

Ratings On Japan Real Estate Investment Corp. Affirmed, Outlook Remains Negative

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OVERVIEW

- JRE commands high market recognition, with the second largest asset portfolio among the listed J-REITs that focus on office buildings.
- We have affirmed our long-term corporate credit and unsecured debt ratings and our short-term corporate credit rating on JRE, given the J-REIT's strong business position and generally stable cash flows, derived from its very high-quality real estate portfolio and strong financial flexibility.
- However, we have maintained our negative outlook on the long-term corporate credit rating on JRE, because the J-REIT's debt-to-capital ratio has risen moderately and its profitability measures and financial indicators are slightly weak, amid the continued sluggish office leasing market.

TOKYO (Standard & Poor's) May 23, 2011--Standard & Poor's Ratings Services today affirmed its 'AA-' long-term corporate credit and senior unsecured debt ratings, as well as its 'A-1+' short-term corporate credit rating, on Japan Real Estate Investment Corp. (JRE). The outlook on the long-term rating on JRE remains negative.

We affirmed our ratings on JRE, reflecting its strong business position in the Japanese real estate investment trust (J-REIT) market and generally stable cash flows, derived from its very high-quality portfolio and strong financial flexibility.

However, we maintained the negative outlook on the long-term rating on JRE, reflecting the following factors:

- JRE's rental revenue is experiencing certain downward pressure amid difficult business conditions; its debt-to-capital ratio has been hovering at levels that are relatively high compared with the target range established under its conservative financial policy, and its profitability measures and financial indicators are rather weak;
- To increase its cash flow, JRE is likely to actively pursue external growth, in which case we see a possibility that the J-REIT may experience some delays in restoring its conservative financial profile; and
- The portfolio's unrealized profit (the difference between the appraisal value and the book value of the portfolio at the end of a fiscal term) is decreasing, thereby weakening JRE's financial buffer to a certain degree.

JRE has said that it intends to pursue a conservative financial policy, maintaining its ratio of debt to total assets at between 30% and 40%. However, as of March 31, 2011 (end of the 19th fiscal term), JRE's debt-to-capital ratio (interest-bearing debt including hoshokin liabilities/(interest-bearing debt including hoshokin liabilities + total net assets), according to Standard & Poor's definition) stood at about 45.1%, which is slightly higher than previous levels. The sluggish conditions in the office leasing market are constraining JRE's rental revenue. The portfolio's average occupancy rate has slightly improved, to 93.2%; however, the declining trend in rent levels persists. JRE's profitability measures have also weakened slightly, and its current financial indicators are slightly weak compared with the levels we assumed in the analysis for our initial ratings assignment. Since JRE believes that real estate market prices have been approaching the bottom, it intends to shift the focus of its operations to external growth and increase its cash flow. However, future financing conditions, if not fully stabilized, may cause delays in restoring the J-REIT's conservative financial profile. Moreover, the unrealized profit on JRE's portfolio has decreased (about 2.2% as of March 31, 2011). Although the Great East Japan Earthquake and ensuing tsunami that struck northeastern Japan on March 11, 2011, have had a limited direct impact on JRE's portfolio, we will continue to carefully monitor the office leasing environment, given the uncertainty stemming from stagnant economic activity as a result of the earthquake.

We may consider lowering the ratings on JRE if the real estate leasing market suffers prolonged weakness, or if the J-REIT's profitability measures and financial indicators remain relatively weak and appear unlikely to improve over the next 12 to 24 months and its ratio of debt to total assets increases further, to around 45%. On the other hand, we may revise the outlook to stable if JRE's profitability measures recover, its debt-to-total assets ratio declines to between 30% and 40% based on its financial policy, and prospects for clear improvement in its financial indicators, including interest coverage measures, emerge as the J-REIT pursues external growth.

JRE boasts the second largest asset portfolio among the listed J-REITs that focus on office buildings. The J-REIT 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. (A+/Stable/A-1), Dai-ichi Life Insurance Co. Ltd. (A/Negative/--), and Mitsui

& Co. Ltd. (A+/Negative/A-1). As of March 31, 2011, JRE owned a portfolio of 57 office properties throughout Japan, located mainly in the 23 wards of Tokyo, worth about ¥660.6 billion based on total purchase price. JRE has steadily acquired properties utilizing its sponsor network, such as Osaki Front Tower (Shinagawa Ward, Tokyo; purchase price: ¥12.3 billion), which the J-REIT acquired in February 2011.

RELATED CRITERIA AND RESEARCH

"Principles Of Credit Ratings," published Feb. 16, 2011

"Rating Policy For Japanese Real Estate Investment Trusts," published May 9, 2001

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