

Survey on Private Real Estate Funds in Japan

July 2014– Results

September 16, 2014

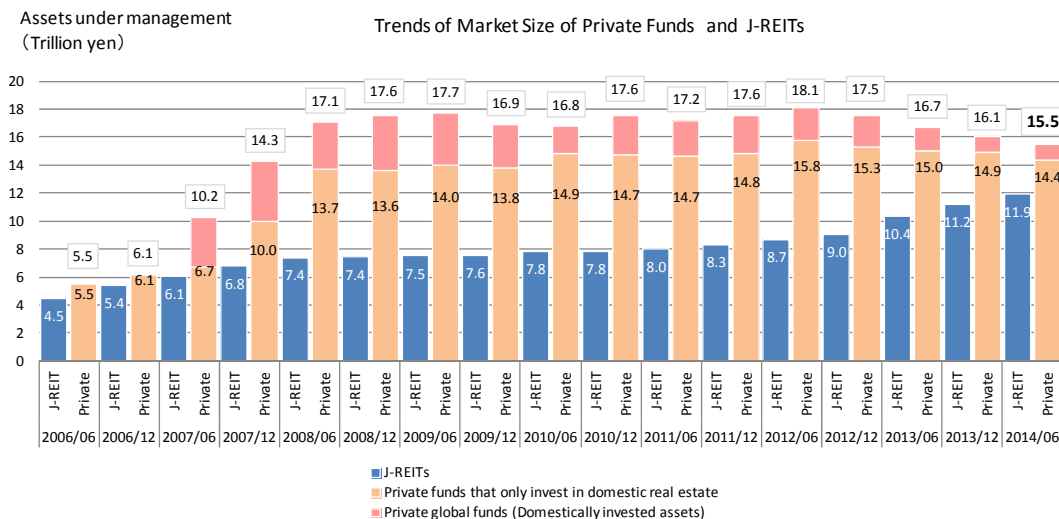
Sumitomo Mitsui Trust Research Institute Co., Ltd

- 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 18th survey based on responses to questionnaires received from 56 real estate investment management companies.
 - Survey subject: Real estate investment management companies that set up and manage private real estate funds which focused on domestic real estate
 - The number of companies to which questionnaires were sent: 111
 - The number of responses: 56 (ratio of valid responses: 50.5%)
 - Time of survey: July 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 June 2014 to be 15.5 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. The market size as of the end of December 2013 was 16.1 trillion yen, which is a decrease of approximately 570 billion yen (3.6%) over a six-month period from the previous January 2014 survey.

The market size of private real estate funds is 15.5 trillion yen including Japanese assets of global funds

- Assets under management (AUM) as of the end of June 2014 were 15.5 trillion yen, declining approximately 570 billion yen (3.6%) for half a year from the time of the previous survey. It seemed that the factor for the decline was that many investment management companies sold properties under the continuing strong real estate market.
- Most of the investment management companies, who did not acquire any properties from January to June 2014, have quoted the difference in pricing and/or severe competition in bidding as their reasons for their activities. This tells that the environment for acquiring properties remained challenging.
- This condition for acquiring properties is expected to continue. As such, we expect that investment management companies will try to purchase properties at reasonable prices, through making the most of their strengths.

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



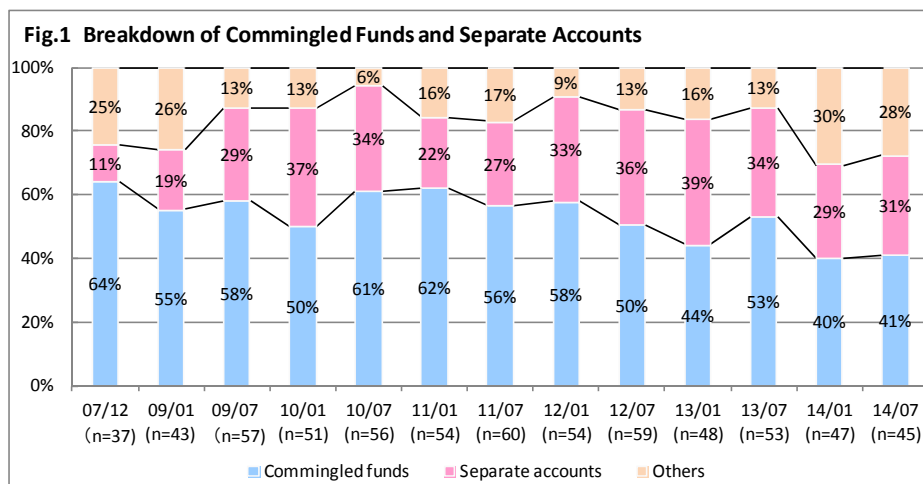
“Survey on private real estate funds” July 2014 Survey Results

(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) 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 3,131.5 billion yen (41%), while separate accounts stood at 2,408.1 billion yen (31%) (Fig. 1)

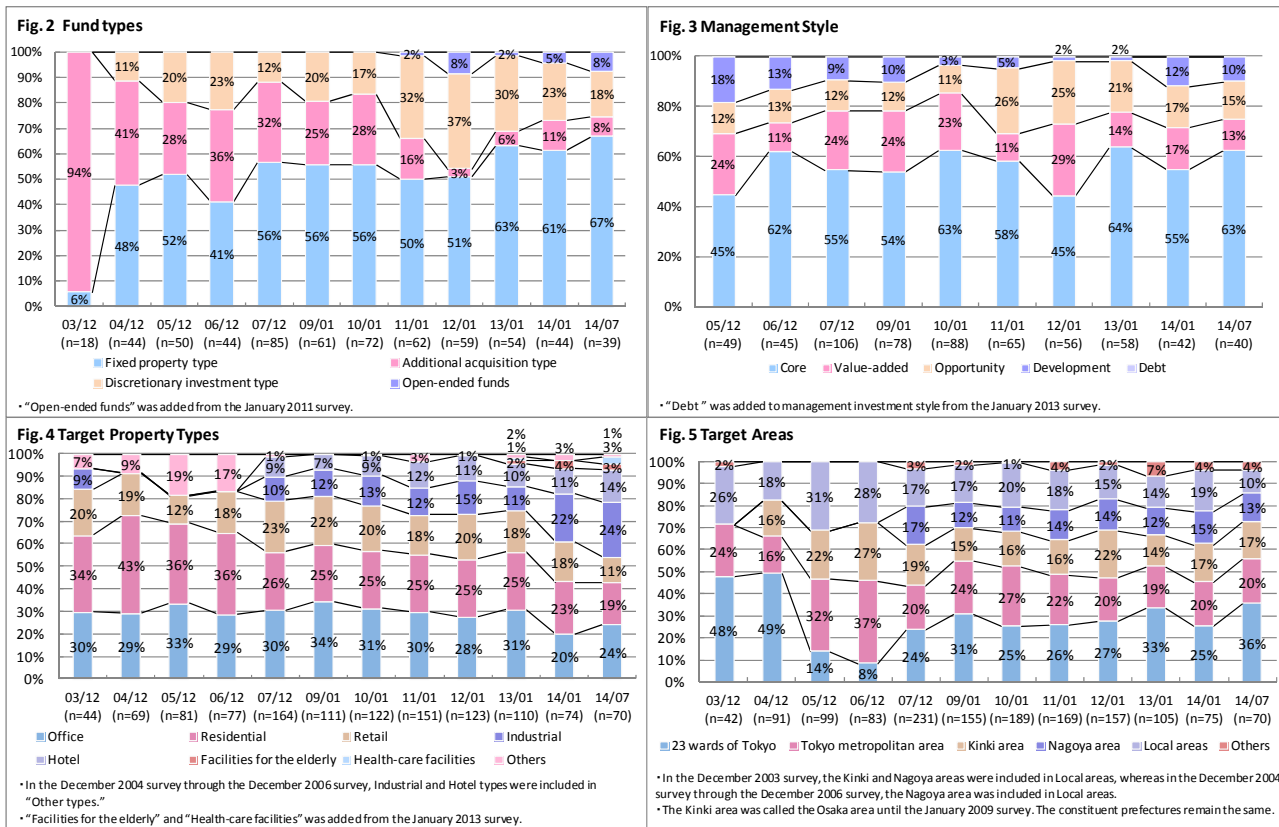


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

The results of the content of currently operating funds showed that the ratio of “*Fixed property type*” in the fund types and that of “*Core*” in management style were increasing (Fig. 2 and Fig. 3). With respect to the target property types, the ratio of “*Office*” increased (Fig. 4) while “*23 wards of Tokyo*” became more popular in terms of the targeted areas. (Fig. 5) Overall, the survey indicates that investors’ risk-on attitude, which became clear in the previous survey, changed slightly.

As for the targeted types, in addition to “*Office*”, the ratio of “*Industrial*” and “*Hotel*” went up marginally. This seems to reflect the current business sentiment and preference of the anticipation of demand associated with increasing numbers of tourists due to the Tokyo Olympics, among other factors.

Although the ratio is still small, investment in “*Facilities for the elderly*” and “*Health-care facilities*” was also confirmed.



The average target investment period of funds currently under management was 6.1 years and those of the funds scheduled to be launched within a year was 5.9 years (Fig. 6). A six-year is becoming the mainstream management period.

The average target asset size of funds under management was 33.2 billion yen, decreased from the previous survey. We believe that the main reason for this is, as described above, that the ratio of the funds having fixed properties was rising (Fig. 2) and they are relatively small.

LTV remained at a level a little higher than 65% on an acquisition price basis (Fig. 9), there is no change in the trends in the levels below 70% the past few years. The largest number of respondents answered 75%, as in the previous survey, it is likely that few funds have more leverage than this level under the present circumstances. It was also confirmed that some funds financed their investment by equity only and not raised debt from the banks. The LTV level remains stable even in a favorable financing environment and we expect it will continue in the foreseeable future.

Fig. 6 Average Target Investment Period

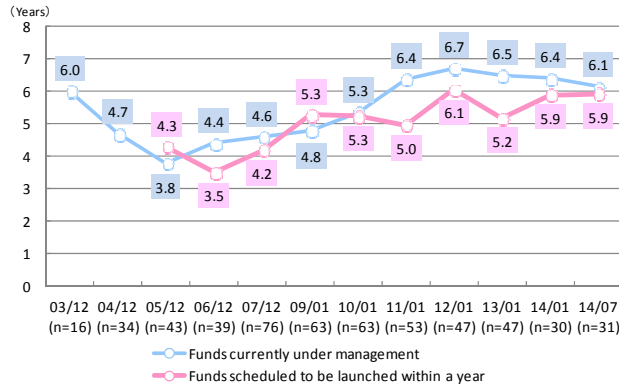


Fig. 7 Breakdown of Average Target Investment Period

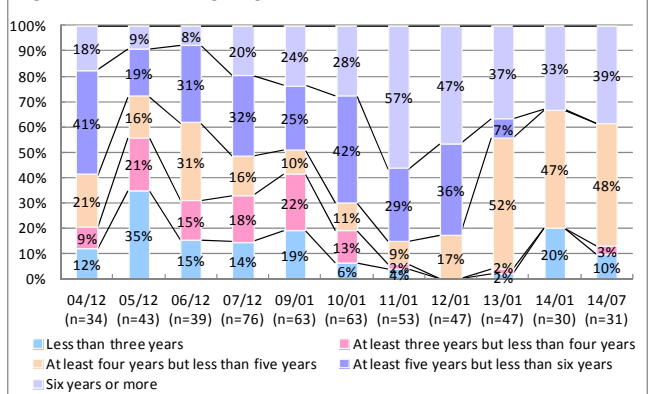


Fig. 8 Average Target Asset Size

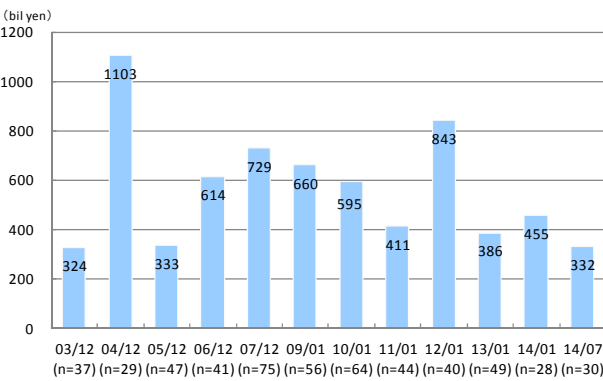
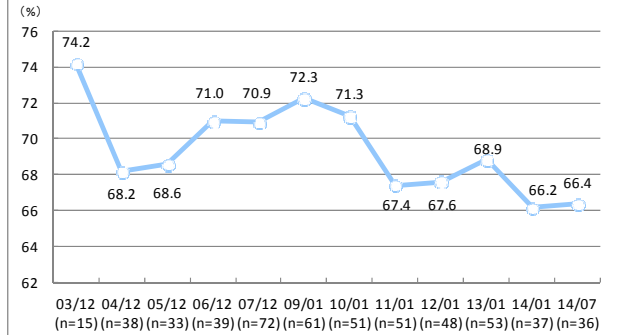
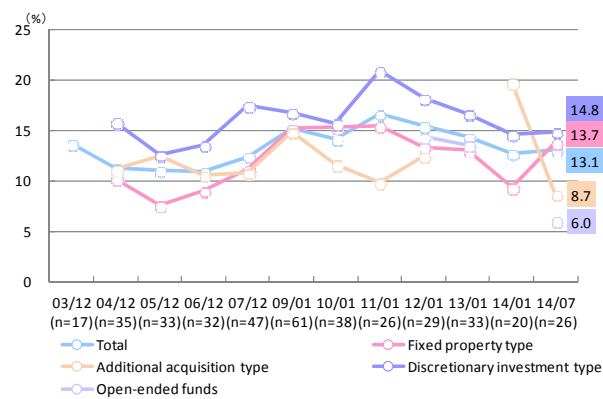


Fig. 9 Average LTV Ratio of Existing Funds



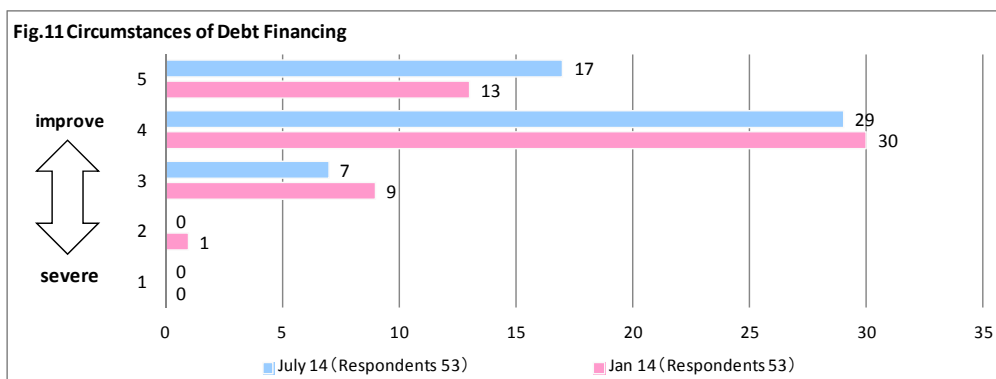
* The question was made if the LTV standard is based on the total investment amount or the acquisition price. As responses based on the acquisition price made up the majority, the average value is calculated based on the acquisition price.

Fig. 10 Average Target IRR



3) Debt Finance

Regarding debt financing, most of the investment management companies selected either “4” or “5” from the choices. (46 of 53 votes) Also, the number of respondents that chose “5” increased from the previous January 2014 survey, which showed more companies believed the debt environment has improved (Fig. 11).



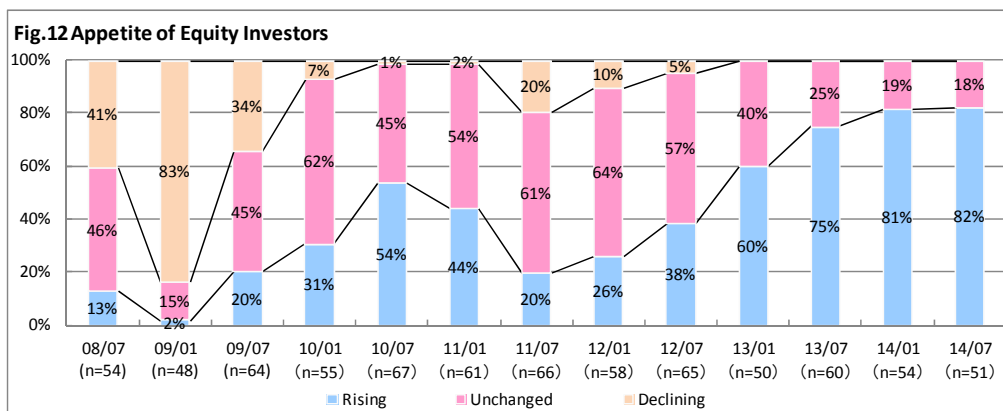
4) Equity Raising

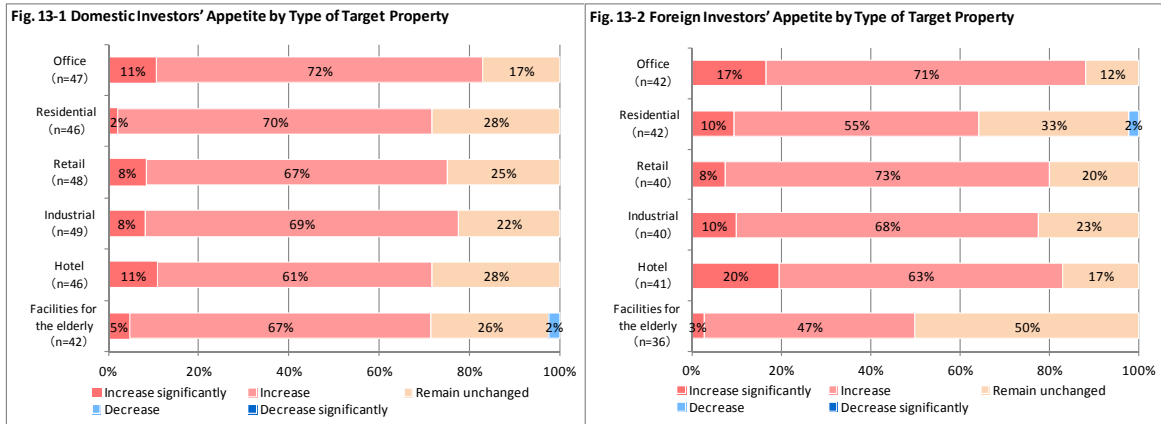
a. Appetite of Equity Investors

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)

As to the property type, that is considered (by respondents) to be chosen by the equity investors, Office accounted for 83%, Industrial, Retail for 78% and 75% respectively in the total of “Increase” and “Increase Significantly” for the Domestic investors. On the other hand, as for Foreign investors, Office accounted for 88%, Hotel, Retail 83% and 81% respectively. (Fig. 13-1, Fig.13-2)

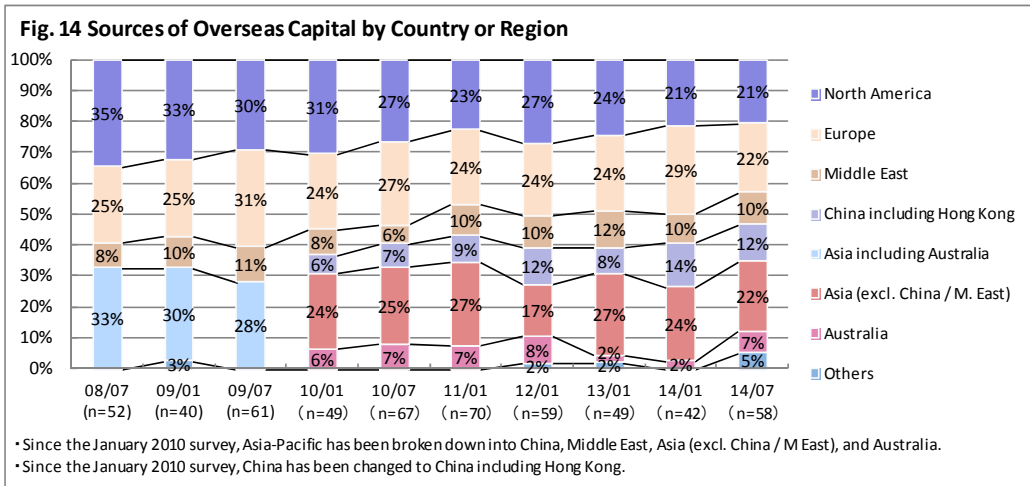
The increase in the appetite to invest in Hotel is believed to reflect the increasing number of foreign tourists, among other factors. We will pay attention to changes in the appetite to invest in commercial facilities in association with the trend in consumer spending after the consumption tax hike.





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

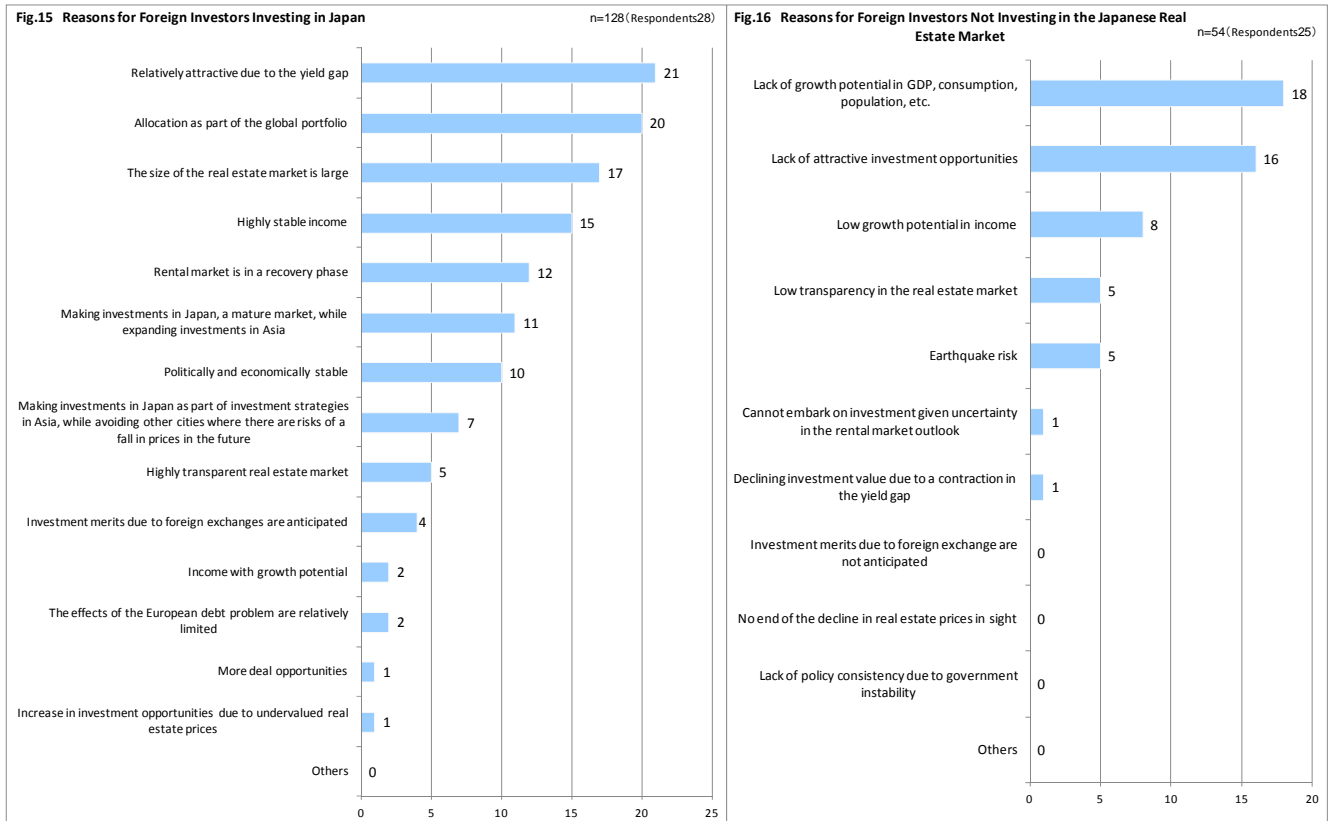
With respect to the sources of overseas capital in investment management companies that manage the overseas capital of foreign investors, the ratio of “Europe” decreased slightly from the previous survey, while the other ratio of responses remain unchanged (Fig. 14).



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

As for the reasons for investors investing in Japan, many respondents pointed out economic factors and investment environment such as “Relatively attractive due to the yield gap”, “Allocation as part of the global portfolio”, “The size of the real estate market is large,” and “Highly stable income” (Fig. 15).

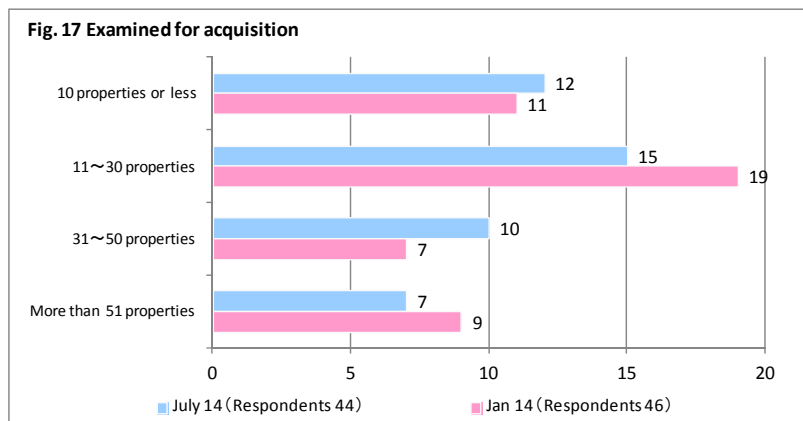
Majority of the respondents chose “Lack of growth potential in GDP, consumption, population, etc” and “Lack of attractive investment opportunities” as the reasons for not investing in Japan, (Fig. 16).



2. Status of the Investment Real Estate Market and Investment Strategies of Managers

1). Acquisition and Disposition of Properties in the January to June 2014

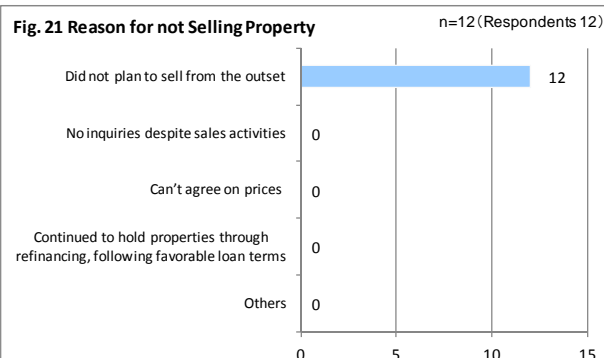
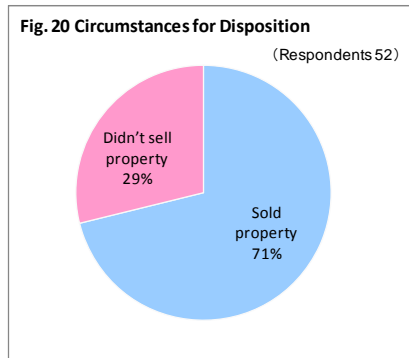
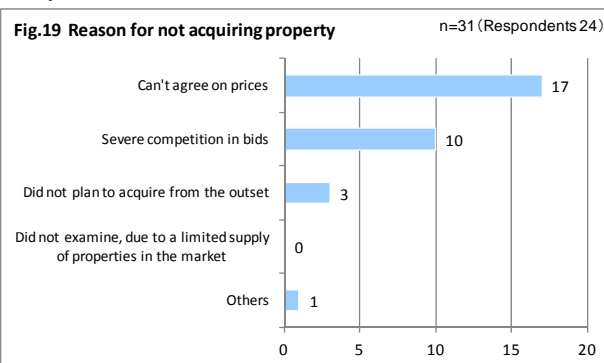
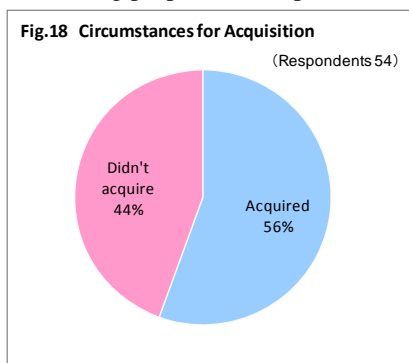
With respect to the number of the properties that companies had considered to acquire (ex. verification of profitability), as in the previous survey, the largest number of respondents answered “11~30”, followed by “10 or less”, and the other ratio of respondents remain unchanged (Fig. 17).



The result of a survey on the acquisition and disposition of properties in the January to June 2014 is as follows (Fig. 18 ~ Fig. 21). More than half of the respondents answered that they had acquired properties (Fig. 18). As the reason for not acquiring properties, the largest number of respondents chose “Can’t agree on prices” followed by “Severe competition in bids” (Fig. 19). These responses showed that the environment for acquiring properties was severe for many companies not acquiring properties, as in the previous survey.

Meanwhile, as to circumstances for disposition of properties, many respondents answered that they had sold properties (Fig. 20). As to the reason for not selling property, all respondents answered “Did not plan to sell from the outset,” (Fig. 21)

It is highly likely that the environment for acquiring properties is expected to remain challenging, while those for selling properties is expected to be easy in the future.



2). Investment Strategies of Managers

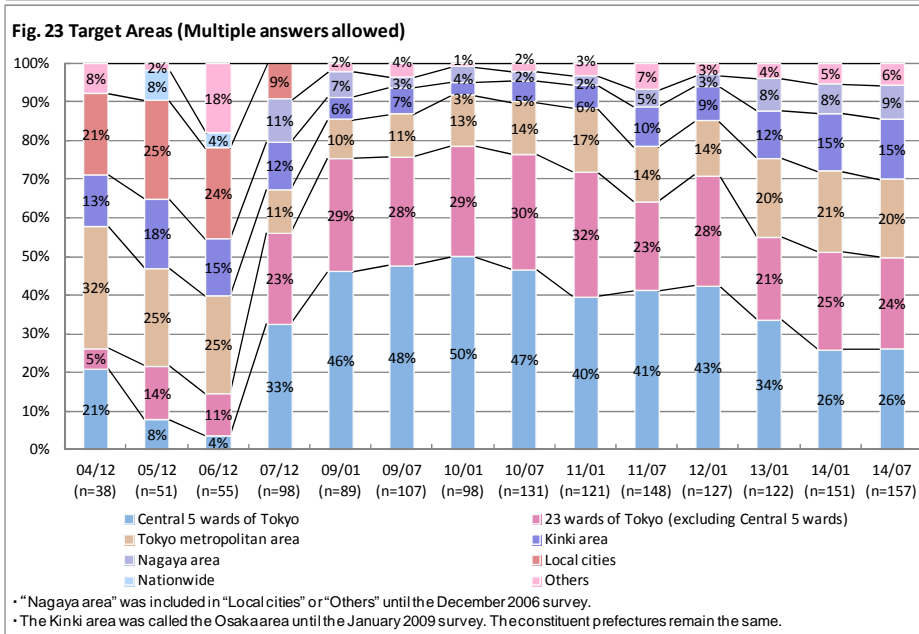
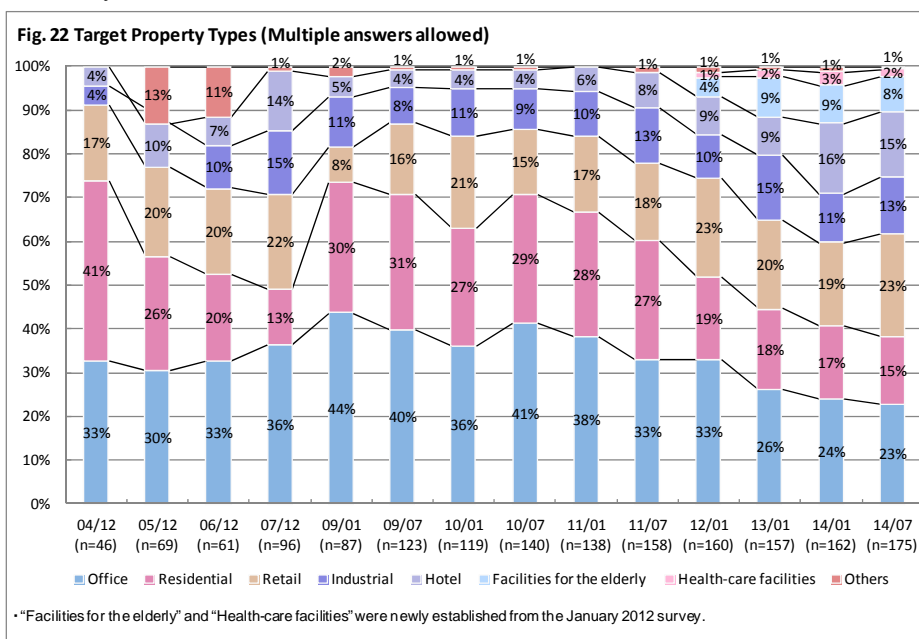
a. Target Property Types (Multiple answers allowed)

With respect to the target property types, the ratio of “Retail” and ”Industrial” increased, while the ratio of “Office” and “Residential” continued to decrease. As in the previous survey, the responses of “Hotel” and “Facilities for elderly ” accounted for a certain ratio, the overall ratio of the target property types has not changed significantly from the previous survey (Fig.22).

b. Target Areas (Multiple answers allowed)

With respect to the target area, the total ratio of “Central 5 wards of Tokyo” and “23 wards of Tokyo (excluding Central 5 wards)” accounted for 50%, overall ratio remain unchanged from the previous survey(Fig.23).

However, regarding at the transition from the January 2012 survey, the total ratio of “Central 5 wards of Tokyo” and “23 wards of Tokyo (excluding Central 5 wards)” decreased, while the total ratio of the other area increased. There seems that the real estate investment in regional areas gradually attracts more attention, chiefly for securing profitability in investment.



3. Business Environment of Private Real Estate Investment Management

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

Regarding involvement in open-ended private funds (so-called private REITs), 20 companies, the largest number of respondents, answered “Seek to develop a better understanding and gather information, but not working on a detailed study,” (Fig. 24).

Meanwhile, 6 companies answered “Preparing for a launch after consideration.” This result suggests that the numbers of Private REITs would increase reflecting strong appetite of equity investors (Fig. 25-1). On the other hand, as the reason of not establishing Private REITs, the largest number of respondents answered “Decided that acquiring properties constantly is difficult” (Fig. 25-2).

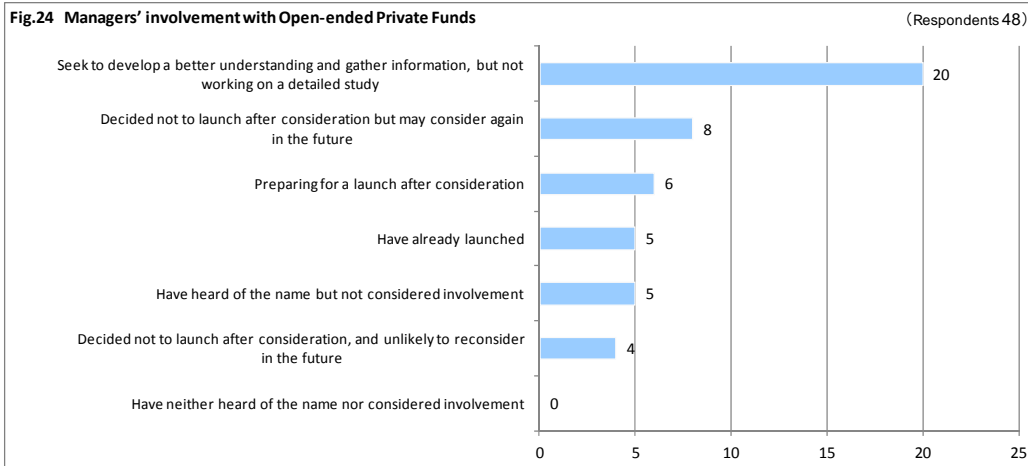


Fig.25-1 Reason for Having Established Open-Ended Private Funds (choosing up to three options)

This question is only for companies that chose “Have already launched” or “Preparing for a launch after consideration” to the question about Managers' Involvement with Open-ended Private Funds (the graph above).

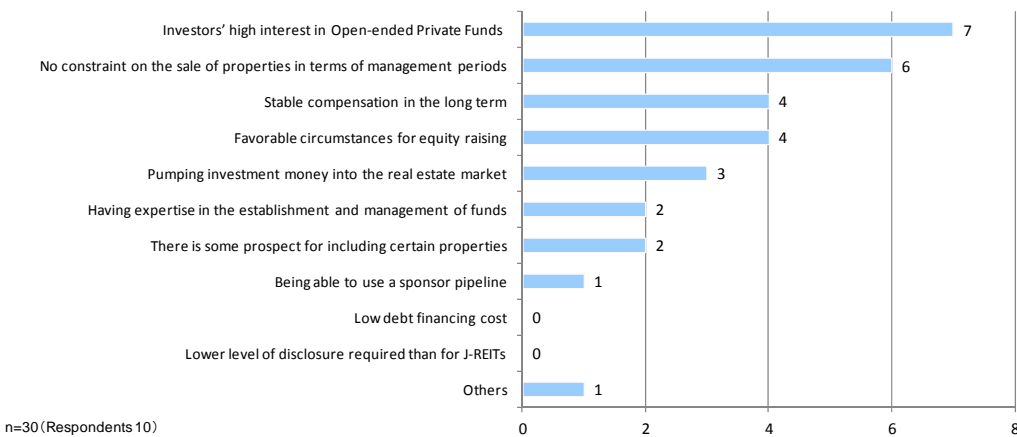
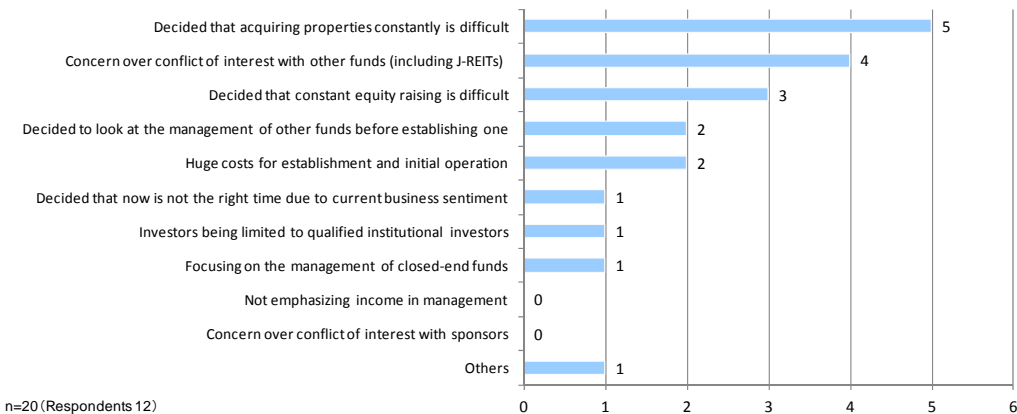


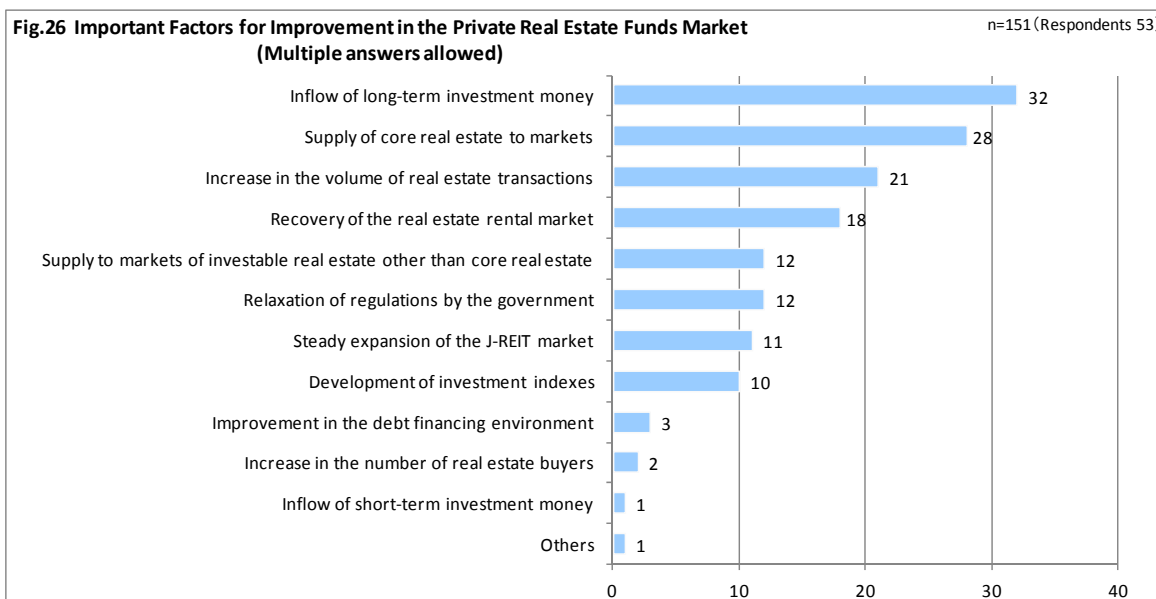
Fig.25-2 Reason of Not Establishing Open-Ended Private Funds(choosing up to three options)

This question is only for companies that chose “Decided not to launch after consideration but may consider again in the future” or “Decided not to launch after consideration, and unlikely to reconsider in the future” to the question about Managers' Involvement with Open-ended Private Funds (the graph above).



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

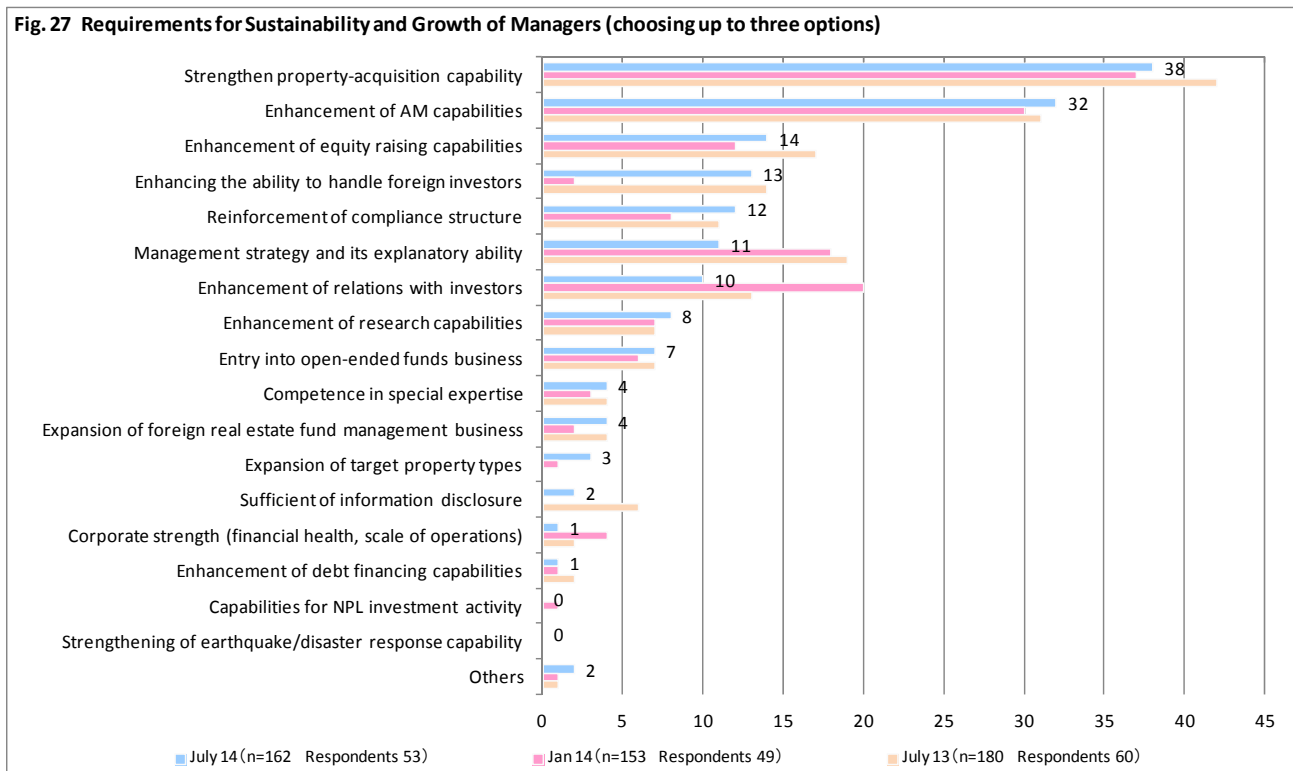
With respect to important factors for improvement in the private real estate funds market in the future, the largest number of respondents answered “*Inflow of long-term investment money*”, followed by “*Supply of core real estate to markets*”, “*Increase in the volume of real estate transactions*” (Fig.26).



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

The most common answer to the question regarding requirements for future growth and sustainability of their businesses was “*Strengthening property-acquisition capability*”, as in the previous survey (Fig. 27).

As discussed above (refer to 2. 1), the condition for acquiring properties is expected to continue. As such, we expect that investment management companies will try to purchase properties at reasonable prices, through making the most of their strengths.



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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