

Study on J-REIT Investment Strategy

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Both “Office Building Fund of Japan” and “Japan Real Estate Investment Company” began trading on the Tokyo Stock Exchange Monday, 10th September, which marked 1.8 to 3.8% higher than its offering price. Both J-REITs seemed to have attracted enough demand through the book building method.

I would like to examine the investment strategy of these two funds through their PPMs. Even though the minimum disclosure is offered, these PPMs are very hard to understand as the volume of data and descriptions differ significantly between the two. This is understandable as these are first real estate investment trusts in Japan and that both funds have come this far without clear guidelines. However, investors must have had hard time understanding the products they are investing in.

I would like to study the investment strategy and fee structure of two J-REITs through the PPMs (please refer to the tables below).

Please note that I have applied same simplified models in order to obtain a set trend. In the model case, I have set the asset of both funds to be 200 billion yen (approximately \$1.6 billion), and compared the fee structures of both (1) 0% growth and (2) 20% growth annually.

As a result, the management fee of Office Building Fund of Japan was higher than that of Japan Real Estate Investment in the case of 0% growth, and the opposite in the case of 20% growth.

This indicates that the management strategy of Office Building Fund with asset size of over 200 billion yen is focused on the stable growth while Japan Real Estate Investment is focused on the growth strategy.

I will leave the judgment to the market, however, a fee structure of incentive based J-REIT is fair compared to the fee structure of existing security investment trusts which fee is set equally.

Conditions	Case 1 (0% Growth)	Case 2 (20% Growth)
Initial asset value	200,000,000	200,000,000
Acquisition of asset (3 properties/price per property)	0	50,000,000
Disposition of asset	0	16,666,667
Asset value at the term end	0	-10,000,000
Asset value at the term end	200,000,000	240,000,000
Equity	140,000,000	168,000,000
Debt	60,000,000	72,000,000
Gross return	10.0%	10.0%
Total revenue	20,000,000	23,000,000
NOI return	6.0%	6.0%
NOI	12,000,000	13,800,000
NCF return	4.5%	4.5%
NCF	9,000,000	10,350,000
LTV	30.0%	30.0%
Loan interest	2.0%	2.0%
Interest	1,200,000	1,440,000
COC return	4.5%	4.5%
Cash dividend	6,930,000	8,316,000
Issued units	150,000	150,000

(Office Building Fund of Japan)		Case 1 (0% Growth)	Case 2 (20% Growth)
Asset management fee 1	3% of profit	600,000	690,000
Asset management fee 2	3% of possible dividend	207,900	249,480
Asset management fee 3	0.2% of acquisition value (10 to 30 billion yen)	0	100,000
		<i>807,900</i>	<i>1,039,480</i>

(Japan Real Estate Investment)		Case 1 (0% Growth)	Case 2 (20% Growth)
Asset management fee 1	3.0 to 10.0% of cash flow	589,000	635,800
Asset management fee 2	3.0% of increased cash flow	0	540,000
Asset management fee 3	0.5% of acquisition price (middle of term)	0	250,000
Asset management fee 4	0.25% of transfer price (middle of term)	0	5,000
		<i>589,000</i>	<i>1,430,800</i>