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Real Estate Analysis Report

Japanese Property Market Quarterly Review, Fourth Quarter 2013

~10 Million Foreign Visitors and Bright J-REIT Market~

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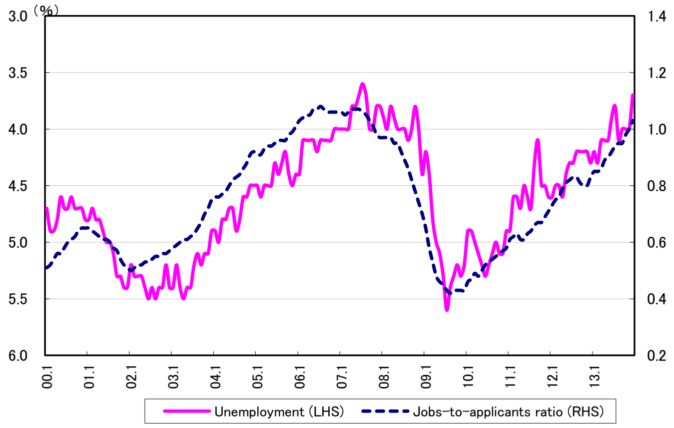
Summary

- "Abenomics," which aims to create a positive economic cycle, has gradually affected employment after stimulating manufacturing activities and individual consumption. The housing market has been robust, with housing starts growing for the fourth consecutive year. The number of condominium units sold in the Tokyo metropolitan area hit 50k for the first time in six years and the transaction volume in the secondary condominium market posted a record high for the second consecutive year. Land prices have been rising in major cities.
- Office demand has increased steadily in Tokyo, though the market spent some time in a standstill after a significant improvement in the first quarter. The rents of Grade-A and other office buildings have recovered after bottoming out. Residential rents in Tokyo have been recovering. Hotel occupancy rates remained high and the number of foreign visitors surpassed 10 million for the first time. Logistics vacancy rates remain low with strong demand though sizable supply continues.
- The J-REIT market was bright in 2013 on the back of "Abenomics" and Tokyo winning the bid to host the 2020 Olympic Games. The annual 35.9% appreciation of the TSE J-REIT index, the total 2.2 trillion JPY amount of J-REITs' asset acquisition and the 7.6 trillion JPY of year-end J-REIT market value were all record highs. Transacted CAP rates for popular sectors and areas have been smaller than those during the previous peak, which might suggest an overheated market.

1. Economy and Housing Market

"Abenomics," which aims to create a positive economic cycle, has gradually affected employment after stimulating manufacturing activities and individual consumption. The unemployment rate improved by 0.3% m-o-m to 3.7% and the jobs-to-applicants ratio posted 1.03 times in December, hovering above 1.0 for the second consecutive month (Chart-1).

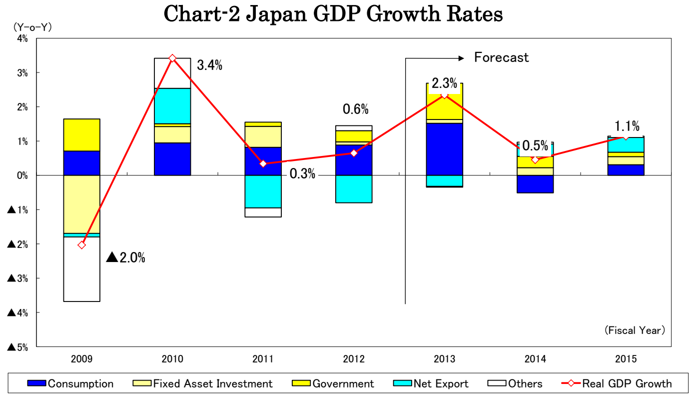
Chart-1 Unemployment and Jobs-to-Applicants Ratios



Source; MIC "Employment Report" , MHLW "Job introduction"

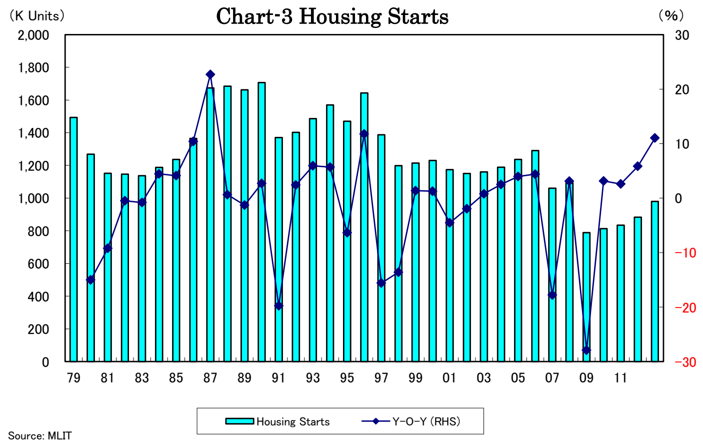
NLI Research Institute revised its Japan GDP growth forecast to 2.3% for fiscal year 2013, 0.5% for 2014 and 1.1% for 2015 (Chart-2). The reversal effect from the rash demand before the introduction of the 8% consumption tax rate will drag down the GDP growth by 1.7% for the fiscal year 2014 and 0.3% for 2015.

Chart-2 Japan GDP Growth Rates

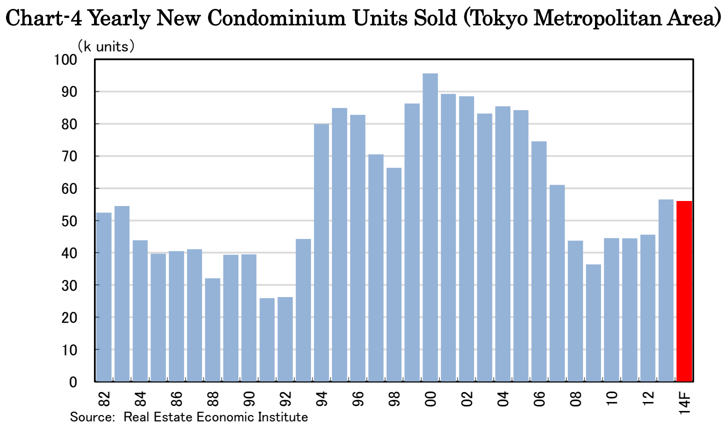


Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
NLI Research Institute "Weekly Economist Letter" February 17, 2014.

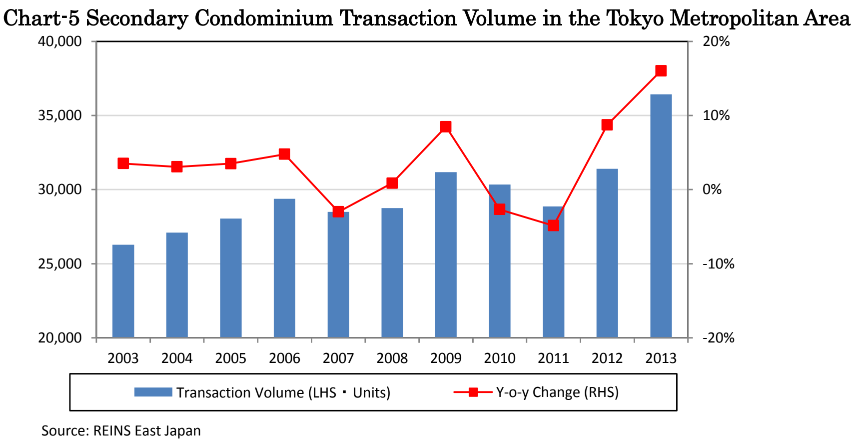
The housing market has been robust. Housing starts posted positive y-o-y growth for the sixteenth consecutive month by 18.0% to 89.6k units in December. Good economic sentiment, shrinking mortgage loans and anticipation of higher construction costs pushed the yearly housing starts number up by 11% to 980k in 2013 for the fourth consecutive year of increase (Chart-3).



The number of new condominium units sold in the Tokyo metropolitan area increased by 23.8% y-o-y to 56k in 2013, exceeding 50k for the first time since 2007. The Real Estate Economic Institute forecasts an unchanged 56k units for 2014 (Chart-4).

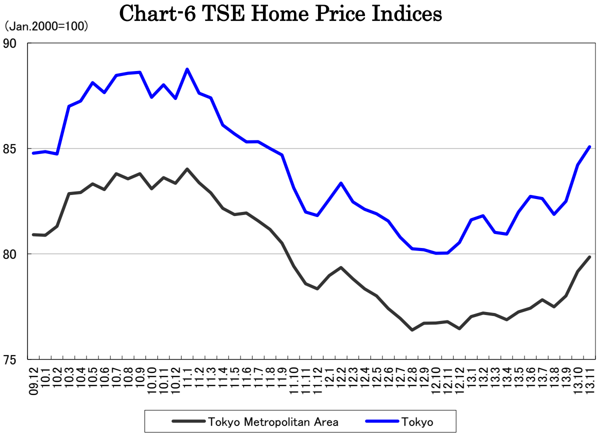


Transaction volume in the secondary condominium market increased by 18.3% y-o-y to 9,087 in the fourth quarter, and by 16% to 36.4k in 2013 posting a record high for the second consecutive year (Chart-5).



TSE Home Price Indices in the Tokyo metropolitan area rose for the third consecutive month in November (Chart-6).

Chart-6 TSE Home Price Indices



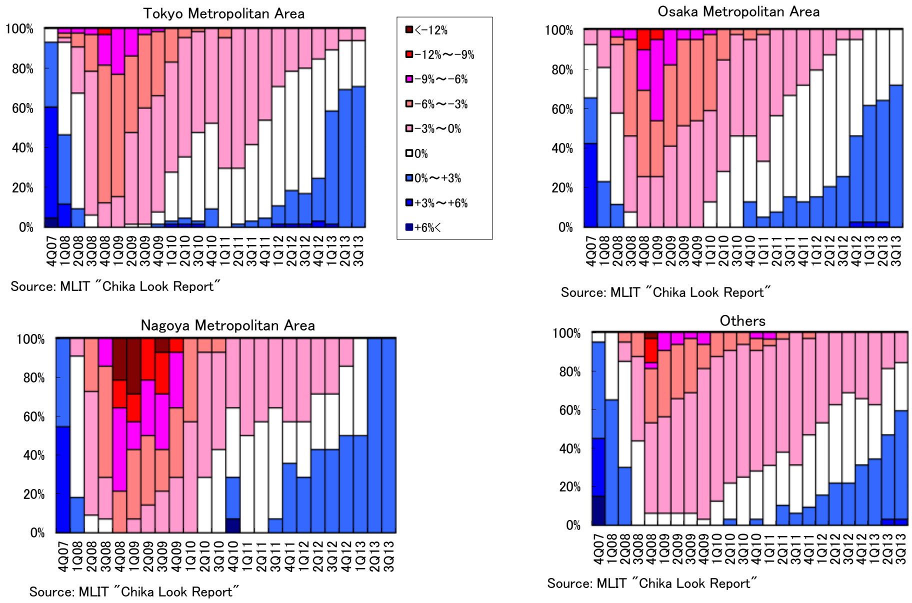
Source: Tokyo Stock Exchange "Home Price Indices"

2. Land Prices

Land prices in major cities have maintained a rising trend on the back of increasing office investment and housing demand.

In the "Chika Look Report in the third quarter 2013" by MLIT, 107 check points, 71% of the nationwide coverage, posted price appreciations, with 71% in the Tokyo metropolitan area, 72% in Osaka, 100% in Nagoya and 59% in other local cities. No check points posted price declines in the Osaka and Nagoya metropolitan area for the third consecutive quarters (Chart-7).

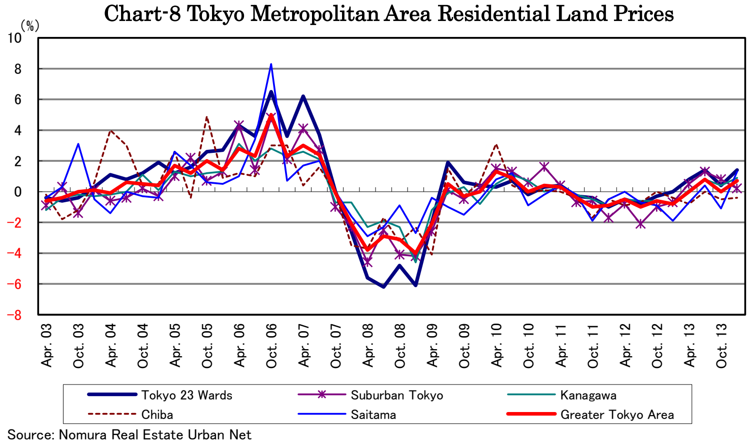
Chart-7 Land Price Changes



According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area rose by 0.7% q-o-q and 1.4% y-o-y in the fourth quarter. Residential land prices in the 23 wards of Tokyo, greater Tokyo, and Kanagawa, Saitama and Chiba prefectures rose by 4.1%, 2.8%, 2.2%, 0% and -0.4% y-o-y, respectively in 2013 (Chart-8).

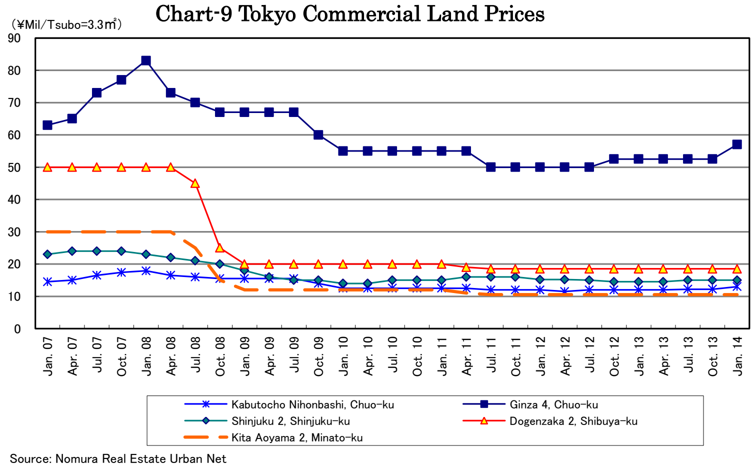
Commercial land prices in the Tokyo metropolitan area rose by 2.1% q-o-q and 3.3% y-o-y. (Chart-9).

Chart-8 Tokyo Metropolitan Area Residential Land Prices



Source: Nomura Real Estate Urban Net

Chart-9 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urban Net

3. Sub-sectors

1) Office

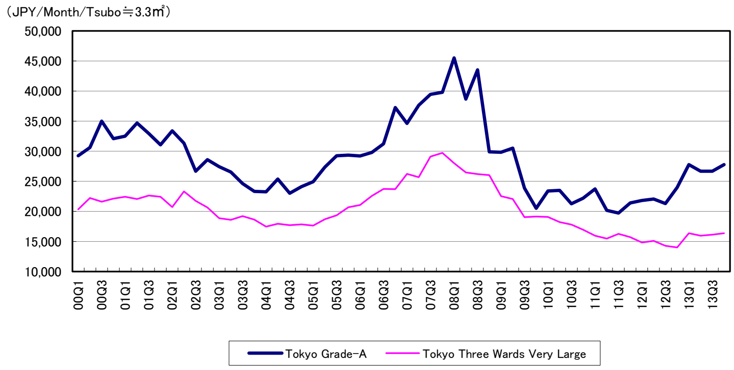
Office demand has increased steadily in Tokyo, though the market spent some time in a standstill after significant improvement in the first quarter.

The vacancy rates of very large sized offices in the main three wards of Tokyo improved significantly by 0.5% q-o-q in the fourth quarter to 5.6%. Moreover, the rent indexes of Tokyo grade-A[1] offices and very large sized offices in the main three wards of Tokyo rose by 4.2%

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

and 1.5% q-o-q respectively in the quarter (Chart-10). The office index for all sizes in the main three wards of Tokyo rose by 9.6% y-o-y, with the office indexes of Tokyo grade-A offices, very large, large, medium and small rising by 15.8%, 16.9%, 15.9% and 5.4% y-o-y, respectively.

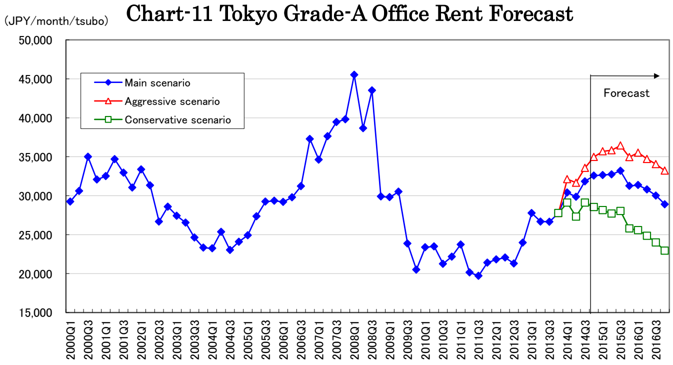
Chart-10 Rent Indexes of Tokyo Grade-A Offices and Very Large Sized Offices in the Main Three Wards of Tokyo



Source: Sanko Estate "Office Rent Data 2012"

NLI Research Institute revised its rent index forecast of Tokyo grade-A offices (Chart-11). The rents of Tokyo grade-A offices are expected to rise based on a good supply demand balance for the time being. However, it is anticipated that another downward cycle will start around the second half of 2015.

Chart-11 Tokyo Grade-A Office Rent Forecast



Source: Sanko Estate, NLI Research Institute

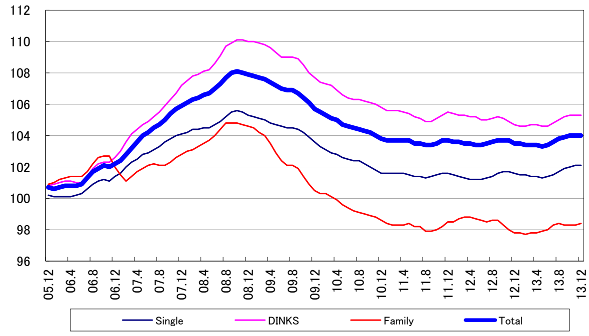
2) Residential Rental

The Tokyo residential rent indexes in each type category of single, DINKS[2] and family, have continued to rise since July (Chart-12).

The vacancy rates of the Tokyo luxury residential market have been improving and the rents also seem to be recovering after bottoming out (Chart-14).

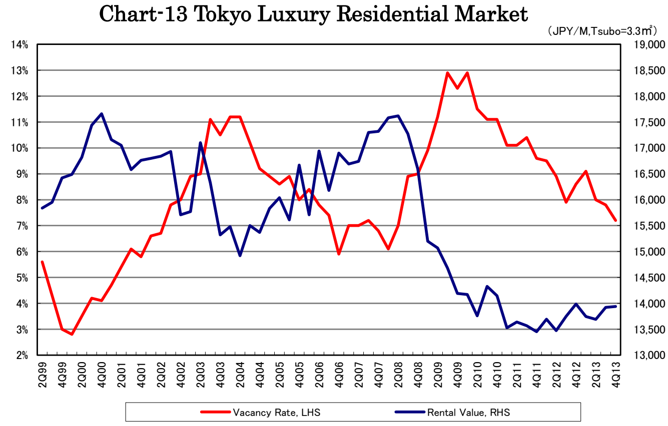
[2] Double Income No Kids

Chart-12 Tokyo Residential Rent Index



Jan 2005=100
Source: IPD・Recruit Residential Index

Chart-13 Tokyo Luxury Residential Market



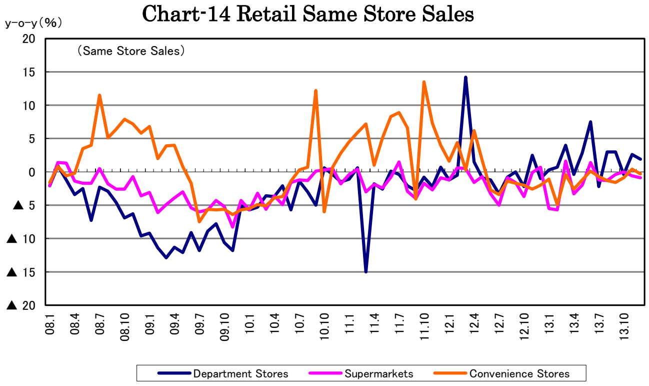
*Sample consists of contracts with more than 300K JPY/M,Tsubo rental value or 30 Tsubo space.
Source: Ken Real Estate Advisors Ltd.

3) Retail, Hotel and Logistics

Retail sales grew by 2.6% y-o-y in December, which was the fifth consecutive month of positive growth. The same store sales of department stores, supermarkets and convenience stores posted 1.9%, -0.9% and -0.3% y-o-y growth respectively in December (Chart-14).

The same store sales of department stores grew by 1.8% y-o-y in 2013, which was the second consecutive year of positive growth. Luxury goods sold well based on the wealth effect of the stock market rally and rash demand before the introduction of the 8% consumption tax. On the other hand, same store sales of supermarkets and convenience stores posted negative growth[3], -1.5% and -1.2% respectively.

Chart-14 Retail Same Store Sales



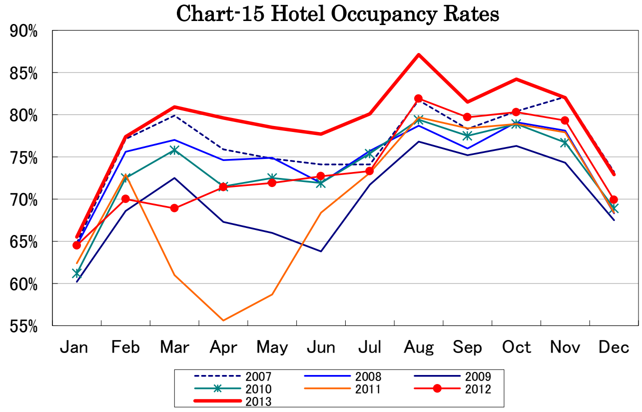
Source: Ministry of Economy, Trade and Industry

[3] Total sales including new stores of supermarkets and convenience stores grew by 0.2% and 4.2% y-o-y in 2013.

Hotel occupancy rates remained high expanding by 3.0% y-o-y to 72.9% in December (Chart-15).

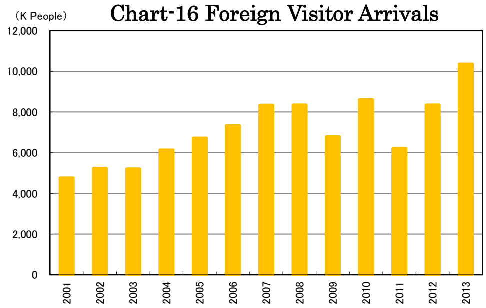
The number of foreign visitors reached 10.34 million surpassing 10 million for the first time by 24% y-o-y growth in 2013, due to JPY depreciation, additional LCC routes and relaxed visa requirements for Southeast Asian visitors. The numbers from Taiwan, Hong Kong and Thailand increased more than 50% y-o-y. Though only the number of visitors from China shrank in 2013, it is expected to recover significantly during the lunar New Year holidays.

Chart-15 Hotel Occupancy Rates



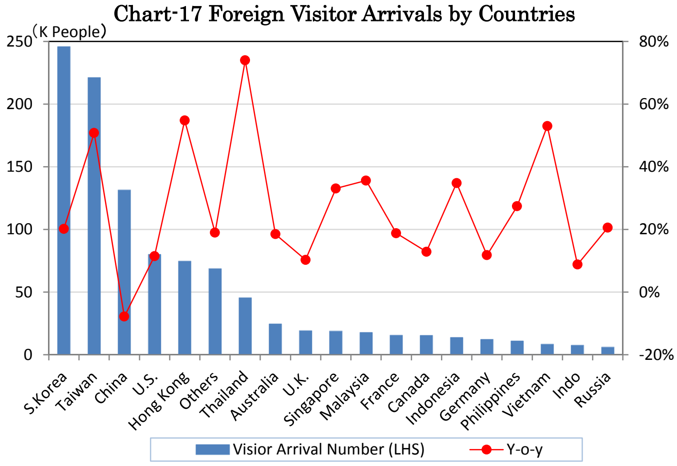
Source: Ohta Publications "Weekly HOTERES"

Chart-16 Foreign Visitor Arrivals



Source: Japan National Tourism Organization (JNTO)

Chart-17 Foreign Visitor Arrivals by Countries



source: Japan National Tourism Organization

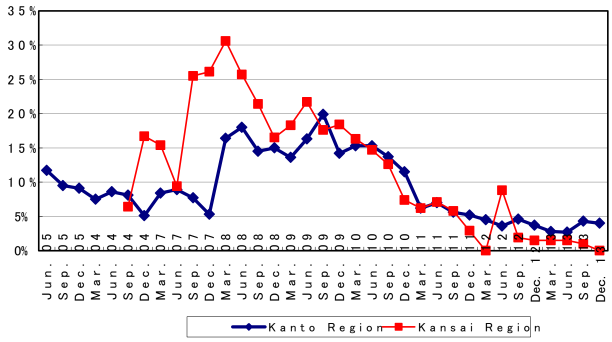
According to CBRE, the vacancy rates of large logistics facilities for multi-tenants in the

Tokyo metropolitan area improved by 0.3% to 4.0% in the fourth quarter. Those of the Osaka metropolitan area improved by 1% and became 0% again (Chart-18).

The largest ever supply of new logistics facilities is scheduled in the Tokyo metropolitan area in the first quarter of 2014, however, the vacancy rates will not rise above 8% given the strong demand.

According to Ichigo Real Estate Service, the monthly logistics rent in the Tokyo metropolitan area grew by 2.0% q-o-q to 4,000 JPY per tsubo, which was the third consecutive month of growth.

Chart-18 Logistics Facility Rents and Vacancy Rates (Large Sized Multi-Tenant-Use)



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

4.Property Investment and J-REIT Markets

Despite some correction after the Tokyo Olympic Games rally in September, the TSE REIT Index managed to grow by 0.3% q-o-q in the fourth quarter. The office sector dropped by 0.3%, residential dropped by 1.0% and others including retail and logistics grew by 2.0% (Chart-19).

At the end of December, the price to NAV ratio of J-REITs was 1.4 times and the dividend yield was 3.6% with a 2.9% yield spread on ten year JGBs.

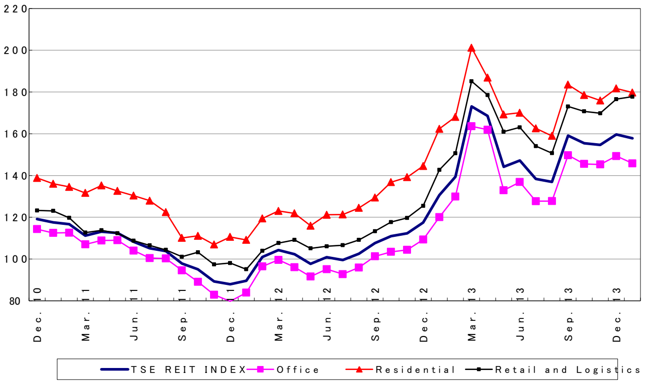
In 2013, the TSE REIT Index posted the largest ever growth of 35.9% y-o-y, and the year-end market value of 7.6 trillion JPY was much larger than the previous peak of 6.8 trillion JPY before the global financial crisis.

The number of J-REITs increased with six IPOs to 43. In total, J-REITs funded 1.1 trillion JPY and acquired assets for 2.2 trillion JPY, which brought the value of total assets owned by J-REITs to 11.2 trillion JPY.

Logistics facilities and retail malls accounted for 34% and 24% of the total amount of assets acquired by J-REITs in 2013, which is quite different from the past when office and residential assets were the main acquisition targets (Chart-20).

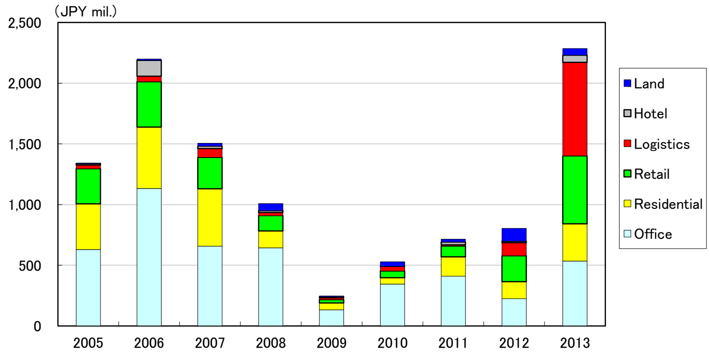
The debt funding conditions are very favorable for J-REITs, the average issuing terms on J-REIT bonds were 0.8% interest rates for 6.3 years.

Chart-19 TSE REIT Index



Source: Tokyo Stock Exchange

Chart-20 J-REIT Asset Acquisitions



Source: NLI Research Institute

The transactions in the property investment market have been active. According to the Urban Research Institute Corporation, the property transaction volume by listed companies in the first half of 2013 exceeded that of before the global financial crisis. It is said that transacted CAP rates for popular sectors and areas have been smaller than those during the previous peak, which might suggest an overheated market.

* 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.

