JAPAN REAL ESTATE MARKET REPORT

2015 Q1

http://www.kenedix.com/eng/

Contents

summary

1. **Macroeconomic Conditions**

   While the real GDP growth rate for October-December 2014 (first preliminary figure) released February 16, 2015 showed annualized positive growth rate of + 2.2% QoQ for the first time in 3 quarters, this still was lower than projected, as the recovery appeared to be weak. Most observers expect the recovery to be further along with personal consumption and corporate capital investment in 2015 as the effects of the increase in consumption tax diminish and the effects of low crude-oil prices are felt, with a real GDP growth rate of +1.1% forecast for 2015 (Bloomberg Consensus).

2. **Real-estate Investment Market Likely to Remain Lively in 2015 As Well**

   The value of investment in commercial real estate in 2014 rose by 14% YoY to JPY4.04 trillion (DTZ). This level is 12% higher than the previous peak in 2007, and it can be described as a sign of a very active market. The year 2014 saw prominent large-scale transactions by business operating companies, developers, and core investors. At the same time, the value of properties acquired by J-REITs was down 29.9% YoY to JPY1.56 trillion, for the first decrease in 5 years. While investor appetite is likely to be strong in 2015 as well, competition to acquire properties can be expected to grow even more intense.

3. **Attention is Focusing on Increased Hotel Demand and Increased Sales at Retail Facilities due to Visitors from Overseas**

   The number of visitors to Japan from overseas in 2014 set a new record high of 13.41 million, up 29.4% YoY. The increase in overseas visitors contributed to rising occupancy rates at hotels in the major cities, which have continued to rise (on a nationwide basis) for 13 consecutive quarters. In addition, the increase in overseas visitors also is having a positive impact on retail facilities, as the total amount of consumption by travelers from overseas rose by 43.3% YoY to JPY2.3 trillion, a new record high.

4. **Cumulative Total Returns of Retail Facilities were Relatively High**

   A review of past performance of the 3 assets of office buildings, residential properties, and retail facilities, based on the AJPI Total Return Index released by the Association for Real Estate Securitization, shows that while office buildings uniformly had demonstrated the highest cumulative performance since April 2004, since September 2012 retail facilities have outperformed them. Probable contributing factors are the relatively high income returns on retail facilities and the fact that capital returns on office buildings have been low for a long period of time. However, it must be noted that this analysis does not take liquidity risk into consideration, that AJPI capital returns are based on appraised value, and that the data used in this analysis mixes urban and suburban retail facilities together.

【Macroeconomic Conditions】

The GDP Growth Rate Does not Appear as Strong as Expected

■ The real GDP growth rate for October-December 2014 (first preliminary figure) released February 16, 2015 showed annualized positive growth rate of +2.2% QoQ for the first time in 3 quarters. However, this was lower than the projected growth rate of +3.86% (source: Japan Center for Economic Research ESP Forecast Survey), so that the recovery turned out to be weaker than expected. While both private-sector final consumption expenditures and capital investment by private-sector businesses rose, by +1.1% and +0.4% QoQ at annualized rate, respectively, the extent of growth was not very high for either of these. At the same time, private-sector residential investment continued to fall as a rebound from the demand rush in advance of the increase in consumption tax, falling for the third consecutive quarter, by -4.8% QoQ at annualized rate.

A Real GDP Growth Rate of Roughly +1.1% Forecast for 2015

■ The economic recovery in 2014 was slowed as the effects of the increase in consumption tax lasted longer than forecast. Most observers expect personal consumption to recover in 2015 as the effects of the increase in consumption tax diminish and for the recovering trends in both personal consumption and corporate capital investment to strengthen due to the effects of low crude-oil prices, with a real GDP growth rate of +1.1% forecast for 2015 (Bloomberg Consensus). In calendar year 2014 the real GDP growth rate was +0.0% while the nominal GDP growth rate was +1.7%. It was the first time in 17 years, since 1997, that the nominal growth rate surpassed the real growth rate. While forecasts of future prices are uncertain, it would seem clear that the economy has taken a step toward breaking free from deflation.

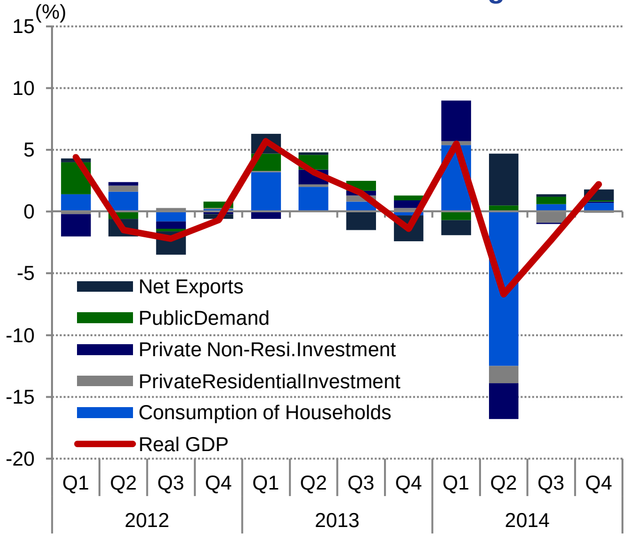
Downward Pressure on Prices due to the Effects of Low Prices of Crude Oil and Other Factors

■ However, recent conditions are not ones that lend themselves to an optimistic forecast concerning price trends. While the consumer price index in December 2014 (core CPI not including fresh foods) maintained positive growth at +2.5%, the rate of increase has slowed. Core CPI in Tokyo, considered a leading indicator, was +2.2% in January 2015, down 0.1% point from the previous month. The possibility has been pointed out that the CPI could drop temporarily to near the 0% level in the future since it appears that the effects of low crude-oil prices will start to be felt fully and the effects of the consumption tax increase will disappear in April 2015.

Volatile Trends in Long-term Interest Rates Should be Observed Closely

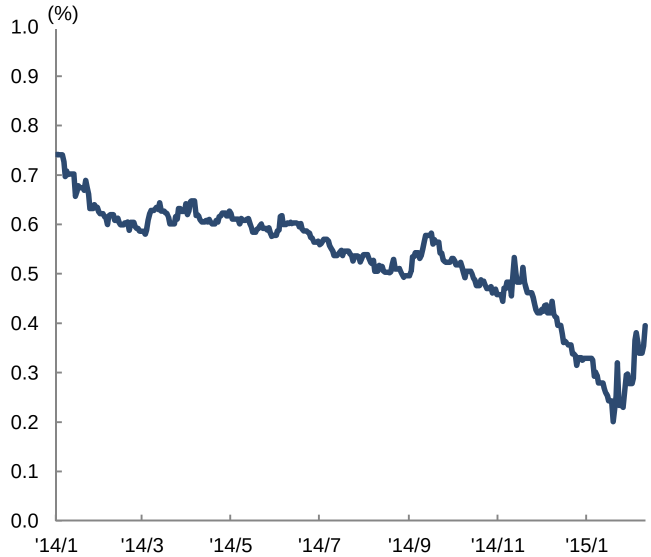
■ Long-term interest rates have continued to fall since the Bank of Japan's decision to expand quantitative and qualitative easing in October 2014, with yields on 10-year JGBs falling to the lowest level ever at 0.201% on January 19, 2015. However, the yields on 10-year JGBs rose rapidly after the sluggish bidding on 10-year JGBs on February 3. Since then yields on 10-year JGBs have remained volatile, with no clear direction up or down. It has been pointed out that one cause is a shortage of liquidity in the markets as the Bank of Japan continues to purchase JGBs in large amounts. Since trends in long-term interest rates have a major impact on the J-REIT market, future developments should be observed closely.

【Fig.1】 Real GDP Growth Rate and Contribution to Change in GDP



Source: The Cabinet Office

【Fig.2】 Yield of 10-year JGBs



Source : Bloomberg

【Real-estate Investment Market】

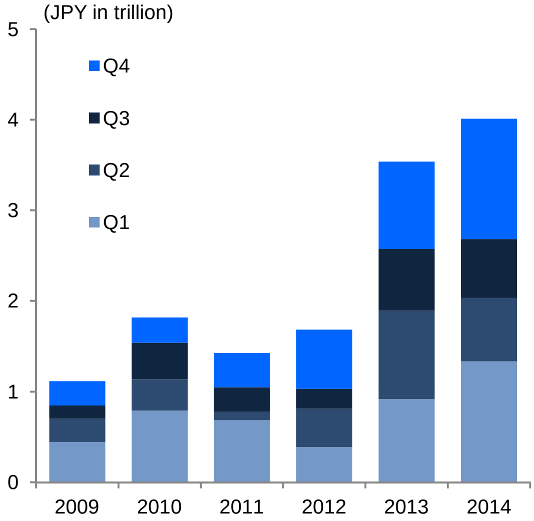
The Value of Transactions in 2014 Surpassed the Previous Peak Level

■ The value of investment in commercial real estate in 2014 rose 14% YoY to JPY4.04 trillion (DTZ). This level was up 12% from the previous peak level in 2007, so that market conditions probably could be described as very strong. The largest transaction in 2014 was Mizuho Bank’s deal for 30% of the dedicated office space of Otemachi Tower, for JPY178.2 billion. The year also saw a succession of other large-scale transactions by business operators and developers for reasons related to their business strategies. There also was a succession of acquisitions by core investors, such as the purchase by the Government of Singapore Investment Corporation (GIC) of Pacific Century Place Marunouchi (office floor). On the other hand, the value of acquisitions by J-REITs fell 29.9% YoY to JPY1.56 trillion, for the first decrease in 5 years. Still, the absolute value of such transactions at more than JPY1.5 trillion definitely was not low, and the hurdle for YoY growth can be said to have been high in 2014. In 2014 the commercial real-estate market probably could be described as having been driven by large-scale transactions of more than JPY100 billion by investors other than J-REITs.

Competition to Acquire Properties Likely to Grow Even Fiercer in 2015

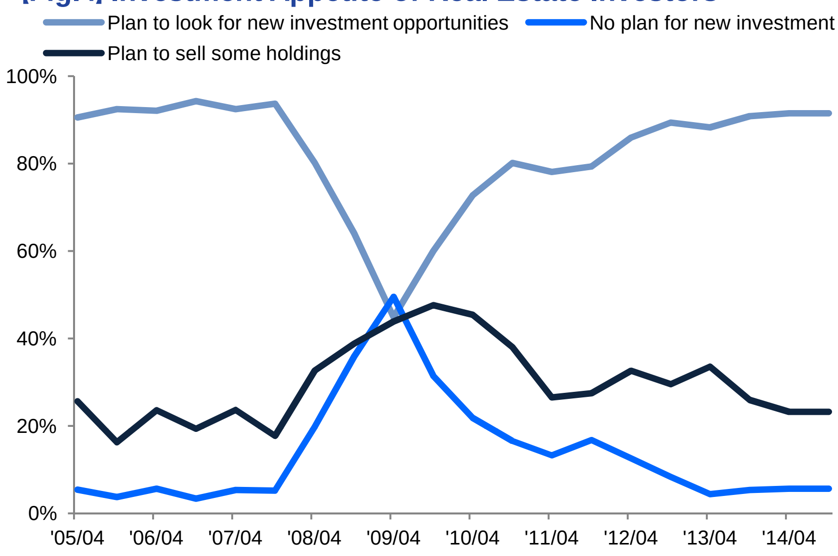
■ DTZ reports that it expects the value of transactions to decrease in 2015 since there is likely to be a smaller number of opportunities for large-scale transactions like those seen in 2014. The year 2014 saw a succession of large-scale transactions involving properties last traded before the financial crisis, as symbolized by the deal for Pacific Century Place Marunouchi. While appetite among investors would appear likely to remain strong in 2015 as well, it is expected that the feeling of a shortage of properties will be even stronger than in 2014, so that competition to acquire properties projected to grow even fiercer.

【Fig.3】Transsaction Volume of Commercial Real Estate



Source: DTZ, Kenedix

【Fig.4】Investment Appetite of Real Estate Investors



Source: Japan Real Estate Institute, Kenedix

【J-REIT Market】

J-REIT Unit Prices Were Strong

■ At the end of 2014 the TSE REIT Index stood at 1,897.92 points, up 25.3% from the end of the previous year. The index can be said to have shown very strong performance, rising over 9 consecutive months from April through December 2014. In November the market capitalization of the J-REIT market reached JPY10 trillion, and at the end of the year it stood at JPY10.5784 trillion. A look at investment trends by investor category shows net buying by the banking sector throughout all of last year, with net buying of JPY226.5 billion over the year as a whole. While net buying by the investment trust sector, which had been the largest class of investors in 2013, decreased somewhat, that sector’s net buying still was second in value only to that of the banking sector, at JPY107.2 billion for the year. Overseas investors, who accounted for the highest share of trading, also were net buyers in 2014 at JPY53.2 billion for the year. At the end of 2014 the net asset value of investment trusts investing in J-REITs was up 44.8% from the end of the previous year, to JPY3.27 trillion. This accounted for about 30% of J-REIT market capitalization.

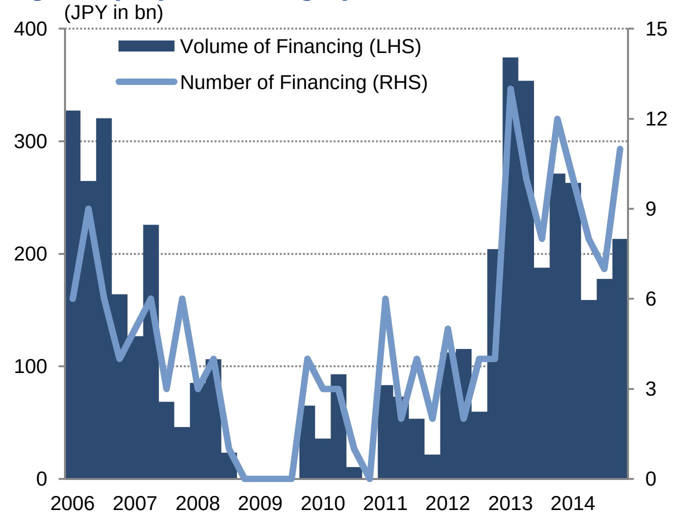
The Amount of Funds Raised and Acquisition Volume by J-REITs Fell by Roughly 30% YoY

- In 2014 the value of properties acquired by J-REITs was down 29.9% YoY to JPY1.56 trillion, while the amount of funds raised by J-REITs was down 31.5% YoY to JPY812.9 billion. Each of these represented the first decrease in 5 years. The number of public offerings (POs) fell by 7 from last year's figure of 43, to 36 POs, while the number of initial public offerings (IPOs) remained unchanged from last year at 6. Although this number of IPOs was unchanged from the previous year, since 2014 lacked any large-scale IPOs raising funds of more than JPY100 billion as were seen in 2013, the amount of funds raised per PO fell by 18.2% YoY to JPY22.5 billion. While the value of properties acquired did fall YoY, it still remained at the third highest level ever after the 2013 and 2006 figures, so that there probably is no need to consider the market to be on the decline. It is thought that these results reflect the effects of fierce competition to acquire properties rather than any difficulty in making POs. To the contrary, in 2015 there is likely to be a need to consider a sense of overheating of the market as dividend yields stood at 3.0% and NAV at 1.6 times at the end of 2014 (source: the Association for Real Estate Securitization) .

The Appetite for Raising Funds Among J-REITs Remains Strong in 2015

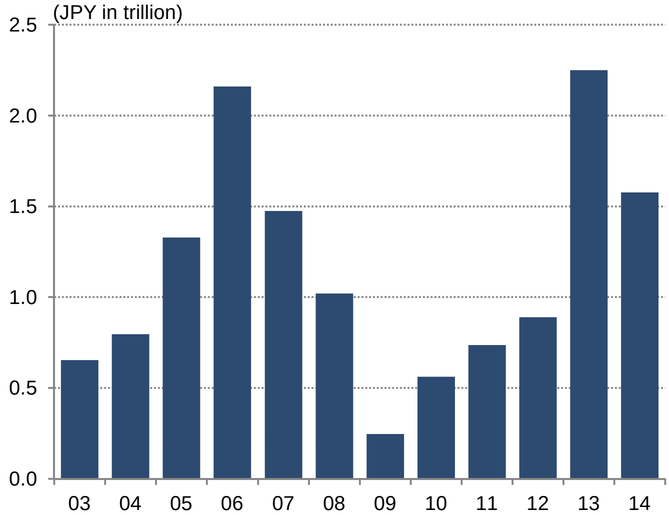
- There has been a succession of announcements of POs since the start of 2015 as well. Already in January alone 7 POs, including the IPO of Kenedix Retail REIT Corporation, have been announced, with their total issue amount expected to be approximately JPY217 billion. Although competition to acquire properties is growing fiercer, the appetite for raising funds remains strong among J-REITs. Some companies are aiming to make IPOs during 2015 as well, so that it appears likely that 2015 too will see active fund-raising and property-acquisition activities among J-REITs.

【Fig.5】Equity Financing by J-REIT



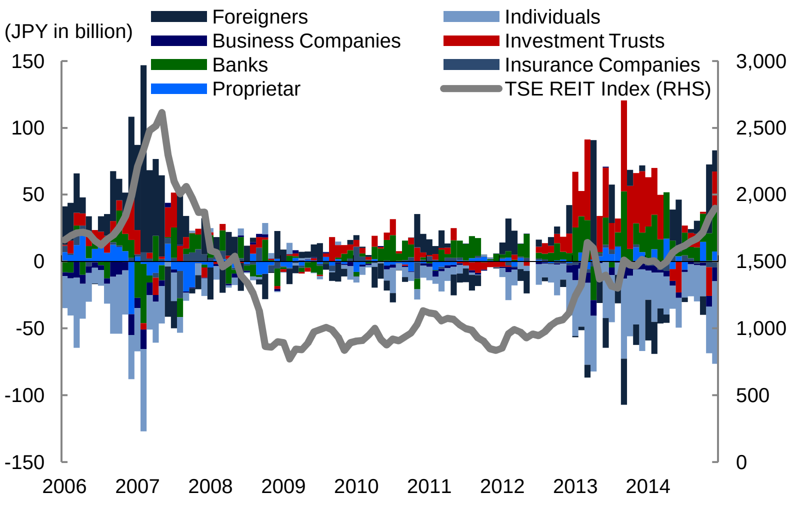
Source: Bloomberg, Kenedix

【Fig.6】Property Aquisition Volume by J-REIT



Source: J-REITs publication documents, Kenedix

【Fig.7】Trading Volume of J-REIT by Investor Type (balance)



Source: Tokyo Stock Exchange, Kenedix

【Fig.8】Public Offering by J-REITs in 2015

Name	Offering Value (JPY in billion)
Premier REIT	27.2
Kenedix Retail REIT	59.6
Conforia Residential REIT	19.5
Japan Hotel REIT	16.2
Kenedix Residential	23.8
Nippon REIT	50.2
Aeon REIT	20.7

Source: Bloomberg, Kenedix

【Number of Visitors to Japan from Overseas】

Number of Visitors to Japan from Overseas Sets New Record High

- The number of visitors to Japan from overseas in 2014 set a new record high of 13.41 million, up 29.4% YoY. Numbers of visitors from all the leading markets in Asia set new record highs, including 2.4 million visitors from China, up 83% YoY, and a new record set for visitors from Taiwan for the third consecutive year. This appears to be being propelled by large-scale easing of requirements for issue of visas and expansion of the system of exemption from consumption tax for overseas visitors, in addition to a sense that a visit to Japan is a bargain due to the devaluation of the yen.

Hotel Occupancy Rates Maintain their High Level

- Hotel occupancy rates in key cities are rising, thanks in part to the increase in the number of visitors from overseas. The occupancy rate in limited service hotels in Q3 2014 was up 3.5% points YoY to 85.2% in Tokyo and up 5.7% points YoY to 87.2% in Osaka. Contributing factors would appear to be increases in domestic travelers avoiding overseas travel since it has become more expensive due to the devaluation of the yen as well as increasing business use as the economy improves, in addition to the increase in the number of visitors from overseas.

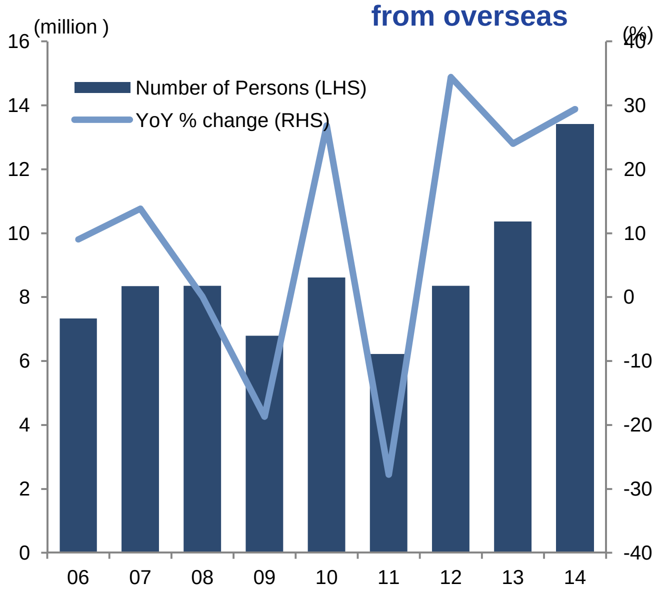
Increasing Consumption by Visitors from Overseas Generates New Business Opportunities for Retail Facilities

- The increase in the number of visitors from overseas also is having a positive effect on retail facilities. The total amount of travel consumption by visitors to Japan from overseas rose 43.3% YoY to JPY2.3 trillion, a new record high. It is estimated that 35.2% of this figure, or JPY714.2 billion, is spend on shopping (according to the Japan Tourism Agency). The move to exempt visitors from overseas from paying consumption tax on all goods including consumables beginning in October 2014 probably can have had an effect. As seen by major drugstore operator Matsumoto Kiyoshi Holdings Co., Ltd. growing its number of stores able to handle exemption from consumption tax, retailers are rushing to serve visitors from overseas. In addition, plans have been announced to open a duty-free shop selling merchandise exempt from not just consumption tax but other taxes and duties including customs duty, tobacco tax, and alcohol tax in autumn 2015 inside Mitsukoshi's Ginza department store. This joint venture between the 4 companies of Isetan Mitsukoshi Holdings, Japan Airport Terminal Co., Narita International Airport, and NAA Retailing aims to open the first duty-free shop in a non-airport location in Japan (other than Okinawa).

Number of Visitors to Japan from Overseas Expected to Increase in 2015 As Well

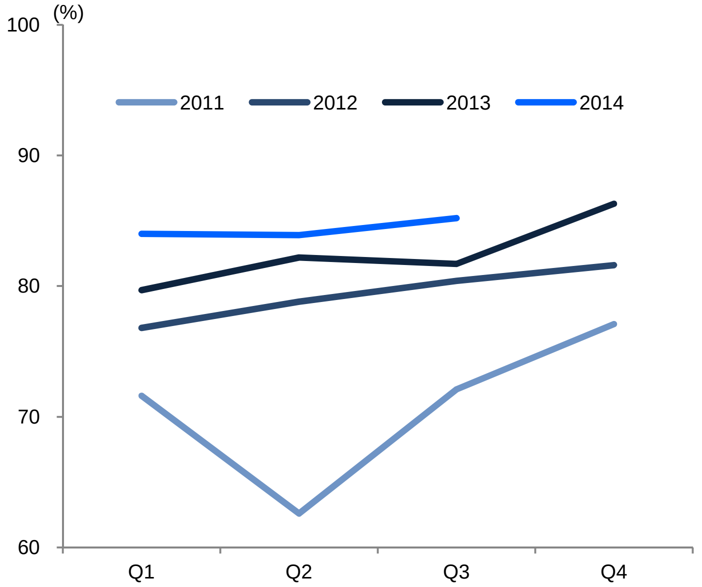
- According to the Prospective Travel Trends in 2015 prepared by JTB Corp., the population of domestic travelers is projected to increase by 1.0% YoY to 290 million while the population of travelers from overseas is projected to rise by 13% YoY to 15 million. Since Japanese people's appetite for leisure travel remains strong and the yen's exchange rate is respected to remain low against other currencies, conditions are projected to remain ones in which it is easy for visitors from overseas to travel to Japan.

【Fig.9】Number of Visitors to Japan from overseas



Source: Japan National Tourist Organization

【Fig.10】Hotel Occupancy Rate



Source: The Japan Tourism Agency

Market View

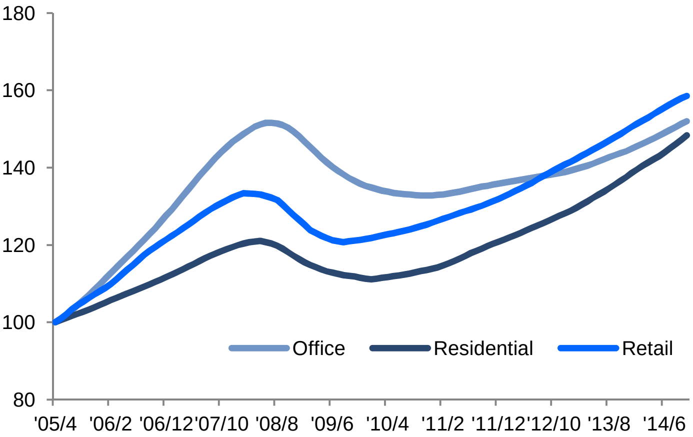
Review of Past Performance of Typical Asset Classes

An inflow of funds to investment real estate continues, and competition to acquire properties is gradually growing fiercer. Investors' risk tolerance is increasing and their types of investment assets and areas invested in continue to grow. In light of these factors, a review of the past performance of the 3 typical asset classes of office buildings, residential properties, and retail facilities follows.

Retail Facilities Surpass Office Buildings in Cumulative Performance Over the Past 10 Years

- This review employs the ARES Japan Property Index (AJPI), published by the Association for Real Estate Securitization (ARES). Fig. 11 shows the total return index for each asset class (April 2005 = 100). While the cumulative performance of office buildings had been highest consistently since April 2004, since September 2012 the cumulative performance of retail facilities has exceeded that of office buildings.

【Fig.11】AJPI Total Return Index



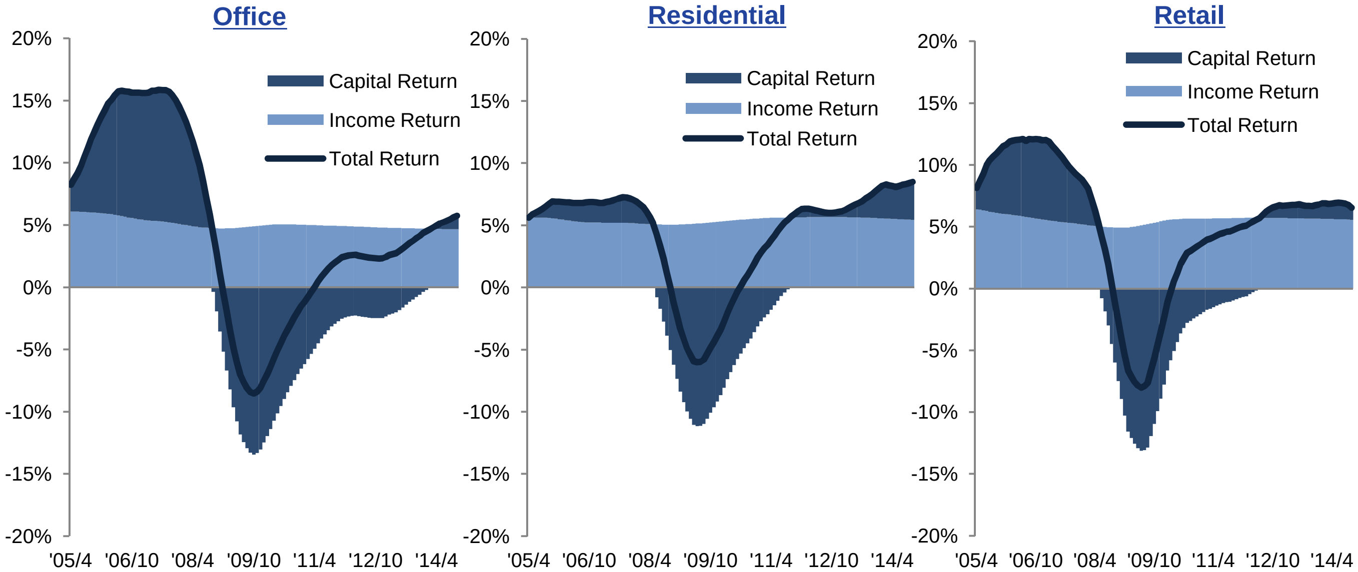
Source: The Association for Real Estate Securitization

The Recovery of Capital Returns is Delayed for Office Buildings

- Fig. 12 shows total returns split into income returns and capital returns. From this it can be seen that the high returns on office buildings from 2004 through 2008 were driven by capital returns.

While capital returns on retail facilities were relatively high over this period, reaching as high as 6.48% (for annualized monthly returns), they were not as high as those of office buildings, which surpassed 10%. However, in October 2008 capital returns on office buildings fell into negative territory, as did total returns in January 2009. While total returns for residential properties and retail facilities also fell into negative territory, they recovered into positive territory earlier than those for office buildings, in April 2010 for both retail facilities and residential properties. Total returns for office buildings would recover into positive territory about 1 year later in April 2011. Even after that, capital returns on office buildings remained negative until finally reaching positive territory in March 2014.

【Fig.12】Return by Asset Classes (annualized rate)



Source: The Association for Real Estate Securitization「Japan Property Index」, Kenedix

Retail Facilities Generate Relatively High Returns

- Conceivable factors behind the higher cumulative performance of retail facilities than office buildings include (i) relatively higher income returns for retail facilities and (ii) low capital returns on office buildings over a lengthy period of time. Fig. 13 shows cumulative performance (annualized) over this period (April 2005 - April 2014). While total returns on retail facilities were highest at 4.41%, the risk (standard deviation) on such facilities at 2.8% was lower than that of office buildings. It is surmised that in addition to retail facilities having maintained a relatively stable, high level of income returns, they also offered a lower level of price fluctuations than office buildings. The figure also shows that residential properties were the assets with the lowest levels of risks and returns.

【Fig.13】Risk/ Return by Asset Type

Total Return	Office	Residential	Retail
Risk	2.2%	1.4%	1.7%
Return	4.82%	4.50%	5.32%

Source: The Association for Real Estate Securitization, Kenedix

Caution Required on Liquidity Risk and Other Factors

- However, this analysis does not take into consideration 3 important points. The first of these is liquidity risk. In general, office buildings are the most popular asset among investors, and they offer a lower exit risk than retail facilities. This is why income returns on office buildings are the lowest. The second point is the fact that AJPI's capital returns are based on appraised value. While appraised values are prices determined through proper assessment by experts, they may differ from actual market values. This analysis ignores this point. The third is the fact that the data on retail facilities used in this analysis mixes urban and suburban retail facilities together. Urban and suburban retail facilities differ completely in character, and it is easy to imagine that their risk-return profiles also differ greatly. Urban retail facilities are similar in character to office buildings. On the other hand, while suburban retail facilities can enjoy relatively stable income returns as long as they have stable occupancy rates, their liquidity risk is higher than that of urban retail facilities. Thus it is surmised that including in the single category of retail facilities these 2 assets that differ in character results in a lower level of risk and a higher level of performance. Put another way, this can be said to demonstrate the possibility of benefiting from diversification of assets.

Real Estate Investment Market

The value of trading in commercial real estate set a record high in 2014

The value of trading in commercial real estate in Q4 2014 rose 38% YoY to JPY1.32 trillion, breaking through the JPY1 trillion barrier and rising for the first time in 3 quarters (DTZ). As a result, the value of trading in commercial real estate in 2014 reached a new record high (JPY4.04 trillion). There was a succession of large-scale transactions including those for Pacific Century Place Marunouchi and the former head office building of Mizuho Bank. In addition, although not included in DTZ's data on the value of trading in commercial real estate, a portfolio of rental residential properties held by GE Japan was purchased by a Blackstone Group investment fund. Particularly prominent were investments made by developers as part of their business strategy and large-scale investments by core investors.

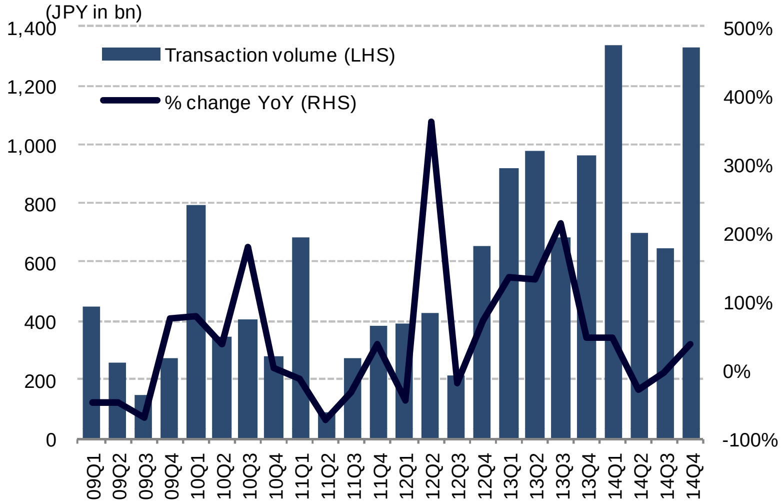
Acquisition of properties by J-REITs down roughly 30% YoY

The value of properties acquired by J-REITs in Q4 2014 was down 22% YoY to JPY499.1 billion. While this was the highest quarterly figure in the year, it was down from the previous year, so that on a full-year basis the value of properties acquired by J-REITs was down 29.9% YoY to JPY1.57 trillion.

Acquisition of properties by J-REITs off to a good start in the new year

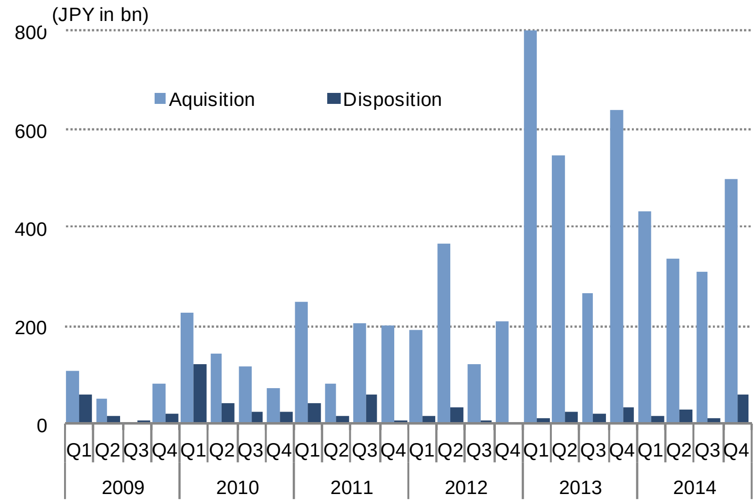
In January 2015 7 POs, including the IPO of Kenedix Retail REIT Corporation, were announced. When acquisitions of properties through capital increase are included, the value of acquisitions announced in January alone already totals JPY323.3 billion, so that the J-REIT market is off to a good start in 2015.

Commercial Property Transaction



Source: DTZ

Property Transaction by J-REITs



Source: J-REITs, Kenedix

Significant Deals

Name	Asset Type	Buyer	Prefecture	Price (¥bn)	GFS (sqm)	Date
A Portfolio of Residential Properties Held by GE	Residential	Blackstone	Nationwide	200.0	-	Nov-14
Pacific Century Place Marunouchi	Office	Government of Singapore Investment Corporation (GIC)	Tokyo	170.0	38,840	Oct-14
Former Mizuho Bank Head Office Building	Office	Mizuho Financial Group	Tokyo	159.0	74,088	Nov-14
Gotenyama SH Building	Office	Sekisui House Reit	Tokyo	51.5	19,813	Dec-14
Shinjuku-I-Land	Office	Tokyu Land	Tokyo	47.6	38,353	Oct-14
Garden City Shinagawa Gotenyama	Office	Sekisui House Reit	Tokyo	39.7	21,033	Dec-14
Shiodome Building	Office	Activia Properies	Tokyo	30.3	17,390	Nov-14
Ginza MTR Building	Office	Nomura Real Estate Development	Tokyo	24.0	23,614	Oct-14
Honmachi South Garden City	Office	Sekisui House Reit	Osaka	23.1	16,699	Dec-14
Ochanomizu Solacity	Office	Hulic REIT	Tokyo	22.9	12,597	Nov-14
Park City Musashikosugi Plaza	Retail	Jowa Real Estate	Kanagawa	10.8	12,224	Oct-14
Mita MT Building	Office	Mori Trust	Tokyo	13.0	21,043	Nov-14

Source: Companies publication documents, News Reports, Kenedix

J-REIT Market

J-REIT unit prices fall in response to the rapid rise in yields on 10-year JGBs

Performance of the TSE REIT Index for October-December 2014 was +13.6%, better than the TOPIX performance of +6.1% over the same period. The TSE REIT Index has shown a particularly rapid rise since the Bank of Japan announced additional monetary easing at the end of October.

However, its performance since the start of 2015 has been weak at -4.5%, even while TOPIX maintains positive performance of +0.7%. This probably is due to the fact that long-term yields rose rapidly in response to the weak bidding on 10-year JGBs on February 3. The yield on 10-year JGBs stood at 0.388% on February 10, reflecting a rapid increase over a short period of time from a level of 0.201% on January 19.

The yield spread rebounds

While the yield spread based on the TSE REIT Index fell by 0.16% points over the period October-December 2014, since the start of 2015 it has risen by 0.08% points to 2.68% (as of February 10). While J-REIT unit prices fell, dividend yields rose by 0.15% points to 3.08 % from 2.93% at the start of the year. While yields on 10-year JGBs also rose, they did not rise by as much as J-REIT dividend yields did.

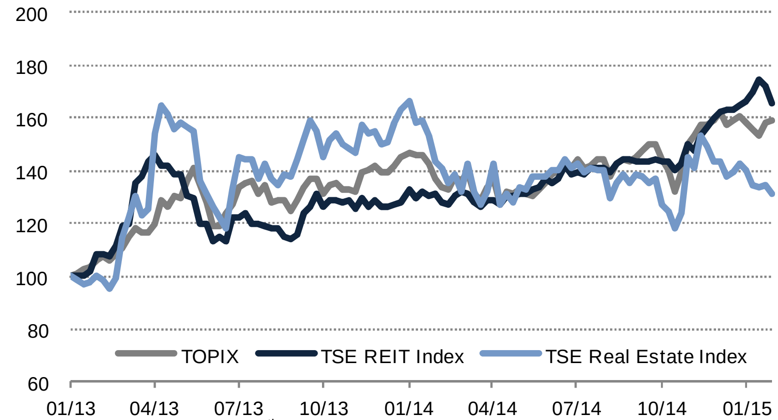
Residential REITs showed the highest rate of growth in 2014

A look at performance by asset type shows that Residential REITs demonstrated strong performance over the period October-December 2014, at +25.5% (vs. +10.9% for office REITs and +12.2% for retail and logistics REITs). Full-year performance for 2014 also showed major differences among asset types, with office REITs up 18.6%, residential REITs up 43.6%, and retail and logistics REITs up 27.8%. However, the performance of residential REITs has been the lowest among these 3 asset types since the start of the year, at -6.4% (over the same period office REITs at -4.2% and retail and logistics REITs at -4.1%).

Solid performance among overseas REITs

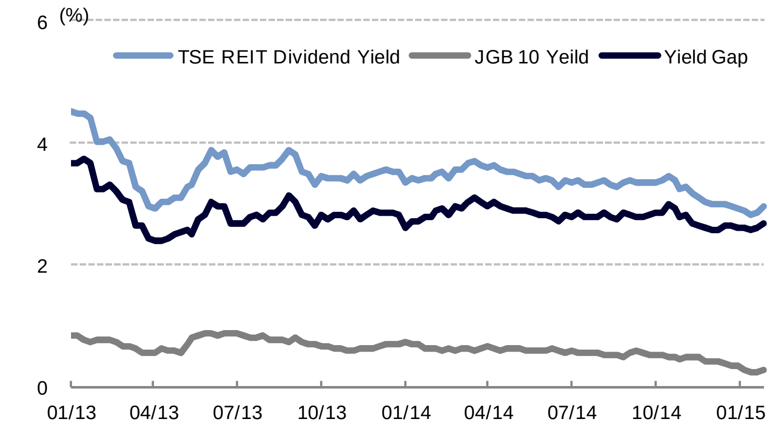
Leading overseas REIT markets showed solid performance over the period October-December 2014. The U.S. REIT index was at +12.9%, the U.K. index +9.6%, the Australian index +9.8%, and the Singapore index +3.9%. While the J-REIT market has been bearish since the start of 2015, overseas REIT markets have been favorable in general. The yield spread in each country based on its REIT index is 1.44% in the U.S., 0.95% in the U.K., 1.33% in Australia, and 3.49% in Singapore. The yield spread rose over this period as the yields on 10-year government bonds fell even more than did dividend yields. However, future developments should be observed closely because yields on 10-year government bonds have shown something of an upward trend recently.

J-REIT Index & Stock Market Index (Jan. 2013=100)



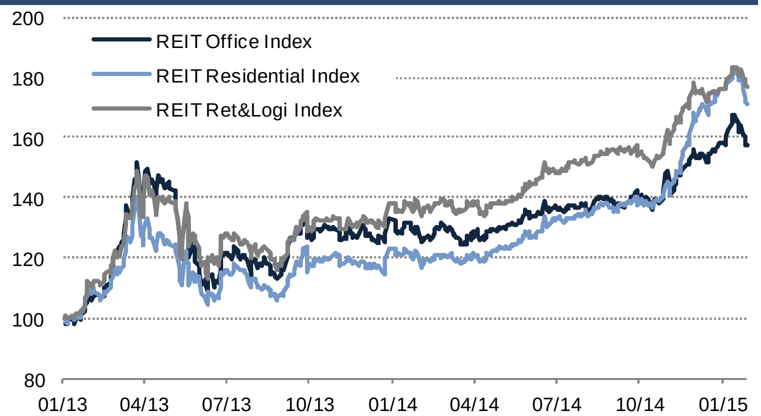
Source: Bloomberg (As of 30th January 2015)

Yield Spread



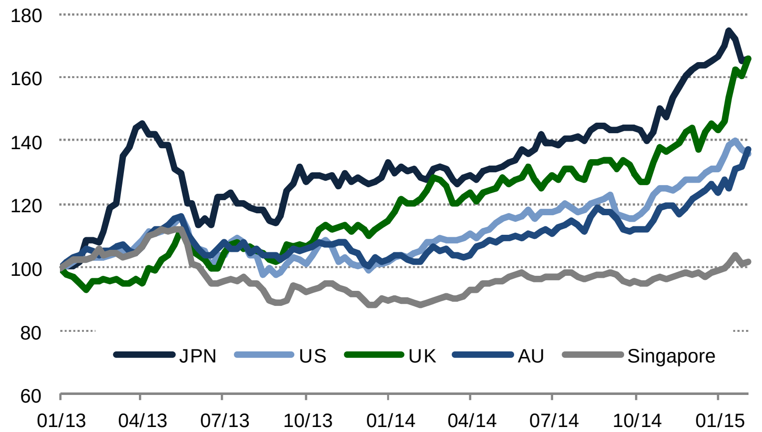
Source: Bloomberg (As of 30th January 2015)

J-REIT Index by Asset Class (Jan. 2013=100)



Source: Bloomberg (As of 30th January 2015)

Key Country REIT Index (Jan. 2013=100)



Source: Bloomberg (As of 30th January 2015)

Steadily decreasing vacancies

The average vacancy rate in the 5 central wards of Tokyo in January 2015 fell by 0.11% points from the previous month to 5.36% (Miki Shoji). This represents a decrease of 0.29% points over a 4-month period from 5.65% at the end of September 2014. Over this period, roughly 20 thousand tsubo (approx. 66 thousand sqm) of vacancies were filled, as vacancies fell over 19 consecutive months through January. A look at vacancies in individual wards shows that in January the vacancy rate increased only in Minato Ward, which saw new supply during this period, whiles falling steadily in the other wards. At the end of January the vacancy rate in Shinjuku Ward had fallen to 5.03%, almost breaking below the 5% barrier, an indication of the strength of demand for office space.

A strong increase in asking rents

Asking rents in January were up 5.3% YoY to JPY17,109/month per tsubo. This represents an increase of about 1% from the previous month, showing the very strong pace of growth. While building owners seem to be seeking rent increases, the decrease in vacancies is likely to be a contributing factor. In particular, it is becoming difficult to secure large groupings of floor area in competitive newer buildings, as the balance between supply and demand appears to be continuing to tighten.

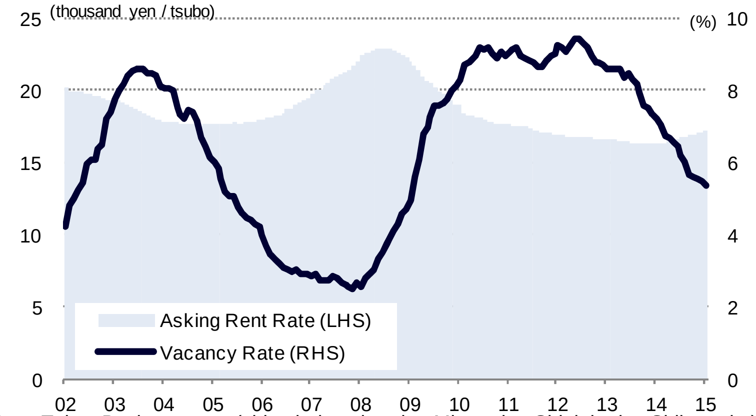
The vacancy rate in grade-B and better office buildings falls to the 3% level

While the vacancy rate on grade-A office buildings in the 23 wards of Tokyo at the end of December 2014 had risen by 0.1% points from the previous quarter, to 4.1%, at the end of January 2015 it fell by 0.3% points to 3.8% (CBRE). The vacancy rate on grade-B office buildings was 3.8% while that on grade-A- buildings was 3.7% (at the end of January 2015), so that the vacancy rate in grade-B and better office buildings has fallen to below the 4% barrier.

Trends in contracted rents should be watched closely

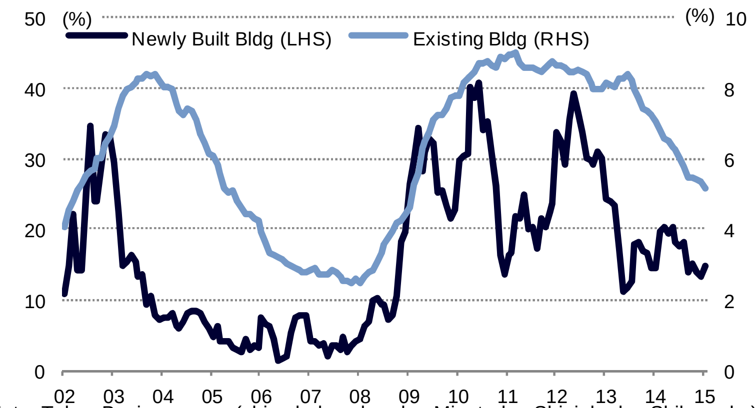
The Office Rent Index published by Sanko Estate and NLI Research Institute (based on contracted rents) shows a slight increase of 0.8% (JPY238) QoQ in rent on class-A office buildings, to JPY30,573/month per tsubo, in Q4 2014. It would appear that while the movement toward increasing asking rents spreads, centered on competitive office buildings, the rate of increase in contracted rents is limited. Average assumed achievable rent on grade-A office buildings, announced by CBRE, was up 1.4% (JPY450) MoM in January 2015 to JPY32,650. This increase compares favorably to that in asking rents announced by Miki Shoji. Trends in contracted rents should be watched closely in the future to see the degree to which tenants accept building owners' bullish approach to rent increases.

Vacancy Rate & Asking Rent Rate



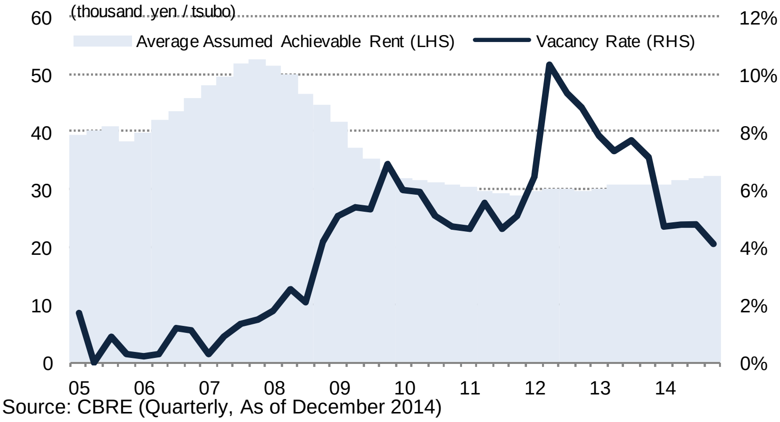
Note: Tokyo Business area (chiyoda-ku, chuo-ku, Minato-ku, Shinjuku-ku, Shibuya-ku)
Source: Miki Shoji Co., ltd. (Monthly, As of January 2015)

Vacancy Rate of Newly Built Bldg & Existing Bldg.



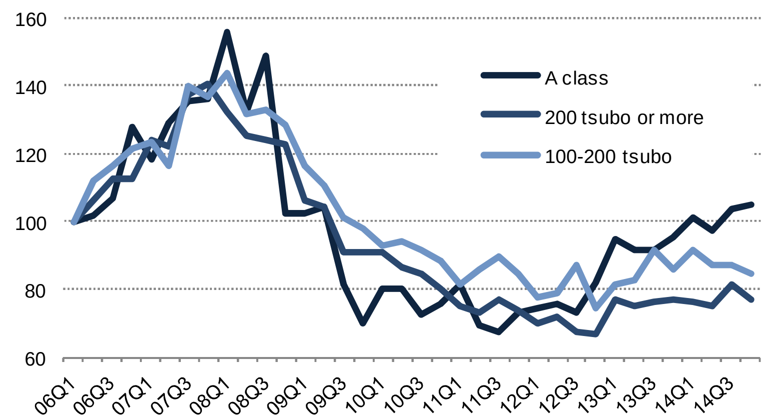
Note: Tokyo Business area (chiyoda-ku, chuo-ku, Minato-ku, Shinjuku-ku, Shibuya-ku)
Source: Miki Shoji Co., ltd. (Monthly, As of January 2015)

Vacancy Rate & Asking Rent Rate for Grade A



Source: CBRE (Quarterly, As of December 2014)

Office Rent Index (2006Q1=100)



Note: Tokyo 23 wards, Source: CBRE (Quarterly, As of December 2014)

PARTNERS IN GROWTH KENEDIX

Population inflow to central Tokyo accelerating

The inflow of population to central Tokyo continues. The rate of population increase (QoQ) in the quarter October-December 2014 was 0.11% in the 23 wards of Tokyo and 0.34% in the 5 central wards, as the increase in population continues at a high level. Also, the population of Fukuoka City rose by 0.17% QoQ, an even higher level than in the 23 wards of Tokyo. On a full-year basis, population increased in 2014 by approximately 1% (86 thousand people) YoY in the 23 wards and approximately 2% (20 thousand people) YoY in the 5 central wards. Fukuoka City's population grew by about 0.8% (12 thousand people) over the same period.

Occupancy rates remain high as owners focus on rents

The occupancy rate at rental apartments in the greater Tokyo area held mainly by residential J-REITs was 95.7% at the end of December 2014, up 0.4% points YoY. While this was down 0.2% MoM, it still represented the fifth consecutive month of YoY increases. Occupancy rates remain high even while residential REITs are strengthening their posture of focusing on rents. Since rents are rising it would appear that demand for high-quality rental residences remains strong as the increase in population in the greater Tokyo area accelerates.

Residential rents are up 5.0% since bottoming out

According to the Condominium Rent Index (for single-bedroom units) published by At Home Co., Ltd. and Sumitomo Mitsui Trust Research Institute Co., Ltd., rents in the 23 wards of Tokyo continue to rise. Rent in Q3 2014 was up 0.1% from the previous quarter, as it increased for the ninth consecutive quarter. Current rents are up roughly 5% since bottoming out in Q3 2011.

Pressure from supply of rental apartments appears limited

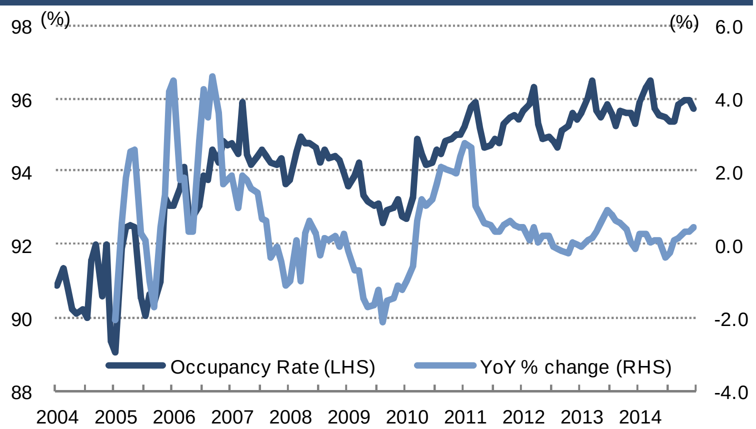
Rental housing starts nationwide in Q4 2014 were down 6.8% YoY to 98 thousand units, dropping for the second quarter in a row. In general, rental housing starts were down YoY in each of the major urban areas, falling YoY by 8.3% in Tokyo, 1.8% in Osaka Prefecture, 6.0% in Aichi Prefecture, and 18.8% in Fukuoka Prefecture. This would appear to be a result of demand for rental residential construction as a tax-saving measure in anticipation of the effective increase in inheritance tax implemented in January 2015 coming to a halt. Rental housing starts in Tokyo during 2014 reached 61 thousand units, up 6.2% YoY. While this figure has increased for 4 consecutive years to reach a level even higher than that around 2010, it is not likely to be a cause for concern since the pace of the increase in housing starts appears to have calmed recently.

Population in Major Cities

	Dec-13	Sep-14	Dec-14	QoQ	YoY
Tokyo	13,294,039	13,378,584	13,389,584	0.08%	0.72%
Tokyo 23 ward	9,067,255	9,143,041	9,153,511	0.11%	0.95%
Central 5 wards in Tokyo	941,825	958,748	962,049	0.34%	2.15%
Nagoya city	2,272,075	2,276,590	2,277,595	0.04%	0.24%
Osaka city	2,683,469	2,686,246	2,686,990	0.03%	0.13%
Fukuoka city	1,509,893	1,519,349	1,521,881	0.17%	0.79%

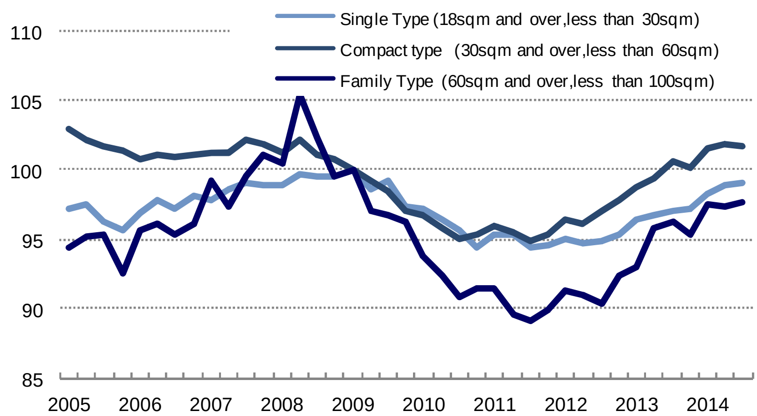
Source: Respective city

Occupancy Rate for Rental Apartment (Hold by J-REIT)



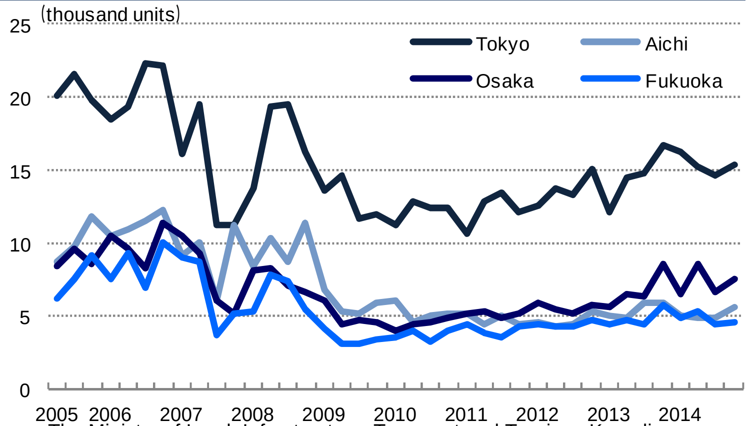
Note: Occupancy rate＝occupancy area / rentable area, in the greater Tokyo area
Source: Kenedix prepared based on data of major residential REIT (As of December 2014)

Condominium Rent index (Tokyo 23 Wards)



Note: adopting "Condominium Rent Index" Chain reaction model
Source: Sumitomo Mitsui Trust Research Institute Co., Ltd., At Home Co., Ltd.

New Construction Starts of Rental Dwellings



Source: The Ministry of Land, Infrastructure, Transport and Tourism, Kenedix
(Quarterly, As of December 2014)

Logistic facilities: booming demand continues

The average vacancy rate in large-scale multitenant logistic facilities in the greater Tokyo area in Q4 2014 was 3.8%, down 1.1% points from the previous quarter (CBRE). All 3 new facilities completed during the quarter are operating at full occupancy, and vacancies appear to have decreased in new properties completed in the earlier quarters of 2014 as well. According to CBRE, new demand over the full year of 2014 totaled 190 thousand tsubo, the second highest level after the record high of 220 thousand tsubo in 2013. In October 2014 Fast Retailing, which operates the Uniqlo stores, and Daiwa House Industry announced plans for the joint construction of a dedicated logistics warehouse and the start of a joint logistics business. Their goals include shortening delivery times and reducing delivery costs. Examples such as this are apparent here and there of businesses in the retail industry hurrying to expand logistics facilities in order to grow their e-commerce sales.

New supply projected to reach a record high in 2015

New supply is projected to reach a record high in 2015. In particular, supply coming on line in Q4 2015 is projected to rise rapidly to 150 thousand tsubo (CBRE). As a result, while there are concerns that the balance between supply and demand could worsen temporarily in areas seeing concentrations of new supply, demand for advanced logistics facilities remains strong from retailers and 3PL firms, so that it would appear to be unlikely that conditions would worsen in the market as a whole.

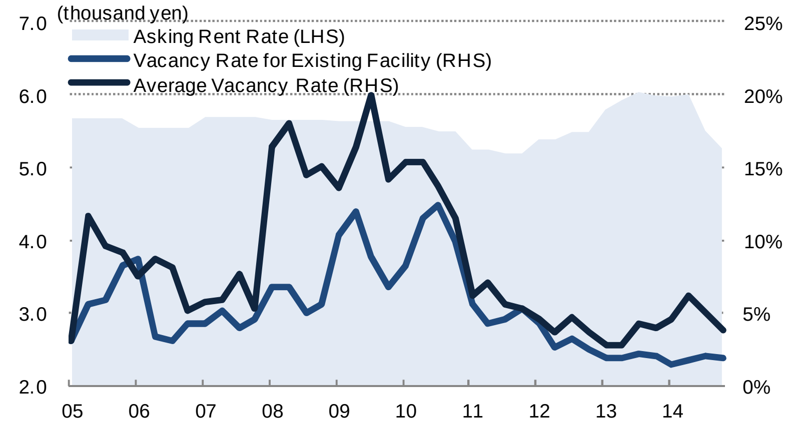
Retail facilities: rising prices of food, beverages, etc. having an impact

Retail sales in December 2014 were up 0.2% YoY for the sixth consecutive month of YoY increases. Existing-store sales at shopping centers were up 0.9% YoY in December, as they continue to experience ups and downs. At the same time, department-store sales have shown negative growth for 9 consecutive months since the consumption tax rate was increased in April. A look at sales by product category shows continuing decreases in sales of products such as apparel, furniture, and home appliances, while sales of other products, including food, beverages, and accessories, continue to rise. While this appears to reflect the impact of rising prices for products such as food and living supplies, future trends should be observed closely in light of recent drops in crude-oil prices.

Conditions differ somewhat between prime locations and peripheral areas

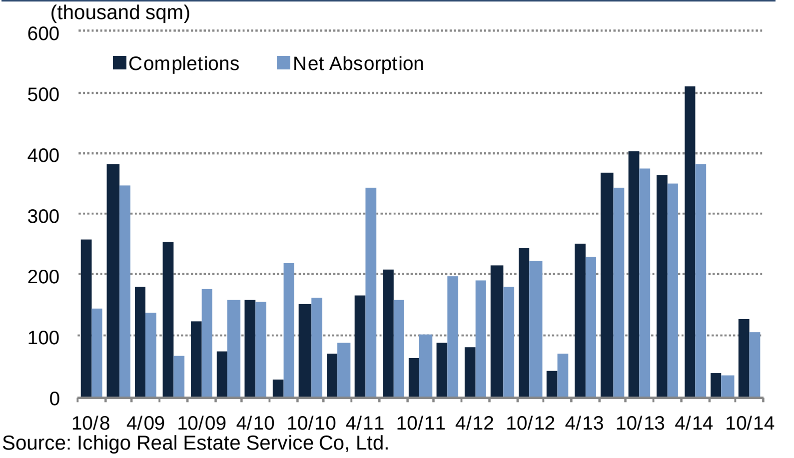
While asking rents on retail stores in central Tokyo appear stable overall, conditions appear to remain tough in other than prime locations. Asking rent in Q3 2014 was up 8.1% QoQ to JPY49,695/month per tsubo on a first-floor space in the Ginza area, but down 6.1% QoQ to JPY25,093/month per tsubo on spaces on floors other than the first. Available first-floor spaces are decreasing in number, while those on other floors are increasing. At the same time, in the Omotesando area available spaces are decreasing on all floors, and asking rent is up 12.7% QoQ.

Asking Rent & Vacancy Rate for Logistics



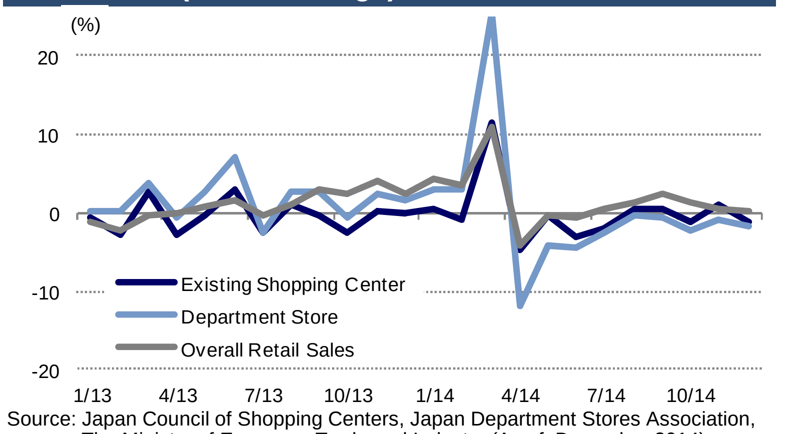
Source: CBRE (Quarterly for Vacancy Rate, as of Q4 2014)

Supply-Demand Balance in Tokyo Area for Logistics



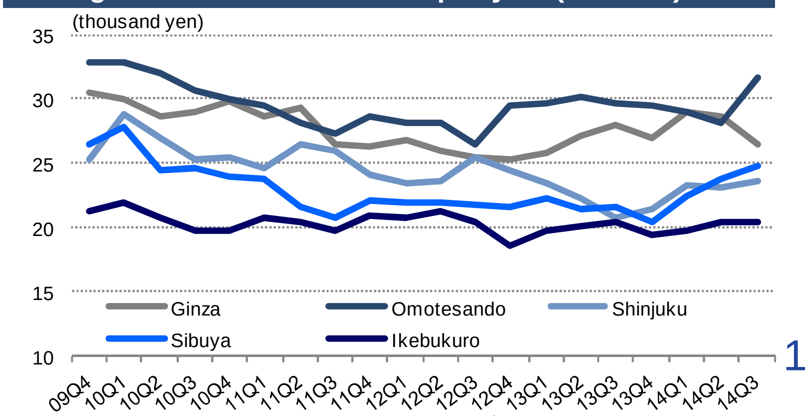
Source: Ichigo Real Estate Service Co, Ltd.

Retail Sales (YoY % change)



Source: Japan Council of Shopping Centers, Japan Department Stores Association, The Ministry of Economy, Trade and Industry (As of December 2014)

Asking Rent Rate for Retail Propertyies (All floor)



Source: BAC Urban Project Co., Ltd. (As of Q3 2014)

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