February 2016

Linking Japan

INVESTMENT INSIGHTS

One

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Dashboard on Japanese Economy February 2016

Publisher's Note

I have hated roller coasters for about twenty years. Something about digesting a meal twice. So, you can imagine what I feel about early 2016. I have never claimed to understand everything, but I can't understand why this is happening now.

Investors have known that China is slowing down, and thus should have adjusted for it. Investors have known that the normalization of relationships between the U.S. and Iran would cause a greater glut in the oil supply and thus lead to even lower prices for us. In the case of China, most complained about unbridled growth. Now as it is brought under control, the complaint is that there is too little growth. Choose and stop complaining. I, for one, feel greater potential out of Japan's neighbor today than I did over the past few years of relentless growth. Meanwhile Japan should reap the benefits of the normalization of U.S. and Iranian affairs since it can now deal more freely with the country.

Amongst all these amusement park-type thrills, twists and turns, real estate continues to do well and steady performance with vacancies of less than 5% in Tokyo is expected to continue. Our focus this issue is on two strong performers in real estate, and we also take a look at how the sharing economy is impacting traditional real estate and hospitality business models in Japan.

J. Michael Owen
Chairman
Transpacific Enterprises

Contents

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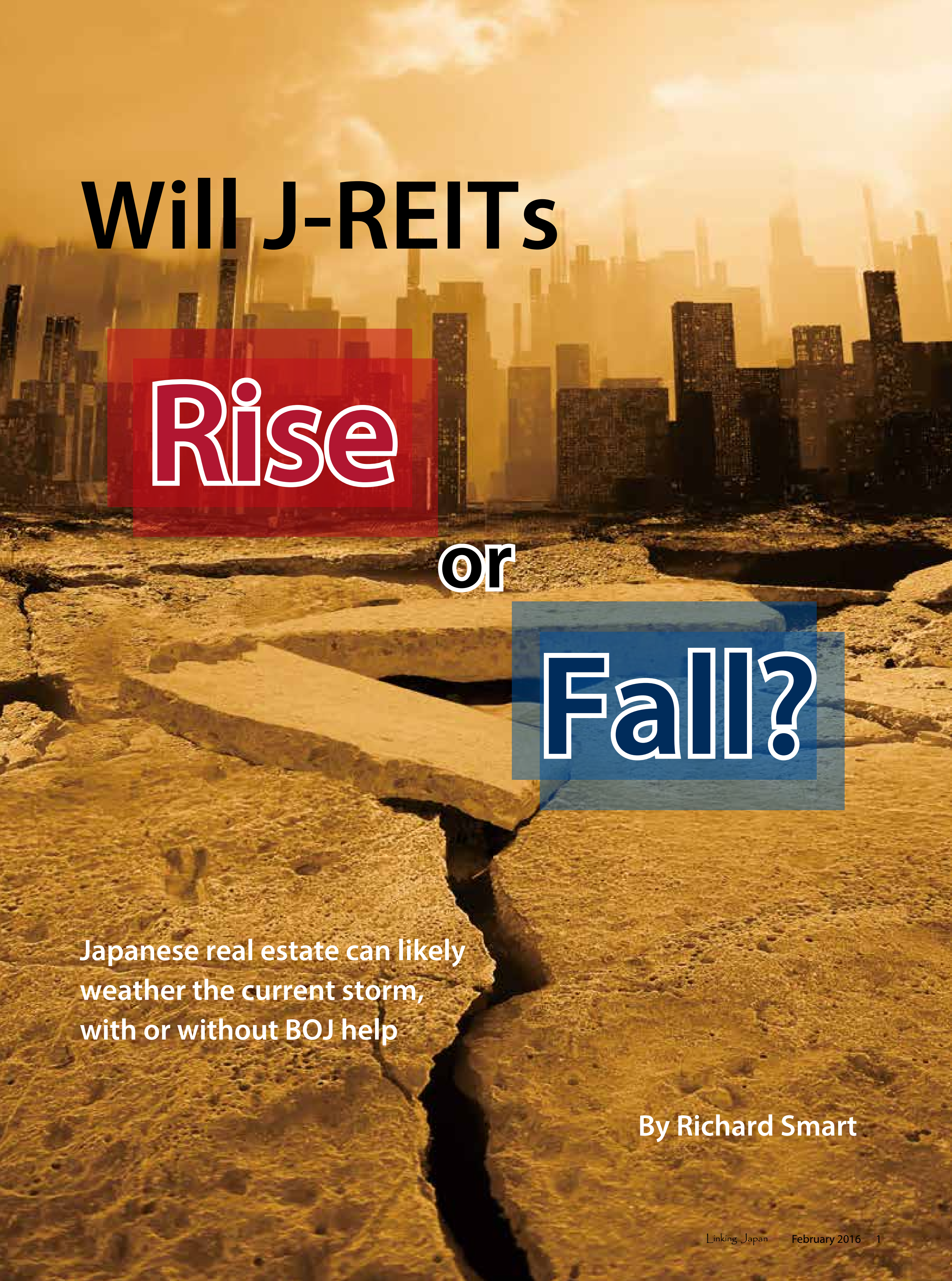


Will J-REITs Rise or Fall?

Japanese real estate can likely weather the current storm, with or without BOJ help

By Richard Smart

The New Year got off to a bad start in Japan. For the first six days of trading, Japanese stocks fell, marking their worst start to a year on record. By February, more than a few were touting the demise of Abenomics as stocks plummeted, the yen soared and bonds went negative.

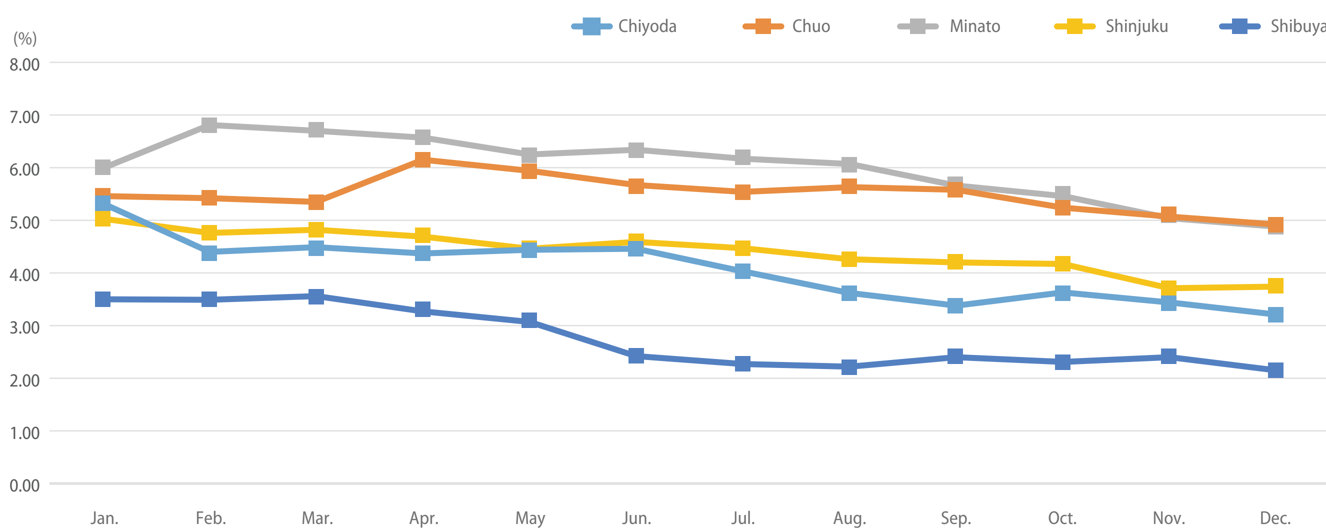
Turmoil across the water in China played a large part. It began the year with a stock selloff that sliced 15% off the Shanghai market. Controls to slow the outflow of cash failed, leaving the market in turmoil and many asking just how much damage any Chinese crisis would do to the rest of the global economy.

Any time that China feels pain, though, Japan winces. Early 2016 has been no different. As well as the decline in stock prices, the yen has strengthened. This has happened a month after Bank of Japan supplementary measures, including an increase in the limits on its Japan Real Estate Investment Trust purchases.

"Since the amount outstanding of the Bank's holdings has been increasing in comparison with the total market value, the maximum amount of each issue of J-REIT to be purchased shall be increased from the current 5% to 10% of the total amount of that J-REIT issued," the bank wrote in its policy statement.

The central bank is rumored to have reached the investment limit under its old rules for J-REITs, and so simply increased the cap. But what does the BOJ change mean for the real estate market? And what is the outlook for 2016?

Office Vacancy Rates – Five Central Wards of Tokyo –2015



Source: Miki Shoji office data (Miki.com, January 2016)

Solid footing

Despite the gloomy news, many analysts and institutions remain unfazed about the state of the global economy. "A global growth decline is plausible," DBS Private Bank wrote.

"However, a crisis in China remains a low probability event. Chinese economic growth will likely continue to slow; the CNY weaken; foreign exchange reserves decline; and the stock markets trade lower in a highly volatile manner. But none of these pose systemic risk. This is a policy-engineered slowdown to restructure the Chinese economy."

The company, however, pointed out that as a traditional safe haven, the yen was likely to generally strengthen over the course of 2016. For real estate, that could be an issue, as a stronger yen means foreign cash does not go as far in Japan. The Japanese currency is at around 110 yen against the dollar. That means the greenback is more than 30 yen more expensive than it was when the Japanese currency was at its strongest in 2011.

However, there are also benefits to the current global economic situation. Lower prices for raw materials because of the commodities downturn, for example, is helping reduce costs for new buildings. Prices are going down for everything from steel to timber to plastics, leading to hopes that construction costs in Tokyo may be about to decline, or at the very least stop growing.

In addition, Japanese real estate at the moment is perhaps the most valued within the Asian market. Koji Naito, capital market researcher at JLL, says that investors are looking to Japan because it has become the most desirable location for real estate in the Asia-Pacific. The Australian market, he says, is saturated, while Singapore and Hong Kong are too small to cope with the sort of cash inflows occurring in Japan.

"Japan is a good destination, even though transparency issues remain and the language barrier is difficult," Naito says. "Property is cut-price at the moment because of the weaker yen. So investors from all across the world are heading to Japan because it is cheap and the quality is fantastic, even compared to Australia, in terms of offices and residential."

JLL believes that this year real estate in Japan will be another good one for Tokyo's real estate market. "So long as monetary policy remains favorable, which should be the case until at least 2018, in the major cities, Japanese real estate should remain an attractive investment option within Asia Pacific for both domestic and foreign investors across all asset classes," a recent report by the company read.

CBRE agrees. The company sees the office market growing not just in Tokyo, but also regional cities. "With existing spaces becoming increasingly difficult to secure, nearly 50% of new Grade A spaces slated for completion in 2016 have already secured tenants," the company wrote. "Grade A assumed achievable rents in Tokyo are expected to rise by 9% over the next two years. Meanwhile, new supply is extremely limited in regional cities, and some of the cities, including Sapporo, Hiroshima and Fukuoka, are now recording historically low vacancy rates at sub-4%." That, the company says, means rents are likely to rise.

In logistics, CBRE sees general growth as online retail and delivery services continue to push for more sophisticated distribution services. For real estate investment, the company says easing by the BOJ is likely to continue to attract foreign cash. In addition, the company sees more properties coming online this year. "Some investors are considering an exit strategy for their investments made as early as 2012," CBRE says. "These may serve to meet still-buoyant demand for acquisitions, leading to higher volume in the investment market."

For new buildings, major work is ongoing around Tokyo, both related to the Olympics and urban revival. In Musashi

Koyama, Meguro, for example, work recently began on a new 41-story housing and residential complex that will house 640 apartments. Alastair Townsend of Bakoko Architects sees the trend for new buildings replacing older neighborhoods increasing. "The highest and best use of those plots of land is always the use of some sort of retail on the lower floors to capture the people coming and going from stations with offices or residential above, perhaps even a hotel … or some combination," he says.

Struggling

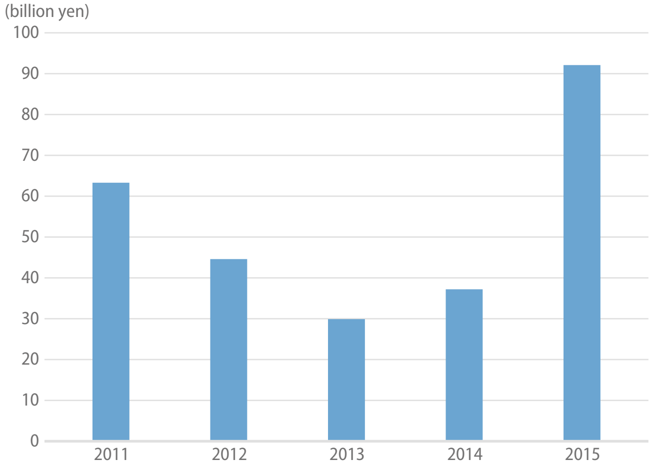
Shares in J-REITs, however, are heading downward. The Listed Index Fund J-REIT, which tracks the capitalization in trusts, peaked at just over 2,000 yen in January last year. A year on, the fund is heading toward 1,600 yen. For retail investors, funds such as this are often the only way to invest in real estate, with many individual J-REIT shares going for hundreds of thousands of yen.

A general decline in the Tokyo market has had an effect on J-REITs. With shares generally heading south, the Bank of Japan acted in December. It did so in completely different circumstances to when Gov. Haruhiko Kuroda first embarked upon his massive easing campaign back in April 2013. The inflation target of 2%, nearly three years on, remains distant. And BOJ purchases have led to speculation that there are limits to the amount that the central bank can do in the bond market. Its 0.1% negative interest rate announcement in January appears to have backfired, pushing 10-year Japan government bonds into negative territory, confusing traders and leading to a widespread view that Kuroda has little left in his policy arsenal.

New moves, such as raising the cap on investment in J-REITs, appear to have been taken to make sure that negativity in the market does not affect the ever-fragile positive sentiment among companies and consumers. "As [the] conversion of firms' and households' deflationary mindset has been progressing under QQE and many firms have become proactive in making investment in physical and human capital, it is desirable that these developments will become further widespread," the bank said. "From this perspective, the Bank decided to adopt supplementary measures for QQE."

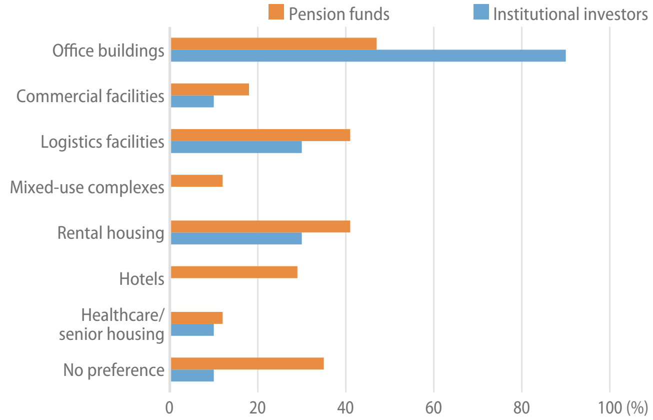
However, the supplementary measures did not have unanimous support. Three of the nine BOJ board members voted against them. On REITs and exchange traded funds, for which the bank will also increase purchases, one board member expressed his worries. "Taking account of neutrality for the private sector's activities, soundness in pricing, and the impact on the Bank's financial soundness, the paces of increase in the amounts outstanding of the Bank's holdings of ETFs and J-REITs should be reduced from the current guidelines," he said.

Purchases of J-REIT Investment Units by Bank of Japan (2011-2015)



Source: Bank of Japan

Property of Interest as Investment Target (held by J-REITs)



Source: "The 15th Questionnaire Survey on Real Estate Investment by Institutional Investors" (The Association for Real Estate Securitization – October 2, 2015)

Of the three concerns, the first two are most noteworthy. How will the bank decide where to allocate its J-REIT investments? And can the market be expected to sit by idly and not put money into those places that the central bank is artificially propping up? Such questions suggest that neutrality and pricing will be difficult to maintain through 2016. As noted above, however, at least for REITs, further purchases appear to be relatively low-risk for this year.

Another board member said the supplementary measures could "raise awareness about the limits of QQE and thereby make the Bank's communication with the market more difficult." However, a different limit, the 5% cap, was close to being reached. If the BOJ had stopped investing in J-REITs, another member feared that the inaction would have been perceived as tapering. It does not appear to be a fun time to be on the BOJ board.

For real estate, however, the outlook appears to be rosier. "Rents are really slightly going up but capital value growth is really steep," says JLL's Naito. "The same thing happened in around 2006, so I would be cautious. But some people in private equity and sovereign wealth funds are really cautious about rental growth when compared to the previous peak. There are some really conservative views on rental growth. [But] companies have learned from past disasters, so this cycle is sustainable for the time being … at least until the end of 2017."

Akira Tanaka
Executive Director
Kenedix Residential Investment Corporation

Naokatsu Uchida
Executive Director
Kenedix Office Investment Corporation

Akihiro Asano
Executive Director
Kenedix Retail REIT Corporation

Taisuke Miyajima
CEO and President
Kenedix, Inc.

COVER STORY

One

Kenedix's unfailing unity and unique business model have made it Japan's largest independent real estate asset management firm

Kenedix, Inc. has been active in the Japanese real estate market for the more than two decades from April 1995 when Kennedy-Wilson Japan opened for business. At the time, the Japanese economy had begun to show signs of emerging from the severe doldrums following the bursting of the bubble, until southwestern Japan was rocked by the devastating Great Hanshin Earthquake on January 17, 1995.

Under conditions that are not theoretically conducive to the successful introduction of a new business, after a decade of tireless effort the company had not only listed on the First Section of the Tokyo Stock Exchange but had transformed itself into a key player in the Japanese asset management industry and also changed its name to Kenedix.

Kenedix began to expand its asset management business in earnest from this point – with assets under management of 100 billion yen at the end of 2003, climbing to 500 billion yen in the fall of 2006 and eclipsing the 1 trillion yen mark in June 2010.

The present incarnation of Kenedix is the result of a restructuring implemented in late 2013, which gave birth to Kenedix Real Estate Fund Management. This group company handles the management of several REITs – spanning office, residential and retail properties as well as multiple private funds – and others including REITs with portfolios featuring logistics and healthcare assets.

CEO and President Taisuke Miyajima successfully secured group-wide acceptance of and support for the new structure. “We’ve created a long-term vision and mission statement. We’ve succeeded in expanding our AUM without using our balance sheet. However, as an asset manager, the creation of value in real estate is as important to us as the expansion of our AUM and short-term internal rates of return. Our employees are all working in concert toward this goal, and in the two-plus years since the new structure was put in place our ability to work as a cohesive team has improved considerably. Kenedix Real Estate Fund Management, Kenedix Property Management, Kenedix Engineering as well as every subsidiary and entity in the group are committed to working together as a united team to maximize returns for investors. This is what we call the One Kenedix concept, and we believe it’s functioning as we envisioned it.”

Aggressive portfolio expansion

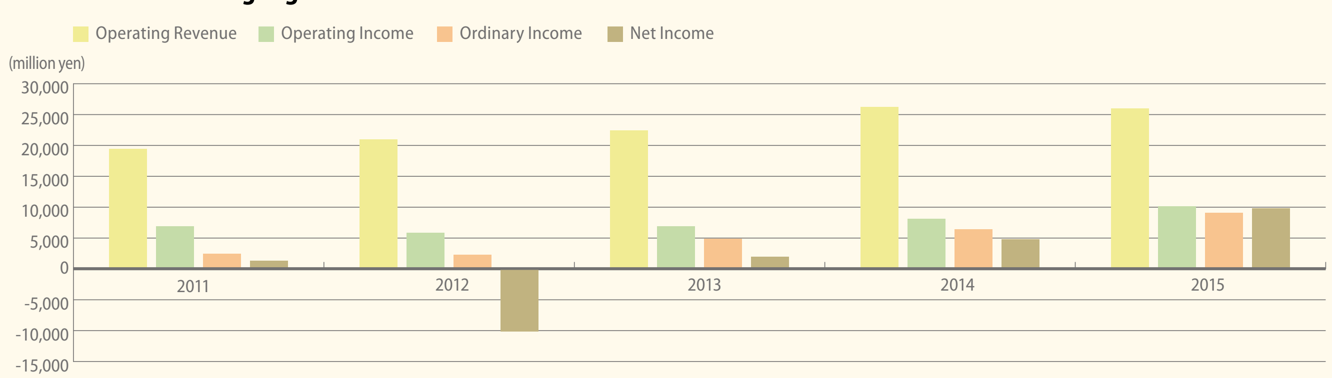
In the three-year period since 2012, assets under management by Kenedix have grown from just under 1.12 trillion yen to nearly 1.64 trillion yen.

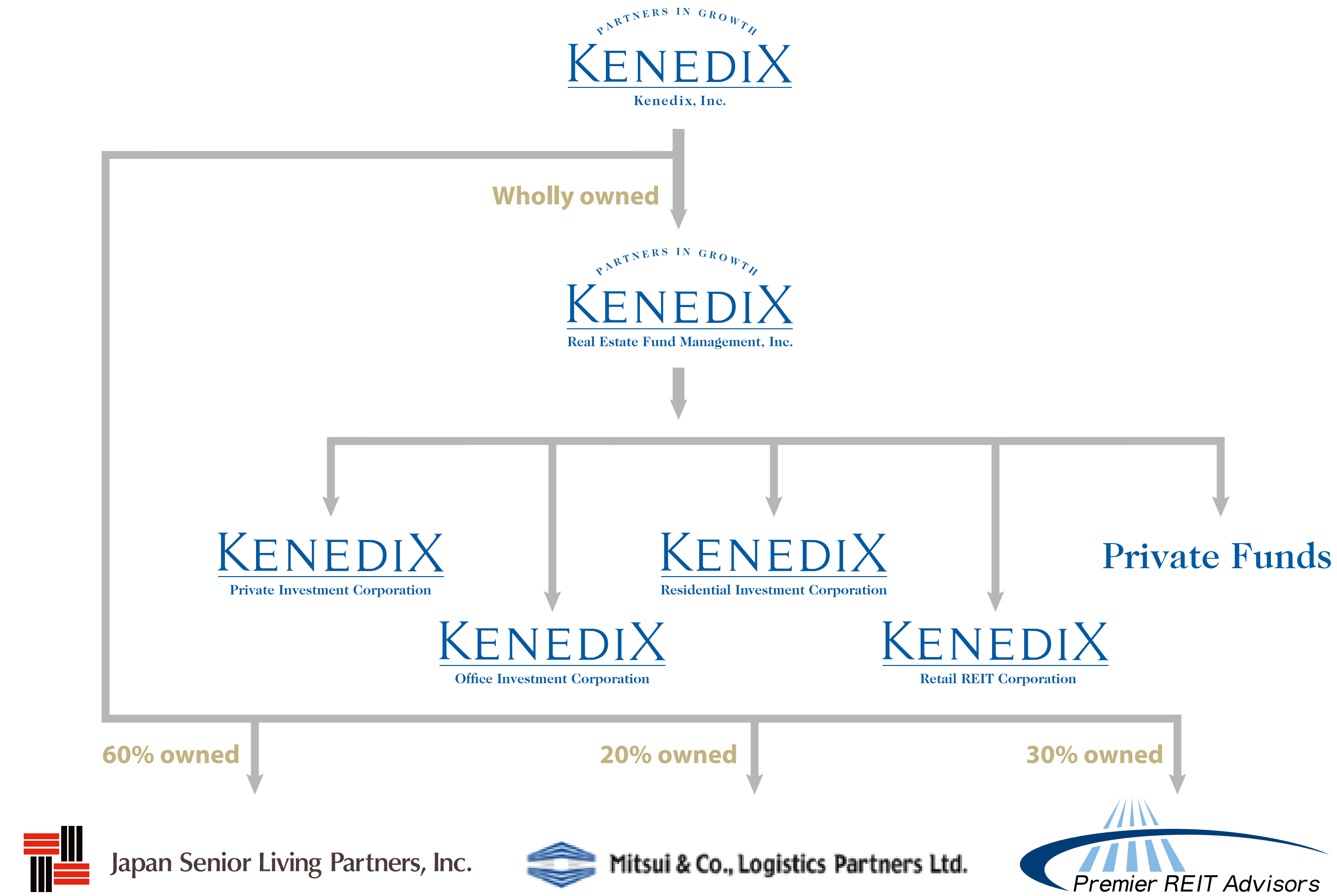
In April 2014, together with five other institutions, Kenedix established Japan Senior Living Partners Co., Ltd. to serve as asset manager for Japan Senior Living Investment Corporation, a REIT whose portfolio will basically comprise two-thirds senior living properties and one-third medical facilities. Kenedix is the major shareholder in the asset management firm, with a 60% stake.

The October 2014 acquisition by Kenedix of a 30% equity interest in Premier REIT Advisors Co. Ltd., the asset manager for office and residential REIT Premier Investment Corporation, was part of a new long-term alliance with NTT Urban Development Corporation.

Kenedix Retail REIT Corporation listed in February 2015. The portfolio is comprised of neighborhood and station-front shopping centers and specialty stores in locations that serve customers living in the vicinity on a daily basis to ensure steady revenue and stable returns.

Kenedix - Financial Highlights 2011 - 2015





This activity, combined with the November 2013 establishment of Kenedix Private Investment Corporation, continued acquisitions by Kenedix Residential Investment Corporation (purchased about 20 properties in 2015) and despite divestitures by Kenedix Office Investment Corporation (sold six properties), led to the AUM of Kenedix rising from 1.2 trillion yen in 2013 to 1.64 trillion yen as of December 2015.

And the company is by no means done expanding its asset size – the AUM target under its long-term vision for 2025 is set at a lofty 4 trillion yen. But how will this be attained with attractive properties being in such short supply, and with such hefty price tags on the ones that are available?

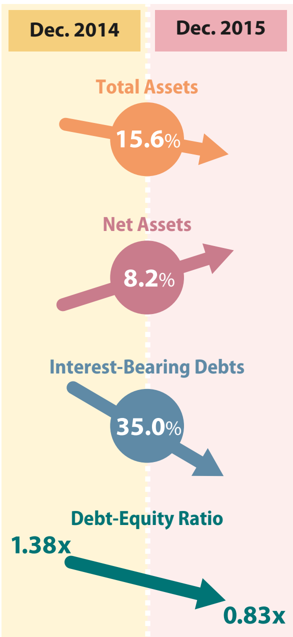
“Kenedix creates bridge funds, operates private funds, and buys properties through the REITs to grow the platform. That’s our core strategy,” affirms Miyajima. “Looking at office and residential properties, the prices are currently high, though if the timing is right we would likely be able to raise funds to make acquisitions in those areas. It really depends on the market for core properties, and what types of properties we are able to source. Looking at mid-sized office properties, through M&A and other activities we should be able to make acquisitions. It won’t be like last year and the year before, but we do believe we can still achieve growth in those areas.”

Small company, large equity

In February and March 2015, Kenedix refinanced 20 billion yen in non-secured loans at a fixed rate of 1.4%, and extended the average repayment period from 1.7 to 4.5 years. The best part is that repayment of these borrowings is not directly linked to the value of real estate held by the funds Kenedix manages – instead it will come from revenue generated in the asset management business and other revenue.

“We now have long-term loans provided by twelve banks. We want them to do business with us while having a full understanding of the business model of Kenedix beyond just the REITs. We believe establishing the One Kenedix concept and bringing it to fruition has aided us in achieving this,” says Miyajima.

“Kenedix itself is not leveraged,” he continued. “On a non-consolidated basis, we’re looking at about 23 billion yen of



borrowings remaining at year's end (2015). In terms of equity, we're at 82 billion yen, so our equity ratio is over 70%. On a consolidated basis, there are funds in which we have an equity interest of 40% or more, meaning our assets increase, so it looks like we are more leveraged, but essentially they are all non-recourse loans. Kenedix is a very small company with very large equity."

Driven to grow

Kenedix has clearly been successful, particularly over the past couple of years, at correctly assessing existing conditions and trends, forecasting future directions and gauging the twists and turns, and then making the necessary adjustments to its medium- and long-term strategies … and the leadership has then been successful at getting the entire Kenedix group to buy in. It has launched its own fund with an emphasis on neighborhood shopping malls. "It's really a niche market and there aren't that many competitors so we do see further growth here," says Miyajima. He is adamant that the retail and healthcare sectors – and to a lesser extent, hotels – are going to serve as key drivers in asset expansion.

Until now, Miyajima says, there hasn't really been a core real estate market in Japan. He believes that, influenced in part by the corporate governance code and the need to improve capital efficiency, companies will want to sell inefficient real estate holdings, leading to increased supply and attracting new capital from core investors, such as the Government Pension Investment Fund (GPIF), KKR, Japan Post Bank and Japan Post Insurance.

"If you asked them to sell at 5% you probably wouldn't have any takers, but their return targets are really low. I do think they will want to sell those properties and allocate the returns to development and other growth activities. The GPIF has begun acquiring real estate assets, Norway has said it is going to establish a core fund, and Chinese investors are also still very active here. I foresee super core funds being launched in Japan."

Among others, Miyajima is closely watching the GPIF, which has stated its intent to increase its real estate holdings, but is concerned about their approach to property acquisition. "If they fail in their strategy, it would be because they buy 'available' properties. They should instead determine in advance how much they will allocate to real estate acquisition over a period of several years – for example, 200 billion yen over five years – toward the creation of a real estate portfolio with a fixed value target of say 1 trillion yen. If they approach it in such a strategic manner, I think they will succeed."

Miyajima also stressed the suitability of Kenedix to manage some of those assets, over other firms that may also own property. "Kenedix has no such conflicts in its balance sheet and is able to purchase from anyone. This is definitely one of our comparative strengths."

Kenedix is also looking to expand its involvement in infrastructure and natural power generation, dependent upon the growth in those fields. "We are a real estate market player so the form in which we can invest in these is limited, but there is potential. Look at energy, for instance – even if only 3% of all energy produced were natural energy, you would require a massive number of power generation facilities. If we are able to find partners and actually create a proper fund, it might become an important area of business for us."

Miyajima prefers to conduct core investment domestically, where he can avoid foreign exchange risk, deal in a familiar market and in a secure environment for financing. Any outbound investment would be of an opportunistic nature, and they have already begun laying the groundwork for a fund in Southeast Asia.

"Kenedix creates bridge funds, operates private funds, and buys properties through the REITs to grow the platform. That's our core strategy."

KENEDIX
Office Investment Corporation

Established	May 2005
Executive Director	Naokatsu Uchida
No. of Properties	97 (Jan. 2016)
Property Types	Office 92.1% (mid-sized office 84.2%), Central Urban Retail 5.7%, Residential 1.3%, Other 0.7%
Occupancy Rate	95.5% (Dec. 2015)
Leasable Area	453,663.61m²
Total Acquisition Price	388,371 million yen (Jan. 2016)

KDX Nihonbashi Kabutocho Building
(acquired Dec. 2011)

This office building is located a two-minute walk from Kayabacho Station on the Tokyo Metro Hibiya and Tozai lines, and also provides convenient access to Tokyo Metro Nihonbashi Station and the Toei Subway Asakusa Line. The Kabutocho area features a concentration of financial institutions – particularly securities firms – and the property is across the street from the Tokyo Stock Exchange.

KENEDIX
Residential Investment Corporation

Established	November 2011
Executive Director	Akira Tanaka
No. of Properties	105 (Dec. 2015)
Property Types	Small family 44.0%, Studio 34.2%, Family 21.8%
Occupancy Rate	95.1% (Dec. 2015)
Leasable Area	286,310.51m²
Total Acquisition Price	148,184 million yen (Dec. 2015)

KDX Residence Ebisu
(acquired Oct. 2015)

This property, located a three-minute walk from Ebisu Station on the JR Yamanote Line, the JR Saikyo and Shonan Shinjuku lines and the Tokyo Metro Hibiya Line, is in one of Tokyo's most prestigious residential areas. It offers convenient access to key business and commercial zones. Stable rental demand from singles and couples can be expected due to the convenience in terms of daily life and the property's proximity to parks, shopping complexes and other destinations for outings.

KENEDIX
Retail REIT Corporation

Established	October 2014
Executive Director	Akihiro Asano
No. of Properties	33 (Jan. 2016)
Property Types	Neighborhood Shopping Centers 47.6%, Urban Station-front Shopping Centers 24.5%, Community Shopping Centers 11.3%, Specialty Stores 9.0%, Supermarkets 7.6%
Occupancy Rate	99.7% (Dec. 2015)
Leasable Area	606,347.08m²
Total Acquisition Price	131,639 million yen (Jan. 2016)

Blumer HAT Kobe
(acquired Apr. 2015)

An NSC, the property houses approximately 40 tenants, including supermarkets, clothing stores, a baby goods store, a cinema complex, restaurants and more. The property is located in the HAT Kobe area, 2km east of Sannomiya, the center of Kobe, and located near Nada Station on the JR Tokaido Main Line and Iwaya Station on the Hanshin Line. Proximity to Hanshin Highway and National Route 2 to the north further enhance the accessibility of the location.

Partners in Growth 2017

Increase Stable Earnings	Improve Capital Efficiency
Base Earnings*1 ¥4 billion (FY2017)	3-year Average ROE*2 8.0%

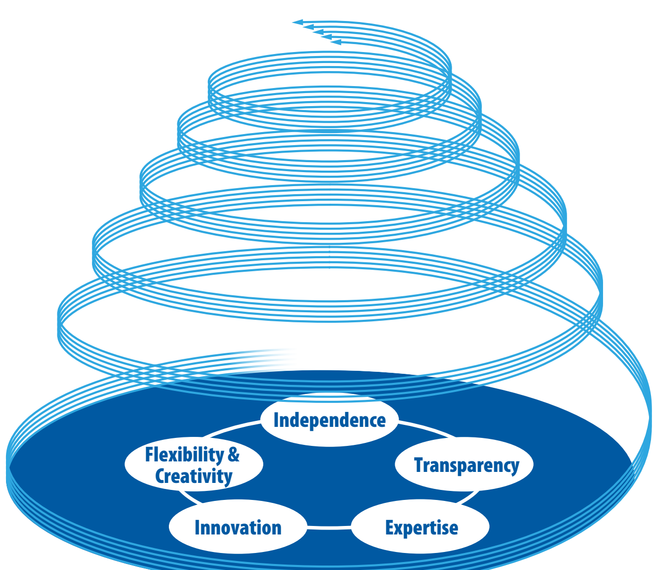
*1: Base Earnings are gross operating income from the Asset Management Business and Real Estate Related Business minus SG&A.
*2: 3-year Average ROE is the return on equity in each year which is calculated by dividing net income by the average of equity at the beginning and end of each year.
Target figures in 1 and 2 do not incorporate the effects of goodwill resulting from acquisitions.

Basic Policies

1. Increase stable earnings mainly through growth of the Asset Management Business
2. Expand the Real Estate Investment Business primarily by using co-investments
3. Achieve the proper balance between financial soundness and shareholder distributions

"I don't see us getting heavily involved in the U.S. and Europe at this time. We do have platforms we've established in Los Angeles and Singapore, the latter of which will serve as the foundation for a Southeast Asia opportunistic Kenedix fund within a couple of years. Kenedix Asia has acquired its first asset in Vietnam, and there are interesting possibilities in Indonesia and Malaysia as well."

Delivering Growth via the Kenedix Model



Perpetual motion

The company's current medium-term business plan, called Partners in Growth 2017, sets targets of 4 billion yen in base earnings (asset management business plus real estate-related business gross operating income minus SG&A) and a three-year average ROE of 8%. The significant boost in base earnings, which totaled 1.3 billion yen in 2014, would be driven by the expansion of asset categories to include a broader suite of non-asset real estate services and expanded property management business, and the operation of funds overseas.

Kenedix established in 2012 the goal of resuming dividend payments no later than 2015, and actually achieved their objective ahead of schedule, paying 3 yen per share after 2014. It hopes to further bolster distributions through the marked increase in base earnings.

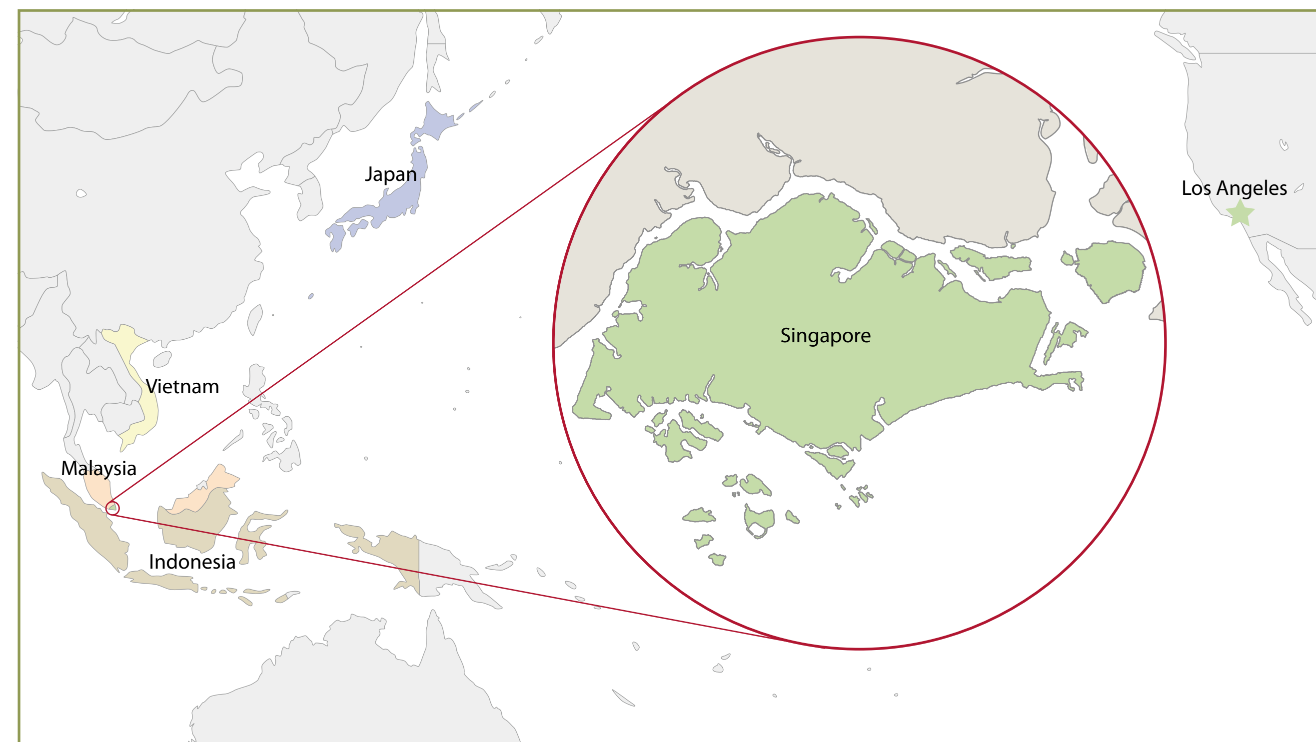
"In the fourth quarter of 2015," says Miyajima, "we decided it was a good time to allocate our capital to a share buyback and executed a small buyback of 2 billion yen that was very well received despite its size. People read it as us having come out of restructuring mode and into our new identity. People were surprised we had the equity to execute a buyback."

Given the effective implementation of the new structure, the establishment of funds with portfolios reflecting the changes in Japan economically and demographically, and the successful reduction in liabilities and increase in equity ratio to about 80% without increased earnings realized over the past two plus years, the goals under Kenedix Vision 2025 (4 trillion yen in assets under management, 2 trillion yen group market cap and 15% ROE) seem appropriately bold but reachable for Japan's largest independent real estate asset management company.

"No matter how much we 'use' our balance sheet, there are limits to what we can do. Maybe I'm a genius and we're the exception, but this is not very likely and we can't play that game. The real estate securitization market has grown considerably, and finance-related technology has advanced greatly, so even if we don't own real estate directly, we can still achieve our goals by expanding our AUM through the use of REITs and other funds. This is really at the essence of our decision to adopt a unique model in the market."

Kenedix Vision 2025

AUM	4 trillion yen
Kenedix Group Market Cap	2 trillion yen
ROE	15%



"We do have platforms we've established in Los Angeles and Singapore, the latter of which will serve as the foundation for a Southeast Asia opportunistic Kenedix fund within a couple of years. Kenedix Asia has acquired its first asset in Vietnam, and there are interesting possibilities in Indonesia and Malaysia as well."

Company Name	Kenedix, Inc.
CEO and President	Taisuke Miyajima
Head Office	KDX Nihonbashi Kabutocho Building, 6-5 Nihonbashi Kabutocho, Chuo-ku, Tokyo 103-0026 Japan
No. of Employees	Kenedix Group: 302 / Kenedix: 108 (as of Dec. 31, 2015)
Website	http://www.kenedix.com/eng/

ULI Japan Spring Conference 2016

Thursday, May 12
Tokyo Midtown Hall & Conference

Join us as we look at how the increase in foreign visitors is impacting the hospitality and real estate industries, the effects of the sharing economy on traditional business models, and much more. ULI Japan's Spring Conference is a great opportunity for discussion, information exchange and networking – if you'd like to participate, contact the ULI Japan office for details.

ULI Member Benefits

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*Access to ULI development case study database, online reports and web seminars
*Access to member directory

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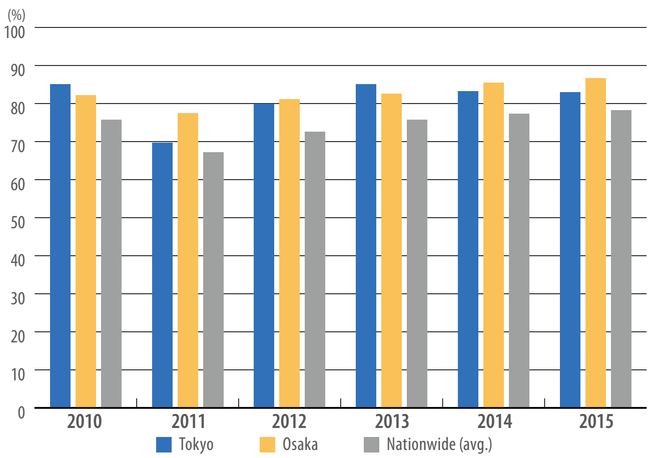
No Room at the Inn

Hopes are high for the legalization and growth of 'minpaku' (home sharing) in Japan to ease the worsening guestroom shortage in Japan's major cities

As of last November, the number of foreign visitors to Japan reached 17.9 million in 2015 – monthly figures for September, October and November were up an average of 43.8% against the preceding year. Though hotel development projects are underway, obstacles such as limited availability of new sites, continued high construction and material costs, and a shortage of labor, mean slow progress in meeting rapidly increasing demand for accommodations.

The legitimization of home sharing, or 'minpaku' in Japanese, is viewed by many as a potentially positive development. "Minpaku would be an effective means of increasing guest capacity in a short time frame," said Japan Tourism Agency Commissioner Akihiko Tamura (Asahi Shimbun online, November 2015). However, Japan's Inns and Hotels Act prohibits the use of private homes as paid accommodations unless they have registered and meet the legal requirements for minpaku. That has not stopped more 'enterprising' people from attempting such ventures. In November 2015, an investigation was started against two men who allegedly leased most of the rooms in a five-story apartment building and, over a period of about three months, rented rooms to an estimated 300 tourists from Asia at between 5,000 and 10,000 yen per night. There have been countless other cases – most on a much smaller scale – all of which are illegal, provided money is exchanged.

City Hotel Occupancy Rate Trends

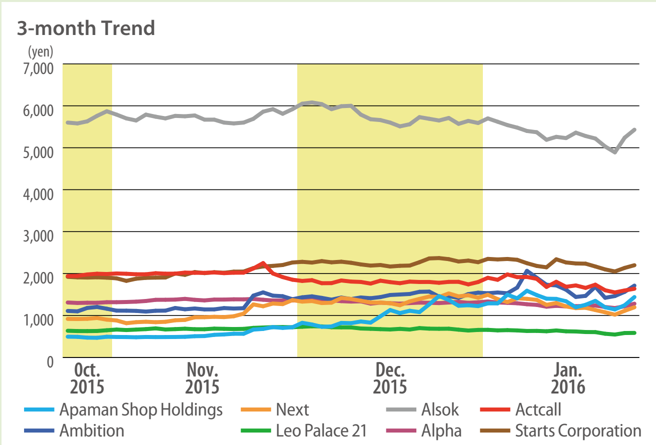


Source: Japan Tourism Agency
*2015 figures are for January – August.

Complicating the issue further from Japan's perspective is the popularity and increased recognition of Airbnb, which has around 16,000 registered providers in Japan. Japan's Ministry of Health, Labour and Welfare and the Ministry of Land, Infrastructure, Transport and Tourism are looking at easing regulations with regard to licensing requirements that would enable more private citizens and businesses to launch minpaku operations, and are planning to roll out new regulations around November of this year.

Some local governments (Osaka and Tokyo's Ota Ward) have taken the initiative and used the National Strategic Special Zone system – currently nine such zones exist nationwide. The zones were established to create new industry and employment opportunities for Japanese and foreigners alike.

Minpaku-related Stock Capsule



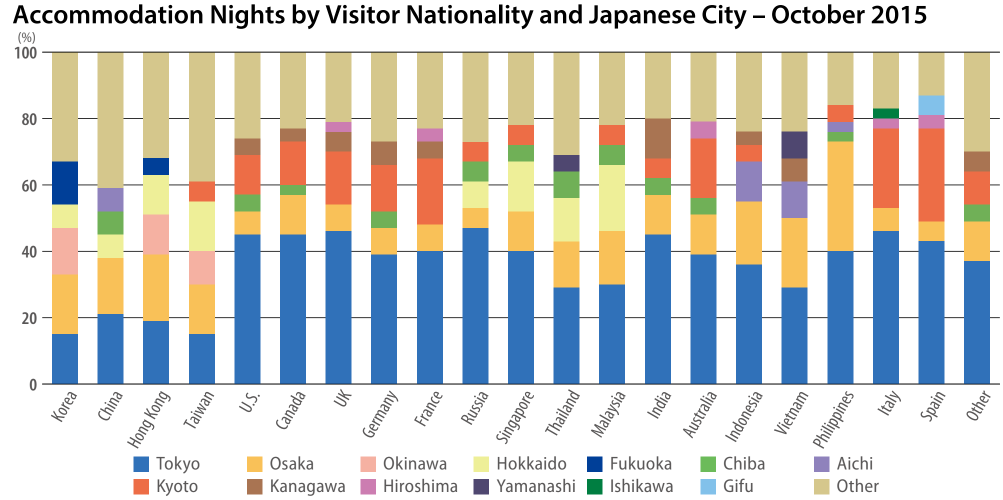
Apaman Shop Holdings	Next	Alsok	Actcall
Securities code: 8889	Securities code: 2120	Securities code: 2331	Securities code: 6064
Real estate properties database; leases, manages properties; short- and mid-term leasing (7-30 days, 1-12 months); furnished units; no deposit or key money	Operator of HOME'S, country's largest property database, other information websites; newly developed "Smart Nairan" smart lock system	Home and office security company; introduced Home Security Basic, a new security service for private citizens (can engage and disengage via smartphone)	Outsourcing company, provides emergency response, call center, payment agency (invoicing and collection) services, etc.
Ambition	**Leo Palace 21**	**Alpha**	**Starts Corporation**
Securities code: 3300	Securities code: 8848	Securities code: 3434	Securities code: 8850
Provides rent guarantor services in conjunction with Room Bank Insure	Apartment leasing and construction contracts; furnished apartments, monthly agreements; operates 6 hotels in Japan	Manufacturer of locks for key and keyless products – cars, homes, industrial machinery, labor-saving devices; mechanical and electric locks	Management and security operations including apartment and condominium management; real estate services including management agent, real estate information website

Stipulations of minpaku operations in such areas, however, include a minimum stay of seven days. According to Sonosuke Mikuchi, Representative Director of Tomareru, Inc. (which operates a recently launched minpaku-type matching site), the stay requirement could prove to slow progress. "It is rare for Chinese tourists, whose numbers are growing, to stay in one place for seven days or longer, so the minimum stay requirement will make it difficult to serve this tourist segment."

His company has capitalized on the proactive stance of Ota Ward in Tokyo and begun accepting applications from property owners in the area. As of early January, their brokerage website had received about 100 applications. Mikuchi's company is part of the Hyakusen Renma group, run by Yasuhiro Kamiyama, which also operates Tomarina, an intermediary website which lists accommodations for people who want to experience countryside living. In a March 2015 interview in the Kanko Keizai Shimbun, Kamiyama indicated his determination to expand his operations while at the same time contributing to the alleviation of a growing societal issue – abandoned homes.

"In order to create an environment which encourages foreign visitors to stay longer, if we can put the 8.2 million abandoned homes in this country – an issue which has become a serious problem in Japan – to use as 'annexes' to existing lodging facilities, I believe this will contribute to alleviating the shortage of guestrooms in Tokyo, Osaka and elsewhere. We also hope to contribute to regional revitalization by offering lodging in the country to travelers," said Kamiyama.

Accommodation Nights by Visitor Nationality and Japanese City – October 2015



Source: Japan Tourism Agency + Ministry of Land, Infrastructure, Transport and Tourism statistics (December 25, 2015)
(only reflects nights at facilities with more than 10 staff members)

The goal of 20 million foreign visitors annually by 2020 was nearly eclipsed in 2015. Mizuho Research Institute estimates that by 2020, guestroom usage will increase by 28.9 million rooms compared to 2014. There are real estate companies, entrepreneurs and private citizens anxious to launch minpaku operations – all they need is for the government to take the cuffs off, though it may take time to gain cultural acceptance for minpaku as a business.

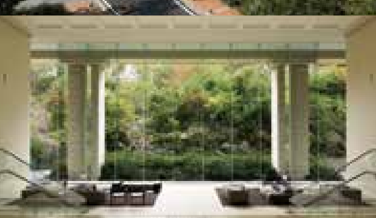
FEATURE

Founded on a Heritage of Quality

With the backing of a powerful sponsor, Sekisui House Reit is poised for prudent, steady growth

SEKISUI HOUSE

SEKISUI HOUSE REIT, INC.



Junichi Inoue

President & Representative Director
Sekisui House Investment Advisors, Ltd.
1-6-6 Motoakasaka, Minato-ku, Tokyo Japan

"Regardless of how high quality a property is, if the location is poor it's hard for it to stay competitive. We need to acquire properties where it's clear the location is superior."

Sekisui House was founded in 1960 and is based in Osaka. As one of Japan's premier residential developers, Sekisui House has built nearly 2.3 million houses and now operates not only in Japan, but also in Singapore, mainland China, Australia and the U.S. It's a globally recognized brand for its quality of service and quality of product.

Sekisui House has been involved in the J-REIT space since 2005 when it acquired an equity stake in Japan Excellent Asset Management, the asset manager for Japan Excellent. Japan Excellent is an office REIT that listed in 2006. Sekisui House sold its interest in the asset manager in 2014.

In March 2010, in a joint venture with Spring Investment, the asset manager for an Australian REIT, Sekisui House acquired a 75% equity interest in Joint Capital Partners, the asset manager of Joint Reit Investment Corporation. Today this REIT is named Sekisui House SI Residential Investment Corporation, and boasts an almost exclusively residential portfolio of 107 properties and an acquisition value of 188,190 million yen as of the end of January 2016.

These preceding experiences in the REIT field provided the groundwork for Sekisui House to establish the wholly owned Sekisui House Investment Advisors. Junichi Inoue, former President of Sekisui House SI Asset Management, who played a key role in redefining the direction and achieving quality growth of the Sekisui House SI Residential portfolio, was appointed President and Representative Director of Sekisui House Investment Advisors, the asset manager of Sekisui House Reit. The new REIT was listed in December 2014 and intends to develop a portfolio with a focus on office, retail and hotel properties.

Sekisui House Reit currently owns four (including proportional ownership interests) office properties, two each in Tokyo and Osaka that were acquired for a total value of 152,900 million yen. The REIT intends to build a portfolio with 80% of the domestic properties in the three major Japanese metropolitan areas of Tokyo, Osaka and Nagoya – areas where its sponsor has an impressive track record of development. Acquisitions are not limited to properties developed by Sekisui House itself but the Sekisui House Reit is guided by the mantra of prime properties in prime locations. As real estate professionals know, location first and foremost determines the long-term quality of real estate – in essence, the competitiveness the property provides for tenants – followed by the quality of the structure. The visual quality and the map location of the properties ensures that investors believe in the strength of their portfolio.

The present portfolio boasts quality properties with excellent environment and sustainability specs – three of the four properties have achieved either a 4- or 5-star rating under the Development Bank of Japan's Green Building certification system. "I don't think we can sustain this level of quality through a larger portfolio," says Inoue, "but we do need properties such as these to serve as the foundation of the REIT. Looking at expansion, though the quality may drop slightly, we will continue to emphasize location. According to our philosophy, the property has to be of high quality, or extremely well located, or both. If we are to choose between the two, I would say location wins out. Regardless of how high quality a property is, if the location is poor it's hard for it to stay competitive. We need to acquire properties where it's clear the location is superior."

The REIT's two Tokyo properties are in the Gotenyama area, which is known to have a solid bedrock, providing additional anti-seismic performance. This fact has led a diverse group of firms to establish data centers here as a part of their business continuity plans. Sekisui House Reit's Gotenyama SH Building, a 7-story structure with a total floor area of nearly 20,000m^2, is occupied by a single tenant, which employs the property as a data center.

In the early days of the REIT market in Japan, single-tenant occupancy was relatively common, but the widespread reorganization and consolidation sparked by the financial crisis of 2008 essentially limited and terminated that line of thinking. Inoue is not concerned, though, as he believes data centers are less prone to frequent relocation. "Naturally the economic climate will play a role, but the majority of facilities within the building are owned by the tenant. They've built up to the point where moving is not really realistic."

"The top issue we currently face is the small physical size of our portfolio," says Inoue, "which means the liquidity from investors is limited. We will overcome this in the coming months and years with proactive acquisitions of prime properties in prime locations from our sponsor and other market players." This REIT also provides stability through master leases on a majority of its properties. "Unfortunately, in a booming real estate market, fixed-rent master leases provide little or no room for internal growth through the raising of rents. However, when the market drops in a poor economy and many leases are renegotiated, master leases provide resilience against the storm and are a very valuable provider of security to the REIT itself. We believe in the stability provided by master leasing. It is our intent to increase the size of the portfolio, and we hope to incorporate pass-through master lease agreements in accordance with the portfolio's expansion."

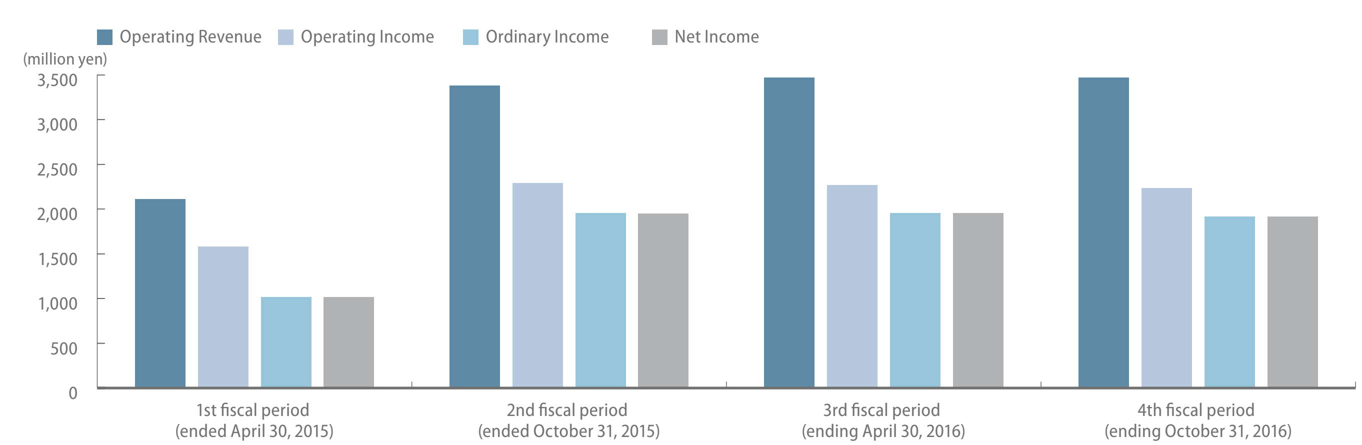
Sekisui House REIT Operational Philosophy

- Provide high-quality social capital and maximize unitholder value
- Invest in commercial properties focused on strategic locations and quality
- Portfolio development policy centering on office buildings
- Growth strategies capitalizing on versatile support of Sekisui House

Sekisui House Reit is also one of the few REITs actively considering investment overseas in Australia and Singapore – locations where Sekisui House is proactive as a developer. "We believe that any location overseas where we own properties has to have a Sekisui House office already established, for purposes of property management. In addition to that, Australia, Singapore and indeed the U.S. are locations where we have other partners," says Inoue. Sekisui House Reit has been offered first refusal rights, exercisable beginning in December 2016, on two projects – Punggol Waterway Point, a retail property that has just opened in January, and Central Park Sydney, a 58,000m^2 residential development Sekisui House is jointly developing with Frasers Property Australia.

Going forward, Inoue's goals are to continue to focus on prime properties, expand and diversify the portfolio at a prudent, sustainable pace, by capitalizing on the strong support of Sekisui House. This investment strategy, combined with sound financial management – maintaining LTV at a manageable level (currently 41%), extending repayment periods and refinancing at fixed interest rates – will ensure the steady growth of this relatively new REIT, while maximizing value for its unitholders.

Financial Highlights and Forecast



Portfolio – Sekisui House Reit

Garden City Shinagawa Gotenyama



Location (residential address)	6-7-29 Kitashinagawa Shinagawa-ku, Tokyo
Acquisition price	39,700 million yen
Structure / Floors	RC, 9F/B1F
Total floor area	62,975.42m² (sectional ownership)
Total leasable area	21,033.47m²
Completion	February 2011
Access	Within 12 minutes on foot from 10 different above-ground and subway train lines; as well as access to Shinkansen and Haneda International Airport
Characteristics	• 5 stars under DBJ Green Building certification system • High-grade appearance • Pillar-free design • Max. ceiling height: 3,000mm • 120mm OA floor • CASBEE S rank • Seismically isolated structure

Gotenyama SH Building

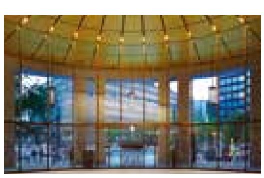
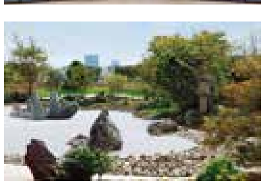

Location (residential address)	6-5-17 Kitashinagawa Shinagawa-ku, Tokyo
Acquisition price	51,500 million yen
Structure / Floors	S/SRC, 7F/B1F
Total floor area	19,812.85m² (sectional ownership)
Total leasable area	19,999.97m²
Completion	February 2011
Access	Within 12 minutes on foot from 10 different above-ground and subway train lines; as well as access to Shinkansen and Haneda International Airport
Characteristics	• Large-scale data center • LED lighting • Floor load 1.5t/m² • Greenery on roof • Exterior walls base isolation design

Hommachi Minami Garden City



Location (residential address)	3-6-1 Kita-Kyuhoujimachi, Chuo-ku Osaka-shi, Osaka
Acquisition price	23,100 million yen
Structure / Floors	S/SRC, 25F/B2F (sectional ownership)
Total floor area	46,010.88m² (sectional ownership)
Total leasable area	16,699.46m²
Completion	February 2011
Access	Situated on main thoroughfare of Osaka; 3-min. walk from three subway lines; convenient access to Shinkansen and two airports
Characteristics	• 4 stars under DBJ Green Building certification system • Lobby ceiling: 8.5m • Pillar-free, 4,000 tsubos + per floor • Ceiling height: 2,800mm • Vibration control structure • Vertical louvers to reduce insulation load

Hommachi Garden City

Location (residential address)	3-6-4 Hommachi, Chuo-ku Osaka-shi, Osaka
Acquisition price	38,600 million yen
Structure / Floors	S/SRC, 27F/B2F (sectional ownership)
Total floor area	49,163.16m² (sectional ownership)
Total leasable area	17,006.94m²
Completion	May 2010
Access	Situated in center of Osaka business district; convenient access to mass transportation, airports
Characteristics	• 4 stars under DBJ Green Building certification system • Ceiling height: 2,800mm • Advanced security system • Vibration control structure • Greenery on roof

Dashboard on Japanese Economy

January 2016

Linking Japan provides regular updates of major Japanese economic indices. Our hope is that this information will adequately convey an overview of Japanese economic trends to our readers. In order to refine and better meet this objective, please provide us with feedback and requests regarding the information posted here.
The fiscal year for most Japanese companies runs from April 1 through March 31.

* Indicates provisional figures.
** Data not available at time of publication.

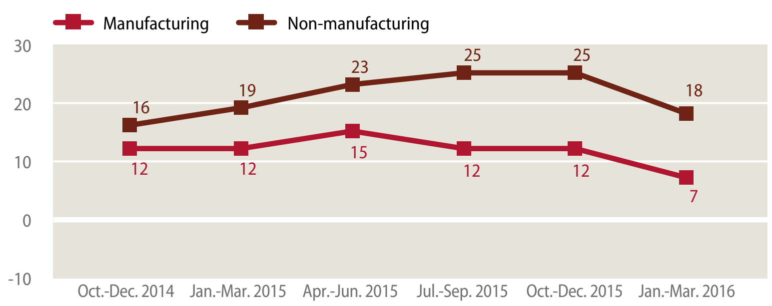
Data accurate as of January 18, 2016.

GDP (Gross Domestic Product)

	Nominal Gross Domestic Product (trillion yen)	Nominal Growth Rate Period-on-period (%)	Real Gross Domestic Product (trillion yen)	Real Growth Rate Period-on-period (%)
FY2011	474.2	-1.3	514.7	0.4
FY2012	474.4	0.0	519.5	0.9
FY2013	482.4	1.7	529.8	2.0
FY2014	489.6	1.5	524.7	-1.0
Jan. - Mar. 2015	498.0	8.4	529.0	4.4
Apr. - Jun. 2015	*498.7	*0.6	*528.3	*-0.5
Jul. - Sep. 2015	*500.7	*1.6	*529.7	*1.0

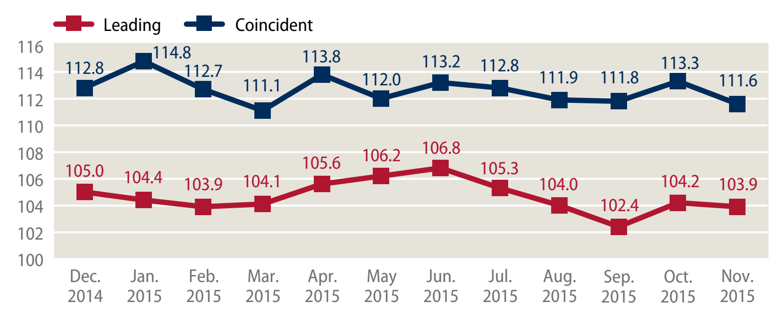
Tankan (Business Conditions)

	Business Conditions (Large Enterprises/ Manufacturing) Favorable (%) - Unfavorable (%)	Business Conditions (Large Enterprises/ Non-manufacturing) Favorable (%) - Unfavorable (%)
Oct. - Dec. 2014	12	16
Jan. - Mar. 2015	12	19
Apr. - Jun. 2015	15	23
Jul. - Sep. 2015	12	25
Oct. - Dec. 2015	12	25
Jan. - Mar. 2016	7	18



Indices of Business Conditions

	Indices of Business Conditions	
	Leading (2010 = 100)	Coincident (2010 = 100)
Jun. 2015	106.8	113.2
Jul. 2015	105.3	112.8
Aug. 2015	104.0	111.9
Sep. 2015	102.4	111.8
Oct. 2015	104.2	113.3
Nov. 2015	*103.9	*111.6



Consumption

	Consumption Expenditure Year-on-year (%)	Retail Sales Value Year-on-year (%)	Number of New Cars Sold (thousand)	Department Store Sales Year-on-year (%)
May 2015	4.8	3.0	33.6	6.3
Jun. 2015	-2.0	1.0	44.3	0.4
Jul. 2015	-0.2	1.8	42.5	3.4
Aug. 2015	2.9	0.8	32.7	2.7
Sep. 2015	-0.4	-0.1	47.9	1.8
Oct. 2015	-2.4	1.8	38.0	4.2
Nov. 2015	-2.9	-1.1	38.9	-2.7

Consumption Expenditure: Household with two or more people, change from actual results of previous year.
Number of New Cars Sold: Total of passenger cars, trucks and busses. Includes light motor vehicles. Survey conducted by Japan Automobile Dealers Association and Japan Mini Vehicle Association.
Department Store Sales: Based on existing department stores. Survey conducted by Japan Department Stores Association.

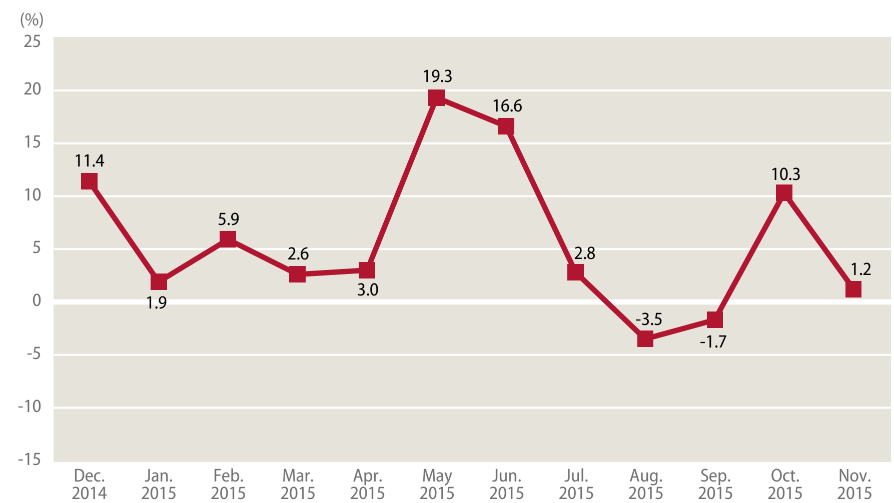
Dashboard on Japanese Economy

Housing

	Number of New Housing Construction Starts (thousand units)	Number of Condominiums Sold		Orders Received for Construction Year-on-year (%)	Contracted Amount of Public Works Year-on-year (%)
		Tokyo Metropolitan Area (units)	Kinki Region (units)		
FY2011	841	45,173	20,415	7.1	-0.5
FY2012	893	46,754	24,114	2.4	10.3
FY2013	987	55,245	23,338	20.1	17.7
FY2014	880	44,529	19,840	8.2	-0.3
Mar. 2015	920	4,457	2,019	10.8	-12.4
Apr. 2015	913	2,286	1,189	-12.1	4.4
May 2015	911	3,495	1,920	-7.4	-14.0
Jun. 2015	1,033	3,503	1,755	15.4	-1.8
Jul. 2015	914	4,785	1,258	4.0	-10.1
Aug. 2015	931	2,610	969	-15.6	-1.3
Sep. 2015	900	2,430	1,798	6.7	-10.9
Oct. 2015	862	2,921	1,223	-25.2	-4.8
Nov. 2015	886	3,496	1,696	5.7	3.3

Machinery Orders / Operating Rate

	Machinery Orders (Private) (Excluding Vessels and Electric Power Generating Equipment) Year-on-year (%)
FY2011	6.2
FY2012	-3.0
FY2013	11.5
FY2014	0.8
Mar. 2015	2.6
Apr. 2015	3.0
May 2015	19.3
Jun. 2015	16.6
Jul. 2015	2.8
Aug. 2015	-3.5
Sep. 2015	-1.7
Oct. 2015	10.3
Nov. 2015	1.2



Indices of Industrial Production

	Shipments		Inventories	
	Change Month-on-month (%)	Change Year-on-year (%)	Change Month-on-month (%)	Change Year-on-year (%)
FY2011	—	-1.5	—	5.2
FY2012	—	-1.8	—	4.5
FY2013	—	2.9	—	-3.4
FY2014	—	-1.1	—	4.1
May 2015	-1.9	-3.2	-0.8	3.9
Jun. 2015	0.6	1.8	1.5	4.0
Jul. 2015	-0.4	-0.8	-0.8	2.7
Aug. 2015	-0.7	0.6	0.3	2.1
Sep. 2015	1.4	-1.5	-0.4	2.1
Oct. 2015	2.1	-0.8	-1.9	0.2
Nov. 2015	*-2.5	*0.6	*0.4	*-0.5

Industry

	Indices of Production Integrated Circuits Year-on-year (%)	Crude Steel Production (thousand tons)	Indices of Tertiary Industry Activity (2010 = 100)
FY2011	-14.0	106,642	100.7
FY2012	-4.0	107,305	102.0
FY2013	7.1	111,524	103.2
FY2014	6.9	109,844	102.1
Mar. 2015	7.8	9,282	103.0
Apr. 2015	18.1	8,402	103.3
May 2015	10.6	8,918	102.8
Jun. 2015	16.6	8,535	103.2
Jul. 2015	5.7	8,841	103.2
Aug. 2015	-4.5	8,796	103.5
Sep. 2015	0.2	8,575	*103.1
Oct. 2015	-5.4	9,007	*104.0
Nov. 2015	*-6.4	*8,743	**

Monthly data for Indices of Tertiary Industry Activity is seasonally adjusted value.

Unemployment Rate and Active Job Openings-to-Applicants Ratio

	Unemployment Rate (%)	Active job openings-to-applicants ratio (times)
FY2011	4.5	0.68
FY2012	4.3	0.82
FY2013	3.9	0.97
FY2014	3.5	1.11
Mar. 2015	3.4	1.15
Apr. 2015	3.3	1.17
May 2015	3.3	1.19
Jun. 2015	3.4	1.19
Jul. 2015	3.3	1.21
Aug. 2015	3.4	1.23
Sep. 2015	3.4	1.24
Oct. 2015	3.1	1.24
Nov. 2015	3.3	1.25

Unemployment Rates from March to August 2011 are supplementary-estimated figures including those for three prefectures of Iwate, Miyagi and Fukushima.

Trade

	Trade and Customs Clearance		Import Price Indices Year-on-year (%)
	Export (billion yen)	Import (billion yen)	
FY2011	65,288.50	69,710.60	7.0
FY2012	63,940.00	72,097.80	1.7
FY2013	70,856.50	84,612.90	13.5
FY2014	74,670.30	83,814.60	0.2
Mar. 2015	6,926.80	6,704.20	-8.2
Apr. 2015	6,550.20	6,609.50	-9.8
May 2015	5,740.30	5,960.90	-8.9
Jun. 2015	6,505.70	6,580.10	-5.9
Jul. 2015	6,663.70	6,934.10	-7.3
Aug. 2015	5,881.80	6,453.30	-9.7
Sep. 2015	6,417.00	6,537.00	-15.5
Oct. 2015	6,542.50	6,437.70	-15.6
Nov. 2015	5,981.20	*6,362.50	-17.6

Finance

	Monetary Basis Year-on-year (%)	Total Outstanding Loans of Banks Year-on-year (%)	Domestically Licensed Bank Weighted Average Lending Rate Annual Rate (%)	Newly Issued Government Bond Yields (10 years) Annual Rate (%)
FY2011	14.9	0.0	1.477	0.985
FY2012	8.7	1.1	1.383	0.560
FY2013	44.0	2.3	1.280	0.640
FY2014	39.3	2.5	1.200	0.400
Mar. 2015	35.2	2.7	1.158	0.400
Apr. 2015	35.2	2.7	1.157	0.340
May 2015	35.6	2.6	1.153	0.390
Jun. 2015	34.2	2.5	1.141	0.455
Jul. 2015	32.8	2.6	1.137	0.410
Aug. 2015	33.3	2.8	1.135	0.380
Sep. 2015	35.1	2.7	1.125	0.350
Oct. 2015	32.5	2.5	1.125	0.300
Nov. 2015	32.5	2.3	1.121	0.300
Dec. 2015	29.5	*2.2	**	0.270

Total Outstanding Loans of Banks: Average of outstanding loans.
Newly Issued Government Bonds Yields (10 years): Figures as of end of the period. Announced by Japan Bond Trading.

Consumer Price Index

	Consumer Price Index (general, excluding fresh food)		
	All Japan (2010 = 100)	Month-on-month (%)	Year-on-year (%)
FY2011	99.8	—	0.0
FY2012	99.6	—	-0.2
FY2013	100.4	—	0.8
FY2014	103.2	—	2.8
Mar. 2015	103.0	0.4	2.2
Apr. 2015	103.3	0.3	0.3
May 2015	103.4	0.2	0.1
Jun. 2015	103.4	0.0	0.1
Jul. 2015	103.4	0.0	0.0
Aug. 2015	103.4	0.0	-0.1
Sep. 2015	103.4	0.0	-0.1
Oct. 2015	103.5	0.1	-0.1
Nov. 2015	103.4	0.0	0.1

Stock and Yen Exchange Rates

	Nikkei Stock Average (yen)	Yen Exchange Rates against the U.S. Dollar (yen)	Yen Exchange Rates against the Euro (yen)
FY2011	9,183.44	79.05	108.96
FY2012	9,612.07	82.89	106.73
FY2013	14,406.76	100.16	134.20
FY2014	16,253.25	109.75	138.69
Mar. 2015	19,197.57	120.39	130.47
Apr. 2015	19,767.92	119.55	128.92
May 2015	19,974.19	120.74	134.84
Jun. 2015	20,403.84	123.75	138.76
Jul. 2015	20,372.58	123.23	135.78
Aug. 2015	19,919.09	123.23	137.19
Sep. 2015	17,944.22	120.22	135.08
Oct. 2015	18,374.11	120.60	134.73
Nov. 2015	19,851.77	122.54	131.64
Dec. 2015	19,202.58	121.84	132.52

Nikkei Stock Average: Average for the period.
Yen Exchange Rates: Tokyo, interbank, spot trading, average for the period.