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Main Q&As at the 34th Fiscal Period Earnings Announcement of Daiwa Office Investment Corporation (DOI)

Date and Time: 17:00-17:35, January 23, 2023 (Monday)

Presenter: Yoshiaki Nishigaki, President and Representative Director

Daiwa Real Estate Asset Management Co. Ltd.

*Questions are presented in sequential order.

Q1. Could you please tell us about any recent changes in the transaction market?

(Answer)

In the transaction market, transactions with low cap rates continue to be seen, and it has not changed much at present.

It seems that there has been some changes in transaction market participants. It appears that some overseas investors from the U.S. who had been carrying out property transactions in very large amounts are refraining from transactions. Meanwhile, some investors are eager to acquire properties that are filling the absence of such investors, and it is our understanding that the cap rates for office buildings in central Tokyo have not changed as a result.

Q2. What is your outlook for unit rents going forward?

(Answer)

When looking at the market as a whole, particularly the central Tokyo market, while there are comparatively active areas such as Shibuya, other areas still have some differences in demand trends depending on the size of the advertised sections rather than the area.

Although demand has weakened somewhat for large properties, we have the impression that small and medium-sized floor spaces continue to move actively. Based on such overall demand trends, we do not think rents will undergo significant adjustments under current conditions.

In the case of DOI, although it depends on individual property characteristics, we would like to prioritize occupancy, especially in cases of advertised sections with a large area. If such trends spill over into the market, the rent adjustment phase may continue a little longer.

Q3. What is your future outlook for debt cost?

(Answer)

Our market outlook is that it has already incorporated long-term interest rates rising to around the range of 0.7% to 0.8%. Although long-term interest rates have risen, we think future rises in the short-term interest rate market will be limited.

The rise in short-term interest rates was taken into account in the earnings forecast made at the time of the thirty-fourth fiscal period earnings announcement. Even if short-term interest rates rise several basis points, the impact on DOI's dividends per unit is expected to be around 10 yen.

At present, we do not expect the long-term interest rates to significantly exceed 1%. If conditions do lead to exceeding 1%, we will perceive this to be an overall inflation scenario, revise not only our financial strategy but also the scenario of the investment corporation itself, and flexibly consider operation methods.

Q4. What is the status of leasing and outlook for the “Properties Subject to Leasing Improvement in the 35th Fiscal Period” mentioned on page 20 of the earnings announcement materials?

(Answer)

We expect that occupancy of the two properties on the top of page 20 of the earnings announcement materials (Shinjuku Maynds Tower, Daiwa Kanda Mikuracho) will recover without the need to lower rent that much. Specifically, we are leasing Shinjuku Maynds Tower by dividing it into groups depending on the floor. Rents are staggered by around 30,000 yen on high-level floors, mid-level floors and low-level floors, and this has not changed significantly from the past. Shinjuku Maynds Tower accounts for a relatively large percentage of area in DOI's portfolio, and although there is also around 1,000 tsubos of vacant space, we are not particularly concerned because it will be able to pick up demand seeping from Shibuya due to the characteristics of the property. Daiwa Kanda Mikuracho is a small property, so we do not believe we will have much difficulty leasing it out.

Meanwhile, we may have relative difficulty with the three properties at the bottom (Daiwa Shibaura, Daiwa Azabu Terrace and Daiwa Tsukishima) because they are located at a certain distance from the stations and have comparatively large areas per floor. We will flexibly adjust leasing terms such as rents and anticipate prioritizing occupancy.

Q5. What property acquisitions do you anticipate in the future?

(Answer)

As has been the case in the past, we have properties for which we can consult with sellers, and believe that there are opportunities to make acquisitions if economic conditions such as pricing match.

We will consider using surplus funds such as the gain on sale of Daiwa SHIBUYA EDGE transferred in the fiscal period ending May 2023 for measures such as property acquisitions, repayment of loans and buy-back of own investment units.

Q6. Will you actively conduct buy-back of own investment units?

(Answer)

Our stance remains unchanged. We will consider measures according to the times with consideration for the macro environment such as inflation.

Q7. With regard to Daiwa SHIBUYA EDGE transferred in the fiscal period ending May 2023, what was the reason for transferring a property with stable revenue in the Shibuya area where there is robust demand?

(Answer)

There are two main reasons. The first is that we wanted to make up for the deterioration in utilities income and expenditure and supplement dividends by recording gain on sale of the property as utilities expenses continue to rise. The second is that Daiwa SHIBUYA EDGE is a property with relatively low NOI yield within our portfolio, and we believe that transferring this property with an even lower yield (NOI yield based on transfer price) to actualize gain on sale was a very meaningful option under these conditions.

Q8. What is the status of the pipeline following Daiwa Nihonbashi Bakurocho, which was the first development project under the REIT, and Kandasudacho 2-Chome Development Project, which was the second?

(Answer)

As a basic policy on property acquisition, we believe it is desirable to acquire properties already expected to generate a certain amount of revenue. However, due to being able to secure property yields by taking certain development risks amid a continually difficult acquisition environment, we started on development projects under the REIT. Therefore, although we will continue to aim to acquire income properties, if this is difficult to achieve, then the next priority will be considering development properties. At present, we have received information on a variety of properties, but we are not specifically considering any.

Q9. What is the sense of yield when acquiring development projects in the future? The estimated NOI yield of Daiwa Nihonbashi Bakurocho under normal conditions is 4.2% and that of Kandasudacho 2-Chome Development Site under normal conditions is 4.0%, so it appears that you have secured relatively high yields. Is there a possibility that the yields will be lower if you newly acquire development projects under conditions in which construction costs, etc. are expected to rise?

(Answer)

As we mentioned in the answer to Q1, we basically believe that the yield of development projects will be the same or decrease in the future because the conditions in which cap rates do not change or decline remain unchanged. When considering acquisitions, we will make decisions based on such yield considerations.

Q10. What is the status of inquiries for the two vacant spaces in Daiwa Nihonbashi Bakurocho? Can you expect an upside in rent?

(Answer)

At present, we have received inquiries for both spaces. We are proceeding with leasing at the same level of rent as initially anticipated.

Q11. Why were you able to obtain a significant gain on sale of Daiwa SHIBUYA EDGE?

(Answer)

The financial environment is gradually changing, but we have a greater impression that the state of excessive liquidity has not changed. We think the greatest reason was that there continue to be strong needs to buy stable income properties in central Tokyo for a reasonable price.

Q12. You expect to record gain on sale of Daiwa SHIBUYA EDGE in the fiscal period ending May 2023, but are you considering divestment of any properties in the fiscal period ending November 2023?

(Answer)

We are not actively considering any divestments at present, but we will consider any offers with good terms.

Q13. You explained that Shinjuku Maynds Tower is a property that can pick up needs in the Shibuya area, but have there been any changes in tenant attributes such as an increase in IT companies?

(Answer)

The main tenant composition of Shinjuku Maynds Tower has not changed significantly, but for the new spaces we are currently offering, we have the impression that demand is seeping from the Shibuya area due to the recent drop in vacancy rates in Shibuya and the fact that there are few vacancies in nearby large properties in close proximity to the station. For that reason, we think the percentage of IT companies among our tenants may increase slightly in the future.