Real Estate Analysis Report

Japanese Property Market Quarterly Review, First Quarter 2014

~Grade-A Offices Lead Full Fledged Market Recovery~

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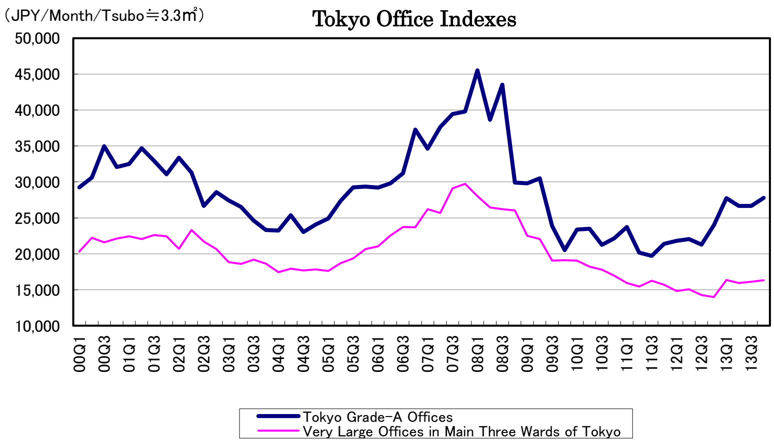
Summary

- Japan`s actual GDP growth is likely to secure 2% in fiscal year 2013 with "Abenomics" and the rush of demand before the consumption tax increase. The housing market has already been affected by a reversal from the rush of demand and rising construction costs. In "Chika Kouji 2014," the number of land price appreciating spots increased significantly.
- Office vacancy rates have decreased in Tokyo due to active moves and expansions by corporations, and the rents of Tokyo Grade-A offices and new buildings have been recovering strongly. Residential rents remained flat, though they are recovering in the medium term. The number of foreign visitors increased further in the first quarter and hotel occupancy rates remained high. Logistics vacancy rates remain low with strong demand though sizable supply continues.
- J-REIT market declined by 3.3% in the first quarter outperforming the equity market. While some corporations and private funds divested their assets with rising property prices, the investment market maintained its vibrancy before the fiscal year end.

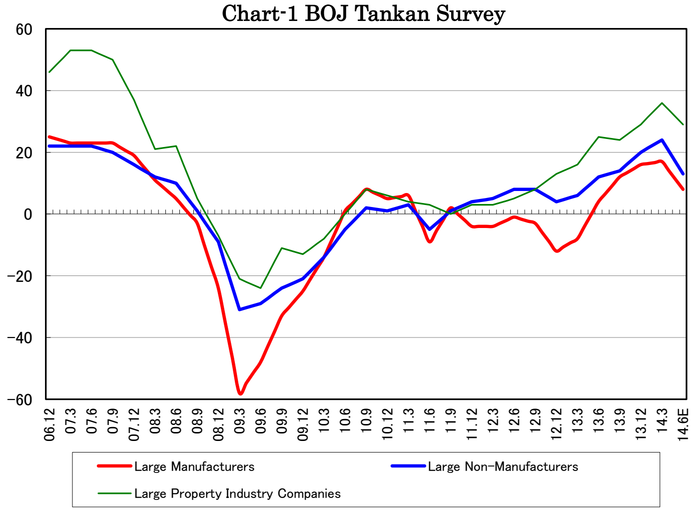


Source: Sanko Estate "Office Rent Data 2014"

1. Economy and Housing Market

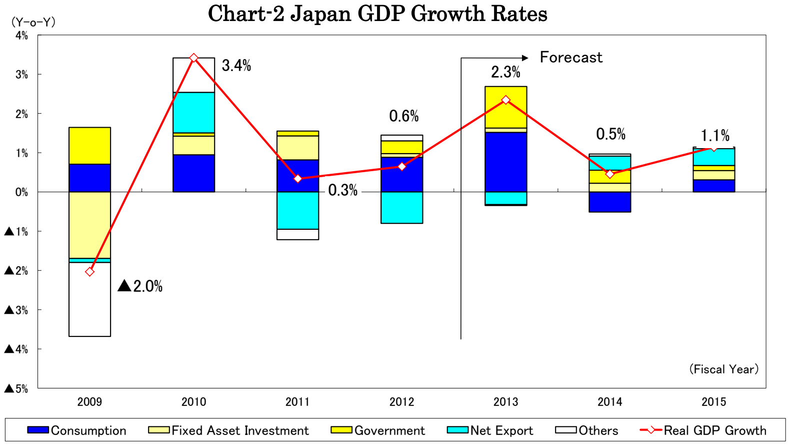
In the BOJ Tankan Survey first quarter 2014, the current business confidence D.I. of large non-manufacturers improved to 24, which was the highest since 1991 (Chart 1). However, outlooks turned cautious based on a reversal effect from the rush of demand in the first quarter before the introduction of the 8% consumption tax rate in April. NLI Research Institute forecasts that Japan's GDP will grow by 2.3% in fiscal year 2013, 0.5% in 2014 and 1.1% in 2015 (Chart-2).

Chart-1 BOJ Tankan Survey



Source: BOJ "Tankan Survey"

Chart-2 Japan GDP Growth Rates

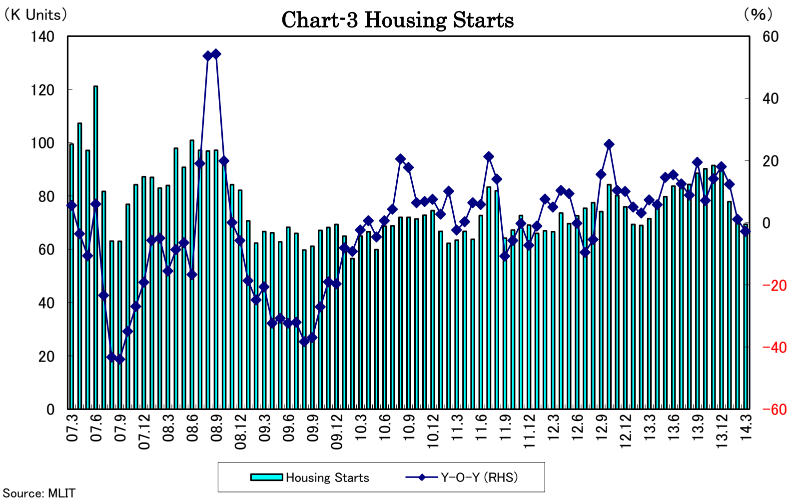


Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
NLI Research Institute "Weekly Economist Letter" March 10, 2014.

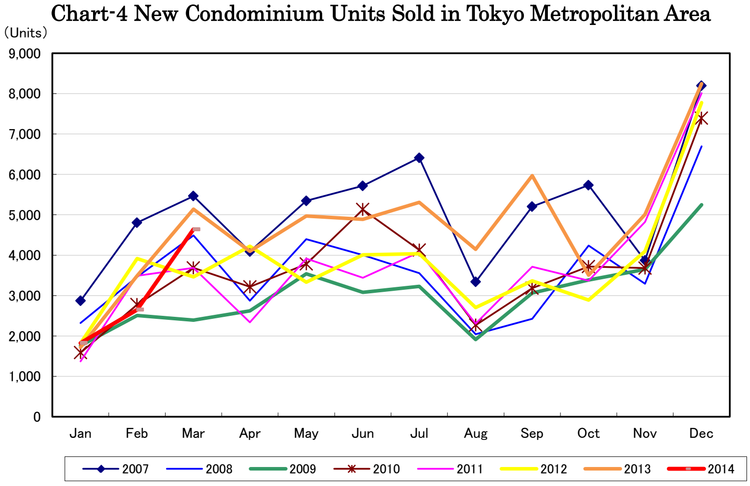
The housing market has already been affected by the reversal effect. Housing starts shrank by 2.9% y-o-y in March for the first time in 19 months (Chart-3). Though housing starts of rental apartments have maintained positive y-o-y growth for 13 months, housing starts of houses and condominiums for own-occupation decreased for the second consecutive month.

The number of new condominium units sold in the Tokyo metropolitan area also decreased y-o-y in February and March consecutively (Chart-4). With the rising construction costs (Chart-5), quite a few customers who had been considering a new condominium have shifted to the secondary market. According to Real Estate Information Network System, the secondary transaction volume in the Tokyo metropolitan area posted 9,993 units in the quarter growing by 3.4% y-o-y for the tenth consecutive quarter (Chart-6).

Tokyo Stock Exchange Home Price Indices, representative secondary home price indices, have been recovering since bottoming out in 2012 (Chart-7).

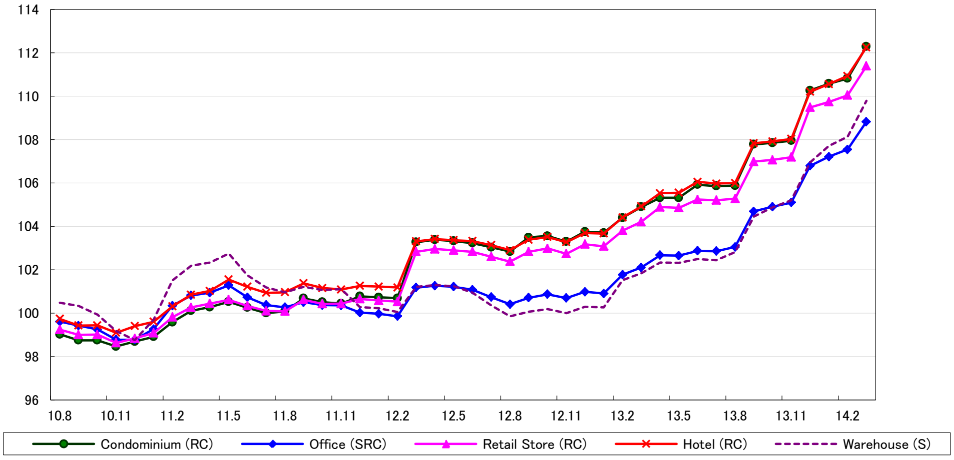


Source: MLIT



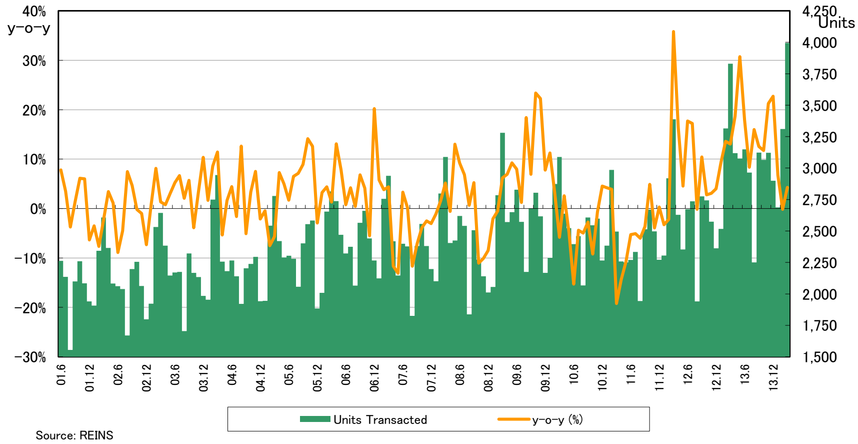
Source: Real Estate Economic Institute

Chart-5 Construction Cost Index



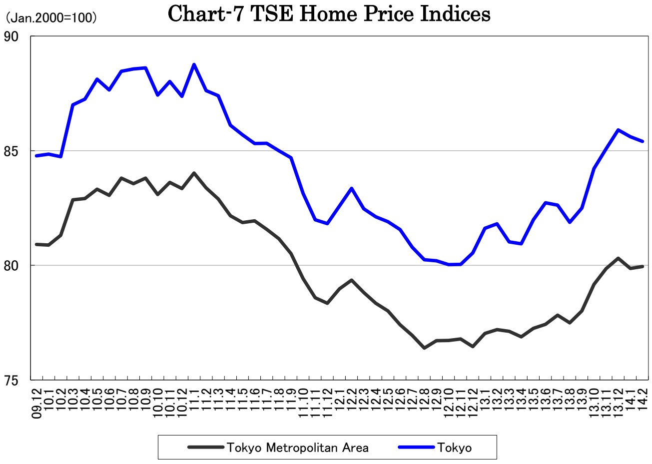
Source: Construction Research Institute

Chart-6 Secondary Condominium Transaction Volume in the Tokyo Metropolitan Area



Source: REINS

Chart-7 TSE Home Price Indices



Source: Tokyo Stock Exchange "Home Price Indices"

2. Land Prices

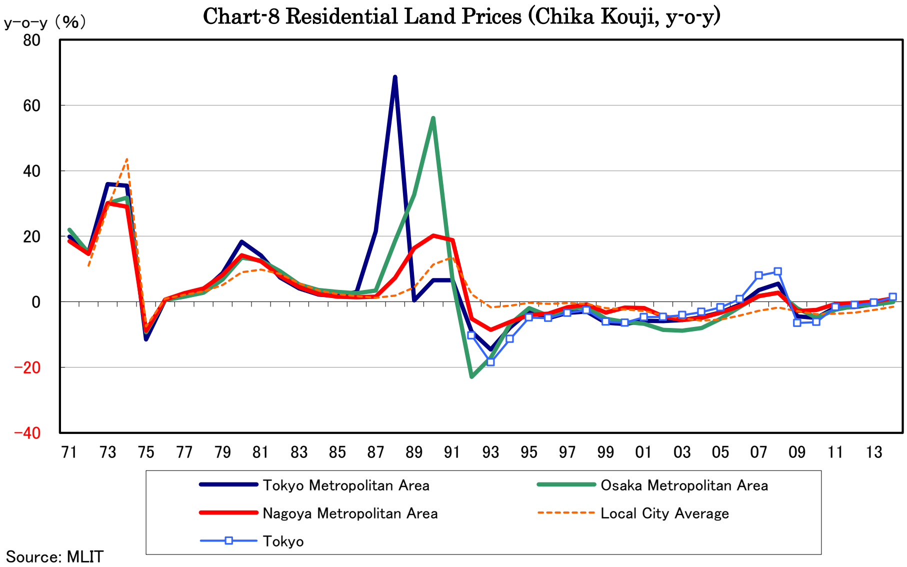
Regarding "Chika Kouji," national land prices as of January 1, 2014, the number of appreciating spots increased significantly, though the national average land price still declined by 0.6% y-o-y. Both residential and commercial land prices in the three major metropolitan areas turned to a y-o-y positive for the first time since 2008, with 51.3% of measured spots appreciating (Chart-8, 9). However, the nationwide ratio of appreciating spots is still lower than those in 2007 and 2008 (Chart-10, 11), with 76.1% of measured spots still declining in local cities.

Some commercial spots in the Tokyo metropolitan area presented remarkable price appreciations, such as the vicinities of Kawasaki and Musashi-Kosugi station, where there were new developments, and Ginza which benefits from robust sales of luxury goods. Some residential spots also presented significant price appreciations such as Kachidoki, Tsukuda and Tsukishima in the Tokyo bay area.

According to Nomura Real Estate Urban Net, average residential land prices in the Tokyo metropolitan area rose by 0.1% q-o-q and 1.6% y-o-y in the first quarter. Residential land prices in the 23 wards of Tokyo, greater Tokyo, and Kanagawa, Saitama and Chiba prefectures rose by 3.9%, 2.8%, 2.1%, 1.2% and -2.1% y-o-y respectively (Chart-12).

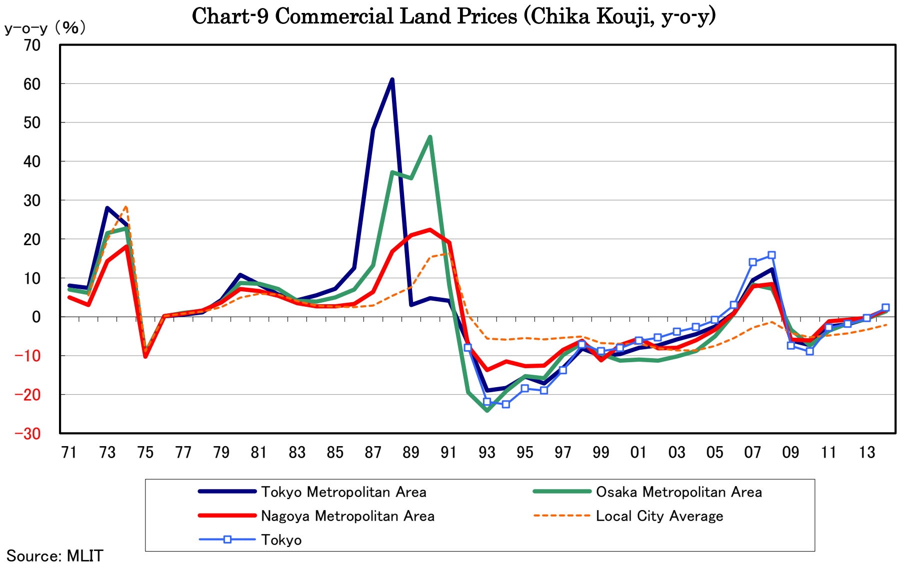
Commercial land prices in the Tokyo metropolitan area rose by 0.4% q-o-q and 3.7% y-o-y in the first quarter (Chart-13).

Chart-8 Residential Land Prices (Chika Kouji, y-o-y)



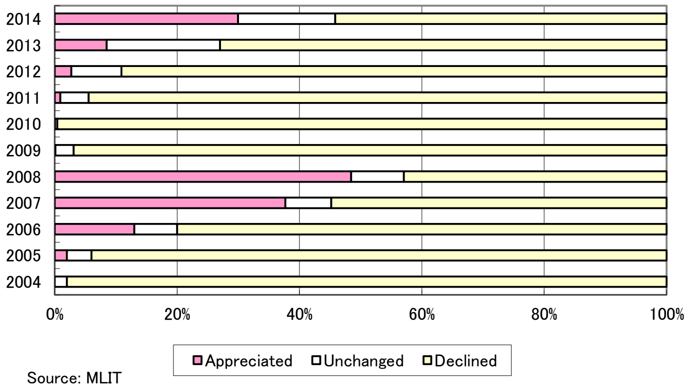
Source: MLIT

Chart-9 Commercial Land Prices (Chika Kouji, y-o-y)



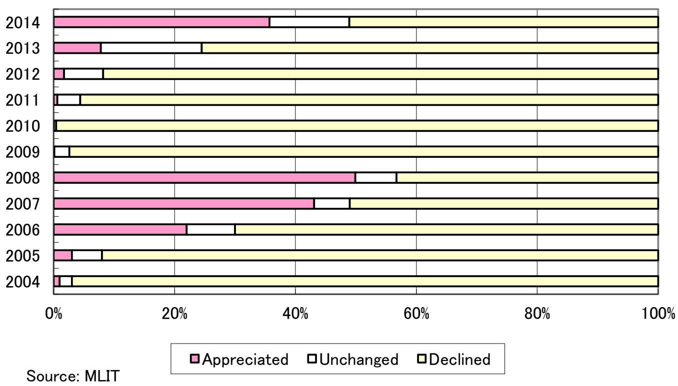
Source: MLIT

Chart-10 Ratios of Residential Land Price Movement



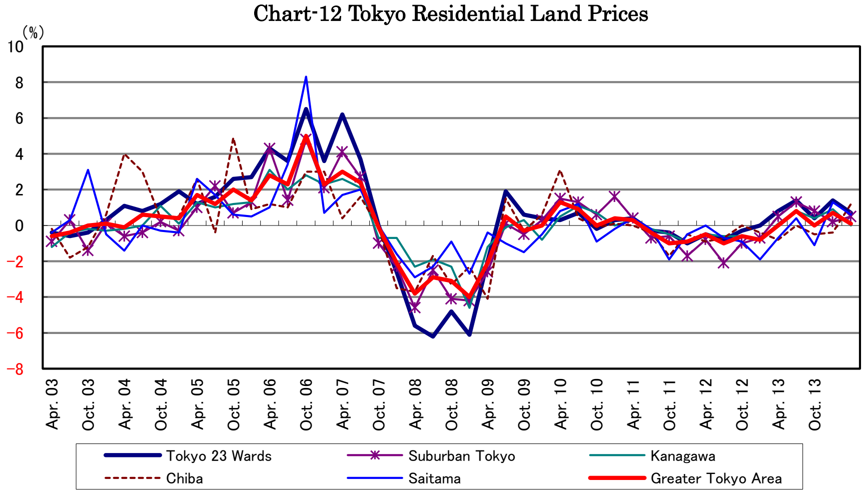
Source: MLIT

Chart-11 Ratios of Commercial Land Price Movement



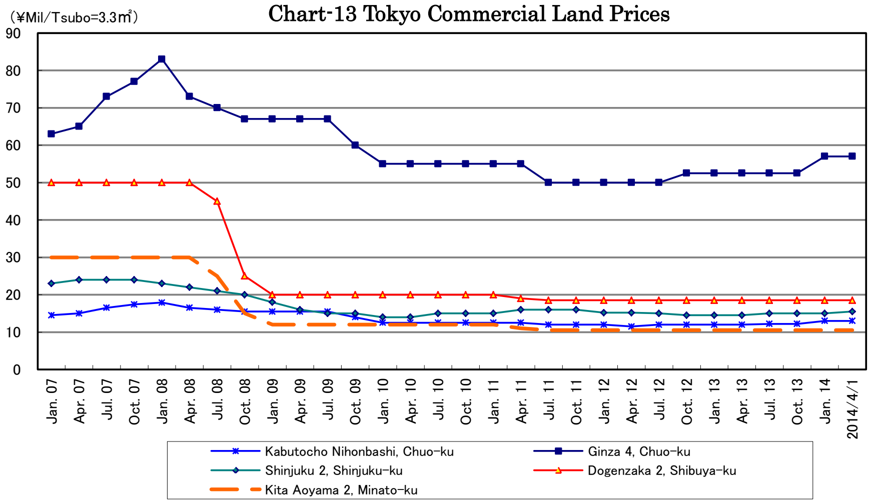
Source: MLIT

Chart-12 Tokyo Residential Land Prices



Source: Nomura Real Estate Urban Net

Chart-13 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urban Net

3. Sub-sectors

1) Office

Tokyo office vacancy rates have decreased due to active moves and expansions by corporations. Office vacancy rates improved in all size categories in the first quarter (Chart-14). It appears the market is shifting from a phase in which building owners just try to secure tenants to the next where some owners consider raising their rents.

The rent index of Tokyo grade-A[1] offices rose to JPY 29,482 by 6.1% q-o-q for the second consecutive month, although the standard category, very large offices in the main three wards of Tokyo, has shown a humble recovery (Chart-15). Regarding office rent indexes by

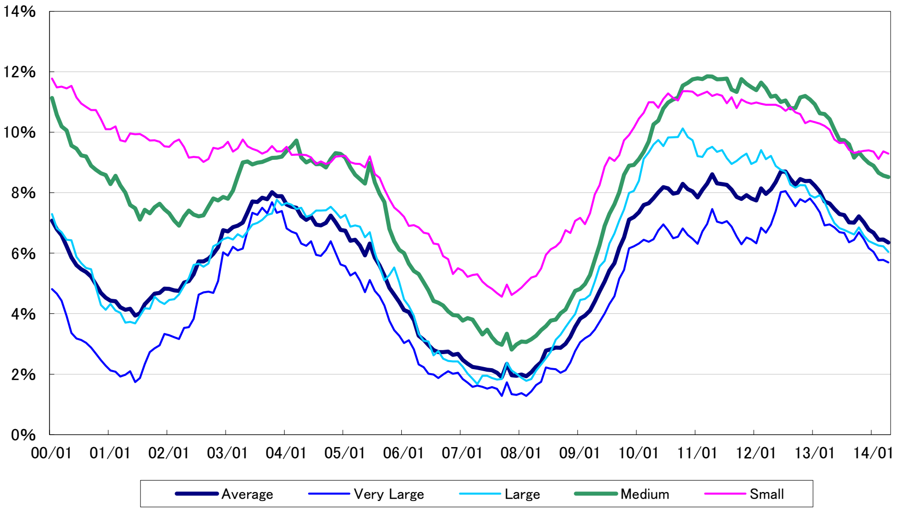
[1] Higher-spec buildings within the very large sized category by Sanko Estate Grade-A-Office Guidelines, the five urban area wards of Tokyo, main office areas and other specially integrated areas, with total floor areas of more than 33,000 m^2, main floor sizes of more than 990 m^2, building age of 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.

size, only the large category posted a remarkable 13.4% q-o-q growth and other categories remained almost flat in the first quarter (Chart-16), though they are recovering in the medium term.

According to Miki Shoji, recent office rents of new buildings in the Tokyo business district have been especially strong (Chart-17). As high-grade buildings that are well-prepared for business continuity planning play a leading role, it is likely the Tokyo office market will enter a full-fledged recovery phase.

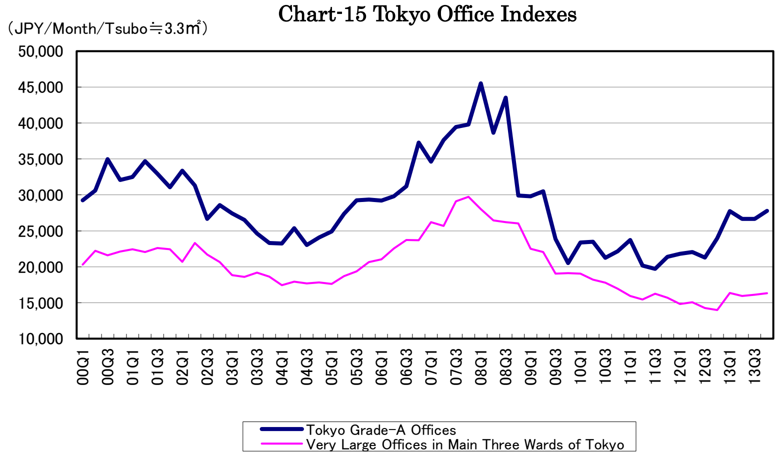
Even outside of Tokyo, local markets have also started recovering, as office vacancy rates in major cities excluding Sapporo improved in the first quarter (Chart-18).

Chart-14 Office Vacancy Rates by Sizes in Tokyo 23 Wards



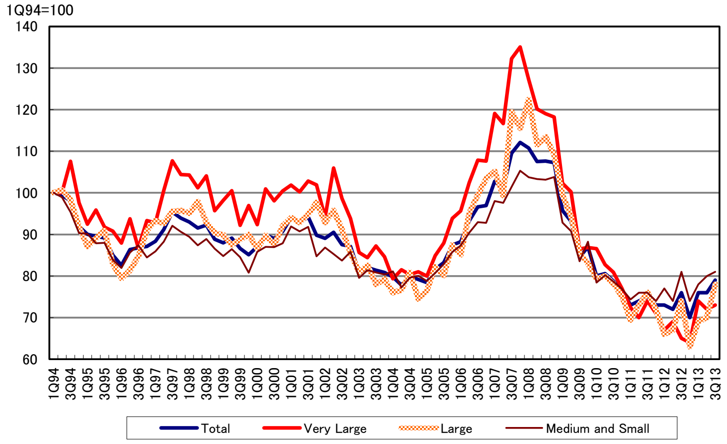
Source: Sanko Estate

Chart-15 Tokyo Office Indexes



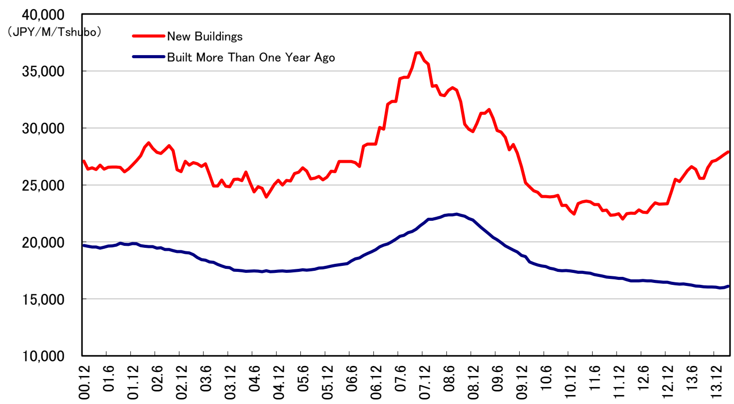
Source: Sanko Estate "Office Rent Data 2014"

Chart-16 Office Rent Indexes by Size in Main Three Wards of Tokyo



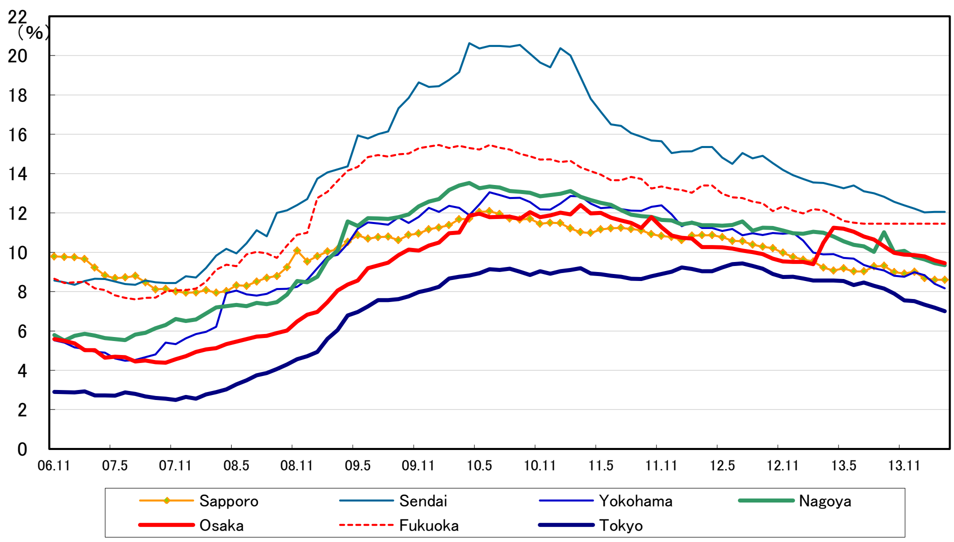
Very Large (Standard floor>200 tsubos), Large (100< and <200), Medium and Small (<100)
Source: Sanko Estate and NLI Research Institute

Chart-17 Office Rents of New and Existing Buildings in the Tokyo Business District



Source: Miki Shoji

Chart-18 Office Vacancy Rates in Major Cities

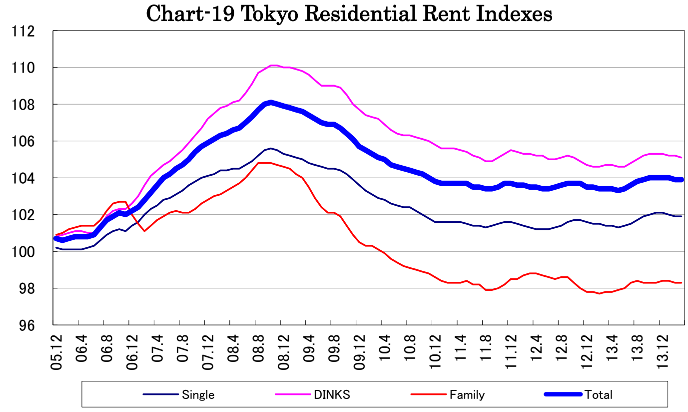


Source: Miki Shoji

2) Residential Rental

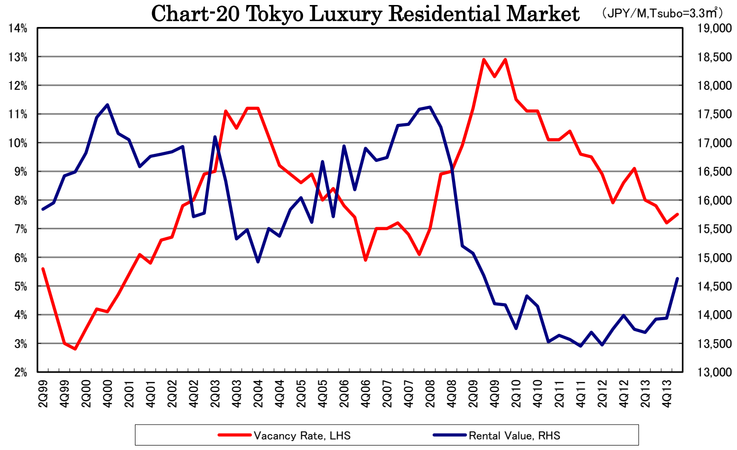
Tokyo residential rent indexes remained flat in the first quarter after a mild recovery in 2013 (Chart-19). On the other hand, Tokyo luxury residential rents showed an evident recovery in the first quarter, even though vacancy rates deteriorated slightly (Chart-20).

Chart-19 Tokyo Residential Rent Indexes



Jan 2005=100
Source: IPD・Recruit Residential Index

Chart-20 Tokyo Luxury Residential Market (JPY/M,Tsubo=3.3㎡)

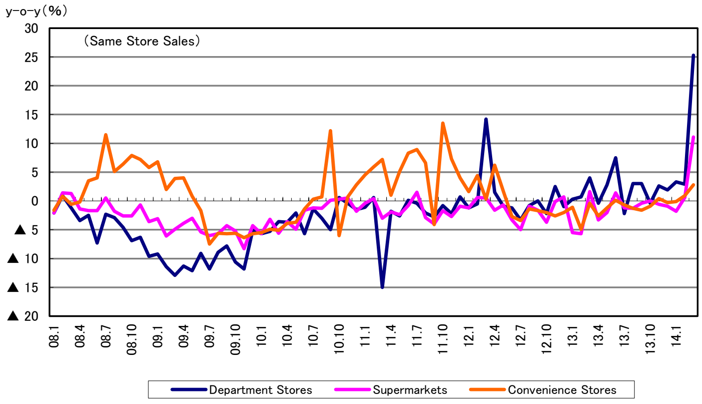


*Sample consists of contracts with more than 300K JPY/M,Tsubo rental value or 30 Tsubo space.
Source: Ken Real Estate Advisors Ltd.

3) Retail, Hotel and Logistics

Retail sales grew by 8.6% y-o-y in March, the eleventh consecutive month of positive growth. Benefiting from a rush of demand before the introduction of the 8% consumption tax rate in April, same store sales of department stores, supermarkets and convenience stores grew by 25.3%, 11.1% and 2.8% y-o-y respectively in March (Chart-21). Positive growth was posted in March by not only department stores, which had shown growth since November, but also others, which had been shrinking. A reversal effect is anticipated in the second quarter following the rush of demand in March before the tax increase.

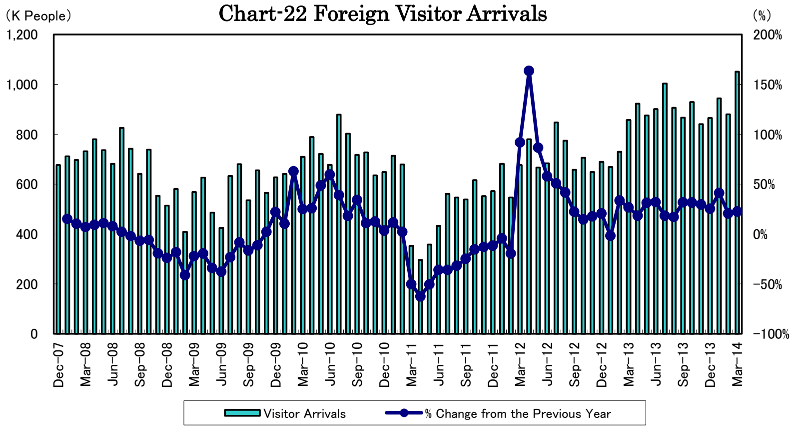
Chart-21 Retail Same Store Sales



Source: Ministry of Economy, Trade and Industry

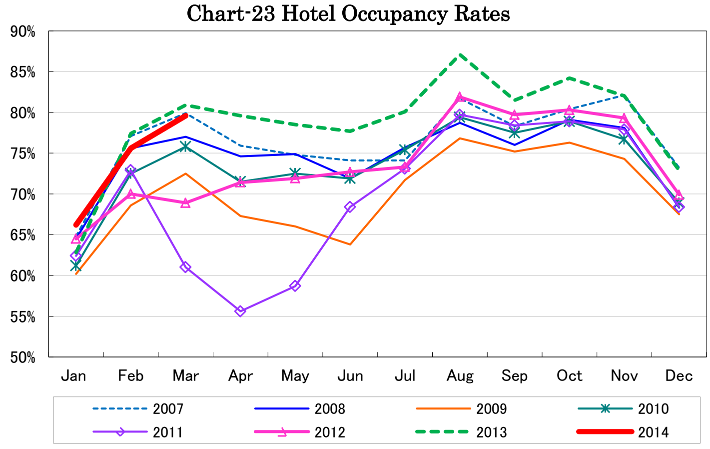
The number of foreign visitors to Japan reached 10.34 million in 2013, surpassing 10 million for the first time. The trend has been maintained with 27.5% y-o-y growth being posted in the first quarter of 2014. The figure for March 2014 was particularly high, a monthly record 1.05 million, breaking the 0.86 million posted in 2013 (Chart-22). In addition to the JPY depreciation, additional LCC routes and relaxed visa requirements for Southeast Asian visitors seen in 2013, Chinese new-year holidays and intensive promotion for the cherry blossom season all contributed to lifting the number of visitors in the quarter. Hotel occupancy rates have thus maintained as high levels as those in 2013 (Chart-23). The hotel sector has also gathered investors' attention, as seen with the construction starts in the sector recovering since bottoming out in 2011 (Chart-24).

Chart-22 Foreign Visitor Arrivals



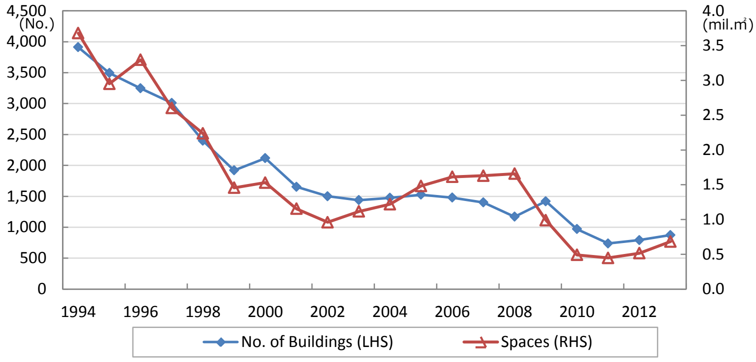
Source: Japan National Tourism Oganization (JNTO)

Chart-23 Hotel Occupancy Rates



Source: Ota Publication

Chart-24 Construction Starts in the Hotel Sector



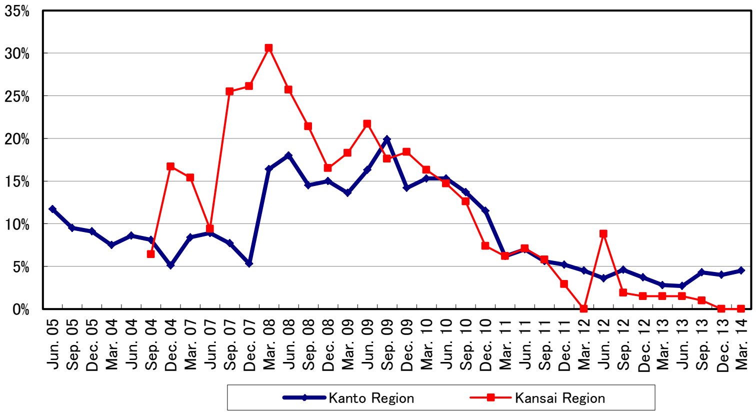
Source: MLIT

According to CBRE, the vacancy rates of large logistics facilities for multi-tenants in the Tokyo metropolitan area deteriorated by 0.5% to 4.5% in the first quarter, while those of the Osaka metropolitan area remained unchanged at 0% (Chart-25).

Despite five new large facilities launching in the Tokyo metropolitan area in the quarter, strong demand absorbed 3.2 million square meters, which was the largest-ever quarterly absorption and kept the vacancy deterioration within 0.5%.

According to Ichigo Real Estate Service, logistics rents in the Tokyo metropolitan area slightly declined by 0.3% q-o-q to 3,990 JPY per tsubo in January.

Chart-25 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

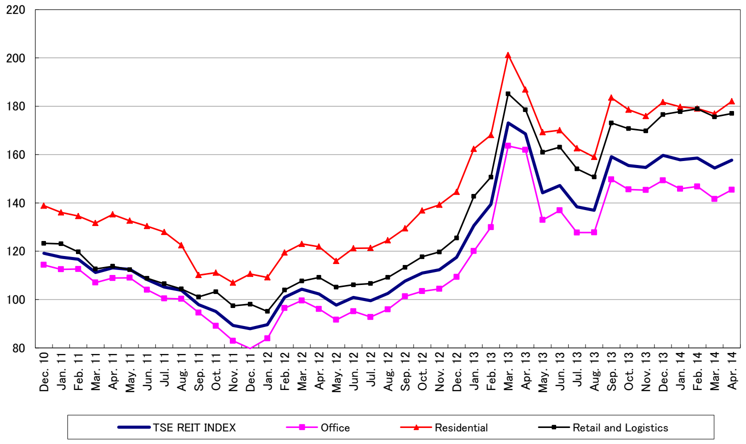
The TSE REIT index drifted within a narrow range of around 1,400 in the first quarter. The index declined by 3.3% q-o-q outperforming the equity market with Topix and property sector index declining by 7.6% and 18.9% respectively. The office, residential and retail logistics sectors of J-REIT declined by 5.2%, 2.6% and 0.5% respectively (Chart-26).

At the end of March, the J-REIT market value was 7.6 trillion JPY, while the price to NAV ratio was 1.3 times and the dividend yield was 3.8%, with a 3.2% yield spread on ten year JGBs.

J-REITs acquired property assets of 432 billion JPY in the first quarter, which was smaller than the overwhelming volume in 2013, but as large as that in 2007 (Chart-27). Hulic REIT, the 44th J-REIT with 21 assets with a value of 101 billion JPY, and Nippon REIT, the 45th J-REIT with 20 assets with a value of 70 billion JPY, were listed in February and March respectively.

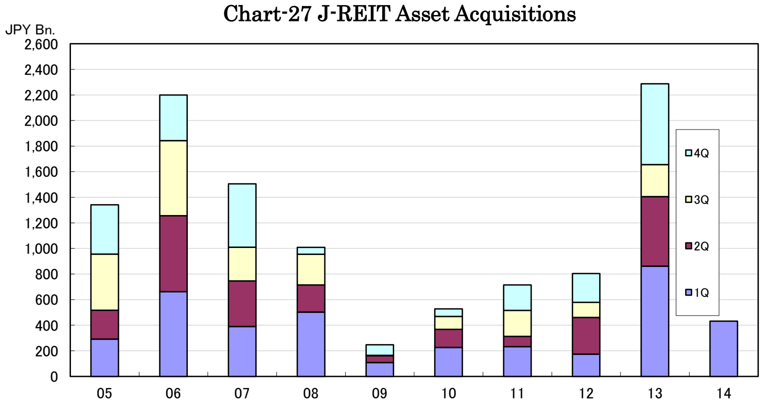
Generally, J-REITs have conducted NOI yield accretive acquisitions (Chart-28), and the dividend per unit grew gradually by 5% in 2013.

Chart-26 TSE REIT Index



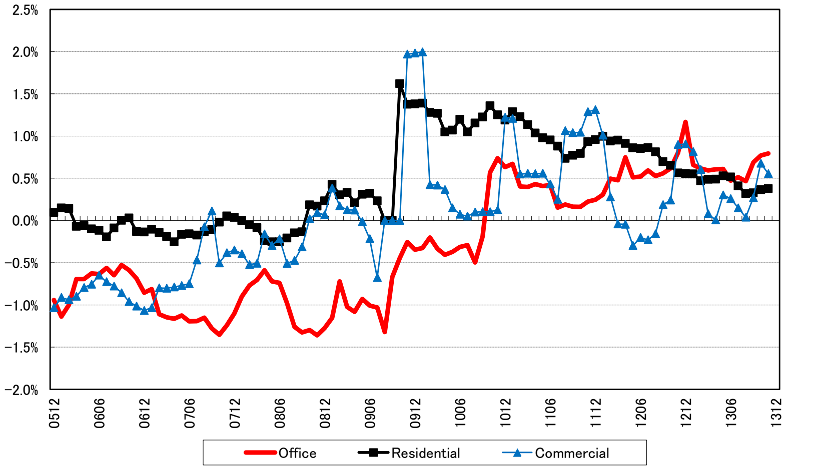
Source: Tokyo Stock Exchange

Chart-27 J-REIT Asset Acquisitions



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

Chart-28 J-REIT Asset Yield Gap (Acquiring NOI Yield – Existing Portfolio NOI Yields)



Source: NLI Research Institute

Transactions in the property investment market remained active in the first quarter. Corporations were major sellers, such as Sony which divested its No.4 and 5 Buildings to Sumitomo Fudosan. Several private funds also sold their assets, some of which had been acquired just a short while before.

On the other hand, more than a few assets were acquired in relation with new fund preparations such as unlisted REITs sponsored by Tokyu Fudosan and Kenedix launched in March.

According to Nikkei Real Estate Market Report, the number of property transactions remained mostly unchanged from 2013 in the first quarter. Even with higher prices, as the average NOI yield transacted in the quarter was 4.3% decreasing by 0.2% q-o-q, the investment market maintained its vibrancy before the fiscal year end.

