Notes to the Consolidated Financial Statements

Notes to Significant Matters Providing the Basis for the Preparation of Consolidated Financial Statements

1. Matters concerning the scope of consolidation

(1) Number of consolidated subsidiaries: 37

Names of principal consolidated subsidiaries

Kenedix Real Estate Fund Management, Inc.
Kenedix Development, Inc.
Pacific Servicing Co., Ltd.
Space Design, Inc.
Kenedix Westwood, LLC
Kenedix GP, LLC
31 other subsidiaries

(2) Names of principal non-consolidated subsidiaries

Kenedix Master Tk, LLC

Kenedix Insurance Agency, Inc., and 3 other subsidiaries

In accordance with Article 63, Paragraph 1, Item 2 of the Ordinance on Company Accounting, 2 non-consolidated subsidiaries including Kenedix Master Tk, LLC were excluded from the scope of consolidation, as they are principally the operators of silent partnership contracts and the value of their assets and gains or losses attributable to the Group was effectively small.

In addition, 3 non-consolidated subsidiaries including Kenedix Insurance Agency, Inc., were excluded from the scope of consolidation, as they are small-scale businesses with none of their combined total assets, net sales, net income or loss (amounts equivalent to the Company's interests in these subsidiaries) or retained earnings (amounts equivalent to the Company's interests in these subsidiaries) having material impact on the Consolidated Financial Statements.

(3) Matters concerning changes in the scope of consolidation

From the fiscal year under review, the following companies have been included in the scope of consolidation: Swift Silent Partnership and 2 other companies as they were newly established; Space Design, Inc. and 1 other company as a result of the acquisition of the equity interests in them; KRF40, LLC due to an increase in its significance.

Meanwhile, from the fiscal year under review, the following companies which were the Group's consolidated subsidiaries in the previous fiscal year have been excluded from the scope of consolidation: Ganimede Investment Silent Partnership and 11 other companies due to the termination of their silent partnership contracts; Y.K. Domani Capital and 1 other company following the completion of their liquidations; Kenedix Advisers, Inc. and 2 other companies following the dissolution thereof as a result of the Group's reorganization; Kenedix Property Inc. because it was dissolved when it was absorbed by a consolidated subsidiary of the Group; Y.K. KW Holdings as a result of the transfer of the entire equity interests in it; and Kenedix Insurance Agency, Inc. due to a decrease in its significance.

(4) Matters concerning accounting periods of consolidated subsidiaries

Of the consolidated subsidiaries, 12 subsidiaries employed different accounting closing dates from that of the Consolidated Financial Statements but their closing dates do not deviate from the consolidated closing date by more than three months. For these subsidiaries, the Consolidated Financial Statements applied their financial statements as of the respective closing dates.

Additionally, for 17 consolidated subsidiaries, the Consolidated Financial Statements applied their provisional financial statements closed on either the consolidated closing date or a specific date within three months of the consolidated closing date.

For any of them, appropriate adjustments were made for significant transactions that arose between the relevant closing dates and the consolidated closing date.

2. Matters concerning application of the equity method

(1) Non-consolidated subsidiaries accounted for under the equity method

There are no non-consolidated subsidiaries accounted for under the equity method.

(2) Affiliates accounted for under the equity method

Number of affiliates accounted for under the equity method: 20

Names of principal affiliates accounted for under the equity method

Mitsui & Co., Logistics Partners Ltd.
Asset One Co., Ltd.
CRES Co., Ltd.
KW Multi-Family Management Group, LLC
Touchstone Holdings Co., Ltd.
15 other affiliates

(3) Principal non-consolidated subsidiaries not accounted for under the equity method

Kenedix Master Tk, LLC

Kenedix Insurance Agency, Inc. and 3 other subsidiaries

In accordance with Article 69, Paragraph 1, Item 2 of the Ordinance on Company Accounting, 2 non-consolidated subsidiaries not accounted for under the equity method including Kenedix Master Tk, LLC were excluded from the scope of application of the equity method, as they are principally the operators of silent partnership contracts and the value of their assets and gains or losses attributable to the Group was effectively small.

In addition, 3 non-consolidated subsidiaries not accounted for under the equity method including Kenedix Insurance Agency, Inc. were excluded from the scope of application of the equity method because the impact of each of their net income or loss (amounts equivalent to the Company's interests in these subsidiaries) and retained earnings (amounts equivalent to the Company's interests in these subsidiaries), etc. were little and these subsidiaries, as a whole, were insignificant.

(4) Matters concerning changes in the scope of application of the equity method

From the fiscal year under review, the following companies which were affiliates accounted for under the equity method until the end of the previous fiscal year have been excluded from the scope of application of the equity method: Trench Silent Partnership and 1 other company due to the termination of their silent partnership contracts; CKRF 4, LLC and 1 other company following the completion of their liquidations; and Y.K. Still Water Investment as a result of the transfer of the entire equity interests in it.

(5) Accounting for affiliates accounted for under the equity method employing different accounting closing dates

In respect of the financial statements of 14 affiliates accounted for under the equity method, the Consolidated Financial Statements applied their provisional financial statements closed on either the consolidated closing date or a specific date.

In this case, appropriate adjustments were made for significant transactions that arose between the relevant closing dates and the consolidated closing date.

3. Matters concerning accounting standards

(1) Evaluation standards and methods for principal assets

1) Marketable securities

Other securities

Securities with market quotations	Stated at market value at the accounting closing date (Unrealized gains or losses are comprehensively reported as a component of net assets and the cost of securities sold is computed using the moving-average method.)
Securities without market quotations	Stated at cost by the moving-average method However, investments in silent partnership are stated on an individual specified cost basis. The details are described in "(8) Accounting method for investments in silent partnerships."
2) Derivatives	Market value method
3) Inventories	Real estate for sale (including real-estate trust beneficiary rights) Primarily stated at cost on an individual specified cost basis (the balance sheet value is computed by the method of devaluing book price to reflect declines in profitability). Real estate for sale, except those acquired temporarily for the purpose of incorporating in funds structured by the Group, is written off and the depreciation is recorded as cost of revenue. Useful lives of these assets are in general 14–43 years.

(2) Depreciation and amortization method for principal depreciable assets

1) Property and equipment (excluding lease assets)	Straight-line method However, some consolidated subsidiaries employ the declining balance method. Useful lives of principal property and equipment are as follows. Buildings and structures: 11-50 years Others (furniture and fixtures): 5-15 years
2) Intangible assets (excluding lease assets)	The costs for software intended for internal use are amortized over an expected useful life of 5 years by the straight-line method.
3) Lease assets	Lease assets are depreciated by the straight-line method over the lease period without residual value.
4) Long-term prepaid expenses	Straight-line method

(3) Accounting method for deferred assets

1) Stock issuance cost	These costs are fully charged to income when they are paid.
2) Bond issuance cost	These costs are fully charged to income when they are paid.

(4) Recognition of significant allowances

1) Allowance for doubtful accounts

To provide for potential loss on loans, the Group records an allowance for the expected amount of irrecoverable loans. Allowances for ordinary receivables are computed based on the historical rate of default. Allowances for acquired non-performing loans and highly doubtful accounts including receivables where the collection is at risk, consist of the individually estimated uncollectible amounts.

2) Allowance for employees' retirement benefits

To provide for the payment of employees' retirement benefits, the Group records an allowance for estimated retirement benefits, based on the projected retirement benefit obligations as of the end of the fiscal year under review.

(5) Accounting standards for the translation of principal foreign currency-denominated assets and liabilities into Japanese yen

Foreign currency-denominated monetary claims and obligations are translated into Japanese yen, using the spot exchange rates on the consolidated closing date, and the resulting translation gains and losses are recognized as income and expenses.
Assets, liabilities, income and expenses of overseas subsidiaries are translated into Japanese yen using the spot exchange rates on the consolidated closing date, and the resulting translation gains and losses are recorded as foreign currency translation adjustments under the net assets section.

(6) Hedge accounting method

1) Hedge accounting method

The Group adopts the deferred hedge accounting.
However, exceptional accounting treatments are applied to the interest-rate swaps and interest-rate caps which meet the requirement of exceptional accounting treatment.

2) Hedging instruments and hedging items

Hedging instruments ·················· Interest-rate swap and interest-rate cap agreements
Hedging items ························· Borrowings

3) Hedging policy

Based on the internal rules that stipulate the authority concerning derivatives transactions and other regulations, the Group mitigates the risk of interest rate fluctuations associated with the hedging items to a defined level.

4) Method for evaluating hedging effectiveness

Hedging effectiveness is basically measured by comparing the accumulated changes in cash flow of the hedging items with those of the hedging instruments. However, for those to which the exceptional accounting treatments are applicable, the evaluation of hedging effectiveness is omitted.

(7) Accounting method for consumption tax

Transactions subject to consumption tax are mainly recorded at the amount exclusive of consumption tax. However, consumer tax and other taxes imposed on non tax-deductible assets are recorded as an expense for the fiscal year when they were incurred.

(8) Accounting method for investments in silent partnerships

For the investment in a silent partnership, the Group recognizes the equivalent amount of its interest in the assets of the relevant partnership as "investment securities." The Group records "investment securities" when it makes an investment in a silent partnership. The Group records the equivalent amount of interests in a net gain or loss made by the relevant partnership (including silent partnerships which are affiliates of the Company) as "revenue" or "cost of revenue," while the same amount is either added to or deducted from "investment securities." Redemption of the investment from an operator is recorded by deducting the redeemed amount from "investment securities."

(9) Accounting method for deposits of investments in silent partnerships

The Company's consolidated subsidiaries are operators of silent partnerships and commissioned to provide services related to the business. As assets of silent partnerships are attributed to operators, all the assets, as well as gains or losses made by the silent partnerships, are incorporated in the Consolidated Financial Statements and stated on a gross amount basis.

Invested funds in silent partnerships are recorded as "other" under long-term liabilities when the Group receives these funds. The equivalent amount of the investors' interests in net gains or losses made by the silent partnerships are recorded as "profit distribution to silent partnerships," which is presented immediately above "income before income taxes" on the Consolidated Statement of Income, while the same amount is either added to or deducted from "other" under long-term liabilities. Withdrawal of an investment is recorded by deducting the relevant amount from "other" under long-term liabilities.

Equity interests in silent partnerships which are consolidated subsidiaries of the Company, held by partners of the silent partnerships other than the Group companies are recognized as "minority interests" and profit distributed to such partners other than the Group companies is recorded as "minority interests."

(10) Accounting method for trust beneficiary rights in real-estate trusts

For trust beneficiary rights in its real-estate trusts, all assets and liabilities with respect to the asset in trust, as well as income generated or expenses incurred with respect to the asset in trust, are recorded in relevant items on the Consolidated Balance Sheet and Consolidated Statement of Income.

(11) Accounting method for acquired non-performing loans

In collection of acquired non-performing loans, the Group subtracts the amount of collection from the acquisition cost of each relevant acquired non-performing loan and records the amount of collection in excess of the acquisition cost as revenue on a net amount basis.

(12) Accounting method and period for amortization of goodwill

Goodwill and negative goodwill recognized on and before March 31, 2010 are amortized using the straight-line method over the estimated effective period of their useful lives (generally 10 years).

Goodwill with insignificant value is amortized in a lump sum for the fiscal year it was recognized.

4. Additional Information

(A change in the purpose of holding)

Due to a change in the purpose of holding some inventories, 8,831 million yen out of the ending balance of inventories for the fiscal year under review has been transferred to property and equipment. In this connection, 227 million yen of deposits held in trust previously recorded under current assets has been transferred to "other" under investment and other assets, and 224 million yen of security deposits previously recorded under current liabilities has been transferred to "long-term security deposits" under long-term liabilities.

5. Changes in disclosure method

(Consolidated Statement of Income)

"Foreign exchange gains" (13 million yen for the previous fiscal year), which was reported as a component of "other" under non-operating income for the previous fiscal year, has been separately reported for the fiscal year under review as it has become significant.

"Gain on sales of investment securities" (1 million yen for the fiscal year under review) under extraordinary income, which was separately reported for the previous fiscal year, has been reported as a component of "other" under extraordinary income as it has become insignificant.

Notes to Consolidated Balance Sheet

	(Millions of yen)
1. Accumulated depreciation of property and equipment	2,754

2. Assets pledged as collateral and collateralized liabilities

(1) Assets pledged as collateral	(Millions of yen)
Cash and deposits	50
Deposits held in trust	387
Buildings and structures	15,242
Land	30,933
Other under property and equipment	127
Leasehold right	2,789
Other under investment and other assets	1,509

(2) Collateralized liabilities	(Millions of yen)
Short-term borrowings	3,541
Long-term borrowings — due within one year	4,932
Long-term borrowings	15,879

(3) Assets pledged as collateral for non-recourse debts

1) Assets pledged as collateral	(Millions of yen)
Cash and deposits	2
Deposits held in trust	513
Real estate for sale	11,181
Buildings and structures	10,848
Land	16,827
Other under property and equipment	4
Other under investment and other assets	949

2) Collateralized liabilities	(Millions of yen)
Long-term borrowings — due within one year	622
Corporate bonds — due within one year	19
Bonds payable	1,909
Long-term borrowings	24,796

The above liabilities represent the loans advanced to the Group's 6 consolidated subsidiaries which own the assets pledged as collateral listed in the above 1). The repayment of these loans is limited to the amounts of their assets.

3. Guarantee liabilities

The Group concluded an agreement to guarantee the rent obligations owed by Healthcare One, LLC and 3 other companies for 7 years, with a value not exceeding 796 million yen, and the rent obligations owned by Healthcare Five, LLC for 2 years, with a value not exceeding 87 million yen.

Separately, the Group concluded an agreement to guarantee the rent obligations owed by Transam Alpha, LLC for 5 years, with a monthly value not exceeding 64 million yen.

Notes to Consolidated Statement of Changes in Net Assets

Matters concerning the class and total number of shares issued

Shares issued

Common stock 265,658,200 shares

Notes to Financial Instruments

1. Matters concerning the financial instruments

(1) The Group's policy for financial instruments

The Group raises its necessary funds mainly through bank loans and bond issuance, while temporary idle funds are invested in low-risk financial assets. It conducts derivative contracts with the objective of avoiding risks as described below and does not engage in either speculative transactions or unusual trading of financial instruments whose market values widely fluctuate.

(2) Details of financial instruments and associated risks

Securities are used to manage temporary surplus assets with a priority on ensuring liquidity and safety of principal. Accounts receivable — trade and acquired non-performing loans, which are operating claims, are exposed to the clients' credit risk. Income taxes refundable represent a refund of income taxes that is recovered in a short period of time.

Investment securities consist in large part of investment units of real-estate investment trust and are exposed to the risk of market price fluctuations. Long-term loans receivable are loans advanced to trading partners, etc. and are exposed to the credit risk of the borrowers.

Payment terms of accounts payable — trade and accrued income taxes, which are operating liabilities, are within 1 year. Borrowings and bonds payable are intended to finance the Group's capital requirements particularly for investments and working capital. Repayment due dates for these liabilities are not longer than 23 years from the settlement dates. Part of them bears variable interest rates and is exposed to the risk of interest rate fluctuations, but the Group uses derivative transactions to hedge against the risk. The derivative transactions represent interest-rate swap and interest-rate cap agreements designed to hedge against the risk of fluctuations in interest rates on the borrowings. For details on hedging instruments, hedging items, hedging policy and the method for evaluating hedging effectiveness concerning hedge accounting, please refer to the aforementioned “(6) Hedge accounting method” in “3. Matters concerning accounting standards.”

(3) Risk management system for financial instruments

1) Management of credit risk (the risk that trading partners may default)

With regard to accounts receivable — trade and acquired non-performing loans, a department in charge regularly monitors principal trading partners’ financial conditions and manages payment dates and outstanding balances of each trading partner’s liabilities so that it can identify and mitigate the potential default of the trading partners at the earliest possible time, arising from the deterioration of their financial conditions or other factors. Further, with regard to long-term loans receivable, the Group regularly assesses major borrowers’ financial conditions, their purposes of loans, etc. both prior and subsequent to the accommodation of loans.

2) Management of market risk (the risk arising from fluctuations in foreign exchange rates, interest rates, etc.)

The Group uses interest-rate swap and interest-rate cap agreements to mitigate the risk of fluctuations in interest payments on its borrowings. With regard to investment securities, it regularly comprehends the movement in market values, market conditions, issuers’ financial conditions and other factors. The Group enters into derivative contracts with high credit rated domestic financial institutions only and therefore does not assume the risk of counterparty default on these contracts. Further, the execution and management of derivative transactions of the Group are conducted in accordance with the Group’s internal rules and require approval by a Director responsible for derivative transactions.

3) Management of liquidity risk associated with financing activities (the risk that the Group may fail to meet its obligations on due dates)

The Group manages the liquidity risk through the deployment of funding plans, which are formulated and updated on a timely basis by a department in charge based on reports submitted by each business unit, as well as by maintaining sufficient liquidity on hand at all times.

(4) Supplementary explanations on matters concerning market value of financial instruments

The market value of financial instruments is stated at either their prices as quoted in respective markets or, if no market quotations are available, reasonably estimated values. These estimated values incorporate variable factors, and therefore they may vary according to differently employed preconditions, etc.

2. Matters concerning the market value of financial instruments

The book value on the consolidated balance sheet and market value of financial instruments as of December 31, 2013 as well as the differences between these values are described below. Financial instruments whose market values appear to be extremely difficult to determine are not included in the table. (See (Note 2))

(Millions of yen)

		Book value on the consolidated balance sheet	Market value	Difference
Assets	(1) Cash and deposits	25,795	25,795	—
	(2) Deposits held in trust	1,103	1,103	—
	(3) Securities	5,000	5,000	—
	(4) Accounts receivable — trade	1,079		
	Allowance for doubtful accounts*1	(57)		
		1,022	1,022	—
	(5) Acquired non-performing loans	353		
	Allowance for doubtful accounts*1	(30)		
		322	322	—
	(6) Income taxes refundable	169	169	—
	(7) Investment securities	2,793	2,793	—
	(8) Long-term loans receivable	548	548	—
Liabilities	(1) Accounts payable — trade	594	594	—
	(2) Short-term borrowings	3,541	3,541	—
	(3) Accrued income taxes	156	156	—
	(4) Bonds payable (including corporate bonds — due within one year)	2,928	3,015	86
	(5) Long-term borrowings (including long-term borrowings — due within one year)	59,555	59,520	(34)
Derivative transaction*2		[33]	[33]	—

*1 Allowance for doubtful accounts provided individually on these items is deducted.

*2 Receivables and payables incurred by derivative transactions are presented in net. Net payables are presented in brackets “[ ].”

(Note 1) Matters concerning the calculation method for the market value of financial instruments, and marketable securities

Assets

(1) Cash and deposits, (2) Deposits held in trust, (3) Securities and (6) Income taxes refundable
These are recorded using book values as their market values approximate their book values because of their short-term maturities.

(4) Accounts receivable — trade
These are recorded using book values as their market values approximate their book values because of their short-term maturities. For specific receivables to which the Group provides allowance for doubtful accounts on an individual basis, the market value is measured by deducting an estimated irrecoverable amount (the amount of allowance) from the relevant receivable.

(5) Acquired non-performing loans and (8) Long-term loans receivable
The market values of these assets are calculated by discounting the compound amount (i.e. the principal and interest income), using an assumed rate applied to a similar type of new loan. For specific receivables to which the Group provides allowance for doubtful accounts on an individual basis, the market value is measured by deducting an estimated irrecoverable amount (the amount of allowance) from the relevant receivable.

(7) Investment securities
Stocks, etc. are recorded using stock exchange quoted prices.

Liabilities

(1) Accounts payable — trade, (2) Short-term borrowings and (3) Accrued income taxes
These are recorded using book values as their market values approximate their book values because of their short-term maturities.

(4) Bonds payable (including corporate bonds — due within one year)
Those with variable interest rates are recorded using book values as their market values are deemed to approximate their book values because their variable interest rates reflect the market prices and the Group's credit standing has not changed significantly since it implemented these bonds. For those with fixed interest rates, the market value is estimated by discounting the compound amount (i.e. the principal and interest income), using an assumed rate applied to a similar type of newly issued corporate bond.

(5) Long-term borrowings (including long-term borrowings — due within one year)
Those with variable interest rates are recorded using book values as their market values are deemed to approximate their book values because their variable interest rates reflect the market prices and the Group's credit standing has not changed significantly since it implemented these borrowings. For those with fixed interest rates, the market value is estimated by discounting the compound amount (i.e. the principal and interest income), using an assumed rate applied to a similar type of newly made borrowings.

Derivative transaction

This is recorded using prices quoted for the relevant derivatives by the respective contracting financial institutions. Interest-rate swaps and interest-rate caps subject to exceptional accounting treatments are recognized together with their hedging items (i.e. long-term borrowings), and therefore their market values are included in the values of the relevant long-term borrowings.

(Note 2) Financial instruments whose market values appear to be extremely difficult to determine

(Millions of yen)

Item	Book value on the consolidated balance sheet
Unlisted shares, etc.*1	9,095
Investments in capital*2	461
Long-term security deposits*3	3,701

*1 The market values of unlisted shares, etc. are not included in (7) Investment securities, as they are not quoted on a stock exchange and it appears to be extremely difficult to determine their market values.

*2 The market value of investments in capital is not disclosed, as they are not quoted on a stock exchange and it appears to be extremely difficult to determine their market values.

*3 The market value of long-term security deposits deposited by the lessees of leasehold properties is not disclosed, as it appears to be extremely difficult to determine reasonable estimates of future cash flows because there are no market prices available and it is difficult to calculate the effective periods of deposits between the lessees' move-in and move-out.

Notes to Real Estate for Rent, etc.

1. Matters concerning the status of real estate for rent, etc.
   Some of the Group's consolidated subsidiaries own office buildings for rent in Tokyo and other areas.

2. Matters concerning the market value of real estate for rent, etc.

(Millions of yen)

Book value on the consolidated balance sheet	Market value as of Dec. 31, 2013
81,114	78,105

Notes: 1. The book value on the consolidated balance sheet was gained by deducting the accumulated depreciation and the accumulated impairment loss from the acquisition cost.

2. The market value as of Dec. 31, 2013 was based mainly on the appraised value of the real estate for rent made by an outside real-estate appraiser (including those adjusted using relevant indexes).

Notes to Per Share Information

1. Net assets per share	268.27 yen
2. Net income per share	8.29 yen

The Company conducted a 100-for-1 stock split on July 1, 2013. The above net assets per share and net income per share were calculated on the assumption that said stock split was conducted at the beginning of the fiscal year under review.

Notes to Significant Subsequent Events

Not applicable

Other Notes

Impairment loss

The Group recorded impairment loss on the following assets for the fiscal year under review.

Principal use	Description of assets	Location
Real estate for rent	Buildings and structures / Land	Hyogo prefecture, etc.

The Group's assets are generally grouped on an individual basis.

Of the real estate for rent, those with recoverable values that fell short of their book values were written down, and the reduced amounts were recorded as impairment loss under extraordinary loss.

The recoverable value was estimated based on the net realizable value, which was set using its projected sale value.

(Amount of impairment loss) (Millions of yen)

Description of assets	Amount
Buildings and structures	30
Land	18
Total	48

Notes to Business Combinations

1. Business combination involving entities under common control

(1) Description of the business combination

The Company completed the reorganization of the Kenedix Group, consisting of Kenedix, Inc. ("KDX"), Kenedix Asset Management, Inc. ("KDAM"), Kenedix Office Partners, Inc. ("KOP"), Kenedix Residential Partners, Inc. ("KRP"), and Kenedix Advisors, Inc. ("KDA").

1) Businesses of the companies subject to the business combination

Company Name	Businesses
KDX	Consulting business related to real estate transactions and usage, as well as asset management Selling, buying, leasing, brokerage and appraisal of real estate, real estate management, Type II financial instruments business operations, and investment advisory and agency operations
KDAM	Supervisory operations for corporations undertaking asset management business, etc.
KOP	Investment management business, administration of the operation of investment corporations, etc.
KRP	Investment management business, administration of the operation of investment corporations, etc.
KDA	Investment advisory and agency operations, and investment management, etc.

2) Date of the business combination

October 1, 2013

3) Agreements and contracts related to the reorganization

A. Merger between KDA and KDAM (hereinafter "Merger I")

This merger is conducted with KDA being the surviving company and KDAM being dissolved.

B. KDA corporate split, with some of its businesses being succeeded by KDX (hereinafter the "Corporate Split")

The Corporate Split is conducted with operations other than those relating to investment management and accompanying operations (mainly the business based on investment advisory contract) within the asset management business of KDA—which refers to KDA after Merger I; the same applies hereinafter in the context of the Corporate Split—being split and succeeded by KDX.

C. Merger of KOP, KRP and KDA (hereinafter "Merger II"), with the trade name being changed to Kenedix Real Estate Fund Management, Inc. (hereinafter "KFM").

A merger of KOP, KRP and KDA—which refers to KDA after the Corporate Split; the same applies hereinafter in the context of Merger II—is conducted with KRP being the surviving company and KOP and KDA being dissolved. Following the merger, KRP is to be renamed Kenedix Real Estate Fund Management, Inc.

	Related contracts	Companies involved
A. Merger I	Absorption-type merger contract	KDA and KDAM
B. Corporate Split	Absorption-type company split contract	KDX and KDA
C. Merger II	Absorption-type merger contract	KDA, KOP and KRP

4) Other matters concerning the description of the business

Through the reorganization, the Group aims to further expand its asset management business by 1) consolidating the know-how on real estate asset management throughout the Group, 2) significantly increasing the competitiveness in asset management capabilities through strategic reinforcement of its resources for acquisition and management of real estate investment targets, 3) building a structure that contributes to the benefit of our client investors through the reinforcement of the internal management systems, and 4) improving the efficiency of asset management operations within the Group.

(2) Outline of the accounting method applied

The Company treated the accounting matters related to the business combination described above as those of a business combination involving entities under common control, in accordance with the Accounting Standard for Business Combinations (ASBJ Statement No. 21, December 26, 2008) and the Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures (ASBJ Guidance No. 10, December 26, 2008).

2. Business combination through acquisition

(1) Description of the business combination

1) Name and business of the acquired company

Name of the acquired company: Space Design, Inc.

Businesses of the acquired company: Selling, buying, leasing and brokerage of real estate, management operations for real estate including office buildings and rental apartments

2) Major reasons for the business combination

Space Design, Inc. is engaged primarily in the operation of serviced apartments and offices and is able to provide tenants of its leased residential and office buildings with higher-value-added services. Through this business combination, it also helps diversify the sources of fee income by giving the Group a new line of real estate services, in addition to the Company's asset management business.

Tokyo was designated as a Special Zone for Asian Headquarters on December 22, 2011, and was selected on September 7, 2013, to host the 2020 Olympics and Paralympics. Increasing the competitiveness of Tokyo as an international metropolis has become an extremely important subject. Tokyo must become a place that facilitates foreigners doing business and living comfortably. In this sense, we believe that the expertise of space Design, Inc. on serviced apartments and offices has great social significance and will contribute to the growth of the Group.

3) Date of the business combination

October 16, 2013

4) Legal form of the business combination

Acquisition of shares

5) Ratio of the voting rights acquired

99.0%

6) Major reason that led to the decision on the acquired company

Because the Company acquired the shares in consideration of cash.

(2) Period for which the business results of the acquired company are included in the Consolidated Financial Statements

From October 1, 2013 to December 31, 2013

(3) Acquisition cost of the acquired company and its breakdown

Consideration for the acquisition	2,334 million yen
Expenses required for the acquisition	182 million yen
Acquisition cost	2,517 million yen

(4) Amount, reason and amortization method and period of the goodwill generated in connection with the acquisition

1) Amount of the goodwill

14 million yen

2) Reason for the goodwill

Because the market value of the net assets of the acquired company at the time of the business combination was lower than the acquisition cost, the difference was recognized as goodwill.

3) Amortization method and period

Because the value of the goodwill was insignificant, it was amortized in a lump sum.

(5) Amount and breakdown of assets and liabilities succeeded on the date of business combination

Current assets	1,158 million yen
Fixed assets	8,809 million yen
Total assets	9,968 million yen
Current liabilities	358 million yen
Long-term liabilities	7,081 million yen
Total liabilities	7,440 million yen

(6) Approximate amount of impact on the Consolidated Statement of Income for the fiscal year under review on the assumption that the business combination was completed at the beginning of the fiscal year under review

Revenue	2,800 million yen
Ordinary income	20 million yen
Net income	10 million yen

(Method of calculation for the approximate amount)

The above approximate amount of impact represents the difference between the amounts of revenue and income or loss calculated on the assumption that the business combination was completed at the beginning of the fiscal year under review and those reported on the acquiring company's Consolidated Statement of Income for the period under review.

This note has not yet received an audit certification.

(Note) Fractions of figures stated in Notes to the Consolidated Financial Statements are rounded down.

Notes to the Non-consolidated Financial Statements

Notes to Significant Accounting Policies

1. Evaluation standards and methods for assets

(1) Evaluation standards and methods for marketable securities

Stocks of subsidiaries and affiliates	Stated at cost by the moving-average method
Other securities	
Securities with market quotations	Stated at market value at the accounting closing date (Unrealized gains or losses are comprehensively reported as a component of net assets and the cost of securities sold is computed using the moving-average method.)
Securities without market quotations	Stated at cost by the moving-average method However, investments in silent partnership are stated on an individual specified cost basis. The details are described in “8. Accounting method for investments in silent partnerships.”
(2) Evaluation standards and methods for derivatives	Market value method

2. Depreciation methods for fixed assets

(1) Property and equipment (excluding lease assets)	Straight-line method Useful lives of principal property and equipment are as follows. Buildings: 15 years Tools, furniture and fixtures: 5-15 years
(2) Intangible assets (excluding lease assets)	The costs for software intended for internal use are amortized over an expected useful life of 5 years by the straight-line method.
(3) Lease assets	Lease assets are depreciated by the straight-line method over the lease period without residual value.
(4) Long-term prepaid expenses	Straight-line method

3. Accounting method for deferred assets

Stock issuance cost	These costs are fully charged to income when they are paid.

4. Recognition of allowances

(1) Allowance for doubtful accounts

To provide for potential loss on loans, the Company records an allowance for the expected amount of irrecoverable loans. Allowances for ordinary receivables are computed based on the historical rate of default. Allowances for acquired non-performing loans and highly doubtful accounts including receivables where the collection is at risk, consist of the individually estimated uncollectible amounts.

(2) Allowance for employees’ retirement benefits

To provide for the payment of employees’ retirement benefits, the Company records an allowance for estimated retirement benefits, based on the projected retirement benefit obligations as of the end of the fiscal year under review.

5. Accounting standards for the translation of foreign currency-denominated assets and liabilities into Japanese yen

Foreign currency-denominated monetary claims and obligations are translated into Japanese yen, using the spot exchange rates on the accounting closing date, and the resulting translation gains and losses are recognized as income and expenses.

6. Hedge accounting method

(1) Hedge accounting method

The Company adopts the deferred hedge accounting.
However, exceptional accounting treatments are applied to certain interest-rate swaps which meet the requirement of exceptional accounting treatment.

(2) Hedging instruments and hedging items

1) Hedging instruments ············· Interest-rate swap agreements
2) Hedging items ····················· Borrowings

(3) Hedging policy

Based on the internal rules that stipulate the authority concerning derivatives transactions and other regulations, the Company mitigates the risk of interest rate fluctuations associated with the hedging items to a defined level.

(4) Method for evaluating hedging effectiveness

Hedging effectiveness is basically measured by comparing the accumulated changes in cash flow of the hedging items with those of the hedging instruments. However, for those to which the exceptional accounting treatments are applicable, the evaluation of hedging effectiveness is omitted.

7. Accounting method for consumption tax

Transactions subject to consumption tax are recorded at the amount exclusive of consumption tax. However, consumer tax and other taxes imposed on non tax-deductible assets are recorded as an expense for the fiscal year when they were incurred.

8. Accounting method for investments in silent partnerships

For the investment in a silent partnership, the Company recognizes the equivalent amount of its interest in the assets of the relevant partnership as "money invested in real estate for sale" under current assets, "investment securities" and "other securities of subsidiaries and affiliates" under investment and other assets. The Company records such asset items when it makes an investment in a silent partnership. The Company records the equivalent amount of its interest in a net gain or loss made by the relevant partnership as "revenue" or "cost of revenue," while the same amount is either added to or deducted from such asset items. Redemption of the investment from an operator is recorded by deducting the redeemed amount from such asset items.

9. Additional Information

(A change in the purpose of holding)

Regarding the investment in silent partnerships that are operated by subsidiaries, due to a change in the purpose of holding inventories at the investment destinations for the fiscal year under review, 543 million yen out of the ending balance of "money invested in real estate for sale" under current assets has been transferred to "other securities of subsidiaries and affiliates" under investment and other assets.

10. Changes in disclosure method

(Non-consolidated Statements of Income)

"Loss on valuation of stocks of subsidiaries and affiliates" (230 million yen for the previous fiscal year), which was reported as a component of "other" under extraordinary loss for the previous fiscal year has been separately reported for the period under review as it has become significant.

Notes to Non-consolidated Balance Sheet

1. Monetary claims and liabilities to subsidiaries and affiliates (excluding those reported separately)

	(Millions of yen)
Short-term monetary claims	671
Long-term monetary claims	630
Short-term monetary liabilities	270

2. Accumulated depreciation of property and equipment (Millions of yen)

49

3. Assets pledged as collateral and collateralized liabilities

The Company has pledged 1,026 million yen worth of stocks of subsidiaries and affiliates as collateral for long-term borrowings due within one year equivalent to 800 million yen and long-term borrowings equivalent to 10,200 million yen.

4. Guarantee liabilities

The Company concluded an agreement to guarantee the rent obligations owed by Healthcare One, LLC and 3 other companies for 7 years, with a value not exceeding 796 million yen, and the rent obligations owned by Healthcare Five, LLC, for 2 years, with a value not exceeding 87 million yen.

Separately, the Company concluded an agreement to guarantee the rent obligations owed by Transam Alpha, LLC for 5 years, with a monthly value not exceeding 64 million yen.

Notes to Non-consolidated Statement of Income

Transactions with subsidiaries and affiliates	(Millions of yen)
Operating transactions	
Revenue	1,031
Cost of revenue	142
Selling, general and administrative expenses	14
Transactions other than operating transactions	13,582

Notes to Tax Effect Accounting

Breakdown of major factors that caused deferred tax assets and liabilities

(1) Deferred tax assets (current)

	(Millions of yen)
Operating loss carried forward	8,453
Accrued business taxes	20
Dividend income from investment in silent partnerships	26
Other	93
Subtotal	8,594
Valuation allowance	8,594
Deferred tax assets (current), net	—

(2) Deferred tax assets (fixed)

	(Millions of yen)
Provision of allowance for doubtful accounts in excess of tax allowance maximum	1,002
Loss on valuation of investment securities	196
Loss on valuation of stocks of subsidiaries and affiliates	1,431
Dividend income from investment in silent partnerships	942
Difference from the book value of stocks of subsidiaries and affiliates	1,371
Other	93
Subtotal	5,037
Valuation allowance	5,037
Deferred tax assets (fixed), net	—

(3) Deferred tax liabilities (long-term)

	(Millions of yen)
Property and equipment corresponding to asset retirement obligations	10
Subtotal	10
Deferred tax liabilities (long-term), net	10

Notes to Transactions between Related Parties

Attribute	Name	Ratio of voting rights holding	Type of relationship	Summary of transactions	Amount of transaction during the fiscal year under review (Millions of yen)	Accounting item	Balance as of Dec. 31, 2013 (Millions of yen)
Affiliate	Asset One Co., Ltd.	Holding Direct 31.5% Holding Indirect 7.6%	-	Sale of stocks of subsidiary	23	-	-
Subsidiary	Y.K. Domani Capital	Holding Direct 100%	-	Liquidation dividend	16	-	-
Subsidiary	Y.K. KW Property 7	Holding Direct 100%	Silent partnership investment	Profit distribution	2,400	-	-
Subsidiary	Kenedix Development, Inc.	Holding Direct 100%	Financial assistance	Interest receipt	53	Other (Current assets)	403
				Loans collected	55	Long-term loans to subsidiaries and affiliates	2,789
					-	Short-term loans to subsidiaries and affiliates	5,366
			-	Collateral deposit	7,346	-	-
Subsidiary	Y.K. KWO Third	Holding Direct 100%	Silent Partnership investment	Profit distribution	17	Other securities of subsidiaries and affiliates	2,609
			-	Collateral deposit	2,551	-	-
Subsidiary	Y.K. KWR Fourth	Holding Indirect 100%	Silent Partnership investment	Profit distribution	105	Other securities of subsidiaries and affiliates	2,711
			-	Collateral deposit	2,577	-	-
Subsidiary	Y.K. KW Property 3	Holding Direct 100%	Silent Partnership investment	Profit distribution	1,493	-	-
Subsidiary	KW Property 2 Silent Partnership	-	Silent Partnership investment	Profit distribution	109	Other securities of subsidiaries and affiliates	2,084
			-	Collateral deposit	2,297	-	-
Subsidiary	Y.K. KW Property 6	Holding Direct 100%	Silent Partnership investment	Profit distribution	190	Other securities of subsidiaries and affiliates	5,114
			-	Collateral deposit	4,946	-	-
Subsidiary	K&U Investment Silent Partnership	-	Silent Partnership investment	Profit distribution	63	Other securities of subsidiaries and affiliates	1,186
			-	Collateral deposit	1,244	-	-
Subsidiary	Y.K. KW Investment 2	Holding Direct 100%	Financial assistance	Interest receipt	58	Other (Investment and other assets)	587
				Loans collected	1,569		
Subsidiary	Y.K. KSLC	Holding Direct 100%	Silent Partnership investment	Profit distribution	1,870	Other securities of subsidiaries and affiliates	985
Subsidiary	Y.K. HKDX	Holding Direct 100%	Silent Partnership investment	-	-	Other securities of subsidiaries and affiliates	4,677
			-	Collateral and guarantee deposits	4,737	-	-
Subsidiary	Y.K. KRF6	Holding Direct 100%	Silent Partnership investment	Profit distribution	202	Other securities of subsidiaries and affiliates	2,300
			-	Collateral and guarantee deposits	2,370	-	-

Attribute	Name	Ratio of voting rights holding	Type of relationship	Summary of transactions	Amount of transaction during the fiscal year under review (Millions of yen)	Accounting item	Balance as of Dec. 31, 2013 (Millions of yen)
Subsidiary	KRF22, LLC	Holding Direct 100%	Silent Partnership investment	Profit distribution	50	Other securities of subsidiaries and affiliates	5,164
				Investment	2		
			-	Collateral deposit	4,669	-	-
Subsidiary	KRF25, LLC	Holding Direct 100%	Silent Partnership investment	-	-	Other securities of subsidiaries and affiliates	4,789
Subsidiary	KRF30, LLC	Holding Direct 100%	Silent Partnership investment	-	-	Other securities of subsidiaries and affiliates	1,500
Subsidiary	Roseo Silent Partnership	-	Silent Partnership investment	Profit distribution	8	Other securities of subsidiaries and affiliates	4,968
Subsidiary	KRF33 Silent Partnership	-	Silent Partnership investment	Profit distribution	98	Other securities of subsidiaries and affiliates	1,790
Subsidiary	Kenedix Asset Management, Inc.	Holding Direct 100%	Financial assistance	Debt assumption	12,947	-	-
Subsidiary	KRF40 Silent Partnership	-	Silent Partnership investment	Investment	2,350	Other securities of subsidiaries and affiliates	2,310
				Collateral deposit	2,603	-	-
Subsidiary	Creak Investment Silent Partnership	-	Silent Partnership investment	Investment	1,125	Money invested in real estate for sale	573
				Profit distribution	26		
Subsidiary	Swift Silent Partnership	-	Financial assistance	Interest receipt	195	Other (Current assets)	3
				Funds collected	61	Long-term loans to subsidiaries and affiliates	6,186
				Loans	6,247		
			-	Collateral and guarantee deposits	8,968	-	-
Subsidiary	KRF41 Silent Partnership	-	Silent Partnership investment	Investment	1,190	Other securities of subsidiaries and affiliates	543
Subsidiary	Space Design, Inc.	Holding Direct 99%	Financial assistance	Loans	2,480	Long-term loans to subsidiaries and affiliates	2,480
						Interest receivable	1

1. Terms and conditions of transactions are determined on similar terms and conditions applied to general transactions, in consideration of the market prices and other factors.
2. Holding indirect is held by CRES Co., Ltd.
3. Interest rates on loans are reasonably determined in consideration of the money market rates.
4. As of October 1, 2013, a merger between Kenedix Asset Management, Inc. and Kenedix Advisors, Inc. was conducted with Kenedix Advisors, Inc. being the surviving company and Kenedix Asset Management, Inc. being dissolved. As of the same date, Kenedix Advisors, Inc. conducted a corporate split, with part of its businesses being transferred to Kenedix, Inc., and a merger of Kenedix Office Partners, Inc., Kenedix Residential Partners, Inc. and Kenedix Advisors, Inc. was conducted with Kenedix Residential Partners, Inc. being the surviving company, for which the trade name was changed to Kenedix Real Estate Fund Management, Inc.
5. The Company recorded 2,525 million yen in allowance for doubtful accounts for loans and rehabilitation claims advanced to subsidiaries and affiliates. In addition, the Company recorded provision of allowance for doubtful accounts equivalent to 372 million yen for the fiscal year under review.

Notes to Per Share Information

1. Net assets per share	260.35 yen
2. Net loss per share	65.32 yen

The Company conducted a 100-for-1 stock split on July 1, 2013. The above net assets per share and net loss per share were calculated on the assumption that said stock split was conducted at the beginning of the fiscal year under review.

Notes to Significant Subsequent Events

Not applicable

(Note) Fractions of figures stated in Notes to the Non-consolidated Financial Statements are rounded down.