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Ratings On Japan Real Estate Investment Corp. Affirmed At 'AA-/A-1+'; Outlook Stable

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TOKYO (Standard & Poor's) May 11, 2009--Standard & Poor's Ratings Services today affirmed its 'AA-' long-term corporate credit and debt ratings and 'A-1+' short-term rating on Japan Real Estate Investment Corp. (JRE). The outlook on the long-term corporate credit rating remains stable.

The affirmations are based on the following factors: (1) Although there is a possibility that JRE's rental revenues may experience a certain level of decline amid difficult business conditions, we expect the Japanese real estate investment trust (J-REIT) to generate stable earnings, backed by its high-quality portfolio and relatively high EBITDA margin; and (2) The company maintains ample liquidity and high financial flexibility, based on its relatively conservative financial policy. Nevertheless, since JRE's leverage ratio has risen slightly to a level higher than the target range stipulated in its financial policy, we will monitor the company's financial indices, such as the debt-to-capital ratio, cash flow protection, and profitability.

JRE boasts the second-largest asset portfolio among the listed J-REITs that focus on office buildings. The company has a strong business position in the J-REIT market and commands high market recognition, backed by the strong brand recognition and credit quality of its sponsors, Mitsubishi Estate Co. Ltd. (Mitsubishi Estate; A+/Stable/A-1), Dai-ichi Mutual Life Insurance Co. (A/Stable/--), and Mitsui & Co. Ltd. (A+/Stable/A-1). In March 2009, Mitsubishi Estate acquired all the shares (27% of total outstanding shares) of

JRE's asset management company that were held by Tokio Marine & Nichido Fire Insurance Co. Ltd. (AA/Stable/A-1+), turning the asset management company into a consolidated subsidiary. Mitsubishi Estate now owns a 63% stake in the asset management company. Going forward, we expect JRE to take advantage of Mitsubishi Estate's real estate development and management expertise to operate more efficiently.

As of March 31, 2009, JRE owned a portfolio of 55 office properties throughout Japan located mainly in the 23 wards of Tokyo, worth ¥566.0 billion, based on total purchase price. In the one-year period from April 1, 2008, JRE invested a combined ¥47.05 billion, including the ¥24.0 billion acquisition of Shin-Fujita Building (Kita-ward, Osaka), as well as the ¥21.25 billion acquisition of Shiodome Building (Minato-ward, Tokyo). The company conducted selective property acquisitions by securing funding in a timely manner despite difficult business conditions.

The prolonged turmoil in the global financial and capital markets has begun to have a negative impact on real estate prices and the property rental market. The impact is more pronounced on the prices and rents of properties located in local areas and areas that are less competitive. JRE itself is finding it difficult to immediately find new occupants for some offices that tenants have vacated after terminating their leases. Nevertheless, the company has a portfolio consisting of generally well-maintained, highly competitive properties mostly located in Tokyo's central districts with an average occupancy rate of 95.5% (as of March 31, 2009), and the portfolio continues to generate stable cash flow. Although we expect the unrealized profit in the portfolio (the difference between the appraisal value at the end of the fiscal term and the book value of the portfolio) to decline slightly in the near future, it was still at a high level of ¥119.2 billion (about 22.7% of book value) at the end of the 14th fiscal term.

With the largest property, Kitanomaru Square Building, accounting for about 14.4% of the portfolio's total value (based on total purchase price), the portfolio has a degree of asset concentration risk. Nevertheless, the property's scarcity value in terms of location, its excellent specifications, and the stable rental revenues generated by long-term leases mitigate this risk.

JRE's portfolio asset size has reached a certain magnitude. The company has therefore refrained from establishing a specific external growth target in light of the slump in the equity market and poor conditions for real estate financing. It intends to focus on boosting internal growth through measures such as lifting rents, keeping occupancy rates stable, and bolstering asset quality through renovations, while maintaining growth at a moderate pace.

JRE pursues a conservative financial policy, maintaining its ratio of debt to total assets at between 30% and 40%. As its asset size has reached a certain magnitude, its leverage has experienced smaller fluctuations. At the end of the 14th fiscal term, the company's debt-to-capital ratio (interest-bearing debt including Hoshokin liabilities/(interest-bearing debt + total net assets) according to Standard & Poor's definition) stood at about 39.5%, which is slightly high. We are of the opinion that JRE's debt-to-capital ratio may hover at levels higher than the target range established under the company's financial policy until the equity market recovers and may add pressure on JRE's credit quality. However, this risk is

partially mitigated because: (1) JRE's very high-quality portfolio consists of properties with high occupancy rates that generate stable cash flow; (2) JRE maintains good business relationships with several financial institutions, giving it high financial flexibility; and (3) The company has issued equity five times since its listing, indicating that it has a certain ability to control leverage. Since its leverage ratio has risen slightly, JRE plans to acquire properties in a careful and selective manner.

All of JRE's long-term debt carries fixed interest rates and with maturities diversified through 2025. In the 14th fiscal term, JRE's EBITDA interest coverage and the ratio of funds from operations (FFO) to debt declined to about 10x and 12.0%, respectively, indicating comparatively high leverage. Yet, the company continues to generate highly stable cash flow.

As of Sept. 30, 2008, JRE had a cash balance of about ¥12.8 billion, which was a sufficient level to cover immediate operating expenses (including security deposit liabilities). The company maintains ample liquidity at hand for debt servicing, supported by ¥25.0 billion worth of unused credit lines and good relationships with several financial institutions. In addition, the company has high financial flexibility, given that all of its current interest-bearing debt is unsecured.

The outlook is stable. Standard & Poor's expects JRE to maintain generally stable earnings, based on its close ties with sponsors and its high-quality real estate portfolio. Nevertheless, since JRE's leverage ratio has risen slightly to a level higher than its target range and its rental revenues may experience a certain level of decline amid difficult business conditions, we see little likelihood of upward movement in our rating on JRE in the near future. We will monitor JRE's financial measures, such as the debt-to-capital ratio, cash flow protection, and profitability. The ratings on JRE may come under downward pressure if the business environment remains difficult for J-REITs and the company's financial indices remain relatively weak, compared with former levels, in the medium term.

A Japanese-language version of this media release is available on Standard & Poor's Research Online at www.researchonline.jp, or via CreditWire Japan on Bloomberg Professional at SPCJ <GO>.

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