Summary of Merger Q&A Session

Date: June 14, 2023

Question 1

Please explain the background of the merger. Kenedix Office Investment Corporation (KDO) was founded as a diversified REIT and once converted into an office specialized REIT. What is the background of the significant change in policy, and what made you decide to once again become a diversified REIT?

Answer 1

The environment surrounding REIT management is changing at an unexperienced pace. We are going through changes in social structures and economic situation such as rising interest rates and inflation. Under such circumstances, the investment unit prices of the 3 REITs have fallen below NAV, which is one of the reasons that triggered us to consider the merger from around January to February of this year. KDO had been converted into a specialized REIT based on our thought that specialized REIT would be more accepted by investors than diversified REIT. While we think that the current mid-sized office environment is not that bad, we believe that to cope with future environmental changes, seeking sustainable growth with flexibility will contribute to further unitholders' interests. That is why we have decided to once again convert KDO into a diversified REIT. In addition, we thought that more investors will accept this decision now than before since the diversified REITs account for about 50% of J-REIT market capitalization now.

Question 2

Please explain the policy regarding asset reshuffling and AUM expansion after the merger. Up until now, KDO has focused on asset reshuffling, while Kenedix Residential NEXT Investment Corporation (KDR) and Kenedix Retail REIT Corporation (KRR) have focused on external growth. What growth strategy do you plan for the New REIT?

Answer 2

It will depend on investment unit price and NAV of the New REIT, but for the time being we will focus on asset reshuffling after the merger. While DPU level after the merger will change depending on how positive or negative goodwill is recorded, we plan to increase DPU by utilizing retained earnings and gain on sales of properties. We will increase acquisition opportunities through asset reshuffling across different asset types and enhance profitability through investing in assets with growth potential, which also leads to the merger rationale.

Question 3

What asset types do you intend to focus acquiring after the merger? Will the focus be on properties such as logistics and hotels that have not been invested before?

Answer 3

We understand the recent negative view on office market based on the oversupply of new office spaces, so we consider selling some of our offices while acquiring assets with growth potential such as hotels and logistics.

Question 4

Since there is no target ratio by asset types in the New REIT's growth strategy, it seems that the asset manager has the discretion about the ratio. To what extent of office ratio in the portfolio do you think is acceptable compared to 38.7% as of the date of the merger?

Answer 4

Although we mentioned selling offices in the context of asset reshuffling, the occupancy rates of our mid-sized offices remain high, so we do not view the current situation negatively, and do not think the current office ratio is too high. On the other hand, our pipeline consists of a large number of hotels and logistics facilities, so we assume that the portion of office will decline as we acquire the pipeline assets. However, we would like to acquire mid-sized office buildings if we have opportunities because expanding our growth opportunities is one of our aims of the merger.

Question 5

Looking at the closing unit price of KDR as of the merger announcement date, it seems to me that the merger ratio includes some discount compared to KRR. I would like your comments on your approach to the merger ratio.

Answer 5

We have discussed the merger ratio of KDO and KDR with our financial advisors and believe that it is within the fair value range. I think you have pointed out that this is a slight discount considering the recent unit price, but we are aware that the recent capital market is moving toward safer assets among subsectors, taking into account macroeconomic environment and geopolitical risks. Looking at longer-term trends, such as three- or six-month periods, we believe that 0.67 level is not low, or rather it is also an advantageous level for KDR when compared to 0.56 under the adjusted net asset value analysis. The merger will allow KDR to enjoy unrealized profits above the current level of KDR, and more than double the current retained earnings. Taking these factors into account, we consider it to be a fair value.

Question 6

As a diversified REIT with a diversified portfolio, there will be a concern about conglomerate discount. Some may say that it will be difficult to see the direction of the New REIT without a target ratio by asset types. How do you intend to communicate with the market after the merger?

Answer 6

First, we will highlight the benefits of converting into a diversified REIT. We recognize that REITs are inherently designed to meet the needs of investors seeking stable distributions. By becoming a diversified REIT, we will appeal to the market while demonstrating a track record of enhanced profitability and sustainable growth, which is one of our stated objectives. Currently, we are advocating a target of 4,000 yen in stabilized DPU, which we aim to achieve while acquiring the properties in our pipeline. After that, we aim for DPU growth of about 2% annually by means including external growth of about 10 bn yen per year. We intend to appeal that stable growth is possible even as a diversified REIT by promoting our track record in the future.

We understand the conglomerate discount, but in the case of specialized REITs, valuations tend to move the same way depending on the environment, and we may be stuck in a declining phase. However, we believe that by becoming a diversified REIT and investing in a variety of asset types, we will be capable of enhancing profitability, through means including asset reshuffling. We would like to appeal to the market that our ability to handle a variety of asset types will lead to more acquisition opportunities, taking advantage of our strength in sourcing of assets.

Question 7

How conscious are you of the DPU forecast level of 3,800 yen (after the investment unit split) for the first fiscal period ending April 2024 (post-merger)? Is this a level you can commit to some extent on achieving, or is it an effort target?

Answer 7

In KDO's financial results announced at the same time as the merger, the DPU forecast for the fiscal period ending October 2023 was 7,600 yen (before the investment unit split). KDO has been telling its unitholders that it will utilize internal reserves to stabilize DPU. For the fiscal period ending April 2024, depending on how positive or negative goodwill is recorded, as well as temporary expenses related to the merger, we would like to secure the announced DPU level by utilizing gains on sales from asset reshuffling and retained earnings. Moreover, until we achieve the stabilized DPU target, we expect to utilize gains on sales from asset reshuffling. The DPU growth range will change depending on whether we acquire assets through equity financing or debt financing. For example, if we acquire 40 bn yen of assets out of the 80 bn yen pipeline, the DPU is expected to increase by approximately 100 yen. Therefore, we will first acquire assets in the pipeline and increase DPU by 100 yen, and then by 200 yen. We would like to achieve the stabilized DPU of 4,000 yen by acquiring assets outside of the pipeline as well.

Question 8

Although you are emphasizing asset reshuffling, what level of LTV (post-merger) will you target? For example, assuming LTV of 45%, you would be able to acquire assets about 40 bn yen. Will you raise the LTV to at least that level, or will you raise the LTV to even 50%?

Answer 8

It depends on the level of the investment unit price. If equity financing is difficult, we will grow by asset reshuffling and utilizing LTV. As we mentioned at KDO's financial results announcement, we will operate with financial discipline to avoid LTV exceeding 50%, although we may allow the possibility of LTV exceeding 45% while watching the trend of investment unit price.

Question 9

Is it correct to say that if the post-merger unit price does not reach the level at which equity financing is possible, LTV will be raised to 45%, and after that level, you are going to consider how to finance, depending on the trend of the investment unit price?

Answer 9

Yes, it's correct.

Question 10

While the press release assumes negative goodwill, the presentation materials provide an explanation of both cases where positive and negative goodwill are recorded. Could you tell us about the background of the projection that negative goodwill will be recorded?

Answer 10

Since it was difficult to predict how the investment unit price will fluctuate after the announcement of the merger, the press release was calculated based on the investment unit price as of June 7, prior to the announcement of the merger, and thus negative goodwill was assumed at that time.

Question 11

On p.16 of the merger presentation material, it states that you are not limiting targeted area in Japan. Does this mean that you are considering investing in overseas assets?

Answer 11

We are not limiting targeted area in Japan, but that does not indicate a policy of investing in overseas. We have no intention to invest in overseas assets.