Survey on Private Real Estate Funds in Japan

January 2019– Results

March 15, 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 27th 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 January to February 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 December 2018 to be 17.7 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 860 billion yen (5.1%) from the previous survey (16.9 trillion yen as of the end of June 2018). The pace of expansion of the market for domestic private real estate funds, which was gradually increasing in recent years, continued to expand. 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 17.7 trillion yen including Japanese assets of global funds

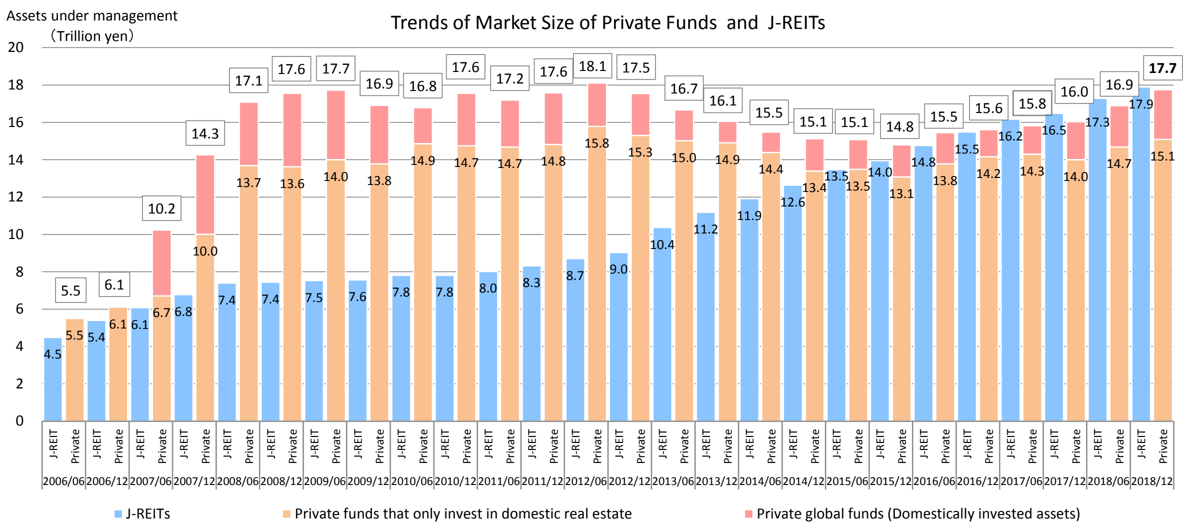
・Assets under management (AUM) as of the end of December 2018 were 17.7 trillion yen（This figure involves Japanese assets managed by global funds）. AUM increased approximately 860 billion yen from the previous survey as of the end of June 2018. The pace of expansion of the market for domestic private real estate funds, which was gradually increasing in recent years, continued to expand.

・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 5.1% from the estimate in the previous survey. The increase in assets under management (AUM) of closed-ended private real estate funds, in addition to the enhancement of private REITs due to external growth, was a significant driver in the expanding private real estate investment funds market.

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

・As for the survey on acquiring or disposing of properties in the second half of 2018, less than 70% of respondents chose *"Acquired,"* and less than half of respondents chose *"Sold property,"* both of which declined from the previous survey. In an environment where the number of properties coming onto the market remains low, the gap in price expectations is widening.

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



" Survey on private real estate funds" January 2019 Survey Results

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

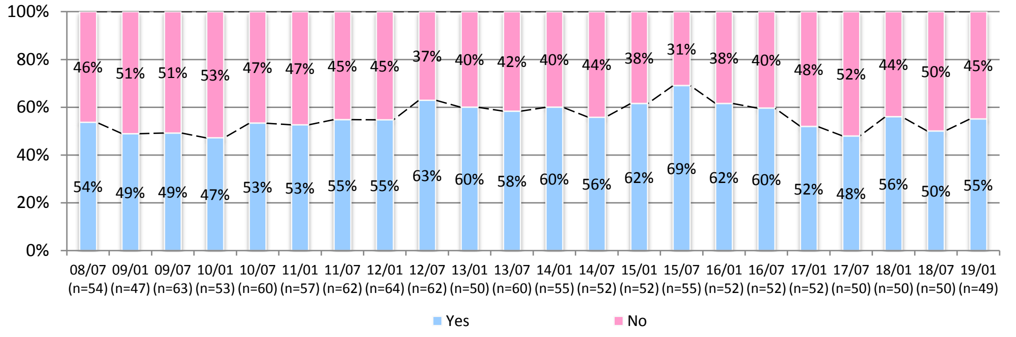
1. Current Status of Real Estate Fund Management Business

1) Management of Overseas Capital

In response to the question as to whether they have managed overseas capital, 55% of respondents chose *"Yes"*, 45% of respondents chose *"No"* (Fig.1). While the percentage of respondents who chose *"Yes"* declined slightly from the level of around 60% in surveys in 2015 and 2016, around 50% of the managers dealt with overseas capital in recent years.

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, surveys results since 2018, 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"*. For management style, "Development" accounts for more than 10%, suggesting the possibility that the launch of "Development" is continuing.

In a survey on target property types, *"Office"* was chosen by the largest percentage of the respondents(21%), followed by *"Residential"*(19%),*"Retail "*and *"Industrial"* (18% each), *"Hotel"* (14%)(Fig.4). Answer proportion of each property type, no significant change was observed from the previous survey. 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

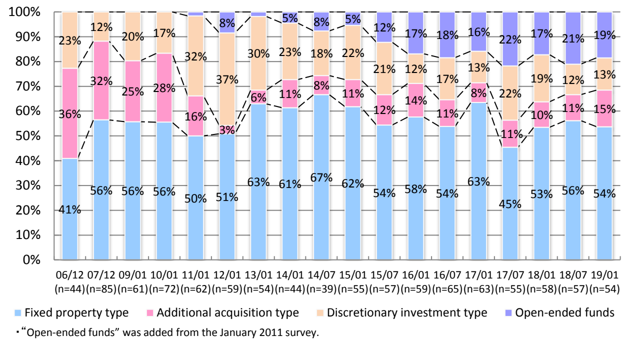


Fig. 3 Management Style

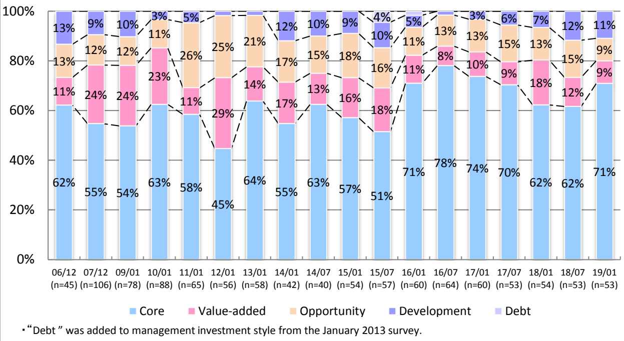


Fig. 4 Target Property Types

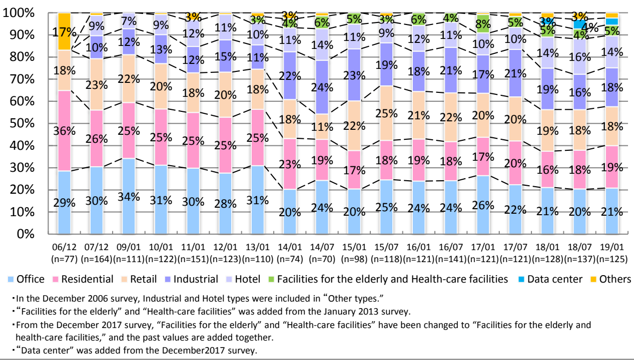
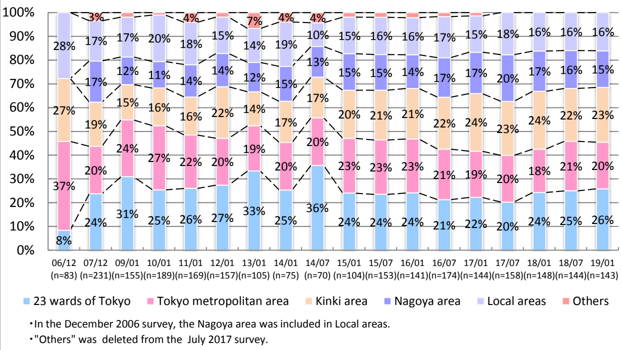


Fig. 5 Target Areas



As to the survey in terms of the average target investment period, it was 7.8 years for funds currently under management and 9.1 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*" *and* "*Ten years or more*"(30% each). The percentage of respondents who chose "*At least seven years but less than 10 years*" was 23%, and respondents who chose long-term funds for seven years or more accounted for the majority, the percentage of "*Less than three years*" decreased to 3% from 18% in the previous survey (Fig.7). With the backdrop of the prospect that the monetary easing policy of the Bank of Japan will be maintained and the competitive acquisition over properties is intensifying, the trend whereby funds with an investment period of five years or more comprise the majority is expected to continue. In fact, the average target investment period of funds to be launched within a year has lengthened 9.1 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

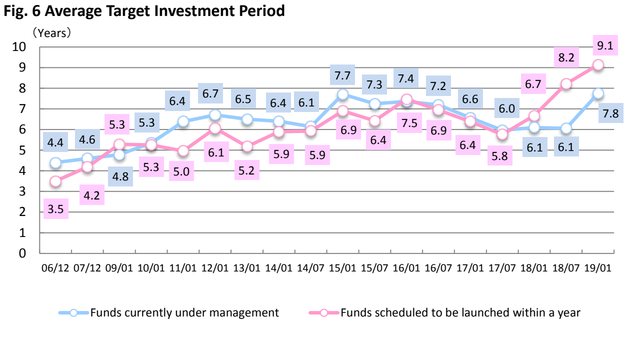
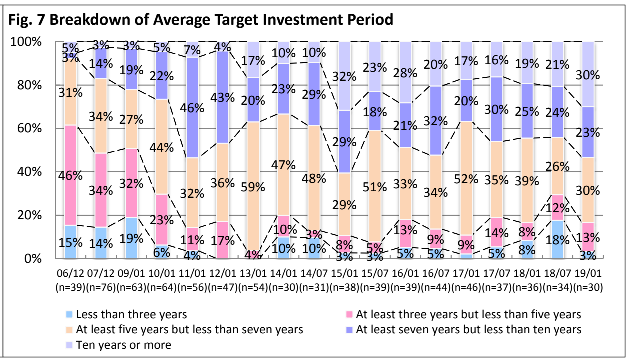


Fig. 7 Breakdown of Average Target Investment Period



The average LTV of funds under management was 56.7%, and that of funds to be launched within a year was 66.7%.(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(29%), followed by *"at least 40% but less than 50%"*(24%). The total share of *"Less than 60%"* is 59%, the largest share ever gained in all of the surveys (Fig.9). The average Loan to Value (LTV) of funds under management remained low. Looking at the breakdown of LTV ranges, the percentage of *"Less than 60%"* continues to show an increasing trend. It seems to reflect investors' orientation toward low risk and low leverage funds that is still strong and reflected in funds under management. This survey item includes responses from open-ended funds, 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 70% but less than 80%"* was 42%, and the percentage of *"at least 60% but less than 70%"* was 33%. As a result, 75% 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 three consecutive surveys, we need to pay attention to whether this upward trendwill continue or not.

With respect to the average target IRR of the funds currently under management, the average target IRR of all types slightly dropped to 10.1% from the previous survey(11.8%)(Fig.10).

Fig. 8 Average LTV Ratio

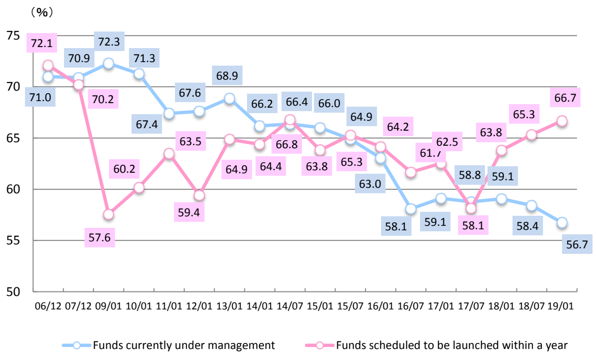


Fig. 9 Range of LTV level (Funds currently under management)

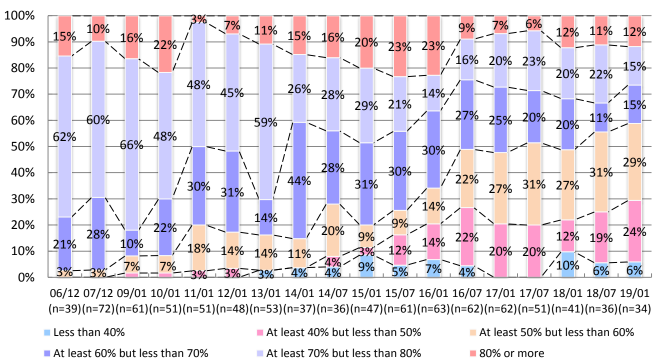


Fig.10 Average Target IRR(Funds currently under management)

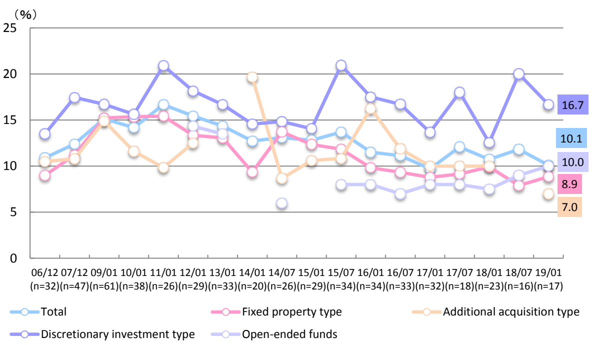
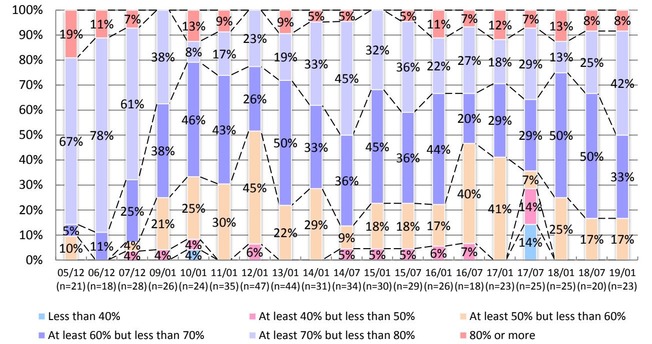


Fig. 11 Range of LTV level (Funds scheduled to be launched within a year)



3) Debt Finance

Regarding debt financing circumstances, the largest number of the respondents chose “*3 (neutral)*”, exceeded that of respondents who chose *“4 (easy)”*(Fig.12-1). Many asset managers seem to feel that there is no particular change in the circumstances where debt financing is relatively easy. However, the number of respondents who chose *“3”* exceeded that of respondents who chose *“4,”* suggesting the possibility that the accommodative debt financing environment has changed slightly (Fig.12-2).

Fig.12-1 Current Circumstances of Debt Financing

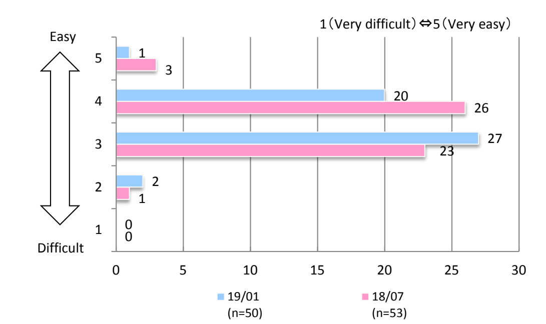
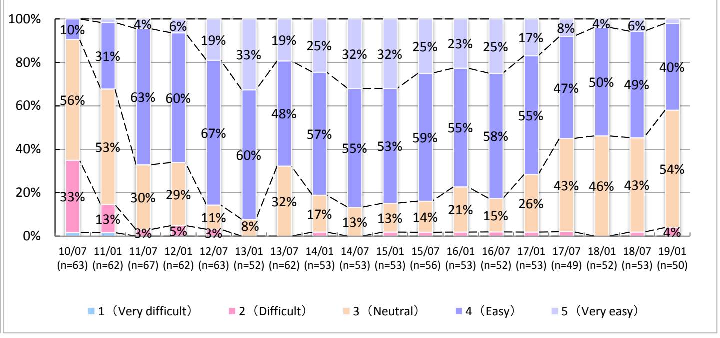


Fig.12-2 Trends in Debt Financing



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 12% from the previous survey (Fig13). Given that the difficult situation for investing continues for a long time even if the investors have an appetite, many asset managers seem to think that there is no particular change in the appetite of equity investors.

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”* for both domestic and foreign investors, unchanged from the previous survey, suggesting that both investors have a strong appetite for investment in hotels sector. In addition, the percentage of respondents who chose *“Industrial”* increased from the previous survey for both domestic and foreign investors. Respondents who answered *“Declining significantly”* were domestic investors who chose *“Facilities for the elderly and Health-care Facilities”* and foreign investors who chose *“Retail.”* (Fig.14-1,14-2).

Fig.13 Appetite of Equity Investors

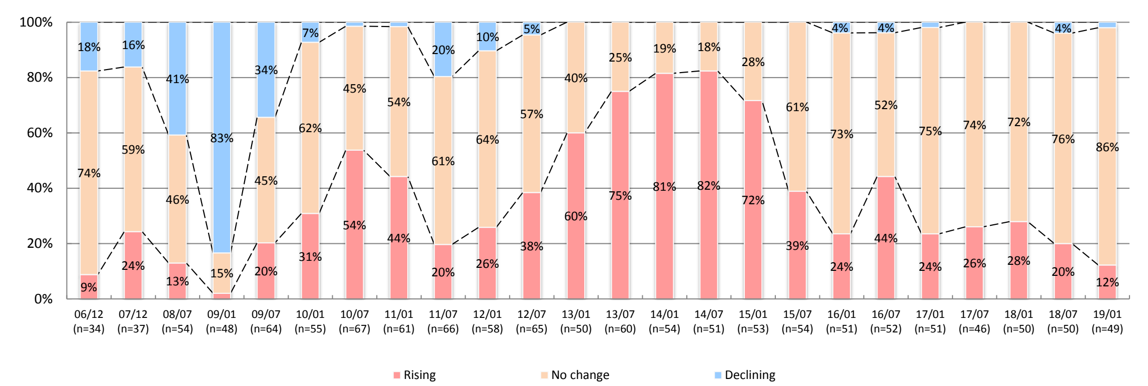


Fig. 14-1 Domestic Investors' Appetite by Type of Target Property

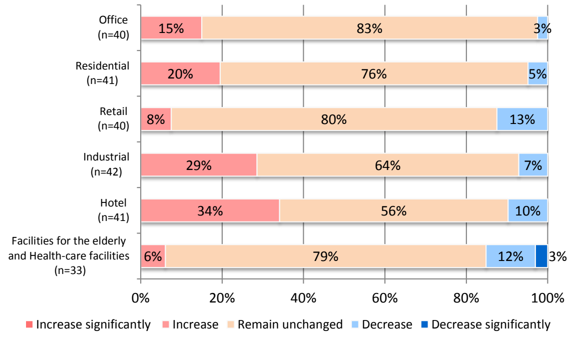
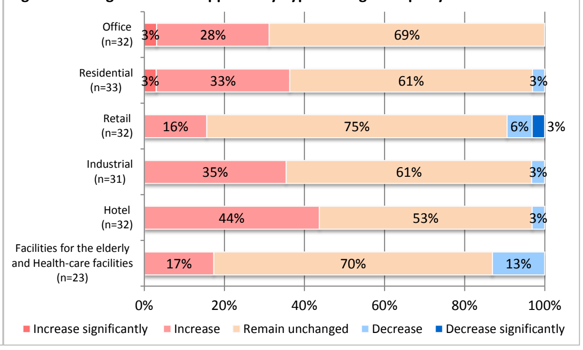


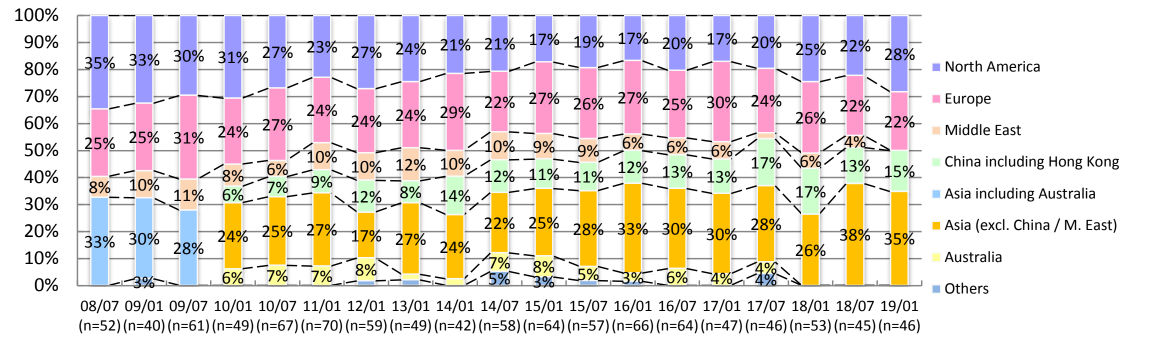
Fig. 14-2 Foreign Investors' Appetite by Type of Target Property



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 35%, followed by "*North America"*(28%), "*Europe*"(22%),"*China including Hong Kong*"(15%). 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



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*", *"Politically and economically stable"* (Fig.16). These choices have been the major reasons indicated in every survey in the past, This shows that these choices support inbound investments in Japan.

As for 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."*. The percentage of respondents who chose *"Rising in real estate prices"* was 25%, the largest percentage in past surveys. This suggests that many asset managers think the concern over the overheating of the real estate investment market is also spreading among foreign investors (Fig.17).

Fig.16 Reasons for Foreign Investors Investing in Japan (Multiple answers allowed) n=99(Respondents27)

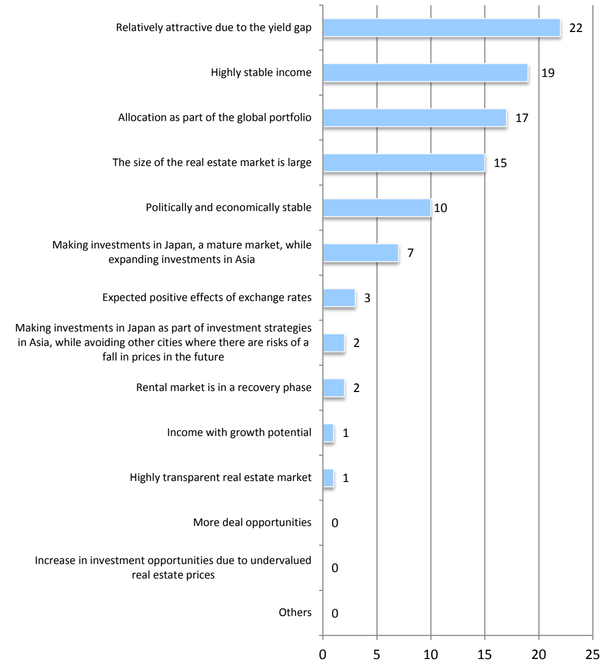
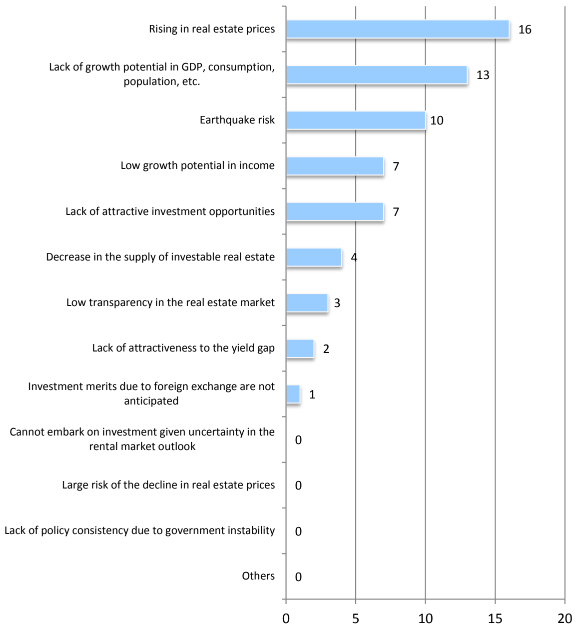


Fig.17 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed) n=63(Respondents25)



d. Acquisition and Disposition of Properties during July to December 2018

As to a survey on the acquisition of properties during July to December 2018, the percentage of respondents who answered "Acquired" accounted 67%, More than 60% of responding companies are in the process of acquiring properties (Fig.18). In terms of reasons for not acquiring any properties, respondents who chose *"Can't agree on prices"* accounted for 65%, the largest percentage since the commencement of the survey. The percentage of respondents who chose *"Severe competition in bids"* has been on a declining trend since 2017, but rose to 24%, increasing again in this survey.

About 90% of the asset managers who did not acquire properties cited the gap in price expectations and the acquisition competition as the reasons (Fig.19), suggesting that the difficult situation for acquiring properties continues against the backdrop of rising prices for real estate.

Regarding the survey on the disposition of properties from July to December 2018, the percentage of respondents who chose *"Sold property"* was 45%, falling below 50% (Fig.20). As for the reasons for not selling any properties, respondents who chose *"Did not plan to sell from the onset"* accounted for 89% (Fig.21). Given that opportunities to sell properties are decreasing due to the prolongation of the investment period and that properties held by open-ended funds are increasing, the case in which the manager of private funds becomes an entity to sell properties is expected to continue declining.

Fig.18 Circumstances for Acquisition

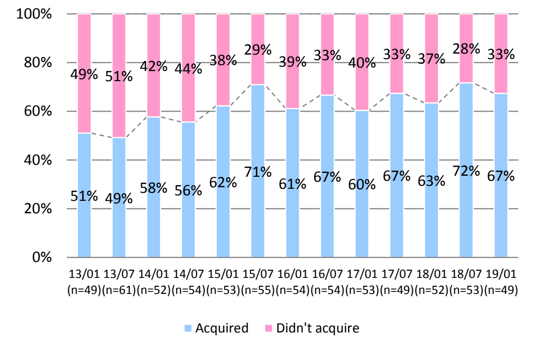


Fig.19 Reason for not acquiring property

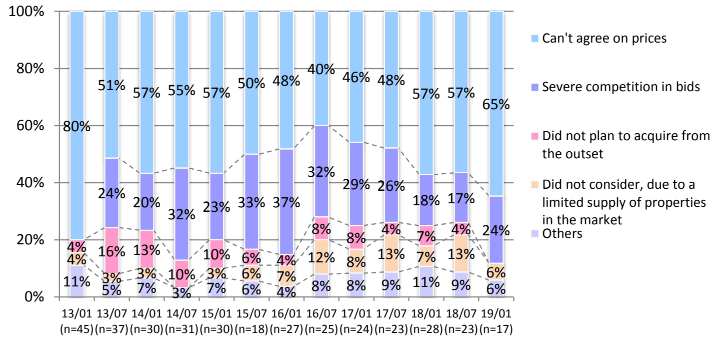


Fig. 20 Circumstances for Disposition

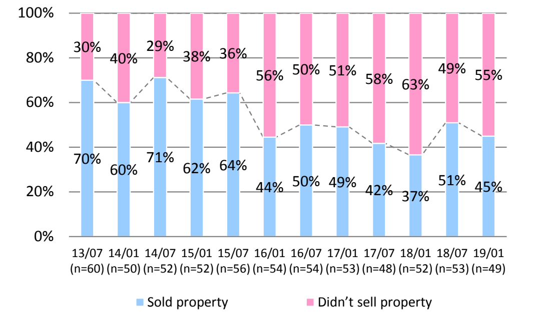
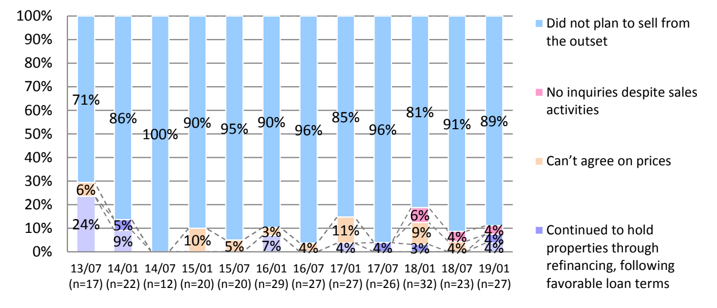


Fig. 21 Reason for not Selling Property



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, 67% 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 85%, that of those who plan to dispose properties accounted for 57% (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

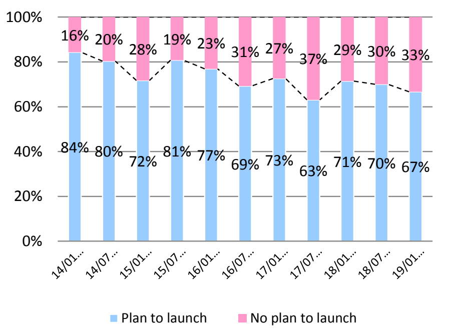


Fig.23 Plans of acquiring properties n=47

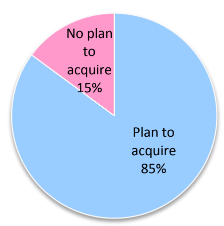
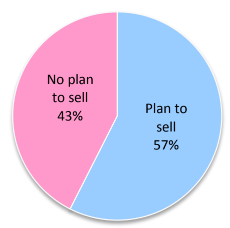


Fig.24 Plans of selling properties n=47



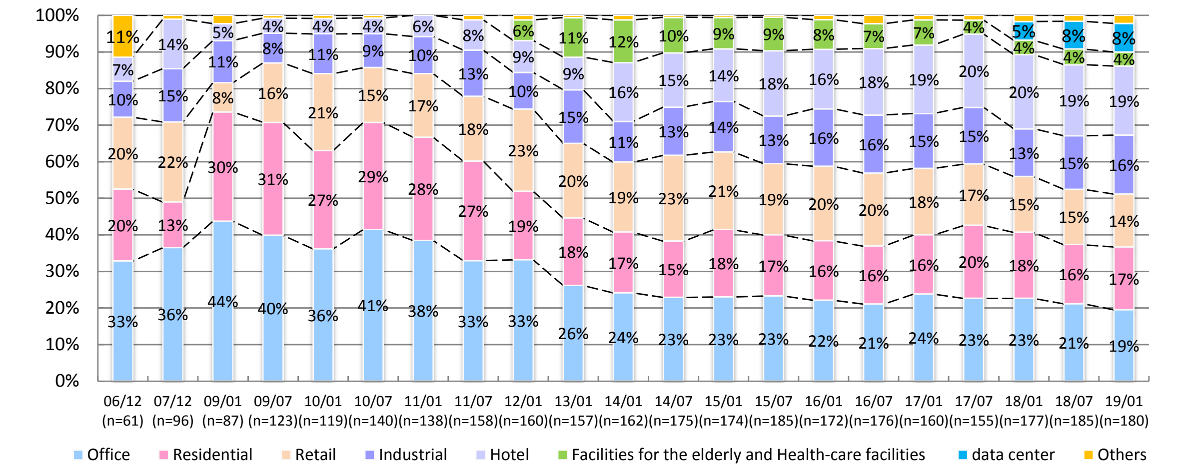
2). Investment Strategies of Asset Managers

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 almost the same position as "*Office*" as a property type in which asset managers show an intention to focus.

The percentage of "*Data center,*" which we added to the target property types in the January 2018 survey, also stayed at 8%. We will pay attention to whether it will become established as a target property type in the future.

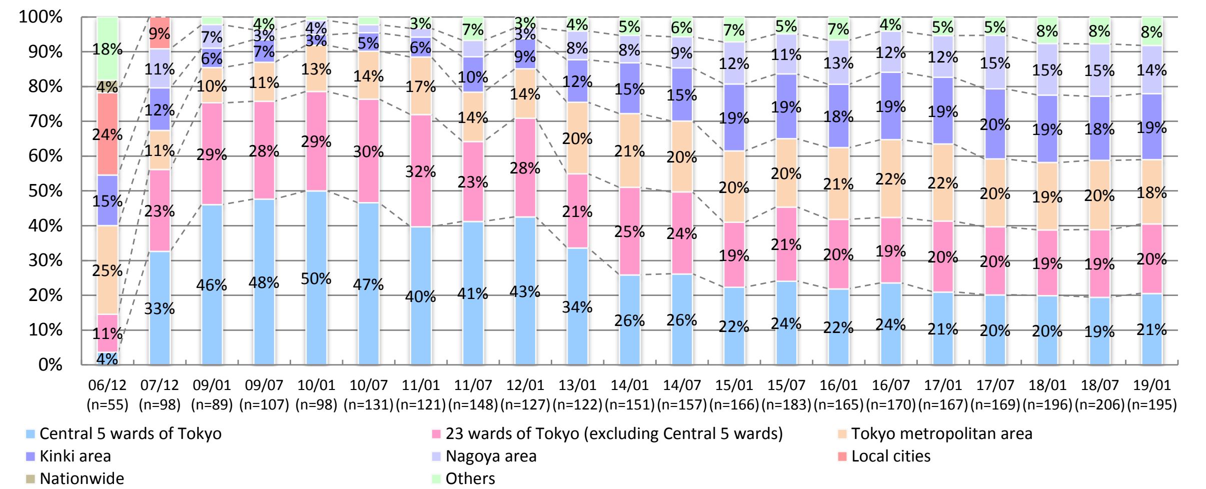
Fig. 25 Target Property Types (Multiple answers allowed)



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)



・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 open-ended private REITs, the largest number of respondents chose *"Have already launched,"* followed by respondents who chose *"Seek to develop a better understanding and gather information, but not working on a detailed study,"* suggesting that the launch of open-ended private REITs has come to a halt (Fig.27). However, given that several asset managers chose *"Preparing for a launch,"* open-ended private REITs could continue to increase slightly going forward.

In terms of important factors for development in the open-ended private REITs market, the largest amount of respondents chose *"Enhancement of the track record"* and *"Expansion of the categories of investors to invest in funds."* 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 such phase (Fig.28).

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

Fig.27 Managers' involvement with private REITs

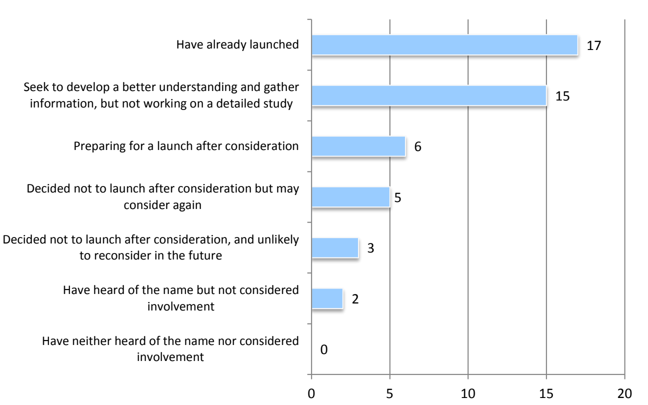
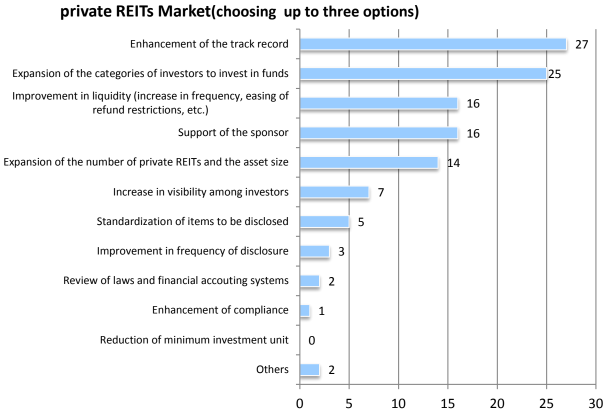


Fig.28 Important Factors for Development in the private REITs Market(choosing up to three options)



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-ended private real estate funds market, the percentage of respondents who expect an increase accounted for about 70% 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 reasons for *"Decrease"* were *"Limited supply of new investment-grade real estate"* and *"Rise in real estate prices,"* reflecting a seller's market.

Fig.29 Assets under management of closed-ended funds

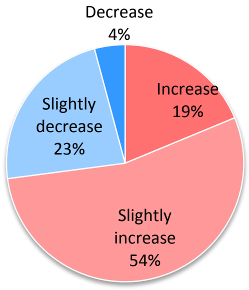
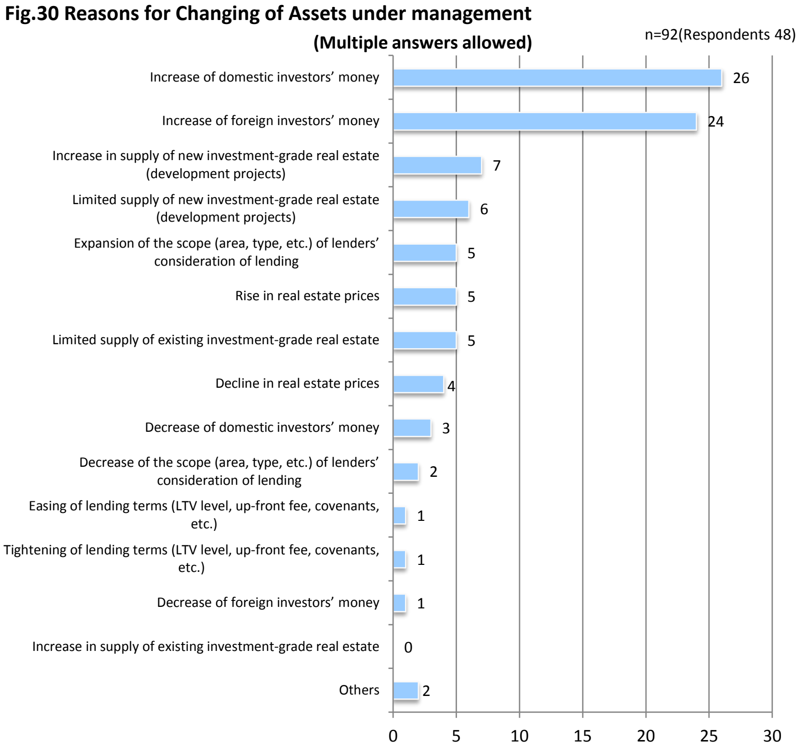


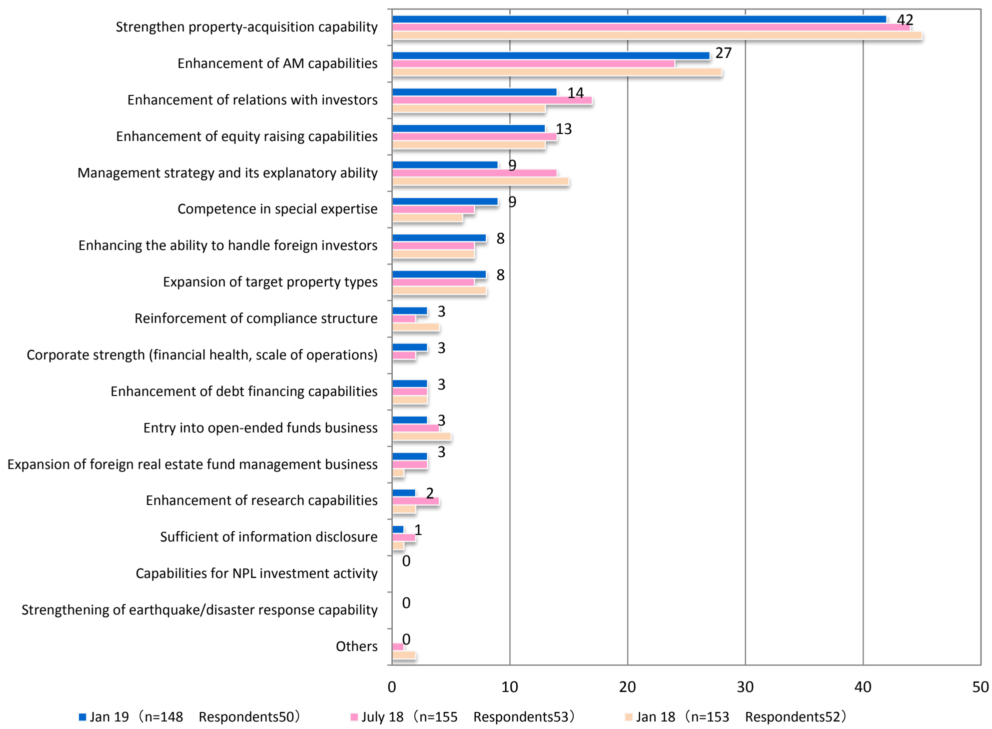
Fig.30 Reasons for Changing of Assets under management (Multiple answers allowed)



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). Under the current environment where the acquisition of properties is difficult due to rising real estate prices, an ability to realize internal growth in properties held is expected for asset managers. Eight respondents also chose *"Expansion of target property types."* Investors are required to discover an investment opportunity by expanding investment targets into diverse assets.

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



Definitions of Terms

The definitions of terms used in this report are as follows;

Private real estate fund:	A private real estate fund is a structure under which investors' funds are managed by professional asset managers. In this report, commingled funds that are designed for multiple investors, and separate accounts, investment programs for single investors are both categorized as private real estate funds. This does not include products governed by the Act Concerning Designated Real Estate Joint Enterprises.
Fixed property type:	A type of fund in which properties to be invested have been identified at the launch of the fund
Additional acquisition type:	A type of fund in which certain percentage of properties to be invested have been identified at the launch of the fund, leaving additional investments after the launch usually at the discretion of manager subject to pre-determined investment guidelines
Discretionary investment type:	A type of fund in which the properties to be invested have not been identified at the launch of the fund, and properties are acquired after the launch at the discretion of a manager subject to pre-determined investment guidelines; Also called a blind pool type
Closed-ended fund:	This refers to private real estate funds with stipulations on the management period. In principle, this system does not allow reimbursement during the management period.
Open-ended fund:	This refers to private real estate funds without stipulations on the management period. The system enables additional investment, cancellation and reimbursement during the management period. The value of the holding is calculated based on the appraisal value at the time. Open-ended funds currently managed in Japan take the form of a private REIT.

＜Management Style＞

Core:	An investment style in which stable long-term investments are envisaged by investing in sound properties generating steady income flows.
Opportunity :	An investment style in which a large capital gain is aimed at by investing in unprofitable properties and selling them after increasing value with improvements. Some of opportunity investments invest in development projects and funds that invest in companies.
Value-added:	An investment style that lies between Core and Opportunity, and aiming at both income gains and capital gains.
Development:	An investment style that specializes in achieving development gains.
Debt:	An investment style in which an investment is made in loans that pay the principal and interests from income from real estate and real estate trust beneficiary rights. Compared with the equity investment, the debt investment generally has a lower risk and a lower return.

＜Investment Area＞

Central 5 wards of Tokyo	Chiyoda Ward, Chuo Ward, Minato Ward, Shinjuku Ward, Shibuya Ward
Tokyo Metropolitan Area:	Tokyo excluding 23 Wards, Kanagawa, Saitama, and Chiba prefectures
Kinki Area:	Osaka, Kyoto, Hyogo, Nara, Wakayama, and Shiga prefectures
Nagoya Area:	Aichi, Gifu, and Mie prefectures
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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