SUMITOMO MITSUI TRUST RESEARCH INSTITUTE

NEWS RELEASE

Survey on Private Real Estate Funds in Japan

January 2015– Results

March 17, 2015

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 19th survey based on responses to questionnaires received from 56 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: 110
  - The number of responses: 56 (ratio of valid responses: 50.9%)
  - Survey period: January 2015
  - 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 2014 to be 15.1 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. The market size as of the end of June 2014 was 15.5 trillion yen, which means a decrease of approximately 360 billion yen (2.3%) over a six-month period from the previous June 2014 survey.

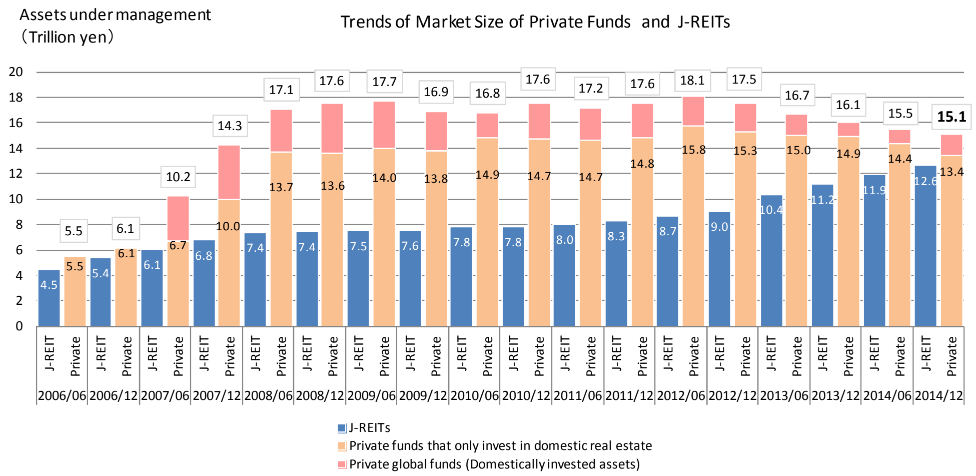
The market size of private real estate funds is 15.1 trillion yen including Japanese assets of global funds

・Assets under management (AUM) as of the end of December 2014 were 15.1 trillion yen, declining approximately 360 billion yen (2.3%) for half a year after the last survey.

・While domestic private real estate funds shrank, the market was supported by an increase in global private funds based chiefly on overseas funds. We have found that there are a number of overseas investors that are attracted to the yield gap in the Japanese real estate market and those are willing to allocate funds to real estate in Japan in their global portfolios.

・Since the survey at the end of December 2012, the market size of private real estate funds has been shrinking. Although acquiring properties in the real estate trading market remains difficult, a number of asset managers are planning to acquire properties within a year or to set up their funds. Against this backdrop, the market of private real estate funds is expected to grow.

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



" Survey on private real estate funds" January 2015 Survey Results

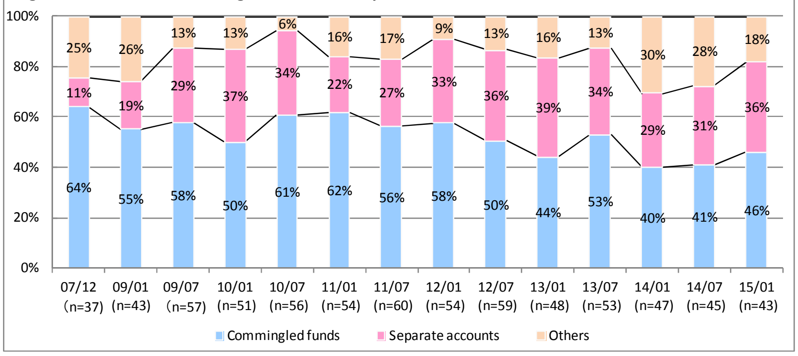
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

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 3,164.9 billion yen (46%), while separate accounts at 2,468.0billion yen (36%) (Fig.1)

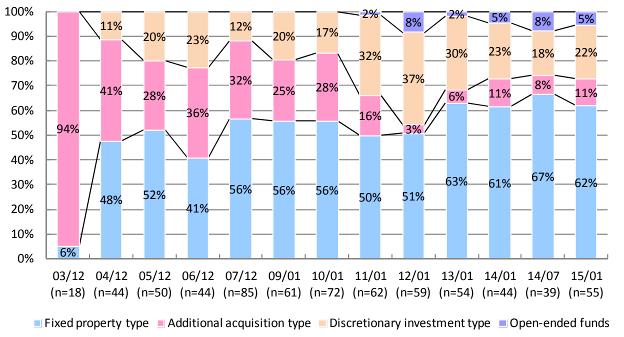
Fig.1 Breakdown of Commingled Funds and Separate Accounts



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

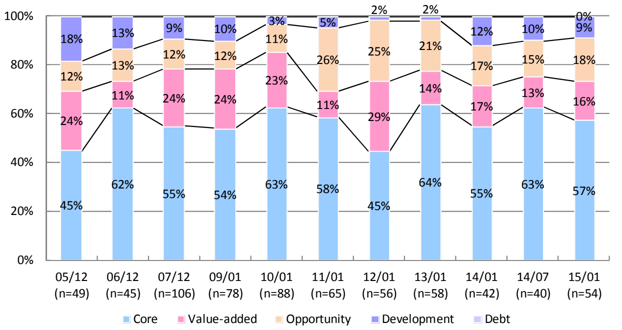
The response from the currently operating funds showed that "fixed asset type," by fund type and "core" by management style continued to have a majority. (Fig.2 and Fig.3) By target property type, the share of "office" and "residential," the two major types of investment properties, declined (Fig.4). In terms of the targeted area,"23 wards of Tokyo" fell (Fig.5) its share. Overall, the asset managers have tried to manage the funds that will likely achieve their planned cash flows as expected but the availability of the properties which would meet their target is forgather limited. Thus, in our view, competition for acquiring those properties is intensifying and they are expanding their investment scope nations and are investing in operational assets and properties in the local cities.

Fig. 2 Fund types



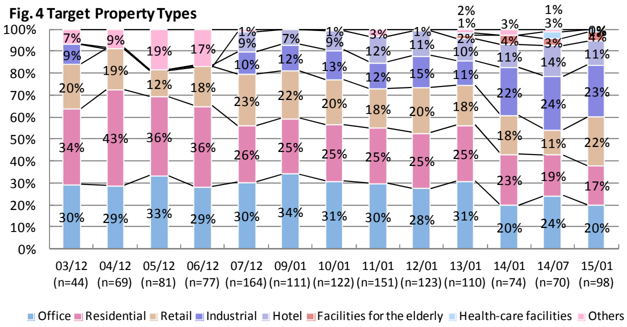
・"Open-ended funds" was added from the January 2011 survey.

Fig. 3 Management Style



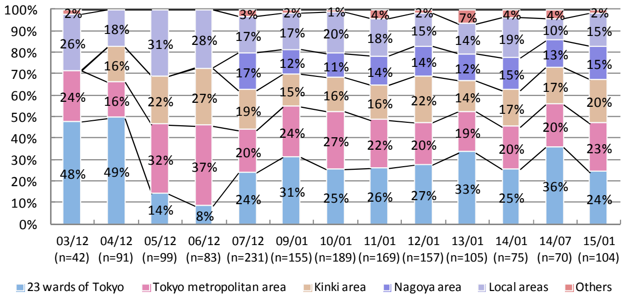
・"Debt" was added to management investment style from the January 2013 survey.

Fig. 4 Target Property Types



・In the December 2004 survey through the December 2006 survey, Industrial and Hotel types were included in "Other types."
・"Facilities for the elderly" and "Health-care facilities" was added from the January 2013 survey.

Fig. 5 Target Areas



・In the December 2003 survey, the Kinki and Nagoya areas were included in Local areas, whereas in the December 2004 survey through the December 2006 survey, the Nagoya area was included in Local areas.

The average investment period of the funds currently under management was 7.7 years and the targeted investment period of the funds scheduled to be launched within a year was 6.9 years (Fig.6). These results show that investment periods were getting longer in general.

The average target fund size of the funds under management was 55.1 billion yen, increased from the previous survey (33.2 billion yen) (Fig.8). Compared with the previous survey (July 2014), the percentages of "additional acquisition type" and "discretionary investment type" rose (Fig.2), and we assume that this rise is one of the reasons of the increase in the average target fund size.

LTV remained at a level a little higher than 65% on an acquisition price basis (Fig.9).There was no significant change in this survey. It was also confirmed that some funds financed their investment by equity only and no debt raised from the banks. We believe that the number of the funds having large amounts of loan is small and the trend to manage investment at a stable LTV will continue for some time to come.

Fig. 6 Average Target Investment Period

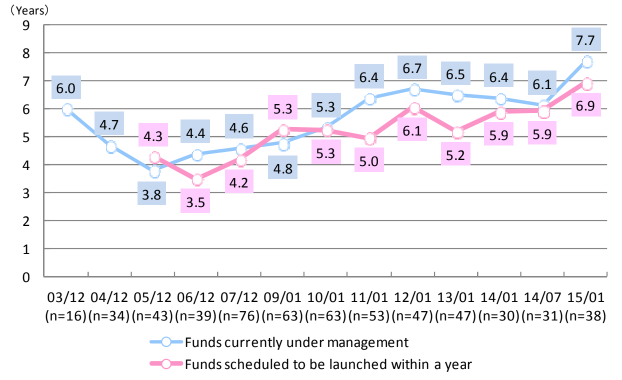


Fig. 7 Breakdown of Average Target Investment Period

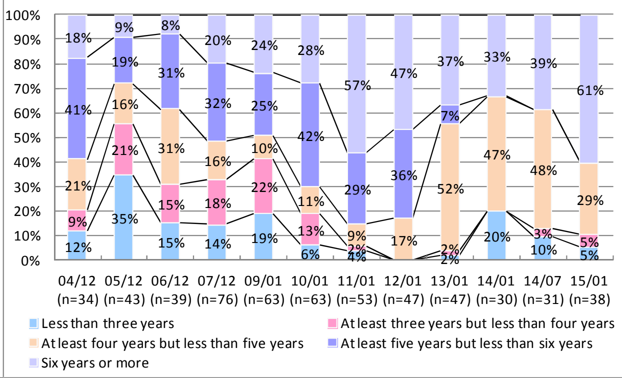


Fig. 8 Average Target Asset Size

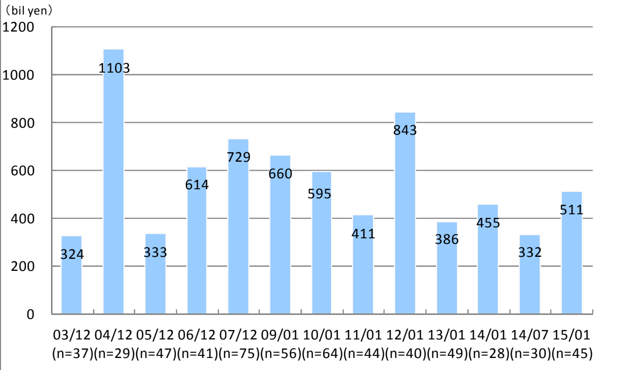
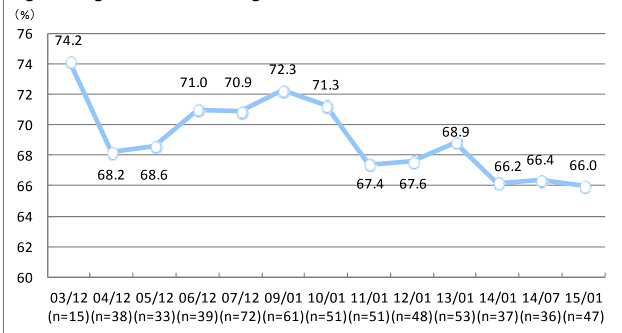
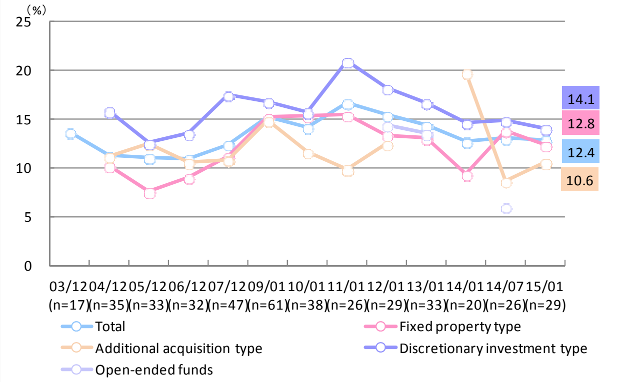


Fig. 9 Average LTV Ratio of Existing Funds



・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.

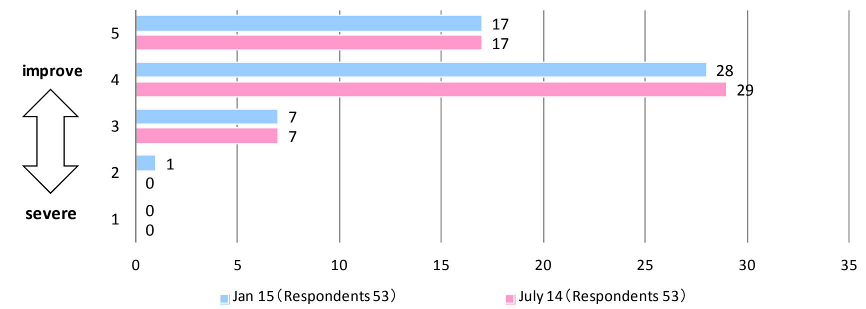
Fig. 10 Average Target IRR



3) Debt Finance

Regarding debt financing, most of the asset managers selected either "*4*" or "*5*" from the choices (45 of 53 votes). The distribution of responses was roughly the same as in the previous survey (July 2014), and the debt financing environment seems to remain favorable for the managers (Fig.11).

Fig.11 Circumstances of Debt Financing



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 "no change" increased. This suggests that a number of the asset managers that chose "no change" thought that investors' appetite remained strong (Fig.12).

As to the property type, the equity investors seem to prefer the hotel sector best and the sector had the highest percentage responding with "increase significantly" for both domestic and foreign investors. (Fig.13-1, Fig.13-2). In the last survey (July 2014), the office had the highest percentage of the responses "increase significantly" and "increase" for both domestic and foreign investors. In this survey, however, the percentage remained high, 77% (88% in the previous survey), for overseas investors, but declined to 56% (83% in the previous survey) for domestic investors. We consider that competition for acquiring offices and residential properties, the main property types, is intensifying and therefore increasing numbers of investors are interested in hotels and facilities for the elderly.

Fig.12 Appetite of Equity Investors

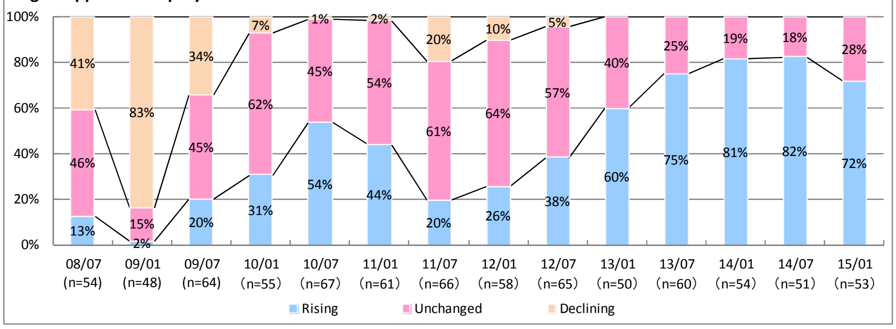


Fig. 13-1 Domestic Investors' Appetite by Type of Target Property

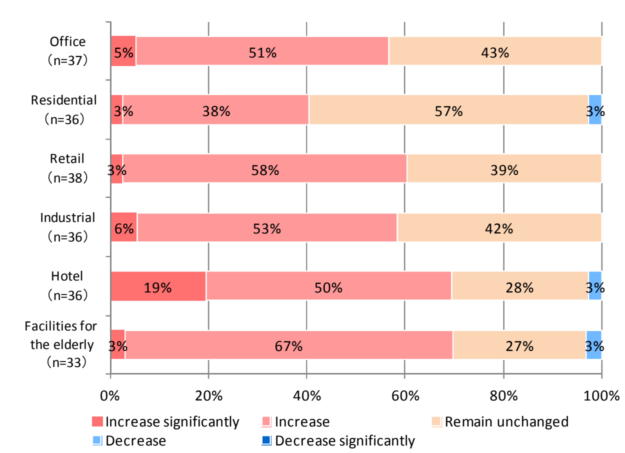
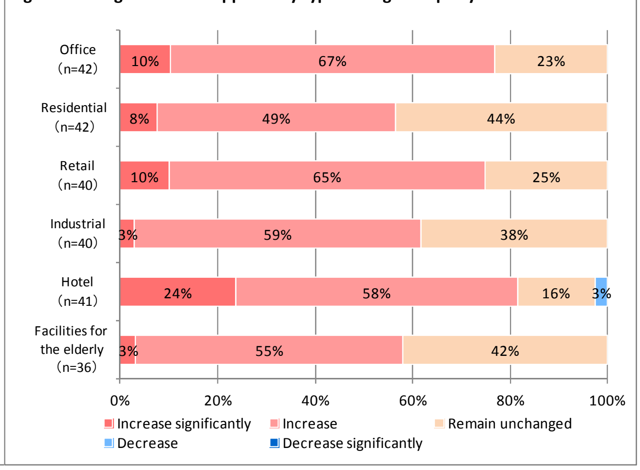


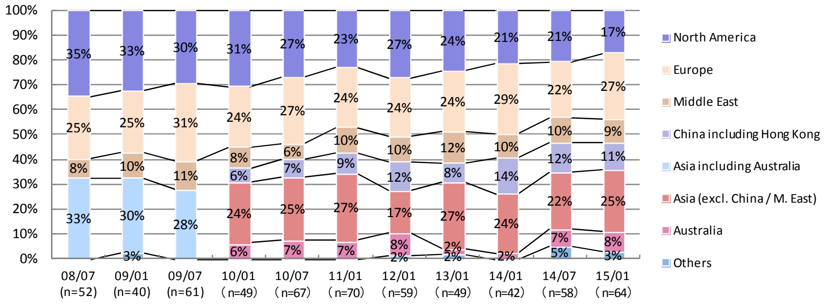
Fig. 13-2 Foreign Investors' Appetite by Type of Target Property



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

With respect to the capital sources from overseas at the asset managers who actually manage the overseas capital of foreign investors, the share of North America has been on a downward trend since the January 2012 survey and fell below 20% (to 17%) for the first time. Europe has remained around 25% (Fig.14).

Fig. 14 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 2010 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*", "*Allocation as part of the global portfolio*". These motives of foreign investors are assumed to be a reason for the growing number of global funds investing in real estate in Japan (Fig.15).

The main reasons that foreign investors do NOT invest in real estate in Japan include country risks, such as "Lack of growth potential in GDP, consumption, population, etc." and "Earthquake risk" (Fig.16).

Fig.15 Reasons for Foreign Investors Investing in Japan n=148 (Respondents31)

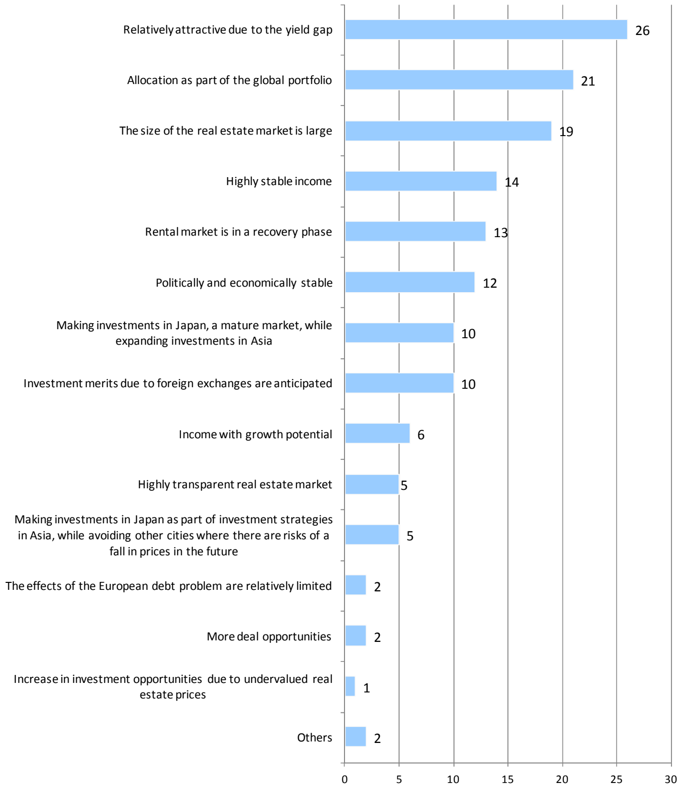
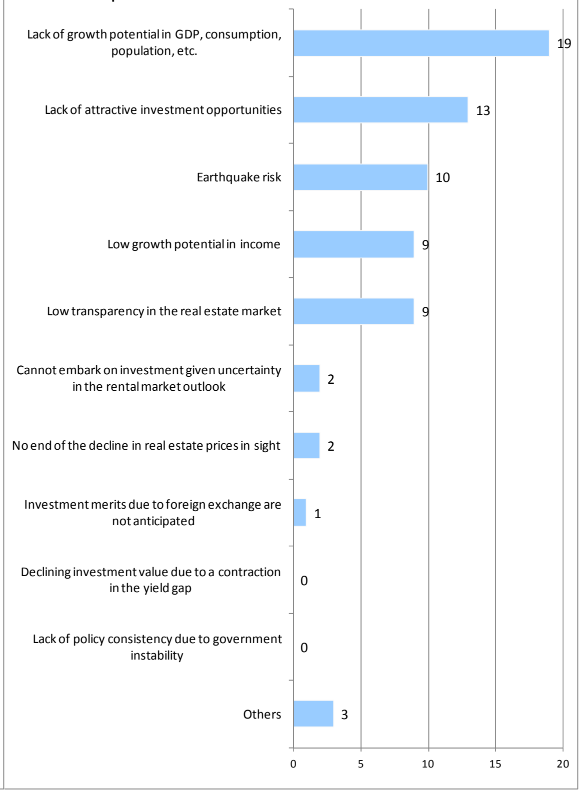


Fig.16 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market n=68 (Respondents28)

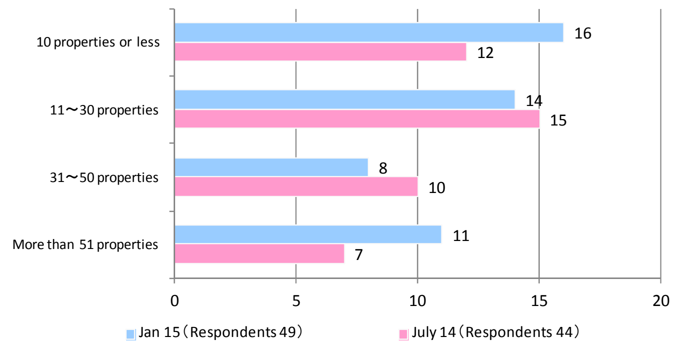


2. Status of the Investment Real Estate Market and Investment Strategies of Managers

1). Acquisition and Disposition of Properties in the July to December 2014

With respect to the number of the properties that companies had considered to acquire (ex. verification of profitability), “10 properties or less” and “51 properties or more” rose from the previous survey (July 2014) (Fig.17). We think these responses reflect the fact that the asset managers focused on properties that were highly likely to be profitable on one hand, and increasing number of the asset managers expanded their scope of the investment property under intensifying competition for acquiring properties and investigated more properties.

Fig. 17 Examined for acquisition



The result of a survey on the acquisition of properties in the July to December 2014 is as follows. More than half of the respondents answered that they had acquired properties (Fig.18). The main reasons that the managers did not acquire any properties were “Can’t agree on prices” and “Severe competition in bids” (Fig.19), which suggests that the environment for acquisitions of properties remained challenging. A survey on the disposition of properties from July to December 2014 reveals that over 60% of the asset managers sold properties (Fig.20). Most of them who did not sell any properties chose “Did not plan to sell from the outset” as their reason (Fig.21). The current real estate market seems to be favorable to sellers.

Fig.18 Circumstances for Acquisition

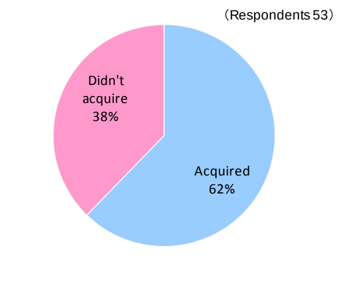


Fig.19 Reason for not acquiring property

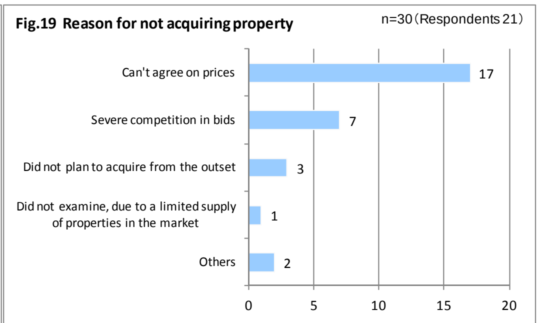


Fig. 20 Circumstances for Disposition

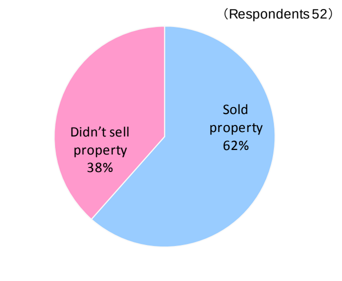
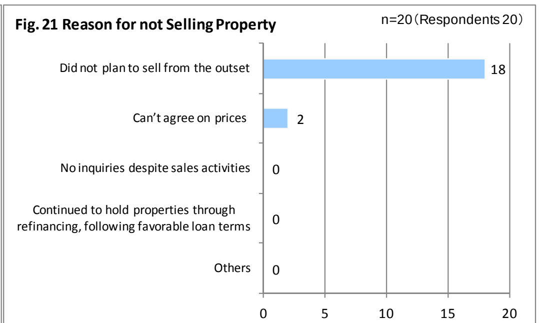


Fig. 21 Reason for not Selling Property



2). Investment Strategies of the Asset Managers

a. Target Property Types (Multiple answers allowed)

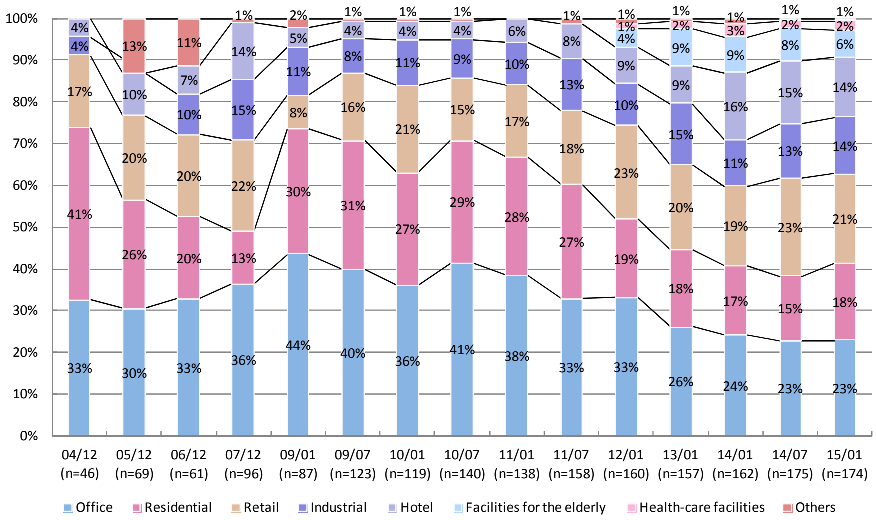
With respect to the target property types, “office,” “retail,” and “residential” accounted for relatively large percentages. The share of “office” and “residential” had been declining. We expect that the managers have been expanding the scope of the investment properties due to the intensifying competition in acquiring offices and residential properties (Fig.22).

b. Target Areas (Multiple answers allowed)

With respect to the target area, the aggregated share of “central 5 wards of Tokyo” and “23 wards of Tokyo (excluding central 5 wards),” fell to 41%. This happens for the first time for the ratio to become less than 50% since December 2007 (Fig.23).

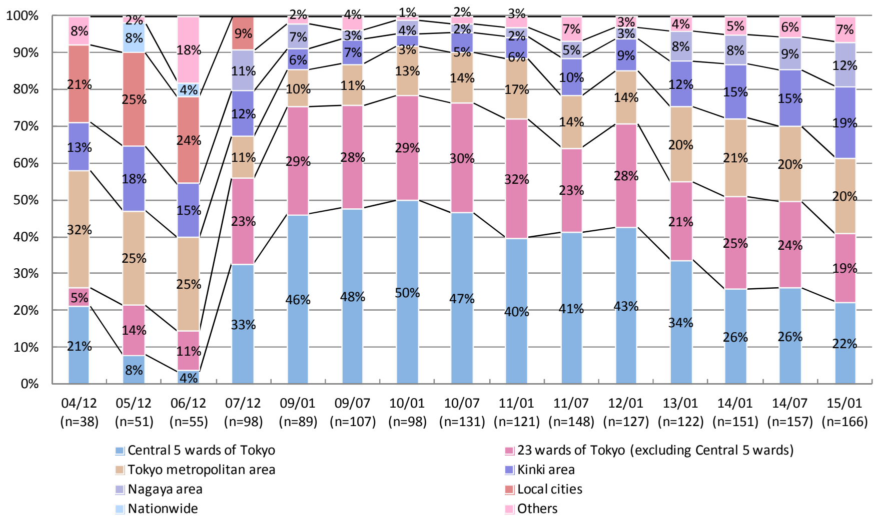
We believe that the asset managers are expanding their target areas into areas outside Tokyo, especially the Kinki area and Nagoya area given the harder completion in central Tokyo.

Fig. 22 Target Property Types (Multiple answers allowed)



・“Facilities for the elderly” and “Health-care facilities” were newly established from the January 2012 survey.

Fig. 23 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.

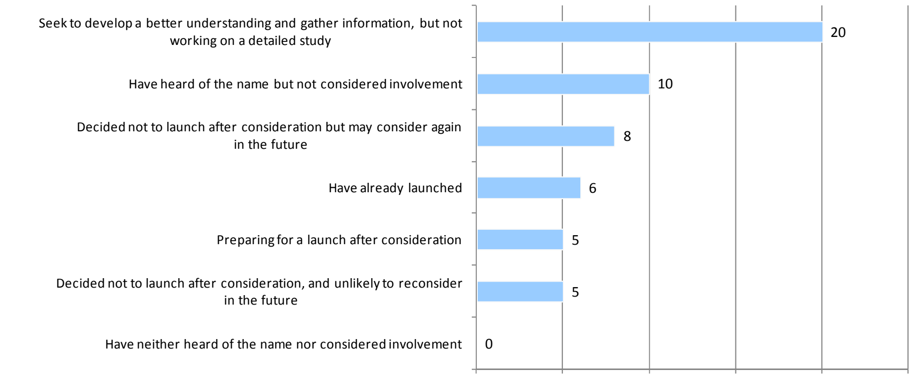
3. Business Environment of Private Real Estate Investment Management

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

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).

Five companies chose "Preparing for a launch after consideration," and we expect that private REITs will increase on the back of equity investors' strong investment appetite (Fig.25-1). As a reason of not establishing open-ended private funds, the largest number of respondents chose "Concern over conflict of interest with other funds (including J-REITs)" (Fig.25-2).

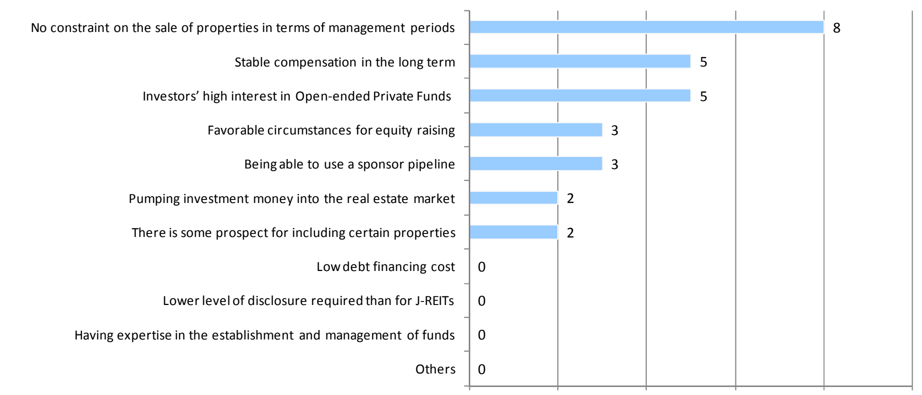
Fig.24 Managers' involvement with Open-ended Private Funds



n=54（Respondents 52）

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

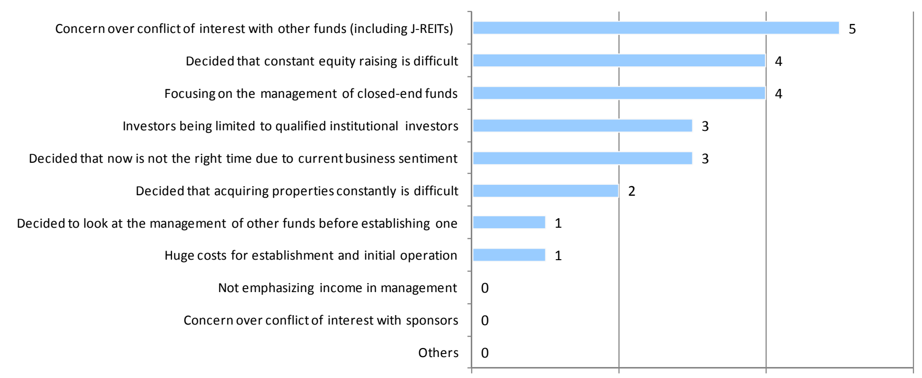
This question is only for companies that chose "Have already launched" or "Preparing for a launch after consideration" to the question about Managers' Involvement with Open-ended Private Funds (the graph above).



n=28（Respondents 11）

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).



n=23（Respondents 13）

2) Closed-ended fund in the future

As an investment management scheme that is expected to be used by more asset managers, the largest number of respondents chose “GK-TK scheme” because of less effort and cost needed for setting up and managing funds (Fig.26-27). We have confirmed the needs also for “TMK scheme.” Relatively large numbers of the asset managers, who chose “TMK scheme” for their preferred scheme, quoted foreign investors as their target equity investors (Fig.28).

Fig. 26 Investment Management Schemes Expected to Be Used More (multiple answers allowed) n=57（Respondents49）

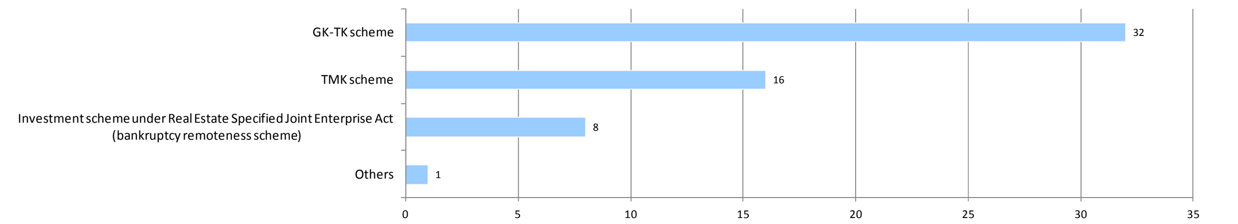
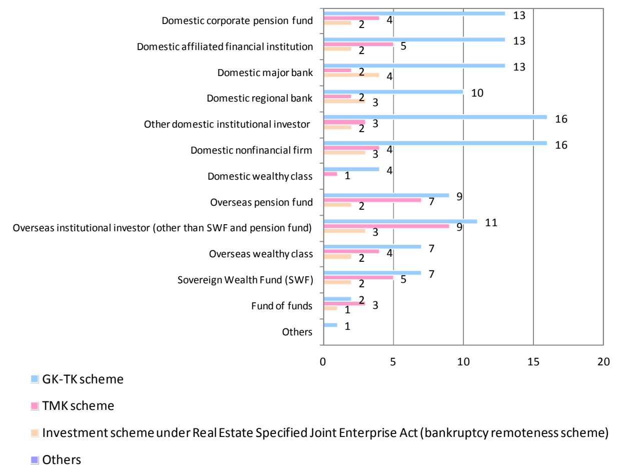


Fig. 27 Reason for Choosing the Scheme (multiple answers allowed) n=115

Fig. 28 Target Equity Investor n=197

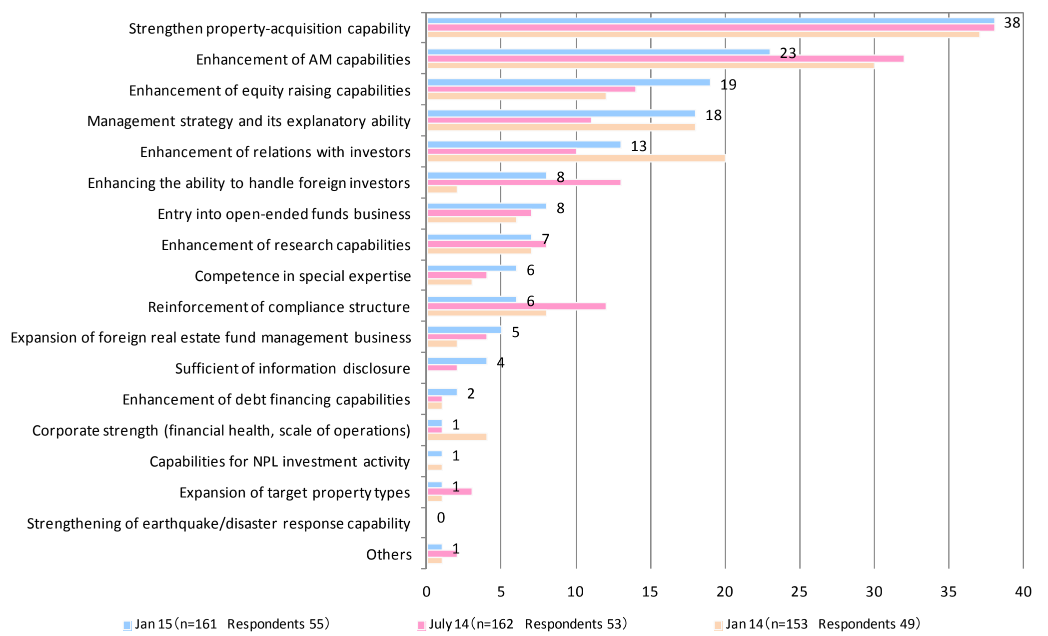


3) Manager's Requirements for Future Growth and Sustainability of their Businesses (Multiple answers allowed)

Among requirements for sustainability and growth of the asset managers, the largest number of the managers chose "Strengthen property-acquisition capability." More asset managers picked up "Enhancement of equity raising capabilities" compared with the previous survey (July 2014) (Fig.29).

We consider given the continued challenging market condition for acquisitions of properties, more asset managers put priority on setting up funds that meet the needs of the equity investors.

Fig. 29 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. 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.

Contact:

Sumitomo Mitsui Trust Research Institute Co., Ltd

3F Hulic Kamiyacho Building. 4-3-13, Toranomon, Minato-ku, Tokyo

105-0001, Japan

https://www.smtri.jp/en/contact/index.html
http://www.smtri.jp/en/