Savills World Research
Japan

# Asian Cities Report
# Japan Investment

2H 2015

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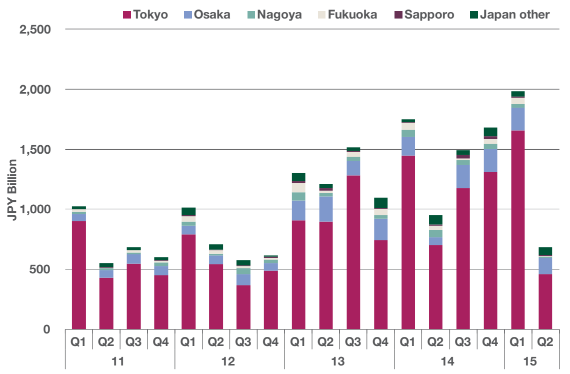
GRAPH 1

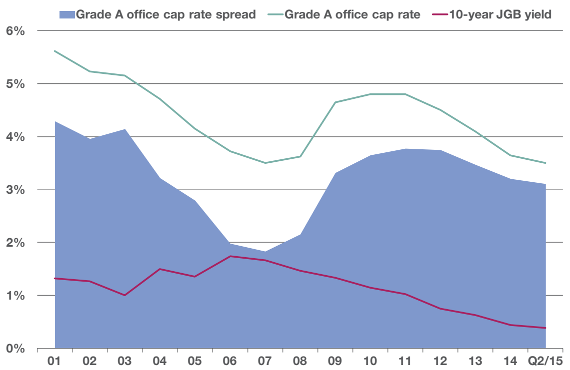
**Japan transaction volumes by area, Q1/2011–Q2/2015**




Source: RCA, Savills Research & Consultancy

GRAPH 2

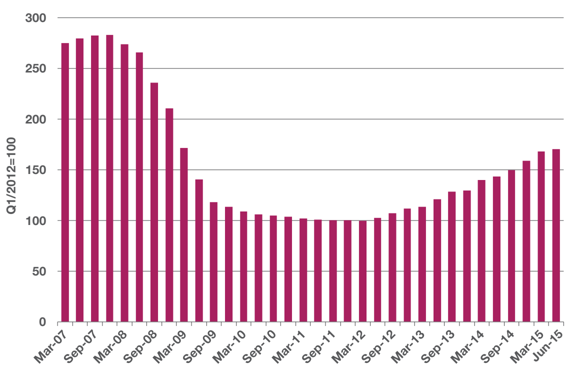
**Tokyo Grade A office cap rates, 2001–Q2/2015**




Source: Savills Research & Consultancy

GRAPH 3

**Tokyo prime office capital value index, Q1/2007–Q2/2015**




Source: Savills Research & Consultancy

## Overview

Transaction volumes for real estate in Japan have increased substantially compared to the market nadir in 2012. Recent figures by Real Capital Analytics (RCA) suggest that approximately JPY2.7 trillion worth of properties were transacted from reported deals in Japan during 1H/2015. Approximately 80% of the total transactions were concentrated in Tokyo, while transactions in other regions also rose as investors sought higher yields. Over the past few years, Japan's transaction volumes in the second quarter have tended to be lower than in the first. The uncertainty of the global economy, however, geopolitics and the scarcity of opportunities in the current market significantly pulled the Q2/2015 figure down to JPY695 billion, the lowest level since late 2012.

The office market in Tokyo has been one of the most popular for many investors thanks to Japan's positive economic outlook and its institutional grade market. Amid interest from overseas investors and strong domestic demand, acquiring assets with reasonable yields has been more challenging, and the expected cap rate[1] for Grade A office buildings in Tokyo has already touched the lowest level since 2007. However, considering the ultra low-financing cost in Japan, Tokyo's office market is appealing as it offers one of the widest yield spreads (approx. 3.1% as of Q2/2015) compared to other major cities. In addition, with the continued positive rental growth in the office sector over the past two years, Tokyo's prime office capital value has a significant potential for further growth. The Q2/2015 capital value still stands at 40% lower than the peak in Q4/2007.

## Investment volumes by asset class

In 1H/2015, the office sector remained the most popular asset class, accounting for about half of Japan's total acquisitions by value, followed by retail at around 16% and residential at just over 9%. One of the notable transactions in 2015 year-to-date was the sale of Meguro Gajoen, a 155,800-sq m office complex in Meguro Ward, by Mori Trust. The buyer was LaSalle Investment Management who reportedly paid approximately JPY140 billion for the asset with China Investment Corporation (CIC) funding.

## Major players in Japan's property market

With strong commitment by the Abe administration and the Bank of Japan (BOJ), Japan's economy has enjoyed reasonable gains in the financial market while export businesses have also generated profits. The TSE REIT Index grew from 957.38 (29 June 2012) to 1,803.13 as of 30 June 2015. The market capitalisation in the J-REIT sector substantially increased – to approximately JPY10.6 trillion as of June 2015 from JPY3.6 trillion as of June 2012. Hence, listed companies and REITs (Listed/REITs) accounted for more than half of all property transactions, while transaction volumes by cross-border investors also grew, with a 15% share of the total.

## Japanese Real Estate Investment Trusts (J-REIT)

During 1H/2015, three new J-REITs were successfully listed on the Tokyo Stock Exchange (TSE). Kenedix Retail REIT specialising in retail facilities was listed in early February, with an initial portfolio of approximately JPY80 billion (18 properties). A month later, Healthcare & Medical Investment Corporation sponsored by Sumitomo Mitsui Banking Corporation (SMBC) and other entities was listed. The J-REIT specialises in healthcare facilities including nursing homes for the elderly, with around JPY24 billion (16 properties) of assets under management (AUM) at the time of the listing. In June, another new J-REIT Samty Residential Investment Corporation was listed on TSE with initial AUM of JPY30.5 billion (28 properties), with regional rental residences comprising 70% of its portfolio. These new players are a testament to the further diversification of J-REITs in terms of asset class and geography.

The current competitive environment has put increased pressure on some market players to diversify their portfolios while keeping an eye out for high quality assets across a variety of sectors. Nomura Real Estate Asset Management recently started an initiative to merge three J-REITs, targeting assets of JPY900 billion or more.

Mitsubishi Corp. - UBS Realty Inc., a joint venture which manages Japan Retail Fund and Industrial & Infrastructure Fund, has acquired 65% of the shares of MID REIT Management, which manages MID REIT (currently known as MCUBS MidCity). The acquisition will expand the asset management company's investment portfolio to include office buildings, while remaining strong in its current sectors – retail and industrial. Following the acquisition, the total AUM of the three listed J-REITs will total around JPY1.2 trillion. The seller, MID Urban Development, will continue to hold the remaining 35% stake.

Private REITs (P-REIT) have also rapidly grown in asset size, hitting a total of over JPY1 trillion during 2015. Some institutional investors prefer P-REITs to J-REITs because of their stable price movement as unlisted vehicles. Acquisition competition between J-REITs and P-REITs has been fiercer than ever.

## Overseas funds

Sentiment towards the Japanese real estate market remains steady, and groups of international investors have successfully raised funds to strengthen their balance sheets, proof of a bullish appetite and positive outlook for the region.

In May, Savills Investment Management (formerly Cordea Savills) announced the first closing of its Greater Tokyo Office Fund with initial purchasing power of JPY40 billion. 100% of first close capital was sourced in Asia with participation from private banks, family offices and institutional investors. Straits Real Estate will be the Sponsor Limited Partner for the fund, and has made an initial commitment of JPY4.9 billion.

In June, CLSA Capital Partners announced the closing of its third Asian real estate fund, named Fudo Capital III L.P., at its hard cap of US$1 billion, higher than its initial target of US$850 million. The fund will focus on acquiring all asset classes in Asia, with the aim to reposition the assets located in first tier cities in Japan, China, Australia, Hong Kong, and others. At the same time, Singapore's SC Capital Partners launched a new US$400 million Asia property fund, following soon after the successful US$850 million close of its RECAP IV fund earlier this year. The fund will focus on more developed markets in Asia, such as Japan and Australia.

## Public pension funds

The positive outlook for economic recovery in Japan has already attracted the attention of pension funds. German pension fund BVK and the Malaysian public pension fund EPF have begun acquiring properties in Japan for the first time.

Norges Bank Investment Management (NBIM), manager of the US$870 billion Norwegian Government Pension Fund Global is set to establish an office in Tokyo within a year. The fund is expected to be targeting Tokyo and Singapore for its first real estate investments in the region, with a focus on mainstream property types such as office buildings and logistics.

## Outlook

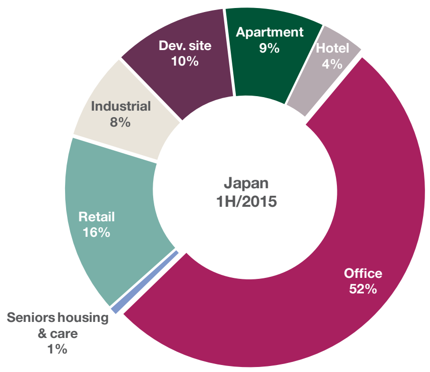
Further cap rate compression for Tokyo's office sector has brought it to the same level as it was in 2007, leading to a cautious attitude by investors. However, rental values still stand at only 60% compared with 2007, implying that there is potential for rental growth which is a comfort for investors. The strong trend will continue along with Japan's positive economic outlook, expanding capital in J-REITs and P-REITs and widely improved lending attitudes. To see cap rates compress further in Tokyo, the market needs to see the expected rental growth first. Cap rates are likely to compress further in regional cities, because of yield gaps between Tokyo and regional cities.

Compared with other developed markets, Tokyo is appealing as it offers a wide yield spread against the 10-year government bond yield, which is likely to remain low for the foreseeable future. In the office sector, considering that Tokyo is still lagging in terms of rental recovery compared to other major international cities, capital values in Tokyo have reasonable potential for steady appreciation going forward.

1 The cap rate is based on Savills' opinion of investors' expected cap rate during the period.

GRAPH 4

### Transaction volumes by asset class, 1H/2015




Source: RCA, Savills Research & Consultancy

TABLE 1

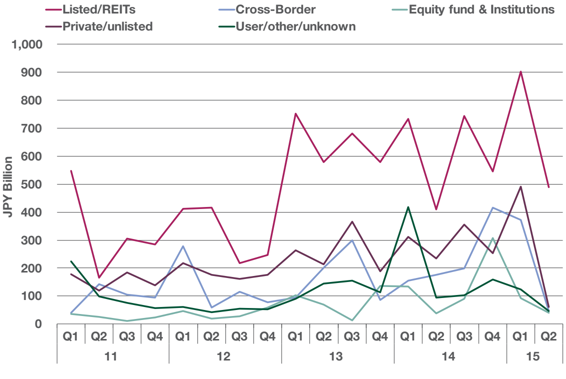
### Major investment transactions, 1H/2015

| Sector | Asset name & location | Price (JPY bil) | Buyer | NOI Cap rate (%) |
|---|---|---|---|---|
| Office | Meguro Gajoen, Meguro Ward, Tokyo | 140.0 | LaSalle Investment JV China Investment Corp. | Low-4% range |
| | Aoyama Building, Minato Ward, Tokyo | 43.7 | GreenOak JV Gaw Capital | 3.9 |
| Residential | Central Crib Roppongi, Minato Ward, Tokyo | 7.49 | ORIX JREIT | 4.6 |
| Retail | Aeon Mall Kyoto, Kyoto City, Kyoto | 21.5 | Aeon REIT | 5.1 |
| Hotel | APA Hotel Yokohama-Kannai, Yokoham City, Kanagawa | 8.35 | J-REIT Invincible Investment | 5.3 |
| Logistics | D Project Nishiyodogawa, Nishiyodogawa, Osaka City | 9.66 | Daiwa House REIT | 5.3 |

Source: RCA, Nikkei RE, Savills Research & Consultancy

GRAPH 5

### Japan transaction volumes by type of buyer, Q1/2011–Q2/2015




Source: RCA, Savills Research & Consultancy

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