

September 2019

# Linking Japan

INVESTMENT INSIGHTS



## Fukuoka

Applying Historical Lessons to become  
Asia's Leading Regional City

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### Real Estate in Fukuoka

Robust Occupancy Driven by  
Population Growth

### Fukuoka REIT

Solid Foundation and  
Accommodating Changes  
for an Even Brighter  
Future Outlook

### J-REITs Active in the Fukuoka City Residential Market

Strong Occupancy due to  
Strong Population Inflow

### Infrastructure Funds

Current Situation and  
Outlook



# Publisher's Note

Fukuoka continues to be one of the more exciting global cities. It has a rich performing arts culture that meshes with a deep history of nearly 2,000 years that local residents are proud to boast about—and they should be proud of it. They are citizens of one of the few, if not the only Japanese city, that functions well despite or without Tokyo. The definitive “like” argument among land investors has always been that the airport is only 10 minutes or less by car or train from the city center.

Second, is its problem solving capacity of the city government. A few years ago a road collapsed on a corner near the central station and snickering such as “Too big for their britches in the end a small town on the fringe,” “constructed in a manner suited to a developing country,” etc. Then a week went by and no one could find the sinkhole as it had been completely repaired and the road reopened. Talk switched to “in Tokyo they would still be talking about protocol and which bureaus should handle it,” “the central government would still be arranging for a fact-finding tour.” This quick action and commitment to excellence were highly appraised.

Third, the city is in very close proximity to the growth centers of Asia including South Korea, Taipei and major cities of China. Add to this that the proximity between Fukuoka and the top three megalopolises of Japan makes it an ideal business continuity plan (BCP) destination. Of course, the cherry on top is the phenomenal cuisine in the area. All is clear evidence that the city should be on your watch and investment list.

J. Michael Owen  
CEO & Chairman  
Transpacific Enterprises

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# Real Estate in Fukuoka

## Robust Occupancy Driven by Population Growth

Even among the many regional urban centers in Japan, Fukuoka City has been a frontrunner on various fronts. On the policy front, Fukuoka City has been selected as a Special Zone for Global Startups; Fukuoka City is also among the top cities in Japan in terms of the number of international conferences hosted or the number of times luxury cruises touch at its port. British life-style magazine Monocle has ranked Fukuoka City in the Top 25 Livable Cities of the world on multiple occasions. During the fund bubble, foreign capital originating from the likes of the U.S., Singapore, and Australia directly purchased real estate in Fukuoka City. In fact, it is widely known that

GIC once owned the Sea Hawk Hotel, Yahoo! Dome, and Hawks Town, commonly referred to as Fukuoka City's three treasures. Presently, Fukuoka City is in the midst of a major project known as Tenjin Big Bang, a strategic reconstruction of the district's aged properties.

### by KENJI YAMASAKI

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Graduated from the Department of Law, Faculty of Law, Keio University in 1985, joined Japan Real Estate Institute in 1987, and after serving as a Fukuoka Prefecture Land Price Publication Representative Manager he became the Chairman of the Fukuoka Association of Real Estate Appraisers in 2017. He is also a real estate appraiser.



## 1. The Price of Land in Fukuoka City

### 1.1 Hakata Station-front area

The price of land in the Hakata Station-front area that was around 3.01 million yen per square meter in 2008 during the fund bubble period, has now reached 5.93 million yen per square meter, rising by almost two-fold. However, in 1991, during what was known as the Heisei bubble, it was 9.6 million yen per square meter. As such, we can see that the current price has not reached the level it was at during the Heisei bubble.

### 1.2 Tenjin area

The Tenjin area is similar to the Hakata Station-front area in that the price of land has surpassed the fund bubble's price of



land, but it is still far from the Heisei bubble's price of land. One thing to note is that the difference in the price of land between Tenjin and Hakata Station-front has rapidly shrunk, given that the price of land in Hakata Station-front has risen more remarkably in the past few years, compared to the price of land in Tenjin. Recently, there has been an increase in tenants who wish to move near Hakata Station-front if they are to move. Moreover, Fukuoka is approaching a period where the city center may relocate to Hakata Station-front from Tenjin similar to what was observed in Sapporo City and Nagoya City. The Tenjin Big Bang was proposed as a project that could help the long-established Tenjin area to recover from this increased presence of Hakata Station-front. Tenjin Big Bang is an urban redevelopment project led by Fukuoka City that aims to further revitalize Tenjin by renewing deteriorating buildings and facilities in Fukuoka Prefecture's business and commercial core, the Tenjin area. The restrictions on building heights within the city will be eased, and 30 private buildings will be reconstructed by 2024. The project hopes to multiply floor area by 1.7-fold and employment by 2.4-fold.

## 2. Characteristics of Fukuoka City's Office Market

### 2.1 The current state of Fukuoka City's office market

To begin with, it is important to note that ever since the JRJP Hakata Building was completed in April 2016, Fukuoka City's office rents have been increasing. That is to say, the JRJP Hakata Building has unmistakably pulled the favorable office market to where it currently stands. In addition to expanding space within buildings, companies are newly setting up new offices in Fukuoka City. However, when setting up new offices they often start by renting 20 or 30 tsubos and there are far fewer new companies that rent 100 or 200 tsubos.

It is commonly said that when the vacancy rate falls below 5%, rents can be raised. Simply put, there is a 5% barrier for vacancy rates. Currently, vacancy rates have easily toppled this 5% barrier, and have reached the 1% level. For this reason, we are seeing an unprecedented powerful force everywhere that is leading to increased rents.

Moreover, there is a trend where tenants are choosing Hakata Station over Tenjin as an office area. This trend is seen to be connected to a lack of newly constructed buildings in Tenjin. However, the S Class buildings due to be built in the Tenjin Big Bang will lead to Tenjin's resurgence.

Next, it is possible to charge expensive rents for vacancies of 100 tsubos or more because they are rare both near Tenjin or Hakata Station. As such, for floors with 100 tsubos or more, one can charge rents that are 1.5 to 2.0 times higher than just a few years ago, even in the case of older buildings. Here, I would like to raise the example of a call center that requires floor space of 100 tsubos or more. Conventionally, call centers have been thought of as an industry that cannot afford expensive rents. However, women are easy to hire in central Tenjin, and in some cases, supply remains even when pay is lowered below market value, and thus, call centers are able to lease office space at high rents. The majority of call centers' costs come from labor, and because they are able to save on labor costs in Tenjin, call centers have a desire to set up offices in Tenjin, despite slightly higher rents. In fact, it is said that the preferred destinations for call centers are Hokkaido and Okinawa, followed by Fukuoka City.

Finally, office rents are decided by the balance of supply and demand. In a time when demand and supply is likely to remain tight, given little supply (construction of new buildings) relative to office demand, office rents will likely remain strong. The highest rent found in Fukuoka City is currently 26,000 yen per tsubo in ACROS Fukuoka. Whether or not the first building being constructed within the Tenjin Big Bang project, the tentatively named Tenjin Business Center, exceeds this value will determine Tenjin's true market value.

### 2.2 Relative evaluation of Fukuoka City's office market

As shown in the graph, if Fukuoka City's office volume is set at 100, Tokyo's would be 1,000, Osaka's 300, Nagoya's 140, Sapporo's 70, and Sendai's 70. While it is a pleasant surprise that Fukuoka City is not far from Nagoya City, which boasts the Meieki area where there are multiple super high-rise buildings of 30 floors or more, it is a humbling reminder that Fukuoka City's economy is only 10 percent of Tokyo's. Next, Fukuoka City has the smallest gross floor area per building among major cities at 1,734 tsubos. One characteristic and problem of Fukuoka City is that there are many small-scale buildings because the Fukuoka Airport is nearby which prevents the construction of high rise buildings. With its abundance of green and its open environment, Fukuoka City should aim for combining land use and increasing high-rises to cultivate creative ideas, concentration for work, employee motivation and satisfaction levels.

### 3. Perspective Needed for Tenjin Big Bang

#### 3.1 Buildings planned under Tenjin Big Bang

Reconstruction plans that have been published are as follows.

##### Office Buildings Planned under Tenjin Big Bang

Property name	Tenjin Business Center	Former site of Daimyo Elementary School	Nishitetsu Fukuoka Building, etc.	IMS	THE GATE HOTEL
Developer	Fukuoka Jisho	Sekisui House, etc.	Nishi-Nippon Railroad	Mitsubishi Estate	Hulic
Location	Tenjin 1-chome	Daimyo 2-chome	Tenjin 1-chome	Tenjin 1-chome	Tenjin 2-chome
Site	3,917m <sup>2</sup>	9,932m <sup>2</sup>	6,200m <sup>2</sup>	4,639m <sup>2</sup>	1,450m <sup>2</sup>
Gross floor area	61,117m <sup>2</sup>	79,392m <sup>2</sup>	100,000m <sup>2</sup>	TBD	FAR up to 1,300%
Floors	19	24	19	TBD	TBD
Height	89m	110m	96m	TBD	up to 115m
Completion	September 2021	December 2022	Spring 2024	Targeting 2024	December 2024
Special notes	Construction design Shohei Shigematsu/OMA	The Ritz-Carlton Hotel will open a hotel	Largest scale in Fukuoka city	Easing height restriction is the key	

#### 3.2 A need for office buildings for temporary tenant relocation

While this is currently a topic of debate by the public, since Fukuoka's vacancy rate is particularly low at 2%, there is a shortage of appropriate relocation sites for tenants that need to move out due to the reconstruction of buildings. While a portion of the tenants will return after the reconstruction, their rents will increase. For this reason, one pressing issue is figuring out how to secure new locations for tenants who do not wish to move back into the reconstructed buildings.

#### 3.3 Big Bang to reconstruct 30 buildings by 2024

If all of the buildings are suddenly made into large-scale buildings, large-scale vacancies will also occur, risking a decline in rents. Not only does this risk lie with the newer buildings, it also lies with older buildings which will have secondary vacancies when tenants move out. As such, it is thought that steps should be taken to create a healthy office market by supplying a limited number of new buildings for a few years.

Despite this, Fukuoka City's solicitation policy is an unprecedented and novel method where they have cut the reconstruction period short while offering incentives to reconstruct deteriorating buildings built under the old earthquake safety



Rendition of exterior of Tenjin Business Center (tentative name)



Rendition of interior of Tenjin Business Center (tentative name)

standards. All of Japan is focusing on the results of this initiative. While they are facing some difficult problems such as rising construction costs and expensive compensation for eviction demands, rising office rents have pushed the Tenjin Big Bang forward. Fukuoka City is now facing a dramatic transition period that comes around once every 50 years.

# Fukuoka

## *Applying Historical Lessons to become Asia's Leading Regional City*

*Interview of Soichiro Takashima, Mayor of Fukuoka City, and Etsuo Matsuyuki, CEO & Representative Director of Fukuoka Realty Co., Ltd.*



**LJ:** For Fukuoka, what would you say is vital as a leading regional city in Asia from the perspectives of the government and business?

**Takashima:** I believe it's time for Fukuoka city to propose a new paradigm for society and the economy rather than just transforming itself. The countries we have come to know as 'developing countries' through our education—in other words countries with underdeveloped social infrastructures and industrial bases—have been able to take in and apply new technologies, thereby transforming themselves into countries that are only a lap behind developed countries and surging. Meanwhile, countries considered as being developed are tightly bound by regulations that make it difficult to accept new technologies. The resulting outcome is a possible dramatic change in the ranks of countries in the coming future.

Today, there is continuous talk of emerging financial technology, crypt assets and a cashless society. There is excitement as to how these things will help create a new world order. To date, we have tried to compete with Tokyo in productivity, but it is evident that we cannot compete at the level of Tokyo and other mega cities under this metric. What will it take then for Fukuoka with a population of 1.5 to 1.6 million people to project itself as a “city” with a strong presence? It is imperative that the city clearly spells out its own unique sense of values and

grows to become a city with distinct characteristics.

The idea of “many high-rise buildings and unique-shaped buildings are what make a great city” is from the old days. We are now in a time of pursuing new ideas. This is reflected in being Asia's leading regional city, where the people, the environment and the vitality of the city are well-balanced. In terms of “people,” it is a city where people help each other when needed, and people work together in preparation for traditional festivals by taking on more roles rather than focusing on their individual work. In terms of the “environment,” it is nature and an environment where people can eat fish from the clear sea and ingredients grown in the rich nature. Fukuoka City is already a world class city both in terms of its “people” and “environment.”

However, it would not work without the vitality of the city despite having a great environment and vibrant festivals, in other words, business. It is inadequate as a town if the smartest children and those that can be successful in the global market, decide to move to Tokyo, Shanghai, or New York for self-realization.

In this sense, it is important to be highly-balanced in terms of the “people,” “environment” and “vitality of the city.” I am convinced that if Fukuoka can enhance the “vitality of the city,” it can boost its presence in synergy with the characteristics of its “people” and the “environment.” “Asia's leading





regional city” represents the city we aim to become and what growing Asian cities want to be.

**LJ:** On the business side, what are the strengths of Fukuoka and the characteristics that are needed?

**Matsuyuki:** It is the last part of what the mayor said—the vitality of the city—that is key. People cannot visit Fukuoka even if they want to if there is not an adequate transportation infrastructure in place to handle that volume of people. We regularly inform overseas investors that Fukuoka has an advanced transportation infrastructure covering land, sea, and air. Its strength is represented in the airport, the extension of the subway Nanakuma Line, the Chuo Futo wharf, and other aspects. Overseas investors value this point highly. The fact that a new station on the Nanakuma Line is being built right next to Canal City Hakata, our core asset, is especially great for Fukuoka REIT as this station will improve access between Tenjin, Hakata Station and Canal City Hakata.

We were shocked by the accident during the subway construction that caused the road in front of the station to collapse suddenly. Initially I felt that this could be fatal for Hakata and Fukuoka, but rather it became an example of the strength and pride of Fukuoka in that the submerged road was repaired in one week. People who saw this on the news as well as investors

were quite impressed. The properly functioning transportation infrastructure is a major indicator of the city’s vitality.

**Takashima:** The ability to recover, or resiliency that we witnessed in the wake of the Kumamoto Earthquake and the sink-hole accident in front of JR Hakata Station has become an important keyword in the world today. Although Fukuoka has relatively lower probabilities of having major earthquakes or tsunami compared to other areas in Japan, preparing a resilient environment for business has become even more important in the context where natural disasters are becoming more intense.

One example of this is arranging various projects for the future of Fukuoka including Tenjin Big Bang, Hakata Connected, Waterfront Next, and FUKUOKA Smart EAST. Tenjin Big Bang is a project to replace old buildings with safer buildings as early as possible through various measures such as national strategic special zones <sup>(Note)</sup>. The first building being constructed within the Tenjin Big Bang project is the Tenjin Business Center being developed by Fukuoka Jisho.

(Note) Special zones designated to verify the effects of deregulations and system reforms within a restricted area to revitalize the Japanese economy. More drastic deregulations and tax system reforms can be expected as the national government leads the decisions on themes and areas for special zones.

The first building being constructed within the Tenjin Big Bang project is the Tenjin Business Center being developed by

## Redevelopment Projects in Fukuoka City

■ Please refer to page 14 for details on the numbers in the map.



### A The Tenjin Big Bang Project

The Tenjin Big Bang Project aims to encourage, through special Fukuoka City government measures, rebuilding by the private sector to generate fresh employment opportunities and create urban new spaces, taking advantage of relaxed regulations in the Tenjin area as part of a National Strategic Special Zone initiative. The Fukuoka City government has received special permission to relax Civil Aeronautics Act-related building height regulations and has also relaxed regulations on floor-space ratios, etc. Work on the first building of the project, Tenjin Business Center (provisional name), started in January 2019.

### C Waterfront District

Both bustling and relaxing spaces that take advantage of the seafront location will be created by encouraging the relocation of private facilities to the district and leveraging the area's unique characteristics and charms, all the while working to strengthen MICE (Meetings, Incentives, Conferencing, and Exhibitions) and cruise-related functions with the aim of building them into drivers of growth for Fukuoka City. Canvassing of the private sector commenced in March 2019 in preparation for subsequent public solicitation of interested business operators.

### B Hakata Connected

Urban functions in the Hakata Station area will be enhanced through redevelopment including construction of highly earthquake-resistant buildings and expansion of the network of pedestrian routes, along with enhancement of transport infrastructure such as extension of the Nanakuma subway line to Hakata Station and redevelopment of Hakata Ekimae Street.

Target area: 500-meter radius around the Hakata Station (about 80 hectares).

### D FUKUOKA Smart EAST

The smart city project is an initiative where industry, academia and government have joined forces to transform a former campus of Kyusyu University in Hakozaki (about 52 hectares), which is located eastern part of Fukuoka city, into the largest smart city in Japan. In order to achieve sustainable development while addressing various challenges associated with town planning such as an aging society with fewer children, the city will implement state-of-the-art technology brought about by innovation to create a comfortable and high quality lifestyle along with urban space, and thereby realizing a model city our citizens can be proud of in future. To pioneer this development, the city will start to implement verification tests in Hakozaki.

Fukuoka Jisho. This building will be equipped with a leading quake-absorbing structure. The building can be used to proactively promote the launching of Japanese operations among business people from overseas who want to conduct business in Japan as they will see the building as being irrefutably safe during an earthquake. I am convinced that these types of structures must be in place to attract high value-added businesses to Japan and in particular to Fukuoka. This project is one way of accomplishing that.

**Matsuyuki:** Until now, nearly all the buildings in Tenjin, the center of Fukuoka, were aged 40 years or older. This is not an appealing characteristic for attracting people to the area. The

construction of new, safer buildings equipped with BCP functions via the Tenjin Big Bang project will bring to Fukuoka people who would not have come previously. I believe the impact of this to be very significant.

**Takashima:** One might ask, why is Fukuoka able to accomplish all this now? This is occurring because of the present alignment of national deregulation, motivation of local governments, and the private sector. One example is the deregulation of height restrictions under the Civil Aeronautics Act. Previously, no matter how motivated the local populace was, nothing could be accomplished because items that fall under the Civil Aeronautics Act are considered national matters and the issue was given



no attention. However, the relationship between the government of Fukuoka and the national government today is very strong. The strength of our relationship has been beneficial in that when Fukuoka became ready to challenge itself to achieve many things, it was able to cooperate firmly with the national government.

One such example is the height restrictions of buildings. Fukuoka Airport is one of the most easily accessible airports in the world, however this proximity to the city center also becomes the bottleneck as the construction of buildings surpassing 67 meters is not allowed under the Act. But designation as a national strategic special zone eventually enabled us to embark on the Tenjin Big Bang Project in which the construction of buildings are permitted under eased limits.

Our relationship combined with the present timing has resulted in several great opportunities. A number of motivated private corporations came out of the woodwork when Fukuoka created the Tenjin Big Bang project by combining national deregulation with deregulation and measures adopted by Fukuoka. Rarely do various participants align themselves like they are now, and we look to make the most of this opportunity for Fukuoka.

**LJ:** What are Fukuoka's strengths versus mega cities and in what areas would you come out ahead as the top regional city not only in Japan but also in Asia? Moreover, why is Fukuoka so appealing among other cities and how do you maintain this strength?

**Takashima:** First of all, I believe the aspect that best represents Fukuoka's individuality is its livability, which is highly evaluated internationally. As for business, our support for startups is a significant strength. Fukuoka has many students. It ranks second nationwide for number of students following Kyoto. In particular there are many engineering students in the city.

Furthermore, the cost of living in Fukuoka is very inexpensive, which is one of the important elements of livability. This makes it possible for the city to create an excellent environment where people can experience failure but bounce back quickly to pursue their next challenge. Support programs we have been taking are startup visas for foreign entrepreneurs under the special zone scheme, the Startup Corporate Tax Cut and the launch of Fukuoka Growth Next, which is one of Japan's largest public-private collaborative start-up support facilities located inside a former elementary school building.

On top of this strong base of students, Fukuoka has established a distinctly large number of incentive programs for startups that make it stand out ahead of others in this area.

Admittedly, Tokyo is the center of Japan, but Fukuoka can



**Soichiro Takashima**

Mayor of Fukuoka City

be recognized as the center of the area comprised of Japan, China, South Korea, and Taiwan.

Why is the location of Fukuoka attracting so much attention now? Clearly the location itself has not changed but the potential of Asia within the world has. I travelled to Shanghai via an ocean cruise last week. Shanghai is in fact the same distance from Fukuoka as Tokyo, and is an enormous mega city. In Asia, including China, South Korea and Taiwan, there is a need to conduct business globally and market opportunities are growing. Consequently, the significance of the location of Fukuoka is also growing. Fukuoka must set out to reinforce the gateway function of the city while preventing bottlenecks from growing. It is with this in mind we are building another runway at the airport to make it easier for international flights to arrive in Fukuoka. The city also receives more ocean liners than any other port in Japan and we are presently extending the terminal by implementing port concessions for the first time in Japan. This will follow the airport concessions that have already been sold. I am convinced that these new pursuits will enable dynamic growth of Fukuoka's potential.

**Matsuyuki:** There are two elements we describe when Fukuoka REIT explains the strengths of Fukuoka to investors. We first talk about the population and how it is both growing and very young. These are overwhelming strengths that the city latently possesses. This is noteworthy when you consider the fact that the overall population of Japan is aging. The second element is our inbound traffic, that is, the overwhelming growth in number of inbound tourists. For example, in the case of Canal City

Hakata, there is clear evidence that there has been an increase in the number of customers from overseas. Therefore, it would be an utter waste if the commercial facility welcoming these customers was not able to do so in both aspects of structure and appeal. This led us to taking measures necessary for handling inbound traffic at Canal City Hakata at an early stage, whereby from around 2008 Union Pay cards were accepted, a duty-free goods counter was opened and specific services targeting inbound visitors were devised. We think it is important to take advantage of our geographical advantage and have recently taken steps to accept WeChat Pay and Alipay along with credit cards from China and South Korea.

**LJ:** It is often mentioned that Tokyo is lacking in entertainment. Does Fukuoka provide a rich entertainment life?

**Takashima:** The greatest form of night entertainment we provide are the yatai—food stalls. There is no place in Japan where you can eat outside and enjoy the breeze at night. This is because of the regulation under the Road Traffic Act designating roads as only for transporting people. The sole exception to this is Fukuoka. Fukuoka is ensuring the continuation of its yatai by being the first municipality in Japan to enact the Basic Ordinance on Yatai. Yatai must follow the letter of the ordinance, but they are true night entertainment. The city is even promoting the use of cashless payment among the yatai also to prevent trouble concerning payment, and we are assisting with the provision of menus in multiple languages.

Another form of night entertainment with a rather contrarian approach is the shopping arcade. Until now, shopping arcades have been losing much of their previous vitality as large retail facilities like Aeon and Yumetown have changed the flow of pedestrians and caused people to no longer visit the arcades. We have been adopting measures to draw people back to the arcades but in that process realized that the arcades are attractive to inbound visitors as well.

The path down the middle of the shopping arcade is designated as a road in the ordinance, thus it is illegal to place pop-up store carts in the middle and to eat outside on the “road.” However, after much thought, we took advantage of the national strategic special zones policy and used the arcades for hospitality events related to international conventions, post-convention events and pre-convention events. At the same time, we asked the arcades to hold night markets. We offer support to arcades that are willing to try new things, for example, provide open stores where people could shop late at night after they had eaten dinner. Young store owners have been very motivated to help us in these areas and many are now voluntarily taking actions. If we diligently expand these efforts to



**Etsuo Matsuyuki**

CEO & Representative Director of  
Fukuoka Realty Co., Ltd.

the point where there are arcades open at night every week, we can list them in guide books. Shopping arcades will be revitalized and inbound customers will become more satisfied if a steady flow of people can be created where people go out after they eat dinner.

**Matsuyuki:** Canal City Hakata has also been very proactive concerning nighttime events and began providing aqua panorama and projection mapping shows two years ago. These shows are enjoyed both by Japanese and inbound customers. Our area has become one symbol of Hakata/Fukuoka in that our customers not only shop and dine at Canal City Hakata but they also shop at the neighboring Kawabata Shopping Arcade.

**LJ:** How do you want Fukuoka to transform in the future and what kind of leader do you want it to be?

**Takashima:** I want Fukuoka to become a leading city in Asia through harmony between people, the environment, and city vitality. The city is pursuing a number of changes to the urban landscape and policies to achieve these goals. For example, Fukuoka as a city has the second largest number of shrines in Japan following Kyoto. While Kyoto's shrines and temples flow throughout the town's streetscapes, those in Fukuoka are merely present and go unnoticed. They have not been appealed as a visitor worthy destination. We are working on a project to change the roads in the old district of Hakata to cobblestone so that even if people come from overseas or are without historical reference, they still feel something. By reconstructing the streetscape, we intend to build a city with distinct interesting and contrasting areas.

These are the measures we will implement with a medium- to



long-term perspective. We also aim to create a place or a society where those who are willing to take on challenges can play active roles. Amid the aging society with low child birthrate, we need a willingness to risk doing something, otherwise there's no innovation or new business models. We must create a society where risk-takers are respected so that more and more young people can take risks without the fear of failure.

We intend to cultivate the attitude of challenging the accepted relentlessly. This attitude of questioning the accepted is the prerequisite really for someone launching a startup. We have created corners in the libraries of all of Fukuoka's elementary schools to further this attitude in an attempt to nurture this spirit among children in their education. We have initiated measures for our city's futures in a variety of dimensions from education to reformulating the structure of our city. As I said at the outset, Fukuoka Growth Next is a part of these efforts. In line with this, we opened an "engineer café" in August. It is a café where engineers, who play an integral role in technological development in this age of AI and IoT, can gather and interact with other engineers. Fukuoka will create a stage for people who want to challenge the accepted and create something new. Fukuoka will be a place where everyone can be successful. This is what we need to update and polish even more from now on.

Some people point out that it is an exaggeration that Fukuoka is a leading city in Asia. Historically, however, Fukuoka was a leader in Asia dating back to 2,000 years ago. The Azumi Clan resided in the city and knew how to read the winds and ocean currents. Accordingly, Fukuoka became a

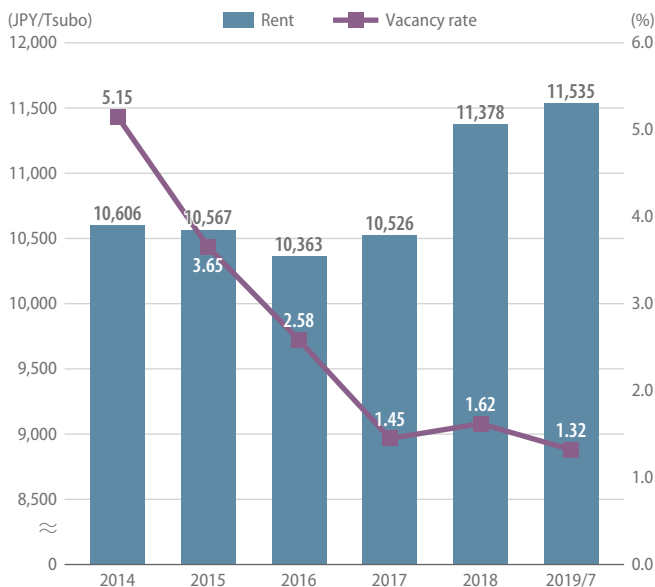
hub for transporting products and people throughout Asia. About 1,300 years ago Kourokan (hospitality facilities) served as exchange gateways to Asia by providing hospitality to overseas guests, and of the three that were in Japan at the time, only the location of the one located in Fukuoka is known today. From long ago, Fukuoka has grown and developed through interaction with Asia, and has a strong presence in Asia. In the past, various interactions occurred centering on temples, but today international interaction and networking is done centering on the business district. Wind-propelled boats have become cruise liners, and airplanes have become low-cost carriers, and the increase and frequency of their arrivals and departures facilitates active interaction. As times change and the ways of interaction change, I believe it is vital that we once again become a hub for interaction in the current day and age by proactively upgrading city functions.

**Matsuyuki:** Fukuoka REIT listed on the stock exchange as a regional REIT in 2005, and we are also convinced that we must adapt ourselves to the era and achieve steady, reliable growth going into the future. As for achieving steady growth, Fukuoka REIT has a strong portfolio with many high-occupancy properties. This is in part due to the robust office environment in Fukuoka where the average vacancy rate as of July 2019 was 1.3%. Our properties are overflowing with new businesses like call centers, online/mail-order companies, content companies and game companies. Furthermore, overseas investors seem to be heavily interested in ESG and we intend to also focus further on this area in the future.

Fukuoka Realty, the asset manager for Fukuoka REIT, was certified by the city last year as a company promoting work-style reform and nearly half of our staff—46.3%—are women. We would like to continue utilizing these strengths as an operator while also contributing to the regional growth of Fukuoka to create an even more attractive city.

**Takashima:** We are implementing rapid changes to the city as we speak. I am often asked if the skyline is really being changed in line with these changes as people will miss the old skyline. They are in a mood for nostalgia. The fact is, however, that the shape will not last forever and must undergo change at some point. The decision on what to change and what not to change is not driven by the simple desire for change. When looking back on the 2,000 years of history of Fukuoka and the path it has traveled based on its DNA, it is important that such decisions are in line with that. As for urban creation, if what we do is on this path created over time, there is no problem. We are resolved in our determination to work on the various challenges going forward.

### Vacancy Rate and Rent in Fukuoka City



Source: Sanko Estate Co., Ltd.

FEATURE

# Fukuoka REIT

**Solid Foundation and Accommodating Changes  
for an Even Brighter Future Outlook**



*Fukuoka REIT Corporation ("FRC") is Japan's first REIT specializing in regional properties with the intention of attracting inflow of capital to the region by introducing excellent properties in the Fukuoka and Kyushu area to investors around the world. As of February 28, 2019, its assets under management had increased by 2.6 times since listing and the investment target which was centered on retail facilities has become more diverse.*

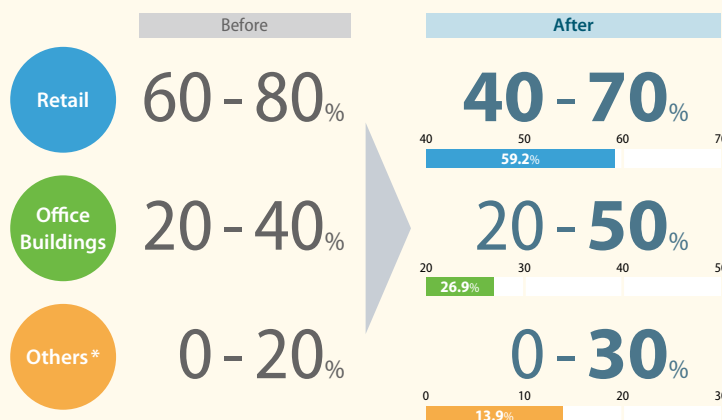
*We interviewed Keishi Tamura, General Manager of Finance Department of Fukuoka Realty Co., Ltd. (the "Asset Manager") on the current status and measures taken by FRC.*



**What are the reasons behind the investment policy change, including the investment asset types?**

FRC changed the investment ratio of its investment assets, which had remained unchanged since listing, in order to allow the asset management company to more flexibly consider investment in excellent properties of investment types other than retail facilities, namely office buildings and others (including hotels, residential properties, logistics facilities, and public facilities). This was done to secure stable earnings over the medium to long term as well as stable growth of investment assets. The investment policy after the change sets investment in retail facilities as accounting for 40 to 70 percent of the portfolio, office buildings for 20 to 50 percent, and other types for 0 to 30 percent.

## Investment Ratios by Investment Type

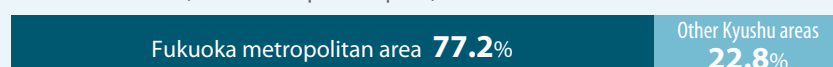


## Portfolio

Investment type (based on acquisition price)



Investment area (based on acquisition price)



Total leasable floor space

**580,665.27 m<sup>2</sup>**

Occupancy rate at end of period

**99.7 %**

\* Figures are based on properties owned as of February 28, 2019.



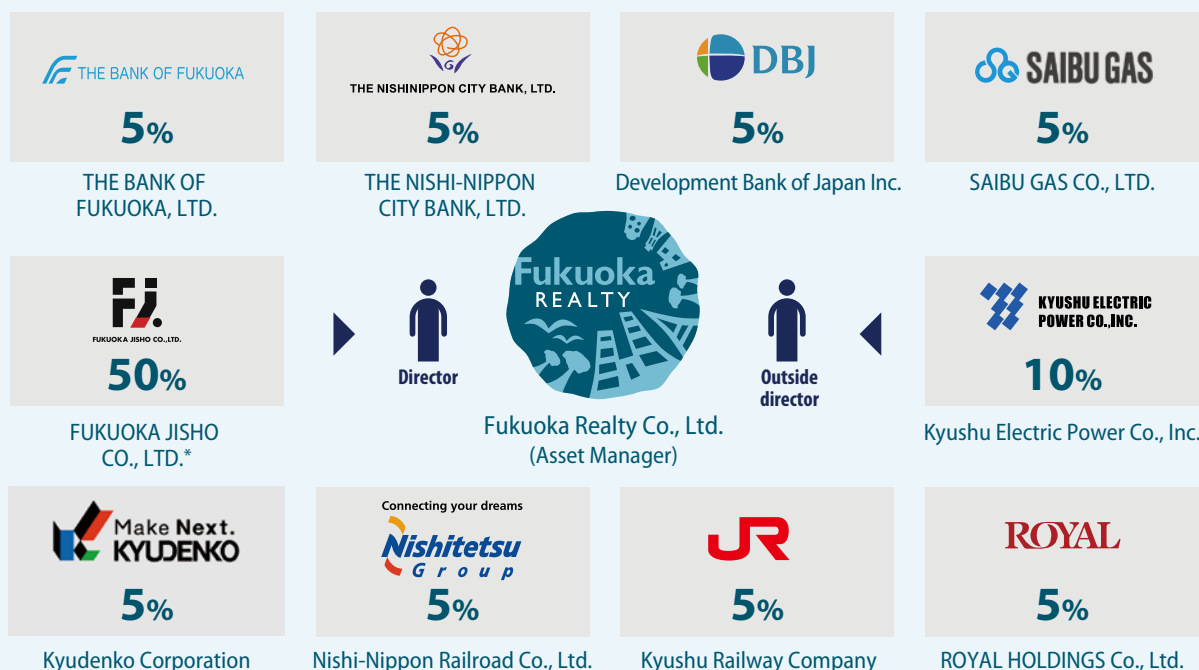
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**Can you tell us about the relationship with and the respective strengths of the current 10 sponsor companies including Fukuoka Jisho Co., Ltd., the main sponsor? Additionally, what are the benefits of concluding a pipeline support agreement with Fukuoka Jisho Co., Ltd.?**

The Asset Manager has Fukuoka Jisho Co., Ltd., Kyushu Electric Power Co., Inc., and other leaders of the Kyushu business world as its sponsors. Fukuoka Jisho Co., Ltd., the largest developer in Kyushu, has concluded an agreement concerning pipeline support, etc. with FRC and the Asset Manager, and provides information on properties, etc. and makes offers of property transactions, etc. to both companies. With regard to external growth, FRC mainly acquires properties

utilizing the sponsor and local networks. Through sponsor pipelines, Fukuoka Jisho Co., Ltd. not only owns office buildings, hotels, etc. in the Fukuoka metropolitan area, it is also pressing ahead with development of office buildings, hotels, and logistics facilities for the future. FRC believes it may acquire properties from among these developments going forward.

### Sponsors



\* Concluded MOU with Fukuoka REIT Corporation and Fukuoka Realty Co., Ltd. concerning pipeline support.

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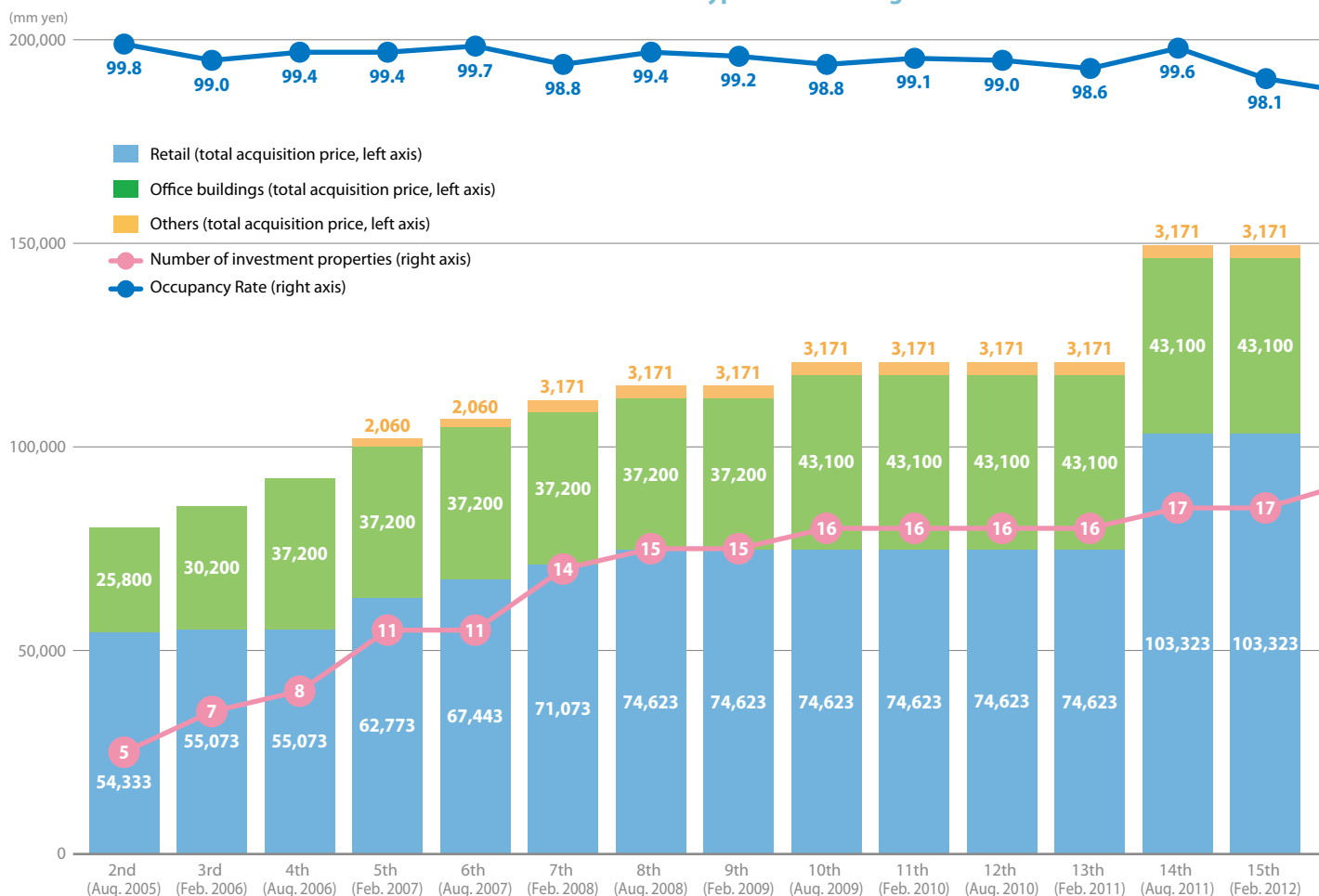
**The asset size, which was 73.5 billion yen at the time of listing in June 2005, has grown to 195.9 billion yen, and the number of assets in the portfolio increased from 5 to 29 properties. FRC acquired a hotel property, Tissage Hotel Naha, in the 29th fiscal period, and amended the investment policy in March this year. Can you explain the outlook and view on future acquisition and portfolio composition?**

As of July 2019, there are 63 J-REITs listed and the market has grown to over around 14 trillion yen in terms of market capitalization. Under such an environment, FRC believes that, as

of the end of February 2019, it needs to continue expanding its asset size.

FRC acquired Tissage Hotel Naha (acquisition price: 2,835

## FRC More than Doubled Asset Size and Diversified Investment Types Since Listing



million yen) last year. It is a newly constructed hotel completed in February 2018 located in Naha, a central city of Okinawa drawing many tourists not only from within Japan but also from abroad in recent years and where strong growth is

expected. Okinawa's proximity to Asian cities and the scheduled start of operations of a second runway at Naha Airport in March 2020 are likely to bring in more inbound tourists, raising expectations for Okinawa becoming an attractive market.



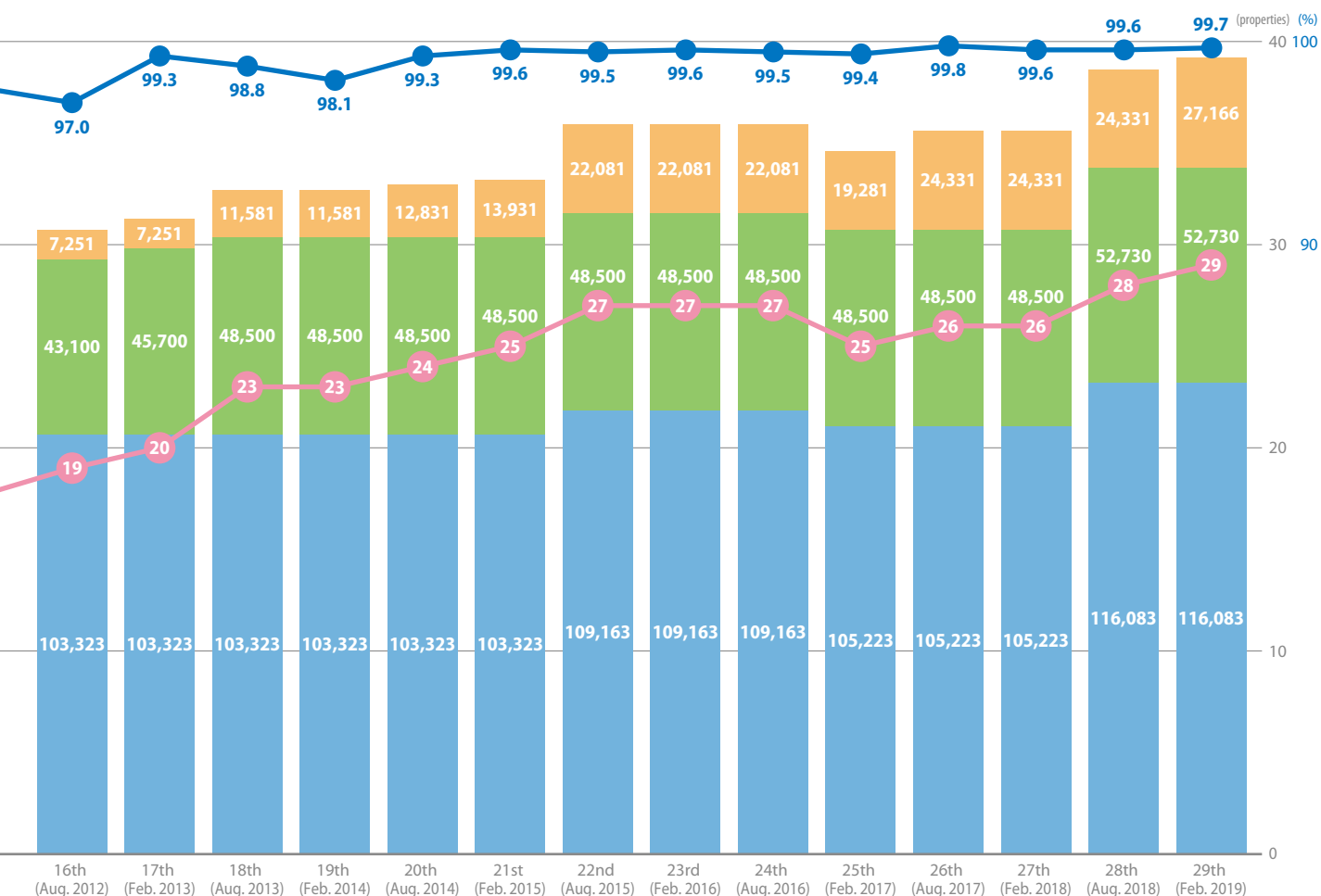
### Can you tell us about the future outlook?

It is our mission to maintain and enhance stable dividends and to maximize unitholder interests. FRC owns excellent properties that represent the Fukuoka and Kyushu area, and keeps them operated at a high occupancy rate. Through these, FRC generates stable cash flows and maintains a high dividend level. As for external growth, FRC carefully selects properties to acquire so that stable cash flows will be continuously created over the long term. As for internal growth, FRC is steadily implementing upward rent revisions, etc. for existing office buildings amid the strong office market trends in Fukuoka. On the financial front, while continuing with the reduction of

interest costs, extension of borrowing terms and diversification of debt maturities, FRC has established a stable financial base through conservative control of its interest-bearing debt ratio.

With the support and cooperation of influential sponsor companies leading the Kyushu business world, FRC will strive to secure growth of the portfolio over the medium to long term as well as stable earnings through sound asset management, while exerting its strength as a region-specific REIT and promptly accommodating changes in the market. FRC appreciates your continued support.





## Dividend Performance

29th fiscal period end

**February 28, 2019**

(semiannual periods ending every February and August)

29th fiscal period days

**181 days**

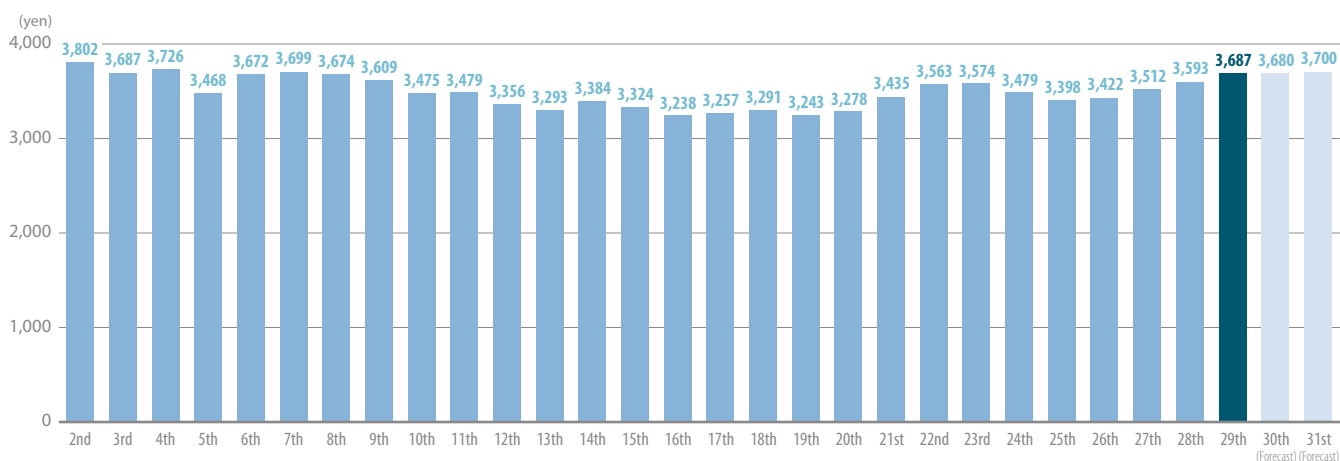
29th fiscal period dividend

**3,687 yen per unit**

29th fiscal period end

**4.4 %**

{{(Dividend / Days × 365) / Unit price  
(as of February 28, 2019)}}



\* FRC implemented a 5-for-1 split of its investment units with March 1, 2014 as the effective date. Dividend per unit indicates the value after the 5-for-1 split.

Figures in parentheses indicate the value before the 5-for-1 split.

## Fukuoka REIT

# Portfolio Overview



### Canal City Hakata

One of the largest entertainment-type retail facilities in Japan and comprising United Cinemas and others



### Canal City Hakata-B

One of the largest entertainment-type retail facilities in Japan and comprising Grand Hyatt Fukuoka and others



### Park Place Oita

A leading retail facility in the Oita area, providing "park entertainment" for families



### SunLive City Kokura

One of the largest malls in Kitakyushu and anchored by a SunLive supermarket chosen by local consumers



### Konoha Mall Hashimoto

A community-based retail facility with SunLive as its anchor tenant and directly connected to Hashimoto Station via a pedestrian bridge



### Square Mall Kagoshima Usuki

A retail facility in Kagoshima, designed by John Jerde who designed Canal City Hakata and Roppongi Hills



### Kumamoto Intercommunity SC

Located along a major arterial road and comprising Sports Depo, Golf 5 and Starbucks coffee



### Hanahata SC

Located in a new residential area and comprising BON REPAS supermarket and Matsumoto Kiyoshi drug store



### Kurume Higashi Kushiwara SC

Located on a corner of a heavy-traffic intersection and comprising Sports Depo and Golf 5



### K's Denki Kagoshima

Having a large floor area and tenanted by an electric appliance store widely attracting customers from nearby cities



### Marinoa City Fukuoka (Marina Side Building)

Located east of Marinoa City Fukuoka and has stable attractiveness through synergy with the Outlet building



### Canal City Business Center Building

An office building expected to exert synergy with Canal City Hakata, with showroom functions



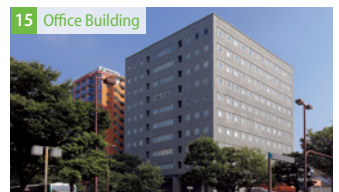
### Gofukumachi Business Center

An office building facing major arterial roads Meiji-dori Street and Taihaku-dori Street, and directly connected to Gofukumachi Station on the city subway



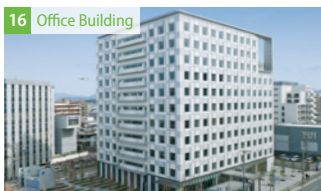
### Sanix Hakata Building

A highly-convenient, station-front office building that is a two-minute walk from Hakata Station



### Taihaku Street Business Center

Good location along Taihaku-dori Street, a two-minute walk from Gion subway station and ten-minute walk from Hakata Station



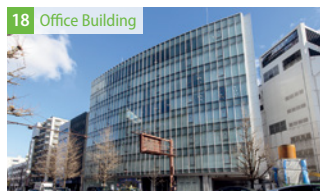
### Higashi Hie Business Center

Directly connected to Higashi Hie subway station, a two-minute ride to Hakata Station and three-minute ride to Fukuoka Airport



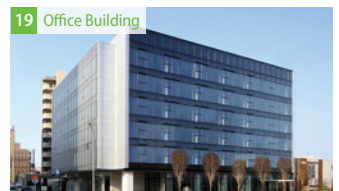
### Tenjin Nishi-Dori Center Building

An office building facing Tenjin Nishi-dori Street where commercial facilities are concentrated



### Tenjin North Front Building

A relatively new office building scarce in the Tenjin area that features Kyushu's largest integration of urban functions



### Higashi Hie Business Center II

Directly connected to Higashi Hie subway station, a two-minute ride to Hakata Station and highly recognized for its excellent business continuity plan (BCP)



### Amex Akasakamon Tower

A tower-type rental condominium near downtown Fukuoka, with traffic convenience and environment that matches a wide range of generations



### City House Keyaki Dori

A high-quality rental condominium in a popular residential area of Fukuoka, featuring traffic and living convenience



### Aqualia Chihaya

A rental condominium comprised of units mainly for singles and small families to match the local characteristics



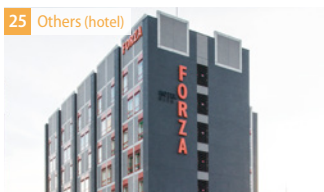
### D-Wing Tower

A large, high-rise (20-story) rental condominium, approximately a seven-minute walk from Tenjin subway station





**24 Others (residence)**  
**Granfore Yakuin Minami**  
A rental condominium in the Yakuin/Hirao area that is popular among younger generations and has plentiful bus networks



**25 Others (hotel)**  
**Hotel FORZA Oita**  
A business hotel located walking distance from Oita Station and specialized for lodging to meet business needs



**26 Others (hotel)**  
**Tissage Hotel Naha**  
A hotel in Naha City, Okinawa Prefecture located a 10-minute car ride from Naha Airport. Guestrooms are of sufficient size and quality to take in leisure demand.



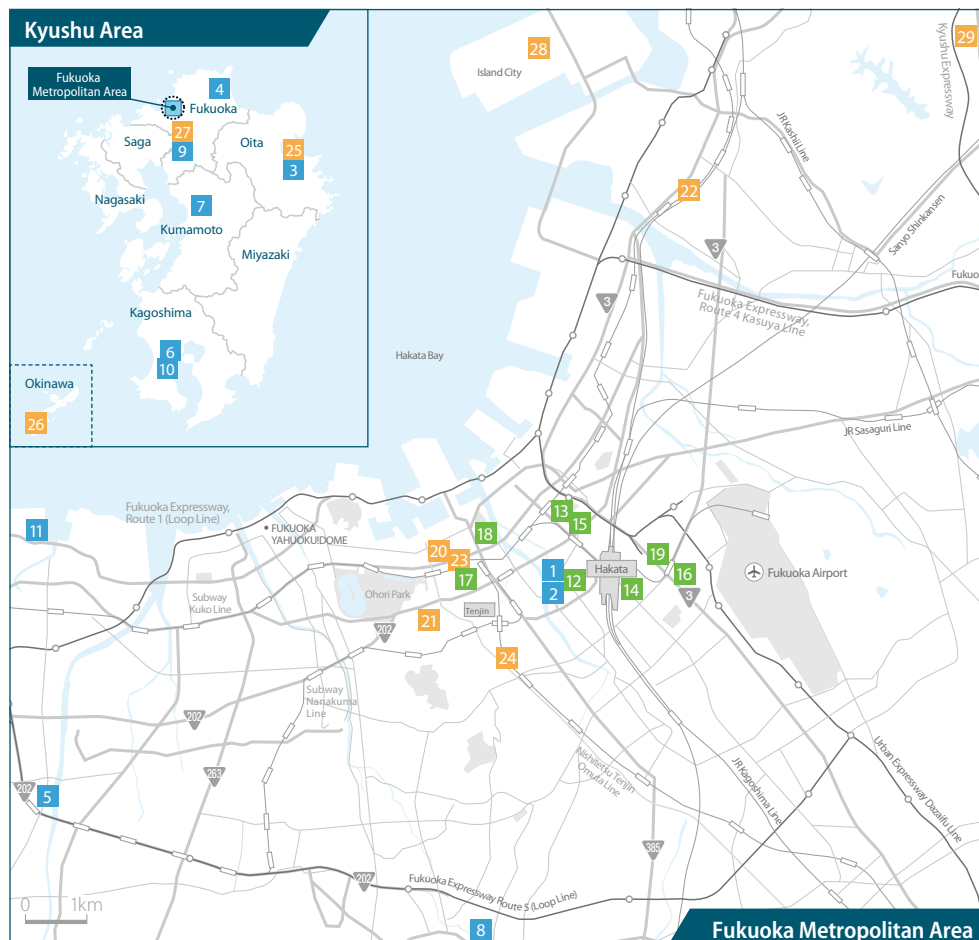
**27 Others (logistics)**  
**Tosu Logistics Center**  
A logistics facility located in the Green Logistics Park Tosu, operating around the clock and with three temperature zones



**28 Others (logistics)**  
**LOGICITY Minato Kashii**  
A logistics facility among the largest in the Fukuoka area, with a location featuring traffic convenience and concentration of such facilities



**29 Others (logistics)**  
**LOGICITY Hisayama**  
Approximately 5 km from the Fukuoka Interchange featuring traffic convenience, and has good general-purpose capabilities



## Fukuoka REIT

# External Evaluation

### GRESB survey

Received the ratings of "Green Star" and "4 stars" in first time participation in GRESB 2019.



### Green Building certificate acquisition ratio [as of August 31, 2019]

Green Building certification obtained for 68.7% of entire portfolio



#### DBJ Green Building certification

total of **9** properties



#### BELS

total of **4** properties



# J-REITs Active in the Fukuoka City Residential Market

Fukuoka City is experiencing a robust rise in momentum due to inbound tourism and urban revitalization achieved through efforts such as being designated a National Strategic Special Zone for Global Startups & Job Creation and a Green Asia International Strategic Comprehensive Special Zone, as well as initiatives like the Tenjin Big Bang project, a project to make Hakata Port able to handle the world's largest cruise ships, the extension of the Nanakuma subway line and other projects. Growth is also being promoted by various initiatives including measures to attract businesses and promote residency. These combined have led to the increase in population inflow being ranked seventh among municipalities throughout Japan in a 2018 survey with a net migration of 6,138 people.

## Ranking of Municipality by Net Migration (2018)

Rank	Municipality	Net migration
1	Special wards of Tokyo (Tokyo)	60,909
2	Osaka City (Osaka Prefecture)	12,081
3	Saitama City (Saitama Prefecture)	9,345
4	Kawasaki City (Kanagawa Prefecture)	8,342
5	Sapporo City (Hokkaido)	8,283
6	Yokohama City (Kanagawa Prefecture)	8,187
7	<b>Fukuoka City (Fukuoka Prefecture)</b>	<b>6,138</b>
8	Nagareyama City (Chiba Prefecture)	4,381
9	Funabashi City (Chiba Prefecture)	3,499
10	Kawaguchi City (Saitama Prefecture)	3,432

Source: Ministry of Internal Affairs and Communications "Results of Internal Migration in 2018"

## Average Occupancy of J-REIT Assets (residences) in Fukuoka City: 97.2%

### List of Properties (residences) in Fukuoka City Owned by J-REITs

#### Fukuoka REIT Corporation

\*Occupancy indicates figures as of February 28, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Amex Akasakamon Tower	Chuo Ward, Fukuoka City	98.8	2,060	4,821.25	66
City House Keyaki Dori	Chuo Ward, Fukuoka City	95.6	1,111	2,710.86	40
Aqualia Chihaya	Higashi Ward, Fukuoka City	99.3	1,280	5,619.69	104
D-Wing Tower	Chuo Ward, Fukuoka City	95.0	2,800	7,187.59	131
Granfore Yakuin Minami	Chuo Ward, Fukuoka City	98.0	1,100	2,496.06	97

#### Advance Residence Investment Corporation

\*Occupancy indicates figures as of January 31, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
RESIDIA Hakata	Hakata Ward, Fukuoka City	97.5	1,220	3,855.60	155
RESIDIA Tenjin-Minami	Chuo Ward, Fukuoka City	94.6	936	3,009.45	56
RESIDIA Hakataeki-Minami	Hakata Ward, Fukuoka City	97.4	324	1,564.59	39
RESIDIA Nishijin	Sawara Ward, Fukuoka City	98.7	2,380	7,187.43	173
RESIDIA Takamiya	Minami Ward, Fukuoka City	100.0	488	1,556.02	51
RESIDIA Tenjin	Chuo Ward, Fukuoka City	97.7	1,122	3,102.88	88
RESIDIA Yakuin-Oodori	Chuo Ward, Fukuoka City	98.9	1,123	3,186.00	91
RESIDIA Hakata II	Hakata Ward, Fukuoka City	97.4	1,358	3,500.50	124
RESIDIA Kego	Chuo Ward, Fukuoka City	94.3	834	2,162.65	86

#### HEIWA REAL ESTATE REIT, Inc.

\*Occupancy indicates figures as of May 31, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
HF HIRAO RESIDENCE	Minami Ward, Fukuoka City	97.9	1,780	6,262.12	200
HF KYUDAIYOINMAE RESIDENCE	Hakata Ward, Fukuoka City	92.6	426	1,525.09	47
HF HAKATA-HIGASHI RESIDENCE	Hakata Ward, Fukuoka City	100.0	880	2,486.82	78

#### Japan Rental Housing Investments Inc.

\*Occupancy indicates figures as of March 31, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
willDo Nakasu	Hakata Ward, Fukuoka City	99.4	2,460	5,759.40	175
Renaissance 21 Hakata	Hakata Ward, Fukuoka City	100.0	1,500	4,010.95	109
Granpark Tenjin	Chuo Ward, Fukuoka City	99.3	4,698	14,299.21	341

#### Kenedix Residential Next Investment Corporation

\*Occupancy indicates figures as of January 31, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
KDX Shimizu Residence	Minami Ward, Fukuoka City	96.2	1,680	6,255.16	148
KDX Residence Tenjin-higashi II	Hakata Ward, Fukuoka City	100.0	680	2,602.53	63
KDX Residence Nishi Koen	Chuo Ward, Fukuoka City	94.9	763	2,522.16	36
KDX Residence Hirao Josui-machi	Chuo Ward, Fukuoka City	96.2	760	2,098.68	24
KDX Residence Ohori Harbor View Tower	Chuo Ward, Fukuoka City	91.6	4,606	11,855.63	212
KDX Residence Nishijin	Sawara Ward, Fukuoka City	96.6	1,600	4,472.72	128

#### marimo Regional Revitalization REIT, Inc.

\*Occupancy indicates figures as of June 30, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Artiza Hakata PREMIER	Hakata Ward, Fukuoka City	97.4	1,060	3,804.39	117
Artiza Hakataeki-Minami	Hakata Ward, Fukuoka City	100.0	500	1,691.50	66

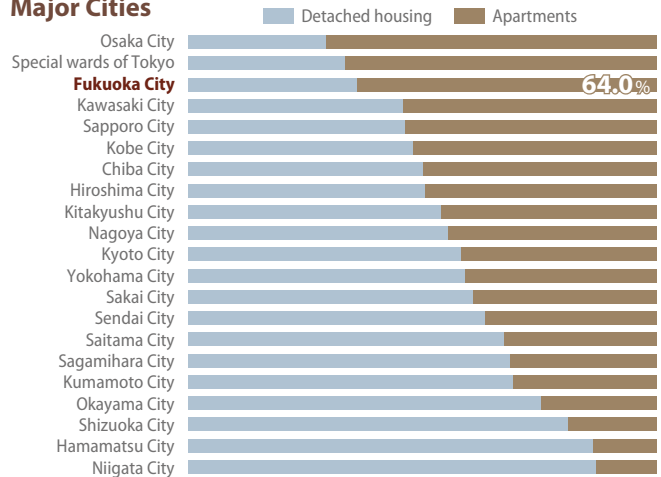


As of August 2019, thirteen J-REITs have residential properties in Fukuoka City. The number of properties totals 48 while the value totals 75.395 billion yen when based on acquisition price, and the leasable floor area totals 237,000 square meters.

Fukuoka City is characterized by its high ratio of apartments compared to other major cities. Its ratio of apartments in total floor area of new dwelling construction starts is 64.0%, which only lags behind Osaka City (70.6%) and the special wards of Tokyo (66.7%) according to a comparative statistical table of large cities for 2017. As the city boasts a large population inflow, J-REITs having residential properties in Fukuoka City also boast a high average occupancy rate of 97.2%.

The residential market of Fukuoka City is expected to continue to be strong as the city government works to attract businesses and promote emigration toward the Tenjin Big Bang.

### Ratio of Apartments to New Detached Housing in Major Cities



Source: The Large Cities Statistical Council "Comparative Statistical Table of Large Cities for 2017"

#### Nippon Accommodations Fund Inc.

\*Occupancy indicates figures as of February 28, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Park Axis Ropponmatsu	Chuo Ward, Fukuoka City	100.0	1,515	3,473.67	112
Park Axis Hakataeki Minami	Hakata Ward, Fukuoka City	98.5	1,890	4,668.29	177
Park Axis Naka Gofukumachi	Hakata Ward, Fukuoka City	99.1	742	2,707.88	112
Park Axis Hakata Minoshima	Hakata Ward, Fukuoka City	99.1	960	3,461.85	112
Park Axis Takamiya Higashi	Minami Ward, Fukuoka City	100.0	605	2,289.21	70

#### NIPPON REIT Investment Corporation

\*Occupancy indicates figures as of June 30, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Ciel Yakuin	Chuo Ward, Fukuoka City	87.7	640	1,544.87	39

#### Nomura Real Estate Master Fund, Inc.

\*Occupancy indicates figures as of February 28, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
PRIME URBAN Hakata	Hakata Ward, Fukuoka City	96.9	588	2,176.23	NA
PRIME URBAN Yakuin Minami	Chuo Ward, Fukuoka City	97.2	265	897.84	NA
PRIME URBAN Kashi	Higashi Ward, Fukuoka City	97.3	398	1,222.34	NA
PRIME URBAN Hakata Higashi	Hakata Ward, Fukuoka City	97.7	622	1,854.13	NA
PRIME URBAN Chihaya	Higashi Ward, Fukuoka City	98.0	604	1,740.70	NA

#### Samty Residential Investment Corporation

\*Occupancy indicates figures as of January 31, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
S-FORT Chikushi Dori	Hakata Ward, Fukuoka City	98.9	1,170	3,706.56	90
S-FORT Fukuoka Kencho Mae	Hakata Ward, Fukuoka City	96.1	979	2,566.72	104
S-FORT Takamiya	Minami Ward, Fukuoka City	98.8	794	2,105.13	82
S-FORT Fukuoka Higashi	Hakata Ward, Fukuoka City	93.9	1,900	5,584.41	135
S-FORT Hakata-Higashi I	Hakata Ward, Fukuoka City	88.8	389	1,034.20	35
S-FORT Hakata-Higashi II	Hakata Ward, Fukuoka City	94.4	382	1,034.20	35

#### Sekisui House Reit, Inc.

\*Occupancy indicates figures as of April 30, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Esty Maison Hakatahigashi	Hakata Ward, Fukuoka City	98.9	2,400	9,106.08	NA
Esty Maison Kamigofuku	Hakata Ward, Fukuoka City	97.0	821	2,261.91	NA
MAST Hakata	Hakata Ward, Fukuoka City	100.0	2,360	9,614.80	NA
Prime Maison Momochihama	Sawara Ward, Fukuoka City	100.0	1,940	7,514.76	NA
Prime Maison Teriha	Higashi Ward, Fukuoka City	100.0	1,260	6,728.20	NA
Esty Maison Yakuin	Chuo Ward, Fukuoka City	96.3	2,430	5,213.51	NA
Prime Maison Central Park	Higashi Ward, Fukuoka City	93.1	2,309	10,268.74	NA
MAST Ijiri	Minami Ward, Fukuoka City	100.0	390	1,430.60	NA

#### Starts Proceed Investment Corporation

\*Occupancy indicates figures as of April 30, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Proceed Fukuoka Takamiya	Minami Ward, Fukuoka City	96.9	453	1,312.29	46

#### XYMAX REIT Investment Corporation

\*Occupancy indicates figures as of February 28, 2019

Property	Location	Occupancy (%)	Acquisition price (million JPY)	Leasable floor area (m <sup>2</sup> )	No. of units
Renaissance 21 Chihaya	Higashi Ward, Fukuoka City	95.1	2,700	10,287.93	138

# Infrastructure Funds

## Current Situation and Outlook

by **HIROYUKI SAKAIDA**

Head of Research / Senior Analyst  
Macquarie Capital Securities (Japan) Limited

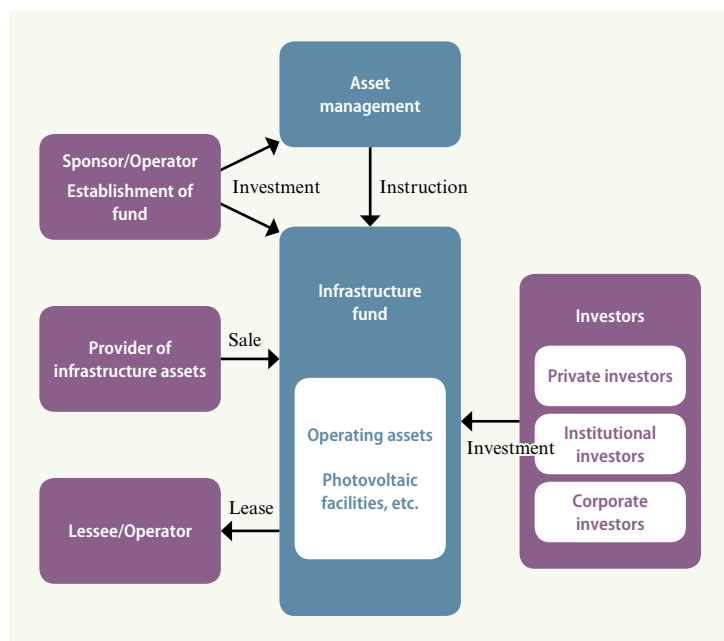
Hiroyuki Sakaida joined Macquarie in 2017 and covers Japan utilities and infrastructure funds, and also leads the equity research department in Japan. He has 25+ years' experience as an equity analyst and has been covering the utilities sector for 19 years since 2000. Hiroyuki also has experience in covering energy, materials, trading companies and transportation sectors at several firms including Nomura Securities and Goldman Sachs. Thomson Reuters StarMine Awards ranked him as one of the three top earnings estimators between 2010 and 2017 including three times at No. 1. Hiroyuki holds a Master of Engineering in Nuclear Engineering from the University of Tokyo.

### Infrastructure fund scheme

The Tokyo Stock Exchange (TSE) created an infrastructure fund market in April 2015. Infrastructure funds have a structure similar to J-REITs and the dividends are tax deductible, which makes them effectively exempt from corporate tax (just as J-REITs), if they meet the conduit criterion of paying a dividend that corresponds to more than 90% of profits available for dividends. Meanwhile, a major difference with J-REITs is investment in infrastructure including solar power facilities, operating rights of public facilities, roads and airports, rather than investment in real estate.

Figure 1 presents the general scheme used by infrastructure funds. The infrastructure fund and asset management firm are separate corporations, just as with J-REITs. Infrastructure funds often purchase solar power assets owned by a sponsor, and the sponsor and asset provider indicated in the figure are the same entity in this scenario.

Figure 1: Structure of Infrastructure Fund



Source: Tokyo Stock Exchange, Macquarie Research



**Figure 2: Overview of the Six Infrastructure Fund Stocks**

Fund Name	Takara Leben Infrastructure Fund	Ichigo Green Infrastructure Investment Corporation	Renewable Japan Energy Infrastructure Fund	Canadian Solar Infrastructure Fund	Tokyo Infrastructure Energy Investment Corporation	ENEX Infrastructure Investment Corporation
Panel output (MW)	72.0	29.4	68.5	108.9	20.1	37.6
Dividend yield (annualized)	5.94%	5.93%	6.74%	7.05%	7.05%	6.43%
Market cap (million JPY)	16,144	6,219	14,701	23,951	4,489	8,503
Latest stock price (JPY)	116,500	60,400	95,000	103,600	97,500	92,600

(Stock price as of Aug 14, 2019 market close)

Source: Company data, Bloomberg, Macquarie Research

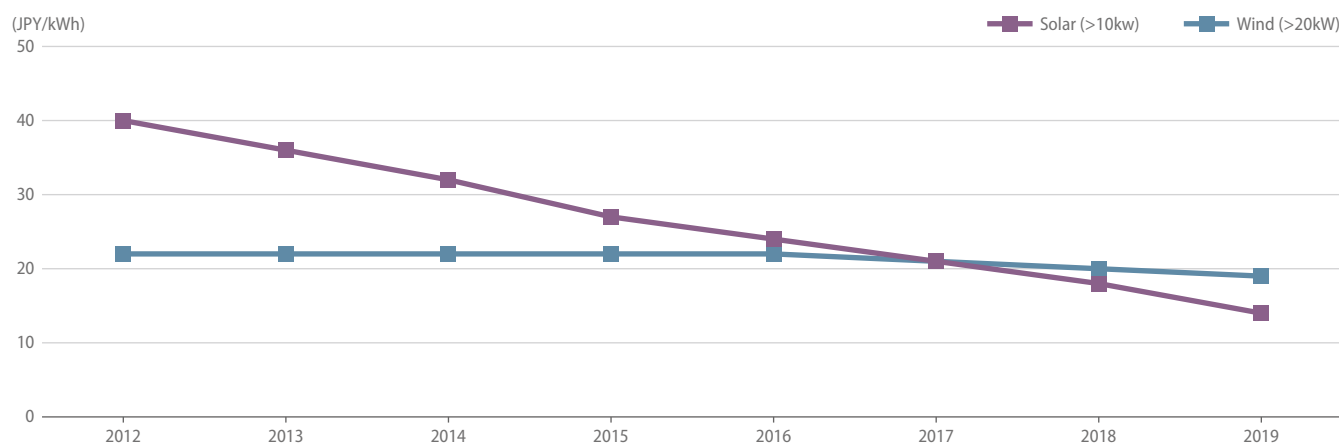
Six infrastructure funds have listed on the market since the listing of Takara Leben Infrastructure Fund as the first listed infrastructure fund in June 2016 (Figure 2). All of these funds invest in solar power facilities under the Feed-in Tariff (FIT) program and are investments that offer stable high yield (6-7% as shown in the table) to investors.

### Feed-in Tariff (FIT) system

The Japanese government adopted the FIT program for renewable energy in 2012. Under this program, electric power companies purchase electricity generated by renewable energy sources at a predetermined price during a fixed period. The program supports deployment expenses for renewable energy facilities with high electricity generation costs via society as a whole by having electric power companies purchase electricity generated with renewable energy at high prices that make it profitable and then broadly collecting a levy on electricity consumers to fill the difference in generation costs with electricity generated from other sources besides renewable energy.

In the case of solar power facilities, the FIT program arranges the purchase of electricity generated by large sites that have at least 10kW in output at a fixed price over 20 years. While the purchase price started at a high level of ¥40/kWh (not including consumption tax) in the fiscal year ending March 2013 when Japan initially implemented the FIT program, authorities have quickly lowered the price thereafter. In the fiscal year ending March 2000, the purchase price for facilities with 10kW to 500kW in output is ¥14/kWh and for large-scale facilities with over 500kW in output is decided through a bidding process. The upper limit purchase price set at a bidding in 2018 was lower than the purchase price for smaller facilities, so a similar tendency is expected in 2019.

The government has recently been discussing revisions to the FIT program itself. An interim plan outlined by a Ministry of Economy, Trade and Industry (METI) council on August 5, 2019 cites the need for fundamental changes to the FIT program. We expect continuation of a moderate downward trend in the electricity purchase price for new renewable facilities, because the government wants to decrease consumer burdens while promoting continuous investment in renewables.

**Figure 3: FIT Purchase Prices**

Source: METI, Macquarie Research

## FIT price reduction and output curtailment in Kyushu are not major concerns

While authorities have been lowering the FIT purchase price as explained above, these reductions only apply to new facilities. For example, in the case of existing facilities that have already started operating at a ¥32/kWh purchase price, the price stays at ¥32/kWh from the time of launching operations until 20 years later. Even unfinished projects given high purchase prices from a few years ago can sustain the initial high purchase price for 20 years after beginning operations if they meet certain conditions. This scheme contributes to steady profits and distributions at infrastructure funds. We expect the stable distributions to continue going forward.

In October 2018, Kyushu Electric Power implemented the curtailment of solar power facility output in Kyushu mainland, which was the first case in Japan excluding outlying islands. It applied these output controls again in 2019, mainly during March to May. Electric power firms typically reduce thermal power output in the spring and fall when there is less power demand to bring supply and demand in line with each other. If electricity supply volume is still excessive after these thermal adjustments, they instruct renewable energy business operators to curtail electricity output from renewable energy sources. The Kyushu region has 8,530MW of solar power facilities, a supply capacity that roughly equals electricity demand at about noon in the spring and fall (7,000 – 9,000MW). Electric power firms utilize surplus electricity in various ways, including absorption by pumped hydro storage power facilities and transmission to other regional areas through cross-regional interconnection lines. When supply remains too large even with these actions, electric power firms need to issue instructions for renewables operators to curtail operations and reduce solar power output.

According to estimates by Renova, which operates solar power facilities, however, the actual curtailment through output controls should only average 4-5% over 20 years even in the case of projects that could be subject to limitless curbing. We think the actual impact on infrastructure fund income should be even smaller because many power generation facilities currently owned by infrastructure funds place a limit on the number of output curtailment times, such as 30 days a year, and output curtailment is less likely in areas like the Greater Tokyo and Kansai

region (Osaka and its neighbouring area) with larger electricity demand than in the Kyushu region. We hence do not anticipate a major impact on infrastructure fund distributions by the output curtailment.

## Key issues: improved liquidity and setting up an index

Japan currently has six listed infrastructure funds. Liquidity, however, is an issue in this market with even Canadian Solar Infrastructure Fund (CSIF), the largest fund, at just ¥23.9 billion and combined value for the six funds at only ¥73.7 billion. Nevertheless, we expect steady expansion of individual stock market caps accompanying capital increases through public offerings and hence improvement in liquidity over time because infrastructure funds frequently do public offerings to acquire additional assets, similar to J-REITs. CSIF, for example, currently owns assets with 108.9MW in power generation capacity versus pipeline assets owned by the sponsor (Canadian Solar Projects K.K.) at 339.5MW, which is three times more than CSIF's existing assets. It has outlined a policy of aiming for ¥100 billion in total asset value over the medium term. We estimate that CSIF could roughly double its net asset scale to about ¥50 billion in this scenario assuming acquisition of new assets through capital increases while maintaining the existing balance-sheet structure.

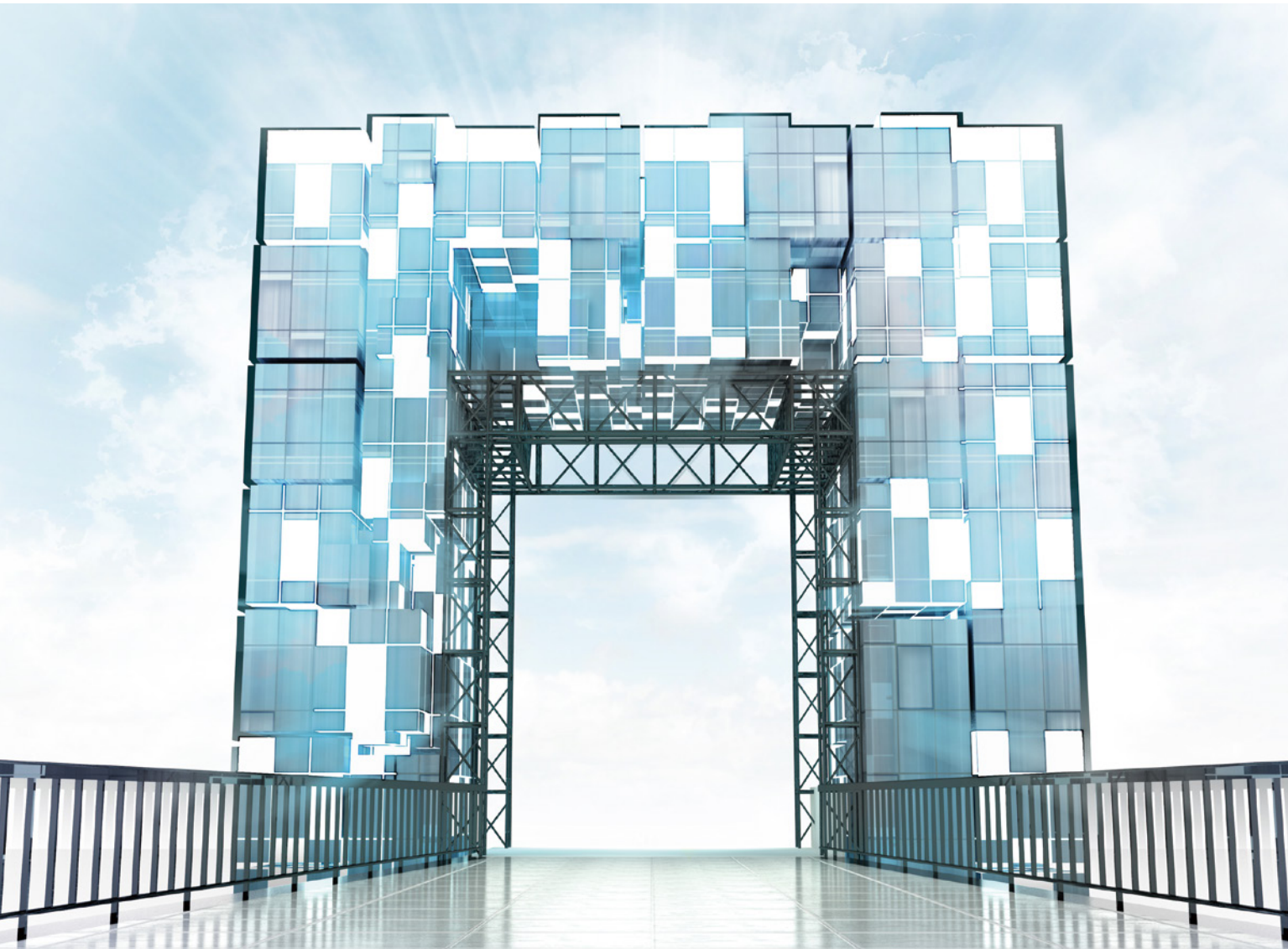
Establishment of a stock index is an important issue, too. We think the presence of an index would facilitate comparison with benchmarks and also help expand the investor scope for infrastructure funds.







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