

Status of Suruga Bank's Response to Loans for Investment Real Estate Other Than Shared Housing (Updated Version)

August 8, 2024
Suruga Bank

Introduction

In response to the organizational negotiation of loans for investment real estate other than shared housing (hereinafter, the "Apaman Issue"), Suruga Bank announced in April 2023 three policies with the strong desire that this issue will be resolved as quickly as possible. The three policies are: (1) propose a plan for early settlement, (2) reduce obligations on debtors by assisting with negotiated sales, and (3) make decisions on an individual basis.

The following is an explanation of the status of our response in accordance with these policies.

Overview of the Apaman Issue

In May 2019, the "Report (Investigation of All Investment Real Estate Loans)" (hereinafter, the "Investigation") was published¹ revealing the full extent of the problems in the Bank's real estate investment-related lending. In light of the fact that the Investigation uncovered falsification or forgery of screening documents in approximately 20% of the total number of investment real estate loans granted (on 37,907 properties, including shared housing), the bank has offered consultations and provided extensive repayment support, by for example, cutting a portion of the principal of these debts.

Currently, as of the end of June 2024, organizational negotiations on 819 properties² (approximately 2.2% of the 37,907 properties) are currently ongoing with the Bank and the Suruga Bank Victims Defense Team (hereinafter, the "SI Defence Team"). In some cases, debtors (hereinafter, the "Organizational Negotiation Debtors") have been withholding rental income earned on these properties and have stopped paying principal or interest to the Bank for an extended period of time. To ensure financial soundness, Suruga Bank has appropriately recorded allowances for these liabilities with a coverage ratio³ of 99.65%.

- Reference Materials 1: Status and coverage of investment real estate loans and organizational negotiation partners

1. Early settlement proposal

With regard to our first policy to propose a plan for early settlement, Suruga Bank proposed an Early Resolution Framework to the SI Defense Team in May 2022. The Early Resolution Framework proposes a three stage process. The first stage is to consider the issue of inflated⁴ property valuations, the second is to consider whether it is highly likely that Suruga Bank and its employees were involved

¹ www.surugabank.co.jp/surugabank/common/english/info/pdf/190515_4_a_en.pdf

² Due to voluntary sales and other factors, from the end of September 2022 to the end of June this year, 109 properties were no longer in organizational negotiations.

³ The figures are as of June 30, 2024.

⁴ The term "inflated" here broadly means that the falsified rent roll led to the "mistake" of thinking that the property in question was more profitable than it actually was, resulting in a higher price than if the "mistake" had not occurred.

in falsifying rent rolls presented to debtors, and the third is to consider the calculation of a settlement figure based on the amount of damage and the degree of responsibility. Consultations have now progressed to the third stage.

However, even now, two and a half years since the SI Defense Team filed for mediation⁵, there are still differences of opinion on some basic points. For example, Suruga Bank has insisted on the need to make decisions on an individual basis⁶, but the SI Defense Team has effectively demanded a blanket settlement, something which we have not been able to come to agreement on.

We will continue to respond in good faith to negotiations involving the courts, and in light of the situation where differences of opinion between the two parties have remained unresolved for an extended period of time, we are communicating to the SI Defense Team our proposal to the effect that even for individual cases that are not under specific consideration, we would like to receive all the necessary information from those debtors who wish to seek early resolution in accordance with our proposed framework.

Through these efforts, Suruga Bank will continue to take the stance of “actively cooperating to clarify the loan circumstances in an effort to achieve an early resolution for certain types of cases where the Bank is likely to be found liable in tort in a lawsuit,” thereby making every effort to resolve the issue as quickly as possible.

2. Reduce obligations on debtors by assisting with negotiated sales

With regard to our second policy to reduce obligations on debtors by assisting with negotiated sales, there have been cases through various proposals and consultations in which measures to assist with negotiated sale have been applied resulting in the sale of such properties. As stated in the document addressed to Organizational Negotiation Debtors (Reference Material 2) described below, we offer consultation and in-depth support in cases where the value of the property is not enough to repay the loan even if private sale proceeds are used⁷, such as in the preparation of a repayment plan after the sale proceeds have been appropriated, depending on the circumstances of each individual case.

3. Decisions on an individual basis

Regarding our third policy, as an example of the need to make decisions on an individual basis, Suruga Bank’s approach to so-called “break-even properties” is explained as follows in a document published in November 2023.

- A break-even property is one that has a high possibility of securing positive “real estate income” even if scheduled repayments continue as per the loan agreement with Suruga Bank.

⁵ The SI Defense Team filed a petition for mediation with the Tokyo District Court in February 2022, but since then, negotiations involving the court alone have taken place 18 times.

⁶ Reasons why we believe that decisions on an individual basis are necessary (summary of materials published in April 2023): (1) In the results of all investigations, no fraud was found in approximately 80% of Apaman loans, so we cannot assume that Suruga Bank committed illegal acts in all cases; (2) The circumstances of the parties involved differ depending on the individual case (For example, there was a report of a real estate agent falsifying documents at the request of the Bank, deceiving property owners. However, Suruga Bank has also seen cases where a real estate agent falsified documents deceiving both the owner and the Bank, and cases where the owner and real estate agent jointly falsified documents to obtain a larger loan from the Bank); and (3) Fairness with debtors with whom individual lawsuits and settlements have already been made (judicial rulings and settlements have already been reached in accord with individual circumstances, so from the perspective of fairness, it is difficult for Suruga Bank to opt for a blanket resolution).

⁷ In the case of Organizational Negotiation Debtors who have been withholding rental income earned on their properties and have stopped paying principal or interest to the Bank, we request that approximately 70% of the amount withheld (after deduction of appropriate and necessary expenses) be added to their repayment.

As such, we believe that, in principle, there is no justifiable reason to suspend loan repayments for an extended period of time.

- The term “real estate income”⁸ here refers to the amount obtained when 30% of the rental income from the property is deemed as necessary expenses, and those necessary expenses and loan payments (interest and scheduled repayments paid to Suruga Bank) are deducted from the rental income. The expenses ratio for a single apartment building, which includes management fees, utilities for common areas, property tax, city planning tax, and refurbishment costs when empty, is generally said to be around 15–20%, but Suruga Bank conservatively assumes an expenses ratio of 30% when calculating “real estate income”.

As explained in the materials released in April 2024, Suruga Bank has prepared a document requesting debtors who own such break-even properties to resume scheduled repayments, consider reducing their repayment obligations through voluntary sale of properties, or to contact us if there are any specific circumstances that make it difficult to make scheduled repayments. We have been sending out this document to debtors from March 2024.

Furthermore, with regard to properties whose real estate income is estimated to be in the red based on materials provided by the debtor and not just for the break-even properties mentioned above, in addition to reducing repayment obligations through voluntary sale of properties, we have been informing debtors from May 2024 that we will be accepting consultations for resuming scheduled repayments by working to create surplus real estate income through interest rate reductions.

- Reference Material 2: Template of document including consultation on interest rate reduction (example)

Suruga Bank is also providing written notice that we will accept inquiries and consultations in other cases, such as when there are special circumstances (e.g., excessive property repair costs) that have not been taken into account in estimated real estate income, or when it is unclear whether the property is profitable or not.

We hope you will understand that we are doing our best to resolve the Apaman issue as quickly as possible by providing repayment advice based on individual circumstances and by proposing measures to reduce repayment obligations to the greatest extent possible, regardless of whether the property is producing income or not.

If however, despite these proposals, you do not respond to our communication to resume repayments, we will be forced to go back to the principles stipulated by law and file our claim that as a bank, it is extremely difficult for us to allow you to miss repayments for an extended period of time.

Future Actions

We will continue to do our utmost to resolve the issue as soon as possible in accordance with the three policies we announced in April 2023.

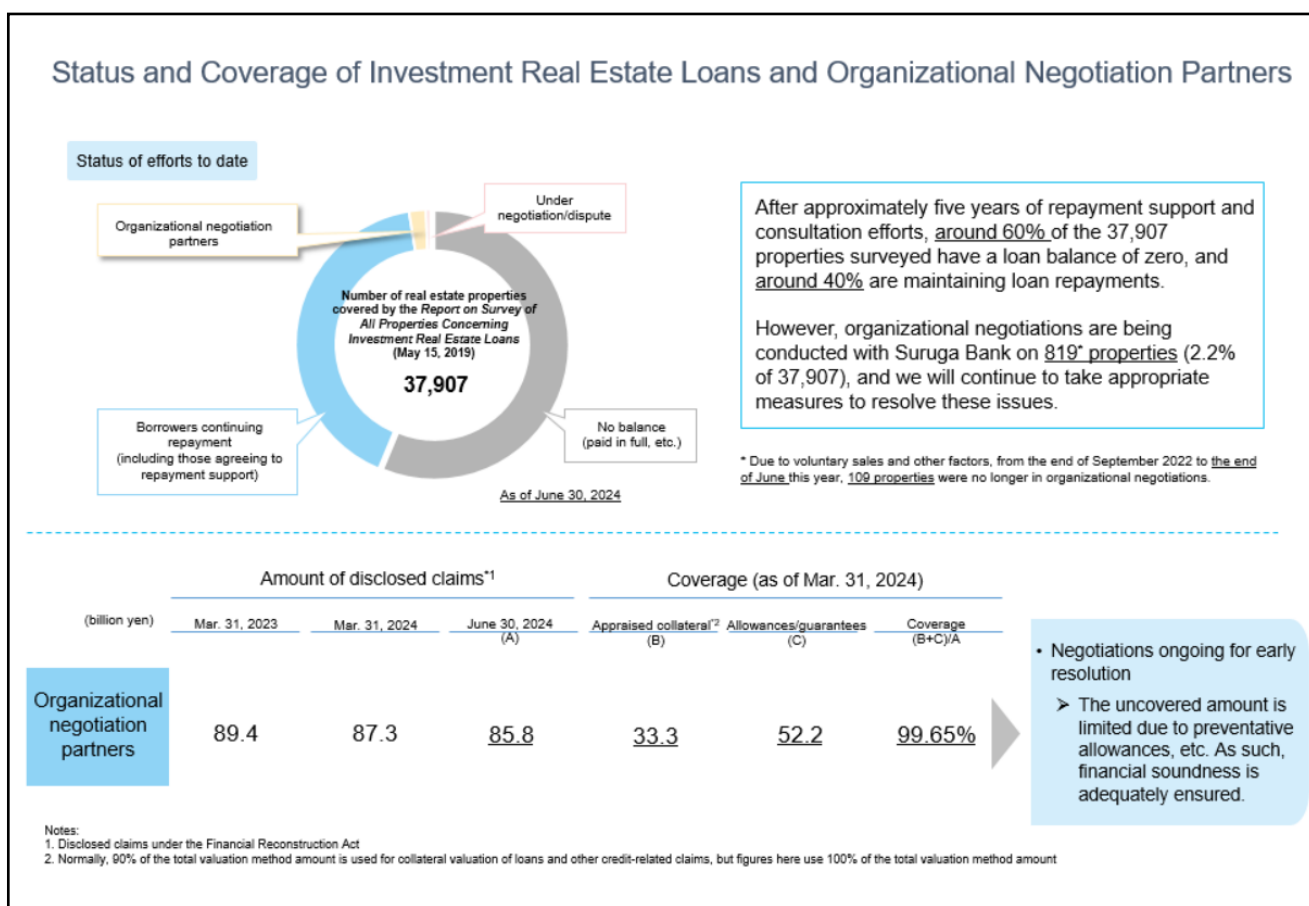
In particular, we believe that it is essential to take prompt measures with our second policy to reduce obligations on debtors by assisting with negotiated sales, given the urgent need to reduce the burden

⁸ In response to a question regarding the definition of “real estate income,” we have provided an explanation that further expands on our previous disclosures.

on Organizational Negotiation Debtors who are struggling to make repayments, and to those who may not be able to achieve the expected sales price depending on future real estate market conditions.

For this reason, we offer the maximum level of support possible to all Organizational Negotiation Debtors. We will do our utmost to bring relief as soon as possible to the many Organizational Negotiation Debtors by quickly reducing their debt obligations, providing assistance in the form of repayment plans, and creating a path to resolving individual issues on a case-by-case basis.

Reference Materials 1



Reference Materials 2

XXXX-XXXX
XXXX, XXXX, XXXX, XXXX
XXXXXXXXXX
Dear Mr./Ms. XXXXXXX

MONTH, 2024
1-7-1 Nihonbashi Muromachi, Chuo-ku, Tokyo
103-8689
Suruga Bank, Ltd.

¹ www.surugabank.co.jp/surugabank/common/english/pdf/240404_05_en.pdf
² Please refer to the website link in footnote 1. A negative cash flow property is defined as a property that is estimated to be in negative territory when 70% of its rental income is considered as real estate income after deducting costs, and the loan payment (interest and scheduled repayment paid to Suruga Bank) is deducted from the income.

Points of Note.
Depending on the specific circumstances of the Property, Suruga Bank may not be able to provide you with such measures to reduce your debt obligations. Please note that terms and conditions apply to Suruga Bank's debt reduction measures.
These debt reduction measures are only being proposed at this time for customers who have promptly consulted with us and agree to the terms and conditions. Suruga Bank makes no guarantee that these debt reduction measures will be available in the future. We therefore ask that you contact our Office to Support Customer Owners of Share Houses and Others at your earliest convenience should you wish to take advantage of any of these measures to reduce your debt obligation.

Office to Support Customer Owners of Share Houses and Others
1-7-1 Nihonbashi Muromachi, Chuo-ku, Tokyo
Toll free: 0120-010-636
Lines open: 09:00-17:00
(Monday through Friday, excluding Saturdays, Sundays, national holidays, and year-end and New Year holidays).

Suruga Bank sincerely apologizes for the long period of uncertainty with regard to negotiations concerning loans for investment properties other than shared houses that have been ongoing for some time. Since we are not able to contact you directly regarding this matter, we appreciate your understanding that this letter has been sent to you by way of your attorney.

Our response to the negotiations concerning loans for investment real estate other than shared housing (hereinafter, the "Apanan Issue") has been explained in a document posted on the Bank's website (dated April 4, 2024).¹ As stated in that document, we strongly hope to resolve the Apanan Issue as soon as possible. We have therefore been working with representative attorneys to propose various means to resolve the issue. We are sending this letter to you to reaffirm how we intend to handle your dealings with Suruga Bank, including debt relief and additional support.

With regard to the real estate purchased with financing from us in connection with the Apanan Issue (hereinafter, the "Property"), as our business relationship continues, we have not received any scheduled repayments for an extended period of time. We are sending this letter to you to discuss the possibility of resuming repayments as any scheduled repayments missed will increase the amount you will have to pay in late payment charges.

- We therefore ask that you contact our Office to Support Customer Owners of Share Houses and Others in cooperation with your attorney. Should there be any special circumstances not taken into account when we estimated the Property's real estate income (e.g., excessive property repair costs, etc.), we again urge you to contact Suruga Bank via the Office to Support Customer Owners of Share Houses and Others.

Based on data already provided by you and in light of general apartment management and rental business conditions, we believe that your Property may be a so-called negative cash flow property.²

If the Property falls under the category of a negative cash flow property and there is little prospect of improved future cash flow, we would like to discuss measures to reduce your debt obligations, for example, interest rate reductions or voluntary sale, on the premise of paying a portion of the rental income earned during the time of missed repayments.

- Please refer to Attachment 1 for specific details of our debt reduction measures through lower interest rates.
- Please refer to Attachment 2 for specific details of our debt reduction measures through voluntary sale.

Attachment 1: Measures to reduce debt obligations through lower interest rates¹⁾

(1) Minimum 1% interest rate reduction²⁾

➢ Please refer to Case A below as an example.

(2) Interest rate reduction and final lump-sum payment of portion of principal³⁾

➢ If implementing measure (1) above does not bring the Property into a positive cash flow and repayment remains uncertain, we will discuss the possibility of a lump-sum payment of a portion of the principal on the final due date after considering individual circumstances (such as possible repayment amount and asset situation).

➢ Please refer to Case B below as an example.

Scope of this debt reduction measure⁴⁾

As a general rule, the customers to whom we propose debt reduction measures through reduced interest rates are limited to the following:

- Customers who, in light of circumstances, applied for a partial principal reduction in May 2019 but did not reach a resolution, filed for civil mediation to the court by the end of August 2021 without resolution, and consulted about an interest rate reduction after April 2024.
- Properties for which, over the past year, the rental income has consistently been negative after deducting expenses (including repair costs⁵⁾ and property taxes) and loan payments (interest and scheduled repayments to Suruga Bank), and for which we have determined that there is little prospect of improved future cash flow (excluding condominiums for investment purposes).

¹ Repair costs for restoration and routine repairs. Excludes repair costs related to capital expenditures such as large-scale renovation projects.

Suruga Bank makes no guarantee that these debt reduction measures will be available in the future. These debt reduction measures are only being proposed at this time for customers who have promptly consulted with us and agree to the terms and conditions.

Examples of measures to reduce debt obligations through lower interest rates¹⁾

Case A: Example of debt reduction measure (1) - Minimum 1% interest rate reduction²⁾

(Roughly calculated based on a loan balance of 100 million yen with a remaining loan term of 25 years)

Initial situation

Repayment funds ³⁾	Rental income/month ⁴⁾	¥570,000 ⁵⁾
	Property expenses/month ⁶⁾	¥170,000 ⁷⁾
	Real estate income ⁸⁾	¥400,000 ⁹⁾
Repayment amount ¹⁰⁾	Loan repayment/month (at 4.00% interest rate) ¹¹⁾	¥530,000 ¹²⁾
Income ¹³⁾		(¥130,000) ¹⁴⁾

The repayment amount (¥530,000) exceeds the available repayment funds (¥400,000) by ¥130,000, making it difficult to foresee a way to meet repayments.

Situation after consultation¹⁵⁾

Repayment funds ³⁾	Rental income/month ⁴⁾	¥570,000 ⁵⁾
	Property expenses/month ⁶⁾	¥170,000 ⁷⁾
	Real estate income ⁸⁾	¥400,000 ⁹⁾
Repayment amount ¹⁰⁾	Loan repayment/month (at 1.40% interest rate) ¹¹⁾	¥395,000 ¹²⁾
Income ¹³⁾		+¥5,000 ¹⁴⁾

The repayment amount (¥395,000) is roughly in balance with the available repayment funds (¥400,000), making it possible to foresee a way to meet repayments.

Case B: Example of debt reduction measure (2) - Interest rate reduction and final lump-sum payment of portion of principal¹⁾

(Calculated based on a loan balance of 100 million yen with a remaining loan term of 25 years)²⁾

Initial situation

Repayment funds ³⁾	Rental income/month ⁴⁾	¥370,000 ⁵⁾
	Property expenses/month ⁶⁾	¥110,000 ⁷⁾
	Real estate income ⁸⁾	¥260,000 ⁹⁾
Repayment amount ¹⁰⁾	Loan repayment/month (at 4.00% interest rate) ¹¹⁾	¥530,000 ¹²⁾
Income ¹³⁾		(¥270,000) ¹⁴⁾

The repayment amount (¥530,000) exceeds the available repayment funds (¥260,000) by ¥270,000, making it difficult to foresee a way to meet repayments.¹⁵⁾

Situation after consultation¹⁶⁾

Repayment funds ¹⁷⁾	Rental income/month ¹⁸⁾	¥370,000 ¹⁹⁾
	Property expenses/month ²⁰⁾	¥110,000 ²¹⁾
	Real estate income ²²⁾	¥260,000 ²³⁾
Repayment amount ²⁴⁾	Loan repayment/month (at 1.00% interest rate) ²⁵⁾	¥257,000 ²⁶⁾
	Final lump-sum payment ²⁷⁾	¥41,000,000 ²⁸⁾
Income ²⁹⁾		+¥3,000 ³⁰⁾

The repayment amount (¥260,000) is roughly in balance with the available repayment funds (¥260,000), making it possible to foresee a way to meet repayments.³¹⁾

- The above two cases (A and B) are examples only. Suruga Bank may not be able to provide you with such measures to reduce your debt obligations.³²⁾ If you wish to proceed, it will be on the condition that you resume repayments and allocate 70% of the rental income received during the time repayments were missed to cover accrued interest, late fees, and other charges.³³⁾ Please contact the Office to Support Customer Owners of Share Houses and Others for more details.³⁴⁾

Attachment 2: Measures to reduce debt obligations through voluntary sale of Property³⁵⁾

(1) Support to customers for voluntary sale³⁶⁾

- We will provide necessary documents and (except in some areas) introduce real estate agents.³⁷⁾

(2) Partial waiver of overdue interest and damages after voluntary sale³⁸⁾

- As a specific measure for a partial waiver, we will discuss an obligation for you to pay, in addition to the proceeds from the voluntary sale, 70% of the rental income earned during the time loan

³⁹⁾ If the amount of accrued interest and late charges exceeds 70% of the rental income received during the time repayments were missed, please contact us to discuss your situation.⁴⁰⁾

repayments were missed, whereby any amount in excess of this will be waived up to an amount equal to overdue interest and damages.⁴¹⁾

- If there are understood to be any special individual circumstances, we will also be happy to discuss the amount equivalent to the real estate balance.⁴²⁾
- Please refer to Case C below as an example.⁴³⁾

(3) Consultation on repayment of outstanding debt after voluntary sale⁴⁴⁾

- As a specific measure for a repayment plan of the outstanding debt (after partial waiver as set out in (2) above), we will discuss with you with respect to 0% interest over a 35 year term, or 1% interest over the same term as the original contract.⁴⁵⁾
- Please refer to Case D below as an example.⁴⁶⁾

(4) Consultation on repayment of outstanding debt through individual repayment plan⁴⁷⁾

- If repayment of the outstanding debt is unlikely even after implementing (3) above, we will consult with the borrower to create an individual repayment plan based on the individual's circumstances (e.g., amount that could be repaid, assets, etc.).⁴⁸⁾

Scope of this debt reduction measure⁴⁹⁾

As a general rule, the customers to whom we propose the aforementioned debt reduction measures are limited to the following:⁵⁰⁾

- Customers who, in light of circumstances, such as the partial cut in principal announced in May 2019 but not yet resolved, applied for civil mediation to the court by the end of August 2021 but not yet resolved, or customers who have conducted voluntary sales since April 2023 when the Bank proposed the aforementioned debt reduction measures to the SI Defense Team⁵¹⁾

Please note that we do not promise to implement any of these debt reduction measures in the future. These measures are only being proposed at this time for those customers who have been able to promptly execute a voluntary sale.⁵²⁾

Examples of measures to reduce debt obligations through voluntary sale⁵³⁾

Case C: Example of debt reduction measure (2) - Partial waiver of overdue interest and damages after voluntary sale⁵⁴⁾

Initial situation

Repayment funds ⁵⁵⁾		Repayment amount ⁵⁶⁾	
Proceeds from sale ⁵⁷⁾	¥20,000,000 ⁵⁸⁾	Loan balance ⁵⁹⁾	¥22,000,000 ⁶⁰⁾
		Overdue interest and damages ⁶¹⁾	¥7,500,000 ⁶²⁾
Total ⁶³⁾	¥20,000,000 ⁶⁴⁾	Total ⁶⁵⁾	¥29,500,000 ⁶⁶⁾

- The funds for repayment (¥20,000,000) are ¥9,500,000 short of the repayment amount (¥29,500,000 yen) required to proceed with the sale (pay off the loan), making it difficult to proceed with the voluntary sale.⁶⁷⁾

Situation after consultation⁶⁸⁾

Repayment funds ⁶⁹⁾		Repayment amount ⁷⁰⁾	
Proceeds from sale ⁷¹⁾	¥20,000,000 ⁷²⁾	Loan balance ⁷³⁾	¥22,000,000 ⁷⁴⁾
70% of rental income earned during time repayments missed ⁷⁵⁾	¥2,500,000 ⁷⁶⁾	Overdue interest and damages ⁷⁷⁾	¥7,500,000 ⁷⁸⁾
		Partial waiver of interest and damages ⁷⁹⁾	(¥7,000,000) ⁸⁰⁾
Total ⁸¹⁾	¥22,500,000 ⁸²⁾	Total ⁸³⁾	¥22,500,000 ⁸⁴⁾

- This is an example which shows that 70% of the rental income (¥2,500,000) earned during the time repayments were missed is allocated to fund repayment of the loan. A portion of the interest and damages is also waived meaning that the voluntary sale can proceed to completion.⁸⁵⁾

Case D: Example of debt reduction measure (3) - Consultation on repayment of outstanding debt after voluntary sale⁸⁶⁾

Repayment funds ⁸⁷⁾		Repayment amount ⁸⁸⁾	
Proceeds from sale ⁸⁹⁾	¥18,000,000 ⁹⁰⁾	Loan balance ⁹¹⁾	¥22,000,000 ⁹²⁾
70% of rental income earned during time repayments missed ⁹³⁾	¥2,500,000 ⁹⁴⁾	Overdue interest and damages ⁹⁵⁾	¥7,500,000 ⁹⁶⁾
		Waiver of interest and damages ⁹⁷⁾	(¥7,500,000) ⁹⁸⁾
Total ⁹⁹⁾	¥20,500,000 ¹⁰⁰⁾	Total ¹⁰¹⁾	¥22,000,000 ¹⁰²⁾

- 70% of the rental income (¥2,500,000) earned during the time repayments were missed is allocated to fund repayment of the loan. But even if the interest and damages (¥7,500,000) accrued during missed repayments is waived in full, there are still insufficient funds to repay the loan (outstanding debt = ¥1,500,000).¹⁰³⁾

Debt reduction measure option (i)¹⁰⁴⁾

Outstanding debt ¹⁰⁵⁾	Applicable interest rate ¹⁰⁶⁾	Loan term ¹⁰⁷⁾	Monthly repayment ¹⁰⁸⁾
¥1,500,000 ¹⁰⁹⁾	1.0% ¹¹⁰⁾	20 years ¹¹¹⁾	Approx. ¥6,900 ¹¹²⁾
	* 3.5% in original contract ¹¹³⁾	* Same as original contract ¹¹⁴⁾	

Debt reduction measure option (ii)¹¹⁵⁾

Outstanding debt ¹¹⁶⁾	Applicable interest rate ¹¹⁷⁾	Loan term ¹¹⁸⁾	Monthly repayment ¹¹⁹⁾
¥1,500,000 ¹²⁰⁾	0% ¹²¹⁾	35 years ¹²²⁾	Approx. ¥3,600 ¹²³⁾

- In this consultation example, a repayment plan was considered based on the customer's individual circumstances. In addition to these two options, other options such as the lump-sum repayment of outstanding debt were also considered.¹²⁴⁾

- The above two cases (C and D) are examples only. Suruga Bank may not be able to provide you with such measures to reduce your debt obligations. Customers who wish to take advantage of any of Suruga Bank's debt reduction measures will be required to agree with our terms and conditions. Please contact the Office to Support Customer Owners of Share Houses and Others for more details.¹²⁵⁾

*This document is an update of some figures (underlined portions) from the document released on July 1, 2024, based on information as of the end of June 2024.

*This document has been translated from the Japanese original for reference purposes only. In the event of any discrepancy between this translated document and the Japanese original, the original shall prevail.