REIT 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 improving portfolio stability by expanding asset size.

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 (TSE) 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 its Real Estate Business for the S-RESIDENCE series, 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 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. As of the end of January 2017, 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 results for FY1/17 (August 1, 2016, to January 31, 2017), operating revenue was ¥1,806mn (up 62.7% from the previous period), operating income was ¥849mn (up 103.7%), ordinary income was ¥606mn (up 82.7%), and net income was ¥605mn (up 82.9%). The REIT achieved major increases in revenue and profits from the 20 properties (¥20,589mn) it acquired following a public offering in August 2016, and it also increased the distribution per unit. In addition, each of operating revenue, the income items, and the distribution per unit exceeded their forecasts due to factors including the improved occupancy rate and cost reductions, and the REIT can be evaluated as having achieved a strong management performance.

The FY7/17 (February 1, 2017, to July 31, 2017) results forecasts are for operating revenue of ¥1,797mn (down 0.5% from the previous period), operating income of ¥745mn (down 12.3%), ordinary income of ¥596mn (down 1.5%), and net income of ¥595mn (down 1.6%), which can be understood to be the results of a normal period. The distribution per unit will be ¥2,625 (including the distribution in excess of earnings per unit), which is down ¥20 from the previous period but still an increase of ¥147 on the FY7/16 normal period forecast distribution of ¥2,478. At FISCO, we believe it can achieve the results forecasts as the preconditions are reasonable. But the same as in the previous fiscal period, it would seem necessary to keep a watch on the factors that may cause management performance to change, including the occupancy rate, rental revenue, and cost reductions. In addition, as it is accumulating sufficient pipeline properties, it will also be necessary to pay attention to the possibility that the preconditions will change greatly from the timings of the acquisitions of new properties.

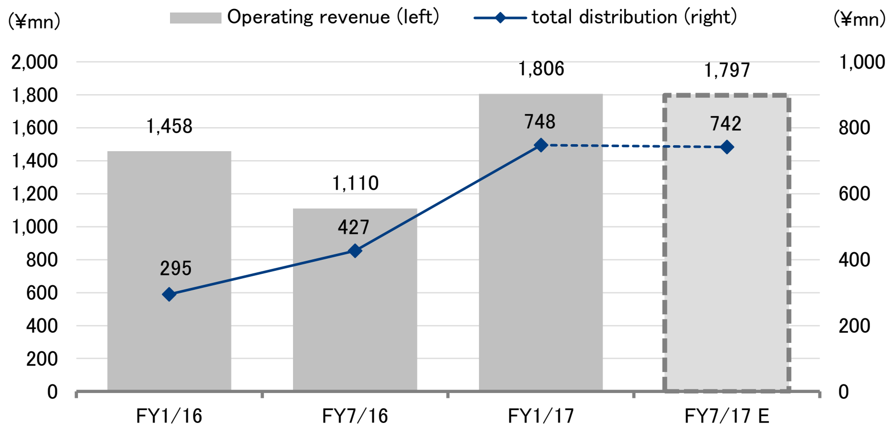
The REIT's growth strategy is based on the twin axes of achieving external growth by focusing on continuously acquiring the S-RESIDENCE properties developed by its sponsor, as well as acquiring other properties owned by its sponsor and by third parties; and achieving internal growth, including through 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 in the 3 years from its listing (FY1/16 to FY7/18). At FISCO, we evaluate that an asset size of ¥100bn from external growth is within an achievable range from the pipeline properties (including those under consideration) that it is steadily accumulating at the present time. For internal growth also, 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.

Also, 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 awareness, 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

- Strengths are its stable supply of properties from the Samty Group and the sponsor support it receives in various areas
- Improved portfolio stability in FY1/17 from expanding the asset size
- As its immediate target, it is aiming for an asset size of ¥100bn in the three years from its listing

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 summary

Overview of the REIT

Is 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 58 J-REITs, 8 specialize in residential properties, but the REIT is the only one that focuses on major regional cities. As of the end of January 2017, the assets under management were 49 properties with a total acquisition price of ¥51,551mn, and although its portfolio is still small compared to the those of the other J-REITs, it has been steadily accumulating pipeline properties toward its immediate goal of an asset size of ¥100bn in the three years following its listing (FY1/16 to FY7/18).

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). Also 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 30m^2, while compact types have an exclusive area of 30m^2 to 59m^2.

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.

(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 (97.5%, as of the end of January 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 are 31.0% for less than 5 years, 34.0% for 5 years to less than 10 years, 29.6% for 10 years to less than 15 years, and 5.3% for 15 years to less than 20 years, so a feature of its portfolio is that the average property age is comparatively new, at 7.9 years. This is largely due to the stable supply of newly constructed properties by its sponsor. 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.

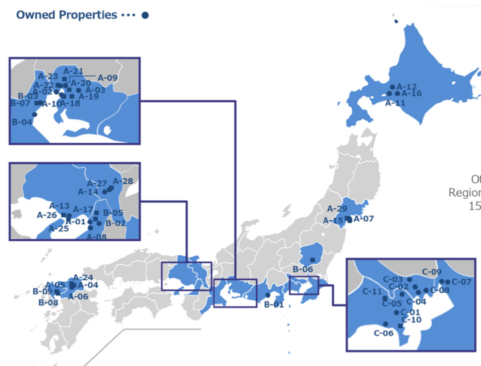
c) Investment ratios by seller

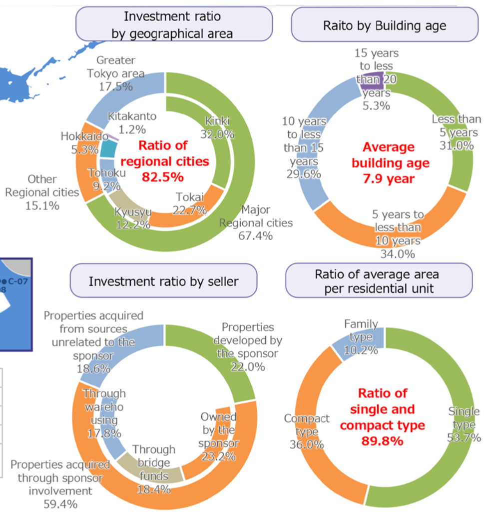
By seller, 22% of the properties were developed by the sponsor, while the sponsor is involved in 59.4% (in addition to properties owned by the sponsor, bridge-fund and warehousing properties), for a combined total of 81.4%.

d) 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.

Portfolio Overview





Asset size	51.5 billion yen
No. of properties	49 properties
Occupancy rate	97.5%
Average building age	7.9 year
Average appraisal NOI yield	5.6%

(Note) The above figures are for 49 properties owned as of today. Occupancy rate and Average building age are figures calculated as of January 31, 2017.

(Note) The above ratios are calculated based on acquisition prices for 49 properties owned as of today.

Source: From the Company's financial 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 March 2017, the total market capitalization of all J-REITs was approximately ¥11.9063 trillion, and the number of J-REITs had risen to 58. There was a phase after the Lehman Shock 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 March 2017, the J-REIT average distribution yield was 3.76% (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, at the same time as maintaining the stability of the financial base and the ability to raise funds to acquire properties in the future, it can be said that effectively utilizing interest-bearing debt leads to an increase in the "distribution per unit," and therefore the J-REIT's financial condition (policy) can also be said to be important information when deciding to invest in it. Other 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." 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 one part 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, including the external economic environment, the real estate market conditions, and its own finances, it decides on the optimal distribution from the free cash flow after the allocation of funds, including to capital expenditure and working capital, alongside the investment to strengthen the financial base and to improve the portfolio's profitability. Also, to avoid damaging the financial basis, it sets restrictions for the target payout ratio of 70% with regard to net income + depreciation (upper limit of 35%)" for the "total distribution (including distribution in excess of earnings per unit)."

Among the J-REITs, there are a few that return the "distribution in excess of earnings per unit" to investors, but 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

Starting with the other J-REITs that specialize in residential properties, most of the residential investment by J-REITs is in properties in the Greater Tokyo area, so in this respect the REIT can be said to occupy a unique position. 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 above the rate in 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, as 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.

*1 In the growth rates in the number of households from 2000 to 2014, the growth rate in Tokyo's 23 wards was approximately 19.8%, while the growth rate in all of the major regional cities was 17.8%, 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 January 2017, the REIT's occupancy rate in the major regional cities was 97.8%, and in the Greater Tokyo area it was 96.7%.

(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

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 January 31, 2017; acquisition price, ¥51,551mn).

The "distribution 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 income ÷ assumed lease agreement period)} ÷ lease-agreement area (the assumed lease agreement period is four years)

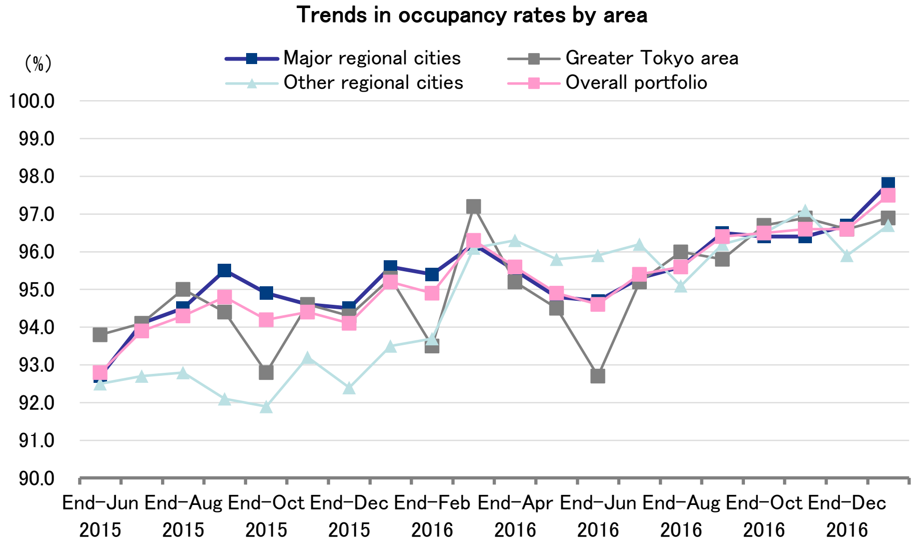
Results trends

(¥mn)

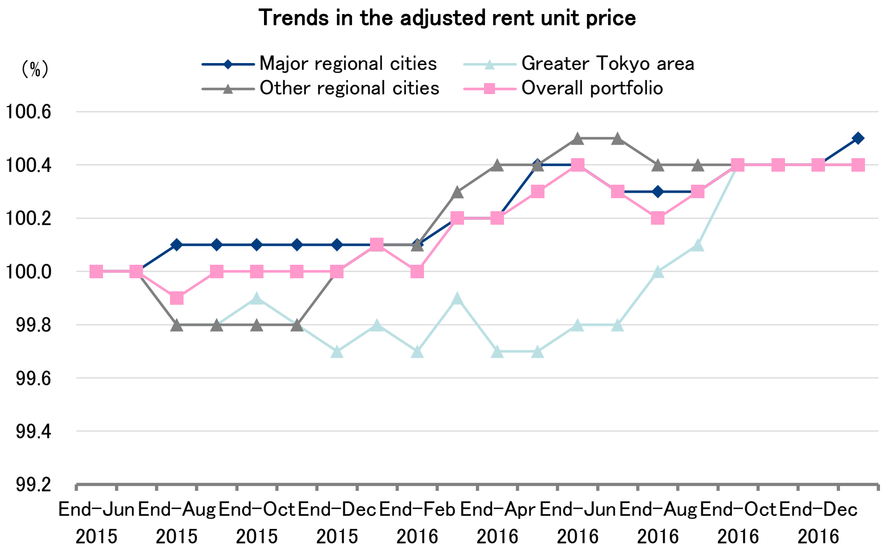
	IPO	FY1/16 (11 months)	FY7/16	FY1/17	FY7/17
Operating revenue	-	1,458	1,110	1,806	1,797
Operating income	-	598	417	849	745
Ordinary income	-	170	331	606	596
Net income	-	168	330	605	595
Total distribution per unit (¥)	-	1,810	2,618	2,645	2,625
Distribution per unit (¥)	-	1,034	2,026	2,138	2,105
Distribution in excess of earnings per unit (¥)	-	776	592	507	520
No. of properties (buildings)	28	29	29	49	
Total acquisition price	30,500	30,962	30,962	51,551	
Appraisal value	30,936	32,434	32,975	55,693	
Appraisal NOI yield	5.6%	5.6%	5.6%	5.6%	
Average building age (years)	7.0	7.6	8.1	7.9	
Occupancy rate	92.8%	95.2%	95.4%	97.5%	
No. of rentable units	2,297	2,345	2,345	3,754	

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

Results trends



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



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

The portfolio's stability is improving from the expansion in asset size

2. The FY1/17 (3rd period) results

In the FY1/17 (August 1, 2016, to January 31, 2017) results, operating revenue was ¥1,806mn (up 62.7% from the previous period), operating income was ¥849mn (up 103.7%), ordinary income was ¥606mn (up 82.7%), and net income was ¥605mn (up 82.9%). It realized major increases in revenue and profits from the 20 properties (¥20,589mn) it acquired following a public offering in August 2016, and it also increased the distribution per unit. In addition, each of the results exceeding their forecasts, with operating revenue up ¥16mn compared to the target, operating income up ¥15mn, ordinary income up ¥23mn, net income up ¥23mn, and the total distribution per unit (including the distribution in excess of earnings per unit) up ¥45, and the REIT can be evaluated as having achieved a strong management performance. At the end of January 2017, the assets under management were 49 properties with a total acquisition price of ¥51,551mn (up 66.5% on the end of the previous fiscal period) and the assets have reached a certain size, if still only on a relatively small scale.

The following were the reasons why the results differed from the forecasts (targets).

In addition to operating revenue exceeding the target (up ¥4mn compared to the target) from the favorable results for the occupancy rate and rental revenue, which are the indicators that the REIT most focuses upon, the rise in other revenues (parking, restoration income, etc.) was also a factor. The average occupancy rate during the period was maintained at the high level of 96.5% (target of 95.4%), and in addition, the rent unit price increased, if only slightly.

Conversely, within operating expenses, leasing business expenses, including leasing promotion expenses and water, lighting, and heating expenses (reduction of ¥20mn compared to the target), and depreciation expenses (reduction of ¥5mn), were reduced to less than the targets. However, the REIT conducted upfront investment for refurbishment expenses, including to increase the value of properties (up ¥23mn), which cancelled out the above-mentioned reduction, and therefore operating expenses were about at the level targeted (up ¥1mn) (as a result, operating income increased ¥15mn compared to the target). The reason why leasing promotions expenses were significantly below the target was that because the occupancy rate trended stably at a high level, the REIT was able to keep down these expenses, such as for campaigns to find replacement tenants. Also, a factor behind depreciation expenses being below the target was the conservative estimates for the newly acquired properties.

With regard to non-operating expenses, the risk of a rise in the base rate was viewed conservatively, and as the interest rate was not raised, interest expenses declined and were ¥7mn below the target (as a result, ordinary income and net income increased ¥23mn compared to the target).

To summarize the 3rd period's results from the above, the REIT achieved a distribution per unit above both the previous fiscal period and the target by expanding the asset size from external growth (property acquisitions), improving stability and management efficiency, and realizing internal growth (including by improving the occupancy rate and reducing costs). Moreover, it can be highly evaluated on the point that it supplemented upfront investment (such as construction work to increase the value of properties) and can be said to have achieved a balanced performance. Particularly with regard to internal growth, the fact that the REIT's portfolio has clearly shown it can generate a stable cash flow would seem to be worthy of praise.

FY1/17 (3rd period) results

(¥mn)

	FY7/16 result	FY1/17 result	YoY		FY1/17 initial forecasts	Difference
				Change rate		
Operating revenue	1,110	1,806	695	62.7%	1,790	16
Operating expenses	693	956	263	38.0%	955	1
Operating income	417	849	432	103.7%	834	15
Non-operating income and loss	-85	-243	158	184.8%	-251	7
Ordinary income	331	606	274	82.7%	582	23
Net income	330	605	274	82.9%	581	23
Total distribution per unit (¥)	2,618	2,645	27	1.0%	2,600	45
Distribution per unit (¥)	2,026	2,138	112	5.5%	2,056	82
Distribution in excess of earnings per unit (¥)	592	507	-85	-14.4%	544	-37
No. of investment units	163,340	283,000	119,660	73.3%		
The average occupancy rate during the period	95.3%	96.5%	1.2P	-	95.4%	1.1P
Capital expenditure	8	26	18	225.0%	42	-16
Depreciation	276	434	158	57.2%	440	-5
Payout ratio	70.4%	72.0%	1.6P	-	72.0%	0.0P

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

Has secured a stable financial base and the ability to raise funds to acquire properties in the future

3. Financial position

As of the end of January 2017, total assets had increased significantly to ¥55,828mn (up 66.1% from the previous period end) from the new acquisition of 20 properties (¥20,589mn). Conversely, net assets also rose to ¥26,397mn (up 62.8%) from the public offering (approximately ¥10,000mn), so the equity ratio trended basically unchanged at 47.3% (48.3% at the end of the previous fiscal period). Interest-bearing debt also increased to ¥28,750mn (up 69.0%) following the acquisition of properties, but total asset-based LTV was 51.5% (50.6% at the end of the previous fiscal period) and so was maintained with the standard range for operations (45% to 55%), and there are no concerns about financial stability or the ability to raise funds in the future.

In terms of the interest-bearing debt, the ratio of long-term debt is 98.1% (94.1% at the end of the previous fiscal period) and long-term, stable funds account for the majority of the debt, while the repayment (redemption) dates have also been diversified to a reasonable extent, so the REIT is mitigating liquidity risk. Also, at the present time the interest-rate level is sufficiently low and taking into consideration to a certain extent that there is a risk of interest rates risking in the future, it has raised the fixed interest rate to 18.1% (0% at the end of the previous fiscal period). The interest-bearing debt is nearly entirely from loans from 15 banks, with 53.2% of the total amount being loans from 11 regional banks, and it can be said that the REIT has a wide bank formation that only it, as a specialist in regional cities, could realize. It also issues investment corporation bonds (private offering, 4 years, ¥1,000mn), and it is working to diversify its fund-raising methods.

Balance sheet and financial indicators

(¥mn)

	End-FY7/16 result	End-FY1/17 result	From end of previous fiscal period	
				Change rate
Total assets	33,611	55,828	22,217	66.1%
Net assets	16,219	26,397	10,177	62.8%
Interest-bearing debt	17,012	28,750	11,738	69.0%
Short-term loans payable	1,012	550	-462	-45.7%
Long-term loans payable	16,000	27,200	11,200	70.0%
Investment corporation bonds	-	1,000	1,000	-
Total asset-based LTV	50.6%	51.5%	0.9P	-
Ratio of long-term debt	94.1%	98.1%	4.0P	-
Ratio of fixed debt	0.0%	18.1%	18.1P	-
Average remaining borrowing period (years)	3.0	2.7	-0.3	-

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

Results are expected to trend stably in FY7/17 as a normal period

4. Outlook for the FY7/17 (4th period) results

The REIT's forecasts for the FY7/17 (February 1, 2017, to July 31, 2017) results are operating revenue of ¥1,797mn (down 0.5% from the previous period), operating income of ¥745mn (down 12.3%), ordinary income of ¥596mn (down 1.5%), and net income of ¥595mn (down 1.6%). It has no plans to acquire new properties at the current time, so these forecasts can be understood to be the results of a normal period. The forecast distribution per unit (including distribution in excess of earnings per unit) is ¥2,625, down ¥20 from the previous fiscal period but still an increase of ¥147 on the FY7/16 normal period distribution forecast of ¥2,478. The forecasts are preconditioned on an average end-of-month occupancy rate during the period of 95.5% (96.5% in the previous fiscal period).

At FISCO, we think that the REIT can achieve its results forecasts as the preconditions to do so are reasonable. The occupancy rate precondition has been set at a slightly lower level than in the previous fiscal year, when it was near to the upper limit, but even so, it can be said that it expects to maintain it at a high level. The same as in the previous fiscal period, it would seem necessary to keep a watch for the possibility that the management performance will be affected by the factors that may cause results to change, such as the occupancy rate, rental revenue, and cost reductions. Further, as it has sufficiently accumulated pipeline properties, we must also be aware that it is possible that the preconditions will change greatly depending on the timings of the acquisitions of new properties.

Growth strategy and the progress made

Aiming for an asset size of ¥100bn in the three years from the listing

1. Growth strategy

The REIT is aiming to achieve an asset size of ¥100bn in the three years from its listing (by FY7/18) 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) Utilize subleasing agreements to stabilize earnings

(3) Financial strategy

a) Make borrowing periods longer and reduce liability costs
b) Expand the bank formation
c) Acquire a credit rating for the future
d) Diversify fund raising

Steadily expand pipeline properties toward external growth

2. Progress made in the growth strategy

(1) Progress made in the external growth strategy

a) Pipeline status

The pipeline properties that that the REIT is scheduled to acquire in the future (properties for which it has been granted exclusive negotiating rights, and properties whose acquisition it is currently negotiating) can be divided into three types; 1) properties under development or already developed by the sponsor to which it has been granted exclusive negotiating rights, 2) sponsor-owned properties it is considering for acquisition (including those scheduled for acquisition), and 3) third party-owned properties it is considering for acquisition. It has secured 15 properties in 1), which has the highest degree of certainty, and it is currently considering 4 properties in 2) and 5 properties in 3), for a total of 24 pipeline properties.

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 Fukaebashi EAST	Higashinari-ku, Osaka	144	Jan-17	Major regional cities
S-RESIDENCE Fukaebashi EAST II	Higashinari-ku, Osaka	96	Jan-17	Major regional cities
S-RESIDENCE Shin Osaka WEST	Yodogawa-ku, Osaka	224	Feb-17	Major regional cities
S-RESIDENCE Miyakojima	Miyakojima-ku, Osaka	120	Jun-17	Major regional cities
S-RESIDENCE Tanimachi 5- chome	Chuo-ku, Osaka	84	Jul-17	Major regional cities
S-RESIDENCE Nagoya Chiyoda	Naka-ku, Nagoya	109	Aug-17	Major regional cities
S-RESIDENCE Minami Horie	Nishi-ku, Osaka	154	Sep-17	Major regional cities
S-RESIDENCE Kikawa Higashi	Yodogawa-ku, Osaka	177	Jan-18	Major regional cities
S-RESIDENCE Nagoya Aoi	Higashi-ku, Nagoya	95	Nov-18	Major regional cities
S-RESIDENCE Esaka Tarumicho	Suita-shi, Osaka	75	Jun-17	Other regional cities
S-RESIDENCE Esakacho	Suita-shi, Osaka	153	Feb-19	Other regional cities
S-RESIDENCE Kawasaki Kaizuka	Kawasaki-ku, Kawasaki-shi	43	Feb-17	Greater Tokyo area
S-RESIDENCE Motoyawata	Ichikawa-shi, Chiba	81	Jan-18	Greater Tokyo area
S-RESIDENCE Shinjyuku	Shinjuku-ku, Tokyo	65	Mar-18	Greater Tokyo area
S-RESIDENCE Matsudo Honcho	Matsudo-shi, Chiba	52	Mar-18	Greater Tokyo area

Source: prepared by FISCO from Samty's FY11/17 Q1 financial results briefing materials

Properties owned by the sponsor under consideration for acquisition
(including those scheduled to be acquired)

Location	Number of units	Scheduled completion date	Area
Tsu-shi, Mie	62	Feb-06	Other regional cities
Oita-shi, Oita	90	Dec-06	Other regional cities
Chuo-ku, Kumamoto	91	Jan-08	Other regional cities
Kawaguchi-shi, Saitama	70	Aug-16	Greater Tokyo area

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

Properties owned by a third party under consideration for acquisition

Location	Number of units	Scheduled completion date	Area
Showa-ku, Nagoya	56	Jan-17	Major regional cities
Naka-ku, Nagoya	84	Feb-18	Major regional cities
Nishinomiya-shi, Hyogo	62	Feb-07	Other regional cities
Chuo-ku, Niigata	83	Feb-18	Other regional cities
Toda-shi, Saitama	62	Jan-17	Greater Tokyo area

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

b) Investment in bridge funds

In order to secure further pipeline properties, the REIT invested in a silent partnership of a bridge fund (¥250mn) on March 13, 2017, and it acquired exclusive negotiating rights to 8 properties within this fund (exclusive negotiating rights exercise price, ¥8,786mn (upper limit)).

Established a model room through cooperating with other companies and is realizing internal growth through various cost reductions tailored to the properties' characteristics and the local environment

(2) Progress made in the internal growth strategy

a) Measures to improve the occupancy rate

To differentiate its properties from its competitors' and to effectively appeal to potential tenants, the REIT has established a model room showing the furniture used in every unit procured from Japanese and overseas manufacturers (having requested the cooperation of these manufacturers), and it is progressing tenant acquisitions from advanced applications. As a result, it has succeeded in connecting this model room to an improvement in the occupancy rate in a short period of time.

b) Cost-reduction measures

The REIT is implementing a variety of cost reduction measures tailored to the properties' characteristics and to the local environments. Specifically, it has reduced costs by measures such as changing the power supply company (31 properties) and installing LED lighting (7 properties), while in addition, in areas with snowfall, it is keeping down fuel usage costs through the real-time, online monitoring of snowfall to control the operations of a snow-melting system according to snowfall conditions. In particular, it is considered that there is still considerable room for further costs reduction in the future from installing LED lighting.

c) Other measures

In addition to introducing car sharing and installing home delivery boxes, the REIT is working on measures to improve the usability of its properties for tenants and to strengthen their competitiveness, as well as to contribute to its improved brand recognition, such as by refurbishing facilities according to tenant needs.

At FISCO, we evaluate that an asset size of ¥100bn from external growth is within an achievable range due to the steady accumulation of 32 pipeline properties (including those under consideration and in the bridge fund) at the current time. Rather, we will be focusing on how it will accelerate growth after it achieves this target of ¥100bn. With regard to internal growth also, while it is maintaining the occupancy rate at close to the upper limit, we can expect effects from the further improvement in management efficiency from the expansion in asset sizes in each of the major regional cities, while there would also seem to be still plenty of room to 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 the other J-REIT that specialize 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 that there are concerns about its management stability because of 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.

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

Information as of March 31, 2017

	Code	Fiscal period	Investment unit Price (¥)	Distribution yield	Market capitalization (¥mn)	P/NAV ratio	Number of buildings	Acquisition price Total (¥100mn)
Sekisui House SI Residential Investment Corporation	8973	March/ September	123,400	3.53%	136,420	1.13	112	2,063
Starts Proceed Investment Corporation	8979	April/ October	149,300	5.59%	38,337	0.77	112	819
Japan Rental Housing Investments Inc.	8986	March/ September	81,700	4.48%	133,993	1.08	202	2,246
Nippon Accommodations Fund Inc.	3226	February/ August	483,500	3.41%	234,266	1.32	118	2,947
Advance Residence Investment Corporation	3269	January/ July	304,500	3.32%	411,075	1.52	257	4,369
Kenedix Residential Investment Corporation	3278	January/ July	313,000	4.13%	109,265	1.09	113	1,552
Comforia Residential REIT, Inc.	3282	January/ July	252,900	3.65%	142,558	1.21	110	1,865
Samty Residential Investment Corporation	3459	January/ July	82,300	5.12% 6.38%	23,291	0.88	49	516

Note: When the upper row showing the REIT's distribution yield does not include the distribution in excess of earnings per unit, it is shown by the value in the lower row.
Source: Prepared by FISCO from Real Estate Investment Trust Data Portal

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