Colliers Halifax
Japan Investment Update 2009

- **Land values declining markedly in all sectors and geographic areas. The rate of decline may ease as early as the end of this year.**
- **The real estate investment market continues to become more institutionalized. Equity will drive the market more than debt.**
- **Japan remains a very attractive investment market based upon its low political risk, strong legal framework, positive cash spread, size and liquidity.**
- **Tokyo office rental market has turned after years of steady rental growth. Negative net demand, due to difficulties in the financial sector and overall economy, started the downturn. Continuous new supply at relatively high levels will amplify the trend.**
- **Regional city office markets will have a tougher time than Tokyo in terms of oversupply in the face of weak demand and downward pressure on rents as vacancies continue to increase.**
- **New condo supply has declined for 4 straight years to historic lows.**
- **The torrid pace of real estate related corporate bankruptcies, which picked up dramatically in 2008, appears to have subsided, indicating the end of "phase one" of the ongoing market correction.**
- **Financing for new real estate acquisitions remains difficult. Margins have widened significantly with LTV's typically in the 50~60% range. The same goes for refinancing terms on properties for which the fair market value may have declined significantly.**
- **JREITs face similar problems regarding refinancing, but government credit support, mergers and new sponsors should all help to prevent a sell-off and further deterioration of asset values.**

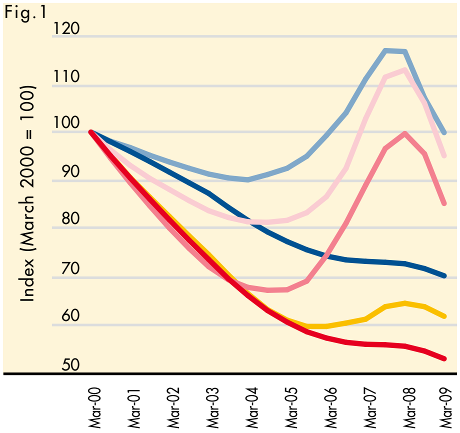
OFFICE

Nationwide average Posted Prices (Koji-kakaku)[1] of all property sectors declined in 2008 for the first time in several years. Commercial land was down -4.7% year-on-year (Y-o-Y). Larger declines were evident in the central areas of the 3 major cities compared to their respective suburbs, with -8.1% in Tokyo outpacing -6.3% in Osaka and -5.9% in greater Nagoya. The trend of declining values has continued during 2009. Koji-kakaku is a government statistic which typically lags the market. Further declines are likely into 2010, with Tokyo stabilizing sooner than regional cities.

The Tokyo office leasing market has fallen significantly over the past year. Negative net demand, brought about by macroeconomic conditions and the financial crisis, combined with greater supply has forced landlords to accommodate tenants for the first time in about 5 years. Supply of new office space is expected to come onto the market at medium levels for 2009 and 2010, but then increase to above average levels in 2011 and 2012, pressuring landlords further.

Land Prices Falling

Fig. 1



Six Large Cities: Tokyo, Yokohama, Nagoya, Kyoto, Osaka, Kobe

Source: Japan Real Estate Institute , Colliers Halifax Research

Vacancy rates have increased most notably in centrally located Most Competitive (Class A) properties, up to 7.5% from only 2.5% at this time last year. Effective rents for these properties are being marked down rapidly, already down in some cases to 2003 levels. Very few tenants are seeking Class A space above 40,000 (yen/tsubo/month including common expenses). Vacancy will increase in the Competitive sector and less central properties in the coming year.

Owners of existing Tokyo office buildings and investors targeting this asset class will need to be vigilant of market developments and pro-active in their management of owned assets during what is expected to be a challenging, but manageable period. Underwriting and asset management fundamentals will once again trump easy credit and market movement plays.

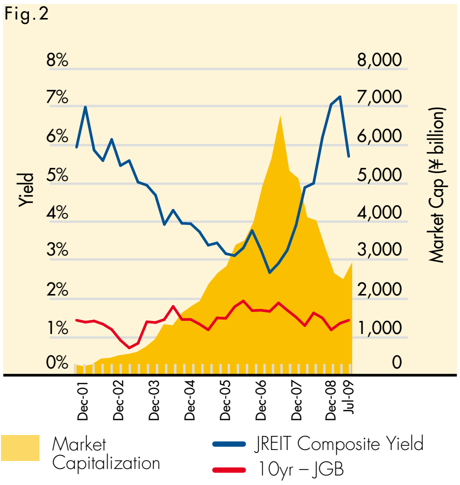
Sales activity almost ground to a halt in the first half of 2009. The expectation gap between bids and offers remains quite wide. The rise in cap rates appears to be leveling off. Interest in regional cities has all but evaporated. Tokyo office buildings are faced with both declining rents and occupancy rates. Buyers and sellers are having difficulty agreeing on average stabilized rents over the intended holding period.

Weakness in the investment environment has been exacerbated by a constricted credit market. Non-recourse loans continue to be difficult to obtain for anything less than the best quality buildings in good locations. Many deals remain pending as investors wait for an improvement in loan pricing, including up front fees and interest rate spreads. However, the positive spread between NOI yields and financing costs, compared with that of other countries, continues to encourage foreign capital investors to target the Japanese market.

The market capitalization of the 41 listed JREITs has recovered somewhat after declining more than 60% since mid-2007. After the first JREIT bankruptcy in October 2008, the government moved quickly to develop a support program that includes clarification of tax rules for mergers, tightened standards for listings, and the creation of a public/private fund which will be a lender of last resort. The first merger has been announced for early 2010, with several more expected to follow. The composite yield for JREITs rose from a low of 2.5% to a peak of 7.2%, and appears to be stabilizing at around 6%. Almost no new property acquisitions have occurred during this difficult period of consolidation. The current weighted average debt to asset ratio of the JREIT market is about 45%, based on stated asset values.

Market Cap Stabilizing

Fig. 2



Source: Compiled by Colliers Halifax from publicly available data

Stratification of the Tokyo Office Market

The stratification of the market into sections – each a combination of location, building quality and price.

Source: Colliers Halifax Research

Fig. 3

	Most Competitive Buildings (A)	Competitive Buildings (B)	Least Competitive Buildings (C)
Building Attributes			
Age:	**New** 1995 or later	**Mid-aged** 1985-1995	**Old** 1985 or older
Floorplate Size:	**Large** 200 tsubo or more	**Medium** 100-200 tsubo	**Small** 100 tsubo or less
Physical Features:	**Intelligent**	**Semi-intelligent**	**Non-intelligent**
	OA floor, 24 hr. use, ample power, A/C and cabling space	Capacity to upgrade existing facilities	Limited capacity to upgrade
Tenant Risk:	**Financially stable tenant**	**Fairly stable tenant**	**Financially unstable tenant**
Seismological Risk:	**Earthquake resistant beyond current code**	**Meets current code**	**Earlier code applies**
Location:	**Central, convenient transportation**	**Relatively convenient**	**Distant, inconvenient transportation**
Market Response			
Vacancy Rates:	**Low** 0-10%	**Medium** 7-15%	**High** 12-25%
Rents:	**Declining**	**Downward Pressure**	**Downward Pressure**
Demand/Supply:	**Weak/Increasing**	**Weak/Increasing**	**Weak/Ample**

RESIDENTIAL

The average Koji-kakaku of residential land decreased by -3.2% nationwide in 2008, led by greater Tokyo at -4.4%, Osaka -2.0% and Nagoya -2.8%. Regional cities lag the Tokyo market and typically fell by less than the national average. New construction fell to record low levels, due to declining income, rising unemployment, construction costs and a lack of credit.

Between June 2008 and May 2009, some 86 large (liabilities of more than ¥3 billion) real estate related companies went bankrupt in Japan, totaling ¥3.5 trillion in liabilities among them. This extremely high level of bankruptcies appears to finally have subsided, but the markets will continue to deal with the aftermath.

Housing starts, a leading indicator of residential investment, continued to decline through early 2009 at a precipitous pace. New condominium supply in the two largest markets, Greater Tokyo and Kinki, declined -28% and -23% respectively in 2008 Y-o-Y. They are projected to decrease again in 2009, for the fourth straight year, by another -20% and -9% respectively.

Although cap rates have moved upward, residential continues to represent a less volatile investment than other sectors, due to relatively stable occupancy, the existence of more transactional comparables for both sales and rents, and a higher degree of liquidity. Smaller companies and high net worth individuals have been contributing to liquidity for transactions below ¥1 billion.

Rents on high-end residential in the central 3 residential wards of Tokyo have declined over the one year period ending June 2009, from the 17,500 (yen/tsubo/month) level to around 15,000, as expats from the financial sector retreated in droves and vacancies increased from around 7% to 10% in the same time frame.

ECONOMY

Industrial output grew 8.3% in April-June after falling a record -22.1% in the previous quarter, helping the economy return to growth in the second quarter following the deepest recession since World War Two.

Revised figures showed the world's second-largest economy grew an annualized 2.3% in the three months ended June, the first expansion in five quarters. However, exports are still down more than -37% Y-o-Y and business investment spending has declined for 9 consecutive quarters.

Japan's industrial output grew for the fifth month in July as global stimulus spending boosted exports, but demand brought about by these temporary measures should soon fade. An expected slowdown may be exacerbated by weak domestic demand in the face of the worsening job situation

Japanese wage earners' total cash earnings dropped -4.8% in July from a year earlier, after falling a record -7% in June. With the jobless rate jumping to a post-war high and companies under pressure to cut costs, downward pressure on wages is expected to continue. This could add to the deflationary pressures in the economy.

[1] *Koji-kakaku (Posted Price): The Ministry of Land, Infrastructure and Transport's annual appraisal of 28,227 nationwide sites by 2,741 appraisers. Valuations are assessed as of January 1st each year and the data released in March.*

[2] *Rosenka (Roadside Price): The National Tax Agency's annual assessment of prices along most major roads in urban areas throughout Japan. Valuations are assessed with reference to Posted Prices and the data released in July.*

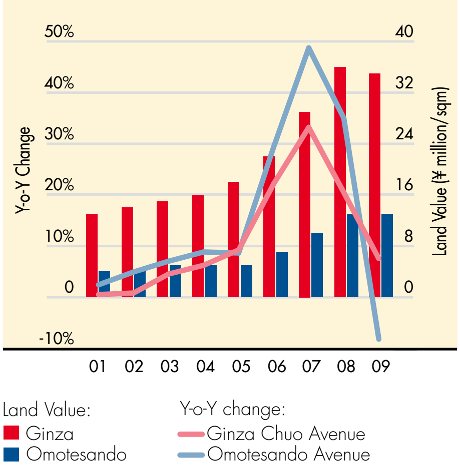
RETAIL

Household income is declining. Private consumption has also decreased significantly. Anxious consumers are holding back on non-essentials in the face of record levels of unemployment and uncertainty about the direction of the economy. Department stores, and more recently supermarkets, continue to experience a steady decline in sales. Items associated with thriftiness and other essentials are the primary exceptions to the overall decline in consumption patterns. Even convenience stores, after the recent "taspo bump", are now experiencing difficulties and seeking new alliances to improve performance.

Land prices in Ginza and Omotesando are declining from recent peaks. The highest Koji-kakaku as of January 2009 showed slight declines from the previous year, -2.5% for Ginza and

Prime Retail Declining

Fig.4

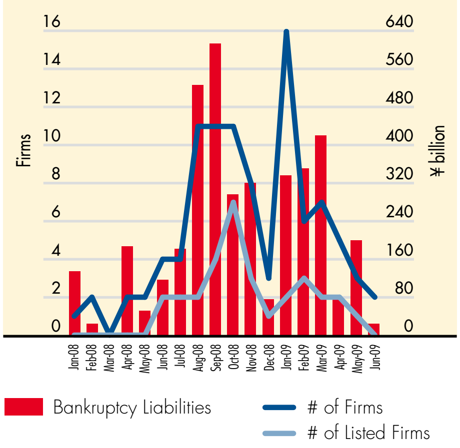


Land value: Koji-kakaku[1]
Y-o-Y changes: Rosenka[2]

Source: National Tax Agency, Ministry of Land, Infrastructure, Transport and Tourism, Colliers Halifax Research

Bankruptcies Peak

Fig.5

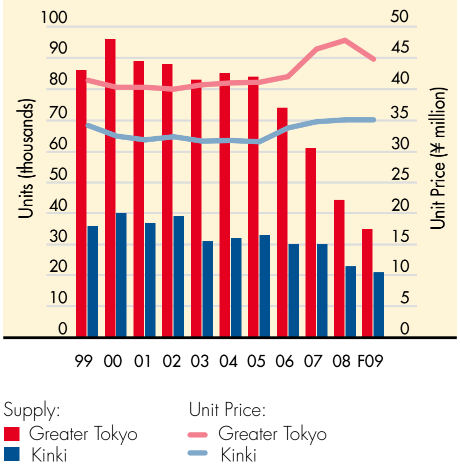


Bankrupcies of Real Estate related companies

Source: Compiled by Colliers Halifax from publicly available data

Even Fewer Condos

Fig.6

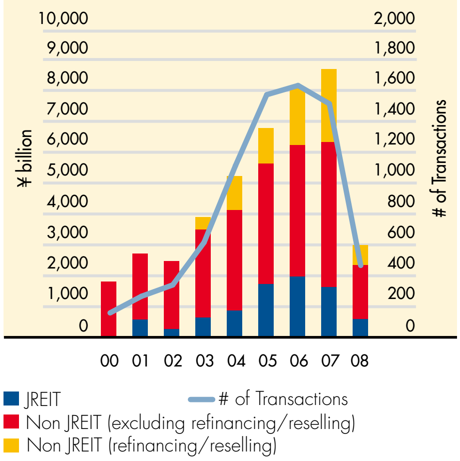


New Condominium Supply
Greater Tokyo: Tokyo, Kanagawa, Chiba, Saitama
Kinki Area: Osaka, Hyogo, Kyoto, Nara, Shiga, Wakayama

Source: Real Estate Economic Institute Co. Ltd, Colliers Halifax Research

Activity Plummets

Fig.7



Real Estate Securitization Transactions

Source: Ministry of Land, Infrastructure, Transport and Tourism, Colliers Halifax Research

-5.6% for Omotesando. Prices are expected to continue falling considerably in all but the very best locations.

Retail property sales activity has dwindled and very few development plans are proceeding. Brands are postponing or even cancelling commitments to new sites and pulling back from some department stores and secondary locations. Some brands are even contemplating vacating flagship shops.

Overall retail rents in prime districts have declined -10-30% over the past year, depending on location. In Ginza, Chuo-dori shop location demand remains more stable, as brands focus on prime locations that offer an attractive shopping experience for consumers. Demand is also relatively resilient in prime Omotesando.

Nationally, 26 more shopping centers were added to the 2008 year-end total of 3,006. Significant increases to floor area throughout this sector continue to put pressure on sales per floor area figures, particularly in the suburbs.

Global Investment Sales

Fig.8

City	2009 H1 (US$ million)	% Change
Tokyo	6,586	-46.4%
London	3,600	-63.4%
Paris	1,720	-73.0%
Seoul	1,638	-25.9%
NYC Metro	1,221	-85.8%
Moscow	872	-0.2%
Shanghai	780	-12.4%
Munich	744	139.7%
Madrid	743	-55.4%
Hong Kong	730	-75.0%
Osaka	417	-79.8%
Total (Weighted avg.)	19,051	(-60.3%)

Office - Top 10 Cities + Osaka (#19)

Source: Real Capital Analytics, Colliers Halifax Research

INDUSTRIAL

The average Koji-kakaku of industrial land declined in the major metropolitan areas for the first time in three years, down -3.0% on average nationwide. Greater Tokyo declined -2.7%, Kinki -1.9% and Chubu -2.8%.

The industrial sector in Japan continues to evolve into an institutionally accepted investment property type, led by foreign developers and investors as well as major local players. The period of strong demand for larger and more efficient logistic centers through the early part of this decade ultimately led to over-building, as tenant demand finally succumbed to macroeconomic pressures. This sector is now going through a period of consolidation. Restructuring of demand in the automobile and other manufacturing sectors, the availability of existing vacant stock, and rising construction costs mean some new development plans will be postponed or even cancelled in the foreseeable future. Industrial land banked by developers is being re-priced and coming back to the market.

Although the development pipeline has been experiencing difficulties of late, well tenanted properties in good locations owned by several JREITs have outperformed the JREIT total return weighted average over the past 3 years, due to the relative stability of this property type.

Factory and warehouse construction starts continued to decline in 2009 due to economic conditions and vacancy. Several projects have been put on hold or cancelled.

1 tsubo = **3.3** sq.m = **35.5** sq.ft

1 hectare = **10,000** sq.m

1 acre = **4,047** sq.m

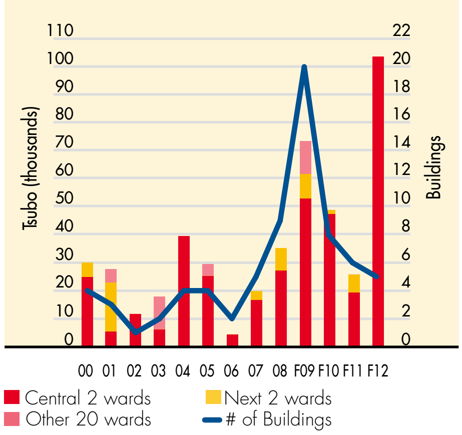
OSAKA

Weak demand combined with over-construction from 2009 through 2012 will continue to place severe pressure on occupancy and rent levels. Landlords of Most Competitive stock completing in 2009-2010 are being forced to adjust rent expectations dramatically downward while increasing concessions including free rent and tenant improvement allowances. Existing office buildings are also pro-actively and competitively marketing increasing vacancy. Less-central Shin-Osaka and the waterfront are struggling.

Record levels of new office supply completing in 2009, returning to historical averages in 2010-2011, only to be exceeded again in 2012. Of the 74,000 net tsubo to be completed in 2009 (a level not reached since 1990), some 70% of it is concentrated in the greater Umeda and Yodoyabashi/Honmachi areas.

Osaka Office Glut

Fig.9



Osaka Net Rentable Office Space 3,000 tsubo or greater
Central 2 wards: Kita-ku, Chuo-ku Next 2 wards: Nishi-ku, Yodogawa-ku

Source: Colliers Halifax Research

Investor interest has ground to a halt along with financing. With the exception of a couple of sale-leasebacks, JREIT transfers, and redevelopment plays, there have been almost no office CBD transactions of any size. Uncertainty about the long-term effects of office oversupply and slumping rents have made many investors wary.

Well-located properties managed with a realistic view of stabilized rental income still represent good value. Some investors will benefit from overly negative market sentiment by acquiring undervalued assets during this downturn. A gap remains between buyers' and sellers' expectations requiring a further market correction to close.

With banks unwilling to provide satisfactory financing terms for residential investment, foreign capital and larger domestic funds have essentially withdrawn from the market, leading to very few transactions for larger residential properties. However, as residential rents tend to be more stable, cash-rich local firms and private investors, often encouraged by their lenders, have begun acquiring smaller assets (less than ¥1 billion) seeking net yields of 8~10%. Newly completed properties with high occupancy in central locations or good transportation access have enjoyed popularity among this property type.

Over-construction has combined with the slump in the global economy to put tremendous pressure on the industrial sector. Some large-scale logistics facilities that completed in early 2009 in the Kansai market are still struggling to find even a single tenant. Some planned projects have been terminated and the land sold off at a significant loss. Investors are seeking net yields of 11~12%.

Strategic Investment/Divestment: The Colliers Halifax Approach

1. Qualified Real Estate Professionals

– Ensure our activities never represent a conflict of interest.
– Apply consultants' in-depth, wide-ranging market expertise.
– Utilize experience on a wide range of transactions of varying size, nature, and complexity.
– Focus on strategy review and development for maximum client returns.

2. Comprehensive Research and Analysis

– Review real estate requirements.
– Evaluate supply and demand, price trends, ownership structure and financing.
– Investigate the property's condition, potential liabilities, projected returns.
– Prioritize, e.g. sale/purchase price, location, product type, timing, ROE, ROA.

3. Consider the Options

– Buy, hold, sell depending on market factors and existing portfolio.
– Improve returns on existing portfolio.
– Change ownership structure to enhance returns or facilitate a sale.
– Sale-leaseback, purchase versus lease, redevelop and sell, exchange, others.

4. Develop a Strategy

– Negotiate from a position of knowledge and strength.
– Maximize leverage by understanding all alternatives to purchase/sell/lease.
– Create momentum to maximize value at time of purchase/disposal.
– Be pro-active; apply client strategy to the market.

5. Monitor and Review

– Market conditions and corporate objectives change.
– An up-to-date strategy is required for investors and owner-occupiers alike.
– Portfolio strategy should be reviewed regularly.
– A qualified consultant will continually update a client with market information.

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