

Ratings On Japan's Frontier Real Estate Investment Corp. Affirmed At 'A+/A-1'

Primary Credit Analyst:

Roko Izawa, Tokyo (81) 3-4550-8674; roko_izawa@standardandpoors.com

Secondary Contact:

Yumi Oikawa, Tokyo (81) 3-4550-8775; yumi_oikawa@standardandpoors.com

OVERVIEW

- Frontier Real Estate Investment Corp. is a Japanese REIT that specializes in retail properties.
- Despite a moderate increase in debt ratios, cash flow from its property portfolio remains stable, thanks to long-term lease contracts.
- We expect FRI to generate mostly stable income and maintain the high quality of its property portfolio.
- We have affirmed our long- and short-term ratings at 'A+/A-1'. The outlook on the long-term rating remains stable.

TOKYO (Standard & Poor's) Feb. 9, 2012--Standard & Poor's Ratings Services today said that it has affirmed its 'A+' long-term corporate credit and senior unsecured debt ratings and 'A-1' short-term rating on Frontier Real Estate Investment Corp. (FRI). The outlook on the long-term corporate credit rating remains stable.

The affirmation reflects FRI's strong business position and conservative financial policy, as well as its high-quality assets. FRI is a Japanese REIT (J-REIT) that specializes in retail properties. As such, it has secured 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. (BBB+/Stable/A-2).

As of the end of the 15th six-month fiscal term (ended Dec. 31, 2011), FRI's real estate portfolio was geographically well diversified, comprising 24 retail properties (including two plots of land with a fixed-term leasehold for

commercial use; "sokochi") located across Japan. The total acquisition value of the portfolio stood at about ¥221.2 billion. The portfolio incorporates various types of assets, primarily large suburban shopping centers, as well as urban retail buildings and outlet malls. Despite continued severe competition in the retail industry, FRI's cash flow remains stable because its portfolio comprises mostly properties that are highly competitive in their respective submarkets and its occupancy rate is 100% on a master lease basis.

In addition, FRI has been steadily pursuing external growth. Specifically, in 2011, the J-REIT acquired two retail properties in the Tokyo metropolitan area, including Mitsui Shopping Park LaLa Garden Kasukabe (Kasukabe City, Saitama Prefecture; purchase price: ¥10 billion).

FRI's portfolio has a degree of concentration in top-tier properties, with the top four properties accounting for about 40% of the total portfolio value as of the end of the 15th fiscal term. The portfolio also shows tenant concentration risk, with FRI's four largest tenants providing about 76% of the J-REIT's total rental revenue as of the end of the 14th fiscal term (ended June 30, 2011). However, these concentration risks are mitigated because: (1) FRI's properties are well located; and (2) the properties are rented out under long-term contracts to highly competitive tenants with high credit quality, such as Aeon Retail Co. Ltd. (NR), and they generate stable cash flows. In addition, we expect this risk to decline modestly over time, as FRI acquires more properties.

FRI intends to keep its ratio of debt to total assets (after including security deposits and hoshokin liabilities) at around 40%-50%, aiming to achieve stable external growth. Due to recent debt-funded acquisitions, FRI's debt-to-total assets ratio was slightly higher than previous levels, standing at about 46.8%, or a debt-to-capital ratio (interest-bearing debt including hoshokin liabilities/(interest-bearing debt including hoshokin liabilities + total net assets, as defined by Standard & Poor's) of about 43.5%, as of the end of the 14th fiscal term. Meanwhile, the average debt maturity (before including hoshokin liabilities) increased to about 2.9 years as of the end of the 14th fiscal term. The J-REIT's debt maturities are diversified through 2018, indicating a conservative debt profile. FRI's capital structure also remains relatively conservative, despite the recent rise in its debt ratios.

Portfolio profitability remains relatively high, although it has declined slightly compared with previous levels. The ratio of funds from operations (FFO) to total debt declined moderately, reflecting an increase in FRI's debt ratios, but remained at a high level of about 12.8% (after including hoshokin liabilities) as of the end of the 14th fiscal term. FRI increased its commitment credit lines to ¥16 billion in total. The J-REIT maintains solid relationships with 12 Japanese financial institutions, which provide it with sufficient liquidity to meet its debt repayment obligations. All of FRI'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 continue to see business conditions in the retail industry, the degree of asset and tenant concentration in FRI's portfolio, and its debt ratios and interest coverage ratios as key factors for the J-REIT's credit quality. We see little likelihood that we will raise the ratings on FRI because it is our view that, amid continued severe competition in the retail industry, the J-REIT will maintain its debt-to-total assets ratio at the current cruising level for the time being in an effort to achieve stable external growth. On the other hand, we may consider lowering the ratings if portfolio cash flow declines due to such factors as tenant moves, and if its debt-to-total assets ratio increases further to around 55%, causing the J-REIT's financial indicators to weaken.

RELATED CRITERIA AND RESEARCH

"Key Credit Factors: Global Criteria For Rating Real Estate Companies," published June 21, 2011

"Principles Of Credit Ratings," published Feb. 16, 2011

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

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