Prelios Credit Servicing S.p.A.

Servicer Report

Ratings

Residential Special Servicer	
Italy	RSS2+
Commercial Special Servicer	
Italy	CSS2+

Servicer Summary

Fitch Ratings affirmed the Italian Residential and Commercial Special Servicer Ratings of Prelios Credit Servicing S.p.A. (PRECS) at 'RSS2+' and 'CSS2+', respectively, on 19 June 2017.

Key Rating Drivers

Improved Corporate Stability: The servicer has successfully completed its 2013-2016 corporate plan, resulting in diversified revenue streams and a reduced cost base. This is reflected in PRECS' financial trend, which shows a continued improvement over the past three years, although net results remain negative. PRECS has not yet demonstrated the long-term corporate stability and financial sustainability that can be seen at highly rated peers.

Continued Focus on Staff Development: The corporate plan included a review of the training and development framework, which is now complete. The training plans now in place demonstrate a good mixture of functional, technical and soft skills courses.

Average training hours for new and existing staff have increased year-on-year (yoy) but remain below the average across Italian Fitch-rated servicers. Rotation opportunities allow for staff to move across the business, increasing operational flexibility. However, the annualised staff turnover rate remains high compared with peers.

Appropriate Loan Administration Activities: In terms of timeliness and controls, loan administration activities are largely in line with highly rated Italian servicers. However, average time to resolve bounced and/or unmatched payments is longer than average seen at peers and PRECS is not permitted to manage client money accounts, so Fitch cannot assess and compare its capabilities in this area. The servicer has also less experience over the past three years of boarding portfolios consisting of a large number of loans than highly rated peers.

Effective Recovery Activity: PRECS continues to demonstrate the effective use of a variety of judicial and out-of-court work-out options. Legal timelines remain in line with the average seen across highly rated peers. PRECS demonstrates a good level of third-party oversight through the review of qualitative and quantitative measures, in line with peers.

Enhanced Governance: PRECS operates a three-line of defence risk management framework, which is in line with industry standards and includes significant quality control checks on the first-line activities. The 2016 internal audit (IA) reports are thorough and demonstrate no significant findings. There is evidence of clear resolution and escalation procedures. Structured IA are complemented with an automated continuous monitoring tool for cash management activities, which provides an additional layer of control around a high risk servicing activity.

Robust Technology Systems: PRECS's technology infrastructure is robust. The servicing platform provides flexible reporting capabilities, an effective diary management system, and system-driven controls of authority processes and loan-level activities. Appropriate system support and development resources are in place at both servicer and group level, and there are robust security protocols.

PRECS has comprehensive business continuity and disaster recovery plans in place, with annual testing and no material findings in 2016. Overall. PRECS' system is above market standards, but not as advanced as highly rated Italian servicers.

Sources of Information

The report is based on information provided to Fitch Ratings as of end-December 2016, unless stated otherwise.

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Company History and Management Experience

Fitch takes PRECS' significant experience into account in the Servicer Ratings. The company was founded in 1986 in order to manage non-performing loan (NPL)s. The servicer has been through a number of different ownership structures, and in October 2013 full ownership and control returned to Prelios SpA (the group). PRECS has access to, and has demonstrated the support of, significant group IT, HR and training resources. This has been taken into consideration during the Servicer Rating process.

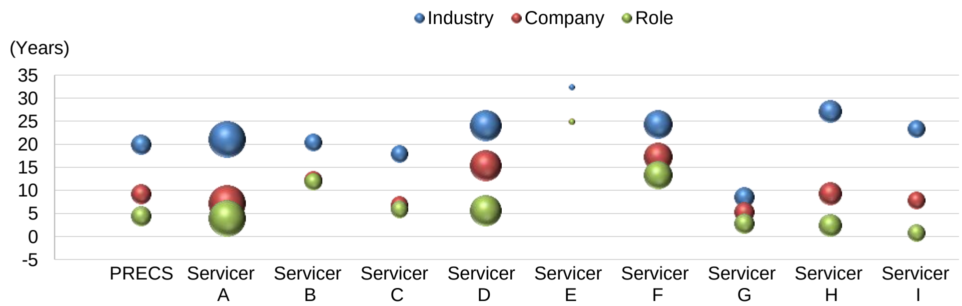
The servicer's 2013-2016 corporate plan has been successfully completed, resulting in diversified revenue streams and a reduced cost base. PRECS has won new mandates to carry out servicing, and other associated activities, for large Italian banks and new international investors entering the market. Fitch notes that PRECS was mandated as special and master servicer on the first securitisation issued under the Italian government guarantee scheme on securitised loans.

This report relates only to the special servicing of residential and commercial mortgage loans; however, Fitch recognises that PRECS holds a number of different roles, for a range of clients, across a variety of portfolios, which is good for the servicer's sustainability in the mid-term. In addition the servicer has obtained the approval from Bank of Italy (BoI) to be enrolled as a financial institution under article 106 of the Italian Consolidated Banking Act (Testo Unico Bancario), which will allow the servicer to offer financing activities.

There has been no turnover at senior management level over the past three years. The team consists of the CEO and six direct reports and average industry experience and company tenure are slightly below the average seen across Fitch-rated peers.

Senior Management Experience

Based on SMT number of people



Source: PRECS and Fitch

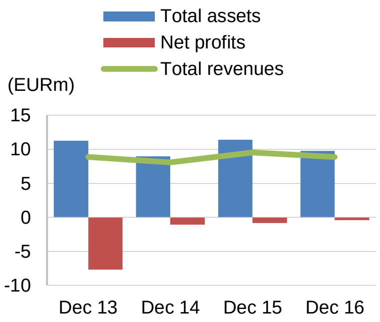
PRECS demonstrates a good level of stability at the strategic level over the past three years, however prior to this there was a period of volatility. PRECS has not yet demonstrated the long-term corporate stability that can be seen at highly rated peers.

Financial Condition

Neither PRECS, nor its parent, hold a Fitch credit rating.

In Fitch's view, PRECS' financial position remains unstable, with reported net losses for every fiscal year since 2013. However, the agency recognises that there is an improving trend and PRECS is expected to return to profit over the next two years. This is supported by stable cost levels, despite increasing assets under management, and a number of newly signed mandates at the time of review.

Financial Results



Source: PRECS

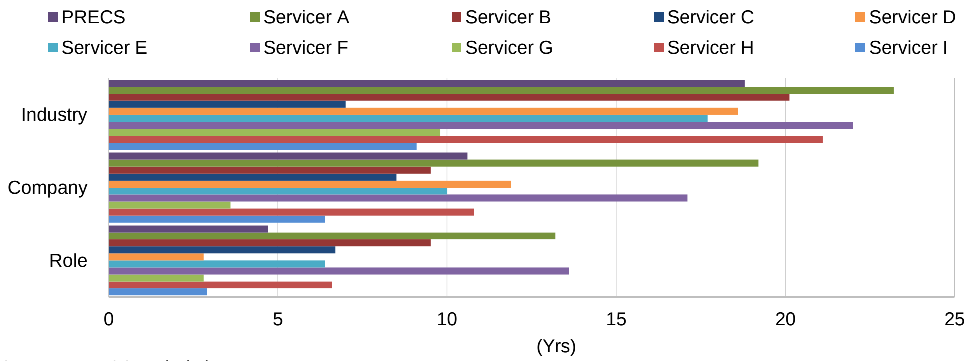
Related Criteria

Criteria for Rating Loan Servicers (February 2017)

Staffing and Training

PRECS is headquartered in Milan, with an office in Rome. The servicer has 65 full-time employees (FTE) (2015: 59 FTE). Taking into account employees from the group, dedicated to the servicing entity, the total number is 106 (2015: 94).

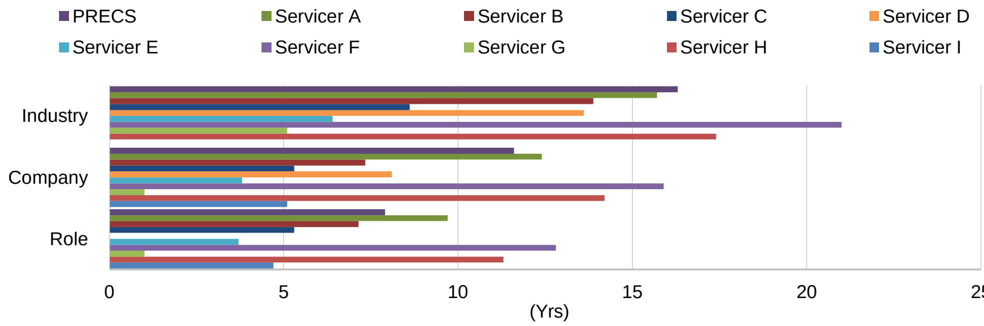
Department Heads Experience



Source: PRECS and Fitch

Industry experience and company tenure across department heads are in line with the average across rated peers; for operational staff, these numbers are higher than the peer average.

Operational Staff Experience[a]



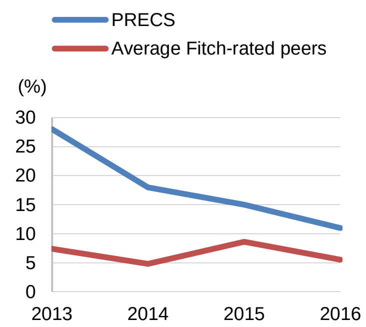
[a] Servicer D does not provide role tenure; Servicer I does not provide industry experience
Source: PRECS and Fitch

The annualised staff turnover rate over the past 12 months continues to be high when compared with other Italian rated servicers; however, Fitch acknowledges that there is a decreasing three-year trend. The operational risks related to high turnover are somewhat offset by the continued high levels of industry experience, which provide comfort around the quality of new hires. PRECS has carried out an annual staff engagement survey since 2015 and has demonstrated the implementation of initiatives to respond to its findings, such as regular company-wide update meetings and cross-functional meetings to enable knowledge sharing. In Fitch's view, this demonstrates that PRECS is working to address the root causes of high staff turnover.

The average training hours delivered to existing staff is just below the average seen at Fitch-rated Italian servicers, whereas average training hours delivered to new hires is significantly low when compared with the same peers. However, Fitch recognises that both have increased year-on-year. The average training hours delivered to existing managers has decreased and is low compared with the same peers; there were no new hires at this level over the past 12 months. The 2015 training plan focused on developing management skills, whereas the 2016 training plan focused more on staff development. Fitch also understands that PRECS does not record on-the-job training hours.

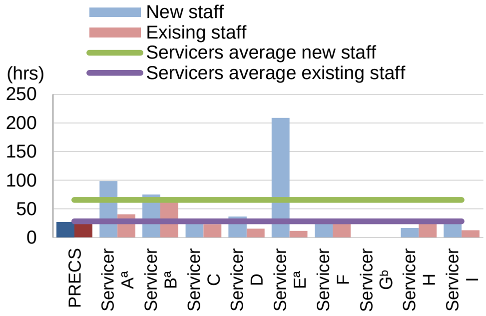
Staff Turnover Trend

Annualised reported turnover



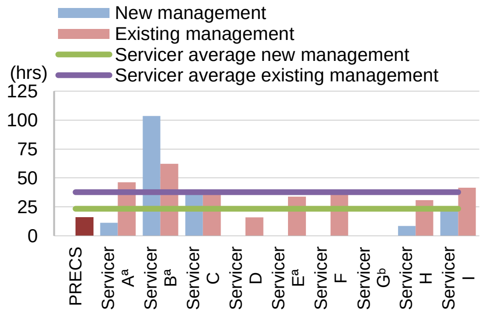
Source: PRECS and Fitch

Average Training Hours for Staff
Over 12 month period[a]



[a] Servicer A, B and E include on-the-job training
[b] Servicer G - no data provided, not included in the average
Source: PRECS and Fitch

Average Training Hours for Managers
Over 12 month period[a]



[a] Servicer A, B and E include on-the-job training
[b] Servicer G - no data provided, not included in the average
Source: PRECS and Fitch

The training programme is well structured, includes a variety of training resources and methods, and covers a wide range of competencies and soft skills. The servicer uses internal topic experts and external consultants to provide training to staff. PRECS continues to develop its training programme, with the support of external consultants and the group, and a number of new models were rolled out over 2016 in response to regulatory and technology changes, which in Fitch's view, is appropriate.

PRECS has a bespoke performance management system which tracks individual employee competencies, and includes workflow management and standardised templates to provide a consistent approach across the company. Employees are subject to an annual performance appraisal which includes a gap analysis assessment; individual training plans are based on the outcome of the assessment.

Fitch has been provided with details of the incentivisation schemes in place at PRECS, including measures to prevent conflict of interests. In the agency's view these are in line with industry standard.

Policies and Procedures

PRECS operates a three-level of defence risk management framework, which is industry standard, and consists of:

- First-line controls at operational level; including operative controls at the business level. Team leaders and department heads are responsible for the day-to-day monitoring and oversight of servicing activities. The servicing system supports this through automated timeline management and quality checks.
- Dedicated compliance, risk management, and anti-money laundering function as second line, responsible for the continued monitoring of adherence to process and regulation, and the identification and mitigation of risks to the business. The function also reviews the continued adequacy of policies and procedures. The head of the function, who has been in this role for two years, is supported by a stable team that has been with PRECS since 2011. Fitch has seen the reports relating to risk management reviews carried out over the past 12 months. The agency considers these to be thorough and in line with what is seen at highly rated peers. The reviews resulted in no material findings. Both the compliance and anti-money laundering review activity highlighted a small number of low or medium risk findings.

- A risk-based IA programme as the third line, with PRECS subject to regular audits by an experienced team sitting independent from operations. The head of IA at PRECS was appointed in May 2014, has over 10 years' auditing experience and works in collaboration with the group IA function. Over the past 12 months, eight key business areas were reviewed, with no material findings. PRECS uses an automated tool to monitor remediation plans put into place following IA findings. In Fitch's view, this provides a good level of oversight.

The standard audit activity is complemented with a tool which carries out ongoing analysis of the controls around cash management processes. The system carries out checks against 33 high risk indicators on a monthly basis, and sends automated alerts to internal audit where a discrepancy is detected. This is not widely seen across Italian rated servicers and, in Fitch's view, provides an additional layer of control around a high risk servicing activity

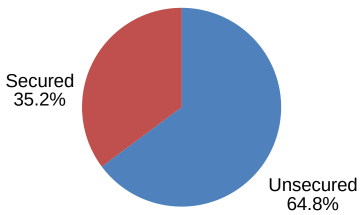
In Fitch's view, PRECS has effective internal controls, which enable the company to monitor risks and comply with regulatory guidelines. The continued low number of complaints reported by the servicer supports this view. The agency also notes that IA, Compliance, and Risk Management functions report directly to the board of directors, providing a good level of independent oversight and an appropriate governance structure.

Fitch has reviewed a sample set of PRECS' policies and procedures which cover all key servicing activities. The agency considers these to be fit for purpose, with clear version control and evidence of recent reviews and updates. Fitch understands from management that a full review of all policies and procedures has been completed over the past two years.

Servicing Methodology – Loan Administration

PRECS is special servicer on a portfolio of NPLs comprising 15,128 loans, with a gross book value of EUR3.21 billion (December 2015: EUR2.82 billion), of which 5,323 loans were secured and 9,805 were unsecured. The securitised portfolios represented 85.7% of the total book under management by value (December 2015: 52%).

Gross Book Value Assets Under Management
By number of loans



Source: PRECS

PRECS' servicing activities are supported by data and services provided by other group entities. Fitch's ratings take into account such group resources, particularly in defaulted loan management, as they imply a wider range of knowledge and expertise than is available to the servicer alone. The use of group resources, rather than external third parties, also typically provides the servicer with greater control of performance. Where servicing activities are supported by the group, this is commented on in the following sections.

New Loan Set-Up

In 2016 PRECS boarded six portfolios, with a mix of secured and unsecured NPLs across 4,077 loans and 2,098 borrowers. PRECS' level of new loan boarding activity by number of loans over the past three years is lower than seen across rated peers over the same period.

Loan set-up follows a robust project-management lifecycle and PRECS has a bespoke loan boarding system (see *Technology* section) which, in Fitch's view, provides a good level of automation and control around the process. This view is supported by the average reported boarding time of 15 to 30 days, which is comparable to highly rated peers.

The portfolio management and business analysis team and the business technology team drive the process and both demonstrate good levels of experience. The teams are involved from the early stages of acquisition to authorisation of the final business plan, which subsequently receives semi-annual reviews. Where a portfolio was boarded following engagement at due diligence, the loan asset manager (LAM) analysis and completes the quality control for those loans which were not part of the due diligence review (see *Servicing Methodology – Defaulted Loan Management* section).

The business plan setting process is robust. The servicer has access to an extensive database of RE data and a network of RICS-qualified valuers through Prelios Valuations.

PRECS works in a paperless environment which, in Fitch's view provides better control of activities, with a full audit trail of activities recorded in Phoenix. Original documents are stored on-site by PRECS or at a third-party storage facility. The agency considers there to be appropriate access controls to be in place.

Loan Accounting and Cash Management

Loan accounting and cash management activities are split across;

- 13.5 FTE in the master servicing team manage SPV accounts; and
- 22 FTE in the LAM teams carry out cash allocation on accounts in unsecuritised portfolios.

The average industry experience for these teams remains largely in line with rated peers. A group entity provides back-office support to PRECS loan accounting and cash management activities. The group entity's system interfaces with Phoenix, providing an efficient and controlled transfer of data.

PRECS administers 50 bank accounts (53 in 2015). However, none are in the name of the servicer, thus Fitch cannot assess the servicer's ability to manage such accounts. The agency recognises PRECS only services securitised portfolios, and so it is not permitted to manage such accounts. Bank cash reconciliations are completed for each account every five days; which is in line with rated peers.

The majority of payments received by PRECS are via bank transfer, with the remainder being cheque payments. This is typical for NPL loans and in line with the market. The average reported time to match a payment received to an account is one working day, which is in line with rated peers. The time to resolve unmatched and bounced payments is reported to be a maximum of one working week. This is longer than the average seen at highly rated peers.

Reporting

Reporting activities are carried out by the portfolio management and business analysis team. The reporting activity is highly automated, with control checks and validation rules built in the servicing system (see *Technology* section). The servicing and reporting systems in place allow the company to capture a large amount of data and provide the flexibility to adapt reporting parameters to produce a variety of reports to a range of client specifications.

All reports are subject to review by at least two people before distribution and data quality checks are incorporated in the continuous monitoring by management of key performance indicators (KPIs) and variances against original business plans.

Fitch does not assign an Issuer Report Grade for the transactions serviced by PRECS; however, in the agency's view, the company has the capability to provide highly comprehensive investor reporting. This view is supported by the fact that PRECS reported no reports issued late or with material discrepancies in the past 12 months.

Servicing Methodology – Defaulted Loan Management

PRECS employs 25 LAMs, including three LAM managers. Average industry experience, company and role tenure, is in line with other Italian rated servicers.

The teams are split according to the size and risk grading of the loans, with the more experienced LAMs having smaller caseloads of high value or high risk loans. The LAM is responsible for the resolution and administration of the loans assigned to them, including coordination with external third parties and maintaining system data. In Fitch's view, this structure provides an appropriate level of specialisation and is in line with that typically seen across Fitch-rated Italian special servicers.

It is difficult to compare judicial and non-judicial resolutions on a cumulative basis year-on-year or with peers, due to a significant note sale and the transfer out of a large portfolio. However, in Fitch's view, PRECS continues to demonstrate its ability to work out loans through a mix of judicial and non-judicial resolution methods.

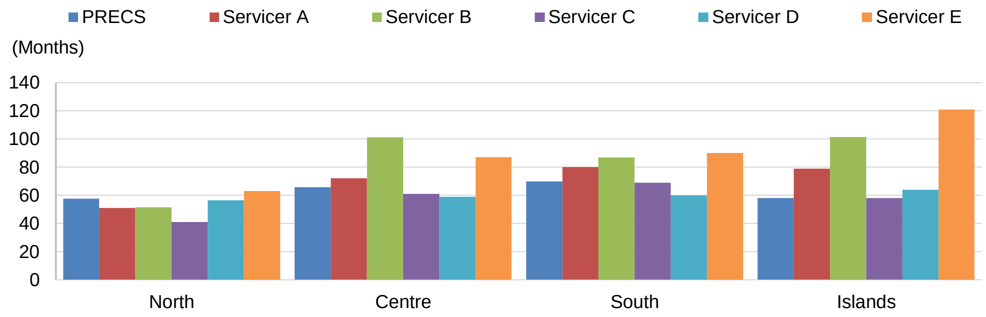
Fitch considers PRECS' business plan monitoring processes to be robust, with a significant amount of performance monitoring. Since the last review, PRECS has developed a new web-based diary management within the servicing system. It is linked to Microsoft Outlook and pushes a colour coded task list, based on priority of the action, to LAMs on a daily basis. In Fitch's view such tools can improve operational efficiency by reducing the risk of human error.

Where a judicial resolution is initiated PRECS has a panel of around 400 external lawyers, covering all Italian jurisdictions. Case allocation to lawyers is based on geographic location and workload. All lawyers on the panel operate under a standardised SLA, which incentivises continued non-judicial collection efforts as well as the expedition of court proceedings. Fitch considers robust third-party oversight a key part of operational risk management, and views PRECS' centralised and standardised approach – with dedicated resources – to be best practice.

During the judicial process, PRECS is active in working with the court and the court technical expert (CTU) to accelerate the process where possible and to ensure a fair CTU valuation outcome. Average legal timelines remain in line with the average seen at highly rated peers.

Prelios Agency – the group's RE agency network – provides the servicer with a network of around 450 agencies across Italy, with broker and advisory services and significant experience in residential and commercial RE resolution. The network's local buyer knowledge also allows for more targeted advertising of RE assets going to auction.

Average Legal Timeline - Comparison
Reported in 2016



Source: PRECS and Fitch

Real-Estate Owned (REO)

REO is available to PRECS as a work-out method, although it is not being actively used for the current servicing portfolios.

Fitch understands that PRECS is working on setting up a dedicated REO team and has procedures in place to manage this activity. However, this was still in progress at the time of the review, thus Fitch cannot assess the operational appropriateness and effectiveness of the team and procedures.

PRECS' is currently facilitated by Prelios Integra in the asset and portfolio management. This is a group entity which additionally provides property and facility management, project and development management and engineering and professional services. Technology

PRECS' key servicing systems are:

- Phoenix: the PRECS proprietary asset management system, which acts as a central repository for all information relating to the loan, borrower and RE assets. It has been continuously developed since its implementation in 2006 and, in Fitch's view, is flexible, user friendly and scalable. It generates automatic alerts when trigger events take place, or where key loan account details have been changed which may impact the business plan. Interfaces between Phoenix and the other key systems allow the automation of essential processes, such as payment allocation and regulatory reporting.
- Phoenix Light: a bespoke due diligence and loan boarding system, in place since 2013, which provides a simplified user interface, focused on key data field collection. The system interfaces with key applications, such as the data warehouse (DWH) and third-party client systems, allowing fast data transfer; it also completes automated data quality checks.
- SAP: well-known third-party loan accounting system, used by PRECS since 2003. Enables timely and controlled processing.
- Partnership Management System (PMS): a customised third-party platform, used by PRECS since 2015 to manage the real-estate activities and mortgage broker network.

Overall, in Fitch's view PRECS' asset management system is robust and above market standards, with a sound level of automation and control, but it is not as advanced as highly rated Italian servicers. Fitch notes that PRECS has an agreement in place between Phoenix and SYGES, an NPL management system widely used by the Italian banking system. Through an interface, PRECS has real-time access to the loan accounting information of its banking clients. At the time of review this was not in active use and so Fitch could not assess its effectiveness or its impact on operations.

There are appropriate technology resources available to support and develop the infrastructure, at PRECS and group level, and the servicer has demonstrated structured change management processes and strong security protocols.

Incremental back-ups are performed daily, with a full system back-up performed weekly, monthly and yearly. This is in line with rated peers. The retention period varies between 30 days and five years, depending on system and back-up types. Physical tapes are sent to a secure, fireproofed offsite location.

PRECS' disaster recovery and business continuity planning is part of wider group plans, which Fitch consider to be robust. Live tests are held on an annual basis and there were no findings from those held in November 2016.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.