

# Reference Materials

# 1. Introduction

# Trends in the Global REIT Market

## REIT Index

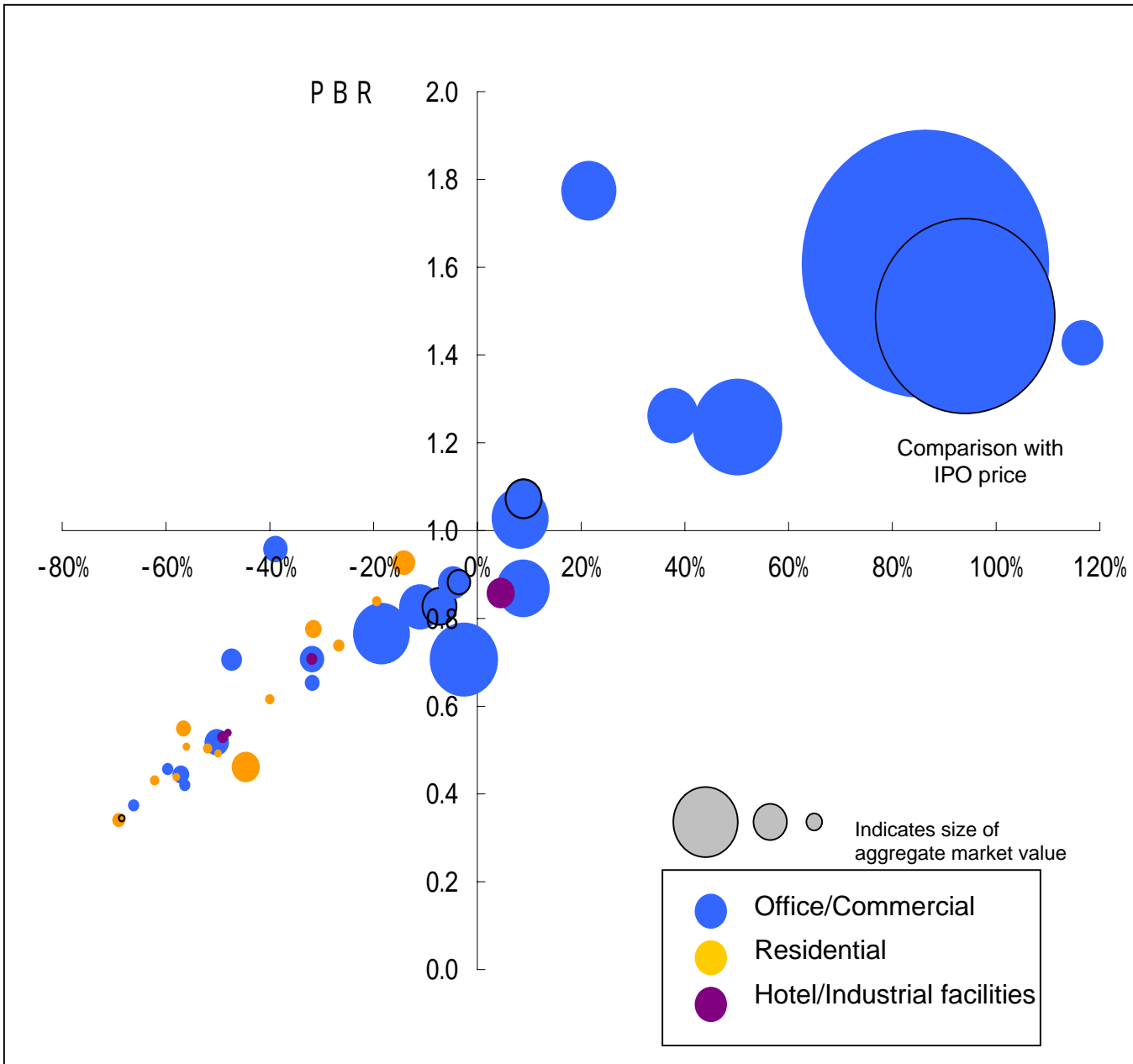
(Index = 100 on December 31, 2003)



Data: Prepared by ARES based on data provided by Bloomberg

## 2. Need to Restructure J-REITs, Including Mergers

# Various REITs Exist



\* P B R (Price-to-Book Ratio) = Aggregate market value ÷ (Net asset – Dividend)

Source: Prepared by Ministry of Land, Infrastructure, Transport and Tourism based on published data (as of August 22, 2008)

# Clauses Concerning Mergers

## Investment Trust and Investment Corporations Act

(Conclusion of Merger Agreement)

**Article 145** Investment corporations may merge with other investment corporations. In this case, the merging investment corporations must conclude a merger agreement.

(Agreement for Absorption-type Merger)

**Article 147** When investment corporations merge by absorption (when an investment corporation merges with another investment corporation, and all rights and obligations of the dissolving investment corporation are succeeded by the surviving investment corporation; hereafter, the same), the following items shall be stipulated in the agreement for an absorption-type merger:

- (i) The trade name and address of the surviving investment corporation (hereafter, the “surviving corporation of an absorption-type merger”) and the dissolving investment corporation (hereafter, the “dissolving corporation of an absorption-type merger”) of the merger by absorption
- (ii) Matters concerning the number of investment units in the surviving corporation of an absorption-type merger that will be issued to investors of the dissolving corporation of an absorption-type merger in accordance with the merger by absorption, the method of calculating the number of investment units, and the total contribution by the surviving corporation of the absorption-type merger
- (iii) Matters concerning the allocation of investment units in the previous item to investors of the dissolving corporation of an absorption-type merger (excludes the dissolving corporation of an absorption-type merger and the surviving corporation of an absorption-type merger; the same applies for the next item)
- (iv) The date that the absorption-type merger takes effect (“effective date” in the next article and Provision 4)

**2** In cases stipulated by the previous section, with regard to matters raised in (iii) of the previous section, investment units of the surviving corporation of an absorption-type merger shall be issued in accordance with the number of investment units owned by the investors of the dissolving corporation of an absorption-type merger.

(Agreement for Consolidation of Corporations)

**Article 148** When two or more investment corporations consolidate (when two or more investment corporations merge, and all rights and obligations of the dissolving investment corporations are succeeded by the investment corporation established through the merger; hereafter, the same), the following items shall be stipulated in the agreement for consolidation of the corporations:

- (i) The trade name and address of the investment corporations dissolving through the consolidation of the corporations (hereafter, the “dissolving corporations after consolidation of the corporations”)
- (ii) The purpose, trade name, address of headquarters, and total number of authorized investment units of the investment corporation to be established through consolidation of the corporations (hereafter, the “corporation established through consolidation of the corporations”)
- (iii) Matters other than those raised in the previous item stipulated by the rules of the corporation established through consolidation of the corporations
- (iv) Name of the executive officer, supervisory officer, and accounting auditor of the corporation established through consolidation of the corporations at the time of establishment
- (v) Matters concerning the number of investment units in the corporation established through consolidation of the corporations that will be issued as a replacement for the investors of the dissolving corporations after consolidation of the corporations in accordance with the consolidation of the corporations, the method of calculating the number of investment units, and the total contribution by the corporation established through consolidation of the corporations
- (vi) Matters concerning the allocation of investment units in the previous item to investors of the dissolving corporations after consolidation of the corporations (excludes dissolving corporations after consolidation of corporations; the same applies for the next section)

**2** In cases stipulated by the previous section, with regard to matters raised in (vi) of the previous section, investment units of the corporation established through consolidation of the corporations shall be distributed in accordance with the number of investment units owned by the investors of the dissolving corporations after consolidation of the corporations.

# Systemic Revisions, etc. to Promote Mergers of J-REITs

## Improvement of conduit formula determining dividend requirement

### – 1 “Revision of the formula determining the dividend requirement”

The distributed dividends of REITs are included in expenses upon fulfilling various requirements (conduit nature), but the current formula determining the dividend requirement, which is one of the requirements, compares accounting income to taxable income as follows. When there is a large gap between accounting and tax (e.g. treatment of repair costs), a risk arises in that the conduit status cannot satisfy the formula. The latest revision is expected to allow judgment through accounting income alone.

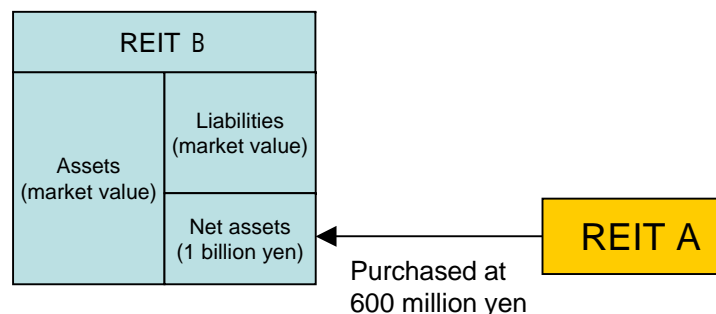
(Before revision)

Dividend from **accounting income** > Taxable income × 90%

(After revision)

Dividend from **accounting income** > **Accounting income** × 90%

### – 2 “Measure for negative goodwill”



In the case where REIT A merges with REIT B with net assets of one billion yen by absorbing REIT B at a price of 600 million yen, the “negative goodwill” of 400 million yen will be booked as REIT A’s liabilities after the merger. In terms of accounting, the 400 million yen will be recognized as profit\*, but since REIT A did not actually attain 400 million in cash, it cannot fulfill the post-revision formula indicated on the left unless it procures over 360 million yen (400 million yen × 90%) in cash by newly selling property, etc. The measure exempts the amount equivalent to “negative goodwill” for this case from the post-revision formula for the business year that the “negative goodwill” occurs.

\* With regard to the treatment of negative goodwill, the “Financial Accounting Standard for Business Combinations (published by the Accounting Standards Board of Japan on December 26, 2008)” revised equal amortization within 20 years to recording as one-time profit within the applicable business year (Timing of application: Applied from business combinations executed on or after April 1, 2010; however, it can be applied from the first business combination executed in business years commencing on or after April 1, 2009).

# System Revisions, etc. to Promote Mergers of J-REITs

## Clarification of possibility of utilizing delivered money due to merger

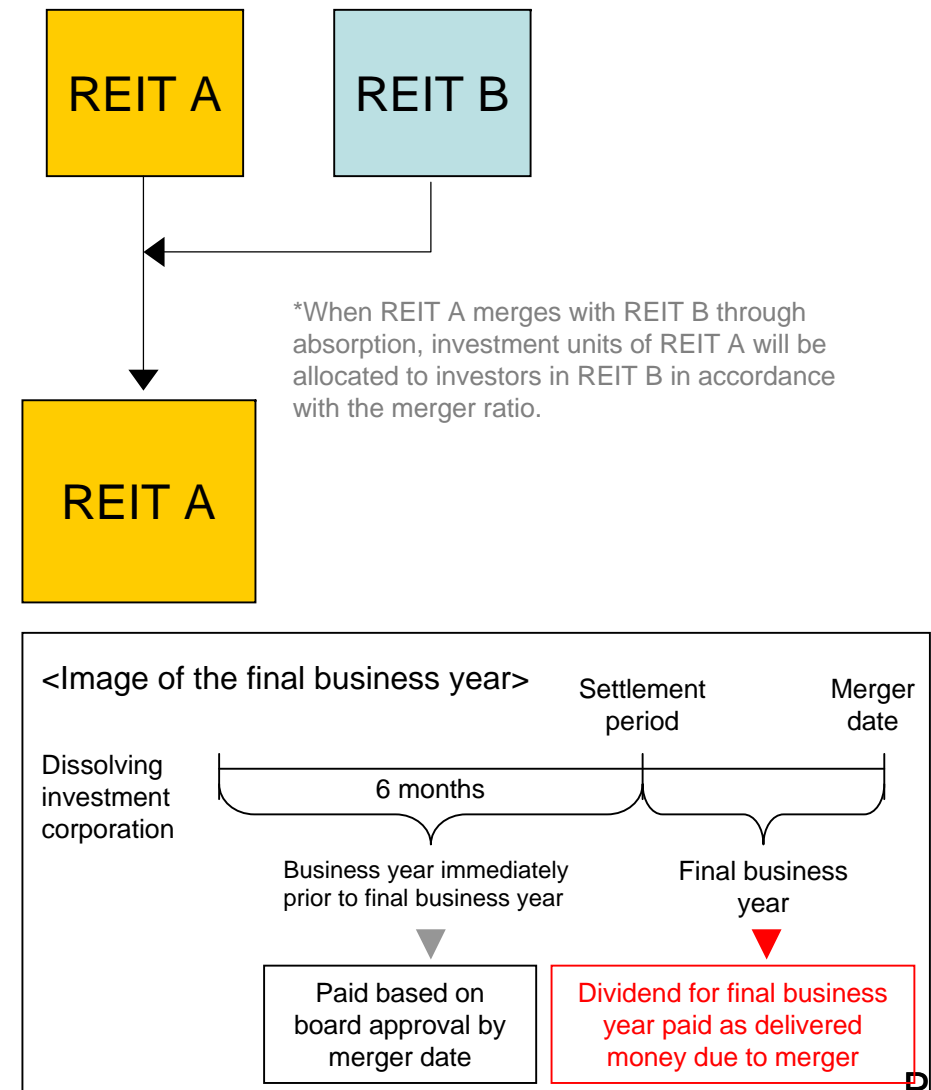
It has been clarified (revisions to cabinet ordinance and regulatory guidelines) that when REIT A merges with REIT B through absorption, cash can be paid to adjust fractions in the merger ratio and to adjust the profit dividend when the settlement periods of the merging parties differ (“delivered money due to merger”).

(Specific example of adjusting fractions in the merger ratio)

Investment units of REIT A will be allocated to the investors in REIT B, but if, for instance, the merger ratio of “REIT A : REIT B = 1 : 2.222” was to be ultimately adjusted to “REIT A : REIT B = 1 : 2,” the 0.222 portion will be paid to investors in REIT B as delivered money due to the merger.

(Specific example of adjusting profit dividend)

The dividend for the dissolving investment corporation for the final business year cannot be paid since a board meeting of the dissolving investment corporation cannot be held. Therefore, the dividend for the final business year will be paid as delivered money due to the merger.



## Outline of Fiscal Year 2009 Tax Reform

### Outline of Fiscal Year 2009 Tax Reform (Ruling party decision on December 12, 2008)

#### XI Other Tax Policies

25 Special exception on taxation of SPCs, etc. shall be reviewed as follows:

- (1) (omitted)
- (2) Requirement that paid dividends exceed an amount equivalent to 90% of distributable income shall be changed to a requirement that paid dividends exceed an amount equivalent to 90% of distributable profit. When there is negative goodwill, necessary adjustment measures shall be taken, such as a deduction from distributable profit in the year that the negative goodwill arises.
- (3) Stipulations in laws and regulations concerning investment corporations have clarified the treatment of delivered money due to the merger of investment corporations. In accordance with this, it shall be clarified that delivered money due to a merger, which is comparable to a dividend, be included in paid dividends that are subject to inclusion in expenses.

### Outline of Fiscal Year 2009 Tax Reform (Cabinet decision on January 23, 2009)

#### IX Other

15 Special exception on taxation of SPCs, etc. shall be reviewed as follows:

- (1) (omitted)
- (2) Requirement that paid dividends exceed an amount equivalent to 90/100 of distributable income shall be changed to a requirement that paid dividends exceed an amount equivalent to 90/100 of distributable profit. When there is negative goodwill, necessary adjustment measures shall be taken, such as a deduction from distributable profit in the year the negative goodwill arises.
- (3) Stipulations in laws and regulations concerning investment corporations have clarified the treatment of delivered money due to the merger of investment corporations. In accordance with this, it shall be clarified that delivered money due to a merger, which is comparable to a dividend, be included in paid dividends that are subject to inclusion in expenses.

# Revision of Ordinance and Regulatory Guidelines Concerning Delivered Money Due to Merger

## Revision of the Ordinance for Enforcement of the Investment Trust and Investment Corporations Act (promulgated on January 23, 2009 and enforced on the same day)

(Advance Disclosure Items for Dissolving Corporation of Absorption-type Merger)

Article 193

(omitted)

- 2 In this article, a “merger consideration” refers to the investment units of the surviving corporation of an absorption-type merger **or cash** delivered to investors in the dissolving corporation of an absorption-type merger upon the absorption as a replacement for the investment units of the dissolving corporation.
- 3 “Matters concerning the reasonableness of a merger consideration” stipulated in Section 1, Item 1 refers to matters concerning the reasonableness of the stipulation (when there is no applicable stipulation, the absence of such stipulation) pertaining to the following items and other items raised in Article 147, Section 1, Items 2 and 3.
  - (i) Matters concerning the reasonableness of the **total** merger consideration (**refers to the total number of investment units and the total amount of cash**)
  - (ii) (omitted)
  - (iii) **If cash is selected as a merger consideration, the reason for such**
- 4 “Matters that should serve as reference for a merger consideration” stipulated in Section 1, Item 2 refers to the following items and other pursuant items (when there is general consent from investors in the dissolving corporation of an absorption-type merger not to indicate or record all or part of these items in written or electromagnetic record, the items subject to such consent shall be excluded).
  - (i) (omitted)
  - (ii) The following items and other items concerning the method of converting into cash the **investment units to be delivered as a merger consideration**
    - a. Market where **applicable investment units** will be traded
    - b. Party to serve as an intermediary, agent, or proxy for the trading of **applicable investment units**
  - (iii) When there is a market price of the **investment units to be delivered as a merger consideration**, matters concerning the price
- 5 (omitted)

\*Red font = Latest revision

# Revision of Ordinance and Regulatory Guidelines Concerning Delivered Money Due to Merger

## Comprehensive Guidelines for Supervision of Financial Instruments Operators, etc. (revised on January 30, 2009 and applied on the same day)

### VI – 2 – 7 Other Considerations

#### VI – 2 – 7 – 3 Considerations Concerning Mergers of Investment Corporations

When calculating investment units to be delivered to investors of the dissolving corporation in the case of a merger by absorption, if the merger ratio adjustment money or dividend substitutions (hereafter, “delivered money due to merger”) are delivered to adjust the merger ratio, etc., it must be noted that the items raised in Article 147, Section 1, Item 2 of the Investment Trust and Investment Corporations Act include the amount of delivered money due to merger, the calculating method, and matters concerning the amount of delivered money due to merger allocated according to the number of investor units owned by the investors in the dissolving corporation.

## Treatment of Fractions Less Than One Issued to Investors in Dissolved Investment Corporation

### Investment Trust and Investment Corporations Act

(Treatment of Fractions Less Than One)

**Article 149-17** In a case where the investment units of the applicable investment corporation are delivered to the party stipulated in each of the following items in the events raised in each item, if there are fractions of less than one investment unit of the applicable investment corporation, the number of investment units equivalent to the total of those fractions (fractions of less than one for the total shall be omitted) shall be **sold in a manner stipulated by the cabinet ordinance**, which is the appropriate method to realize sale at a fair value, and distribute the money obtained from the sale to the applicable party.

(i) **Absorption-type merger** (limited to cases where the applicable investment corporation survives the absorption-type merger)  
**Investors in the dissolving corporation of an absorption-type merger**

(ii) **Investors in the dissolving corporations after consolidation of corporations that issue investment units at the time of establishment of the new investment corporation based on the agreement for the consolidation of corporations**

2 Stipulations in Article 88, Sections 2 and 3 shall apply correspondingly in the cases of the previous section.

### Ordinance for Enforcement of Investment Trust and Investment Corporations Act

(Method of Handling Fractions of Investment Units)

**Article 199** The method established in the cabinet ordinance stipulated in Article 149-17, Section 1 shall be the method stipulated in each item below according to the classification of investment unit

(i) **Sale through trading on the financial instruments market** where the investment units of the investment security are listed on the financial market exchange

(ii) **Sale through trading on the over-the-counter market** where the investment units of the investment security comprise an over-the-counter security

(iii) **Sale at a fair and rational price in light of the net asset amount of the investment corporation that issues investment units other than the investment units mentioned in the above two items**

# What is ToSTNeT Trading?

## **Can REITs be traded through ToSTNeT?** (excerpt from the Tokyo Stock Exchange website, “Q&A for Investors on REITs”)

Q: Can REITs be traded through ToSTNeT?

A: REITs can be traded and the trading rules are exactly the same as stocks.

## **What is ToSTNeT trading?** (excerpt from the Tokyo Stock Exchange website)

ToSTNeT trading is the buying and selling of securities and listed derivatives trading on the ToSTNeT market. ToSTNeT trading of cash commodities comprises Single Issue Trading, Basket Trading, Trading on Closing Price and Off-auction Repurchase of a company’s own shares. Also, ToSTNeT trading of futures and options allows Cross-trading by the same participant and trading by different participants.

## **What is the ToSTNet market?**

The ToSTNeT market refers to the off-auction market of the Tokyo Stock Exchange. Transactions executed on the ToSTNeT market through the electronic trading network system ToSTNeT (Tokyo Stock Exchange Trading Network system) are referred to as off-auction trading.

In response to the sophistication and diversification of off-auction trading, the Tokyo Stock Exchange revised its off-auction market system and established the “ToSTNeT Market” on January 15, 2008.

Domestic stocks, foreign stocks, and convertible bonds (CB) listed on the auction market are all listed on the ToSTNeT market and are available for off-auction trading. The main types of trading are Single Issue Trading, Basket Trading, Trading on Closing Price and Off-auction Repurchase of a company’s own shares.

# Thinking on Merger Ratio Calculation Method

## Thinking on Merger Ratio Calculation Method

Various methods can be conceived of in calculating the valuation of a firm, which is required when calculating the merger ratio. The following are examples of working group considerations:

### Market Price

Market value of investment corporation

### NAV (Net Asset Value)

Definition of NAV (from ARES "Real Estate Securitization Handbook 2008-2009")

"Appraised value of real estate, etc. incorporated in investment corporation less liabilities such as loans"

Appraised value represents the valuation of assets at the current market price and is not an appraisal. However, it is difficult to grasp the current market price in actuality. There are various methods for calculating NAV, but a simplified method for calculating NAV using an appraisal, for example, is as follows:

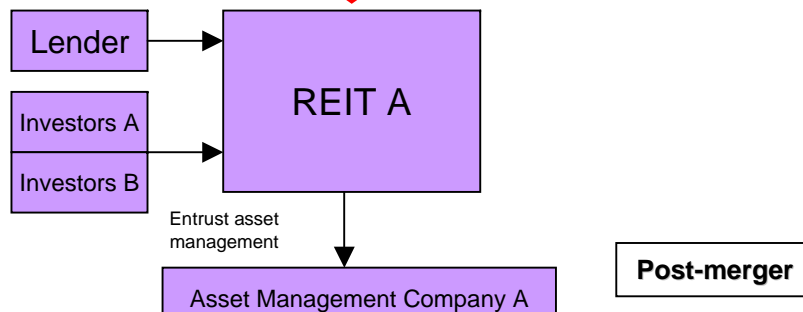
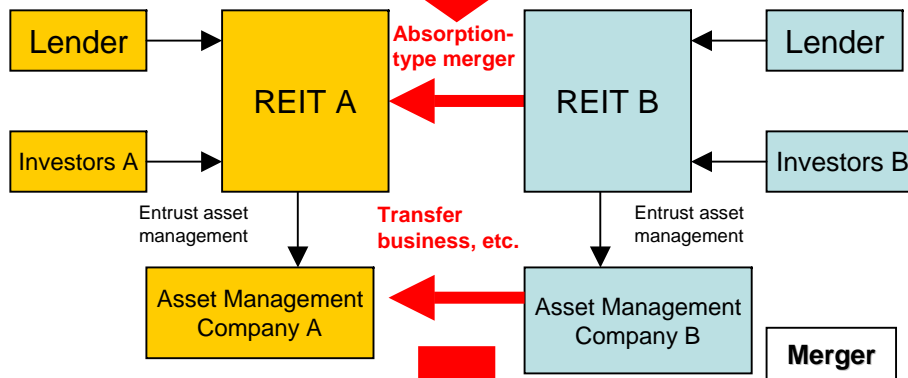
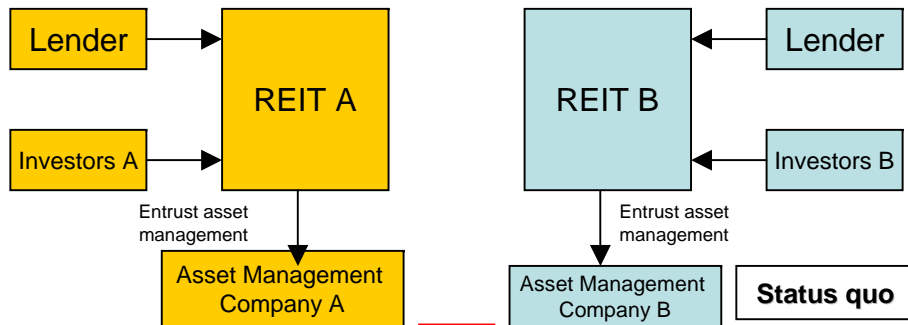
Simplified NAV = Net assets [post dividend] + (Total appraised value - Total book value)

\*Net assets [post dividend] = Net assets - Total distribution

(from Masters Training Program Textbook 203 [ARES])

# Merger Simulation Model

## Flow of merger (in the case of absorption-type merger)

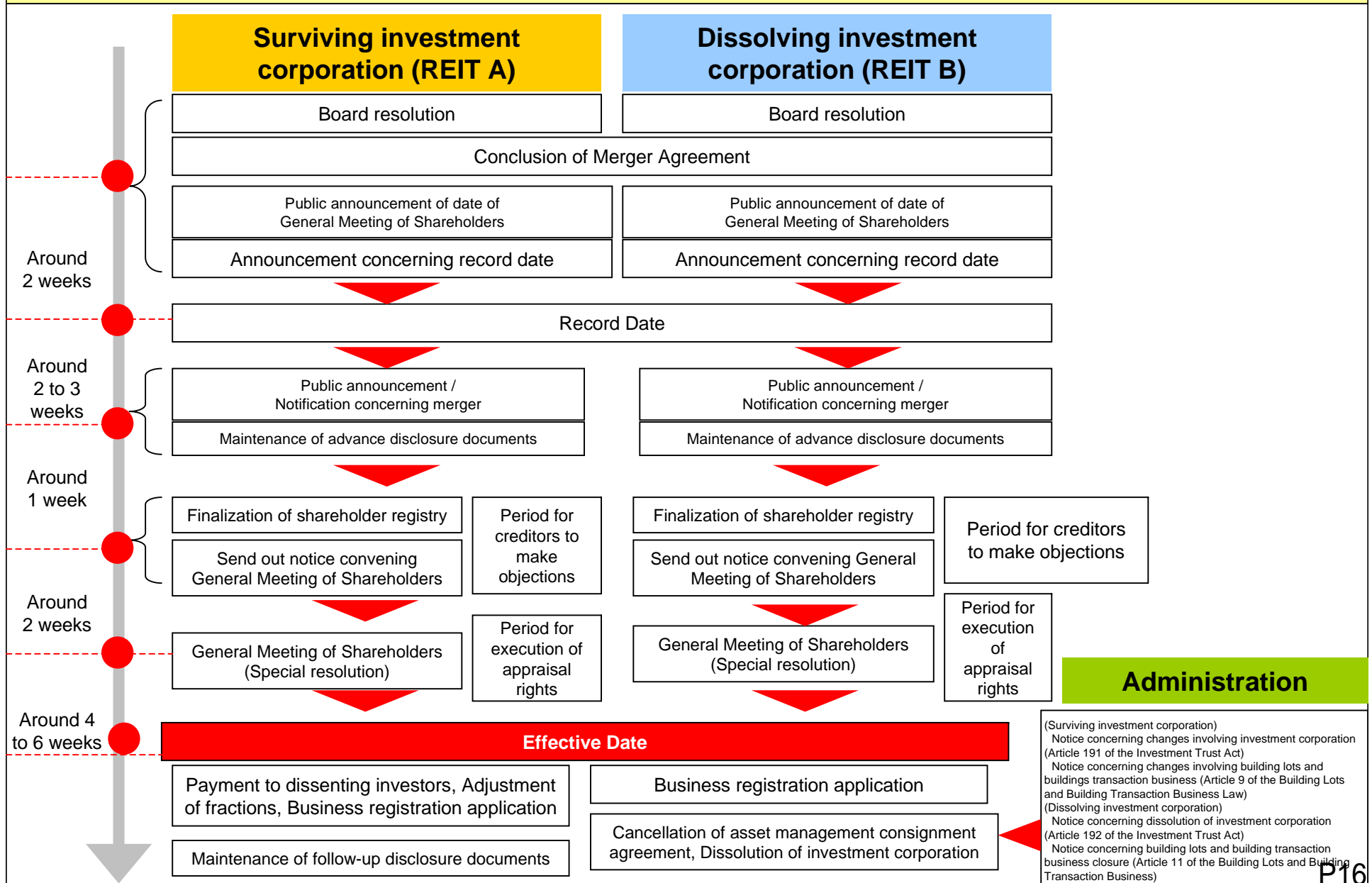


## Considerations debated by WG

- Calculation of merger ratio · · · · · Must be fair merger ratio, full explanation to investors essential
- Fraction adjustment for merger ratio · · Utilize delivered money due to merger (possibility of utilizing clarified by revision of Cabinet Office ordinance, etc.)
- Debt finance · · · · · coordination with lenders, etc. required
- Fraction adjustment at time of delivery of investment units · · Sell using ToSTNet trading
- Dividends from dissolved investment corporation · · Dividends for the final business year paid by using delivered money due to merger (possibility of utilizing clarified by revision of Cabinet Office ordinance, etc.)
- Treatment of negative goodwill · · · · · Expected to be deducted from conduit formula for the year in which it arises

# Merger Simulation Model

## Schedule



## Changes in Major Shareholders (Sponsors) at Asset Management Companies

For J-REITs, there are neither case examples of mergers of investment corporations nor changes in asset management companies. There are examples of changes in major shareholders (sponsors) at asset management companies.

Date	Asset Management Company	Description
Dec. 2008	Creed REIT Advisors (Japan Office Advisors) *Trade name change as of December 22, 2008	<b><u>CREED Corporation</u></b> <b><u>Ichigo Asset Trust</u></b> *All of the shares owned by main sponsor CREED Corporation and other shareholders were transferred to Ichigo Asset Trust.
Nov. 2008	Morimoto Asset Management	<b><u>Morimoto</u></b> <b><u>Daiwa House Industry</u></b> *Daiwa House Industry acquired shares owned by main sponsor Morimoto and CapitaLand Japan, raising its stake from 10.0% to 73.5%. Morimoto's stake declined from 50.1% to 20.0%.
Oct. 2008	re-plus REIT Management (Mi-Casa Asset Management) *Trade name change as of October 24, 2008	<b><u>re-plus</u></b> <b><u>AppleRingo Holdings (Oaktree)</u></b> *AppleRingo Holdings (Oaktree) launched a TOB for the investment corporation while simultaneously acquiring 35% of the shares in the asset management company from re-plus. After the bankruptcy of re-plus, Oaktree additionally acquired a 55% stake, and ultimately a 90% stake.
March 2008	Frontier REIT Management	<b><u>Japan Tobacco</u></b> <b><u>Mitsui Fudosan</u></b> *Japan Tobacco transferred its 100% stake to Mitsui Fudosan.
Nov. 2007	LaSalle Investment Advisors	<b><u>Asset Managers</u></b> <b><u>LaSalle Investment Management</u></b> *Asset Managers purchased all shares owned by other shareholders and transferred them entirely to LaSalle Investment Management. The investment corporation's trade name was changed from eASSET Investment Corporation to LaSalle Japan REIT Inc.

## Example of Concern Regarding Protection of Dissenting Investors When Delisting Investment Corporation

- With regard to making a REIT open-ended, which allows redemption of investment units at the investor's request (converting to an open-ended structure violates the Tokyo Stock Exchange's delisting rules, resulting in delisting), a special resolution by the general meeting of stakeholders is required. Although an investor protection process exists, will the reason for converting to an open-ended structure, various procedures and other information disclosure sensitive to investor protection be implemented as items recognized as a reference for investors executing voting rights on reference material at the general meeting of stakeholders?
- When redeeming investment units to dissenting investors, redemption at a "fair price in light of assets owned" (Article 125, Section 1 of the Investment Trust and Investment Corporations Act) is required. How do you explain the grounds for such an amount to investors?

<Violates the criteria for delisting in Article 1218-2-11 of the security listing regulations of the Tokyo Stock Exchange>

Listing regulations (criteria for delisting)

Article 1218 (omitted)

2 A REIT will be delisted if any of the following items apply. The handling of each item shall be stipulated by the enforcement rules.

(omitted)

(11) With regard to a listed REIT, in the case where redemption of investment units at an investor's request or cancellation during the trust agreement period at beneficiary request is made possible by a change in the investment corporation's rules or the investment trust contract

(omitted)

## 3. J-REIT Governance

## J-REITs Incur Administrative Penalties Due to Conflicts of Interest or Inadequate Internal Control

J-REITs incur administrative penalties due to conflicts of interest or inadequate internal control

### Company A (December 2008) [Punishment: Business improvement order (Management company only)]

When a management company **acquired property from an interested party**, with regard to one property, **it failed to take measures** to satisfy standards specified in the investment policy, etc. concerning the acquisition of property using asbestos stipulated by the management company and caused **the investment corporation to incur unnecessary expenses**.

Also, for another property, the management company had the investment corporation acquire the property without considering that there would not be rental revenues during the period of renovations and additions to the structure.

### Company B (October 2008) [Punishment: Business improvement order (Regarding petition for commencement of civil rehabilitation proceedings: Investment corporation and management company; Regarding advisory from Securities and Exchange Surveillance Commission (November 2008): Management company only)]

With regard to the investment corporation filing a petition for commencement of civil rehabilitation proceedings, it became necessary to have the investment corporation and management company take all possible measures from the perspectives of preservation of the investment corporation's assets, prohibition of unreasonable expenditures, and investor protection.

Also, when the management company conducted capital increases through issuing investment units by way of third-party allocation, **despite the fact that one outside director opposed** at a meeting of the investment committee, which requires approval from all outside directors with voting rights, the management company processed this as having reached a decision by a majority vote and **took measures such as writing minutes that ran counter to the truth**.

### Company C (September 2008) [Punishment: Business improvement order (Management company only)]

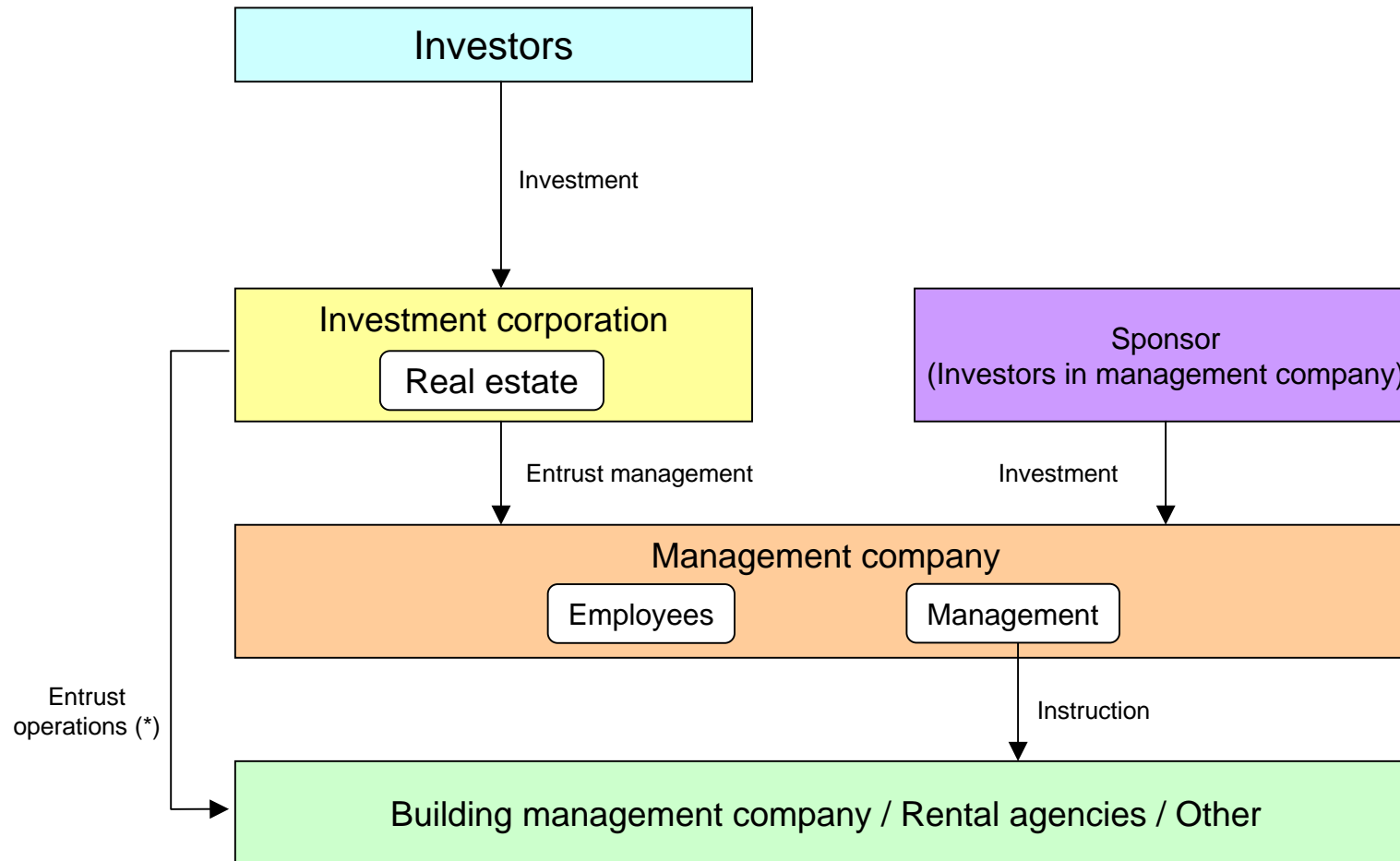
With regard to obtaining an appraisal at the time of acquiring an asset, the company took inappropriate actions that impaired the appraiser's independence, such as **asking the appraiser for an appraisal that was equal to or more than the asking price of the seller (an interested party of the management company)**. Furthermore, the company was engaged in **inappropriate processes in selecting appraisers**, such as asking for estimates from multiple appraisers until obtaining a price that was close to the asking price and selecting the appraiser that presented the highest price.

### Company D (March 2008) [Punishment: Business improvement order (both the investment corporation and management company)]

At the time of acquiring an asset, the **investment corporation shouldered costs that should have been born by the seller (an interested party of the management company) exceeding the appropriate price of the asset**. Also, the management company, which is supposed to adequately control the investment corporation's sales contracts, failed to do so in this case.

# REIT Schemes in Different Countries

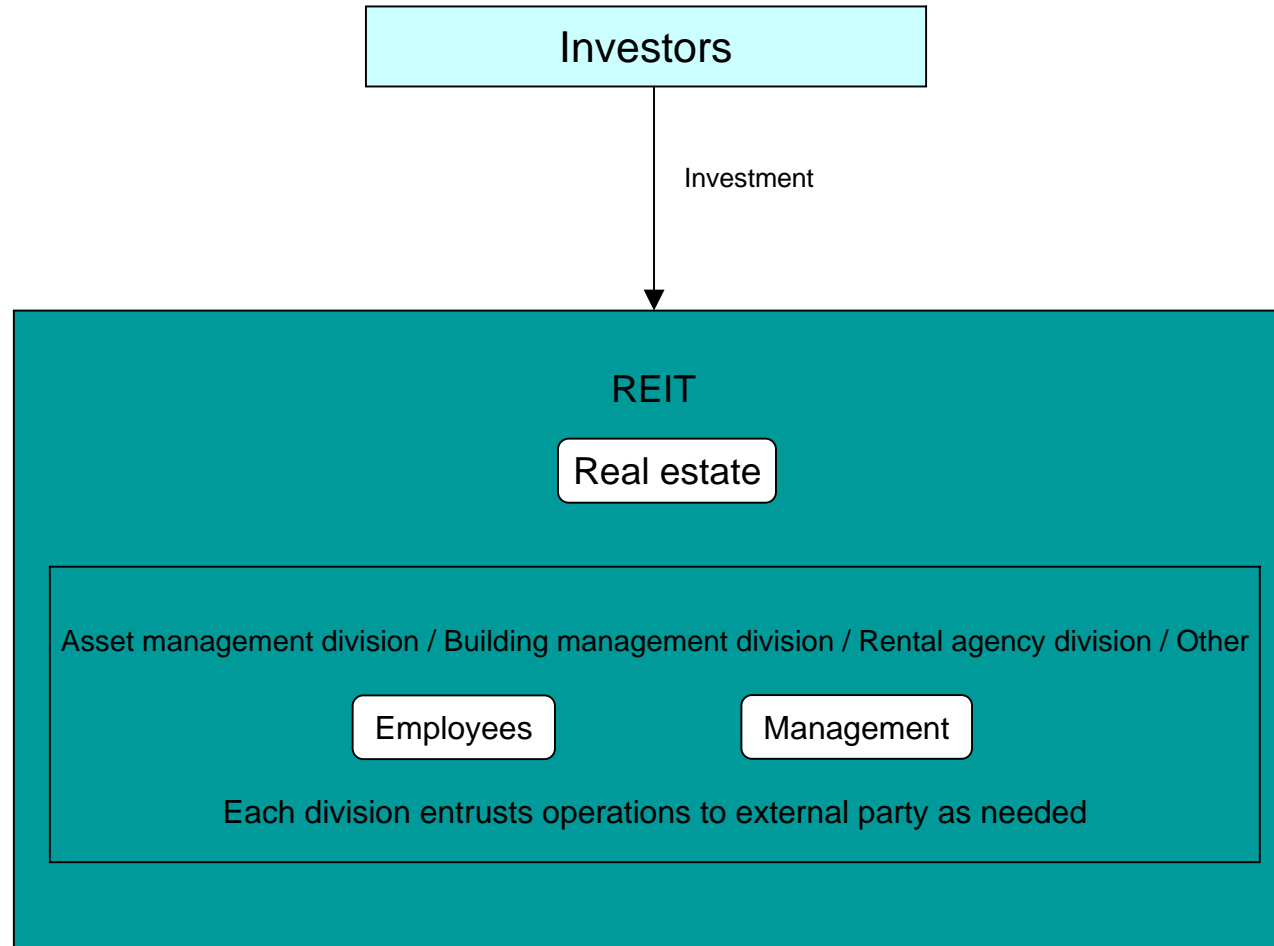
## 1. Japan (J-REITs) ~External management structure~



(\*) However, there are cases where operations are re-commissioned via management companies.

# REIT Schemes in Different Countries

## 2. U.S. (U.S. REITs) ~Internal management structure~

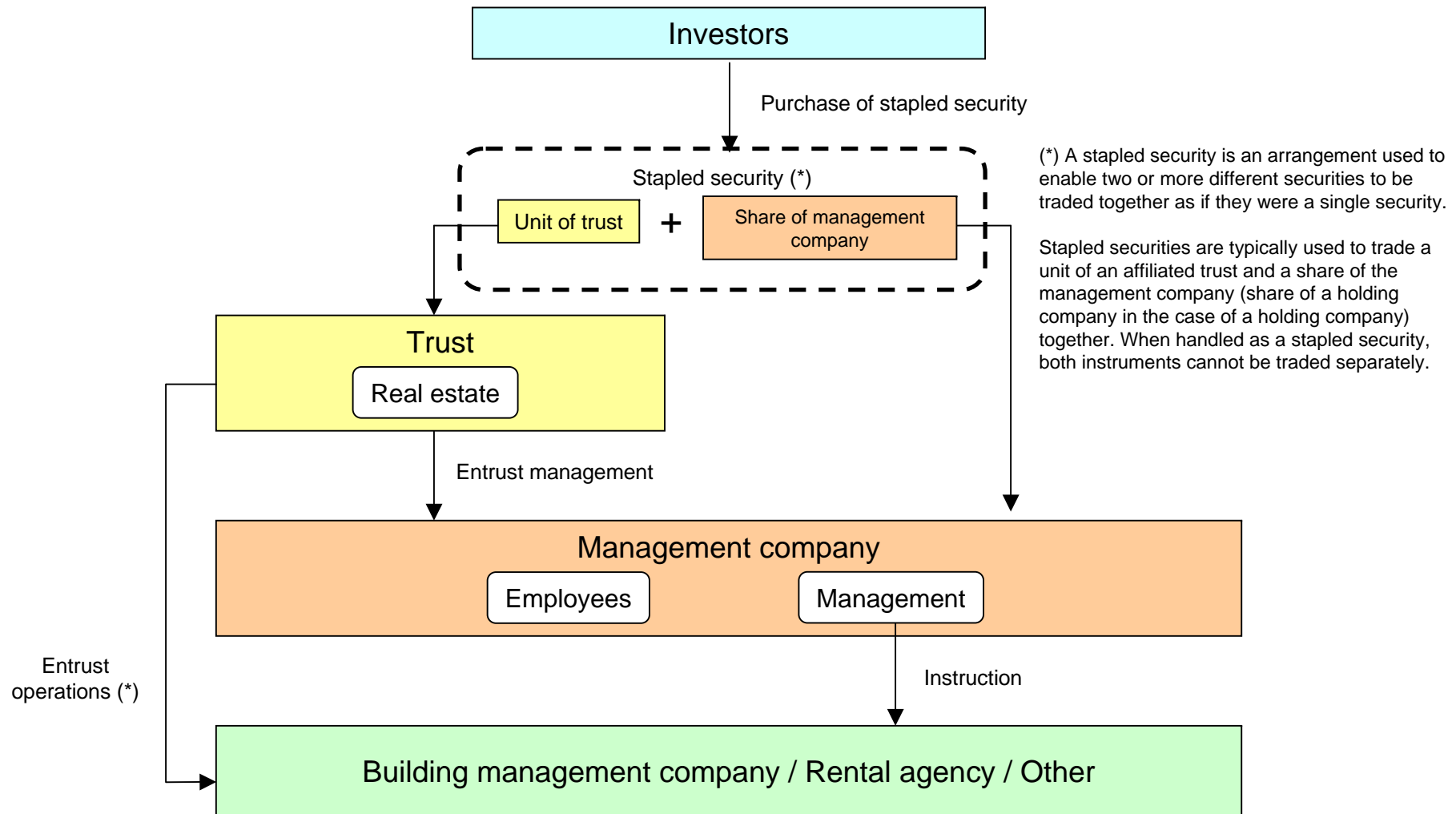


# Major Advantages and Disadvantages of Internal and External Management

	Advantages	Disadvantages
External Management	<ul style="list-style-type: none"> <li>· Easier to gain cooperation from the sponsor since the management company is a subsidiary of the sponsor. (e.g., operation management capability, securing human resources, property supply function, credit capability, etc.)</li> <li>· Tax benefits (possible to include dividends in expenses because it is deemed as a conduit since it does not manage assets on its own)</li> </ul>	<ul style="list-style-type: none"> <li>· Possibility of conduct conflicting with investor interests since asset management is entrusted to an external management company</li> <li>· Since asset management is entrusted to an external management company, costs for establishing the investment corporation and ensuring the management company acts in accordance with investor interests (e.g., costs to monitor management company operations, incentive remuneration to management company) tend to lead to higher costs compared to internal management</li> </ul>
Internal Management	<ul style="list-style-type: none"> <li>· Conduct conflicting with investor interests less likely to occur since asset management is handled internally</li> <li>· Since asset management is handled internally, costs tend to be lower due to the absence of costs needed in the case of external management to ensure the management company takes action in accordance with investor interests</li> </ul>	<ul style="list-style-type: none"> <li>· Since asset management is handled internally and there is no external management company that is a subsidiary of the sponsor, it is hard to gain sponsor cooperation</li> <li>· Since asset management is handled on its own, there is risk that its attribute as conduit is lost and tax benefits cannot be obtained</li> </ul>

# REIT Schemes in Different Countries

## 3. Australia ~Stapled structure~



(\*) However, there are cases where operations are re-commissioned via management companies.

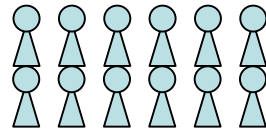


# Example of Strengthening Governance

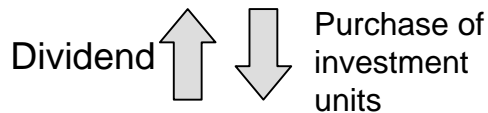
## Strengthening Investment Corporations' Monitoring of Duty of Loyalty, etc. of Management Companies

The major task of executive officers of investment corporations as representative of investors is to monitor whether management companies' handling of asset management based on their consignment contracts with investment corporations are fully performing their Duty of Loyalty, Duty of Care, etc. to the investment corporations.

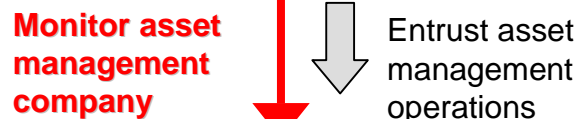
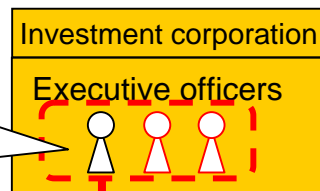
Investment corporations may as well secure the personnel and funds required to monitor the Duty of Loyalty, Duty of Care, etc. of management companies so that their executive officers can fully and proactively perform their duties (increase board members, partial outsourcing of monitoring function as necessary, etc.).



Investors



**Secure personnel and funds required to monitor Duty of Loyalty and Duty of Care of management company**



Asset management company  
(Financial instruments business operator)

## Duty of Loyalty and Duty of Care of Asset Management Companies

· Financial Instruments and Exchange Act

(Duties to Right Holders)

Article 42 A Financial Instruments Business Operator, etc. shall engage in Investment Management Business with loyalty to Right Holders (meaning the persons prescribed in the following items for the Categories of Business listed in the respective items; hereafter, the same shall apply in this Subsection):

(i) Business of conducting the act specified in Article 2(8)(xii): the other party of the contract set forth in (a) or (b) of said item;

(ii) Business of conducting the act specified in Article 2(8)(xiv): the person who holds rights indicated on Securities listed in said item or other rights designated by a Cabinet Order; and

(iii) Business of conducting the act specified in Article 2(8)(xv): the person who holds rights listed in (a) to (c) of said item or other rights designated by a Cabinet Order as prescribed in said item.

2 A Financial Instruments Business Operator, etc. shall engage in Investment Management Business with the due care of a prudent manager for Right Holders.

# Executive Officers of Investment Corporations

## How many executive officers must an investment corporation have?

Stipulated by the Investment Trust and Investment Corporations Act, with the number stipulated by respective investment corporations in their bylaws

(Change to investment corporation bylaws (general meeting of shareholders resolution) is required when increasing the number to exceed the number of executive officers stipulated by the bylaws)

### Investment Trust and Investment Corporations Act

Article 95 Investment corporations shall establish the following organizations:

- (i) One, two or more executive officers
- (ii) Supervisory officers totaling at least one more than the number of executive officers
- (ii) Board
- (iv) Accounting auditor

### Example of investment corporation bylaw

(Number of executive officers and supervisory officers)

Article The number of executive officers shall be two or less, and the number of supervisory officers shall be three or less. However, the number of supervisory officers must be at least one more than the number of executive officers.

## Is it possible for investment corporations to outsource operations?

The Investment Trust and Investment Corporations Act requires outsourcing of the following operations. There are also cases where investment corporations entrust real estate management to real estate management companies.

Outsourcing administrative matters (e.g., reparation and maintenance of the register of unitholders)

..... Article 117 of the Investment Trust and Investment Corporations Act

Outsourcing asset management of its assets (e.g., acquisition or transfer of real estate)

..... Article 198 of the Investment Trust and Investment Corporations Act

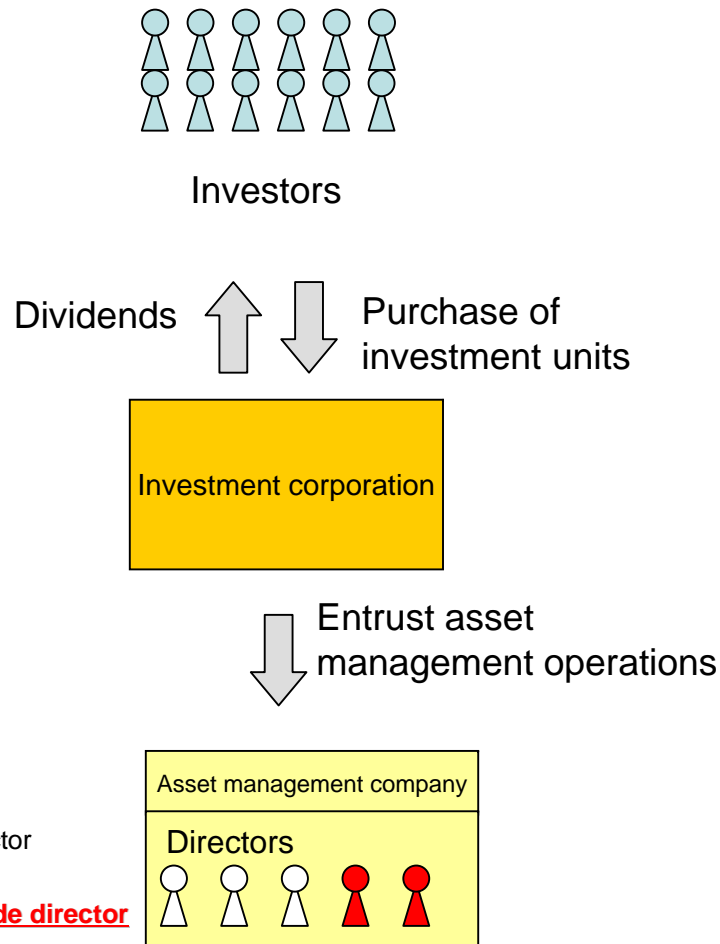
Outsourcing custody of its assets (e.g., custody of vital documents such as registration certificates of real estate)

... Article 208 of the Investment Trust and Investment Corporations Act

# Example of Strengthening Governance

## Selection of Outside Directors at Management Companies

From the perspective of strengthening governance at a management company and heightening investor confidence, the investment corporation can consider selection of highly independent outside directors that can be expected to monitor execution of operations at a management company from the perspective of securing investor profit.



### What is an outside director?

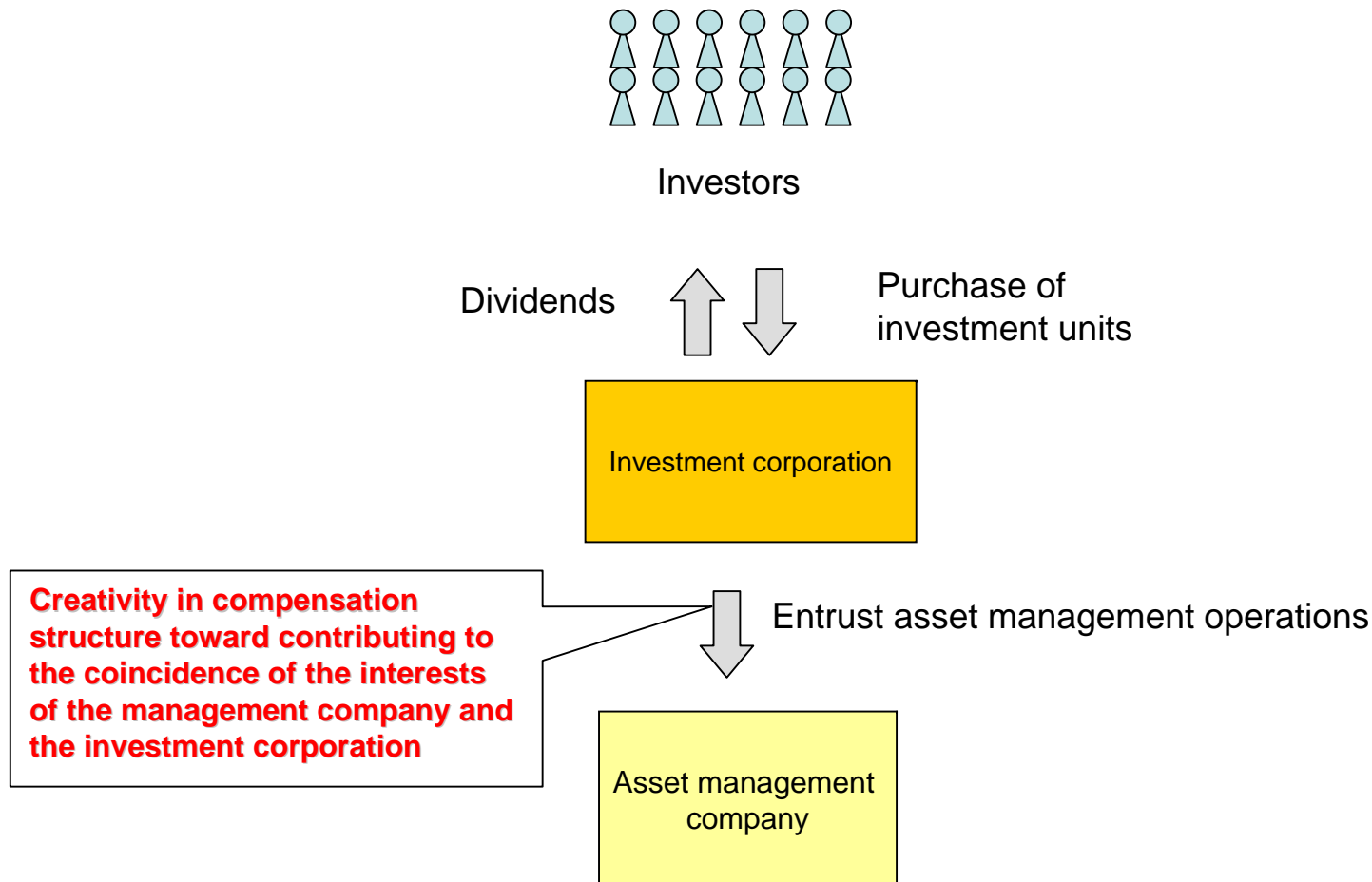
The Companies Act Article 2 (xv) defines the outside director as “a director of any Stock Company who is neither an Executive Director nor an executive officer, nor an employee, including a manager, of such Stock Company or any of its Subsidiaries, and who has neither served in the past as an executive director nor executive officer, nor as an employee, including a manager, of such Stock Company or any of its Subsidiaries,” thus demanding the role of making management decisions from an objective standpoint of not executing operations.

Outside directors are often introduced for the purpose of strengthening supervisory activities of the Board of Directors amid calls for companies to strengthen the separation of the execution and supervision of management.

## Example of Strengthening Governance

### Further Creativity in Compensation Structure of Management Companies

Even more creativity can be considered regarding the compensation structure at a management company toward contributing to the coincidence of the interests of the management company and the investment corporation.



## Example of Management Fee

### Management Fee Case Example 1

Management fee = Basic Fee 1 + Basic Fee 2

Type of Fee	Calculation Method and Timing of Payment
Basic Fee 1	<b>Total assets multiplied by 0.15%</b> (fractions of less than one yen omitted) shall be the Basic Fee 1. "Total assets" refers to the total assets indicated on the Balance Sheet (limited to that approved by Article 131 Section 1 of the Investment Trust and Investment Corporations Act) for the investment corporation's fiscal term immediately prior to the first day of the applicable business period. The payment date of the Basic Fee 1 shall be within the applicable business period.
Basic Fee 2	<b>Distributable amount multiplied by 3.0%</b> (fractions of less than one yen omitted) calculated each fiscal term shall be the Basic Fee 2. When there is a loss carried forward in the net income before taxes before the Basic Fee 2 is deducted in accordance with GAAP, "distributable amount" refers to the amount after such loss carried forward is covered. The payment date of the Basic Fee 2 shall be within a month after board approval of financial documents, etc. (refers to financial documents, etc. stipulated by Article 129 of the Investment Trust and Investment Corporations Act) concerning the applicable business period.

### Management Fee Case Example 2

Management fee = Basic Fee 1 + Basic Fee 2

Type of Fee	Calculation Method and Timing of Payment
Basic Fee 1	<b>Amount equivalent to 2.5%</b> (fractions of less than one yen omitted) of rent, common expenses, parking fees, auxiliary income, facility rental fees, facility installation fees, delay damages, cancellation fees or similar charges in accordance with the cancellation of rental agreements and other profit arising out of the rental of the real estate under management (including beneficiary interests in trust acquired by the investment corporation and other assets backed by real estate; hereafter, "real estate" in this article) calculated every settlement date (however, this excludes profit from the sale of real estate and other assets under management; hereafter, "rent revenue" in this section). Based on the fiscal management plan the company entrusted with asset management submits to the investment corporation at the beginning of every year in line with the asset management consignment contract, the amount equivalent to 2.5% of rent revenue for the preceding three months will be paid on the last day of March, June, September, and December each year (the business day immediately prior when such date is a bank holiday) and the excess and deficiency will be balanced upon approval of accounts without delay.
Basic Fee 2	<b>Amount equivalent to 3%</b> (fractions of less than one yen omitted; however, negative values deemed as 0 yen) of <b>net income before taxes</b> before the Basic Fee 2 calculated every settlement date is deducted (however, when there is a loss carried forward, the amount after covering all such) and shall be paid upon approval of accounts without delay. If the pay corresponds to a period short of an accounting period, the pay shall be adjusted per diem.

\*Management fees are indicated on "investment corporation rules" posted on each investment corporation's website.

## Example of Management Fee

### Management Fee Case Example 3

Management fee = Basic Fee 1 + Basic Fee 2 + Incentive fee

Type of Fee	Calculation Method and Timing of Payment
Basic Fee 1	<p>Total of amounts obtained by the following calculation formula <b>according to the total appraised value of managed assets</b> as of the end of the previous business period.            Here, the total appraised value of managed assets refers to the total of the appraised values of respective real estate properties (real estate that is the trust asset in the case of beneficiary interest in real estate).            [Calculation Formula]            · Portion whose total appraised value of managed assets of 200 billion yen or less multiplied by 0.150%            · Portion whose total appraised value of managed assets exceeds 200 billion yen multiplied by 0.125%            Fee for the applicable period shall be paid by the settlement period of the applicable business period.</p>
Basic Fee 2	<p>Total of amounts obtained by the following calculation formula <b>according to recurring cash flow</b> during the applicable business period. Here, recurring cash flow refers to depreciation costs and the amortization of deferred assets added to the recurring profits / losses and excluding profits / losses on sales and appraisal of specified assets (excluding those booked under extraordinary income and expenses) (hereafter "CF"). When calculating the Basic Fee 2, the CF before deduction of the Basic Fee 1, the Basic Fee 2 and the Incentive fee stipulated below shall serve as the criteria.            [Calculation Formula]            · Portion whose CF is 5 billion yen or less multiplied by 6.0%            · Portion whose CF exceeds 5 billion yen multiplied by 5.0%            Fee shall be paid within two months of the settlement period pertaining to the applicable business period.</p>
Incentive fee	<p>Amount obtained by the following calculation formula <b>according to the investment unit price (closing price)</b> on the Tokyo Stock Exchange during the applicable business period. However, the following calculation formula shall be promptly reviewed if the investment corporation merges or splits investment units.            [Calculation Formula]            · (Average closing price of investment unit during applicable business period - Highest price among the average closing prices of respective business periods up until the previous business period) X Number of outstanding investment units as of the end of the previous business period X 0.4%            The average closing price of investment unit shall be calculated by totaling the investment unit price (closing price) on each business day of the applicable business period and dividing it by the number of business days. Business days without closing prices shall be excluded from the calculation.            If the average closing price of the investment unit during the applicable business period does not exceed the highest price among the average closing prices of respective business periods up until the previous business period, the fee shall be 0 yen.            Fee shall be paid within two months of the settlement period pertaining to the applicable business period.</p>

\*Management fees are indicated on "investment corporation rules" posted on each investment corporation's website

## 4. Financing for J-REITs

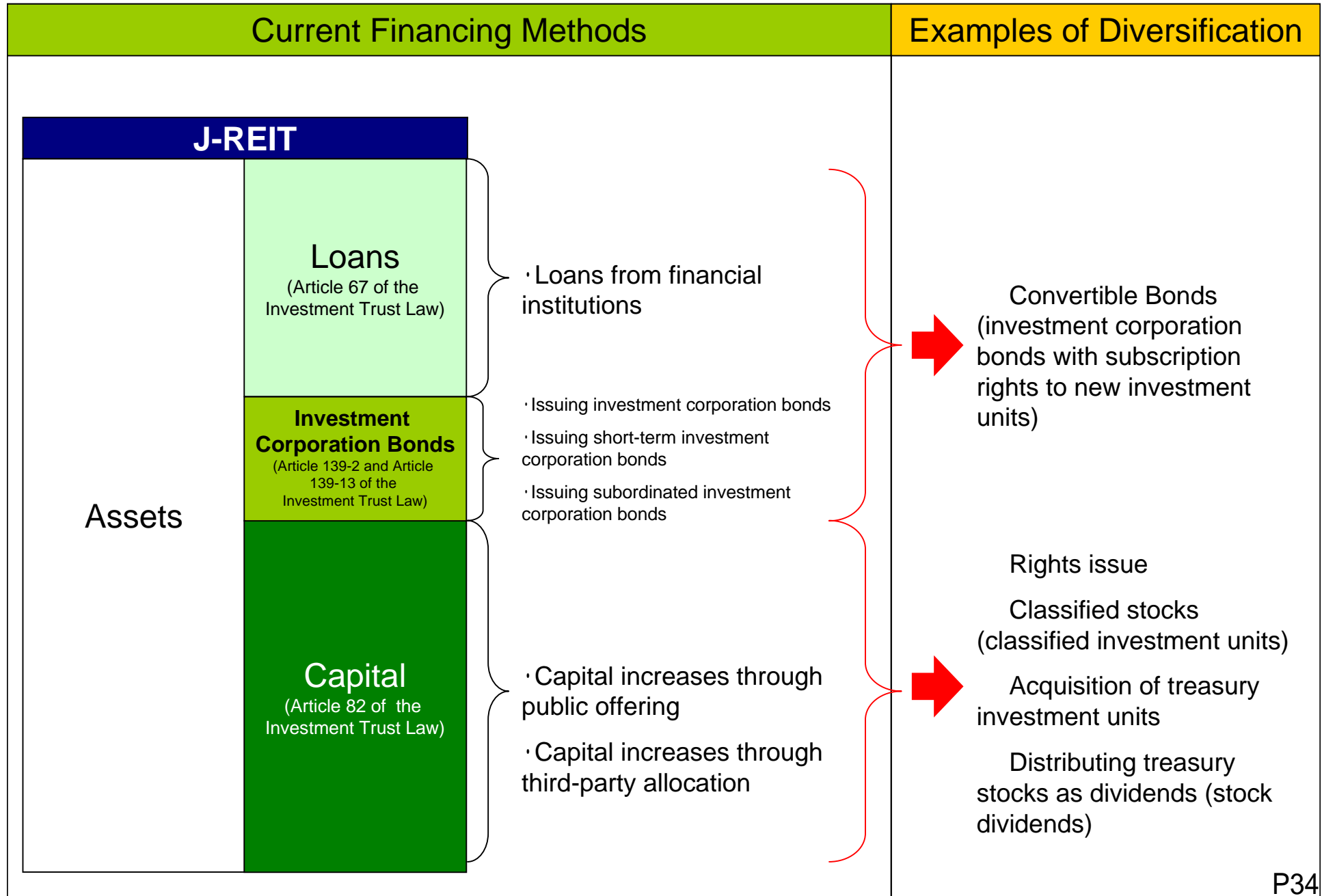
## Gearing (LTV) Regulations for REITs in Major Countries

### Gearing (LTV) Regulations for REITs in Major Countries

U.S.A.	None
Australia	None (only undercapitalization rules)
Hong Kong	45% of asset value
Singapore	35% of real estate asset value (possible up to 60% by acquisition of ratings and disclosure)
France	None (only undercapitalization rules)
U.K.	Interest coverage test (taxable income before interest and financial expense deductions / interest paid > 1.25)
Germany	45% of value of fixed assets (IAS40)
Belgium	65% of total assets

\*By Baker and Mckenzie GJBJ Tokyo Aoyama Aoki Koma Law Office

# Diversification of Financing Methods



## Capital Increases through Third-party Allocation

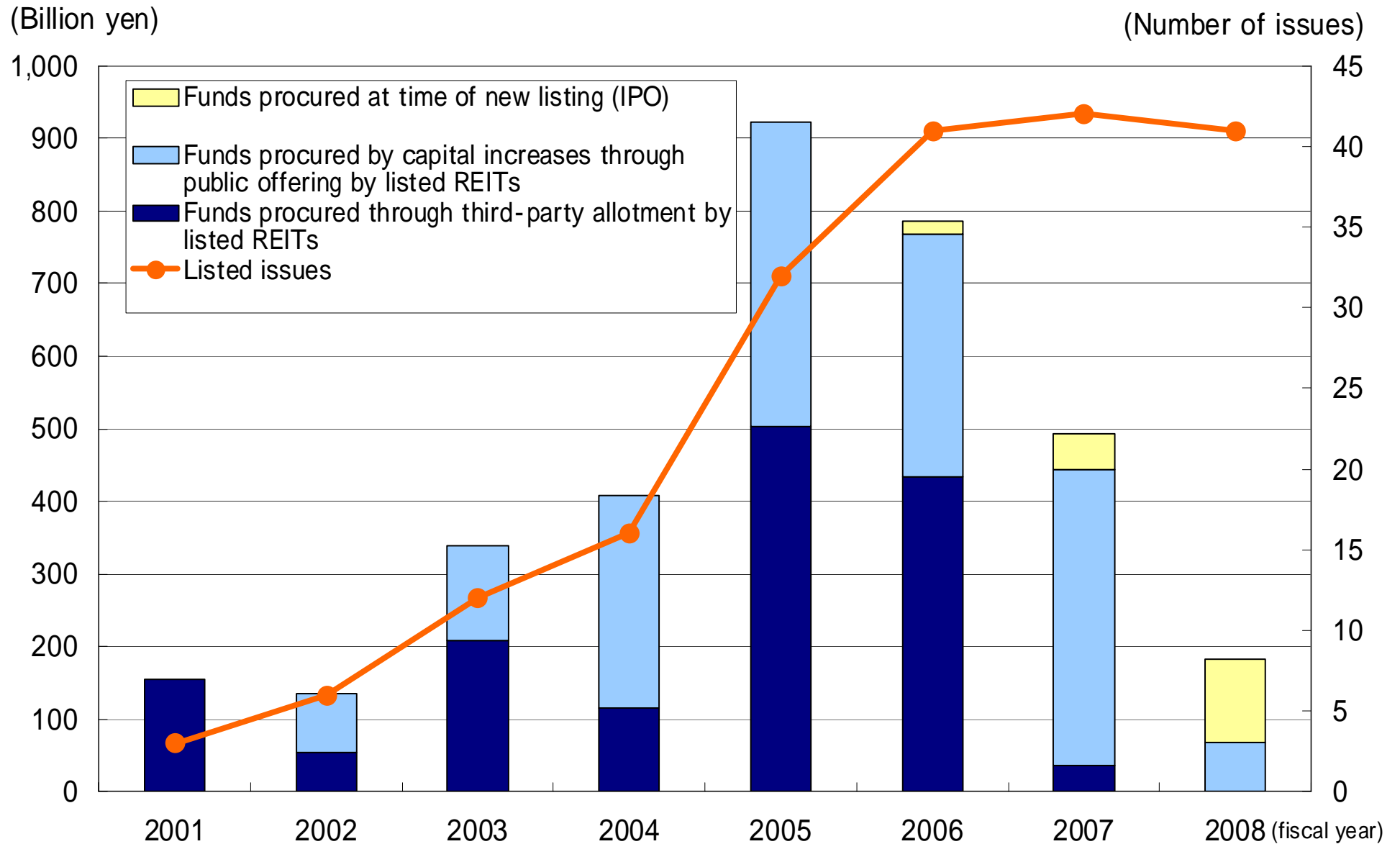
### Capital Increases through Third-party Allocation in the Past Year

With regard to capital increases through third-party allocation that were undertaken in the past year, there were some cases where dividends decreased by 30% to 40%.

Press Release	Investment Corporation Name	Dividend Forecasts		Volatility	Procured Amount	Use of Funds
		Before Capital Increase	After Capital Increase			
April 2008	Company A	14,954yen	10,050yen	32.8%	5.1bn yen	Loan repayment, property acquisition
May 2008	Company B	14,706yen	14,232yen	3.2%	60.0bn yen	Loan repayment, redemption of investment corporation bonds
Aug. 2008	Company C	10,321yen	5,766yen	44.1%	12.3bn yen	Loan repayment, property acquisition
Sep. 2008	Company D	14,117yen	13,500yen	4.4%	14.7bn yen	Property acquisition
Sep. 2008	Company E	20,334yen	20,500yen	0.8%	17.6bn yen	Loan repayment (However, dividend forecasts increased since the revenue from property recently acquired is reflected.)
Jan. 2009	Company F	22,027yen	18,862yen	14.4%	1.5bn yen	Loan repayment
Mar. 2009	Company G	5,200yen	4,200yen	19.2%	2.0bn yen	Loan repayment

\*Compiled based on press releases of companies.

# Equity Procurement by J-REITs



\*As of March 31, 2009 (by Daiwa Institute of Research Ltd. based on public data from investment corporations)

# Rights Issue (Capital Increases through Unitholder Allocation)

What is rights issue?

· Issuance of new investment units conducted by REITs through the granting of rights to receive investment units to all unitholders listed in the register of unitholders on a certain record date.

(Unitholders decide whether to respond to the offer. Therefore, the fund procurement amount varies according to the proportion of unitholders who respond to the offer.

Unitholders who do not respond to the offer lose these rights.)

<Interpretation of capital increases through unitholder allocation>

The answer by the FSA regarding how to interpret capital increases through unitholder allocation in the regulatory reform requests (Cabinet Office) received on October 2008:

“It is not necessarily against the law for an investment corporation to allocate investment units to existing unitholders at a **fair value**.”

## Advantages

· Since all unitholders are able to acquire rights, it is different from a capital increase through third-party allocation in that there is no discrimination, etc. and all unitholders receive the opportunity to participate.

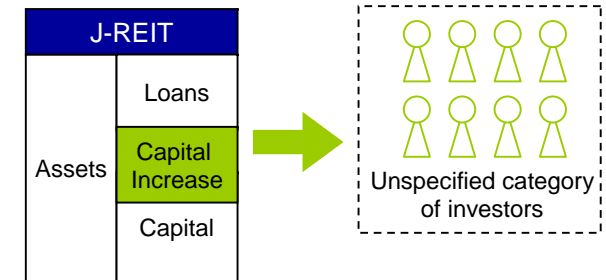
· Since this offer made to all unitholders is cheaper compared to market prices, unitholders find it easier to respond and therefore, it becomes possible to procure equity during periods when investment unit prices are low.

## Points of caution from the viewpoint of protecting investors

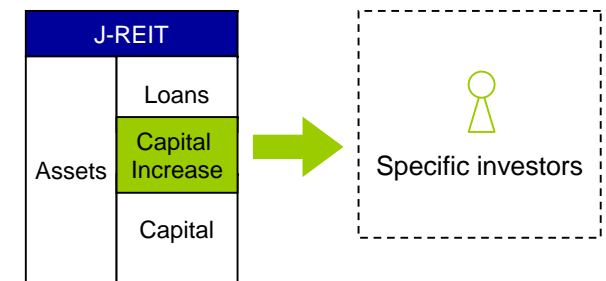
· Since capital increases through unitholder allocation represent a request for capital to existing unitholders who had not originally wished to increase their purchase, REITs generally increase capital by issuing at discounted prices compared to market prices, in order to motivate existing unitholders to invest, etc. There may be unitholders who lack the funds and do not respond to the offer and who end up losing the rights, thereby choosing to sell their investment units in order to avoid a decrease in distribution per investment unit (dilution). In addition, the amount of procured funds can vary in accordance with the proportion of investors losing their rights, so that care must be taken regarding how the funds are used.

## Diagram

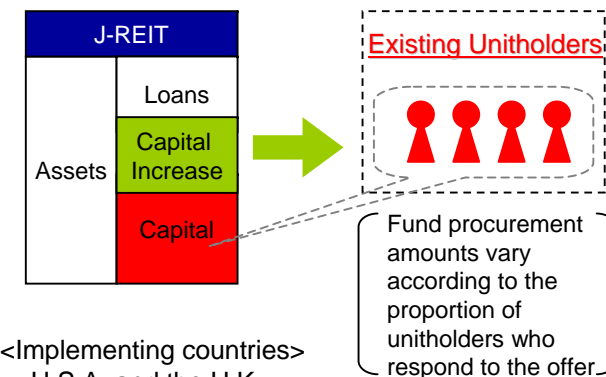
<Capital increases through public offering>



<Capital increases through third-party allocation>



<Capital increases through unitholder allocation>



<Implementing countries>

· U.S.A. and the U.K.

## Rights Issue (Capital Increases through Unitholder Allocation)

### Major Cases of Implementation in Foreign Countries (Rights issue)

Nation	REIT	Period	Amount	Discount Rate of Issue Price
Australia	GPT Group	Announced 2008/10/23	About 79.3 bn yen	-48% (compared to closing price on Oct. 21)
	Goodman Group	Announced 2008/10/29	About 44.3 bn yen	-29.7% (compared to closing price on Oct. 28)
	Mirvac Group	Announced 2008/11/5	About 26.1 bn yen	-37.5% (compared to closing price on Nov. 4)
	ING Office Fund	Announced 2008/12/8	About 15.3 bn yen	-22% (compared to closing price on Dec. 2)
U. K.	Workspace Group	Announced 2009/1/27	About 13.1 bn yen	-69.2% (compared to closing price on Jan. 26)
	Hammerson	Announced 2009/2/9	About 87.6 bn yen	-62.2% (compared to closing price on Feb. 6)
	British Land	Announced 2009/2/12	About 110.0 bn yen	-53% (compared to closing price on Feb. 11)
	Land Securities	Announced 2009/2/19	About 113.4 bn yen	-51% (compared to closing price on Feb. 18)

\*Compiled based on press releases, etc. of REITs. Based on the assumption that 1 GBP = 150 yen and 1 AUD = 61 yen.

# Convertible Bonds (Investment Corporation Bonds with Subscription Rights to New Investment Units)

What are investment corporation bonds with subscription rights to new investment units?

· Investment Corporation Bonds with Subscription Rights to New Investment Units  
They are first issued as investment corporation bonds, and if the buyer makes a request within a certain set period, then he/she can convert those bonds into investment units of the REIT at a price (conversion price) agreed upon at the time those bonds were issued.

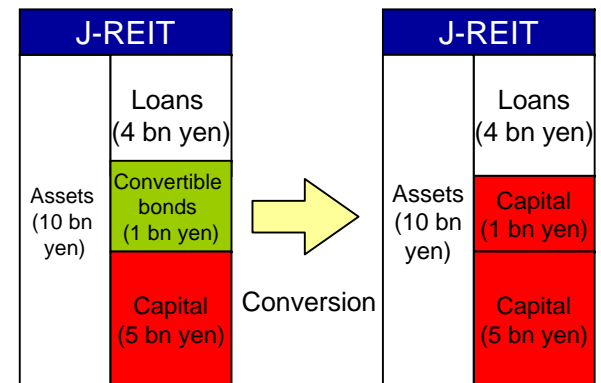
## Advantages

- <In the case where convertible bonds are issued when investment unit prices are low>
- When prices of investment units underestimated in the market are recovering to their net asset values and the conversion rights are exercised, then LTV can be reduced.
- Capital sources such as strategic investors might be more inclined to buy convertible bonds in anticipation of the advantages that they could execute conversion rights in a process of rising investment unit prices
- Such capital sources would help decelerate the speed of dilution, caused by the conversion into investment units, throughout the lives of the convertible bonds.

## Points of caution from the viewpoint of protecting investors

- There is a possibility that, depending on how the conversion prices of the convertible bonds are set, a significant level of dilution would be caused through their conversion into a huge amount of investment units. Dilution might be further accelerated if the conversion prices were subject to some unlimited moving strike clauses.
- Furthermore, downward pressure on investment unit prices may arise if trade practices are employed in which investment units are sold while at the same time conversion rights are executed (a decrease of market prices as a result of short-selling large volumes, etc. and conversion prices are then corrected according to market prices; after the price correction the conversion right is exercised, only to be followed by another round of selling.)
- On the other hand, no financial improvement – such as improvements in LTV – anticipated initially might be achieved if investment unit prices would not rise after the issuance and the convertible bonds were not converted into common stocks (investment units) despite the arrival of conversion deadlines.
- Therefore, we believe that prudent investigations should be made as to the product characteristics of convertible bonds and other factors, such as fully securing governance and the need for system design for investor protection.

## Diagram



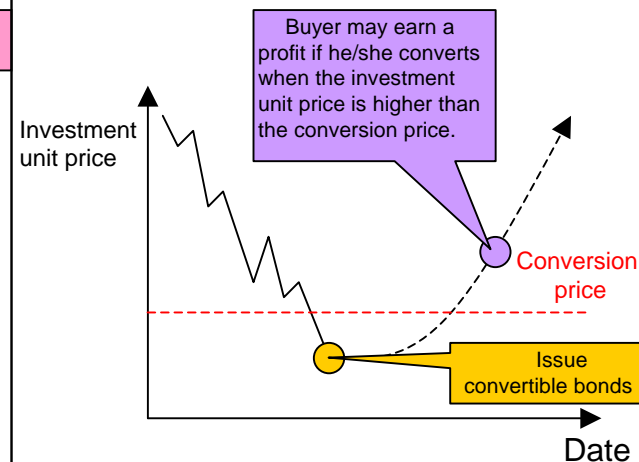
Before conversion

After conversion

$$\text{LTV} = (40+10) / 100 = \underline{\underline{50\%}}$$

$$\text{LTV} = 40 / 100 = \underline{\underline{40\%}}$$

(Improvement of financial base)



<Implementing countries>  
· U.S.A. and Australia.

# Convertible Bonds (Investment Corporation Bonds with Subscription Rights to New Investment Units)

## Cases of Implementation in Foreign Countries (Convertible bonds)

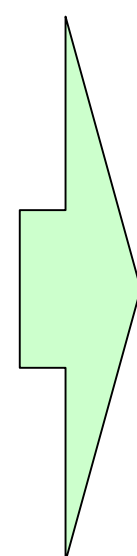
<Australia: The GPT Group> completed on Nov. 28, 2008

- The convertible bonds were used to repay existing debts. Furthermore, the company combined capital increases by way of a shareholder allocation of stocks and an issuance of perpetual subordinated bonds with conversion rights to common stocks in an effort to reconstruct its financial structure, and was thus able to procure funds that totaled 1.55 billion Australian dollars (about 94.6 billion yen).
- As a result, **its LTV decreased from about 47% to about 42%.**

Rights Issue (total of 1.3 billion Australian dollars (about 79.3 bn yen))
<p><u>1. Shares allocated to institutional investors</u></p> <ul style="list-style-type: none"> <li>· 1 billion Australian dollars (about 61 billion yen)</li> <li>· Allocation of 1 unit per unit at 0.60 Australian dollars per unit (-48% discount)</li> </ul>
<p><u>2. Shares allocated to retail investors</u></p> <ul style="list-style-type: none"> <li>· 0.3 billion Australian dollars (about 18.3 billion yen)</li> <li>· Allocation of 1 unit per unit at 0.60 Australian dollars per unit (-48% discount)</li> </ul>



GIC RE underwrote the shares for which there were no applications by retail investors



Reduction in  
LTV

About 47%  
About 42%

Perpetual subordinated bonds with conversion rights to common stocks (0.25 billion Australian dollars (about 15.3 billion yen))
<ul style="list-style-type: none"> <li>· Underwritten by GIC RE: 0.25 billion Australian dollars (about 15.3 billion yen)</li> <li>· 10% yield</li> <li>· Able to convert to common stocks at 1.25 Australian dollars per unit, but limited to 41 days after issuance .</li> </ul>

Implemented  
buybacks of  
medium-term  
bonds worth about  
0.53 billion  
Australian dollars

\*GIC RE : The Government of Singapore Investment Corporation Real Estate Pte Ltd

\*Compiled based on press releases, etc. of REITs. Based on the assumption that 1 AUD = 61 yen.

# Classified Stocks (Classified Investment Units)

## What are classified investment units?

· Investment units whose content varies from that of common investment units in terms of dividend rights. (Preferred investment units: a type of classified investment unit and an investment unit for which a right to receive dividends and distribution of residual assets is granted at a higher priority than unitholders of common investment units.)

For example, the Corporate Law stipulates classified stocks as the following:

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>Distribution of retained earnings</li> <li>Distribution of residual assets</li> <li>Resolution rights</li> <li>Restriction on transfers</li> <li>Put options for shareholders</li> </ul> | <ul style="list-style-type: none"> <li>Shares subject to call by the company</li> <li>Class share subject to class-wide call</li> <li>Veto</li> <li>Right to appoint executives</li> </ul> |
|---|--|

<Reference> For many of the preferred shares of ordinary companies, shareholders of common stocks may receive dividends and distributions of residual assets on a priority basis in place of not receiving resolution rights in shareholders' meetings (After distributing dividends to preferred shareholders at a dividend price higher than that decided at the time of issuance, and there still remains some retained earnings, those are distributed to common shareholders. After distributing residual assets to preferred shareholders at a price decided on at the time of issuance, and there still remains residual assets, those are distributed to common shareholders.). Furthermore, after a certain period of time, there are certain conditions attached. For example, investors can convert them into common stocks or demand buybacks from companies, or companies can repurchase them.

## Advantages

· Even in the face of a difficult environment in obtaining financing, leaving the option open for various issuances of classified investment units to respond to various investor needs allows REITs to improve their finances, which in turn may lead to an increase in investor trust. For example, although there are no resolution rights attached, if unitholders of preferred investment units can receive dividends at a higher priority than unitholders of common investment units, this would make it easier for companies to obtain financing.

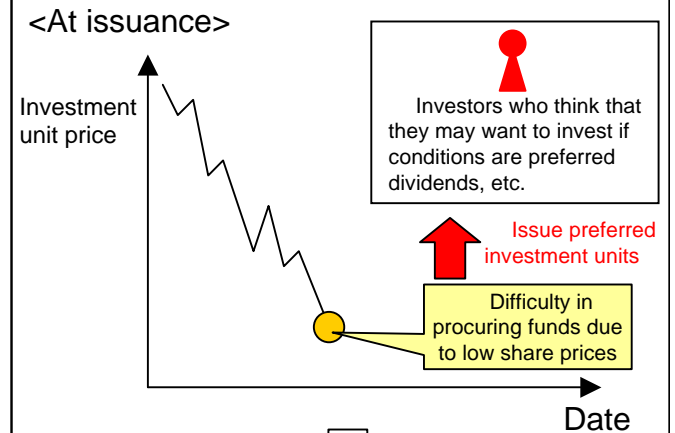
## Points of caution from the viewpoint of protecting investors

· However, issuing preferred investment units, for example, might also bring about a negative impact, as they would make all outstanding investment units subordinate to them and have a major impact on existing investors. Redemption of such preferred investment units would also become a big problem.

· Furthermore, there is a possibility that, if existing investors of investment units become relatively subordinated, such a situation would not fit the product characteristics of REITs as financial products oriented to stable income gains.

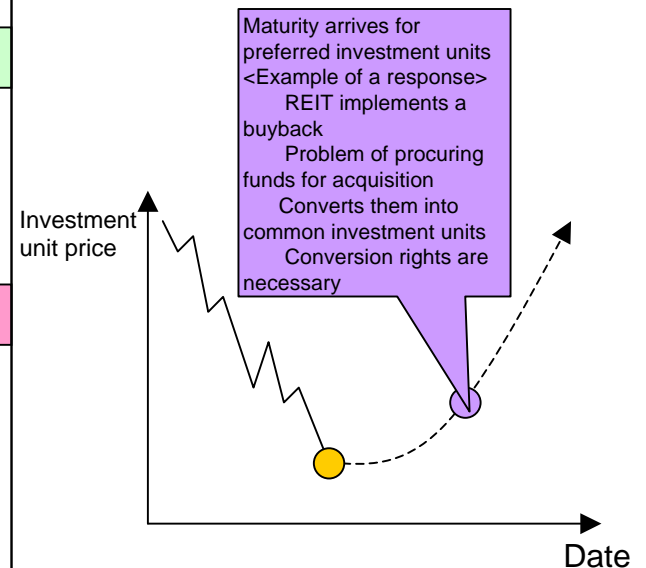
· Therefore, it is necessary that discussions be made regarding the ideal classified stocks while considering factors securing governance and protecting investors.

## Diagram



After a certain period of time

<At maturity>



<Implementing countries>

· U.S.A. and the U.K.

## Classified Stocks (Classified Investment Units)

### Cases of Implementation in Foreign Countries (Classified stocks)

<Past Capital Increases of U.S.-Listed REITs>

Year	Common Stocks		Preferred Stocks	
	Cases	Amount	Cases	Amount
2000	11	1.2 bn USD	31	1.7 bn USD
2001	58	4.2 bn USD	21	1.9 bn USD
2002	85	5.8 bn USD	25	2.0 bn USD
2003	82	5.5 bn USD	64	5.2 bn USD
2004	79	7.3 bn USD	61	5.9 bn USD
2005	71	8.5 bn USD	36	3.1 bn USD
2006	75	15.7 bn USD	39	4.2 bn USD
2007	56	11.9 bn USD	26	4.2 bn USD
2008	60	11.1 bn USD	9	1.2 bn USD

\*Compiled using NAREIT's "Industry Capital Offerings – Summary Historical Offerings: April 2009"

<Examples>

REIT	Announced	Amount	Details
Alexandria Real Estate Equities	2008/3/18	0.25 bn USD	Preferred stocks with conversion rights (7.0% interest rate)
Entertainment Properties Trust	2008/3/26	0.09 bn USD	Preferred stocks with conversion rights (9.0% interest rate)

\*Compiled based on press releases, etc. of REITs.

# Acquisition of Treasury Investment Units

## What is an acquisition of treasury investment units?

- The acquisition of a REIT's own outstanding investment units.

## Advantages

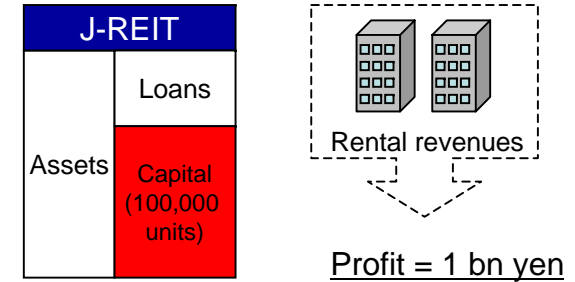
- If a REIT acquires its own outstanding investment units, the number of investment units traded in the market will decrease. Therefore, the above would enable the effect of maintaining investment unit prices.
- Furthermore, in the case of acquiring its own outstanding investment units and retiring them (in the case of decreasing the number of outstanding investment units) and if the profit is the same, then implementing the above would have the effect of increasing profit per investment unit.
- Due to this, companies in countries implementing the above like the U.S. utilize this for their capital and dividend policies as a means to counter stagnant stock prices or to improve dilution that occurs after capital increases. It is also expected to possibly help improve investor trust.

## Points of caution from the viewpoint of protecting investors

- Care must be taken with regard to the relationship with existing creditors when using the capital of the REITs as funds to acquire treasury investment units, and to fair and equal handling of all investors when using distributable profits to investors, since this would involve the repayment of capital invested.
- Since it is possible that the executives, employees, etc. of the same REIT may obtain internal information and sell or purchase the REIT's investment units before said information is announced, regulations on insider trading may need to be introduced.

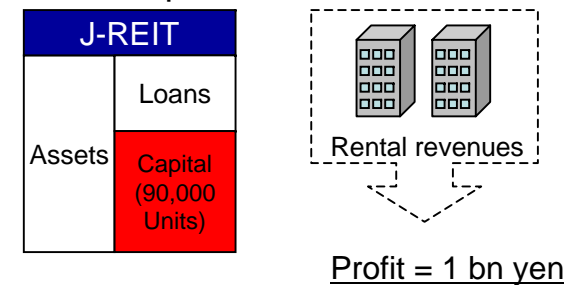
## Diagram

### <Before Acquisition>



$$\begin{aligned}
 &\text{Profit per investment unit} \\
 &= 1 \text{ bn yen} / 100,000 \text{ units} \\
 &= \underline{10,000 \text{ yen / unit}}
 \end{aligned}$$

### <After Acquisition>



$$\begin{aligned}
 &\text{Profit per investment unit} \\
 &= 1 \text{ bn yen} / 90,000 \text{ units} \\
 &= \underline{11,000 \text{ yen / units}} \\
 &\text{(up by about 1,000 yen)}
 \end{aligned}$$

### <Implementing countries>

- U.S.A., Australia, Hong Kong and Canada

### Cases of Implementation in Foreign Countries (Acquisition of treasury investment units)

#### <U.S.A. : Plum Creek>

· Plum Creek purchased about 3.3 million shares or about 2% of their outstanding shares, which totaled about 166 million shares at about 87 million dollars during the applicable fiscal term (Jan. 2009 ~ Mar. 2009). Rather than retiring them, it kept them as is (treasury stocks). As a result, Plum Creek's treasury stocks increased from 773 million dollars to 860 million dollars.

#### <U.S.A. : SL GREEN>

· On March 2007, SL Green announced that it would buy about 300 million dollars of its treasury stocks (equivalent to about 3.4% of its outstanding shares) by December 2008.  
· Following this, it periodically acquired treasury stocks which resulted in a purchase of about 300 million dollars of its treasury stocks by December 2008. It is currently keeping them as treasury stocks.

# Distributing Treasury Stocks as Dividends (Investment Unit Dividends)

## What are investment unit dividends?

· The act of distributing investment units as dividends, rather than in cash.

<Example in the U.S.>

In the U.S., a new rule was enforced in December 2008 in relation to the dividend requirement of distributing 90% or more of taxable income as a conduit requirement in which REITs were permitted to distribute stock dividends according to investors' choices (although at least 10% of dividends must be conducted in cash).

(\*A temporary legislation which shall be applied to dividends paid in the limited time frame of January 1, 2008 through December 31, 2009)

## Advantages

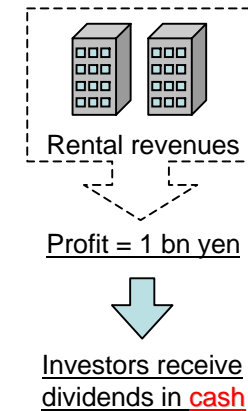
· In the U.S., even major blue-chip REITs paid out share dividends and it is pointed out that this measure has helped to control the outflow of cash on hand and to reduce refinancing risks without violating the conduit requirements.

## Points of caution from the viewpoint of protecting investors

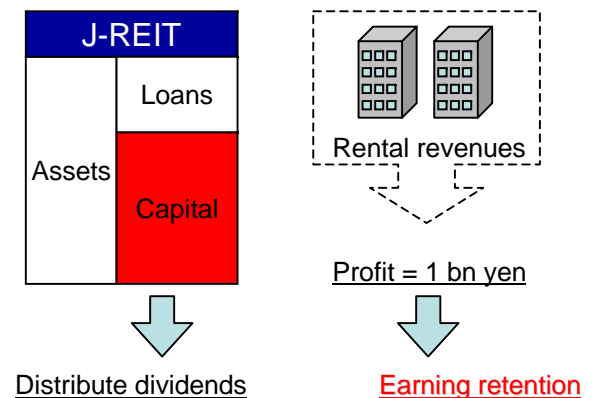
· Investment unit dividends are usually implemented during periods when investment unit prices are low as a result of refinancing risk, etc. Thus investors may be at a disadvantage when they want to liquidate stock dividends, since the market prices are low and selling them in the market would further lower the stock prices.

## Diagram

<Ordinary Dividends>



<Investment Unit Dividends>



Investors

- Continue to hold units and receive dividends
- Sell units and receive a profit on sales

<Implementing countries>

· U.S.A.

# Distributing Treasury Stocks as Dividends (Investment Unit Dividends)

## Cases of Implementation in Foreign Countries (Stock dividends)

<U.S.A.>

· In the U.S., a Guidance was officially released from the IRS (Internal Revenue Service) last December saying that a maximum of 90% of dividends can be paid using shares. Major REITs are now paying out part of their dividends in shares rather than in cash.

### Vornado Realty Trust (Announced on January 14, 2009)

· Vornado paid share dividends in order to reduce its refinancing risk, etc.

In 2009, if it is able to maintain this policy, its plan is to raise retained earnings of 390 million dollars (about 39 billion yen).

\*Based on the assumption that 1 USD = 100 yen.

- Shareholders can choose between shares and cash when receiving dividends. However, the system allows a payout in cash of no more than 40% of dividends for the applicable fiscal term.

Firstly, shareholders choose whether they would like to receive all of their dividends in cash or all of their dividends in common stocks.

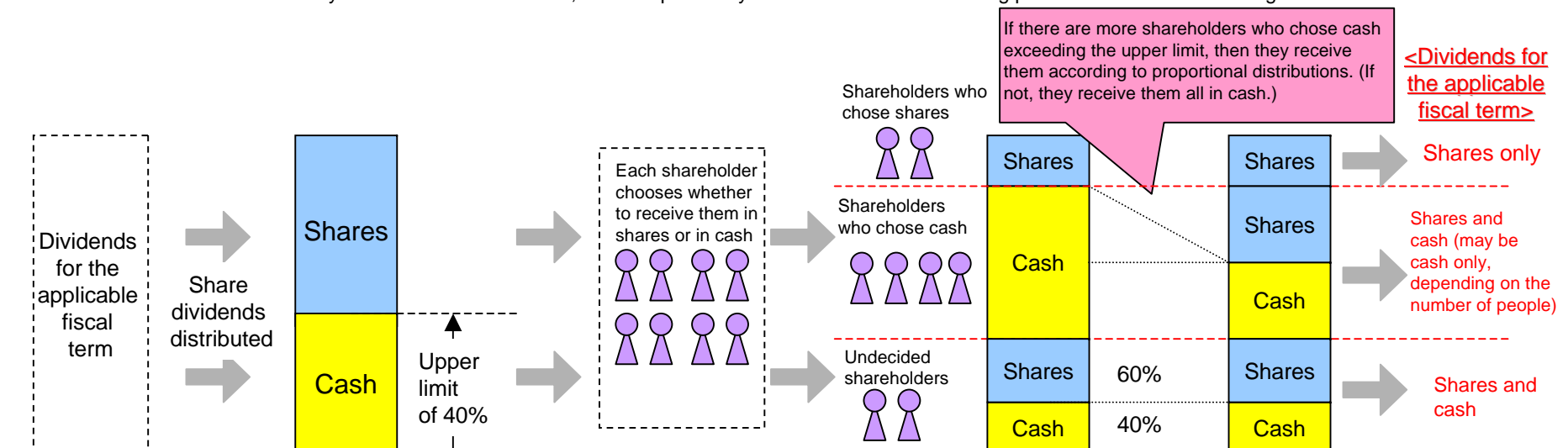
Shareholders who did not make a choice can receive 60% of their dividends in shares and 40% in cash.

For shareholders who chose to receive all their dividends in shares, they may receive all of their dividends for the applicable fiscal term in shares.

For shareholders who chose to receive all of their dividends in cash, the amount of cash they receive varies depending on the proportion of shareholders who chose to do likewise.

If there are many shareholders who chose likewise, then they receive cash in proportional distributions and the rest are paid in shares since the payment of dividends in cash is limited by up to 40% of the dividends for the applicable fiscal term.

If there are only a few who chose likewise, then the possibility of all of their dividends being paid out in cash becomes higher.



# Establishment of Provisions Concerning Capital Decreases

## What is a capital decrease?

- A capital decrease is when a company decreases its capital.
- If a company produces a loss in their financial results of a fiscal term, it can post it as a loss carried forward in the balance sheet and then cover the loss carried forward using the profit from the next fiscal term. However, if the profit from the next fiscal term is not sufficient to cover it, then the loss carried forwards remains until the fiscal term following the next, and so forth. If this is the case, there arises the concern that it would face difficulty in distributing profits until it is able to produce profits. In order to solve this problem, the method called capital decrease may be used to reverse capital and dispose the loss carried forward at once.
- There are cases when an ordinary company that conducts a capital decrease conducts a capital increase immediately afterwards since shareholders' equity also decreases.

## Advantages

- Take for example a REIT whose assets amount to 100 billion yen and whose net income every fiscal term is 1 billion yen. If, due to the large drop in the prices of real estate owned, an impairment loss of 5 billion yen is incurred and the company produces a net loss of 4 billion yen, then 4 billion yen would be posted as loss carried forward. Three billion yen would then be posted as loss carried forward during the next fiscal term and the loss would be carried forward until after the fiscal term following the next.
- If a J-REIT has a loss carried forward, it may find it difficult to distribute profits as dividends. Furthermore, financial institutions who are lending to the REIT would be faced with the situation of having to review lending to a company with losses and may find difficulty in making the loan. In this regard, there was an opinion that a capital decrease was conducted to allow it to cover losses, and such an arrangement would also be effective in view of financing measures.

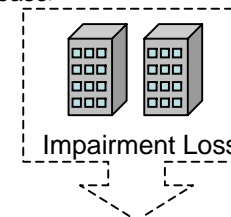
## Points of caution from the viewpoint of protecting investors

- Since conducting a capital decrease would have a significant impact on investors as a result of a decrease in shareholders' equity and increase in LTV, etc., it is advisable that careful discussions are made regarding the decision-making process for conducting capital decreases (a resolution at a shareholders' meeting is necessary for joint stock companies).

## Diagram

<Flow from the Incurring of Losses until the Conducting of Capital Decrease>

J-REIT	
Assets 1000	Liabilities 600
	Capital 400



Posting as loss on impairment	-50
Profit	10
Net loss	-40

**Loss of -40 carried forward**

J-REIT	
Assets 960	Liabilities 600
Losses -40	Capital 400

The loss carried forward is reduced by using profits from each fiscal term. However, excess profits are not produced until it disappears and so dividend payouts are made difficult.

**Implement a capital decrease of -40**

J-REIT	
Assets 960	Liabilities 600
	Capital 360
Losses -40	Capital -40

If the loss carried forward disappears as a result of the capital decrease, then dividend payouts can be restarted earlier.

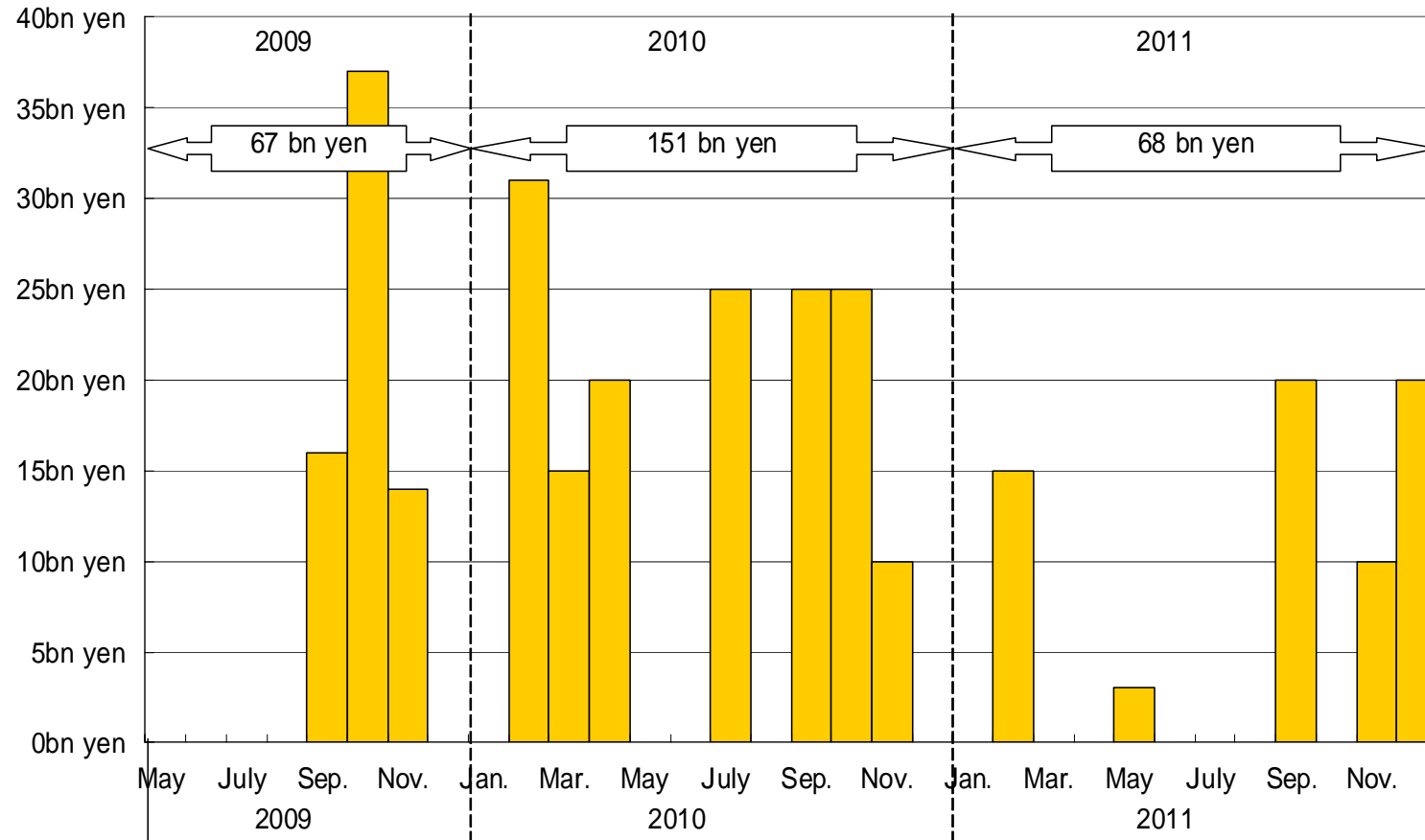
<Implementing countries>

- U.S.A. and the U.K.

# Redemption of Investment Corporation Bonds by J-REITs

## Redemption of Investment Corporation Bonds

(Billion yen)



(Reference)

Year of Redemption	Amount of Redemption
2009	67 bn yen
2010	151 bn yen
2011	68 bn yen
After 2012	353 bn yen
Total	639 bn yen

J-REIT's total interest-bearing debts: About 3.5 tn yen (as of April 30, 2009)

Of which, loans:  
About 2.9 tn yen

Of which, investment corporation bonds:  
About 640 bn yen

\*As of April 30, 2009 (by Daiwa Institute of Research Ltd. based on public data from investment corporations)

# Subordinated Investment Corporation Bonds

## Subordinated Investment Corporation Bonds

Investment Corporation	Industrial & Infrastructure Fund Investment Corporation
Name of Issue	Industrial & Infrastructure Fund Investment Corporation First Unsecured Corporate Bonds (Subordinated corporate bonds exclusively for qualified institutional investors)
Recipient of Allotment	Mitsubishi Corporation
Total Issuing Amount	8,000 million yen
Date of Issuance	February 27, 2009

### <Subordinated Investment Corporation Bonds>

- In the case that an investment corporation goes into liquidation or bankruptcy, the assets of the investment corporation are distributed to general creditors, but their repayment is normally lower in priority than that of ordinary investment corporation bonds. Firstly, repayment to general creditors is given priority, and if residual assets still remain, they are distributed to the holders of subordinated investment corporation bonds.
- Therefore, an ordinary company sets the interest rate for subordinated corporate bonds, whose risk is higher than that of ordinary corporate bonds, at a higher rate.
- Furthermore, repayment for loans made to the investment corporation by banks is given higher priority than to holders of subordinated investment corporation bonds. Some banks thus view subordinated investment corporation bonds as capital rather than as liabilities when conducting loan examinations. In that case, subordinated investment corporation bonds are not treated as interest-bearing debt when calculating the LTV (= Interest-bearing debt / Total assets). Some have pointed out that REITs are then able to suppress the LTV in comparison to the case of issuing normal investment corporation bonds, and as a result may receive loans more easily.

# Qualification of Investment Corporation Bonds as Eligible Collateral

## Qualified as Eligible Collateral by the Bank of Japan

- To be selected by the Bank of Japan (BOJ) as a collateral asset when the BOJ provides funds to a financial institution.
- The BOJ selects qualified collateral assets by placing priority on their trustworthiness and marketability.

<Press Release (Jan. 22, 2009)> Amendments to “Guidelines on Eligible Collateral” (excerpts):

“At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, with a view to further facilitating the Bank’s money market operations, to accept **bonds issued by real estate investment corporations**, dematerialized commercial paper issued by real estate investment corporations, bills drawn by real estate investment corporations, commercial paper issued by real estate investment corporations, and loans on deeds to real estate investment corporations as eligible collateral for the Bank’s provision of credit and to add dematerialized commercial paper issued by real estate investment corporations and commercial paper issued by real estate investment corporations to the list of CP purchased with repurchase agreements.”

Collateral Category	Eligibility Standard
<b>Bonds Issued by Real Estate Investment Corporations</b>	<p>Bonds issued by real estate investment corporations satisfying the following requirements:</p> <p>(1) Publicly-offered bonds issued by investment corporations (as defined in Article 2, Paragraph 12 of the Investment Trust and Investment Corporations Act, Act No. 198, 1951) which are deemed eligible in light of creditworthiness and other relevant factors, <b>such as being rated AA or higher</b> by an eligible rating agency. (When bonds are guaranteed by other companies, factors regarding the creditworthiness of the companies such as being rated A or higher would also be taken into account. The same criteria will be applied to all debt of real estate investment corporations.)</p> <p>(2) Principal investment objects of debtor investment corporations should be real estate, a leasehold of real estate, superficies of real estate, asset-backed securities backed by these assets or real estate-related assets which are deemed corresponding to these assets.</p>
Dematerialized Commercial Paper Issued by Real Estate Investment Corporations Bills Drawn by Real Estate Investment Corporations Commercial Paper Issued by Real Estate Investment Corporations	<p>Dematerialized commercial paper issued by real estate investment corporations, bills drawn by real estate investment corporations, and commercial paper issued by real estate investment corporations satisfying the following requirements:</p> <p>(1) Those deemed appropriate in light of creditworthiness of debtor investment corporations and other relevant factors.</p> <p>(2) Principal investment objects of debtor investment corporations should be real estate, a leasehold of real estate, superficies of real estate, asset-backed securities backed by these assets or real estate-related assets which are deemed corresponding to these assets.</p> <p>(3) Those with an original maturity of up to 1 year.</p>

Outstanding collateral accepted by the BOJ: Real estate investment bonds = 4.3 billion yen (principal) as of April 30, 2009

# Short-term Investment Corporation Bonds

## Past Issuances of Short-term Investment Corporation Bonds

Investment Corporation	Period	Amount	Use of Funds
Nomura Real Estate Office Fund, Inc.	April 24, 2008 to June 6, 2008	20 bn yen	Property acquisition
	June 24, 2008 to Sep. 24, 2008	15 bn yen	Property acquisition
Japan Retail Fund Investment Corporation	Dec. 25, 2007 to Mar. 23, 2008	25 bn yen	Property acquisition
	Mar. 24, 2008 to June 23, 2008	25 bn yen	Redemption of existing short-term investment corporation bonds
	June 24, 2008 to Sep. 23, 2008	25 bn yen	Redemption of existing short-term investment corporation bonds
	Sep. 24, 2008 to Dec. 24, 2008	25 bn yen	Redemption of existing short-term investment corporation bonds

Investment Trust and Investment Corporations Act (Special Provisions Concerning Short-term Investment Corporation Bonds)  
 Article 139-12: Notwithstanding the provisions of Article 681 of the Corporate Law which is applied mutatis mutandis to Article 139-7, an investment corporation that has issued investment corporation bonds that meet any of the following conditions need not make an investment corporation bond register.

- (i) The amount of an investment corporation bond is no less than 100 million yen.
  - (ii) A set period of **less than one year** is designated from the day that the total amount of the investment corporation bond is paid until the principal redemption date and there are no specifications on divided payments.
  - (iii) There are provisions that stipulate the payment date of interest as being the same date as the redemption date set forth in the previous item.
  - (iv) Collateral is not posted pursuant to provisions under the Secured Bonds Trust Law.
- (2) Provisions under Articles 139-8 to 139-10 shall not apply to short-term investment corporation bonds.

(Issuance of Short-term Investment Corporation Bonds)

Article 139-13: Investment corporations shall not issue short-term investment corporation bonds except in the following cases:

- (i) When they meets all of the following conditions:
  - (a) **The purpose of the issuance is the procurement of funds necessary to acquire specified assets (limited to real estate and assets prescribed other Cabinet Orders) and other purposes set out under Cabinet Office Ordinance.**
  - (b) A limit is set as to the issuing amount in the bylaws.
  - (c) Other than those set out under (a) and (b), conditions that are stipulated by the Cabinet Office Ordinance in order to protect unitholders.
- (ii) In the case of procuring funds to redeem short-term investment corporation bonds (limited to cases prescribed by the Cabinet Office Ordinance).

Enforcement Order for the Investment Trust and Investment Corporations Act

(Conditions of Issuance of Short-term Investment Corporation Bonds)

Article 98-2: Assets set forth under Article 139-13, item (i) (a) of the Act and prescribed by Cabinet Order are the following:

- (i) Assets set forth under Article 3, items (iii) to (v).
- (ii) Trust beneficiary rights which only entrust assets set forth under the preceding item.
- (iii) If one party makes an investment in the other party so that it may conduct management of assets set forth under the preceding two items, and the other party manages the invested assets only for the purpose of investing in said assets, then the interests of investment in relation to an agreement that stipulates that profit arising from said management will be distributed.
- (iv) Preferred investment securities set forth under Article 2, paragraph 9 of the Law on Securitization of Assets issued by a special purpose company prescribed under Article 2, paragraph 3 of the Law on Securitization of Assets (limited to specified assets set forth under Article 2, paragraph 1 and that are set forth under items (i) and (ii)).

# Short-term Investment Corporation Bonds

## Enforcement Ordinance of Investment Trust and Investment Corporations Act (Conditions of Issuance of Short-term Investment Corporation Bonds)

Article 192: Purposes prescribed by the Cabinet Office Ordinance stipulated under Article 139-13, item (i) (a) of the Act are the following:

- (i) **Procurement of funds necessary to acquire specified assets** (limited to assets set forth under all items in Article 98-2 of the Ordinance. The same shall apply for the next paragraph, item (ii).)
- (ii) **Procurement of funds necessary to repair** the following **real estate** (limited to those that need urgent repairs as a result of accidents, natural disasters, etc.).
  - A. Real estate owned by an investment corporation.
  - B. Real estate that are trust assets for trust beneficiary rights stipulated under provisions in Article 98-2, item (ii) of the Ordinance that are owned by the investment corporation
- (iii) **Procurement of funds necessary to refund deposits or guarantees to tenants of real estate** set forth under (a) and (b) in the preceding item.
- (iv) **Procurement of funds necessary for the issuance of investment securities or investment corporation bonds in the case of procuring funds until the time of issuance.**

### **Limitations on Use of Funds (the above items (i) to (iv))**

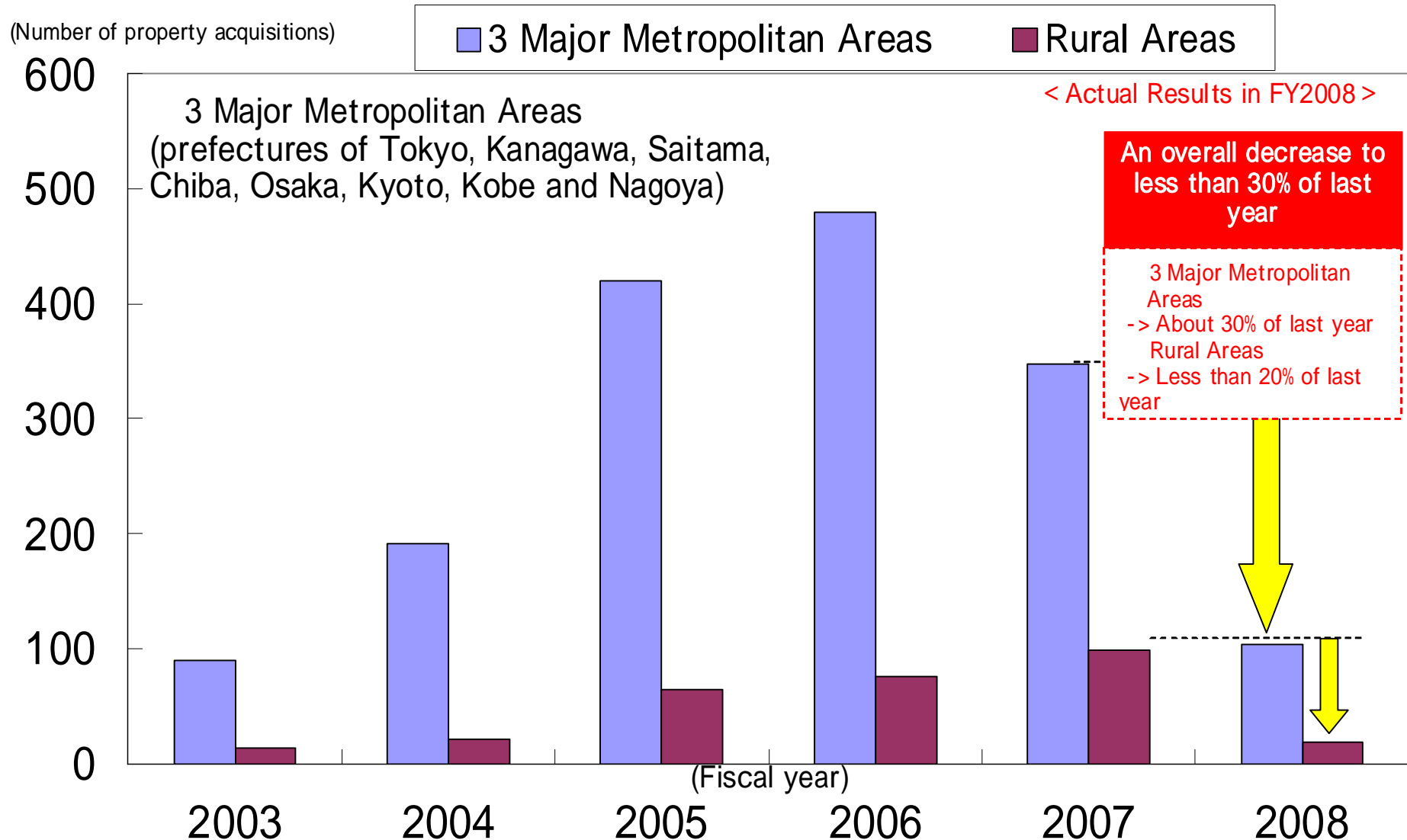
(2) Conditions stipulated by Cabinet Office Ordinance stipulated under Article 139-13, item (i) (c) of the Act are the following:

- (i) A short-term investment corporation bond scheduled for issuance has received a credit rating stipulated under provisions of Article 9-5 of the Cabinet Office Ordinance on the Disclosure of Corporate Information, etc. by a designated credit rating agency. (This refers to a designated credit rating agency stipulated under provisions of Article 1, item (xiii) (b) of the Ordinance. The same shall apply for the next paragraph, item (i).)
  - (ii) In the case of issuing short-term investment corporation bonds for the purpose stipulated under the preceding paragraph, item (i), an agreement for acquiring specified assets set forth in the same item shall either have been concluded, or it is certain that it will be concluded.
  - (iii) In the case of issuing short-term investment corporation bonds for the purpose stipulated under the preceding paragraph, item (ii), an agreement for repairing real estate set forth in the same item must either have been concluded, or it is certain that it will be concluded.
  - (iv) In the case of issuing short-term investment corporation bonds for the purpose stipulated under the preceding paragraph, item (iii), it is certain that the lease agreement will be terminated.
  - (v) In the case of issuing short-term investment corporation bonds for the purpose stipulated under the preceding paragraph, item (iv), there are provisions saying that the period until the principal redemption date is less than 6 months from the time the total amount of said short-term investment corporation bonds were paid.
- (3) In the case that the provisions under the Cabinet Office Ordinance set forth under provisions of Article 139-13, item (ii) of the Act, all of the following conditions shall be met.
- (i) A credit rating stipulated under provisions of Article 9-5 of the Cabinet Office Ordinance on the Disclosure of Corporate Information, etc. is granted by a designated credit rating agency for the short-term investment corporation bond scheduled for issuance.
  - (ii) If either one of the following applies:
    - (a) In the case that any specified short-term investment corporation bonds (This refers to short-term investment corporation bonds whose funds for repayment will be acquired by issuing the short-term investment corporation bonds scheduled for issuance. The same shall apply to (b) below and the next paragraph.) are issued for the purposes set forth under paragraph 1, items (i) to (iii), there are provisions saying that the period until the principal redemption date is less than one year from the time the total amount of said specified short-term investment corporation bonds were paid.
    - (b) In the case that any specified short-term investment corporation bonds are issued for the purposes set forth under paragraph 1, item (iv), there are provisions saying that the period until the principal redemption date is less than six months from the time the total amount of said specified short-term investment corporation bonds were paid.
- (4) The short-term investment corporation bonds set forth under the preceding paragraph, items (ii) (a) and (b) whose funds for repayment will be acquired by issuing specified short-term investment corporation bonds (including short-term investment corporation bonds that are deemed as specified short-term investment corporation bonds as set forth under provisions of this paragraph) will be deemed as specified short-term investment corporation bonds.

\*Since the use of funds is limited to property acquisitions or repairs, refunds of deposits, or stopgap funds required until the issuance of investment corporation bonds, short-term investment corporation bonds cannot be used as short-term funds, etc. until the acquisition of new loans.

# Results of Property Acquisition by J-REITs

Property acquisitions by J-REITs fell significantly last year, which is greatly affecting the real estate market.



# Need for Stability in the Real Estate Market

In the current real estate market, fund supplies provided to buyers has gone down significantly. Furthermore, due to the dumping of properties in order to procure funds, there is concern about the significant decrease of actual selling prices.

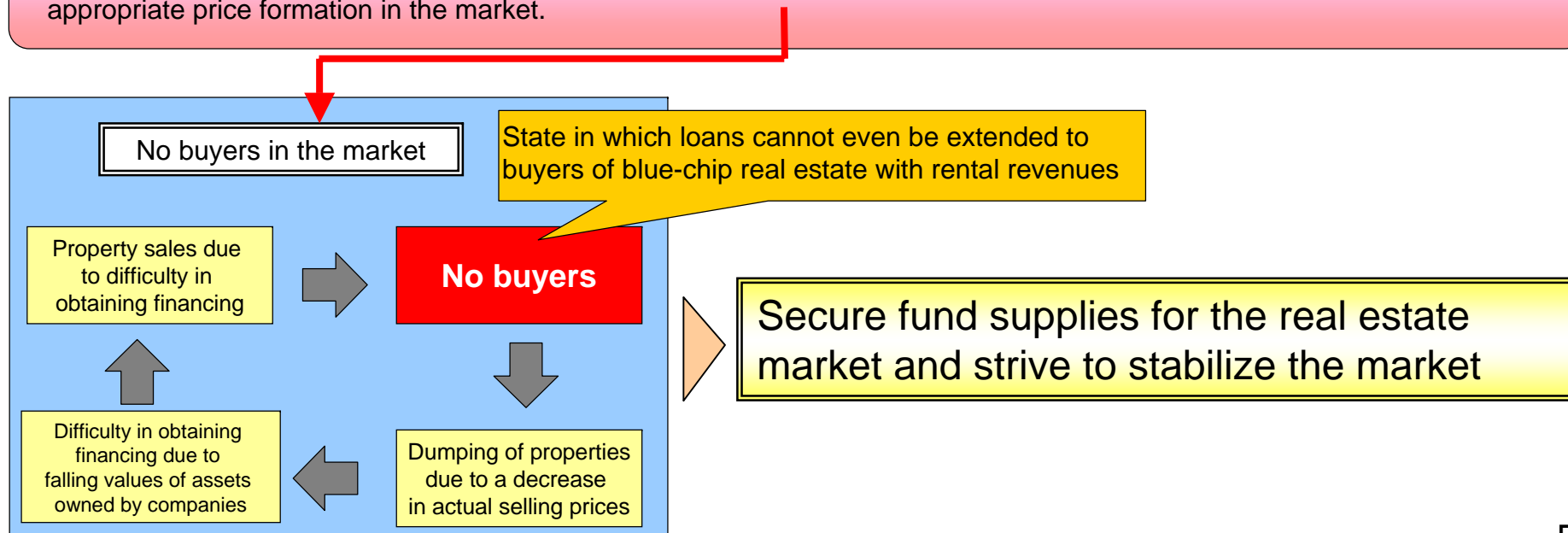
Even J-REITs that have been major buyers are having problems making further property acquisitions due to the recent slumping share prices, credit crunch, etc., resulting in a shortage of financial institutions in the market willing to provide funds.

\*In fiscal 2007, J-REITs acquired about 1.5 trillion yen out of the total real estate sales amount for listed companies, etc., which was about 3.3 trillion yen.

Therefore, we will discuss acquisition methods using a wide variety of funds for J-REITs, etc. and thereby strive to stabilize the real estate market by increasing funds for the acquisition of real estate.

## <Current Issues That the Real Estate Market Is Facing>

· In the current financial environment, most real estate market players are sellers and there are not enough buyers. If this situation is left to stand, then the real estate market may fall into a “**negative spiral**,” which is the condition of a lack of appropriate price formation in the market.

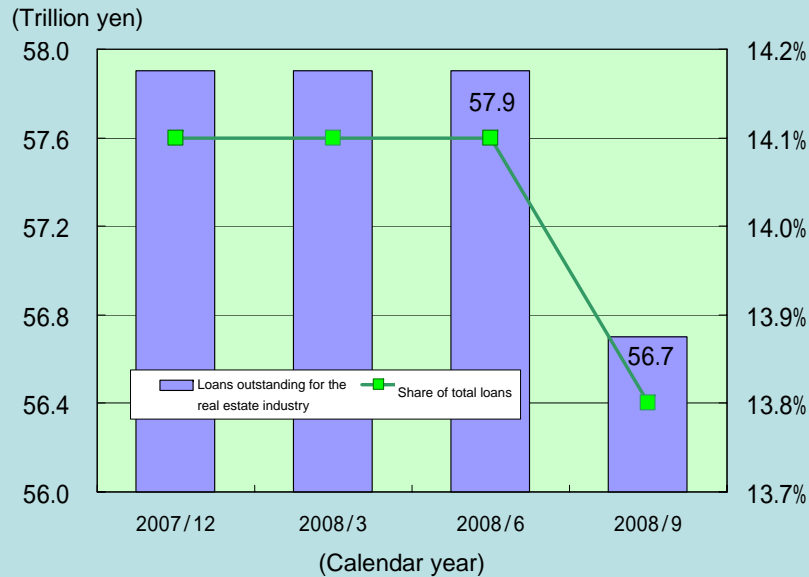


# Funding Support Utilizing Crisis Response Facilitation Operations of the Japan Finance Corporation

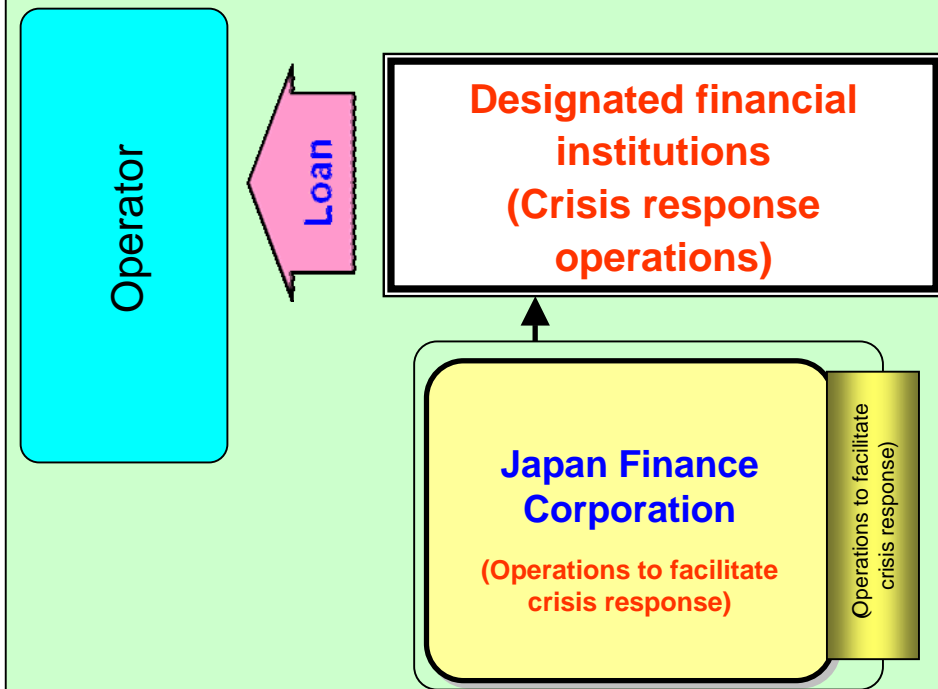
Due to the impact of the turmoil in the global financial market triggered by the subprime loan problem, domestic financial institutions are tightening their lending stance toward the real estate industry. In response to the rapid credit crunch, we will provide funding support to housing and real estate operators with sound businesses by utilizing the crisis response facilitation operations of the Japan Finance Corporation.  
 (Announcement by the Ministry of Land, Infrastructure, Transport and Tourism, December 15, 2008)

## Contraction of funds for operators

Loans outstanding for the real estate industry declined by 1.2 trillion yen from the end of June to the end of September



## Funding support utilizing crisis response facilitation operations of the Japan Finance Corporation



# Provision of Funds for J-REITs through Fund to Be Jointly Established by the Government and Private Sector

## [Purpose for Establishing the Fund]

Due to the sudden credit crunch which occurred as a result of confusion in the international financial markets, J-REITs are having trouble with fund procurement despite their stable cash flows and secured profits. This shows that the real estate market has fallen into a “negative spiral,” where there is a lack of appropriate price formation.

This measure aims to stabilize the real estate market and prevent asset deflation by working to recover the price formation functions in the market through the activities of J-REITs. In order to do so, the measure aims to form a Fund through cooperation between the government and the private sector in order to recover the function of J-REITs as buyers by newly providing funds to them.

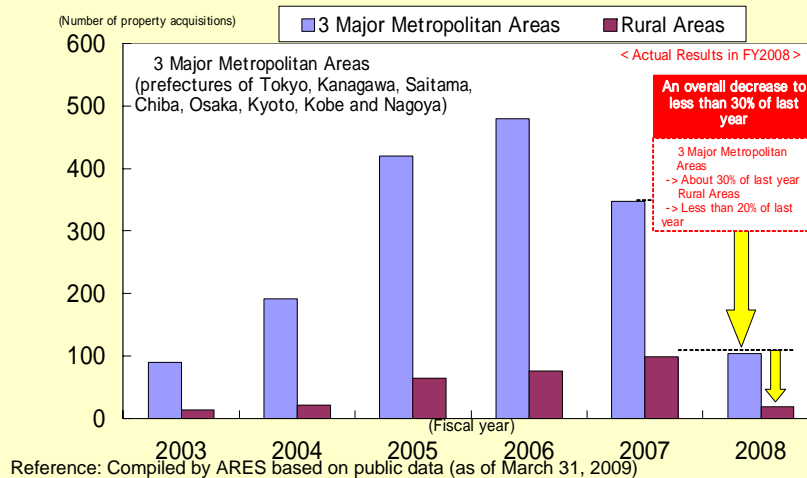
## [J-REITs That Are Major Buyers]

\*The total amount of real estate sales for listed companies, etc., in fiscal 2007: J-REITs acquired about 1.5 trillion yen out of a total of about 3.3 trillion yen.

\*Source: ARES Handbook 2008-2009



## [Property acquisitions by J-REITs fell significantly]



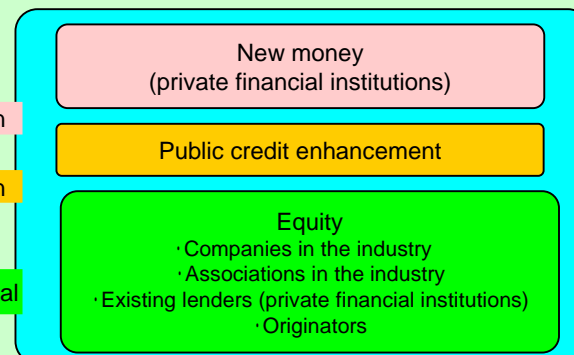
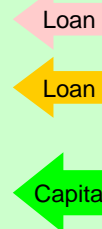
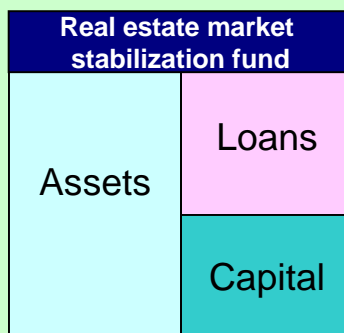
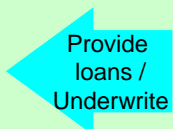
## [Establishing the Fund]

In order to establish a fund through cooperation between the government and the private sector for the purpose of supplying funds to J-REITs, rules concerning incorporation need to be clarified, such as investment, loans, etc. upon consultation with related industries (the real estate industry, REITs, financial institutions), government authorities, experts, practitioners, etc.

### J-REITs

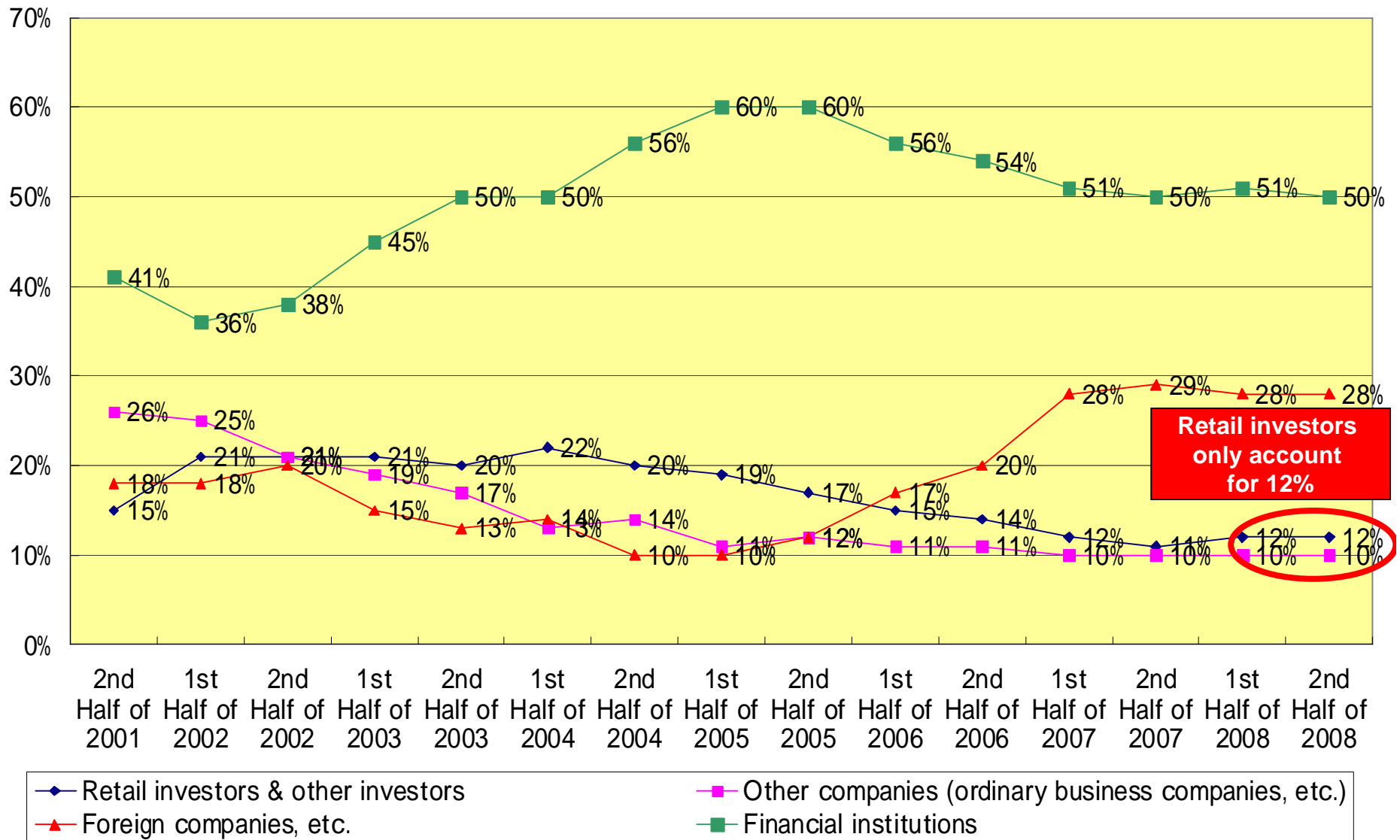
[Examples that would involve loans, etc.]

New property acquisitions by J-REITs  
Funds necessary for reconstruction related to mergers, etc.  
Refinancing investment corporation bonds, etc.



# Ratio of Retail Investors

Investment in J-REITs by Unitholder Type (based on amount)

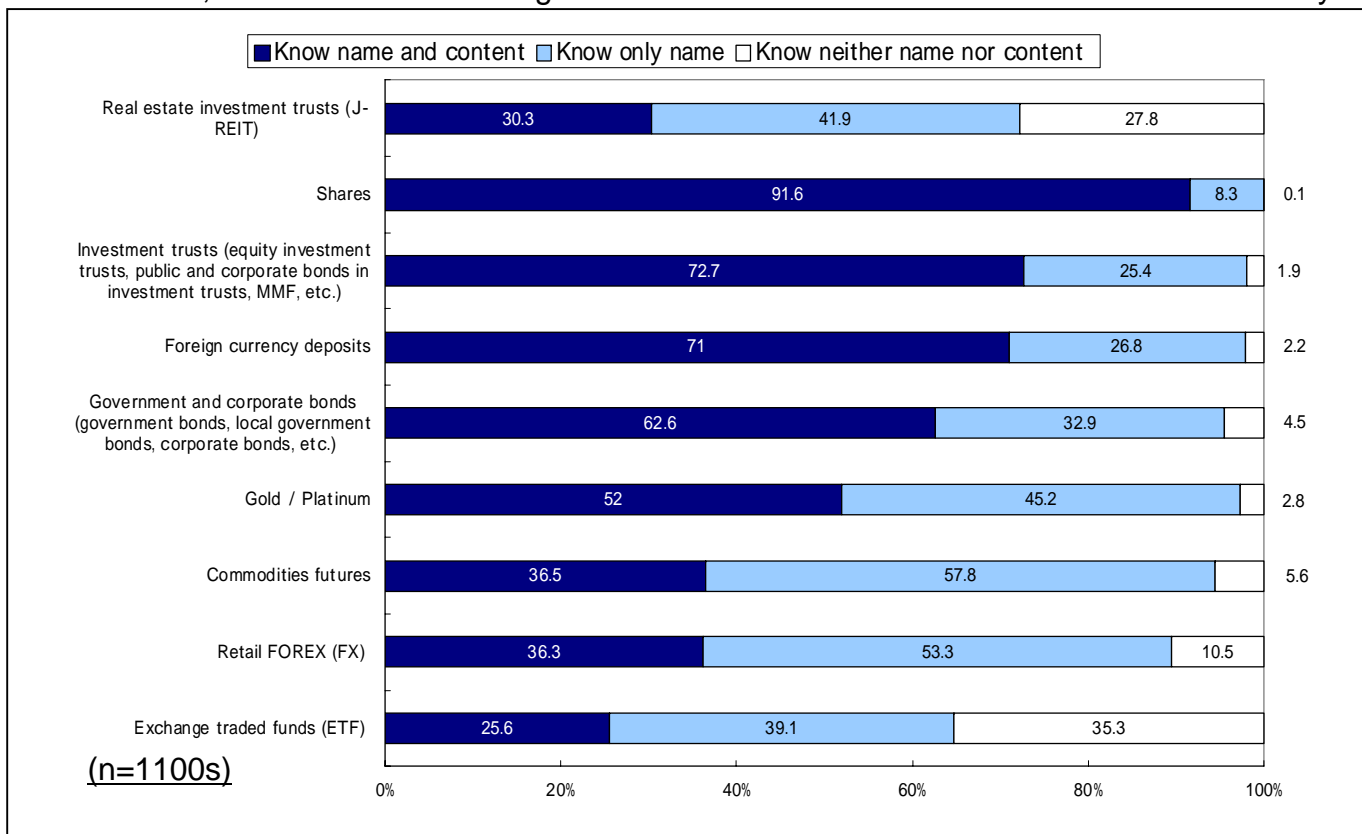


\*Reference: ARES

# Awareness Level of J-REITs by Retail Investors

## Awareness Level

The awareness of J-REITs by retail investors is about one-third of that of shares, and is lower than that of commodities futures and retail FOREX, etc. There is also a large number of retail investors who do not even know they exist.



Overview of "J-REIT Awareness Survey"  
 Investigation period: December 2008  
 Investigation method: Internet  
 Sampling: Internet monitors from Nikkei Research, Inc.  
 Target area: Nationwide  
 Targets: Retail investors (Owners of financial products, excluding savings and insurance)  
 Responses: 1,100

\*Reference: ARES

## Sale of Investment Trusts, Including J-REITs, at Bank Tellers

### Investment Trusts Targeting J-REITs as an Investment Target Sold at Bank Tellers of Major Banks

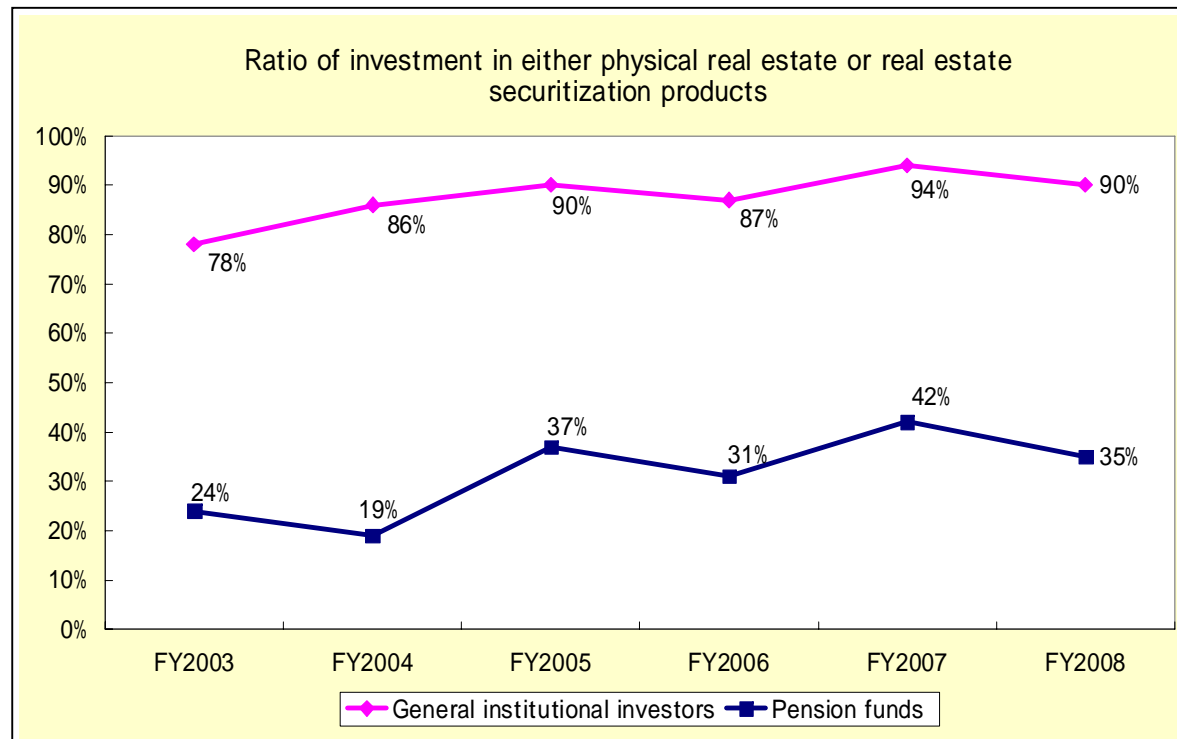
Name of Bank	Products Sold at Bank Tellers
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	NISSAY J-REIT Fund (2 months, settlement type)
	World REIT Open (every month, settlement type)
Mizuho Bank, Ltd.	Mizuho J-REIT Fund
Sumitomo Mitsui Banking Corporation	J-REIT Open
The Sumitomo Trust and Banking Co., Ltd.	Sumishin J-REIT Research Open (every month, settlement type)
Mitsubishi UFJ Trust and Banking Corporation	Mitsubishi UFJ J-REIT Open (3 months, settlement type)
	NISSAY J-REIT Fund (2 months, settlement type)
	Nomura Japan-US REIT Fund (monthly, dividend payment type)
	World REIT Open (every month, settlement type)
The Chuo Mitsui Trust and Banking Company, Limited	Chou Mitsui J-REIT Fund
Japan Post Bank Co., Ltd.	Nomura World Six Assets Distribution Investment Trust
	Nomura Asset Design Fund
	DIAM World REIT Index Fund (monthly, dividend payment type)

\*Posted on each bank's website (as of May 20, 2009).

## Real Estate Investment by Pension Funds

### Changes in the Ratio of Pension Funds Conducting Investment in Real Estate

The ratio of pension funds investing in real estate is on the rise. However, in comparison with general institutional investors (life insurance companies, non-life insurance companies, banks, trust banks, etc.), the ratio is low.



\*Reference: "The 8th Questionnaire Survey on Real Estate Investment by Institutional Investors" by The Association for Real Estate Securitization (July 2008)

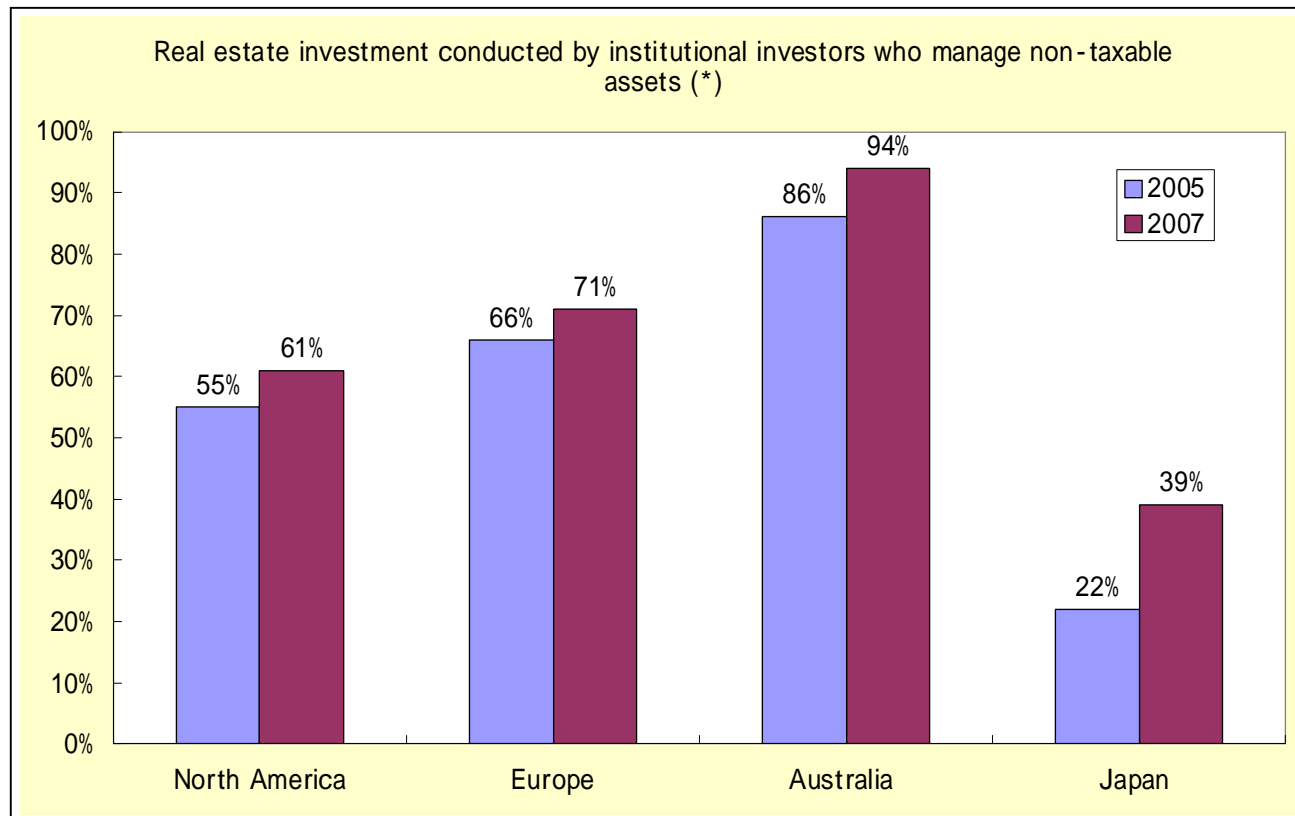
\*Moreover, a point to note is that the possibility that respondents of the questionnaire conducted by ARES (The 8th Questionnaire Survey on Real Estate Investment by Institutional Investors) having a high interest in real estate investment is high due to the nature of the questions. For example, according to the questionnaire conducted by Daiwa Fund Consulting Co., Ltd., the ratios of pension funds actually investing in real estate are as follows:

2005: 16.8%; 2006: 17.0%; 2007: 20.1%

# Real Estate Investment by Pension Funds

## Real Estate Investment by Pension Funds in Various Countries

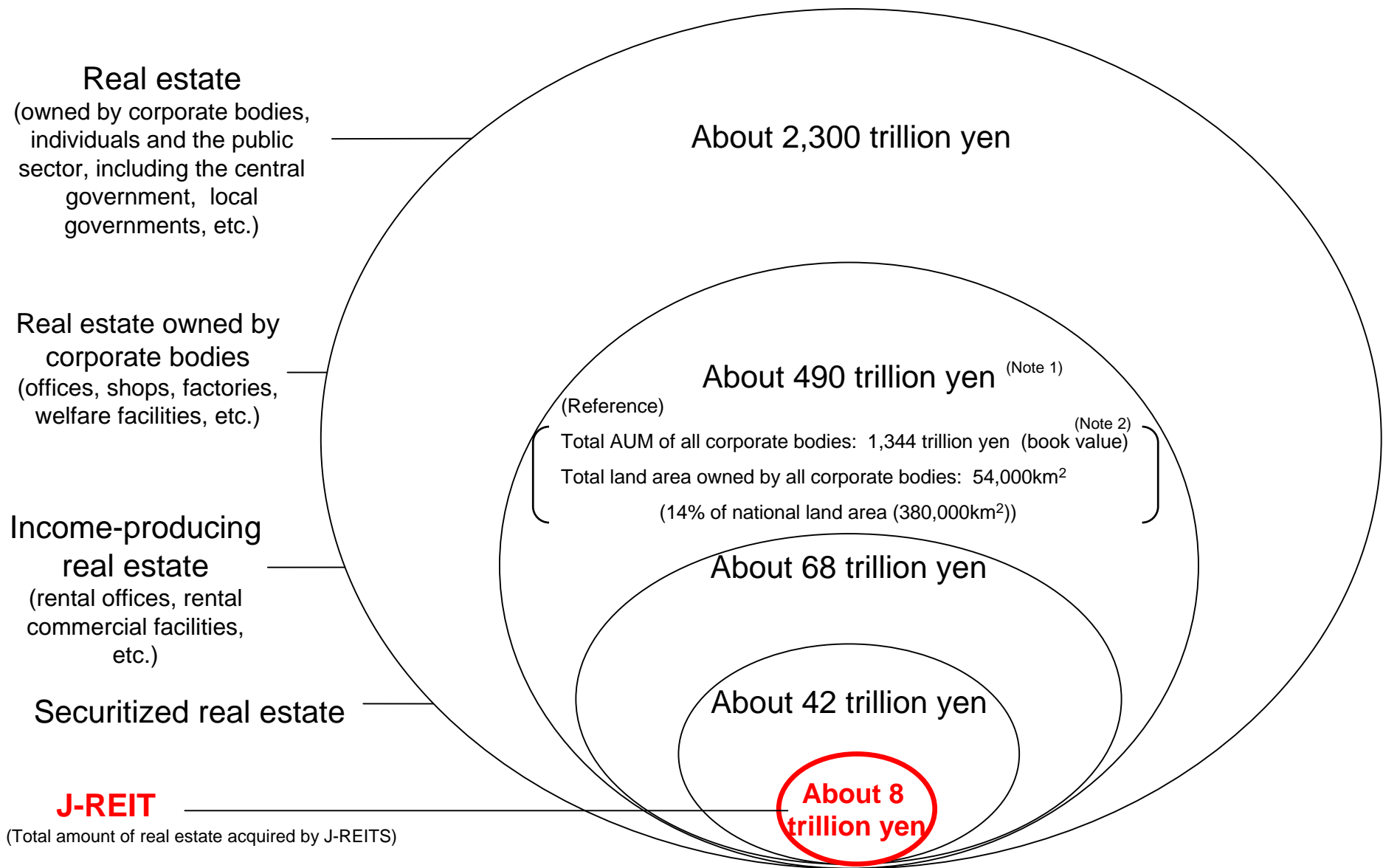
We compare the state of real estate investment conducted by non-taxable institutional investors, starting with pension funds in North America, Europe and Australia with those in Japan. You can see that although there is an increase in Japan, there is still a large gap between the former three and Japan in terms of level.



\*The ratio of respondents in the questionnaire who responded that they conducted real estate investment.

\*Reference: Compiled by ARES based on the public data of Russell Investments, "The 2007-2008 Russell Investments Survey on Alternative Investing"

# Asset Size of Japanese Real Estate

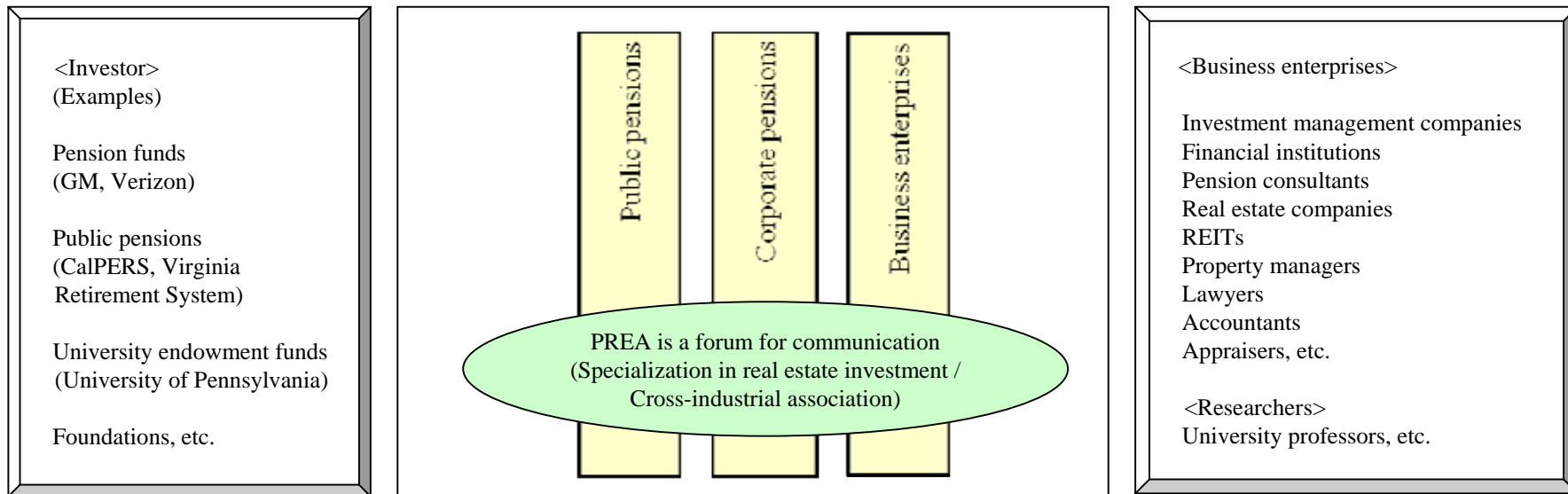


Reference: "National Accounts for 2005" (annual report), General Report of "Basic Survey on Land" (2006), "Real Estate Securitization Survey" (2007); (The AUM for "real estate," "real estate owned by corporate bodies" and "income-producing real estate" is based on January 1, 2003 data; the AUM for "securitized real estate" and "J-REIT" is based on end of FY2007 data)

(Note 1) Market value is based on the "Basic Survey on Land" (as of January 1, 2003); (Note 2) Book value is based on the "Financial Statements Statistics of Corporations by Industry" (as of the end of 2005); (Note 3) The actual cumulative size of securitized real estate (as of the end of FY2007); (Note 4) As of the end of FY2007; (Note 5) Including areas for roads, water conduits, etc. **P62**

# PREA (Pension Real Estate Association in the U.S.)

## PREA (Pension Real Estate Association in the U.S.): What it is



PREA, located in the U.S., is a membership organization for a wide range of sectors, such as pension funds, corporate pensions, business enterprises and researchers. It specializes in real estate investment and provides a forum for discussion across industries.

What is the PREA (Pension Real Estate Association)?

In 1979, it was established with the aim of providing a forum for conducting communication between investors, management institutions and real estate service operators.

It places focus on the education and enlightenment of members and provides information through conferences, newsletters, etc.

The association provides funds for academic research relating to real estate investment, such as by becoming a sponsor for researchers pertaining to academic research or by conducting management of research institutions.

Participation in the formulation of the Real Estate Information Standard.

# The Principles for Responsible Investment

## Socially Responsible Investment (SRI)

Socially Responsible Investment is the introduction of countermeasures regarding morality, environmental issues, etc. in the evaluation of investment in a company, and not simple the outlook of revenues and growth.

## The Principles for Responsible Investment (PRI)

The Principles for Responsible Investment is a global guideline for investors, which incorporates the idea of “sustainable development” into the analysis and evaluation of investment and was formulated in 2005 when the then Secretary-General of the United Nations invited major institutional investors across the world for this purpose. It is based on the assumption that “Environmental, Social and Corporate Governance issues” (=ESG) affect investment performance and was formulated with the aim of incorporating the ESG perspective in the decision-making process of the investment decisions of institutional investors of the world, such as major pension funds or management institutions, within their range of responsibilities as trustees.

The work of formulating The Principles for Responsible Investment was led by the United Nations Environment Programme Finance Initiative (UNEP FI) and the UN Global Compact and was officially announced in 2006.

## Major Points of Responsible Real Estate Investment

One of the working groups of UNEP FI, called the UNEP FI Property Working Group (UNEP FI PWG), conducts activities to promote real estate financing by financial institutions across the world cooperating in bringing about sustainable development. They announced the major points of The Principles for Responsible Investment.

	Focus	Details
1	Energy conservation	Reducing energy consumption
2	Transportation access	Promoting the use of public transportation and reducing the use of automobiles
3	Residential environment and circulation environment	Environment in rooms, common space facilities, measures for the handicapped
4	Environmental protection	Countermeasures against global warming, conserving water resources, utilizing environmentally conscious materials
5	Certification / Branding	Energy conservation, various certifications regarding green buildings (environmentally conscious buildings)
6	Publicness	Compliance with laws and regulations / disclosure, etc.
7	Fairness	Fair labor environment / employment opportunities / low-income housing, etc.
8	Safety / Security	Security measures
9	Urban redevelopment	Contribution to revitalization of urban areas

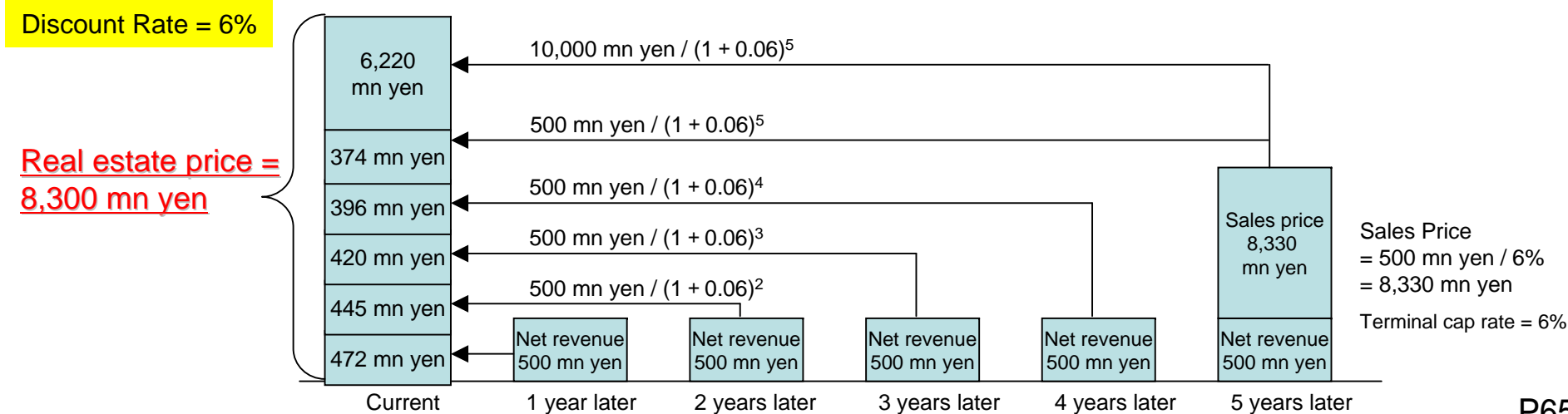
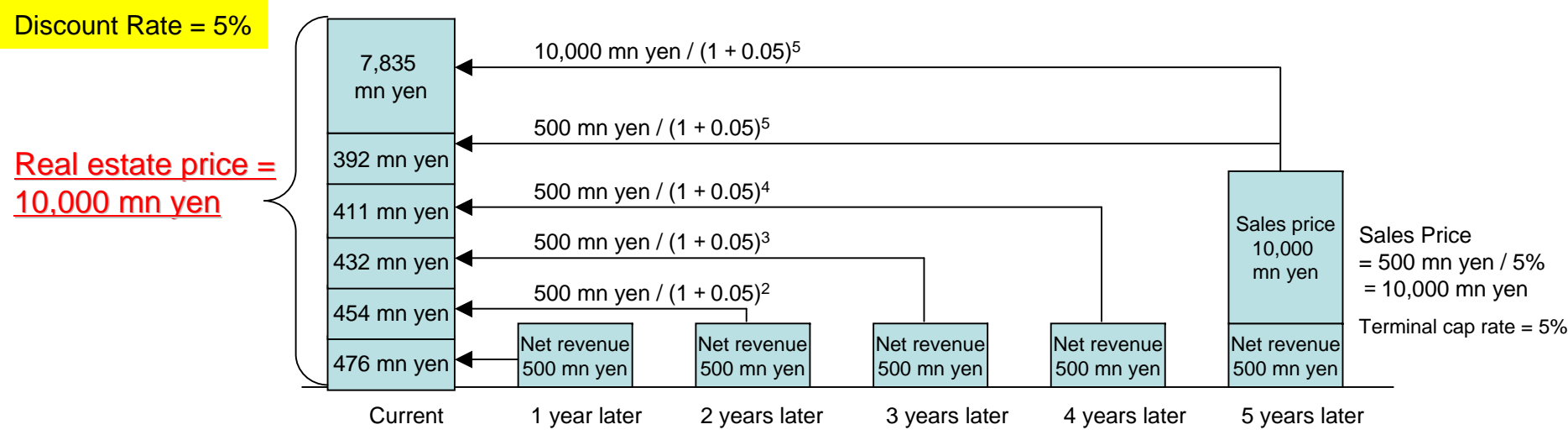
\*Reference: UNEP FI PWG and Responsible Property Investment Center

# Discounted Cash Flow Method

## DCF Method

The DCF Method is a method for seeking the current real estate price by discounting the total of net revenues that the targeted real estate will produce in the future over a certain period of time and the sales price after a certain period of time from the current value.

A difference of 1% in the discount rate of a property worth 10,000 million yen results in a difference in real estate price of about 2,000 million yen.



## Example of Price Fluctuation Due to Increase in Cap Rate

### Example of Price Volatility Due to Increase in Cap Rate

As for the appraisal of properties owned by J-REITs at the end of each fiscal term, there can be seen examples of appraisal values decreasing as a result of an increase in the cap rate rather than as a result of a decrease in the estimated rents in the future.

		Building A			Building B		
		End of Dec. 2007	End of Dec. 2008	Volatility	End of Dec. 2007	End of Dec. 2008	Volatility
Appraisal value (survey price)		6280	5260	-16.2%	5730	5190	-9.4%
NCF (appraisal)		227	228	0.4%	232	238	2.6%
Direct capitalization approach	CR (cap rate)	3.6%	4.3%	-16.3%	4.0%	4.50%	-11.1%
	DCF Method	DR (discount rate)	3.5%	4.2%	-16.7%	3.8%	4.30%
	TCR (terminal cap rate)	3.6%	4.3%	-16.3%	4.0%	4.50%	-11.1%

\*NCF: Net cash flow (= Rent – Expenses + Profit from the management of deposits, etc. – Capital expenditures)

Report by the Real Estate Appraisal Working Group of the Land Policy Division at the National  
Land Council of the Ministry of Land, Infrastructure, Transport and Tourism

The “Report by the Real Estate Appraisal Working Group of the Land Policy Division at the National Land Council of the Ministry of Land, Infrastructure, Transport and Tourism” announced on April 2009 indicated directions that included reinforcing internal control systems in order to enhance the credibility of appraisals.

Enhancing the credibility of the appraisal operations of securitized real estate, etc. so that they are  
widely used by the public

It is thought that appraisal of real estate securitization and real estate in corporate books can greatly impact a wide range of investors and other persons. Therefore, it becomes necessary to ensure the transparency and objectivity of appraisals more than ever before, as well as the independence and neutrality of appraisers from applicants, etc.

1. Enhancing the internal control systems of appraisers

We need to establish a system of auditing the appraisal report and a firewall between the appraisal division and other divisions, such as the sales division, etc., discuss how progress reports given to applicants regarding the value should appear, and establish internal control systems to prevent insider trading, etc.

2. Requiring the involvement of several real estate appraisers / Developing a system of auditing appraisal reports

In order to maintain or improve the quality of appraisals, it is desirable that several real estate appraisers become involved in the production of one appraisal. Thus, a system for auditing an appraisal report made by an appraiser by other appraisers needs to be established, etc.

3. Establishing transparency for applications from related parties and postponement of orders

It is desirable that the independence and neutrality of appraisers / appraisal companies are obvious in an objective manner. Furthermore, as for applications for appraisals made by interested parties and other specially related parties of the targeted real estate, we need to inform the applicant about whether a special relationship exists and we need to strive to maintain transparency by writing the details in appraisal reports.

## Information Disclosure by J-REITs

### Examples of Items Concerning Which Information Disclosure Is Desirable

The following are examples of items, etc. where it is desirable that a REIT conducts discussions with market participants and continues to do its utmost to make improvements.

Examples	Current Conditions of REITs
English disclosures for overseas investors (including English websites)	35 companies out of 41 listed REITs are implementing English language disclosures.
Disclosure of NOI*, which would form the basis of appraisals and disclosure of cap rates, etc.	39 companies out of 41 listed REITs are conducting disclosure.
Disclosure of long-term repair expenses at the time of property acquisition	17 companies out of 41 listed REITs are conducting disclosure.
Other <ul style="list-style-type: none"> <li>· Disclosure of assets, etc. that back the funds in the case of forward commitments, etc.</li> <li>· Abstain from incorporating the gain on sales of property for which the sale has not been finalized into performance forecasts.</li> <li>· Disclosure of information regarding contract periods, etc. with large tenants</li> <li>· Disclosure of loan-related expenses</li> <li>· Disclosure of estimated cap rates, etc. at the time of acquiring the property, etc.</li> </ul>	/

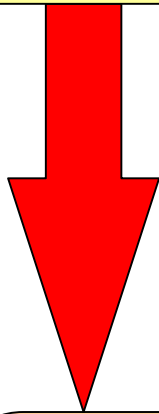
\*NOI: Net operating income.

Note: Compiled based on press releases, asset management reports, etc. announced by companies (as of May 20, 2009).

# Residential Price Indices

In the U.S., housing indices based on actual selling prices are publicly available, such as the S&P / Case-Shiller Home Price Indices.\*

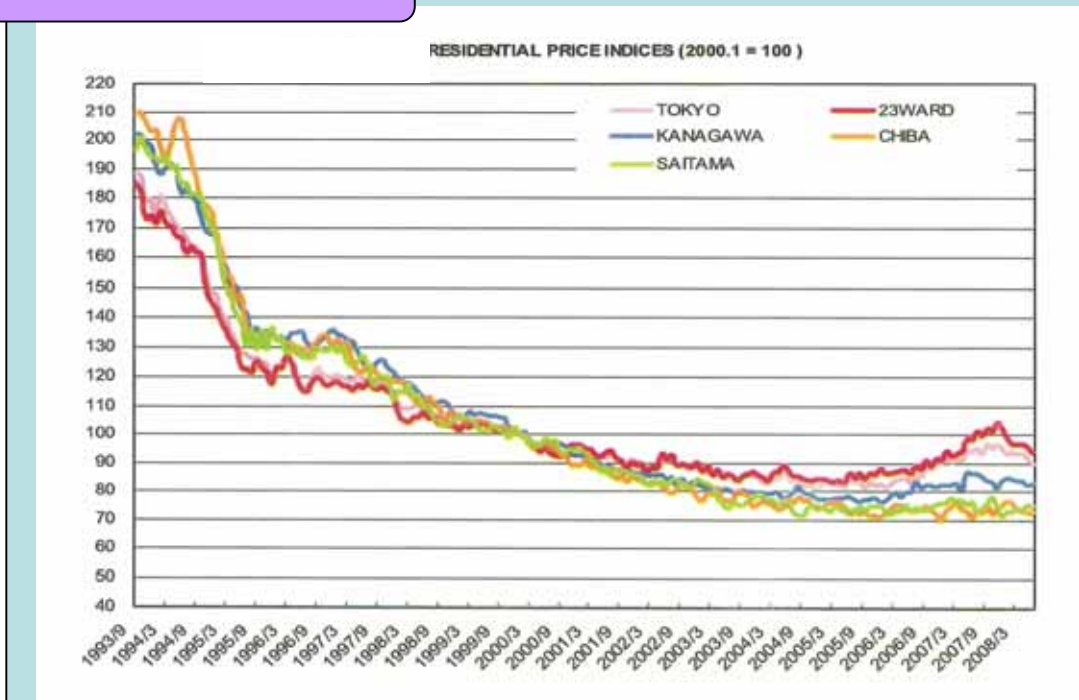
As a result, these indices make it possible to grasp housing price trends over a wide range of areas, and serve as important information for investors, business enterprises and buyers of used housing, etc. There is no counterpart to these indices in Japan, and some people point out that this lack is one reason why the housing values perceived in the market are lower than what they are supposed to be.



## Sample of a Residential Price Index

**Therefore, we believe it is necessary for Japan to develop housing price indices based on actual selling prices, and to make them widely available.**

Enhance the transparency of the real estate investment market, which in turn would activate the market.

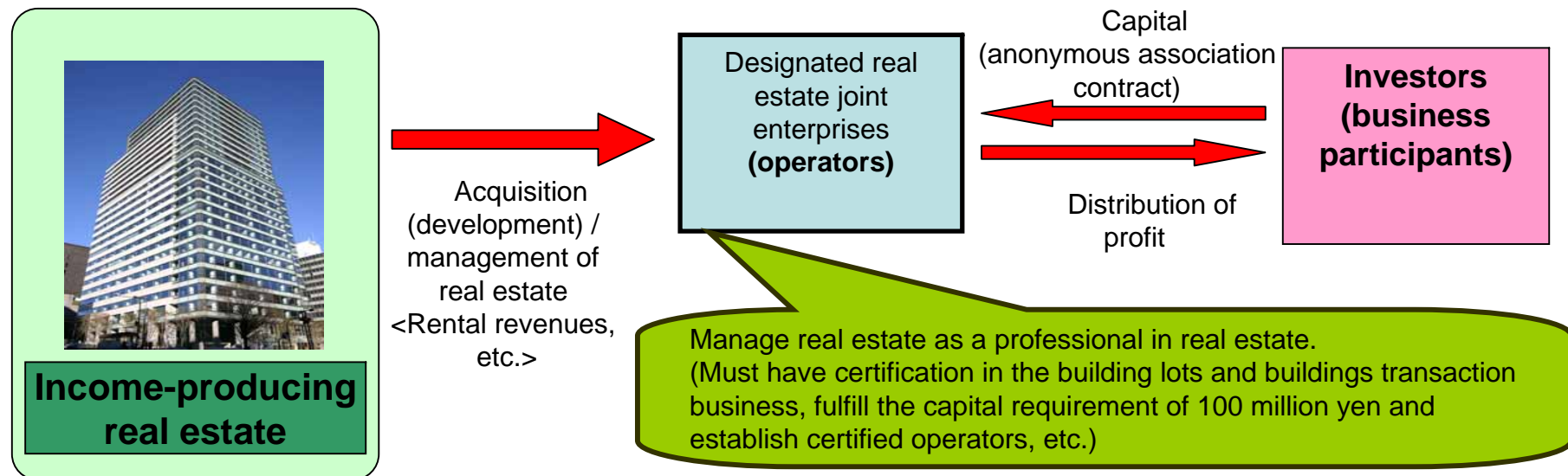


\*The S&P / Case-Shiller Home Price Indices target residential real estate in the U.S. The price indices are provided by the credit rating agency Standard & Poors and are the most commonly used of their kind.

# Development of Diversified Business Methods (Example of Demand)

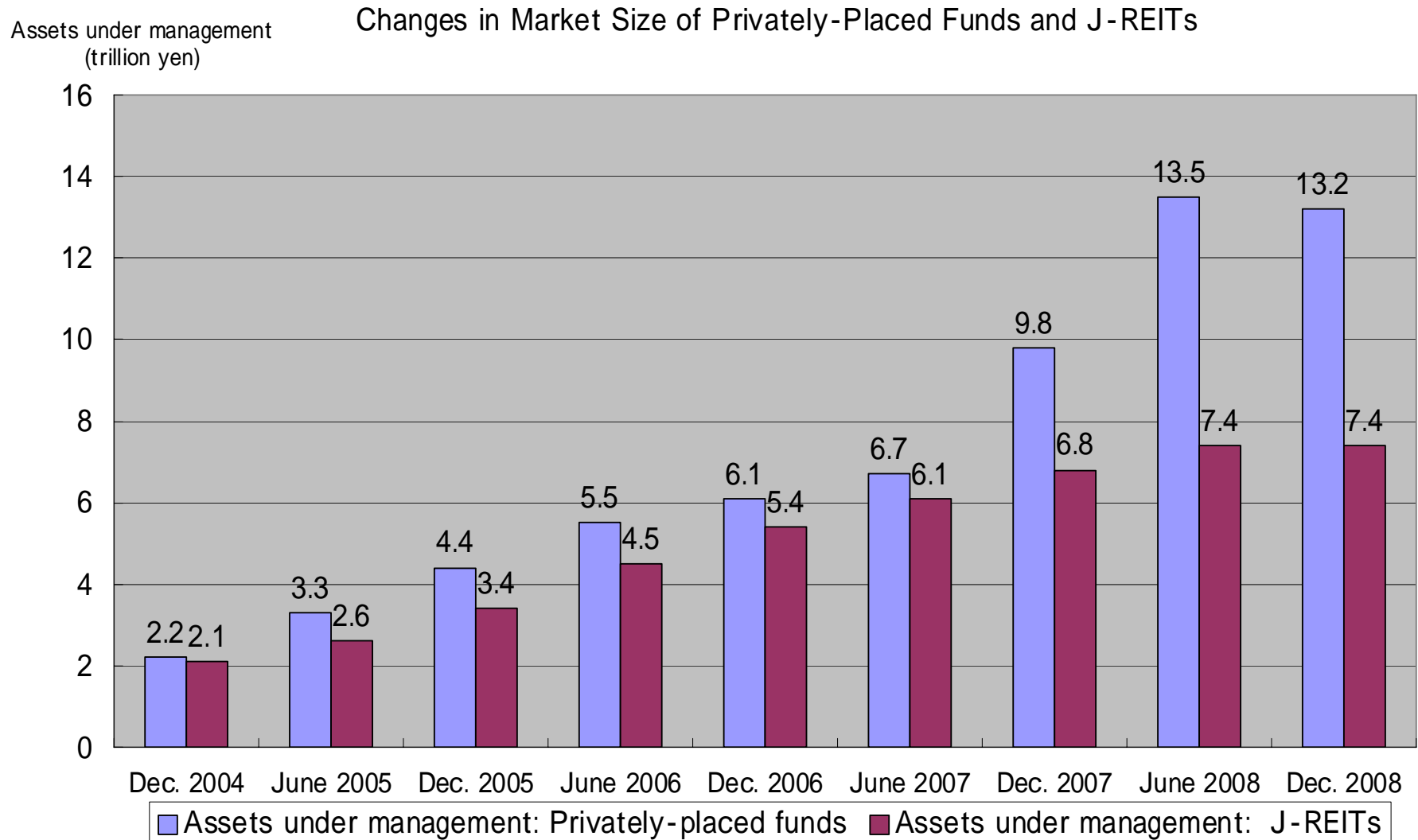
As for designated real estate joint enterprises, which are part of the securitization scheme of physical real estate, a business operator (a designated real estate joint enterprise) that is party to an equity instrument (anonymous association contract) is required to have more than 100 million yen of capital and must have established certified operation managers, etc. Therefore, it is difficult to use it as a paper company, such as is the case with ordinary SPCs.

Therefore, some are of the opinion that when a joint enterprise consisting only of developers or professionals in real estate investment tries to undertake a development project using this scheme, it faces difficulties in procuring non-recourse loans through a paper company.



**Need to periodically discuss methods for promoting the development of various businesses that respond to market demands, including measures, etc. for the above types of demands.**

# Market Size of Privately-Placed Funds



\*Reference: STB Research Institute Co., Ltd.