Survey on Private Real Estate Funds in Japan

January 2018– Results

March 15, 2018

Sumitomo Mitsui Trust Research Institute Co., Ltd

- Starting in 2003, Sumitomo Mitsui Trust Research Institute Co., Ltd. has conducted the "Survey on Private Real Estate Funds" as part of its research activities concerning real estate investment markets. This is the 25th survey based on responses to questionnaires received from 52 real estate asset managers.
  - Survey subject: Real estate investment asset managers that set up and manage private real estate funds which focused on Japanese real estate
  - The number of questionnaires sent: 107
  - The number of responses: 52 (ratio of valid responses: 48.6%)
  - Survey period: in the January to February 2018
  - Survey methodology: Questionnaire survey sent by post and e-mail
- Based on the results of the survey, hearings and published information, we estimated the market size of private real estate funds (on an invested asset basis) as of the end of December 2017 to be 16.0 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 210 billion yen (1.3%) from the previous survey (15.8 trillion yen as of the end of June 2017). The market for domestic private real estate funds continued to expand, albeit slightly.

The market size of private real estate funds is 16.0 trillion yen including Japanese assets of global funds

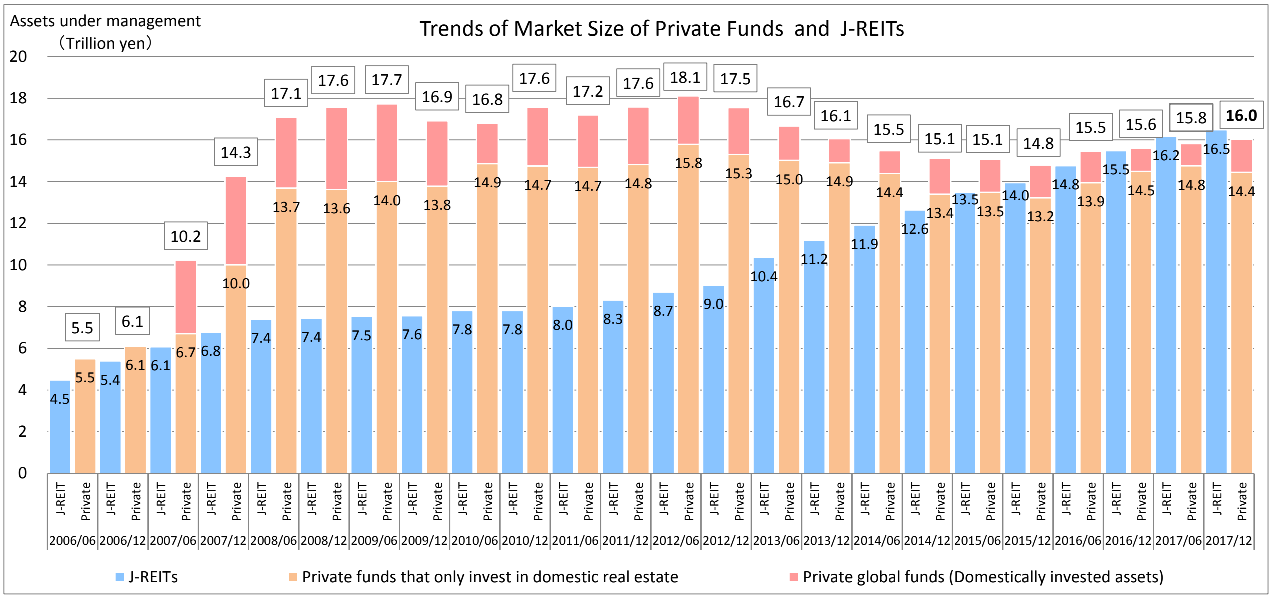
・Assets under management (AUM) as of the end of December 2017 were 16.0 trillion yen（This figure involves Japanese assets managed by global funds）. Assets under management (AUM) increased approximately 210 billion yen from the previous survey as of the end of June 2017. The market for domestic private real estate funds continued to expand, albeit slightly.

・The number of asset managers who said that their assets under management increased was more than the number of asset managers who said that their assets under management decreased. Overall, assets under management rose approximately 1.3% from the estimate in the previous survey. The AUM of private REITs expanded, while the AUM of private funds that only invest in domestic real estate declined.

・With debt financing conditions remaining favorable, many managers seem to believe that equity investors' appetite for investment is continuing at a high level. Nevertheless, no further easing of debt financing environment or increase in the appetite of equity investors are likely.

・As to the survey on their involvement to open-ended private funds(what we call Private REITs), 16 managers answered that they had already commenced management and some managers answered that they are preparing for it. Although the launch of open-ended private funds shows a sense of completion, the number of launch is likely to increase slightly. In terms of the important factors for the development of the market for open-ended private funds, the largest number of respondents chose *"Enhancement of the track record"*.

(*) We define "global fund" as a fund targeting real estate investments in various countries including Japan.



“ Survey on private real estate funds” January 2018 Survey Results

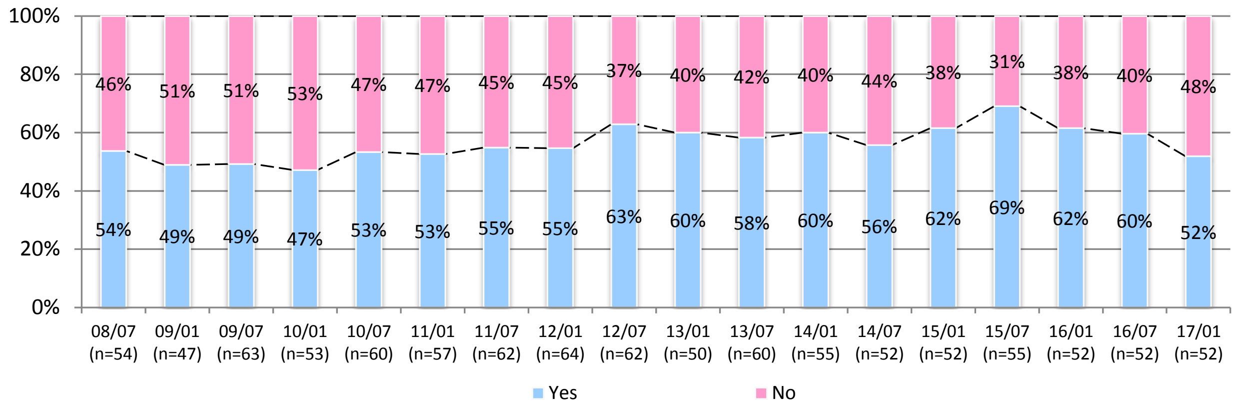
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

1. Current Status of Real Estate Fund Management Business

1) Management of Overseas Capital

In response to the question as to whether they have managed overseas capital in their private real estate funds, 56% of respondents chose *“Yes”*. While the percentage of respondents who chose *“Yes”* increased from the previous survey, it still remained at a level of the downward trend since the January 2016 survey, which seems to continue. One of the causes is thought to be a sense of caution among overseas investors against rising real estate prices in Japan (Fig.1). However, there is also the possibility that overseas capital flowed in during the second half of fiscal 2017.

Fig.1 Do you manage overseas capital?



2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

The response from the currently operating funds regarding the detail of their funds showed that *“Fixed property type”* by fund type and *“Core”* by management style continued to have a majority (Fig.2 and Fig.3). However, the percentage of respondents who answered *“Core”* declined for the third consecutive period, suggesting the possibility that the launch of *“Value-added”* and others are increasing.

In a survey on target property types, while the percentage of respondents who answered *"Residential"* declined 4 percentage points from the previous survey (20%), the percentage of those who answered *"Hotel"* rose 4 percentage points from the previous survey (10%), to 14%. This suggests that the presence of *"Hotel"* as a target property type has increased. In a survey on target areas, the percentages of investments in the target areas have remained generally the same since the January 2015 survey, suggesting that investments in diversified areas have been taking root (Fig.4 and Fig.5).

Fig. 2 Fund types

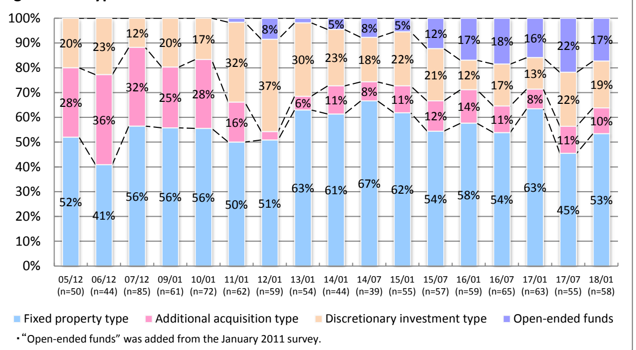


Fig. 3 Management Style

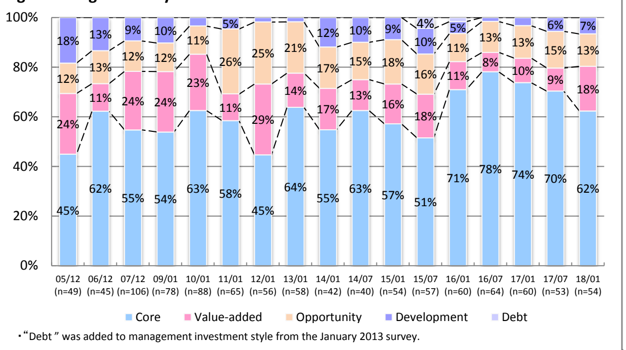


Fig. 4 Target Property Types

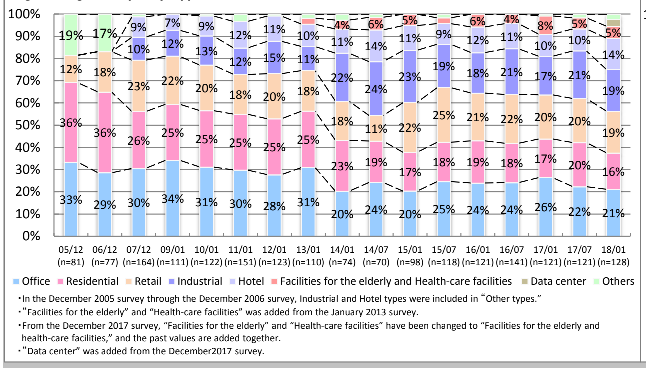
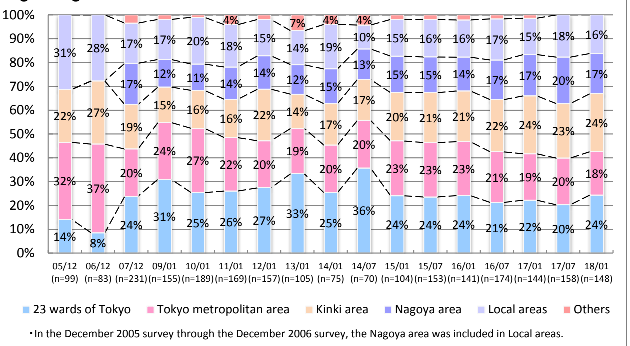


Fig. 5 Target Areas



As to the survey in terms of the average target investment period, it was 6.1 years for funds currently under management and 6.7 years for funds to be launched within a year (Fig.6). Looking at the breakdown of the investment period of funds currently under management, the largest share of respondents chose *"At least five years but less than seven years"* (39%). *"At least seven years but less than ten years"* comprised 25%, and *"Ten years or more"* accounted for 19%. The percentage of respondents who answered with a long-term investment period of five years or more totaled 83% (Fig.7). Chiefly against the backdrop of the prospect that quantitative and qualitative monetary easing by the Bank of Japan will be maintained, the trend whereby funds with an investment period of five years or more comprise the majority is expected to continue.

The survey of the investment period does not include open-ended funds (private REITs), whose investment period is indefinite.

Fig. 6 Average Target Investment Period

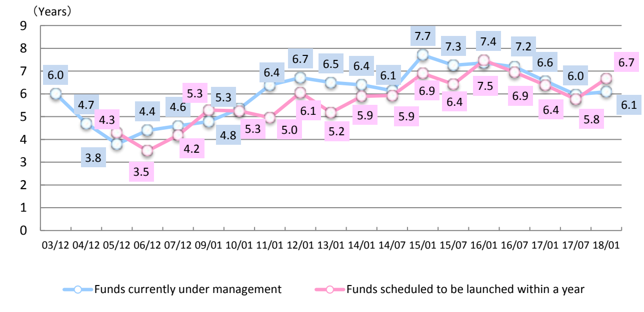
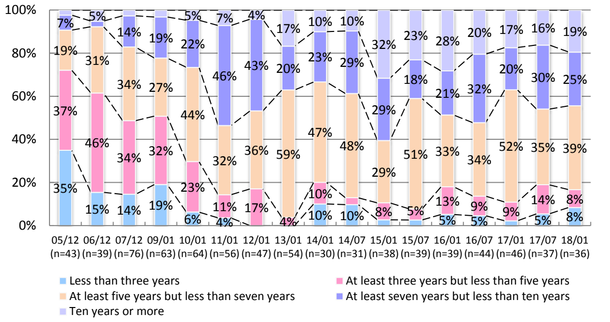


Fig. 7 Breakdown of Average Target Investment Period



The average LTV of funds under management stood at 59.1%, and that of funds to be launched within a year was 63.8%. While the average LTV is currently turning upward, it remains at around 60% (Fig.8). While there are some respondents who answered that LTV was *"80% or more,"* an increase in the number of private REITs making stable long-term investments has become a factor to push down the LTV level.

Looking at the breakdown of LTV ranges, for funds currently under management, the percentage of "*less than 40%* " and "*80% or more*" increased from the previous survey, while that of "*at least 40% but less than 50%*" and "*at least 70% but less than 80%*", decreased(Fig.9). This survey item includes responses from private REITs.

For funds to be launched within a year, the percentage of *"less than 40%"* , "*at least 40% but less than 50%"* and "*at least 70% but less than 80%"*, decreased, while that of "*at least 50% but less than 60%*", "*at least 60% but less than 70%*" and "*80% or more*" increased(Fig.11).

With respect to the average target IRR of the funds currently under management, the average target IRR of all types excluding *"Fixed property type"* of funds declined from the previous survey, total average target IRR was 10.7%(Fig.10). Looking at trends of average target IRR of all funds, it has been moderately declining after peaking out in the January 2011 survey. A fall in the level of expectation regarding yield among investors due to rising real estate prices appears to be reflected.

Fig. 8 Average LTV Ratio

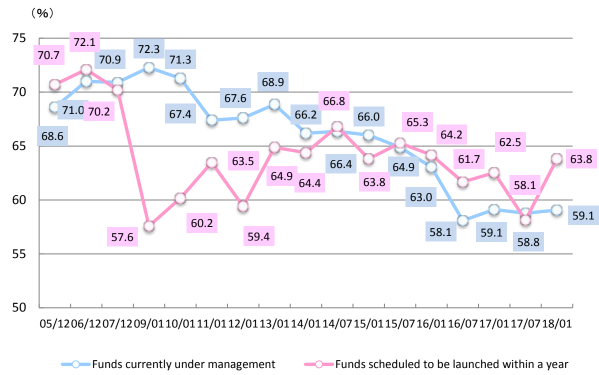


Fig. 9 Range of LTV level (Funds currently under management)

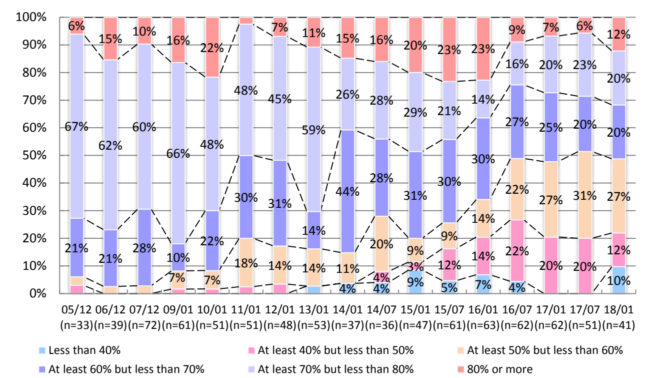


Fig.10 Average Target IRR(Funds currently under management)

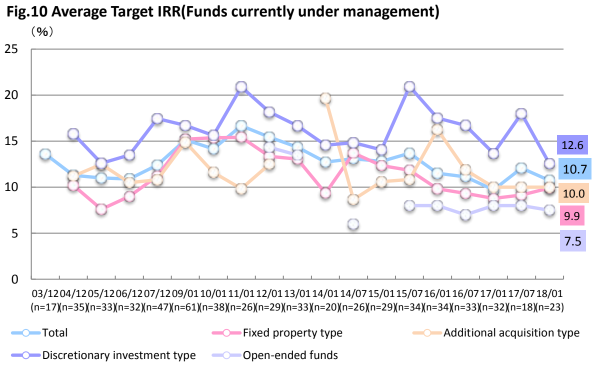
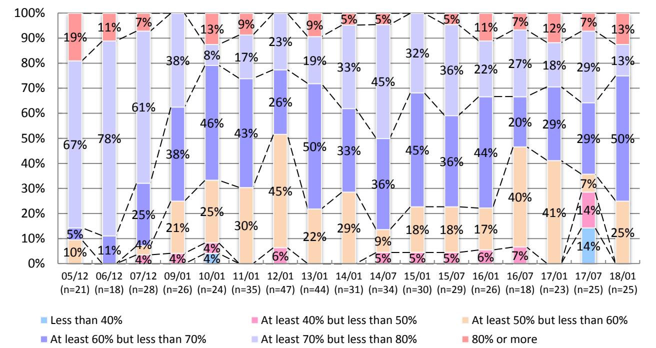


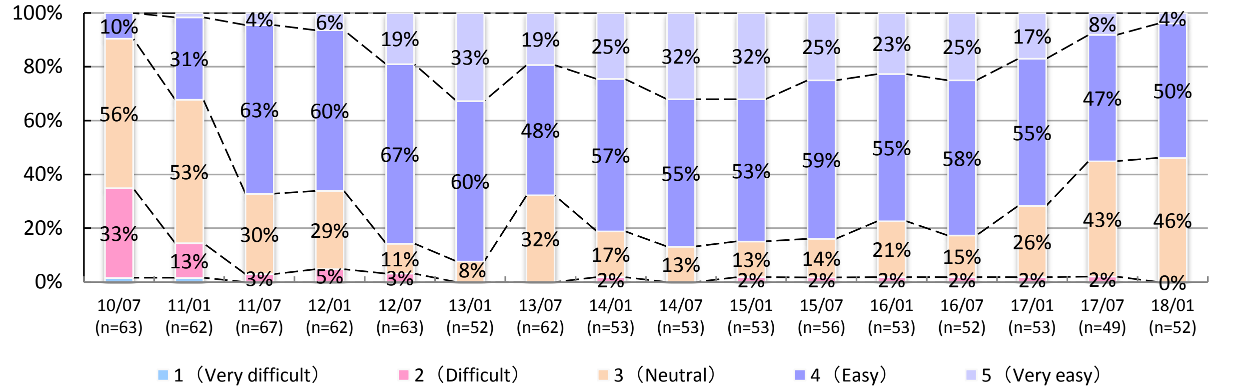
Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt financing circumstances, the percentage of respondents who selected "*5 (very easy)*" slightly decreased, while "*3 (neutral)*" and "*4 (easy)*" slightly increased (Fig.12). Debt financing circumstances can be said to remain favorable, but attention is increasingly focused on what may trigger changes in those circumstances.

Fig.12 Circumstances of Debt Financing



4) Equity Raising

a. Appetite of Equity Investors

In terms of a question on the appetite of equity investors, the number of respondents who chose *"No change"* accounted for a large percentage, and the percentage of respondents who chose *"Rising"* also increased slightly. On the other hand, no respondents chose *"Declining"* in the survey this time, or in the previous survey, suggesting that many asset managers believe that the appetite of investors remains high (Fig13).

In regards to the target property types likely to be tapped by equity investors, the percentage of respondents who chose *"No change"* have a majority in all property types for both domestic and foreign investors. As for *"Hotel"* nearly half of respondents, both domestic and foreign investors, chose "Increase significantly" or "Increase"(Fig.14-1, Fig.14-2). It shows that both domestic and overseas investors have a strong appetite for investment in hotels sector.

Fig.13 Appetite of Equity Investors

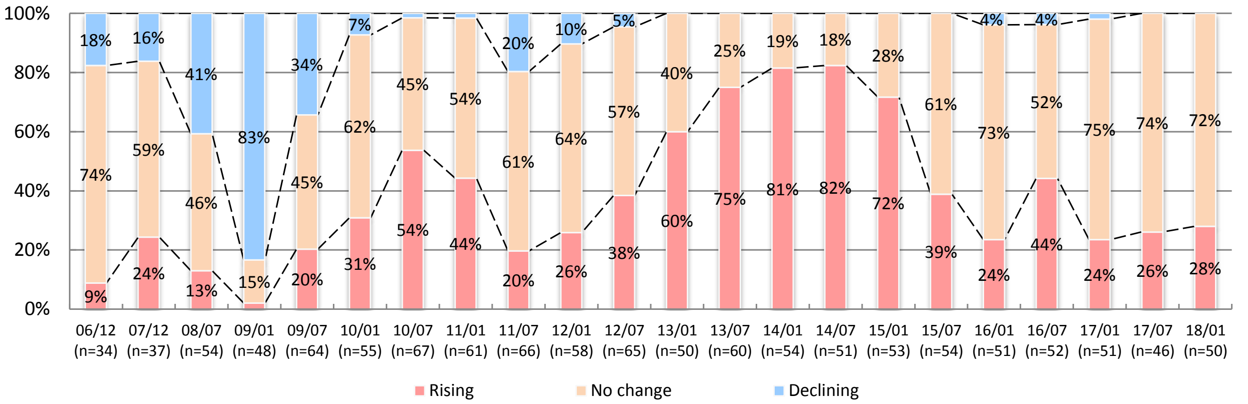


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

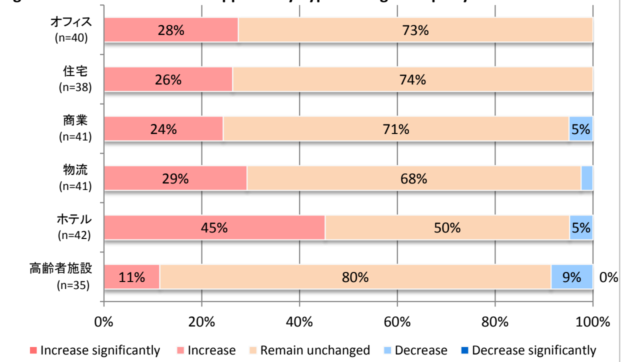
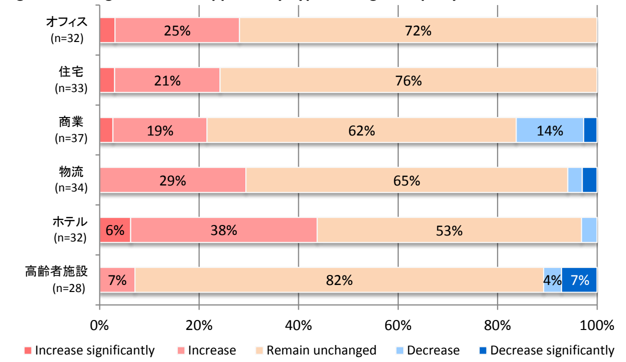


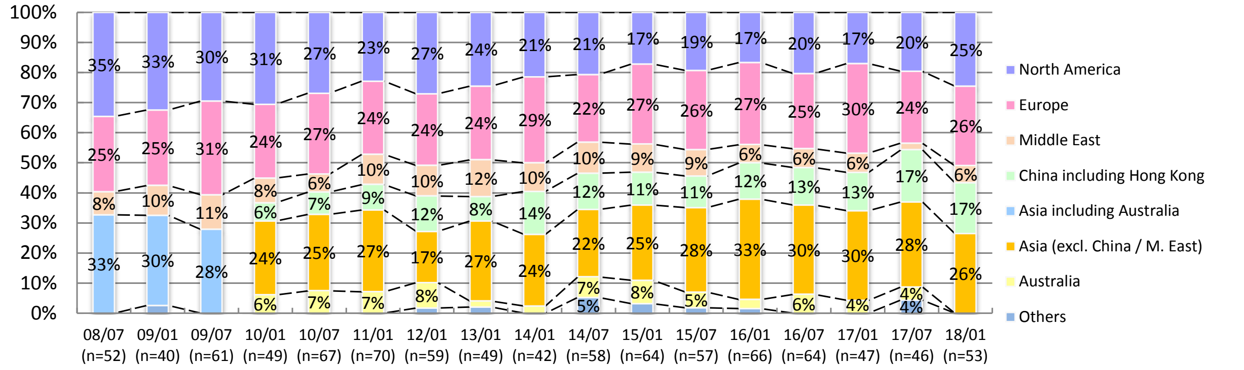
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



b. Sources of Overseas Capital (or Foreign Funds) by Country or Region

With respect to the survey(targeted to the managers which handle overseas capital), the highest response rate regarding their capital sources was for investors from *"Europe"*and*"Asia (excl. China /M.East)"*at 26%. The percentage of *"North America"*, *"Europe"* and *"Middle East"* increased from the previous survey(Fig.15).

Fig. 15 Sources of Overseas Capital by Country or Region



・Since the January 2010 survey, Asia-Pacific has been broken down into China, Middle East, Asia (excl. China / M East), and Australia.
・Since the January 2012 survey, China has been changed to China including Hong Kong.

c. Reasons for Foreign Investors Investing / Not Investing in Japan (Multiple answers allowed)

As for the reasons for investors investing in Japan, majority of the respondents chose *"Relatively attractive due to the yield gap"*,*" Highly stable income"*, *"Allocation as part of the global portfolio"* , *"The size of the real estate market is large"* , and *"Politically and economically stable"* (Fig.16). These choices have been the major reasons indicated in every survey in the past, and have been established as the reasons for foreign investors investing in Japan.

As the reasons for not investing in Japan, the largest number of the respondents chose *"Lack of growth potential in GDP, consumption, population, etc."*, followed by *"Rising in real estate prices"*. The results did not change significantly from the previous survey. Concern over rising real estate prices seems to remain strong (Fig.17).

Fig.16 Reasons for Foreign Investors Investing in Japan (Multiple answers allowed) n=109(Respondents29)

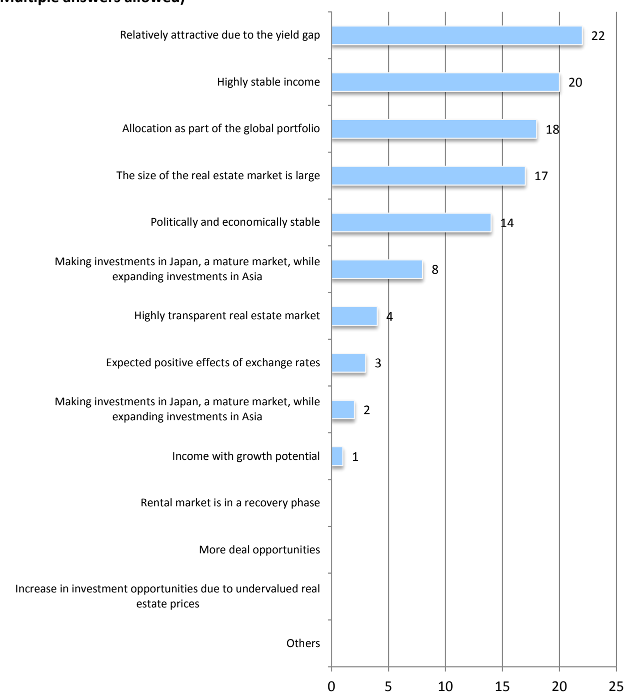
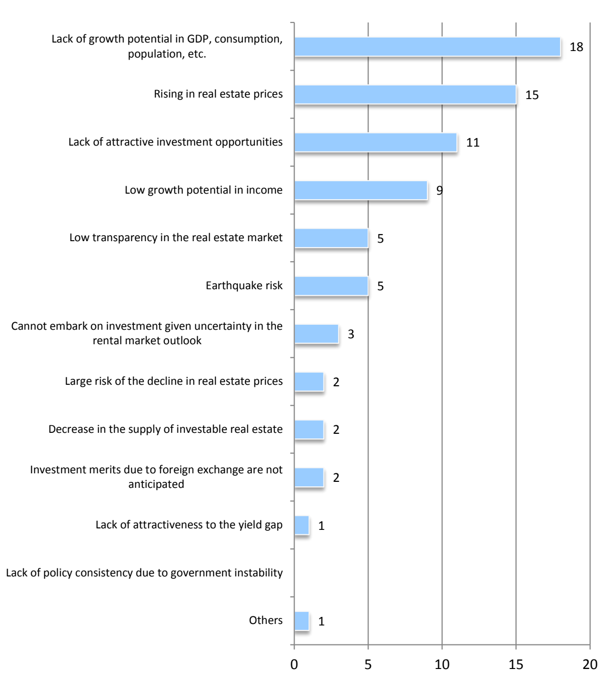


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed) n=74(Respondents29)



d. Acquisition and Disposition of Properties during July to December 2017

As to a survey on the acquisition of properties during July to December 2017, the percentage of respondents who answered *"Acquired"* accounted 63% (Fig.18). The main reasons that the managers did not acquire any properties were *"Can't agree on prices"* and *"Severe competition in bids"*, the total share of those reason accounted for 75%(Fig.19). The results indicate that the environment for the acquisition of properties remained challenging.

As to a survey on the acquisition of properties during July to December 2017, the percentage of respondents who answered *"Sold property"* was 37%, the lowest since the July 2013 survey (Fig.20). The great majority of reasons for *"Didn't sell property"* was *"Did not plan to sell from the onset,"* but some managers answered *"Can't agree on prices"* and *"No inquiries despite sales activities,"* neither of which were chosen in the previous survey (Fig.21).

Fig.18 Circumstances for Acquisition

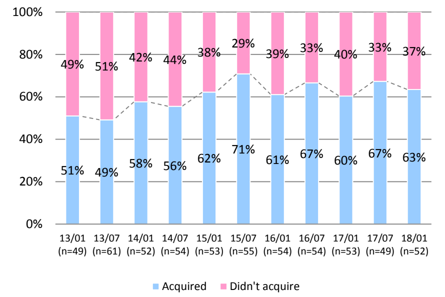


Fig.19 Reason for not acquiring property

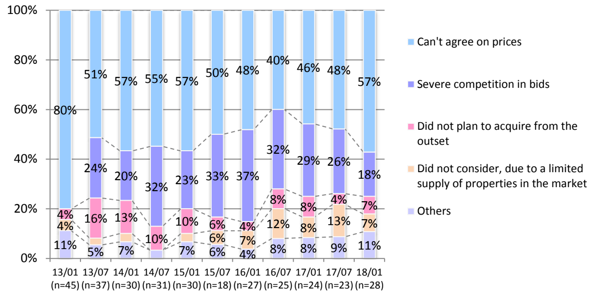


Fig. 20 Circumstances for Disposition

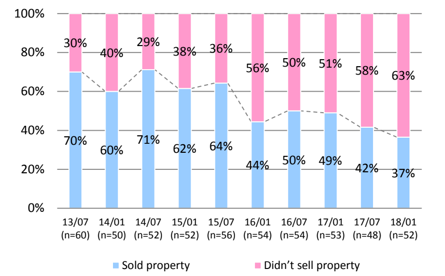
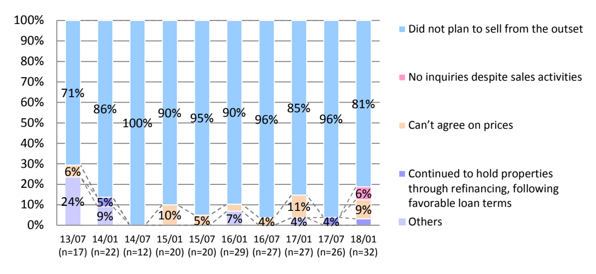


Fig. 21 Reason for not Selling Property



2. Plans and Investment Strategies of Asset Managers

1). Plans of Launch of New Funds and Acquisition /Disposition of Properties within a year

Regarding the funds scheduled to be launched within a year, 71% of respondents answered that they *"Plan to launch"* (Fig.22). The percentage of *"Plan to launch"* had declined slightly in the previous survey but moved up in the survey this time.

As to plans of acquiring or disposing properties within a year, the percentage of respondents that they plan to acquire properties accounted for 90% in this survey (Fig.23). On the other hand, that of those who plan to sell properties within a year accounted for 56% (Fig.24). While almost all managers are eager to acquire properties, it is likely that the low supply of investment-grade properties will continue throughout the entire market, which will cause decline in the number of transactions and further rise in real estate prices.

Fig.22 Plans of Launch of New Funds

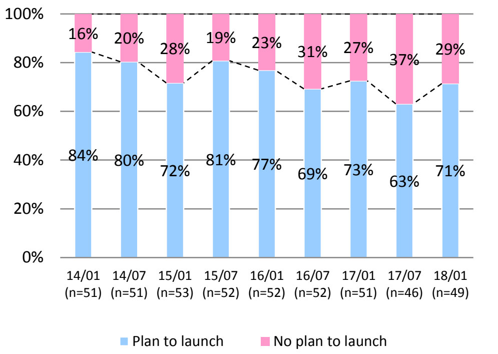


Fig.23 Plans of acquiring properties

n=51

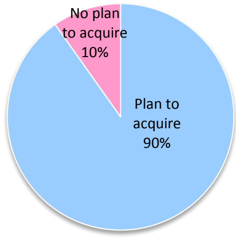
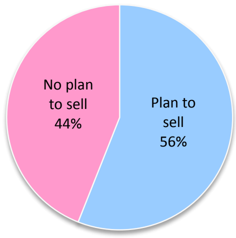


Fig.24 Plans of selling properties

n=50



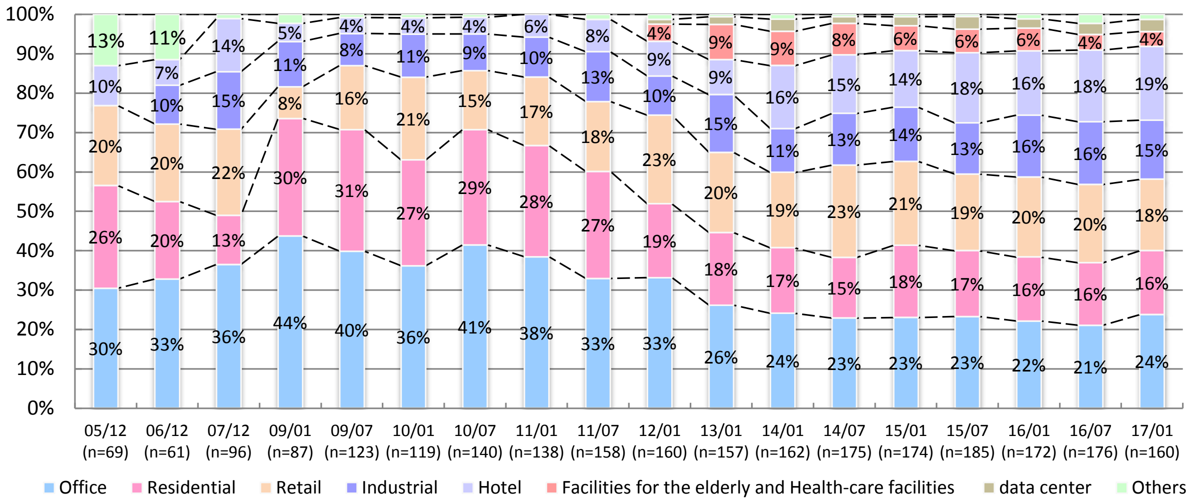
2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

In terms of the target property types, "*Office*" was chosen by the largest percentage of the respondents, followed by "*Residential*", and "*Hotel*" (Fig.25).

We have added *"Data center"* to the target property types in the survey this time. As a result, we have grasped the situation whereby 5% (9 cases) of respondents considered *"Data center"* as a target property type. We can see that the property types on which the asset managers wish to focus are diverse.

Fig. 25 Target Property Types (Multiple answers allowed)

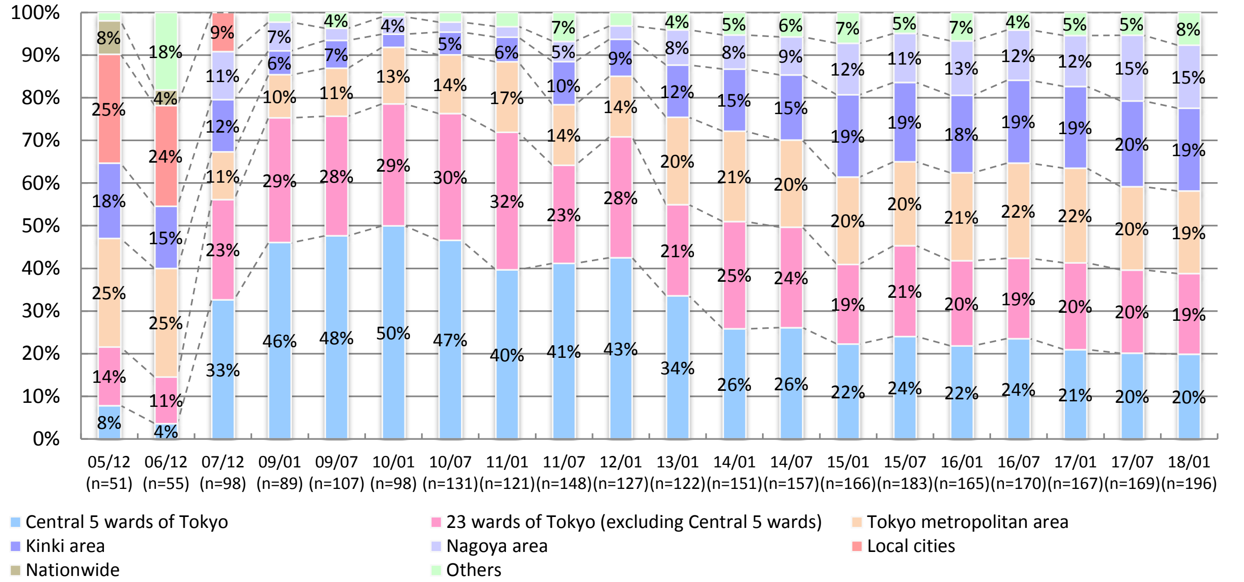


・From the December 2017 survey, "Facilities for the elderly" and "Health-care facilities" have been changed to "Facilities for the elderly and health-care facilities," and the past values are added together.
・"Data center" was added from the December2017 survey.

b. Target Areas (Multiple answers allowed)

In terms of the target area, the percentages of "Central 5 Wards of Tokyo" , "23 Wards of Tokyo (excluding Central 5 wards)" , "Tokyo metropolitan area" and "Kinki area" were all 20% (Fig.26). Given intensifying competition in the acquisition of properties in central Tokyo, target areas have been diversified primarily into *"Kinki area"* and *"Nagoya area"* to a certain degree.

Fig. 26 Target Areas (Multiple answers allowed)



・"Nagaya area" was included in "Local cities" or "Others" until the December 2006 survey.
・The Kinki area was called the Osaka area until the January 2009 survey. The constituent prefectures remain the same.

3. Business Environment of Private Real Estate Investment Management

1) Involvement in Open-Ended Private Funds (so-called Private REITs)

In response to a question about involvement in private REITs, the largest percentage of respondents answered *"Seek to develop a better understanding and gather information, but not working on a detailed study"*. The second largest percentage of respondents answered *"Have already launched"* (Fig.27).

Four asset managers said that they were preparing to launch a private REIT. Open-ended private funds may increase slightly.

As for important factors for development in the private REITs market, the largest number of respondents chose *"Enhancement of the track record"* which indicates that the continuation of stable management, including responses to a downturn in the real estate market, is attracting attention (Fig.28).

About eight years have passed since the establishment of the first open-ended private fund, and more than 20 private REITs are now managed. We believe that *"Enhancement of the track record,"* which was chosen as an important factor, is being satisfied to a certain degree.

Fig.27 Managers' involvement with private REITs n=50(Respondents 49)

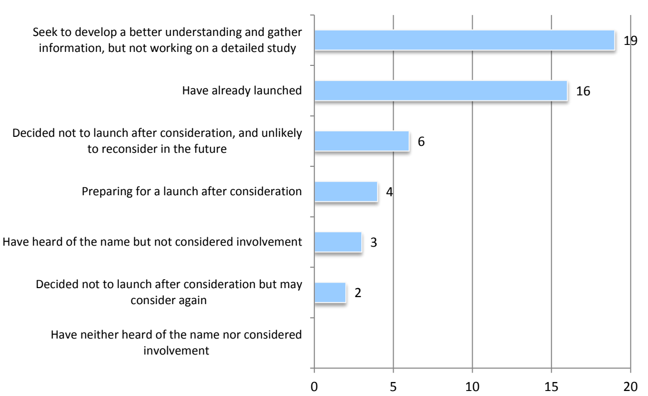
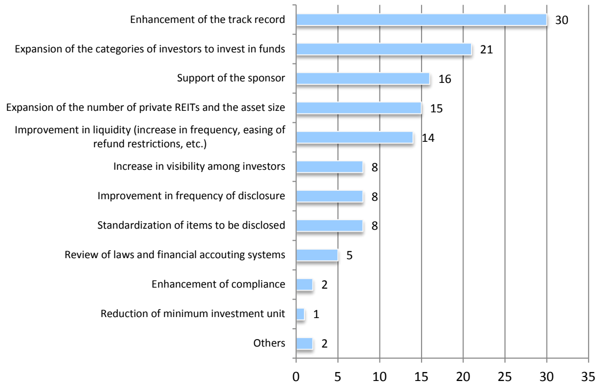


Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options) n=130(Respondents 47)



2) Outlook of asset size in the Closed-ended private real estate funds market

With regard to the outlook on asset size in the closed-ended private real estate funds market, the number of respondents who expect an increase accounted for about 60% of the total (Fig.29).

As for the reasons responding *"Increase,"* the largest number of respondents chose *"Increase of domestic investors' money"* (Fig.30). We believe that many asset managers expect continued inflows of funds into real estate investments due to the continuation of quantitative and qualitative monetary easing with yield curve control by the Bank of Japan.

The main reasons for *"Decrease"* were *"Rise in real estate prices" and "Limited supply of existing investment-grade real estate".*

"Others" includes a shift from closed-ended private funds to open-ended private funds, which was pointed out by several respondents.

Fig.29 Assets under management of closed-ended funds

n=51

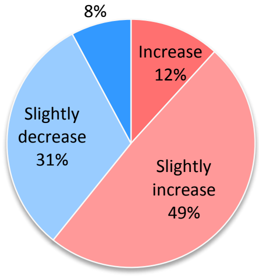
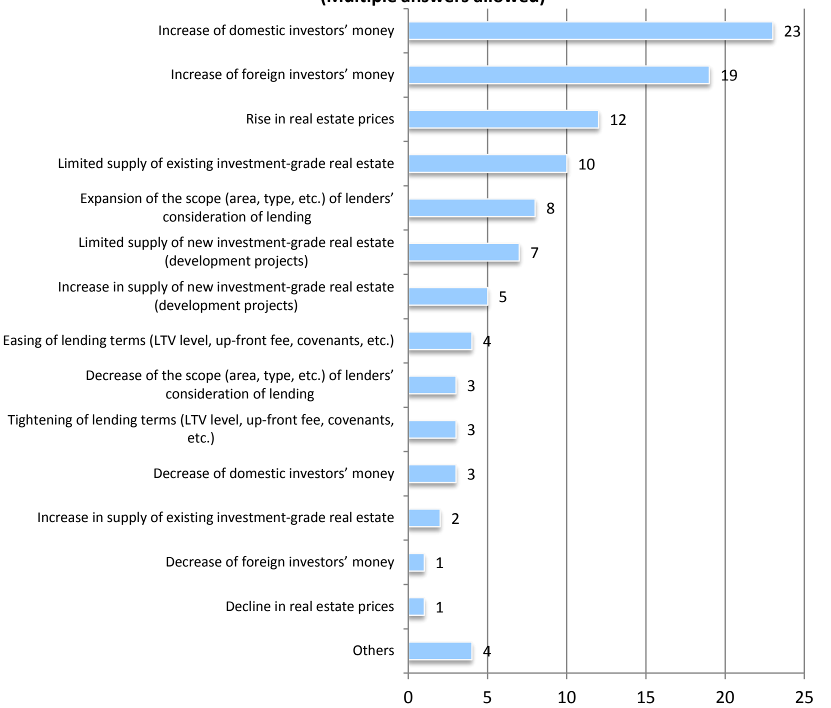


Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)

n=105(Respondents 51)

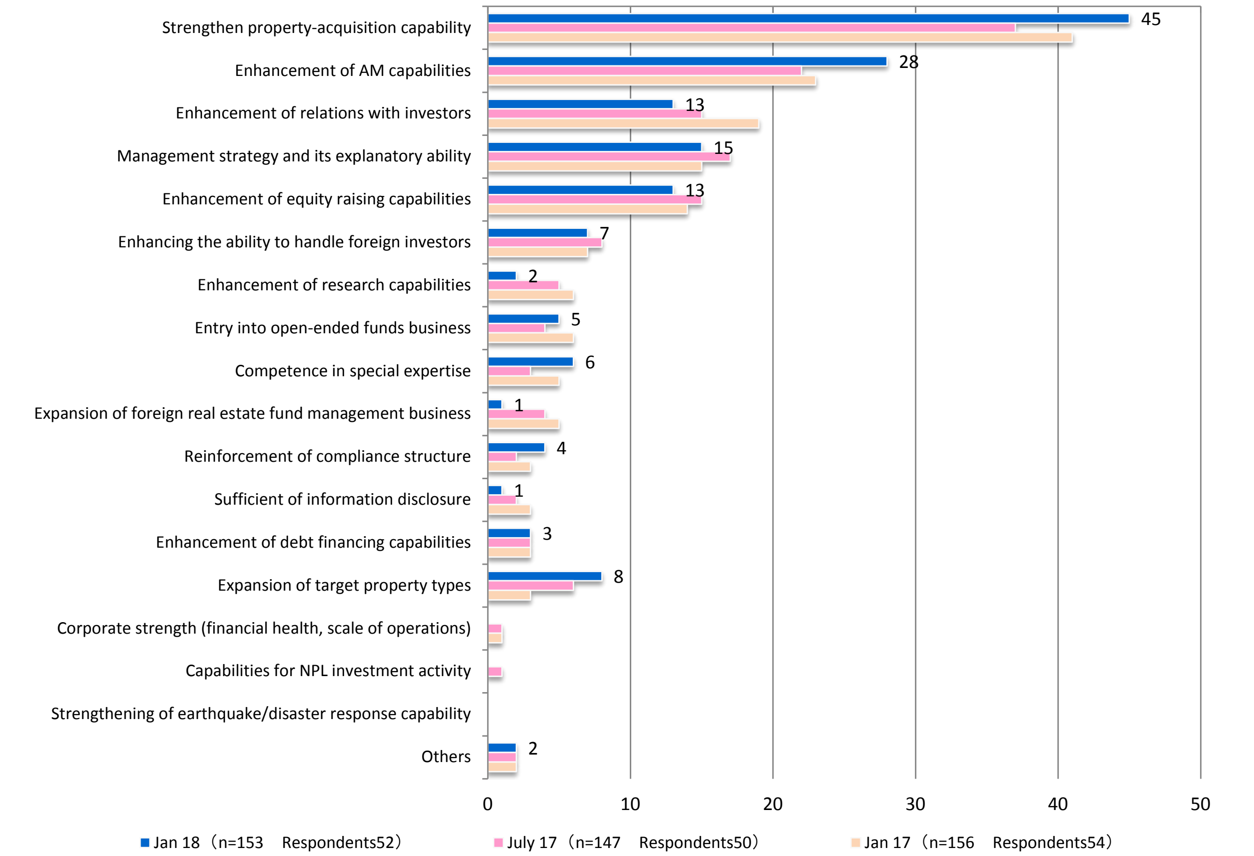


3) Manager's Requirements for Future Growth and Sustainability of their Businesses **(Multiple answers allowed)**

Among requirements for sustainability and growth of the asset managers, the majority of managers chose *"Strengthen property-acquisition capability"*, *"Enhancement of AM capabilities*" (Fig.31). Acquiring properties is becoming more challenging given rising real estate prices. In this environment, asset managers are required to enhance their ability to achieve the internal growth of properties they own.

There were also eight respondents who answered *"Expansion of target property types."* It is necessary to find investment opportunities by expanding target properties to operational assets such as industrial properties and hotels.

Fig. 31 Requirements for Sustainability and Growth of Managers (choosing up to three options)



Definitions of Terms

The definitions of terms used in this report are as follows;

Private real estate fund:	A private real estate fund is a structure under which investors' funds are managed by professional asset managers. In this report, commingled funds that are designed for multiple investors, and separate accounts, investment programs for single investors are both categorized as private real estate funds. This does not include products governed by the Act Concerning Designated Real Estate Joint Enterprises.
Fixed property type:	A type of fund in which properties to be invested have been identified at the launch of the fund
Additional acquisition type:	A type of fund in which certain percentage of properties to be invested have been identified at the launch of the fund, leaving additional investments after the launch usually at the discretion of manager subject to pre-determined investment guidelines
Discretionary investment type:	A type of fund in which the properties to be invested have not been identified at the launch of the fund, and properties are acquired after the launch at the discretion of a manager subject to pre-determined investment guidelines; Also called a blind pool type
Closed-ended fund:	This refers to private real estate funds with stipulations on the management period. In principle, this system does not allow reimbursement during the management period.
Open-ended fund:	This refers to private real estate funds without stipulations on the management period. The system enables additional investment, cancellation and reimbursement during the management period. The value of the holding is calculated based on the appraisal value at the time. Open-ended funds currently managed in Japan take the form of a private REIT.

＜Management Style＞

Core:	An investment style in which stable long-term investments are envisaged by investing in sound properties generating steady income flows.
Opportunity :	An investment style in which a large capital gain is aimed at by investing in unprofitable properties and selling them after increasing value with improvements. Some of opportunity investments invest in development projects and funds that invest in companies.
Value-added:	An investment style that lies between Core and Opportunity, and aiming at both income gains and capital gains.
Development:	An investment style that specializes in achieving development gains.
Debt:	An investment style in which an investment is made in loans that pay the principal and interests from income from real estate and real estate trust beneficiary rights. Compared with the equity investment, the debt investment generally has a lower risk and a lower return.

＜Investment Area＞

Central 5 wards of Tokyo	Chiyoda Ward, Chuo Ward, Minato Ward, Shinjuku Ward, Shibuya Ward
Tokyo Metropolitan Area:	Tokyo excluding 23 Wards, Kanagawa, Saitama, and Chiba prefectures
Kinki Area:	Osaka, Kyoto, Hyogo, Nara, Wakayama, and Shiga prefectures
Nagoya Area:	Aichi, Gifu, and Mie prefectures
Others	Other than those above

LTV (Loan To Value):	The Loan to Value (LTV) ratio is a ratio of debt against asset value. Asset value represents the appraisal value, actual acquisition price or total investment cost for acquisition.
Cash-on-cash yield:	The cash-on-cash yield is the yield of annual cash flow on the total investment amount. This shows the collection rate of own capital.
IRR (Gross):	The Internal Rate of Return (IRR), an indication of return on investment, is the discount rate that makes the present value of future cash flow of an investment equal to its original value of the investment.

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