Japan Retail Fund Investment Corporation
February 2019 (34th) Period Analyst Meeting
Q&A Session Summary

Date: April 16, 2019

In the Analyst Meeting Q&A session, five participants put forward a total of ten questions. They have been grouped under the titles "Medium-term Strategy (Asset Replacement)" and "Others" based on the content of the questions.

Medium-term Strategy (Asset Replacement)

Q1.: JRF is pursuing the acquisition of Core assets as means to utilize the proceeds from sale of Sub assets. I understand that the Core assets category comprises Prime type properties and other types of properties (Major Station and Residential Station type properties). Is JRF planning to pursue the acquisition of the Prime type properties? Is there any difference in the difficulty level of acquisition between the Prime type properties and other type of properties (Major Station and Residential Station type properties)?

A1.: With regard to the asset replacement measures of about 100 billion yen, we will aim for an NOI yield after depreciation of 3.3% or more. Regarding the Prime type properties, the need to open stores by tenants is strong in urban areas and the rent growth for such properties is high. Therefore, we will acquire the Prime type properties if they have a high NOI yield after depreciation. In reality, the Prime type properties tend to be priced high with low yield levels. So, we will acquire properties in the Core asset category (Prime, Major Station, and Residential type properties) in a well-balanced manner so that we can achieve an overall NOI yield after depreciation of 3.3% or more.
Regarding the difficulty level of acquisition, we are experiencing increasing competition for property acquisition amid the favorable real estate transaction market. In fact, there have been cases in which information on deals is directly brought by owners of properties to JRF, because, for instance, in the operation of properties with multiple tenants, property management capabilities are required, so players that are able to acquire such properties are limited. When the market is buoyant, we see high-quality properties being put on sale, and of assets under consideration for acquisition, the largest number are properties of the Prime type. If properties are priced appropriately, we think the timing is right for acquiring excellent properties.

Q2.: In the course of shifting the focus of property portfolio to Core assets, JRF has recently been acquiring small-scale properties price-wise. Will you aim to acquire large-scale properties at advantageous prices as you have done before, or will you continue to acquire small-scale properties as in the case of your recent property acquisitions?

A2.: We have acquired two small-scale properties in a row as part of asset replacement measures. Meanwhile, the current pipeline list includes many Prime type properties in Core assets and also large-scale properties. When compared with suburban shopping center and mall type properties, urban type properties tend to be relatively small in scale.

However, urban type properties are not necessarily only limited to small-scale ones, so we are examining varying properties.

Q3.: JRF has announced that it will record gains on sale of properties for the two properties whose scheduled sale has been announced (8953 Osaka Shinsaibashi Building and AEON Sendai Nakayama) and a loss on sale of properties for one existing property which is scheduled for sale. Meanwhile, looking at recent property sale cases of other retail J-REITs, we occasionally come across cases where properties are sold at a price significantly below their appraisal value. While I understand that JRF has completed sale of properties that had risk of being sold at a price significantly below their appraisal value, please discuss whether JRF assumes any potential sale of properties at a price well below their appraisal value during the ongoing process of sale of properties for asset replacement.

A3.: JRF executed and completed the sale of non-Core assets with a high risk of about 100 billion yen over the past three years, and most of such assets were sold at a price above their appraisal value back then. None of the Sub assets of about 100 billion yen, which are subject to replacement under the new medium-term strategy, are experiencing a significant decline in profitability, and we are proceeding with sale of such properties proactively with an eye on our future strategy. Our basic stance is to sell properties at a price above appraisal value.

Q4.: Please share with us a specific time frame for asset replacement going forward. With sale of assets taking place at a faster pace than acquisition of assets in the course of asset replacement, I assume that your plan is to maintain the level of distribution per unit by transferring gain on sale of properties to reserve for dividends and reversing such reserve to cover a decrease in revenues during period. I understand that JRF has capacities to build up reserves by utilizing tax loss carried forward and the system of reserve for reduction entry of property. In the meantime, revenues will decrease when sale of Sub assets takes place at a faster pace than acquisition of Core assets. Please explain for how long you expect to maintain the level of distribution per unit by building up reserves and reversing such reserves.

A4.: We will execute asset replacement, with about 100 billion yen as the mid-term target, aiming for completion in three years at the latest. Sale of properties has been steadily executed with speed. Considering that there is no benefit to missing the timing for property sale, there is a possibility that asset replacement will be carried out according to a schedule with a time frame of less than three years depending on circumstances. In the meantime, selling Sub assets at too fast a pace without acquiring Core assets will result in a decrease in revenues during period. The scheduled sale of 8953 Osaka Shinsaibashi Building and AEON Sendai Nakayama, which has already been announced, will lead to a decrease in revenues during period of about 500 million yen/period (about 200 yen per unit). As of February 28, 2019 (the 34th fiscal period) the balance of reserves stood at about 5 billion yen, and based on a simplified calculation, we have enough reserve to cover a decrease in revenues during period for 10 fiscal periods extending over five years even if acquisition of Core assets lags behind sale of Sub assets. We are undertaking asset replacement with an ample amount of reserve secured. In the past, reserves were mostly used to cover a decline in revenues and temporary expenses associated with large-scale renovation projects for KAWASAKI Le FRONT and other commercial facilities. However, with the renovation of KAWASAKI Le FRONT, which will be our last large-scale renovation project for the time being, nearing its completion, we think we can allocate reserves to cover a decrease in revenues during the period resulting from sale of Sub assets going forward. Even if sale of Sub assets moves faster than acquisition of Core assets to some extent, we have enough reserves to cover a decrease in revenues. So, we will take a cautious stance on property acquisition without rushing to make decisions.

Q5.: I expect that a shift in portfolio mix to urban properties in the course of asset replacement tends to lead to a fall in NOI yield after depreciation. Meanwhile, JRF has set a benchmark target for NOI yield after depreciation of 3.3%, and with rent in major commercial areas on an upward trend as shown in p.13 of the analyst meeting material, are you going to acquire properties that have a rent gap even if their NOI after depreciation is slightly below 3.3%? Or, are you going to stick to the benchmark target? Please explain JRF's stance on property acquisition.

A5.: There is a possibility that we will acquire properties with an NOI yield after depreciation below 3.3% if they are located in excellent locations, such as prime areas in Ginza and Omotesando. Our aim is to achieve an overall NOI yield after depreciation of 3.3% or more after completing asset replacement measures of 100 billion yen. Accordingly, there is a possibility that we will acquire Major Station and Residential Station type properties with an NOI yield after depreciation of 3.3% or more and excellent Prime type properties with an NOI yield after depreciation of below 3.3%.

Others

Q6.: The acquisition of m-city Kashiwa is lagging behind the initially announced schedule. What is the reason for this?

A6.: The reason for the delay in the scheduled acquisition date is that part of due diligence in connection with the acquisition of m-city Kashiwa has not been finished. At this time, we have the completion of addressing matters requiring correction within sight, so I think that we can make an announcement on acquisition of m-city Kashiwa shortly.

Q7.: JRF described in p.11 of the analyst meeting material that it will "consider repurchase of own investment units if the P/NAV ratio stays at around 0.9 times intermittently." JRF executed repurchase of own investment units last time with P/NAV ratio at the same level but the price of investment units did not perform well subsequently in the stock market. JRF is currently executing asset replacement measures where sale of Sub assets is taking place ahead of acquisition of Core assets and appropriating funds for renovation of facilities and other purposes, and moreover the LTV ratio is a little high. Please share with us what kind of discussions are taking place in the company as to the effectiveness of repurchase of own investment units as the use of funds under these circumstances given the movement of the price of investment units after the previous repurchase of own investment units (which shows the stock market's evaluation of the repurchase) and the situation surrounding JRF.

A7.: Last time we implemented repurchase of own investment units of 10 billion yen at a point when the P/NAV ratio was 0.93 times. Looking at subsequent case examples at other investment corporations, there was feedback that JRF's repurchase of own investment units would have been more effective in boosting the price of investment units if it had been implemented at a point when the P/NAV ratio was lower than that level. Therefore, the P/NAV ratio of around 0.9 times was provided in the analyst meeting material as one measure of timing for implementing repurchase of own investment units. When we think about what will be the best use of proceeds from sale of properties with a high NOI yield after depreciation, such as AEON Sendai Nakayama whose scheduled sale has been announced, from the viewpoint of boosting the unitholder value, we think that, in addition to acquiring Core assets, we should continue to examine repurchase of own investment units as an option depending on the price of investment units.

Q8.: I would like to know whether JRF has considered investing in logistics facilities. JRF is actively implementing asset replacement measures and facility renovation, etc. Meanwhile, if the situation requires JRF to focus on defensive investment amid the challenging business environment for retail facilities, I think it's a possible option to reexamine investment targets. Please share with us if you are considering investing in new fields, not limited to the logistics field.

A8.: We are not considering investing in logistics facilities at this point in time. JRF's approach to investment is to invest in "locations where people gather," such as Major Station type properties in urban areas. When we take an overview of real estate properties in Japan, considering the change in demographics and the expansion of inbound tourism, we expect that with the shift in population toward urban areas, properties for all purposes, not limited to commercial properties that are the center of consumption activities, but also office buildings, residential buildings, and hotels, will gather in the middle of urban areas centering around Tokyo and Osaka. Considering this, it is likely that properties located in commercial areas with hotels and offices in upper floors, rather than logistics facilities, will be our new investment target. In fact, two properties out of our 101 portfolio properties have become mixed use properties by inviting hotels in the middle to upper floors, which has led to a rent increase from some tenants. Therefore, there is a possibility that we will increase investment in such mixed use properties.

Another thing is, as I mentioned at the analyst meeting for the previous fiscal period, we think there will be a change in how commerce is run. For instance, the mainstream of lease contracts with tenants in the past was to conclude a relatively long-term contract of 5–8 years. We think it is feasible, for instance, to manage commercial buildings with tenants replaced at relatively short intervals based on short-term lease contracts of six months or so. In addition to consider the feasibility of realizing such investment projects, we are considering an investment approach to accommodate the change in how commerce is run.

Q9.: According to the earnings forecast in p.25 of the analyst meeting material, capital expenditures for the February 2020 (36th) fiscal period will be 5,729 million yen, which exceeds depreciation of 5,459 million yen by 270 million yen. What is the reason for the high level of capital expenditures even though the renovation project for KAWASAKI Le FRONT is in the final stage?

A9.: A large share of capital expenditures will be spent on expenses associated with renovation of KAWASAKI Le FRONT. Renovation work for the property will be carried out mainly in the August 2019 (35th) fiscal period, but expenses are recognized in the period upon completion of renovation work. That's why we forecast a large amount of capital expenditures to be recognized in the February 2020 (36th) fiscal period. Specifically, we forecast that capital expenditures will be 2,100 million yen for the August 2019 (35th) fiscal period and 2,800 million yen for the February 2020 (36th) fiscal period. We also plan to implement renovation and tenant replacement for GYRE and mozo wonder city, and we expect that expenses for these will also be recognized in the February 2020 (36th) fiscal period.

Q10.: We have recently seen an increasing number of cases where tenants of commercial facilities close their stores. For instance, GAP will close its flagship store in Harajuku. I see the risk of closing stores is rising. Looking at JRF's portfolio properties, some of the core tenants, such as VIVRE, SPORTS AUTHORITY, and Futaba Tosho, have closed their stores in mozo wonder city. Please discuss JRF's view on the risk of tenants' store closures.

A10.: The scheduled closure of the GAP store in Harajuku has become a topic of conversation in commercial circles. But I've heard on the grapevine that the property has found a succeeding tenant with good terms and conditions. Although JRF has had some closure of stores in its portfolio properties, we do not see that a spate of store closures or bankruptcies of department stores, home electronics stores, and sports shops, etc. is occurring in Japan as they did in the U.S. as a result of the advance of ecommerce companies. Apparel companies in Japan have been clearly divided into successful ones and unsuccessful ones, and we have seen unsuccessful ones reduce the number of stores. Meanwhile, JRF has stuck to the policy of acquiring properties located in prime locations without depending on tenants and replaces tenants which have started to show signs of slump with thriving tenants.

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the market or an amount of distributions declines, according to economic and interest rate circumstances, a balance of supply and demand for units, real estate market environment, fluctuations of prices of, and rent revenues from real estate properties under management, disasters, aggravation of financial status of JRF and other reasons. For details, please see "Investment Risk" in the Securities Registration Statement (offering circular) and the Securities Report of JRF.