Survey on Private Real Estate Funds in Japan

July 2016– Results

September 2, 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 22th survey based on responses to questionnaires received from 54 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: 108
  - The number of responses: 54 (ratio of valid responses: 50.0%)
  - Survey period: in the July to August 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 June 2016 to be 15.5 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. The market size, had been on a decline since the January 2013 survey, increased approximately 660 billion yen (4.4%) from the previous January 2016 survey (14.8 trillion yen), the trend reversed for the first time in 4 years.

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

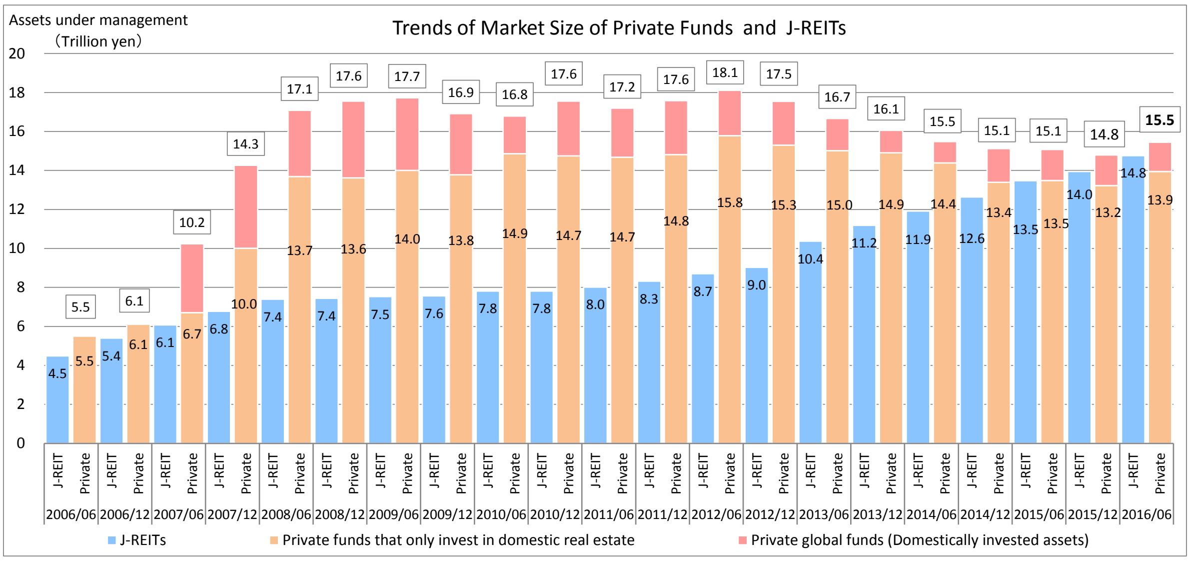
・Assets under management (AUM) as of the end of June 2016 were 15.5 trillion yen. The market size, had been on a decline since the January 2013 survey, increased approximately 660 billion yen from the last survey, the trend reversed for the first time in 4 years.

・The number of asset managers whose AUM increased largely exceeded the number of asset managers whose AUM decreased. Overall, the market size increased approximately 4.4% from the previous January 2016 survey. In the past few years, asset managers, primarily foreign managers, have sought to sell of properties, while recently this trend has slowed. We estimate that many asset managers' asset sizes have increased, reflecting active acquisitions of properties, which exceeds sales.

・This was the first survey since Bank of Japan introduced the negative interest rate policy, 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 extremely favorable, just as they had been in the previous surveys. On the other hand, as for the appetite of equity investors, the share of responses of "*Rising*" turned to increase for the first time in 2 years. We have found that there was a certain percentage of asset managers who think that the appetite of equity investors to real estate have increased through the introduction of the negative interest rate policy.

・In regards to involvement in open-ended private funds (so-called private REITs), 14 managers answered that they have already launched. In terms of important factors for development in the private REITs market in the future, the largest number of respondents chose *"Expansion of the categories of investors to invest in funds",* it exceeded *"Expansion of the numbers of private REITs and the asset size"* ,the largest managers chose in the previous January 2016 survey and the July 2015 survey. The market of private REITs has expanded to some extent. We can say that the market is entering the second stage, where the market will pursue not only the size but also stable quality.

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



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

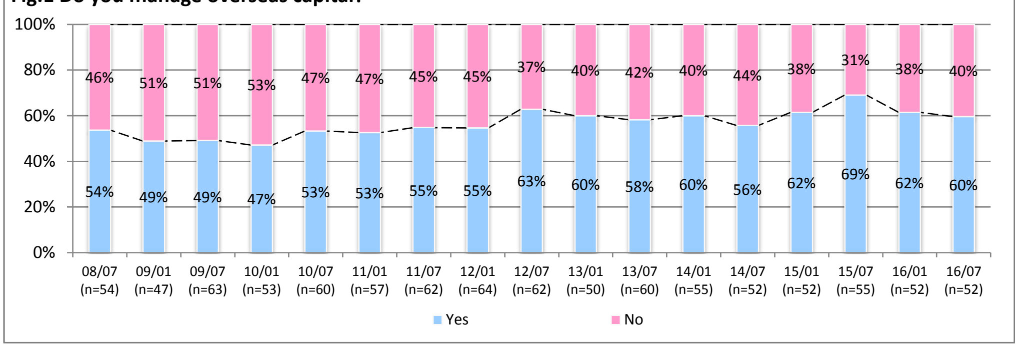
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

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, 60% of respondents chose "Yes", around 60% managers continued to manage overseas capital (Fig.1).

Fig.1 Do you manage overseas capital?

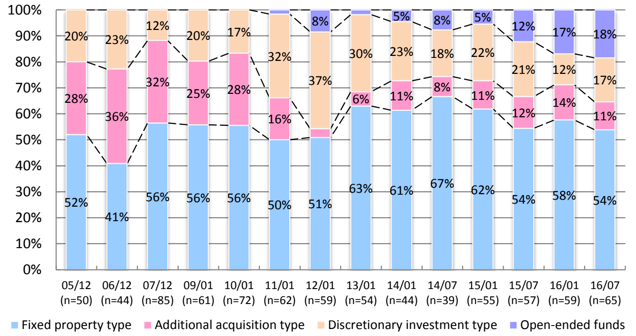


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

The response from the currently operating funds showed that "*Fixed property type*" by fund type continued to have a majority, however the percentage of "*Open-ended funds*" have increased for three consecutive surveys and it continued to exceed that of "*Additional acquisition type*" and "*Discretionary investment type*"(Fig.2). By management style, "*Core*" accounted for 78%, the highest since we started this survey(Fig.3). The "*Core*" style, aiming at steady income gains, accounted for an extremely high proportion, while the percentage of "*Development*" accounted for only 2%. Also, that of "*Value-added*" and "*Opportunity*" have been decreasing.

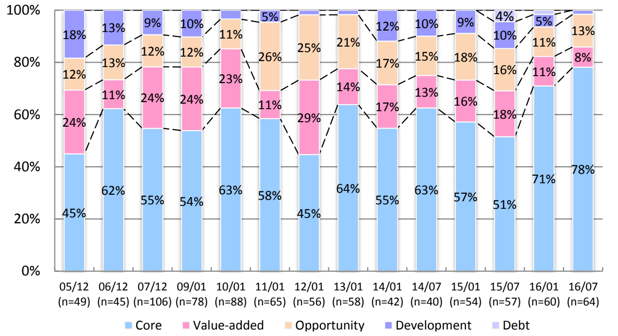
The breakdown of target properties types and areas remained almost unchanged from the previous survey, which indicates that many managers have widely targeted at both properties types and areas (Fig.4 and Fig.5).

Fig. 2 Fund types



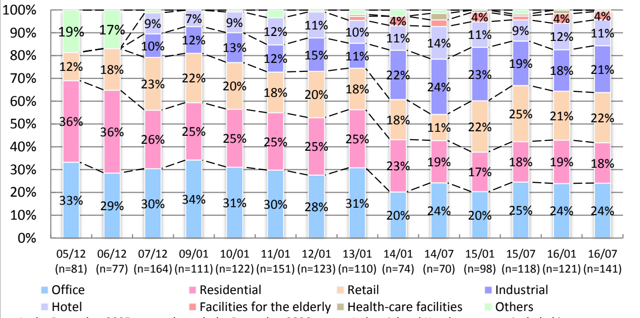
・"Open-ended funds" was added from the January 2011 survey.

Fig. 3 Management Style



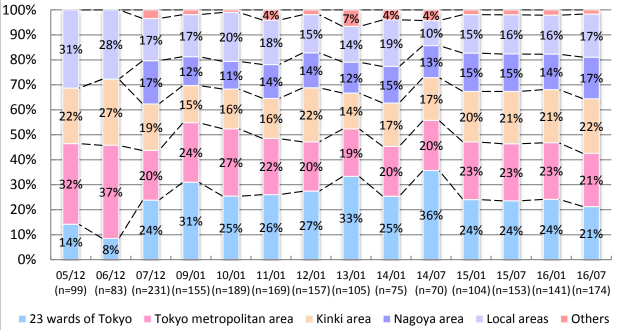
・"Debt" was added to management investment style from the January 2013 survey.

Fig. 4 Target Property Types



・In the December 2005 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 2005 survey through the December 2006 survey, the Nagoya area was included in Local areas.

The average target investment period was 7.2 years for funds currently under management and 6.9 years for funds to be launched within a year, each of them got shorter than the previous survey(Fig.6). Looking at the breakdown of the investment period of funds currently under management, the largest share of respondents chose "*At least five years but less than seven years*"(34%). The share of "*at least 7 years but less than 10 years*" accounted for 32%, when combined with " *10 years or more*" (20%), had a majority(Fig.7). The aggregated share of "*Less than five years*" accounted only 14%, it shows that middle and long term funds accounted for the most in the market.

The survey of the investment period does not include open-ended funds, whose investment period is indefinite.

Fig. 6 Average Target Investment Period

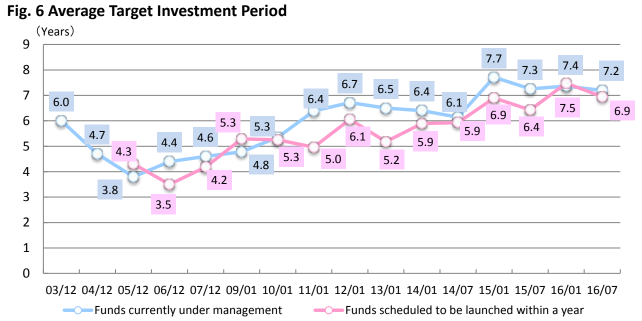
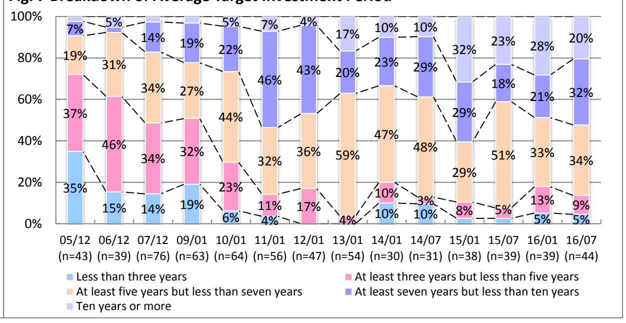


Fig. 7 Breakdown of Average Target Investment Period



Average LTV of funds under management and funds to be launched within a year, each of them declined from the previous surveys, standing at 58.1% and 61.7%, respectively(Fig.8). Especially that of funds under management drastically declined to the level below 60% for the first time since we started this survey.

Looking at the breakdown of LTV ranges, for funds currently under management, the percentage of "*at least 40% but less than 50%,*" and "*at least 50% but less than 60%*" increased from the previous survey, while that of " *80% or more*", so-called highly leveraged funds considerably decreased(Fig.9). This survey item includes responses from private REITs, and an increase in the number of responses is a reason for the decline in the average LTV.

For funds to be launched within a year, the percentage of "*at least 50% but less than 60%*" drastically increased, while that of "*at least 60% but less than 70%*" drastically decreased and " *80% or more*" slightly decreased(Fig.11).

With respect to the average target IRR of the funds currently under management, the average target IRR of all types of funds declined from the previous survey, total average target IRR was 11.1%(Fig.10). Looking at trends of average target IRR of all funds, it has been moderately declining after peaking out in the January 2011 survey. The average LTV of the funds currently under management has also been declining, which indicates that the return target is on a downward trend, as core funds, which hold down leverage, are preferred more and more.

Fig. 8 Average LTV Ratio

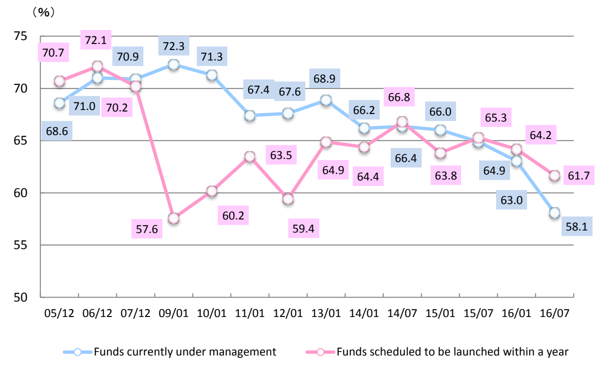


Fig. 9 Range of LTV level (Funds currently under management)

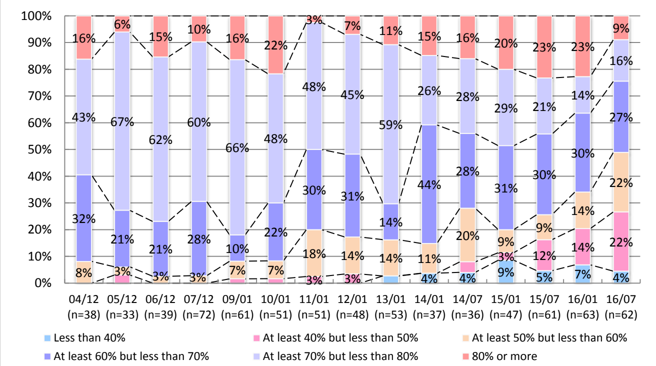


Fig.10 Average Target IRR(Funds currently under management)

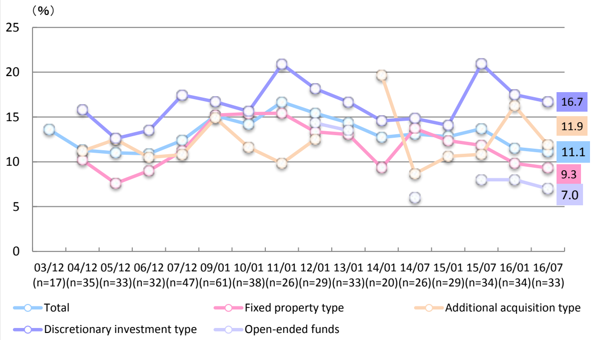
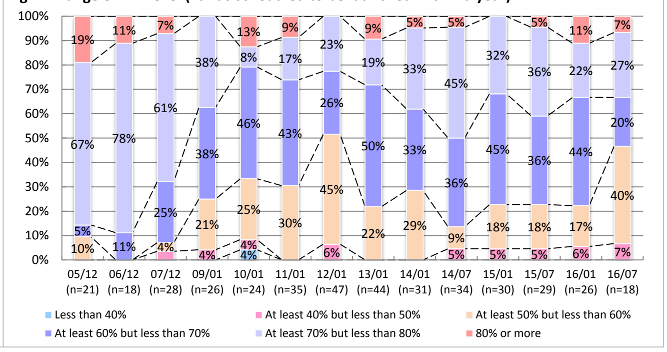


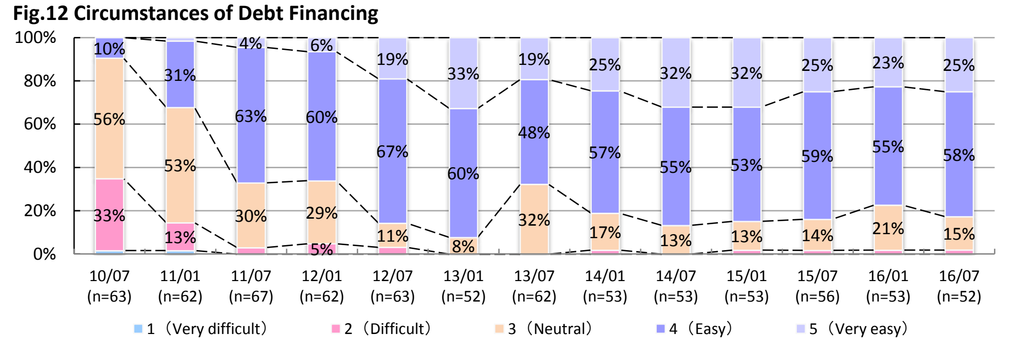
Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt financing circumstances, the percentage of respondents who selected "*5 (very easy)*" and "*4 (easy)*" slightly increased, while "*3 (neutral)*" slightly decreased, resulting in mostly same proportion with the July 2015 survey(Fig.12). This was the first survey since Bank of Japan introduced the negative interest rate policy in January 2016, however, in the past few years, the debt financing environment has remained favorable, we consider that further monetary easing is unlikely.

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 from the January 2015 survey, the trend reversed in this survey(Fig13). This result reveals that the Bank of Japan's introduction of the negative interest rate policy has not had a very big influence on debt financing circumstances in private funds market, it has been found out that, while a certain number of asset managers think that equity investors' appetite for real estate has risen.

In regards to the target property types likely to be tapped by equity investors, the percentage of respondents who chose "*No change*" have a majority in all property types excluding "*Hotel*" for both domestic and foreign investors. As for "*Hotel*," a majority of respondents, both domestic and foreign investors, chose "Increase significantly" or "Increase."(Fig.14-1, Fig.14-2). It shows that both domestic and overseas investors have a strong appetite for investment in hotels sector.

Fig.13 Appetite of Equity Investors

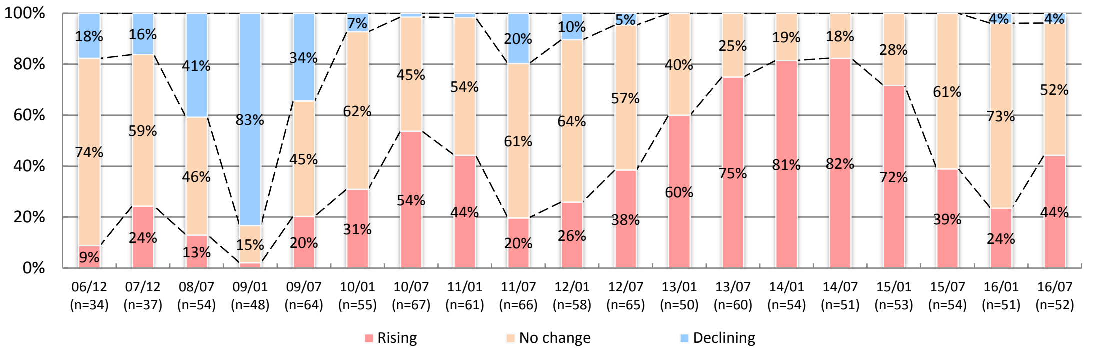


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

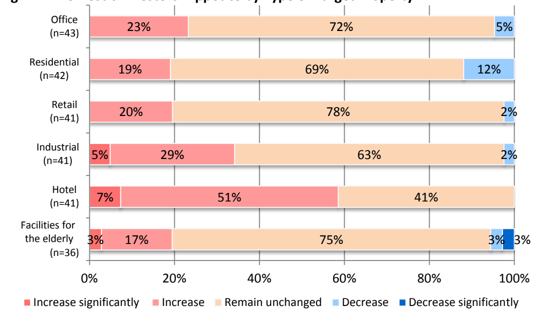
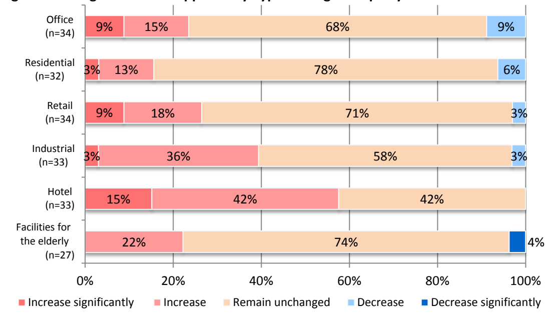


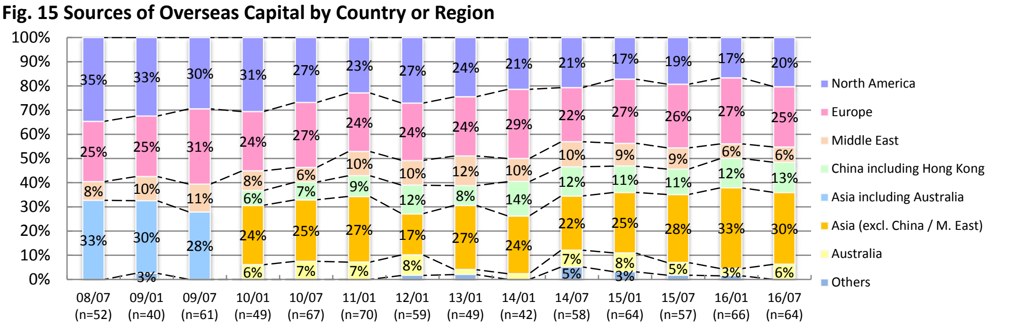
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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 30%. The percentage of "*Asia (excl. China /M.East)*" has been the largest for three consecutive surveys, growing 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 2012 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*”, ” *Highly stable income*”, “*The size of the real estate market is large*”, 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, 10 respondents chose “*Expected positive effects from exchange rates*”, it decreased to 4 in this survey with strengthening of the yen.

As the reasons for not investing in Japan, the largest number of the respondents chose “*Lack of growth potential in GDP, consumption, population, etc.*”, followed by “*Rising in real estate prices*”. The number of respondents who chose “*Rising in real estate prices*” increased to19 in this survey from 12 in the previous survey, which indicates that concern over rising real estate prices has increased (Fig.17).

Fig.16 Reasons for Foreign Investors Investing in Japan (Multiple answers allowed)

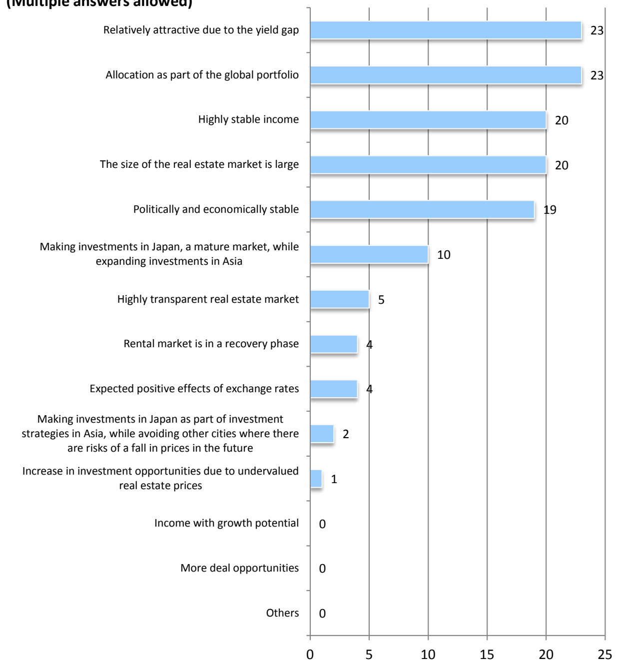
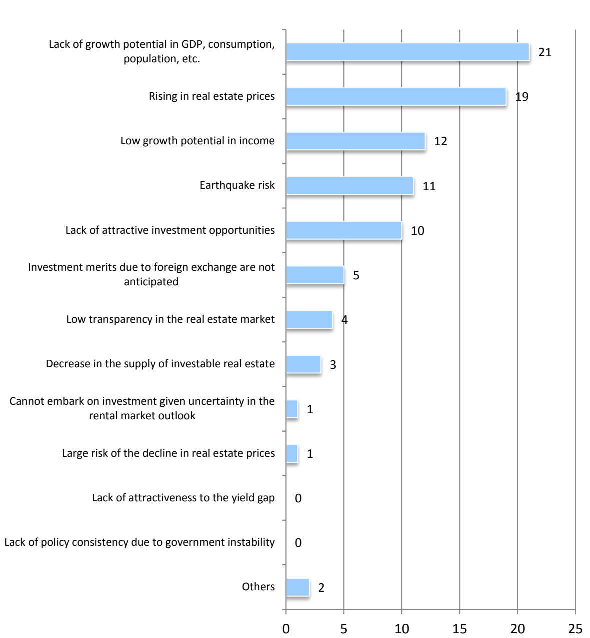


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed)



d. Acquisition and Disposition of Properties in the January to June 2016

As to a survey on the acquisition of properties in the January to June 2016, the percentage of respondents who answered *"Acquired"* accounted 67% (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 72%(Fig.19). Also, the percentage of respondents who answered “*Did not consider, due to a limited supply of properties in the market*” slightly increased, which indicates that as acquiring properties remains difficult, there is a trend of avoiding acquiring properties when their prices are high.

A survey on the disposition of properties in the January to June 2016, the respondents who answered “*Sold property"* and “*Didn't sell property"* are equally divided(Fig.20). The percentage of respondents who answered “*Sold property"* slightly increased from the previous survey, on the other hand, it has been decreased from the July 2013 survey. Most of them who did not sell any properties chose “*Did not plan to sell from the outset*” as their reason (Fig.21). It seems that increasing the number of open-ended funds and extending the investment period of closed-ended funds affect the decrease of opportunities as sellers.

Fig.18 Circumstances for Acquisition

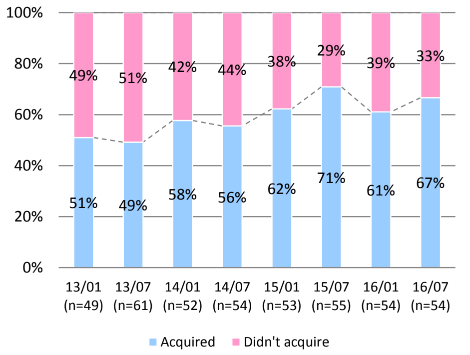


Fig.19 Reason for not acquiring property

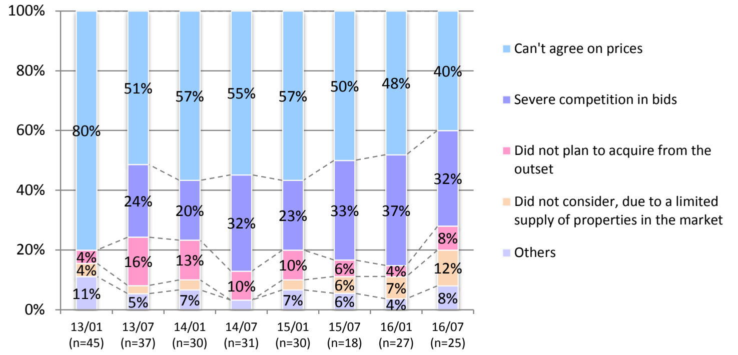


Fig. 20 Circumstances for Disposition

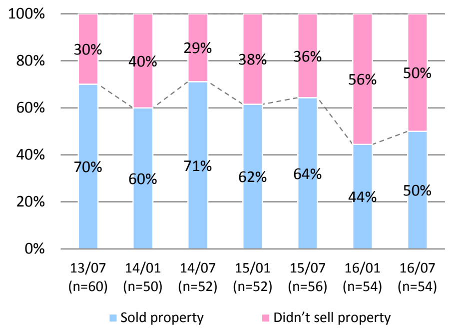
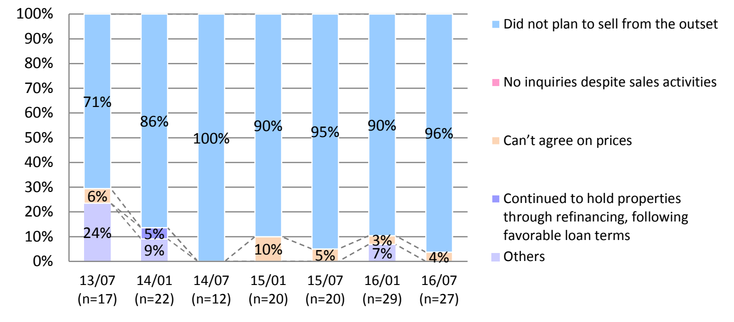


Fig. 21 Reason for not Selling Property



2. 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, 69% of respondents answered that they *"Plan to launch"* (Fig.22). The percentage of those who answered that they *"Plan to launch"* has been slightly decreased from the January 2014 survey.

As to plans of acquiring properties within a year, the percentage of respondents that they plan to acquire properties accounted for 88% in this survey (Fig.23). On the other hand, that of those who 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, while almost all managers eager to acquire properties.

Fig.22 Plans of Launch of New Funds

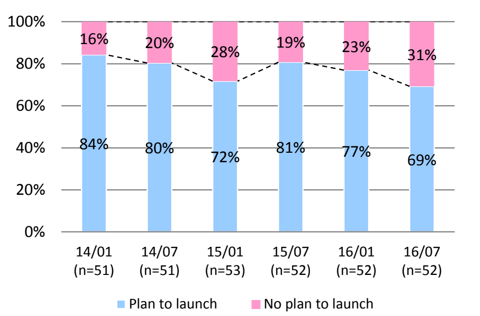


Fig.23 Plans of acquiring properties

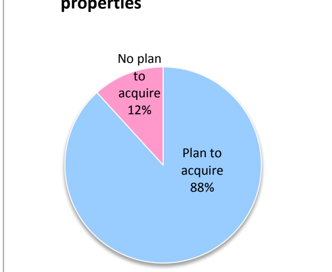
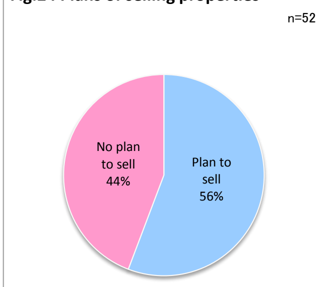


Fig.24 Plans of selling properties



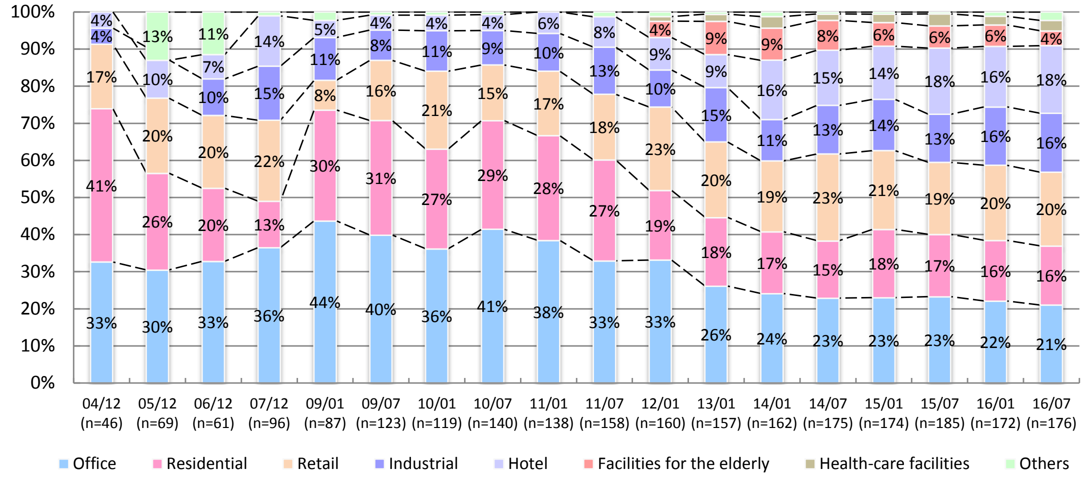
2). Investment Strategies of Asset Managers

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*", and "*Hotel*" (Fig.25).

Traditionally, "*Office*" and "*Residential*" were two major types of target properties, after that, the types has become diversified, managers have been focusing roughly equal degree to acquiring five types of properties *(Office, Residential, Retail, Industrial and Hotel)* in recent years.

Fig. 25 Target Property Types (Multiple answers allowed)

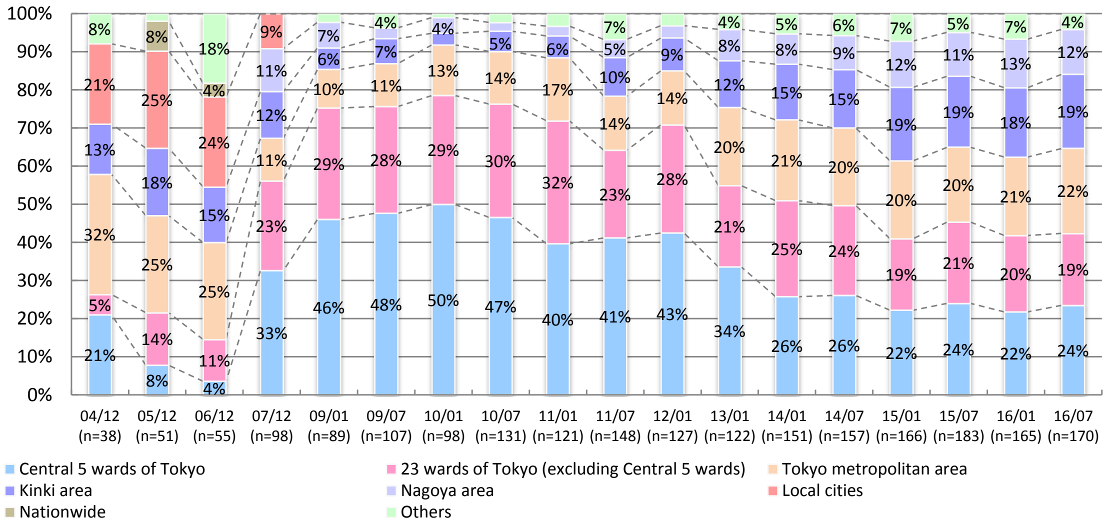


・"Facilities for the elderly" and "Health-care facilities" were newly established from the January 2012 survey.

b. Target Areas (Multiple answers allowed)

In terms of the target area, *"Central 5 wards of Tokyo"* accounted for the largest proportion(24%), and we did not see any major change from the previous survey in terms of future target areas (Fig.26). From 2009 to 2012, target areas concentrated in the 23 wards of Tokyo, including the central 5 wards. Subsequently, target areas expanded to the Tokyo metropolitan area and the provincial areas. In recent years, the Tokyo metropolitan area, Kinki area, and Nagoya area have been accounting for certain percentage ranges.

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 "*Have already launched (14 respondents)*", the number of the respondents increased by 3 from the previous survey (Fig.27).

In terms of important factors for development in the private REITs market in the future, the largest number of respondents chose *"Expansion of the categories of investors to invest in funds"*, it exceeded *"Expansion of the numbers of private REITs and the asset size"* ,the largest managers chose in the previous January 2016 survey and the July 2015 survey. The market of private REITs has expanded to some extent. We can say that the market is entering the second stage, where the market will pursue not only the size but also stable quality.

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

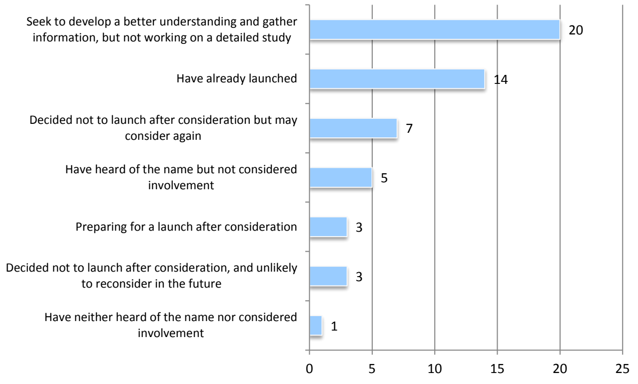
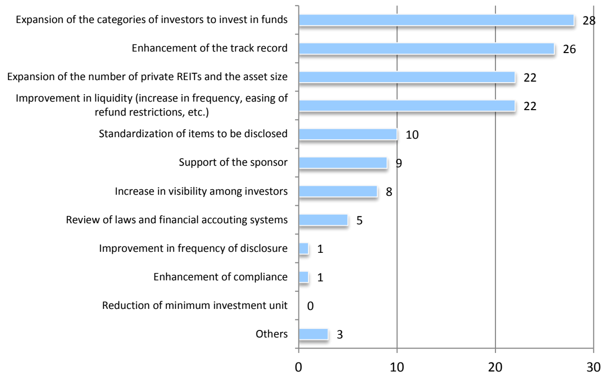


Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options) n=135(Respondents 51)



2) Outlook of asset size in the Closed-ended private real estate funds market

In regards to the outlook of asset size in the closed-ended private real estate funds market, the number of respondents that expect an increase and those who expect a decrease are roughly equal, but a majority of the respondents chose "Increase" or "Slightly increase."(Fig.29)

As for the reasons responding *"Increase"* or *"Slightly increase"*, the largest number of respondents chose "*Increase of domestic investors' money"* (Fig.30). This could indicate that, with the introduction of negative interest rate policy, many asset managers expect that domestic investors will pump funds into the real estate market.
Many respondents who chose " *Decrease"* or *"Slightly decrease"* options indicating the limited supply of investment-grade real estate including existing real estate and new developments. Meanwhile, as for the reasons responding *"Others"*, some managers answered that increasing of asset size in open-ended private funds and J-REIT market will lead to a reduction in market size of closed-ended funds.

Fig.29 Assets under management of closed-ended funds

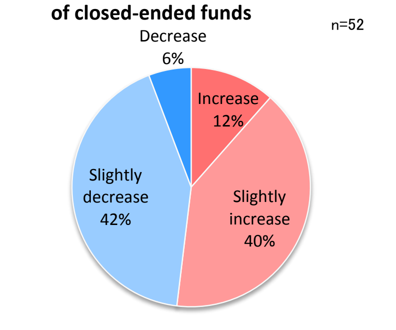
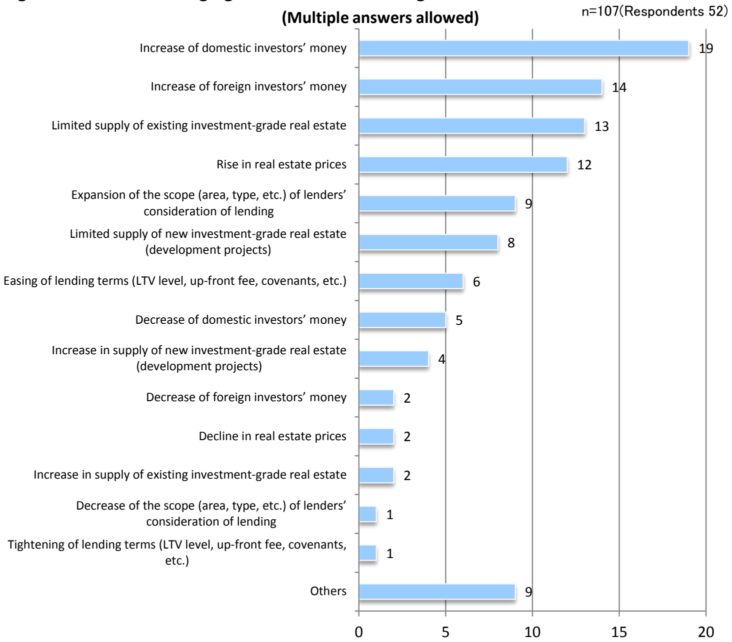


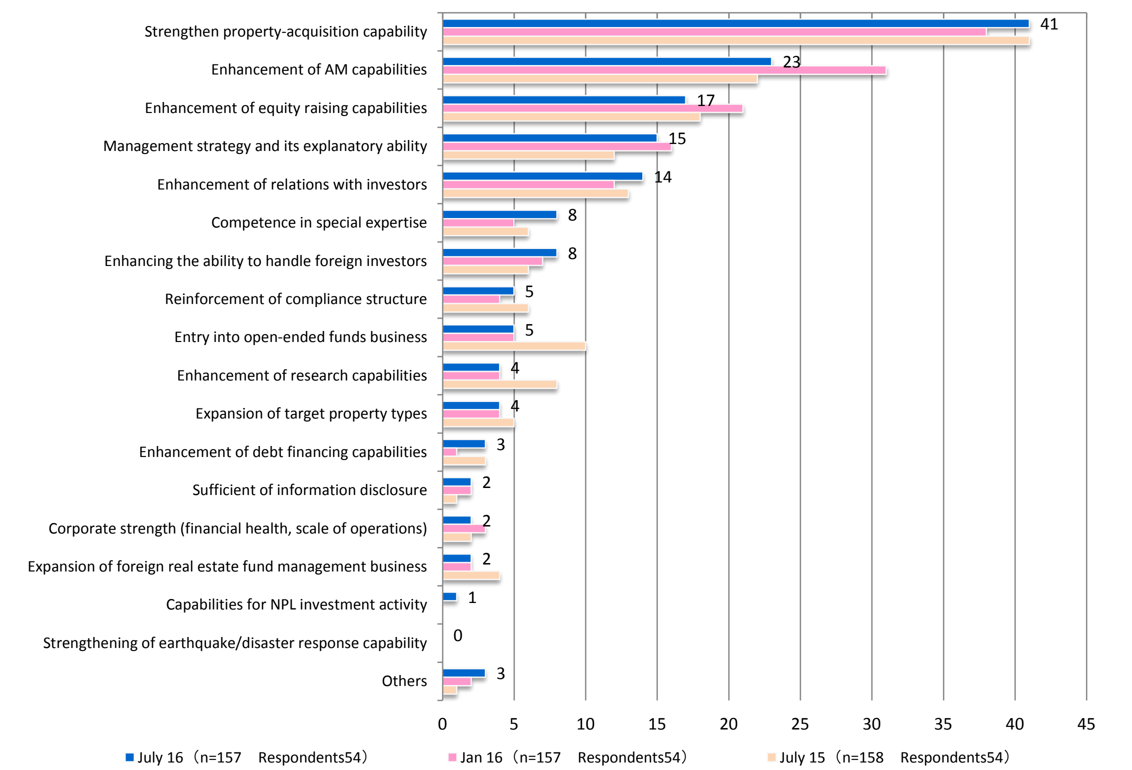
Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)



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"* (Fig.31). In the last five times survey, the largest number of respondents chose *"Strengthen property-acquisition capability"*. Given the continued challenging market condition for acquisitions of properties, we consider that many managers attach high priority to strengthen property-acquisition capability.

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.

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