

## Ratings On Frontier Real Estate Investment Corp. Affirmed

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OVERVIEW

- Frontier Real Estate Investment Corp. is a J-REIT that specializes in retail properties and commands high market recognition.
- Although leverage has increased slightly, FRI's properties are rented out under long-term contracts, generating stable cash flow. We expect FRI to generate stable income, while maintaining a high-quality asset portfolio.
- We are affirming our long-term and short-term ratings on FRI. The outlook on the long-term rating remains stable.

TOKYO (Standard & Poor's) Jan. 28, 2010--Standard & Poor's Ratings Services today affirmed its 'A+' long-term and 'A-1' short-term corporate credit ratings on Frontier Real Estate Investment Corp. (FRI). The outlook on the long-term corporate credit rating remains stable.

The ratings reflect FRI's strong business position and conservative financial policy, as well as its high-quality assets. FRI is a Japanese real estate investment trust (J-REIT) that specializes in retail properties. As such, it has a leading position in the J-REIT market, backed by the brand recognition and the real estate development and management expertise of its sponsor, Mitsui Fudosan Co. Ltd. (Mitsui Fudosan; BBB+/Stable/A-2).

As of Dec. 31, 2009 (the end of the 11th fiscal term), FRI's real estate portfolio was geographically well diversified, comprising 20 retail properties (including two plots of land with a fixed-term leasehold for commercial use; sokochi) located across Japan. The total acquisition value stood at about ¥178.0 billion. The portfolio incorporates various types of assets, mainly large suburban shopping centers, urban retail buildings, and outlet malls.

There is concern over sluggishness in the retail industry amid a slowdown in domestic consumption, indicating that overall business conditions remain difficult. Nevertheless, as the company's portfolio consists mostly of properties that are highly competitive in their respective submarkets, its occupancy rate is 100% on a master lease basis, contributing to the stability of the company's cash flow.

FRI's portfolio has a degree of asset concentration, with the top four properties accounting for about 49% of total portfolio value (as of Dec. 31, 2009). In addition, the portfolio shows tenant concentration risk because FRI's four largest tenants generated about 68% of total rental revenues. Yet, these concentration risks are mitigated because: (1) FRI's properties are well located; and (2) FRI's properties are rented out under long-term contracts to tenants with high competitiveness and credit quality such as Aeon Retail Co. Ltd. (NR), and they generate stable cash flows.

Under FRI's conservative financial policy, it aimed to maintain its debt-to-total assets ratio at an average of between 30% and 40% (cruising range). However, in light of recent equity market conditions, the company has decided to maintain its debt-to-total assets ratio at around 40% in the near future. FRI's debt-to-capital ratio (according to Standard & Poor's definition: interest-bearing debt/(interest-bearing debt + unitholders' capital) after incorporating hoshokin liabilities had risen moderately to about 41.4% as of the end of the tenth fiscal term. Along with a decline in unrealized profit on the portfolio (based on the portfolio's appraisal value at the end of the term), this is a cause for concern.

FRI has shifted some of its debt to longer maturities, thereby extending its average debt maturity (about two years before incorporating hoshokin liabilities as of the end of the 11th fiscal term). Debt maturities are diversified through 2016, indicating a conservative capital structure. Meanwhile, portfolio profitability has declined moderately, although it remains high. The ratio of funds from operations (FFO) to total debt has been declining gradually due to increased debt-to-total assets ratio, but remained at a high level of about 13.6% (after incorporating hoshokin liabilities) as of the end of the 10th fiscal term. The company maintains solid relationships with 10 Japanese financial institutions, giving it sufficient liquidity to meet its debt repayment obligations. All the company's debt from financial institutions is unsecured, indicating high financial flexibility.

The outlook on the long-term corporate credit rating is stable. Standard & Poor's expects FRI to generate stable income from its high-quality properties rented out under long-term contracts, backed by its sponsor, Mitsui Fudosan. We intend to focus on business conditions in the retail industry, the degree of asset and tenant concentration in FRI's portfolio, as well as its leverage, and interest coverage. We see little likelihood of ratings on FRI being raised as it is our view that business conditions in the retail industry may remain difficult. On the other hand, we may consider lowering the ratings if portfolio cash flow declines further, and if leverage increases, causing the company's financial indices to weaken.

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RELATED RESEARCH

"Rating Policy for Japanese Real Estate Investment Trusts", published May 9, 2001

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