SUMITOMO MITSUI TRUST RESEARCH INSTITUTE

News Release

Survey on Private Real Estate Funds in Japan

July 2019– Results

September 11, 2019

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 28th survey based on responses to questionnaires received from 51 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: 111
  - The number of responses: 51 (ratio of valid responses: 45.9%)
  - Survey period: in the July to August 2019
  - 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 2019 to be 19.2 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 1,480 billion yen (8.4%) from the previous survey (17.7 trillion yen as of the end of December 2018). The pace of the expansion of the market for domestic private real estate funds, which had been increasing gradually, accelerated, and the market grew to a record size. 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 19.2 trillion yen including Japanese assets of global funds

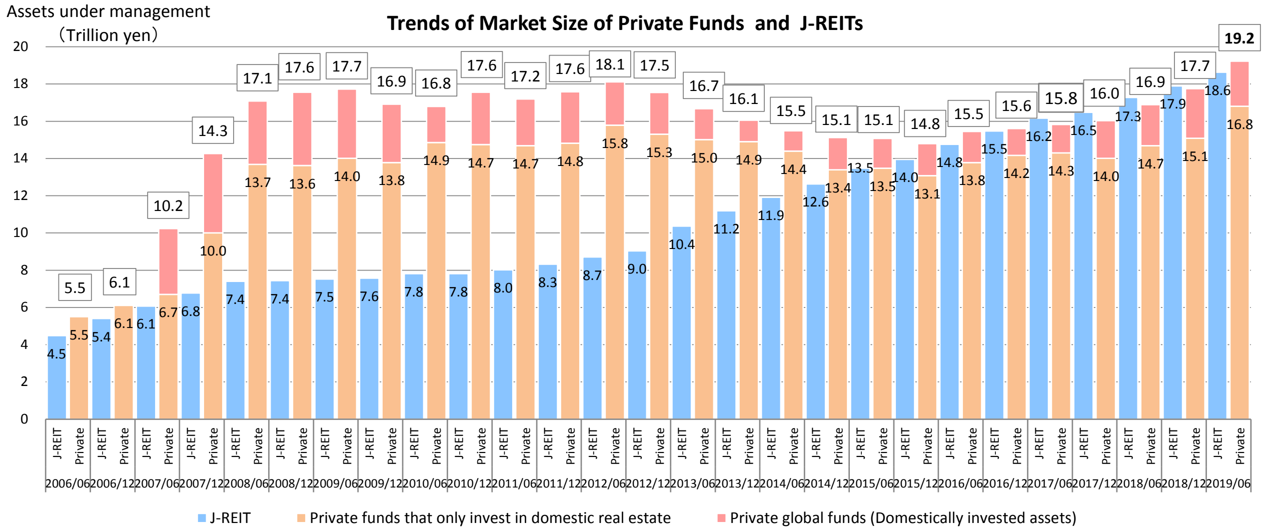
・Assets under management (AUM) as of the end of June 2019 were 19.2 trillion yen（This figure involves Japanese assets managed by global funds）. AUM increased approximately 1,480 billion yen from the previous survey as of the end of December 2018. The pace of the expansion of the market for domestic private real estate funds, which had been increasing gradually, accelerated, and the market grew to a record size.

・The number of asset managers whose AUM increased exceeded the number of asset managers whose AUM decreased, and there are some asset managers whose AUM increased significantly. Overall, the market size we estimated rose approximately 8.4% 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 2019, while the percentage of respondents who chose "*Acquired*" was just over 70%, the percentage who chose "*Sold property*" declined to just over 40%. With the number of properties held by open-end funds increasing while the investment period tending to lengthen, property sales by private fund asset managers are expected to decrease in the future.

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



“ Survey on private real estate funds” July 2019 Survey Results

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

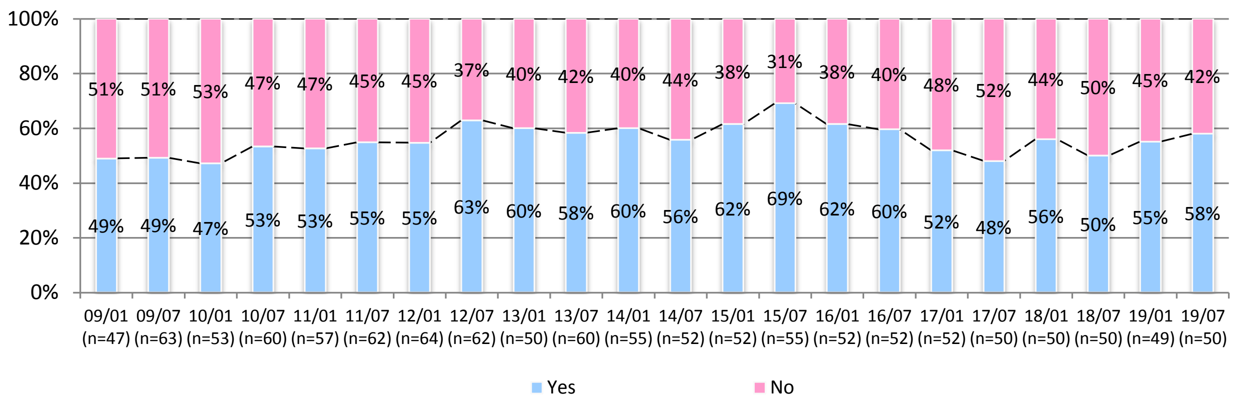
1. Current Status of Real Estate Fund Management Business

1) Management of Overseas Capital

In response to the question as to whether they have managed overseas capital, 58% of respondents chose “*Yes*”, 42% of respondents chose “*No*”. However, 58% of respondents chose “*Yes*” in the latest survey, which showed slight increase compared with around 50% since 2017 survey (Fig.1).

From 2016 through 2017, the percentage of respondents who chose “*Yes*” had been showing a downward trend mainly due to a sense of caution among overseas investors against rising real estate prices in Japan but, judging from the most recent survey results, it is once again starting to trend upwards.

Fig.1 Do you manage overseas capital?

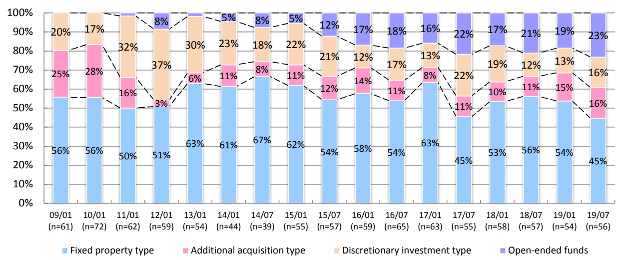


2) Status of the Funds under Management – Results of the funds currently operating and agree to disclose their data

Aggregating responses to questions on the content of currently operating funds revealed that, in terms of funds types, the percentage of respondents who chose “*Open ended funds*” was 23%, which is slightly higher than in previous surveys (Fig. 2) and that the number of responses increased by 3 from the previous survey. Meanwhile, in terms of management style, the percentage of respondents choosing “*Core*” continued to account for a majority (Fig. 3). Looking at individual styles, it is interesting that the percentage of respondents choosing “*Development*” has accounted for more than 10% in three consecutive surveys starting from the July 2018 survey. This suggests that, with investment-grade properties still in short supply, a certain level of demand for development funds exists among investors.

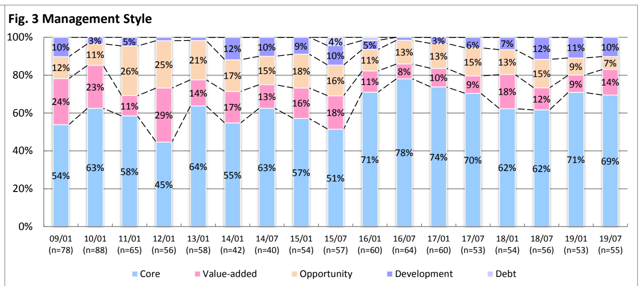
In a survey of target property types, “*Office*” and “*Residential*” (20% each) were chosen by the largest percentage of respondents, followed by “*Industrial*” (19%) (Fig.4). There has been no significant change in the percentage of responses choosing each property type in recent years. Although a certain number of respondents have chosen “*Facilities for the elderly and Health-care facilities*” and “*Data center*” since the January 2018 survey, the percentage of respondents choosing these has not grown. In a survey on target areas, the percentage of respondents choosing “*23 wards of Tokyo*” was highest at 25%, followed by “*Tokyo metropolitan area*” and “*Kinki area*” (21% each) and then “*Nagoya area*” and “*Local areas*” (17% each) (Fig. 5). As seen in the target property types, the percentage of respondents choosing each target area has not changed much, showing that investment in diversified areas has taken root.

Fig. 2 Fund types



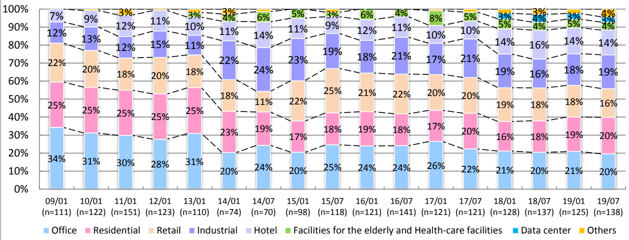
・“Open-ended funds” was added from the January 2011 survey.

Fig. 3 Management Style



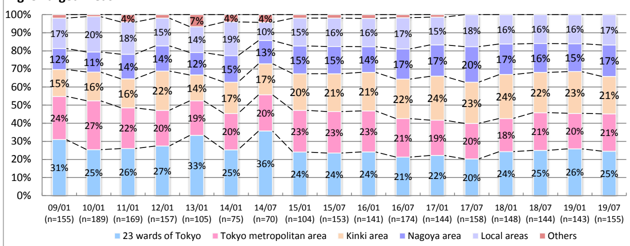
・“Debt” was added to management investment style from the January 2013 survey.

Fig. 4 Target Property Types



・“Facilities for the elderly” and “Health-care facilities” was added from the January 2013 survey.
・From the January 2018 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. And “Data center” was added .

Fig. 5 Target Areas



・"Others" was deleted from the July 2017 survey.

The average target investment period for funds currently under management was 8.5 years, which is longer than in the previous survey (7.8 years). However, as in the previous survey, the result was significantly affected by the inclusion of ultra-long-term funds (3 in total) with an investment period of 20 years or 30 years and it is not the case that, generally speaking, the investment period has lengthened significantly (Fig. 6). A breakdown of the average target investment period of funds currently under management by range shows that the percentage of respondents who chose “*At least 7 years but less than 10 years*” was highest at 32%. Next came “*Ten years or more*” (29%) and the percentage of respondents choosing long-term funds with an investment period of seven years or more accounted for around 60%. The total percentage of respondents choosing short-term funds with an investment period of less than 5 years was only 12% (Fig. 7).

The percentage of investment accounted for by long-term funds has trended higher in recent years. With the monetary easing policy expected to be maintained, the tendency for medium-term and long-term funds to account for the majority of investment is likely to continue and it will be interesting to see whether the upward trend continues in the future. 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

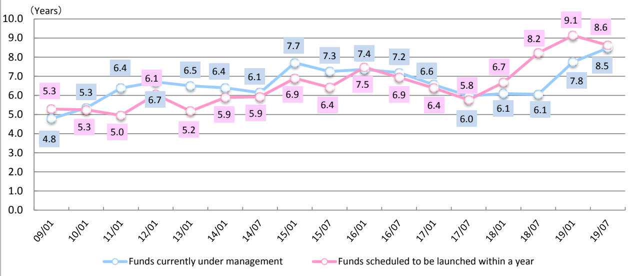
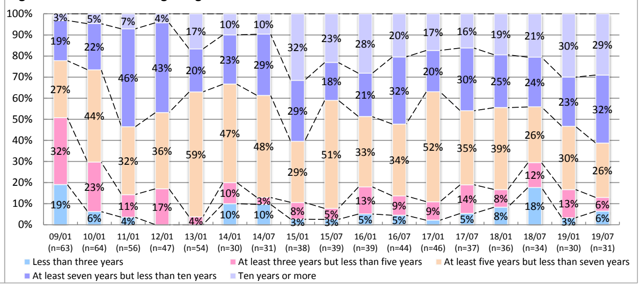


Fig. 7 Breakdown of Average Target Investment Period



Since the July 2017 survey, the average Loan to Value (LTV) of funds under management has shown a downward trend while the average LTV of funds to be launched within a year has been in an upward trend (Fig. 8). One of the factors behind the low LTV of funds under management is the increasingly number of newly launched private REITs that aim for long-term stable operation. As for funds to be launched within a year, LTV is set higher because they are mostly closed-end funds launched when a lull in launches of private REITs is seen and the lending environment is favorable.

In fact, a breakdown of the LTV levels of funds currently under management shows that although the percentage of respondents choosing "*at least 60% but less than 70%*" increased to 29%, no respondents chose "*80% or more*." Since the July 2015 survey, the total percentage of respondents choosing less than 60% has trended upward but the survey results are significantly affected by the increase in open ended funds responses and reflect a preference for low risk and low leverage among investors (Fig. 9). Meanwhile, a breakdown of the LTV levels of funds scheduled to be launched within a year shows an increase in the percentage of "*at least 60% but less than 70%*" responses and expansion in the share of "*80% or more*" responses to 22% (Fig. 11).

The average target IRR of the funds currently under management was 10.4%, rising slightly from the total average (10.1%) in the previous survey (Fig. 10). However, a breakdown of the average target IRR by type shows that there is no major change from the previous survey for any type. It should be remembered that for this survey item, as in the target yield, the sample size is small, and the results are easily affected by sample selection bias.

Fig. 8 Average LTV Ratio

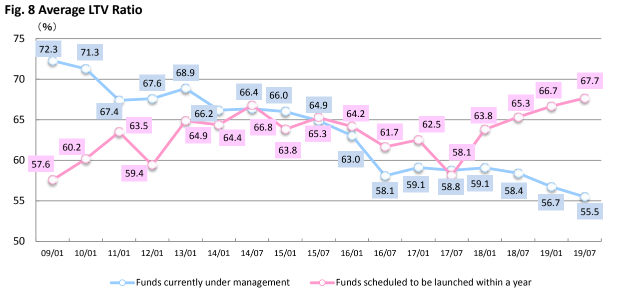


Fig. 9 Range of LTV level (Funds currently under management)

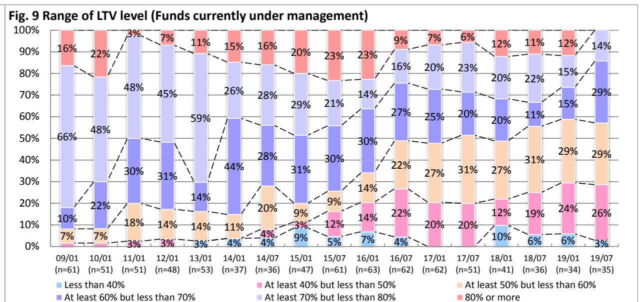


Fig.10 Average Target IRR(Funds currently under management)

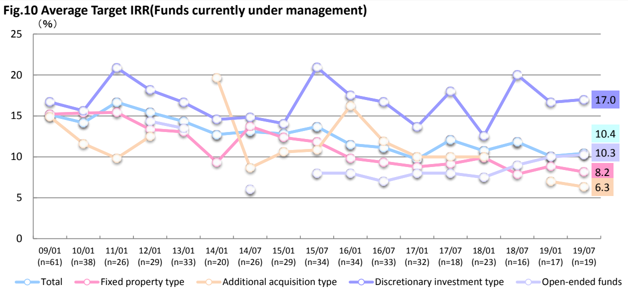
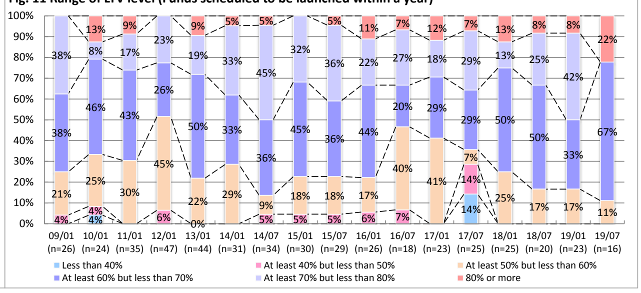


Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt finance circumstances, the number of respondents that chose “*3 (Neutral)*” was 28, which was the highest, exceeding the number who chose “*4 (Easy)*” which amounted to 20. Meanwhile, the number of respondents choosing “*2 (Difficult)*”was 2 (Fig. 12-1). This suggests that the debt finance environment remains favorable (Fig.12-2).

Fig.12-1 Current Circumstances of Debt Financing

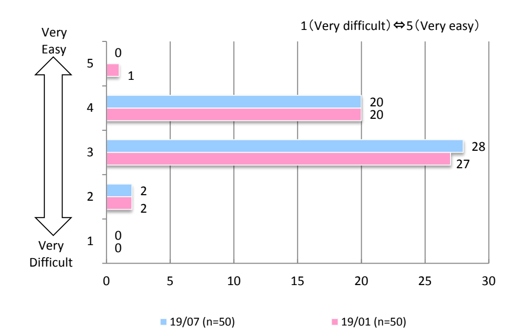
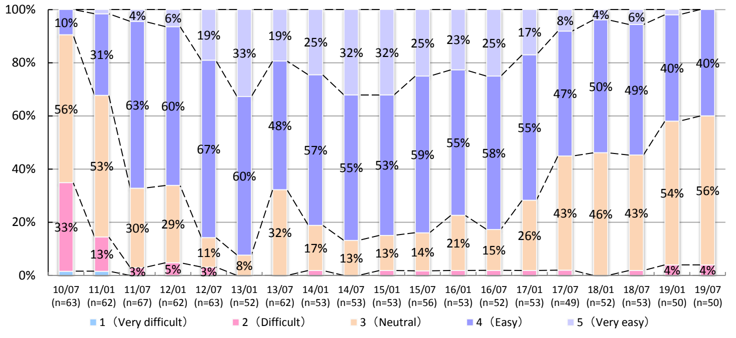


Fig.12-2 Trends in Debt Financing



4) Equity Raising

a. Appetite of Equity Investors

In terms of the appetite of equity investors, respondents choosing “*No change*” accounted for 83%, while those choosing “*Rising*” was 17%. No respondent chose “*Declining*” (Fig. 13). As the situation in which investment is difficult regardless of investment appetite drags on, many assets managers presumably think that there is no particular change in the appetite of equity investors.

A breakdown of appetite of equity investors by property type for both domestic and foreign investors shows that the response “*No change*” was most common for both domestic and foreign investors and for all property types. No respondents chose “*Increase significantly*” or “*Decrease significantly*” (Fig 14-1, 14-2). The property types for which the response “*Increase*” was most common among domestic investors were “*Residential*” and “*Hotel*” (25% each), followed by “*Industrial*” (24%). Among overseas investors, the property type with the highest number of “*Increase*” responses was “*Residential*,” accounting for 38%, followed by “*Office*” and “*Hotel*” (28% each).

Since the January 2015 survey, the property type that has elicited the most “*Increase*” responses among both domestic and overseas investors have been “*Hotel*.” In the latest survey, however, the number of “*Increase*” responses for “*Hotel*” decreased and there were more “*Increase*” responses for “*Residential*” than for “*Hotel*”. Factors such as the surge in foreign visitors to Japan had spurred moves to develop hotels, especially in Tokyo and Osaka, but presumably investors are increasingly becoming more cautious about investing in hotels due to a growing sense of oversupply in the market, changing from their stance of active investment in hotels.

Fig.13 Appetite of Equity Investors

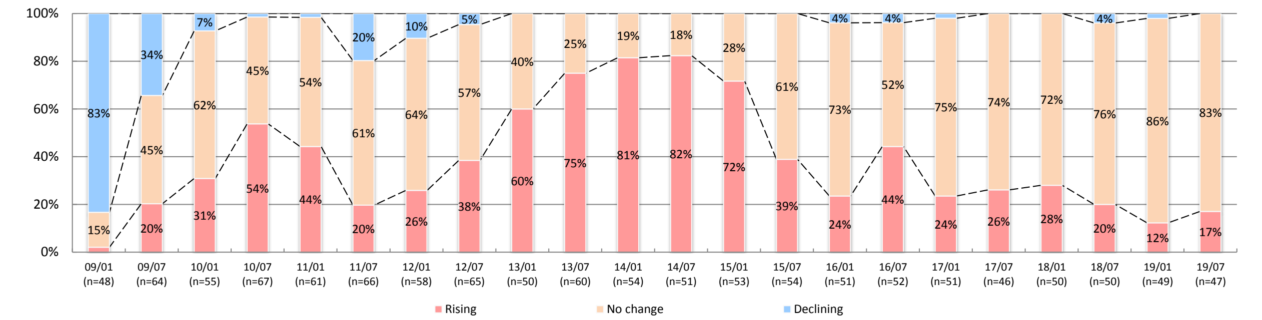


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

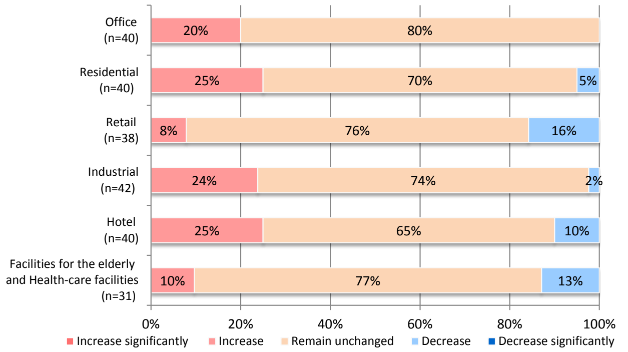
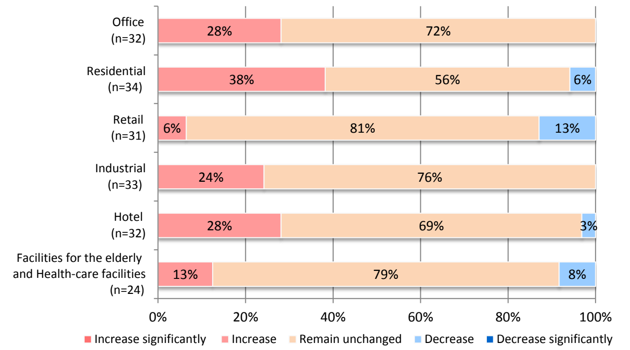


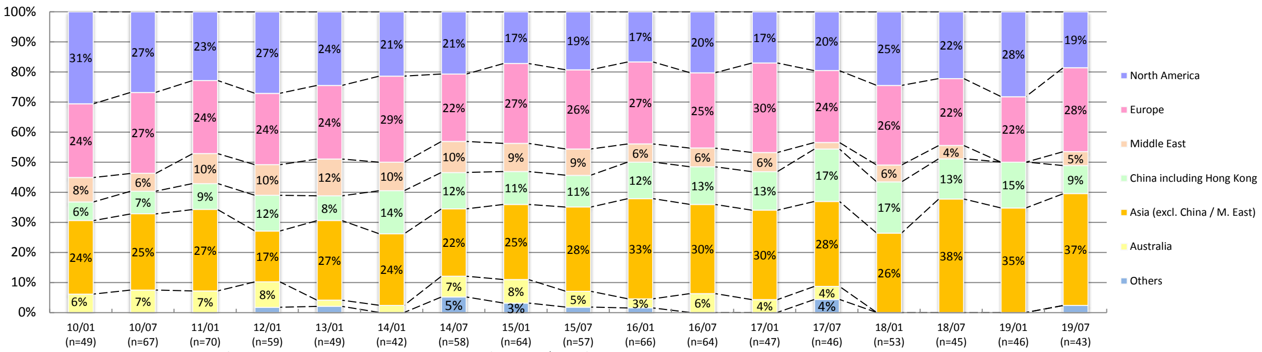
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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

The most common response based on a breakdown of the aggregate number of responses of foreign investors by the region to which they belong was "*Asia (excl. China/M. East)*" (37%), followed by "*Europe*" (28%), and then "*North America*" (19%). The percentage responding "*Asia (excl. China/M. East)*" has accounted for more than one-third for three periods running since the July 2018 survey, and it is fair to say that investors from this region have increased their presence among the foreign investors. While the percentage responding "*Europe*" increased from 22% in the previous survey to 28%, the percentage responding "*North America*" fells from 28% in the previous survey to 19%, with the two responses swapping position in the rankings (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*", "*Highly stable income*", "*Allocation as part of the global portfolio*", "*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 for the reasons foreign investors give for not investing in Japan, the percentage responding "*Rising in real estate price*" was still higher than that responding "*Lack of growth potential in GDP, consumption, population, etc.*" "*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)

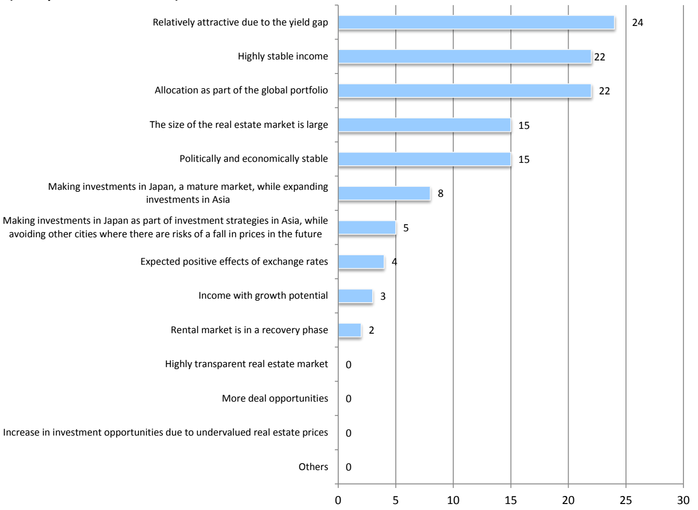
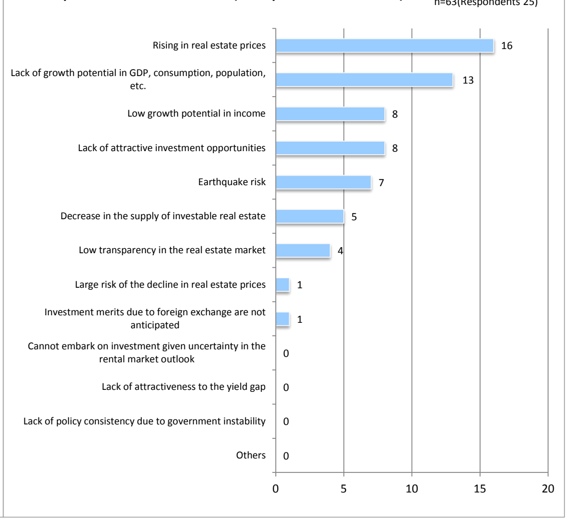


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed)



d. Acquisition and Disposition of Properties during January to June 2019

As to a survey on the acquisition of properties during January to June 2019, the percentage of respondents who answered "*Acquired*" accounted for 71%, remaining at a high level (Fig. 18). In terms of reasons for not acquiring any properties, respondents who chose "*Can't agree on prices*" accounted for the majority. The percentage choosing "*Severe competition in bids*" was 17%, falling slightly from the previous survey. Since the July 2013 survey, more than 70% of the asset managers who didn't acquire properties in the preceding six-month period have cited the gap in price expectations and acquisition competition as reasons, suggesting that the difficult situation for acquiring properties continues against the backdrop of rising prices for real estate (Fig. 19).

Regarding the survey on the disposition of properties from January to June 2019, the percentage of respondents who chose "*Sold property*" was 43%, falling below 50% as in the previous survey (Fig. 20). As for the reasons given for not selling any properties, respondents who chose "*Did not plan to sell from the outset*" accounted for 89% (Fig. 21). No respondents chose "*No inquiries despite sales activities*" or "*Can't agree on prices*."

With the investment period tending to lengthen and the number of properties held by open ended funds increasing, property sales by private fund asset managers are expected to decrease in the future.

Fig.18 Circumstances for Acquisition

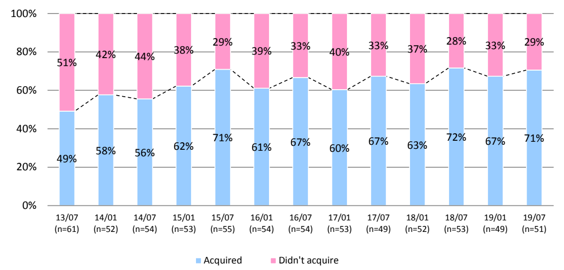


Fig.19 Reason for not acquiring property

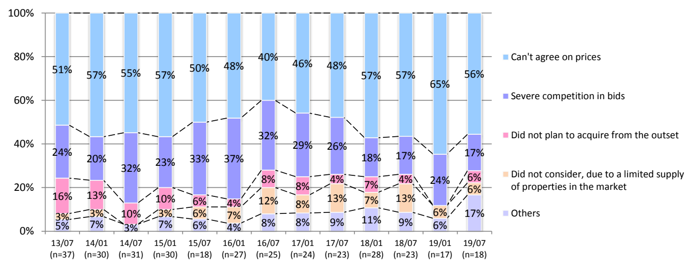


Fig. 20 Circumstances for Disposition

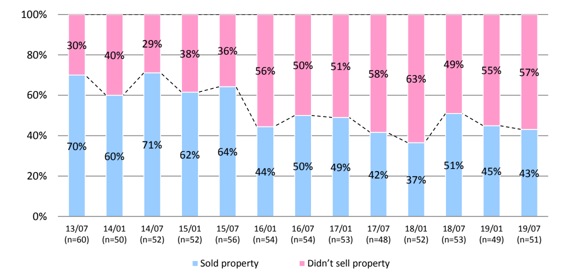
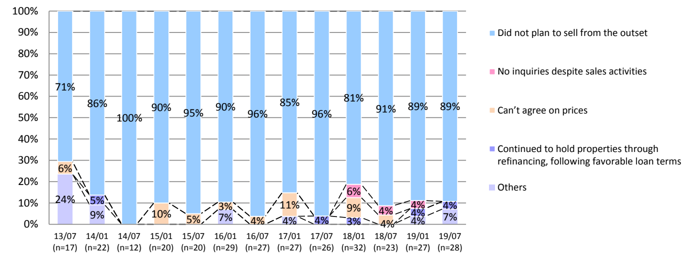


Fig. 21 Reason for not Selling Property



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, the percentage of respondents answering "*Plan to launch*" was unchanged at 67% (Fig. 22). 84% of asset managers answered that they plan to acquire properties within a year. Many of the assets managers who plan to acquire properties gave expected stable cash flow as the reason. Meanwhile, the responses of asset managers who do not plan to acquire properties suggest that the difficult situation for acquiring properties continues against the backdrop of an environment unconducive to acquisition and rising prices for real estate (Fig. 23).

Meanwhile, 57% of asset managers responded that they plan to dispose of properties within a year. The most common reasons given for their plans to dispose of properties were "*Succeeded in agreeing on prices*," and "*Existence of maturing loan or fund reaching maturity date*." The survey results concerning property sales suggest that it is still a sellers' market.

Fig.22 Plans of Launch of New Funds

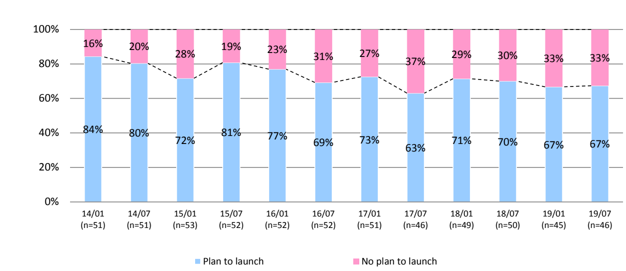


Fig.23 Plans of acquiring properties

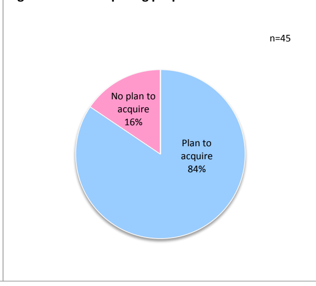
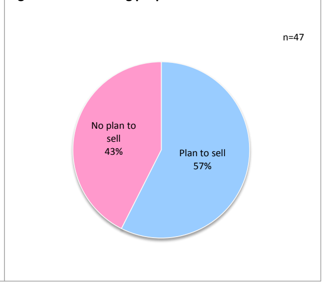


Fig.24 Plans of selling properties

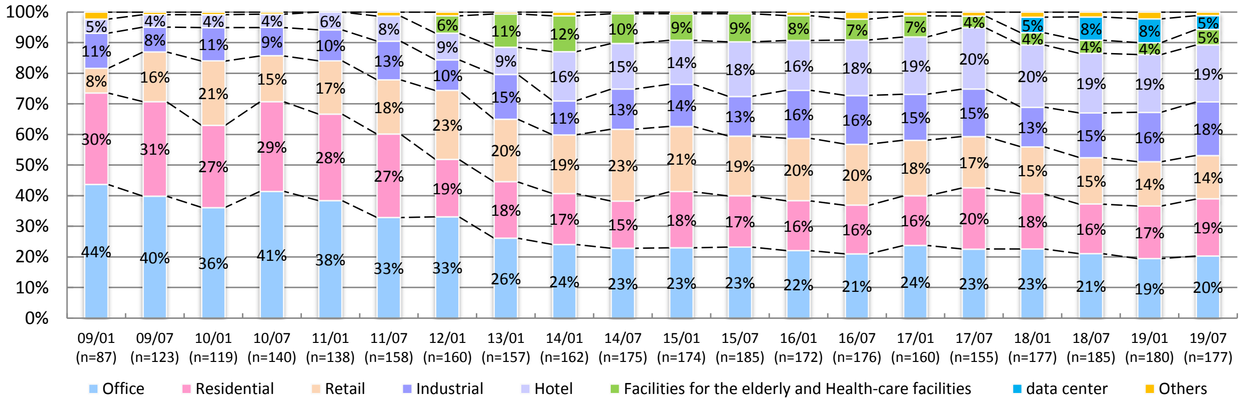


2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

In terms of target property types, around 20% of respondents chose “*Office*,” while “*Residential*” and “*Hotel*” both accounted for 19% shares (Fig. 25). A breakdown shows that there is no particular bias towards a certain property type. “*Data center*,” which was added as a possible response from the January 2018 survey, was also chosen by a certain number of respondents in the latest survey.

Fig. 25 Target Property Types (Multiple answers allowed)

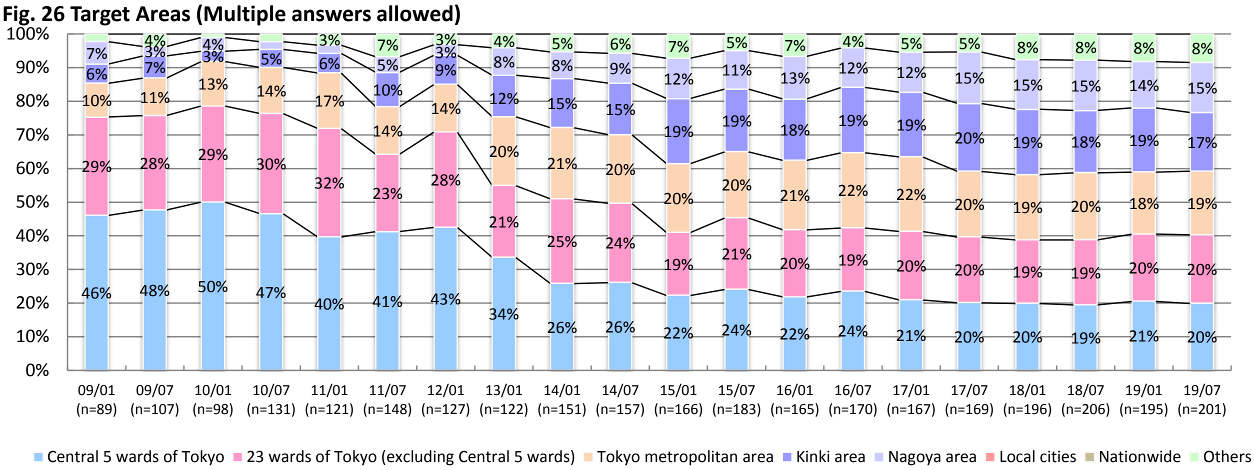


・From the January 2018 survey, “Facilities for the elderly” and “Health-care facilities” have been changed to “Facilities for the elderly and health-care facilities,” and the past values are added together.
・“Data center” was added from the January2018 survey.

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% (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)



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 open-ended private REITs, the largest number of respondents chose "*Have already launched*", but this was followed by the response "*Seek to develop a better understanding and gather information, but not working on a detailed study.*" Moreover, in view of factors such as the increase in the response "*Have heard of the name but not considered involvement*" (increase from 2 responses in the previous survey to 5 responses in the latest survey) and the decrease in the response " *Preparing for a launch after consideration*" (from 6 responses in the previous survey to 4 responses in the latest survey), there appears to be a lull in the creation of new open ended funds (Fig. 27).However, in the latest survey, there was still a number of asset managers who answered "*Preparing for a launch*," and open ended funds may continue to increase slightly in the future.

In terms of important factors for development in the open-ended private REITs market, most respondents chose one of "*Expansion of the categories of investors to invest in funds*," "*Enhancement of the track record*," "*Improvement in liquidity (increase in frequency, easing of refund restrictions, etc.*" and "*Support of the sponsor*". In particular, "*Improvement in liquidity*" (from 16 responses in the previous survey to 20 responses in the latest survey) and "*Support of the sponsor*" (from 16 responses in the previous survey to 19 responses in the most recent survey) increased, showing that asset managers recognize liquidity and external growth as issues.

Fig.27 Managers' involvement with private REITs

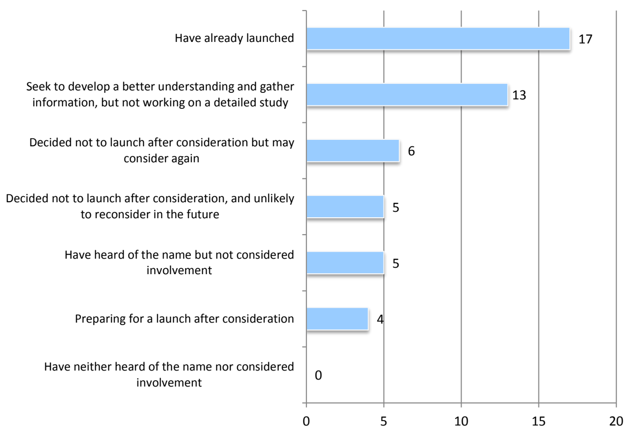
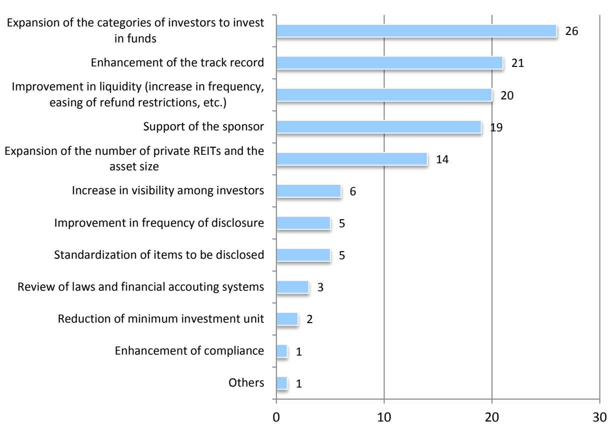


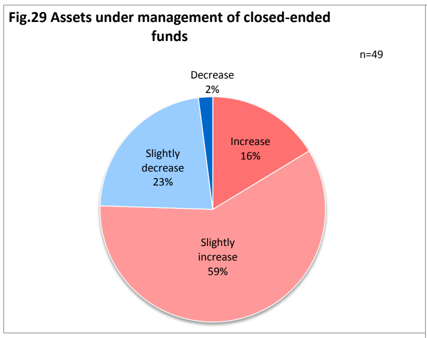
Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options)

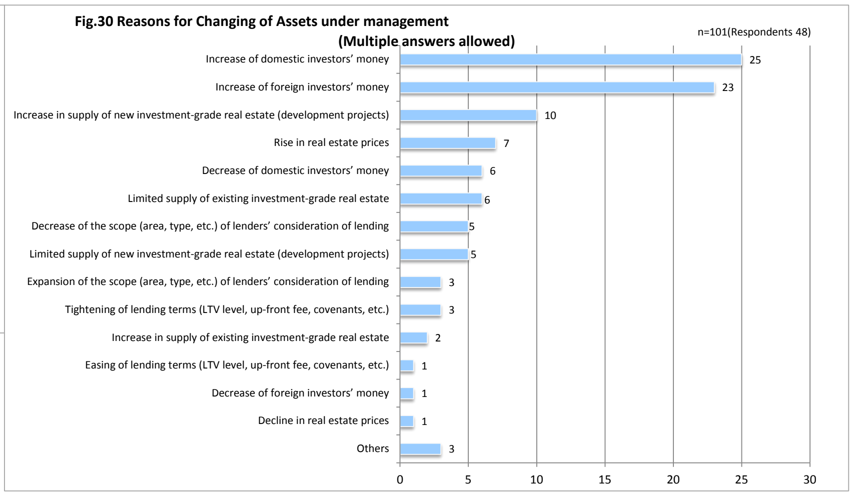


2) Outlook of asset size in the Closed-ended private real estate funds market

With regard to the outlook on asset size in the closed-end private real estate funds market, the percentage of respondents who chose "*Increase*" or "*Slightly increase*" was 75% in total (Fig. 29). As reasons for this, many respondents chose "*Increase of domestic and foreign investors' money*" (Fig. 30). We believe that many asset managers expect continuing inflows of funds into real estate investment due to the continuation of the monetary easing policy.

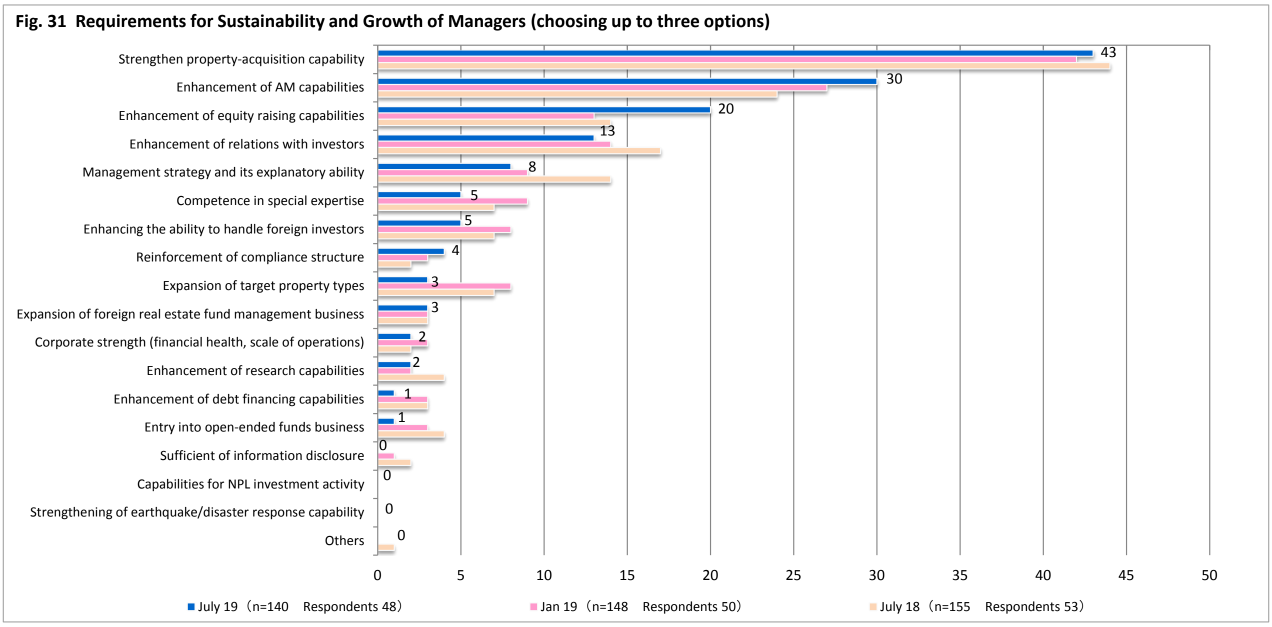
The main reasons given for "*Decrease*" included "*Rise in real estate prices*" and "*Limited supply of investment-grade real estate,*" showing that there is still a certain number of asset managers who believe that they will not be able to agree on a purchase because of rising real estate prices and that a shortage of investment-grade real estate will lead to market contraction.





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, the number of respondents who chose "*Enhancement of equity raising capabilities*" was higher than in the past two surveys. This suggests that many asset managers recognize that it is important to strike a balance between acquisitions and fund raising.



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 82% 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?*” 75% of domestic investors and 78% of foreign investors chose “*Increase*.”(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

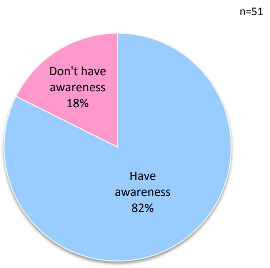
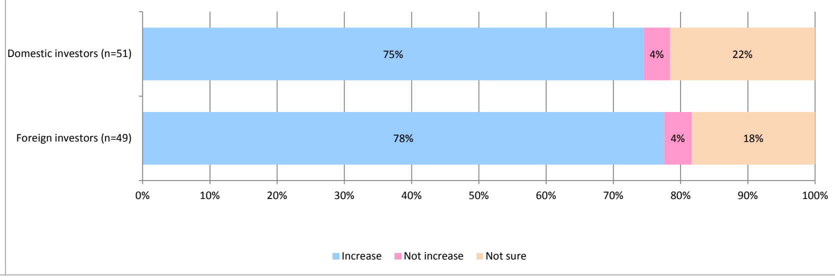


Fig.33 Outlook for ESG Orientation among Investors



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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