

LENDING ISSUES IN JAPAN
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In Japan, real estate transactions are subjected to literally hundreds of laws, statutes, rules, regulations and court precedents, including separate prefectural and municipal ordinances. While buyers must employ appropriate experts to deal with these rules and their implications, they must at least be aware of their existence and functions. The following compilation deals with a few of the many issues regarding Japanese lenders and borrowers under the lending laws of Japan.

In the text that follows, you will quickly recognize vast differences between many 'equivalent' Japanese and American lending laws. You will also find laws for which there are no US equivalent. Perhaps you may even spot a reason behind what appeared to be the completely illogical suspension or termination of a contemplated transaction.

Lending Under Japanese Laws

Legal Ability to Originate Loans

The easiest method to originate a loan is to either incorporate a new entity or acquire an existing entity in Japan, and then license it as a Money Lender (Kashikin Gyo) under "The Statute to Regulate Money Lenders Activities (Kashikin Gyo no Kisei tooni Kansuru Hootritu Code No. 32- 1983)."

The licenses for banks, trust banks, mutual banks and other financial institutions allow them to 'originate loans' as well.

Either a corporate entity or an Individual can apply for the license under this statute.

If the license holder is to operate within only one prefecture, a 'Gubernatorial License' is sufficient. If, however, the license holder is to operate in more than two prefectures, the 'Prime Minister's License' is required.

The administration for licensing in the jurisdiction of the Prime Minister under this statute is delegated to the Director General of "Financial Institution Supervisory Agency - Kinyuu Kantokucho."

The statute mandates that license holders join the Local Association of Money Lenders which provides supervision, staff training, etc.

Borrowing on a Non-recourse Basis:

Non-recourse borrowings and/or lendings are possible contractually; however, non-recourse borrowings are rare, if not totally nonexistent in Japan, so it is necessary to consult local attorneys or local tax accountants to avoid legal and/or tax consequences.

Can Lender be Foreign?

There seems to be no specific or explicit prohibition of a foreign entity or individual acting as a money lender under this statute. Nevertheless, it would be more desirable to form a Japanese corporation to provide "corporate veil." (Foreigners have been successful in applying for new Money Lender licenses, or have acquired a Japanese corporation holding a Money Lender's license as witnessed by the recent acquisition of Osaka-based Lake, Inc. by GE Capital.)

Currency/Interest Rate Swaps:

If the Swap arrangement is done in the Party's own name and for its own account, it may be done without any limitation. Such transactions will be subject to the provisions of "Financial Future Dealings Act --Kin-yuu Sakimono Torihiki Hoo Code No. 77 - 1988," and must be dealt through 'Financial Future Exchange' established by the Act and the deals must be done only by or through a member of the exchange. To become a member of the exchange for the purpose of providing the services of transacting deals for non-members for a fee, one must be licensed as a 'Financial Future Dealer: Kin-yuu Sakimono Torihiki Gyoosha (Code 77 - 1988 Articles 56 through 74). A foreign corporation may be licensed provided it has a place of business or an office within Japan (Article 56). The service of arranging or providing such 'currency/interest rate swaps' services to the public is a matter to be discussed with regulatory agencies. Such service is considered to be more in the domain of banks or securities firms.

Foreign Ownership Restrictions:

There are no 'Foreign Ownership Restrictions' concerning land and/or buildings in Japan.

Any Artificial Limit of Loan Amount: Other Constraints on Underwriting:

There is no limit to the amount of a loan one can make. If the 'Underwriting' means an activity of selling securities to the public, the chances are that the party are liable to obtain a Securities Dealer's license under Article 28 of "Securities Exchange Act" (Shookan Torihkihoo Code No. 25 -1948).

The reader is also referred to the "Securitized Mortgage Act" (Teitoo Shookan Hoo Code No. 15 - 1931) regarding the sale of mortgage loans.

Japanese courts do not allow a claim for punitive (treble) damages; however, it provides for a predetermined penalty for default of not more than the maximum allowable interest rates under the Statute of Usury Prevention Act, No. 100 - 1954 as shown below.

Validity of Mortgage

Creation and Enforcement of Liens on Real Property:

Japanese Civil Code (Minpo: Code No. 89 - 1896), is the most basic code governing private sector activities of individuals. Articles 368-398 provide for creation and enforcement of a lien generally similar to mortgages in

the U.S., although the foreclosure and auction procedures (identical with the U.S. 'judicial foreclosures') are somewhat different from practices in the U.S., e.g., mandatory preliminary appraisal by a court-appointed appraiser, etc. Apart from the Civil Code, there are other specialized statutes for the creation of liens on special types of assets such as an entire factory.

For the creation of a lien purporting the transfer of title to collateral to the lender in the event of default, it is necessary to refer to "Statute of Registration of the Claim for Transfer of the Title In Case of Default In Performing Monetary Obligations (Kari Tooki Tanpo Keiyaku ni Kansuru Houritu, Code No. 78 - 1978)."

2, "Intervening Liens"; Tax liens are the most notable. For other liens, the provisions of Civil Code Articles 303 through 341 cover the situation. These may be unrecorded liens such as employee's wages.

3. Statute of Usury Prevention: Risoku Selgen Hoo. Statute No 100 - 1954 provides:

For the principal amount Less than Yen 100,000 max. 20 % per annum

More than Yen 100,000 and less than Yen 1,000,000 max. 18% p.a.

More than Yen 1,000,000 max. 15% p.a.

Note, however, voluntary payments by the borrower preclude later recovery from the lender.

"Money Lenders Act" (No.32 - 1983) Article 43 provides exceptions on certain types of voluntary payments involving prior written warnings.

Enforcement and Foreclosure

Who May Act:

"Civil Execution Act: Minji Shikkoo Hoo: Code No. 4 - 1980" Article 22 defines the types of court orders, notarized documents and other Instruments under which debt collection enforcement and foreclosure may be commenced. Article 23 provides which parties named in these documents may petition for the commencement of the execution.

Requirements for Exercising Remedies:

Limitation: Japanese system of 'Limitation*' as provided in Civil Code Articles 145, 146, 162, 167, etc., stipulates that one may acquire or lose the title to a property after certain a duration of time during which there was continued absence of assertion of claim by parties; however, a court cannot invoke such rights unless asserted by a party in a court proceeding.

Generally speaking, the party whose name is registered as the mortgagee is allowed to commence the foreclosure process. Other parties such as the mortgagee's creditor may act provided such party has received the appropriate court order, e.g., subrogation. Any mortgagee, irrespective of priority, may commence the foreclosure procedure, but shall not receive any preferential treatment in the distribution of the sale proceeds

because of commencing the action (Civil Code Articles 366,373, etc.).

The slowness of Japan's court procedure in mortgage foreclosures is well known, but it should be possible to conclude within a maximum of 24 months. To acquire title to real estate collateral without going through Civil Code Foreclosure Procedure, it may be beneficial for the lender to resort to the Registration of the Claim for Transfer of the Title in the event of default in the repayment of the loan (Daibutu Bensai Yoyaku no Kari Tooki) provided by 'Statute on Registration of Right to Claim the Transfer Title In Case of Default In Performing Monetary Obligations' (Kari Tooki Tanpo Keiyaku Ni Kansuru Hooritu Code No.78 of 1978) that is mentioned above.

The registration of Code.78-1978 claim can concurrently be filed with the Civil Code mortgages. The available remedies to the lender/mortgagee are not only for restitution, but also for damages for undue losses. However, a Japanese high court denied the execution for punitive damages awarded by an Oregon court citing the absence of an identical or a similar penalty under the Japanese system. It may be prudent to include a provision in the original contract stipulating a specific sum as the default penalty (must be acceptable to the Japanese court).

Restricted to Monetary Default?

Although the loan agreement may provide explicitly and specifically the covenants of 'Technical Defaults' (non-monetary defaults) in addition to 'monetary defaults,' it may be possible that the Japanese court may accept only certain types of "Technical Defaults" as the cause for triggering of foreclosure while rejecting other types of technical defaults. For example, if a third party lender to the borrower/mortgagor with a major loan starts a suit to recover the loan citing defaults, and the loan agreement between the parties carries a clause stating that a suit commenced by a third-party constitutes a "Technical Default," there is the high likelihood that a Japanese court may allow the commencement of foreclosure proceedings. On the other hand, if certain 'financial ratios' such as the ratio between the amount of cash received for the month to the book value of the property falls below 10%, and the mortgagee claims 'Technical Default' even though there is no 'monetary default' and seeks foreclosure and if a third party junior mortgagee raise the objections against the motion, that can be a highly arguable issue,

One of the reasons is that the Japanese real property registration system specifies what are the matters which must be 'registered' and what are not. Also what you can inspect at the Registrar's Office (Tooki-sho) are not the documents filed by the parties to a transaction, but only the excerpt formats filled out by the registration officers in accordance with the statutory standards. This means some covenants which do not fall into the category of 'official disclosure' will be barred from public disclosure.

Real Property Registration Act" (Fudoosan Tooki Hoo Code No. 24 - 1899) stipulates the matters to be made available for the public display for mortgage (Article 117) and it is doubtful whether 'Non-monetary Technical Defaults' provisions may be included in the excerpt formats while this statutory provision explicitly calls for the inclusion of monetary default matters. The situation may be clarified only after legislative actions. It will be necessary to have an extensive dialogue with the Justice Ministry to which the Registrar's Offices belong.

(It will be always desirable to have Informal discussions with the supervisory bureaucracy first and keep such a meeting secret if you want to quickly start something new in Japan. They can claim to the world that they took the initiative in the 'innovation.').

Requirements for Holding Title to Real Property: Foreign Ownership:

Being a foreign national does not constitute any impediment to become an owner of real property in Japan or a mortgagee. If the subject party is registered in Japan to do business in Japan as a branch office of a foreign corporation, or a Japanese legal entity owned by a foreigner and the obligation so secured is the result of a transaction made in Japan under the Japanese laws, the party can exercise its right to the full extent in the same manner as a Japanese national would do in Japan with regard to acquiring a mortgage or foreclosing thereof.

If the obligation secured by the mortgage on a property located in Japan was created by a transaction outside of Japan unrelated to any Japanese party and Japanese laws and/or regulations, the foreclosure thereupon still must be under the Japanese law (Law Concerning Application of the Laws In General: Hoorei Code No. 10 - 1898 Article 10), but whether the business registration in Japan of the mortgagee is a mandatory requirement will be determined at the pleasure of the court case-by-case but not a requirements across the board. It may possible that the that the mortgagees may be subjected to the Japanese tax at a later date, however, the tax situation will not have any adverse effects on the mortgage or the foreclosure.

Convention:

So far almost all of the loans made by the Japanese to another Japanese in Japan have been with recourse to the borrower, meaning the lender/mortgagee can either foreclose on the specific collateral or ask the court for the Judgment of default and create judgment a judgement lien on assets other than the collateral even before the mortgage foreclosure and should there be a deficiency, further pursue the borrower for bankruptcy. There is almost no court precedent on non-recourse loan defaults in Japan.

Prepayment Issues:

The Japanese statute provides as follows (Civil Code Article 136):

Section 1 ['The benefit of time' is assumed to be provided for the benefit of the party liable for performance of an obligation]

Section 2 [A party liable to perform a certain deed by a certain specified time may waive Its 'benefit of time;' however, it is not entitled to cause loss to the other party by such a waiver.]

Certainly the lender can provide a stipulation that the contractual interest must be paid up to the originally agreed maturity date, irrespective of prepayment; however, whether any higher penalty may be enforceable on prepayment is at the discretion of the court case-by-case.

Cash Management:

As long as the protective measures taken by the lender to prevent the misappropriation of the cash flow is 'reasonable in the view of the court' that can be enforceable and the protective measures can be extensive, including the arrangements similar to a U.S. lock box. It is necessary on a per-case basis to research appropriate precedents. One of the practices which was often used by the banks was to "plant an accountant from the bank" at the borrower's office-sometimes on a full time basis. It is possible to engage a third party - such as a CPA firm - to handle the cash or even the entire accounting/finance.

Additional Indebtedness:

This again must be judged in a Japanese court on case-by-case basis.

As long as the parties mutually agree to a contractual provision prohibiting the borrower to incur any additional indebtedness after *fair bargaining", there is no reason why it cannot be enforceable. While the breach of such a provision in a loan agreement can certainly be a sufficient course of action for damage or even termination of the loan if it is so specified in the loan agreement, whether it can immediately trigger the foreclosure proceeding of a specific collateral as a 'technical default' appears to be at the discretion of the court case by case. It may be necessary to first obtain a judgment for default before starting foreclosure on the collateral.

Insurance:

Civil Code Article 304 Sections 1 and 2 speaks to this Issue. For casualty insurance proceeds this is done by 'pledging' the policy naming the mortgagee as additional insured or the loss payee. Once such monies or commodities (particularly those indistinguishable by nature) are paid or delivered to the borrower/mortgagor and co-mingled with the borrower/mortgagor's other assets, the claim may become moot, so Article 304 provides the lien holding claimant needs to attach the subject monies or commodity prior to the payment or delivery to the borrower/mortgagor.

Casualty/Condemnation:

"Law Mandating Application" does not exist in Japan. However, when the contract is silent on the Issue, and the parties are confronted with fire damage, condemnation, etc., and if the lender/mortgagee specifically and expressly claims the right under Civil Code Article 304, and the opponent is unable to prove that any agreement contrary to the statutory proviso existed, then the lender/mortgagee can claim as if the contract contained the Article 304, (also refer to Commercial Code: Shou Hoo Code No. 48 - 1899: Article 1)

The Risk of Condemnation:

In Japan, particularly in urban areas, the possibility of an existing development condemned for 'City Plan Adjustment,' 'New Zoning,' or for the purpose of "public use' will be very low. In view of the chronically declining real estate market in Japan, some property owners may be happy to see their property condemned for the public use at the assessed value of several years ago.

The highest risk is the Condemnation through Physical damages caused by earthquake, typhoon or other acts of God. No compensation is payable in such a case so one must rely on Earthquake Insurance which is said to be inadequate. It will be necessary to discuss the Japanese earthquake casualty Insurance with Insurance companies.

Late Charges/Default Interest:

As previously mentioned, the "Statute of Usury Prevention" (Code No, 100 - 1954) Article 4 Section 1 provides "When the parties to a loan agreement agree on the 'penalty' for default by the borrower, if the percentage of such penalty amount against the amount of the loan principal is more than twice the maximum allowable annual interest percentages provided in Article 1 Section 1 of the statute (e.g. 20% p.a. where the loan principal amount is smaller than Yen 100,000, 18% p.a. where the loan principal amount is more than Yen 100,000,- and less than Yen 1,000,000, 15% p.a. where the loan principal amount Is Yen 1,000,000 or more), any penalty percentage rate in excess of twice the statutory maximum interest percentages, shall be not enforceable."

Article 1 Section 2 provides that if the borrower voluntarily paid the excess percentage of the interest and/or the penalty, the borrower shall be unable to claim to recover such excesses.

Article 4 Section 3 provides that the agreement contained in a loan agreement stipulating the amount payable to the lender in case of the default by the borrower, shall be construed as the agreement for the indemnities for the defaults."

Can You Collect "Interest on Interest"?

Article 3 of Code. No. 100 - 1954 stipulates that in the calculation of interest, all monies except the repayment of the principal which the lender receives shall be construed as the interest. You can collect "interest on interest" within this limit.

Alteration of the Property:

Restrictions on the alteration of the mortgagee property should be enforceable under Japanese laws; however, it appears Japanese courts may be sympathetic to the borrower if the attempted alteration Is for the enhancement of the property value to the extent to override the lender's objection or contractual provisions.

Defaults

Mandatory Notice and Cure Right:

As to the default of the loan, the contract provisions will prevail except for 'Tekijo' and "Zouka-Kyoobai" provided in Civil Code Articles 378 through 387 (a combination of an offer for pre-emption of mortgage, auction and 'Buy-Sell' arrangement). The Civil Execution Act (Code No. 4 - 1880) Article 45 provides that the court with jurisdiction must deliver the notice of foreclosure/attachment auction to the borrower.

Civil Code Article 381 provides that when a mortgagee wishes to foreclose on the collateral, the mortgagee is required to notify (Article 381 Notice) such intentions to third party(ies) who acquired ownership, easement or sharecropping right on the property "subject to the mortgage" or the party who had agreed that the property may be encumbered by the mortgage.

Civil Code Article 378 provides that a third party described in Article 381 above shall have the right to preempt the subject mortgage and acquire the ownership of the property free and clear by either paying to the mortgagee or depositing (Kyootaku) at the Registrar's Office-which concurrently acts as a Public Deposit Office Kyootakusho-cash in the amount agreed with the mortgagee pursuant to the provisions of Article 382 through 384.

The party intending to acquire the property through 'Tekijo' must submit notices to all of the registered mortgagees in the manner prescribed in Article 383 within thirty (30) days of the receipt of notice of commencement of the foreclosure or attachment procedure provided in Article 381 above. The parties entitled to exercise "Tekijo" also have the right to commence 'Tekijo' proceedings at any time prior to the Article 383 notice. The Article 383 Notice shall include, among other things, the amount to be paid to the mortgagee for 'Tekiljo' (preemption of the mortgage encumbrance on the property).

Civil Code Article 384 provides that the lender/mortgagee, within one (1) month of the receipt of the Article 383 'Tekijo' notice, may notify (Article 384 Notice) the sender of the Article 383 'Tekijo' notice and also the parties whose interest in the subject proper as the owner, the holder of the Land Use Right: Chijooken: (refer to Civil Code Articles 265 through 269/2) or Sharecropping Right: Elkosakuken: (refer to Civil Code Articles 270/279), that the lender/mortgagor shall purchase the property at a price ten percent (10%) above the price offered in the Article 383 notice, if the foreclosure auction falls to realize the sale at a price ten percent (10%) above the price offered in the Article 383 notice, then the sender of the Article 384 Notice shall purchase the property at the price ten (10)% above that offered In the Article 383 Notice.

If the lender/mortgagee chooses not to send the Article 384 Notice within thirty (30) days of the receipt of the Article 383 Notice, it shall be construed that the mortgagee accepted the Article 383 Notice and the property shall be 'sold' to the issuer of Article 383 Notice without foreclosure auction procedure.

The lender/mortgagee must send Article 384 Notice within one (1) month of the receipt of the Article 383 Notice by the lender/mortgagee to the borrower and the owner (mortgagor) of the subject property.

Civil Code Article 387 provides that if the mortgagee does not receive repayment in full or the Article 383 Notice within one (1) month of the recipients' receipt of Article 381 Notice, the mortgagee may pursue the foreclosure auction.

Other Restrictions on the Ability of the Lender to Call a Default:

Except for contractual provisions, not much can be expected. At issue is Civil Code Article 533 which provides that in a bilateral contract requiring two or more parties to perform their respective duties simultaneously, if one or more of the parties fails to offer to perform its own obligation immediately (such as tendering cash or cashier's check for payment, or a complete set of documents necessary for the registration of transfer of the title for a parcel of land), then the other party who stands ready to perform its duties may lawfully suspend or withhold without incurring a penalty. This can be roughly translated as "the pro under simultaneous mutual performance: Douji Rikoo No Kooben Ken."

In the U.S. where there are many reliable licensed 'Escrow Agents' who would perform the services to implement 'simultaneous mutual performance' among two or more parties, Article 533 may seem ludicrous, but this is a serious issue when you do not have something similar. (Of course there are many real property where the Escrows do not close.)

Another Issue Is Civil Code Article 1 which lays out three basic principles:

1. Private rights shall not infringe upon the welfare and benefit of the general public: Kookyoo no Fukusi;
2. In exercising the private rights and performing their obligations, the parties must act in fairness and earnestness: Shingi Seljitu No Gensoku;
3. Abuse of the rights shall be prohibited: Kenri Ranyoo No Kinshi

Non-Japanese parties may find that these basic statutory principles are used in a way which may not necessarily be compatible with established American legal practices. Such differences are sometimes caused because of the difference in the historical development of business practices or the basic concept of the role and functions of civil statutes in Japan which is adapted in Japan and their counterparts in the United States or other countries. Important for the non-Japanese trying to do business in Japan is the identification of the basic differences as quickly as possible and to adapt to them, rather than trying to do things in ways similar to those in other countries.

Japanese courts interpreted these doctrines in various manners for almost one and one-half century and for certain types of transactions, fairly stable principles of case laws have been established. These should be systematically studied for the particular area for which a particular non-Japanese client is interested.

Because of the extremely slow and poor interaction between the Japanese judiciary and legislature and the overbearing intrusion of the executive branch ("unwritten ministerial guidance and oral rulings which vary from one geographic area to another, etc."), it is hazardous to attempt drawing parallels between the Japanese business practices and the U.S. counterparts.

Enforceability of Transfer Restrictions:

It appears there are no statutory provisions in the Japanese codified laws which prohibits the enforcement of the 'Due on Sale' type provisions.

What should be realized as the basic difference between Japanese and U.S. real estate financing is that in Japan, the mortgage-backed loan is usually 'with recourse' to the owner, either an individual or a legal entity, while in the U.S. they are almost as a rule 'non-recourse,' the only recourse being the property which is the collateral for the loan.

So the sale of the collateral subject to an existing mortgage in Japan is for the buyer, not to assume the entire liability for the loan which is still the obligation of the borrower, but to assume (in this case, 'non-recourse' to the buyer-the new owner) a part of the obligation of the borrower. From the point of view of the owner/seller of the property, under the Japanese practice of 'Recourse' Loan, he must remain liable to repay the loan as the primary obligor. Under the Japanese system, the lender can pursue the borrower first if the lender so wishes without foreclosing on the collateral, there is no motivation for the property seller to insist on the continuation of the loan.

As for the buyer/new-owner of the property, the property may or may not be foreclosed due to the financial status of the original borrower that is entirely beyond the control of the new owner whose position becomes untenably unstable. Consequently, there is no motivation for him to insist on the continuation of the loan either. Thus, the normal average Japanese will not purchase a property 'subject to mortgage' unless there is a special reason, therefore, 'Due on Sale' type provisions do not find merit in Japan.

The Japanese are more adamant to keep the title of their property clean, and this is one reason why Civil Code provides for 'Tekijo-Preemption' Articles 378 through 387 referred to above. In order to promote the real estate finance-related business in Japan, the establishment of the legal structure and business practices based on 'Non-Recourse Loans' will become most important.

Additional Security

Property-specific needs by means of pledged reserves & escrows funded with loan proceeds?

There is no equivalent of "escrow" in Japan.

In ordinary loans secured by a mortgage on a real property, usually there is a provision that the borrower has the obligation to provide necessary repair, maintenance and management so that the value of the collateral will not diminish at the expense of the borrower. There seems to be no precedence where the court denied the effect of such a provision. In other words, the lender can demand all 'reasonable' efforts be made to ensure such arrangements, but the lender cannot demand the borrower to incur expenses which are unreasonable relative to the amount of the loan and the value and the nature of the collateral.

It is possible to set up a 'sinking fund" at a bank or a trust bank which may be used only for the specific

purposes of maintaining the collateral in good condition such as the reserve for the repair or leasing commissions, etc., which can be in possession or under the control of the lender.

If such advances from the lender may be used for the said purposes at the borrowers discretion, it may be construed that this is the loan to the borrower already disbursed and as such the lender can charge interest. Whether such a sinking fund may be deposited with a bank in an interest accruing account, and who is entitled to receive the interest will decide whether the interest will be chargeable by the lender or not.

On the other hand, if the use of the funds advanced by the lender is subject to the approval of the lender, then the lender can not charge interest unless and until the funds have actually been paid to a third party such as the contractor for repair work.

One of the limitations to the lender's ability to charge interest on portions of the loan advanced into the sinking fund for the upkeep of the property is "Usury" Act already stated. Another is whether the amount of the sinking fund so required by the lender is reasonable in view of the nature of the property. If an unnecessarily large amount is kept in the sinking fund account, and the borrower has to pay the interest on such unnecessarily large amounts, it is highly likely that the borrower may be entitled to either reduce the amount or cancel the arrangement altogether.

Encumbrance of Personal Property/Fixtures: Any UCC Filing Analogous?

Under the civil code, the security interest which you can create on "personal property" (chattels and movables) is a 'pledge' whereby the physical possession of the asset must be transferred to the lender. However, when the collateral offered to secure a loan is a combination of land, buildings and movables such as machinery and equipment at a factory for sophisticated manufacturing industry which are far more valuable than real property, the values of the non-real estate assets, the civil code provision is not adequate. So several special legislations were made.

1. "Business Entity Mortgage Act: KigyooTanpo Hoo Code 106 - 1958: Article 1 provides "In a Kabushiki Kalsha (a limited liability corporation as provided In Commercial Code Article 165 through 456), the entire assets of the corporation may be subjected to a 'business entity mortgage' -Kigyoo Tanpo - as a single asset." Also, Article 37 provides that if the entire assets of a business entity is to be liquidated, It shall be done by either an competitive auction or a voluntary negotiated sale in which the subject entire assets shall be treated as a single asset.

2. "Factory Mortgage Act:" Koojoo Teltoo Hoo: Code 4 - 1905: Article 2 provides" the effect of a mortgage created to secure an obligation on land and/or a building(s) of a factory shall extend to whatever fixtures fixed to land and/or building(s) and all machinery, equipment and other things used for the purpose of the factory.

3. "Mining Mortgage Act" Koogyoo Teltoo Hoo: Code 15 - 1931: Articles 1 and 2 provide that an owner of a mining right may create a "Mining Trust" Koogyoo Zaidan for the purpose of subjecting the entire assets of the Mining Trust as the collateral of a loan. Koogyoo Zaidan can consist of all or a part of the following:

- 1) Mining rights
- 2) Land and buildings
- 3) Chijooken "Land Use Right" Civil Code 265 - 269-2 and other land use rights.
- 4) The right to rent any property
- 5) Machinery, equipment, rolling stock, ships and other accessories to the mine.
- 6) Industrial properties

4. "Automobile Mortgage Act" Jidousha Teltoo Hoo: Code No.187 - 1952 Article 4 provides that the mortgagee of the subject automobile under this act is entitled to collect the loan he has made in preference over other creditors by treating the subject automobile as the security of the loan without the borrower or a third party owner surrendering the possession thereof to the lender.

5. "Construction Plant Mortgage Act" Kensetsu Kikai Teltoo Hoo: Code No. 97 -1964: provides that a construction plant may, at the discretion of the owner, be registered at the Registrar's Office. If such a registration has been made, the plant may be submitted as collateral for a loan.

Title Insurance:

There is no title Insurance in Japan.

Pooling Issues:

Are there any legal restrictions on the ability to transfer mortgage loans?

Loans may be transferred; however, the lender and the borrower may agree on a discretionary provision to the effect that the particular loan is not transferable, but such a provision shall not bind a third party with no previous notice of such a special agreement.

Usually a party who transfers the loan to a third party must inform the debtor that the transfer was made or the debtor must acknowledge such transfer has taken place. Also, in order to assert the transfer has taken effect, such notice by the former lender or the acknowledgment by the debtor must be made in writing of which date is certified by a postmaster, notary public or other public official.

It must also be noted that the "Securitized Mortgage Act" Teitoo Shookan Hoo Code 15 - 1931, Article 15 provides "transfer of Teitoo shookan must be done by endorsement of the shookan." In this case, the delivery of the mortgage loan instrument shall be necessary for an effective transfer to take place.)

Vehicle Selection

Isolation of Mortgage Pool:

Japan has much fewer choices for available types of 'business entities' compared to the United States. Additionally, the Japanese do not pay as much attention to the avoidance of double taxation, i.e., corporation vs. partnership. As a consequence, there are no form of entities in Japan comparable to partnerships in the US.

Having said the above, one can provide a 'means of isolation' through a 'corporate veil' if the tax ramifications are ignored.

Another possibility is setting up partnerships in the U.S. (or tax-haven corporations) which would act as the vehicle/conduit for originating and selling loans secured by real property in Japan.

Availability of Vehicles to Weaken Bankruptcy Impacts:

It appears that the Japanese system does not provide such a vehicle by itself; however, it may be possible to arrange such through a vehicle structured in a third country. More detailed studies are required on more specific cases.

Non-Taxable Conduit/Entity:

So far no such entity/conduit comparable to any of the U.S. examples shown is known in Japan; however, it may be possible to structure an entity taking advantage of the U.S.(or third country's) non-taxable entities to achieve the same consequences.

Such attempts were made by several Japanese trust banks to structure an entity which reduces the tax impact in attempts to 'securitize' Japanese non-performing loans generally adapting the U.S. limited partnership form.

It is not known whether it was the 'structural defects' or the very low quality of the loans as the underlying assets which did not make the attempt a spectacular success, but the use of a multi-national combination of forms of entities may produce some interesting results. Also it appears to be necessary to refer to Article 15 et al in the 'Japan-U.S. Treaty for the Prevention of Double Taxation on Income and Avoidance thereof' (Treaty No. 6 - 1872, effective on July 9, 1972).

Withholding Taxes:

With regard to the withholding tax in Japan applicable to investors from the United States, Articles 11, 12, 13 and 14 of the aforementioned Treaty No. 6 - 1972 should be referred to.

Transfer Taxes:

Currently there are three types of real estate transactions taxes imposed in Japan:

1. Document Stamp Duty; Imposed by "Stamp Duty Act: Inshi Zei Hoo: Code No. 23 - 1967 Table One; Current Rate is for a Loan Agreement where the loan amount is in excess of Five Billion Yen, the stamp required per instrument is Yen 600,000. If the instrument is prepared in duplicate, each document must be stamped for the full amount separately so the total amount of the stamp duty becomes Yen 1,200,000.

2. Registration Tax: Imposed by "Registration and Licensing Tax Act: Touroku Menkyo Zei Hoo: Code No. 35 -1967 Table One: Current Rates are for the registration of a new owner due to the sale-purchase of land is 0.5% of the transaction value. For the registration of a newly created mortgage, 0.4% of the amount of the loan secured by the mortgage. For the registration of the transfer of the mortgage interest, 0.2% of the amount of the loan secured thereby.

3. Real Property Acquisition Tax: Fudoosan Shutoku Zei. This tax is imposed upon the buyer of a real property by prefectural government and the rates differ from one prefecture to another. Also the creation/transfer of mortgage interest shall not be subjected to this tax.

Servicing

Separation from the Ownership:

So far, the Japanese legal system has not addressed the Issue of 'Servicer.' With the current problems of 'Non-performing loans' and the needs for "securitization", however, the LDP is now attempting to pass legislation regulating 'Servicers.' It is generally assumed that the end of 1998 calendar year at the la will see such legislation enacted. Japanese financial institutions and real estate companies are trying to enter the market and collect relative information.

Outside Servicers:

The Borrowers should not object to outside servicers because of the increased disclosure relative to raising funds. Of course when finalized, the new legislation referred to above may affect certain minor details.

Rating Agency Diversity and Concentration Requirements:

The recent financial fiasco in Japan effectively destroyed 'Keiretsu' and other disguised affiliations because of the banks' inability to provide the necessary financing to members of the group which the bank was supposed to have fulfilled and also Japanese corporations which have been used to the keiretsu-based interlocking share-holdings with nominal dividend payments are liquidating these holdings in order to stream-line their financial structures. This trend is irreversible particularly because new 'inter-keiretsu' strategic alliances among major manufacturers are becoming more conspicuous.

As far as the Investment vehicles to be marketed In Japan are concerned, the Japanese Investors may be more comfortable with a creation of "neutral" major foreign players such as have been witnessed In Tokyo over the fast 18 months or so.

Offering Issues - Creating Interests

Debt versus Equity:

Debt-based securities may be more readily accepted in Japan. The investors are fed up with 'high risk-high return' investment instruments which are reminiscent of the Bubble Days.

Form of Entity:

The use of U.S. limited partnership interests and other third country tax-haven structures must be considered because the tax treatment of these entities in Japan are different from those in the United States. For Instance, in 1986, when the U.S. canceled the income tax filing setting off 'passive losses' against 'active profit,' Japan continued thereby creating significantly different tax consequences between the U.S. and Japanese investors. Use of limited liability companies should be considered along with their state-to-state diversity and the added flexibility in participation eligibility.

The use of the Japanese-style 'trust' must be seriously considered.

The size of the fund does not necessitate a public offering. One must seriously consider private offerings.

Offering of Interests (Assumed to be U.S. and Europe):

This issue is premature until a further analysis of Japanese real estate financing is completed,

Unique Non-U.S.Issues/Applicable Bankruptcy Law:

As far as the applicable bankruptcy law is concerned, 'Law Concerning Application of Laws In General': Horei: Code No. 10 - 1898" Article 3 provides that the ability of a person is determined in accordance with the laws of the person's nationality.

There appears to be no other authority in the Japanese system to determine the applicable bankruptcy law. It is possible to use an entity incorporated or organized under the U.S. laws to conduct the business outside of the United States, which is done by thousands of manufacturers and distributors.

Currency Issues:

The matter of currency repatriation should be left to the respective investors