

Survey on Private Real Estate Funds in Japan

January 2014– Results

March 31, 2014

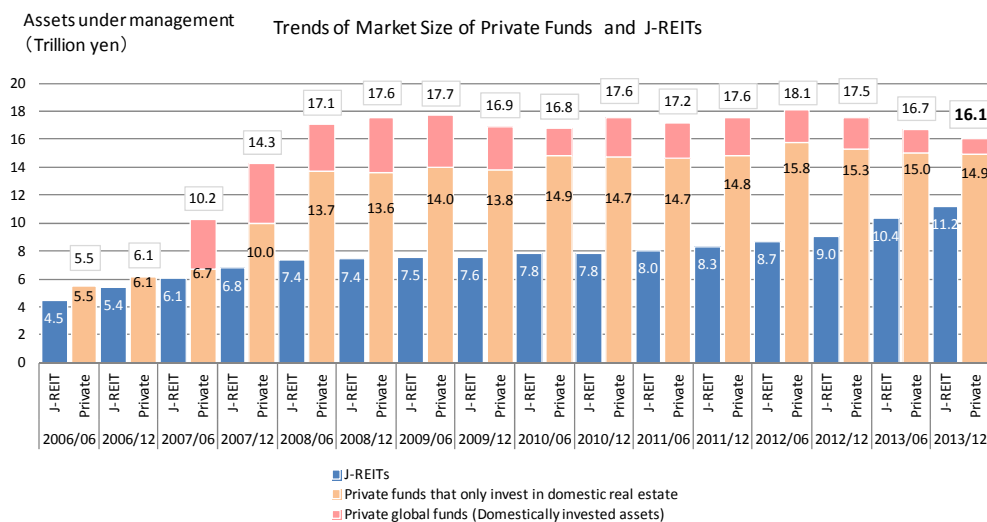
Sumitomo Mitsui Trust Research Institute Co., Ltd

- 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 17th survey based on responses to questionnaires received from 55 real estate investment management companies.
 - Survey subject: Real estate investment management companies that set up and manage private real estate funds which are focused on domestic real estate
 - Number of companies to which questionnaires were sent: 114
 - Number of companies responding: 55 (ratio of valid responses: 48.2%)
 - Time of survey: January 2014
 - Survey method: Distribution and collection of questionnaires 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 2013 to be 16.1 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. The market size as of the end of June 2013 was 16.7 trillion yen, which is a decrease of approximately 600 billion yen (3.7%) over a six-month period from the previous July 2013 survey.

The market size of private real estate funds is 16.1 trillion yen including Japanese assets of global funds

- Assets under management (AUM) as of the end of December 2013 were 16.1 trillion yen, declining approximately 600 billion yen (3.7%) for half a year from the time of the previous survey. The factor for the decline was that the amount of assets decreased in many investment management companies as they sold properties to J-REITs etc. (including listing) under the strong real estate market conditions, as in the time of the previous survey.
- As most of investment management companies feel that the financing environment continues to be favorable in both debt and equity aspects, it was confirmed that many investment management companies planned to set up new funds, including open-ended funds, with such a favorable financing environment as a backdrop.
- The next and subsequent surveys we will focus on whether the private real estate funds market will continue to decline due to the sale of properties or if the contraction will show signs of touching bottom as new private funds are created.

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



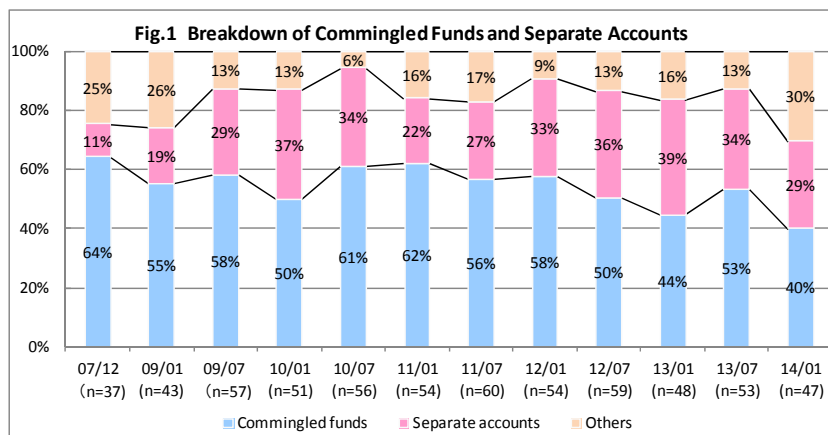
“Survey on private real estate funds” January 2014 Survey Results

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

1. Current Status of Fund Management

1) Breakdown of Commingled Funds and Separate Accounts

This survey categorized private real estate funds into “*commingled funds*” that are managed for multiple investors, and “*separate accounts*” managed for single investors. AUM of the commingled funds managed by the respondents stood at 3,277.2 billion yen (40%), while separate accounts stood at 2,399.4 billion yen (29%) (Fig. 1)

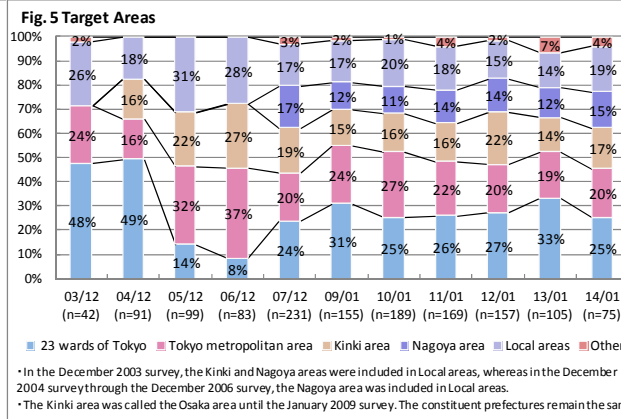
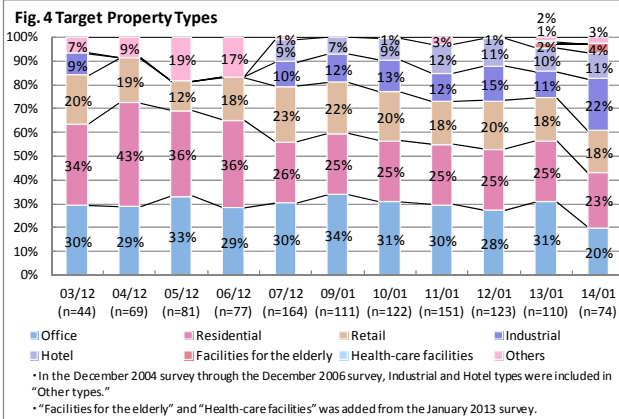
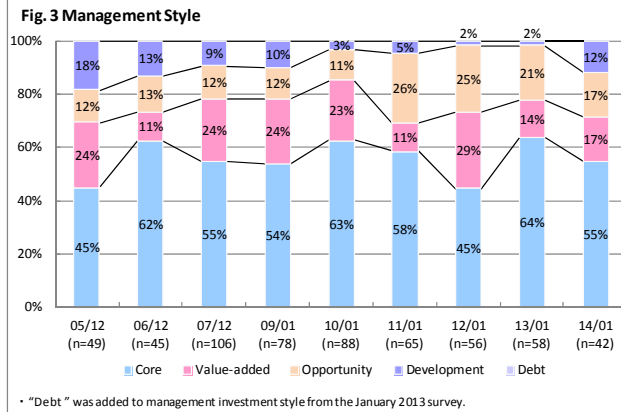
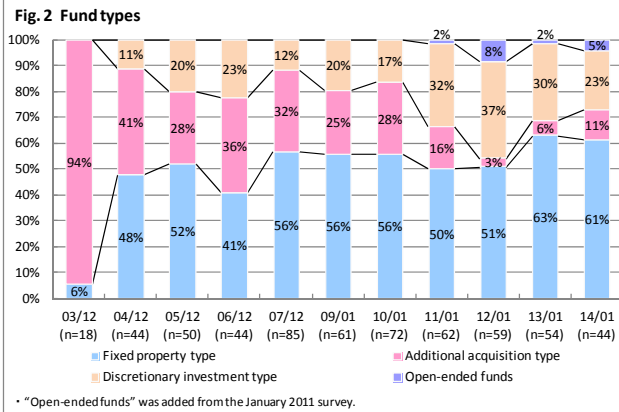


2) A Description of Funds under Management (Results of Tallying Funds Currently under Management for Which Data can be Recorded in the Survey)

The result of tallying responses on the content of funds currently under management showed that the ratio of “*additional acquisition type*” in the fund types and the ratio of “*Development*” in management style was increasing, a result that reflects the risk-on attitude of investors (Fig. 2 and Fig. 3).

With respect to the target property types, the ratio of “*Office*” declined, while the ratio of “*Industrial*” increased substantially (Fig. 4). Investment in “*Facilities for the elderly*” was also confirmed, although it is modest, and as for target areas, it was confirmed that the ratio of all areas other than “*23 wards of Tokyo*” and “*Others*” increased (Fig. 4 and Fig. 5).

A trend of expanding areas of investment from “*23 wards of Tokyo,*” where the acquisition of properties is difficult, to other areas was observed, as was a trend of diversifying portfolio properties to those other than “*Office*” and “*Residential*” from the standpoint of investment profitability.



The survey result showed that the average target investment period of funds currently under management was 6.4 years, almost the same as the 6.5 years in the previous survey (Fig. 6). Looking at the responses (Fig. 7), the reason why the average target investment period remains almost unchanged from the previous survey despite the strong increase in the ratio of "Less than three years" is that several funds set up a long investment period of 15 or 20 years (which are counted as "Six years or more" in the tallying). Response of "At least five years but less than six years" disappeared, and the ratio of response of "Less than three years" increased significantly. As a result, the trend of diversifying the investment period according to the characteristics of funds was confirmed.

LTV remained at a level a little higher than 65% on an acquisition price basis (Fig. 9). As the greatest number of respondents answered 75%, it was assumed that funds that were leveraged beyond this level were few under the present circumstances. It was also confirmed that some funds did not raise finance from banks but made investments using equity financing only.

The result suggests that the LTV level remains stable even under a favorable financing environment.

Fig. 6 Average Target Investment Period

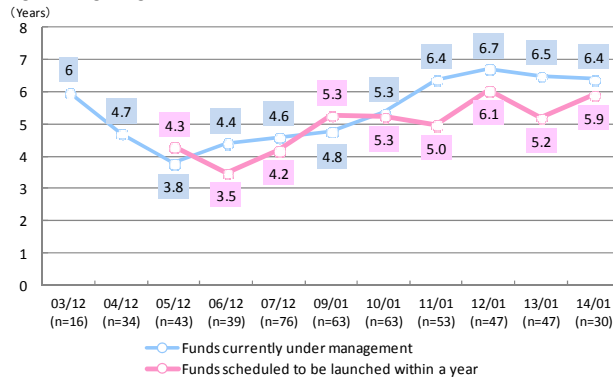


Fig. 7 Breakdown of Average Target Investment Period

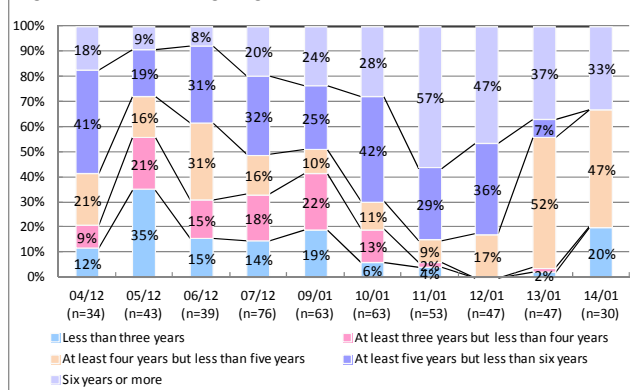


Fig. 8 Average Target Asset Size

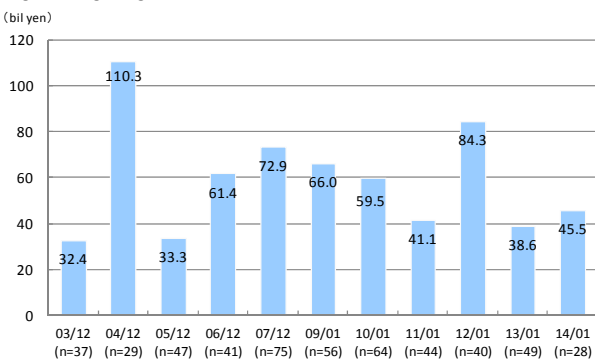


Fig. 9 Average LTV Ratio of Existing Funds

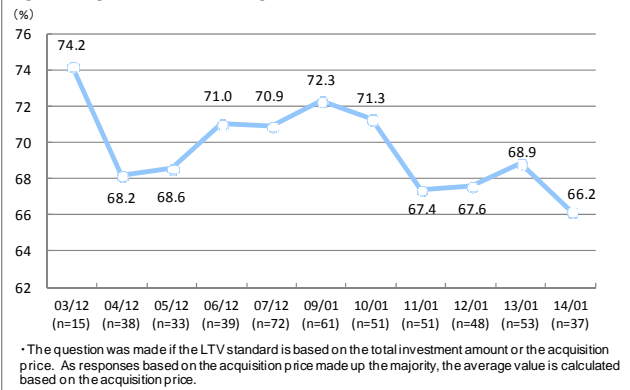
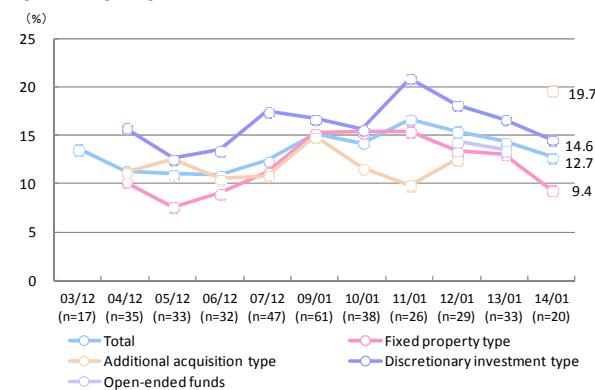


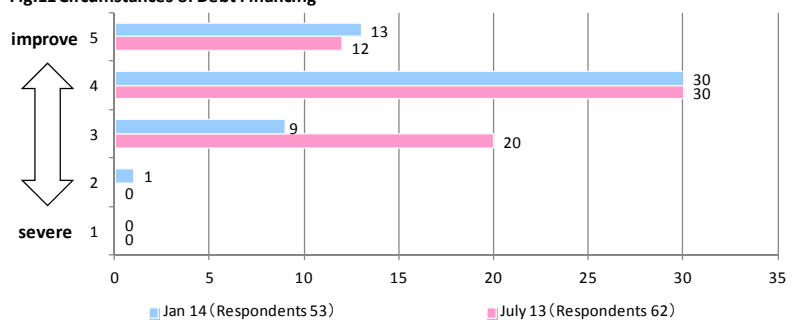
Fig. 10 Average Target IRR



3) Circumstances of Debt Financing

In a survey on the debt financing environment, most investment management companies answered “4” or “5.” (43 of 53 companies), suggesting that the number of investment management companies that believed the debt financing environment had improved from the previous survey (July 2013) increased (Fig. 11).

Fig. 11 Circumstances of Debt Financing



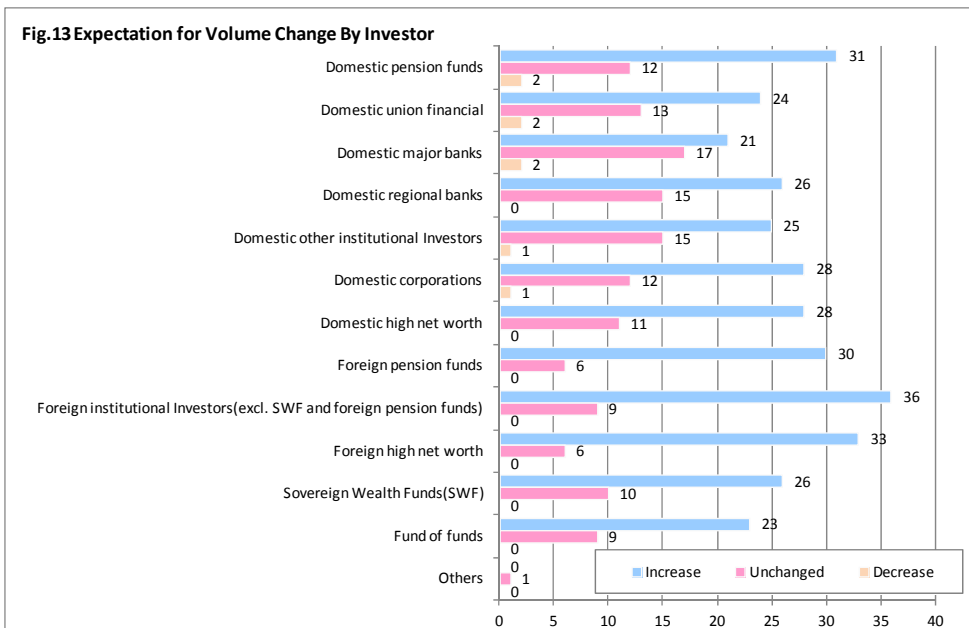
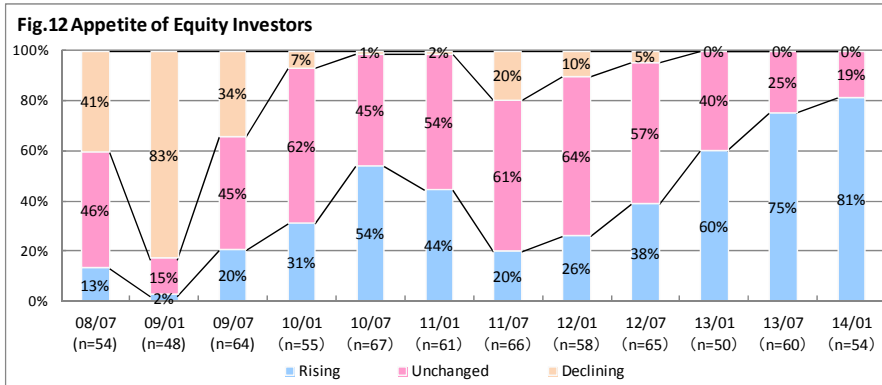
4) Circumstances of Equity Raising

a. Appetite of Equity Investors

With respect to the appetite of equity investors, as in the previous survey, no respondents answered “Declining” in the survey this time, while the ratio of responses of “Rising” increased solidly (Fig. 12).

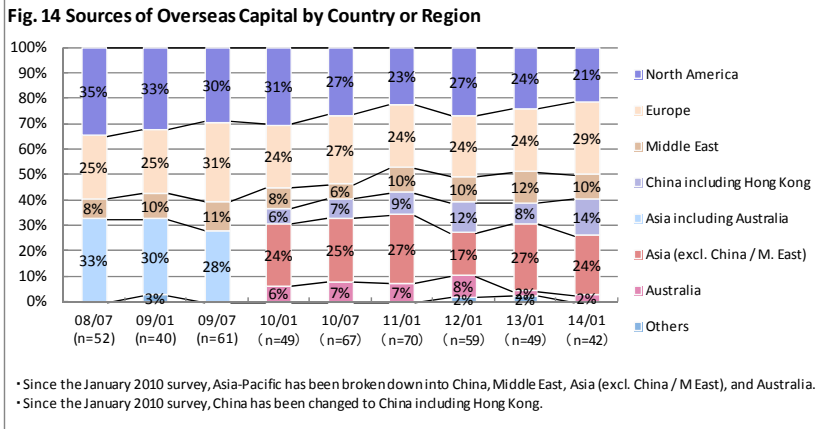
Fig. 13, which shows the numbers of equity investors considered to be increasing or decreasing their investment amount, indicates that the response that the investment amount will increase made up the majority of all attributes of equity investors.

The survey found that equity investors have a very strong appetite in Japan and overseas.



b. Sources of Overseas Capital by Country or Region

The results of a question on the location of settlors of overseas capital in investment management companies that manage the overseas capital of foreign investors shows that the ratio of “North America” declined from the previous survey while the ratio of responses of managing overseas capital from “Europe” was the largest (Fig. 14).

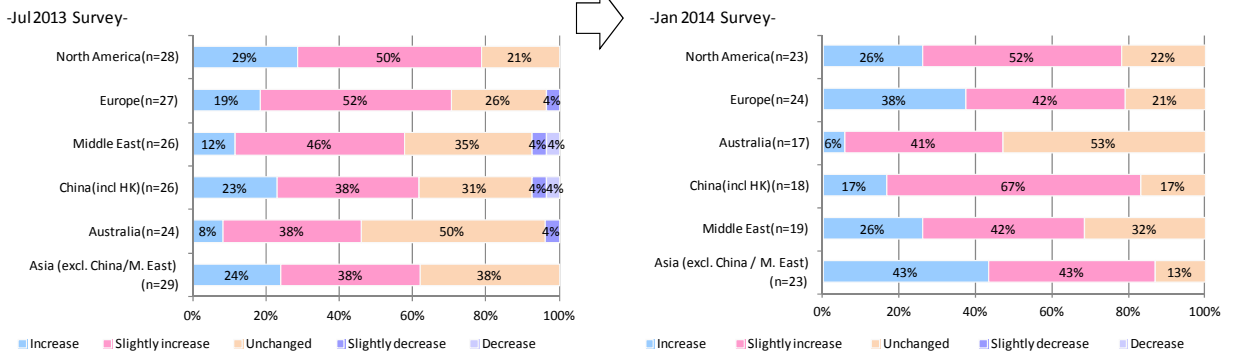


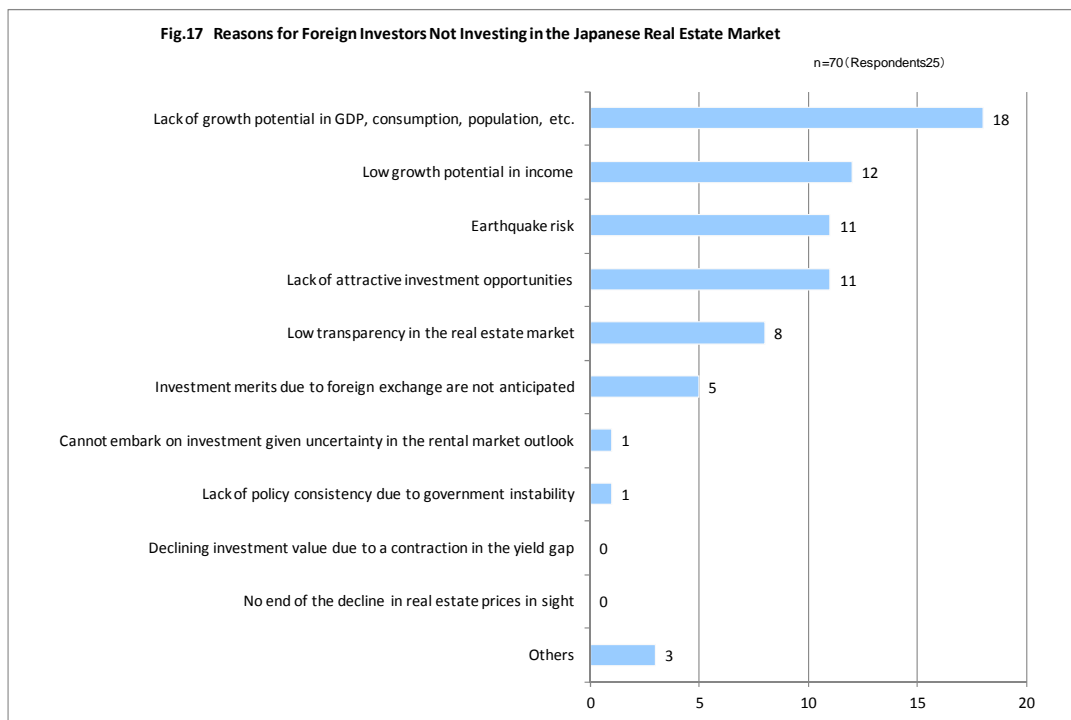
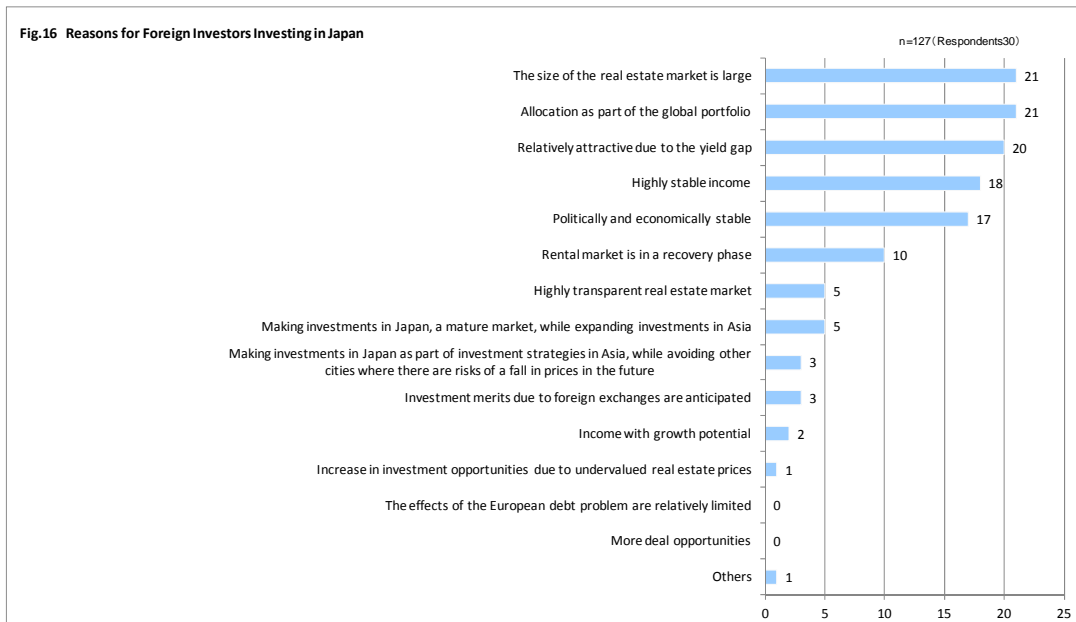
c. Expectation of Cash Inflow from Foreign Investors by Region and Reasons for Investing/Not Investing in Japan (Multiple answers allowed)

Regarding the expectation of cash inflow from foreign investors, although the responses of “Slightly decrease” and “Decrease” were often observed in the previous survey (July 2013), these responses disappeared in this latest survey. The result shows that more investment management companies than in the previous survey think that foreign investors in all areas are more willing to invest in real estate in Japan (Fig. 15).

Among the reasons for foreign investors to invest in Japan that ranked highly, many respondents pointed out economic merits such as “the large size of the real estate market,” “allocation as part of the global portfolio” and “relatively attractive due to the yield gap” (Fig. 16). As for the reasons for investors not investing in Japan, some respondents pointed out non-economic factors such as “different language” (included in “Others” in the tallying), while many respondents cited economic factors (Fig. 17).

Fig. 15 Expectation of Cash Inflow to Japanese Real Estate from Foreign Investors





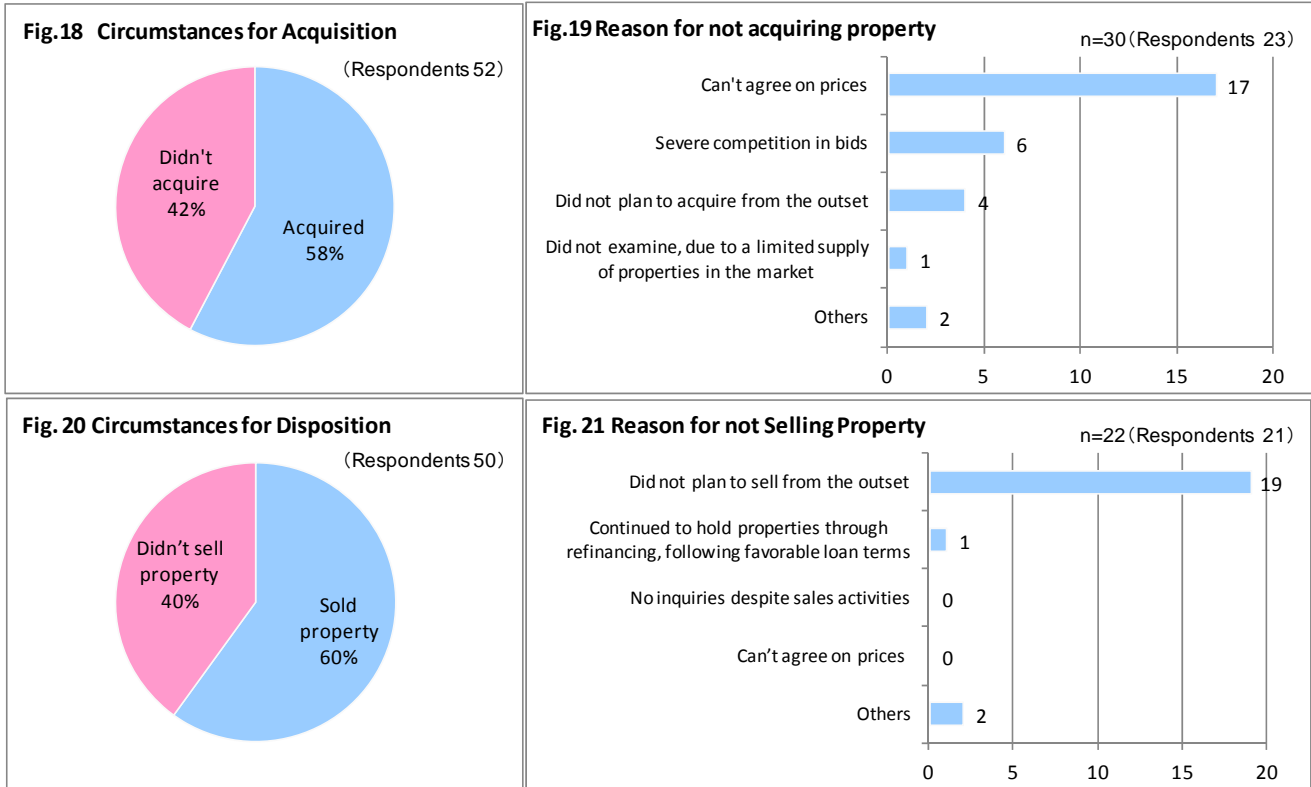
5) Circumstances for Acquisition and Disposition of Properties in the Second Half of 2013

a. Circumstances for Acquisition and Disposition of Properties in the Second Half of 2013

The result of a survey on the acquisition and disposition of properties from July 2013 to December 2013 is as follows (Fig. 18 and Fig. 20):

As the reason for not acquiring property, the largest number of respondents indicated “*Can’t agree on prices*” followed by “*Severe competition in bids,*” and investment management companies said that the environment for acquiring properties was difficult (Fig. 19).

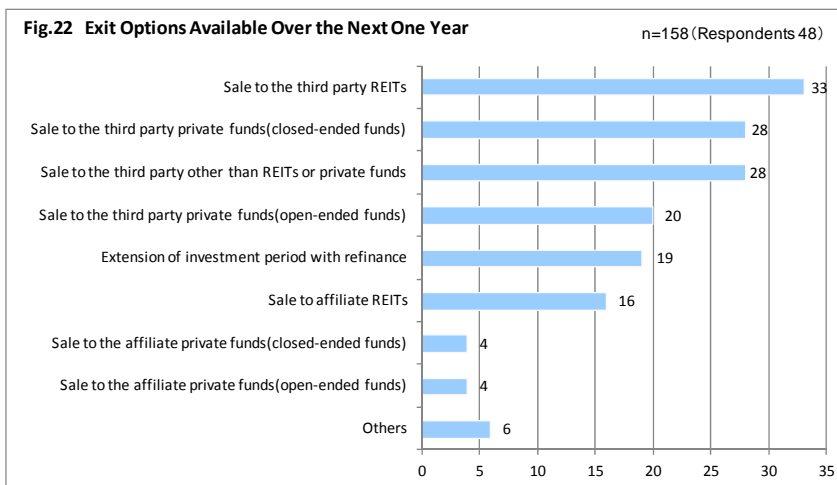
As the reason for not selling property, although many respondents selected “*Did not plan to sell from the outset,*” some answered “*Continued to hold properties through refinancing, following favorable loan terms,*” indicating a significant move by some funds to invest in properties with a flexible approach (Fig. 21).



b. Exit Options Available Over the Next One Year (Multiple answers allowed)

In the question asking what options are likely to be taken over the next year as an exit strategy for the fund, the greatest number of respondents answered “Sale to a third-party REIT,” confirming that many investment management companies assume that REITs have a strong capacity to acquire properties at present (Fig. 22).

There are a certain number of responses of “Sale to a third party other than a REIT or private fund,” suggesting that investment management companies think that there are a variety of potential purchases under the present conditions.



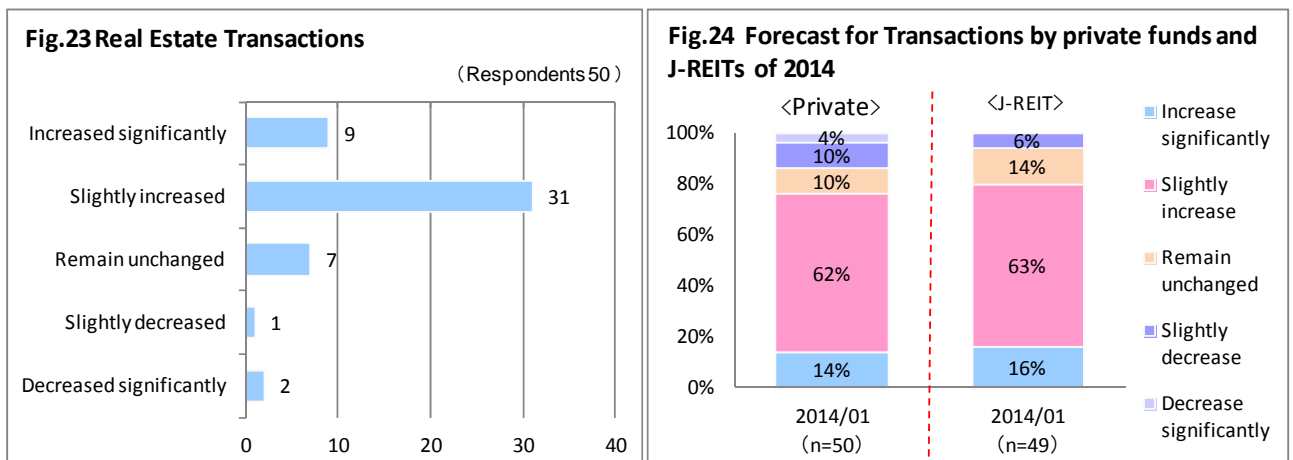
2. Status of the Investment Real Estate Market and Efforts of Investment Management Companies

1) Real Estate Transaction Activity from July 2013 to December 2013 and Forecasts

In a question on real estate transaction volume from July 2013 to December 2013, “Increased significantly” and “Slightly increased” accounted for 80% of all responses, indicating that investment management companies that increased their real estate transaction volume accounted for the majority (Fig. 23).

In a question on forecasts for the real estate transaction volume of private funds and J-REITs in 2014, many investment management companies expected that real estate transactions would be pick up in both private funds and J-REITs (Fig. 24).

In 2014, as real estate transactions are likely to be active, especially in private funds and J-REITs, competition among market players is expected to remain severe, particularly in the acquisition of properties.



2) Future Efforts for Real Estate Investment

a. Target Property Types in the Future (Multiple answers allowed)

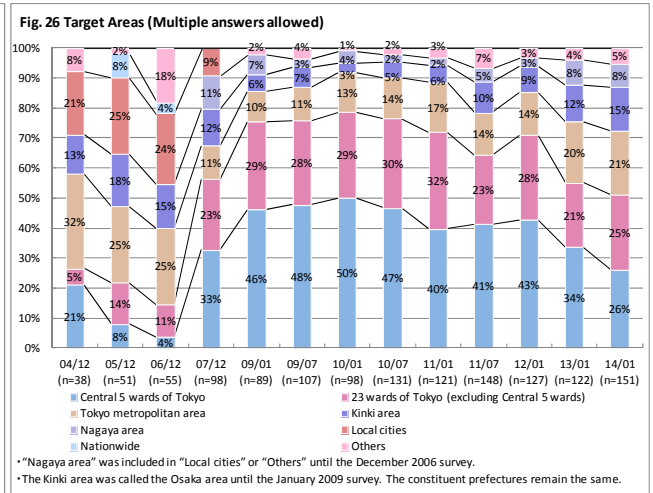
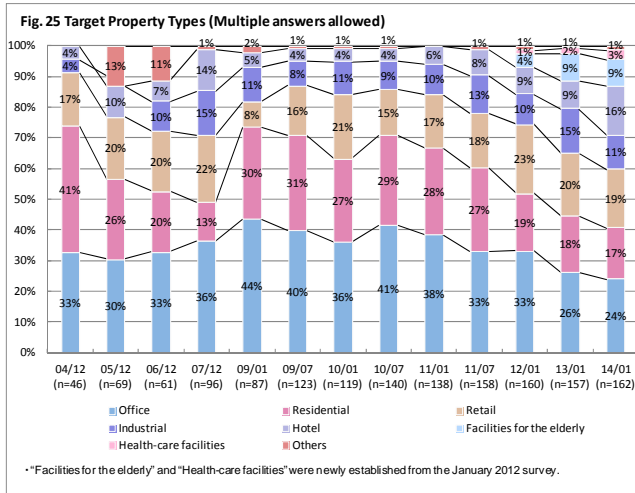
In a question on target property types in the future as an effort for real estate investment, the ratio of responses of “Hotel” increased, while the ratio of responses of “Retail” was the second highest after “Office” but higher than “Residential” (Fig. 25). Real estate types such as “Hotel” and “Retail,” which tend to be linked to business confidence appear to be selected by investment management companies.

In addition, as in the previous survey, some investment management companies answered “Facilities for the elderly,” in anticipation of higher demand in the future, confirming the existence of investment management companies that continue to be interested in healthcare assets.

b. Target Areas in the Future (Multiple answers allowed)

A question on target areas in the future as an effort for real estate investment suggests the tendency of many investment management companies to expand investment areas to secure investment profitability, as multiple investment management companies answered areas other than the “Central 5 wards of Tokyo” and “23 wards of Tokyo (excluding Central 5 wards)” (Fig. 26).

In addition, among the responses of “Others,” a number of investment management companies gave “Fukuoka” as a specific area, indicating a high degree of attention and interest directed at this area.

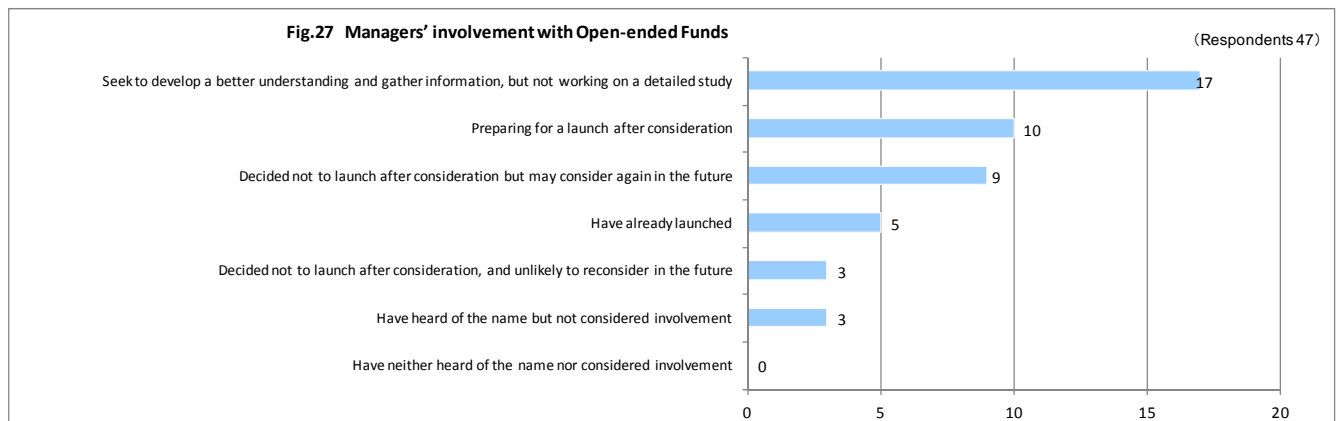


3. Business Environment of Private Real Estate Investment Management

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

In a question on involvement in open-ended private funds (so-called private REITs), 17 companies, the largest number of respondents, answered “Seek to develop a better understanding and gather information, but not working on a detailed study,” while 10 companies answered “Preparing for a launch after consideration.” This result suggests that interest in private REITs remained high (Fig. 27).

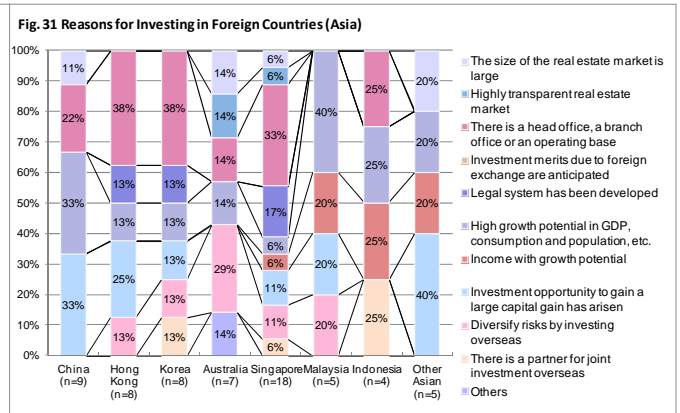
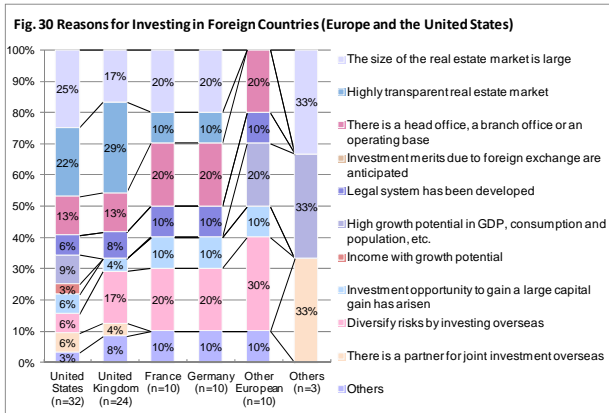
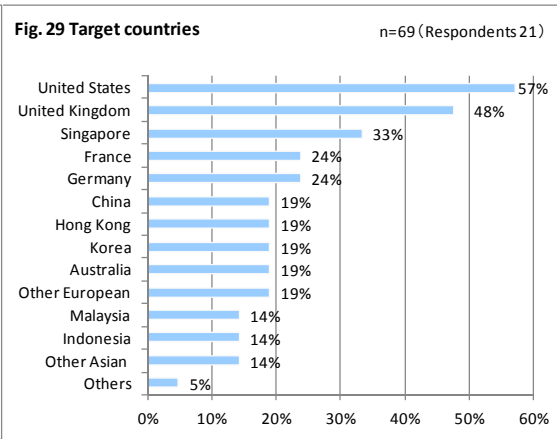
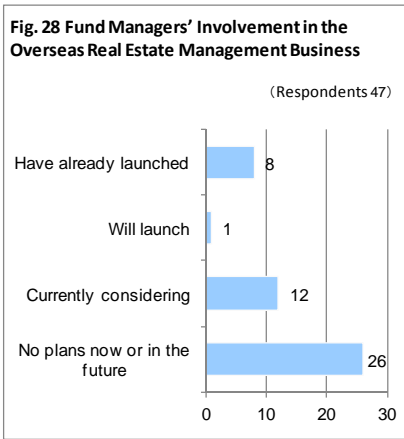
Many investment management companies pointed to high investor interest as well as the possibility of flexible investment due to the unrestricted investment period of fund as a reason for a launch or preparing for a launch. As mentioned above (refer to 1. 4) a. Appetite of Equity Investors), the strong appetite of equity investors was an impetus for the launch and the study of private REITs.



2) Fund Managers' Involvement in the Overseas Real Estate Management Business

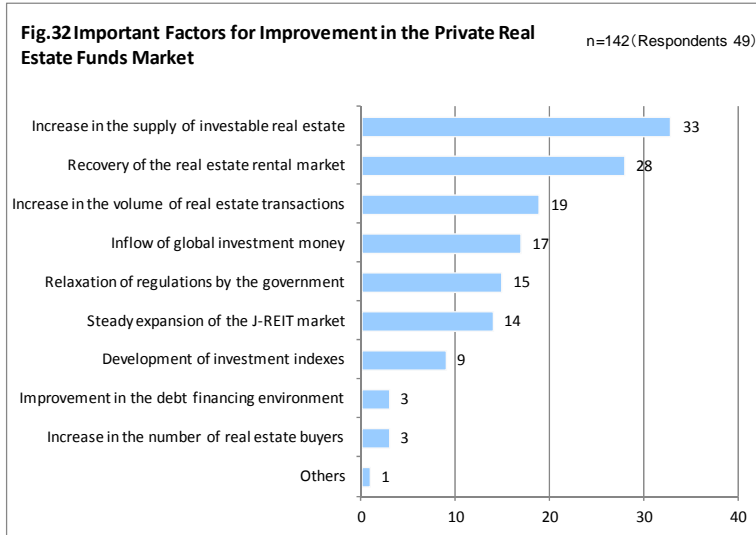
The result of a question on efforts for real estate management business targeting foreign properties is as follows (Fig. 28).

Among investment destinations selected by investment management companies that invest, plan to invest or are considering investing in foreign properties, the ratio of "United States" was the highest (Fig. 29). The investment environment, such as market size and transparency, were pointed out as the reason for investing in the United States and Europe, while economic factors such as the earning of income and capital gains were pointed out as the reason for investing in Asia, showing a contrasting result (Fig. 30 and Fig. 31).



3) Important Factors for Improvement in the Private Real Estate Funds Market (Multiple answers allowed)

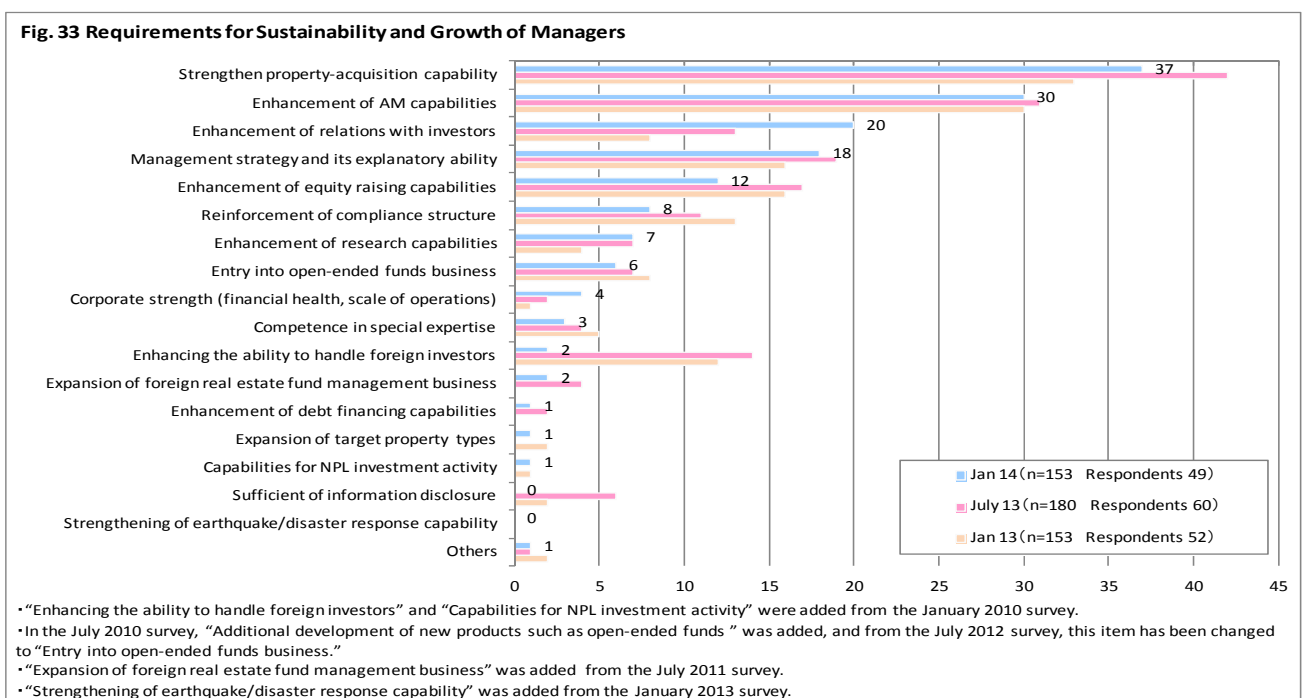
In a question on important factors for improvement in the private real estate funds market in the future, the largest number of respondents answered “Increase in the supply of investable real estate” followed by “Recovery of the real estate rental market” (Fig. 32).



4) Manager’s Requirements for Future Growth and Sustainability of their Businesses (Multiple answers allowed)

In the question on manager’s requirements for future growth and sustainability of their businesses, “Strengthening property-acquisition capability” was the most common response, as in the previous survey (Fig. 33).

As discussed above (refer to 2. 1) Real Estate Transaction Activity from July 2013 to December 2013 and Forecasts), as active real estate transactions are expected to be carried out mainly in private funds and J-REITs in 2014, the property-acquisition capability of investment management companies is likely to be focused more than ever.



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 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 private real estate funds. This does not include products governed by the Act Concerning Designated Real Estate Joint Enterprises. Commissioned AM means only the acceptance of only asset management commissioned by funds set up by other companies, without engaging in fund management.
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.
Equity commitment fund:	A type of private real estate funds in which equity is contributed in block or installments according to capital needs of the fund within the equity limit prescribed in the investment agreement. This is also called a capital call fund.
<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>	
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
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 an annual cash flow on the total investment amount.
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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