

Real Estate Analysis Report

Japanese Property Market Quarterly Review Fourth Quarter 2011

~Tokyo Office Recovery Halts on Economic Standstill~

This is the English translation of Toru Matsumura, “国内景気の足踏みでオフィスセクターの回復進まずー不動産クォーターリー・レビューー2011年第4四半期” NLI Research Institute, *Real Estate Analysis Report*, January 31, 2012

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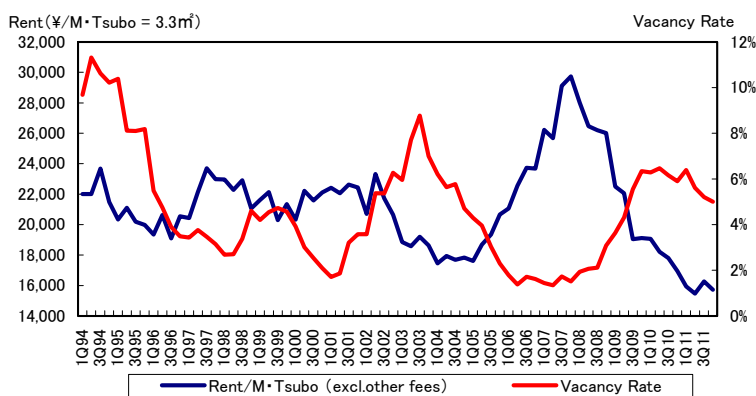
Summary

The Japanese economy has come to a standstill in the recovery from the earthquake, and the business confidence of large manufacturers deteriorated significantly in fourth quarter 2011 with negative factors from overseas such as the European financial crisis, emerging economic slowdown and the extraordinary flooding in Thailand.

Tokyo office rents turned negative again following a small pick-up last month, as corporate demand shrank in line with deteriorating business confidence. On the other hand, apartment rents bottomed out and the occupancy rates of hotel and logistics facilities improved substantially.

In the Tokyo metropolitan area, corporations and consumers have become more risk sensitive after the earthquake and the nuclear plant accident, and market polarization progresses in land and property prices with more stringent appraisal of locations, building structures and equipment.

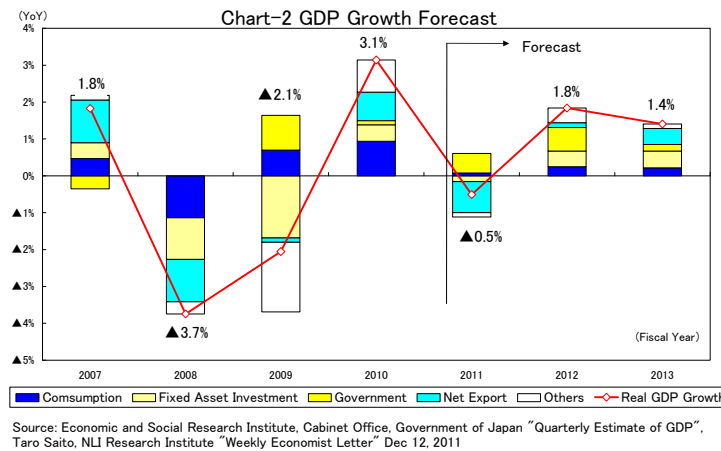
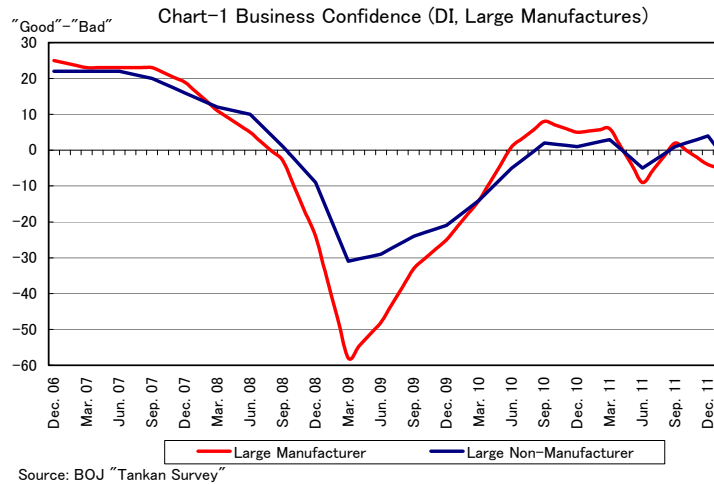
The TSE J-REIT index declined by 10.1%, q-o-q, in the midst of global financial uncertainty, but expected Cap rates remained unchanged and fund raising conditions still improved. While existing funds sold some assets, some new funds were seen being established.



1. Economy Outlook

The Japanese economy came to a standstill from the recovery trend after the earthquake, and the business confidence of large manufacturers deteriorated significantly in fourth quarter 2011 (Chart-1) with negative factors from overseas such as the European financial crisis, emerging economic slowdown and the extraordinary flooding in Thailand.

NLI Research Institute made downward revisions on the forecast of Japan's GDP growth of -0.5% in 2011 and 1.8% in 2012 (Chart-2).¹



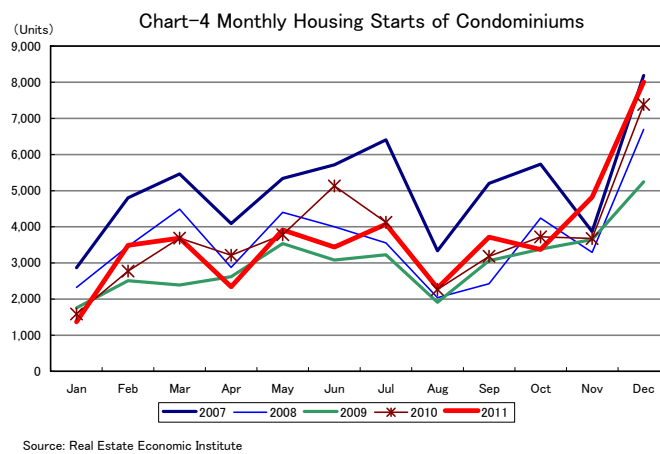
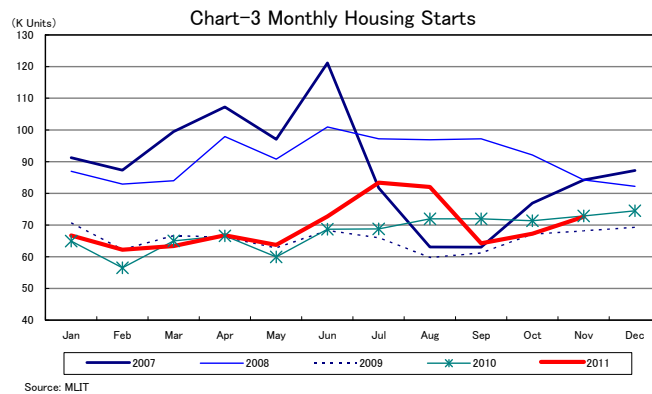
Housing starts in November shrank by 0.3% y-o-y to 72k for the third consecutive month of decline (Chart-3), influenced by termination of the special low interest rate campaign on "Flat 35."² The construction starts of rental apartments shrank for the third consecutive month, but that of condominiums grew for the second consecutive month.

The condominium supply in the Tokyo metropolitan area in December grew by 8.4% y-o-y for the second consecutive month, however, the annual supply in 2011 turned out 44.5k,

¹ Taro Saito, "Economic Forecast for 2011 and 2013: Revision of Real GDP Growth Forecast following the 2Q Number," in *Weekly Economist Letter*, NLI Research Institute, Dec 12, 2011.

² "Flat 35" program offers low-interest-rate-35-year loans to home buyers.

which was 0.1% lesser than that of last year (Chart-4).



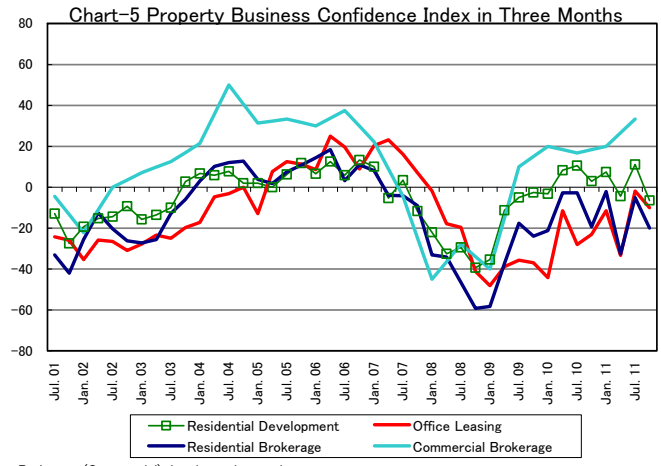
2. Land Price and Property Business Confidence

Regarding the property business confidence survey by the Land Institute of Japan in October, the business category “residential development” scored positive for the second consecutive month, but “residential brokerage” and “office leasing” have remained negative since July 2007 and Oct 2008 respectively. All business categories are expected to be negative in the next three months (Chart-5).

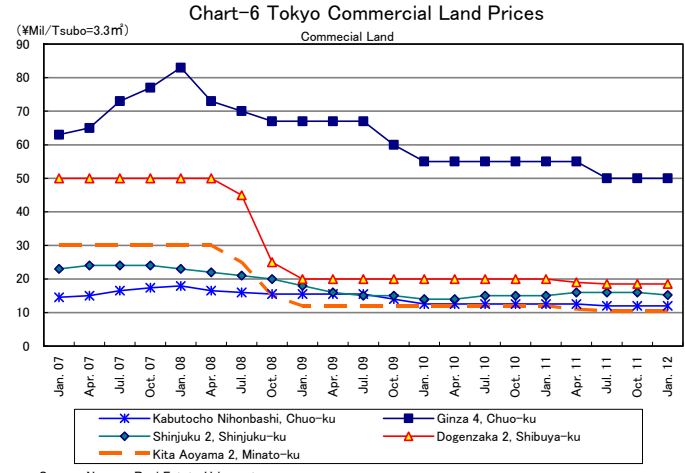
According to Nomura Real Estate Urban Net, commercial land prices in Tokyo remained unchanged for three quarters, excluding Shinjuku, after taking a fall following the earthquake (Chart-6). On the other hand, residential land prices in the Tokyo metropolitan area declined by 0.9% q-o-q and 2.0% y-o-y (Chart-7).

In the Tokyo metropolitan area, corporations and consumers have become more risk sensitive after the earthquake and the nuclear plant accident, and market polarization progresses in land and property prices with more stringent appraisal of locations, building structures and equipment. In Chiba prefecture, where extreme liquefaction was seen in bay-side and some in-land areas and many radioactive contaminated sites called hot spots were detected, the municipal population began shrinking and the residential land price

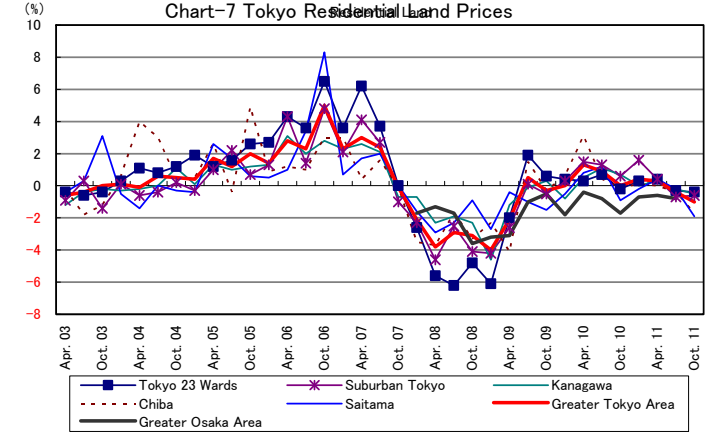
dampened with quiet condominium supply and second market transaction (Chart-8, 9). In the details of the Nomura Real Estate Urban Net data, land prices in cities of Chiba prefecture such as Abiko, Nagareyama, Kashiwa and Kashiwa-no-ha posted more than 5% y-o-y decline, and notorious liquefaction site, Urayasu, declined 1.8% y-o-y.



*Brokerage (Commercial) data is semi-annual.
Source: The Land Institute of Japan "Property Business Confidence Survey"



Source: Nomura Real Estate Urbannet



Source: Nomura Real Estate Urbannet

Chart-8 Population Move in Kanto Region

Prefecture	Move-In				Move-Out				Net Increase	
	2011 Mar~Nov	2010 Mar~Nov	Change from Prev. Year		2011 Mar~Nov	2010 Mar~Nov	Change from Prev. Year		2011 Mar~Nov	2010 Mar~Nov
			Actual	y-o-y(%)			Actual	y-o-y(%)		
Saitama	130,471	132,813	-2,342	-1.8	119,939	119,419	520	0.4	10,532	13,394
Chiba	113,718	124,998	-11,280	-9.0	115,934	111,629	4,305	3.9	-2,216	13,369
Tokyo	322,841	326,359	-3,518	-1.1	282,090	279,208	2,882	1.0	40,751	47,151
Kanagawa	174,012	178,841	-4,829	-2.7	162,833	163,488	-655	-0.4	11,179	15,353

Source: MIC Japan, "The impact of the earthquake on population move," Dec. 26, 2011

Chart-9 Condominium Construction Starts in Kanto Region

Prefecture	Condominium Construction Starts					
	2011 Apr~Nov	Change from Prev. Year		2010 Apr~Nov	Change	
		Actual	y-o-y(%)		Actual	y-o-y(%)
Saitama	4,701	2,063	78.2	2,638	-28.1	
Chiba	2,538	-567	-18.3	3,105	117.7	
Tokyo	28,584	5,653	24.7	22,931	105.1	
Kanagawa	11,505	5,616	95.4	5,889	34.0	

Source: MLIT Japan

3. Sub-sectors

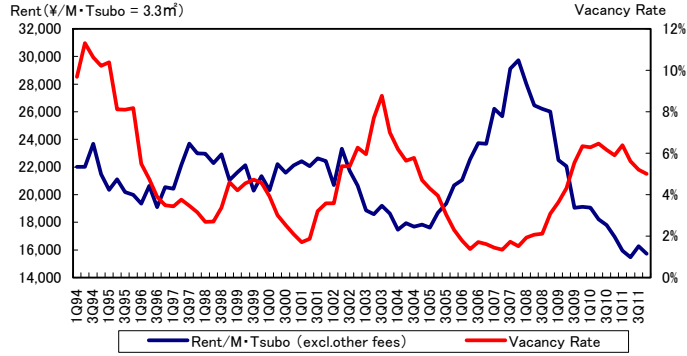
① Office

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 fourth quarter 2011, for the third consecutive quarter. However, the office rent, which turned for the first time in fifteen quarters last month, declined again in line with deteriorating corporate business confidence (Chart-10). However, the pace of y-o-y decline is mitigating (Chart-11).

As the expected volume of new supply in the Tokyo 23 wards in 2012 is the second largest following that of 2003, the market demand-supply balance is a significant concern especially in the first half of 2012. According to Sanko Estate, the volume of new supply in Tokyo for the next three years could be equivalent to 7% of the existing stock, which ratio is much higher than those of other cities (Chart-12).

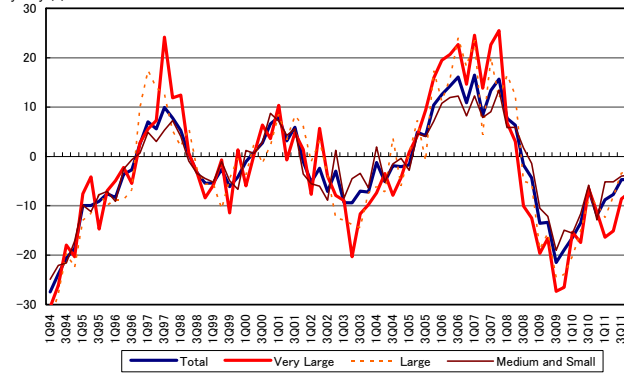
However, factoring in new office demand related to national reconstruction and foreign corporations returning due to deregulations, the grade-A office market in Tokyo's central business district is likely to recover. A survey by Mori Building shows that more potential corporate tenants have come to focus on quake-resistance and disaster prevention after the earthquake, though lower cost had always been their top priority (Chart-13). Most new large-sized buildings completed this year will meet corporations' BCP requirements in quake-resistance in terms of location and structure, multiple electric power sources, energy-efficient equipment and good risk management systems, and thus they can differentiate clearly from existing stocks.

Chart-10 Tokyo Three Wards Office Market



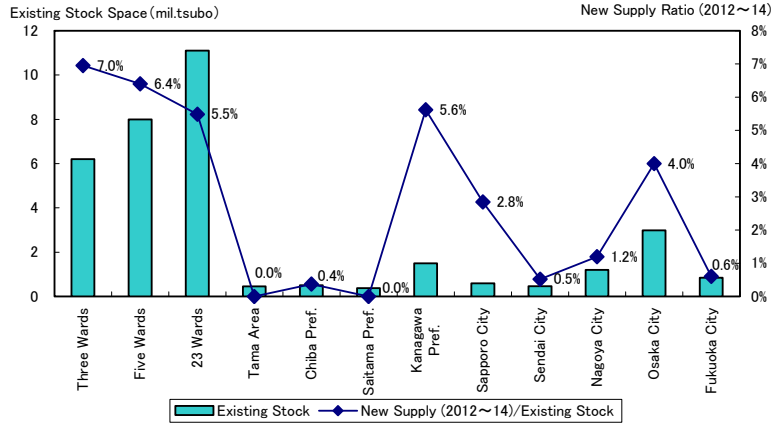
Very Large Size Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate·Sanko Estate, Rent·Sanko Estate and NLI Research Institute

Chart-11 Office Rent Index (Tokyo Three Wards)



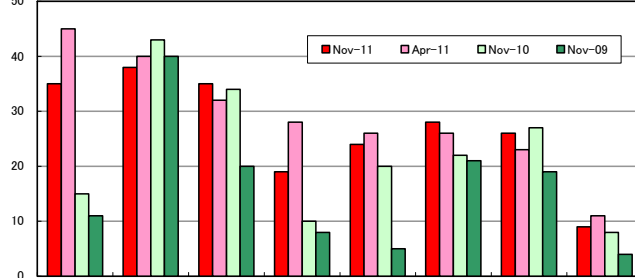
Very Large (Standard floor>200 tsubos), Large (100< and <200), Medium and Small (<100)
Source: Sanko Estate and NLI Research Institute

Chart-12 New Supply Ratio (2012~14) to Existing Stock



Source: Sanko Estate

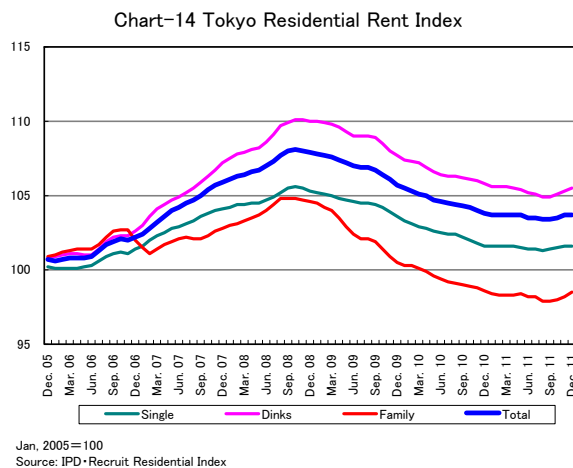
Chart-13 Focus Factor by Potential Corporate Tenants



Source: Mori Building "Tokyo 23 wards office needs survey"

② Rental Apartment

It seems rents finally bottomed out after some weakness following the earthquake (Chart-14). However, the luxury market, where foreigners and high-income workers are mainly targeted, remains unbalanced with continuing large supply and less demand from foreigners.



③ Retail, Hotel, and Logistics

Same store sales at large retail stores declined for the fifth consecutive months since August. Those of convenience stores have maintained positive growth for three months and those of department stores turned positive for the first time in six months, while those of supermarkets have been shrinking for five months (Chart-15).

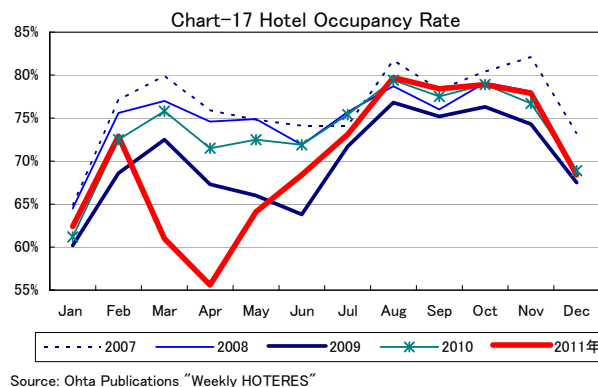
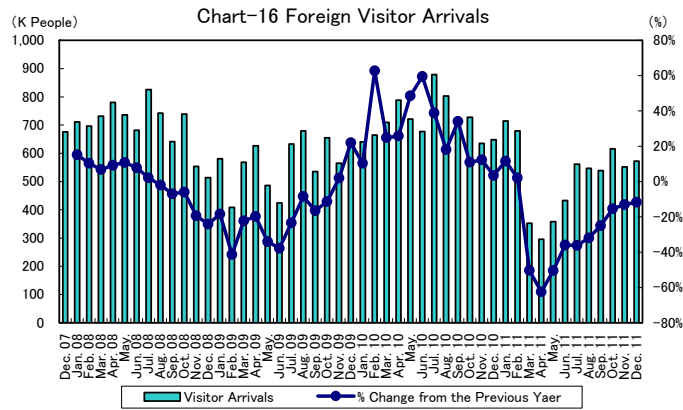
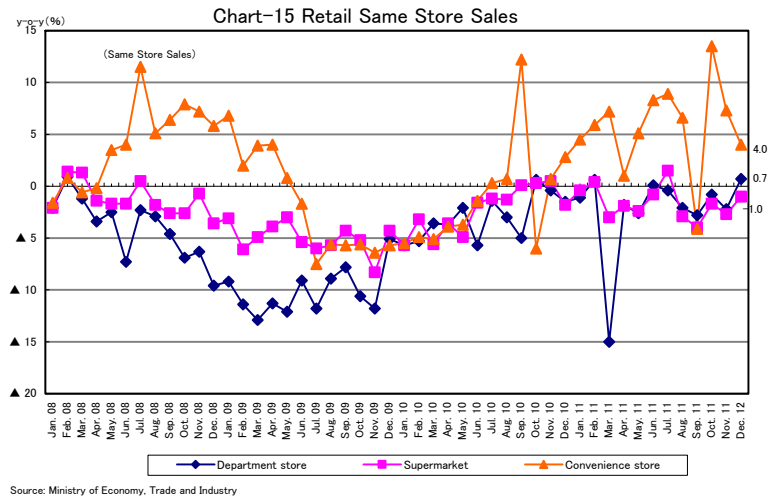
The consumer confidence index turned negative for the first time in seven months in November, as categories such as overall livelihood, income growth and employment deteriorated significantly. In addition, in the family income and expenditure survey, the expenditure of two-or-more-person households posted the six month of consecutive decline.

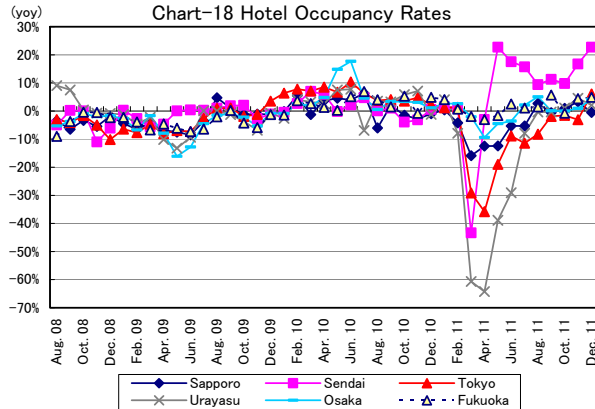
On the other hand, convenience stores have gained more women and elderly customers, as they functioned well as an urban lifeline during the earthquake. In 2012, the five major convenience store chains have plans to collectively open more than 3,400 stores nationwide, the largest expansion in history.

In the hotel market, although foreign visitor arrival numbers have not recovered yet, the occupancy rate has normalized boosted by the recovery of business travel and deep room rate discounts. And it seems some city hotels are starting to raise room rates (Chart-16, 17). Cities such as Urayasu, which suffered badly from the closing of Disney resort after the earthquake, and Sendai, which has experienced unexpected reconstruction worker demand, showed remarkable moves (Chart-18).

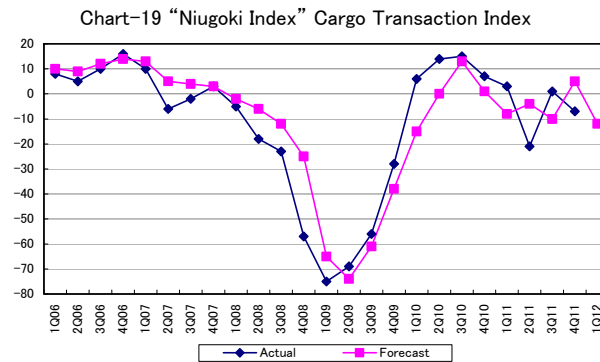
In the logistics market, the vacancy rate of large multi-tenant facilities, which fund investors focus on, improved to an historic low in both the Kanto and Kansai regions (Chart-19, 20), while a leading indicator, “Niugoki index,” a cargo transaction index, began

declining with rents still remaining weak. With the improving vacancy rate, new development plans and large scale investments have recently been announced one after another.

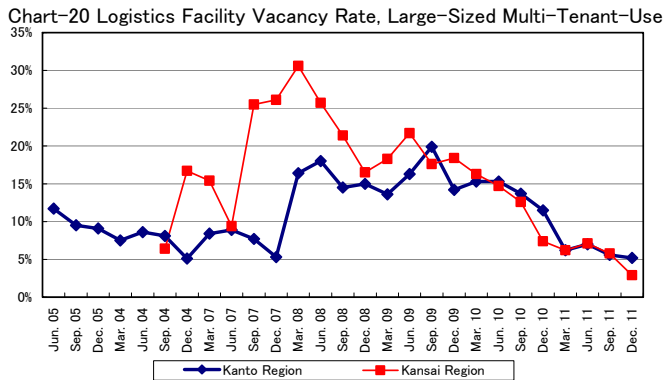




Source: Ohta Publications "Weekly HOTERES"



Source: Nittsu Research Institute and Consulting



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

4. Property Investment and J-REIT Markets

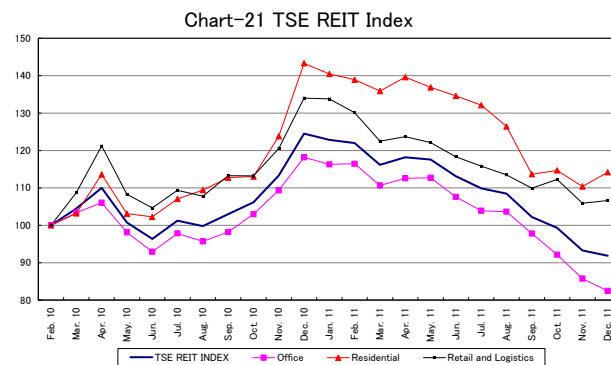
The TSE REIT index plunged by 10.1% q-o-q with risk-off moves in the European financial crisis and global economic uncertainty. The office sector performed worst declining -15.7%, while the residential sector made a 0.4% positive q-o-q return (Chart-21). BOJ spent JPY 12.0 billion on buying J-REIT units in the quarter, which was much smaller than the 34.8 billion in the previous quarter (Chart-22). The transaction volume recorded 198.8 billion JPY as high as that of the pervious quarter sustained by active J-REIT acquisitions.

The total AUM of private property funds posted a 3.7% y-o-y increase for the first time in three years accumulating to 9.8 trillion JPY. This market growth can be based on factors such as less fund defaults at maturity with banking support, easy refinancing conditions and

a trend of resuming long-term core investments.

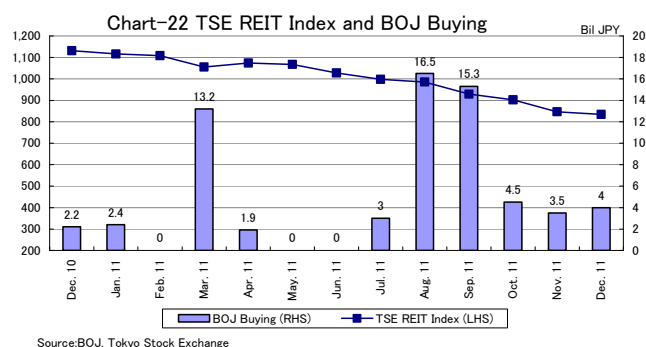
From surveys among investors, expected Cap rates seem mostly unchanged and fund raising conditions are improving. While more asset sales by exiting funds are seen, new funds are seen being established. Private investment funds which had been active before the Lehman Shock play a role as main sellers of recent transactions, while J-REITs, Asian Investors, U.S. hedge-funds, trading companies and property developers are seen on the buying side, in addition, schools and welfare corporations are also seen actively buying assets for their own use.

In the property investor survey by Japan Real Estate Institute in October 2011, to a question regarding the influence of the earthquake on the Japanese property market, 43% of the respondents replied “the influence has gone” and very few replied “the influence will remain for the long term.” It was suggested that the earthquake had little effect on changing regional preference in terms of portfolio diversification, while individual location and building quake-resistance have become more important in investment decisions.



	TSE REIT	Office	Residential	Retail Logistics
Apr-Jun.2010	-7.8%	-10.1%	-0.9%	-3.7%
Jul-Sep.2010	6.9%	5.7%	10.3%	8.2%
Oct-Dec.2010	20.9%	20.3%	27.1%	18.3%
Jan-Mar.2011	-6.7%	-6.4%	-5.2%	-8.6%
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%

Source:Tokyo Stock Exchange



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