

Japan Real Estate Investment Corporation

The Period ended September 2017 Performance Review Q&A
(held on November 16, 2017)

Japan Real Estate Asset Management Co., Ltd.

This Q&A is a summary of the Q&A session of Japan Real Estate Investment Corporation's performance review for the period ended September 2017. "Q" represents a question raised by participants and "A" represents an answer provided by Japan Real Estate Asset Management Co., Ltd.

The Q & A below is partly touched up for your convenience.

The video of the latest performance review is also available on the home page of our website.

Q1: Please explain your future outlook for JRE's internal growth, external growth and financial strategies (the three key engines)?

A1: Although the three key engines cannot always be utilized simultaneously as in the September 2017 period, we predict that our internal growth will continue to be steady. The rent gap ratio is now -0.7% and upward rent revision is smoothly in progress.

As for external growth, our policy to purchase properties when possible without overextending ourselves and avoid the purchase of high-priced properties has not changed. Our sponsor, Mitsubishi Real Estate emphasizes in its medium-term business plan the enhancement of property supply. Therefore, our aim is to select and purchase such properties.

As for financial strategies, although interest rates are unpredictable, we do not consider it likely that rapid interest-rate hikes will occur. If no significant changes occur to the current environment, interest expenses will decline steadily through around 2020 or 2021.

Q2: What are the background factors of the easing concerns regarding large supply of office space?

A2: Leasing personnel at the sites sense strong demand from tenants. Even if leased office space is returned, many of the existing tenants in the same building will take the returned space in order to expand their offices. Many tenants may currently be forced to refrain from expanding their office space due to full occupancy of the buildings. Another reason why we realize the easing concerns is because properties held by JRE will not directly compete with the newest large-scale buildings which are expected to be supplied in a large amount in 2018.

Q3: With the extremely high occupancy rate, the risk of returned office space is expected to increase. What are your risk control measures on this matter?

A3: Although there are no godlike measures to prevent tenants from leaving, we have been conducting traditional measures such as developing good relationships with existing tenants. In addition, we have put our efforts into avoiding the expiry of fixed-term lease contracts overlapping the period when large office supply is expected.

Q4: If the occupancy rate is at its highest, further rise in rent is required in order to maintain momentum of increasing cash flows. What is your outlook on this matter?

A4: As you have pointed out, further improvement in occupancy rate is limited. However, there are still many tenants with below market rent. Therefore, we believe there is still room left for a gradual increase in rent. Even if market rent has reached a peak, we predict that the market environment will not dramatically collapse. If our internal growth slows down, we would seek stable growth in cash flows with the support of our external growth.

Q5: Monthly rent increased to 36 million yen due to internal growth during the September 2017 period. What is your future outlook?

A5: For the March 2018 period, due to a declining occupancy rate resulting from tenant turnover, we predict a minor decrease in monthly rent with tenant turnover and an increase with upward rent revision for those fixed at present. For the September 2018 period, we assume a recovery in the occupancy rate and predict an increase with tenant turnover and upward rent revision although the fixed portion is small at present. Upward rent revision is highly expected to exceed the estimation, as in the past.

The range of increase is uncertain as it depends on the size of the rent contracts subject to rent revision during the relevant period. However, we expect that the upward revision will maintain the same level as in the September 2017 period.

Q6: What are the factors for the decrease in utilities and other revenues for the September 2018 period forecast compared with the March 2018 period forecast?

A6: We estimated an increase in utilities revenues as the September 2018 period includes summer season. However, certain amount of temporary revenues such as revenues equivalent to expenses on restoration to original state in the previous period will be removed, resulting in a decrease in the total.

Q7: What are the impacts of property tax raise in the September 2018 period? Will they increase after the September 2019 period due to mitigation measures on rapid tax raise? What is the level of the impact?

A7: For the September 2018 period, we estimated a total increase of 180 million yen including the increase from property acquisitions during 2017. Approximately two-thirds of the estimate constitutes an increase for the existing properties and the impact on DPU will be less than 100 yen. According to our forecast, we expect an increase in the September 2019 period and the September 2020 period respectively and the range of increase will become smaller and smaller towards the future. We predict the total increase of these two periods to be just below the increase of the September 2018 period. As for properties with a large rise in assessed values such as Ginza, property taxes are expected to increase for three periods, to 2020.

Q8: How do you forecast rental revenues in other major cities where the vacancy rate is very low? Do you intend to purchase properties in other major cities in the future?

A8: The office market in other major cities continued to be stable at low levels for a long time. As new supply of office space has been seldom seen recently, vacancy rate is very low. As a result, we expect the trend of moderate increase in rent to continue. There are some areas, such as Sapporo or Fukuoka, with an extremely low vacancy rate. And available office space is very limited. If there are some tenants who wish to relocate their office regardless of high rent, they cannot do it. Therefore, significant market rent increase is not realized. This may be one of the reasons that cause slow increase in rent.

We recognize that properties in other major cities suit the characteristics of J-REIT as a means of generating stable cash flows. If possible, we would like to acquire properties in other major cities, however, the number of properties for sale which meet our target is extremely limited which is why

acquiring such property is not easy.

Q9: What are the background factors for additional acquisition of Shiodome Building?

A9: We are always striving to purchase well performing properties at a reasonable price, however, the current market is overheated and in most cases properties do not meet our target. Under such market conditions, JRE was able to purchase Shiodome Building at 3.5% NOI Yield from our sponsor. If this was in the market, the yield rate would be much lower. Another factor for the acquisition was that we were very familiar with the building and knew that the office space was leased to many excellent tenants and the building was almost fully occupied.

Q10: What are your thoughts on selling properties? Properties could be sold at a high price in the current environment.

A10: We understand that in the current market, some properties can be sold at an extremely high price. We may sell properties if the offered price significantly exceeds our valuation. Otherwise, we do not intend to aggressively sell our properties. If we can maintain an almost full occupancy rate, we consider that generating cash flows over the medium to long-term instead of short-term returns from selling properties best serve the interests of the unitholders.

Q11: The unit price is at a level nearly 1 P/NAV ratio. What are your thoughts on purchasing treasury units?

A11: At present, P/NAV ratio exceeds 1 and we predict that further external growth is possible with the pipelines of the sponsors. We do not consider purchasing treasury units as a use of funds. If the unit price falls below NAV per unit and further declines, purchasing treasury units may be an option if it contributes to the interests of the unitholders.

Q12: Recently some REITs seem to boost their unit prices through the purchase of treasury units or merger. As a leader of REIT, what is your view for vitalizing J-REIT market as a whole?

A12: We cannot control the unit price and the current situation is caused by short-term supply and demand factors. We can only wait for such storms to pass, so we do not have any particular bright ideas for improvement.

For the overall J-REIT market, we have been proactively participating in the activities of industry associations such as ARES (The Association for Real Estate Securitization) and will actively make a proposal for improvement, if necessary.