

Real Estate Analysis Report

Japanese Property Market Quarterly Review Third Quarter 2011 ~Tokyo Office Rent Finally Turns~

This is the English translation of
Toru Matsumura, “不動産クォーターリー・レビュー 2011年第3四半期 一ようやく下げ止まった東京都心のオフィス賃料”
NLI Research Institute, *Real Estate Analysis Report*, October 28, 2011.

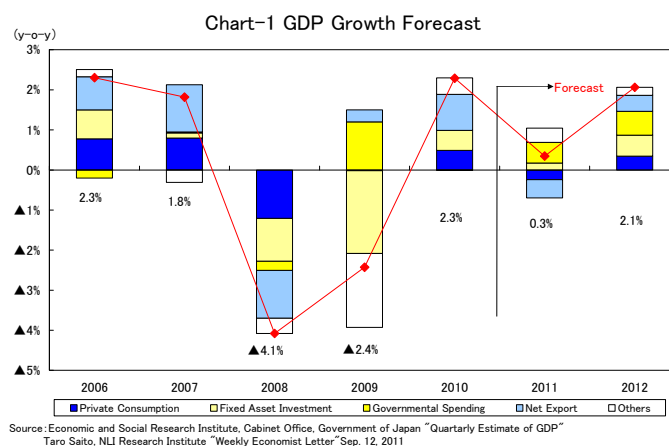
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1. Economy Outlook

NLI Research Institute forecasts Japan's GDP growth at 0.2% in 2011 and 2.1% in 2012. Though the economy has already bottomed out with the supply chain restoration and production recovery, the influence of the global economic uncertainty and JPY appreciation remain as concerns (Chart-1).¹



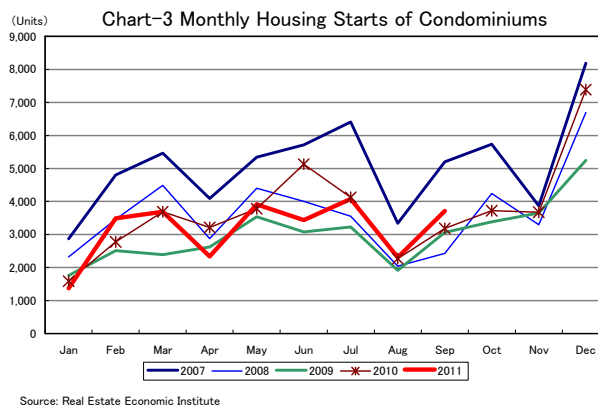
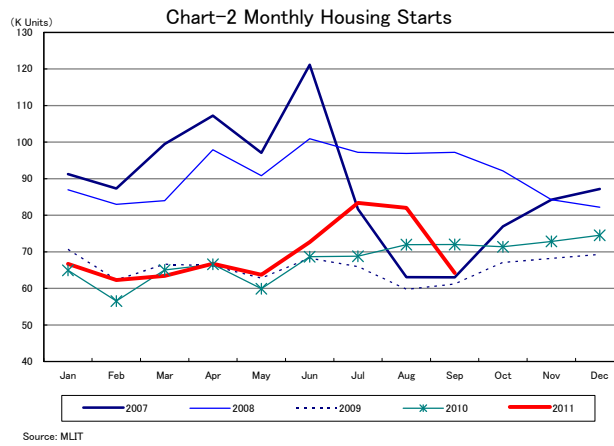
Despite the earthquake, housing starts in August grew by 14% y-o-y to 82k for the fifth consecutive month of increase (Chart-2). The number of condominiums, apartments to let and individual houses grew for the fifth, third and second consecutive months respectively. And supported by the resumption of governmental support programs,² strong numbers in housing starts are forecasted to follow for some time.

The condominium supply in the Tokyo metropolitan area in August grew by 1.7% y-o-y for the first time in three months (Chart-3).

According to a survey by Nomura Real Estate Urban Net in July, the residential customer attention is focused on “ground stability, 84.5%,” “building quake-resistance, 77.4%,” “disaster-prevention measures, 32.9%” and “transportation accessibility, 32.7%.”

¹ Taro Saito, “Economic Forecast for 2011 and 2012: Revision of Real GDP Growth Forecast following the 1Q Number,” in *Weekly Economist Letter*, NLI Research Institute, June 10, 2011.

² The Eco-point program offers gift vouchers to consumers who buy designated eco-friendly products including eco-friendly houses or equipment. And the Flat 35S program offers low interest rate 35 year loans to home buyers.



2. Land Price and Market Confidence

In “Kijun-chika” July 1, 2011, the national land price posted a 3.4% y-o-y decline for the twelfth consecutive year of decrease, though better than the 3.1% in the previous year. While Tokyo, Osaka and Nagoya metropolitan areas showed a recovery during the fund boom from 2006 to 2008, local cities have never experienced a land price recovery since the land price bubble burst in 1991. Even in Tokyo metropolitan area, both residential and commercial land prices had an accelerated decline in the first half of this year (Chart-4).

According to Nomura Real Estate Urban Net, commercial land prices in Tokyo 23 wards remained at the same level in July and October, after some areas showed weakening in April (Chart-5).

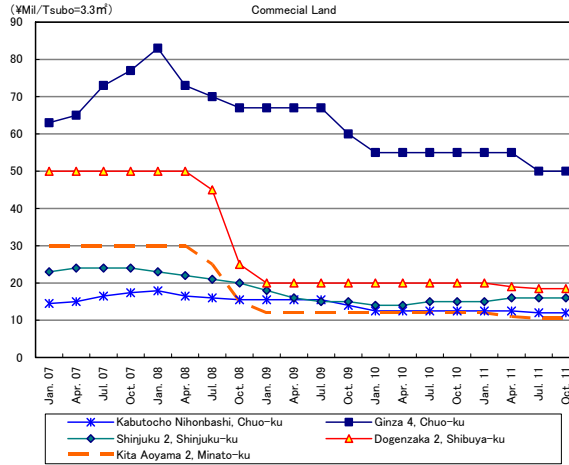
Regarding the property business confidence survey in July by the Land Institute of Japan, only the business category “residential development” maintained a positive score, while others sunk into negative territory. However, all business categories are expected to improve in the next three months (Chart-6).

Chart-4 Land Price H-o-H Change

	h-o-h(%)			
	Residential		Commercial	
	1H10	1H11	1H10	1H11
All of Japan	-1.2	-1.3	-1.7	-1.8
Three metropolitan areas	-0.7	-0.8	-1.1	-1.2
Tokyo metropolitan	-0.7	-1.0	-1.1	-1.4
Osaka metropolitan	-1.0	-0.7	-1.4	-1.1
Nagoya metropolitan	-0.1	-0.3	-0.5	-0.6
Local	-1.8	-1.8	-2.4	-2.3

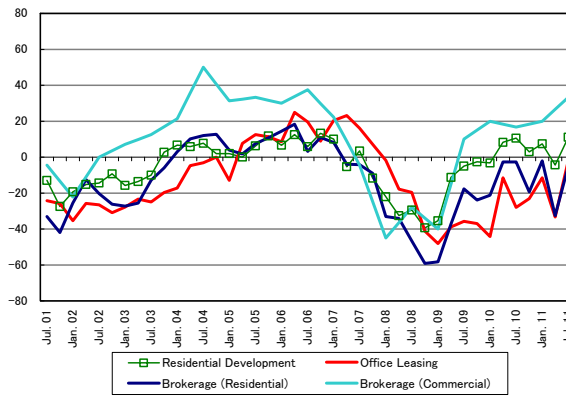
Source: MLIT

Chart-5 Land Price



Source: Nomura Real Estate Urbannet

Chart-6 Property Business Confidence Index in Three Months



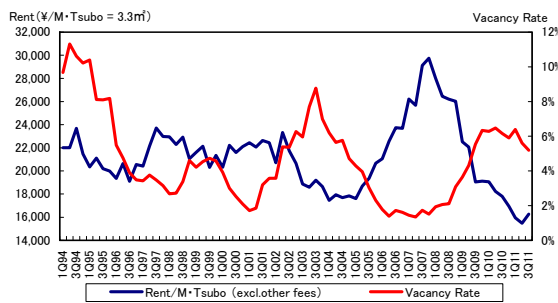
*As only Brokerage (Commercial) data is semi-annual, the April number is not plotted.
Source: The Land Institute of Japan "Property Business Confidence Survey"

3. Sub-sectors

① Office

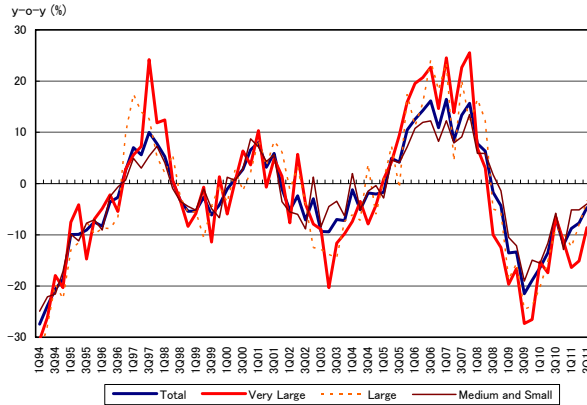
As seen in the index, a contract-based office rent index developed by Sanko Estate and NLI Research Institute, the office vacancy rate of very large sized buildings (standard floor larger than 200 tsubos) in the Tokyo three wards improved in 3Q 2011, for the second consecutive quarter (Chart-7). In addition, the office rent also showed a q-o-q recovery for the first time in fifteen quarters. The average office rent of all buildings in the Tokyo three wards also continued a q-o-q recovery, and each of the three size categories managed to shrink their y-o-y declines (Chart-8).

Chart-7 Tokyo Three Wards Office Market



Very Large Size Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate-Sanko Estate, Rent-Sanko Estate and NLI Research Institute

Chart-8 Office Rent Index (Tokyo Three Wards)

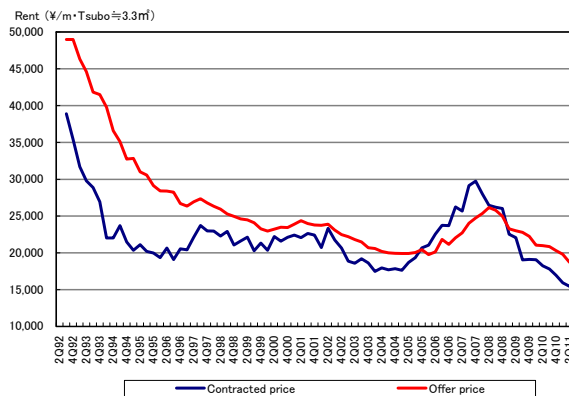


Very Large (Standard floor>200 tsubos), Large (100< and <200), Medium and Small (<100)
Source: Sanko Estate and NLI Research Institute

As this contract-based office rent index tends to precede the market trends of other common rent indexes based on offer price data, it is possible that Tokyo office rent is finally turning to a recovery trend (Chart-9).

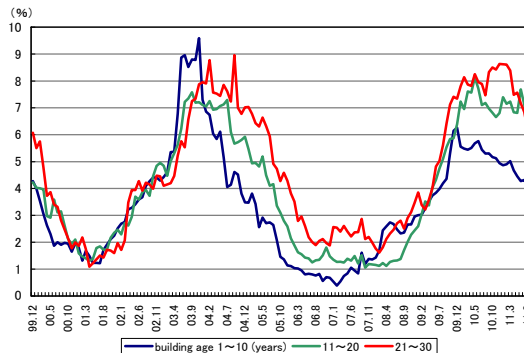
Furthermore, following the earthquake the vacancy rate gap between new buildings and older buildings has become more noticeable in terms of quake-resistance and energy-saving³ (Chart-10).

Chart-9 Office Rent Index Type Comparison (Tokyo Three Wards)



Source: Sanko Estate and NLI Research Institute

Chart-10 Office Vacancy Rates by Building Age (Tokyo Five Wards)



Source: Sanko Estate

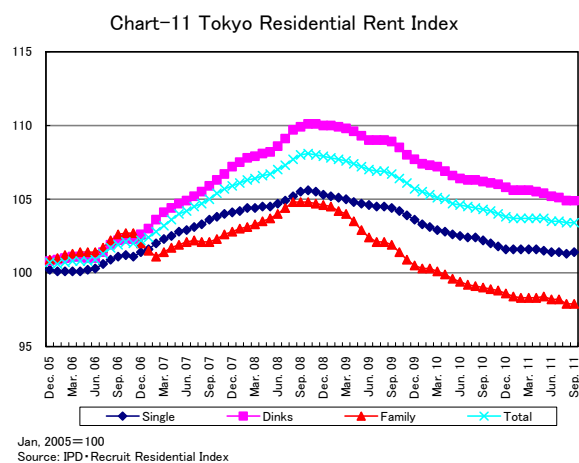
³ In a survey by Mori Building in April, the responses of “want to move to a quake-resistant building” increased substantially to 45% of all respondents from 15% in Nov. 2010, and outnumbered the most common response last year of “want to move to a cheaper rent building” which was 40% this year.

② Rental Apartment

In the Tokyo 23 wards, where signs of recovery had been started to be seen, the rents indicated some weakening after the earthquake (Chart-11). However, the Tokyo luxury market, where foreigners and high-income workers are the main customers, still remains mostly unchanged after excess supply lowered rents significantly last year.

In addition, high-grade rental apartments owned by J-REITs and large private funds have kept their high occupancy rates even after the earthquake.

According to a home buyer confidence survey during September and October by Nikkei Newspaper, the response “want to buy a home someday” was only given by less than half of the 1,000 respondents comprised of both men and women in their twenties to fifties.⁴ The most common reason for their hesitation was “rental units are easier for relocation,” followed by “difficult to prepare a down-payment” and “rental units are more economical.”⁵ It seems that the 20-year-long decline in land price and the recent earthquake have had a large influence on the perception of home ownership.



③ Retail, Hotel, and Logistics

After some store retail sales showed a sharp 7.5% decline due to the earthquake in March, it recovered for the first time in five months in July, but declined again by 2.6% in August. Though convenience store sales have maintained positive growth for ten months, supermarket and department store sales are still shrinking. However, in major department stores, sales of luxury goods such as watches, jewelry and brand products are recording strong numbers, even in the Tohoku region.

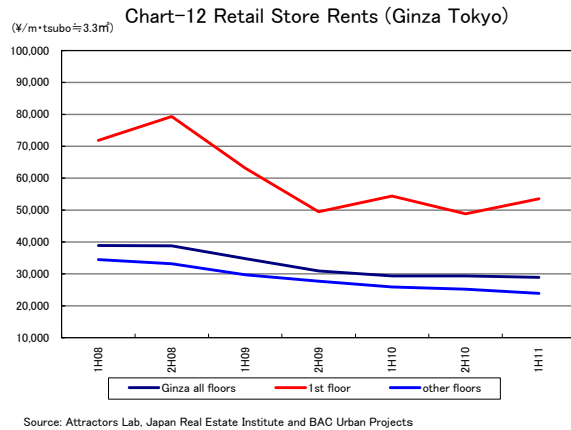
The retail store first floor rents in Ginza appreciated by 10% h-o-h in 1H 2011 (Chart-12) followed by other areas in Tokyo such as Shinjuku, Shibuya and Ikebukuro, but local cities are suffering from shrinking rents excluding Sapporo and Yokohama.

Domestic home shopping sales grew 8.4% to JPY 4.67 trillion in 2010, posting the twelfth

⁴ Generally in the national survey by the government, more than 70% of the respondents indicate they want to buy a home someday.

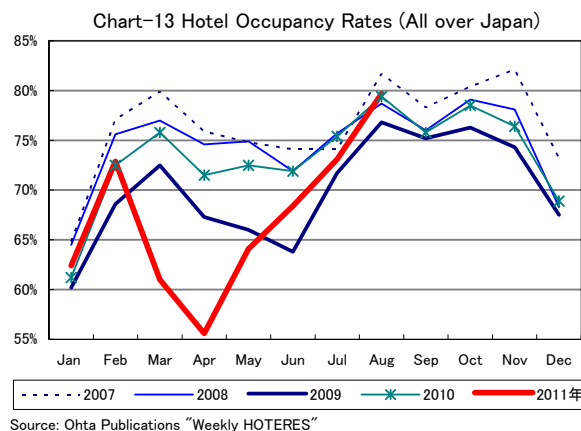
⁵ In a survey of 500 households between the ages of 25 to 45 currently leasing, by Sekisui Chemical in July 2011, “Continue to lease” was cited by more than half the respondents. The most common reason was “can move easily” followed by “cannot afford to buy.”

consecutive year of growth, bolstered by the penetration of the internet. As traditional retailers such as supermarkets are trying to focus on internet sales, the dynamics of the retail business are structurally changing, and it is possible that the demand for traditional store space will shrink in the mid- to long-term, with smartphones, for example, partly becoming an alternative means of selling.

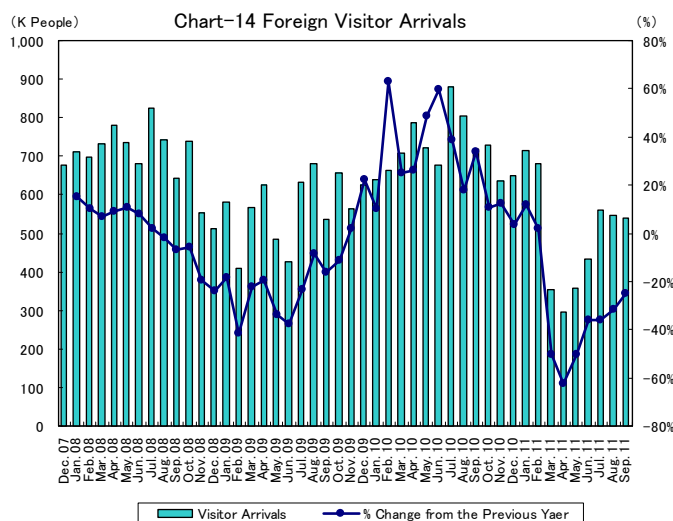


In the hotel sector, which was the sector most seriously affected by the earthquake, occupancy rates are improving with the recovery of business customers and the drastic discounting of room rates (Chart-13). According to the Nikkei Newspaper, the occupancy rate of Tokyo city hotels was 71.9% in August, which was 3.7% lower than that of a year ago to post the sixth consecutive month of decline, but recovered to above 70% for the first time since the earthquake. While the Osaka city hotel occupancy rate was 90.4% in August, which was better than that of a year ago for the second consecutive month, and recovered to above 90% for the first time in four years.⁶

On the other hand, foreign visitor arrivals declined by 31.9% y-o-y in August showing significant declines for six months (Chart-14). It seems that it will take quite some time before returning to normal, following the deterioration of the Japanese brand image of safety and security, in addition to the JPY appreciation.



⁶ Resort Trust has a plan to open two business hotels in Osaka in 2012 and Kanazawa in 2013, with the business customer recovery. The company has stopped opening hotels since March 2009 affected by the Lehman shock.



Source: Japan National Tourism Organization (JNTO)

Regarding the logistics leasing market, the cargo movement index, Niugoki Index by Nittsu So-ken, recovered for the first time in four quarters in 2Q 2011, and the 3Q number is forecasted to improve even further.

As the structural trend of e-commerce expansion and third party logistics penetration remains intact, new entrants and developments have been noticed in the large size logistics market where J-REITs and private funds like to invest.⁷

4. Property Investment and J-REIT Markets

The TSE REIT index plunged by 5.7% m-o-m in September with risk-off moves based on the European crisis and global economic uncertainty. BOJ spent JPY 15.3 billion on buying J-REIT units in September, totaling JPY 54.5 billion so far (Chart-15). It has plans to spend a total of JPY 110 billion on buying J-REIT units by the end of 2012.

The J-REIT dividends in 1H 2011 turned out not to be disappointing, as 30 of 34 J-REITs did not miss their guidance forecasts even with the extraordinary losses related to the earthquake. But their office and other buildings still continue to generate smaller NOI each quarter. Regarding transactions, they acquired 14 assets totaling JPY 40.8 billion in September, which was less than last month, and sold two assets totaling JPY 2.1 billion.

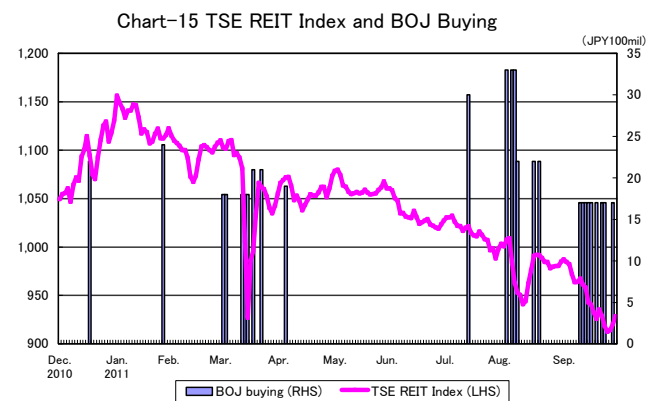
The funding conditions for private fund players have improved greatly and they are not feeling pressured to sell buildings. While most foreign investors did not retreat from Japan after the earthquake, the domestic investors and developers as well as Asian investors from Singapore and Hong Kong are already active in the investment market. In terms of liquidity and stability at the moment, no alternative to the Japan market is recognized in Asia and the yield gap in Japan looks better than that in other markets

In a survey by NLI Research Institute in October,⁸ the predominant response as the current

⁷ GLP, a logistics property developer and manager under the Singaporean SWF, GIC, is launching a fund, 10 year long and USD 500mil size, to develop logistics properties in Japan with a Canadian pension fund.

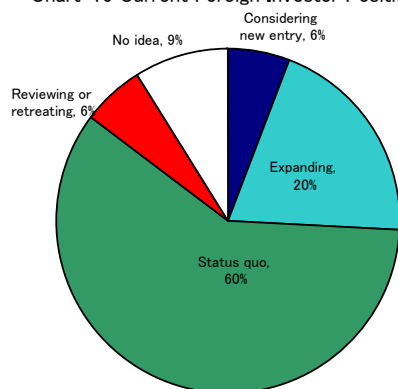
⁸ Mamoru Masumiya “[Polarization Progresses in Disaster-prevention and Energy-saving, and Remarkable Change Seen in Sector Preference -The Eighth Japanese Property Market Survey-](#)” Real Estate Analysis Report, NLI Research Institute, October 25, 2011.

sentiment in the property investment market was “Somewhat bad” cited by 59.8% of respondents (Chart-17). Combined with “Bad” responses, negative sentiment reached 70% of the total. Regarding the six month property investment market outlook, the response “Somewhat better” accounted for more than 40% of respondents followed by “No change,” while the response “Worse” emerged again and “Somewhat worse” showed a categorical increase (Chart-18).



Source: Tokyo Stock Exchange, BOJ

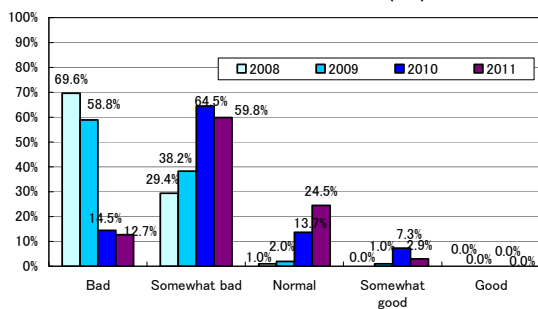
Chart-16 Current Foreign Investor Position



*n=35, surveyed in Jun. 2011

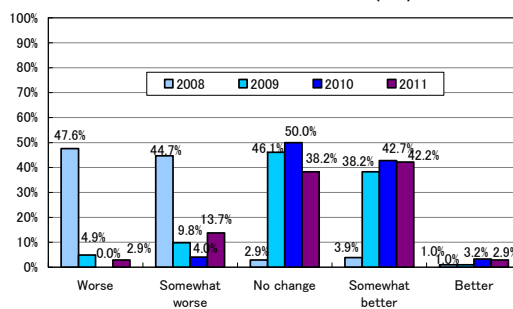
Source: Nikkei Real Estate Market Report, Aug. 2011

Chart-17 Current Market Sentiment (SA)



Source: NLI Research Institute, *Property Market Survey*, 2008~2011

Chart-18 Six Month Market Outlook (SA)



Note: In 2008, the survey did not specify the market outlook period.
Source: NLI Research Institute, *Property Market Survey*, 2008~2011.

5. Influence of Earthquake on Property Market

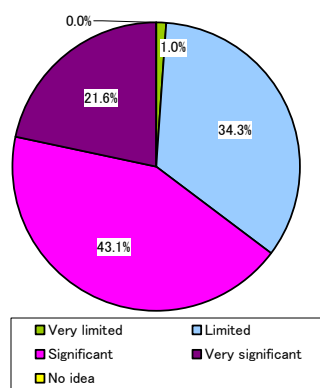
In the NLI Research Institute survey, regarding the influence of the earthquake on the Japanese property market, the sum of the responses “Very limited” and “Limited” added up to 35.3% of the total (Chart-19). Considering the sum of “Somewhat serious”, “Serious” and “Very serious” accounted for more than 90% in April just after the earthquake, it looks like the uncertainty surrounding the market has greatly eased. But it is not ignorable that the response “Very significant” still accounted for 21.6%.

When asked what developments are most likely to be seen in the property market in the mid- to long-term, about 80% of the respondents cited “Market polarization” and about 60% cited “Disaster-prevention and energy-saving technology enhancement” (Chart-20).

Regarding the most preferable sector for investment in terms of price appreciation and market growth, “China and Asia” accounted for nearly half of the responses, followed by “Logistics” cited by more than 40% (Chart-21). On the other hand, the main investment sector of “Office” declined significantly.

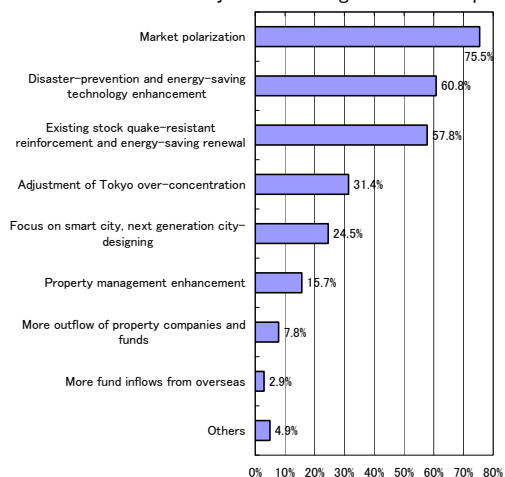
Finally, we asked how much of a premium (cap rate reduction) would be acceptable for high performance disaster-prevention and energy-saving properties compared with equivalent properties, the response “None in particular” definitely declined compared with responses to a similar question in last year’s survey, and 6.9% of respondents cited “~—1.0%, categorically noticeable premium”, which no one cited last year (Chart-22). As disaster-prevention and energy-saving capabilities become recognized as additional value, more related investment can be expected not only for newly built buildings but also for existing stock.

Chart-19 Influence of Earthquake on Property market



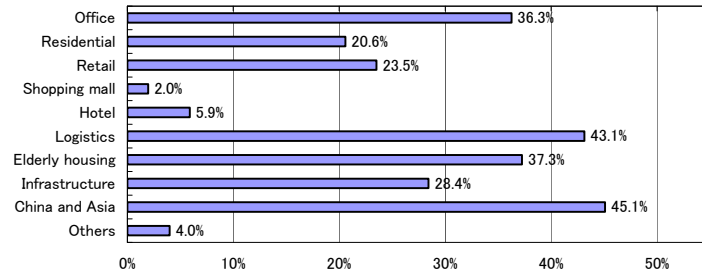
Source: NLI Research Institute Oct 2011

Chart-20 Most Likely Mid- to Long-Term Development (MA.3)



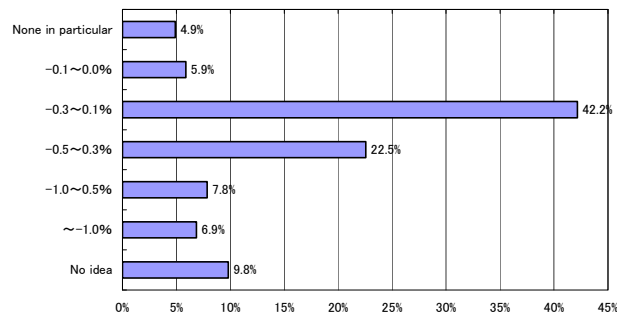
Source: NLI Research Institute, October 2011

Chart-21 Preferred Sectors Expected Price Appreciation and Market Expansion (MA.3)



Source: NLI Research Institute, October 2011

Chart-22 Acceptable Premium on Properties Well Equipped for Disaster-prevention and Energy-saving (SA)



Source: NLI Research Institute, October 2011

*This report includes data from various sources and NLI Research Institute does not guarantee the accuracy and reliability. In addition, this report is intended only for providing information, and the opinions and forecasts are not intended to make or break any contracts.