

2012 Japanese Investor Survey on Real Estate Investment

November 21st 2012

Sumitomo Mitsui Trust Research Institute Co., Ltd

From September to October, 2012, Sumitomo Mitsui Trust Research Institute Co., Ltd. conducted the “Japanese Investor Survey on Real Estate Investment”.

Target investors of this survey and methodology

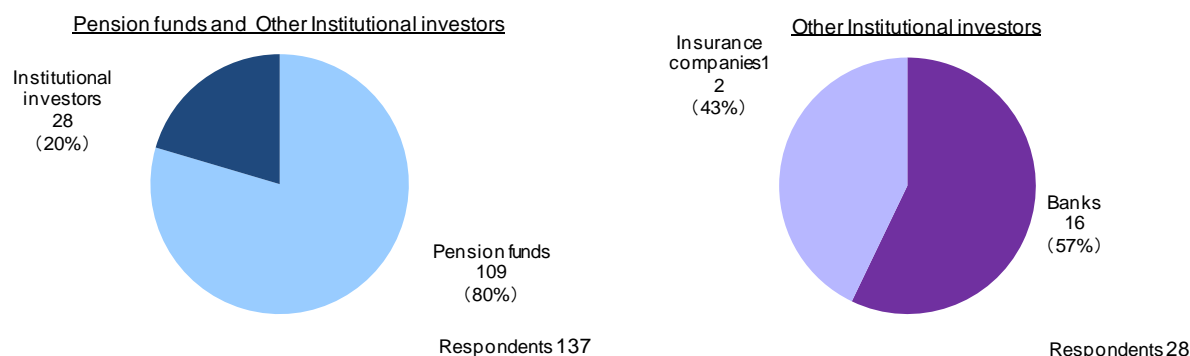
-Number of institutions to which questionnaires were sent:713

Of which, 542 institutions were pension funds, while 171 institutions were other institutional investors. “other institutional investors” includes 100 banks (such as major banks, regional banks and trust banks) and 71 life and non-life insurance companies. In this survey “other institutional investors” is referred to as “institutional investors”.

- Number of institutions which responded: 137 (109 pension funds and 28 institutional investors) (response rate: 19.2%)

- Survey period: September to October, 2012

- Survey method: Distribution and collection of questionnaires by post

**Executive summary of this survey**

- Over 80% of the investors who responded to the survey had invested in alternatives (hedge funds, real estate, private equity, infrastructure funds, etc.) This indicates the increasing penetration of alternative investments. However, the number of investors who invested in real estate (44) was limited to approximately half of the number who invested in hedge funds (83).
- As for their reason for investing in real estate, most respondents indicated it was due to the poor performance of the traditional four asset groups (domestic bonds, domestic equities, foreign bonds, and foreign equities). The respondents purpose for real estate investment included “to increase returns” along with “diversification” and “to ensure stable cash flows.”
- Regarding real estate products which were expected to be added soon, or increased in the future, pension funds planning to invest in “private placement funds for investment in domestic real estate (open-end)” represented the largest share of respondents in that category. Meanwhile, the largest share of institutional investors indicated that they were planning to invest in J-REITs. The Pension Funds are focusing on the product characteristics of “private placement funds for investment in domestic real estate (open-end)”, such as “smaller price fluctuations than listed products” and that a “certain redeemability is maintained.” Institutional Investors are likely to prefer J-REITs consisting of listed products for their current yields and a liquidity equivalent to that of equities.
- As part of the infrastructure requirements for real estate investment, a number of investors pointed to the “assurance of and an increase in liquidity” and “adequate information disclosure.” Pension Funds that invested in real estate most often selected the “accuracy and improved reliability of real estate appraisal values” second to that they chose “assurance of and an increase in liquidity.” This reflects the demand for greater reliability in response to the increased awareness of pricing problems in real estate investment caused by the decline in property values since 2007.

Results of September 2012 Investor Survey on Real Estate Investment

* The “n” in the graph represents the number of valid responses.

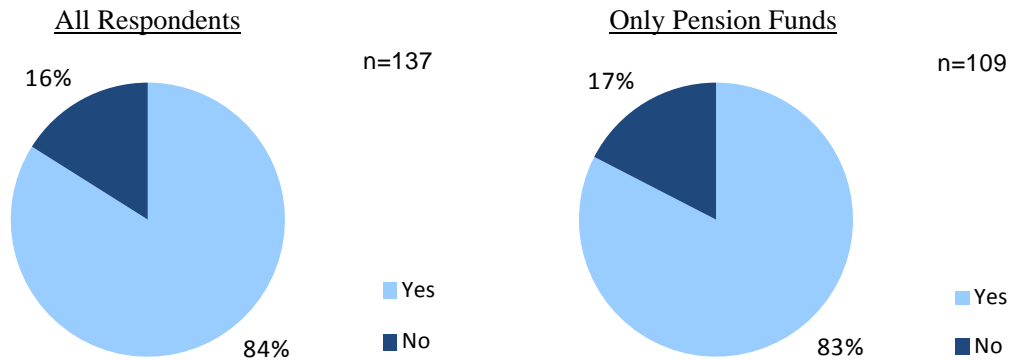
1. Past investment experience and current policy in alternatives

(Questions directed at all the investors that were sent questionnaires)

a) Past experience in alternative investments

Of all respondents, 84% answered that they had invested in alternatives in the past, as for Pension Fund respondents, 83% had investment experience in alternatives. This indicates their increasing penetration of alternative investments.

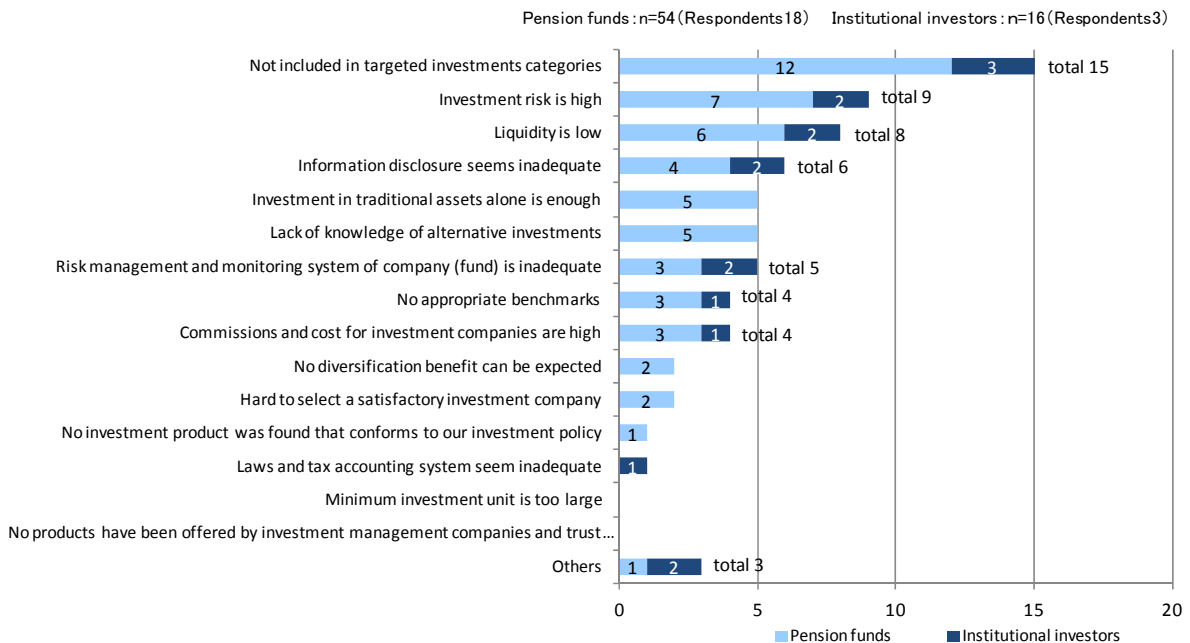
【Past experience in alternative investments】



b) Reasons for not investing in alternatives

This question was directed at investors with no prior experience in alternative investments. Particularly among Pension Funds, many investors replied “not included in targeted investments categories.” This suggests that a notable number of Pension Funds are limiting their investments to traditional assets such as equities and bonds. This was followed by “investment risk is high,” “liquidity is low,” and “information disclosure seems inadequate.”

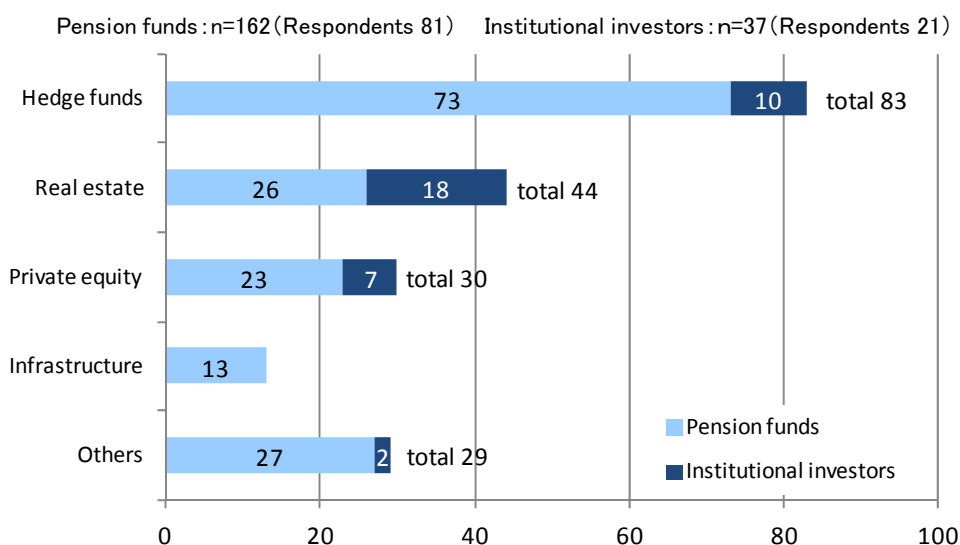
【Reasons for not investing in alternatives】



c) Specific alternative investment products of investors currently investing in alternatives

Of all investors currently investing in alternatives, 83 respondents, the largest share, answered that they had invested in hedge funds. This answer was followed by “real estate” which accounted for half the number who had invested in hedge funds. Pension Funds comprised 88% of all respondents in this category, which demonstrated the importance of hedge funds as a major alternative investment for pension funds in Japan. As for Institutional investors, real estate is evidently the most popular choice and forms the core of their investment strategy in alternatives.

【Specific alternative investment products of investors currently investing in alternatives】



2. Experience in and policy for real estate investment

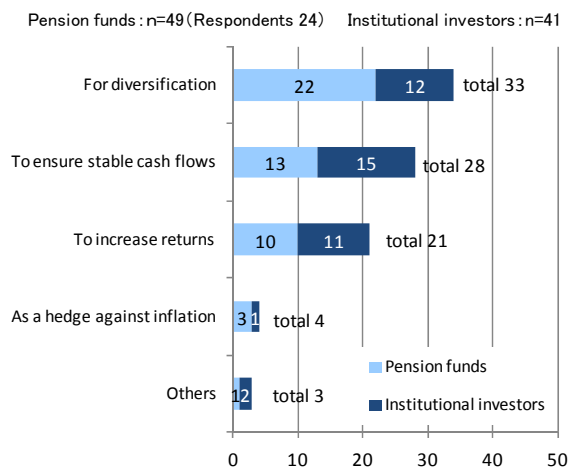
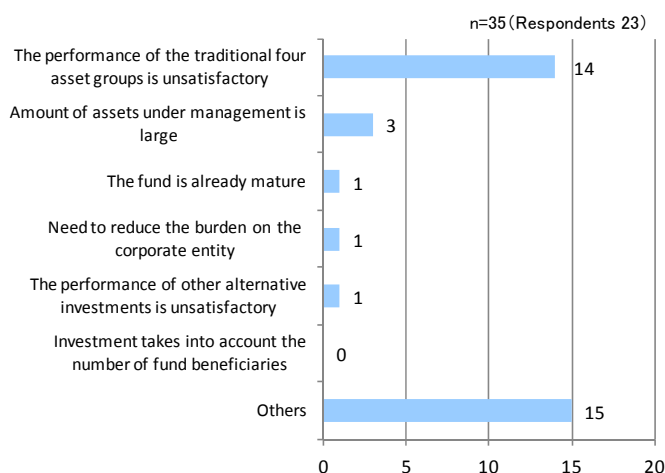
(Questions directed at Pension Funds and Institutional Investors that are currently invest in real estate)

a) Objectives of and the background behind real estate investment

As for the reason for investing in real estate, a particularly large number of the Pension Funds that are currently investing in real estate answered “the performance of the traditional four asset groups is unsatisfactory.” When both Pension Funds and Institutional Investors were asked about the objectives of their real estate investment, “for diversification” ranked first as an answer, followed by “to ensure stable cash flows” and “to increase returns.” A significant proportion of both Pension Funds and Institutional Investors selected the same top three answers suggesting that there exists some generally shared objectives between them.

【Background behind real estate investment (Pension Funds only)】

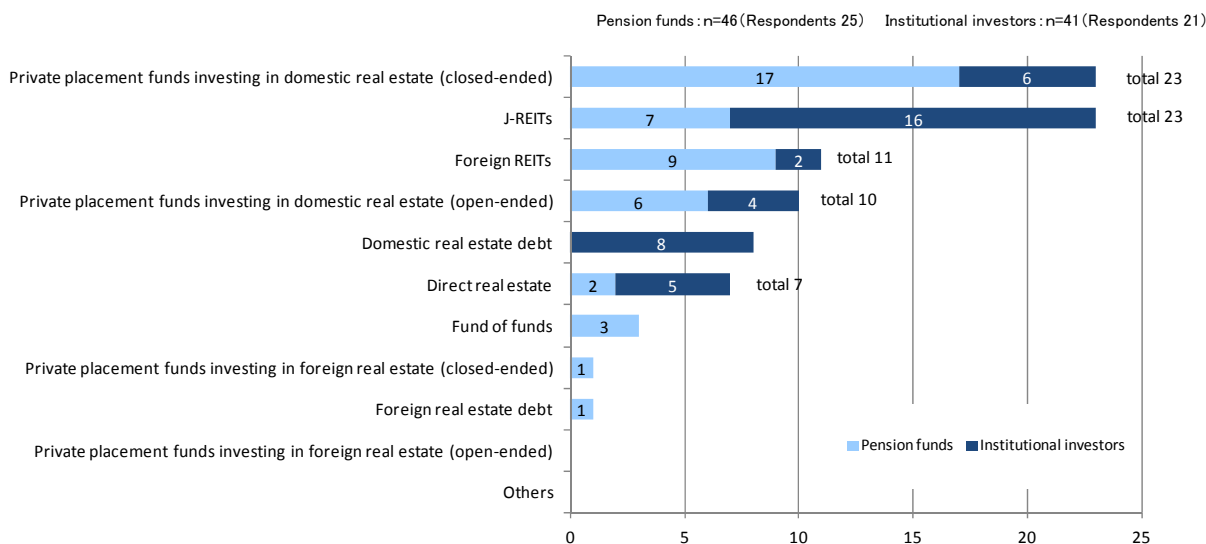
【Objectives of real estate investment】



b) Breakdown of real estate assets under management

Of all respondent, 23 ranked both “private placement funds investing in domestic real estate (closed-ended)” and “J-REITs” first, implying a general preference for domestic real estate investment. While Pension Funds selected “private placement funds investing in domestic real estate (closed-ended)” as their primary assets, the first choice of Institutional Investors was “J-REITs,” revealing their differing tendencies. More Pension Funds selected “foreign REITs” than “J-REITs,” which indicated a tendency to diversify globally by using listed products. Meanwhile, more than 10% of respondents selected “Private placement funds investing in domestic real estate (open-ended),” indicating this category has had a growing popularity since their launch in 2010.

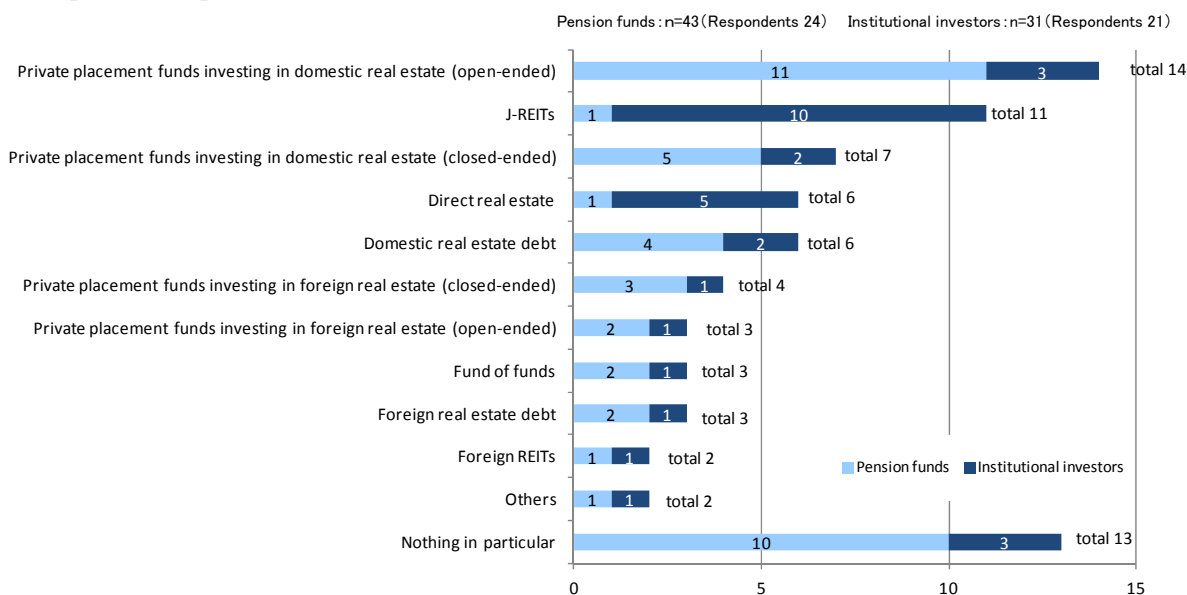
【Breakdown of real estate assets under management】



c) Real estate products expected to be added soon or increased in future investments

The number of respondents that chose “Private placement funds investing in domestic real estate (open-ended)” was the largest, at 14, of which 11 were Pension Funds. The latter are focusing on product characteristics such as “smaller price fluctuations than listed products” and “a certain redeemability is maintained.” Institutional Investors, on the other hand, are likely to prefer J-REITs for their current yields and the fact that their liquidity is equivalent to equities due to their listed status. A notable 13 respondents, of which 10 were Pension Funds, answered, “nothing in particular.” This indicates that a certain number of investors do not plan to increase their real estate investments in the future, despite the fact that they are already holding real estate assets.

【Real estate products expected to be added soon or increased in future investments】



3. Preferred real estate investment categories

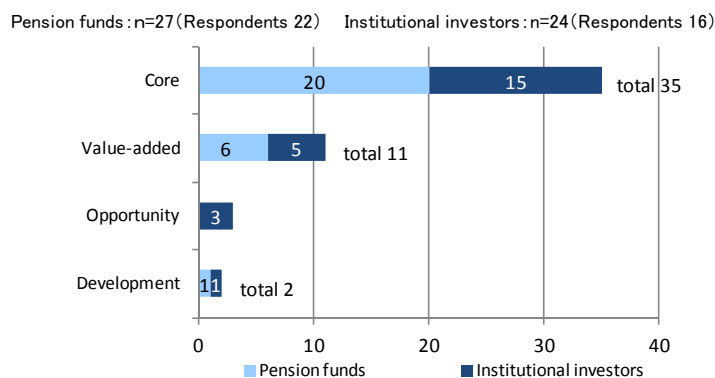
(Questions directed at Pension Funds and Institutional Investors that invest in real estate)

(See the “Glossary” at the end of this document for “investment style,” “level of discretion of investment company regarding investment timing and redeemability,” and “investment areas.”)

a) Investment style (risk level)

The responses of both Pension Funds and Institutional Investors were concentrated in “core” investments, which focus on stable income. This suggests that domestic investors are drawn to less risk-averse investment styles.

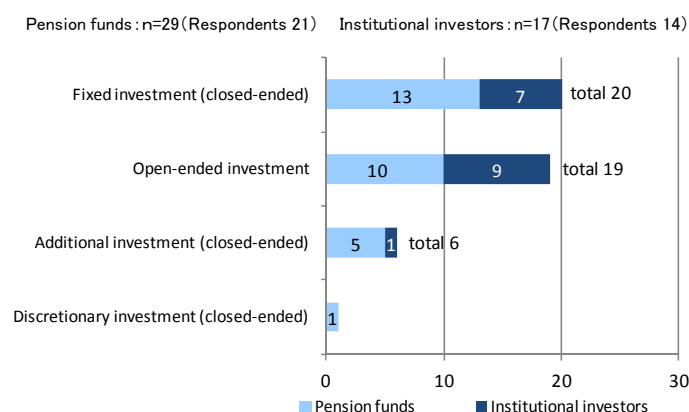
【Investment style (risk level)】



b) Redeemability and the level of discretion of the investment management company regarding investment timing

“Fixed investment (closed-ended),” in which the real estate invested in is fixed and generally not redeemable, was the most popular response. This was followed by “open-ended investment,” in which a certain redeemability is maintained and additional investments are made at the discretion of the investment company after investment. Very few respondents selected “additional investment (closed-ended)” or “discretionary investment (closed-ended),” which are generally not redeemable and for which the investment company determines the investment timing, reflecting their low popularity among domestic investors.

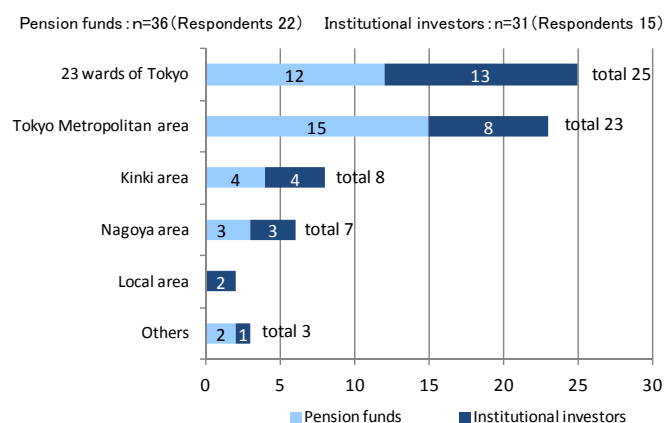
【Redeemability and the level of discretion of the investment management company regarding investment timing】



c) Investment areas

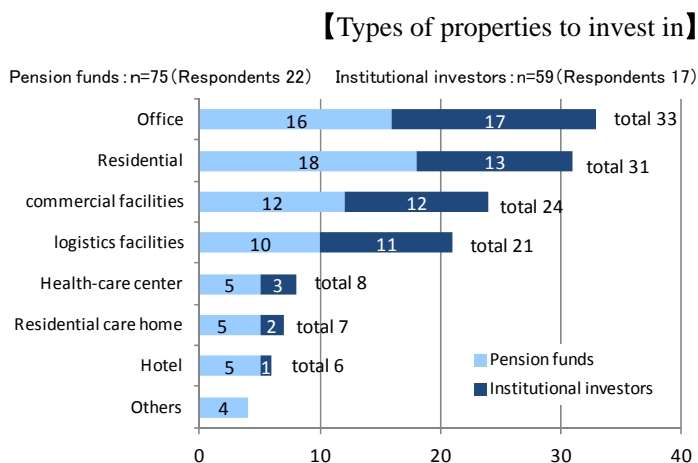
Regarding the geographical areas targeted for investment, the “23 wards of Tokyo” ranked highest, with 25 responses, and the “Tokyo metropolitan area” ranked second, with 23 responses. The total for these two comprised 70% of all responses, and notably few selected other areas for investment. This implies that most domestic investors consider Tokyo and its surrounding areas to be more stable and appropriate for investment than other areas.

【Investment areas】



d) Types of properties to invest in

“Offices” ranked highest among responses, followed by “residential,” “commercial facilities,” and “logistics facilities.” Among Pension Funds, “residential” was the first choice for many investors, perhaps due to their focus on stable cash flows and transaction liquidity.

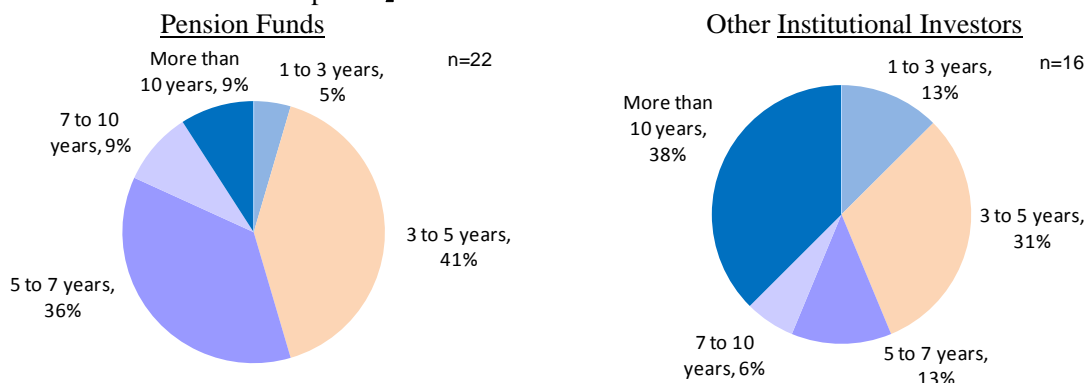


e) Expected real estate investment period

Among Pension Funds, 41% of respondents, the most, chose “3 to 5 years.” This was followed by “5 to 7 years,” selected by 36% of respondents. The total for these two groups comprised 77% of all responses for a period of “3 to 7 years”. Despite the general impression of real estate being a long-term investment, this result reveals that many Pension Funds are opting out of long-term investments in their decisions regarding individual products.

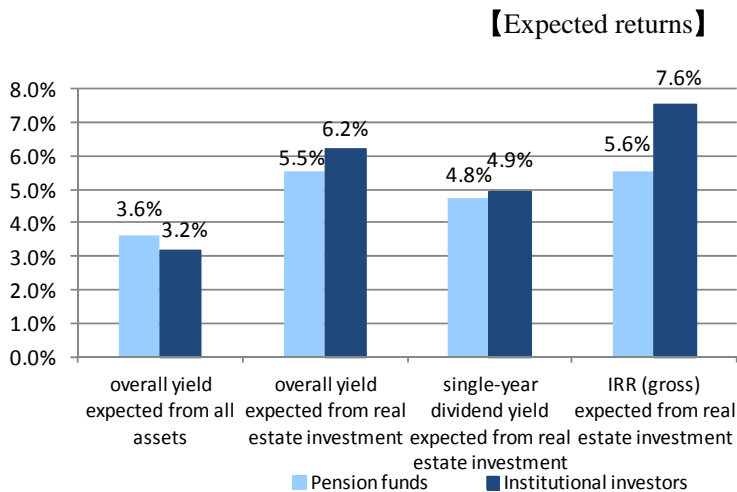
Institutional Investors were divided between “more than 10 years,” which the most—38%—chose, and “3 to 5 years,” which was the second most popular option, chosen by 31%. This suggests that real estate investment periods vary depending on the type of investor and the type of product invested in.

【Expected real estate investment period】



f) Expected returns

The “overall yield expected from real estate investment” was approximately 2% higher than the “overall yield expected from all assets” for Pension Funds and 3% higher for Institutional Investors, reflecting the demand for relatively high returns on real estate investment. The “single-year dividend yield expected from real estate investment” was generally at the same level for both Pension Funds and Institutional Investors, at 4.8% and 4.9%, respectively. However, the “overall yield expected from real estate investment” and “IRR (gross) expected from real estate investment” were higher for Institutional Investors. This may be a result of Pension Funds focusing on income gains on real estate, in contrast to Institutional Investors’ expectations of a return on investment that includes capital gains.



4. Investor expectations for real estate investment management companies

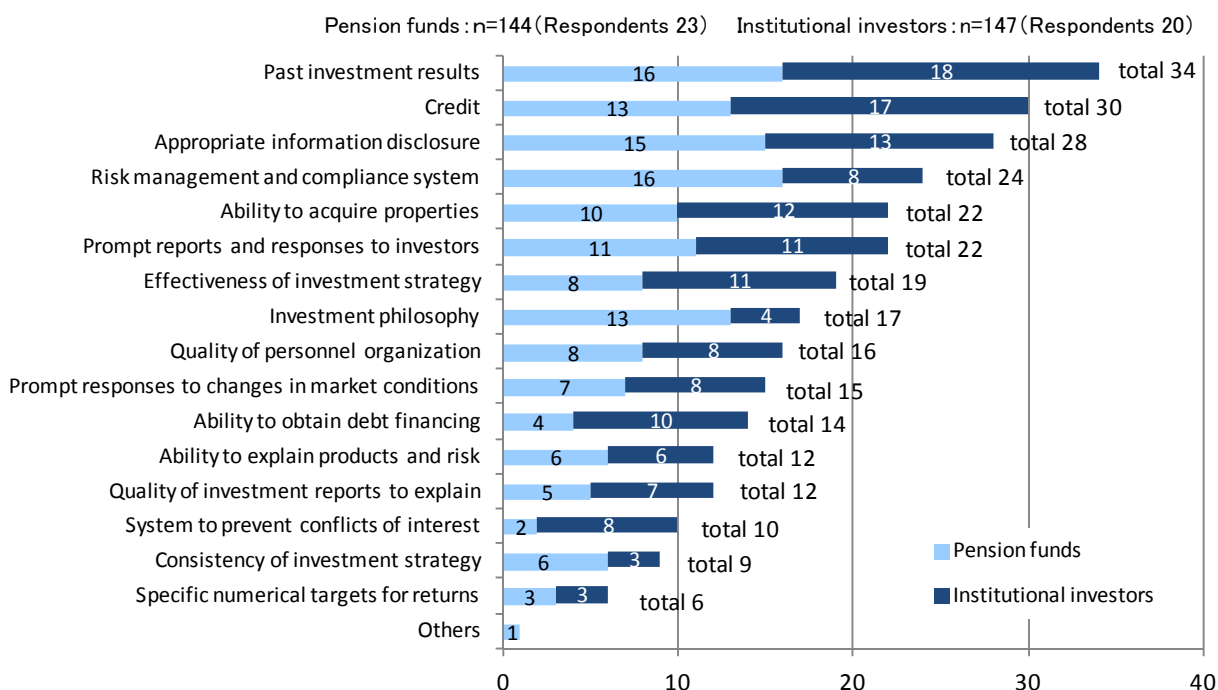
(Questions directed at Pension Funds and Institutional Investors that currently invest in real estate)

a) Criteria for selecting an investment management company

The most popular criterion for selecting an investment company was “past investment results,” indicating the emphasis on performance. This was followed by “credit” and “appropriate information disclosure.”

Among Pension Funds, most respondents chose “past investment results” and “risk management and compliance system.” The tendency to focus on the “risk management and compliance system” has likely been increasing since the AIJ scandal.

【Criteria for selecting an investment management company】

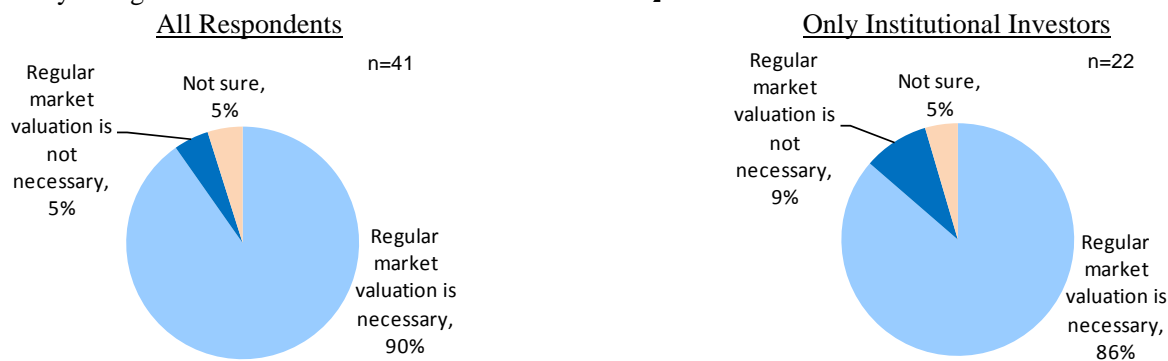


b) Necessity of regular asset valuation for real estate investment

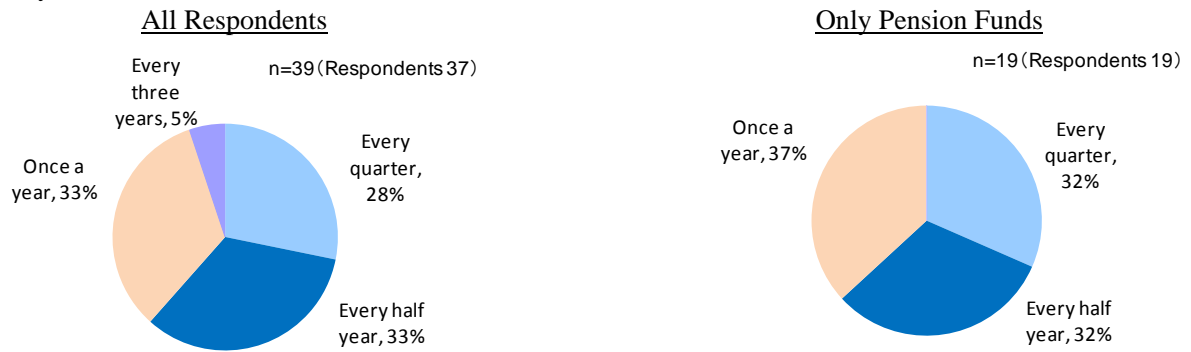
Of all investors, 90% responded that “regular market valuation is necessary,” with 86% of Pension Funds indicating this.

Valuation frequency was divided between “every quarter,” “every half year,” and “once a year,” with generally a third of all respondents selecting each.

【Necessity of regular asset valuation for real estate investment】



【Frequency of asset valuation for real estate investment】



5. Open-ended private placement real estate funds

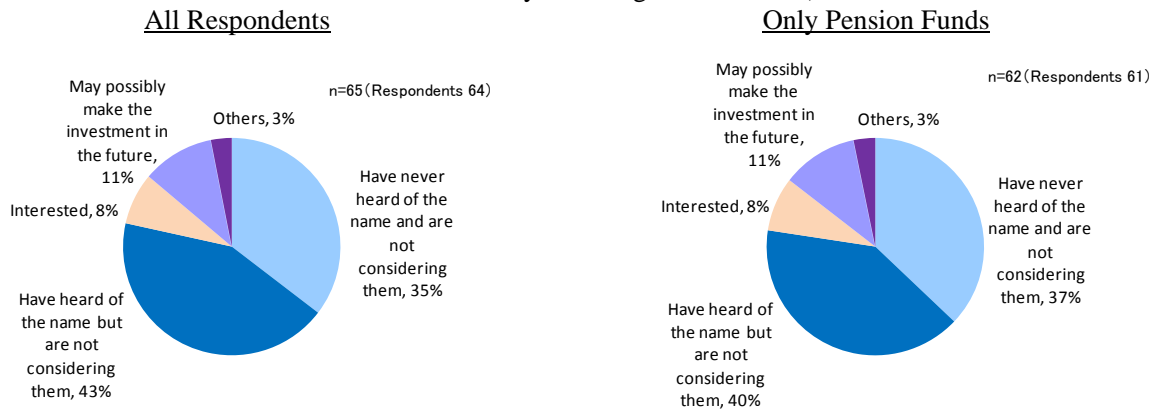
(Questions for all investors that were sent questionnaires)

a) Investor consideration for open-ended private placement real estate funds

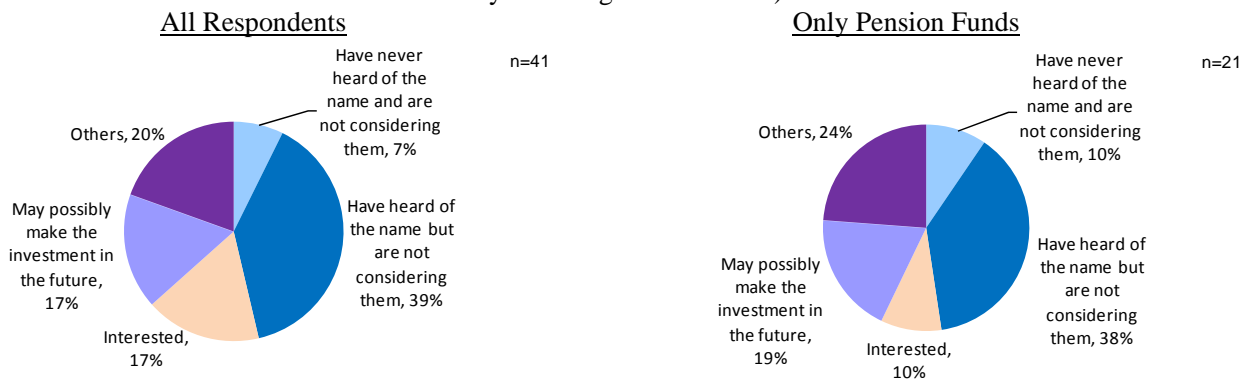
Among investors who responded that they are not currently investing in real estate, 35% indicated that they had never heard of an open-ended private placement real estate fund, and weren't considering them. However, there was a high recognition of this fund among investors who are currently investing in real estate, and those who "have never heard of the name and are not considering them" were limited to 7%. The total of those who responded that they were "interested" and "may possibly make an investment in the future" was 34%, indicating a relatively high degree of interest among real estate investors in an open-ended private placement real estate fund.

【Investor Consideration of investment in an open-ended private placement real estate funds】

(Questions directed at "investors that are NOT currently investing in real estate")



(Questions directed at "investors that are currently investing in real estate")

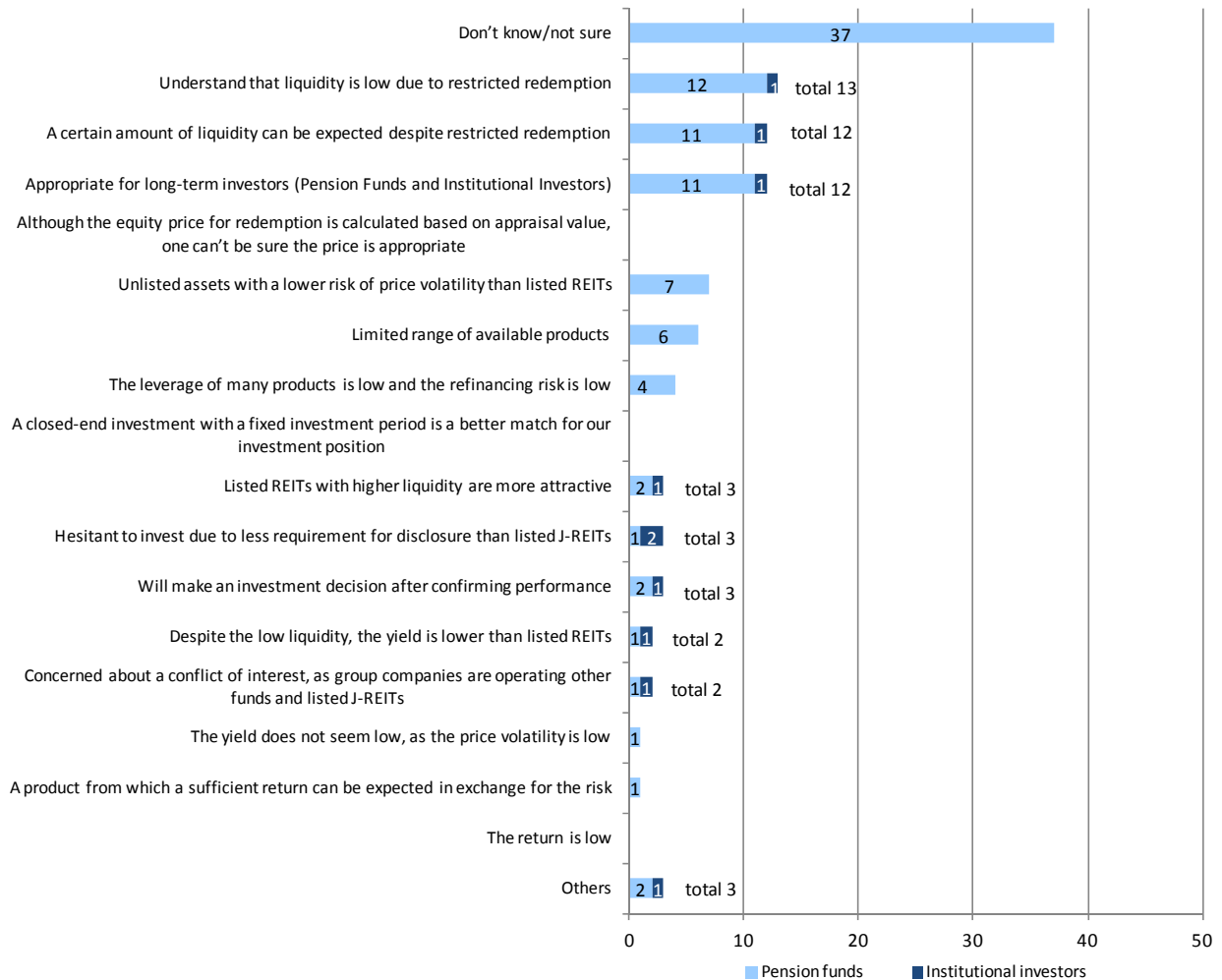


b) Awareness of open-ended private placement real estate funds

(Questions directed at “investors that are NOT currently investing in real estate”)

The most common answer was “don’t know/not sure,” demonstrating again the low level of recognition.

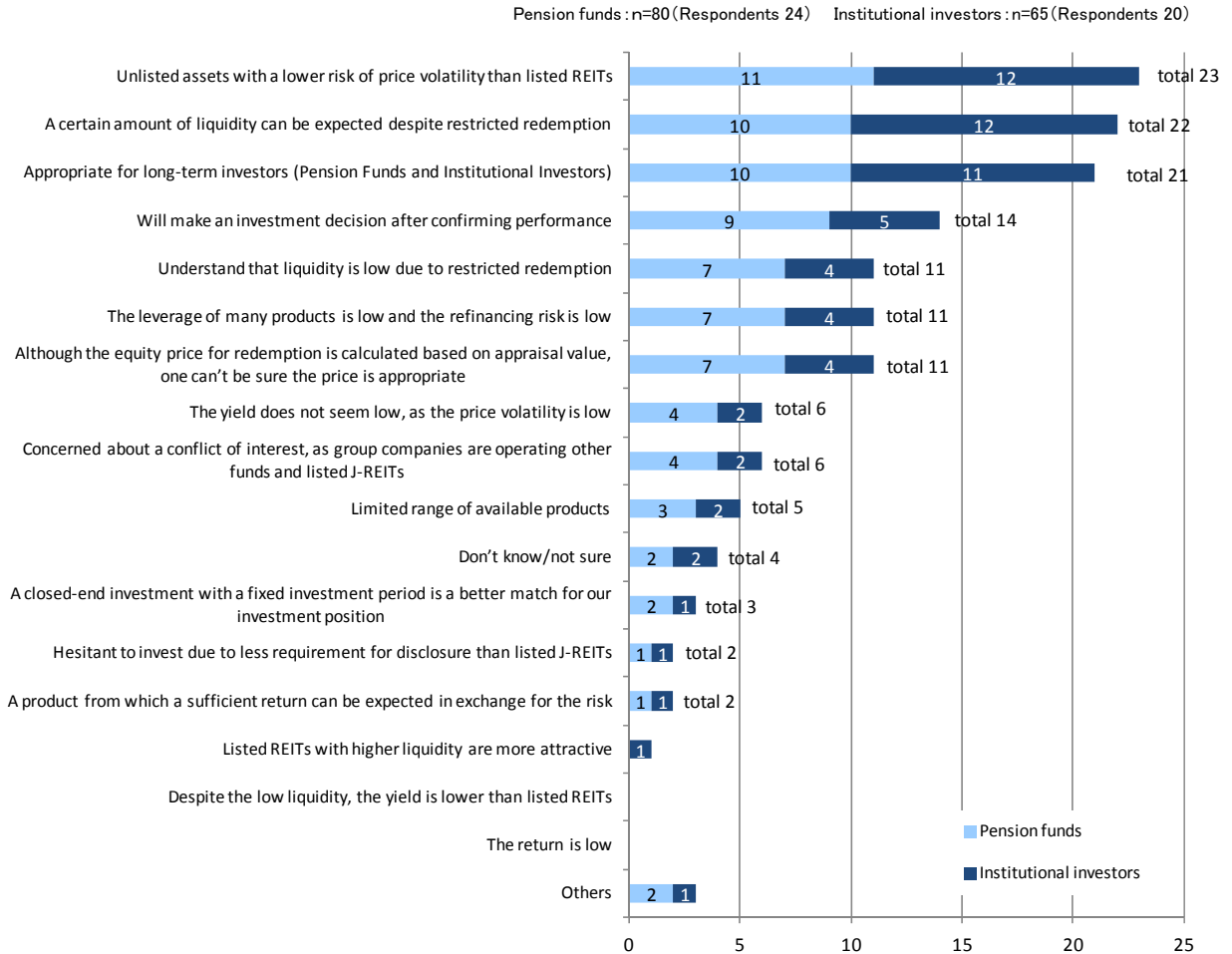
Pension funds : n=110 (Respondents 63) Institutional investors : n=12 (Respondents 3)



c) Awareness of open-ended private placement real estate funds

(Questions directed at “investors that are currently investing in real estate”)

The answer “unlisted assets with a lower risk of price volatility than listed REITs” was selected the most, followed by “a certain amount of liquidity can be expected despite restricted redemption.”



6. Investor requirements for real estate investment

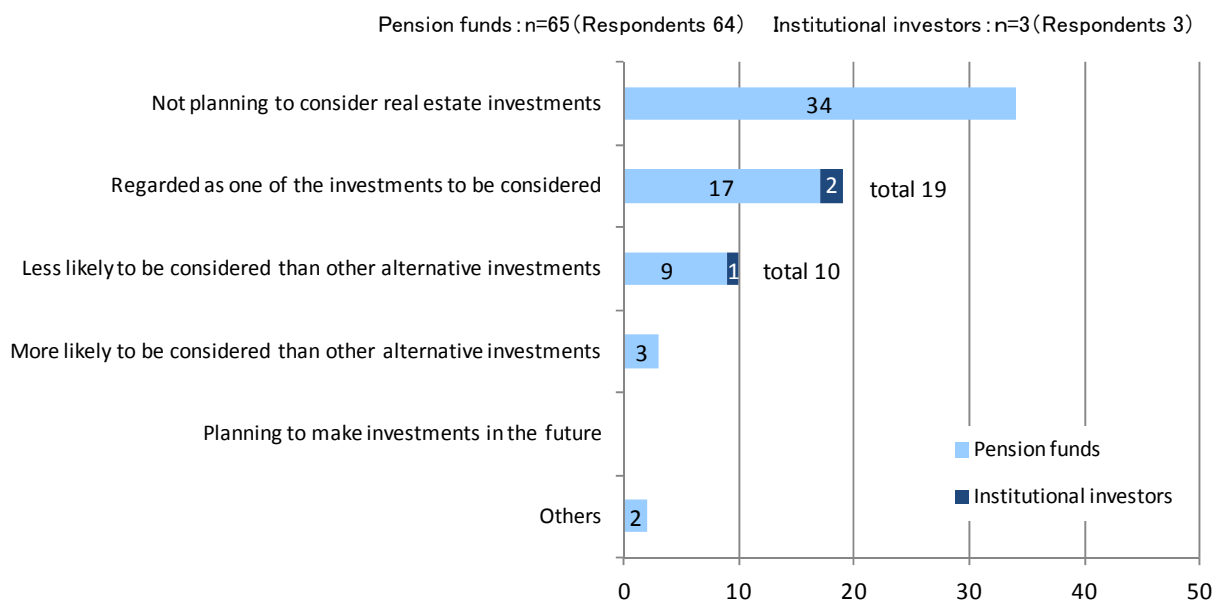
(Questions for all investors that were sent questionnaires)

a) Current attitude toward real estate investment

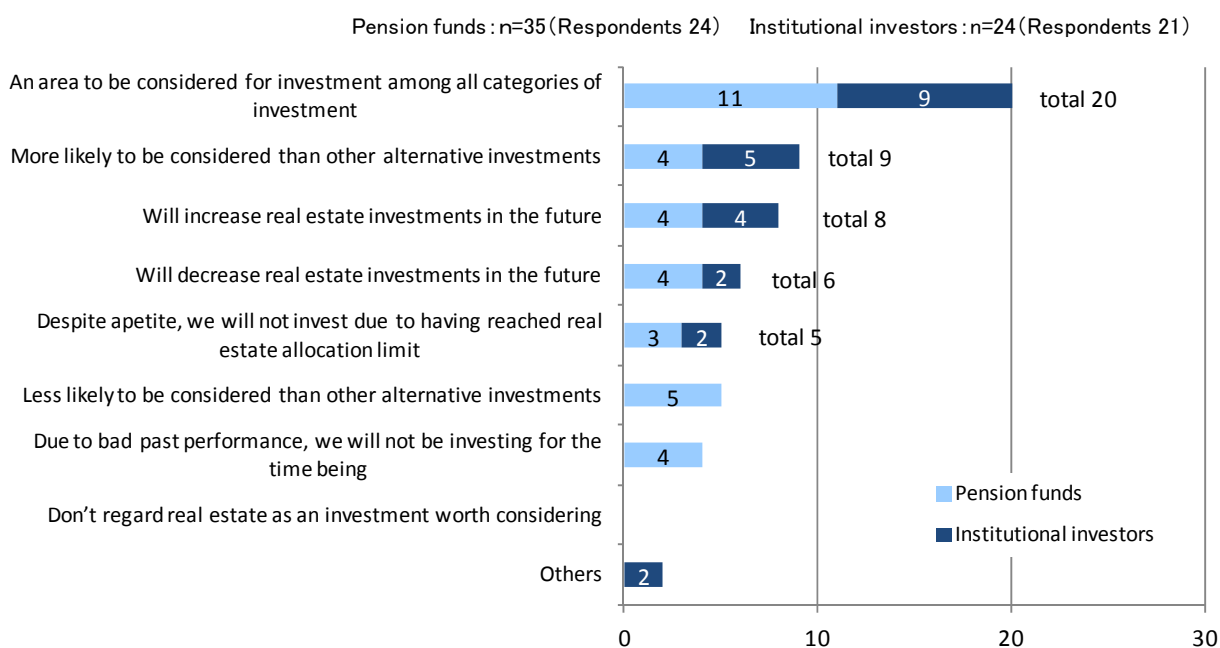
The answer selected the most by “investors not currently investing in real estate” was “not planning to consider real estate investments.” On the other hand, the top three responses of “investors currently investing in real estate” indicated a positive attitude toward real estate investment. It may be concluded that investors that are already investing in real estate tend to consider further investments in real estate, while those not investing in real estate are not likely to consider such investments.

【Current attitude toward real estate investment】

(Questions directed at “investors that are NOT currently investing in real estate”)



(Questions directed at “investors that are currently investing in real estate”)



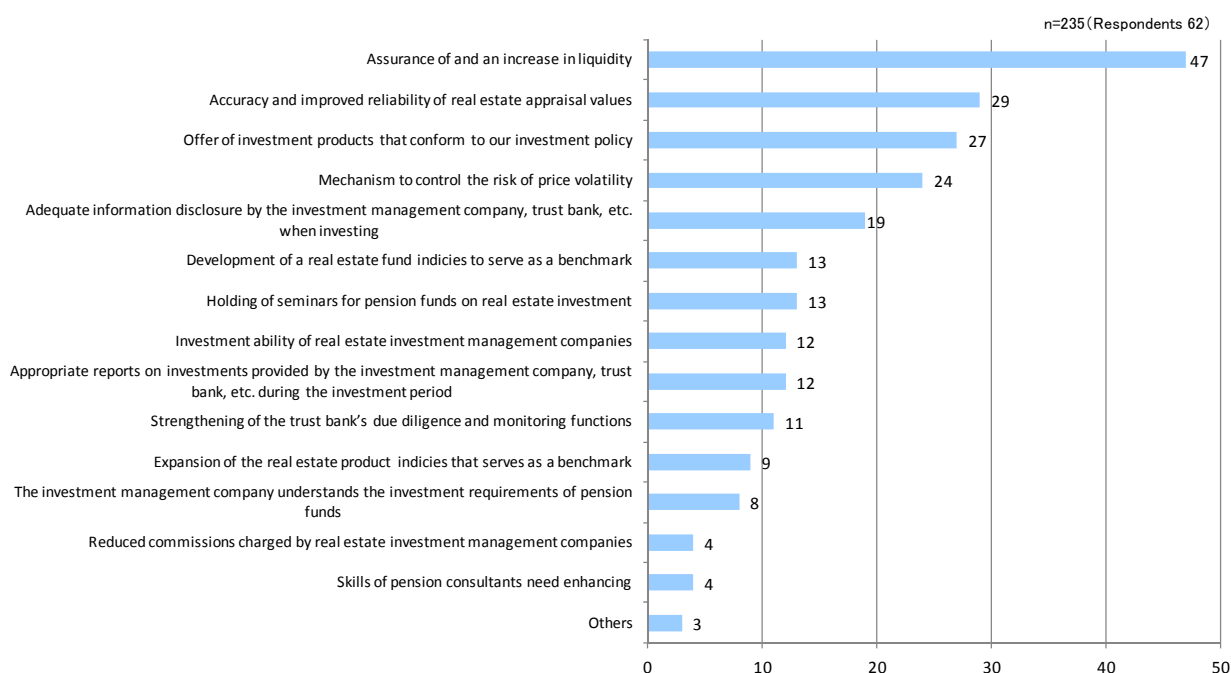
b) Investor requirements for real estate investment

Irrespective of whether or not they invest in real estate, many investors selected aspects including “assurance of and an increase in liquidity” and “adequate information disclosure” as part of the infrastructure requirements for real estate investment.

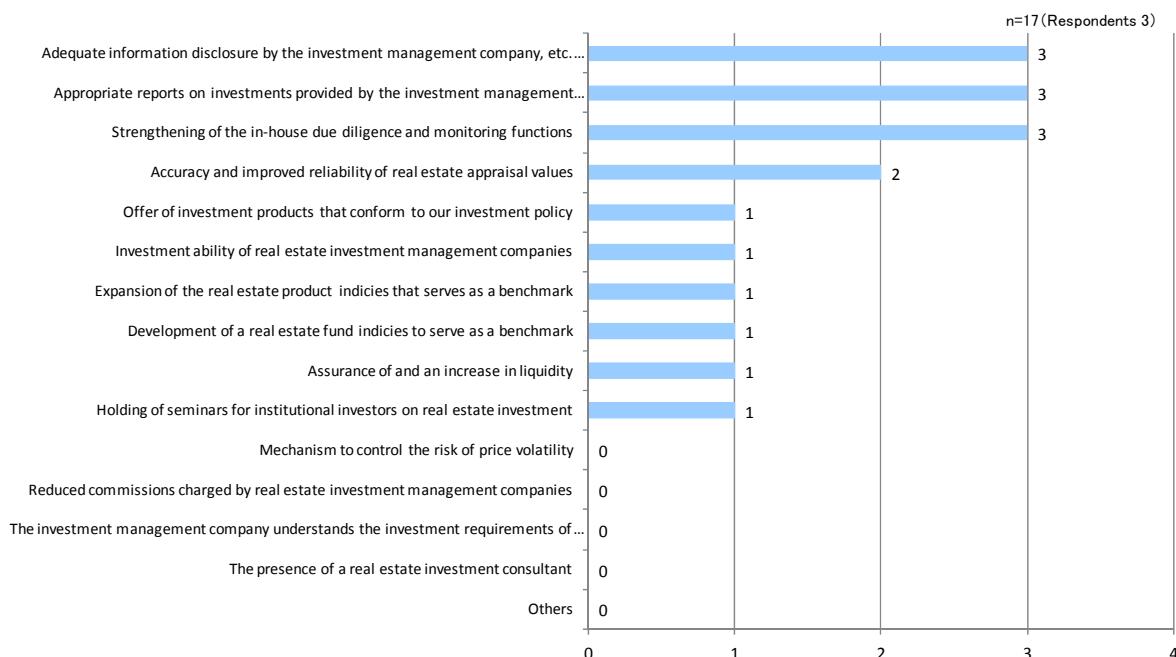
A significant number of “Pension Funds currently investing in real estate” selected “assurance of and an increase in liquidity,” which was followed by “the accuracy and improved reliability of real estate appraisal values.” The results revealed that Pension Funds with experience in real estate investment are demanding reliable pricing for real estate investments in response to the decline in real estate prices since the bankruptcy of Lehman Brothers.

【Conditions and infrastructure requirements for real estate investment】

(Questions directed at “Pension Funds that are NOT currently investing in real estate”)

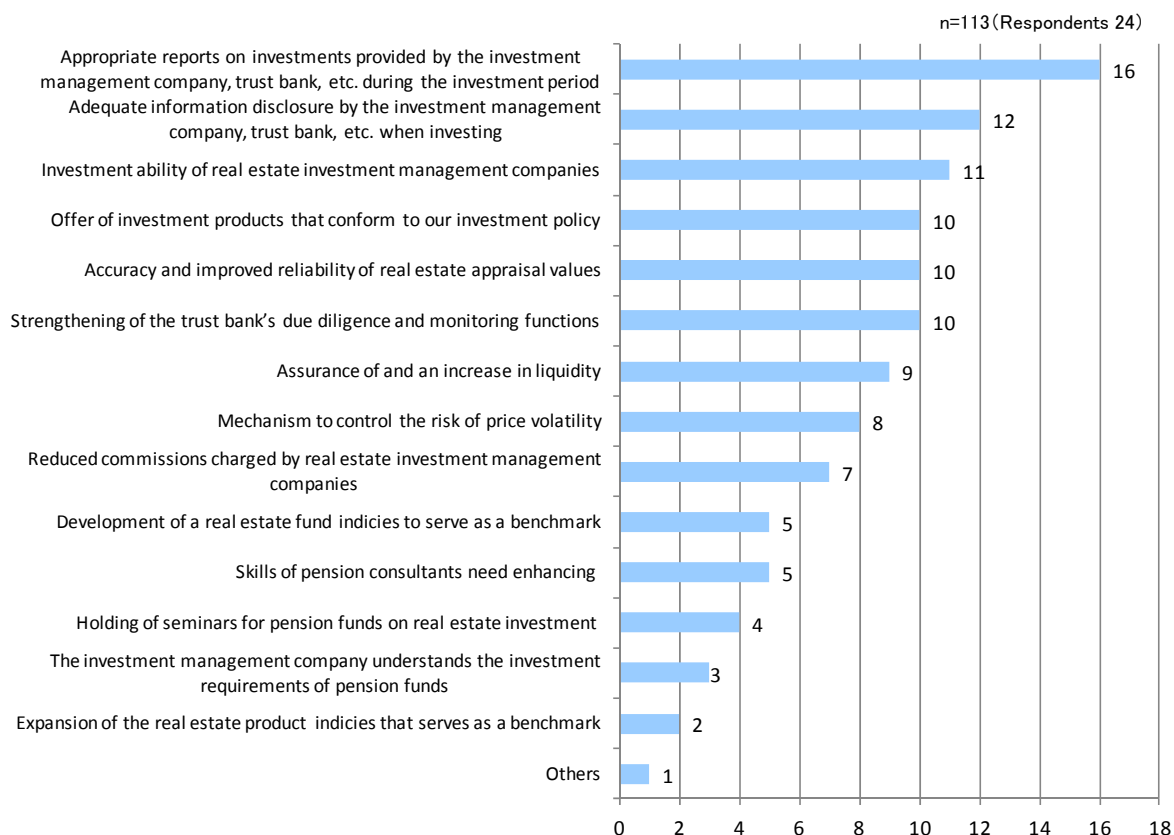


Questions directed at “Institutional Investors that are NOT currently investing in real estate”)

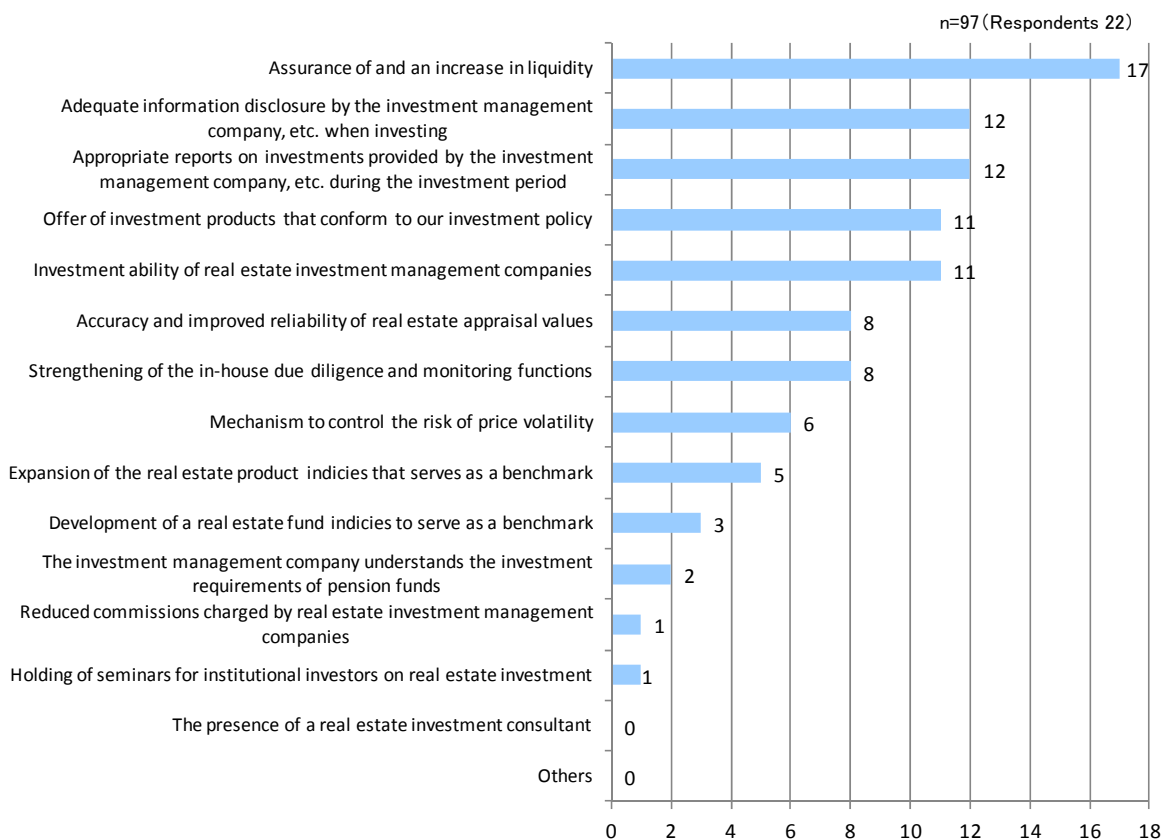


【Infrastructure requirements for real estate investment】

(Questions directed at “Pension Funds that are currently investing in real estate”)



(Questions directed at “Institutional Investors that are currently investing in real estate”)



Definitions of Terms

Real Estate Investment:

- Investment in Privately placed real estate fund (refer to the Privately placed real estate fund below)
- Investment in listed REIT (Including both J-REIT and foreign REIT)
- Investment in real estate debt (Including domestic and foreign NRL)
- Fund of funds

Privately placed real estate fund:

The privately placed real estate fund is a structure under which investors' funds are managed by professional investment managers. In this report, commingled funds that are designed for multiple investors, and separate accounts, investment programs for single investors are both categorized as privately placed funds. This does not include products governed by the Act Concerning Designated Real Estate Joint Enterprises. Privately placed real estate fund is classified into the following 2 categories.

1. Level of discretion of investment company regarding investment timing and redeemability

- Closed-ended fund: This refers to privately placed real estate funds without cancellation and reimbursement through the management period. In addition, Closed-ended fund is classified into the following 3 categories.
- 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
- Open-ended fund: This refers to privately placed real estate funds without stipulations on the management period. The system enables participation, cancellation and reimbursement for a certain period. The value of the investment is calculated based on the appraisal value at the time.

2. Management Style

- Core style: An investment style in which stable long-term investments are envisaged by investing in sound properties generating steady income flows.
- Opportunity style: An investment style in which high-risk high-return investments are contemplated, such as investments in currently unstable properties seeking for a large capital gain by increasing value with improvement of asset and/or management, by betting on the market cycle, or by employing a large discount power for bulk transactions. Opportunity style may exploit various opportunities, such as investment in development type projects and corporate stocks.
- Value-added style: An investment style that lies between Core and Opportunity, and aiming at both income gains and capital gains.
- Development style: An investment style that specializes in achieving development gains.

Investment Area:

- Tokyo Metropolitan Area: Tokyo excluding 23 Wards, Kanagawa, Saitama, and Chiba Prefecture
- Kinki Area: Osaka, Kyoto, Hyogo, Nara, Wakayama, and Shiga Prefecture
- Nagoya Area: Aichi, Gifu, and Mie Prefecture
- Regional Area: Except Tokyo Metropolitan Area, Kinki Area and Nagoya Area

- IRR (Gross) :** The internal Rate of Return (IRR) is the discount rate that makes the present value of future cash flow of an investment equal to its current value of the investment.

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https://www.smtri.jp/english/contact/form-private/private_fund.html

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