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# Outlook On Nomura Real Estate Office Fund Revised To Negative From Stable

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TOKYO (Standard & Poor's) Feb. 10, 2009--Standard & Poor's Ratings Services today revised to negative from stable the outlook on its 'A' long-term corporate credit rating on Nomura Real Estate Office Fund Inc. (NOF). The outlook revision is based on: 1) a rising leverage ratio and weak financial indices, such as cash flow protection, resulting from a relatively aggressive external growth strategy amid a severe market environment for Japanese real estate investment trusts (J-REITs); and 2) a possible delay in the recovery of NOF's financial profile due to turmoil in the capital market. At the same time, Standard & Poor's affirmed its 'A' long-term and 'A-1' short-term corporate credit ratings on NOF, its 'A' rating on NOF's outstanding senior unsecured bonds, series 1 through 7, and its 'A-1' rating on NOF's unsecured short-term note program (up to ¥30.0 billion), supported by a real estate portfolio with a high occupancy rate, adequate liquidity at hand, and the company's financial flexibility.

NOF is one of the top-tier J-REITs in terms of its asset size, and it is supported by a high-quality portfolio of office properties and the strong real estate development and management capability of its sponsor, Nomura Real Estate Holdings Inc. (NR). Due to the long-running turmoil in the global debt and capital markets, a negative impact on real estate values and the property rental market, especially for properties located in some local areas or properties that are relatively less competitive, is observed. On the other





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hand, NOF's real estate portfolio generates stable cash flow with a high occupancy rate.

As of the end of its 10th business term (ended Oct. 31, 2008), NOF's portfolio comprised 46 office properties worth approximately ¥362.2 billion, based on purchase price. From the ninth (ended April 30, 2008) to the 10th business term, NOF acquired 13 office properties worth about ¥69.8 billion, including acquisitions from its sponsor's related companies, which were conducted in a relatively aggressive manner. Its real estate portfolio generates stable cash flow with a high occupancy rate of about 97.3%, including some competitive properties, such as the Shinjuku Nomura Buildings (Shinjuku-ward, Tokyo). On the other hand, there is a risk that unrealized profit in the portfolio (the difference between the appraisal value and the book value of the portfolio) has peaked in the ninth business term, although the risk is partially mitigated by an unrealized profit worth about ¥75 billion, or about 20.7 % of the book value of the properties in NOF's portfolio (as of the end of the 10th business term). Meanwhile, other potentially negative factors include a possible increase in the vacancy rate in some submarkets, a weighted average property age of about 22 years, and a risk of concentration in its top assets. These factors, however, are partially mitigated by NOF's relatively competitive real estate portfolio and other attributes.

As of January 2009, NOF has acquired properties from, and sold properties to, its sponsor's related companies, including Nomura Real Estate Development Co. Ltd. (NR). NOF conducted these acquisitions and sales because the ratio for properties in local districts outside Tokyo has been relatively higher than the range of between 10% and 20% specified in its operating strategy. Through the aforementioned transactions, the ratio now stands at 27.6%, (based on purchase price, including properties that will be purchased in the 11th business term, as of January 2009) and NOF plans to decrease the ratio.

Even though NOF aims to increase its portfolio size to ¥500 billion, the company has suspended new investments for a while, taking into consideration current market conditions. NOF now pursues portfolio improvement through internal growth, supported by its sponsor's real estate management capability.

Under NOF's relatively conservative financial policy, it aims to maintain its debt-to-capital ratio at between 35% and 45%. Despite the stagnant investment unit market for J-REITs, NOF issued equity of approximately ¥28.7 billion between May to June 2008, and controlled its leverage. However, as NOF acquired properties thereafter, taking on loans from financial institutions, NOF's debt-to-capital ratio (total debt/total debt + unit holders' capital, excluding security deposit liabilities from total assets as defined by Standard & Poor's) stood at about 48.8% as of the end of the 10th business term, relatively higher than the ratio in the past.

As of the end of the 10th business term, NOF's cash flow protection showed a slight declining trend, its EBITDA interest coverage was about 6.0x, and its ratio of funds from operations (FFO) to total debt stood at about 7.7% (indices are based on Standard & Poor's definitions). A possible delay in the recovery of its financial profile until debt and capital markets recover is one of the factors weighing on NOF's credit standing.

NOF had a cash balance of about ¥38.6 billion at the end of the 10th business term, and the amount would sufficiently cover immediate operating expenses (including security deposit liabilities). The company maintains good relationships with 29 domestic banks, including mega-banks, securing sufficient liquidity to cover its debt repayments. NOF has high financial flexibility because all of its debt is unsecured.

The outlook on the long-term credit rating is revised to negative from stable. As a result of NOF's relatively aggressive external growth, the leverage ratio has increased, and its financial indices have remained at a relatively low level, as Standard & Poor's had initially expected. Hereafter, NOF will improve its financial profile by refraining from external growth and focusing more on internal growth.

NOF's rating may come under downward pressure if the financial measures reflecting its leverage, interest coverage, and profitability do not improve. On the other hand, Standard & Poor's may consider revising upward the outlook on NOF if the company succeeds in improving its portfolio quality and profitability, and strengthening its financial profile by decreasing leverage ratio.

A Japanese-language version of this media release is available on Standard & Poor's Research Online at www.researchonline.jp, or via CreditWire Japan on Bloomberg Professional at SPCJ <GO>.