RESEARCH & FORECAST REPORT

JAPAN INVESTMENT UPDATE 2012

- Land values decline at a slower pace than previous three years
- Office rent remain under pressure
- Cap rates leveling in most sectors/ locations
- Limited "3/11" damage to institutional grade properties
- Occupiers and investors more sensitized to seismic resistance standards
- Net foreign investor interest unchanged post-disaster
- Japan remains attractive due to stable legal, political and economic environment
- Positive cash spreads and reliable liquidity
- JREIT market consolidated and poised for expansions
- Transactional activity increasing slightly after post-disaster pause

CAPITAL VALUES

Declines experienced over the past several years in every property sector finally abated for some in late 2010 and early 2011 to the point where cap rate compression appeared in some areas in anticipation of an improvement in market fundamentals and financing availability. The triple disaster of 3/11 caused the market to come to a temporary halt. After only several months, cap rates appear to be unchanged.

The post 3/11 losers in terms of the market fundamentals of demand, occupancy and rents, have been retail, hotel and leisure, high-end expat residential and anything that has not been built or reinforced to modern seismic standards. One of the winners appears to be institutional grade logistics.

Office and residential in the Greater Tokyo area collectively represent more than half of what is widely recognized as institutional real estate investment in Japan. Office property values remain under pressure due to persistently high vacancy, and continued downward pressure on rents, especially for lower quality buildings in secondary locations. As rents for existing tenants continue to get renegotiated down toward market, or tenants move to alternative locations at market rents, this trend is expected to subside in 2013.

Greater Tokyo residential is a tale of two types. High-end expat rental properties are suffering from a second shock, this time post 3/11, before ever recovering from the Global Financial Crisis. Market fundamentals are driving the decline in capital values. In the far broader and deeper market of middle-income rental properties, the fundamentals have been very stable, largely unaffected by the spring disaster, and capital values have held up well.

Office properties in most regional cities remain under pressure due to high vacancies and declining rents. Residential rental properties have performed more steadily on average.

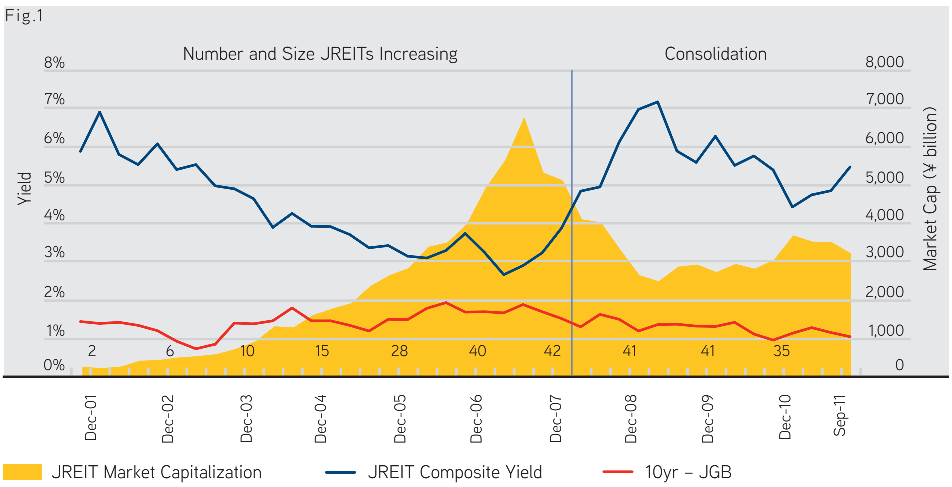
Hotel and retail properties, two of the most volatile sectors over the past several years, were negatively affected by the spring disaster, but over time are expected to recover. Conversely, modern logistics properties appear poised to gain as vacancies decline due to a shift to quality and modern seismic standards in the industry.

The JREIT weighted average dividend yield is an excellent indicator of cap rate movement across all property types. Yields and capital values have remained fairly steady from about a year ago, remarkably so since 3/11.

The non-recourse financing environment has improved considerably at both the senior and mezzanine levels. However, with capital values still under pressure in many sectors, banks continue to take a cautious view toward value in their underwriting.

Yields Remain Steady, Even Post 3/11

Fig.1



Source: Compiled by Colliers International Research from publicly available data

OFFICE

In Tokyo, above average new supply continues to put pressure on occupancy and rents. This trend is expected to continue through 2012, after which new supply will decline to, or even below, long term average levels. The vacancy rate has stayed at a relatively high level of about 8% since 2008. For the first year or two after the Global Financial crisis, the significant increase in office vacancy was due to a sharp contraction in demand. In 2010 and 2011, as demand gradually returned to normal levels, vacancy has remained high because of above average levels of new supply. Rents have declined to historic lows not seen since 2004. As the market enters its fourth straight year of rental declines, most, but not all, tenants have been readjusted to, or near to, current market rent levels.

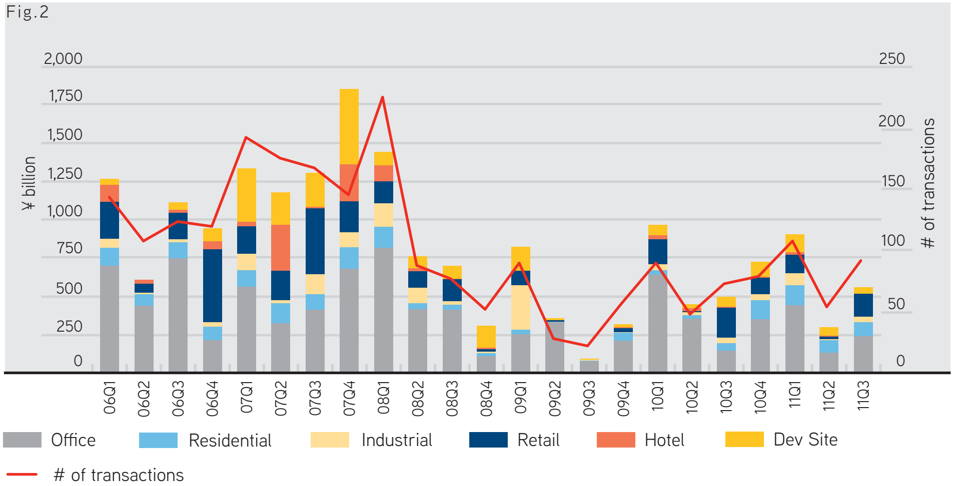
Higher quality and well-located new supply will continue to draw tenants away from B class and lower grade office buildings. Investors looking to acquire or already invested in B class office buildings will still have to pay careful attention to tenant retention strategies for the foreseeable future.

Transactional activity has continued to increase through 2011, with a brief pause after 3/11. Smaller office building transactions have been dominated by small and medium domestic investors and occupiers, with the medium to larger office building transactions led by JREITs and their sponsors.

With little prospect of growth in the regional cities, even small increases to supply will put pressure on less competitive buildings. Most regional cities continue to experience historically high vacancy levels.

Transactional Activity: 3/11 Stalls Rebound

Fig.2



Real Estate Transactions (over JPY1 billion)
Source: Real Capital Analytics, Colliers International Research

RESIDENTIAL

The average Posted Prices (Koji-kakaku)[1] of residential land decreased by -2.7% nationwide and -1.7% in Greater Tokyo in 2010. The Greater Osaka and Nagoya markets declined by -2.4% and -0.6% respectively. The rate of decline was lower than the previous year in all major markets.

The number of housing starts, a leading indicator of residential investment, has recovered somewhat over the past two years from historic lows set after the Global Financial Crisis. But they still remain below the 10 year moving average for a fifth straight year.

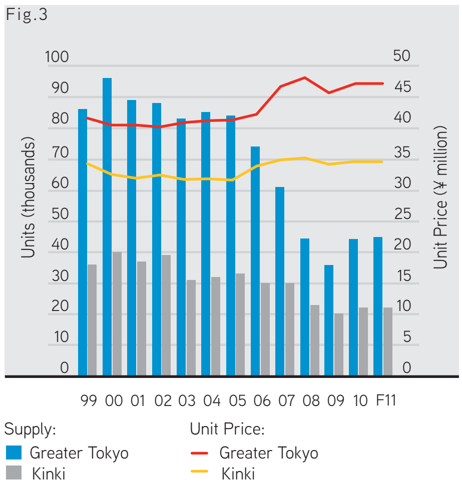
The Tokyo high end and expatriate rental market has been hit hardest within the residential sector. Before a recovery from the Global Financial Crisis could materialize, the disasters of 3/11 caused many expatriates to leave Japan. Older stock continues to be taken offline altogether, or converted to condominiums for sale. This should eventually bring down the persistently high vacancy rate.

For the first time, single people have become the largest category of household in Japan. Middle income and compact rental units have performed much more steadily than the high end subsector in Tokyo, with relatively strong rental demand. Fewer residential purchases over the past several years have also kept more middle income consumers in the rental market. Greater Tokyo continues to experience net increases in number of households, unlike most regional cities. This product typically represents less volatility than other property sectors. Occupancy and rent levels have remained stable. Rental comparables are abundant and reliable. The spread between asking and achieved rents is much narrower than in other sectors. The availability of meaningful sales comparables and liquidity also contribute to robust transactional volume, particularly for deals below JPY 1 billion.

The population of most major regional cities has continued to grow slightly, as they draw people from tertiary cities and rural areas within their region. The growth is much lower than Greater Tokyo on average. Nationwide, average household size continues to decline, and new household formation remains slightly positive. The middle income and compact rental residential markets have continued to be relatively stable investments in terms of rents and occupancy.

Condos Still at Historic Lows

Fig.3



New Condominium Supply
Greater Tokyo: Tokyo, Kanagawa, Chiba, Saitama
Kinki Area: Osaka, Hyogo, Kyoto, Nara, Shiga, Wakayama
SSource: Real Estate Economic Institute Co. Ltd, Colliers International Research

RETAIL

Unemployment was at 4.1% at the end of September 2011, but is understated. People who have given up looking for a job are not included. Monthly household income has declined 0.7% over the one-year period ending September, and monthly household spending declined 1.9% during the same period. Even if household income increases, consumers are saving more and trying to pay down debt. The outlook for consumer demand on a macroeconomic level therefore still remains weak.

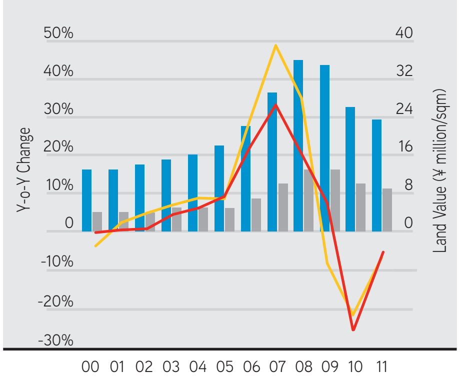
For the high street locations such as Ginza and Omotesando, the significant rental declines of 2010 have begun to abate in the first three quarters of 2011. There has been a noticeable shift away from luxury goods to reasonably priced casual fashion competing for the most prime sites. This trend has been exacerbated by 3/11, as consumers go out of their way to avoid conspicuous consumption during Japan's disaster recovery.

Other non-prime central Tokyo locations have been faring less well than most prime locations, reflecting a shift in retailers' strategies and overall weak consumer demand.

Given the weak economy, the constant threat of a new competitor in or near one's catchment area, and the steady gains of internet commerce, the suburban and regional retail sector remains the most challenged. Investors need to be sensitive to tenant credit, reputation, same store sales and deal structure to overcome these challenges.

Prime Retail Decline Abating

Fig.4



Land Value:
- Ginza
- Omotesando

Y-o-Y change:
- Ginza Chuo Avenue
- Omotesando Avenue

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

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

INDUSTRIAL

The average Koji-kakaku of industrial land has continued to decline in the major metropolitan area, down -1.3% on average nationwide in 2010. The rate of decline was lower than for the previous year.

After struggling with relatively high vacancy, in the double digit range, and weakening rents for several years through early 2011, the institutional grade logistics sector has experienced a significant uptick in demand and a resulting decline in vacancy to around 5% in the months following 3/11. The earthquake and tsunami forced major manufacturers and logistics companies to reconsider their logistics footprints and to accelerate the shift toward buildings that meet modern seismic standards.

Global Investment Sales

Fig.5

City	Last 12 Months (US$ million)	Estimated Cap Rate
NYC Metro	39,382	6.97%
London Metro	32,658	5.78%
Beijing	30,582	
Tokyo	**23,395**	**5.57%**
Hong Kong	23,308	3.26%
Shanghai	23,123	
Singapore	23,018	6.71%
Paris	18,457	6.38%
DC Metro	17,593	7.53%
LA Metro	16,127	7.14%
Osaka	**2,776**	**6.39%**

Top 10 Cities + Osaka (#61)
Source: Real Capital Analytics, Colliers International Research

Rental rates for warehouse space in the Greater Tokyo Bay areas range from 5,000 ~ 7,500 (yen/tsubo/month), and for inland locations from as low as 3,000 ~ 4,000 (yen/tsubo/month). Due to the relatively stable, long-term nature of tenancy for most logistics properties, cap rate stability has been better in this sector than others. With rents having a chance to finally firm up after years of downward pressure, cap rates are also firming up in the 5.5% to 6.5% range for Greater Tokyo, and correspondingly higher for the regional cities and more remote areas.

More than 90% of warehouses in Japan remain below institutional quality and size, and the ownership pattern is highly fragmented. Many major developers and institutional investors are paying more attention to this market. The trend towards the acceptance of modern, large scale logistics properties by institutional investors, both foreign and domestic, should continue to accelerate in the wake of 3/11.

DEVELOPMENT

Although local conditions may differ from macroeconomic trends, it is possible to comment broadly about where each property sector is in terms of the environment for new development.

In the office sector, the environment is very negative for new development, not only in Tokyo, but even more so for the regional cities. Persistently high vacancy and projected strong additions to supply again in 2012 should be scaring smaller and medium size speculative developers away from acquiring land for new office projects. Many large projects with long lead times continue to be announced by well capitalized developers because their long awaited land assemblies have been achieved, the cost of moving tenants around is relatively low, and they prefer to not to postpone any further.

Conditions appear favorable for acquiring land to develop middle income and compact rental residential in the Greater Tokyo area. Population trends are positive, as people continue to move to Tokyo for jobs and the number of households grows. Rents and occupancy have held up well during both the Global Financial Crisis and 3/11. New supply of residential for sale remains very low. Acquisitions of land for residential redevelopment by major and medium sized players are more active.

Development of retail is currently highly sensitive to location and price. Properties in the most prime locations are few and far between and always in demand for redevelopment. Non-prime urban locations are price sensitive and currently not in as much demand. Most suburban and regional areas are saturated for the most part from the previous development cycle, which ended around 2008. Given fundamental changes such as the increase of internet shopping, retail development will remain location and price sensitive for the foreseeable future.

The environment for industrial development has changed significantly post 3/11, especially for logistics. Vacancy rates have dropped precipitously into single digits and rents appear to be firming up for the first time in many years. We expect a strong surge of industrial land acquisitions for development by foreign and domestic players in 2012.

After suburban retail, the sector for which conditions are least favorable for development is the hotel sector. The long-term outlook for tourism and business travel will need to improve significantly before developers come back to this market.

Of course there will be development activity on an exceptional basis even for the sectors that are not described above as being there yet. This is to be expected in a market as wide and deep as Japan's, where land assembly remains a challenge, and where older stock continually needs to be replaced by higher and better uses, modern seismic standards and superior design and construction.

Government Land Values

Nationwide average Koji-kakaku in all property sectors declined for the third straight year in 2010, but the rate of decline was lower than in the previous year in all geographical areas. Further declines expected in most sectors in 2011, with some areas leveling off.

	Tokyo	Osaka	Nagoya	Nationwide
Commercial	- 2.5	- 3.6	- 1.2	- 3.8
Industrial	- 1.9	3.3	- 1.3	- 1.3
Residential	- 1.7	- 2.4	- 0.6	- 2.7

[1] *Koji-kakaku (Posted Price): The Ministry of Land, Infrastructure and Transport's annual appraisal of 26,000 nationwide sites by 2,716 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; data released in July.*

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-Focus on strategy review and development for maximum client returns.

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-Review real estate investment objectives.
-Evaluate supply and demand, price trends, ownership structure and financing.
-Investigate the property's condition, potential liabilities, projected returns.
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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
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-Be pro-active; apply client strategy to the market.

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-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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