Real Estate Analysis Report

Japanese Property Market Quarterly Review, Third Quarter 2012

~Favorable Investment Sentiment Despite Economic Uncertainty~

This is the English translation of Toru Matsumura, "改善する投資市況と懸念される景気後退リスク―不動産クォータリー・レビュー2012 年第 3 四半期" NLI Research Institute, *Real Estate Analysis Report*, November 1, 2012

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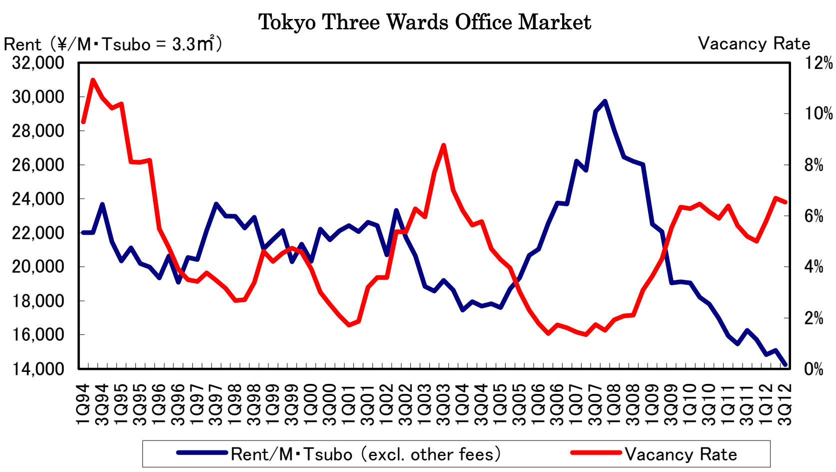
Summary

- The Japanese economy is losing momentum with slowing domestic consumption and shrinking foreign demand from China and other countries. NLI Research Institute revised its GDP growth forecast for Japan in 2012 downward to 1.7%. New condominium sales in the Tokyo metropolitan area maintained good momentum with high contract rates. The land prices in metropolitan areas are turning around.
- Apparently, the office market recovery is delayed because of the declining rents of very large sized buildings. However, unless the economic slowdown becomes serious, rents of grade-A buildings can expect to recover in the first half of next year. The Tokyo residential rents for all usages showed some stability. While hotel vacancy rates recovered to the level before the earthquake, hotel operators in sightseeing areas are concerned about the declining number of foreign visitors. The large logistics markets have been quite tight.
- The TSE REIT Index appreciated by 6.7% in the third quarter, as investors favored the relatively high dividend yield above 5%. The investment market has remained favorable with funding conditions for private funds improving and many new funds being set up, but housing sales and office leasing markets are subject to economic uncertainty.

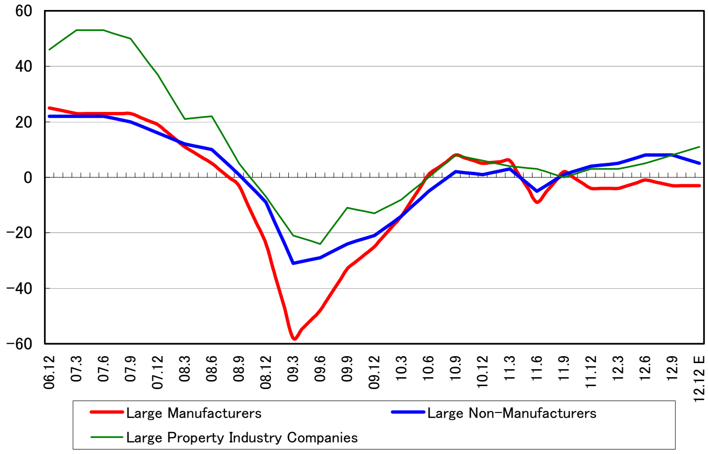


Very Large Sized Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate・Sanko Estate, Rent・ Sanko Estate and NLI Research Institute

1. Economy and Housing Market

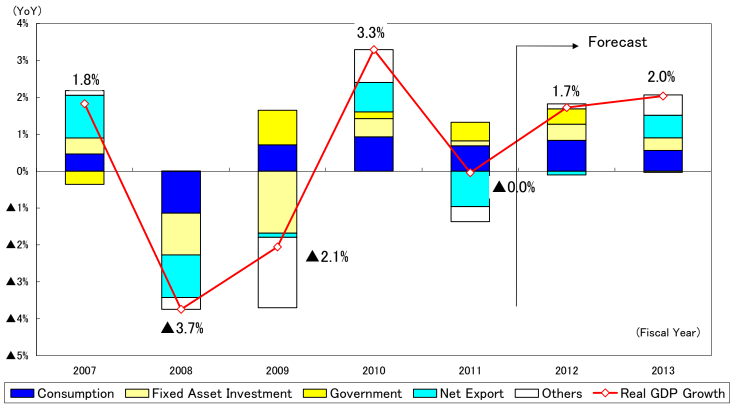
The Japanese economy is losing momentum with slowing domestic consumption, which had been strong until recently, and shrinking foreign demand from countries such as China. In the BOJ Tankan survey third quarter 2012, the current business confidence D.I. of large manufacturers deteriorated by two points to -3, while that of large non-manufacturers remained the same at 8 and that of large property industry companies improved by three points to 8 (Chart-1). NLI Research Institute revised its Japan GDP growth forecast for 2012 downward to 1.7% and upward to 2.0% for 2013 based on rush demand for housing and others before the increase in the consumption tax is implemented (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" September 11, 2012.

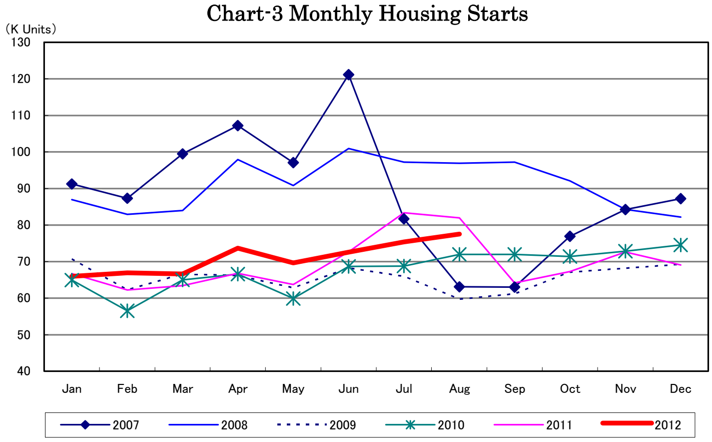
Housing starts in August decreased by 5.5% y-o-y to 78k for the third consecutive month after termination of the eco-point program (Chart-3).

New condominium sales in the Tokyo metropolitan area maintained good momentum with high contract rates, even with volatile y-o-y changes based on the earthquake last year, -1% in July, +17.3% in August and -9.3% in September (Chart-4).

[1] Taro Saito, "Economic Forecast for 2012 and 2013: Revision of Real GDP Growth Forecast following the 2Q12 Number," in *Weekly Economist Letter*, NLI Research Institute, September 11, 2012.

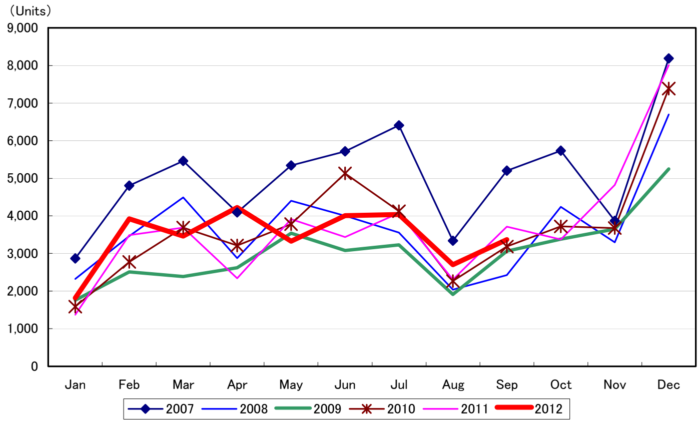
According to the Real Estate Information Network System (REINS), the transaction volume of secondary condominiums increased for the fourth consecutive quarter by 9.7% y-o-y to 7,451 units in the third quarter.

Chart-3 Monthly Housing Starts



Source: MLIT

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



Source: Real Estate Economic Institute

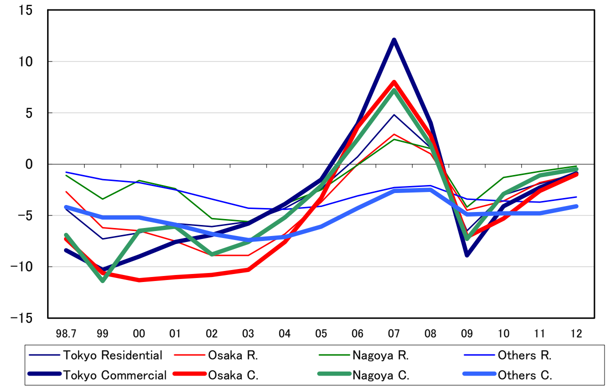
2. Land Price and Property Business Confidence

The national standard land price as of July 1, 2012 decreased by 2.7% y-o-y, but the pace of decline was mitigated compared to the previous year at -3.4%. Especially in the Nagoya area the price did not decrease with many observing points posting positive numbers (Chart-5). Still, land prices continue to decline nationally. Those in metropolitan areas, however, are turning around with an increasing number of appreciating points.

According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area decreased by 0.6% q-o-q, a slowing pace of decline (Chart-6). Suburban Tokyo posted the worst, -5.3% y-o-y, followed by Tokyo 23 wards at -2.7% and Kanagawa prefecture at -2.5%, Chiba prefecture and Saitama prefecture posted -2.1% and -2.0%, respectively, showing a much slower pace of decline compared to the previous year.

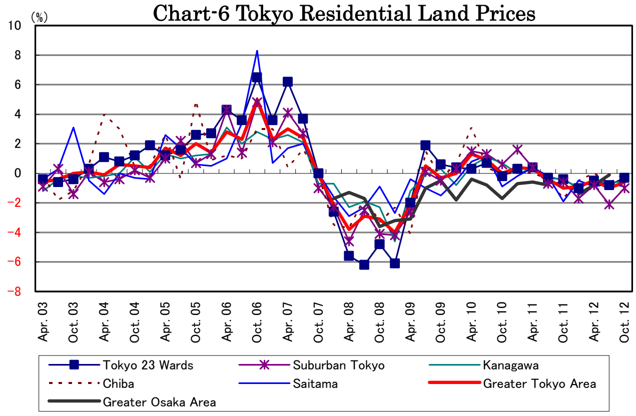
Commercial land prices in the Tokyo metropolitan area appreciated by 0.2% q-o-q and -1.0% y-o-y (Chart-7) while Osaka metropolitan area appreciated by 1.1% q-o-q and 4.0% y-o-y.

Chart-5 Standard Land Prices by Region



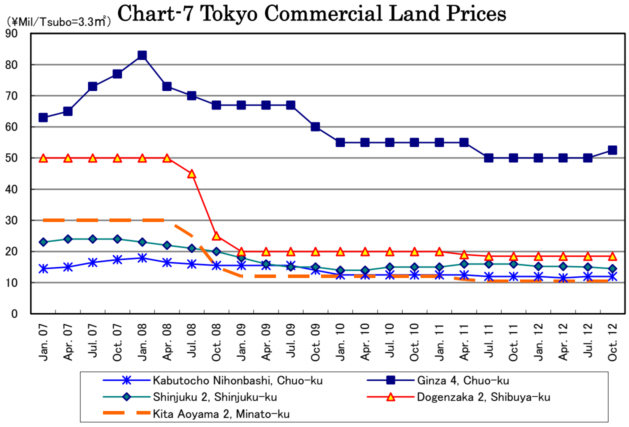
Source: MLIT

Chart-6 Tokyo Residential Land Prices



Source: Nomura Real Estate Urbannet

Chart-7 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urbannet

3. Sub-sectors

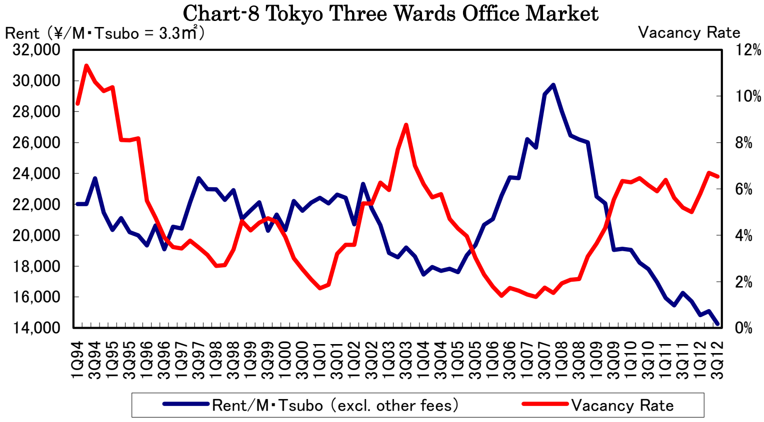
1) Office

The vacancy rates of very large sized office buildings (standard floor larger than 200 tsubos) in the Tokyo three wards improved a little to 6.5% for the first time in three months (Chart-8). The gap between the vacancy rates of new buildings and old buildings narrowed due to the many large buildings newly launched with high vacancy rates (Chart-9).

As seen in the index, a contract-based office rent index developed by Sanko Estate and NLI Research Institute, the third quarter rents of very large sized office buildings (standard floor larger than 200 tsubos) in the Tokyo three wards decreased by -12.3% y-o-y to JPY 14,260, accelerating the pace of decline again (Chart-8). On the other hand, the pace of rent decline of large sized buildings (standard floor larger than 100 tsubos and smaller than 200 tsubos) and medium and small sized buildings (standard floor smaller than 100 tsubos) posted positive q-o-q and y-o-y numbers (Chart-10).

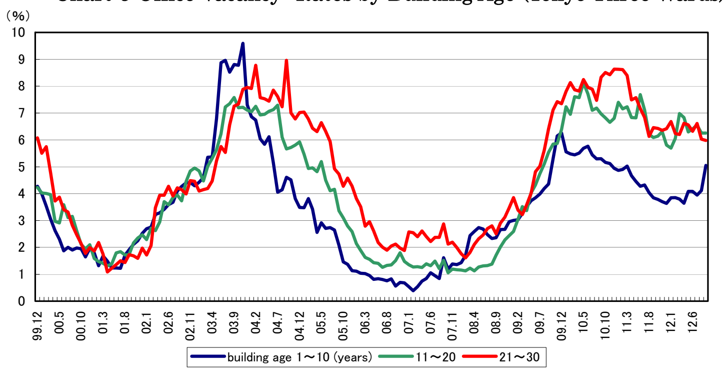
Apparently, the office market recovery is delayed because of the declining rents of very large sized buildings, as leasing competition intensified following the introduction of a number of new buildings this year even in the growing economic uncertainty. However, unless the economic slowdown becomes serious, rents of grade-A buildings well equipped for disaster prevention and energy saving can expect recovery in the first half of next year.

Chart-8 Tokyo Three Wards Office Market



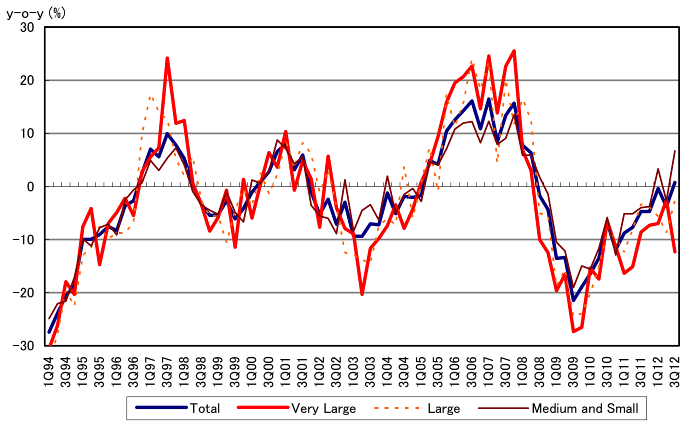
Very Large Sized Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate・Sanko Estate, Rent・ Sanko Estate and NLI Research Institute

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



Source: Sanko Estate

Chart-10 Office Rent Y-o-Y Changes by Building Size (Tokyo Three Wards)



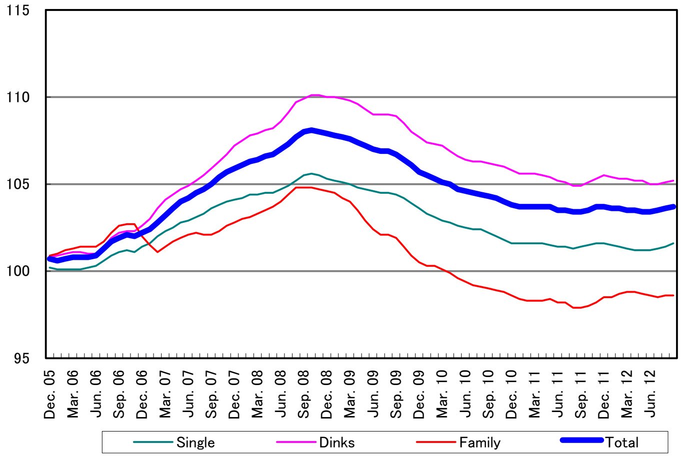
Very Large (Standard floor>200 tsubos), Large (100< and <200), Medium and Small (<100)
Source: Sanko Estate and NLI Research Institute

2) Residential Rental

The Tokyo residential rents for all usages showed some stability in the third quarter even though they had weakened in the previous quarter (Chart-11). Moreover, Osaka residential rents recovered to their peak level as of 2008. Furthermore, according to the "residential market index" by the Japan Real Estate Institute (JREI), Tokyo 23 wards residential rents are predicted to be minimally affected by the increase in the consumption tax and remain mostly unchanged until 2020.

On the other hand, the Tokyo luxury residential market, which targets foreigners and high-income workers, is suffering from weak demand following the earthquake and will take a long time to recover considering the continuous supply of new projects by property developers.

Chart-11 Tokyo Residential Rent Index



Jan 2005＝100
Source: IPD・Recruit Residential Index

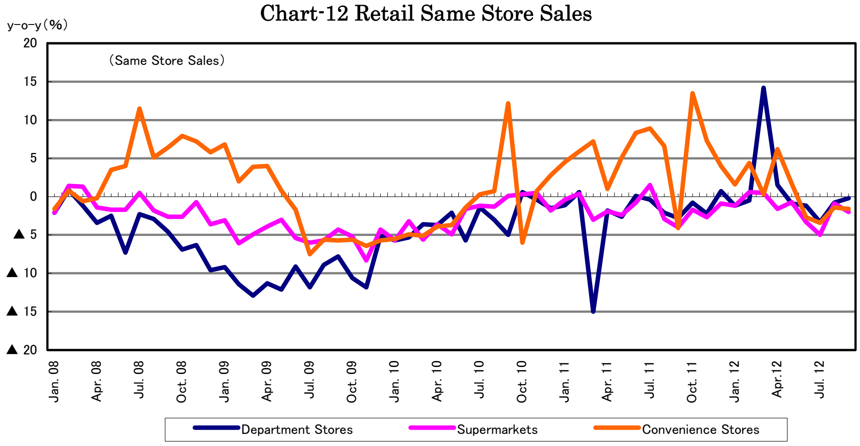
3) Retail, Hotel, and Logistics

Retail sales weakened further with slowing consumption in the third quarter as September same store sales of convenience stores, department stores and supermarkets shrank for the fourth, fifth and seventh consecutive month, respectively (Chart-12).

Regarding the hotel sector, the number of foreign visitors in September shrank by 8% compared to 2010. Especially affected was the number of Chinese visitors by 10%, due to the recent deterioration in relationships between the two countries, though it posted positive y-o-y growth for the seventh consecutive month (Chart-13). While hotel vacancy rates recovered to the level before the earthquake, hotel operators in sightseeing areas heavily dependent on foreigners are very concerned about the decline in the number of foreign visitors.

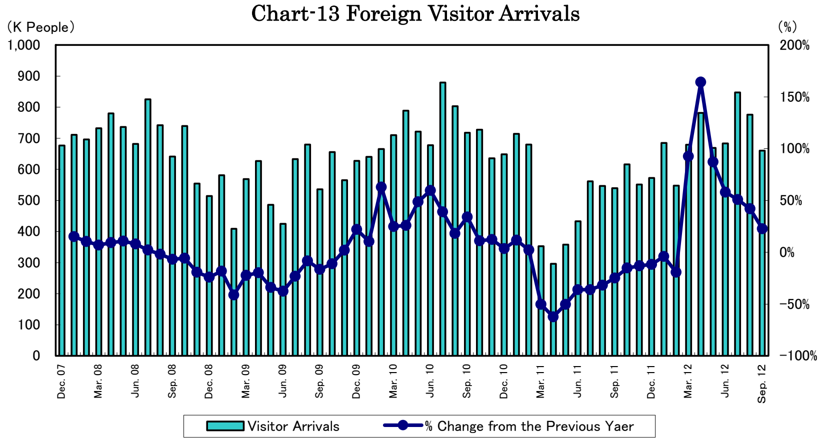
According to CBRE, the vacancy rates of large multi-tenant logistics facilities decreased slightly in the Kanto region to 4.6%, still a very healthy number, with 3.2% excluding very new supplies, while the Kansai region improved again to 1.9% with 0% excluding very new supplies (Chart-16). The large logistics markets have been quite tight and some facilities have raised their rents in Tokyo.

Chart-12 Retail Same Store Sales



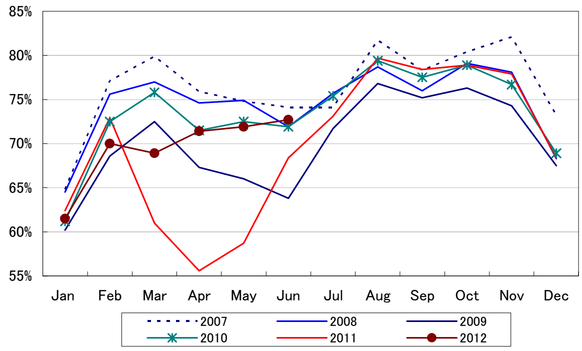
Source: Ministry of Economy, Trade and Industry

Chart-13 Foreign Visitor Arrivals



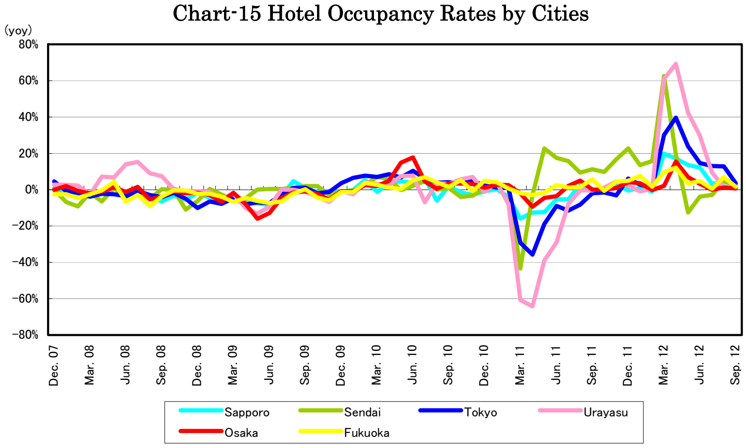
Source: Japan National Tourism Organization (JNTO)

Chart-14 Hotel Occupancy Rates



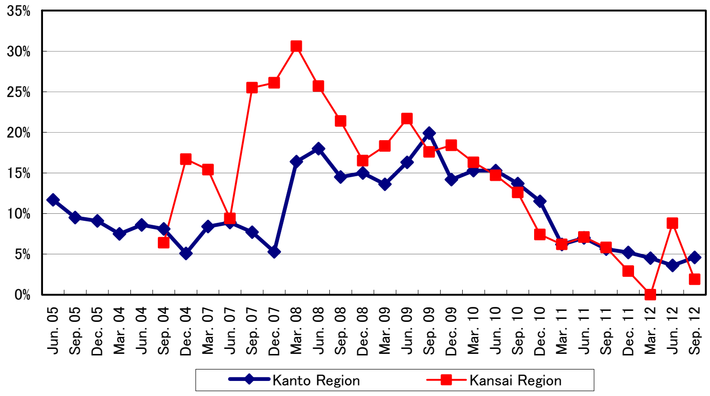
Source: Ohta Publications "Weekly HOTERES"

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 33,000m² or more, 49 assets)
Source: CBRE

4. Property Investment and J-REIT Markets

According to the property market survey by NLI Institute in October 2012[2], the six-month property investment market outlook resulted in the most optimistic outlook since the global financial crisis in 2008, with "Somewhat better" responses predicting higher prices and more transactions accounting for nearly two-thirds of the total (Chart-17). However, it should be noted cautiously that about 80% of the respondents predicted "Market polarization" when asked what developments are most likely to be seen in the property market in the mid- to long-term (Chart-18).

The TSE REIT Index appreciated by 6.7% in the third quarter, as investors favored the relatively high dividend yield above 5%, even while the whole equity market showed weakness. All J-REIT sectors appreciated with office by 6.5%, residential by 6.8% and retail and logistics by 6.8% (Chart-19).

J-REITs acquired 43 assets at JPY 118.2 billion in total in the third quarter, which was much smaller than the JPY 287.3 billion in the second quarter when two IPOs were

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[2] Mamoru Masumiya, "Most Optimistic Outlook since 2008, Focus on Market Polarization and China Risk Aversion - The Ninth Japanese Property Market Survey," in Real Estate Analysis Report, NLI Research Institute, October 29, 2012.

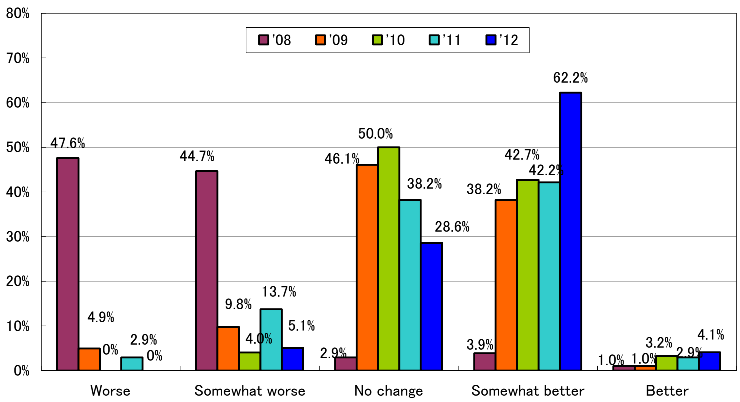
conducted (Chart-20). On the other hand, Daiwa House announced that it will acquire JPY 114.5 billion of 24 retail and logistics facilities planning an IPO in November. With this IPO, J-REIT acquisition will grow for the third consecutive year in 2012.

Investors have become confident in the J-REIT market, as 32 out of the 33 J-REITs secured dividends as much as forecasted in the first half results of 2012, and moreover, dividends in coming years are forecasted to be stable or increase.

While funding conditions for private funds are improving and many new funds have been set up, large-sized transactions and refinancing deals have been observed in the investment market (Chart-22).

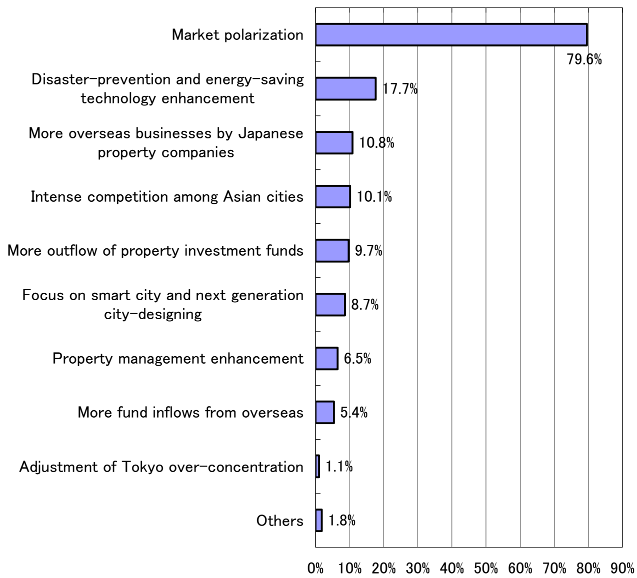
Overall, the property investment market sentiment remains favorable, while housing sales and office leasing markets are subject to economic uncertainty.

Chart-17 Six-Month Market Outlook (SA)



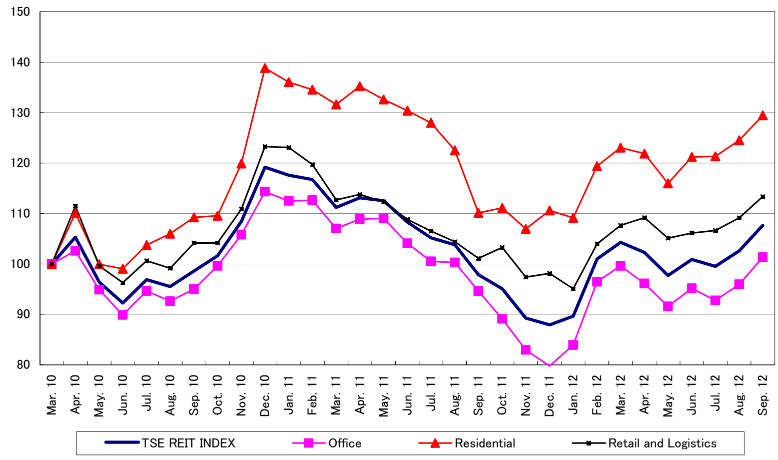
Source: NLI Research Institute, *Propety Market Survey*, 2008～12

Chart-18 Likely Mid- to Long-Term Development (MA3)



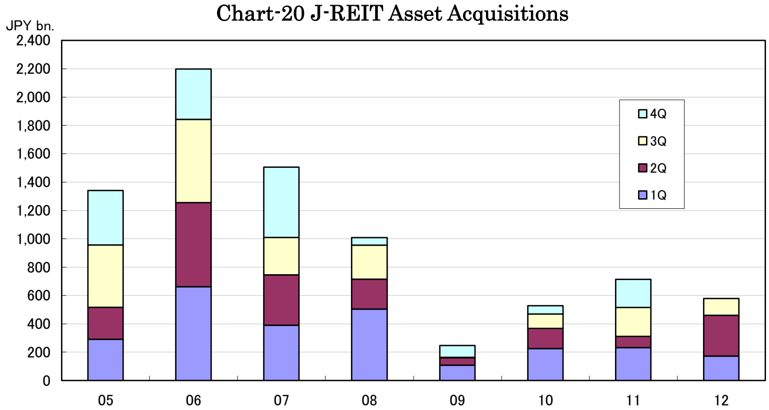
Source: NLI Research Institute, October 2012

Chart-19 TSE REIT Index



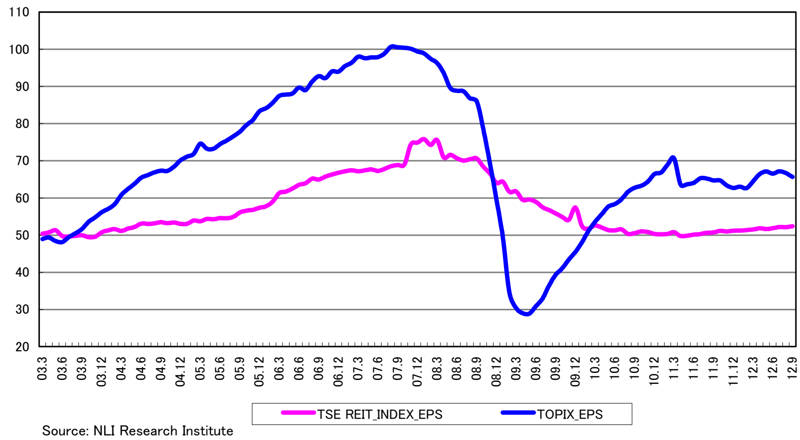
Source: Tokyo Stock Exchange

Chart-20 J-REIT Asset Acquisitions



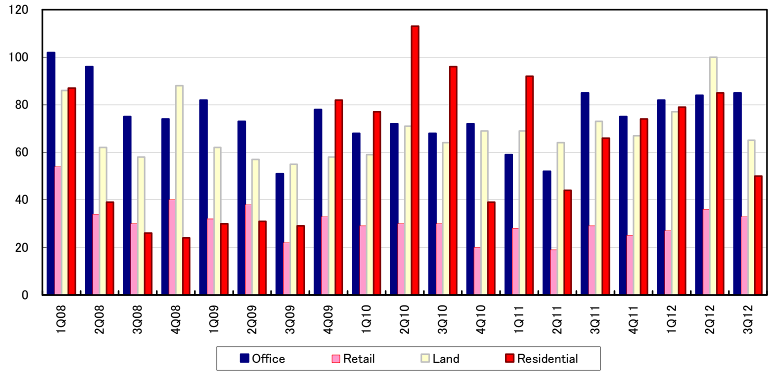
*New REIT assets are included on IPO
Source: NLI Research Institute

Chart-21 Estimated EPS of TSE-REIT-Index and TOPIX



Source: NLI Research Institute

Chart-22 No. of Property Transactions



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

*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.

