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Main Q&A at the 28th Fiscal Period Earnings Announcement

Date and Time: 15:30-16:30, January 22, 2020 (Wednesday)

Presenter: Toshio Fukushima/ President and Representative Director

Daiwa Real Estate Asset Management Co. Ltd.

*Questions are presented in sequential order.

Q1. The AUM has not expanded since 2017. What is the outlook for the AUM going forward?

(Answer)

As the cap rate in the real estate market has been extremely low, only a limited number of properties can be seriously examined for acquisition. Even amidst such, we intend to acquire small but hard-to-find properties like Daiwa Nakano-Sakaue. That said, however, it is difficult to foresee the future since the situation does not allow us to say with confidence that we can expect to acquire a building with a value of 10 billion yen or more.

Q2. Are there any new measures for external growth, such as having a new sponsor possessing a property pipeline?

(Answer)

The asset management company has not discussed having a new sponsor. Although various measures have been discussed, there are currently no feasible ideas. However, since there are some properties in the portfolio that can be used for asset swap, we would like to utilize them in the future.

Q3. Will there be any changes to the areas of focus for investment under the current difficult acquisition environment?

(Answer)

We will stick to the current policy and not widen the investment area without justification. We will purchase properties not only in the five central wards of Tokyo but also in regional major cities (Sapporo, Fukuoka, etc.) if they suit our investment criteria.

Q4. Will 2020 see the impact of the increase in office building supply?

(Answer)

The performance forecast has taken the finalized cancellations into consideration, but the ratio of move-outs is expected to be very low. We currently see no negative impact of an increase in secondary vacancies in the market on the Investment Corporation's portfolio for the 29th and 30th fiscal periods. In the case of likely move-out by a tenant, we will try to grasp the schedule at an early stage to shorten the downtime and increase rent.

Q5. Does the large rent increase achieved through tenant replacement shown on pages 18 and 19 of the presentation material indicate that you just closed the gap with market rent, or you successfully negotiated to increase rent beyond market rent?

(Answer)

Basically it should be considered a reduction of the rent gap. However, with smaller leasable floors, there are some cases in which we look for tenants at higher-than-market rent and the tenant accepts it, whereas the rent gap still seems to be widening in Shinjuku and Shibuya area.

Q6. What is the outlook for internal growth from tenant replacements and contract renewals?

(Answer)

Since there are relatively few tenant replacements in the 29th fiscal period, rent increase attributable to tenant replacements is highly likely to decline from the previous fiscal period. On the other hand, almost 40 percent of all contract renewal cases have already achieved rent increase, and thus contract renewals are expected to contribute to internal growth more than tenant replacements in the 29th fiscal period.

Q7. In the case internal growth slows down, how will you compensate for DPU growth?

(Answer)

In principle, internal growth is the strongest driving force for DPU growth. External growth is uncertain and debt cost is unlikely to decline since we have already went through multiple negotiations with lenders for further cost reduction, so it seems to be difficult to expect too much profit increase through them. Expenses relating to the leasing business are also pushed up by an increase in labor costs in building maintenance, etc. The area where we may be able to cut costs would be refurbishment costs, like repair cost or CAPEX. As we have implemented various refurbishment work ahead of schedule under a favorable business environment in recent years, we believe we can save costs by adjusting the amount of refurbishment work going forward.

Q8. In what situations does a tenant respond negatively to a request for rent increase?

(Answer)

If the vacancy rate rose across the market, aggressive negotiation for rent increase could be difficult. However, we own many Class A to Class B+ buildings, which are categories with relatively fewer new supply. Furthermore, the rent at these buildings is not so high, mostly in the 20,000 yen/tsubo mark, and the vacancy rate in the market with the price range has remained extremely low. For these reasons, we do not expect the vacancy rate to increase for the time being and believe rent will continue to be on an upward trend.

Q9. What percentage of contracts are fixed-term lease contracts?

(Answer)

Fixed-term lease contracts account for roughly 20 percent of all contracts.

Q10. Is there a possibility of other REITs under the asset management company jointly investing in multi-use large-scale buildings? Are there any bulk investment deals?

(Answer)

Joint investment is possible although nothing has materialized for now. Properties valued at several billion yen will be purchased by a single REIT according to the main use. However, large properties worth more than 10 billion yen could be purchased by multiple REITs with sectional ownership or co-ownership interest. We would like to address bulk investment involving various types of properties if we have a chance.