Survey on Private Real Estate Funds in Japan
January 2016– Results

March 23, 2016

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 21th survey based on responses to questionnaires received from 55 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: 105
  - The number of responses: 55 (ratio of valid responses: 52.4%)
  - Survey period: in the January to February 2016
  - 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 2015 to be 14.8 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. The market size decreased approximately 280 billion yen (1.9%) from the previous July 2015 survey (15.1 trillion yen).

The market size of private real estate funds is 14.8 trillion yen including Japanese assets of global funds

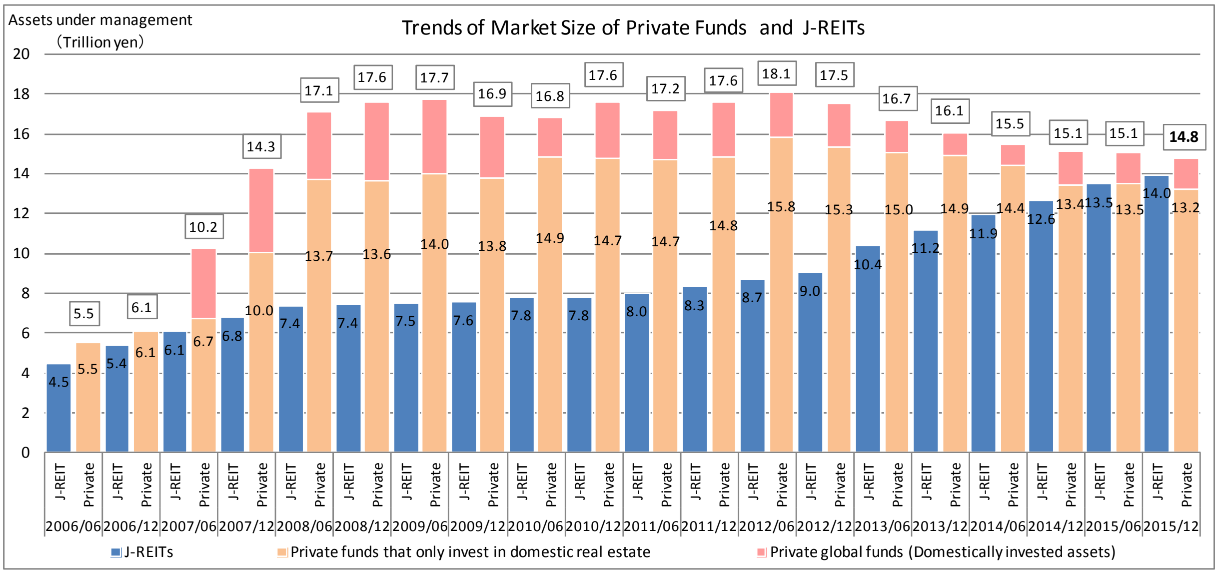
・Assets under management (AUM) as of the end of December 2015 were 14.8 trillion yen. The market size decreased approximately 280 billion yen from the last survey.

・The number of asset managers whose AUM decreased exceeded the number of asset managers whose AUM increased. Overall, The market size decreased approximately 1.9% from the previous July 2015 survey. While many asset managers lowered their AUM, the number of overseas asset managers who sold AUM (including the listings on J-REIT market) appears to be large.

・We did not see any significant change in the response to debt financing circumstances because the great majority of asset managers were found to view the circumstances as favorable, just as they had been in the previous surveys. On the other hand, we confirmed there was a certain percentage of equity investors, among those who responded regarding the investment appetite, who chose "*Declining*" for the first time in three and half years.

・In regards to future trends in the size of the private real estate fund market, most asset managers were found to believe that the market will continue to expand in the foreseeable future. However, many of them also chose "*Will expand for some time and then decline*." Consequently, we were not able to clarify future trends in the market size of the private real estate funds from the questionnaire. The conditions in the real estate market are expected to remain challenging in terms of the acquisition of properties. Going forward, the approach asset managers take to acquiring properties at reasonable prices and launching funds in these conditions appears to be an important factor in terms of changes in the size of the private real estate fund market.

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



" Survey on private real estate funds" January 2016 Survey Results

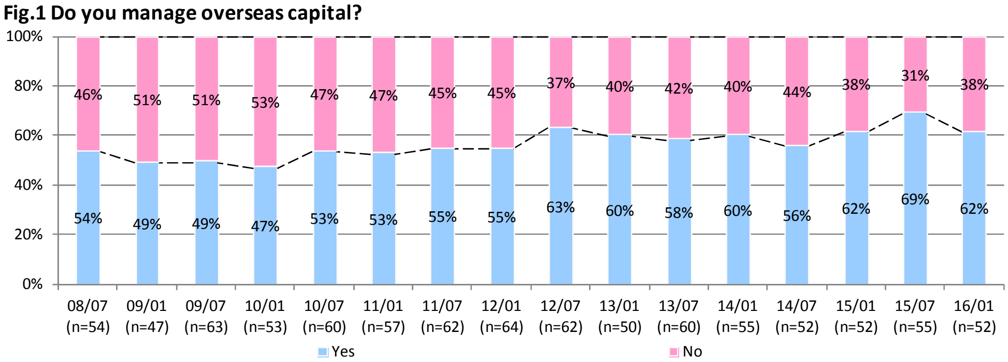
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

1. Current Status of Real Estate Fund Management Business

1) Management of Overseas Capital

In response to the question as to whether they have managed overseas capital, the percentage of respondents who chose "Yes" has continued to exceed 60% although it decreased from the last survey (Fig.1).

Fig.1 Do you manage overseas capital?

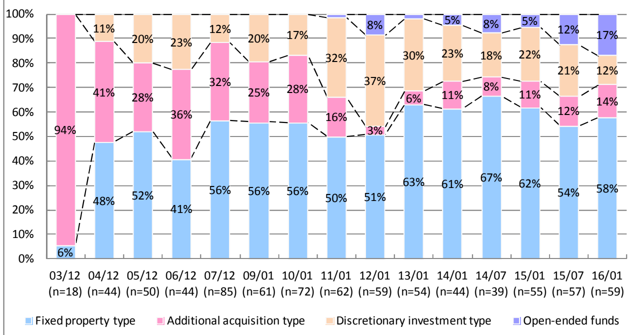


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

The response from the currently operating funds showed that *"Fixed property type"* by fund type and *"Core"* by management style continued to have a majority (Fig.2 and Fig.3), however the ratio of *"Open-ended funds"* by fund type increased from the last survey and it exceeded that of *"Additional acquisition type"* and *"Discretionary investment type"*.

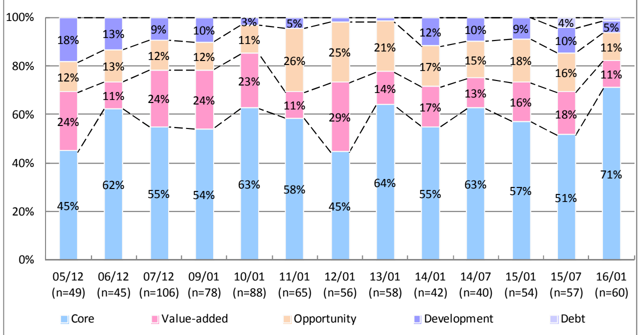
The breakdown of target properties by types and areas remained almost unchanged from the previous survey (Fig.4 and Fig.5).

Fig. 2 Fund types



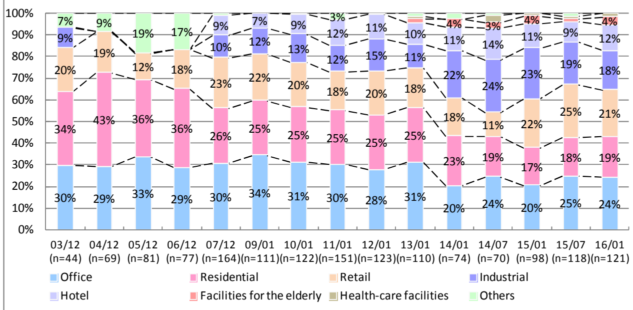
・"Open-ended funds" was added from the January 2011 survey.

Fig. 3 Management Style



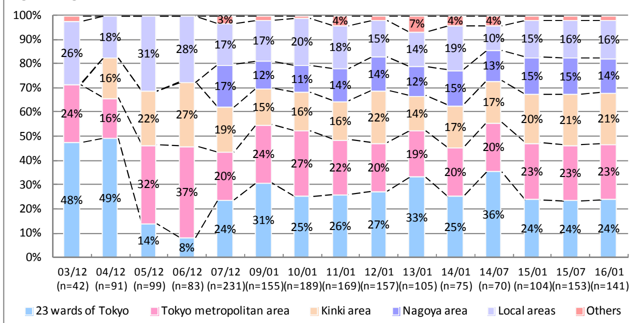
・"Debt" was added to management investment style from the January 2013 survey.

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 target investment period was 7.4 years for funds currently under management and 7.5 years for funds to be launched within a year, reversing the previous results, albeit slightly (Fig.6). Looking at the breakdown of the investment period of funds currently under management, there was an increase in the percentage of respondents who chose a comparatively short term of "*less than 3 years*" or "*at least 3 years but less than 5 years*," or comparatively long term of "*at least 7 years but less than 10 years*" or " *10 years or more*," while the number of respondents who selected "*at least 5 years but less than 7 years*" decreased sharply(Fig.7). As a result, the average target investment period remained almost unchanged from the previous survey. On the other hand, the investment term for funds to be launched within a year increased a little more than one year from the previous survey, reflecting the impact of multiple respondents who planned to launch funds focused on long-term investments, such as 15 or 20 years.

Fig. 6 Average Target Investment Period

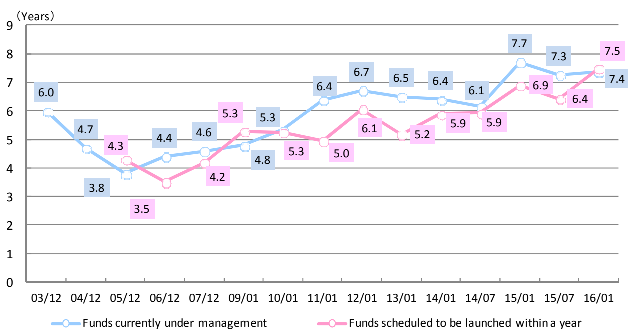
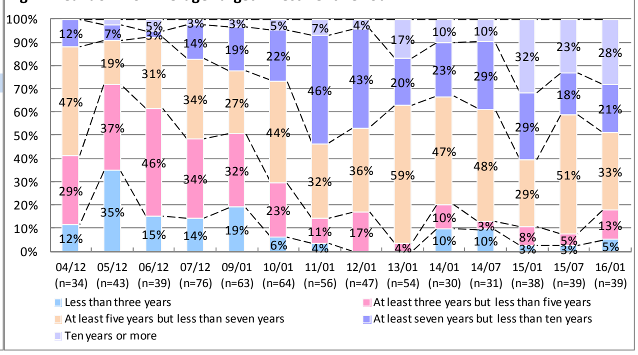


Fig. 7 Breakdown of Average Target Investment Period



Average LTV for funds under management and funds to be launched within a year edged down from the previous surveys, standing at 63% and 64.2%, respectively (Fig.8)

Looking at the breakdown of LTV ranges, for funds currently under management, the percentage of respondents who chose highly leveraged funds with a level of "*80% or more*" remained flat, while the percentage of respondents who chose "*less than 40%,*" "*at least 40% but less than 50%,*" or "*at least 50% but less than 60%*" increased(Fig.9), causing the average LTV levels to decline from the previous survey. In the breakdown of LTV levels for funds to be launched within a year, more than 10% of respondents chose "*80% or more*" for the first time in six years, the last time being in the January 2010 survey (Fig.11). The reason for this increase appears to be the need to secure a certain level of fund returns amid factors such as surging property prices and the utilization of favorable debt financing environments.

In terms of the average target IRR for funds currently under management, respondents aimed to achieve more than 10% for "discretionary investment types" and "additional acquisition types," and below 10% for fixed property type and open-ended funds. As a result, the average target IRR on a whole stood at 11.5%, recording a decline from the previous survey (Fig.10).

Fig. 8 Average LTV Ratio

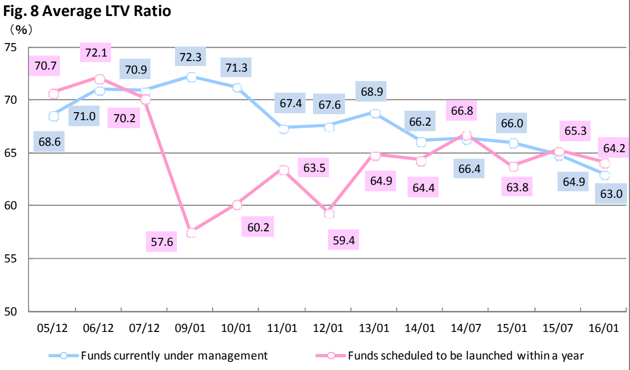


Fig. 9 Range of LTV level (Funds currently under management)

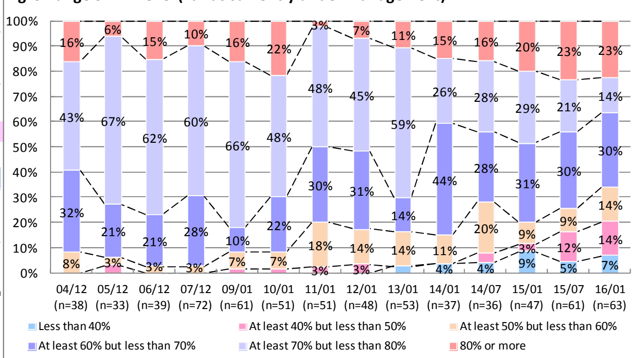


Fig.10 Average Target IRR(Funds currently under management)

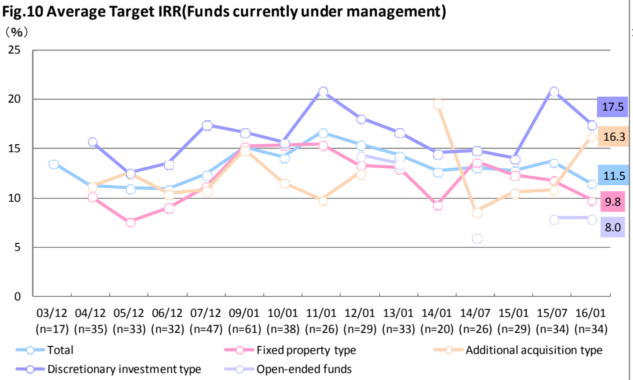
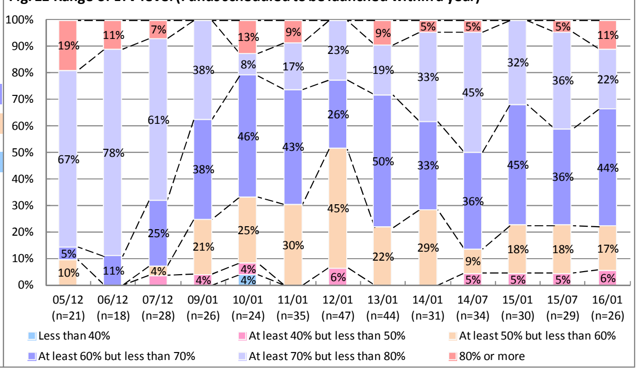


Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



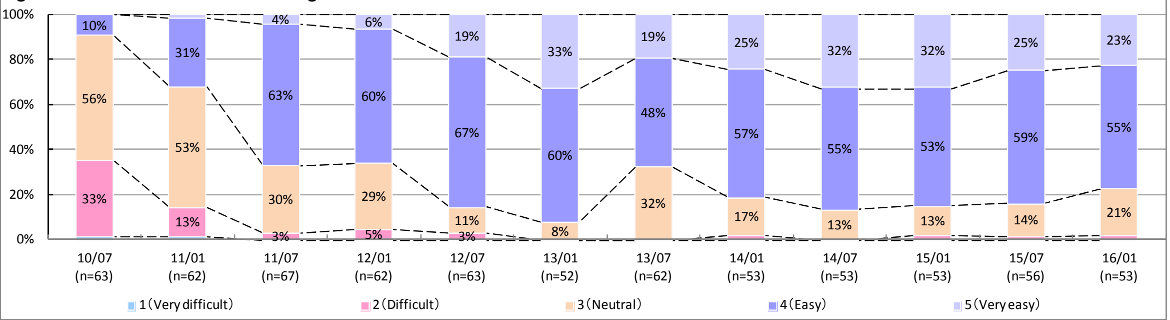
※In our questions, we distinguish the loan-to-total assets ratio and the loan-to-acquisition value ratio. The average LTV level is calculated based on the loan-to-acquisition value ratio.

3) Debt Finance

Regarding debt financing circumstances, the percentage of respondents who selected "*5 (very easy)*" and "*4 (easy)*" declined, while "*3 (neutral)*" picked up. That said, the total number of respondents who chose "*5 (very easy)*" and "*4 (easy)*" still adds up to as high as 78%, showing that the debt financing circumstances have been favorable for the past several years (Fig.12).

In the next survey, we will pay attention to changes in the asset managers' impressions of lenders in light of the negative interest policy introduced recently by the Bank of Japan.

Fig.12 Circumstances of Debt Financing



4) Equity Raising

a. Appetite of Equity Investors

Looking at the appetite of equity investors, there were continued signs that the percentage of respondents who chose "*Rising*" was declining, while that for those who chose "*No change*" was increasing. At the same time, there were some respondents who selected "*Declining*" for the first time in three and half years since the July 2012 survey (4%).(Fig13).

In regards to the target property types likely to be tapped by equity investors, "*Increase significantly*" or "*Increase*" was chosen for "*Hotel*" by the largest number of domestic investors and overseas investors, with 70% of domestic investors and 71% of overseas investors selecting either one of these answers (Fig.14-1, Fig.14-2). Both domestic and overseas investors have a strong appetite for investment in hotels in light of the increasing number of foreigners visiting Japan and the upcoming Tokyo Olympics to be hosted in 2020. That being said, more than 10% of domestic and overseas investors chose "*Decrease*" for "*Residential*," with the reason appearing to be attributable to the ongoing surge in residential housing prices.

Fig.13 Appetite of Equity Investors

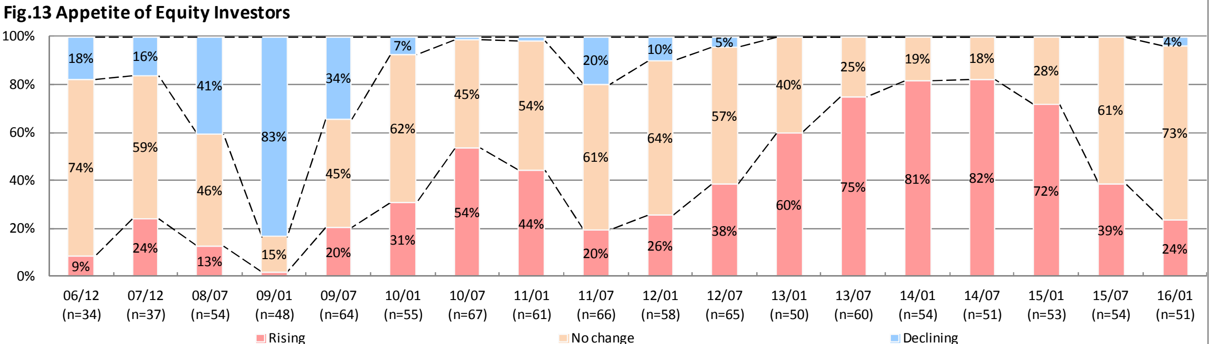
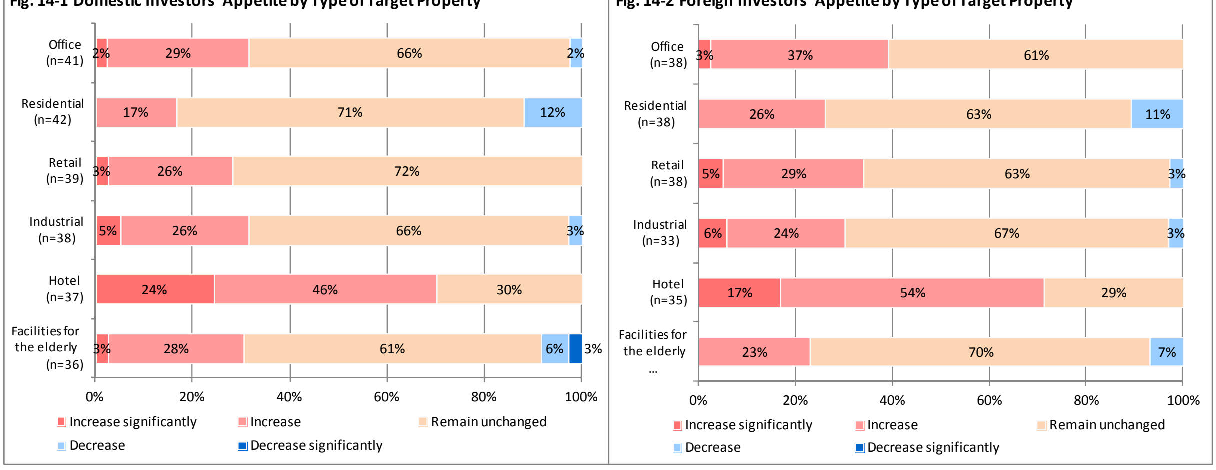


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

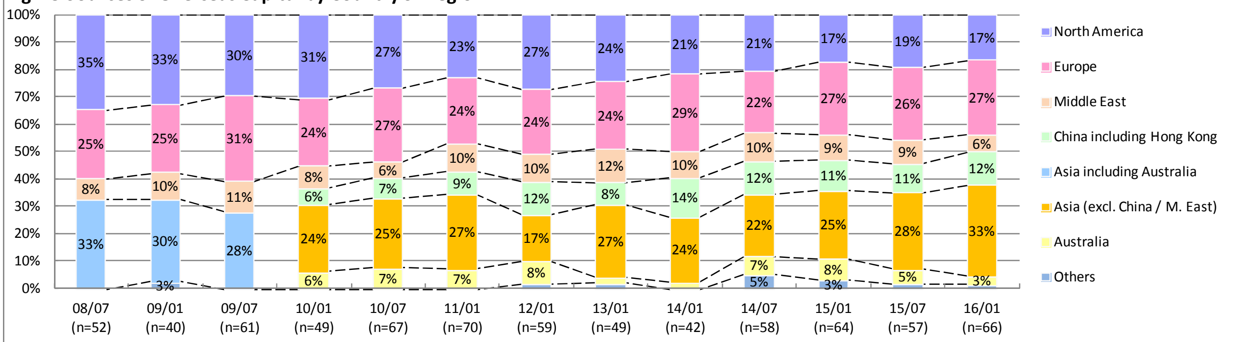
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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

With respect to the capital sources from overseas, the highest response rate was for investors from *"Asia (excl. China /M.East)"*at 33%. The percentage of *"Asia (excl. China /M.East)"* has risen steadily in this several years, the investors from *"Asia (excl. China /M.East)"* have been enhanced their presence as foreign investors (Fig.15).

Fig. 15 Sources of Overseas Capital by Country or Region



・Since the January 2010 survey, Asia-Pacific has been broken down into China, Middle East, Asia (excl. China / M East), and Australia.
・Since the January 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*", "*The size of the real estate market is large*", "*Allocation as part of the global portfolio*", *" Highly stable income"* and *"Politically and economically stable"* (Fig.16). These choices have been the major reasons indicated in every survey in the past, and have been established as the reasons for foreign investors investing in Japan.

In the previous survey, "*Expected positive effects from exchange rates*" was chosen by 16 respondents, accounting for a certain level of the percentage (11%). In the current survey, however, it was chosen by 10 respondents, which was equal to the number of one year ago. We infer that the decline in the number of respondents who expected positive effects from exchange rates is attributable to the fact that future trends in exchange rates are becoming difficult to follow due to factors such as the slower pace of interest rate increases in the United States and the continuation of monetary easing steps in Europe.

As the reasons for not investing in Japan, majority of the respondents chose *"Lack of growth potential in GDP, consumption, population, etc."* and *"Rising in real estate prices"* (Fig.17).

Fig.16 Reasons for Foreign Investors Investing in Japan (Multiple answers allowed) n=128(Respondents31

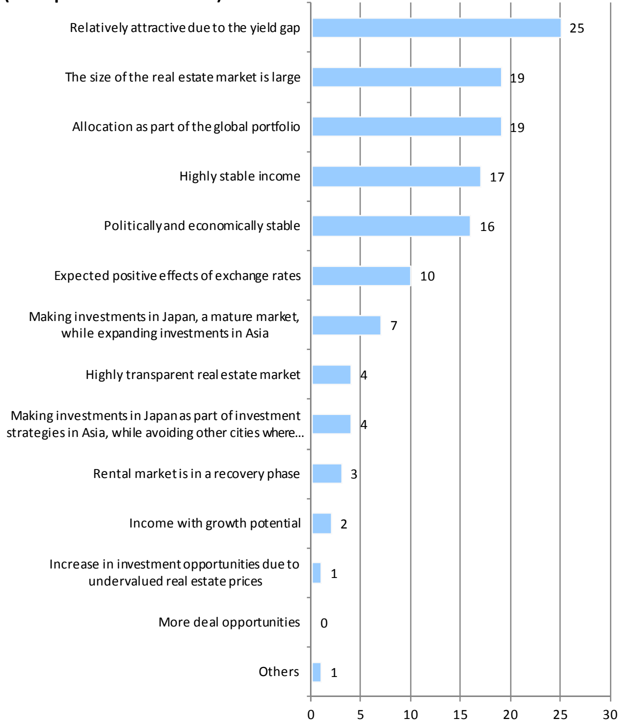
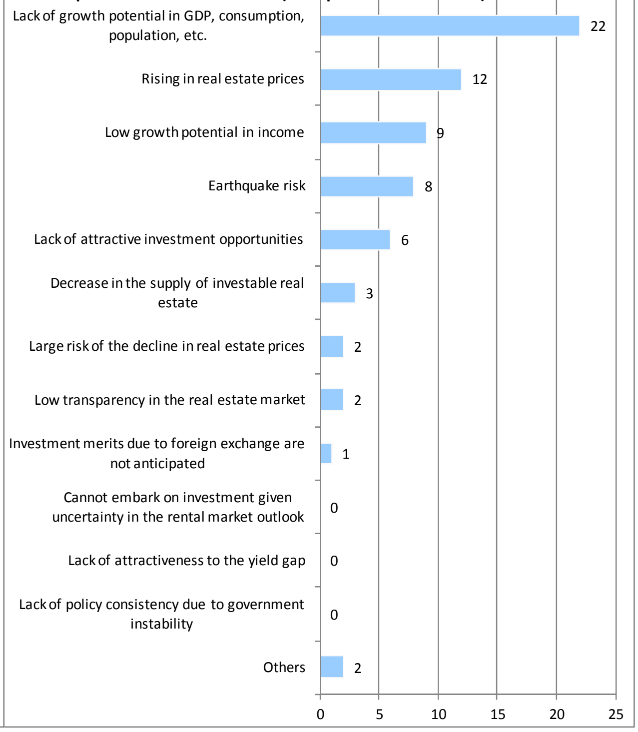


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed) n=67(Respondents28)



d. Acquisition and Disposition of Properties in the July to December 2015

As to a survey on the acquisition of properties in the July to December 2015, the percentage of respondents who answered *"Didn't acquire"* increased 10% from the previous survey, accounted for 39% in this survey (Fig.18). The main reasons that the managers did not acquire any properties were *"Can't agree on prices"* and *"Severe competition in bids"* , the total share of those reason accounted for 85%, which suggests that the real estate prices remained high (Fig.19). The percentage of respondents who answered they had acquired properties had been increased since the January 2014 survey, it turned to decrease in this survey.

A survey on the disposition of properties in the July to December 2015, the percentage of respondents who answered *"Didn't sell property"* increased 20% from the previous survey, accounted for 56% (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). "*Others*" includes responses such as the extension of the scheduled timing of sales of properties, reflecting individual situations instead of market conditions.

Fig.18 Circumstances for Acquisition

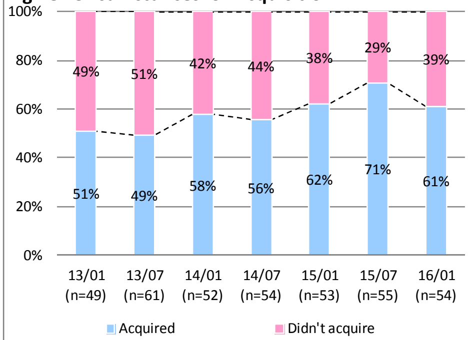


Fig.19 Reason for not acquiring property

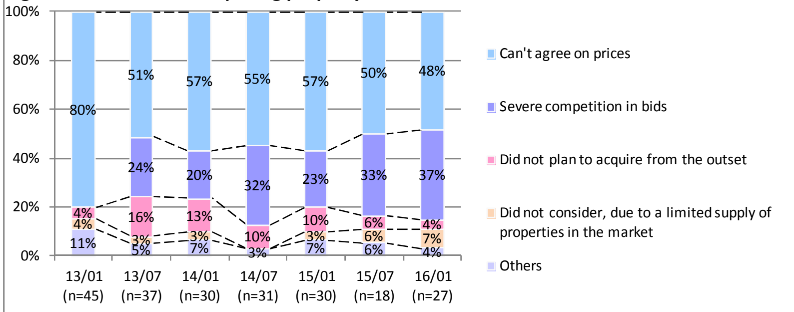


Fig. 20 Circumstances for Disposition

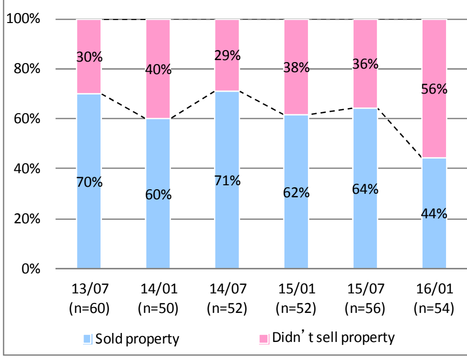
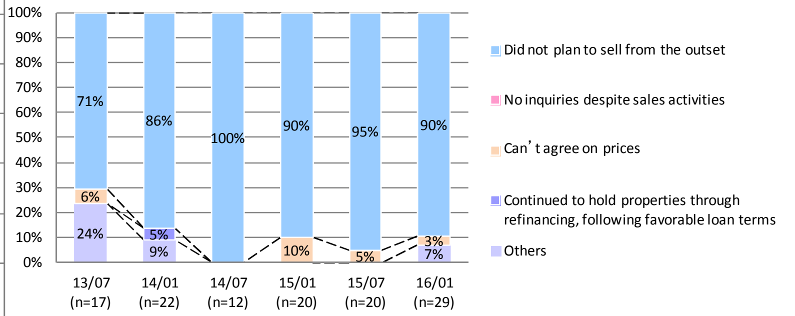


Fig. 21 Reason for not Selling Property



2. Plans and Investment Strategies of Asset Managers

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

Regarding the funds scheduled to be launched within a year, 77% of respondents answered that they *"Plan to launch"* (Fig.22).

As to plans of acquiring properties within a year, the percentage of respondents that they plan to acquire properties accounted for 90% in this survey (Fig.23). On the other hand, the percentage of respondents that they plan to sell properties within a year accounted for 56% (Fig.24). The market is expected to be favorable for sellers for some time to come, because the low supply of investment-grade properties will continue throughout the entire market.

Fig.22 Plans of Launch of New Funds n=52

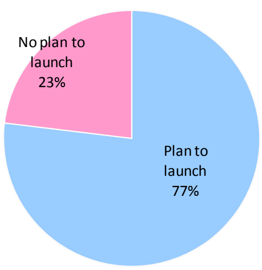


Fig.23 Plans of acquiring properties n=52

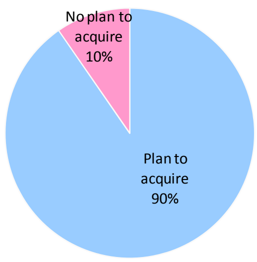
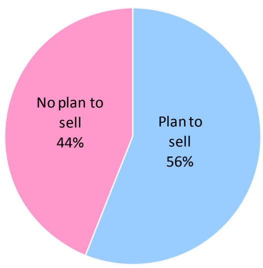


Fig.24 Plans of selling properties n=50



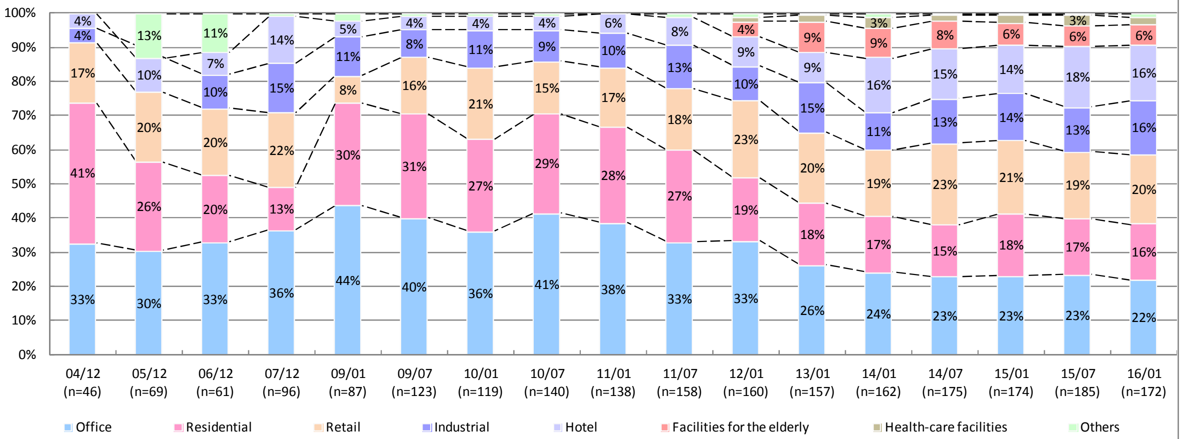
2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

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

Investors are putting an equal degree of effort into acquiring five types of properties. In addition to "*Office*" and "*Residential*," two types of properties which accounted for the majority of the target properties selected, "*Retail*," "*Industrial*," and "*Hotel*" are also garnering interest as favorite properties.

Fig. 25 Target Property Types (Multiple answers allowed)



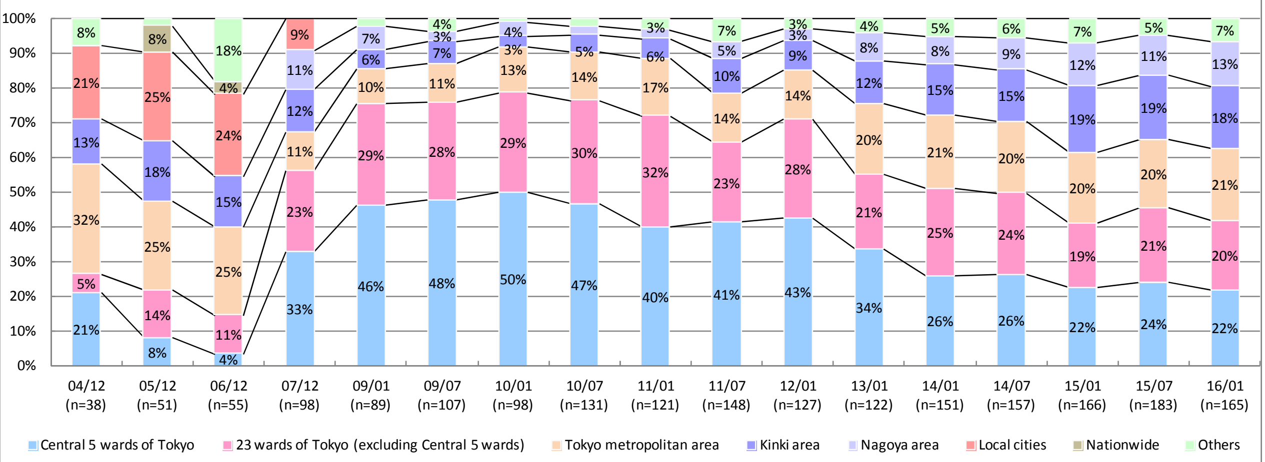
・"Facilities for the elderly" and "Health-care facilities" were newly established from the January 2012 survey.

b. Target Areas (Multiple answers allowed)

We did not see any major change from the previous survey in terms of future target areas (Fig.26). The percentage of respondents who chose "*Central 5 wards of Tokyo*," "*23 wards of Tokyo (excluding central 5 wards)*," and "*Tokyo metropolitan area*" have each accounted for approximately 20% in recent years.

"Others" include four respondents who specifically named Fukuoka, a city where large-scale developments are projected and the number of visiting foreigners is increasing remarkably (including responses of Kyushu). Given the ongoing difficulties of acquiring investment-grade properties in the central areas of Tokyo, it appears that target investment areas are more diversified and investors are increasingly turning to regional cities that look attractive as investment areas.

Fig. 26 Target Areas (Multiple answers allowed)



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

3. Business Environment of Private Real Estate Investment Management

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

Regarding involvement in open-ended private funds (so-called private REITs), 20 managers, the largest number of respondents, chose "*Seek to develop a better understanding and gather information, but not working on a detailed study*". Followed by the number of managers who chose "*Have already launched" (11 respondents)*," the survey results showed that the number of private REITS was increasing (Fig.27).

In terms of important factors for development in the private REITs market in the future, the majority of managers chose "*Expansion of the numbers of private REITs and the asset size*", "*Enhancement of the track record*", "*Improvement in liquidity (Increase in frequency, easing on refund restrictions, etc.)*" and "*Support of the sponsor*" (Fig.28). Many asset managers believe that in order to develop the private REITs market, they need to achieve improvements in various factors such as the level of funds or merchantability.

Fig.27 Managers' involvement with private REITs n=53(Respondents 52)

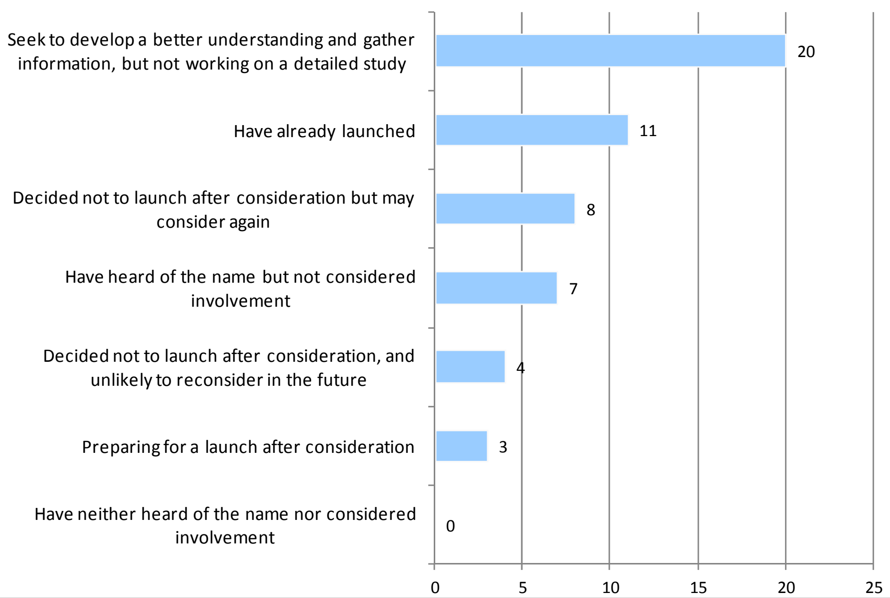
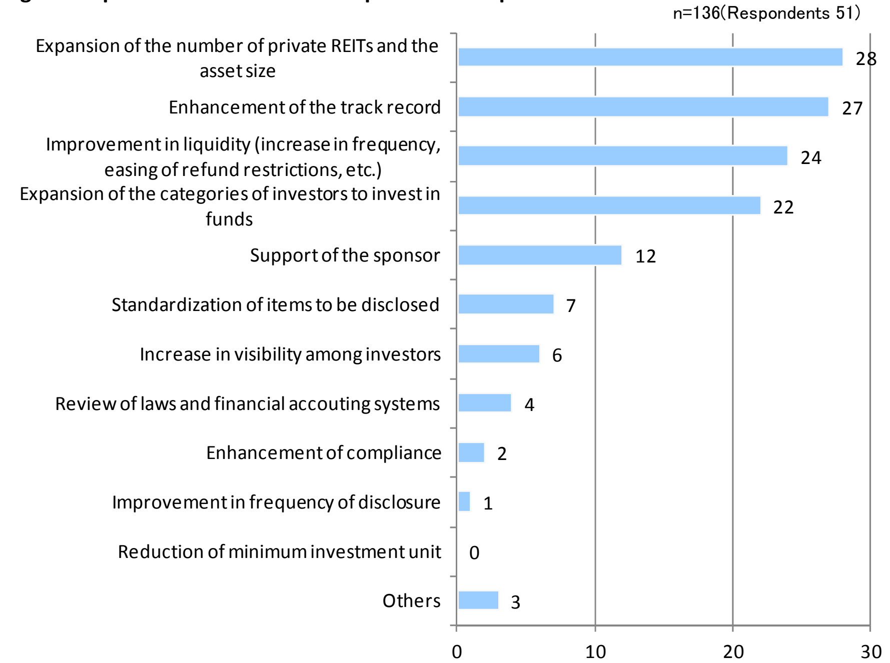


Fig.28 Important Factors for Development in the private REITs Market n=136(Respondents 51)



2) Private Real Estate Funds in the Future

In regards to the outlook of asset size in the private real estate funds market, 21 respondents chose "*Will continue to expand*," the largest share of responses following on from the previous survey. This was followed by respondents who chose "*Will expand for some time and decline*," although the number of respondents was a bit lower than the largest number (Fig.29). Given these two most favored choices, it is reasonable to conclude that most managers expect the private real estate market to expand (for some time).

Meanwhile, it is interesting to note that respondents chose "*In more than a year but within three years*" for the timing of reverses, despite the totally different conclusion drawn from "*Will decline for some time and then expand*" and "*Will expand for some time and then decline*." (Fig.30-1, Fig.30-2).

Fig.29 Change in asset size in private real estate funds in the future

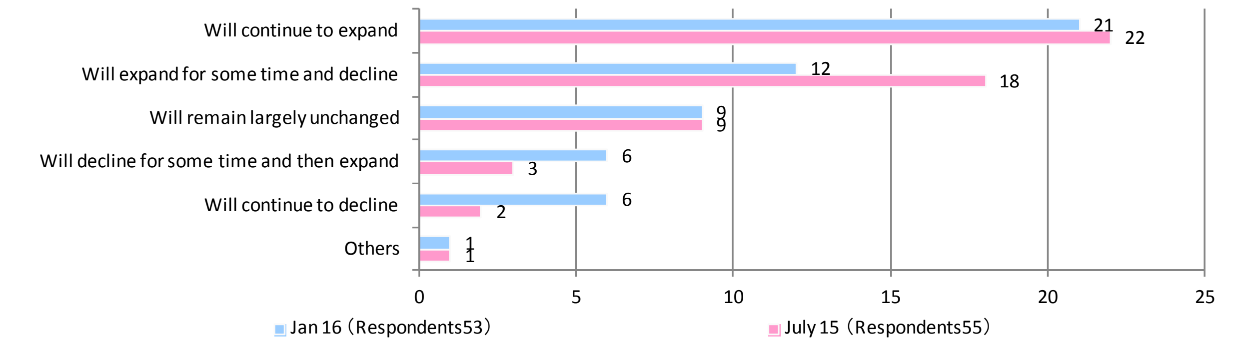


Fig.30-1 Timing of reverse n=6
(Will decline for some time and then expand)

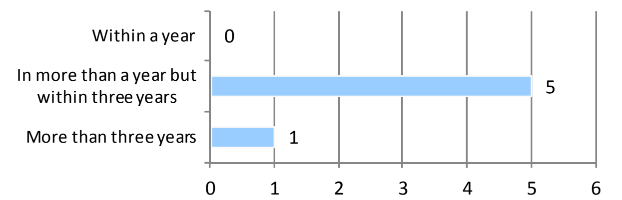
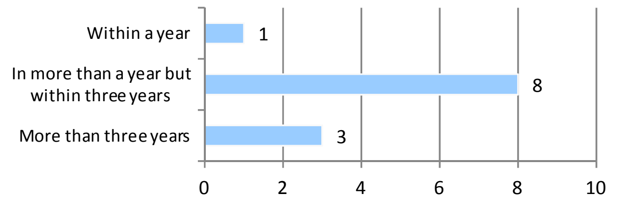


Fig.30-2 Timing of reverse n=12
(Will expand for some time and decline)

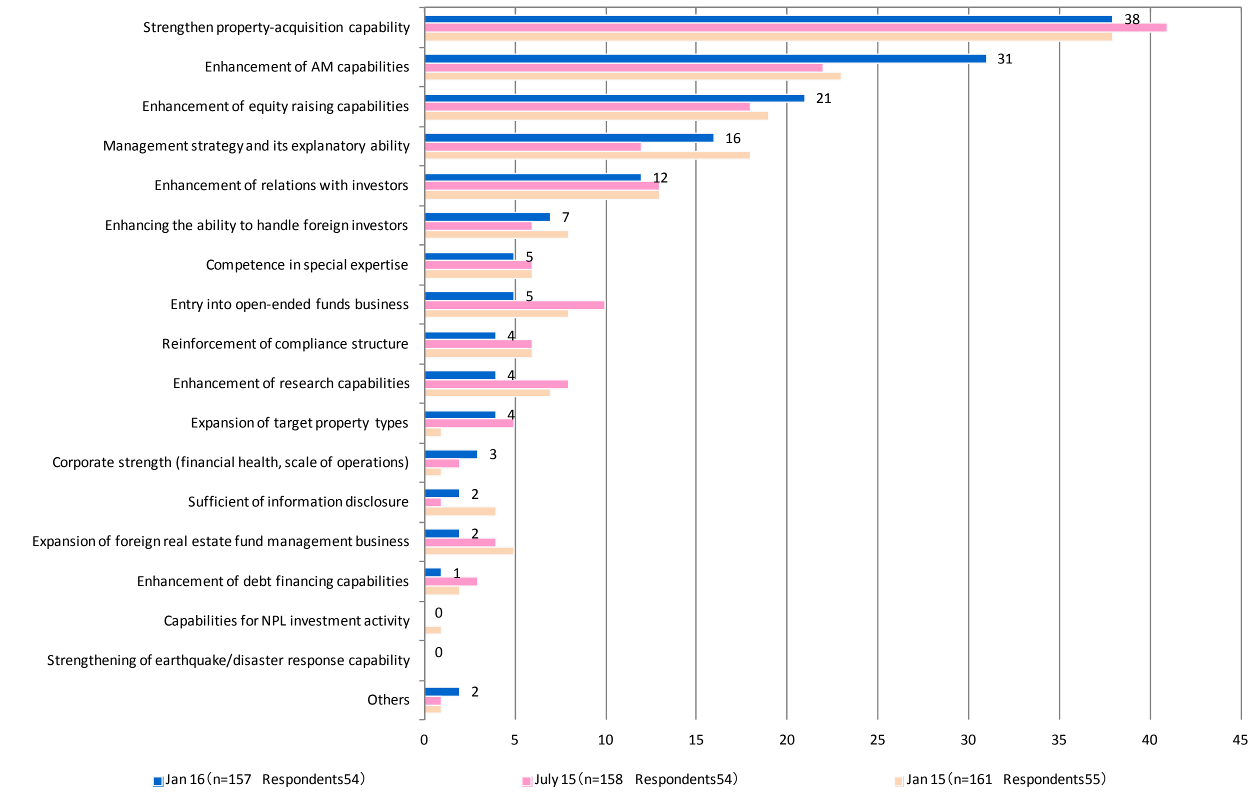


3) Manager's Requirements for Future Growth and Sustainability of their Businesses (Multiple answers allowed)

Among requirements for sustainability and growth of the asset managers, the majority of managers chose "*Strengthen property-acquisition capability*", "*Enhancement of AM capabilities*" in the last three times survey (Fig.31).

Given the continued challenging market condition for acquisitions of properties, we consider that the numbers of managers who attach high priority to strengthen property-acquisition capability remained to be large.

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



Definitions of Terms

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

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

＜Management Style＞

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

＜Investment Area＞

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