

Announcement: Moody's changes FRI's outlook to stable from negative

Global Credit Research - 30 Sep 2010

Tokyo, September 30, 2010 -- Moody's has changed to stable from negative the outlook for its A2 issuer rating on Frontier Real Estate Investment Corporation (FRI).

This outlook change reflects Moody's view that cash flow from FRI's portfolio will be stable and that FRI will use a conservative approach to expand its business platform, exemplified by the improvement to leverage afforded by the company's public offering in July.

FRI's portfolio comprises mostly retail properties with good long-term tenants (the occupancy rate was 100% as end-August 2010), which contributes to the stability of rent revenues.

After Japan Tobacco (Aa3, stable) was replaced as sponsor by Mitsui Fudosan Co., Ltd. (A2, negative) in March 2008, FRI expanded its portfolio mainly by purchasing property from Mitsui Fudosan; at this point about 40% (based on acquisition prices) of its properties have been purchased after the sponsor's change.

FRI has also purchased some fairly young properties, which is helping keep the average age of the portfolio at about the same as it was when Japan Tobacco was sponsor.

Tenant concentration is somewhat high, with the Ion Group taking up 40% of the company's portfolio. However, FRI also has a number of good core tenants, such as Mitsui Fudosan and the Seven & i Group, which mitigates its concentration risk.

Moreover, in light of the properties' strong competitiveness in their sub-markets and the preponderance of long-term leases, Moody's expects that any potentially adverse effects of tenant concentration to FRI's cash flow will be limited.

Also, the two properties FRI bought from Mitsui Fudosan for around JPY29 billion in July 2010 have raised the value of the portfolio to more than JPY200 billion (based on acquisition prices) and have alleviated its property concentration somewhat.

Furthermore, the property pipeline from, and the SC Management Agreement with, Mitsui Fudosan (for the management and operation of Mitsui's retail properties) will be critical to expanding FRI's business platform.

FRI used JPY20 billion of the proceeds from the public offering for its July purchases. As a result, it needed to take out a loan of only JPY10 billion for the buy, and its debt ratio -- by FRI's definition, of (debt plus deposits and guarantee funds minus usable cash)/(total assets minus usable cash) -- improved to 43% from 45.7%, the second time its leverage has declined since July 2008.

Although FRI is aiming to expand its assets to JPY300 billion over the medium term, it also plans to strengthen its business platform. Moody's expects that FRI will maintain a conservative financial approach and will continue to focus on lowering leverage, which may fluctuate. Moreover, the company's share price, as indicated by its price to book, is higher than that of many other listed REITs, which is a support factor for its debt management.

FRI takes advantage of its investment focus on retail properties, which require "deposits and guarantee funds," and uses these funds for financing. (Tenants' guarantee funds are similar to deposits, but are paid back over 10 years or so with almost zero interest.) With these funds taken into account, its debt (loans only) to total assets has been as low as 24% and its interest coverage as high as 14.6x, which allows for longer debt durations.

FRI includes deposits and guarantee funds in its long-term debt, for a ratio of 75% as of August 2010. However, its long-term debt (loans only) comprises 56% of total debt (loans only), which is low for a REIT. To further expand its portfolio FRI will need to lengthen its debt duration and diversify its loan maturities.

In August, FRI set up an additional commitment line in the amount of JPY3 billion (it had set up a line of JPY3 billion earlier) to be used for refinancing, which has improved its liquidity. Nevertheless, it still has JPY23.7 billion in short-term loans as of end-August 2010, so it still needs to further strengthen its liquidity.

Moody's previous rating action on FRI took place on April 21, 2009, when it downgraded FRI's issuer rating to A2 from A1, with a negative outlook. The rating had previously been placed under review for possible downgrade on January 15, 2009.

The principal methodology used in rating real estate investment trusts is Moody's "Global Rating Methodology for REITs and Other Commercial Property Firms," published in July 2010, which can be found at www.moody's.com in the Research & Ratings directory, in the Ratings Methodologies subdirectory.

Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Ratings Methodologies subdirectory.

Frontier Real Estate Investment Corporation is a J-REIT that invests in and manages retail properties. Its revenues totaled approximately JPY 6.4 billion for the fiscal half-year ended June 2010.

Tokyo
Hideyasu Yamamoto
Analyst
Structured Finance Group
Moody's Japan K.K.
JOURNALISTS: (03) 5408-4110

SUBSCRIBERS: (03) 5408-4100

Tokyo
Tetsuji Takenouchi
Senior Vice President - Team Leader
Structured Finance Group
Moody's Japan K.K.
JOURNALISTS: (03) 5408-4110
SUBSCRIBERS: (03) 5408-4100

Moody's Japan K.K.
Atago Green Hills Mori Tower 20fl
2-5-1 Atago, Minato-ku
Tokyo 105-6220
Japan



© 2010 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S ("MIS") CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder

Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.