Real Estate Analysis Report

Japanese Property Market Quarterly Review, First Quarter 2012

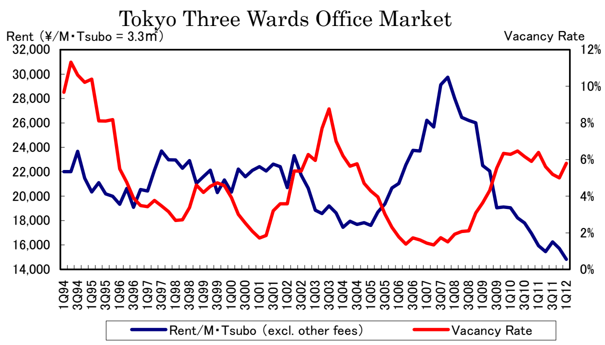
~Sizable Grade-A Supply Overwhelms the Tokyo Office Market~

This is the English translation of Toru Matsumura, "大型ビル竣工ラッシュで弱含む東京オフィス市場 — 不動産クォータリー・レビュー2012年第1四半期" NLI Research Institute, *Real Estate Analysis Report*, April 26, 2012

Real Estate Investment Team, Financial Research Group
Toru Matsumura
omatsu@nli-research.co.jp

Summary

- The Japanese economy apparently resumed recovering, as corporate production has become active again with retail consumption remaining resilient. Both new and secondary condominium sales posted good numbers in the Tokyo Metropolitan area. National land prices declined at a mitigated pace as land prices of certain areas with redevelopment projects or new transportation access and some popular residential areas began appreciating, while disaster hit areas were still struggling.
- The Tokyo office market suffered from higher vacancy rates and lower rents, as many large sized offices were completed in the quarter, though the pace of rent decline slowed somewhat. Residential rents showed weakness again after suggesting stabilization in the previous quarter. Hotel occupancy rates have recovered to the level before the Great East Japan Earthquake. In the logistics sector, regarded as a bright spot with sizable predicted demand for large sized facilities, major property developers have entered into the development market.
- The TSE REIT Index soared by 18.6% in the quarter based on positives such as additional BOJ financial loosening, European debt concern mitigation and expected global economic recovery. Especially, the office sector rebounded outstandingly by 24.9% following the recent drastic decline. The transaction volume increased toward the fiscal year end, with J-REITs, S-REITs and domestic developers showing noticeable acquisition activity.

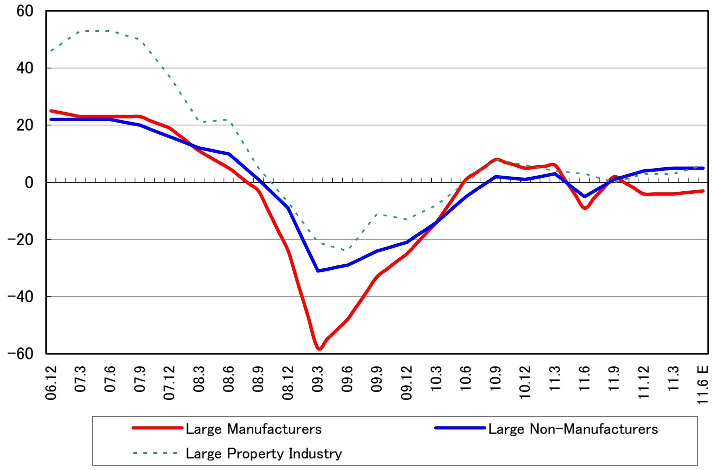


Very Large Size Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate･Sanko Estate, Rent･ Sanko Estate and NLI Research Institute

1. Economy Outlook

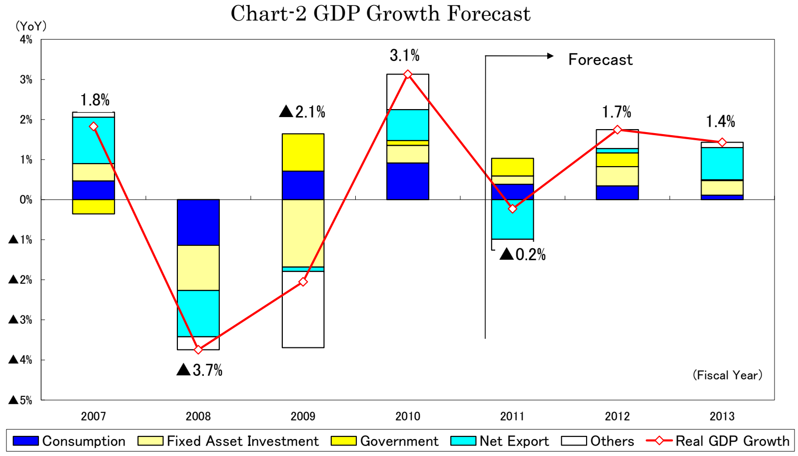
The Japanese economy apparently resumed recovering as corporate production has become active again with retail consumption remaining resilient. In the BOJ Tankan survey first quarter 2012, the current business confidence, D.I. of large manufacturers, remained at -4 points, while future business confidence improved to -3 points from -4 in the previous quarter (Chart-1). NLI Research Institute forecasts Japan's GDP growth at -0.2% in 2011, +1.7% in 2012 and +1.4% in 2013 (Chart-2).[1]

Chart-1 Business Confidence (DI, Large Manufacturers)



Source: BOJ "Tankan Survey"

Chart-2 GDP Growth Forecast



Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
Taro Saito, NLI Research Institute "Weekly Economist Letter" Mar 9, 2012.

Housing starts in February increased by 7.5% y-o-y to 67k for the first time in six months, supported by the resumption of Eco-point program (Chart-3).[2] Regarding housing starts, stand-alone houses posted an increase for the fourth consecutive month, while rental apartments for the second consecutive month and condominiums for the first time in three months. Among the disaster hit areas, Iwate and Miyagi Prefectures marked double digit growth in housing starts, while Fukushima Prefecture posted a decline.

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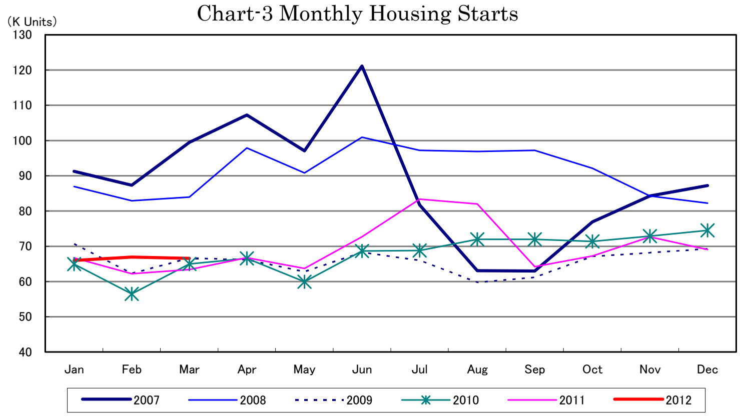
[1] Taro Saito, "Economic Forecast for 2012 and 2013: Revision of Real GDP Growth Forecast following the 4Q Number," in *Weekly Economist Letter*, NLI Research Institute, Mar 9, 2012.

[2] The Eco-point program offers gift vouchers to consumers who buy designated eco-friendly products including eco-friendly houses or equipment.

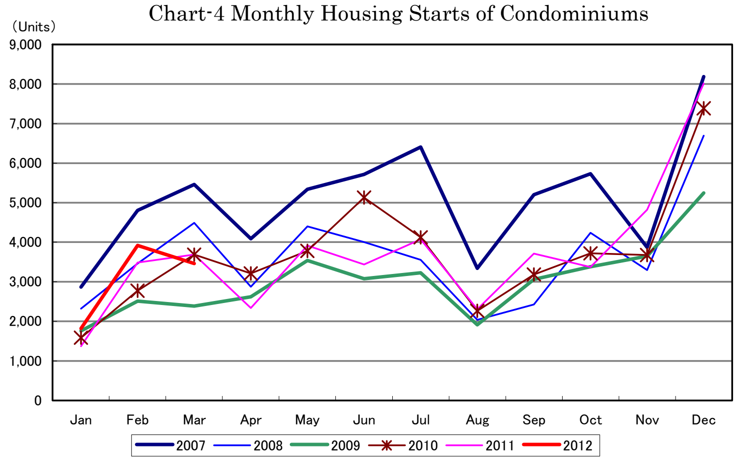
New condominium supply in the Tokyo metropolitan area in March decreased for the first time in five months by 6.1% y-o-y to 3,462 units, as certain large projects were postponed to April (Chart-4). According to Real Estate Information Network System, the transaction volume of the secondary condominium market increased for the second consecutive month by 9.5% y-o-y, specifically 3,388 units in March marked a monthly historic record.

Chart-3 Monthly Housing Starts



Source: MLIT

Chart-4 Monthly Housing Starts of Condominiums



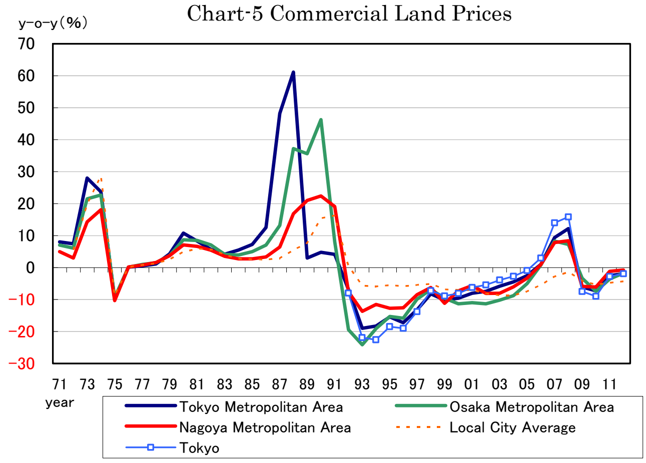
Source: Real Estate Economic Institute

2. Land Price and Property Business Confidence

The official national land prices as of 1st of January were disclosed by MLIT. The average prices of residential lands and commercial lands declined by 2.3% and 3.1% respectively, though the pace of the decline eased a bit (Chart-5). The sum of the check-points, 546 points posting price appreciation and unchanged 1,849 points, increased significantly from the previous year, but still 23,099 check–points, nearly 90% of the total, posted price declines (Chart-6). The land prices of certain areas with redevelopment projects or new transportation access and some popular residential areas began appreciating, while disaster hit areas were still struggling.

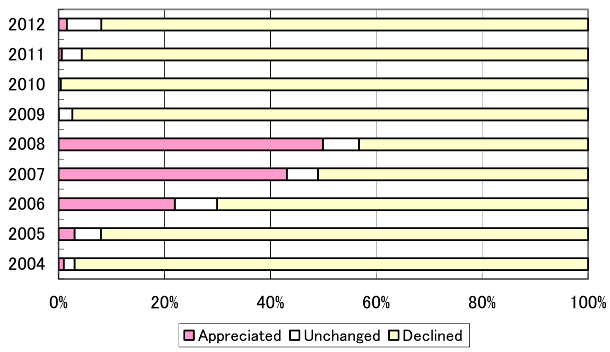
According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area declined at a mitigated pace of 0.5% q-o-q. The y-o-y decline was 2.8%, with Tokyo suburbs posting the highest at 3.7%, Chiba 3.3%, Saitama 2.6%, Tokyo 23 wards 2.2% and Kanagawa 2.1% (Chart-7). Some areas in Chiba prefecture suffering from liquefaction and others posted remarkable declines such as Abico 16.7%, Nagareyama 11.8%, Kashiwa 8.6% and Urayasu 1.8%. Regarding commercial land prices, the Tokyo metropolitan area recorded a 0.7 % q-o-q decline; while in contrast, the Osaka metropolitan area recorded a 2.7% increase (Chart-8).

Chart-5 Commercial Land Prices



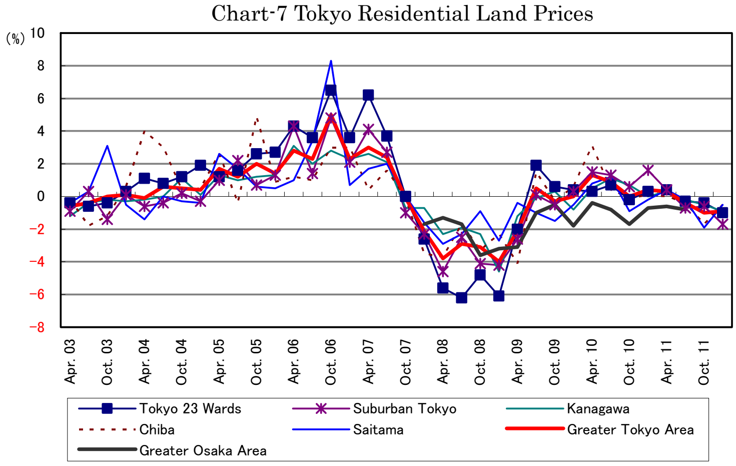
Source: MLIT

Chart-6 Commercial Land Price Changes



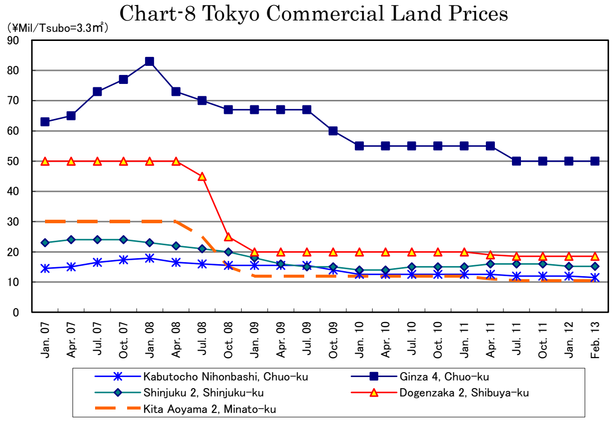
Source: MLIT

Chart-7 Tokyo Residential Land Prices



Source: Nomura Real Estate Urbannet

Chart-8 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urbannet

3. Sub-sectors

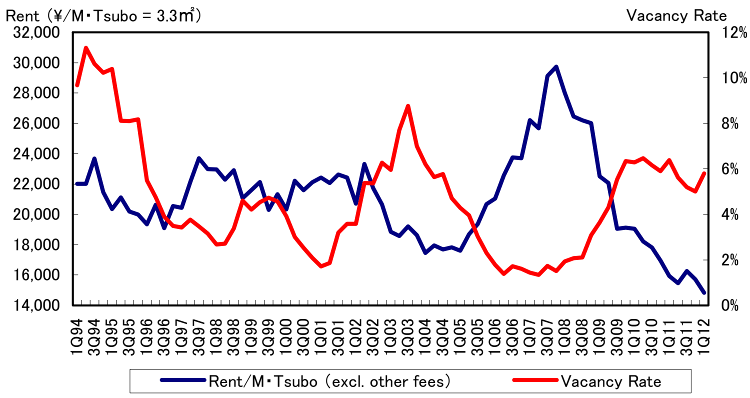
1) Office

The Tokyo office market suffered from higher vacancy rates and lower rents as many large sized offices were completed in the quarter. As seen in the index, a contract-based office rent index developed by Sanko Estate and NLI Research Institute, the first quarter office vacancy rates of very large sized buildings (standard floor larger than 200 tsubos) in the Tokyo three wards deteriorated for the first time in four quarters to 5.8%, while the rents declined for the second consecutive month to JPY 14,828 per tsubo per month (Chart-9).

Regarding new offices completed within one year, the vacancy rates remained very high (Chart-10). Many new offices and offices under construction are competing fiercely for leasing tenants. However, as the pace of rent decline is mitigating, it is likely that the Tokyo office market, especially the prime office market, will stabilize in the latter half of this year when new supplies diminish (Chart-11).

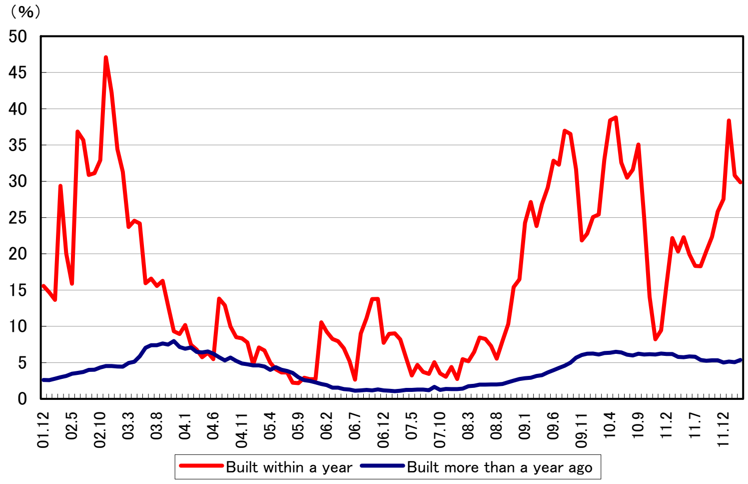
Most new large-sized offices completed this year are categorized as Grade-A which meets corporations' BCP requirements for quake-resistance in terms of location and structure, multiple electric power sources and energy-efficient equipment, and thus they can differentiate themselves clearly from existing stocks. These new Grade-A-offices are also called "sustainable building," the definition of which requires not only physical conditions, but also risk management capability of building owners and property managers.

Chart-9 Tokyo Three Wards Office Market



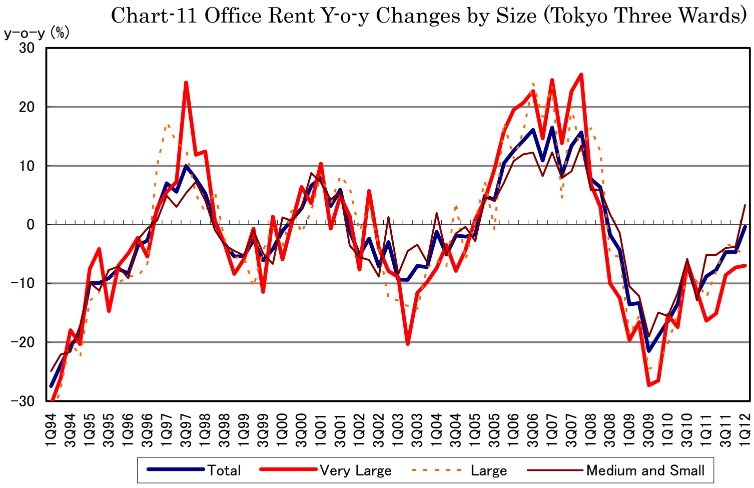
Very Large Size Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate･Sanko Estate, Rent･ Sanko Estate and NLI Research Institute

Chart-10 Office Vacancy Rates of New and Existing Stocks (Tokyo Three Wards)



Source: Sanko Estate

Chart-11 Office Rent Y-o-y Changes by Size (Tokyo Three Wards)



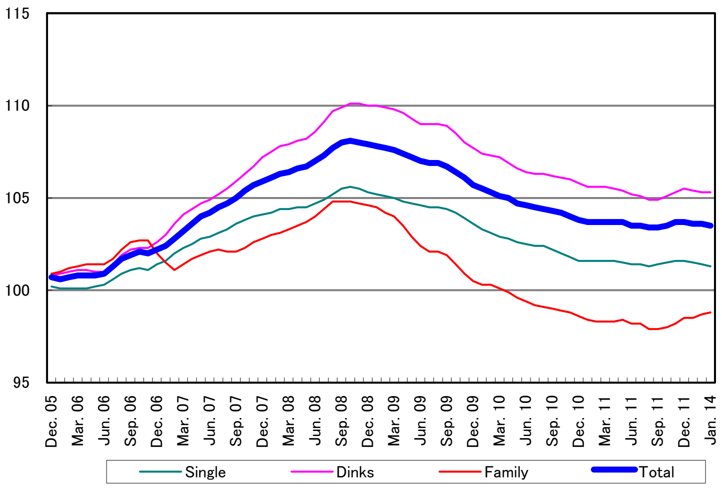
Very Large (Standard floor>200 tsubos), Large (100< and <200), Medium and Small (<100)
Source: Sanko Estate and NLI Research Institute

2) Residential Rental

Though it seemed rents finally bottomed out in the previous quarter, still some weakness remained in the Tokyo residential market in the first quarter (Chart-12). In contrast, Osaka residential rents clearly looked to be recovering. The luxury residential market which targets foreigners and high-income workers is suffering from weak demand following the Great East Japan Earthquake, while property developers continue to supply new projects.[3]

[3] Mitsubishi Real Estate established its luxury rental residential brand "Park Habio" and plans to develop 1,000 units by 2014.

Chart-12 Tokyo Residential Rent Index



Jan 2005＝100
Source: IPD･Recruit Residential Index

3) Retail, Hotel, and Logistics

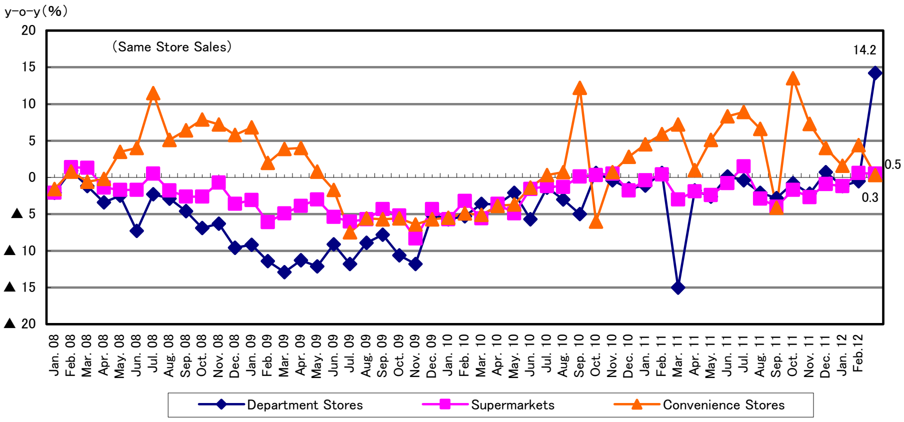
By gaining popularity among housewives and elderly people, same store sales of convenience stores continued to grow for the fifth consecutive month. Those of department stores turned to positive for the first time in three months while those of supermarkets continued shrinking for the eighth consecutive month, which looked to be a counteraction to last year when department stores struggled with the trend of refraining from luxury consumption and supermarkets experienced temporary demand for stocking daily products after the Great East Japan Earthquake (Chart-13).

Regarding the hotel market, foreign visitor arrival numbers have recovered close to the level before the Great East Japan Earthquake with -4.4% to March 2010 (Chart-14). With business customers returning, the occupancy rates have already turned normal, while foreign tourists are still inactive mainly in eastern Japan regions (Chart-15). Especially the occupancy rates in Sendai remained very high supported by reconstruction demand after the Great East Japan Earthquake (Chart-16).

In the logistics market, the vacancy rates of large multi-tenant facilities improved to an historic low, 4.5% in the Kanto region and 0% in the Kansai region (Chart-17), as no new supply was observed in the first quarter.

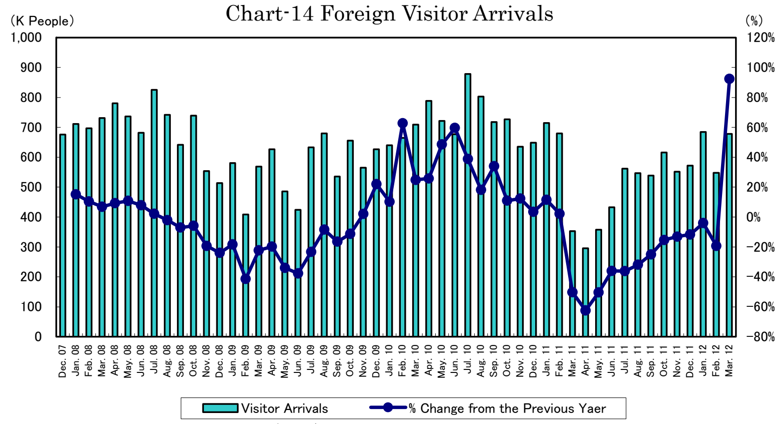
Foreign developers dominated the large sized logistics development in Japan until a few years ago, but now many domestic developers are starting developments to meet demand for new and large logistics facilities. Mitsubishi Real Estate and Mitsui Fudosan set up their special teams for logistics development. Mitsubishi Real Estate completed “Nakano Shokai Tatsumi Centre” in February and is developing “Logiport Sagamihara” with LaSalle Investment. Mitsui Fudosan is developing “Ichikawa Shiohama Project” with GL Properties.

Chart-13 Retail Same Store Sales



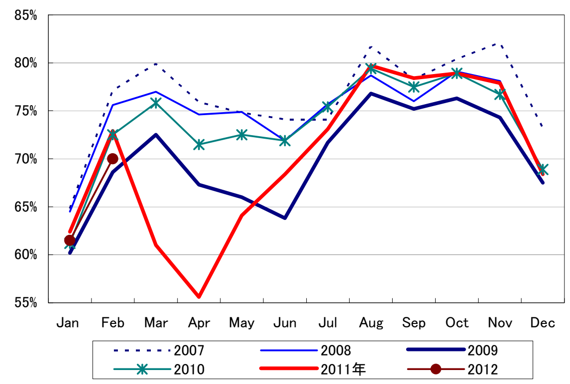
Source: Ministry of Economy, Trade and Industry

Chart-14 Foreign Visitor Arrivals



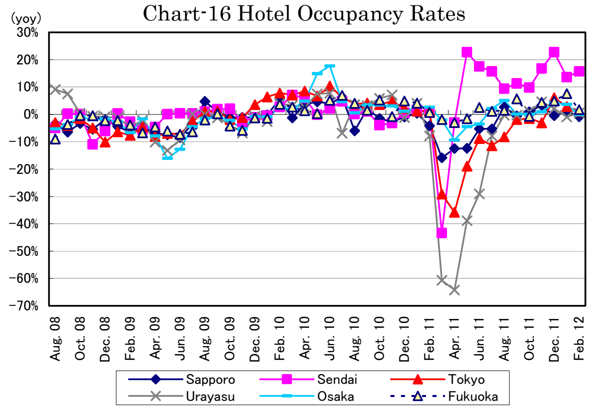
Source: Japan National Tourism Organization (JNTO)

Chart-15 Hotel Occupancy Rates



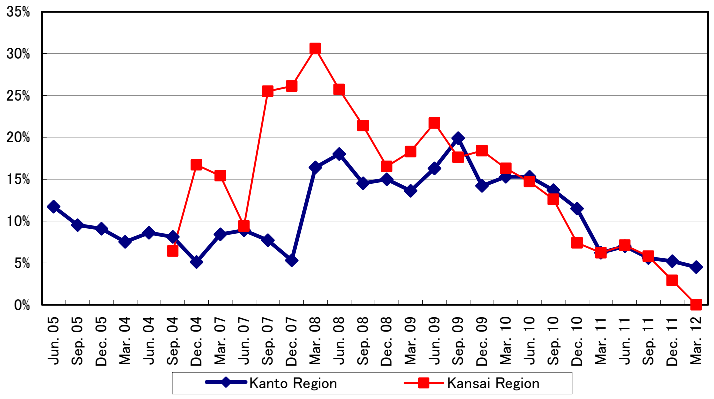
Source: Ohta Publications "Weekly HOTERES"

Chart-16 Hotel Occupancy Rates



Source: Ohta Publications "Weekly HOTERES"

Chart-17 Logistics Facility Vacancy Rate, Large-Sized Multi-Tenant-Use



*Large-sized multi-tenant-use (GFA 33,000㎡or more, 49 assets)
Source: CBRE

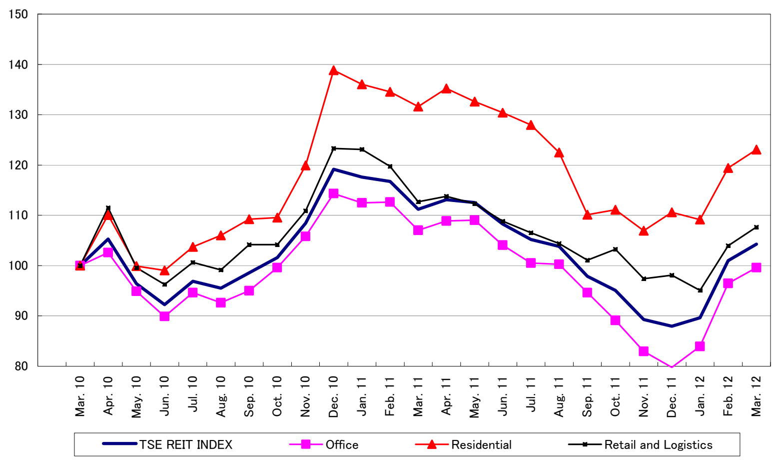
4. Property Investment and J-REIT Markets

The TSE REIT Index soared by 18.6% based on positives such as additional BOJ financial loosening, European debt concern mitigation and global economic recovery expectation. The office sector rebounded outstandingly by 24.9% following the recent drastic decline (Chart-18). Consequently, the J-REIT average dividend yield shrank to 5.2% from the recent more than 6%. J-REITs acquired JPY 173.6 billion of assets in the first quarter following the very active previous quarter of JPY 198.8 billion.

As Kenedix Residential was newly listed, which was the first IPO since October 2007, the number of listed J-REITs became 34. Other IPOs are likely to follow this year, which will enlarge the J-REIT market size and diversity (Chart-19).

The transaction volume increased toward the fiscal year end, with J-REITs, S-REITs and domestic property developers such as Hulic or Mitsubishi Real Estate showing noticeable acquisition activity. More than a few private funds announced their acquisitions and refinances, which means the property investment market remained active.

Chart-18 TSE REIT Index



Source: Tokyo Stock Exchange

	TSE REIT	Office	Residential	Retail,Logistics
Apr.-Jun.2011	-2.6%	-2.8%	-0.9%	-3.4%
Jul.-Sep.2011	-9.6%	-9.1%	-15.5%	-7.1%
Oct.-Dec.2011	-10.1%	-15.7%	0.4%	-3.0%
Jan.-Mar.2012	18.6%	24.9%	11.3%	9.7%
Fiscal Year 2011	-6.2%	-6.9%	-6.5%	-4.5%

Source:Tokyo Stock Exchange

Chart-19 J-REITs to be Listed

Sponsor	REIT Name	Est. IPO Size	Timing	Asset Type
Kenedix	Kenedix Residential Investment Co.	JPY 30 billion	Apr 26, 2012	Residential
Tokyu Real Estate	Conforia Residential Investment Co.	JPY 100 billion	2014-2015	Residential
Tokyu Real Estate	Activia Properties Investment Co.	JPY 150 billion	2012	Retail・Office
Daiwa House Industrial	Daiwa House REIT Investment Co.	JPY 150-200 billion	2012	Retail・Logistics
GLP	GLP Investment Co.	JPY 200-300 billion	2012	Logistics
Hulic	–	–	2015	Office and others

Source: NLI Research Institute

