Real Estate Analysis Report

Interest Rate Concerns Emerge, Property Prices Forecasted to Decline after Going Sideways

～The Thirteenth Japanese Property Market Survey～

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Summary

- The thirteenth annual *property market survey* indicated that the current sentiment remained strong with "Good" or "Somewhat good" accounting for 74% of responses, declining however from around 90% of responses over the past three years.
- Regarding the six-month outlook, "No change" accounted for two-thirds of the responses, suggesting the market has lost direction.
- When asked which property sectors were the top three preferable investment targets in terms of price appreciation and market growth, "Hotel" ranked first, selected however by 20% less respondents than last year.
- When asked which risk factors were the top three influential concerns for the property investment market, "Interest rates" ranked first followed by "the U.S. and EU economies" at second.
- Regarding the J-REIT market forecast, 72% of respondents selected "0~+15%" of return for the TSE REIT index in 2017.
- Finally, when asked about a likely pathway of property prices in Tokyo, "Go sideways for a while and decline before or after the 2020 Tokyo Olympic Games and thereafter" accounted for about 40% of the responses.

Introduction

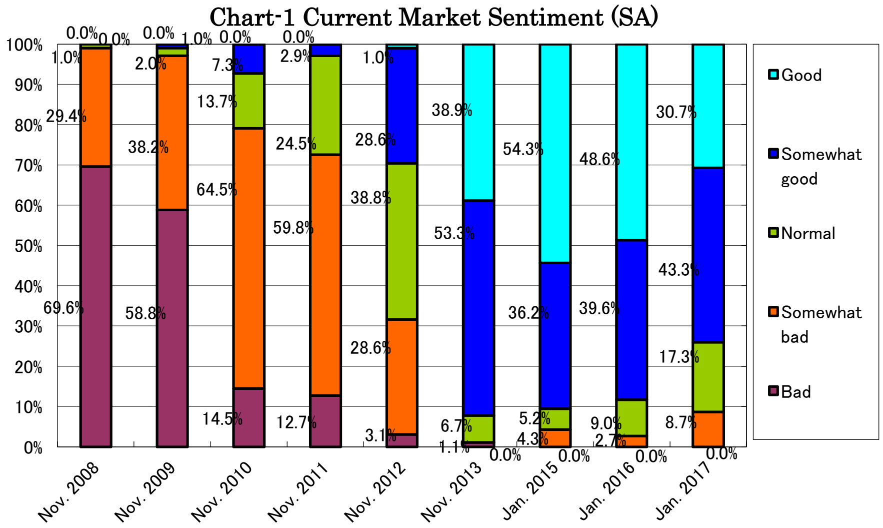
NLI Research Institute conducted the thirteenth annual *Property Market Survey* of investment market sentiment among Japan-based property professionals[1]. This time we sent out 196 questionnaires by email on January 5, 2017, and received 127 valid responses by January 13 (65% collection rate).

Results

1. Current Sentiment

Regarding the current sentiment in the property investment market, “Good” or “Somewhat good” accounted for 74% of responses, declining however from around 90% of responses over the past three years (Chart-1). The sentiment apparently lost some steam, but still remains very healthy with “Somewhat bad” responses accounting for less than 10% of the responses.

Chart-1 Current Market Sentiment (SA)



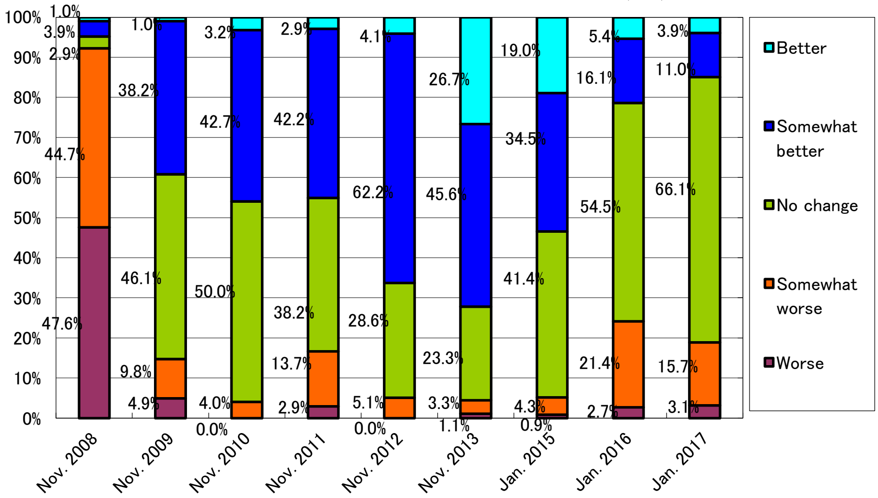
Source; NLI Research Institute, *Property Market Survey* 2008～2017

2. Six-Month Outlook

Regarding the six-month outlook of the property investment market, “Somewhat better” or “Better” anticipating higher prices or more transactions declined to 14.9% after peaking out last year (Chart-2). However, “Somewhat worse” or “Worse” also declined and the overall outlook did not necessarily deteriorate (Chart-3). Thus, “No change” ranked first, selected by the largest ever 66.1% of respondents. The property investment market seems to remain stable supported by the BOJ attempting to adjust 10-year-bond yields to around 0%. Not only that, but it seems not a few players cannot read the market direction with the uncertainty of how the new U.S. government will impact the global economy.

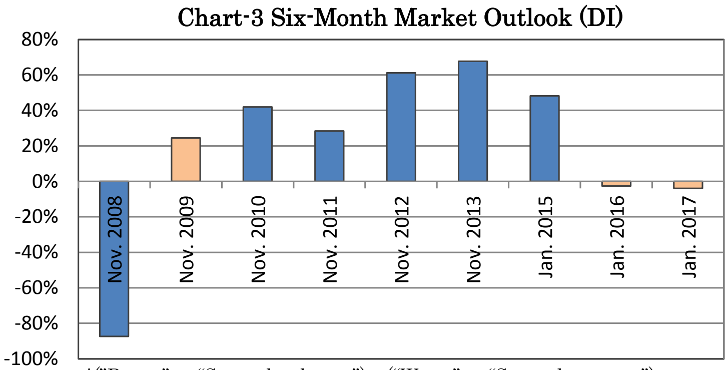
1 The Japan-based property professionals are those engaged in various work such as development, construction, banking, insurance, brokerage, property management, fund management, advisory, consulting, research and publishing.

Chart-2 Six-Month Market Outlook (SA)



Source; NLI Research Institute, *Property Market Survey* 2008～2017

Chart-3 Six-Month Market Outlook (DI)



*("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, "Hotel" ranked first for the third consecutive year, selected by 60.6% of respondents (Chart-4), which, however, was 20% less than last year (Chart-5). "Hotel" is still regarded as a promising sector and many new projects are actively developed. However, the pace of foreign visitor increase has slowed recently and the number of hotel stays in Japan has been shrinking y-o-y almost every month. In addition, private accommodation units operated with Airbnb and others have grabbed some market share from hotels.

Besides the slowing growth of foreign visitors, consumption per visitor during stays in Japan declined significantly[2]. This has brought a noticeable reduction in sales of luxury goods at department stores and retail malls. Thus, "Urban retail" declined to 20.5%.

"Healthcare property" or "Logistics facility" remained at high ranks, selected by 39.4% and 37.8% of respondents, respectively. Even though healthcare properties are difficult to invest in

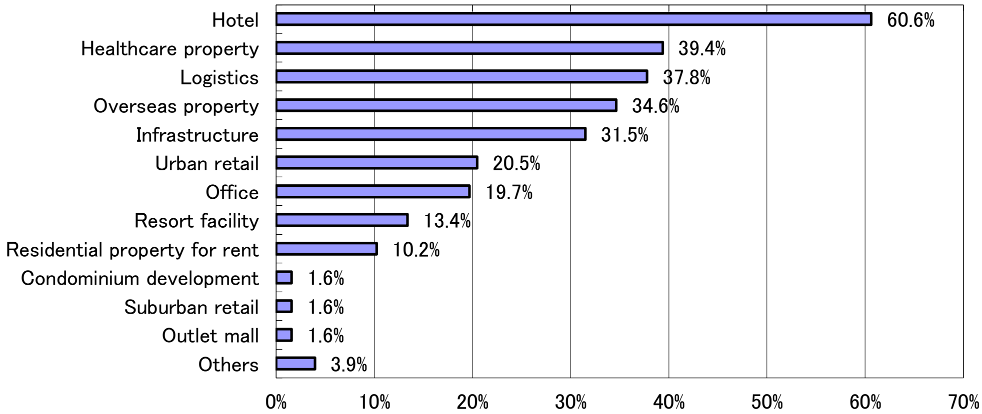
[2] Mamoru Masumiya "Japanese Property Market Quarterly Review, Third Quarter 2016-Inbound Demand Peaks Out Affecting Retail Stores and Hotels-" Real Estate Analysis Report, November 8, 2016

due to the small size of individual assets, and the logistics market is suffering from the recent supply glut, both sectors have been regarded as high growth markets for the medium to long term.

"Overseas property" rose noticeably to 34.6%. In addition to growth opportunities in Asia, many investors have become interested in the U.S. in order to capitalize on Trump's America first policy.

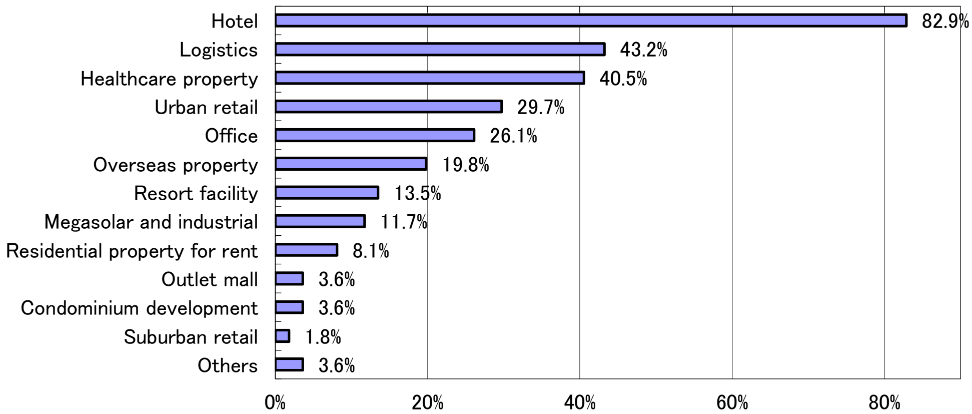
"Infrastructure" also ranked high, selected by 39.4% of respondents. Several privatization cases of local airports have been progressing, thus the Japanese infrastructure investment market has become diversified from the solar panel-oriented market. In the current low property yield conditions, many investors have become interested in infrastructure investment.

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



Source: NLI Research Institute, January 2017

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



Source: NLI Research Institute, January 2016

4. Risks for Property Investment

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

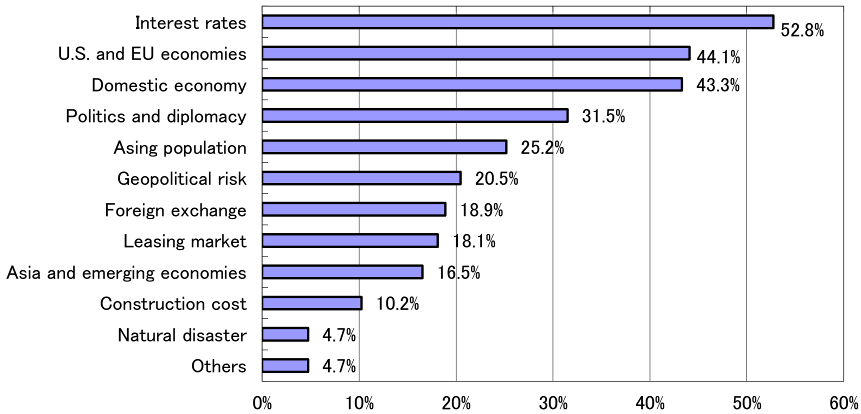
This time, "Interest rates" ranked first for the first time, selected by 52.8% of respondents (Chart-6). Despite the BOJ attempting to adjust 10-year-bond yields to around 0%, the boost of

U.S. bond yields have brought concerns that Japanese bond yields will also rise sooner than previously expected.

"The U.S. and EU economies" ranked second, selected by 44.1% of respondents. While "Global economy" ranked first, selected by 79.3% last year (Chart-7), the main concern at that time focused on the Chinese economy. This time, with "Asia and emerging economies" moderating to 16.5%, attention on the market has focused on whether the new administration of the U.S. government can meet the high market expectations. Of course, the economy of the EU has also been a sizable concern with the progressing U.K. withdrawal.

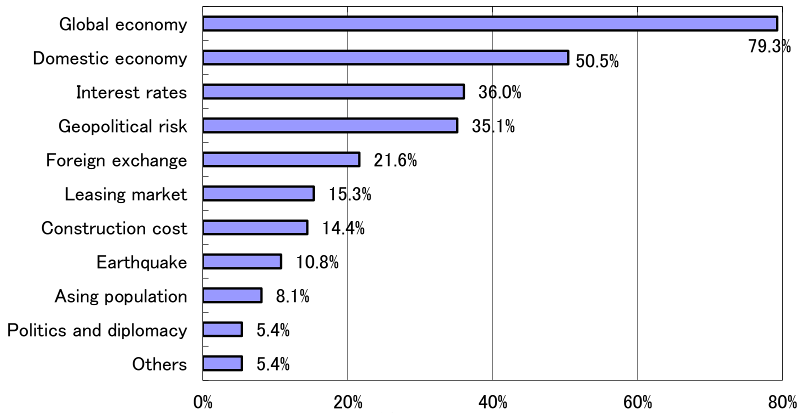
Similarly, "Politics and diplomacy" drew attention, selected by 31.5% of respondents. Japanese exporters are heavily concerned about rising protectionism, with the U.S. dropping out of the TPP and seeking renegotiation on NAFTA. In Europe, important elections scheduled in 2017 could bring another country to follow the U.K. and withdraw from the EU. In Asia, it is possible that new U.S. diplomatic measures may impact tensions surrounding the South China Sea and the South Korean president-to-be could damage the fragile relationship with Japan.

Chart-6 Current Anticipated Risk Factors (MA3)



Source: NLI Research Institute, January 2017

Chart-7 "Last Year" Current Anticipated Risk Factors (MA3)



Source: NLI Research Institute, January 2016

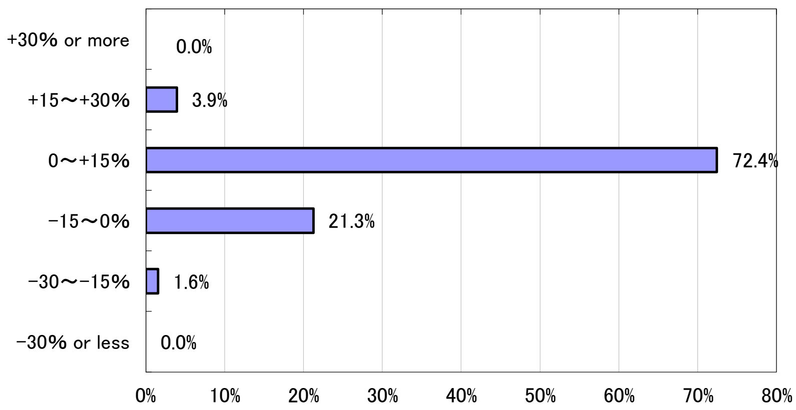
5. J-REIT Performance Forecast for 2017

Regarding the J-REIT market forecast, 72.4% of respondents selected "0~+15%" of performance for TSE REIT index in 2017 (Chart-8). More than 90% of the respondents forecasted that the J-REIT prices will stay within a range of ±15% at the end of 2017.

Underperforming against equities after the U.S. presidential election, J-REIT prices apparently have some room to appreciate. However, few forecasted a high performance as market attentions shifted from the benefits of interest rate decline to the effects of interest rate hike. Thus, property rents are required to rise for J-REIT prices to appreciate as equities, while the America first policy will not directly impact the Japanese domestic economy nor boost property rents in Japan.

On the contrary, J-REIT prices will show relative resilience in case of a market correction disappointed under the Trump administration, as easing concerns about interest rate hike or investors who prefer yields of J-REITs will support J-REIT prices.

Chart-8 2017 J-REIT Performance Forecast (SA)



Source: NLI Research Institute, January 2017

6. Likely Pathway of Property Prices in Tokyo

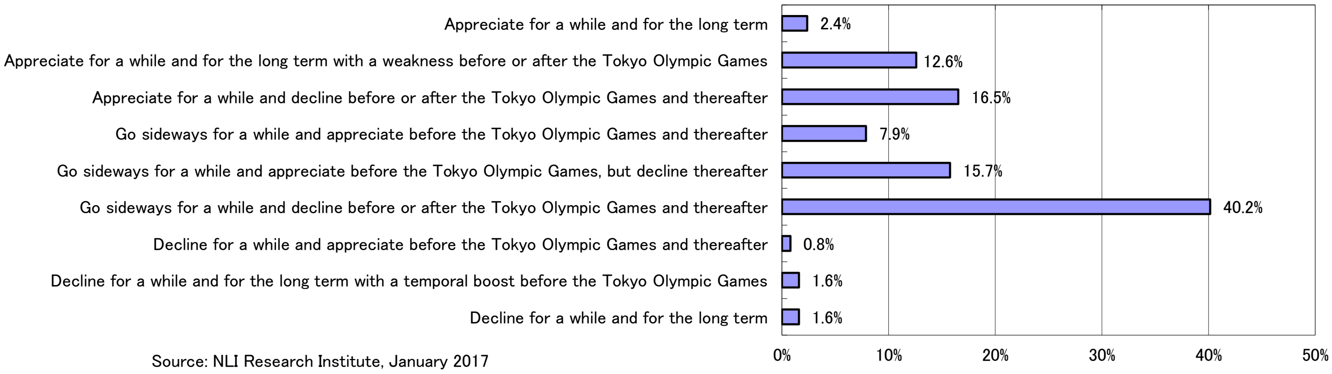
Finally, when asked to select a likely pathway of property prices in Tokyo, "Go sideways for a while and decline before or after the 2020 Tokyo Olympic Games and thereafter" ranked first, selected by 40.2% of respondents (Chart-9).

For a while, considering the recent equity market recovery and the BOJ attempting to adjust 10-year-bond yields to around 0%, the concern about property price decline is quite limited with "Go sideways" and "Appreciate for a while" selected by about two-thirds and one-third of respondents, respectively.

However, regarding property prices before or after the 2020 Tokyo Olympic Games, the responses anticipating a property price decline accounted for more than 70% of responses. Glut of office supply is scheduled in 2018, 2019 and 2020, and the consumption tax rate hike to 10% is scheduled in October 2019. Around that time, exit measures of the monetary easing policy should be discussed. Besides these, not a few investors who bought properties expecting price appreciation until the 2020 Tokyo Olympic Games should consider selling out.

Regarding property prices for the long term, “decline thereafter” accounted for nearly 80% of responses. It seems few players expect the Olympic event to make Tokyo more competitive as an international city or future inflation to support property prices for the long term. As the Tokyo metropolitan government forecasts the population of Tokyo will begin to decline after 2020, it seems structurally difficult to expect property prices to appreciate for the long term.

Chart-9 Tokyo Property Price Forecast (SA)



Source: NLI Research Institute, January 2017

*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 secure or violate any contracts.

