Figures 2-4 and 2-5 outline the framework of real estate securitization in Japan today.


There are two categories for real estate securitization as a collective investment structure (Figure 2-6).

The first is commonly referred to as “monetization” and involves the owner of the real estate (originator) transferring the real estate to a securitization vehicle from its balance sheet (moving the asset off the balance sheet) and procuring capital by using the future cash flow from the real estate asset to service the investment of third party investors. This is known as asset monetization real estate.
securitization and the securitization is built around the real estate itself.

The other category is known as asset management real estate securitization. In this securitization, the assets of investors are gathered to form a fund and these funds are then invested into real estate by the fund manager (asset manager) and the earnings from the assets purchased are distributed to investors. In contrast to asset monetization securitization, fund securitization is built around capital.

These patterns of real estate securitization differ not only in their objectives but also in the relevant laws and securitization vehicles. Since different laws apply, depending on the securitization vehicle used, the securitized asset either can or cannot be switched (i.e., sold and replaced with a different asset). Therefore, the choice of the securitization structure should be made only after giving sufficient consideration to the objective of the securitization.


There are two basic elements to real estate securitization; the contract and vehicle.

The typical contracts include the Tokumei Kumiai (TK, silent partnership) contract under the Commercial Code, the Nin-i Kumiai (NK, voluntary partnership) contract and trust contract under the Civil Code. In the case of contracts, the business of the real estate securitization is implemented based on a contract between the parties (partnership investors, operator, trust settlor, trustee, etc.). The TK securitization contract and NK securitization contract under the Real Estate Syndication Act are special contract forms based on TK contracts and NK contracts as typical contracts. Trusts are also sometimes used as a vehicle and can take the form of special purpose trusts (SPT) governed under the Asset Securitization Law and investment trusts under the Investment Trusts and Investment Corporation Law.

Vehicles are formed as the entity created as a new entity to conduct the real estate securitization. The representative type of vehicles are the Tokutei Mokuteki Kaisha (TKK, special purpose company) governed by the Asset Monetization Law (“Act on Securitization of Assets,” revised and implemented in 2000) and the investment corporation governed by the Investment Trusts Law (“Investment Trusts and Investment Corporation Law,” revised and implemented in 2000). There are also many cases where practical reasons lead to Godo Kaisha (GKs; limited liability companies) and joint stock corporations being used as the securitization vehicle.

[3] Debt and Equity

The securities issued as part of the process for real estate securitization can be split into two broad groups: debt and equity.

Debt obligations require the issuer to pay principal and interest, much like a loan or corporate bond, from the revenue of the asset being securitized. For the investor this is a pledge from the borrower to receive fixed interest and principal payments on set dates designated in advance.

Equity is the remaining capital after debts are subtracted from the total assets of the securitization vehicle.

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**FIGURE 2-6 TWO REAL ESTATE SECURITIZATION STRUCTURES**

<table>
<thead>
<tr>
<th>Asset Monetization Structure</th>
<th>Asset Management Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Concept</strong></td>
<td>Funds gathered from multiple investors are pooled (formed into a fund), invested in real estate and managed, and operating earnings are distributed to investors.</td>
</tr>
<tr>
<td><strong>Representative vehicle and base law</strong></td>
<td>Investment corporation and investment trust/Investment Trusts Law (YK+TK/Commercial Code, Company Law)</td>
</tr>
<tr>
<td><strong>Primary characteristics of securitization vehicle</strong></td>
<td>Create the fund using investments from investors. The real estate can be freely replaced in principle. In the case of J-REITs, management is outsourced to an outside investment trust manager. The key is the prowess of the fund manager. In principle, an investment corporation is a “going concern.”</td>
</tr>
<tr>
<td><strong>Remarks</strong></td>
<td>There are no special regulations on bankruptcy remoteness with investment corporations. In the case of an investment corporation or investment trust, the booking of dividends as expenses is allowed if certain requirements are met (pay through).</td>
</tr>
</tbody>
</table>

(Note) “YK+TK” represents the combination of a Yugen Kaisha and Tokumei Kumiai. Under the new Company Law, TKs that existed when the Law came into effect in principle survive as KKs.

“LLC+TK” represents the combination of a Limited Liability Company and Tokumei Kumiai.

Prepared by ARES.
This capital is most commonly comprised of shares and equity-like securities (investment securities issued by investment corporations, specific investments and preferred equity securities of TMKs, etc.) issued by the securitization vehicle, investments in TKs and NKs and other investments that take the first loss if anything negative occurs.

Note: On the balance sheet of a TK, the investment of a TK member is shown on the "Asset" side of the balance sheet but the balance sheet of the operator itself is limited by the amount indicated as paid-in capital in the commercial registry. Therefore, the investment of a TK member is ordinarily indicated as a "long-term deposit" or, when the amount is not material, the account category of "other liabilities" is used. (Excerpt from page 89 of "Monetization and Securitization Accounting and Taxation, Second Edition" published by Chuokeizai-sha).

Equity investors can only receive dividends after all debt obligations have been met and so they receive dividends from the property remaining after the principal is repaid to the debt investors at the time of settlement. Thus the debt investor has preference over the equity investors.

While the debt investor has the right to receive only the principal and interest agreed to in advance, distribution to the equity investor is greatly impacted by the success or failure of the business. While the equity investor may obtain a very high return, the equity investor may receive less absolute distribution than the debt investor; this increases the risk, but equally the returns, if successful, are high.

Financial institutions that provide loans to a securitization vehicle are the debt investors. Financial institutions often take a different approach that involves pooling a diverse range of credits from real estate backed loans, placing these in an SPE as an asset and then issuing asset-backed securities (ABS) backed by these loan credits. These ABS securities are known as mortgage-backed securities (MBS) and can be subdivided further into commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS); both of these have been issued continually since 2001 by the Japanese Government Housing Loan Corporation (the Japan Housing Finance Agency since April 2007).

### 11 Key Legal, Tax and Accounting Considerations in Real Estate Securitization

#### [1] Legal Considerations

**1. Bankruptcy Remoteness: Concept and Necessity**

As mentioned in the first section of this chapter, one of the most basic requirements of the real estate securitization structure is to ensure that the entity bankruptcy is remote from the originator and any investors and vice versa. Thus the concept of bankruptcy remoteness is that even if an interested party of a securitization, especially the originator and vehicle, goes bankrupt, the cash flow of the securitized asset and thus the redemption of the principal and interest and any equity returns as defined at the inception of the securitization are not affected by the bankruptcy of the interested party as a result of the performance of the assets being based on the assets in the structure and the structure itself with cash flow continuing to be paid.

Securitization transfers the securitized asset from the originator and places it in a securitization vehicle which has a capital structure created based on the cash flows that the asset can generate. In principle the securitization is not dependent on the creditworthiness of the originator and so investors demand that any direct impact on the investors of bankruptcies to the originator or the vehicle itself be eliminated; this is referred to as being bankruptcy remote.

Bankruptcy remoteness is essential in an asset monetization securitization, which requires the stability of the securitization vehicle, and the steps taken to ensure bankruptcy remoteness would include:

- Legally separating the securitized asset from any influence of the bankruptcy of the originator; and
- Minimizing the bankruptcy risk of the actual vehicle owning the asset subject to securitization (TMKs under the Asset Monetization Law, SPEs with the form of KKs and LLCs, etc.).

**2. Separation from Originators**

If a securitization vehicle receives staffing or capital influences in its administration from the originator or equity investors, the vehicle may become embroiled in bankruptcy proceedings if the originator were to go bankrupt. This may lead to the investors being treated as general creditors, which may disallow investors from receiving profit distributions or receive the redemption of principal and interest.

For this situation to occur the custodian appointed on bankruptcy of the originator would judge that the transfer of the asset was not a true sale (see (4)) but that it was a transfer of collateral and thus deny the original transfer of the asset to the securitization vehicle. If this were to occur, the collection of investment funds is only possible through reorganization of collateral rights in relation to the corporate reorganization of the originator.

The following are considered when judging the bankruptcy remoteness of a securitization vehicle from its originator:

- Rational intent of the interested parties as indicated by the contract