

Main Q&As Regarding the Financial Results of NTT UD REIT Investment Corporation for the 37th Fiscal Period

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Speaker: Tomoyoshi Kosugi, President and CEO, NTT Urban Development Asset Management Corporation

Q. You have explained that leasing of vacated spaces at office buildings is slightly lagging. Can you tell me your view about, or possible direction of, the NTT Group companies using the office floors going forward?

A. In our earlier performance forecast, we had anticipated filling the vacated spaces by the end of the 37th fiscal period. However, especially for Urbannet Gotanda NN Building, returning to the earlier level has been at a slow pace due to the extension of the state of emergency declaration, among other factors. There continue to be space needs, though, and specific actions like private previews are finally starting to take place. We foresee that filling the vacated spaces will be postponed by some months, to be done through the end of the 38th fiscal period and into the 39th fiscal period. As such, we have modified our forecast more conservatively. As for the NTT Group as a whole, it is true that companies of certain business areas (mainly NTT DATA) are raising the ratio of work from home and reducing their office spaces. That was the case for Urbannet Gotanda NN Building, from which an NTT Group company moved out in March. On the other hand, large tenants like NTT Facilities and DOCOMO CS are labor-intensive, and are assumed to require larger office spaces due to expanded operations consigned from within the NTT Group and other factors, while integrating office, going forward.

Q. On the investment side, do you perceive that the market conditions, especially in the capital market, have recovered enough for you to make new investments? As your LTV has risen to 47.7%, I would like to know if you see it necessary to reduce LTV to around 45%.

A. The LTV had remained at around 45% but rose to 47.7% as a consequence of acquiring Shinagawa Season Terrace through debt financing. As our target LTV is around 50%, we do not see any need to promptly reduce LTV to the earlier level. Going forward, however, if we have opportunities to acquire properties from the sponsor whose pipeline support has been reinforced, we would like to conduct equity financing with the understanding of unitholders. I somehow feel that we may better lower the LTV level a bit to secure room for debt financing so that we do not miss future opportunities for further growth and acquisitions.

Q. You said that you want to maintain DPU under normal operations as stably as possible (going forward), but do you see there being room for an increase in DPU in accordance with external growth? Such an increase may be difficult to achieve as the cap rate of properties for acquisition will be lower, but can you also explain the direction you aim to follow?

A. As you can see in the historical data, DPU sat at the 2,500-yen level until about five years ago, and we have gradually raised it to the 2,700-yen level. Essentially, we would like to focus on keeping stable the distribution yield while increasing the quality of owned properties, rather than significantly raising the cash distribution level.

Q. With regard to the change rate of leasing rent, the figure at tenant turnover is +0.3% for office buildings and +0.5% for residential properties. If the occupancy rate is to increase going forward, can I anticipate that the change rate will remain flat?

A. For the moment, the office market is in a condition in which hard negotiations are needed when discussing rent with tenants, and the situation makes it difficult to raise rent either at tenant turnover or contract renewal. However, we have continued negotiations with the tenants of the NTT Group from a medium- to long-term perspective and, for the 37th fiscal period, they accepted a certain level of rent increase at contract renewal. For the tenants whose rent level is below market rent, we intend to keep negotiating to fill the gap. In the 38th fiscal period, however, approximately 30% of the tenants are at a level below market rent, and all of such tenants are not NTT Group companies. Accordingly, it is hard to expect room for rent increase. Residential properties have become polarized, and those with inferior conditions in the market tend to have longer vacancies. We will work to revise rent setting for them. As for properties with superior conditions, we will continue with bullish rent setting. As such, strong properties and weak properties are mixed. For residential properties as a whole, however, the occupancy rate settled at around 95%. Going forward, we believe we can prevent the occupancy rate from falling and maintain the current level by flexibly responding to the situation. As for leasing of office buildings, we want to fill vacated spaces as early as possible, with a focus on NTT Group tenants.

Q. Earlier, when talking about external growth utilizing the sponsor pipeline, you said you were considering it from a long-term perspective. But has it fairly boiled down to specific projects? I would like to know how you feel about the prospect.

A. I have not been able to make a clear statement about the outlook of property supply from the sponsor, but what has taken shape recently is that we need to re-conclude the pipeline support agreement to enhance it. In light of the reorganization of the NTT UD Group, investment will be needed to promote the urban solutions business. Nevertheless, the pace of development by the sponsor has not been increased, and we our long-term perspective will be kept unchanged when it comes to the possible large-volume supply of properties from the sponsor. However, we understand that the acquisition of Shinagawa Season Terrace and Otemachi Financial City Grand Cube is part of the sponsor's efforts to reinforce its support. For deals of properties whose size is as large as flagship-class buildings like these, you may see the possibility from a closer perspective.

- Q. Regarding property acquisition, will the office portfolio be shifting to Class A buildings in central Tokyo? Please explain how you see the direction.
- A. There are Class B properties in the pipeline as well, but the size of each property as well as the supply volume is becoming larger. The class of properties to be selected is also being upgraded, as suited for a REIT that has its sponsor's name affixed. In the medium to long term, it may be possible that properties having a concept that is different from conventional office buildings are incorporated into the portfolio, as NTT's urban solutions concept promotes development of new (multi-use-type) projects over a wide area.
- Q. I have the impression that leasing of residential properties has exited the worst period. Looking ahead, will you be turning to a more aggressive approach? As you have many luxury properties, I would like to ask you what your strategy on rent per unit will be.
- A. Rent increase and rent decrease have turned out to be mostly comparable by value. Overall, leasing is somewhat lagging compared with before the pandemic, but it is mostly returning to the situation under normal operations. We can maintain occupancy at the current level, but certain properties may allow us to aim for upside gains. For the upper-class properties owned by NUD, we feel there has been almost no impact from COVID-19. As such, we would like to pursue upside potential.
- Q. Will ESG factors be incorporated into your criteria for property acquisitions in the future? From a long-term perspective, the cap rate of properties with ESG factors will be higher when sold. Therefore, I would like to ask you about the possibility of incorporating ESG factors, which will call for property replacement for better environmental scores, etc., as well as about evolution in the ESG-related disclosure aspect.
- A. We are focusing on ESG even more, as shown by the issuance of green bonds, the first such bonds for NUD, in the 37th fiscal period. Going forward, we are resolved to continue endeavoring so as not to fall behind the trends of the capital market. All of the NTT Group's core properties are ESG-friendly. In particular, Shinagawa Season Terrace acquired by NUD the 37th fiscal period is a project that built a park and a building above the water supply facilities of the Tokyo Metropolitan Government. The building features high environmental performance, and the property can obtain high scores on ESG issues. Going forward, it is likely that properties acquired through the sponsor pipeline will have higher environmental performance than those in the current portfolio. Therefore, we will endeavor to obtain market evaluation for such properties; not only direct evaluation on their cap rates but also something extra including environmental scores.

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