COMPANY RESEARCH AND ANALYSIS REPORT

Samty Residential Investment Corporation

3459

Tokyo Stock Exchange REIT

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Index

Summary

Characterized by residential investment, mainly in major regional cities
Is realizing management performance exceeding forecasts through steady internal growth

Samty Residential Investment Corporation (hereafter, also “the REIT”) <3459> is a REIT sponsored by Samty Co., Ltd. <3244>, a Kansai-based real estate group with a rich track record of investing in major regional cities. The REIT was established in March 2015 and in June of the same year, it was listed on the Tokyo Stock Exchange Real Estate Investment Trust market (J-REIT market). It has two fiscal periods a year (ending in January and July). The business of its sponsor, Samty, is based on the twin axes of the Real Estate Business (development and sales of income condominiums for investors), including its own development brand the S-RESIDENCE series, and the Property Leasing Business (including the management of leasing condominiums). Samty also manages business hotels and conducts other related operations. Its strengths include its track record of developing (residential) leasing properties in major regional cities and its leasing abilities.

The REIT’s main features are that it invests primarily in residential properties in major regional cities and is supported by the Samty Group. In particular, the stable supply of properties developed and owned by the Samty Group (to which the REIT is granted exclusive negotiating rights) and the sponsor support it receives in various areas has become the REIT’s powerful growth engine. The assets under management were 49 properties with a total acquisition price of ¥51,551mn, and although its portfolio is still small compared to those of other J-REITs, it has been steadily accumulating pipeline properties toward its immediate goal of an asset size of ¥100bn.

In the FY7/17 (February 1 to July 31, 2017) results, although there was no external growth from the acquisition of properties, operating revenue was ¥1,840mn (up 1.9% compared to FY1/17), operating income was ¥759mn (down 10.7%), ordinary income was ¥614mn (up 1.4%), net income was ¥613mn (up 1.4%), and the distribution per unit (including the distribution in excess of earnings per unit) increased by ¥25 compared to FY1/17 to ¥2,670. Compared to the forecasts, due to the steady internal growth, including from the higher revenues from rentals, key money, and renewal fees, and from the cost reductions, each of operating revenue, every profit item, and the distribution per unit (including the distribution in excess of earnings per unit) exceeded their forecasts, and the REIT can be evaluated as having achieved a strong management performance.

The REIT has announced forecasts for FY1/18 (August 1, 2017 to January 31, 2018) and for FY7/18 (February 1 to July 31, 2018). For FY1/18, it is forecasting operating revenue of ¥1,826mn (down 0.8% compared to FY7/17), operating income of ¥778mn (up 2.6%), ordinary income of ¥615mn (up 0.0%), net income of ¥614mn (up 0.0%), and distribution per unit (including the distribution in excess of earnings per unit) of ¥2,670 (unchanged from FY7/17). For FY7/18, it is forecasting operating revenue of ¥1,842mn (up 0.9% compared to FY1/18), operating income of ¥794mn (up 2.0%), ordinary income of ¥615mn (up 0.0%), net income of ¥614mn (up 0.0%), and distribution per unit (including the distribution in excess of earnings per unit) of ¥2,670 (unchanged from FY1/18), so the outlook is to continue to trend stably. At FISCO, we think that it is fully possible that it will achieve these forecasts, as their preconditions are reasonable and the cash flow is stable. Rather, the same as in FY7/17, the key point would seem to be to what extent the results will exceed their forecasts, from factors such as the higher rental revenue and the cost reductions.

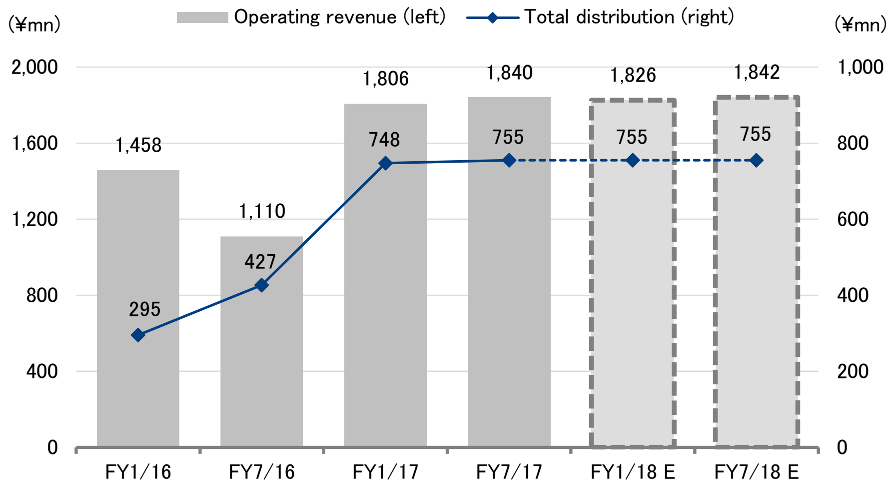
The REIT's growth strategy is based on the twin axes of achieving external growth by focusing on continuously acquiring the S-RESIDENCE properties developed by its sponsor, as well as acquiring other properties owned by its sponsor and by third parties; and achieving internal growth, including through leasing that is tailored to regional and property characteristics, and cost reductions. In terms of the immediate target, it is aiming to achieve an asset size ¥100bn. At FISCO, we evaluate that the target is within an achievable range from the pipeline properties (including those under consideration) that it is steadily accumulating. For internal growth, we can expect effects from the further improvement in management efficiency from the expansion in asset size in each of the major regional cities, while in addition, we consider that it can achieve steady growth by accumulating management expertise that is tailored to regional characteristics.

Compared to other J-REITs specializing in residential properties, it feels that the REIT's investment unit price is clearly undervalued when judged from factors such as the distribution yield and the P/NAV ratio. Therefore, from the progress being made in areas including expanding the asset size, improving name recognition, and accumulating a management track record, we judge that there is plenty of room for the unit price to be upwardly adjusted in the future.

Key Points

- A J-REIT specializing in residential investment, mainly in major regional cities
- Strengths are its stable supply of properties from the Samty Group and the sponsor support it receives in various areas
- Realized management performance exceeding the forecasts through steady internal growth in FY7/17
- Aiming for an asset size of ¥100bn as its immediate target

Results trends



Note: FY1/16 results are for 11 months, from March 16, 2015 to January 31, 2016.
Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

Overview of the REIT

A J-REIT specializing in residential investment, mainly in major regional cities
Its strengths include the support from its sponsor, the Samty Group

1. The REIT and its sponsor

The REIT is sponsored by Samty Co., Ltd., a Kansai-based real estate company with a rich track record of investing in major regional cities, while it entrusts asset management to Samty Asset Management Co., Ltd. It was established in March 2015, and in June of the same year it was listed on the TSE J-REIT market. It has two fiscal periods a year (ending in January and July).

Its sponsor, Samty, is a comprehensive real estate company established in December 1982 in Higashiyodogawa Ward, Osaka City. Its business is based on the twin axes of its Real Estate Business for the S-RESIDENCE series, which is a brand that it itself develops (development and sales of income condominiums for investors), and Property Leasing Business (including the management of leasing condominiums), while it also manages business hotels and conducts other related operations. Its strengths include its track record of developing (residential) leasing properties in major regional cities and its leasing abilities.

The REIT's biggest features are that it invests primarily in residential properties in major regional cities and that it is supported by the Samty Group. In particular, the stable supply of properties developed and owned by the Samty Group (to which it is granted exclusive negotiating rights) and the sponsor support it receives in various areas has become the REIT's powerful growth engine. Of the 59 J-REITs, 8 specialize in residential properties, but the REIT is the only one that focuses on major regional cities. The assets under management were 49 properties with a total acquisition price of ¥51,551mn, and although its portfolio is still small compared to those of the other J-REITs, it has been steadily accumulating pipeline properties toward its immediate goal of an asset size of ¥100bn.

A portfolio that creates stable cash flow from a high occupancy rate

2. Investment policy and portfolio status

(1) Investment policy

a) Investment in accommodation assets and other facilities, mainly residential properties (leasing residences)

In addition to incorporating 80% or more residential properties, the REIT can incorporate operating facilities (such as hotels and health care facilities) if they are 20% or less of the portfolio (it has no such properties at the current time). For the residential properties, it prioritizes single and compact types* that can be expected to capture the steady demand from single-person households.

* Single types have an exclusive area per unit of less than 30m2, while compact types have an exclusive area of 30m2 to 59m2.

b) Investment mainly in major regional cities

The policy is to have 50% or more of the properties in major regional cities (Sapporo, Sendai, Nagoya, Kyoto, Osaka, Kobe, Hiroshima, and Fukuoka), 20% or less in other regional cities, and around 30% in the Greater Tokyo area*.

* Based on the acquisition price. The above investment ratios are targets, and the actual portfolio situation may deviate from them.

(2) Portfolio status

a) Investment ratios by area

Properties in major regional cities constitute 67.4% of the portfolio, other regional cities 15.1%, and the Greater Tokyo area 17.5%, and the total regional city investment ratio is 82.5%. Most J-REITs concentrate their residential investment in the Greater Tokyo area where high occupancy rates can be expected, but the REIT can be said to have a unique presence in that it is achieving a high occupancy rate (95.6% as of the end of July 2017) for properties mainly located in regional cities. In addition, while the ratios for Kinki and Tokai are high, at 32.0% and 22.7% respectively, another feature can be said to be its nationwide development, with 12.2% in Kyushu, 9.2% in Tohoku, 5.3% in Hokkaido and 1.2% in Kita Kanto.

b) Investment ratios by building age

The ratios by building age as of the end of July 2017 are 31.0% for less than 5 years, 30.4% for 5 years to less than 10 years, 31.0% for 10 years to less than 15 years, and 7.6% for 15 years to less than 20 years, so a feature of its portfolio is that the average property age is comparatively new at 8.4 years, the lowest average age among J-REITs specializing in acquiring residential properties. The fact that it has many relatively new properties has the merits of keeping down costs for repairs and leading to a high occupancy rate, as such properties are popular among tenants.

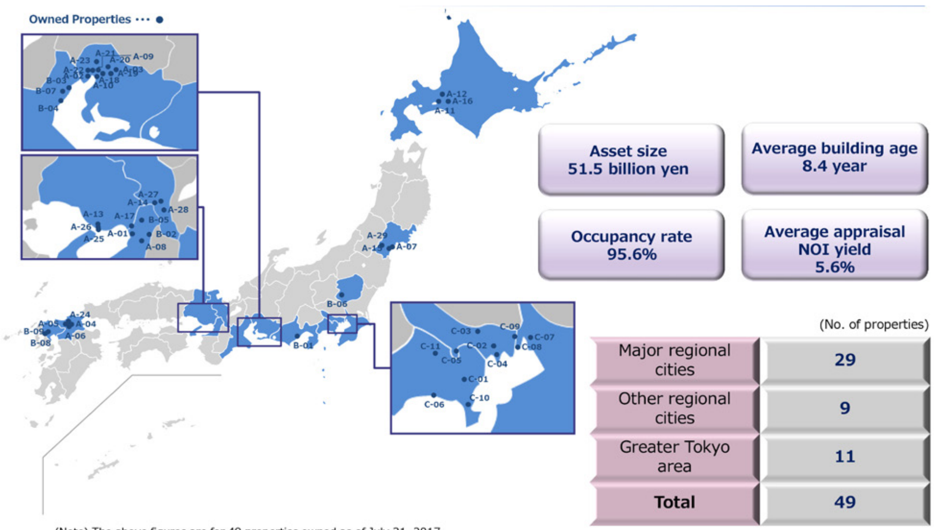
c) Ratio of average area per residential unit

The single type constitutes 53.7% and the compact type 36.0%, for a combined total of 89.8%. The rest are the family type.

d) Investment ratios by seller

In terms of the routes for the acquisition of properties, 66.7% are from development and ownership/warehousing by the sponsor, and for the remainder, 14.8% are from the utilization of bridge funds and 18.6% are acquired externally. For the information routes for the owned properties, 46.7% are from the sponsor and 53.3% are from the REIT's management company.

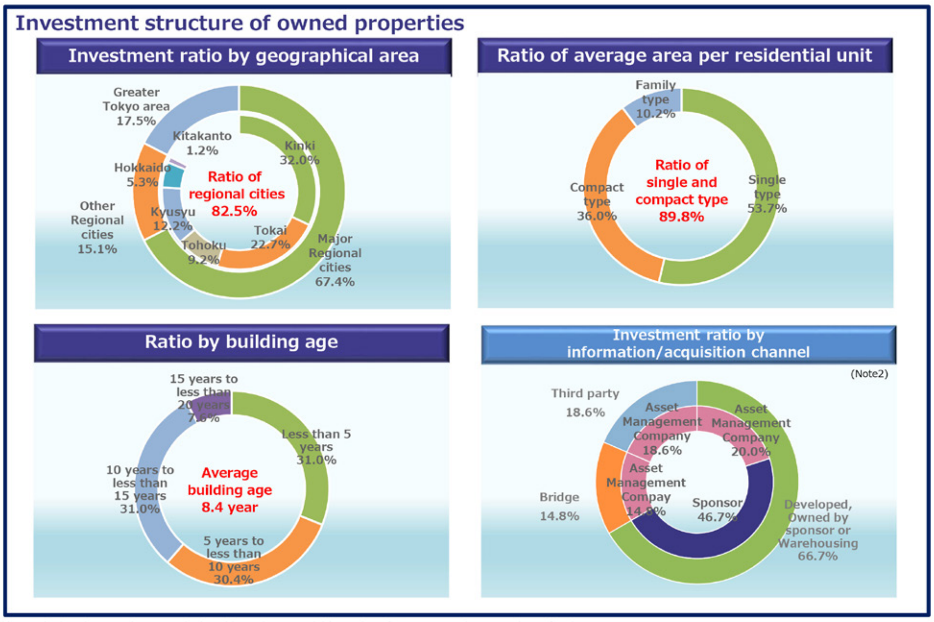
Portfolio overview



(Note) The above figures are for 49 properties owned as of July 31, 2017.

Source: The Company's results briefing materials

Structure of owned properties



(Note1) The above ratios are calculated based on acquisition prices for 49 properties owned as of today.
(Note2) The outer ring indicates the ratio of acquisition channel of owned properties while the inner ring indicates that of information channel of owned properties.

Source: The Company's results briefing materials

Current state of the J-REIT market

The J-REIT market is steadily expanding from favorable factors in the external environment and the diversification of investment targets

1. What is a J-REIT?

A J-REIT is a financial product that uses funds collected from investors to invest in income real estate (such as office buildings, residential properties, and commercial facilities) and distributes to investors the income obtained from this real estate. Its features include that the investment targets are income real estate that generate stable cash flow, and in addition, that can be expected to have a comparatively high yield*. To explain a REIT simply, it can be said to be located in the middle ground (middle risk, middle return) between high-risk high-return shares and low-risk low-return bonds. At the end of September 2017, the total market capitalization of all J-REITs was approximately ¥11,297.8bn, and the number of J-REITs was 59. There was a phase after the global financial crisis when the market temporarily slumped due to the effects of monetary tightening and other factors, but since 2012, it has been expanding thanks to factors like the recovery of the Japanese economy and the effects of long-term monetary easing. In addition, recently there has been a diversification of the investment targets, such as to commercial facilities and hotels for which inbound demand is expected to increase, and for long-term care facilities with an eye to Japan's aging population. In this way, various opportunities for investment are being created and there remains considerable room for the market to grow.

* As of the end of September 2017, the average distribution yield for J-REITs was 4.16% (from a FISCO survey).

Trends in the TSE J-REIT index

Source: Prepared by FISCO from Tokyo Stock Exchange, Inc. website

2. Points for an investment decision

The points for a decision to invest in a J-REIT can be said to be how it realizes stable and continuous growth from the cash flow obtained from income real estate from the viewpoints of stability, growth potential, and profitability. In particular, since the quality of the cash flow changes greatly depending on the properties owned (the asset type), it is necessary to pay attention to each J-REIT's investment policy and portfolio status. Generally speaking, the residential properties that the REIT targets for investment are comparatively unaffected by economic conditions, and because users are distributed small lots, the stability of cash flow can be said to be high. But on the other hand, its profitability tends to be a little lower than the J-REITs specializing in office buildings.

The important indicators are trends (changes) in the rent unit price and occupancy rate to evaluate stability; growth in the asset balance and improvements (and room for improvements) in the rent unit price and the occupancy rate, and reductions (and room for reductions) in leasing business costs to evaluate growth potential; and the NOI yield*1 and the profit margin to evaluate profitability. Also, the J-REIT's financial condition (policy) is also important information to consider in making an investment decision, since maintaining the stability of the financial base and the ability to raise funds to acquire properties in the future while making effective use of interest bearing debt leads to an increase in the distribution per unit. Important indicators include the total asset based LTV*2 and the ratio of long-term to short-term interest-bearing debt.

*1 (Real estate rental revenue + depreciation) ÷ real estate acquisition price
*2 Abbreviation of "loan to value." Interest-bearing debt ÷ total assets.

It is necessary to evaluate growth from two aspects, external growth and internal growth. External growth entails expanding the asset size by acquiring new properties and increasing the overall cash flow. However, it is necessary to be aware that as the number of units issued increases following a public offering, it is not always the case that the distribution per unit will also increase. Of course, even in such a case, the expansion in asset size can become a factor promoting internal growth by improving management efficiency. Therefore, the key is acquiring routes to high-quality properties. On the other hand, internal growth entails increasing the cash flow from the properties owned by raising the rent unit price, improving the occupancy rate, and achieving cost reductions. The key points to achieve it are efficient management and administration and the utilization of expertise.

The REIT's features

The support from its sponsor, including a stable supply of properties, is its powerful growth engine

1. Growth model

The REIT's growth model is, the same as for other REITs, to aim to increase cash flow from external growth and internal growth and thereby raise the distribution per unit (including distribution in excess of earnings per unit). In particular, the stable supply of properties from its sponsor is the REIT's powerful growth engine for external growth. Its policy for the future is also to strengthen its acquisition of properties from third parties, but even in these cases, it is considered that it will utilize its major weapon of the support its receives from its sponsor in various areas, including for the warehousing function. In addition, the key points for internal growth are that as its properties are mainly in regional cities, it conducts detailed leasing and costs reductions tailored to the regional and property characteristics, and the surrounding market conditions.

2. Returns to investors of a distribution in excess of earnings per unit

One of the REIT's major characteristics is its returns to investors of a distribution in excess of earnings per unit. Normally, a REIT fundamentally returns all net income to investors through distributing the results of the asset management. But in the case of the REIT, it adopts a distribution policy of returning to investors some of the depreciation, in addition to net income. This part in excess of the normal distribution of income is called the distribution in excess of earnings per unit. However, originally, depreciation has the quality of being used for capital expenditure to maintain the functions of buildings and other assets, so the REIT's policy is to implement this distribution based on certain cash management conditions and restrictions. In other words, after comprehensively considering a range of factors such as the external economic environment, the real estate market conditions, and its own finances, the REIT decides on the optimal distribution from free cash flow after the allocation of funds to capital expenditure, working capital, and so forth, alongside investment to strengthen the financial base and to improve the portfolio's profitability. Also, to avoid damaging the financial base, the REIT aims for a target payout ratio of 70%, representing the ratio of net income + depreciation (upper limit of 35%) to total distribution (including distribution in excess of earnings per unit).

Among the J-REITs, there are few that return the distribution in excess of earnings per unit to investors, and only the REIT does so among those that specialize in acquiring residential properties. It is the characteristics of the REIT's portfolio that makes this possible; namely, that as it mainly acquires regional residential properties, depreciation tends to be a large percentage of the property's acquisition price, and also because it has many relatively new properties, capital expenditure (repair expenses, etc.) is small (so it can more easily generate surplus funds). At FISCO, we think that in the future also, it will be able to return a distribution in excess of earnings per unit to investors because it can be expected to be stably supplied with new properties by its sponsor, which can be seen as one reason why the REIT is an attractive investment.

3. The portfolio's characteristics and competitive advantages

(1) Mainly invests in residential properties in major regional cities

Most of the residential investment by J-REITs, including by the other J-REITs specializing in residential properties, is in properties in the Greater Tokyo area, so in this respect the REIT can be said to occupy a unique position. Since the REIT was listed (on June 30, 2015), among all the properties acquired by the listed J-REIT, the REIT's share of the number of properties acquired in regions other than Tokyo and the Greater Tokyo area is 41.8%. The situation in the Greater Tokyo area, where competition is fierce, is that it is difficult to acquire properties because of factors such as the soaring prices of real estate. So one of the merits of acquiring properties in regional cities where there are comparatively few players is that they are easier to acquire at a reasonable price.

Conversely, compared to the Greater Tokyo area (particularly Tokyo's 23 wards), where the population inflow and the growth in single-person households is great, there are concerns about the occupancy rates for properties in regional cities, while additional issues are that there may be no routes or networks to acquire properties, and management efficiency after the acquisition can be low. These are the factors that have led other J-REITs to regard regional properties as difficult to deal with. However, in the major regional cities that the REIT focuses on, the growth rate in the number of households and the net migration are actually comparable to in Tokyo's 23 wards*1. In fact, the occupancy rate of the REIT's properties in the major regional cities has been trending at about the same rate as the Greater Tokyo area*2, and it is also at a high level compared to the rates of the other J-REITs specializing in residential properties. In addition, with regard to issues of the routes and networks to acquire properties and management efficiency, the REIT is supported by the Samty Group and can cooperate with it. If it makes progress in expanding the asset size in each of the major regional cities in the future, we can also expect a virtuous circle, in which the expanding asset size leads to the construction of an network and improvements in management efficiency, which in turns leads to further expansion in the asset size. Recently, due to the recognition of its investment performance in major regional cities, it has become easier for the REIT to obtain information on properties locally, including projects that are brought to it.

*1 In the growth rates in the number of households from 2000 to 2016, the growth rate in Tokyo's 23 wards was approximately 23.0%, while the growth rate in all of the major regional cities was 20.1%, so their respective increase trends were nearly the same. Also, from 2000 onwards, taken as a whole the net migration into the major regional cities has been trending stable, the same as for Tokyo's 23 wards.

*2 As of the end of July 2017, the REIT's occupancy rate in the major regional cities was 95.2%, and in the Greater Tokyo area it was 97.8%.

(2) Sponsor support from the Samty Group

As previously explained, it is the support that the REIT receives from its sponsor, the Samty Group, that makes possible its unique portfolio. In particular, the stably supply of properties that are mainly newly-built properties, such as the S-RESIDENCE brand series of properties being developed by the Samty Group itself, is the source of its competitive advantage. Also, in addition to the abundance of management expertise that the Samty Group has cultivated in the major regional cities, the REIT utilizes the support of the Samty Group in various areas to acquire external properties. Representative examples of this include the provision of a warehousing function,*1 support for redevelopment, provision of fixed rent master leases,*2 and the provision of leasing-support operations.

*1 A method of acquiring property acquired by a sponsor or an established SPC (bridge fund) before the acquisition by the investment corporation in order to stabilize income and adjust the acquisition timing

*2 A lease to guarantee fixed rent to the REIT from bulk leasing (subleasing) by the master lease company.

Results trends

Although its portfolio is still small, it is steadily expanding leveraging its unique position

1. Results trend since the listing

When the REIT was listed (July 1, 2015), the asset size was 28 properties (total acquisition price ¥30,500mn), but following the acquisition of properties, including from the August 2016 public offering, its portfolio has steadily expanded and, while still only small, it currently contains 49 properties (as of July 31, 2017; acquisition price, ¥51,551mn).

The distribution per unit (including the distribution in excess of earnings per unit) is also steadily rising, including from the improvement and stabilization of the occupancy rate and the increase in the adjusted rent unit price*.

* Calculated by {monthly rental revenue + (key money revenue ÷ assumed lease agreement period)} ÷ lease agreement area (the assumed lease agreement period is four years). The adjusted rent unit price for each area is calculated as the average of the adjusted rent unit price for each individual property weighted by lease agreement area ratio of each property in each area.

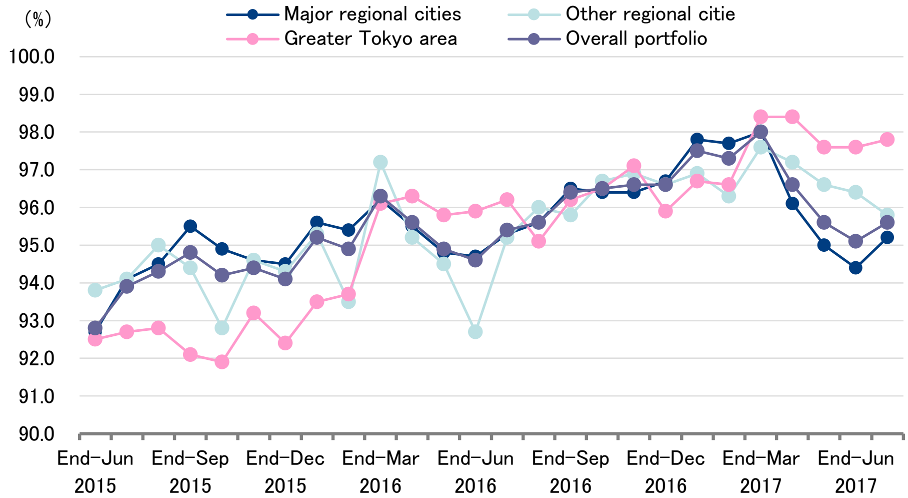
Results trends

(¥mn)

	IPO	FY1/16 (11 months)	FY7/16	FY1/17	FY7/17
Operating revenue	-	1,458	1,110	1,806	1,840
Operating income	-	598	417	849	759
Ordinary income	-	170	331	606	614
Net income	-	168	330	605	613
Total distribution per unit (¥)	-	1,810	2,618	2,645	2,670
Distribution per unit (¥)	-	1,034	2,026	2,138	2,169
Distribution in excess of earnings per unit (¥)	-	776	592	507	501
No. of properties (buildings)	28	29	29	49	49
Total acquisition price	30,500	30,962	30,962	51,551	51,551
Appraisal value	30,936	32,434	32,975	55,693	56,490
Appraisal NOI yield	5.6%	5.6%	5.6%	5.6%	5.6%
Average building age (years)	7.0	7.6	8.1	7.9	8.4
Occupancy rate	92.8%*	95.2%	95.4%	97.5%	95.6%
No. of rentable units	2,297	2,345	2,345	3,754	3,754

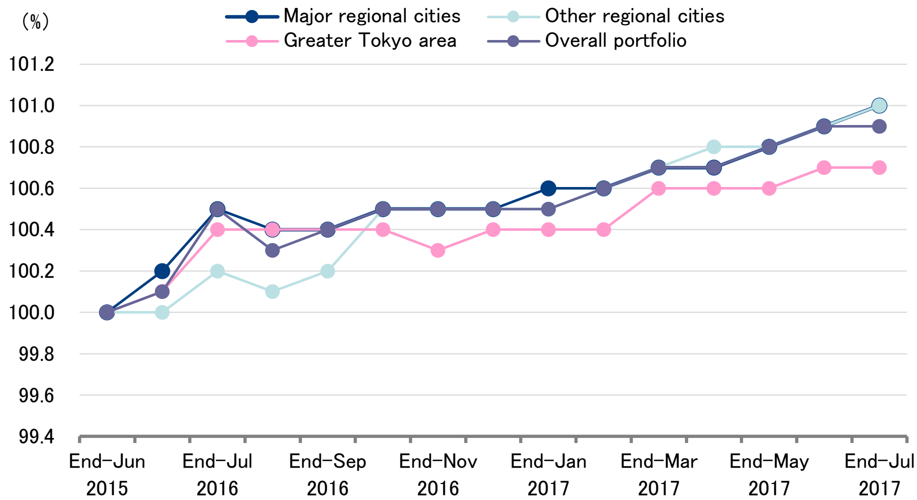
* The occupancy rate at the time of listing is from the end of June 2015, and the figure excludes S-FORT Tsurumai marks and S-FORT Shonan Hiratsuka, which had just been completed, and S-FORT Gakuenmae acquired on October 1, 2015.
Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

Trends in occupancy rates by area



Note: The occupancy rate for April to August 2015 excludes S-FORT Tsurumai marks and S-FORT Shonan Hiratsuka, which had just been completed, and S-FORT Gakuenmae acquired on October 1, 2015.
The September 2015 occupancy rate includes S-FORT Tsurumai marks and S-FORT Shonan Hiratsuka, but excludes S-FORT Gakuenmae prior to its acquisition.
The July 2016 occupancy rate does not include the 20 properties acquired in August 2016.
The August 2016 occupancy rate excludes S-FORT Tsurumai cube, which had just been completed.
Source: Prepared by FISCO from the Company's results briefing materials

Trends in the adjusted rent unit price



Note: Calculated by {monthly rental revenue + (key money revenue ÷ assumed lease agreement period)} ÷ lease agreement area (the assumed lease agreement period is four years). The adjusted rent unit price for each area is calculated as the weighted average of the adjusted rent unit price for each individual property, in accordance with the lease agreement area ratio of each property in each area.
Source: Prepared by FISCO from the Company's results briefing materials

The FY7/17 results trended favorably from the steady internal growth The distribution per unit (including the distribution in excess of earnings per unit) also increased and exceeded the forecast

2. The FY7/17 (4th period) results

In the FY7/17 (February 1 to July 31, 2017) results, although there was no external growth from the acquisition of properties, operating revenue was ¥1,840mn (up 1.9% compared to FY1/17), operating income was ¥759mn (down 10.7%), ordinary income was ¥614mn (up 1.4%), net income was ¥613mn (up 1.4%), and the distribution per unit (including the distribution in excess of earnings per unit) increased by ¥25 compared to FY1/17 to ¥2,670. Compared to the forecasts, all of the items exceeded their respective forecasts, of operating revenue by ¥42mn, operating income by ¥13mn, ordinary income by ¥18mn, net income by ¥18mn, and the distribution per unit (including the distribution in excess of earnings per unit) by ¥45, and the REIT can be evaluated as having achieved a strong management performance.

The reasons for the differences with the forecasts are as follows.

Operating revenue exceeded its forecast because the occupancy rate and rental revenue trended favorably (up ¥6mn compared to the forecast), and also other revenue (including key money revenue, renewal fees revenue, and restoration revenue) increased (up ¥35mn) (as a whole, operating revenue was ¥42mn above its forecast). The average occupancy rate during the period was 96.4% (the forecast was 95.5%), maintaining its high level, while in addition, the REIT has also been able to steadily improve the adjusted rent unit price*. What is worthy of note here is the upside in the receipt of key money revenue and renewal fees revenue. Although these are practices that are not necessarily firmly established in the regions, it seems that the number of receipts is increasing, due to factors including the appeal of the properties and the effectiveness of the leasing activities.

* At the end of FY7/17, the adjusted rent unit price (including key money revenue) had risen approximately 0.4 of a percentage point compared to the end of the previous period (end of FY1/17).

Meanwhile, operating expenses were also above the forecast, as repair expenses increased (up ¥35mn) alongside the active upfront investment, including for construction work to improve the value of properties, although water, lighting, and heating expenses were reduced to less than the forecast (down ¥5mn compared to the forecast). Operating expenses as a whole were up ¥29mn compared to the forecast. The construction work to improve value, which was a factor behind the higher costs, will have the effect of creating surplus capacity toward improving profits in the future, so it can be said to be an intentional development for the REIT.

Non-operating income was ¥4mn above the target (positive factor) as interest expenses declined. The company had estimated the risk of a rise in the base rate conservatively, but it was not raised.

To summarize the FY7/17 results from the above, the REIT delivered a noteworthy performance. While there was no external growth (acquisition of properties), thanks to steady internal growth, the distribution per unit (including the distribution in excess of earnings per unit) exceeded both the result of the previous period and the forecast. Also, the REIT was able to supplement upfront investment (including construction work to improve the value of properties) toward internal growth in the future.

Results trends

FY7/17 (4th period) results

(¥mn)

	FY1/17 result	FY7/17 result	From end of previous fiscal period	Change rate	FY7/17 initial forecasts	Difference
Operating revenue	1,806	1,840	34	1.9%	1,797	42
Operating expenses	956	1,081	124	13.0%	1,052	29
Operating income	849	759	-90	-10.7%	745	13
Non-operating income and loss	-243	-144	99	-	-148	4
Ordinary income	606	614	8	1.4%	596	18
Net income	605	613	8	1.4%	595	18
Total distribution per unit (¥)	2,645	2,670	25	0.9%	2,625	45
Distribution per unit (¥)	2,138	2,169	31	1.4%	2,105	64
Distribution in excess of earnings per unit (¥)	507	501	-6	-1.2%	520	-19
No. of investment units	283,000	283,000	-	-	283,000	-
The average occupancy rate during the period	96.5%	96.4%	-0.1pt	-	95.5%	0.9pt
Capital expenditure	26	41	15	57.7%	55	-14
Depreciation	434	434	-0	-0.0%	436	-1
Payout ratio	72.0%	72.0%	-	-	72.0%	-

Source: Prepared by FISCO from the Company's financial results and results briefing materials

3. Financial position

At the end of July 2017, there had been no major changes to the financial position. Total assets were ¥55,525mn (down 0.5% on the end of the previous period) and net assets were ¥26,262mn (down 0.5%), so they trended basically unchanged, while the equity ratio was 47.3%, also maintaining the same level (47.3% at end of previous period). Interest bearing debt was ¥28,600mn (down 0.5%), while total asset-based LTV was 51.5% (51.5%), so these items also trended basically unchanged, and there are no concerns about financial stability or the ability to raise funds in the future.

Balance sheet and financial indicators

(¥mn)

	End-FY1/17 result	End-FY7/17 result	From end of previous fiscal period	Change rate
Total assets	55,828	55,525	-303	-0.5%
Net assets	26,397	26,262	-134	-0.5%
Interest-bearing debt	28,750	28,600	-150	-0.5%
Short-term loans payable	550	400	-150	-27.3%
Current portion of long-term loans payable	-	5,000	-	-
Long-term loans payable	27,200	22,200	-5,000	-18.4%
Investment corporation bonds	1,000	1,000	-	-
Total asset-based LTV	51.5%	51.5%	0.0pt	-
Ratio of long-term debt	98.1%	81.1%	-17.0pt	-
Ratio of fixed debt	18.1%	18.2%	0.1pt	-
Average remaining borrowing period (years)	2.7	2.3	-0.4	-

Source: Prepared by FISCO from the Company's financial results and results briefing materials

4. Outlook for FY1/18 (5th period) and onward

The FY1/18 (August 1, 2017 to January 31, 2018) forecasts are for operating revenue of ¥1,826mn (down 0.8% compared to FY7/17), operating income of ¥778mn (up 2.6%), ordinary income of ¥615mn (up 0.0%), net income of ¥614mn (up 0.0%), and distribution per unit (including the distribution in excess of earnings per unit) of ¥2,670, which is the same level as FY7/17. The average occupancy rate during the period is expected to be 95.5% (96.4% in FY7/17).

The FY7/18 (February 1 to July 31, 2018) forecasts are for operating revenue of ¥1,842mn (up 0.9% compared to FY1/18), operating income of ¥794mn (up 2.0%), ordinary income of ¥615mn (up 0.0%), net income of ¥614mn (up 0.0%), and distribution per unit (including the distribution in excess of earnings per unit) of ¥2,670. So the outlook is for net income and the distribution per unit (including the distribution in excess of earnings per unit) to trend basically unchanged for the second consecutive period. The average occupancy rate during the period is expected to be 95.5%.

At FISCO, we think that it is fully possible that it will achieve these forecasts, as their preconditions are reasonable and the cash flow is stable. Rather, the same as in FY7/17, the key point would seem to be to what extent the results will exceed the forecasts, from factors such as the higher rental revenue and the cost reductions. Also, since it is sufficiently accumulating pipeline properties, it is necessary to be aware that the preconditions may change greatly, depending on the timing of the acquisitions of new properties.

Growth strategy and the progress made

Aiming for an asset size of ¥100bn

1. Growth strategy

The REIT is aiming to achieve an asset size of ¥100bn as the immediate goal, and it will work on the measures described below for the external growth strategy, the internal growth strategy, and the financial strategy. First, to provide an overview of the overall strategy, the strategy items will be listed and then each strategy and the progress made for it will be explained.

(1) External growth strategy

a) Expand the asset size and improve the quality of the portfolio by continuously acquiring the S-RESIDENCE properties developed by the sponsor
b) Acquire properties from sponsor support
c) Acquire properties by utilizing the independent routes of the asset management company
d) Utilize a policy of constructing a differentiated portfolio

(2) Internal growth strategy

a) Improve asset value and the profit margin by reviewing existing facilities, etc.
b) Reduce management costs
c) Strengthen the competitiveness of properties and improve usability for tenants by introducing new facilities
d) Stabilize revenue by utilizing fixed rent ML contracts

(3) Financial strategy

a) Make borrowing periods longer and reduce liability costs

b) Expand the bank formation

c) Acquire a credit rating in the future

Steadily expand pipeline properties toward external growth

2. Progress made in the growth strategy

(1) Progress made in the external growth strategy

a) Investment in a bridge fund

The REIT invested in a silent partnership of a bridge fund (¥250mn) in March 2017, and it acquired exclusive negotiating rights to 8 properties within this fund (exclusive negotiating rights exercise price, ¥8,786mn (upper limit)).

b) Warehousing in cooperation with its sponsor

The REIT is continuing to work on warehousing through cooperating with its sponsor by utilizing its abundance of routes to acquire information and properties. As of the end of July 2017, it had secured 14 properties, mainly properties adjacent to medical facilities and universities.

c) Pipeline status

Including the above, the pipeline properties, which are the properties that are scheduled to be acquired in the future, are as follows: 1) properties under development or already developed by the sponsor to which it has been granted exclusive negotiating rights (7 properties), 2) properties owned by the sponsor and warehousing properties (b, above), 3) properties for which it has acquired the exclusive negotiating rights by investing in a bridge fund (a, above), and 4) properties owned by a third party that has concluded a sales agreement with the sponsor (2 properties). In total, it has secured 31 such properties and can be said to be steadily accumulating a pipeline. In the future also, the REIT's policy is to aim to secure stable revenue by continuously investing in properties adjacent to medical facilities and universities and other educational facilities, and utilizing fixed rent master lease (ML) contracts.

Properties under development or developed by the sponsor to which it has been granted exclusive negotiating rights

Property name	Location	Number of units	Scheduled completion date	Area
S-RESIDENCE Tsurumai	Naka-ku, Nagoya City	109	Sep-17	Major regional cities
S-RESIDENCE Kikawa Higashi	Yodogawa-ku, Osaka City	177	Jan-18	Major regional cities
S-RESIDENCE Nagoya-shi Higashi-ku	Higashi-ku, Nagoya City	95	Dec-18	Major regional cities
S-RESIDENCE Suita-shi Esakacho	Suita City, Osaka	153	Feb-19	Other regional cities
S-RESIDENCE Kawasaki Kaizuka	Kawasaki-ku, Kawasaki City	43	Feb-17	Greater Tokyo area
S-RESIDENCE Motoyawata	Ichikawa City, Chiba	81	Nov-18	Greater Tokyo area
S-RESIDENCE Matsudo Honcho	Matsudo City, Chiba	52	Oct-18	Greater Tokyo area

Source: Prepared by FISCO from the Company's results briefing materials

Properties owned by the sponsor and from warehousing

Property name	Location	Number of units	Completion date	Area
Samty Nakahiro-dori	Nishi-ku, Hiroshima City	72	Mar-07	Major regional cities
Samty Noborimachi	Naka-ku, Hiroshima City	60	Apr-08	Major regional cities
Samty Tsurumi	Naka-ku, Hiroshima City	51	Oct-08	Major regional cities
GRANDUKE Tsurumai reale	Showa-ku, Nagoya City	56	Jan-17	Major regional cities
AS Residence Tsu City	Tsu City, Mie	62	Feb-06	Other regional cities
Samty Honjo	Chuo-ku, Kumamoto City	99	Feb-06	Other regional cities
Samty Suizenji	Chuo-ku, Kumamoto City	119	Jul-06	Other regional cities
Studio Square Takasagomachi	Oita City, Oita	92	Dec-06	Other regional cities
Uni E'terna Nishinomiya Uegahara	Nishinomiya City, Hyogo	62	Feb-07	Other regional cities
Samty Kumamoto Keitokukomae	Chuo-ku, Kumamoto City	91	Jan-08	Other regional cities
GRANDUKE Tsu Shinmachi	Tsu City, Mie	69	Jan-10	Other regional cities
CREST TOWER Kashiwa	Kashiwa City, Chiba	37	Mar-06	Greater Tokyo area
S-FORT Kawaguchi Namiki	Kawaguchi City, Saitama	70	Jul-16	Greater Tokyo area
S-FORT Todakoen	Toda City, Saitama	62	Jan-17	Greater Tokyo area

Source: Prepared by FISCO from the Company's results briefing materials

Properties for which it has acquired the exclusive negotiating rights through investing in a bridge fund

Property name	Location	Number of units	Completion date	Area
S-FORT Aoba Uesugi	Aoba-ku, Sendai City	66	Oct-07	Major regional cities
S-FORT Toyohira Sanjo	Toyohira-ku, Sapporo City	63	Mar-08	Major regional cities
S-RESIDENCE Midoribashi SF	Higashinari-ku, Osaka City	148	Oct-16	Major regional cities
Samty Nishinomiya Residence	Nishinomiya City, Hyogo	102	Mar-09	Other regional cities
College Square Hoya	Nishitokyo City, Tokyo	60	Mar-07	Greater Tokyo area
CQ Residence Tamagawagakuen	Machida City, Tokyo	60	Feb-08	Greater Tokyo area
Trois Bonheur Honcho	Funabashi City, Chiba	117	Mar-08	Greater Tokyo area
S-RESIDENCE Yokohama Tammachi	Kanagawa-ku, Yokohama City	36	Nov-16	Greater Tokyo area

Source: Prepared by FISCO from the Company's results briefing materials

Properties owned by a third party that has concluded a sales agreement with the sponsor

Property name	Location	Number of units	Scheduled completion date	Area
Nagoyashi Nakaku Matsubara PJ	Naka-ku, Nagoya City	84	Feb-18	Major regional cities
Niigata City Chuo PJ	Chuo-ku, Niigata City	83	Mar-18	Other regional cities

Note: The decisions to acquire the above-described properties are not yet facts.
Source: Prepared by FISCO from the Company's results briefing materials

Is realizing steady internal growth, including from the increase in revenue from key money and renewal fees

(2) Progress made in the internal growth strategy

a) Trends in the occupancy rate and the rent unit price

The occupancy rate continues to trend at the high level of above 95% due to the competitiveness of the properties themselves, including their locations, and the REIT's excellent leasing capabilities. The adjusted rent unit price also improved by 0.4 of a percentage point on the end of the previous period because of its management that is tailored to the properties' characteristics. In particular, among the properties whose tenants changed (465 properties), the amount increased at 275 properties (59.1% of all properties), it was unchanged at 55 properties (11.8%), and it decreased at 135 properties (29.0%). The percentage of properties with an increased amount rose 1.1% compared to FY1/17 (conversely, the percentage with a decreased amount fell 1.2%). The REIT succeeded in increasing the amounts by measures including installing furniture and home electrical appliances, and by introducing Internet equipment. In addition, the acquisition of key money when a new tenant enters and the elimination of the rent gap also seem to have contributed to the higher amounts. With regards the renewal conditions at owned properties, the renewal rate is being maintained at the high level of 91.2% (number of renewals, 913 times), while renewal fees were collected 223 times (24.4% of all renewals), and this number has been steadily increasing.* Moreover, key money was received 269 times, which is an increase on the 186 times in FY1/17, and as previously stated, while this practice is not necessarily firmly established in the regions, to look at this in other way, this can be seen as signifying that there is still room for growth in the future (toward increasing internal growth).

* Among the 657 renewals in the previous period (FY1/17, renewal rate, 94.3%), renewal fees were collected 99 times (15.1% of the total renewals).

b) Cost-reduction measures

The REIT is continuing to work to reduce spending through reviewing its services that are tailored to the characteristics of regions and properties. Specifically, it is reducing costs through changing the gas supply company and reviewing the content of water supply contracts. Moreover, in areas with snowfall, it is keeping down fuel usage costs through the use of real-time, online monitoring of snowfall to control the operations of a snow-melting system according to snowfall conditions.

c) Other measures

The REIT is providing security, safe and pleasant living environments for tenants, and improving the value of properties by installing home delivery boxes, security cameras, intercoms, and so forth. These measures will contribute to improved name recognition for the REIT.

Acquired the DBJ Green Building certification for real estate that is considerate to the environment and to society

(3) Measures for sustainability

As part of its measures to be considerate to the environment and to society and to contribute to the improved satisfaction of its tenants, the REIT has made some progress towards acquisition of the DBJ Green Building certification. In particular, the fact that it acquired it for S-RESIDENCE Esaka, which was developed by the sponsor, despite a situation in which it was difficult to do so because of the rental specifications, can be expected to not only have the effect of improving the evaluation of the REIT, but also to contribute to the accumulation of expertise and the improvement of motivation within the Samty Group as a whole. Amid a trend towards ESG investment, it seems that inquiries are increasing from institutional investors and others.

* This is a certification system established by the Development Bank of Japan (DBJ) in April 2011 to support real estate that is considerate to the environment and to society. In addition to the environmental performance of the property, it evaluates and certifies real estate as being required by society and the economy based on a comprehensive evaluation, including for disaster prevention and the responses to various stakeholders, such as showing consideration to the local community, to support measures for these aspects.

At FISCO, we evaluate that achieving an asset size of ¥100bn is in sight due to the steady accumulation of pipeline properties. The requirements for the acquisition of pipeline properties are responding quickly to changes in the market environment and improving the market's valuation, and the Company's policy is to acquire properties in this way while paying attention to the timing of acquisitions. Moreover, an important point will be how to accelerate the pace of growth after achieving this target of ¥100bn. In particular, in addition to the size of the potential in major regional cities and their surrounding cities, its advance into the hotel market should be noted. The sponsor already owns and manages several hotel properties, and their stable operations can be expected, depending on the qualities of the properties, their operating conditions (or prospects for the future), and the type of operations (for example, utilizing fixed rent ML). Therefore, it would seem that expanding the drivers of external growth can be evaluated as a positive development in terms of accelerating the pace of growth and securing the stability of the portfolio. On the other hand, with regards to internal growth, the occupancy rate is trending at a high level and the REIT is working on reducing costs. In addition, we can expect the rent unit price to improve in the future (including from key money and renewal fees), just as it did in FY7/17. Moreover, if the asset size expands in each of the major regional cities through external growth, we can expect effects from the further improvement in management efficiency, while there would also seem to be still plenty of room to continuously increase the value of its properties and to reduce costs through accumulating expertise in management tailored to regional characteristics. Going forward, we will be focusing on how the REIT evolves the portfolio that is unique to it.

Benchmarking

The investment unit price feels undervalued and has considerable room to be adjusted from the expansion in asset size and the improved name recognition

Compared to other J-REITs specializing in residential properties, the REIT's investment unit price feels clearly undervalued when judged from its high distribution yield (not including distribution in excess of earnings per unit) and low P/NAV ratio. The reasons for this undervaluation are considered to be the small asset size, that its lacks name recognition and the attractiveness of investing in its product has not been sufficiently communicated, and that investors are still at the stage of observing its management performance as it is the first portfolio with properties mainly in major regional cities. It seems highly likely that the concerns about stability will be eliminated from its steady accumulation of pipeline properties toward an asset size of ¥100bn. It can also be expected to eliminate the issues with regard to name recognition and investment attractiveness from its policy of actively conducting IR activities. Further, on considering that it has now been verified that the REIT is able to generate stable cash flow from having the first portfolio with properties mainly in major regional cities, it would seem that there is considerable room for the investment unit price to be adjusted in the future. In addition, there would seem to be some effects from the fact that at the present time, the J-REIT market as a whole is trending somewhat weakly, and if momentum returns to the market as a whole, we can envisage a scenario in which attention becomes immediately focused on issues that are considered to be undervalued. Therefore, it would seem necessary to pay attention to the timing of the reversal of the investment unit price, from both the internal and external factors.

Comparison with other J-REITs specializing in residential properties from various indicators

Information as of October 17, 2017

	Code	Fiscal period	Investment unit price (¥)	Distribution yield	No. of units	Market capitalization (¥mn)	P/NAV ratio	Number of properties	Acquisition price total (¥100mn)
Sekisui House Residential Investment Corporation	8973	March/ September	111,800	3.97%	1,105,510	123,596	0.99	113	2,069
Starts Proceed Investment Corporation	8979	April/ October	160,300	5.50%	256,777	41,161	0.83	106	810
Japan Rental Housing Investments Inc.	8986	March/ September	79,400	4.71%	1,640,060	130,221	1.00	199	2,258
Nippon Accommodations Fund Inc.	3226	February/ August	430,000	3.81%	484,522	208,344	1.15	121	3,016
Advance Residence Investment Corporation	3269	January/ July	266,400	3.87%	1,350,000	359,640	1.25	260	4,427
Kenedix Residential Investment Corporation	3278	January/ July	293,000	4.64%	349,089	102,283	0.96	115	1,644
Comforia Residential REIT, Inc.	3282	January/ July	229,500	4.09%	563,694	129,368	1.04	111	1,885
Samty Residential Investment Corporation	3459	January/ July	87,500	4.96% 6.10%	283,000	24,763	0.86	49	515

Note: In the distribution yield for the REIT, the upper row value does not include the distribution in excess of earnings per unit, and the lower row value shows the value including excess of earnings.
Source: Prepared by FISCO from Real Estate Investment Trust Data Portal

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