

## J-REIT - Arbitrage Game

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J-REITs are finally coming into the market. Both “Office Building Fund of Japan” sponsored by Mitsui Fudosan and “Japan Real Estate Investment Company” sponsored by Mitsubishi Estate, Tokio Marine & Fire Insurance, and Dai-ichi Mutual Life Insurance will be listed in the TSE on the 10<sup>th</sup> of September. The temporary conditions have already been determined through the book-building process, and various speculations concerning the final offering price are going around in the market.

I would like to look into the arbitrage game of these J-REITs. Of the first two J-REITs, Mitsui Fudosan’s fund seems to be more into this arbitrage game, since their temporary condition is set with premium on the stock market even though their private offering in the spring was based on purchase price.

Table 1 (JPY)

	Building Fund	Japan Real Estate
NAV per unit	499,907	497,491
Tentative Price	550,000 to 625,000	475,000 to 525,000
LTV	36%	22% to 24%
Expected Yield	4.2% to 4.6%	4.5% to 4.9%

Table 1 indicates the comparison of conditions of two funds. Book value of the properties seems like NAV evaluated in market value since there is not much difference between the purchase price and appraisal value (though an accuracy of appraisal value is another debatable issue). In the case of Building Fund, an offering price according to the temporary condition includes premium of 550,000 to 625,000 yen, while NAV is 500,000 yen. An offering price of Japan Real Estate is set less aggressive at 475,000 to 525,000 yen, however, the final offering price is likely to include some premium. Some predicts price increases of some 30% after IPO. In such a case, the return based on property would be low as 3%. Japanese NPL issues should improve enormously if Japanese real estate is traded at the cap rate of 3%.

Judging from the IPO, it seems like the first two J-REITs have succeeded in the arbitrage game.

This is already influencing the real estate market. Some are applying this arbitrage for their exit strategy and return of J-REIT is affecting the real estate value, which reminds me of the card game. Careful analysis of capital market, without being blinded by the short-term high return of arbitrage game, is crucial, if you don't want to be left holding the "old maid" when a game is over.