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

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OVERVIEW

- Business conditions in the residential property market appear to be stabilizing. Even so, since NAF's debt-to-capital ratio remains high, it may take a certain amount of time until we see a complete recovery in the J-REIT's financial profile.
- We have affirmed our long-term and short-term corporate credit ratings on NAF because the J-REIT has a strong business position and a high-quality real estate portfolio, allowing it to generate stable cash flows.
- We have maintained the negative outlook on the long-term rating on NAF.

Tokyo, Dec. 17, 2010 – Standard & Poor's Ratings Services today affirmed its 'A+' long-term corporate credit and senior unsecured debt ratings, as well as its 'A-1' short-term corporate credit rating on Nippon Accommodations Fund Inc. (NAF). The outlook on the long-term rating on NAF remains negative.

We today maintained the outlook on the long-term rating on NAF because:

- Financing conditions and business conditions in the residential property market appear to be stabilizing. In addition, NAF's financial indicators seem to have improved slightly. Yet, they are still weak compared with former levels. In particular, the Japanese real estate investment trust's (J-REIT) debt-to-capital ratio has remained high for five consecutive fiscal terms.
- Given current conditions in the real estate market, NAF is likely to actively pursue external growth. As such, we believe it may take a certain amount of time until we see a complete recovery in NAF's

financial profile.

As for NAF's credit quality, the J-REIT maintains a strong business position and generates stable cash flows from its high-quality portfolio of residential properties with high occupancy rates. Accordingly, we today affirmed our long-term and short-term corporate credit ratings on NAF.

NAF's management had said that it expected to maintain the company's debt-to-total assets ratio in the 40% to 50% range (cruising range), which is relatively conservative. Recently, however, NAF's debt-to-total assets ratio has hovered at levels that are slightly higher than previous levels due to the impact from prolonged instability in the capital markets. As NAF acquired 18 properties and raised about ¥20.1 billion through equity offerings in the eighth fiscal term (ended Feb. 28, 2010), its leverage has declined slightly. However, since the J-REIT used debt to finance its acquisitions, its debt-to-capital ratio [interest-bearing debt/(interest-bearing debt + net assets), according to Standard & Poor's definition] stood at about 55.8% as of the end of the ninth fiscal term (ended Aug. 31, 2010). The uptrend in the share of the unrealized loss to the total value of NAF's portfolio appears to have come to a halt. Even so, the share was still about 5.6% as of the end of the ninth fiscal term, suggesting that the J-REIT's financial buffer has weakened to a certain degree.

Because NAF expects the residential market to bottom out in the foreseeable future, it intends to phase in a business policy focused on external growth in an effort to meet its near-term growth targets (portfolio size: ¥300 billion, or 10,000 residential units). Although the J-REIT's financial indicators appear to have improved slightly, they are still relatively weak compared with our assumptions at initial rating assignments. Hence, it is our view that a certain amount of time may be needed for the J-REIT to see a complete recovery in its financial profile.

NAF's operating strategy is to invest in high-quality residential properties that are, for the most part, located in the 23 wards of Tokyo, backed by the real estate management and development capabilities, and brand recognition of its sponsor, Mitsui Fudosan Co. Ltd. (BBB+/Stable/A-2). As of Nov. 30, 2010, NAF owned a portfolio of residential properties with a total purchase price of about ¥187.0 billion. From the eighth to the ninth fiscal term, the company acquired a relatively large volume of properties, allowing it to secure reasonable acquisition yields. Hence, its portfolio has become more diversified and its portfolio yield has improved to a degree.

NAF is expected to maintain good credit quality, backed by its strong business position, its portfolio of well-managed and well-maintained rental properties, its liquidity at hand, and its high financial flexibility. We may consider lowering the ratings on NAF if the recovery of its financial profile, particularly its debt-to-capital structure, is delayed, or if we see a higher likelihood of the J-REIT suffering prolonged weakness in its financial indicators for over one year and the financial indicators appear unlikely to improve in the near term. On the other hand, we may revise the outlook on the rating on NAF to stable from negative if leverage declines to a level that is in the cruising range of its financial policy and the outlook for improvement in financial indicators, such as interest coverage and profitability indicators, becomes clear as the J-REIT moves forward with its external growth strategy.

RELATED CRITERIA AND RESEARCH

Principles Of Corporate And Government Ratings, June 26, 2007
Rating Policy For Japanese Real Estate Investment Trusts, May 9, 2001

RATINGS AFFIRMED

Nippon Accommodations Fund Inc.	Rating
Long-term corporate credit rating	A+/Negative
Short-term corporate credit rating	A-1
Senior unsecured J-REIT bonds series 1 and 2	A+

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