Real Estate Analysis Report

Japanese Property Market Quarterly Review, First Quarter 2015

~Office Rents Steady and Transactions Increase~

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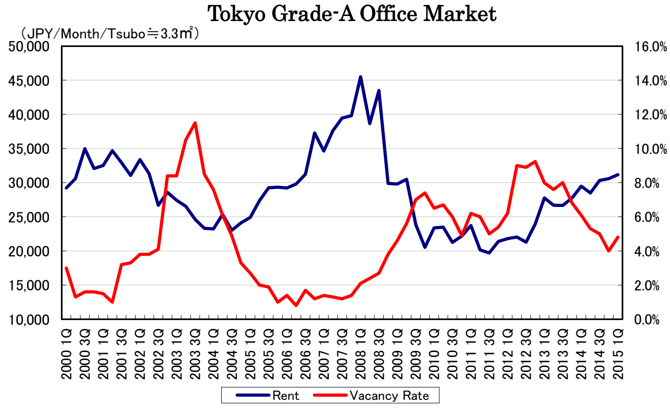
Summary

- Japan`s real GDP growth is likely to become negative at -1% in fiscal 2014, however, it is expected to strengthen hereafter supported by the fallen oil prices. The housing market has been suppressed by a weak demand following the consumption tax hike and increasing construction costs, but the y-o-y growth of housing starts finally turned positive in March. An increasing number of monitoring sites posted land price appreciations and the average national land price declined at a milder pace by 0.3% y-o-y.
- Office rents in Tokyo have steadily increased though at a slow pace backed by the robust demand. Residential rents in the five major wards in Tokyo have been on a mild ascending trend. The number of foreign visitor arrivals has renewed record highs in each month this year. Hotel occupancy rates have maintained higher levels than last year when the market had already been quite strengthened. The vacancy rates of large logistics facilities remained low backed by the strong demand in both Tokyo and Osaka metropolitan areas.
- The J-REIT market declined by 1.8% in the first quarter affected by the volatile bond market and sizable public offerings. J-REITs acquired as much assets as last year even on difficult low yield conditions.

Tokyo Grade-A Office Market



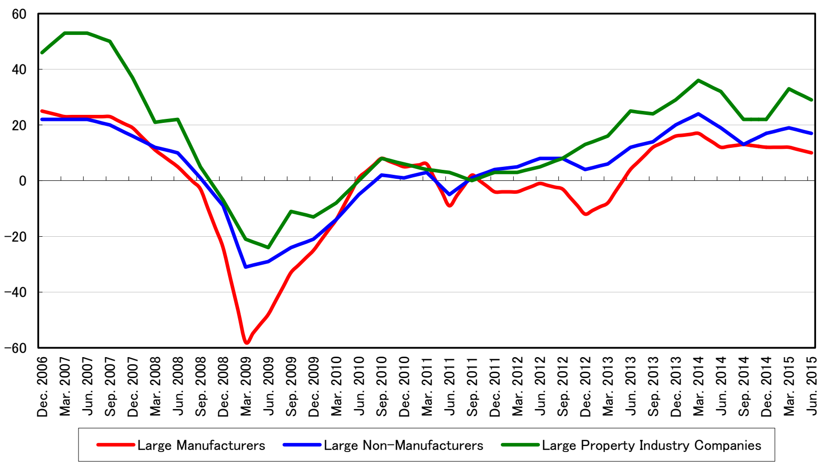
Source: Vacancy Rate・Sanko Estate, Rent・Sanko Estate and NLI Research Institute

1. Economy and Housing Market

Economic conditions have been moderately improving with the recovery of consumer spending and corporate earnings. In the BOJ Tankan Survey for the first quarter of 2015, the current business confidence D.I. of large non-manufacturers somewhat improved led by the property industry, while that of large manufacturers was sidelined, and outlooks for the second quarter turned cautious (Chart-1). Unemployment rates maintained a low number at 3.4% and the jobs-to-applications ratio posted 1.15 times in March, surpassing the previous peak of 1.08 times in July 2006.

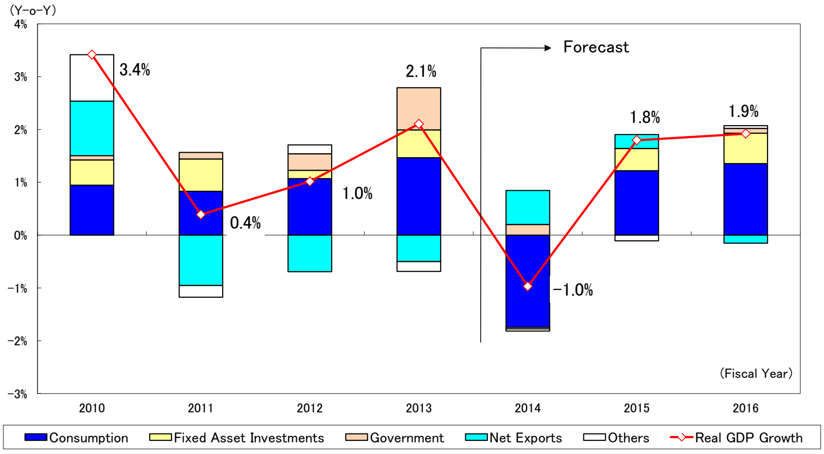
NLI Research Institute forecasts that Japan's real GDP will grow by 1.8% in fiscal 2015, 1.9% in 2016 after shrinking by 1.0% in 2014 (Chart-2). The fallen oil prices are expected to support the economic conditions hereafter although the current economic recovery has not become reliable yet since the slump following the consumption tax hike in April 2014.

Chart-1 BOJ Tankan Survey



Source: BOJ "Tankan Survey"

Chart-2 Japan GDP Growth Rates

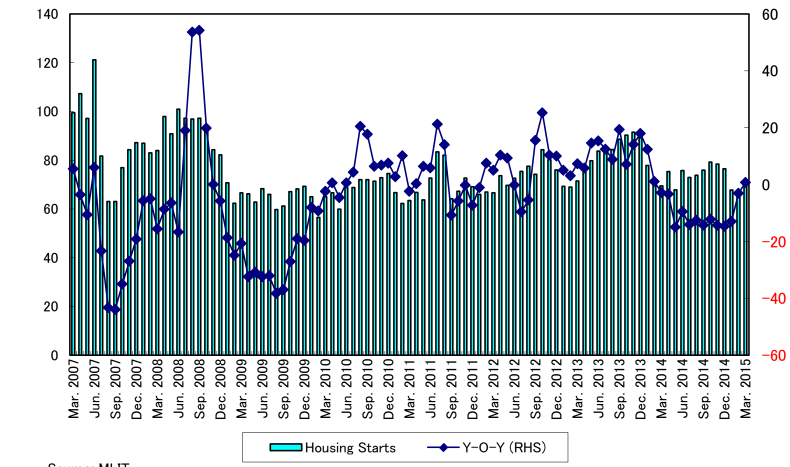


Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
NLI Research Institute "Weekly Economist Letter" March 9, 2015.

Housing starts posted a 0.7% y-o-y growth in March (Chart-3), which was the first positive y-o-y growth in thirteen months, suggesting a sign of recovery from the stagnation that was suppressed by increasing construction and land acquisition costs following the consumption tax hike in April 2014.

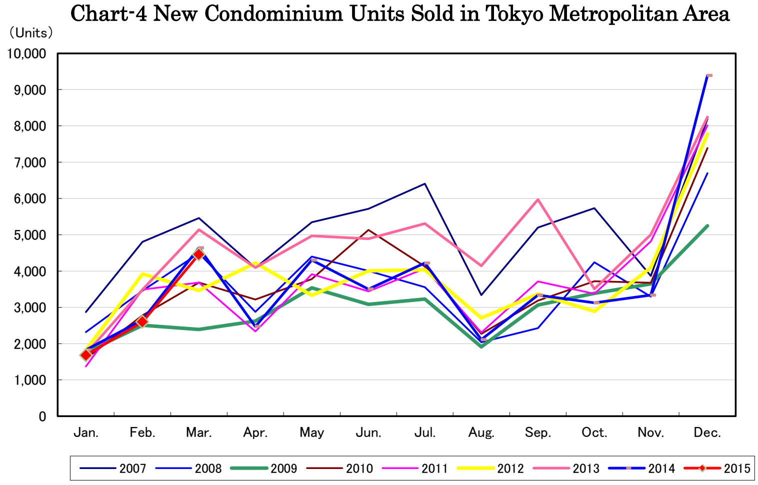
The number of new condominium units sold in the Tokyo metropolitan area also stabilized, shrinking only slightly y-o-y after declining noticeably in 2014 (Chart-4).

Chart-3 Housing Starts



Source: MLIT

Chart-4 New Condominium Units Sold in Tokyo Metropolitan Area



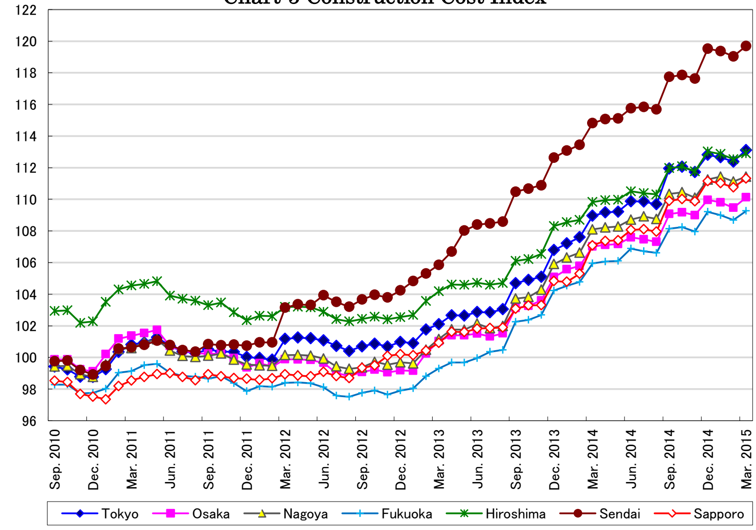
Source: Real Estate Economic Institute

Construction costs have been on the rise at a seemingly milder pace, though some in the industry insist that they have already peaked out (Chart-5). Therefore, the demand for secondhand condominiums that are not affected by the increasing construction costs has been strong. However, the secondary transaction volume has been shrinking due to its limited inventory while prices are continuously on the rise.

According to Real Estate Information Network System, secondary transaction volume in the Tokyo metropolitan area posted 9,460 units in the quarter, shrinking by 5.3% y-o-y for the fourth consecutive quarter (Chart-6).

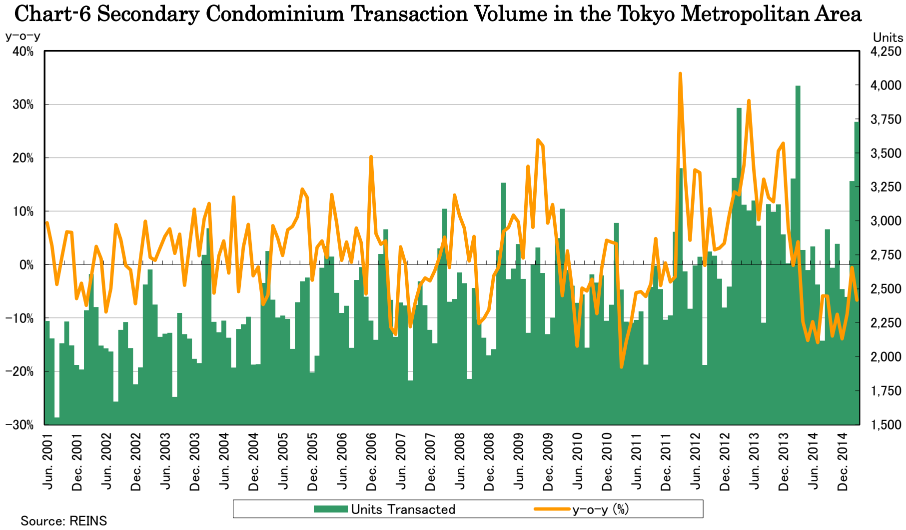
The Home Price Index by Japan Real Estate Institute, a representative secondary home price index in the Tokyo metropolitan area, maintained its ascending trend (Chart-7).

Chart-5 Construction Cost Index



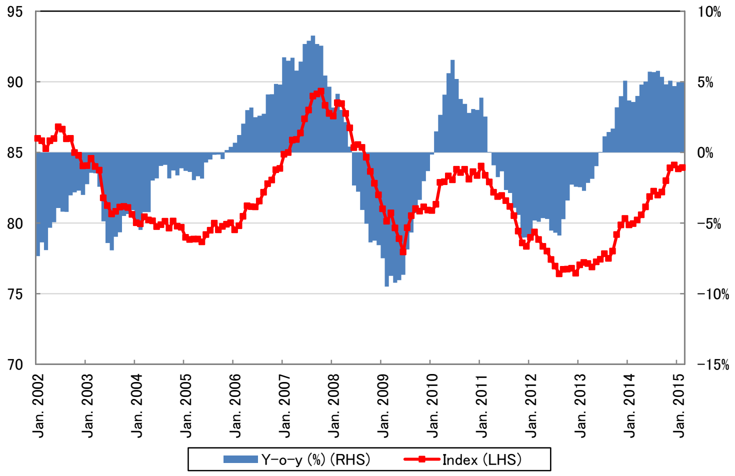
Source: Construction Research Institute

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



Source: REINS

Chart-7 Home Price Index



Sources: Japan Real Estate Instiitute

2. Land Prices

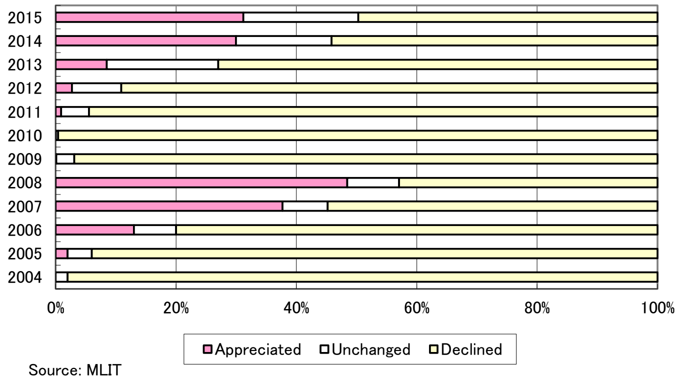
Regarding "Chika Kouji," national land prices as of January 1, 2015, the ratio of appreciating monitoring sites increased to 32.9% from 30.9% last year, with the average national land price declining at a milder pace by 0.3% y-o-y. More than half of the monitoring sites in the three major metropolitan areas posted land price appreciations as were seen last year. In rural areas, 69.3% of the monitoring sites still posted land price declines though this was better than the 76.1% last year. However, the ratios of the appreciating monitoring sites are still much lower than those in 2008 (Chart-8, 9).

The most appreciated commercial land price was witnessed in front of Kanazawa station by 17.1% y-o-y based on expectations to benefit from the inauguration of the Hokuriku Shinkansen bullet train. In the Tokyo metropolitan area, eight monitoring sites in Ginza were listed in the top ten ranks for commercial land price appreciation. Regarding residential land prices, monitoring sites in Iwaki City into which evacuees have flowed from the nuclear plant incident, occupied all of the top ten ranks in Japan.

According to Nomura Real Estate Urban Net, the average residential land price in the Tokyo metropolitan area rose by 0.5% q-o-q and 2.2% 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 4.6%, 2.3%, 1.3%, 0.3% and 0.2% y-o-y, respectively (Chart-10).

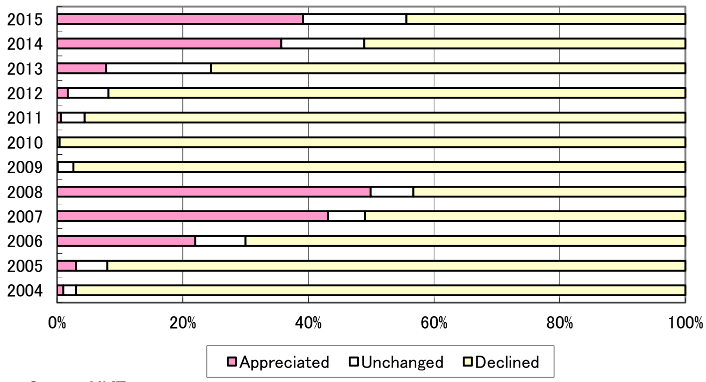
Commercial land prices in the Tokyo metropolitan area rose by 0.4% q-o-q and 3.7% y-o-y, led by Ginza appreciating by 14.0% y-o-y in the first quarter (Chart-11).

Chart-8 Ratios of Residential Land Price Movement



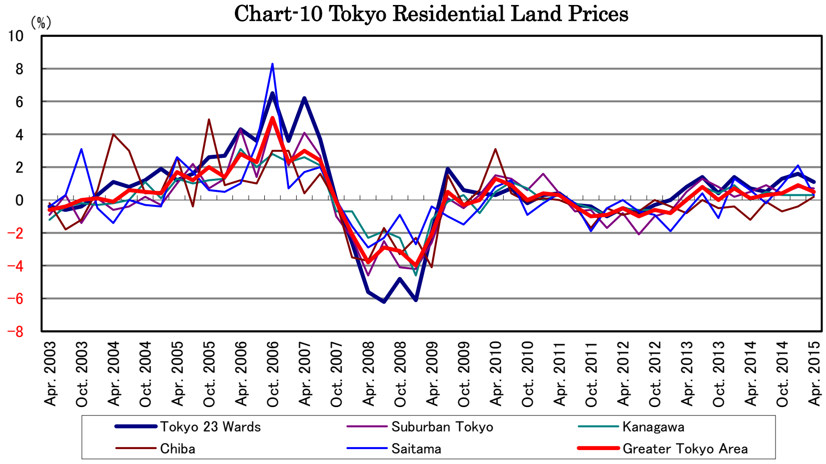
Source: MLIT

Chart-9 Ratios of Commercial Land Price Movement



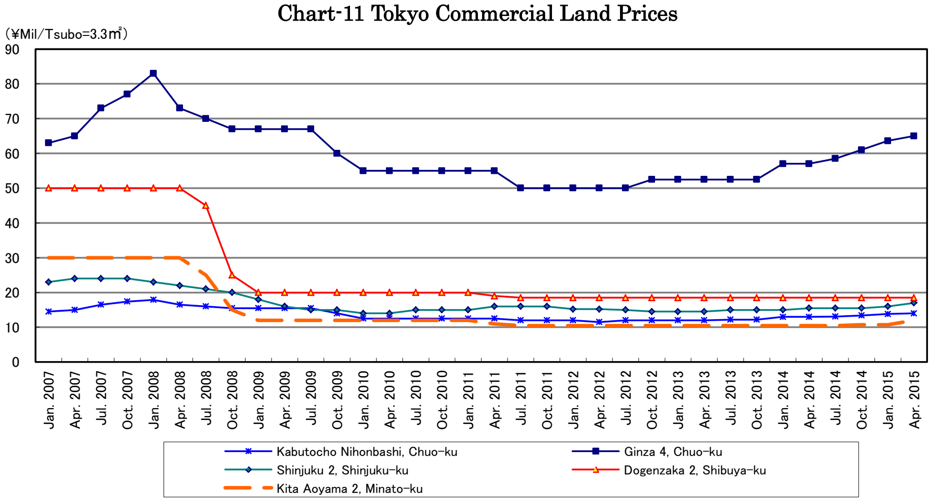
Source: MLIT

Chart-10 Tokyo Residential Land Prices



Source: Nomura Real Estate Urban Net

Chart-11 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urban Net

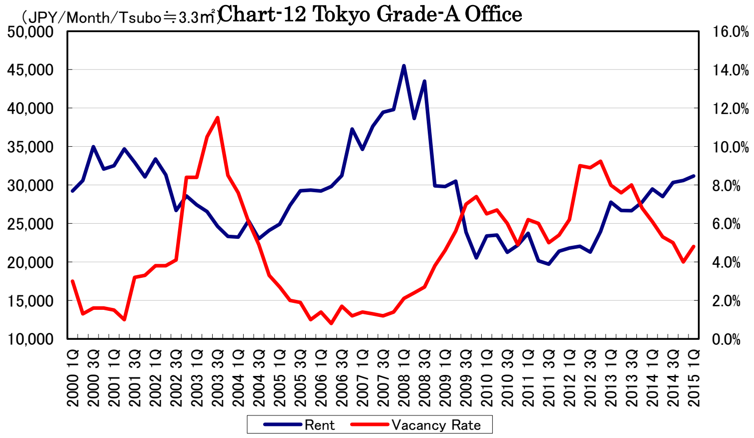
3. Sub-sectors

1) Office

Office rents in Tokyo have steadily increased though at a mild pace. The rent index of Tokyo grade-A[1] offices rose to 31,166 JPY per tsubo or by 1.9% q-o-q for the third consecutive quarter (Chart-12). However, the vacancy rates of Tokyo grade-A offices increased for the first time in six quarters due to a large building being completed with a sizable vacant space.

The rent index of Tokyo grade-B[2] offices rose to 19,006 JPY or by 10.9% q-o-q while the vacancy rates improved to 3.7% with the robust demand (Chart-13). The office vacancy rates have also been improving in other major cities excluding Sendai (Chart-14).

Chart-12 Tokyo Grade-A Office

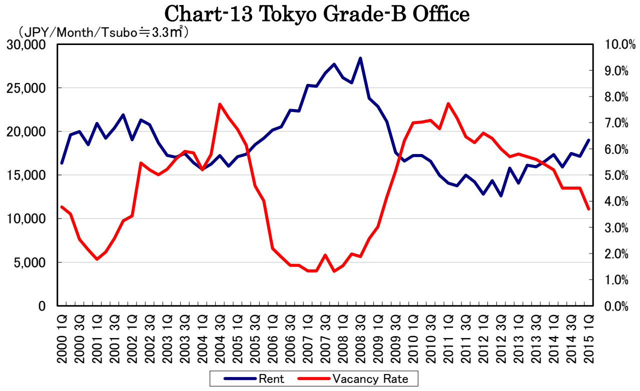


Source: Vacancy Rate・Sanko Estate, Rent・Sanko Estate and NLI Research Institute

[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.

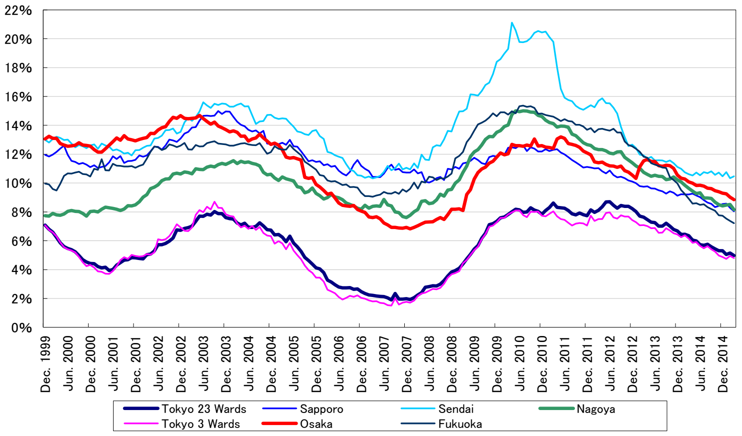
[2] Large office buildings with main floor sizes more than 660 m^2 but lower-spec than grade-A offices.

Chart-13 Tokyo Grade-B Office



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

Chart-14 Office Vacancy Rates in Major Cities



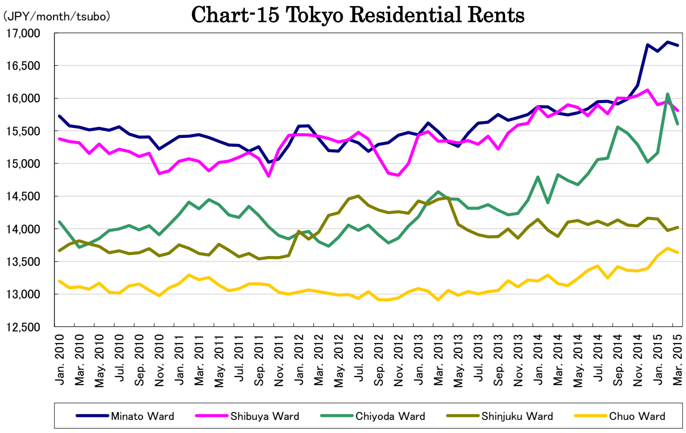
Source: Sanko Estate

2) Residential Rental

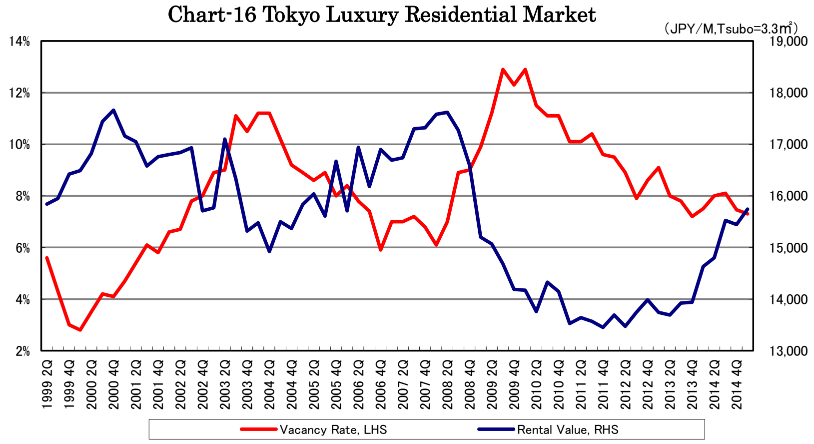
Tokyo residential rents have been on a mild ascending trend since 2012. In particular, residential rents in Minato, Chiyoda and Chuo wards rose noticeably in the first quarter of 2015 (Chart-15).

Tokyo luxury residential rents also rose to 15,743 JPY per tsubo with continuously improving vacancy rates (Chart-16).

Chart-15 Tokyo Residential Rents



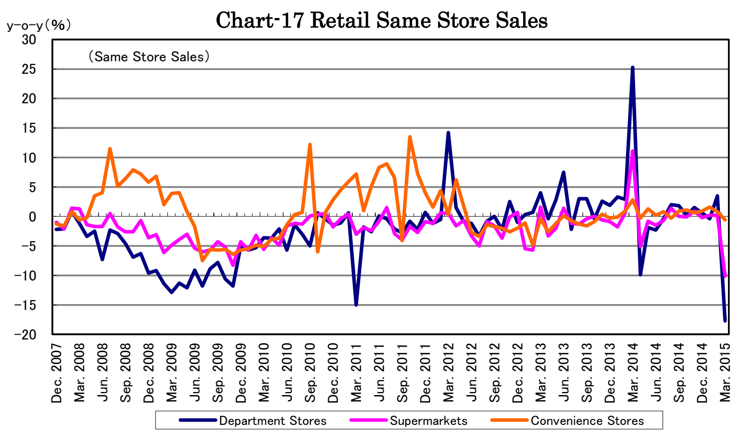
Source: Leasing Management Consulting



*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 declined significantly y-o-y in March since last year's numbers were inflated by the rush demand before the consumption tax hike (Chart-17). However, retail sales outnumbered those of March 2013, and same store sales of department stores are especially benefitting from the widened tax exemption for foreign customers.



Source: Ministry of Economy, Trade and Industry

The vacancy rates of 61 hotels in Japan have posted higher numbers than last year when the market had already been quite strengthened (Chart-18).

The main contributor was increases of foreign visitor arrivals posting record high numbers in each month of 2015. In particular, the number increased to 1.52 million visitors or by 45.3% y-o-y in March, posting a monthly record surpassing 1.5 million visitors for the first time (Chart-19). The JPY depreciation, widened tax exemptions and relaxed visa requirements for Southeast Asian visitors seemed to contribute effectively. In particular, visitors from China and Hong Kong ballooned by more than 80% y-o-y. Backed by the strong

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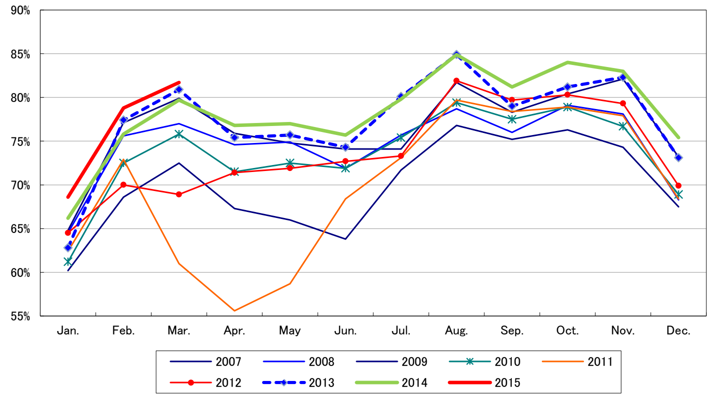
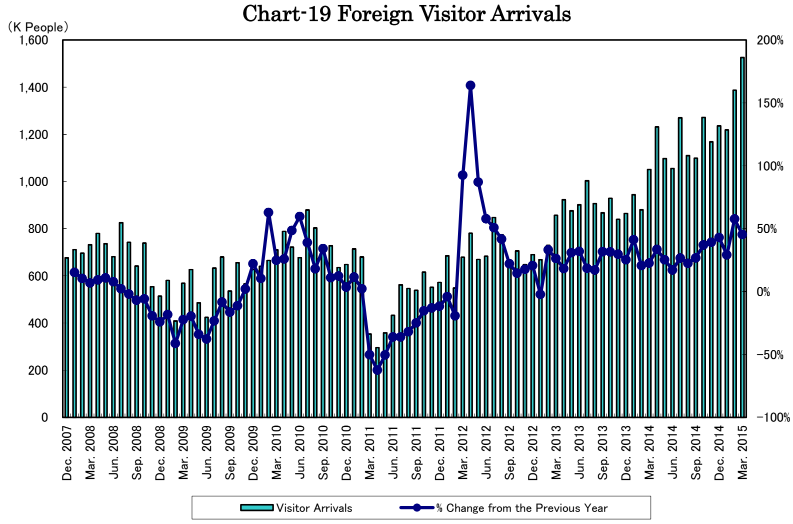
demand, investors are actively acquiring existing hotels, and developers announced new hotel construction plans one after another.

Chart-18 Hotel Occupancy Rates



Source: Ohta Publications "Weekly HOTERES"

Chart-19 Foreign Visitor Arrivals



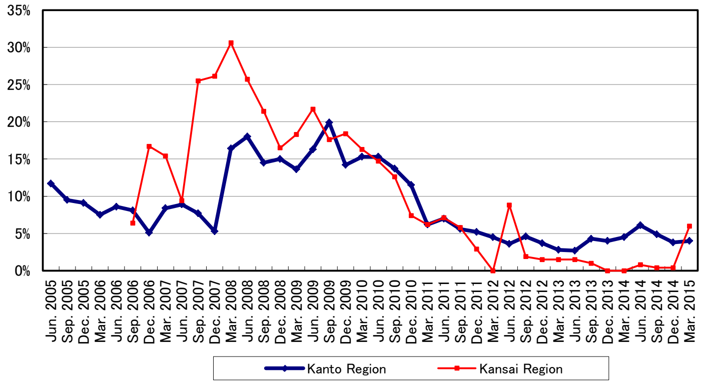
Source: Japan National Tourism Organization (JNTO)

According to CBRE, the vacancy rates of large logistics facilities for multi-tenants in the Tokyo and Osaka metropolitan area deteriorated by 0.2% to 4.0% and by 5.6% to 6.0% respectively (Chart-20). Buoyed by the strong demand, the vacancy rates increased just a little even with new completions in the Tokyo metropolitan area. In the Osaka metropolitan area, though new completions lifted the vacancy rates somewhat, the demand supply balance still seems quite healthy and some new development plans were announced.

According to Ichigo Real Estate Service, logistics rents in the Tokyo metropolitan area remained almost unchanged at 4,000 JPY per tsubo in January.

An unlisted logistics REIT began operation in the first quarter that is co-managed by Sagawa Express and Xymax.

Chart-20 Logistics Facility Vacancy Rates (Large Sized Multi-Tenant-Use)



Source: CBRE

4. Property Investment and J-REIT Markets

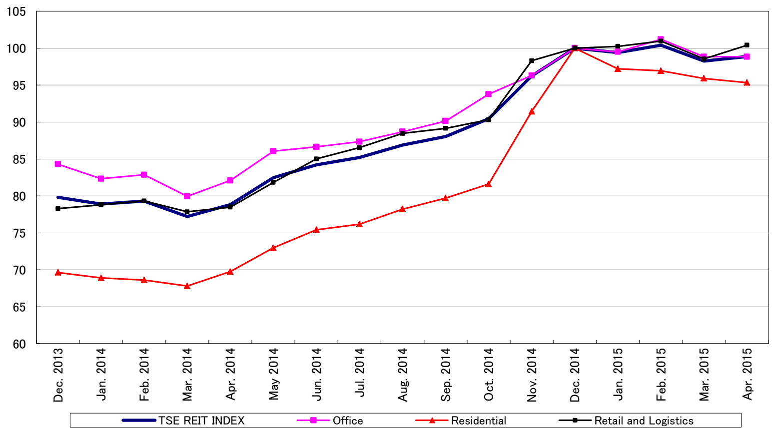
The TSE REIT index declined by 1.8% in the first quarter affected by the volatile bond market and sizable public offerings, though it started positively at the beginning of the year. The office, residential and retail logistics sectors of the J-REIT market declined by 1.2%, 4.1% and 1.5% respectively (Chart-21).

At the end of March, the J-REIT market value was 10.7 trillion JPY, while the price to NAV ratio was 1.5 times and the dividend yield was 3.1%, with a 2.7% yield spread on ten year JGBs.

J-REITs acquired property assets of 496 billion JPY in the first quarter, which was nearly the same volume as last year even on difficult low yield conditions (Chart-22).

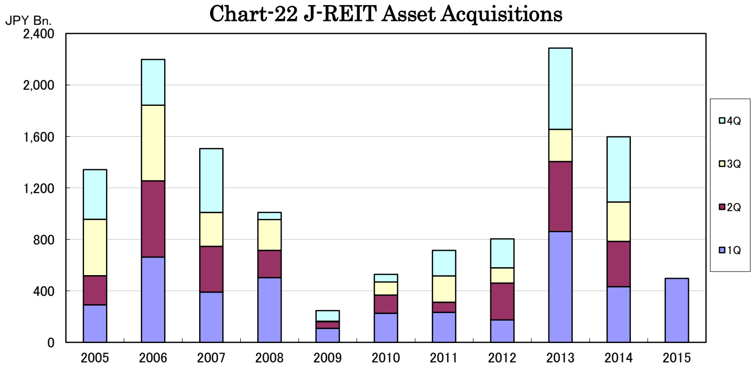
Kenedix Retail REIT with 18 assets valued at 808 billion JPY and Healthcare and Medical Investment Corp with 16 assets valued at 237 billion JPY were listed in February and March respectively, lifting the number of J-REITs to 51. The average dividend per unit is expected to grow by 4% in 2015. The q-o-q growth rates of J-REIT's NOI (Net Operating Income) finally turned positive in the latter half of 2014 following the office market recovery (Chart-23).

Chart-21 TSE REIT Index



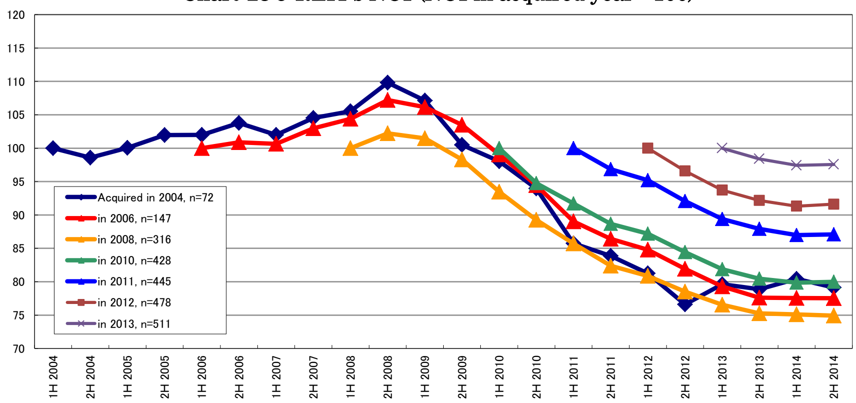
Source: Tokyo Stock Exchange

Chart-22 J-REIT Asset Acquisitions



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

Chart-23 J-REIT's NOI (NOI in acquired year =100)



Source: NLI Research Institute

According to Nikkei Real Estate Market Report, transactions in the property investment market reached 1.4 trillion JPY in the first quarter, which was the largest since the Global Financial Crisis.

In addition to J-REITs acquiring assets with POs and IPOs, overseas investors noticeably acquired Japanese assets backed by the JPY depreciation. Other remarkable activities seen in the market were land acquisitions for new developments and asset divestments by domestic developers and asset managers at high prices.

