Real Estate Analysis Report

Asian Money Inflows Boost Japan's Property Market

～Market Participants Can Help by Improving Transparency～

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Introduction

Although the global economy is on the recovery course after the Lehman shock, uncertainties stemming from the EU and U.S. economies are weighing on the outlook. Japan's economy is also slowing down, while the presence of Asian emerging markets is increasing in the world. In the Japanese property investment market, the growing inflow of Asian money has become more noticeable and is expected to boost the market recovery. This report reviews the Asian money inflows, and proposes that the property investment market can benefit from efforts by market participants to improve market transparency.

1. The Growing Asian Money Inflow: How Much and Why?

Recently, investment from Asia has attracted attention as a factor supporting Japan's property investment market. In fact, not a few Asian investors primarily from Singapore and Hong Kong have appeared on the list of major property transactions in 2010 (Chart-1). While mainland Chinese investors are not found on the list yet,[1] they are purported to be investing in Japan via Hong Kong investment funds.

Chart-1 Major Property Investment Transactions in Japan by Asian Investors 2010

Investor name	Investor's country	Property name	Amount JPY 100 mil	Date
Mapletree Logistics Trust	Singapore	Logipartners Kashiwa Logistic Center 2	43.6	2010.2
Kech Seng Investment、Meadpoint	Hong Kong, Singapore	New City Apartments Ginza East Ⅱ	17	2010.2
Mapletree Logistics Trust	Singapore	IXINAL Monzennakacho		2010.3
YTL Corporation	Malaysia	Niseko Village	60	2010.3
Hong Kong Individuals	Hong Kong	Hyatt Regency Hakone Resort and Spa		2010.3
Fund of a Hong Kong Conglomerate	Hong Kong	Storia Shinagawa	70	2010.4
Transam Alpha (Kenedix Funds for Korean Investors)	South Korea	Kiriyama and Kiriyama Annex building、Shin Yokohama Tarblekan	100	2010.5
Kech Seng Investment、Meadpoint	Hong Kong, Singapore	New City Apartments Nihonbashi Suitengu	21.8	2010.6
Mapletree Logistics Trust	Singapore	Sendai Center	14.9	2010.6
IPC Corporation	Singapore	Hotel Skycourt Asakusa, Hotel Skycourt Asagaya	18.66	2010.6
Parkway Life REIT	Singapore	Six nursing homes from Uchiyama Group	39	2010.6
Parkway Life REIT	Singapore	Five nursing homes from Uchiyama Group	30.87	2010.7
Rockrise	Malaysia	70% share of Nippon Hotel Reit Advisors		2010.7
Mapletree Logistics Trust	Singapore	Three logistic properties in Saitama and Chiba-prefecture	130	2010.7
Mapletree Logistics Trust	Singapore	Iwaki Logistic Center	48	2010.7
Mapletree Logistics Trust	Singapore	Irima Logistic Center	34	2010.7
Mapletree Logistics Trust	Singapore	Noda Logistic Center	48	2010.7
TMK of HKR International	Hong Kong	Homattsan (residential)	34.5	2010.7

Source: *Nikkei Real Estate Market Report*

[1] Small-size individual transactions by mainland Chinese appear to be on the increase. Amid news of China's rapid economic growth and worsening bilateral tensions, the Japanese media frequently reports that wealthy individuals from mainland China take sightseeing tours in Japan to look at investment properties.

Generally, Western investors consider the long-term prospects of Japan's property market to be unattractive based on the shrinking population projection. On the other hand, the recent money inflow from Asia can be attributed to factors such as the following.

First, SWFs (sovereign wealth fund) are growing in size while also diversifying into Japan. Typical examples include the foreign reserve and public pension funds of Singapore and Hong Kong. Although these countries are small in size, their SWFs are among the world's largest. In particular, total assets under management by Singapore's GIC and Temasek Holdings amount to nearly USD 380 billion (Chart-2). Considering that the domestic property investment market is only USD 79 billion according to DTZ (Chart-3), it is apparent they also need to aggressively invest overseas.

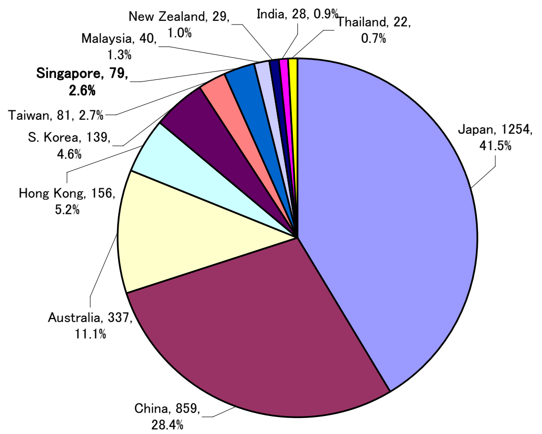
SWFs are huge in China as well. China Investment Corporation (CIC) and SAFE Investment Corporation (SAFE) have a significant influence in global financial markets. Though they are allowed to invest in foreign properties, no deals have been reported in Japan yet (Chart-4). But considering the Singaporean case, it is likely for Chinese SWF to begin investment in Japanese properties from the point of view of diversification.

Chart-2 Largest SWF by AUM (Sep. 2010)

Country	Fund Name	Assets US$ bn
UAE – Abu Dhabi	Abu Dhabi Investment Authority	627
Norway	Government Pension Fund – Global	512
Saudi Arabia	SAMA Foreign Holdings	415
China	SAFE Investment Company	347
China	China Investment Corporation	332
Singapore	Government of Singapore Investment Corporation	248
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	228
Kuwait	Kuwait Investment Authority	203
China	National Social Security Fund	147
Russia	National Welfare Fund	143
Singapore	Temasek Holdings	133

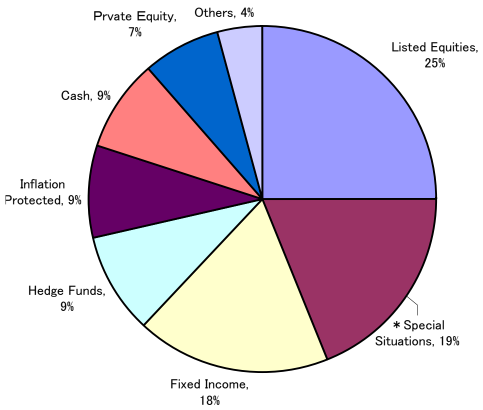
Source: Sovereign Wealth Fund Institute

Chart-3 Asia Pacific Investment Properties 2009 (US$bn)



Source: DTZ Research

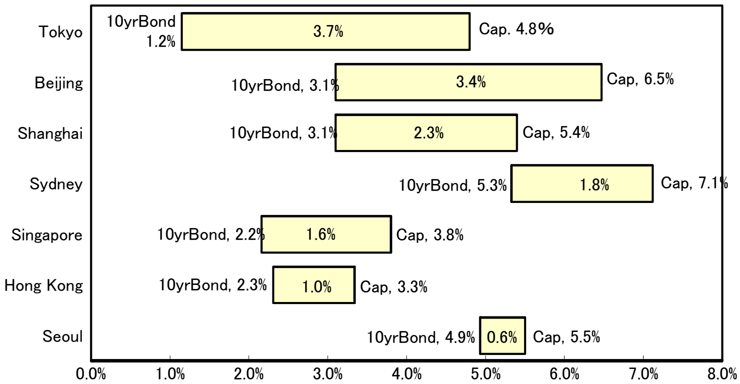
Chart-4 CIC Global Investment Portpholio (08/06/2010)



＊Including event driven funds
Source: Sovereign Wealth Fund Institute

Second, Japanese properties are relatively undervalued based on the yield gap against the risk-free rate. With global excess liquidity on the rise, the inflow of money into Asian property markets has been particularly conspicuous, raising concerns about rising prices and even a potential property bubble. On the other hand, Japanese property prices remain modestly priced even after the market bottomed out, and appear relatively inexpensive in the region. For example, Hong Kong and Singapore have lower office Cap rates than Tokyo, which means prices are higher. Moreover, Tokyo has a bigger office yield gap against ten-year government bonds than other major cities in Asia including China. On this point, investment conditions in Tokyo are very attractive with good leverage opportunity (Chart-5).

Chart−5 Asia Major City CBD Office Yield Gap (June 2010)



Source: Colliers International, *Global Office Real Estate Review 1H2010*.

Third, the size and robust growth prospects of Tokyo's economy are highly regarded. Even as the rest of Japan's population continues to shrink, Tokyo's population is expected to grow due to migration from other areas. Thus Tokyo's economy will likely remain the world's largest over the long term, commanding a lasting presence among global investors as one of the most significant international markets (Chart-6). Moreover, Tokyo is home to the largest number of company headquarters, and the diversity of industries in Tokyo makes it more stable and resistant to market shocks than financial capitals such as London, New York, or Hong Kong.

Chart−6 Richest Cities and Urban Areas in 2020

Rank	City / urban area	Country	Est GDP in 2020 in US$bn	Est annual growth 2005-2020
1	Tokyo	Japan	1602	2.00%
2	New York	USA	1561	2.20%
3	Los Angeles	USA	886	2.20%
4	London	UK	708	3.00%
5	Chicago	USA	645	2.30%
6	Paris	France	611	1.90%
7	Mexico City	Mexico	608	4.50%
8	Philadelphia	USA	440	2.30%
9	Osaka/Kobe	Japan	430	1.60%
10	Washington DC	USA	426	2.40%
11	Buenos Aires	Argentina	416	3.60%
12	Boston	USA	413	2.40%
13	Sao Paulo	Brazil	411	4.10%
14	Hong Kong	China	407	3.50%
15	Dallas/Fort Worth	USA	384	2.40%

Source: City Mayors.com, researched by Price Waterhouse Coopers.

Fourth, the Japanese property investment market is now the largest in the Asia Pacific region, while those in emerging markets are still very small by comparison. Large institutional investors around the world including pension funds and SWFs cannot allocate meaningful investments among Emerging markets due to the illiquidity of these markets. Thus whenever large institutional investors allocate investments in the Asia Pacific region, they put a high priority on the Japanese market.

2. How to encourage more foreign money inflow～improvement of market transparency～

The following discussion clarifies what market participants can do to make foreign money inflows a lasting trend.

According to a global investor survey,[2] the leading response cited as the most important factor for regional (country) selection is "growth of the property market." On this point, the lack of macroeconomic growth and shrinking population might direct investment money away from Japan to other growing Asian countries. However, this is a national strategic issue which is too big to deal with for property market participants. On the other hand, many respondents chose "quantity and quality of market information" and "accessibility to investment market information," both of which relate to market transparency. This is an area in which market participants can and should do a lot to improve.

A useful measure of property market transparency is Jones Lang LaSalle's biennial "Global Real Estate Transparency Index," which integrates five factors—performance measurement, market fundamentals, regulatory and legal environment, listed vehicles, and transaction process. The index shows that Japan's transparency is far behind that of Western developed countries, and lags behind even in the Asia Pacific region at 26th place after countries such as Australia, Singapore, Hong Kong, and Malaysia. This means not only that Japan has considerable room to improve compared with its Western peers, but that lower-ranked Asian countries like China, Taiwan and Korea can also catch up rapidly. Market transparency is an urgent issue that market participants must address in order to encourage more foreign money inflow from abroad (Chart-7). Moreover, increased transparency will also encourage domestic pension funds to raise their property investment weights, which are now very low compared to those of their counterparts abroad (Chart-8).

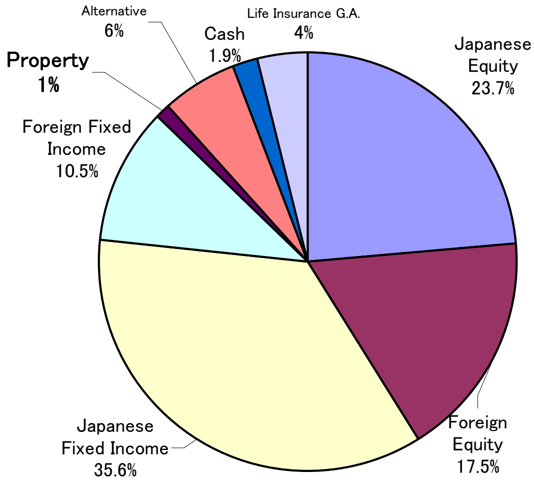
[2] Ministry of Land, Infrastructure, Transport and Tourism, *Foreign Investor Survey 2010* (July 2010).

Chart-7: Global Real Estate Transparency Index

Transarency Level	Rank	Market	Score
High	1	Australia	1.22
	2	Canada	1.23
	3	UK	1.24
	4	New Zealand	1.25
	5	Sweden	1.25
	6	USA	1.25
	7	Ireland	1.27
	8	France	1.28
	9	Netherlands	1.38
	10	Germany	1.38
	11	Belgium	1.46
	12	Denmark	1.5
Transparent	16	Singapore	1.55
	18	Hong Kong	1.55
	25	Malaysia	2.25
	26	Japan	2.39
Semi	33	Taiwan	3.07
	39	Thailand	3.15
	41	India Tier1	3.16
	42	South Korea	3.23
	44	Macau	3.33
	45	China Tier1	3.34
	48	Philippines	3.38
Low	49	India Tier2	3.51
	54	China Tier2	3.54
	55	India Tier3	3.65
	57	Indonesia	3.68
	65	China Tier3	3.97
	73	Pakistan	3.97
	76	Vietnam	4.29

Note: Shows only Asian countries from rank 16 downward.
Source: Jones Lang LaSalle、LaSalle Investment Management

Chart-8 Japanese Pension Fund Policy Asset Mix



Source: ARES, "10th Questionnaire Survey on Real Estate Investment by Institutional Investors," August 2010.

Following are some major transparency issues afflicting Japan's property market. First, conventional lease contracts in Japan, which are renewed biennially, allow tenants to terminate without penalty by giving six-month notices. By comparison, other countries typically use fixed-term lease contracts, which allow investors to anticipate the income amount for the full contract term. Moreover, if there is a "free rent" period, the actual monthly rent can easily be calculated by averaging out the full income amount over the contract term. Thus the conventional Japanese lease contract is heavily criticized by foreign investors for increasing the volatility of cash flow. While the fixed-term lease contract is still minor in Japan and very limited to competitive large-sized Tokyo offices, it could be increasingly adopted particularly for leasing of corporate headquarters and offices of foreign companies.

In addition, the common-area service fee of conventional lease contracts has been criticized for having an unclear composition. However, since the new energy saving law that took effect in April 2010 requests both owners and tenants to make energy saving efforts, the need to allocate energy savings could encourage clarification of the common-area service fee.

As for residential, commercial and hotel property sectors, the lack of market data makes the market transparency low. However, the data infrastructure is gradually improving in these markets as the securitization market grows. For example, for the residential sector, the Ministry of Land, Infrastructure, Transport and Tourism is now preparing a new residential property index based on global standards.

Since many of these issues are deeply routed in Japanese market practices, much time will be needed to improve market transparency. However, given that the direction of improvement is visible, market participants can expect to see concrete results if they persist in their efforts.

3. Transparency Improvement by Fund Managers and Institutional Investors

Meanwhile, the J-REIT market is noted for having a high transparency in line with other developed markets. And despite criticism regarding the lack of disclosures in English, most of the larger J-REITs already have English language websites that provide financial results and presentation materials, although English fund annual reports can be spotty (Chart-9).

Chart-9 Status of J-REIT English Language Websites

Status	Information in English	No. of issues	
Same basic content in Japanese and English	Fund annual reports Presentation materials Financial results	16	28
	Presentation materials Financial results	12	
Large gap in content	Financial results only		4
No English content	None		3
		Total	35

Source: NLI Research Institute

As for areas in need of improvement, one is to shorten the time lag between Japanese and English announcements. Sometimes only a Japanese announcement is made during the trading session, with the English announcement following after closing or even days later. Now that not only Western but Asian investors are important, the time gap needs to be bridged. In this sense, a new service by Bloomberg[3], which provides same-day English announcements, represent a meaningful step forward.

Also, it is important to enhance communication using means other than written documents. For example, market transparency could be improved if more J-REITs set up IR teams that can respond to inquiries from foreign investors and meet regularly with them.

But the biggest problem regarding market transparency is that the J-REIT market represents only a small fraction of the Japanese property market. For example, the private property fund market is far larger than the J-REIT market, and has very low transparency. While private funds as a whole are not subject to disclosure requirements, in the West they provide data to data service companies so that indexes can be compiled. For example, IPD (U.K.) compiles data provided by private funds and publishes the "IPD Pooled Property Fund Indices" to help investors evaluate fund performance (Chart-10).

[3] J-REIT Flash was launched by Bloomberg for professional users in November 2010. It delivers same-day English announcements and notices English updates on J-REIT websites.

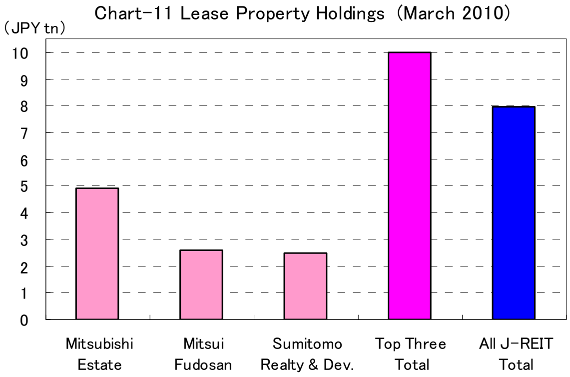
Chart-10 IPD Property Indices Type List (Major Markets)

	Property Index (sector breakdown)	Pooled Property Fund Indices
Japan	Monthly (updated three months later)	None
UK	Monthly (updated next month)	Quarterly
Australia	Quarterly	Monthly (updated next month)
U.S.	Quarterly	Quarterly

Source: IPD

Furthermore, the Japanese property investment market has a somewhat unique ownership structure in which major property developers and financial groups comprise a large share of long-term holdings in high-class buildings. For example, holdings of the top three developers exceed the holdings of the entire J-REIT market (Chart-11).

Chart-11 Lease Property Holdings (March 2010)



Source: NLI Research Institute

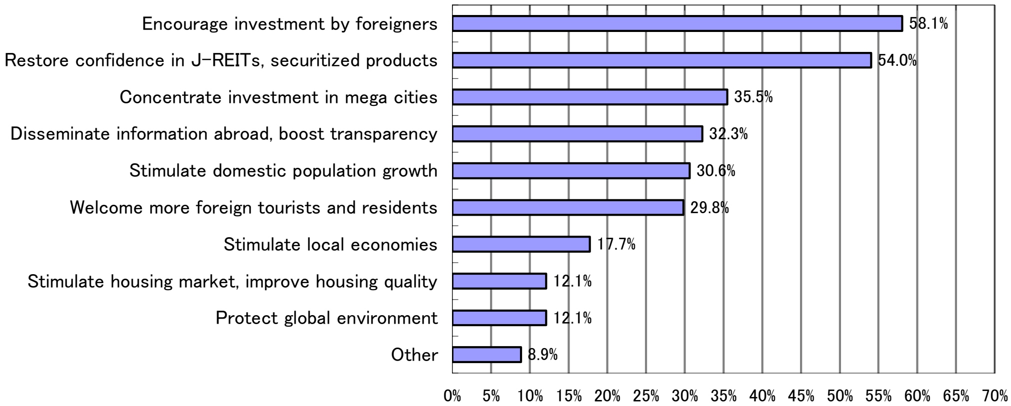
As a result, property investment performance is more difficult to evaluate in Japan, which tends to widen the transparency gap with developed Western markets.

Since additional costs are a large impediment to further disclosure by J-REITs and data provision by private funds, tangible benefits are needed to offset these costs, such as greater ease of financing and invigoration of the property market. In this regard, the latest *Property Market Survey* conducted by NLI Research[4] revealed a remarkable result—when asked what was the "most required policy measure for long-term sustainable growth of the property market," the top response was to "encourage investment by foreigners" (Chart-12). Apparently, expectations toward foreign investors are rising due to the recent growth of Asian money inflow, suggesting that the disclosure environment is set to move forward with foreign investors strongly in mind.

Moreover, with the implementation in March 2010 of mark-to-market accounting rules on property for lease, previously reluctant institutional investors, developers, and fund managers are expected to consent more readily to providing data for index construction.

[4] NLI Research Institute" Outlook Remains Cautious; Focus is on Eco Properties and Foreign Factors－The Seventh Property Market Survey" 28.Oct.2010

Chart-12 Required Policy Measures for Long-term Sustainable Growth of Property Market 2010 (MA)



Source: NLI Research Institute, *Property Market Survey*, October 2010.

Final Note

With the globalization of property investment, Asia's regional economic growth is a decidedly positive factor for the Japanese property investment market. Looking ahead, as global investors seek to diversify risk across Asian markets, Japan, as Asia's most developed country, can expect to receive its fair share of investment allocation. Although some factors such as fixed-term leasing contracts will take a long time to become established and improve market transparency, many other factors are technologically within reach of market participants, such as enhanced disclosure by fund managers and data provision for index construction by institutional investors. By making further efforts to improve market transparency, market participants can play a constructive role in encouraging more investment from abroad.