

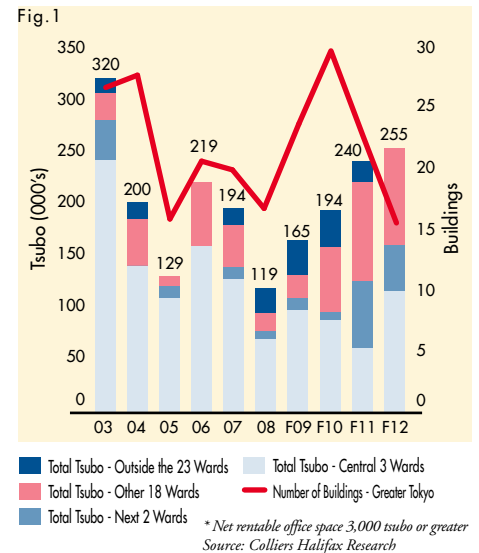
“Space reductions have been the main feature of the market this year. Tenant focus has been squarely on cost cutting and capital preservation. Supply will supplant Demand as the key factor in the market over the next several years. Relocations will increase.”

Increasing from 2009. Large building completions were up by nearly 39% during the year to 165,000 tsubo (5,900,000 sf) in greater Tokyo. The 2010 supply of 194,000 tsubo (6,900,000 sf) represents a further increase of more than 17% over 2009. Both years represent a medium supply level. In 2011 and 2012 these figures move well into the large range. Supply will supplant Demand as the key factor in the market over the next several years.

New and existing **Most Competitive** buildings are under pressure. Smaller and older stock will begin to face challenges from larger and newer properties. New, but less central buildings will increasingly place stress on buildings in more prime locations. **Competitive** buildings are likely headed into multiple years of weakness as competition for tenants intensifies.

A larger percentage of the total supply will be delivered outside core Central Business District

Increasing Supply



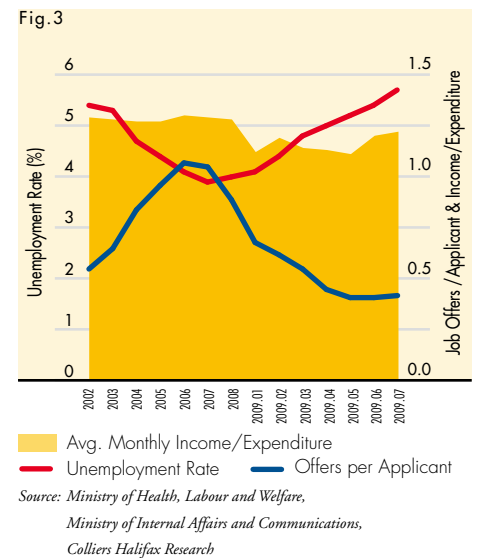
DEMAND

Collapsed during 2009. Tenants turned cautious on rents in 2008 before changing focus to space requirements. Major space reductions have been the defining feature of the market this year. Overall, demand has been nil to negative across most industries. Tenants are reluctant to invest the capital required to relocate and have focused on reducing space in buildings currently under lease. Larger blocks of vacant space are increasingly common. Contracting demand has been the main theme in the market.

Most Competitive properties are struggling. Buildings completing from mid 2008 have found pre-leasing difficult and post-completion vacancy hard to fill. Existing stock enjoys only weak and highly price-sensitive demand when tenants vacate or partially return space to the market.

The **Competitive** sector has peaked. The next few years will force rents lower and vacancy upward in B Grade properties as central and

Weak Economy



RENT

After peaking in mid 2007 and drifting for much of 2008, rents are falling. Achievable rents for new leases are sometimes lower than the current rates of tenants facing renewals. This is particularly true for new leases signed or renewal increases accepted during 2006-2008.

The market has rapidly transitioned from an extreme “Landlords’ Market” to a moderate “Tenants’ Market”. Owners are uncomfortable with supply, vacancy and rental trends over the next few years. Ignore broker and landlord statements to the contrary.

Lease renewals will often represent savings opportunities. In recent years, owners were focused on rental increases. Landlords are shifting into tenant-retention mode as new supply confronts well-occupied properties. Lease language should also be reviewed. It may be possible to create more flexible terms in

Fixed Term Leases or even switch to Traditional Japanese Leases.

Rents on new leases signed in the Most Competitive sector dropped by an average of 21% in 2009. Competitive buildings with significant vacancy suffered a similar fate. Larger incentives are returning to the market.

Most Competitive stock rents are plummeting. Marunouchi, Otemachi and a few landmark properties in other CBDs are dropping back to 40,000 (yen/tsubo/month including common expense) and below. Securing whole floor or multiple floor tenants above 35,000 is difficult. Even lower rents are common outside of specific CBDs and key properties in those districts.

Competitive buildings have held steady, but some are already feeling the heat when tenants reduce space or are lost to other buildings. After achieving high rents in recent years, these

- Increasing supply 2009-2010. Large supply from 2011
- More peripheral locations
- Sinking economy seeking a bottom
- Demand collapsed. Strong and speedy recovery unlikely
- Many tenants reducing or returning leased space
- Rents for new leases down sharply
- Lease renewals are cost reduction opportunities
- Professional negotiation, focused strategy required to maximize leverage
- Vacancy expanded rapidly
- Osaka market weak. Heading lower

(CBD) areas for the next several years. This should gradually put pressure both on back office and more prime locations.

Marunouchi, Yaesu and Nihonbashi area gentrification is ongoing. Some 47,000 tsubo (1,680,000 sf) of new stock completed during 2009 with another 25,000 tsubo (912,000 sf) opening in 2010. As Marunouchi redevelopment proceeds, Nihonbashi and Kyobashi will progressively be a new focus of central Tokyo office project developments.

Roppongi, Kamiyacho and Akasaka had no new completions in 2009, but tenants reducing space or relocating created vacancy in existing Most Competitive and Competitive properties. A limited supply of 12,000 tsubo (427,000 sf) will hit the market in 2010.

Shinagawa, Osaki and Higashi Shinagawa added 11,000 tsubo (402,000 sf) during 2009 and over 16,000 tsubo (591,000 sf) is scheduled

for 2010. Like other central areas, tenant restructuring has increased vacancy in spite of limited new construction.

Shinjuku, Nakano Sakaue and Hatsudai had no new construction for five years and then only a trickle of supply in 2008. Some 11,000 tsubo (392,000 sf) will finish in 2009. Supply in other areas is likely to expose buildings in this CBD to competition along with new supply in Shinjuku.

Yokohama, Shin Yokohama and Minato Mirai is building its way into trouble. Even though multiple projects have been suspended, nearly 33,000 tsubo (1,166,000 sf) open in 2009 with a similar amount due the following year.

The projected four consecutive years of rising large building supply in greater Tokyo is unusual. The total tsubo of large buildings entering the market 2010-2012 is larger than the 2002-2004 period when rents last bottomed. The average size of these buildings rises significantly

after 2010. While a greater proportion of the new supply is outside of the most central wards and core CBDs, significant supply will be realized in prime areas as well.

In recent years, construction of medium sized buildings partially offset the declining supply of new large buildings. A number of smaller projects sponsored by minor developers have recently been scrapped. Larger projects are on schedule or only slightly delayed.

Existing stock has suffered from tenants partially terminating space in a bad economy. This trend increased vacancy in a period of low supply.

Areas of supply outside major CBDs through 2011 include Shibuya, Ikejiri Ohashi, Harajuku, Gotanda, Tamachi, Hanzomon, Kojimachi, Kudan, Shimbashi, Kachidoki, Ariake, Tsukishima, Daimon, Ginza, Iidabashi, Akihabara, Kanda, Kiba, Toyosu, Oshiage, Kawasaki and Futakotamagawa.

DEMAND

peripheral Most Competitive buildings attempt to attract tenants to relocate to better quality and higher value-for-money properties.

Landlords seeking rents above 40,000 (yen/tsubo/month including common expense) are generally unable to secure occupancy. Tenants with budgets over 30,000 are limited. Most Competitive stock priced below these levels enjoys somewhat stronger demand.

Tenant focus has been squarely on cost cutting and capital preservation. Large one-time costs have been unacceptable irrespective of the payback period. These factors have restricted relocations and allowed existing stock to retain tenants. As supply rises and tenant confidence gradually returns, expect incentives from landlords of poorly occupied buildings to increase rapidly in addition to lower rents. The result will be an increasing number of office relocations.

The economy will likely begin to recover after a horrible performance during the last two-years. GDP turned positive in Q2 for the first time in five quarters. The Nikkei is well up from a twenty-six year low hit in October 2008, but corporate profits, consumer confidence and many other indicators are deeply into negative territory or testing multi-year lows. Bankruptcies recently reached a six-year high including many real estate and construction-related businesses. Office demand tends to recover several quarters after tenants see business stabilize and growth return.

Non-Japanese companies, especially the financial sector, have been downsizing in 2009. Domestic firms drove demand in recent years. While the developing trend of mergers and consolidation among Japanese firms is expected to gradually stimulate demand for larger blocks of space in relocations, it may ultimately represent less total demand in aggregate.

Back office markets are more stable for now. Yokohama, Toyosu, Kiba and Futakotamagawa new supply will create serious alternatives for tenant favorites such as Kawasaki, Higashi Shinagawa, Tennozu and Kinshicho. New supply in Ariake and Odaiba will also be problematic.

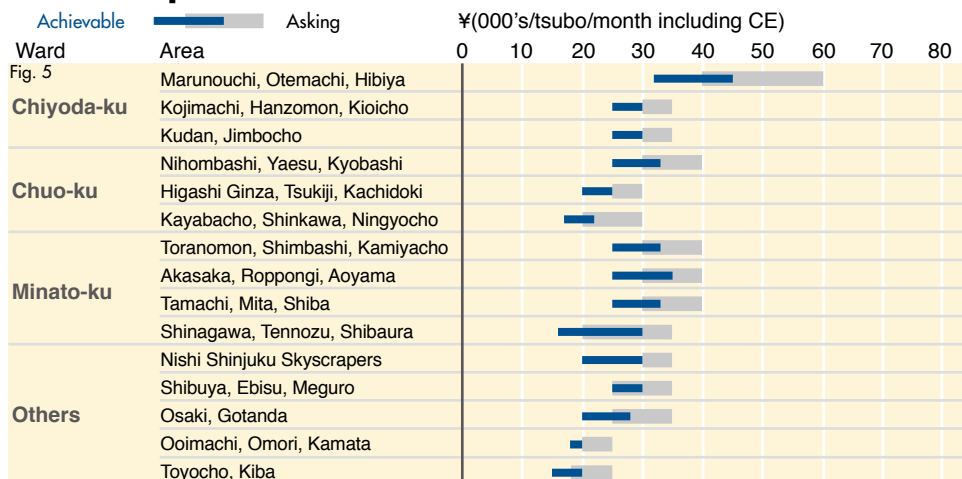
At least tepid demand is sure to return mid-term. It is unlikely that the scale of interest will keep pace with the new construction being delivered to the market. Expect the current demand crisis to morph into a supply-side issue.

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

RENT

Most Competitive Sector Rents

Source: Colliers Halifax Research



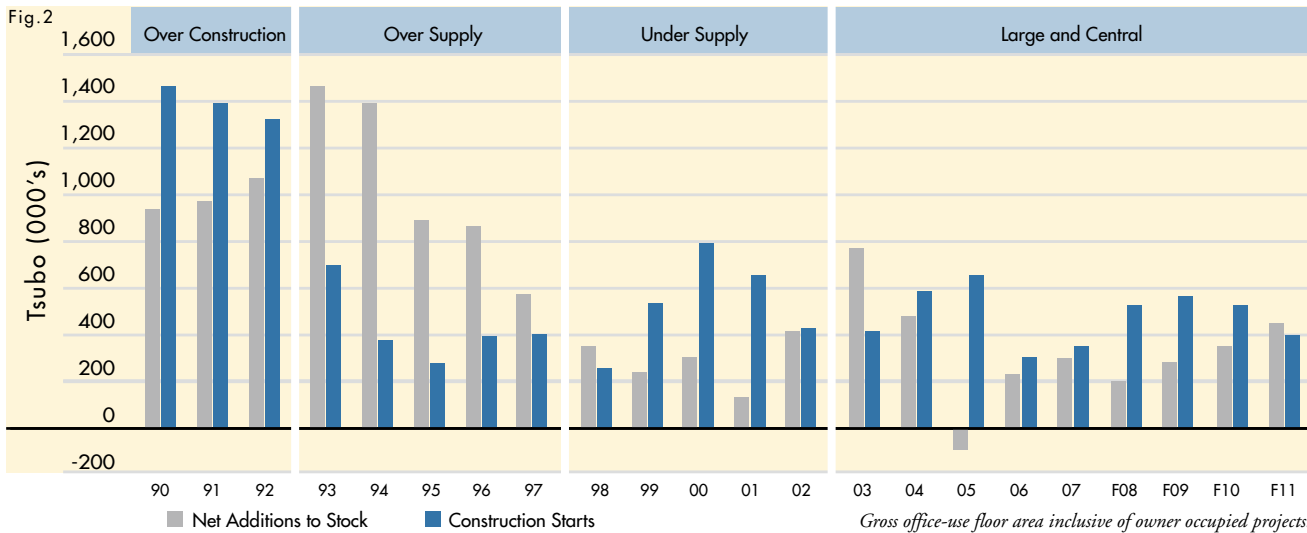
Colliers Halifax's experience shows that after implementing a carefully constructed negotiating strategy, tenants are able to realize what is often a significant difference between the landlord's asking (higher) rent and the rent that is actually achieved.

properties now represent lower value for money to tenants. Expect greater flexibility on terms and conditions in these buildings.

Rent increases were a familiar feature of lease renewals over the last four-years, but should not be a concern for some time. Reductions of 10-15% were common during 2009. In a weakening market, savings maximization requires a broad view on achievable conditions, emerging trends and proven negotiation skills. The new supply will create a variety of options for tenants during the next several years.

Lease renewals are opportunities. **Fixed Term Leases** should be reviewed at least one-year prior to renewal to insure leverage is not lost. **Traditional Japanese Leases** should be evaluated six-months or more before renewal. Mid-term renegotiations should be considered as compelling incentives from relocation candidate buildings create leverage.

Office Construction Starts and Net Additions to Stock in Tokyo's 23 Wards



Construction starts peaking. Small and medium sized project already declining due to financing difficulties. Overall starts likely to decline from 2010 due to over-supply. Net additions arcing upward from 2008 bottom. Larger projects represent a higher percentage of net additions from 2011.

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. 4

	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 OA floor, 24 hr. use, ample power, A/C and cabling space	Semi-intelligent Capacity to upgrade existing facilities	Non-intelligent Limited capacity to upgrade
Pricing:	High value for money	Moderate value for money	Low value for money
Credit Risk:	Financially stable owner	Fairly stable owner	Financially unstable owner
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

VACANCY

Vacancy rose rapidly in 2009. An up-tick in supply combined with a large contraction in demand rocketed vacancy into tenant friendly territory. Available space has been concentrated in a limited number of buildings where tenants partially terminated space or vacated entirely and in newly constructed buildings. The problem will become more evenly distributed across the market going forward.

Overall vacancy in the 23 wards of Tokyo increased to 6.0% from 4.0% in mid 2009. Vacancy rates in the five central wards expanded to 6.5% from 3.5%. Most Competitive stock in these areas jumped to 7.5% from 2.5%.

Many buildings remain well tenanted. Most Competitive properties have suffered first. Vacancy will increase in the Competitive sector and less central properties in the coming year. The lowest tier of properties will experience tenants 'trading-up' to better buildings.

OSAKA UPDATE

Office closures, contractions, and consolidations have combined with over-construction to place severe pressure on rents. Vacancies are on the rise. Landlords of Most Competitive stock completing in 2009-2010 are forced to reduce rent expectations while increasing other incentives and concessions. Existing properties are competitively marketing their expanding vacant space. Non-central markets including Shin Osaka are struggling.

Supply: Over 70,000 tsubo completed in 2009, the largest amount since at least 1990. Nearly 70% of this new supply located in Greater Umeda or Yodoyabashi/Honmachi. Completions decrease to 48,000 tsubo in 2010 and 25,000 in 2011, but the three-year total represents over 7% of the existing large building supply. Thereafter in 2012, the Umeda freight yard redevelopment and other projects will add a massive 100,000 tsubo. Over-supply conditions will continue.

Demand: Even prime locations are suffering from office closures and partial terminations. Fewer relocations of any size are realized. Moving to smaller offices or consolidating existing offices into a reduced space is common. Opportunities to upgrade to prime locations abound.

Rent: Falling. Prime buildings in Umeda have dropped to 22,000 (yen/tsubo/month including common expense) and those along Midosuji have fallen to 20,000. Some Umeda and Midosuji properties are already below 20,000. Competitive properties in the same locations are at 15,000 and 13,000 respectively. New supply will compound the problem and push down further.

Vacancy: Increased to 9.5% market-wide. Large-scale, Most Competitive buildings are at 6.5%. Kobe is at 15%. Vacancy in new completions higher. Even Umeda is experiencing a rise in vacant space.

Conclusion

- Continuing supply increase through 2012.
- Plummeting demand already tilted market balance towards tenants. Increasing supply will sustain the pressure.
- Rent down sharply on new leases.
- Pressure mounting for rent reductions on lease renewals.
- Vacancy has surged from recent multi-year lows.
- Opportunities encompass more than simply rent and deposit. Value the overall transaction including incentives and less transparent costs to maximize benefits for your tenancy.
- Osaka also suffering from reduced demand. Relatively large new supply will weaken the market further mid-term. Large supply thereafter will preserve tenant friendly conditions through 2013.
- Nagoya facing weak demand as manufacturing based industries restructure. New supply is less dramatic than some other cities. However, rent reduction opportunities common.
- Regional cities and suburban markets weaker than Tokyo. Over-supply and limited demand challenging Sendai, Yokohama and Fukuoka landlords.
- Tenants with nationwide sales or representative offices reviewing lease portfolios to create savings. Rent reductions, consolidations and downsizing common.

Take Control of Your Occupancy Strategy

1. Engage a Qualified Advisor



- Ensure that the advisor is independent and has no conflicts of interest with landlords.
- Confirm that the advisor provides thorough market coverage.
- Review the advisor's knowledge base – e.g. number of transactions recently completed.
- Select an advisor who can assist with strategy development and implementation.

2. Understand The Current Status



- Review current and future occupancy needs.
- Evaluate the terms and conditions of the lease.
- Investigate the building's physical quality.
- Prioritize requirements (e.g. rents, deposits, facilities, efficiency, location).

3. Consider the Options



- Current status adequate – no action required.
- Expand, contract or renegotiate to obtain better terms in the present location.
- Relocate/consolidate to achieve better terms, facilities and space efficiencies.
- Structure a hybrid solution tailored to specific corporate needs.

4. Develop a Strategy: Implement



- Negotiate from a position of knowledge and strength.
- Maximize leverage through exploring and understanding all options.
- The key to success is flexibility.
- Apply your strategy to landlords rather than playing their game.

5. Monitor the Situation

- Market conditions and corporate objectives may change frequently.
- Traditional Japanese Leases commonly allow for immediate redress of inequities.
- A qualified advisor can continually update a tenant with market information.
- Occupancy strategy is ongoing and should be reviewed at least annually.

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