

Real Estate Analysis Report

Japanese Property Market Quarterly Review, Third Quarter 2014 ~Leasing and Investment Markets Robust while Housing Slows~

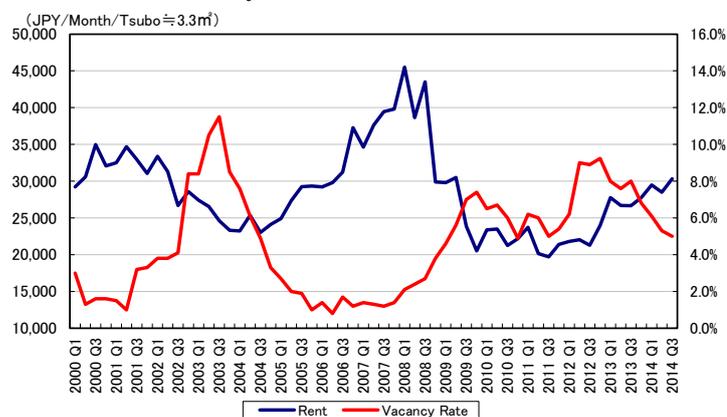
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Summary

- Domestic economic sentiment has not noticeably improved after recovering from the temporal depression following the consumption tax rate hike in April. Housing starts, sales and transactions have been suppressed while housing prices continue to rise. Land prices in major metropolitan areas increased for the second consecutive year.
- The Tokyo office market has recently strengthened based on strong demand and modest supply after a standstill following the rapid recovery in the fourth quarter of 2012.
- Tokyo residential rents have been in a recovery phase following rising condominium prices. Retail stores and hotels are benefiting from the increase in foreign visitors. In particular, hotels are enjoying very high occupancy rates and have raised their room rates. The logistics facility market has been facing a tight supply-demand balance.
- The TSE REIT Index rose by 4.5% in the third quarter on the back of the favorable equity market, lower interest rates and recovery in office rents. Transactions in the property investment market have been active and property amounts acquired by foreigners until October have already exceeded full year amounts of 2013.

Tokyo Grade-A Office Market



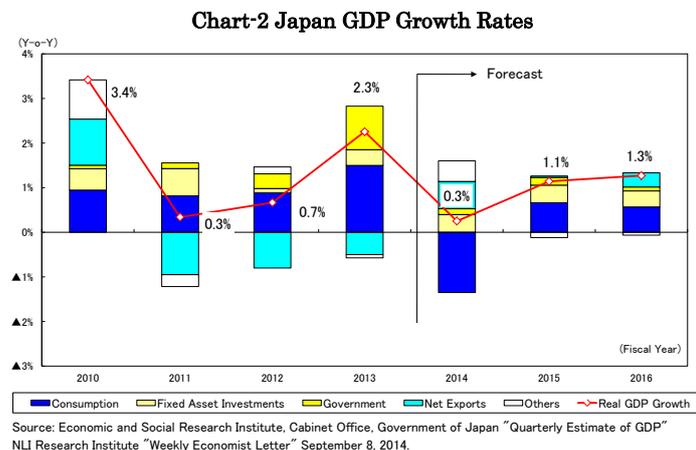
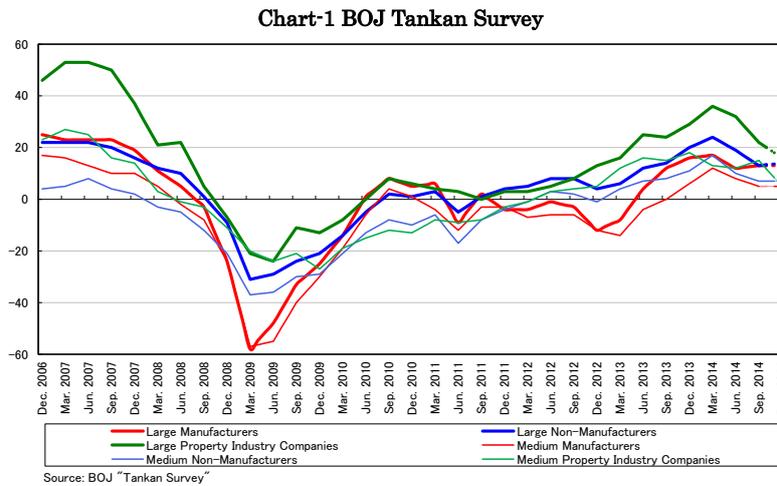
Source: Vacancy Rate·Sanko Estate, Rent·Sanko Estate and NLI Research Institute

1. Economy and Housing Market

Domestic economic sentiment has not noticeably improved after recovering from the temporal depression following the consumption tax rate hike in April. Consumer spending has been inactive, shrinking again by 5.9% and 4.7% y-o-y in July and August, respectively, after some improvement in June when it shrunk by 3% following an 8% drop in May. Negative reversal effects since April from the rush demand before the consumption tax rate hike has settled, however, the actual decrease in household income due to inflation has suppressed consumer spending.

In the BOJ Tankan Survey in the third quarter of 2014, the current business confidence D.I. of large manufacturers improved from 12 to 13. However, the D.I. of large non-manufacturers deteriorated significantly from 21 to 13, and especially that of property industry Companies deteriorated from 32 to 22 and is anticipated to drop further in the fourth quarter (Chart-1).

NLI Research Institute reduced its Japan GDP growth forecast by 0.1% to +0.3% for 2014 and forecasts +1.1% for 2015 and +1.3% for 2016, following the cabinet office downward revision of the second quarter GDP growth (Chart-2).



Housing starts, sales and transactions have been suppressed while housing prices continue to rise. In addition to insistent negative reversal effects from the rush demand before the consumption tax rate hike in April, increasing construction costs have been weighing on the industry.

Housing starts shrank by 14.5% y-o-y to 75.9k units in September for the seventh consecutive month of negative y-o-y growth (Chart-3). Even the number of apartments for lease has tuned to negative growth since July, affected by the increase in construction costs, though it had maintained positive growth on the back of strong construction demand from land owners in order to save on inheritance tax (Chart-4).

New condominium units sold in the Tokyo metropolitan area also decreased significantly by 44% y-o-y to 3,336 units in September (Chart-5). It looks like the rising pace of condominium prices overwhelms household income growth, and the sales number is struggling to grow.

According to Real Estate Information Network Systems, the average unit price in the secondary condominium market also rose by 3.6% y-o-y to 27 million JPY, while the transaction volume shrank by 5.9% y-o-y for the sixth consecutive month.

In the same way, TSE Home Price Indices in the Tokyo metropolitan area have been on an apparent recovery trend from bottoming out in 2012 (Chart-6).

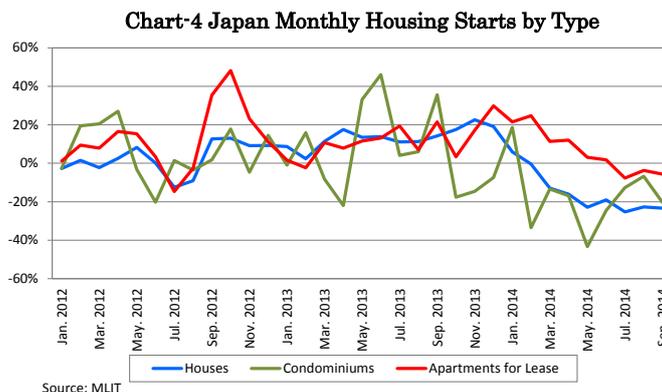
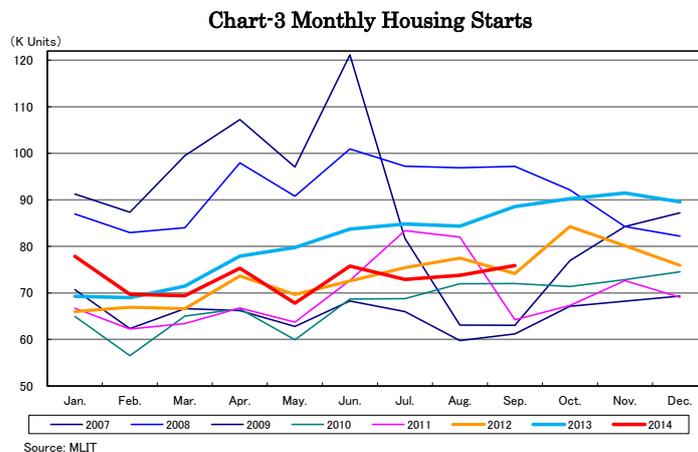


Chart-5 Monthly New Condominium Units Sold (Tokyo Metropolitan Area)

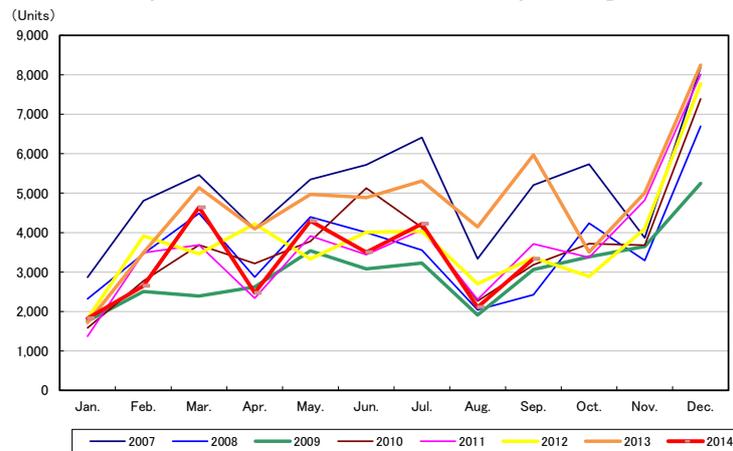
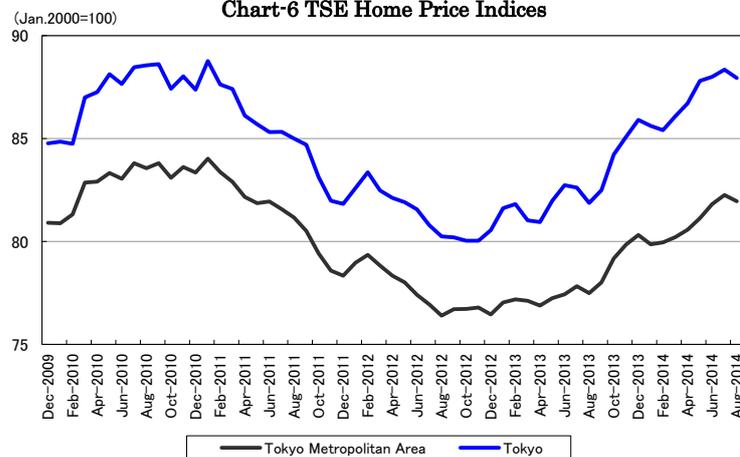


Chart-6 TSE Home Price Indices

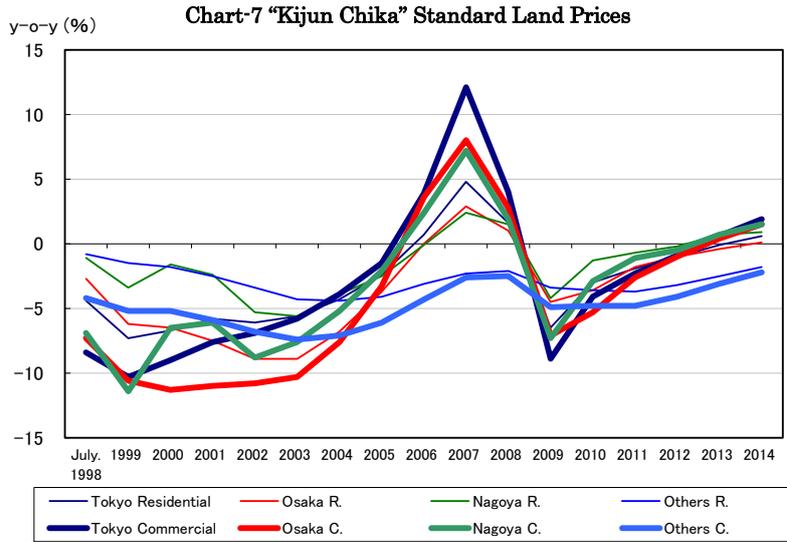


2. Land Prices

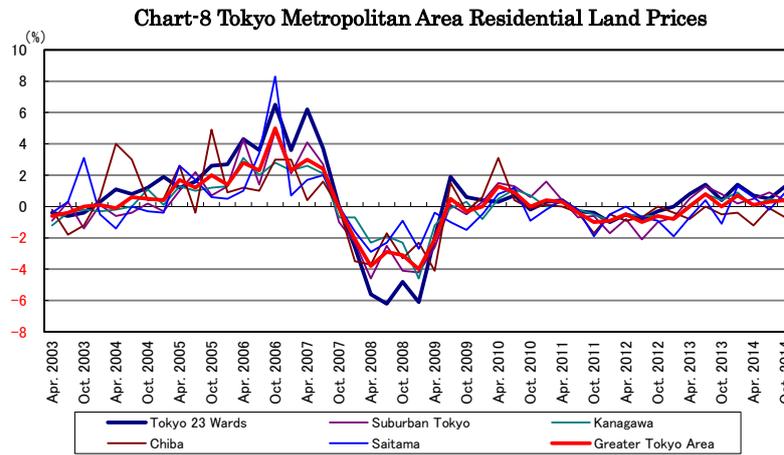
Regarding “Kijun Chika,” national standard land prices as of July 1, 2014, land prices in the three major metropolitan areas of Tokyo, Osaka and Nagoya appreciated for the second consecutive year, posting 0.8% y-o-y growth (Chart-7). Residential land prices in the same areas also turned to a positive y-o-y growth a year after commercial land prices. However, land prices in other local cities still declined and the national average land price declined for the 23rd consecutive year posting a 1.2% y-o-y decline.

According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area appreciated for the fourth consecutive quarter posting a 0.4% q-o-q growth (Chart-8). Residential land prices in the Tokyo 23 wards, greater Tokyo and Kanagawa prefecture rose for the third consecutive quarter by 1.3%, 0.4% and 0.3% q-o-q, respectively, while in Chiba prefecture they declined by 0.7% marking the fifth consecutive quarter of decrease.

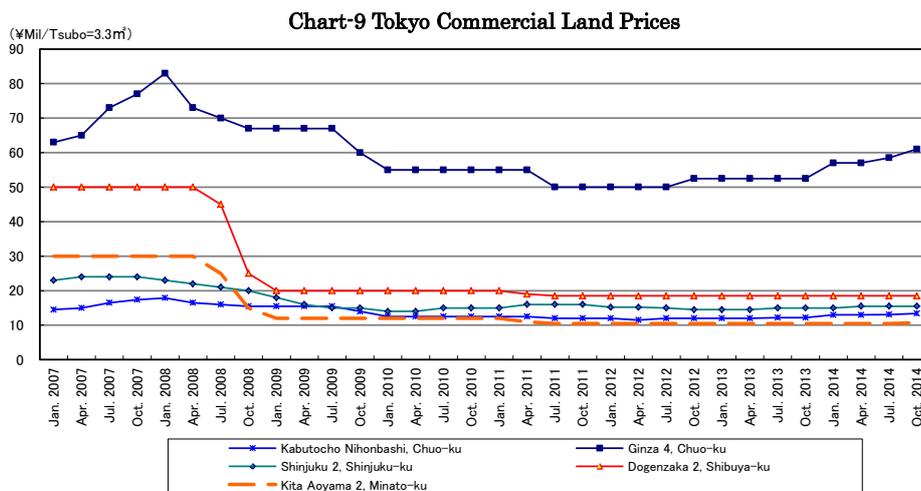
Among commercial land prices in the Tokyo metropolitan area, those in Ginza appreciated noticeably (Chart-9).



Source: MLIT



Source: Nomura Real Estate Urban Net



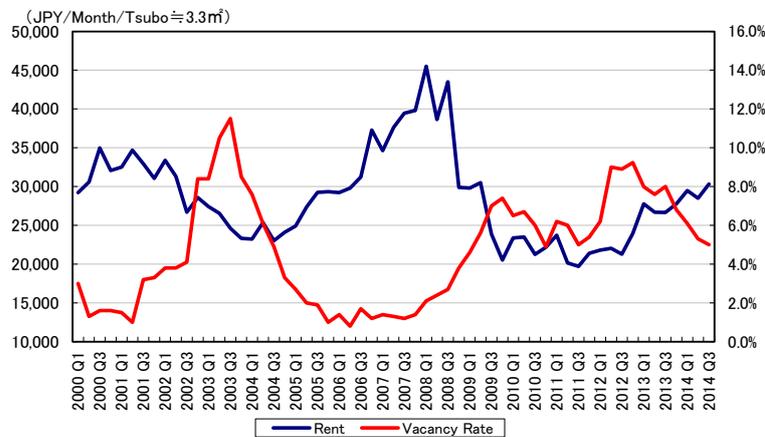
Source: Nomura Real Estate Urban Net

3. Sub-sectors

1) Office

The Tokyo office market has recently strengthened after a standstill following the rapid recovery in the fourth quarter of 2012. Vacancy rates of Tokyo grade-A¹ offices and very large sized offices in the Tokyo three wards improved by 0.3% and 0.1% q-o-q to 5.0% and 4.7%, respectively, in the third quarter (Chart-10). Moreover, office rents rose in the quarter, as seen in the fact that the office rent index of Tokyo grade-A offices and very large sized offices in the Tokyo three wards grew by 6.4% and 7.1% q-o-q, respectively. The office rent index of Tokyo grade-A offices reached 30,000 JPY for the first time since the third quarter of 2009.

Chart-10 Tokyo Grade-A Office Market



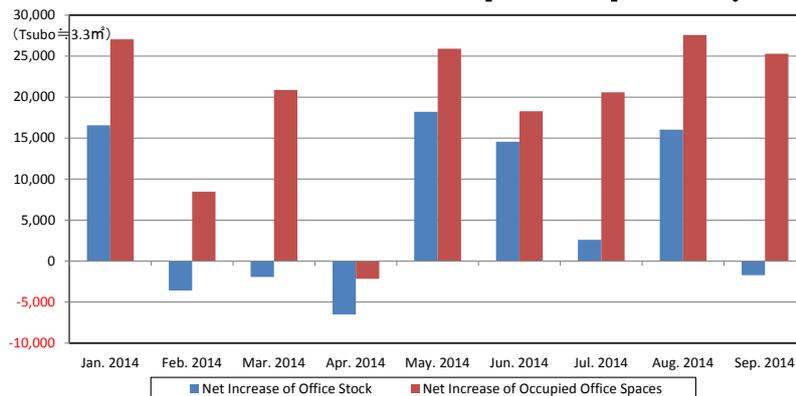
Source: Vacancy Rate • Sanko Estate, Rent • Sanko Estate and NLI Research Institute

One of the main drivers of the improving office market is strong office demand from such as occupying more space in the same building. Incremental occupied office spaces exceeded the net increase of office stock every month this year, and office stock decreased in September, which accelerated tightening of the supply-demand balance of the office market (Chart-11).

NLI Research Institute forecasts that rents will continue to rise for the time being until the second half of 2015 based on the view that the supply-demand balance improves further (Chart-12).

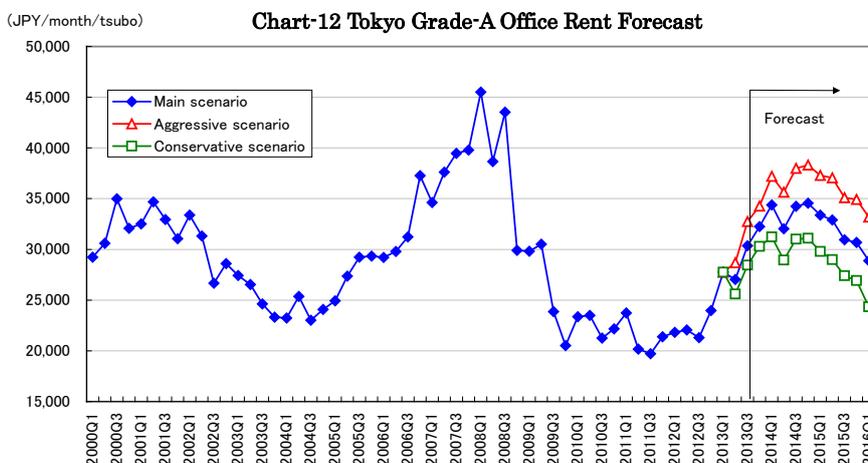
¹ Higher-spec buildings within the very large sized category by Sanko Estate Grade-A-Office Guidelines, urban area Tokyo five wards, main office areas and other specially integrated areas, with total floor areas of more than 33,000 m², main floor sizes of more than 990 m², building age of 15 years or less (including some well-refurbished older buildings), facilities with ceiling heights of 2.7m or more, individual air-conditioning, earthquake resistance and environmental friendliness.

Chart-11 Net Increase of Office Stock and Occupied Office Spaces in Tokyo Five Wards



Source: Miki Shoji

Chart-12 Tokyo Grade-A Office Rent Forecast

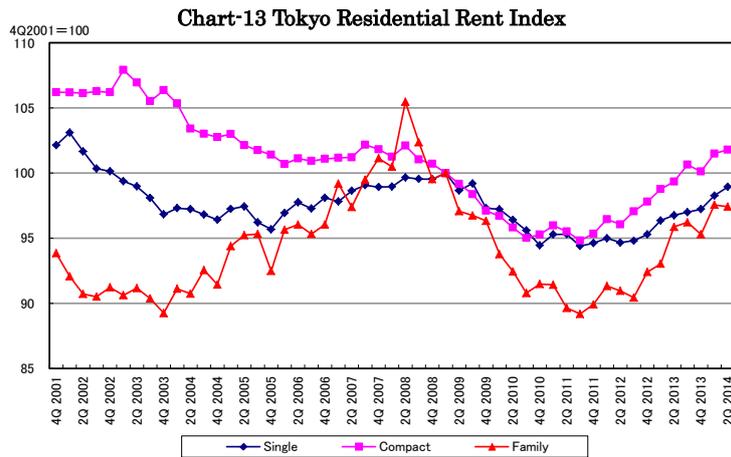


Source: Sanko Estate, NLI Research Institute

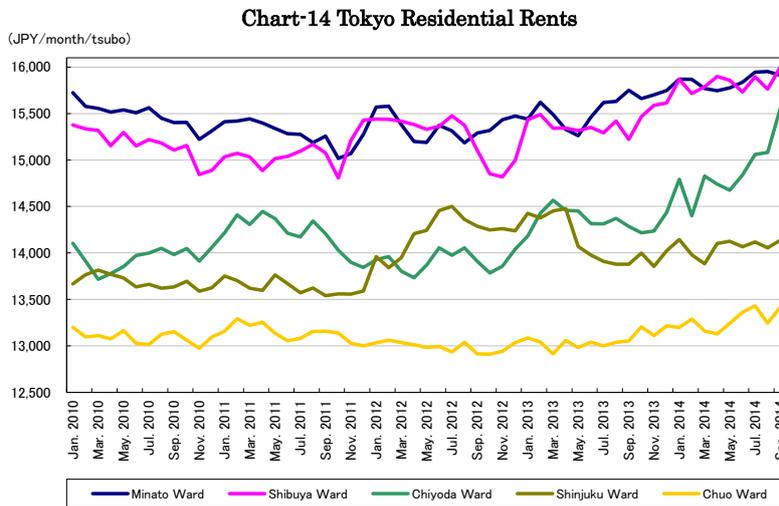
2) Residential Rental

Tokyo residential rents have been in a recovery phase following rising condominium prices. Tokyo residential rent-indexes have continued to rise since 2012 in all type categories, single, compact and family (Chart-13). Rents are rising in the Tokyo five wards, especially in Chiyoda ward, though those in Shinjuku ward, where rents had risen considerably in 2012, are struggling to grow (Chart-14).

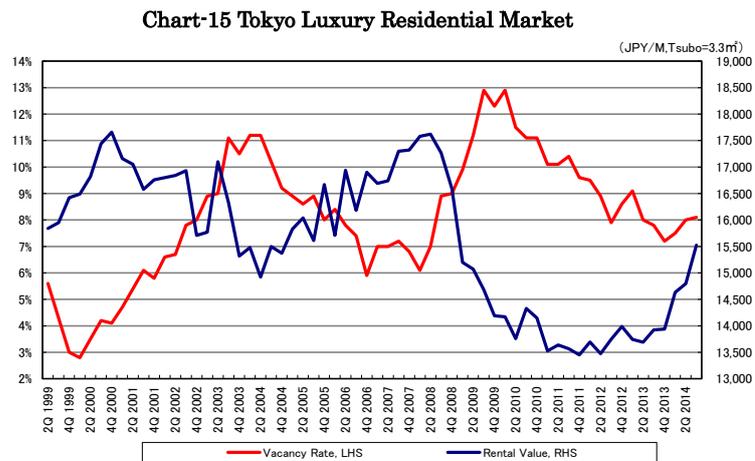
Above all, the Tokyo luxury residential rents had accelerated rising, growing by 4.9% q-o-q in the third quarter (Chart-15). As the foreign population of Tokyo grew by 5.1% y-o-y in September, increasing foreign residents apparently play an important role in lifting luxury residential rents.



Source: Mitsui Sumitomo Trust Research Institute Co. Ltd. and At Home Co. Ltd.



Source: Leasing Management Consulting



*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 have shown some recovery from the downturn after the consumption tax rate hike in April. Same store sales of department stores grew for the second consecutive month posting a 1.7% y-o-y growth in September (Chart-16). The growth of convenience store sales also turned positive by 0.9% y-o-y, while that of supermarkets slightly shrank by 0.1%. Department stores are especially benefiting from significant growth of duty free sales targeting foreigners, which grew by 58.2% y-o-y in September for the 20th consecutive month of increase.

Foreign visitor arrival numbers have maintained considerable y-o-y growth in 2014, with a 26.7% y-o-y increase in September (Chart-17). Monthly numbers have been hovering above one million since March

Hotels which can benefit more from the foreign visitor increase than retail stores have maintained very high occupancy rates (Chart-18). It looks like the stormy weather, which affected all of western Japan this summer, did not have much effect on the industry. Major hotels in Tokyo lifted their room rates aggressively based on strong demand from business travelers and wealthy Asians. Budget hotels also raised their room rates benefiting from increasing foreign visitors, especially in areas convenient for sightseeing and shopping.

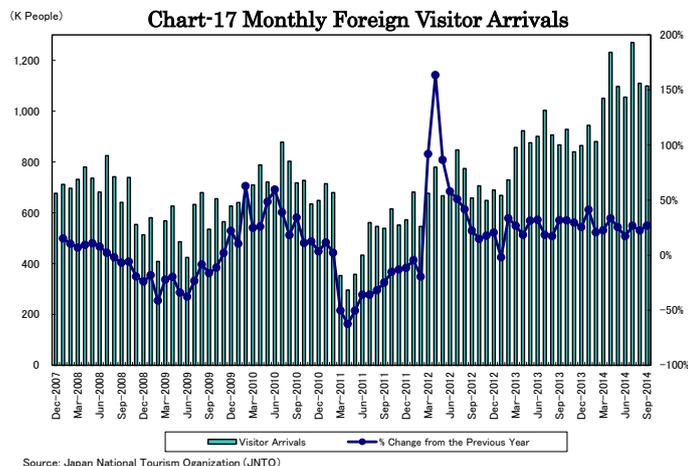
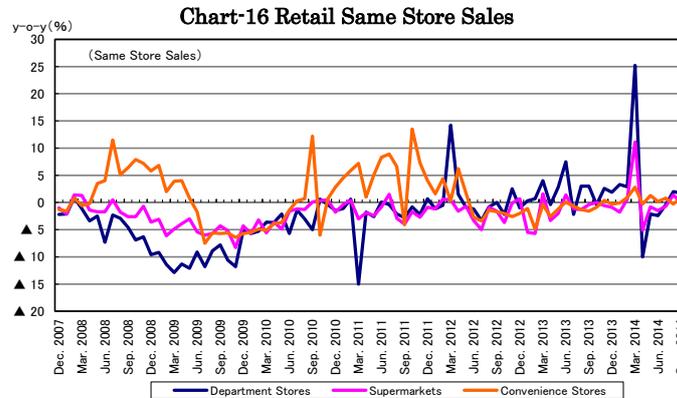
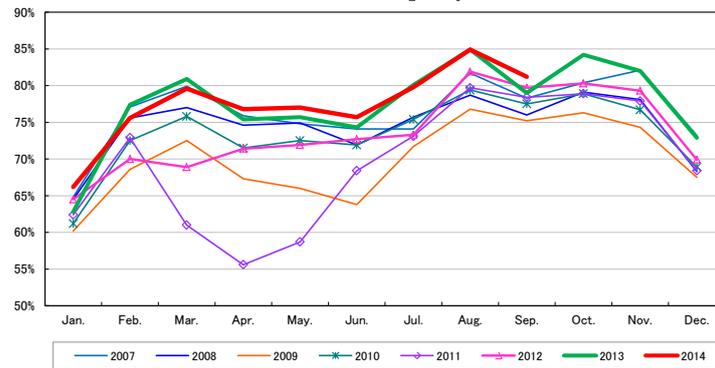


Chart-18 Hotel Occupancy Rates

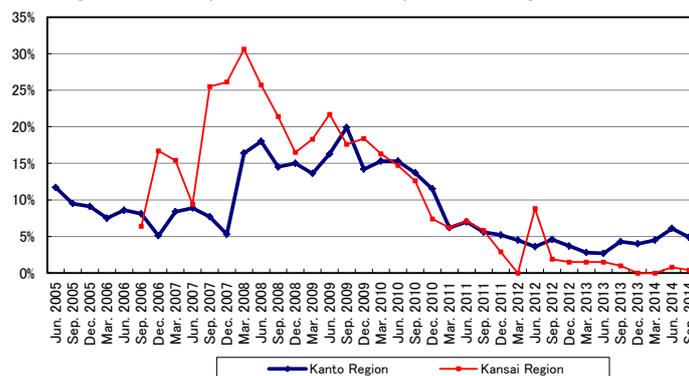


Source: Ota Publication

The logistics leasing market has been facing a tight supply-demand balance. Vacancy rates of large logistics facilities for multi-tenants in the Tokyo metropolitan area improved again from 6.1% to 4.9% after some deterioration in the previous three quarters. Vacancy rates in the Osaka metropolitan area also improved further from a very low 0.8% to 0.4% (Chart-19). Growing internet home shopping and 3PL services have created strong demand and vacancy rates improved with only one new logistics facility completed in the third quarter.

Vacancy rates are expected to shrink further in the fourth quarter, as three logistics facilities scheduled to be completed have already secured tenants. However, a shortage of truck drivers and workers in logistics facilities has become severe and is weighing on costs in the 3PL business. A concern is that the supply-demand balance will deteriorate in the latter half of 2015 when a number of new facilities are scheduled to be completed.

Chart-19 Logistics Facility Rents and 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

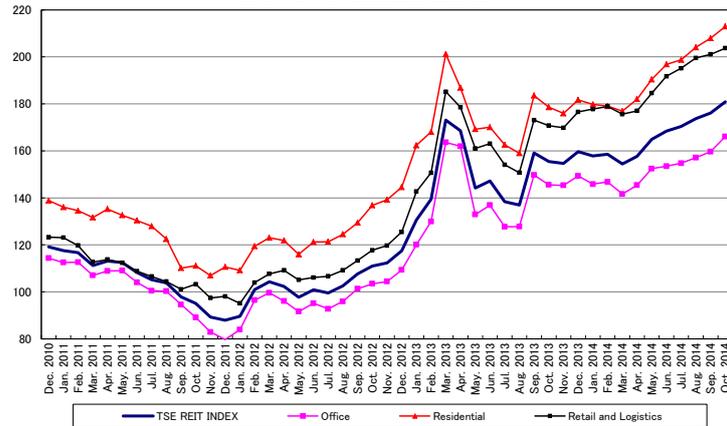
The TSE REIT Index rose by 4.5% in the third quarter on the back of the favorable equity market, lower interest rates and recovery in office rents. The office sector rose by 4.0%, residential 5.7% and others – including retail and logistics – by 4.9% (Chart-20).

J-REITs acquired properties amounting to 306 billion JPY in the third quarter, totaling 1.9 trillion JPY in 2014 (Chart-21). As high property prices make transaction activity difficult,

the total acquisition amount has been smaller than that of last year, though still as large as that in 2007. In the fourth quarter, Nippon Healthcare Investment Corporation as the first Japanese healthcare REIT, Tosei Reit Investment Corporation and Sekisui House Reit, Inc. are scheduled to be listed and the number of IPOs will be six in 2014, bringing the total of listed REITs on the TSE to 49.

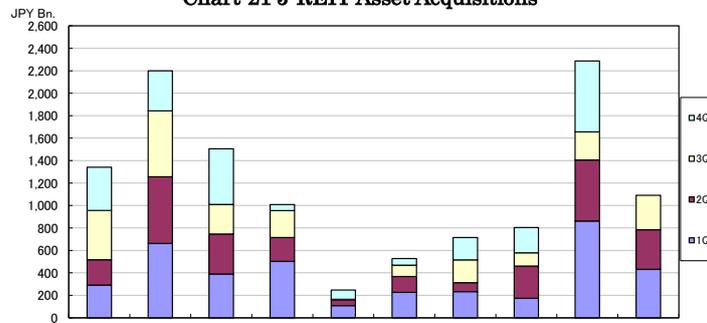
Earnings of J-REITs have improved since 2012 just from lower interest costs (Chart-22). It is expected that NOI will turn to an increase based on the rise in office rent, and contribute to dividend growth.

Chart-20 TSE REIT Index



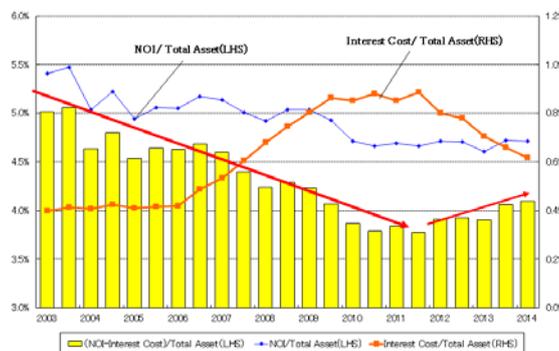
Source: Tokyo Stock Exchange

Chart-21 J-REIT Asset Acquisitions



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

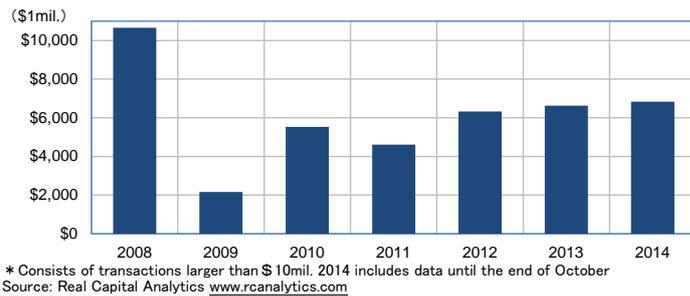
Chart-22 J-REIT Profitability



* J-REITs listed within six months are not included
Source: NLI Research Institute

Transactions in the property investment market have been active. Although J-REIT acquisitions decreased significantly in 2014 (Chart-21), transactions by other players have been increasing. Foreign investors have also been transacting actively, with property amounts acquired by foreigners up to October already exceeding the full year amounts of 2013 (Chart-23). The office sector accounts for nearly half of the transactions; however, other sectors such as residential, retail, logistics and hotel have also been actively transacted.

Chart-23 Acquisitions by Foreigners



* 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.