Q&A Session at Explanatory Meeting for Investors and Analysts
for the 22nd Fiscal Period Ended July 31, 2014
Held on September 16, 2014 (Summary)

[Q&A]

<Questioner A>

(Question A-1) Timely disclosure has been made about amendments to investment management fees. Please describe the thinking behind and outlook for the amendments.

(Answer) The plan is to keep the investment management fee structure unchanged, but change the rate. Although initially designed so that the amount of base fee 1 linked to asset valuation and the amount of base fee 2 linked to cash flow are of the same level, it is becoming imbalanced in the current state. Real estate prices have increased as a result of structural decrease in the cap rate due to such factors as enhancement of transparency and liquidity of the Japanese real estate market. This is causing the amount of base fee 1 to be more. In addition, the plan is to change also the incentive fee linked to investment unit price. This is in response to investors questioning the highest average investment unit price over all previous periods (high-water mark), at 248,307 yen, being a level that is unrealistic to attain and thus not functioning as an incentive.

(Question A-2) The phrase “Aiming to be a 100-year REIT” is on the cover of the financial results presentation. Please describe the aspects that are currently insufficient to become a 100-year REIT.

(Answer) Asset size could be an insufficient aspect. We have been saying from before that an asset size of at least 300 billion yen is required for stable management of the portfolio.
Additionally, we believe human resources development is important in aiming to be a 100-year REIT. We intend to step up development of the next generation and the generation after that to succeed our investment management philosophy.

<Questioner B>

(Question B-1) At what level is distribution being maintained? In addition, by when will the 2,600 yen distribution that has been set as the target be attainable? Please also describe the future weighting of internal growth, external growth, etc. for attaining such.

(Answer) Distribution is currently maintaining a level slightly below 2,300 yen. This is largely due in part to the factor that, of the buffer for decrease in amount, the portion of positive difference in amount is not counted in the forecast cash flow in the earnings forecasts for the 23rd and 24th fiscal periods. While we intend to also pursue external growth by purchasing favorable properties, internal growth is thought to be the main in order to attain the 2,600 yen distribution.

<<Supplement>>

Earnings forecasts are prepared with rent income on the basis of contract rent as of the reference date and factoring in certain buffer for decrease in amount. Buffer for decrease in amount refers to items of reduction of revenues that have been set for the purpose of security against future downward swings in performance. This is made up of negative factors due to rent amount decreases and tenant move-outs, plus positive factors due to rent amount increases and tenant move-ins. In light of its nature as security against downward swings in revenues, the maximum is set as zero. In earnings forecasts to date, future negative factors exceeded positive factors and so income on a contract rent basis factored in for certain negative amount. In the earnings forecasts for the 23rd and 24th fiscal periods, on the other hand, upturn in real estate market conditions led to the state of positive factors exceeding negative factors. However, the excess portion of positive difference in amount is not counted in earnings forecasts as a rule as to date.

(Question B-2) Although the number of investors and other various conditions of the real estate market differ with those at the time of the previous real estate market peak, do you think that the cap rate will fall to the level at the time of the peak going forward?

(Answer) (page 51 of the financial results presentation) Firstly, cap rate has not fallen to the level of 2007 (the time of the previous real estate market peak). Even in terms of TOKYU REIT's portfolio cap rate (based on appraisal value at end of period), it is 4.42% at present, but considering that it had fallen to 4.20% in 2007, there is still room for decrease. We think that the cap rate will fall to the 2007 level or even lower depending on the circumstances. Indeed, the real estate market has matured because of the absence of the sort of aggressive investors that would drive up prices. The lending attitude DI of financial institutions, which is regarded as a leading indicator for cap rate, has reached around the 2007 level, but the occupancy rate, which is a leading indicator for cash flows, has not reached the 2007 level. In 2007, lending attitude and occupancy rate increased at the same pace as if in competition, and real estate prices increased. At present, however, with cash flows yet to recover to that extent, there is a gap in the degree of recovery between cap rate and cash flows. There is still room for increase in cash flows, but the rent gap has valuation implications that recovery of increase in cash flows cannot be strongly expected. However, the high investment appetite of investors for real estate has valuation implications that leave no choice but to adjust with the cap rate. As a result, the cap rate falling beyond the 2007 level is a possible scenario.

In addition, the thinking on pricing in real estate transactions based on the value indicated by the cost approach (value arrived at by adding building costs to land value) rather than the value indicated by the income approach could emerge among some investors. In the case of the sort of properties invested by TOKYU REIT to date, the value indicated by the income approach has been about 120-130% of the value indicated by the cost approach, but there is the possibility of a phase in which the value indicated by the cost approach exceeds the value indicated by the income approach being brought on by building costs rising due to soaring construction costs. In such phase, there may not be any other way to explain the concerned value by the capitalization method than to estimate the cap rate lower.

To date, we have been saying that the cap rate will not fall to the 2007 level, but considering that there is a gap between the lending attitude of financial institutions and the occupancy rate, there is still a wide spread between the real estate market cap rate and debt costs due to unprecedented monetary easing, construction costs are soaring and other factors, there is the possibility of various types of investors entering the market. Additionally, assuming that inflow of funds from countries with a lower cap rate than Japan can also be anticipated, we think there is the possibility that the cap rate will fall to the 2007 level or even lower depending on the circumstances.

<Questioner C>

(Question C-1) The understanding is that internal growth will be the main in order to attain the 2,600 yen distribution. Please restate whether or not the policy is to proactively pursue external growth.

(Answer) The competition environment is severe, but we intend to proactively acquire prime properties. Internal growth will be the main, but we intend to also proceed with replacement of properties in line with the Long-Term Investment Management Strategy (Surf Plan).

(Question C-2) OK with preparing conservative earnings forecasts, but I feel that having a buffer for decrease in amount makes it difficult to forecast future increase in distribution by internal growth. I would think that the preparation of earnings forecasts could be done with a little more positive view. Please provide your opinion.

(Answer) We are reluctant to change the "contract basis and buffer for decrease in amount" thinking that we have applied to date. The role of the buffer for decrease in amount may seem to be ending due to upturn in real estate market conditions, but the preparation of earnings forecasts on a contract rent basis as of the reference date has been underlying the preparation of earnings forecasts to date and so we are hesitant about introducing a buffer for increase in amount at this timing. We have thus not included it in the earnings forecasts this time.

We intend to review the future policy on preparing earnings forecasts.