

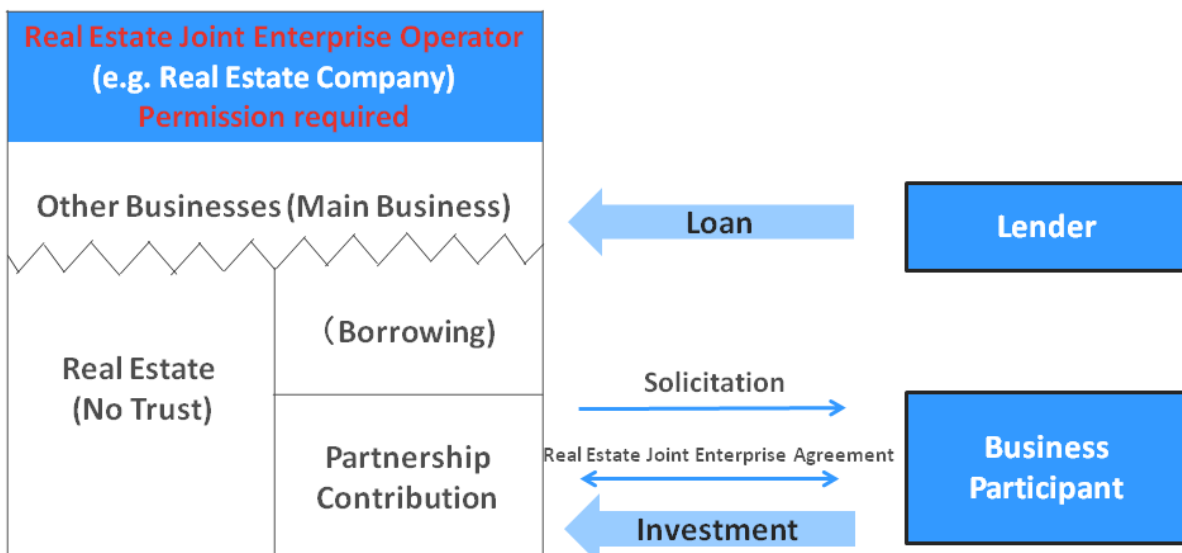
Amendment to the Real Estate Joint Enterprise Act - Possible Expanded Application of the TK/GK Scheme

On 20 December 2013, the Act to Amend the Real Estate Joint Enterprise Act (the "**Amendment Act**") came into effect. The impact of the Amendment Act should be carefully examined with respect to the possibility of expanding the use of the TK/GK scheme, under which a *godo kaisha* ("**GK**", i.e. a Japanese limited liability company) is incorporated as a special purpose company ("**SPC**") and funded by equity investors through a *tokumei kumiai* ("**TK**", i.e. a Japanese anonymous or silent partnership) agreement.

Background and Purpose of the Amendment Act

Prior to the Amendment Act, those who intended to manage a real estate joint enterprise (i.e. a business distributing profits earned from a real estate transaction to investors contributing in such transaction) needed to obtain a license from the competent authorities under the Real Estate Joint Enterprise Act (the "**Act**"). In order to obtain such a license, strict conditions, such as minimum capital and personnel requirements, had to be satisfied.

Real Estate Joint Enterprise Scheme BEFORE Amendment of the Act



Another difficulty for investors was the fact that a real estate joint enterprise was not distinguished from the licensed operator's other businesses. As a result, even if investors were able to obtain the above-mentioned license, they needed to consider not only the risks arising from the management of the targeted real estate but also the risks from the operator's other businesses.

In real estate investment, it is common to use a bankruptcy remote scheme through an SPC in order to limit investment risks to risks arising from the management of the targeted real estate. However, prior to the Amendment Act, it was difficult for such an SPC to satisfy the above-mentioned strict conditions under the Act. Given this difficulty, market players tended to avoid falling under the application of the Act to the extent possible.

One solution to avoid the application of the Act was to create trust beneficial interests ("**TBIs**") in the TK/GK scheme. Here, TBIs were created by entrusting with a licensed trustee the real estate, which interests would then be held or acquired by a GK. However, it was difficult to create TBIs in cases where the real estate was not expected to yield immediate profits (e.g. where earthquake-resistant construction was necessary).

Apart from the TK/GK scheme, another typical bankruptcy remote structure is the TMK scheme, where a *tokutei mokuteki kaisha* ("**TMK**", i.e. a Japanese specific purpose company) is incorporated under the Asset Liquidation Act and investors contribute equity into the TMK in the form of preferred shares. Prior to the Amendment Act, if the targeted real estate was not suitable for entrustment under the TK/GK scheme, it was practically required to use the TMK scheme in order to avoid the application of the Act. However, because the TMK scheme is subject to certain regulations (e.g. pre-filing of an asset liquidation plan and satisfaction of tax conduit requirements under the Act on Special Measures Concerning Taxation), it is difficult to maintain flexibility of the scheme and the costs of establishment and management may be relatively higher than for the TK/GK scheme.

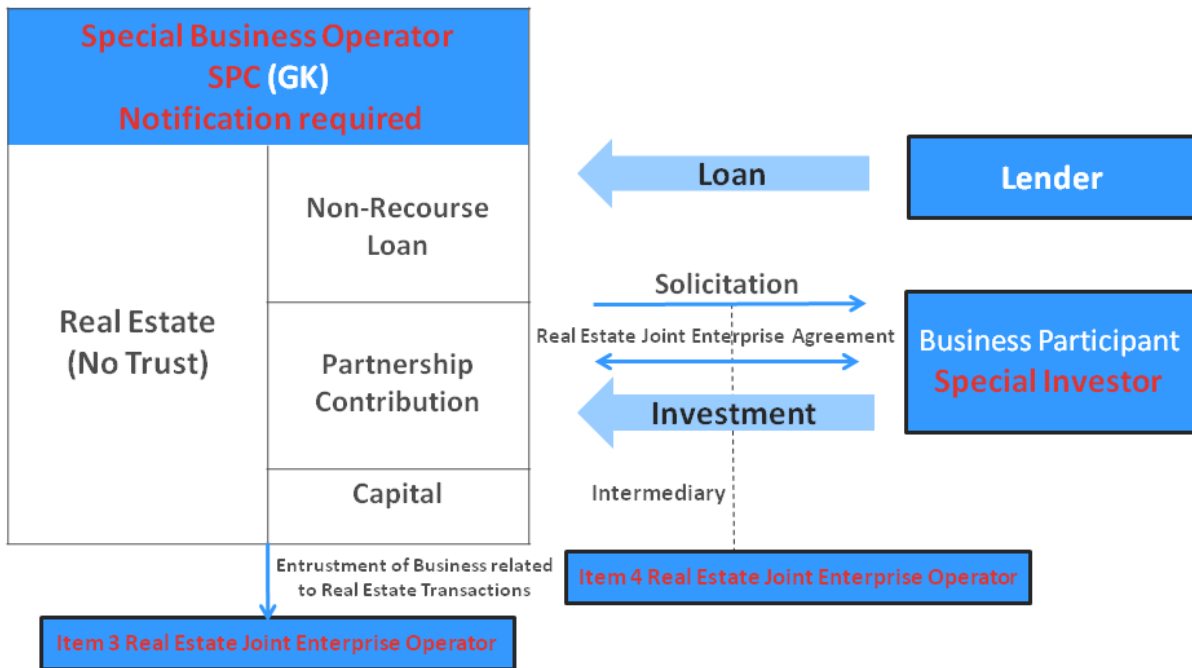
Conditions to Utilise the License Exempted Scheme under the Amendment Act

With the implementation of the Amendment Act, a real estate joint enterprise can now be more effectively implemented through the TK/GK scheme so long as certain conditions as set out below are satisfied, with the lighter requirement to provide only a prior notification (i.e. no license is required). As a result, the Amendment Act could broaden the effectiveness of the TK/GK scheme by allowing investors of a real estate joint enterprise to achieve bankruptcy remoteness even when no trust is set up for the underlying real estate ("**Hard Assets**"), provided that certain conditions as set forth below are satisfied (the "**License Exempted Scheme**").

Under the Amendment Act, if an SPC satisfies each of the following conditions (i) to (iv) and provides a prior notification, it is then qualified to implement a real estate joint enterprise as a "**Special Business Operator**" and can utilize the License Exempted Scheme to implement a real estate joint enterprise.

- (i) The SPC is a corporation with the purpose of exclusively operating a real estate joint enterprise.
- (ii) The SPC delegates (1) an asset management business to a real estate joint enterprise operator licensed under item 3 of the relevant provision of the Act ("**Item 3 Real Estate Joint Enterprise Operator**") and (2) solicitation of real estate joint venture agreements (e.g. TK agreements) to a real estate joint enterprise operator licensed under item 4 of the relevant provision of the Act ("**Item 4 Real Estate Joint Enterprise Operator**").
- (iii) The participant in the SPC's business is either (i) a person who has expertise and experience in real estate investment (e.g. bank or trust company) or (ii) a stock company (*kabushiki kaisha*) with capital exceeding certain threshold (*tokurei toshika*, "**Special Investor**").
- (iv) The SPC conforms to certain other requirements as set out in the relevant ordinances related to the Act which are intended to protect the interests of other business participants.

Real Estate Joint Enterprise Scheme AFTER Amendment of the Act



In addition, set forth below are further details to clarify the scope of a Special Investor, a Real Estate Joint Enterprise Operator and the notification required to be provided by the Special Business Operator.

Scope of Special Investor

The requirement of Special Investors as mentioned in item (iii) above is stipulated in the Ordinance for Enforcement of the Amendment. The scope of a Special Investor includes banks, trust companies, real estate joint enterprise operators, licensed real estate transaction business operators, stock companies (*kabushiki kaisha*) with capital of JPY 500 million or more and any specified investor ("TT", i.e. *tokutei toshika*, as defined in the Financial Instruments and Exchange Act). Specified investors who have transitioned from general investors and foreign companies also fall within the definition of a TT. The concept of a Special Investor under point (iii) is broader than that of a "qualified institutional investor" and TT under the Financial Instruments and Exchange Act, and thus it is not difficult to fulfil this requirement. However, it should be noted that each investor engaging in the License Exempted Scheme under the Amendment Act needs to be a Special Investor.

Scope of Real Estate Joint Enterprise Operator

The standards for permission for an Item 3 and Item 4 Real Estate Joint Enterprise Operator mentioned in point (ii) above are the same as those for a real estate joint enterprise operator defined in the Act prior to the implementation of the Amendment Act (i.e. Item 1 Real Estate Joint Enterprise Operator), except that an Item 4 Real Estate Joint Enterprise Operator is additionally required to be registered as a Type 2 Financial Instruments Business Operator under the Financial Instruments and Exchange Act.

The number of business operators who had obtained permission to act as Real Estate Joint Enterprise Operators under the Act prior to the Amendment Act became effective was 79 as of 1 July 2013.

Notification by Special Business Operator

The required notification under the Amendment Act involves the submission of a notification form and attachments in the format prescribed in the Ordinance for Enforcement of the Amendment Act.

Matters to be notified include (1) trade name or name and address, (2) name of officers and employees stipulated under the Cabinet Order, (3) name and address of the office and (4) the amount of capital and contribution.

Attachments include (1) articles of incorporation, (2) certificate of registered matters and (3) a brief summary of the officers' careers.

Conclusion and Issues to Monitor

The License Exempted Scheme under the Amendment Act expands the possibilities of using a TK/GK scheme even when Hard Assets are traded and consequently allows for more flexible usage of either a TK/GK scheme or a TMK scheme, depending on the nature of each transaction.

However, it should be noted that the following issues may need to be addressed in order to facilitate the expanded use of the TK/GK scheme:

- (i) While the GK as a Special Business Operator needs to appoint Item 3 and 4 Real Estate Joint Enterprise Operators, it is not yet common for asset managers to be registered as Item 3 and 4 Real Estate Joint Enterprise Operators. Complying with this condition will be important to achieve widespread use of the License Exempted Scheme.
- (ii) Even if the issue in point (i) immediately above is addressed, under the License Exempted Scheme, TK agreements entered into by a Special Business Operator must be concluded based on pre-fixed terms and conditions (*yakkan*) created by an Item 3 Real Estate Joint Enterprise Operator to whom the Special Business Operator entrusts the business. As a result, the Special Business Operator will be subject to the regulations imposed by such terms and conditions. Furthermore, while a Special Business Operator does not need to obtain any permission under the Building Lots and Buildings Transaction Business Act (the "**Real Estate Brokerage Act**"), it should be noted that the Special Business Operator is deemed a licensed real estate broker and is therefore subject to the Real Estate Brokerage Act (except for certain provisions). The following are examples of regulations imposed on Special Business Operators under the Real Estate Brokerage Act:
 - (a) The Special Business Operator is obliged to make a JPY 10,000,000 business security deposit for its main office unless it becomes a member of the National Association for Real Estate Transaction Association (*takuchi tatemono torihikigyo hosho kyokai*) and is exempted from the obligation to make the business security deposit.
 - (b) When the Special Business Operator as a seller enters into a sale and purchase contract under which the purchaser is not a licensed real estate broker, the Special Business Operator may not enter into a special agreement that limits the period of defect liability to less than 2 years from delivery.

Given the above issues, the development of the License Exempted Scheme and its actual usage in practice in the real estate markets should continue to be carefully monitored to determine its success and whether it will be widely used.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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