Real Estate Analysis Report

Outlook Reverses, Divergence in Forecasts of Property Price Peak from 2015 to 2018

～The Twelfth Japanese Property Market Survey～

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Summary

- The twelfth annual *property market survey* indicated that the current sentiment remained strong with “Good” or “Somewhat good” responses accounting for nearly 90% of the responses.
- Regarding the six-month outlook, the sum of negative responses outnumbered the positives for the first time since 2008.
- When asked which property sectors were the top three preferable investment targets in terms of price appreciation and market growth, “Hotel” overwhelmed other sectors and “Office” declined noticeably.
- When asked which risk factors were the top three influential concerns for the property investment market, more respondents chose “Global economy” than “Domestic economy,” and not a small number of respondents chose “Geopolitical risk.”
- Regarding the J-REIT market forecast, two-thirds of respondents chose “0~+15%” of return for the TSE REIT index in 2016 and more than 90% of the respondents forecasted that the J-REIT prices will stay within a range of ±15% at the end of 2016.
- Finally, when asked about the peak year forecast for property prices in Tokyo, responses were divided into the three periods of “2015 or now,” “2016～the first half of 2017” and “the second half of 2017～2018.”

Introduction

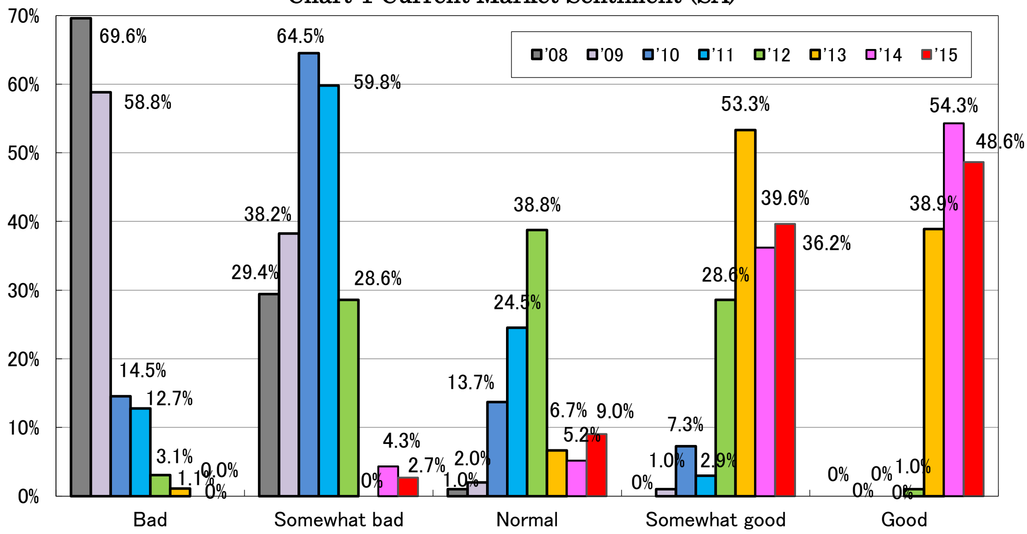
NLI Research Institute conducted the twelfth annual *Property Market Survey* of investment market sentiment among Japan-based property professionals[1] for fiscal year 2015. This time we sent out 202 questionnaires by email on January 7, 2016, and received 111 valid responses by January 15 (55% collection rate).

Results

1. Current Sentiment

Regarding the current sentiment in the property investment market, "Good" or "Somewhat good" responses accounted for nearly 90% of responses for three consecutive years (Chart-1). The sentiment looks totally opposite of that during the global financial crisis in 2008 and 2009 when "Bad" responses accounted for more than half of the responses.

Chart-1 Current Market Sentiment (SA)



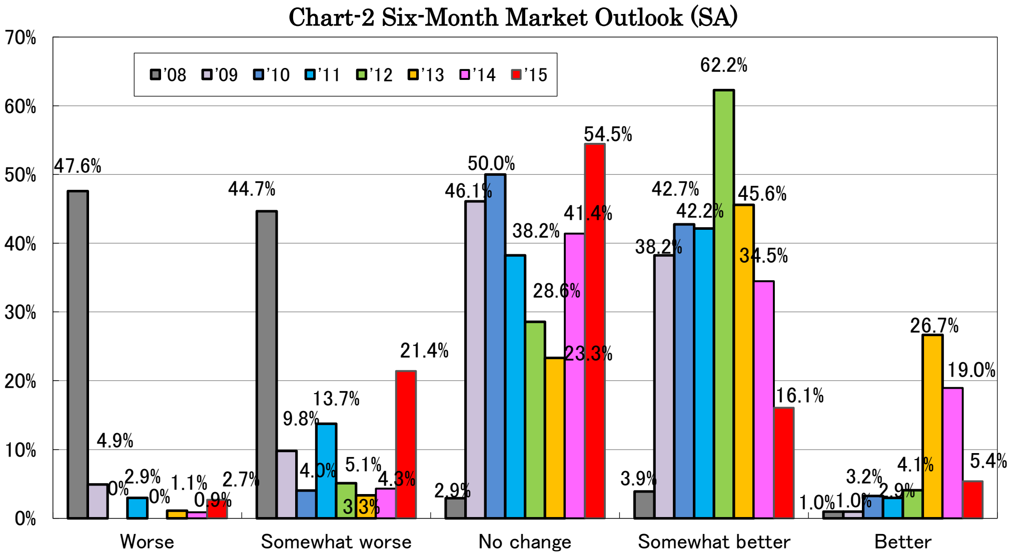
Source: NLI Research Institute, *Propety Market Survey,* Fiscal Year 2008〜2015

2. Six-Month Outlook

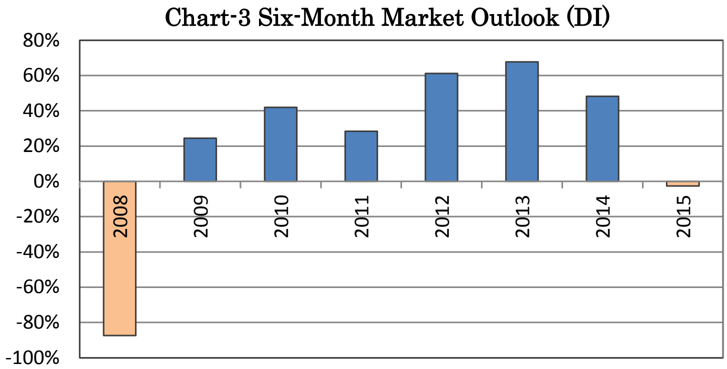
Regarding the six-month property investment market outlook, "No change" responses ranked first chosen by 54.5% of respondents (Chart-2).

"Somewhat better" or "Better" responses predicting higher prices or more transactions accounted for more than half of the responses until last fiscal year. However, this time "Worse" or "Somewhat worse" responses outnumbered the sum of the optimistic responses, which was the first time since 2008 (Chart-3) as the six-month outlook had already improved even in 2009 when the sentiment was at the bottom.

[1] The Japan-based property professionals are those engaged in various work such as development, construction, banking, insurance, brokerage, property management, fund management, advisory, consulting, research and publishing.



Source: NLI Research Institute, *Propety Market Survey,* Fiscal Year 2008～2015



*("Better" or "Somewhat better") – ("Worse" or "Somewhat worse")
Source: NLI Research Institute, January 2016

3. Preferred Sectors

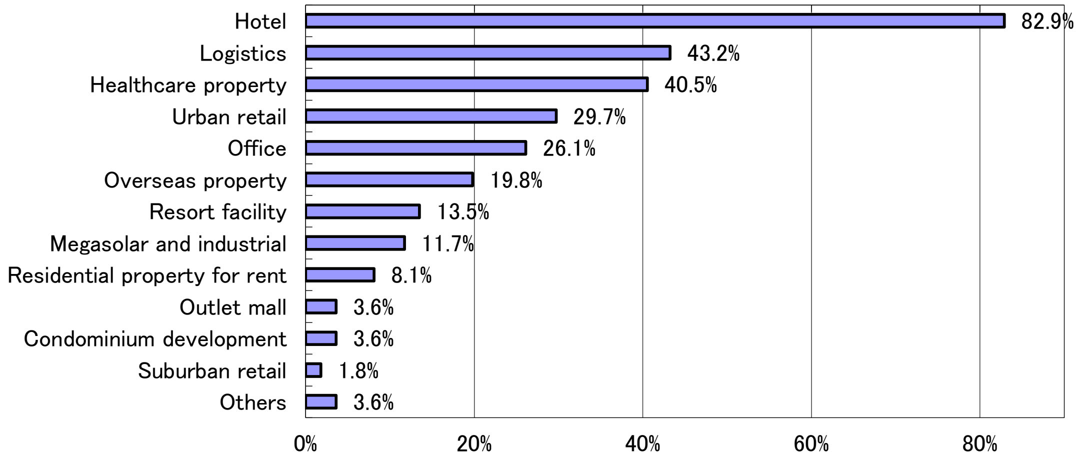
When asked which property sectors were the top three preferable investment targets in terms of price appreciation and market growth, a dominating 82.9% of the respondents chose "Hotel" (Chart-4). As the foreign visitor arrival number grew faster than expected by 47% y-o-y to 19.7 million already in 2015 with the government target of 20 million by 2020, hotel occupancy rates have remained at an all-time high. "Hotel" had been regarded as a niche sector for specialists; however, many companies have newly established or strengthened their hotel investment teams recently. In addition to "Hotel," the number of respondents who chose "Resort facility" almost doubled to 13.5%.

The number of respondents who chose "Logistics facility" also increased significantly following a temporal decline last year (Chart-5). As volumes of logistics facilities were supplied in the fourth quarter of 2015 and are scheduled to continue, vacancy rates are anticipated to increase for a while. However, it is expected that the larger stock and more liquidity will enhance the attraction of the logistics investment market.

On the other hand, "Office," which had steadily ranked as one of the top main investment targets, declined significantly to 26.1% this time. Even with improving vacancy rates and rising office rents, the demand growth has recently shown some weakness[2]. As the office market best shows a classic price cycle among the sectors, some respondents apparently anticipated the cycle to peak out and shifted to other growing sectors.

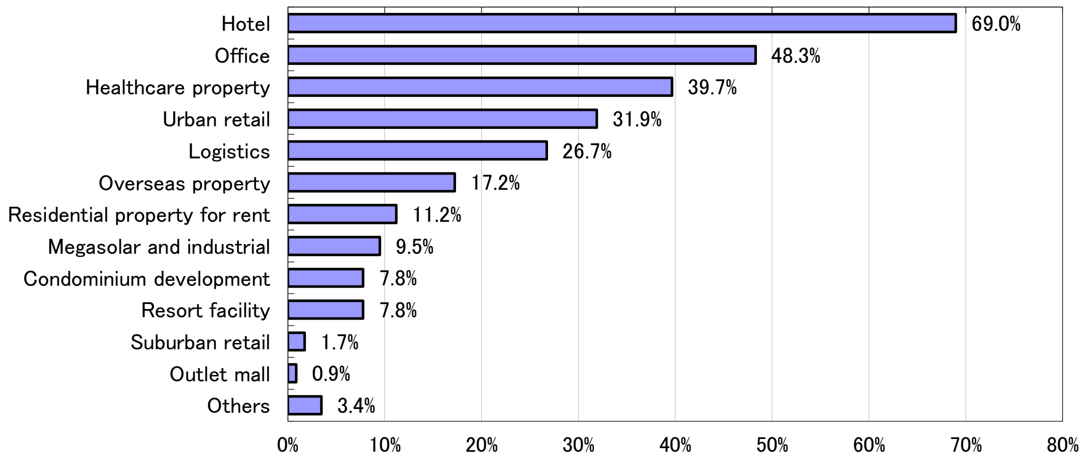
The number of respondents who chose "Condominium development" also declined noticeably. In addition to structural concerns based on the shrinking population, the recent sales slowdown with high prices and the fabrication of structural piling data presumably affected.

Chart-4 Preferable Sectors Expected Price Appreciation and Market Expansion (MA3)



Source: NLI Research Institute, January 2016

Chart-5 "Last Fiscal Year" Preferable Sectors Expected Price Appreciation and Market Expansion (MA3)



Source: NLI Research Institute, January 2015

[2] Mamoru Masumiya, "Japanese Property Market Quarterly Review, Third Quarter 2015-Markets Steady but Some Weaknesses Creeping In-" Real Estate Analysis Report, NLI Research Institute, November 16, 2015.

4. Risks for Property Investment

The next question was about which risk factors were the top three influential concerns for the property investment market.

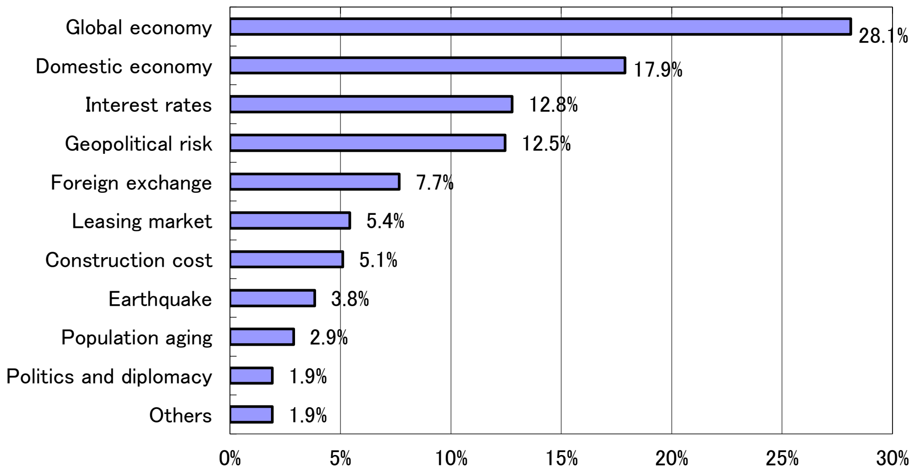
Foreign factors basically have indirect effects on the domestic property market, however, more respondents chose "Global economy" than "Domestic economy," and not a small number of respondents chose "Geopolitical risk" as well (Chart-6).

Economic growth in many emerging Asian countries has slowed down, affected by the stagnating Chinese demand. It is anticipated that office demand from global companies and shopping and hotel demand by inbound travelers will plateau. In addition, a negative effect is the concern over foreign capital entering the Japanese property investment market, which ballooned in 2014.

Terrorist attacks have expanded out of the Middle East into developed cities such as Paris and Asian cities such as Bangkok and Jakarta, suggesting even the Japanese property market can no longer ignore geopolitical risks.

On the other hand, "Domestic economy," the most influential factor on the domestic property market, was chosen by only 17.9% of the respondents, as the current economic conditions are still sound. In the same way, only a limited number of respondents chose "Interest rates," as the loosening monetary policy is expected to continue for the time being. The number of respondents who chose "Construction cost" was also limited with related prices recently leveling off after years of dramatic rise.

Chart-6 Current Anticipated Risk Factors (MA3)



Source: NLI Research Institute, January 2016

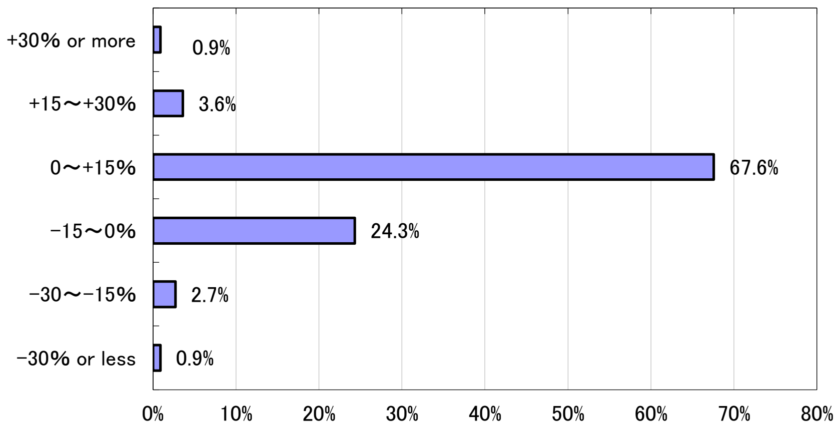
5. J-REIT Performance Forecast in 2015

Regarding the J-REIT market forecast, 67.6% of respondents chose "0~+15%" of performance for TSE REIT index in 2016 (Chart-7). More than 90% of the respondents forecasted that the

J-REIT prices will stay within a range of ±15% at the end of 2016.

J-REITs have shown relative resilience during the violent equity market correction at the beginning of this year, partly because J-REITs under-performed in 2015 and quite a few investors apparently prefer the stable dividends of J-REITs. On the other hand, it is difficult to imagine J-REIT prices to go beyond the level where dividend yields shrink to 3% as was seen at the beginning of 2015.

Chart-7 2015 J-REIT Performance Forecast (SA)



Source: NLI Research Institute, January 2016

6. Property Price Peak Year

Finally, when asked about the peak year forecast for property prices in Tokyo, responses were divided into the three periods of "2015 or now" with 27.9%, "the second half of 2017～2018" with 27.9% and "2016～the first half of 2017" with 27.0% (Chart-8).

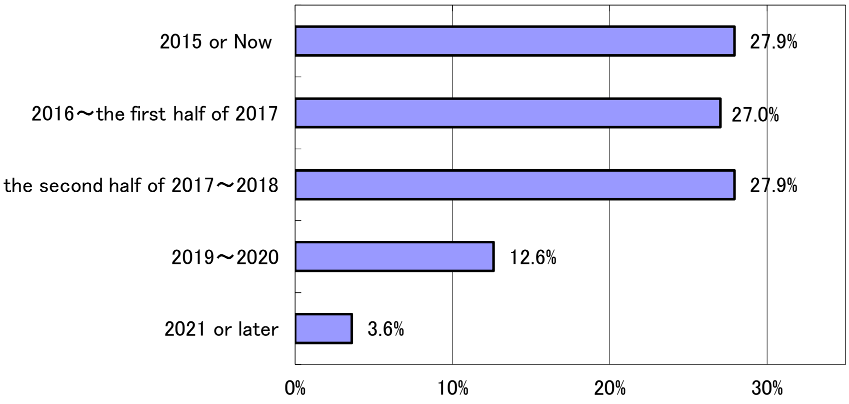
Considering the recent risk aversion in financial markets and high transaction prices in the physical property market, quite a few respondents think the property prices have already peaked out.

On the other hand, more than half of respondents still think the investment market has been in a positive mood. However, half of them forecast the price appreciation to continue to no later than the first half of 2017, considering the US interest-rate increases and the domestic consumption tax-rate hike in 2017. The other half think the domestic loosening monetary policy continues for years and that property prices can benefit from the conditions.

Despite the 2020 Tokyo Olympic Games definitely being a positive for the property market, only a limited number of respondents forecasted property prices to continue to appreciate until the Olympic event.

The responses "2021 or later" were even less, suggesting few respondents expect the Olympic event to make Tokyo more competitive as an international city or future inflation to support property prices for the long term.

Chart-8 Tokyo Property Price Peak Year Forecast (SA)



Source: NLI Research Institute, January 2016

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