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

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TOKYO (Standard & Poor's) Dec. 19, 2008--Standard & Poor's Ratings Services today affirmed its 'A+' long-term and 'A-1' short-term corporate credit ratings on Nippon Accommodations Fund Inc. (NAF). At the same time, Standard & Poor's affirmed its 'A+' long-term senior unsecured debt rating on NAF's ¥10 billion series 1 senior unsecured bond issuance. The outlook on the long-term corporate credit rating is stable.

The ratings reflect NAF's strong business position and moderately conservative financial profile. The company's real estate portfolio generates stable cash flow as it comprises residential properties that are in good locations, have a low average property age, and have good leasing conditions. NAF's operating strategy is to specialize in very high quality residential properties located mainly within the 23 wards of Tokyo, backed by the real estate development capabilities, real estate expertise, and brand recognition of the sponsor, Mitsui Fudosan Co. Ltd. (BBB+/Stable/A-2). NAF has a conservative capital structure and high financial flexibility. These strengths are partly offset by issues regarding property concentration risk in NAF's portfolio.

NAF is a Japanese real estate investment trust (J-REIT) that went public on the Tokyo Stock Exchange in August 2006. As of the end of its fifth six-month fiscal term (ended Aug. 31, 2008), NAF's portfolio featured 44 properties, consisting of 4,247 leasing units located mainly in the 23 wards of Tokyo, and had a total value of about ¥140 billion, based on purchase price. The portfolio is diversified in terms of unit type, comprising single, family-type, and large leasing units, with a focus on comparatively high-demand compact units. The company has acquired a total of seven properties worth ¥16.8 billion in 2008, including Park Axis Nihonbashi Hamacho located in Chuo-ku, Tokyo, for ¥5.54 billion, and Park Cube Itabashi-honcho located in Itabashi-ku, Tokyo, for ¥4.17 billion. As the business environment surrounding the J-REIT market worsens further amid the dislocation in global and domestic financial and capital markets, NAF has adopted a selective asset acquisition strategy, using sponsor pipelines.

As part of its strategy, NAF limits its investments to residential properties. Activity in the residential property capital market has stagnated recently amid difficult conditions. Generally, however, Standard & Poor's considers residential properties to have more stable cash flows compared with other property types. This is generally due to high tenant diversification, relative ease in finding new tenants, and small fluctuations in rents during economic cycles. NAF's investment area is the metropolitan area of Tokyo and major ordinance-designated cities, with the company aiming to keep allocating more than 80% of its portfolio investments to properties located in the 23 wards of Tokyo. Currently, properties located within the 23 wards make up about 92% of the entire portfolio, which is in line with its investment policy.

The portfolio includes high-quality, competitive properties located in high-demand and convenient residential areas. The portfolio's occupancy rate at the end of the fifth fiscal term was 96.0 %, and contributes to the stability of cash flows. The weighted average property age of the portfolio is about 6.3 years as of Aug. 31, 2008, which is low. Moreover, the weighted average property age drops to about 2.7 years if the Okawabata Apartment communities, completed in 1988 and 1989, are excluded, since the majority of the other properties are very new.

The portfolio has asset concentration risk with the Okawabata Apartment communities comprising 21.2% of the total portfolio value. However, this risk is mitigated by such factors as good tenant diversification at the property, high occupancy rate, stable cash flows, and high competitiveness in the submarket. Asset concentration risk is expected to decline modestly over time, as NAF acquires more properties.

NAF aims to enlarge its portfolio by ¥300 billion, or by 10,000 residential units, by 2010-2011. However, the company is not focused solely on expanding its portfolio size, taking into consideration sluggish equity markets and uncertainty hanging over the real estate market. NAF's portfolio growth rate has been moderate thus far.

NAF's management expects to maintain the company's debt-to-capital ratio (interest-bearing debt/total assets) at an average of 40% to 50%, or at a maximum of 60%, which is a relatively conservative level. NAF recorded a debt-to-capital ratio (interest-bearing debt including security deposits/(interest-bearing debt + unitholders' capital) according to Standard & Poor's definition) of 56.4% at the end of its fifth six-month fiscal period, which was relatively high. Its debt-to-capital ratio may hover at levels higher than the cruising level until equity markets recover and may add pressure on NAF's credit quality. Any pressure, however, would be mitigated to some extent by: 1) the portfolio of high-quality residential properties for rent with high occupancy rates that are generating stable cash flow; and 2) NAF's maintenance of ample liquidity at hand and good relations with multiple financial institutions.

Given that its leverage is relatively high, NAF intends to adopt a cautious and selective property acquisition strategy by using its sponsor's warehousing function.

As of the end of the fifth six-month fiscal period, all of NAF's long-term debt obligations carry fixed interest rates, and its debt repayment schedule is diversified through 2014. The company's EBITDA interest coverage is about 5x and its ratio of funds from operations (FFO) to total debt stands at 6.1%, both of which are lower than the previous period, reflecting relatively higher leverage. Regarding the portfolio's profitability, return on assets (ROA) stood at about 4.4%. On the other hand, the EBITDA margin (EBITDA/real estate rental revenue) is high at about 68%.

NAF currently has relatively good liquidity, with long- and short-term credit available to meet the company's near-term debt maturities, as well as to expand its portfolio. NAF's financial flexibility is considered high, reflecting its established relationships with several major financial institutions, from which it borrows on an unsecured basis.

NAF's portfolio of high-quality assets should generate stable income despite the aforesaid asset concentration and the difficult business environment. With the support of its sponsor, we expect NAF to maintain the high quality of its assets and a relatively conservative financial profile. In light of a relatively higher debt-to-capital ratio, Standard & Poor's will pay particular attention to the ratio, the company's cash flow protection, as well as its profitability.

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>.