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Ratings On Nippon Accommodations Fund Affirmed At 'A+/A-1'; Outlook Stable

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OVERVIEW

- Nippon Accommodations Fund is a J-REIT that specializes in residential properties.
- NAF has a relatively high debt-to-capital ratio. Nevertheless, NAF's recent property acquisitions have improved the J-REIT's business profile, particularly the diversity and, to a degree, the profitability of its portfolio.
- Amid relatively favorable conditions in the residential property rental market, we expect NAF to continue to generate stable cash flow, supported by its strong business position and high-quality real estate portfolio.
- We have affirmed our 'A+' long-term corporate credit and unsecured debt ratings and our 'A-1' short-term credit rating on NAF. The outlook on the long-term corporate credit rating remains stable.

TOKYO (Standard & Poor's) Dec. 3, 2012--Standard & Poor's Ratings Services today said that it has affirmed its 'A+' long-term corporate credit and unsecured debt ratings and its 'A-1' short-term credit rating on Nippon Accommodations Fund Inc. (NAF). The outlook on the long-term corporate credit rating on NAF remains stable.

NAF is a Japanese REIT (J-REIT) that specializes in residential properties. NAF has secured a firm position in the J-REIT market, backed by the real estate management and development capabilities and brand recognition of its sponsor, Mitsui Fudosan Co. Ltd. (BBB+/Stable/A-2). The ratings on NAF reflect its strong business position, its high-quality portfolio of rental properties with high occupancy rates, and its high financial flexibility. Meanwhile, we see some factors that constrain the ratings. In particular, NAF's debt-to-capital ratio is hovering at levels that are relatively higher than the target range it established under its financial policy. In addition, NAF has a level of unrealized losses (the difference between the portfolio's appraisal value and book value at the end of a fiscal term) in its portfolio and bears a degree of asset concentration risk from its largest property.

As of Nov. 30, 2012, NAF owned a portfolio of 89 residential properties that are, for the most part, located in the 23 wards of Tokyo, with a total purchase price of about ¥233.1 billion. From January to November 2012, NAF purchased four properties and acquired anonymous partnership ("tokumei kumiai") equity interests in a special-purpose company (SPC) that holds two properties in Tokyo. Moreover, NAF is set to acquire Apartments Tower Meguro (Meguro Ward, Tokyo; purchase price: ¥9.0 billion) in December 2012, indicating its pursuit of external growth. NAF resumed property acquisitions in 2009, and as a result, it has been able to improve its business profile, particularly the diversity and, to a degree, the profitability of its portfolio. Although NAF's portfolio still has a degree of concentration in its largest property, we note that the J-REIT's recent expansion of its portfolio has reduced this asset concentration risk.

Meanwhile, NAF has been acquiring other types of housing assets, such as student dormitories and corporate housing facilities, which the J-REIT categorizes as "other accommodation assets." Although property operators manage these assets, which entail a degree of operational risk, we consider any possible adverse impact on cash flow to be limited because: (1) NAF can easily convert these assets into typical rental properties; and (2) the total purchase price of the assets represented only about 4.2% of the total value of NAF's portfolio as of Nov. 30, 2012. We consider business conditions for residential J-REITs to be somewhat favorable, given the current limited supply of rental housing in the real estate market. Rents at NAF's properties, which have high occupancy rates, are showing signs of bottoming out, and the cash flows from these properties are stable. As such, we expect NAF's profitability to slowly improve as the residential housing rental market regains strength.

NAF aims to maintain its ratio of debt to total assets at a relatively conservative level of between 40% and 50% (cruising level). As of the end of NAF's 13th six-month fiscal term (ended Aug. 31, 2012), its ratio of debt to total assets was about 53.2% and its debt-to-capital ratio [interest-bearing debt including hoshokin liabilities/(interest-bearing debt including hoshokin liabilities + total net assets), as defined by Standard & Poor's] stood at about 54.4%. We consider both ratios to be fairly high. Meanwhile, although the share of unrealized losses to the total book value of NAF's portfolio had declined to about 3.1% as of the end of the same term, the J-REIT's financial buffer remains lower than the levels seen during market upswings. On the other hand, NAF's interest coverage indicators are stable because portfolio cash flow has improved. Indeed, we expect NAF's ratio of funds from operations (FFO) to debt to hover at or slightly higher than 7.0% over the next one to two years, compared with 7.0% as of the end of the 13th term.

NAF has shifted its focus to property acquisitions to meet its near-term growth targets (portfolio size: ¥300 billion, or 10,000 residential units). Accordingly, to maintain our current ratings on NAF, we will need to see the J-REIT maintain a balance between achieving external growth and preserving its financial health by controlling debt levels.

Our short-term credit rating on NAF is 'A-1', reflecting our long-term credit rating and assessment of the J-REIT's liquidity as "adequate." We expect the J-REIT's sources of liquidity--such as liquidity on hand and FFO--to be sufficient in the 14th fiscal term (ending Feb. 28, 2013) to cover its uses of liquidity--including debt repayments, capital expenditures, and dividend payments. Although NAF does not have committed credit lines to complement liquidity, it held cash and deposits of about ¥6.2 billion as of the end of the 13th term. Furthermore, the J-REIT maintains good relationships with multiple major financial institutions, from which it borrows on an unsecured basis. Based on this, we believe NAF has high financial flexibility.

The outlook is stable. NAF's solid business position; its portfolio of well-managed and well-maintained rental properties, with improved diversification in terms of the value and number of assets; and its high financial flexibility underpin the J-REIT's credit quality. Nevertheless, we believe the likelihood of an upgrade is limited for the foreseeable future because NAF's debt-to-capital ratio has been hovering at relatively high levels. On the other hand, the ratings may come under pressure if NAF suffers prolonged weakness in its financial indicators, particularly if its ratio of debt to total assets rises and remains above 55%, or if its ratio of FFO to debt declines and remains below 6.5%. This could happen if NAF's debt profile and capital structure, as well as its interest coverage ratios, deteriorate as a result of property acquisitions funded by debt.

RELATED CRITERIA AND RESEARCH

"Key Credit Factors: Global Criteria For Rating Real Estate Companies," June 21, 2011
"2008 Corporate Criteria: Analytical Methodology," April 15, 2008
"Rating Policy For Japanese Real Estate Investment Trusts," May 9, 2001

RATINGS LIST

Ratings Affirmed

Nippon Accommodations Fund Inc.	Rating
Corporate credit ratings	A+/Stable/A-1
Senior unsecured J-REIT bonds series 1 and 2	A+

Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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