

Japan Real Estate Investment Update

2015 Asia Pacific Real Estate Conference
December 2015



Agenda

- Section I.** Abenomics
- Section II.** Japanese real estate market update
- Section III.** J-REIT update
- Section IV.** Japanese investment structures
- Section V.** Tax reform trends

Section I.

Abenomics

Abenomics



Economic stimulus package driven by Prime Minister Abe, originally consisting of 3 main elements

Monetary Easing

- Quantitative Easing continues - for 2015, BOJ has planned to increase its balance sheet by 15 percent of GDP.
- BOJ seeks to end deflation and reach target of 2% inflation by the end of 2015.
- Japan's US\$1.1 trillion government pension fund (GPIF) will increase its overall equity holdings from 24% to 50%.

Flexible Fiscal Policy

- For 2015, the Abe government has approved a stimulus package worth US\$29.1 billion.
- For 2016, a further stimulus package of US\$25 billion is considered.

Deregulation

- The combination of structural reforms as part of a comprehensive growth strategy that aims to boost investment, employment, and productivity

Impact:

- Nikkei 225 index has risen to around **20,000** – just a month before Abe won the LDP presidential election in 2012, the Nikkei had closed at **8,840** (November 2012).
- Yen has weakened from **80** to around **120** against the U.S. Dollar.

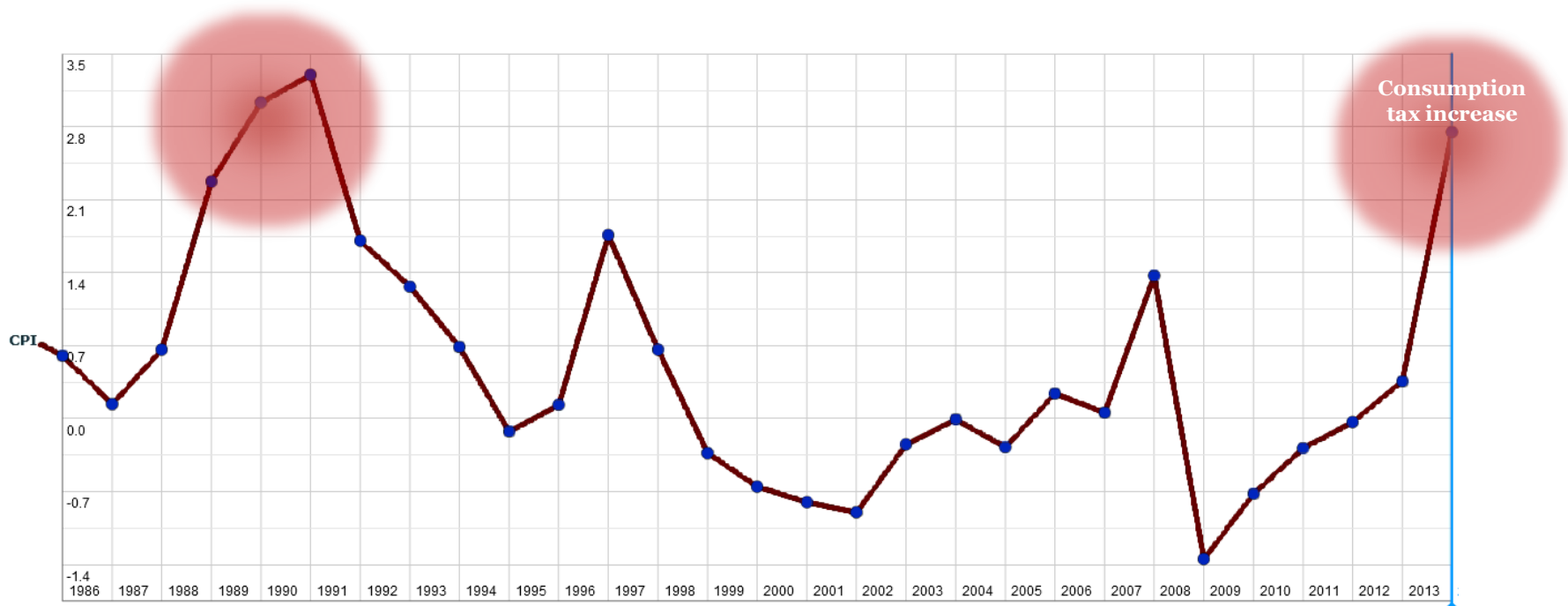


Abenomics

- In December 2012, Shinzo Abe became Prime Minister.
- The Japanese central bank (BOJ) committed to continue monetary easing until an inflation target of 2% (CPI) is achieved.
- Inflation exceeded 2% only three times in the last thirty years.
- Asset prices (stock market and real estate market) have started to rise but it is not expected that inflation will reach 2%.
- Banks are under pressure by the FSA to increase lending aggressively.
- People do not believe in higher CPI, and JGB interest rates continue to be low (less than 0.5% for 10 years).
- Global asset allocation to Japan continues to increase back to normal levels from underweight.

Abenomics

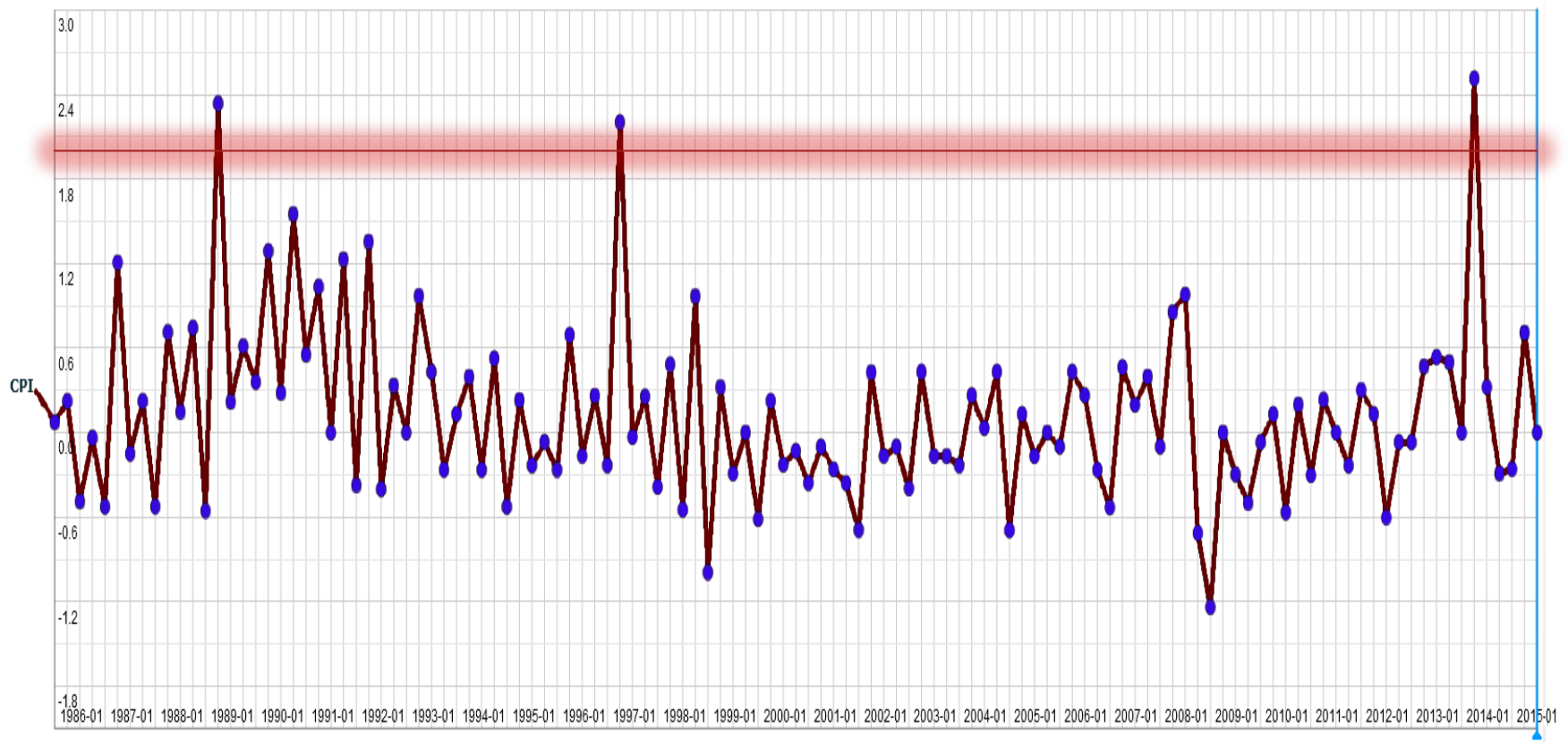
- CPI (all items; YoY): Inflation exceeded 2% only three times in the last thirty years



Source: OECD - https://stats.oecd.org/Index.aspx?DataSetCode=G20_PRICES#

Abenomics

- CPI (all items; QoQ): Inflation exceeded 2% only three times in the last thirty years



Source: OECD - https://stats.oecd.org/Index.aspx?DataSetCode=G2o_PRICES#

Section II.

Japanese real estate market update

Japanese real estate market update

1. Major Transactions in 2015 Q1-Q3

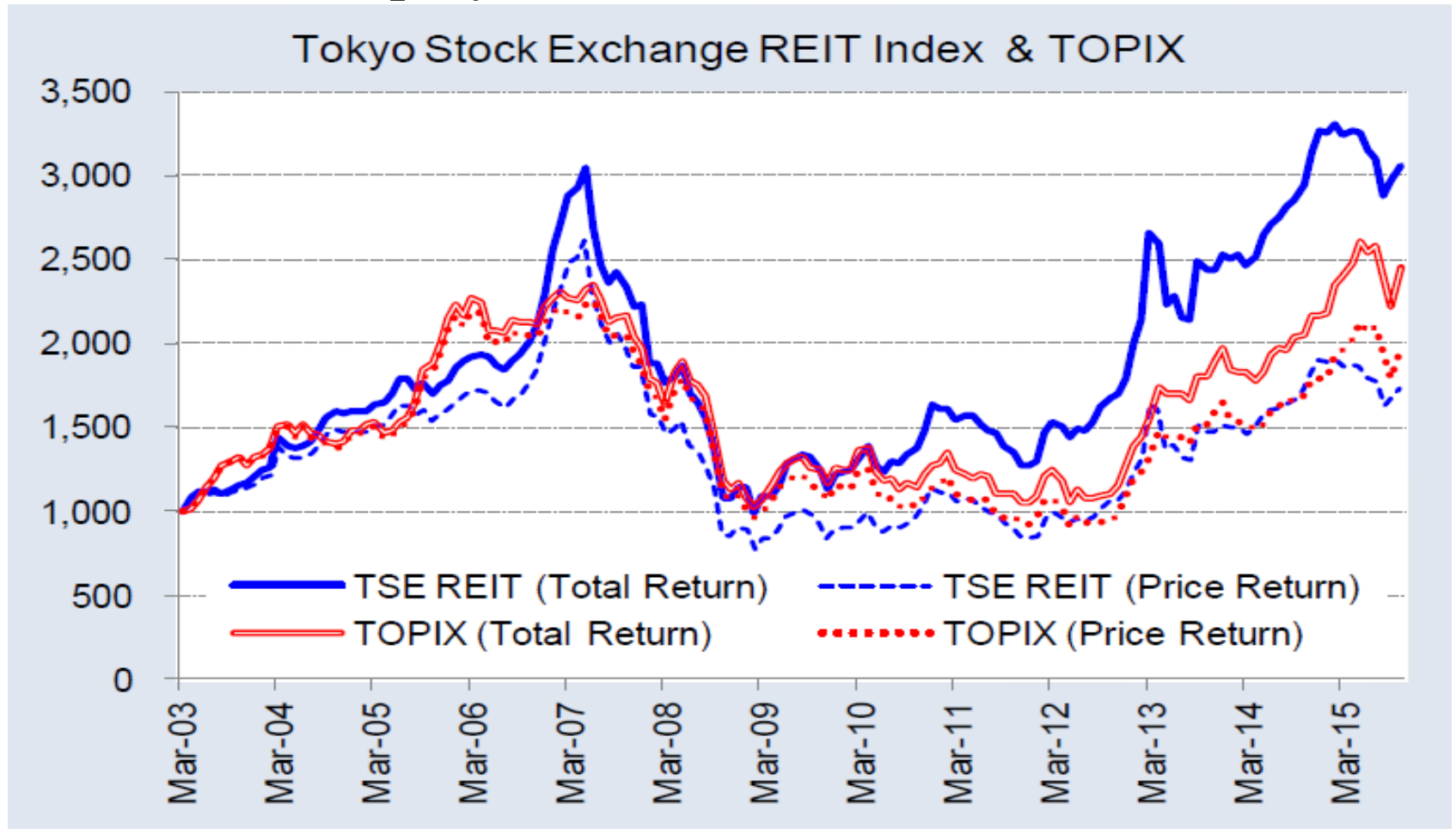
	<i>Month</i>	<i>Price (JPY bn)</i>	<i>Price* (USD m)</i>	<i>Property</i>	<i>Type</i>	<i>Location</i>	<i>Buyer</i>
1	01-2015	140	1,167	Meguro Gajoen	Office	Tokyo	CIC
2	07-2015	100	833	G-Terrace Kioicho etc. (26 properties)	Office	Tokyo etc.	PAG
3	02-2015	95	792	Tokyo Square Garden (46%)	Office	Tokyo	Tokyo Tatemono
4	01-2015	77	642	Shibakoen 3 chome Bldg etc. (31 properties)	Office	Tokyo etc.	NBF
5	05-2015	59	492	Portfolio of 50 apartment properties	Residential	Tokyo etc.	PAG
6	08-2015	52	433	Kirarito Ginza	Retail	Tokyo	SOFAZ
7	07-2015	50	417	MG Ikenohata Bldg etc. (24 properties)	Office	Tokyo etc.	Ichigo
8	04-2015	50	417	Rivergate (3 properties)	Office	Tokyo	Daiwa Office Investment
9	07-2015	49	408	G-Square Dogenzaka etc. (5 properties)	Office	Tokyo etc.	MCUBS MidCity
10	03-2015	48	400	D Project Kuki V etc. (6 properties)	Industrial	Saitama etc.	Daiwa House REIT
11	07-2015	47	392	Omiya Center etc. (11 properties)	Office	Saitama etc.	NBF
12	02-2015	46	383	Aoyama Bldg	Office	Tokyo	GreenOak
13	04-2015	44	367	Ichigo Jingu-mae Bldg (12 properties)	Office	Tokyo etc.	Ichigo REIT
14	10-2015	43	358	ANA Hotels etc. (6 properties)	Hotel	Hiroshima etc.	Hoshino Resorts REIT
15	09-2015	43	358	Logiport Sagamihara	Industrial	Kanagawa	Mitsubishi Estate
16	05-2015	41	342	Akasaka Garden City (70%)	Office	Tokyo	Sekisui House

* USD 1 = JPY 120

Source: Deutsche Asset & Wealth Management quarterly Japan Real Estate Research Reports

Japanese real estate market update

2. J-REIT vs. Equity index



Source: ARES J-REIT Report October 2015

Section III.

J-REIT update

J-REIT update

1. Overall market trends

One of the Abenomics policies, a large scaled monetary easing, has triggered rise of various asset prices including real estate.

- Trend of capital in-flow to the REIT market, especially through banks and investment trusts.
- TSE REIT index has marked around 30% appreciation in 2014, outperforming TOPIX. However, slightly declining in 2015.
- Rise of the asset prices and the low financing cost is heating up the acquisition race among the players.

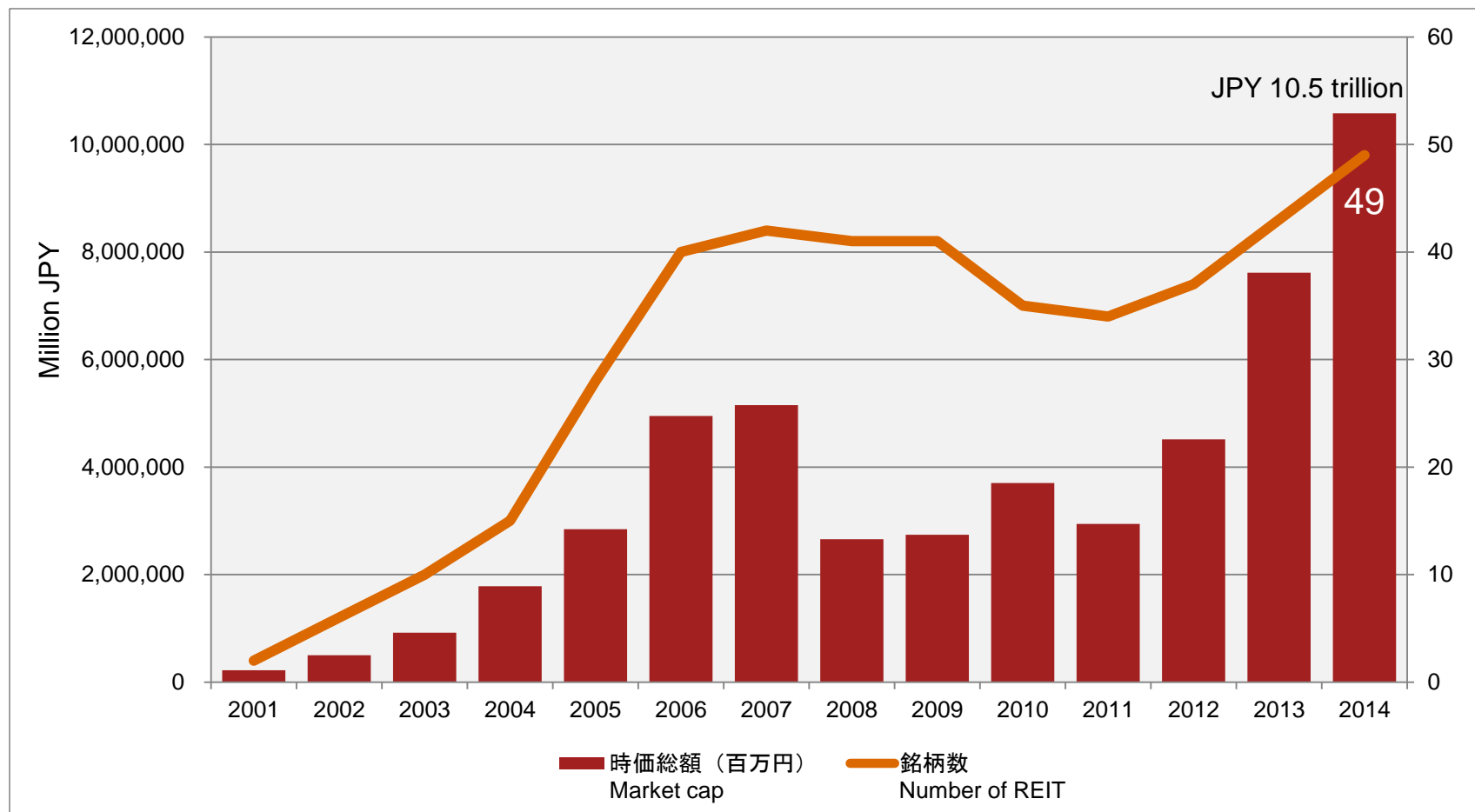
Good financing environment continuing in both equity and debt market.

- IPO and PO continue to increase from 2012.
- Debt financing cost is low and still declining.

Number and AUM of Private REIT, non listing but open-end, is increasing.

J-REIT update

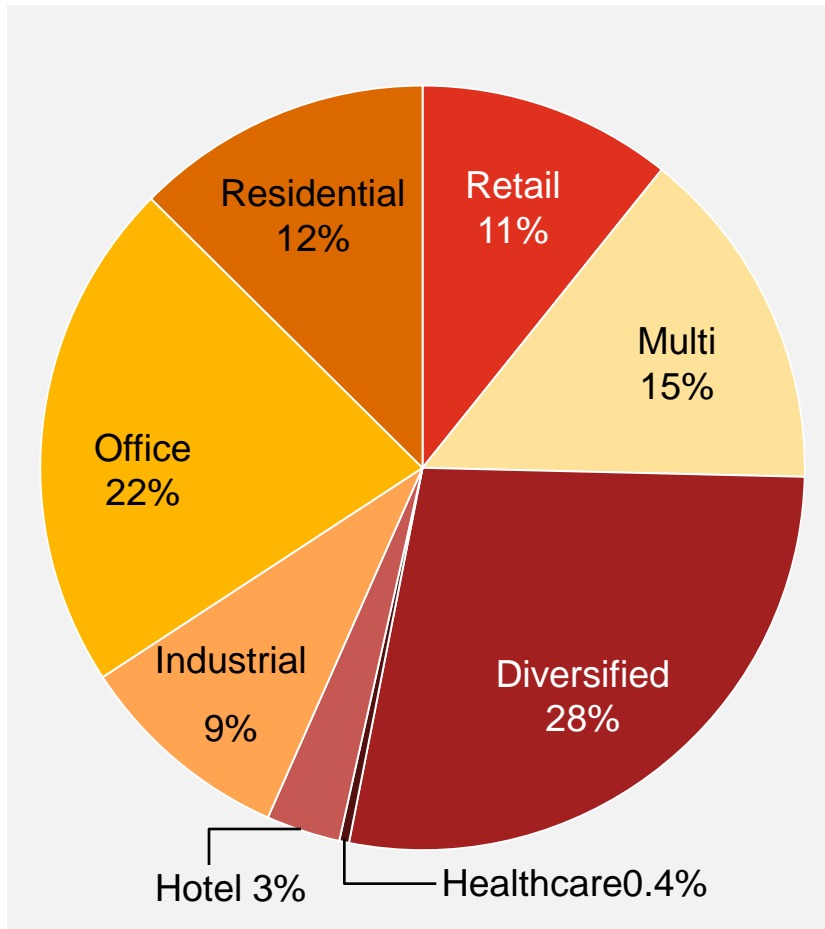
2. Market capitalization



source: j-reit.jp/download/J-REIT_Databook_20150630.xls

J-REIT update

3. Market cap percentage by asset type



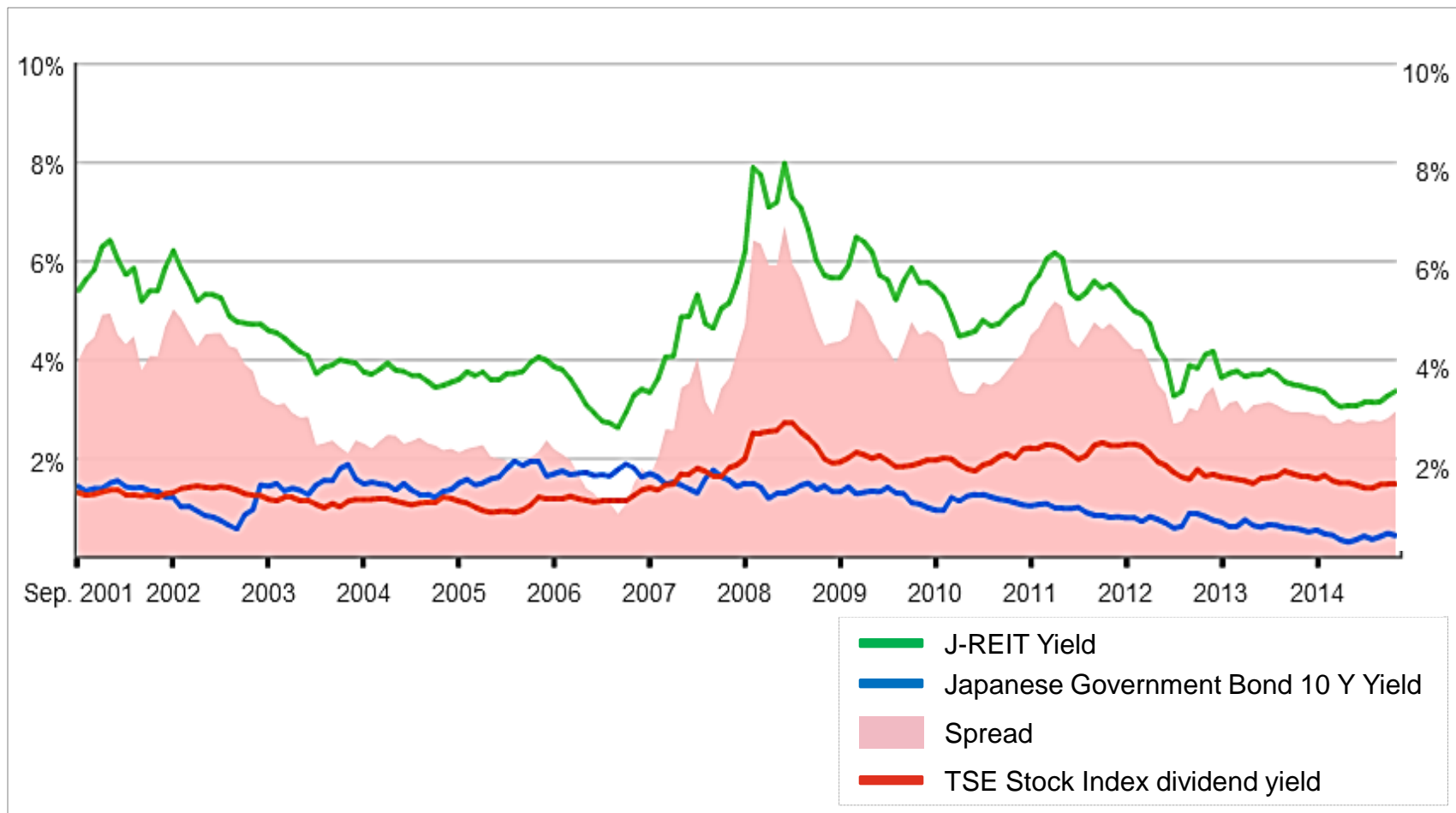
(as of Sep 2015)

Potential assets

- Guideline for Hospital as REIT Asset was released in June 2015
- Infrastructure Fund market, similar to J-REIT market, was developed and available since April 2015

J-REIT update

4. J-REIT Yield Spread



Source: ARES Home Page

J-REIT update

5. Regulatory Updates

The “Act on Investment Trusts and Investment Corporations” has been recently amended (effective from December 2014).

Following are the key rules that have been newly put in practice.

- Capital reduction in order to clear up loss carry forward
- Repurchase of shares
 - Previously repurchasing shares has been limited to certain occasions.
 - The amendment enabled J-REITs to repurchase its own shares when agreed with the investors through the articles of incorporation.
- Rights offering
 - While J-REIT’s financing option is limited compared to a business corporation, rules of “share acquisition right” has been newly introduced to enable REIT’s financing through rights offering.

J-REIT update

5. Regulatory Updates (cont'd)

- REIT 90% payout rule - dividend deductibility
- Need to minimize difference between accounting profit and tax profit
 - Assets generate accounting and tax difference are not suitable for REIT
- Introduction of those accounts able to change practice
 - Allowance for Temporary Difference Adjustments
 - Reserve for Temporary Difference Adjustments

J-REIT update

5. Regulatory Updates (cont'd)

- Investment to foreign real estate assets
 - Some countries forbid direct investment to its domestic properties. In such cases, a J-REIT may be able to make indirect investment on foreign properties through a foreign subsidiary (SPC) located in that country.
 - Previously, majority investment in corporate shares has been restricted in the “Act on Investment Trusts and Investment Corporations”, which was blocking the channel for a J-REIT to invest in foreign properties.
 - The amendment allows J-REITs to hold majority shares of an entity for the purpose of indirect foreign property investments, in case direct investment is restricted in that country.

J-REIT update

6. Inspection by Regulatory authority

Inspections completed for period from April 2014 - March 2015

Category	Apr 2014 - Mar 2015
Total number of inspection	277
Financial instruments	232
Type 1 Financial Instruments	86
Type 2 Financial Instruments	94
Investment Advisory and Agency Services	38
Investment Manager	14
REIT	1
Operators of Specially Permitted Businesses for Qualified Institutional Investor	24
Financial Instruments Intermediary Service Provider	16
Credit Rating Agencies	0
Self-Regulatory Organizations	0
Registered Financial Institutions	1
Others	3

- Among the 14 Investment managers and 1 REIT inspection completed for the period April 2014 – March 2015, 5 had issues regarding investor protection and other operational issues.
- 1 received an administrative punishment from the FSA.
- 2015 Plan for Investment managers
 - Effective due diligence and Monitoring
 - Appropriate Solicitation
 - Fiduciary duty
 - Related party transaction and conflict of interest

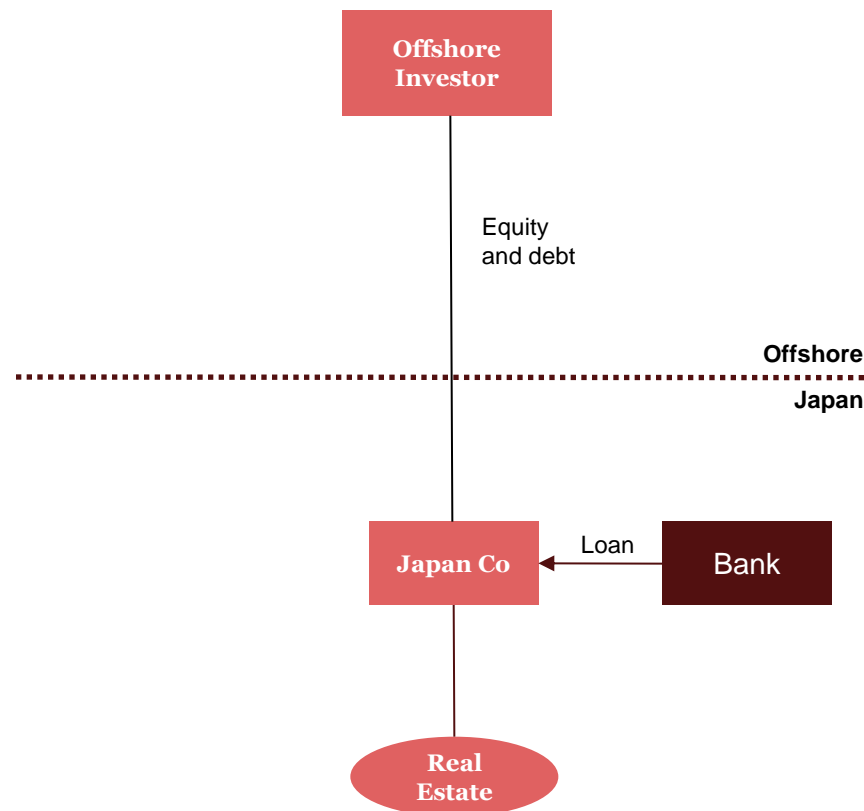
Section IV.

Japanese investment structures

Japanese Investment Structures

1. Base Case: Direct corporate ownership

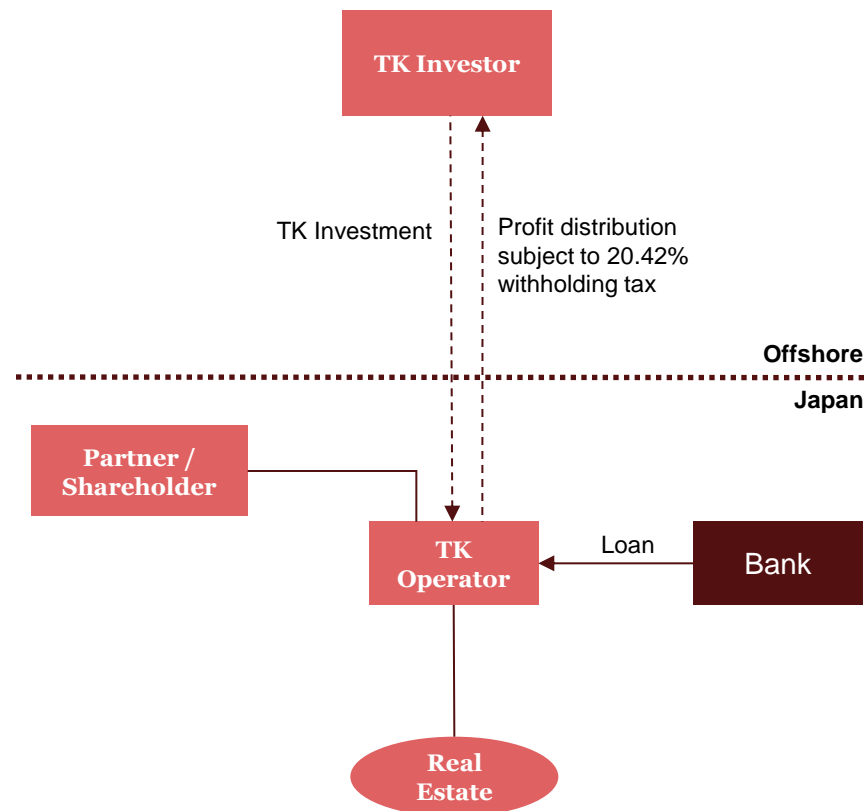
- The property is owned by a Japanese company, held directly from directly offshore.
- Easy to understand, easy to finance, easy to operate
- The tax rate is approximately 40% (a combination of Japanese corporate taxes and withholding taxes.)



Japanese Investment Structures

2. Tokumei kumiai (TK)

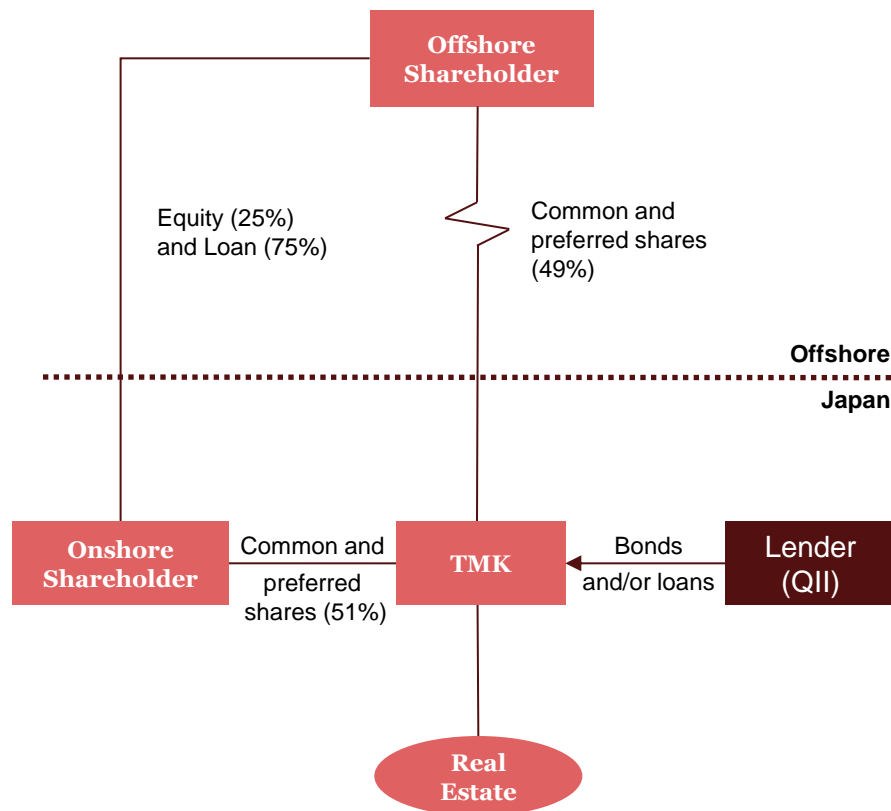
- A TK is a contractual relationship whereby an silent investor (TK Investor) invests into the business of a business operator (TK Operator) in exchange for a share of the profits and losses from that business.
- Generally, a TK Investor is taxed at 20.42% by way of withholding tax; no return is required.
- Issues include need for partner and various control issues.



Japanese Investment Structures

3. Tokutei mokuteki kaisha (TMK)

- A TMK is a taxable entity, but receives a dividends paid deduction.
- TMK provides a stable platform for real estate investment.
- TMKs are relatively complex, with some restrictions on financing, operations, cash repatriations and shareholdings.
- TMK shareholders can have control.



Section V.

Tax reform trends

Tax reforms trends

- Further decrease in effective tax rates
 - 23% + 10%; comparing to TK?; changing fiscal year to March end?
- Changes to tax treaties, introduction of LoB provisions
- Earnings stripping rules
- Limiting utilization of NOLs
- Consumption tax planning (10% from April 2017)
- Changes to the definition of small and medium sized companies
- Solar REITs (10 to 20 years)
- Deductibility of excess interest

Tax reforms trends

- Changes to the tax haven rule threshold (from 20% to 18%??; UK??)
- Changes to depreciation rules
 - Straight line method (abolishing declining balance method?)
- Treatment of Delaware LPs
- Wider definition of Representative PE under BEPS

Any questions ?



Appendix

Continue the conversation...
Presenter CVs

Presenter CVs



Hiroshi Takagi

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Hiroshi is a partner with PwC Tax Japan and leads the financial services and real estate tax practice. Hiroshi has extensive experience with both foreign investors investing into the Japanese real estate market and domestic real estate investors investing overseas.

He is a leading tax advisor to the REIT market, both public and private. Hiroshi advises clients throughout the life cycle of the real estate investment, from structuring, administration and compliance. His specialties include investments through *Tokumei Kumiai* (TK) and *Tokutei Mokuteki Kaisha* (TMK) structures.

Hiroshi graduated from the University of Tokyo and the University of Chicago graduate school of business. He is a Certified Public Accountant in Japan and the US, as well as a Licensed Tax Accountant in Japan.

Presenter CVs



Hideo Ohta

Japan Real Estate Assurance Leader

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Hideo is a partner with the Asset Management industry in PricewaterhouseCoopers Aarata, with more than 15 years experience in providing audit and consulting services to companies in the real estate and other financial services industries.

Hideo provides assurance services to a number of listed/unlisted Japanese real estate funds, infrastructure funds, private equity funds and other alternative products. In addition, Hideo is involved in accounting advisory services for them as well as internal control advisory.

Hideo is a member of the Investment Manager Committee and also the Valuation Committee of the Japan Institute of CPA. Hideo is a member of the IFRS working group of the "Association for Real Estate Securitization" in Japan and also of the PwC Real Estate Industry Accounting Group. He coauthored the book, "Accounting and Tax for real estate investment funds".



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