Activia Properties Inc.
FP18 Ended November 2020 Q&A Session
Q&A Session Summary

Date: Tuesday, January 19, 2021 (Telephone Conference)

First, I would like to give you a brief explanation about the impact of the current state of emergency on our operation.

Following the emergency declaration, restaurants and bars operating in the 11 prefectures under emergency are requested to voluntary close businesses after 20 o'clock. Though, this time, we will not conduct business closure of the whole buildings or subsequent rent reduction. The subject tenants are totaling to 86, and they agreed on the closure after 20 o'clock as requested. There are likely to be no significant problem, therefore we deem no major impact will occur on our performance for the current period that ending May 2021 and beyond.

Q1 : On the page 7 of the briefing material, you provided us with a robust message saying that the occupancy at the period ending May 2021 will bottom of your operation. Though I remember that under the first emergency of last year, you had a significant difficulty in the leasing activities of office. Will not be the same for this time? Could we expect a certain progress in your leasing as forecasted? For Ebisu Prime Square also, the occupancy at the end of the period ended November 2020 was 94.2%. The property is co-owned with another co-owner, and can we expect that you can proceed leasing without ignoring rent level?

A1 : As shown in "1. Trend in new lease contract & cancellation" on the page 7, from April to June last year, lease cancellation that we received outnumbered new contracts, and new contracts were mainly limited to those which were already nearly concluded. From July, we started to conclude brand new contracts. From October, the situation tends to improve as the number of cancellations is decreasing, while leasing activities is firmly progressing. The new tenants with whom we made contracts by December last year, basically they have a solid capacity to pay the rent and wished to rent a good space. We believe that corporate earnings will gradually recover from this spring to summer, and subsequently the momentum of office market will improve. Under such circumstances, we believe the leasing of remaining area will also favorably progress.

As for Ebisu Prime Square, we achieved rent growth right after the acquisition of the property in January 2020, and new contracts were concluded with rents higher than market. This was because many of the new tenants arrived just after our acquisition are somehow agile in their decision making and action, and therefore, some of them also decided rapidly to leave due to the pandemic. The buildings of the property are high grade with an excellent visibility, but those are relatively distant from the train station compared to our other buildings in the area. Due to that, Ebisu Prime Square is positioned a little behind our other properties in the area in terms of the preference from tenants. Although, the office building is excellent in its usability with a standard office floor area of 300 tsubo dividable into four spaces with no loss of efficiency. A certain number of new leases has been contracted, and we assume that the rent will be maintained at a certain level, even if it will be softened from that at the momentum before COVID-19. In any case, as the buildings of the property are high grade and very mush visible, we are not so much concerned for the middle to long term perspective.

Q2 : I believe that you are in discussion with the operator on the next lease contract of Tokyu Plaza Akasaka. It should be difficult to provide us with the detail of the contract, though can we know whether the current rent level is acceptable or not for the operator?

A2 : The contract for the hotels in Sapporo and in Akasaka will expire at the end of this October. For Sapporo, last year we renewed the contract with an increase in fixed rent. And for Kobe, the current contract has still a long period to maturity. As for Akasaka, the property is co-owned with the Sponsor by a 50% co-ownership interest for each, the discussion on a contract renewal is being held with them. Before the COVID-19, thanks to its location and accessibility, Akasaka performed the most favorably among the three hotels. Before the pandemic, inbound tourists and business demand accounted for the major part of the earnings, so we believe if there’s a sign of recovery in those factors, the operator will also be able to expect a recover in its performance. Though, as the “Go To Travel” campaign is currently suspended, the situation is not favorable at all for them, they might need more time to decide. The operator, Tokyu Hotels, is one of our top 10 tenants, so we plan to disclose the results of the negotiation after signing the new agreement.

Q3 : As for the Sponsor support, on the page 19 of the briefing material, you mentioned the "asset-recycling model" which should be linked to asset replacement strategy. Will it be the core model for your future operation? And have you set this model because of the current unit price in the market, or will you continue this strategy even if the P/NAV performance recovers to 1 or more?

A3 : Within the Sponsor's "cyclical reinvestment business" strategy to leverage the REIT business, we had already taken measures to fully capitalize our assets. Those measures include the disposition to the Sponsor of the building of TAMACHI SQUARE which they renewed afterwards. And this time we highlighted those measures as the "asset-recycling model". We think this kind of measures will be the key in our future operation, and we need to determinedly promote asset replacement strategy, while fully leveraging the function of the Sponsor as a comprehensive real estate developer, in line with the future city planning and redevelopment plans they are projecting, which contributes to maximize our unitholder value at the same time. Promoting this strategy with taking advantage of the Sponsor being a comprehensive real estate developer, we will strengthen our presence in terms of external growth. The Sponsor understands our strategy of the "asset-recycling model" as we are aware of that the REIT business faces an important phase in terms of external growth strategy. Regardless of the performance of the unit price and NAV, etc. we will work hard on this strategy as one factor for our external growth.

Q4 : At the results briefing, you were confident that you could pursue further increase of rent in the office management, though given that the rent gap narrowed from 9% to 6% in six months and the vacancy is on rise, tenants are provided with alternative options. I think the current environment is not suitable to pursue rent increase. Could you give an extra explanation about the internal growth strategy with maintaining high occupancy?

A4 : The rent gap for the Tokyo Office Properties for the last period that ended November 2020 narrowed by 3 points to 6% from the previous period ended May 2020. These 3 points are composed by 1 point from the increase achieved in rent in place and 2 points from the adjustment of market rent, and we consider we are still capable to work to bridge the gap. We expect that the average rent for API's overall portfolio will increase as we will pursue rent growth, though the market rent level will not change as the occupancy is still on the phase of recovery. With these factors, we expect the rent gap will be a little more narrowed for the current period ending May 2021. Under the current stagnated market, we will focus on bridging the gap. Though we expect the market rent will be back to uptrend for the periods ending May and November 2021, while we work hard to improve the occupancy at the same time.

Q5 : In the previous period, you had a target stabilized DPU of 10,000 yen. How do you position it now?

A5 : If you neglect the amount of the COVID-19 impact indicated on page 5, the DPU for respective period would have been around 10,100 yen to 10,300 yen. This shows that we have constantly accumulated internal growth so far, and I believe our potential ability is worth a DPU of 10,000 yen. However, as it has not been realized yet, we will firmly promote the leasing of offices during the current period ending May 2021 and the next period ending November 2021, to set a base for a DPU of 10,000 yen. If we realize a DPU of 10,000 yen, we will be at a stage to challenge next target for the period ending May 2022 and beyond, through achieving external growth and further internal growth.

Q6 : At the previous financial results briefing, we recognized that there was no reduction in the fixed rent of hotels, but in this briefing material and the video presentation, you explained that all three hotels have already granted the rent reduction and the effect has been incorporated. I would like to ask if this is within the range of the expected temporary reduction, or if it was not expected, but as a result, it is within the range of the expected overall temporary reduction. Also, if the temporary reduction is factored in, I would like to ask about when it will recover.

A6 : Tokyu Hotels is not our stakeholder, but in the big picture it is the Tokyu Group. And for Kobe, as the recovery was relatively quick, we were cautious for rent relief. However, as a result, we agreed on the reduction of fixed rent. The reduction impact is already incorporated into the guidance for the period ended November 2020 and the period ending May 2021 as indicated on page 5. We consider it will not give further impact as the reduction will end by the end of the period ending May 2021.

Q7 : Regarding the debt side, I don't think there will be any particular change in the borrowing environment, but while looking at the earnings forecast, it is expected that financial-related costs will increase considerably, but at the refinancing schedule, there may be no factor that raises cost that much. Therefore, I would like to ask if it is simply conservative or if there is any invisible cost.

A7 : In the DPU summary on page 9, the debt finance (interest rate) values are negative, and I believe you pointed that out. You can basically take this as a buffer. Regarding the borrowing environment, financial institutions have not changed their stance significantly, and it is unlikely that interest rates will rise for the time being, so we expect that they will remain stable. In the bar chart on page 9, the assumption is 0.775% for the period ending May 2021 and 0.80% for the period ending November 2021, but the actual is below 0.7%. So you can think that we took a sufficient buffer.

Q8 : Regarding the asset replacement strategy, the briefing material states that while you focus on the office for the acquisition, for the disposition, you do not specify the category. In fact, will you sell office and buy office, or sell retail / hotel and buy office so that the portfolio will be focused on offices? I would like to ask you a little more about the replacement strategy.

A8 : As explained earlier, we added the “asset-recycling model”, but our strategy has not changed from when we provided the results briefing for the period ended May 2020. For the acquisition, we aim at mainly the offices on the south side of the Yamanote Line, and for the disposition, we will consider based on the three axes of 1. profitability, 2. building age, and 3. competitiveness. As a case for 1. profitability, we disposed of a property in front of the Shinbashi station because of its lowered profitability. For 2. building age, we disposed of the building of a property in Tamachi in order that the Sponsor rebuild, which they converted to an office equipped with a laboratory for use for the time being. As for 3. competitiveness, a property in Akasaka was disposed because it was hard to maintain operation due to the low competitiveness as there are many similar properties for restaurants & bars in the area. For the all three cases, the strengths and weaknesses of each of them were individually judged. And I feel that the retail properties will be a little uneasy due to the future influence of e-commerce, etc. if we look at 3. competitiveness. So, it can be somehow natural to focus on one of the categories.

Q9 : The numbers of requests from tenants in the commercial facilities and the number of reduction agreements have been disclosed, but please tell us which tenant industries are included in those requests and reduction agreements.

A9 : The breakdowns of the tenants by industry with which we agreed rent reductions and cancellations are shown on page 50. In both rent reductions and cancellations, restaurants and bars account for a large percentage, followed by services and apparel. As reported, they are significantly affected by the pandemic. Under the second emergency, mainly those industries are requested to voluntary refrain from operating business and shorten the hours, so although they will receive subsidies, we recognize that those industries such as restaurants & bars are in a very tough situation.

Q10 : In the previous state of emergency, large properties such as Omotesando and Odaiba were closed for the entire facility, and I think that the subsequent rent reduction had a major impact on Activia's business performance. I understand that, in other words, the impact of rent reductions will not be extremely large without closure of the entire buildings. Is that correct in the future? Or as it is the second state of emergency, the tenants may have been cumulatively damaged, is there a possibility that many tenants will request a large reduction due to poor business performance even if you do not close the buildings?

A10 : To be honest, I don't know if the same thing will happen when the state of emergency is prolonged and if there will be more requests. However, if this situation continues, the small-sized restaurant & bar tenants who have worked hard so far will be possibly heading toward cancellation, and in that case, we will need to respond individually. Unless there is a situation like lockdown as in April and May, we do not anticipate that we need to close the entire building. And we will work to lease the vacant lots firmly, while responding to each request from tenant. I think we will be able to lease up well good areas, though there will be some very difficult blocks such as restaurant & bar areas on the upper floors. For such areas, we will make effort for leasing, including approaching to tenants such as beauty clinics, fitness centers and showrooms.

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