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Press Release

Structured Finance Ratings & Research

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S&P Assigns 'A+/A-1' Ratings To Frontier Real Estate Investment Corp.; Outlook Stable

Tokyo, Dec. 26, 2006 – Standard & Poor's Ratings Services today assigned its 'A+' long-term and 'A-1' short-term corporate credit ratings to Frontier Real Estate Investment Corp. (FRI). The outlook on the long-term corporate credit rating is stable.

The ratings reflect FRI's strong business position and conservative financial policy. FRI owns a portfolio comprised of nine retail properties of a very low average age and of relatively high quality. The portfolio generates stable cash flows since most of the properties are under long-term leasing agreements with tenants that have strong credit quality. FRI has a stable position in the Japanese real estate investment trust (J-REIT) market as it is a REIT that specializes in retail properties, backed by the sponsor's strong credit quality. FRI has a very conservative capital structure and high financial flexibility, underpinned by relatively high profitability. However, the rating is partially constrained by various concerns, including tenant and asset concentration risk relating to some assets in FRI's portfolio, and FRI's dependence on its sponsor for provision of properties.

The ratings also take into account the unique structure of J-REITs compared with REITs rated by Standard & Poor's in other global markets, which restricts management from pursuing certain high-risk activities, such as ground-up development, to safeguard investors.

FRI was established in May 2004 and was listed on the Tokyo Stock Exchange in August 2004. The sponsor of FRI's asset manager, Frontier REIT Management Inc., is Japan Tobacco Inc. (JT; AA-/Watch Neg/--), which has a 7.4% investment in FRI. JT has solid credit quality and a certain track record in real estate development.

FRI's real estate portfolio consisted of nine properties in locations nationwide as of Nov. 30, 2006. The portfolio is well-diversified geographically, with about 36% of the properties located in the Kanto region (Tokyo, and Kanagawa Prefecture), about 26% in the Chubu region (Nagoya), about 21% in Kinki (Osaka and Kyoto prefecture), and about 17% in other regions (Okayama and Fukuoka prefectures). The nine properties have 11 tenants, and a net rentable area (NRA) of 171,965 tsubo. The portfolio's value stands at ¥94.8 billion in terms of purchase price, and at ¥103.8 billion in terms of appraisal value. The nine properties include large-scale, highly competitive retail properties, such as AEON NAGOYADOME-mae Shopping Center (Nagoya, Aichi Prefecture), AEON Shinagawa Seaside Shopping Center (Shinagawa ward, Tokyo), and MYCAL Ibaraki (Ibaraki, Osaka). Some tenants have high credit quality, including Aeon Co. Ltd. (A-/Stable/--), and Ito-Yokado Co. Ltd. (AA-/Stable/A-1+), both of which have signed long-term lease contracts. The portfolio's weighted average net cash flow cap rate is about 6.0% according to Standard & Poor's underwriting, reflecting the nationwide diversification of the retail properties in the portfolio.

FRI's strategy is to limit its investments to suburban retail properties and retail properties located in city centers. Geographically, FRI's policy is to make diversified investments in retail properties in various locations throughout Japan, and, in principle, to incorporate lease contracts that extend for more than five years. FRI's current portfolio generally adheres to these policies.

FRI and JT have a “pipeline contract” in which FRI holds priority negotiation rights for any retail properties built on vacant factory sites that JT plans to sell. FRI’s policy is to expand the scale of its asset portfolio through stable and continuous acquisitions of retail properties that have been developed on vacant land, or on sites that are expected to be vacated, held by JT.

The probable maximum loss (PML) of each property within the portfolio, excluding Joyfultown Hadano (Hadano, Kanagawa Prefecture), ranges from 1% to 14%. Joyfultown Hadano has a somewhat high PML of 23%. However, this property is covered by earthquake insurance. Therefore, the aggregate portfolio risk from earthquakes is deemed to be somewhat limited. The average property age is about 5.0 years, which is very low. Moreover, cash flows are stable as the lease contracts are mostly long-term lease contracts, and the portfolio's current average occupancy rate was high at 100% as of Nov. 30, 2006.

The portfolio has a degree of asset concentration, with the largest property, AEON NAGOYADOME-mae Shopping Center, comprising about 26.2% of total portfolio value. Moreover, the top four properties comprise about 78% of the entire portfolio. However, asset concentration risk is mitigated by such factors as the good credit quality of the tenants, stable cash flows from long-term lease contracts, and high competitiveness in the submarket. In addition, the portfolio has tenant concentration risk, as about 82% of the total rent revenues come from three companies: Aeon, Mycal Corp. (NR), and Ito-Yokado. Tenant concentration risk is mitigated by the fact that Aeon and Ito-Yokado have superior competitiveness as domestic retailers and maintain strong credit quality. Also, FRI is expected to gradually decrease asset concentration risk over the long term by acquiring other new properties.

FRI had initially been aiming to increase the size of its portfolio to ¥200 billion in the medium to long term. Due to changes in the market environment, however, FRI now aims to enlarge its portfolio at a moderate pace to ¥120 billion by February 2008. Standard & Poor’s expects that FRI will enlarge its portfolio at a moderate pace via cooperation with its sponsor.

FRI’s management expects to maintain the company's debt-to-capital ratio at an average of 30% to 40%, which is conservative. FRI recorded a debt-to-capital ratio (interest-bearing debt/(interest-bearing debt + unitholders' capital) according to Standard and Poor’s definition), after incorporating hoshokin liabilities (including hoshokin liabilities without interest payments) of about 25% at the end of its fourth six-month fiscal period (ended June 30, 2006). To fund future property acquisitions, FRI anticipates a strategy of timely equity issues aimed at stabilizing its leverage. FRI's financial profile is solid, with ¥3 billion in short-term borrowings as of Nov. 30, 2006, which is an extremely small balance. On the other hand, the total balance for security deposits and hoshokin liabilities stood at about ¥31.1 billion at the end of the fourth fiscal year, with the money used to cover medium- to long-term funding. For this reason, based on current funding costs, EBITDA interest coverage and the ratio of funds from operations (FFO) to total debt are extremely high. FRI’s portfolio has relatively high profitability, with an ROA of 5.3% and ROE of 5.3% as of the end of the fourth fiscal period. EBITDA margin (EBITDA/effective gross income) is also high, as the expense ratio of each property is kept low.

FRI has ample liquidity, with credit available to meet the company's debt maturities, as well as to expand its portfolio. FRI's financial flexibility is considered very high, reflecting its established relationships with four major Japanese financial institutions, from which it borrows on an unsecured basis.

FRI's portfolio of high-quality, well-diversified assets should generate stable income. With the support of its sponsor, FRI is expected to maintain the relatively high quality of its assets as its portfolio grows. Although FRI's financial ratio may fluctuate as it pursues acquisitions of properties, it is expected to maintain its financial profile within the range mentioned above, under conservative leverage control.

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>.

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