Activia Properties Inc.
FP17 Ended May 2020 Q&A Session (Telephone Conference)
Q&A Session Summary

Date: Thursday, July 16, 2020

Q1 : Is COVID-19 impact in the closed facilities including but not limiting to those which closed their entire facilities, or those which partially closed were also incorporated into the forecast DPU for the FP18 ending November 2020?
Determined amount seems still not significant, please tell me the negotiation status.

A1 : Forecast DPU for the FP18 ending November 2020 incorporate a negative impact from COVID-19 adding up to ￥1,195. The impact of the whole facility closure of some retail properties had already been factored in FP17, and for the FP18, we included impact of respective request from other tenants such as rent relief and else. As you can see the status of negotiation progress in slide 7, we have already concluded roughly a half of 115 negotiations on temporary reduction.
Determined value for the agreed temporary reduction shown in dark grey color in the graph at lower left of slide 9 is not significant, which indicates that we have terminated a half of the negotiations with consuming only a small part of the amount incorporated into the forecast DPU.
There are few relief requests that we have received for July and after, though we have to look ahead to the second and third waves of COVID-19. Therefore, we will continue to negotiate firmly on further requests from tenants to minimize COVID-19 impact to us.

Q2 : You mentioned that the increased amount of rent on offices for the FP17 ended May 2020 was a record-high. Had it already been achieved before the spread of COVID-19? Or in addition to the part achieved before crisis, is there some portion accomplished amid COVID-19 pandemic? I would like you to talk about it with reference to current office’s performance in rental increase.

A2 : As for the rental increase on offices achieved for the FP17 ended May 2020, we had agreed on most of arrangements before March, and in addition, we could conclude 11 cases with rent raise from March to May. With a tenant in Shinagawa area, we have increased rent by 28.5% at contract renewal in May. We see that rent uptrend has continued in the specific area and properties with strength although vigor is restricted. There are also a few cases of rental increase at tenant replacement in April and after such as an office in Osaka. So, we consider that the market remains healthy in some parts of our portfolio.

Q3 : Recently, a discussion on necessity of office space called into question fill the headlines of some media, saying that office is not required in near future mainly for IT companies located in Shibuya. Please tell us about actual office demand with reference to your impression on demand in the greater Shibuya area amid COVID-19.

A3 : If I mention the overall trend including Shibuya area, office supply will be historically low in 2021 and 2022, and we consider that the market will remain solid with well-balanced demand and supply.

Due to the impact of COVID-19, work from home (WFH) has been verified progressively, and we are recognizing the industries or businesses more adapted to WFH than others as well as some underlying problems. We believe that the importance of office space is also recognized anew, and office space will coexist with telework maintaining its conventional role. That means office space becomes more important not only as a place to perform tasks individually but also as a communication-oriented place where we share vision, collaborate, innovate and manage people. Therefore, we think properties having a good accessibility which facilitate gatherings and offering exciting and energetic environment will be required. From that perspective, Shibuya area is suitable for new workstyle, because the center of Shibuya where is attractive and stimulating is also close to living area and office supply is limited. Temporarily, vacancy rate of Shibuya area has risen slightly, though the number of tenants in Shibuya is relatively small as each tenant occupies a large office space, and growing companies wishing to move Shibuya flow into the area. Through our leasing activities and rental increase effort, we feel the area, Ebisu and Gotanda especially has strongly demanded.

Q4 : Concerning retail properties in the greater Shibuya area, you mentioned that number of visitors become increasing and the trend so far accelerates. Do you think visitors will return to the level of before COVID-19 as time advances? Or will the after COVID-19 be different from situation so far? Please tell me about your outlook with reference to how to coexist with e-commerce.

A4 : Although there is no doubt that some sectors including restaurant and bar are facing difficulty, we think requirements for retail properties especially in a good location will be changed. Location of properties will justify the purpose to open a store on that place, and therefore the location of the property has been important. And from now on, stores which have branding effect and admitted valuable will have been strong. We consider that effectiveness which can add value are very strong, and the value of opening stores in those location will be unchanged in future despise progressing e-commerce. We will make leasing effort emphasizing locational advantage of the properties as we believe the value of cities and places where people gather remain unchanged.

Q5 : New lease contract with A-FLAG SAPPORO shown in slide 17 was concluded in March, and I recognize that the impact of COVID-19 was not yet serious. The new contract seems advantageous for API, and Tokyu Hotels accepted rising fixed costs. Under the COVID-19 pandemic, what do you think about this contract continuity in future?

A5 : This lease contract was concluded at end of march, so the impact of COVID-19 became already obvious. This time, part of sales-linked rent is transferred to fixed rent, so if Tokyu Hotels' sale increases, they also have merit from sales-linked rent. The reason why Tokyu Hotels concluded the contract is that I think they are sure that sales and sales-linked rate will rebound with recovering inbound visitors in future. API and Tokyu Hotels don't think this is negative contract.

Q6 : NAV per unit for the period under review shows us that appraisal value of the properties seems not affected from COVID-19. How do you expect the change of capitalization rate especially for retail properties in FP18?

A6 : We are not sure about how the appraisal value affected from crisis as it is appraised by professional. There should be some factors affecting NAV such as whether the impact of rent reduction on NOI will be constant and what are the actual terms and conditions implemented to transactions, etc. We cannot affirm NAV will not fluctuate in future, however, good location and profitability of the property are important, and we believe those conditions are evaluated by appraiser.

Q7 : Concerning retail properties, although you explained that there are some potential demands of opening stores in prime location, my feeling does not correspond with that. Please tell me in more detail such as tenant attribution and their demand as far as possible.

A7 : We are implementing leasing effort for properties like Tokyu Plaza Omotesando Harajuku, and there are some demands to good location in order to sustain superiority of their brand and they actually request first refusal right. There is a trend like that in prime locations of Tokyo and Osaka. In particular, we continue to communicate with a foreign-owned corporation to resume discussion once interrupted, although their decision is depending on the headquarters. Unfortunately, we cannot give their name now, however, we will be able to announce when it makes a little bit more progress. There is still a demand from a brand of which everyone knows the name.

Q8 : Concerning office situation, I was explained that there are some cancellations occurred due to COVID-19. I understand these are due to business decline of tenant. Are there any example of cancellation because of moving into WFH?

A8 : We think tenant’s earnings decline due to impact of COVID-19 is the main reason. For example, some cancellations came from a temporary staffing company in restaurant business or an apparel company. COVID-19 was the clincher for tenants having had bad performance since before COVID-19 for both office and retail tenants. On the other hand, we cannot observe an impact from promoted WFH, however, cancellation from the tenant who wanted once to expand their leasing area might be an impact of COVID-19. There are some cases that quick decision-making companies such as venture company canceled expansion of leasing area by COVID-19.

Q9 : Did you consider repurchasing of own investment units? And why did you decide not to do it?

A9 : We have prepared the framework to implement repurchasing of own investment units. Although we considered it as one of our options using cash like property acquisition or debt repayment, we decided not to do it this time. When we deem it will be the best in several options, we will continue to consider doing it.

Q10-1 : It was quite a surprise that rental increase on offices is going well, and I would like to know how you have made it happen. Have you started a discussion with a high rent to see how the tenant response to the proposal or your tenants accepted the proposal smoothly?

A10-1 : We have explained our tenants thoroughly the market situation. We start from having them understand that their leased space worth the rent. After that, discussion progress depends on a variety of factors such as how much they can accept or what is their contract term. On the other hand, we emphasize also replaceability of tenants, each discussion has been differently developed for example judging tenant' s business scale and setting reviewed downtime. And such effort to let them understand the market have made the recent outcome in rental increase.

Q10-2 : Do you reference sources such as the CBRE market overview?

A10-2 : You can see the rent gap situation on slide 14 in the presentation material, and it' s an extract from CBRE-sourced data for all of our properties. Those kinds of data allow us to provide the tenant a detailed explanation.

Q11-1 : Concerning the risk of fixed-rent reduction on hotels, what is the break-even point for the operators in terms of RevPAR year-on-year percentage change in order that they make profit after paying fixed rent? Or, what is the y-o-y percentage decrease in RevPAR for you to decide fixed-rent reduction?

A11-1 : The exact number for the breakeven point is not available right now, though I assume that it would be around 50-60%, as I heard before. And I believe that, as we have contracted a long-term lease, the operators will ask for different things depending on how they identify this hotel in their facilities or how they continue their operation. Operation in all of three of our hotels had favorably progressed before the crisis, and we deem them three important assets of API. Therefore, it would be possible that we will consider rent reduction on hotels as one potential measure against COVID-19 if needed.

Q11-2 : Do forecast DPU include buffer from potential reduction in hotel fixed rent?

A11-2 : You can consider that buffer is to absorb all COVID-19 impact on our portfolio. We formed a certain hypothesis on respective property in order to factor into the estimated amount into forecast DPU.

Disclaimer

This document is provided solely for informational purposes and should not be construed as an offer, solicitation or recommendation to buy or sell any specific product including investment units. Any decisions making on investment absolutely rest on your own judgment and on your own responsibility.

This document is not a disclosure document or statement of financial performance required by the Financial Instruments and Exchange Act, the Act Concerning Investment Trusts and Investment Corporations of Japan, the rules governing companies listed on the Tokyo Stock Exchange or any other applicable rules.

This document includes charts and data described by TLC REIT Management Inc. (hereinafter the “Asset Manager”) and refers to data, index and other information provided by third parties in addition to information about Activia Properties Inc. (hereinafter the “Investment Corporation”). Also analyses, judgments and other points of view of the Asset Manager under the present situation are included.

The information contained in this document is not audited and there is no guarantee regarding the accuracy and certainty of the information. Analyses, judgments and other non-factual views of the Asset Manager merely represent views of the Asset Manager as of the preparation date. Different views may exist and the Asset Manager may change its views in the future.

The figures included in this document may be different from the corresponding figures in other disclosure materials due to differences in rounding. Although the information contained in this document is the best available at the time of its publication, no assurances can be given regarding the accuracy, certainty, validity or fairness of this information. The content of this document can be modified or withdrawn without prior notice.

The Investment Corporation and the Asset Manager do not guarantee the accuracy of the data, indexes and other information provided by third parties.

The Investment Corporation’s actual performance may be materially different from results anticipated by forward-looking statements contained in this document.