

Outline and Current Issues of Japanese Real Estate Investment Trust

Junko Ogushi* • Yuri Suzuki**

Contents

I. Introduction	V. Listing
II. Overview of J-REITS	1. Listing Status
1. Introduction of J-REIT System	2. Listing Requirements
2. Development of J-REITs and Challenges	3. Schedule
III. Basic Structure of J-REIT	VI. Fund Raising
1. Scheme Overview	1. Issuance of Investment Units
2. Incorporation and Registration of Investment Corporations	2. Issuance of Investment Corporation Bonds
3. Governance Structure of J-REITs	3. Loans from Financial Institutions
4. Distributions to Investors by J-REIT and Preferential Tax Treatment in Japan	VII. M&A of J-REITs
IV. Asset Manager, Asset Custodian Company, Administrative Agent and Sponsor	1. M&A of J-REITs
1. Overview	2. Procedure of Statutory Mergers of J-REITs
2. Asset Manager	3. Reform Related to Merger of J-REITs
3. Asset Custodian Company	VIII. Recent Issues
4. Administrative Agent	1. Purchase of Investment Units by the Bank of Japan
5. Sponsor	2. Amendments to the Investment Trust Law in the Near Future
	IX. Conclusion

I . Introduction

In September 2001, investment units of a Japanese real estate investment trust (“J-REIT”) were listed on the Tokyo Stock Exchange (“TSE”) for

* Partner Attorneys-at-law, Atsumi & Sakai

** Partner Attorneys-at-law, Atsumi & Sakai

the first time. Since then, the market for J-REITs has developed significantly. Although J-REITs have been affected by the financial crisis, parties involved in the business of J-REITs have tried to address issues posed by the recession following the financial crisis. Currently, the Japanese government is considering a partial reform of the J-REIT legal system in order to make J-REITs more appealing to investors and more convenient to parties involved in J-REIT businesses.

In this paper, we will first present an overview of J-REITs. Then, we will briefly explain the legal system of J-REITs which includes the basic structure of a J-REIT, the role of the asset manager of a J-REIT, listing criteria and schedule of investment units of a J-REIT, financing to a J-REIT, and M&A of J-REITs. Finally, we will discuss some of the current issues of J-REITs.

II. Overview of J-REITS

1. Introduction of J-REIT System

In 2000, the Law Concerning Securities Investment Trust and Securities Investment Corporation of Japan (Law No. 198 of 1951, as amended) was revised and renamed the Law Concerning Investment Trust and Investment Corporation (*toshi shintaku oyobi toshi hojin ni kansuru horitsu*, the “Investment Trust Law”). The Investment Trust Law permits the establishment of an investment corporation (*toshi hojin*)¹⁾ that mainly invests in real

1) An investment corporation is a corporation incorporated under the Investment Trust Law for purposes of investing its assets(*e.g.*, funds raised

properties and is commonly referred to as a “J-REIT”. In 2001, the TSE amended its listing rules to allow J-REITs to list their investment units (*toshi kuchi*)²⁾ on the TSE.

Under the Investment Trust Law, there are two types of investment vehicles: investment trusts and investment corporations. However, as of today, all J-REITs with their investment units listed on stock exchanges have been formed as an investment corporation, not as an investment trust.

2. Development of J-REITs and Challenges

On September 10, 2001, investment units of two J-REITs (Nippon Building Fund Inc. and Japan Real Estate Investment Corporation) were listed on the TSE. Since then, until 2007, the market for J-REITs has rapidly developed, and their market capitalization has increased. In October 2007, there were more than 40 listed J-REITs. In October 2008, however, a J-REIT filed a petition for insolvency proceedings, since the global recession, precipitated by the financial crisis, made it difficult to finance. The financial crisis has slowed down the J-REIT market, and thus measures were introduced to support J-REITs, followed by a series of M&As of J-REITs from 2010 to 2011. The current J-REIT market has the potential to grow again. It was reported during the year 2012 that four listings of investment units of J-REITs on the TSE were performed, one of which was accompanied by the second biggest J-REIT initial public offering to date.³⁾

by investors) in certain types of properties, including real properties. Investment Trust Law, art. 2, para. 12.

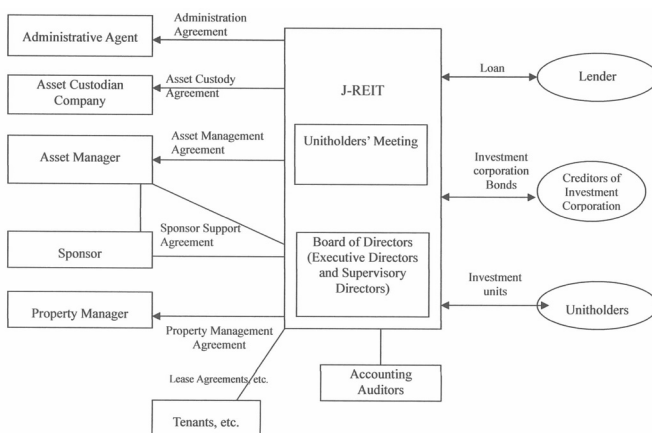
2) Investment units are equity securities of a J-REIT. Investment Trust Law, art. 2, paras. 14 and 15. *See also* Parts II and III.

3) *See* the Association for Real Estate Securitization, *ARES J-REITs Report* vol.

Ⅲ. Basic Structure of J-REIT

1. Scheme Overview

A basic overview of a J-REIT scheme is shown below in Diagram.



〈Diagram〉 J-REIT Scheme Overview

2. Incorporation and Registration of Investment Corporations

An investment corporation that is used as an investment vehicle for J-REITs is considered to be established upon registration of the investment corporation by the incorporator after preparation of all necessary formation documents and completion of certain other procedures required under the Investment Trust Law. After its establishment, the investment corporation

37(2012), available at http://www.ares.or.jp/en/pdf/ares_jreitreport_vol37_en.pdf, last visited on December 27, 2012.

must complete registration as a “registered investment corporation”⁴⁾ with the Prime Minister in order to begin investing its assets. In practice, it is more common for the sponsor to incorporate an asset manager prior to incorporation of the investment corporation, and subsequently cause the asset manager to act as the incorporator.

3. Governance Structure of J-REITs

3.1 Overview

A J-REIT is required to have the following administrative bodies: (1) unitholders’ meetings; (2) board of directors; (3) executive directors; (4) supervisory directors; and (5) an accounting auditor.⁵⁾ As an investment corporation is a vehicle for asset management, the Investment Trust Law requires an investment corporation to engage external service providers to carry out its business operations. Therefore, the above-mentioned administrative bodies of the investment corporation mainly function in a supervisory role to oversee performance by such service providers.

3.2 Unitholders’ Meetings

The unitholders’ meeting is a decision-making body within an investment corporation that consists of all its unitholders, and is permitted to vote only on matters provided in the Investment Trust Law or matters specified in its articles of incorporation.⁶⁾ Unitholders supervise the J-REIT by exercising

4) Investment Trust Law, art. 2, para. 13.

5) Investment Trust Law, art. 95.

their voting rights at unitholders' meetings. On the other hand, because an investment corporation is only an investment vehicle, unitholders cannot be expected to actively exercise their voting rights at these unitholders' meetings. For this reason, the Investment Trust Law provides that an investment corporation may stipulate in its articles of incorporation that if any unitholder does not attend the unitholders' meeting to vote and does not exercise their voting rights in writing, said unitholder shall be deemed to have agreed to the proposal submitted at that respective unitholders' meeting.⁷⁾

3.3 Board of Directors (Executive Directors and Supervisory Directors) and Accounting Auditor

The board of directors of a J-REIT consists of both executive directors and supervisory directors.⁸⁾ In addition to the powers conferred to it under the Investment Trust Law and the articles of incorporation, the board of directors is responsible for supervising the performance of its executive directors.⁹⁾

Executive directors, supervisory directors and accounting auditors are elected at the unitholders' meetings.¹⁰⁾

The executive director has the authority to represent the J-REIT and to execute the business of the J-REIT.¹¹⁾ However, as mentioned above, because the business operations of a J-REIT are carried out by external

6) Investment Trust Law, art. 89, para. 1.

7) Currently, all listed J-REITs have adopted the system of "deemed approval".
Investment Trust Law, art. 93, para. 1.

8) Investment Trust Law, art. 112.

9) Investment Trust Law, art. 114, para. 1.

10) Investment Trust Law, art. 96, para. 1.

11) Investment Trust Law, art. 109, para. 1.

service-providers, the principal responsibility of the executive director is to supervise the asset manager, and the role of the executive director is limited to duties such as the appointment of external service providers and convocation of unitholders' meetings. The supervisory director is responsible for supervising the executive director's performance.¹²⁾ The accounting auditor is responsible for auditing the financial statements of the J-REIT and for preparing accounting audit reports.¹³⁾

4. Distributions to Investors by J-REIT and Preferential Tax Treatment in Japan

4.1 Accounting and Distributions by J-REITs

For each fiscal year, a J-REIT is required to prepare financial statements, asset management reports and statements related to the distribution of monies as well as detailed statements in relation to these documents.¹⁴⁾ Distribution of monies to unitholders is conducted in accordance with the statements related to the distribution of monies.¹⁵⁾ A J-REIT is not allowed to make interim distributions under the Investment Trust Law. Thus, in practice, it is common for the J-REIT to set a fiscal year period of six (6) months so as to make distributions at the same interval as interim distributions.¹⁶⁾

12) Investment Trust Law, art. 111, para. 1.

13) Investment Trust Law, art. 115-2.

14) Investment Trust Law, art. 129, para. 2, and Ordinance on Account Rules of Investment Corporation, art. 34, para. 1.

15) Investment Trust Law, art. 137, para. 1.

16) Atsumi / Sakai, *Real Estate Investment Trust—Theory and Practice* (REIT no Riron to Jitsumu) (Kobundo, 2011), p.26.

4.2 Preferential Tax Treatment in Japan(Conduit Requirements)

A J-REIT is subject to corporate tax and other taxes.¹⁷⁾ However, a J-REIT is effectively a collective investment vehicle, and is essentially a conduit for the distribution of profits. Therefore, a J-REIT that satisfies certain requirements under the Act on Special Measures Concerning Taxation (the so-called Conduit Requirements) is permitted to include its distributions as a deductible expense (so-called “pay through”). The Conduit Requirements are as outlined below.^{18) 19)}

- I. The investment corporation must satisfy all of the following requirements:
 - (i) It must be registered pursuant to Investment Trust Law, art. 187;
 - (ii) One of the following description must apply to it:
 - (a) Investment units are issued at the time of incorporation by public offering and the total issue price is JPY100,000,000 or more;
 - (b) Investment units at the end of the relevant fiscal year are held by 50 persons or more; or
 - (c) Investment units are held only by institutional investors²⁰⁾ at the end of the relevant fiscal year.
 - (iii) Its articles of incorporation provides that more than 50% of its investment units to be issued are offered in Japan; and
 - (iv) Its fiscal year period is not longer than one year.
- II. The investment corporation must satisfy all of the following requirements in the relevant fiscal year:
 - (i) It is not in breach of Investment Trust Law, art. 63 (*i.e.*, engaging in businesses other than asset management, or establishing any business office other than its head office or having any employees)
 - (ii) It engages an asset manager to provide asset management services;
 - (iii) It engages an asset custodian company to provide asset custody services;
 - (iv) At the end of the fiscal year, it does not fall within the entity set forth in the Cabinet Order²¹⁾ under the definition of private holding company (*douzoku kaisha*) under the Corporate Tax Act (*hojin zei ho*), art. 2, para 10.;
 - (v) It distributes more than 90% of its distributable profits in the relevant fiscal year;
 - (vi) It does not hold shares representing 50% or more of the issued shares or units of another company or entity in terms of either the number of shares or the total amount;
 - (vii) It has not borrowed monies from any person other than institutional investors.

17) Corporate Tax Act(Hōjin Zeihō), art. 2, no. 3 and no. 9.

18) Act on Special Measures Concerning Taxation(Sozei Tokubetsu Sochi Hō), art. 67–15, para. 1, and Order for Enforcement of Act on Special Measures Concerning Taxation(Sozei Tokubetsu Sochi Hō Shikō Rei), art. 39–32–3.

IV. Asset Manager, Asset Custodian Company, Administrative Agent and Sponsor

1. Overview

J-REITs are not permitted to engage in any business other than asset management businesses, and are also required under the Investment Trust Law to engage certain external service providers to carry out its business operations. Such external service providers include asset managers, asset custodian companies and administrative agents. In practice, a trust bank often acts as both asset custodian and administrative agent.

2. Asset Manager

An asset manager is a financial instruments business operator²²⁾ engaged by a registered J-REIT to provide asset management services.²³⁾²⁴⁾ A

19) Atsumi / Sakai, *op. cit.*, p.40.

20) Act on Special Measures Concerning Taxation (Sozei Tokubetsu Sochi Hō), art. 67–15, para. 1, no. 1, (b), (2), Ordinance for Enforcement of the Act on Special Measures Concerning Taxation (Sozei Tokubetsu Sochi Hō Shikō Kisoku), art. 22–19, para. 1.

21) Order for Enforcement of Act on Special Measures Concerning Taxation (Sozei Tokubetsu Sochi Hō Shikō Rei), art. 39–32–3, para. 5.

22) Investment Trust Law, art. 2, para. 11.

23) An asset manager must be a stock company (kabushiki kaisha) incorporated under the Companies Act (kaisha ho) of Japan (with a board of directors and a statutory auditor or committees) or a legal entity equivalent to a stock company with a board of directors incorporated under the laws of a foreign jurisdiction with a branch office or business office in Japan. FIEA, art. 29–4, para. 1 no. 5 (a).

registered J-REIT must engage an asset manager to provide services related to management of its assets.²⁵⁾

An asset manager must complete registration as an investment management business as set forth in the Financial Instruments and Exchange Act (“FIEA”), art. 28, para 4.²⁶⁾ In addition, an asset manager of a J-REIT must obtain at least the following license and permit: (1) a buildings lots and buildings transaction business license;²⁷⁾ and (2) permission to act as discretionary transaction agent etc (*torihiki ichinin dairi to*).²⁸⁾

An asset manager for a J-REIT must comply with the regulations under the FIEA, the Investment Trust Law and the Building Lots and Buildings Transaction Business Act. For instance, the FIEA prohibits an asset manager from engaging in transactions that are considered unnecessary in light of its investment policy for investment management businesses, the amount of investment assets and the market condition, for the purpose of gaining profits for its parent juridical person, etc.²⁹⁾ or its subsidiary juridical person, etc.³⁰⁾³¹⁾

24) Investment Trust Law, art. 2, para. 19.

25) Investment Trust Law, art. 198.

26) FIEA, art. 28, para 4, no. 1, art. 2 para. 8 no. 12(a).

27) Building Lots and Buildings Transaction Business Act(Takuchi Tatemono Torihiki Gyō Hō), art. 3, para. 1. A building lots and building transaction business license(takuchi tatemono torihiki gyo) allows such person to act as an agent or intermediary in transactions regarding building lots or buildings, such as purchase and sale or leases, as listed in the Building Lots and Buildings Transaction Business Act, art. 2, no. 2 and 3.

28) A “torihiki ichinin dairi to” means a building lots and buildings transaction business operator(takuchi tatemono torihiki gyosha) that is fully or partly entrusted with the discretion to make decisions on transactions regarding items listed in the Building Lots and Buildings Transaction Business Act, art. 50-2, para. 1 and acts in its discretion as an agent or intermediary for such transactions. Building Lots and Buildings Transaction Business Act, art. 50-2, para. 1.

Thus, for example, if the sponsor is the parent company³²⁾ of the asset manager, and the sponsor wishes to contribute real estate to the J-REIT, the above restriction may apply.

3. Asset Custodian Company

An asset custodian company is a legal entity engaged by a registered J-REIT to provide services related to custody of the assets.³³⁾ A registered J-REIT must engage an asset custodian company to provide services related to custody of its assets.³⁴⁾ Custody of assets does not mean keeping custody of real estate itself, but holding all segregated cash and accounts of the real property.³⁵⁾

4. Administrative Agent

An administrative agent is the person engaged by a J-REIT to provide services outside the scope of services related to asset management and custody of assets.³⁶⁾ A J-REIT is required to engage a service-provider that

29) FIEA, art. 31-4, para. 3.

30) FIEA, art. 31-4, para. 4.

31) FIEA, art. 44-3, para. 1, no. 3.

32) A parent company is included in the definition of parent juridical person, etc. under the FIEA.

33) Investment Trust Law, art. 2, para. 20.

34) Investment Trust Law, art. 208, para. 1.

35) The Investment Trust Law has adopted a structure whereby the asset custodian company handles custody of the assets independently from the asset manager to prevent risks of commingling and for checks and balances, Atsumi / Sakai, *op. cit.*, p.55.

36) Investment Trust Law, art. 2, para. 21.

performs services provided in the Investment Trust Law, such as services related to unitholders' registry and other administrative operations of the administrative bodies, other than those related to asset management and custody of assets.³⁷⁾

5. Sponsor

The sponsor is a company or group of companies that is an interested party of the J-REIT, such as the shareholder of the asset manager or an investor, and plays a leading role in the incorporation of the J-REIT, the listing of the J-REIT, and providing information of acquiring real properties, etc. of the J-REIT.

In practice, the sponsor incorporates a stock company (*kabushiki kaisha*) to act as the incorporator and the asset manager. Furthermore, in addition to the management and operation of the asset manager, the sponsor is involved in the provision of real properties to the J-REIT for investment purposes under a sponsor support agreement and a pipeline support agreement. Since a J-REIT is a real estate investment fund, the credit evaluation of the sponsor and the credit evaluation of the J-REIT are separate. However, if the sponsor is a shareholder of the asset manager of the J-REIT, when unitholders try to determine the investment management capabilities of an asset manager, they tend to consider both the performance history of the sponsor together with the performance history of the asset manager. For this reason, replacement of a sponsor may greatly affect the

37) Investment Trust Law, art. 117, and Order for Enforcement of Law Concerning Investment Trusts and investment corporations(*Toshin Hō Shikō Rei*), art. 169 para. 2.

price of investment units of a J-REIT.³⁸⁾

Furthermore, as stated below, in practice, prevention of conflict of interests often becomes an important issue, as there are potentially many situations where conflicts of interest may arise between a J-REIT and its sponsor.

V. Listing

1. Listing Status

As discussed in Part II above, on September 10, 2001, investment units of two J-REITs (Nippon Building Fund Inc. and Japan Real Estate Investment Corporation) were listed on the TSE. Since then, over 40 J-REITs have been listed on the Japanese exchange, but the number of new listings has decreased since the so-called “Lehman Shock” and due to mergers of J-REITs. A new J-REIT was listed in April of 2012 for the first time in four and a half years, followed by three other listings during the year 2012, and currently there are 37 brands that remain listed as of December 2012.

As of December 2012, the following 37 J-REITs have their investment units listed on the TSE.³⁹⁾ As of the end of October 2012, the J-REIT market recorded a market capitalization of approximately JPY4.0 trillion.⁴⁰⁾

38) Atsumi / Sakai, *op. cit.*, p.59.

39) For “Securities Code,” “Name,” and “Date of Listing,” *see* the webpage of the TSE, Listed REITs, available at <http://www.tse.or.jp/english/rules/reits/list.html>, last visited on December 27, 2012. For “Sector,” *see* the Association for Real Estate Securitization, *ARES J-REITs Report* vol. 37(2012), available at http://www.ares.or.jp/en/pdf/ares_jreitreport_vol37_en.pdf, last visited on December 27, 2012.

Securities Code	Name	Date of Listing	Sector
8951	Nippon Building Fund Inc.	Sep. 10, 2001	Office
8952	Japan Real Estate Investment Corporation	Sep. 10, 2001	Office
8953	Japan Retail Fund Investment Corporation	Mar. 12, 2002	Retail
8954	ORIX JREIT Inc.	Jun. 12, 2002	Diversified
8955	Japan Prime Realty Investment Corporation	Jun. 14, 2002	Diversified
8956	Premier Investment Company	Sep. 10, 2002	Diversified
8957	TOKYU REIT, Inc.	Sep. 10, 2003	Diversified
8958	Global One Real Estate Investment Corporation	Sep. 25, 2003	Office
8959	Nomura Real Estate Office Fund, Inc.	Dec. 04, 2003	Office
8960	United Urban Investment Corporation	Dec. 22, 2003	Diversified
8961	MORI TRUST Sogo Reit, Inc.	Feb. 13, 2004	Diversified
8963	Invincible Investment Corporation	Aug. 01, 2006	Diversified
8964	Frontier Real Estate Investment Corporation	Aug. 09, 2004	Retail
8966	HEIWA REAL ESTATE REIT, Inc.	Mar. 08, 2005	Diversified
8967	Japan Logistics Fund, Inc.	May 09, 2005	Industrial
8968	Fukuoka REIT Corporation	Jun. 21, 2005	Diversified
8972	Kenedix Realty Investment Corporation	Jul. 21, 2005	Diversified
8973	Sekisui House SI Investment Corporation	Jul. 28, 2005	Diversified
8975	Ichigo Real Estate Investment Corporation	Oct. 12, 2005	Diversified
8976	Daiwa Office Investment Corporation	Oct. 19, 2005	Office
8977	Hankyu REIT, Inc.	Oct. 26, 2005	Diversified
8979	Starts Proceed Investment Corporation	Jul. 27, 2010	Residential
8982	Top REIT, Inc.	Mar. 01, 2006	Diversified
8984	Daiwa House Residential Investment Corporation	Mar. 22, 2006	Residential
8985	Japan Hotel REIT Investment Corporation	Jun. 14, 2006	Lodging/ Resorts
8986	Japan Rental Housing Investments Inc.	Jun. 22, 2006	Residential
8987	Japan Excellent, Inc.	Jun. 27, 2006	Office
3226	Nippon Accommodations Fund Inc.	Aug. 04, 2006	Residential

- 40) See the webpage of the Association for Real Estate Securitization, *Ratio of J-REIT Market Capitalization to TSE First Section Market Capitalization*, available at http://jreit-view.ares.or.jp/jreit_e/JRV003.html, last visited on December 27, 2012.

Securities Code	Name	Date of Listing	Sector
3227	MID REIT, Inc.	Aug. 29, 2006	Diversified
3234	MORI HILLS REIT INVESTMENT CORPORATION	Nov. 30, 2006	Diversified
3240	Nomura Real Estate Residential Fund, Inc.	Feb. 14, 2007	Residential
3249	Industrial & Infrastructure Fund Investment Corporation	Oct. 18, 2007	Industrial
3269	Advance Residence Investment Corporation	Mar. 02, 2010	Residential
3278	Kenedix Residential Investment Corporation	Apr. 26, 2012	Residential
3279	Activia Properties Inc.	Jun. 13, 2012	Diversified
3263	Daiwa House REIT Investment Corporation	Nov. 28, 2012	Logistics
3281	GLP J-REIT	Dec. 21, 2012	Logistics

When established, J-REITs are generally structured with the assumption that they will be listed in the future, on the grounds that investment units of unlisted J-REITs would have low liquidity, and that the listing would enable the J-REIT to more easily meet requirements to receive tax incentives. However, the recent trend seems to be that not all J-REITS are scheduled to be listed, and the future movement of J-REITs is drawing people's attention.

2. Listing Requirements

In order to be listed on a stock exchange, the J-REIT must meet various criteria. For example, in order to be listed on Tokyo Stock Exchange, the J-REIT must be expected to have total net assets of at least JPY 1 billion and total assets of at least JPY 5 billion by the time of its listing,⁴¹⁾ and if these amounts are not maintained for a certain time period after the listing, the J-REIT will be de-listed.⁴²⁾ In addition, real properties must comprise

41) Securities Listing Regulations, art.1205, no. 2 f and g.

at least 70% of the entire investment assets held by the J-REIT, and real properties and other assets related thereto must comprise at least 95% of the entire investment assets.⁴³⁾ If the above ratio is not maintained for a certain time period after the listing, the J-REIT will be de-listed.⁴⁴⁾ Another listing requirement is that unitholders cannot request redemption of their investment units,⁴⁵⁾ and therefore all J-REITs listed on the Japanese stock exchange are structured as “closed end” J-REITs.

3. Schedule

According to the flowchart published by the Tokyo Stock Exchange,⁴⁶⁾ the standard processing time for listing of a J-REIT is three and a half months from the time of application. However, with the prior and thorough consultation with the Tokyo Stock Exchange, this process may be expedited in certain cases.

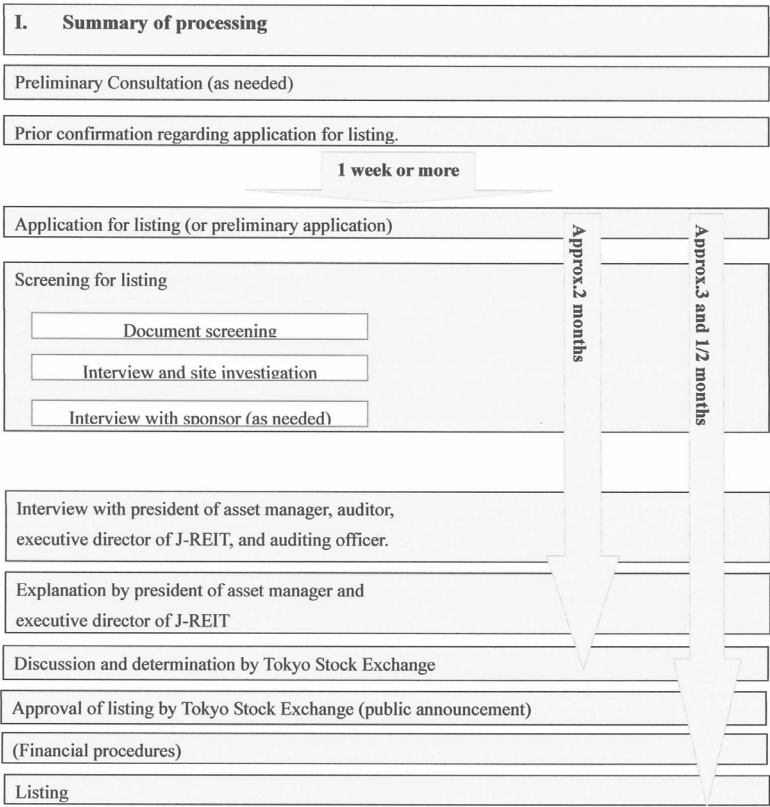
42) Securities Listing Regulations, art.1218, para. 2, no. 4 and 5.

43) Securities Listing Regulations, art.1205, para. 2 a.

44) Securities Listing Regulations, art.1218, para. 2, no. 1 and no. 2.

45) Securities Listing Regulations, art.1205, no. 2 k.

46) See REIT(*tōshi shōken*) *jōjō no tebiki* of Tokyo Stock Exchange, available at <http://www.tse.or.jp/rules/reit/b7gje60000005y9d-att/reit_tebiki.pdf>, last visited on December 27, 2012.



VI. Fund Raising

J-REITs are required to distribute more than 90% of their distributable profit as dividends in order to receive favorable tax treatment. Therefore, in practice, J-REITs distribute almost all of their distributable profits to their investors, and thus must rely on external financing when raising funds to acquire real estate.

The Investment Trust Law provides three different methods that J-REITs

may use for fund-raising from external sources: (1) issuance of investment units, as an equity financing method, and (2) issuance of investment corporation bonds and (3) loans extended from financial institutions, both as debt financing methods. Each J-REIT must consider the requirements and nature of the above-mentioned methods to determine which method best matches their strategies on balance. The following is a brief discussion of each of these fund-raising methods.

1. Issuance of Investment Units

The primary method for raising capital for J-REITs is through issuance of investment units. The J-REIT must obtain board approval in order to issue investment units.⁴⁷⁾

The Investment Trust Law provides that investment units of a J-REIT must be issued at a “fair price” in light of all the assets held by the J-REIT.⁴⁸⁾ While stock companies established under the Companies Act in Japan may issue shares at a selling price that are not considered “fair” if the stock company takes special procedures, the Investment Trust Law does not stipulate any such special procedures. Thus, J-REITs are not permitted to issue investment units at any price below its “fair price”. In the past, an investor of a J-REIT requested the Tokyo district court to issue an injunction against the J-REIT to prevent issuance of investment units, claiming that the J-REIT did not issue investment units at a “fair price.”⁴⁹⁾

It has long been argued whether it is possible for J-REITs to issue

47) Investment Trust Law, art 82, para. 1.

48) Investment Trust Law, art 82, para. 6.

49) See Tokyo District Court ruling as of May 10, 2010.

investment units by granting allocation rights of investment units to all investors existing as of the relevant base date. The Financial Services Agency has indicated its current interpretation that the Investment Trust Law does not prohibit issuance of investment units by using such method. However, due to other practical problems, there seems to be no previous case where a J-REIT actually issued investment units utilizing this method.

2. Issuance of Investment Corporation Bonds

Although a J-REIT must obtain approval from its board in order to issue investment corporation bonds, under the Investment Trust Law, not all J-REITs are permitted to issue such bonds. Only J-REITS which are “closed-ended” (i.e., prohibits unitholders to request redemption of investment units) are allowed to issue investment corporation bonds.⁵⁰⁾

However, as mentioned above, J-REITs listed in Japan are structured as “closed-ended” types of J-REITs, so most listed J-REITs conduct fund raising through issuance of investment corporation bonds. In addition, neither the Investment Trust Law nor the tax law limits the eligibility requirement regarding the purchasers of investment corporation bonds, and therefore it is possible to issue investment corporation bonds to individual investors.

3. Loans from Financial Institutions

One of the primary methods for fund-raising is through securing loans from financial institutions. Many J-REITs enter a commitment line agreement with banks and other financial institutions in order to secure

50) Investment Trust Law, art. 139-2, para. 1.

borrowings so that they can strategically seize the opportunity to acquire attractive real properties when they become available.

There is no requirement under the Investment Trust Law regarding the eligibility of the lender who extends loans to the J-REIT. However, in order for the J-REIT to receive tax incentives, the lender must be an “institutional investor” such as a bank. Therefore, the number of potential fund providers is limited compared to the number of potential fund providers in the case of issuance of investment corporation bonds.

VII. M&A of J-REITs

1. M&A of J-REITs⁵¹⁾

The Investment Trust Law does not stipulate the following four M&A procedures for investment corporations, such as those available for ordinary stock companies (*kabushiki kaisha*): (i) transfer of the whole or a substantial part of business of a company (*jigyo jyoto*), (ii) company split (*kaisha bunkatsu*), (iii) share exchange (*kabushiki kokan*), or (iv) share transfer (*kabushiki iten*). Rather, possible methods to conduct M&A are limited to the following: (a) acquisition of investment units of a J-REIT, (b) transfer of certain assets of a J-REIT, and (c) statutory merger (*gappei*).⁵²⁾

The first method, the acquisition of investment units, may result in a

51) It is also possible to change, or to acquire control of, the asset manager by acquiring shares of the asset manager. In this paper, however, we will not explore M&A of the asset manager.

52) A J-REIT may only merge with another investment corporation.

violation of the Conduit Requirements depending on the volume of the units so acquired. The second method, the transfer of assets of a J-REIT, is also problematic since the transfer may violate the TSE rules and/or the J-REIT's articles of incorporation, and furthermore, the transfer may be subject to taxes. Although these two methods may be conducted in some circumstances, J-REITs have typically conducted the third method, statutory mergers, (i.e., merger procedures conducted under the Investment Trust Law), to accomplish M&A transactions. Eight statutory mergers of J-REITs have been conducted from 2010 to 2011.

We will briefly explain the procedure of statutory mergers of J-REITs.

2. Procedure of Statutory Mergers of J-REITs

If a new J-REIT is created to absorb two merging J-REITs, such merger must be approved by both merging J-REITs by the board of directors at the board meeting⁵³⁾ and by the unitholders at the meeting of unitholders.⁵⁴⁾ At the unitholders' meeting, two-thirds or more vote of the investment units present at a meeting of unitholders are required, and the quorum of the meeting shall be a majority of the total number of issued and outstanding units.⁵⁵⁾

If one J-REIT continues to exist whilst the other J-REIT is absorbed by the continuing J-REIT, such merger must be approved by both the board and unitholders for both J-REIT entities.⁵⁶⁾ However, a unitholders' approval

53) Investment Trust Law, art. 109, para. 1, no. 5.

54) Investment Trust Law, art. 149-12, para. 1.

55) Investment Trust Law, art. 93-2, para. 2, no. 5.

56) Investment Trust Law, art. 149-2, para. 1, 149-7, para. 1. If the surviving J-REIT amends its articles of incorporation, the surviving J-REIT is

is not required for the surviving J-REIT if (i) the total number of investment units delivered from the surviving J-REIT to the extinguishing J-REIT unitholders in consideration of the merger does not exceed (ii) the number of authorized investment units, but not issued and outstanding, of the surviving J-REIT.⁵⁷⁾

3. Reform Related to Merger of J-REITs

As mentioned in Part II, in October 2008, a J-REIT called New City Residence Investment Corporation, filed a petition for civil rehabilitation proceeding, an insolvency proceeding under the Japanese law. Since then, it was recognized that removal of any constraints on statutory mergers of J-REITs were imperative, since statutory mergers are useful tools in supporting a J-REIT having difficulty acquiring real properties or otherwise in financial difficulty.

In response, the Japanese government decided to make the following amendments with respect to mergers of J-REITs.

First, in January 2009, the Ordinance for Enforcement of the Investment Trust and Investment Corporation Law (*toshi shintaku oyobi toshi hojin ni kansuru horitsu shiko kisoku*) was amended to enable a surviving J-REIT in statutory mergers to deliver cash, together with its investment units, to unitholders of an extinguishing J-REIT as consideration of the merger.⁵⁸⁾

required to hold a meeting of unitholders to approve such amendment.

57) Investment Trust Law, art. 149-2, para. 2.

58) Ordinance for Enforcement of Law Concerning Investment Trusts and Investment Corporations(*Tōshi Shintaku Oyobi Tōshi Hōjin Ni Kansuru Hōritsu Shikō Kisoku*), Ordinance of the Prime Minister's Office No. 129 of 2000, art. 193, para. 2(Japan).

Such amendment would be useful to adjust the merger ratio.

Second, the National Tax Agency of Japan (*kokuzeicho*) published its opinion that a statutory merger of J-REITs may be a tax-qualified merger (*tekikaku gappei*) if certain conditions are met.⁵⁹⁾

Third, before the 2009 reform, the Conduit Requirements⁶⁰⁾ required the distribution of more than 90% of taxable income. However, because the amount of distribution is limited to the amount of profits for accounting purposes, if the taxable income increases for any given reason, such as after a tax inspection, the J-REIT may not be able to satisfy the Conduit Requirements. Thus, in 2009, the distribution requirements were amended and currently a J-REIT satisfies the Conduit Requirements if it distributes more than 90% of profits calculated on an accounting basis.⁶¹⁾ This amendment allows a surviving J-REIT that could not satisfy the distribution requirements of the Conduit Requirements after a merger due to an increase in taxable income to actually satisfy such requirement.

Fourth, even if a surviving J-REIT obtains negative goodwill (*fu no noren*, i.e., unrealized gain of an extinguishing J-REIT) by conducting a statutory merger, the surviving J-REIT may deduct the negative goodwill from the distributable income in the fiscal year as long as the gains are not realized.⁶²⁾

59) Available at <<http://www.nta.go.jp/shiraberu/zeiho-kaishaku/bunshokaito/hojin/090319/index.htm>>, last visited on December 27, 2012.

60) See Part III.

61) Act on Special Measures Concerning Taxation(*Sozei Tokubetsu Sochi Hō*), Law No. 26 of 1957, art. 67–15, para. 1, no. 2, ho; Order for Enforcement of the Act on Special Measures Concerning Taxation(*Sozei Tokubetsu Sochi Hō Shikō Rei*), Cabinet Order No. 43 of 1957, art. 39–32–3, para. 6; Ordinance for Enforcement of the Act on Special Measures Concerning Taxation(*Sozei Tokubetsu Sochi Hō Shikō Kisoku*), Ordinance of the Ministry of Finance No. 15 of 1957, art. 22–19, para. 2.

VIII. Recent Issues

1. Purchase of Investment Units by the Bank of Japan

As mentioned in Part II, the petition for insolvency proceeding filed by the J-REIT in October 2008 may be partially due to the following Japanese legal systems regarding J-REITs. J-REITs usually depend on both equity and debt financing since their financing measures are limited. Furthermore, in order to satisfy the Conduit Requirements, a J-REIT must distribute more than 90% of its profits. Therefore, during a period of a recession when loans or bonds are not easily available, a J-REIT may not repay its debt even if its real properties are generating profit.

The Bank of Japan has established a system whereby the Bank of Japan may purchase investment units of J-REITs in order to stabilize the market of J-REITs. The Bank of Japan has actually purchased J-REIT investment units under this system, the aggregate amount of which to date is more than JPY100 billion.⁶³⁾

2. Amendments to the Investment Trust Law in the Near Future

(1) The Financial System Council,⁶⁴⁾ which is an advisory panel to the

62) Ordinance for Enforcement of the Act on Special Measures Concerning Taxation(*Sozei Tokubetsu Sochi Hō Shikō Kisoku*), Ordinance of the Ministry of Finance No. 15 of 1957, art. 22-19, para. 2, no. 2.

63) See “J-REIT Index marked record-high in 2012”(REIT Shisu ga nenshorai takane), Nihon Keizai Shimbun, December 18, 2012.

64) The Financial System Council is a body established within the Financial Services Agency. One of its working groups, “Working Group review of the

Commissioner of the Financial Services Agency, has held discussions regarding the amendments to the Investment Trust Law aiming to submit such amendment to the congress by 2013. The first topic is how to diversify finance options for J-REITs, given the current stagnant REIT market in Japan.

As mentioned earlier, with the introduction of a REIT based on the amendment to the Investment Trust Law in 2000, the REIT was viewed as an investment vehicle. Therefore, only basic governance structures were implemented for REITs, and methods of procuring funds for J-REITs were limited to only basic ones as well.

(2) In the J-REIT market that is stagnant due to the financial crisis and the following debt crisis, not only is the public offering of units difficult to implement, but also any allotment to specified persons is difficult to implement as well.

One of the proposed solutions to this problem is to allow J-REITs to conduct “rights offerings”, in which all existing unitholders are granted options to purchase additional units. Under this system, each of the existing unitholders will have an option to purchase units in an amount proportionate to such unitholder’s current holdings. Exercising this option will prevent dilution of the unitholder’s interest. These options may be listed on the Stock Exchange, and thus if there are unitholders that do not want to exercise their options, these options will easily be sold on the market. Compared

investment trust and investment corporation legislation” has finalized its Final Report on December 7, 2012. The Final Report is available at the webpage of the Financial Services Agency, http://www.fsa.go.jp/singi/singi_kinyu/tosin/20121212-1/01.pdf, last visited on December 27, 2012.

to public offerings or allotment to specified persons, this is a method to procure funds while protecting the existing unitholders' interests.

Furthermore, these options may be offered with a repurchase option by the J-REIT. When any unitholder does not exercise its option, the REIT may repurchase such options and sell such options to a securities company. The securities company will then exercise such options effectively acting as an underwriter, which we call a "Commitment type Rights Offering." In a Commitment type Rights Offering, the J-REIT has the benefit of ensuring that they will procure funds almost as scheduled even in a stagnant market.

The Companies Act stipulates provisions for such options, and the Tokyo Stock Exchange established a system regarding listing of such options in December 2009. In contrast, the current Investment Trust Law does not stipulate such provisions. Therefore provisions similar to the Companies Act should be established.

(3) In addition to the rights offering mechanism, another method that may solve the problem of dilution of unitholders interests is allowing the issuance of convertible bonds. Also, Issuance of different classes of investment units may also be beneficial to solve the problem of shortfall of funds if the prices of the investment units decrease. For example, by creating a class without voting rights or subordinated rights to dividends, the existing unitholders' rights will not be diluted to a certain extent, and the REIT may procure funds from investors that are aiming for high-risk high-return type of investments. However, to diversify methods of procuring funds for a J-REIT means that there are risks of potentially harming the existing unitholders rights or of causing conflict of interests among different classes of unitholders. The Investment Trust Law provides that a J-REIT

may stipulate in its articles of incorporation that if any unitholder does not attend the unitholders' meeting to vote, said unitholder shall be deemed to have agreed to the proposal submitted at the meeting. So far as such system is adopted to J-REIT, it is not appropriate to introduce new mechanism of financing which may easily harm the unitholders' interests.

(4) Under the Companies Act, limited companies are permitted to purchase their own shares, although there are restrictions regarding funds used for such purchase. Currently, J-REITs are not permitted to purchase their own units. When the prices of units are declining, the predominant view is that the Investment Trust Law should be amended to permit the purchase by J-REITs of their own units, so that the market price of the units will increase. Of course if such amendment is effected, insider trading regulations, as seen below, will need to be extended to the units of J-REITs.

(5) J-REITs are investment vehicles that own assets, and in theory, units should be valued based on the net asset value of the J-REIT's assets and thus their price should not be affected by decisions made by or in relation to the J-REIT. However, as mentioned previously, prices of units are affected by the financial market, and in practice units of J-REITs are financial instruments with high volatility. The amendments to the Investment Trust Law are expected to include an imposition of insider trading regulations on units of J-REITs. Of course such regulations must carefully determine the category of "interested persons" and "important matters" because a J-REIT is just an investment vehicle.

(6) As a means to enhance the unitholders powers, and to prevent any

illegal issuance of investment units, a solution may be a right to seek an injunction against such illegal issuance of investment units. Currently, there are no relevant provisions in the Investment Trust Law, and an injunction was granted in the past by referring to a similar provision of the Companies Act, but the requirements under such provision are more stringent towards the unitholders. Thus, the predominant view is that the Investment Trust Law should be amended to provide the unitholders with the proper right for an injunction against such illegal issuance of investment units.

(7) Under the Investment Trust Law, a J-REIT must engage an external asset manager to provide asset management services, and the powers of the board of directors are limited to basic matters. Therefore, the asset manager has discretion even in transactions with related persons such as the sponsor, and it is questionable whether adequate measures are taken to deal with any potential conflict of interests with unitholders. The Financial System Council's Final Report recommends that the Law shall be amended so that the asset manager must obtain a prior consent of the board of directors of the J-REIT for such transactions.

IX. Conclusion

Ten years have passed from the emergence of J-REITs. J-REITs have attracted many investors, and have continuously distributed more than JPY1.4 trillion to investors which has contributed to the wealth of such investors.⁶⁵⁾ This may be due to J-REITs' effective strategies and profitable properties held by J-REITs.

Although some issues have become apparent through the financial crisis, J-REITs and people involved in J-REIT businesses have overcome some of these issues. In addition, if the amendments mentioned in Part VIII. B. are implemented, J-REITs would be further stabilized and the level of risks of J-REITs and their investors will be lowered. We must therefore pay much attention to J-REITs in the future.

(투고일 2012년 12월 31일, 심사(의뢰)일 2013년 2월 5일, 게재확정일 2013년 2월 12일)

Key Words : J-REIT, the law concerning investment trust and investment corporation, investment corporation, real estate, investment unit, conduit requirements, listing, amendments to the law concerning investment trust and investment corporation

65) See the Association for Real Estate Securitization, *ARES J-REITs Report* vol. 37, 5(2012), available at <http://www.ares.or.jp/works/pdf/ares_jreitreport_2012.12_vol37.pdf>, last visited on December 27, 2012.

References

1. Book

Atsumi / Sakai, *Real Estate Investment Trust-Theory and Practice*,
Kobundo, 2011.

2. Case

SJ Securities, L.L.C. v. undisclosed defendant, 1343 Kinyu shoji hanrei
21-43 (Tokyo District Court, May 10, 2010)

3. Others

National Tax Agency, “Regarding judgment of tax-qualified merger of
J-REITs”, March 2009, available at <<http://www.nta.go.jp/shiraberu/zeiho-kaishaku/bunshokaito/hojin/090319/index.htm>>, last visited
on December 27, 2012.

Nihon keizai shinbun(Japan), “J-REIT Index marked record-high in
2012”, December 18, 2012.

The Association for Real Estate Securitization, “ARES J-REITs Report
vol. 37”, December 2012, available at <http://www.ares.or.jp/en/pdf/ares_jreitreport_vol37_en.pdf>, last visited on December
27, 2012. and, <http://www.ares.or.jp/works/pdf/ares_jreitreport_2012.12_vol37.pdf>, last visited on December 27, 2012.

The Association for Real Estate Securitization, “Ratio of J-REIT Market
Capitalization to TSE First Section Market Capitalization”,

November 2012, available at <http://jreit-view.ares.or.jp/jreit_e/JRV003.html>, last visited on December 27, 2012.

Tokyo Stock Exchange, “Listed REITs”, December, 2012, available at <<http://www.tse.or.jp/english/rules/reits/list.html>>, last visited on December 27, 2012.

Tokyo Stock Exchange, “Guide to Listing of REIT”, July 29, 2011, available at <http://www.tse.or.jp/rules/reit/b7gie60000005y9d-att/reit_tebiki.pdf>, last visited on December 27, 2012.

Working Group for Reviewing the Legislation of Investment Trusts and Investment Corporations “Final Report”, December 7, 2012, available at <http://www.fsa.go.jp/singi/singi_kinyu/tosin/20121212-1/01.pdf>, last visited on December 27, 2012.

[국문초록]

일본 부동산투자신탁회사의 개관과 현안

Junko Ogushi* · Yuri Suzuki**

본 논문은 일본의 부동산투자신탁제도(J-REIT)에 관한 중요한 내용을 개관한다. 일본 부동산투자펀드(J-REITs)는 주로 부동산에 투자하는 법인으로서, 투자신탁 및 투자법인에 관한 법률의 적용을 받는다. 이 논문에서는 일본 부동산투자신탁제도의 기본적 구조, 조세지원제도, 투자자의 역할, 자산관리사와 다른 외부 서비스 제공자들, 일본 부동산투자신탁회사의 상장기준들과 일정, 그리고 일본 부동산투자신탁 관련 금융과 M&A에 대하여 논의한다. 일본 부동산투자신탁회사의 주식이 2001년 처음으로 도쿄 증권거래소에 상장된 이후, 일본 부동산투자신탁 펀드 시장은 금융위기와 이후의 경제침체에서 살아남아 크게 성장하고 성숙했다. 이 논문에서는 또한 금융위기로 인한 최근의 현안들에 대해 언급하고 있으며 이와 아울러 매수청구권, 전환사채와 리츠회사 주식의 차등화, 부동산투자신탁펀드들의 자기거래, 내부거래에 관한 규정들, 리츠회사의 주식불법발행에 대한 금지청구권 등과 같은 일본 부동산투자신탁펀드에 대한 다양한 재정적 선택사항과 관련하여 최근 일본 정부에 의해 논의되고 있는 일본 부동산투자신탁법제의 일부개정에 관해서도 언급한다.

* Atsumi & Sakai, 구성원 변호사

** Atsumi & Sakai, 구성원 변호사

주제어 : 일본 부동산투자신탁, 투자신탁 및 투자법인에 관한 법률, 투자법인, 부동산, 리츠회사 주식, 조세지원제도, 상장, 투자신탁 및 투자법인에 관한 법률 개정

