Nippon Accommodations Fund Inc.

38th Period (September 2024 – February 2025) Investor Presentation

Q&A

Q As far as the Investment Corporation's DPU growth target of 2 to 3% on Page 25 of the Investor Presentation (hereafter, the "Presentation") is concerned, NAF achieved 3.1% per year over the past three years primarily on the back of internal growth. Amid an accelerating pace at which rents are rising, however, do you feel you will be able to steadily reach this target, or do you feel you will need to do something additional given increasing costs and other circumstances?

A Although we presented a future target of 2 to 3% based on the average growth rate of 3.1% that we achieved over the past three years, we do not intend to engage in activities that completely differ from those of the past in order to reach this target. First and foremost, our most important objective is to firmly realize internal growth. Although the percentage increase in rents at the time of tenant turnover stood at 7.7% during the 38th period, we actually recorded a rate of approximately 10% on a monthly basis in February and March. We feel the outcomes of our efforts to more aggressively increase rents at the time of renewal will begin to emerge around the middle of the current year. We also aim to maximize NOI by securing a good balance between key money and renewal fees. Meanwhile, we were able to carry out external growth by using the cash generated through depreciation to secure a yield that exceeds the implied cap rate for four properties over the past two periods. Although the greatest factor among the various cost increases here was interest, we intend to achieve growth of 2 to 3% by using a combination of internal growth and external growth to cancel out these higher costs.

Q What are your priorities for the four uses for cash regarding cash management on Page 28 of the Presentation?

A We intend to prioritize the four uses of cash based on what will contribute the most to unitholder value from a medium- to long-term perspective as we observe the market. Taking a look first at the repayment of debt, although we will refinance as the repayment deadline for a certain amount of debt arrives each period, considering the current financial environment and the investment corporation's LTV level, we do not believe that simply making on-time payments to lower the LTV will be a highly effective use of cash. Which is why we basically intend to refinance our debt. Meanwhile, as far as CAPEX is concerned, some of our aging properties will require investments for the large-scale repairs necessary to preserve these buildings as well as to maintain and increase rents. Funds are also required for capital expenditure. We believe that acquiring carefully selected properties and implementing buybacks are both effective, and that these are valuable means of using cash if there are investment opportunities that will expand unitholder value over the medium- to long-term, naturally with an awareness of the implied cap rate. If we were to assume there are no meaningful investment opportunities, then, depending on the unit price, we also feel that buybacks would be another extremely effective use of cash.

Q As far as the growth targets on Page 25 of the Presentation are concerned, I believe NAF will generate this growth through a combination of financial cuts and external growth over the short term, with the likelihood that internal growth outcomes will emerge thereafter. Can you tell us about the Investment Corporation's assumptions regarding the timing that this internal growth will contribute to DPU growth?

A We recognize there is a time lag between the timing of interest and other cost hikes compared with the pace at which the top line will grow. According to the performance expectations we recently released, we foresee the 40th period DPU coming in slightly above the results for the 38th period. Although these expectations are somewhat conservative in certain respects, due to this time lag, it is not clear whether growth of 2 to 3% can be achieved soon after a year. The figure will more likely come in around 2% through internal growth. Looking ahead two to three years, however, we feel that internal growth will have an effect on DPU of around 3%.

Q Please tell us if there is any interest cost simulations or sensitivity. For example, have you estimated the impact that an additional 10 basis points would have on current procurement costs on a dividend basis?

A At its regular pace, the Investment Corporation refinances about ¥20 billion per year. If we were to assume interest rates rose 1% during refinancing, this would increase interest payments by ¥200 million per year, amounting to around 2% of the ¥11 billion in net income the Investment Corporation records annually.

Q Looking at the Appraisal Value data in the Presentation, there are a number of properties where the appraisal cap rate has increased 10 basis points. Can we assume that this is transitory and takes into account the aging process?

A Appraisal companies typically increase the appraisal cap rate 10 basis points after a property reaches a certain age. Accordingly, we assume that the higher cap rate for several properties this time around is for this reason, transitory. I believe the gist of your question points to whether there is a trend toward higher cap rates in light of higher interest rates and other factors besides age, but we do not believe this is the case. Although the risk free rate is rising due to higher interest rates, the rent for every type of asset is also on the upswing, which the real estate appraisers are also likely taking into consideration when they determine the cap rate and discount rate. During times when rent increases are clearly foreseeable, we believe it is possible for the cap rate to remain stable, or even decline, despite any small increases in the risk free rate. At present, it is our understanding that, aside from the factor of age, the cap rate will remain nearly flat when taking both the risk free rate and higher rents into consideration.

Q As far as NAF's operating policy going forward on Page 25 of the Presentation is concerned, the current dividend yield for the Investment Corporation has fallen below 4%, which is a level that stands about 1% below the J-REIT average. It seems that since the DPU growth rate over the past three years was 3.1% annually, NAF's new growth target of 2 to 3% per year is, in fact, a dividend cut against the backdrop of worsening inflation. Looking at the balance sheet, however, the unrealized asset profit rate will increase to 58.7%, the highest level of any REIT. Taking this into consideration, if you do not present a higher DPU growth target that also considers the return of gains on disposal using every management resource, I do not believe your target will lead to higher investment unit prices. What are your thoughts in regard to this?

A I believe your question is about our stance regarding the disposition of properties amid high unrealized gain rates. From a disposal perspective, I am not denying that. We constantly focus on the standing of each property, and regularly investigate approaches to increasing EPU, including disposing of any properties that lack future potential, as well as two-way asset transactions with sponsors. At present, however, the situation does not offer any properties that simply need to be sold in the short-term. Simply achieving unrealized gains through disposition would have a negative impact on future EPU growth through the loss of NOI due to disposition. If we were to dispose of properties, we would also acquire replacement properties whenever possible, and focus on those replacement properties that contribute to future EPU growth. Turning to your comment about this approach losing out to inflation, we will acquire slightly older properties at a higher yield than the implied cap rate, and improve their value as a means of realizing growth. At the same time, however, by making replacement transactions that dispose of properties while acquiring these kinds of older properties, we will increase internal growth-based DPU growth to above 3%, which we believe will allow us to operate the REIT in a way that is unaffected by inflation.

Q As far as updating the calculation method for asset management fee II on Page 28 of the Presentation is concerned, NAF will switch from distributable profits × 5% to distributable profits × EPU × 0.0019%. Did the Investment Corporation set this 0.0019% to approach the 5% of the original calculation method? Or, does distributable profits × EPU × 0.0019% and including distributable profits twice serve to align the target of maximizing EPU for both the Investment Corporation and the asset management company? Can you explain the background to this change?

A We plan to make this change following approval at the upcoming general unitholders' meeting, but the 0.0019% figure, as you pointed out, was set by calculating backwards based on past performance so that the fee value comes in at the same level as the fee value based on the original calculation. Without question, the recent proposal for updating the calculation formula aims to better link the profits of the unitholders and the asset management company. With the original fee calculation method, which is only linked to distributable profits, even if we were to, for example, make a capital increase to dilute capital–although we have no intention of doing so–EPU would remain steady despite higher profits, which would cause an unusual situation where asset management fees alone would rise. We feel EPU is extremely important in that we need to avoid this kind of situation and increase EPU in a way that contributes to higher profits for unitholders by also raising unit prices in the future. We therefore proposed changing to an asset management fee structure that enables further growth in profits for unitholders to align with the fees received by the asset management company.

Q Construction costs are skyrocketing at present. What is your outlook for the future risk of rising repair expenses and costs involved in restoring units to their original state?

A Although we will naturally be affected by rising construction costs, the Investment Corporation is involved in the rental business, so engages in repair work instead of new building construction. Repair work does not incur any of the major temporary construction required for new construction projects, for example, so the impact of any major cost increases seen with new building or condominium construction will be limited in the case of repair work.

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