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Main Q&As at the 33rd Fiscal Period Earnings Announcement of Daiwa Office Investment Corporation (DOI)

Date and Time: 15:30-16:10, July 22, 2022 (Friday)

Presenter: Yoshiki Nishigaki/President and Representative Director

Daiwa Real Estate Asset Management Co. Ltd.

*Questions are presented in sequential order.

Q1. With regard to the increase in electricity rates, explanation was to review the billing method and contract unit prices after gaining the understanding of tenants, and take steps to eliminate the so-called reverse spread. Could you elaborate on the possible time frame for taking a specific approach to addressing this issue?

(Answer)

Although we have finalized the details of our specific approach to addressing this issue, it will be difficult to achieve a certain result during the fiscal period ending November 30, 2022, and we expect that the results will become apparent only in May 2023 or later.

We intend to carefully respond to tenants so that they can understand the current situation of soaring energy prices by adopting a two-pronged approach: (1) raising the billing unit price of electricity rates, and (2) asking tenants to bear a certain amount of the increased burden in proportion to the unit price of electricity supplied by electric utility companies (the so-called pass-through method).

Q2. Regarding the trends in new leases/cancellations on page 12, the expected new leases ratio for the fiscal period ending May 31, 2023 is "2.2%," which seems to be a conservative forecast. Please walk us through your current responses to leasing in light of the current office market conditions, in relation to the details on page 41, "Analysis of Leasing Business - Improvement in Basic Strength."

(Answer)

With regard to leasing, while leasing of large sections continues to be sluggish, leasing activity is brisk and favorable for floors of around 100 tsubos, and we do not feel that fundamentals related to the office market have deteriorated significantly over the past six months. In fact, we even have a sense that

leasing is becoming more active in certain areas.

However, in terms of the office market as a whole, a certain number of vacancies are occurring in a reasonable number of properties, and we do not believe that we are at a point where we can add significant amount to unit rents. In terms of basic strengths, although it is expected that some time will be required for the market to recover to a positive level, the office market is not in a phase where the supply-demand balance will deteriorate significantly.

Q3. What is the background and tenant stickiness supporting the strong leasing of the Bakurocho 1-Chome Development Project, as provided on page 19, while other office buildings are struggling with leasing?

(Answer)

The property is a development project that began with the purchase of land. In addition to the fact that it is a newly constructed building, we believe the key to success was that the asset management company itself was involved in the planning and design, utilizing its expertise to facilitate leasing. The tenant, who had already signed a lease for seven floors, had been looking for a property in the vicinity for a while and this property exactly matched its need in terms of area size and usability, leading to a successful contract with a long-term tenant. In addition to the tenant in question, we feel that tenants in the vicinity of the property tend to circulate in the surrounding area.

Q4. The explanation earlier was that you are considering the pass-through method as one of the options to be proposed to tenants in the future to cope with the increase in electricity rates. As for the contract for electricity rates with the existing tenants, is the previous contract format adopted by DOI the norm, or is the pass-through format the standard?

(Answer)

In general for office buildings, as with the current contract format adopted by DOI, electricity is charged to tenants at a fixed price, and fluctuations in the electricity supply from electric utility companies are often borne by the owner. Nowadays, however, we hear that an increasing number of owners are adopting the pass-through method.

Q5. The projected occupancy rate as of the end of the fiscal period ending November 2022 was "97.1%" in the previous earnings announcement, which is the same as in the current earnings announcement, while that rate excluding development projects was "98.1%" according to the note. What is the expected occupancy rate excluding development projects as with the previous period?

(Answer)

The number of cancellations increased compared to the previous forecast due to cancellations at Daiwa Tsukishima Building and other large sections. When excluding development projects as with the previous forecast, the expected occupancy rate would be "97.3%."

Q6. The explanation was that you will consider various measures to increase the ongoing EPS over the medium to long term. Do you plan to prioritize the acquisition of existing properties that are already in operation over development projects?

(Answer)

We intend to pursue all possible measures to raise the ongoing EPS over the medium to long term, despite the harsh office market environment. It would be best if we could acquire operating properties with potential to provide good returns in the future at affordable prices. We are currently working on two development projects, the Bakurocho 1-Chome Development Project and the Kandasudacho 2-Chome Development Project. Our main focus moving forward will not be to start new development projects one after another, but rather to acquire operating properties.

Q7. The electricity rates resulted in a reverse spread, but does this mean that DOI did not adopt a general form of contract with regard to supply contracts with electric utility companies?

(Answer)

In general, a contract is concluded with local electric utility companies in the area where the property is located to receive electricity supply. However, as part of a management effort, DOI had been regularly bidding for electric utility companies and receiving supply from the company with the best terms. Currently, we conclude contracts for electricity supply with three electric utility companies, but one of them (a major regional electric utility company) has notified us in March 2022 that it will be difficult for that company to supply electricity in the future due to the recent tight electric power supply and demand situation. We have been making efforts to curb electricity costs by reviewing electric power supply contracts on a case-by-case basis, based on proposals from multiple electric utility companies. However, because of the unexpectedly tight electric power demand these days, we could not avoid the increase in electricity costs resulting from the switch to a contract format known as a last resort service agreement.

Q8. At the time of the previous earnings announcement six months ago, there was an explanation that there was a rent gap of about 0-5%. Do you sense any changes in the current level?

(Answer)

Although there are some cases where contracts have been signed at rents above the market level, overall, we recognize that the current rent gap is almost negligible.

Q9. In terms of distribution forecasts going forward, is the 13,600 yen level the lower limit of distribution? Is there a possibility that you will further revise the distribution level downward in the future, given the continuously severe office market environment?

(Answer)

Although the outlook for the office market environment remains severe, we have set 13,600 yen as the lower limit for distribution. We will continue to manage our properties with the recognition that this is a target that must be achieved.

Q10. It will be difficult to raise rents, assuming that the current rent gap is at a negligible level while the office market continues to decline. In that case, how will the 13,600 yen level of distribution be secured in the future?

(Answer)

We have mentioned that we will continue to focus on leasing with an emphasis on occupancy rates amid the severe office market environment. However, we have set the distribution level at 13,600 yen based on a conservative budget, assuming a fairly severe scenario in light of future property replacements and contract renewals with tenants.