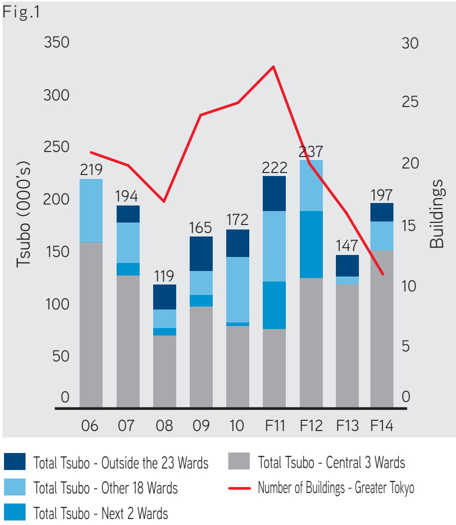
RESEARCH & FORECAST REPORT

JAPAN LEASING UPDATE 2012

- Supply peaking in 2012
- Central supply high 2012~2014
- Lukewarm demand
- Economic weakness
- Rent bottoming at multi-year lows
- Large incentives and selection for relocations
- Vacancy at elevated levels, should remain high
- Osaka weakness continues
- Leverage weak market conditions to upgrade at below current cost basis

Supply Peaking

Fig.1



** Net rentable office space 3,000 tsubo or greater*
Source: Colliers International Research

SUPPLY

Large and progressively more central. Completions increased for the third consecutive year. Over 222,000 tsubo (7,900,000 sf) was added in 2011, the second largest supply in ten years. Large building completions rise to 237,000 tsubo (8,400,000 sf) in 2012, a 7% increase. Supply peaks in 2012 and is more heavily concentrated in central Tokyo.

Large central supply in 2012 is followed by similar levels of centrally located properties in 2013 and 2014 ratcheting up the competition for tenants. Some 2012 supply has secured commitments from group companies or portfolio tenants, which will create vacancy in existing buildings. Much of the new supply has yet to secure meaningful occupancy.

Competitive properties are feeling the heat. After losing key tenants to new construction, existing Competitive buildings are accepting the lower rents and greater incentives that **Most Competitive** stock embraced earlier in the cycle. Building renovation, rent renegotiations, and back-filling vacancy will be the main focus for these desirable, but one/two generation-old buildings.

Marunouchi, Yaesu and Nihonbashi had no major completions in 2011. However a whopping 80,000 tsubo (2,847,000 sf) of new stock concentrated mainly in four large Marunouchi buildings open in 2012. New developments completing in Kyobashi and Nihonbashi in 2013 shift the trend of scrap and build to the other side of Tokyo station.

Roppongi, Kamiyacho and Akasaka had just 15,000 tsubo (540,000 sf) of additions in 2011. With just one building completing in 2012, supply levels remain relatively modest at 13,000 tsubo (462,000 sf). Key buildings have secured tenants and addressed vacancy issues. Vacancy has cycled into other properties in this Central Business District (CBD).

Shinagawa, Osaki and Higashi Shinagawa added 34,000 tsubo (1,105,000 sf) in 2011. Another 20,000 tsubo (712,000 sf) will be returned to the market by firms moving into owned premises. Large blocks of vacancy also exist due to tenants relocating to other CBDs. Even with no new completions in 2012, digesting current vacancy and new supply will be a slow process.

Shinjuku, Nakano Sakaue and Hatsudai is awash with new supply. The area added 45,000 tsubo (1,618,000 sf) in 2011 and another 42,000 tsubo (1,509,000 sf) completes in 2012. This mature CBD is under intense pressure to simultaneously attract new tenants from other areas and retain existing firms.

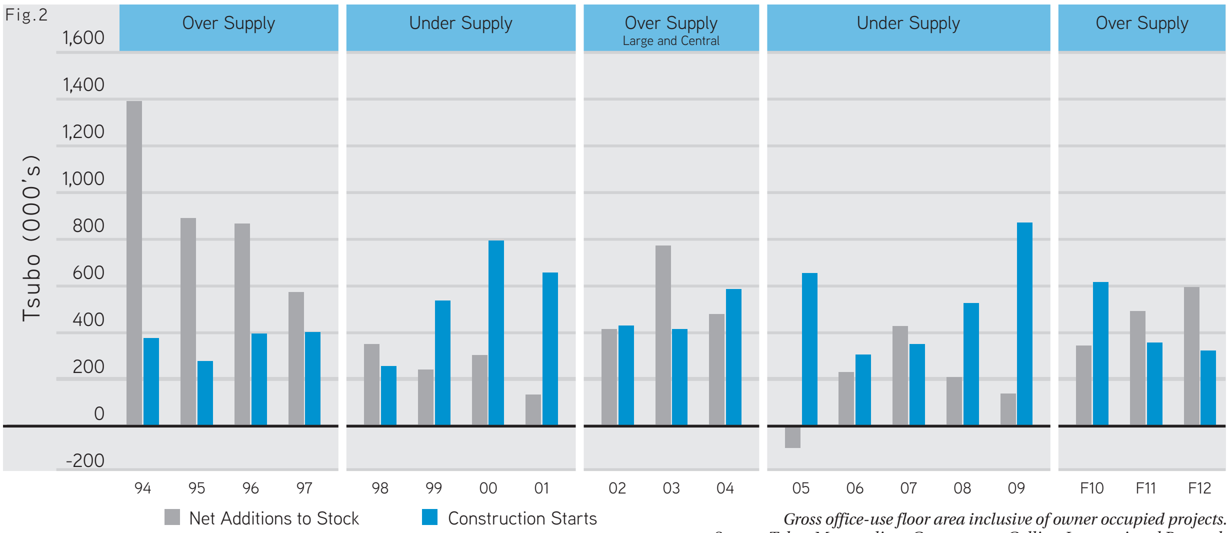
Yokohama, Shin Yokohama and Minato Mirai saw a third year of elevated supply in 2011 with 34,000 tsubo (1,207,000 sf) completing. No new supply in 2012 should allow landlords respite to consolidate and work through the backlog of vacancy.

Other areas with new supply in 2012 include Kachidoki, Kanda, Kojimachi, Kyobashi, Mita, Nakano, Odaiba, Shibuya and Toyosu.

The cycle of new supply moving between central and peripheral locations is returning to center. Projects planned in the high-rent days of 2007 complete in central Tokyo during the next few years. It is critical to understand both new supply and pending vacancy in existing stock as it specifically relates to your market sector and space requirement.

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

Fig.2



Construction starts bottoming as net additions peak. A new cycle of increasing starts commences in 2013.

Gross office-use floor area inclusive of owner occupied projects.
Source: Tokyo Metropolitan Government, Colliers International Research

DEMAND

Demand increased modestly in 2011 after stabilizing in 2010. With more new construction and lower pricing in existing Most Competitive buildings, larger tenants continue to consolidate offices. Tenants with large expansion requirements are rare.

The Tohoku earthquake and tsunami have created some demand to trade up in building quality, particularly for those tenants in older buildings. However the macro market dynamics remain largely unchanged.

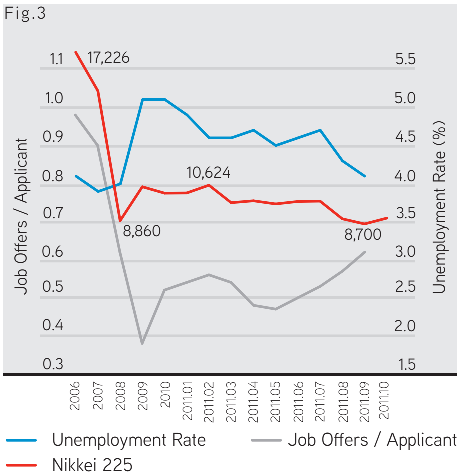
There is no real market for Most Competitive space priced over 40,000 (yen/tsubo/month including common expense). Demand for space above 30,000 is limited and not firm above 25,000. Well-located, quality stock priced below 25,000 enjoys stronger demand. Competition for tenants is increasing among landlords and CBDs as central locations and new construction battle against existing stock.

After the earthquake, the Nikkei recovered to the 10,000 mark, but has since declined amidst uncertainty in the global economy. Government spending for reconstruction of earthquake and tsunami damage is expected to support modest growth into 2012.

Economic indicators remain weak and contradictory. Monthly unemployment numbers are up and down. The ratio of job offers to applicants has increased but remains low. Consumer confidence and retail sales are down and a deflationary trend persists. The strengthening yen reduces profitability for exporters. The economy is unlikely to rally enough to spur substantial leasing demand during 2012.

Economic Weakness

Fig.3



Source: Nikkei Co., Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare, Colliers International Research

Stratification of the Tokyo Office Market

The stratification of the market into sections – each a combination of location, building quality and price. *Source: Colliers International 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**	**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
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:	**Levelling**	**Declining**	**Declining**
Demand/Supply:	**Weak/Increasing**	**Weak/Ample**	**Weak/Over-supply**

RENT

Bottoming. After 20% and 10% drops in 2009 and 2010 respectively, the pace of decline eased below 5%. A limited number of Most Competitive buildings have even enjoyed a slight improvement in pricing power as occupancy issues have been addressed. Unfortunately for landlords, rent levels remain at 2004 lows and record tenant incentives were required to create this bottom. This does not bode well for new buildings or existing buildings with vacancy pending.

Pricing strategy varies by property. Rent levels for new tenants are below historical lows in some key buildings. Generally, these properties will neither experience large declines nor gain enough traction to raise rents during 2012.

A common strategy for Competitive properties with high vacancy has been to offer very low rents, significant free rent periods, tenant-friendly leases and other incentives to stimulate relocations. This creates leverage for tenants in other Competitive class buildings as the one-time-costs of moving are reduced.

Landlords are proactively offering revised lease terms to protect existing tenancies. Relative to current terms these offers may appear attractive, but they should be benchmarked against market alternatives.

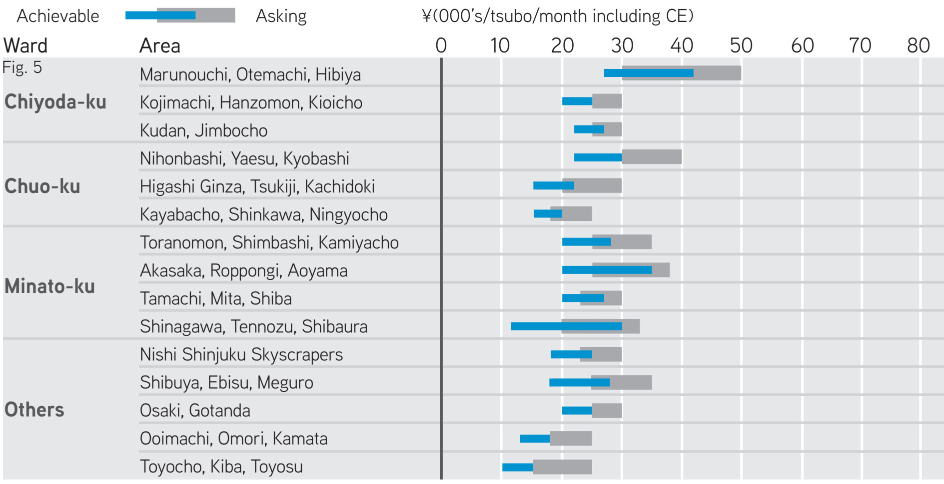
As rents are squeezed landlords look for revenue from other sources; unbundled costs for HVAC, and less transparent costs for utilities and services require greater scrutiny prior to lease execution.

Rent levels for new leases continually decreased over the last 48 months. Rent reductions at renewal are common in Tokyo and throughout regional cities. Reductions of 10-20% have been the norm in 2011.

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.

Most Competitive Sector Rents

Source: Colliers International Research



Colliers International'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.

VACANCY

Vacancy peaked in late 2010 and has since moderated slightly. The pathway back to a level of vacancy that supports a "Landlords' Market" is unclear and will require considerable time. New supply levels will keep vacancy high and provide tenants leverage through at least early 2013.

Overall vacancy in the 23 wards decreased from 9.0% to 8.0% in mid 2011. Vacancy rates in the five central wards declined from 9.0% to 8.0%. Most Competitive stock in these areas decreased from 8.5% to 8.0%.

Vacancy continues to be unevenly distributed, but is beginning to cycle down the quality curve. Older, smaller and less well-located buildings are losing out to newer, larger more centrally located buildings even as they offer lower rent and incentives.

OSAKA UPDATE

Though in the midst of multiple high-supply years, Osaka will see no significant completions until late 2012. Large relocations/consolidations in 2011 were concentrated in central locations, primarily Umeda, further strengthening its position as Osaka's prime CBD as Yodoyabashi/Honmachi continues to weaken.

Reduced yet significant supply (30,000 tsubo) completed early in 2011. An 18-month break from new supply ends with 22,000 tsubo opening in Autumn 2012, then over 80,000 tsubo in just 4 buildings delivered in 2013, 90% in Umeda.

Demand remains weak market-wide although activity increased as favorable achievable conditions enticed some large domestic firms to relocate/consolidate, trading-up to central, newer buildings. Earthquake-related demand, though briefly intense for short-term occupancy, has not significantly impacted the market.

Rents have continued to decline overall but have stabilized in Umeda, where Most Competitive buildings are at 22,000 yen/tsubo/month and Competitive at 15,000. Midosuji and Shin Osaka Most Competitive rents are 17,000. Competitive rents off Midosuji are 10,000.

Vacancy market wide has hovered near 12% over 12 months; Umeda vacancy, currently at 11%, will improve in 2012 before large new supply completes late in the year and early 2013. Newly completed buildings still suffer from high vacancy. Kobe remains above 15%.

CONCLUSION

- Supply peaks in 2012 after four years of increase. This additional stock will be introduced to a market with high levels of vacancy.
- The March 2011 earthquakes have had minor impact on construction delivery dates with a few projects being pushed back one or two months on construction material supply delays.
- Demand improved from 2010 levels but still not supporting significant take up of new stock and vacancy in existing buildings.
- High spec buildings enjoy increased interest in response to earthquake and tsunami.
- Rents for new tenants have found support at multi-year lows albeit in combination with large tenant incentives.
- Vacancy levels decreased marginally after peaking in 2010.
- Numerous large Osaka relocations/ consolidations as trading-up continues to strengthen the Umeda CBD.
- New, high quality, inexpensive supply in suburban locations creates alternatives and leverage for tenants in other back office areas and central Tokyo locations.
- Regional cities and suburban markets weaker than Tokyo. Review nationwide lease portfolios for cost reduction opportunities.

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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