Real Estate Analysis Report

Cross Border Capital Flows into Japanese Properties in 2015

~Risk-Off Sentiment Restrains Property Transactions~

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Summary

- While the risk-off sentiment spread into financial markets all over the world, the transaction volume of Japanese properties shrank for the first time in four years in 2015.
- The volume of acquisitions of Japanese properties by cross border capital fell short of half of that of the same period one year ago in the second half of 2015.
- Cross border capital decreased acquisitions for all property sectors, however, Asian capital increased to acquire Japanese hotels.
- Cross border capital has shown an increasing preference for Tokyo.
- Both U.S. and Asian capital decreased acquisitions of Japanese properties.
- It is not likely that cross border capital acquisitions of Japanese properties will increase for the time being, however properties with a growth driver, or positioned to benefit from the better infrastructure of Tokyo will continue to attract cross border capital.

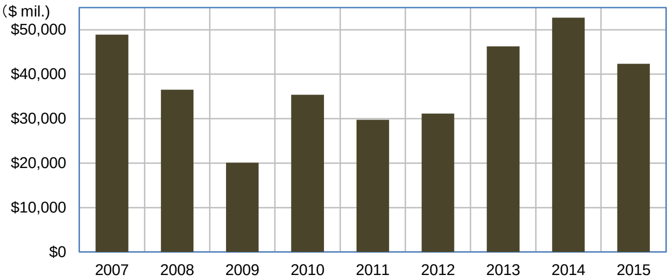
1. Transaction Volume of Japanese Properties

In the first half of 2015, the Japanese equity market rallied and an increasing number of sizable properties were transacted. However, once the Shanghai equity market plunged in August, the risk-off sentiment concerning the hard-landing of the emerging Chinese economy rapidly spread into financial markets all over the world.

The transaction volume of Japanese properties shrank for the first time in four years in 2015. According to Real Capital Analytics, the transaction volume of Japanese properties shrank by about 20% to 42.4 billion USD in 2015 (Chart-1). Though the transaction volume remained above the ten year average, the recent increase trend ended in 2015. Considering that J-REITs, which mainly acquire properties internally from their sponsors, acquired no less in 2015 than in 2014, open transactions such as those in auctions apparently shrank by a significant amount.

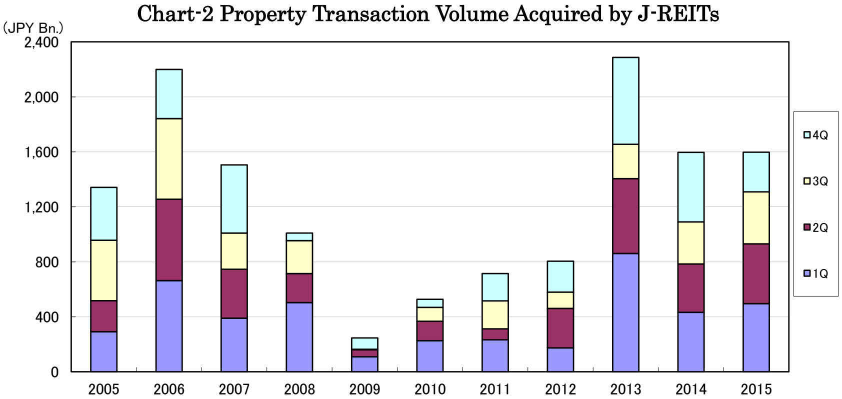
It seems the transaction volume declined because few purchasers accepted offered-prices immediately in the risk-off sentiment while owners did not hurry to sell their properties with no other alternative measures to secure certain income yields.

Chart-1 Property Transaction Volume in Japan



＊Data includes deals larger than $10mil. and does not include land deals.
Source: Real Capital Analytics www.rcanalytics.com

Chart-2 Property Transaction Volume Acquired by J-REITs



*Assets of new J-REITs are included at IPO
Source: NLI Research Institute

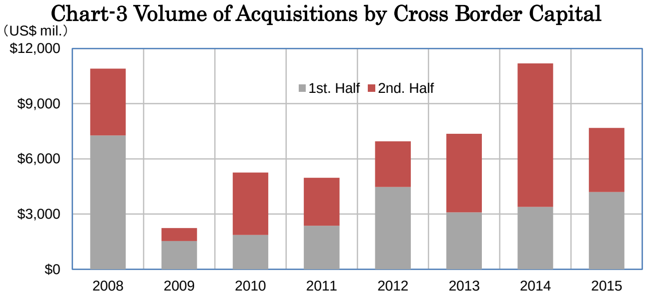
2. Volume of Acquisitions by Cross Border Capital

As cross border capital sometimes drives significant movement of property prices, monitoring its movement should be meaningful.

Cross border capital acquired USD 7,700 million of Japanese properties in 2015, declining by nearly 30% y-o-y (Chart-3).

The risk-off sentiment overshadowed cross border capital particularly in the second half of 2015. The volume of acquisitions exceeded that of the same period one year ago in the first half; however the volume fell short of even half of that of the same period one year ago in the second half of 2015.

Chart-3 Volume of Acquisitions by Cross Border Capital



＊Data includes deals larger than $10mil
Source: Real Capital Analytics www.rcanalytics.com

However, the volume of acquisitions did not desperately shrink and still remained as much as that in 2013, though the increasing trend of cross border capital acquiring Japanese properties ended in 2015.

Moreover, it should be noted that some large individual deals have had significant impacts on the volume number. For example, the largest deal in 2014, Government of Singapore Investment Corporation (GIC) acquiring Pacific Century Place, posted USD 1,700 million, while the largest deal in 2015, China Investment Corporation (CIC) acquiring Meguro Gajoen, posted USD 1,170 million. Just the gap of these two deals explains a volume decline of about USD 570 million.

3. Sector Preference

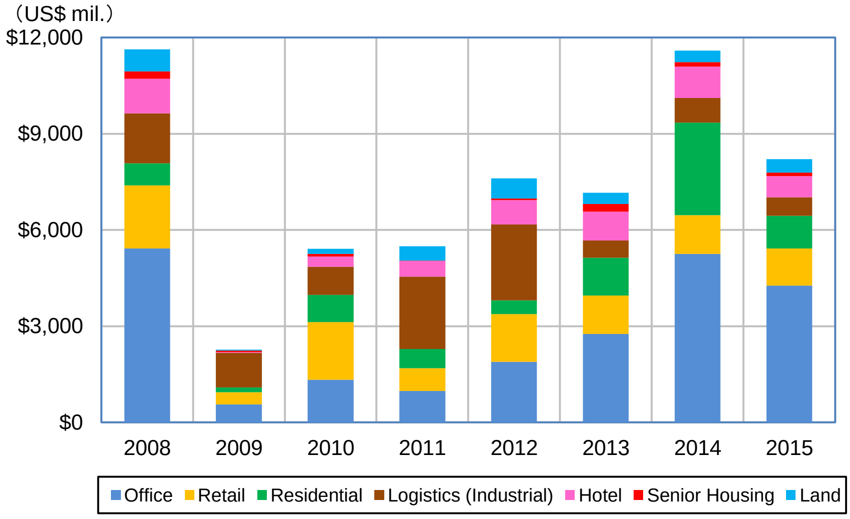
Cross border capital did not focus on any particular sector in 2015, acquiring fewer properties than that of one year ago in all sectors.

For instance, cross border capital acquired USD 660 million of Japanese hotels in 2015, declining by about 30% y-o-y. Though Japanese hotels recorded the highest occupancy rates through 2015 with nearly 20 million foreign visitor arrivals to Japan, cross border capital did not rush to acquire Japanese hotels.

The risk-off sentiment was particularly noticeable in the office sector which was mainly invested in by institutional investors. Cross border capital acquired USD 4,300 million of Japanese offices in 2015, declining by about 20% y-o-y. Cross border capital had become stagnant since the equity market plunge, and the volume of acquisitions stood at only USD 600 million over the four months through the end of 2015.

Moreover, cross border capital acquired USD 1,020 million of Japanese residential properties, declining by more than 60% y-o-y. The volume of acquisitions shrank significantly because Blackstone had acquired a huge residential portfolio totaling USD 1,440 million in 2014. However the volume of acquisitions in 2015 fell short of even that of 2013.

Chart-4 Volume of Acquisitions by Cross Border Capital by Sector

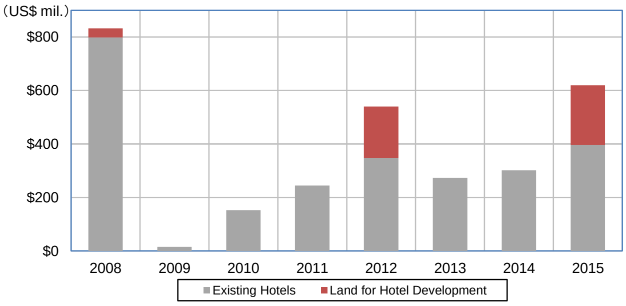


＊Data includes deals larger than $10mil
Source: Real Capital Analytics www.rcanalytics.com

However, Asian capital has been active in a certain area with growing inbound demand. Asian capital rushed to acquire Japanese hotels in 2015 (Chart-5). The recent inbound demand mostly consists of Asian travelers, mainly from China and ASEAN. Asian capital can make use of networks with Asian travel agencies and put acquired hotels into tours traveling from Asian countries to Japan.

What is more noticeable is that Asian capital acquired Japanese land for hotel development (Chart-5). Asian capital has been diversifying in hotel businesses in Japan, as Hong Kong based Great Eagle acquired land in Roppongi for developing a hotel under its own brand, Langham.

Chart-5 Volume of Hotel Acquisitions by Asian Capital

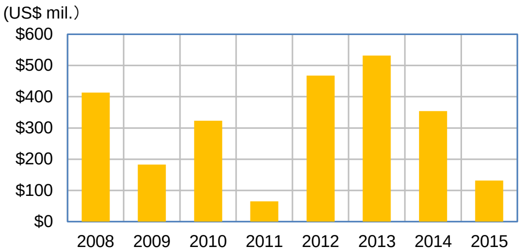


＊Data includes deals larger than $10mil
Source: Real Capital Analytics www.rcanalytics.com

Although retail properties have also benefited from the growing inbound demand, Asian capital has not proactively acquired Japanese retail properties yet (Chart-6).

In the matured and competitive Japanese consumer market, managing retail properties requires sophisticated skills. Well-experienced property funds in the U.S. sometimes acquire Japanese retail properties and western retail chains and luxury brands do so for their own stores. On the other hand, Asian capital rarely acquire Japanese retail properties, though Singapore or Hong Kong companies who have developed retail malls all over Asia are noticed occasionally.

Chart-6 Volume of Retail Property Acquisitions by Asian Capital



＊Data includes deals larger than $10mil
Source: Real Capital Analytics www.rcanalytics.com

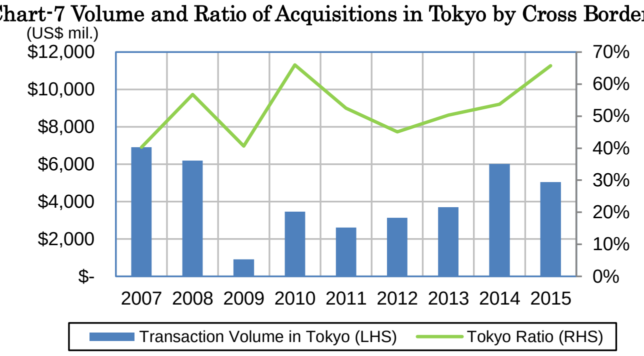
4. Concentration on Tokyo

Cross border capital has shown an increasing preference for Tokyo, with the ratio of acquisitions in Tokyo growing larger (Chart-7).

Incidentally, investment property stock in Japan has been diversified with growing sectors such as logistics and healthcare facilities, which are primarily located outside of Tokyo. Even with this diversification the ratio of acquisitions in Tokyo has been higher, suggesting the trend toward Tokyo cannot be ignored.

It looks like foreign investors are concerned about the nationwide stagnation of the Japanese economy due to demographic declination. On the other hand, Tokyo can expect to improve its infrastructure in preparation for the 2020 Tokyo Olympic Games. However, even in Tokyo, quite a few investors will appear to consider only short term investments until the Olympic Games. It is imminent thus to maintain and reinforce the competitiveness of Tokyo as one of the prime Asian cities from a long-term perspective.

Chart-7 Volume and Ratio of Acquisitions in Tokyo by Cross Border Capital



＊Data includes deals larger than $10mil
Source: Real Capital Analytics www.rcanalytics.com

5. Capital Inflows from the U.S. and Asia

The volume of Japanese property acquisitions by both U.S. capital and Asian capital declined by about 30% y-o-y in 2015. Though Asian capital increased its ratio slightly through the abovementioned aggressive hotel acquisitions, the volume of acquisitions by cross border capital shrank, regardless of the country.

While during the global financial crisis in 2009, U.S. capital drastically lost momentum as Asian capital maintained its pace, both declined to a similar degree in 2015 with U.S. capital holding steady and Asian capital suffering the effects of concerns over the Chinese economy.

Chart-8 Volume and Ratio of Acquisitions by U.S. Capital

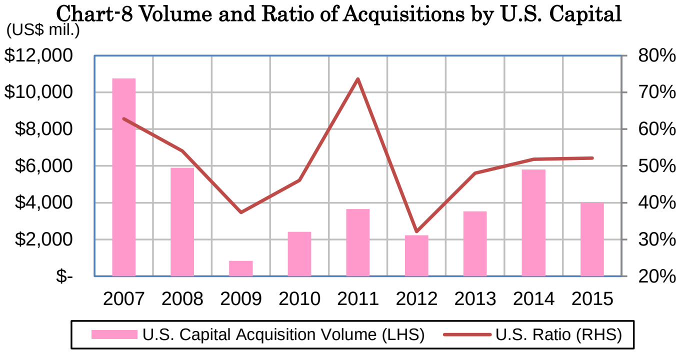
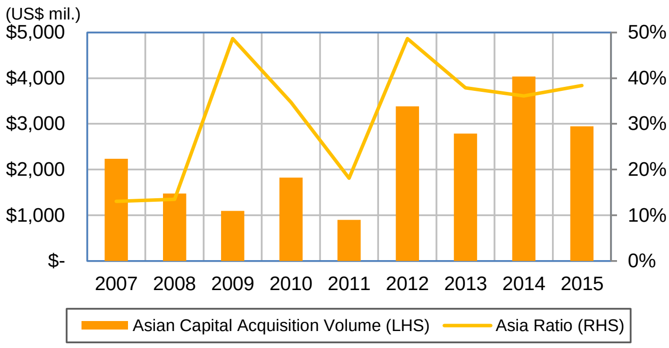


Chart-9 Volume and Ratio of Acquisitions by Asian Capital



6. Final Note

In contrast to financial markets, the Japanese property market has not been noticeably affected by the risk-off sentiment. Leasing markets have been improving as representative Tokyo office rents continue rising (Chart-10), and quite a few market participants still forecast property prices to appreciate for the time being[1] with the stagnating equity market (Chart-11). In addition, the recent negative interest rate policy will possibly push excess liquidity into the property investment market.

However, different from the equity market where stock prices are available every day, the movement of property prices is difficult to grasp with limited transaction data. Therefore, transaction volume is considered as important data to understand the property investment sentiment, however, as seen above, the transaction volume declined in 2015, and, in particular, acquisitions by cross border capital declined noticeably.

Chart-10 Tokyo Office Market

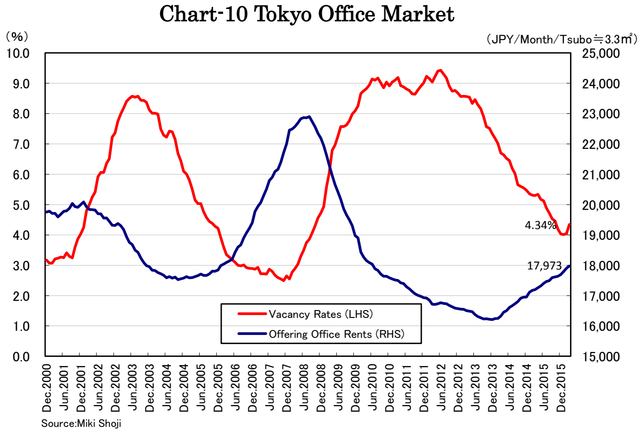
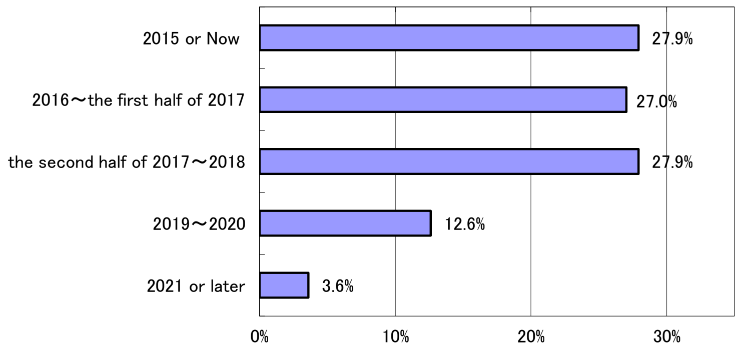


Chart-11 Peak Period of Property Prices



Source: NLI Research Institute, January 2016

With the uncertainty concerning the hard-landing of the emerging Chinese economy and the pace of U.S. economic growth, accompanied by the appreciation of the Japanese yen, it is not

[1] Mamoru Masumiya "Outlook Reverses, Divergence in Forecasts of Property Price Peak from 2015 to 2018～The Twelfth Japanese Property Market Survey～" Real Estate Analysis Report, February 2, 2016

likely that cross border capital acquisitions of Japanese properties will increase for the time being. What is closely monitored is how much domestic capital generated by the negative interest rate policy will support the property investment market.

Although the trend of increased cross border capital acquisitions of Japanese properties ended in 2015, acquisitions of Japanese hotels by Asian capital still increased. As seen in the hotel case, properties with a growth driver, or positioned to benefit from the improved infrastructure of Tokyo will continue to attract cross border capital.

