R&I

NEWS RELEASE

Sep 28, 2011

R&I Affirms BBB, Changes Outlook to Positive: Heiwa Real Estate REIT, Inc.

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Heiwa Real Estate REIT, Inc.**

Issuer Rating: BBB, Affirmed
Rating Outlook: Positive, Changed from Stable

RATIONALE:

Heiwa Real Estate REIT, Inc. (HFR) is a REIT that invests in small and midsized office buildings and apartments located mainly in the Tokyo area. In October 2009, Heiwa Real Estate Co., Ltd. acquired a 100% stake in the REIT's asset management company (currently named Heiwa Real Estate Asset Management Co., Ltd.). The acquisition of the asset management company made Heiwa Real Estate a sole sponsor.

The Rating Outlook has been changed to Positive for reasons such as: 1) some improvements are seen in the quality and profitability of its portfolio, through a merger, sale of properties and leasing, 2) the financial position, which temporarily deteriorated due to the merger, has been on a recovery track and 3) improvements in both business and financial aspects continue to be expected owing to supports by Heiwa Real Estate.

In October 2010, HFR merged with Japan Single-residence REIT Inc. (JSR). Since a majority of JSR properties are rental apartments generating stable cash flows and the asset scale has greatly been expanded, the merger has contributed to the improvement in the asset composition in terms of both quality and quantity. The present portfolio on the basis of an acquisition price is comprised of 34% office buildings, 63% residences and 3% hotels providing only accommodation services. Properties in 23 wards of Tokyo account for 77% of the total portfolio.

On the other hand, office buildings HFR has held since before the merger are mainly small properties and far from competitive. In addition, among residential properties, not a few properties were obtained at the height of the real estate boom, generating lower earnings. HFR, as a part of the portfolio reconstructing initiative, sold off three properties (book value totaling 14.6 billion yen) with especially huge latent losses in February 2011 and offset the losses with surplus funds generated by the negative goodwill gain from the merger. Though surplus funds greatly decreased, HFR plans to continue efforts in improving the portfolio, supported by the sponsor.

Since the occupancy rates for office buildings have significantly improved due to rent adjustments and other measures, the entire occupancy rate has recovered to the 94% level. Given the competitiveness of the REIT's office buildings and challenging market conditions, however, some concern remains over the earnings outlook. Earnings of residential properties, which mainly come from single-person apartments with large demand, will likely be maintained at the present level.

The debt ratio has remained in the mid 40% range. Nevertheless, at more than 50% on an appraisal value basis as of the end of May 2011, the debt ratio is not necessarily low. HFR plans to maintain conservative financial management, without significantly raising the debt ratio from the current level.

Funding conditions are improving on the back of the sponsor's stronger creditworthiness. As a result of the transfer of JSR's entire current debt of approximately 30.5 billion yen, the debt structure temporarily deteriorated, but since then some progresses have been made in longer maturities, diversification of lenders and due dates and reduction in financial costs through refinancing of loans. Even so, the net worth of collateral, length of terms, the balance of lenders and financial costs, among other things, still require further improvements.

Challenges facing HFR would include: (1) to enhance the quality and profitability of the portfolio by the acquisition or reshuffle of properties and achieve steady growth and (2) to further reinforce the financial position by, for example, lengthening funding maturity, improving the balance of lenders and decreasing

■Contact : Investors Service Division TEL.+81-(0)3-3276-3511 E-mail. infodept@r-i.co.jp
■Media Contact : Corporate Planning Division (Public Relations) TEL.+81-(0)3-3276-3438
Rating and Investment Information, Inc. Nihonbashi 1-chome Bldg., 1-4-1, Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan http://www.r-i.co.jp

financial costs. However, due partly to slightly harsh competitive environment around the acquisition of excellent properties, the pace of portfolio improvement may be moderate. Since substantial improvement is required in funding, compared to other REITs, and the redemption of the corporate bonds of 10 billion yen is scheduled in 2012, further reinforcement of the funding base is needed. Even so, the fact that relatively clear commitment is given by Heiwa Real Estate that has an appropriate business base in the real estate sector, is positively viewed. R&I will keep a close eye on how HFR will solve these issues and whether it is able to achieve further reinforcement of its business and financial bases.

The primary rating methodologies applied to this rating are provided at "Basic Methodologies for R&I's Credit Rating" and "Rating Methodology for J-REIT". The methodologies are available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
http://www.r-i.co.jp/eng/cfp/about/methodology/index.html

R&I RATINGS:

ISSUER:	**Heiwa Real Estate REIT, Inc. (Sec. Code: 8966)**
	Issuer Rating
RATING:	**BBB, Affirmed**
RATING OUTLOOK:	**Positive, Changed from Stable**

Unsec. Str. Bonds No.2	**Issue Date**	**Maturity Date**	**Issue Amount (mn)**
	Oct 31, 2007	Oct 31, 2012	JPY 10,000
RATING:	**BBB, Affirmed**		

■Contact : Investors Service Division TEL.+81-(0)3-3276-3511 E-mail. infodept@r-i.co.jp
■Media Contact : Corporate Planning Division (Public Relations) TEL.+81-(0)3-3276-3438
Rating and Investment Information, Inc. Nihonbashi 1-chome Bldg., 1-4-1, Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan http://www.r-i.co.jp