administer and collect on performing Italian residential and commercial mortgage loans.

The ratings are based on the company's proven business model and sound organisational structure, its long industry tenure across senior management and operational staff, its strong internal controls and its sound IT systems. Fonspa also benefits from the financial and strategic backing of its parent, Morgan Stanley ("MS", rated 'AA-/F1+'). The ratings also reflect the continued development of the residential origination platform and the subsequent benefits to the servicing departments; total loans under management increased to EUR2.06bn at 31 May 2006, up from EUR1.3bn at 31 December 2004.

The company is administering three types of mortgage loan products: Fondiario loans (medium- to long-term loans to real estate developers or mortgages on apartments already built) advanced to private buyers, industrial loans (to build or redevelop industrial plants) and public works loans (to municipalities or public entities).

■ Strengths

- Long company tenure among staff and experienced management team.
- Comprehensive policies and procedures, available online to all staff.
- Continued investment in technology, to include new International Accounting Standards ("IAS") software and enhancement of the electronic mortgage loan system.
- Good investor and regulatory reporting.

■ Challenges

- To ensure that the number of training hours per employee meets the plans set out for the year and improves on current levels.
- Following the acquisition of Fonspa by MS in June 2006, a new business plan is being developed, but yet to be completed.
- To further develop the commercial property surveillance process, specifically the new procedures that were introduced in 2006.

■ Mitigants

- Senior management and staff have extensive levels of company and industry experience, and there is an unmeasured amount of 'on-the-job' training.
- Senior executives from MS and Fonspa have been in discussions about the future business plan and common goals appear to have been agreed. Fonspa continues to follow a 'business as usual' culture with the added benefit of best practices being shared between management.
- Property surveillance including periodic site inspections is a new feature of Fonspa's procedures for 2006 – a continuous improvement programme is planned for 2006/2007.

■ Company History and Management Experience

Fonspa, formerly an Italian Fondiario mortgage bank, was previously owned by Morgan Stanley Real Estate Funds (“MSREF”) and was seen to complement the servicing activities of MSREF companies Servizi Immobiliari Banche S.p.A. and Morgan Stanley Properties Corso Venezia S.r.l. As part of a corporate reorganisation in June 2006, Fonspa was acquired by European Principal Assets Limited, a wholly-owned subsidiary of MS.

Fonspa was established as a primary servicer in February 2001 following a broad restructuring launched in October 2000 and completed in 2002, under which Fonspa’s loan portfolios were securitised. Its non-performing loans (“NPLs”) were securitised in the International Credit Recovery (“ICR”) 6 transaction in October 2001, and its performing loans in the Colombo deal (predominantly comprising public works and public entity loans). Its remaining performing loans were securitised in two privately-placed, unrated transactions.

Although this report is concerned with Fonspa’s activity as a primary servicer of residential and commercial mortgage loans, it undertakes many different roles in relation to securitisations, such as master servicer, calculation agent and sub-servicer. At 31 May 2006, Fonspa was responsible in some capacity for administration and/or reporting on eight residential performing portfolios, seven non-performing portfolios and eight commercial portfolios – a total of 23 deals. At the same time, the servicing portfolio totalled EUR7.3bn with 40,107 loans and over 20,000 borrowers.

At end-May 2006, Fonspa acted as primary servicer for five residential mortgage portfolios comprising approximately 16,500 loans with a balance outstanding of EUR913m. The two commercial securitised portfolios where Fonspa was named as primary servicer consisted of six loans, with EUR1.44bn outstanding.

During 2004 and early 2005, Fonspa made significant inroads in developing its residential

mortgage lending programme for prime borrowers. Product marketing is currently realised through a leading Italian distributor (Mediolanum) as well as through ‘Mortgage Group’ a nationwide mortgage broker in which Fonspa holds a minority shareholding. The loans are funded via the interbank deposit market and two short-term revolving facilities with Italian banks, prior to being sold to a special-purpose vehicle (“SPV”). The SPV will enable Fonspa to securitise these loans once critical mass has been reached.

Fonspa uses a credit scoring tool supplied by Experian when originating loans. This helps loan evaluation and combines information gleaned from social-demographic scoring, a credit bureau analysis and income and expenditure calculators. Manual underwriting processes are used to collate the information provided by the credit score; these processes focus on assessment of documentation and fraud avoidance.

As a result of the credit scoring and underwriting process, each loan is assigned a risk level which corresponds to a ‘decline’, ‘accept’ or ‘further information required’ decision.

The company is led by a general manager with 27 years’ industry experience who can call on a senior management team with an average industry tenure of approximately 30 years. Company tenure is just over five years.

■ Financial Condition

Fonspa is a wholly-owned subsidiary of MS. At end-2005, Fonspa reported total assets of EUR224.4m, up from EUR153.5m at end-2004. Fonspa showed a total net worth of EUR23.3m, a slight increase from EUR22.4m at end-2004. It also reported a reduced capital adequacy ratio of 10.4% compared with 11.8% for the previous 12 months, above the minimum requirement of 8%. Although Fonspa is financially independent of its parent, it benefits from the ultimate financial and strategic backing of Morgan Stanley. Fonspa is profitable in its own right and expects profitability to increase as the residential origination business grows. During 2004, all departments of Fonspa were reviewed and all are

Residential Performing Loan Portfolio Statistics

Securitised Portfolio	Loan Type	As at 31 May 2006		As at 31 Dec 2005		As at 31 Dec 2004	
		Balance (EURm)	Number of Loans	Balance (EURm)	Number of Loans	Balance (EURm)	Number of Loans
Augusto 1	Performing Fondiario	52,000,000	3,554	59,200,000	3,878	78,300,000	5,305
Augusto 2	Performing Fondiario	24,000,000	1,444	27,600,000	1,588	36,500,000	2,065
Diocleziano	Performing Loans	259,000,000	3,499	281,500,000	3,841	336,800,000	4,801
Total		335,000,000	8,497	368,300,000	9,307	451,600,000	12,171

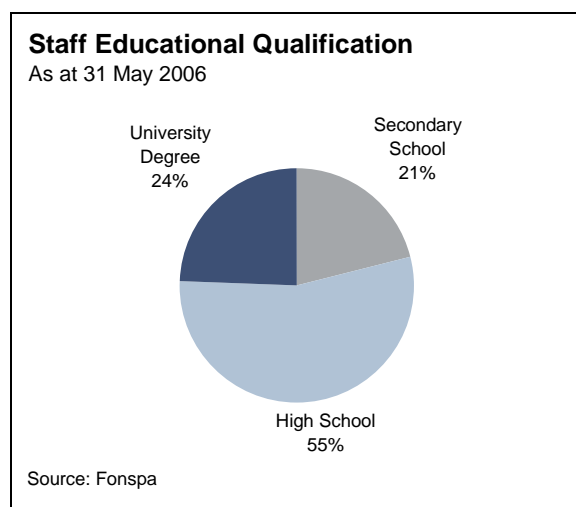
Source Fonspa

now treated as separate profit/loss centres, enabling tight focus and controls on servicing costs.

■ **Staffing and Training**

The company employs 143 staff on Italian banking contracts, slightly down on the figure of 151 reported in the previous review. Department heads and senior managers have an average of 26.5 years' experience in the banking industry. Operational staff have an average of 21 years' experience within Fonspa and are well experienced in the banking sector, as Fonspa was originally a mortgage lender.

Of the 143 employees, 24% hold university degrees.



In 2002, the company introduced a “management by objectives” system, which sets targets for employees and is also used to annually review staff performance. A new remuneration system was launched following the restructuring that provides for a maximum discretionary annual bonus of 30% of basic salary depending on the company’s profitability and individual performance.

Fitch noted that total training hours of 3,460 in 2005 did not match the budgeted target of 5,704 hours. This is significantly under target, and the average per employee figure of 24 hours per annum does not meet the Fitch benchmark of 40 hours. However, this is somewhat mitigated by the extensive operational experience within the business and the unmeasured ‘on-the-job’ training.

Training requirements for both 2006 and 2007 have been identified and total over 15,000 hours. This would average over 50 hours per employee for each of the two years, a challenging target that is significantly ahead of 2005 figures. The company is expected to continue its focus on English language skills, risk analysis and IT training. The company maintains a good balance between external and

internal training, benefiting from the experience within Fonspa and the group. The closer ties with MS also provide opportunities for staff to visit the Morgan Stanley Mortgage Servicing (rated ‘CPS1-(minus)_{UK}’ and ‘CSS2-(minus)_{UK}’ by Fitch) operation in London. This will help Fonspa to better understand commercial servicing ‘best practices’.

Each employee completes an online “skills framework” to identify future training and development needs.

■ **Policies and Procedures**

Fonspa has well documented and easily understandable policies and procedures manuals that are available electronically on the company’s intranet. Procedures are updated on a regular basis by the human resources department in accordance with any organisational change. Senior management and the internal audit group have reviewed the procedures manuals to ensure controls are appropriately identified and comprehensive.

The company has a dedicated internal audit team of two with an average of 34 years’ experience with Fonspa. Both members of the team have been in their current roles since inception of the internal audit function in 2002. The team has direct responsibility for all company activities as well as three of the group’s NPL SPVs, ICR123, ICR5 and ICR6. This audit function reports to an MS auditor who has overall control at a group level. Both the audit team and the MS auditor report to the Fonspa board on a quarterly basis.

A key focus of the internal audit function during 2006 has been a full analysis and review of the IT infrastructure within the company. This has been completed with the assistance of professionals from IBM and comprises an audit of the acquisition process, review of the management of IT infrastructure and services along with an analysis of the development and management of software modifications.

Under Law 130, the audit function is responsible for the accuracy of servicing activities and, as part of its duties, also ensures each department employs a series of specific controls. Internal audit reports on the control activities carried out on each portfolio are submitted to the board of directors, to the board of statutory auditors and to the Bank of Italy on a periodic basis.

In addition to ‘second level’ checking controls, ‘first level’ checks are performed regularly by each department to ensure activities are in compliance with servicing agreements.

Particular attention is given to controls relating to reporting, functioning of the asset management system, consistency of accounting principles within the group and verification of cash flows and information flow among all the group companies. Fonspa's system allows a full audit trail of actions in order to recreate previous activities and access data subsequently modified.

The Bank of Italy completed an inspection of Fonspa's activities in Q205, the results of which were reported to the board of directors in October 2005. No major issues were identified, but recommendations were made to implement tighter controls within accounting relating to Real Estate Owned companies ("REOCO") and to complete specialised auditing of IT. The IBM review referred to earlier in this report was a result of the Bank of Italy recommendations.

The 2005 audit plan for Fonspa was approved by the board of directors in December 2004. The plan listed numerous audit activities, including:

- follow up of the recommendations made in previous reports;
- analysis of the IAS software;
- mapping of operational risks and mitigants;
- analysis of the disaster recovery plan; and
- portfolio analysis.

The audit plan was completed, and audit reports submitted to the board of directors at various points during the year. No major issues were identified.

The 2006 audit plan was approved by the board in December 2005. The results are yet to be published.

■ Servicing Methodology – Loan Administration

Fonspa's loan administration department is presently staffed by 23 full-time employees structured into four units: loan boarding and total loan outstanding ("TLO") calculation, payment processing (including loan accounting and cash management), loan management and insurance and fee management.

The insurance and fee management team is a new entity, responsible for the handling of all Fonspa and SPV insurance requirements. This includes managing compulsory fire protection insurance policies for residential loans, managing relationships with the insurance companies and managing fee arrangements with brokers.

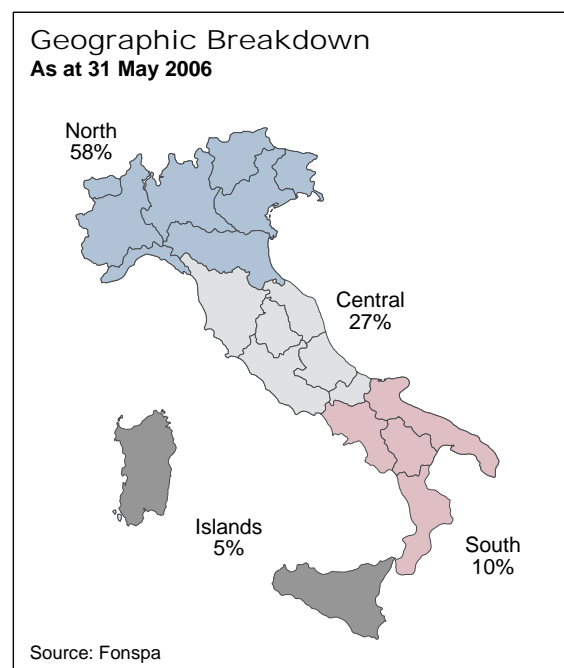
Fonspa continues to perform a number of administration functions for a variety of NPL portfolios. Whilst this is beneficial to the platform as

a whole, NPL administration does not constitute part of the primary servicer rating.

New Loan Set-Up

Seven staff are responsible for the loan boarding process and the TLO calculation. The company uses FIS/K4F, a powerful operating system that enables the electronic boarding of portfolios from the originating bank. Portfolio data is split into six categories and tests are performed to check accuracy. Accuracy and completeness of data are crucial for the administration of all loans and, while the system employed by Fonspa cannot 'correct' or 'find' inaccurate data, it is a powerful tool in helping identify missing data through automatic reconciliation and checking processes. The loan boarding team completes due diligence which is targeted to analyse certain portfolio data, and further tests are completed in conjunction with the IT department and the internal statutory reporting office to ensure all servicing requirements are met.

In 2005, a new NPL portfolio – ICR8 Mastino – was successfully boarded onto the Fonspa platform. This comprised 2,812 loans, totalling EUR829m.



Loan Accounting and Cash Management

The company's current loan administration responsibilities include cash collections, administration of legal expenses, calculation of contractual defaulted interest and reconciliation of collections credited to an SPV's bank accounts.

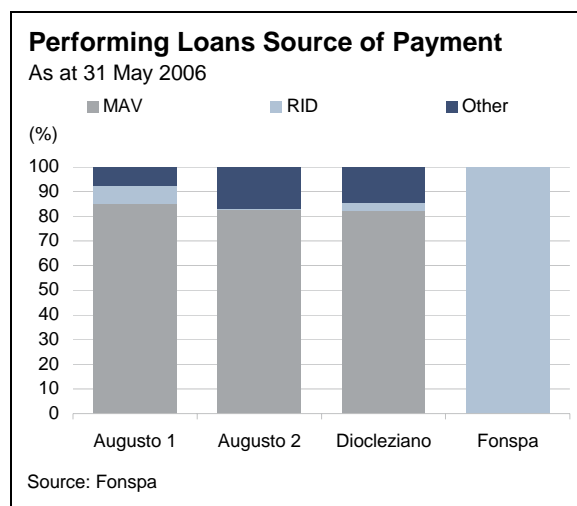
Payment details on performing loan collections are received daily through a corporate remote banking system ("CORBAN"). Collections from this are

transferred to FIS/K4F nightly and matched to loans. In strengthening the platform in anticipation of mortgage originations, the payment processing system has been reviewed and processes for the efficient and timely chasing of missed payments are in place.

The company can accept payments by direct debit known as RID, MAV (an Italian system whereby the borrower receives a payment notice by mail and makes the payment through the banking system), direct payments at a bank branch and wire transfers.

First level control procedures verify data accuracy. Fluscont, a proprietary control system, reconciles loan administration and accounting data.

Collections under commercial performing portfolios are managed according to the different transactions under administration, typically with the collection of rental income. Fonspa's collections monitoring function is performed through the "Corban" system to ensure timely payment.



Customer Relations

The loan management office supports the loan administration group in addressing borrower enquiries, dealing with an average of 20 customers a day. Mortgage redemption is a smaller unit of the customer relations department and responds to requests from customers and public notaries for settlement, mortgage cancellations and amendments.

Investor Reporting

The investor reporting department interfaces with investors and the SPV equity holders. The department consists of six staff with extensive industry and company experience, and is responsible for ensuring that all parties involved in any securitisation comply with Law 130 and contractual agreements. The department is structured into two

units – reporting and analysis/control. The reporting unit performs first level quality controls, reconciling data from the accounting system. The analysis/control unit prepares a series of checklists for each transaction under management and is also responsible for the preparation and submission of Law 130 servicing reports to the board of directors, statutory auditors and the Bank of Italy.

Fonspa continues to develop and enhance its investor reporting area. Fonspa have been awarded a Fitch Issuer Report Grade ("IRG") of '4 Stars' for its preparation and reporting of the ICR 5 transaction and '3 Stars' for both the Imser and Taurus CMBS transactions. During 2005/2006, Fonspa provided a website with access to performance reports for investors.

Asset Administration

Fonspa has recently introduced a basic form of property surveillance for commercial assets. Annual inspections are carried out by in-house property experts on 'top' assets – classified by OMV and/or rental stream. It is expected that this process will develop further over the next 12 months. The adequacy of the asset as security for the transaction is monitored through tight control on all expenses incurred by borrowers in relation to the properties (such as maintenance, repair works and refurbishment costs) and also the relevant financial ratios (such as the interest cover ratio and the loan to value ratio). Financial statement analysis and borrower credit reviews are completed annually.

Portfolios under administration mainly comprise commercial properties with multiple tenants (such as multi-family properties).

Under commercial mortgaged backed portfolios, Fonspa is also generally appointed as security agent and is therefore responsible for mortgage release, which according to Italian regulations is performed in front of public notaries.

■ Servicing Methodology – Defaulted Loan Management

Fitch's primary servicer rating addresses the administration of early delinquencies – up to two late payments. Depending on the service level agreement, the company generally administers delinquencies of up to 60 days.

The collections department has benefited from the refocusing on mortgage originations. The department, based in Rome, consists of 12 staff including the department manager, with staff split across two units:

- customer relationships and mortgage formalities, which consists of seven staff with long industry tenure (all spent at Fonspa), and is responsible for early collections, appropriate referral to NPL management office and for general redemption and renewal queries;
- the NPL management office, which is responsible for managing out of court settlements and judicial procedures.

Collectors are allocated loans based on geographic location and are assigned automatically by the K4F system. Borrowers are sent a first automated 'late notice' at seven days past due. Two days later, collectors will try and establish telephone contact to return the loan to performing. After the second missed payment, a second automated late notice is mailed to the borrower, followed by further attempts at telephone contact and written payment requests. At three months past due, legal proceedings are initiated by Fonspa.

All collectors are responsible for controlling the timely receipt of payments under repayment plans. Fonspa currently manages five performing residential mortgage loan portfolios and two commercial performing portfolios, using the collections policy manual provided by the originators. The expansion of the origination programme has tested Fonspa's collection policy – early indications seem to be positive. The growing experience of this process will be valuable in discussing collection techniques with any new performing loan clients.

■ Technology

The IT department employs 13 staff in three units:

- the performing loan and NPL IT unit, which manages the core K4F system and provides helpdesk facilities;
- the Infocentre unit, which is responsible for managing and supporting all applications except K4F; and
- the network and technology office, which manages the local network and updates the company's intranet.

Fonspa installed FIS/K4F, a centrally-integrated loan administration system, in 1999. It runs on an IBM mainframe and has the flexibility to meet specific servicing requirements. In 2004, consideration was given to moving the mainframe to a new platform; however, after thorough cost benefit analysis, the existing mainframe has been retained and further enhanced to gain increased stability and reliability.

New technology has been developed to conform to IAS requirements. Implementation was successfully achieved in December 2005.

Further IT enhancement has been made to assist with the calculation of broker fees and insurance premiums, therefore reducing the possibility of incorrect payments.

Fonspa is continually striving to improve its IT platforms, and is currently considering implementation of a full imaging solution, along with improvements to the website for third party use. Fitch believes that the additional features and functionalities introduced and planned will further enhance an already robust and flexible environment.

Disaster recovery procedures are documented and owned by the IT department. The disaster recovery plan was successfully tested in December 2005 and June 2006. The next disaster recovery test is scheduled for December 2006.

Data back-ups are performed at both a mainframe and local level. The mainframe is backed-up nightly at a telecoms data centre in Bologna. Weekly tapes are then prepared and copies stored at the site in Bologna and an alternate site in Bari. Local servers are also backed up daily.

■ Surveillance

Servicer ratings are valid for a period of 12 months from the date of being assigned. Servicers are subject to an annual review for the ratings to be maintained. Servicer surveillance will work closely with transaction surveillance to enhance the proactive identification of issues that may affect Fitch-rated transaction performance.

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