Ratings On Japan Prime Realty J-REIT Raised To 'A/A-1'; Outlook Stable

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TOKYO (Standard & Poor's) Jan. 16, 2008--Standard & Poor's Ratings Services today raised by one notch to 'A/A-1' from 'A-/A-2' its long-term and short-term corporate credit ratings on Japan Prime Realty Investment Corp. (JPR). At the same time, Standard & Poor's raised by one notch to 'A' from 'A-' its long-term senior unsecured debt rating on the company. The outlook on the long-term corporate credit rating is stable.

Standard & Poor's raised its ratings on JPR to reflect the increased stability of the company's operating base, thanks to an expanded property portfolio in tandem with reduced property and tenant concentration risk. The company has also achieved moderately conservative and stable operations through steady external growth and appropriate control of its leverage. JPR further improved its financial flexibility and financial profile in terms of its debt-to-capital structure, thanks to a decrease in the percentage of secured debt.

JPR holds a leading position in the Japan real estate investment trusts (J-REITs) market. The credit quality of JPR's sponsors has been improving. The company's sponsors are Tokyo Tatemono Co. Ltd. (NR), Meiji Yasuda Life Insurance Co. (A-/Positive/A-1), Taisei Corp. (BBB-/Stable/--), Sompo Japan Insurance Inc. (AA-/Stable/--), and Yasuda Real Estate Co. Ltd. (NR). Despite the severe environment for real estate acquisitions, JPR has acquired property steadily by collaborating with its sponsors, mainly Tokyo Tatemono and Taisei

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Corp. JPR's portfolio produces stable cash flows as it comprises well-maintained office and retail properties with high occupancy rates, and the company's financial profile is relatively sound.

As of the end of its 12th six-month fiscal period (ended Dec. 31, 2007), JPR held in its property portfolio 35 office buildings throughout Japan, plus 14 retail properties, equivalent to a total purchase price of about ¥251.9 billion. In addition, the company holds preferred stock in Meieki Nichome Kaihatsu TMK, equivalent to about ¥340 million. JPR also plans to acquire the Konan Nichome building (tentative name), located in Minato-ku, Tokyo, for ¥1.87 billion in December 2008, and the KM Fukugo-building (tentative name), located in Chuo-ku, Osaka, for ¥9.25 billion in March 2009. After selling the Tsurumi Fuga 1 building in Yokohama in April 2007, the company's dependence on its largest tenant in terms of total rental revenues, Seiyu Ltd. (NR), has decreased, mitigating concern over concentration risk centering on its largest tenants. Thus far, JPR has sold eight other properties.

The company is focusing on areas with investment significance, and on improving the quality of its portfolio by implementing a "value up" strategy and replacing its assets. JPR has been diversifying its portfolio, with the top four properties making up only 22% of the total value of its portfolio as of Nov. 30, 2007. Total tenants in its portfolio have increased to 519 from 344, seen when Standard & Poor's first assigned JPR a rating in October 2003. Geographically, the company has been investing in line with its investment policies. Occupancy rates have grown solidly since the company began its operations, and are currently high at 98.4%, thereby contributing to stable cash flows for JPR.

JPR has maintained external growth at a comparatively moderate pace of about 16% annually, starting from Standard & Poor's first rating assignment to Dec. 31, 2007. Although the company was unable to meet its external growth target of ¥300 billion for property investments, JPR has asserted that it now intends to achieve its targets at a steady pace without setting specific timeframes. The company's financial policy lists a debt leverage ratio target in the 35% to 50 % range. As the company has a track record of investment growth that spans three equity issues since listing on the Tokyo Stock Exchange, Standard & Poor's expects JPR to maintain its debt leverage ratio at a conservative level in the low-40% range, as a normal operational base with low fluctuation, under sound leverage control, even as it pursues external growth.

As of December 2007, an investment breakdown shows that office buildings account for 62.7% of JPR's portfolio, and retail properties account for 37.3%, with the percentage of retail properties on the rise. Investment in retail properties can be more complicated than investment in office buildings, and can require a higher level of portfolio management. Despite this, there are no particular concerns at present, given that JPR invests selectively in retail properties that are in good locations. Nevertheless, JPR's portfolio needs to be closely monitored because it has a comparatively high percentage of properties in which the company does not have full ownership.

As of the end of the company's 11th fiscal period in June 2007, JPR had total rental revenues of about ¥9.5 billion, net income of about ¥4.3 billion, and a debt-to-capital ratio (interest-bearing debt/(interest-bearing debt + unitholders' capital) according to Standard & Poor's definition) of about

36.6%. As of December 2007, long-term fixed loans comprised about 90% (not including long-term fixed loans and senior unsecured bonds that will be repaid within one year) of the company's total debt. In addition, the maturities of these long-term loans are diversified through 2026 (including 20-year senior unsecured bonds due 2026), and the repayment amounts per fiscal year are kept within a certain level. JPR's cash flows are relatively stable, and the company recorded an EBITDA interest coverage ratio of about 8.8x, a ratio of FFO to debt of about 12.0%, and a coverage ratio (net cash flow to interest expense plus dividends) of about 1.3x as of June 2007. The balance of JPR's cash and deposits was about ¥28.0 billion on June 30, 2007, a level that amply covers its operating costs even in an emergency (including security deposit refund liabilities). The company has secured liquidity on hand to apply to its debt repayments, with ¥20 billion in unused commitment lines and good relationships with several financial institutions. JPR's financial flexibility is increasing, given that secured debt comprised about 9% of its total borrowings as of Dec. 31, 2007, while the rest of its loans were unsecured.

The outlook on the long-term corporate credit rating is stable. JPR is expected to steadily increase its income through consistent external growth, as it has close ties with its sponsors, and to pursue internal grow through steady, modest rental rate increases. Standard & Poor's will examine whether the company can maintain its current financial profile, including its debt-to-capital structure and its capacity to cover future interest rate hikes, as it controls leverage at a conservative level in the low-40% range. The leverage level, as a normal operational base with low fluctuation, is set by taking into consideration both portfolio size and asset types.

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