

## Minutes: 4th Forum for Building Up the Real Estate Investment Market that is Trusted by Investors

Date: February 10, 2009 (Tue) 15:00 ~ 17:00

Venue: Tokai Club (Kasumigaseki Bldg., 33F), "Bosei no Ma" (Room)

Attendees: [Member]

Shinsaku Iwahara (Chair), Yuichiro Kawaguchi (Acting Chair), Noriyoshi Ichikawa, Toshihiko Okino, Yasuki Kaibori, Masao Shibuya, Kohtaro Tamura, Hiroshi Danno, Daisuke Hamaguchi, Shohei Harada, Ryosuke Homma

[Observer]

Hideki Kono, Director, Listing Department, Tokyo Stock Exchange, Inc.

Absentees: [Member] Kumi Fujisawa

[Observer] Tokio Morita, Director, Securities Business Division, Supervisory Bureau, Financial Services Agency

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- Opening of the meeting
  - Greeting from Mr. Ozawa, Deputy Vice-Minister for Construction, Engineering, Real Estate Industry, Ministry of Land, Infrastructure, Transport and Tourism

<From this point onwards, the Chair led the meeting>

- Explanation from the Chair regarding the purpose of holding this forum
- Mr. Harada, the chair of the Working Group, remarks on the ad interim report on discussion results by the Working Group.
- Explanation on the "Ad Interim Report on Discussion Results by the Working Group," with the use of materials (from Mr. Takuya Ishikawa, Director, Real Estate Investment Market Office, Real Estate Industry Division, Policy Bureau, Ministry of Land, Infrastructure, Transport and Tourism)
- Free discussion

<Mr. Shibuya, Member>

- We can highly evaluate the fact that specific developments of the system were made to facilitate mergers and reorganizations of J-REITs. However, it takes some time to be able to master using such systems and I fear that it is possible that the system will not immediately start functioning effectively with the present phase of the market that is accompanied by severe fluctuations. Therefore, taking into consideration the current environment, short-term measures and mid- to long-term measures should be implemented in a balanced manner.
- Diligent efforts should be taken to improve the governance as needed. However, as for the extent, we should also consider the perspective of investors while comparing with other nations. Some overseas sources think that the level of information disclosure conducted by J-REITs is high. Although efforts have been made overseas, there are both pros and cons for each of them. Therefore, rather than simply thinking of “how things should be,” market participants should try to improve flexibly in accordance with the situation.
- The most pressing short-term issue for J-REITs is financing. There is a need for practical measures to be taken as soon as possible. One may say that with the conditions surrounding the current market, the sustainability of all J-REITs is under question. So in order to be evaluated as a sound market, the key is to carry out measures to evade the sudden event of not being able to maintain stability. Emergency measures are being taken, such as assistance through public financing or with the Bank of Japan’s (hereafter, “BOJ”) acceptance of investment corporation bonds as eligible collateral. However, some market participants say that further measures need to be taken.

<Mr. Okino, Member>

- It is good to hear that the systemic reform of J-REITs is progressing as was just explained. However, an urgent issue for the real estate investment market currently is financing.
- On the other hand, we also need to face the fact that liquidity in the real estate investment market is extremely low. J-REITs and private funds not only have to rollover their loans, but also have to repay loans through the sale of real estate. Currently, however, the real estate investment market is hardly functioning as it should. As you all know, real estate prices are currently undergoing an adjustment phase, but it can hardly be said that the adjustment is backed by a sufficient volume of transactions. Appraisal values announced by J-REITs are dropping

sharply, but there is no evidence pointing to a large drop in cash flow, meaning that it is caused by rising cap rates. I think that the greatest reason for the rising cap rates is the increasing liquidity premiums because of tight debt finance, among other reasons. However, this kind of price adjustment can hardly be called sound, since prices are continuing to fall as cap rates rise due to liquidity risk hovering at high levels, despite there being no great changes in cash flow and without enough transactions in the real estate investment market. As past examples indicate, I fear that if this kind of situation continues, it may lead to the accumulation of non-performing loans by financial institutions.

- The adjustment of real estate prices is itself unavoidable. Rather, the problem lies with the dwindling number of transactions as the real estate investment market ceases to function, and the significant decline of liquidity. Discouraging moral hazards is of course necessary, but meanwhile, I think that a measure to increase real estate liquidity also needs to be discussed. In Australia, the government and four major banks are in the process of originating a fund and so various measures need to be discussed, including the necessity of such a fund. I think that the protection of asset prices, the treasure of the entire nation, is a pressing issue.

<Mr. Kawaguchi, Acting Chair>

- If we analyze current J-REIT prices, we can see a high correlation between illiquidity indexes or exchange rates and indicators of yen carry trades that are comprised of interest-rate differentials. In other words, one reason behind J-REIT stagnation is that prices are moving regardless of fundamentals. Appraisal values tend to move in tandem with J-REIT prices, and so appraisal values are falling along with prices, leading to the decrease in prices of actual property in the real estate market.
- Due to the recent registration of losses by corporations and the economic outlooks announced by the BOJ, a pessimistic mood permeates the private sector in regards to the Japanese economy. Stock prices are also falling at a higher rate than in the U.S. Therefore it is extremely important to think from the perspective of protecting Japan's assets. While there are corporations that can obtain financing despite having registered losses, there are J-REITs that have posted profits but cannot obtain refinancing. I would say that this is an abnormal situation. Equity REITs are structures in which it is difficult for bankruptcies to occur, and so I think that the topics recently discussed by the Working Group will contribute to this protection of assets.

- We need to think about how we can recover the original product characteristics of J-REITs as defensive instruments. If the obstacle is something other than the positive cash flow of J-REITs, then for example, conducting mergers with J-REITs that are currently going through civil rehabilitation proceedings might lead to the recovery of market trust. This may then lead to an increase in the product being used as a defensive instrument. If governance improves as a result of the mergers, then it seems that this would change the views of rating agencies and equity investors towards J-REIT.

<Mr. Tamura, Member>

- Generally, even if an investment corporation starts filing for civil rehabilitation, it would not affect the continuation of business. Not only that, the executive officers would not change, nor would consignment contracts be cancelled with the asset manager. Unitholders may have the view that a merger is better than expiry and thus a special resolution necessary for a merger is possible. However, since the approval of creditors is necessary, should civil rehabilitation proceedings take place, conflicts might occur, surrounding claim protection from the creditors' standpoint. Therefore, carrying out this idea may not be that easy.
- Short-term measures need to be taken into consideration separately from medium- to long-term measures. There may be a little more time left until repayment dates of investment corporation bonds start arriving, but on the other hand, many refinancing deadlines are starting to arrive. If this latter matter ends in failure, then there is the possibility of a second round of civil rehabilitations occurring. Should this happen, the J-REIT market might severely be affected. For example, from a governance perspective, I would think that this kind of crisis calls for a drastic response. For example, this would include making preferred equity investments to supply the funds necessary for refinancing as well as funds and public sector financial institutions providing capital, while taking measures to discourage moral hazard.
- Careful discussions need to be conducted regarding governance. In the case of internally-managed REITs, this involves the issue of partnerships with sponsors, which creates a problem when trying to smoothly dispose of properties.

<Mr. Kaibori, Member>

- It is important for the Working Group to summarize and transmit information to those involved in land appraisal and to corporate auditors, not about assets that

produce gain through sales. Rather they need to disseminate orderly information regarding assets that produce a stable cash flow and produce profits through management, based on the perspective of business corporations in terms of the desirable book values or market values of such assets. There are some who suggest that the BOJ's reports should differentiate between owned real estate and real estate for development in terms of risk, management and evaluation methods.

- J-REITs, which originally are meant to purchase and own assets, are now having to sell assets in order to produce cash flow due to severe financial circumstances. Furthermore, it is paradoxical that despite their producing positive cash flow in terms of economic activities, they are being forced to sell.
- In order to stabilize the real estate market under such a financial environment, one major strategy is to first of all create an environment so that J-REITs who are ownership-oriented start purchasing, and by doing so to ensure market liquidity.
- We need to transmit information in an easy-to-understand manner about logical appraisal methods that are based not on derivations of cap rates calculated back from bid and ask prices, but based on derivations of cap rates by organizing the relationship between economic indicators and cash flows.

<Mr. Harada, Member>

- From an accounting audit perspective, the decrease of appraisal value leads to impairment loss. Traditionally, impairment loss was accounted for as loss under accounting standards, but was excluded from expenses under standards for tax practice. This created concern that the decrease would violate conduit requirements. However, countermeasures were taken regarding this point and my understanding is that such a situation will be evaded. However, despite such measures, taxation on said losses cannot be avoided, which means that profit distributions would be decreased.
- There are times when J-REITs finalize agreements beforehand when acquiring property, such as 6 months or 1 year before construction is completed. This creates the situation where it is possible for cancellation fees to arise if the corporation cannot acquire the property due to financing problems or for the property to record unrealized losses even if the corporation is able to make the acquisition. In terms of accounting audit, such situations would create problems in relation to the corporation's premise of a going concern. Furthermore, once a loss occurs, since J-REITs cannot decrease capital, they are faced with the problem of not being able to pay dividends unless they cover the losses using profit from the next period

onwards.

<Mr. Kaibori, Member>

- The Crises Response Operations of the Japan Finance Corporation is a system for lending to good-standing corporations through financial institutions designated by the Japan Finance Corporation (Development Bank of Japan Inc. (hereafter, “DBJ”) and Shoko Chukin Bank). Said operations are basically not a credit enhancement measure conducted by the government, but rather a system for individual financial institutions to control the risk of distressed debt, etc. using their own capital. The second supplementary budget for fiscal 2008 includes the purchase of CP amounting to 2 trillion yen, out of which 1 trillion yen is for business corporations. The government plans to further expand the 1 trillion yen limit for business corporations in the budget for fiscal 2009.
- What I would like J-REITs to understand is that simply because other banks are not lending to them does not mean that the DBJ will automatically lend to them. The DBJ lends to corporations only after having reviewed the conditions of each corporation. I sometimes hear the rumor that they do not lend to J-REITs, but that is not true. Same as other financial institutions, corporations need to negotiate with the financial institution in the normal way and they should not think that they can withdraw cash just like they can at an ATM machine. In order for J-REITs to obtain a loan, I believe that they need to conduct appropriate IR activities towards banks, including the DBJ.

<Mr. Kawaguchi, Acting Chair>

- Regarding lending towards J-REITs, there have been cases when despite their cash flow being evaluated as stable from local representatives, the board of directors, etc. who did not deal directly with the business people made the final decision not to lend. The decision-making mechanism of these types of financial institutions creates a problem. Some recent research has shown that 25% of corporate value decreased as a result of illiquidity, and financial institutions may have these kinds of things in mind. However, liquidity risk does not continue for more than a few years. If that is the case, then it seems that the problem probably lies with the way financial institutions view liquidity risk. This point needs to be discussed.
- There are only two measures for addressing a combined recession. They are the expansion of effective demand and the recovery of credit. In the U.S., there are explicit messages being conveyed, such as the announcement of the purchase of

distressed debt, etc. However, in Japan, that type of message cannot be heard. I would like to ask financial institutions to hold extensive debates regarding this point. Non-performing companies of course must be eliminated, but it is unfortunate for the Japanese economy if corporations that were supposed to have continued business fall into bankruptcies due to irrational external factors.

<Mr. Danno, Member>

- Private financial institutions cannot easily accept requests for refinancing due to considerations of future risk or policies on asset reduction caused by stock price decreases, etc. It is important for J-REITs to go through the process of being reviewed and obtaining loan eligibility from the DBJ and Shoko Chukin in the same manner as with private financial institutions. However, based on the current situation which calls for an urgent response, I would strongly request that these institutions take effective measures to determine the soundness of REITs, etc. and that they actually extend loans to them.
- I would like to thank the authorities for their quick response by improving the market system in order to facilitate the reorganization of J-REITs. The revisions of the formula used to determine whether conduit requirements are satisfied, signifies a great step forward. Furthermore, due to responses towards the practical aspects of mergers, such as the clarification of the cash delivered during a merger, I firmly believe that this will lead to activation of the J-REIT market. There were discussions about this being a medium- to long-term measure, but I think that even as a short-term measure, it will not only help stabilize the market, but will help increase the attractiveness of products. I would like to promote the utilization of this improved system by our industry.
- Discussions need to be held regarding governance from a medium- to long-term perspective. However, based on the perspective of requiring emergency measures, it is important that it can be conducted under the current laws and regulations. It is especially important to take an appropriate response towards the internal control systems of asset managers and the governance of transactions involving conflicts of interest made with sponsors.

<Mr. Hamaguchi, Member>

- The inability to obtain refinancing despite a positive cash flow is a liquidity issue and is an issue that is being faced by many corporations and banks in the world, not just by real estate. Furthermore, similar situations have occurred in the past. How

one manages finance depends on the financial management capabilities of every management company and investment corporation. So before discussing the big picture, we need to discuss and evaluate individual entities, including from a technological aspect. Furthermore, not only J-REIT prices, but also stock prices are now half the value they once were, and the PBR for the TSE as a whole has decreased below one. Other assets are also facing a similar situation.

- If bankruptcies of REITs increase and as a result, distress selling of real estate owned by J-REITs occurs, then the effect this might have on the real estate market would become a policy issue. Since the period until refinancing of private funds is shorter than for J-REITs, we sometimes hear the view that distress selling will soon start. I think the real issue is about how we are to respond to this situation, including the abovementioned phenomenon. As long as it is impossible for the government to deal with everything, the government might respond by drawing a line between areas in which they must intervene and areas that should be left to market movements. If the entire real estate market enters a serious situation triggered by a certain incident, then we as investors would demand that counter measures be taken. However, without enough information being provided, it is not easy to make specific requests.

<Mr. Ichikawa, Member>

- I am participating as a representative of a federation for actual real estate transactions and am not in the position of making comments regarding the problems and needs for improvements of J-REITs. However, I think that as long as the liquidity of actual real estate and the activity of the market cannot be increased, the activation of J-REITs and private funds cannot be realized. Based on this view and from a financing perspective, currently there are cases when despite having a positive cash flow, the financing of actual real estate does not go well. The important point is how to activate these areas while utilizing the system provided by the Japan Finance Corporation, etc.

<Mr. Homma, Member>

- In general, there is a need to increase the liquidity of real estate and so it is a great step forward that a system has been established for funds to flow from the Japan Finance Corporation and for actual lending to be conducted by designated financial institutions. If we compare the short-term perspective with the medium- to long-term perspective, then the most important for now is short-term.

- My understanding is that the system is such that designated financial institutions check the soundness of the project plan, perform a review for each, and based on that evaluation, extend a loan. However, policy is effective only when it is put into practice. Therefore, from the perspective of improving the J-REIT market, symbolically speaking, it is desirable that emergency loans be extended to several J-REITs.

<Mr. Kono, Observer>

- Upon hearing everyone's opinions, it seems that the greatest issue for now is refinancing, as was the case during the previous forum. Various measures have been taken until now, but I hear that the Working Group will continue to discuss the diversification of capital policies of investment corporations mentioned in the ad interim report. Therefore, in their discussions, I think that a temporary easing measure can be discussed despite there being systemic difficulties, such as for example a response for a limited time period.
- We also have received requests for advice about mergers from listed J-REITs, but there was no progress made due to practical obstacles among other reasons. As mentioned in the ad interim report, many of the obstacles have been cleared and I feel we are moving in the right direction.
- J-REITs might be middle-risk and middle-return products, but to a certain point, they have grown due to leveraging. On the other hand, it seems that people had originally envisaged the possibility that the contrary would happen should adverse winds start to blow. From that perspective, J-REITs are moving in the right direction with the establishment of a system for enhancing governance to enable the testing and supervision of financial management, etc.

<Mr. Ozawa, Deputy Vice-Minister for Construction, Engineering, Real Estate Industry, Ministry of Land, Infrastructure, Transport and Tourism>

- From the start, the Ministry of Land, Infrastructure, Transport and Tourism (hereafter, "MLIT") has been aware that the greatest problem is the issue of refinancing. MLIT has for example, encouraged financial institutions to provide financing, while exchanging opinions with the Financial Services Agency. Last December, we reintroduced the government's policy tool that was being used directly until recently, such as the Japan Finance Corporation and the DBJ. Rather than making financing a topic for discussion in the Working Group I would like for you to understand that we have prioritized short-term responses that are an

accumulation of actual operations.

- If asked whether or not the lending criteria for the framework we made with the DBJ are similar to that of private banks, the answer is yes. In Japan, we have changed policy tools, such as the one just mentioned amidst the reform conducted in the past few years. Therefore, since we have reached a critical moment and since there is no time to wait for laws and regulations to be revised, we decided to have them come back to life. Meanwhile, we derived a system for making loans to businesses from the Japan Housing Finance Agency, which cannot procure funds in the discussions regarding privatization, based on our view that this might help activate the real estate market. Therefore, I think that rather than making this a debate about how the financing system should function, we have prioritized how to use the tools we already possess in order to actually make funds flow to businesses or the market.
- I fully realize the urgency of the opinion that there needs to be taken one further step without having heard today's comments. We are holding discussions about the contents of the next step to take, but I feel that measures need to be constructed based on today's comments and by taking advantage of the wisdom of the Working Group.

<Mr. Iwahara, Member>

- Each member made comments that were filled with a sense of urgency and I think that the authorities understand this well. Furthermore, my understanding is that the authorities are making the most out of the tools they currently possess.
- Some of the contents of the comments expressed today also refer to large problems that MLIT cannot deal with alone. Rather, we must think about how much funds the government as a whole can provide with what kind of standards through government-affiliated funds, in order to subdue this liquidity crisis. This is a situation that is occurring in the nation of Japan as a whole and I think it is a matter of setting up priorities and doing things on a best-effort basis. I also think that the BOJ can do more. However, amidst such circumstances in which it seems that things look difficult from now on, I would like to ask that the authorities conduct crisis management as a single government while giving due consideration to the point just mentioned, so that the Japanese economy does not fall into a serious situation.
- It certainly is true that the near-term problem is financing, but on the other hand, we must not forget about governance. A scheme that is not trusted by investors does

not last long and so I would like the authorities to make progress in this area as well.

- The following agenda were approved in regards to how to proceed with the forum in the future:
- To continue discussions within the Working Group on issues that remain, etc., while taking into consideration discussions held at this forum (4th Forum).
- In the next forum (5th Forum), receive reports on the summary made by the Working Group, hold necessary discussions regarding the report and compile a summary at the forum.
  
- Forthcoming schedule:  
(Explanations from the Secretariat)
- Information regarding the “J-REIT Fair 2009” that is to be held
- The 5th Forum is scheduled to be held after April.
  
- Closing of the meeting