STANDARD & POOR'S

Structured Finance

J-REIT Rating Report

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Office Building Fund of Japan, Inc.

New Rating
Long-term rating: A
Short-term rating: A-1
Outlook: Stable

Rationale

On May 1, Standard & Poor's assigned its 'A' long-term and 'A-1' short-term corporate credit ratings to Office Building Fund of Japan, Inc. (NBF). The outlook on the long-term rating is stable.

The ratings are based on the following strengths:
- The highly regulated nature of Japanese real estate investment trusts (J-REIT);
- NBF's strong business position and relatively conservative financial profile;
- The high quality of the real estate portfolio that generates a stable cash income stream;
- The excellent portfolio management capabilities of Office Building Fund Management Japan. Ltd. (NBFM), the asset management firm appointed by NBF; and
- The excellent property management and leasing capabilities of the property management firm.

These strengths are partly offset by:
- The unseasoned market in which NBF operates;
- The company's aggressive investment policy and growth strategy;
- Its portfolio's concentration risk on larger assets, as well as tenant concentration risk; and
- Relatively weak credit quality of the sponsor companies.

A corporate credit rating (or issuer credit rating) represents a current opinion of an obligor's creditworthiness, or in short, its overall ability to pay its financial obligations. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, and it is not a recommendation to buy or sell any securities or stocks issued by NBF.

This rating report is based on portfolio information as of May 1, 2002, excluding the financial descriptions, which are based on information as of December 31, 2001.

Rating Analysis

Rating approach for J-REITs.

Standard & Poor's published its rating approach for J-REITs in May 2001, in "Rating Policy for Japanese Real Estate Investment Trusts". The above rating has been assigned based on the approach explained in that policy article.

Credit characteristics of a J-REIT corporation.

J-REIT corporations are governed by various sets of legal requirements under the Investment Trust Law. The business purpose of J-REIT corporations is limited to the acquisition, holding, and selling of cash-flow generating properties. They are prohibited from engaging in other business activities and are subject to strict disclosure requirements. J-REIT corporations are required to outsource all aspects of their real estate investment and asset management functions to an external asset management company. They are also prohibited from having their own office, or from hiring employees, so in essence, although they carry a corporation name, they are more like Special Purpose Companies (SPC), similar to those used in securitization transactions. Hence, the operation of J-REIT corporations is expected to be more predictable than that of public corporations. Under the current interpretation of the Investment Trust Law, J-REITs may be precluded from engaging in full-scale development projects, which sets them apart from REITs in other countries, such as U.S. REITs or Australian Property Trusts. In general, development projects give REITs the opportunity for future income and growth, but at the same time expose them to land environmental risk, development permission risk, construction risk and completion risk, which may in turn increase the unpredictability of the overall business risk.

Corporate credit ratings.

Standard & Poor's rating analysis on J-REIT corporations takes into account two major aspects of the company: its business profile and its financial profile.

In assessing a J-REIT corporation's business profile, Standard & Poor's evaluates its competitiveness by considering the following factors:

- Market position.
- Asset quality.
- Portfolio diversification and cash flow stability.
- Operating strategy and management evaluation.

In assessing a J-REIT corporation's financial profile, Standard & Poor's evaluates its financial health by considering the following factors:

- Financial strategy.
- Profitability.

- ❖ Capital structure.
- ❖ Cash flow protection and debt-servicing ability.
- ❖ Financial flexibility.

Business Profile:

Market position.

As one of the first two J-REIT companies to be listed on the Tokyo stock exchange in September 2001, NBF has a strong business position and enjoys high brand recognition. NBFM, its asset management arm, is sponsored by eight well-branded sponsors, albeit ones with relatively low credit quality, and is expected to maintain its leading position in the J-REIT market. The eight sponsors consist of major real estate companies and financial institutions, such as Mitsui Fudosan Co. Ltd. [—/—/B], and Sumitomo Life Insurance Co. [BBB/Negative/—]. Between them, these companies own a combined 14.8% of NBF, as well as 100% of NBFM. Mitsui Fudosan Co. Ltd. and Sumitomo Life Insurance Co. own 43% and 35% of NBFM, respectively.

Table 1:Sponsorship breakdown of NBF and NBFA

	NBFM		NBF	
	# shares	% share	# units	% share
Mitsui Fudosan Co. Ltd.	4,257	43	16,200	5.77
Sumitomo Life Insurance Co.	3,465	35	10,000	3.56
Chuo Mitsui Trust & Banking Co. Ltd.	495	5	*15,400	5.47
Sumitomo Mitsui Banking Corp.	495	5		
Daido Life Insurance Co.	297	3		
Mitsui Sumitomo Insurance Co. Ltd.	297	3		
Mitsui Mutual Life Insurance Co.	297	3		
Britel Fund Trustees Ltd.	297	3		
Others	-	-	239,100	85.20
Total	9,900	100	280,700	100

*Combined total held by some of the sponsors

The management team of NBFM has considerable prior experience in both the real estate investment management or financial operations of their respective parent companies, and also acts as the managers of NBF, utilizing the team's strong operational capabilities. While these sponsors do not have direct relationships with NBF's management, their credit standings play an important role in determining NBF's credit quality. Standard & Poor's has incorporated the sponsors' relatively weak credit quality in its assessment of NBF's corporate ratings.

NBF's units are held by a wide range of investors, comprised of individuals (14.9%), financial institutions (35.3%), other domestic corporations (26.2%), foreign investors (17.9%), and securities houses (5.7%).

Table 2: Portfolio description

	Location	Net Rentable Area ('000 sq.m.)	Appraisal Value (¥ million)	% share
NKK Headquarters Building	Chiyoda Ward, Tokyo	65	73,826	29.4
Shiba NBF Building	Minato Ward, Tokyo	25	31,500	12.6
GSK Building	Shibuya Ward, Tokyo	20	17,100	6.8
Shinjuku Mitsui Building No. 2	Shinjuku Ward, Tokyo	15	16,700	6.7
Kowa Nishi Shinbashi Building B	Minato Ward, Tokyo	10	13,880	5.5
Takanawa Ichome Building	Minato Ward, Tokyo	10	6,980	2.8
Nihonbashi Muromachi Center Building	Chuo Ward, Tokyo	8	10,300	4.1
Mita City Building	Minato Ward, Tokyo	6	5,280	2.1
Shinjuku Yocho Machi Building	Shinjuku Ward, Tokyo	5	2,480	1.0
Yokohama ST Building	Yokohama City	20	14,195	5.7
Tsukuba Mitsui Building	Tsukuba City	13	6,742	2.7
Daido Life Omiya Building	Saitama City	4	2,630	1.0
Inage Kaigan Building	Chiba City	6	1,810	0.7
Matsudo City Building	Matsudo City	5	2,700	1.1
Sapporo Minami Nijo Building	Sapporo City	5	2,030	0.8
Daido Life Sendai Building	Sendai City	8	3,640	1.5
Unix Building	Fukushima City	13	4,260	1.7
Niigata Telecom Building	Niigata City	10	4,310	1.7
Hamamatsu City Building	Hamamatsu City	5	1,299	0.5
Sakai Higashi Center Building	Sakai City	5	2,450	1.0
Otemae Center Building	Osaka City	5	2,090	0.8
Shijo Karasumaru Minami Building	Kyoto City	4	1,760	0.7
Kyomachibori Center Building	Osaka City	3	710	0.3
Hakata Gion 21 Building	Fukuoka City	5	2,472	1.0
Subtotal (as of end December 2001)	-	277	231,144	92.1
Nakano Sakaue Sun Bright Twin	Nakano Ward, Tokyo	12	9,240	3.7
San Marion Osaka Building	Osaka City	15	10,531	4.2
Total (as of end April, 2002)		304	250,915	100.0

Asset Quality

NBF's asset quality is a key factor underpinning its credit strength. As of the end of April 2002, NBF had invested a total of ¥250.9 billion in 26 office properties, based on the appraisal value provided from NBF, up from a total investment amount of ¥231.1 billion in 24 office buildings as of the end of December 2001. All the assets have excellent building structures, good facilities, have been well maintained, and are competitive in their respective sub markets. The quality of the assets is also reflected in their occupancy rates, which are above the market average.

Age of the Buildings and Maintenance

All of the buildings in the portfolio except one were built after 1981, when a new construction code was introduced that incorporated more stringent anti-earthquake standards. The average age of the buildings is about 12 years old. The exception is NKK Headquarters Building, which was built in 1974. Although it is considered old, it meets the latest earthquake durability standards, and the level of capital expenditure that will be necessary to maintain the condition of the property in the future has been factored into the term lease agreements that the tenants enter into. All the properties are well maintained, and refurbishing and facility upgrades are carried out as warranted by market conditions. Nearly half of the properties in the portfolio are equipped with office automation (OA) floors, including some in regional cities, such as Fukuoka, Kyoto, and Osaka. Furthermore, around half of the properties are installed with fiber optic cables, which meet the demands of modern tenants

Occupancy Rate / Rent Level

Most of the assets in the portfolio have above average occupancy rates for their respective markets, with the current average occupancy at approximately 97.4%. The rate of the nine properties in Tokyo is especially high at 99.99%, while the rate of the 11 properties located in regional cities is 95%. Standard & Poor's assessed the actual rent paid to NBF by the various tenants by examining the rent roll on each property, and determined that the rent levels were consistent with sub-market rents. The high occupancy rate is supported by the strong leasing ability of the property managers appointed by NBF, as well as the high quality of the properties.

Legal ownership status

NBF holds the fee simple in 20 out of the 26 office buildings contained in the portfolio. The remaining six assets (representing 34% of the portfolio's total appraisal value) are either held under condominium ownership or co-ownership (Kowa Nishi Shinbashi Building B, Nihonbashi Muromachi Center Building, Yokohama ST Building, Tsukuba Mitsui Building and Nakano Sakaue Sunbright Twin), or by way of ground leasehold (Shiba NBF Tower). As these are subject to the claims of third parties, they are regarded as less marketable. To mitigate some of this liquidity risk, NBF has entered into a guarantee agreement to insulate itself from any adverse consequences should one of the co-owners become insolvent. Also, security deposits that belong to the co-owners are managed through trust accounts. NBF has examined thoroughly the legal ownership status of each property and incorporated sound risk management systems to deal with any related problems that may arise. Standard & Poor's believes that the portion of NBF's portfolio that these six assets represent is within an acceptable range.

Asset diversification and cash flow

The portfolio is relatively diversified geographically, but is somewhat skewed towards larger assets and large tenants. Despite this concentration risk, the portfolio is expected to generate stable rental income from high quality assets with high occupancy rates.

Property type / geographical diversification

The portfolio consists of 26 office buildings located through out Japan. In terms of appraisal value, assets in Tokyo account for 74.6%, in the Kanto region (excluding Tokyo) 11.2%, in Osaka and Kyoto 7.0%, and in other regions 7.2%.

Although the assets are concentrated in Tokyo and its vicinity, as the center of business activities in Japan, the capital has the highest office demand in the nation, and so the impact from the economic slowdown is not expected to be as strong. Therefore, Standard & Poor's does not regard asset concentration in Tokyo as an immediate negative factor.

Property value diversification

The portfolio is weighted to larger assets, with the top four assets representing 55.4% of the appraisal portfolio value. The NKK Headquarters Building accounts for 29.4% of the portfolio, followed by Shiba NBF Tower (12.6%), GSK Building (6.8%), and Shinjuku Mitsui Building No.2 (6.7%). The remaining individual assets account for 0.3% to 5.7% of the total appraisal value. Asset concentration in the NKK Headquarters Building is a source of concern although this risk is mitigated to some extent by the benefit of its prime location in the vicinity of Tokyo station, its high quality, and the expected stability of its cash flow due to the long-term lease with NKK Corp. at near market rates. Furthermore, the portfolio's asset concentration risk is expected to decline over time, as NBF acquires more properties.

Tenants

The portfolio has approximately 450 tenants in total. The portfolio is subject to tenant concentration risk as approximately 37.4% of the total net rentable area is accounted for by the top three tenants, NKK Corp. [Bpi/—/—] (23.6%), GlaxoSmithKline [AA/Stable/A-1] (7.4%), and Matsushita Investment & Development Inc. [NR] (6.4%). These tenants occupy the top three assets in terms of appraisal value. The rest of the tenants individually occupy less than 3% of the total net rentable area each. The relatively weak credit quality of the top tenant, NKK Corp., is a source of concern for the portfolio. However, rent-rolldown risk is modest because NKK's in-place rents are generally in line with market rates. Additionally, Standard & Poor's believes that tenant concentration risk will lessen over time, as NBF enlarges its portfolio.

Insurance / Earthquake risk

Fire and general liability insurance is attached to all assets. In addition, NBF has researched the risks involved in the management of office buildings and as a result has created some tailor made insurance agreements. For example, their fire insurance contracts contain a special supplementary clause, under which up to a certain period of rent payments at the contractually agreed rate will be paid if the property were to sustain damage as a result of an earthquake or tsunami. Through the addition of these types of insurance clauses, Standard & Poor's believes the stability of the portfolio performance is enhanced. According to the seismic report provided by NBF, the probable maximum loss (PML) rate of the portfolio for the 26 assets is very low at 4.4%.

Standard & Poor's Underwriting Value

Standard & Poor's underwrote the individual cash flows and property values for the properties, after conducting on site inspections of the core assets. Standard & Poor's conducted on site inspections of 12 of the 26 buildings that make up NBF's asset portfolio and underwrote the property value of 19 of the assets individually. As a result, Standard & Poor's assessed the total portfolio value as being ¥235.9 billion (¥218 billion for the 24 assets that comprised the portfolio as of the end of December 2001). The purpose of Standard & Poor's underwriting was to confirm that NBF had acquired these assets at the appropriate purchase price. Standard & Poor's underwriting value was 95.4% of NBF's acquisition cost, and 94.0% of its portfolio appraisal value. As the discrepancies between Standard & Poor's and NBF was around 5%, Standard & Poor's concluded that NBF's purchasing costs had been at an appropriate level.

Standard & Poor's used a Direct Capitalization Method (DCM) to underwrite NBF's portfolio, the same as it uses for CMBS securitization deals. Individual property values using DCM are obtained by dividing stabilized net cash flow (NCF) over the next few years by a cap rate. The cap rate is defined as the investor's required rate of return on a particular asset. The rate is derived by adding the risk premium specific to each property, such as location, age of the property, building structure, legal ownership status, marketability, etc. and the risk premium specific to Japan's real estate market to the risk free rate. Standard & Poor's applied cap rates of 5.0%-7.5% depending on the properties (5.0% for NKK Headquarters Building) to underwrite NBF's portfolio value (see the individual collateral descriptions below for more details).

Operating Strategy / Management

Investment strategy.

NBF's strategy is to invest in high quality properties throughout Japan, with acquisitions limited to office buildings only. The company, in principle, will adhere to a "buy and hold" investment approach, whereby it will seek to maintain the portfolio's performance through purchasing properties at appropriate price levels, and then try to generate stable cash flows through efficient property management and maintain good occupancy rates. The company's guidelines on asset acquisition are on the whole conservative. There is some concern that NBF may try to purchase buildings under development but nearing completion, which may, to some extent, affect the company's ability to generate stable income. However, these "development assets" are expected to comprise less than 10% of total assets, and would only be purchased once the portfolio size reaches approximately ¥300 billion.

Geographical diversification

NBF's aim is to allocate over 70% of its investment to the Kanto region, including Tokyo, and the remaining 30% to other major cities. Office markets in regional cities are small, and considered to be susceptible to cash flow volatility, with relatively high liquidity risk. Consequently, NBF has set a moderate investment threshold for each regional city.

Property age / Building structure:

NBF will invest in properties constructed after 1981 under the new construction code. Otherwise, it will acquire properties with similar seismic resistance and structural characteristics to those constructed under the new code. Its aim is to acquire relatively newer assets.

Property size:

NBF will, in principle, invest in properties with a total building area of approximately 500 *tsubo* (3.3 sq.m.) or above, and standard floor space of approximately 100 *tsubo* or above.

Target yield:

The overall average Net Operating Income (NOI) yield of the portfolio is approximately 6.0%. NBF aims to maintain or enhance the NOI yield in the longer term.

Currently underdeveloped properties:

Once the portfolio size reaches approximately ¥300 billion, with the cap rate at 10% of the total investment value, NBF will consider acquiring properties that are still under construction, which will leave it exposed to potential completion risk and leaseup risk.

Growth strategies:

Internal growth strategy:

- Maximize cash flow: increase rental revenue, reduce vacancy rate, prevent lease contract cancellations, and extend lease term of existing lease contracts, or convert them into term lease contracts.
- Reduce operating costs: reduce property operating costs (by 10% by FY 2003, and 5% in FY2002). In addition, try to reduce public utilities expenditures, and enhance portfolio competitiveness through additional investment by way of making improvements to purchased properties.

External growth strategy:

- Enlarge and maintain portfolio volume through acquisition of new properties for the economies of scale in cost reduction, financing ability and risk diversification.
- Achieve a portfolio volume of ¥300 billion by December 2002, and ¥500 billion by December 2005.

NBF's targets for reducing operating costs are considered somewhat aggressive. However, Standard & Poor's considers them to be achievable to a certain degree because of the following factors:

1) Through replacing property managers and choosing them through auctions, NBF has devised a realistic cost reduction plan for each property.
2) The portfolio contains a number of office buildings that used to be inefficiently managed by owners who generated high costs in maintaining their properties.

NBF's external growth strategy is considered aggressive. The company aims to double its portfolio volume from its current level of approximately ¥250.9 billion (in terms of their appraised value) within 3.5 years. In order to meet this target, NBF will have to acquire ¥71.2 billion of new properties each year, equivalent to an annual growth rate of slightly less than 30%. Standard & Poor's believes that this acquisition plan is attainable, given NBF's information resources on the real estate market, and its solid and growing market position, and that of its sponsors too. Nevertheless, Standard & Poor's considers that NBF may face higher financial risk due to increased leverage, as a result of pursuing an aggressive acquisition plan that is reliant on debt financing.

Property Management

Currently, NBF outsources its property management and leasing management services to an outside real estate company, Mitsui Fudosan Co. Ltd. Mitsui Fudosan in turn, outsources its operation to NBF Office Management Co, Ltd. (NBFOM), a wholly owned subsidiary. NBFOM has strong property management skills and leasing capabilities, leveraging the property management expertise, tenant information, and operating system of Mitsui Fudosan Group. While Standard & Poor's regards this strategy as an efficient way of attempting to reduce costs, it contrasts with the approach adopted by other J-REITs of diversifying property management contracts among different vendors. NBFOM upgrades the facilities to meet the needs of tenants as determined by tenant satisfaction surveys. NBF is also working on cost reduction, and strives to improve its brand recognition through the use of advertising sign boards. Standard & Poor's regards the property management capability of NBFOM as a positive factor that helps contribute to the stability of the cashflow generated by the portfolio.

Conflicts of Interest

Under the J-REIT system, a company's entire operation must be outsourced to third party companies, which tends to increase the potential for conflicts of interest between J-REIT corporations and those third parties. Standard & Poor's confirmed that NBF has introduced adequate measures to mitigate these potential conflicts. For instance, in terms of the relationship with the sponsor companies, where the potential for conflict of interest is the greatest, NBF has documented procedures and manuals in order to prevent sponsor companies from interfering with the business decisions of NBF. Also, NBFOM manages NBF's properties only, and its daily operations are completely separate from those of Mitsui Fudosan. Furthermore, the fees of NBFM and NBFOM are performance-related. Through this arrangement, NBF has succeeded in aligning the economic interests of the out-sourced third parties with those of the investors.

Financial Profile

Standard & Poor's examined NBF's leverage and capital structure, in terms of both its debt-to-capital ratio and its loan-to-value (LTV) ratio, based on financial data provided by the company. The debt-to-capital ratio is based on the book value, which is derived from NBF's balance sheet, while the LTV ratio is based on Standard & Poor's underwriting value of the properties.

Debt-to-capital ratio= interest bearing liabilities (long-term loans + short term loans + debentures) / total capital (interest bearing liabilities + shareholder's capital)

LTV Ratio = interest bearing liabilities (long-term loans + short term loans + debentures) / (Standard & Poor' s underwriting value of property portfolio – outstanding balance of security deposit)

The denominator of the LTV ratio is based on Standard & Poor's property value attained from DCM, and therefore it is a ratio based on market values. The security deposit was excluded from the denominator, because it is unlikely that such liabilities will be set aside in an escrowed reserve account in cash, as is common in CMBS deals, but will instead be funded through the company's working capital. For any J-REIT corporations that set aside the security deposit liability in cash fully in a separate account, there is no need to subtract the security deposit in the above calculation. In case of NBF, it reserves all the security deposit liability in cash in separate accounts in accordance with their policy, thus Standard & Poor's has not subtracted the security deposit in the calculation.

Financial policy

NBF's financial policy is moderately conservative. NBF's management expects to maintain its debt-to-capital ratio, on average, to between 40%-50%. Standard & Poor's expects the company's average debt-to-capital ratio could periodically rise to 60%, as the company pursues its growth strategy by using debt to acquire additional properties. Following acquisitions, the company is expected to raise additional equity, returning the leverage level to a more moderate range. However, this strategy and policy is not fully tested and raises a concern as to what extent the company will actually be able to raise the required equity in a timely manner, since the J-REIT market is still immature and the investor base is relatively limited. However, NBF has on three previous occasions attempted to raise equity, including when it was operating as a private fund. Furthermore, the existence of several sponsors coupled with the company's sound investment criteria and underwriting procedures, somewhat offset these concerns.

Dividend Policy

According to the Japanese tax law, in order to enjoy exemption from corporate tax, a J-REIT corporation must distribute more than 90% of its distributable profit to the unit holders as dividends. Compliance with this rule is one of NBF's policies, and its principal investment policy is to pay 100% of distributable income to the shareholders. However, NBF will not distribute dividends in excess of its profit to prevent investors becoming subject to different taxations. The dividend per unit of the first fiscal term was ¥19,026, equivalent to an annualized yield of approximately 6.1%, based on the stock price at fiscal year end, which was higher than originally forecast.

Profitability

NBF ended its first fiscal year end in December 2001 (with the actual number of operation days reaching 223). The net operating income (NOI, net operating income from properties before depreciation) was around ¥9.0 billion, with net income at ¥5.3 billion, which was ¥800 million, or 17%, higher than the company's original forecast. Although the main factor was a reduction in property operating costs, this was also attributable in part to changes on certain items in accounting and lower than estimated depreciation costs.

NBF's operational efficiency is relatively good, evidenced by the overall expense ratio (operating expense excluding depreciation cost, divided by rental income) of 34%, which leaves some room for further cost reduction. In addition, the company is highly profitable, with an overall portfolio NOI yield of around 6.0%.

Annualized return on assets (ROA), and return on equity (ROE) were 4.2% and 6.9% respectively, as of December 2001. For fiscal 2002, NBF estimates NOI will be about ¥8.6 billion. Based on this estimate, ROE will be around 5.6%. Standard & Poor's expects that ROE will remain around 5%-6%, taking into account the stable cash flow generation from the portfolio, an NOI yield forecast of around 6%, and assuming that NBF can achieve its goal of keeping its moderately conservative debt-to-capital ratio at around 40%-50%.

Capital Structure

NBF has a moderately conservative capital structure. The capital structure as of December 2001 consisted of ¥148.9 billion equity, ¥20.9 billion short-term variable rate loans, ¥50 billion long-term fixed rate loans, and ¥8 billion debentures. All debts are unsecured, and long-term loans, which account for a large proportion of the debt, are well diversified in terms of maturity, thereby reducing refinancing risk. NBF's debt financing policy is to finance by short-term variable rate loans as it acquires more properties, while gradually shifting to long-term fixed rate loans with favorable interest rates. The company attempts to use debt instruments that are suitable for its "buy and hold" investment strategy, and has also taken measures to hedge interest rate risk.

As of December 2001, the debt to capital and LTV ratios were 33.8% and 36.2%, respectively. The company's forecasts for fiscal 2002, based on the portfolio's current 26 properties, are ratios of 39.5% and 42.5%, respectively. NBF is planning to invest ¥50 billion to purchase new properties, mainly through debt financing, and therefore the leverage level is expected to rise periodically. Based on this scenario, and assuming that equity financing will not be available, the ratios will be 49.4% and 52.9% at the end of 2002. An LTV ratio of 36%-53% is considered moderately conservative, since it would satisfy the leverage levels required for tranches rated from 'AAA' to 'A' in a standard CMBS transaction that involves a perfect bankruptcy-remote SPC structure. However, the bankruptcy-remoteness of J-REIT corporations is considered to be imperfect and weak compared to that of SPCs used in CMBS transactions. Also, the J-REIT portfolio is not as static as a CMBS pool, since the J-REITs are likely to purchase and sell properties in the long term. These factors may put certain constraints on the rating level of a J-REIT corporation in comparison to the ratings achievable in a CMBS transaction.

Cash Flow Protection

NBF's portfolio produces a stable rental revenue stream backed by an extremely high occupancy rate, and the strong quality of its assets. Cash flow stability is solid, with the debt service coverage ratio (DSCR) expected to remain around 2.5-3.0 times (x), applying Standard & Poor's conservative stressed constant interest rate of 6%. At present EBITDA interest coverage, based upon currently attractive actual weighted average financing costs of 1.2% is 12x-17x. These results show that the company has strong debt servicing abilities, and is expected to maintain them even if interest rates rise in the future.

Financial Flexibility

NBF has good financial flexibility as all of its debt is unsecured, it has a high net worth of collateral, and additionally it has sound banking relationships. As part of its J-REIT analysis Standard & Poor's conducts a review of the company's loan contracts to determine if they contain any financial covenants or triggers, which could constrain the issuer's financial flexibility. Standard & Poor's concluded that there is no loan clause that is likely to have any material affect on NBF's financial flexibility. If more than 50% of a company's net operating income was encumbered, the rating on any unsecured note issue would be one notch below the company's corporate credit rating. However, currently all of NBF's debt is unsecured, thus the ratings on any unsecured notes are expected to be equal to NBF's corporate rating.

Outlook : Stable

NBF's high quality assets should provide the company with a stable income stream and sustainable profitability. It is expected to maintain a moderate financial profile as the company pursues acquisitions and portfolio growth. The rating anticipates that although NBF's leverage may vary throughout this portfolio growth period, average leverage is expected to remain in the moderate range indicated.

Portfolio Analysis

NKK Headquarters Building:

Address: 1-1-2 Marunouchi, Chiyoda-ku, Tokyo.
Construction completed: June 1974.
Structure of the property: 18 floors, four basement floors, used as office space.
Public transportation access: near to Otemachi station on the Chiyoda and Mita subway lines.
Property legal ownership: fee-simple ownership.
Property appraisal value: ¥73.826 billion.
Standard & Poor's underwriting value: ¥69.285 billion.
Rentable Area: 19,747 Tsubo.
Occupancy rate: 100%.
Number of Tenants: 1.
Anchor tenant: A manufacturing company.
Standard & Poor's assessment: A large-scale property facing the intersection of Hibiya Dori and Eitai Dori in Marunouchi, Tokyo area, which is the prime business district in Japan. The property enjoys good access to Otemachi station. The area contains the head offices of several top-tier domestic corporations. The west side of the building faces Imperial Palace with an excellent view. The building is the oldest asset in the portfolio and so it requires substantial renovation costs, although it is well maintained and has a relatively high degree of earthquake durability. The entire building is occupied by NKK Corp. as the sole tenant under a long-term lease contract until 2011. Therefore, the asset is expected to generate a stable cash flow for a relatively long period.

Shiba NBF Tower:

Address: 1-1-30 Shiba Daimon Minato-ku, Tokyo.

Construction completed: October 1986.

Structure of the property: 18 floors, three basement floors, used as office space.

Public transportation access: four minutes walk to Onarimon station on the Mita subway line, and seven minutes walk to Daimon station on the Asakusa subway line.

Property legal ownership: ground leasehold (94%) / fee simple ownership of the building.

Property appraisal value: ¥31.5 billion.

Standard & Poor's underwriting value: ¥28.648 billion.

Rentable Area: 7,430 Tsubo.

Occupancy rate: 100%.

Number of Tenants: 2.

Anchor tenants: A real estate company and a life insurer.

Standard & Poor's assessment: The property is located in between Dai-Ichi Keihin thoroughfare and Hibiya dori, in the commercial district of Shiba Daimon. The area contains many office buildings, both old and new, a number of which have been occupied by Matsushita Group companies. The area benefits from good access to downtown Tokyo. The asset was formerly owned by a life insurance company (formerly Tokyo Life Insurance Co.). It is well maintained and is regarded as a highly competitive property in the market. It also benefits from relatively good tenants. The land is leased from Japan Red Cross Society under a long-term ground leasehold agreement that is valid for another 34 years.

GSK Building:

Address: 4-6-15 Sendagaya Shibuya-ku, Tokyo.

Construction completed: November 1990.

Structure of the property: 18 ground floors, four basement floors, used as office space.

Public transportation access: seven minutes walk from Yoyogi station, 10 minutes walk from Sendagaya station on JR Sobu line.

Property legal ownership: fee-simple ownership.

Property appraisal value: ¥17.1 billion.

Standard & Poor's underwriting value: ¥16.436 billion.

Rentable Area: 6,173 Tsubo.

Occupancy rate: 100%.

Number of Tenants: 1.

Anchor tenants: a pharmaceutical company.

Standard & Poor's assessment: The property faces Meiji Dori, near Shinjuku. The area has a mixture of office buildings and residential properties, including apartments. The access to public transportation is not competitive for an office building. However, it is a large-scale property, suitable for corporate tenants that require wide office spaces, thus, it should be able to secure tenants with such demands. The property was built and used by a real estate developer, and is a high grade building with strong earthquake durability (the PML rate is 2.2%). GlaxoSmithKline, the current sole tenant uses the entire property as its head office, under a long-term lease agreement valid until 2010.

Shinjuku Mitsui Building No.2.:

Address: 3-2-11 Nishi Shinjuku, Shinjuku-ku Tokyo.
Construction completed: October 1983.
Structure of the property: 18 floors, four basement floors, used as office and retail space.
Public transportation access: seven minute walk from Shinjuku station on Keio Shinsen line, and a nine minute walk from JR Shinjuku station.
Property legal ownership: fee simple ownership.
Property appraisal value: ¥16.7 billion.
Standard & Poor's underwriting value: ¥16.144 billion.
Rentable Area: 4,521 Tsubo.
Occupancy rate: 100%.
Number of Tenants: 27.
Anchor tenants: A non-life insurer, a manufacturer, and an IT company.
Standard & Poor's assessment: The property is located in the commercial district along Koshu kaido. Its proximity to the Tokyo metropolitan government office and other high-rise office towers, which stand at the northern side of the property, should help generate tenant demand, even though it is somewhat far from the station. The property is well maintained and is relatively competitive in its sub-market. Many of the area's buildings are occupied by IT firms and other foreign companies, although there is the possibility that there will be a fall in demand for office space from such tenants as a result of the prolonged recession. Therefore, the property may face a modest challenge in maintaining its competitive position in the marketplace.

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