Teleconference Date: October 18, 2024

Nomura Real Estate Master Fund, Inc. (NMF)

Questions and Answers Teleconference for the 18th Fiscal Period Ended August 31, 2024

Summary of Questions and Answers

Q.1

I would like to ask about the future asset replacement strategy. As announced last year, the ratio of the office sector has been reduced to the 39% range and that of the hotel sector has increased so far. Will this trend continue in the future? Alternatively, is asset replacement going to consist of buying individual properties with positive prospects regardless of their use, and selling those without? Are there any changes in the sector allocation strategies?

A.1

As you recognize, going forward, we would like to examine and promote the replacement of individual properties, not limited to the office sector. For instance, under current conditions, we still properties for potential sale in the office sector, and also in the residential sector. In the future, from the perspective of building an inflation-resistant portfolio, we will sell those properties with stagnant or declining cash flows and acquire those with upside cash flow potential.

Q.2

With regard to the office sector, we are starting to see rent increases. Is the outlook for the sector improving? What is your view of the office sector as part of NMF’s portfolio?

A.2

So far, we have increased rents in the office sector for properties in regional areas with rent gaps. In addition, the office market in the Greater Tokyo area is recovering with strong demand, and in our results for the fiscal period ended in August 2024, the rate of change in monthly rent upon tenant replacement has moved into positive territory. Going forward, we would like to conduct operations so that we can increase office rents in the Greater Tokyo area, and the asset manager in charge of this area also believes that rents will increase.

Q.3

As announced, this is the second time in a short period that NMF has utilized funds from the sale of properties for asset replacement to purchase its own investment units. What is your view on the current price level of investment units? Would you share your thoughts on the sustainability of this initiative?

A.3

In our view, our operating conditions have been solid, but investment unit price levels remain weaker than expected. We understand that the tide in the J-REIT market has changed due to the end of negative interest rates and the policy interest rate hike, among other effects. In this sense, we recognize that the top priority still lies in improving profitability, which is the number one measure in J-REIT management, or in other words, achieving internal growth.

As long as current investment unit price levels continue, we will continue to enhance unitholder returns by purchasing our own investment units using funds from property sales through property replacement.

Q.4

You mentioned that you have no particular sector in mind in terms of future property sales. Should I understand that there is no clear target ratio specified for the future, such as x% range in the office sector and so on?

A.4

The office sector ratio has been reduced to the 39% range, as we stated. There are still some properties to be sold in the future. However, we would like to consider and assess the upside of potential cash flows for properties like next-generation style offices such as H1T and H1O that have been developed by sponsors.

Q.5

Following the recent sale of the Harumi Triton Y, will the Harumi Triton Z also be put up for sale?

A.5

We would like to refrain from commenting on the sales strategy for individual properties, but we plan to review its inflation resistance and other aspects as we did with Harumi Triton Y.

Q.6

With regard to the residential sector, you mentioned that at this time you are offering incentives for contract renewals, but will this boost momentum for rent increases? Can we also expect the ratio properties with rent increase to go up?

A.6

In the residential sector, the impact of the new rent increase incentive fees for PMs is already visible. For the three-month period from September to November, rents at the time of contract renewal increased by approximately 2%. This rate is also increasing from month to month, so we expect to see a little more increase in the future.

As described on page 22, rent changes upon renewal in the fiscal period ended August 2024 were flat for approximately 80%. Due to the Act on Land and Building Leases, there are some difficulties in negotiations, but we see the next challenge as how much we can reduce this 80% figure in the future.

Q.7

I understand that the recent purchases in the hotel sector are based on GOP-linked lease contracts, which I presume are based on the determination that they are inflation resistant.

Would you also consider hotels other than those specializing in lodging, such as full-service hotels including restaurants and banquets?

The reason behind this question is that, in the case of full-service hotels, the break-even point is higher due to restaurants and banquets, so there is margin to question whether they are indeed inflation resistant or not.

A.7

Full-service hotels have also been considered as acquisition targets. The properties we have acquired so far have been of the type specializing in lodging, but we may consider acquiring full-service hotels if they are under a lease contract rather than an MC agreement.

Even in such a case, the risk is roughly the same as for other hotels specializing in lodging as long as we acquire them after a reasonable assessment of the cash flows of the restaurant and banquet departments.

Q.8

For properties like next-generation style shared offices that are being developed by sponsors, are factors such as acquisition yield different from standard offices?

Also, in the case of shared offices, tenant turnover could conceivably be more frequent than at standard offices, but will sponsors sign master lease agreements with fixed rent? Alternatively, is it possible to consider an operation-linked rent system such as sales-linked rents?

A.8

We do not yet have specific cases of acquiring shared offices. As a result, we will have to think about how to acquire such properties or how to assess acquisitions. For example, cap rates will be desirable to add a small risk premium by incorporating the operational aspects of the property compared to PMOs and others.
As for the type of contract with tenants, lease contracts are signed with fixed rents, in principle, but as you are aware, the frequency of move-in and move-out is high, and there have been cases where rents have increased. We would like to discuss this with the sponsor to explore the possibility of establishing a mechanism to increase cash flow by offering a portion of the rent increase as an incentive to PMs.

Q.9

How is the sponsor pipeline in the hotel sector? Would the properties owned by or associated with UDS, an affiliate of the sponsor, be included?

A.9

The hotel sector does not have a lot in the pipeline under Nomura Real Estate, and only a few properties under NOHGA HOTEL. As you know, UDS has become a group company of the sponsor. We expect to strengthen the operating capabilities and incrementally increase the pipeline through projects such as NMF acquiring properties at the time of disposition.

Q.10

I have a question regarding unitholder returns on page 7 of the briefing materials. You previously purchased seven billion yen of the fund’s own investment units and three billion yen this time, and the purchase of own investment units seems to continue in the future However, the amount of the purchases declined compared to the previous purchase. Given the scale of NMF’s assets, larger purchases seem appropriate. What were the reasons behind this three billion yen purchase?

A.10

When the NMF Shinjuku Minamiguchi Building was sold, the book value equivalent amount was used to acquire hotels in Hakodate and Shin-Osaka as asset replacements. The remaining portion, or the gain on sale equivalent amount of approximately three billion yen, was used to purchase our own investment units. Overseas investors have suggested that we sell properties and purchase our own investment units on a much larger scale. One of our main purposes of purchasing our own investment units this time, as well as the last time and the first time, was to see how the market would react. In the future, depending on the price performance of the investment units, we will consider purchasing our own investment units for the book value equivalent amount of properties sold.

Q.11

On page 8 of the briefing materials, assets, borrowings, and returns are presented as a response to inflation. Is there a priority among them?

A.11

Profitability improvement is a top priority, as current conditions are conducive to rent increases in all sectors. In the case of borrowings, some aspects of borrowings are difficult to control as they are largely dependent on market developments concerning interest rates. For these reasons, we prioritize these measures in the order of assets, returns, and borrowings.