Survey on Private Real Estate Funds in Japan
January 2020 – Results

March 18, 2020

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 29th survey based on responses to questionnaires received from 43 real estate asset managers.
  - Survey subject: Real estate investment asset managers that set up and manage private real estate funds which focused on Japanese real estate
  - The number of questionnaires sent: 109
  - The number of responses: 43 (ratio of valid responses: 39.4%)
  - Survey period: in the January to February 2020
  - Survey methodology: Questionnaire survey sent by post and e-mail

The market size of private real estate funds is 20.2 trillion yen including Japanese assets of global funds

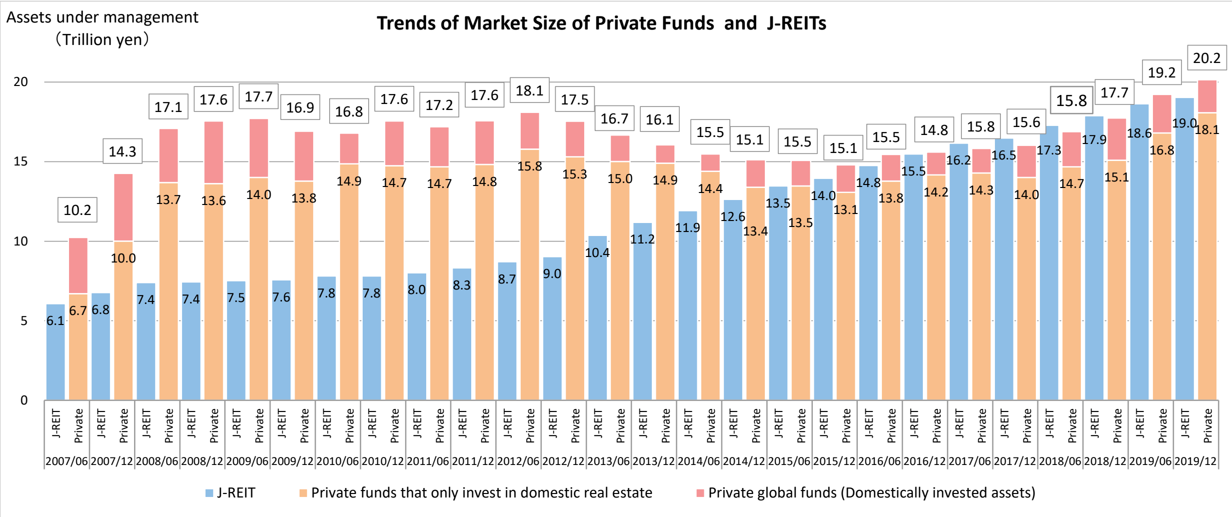
- Based on the results of the survey, hearings and published information, we estimated the market size of private real estate funds (on an invested asset basis) as of the end of December 2019 to be 20.2 trillion yen. This figure involves Japanese assets of global funds (*) that we were aware of. Assets under management (AUM) increased approximately 920 billion yen (4.8%) from the previous survey (19.2 trillion yen as of the end of June 2019), exceeded 20 trillion yen and has replaced the past highest record. Although the pace of the expansion of the market for domestic private real estate funds slowed down slightly compared to the previous survey, which increased 1.5 trillion yen, the market continues to grow.

  (*) We define "global fund" as a fund targeting real estate investments in various countries including Japan.
- The number of asset managers whose AUM increased exceeded significantly the number of asset managers whose AUM decreased. While the AUM of some asset managers significantly decreased primarily due to the end of fund management, there were more companies comprised largely of domestic asset managers whose AUM increased considerably. Overall, the market size we estimated rose approximately 4.8% from the estimate in the previous survey.

The appetite for investment in Hotel, Retail has decreased

- A noteworthy finding of this survey is that while the majority of the managers presumably believe that investors' appetite for investment is at a high level, responses by property type indicate an increase in responses that the appetite of both domestic and foreign investors for investment in hotels and retail is decreasing. Until the previous survey, the largest number of asset managers chose "Hotel" as the property type which the appetite of equity investors had been increased. However, it is likely that investors are increasingly becoming more cautious about investing in hotels due to a fall in demand for inbound tourism and a growing sense of oversupply in the market. Asset managers assuming a decrease in investors' appetite for investment in retail due in part to the consumption tax hike and growth of the e-commerce market appear to be increasing.

※It should be noted that this survey was conducted in January and early February 2020, prior to the increase in the impact of COVID-19 coronavirus, which will begin to appear in the next survey result.



" Survey on private real estate funds" January 2020 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) Debt Finance ～Debt financing circumstances can be said to remain favorable

Regarding debt financing circumstances, the number of respondents that chose "*3 (Neutral)*" was 24, which was the highest, followed by respondents who chose "*4 (Easy)*", which amounted to 15 (Fig.1-1). Since the January 2019 survey, there is little change about the percentage of each terms (Fig.1-2), debt financing circumstances can be said to remain favorable. However, 3 respondents chose *"2(Difficult)"* in this survey, it will be necessary to keep a watch on the trend in the future.

Fig.1-1 Current Circumstances of Debt Financing

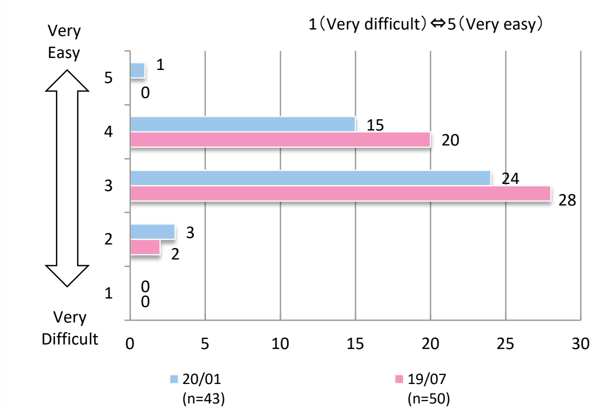
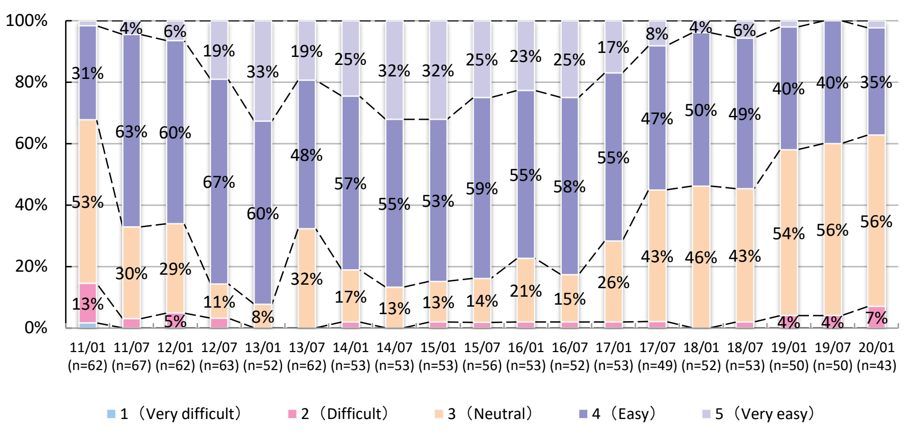


Fig.1-2 Trends in Debt Financing



2) Equity Raising

a. Appetite of Equity Investors ～Appetite for “Hotel” and “Retail” has decreased

In terms of a question on the appetite of equity investors, the percentage of respondents who chose *“No change”* accounted 81% (Fig2). Respondents choosing “*Rising*” have been gradually decreasing after peaking around 2014 while those choosing “*No change*” have been increasing, which suggests that the situation causing difficulty in investment has been established due to the zero-interest rate policy and investors’ appetite for investment in real estate remains at a high level.

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 (Fig.3-1,3-2). However, as for *“Hotel*” that got the largest number of responses of *“Increase”* for domestic investors in recent surveys, the total percentage of respondents choosing *“Decrease”* or *“Decrease significantly”* accounted for 42%, greatly exceeded that of respondents who chose *“Increase”*(13%) in this survey. Also, as for *“Retail”*, the total percentage of respondents choosing *“Decrease”* or *“Decrease significantly”* accounted for 31%. Among overseas investors, the property type with the largest percentage of respondents who chose “*Increase*” or *“Increase significantly”* was “*Residential*,” accounting for 48% in total. Meanwhile, many respondents chose *“Decrease”* for *“Hotel”* and *“Retail”*, same as domestic investors. It is likely that investors are increasingly becoming more cautious about investing in hotels due to a fall in demand for inbound tourism and a growing sense of oversupply in the market. Asset managers assuming a decrease in investors’ appetite for investment in retail due in part to the consumption tax hike and growth of the e-commerce market appear to be increasing.

Fig.2 Appetite of Equity Investors

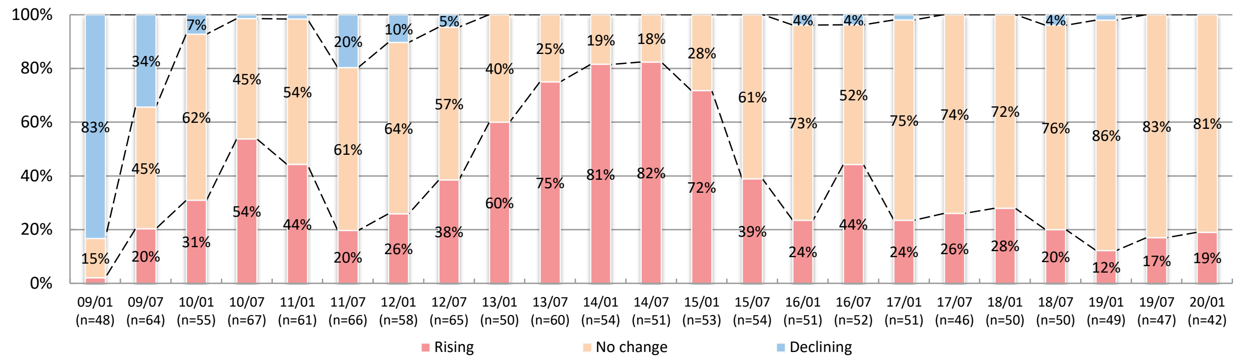


Fig.3-1 Domestic Investors’ Appetite by Type of Target Property

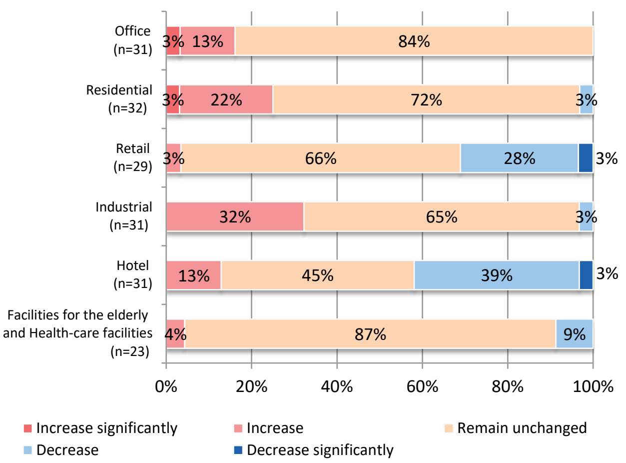
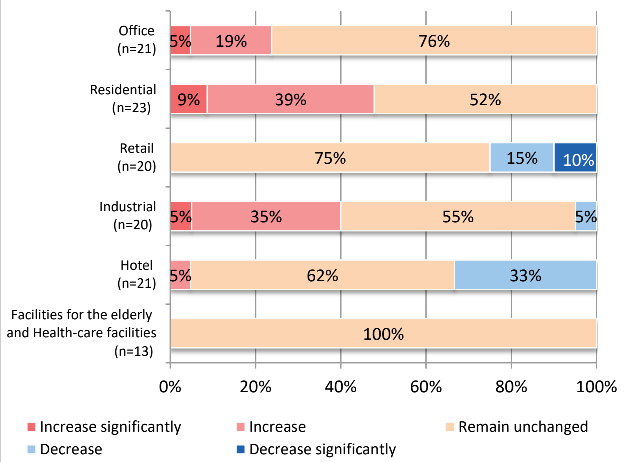


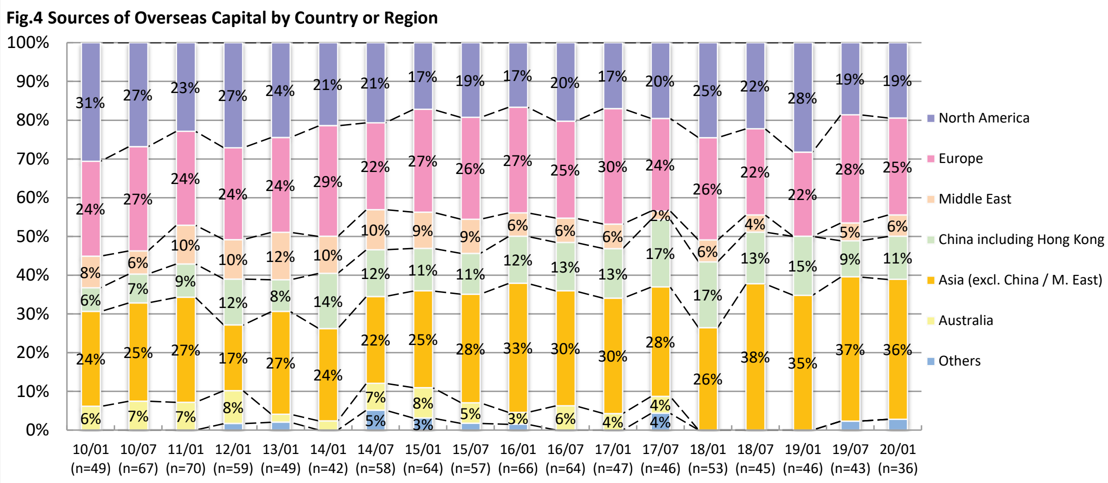
Fig.3-2 Foreign Investors’ Appetite by Type of Target Property



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

～the highest response rate was for investors from "*Asia (excl. China/M. East)*

With respect to the capital sources from oversea, the highest response rate was for investors from "*Asia (excl. China/M. East)*" (36%), followed by "*Europe*" (25%), and then "*North America*" (19%)(Fig.4). The percentage responding "*Asia (excl. China/M. East)*" has accounted for more than one-third for four periods running since the July 2018 survey, it seems that the investors from this region has increased its presence among the foreign investors who invest in domestic real estate funds.



c. Reasons for Foreign Investors Investing / Not Investing in Japan (Multiple answers allowed)

～While real estate in Japan is attractive due to the yield gap, a surge in real estate prices causes concern.

As for the reasons for investors investing in Japan, majority of the respondents chose "*Relatively attractive due to the yield gap*", "*Highly stable income*", "*Politically and economically stable*" , "*Allocation as part of the global portfolio*" (Fig.5). These choices have been the major reasons indicated in every survey in the past and are evidently supporting foreign investors' investment in real estate in Japan.

As for the reasons for not investing in Japan, the largest number of managers chose "*Rising in real estate price*", exceeded "*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 an increase in foreign investors' recognition that real estate prices are in a steeply rising phase (Fig.6).

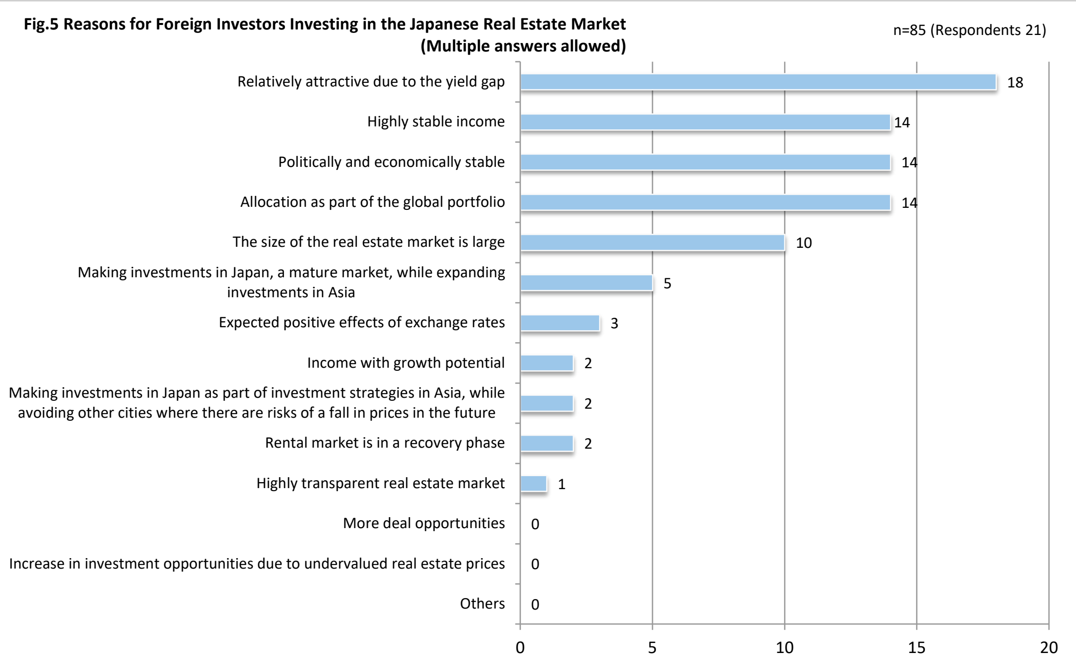
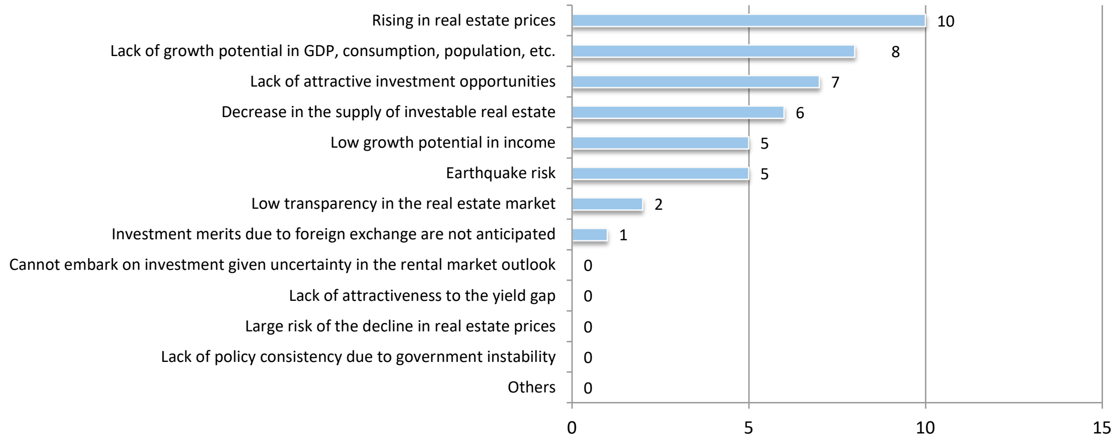


Fig.6 Reasons for Foreign Investors Not Investing in the Japanese Real Estate Market (Multiple answers allowed)



3) **Status of the Funds under Management –** Aggregating responses to questions on the content of currently operating funds

a. Fund type, Management style

～"Open ended funds" increased significantly, "Core" continues to account for a majority

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 33%, the largest share ever gained in every survey in the past(Fig. 7), the number of responses increased by 4 from the previous survey. In terms of management style, the percentage of respondents choosing "*Core*" continued to account for around 70% (Fig. 8). Because open ended funds are increasingly becoming the flagship funds of domestic asset managers, the percentage of responses has tended to rise.

Fig.7 Fund types

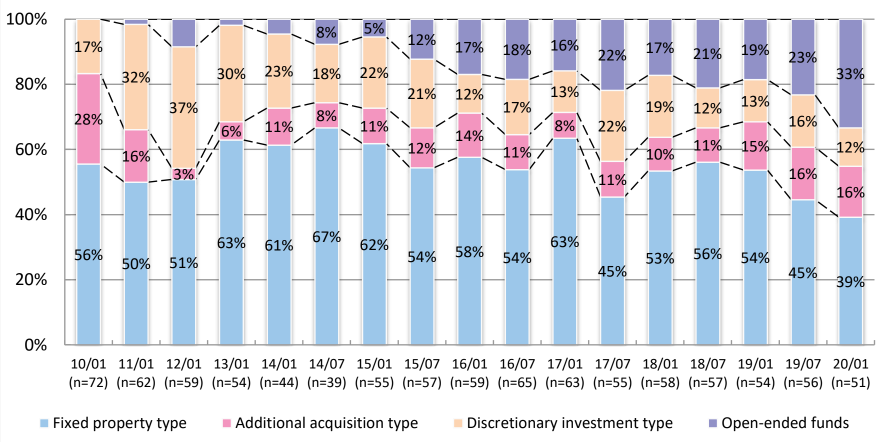
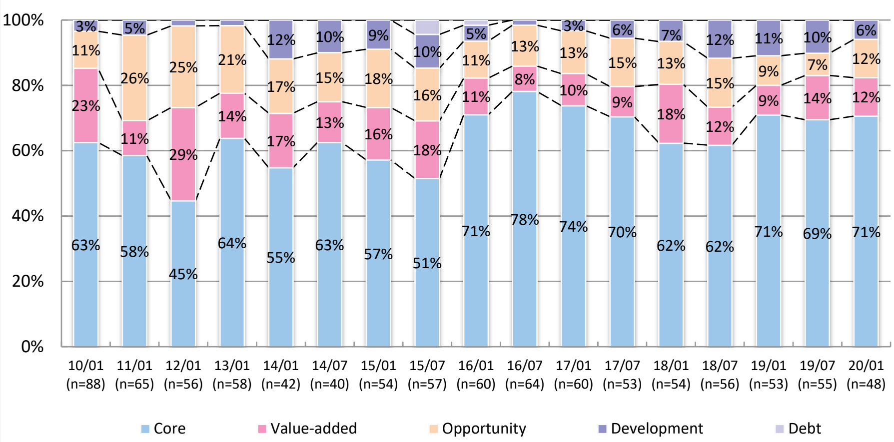


Fig.8 Management Style



b. Target property types, target areas

～Both target property types and target areas are wide-ranging, and the trend of diversified investment continues.

In a survey of target property types, the percentage of respondents choosing "*Office*", "*Residential*", "*Retail*" and "*Industrial*" were almost the same (around 20% each), there has been no significant change since the January 2018 survey(Fig.9). As for target areas, the percentage of "*23 wards of Tokyo*", "*Tokyo metropolitan area*" and "*Kinki area*" were almost the same (22～23% each) (Fig.10). One of the trends in recent years is that the situation causing difficulty in acquiring offices and residential properties in the Tokyo metropolitan area has been established and investment targets have been expanding to other property types and areas, which may be affected by the large number of responses were of open ended funds, which is targeting various property types and major cities across Japan.

Fig.9 Target Property Types

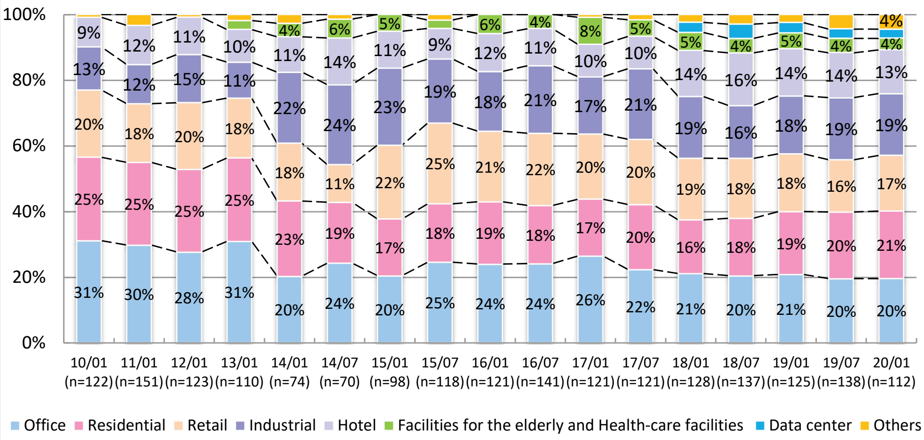
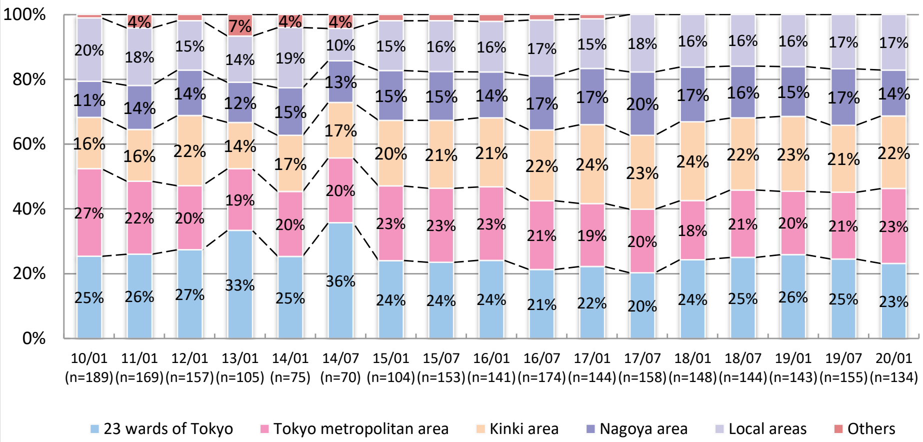


Fig.10 Target Areas



c. Target investment period ～"Ten years or more" has been increasing

The average target investment period for funds currently under management was 8.4 years (Fig.11), which was almost the same with the previous survey (8.5 years). 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. The average target investment period for funds to be launched within a year was 10.1 years, which was also significantly affected by the inclusion of ultra-long-term funds. A breakdown of the average target investment period of funds currently under management by range shows that the percentage of respondents who chose "*Ten years or more*" was highest at 36%, followed by "*At least 5 years but less than 7 years*" (32%). The percentage choosing "*At least 7 years but less than 10 years*" was 18%, decreased from the previous survey (Fig.12). Since 2018 survey, the percentage of respondents choosing long-term funds with an investment period of ten years or more has been increasing. With the monetary easing policy expected to be maintained and difficulty in acquiring properties expected to continue, the tendency for long-term funds to be the mainstream is likely to continue. Also, the survey of the investment period does not include open-ended funds（private REITs）, whose investment period is indefinite.

Fig.11 Average Target Investment Period

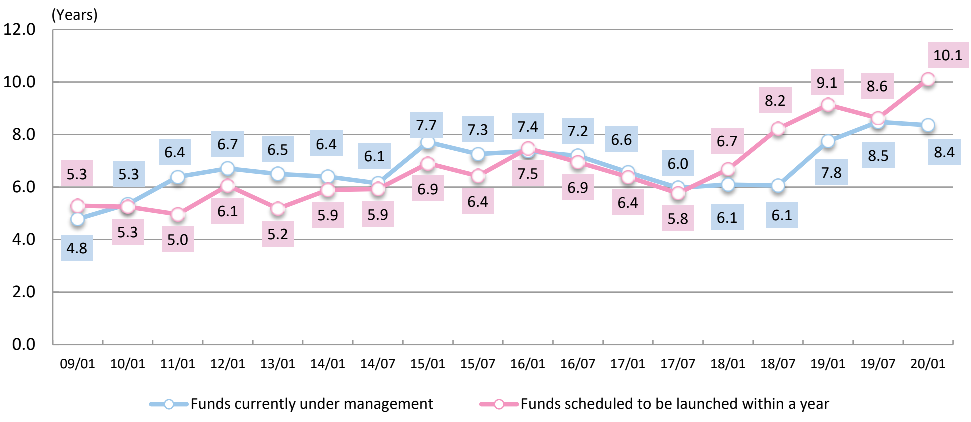
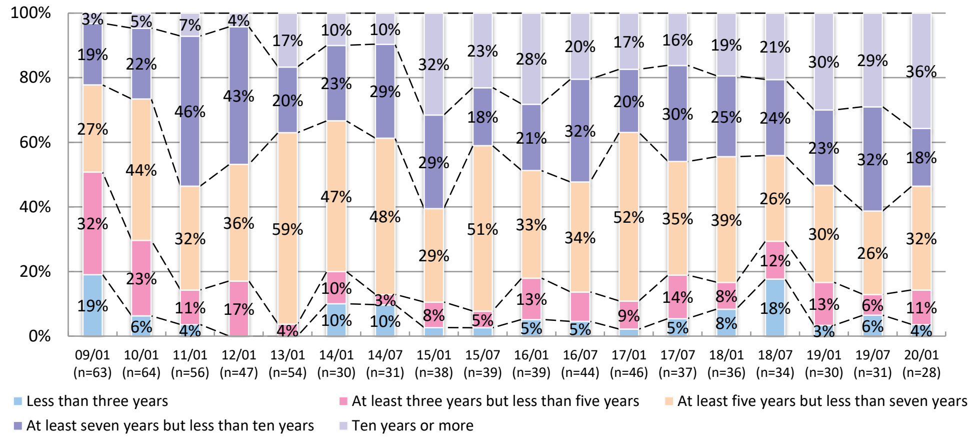


Fig.12 Breakdown of Average Target Investment Period



d. LTV ratio, Target IRR ～Downward trend of LTV of funds under management and upward trend of LTV of funds to be launched within a year continue

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. 13). The average LTV of funds under management was 54%, the lowest in every survey in the past. Looking at the breakdown of the LTV levels of funds under management (Fig. 14), the largest share of respondents chose “*at least 40% but less than 50%*”(34%), most of those were responses of private REITs, followed by “*at least 50% but less than 60%*” and “*at least 60% but less than 70%*” (24% each). The total percentage of respondents choosing less than 60% accounted for around 60%.

Meanwhile, the average LTV of funds to be launched within a year was 71%, slightly high level compared to the past surveys. Looking at the breakdown of LTV levels of funds, the percentage of responding “*at least 60% but less than 70%*” accounted for 67% (Fig. 15). The responses of open ended funds was limited while the majority was of closed-end funds, and the lending environment continues to be favorable, while, at the same time, real estate prices are on an upward trend. Given this condition, asset managers hoping to raise LTV at the request of investors and secure investment return may be increasing.

The average target IRR of the funds under management was 10.7%, rising slightly from the total average in the previous survey (10.4%)(Fig. 16). It should be remembered that for this survey item and the LTV of funds to be launched within a year, the sample size is small, and the results are easily affected by sample selection bias.

Fig.13 Average LTV Ratio

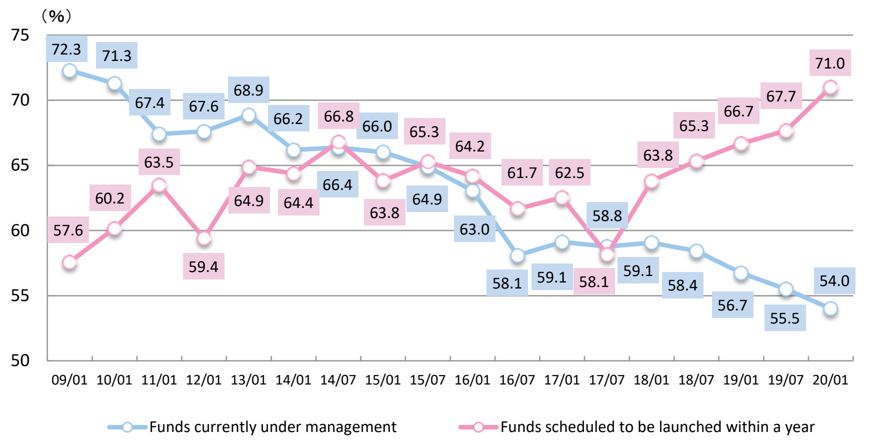


Fig.14 Range of LTV level (Funds currently under management)

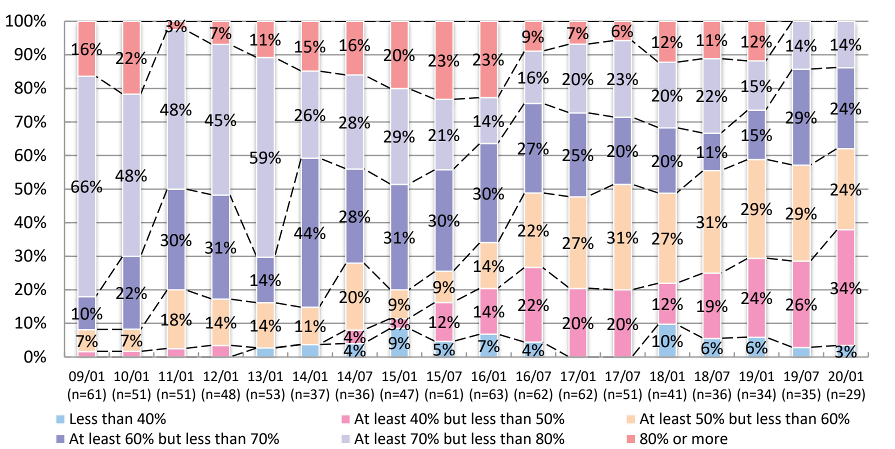


Fig.15 Range of LTV level (Funds scheduled to be launched within a year)

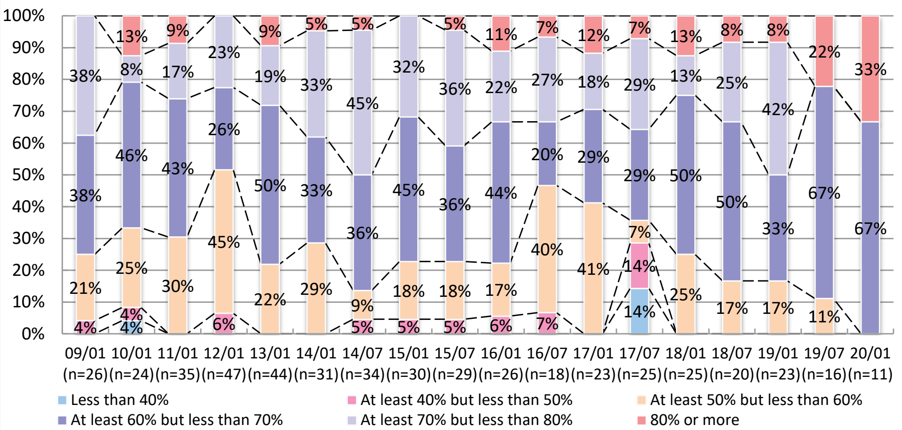
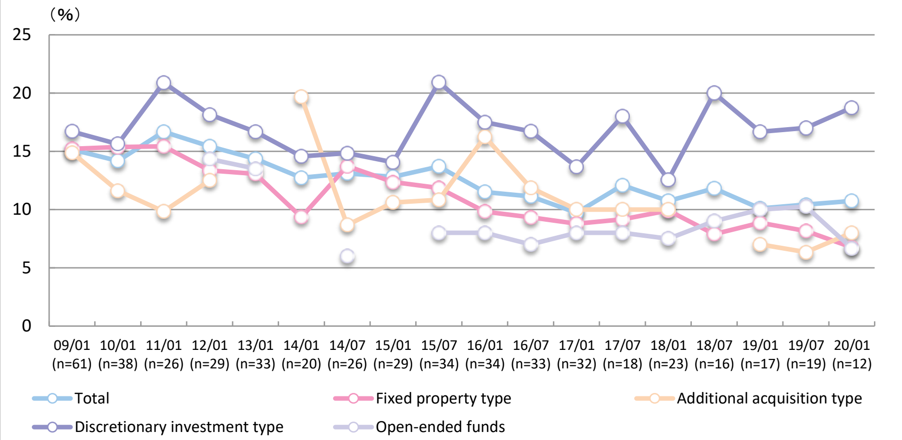


Fig.16 Average Target IRR (Funds currently under management)



4) Acquisition and Disposition of Properties during July to December 2019

～More than 60% of asset managers acquired properties, while less than 40% sold properties

As to a survey on the acquisition of properties during July to December 2019, the percentage of respondents who answered "*Acquired*" accounted for 67%, remaining at a high level (Fig. 17). In terms of reasons for not acquiring any properties, respondents who chose "*Can't agree on prices*" accounted for more than 60%. The percentage choosing "*Did not plan to acquire from the outset*" was 14% in this survey, which suggests the emergence of cases in which acquisition itself is not considered due to the prolonged difficulty in property purchasing caused by disagreement on prices. (Fig. 19).

As to a survey on the disposition of properties from July to December 2019, the percentage of respondents who chose "*Sold property*" was 38% (Fig. 18). As for the reasons given for not selling any properties, all respondents chose "*Did not plan to sell from the outset*" (Fig. 20).

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, and the opportunities for property buyers to consider acquisition are likely to further decrease.

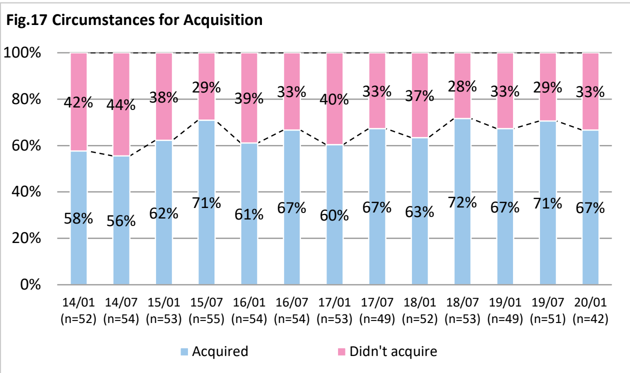


Fig.17 Circumstances for Acquisition

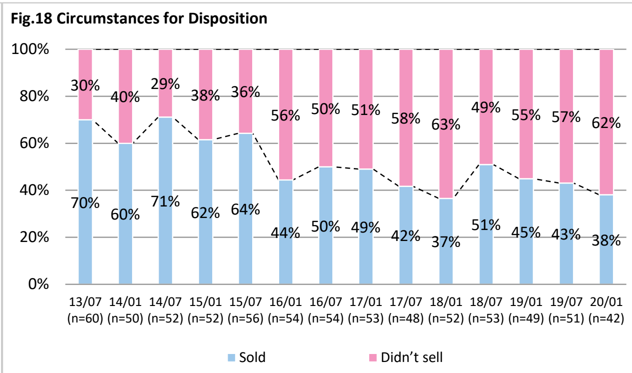


Fig.18 Circumstances for Disposition

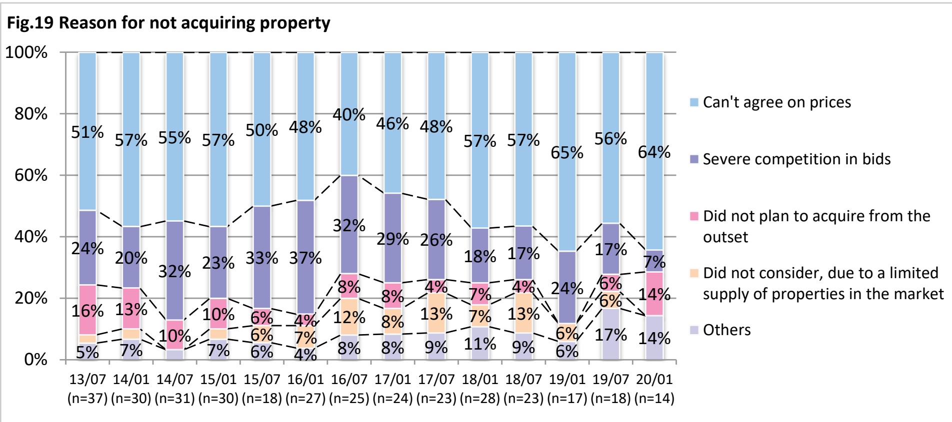


Fig.19 Reason for not acquiring property

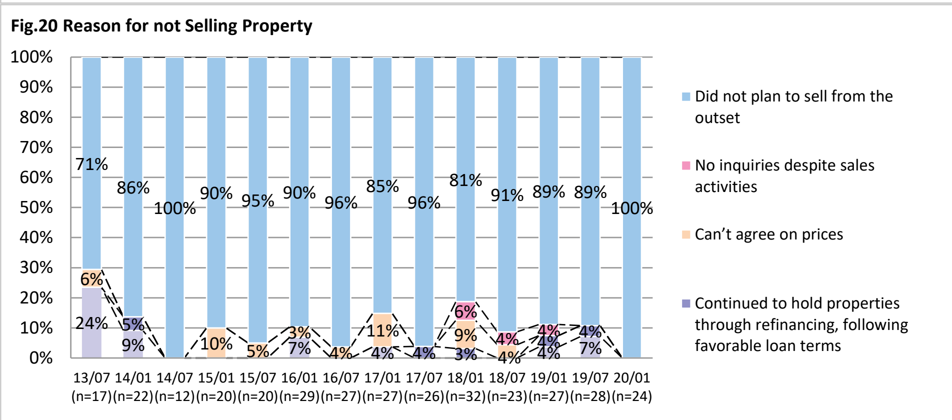


Fig.20 Reason for not Selling Property

2. Plans and Investment Strategies of Asset Managers

1) Plans of Launch of New Funds and Acquisition /Disposition of Properties within a year

～90% of asset managers plan to acquire properties by expecting stable cash flow

Regarding the funds scheduled to be launched within a year, the percentage of respondents answering "*Plan to launch*" was 65% (Fig. 21). 90% of asset managers answered that they plan to acquire properties within a year (Fig. 22). A majority of the asset managers who plan to acquire properties gave expected stable cash flow as the reason, which significantly exceeded the number of respondents choosing an increase in real estate prices after acquisition. This suggests a large portion of asset managers emphasizing income gain rather than capital gain.

Meanwhile, 64% of asset managers responded that they plan to dispose of properties within a year (Fig. 23). The most common reasons given for their plans to dispose of properties were "*Succeeded in agreeing on prices*", exceeded the number of respondents choosing "*Existence of maturing loan or fund reaching maturity date.*"

Fig.21 Plans of Launch of New Funds within a year

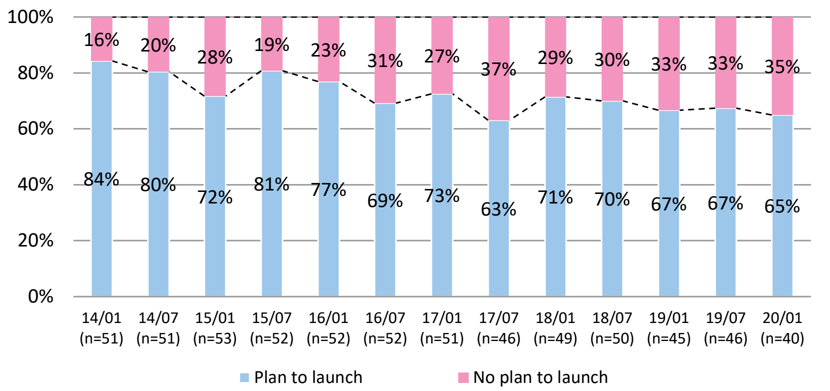


Fig.22 Plans of acquiring properties

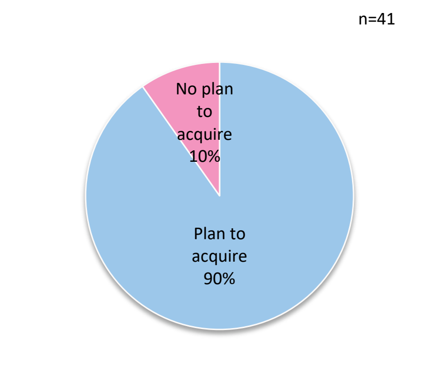
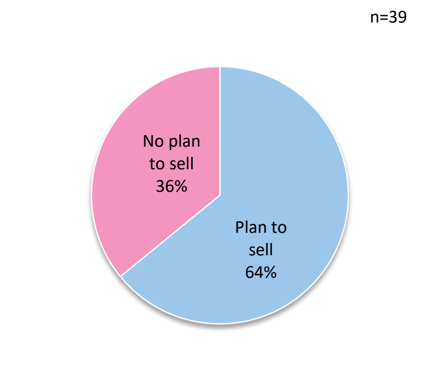


Fig.23 Plans of selling properties



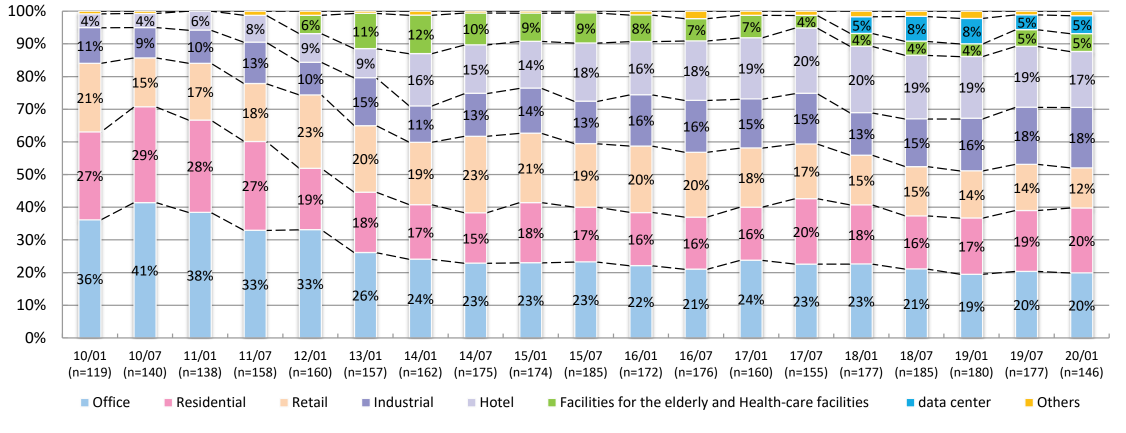
2). Investment Strategies of Asset Managers

a. Target Property Types (Multiple answers allowed)

～Many respondents chose Office, Residential, Industrial, while responses of Retail decreased

In terms of target property types, the percentage of "*Office*" and "*Residential*" accounted for 20% each, followed by "*Industrial*"(18%), "*Hotel*" (17%)(Fig.24). The percentage of "*Retail*" accounted for only 12%, was the lowest since January 2010 survey. As we mentioned before, the number of asset managers assuming a decrease in both domestic and overseas investors' appetite for investment in retail increased (Fig.3-1,3-2), it seems to affect the target property types.

Fig.24 Target Property Types (Multiple answers allowed)

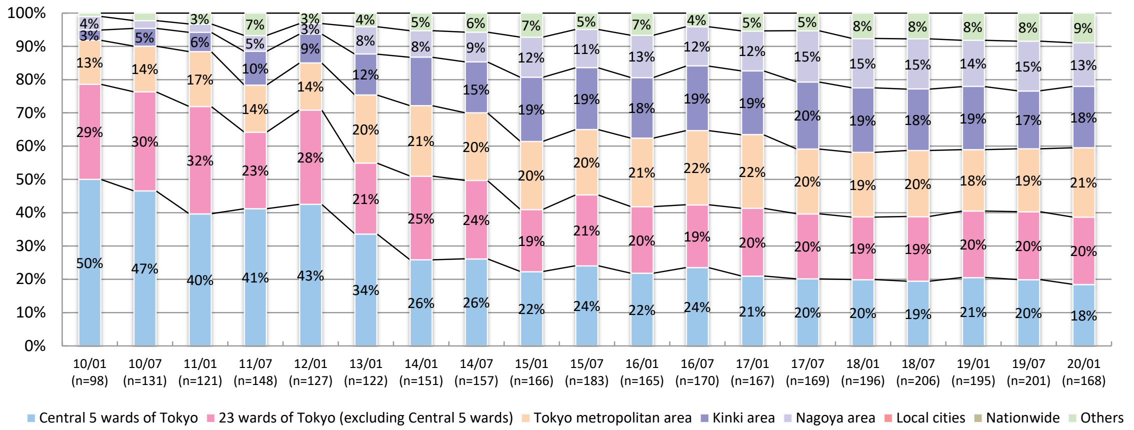


b. Target Areas (Multiple answers allowed)

～Recent trends of targeting a wide range of areas in major domestic areas in Japan continue

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.25). 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.25 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)

～Largest number of respondents answered that they have already launched, and many asset managers consider the further enhancement of track records and expansion of investor categories to be necessary for development in the market

In response to a question about involvement in open-ended private REITs, the number of respondents that chose "*Have already launched*" was 17, which was the highest, followed by "*Seek to develop a better understanding and gather information, but not working on a specific study preparing for a launch.*", which amounted to 13(Fig.26). The number of the respondents choosing " *Preparing for a launch after consideration*" decreased from 6 in the January 2019 survey to 4 in the previous survey, to 3 in this survey, there appears to be a lull in the creation of new open ended funds. However, as mentioned above, 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 "*Enhancement of the track record*", "*Expansion of the categories of investors to invest in funds*"(Fig.27). While more than nine years have passed since the establishment of private REITs in Japan and the number of private REITs rose to 31 by the end of 2019, the Japanese private REIT market is yet to experience a declining phase in the business cycle. Taking into account this aspect, it is likely that many asset managers consider the further enhancement of track records and expansion of investor categories to be necessary.

Fig.26 Managers' involvement with private REITs

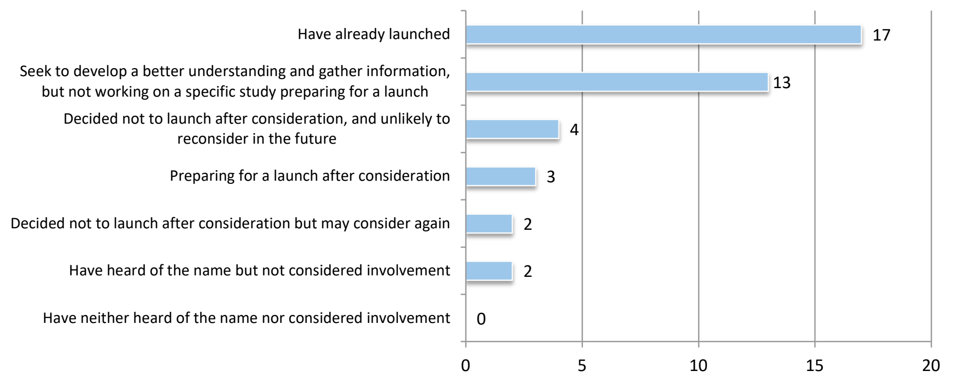
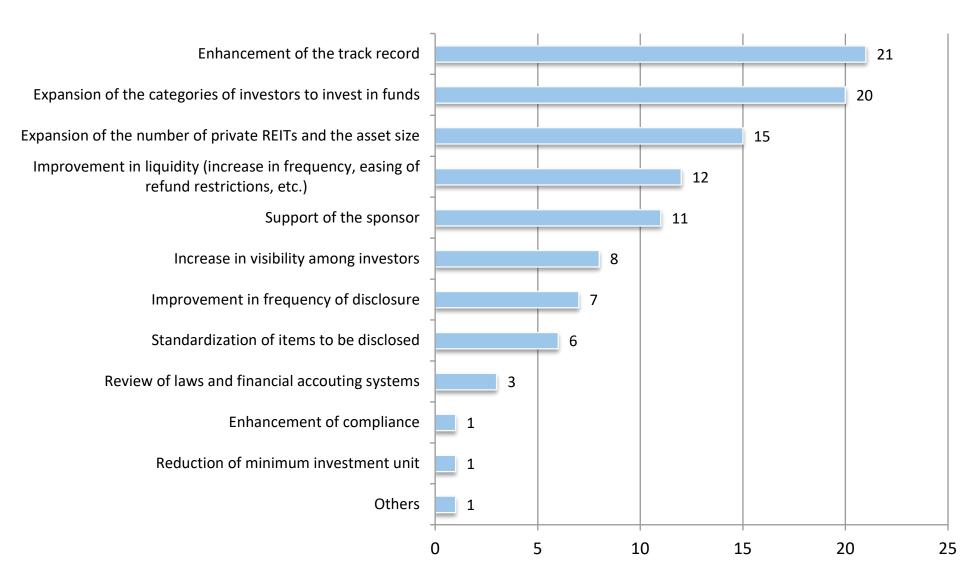


Fig.27 Important Factors for Development in the private REITs Market (choosing up to three options)

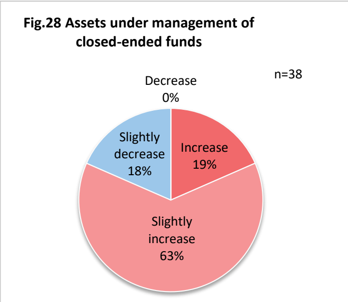


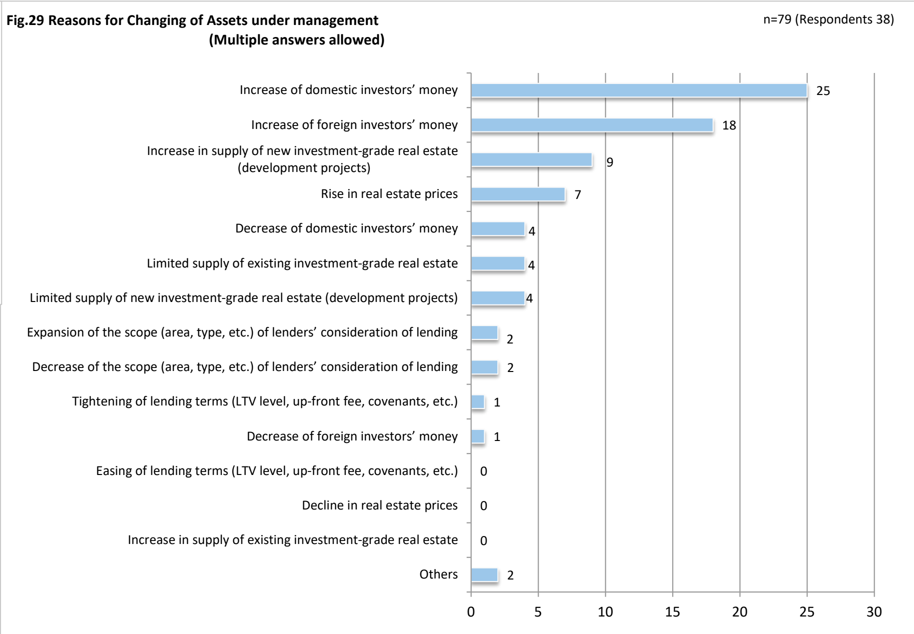
2) Outlook of asset size in the Closed-ended private real estate funds market

～Majority expect the asset size to increase by increasing of domestic and foreign investors' money

With regard to the outlook on asset size in the closed-ended private real estate funds market, the percentage of respondents who chose "*Increase*" or "*Slightly increase*" was 82% in total (Fig. 28). As reasons for this, many respondents chose "*Increase of domestic investors' money*" and "*Increase of foreign investors' money*", and several respondents chose "*Increase in supply of new investment-grade real estate (development projects)*" (Fig. 29). We believe that many asset managers expect the closed-ended fund market to expand by continuing inflows of investment money due to the continuation of the monetary easing policy and increase in development projects.

The main reasons given for "*Slightly decrease*" included "*Rise in real estate prices*" and "*Limited supply of investment-grade real estate*". We realized that there are a certain number of managers who believe that those factors will lead to a decrease in market size.



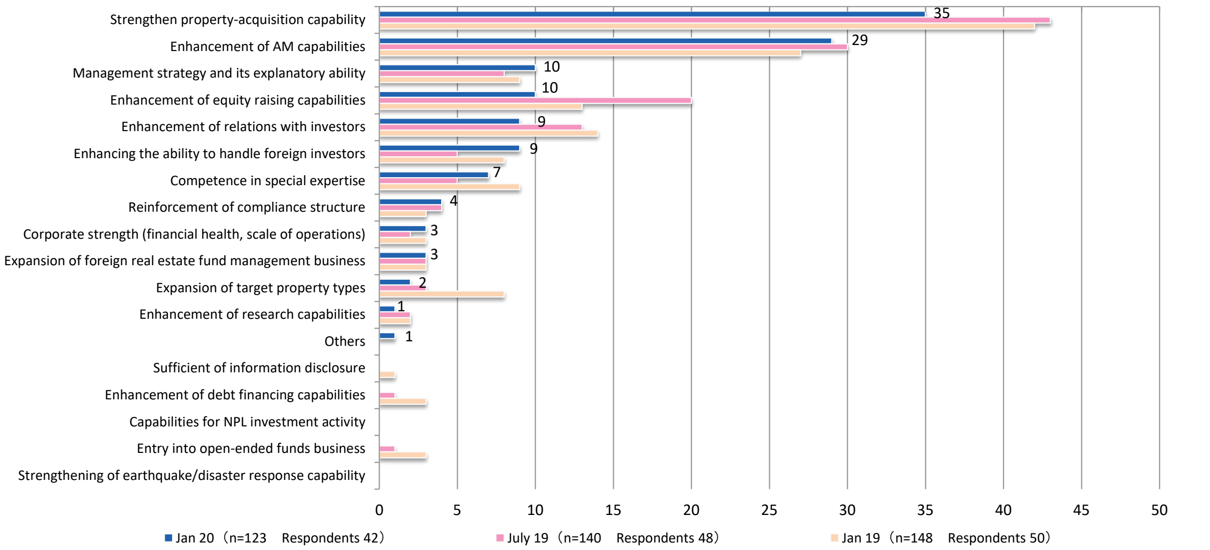


3) Manager's Requirements for Future Growth and Sustainability of their Businesses **(Multiple answers allowed)**

～Many managers emphasize the strengthen property-acquisition capability and enhancement of AM capabilities.

Among requirements for sustainability and growth of the asset managers, the largest number of managers chose "*Strengthen property-acquisition capability*", and second most frequent answer was "*Enhancement of AM capabilities*" (Fig.30). With limited supply and rising real estate prices continuing, most asset managers emphasize the strengthen property-acquisition capability and enhancement of AM capabilities.

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



4) Willingness to achieve SDGs※

～60% of managers answered that they are willing to achieve the SDGs in real estate investment management

This survey asked about the asset managers' willingness to achieve SDGs and the areas in which the respondents could contribute to the achievement of the 17 global goals. To the question "Are you willing to achieve the SDGs in your real estate investment management?" about 60% answered "I am."(Fig.31)

As to the contribution to achieve the 17 global goals, many managers chose *"Sustainable cities and communities"*, *"Climate action"*, *"Affordable and clean energy"* (Fig.32). The potential for contribution through development of communities, in which various people including the elderly and people with disabilities gather and live lively, is high. In the aspect of climate change, the survey results suggested that the respondents believed that not only energy conservation and reduction of CO_2 emissions, but investment in resilient environmental real estate would facilitate the achievement of the SDGs.

※The Sustainable Development Goals are international goals to create a sustainable and better world, which are included in the 2030 Agenda for Sustainable Development adopted at the UN summit held in September 2015.

Fig.31 Awareness of SDGs Achievement (n=41)

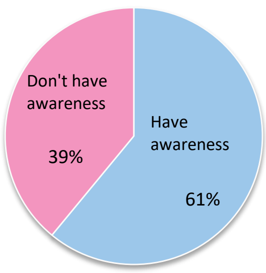
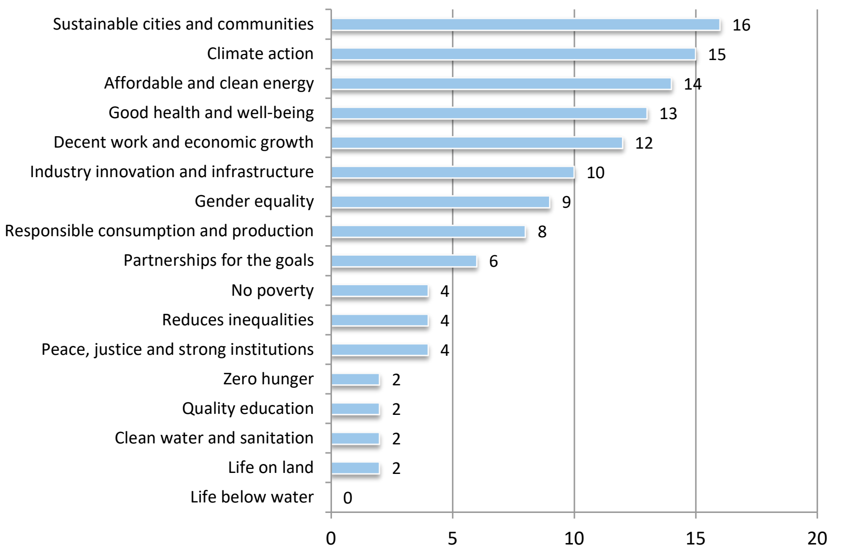


Fig.32 Factors Contribute to Achieving SDGs (Multiple answers allowed) n=123 (Respondents 24)



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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