December 18, 2024

Main Q&As Regarding the Financial Results of NTT UD REIT Investment Corporation for the 44th Fiscal Period

Date and time: December 17, 2024 (Tuesday) at 11:30 a.m. (Teleconference)
Speaker: Yutaka Torigoe, President & CEO, NTT Urban Development Asset Management Corporation

Q. Regarding the future property replacement strategy, this round of replacement seems to have been based on the recognition that the properties sold had issues. Are there still properties with issues currently you recognize? If so, would the focus be on offices or residences when replacing them?

A. With this round of replacement, we plan to sell Landic Shimbashi 2 Building and NTT CRED Okayama Building, which we believe will address significant property issues. However, other lower-priority properties with challenges still exist, and we will continue to consider selling them in the future.
We plan to acquire two residential properties this time, which will slightly increase the residential ratio. However, compared to the past, the ratio remains low. Our fundamental framework is to maintain a 70% office and 30% residential ratio, so we aim to continue acquiring properties while maintaining a balance.

Q. What is your outlook on the potential for future increases in office rents?

A. While the overall office rental market has been improving, this has not yet been reflected in our rent revisions. Due to the inevitable delay in such adjustments, rent upon replacement in the 44th Fiscal Period resulted in a slight decline. However, we feel that things are gradually improving, and we believe that the leasing situation is also improving as we sort out problematic properties. For the 45th Fiscal Period, we would like to reduce the negative margin at least and, if possible, turn it into a positive. We believe the environment will gradually improve, allowing us to reflect these changes in our rent revisions.

Q. During the last financial results briefing, Kanagawa Science Park (KSP) was mentioned. Could you provide an update on this?

A. KSP still faces challenges related to greater repair costs, and our recognition of these issues has not changed. We are continuing to explore improvement measures, including ways to reduce repair costs.

Q. Regarding Landic Shimbashi 2 Building, the decision to sell was influenced by declining occupancy rates, and an appraisal was conducted considering its highest and best use as vacant land. Regardless of the sale, do you believe a similar re-evaluation approach could be applied to the adjacent Landic Shimbashi Building?

A. The situation for Landic Shimbashi Building differs from that of Landic Shimbashi 2 Building. While they are adjacent, the former has high visibility facing Hibiya-dori Avenue and does not have specifications issues such as low ceiling height, which affects the latter. As a result, there is a significant difference in leasing potential between the two properties. Therefore, we do not currently plan to sell Landic Shimbashi Building like Landic Shimbashi 2 Building. However, given its age, we will consider future utilization options.

Q. Regarding NTT CRED Okayama Building, it was acquired back then with a 60:40 ownership ratio between NTT UD REIT Investment Corporation and NTT Urban Development, based on the expectation of stable cash flow. However, subsequent performance appears to have been below expectations. Has this influenced your stance on future transactions involving the sponsor?

A. As you mentioned, the performance after acquisition did not meet expectations. Two reasons for this are: first, Okayama's commercial district shifted significantly from the older central area, where CRED Okayama Building is located, to the station area; second, repair cost estimates using ER upon acquisition were significantly exceeded in reality. While this property was jointly owned by the sponsor, we do not believe this was the cause of the miscalculation. Therefore, we do not think this will impact future collaboration with the sponsor.

Q. Regarding the acquisition of own investment units, the announced scale seems slightly large in comparison to other REITs. Is this a one-time measure due to proceeds from property sales, or is it part of a continuous strategy based on certain rules, including potential property sales for this purpose if the stock price does not recover?

A. We have not established any clear rules regarding the continuous acquisition of own investment units. However, while our recent efforts have been well-received, leading to an increase in unit prices, they remain undervalued. We believe continuous actions are necessary in such circumstances. The current initiative focuses on two pillars: portfolio improvement and capital efficiency. We will continue to consider these two points when taking action in the future. As mentioned earlier, we intend to continue prioritizing property sales as a form of replacement for portfolio improvement. In such cases, the proceeds will likely be allocated to own investment units under the current environment.

Q. Regarding future leverage control, if the current capital policy is continued, would maintaining leverage require repaying about half of the debt while acquiring own investment units? I understand that you intend to sustain the current LTV and proceed with B/S control and capital policy using this approach. Is this feasible?

A. Your understanding is generally correct. When acquiring own investment units, we will simultaneously repay debt, and we expect the LTV level to remain roughly at its current level, with some fluctuations.

Q. Regarding the acquisition of student dormitories, why were these selected over regular residential properties? Regular residences might have offered greater expectations for rent increases, whereas operational properties like dormitories seem less likely to see rapid rent hikes. Is the rent set relatively high from the start? Could you elaborate on this decision?

A. During discussions with the sponsor, the proposal for acquiring student dormitories came from them rather than us. The properties are relatively new and offer good yields, prompting us to consider them. Regarding rent increases, the two properties being acquired have different contract types. Mondoyakujin has a pass-through-type contract that allows for potential rent increases, while Hatanodai requires negotiations with the operator, National Students Information Center Co., Ltd., due to its single-lease structure. In any case, the favorable market environment and slightly under-rented conditions suggest future rent increases are possible.

Q. Regarding the sponsor pipeline, the material includes details about the sponsor's properties and recent initiatives, including for large-scale properties. What types and scales of properties are realistically likely to be incorporated into the REIT? Additionally, are overseas properties an option?

A. Given the current equity market conditions, we have no immediate plans to acquire properties from the sponsor, though this could be considered in the future. NTT Urban Development is advancing developments nationwide, including Hibiya, Otemachi, Sapporo, and Sendai. Still, new large-scale developments have limited yields, so properties likely to be acquired by the REIT would be more mature assets that are already under ownership. As for overseas properties, NTT Urban Development is involved in projects in Vietnam, Australia, and London, but we currently do not intend to acquire overseas assets.

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