Apr 13, 2009

R&I's Rating Methodology for Japan Housing Finance Agency MBS

(This report is an English translation of the original report in Japanese.)

The Government Housing Loan Corp. (GHLC) was abolished on March 31, 2007, based on the Housing Loan Support Agency Law ("dokuritsu gyousei houjin juutaku kinnyu shien kikou hou") approved during the regular 2005 session of the Diet, and the Japan Housing Finance Agency (JHF), which was created on April 1, 2007, succeeded to GHLC's rights and obligations. JHF also succeeded to the rights and obligations of the Housing Loan Guarantee Corporation, which was abolished on March 31, 2007.

Beginning with the first securitization issue in March 2001, GHLC and JHF completed 98 GHLC MBS issues through March 2009 including the Series S Bonds, for a total MBS issue amount of approximately 9.5 trillion yen. In this report, the MBS issued by GHLC until March 2007, and the MBS issued by JHF after April 2007, are referred to collectively as JHF MBS.

From Bonds No. 1 through No. 13, only direct housing loans provided by GHLC were included in JHF MBS securitized loans, but housing loans under the Securitization Support Program (Kaitori-Gata) were added to loans eligible for securitization as of GHLC Bonds No. 14 issued in January 2004.

The enactment of the Law for the Partial Amendment to the Public Housing Law ("kouei juutaku hou") for the Publicly funded Improvement in Supply System of Houses and Land for Housing ("kouteki shikin ni yoru juutaku oyobi takuchi no kyokyu-taisei no seibi no tameno kouei juutaku hou no ichibu wo kaiseisuru houritsu") in June 2005 and the Housing Loan Support Agency Law in July 2005 has made it possible for GHLC and JHF to issue Series Series S Bonds (securitization of previously existing loans). It is JHF's intention to make early repayments of fiscal loan funds with funds raised from the Series S Bonds.

JHF's housing loan screening does not establish any conditions for applicants' minimum annual income or the collateral conversion value of the pledged properties. The reason is JHF is the entity for implementing Japan's national housing policy of broadly providing housing for the general public, and cannot refuse financing simply on the grounds an applicant's income is low or the collateral does not have sufficient conversion value. For the same reason, JHF must originate housing loans eligible for the Securitization Support Program. The creditworthiness of the housing loan portfolios that provide the backing for securitization involves income disparities by region, and changes in tandem with macroeconomic fluctuations. This makes it important to analyze the product risk, default rate, change in the prepayment rate over time and other factors when investing in JHF MBS.

[Main Areas Covered in the Report]
1. Outline of the JHF MBS scheme
2. R&I's rating approach to JHF MBS
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4. Changes to the past changes on qualifying standard and their impact on the calculation of overcollateralization ratio (from Bonds No. 40)
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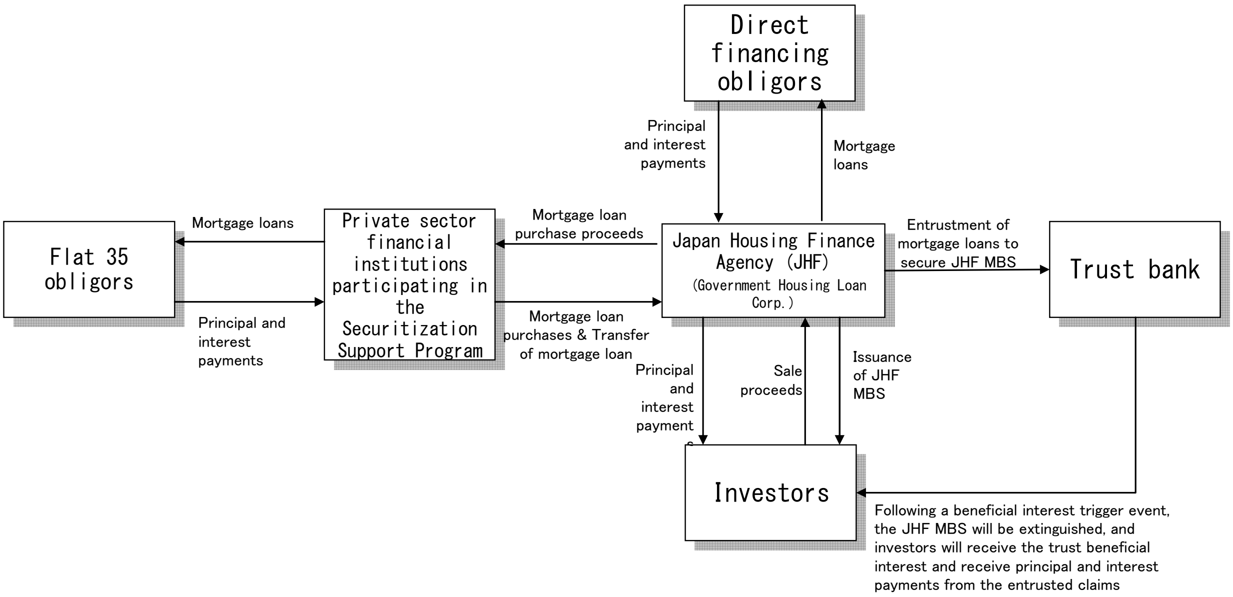
1. Outline of the JHF MBS scheme

JHF Bonds are divided into four types:

I. Monthly GHLC Bonds (No. 1 through No. 53 issued from March 2001 through March 2007)
II. Series S Bonds (GHLC Bonds No. S-1 through GHLC Bonds S-10 issued between August 2005 and December 2006)
III. Monthly JHF Bonds (No. 1 and after issued since May 2007)
IV. Series S Bonds (JHF Bonds No. S-1 and after issued since May 2007)

The key difference between the schemes for I, II, IV and III is in the handling of mortgage loan claims that are four months or more months in arrears (refer to Point 3 under 1. (1) Monthly Bonds scheme, Point 3 under 1. (2) The Series S Bonds scheme and 4. (5) 1) Revision of the Monthly Bonds scheme (change in the "entrusted claims substitution" system) below).

(1) The Monthly Bonds scheme



1) JHF entrusts housing loan claims financed directly by JHF and Kaitori-Gata housing loan claims to a trust bank. The trusts are alternative beneficiary trusts (Taeki Shintaku) under which the bondholders of the JHF MBS are the beneficiaries. When entrusting the mortgage loan claims, the transfer of the movable assets and claims is perfected as against any third party by registration pursuant to the Law Regarding Special Exceptions to the Civil Code with Respect to Perfection Requirements for Assignment of Movables and Claims. When transferring Kaitori-Gata mortgage loan claims from private financial institutions to JHF, the transfer also is perfected as against any obligor by obtaining the unconditional consent with a certified date (kakutei-hizuke) from the mortgage loan obligors.

2) Collection of the entrusted claims will be consigned to JHF. JHF will then re-consign the collection business for mortgage loan claims financed directly by JHF to the financial institutions that accepted the mortgage loan applications, and will re-consign the collection business for mortgage loan claims JHF has purchased to the financial institutions that are the sellers of the Kaitori-Gata loans, respectively. In the event consignment of the collection business to JHF is nullified because of a beneficial interest trigger event, the collection business will be performed by the trustee or by a third party to which the trustee consigns the collection business.

3) The handling of any entrusted loans on which payments are overdue by four months and any entrusted loans where the loan terms have been altered (loan claims four months in arrears etc.) is different for (a) Monthly GHLC Bonds and (b) Monthly JHF Bonds:

(a) Monthly GHLC Bonds (same for Series S Bonds mentioned below)

JHF has the right to exchange any entrusted loans on which payments are overdue by four months and any entrusted loans where the loan terms have been altered with other appropriate directly financed loan claims

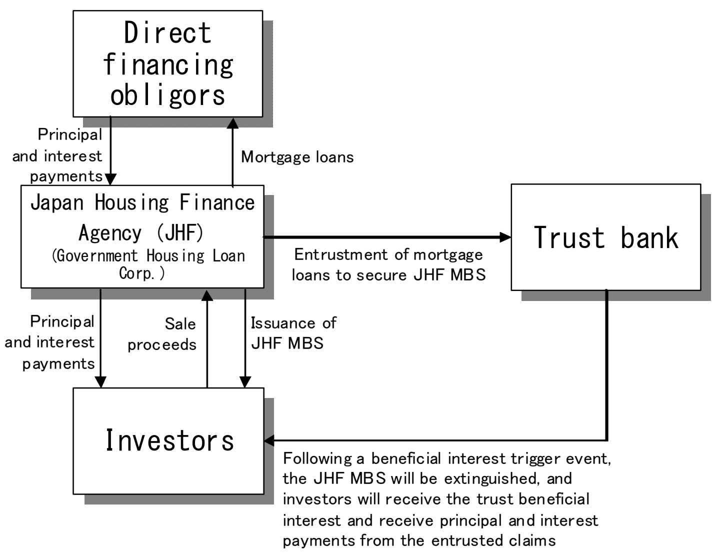
(b) Monthly JHF Bonds

JHF has the right to prepay JHF MBS in an amount calculated by dividing the outstanding balance of such loan claims by "1 + overcollateralization rate". The entrusted loan claims will be returned to JHF.

4) The JHF MBS will be repaid using a monthly pass-through. The amount to be redeemed each month will be based on the amount of principal recovered on the entrusted claims two months previously (Note 1). In addition, after entrusted claims equivalent to an amount calculated by multiplying the balance of the JHF MBS after each monthly redemption by "1 + the overcollateralization rate" are assured, the portion of entrusted claims serving as security that exceeds this amount will be returned to JHF.

5) Following a beneficial interest trigger event (Note 3), the beneficial interest will be exercised and the JHF MBS will be extinguished, and investors will receive and hold the trust beneficial interest that served as security. After the beneficial interests have been exercised, the trust beneficial interests will be redeemed by a monthly pass-through using the collection money each month less an amount for the trust interest and various costs (turbo redemption).

(2) The Series S Bonds scheme



1. JHF entrusts housing loan claims financed directly by JHF to a trust bank. The trusts are alternative beneficiary trusts (Taeki Shintaku) under which the bondholders of the JHF MBS are the beneficiaries. When entrusting the mortgage loan claims, the transfer of the movable assets and claims is perfected as against any third party pursuant to the Law Regarding Special Exceptions to the Civil Code with Respect to Perfection Requirements for Assignment of Movables and Claims.

2. Collection of the entrusted claims will be consigned to JHF. JHF will then re-consign the collection business for mortgage loan claims to the financial institutions that accepted the mortgage loan applications. In the event consignment of the collection business to JHF is nullified because of a beneficial interest trigger event or other reason, the collection business will be performed by the trustee or by a third party to which the trustee consigns the collection business.

3. JHF has the right to replace any entrusted loans on which payments are overdue by four months or more and any entrusted loans where the loan terms have been altered with other eligible directly financed mortgage loans.

4. The JHF MBS will be repaid using a monthly pass-through. The amount to be redeemed each month will be based on the amount of principal recovered on the entrusted claims two months previously (Note 2). In addition, after entrusted claims equivalent to an amount calculated by multiplying the balance of the JHF MBS after each monthly redemption by "1 + the overcollateralization rate" are assured, the portion of entrusted claims serving as security that exceeds this amount will be returned to JHF.

5. Following a beneficial interest trigger event (Note 3), the beneficial interest will be exercised and the JHF MBS will be extinguished, and investors will receive and hold the trust beneficial interest that served as security. After the beneficial interests have been exercised, the trust beneficial interests will be redeemed by a monthly pass-through using the collection money each month less an amount for the trust interest and various costs (turbo redemption).

Note 1: JHF MBS monthly redemption amount (Monthly JHF Bonds)
MBS principal redemption amount = MBS unredeemed balance – MBS current period scheduled balance
MBS current period scheduled balance = MBS unredeemed balance x A

A = Entrusted claims balance after deduction of claims in arrears at end of period / (Entrusted claims balance after deduction of claims in arrears at beginning of period + Entrusted claims balance for early redemption after deduction of claims in arrears at beginning of period)

- In the above equation, "unredeemed balance" is the amount on the day before the redemption date concerned
- "Entrusted claims for early redemption" refers to loan claims four months in arrears etc. that become subject to prepayment
- "Entrusted claims balance after deduction of claims in arrears at beginning of period" and "Entrusted claims balance after deduction of claims in arrears at end of period" are the balances excluding "entrusted claims for early redemption"

Note 2: JHF MBS monthly redemption amount (Series S Bonds and Monthly GHLC Bonds)
MBS principal redemption amount = MBS unredeemed balance – MBS current period scheduled balance

MBS current period scheduled balance = Unredeemed balance × (Entrusted claims balance after deduction of claims in arrears at end of period / Entrusted claims balance after deduction of claims in arrears at beginning of period)

- In the above equation, "unredeemed balance" is the amount on the day before the redemption date concerned

Note 3: Beneficial interest trigger events
(1) When the entity that will succeed to the obligations of the MBS has not been designated by law, and JHF has been dissolved
(2) When a law is enforced making the entity that will succeed to the obligations of the MBS a corporation to which the Corporate Rehabilitation Law or similar law can be applied, and JHF has been dissolved
(3) When a law is enforced making JHF a corporation to which the Corporate Rehabilitation Law or similar law can be applied, and an obligor of the MBS has become the corporation concerned
(4) When JHF fails to perform its payment obligation related to the MBS or other payment obligations, and JHF has not remedied this situation within seven days

2. R&I's rating approach to JHF MBS

The rating methodology for both Monthly Bonds and Series S Bonds is basically identical. The characteristic points of the analysis methodology for JHF MBS are (1) use of the Issuer Rating for the JHF as a base and (2) the possibility of notching up from the base rating.

In addition, compared with a private sector securitization, the probability of timely payments and the commingling loss risk, etc., depend on the JHF's creditworthiness.

(1) Possibility of notching up higher than the creditworthiness of JHF itself

The JHF MBS are backed by mortgage loan claims entrusted under an alternative beneficiary trust (Taeki Shintaku). Because JHF is the issuer of the JHF MBS, any downgrade of JHF's Issuer Rating prior to the time when the beneficial interests are exercised could result in a downgrade of the rating for the JHF MBS. Nevertheless, because sufficient overcollateralization has been set, and the Corporate Reconstruction Law, which would greatly limit JHF's ability to dispose of assets, does not apply, the rating for the JHF MBS may be higher than the Issuer Rating for JHF itself.

(2) Ability to make timely payments

Because no initial liquidity enhancement is set, the ability to make timely payments of interest before the beneficial interests are exercised depends on JHF's creditworthiness. There is a possibility the delivery of collected funds from JHF to the trustee would be delayed temporarily, and payment of various costs and interest from the entrusted assets postponed, if a beneficial interest trigger event occurs. After the beneficial interests have been exercised, however, the payment will be reserved by setting aside a cash amount equivalent to three months worth of trust interest and various costs from the collection money at the stage before redemption of the principal.

(3) Risk of commingling loss

Because no credit enhancement will be established against commingling loss risk, the risk of commingling loss at JHF, the servicer, depends upon JHF's creditworthiness.

Commingling losses might also be incurred should consignment of the collection business to JHF be terminated, or if a financial institution to which the collection business has been re-consigned fails. R&I evaluates this risk to be limited because re-consignment will be made to a number of financial institutions and the risk will be diversified adequately, and Kaitori-Gata mortgage loan claims are perfected as against the obligors (refer to Reference Document 5).

(4) Offset risk

Because JHF does not accept deposits, there is no risk the collateral bond obligors will offset deposit claims and the housing loan obligations. In one sense there is offset between the mortgage bond-related claims and the mortgage loan obligations, because individuals purchase the "Tsumitate Kun" mortgage-backed bonds GHLC issued in the past. Nevertheless, mortgage bonds are believed to be purchased for the purpose of accumulating capital funds for purchasing a home or other assets and repaid when the bondholders borrow housing loans, so the likelihood of offset following a home purchase is low.

Moreover, when transferring Kaitori-Gata mortgage loan claims from private financial institutions to JHF, the transfer also is perfected as against any obligor and as against any third party by obtaining the unconditional consent with a certified date (kakutei-hizuke) from the mortgage loan obligors. In addition, when a private financial institution fails, there will be no offset with assets such as deposit claims because a declaration of obligor approval or a statement to the effect the obligors waive the right of offset and other rights is included in the loan agreement concluded between the private financial institutions and the obligors.

(5) Overcollateralization

Overcollateralization is set bearing in mind the characteristics of JHF's housing loan portfolio. Before the beneficiary agent exercises the beneficial interests, the portion of the entrusted claims exceeding the amount to maintain the JHF MBS overcollateralization rate at a constant level is returned to JHF. Although JHF can prepay the full amount of the unredeemed balance when the JHF MBS balance falls to 10% or less of the initial amount, there is a concern the degree of concentration of the obligors will rise because the remaining number of obligors will decline when the beneficial interests are exercised when the trust period has passed a certain point in time and the JHF has not redeemed the bonds before maturity. Therefore, R&I confirms the extent of notch-up level taking account of the number of obligors, the degree of concentration of the obligors, the loan attribute, the recovery condition and the repayment historical data, etc. After the beneficiary agent exercises the beneficial interest, in return for extinguishing the JHF MBS the investors will receive the trust beneficial interest that secured the JHF MBS, and the trust beneficial interest will be redeemed by monthly pass-through using the amount of collected funds each month after deduction of the trust interest and various costs.

(6) JHF MBS overcollateralization calculation methodology

The overcollateralization level is calculated by subtracting the excess spread from the credit enhancement for defaults.

R&I basically calculates the credit enhancement for defaults by applying the stress scenario for a AAA rating to the default rate and recovery rate, etc., for entrusted claims. Because the overcollateralization rate calculation normally is performed before the JHF MBS coupon rate is decided, however, there is a possibility the credit enhancement for defaults will not satisfy the AAA scenario if the excess spread decreases because, for example, interest rates rise above the assumed rate after the calculation has been made. Even in this situation, however, R&I believes it is possible to notch up the rating for the JHF MBS, based on JHF's Issuer Rating, if the level of credit enhancement for defaults satisfies the stress scenario required for an extremely high rating. The width of the notch up will be smaller than that applied when the AAA stress scenario is met.

R&I will assign the actual rating after confirming the credit enhancement for defaults satisfies the stress scenario necessary for an extremely high rating. R&I intends to describe whether the overcollateralization meets the credit enhancement level for defaults necessary to satisfy the stress scenario for a AAA rating in the press releases for the actual ratings.

1) Credit enhancement for defaults

When calculating the credit enhancement against defaults, R&I applies the monthly default and prepayment rate trends to the trends of outstanding amount of the entrusted claims principal to obtain the default amount for each month. R&I also determines the loss amount for each month and calculates the cumulative loss amount (credit enhancement amount against defaults) by tempering the default amount for each month using the amounts collected from collateral. In the cash flow analysis, R&I calculates the credit enhancement ratio by taking account of the timing of a beneficial interest trigger event.

The numerical values such as the default rate used in the calculation are set by application of stress factors corresponding to the target rating, based on repayment historical data. The historical repayment data are historical data covering (1) claims extracted by bracket sampling of claims equivalent to 10% of all eligible claims that can be entrusted for securitization from among the housing loan claims (directly financed loan claims) held by JHF and (2) all Kaitori-Gata housing loan claims.

JHF establishes a first mortgage on the housing loan claims. The mortgages are assumed to accompany the assignment of the claims, and it is thought possible to anticipate collection from the sales proceeds of a collateral property by exercising the mortgage, once the beneficial interest has been exercised. For collection from collateral, R&I conservatively estimates the future percentage

of decline in land prices, collateral collection period, loan balance and property sales costs, and incorporates these into the credit enhancement calculation.

For an analysis of the default rate and the prepayment rate for the repayment historical data, please refer to Reference Documents 1 through 3.

2) Excess spread

The amount of the excess spread is calculated by subtracting various costs such as interest payments on the JHF MBS and trust fees from the interest income on the entrusted mortgage loans. Because the overcollateralization rate calculation normally is performed before the JHF MBS coupon rate is decided, however, there is a possibility the excess spread will decrease because, for example, interest rates rise above the assumed rate after the calculation has been made.

3) Factors causing changes to the overcollateralization ratio (credit enhancement ratio) for each MBS series

When calculating credit enhancement against defaults in 1), R&I takes into account an analysis of loan attributes and recent trends in the incidence of default in repayment historical data. With regard to loan attributes, particular attention is given to factors such as the proportion of obligors with high Loan to Value (LTV) ratios, the breakdown by occupation and the proportion of low-income earners, the proportion of obligors with high Debt to Income (DTI) ratios, the proportions of loan types, the proportions of property locations, and the number of obligors.

In the news release for each MBS series, R&I describes the factors causing changes from the previous MBS series concerning the calculation of the overcollateralization ratio calculation (credit enhancement ratio).

Reference materials

(1) “R&I Analysis of Housing Loan Defaults (2006 Update)” (News Release dated June 30, 2006)
(2) “R&I Analysis of Housing Loan Prepayments (2006 Update)” (News Release dated May 26, 2006)
(3) “Analysis of Housing Loans by Attribute” (News Release dated November 20, 2007)
(4) “R&I View on Commingling Risk of a Servicer that is a Financial Institution covered by the Deposit Insurance System” (News Release dated March 3, 2005)
(5) “Report on The Government Housing Loan Corp.” (News Release dated December 13, 2005)
(6) “R&I Assigns AAA, Negative: JHF” (News Release dated March 30, 2007)
(7) "R&I Affirms AAA, Negative: JHF" (News Release dated November 5, 2008)
(8) “All About Mortgage Securitization” (Yuji Orui and R&I, Rating and Investment Information, Inc.

Note: Reference materials 1, through 7 are available on R&I’s website.

3. Changes to R&I's overcollateralization rate (credit enhancement rate) calculation methodology

There are three revisions R&I made to its overcollateralization rate calculation methodology in the past. When changing the calculation methodology, R&I describes the details of the change in the press release for each MBS series.

(1) Changes applied in April 2007

a. Methodology for calculation of the rate of recovery from collateral

For collection from collateral, R&I conservatively estimates the future percentage of decline in land prices, collateral collection period, loan balance and property sales costs, and incorporates these into the credit enhancement calculation. For the future percentage of decline in land prices, R&I established a conservative ratio based on conditions following the collapse of Japan's bubble economy, using the assumption that land prices will continue falling for 35 years at the same rate. In light of considerations such as the recent slowdown in the rate at which land prices are declining, R&I believes it is possible to set a floor on falling land prices. Specifically, R&I has set the floor at a conservative level, based on the rate of decline after the economic bubble burst. Until a floor is reached, R&I will assume real estate price will decline under the same conditions that have prevailed to date.

(2) Changes made for GHLC Bonds No. 20 and GHLC Bonds No. 22

R&I revised its methodology for calculating the rate of recovery from collateral beginning from GHLC Bonds No. 20 and GHLC Bonds No. 22, and revised its approach to the prepayment rate for the GHLC Bonds No. 22.

a. Methodology for calculation of the rate of recovery from collateral

Beginning from GHLC Bonds No. 20, R&I revised its scenario for collections from the collateral, taking into consideration recent trends concerning debt collection. R&I also changed the LTV used when estimating the recovery rate from collateral, beginning from GHLC Bonds No. 22. When calculating the recovery rate, R&I does not need to consider loans from other financial institutions because a first mortgage is established for JHF financing. When calculating the recovery rate, R&I traditionally employed a LTV (loan/mortgage property value) figure that used total borrowing from JHF and other financial institutions as the loan amount, but from this issue R&I decided to use the LTV based only on the loans from JHF (i.e., excluding loans from other financial institutions). R&I therefore changed the value used to arrive at an accurate recovery rate calculation.

b. Approach to the prepayment rate when calculating the overcollateralization rate

In the past, R&I assumed a change in the prepayment rate would have a substantial affect on the cumulative default amount. For example, the cumulative default amount was expected to increase if the prepayment rate declined because the remaining term of the claims pool would be prolonged but the monthly default rate would be unchanged.

Based on an R&I study showing obligors with excellent creditworthiness will make prepayments easily, however, beginning from GHLC Bonds No. 22 R&I decided to adopt the view that prepayment amounts have a limited affect on the amount of cumulative defaults. Although the remaining term of the claims pool grows shorter as prepayments occur, assuming the ratio of obligors with excellent creditworthiness falls as a percentage of the claims pool there is a possibility the monthly default rate will rise. Oppositely, the remaining term of the claims pool will be longer when the prepayment rate is low, but the monthly default rate will decline because a larger number of obligors with excellent creditworthiness will remain in the claim pools. R&I therefore considered the affect exerted on the cumulative default amount of the claims pool by the amount of prepayments to be limited and revised its prepayment rate assumption.

4. Changes to the past changes on qualifying standard and their impact on the calculation of overcollateralization ratio (from GHLC Bonds No. 40)

(1) Change in qualifying standards for entrusted loan claims in initial entrustment and in substitution beginning with GHLC Bonds No. 40

Commencing with GHLC Bonds No. 40, the qualifying standards for entrusted loan claims and instances where substitutions are made were changed on four accounts.

a. Abolition of guarantee requirements for JHF direct finance loans

In the past, direct finance loans carried a guarantee from the Housing Loan Guarantee Corporation. As of April 2005, however, JHF has abolished the guaranty requirements for applications for loans received from April 2005 onwards, and will add a premium corresponding to the cost required for the credit enhancement on the interest rate instead. This measure is to prevent the guarantee obligation and the guarantee claims held by GHLC to be commingled and be extinguished when JHF is established in April 2007 and succeeds to the loan guarantee obligations of the guarantee association.

Loan claims for which applications are received from April 2005 onwards will now included in the entrusted loan claims of GHLC Bonds No. 40 onwards. In line with this change, changes have also been made to qualifying standards in initial entrustment and in substitution.

In its rating analysis for securitizations, R&I did not factor in the guarantee capacity of the Housing Loan Guarantee Corporation, so the change on this occasion will not have an effect on R&I's analysis of the credit enhancement ratio.

As before, Securitization Support Program (Kaitori-Gata) loans have no guaranty requirements.

<table>
<tr><th>Type of loan</th><th>Provisions under the Agency Law</th><th>Classification under entrusted mortgage loan claims</th></tr>
<tr><td>New residential dwellings (<u>Including dwellings apart from single houses</u>)</td><td rowspan="6">Article 17-1 or 17-2</td><td>1) Residential dwellings, <u>etc.</u></td></tr>
<tr><td>Condominiums</td><td>2) Condominium</td></tr>
<tr><td>Ready-build houses</td><td>3) Ready-build houses</td></tr>
<tr><td>Blue-chip condominiums</td><td rowspan="2">4) Blue-chip condominiums etc.</td></tr>
<tr><td><u>Government Corporation condominiums</u></td></tr>
<tr><td><u>Pre-existing houses</u></td><td><u>6) Pre-existing house</u></td></tr>
<tr><td><u>Houses at risk of landslide</u></td><td>Article 17-7</td><td>1) Residential dwellings, <u>etc.</u></td></tr>
<tr><td>Urban Residence Renaissance (<u>building</u> and purchasing)</td><td rowspan="3">Article 17-11 or 17-12</td><td rowspan="3">5) Urban Residence Renaissance <u>etc.</u></td></tr>
<tr><td><u>Urban Area Redevelopment</u></td></tr>
<tr><td><u>Medium- to High-Rise Buildings</u></td></tr>
</table>

Note: Underlined items above are new loan categories that have been added to the GHLC entrusted mortgage loan claims from GHLC Bonds No. 40.

b. Increase in types of direct finance loans

The types of financing available for loan applications received from April 2005 onwards have been increased. Seven new types of loans have been added to existing loans: new residential dwellings (apart from free-standing houses), public corporation condominiums, pre-existing houses, houses at risk from landslides, etc., urban residence renaissance, urban area redevelopment (construction), and medium- to high-rise buildings.

Like purchased pre-existing houses that have been included in entrusted claims since the issue of GHLC Bonds No. 25, data from pre-existing houses, such as default ratios on pre-existing blue chip houses and prepayment ratios, serve as useful repayment historical data references.

Furthermore, R&I obtained data on these loans and loan attributes and has reflected this in the calculation of the credit enhancement ratio.

c. Inclusion of second home loans in direct finance loans and Securitization Support Program (Kaitori-Gata) loans

A Second House Loan is a loan for the acquisition of a second house for weekend use (residence) by an obligor in addition to the primary residential dwelling.

Second House Loans were added to the Securitization Support Program (Kaitori-Gata) loans in January 2006; however, these loans had previously been offered through direct finance loans under the name "Home Expansion Special Financing (Owner Occupied-type)."

R&I analyzed data on these loans regarding past defaults. While the period covered by the data and the type of data was limited and broad generalizations cannot be made on that basis alone, there were no particular differences with the previous entrusted loan claims.

In the analysis of the credit enhancement ratio, it was deemed that the obligors' motivation to make payments on the Second House Loans is weaker than for residences for dwelling purposes, so R&I raised the stress for this type of loan somewhat. R&I also obtained data on the loan attributes for this type of loan and reflected it in the calculation of the credit enhancement ratio.

(Note 3) Ratio of the total of Second House Loans of Kaitori-Gata loans and Home Expansion Special Financing (Owner Occupied-type) direct-finance loans against the entrusted loan claims.

	GHLC No. 40	GHLC No. 41	GHLC No. 42	GHLC No. 43	GHLC No. 44
(1) Special Financing direct-finance loans	2.06%	0.13%	0.04%	0.06%	0.51%
(2) Second house loans	1.54%	0.29%	0.51%	0.78%	1.32%
	GHLC No. 45	GHLC No. 46	GHLC No. 47	GHLC No. 48	GHLC No. 49
(1) Special Financing direct-finance loans	0.17%	0.13%	0.11%	0.03%	0.07%
(2) Second house loans	0.90%	0.86%	0.82%	0.72%	0.63%
	GHLC No. 50	GHLC No. 51	GHLC No. 52	GHLC No. 53	
(1) Special Financing direct-finance loans	0.02%	0.24%	0.04%	0.02%	
(2) Second house loans	1.29%	0.84%	1.22%	2.06%	

	JHF No. 1	JHF No. 2	JHF No. 3	JHF No. 4	JHF No. 5
(1) Special Financing direct-finance loans	0.01%	0.11%	0.53%	0.17%	0.01%
(2) Second house loans	1.81%	1.66%	3.09%	3.10%	1.58%
	JHF No. 6	JHF No. 7	JHF No. 8	JHF No. 9	JHF No. 10
(1) Special Financing direct-finance loans	0.01%	0.00%	0.01%	0.00%	0.00%
(2) Second house loans	1.95%	2.36%	2.23%	3.15%	2.06%
	JHF No. 11	JHF No. 12	JHF No. 13	JHF No. 14	JHF No. 15
(1) Special Financing direct-finance loans	0.00%	0.00%	0.00%	0.07%	0.10%
(2) Second house loans	2.10%	3.06%	3.39%	2.70%	3.86%
	JHF No. 16	JHF No. 17	JHF No. 18	JHF No. 19	JHF No. 20
(1) Special Financing direct-finance loans	0.00%	0.08%	0.00%	0.00%	0.04%
(2) Second house loans	3.37%	4.75%	3.68%	3.22%	3.07%
	JHF No. 21	JHF No. 22	JHF No. 23		
(1) Special Financing direct-finance loans	0.00%	0.00%	0.00%		
(2) Second house loans	2.64%	3.71%	2.64%		

d. Changes in the handling of the initial incidence of delinquency

Loan claims that are in arrears on the base sampling date or the trust execution date have been excluded from the entrusted loans by substitution with other loan claims on the grounds that they do not fulfill the qualifying standards. Payment delays on the initial payment date can be due to various reasons, such as arrangements for bank transfers, etc. might not be on time. Such circumstances do not constitute a credit incident, and to avoid substitution exercises which do not reflect the true reason, treatment of the first payment in arrears has been changed. To be specific, delay in payment on the first repayment day right after the loan agreement is not handled as a delinquent loan.

This change applies to direct finance loans and Securitization Support Program (Kaitori-Gata) loans; however, with direct finance loans, since there is some leeway for the loan agreement to the first payment date, this change will be intended mainly for Securitization Support Program (Kaitori-Gata) loans.

The average proportion of loan payments in arrears on the first payment for Kaitori-Gata loans in GHLC Bonds No. 30 to GHLC Bonds No. 39 was 0.21%, and the ratio of loans where the payment remained in arrears in the following month was 0.02%. Approximately 90% of the loans that were in arrears on the first payment date met the payment by the following month.

Because payments for the majority of loans that were late in making the initial were on time the following month, the ratio of loans where payments remained in arrears was extremely small, and because the delays in loan payments on the first payment were included in the repayment historical data used for the analysis, R&I does not see any particular problem.

(2) Implementation of exception regarding the initial repayment (Initial Repayment Exception System): Implemented from GHLC Bonds No. 46

Starting July 1, 2006, for Kaitori-Gata loans financed by non-deposit-accepting financial institutions, the initial repayment date of the loan can be scheduled to fall on the second transaction date following the financing if the financial institution in question requests the use of the Initial Repayment Exception System. This system defers the repayment due on the initial transaction date that falls immediately after the financing, and the first two installment payments are made on the initial repayment date. This results in one less repayment than originally, compared to when the Initial Repayment Exception System is not implemented. Loans for which this system applies are included in the entrusted loans starting with the GHLC No. 46 Bonds.

Regarding the Kaitori-Gata loans financed by non-deposit-accepting financial institutions, when the transaction date fell immediately after the financing, the institution faced the inconvenience of not having enough time to complete the relevant paperwork. This problem can be avoided by implementing the Initial Repayment Exception System.

The system will affect only the first two repayments of the overall repayment schedule for entrusted loans. According to the historical repayment data, the delinquency rate at the point in time when one month has elapsed since the repayment has started averages about 0.27%; 90% of these cases do not lead to a second delay, however, but are resolved. Moreover, because the initial ratio of such loans to which the exception is applied is low, R&I believes this is not a particular problem for its analysis of the credit enhancement ratio.

(3) Change in administration when the land is sublease ground: Implemented from GHLC Bonds No. 47

Since September 2005, properties for which the land leasehold is a sublease have been eligible for purchase (1) when a first mortgage can be established on the site or (2) when the party holding title to the land is a public enterprise that has concluded a "Memorandum Concerning Adjustment of Rights" with JHF that provides for the protection of the right of use of the housing lot and a mortgage or other security has not been established for any third party (excluding the establishment of a mortgage on the land).

Beginning with loans purchased from August 2006, the parties able to conclude such a memorandum will be expanded to include private sector entities. Although JHF is assuming special treatment for each separate zone regarding sublease land properties in which private sector entities participate, the funding execution period is planned from 2008.

(4) Change in treatment for leasehold acquisition expense: Implemented from GHLC Bonds No. 48

Beginning with loans purchased from September 2006 (entrusted loans for the GHLC No. 48 Bonds), GHLC has implemented treatment of loans that make the guaranty money or deposit required when purchasing a leasehold eligible for financing as leasehold acquisition expense (key money has always been eligible for financing) when the land for a house that is eligible for Kaitori-Gata financing is a fixed-term land leasehold.

The share of guaranty financing as a percentage of total GHLC direct finance loans is at a level that has not exceeded 0.4% on a number of obligors basis (figures on a fiscal year basis for fiscal 2000-fiscal 2005). While borrowers of Kaitori-Gata financing with a leasehold are believed to have increased somewhat along with expansion of the types of loans eligible for financing, when the supply of homes having a fixed-term land leasehold is considered it is difficult to view this growth as an extreme increase.

Because it considers the ratio of such loans currently to be low, R&I believes the affect on the credit enhancement ratio is limited.

(5) Changes to the Monthly Bonds scheme and changes to the Flat 35 system (for trusts established from March to May 2007)

1) Revision of the Monthly Bonds scheme (change in the "entrusted claims substitution" system)

For GHLC MBS issued up until now, when arrears of four months or longer occurred in the entrusted claims prior to the occurrence of a beneficial interest trigger event, GHLC had the right to replace such loans with other loans it held ("entrusted claims substitution" system), and in fact GHLC did make such substitutions. For JHF MBS issued from April 2007, JHF will prepay the JHF MBS in an amount calculated by dividing the outstanding balance of loan claims on which payments are overdue by four months by "1 + overcollateralization rate". This response is identical to JHF's response when prepayments are made on the entrusted claims. A similar "entrusted claims substitution" system has been applied until now for Monthly Bonds issued by March 2007 (Bonds No. 1-53), and the "entrusted claims substitution" system will be continued for Series S Bonds in the future.

As a result of the change in the "entrusted claims substitution" system, in its analysis of the cash flow from entrusted claims R&I assumes it will be possible to handle claims in arrears in the same manner as prepayments until a beneficial interest trigger event has occurred, and that the cash flow average remaining term will decrease somewhat. R&I believes the affect on the overcollateralization rate will be limited, however, because of the fact the size of the decrease in the average remaining term is small, and the fact the excess spread also will decrease in conjunction with the shortened maturity.

2) Changes in the Flat 35 system

a. Special measure for the time limit to establish and record mortgages or other liens concerning large-scale condominiums and other properties (for trusts established in March 2007)

Beginning from Kaitori-Gata purchases in January 2007, GHLC began extending by one month the period for establishing and recording mortgages or other liens for large-scale condominiums when application had been made to GHLC in advance. Although the time limit to establish and record mortgages or other liens had been the month subsequent to the month when financing was executed, this will now be possible until the second subsequent month. The setting up of the trust will be completed after establishment and registration of the mortgage has been confirmed. Loans related to this special measure will be included in the entrusted loans starting with the GHLC No. 53 Bonds.

Effects anticipated from growth in the number of large-scale condominiums financed include an increase in condominiums by type of financing and greater concentration of property locations. For GHLC Bonds No. 53, the affect of this special measure is expected to be limited, because no particular differences in the increase in the number of condominiums or concentration of property locations can be verified when entrusted claim attributes are compared with MBS issued at the same time in the past. For GHLC Bonds No. 54 and future issues, R&I will pay attention to the change in attributes resulting from an increase in the number of condominiums or property location concentration.

b. Increase in financing rate (LTV) (90% financing) (for trusts established beginning from April 2007)

Under the Flat 35 program until now, home buyers could finance up to 80% of the cost required to build or purchase a home. For trusts established beginning from April 2007, lenders will be able to finance up to 90% of all costs. There is a possibility the LTV for buyers who use only loans provided through Flat 35 will rise, and that the LTV for loans from private financial institutions will rise as well, should the number of such loans increase.

The affect of the LTV on the level of the overcollateralization rate can be divided into the stress applied to the default rate and the collection from collateral for claims in default. The stress applied to the default rate is set based on a LTV level that also considers private financial institutions loans, while the collection from collateral for claims in default is affected by the LTV level that only considers Flat 35 loans. For each JHF MBS until now, these levels have been reflected in the overcollateralization rate.

R&I will continue to pay attention to the LTV including private financial institution loans, and the LTV for Flat 35 loans only, because of the possibility both values will be affected by this system change.

(6) Introduction of JHF mortgage loan group credit life insurance with rider covering the three major diseases

JHF introduced mortgage loan group credit life insurance with a rider covering the three major diseases beginning with the Kaitori-Gata housing loan claims in April 2007, and such loans will be included among the entrusted claims beginning with JHF Bonds No. 2. Although the proportion of entrusted claims whose borrowers are covered by this type of insurance rider is not very large at the present time, should the percentage of such entrusted claims grow larger over time, there is a possibility the number of prepayments will increase somewhat. Under the present circumstances, R&I views this conservatively and has not incorporated such an increase in the prepayment assumptions.

(7) Changes from JHF Bonds No. 8

1) Introduction of a new interest rate system based on repayment period (Flat 35)

From October 2007, a new interest rate system based on repayment period (less than 20 years or more than 20 years) has been introduced to Flat 35 regarding mortgage loans eligible for JHF purchasing for JHF Bonds No. 8. The previous Flat 35 set interest rates regardless of the repayment period. However, the new system will allow private financial institutions to set lower interest rates on loans with repayment period of less than 20 years.

2) Revision of the criteria for screening Flat 35 (Abolition of the monthly income criteria - "Four or more times the amount of the monthly repayment" and revised DTI Ratio)

There was a revision on loans applied after October 2007. The revisions were the abolition of the monthly income criteria which restricted to those who has "four or more times the amount of the monthly repayment," and the revision of DTI standards (see the following table).

Revised DTI Standard (JHF Bond No. 8 and after)

<table>
<tr><td rowspan="2">Annual Revenue</td><td colspan="2">DTI Standard</td></tr>
<tr><td>former standard</td><td>Borrowings applied after October 1, 2007</td></tr>
<tr><td>Less than 3 million yen</td><td>25% or lower</td><td rowspan="2">30% or lower</td></tr>
<tr><td>3 million - 4 million yen</td><td>30% or lower</td></tr>
<tr><td>4 million - 7 million yen</td><td>35% or lower</td><td rowspan="2">35% or lower</td></tr>
<tr><td>7 million yen and above</td><td>40% or lower</td></tr>
</table>

(8) Expansion of Support Scheme for Acquiring a Good Quality House

The Support Scheme for Acquiring a Good Quality House (Flat 35S) has been expanded to cover pre-existing houses that meet the criteria of energy-saving or barrier-free performance in addition to those that meet the Flat 35 criteria (including the case where a pre-existing house is renovated after purchase, in a way as to meet the criteria). These will be included in the entrusted claims from JHF Bonds No. 22.

5. Expansion of loans eligible for Series S Bonds

In Series S Bonds, housing loan claims eligible for entrusted claims are those which were applied to GHLC in FY2000 and after. In April 2009, those applied prior to FY1999 have also been included.

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