REIT REPORT

XYMAX REIT Investment Corporation

3488

Tokyo Stock Exchange REIT

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Summary

As the REIT of the real estate management major the XYMAX Group, aims to increase the distribution through progressing a growth strategy

1. A major strength is the support it receives from the XYMAX Group, a real estate management major

XYMAX REIT Investment Corporation <3488> (hereafter, also "the REIT") is a member of the XYMAX Group, which is centered on XYMAX Corporation (not listed), and it is a comprehensive-type REIT that invests in real estate such as offices, retail facilities, and hotels, primarily in Tokyo's 23 wards and surrounding prefectures. The REIT aims to draw-out the value of real estate to the greatest possible extent and to maximize investor value by conducting appropriate portfolio management that utilizes the knowledge and expertise in real estate possessed by its sponsor, the XYMAX Group that has one of the leading track records for real estate management in Japan. All of the actual asset management is consigned to XYMAX REAL ESTATE INVESTMENT ADVISORS Corporation, and a strength is the various types of support it can receive from the Group.

2. The FY8/21 results exceeded the initial forecasts, even while sales increased only slightly and profits decreased

For the FY8/21 results, the impact of the novel coronavirus pandemic (hereafter, COVID-19) continued and states of emergency were declared intermittently, but even in this situation, the results still exceeded the initial forecasts. Operating revenue was ¥1,305mn (up 0.9% compared to the previous period) and operating income was ¥701mn (down 2.1%). So revenue increased only slightly and income decreased, but compared to the initial forecasts, operating revenue and operating income were 1.1% and 3.7% above their respective forecasts. In operating revenue, hotel variable rent revenue slumped, but revenue still increased because revenue from offices and residential properties were higher than forecast, and also from acquisitions of two properties, XYMAX Mita Building (offices) and the Park House Totsuka Front (commercial lots on the first and second floors) that were not included in the initial forecasts. Also, in operating costs, through the steady filling of vacancies and a decline in the vacancy volume compared to the forecast, running costs (the costs of real estate rental support operations) decreased, which was a factor behind operating income being higher than forecast. Alongside some tenants withdrawing, the occupancy rate of offices declined slightly, but the occupancy rates of retail facilities and hotels were 100% and for the portfolio as whole, the rate was maintained at the high level of 97.9%. Due to the above, the distribution was ¥2,900 per unit (down ¥11), but this was still ¥112 above the initial forecast. The financial condition is that total assets' LTV is low at 36.1% and the REIT has plenty of room to conduct borrowing up to 50%. Also, it is building a wide-ranging and stable lender platform, centered on megabanks and regional banks, and it will be able to flexibly acquire properties in the future.

3. The FY2/22 and FY8/22 forecasts are based on conservative assumptions

The forecasts for FY2/22 are operating revenue of ¥1,383mn (up 6.0% compared to FY8/21) and operating income of ¥740mn (up 5.5%). For operating revenue, the forecasts are for an increase in hotel rent revenue (recovery of fixed rent revenue) and the full fiscal-period contributions of the two Mita and Totsuka properties acquired in the previous period. However, the operating costs forecast incorporates higher cost of sales due to the full period operations of the Mita and Totsuka properties. Therefore, the FY8/22 forecasts are basically unchanged on the previous period, with operating revenue of ¥1,387mn (up 0.2%) and operating income of ¥732mn (down 1.0%). The operating revenue forecast incorporates factors including an increase in office rent revenue and a decrease in retail facilities rent revenue, mainly due to contract cancellations at retail facilities. Also, the operating costs forecast incorporates the normalization of running costs. As a result of the above, the distribution is forecast to increase to ¥2,977 per unit (up ¥77 compared to the previous period) in FY2/22 and to ¥3,013 per unit (up ¥36) in FY8/22. But these forecasts appear conservative, the same as for the FY8/21 results forecast.

4. Aims to improve investor value through external growth from offices, retail facilities, etc.

As the external growth strategy for the future, based on the sponsor-support contract, the REIT ascertains needs for sales of real estate it can acquire from the XYMAX Group's customer base, which it aims to lead to opportunities for it to acquire properties. In the offices growth strategy, its policy is to acquire properties that are mainly located in Tokyo's eight central wards and the central areas of Nagoya, Osaka, and Fukuoka; that are near to stations within a range of around five minutes' walk from the nearest station; that have a rent unit price per tsubo (a Japanese unit of area equal to approximately 3.31 sq. meters) in a range of ¥10,000 to ¥20,000; and that are appealing to renters. For retail facilities, the plan is to acquire properties with a focus on those whose tenant rent revenue is stable and whose property prices are inexpensive. For hotels, it plans to acquire properties located in areas that have excellent access to transport hubs and in areas where the number of overseas visitors to Japan is expected to increase. However, at the current time recovering earnings can be said to be the top priority issue. Also, a notable feature of the REIT is that it is actively working on ESG initiatives, including acquiring environmental certification and implementing environmental and energy-saving measures and promoting the efficient use of energy in the properties it owns.

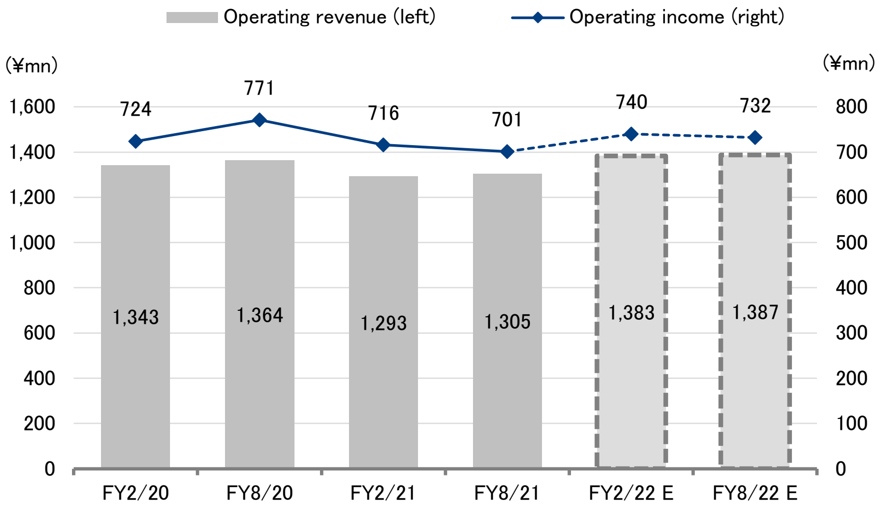
5. Alongside the strengthening of external growth, investors' evaluation is expected to improve

The price of the REIT's investment unit declined sharply in March 2020 due to concerns about a global economic recession because of COVID-19, but it recovered after that. However, compared to the rise of the Tokyo Stock Exchange's (TSE) REIT Index, the recovery of REIT has been only moderate. This is thought to stem from factors such as small market capitalization and low liquidity. As a result, recently, the REIT's NAV multiple was 0.80 times, which is significantly below the average of comprehensive-type REIT of 1.02, and there is a strong sense of it being undervalued. Its policy going forward is to strengthen the external growth strategy, and as investors' understanding of this deepens, at FISCO we think that attention will come to be focused on it from providing a distribution yield at an appealing level.

Key Points

- A comprehensive-type REIT that invests in offices, retail facilities, hotels, etc., mainly in Tokyo's 23 wards and surrounding prefectures, and a major strength is the support it receives from the XYMAX Group
- The FY8/21 results were above the initial forecasts, even while revenue increased only slightly and income decreased, The impact of COVID-19 was limited and the effects of acquisitions of new properties was large. The distribution of ¥2,900 per unit was also higher than initially forecast. Total assets' LTV is low and it will be able to flexibly acquire properties in the future.
- The forecasts are for revenue and income to increase in FY2/22 and to be basically unchanged in FY8/22. The distribution is forecast to increase to ¥2,977 per unit in FY2/22 and to ¥3,013 per unit in FY8/22. The forecasts seemed to have been set based on conservative assumptions, the same as for the FY8/21 results forecast.
- As the external growth strategies, for offices it acquires properties in the major metropolitan areas that are near to stations, with inexpensive, and that are appealing to renters. For retail facilities, it acquires properties with stable tenant rent revenue and inexpensive property prices. For hotels, it aims to acquire properties with excellent transport access and for which overseas visitors to Japan are expected to increase. But at the current time, it is prioritizing recovering earnings. It also actively conducts initiatives for ESG.
- The recovery of the REIT's investment unit price has been moderate compared to the market average. But as investors come to understand its policy of strengthening the external growth strategies, it seems attention will focus on it from providing an appealing distribution yield.

Results trends



Source: Prepared by FISCO from the REIT's financial results

Features and competitive advantages

Utilizes the XYMAX Group's knowledge and expertise to the greatest possible extent

1. The REIT's framework

The REIT is a member of the XYMAX Group, which is centered on XYMAX Corporation (not listed), and it is a comprehensive-type REIT that invests in real estate such as offices, retail facilities, and hotels, primarily in Tokyo's 23 wards and surrounding prefectures. It was established in September 2017 and then in February 2018, it was listed on the Tokyo Stock Exchange's Real Estate Investment Trust (J-REIT) market. Its basic philosophy is to aim to draw-out the value of real estate to the greatest possible extent and to maximize investor value by appropriate portfolio management that utilizes the knowledge and expertise in real estate possessed by the XYMAX Group.

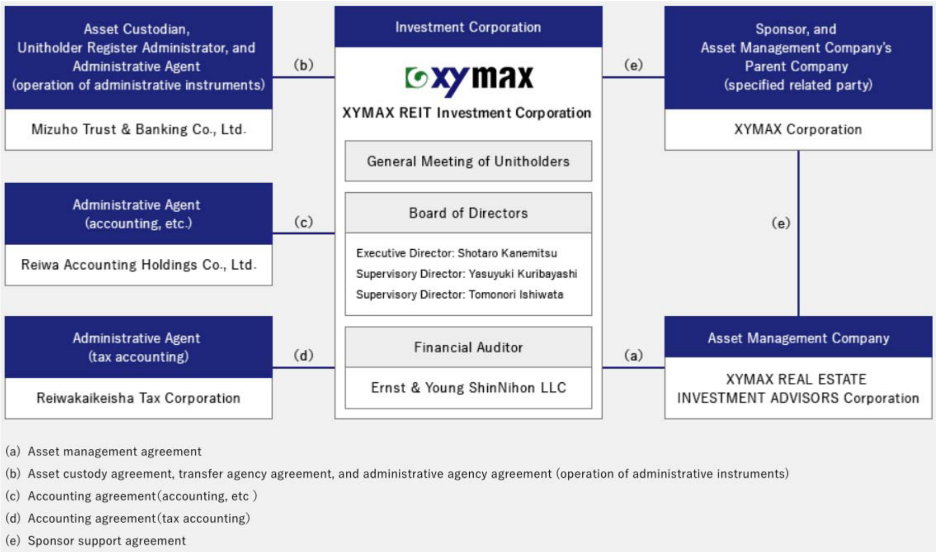
The XYMAX Group's name is derived from the aim of "maximizing the relationship between the unknown number of X (customers) and Y (the Group)." The XYMAX Group conducts businesses including an office property management business, a retail property management business, an asset management business, and a hotels-related business, and its features are as follows. First, it has "Japan's prominent real estate management record." Specifically, its track record of consignments of real estate management are 1,009 buildings with a total floor area of approximately 5.3mn tsubo, and its track records of consignments from J-REIT other than the REIT is 29 companies and 192 properties. For human resources also, it is building a structure comprised of 2,061 real estate management personnel, 61 leasing personnel, and 80 CRE (corporate real estate) sales personnel. Next, it conducts "real estate management utilizing accumulated various data and development of new businesses applying expertise and know-how." In other words, it conducts real estate management that utilizes its abundant stock of real estate data, of completed contract rent revenue data on 39,779 buildings and 128,747 cases, asking rent data on 56,237 buildings and 32,798 cases, and construction work data on 154,621 buildings. It also utilizes the knowledge and expertise it has accumulated through real estate management to develop new businesses, including the ZXY membership satellite office business and Karaksa Hotels, which is its own hotel brand business. Moreover, it has "a track record of real estate sales and mediation that utilizes its strong customer base." Its real estate owner relations have reached approximately 330 companies, and its track record of real estate sales and mediation is 345 buildings with a total value of approximately ¥580bn (cumulative total from April 1, 2010, to March 31, 2021).

In such ways, the XYMAX Group is one of the leading real estate management groups. In real estate investment, which is generally said to be middle-risk middle-return, it is considered that the real estate management capabilities possessed by the Group are essential in order to stably acquire earnings in the medium- to long-term.

The REIT aims to draw-out to the greatest possible extent the value of real estate and to maximize investor value through appropriate portfolio management that utilizes the XYMAX Group's real estate knowledge and expertise. All of the actual asset management is consigned to XYMAX REAL ESTATE INVESTMENT ADVISORS, and a strength is the various types of support it can receive from the Group.

The REIT, which utilizes this support to the greatest possible extent, is aiming to progress a steady growth strategy.

The REIT's framework



Source: Reprinted from the REIT's website

2. The REIT's strengths

The REIT aims to maximize investor value by utilizing the knowledge and expertise of its sponsor, the XYMAX Group, in terms of the following "3 strengths."

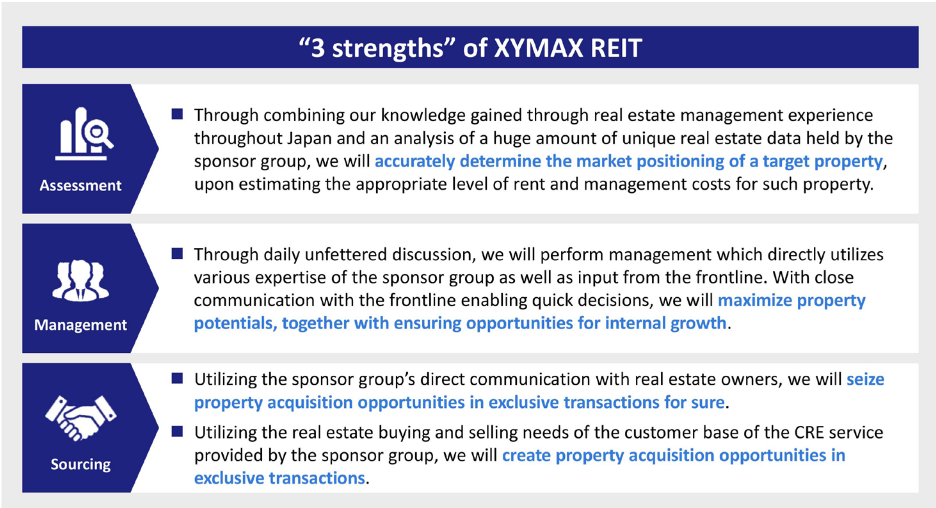
The first is "assessment." Through combining the knowledge gained through real estate management experience throughout Japan and an analysis of a huge amount of unique real estate data held by the sponsor group, the REIT can accurately determine the market positioning of a target property, upon estimating the appropriate level of rent and management costs for such property.

Second is "management." Through daily unfettered discussion, the REIT can perform management which directly utilizes various expertise of the sponsor group as well as input from the frontline. With close communication with the frontline enabling quick decisions, the REIT can maximize property potentials, together with ensuring opportunities for internal growth.

Third is "sourcing." Utilizing the sponsor group's direct communication with real estate owners, the REIT can seize property acquisition opportunities in exclusive transactions for sure. In addition, by utilizing the real estate buying and selling needs of the customer base of the CRE service provided by the sponsor group, the REIT can create property acquisition opportunities in exclusive transactions.

By fully wielding these "three strengths," it seems that the REIT is able to continuously realize steady growth.

The REIT's strengths



Source: The REIT's results briefing materials

3. Portfolio

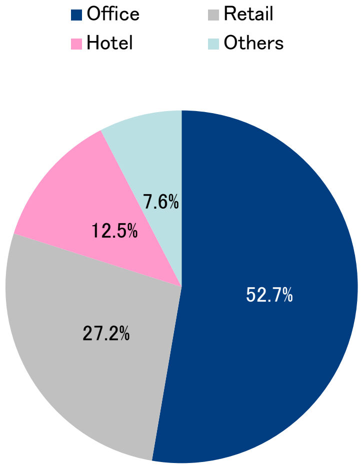
According to usage, the REIT invests mainly in offices, retail facilities, and hotels, and also according to geographic area, it concentrates investments in metropolitan areas, particularly Tokyo, and in ordinance-designated cities. The stable occupancy rates through strategically diversifying the portfolio have become the source of earnings.

At the end of FY8/21, the breakdown of the REIT's portfolio by usage (based on acquisition prices) was 52.7% for hotels (8 buildings), 27.2% for retail facilities (5 buildings), 12.5% for hotels (1 building), and 7.6% for others (residential, 1 building). Also, the breakdown by geographic area was 42.1% for Tokyo's five central wards (Chiyoda Ward, Chuo Ward, Minato Ward, Shinjuku Ward, and Shibuya Ward), 3.3% for the rest of Tokyo's 23 wards, 31.5% for the Tokyo Economic Zone (Metropolitan Tokyo other than the 23 wards, Kanagawa Prefecture, Saitama Prefecture, and Chiba Prefecture) and 23.1% for ordinance-designated cities.

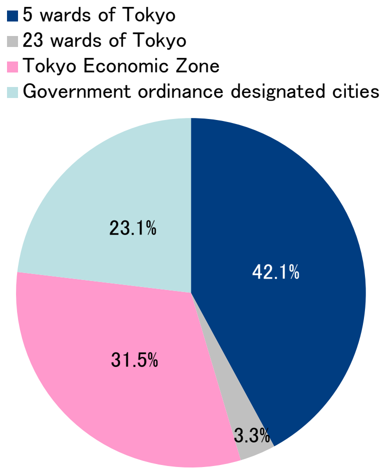
In this way, the REIT has invested 92.4% in offices, retail facilities, and hotels that it has positioned as its main assets. It has also invested 76.9% in the Tokyo area (the Tokyo's 23 wards and the Tokyo Economic Zone). For offices, 74.1% are within 3 minutes of the nearest station and for retail facilities, 80.7% are next to a station, and in such ways, it also sufficiently considers the location. It can be said to be building a portfolio able to purse both profitability and stability by investing with a good balance of usage for properties in excellent locations in which are concentrated people and companies.

Portfolio distribution conditions (at the end of FY8/21)

Percentage by asset type



Percentage by geographic area



Source: Prepared by FISCO from the REIT's financial briefing materials

Results trends

The FY8/21 results were higher than the initial forecasts, even though revenue increased only slightly and income decreased

1. Overview of Business Performance for FY8/21

In the REIT's FY8/21 (7th period) results, the impact of the COVID-19 pandemic continued and states of emergency were declared intermittently, but even in this situation the results still exceeded the initial forecasts. Specifically, operating revenue was ¥1,305mn (up 0.9% compared to the previous period), operating income was ¥701mn (down 2.1%), ordinary income was ¥648mn (down 0.4%), and net income was ¥647mn (down 0.4%), so revenue increased only slightly and income decreased. However, compared to the initial forecasts announced at the same time as the FY2/21 results announcement, every item was higher than forecast, operating revenue by 1.1%, operating income by 3.7%, ordinary income by 4.1%, and net income by 4.2%. In operating revenue, hotel variable rent revenue slumped, but revenue still increased because office and residential building revenue were higher than forecast, and also from acquisitions of two properties, the XYMAX Mita Building (offices) and the Park House Totsuka Front (commercial lots on the first and second floors) that were not included in the initial forecasts. The Park House Totsuka Front will include ZXY offices, which are a satellite offices service managed by XYMAX. Also, in operating costs, through steadily filling vacancies and a decline in the vacancy volume compared to the forecast, running costs (the costs of real estate rental support operations) decreased, which was a factor behind operating income being higher than forecast.

Excluding the decline in hotel revenue, the impact of COVID-19 on the REIT's results has been limited. In the event that the REIT pays a distribution of more than 90% of net income before taxes, it is exempt from corporation tax, and therefore net income is basically at the same level as ordinary income.

Reflecting the above results, the REIT paid a distribution of ¥2,900 per unit, which was a decline of ¥11 compared to the previous period but still ¥112 higher than the initial forecast of ¥2,788 per unit. The occupancy rate of the portfolio as a whole is 97.9%, which although is a decline of 1.0pt compared to the previous period, can still be said to be maintaining a high level in the current severe economic conditions. By asset type, the occupancy rates of retail facilities and hotels are being maintained at 100% and others (residential) at 96.5%. Conversely, while the occupancy rate of offices was previously high, it has fallen to 94.4% due to some tenants withdrawing. The tenant must give six-months' notice prior to withdrawing from an office, and therefore the impact of this has already been incorporated into the FY8/21 results. Also, the outlook for FY2/22 is that the rate will recover to 100% through entries of new tenants. The NOI yield (also referred to as the actual yield, calculated as actual rent revenue / acquisition price converted into a yearly rate), was 5.5%, down 0.2pt compared to in the previous period, but it continues to be maintained at a high level.

Results for FY8/21 (7th FP) Business Performance

(¥mn)

	FY2/21 Results	FY8/21 Results	Change compared to previous fiscal period		FY8/21 The latest forecast	Compared to the most recent forecast	
			Amount	%		Amount	%
Operating revenue	1,293	1,305	12	0.9%	1,291	13	1.1%
Operating income	716	701	-15	-2.1%	676	24	3.7%
Ordinary income	651	648	-2	-0.4%	623	24	4.1%
Net income	650	647	-2	-0.4%	622	24	4.2%
Net income per unit (yen)	2,911	2,899	-12	-0.4%	-	-	-
Distribution per unit (yen)	2,911	2,900	-11	-0.4%	2,788	112	4.0%
Occupancy rates	98.9%	97.9%	-1.0pt	-	-	-	-
NOI yield	5.7%	5.5%	-0.2pt	-	-	-	-
Number of issued investment units	223,400	223,400	-	-	-	-	-

Note: the forecasts are the initial forecasts announced at the time of the FY2/21 results announcement
Source: Prepared by FISCO from the REIT's financial results summary report and financial briefing materials

2. Financial Position

The financial position at the end of FY8/21 is total assets of ¥38,971mn (up 3.5% from the end of the previous fiscal period), net assets of ¥23,233mn (down 0.0%), and interest-bearing debt of ¥14,050mn (up 9.9%).

Interest-bearing debt's average interest rate declined by 0.017pt compared to in the previous period to 0.581%. The fixed interest rate ratio decreased 8.0pt to 81.0% and the average remaining borrowing period fell by 8 months to 1 year 9 months. However, this is due to obtaining a short-term loan until the end of January 2022 for acquiring the Mita and Totsuka properties. The REIT is planning to convert the borrowing to a long-term borrowing by the end of January 2022 and return the fixed interest rate ratio along with the remaining borrowing period to their previous levels. For this reason, there are no concerns about the REIT's financial stability. The parties it borrows from are diverse, but are mainly the sponsor and the megabanks and regional banks with which it has financial transaction relations, and it is building a stable lender formation. In addition, total assets' LTV (Loan to Value: the ratio of the loan amount to the real estate price) is low at 36.1% and the REIT has considerable room to conduct borrowing up to 50%, so it will be able to flexibly acquire properties in the future through additional borrowing.

FY8/21 (7th period) Financial Position

(¥mn)

	FY2/21 Actual results	FY8/21 Actual results	Change compared to previous fiscal period	
			Amount	%
Net assets	37,636	38,971	1,335	3.5%
Total assets	23,236	23,233	-2	-0.0%
Non-operating expenses	12,780	14,050	1,270	9.9%
Average interest rate	0.598%	0.581%	-0.017pt	-
Fixed rate ratio	89.0%	81.0%	-8.0pt	-
Average remaining borrowing period	2 year 5 months	1 year 9 months	-8 months	-
Total assets' LTV	34.0%	36.1%	2.1pt	-

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

Outlook

The FY2/22 and FY8/22 forecasts are based on conservative assumptions

● **The FY2/22 and FY8/22 results forecasts**

For the FY2/22 (8th period) results, the REIT is forecasting higher revenue and income, of opera/ting revenue of ¥1,383mn (up 6.0% compared to FY8/21), operating income of ¥740mn (up 5.5%), ordinary income of ¥665mn (up 2.7%), and net income of ¥664mn (up 2.6%). For operating revenue, the forecast incorporates an increase in hotel rent revenue (recovery of fixed rent revenue) and the full fiscal-period contributions of the two Mita and Totsuka properties acquired in the previous period. The operating costs forecast incorporates higher cost of sales due to the full period operations of the Mita and Totsuka properties, but the forecast still calls for the increase in revenue to outweigh the increase in operating costs. However, in non-operating income and expenditure, financing-related costs will be recorded alongside the conversion of borrowing, so the outlook is that the increase rates of ordinary income and net income will only be small. Due mainly to the acquisitions of new properties, compared to the previous forecasts announced at the time of the FY2/21 (6th period) results announcement, the forecast of every item, from operating revenue through to net income, has been upwardly revised.

For the FY8/22 (9th period), the REIT forecasts results to remain unchanged from FY2/22 with operating revenue of ¥1,387mn (up 0.2%), operating income of ¥732mn (down 1.0%). ordinary income of ¥674mn (up 1.2%), and net income of ¥673mn (up 1.2%). The REIT projects a slight decrease in operating income due to higher operating costs. This is due to the fact that operating revenue, in which the decrease in rental revenue from retail facilities will be subtracted from the increase in rent revenue from offices, will outweigh the increase in operating costs, in which the increase in taxes and other public charges will be subtracted from the normalization of running costs. At retail facilities, in Muza, which is a multi-tenant facility, contracts for 2 lots are scheduled to be cancelled in FY8/22, but there have already been positive sales discussions for one of these lots and there is still plenty of time until the end of the contract of the other lot, and it is thought that the REIT wants to conclude contracts with the best possible conditions. Due to the above, operating income is forecast to decrease slightly, but in non-operating income and expenditure, financing-related costs will decline in FY2/22, so the outlook is that ordinary income and net income will increase slightly.

Based on the above results forecasts, the forecasts are for a distribution of ¥2,977 per unit (up ¥77 compared to FY8/21) for FY2/22, and ¥3,013 per unit (up ¥36 compared to FY2/22) for FY8/22. However, the REIT set the initial results forecasts based on conservative assumptions, the same as for the FY8/21 results forecasts.

FY2/22 (8th fiscal period) / FY8/22 (9th fiscal period) Earnings Forecasts

(¥mn)

	FY8/21 Actual results	FY2/22 Forecast	Change from the previous fiscal period		FY8/22 Forecast	Change from the previous fiscal period	
			Amount	%		Amount	%
Operating revenue	1,305	1,383	78	6.0%	1,387	3	0.2%
Operating income	701	740	38	5.5%	732	-7	-1.0%
Ordinary income	648	665	17	2.7%	674	10	1.2%
Net income	647	664	17	2.6%	673	10	1.2%
Distribution per unit (yen)	2,900	2,977	77	2.7%	3,013	36	1.2%

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

Growth Strategy

Aims to improve investor value by improving cruise DPU through external growth centered on offices, retail facilities, etc.

1. The future management growth strategy

The REIT's awareness of its environment and management growth strategy for FY2/22 (8th period) and FY8/22 (9th period) are thought to be as follows.

Specifically, due to the impact of COVID-19, in FY8/21 (7th period), the DPU (distribution per unit) declined, but going forward, the REIT is aiming to improve investor value by improving the DPU from a cruising level through the recovery of earnings of offices properties and external growth (growth through new acquisitions of real estate). The same as up to the present time, it will maintain a good balance between office rent and occupancy rates with an eye to the future, and based on this, going forward it is aiming to not only recover DPU through promoting leasing, but also looking to improve it through external growth. Moreover, from September 2021 onwards, the outlook is that the DPU will recover alongside the recovery of the hotel's fixed rent revenue.

As an external growth strategy, based on the sponsor-support contract, the REIT ascertains needs for buying and selling of real estate acquired from the XYMAX Group's customer base with the intention of leading to opportunities for property acquisition. The XYMAX Group provides a one-stop real estate strategy management service, from the planning of the real estate strategy and consulting through to practical services based on this. The REIT ascertains the real estate buying and selling needs of the Group's customer and matches them to its own real estate buying and selling needs, with the aim of creating a win-win situation for both parties. Its policy is to accumulate a pipeline while accurately identifying potential, at the same time as also continuing to firmly maintain yield of a certain level.

As the internal growth strategy, the XYMAX Group provides its knowledge and expertise on various types of real estate management to the REIT. Based on this, the REIT conducts stable and efficient management that utilizes aspects such as the Group's real estate management knowledge and expertise, database, management system and management experience in private placement funds.

The REIT implements a financial strategy that puts emphasis on stability and soundness and provides flexibility in financing while taking into consideration securing stable earnings in the medium- to long-term and steadily growing the scale of management assets. With the low level of LTV in the background, its policy is to continue to strategically utilize its borrowing capacity, and also to coordinate with the sponsor's group and to continue to deepen lender relations.

2. The offices growth strategy

For the REIT, offices constitute the largest asset in its portfolio and is the business it will focus on going forward.

According to analysis by the XYMAX REAL ESTATE INSTITUTE Corporation, in the offices market environment, remote working has increased due to COVID-19, but the disadvantages of it have also been seen, including difficulties in communication and in conducting management, such as for operations and evaluations. In this situation, it seems that the function of offices as places to gather people and functions are being reconfirmed. Moreover, in terms of the rate of employees attending the office after the COVID-19 pandemic has settled down (the post-corona period), the percentage of companies in the 50% range is the highest, but for SMEs, in contrast to large-scale companies, the percentage considering 100% office attendance is growing.

Also, on analyzing the distribution of the number of completed office rental contracts in Tokyo's 23 wards in the rental market from the past until the present time, we see that there are strong tenant needs for a unit price per tsubo in a range of around ¥10,000 to ¥20,000, and also that the vacancy rates of properties within 5 minutes' walk of the nearest train station are low compared to properties that are more than 5 minutes' away. Conversely, the supply of new medium- and small-scale office buildings is limited, and it is thought that this scarcity will increase in the future. Looking at the trend in newly contracted rent according to office scale, compared to large-scale buildings, the rental-revenue volatility of medium- and small-scale buildings is low, indicating that they generate highly stable earnings.

Currently, spurred-on by COVID-19, the REIT is seeing an acceleration of the diversification of offices. In other words, there are differences in the plans for employees to work at the office in the future depending on each company's scale and industry. Moreover, among companies that are progressing the diversification of workplaces, the elements that make-up each workplace are also diversifying. In other words, the main offices are becoming bases serving as "gathering places" for employees and are required to be in highly convenient places for employees to gather (city centers), to have safe-building performance (seismic performance and security performance) and to have good building conditions in terms of cleaning and hygiene, and maintenance management. Conversely, offices other than the main offices are "touchdown" bases (places with an environment has been established in which users from other offices can come and work) and bases to work near to one's home, and it is considered that they must be in locations near to the homes of people who visit the office and of employees, and to have features such as a high security performance and an Internet environment (a safe Wi-Fi environment).

In such ways, the diversification of workplaces is accelerating, spurred-on by COVID-19. But it is considered that the offices owned by the REIT whose strengths include “excellent locations” and “high-quality management” will have a competitive advantage in the post-COVID-19 period. More specifically, the REIT has established a competitive advantage in that it can ascertain trends in “ways of using real estate” and companies’ office strategies through having a real estate management business and the ZXY business, and also through utilizing the Group’s knowledge and expertise cultivated through the surveys and research carried out by the XYMAX Real Estate Institute. In fact, on looking at the trend in the average occupancy rates of the offices owned by the REIT, a point worth noting is that while the occupancy rates of offices owned by other J-REIT declined after the Lehman Brothers Shock, the offices owned by the REIT have consistently maintained high occupancy rates. In FY8/21, the occupancy rate temporarily declined due to some tenants withdrawing, but the REIT is forecasting that it will recover to 100% in FY2/22 because it is steadily filling vacant lots and no new tenant withdrawals are scheduled.

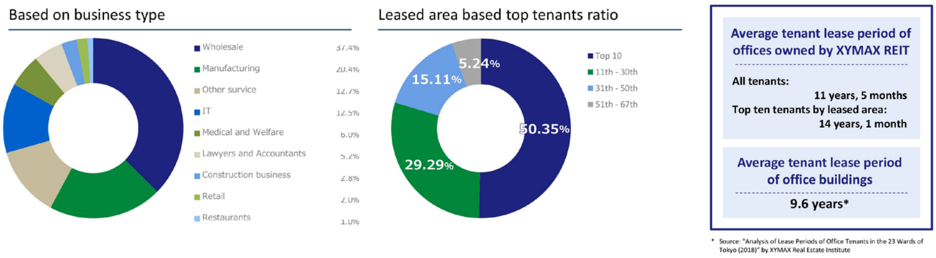
The REIT’s competitive advantages for offices

✓ Knowledge and know-how of XYMAX Group	● Capturing trends on “how real estate is used” for uses and locations through the real estate management business ● Capturing trends in corporate office strategies through the ZXY business ● Research and studies on real estate by XYMAX REAL ESTATE INSTITUTE Corporation
✓ Central office	● Locations near stations in city centers and a reasonable rent unit price suitable for main offices and meeting places ● Confirmation of buildings’ capacity by using the “strength of assessment” ● Maintenance and management of buildings by using the “strength of management”
✓ Suburban offices ✓ Suburban retail properties	● Competitive edge when finding new tenants by using the strengths of “assessment” and “management” (Hachioji) ● Capturing needs of workplaces close to homes → A satellite base operated by a certain company moved into Hachioji and ZXY, the satellite office service, moved into Totsuka

Source: The REIT’s results briefing materials

At the end of FY8/21, the REIT owned 8 office buildings that constituted 52.7% of the total portfolio on an acquisition-price basis. Looking at the distribution of the 67 tenants after excluding obligated residences (for businesses that build and develop offices buildings and other buildings above a certain scale, multiple-dwelling residential buildings with a certain number of required units or more depending on the development), there is little bias toward a specific industry among the tenants. Also, the leasing period of the top 10 companies in terms of rented floor space has reached 14 years and 1 month, which is higher than the average for all the tenants of the offices owned by the REIT of 11 years 5 months, and also higher than the average leasing period for the buildings in Tokyo’s 23 wards announced in the Analysis of Lease Periods of Office Tenants in the 23 Wards of Tokyo (2018) by the XYMAX Real Estate Institute, of 9.6 years. This shows that the REIT’s tenants are highly attached to their properties and are also highly satisfied with the quality of its management.

Office tenant diversification (67 office tenants, based on rent revenue)



Source: The REIT’s results briefing materials

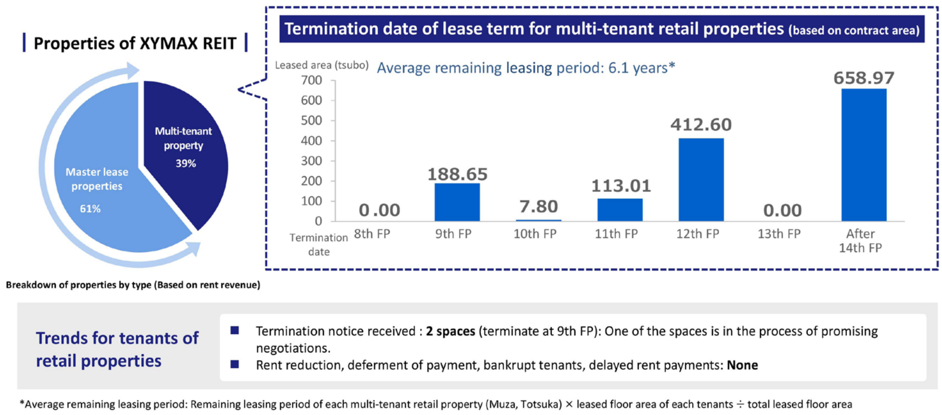
Also, as measures to prevent COVID-19 infections, the REIT is bringing together the administration and management expertise of its sponsor, the XYMAX Group, to progress measures for the “safety and security” of offices. Specifically, it is implementing measures including applying virus-inactivation coating in all offices and installing foot operated hand sanitizer dispenser stands in common areas. Also, the sponsor’s group is implementing proposals for all building owners for “offices in the with-corona period,” including alcohol disinfectant stands, antivirus wallpapers, and antibacterial filters.

3. The retail facilities growth strategy

According to an analysis by the XYMAX REAL ESTATE INSTITUTE, in the retail facilities market, the desire to visit restaurants and related establishments in the food and drinks industry has declined greatly due to COVID-19 and business withdrawals are clearly occurring. Conversely, the changes in other industries, including in the retail (food) and entertainment industries, have been small, and the impact on the retail sector as a whole has been limited. Also, consumers’ behaviors and values are changing, and nesting (stay-at-home) consumption will continue to increase and teleworking will grow in the future as well. For this reason, items such as the increase in stores in the suburbs will account for a higher proportion. In these ways, we are seeing changes to consumers’ needs, and retail facilities located in the suburbs are expected to perform strongly.

In this sort of environment, the impact of COVID-19 infections on the five retail facilities owned by the REIT has been extremely small, and as basically all tenants have fixed rental contracts, they are stably generating rent revenue. Also, all of the retail facilities that it owns are located in the suburbs of major metropolitan areas where the business conditions of tenants are forecast to be strong. Single tenant properties rented to stores that rent that entire building and to master lease businesses provide 61% of total rent revenue. In addition, among the multi-tenant-type retail facilities, which provide 39% of total rent revenue, Muza Kawaski includes a restaurant tenant, but apart from some tenants that are temporarily closed, many of the tenants are stores that target the families in the neighboring residential area and that are maintaining sales of a certain level. Also, the Park House Totsuka Front’s tenants include clinics, dispensing pharmacies, and ZXY offices managed by the sponsor’s Group, and the tenant composition is not easily affected by COVID-19. The tenants of two lots in Muza have applied to cancel their contracts in FY8/22, but the REIT is already conducting promising sales discussions for one of these lots and it has plenty of time until the end of the contract for the other lot, and it is thought it is searching for tenants with as favorable rent contract conditions as possible. The effects of these contract cancellations have been incorporated into the results forecasts. At the retail facilities, currently no reductions in rent, deferred rent payments, and non-payments of rent are occurring, but the REIT’s policy is to continuously pay attention to sales trends in order to ascertain its tenants’ business conditions.

The REIT’s retail facilities



Source: The REIT’s results briefing materials

4. Growth strategy in the hotel business

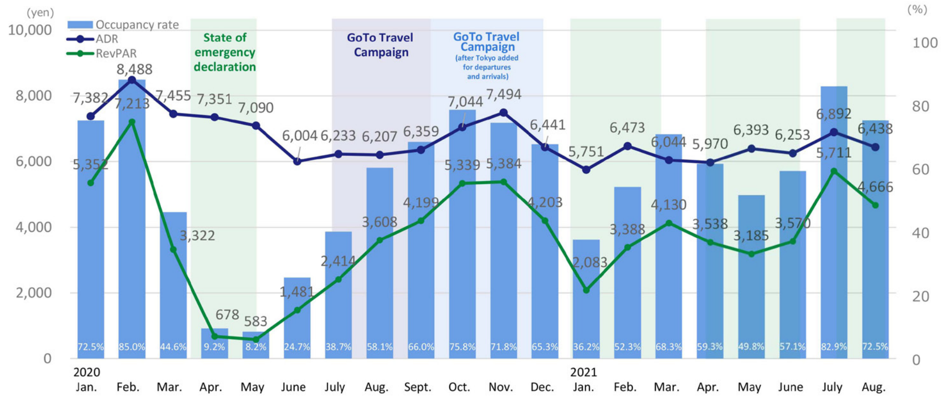
In the hotel business, the REIT owns only one property, Hotel Vista Sendai, which is in an excellent location of only four minutes' walk from JR Sendai Station. However, it is currently being greatly impacted by COVID-19, and it is the business field that is suffering the most during the pandemic.

Specifically, in September 2020 against the backdrop of the "evaporation" of demand, the REIT received a request for a rent exemption from the operator (a management consignment company), and in January 2021, they agreed to change the rent conditions. In March 2021, the operator petitioned the Tokyo District Court to begin civil rehabilitation proceedings, and in October 2021, the civil rehabilitation proceedings were completed and the new sponsor became the parent company. This hotel is a property in an excellent location that generates earnings, so the operator applied to continue with the rental contract, and the plan is to continue with the same contract conditions that were agreed in January 2021 in the future also.

The details of the revised rental contract conditions are as follows. Up to August 2021 in consideration of COVID-19, they will adopt a completely variable rent system linked to monthly GOP (Gross Operating Profit) as the rental condition. However, the fixed rent system will be reinstated from September 2021, and also a system will be adopted to enable variable rent to be received when GOP exceeds a certain amount. Moreover, from September 2022, the fixed monthly rent will increase by ¥0.5mn and the aim is to recover the amount lost up to the previous period due to the exemption within the period of the completely variable rent system. However, the REIT anticipates to receive only fixed rent revenue in FY2/22 and FY8/22, so has set cautious forecasts. Among the facilities managed by operators, Hotel Vista Sendai ranks at the top for performance and for the future as well, it has been positioned as one of the most important bases for operator management, and it is continuing to pay rent as scheduled.

Looking at how the results of Hotel Vista Sendai have trended, since February 2021 following the Japanese government's second declaration of a state of emergency due to COVID-19, the occupancy rate, ADR (Average Daily Rate: average daily rate per room for which sales are actually made) and RevPAR (Revenue Per Available Room: the average unit price for all rooms available for sales) have been recovering. Also, the government issued the fourth declaration of a state of emergency in the second half of July due to the increase in the number of infected people, but no significant drop was seen in the results of hotels to the same extent as when the first and second declarations were issued. It seems that in the background to this is that among people, awareness has spread of the ways to respond to COVID-19 in order to prevent infections. Currently, the number of infected people is declining greatly, but although the state of emergency has been lifted, it is possible that infections will spread once again and we cannot be overly optimistic about the situation. Hotel Vista Sendai is originally a property with a high occupancy rate, so the REIT's policy is to focus on the developments in the tenant's civil rehabilitation proceedings and how hotel room sales trend, and also on the appropriateness of hotel management costs.

Actual Results of Hotel Vista Sendai



Source: The REIT's results briefing materials

5. Points to focus on for the external growth strategies

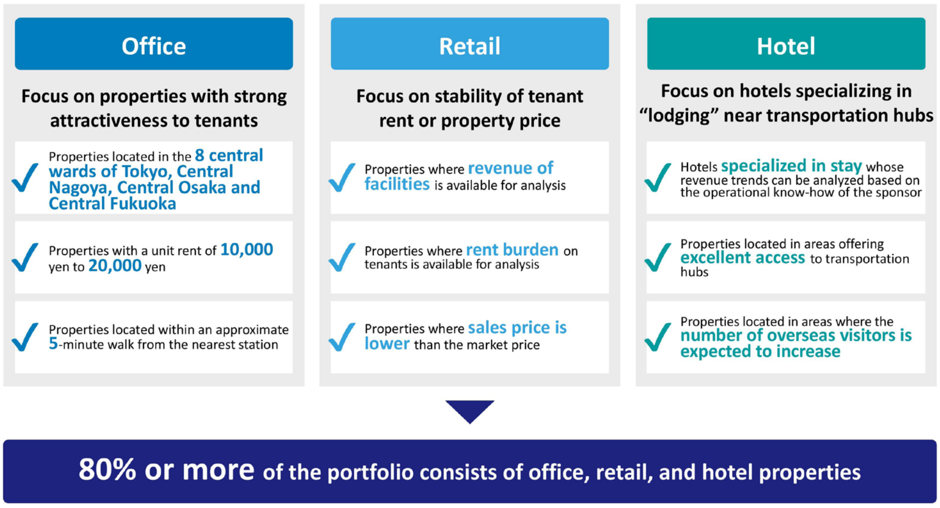
Based on the above-described current conditions, the REIT has established the following strategies according to the asset type. Specifically, on considering that the strength of tenant needs is an important factor in ascertaining the earnings potential of real estate, it is aiming to build a highly profitable portfolio by taking comprehensive decisions by asset type for the following points. Also, going forward, the plan is for offices, retail facilities, and hotels to constitute more than 80% of the portfolio.

First, for offices, the REIT is focusing on real estate that is highly appealing for tenants. Specifically, its policy is to continue to acquire properties that are appealing to renters located in Tokyo's 8 central wards, and in the centers of Nagoya, Osaka, and Fukuoka; that are within 5 minutes' walk of the nearest station; and with a rental unit price of ¥10,000 to ¥20,000 per tsubo.

Next, for retail facilities, the REIT is focusing on properties with stable tenant rent revenue and inexpensive property prices. Specifically, its plan is to acquire properties for which it can analyze the ratio of tenant rent to facilities sales, and that are relatively inexpensive compared to market prices.

For the growth strategy for hotels in the future, it intends to focus on accommodation specialized-type hotels located at transport hubs. Accommodation specialized-type hotels can be analyzed based on the sponsor's management expertise. The plan is to acquire properties in areas where demand is forecast to be strong, such as areas with excellent access to transport hubs and areas in which visitors to Japan from overseas are expected to increase. But at the current time, its policy is to focus on recovering demand for stays at hotels.

Points to focus on for the external growth strategies by asset type



Source: The REIT's results briefing materials

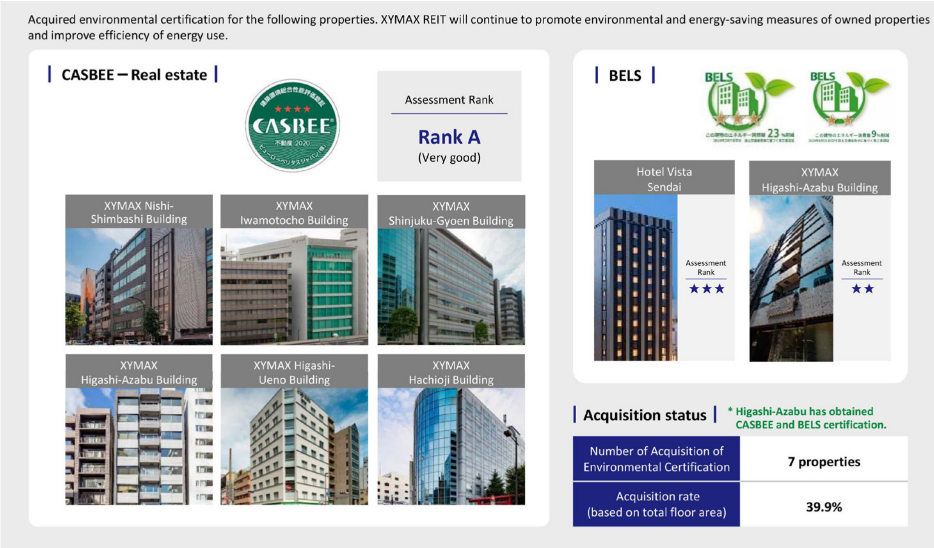
The REIT is strictly adhering to the above-described focus points according to asset type, and going forward, it will investigate property acquisitions in accordance with its portfolio strategy. Also, its policy is to continue sourcing activities to determine the fundamental value of the target properties, with an awareness of the balance between DPU growth and financial soundness. When acquiring a property, it will maximize the use of the XYMAX Group strengths of assessment and sourcing, and assume the investment that is made after assessing the inherent profitability of the property. Also, as the REIT's LTV level is low, it can choose to acquire properties flexibly through borrowing based on the trends in the prices of investment units. It is currently investigating acquisitions of 5 properties in total worth more than ¥12bn, of 1 office building in Tokyo's 23 wards, 1 office building in a regional governance-ordinance designated city, 1 retail facility in a regional hub city, 1 accommodation-specialized-type hotel, and 1 other building (dormitory) in Tokyo's 23 wards. Each are properties for which the asset management company has first refusal rights (the right to negotiate with the seller in advance of other buyers).

6. Initiatives for ESG

The REIT is also actively conducting initiatives for ESG (Environment, Social, Governance).

In the Environment field, among the properties it owns, 7 properties have acquired certification for CASBEE (Comprehensive Assessment System for Built Environment Efficiency, a tool from the Institute for Building Environment and Energy Conservation) and BELS (Building house Energy efficiency Labelling System). In particular, it has acquired the highest evaluation of an A rank for CASBEE. Also, as an initiative to reduce the burden on the environment, by November 2021 the REIT plans to introduce electric power that is 100% from renewable energy in 4 office buildings, and in the future also, it intends to progress environmental and energy-saving measures and to improve the efficiency of energy use in the properties it owns.

Status of acquisitions of environmental certification



Source: The REIT's results briefing materials

In the Social field, the REIT is progressing initiatives for tenants and for regional communities (such as installing elevator emergency storage boxes and introducing disaster-support vendors). In addition, it is implementing initiatives including that XYMAX REAL ESTATE INVESTMENT ADVISORS has signed-up to the 21st Century Financial Behavior Principles and that it is promoting paperless workplaces, supporting employees' acquisitions of qualifications, and respecting diversity. Also, the sponsor's group is working to develop real estate business human resources through the Karakusa Real Estate School.

In the field of governance, the REIT establishes a decision-making process for XYMAX REAL ESTATE INVESTMENT ADVISORS for those items that will greatly affect investor profits through a committee that includes external committee members, with the aim of securing profits for investors. Other initiatives include conducting compliance education and investment by the sponsor in the REIT (the sponsor realizes an improvement of investor value by matching the REIT's ownership of investment units to investors' interests).

In recent years, ESG investment, of investment that analyzes companies from an ESG viewpoint, has been increasing, mainly in Europe and the United States. The global ESG investment amount grew from US$18.2trn in 2014 to US$35.3trn in 2020. In Japan, ESG investment lags behind that of Europe and the United States, but by 2020 it had reached US$2.8trn and its share of the global amount has risen rapidly to 8.1%. In the context of the trend for the global expansion of ESG investment, it can be said that there remains plenty of room for it to grow in Japan as well. In this sense, the REIT's active initiatives for ESG are worthy of attention.

Benchmarking

The evaluation of investors is expected to improve alongside the strengthening of external growth

As its policy to return profits to investors, the REIT pays a high-level distribution twice a year, for each half year. In FY8/21, the distribution per unit (not including a distribution in excess of earnings) was ¥2,900, which was ¥112 above the initial forecast of ¥2,788. Also, it is forecasting a distribution of ¥2,977 for FY2/22 and ¥3,013 for FY8/22. As described in detail in the results forecasts section, the forecasts incorporate the full fiscal period contributions of the newly acquired properties in FY2/22 and the reduction in financing-related costs in FY8/22. However, as the REIT continues to set results forecasts based on conservative assumptions, going forward, at FISCO we think that the distributions may further exceed the forecasts due to the improvement of the business environment more than expected toward the end of the COVID-19 pandemic and its plan to acquire new properties in the future.

Looking at the trend in the REIT's investment unit price, in March 2020 it rapidly declined due to the strengthening of concerns about a global economic recession because of COVID-19, but it subsequently recovered. However, in September 2021, Japan's Prime Minister Suga announced his resignation, and due to concerns about political instability, investors' risk preference attitude strengthened and the shift from funds to stocks has progressed, so overall the J-REIT market has been trending bearishly. Also, compared to the rise in the TSE REIT index, the recovery of the REIT's investment unit price since March 2020 has only been moderate. This is thought to stem from factors such as small market capitalization and low liquidity. As a result, as of October 26, 2021, the REIT's NAV multiple (investment unit price /net assets per unit) was 0.80 times, which is significantly below the average of comprehensive-type REITs of 1.02, and there is a strong sense of it being undervalued. Conversely, the distribution yield was 5.18%, greatly above the average of 4.31%.

As already explained, the REIT's policy going forward is to strengthen the external growth strategy through acquiring the properties it is currently investigating, and it plans to further increase the distribution. As investors' understanding of this strategy deepens and in the situation at the current time, in which the low interest rates are expected to continue, at FISCO we think that attention will come to be focused on the REIT from it providing a distribution yield at an appealing level.

The REIT previously disclosed a medium-term target for the distribution, but currently it has stopped doing this due to the changes to its business environment, particularly the deterioration of the results of hotels due to COVID-19. However, the COVID-19 pandemic is approaching its end, so it would seem important for it to disclose targets at the stage when the results of hotels have recovered in the future in order to appeal to even more investors.

In addition, since FY8/21, the REIT has changed to an asset management remuneration system in order to contribute to improving investor profits. Specifically, for management remuneration during the fiscal period, it has raised the percentage of remuneration linked to management performance from 28.7% to 50.4%, while for capital gains remuneration, it has changed to results-based remuneration that is paid only when capital gains are generated. These changes have increased the strength of the linkage between the profits of investors and the profits of the management company. At FISCO, we think this management policy that prioritizes investor profits will be highly evaluated by investors.

Comparison of the various comprehensive-type REIT indexes

Security code	Investment corporation	Investment unit price on October 26, 2021 (¥)	Investment unit price compared to previous day	Distribution yield (%)	NAV per unit (¥)	NAV multiple	Market cap. (¥mn)	Balance (unit)	Fiscal period (month)
3488	XYMAX REIT	115,700	-0.17%	5.18	145,420	0.80	25,847	479	2/8
2989	Tokaido REIT	107,600	-0.37%	4.61	-	-	19,024	319	1/7
3278	Kenedix Residential Next Investment Corporation	214,500	-0.37%	3.82	190,006	1.13	213,617	1,903	1/7
3279	Activia Properties Inc.	454,000	0.11%	4.11	445,901	1.02	373,530	1,161	5/11
3295	Hulic Reit, Inc.	172,300	-0.52%	4.24	176,084	0.98	233,122	8,128	2/8
3296	NIPPON REIT Investment Corporation	427,000	-	4.78	386,012	1.11	192,120	577	6/12
3309	Sekisui House Reit, Inc.	89,500	-2.29%	3.88	84,778	1.06	383,836	28,483	4/10
3451	Tosei Reit Investment Corporation	137,100	-0.15%	5.15	139,051	0.99	46,683	1,913	4/10
3453	Kenedix Retail REIT Corporation	285,000	-0.14%	4.91	255,692	1.11	165,920	1,273	3/9
3462	Nomura Real Estate Master Fund, Inc.	168,200	-0.53%	3.85	166,206	1.01	793,097	7,283	2/8
3468	Star Asia Investment Corporation	58,900	-0.17%	4.98	52,880	1.11	105,395	2,799	1/7
3470	marimo Regional REIT, Inc.	131,700	0.69%	5.18	139,285	0.95	20,108	174	6/12
3476	MIRAI Corporation	53,600	0.19%	4.70	50,032	1.07	89,096	4,587	4/10
3492	Takara Leben Real Estate Investment Corporation	109,200	0.09%	5.49	109,005	1.00	62,790	786	2/8
8953	Japan Metropolitan Fund Investment Corporation	105,000	0.38%	4.29	109,501	0.96	733,855	13,416	2/8
8954	ORIX Real Estate Corporation	183,800	1.27%	3.61	185,672	0.99	507,288	9,745	2/8
8955	Japan Prime Realty Investment Corporation	409,000	0.49%	3.69	373,566	1.09	391,924	815	6/12
8957	TOKYU REIT, Inc.	188,200	0.32%	3.62	197,534	0.95	183,984	1,086	1/7
8960	United Urban Investment Corporation	143,400	0.21%	4.32	158,842	0.90	447,170	9,881	5/11
8961	MORI TRUST Sogo Reit, Inc.	145,800	0.21%	4.12	144,694	1.01	192,456	1,223	3/9
8966	Heiwa Real Estate Co., Ltd.	155,300	-0.96%	3.67	130,780	1.19	163,955	1,273	5/11
8968	Fukuoka REIT Corporation	167,700	0.48%	4.17	171,943	0.98	133,489	932	2/8
8977	Hankyu Hanshin REIT, Inc.	164,600	0.06%	3.53	162,315	1.01	114,430	665	5/11
8984	Daiwa House REIT Investment Corporation	320,000	-1.69%	3.55	280,700	1.14	742,400	3,856	2/8

Source: Prepared by FISCO from the Real Estate Investment Trust Data Portal

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