Real Estate Analysis Report

Japanese Property Market Quarterly Review, Fourth Quarter 2015

~J-REITs Decline for First Time in Four Years, Foreign Visitor Arrivals Increase 47% ~

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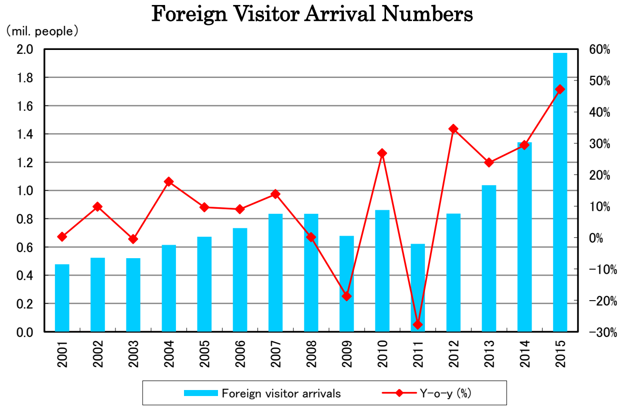
Summary

- After recovering to a positive number in the third quarter, the real GDP growth rate turned negative again due to weak private consumption in the fourth quarter. Housing starts increased again in 2015 and land prices continued to appreciate based on a strong demand for hotels and retail stores benefitting from an increase in inbound visitors. While a decreasing number of new condominium units have been sold in the Tokyo metropolitan area for two years, the transaction volume in the secondary condominium market increased.
- The office vacancy rates in Tokyo have further improved and office rents continued to rise for the fifteenth consecutive quarter. However office rents declined q-o-q in the fourth quarter. Residential rents in Tokyo have been rising. Foreign visitor arrivals increased by 47% to 19.73 million in 2015. Hotel room occupancy rates have remained at a record high. Logistics vacancy rates rose due to the largest ever new supply.
- The TSE REIT Index declined by 7.9% in 2015 for the first time in four years. J-REITs acquired property assets valued at 1.6 trillion JPY in 2015 and the total asset value expanded to 14 trillion JPY with 52 J-REITs listed. The property transaction volume declined in 2015 and the NLI Research Institute investment survey suggested the market has peaked.

Foreign Visitor Arrival Numbers



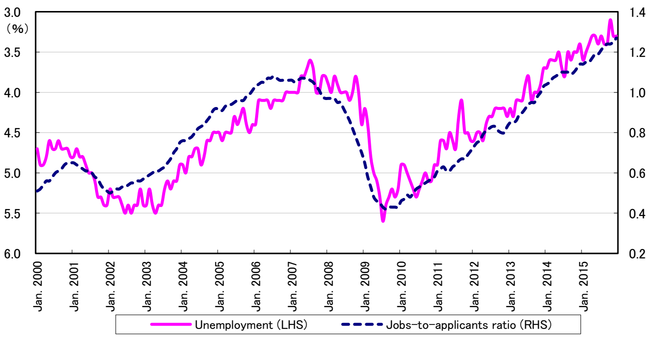
Source: Japan National Tourism Organization (JNTO)

1. Economy and Housing Market

Japan's GDP growth rate was revised up to 0.3% q-o-q in the third quarter from the negative number in the second quarter. However, the growth rate turned negative again to -0.4% in the fourth quarter due to weak private consumption. According to the Ministry of Internal Affairs and Communications, real consumption declined by 4.4% y-o-y in December mainly due to the slow sales of winter clothes.

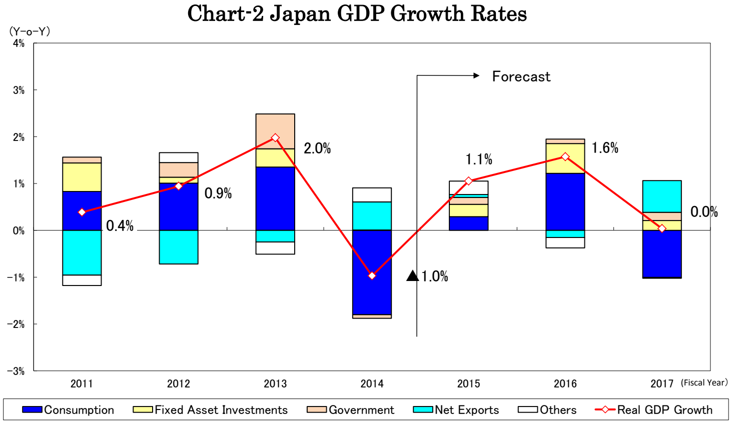
NLI Research Institute modified its GDP growth rate forecasts in December to +1.1%, +1.6% and +0.0% y-o-y for 2015, 2016 and 2017 respectively (Chart-2). The number for 2016 will be high with active corporate facility investments and a rush demand before the consumption tax hike scheduled for April 2017, following which a decreased demand will cut the number considerably.

Chart-1 Labor Market



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

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" December, 2015.

While housing prices continued to rise, housing starts and new condominium sales declined in the fourth quarter.

Housing starts shrank by 1.3% y-o-y to 75.4k units in December, however, the number recovered by 1.9% to 909k units for the whole year in 2015 from the negative growth due to the consumption tax hike in 2014 (Chart-3). Housing starts of apartments for lease increased by 4.6% y-o-y for the fourth consecutive year and those of condominiums increased by 4.7%

after the negative growth in 2014.

New condominium units sold in the Tokyo metropolitan area decreased by 9.9% y-o-y to 40,449 units in 2015. The average unit price rose by 9.1% to 55.18 million JPY, the highest level since 1991. Real Estate Economic Institute forecasts a 6.3% y-o-y increase of sales to 43,000 units in 2016 (Chart-4).

According to Real Estate Information Network Systems, the transaction volume in the secondary condominium market in the Tokyo metropolitan area increased by 5.1% y-o-y to 8,391 units in the fourth quarter and by 2.9% to 34.8k units in 2015 (Chart-5). The average transaction price rose by 6.1% y-o-y to 28.92 million JPY for the third consecutive year.

The Home Price Indices in the Tokyo metropolitan area by Japan Real Estate Institute appreciated m-o-m for the seventh consecutive month and y-o-y for the sixth consecutive month in November (Chart-6).

One of key factors for the housing market hereafter is how much mortgage rates will be affected by the negative interest rate policy introduced in February 2016. Furthermore, the government is preparing supporting measures for home buyers such as subsidy increases or enlarging inheritance tax exemptions before the consumption tax hike scheduled for April 2017. On the other hand, the tax authority is considering a review on inheritance tax conditions to prevent luxury condominiums from being abused for minimizing taxable bases.

Chart-3 Yearly Housing Starts

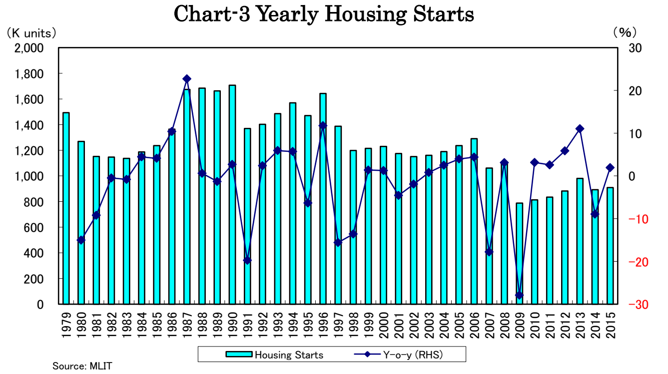
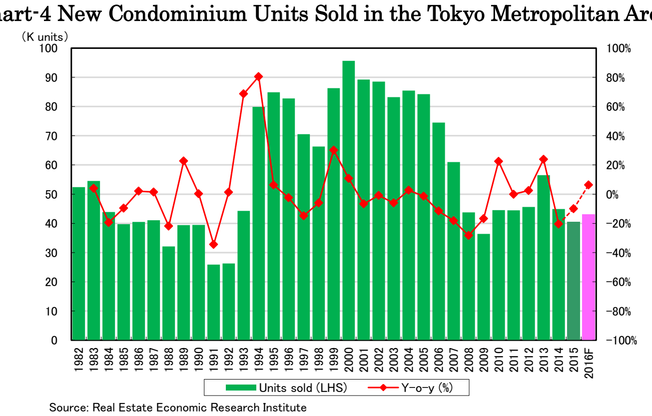
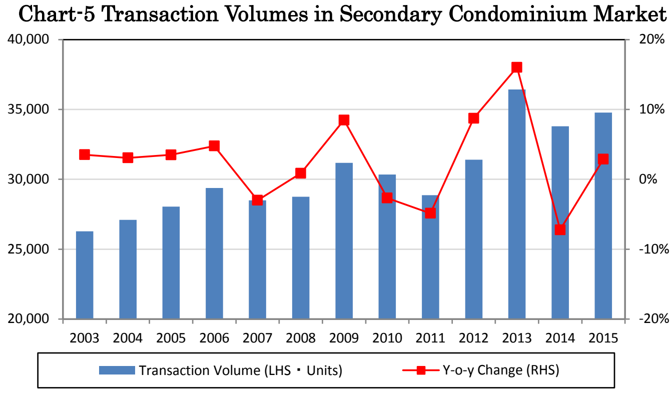
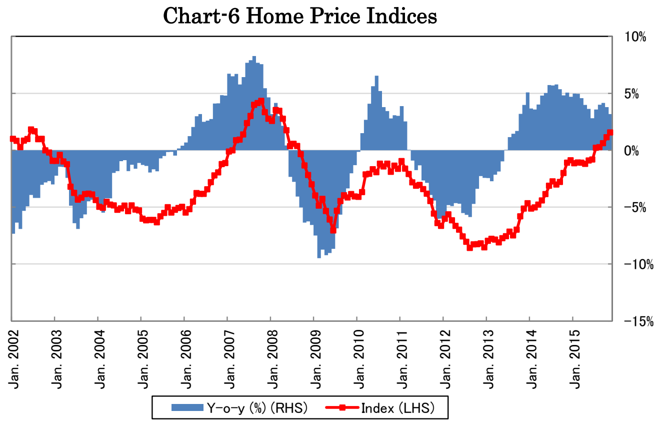


Chart-4 New Condominium Units Sold in the Tokyo Metropolitan Area





Source: REINS East Japan

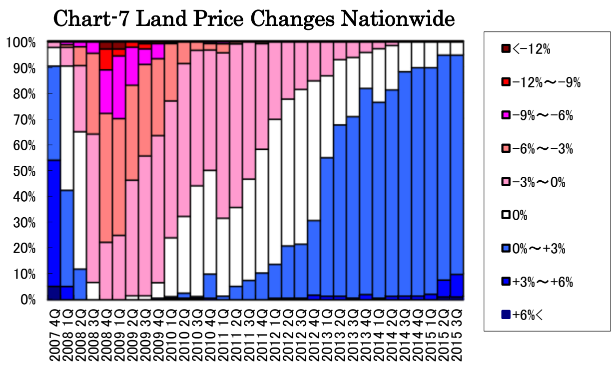


Sources: Japan Real Estate Instiitute

2. Land Prices

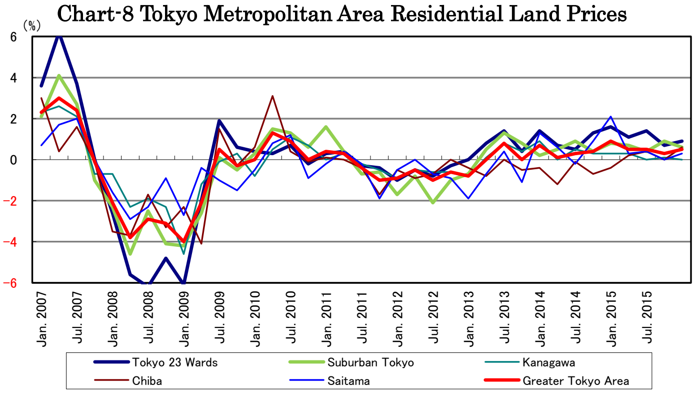
Land price appreciation has continued on the back of strong demand from retail stores and hotels benefiting from increasing foreign visitor arrivals. In "Chika Look Report 3Q 2015" by MLIT, no monitoring points recorded land price depreciation for the fifth consecutive quarter, with 95% of monitoring points in Tokyo, 88% in Osaka, 100% in Nagoya, 65% in rural cities and 87% nationwide posting price appreciations (Chart-7).

According to Nomura Real Estate Urban Net, residential land prices in the Tokyo metropolitan area appreciated by 0.5% q-o-q for the tenth consecutive quarter and by 1.8% y-o-y (Chart-8).



Source: MLIT "Chika Look Report"

Chart-8 Tokyo Metropolitan Area Residential Land Prices



Source: Nomura Real Estate Urban Net

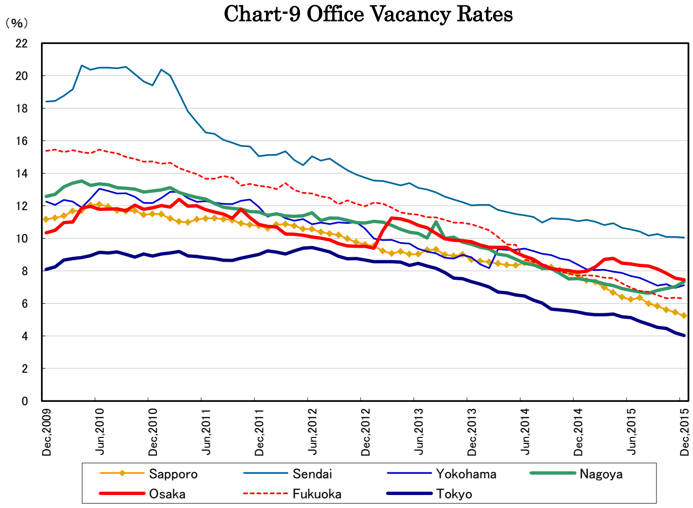
3. Sub-sectors

1) Office

According to Miki Shoji, office vacancy rates in Tokyo declined by 0.16% to 4.03%, remaining below 5% for the sixth consecutive month where building owners have more power than tenants in leasing term negotiations. Office vacancy rates of other major cities also continued to decline (Chart-9).

The rent index of Tokyo grade-A[1] offices declined by 7.8% q-o-q to 32,872 JPY per month per tsubo in the fourth quarter as a push back from the 14% appreciation in the previous two quarters (Chart-10). However, the index has risen y-o-y for the fifteenth consecutive month. Mori Building forecasts 1.07 million square meters of new office supply in 2016, which is slightly more than the past average of 1.03 million square meters. NLI Research Institute forecasts that the rent index will stay on the rise during 2016.

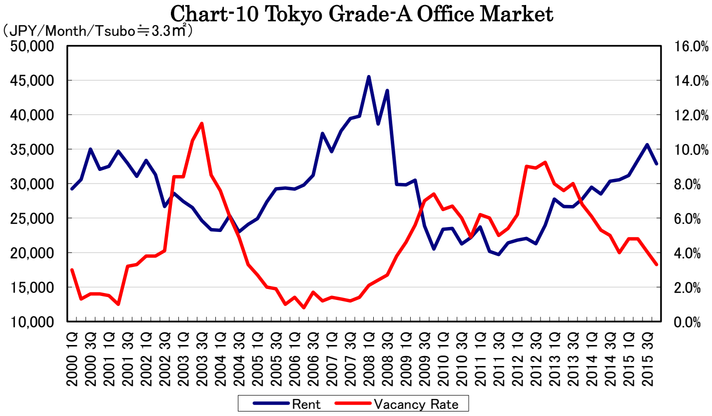
Chart-9 Office Vacancy Rates



Source: Miki Shoji

[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 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 and environmental friendliness.

Chart-10 Tokyo Grade-A Office Market

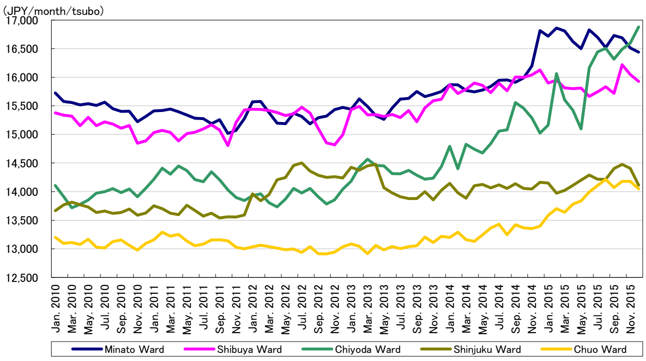


Source: Vacancy Rate・Sanko Estate, Rent・Sanko Estate and NLI Research Institute

2) Residential Rental

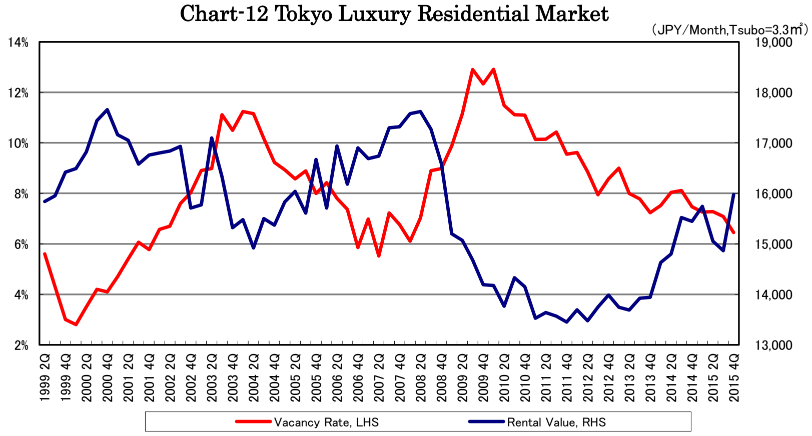
Residential rents in Tokyo major five wards have continued to rise, particularly by 8.6% y-o-y in Chiyoda ward and by 6.25% in Chuo ward (Chart-11). In addition, Tokyo luxury residential rents rose by 3.5% y-o-y to 15,979 JPY per month per tsubo in December on the back of the improving vacancy rates (Chart-12).

Chart-11 Tokyo Residential Rent Index



Source: Leasing Management Consulting

Chart-12 Tokyo Luxury Residential Market

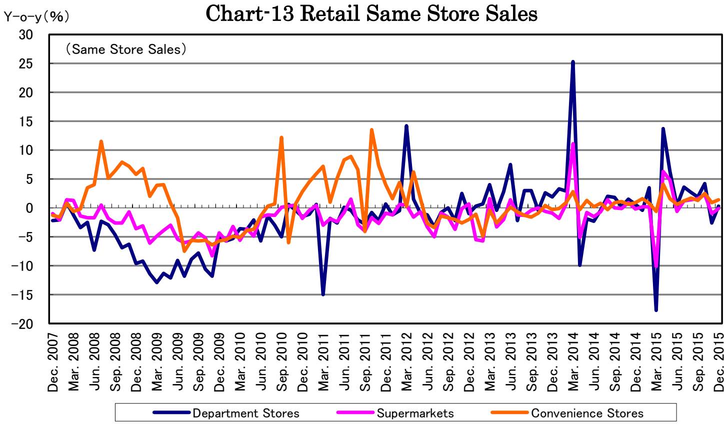


*Sample consists of contracts with more than 300K JPY/Month, tsubo rental value or 30 tsubo space.
Source: Ken Real Estate Advisors Ltd.

3) Retail, Hotel and Logistics

Same store sales of department stores, supermarkets and convenience stores grew by 0.5%, 0.3% and 1.6% y-o-y, respectively in the fourth quarter (Chart-13). After resolving the negative effects of the consumption tax hike in 2014, same store sales for the whole year of 2015 remained stable with department stores, supermarkets and convenience stores growing by 0.5%, 0.3% and 0.9% y-o-y respectively.

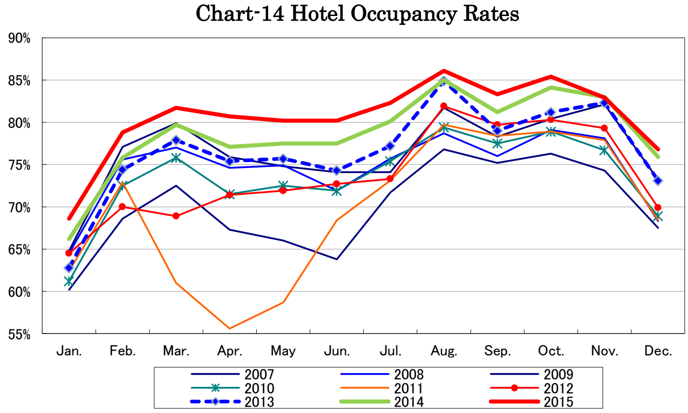
Chart-13 Retail Same Store Sales



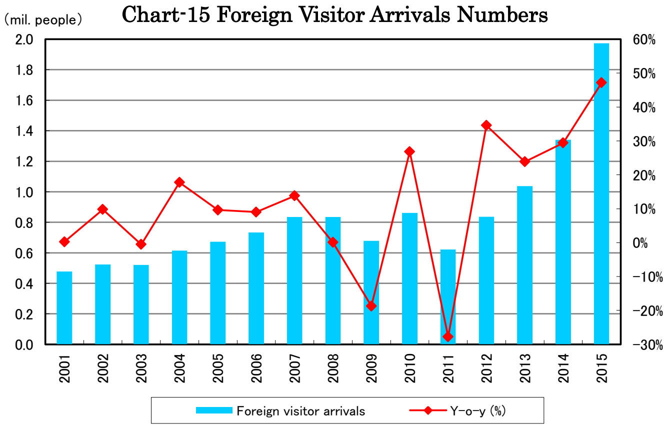
Source: Ministry of Economy, Trade and Industry

Hotel occupancy rates improved nationwide across 61 cities by 0.9% y-o-y to 76.8% in December, posting a December record (Chart-14). Foreign visitor arrivals increased by 47% to 19.73 million in 2015 for the third consecutive record-setting year. The government target of 20 million in 2020 was mostly realized years ahead of schedule on the back of the depreciation of JPY, loosened visa issuance conditions and expanded duty free items. Visitor arrivals from China increased the most by 107% y-o-y to 4.99 million, followed by South Korea and Taiwan. These three countries accounted for 64% of all foreign visitor arrivals (Chart-15, 16). Furthermore, consumption by foreign visitors in Japan increased by 71% to 3.4 trillion JPY, 40% of which was accounted for by Chinese. The amount was as large as the export industry of major Japanese products such as electronics components at 3.6 trillion JPY or automobile components at 3.4 trillion JPY.

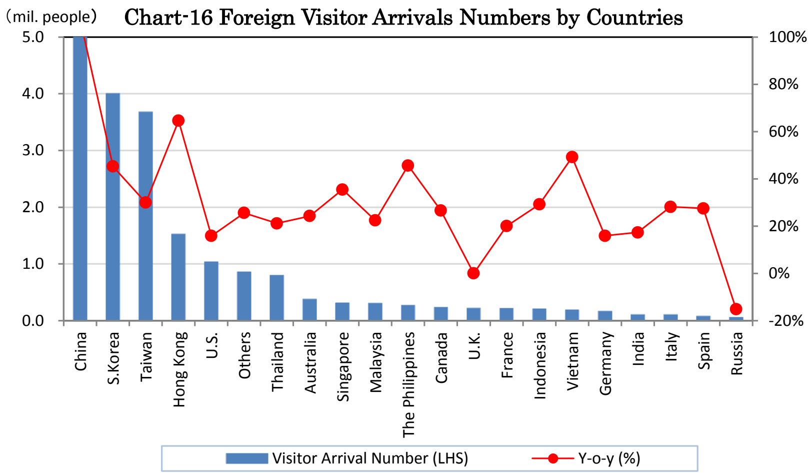
Chart-14 Hotel Occupancy Rates



Source: Ohta Publications "Weekly HOTERES"



Source: Japan National Tourism Organization (JNTO)

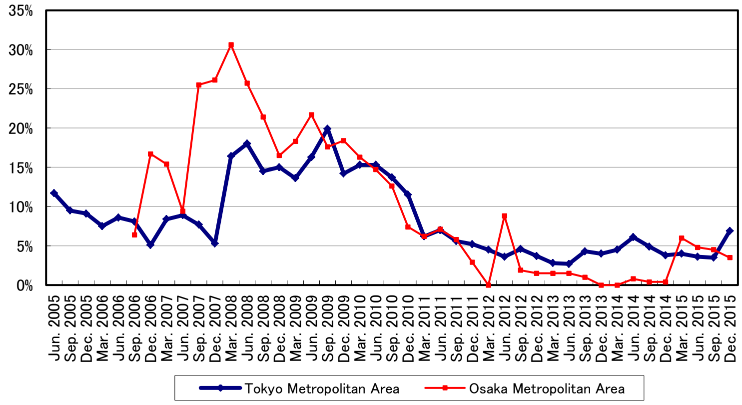


Source: Japan National Tourism Organization

According to CBRE, vacancy rates of large logistics facilities for multi-tenants in the Tokyo metropolitan area increased by 3.4% q-o-q to 6.9%, while those in the Osaka metropolitan area declined by 1.0% y-o-y to 3.5% (Chart-17). The largest ever supply of 0.5 million square meters of new space in the Tokyo metropolitan area raised the average vacancy rates in the fourth quarter. However, strong demand for large sized logistics facilities on the back of growing electric commerce improved vacancy rates of existing facilities to 1.2%. New supply in the Tokyo metropolitan area is forecasted to increase by 20% y-o-y to 1.2 million square meters in 2016 and vacancy rates may soar in some oversupplied areas.

According to Ichigo Real Estate Service, logistics rents in the Tokyo metropolitan areas remained almost unchanged declining by 0.3% m-o-m to 3,990 JPY per month per tsubo in October.

Chart-17 Logistics Facility Rents and Vacancy Rates (Large Sized Multi-Tenant-Use)



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

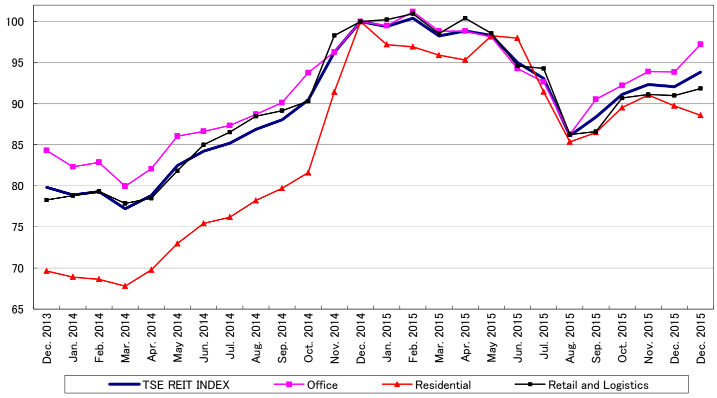
4. J-REIT and Property Investment Markets

The TSE REIT Index rose by 4.2% in the fourth quarter based on an improved demand supply balance with limited private offerings. The office sector rose by 3.7%, residential sector by 3.7% and other sectors – including retail and logistics – by 5.1% (Chart-18). The Bank of Japan announced a new rule that they can acquire 10% of each J-REIT unit, an increase from the current 5%. At the end of December, the J-REIT market value was 10.5 trillion JPY, while the price to NAV ratio was 1.3 times and the dividend yield was 3.5%, with a 3.2% yield spread on 0.3% of ten year JGBs.

The TSE REIT Index declined by 7.9% through the whole year of 2015 for the first time in four years. The index fluctuated by 24% from a peak of 1,990 points in January to a low of 1,509 points in September on the back of global economic uncertainty before the recovery from the expectation of additional monetary loosening measures.

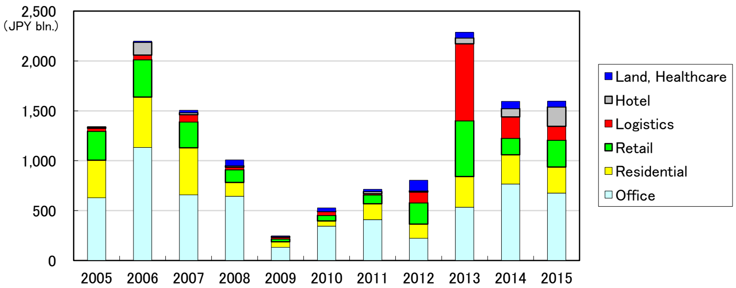
J-REITs acquired property assets amounting to 1.6 trillion JPY in 2015 no more than that of 2014. The very high pace of acquisition until the third quarter slowed down in the fourth quarter declining 43% y-o-y to 288 billion JPY. Acquisitions of retail stores and hotels increased by 63% y-o-y and 133% y-o-y respectively (Chart-19), while offices still accounted for the largest share of 42%. Three J-REITs went public with the number of J-REITs increasing to 52 with a total asset value of 14 trillion JPY. The funding environment has been comfortable with the J-REIT bond issuance conditions being 7.9 years and 0.67% (Chart-20).

Chart-18 TSE REIT Index



Source: Tokyo Stock Exchange

Chart-19 J-REIT Asset Acquisitions

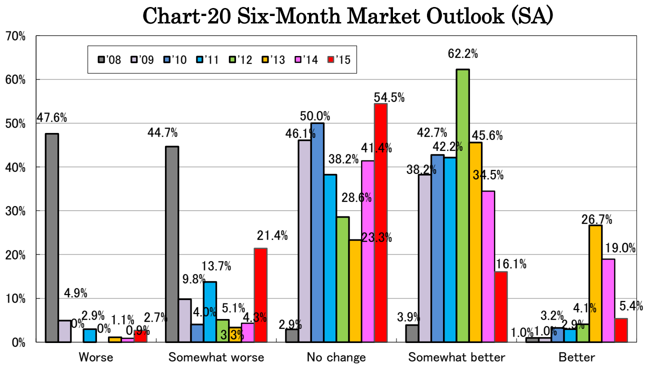


Source: NLI Research Institute

According to Nikkei Real Estate Market Information, the transaction volume of the Japanese property investment market declined by 13% y-o-y to 3.6 trillion JPY in 2015. The transaction volume of hotels doubled and acquiring property owner companies increased to avoid acquiring each physical asset at an expensive price.

In the property investment market survey conducted by NLI Research Institute[2], "Good" or "Somewhat good" responses accounted for nearly 90% of the responses in terms of the current sentiment for the third consecutive year. However,"Worse" or "Somewhat worse" responses in terms of six-month outlook outnumbered "Better" or "Somewhat better" responses for the first time in seven years (Chart-20, 21).

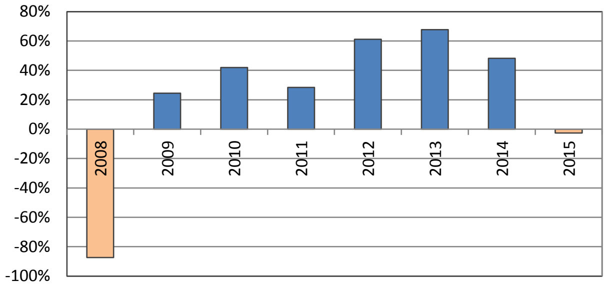
Chart-20 Six-Month Market Outlook (SA)



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

[2] Mamoru Masumiya "Utmost Optimistic Sentiment Still Rising, but Property Prices to Peak Out by 2017-The Eleventh Japanese Property Market Survey-" Real Estate Analysis Report, February 6, 2016

Chart-21 Six-Month Market Outlook (DI)



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

* 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.

