

Activia Properties Inc.
FP22 Ended November 2022 Financial Results
Q&A Session Summary

Date: Wednesday, January 18, 2023 (Telephone Conference)

Q1 : As for the probability of the recovery in occupancy rates, recently there have been cases where the actual rates have fallen short of the estimation in your earnings forecasts, and the office occupancy for the period under review fell short of the previous forecast. What is the probability of the estimation in this time's forecast?

A1 : The actual rates for the period November 2022 underperformed its previous forecast, and we revised the forecast for the period May 2023 downward from the previous forecast. We assume that we will reach a level close to the previously issued forecast for the May 2023 in November 2023, which means the recovery is about six months behind. This is largely due to three properties - namely Shiodome Building, A-PLACE Shinagawa Higashi, and A-PLACE Shinbashi - and we believe that the key to recovery is especially A-PLACE Shinagawa Higashi. The latest forecast assumes that the occupancy of the property will be 70% at the end of May 2023, and will recover to 100% at the end of November 2023. As competition remains tough in the area, the outlook is more of a challenge than a certainty. However, this is not to say that there are no prospective tenants at all, and we intend to further strengthen leasing through efforts such as value-up construction to increase the attractiveness of the property. Shiodome Building and A-PLACE Shinbashi are in slightly better condition than A-PLACE Shinagawa Higashi. For Shiodome Building, the leasing is proceeding diligently. Although the figures have not yet reflected this, we expect to achieve the forecast as we are starting to see moves. For A-PLACE Shinbashi, although the recovery has been slower than previously expected, we believe that it will be able to fill steadily to some extent, partly because the size of the property is relatively small, while the number of prospective tenants is large. The other areas are active, and we believe that the occupancy can be maintained with some tenants coming and going.

Q2 : Regarding the rent trends at offices, negative growth has been deepened at both rent revisions and tenant replacements; what is your outlook for future rents?

A2 : As competition has been intense, rents are being pressured downward at lease renewals as well as at tenant replacements, and we expect it will continue in the future. However, in terms of area, downward pressure on rents in the west side of the Yamanote Line, Gotanda, and the greater Shibuya area is subsiding. In those areas, we have achieved upward rent revisions, and Osaka is also performing relatively well with some upward revisions being achieved. Situation depends on the areas. The issue is future rent levels in the east of the Yamanote Line, as some sources forecast that the area's occupancy will not rise. Therefore, we need to be vigilant for the area.

Q3 : With regard to the minimum DPU level, last time you mentioned the possibility of raising the minimum target once the entire portfolio's earnings would show a sign of stabilization. Have you any updates on that? I got the impression from the presentation material that such a situation has not yet emerged. What is the situation, though?

A3 : At this point, we expect that operations will return to normal in the second half of 2024. We are therefore not planning to raise the minimum target in 2023 or the first half of 2024, and we are uncertain about later. Other factors to consider include how much we can expect the sales-linked rent from the retail and hotel properties and earnings can be improved through asset replacement. We will strive to raise the minimum target at the earliest possible time.

Q4 : I would like to identify the significance of investment in a hotel as you have just acquired A-FLAG NISHI SHINSAIBASHI. In general, you would expect future upside for a hotel despite its volatility, though, the property is under a fixed-rent lease.

Don't you expect any upside, or is there a possibility that the rent structure may be changed when the market environment fully recovers? Do you plan to acquire more hotels in the future? At your last financial results presentation, I did not assume you would acquire a hotel, so please let me know about the backdrop of the acquisition.

A4 : Actually, the decrease in rent revenue from existing tenants and the lowered profitability of portfolio weigh on Activia's operational performance, and it has become important for us to raise the profitability through asset replacements.

Through the asset replacement together with the properties precedingly decided to be disposed, the portfolio's profitability improved, and that is one of the key points of this acquisition.

A-FLAG NISHI SHINSAIBASHI was developed by our sponsor and has leased to one of our sponsor group's companies, or an API's support company. We decided to invest in the property because of this creditworthiness and the long-term stability, as well as that, it contributes to the improvement of our portfolio's profitability. The key point is, therefore, to ensure stability and profitability.

Of course, stability is ensured in part by the property's high value. In terms of future acquisitions, there is a possibility that we acquire another hotel if it can be expected to have upside potential in the future. Although the size would not be large, hotel could be a good candidate.

Q5 : I have one question on properties to be disposed. You mentioned that while offices in the greater Shibuya area and Osaka are performing well and retails are also recovering, offices in the Shinagawa to Shinbashi area are still in a quagmire. Will the properties for disposition be those offices currently struggling?

A5 : A key focus on what we will do is to improve the profitability of the overall portfolio. For that, assessing the medium- to long-term profitability of each property, and disposing low-yield properties and acquiring high-yield properties will be the approach that we should take. Therefore, lower yield will remain a key to select the properties to dispose. At this time, we are unable to provide you with specific candidate properties, but based on this policy, we will continue the asset replacement strategy.

Q6 : You mentioned that office leasing in the greater Shibuya area proceeds well, but are there any characteristics in the area's tenant demographics? According to the sponsor's latest financial results, the vacancy rate in the area is low at around 1%, and the recent Miki Shoji's data shows the area's strong performance, too.

So please let me know whether there are some tenant groups with strong demand other than tech companies.

This week, a listed company named Sun Frontier Fudousan opened a building dedicated to startups in Shibuya. Are your startup tenants increasing areas in API's offices, too? What is the current situation?

A6 : As you pointed out, the office vacancy rate in the greater Shibuya area once exceeded 5% as the area quickly reacted to the changing demand for office space ahead of the overall market, but it has recently settled down to a 3% level. In addition to the large number of relatively young companies, mainly tech companies, there is a strong demand for office expansion mainly in Ebisu area, by service-related tenants who consider office space important, and the growing demand for additional floor space by tenants in properties of 100 tsubo or less is contributing to the declining vacancy rate.

Q7 : Can you expect sponsor support regarding the soaring electricity charges? The sponsor has been running TV ads on its renewable energy business, and you mention it in your earnings presentation material, too.

Are there any measures to hedge against the rising price of electricity, such as passing on the cost to rents for the electricity generated from renewable energy?

A7 : I believe that our sponsor is one of the industry leaders in ESG, especially in terms of environmental initiatives. And we are constantly sharing information with our sponsor. However, since the properties that we manage are different and support from the sponsor in the form of supplying renewable-energy related electricity is not embodied, we have not yet any concrete initiatives or results that can be shown in figures. That said, as we are working on the theme across the entire group, we would like to continue our efforts to add value to tenants and investors.

Q8 : I understand that your growth strategy will be a little more dependent on property dispositions. As for the cap rate outlook, do you believe that the environment is conducive to property disposition? It may be a bit difficult to forecast the cap rate, but what is your view of the current market?

A8 : The impact of interest rates on the transaction market is uncertain, so we recognize we need to monitor it closely. On the other hand, market appetite for asset acquisition remains strong, and the environment seems to have not changed much as cap rates remain low while we do not expect prices to rise sharply. Therefore, we believe that there is a reasonable probability of property dispositions. We believe that there is certain acquisition demand for the properties that we hold, and disposition price will remain at the same level as in the past.

Q9 : The appraisal value of A-PLACE Shinagawa Higashi has decreased by about 2.2 billion yen since the preceding period, please let me know if there is any reason for this.

A9 : This was largely due to higher estimates for repair investment. The ER has recently been reviewed, and it was determined that a large investment in repairs is required, and there was also the impact of the sharp rise in material prices. In addition, rents have been weak in the market. These two factors have led to the decline in the appraisal value, the main reason for the decline was the large investment estimation of repair investment, though.

Q10 : Regarding the outlook for interest rates on debt financing, at the most recent refinancing you implemented, the borrowing rate has exceeded 1% for a 9-year loan term, but I assume that the interest rate will further gradually rise at each refinancing. Are there any changes in strategy in terms of borrowing duration and all-in costs in light of the underlying situation?

A10 : Interest rates are indeed in an upward phase due to rising interest rates overseas and the BOJ's monetary policy change at the end of the last year. And we need to keep a close watch on this. There were no surprises at the BOJ policy meeting as of today, but we believe it is necessary to manage our operations based on the assumption that interest rates will rise further while closely monitoring the trends in prices and overseas interest rates.

As there is a possibility that the interest-rate hike will have a material impact on costs, we will maintain a certain degree of flexibility in terms of borrowing periods, and although the interest rate will be fixed in principle, we may consider adopting variable interest rates in some cases to control the overall interest rate.

Q11 : Regarding transaction yields, A-FLAG NISHI SHINSAIBASHI has a relatively high yield of 3.6% after depreciation, but in the sponsor's pipeline, there are many properties in the greater Shibuya area with relatively low yields. Are there any candidates in the pipeline that may be able to maintain the acquisition yields in previous cases?

A11 : We recognize that the acquisition cap rate is low at the moment, as is the disposition cap rate. While we are considering also acquisitions from third parties, the sponsor is still the main channel for API. The sponsor understands our growth strategy and importance of the stability in management, and that our current focus is to improve the profitability of the portfolio. While being aware of the level of market cap rate, we believe that we can conduct transactions

at a level that is reasonable for both API and the sponsor.

Q12 : You revised upward the estimate of revenue from sales-linked rent in Kobe Kyukyoryuchi 25Bankan, but do you expect any further upside in FY2022? Please also tell us about the outlook for FY2023 and beyond.

A12 : Operation at Kobe Kyukyoryuchi 25Bankan has been strong, with the occupancy rates exceeding pre-Covid levels of 2019 in some months and RevPAR reaching or even exceeding its former levels in some months. This hotel has a very high percentage of weddings, and the operation remains favorable thanks to the stable wedding sales. The property is mainly driven by domestic demand rather than inbound demand, so even if there were a covid rebound, we believe that we would be able to continue stable operations.

Q13 : What is your current thinking on the unit buyback, please?

A13 : There is no change in our policy. For the use of cash on hand, acquisition of qualified assets will be given higher priority than unit buyback. The buyback was conducted last year because it was considered rational compared to property acquisitions amid declining unit prices, and it was a message that we did not tolerate the level of unit prices. Therefore, unit buyback is an option we always have, and we will make a comprehensive judgment on timing and other factors from such perspective.

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