# Real Estate Analysis Report

## Japanese Property Market Quarterly Review, Second Quarter 2012

### ~Signs of Recovery in Tokyo Grade-A Office Rents~

This is the English translation of Toru Matsumura, "底打ちの兆し強まる東京都心の優良ビル賃料—不動産クォータリー・レビュー2012 年第 2 四半期" NLI Research Institute, *Real Estate Analysis Report*, August 1, 2012

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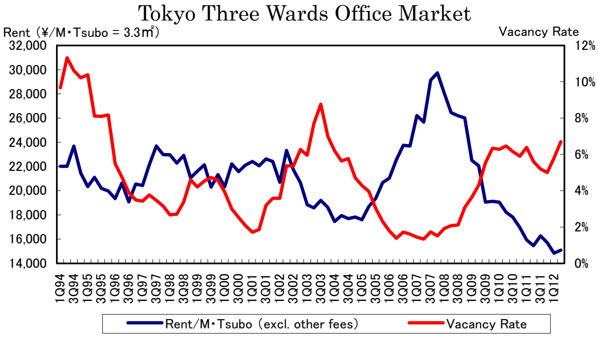
**Summary**

- The Japanese economy has maintained its recovery in the second quarter, as corporate production has been active with retail consumption remaining resilient. Both new and secondary condominium sales posted good numbers, while national land prices declined at a mitigated pace.
- The Tokyo office market especially of grade-A offices showed signs of rent recovery. Now that the volume peak of newly completed large office buildings has passed, grade-A offices will lead the market recovery in the second half of 2012 or the first half of 2013, as they are overwhelmingly superior to older buildings in terms of corporate needs for business continuity planning and energy saving. The Tokyo residential rents for all usages showed weakness including those for family-use which had showed some recovery in the second half of 2011. The hotel occupancy rates recovered to the pre-earthquake level. The large logistics facility rents in Tokyo are about to rise.
- The TSE REIT Index declined in the second quarter as a reversal of large appreciation in the previous quarter. However, J-REITs acquired a large volume of assets equivalent to that of the first quarter of 2008 before the global financial crisis, contributed to by the two newly listed J-REITs. While financial conditions for private funds are improving and many new funds have been set up, large-sized transactions and refinancing deals have been noticed in the investment market.

Tokyo Three Wards Office Market



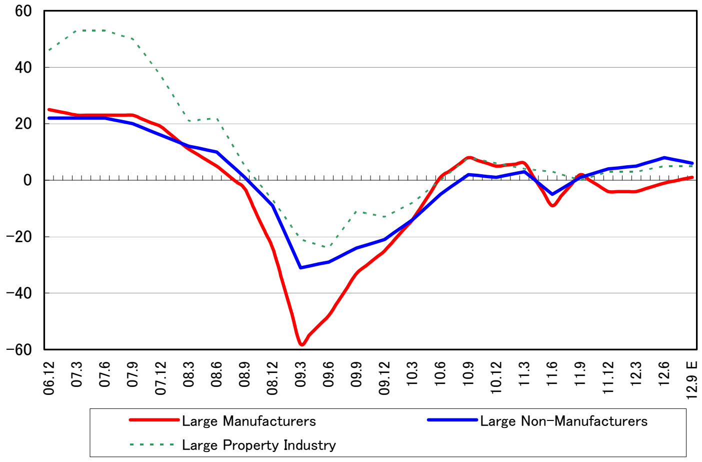

Very Large Size Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate･Sanko Estate, Rent･ Sanko Estate and NLI Research Institute

## 1. Economy and Housing Market

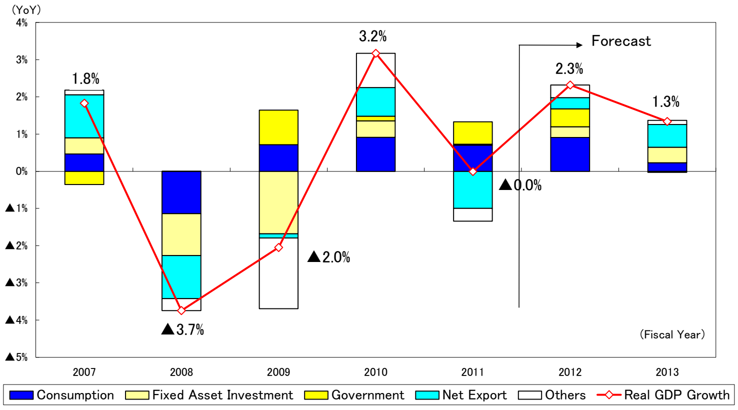
The Japanese economy has maintained its recovery in the second quarter, as corporate production has been active with retail consumption remaining resilient. In the BOJ Tankan survey second quarter 2012, the current business confidence, D.I. of large manufacturers, improved by three points to -1, while three month future business confidence improved to positive (Chart-1). NLI Research Institute forecasts Japan's GDP growth at +2.3% in 2012, +1.3% in 2013 (Chart-2).[1]

Chart-1 Business Confidence (D.I., 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"
NLI Research Institute "Weekly Economist Letter" June 11, 2012.

Housing starts in May increased by 9.3% y-o-y to 69k for the fourth consecutive month (Chart-3). Especially in three disaster-hit prefectures the increase reached historic highs in May driven by the reconstruction activities.

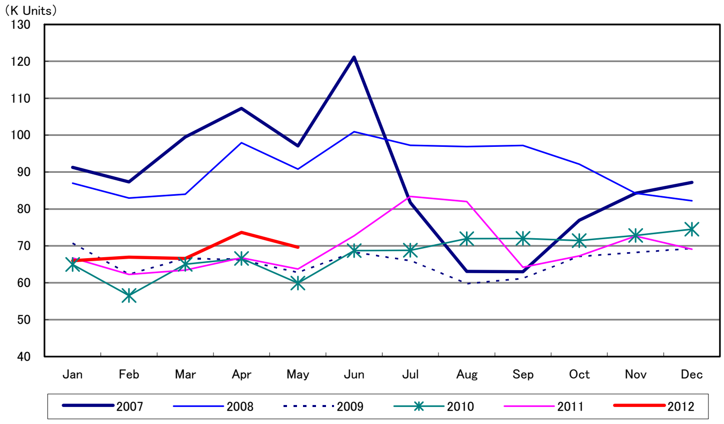
New condominium sales in the Tokyo metropolitan area posted strong y-o-y numbers, though very volatile based on the earthquake last year, +81.7% in April, -14.9% in May and +16.4% in June (Chart-4).

According to Real Estate Information Network System, the transaction volume of secondary condominiums increased for the third consecutive quarter by 12.9% y-o-y to 7,653 units in the second quarter.

[1] Taro Saito, "Economic Forecast for 2012 and 2013: Revision of Real GDP Growth Forecast following the 1Q12 Number," in *Weekly Economist Letter*, NLI Research Institute, June 11, 2012.

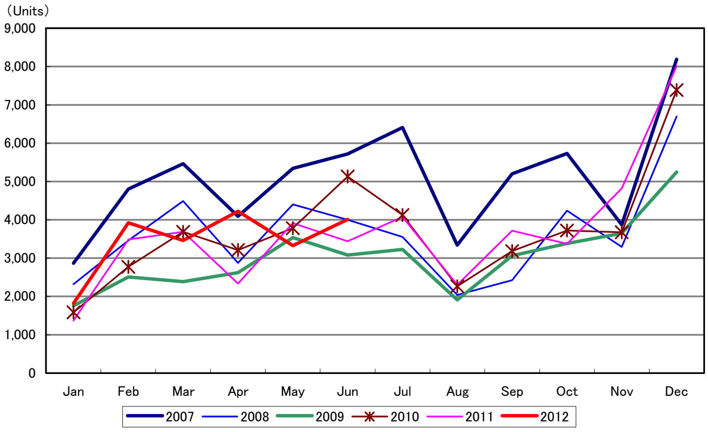
 

Chart-3 Monthly Housing Starts




Source: MLIT

Chart-4 Monthly Housing Starts of Condominiums (Tokyo Metropolitan Area)



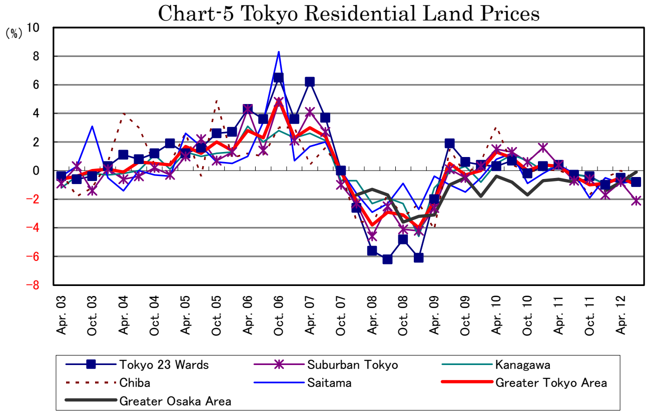

Source: Real Estate Economic Institute

## 2. Land Price and Property Business Confidence

The Chika LOOK Report, the quarterly national land price report by MLIT, still showed some price decline in the second quarter, but the pace of decline mitigated suggesting the bottom of the cycle is quite close.

According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area declined at 1.0% q-o-q (Chart-5). And commercial land prices in the Tokyo metropolitan area remained stable (Chart-6).

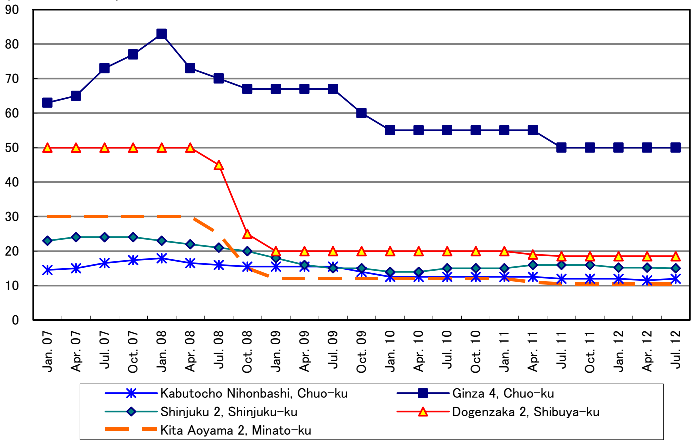
Chart-5 Tokyo Residential Land Prices




Source: Nomura Real Estate Urbannet

 NLI Research Institute |  | 

Chart-6 Tokyo Commercial Land Prices




Source: Nomura Real Estate Urbannet

## 3. Sub-sectors

### 1) Office

The Tokyo office market especially of grade-A offices showed signs of rent recovery. As seen in the index, a contract-based office rent index developed by Sanko Estate and NLI Research Institute, the second quarter rents of very large sized office buildings (standard floor larger than 200 tsubos) in the Tokyo three wards declined by only -2.5% y-o-y to JPY 15,081, a pace of decline which shrank for the fifth consecutive month, though the office vacancy rates deteriorated to 6.7% with new large vacant supply (Chart-7).

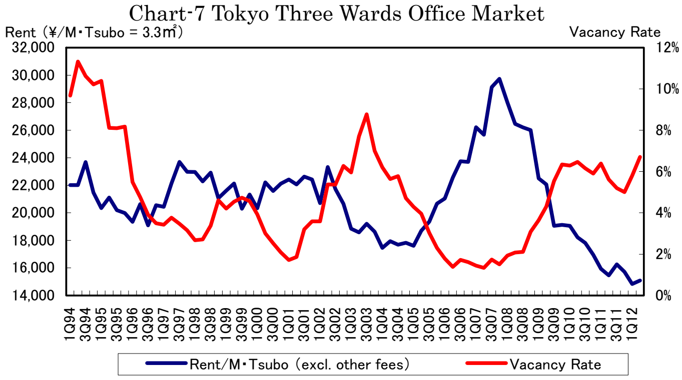
On the other hand, the pace of rent decline of large sized buildings (standard floor larger than 100 tsubos and smaller than 200 tsubos) expanded for the third consecutive quarter, and the vacancy rates are much higher by about three points (Chart-8, 9).

Now that the volume peak of newly completed large office buildings has passed, the new supply will be smaller in 2013, though we can see increase again in 2014.

Grade-A offices will lead the market recovery in the second half of 2012 or the first half of 2013, as they are overwhelmingly superior to older buildings in terms of corporate needs for business continuity planning and energy saving, and their rents are relatively inexpensive.

How to deal with vacancies in older buildings which are losing tenants to the new grade-A buildings could be a key for the entire Tokyo office market.

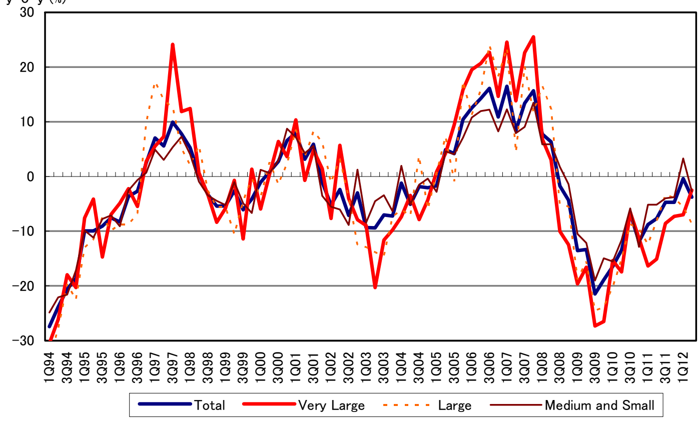
Chart-7 Tokyo Three Wards Office Market




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

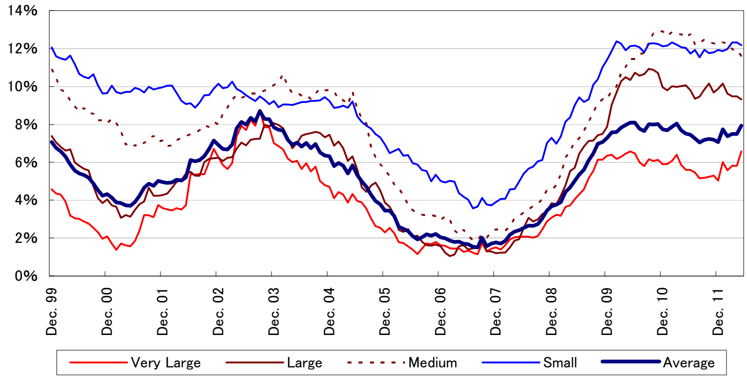
 

Chart-8 Office Rent Y-o-Y Changes by Size (Tokyo Three Wards)




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

Chart-9 Office Vacancy Rates by Size (Tokyo Three Wards)




Source: Sanko Real Estate

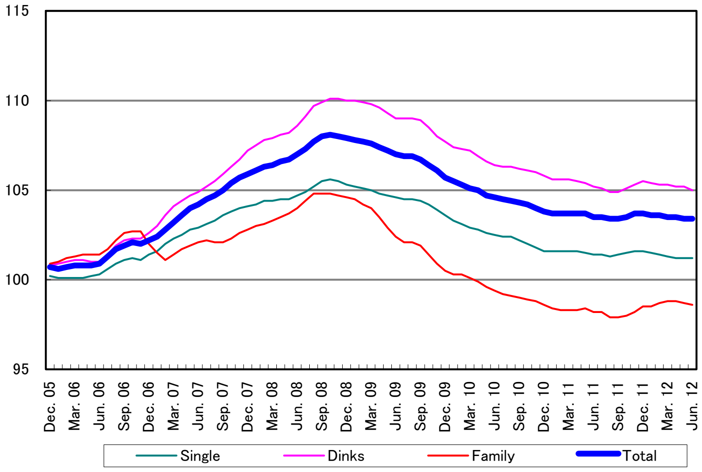
### 2) Residential Rental

The Tokyo residential rents for all usages showed weakness in the quarter including those for family-use which had showed some recovery in the second half of 2011 (Chart-10). In contrast, Osaka residential rents maintained an upward-trend.

The Tokyo luxury residential market which targets foreigners and high-income workers is suffering from weak demand following the earthquake, while property developers continue to supply new projects. Judging from the improving vacancy rates and rent declines, it seems operators are trying to secure tenants by discounting rents (Chart-11).

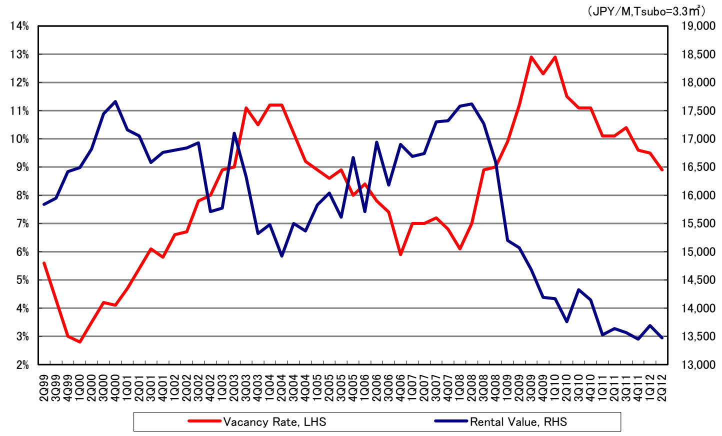

 

Chart-10 Tokyo Residential Rent Index




Jan 2005＝100
Source: IPD・Recruit Residential Index

Chart-11 Tokyo Luxury Residential Market




*Sample cosists of contracts with more than 300K JPY/M,Tsubo rental value or 30 Tsubo space.
Source: Ken Real Estate Advisors Ltd.

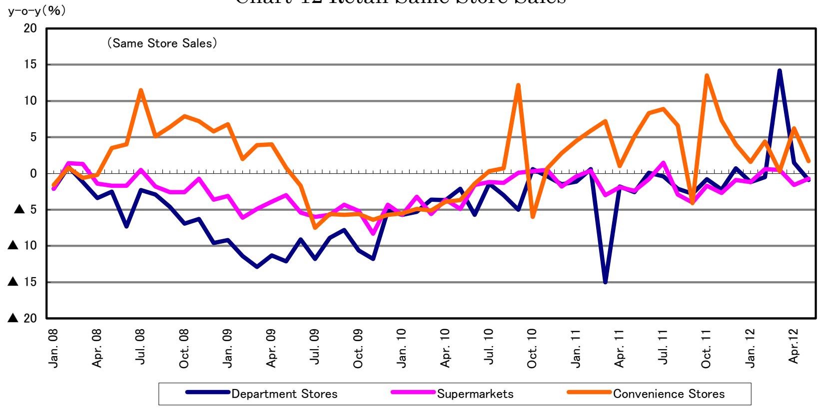
### 3) Retail, Hotel, and Logistics

Retail sales generally weakened in June, as June same store sales of convenience stores shrank for the first time in nine months influenced by bad weather, though gaining popularity among housewives and elderly people. In addition, same store sales of department stores and supermarkets continued shrinking for the second and fourth consecutive months respectively (Chart-12).

Regarding the hotel market, foreign visitor arrival numbers have expanded by more than 50% y-o-y for the fourth consecutive months and +1.4 % over that of June 2010 recovering to the pre-earthquake level for the first time (Chart-13). Since April, hotel occupancy rates have already been as high as those of 2010 (Chart-14). The occupancy rates in Sendai noticeably shrank by 12.6% y-o-y, as strong reconstruction demand had grown last year after the earthquake (Chart-15).

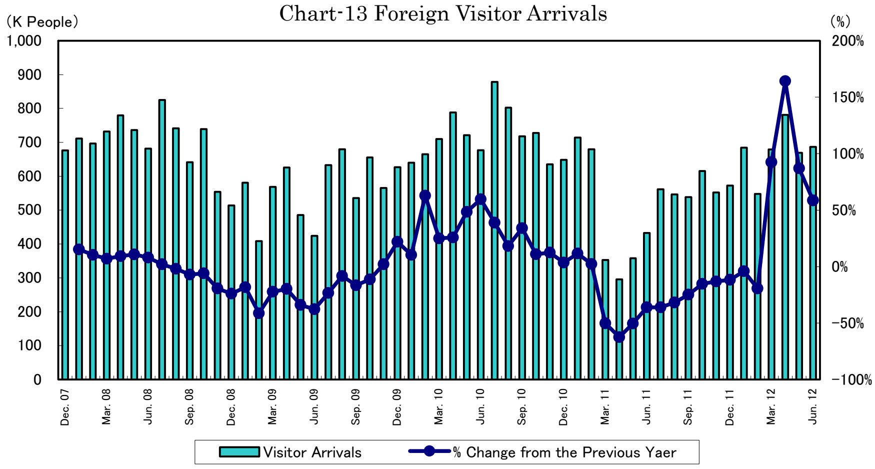
According to CBRE, the vacancy rates of large multi-tenant logistics facilities improved to an historic low of 3.6% in the Kanto region with 2.6% excluding new supply and 8.8% in Kansai region with 0% excluding new supply (Chart-16). The markets have been quite tight and the rents in Tokyo are about to rise.

Chart-12 Retail Same Store Sales



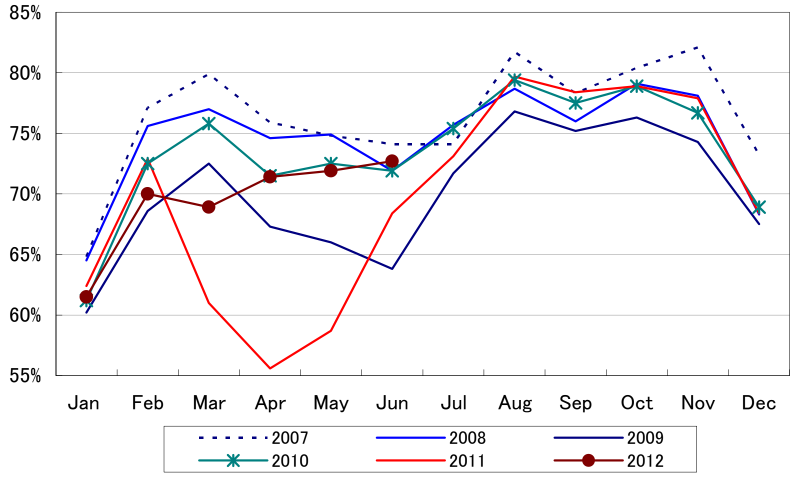

Source: Ministry of Economy, Trade and Industry

Chart-13 Foreign Visitor Arrivals




Source: Japan National Tourism Oganization (JNTO)

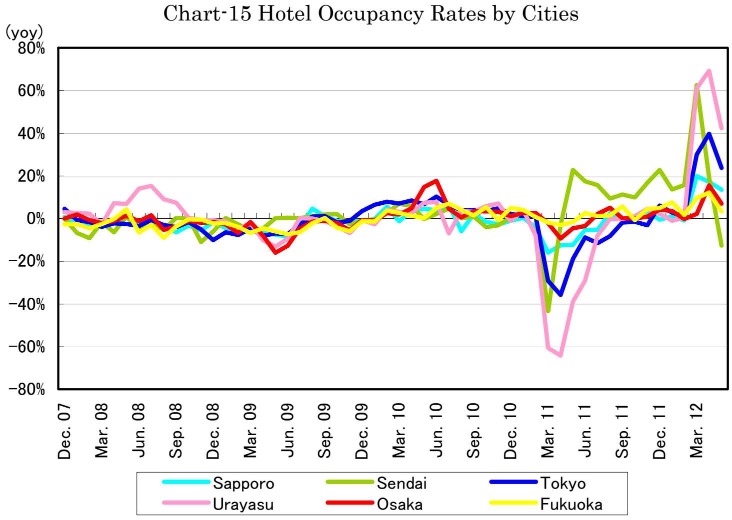
Chart-14 Hotel Occupancy Rates




Source: Ohta Publications "Weekly HOTERES"

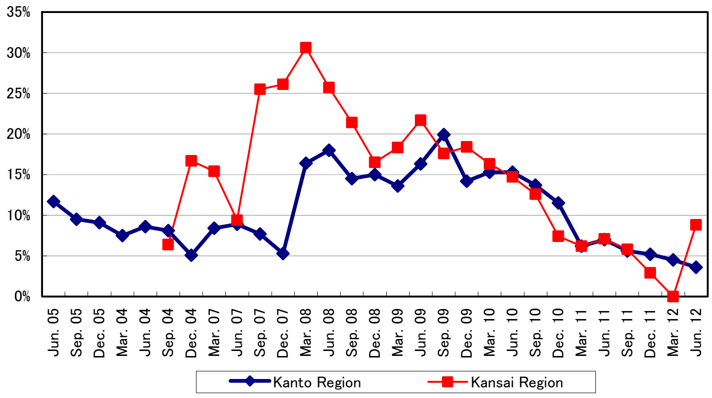
 

Chart-15 Hotel Occupancy Rates by Cities




Source: Ohta Publications "Weekly HOTERES"

Chart-16 Logistics Facility Vacancy Rates (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 declined by 3.3% in the second quarter as a reversal of the large appreciation in the previous quarter. All sectors declined, with the office sector at -4.5%, residential -1.5% and retail and logistics -1.4% (Chart-17).

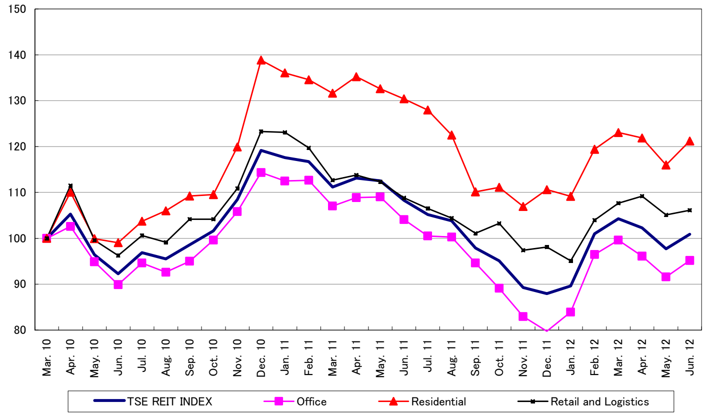
Kenedix Residential and Activia Properties were newly listed in April and June respectively, which were the first IPOs in four and a half years. Then, the number of listed J-REITs became 35 after contracting for a while through M&A activity.

J-REITs acquired JPY 287.3 billion of assets in total in the second quarter, which was as large a volume equivalent to that of the first quarter of 2008 before the global financial crisis, contributed to by the two newly listed J-REITs (Chart-18).

A FSA working group set up in March to review regulations over mutual funds and investment firms announced its interim report in July. It suggests diversifying J-REIT capital policies and funding measures by allowing them to conduct share buyback and capital reduction among other measures.

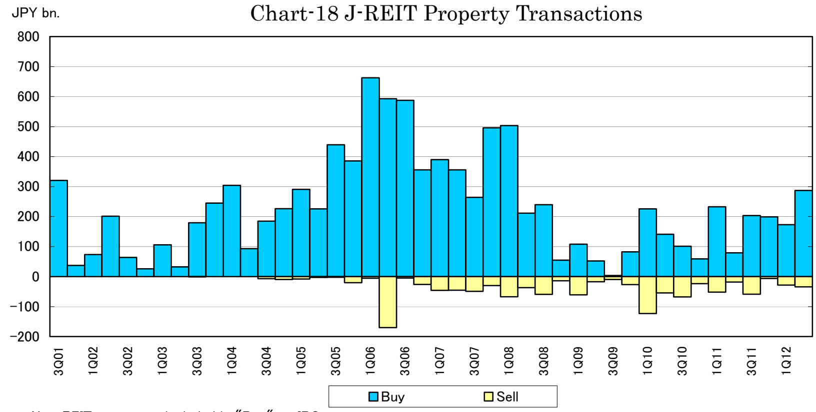
While funding conditions for private funds are improving and many new funds have been set up, large-sized transactions and refinancing deals have been noticed in the investment market (Chart-19).

Chart-17 TSE REIT Index



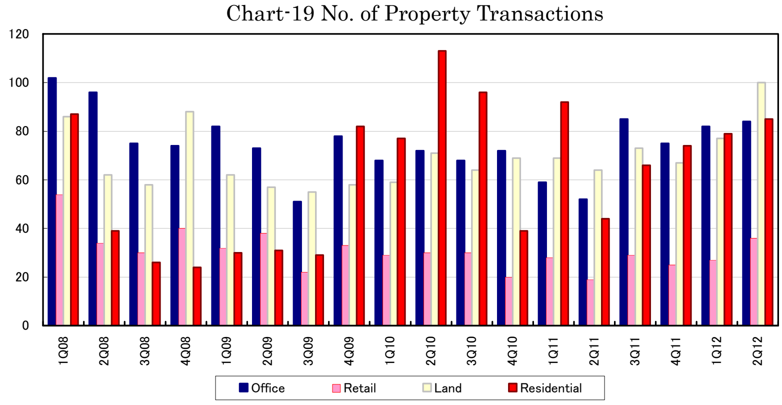

Source: Tokyo Stock Exchange

Chart-18 J-REIT Property Transactions




*New REIT assets are included in "Buy" on IPO
Source: NLI Research Institute

Chart-19 No. of Property Transactions




*"Residential" does not include strata title transactions.
Source: NLI Research Institute based on Nikkei Fudosan Market Infomation

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