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Rating Action: Moody's affirms Japan Real Estate at A1; outlook stable

29 Nov 2018

Tokyo, November 29, 2018 -- Moody's Japan K.K. has affirmed the issuer and senior unsecured ratings of Japan Real Estate Investment Corporation (JRE) at A1.

The rating outlook remains stable.

RATINGS RATIONALE

"The A1 ratings reflect the stable cash flow from its large, diversified portfolio of office buildings," says Akifumi Fukushi, a Moody's Vice President and Senior Analyst.

JRE's credit metrics have been improving for the past few years, but its most recent results suggest peak-of-the cycle conditions. Its cash flow leverage, measured by net debt/EBITDA, improved to 8.9x in September 2018 from 9.6x in March 2018 as a result of cash flow growth, as well as equity capital of about JPY39 billion raised in April-May this year. The company's debt/gross asset improved as well to 35.7% from 38.5% during the same period.

Moody's believes, however, JRE is weakly positioned relative to global peers in terms of cash flow leverage, which is high for its rating. Net debt/EBITDA has been high at around 9x level for the last three years. Moody's expects that the ratio will remain at about this level, and may temporarily exceed 9x, if it purchases new properties with debt financing.

Declining asset yields will also put upward pressure on net debt/EBITDA. JRE's portfolio yield could begin to decline next year, due to the lower asset yields of newly purchased properties, while the increase in rents from its existing properties will slow. Given the low yields of the portfolio, the increase in debt to finance acquisitions will outpace the incremental cash flow, as measured by EBITDA.

JRE's A1 ratings benefit from its strong relationships with its lenders including MUFG Bank, Ltd. (A1 stable) and the support by its main sponsor, Mitsubishi Estate Co., Ltd. (A2 stable), which are core members of the Mitsubishi Group. These relationships will help JRE maintain capital market access and mitigate refinancing risk.

The stable outlook reflects the stable growth in JRE's cash flow from a steadily expanding portfolio and reasonable financial policies, including periodic equity issuances and sufficient liquidity arrangements.

Factors that could lead to a downgrade of JRE's ratings include (1) a deterioration in its portfolio's cash flow; and (2) an increase in financial leverage, for example, JRE's ratings could be downgraded if JRE is unable to keep net debt/EBITDA below 9x and debt/gross assets below 40%.

JRE's ratings are unlikely to be upgraded in the foreseeable future, given that they are already on par with Japan's sovereign rating (A1 stable). However, a substantial improvement in profitability or a reduction in debt could strengthen JRE's ratings.

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms (Japanese) published in September 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Japan Real Estate Investment Corporation, headquartered in Tokyo, is a publicly listed REIT. The company invests in and manages office buildings.

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