NEWS RELEASE

Survey on Private Real Estate Funds in Japan

July 2017– Results

September 21, 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 24th survey based on responses to questionnaires received from 50 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: 107
  - The number of responses: 50 (ratio of valid responses: 46.7%)
  - Survey period: in the July to August 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 June 2017 to be 15.8 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 220 billion yen (1.4%) from the previous survey (15.6 trillion yen as of the end of December 2016). The market for domestic private real estate funds continued to expand, albeit slightly.

The market size of private real estate funds is 15.8 trillion yen including Japanese assets of global funds

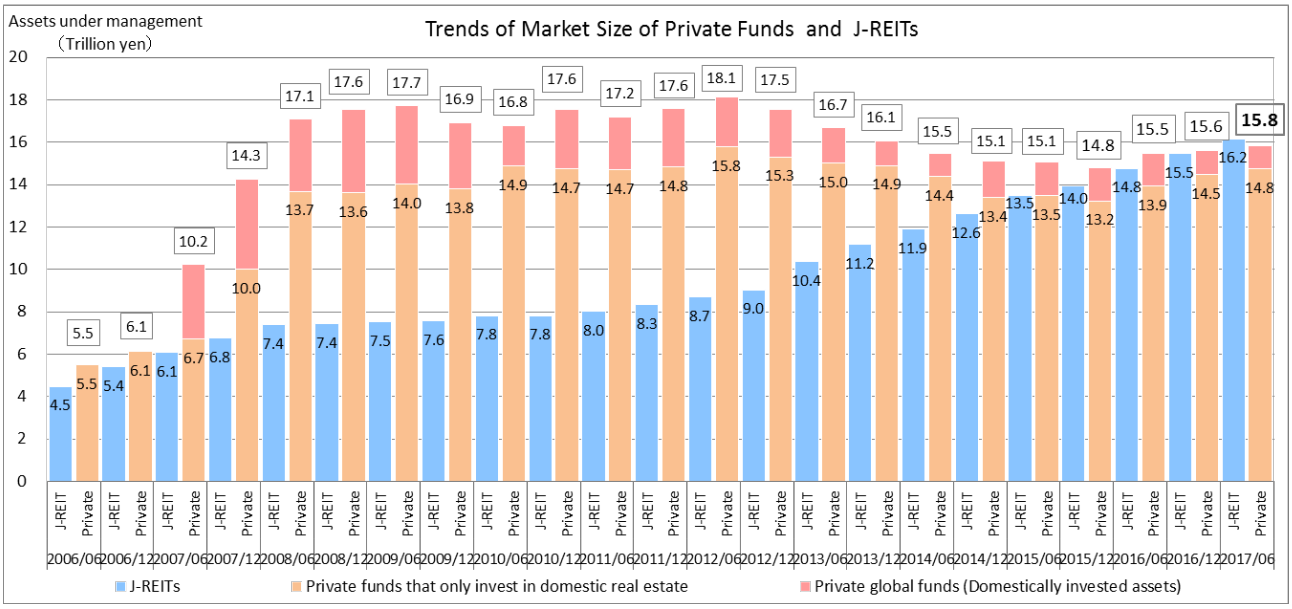
・Assets under management (AUM) as of the end of June 2017 were 15.8 trillion yen. Assets under management (AUM) increased approximately 220 billion yen from the previous survey. The market for domestic private real estate funds continued to expand, albeit slightly.

・The number of asset managers who said that their assets under management increased was more than the number of asset managers who said that their assets under management decreased. Overall, assets under management rose approximately 1.4% from the estimate in the previous survey. While assets at domestic real estate funds, primarily private REITs, expanded, assets at global funds declined slightly.

・Equity investors' appetite for investment is considered to remain favorable. The circumstances of debt financing may be changing gradually.

・To a question about from where major properties will be supplied, the largest number of respondents answered, "A third party other than J-REITs and private real estate funds." The second largest number of respondents answered, "Sponsors, group companies, etc." These answers suggest that many asset managers are seeking supply from a third party, such as operating companies, but are forced to depend on pipelines from sponsors and group companies, etc. due to a lack of supply of properties.

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



" Survey on private real estate funds" July 2017 Survey Results

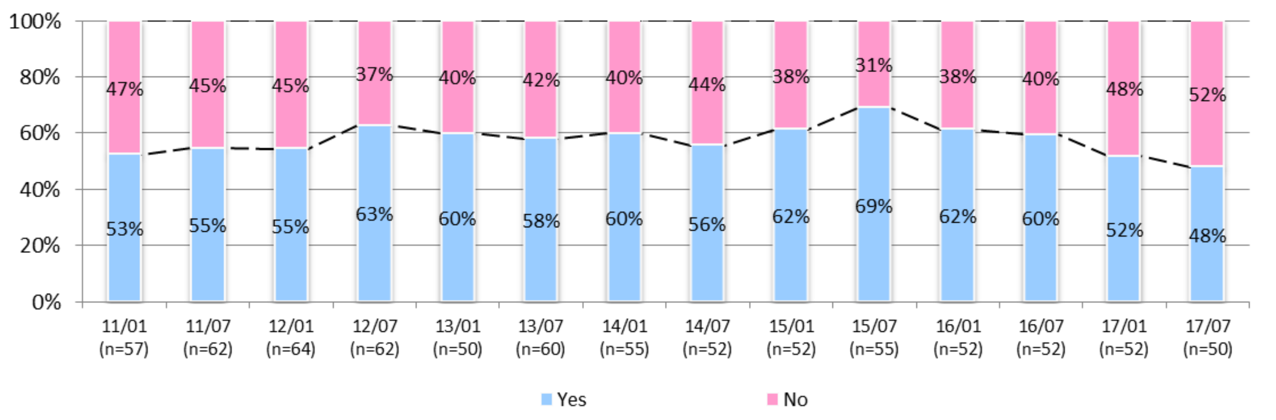
(Note) [n] shown in the figures throughout this document indicates the number of effective responses.

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, 48% of respondents chose "Yes". "Yes" has been on a downward trend since the survey in July 2015. Some overseas investors are considered to have a sense of caution over rising prices of domestic real estate (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

In response to a question about the types of funds being managed, respondents who chose "Fixed property type" declined to 45%. The percentage of "Additional acquisition type" and "Discretionary investment type" rose. (Fig.2). "Open-ended funds," which had accounted for steadily increasing percentages in the past few years, had a certain presence, with the number of issues managed exceeding 20. However, the pace of increase slowed. With regard to management style, the percentage of "Core" remained high. (Fig.3).

As for target property types, the percentage of "Office" declined, and as a result, differences in percentage among property types narrowed. One of the reasons is that the acquisition of offices remains difficult (Fig. 4). Looking at target areas, the percentage of “23 wards of Tokyo” declined from the previous survey, while the percentages of “Nagoya area” and “Local areas” rose. This indicates that investment may be expanding into major provincial cities, albeit moderately. (Fig5).

Fig. 2 Fund types

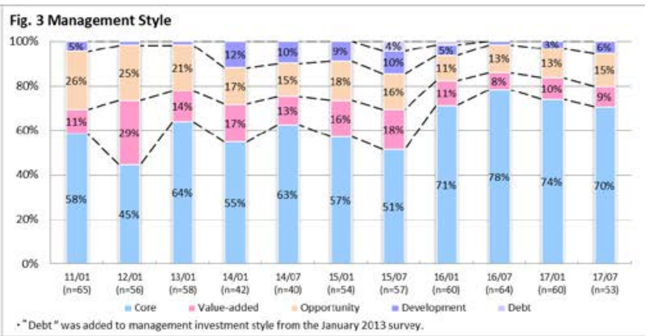


Fig. 3 Management Style

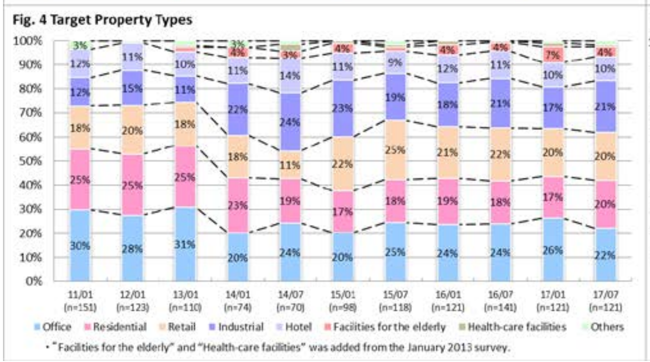


Fig. 4 Target Property Types

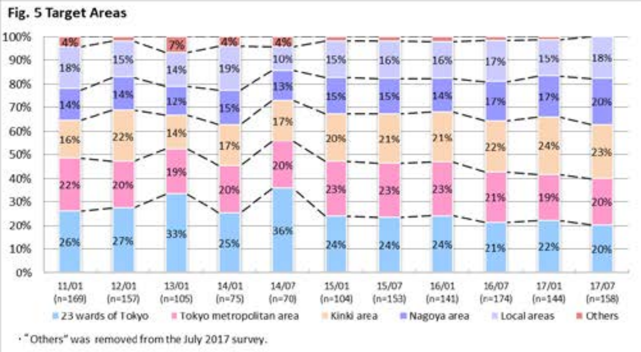


Fig. 5 Target Areas

The average target investment period was 6.0 years for funds currently under management and 5.8 years for funds to be launched within a year (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*”(35%). As for the investment period of funds currently under management, the period less than five years increased slightly. However, against the backdrop of the Bank of Japan’s continued quantitative and qualitative monetary easing with yield curve control, the mainstream remained medium- to long-term funds (Fig.7).

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

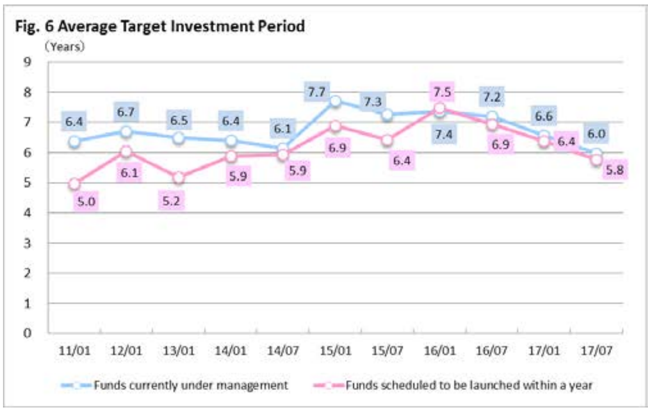


Fig. 6 Average Target Investment Period

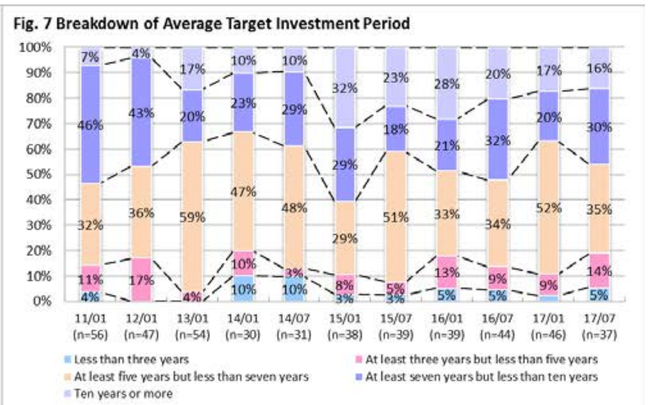


Fig. 7 Breakdown of Average Target Investment Period

Average LTV of funds under management stood at 58.8%, and that of funds to be launched within a year was 58.1%. 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 60% but less than 70%*”, decreased(Fig.9). This survey item includes responses from private REITs.

With regard to the LTV level of funds scheduled to be launched within a year, the percentage of "At least 50% but less than 60%" fell sharply, while the percentage of the period less than 50% rose sharply. "Less than 40%," which has not been chosen by any respondents after the survey in January 2011, accounted for 14% (Fig.11).

The overall average target IRR is considered to remain on a moderate downward trend after it hit a peak in the January 2011 survey. In this survey, the overall average target IRR was affected by a rise in the target IRR of the discretionary investment type, but the target IRR of the fixed property type and the additional acquisition type remained roughly flat. (Fig.10). The average LTV is also on a downward trend. This indicates that core funds whose leverage is low are becoming popular and the target return is on a downward trend.

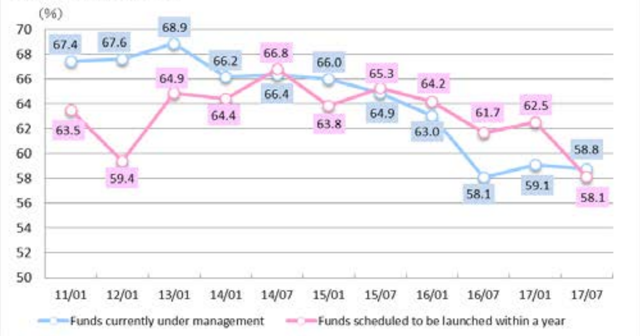


Fig. 8 Average LTV Ratio

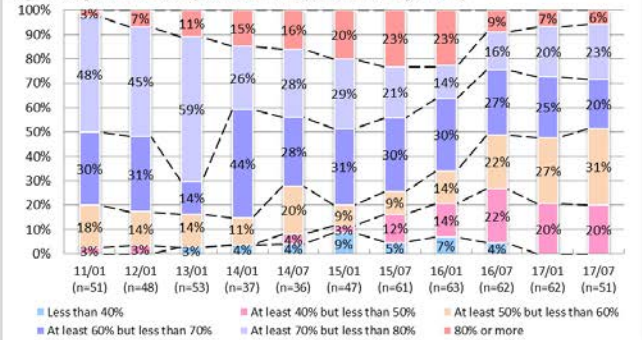


Fig. 9 Range of LTV level (Funds currently under management)

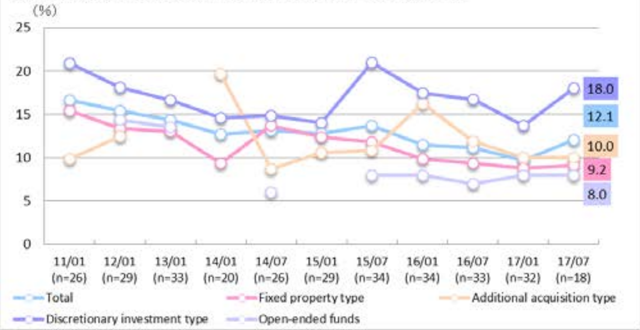


Fig.10 Average Target IRR(Funds currently under management)

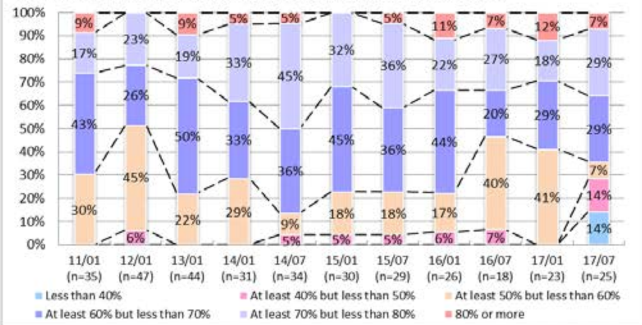
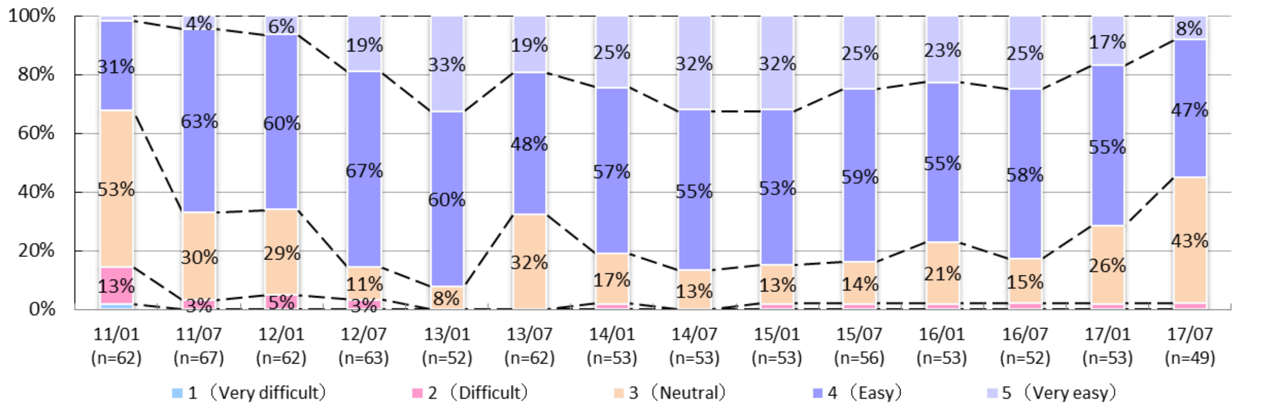


Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)

3) Debt Finance

In response to a question about the circumstances of debt financing, the percentage of "5 (Very easy)" and "4 (Easy)" continued to fall, while the percentage of "3 (Neutral)" increased (Fig.12). The circumstances of debt financing may be gradually changing.

Fig.12 Circumstances of Debt Financing



4) Equity Rising

a. Appetite of Equity Investors

As to a survey of the appetite of equity investors, the percentage of “Rising” rose slightly, and most of the respondents chose “No change.” The appetite of equity investors remains strong (Fig13). The percentage of “Rising” rose sharply in the survey before last largely due to the Bank of Japan’s introduction of negative interest. The appetite of equity investors remains favorable against the backdrop of the Bank of Japan’s low interest rate policy.

In response to separate questions about domestic and foreign equity investors’ appetite by type of target property, only small percentages of the respondents answered “Decrease significantly” or “Decrease.” As in the survey before last, a larger percentage of investors, both domestic and foreign, chose “Increase significantly” or “Increase” for hotels than for other property types. Domestic and foreign investors have a strong interest in hotels.

There is concern about a decreased interest in “Facilities for the elderly” among domestic and foreign investors. Most respondents chose “Remain unchanged,” but some foreign investors chose “Decrease significantly.” (Fig.14-1, Fig.14-2).

Fig.13 Appetite of Equity Investors

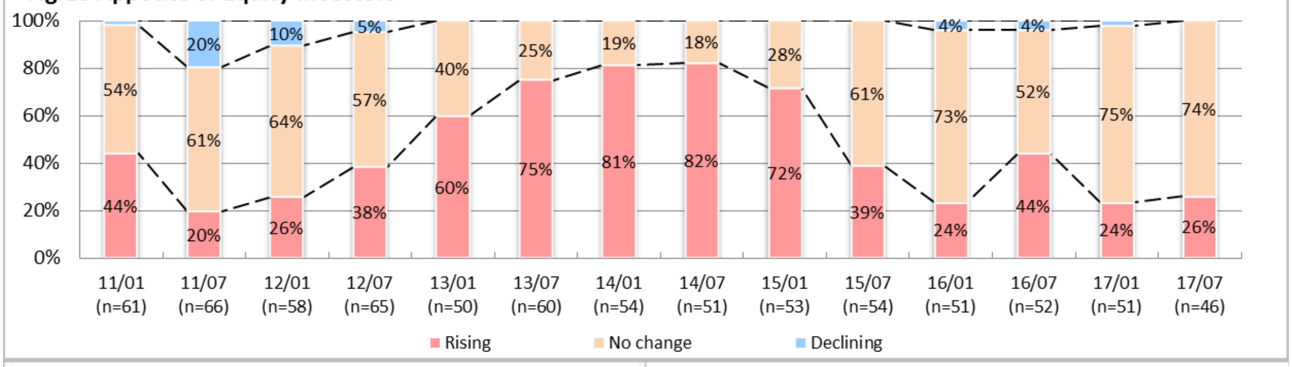


Fig. 14-1 Domestic Investors’ Appetite by Type of Target Property

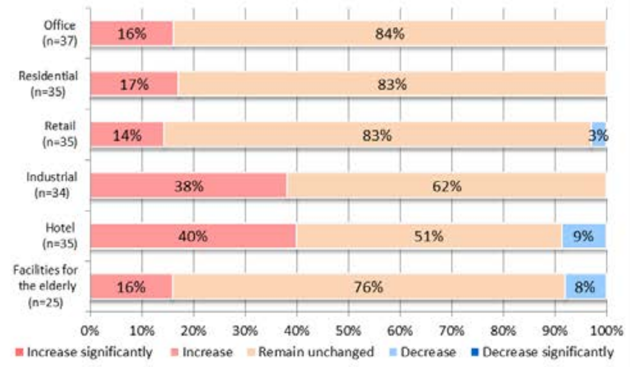
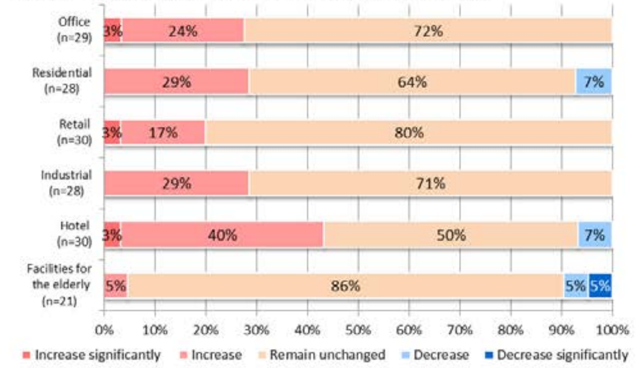


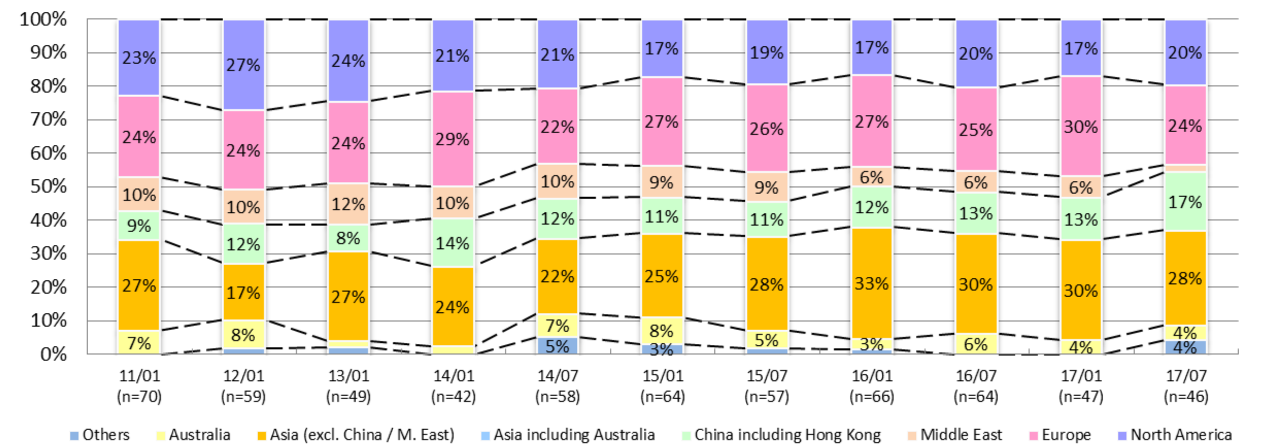
Fig. 14-2 Foreign Investors’ Appetite by Type of Target Property



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

With respect to the capital sources from overseas, the highest response rate was for investors from *"Asia (excl. China /M.East)"* at 28%. The percentage of the "Middle East" is on a downward trend, while the percentage of "China including Hong Kong," which had been around 12%, rose to 17% in this survey (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 "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.

As the reasons for not investing in Japan, the largest number of the respondents chose "Rising in real estate prices" followed by *"Lack of growth potential in GDP, consumption, population, etc."*. 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=83(Respondents23)

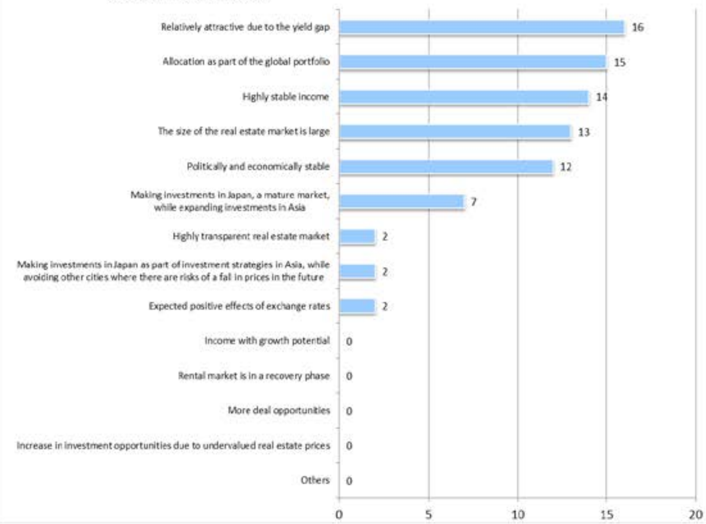
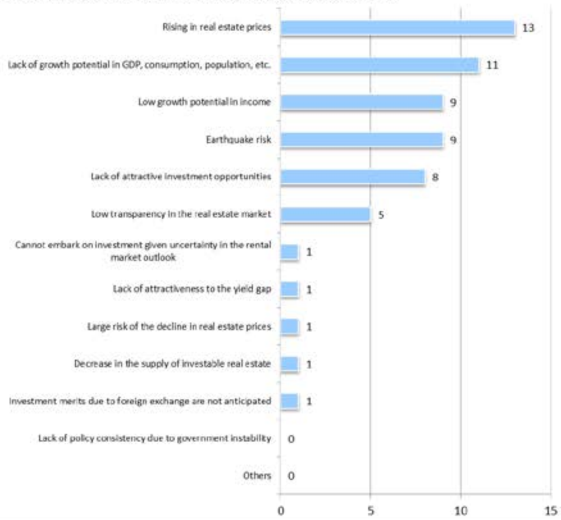


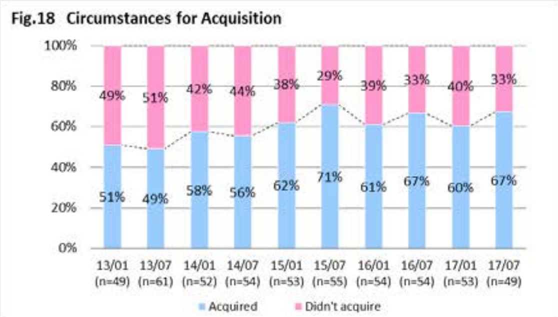
Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed) n=60(Respondents21)

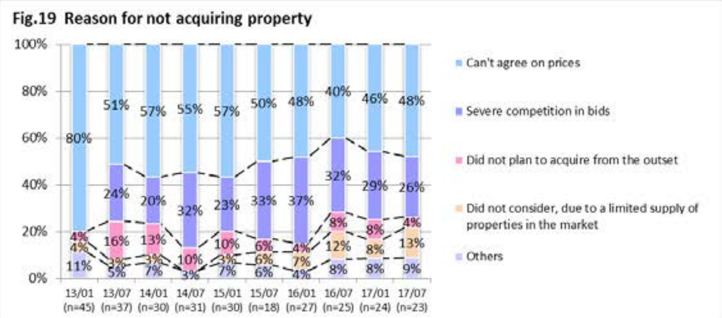


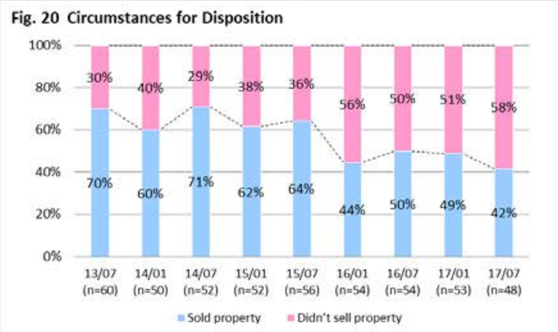
d. Acquisition and Disposition of Properties in the January to June 2017

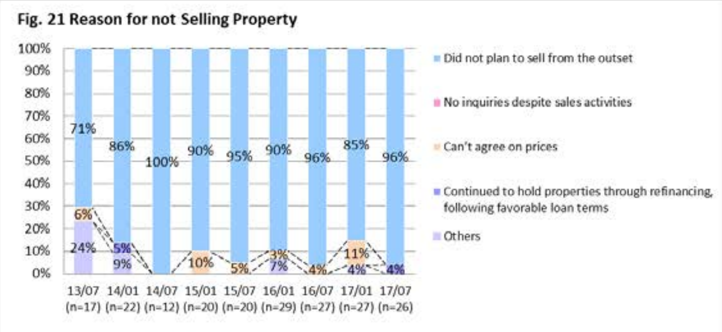
As to a survey on the acquisition of properties in the January to June 2017, the percentage of respondents who answered *"Acquired"* accounted 67% (Fig.18). The main reasons that the managers did not acquire any properties were *"Can't agree on prices"* accounted 48% (Fig.19). Due to rising real estate prices, disagreement on prices seems to be continuing.

In response to a question about sales of properties from January to June, 2017, 42% of respondents answered "Sold property." As a reason for not selling property, 96% of respondents answered "Did not plan to sell from the outset." (Fig.21) . No respondents answered "Can't agree on prices." Comparison with the percentage of "Can't agree on prices" as a reason for not acquiring property, 48%, reveals that a sellers' market is continuing.









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, 63% of respondents answered that they *"Plan to launch"* (Fig.22). The percentage of "Plan to launch" rose in the January 2017 survey but has been on a downward trend.

As to plans of acquiring properties within a year, the percentage of respondents that they plan to acquire properties accounted for 85% in this survey (Fig.23). On the other hand, that of those who plan to sell properties within a year accounted for 50% (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

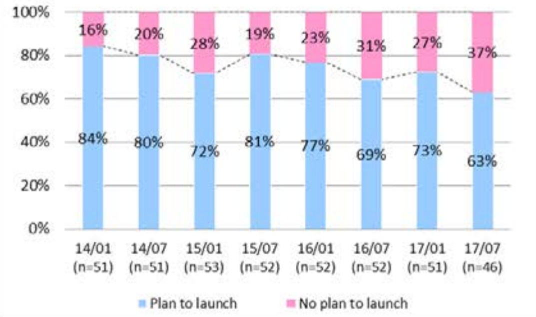


Fig.23 Plans of acquiring properties

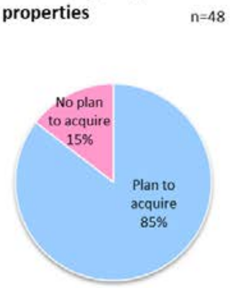
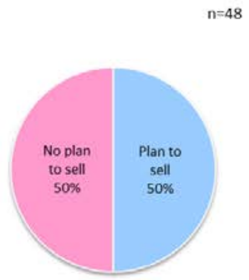


Fig.24 Plans of selling properties



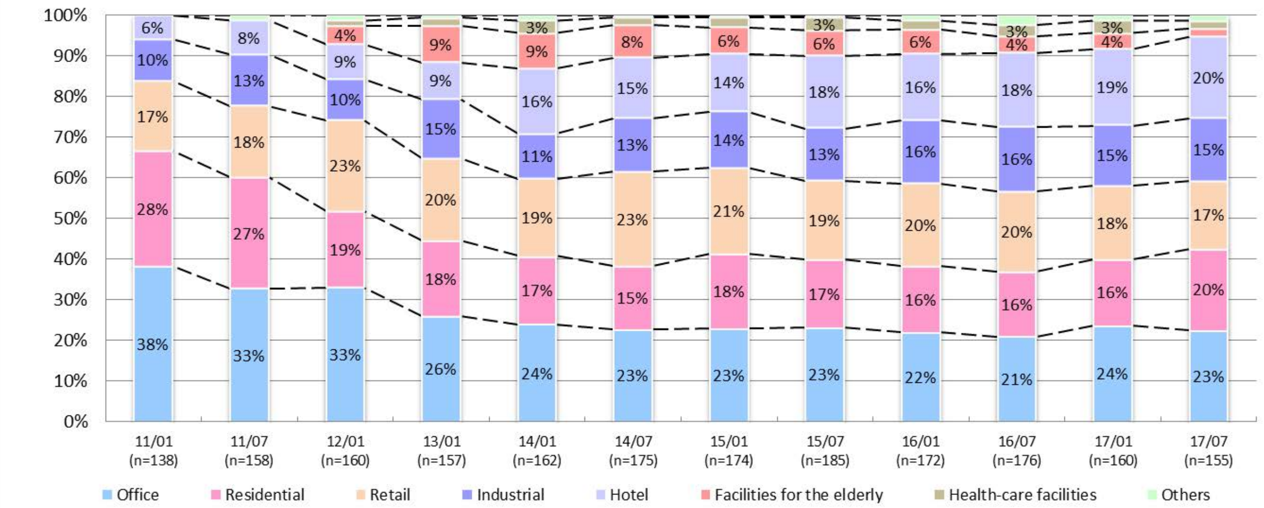
2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

As a target property type, there are no big differences between "Office," "Residential," "Retail," "Industrial," and "Hotel." There is diversity in target property types (Fig.25).

The percentage of "Hotel" as a target property type was more than that of "Retail" as in the previous survey. The popularity of "Hotel" as a target property type may remain high for some time to come as increasing numbers of inbound tourists are clearly recognized.

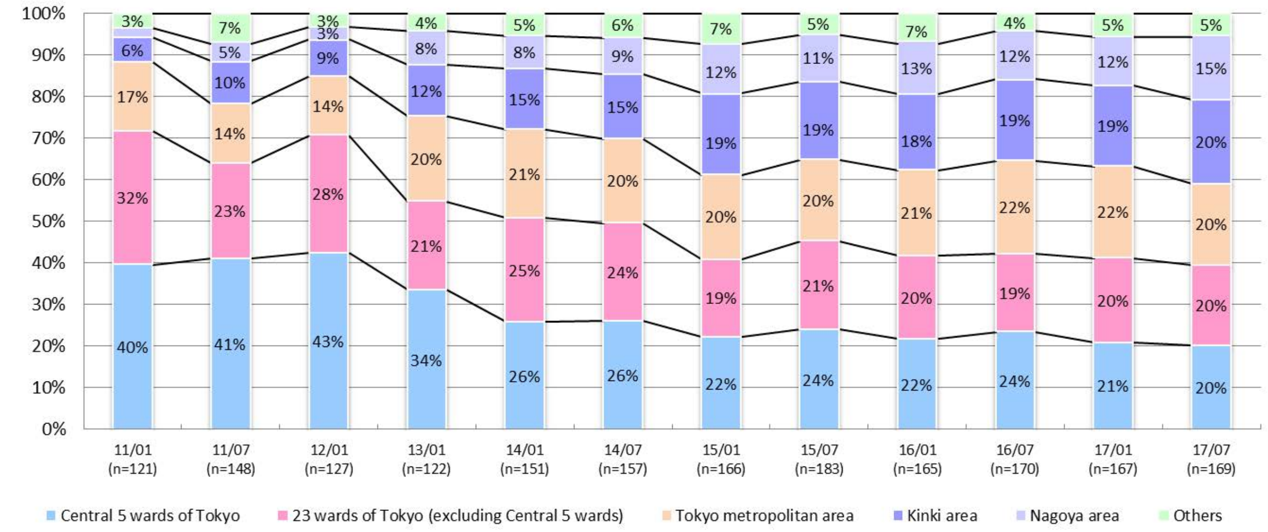
Fig. 25 Target Property Types (Multiple answers allowed)



b. Target Areas **(Multiple answers allowed)**

As a 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 20% (Fig.26). The percentage of the Tokyo metropolitan area including Tokyo was 60%, and the percentages of “Kinki area” and “Nagoya area” increased gradually, which indicates that investment targets have been expanding into the provinces.

Fig. 26 Target Areas (Multiple answers allowed)



3. <u>Business Environment of Private Real Estate Investment Management</u>

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

In response to a question about involvement in private REITs, the largest percentage of respondents answered “Seek to develop a better understanding and gather information, but not working on a detailed study.” The second largest percentage of respondents answered “Have already launched.” (Fig.27).

Five asset managers said that they were preparing to launch a private REIT. Open-ended private funds may increase slightly.

As an important factor for development in the private REITs market, the largest percentage of respondents (27 respondents) chose “Enhancement of the track record.” Continuing stable management, including dealing with deterioration in the real estate market, is emphasized (Fig.28).

Fig.27 Managers' involvement with private REITs

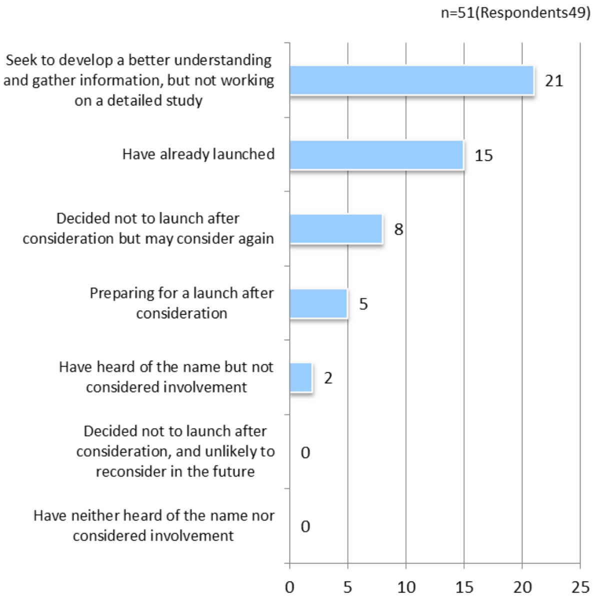
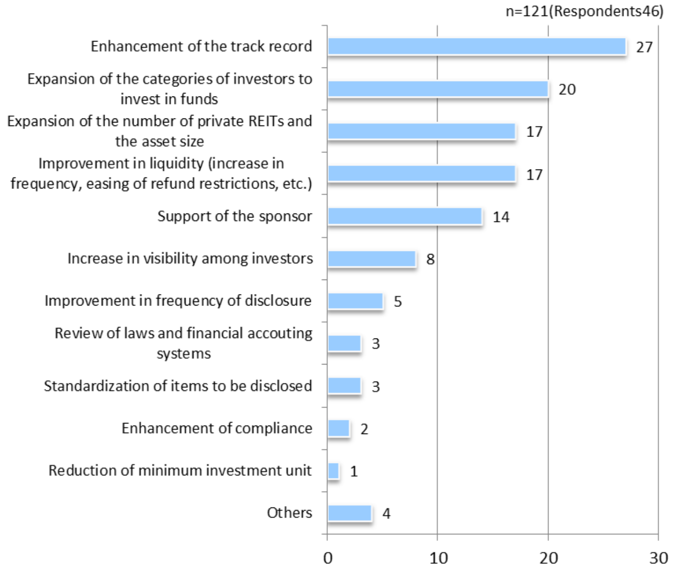


Fig.28 Important Factors for Development in the private REITs Market (choosing up to three options)



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

As for the outlook on asset size in the closed-ended private real estate funds market, the percentage of "Increase" exceeded the percentage of "Decrease" slightly (Fig.29).

As a reason for an increase, many respondents chose "Increase in domestic investors' money," which indicates that many asset managers expect investment in real estate to continue due to the Bank of Japan's continued quantitative and qualitative monetary easing with yield curve control (Fig.30).

As a reason for a decrease, respondents chose "Limited supply of existing investment-grade real estate" and "Rise in real estate prices." Other answers included the opinion that the expansion of open-ended private funds is a reason for the decrease in closed-ended private funds.

Fig.29 Assets under management of closed-ended funds

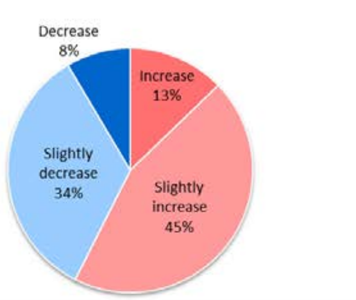
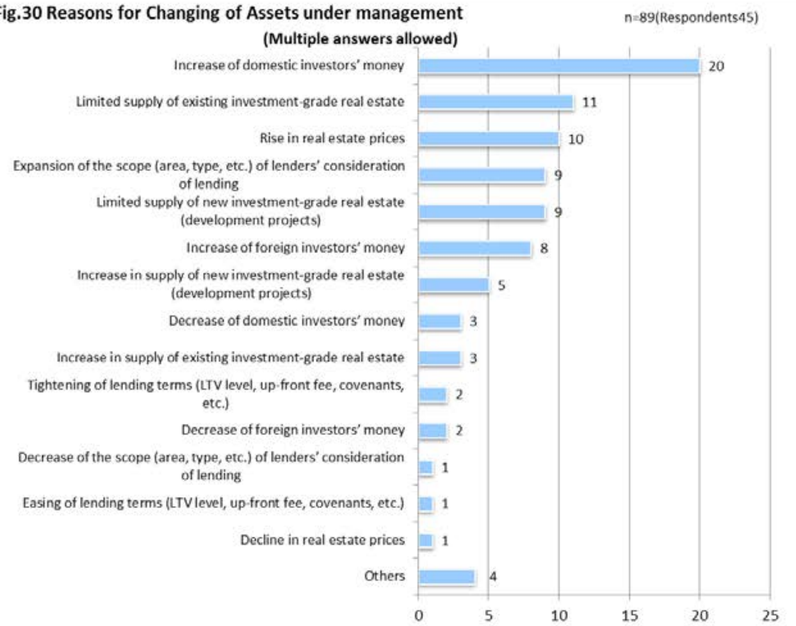


Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)

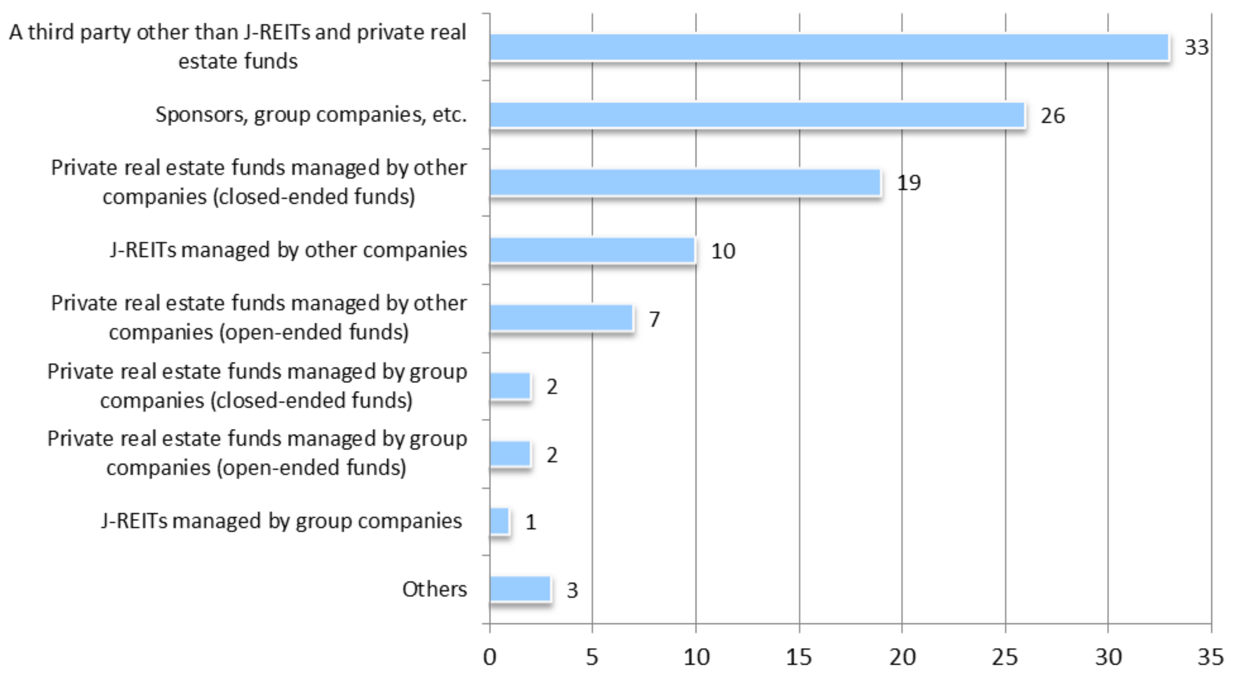


3) Where properties will be supplied

To a question as to where properties will be supplied from, the largest number of respondents chose “A third party other than J-REITs and private real estate funds.” The second largest number of respondents chose “Sponsors, group companies, etc.” (Fig.31).

This indicates that many asset managers are looking for supply from a third party, such as operating companies, but are forced to depend on pipelines from sponsors and group companies, etc. due to a lack of supply of properties.

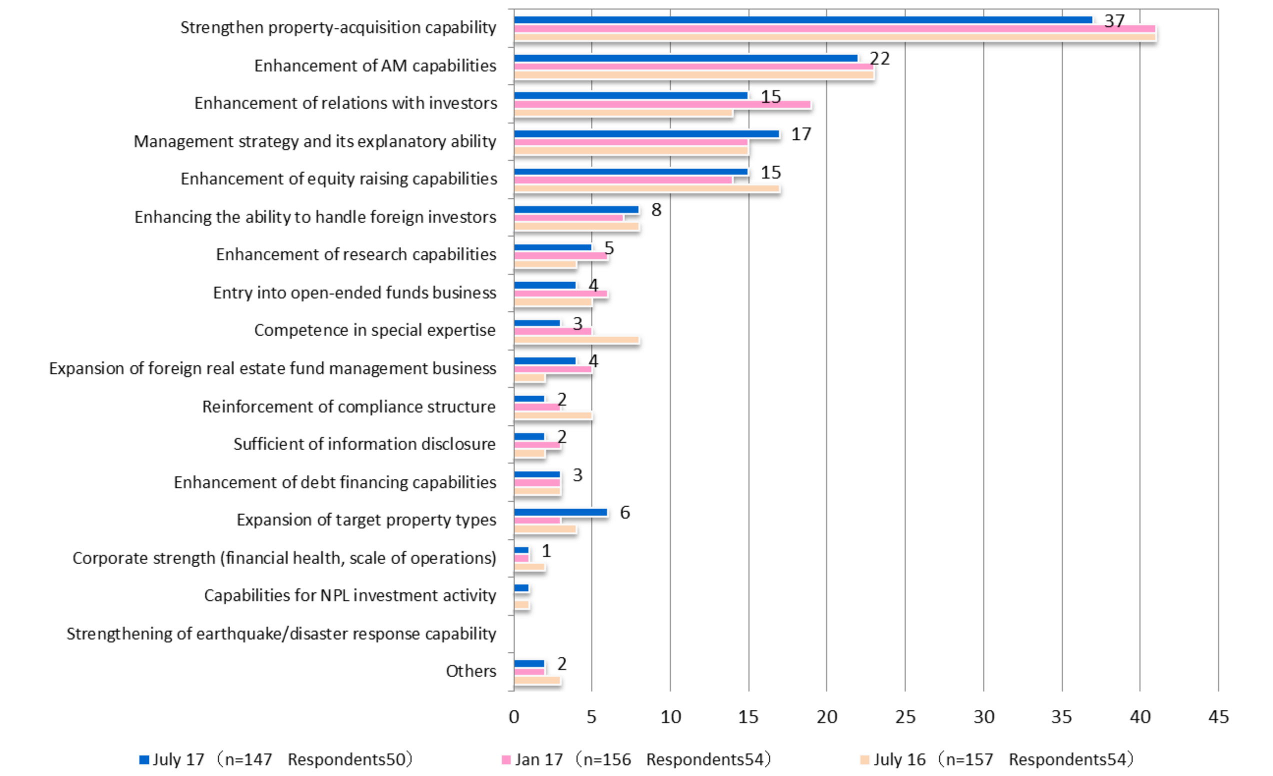
Fig.31 Where properties will be supplied (Multiple answers allowed)



4) 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.32). 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. 32 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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