Real Estate Analysis Report

Japanese Property Market Quarterly Review, Second Quarter 2015

~Housing Starts Recover, Foreign Visitors Boost Hotel and Retail~

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Summary

- Japan's real GDP shrank due to declining exports in the second quarter for the first time in three quarters. Construction costs have remained at a high level even after the somewhat eased labor shortages halted the surging trend. Housing starts have turned to a strong growth from the stagnation which continued ever since last year's consumption tax hike.
- Office vacancy rates have improved in major cities. While Tokyo's grade-A office rents rose by 7.1% q-o-q in the second quarter, the grade-B rents declined by 4.6%. Although the absorbed volume has been moderate recently, office demand still looks healthy with preleasing activities seen in new buildings to be completed in the second half of the year.
- Residential rents have been on the upward trend. Hotel occupancy rates have remained very high, supported by the growing number of foreign visitors and local travelers. Foreign visitors have also contributed to retail sales especially in urban department stores. The demand for large logistics facilities has remained strong with no vacant spaces left in Tokyo Bay area.
- The J-REIT market declined by 3.3% in the second quarter, affected by the volatile bond market and the Greek debt crisis. J-REITs have acquired even more assets than last year despite difficult low yield conditions.
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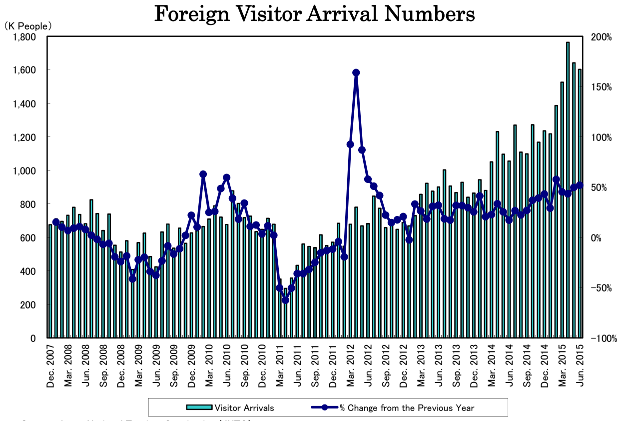
Foreign Visitor Arrival Numbers



Source: Japan National Tourism Oganization (JNTO)

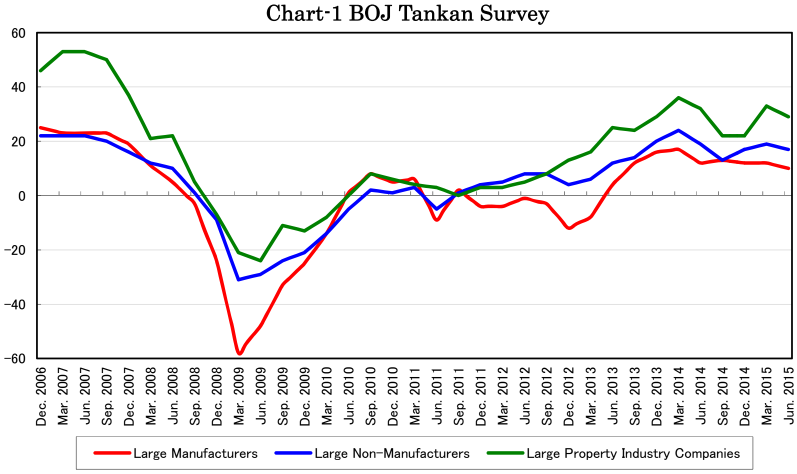
1. Economic Conditions

About 70% of corporations posted positive y-o-y earnings growth in the second quarter supported by the JPY depreciation and foreign visitor increase, with the Nikkei 225 Index recovering 20,000 points for the first time in 15 years, despite the volatile overseas markets affected by the Greek debt crisis and the plummeting Shanghai equity market.

In the BOJ Tankan Survey for the second quarter of 2015, the current business confidence D.I. of large manufacturers and non-manufacturers rose by 3 and 4 points respectively (Chart-1). However, the coincident index of business conditions, compiled by the Cabinet Office, has been weakening ever since the consumption tax hike in April 2014 (Chart-2).

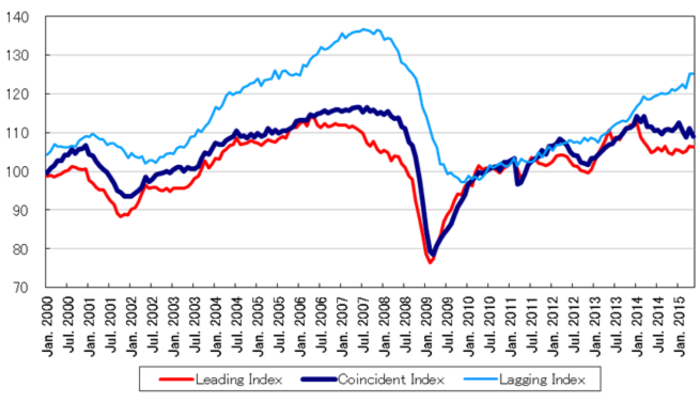
NLI Research Institute forecasts that Japan's real GDP will grow by 1.8% in fiscal 2015, 1.9% in 2016 after shrinking by 0.9% in 2014 (Chart-3). However, it seems that the real GDP shrank by 0.7% q-o-q in the second quarter, affected by declining exports, weakening individual consumptions and equipment investments. Though the real GDP is expected to recover in the third quarter, exports will remain stagnant for a while.

Chart-1 BOJ Tankan Survey



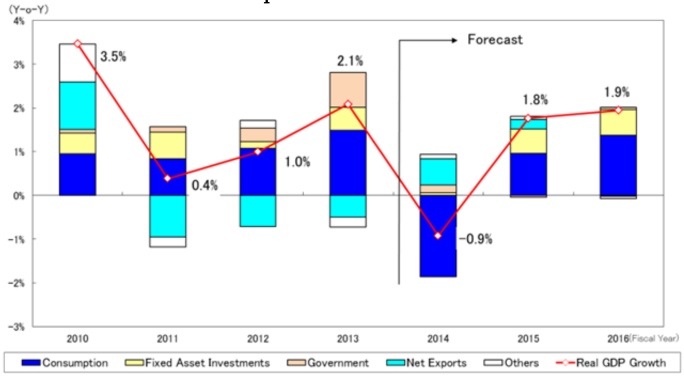
Source: BOJ "Tankan Survey"

Chart-2 Indexes of Business Conditions



Source: Cabinet Office

Chart-3 Japan GDP Growth Rates



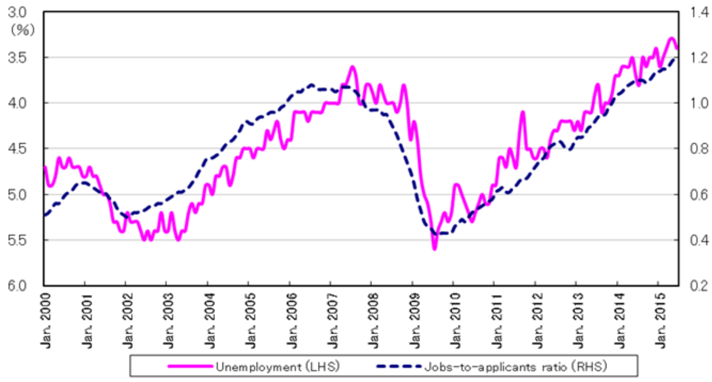
Source: Economic and Social Research Institute, Cabinet Office, Government of Japan "Quarterly Estimate of GDP"
NLI Research Institute "Weekly Economist Letter" June, 2015.

2. Eased Labor Shortage and High Construction Costs

The unemployment rate and the jobs-to-applications ratio have both improved to 3.4% and 1.19 times, respectively in June (Chart-4).

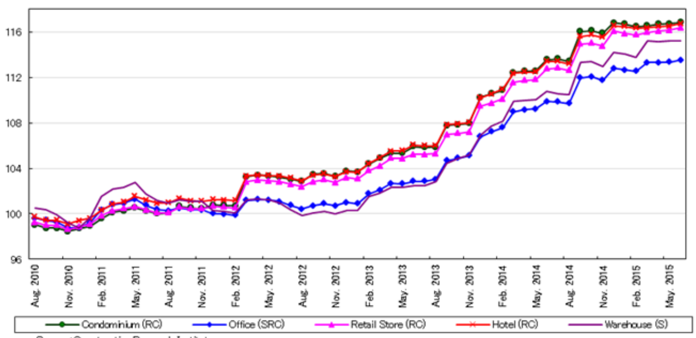
Construction costs have remained at a high level even after the somewhat eased labor shortages halted the surging trend (Chart-5). However, skilled labor is still in serious shortage in the three prefectures affected the most by the Great East Japan Earthquake: Iwate, Miyagi and Fukushima prefectures.

Chart-4 Unemployment rate and Jobs-to-Applications Ratio



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

Chart-5 Construction Cost Index



Source: Construction Research Institute

3. Housing Market

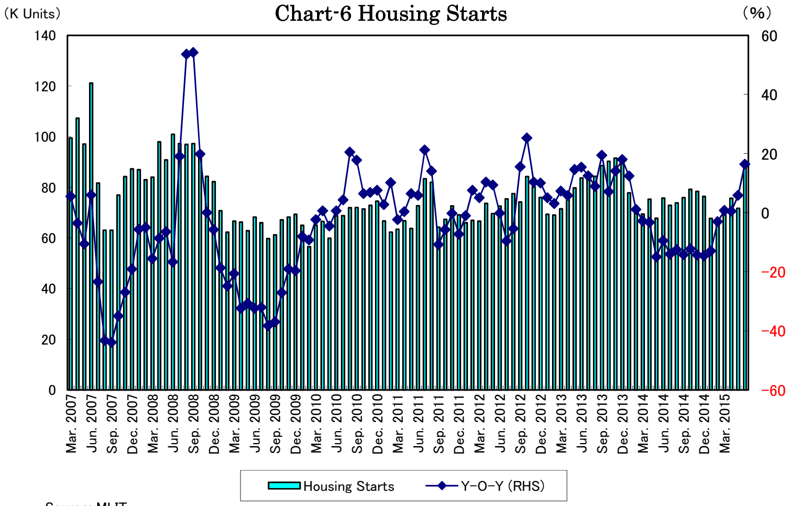
Housing starts grew by 16.3% y-o-y to 88 thousand units in June (Chart-6). Those of apartments for lease and houses grew by 14.6% y-o-y to 36 thousand units and 7.4% to 26 thousand units, respectively (Chart-7). Especially those of condominiums for sale grew by 82.8% y-o-y to 14 thousand units relying on an expected demand from wealthy locals trying to save on inheritance taxes and foreigners rushing to luxury units.

However, the numbers of new condominium units sold in the Tokyo metropolitan area have been at a low level (Chart-8).

The secondary transaction volume of condominiums in the Tokyo metropolitan area posted the first positive y-o-y growth in April since April 2014 (Chart-9). Though available condominium stock in the secondary market increased for the first time in 29 months, transacted prices have been increasing y-o-y for the 30th consecutive month (Chart-9).

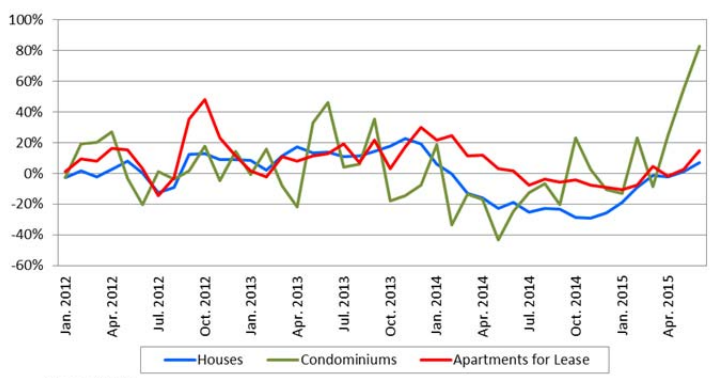
According to Tokyo Kantei, a polarization has developed where condominium prices are appreciating in major cities and declining in other areas.

Chart-6 Housing Starts



Source: MLIT

Chart-7 Housing Starts by Sector



Source: MLIT

Chart-8 New Condominium Units Sold in the Tokyo Metropolitan Area

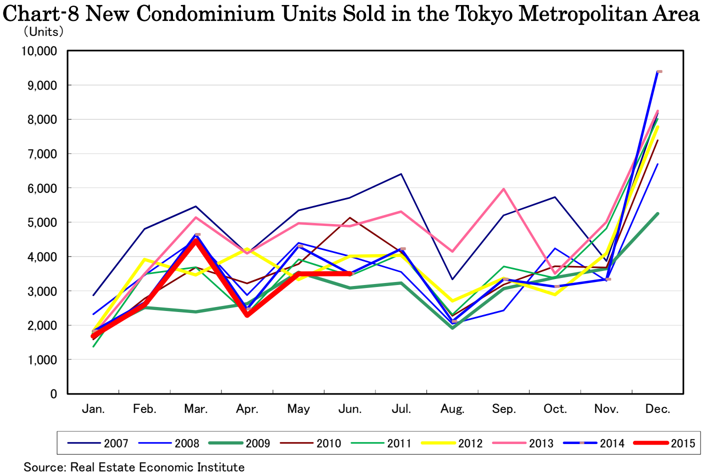
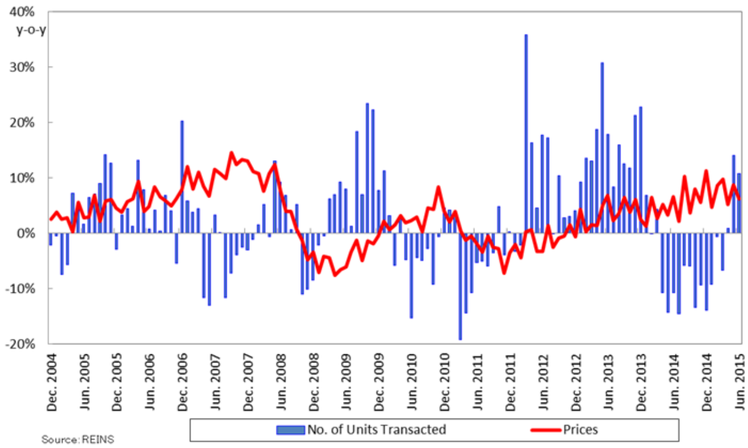


Chart-9 Secondary Condominium Transactions and Prices in the Tokyo metropolitan area (y-o-y)



4. Land Prices

Land prices continued to appreciate mainly in the center of major metropolitan areas. However, the number of price appreciating points did not increase as much as last year. According to "Chika Look Report," published by MLIT, 84% of nationwide land price monitoring points recorded positive q-o-q growth (Chart-10). In the Tokyo, Osaka and Nagoya metropolitan areas, 90.7%, 88.0% and 100.0% of monitoring points posted positive q-o-q growth, respectively. However, only 60.9% of monitoring points in rural areas posted positive q-o-q growth declining from 65.6% of last year and monitoring points where prices remained unchanged increased to 39.1%.

According to Nomura Real Estate Urban Net, residential land prices in the Tokyo metropolitan area rose by 0.5% q-o-q in the second quarter (Chart-11). While land prices in the 23 wards of Tokyo rose by 1.4% q-o-q, even Chiba prefecture, which had been negatively affected by the earthquake for years, rose for the second consecutive quarter.

Commercial land prices in the center of Tokyo appreciated significantly, such as Ginza and Kita-Aoyama growing by 12.8% and 42.9% y-o-y, respectively (Chart-12).

Chart-10 Land Price Changes (q-o-q)

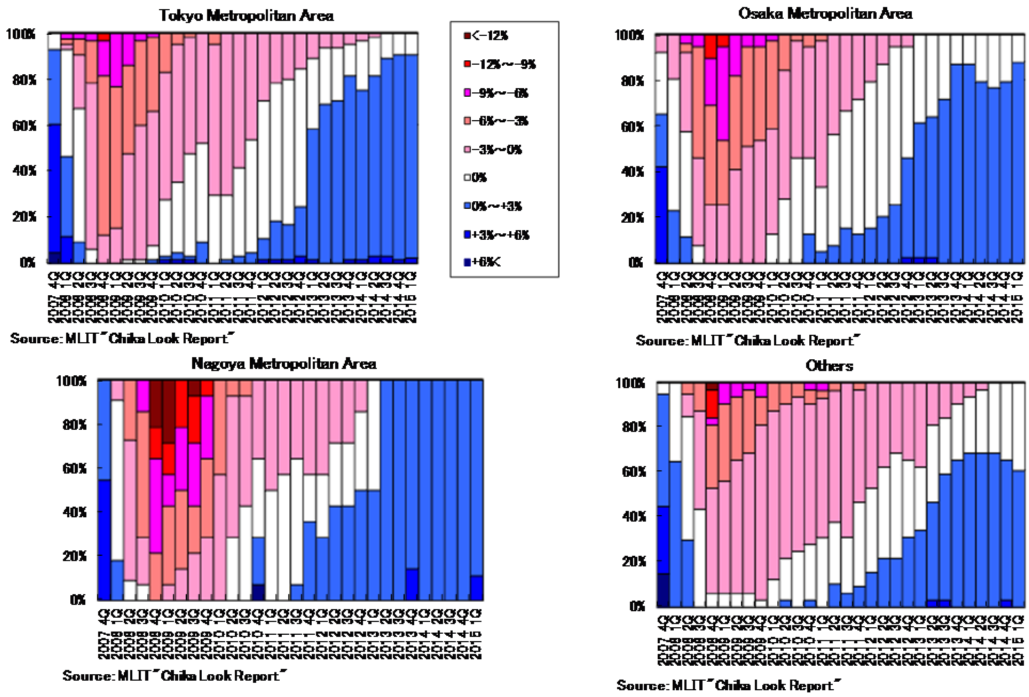
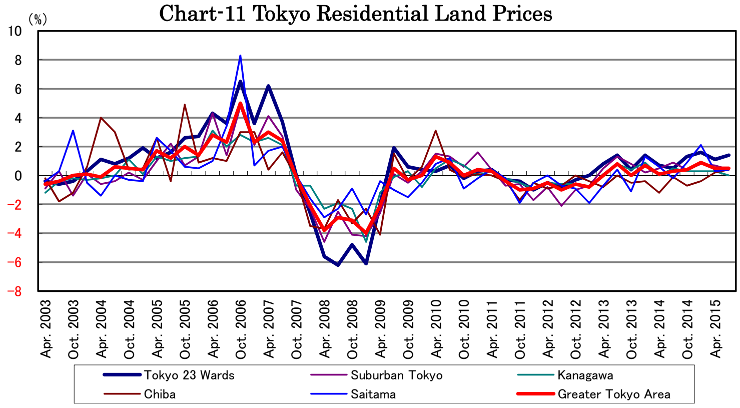
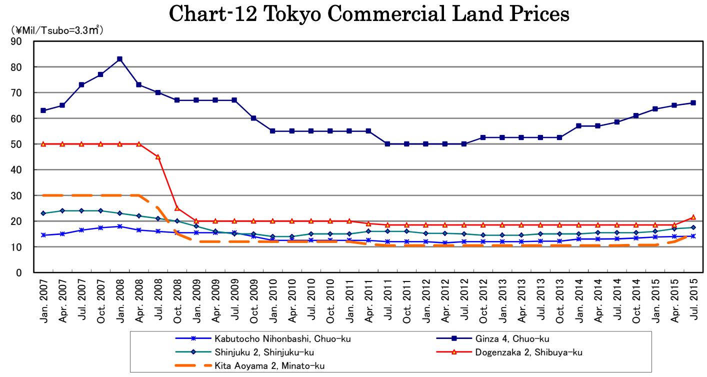


Chart-11 Tokyo Residential Land Prices



Source: Nomura Real Estate Urban Net

Chart-12 Tokyo Commercial Land Prices



Source: Nomura Real Estate Urban Net

5. Sub-sectors

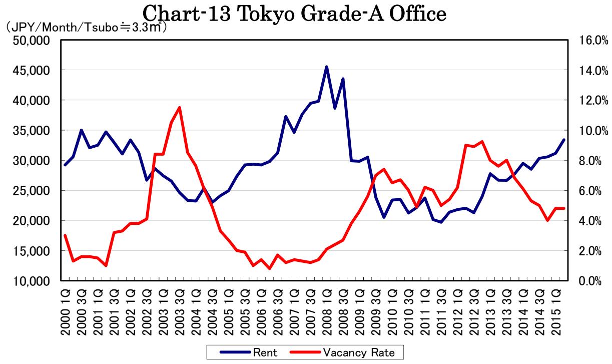
1) Office

The vacancy rates of Tokyo grade-A[1] offices increased by 0.8% to 4.8% in the first quarter and remained unchanged in the second quarter (Chart-13), affected by a large supply such as Shinagawa Season Terrace with a 206 thousand m^2 gfa, Tokyo Nihombashi Tower 137 thousand m^2, Osaki Bright Tower 92 thousand m^2 and Bright Core 45 thousand m^2. However, rents of Tokyo's grade-A offices continued to rise by 7.1% q-o-q and by 17.2% y-o-y (Chart-13).

The center of Tokyo has been leading the market as can be seen through the improved vacancy rates of large office buildings in Shibuya ward and Chiyoda ward to a low 1.25% and 2.51% (Chart-14). According to Mitsubishi Estate, vacancy rates of its buildings in the Marunouchi area in Chiyoda ward have fallen to 1.8%.

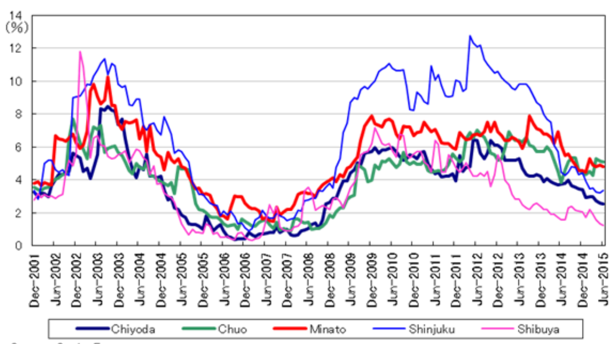
In contrast to rents of Tokyo's grade-A offices, the grade-B rents declined by 4.6% q-o-q retroacting to the strong previous quarter (Chart-15). Rents of Tokyo's grade-A offices and grade-B offices have risen by 69.5% and 43.9% from the bottom some years ago, however, average rents in the Tokyo major three words rose by only 5.7%, suggesting that small and medium sized buildings have been straggling behind in competition.

Chart-13 Tokyo Grade-A Office



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

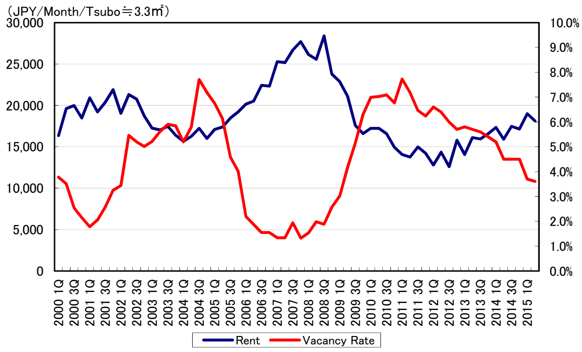
Chart-14 Office Vacancy Rates in Tokyo Five Wards



Source: Sanko Estate

1 Sanko Estate chooses high grade buildings individually on its guidelines such as gfa of more than 33,000m^2, main floor sizes of more than 990 m^2, building age of 15 years or less and so on.

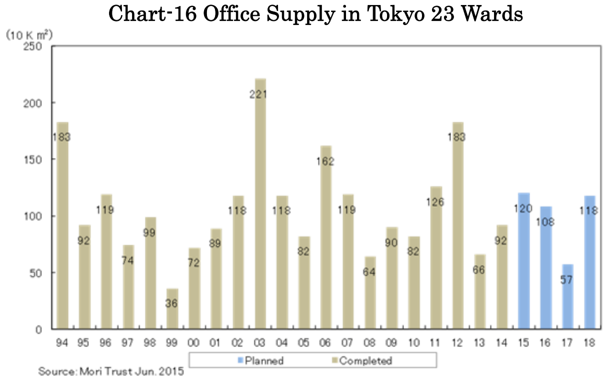
Chart-15 Tokyo Grade-B Office



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

Though some large buildings were completed in the first half, overall office supply has been manageable and recently, absorbed volume has been moderate. However, office demand still looks healthy with preleasing activities seen in new buildings to be completed in the second half of the year. Some office developments have been extended for one or more years due to labor shortage and cost increase and significant supply is not expected in the foreseeable future (Chart-16), which could also support the market for a while.

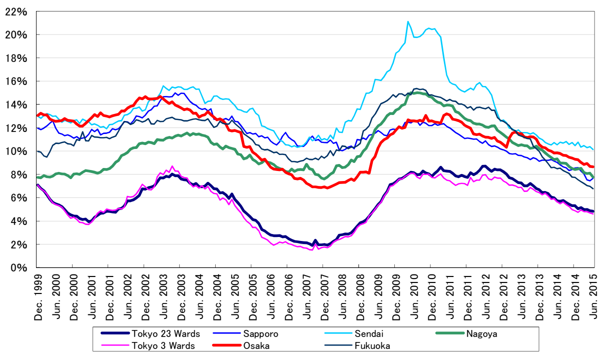
Chart-16 Office Supply in Tokyo 23 Wards



Source: Mori Trust Jun. 2015

Office vacancy rates in major local cities also continued to improve (Chart-17). The Nagoya office market is especially gathering attention in preparation for significant supply later this year, such as Dai Nagoya Building with a 147 thousand m² gfa and JP Tower Nagoya 180 thousand m², respectively.

Chart-17 Office Vacancy Rates in Major Cities



Source: Sanko Estate

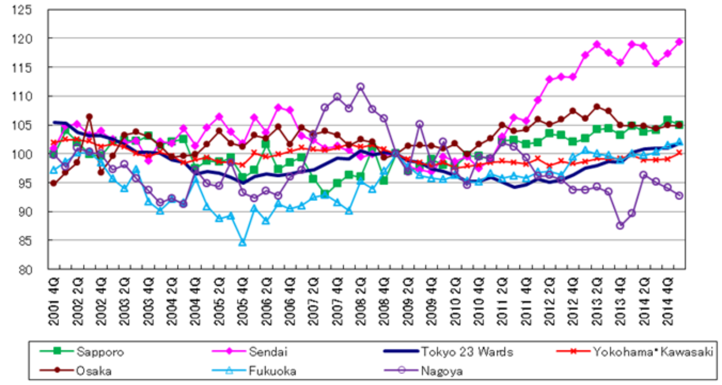
2) Residential Rental

Residential rents in Tokyo and other major cities such as Sapporo and Fukuoka have been rising, while those in Osaka and Nagoya have leveled off (Chart-18).

In Sendai, the current tight supply and demand balance, affected by the earthquake will ease gradually hereafter with the completion of redeveloped houses and public apartments.

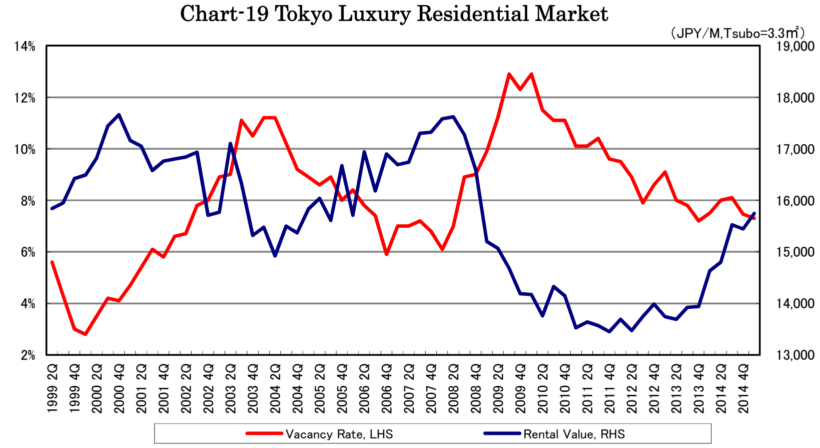
Tokyo luxury residential rents dropped the most since the earthquake in 2011 (Chart-19). However, no meaningful negative factors have been noticed and the upward trend is expected to continue supported by the centralization of locals and the increasing demand from foreigners.

Chart-18 Residential Rents in Major Cities



Source: Sumitomo Mitsui Trust Research Institute, At Home

Chart-19 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.

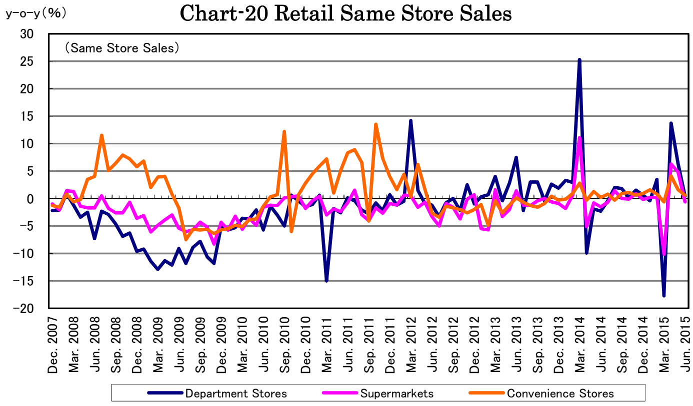
3) Retail, Hotel and Logistics

Retail sales grew by 2.9% and same store sales of large sized stores grew by 4.4% in the second quarter. These strong numbers are just compared with those following the consumption tax hike in April last year, and the growth momentum has already moderated to 0.4% in June (Chart-20).

According to Japan Department Stores Association, tax exempt sales to foreign customers grew by 307.1% in June. Nikkei Newspaper said the tax exempt sales accounted for 24.7% of the entire sales in Mitsukoshi Isetan Ginza in May and recently, the tax exempt sales sometimes accounted for 40% of the daily entire sales in Daimaru Osaka Shinsaibashi.

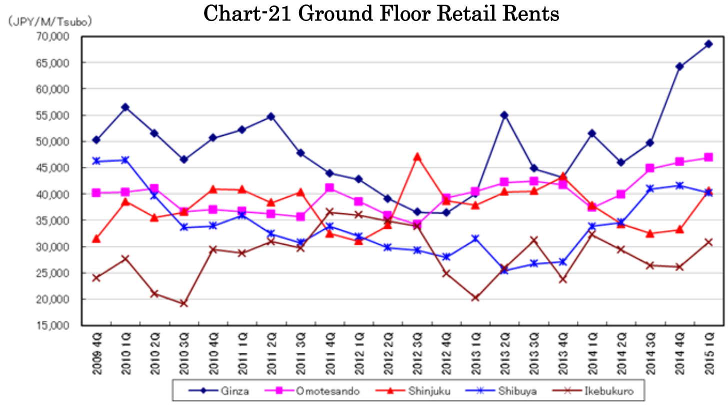
Retail rents have been rising especially in the center of Tokyo. Ground floor rents in Ginza, Omotesando and Shibuya grew significantly in the first quarter by 33.1%, 25.6% and 18.7% y-o-y, respectively (Chart-21).

Chart-20 Retail Same Store Sales



Source: Ministry of Economy, Trade and Industry

Chart-21 Ground Floor Retail Rents



Source: Attractors Lab Co. and BAC Urban Project, Nikkei Real Estate Market Report

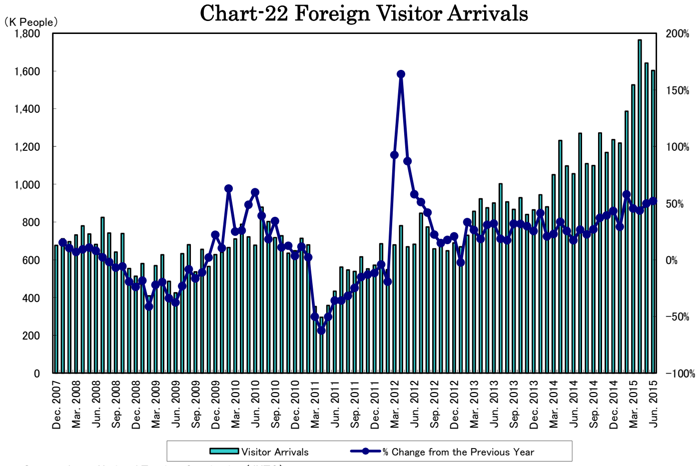
The number of foreign visitors grew by 51.8% y-o-y to 1.6 million in June (Chart-22). It is mostly secured that the annual number will reach 18 million in 2015.

The occupancy rates of 61 hotels in Japan have been posting highest numbers each month (Chart-23). According to tourism statistics by MLIT, the total visitor number in Japan grew by 7.2% y-o-y to 118 million in the second quarter with local travelers increasing by 2.0% and foreigners increasing by 49%. Foreigners accounted for 14.8% of the entire visitors in the second quarter, increasing from 6 or 7% in 2010.

Local travelers are expected to increase in August and the shortage of accommodation facilities will be problematic. While the construction of hotels has become difficult due to the cost increase, small hostels and capsule holes are mushrooming to meet the strong demand.

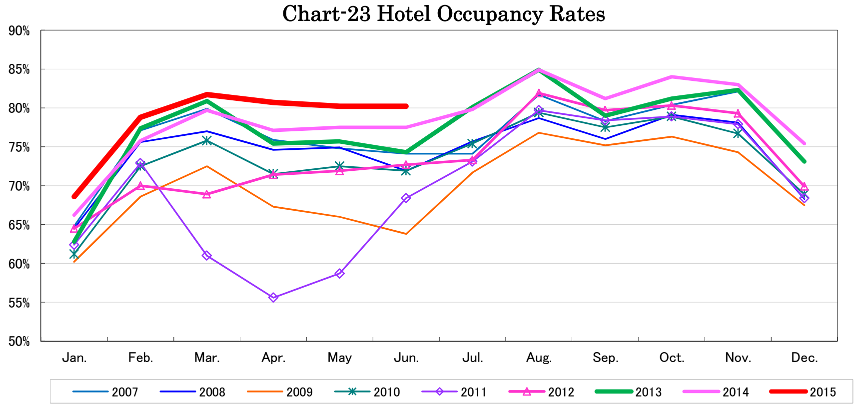
While more accommodation facilities are necessary for hosting the Tokyo Olympic Games in 2020, the deregulation of new services is being discussed such as the utilization of normal apartments and condominiums for visitors.

Chart-22 Foreign Visitor Arrivals



Source: Japan National Tourism Organization (JNTO)

Chart-23 Hotel Occupancy Rates



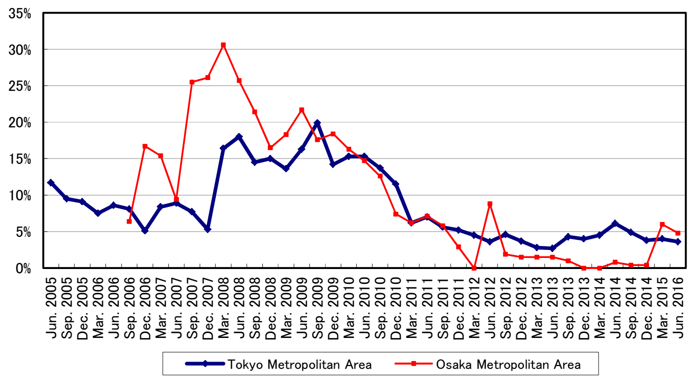
Source: Ota Publication

According to CBRE, the vacancy rates of large logistics facilities for multi-tenants in the Tokyo and Osaka metropolitan area improved by 0.4% to 3.6% and by 1.2% to 4.8%, respectively (Chart-24).

The supply and demand balance has been tight all over the Tokyo metropolitan area, especially with no vacant spaces left in areas such as Tokyo Bay and Outer Ring Road. Sizable supply is scheduled in the fourth quarter and it is said that 30% of the supply has been preleased on the back of strong demand. In the Osaka metropolitan area, the vacant spaces supplied last quarter have been absorbed healthily.

Average rents of large logistics facilities have been on the upward trend in all major metropolitan areas (Chart-25).

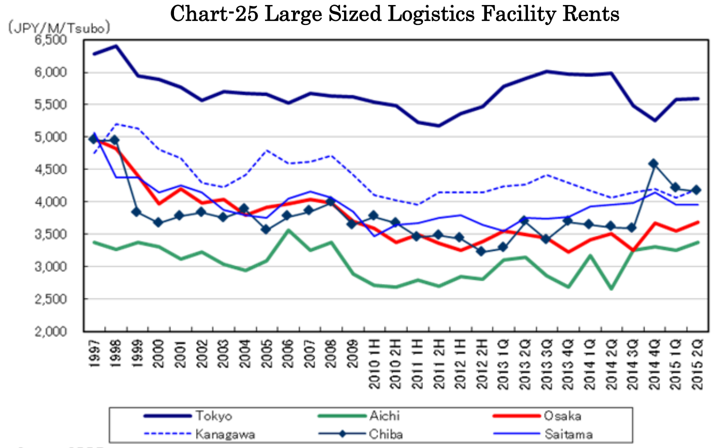
Chart-24 Logistics Facility Vacancy Rates (Large Sized Multi-Tenant-Use)



*Large sized multi-tenant-use (GFA 33,000㎡ or more)

Source: CBRE

Chart-25 Large Sized Logistics Facility Rents



Source: CBRE

6. J-REIT and Property Investment Markets

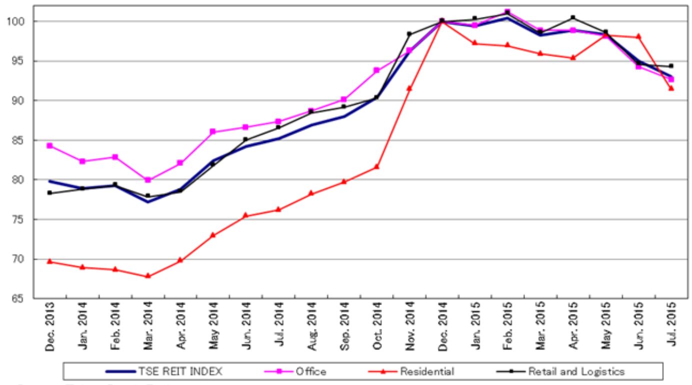
The TSE REIT index declined by 3.3% in the second quarter, affected by the volatile bond market and the Greek debt crisis. Though the residential sector of J-REIT rose by 2.2%, office and retail-logistics sectors declined by 4.6% and 4.0%, respectively (Chart-26). The index declined by 5.0% in the first half contrary to the healthy equity market. However, the fundamentals of J-REIT have been improving as seen in that the total appraisal value of J-REIT's assets appreciated by 4% y-o-y and the total unrealized value grew to 815 billion JPY (Chart-27).

At the end of June, the J-REIT market value was 10.5 trillion JPY, while the price to NAV ratio was 1.4 times and the dividend yield was 3.2% with a 2.8% yield spread on ten year JGBs.

J-REITs acquired property assets of 434 billion JPY in the second quarter and 930 billion JPY in the first half (Chart-28), which was 19% larger than last year despite difficult low yield conditions. Samty Residential Investment Corporation with 28 assets valued at 305 billion JPY was listed in June 30, lifting the number of J-REITs to 52.

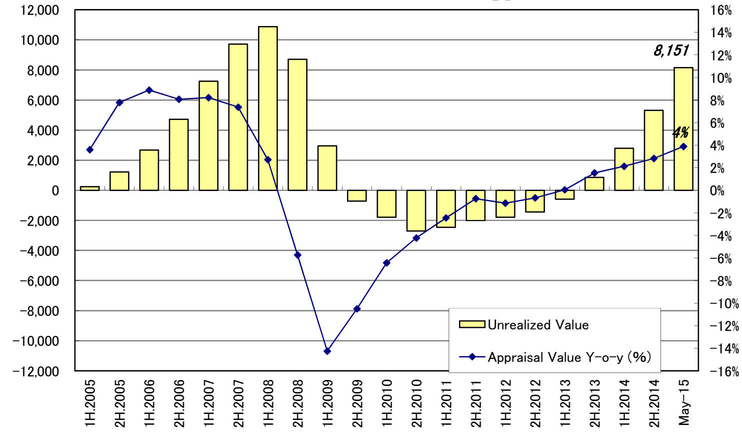
According to the Nikkei Real Estate Market Report, transactions in the property investment market remained unchanged from last year at 776 billion JPY in the second quarter. Though the volume shrank a lot from 1.4 trillion in the first quarter, it is a normal seasonality and is expected to grow in the third quarter.

Chart-26 TSE REIT Index



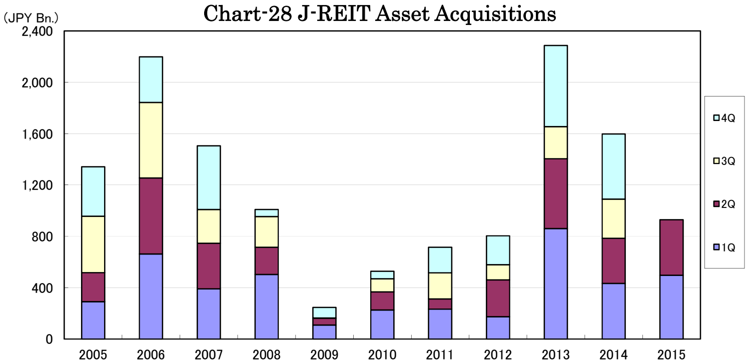
Source: Tokyo Stock Exchange

Chart-27 J-REIT Asset Value Appraisal



Source: NLI Research Institute

Chart-28 J-REIT Asset Acquisitions



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

* 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.

