Real Estate Analysis Report

Japanese Property Market Quarterly Review, Fourth Quarter 2012

~Visible Polarization in Tokyo Office Market~

This is the English translation of Toru Matsumura, "二極化が鮮明になった東京オフィス市場―不動産クォータリー・レビュー2012 年第 4 四半期" NLI Research Institute, *Real Estate Analysis Report*, February 5, 2013

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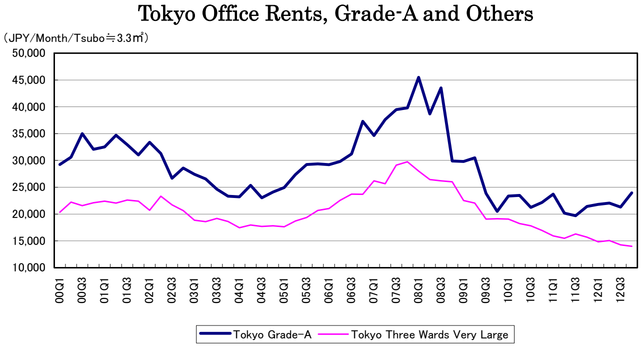
Summary

- The Japanese economy remained weak in the fourth quarter with shrinking foreign demand and a deteriorating relationship with China. However, an optimistic outlook prevails in line with the Japanese yen depreciation and an equity market rally based on expected further monetary easing and emergency economic measures. New condominium sales shrank in the fourth quarter, though housing starts and secondary housing transactions continued to increase.
- The Tokyo grade-A[1] office rents rose noticeably while the office rents of very large sized buildings in the Tokyo three wards kept falling, indicating visible market polarization. Tokyo residential rents weakened again. Hotel occupancy rates remained at a level as high as that before the earthquake. Large sized logistics facilities are still in short supply.
- The TSE REIT Index recovered to 1,000 points for the first time in six months, and maintained good momentum to return to the level before the earthquake. The index posted a 9.1% q-o-q return in the fourth quarter and a 33.6% record best yearly return in 2012. While the private property investment fund market maintained good momentum, the property investment market apparently continues to improve further on the back of a depreciating Japanese yen and a recovering equity market since the end of last year.

Tokyo Office Rents, Grade-A and Others



Source: Sanko Estate "Office Rent Data 2012"

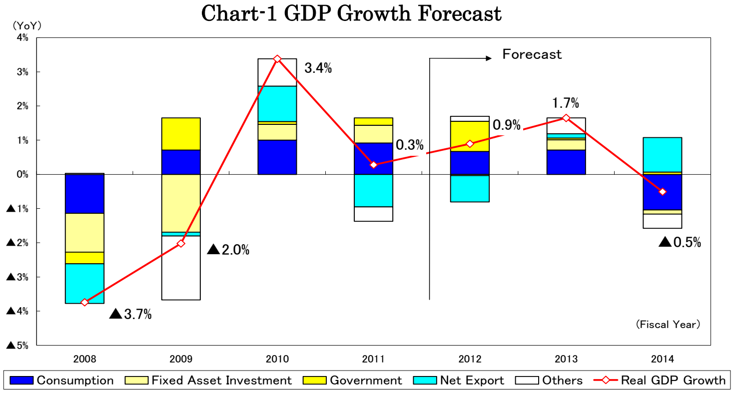
[1] Higher-spec buildings within the very large sized category by Sanko Estate Grade-A-Office Guidelines, urban area Tokyo five wards, main office areas and other specially integrated areas, with total floor area more than 33,000 m^2, main floor size more than 990 m^2, building age 15 years or less (including some well-refurbished older buildings), facilities ceiling height of 2.7m or more, individual air-conditioning, earthquake resistance, environmental friendliness.

1. Economy and Housing Market

The Japanese economy remained weak in the fourth quarter with shrinking foreign demand and a deteriorating relationship with China. However, an optimistic outlook prevails with the Japanese yen depreciation and an equity market rally based on expected further monetary easing and emergency economic measures.

NLI Research Institute forecasted Japan GDP growth at 1.7% for 2013 last December,[2] but calculated that another 0.6% can be expected from the emergency economic measures of the new government.

Chart-1 GDP Growth Forecast

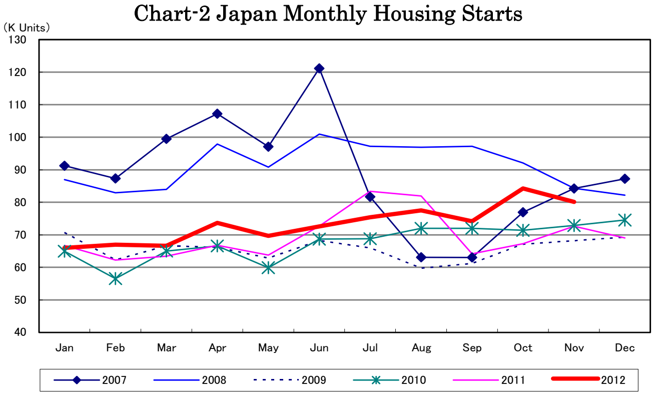


Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
NLI Research Institute "Weekly Economist Letter" December 11, 2012.

Housing starts in December increased for the fourth consecutive month by 10% y-o-y to 76k, and yearly housing starts in 2012 reached 882k, increasing by 5.8% y-o-y (Chart-2, 3).

New condominium units sold in the Tokyo metropolitan area increased to 45,602 in 2012, 2.5% more than 2011 when the earthquake hit eastern Japan (Chart-4). However, the numbers declined every month in the fourth quarter by -14.4% y-o-y in October, -15.1% in November and -3% in December. The Real Estate Economic Institute forecasts an increase of 9.6% y-o-y to 50k units for 2013. According to the Real Estate Information Network System (REINS), the transaction volume of secondary condominiums increased for the fifth consecutive quarter by 3.3% y-o-y to 7,681 units in the fourth quarter, and posted a record high yearly number of 31k units in 2012.

Chart-2 Japan Monthly Housing Starts



Source: MLIT

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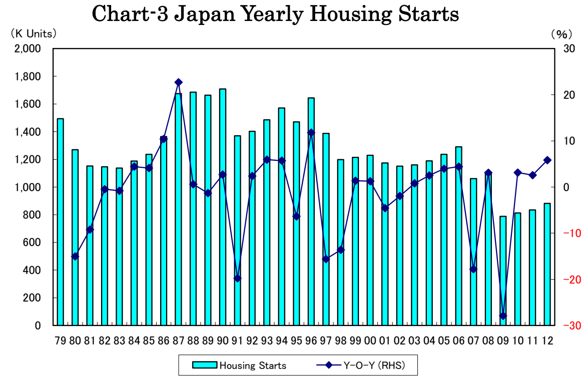
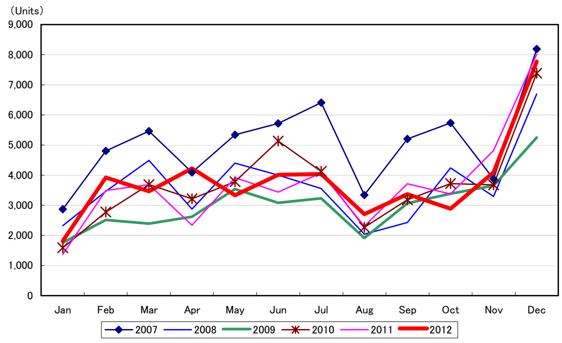
[2] Taro Saito, "Economic Forecast for 2012~2014: Revision of Real GDP Growth Forecast following the 3Q12 Number," in *Weekly Economist Letter*, NLI Research Institute, December 11, 2012.

Chart-3 Japan Yearly Housing Starts



Source: MLIT

Chart-4 Monthly New Condominium Units Sold (Tokyo Metropolitan Area)



Source: Real Estate Economic Institute

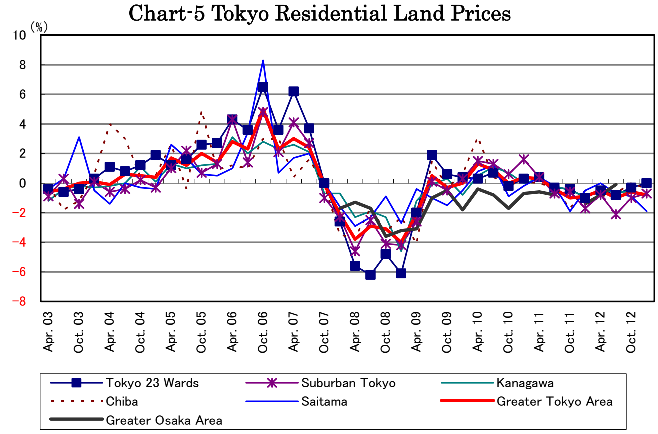
2. Land Price

While the average national land price is still declining, prices in large cities are bottoming out and an increasing number of areas are expected to show price appreciation in the “Kouji Chika” official land prices as of January 1, scheduled to be released in March.

According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area depreciated by the accelerated pace of 0.8% q-o-q (Chart-5). Regarding yearly changes, Suburban Tokyo posted the worst decline at -4.4%, Kanagawa Prefecture -2.4%, Chiba Prefecture 2% and Tokyo 23 wards -1.7%, each showing slower paces of decline compared to the previous year except Saitama Prefecture which posted -3.5%.

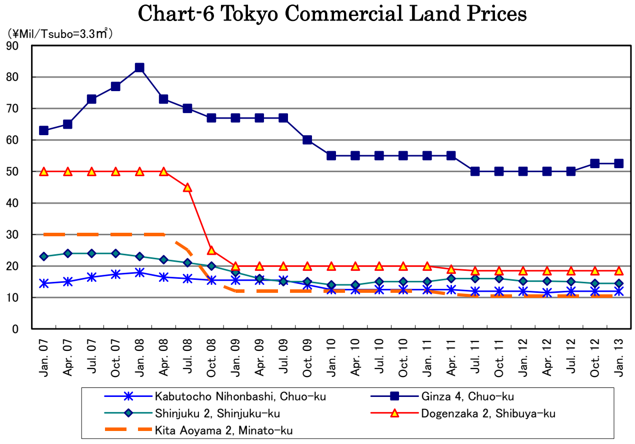
Commercial land prices in the Tokyo metropolitan area remained stable, quarterly unchanged and yearly -0.4% (Chart-6).

Chart-5 Tokyo Residential Land Prices



Source: Nomura Real Estate Urbannet

Chart-6 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urbannet

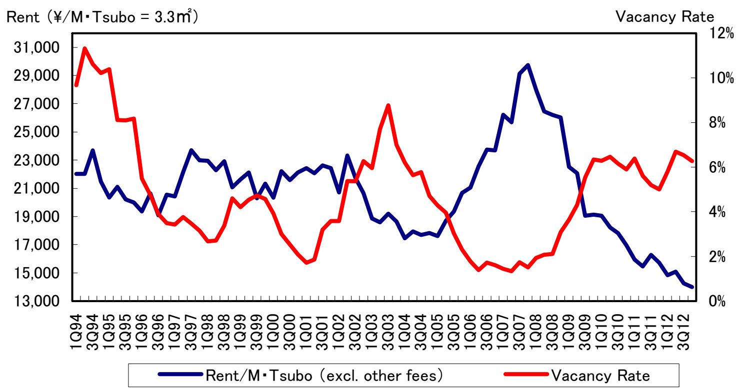
3. Sub-sectors

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 6.3% for the second consecutive quarter (Chart-7).

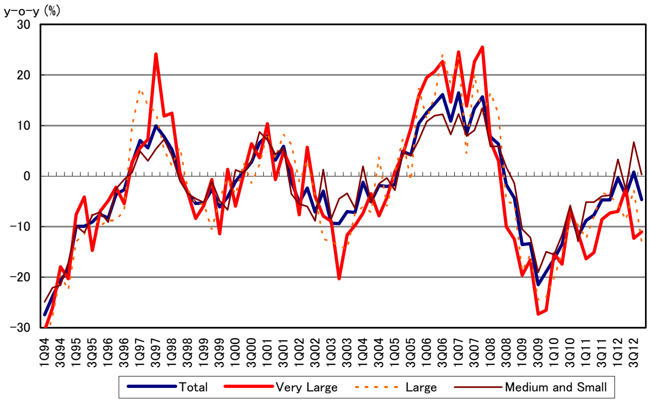
As seen in the rent index, a contract-based office rent index developed by Sanko Estate and NLI Research Institute, the fourth quarter rents of very large sized office buildings (standard floor larger than 200 tsubos) in the Tokyo three wards continued to decline by -11% y-o-y to JPY 13,983, (Chart-7, 8). However, the office rents of Tokyo grade-A category which consists of top buildings rose noticeably by 12% y-o-y to JPY 23,969 (Chart-9), indicating visible market polarization. Grade-A buildings well equipped for disaster prevention and energy saving can meet demanding corporate requests for BCP following the earthquake, while it seems difficult for older buildings with low earthquake resistance and outdated equipment to find new tenants for vacant spaces as well as raise rents.

Chart-7 Tokyo Three Wards Office Market



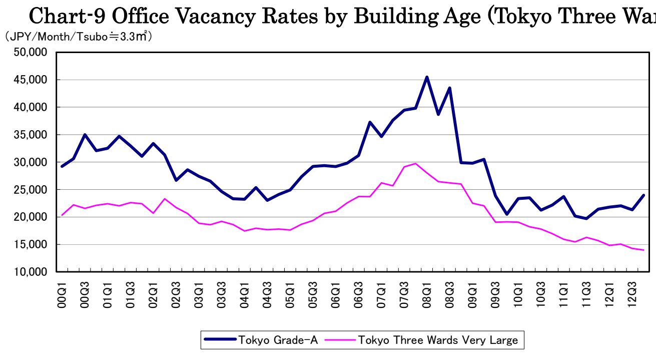
Very Large Sized Buildings (standard floor larger than 200 tsubos)
Source: Vacancy Rate・Sanko Estate, Rent・Sanko Estate and NLI Research Institute

Chart-8 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

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



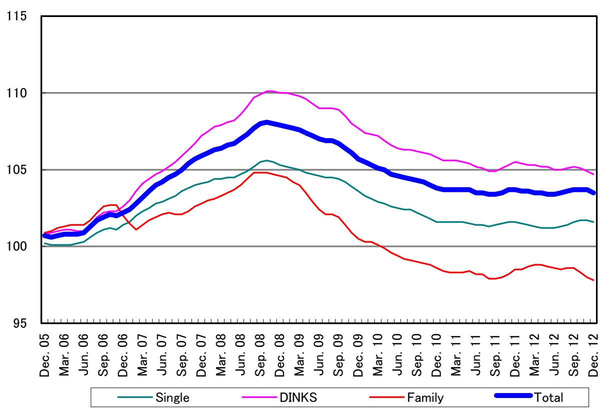
Source: Sanko Estate "Office Rent Data 2012"

2) Residential Rental

The Tokyo residential rents for all usages fell in the fourth quarter again after showing some stability in the pervious quarters (Chart-10), while Osaka residential rents maintained their recovering trend.

The Tokyo luxury residential market, which targets foreigners and high-income workers, has showed rent recovery recently, but the vacancy rates deteriorated again in the fourth quarter (Chart-11), which considering the continuous supply of new projects by property developers, suggests that it will take a long time to recover fully.

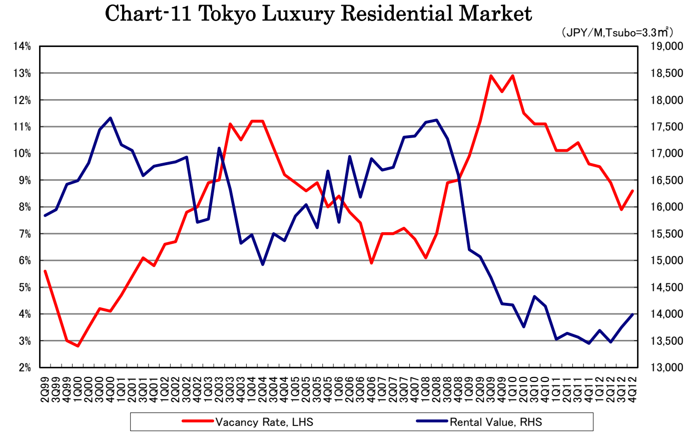
Chart-10 Tokyo Residential Rent Index



Jan 2005=100
Source: IPD・Recruit Residential Index

 NLI Research Institute | Real Estate Analysis Report February 8, 2013 |

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

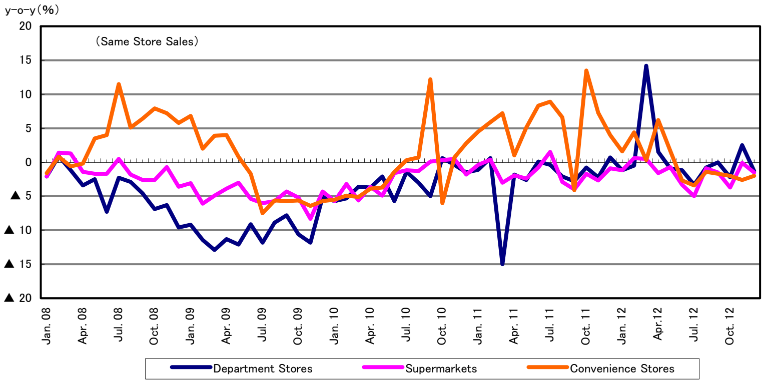
Retail sales weakened further with slowing consumption in the fourth quarter as December same store sales of convenience stores, department stores and supermarkets shrank for the seventh, ninth and second consecutive month, respectively (Chart-12).

Department stores posted a positive yearly sales growth in 2012, as large stores increased their spaces in the Tokyo and Osaka central business districts and reversal effects came from the voluntary consumption restraint following the earthquake in 2011. However, convenience stores and supermarkets yearly sales shrank by -0.3% and -1.9%, respectively, amidst the intense competition.

Regarding the hotel sector, the number of foreign visitors in December increased for the tenth consecutive month by 20.5% y-o-y to 690k (Chart-13). The annual number posted 8.4m, a 34.6% y-o-y increase, with reversal effects from the exceptionally bad sentiment following the earthquake and Japanese airports' acceptance of low cost airlines. Hotel occupancy rates remained higher than before the earthquake (Chart-14, 15).

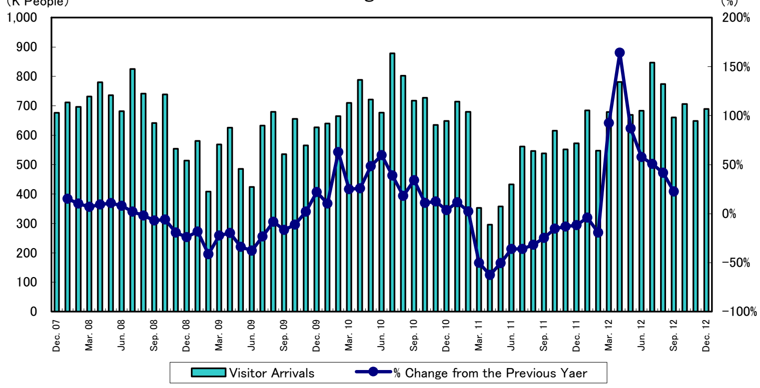
According to CBRE, the vacancy rates of large multi-tenant logistics facilities improved in the Kanto region to 3.76%, with 2.5% excluding new completions, while the Kansai region also improved to 1.5%, with 0% excluding new completions for the fourth consecutive quarter (Chart-16). Property companies have a positive view of the market and plan to develop projects aggressively in the Tokyo metropolitan area.

Chart-12 Retail Same Store Sales



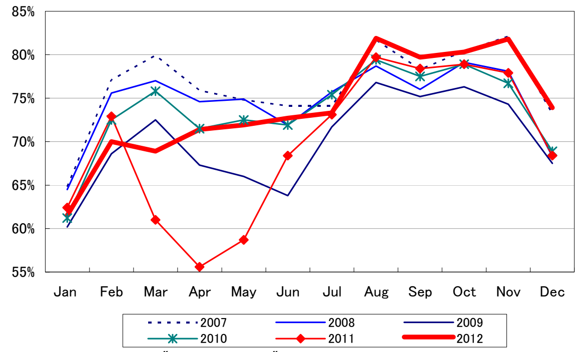
Source: Ministry of Economy, Trade and Industry

Chart-13 Foreign Visitor Arrivals



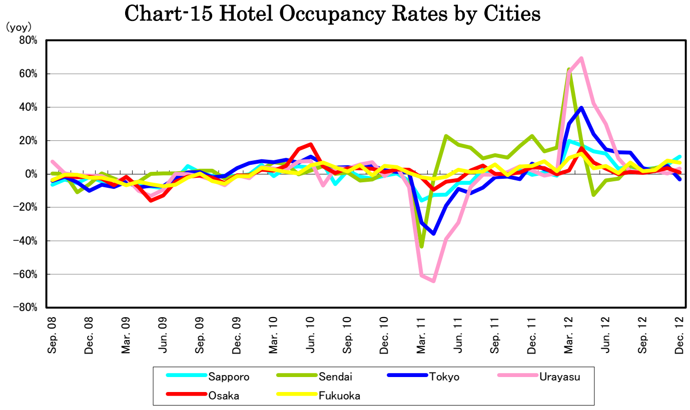
Source: Japan National Tourism Oganization (JNTO)

Chart-14 Hotel Occupancy Rates



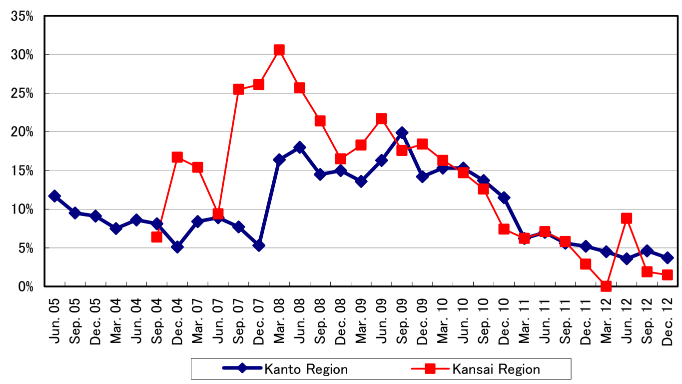
Source: Ohta Publications "Weekly HOTERES"

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

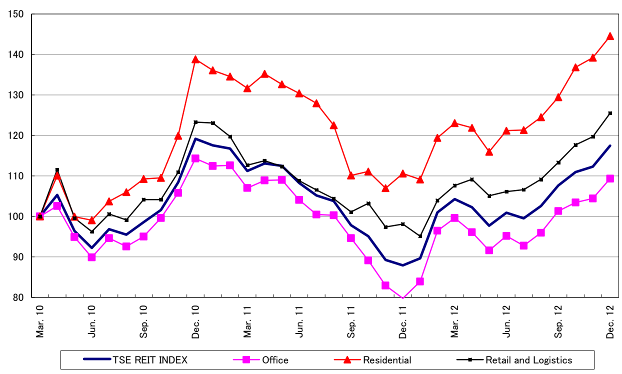
The TSE REIT Index recovered to 1,000 points in September for the first time in six months and maintained good momentum to return to the level before the earthquake (Chart-17). The index posted a 9.1% q-o-q return in the fourth quarter and a 33.6% record best yearly return in 2012, with 37.1% for offices, 30.7% for residences and 27.9% for others including retail and logistics.

J-REITs acquired 51 assets totaling JPY 225.2 billion in the fourth quarter and more than JPY 800 billion in 2012, increasing for the third consecutive year (Chart-18). A variety of assets other than offices were acquired, 28% consisting of offices, 27% retail, 17% residences, 13% logistics facilities and 8% leased land. Some new REITs focusing on logistics facilities and residences are conducting IPOs in 2013 and the current office biased weight of J-REIT will gradually be adjusted.

The mutual fund low is going to be reviewed in 2013 for the first time in 13 years. It is highly likely that J-REITs will be allowed to offer rights to unitholders and buy back their units. Other subjects are under discussion as well, such as requiring committee approval for asset acquisitions from sponsors, disclosing details of asset appraisal, adoption of regulations on insider trading and deregulation for J-REITs acquiring overseas assets. These will all contribute to protecting investors' interest and narrowing the gap from the global standard, which the market will appreciate.

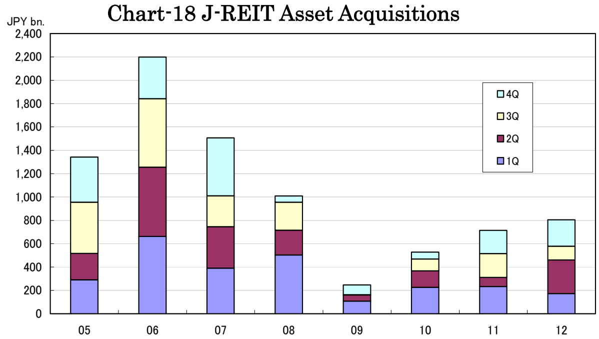
While the private property investment funds maintained good momentum, the property investment market apparently continues to expand further on the back of a depreciating Japanese yen and a recovering equity market since the end of last year.

Chart-17 TSE REIT Index



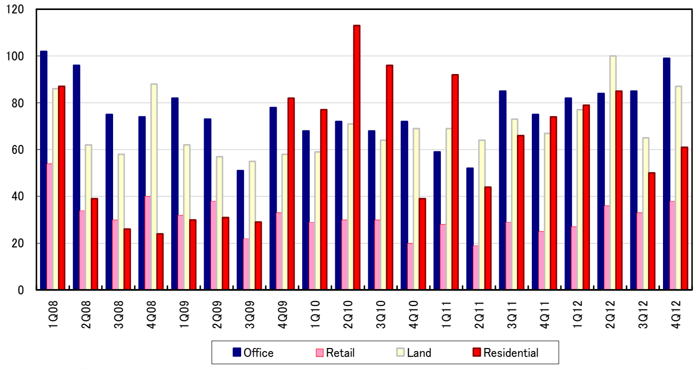
Source: Tokyo Stock Exchange

Chart-18 J-REIT Asset Acquisitions



*New REIT assets are included 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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In addition, this report is intended only for providing information, and the opinions and forecasts are not intended to make or break any contracts.

