Japan Real Estate Investment Corporation

The Period ended March 2017 Performance Review Q&A
(held on May 17, 2017)

Japan Real Estate Asset Management Co., Ltd.

Q1: You expect the strong demand for leased office space to continue. Are there any significant factors for this assumption other than business performance?

A1: While our assumption is based on performance to a degree, we are also frequently seeing new job opportunities and business expansions caused by the increase of the number of employees.

Q2: How do you estimate internal growth during the September '17 and March '18 periods? Is there any difference in the number of tenants subject to rent revisions?

A2: Many of the rent revisions for the September '17 period are fixed at present. Therefore, we expect the same level as in the March '17 period. We estimate that the same trend will continue for the March '18 period, although only a few rent revisions are fixed for this period (the performance forecast includes only rent revisions that are fixed).
Tenant turnover for the September '17 period and March '18 period is estimated to be lower than in the March '17 period, as our outlook for the March '18 period occupancy rate is rather conservative.
The number of tenants subject to rent revisions shifts around 15% every period, and is not much different each period.

Q3: What is the reason for the expansion of the rent gap? Do you expect the upward rent revision trend to continue in the future?

A3: Our aggregated calculation excludes fixed revenues of more than one year due to long-term lease contracts. However, the rent gap increased this period due to the inclusion of certain tenants with fixed revenues within one year to the aggregated calculation. The rent increase trend has not changed. Therefore, we are not concerned about future rent revisions.

Q4: While there is strong additional need for floor area among the existing tenants, some anticipate that the rent increase will slow down due to the large supply after 2018. What is your prediction for rent in the future?

A4: The issue of 2018 is constantly being brought up, and there are concerns that the steady real estate market may reach a peak due to the large supply. Small adjustments may occur, including the problem of vacancy from tenants shifting to new buildings (second vacancy) and tenants shifting to the building of the second vacancy (third vacancy). However, we do not predict that the market will decline significantly, taking into account the actual supply level and the strong demand for leased office space.

Q5: Has your assumption changed from six months ago regarding the impact of the large supply after 2018 in the leased office space market?

A5: Six months ago, we were paying close attention to the future trend as we still did not know what would happen. Now, six months has past and we see the leasing of office space in progress for buildings that will be completed in 2018. As a result, we expect that the market will not decline dramatically, although it may face a minor impact.

Q6: Do you consider the impact from second vacancy and third vacancy to be larger than the direct impact regarding the large supply?

A6: We do not consider that it will have an immediate impact as our portfolio does not compete directly with the large supply. However, we need to pay attention to some extent as second and third vacancies may have some impact on our business.

Q7: You have mentioned that your outlook for the occupancy rate is somewhat conservative regarding the performance forecast for the March '18 period. How much is the level?

A7: We do not expect a significant decline. The occupancy rate of our portfolio for this period has reached 98.8%, which is the highest level since our IPO. We expect that it will maintain the same level for the September '17 period. We merely expect a small adjustment for the March '18 period from a shift to ordinary state occupancy.

Q8: While rent assessments in other major cities are increasing, rent assessments in the Tokyo metropolitan area seem to have ceased. What do you think of this?

A8: We cannot judge this trend based just on JRE's portfolio due to its limited parameters. However, we consider properties in other major cities to be a steady market because of their low vacancy rate while supply is limited. We see rent for properties in the Tokyo metropolitan area as continuing their moderate increase, not as remaining flat.

Q9: In order to promote work style reforms, many companies are focusing on using their offices efficiently, such as adopting free address offices. In addition, there seems to be a trend toward less space per employee. What are your thoughts on this?

A9: The total demand for leased office space will decrease as a whole from the macro perspective. However, from the individual perspective, many companies value creating "interesting" or "attractive" offices in order to meet the challenge of acquiring new talents amidst an aging society with extremely low birthrates. We think that buildings will be selected by tenants in the future, therefore we recognize that it is important "to create a strong portfolio that will be chosen by tenants" through property acquisitions and creating value in properties held by JRE.

Q10: Regarding appraisal values, what are the factors that contribute to the decline of assessed cash flow in many properties?

A10: The main factors are the low investment yield of deposits, the inclusion of property taxes on land and the increase of city planning taxes which will be imposed next year. Other possible causes include revisions of future repair expenses and capital expenditures along with the update of engineering reports, depending on the properties.

Q11: Regarding property acquisition, approximately how many properties are under detailed review? What are your thoughts on target yield for acquisition?

A11: Unlike the previous period, we did not disclose the amount of properties under review because review status for property acquisition fluctuates daily. If we sum up all of the properties under review, it will add up to tens of billions of yen.

Concerning target yield, our estimation is long-term, and the impact from the low interest rates was not included previously and was left unchanged. However, taking into account the continuing low-interest climate, we slightly lowered the target yield from April. However, this is not a reduction that will remarkably ease property acquisition, and our policy of being highly selective in making investments on properties capable of maintaining a competitive edge over the medium to long term has not changed.

Q12: Yield is higher for properties in other major cities compared with the Tokyo metropolitan area. Do you intend to increase investments in other major cities?

A12: We have not changed our acquisition policy, which is to maintain 70% or more of our portfolio properties within the Tokyo metropolitan area. The market for leased office space in other major cities is stable, and we would like to continue acquiring good properties. However, properties for sale are limited. Accordingly, we will purchase properties when possible, without overextending ourselves.

Q13: The current environment is positive for selling properties. Sponsors may wish to sell their properties at a higher price under such condition. How will you construct a win-win relationship?

A13: We have not changed our policy, which is to acquire properties at a reasonable price, whether it is from sponsors or non-sponsors. With such fierce competition in property acquisition, we believe property acquisition from sponsors is highly probable because price negations based on appraisal values is possible with them.

Q14: When selling properties, do you accept the buyer to be other REIT competitors?

A14: Our basic policy is to expand our portfolio, so we do not intend to aggressively sell our properties. However, if the offered price significantly exceeds our target, we may sell our properties. We cannot definitely say that the buyer will not be another REIT competitor. However, the possibility of the buyer being another REIT competitor is low, as the target gap between REIT competitors and us is small.