SUMITOMO MITSUI TRUST RESEARCH INSTITUTE

NEWS RELEASE

Survey on Private Real Estate Funds in Japan

January 2017– Results

March 27, 2017

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 23th 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: 109
  - The number of responses: 55 (ratio of valid responses: 50.5%)
  - Survey period: in the January to February 2017
  - 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 2016 to be 15.6 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 180 billion yen (1.1%) from the previous survey (15.5 trillion yen as of the end of June 2016). The market for domestic private real estate funds continued to expand, albeit slightly.

The market size of private real estate funds is 15.6 trillion yen including Japanese assets of global funds

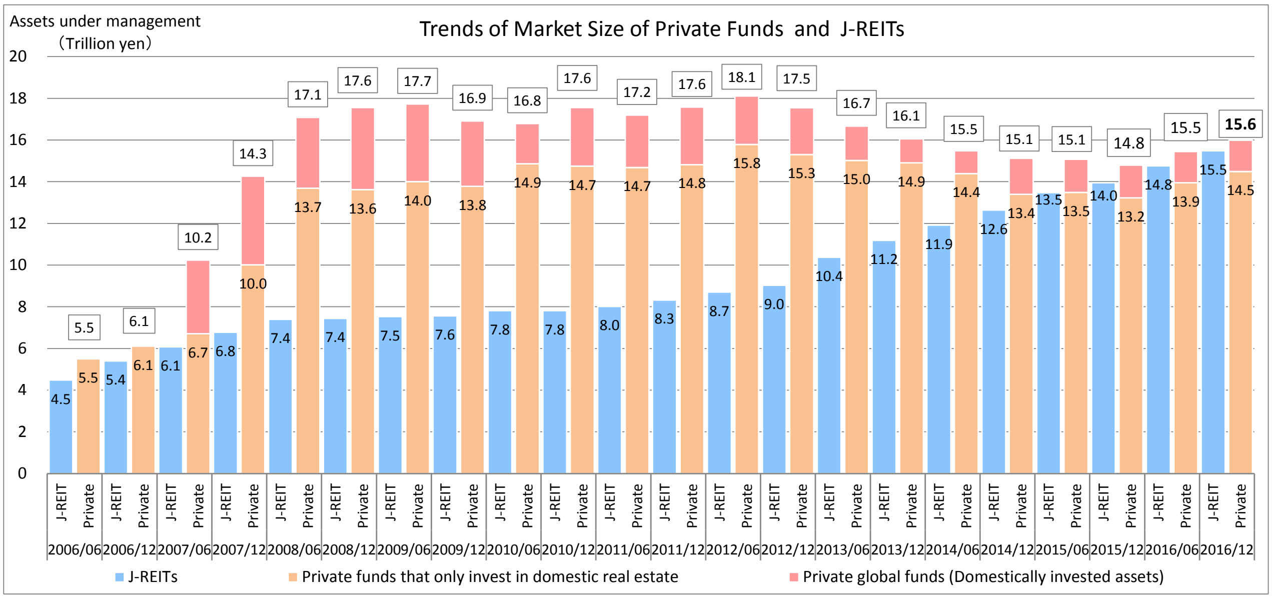
・Assets under management (AUM) as of the end of December 2016 were 15.6 trillion yen. Assets under management (AUM) increased approximately 180 billion yen from the previous survey. The market for domestic private real estate funds continued to expand, albeit slightly.

・The number of asset managers who said their AUM increased exceeded by about 10% the number of asset managers who said their AUM, and overall AUM increased approximately 1.1%. AUM of funds, primarily private REITs, which invest in domestic real estate expanded, while AUM of global funds declined.

・Debt financing conditions and the appetite of equity investors are expected to remain favorable. No significant changes from the previous survey were observed, and no easing of debt financing circumstances or increase in the appetite of equity investors are likely.

・In regards to involvement in open-ended private funds (so-called private REITs), 16 managers answered that they have already launched. In terms of important factors for development in the open-ended private funds market going forward, the largest number of respondents chose *"Enhancement of the track record,"* which indicates that the continuation of stable management, including responses to a downturn in the real estate market, is attracting attention. 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" January 2017 Survey Results

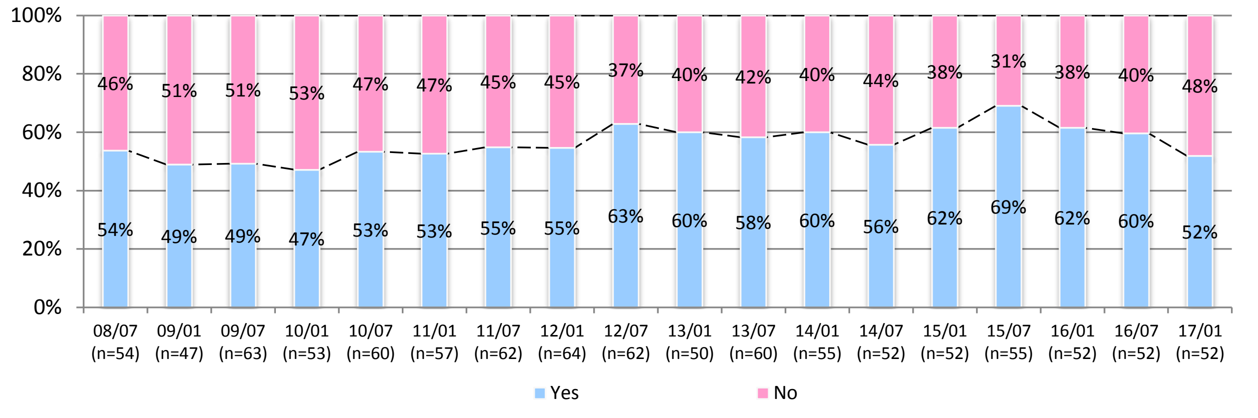
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

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, 52% of respondents chose "Yes". The percentage of overseas capital fell well below 60%, the level that had been maintained since the January 2015 survey. As domestic real estate prices rose, overseas investors may have sold investment properties or they may be more cautious about new investment (Fig.1).

Fig.1 Do you manage overseas capital?

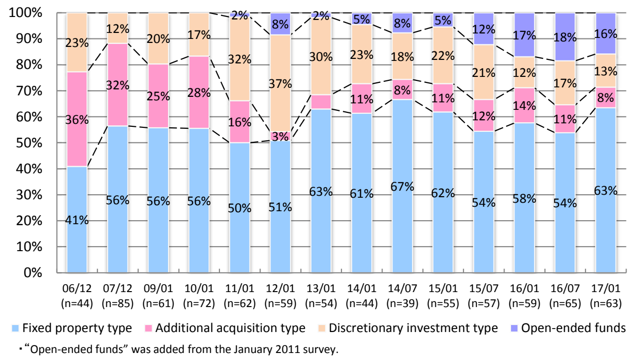


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

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). The percentage of open-ended funds has increased steadily in the past few years. However, the number of open-ended funds exceeded 20, and the pace of setting up new funds appears to have slowed.

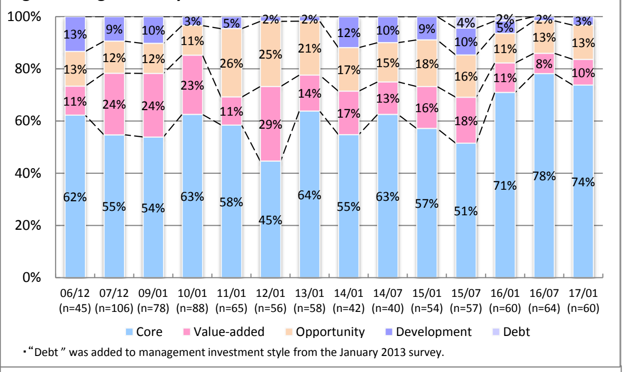
The breakdown of target properties types and areas remained almost unchanged from the previous survey, which indicates that many managers have widely targeted at both properties types and areas (Fig.4 and Fig.5).

Fig. 2 Fund types



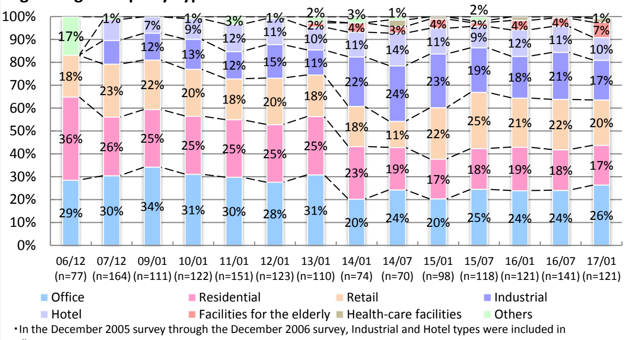
・"Open-ended funds" was added from the January 2011 survey.

Fig. 3 Management Style



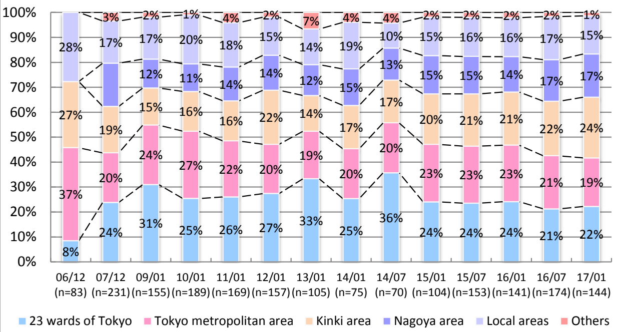
・"Debt" was added to management investment style from the January 2013 survey.

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 6.6 years for funds currently under management and 6.4 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*"(52%). The average target investment period shortened slightly from the previous survey, reflecting declines in the percentages of "*At least seven years but less than ten years*" and "*Ten years or more*"(Fig.7). The aggregated share of "*Less than five years*" accounted only 11%, 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

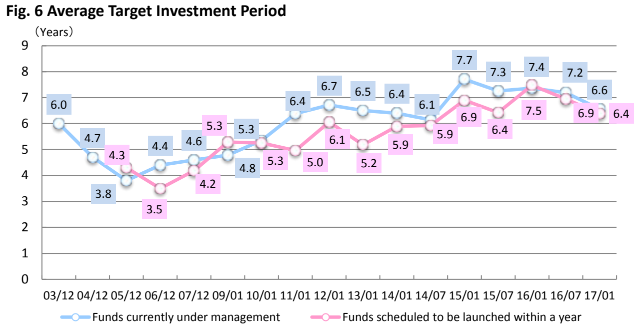
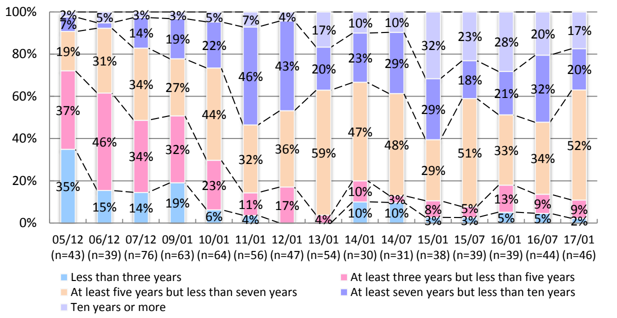


Fig. 7 Breakdown of Average Target Investment Period



Average LTV of funds under management stood at 59.1%, and that of funds to be launched within a year was 62.5%. Although average LTV rose temporarily, it has been on a downward trend (Fig.8). One of the reasons for the downward trend is considered to be an increase in the number of private REITs that prefer long-term stability.

Looking at the breakdown of LTV ranges, for funds currently under management, the percentage of "*at least 50% but less than 60%*," and "*at least 70% but less than 80%*" increased from the previous survey, while that of "*at least 40% but less than 50%*," and "*at least 60% but less than 70%*", decreased(Fig.9). This survey item includes responses from private REITs.

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

With respect to the average target IRR of the funds currently under management, the average target IRR of all types excluding "Open-ended funds" of funds declined from the previous survey, total average target IRR was 9.7%(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

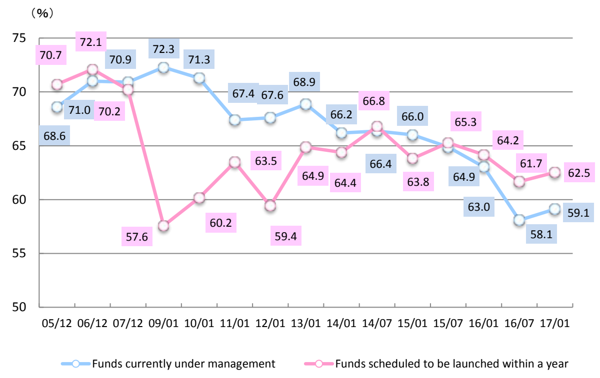


Fig. 9 Range of LTV level (Funds currently under management)

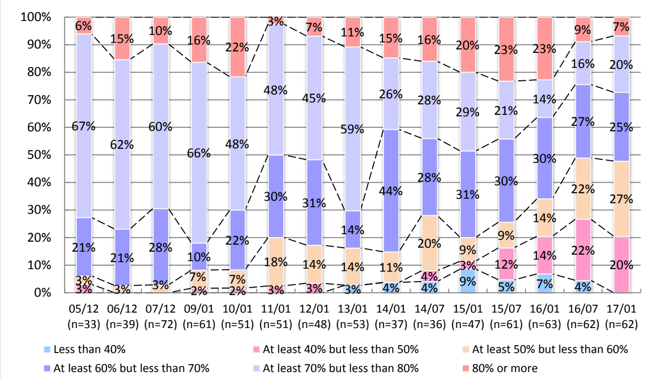


Fig.10 Average Target IRR(Funds currently under management)

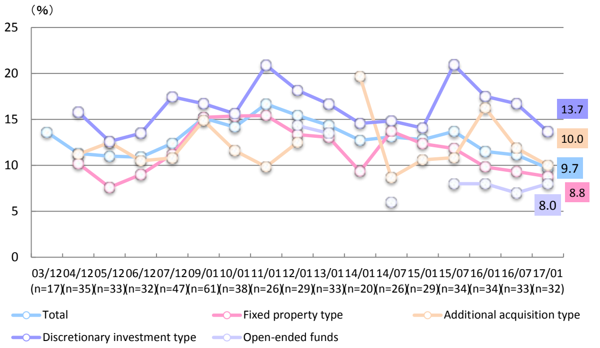
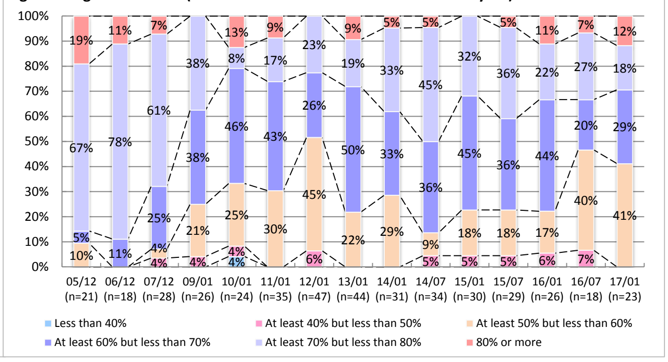


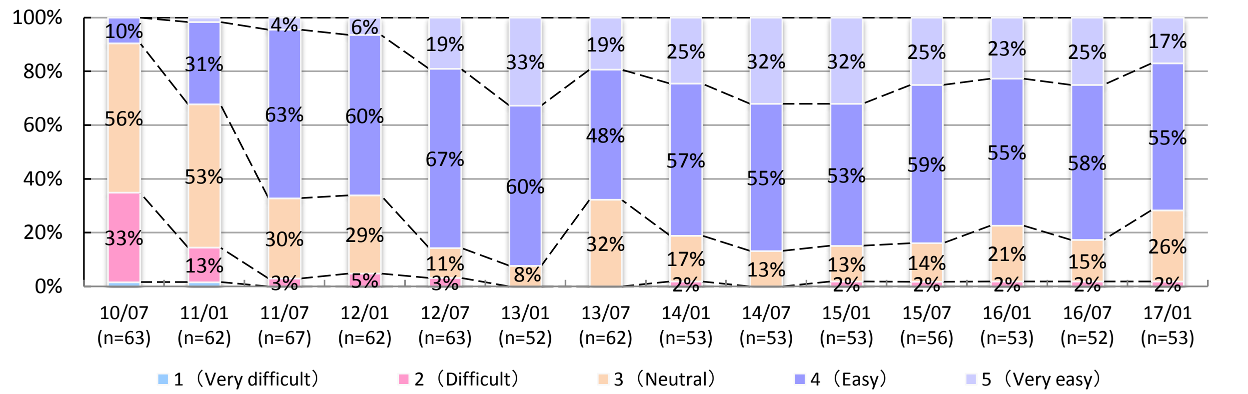
Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt financing circumstances, the percentage of respondents who selected "*5 (very easy)*" and "*4 (easy)*" slightly decreased, while "*3 (neutral)*" slightly increased(Fig.12). Debt financing circumstances can be said to remain favorable, but attention is increasingly focused on what may trigger changes in those circumstances.

Fig.12 Circumstances of Debt Financing



4) Equity Raising

a. Appetite of Equity Investors

To a question on the appetite of equity investors, a smaller percentage of respondents chose *"Rising,"* while most respondents continued to choose *"No change."* The appetite of equity investors remained strong (Fig13). The sharp increase in *"Rising"* in the previous survey is assumed to be largely attributable to the Bank of Japan's introduction of a negative interest rate policy.

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*," nearly half 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

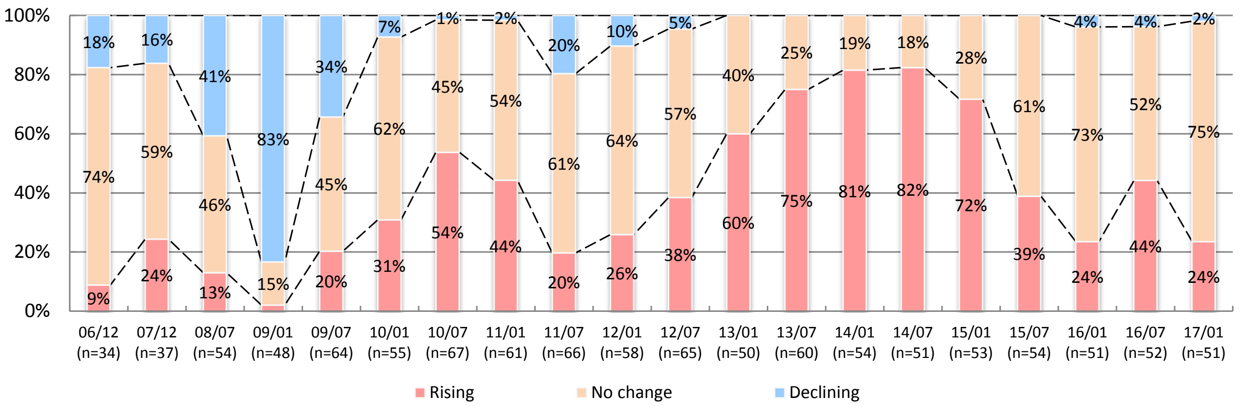


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

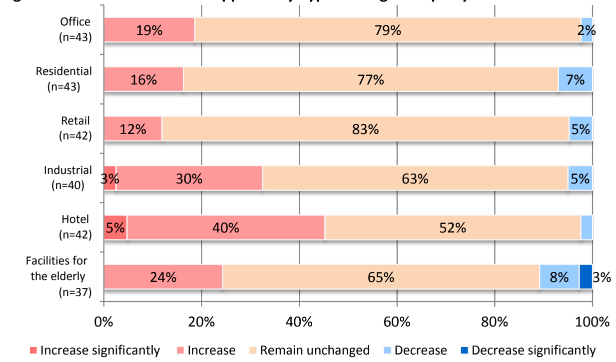
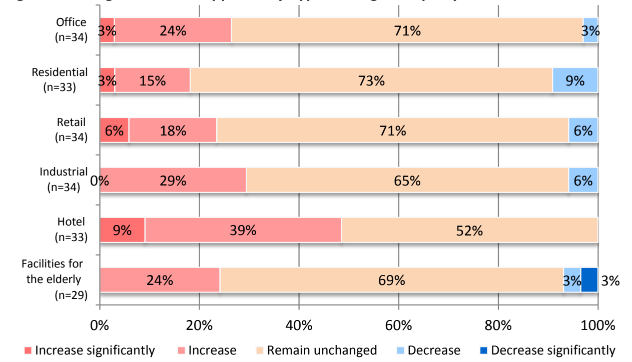


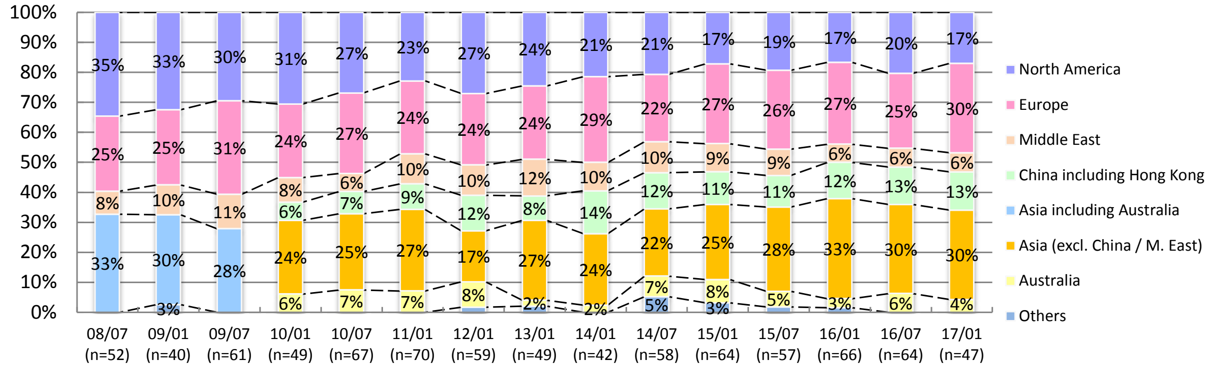
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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 *"Europe"and"Asia (excl. China /M.East)"*at 30%. The percentage of *"Asia (excl. China /M.East)"* has been the largest for four consecutive surveys, since the survey as of July 2015 growing their presence as foreign investors(Fig.15).

Fig. 15 Sources of Overseas Capital by Country or Region



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 *" Highly stable income"*, "*Relatively attractive due to the yield gap*", "*Politically and economically stable*" , "*Allocation as part of the global portfolio*" , and "*The size of the real estate market is large*" (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.

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 results did not change significantly from the previous survey. Concern over rising real estate prices seems to remain strong (Fig.17).

Fig.16 Reasons for Foreign Investors Investing in Japan (Multiple answers allowed) n=95(Respondents26)

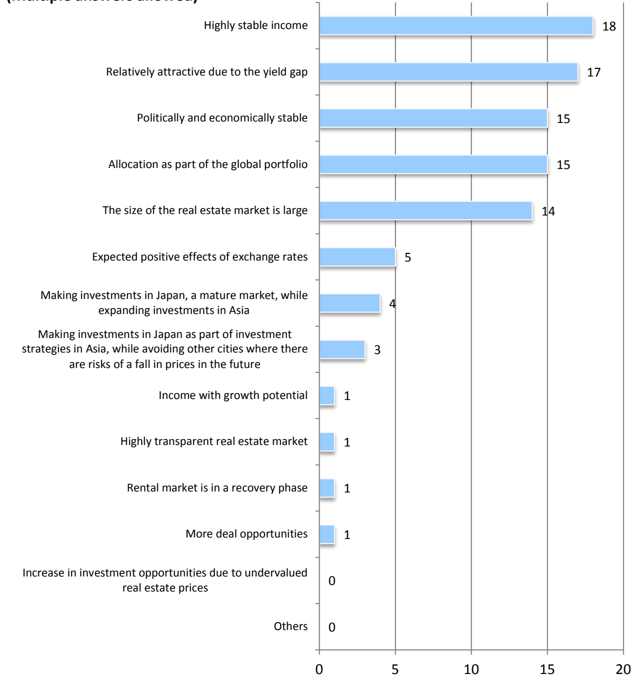
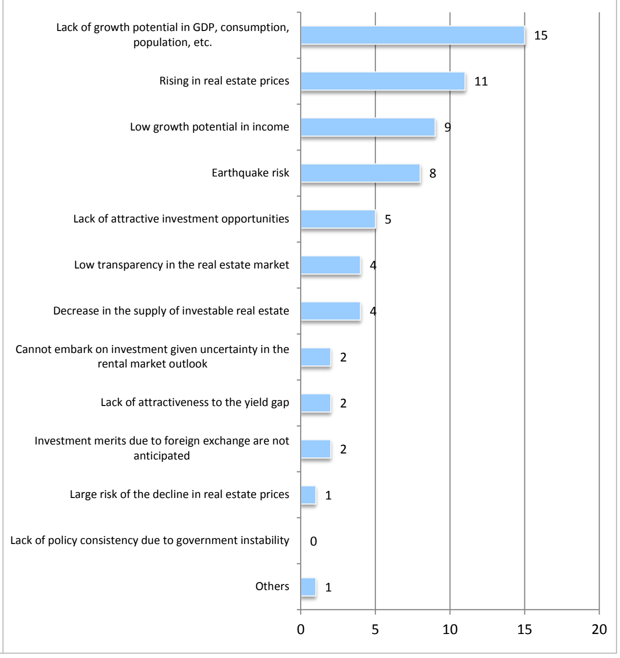


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed) n=64(Respondents23)



d. Acquisition and Disposition of Properties in the July to December 2016

As to a survey on the acquisition of properties in the July to December 2016, the percentage of respondents who answered *"Acquired"* accounted 60% (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 75%(Fig.19). The results indicate that the environment for the acquisition of properties remained challenging.

A survey on the disposition of properties in the July to December 2016, the respondents who answered *"Sold property"* and *"Didn't sell property"* are equally divided(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) . 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

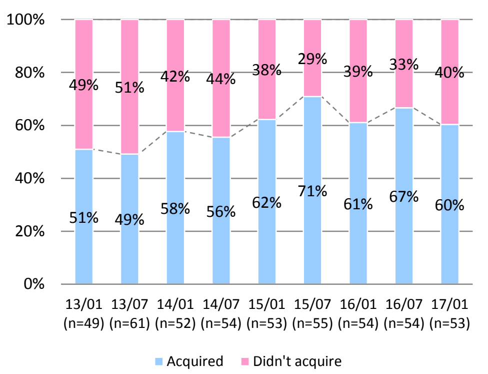


Fig.19 Reason for not acquiring property

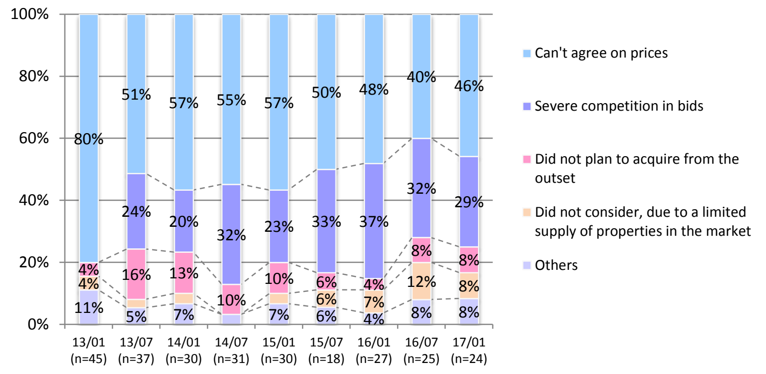


Fig. 20 Circumstances for Disposition

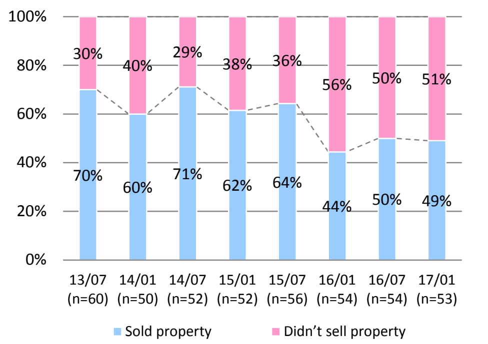
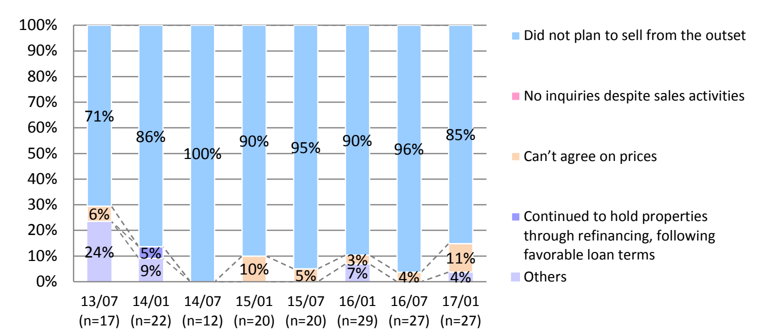


Fig. 21 Reason for not Selling Property



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, 73% of respondents answered that they *"Plan to launch"* (Fig.22). The percentage of *"Plan to launch"* rose after a decline since the January 2016 survey.

As to plans of acquiring properties within a year, the percentage of respondents that they plan to acquire properties accounted for 92% in this survey (Fig.23). On the other hand, that of those who plan to sell properties within a year accounted for 53% (Fig.24). As the number of transactions is declining, real estate prices may rise further. 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

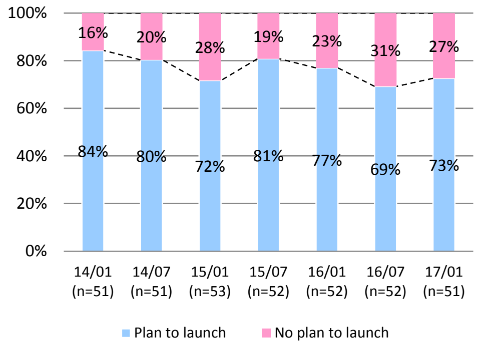


Fig.23 Plans of acquiring properties

n=51

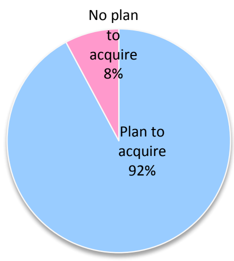
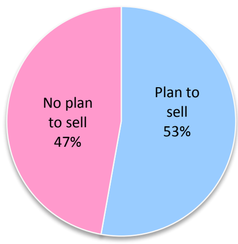


Fig.24 Plans of selling properties

n=53



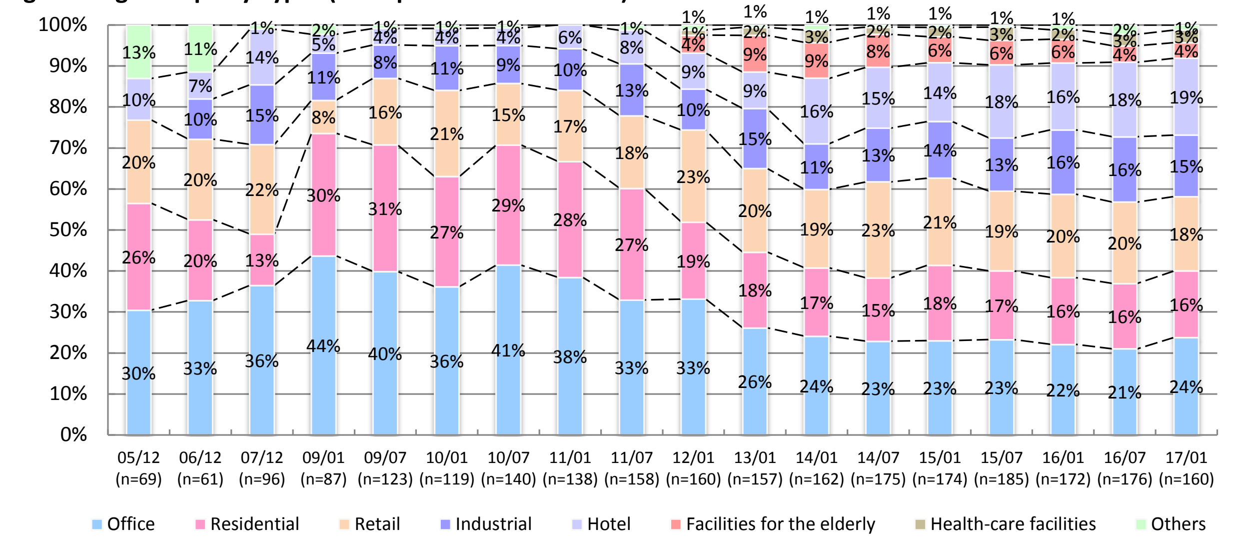
2). Investment Strategies of Asset Managers

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, but target property types have been diversified as a result of intensifying competition in the acquisition of properties.

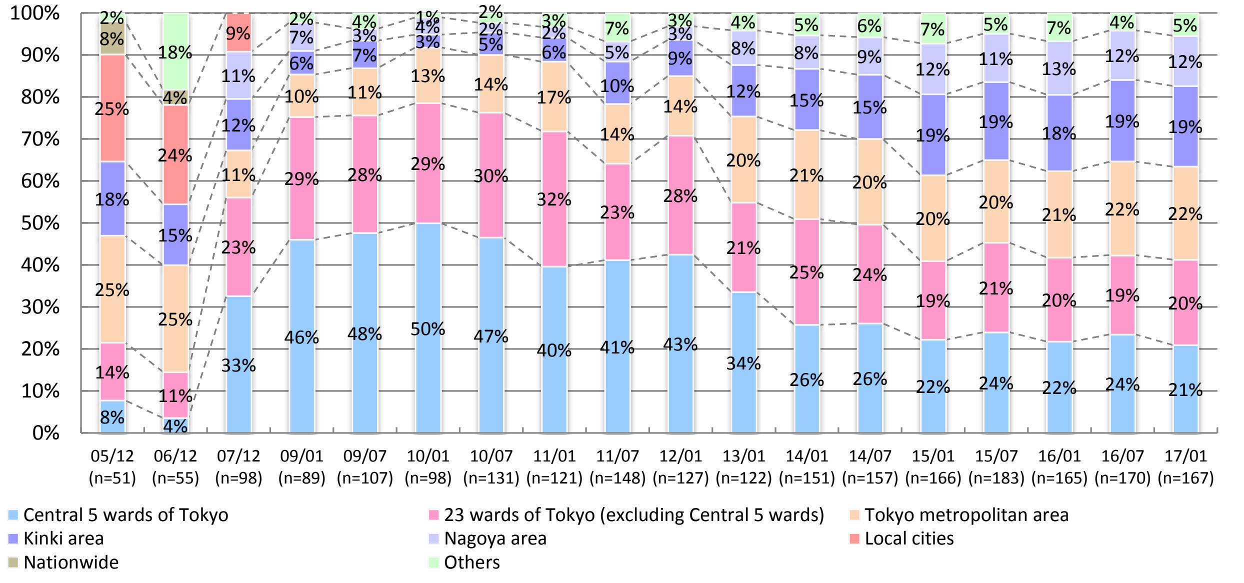
Fig. 25 Target Property Types (Multiple answers allowed)



b. Target Areas (Multiple answers allowed)

In terms of the target area, "*Tokyo metropolitan area*" accounted for the largest proportion(22%), and we did not see any major change from the previous survey in terms of future target areas (Fig.26). Given intensifying competition in the acquisition of properties in central Tokyo, target areas have been diversified primarily into "*Kinki area*" and "*Nagoya area*" to a certain degree.

Fig. 26 Target Areas (Multiple answers allowed)



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), 19 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 (16 respondents)*", the number of the respondents increased by 2 from the previous survey (Fig.27).

As for important factors for development in the private REITs market, the largest number of respondents chose "*Enhancement of the track record,*" which indicates that the continuation of stable management, including responses to a downturn in the real estate market, is attracting attention. 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=54(Respondents 52)

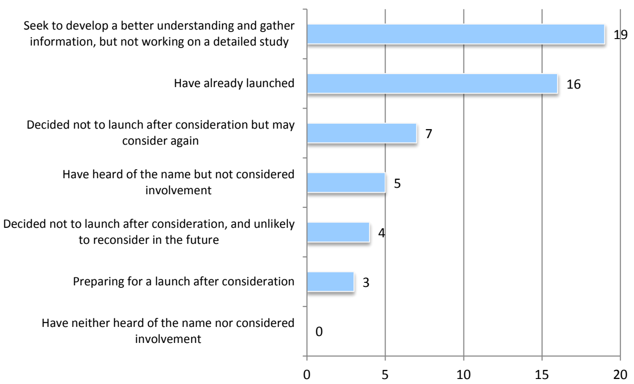
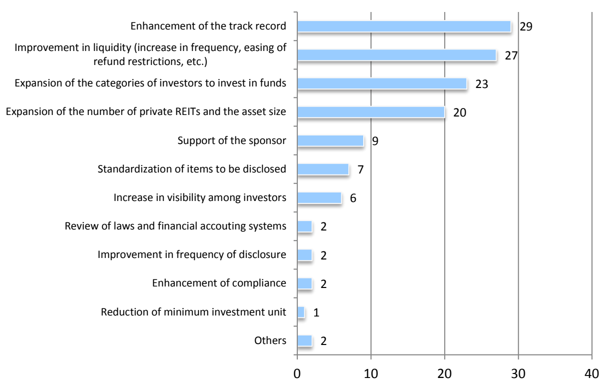


Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options) n=130(Respondents 49)



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 (Fig.29).

As for the reasons responding *"Increase"* or *"Slightly increase"*, the largest number of respondents chose *"Increase of domestic investors' money"* (Fig.30). We assume that a number of asset managers expect continued inflows of funds into real estate investment due to the effect of the Bank of Japan's introduction of negative interest rates.

The main reasons for *"Decrease"* were *"Limited supply of existing investment-grade real estate"* and *"Rise in real estate prices."*

"Others" include opinions to the effect that the expansion of open-ended private funds is leading to a decline in closed-ended private funds.

Fig.29 Assets under management of closed-ended funds

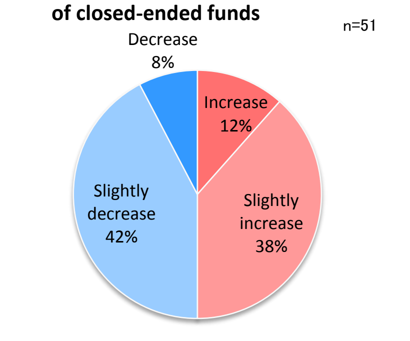
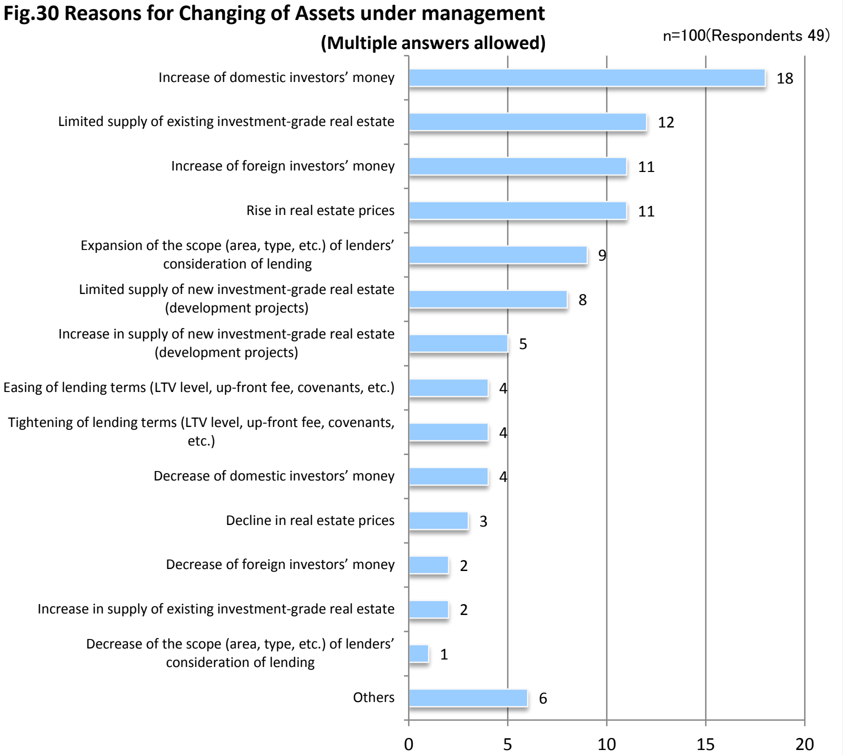


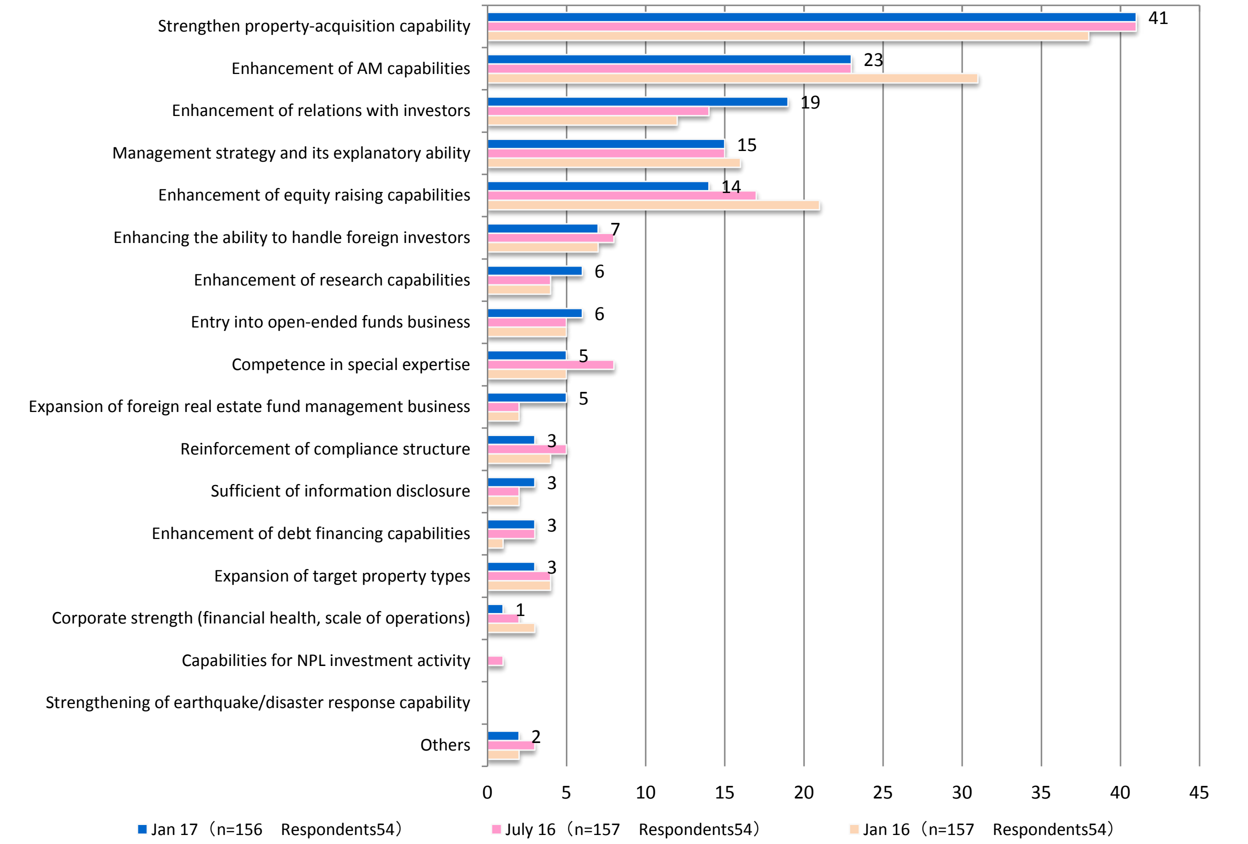
Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)



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). Acquiring properties is becoming more challenging given rising real estate prices. In this environment, asset managers are required to enhance their ability to achieve the internal growth of properties they own.

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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