News Release

Survey on Private Real Estate Funds in Japan

July 2018– Results

September 10, 2018

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 26th survey based on responses to questionnaires received from 53 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: 53 (ratio of valid responses: 48.6%)
  - Survey period: in the July to August 2018
  - 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 2018 to be 16.9 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 860 billion yen (5.4%) from the previous survey (16.0 trillion yen as of the end of December 2017). The pace of expansion of the market for domestic private real estate funds, which was gradually increasing in recent years, has accelerated slightly. In this survey, we have revised the past figures to reflect the new information which was obtained.

The market size of private real estate funds is 16.9 trillion yen including Japanese assets of global funds

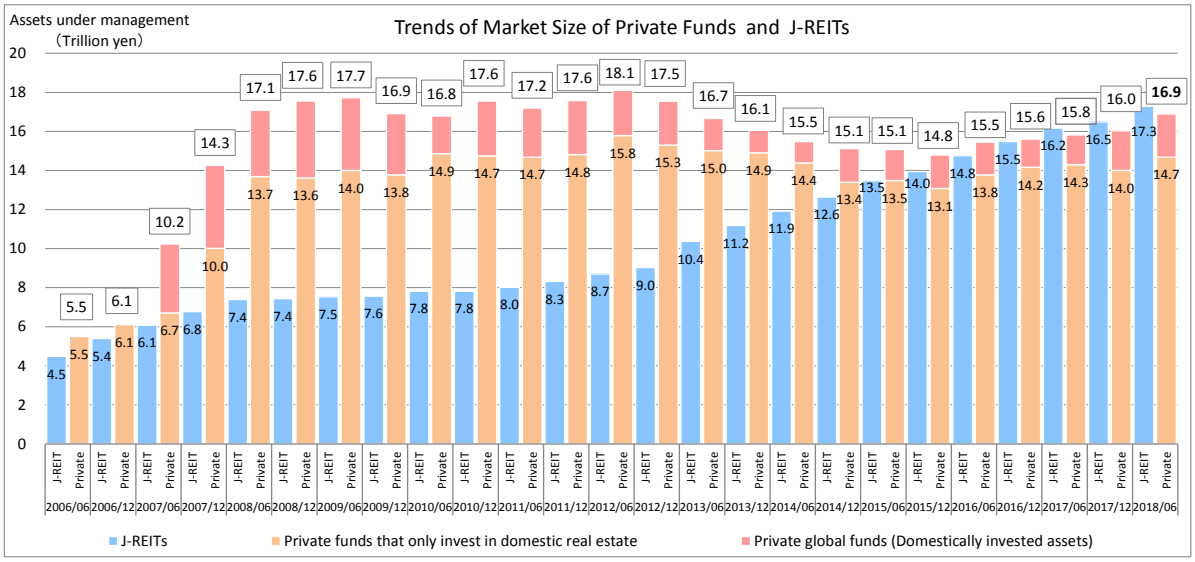
・Assets under management (AUM) as of the end of June 2018 were 16.9 trillion yen（This figure involves Japanese assets managed by global funds）. AUM increased approximately 860 billion yen from the previous survey as of the end of December 2017. The pace of expansion of the market for domestic private real estate funds, which was gradually increasing in recent years, has accelerated slightly.

・The number of asset managers whose AUM increased exceeded the number of asset managers whose AUM decreased and there are some managers whose AUM increased more than 100 billion yen. Overall, the market size we estimated rose approximately 5.4% from the estimate in the previous survey. Both the numbers and AUM of private REITs increased, the total AUM of asset managers who only manage private funds (excluding private REITs) also increased. We realized that the market size of private real estate funds is expanding by the increase of both private REITs and private funds.

・With debt financing conditions remaining favorable, many managers seem to believe that equity investors' appetite for investment is continuing at a high level.

・As to a survey on acquiring or disposing properties in the first half of 2018、more than 70% of respondents answered *"Acquired"*, also more than half of the respondents answered *" Sold property "* ,both of them increased compared to the recent surveys. In the environment that the number of properties coming onto the market remains low, the managers on its sellers' side seemed to have little trouble disposing properties due to the narrowing gap in price expectations between sellers and buyers and so on. It shows that active acquisition of properties continued with a background of brisk demand for acquisitions.

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



“ Survey on private real estate funds” July 2018 Survey Results

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

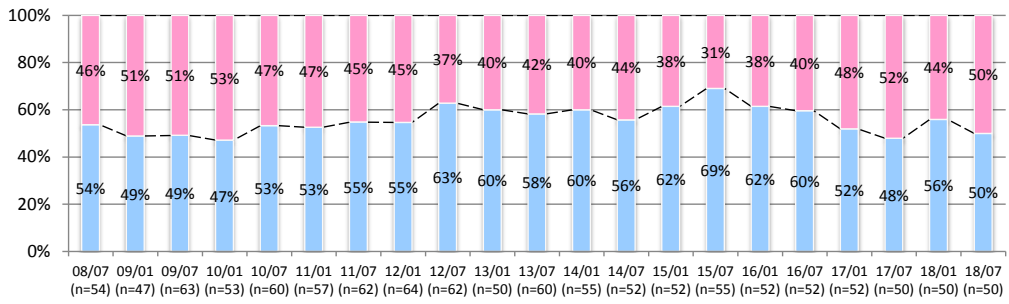
1. Current Status of Real Estate Fund Management Business

1) Management of Overseas Capital

In response to the question as to whether they have managed overseas capital in their private real estate funds, both “Yes” and “No” accounted for 50% (Fig.1). The percentage of respondents who said *“Yes”* accounted for 69% in the July 2015 survey, after that was on a downward trend.It has been around 50% since the January 2017 survey.

The reason why the percentage of the managers who managed overseas capital showed a downward trend since 2016 is thought to be a sense of caution among overseas investors against rising real estate prices in Japan. However, based on the results of the recent two surveys, the downward trend seem to have ended and bottoming out. It will be necessary to keep a watch on the trend in the future.

Fig.1 Do you manage overseas capital?

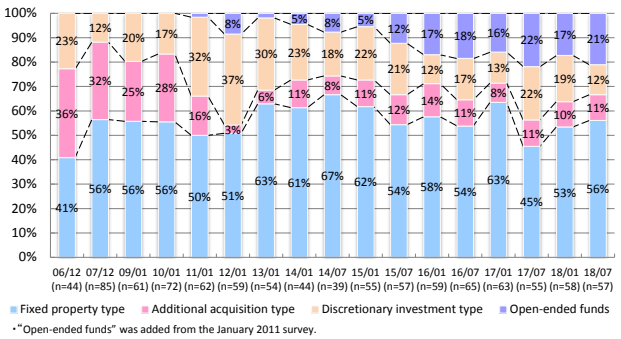


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

The results of the content of 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). “Open-ended funds” by fund type is around 20%, which is the second largest share following *“Fixed property type”*. By management style, *“Development”* has increased 5% points to 12% from the previous survey, suggesting the possibility that the launch of *“Development”* are increasing.

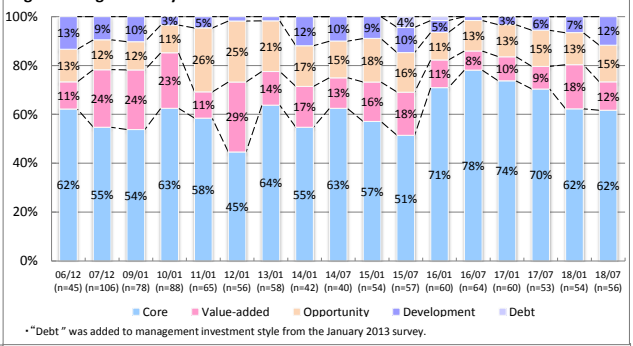
In a survey on target property types, *“Office”* was chosen by the largest percentage of the respondents(20%), followed by *“Residential”* and *“Retail”* (18% each), *“Industrial”* and *“Hotel”* (16% each)(Fig.4). The percentage of *“Hotel”* was the same as *“Industrial“*, suggesting that the presence of *“Hotel”* as a target property type has increased. In a survey on target areas, the percentages of investments in the target areas have remained almost the same since the January 2015 survey, suggesting that investments in diversified areas have been taken root (Fig.5).

Fig. 2 Fund types



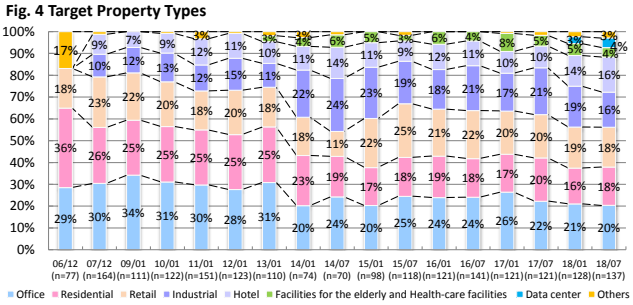
・"Open-ended funds" was added from the January 2011 survey.

Fig. 3 Management Style



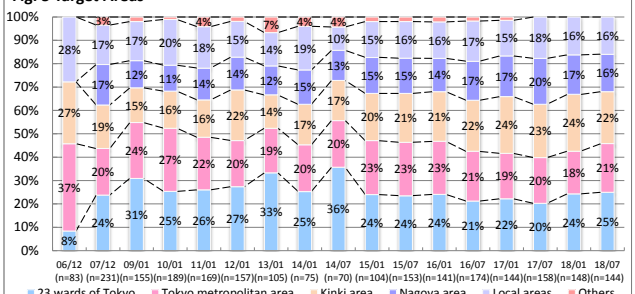
・"Debt" was added to management investment style from the January 2013 survey.

Fig. 4 Target Property Types



・In the December 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.
・From the December 2017 survey, "Facilities for the elderly" and "Health-care facilities" have been changed to "Facilities for the elderly and health-care facilities," and the past values are added together.
・"Data center" was added from the December2017 survey.

Fig. 5 Target Areas



・In the December 2006 survey, the Nagoya area was included in Local areas.
・"Others" was deleted from the July 2017 survey.

As to the survey in terms of the average target investment period, it was 6.1 years for funds currently under management and 8.2 years for funds to be launched within a year (Fig.6). Looking at the breakdown of the investment period of funds currently under management, although the largest share of respondents chose *"At least five years but less than seven years"*（26%）, it decreased 13% points from the previous survey. While the percentage of respondents who chose *"At least seven years but less than ten years"* and *"Ten years or more"* accounted for 45% in total, the percentage of *"Less than three years"* increased to18%, *"At least three years but less than five years"* to 12% from 8% each in the previous survey(Fig.7). With the backdrop of the prospect that monetary easing policy by the Bank of Japan will be maintained, the trend whereby funds with an investment period of five years or more comprise the majority is expected to continue. On the other hand, there seems to be new needs recently for funds with a short target investment period, such as bridging funds. In fact, the average target investment period of funds to be launched within a year has lengthened from 6.7 years to 8.2 years. This is significantly affected by the answer that the target investment period is thirty years, which multiple respondents provided. It does not signify a general trend in which the target investment period of funds to be launched has become much longer. Also, the survey of the investment period does not include open-ended funds（private REITs）, whose investment period is indefinite.

Fig. 6 Average Target Investment Period

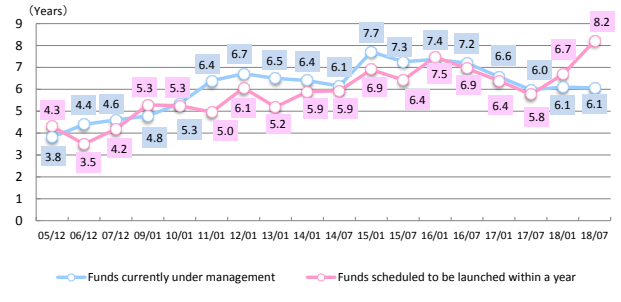
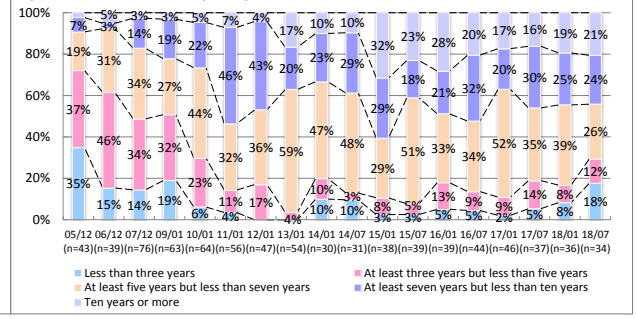


Fig. 7 Breakdown of Average Target Investment Period



The average LTV of funds under management was 58.4%, and that of funds to be launched within a year was 65.3%.(Fig.8). Looking at the breakdown of LTV ranges, for funds currently under management, *"at least 50% but less than 60% "* accounted for the largest share(31%), followed by *"at least 70% but less than 80%"*(22%) (Fig.9). Looking at the trend from the past survey, the total share of *"Less than 60%"* is on an increasing trend, it seems to reflect investors' low risk and low leverage intention. This survey item includes responses from private REITs, and the impact of the increase in the number of these respondents is also large. For funds to be launched within a year, the percentage of *"at least 60% but less than 70%"*accounted for 50% as in the previous survey, followed by *"at least 70% but less than 80%"*(25%). As a result, over 80% of respondents chose *"60% or more"* in total (Fig.11).

While the average LTV of funds under management remain stable at a low level, that of funds to be launched within a year rises for two consecutive surveys, we need to pay attention to whether this upward trend will continue or not.

With respect to the average target IRR of the funds currently under management, the average target IRR of all types slightly rose to 11.8% from the previous survey(10.7%)(Fig.10). It was affected by rising drastically in *"Discretionary investment type"* while declining in *"Fixed property type"*.

Fig. 8 Average LTV Ratio

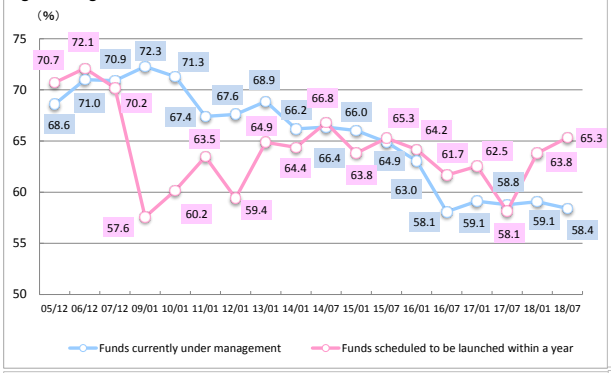


Fig. 9 Range of LTV level (Funds currently under management)

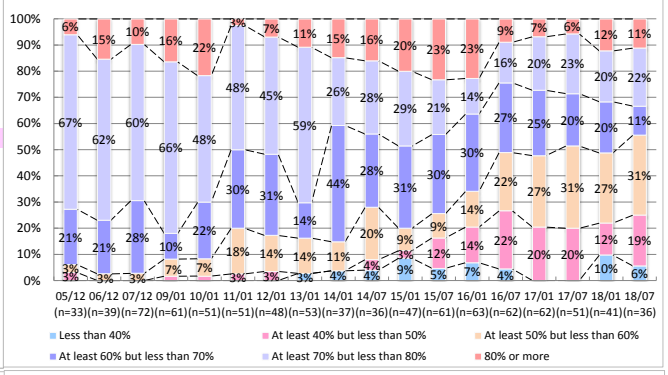


Fig.10 Average Target IRR(Funds currently under management)

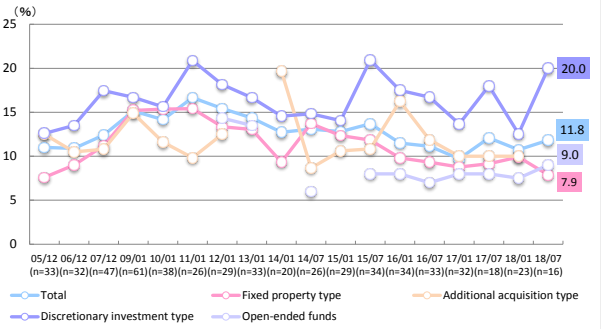
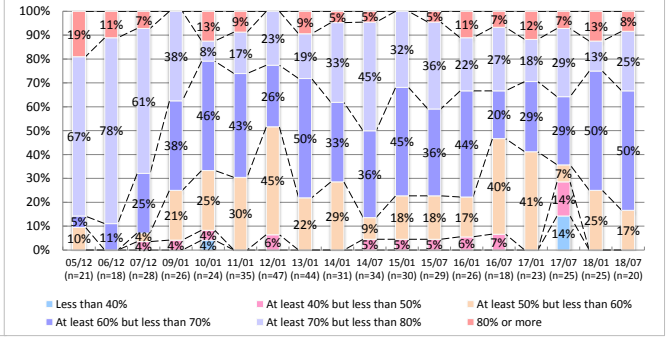


Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt financing circumstances, the largest number of the respondents chose "4 *(easy)*", exceeded that of respondents who chose "*3 (neutral)*"(Fig.12-1). The result of this survey have hardly changed since the July 2017 survey and debt financing circumstances can be said to remain favorable(Fig.12-2).

Fig.12-1 Current Circumstances of Debt Financing

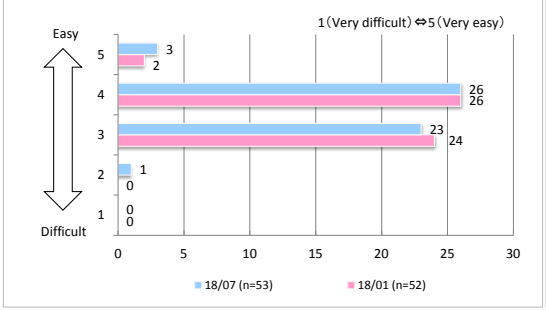
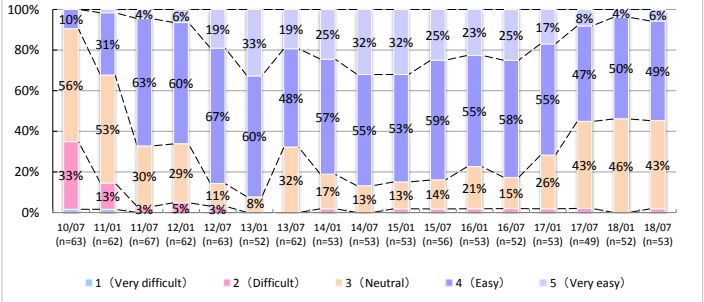


Fig.12-2 Trends in Debt Financing



4) Equity Raising

a. Appetite of Equity Investors

In terms of a question on the appetite of equity investors, the great majority of respondents chose *"No change"*. The percentage of respondents who chose *"Rising"* decreased 8% points to 20% from the previous survey. Also, the respondents who chose *"Declining"*, which there were no respondents in the past two surveys, accounted for 4% (Fig13). It seemed that many asset managers believe that the appetite of investors remains high and the views that the appetite of equity investors is declining are minority at this stage, but we need to pay attention to future survey results.

In regards to the investment appetite of domestic and foreign investors by property types, the percentage of respondents who chose *"No change"* had a majority in all property types for both domestic and foreign investors. It was "Hotel" that got the largest number of responses of *"Increase significantly"* or *"Increase"* for both domestic and foreign investors, unchanged from the previous survey, suggesting that both investors have a strong appetite for investment in hotels sector. On the other hand, for foreign investors, some respondents chose *"Declining significantly"* for *"Retail"*, and combining with *"Declining"*, accounted for 12% in total. A certain number of foreign investors seem to be cautious on investment in commercial facilities in Japan, as they are affected by the adverse circumstances of certain commercial facilities of America. As for *"Facilities for the elderly and Health-care Facilities"*, about 10% of respondents chose *"Declining"* for both domestic and foreign investors. It shows that a certain number of respondents think the appetite for investment in this sector is declining(Fig.14-1,14-2).

Fig.13 Appetite of Equity Investors

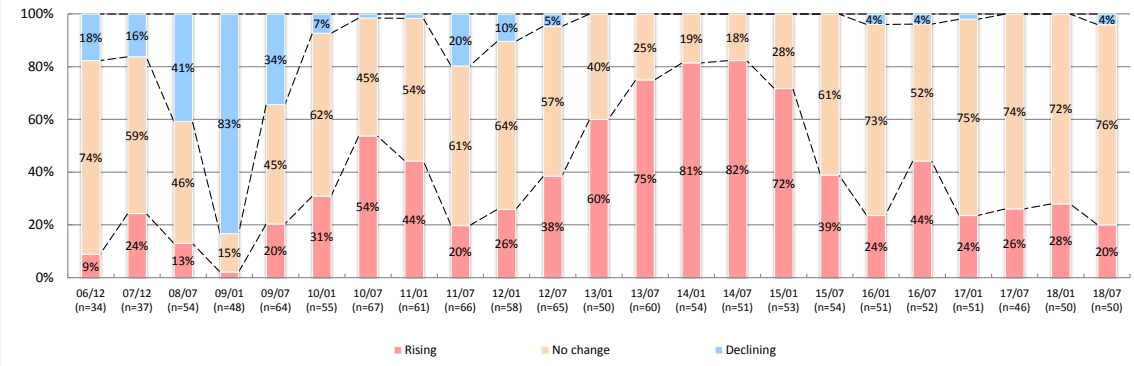


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

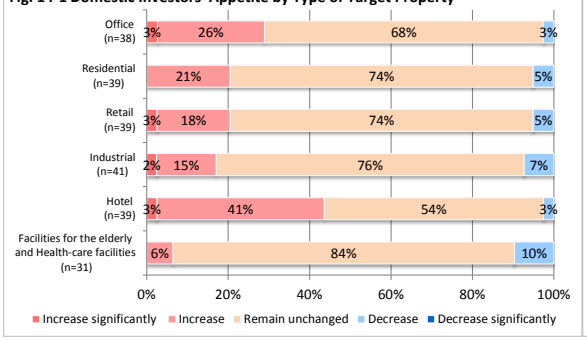
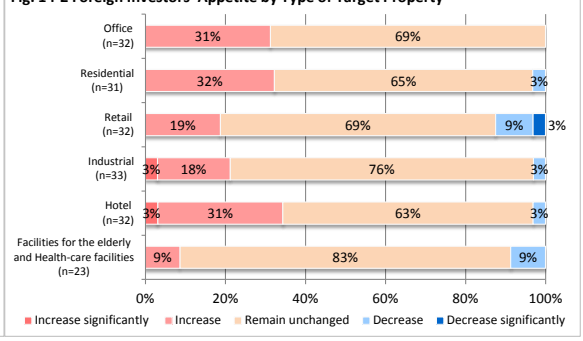


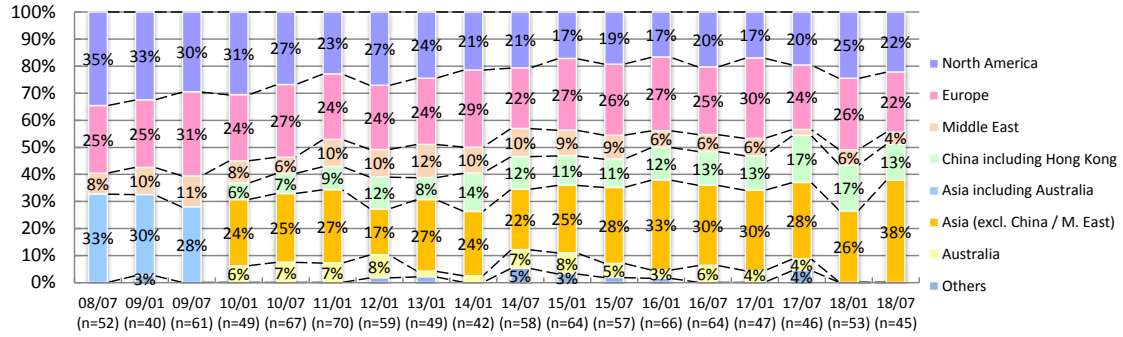
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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

With respect to the capital sources from overseas (targeted to the managers which handle overseas capital), the highest response rate was for investors from *"Asia (excl. China /M.East)"*at 38%. The percentage of *"Europe"* and *"North America"* decreased to 22% from the previous survey. It seems that the investors (which couduct investment by funds) from *"Asia (excl. China /M.East)"* has increased its presence among the foreign investors who invest in domestic real estate funds (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*", "*The size of the real estate market is large*"," *Highly stable income"* and *"Politically and economically stable"* (Fig.16). These choices have been the major reasons indicated in every surveys in the past, and have been established as the reasons for foreign investors investing in Japan.

As for 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"*. *"Rising in real estate prices"* have been the major reason indicated since the January 2016 survey, suggesting the concern over rising real estate prices seems to remain strong (Fig.17).

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

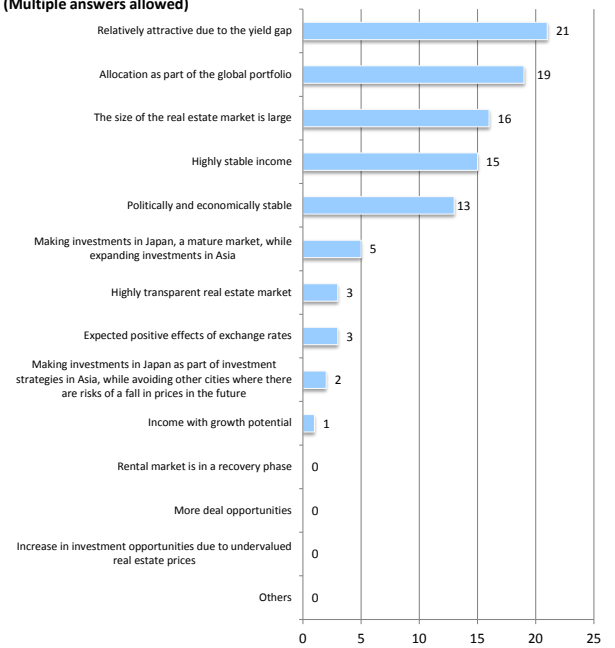
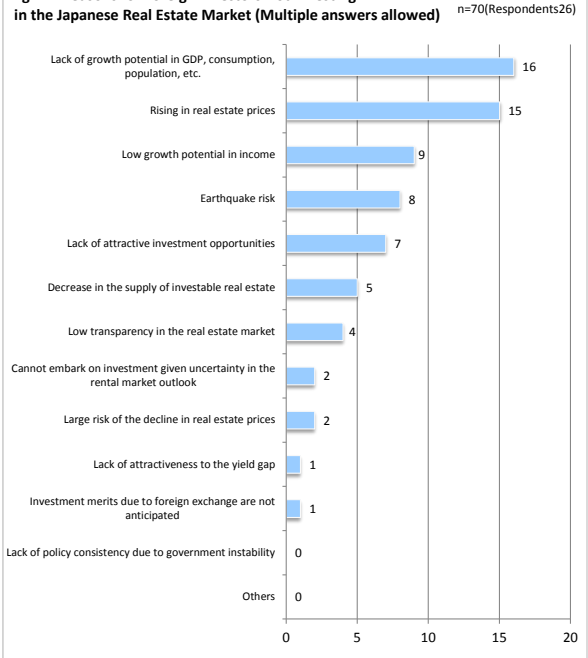


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed)



d. Acquisition and Disposition of Properties during January to June 2018

As to a survey on the acquisition of properties during January to June 2018, the percentage of respondents who answered *"Acquired"* accounted 72%, exceeded 70% for the first time in 3 years since the July 2015 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"*, accounted for 74% in total (Fig.19). The results indicate that many managers acquired properties, although the environment for the acquisition of properties remained challenging.

As to a survey on the disposition of properties during January to June 2018, the percentage of respondents who answered *"Sold property"* was 51% (Fig.20). The percentage of that had been decreased since the January 2015 survey, fell to 37% in the previous survey, but turned up in this survey. The great majority of reasons for *"Didn't sell property"* was *"Did not plan to sell from the onset"*, the percentage of that increased 10% points from the previous survey (Fig.21). The reasons for the increase in the number of managers disposing properties in this survey are not known, because they are not covered by the survey scope, however, there is a possibility that more funds are reaching the exit stage and there is a fact that while market conditions have remained favorable to sellers, the gap in price expectations with buyers has narrowed. In the first half period of 2018, both acquisition and disposition of properties have become more active. The future status of acquisition/disposition of properties by real estate asset managers should be watched closely.

Fig.18 Circumstances for Acquisition

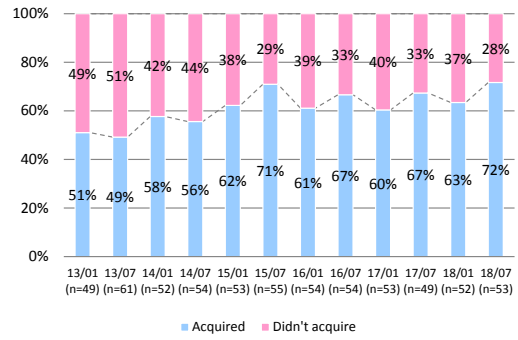


Fig.19 Reason for not acquiring property

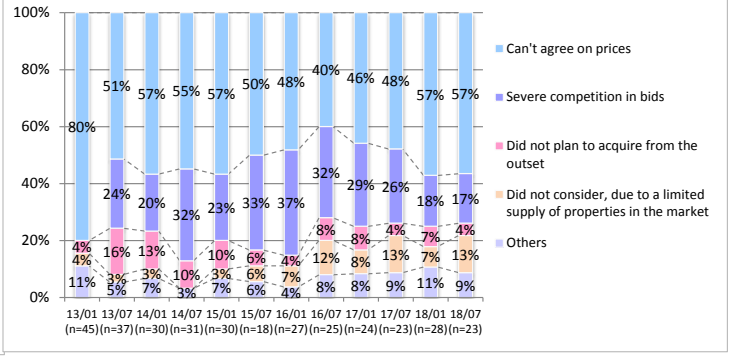


Fig. 20 Circumstances for Disposition

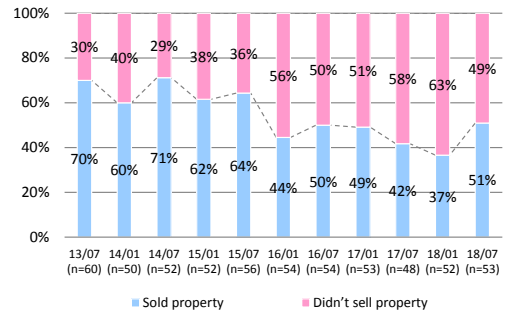
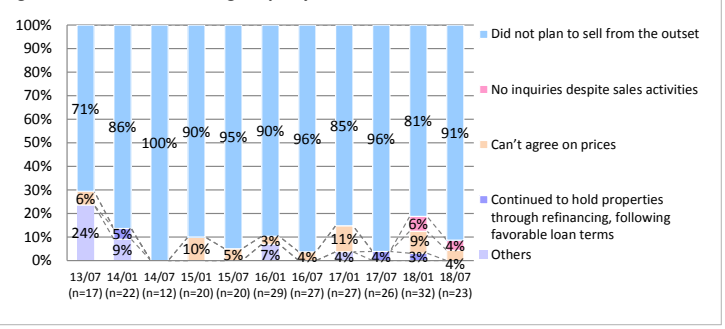


Fig. 21 Reason for not Selling Property



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, 70% of respondents answered that they *"Plan to launch"* (Fig.22). Around 70% of respondents plan to launch of new funds as in the previous survey.

As to plans of acquiring or disposing properties within a year, the percentage of respondents who plan to acquire properties accounted for 86%, that of those who plan to dispose properties accounted for 60% (Fig.23,24).

A large majority of managers have the intention of acquiring properties. However, it is likely that the low supply of investment-grade properties will continue throughout the entire market

Fig.22 Plans of Launch of New Funds

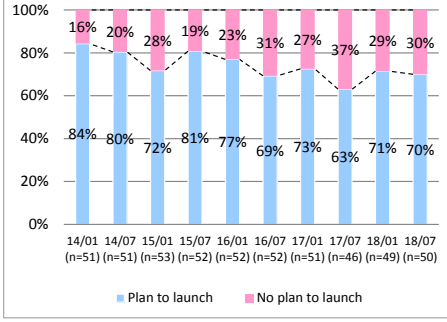


Fig.23 Plans of acquiring properties n=50

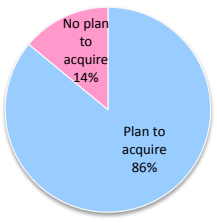


Fig.24 Plans of selling properties n=48

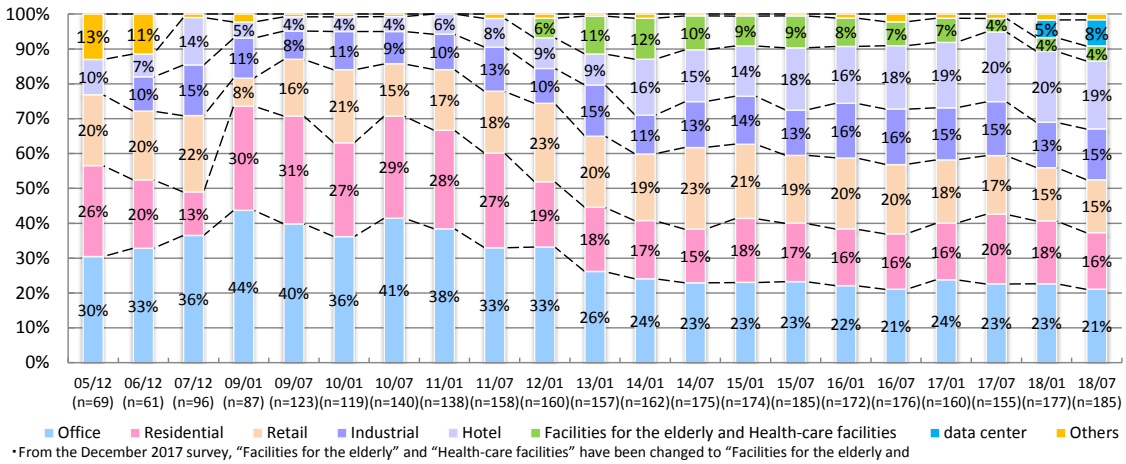
2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

In terms of the target property types, the percentage of "*Office*" and "*Hotel*" accounted for about 20% respectively, followed by "*Residential*", "*Retail*" and "*Industrial*"(around 15% each)(Fig.25). Since the January 2017 survey, the percentage of "*Hotel*" has been around 20% and established the position following "*Office*" among the target property types on which managers will focus.

The percentage of "*Data center*", we added to the target property types in the previous survey, increased to 8%(14 cases) from 5% (9 cases) in the previous survey. We will pay attention to whether it will become established as a target property type in the future.

Fig. 25 Target Property Types (Multiple answers allowed)

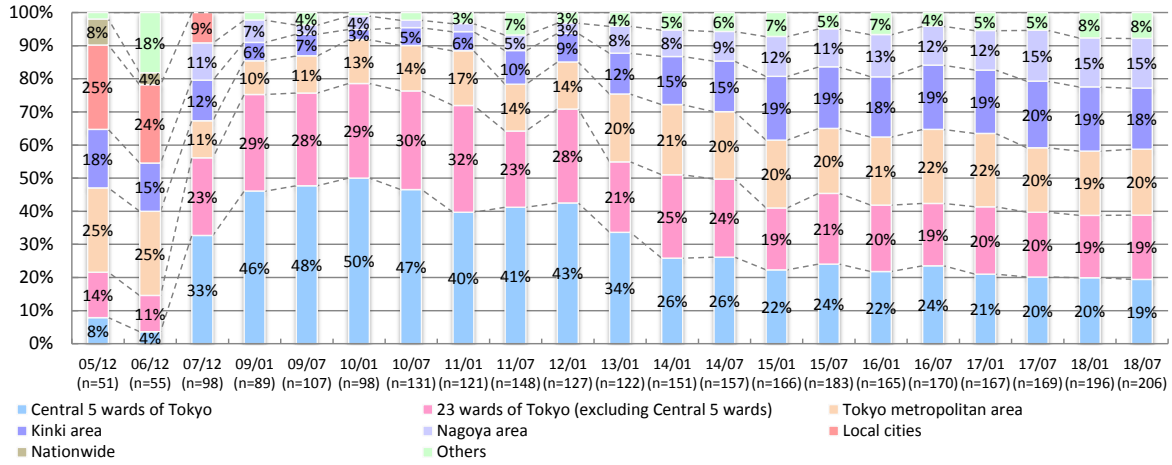


・From the December 2017 survey, "Facilities for the elderly" and "Health-care facilities" have been changed to "Facilities for the elderly and health-care facilities," and the past values are added together.
・"Data center" was added from the December2017 survey.

b. Target Areas (Multiple answers allowed)

In terms of the target area, the percentages of "*Central 5 Wards of Tokyo*", "*23 Wards of Tokyo (excluding Central 5 wards)*", "*Tokyo metropolitan area*" and "*Kinki area*" were all around 20%, there is little change in recent surveys (Fig.26). Because it is expected that challenging market condition for acquisitions of properties will continue, we believe that many asset managers will continue to target a wide range of areas including not only in Tokyo but also in major domestic areas in Japan.

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)

In response to a question about involvement in private REITs, the largest number of respondents answered *"Seek to develop a better understanding and gather information, but not working on a detailed study"* as in the past surveys. However, in this survey, the number of respondents who answered *"Have already launched"* was also the largest at 17 respondents(Fig.27). In addition, three managers said that they were preparing to launch a private REIT, which indicates open-ended private funds may increase slightly.

As for important factors for development in the private REITs market, the largest number of respondents chose *"Enhancement of the track record"*, followed by *"Expansion of the categories of investors to invest in funds"* (Fig.28). It seems that many managers feel that it is necessary to build a track record, including a response to the downward phase of real estate market conditions, something that Japan's real estate open-ended fund market has yet to experience, and broaden the investor base to overcome that phase.

In addition, there were a certain number of responses to items such as support of sponsors, expansion of market size, and improvement of liquidity.

Fig.27 Managers' involvement with private REITs n=50(Respondents 50)

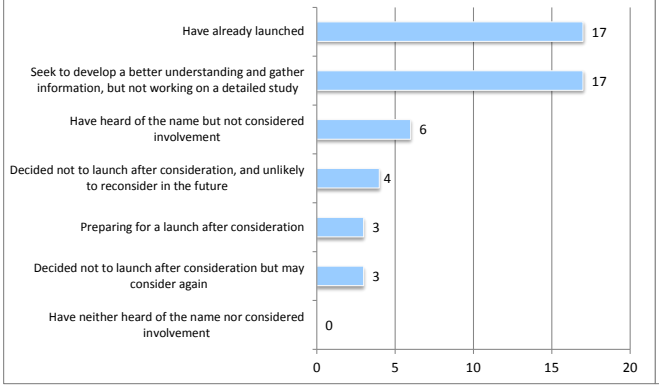
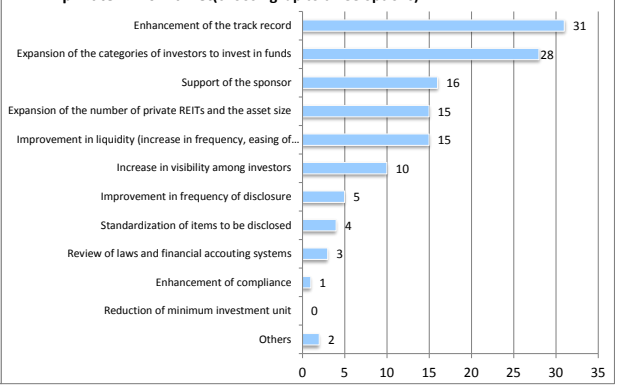


Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options) n=130(Respondents 48)



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

With regard to the outlook on asset size in the closed-ended private real estate funds market, the percentage of respondents who expect an increase accounted for about 60% of the total (Fig.29).

As for the reasons responding *"Increase,"* many respondents chose *"Increase of domestic investors' money"* and "*Increase of foreign investors' money"*(Fig.30). We believe that many asset managers expect continuing inflows of funds into real estate investments due to the continuation of monetary easing policy by the Bank of Japan.

The main reason for *"Decrease"* was *"Limited supply of existing/new investment-grade real estate"*. We realized that there are a certain number of managers who believe that limited supply of investment-grade real estate will lead to a decrease in market size.

Fig.29 Assets under management of closed-ended funds

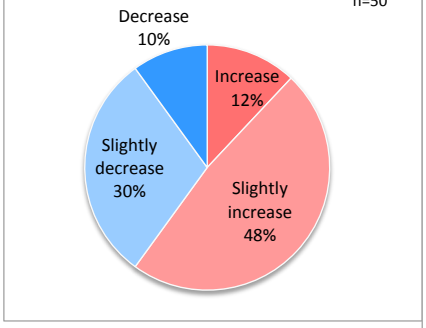
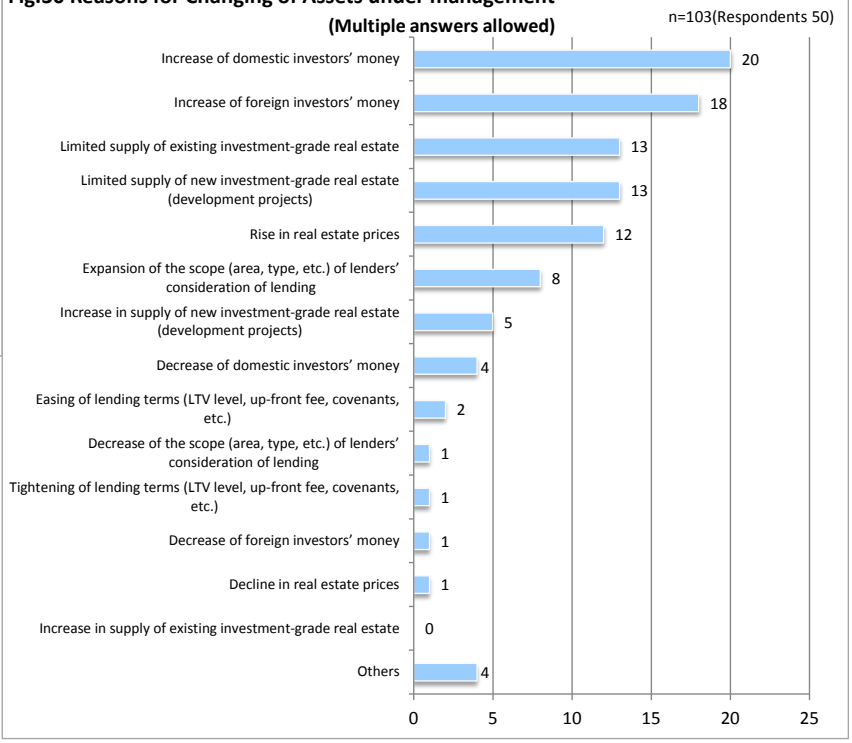


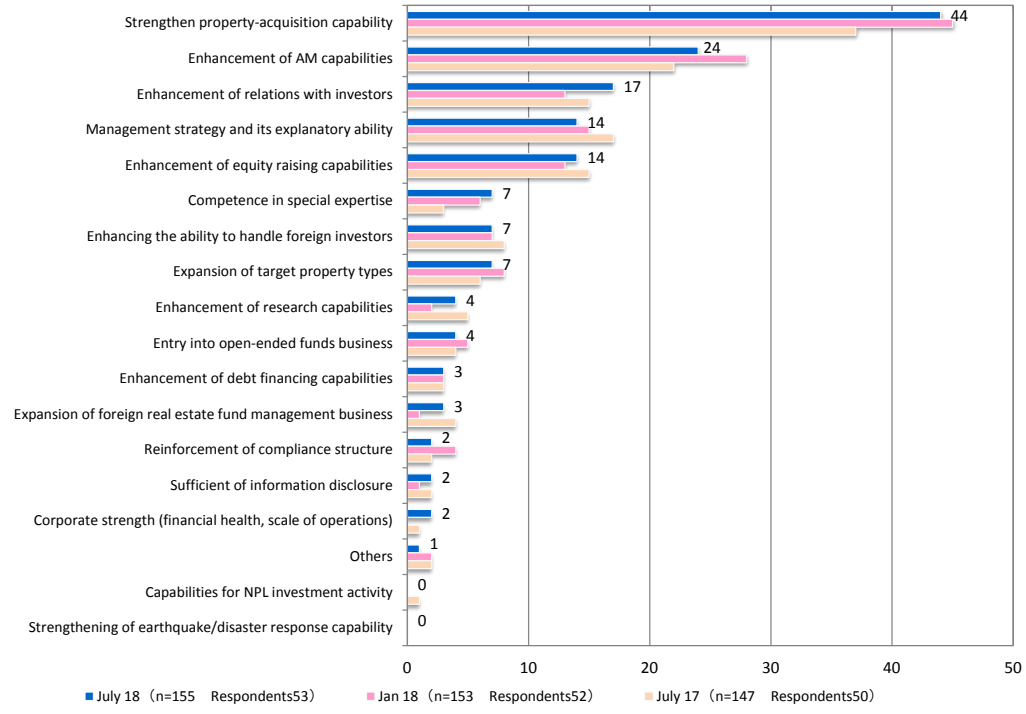
Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)



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 largest number of managers chose *"Strengthen property-acquisition capability"*, greatly exceeded the second most frequent answer *"Enhancement of AM capabilities*" (Fig.31). With limited supply and rising real estate prices continuing, most asset managers emphasize the strengthen property-acquisition capability. In addition to the above, the number of managers who chose *"Enhancement of relations with investors"* increased compared with the past two surveys. Many managers seem to recognize the need for more attentive services for investors.

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



4) Awareness of ESG※ initiatives

Given that investment taking ESG into consideration has rapidly become the mainstream in real estate investment, this survey asked about the awareness of ESG initiatives among asset managers and the outlook for ESG orientation among investors and so on. To the question “Do you have an awareness of investors who choose investments based on ESG initiatives taken by asset managers?”, about two thirds of respondents answered that “I have such awareness”(Fig.32). In addition, to the question “Do you think that the number of investors considering ESG initiatives taken by asset managers will increase?” separately asked of domestic investors and foreign investors, the percentage of respondents who chose “Increase” had a majority for both domestic and foreign investors. Particularly for foreign investors, about three quarters of respondents chose that answer(Fig.33). With respect to the “Principles for Responsible Investment (PRI)” which the United Nations put forward in 2006, many institutional investors in Japan and abroad have signed them and the number of signatories has been increasing. Reflecting this situation, many respondents seemed to have given the answer that the number of investors considering ESG factors will “Increase.”

※The concept of “Environment”, ”Society” and ”Governance”, recommended to incorporate into asset management in the “PRI：Principles for Responsible Investment”

Fig.32 Awareness of ESG Initiatives

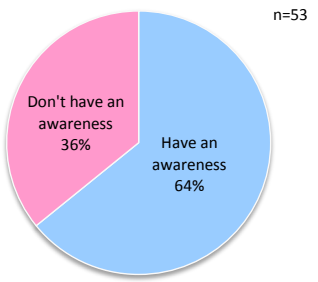
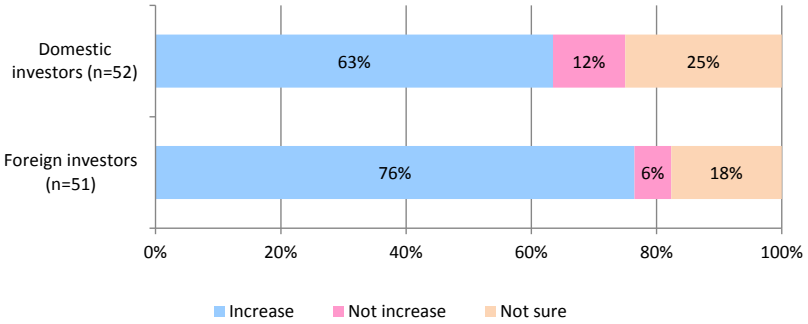


Fig.33 Outlook for ESG Orientation among Investors



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

Others Other than those above

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 annual cash flow on the total investment amount. This shows the collection rate of own capital.

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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