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Savills World Research
Japan

Spotlight

Real estate investment market: Review of 2012 and outlook for 2013

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"Investment volume remained stifled by a lack of sell-side momentum in 2012, belying the strength of investor appetite through the year. Liquidity in the capital and debt markets improved along with sentiment, while Japan's low position in the rent cycle relative to certain regional hubs has spurred increased cross-border interest."

SUMMARY

- Based on reported pricing, property investment in Japan totalled an estimated JPY2.1 trillion (US$26.1 billion) in 2012, down approximately 10% year-on-year (YoY) due to a lack of purchasing opportunities in the office sector.
- Driven by initial public offerings (IPOs), property purchases conducted by J-REITs totalled approximately JPY736 billion (US$9.2 billion), up by around 8% YoY.
- Four new J-REITs were successfully listed in 2012 – the first in as many years – demonstrating renewed willingness in the capital markets to finance property acquisitions.
- Improved access to debt finance was reported through the year, with eased lending criteria contributing to heightened investor appetite across the core asset classes.
- Overseas investors were notably more active, with a number of well-known global names completing sizable property acquisitions in locations nationwide.
- Investment volume across all property sectors is expected to increase in 2013, driven by continued growth in the REIT market and strengthened investor sentiment.

Introduction

The regionally-unrivalled depth of Japan's real estate market was highlighted in 2012 as deal flow shifted away from an office sector constrained by a lack of purchasing opportunities to alternative asset classes, most notably retail and logistics. Increased liquidity in the capital markets was demonstrated by the structuring of four new listed J-REITs – the first in as many years – as well as new private placement REITs affiliated with blue-chip names such as Goldman Sachs and Mitsubishi Corporation. In addition to expansion in the REIT market, overseas funds seeking stable, long-term returns refocused their attention on Tokyo and the country's key regional cities. The resulting broad-based competition for quality assets maintained downward pressure on cap rates across the core market sectors.

Investment volume

Preliminary figures compiled by Real Capital Analytics (RCA) suggest that approximately JPY2.1 trillion (US$26.1 billion) of property was transacted in reported deals in Japan during 2012.[1] An estimated 77% of these comprised asset purchases in Greater Tokyo. Proportionally, the office sector accounted for about 43% of Japan's total acquisition value, followed by retail at around 20% and residential at just over 16%. The share attributed to logistics properties was close to 13% – stable from the previous year but twice that of 2010 on the back of heightened investor interest in this sector.[2]

The indicative total investment volume for 2012 across all sectors was approximately 10% lower than that of 2011, led by a decline in the office sector equivalent to around 25% YoY. The total value of property purchases conducted by J-REITs, however, rose by about 8% YoY. With acquisitions totalling approximately JPY736 billion (US$9.2 billion), the J-REIT market accounted for around 36% of total real estate investment in Japan in 2012, based on reported transaction pricing.[3] This share is up from 30% in 2011, and approximately 12% in both 2010 and 2009.

Mirroring the market as a whole, the volume of office acquisitions by J-REITs fell approximately 26% YoY in terms of purchase price, with the retail and logistics sectors rising to fill the gap. The share of J-REIT acquisitions occupied by the retail sector rose to approximately 27% from 13% in 2011, while logistics accounted for a 19% share, up from less than 2% the previous year.

In terms of individual assets, just over half of acquisitions conducted by J-REITs comprised property transfers from a related party, predominantly investment vehicles of sponsor companies. Nonetheless, J-REITs were active purchasers on the open market, concluding approximately 45% of their deals through third-party vendors.

Drivers of investment

Investment activity in 2012 was supported by heightened liquidity in the capital and debt markets.

New REIT offerings – listed

Backstopped by the Bank of Japan's (BOJ) Asset Purchase Programme, which invested some JPY40.6 billion

1 RCA based on independent reports of properties and portfolios of US$10 million and greater.

2 Logistics includes distribution and other industrial-type units.

3 Savills Research & Consultancy based on J-REIT press releases and scheduled acquisition dates.

(US$509 million) in domestic REITs during 2012, expansion of the J-REIT market provided major developers and blue-chip corporations with a natural exit point for stable properties held on their balance sheets.

Investment volumes, particularly in the commercial and logistics sectors, were bolstered by willingness in the capital markets to finance new REIT offerings. Four J-REITs were listed through the year on the Tokyo Stock Exchange, with Kenedix Residential Investment Corporation's successful IPO in April marking the first new J-REIT in approximately 4.5 years. The Kenedix-sponsored investment trust started trading with an initial portfolio of 20 residential assets located across Japan, acquired for a total of JPY30.4 billion (US$360 million).

The listing of Tokyu Land's Activia Properties REIT followed in June, with 18 seed assets acquired from its sponsor for approximately JPY170 billion (US$2.1 billion). Its opening assets under management comprised a mix of high-street and suburban retail facilities, offices and a lease-land asset, located predominantly in the Greater Tokyo region. Reflecting a price tag of JPY45 billion (US$564 million) and an NOI yield of 3.9%, the trophy asset of the portfolio is Tokyu Plaza Omotesando Harajuku, a prime high-street retail property that opened in central Tokyo in April.

In the third J-REIT listing of the year, Daiwa House REIT used the proceeds of its November IPO to part-fund the acquisition of 19 logistics facilities and a shopping centre from its sponsor, Daiwa House Industry and related companies for JPY95.05 billion (US$1.2 billion). The listing had previously been scheduled for June 2008 but was abandoned due to weakening market conditions. Japan's second biggest IPO to date followed in December with the listing of GLP Reit. Singapore-based Global Logistics Properties will initially contribute 30 logistics properties to the REIT in January 2013 with a transfer price of JPY208.7 billion (US$2.6 billion).

New REIT offerings – private
Illustrative of growth in the burgeoning non-listed REIT sector, Goldman Sachs Asset Management acquired three core properties in Tokyo to incorporate into its newly-structured private REIT for approximately JPY25 billion (US$312.5 million). The REIT is the first private trust set up by an overseas financial institution in Japan and there are plans to eventually increase its asset size to about JPY300 billion (US$3.75 billion).

Separately, DREAM Private REIT was structured by Diamond Realty Management, a Mitsubishi Corporation subsidiary, with an initial JPY31.7 billion (US$402.0 million) investment in three Tokyo assets. A first of its kind affiliated to a trading company, the private placement REIT focuses largely on top-grade properties in the retail and logistics sectors and targets an asset volume of JPY250 billion (US$3.1 billion) in five years.

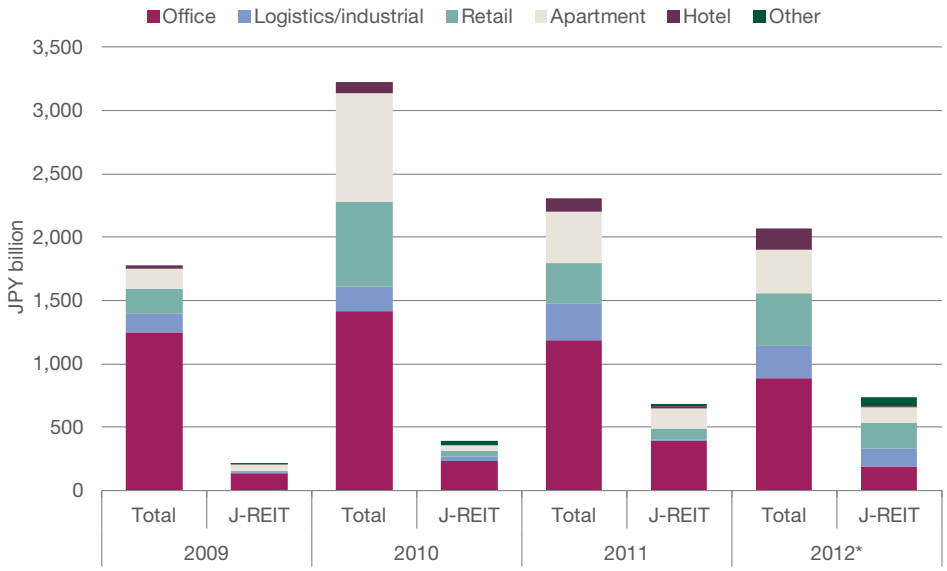
Improved access to debt finance
Coinciding with increased liquidity in the capital markets for real estate investment, a gradual easing of lending criteria in the debt market was noted by property investors – as illustrated by the BOJ's benchmark Tankan survey (Graph 2). This is considered to be a contributing factor behind the noticeable increase in purchases of traditionally alternative asset types through the year by blue-chip domestic and overseas players.

Overseas investors becoming more active
Domestic investors have driven Japan's real estate market after credit tightening in the wake of the global financial crisis led to an exodus of their generally higher-leveraged overseas counterparts. It is nonetheless important to note that transaction data indicates increased activity by overseas investors in recent years, with a number of well-known global names completing sizable property acquisitions in locations nationwide in 2012.

Significant deals involving overseas players included Angelo Gordon and minority partner Orix Real Estate Capital's purchase of ownership in the Kioicho Building, an office property in central Tokyo, for an estimated JPY24.2 billion (US$293.7 million). Secured Capital Investment Management and Aviva Investors'

GRAPH 1

Japan real estate investment volume – estimated annual total vs J-REIT acquisitions by sector, 2009–2012



Source: Compiled by Savills Research & Consultancy based on RCA and publicly disclosed J-REIT data
*Preliminary data

jointly-managed Tokyo Recovery Fund also targeted the office sector, acquiring its first two assets for an unconfirmed price tag of around JPY15 billion (US$186 million).

Property transactions exceeding JPY5 billion (US$63 million) were also concluded across the office, retail, hospitality and logistics sectors by international groups such as MGPA, RREEF, CapitaMalls Asia, Credit Suisse, SEB Asset Management, S-REIT Ascendas Hospitality Trust, US-REIT W. P. Carey and CBRE Global Investors.

Increased liquidity is one aspect behind this apparent refocus of global capital on the Japanese real estate market. Another driving factor is the perception that current pricing is at a cyclical low and that capital growth, led by a recovery in the office sector, may occur in the short- to medium-term.

Anticipation of a recovery in the office sector failed to bring increased investment volume

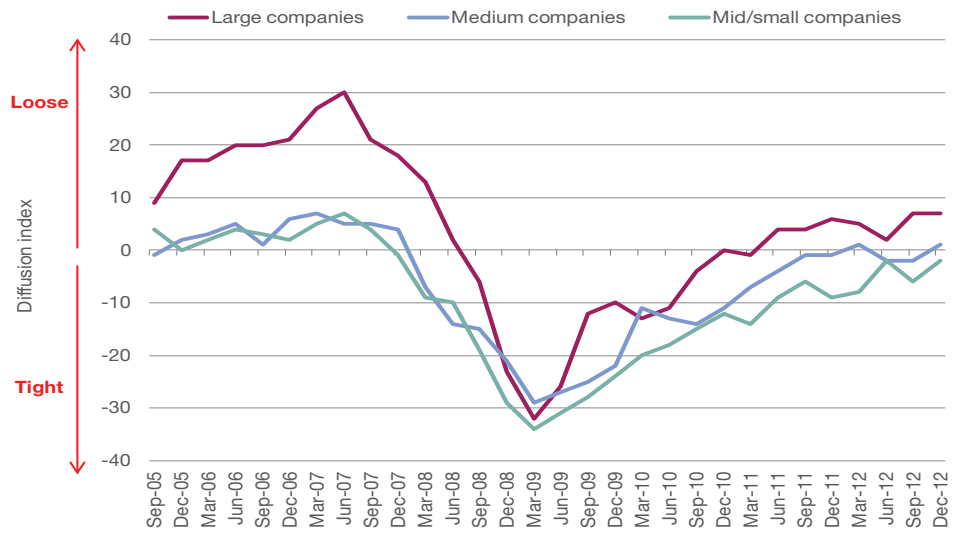
As a result of sharp rental reductions in 2008 and 2009, and softened cap rate expectations, current pricing in Tokyo's office market looks comparatively cheap from an historical perspective. In fact, indicative capital values for Grade A space in 2012 were down as much as 60% from their 2007 peak based on mark-to-market NOI assumptions.

Complementing the view that the Tokyo market has become 'good value', investment appetite has been spurred by growing anticipation of a recovery in office rents – sentiment that 2012 leasing data appears to support. After a bulge in speculative Grade A supply, stable tenant demand saw prime vacancy fall back from 7.0% in Q2 to approximately 5.9% in Q4. Declining availability in certain submarkets enabled landlords to firm-up rental expectations for well-positioned properties, while the addition of new high-specification buildings helped to pull prime market rents up through the year. The combined effect was that average Grade A office passing rents in 2012 rose 1.2% over average 2011 rental pricing.

Improved sentiment towards the Tokyo office sector saw investors actively looking for core and core-plus purchasing opportunities. Nonetheless, as reported above, the office sector failed to see an increase in investment volume. This is principally attributable to the limited availability of investment grade properties on offer, a trend that in part stems from domestic vendors' disinclination to sell on the open market given the lack of investment alternatives and their generally conservative gearing.

GRAPH 2

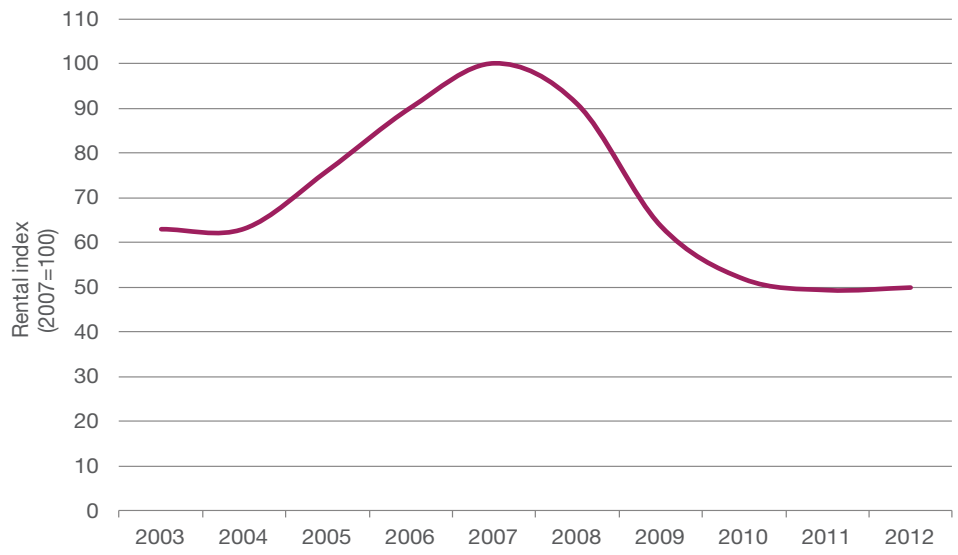
Lending attitudes of Japanese financial institutions towards real estate, Sep 2005–Dec 2012



Source: BOJ Tankan Survey, Savills Research & Consultancy

GRAPH 3

Grade A office rental index – Tokyo central five wards, 2003–2012



Source: Savills Research & Consultancy

TABLE 1

Major investment transactions, 2012

Quarter	Property	Location	Price (approximate)	Buyer	Usage	Notes
Q1	15-asset portfolio	Greater Tokyo, Osaka, etc.	JPY122.6 bil/ US$1.6 bil	Global Logistic Properties and China Investment Corp	Logistics	Joint venture purchase from LaSalle Investment Management.
Q1	Fukuoka Yahoo Japan Dome	Jigyohama, Chuo Ward, Fukuoka	JPY87 bil/ US$1.06 bil	Softbank Corp	Sports stadium	Purchase of 38,561-seater home of pro-baseball team Fukuoka SoftBank Hawks by the team sponsor, telecoms firm Softbank Corp. Vendor was Singapore sovereign wealth fund GIC.
Q1	Yebisu Garden Place (15% sectional ownership)	Ebisu, Shibuya Ward, Tokyo	JPY40.5 bil/ US$500 mil	Sapporo Holdings	Mixed-use	Acquisition of Morgan Stanley Capital's 15% interest in Ebisu Garden Place by the majority stakeholder.
Q1	6-asset portfolio	Greater Tokyo	JPY37.3 bil/ US$471 mil	Industrial & Infrastructure Fund Investment Corp (J-REIT)	Industrial/ logistics	Portfolio of industrial facilities including logistics, R&D and data-centre units. Multiple sellers including entities formed by Goodman Japan and Mapletree.
Q1	Kioicho Building (approximately 70% of interest)	Kioicho, Chiyoda Ward, Tokyo	JPY24.2 bil/ US$293.7 mil	Angelo Gordon, Orix Real Estate	Office/retail/ residential	Compartmentalised ownership in a 62,540-sq m mixed-use property sold by Mori Building. The deal was arranged by Orix Real Estate, who invested in a minority interest.
Q2	18-asset portfolio	Greater Tokyo, Osaka, etc.	JPY170.37 bil/ US$2.13 bil	Activia Properties (J-REIT)	Office/retail/ leased land	Transfer of 18 seed assets from developer Tokyu Land to its newly established REIT, Activia Properties. Flagship assets included two prime central Tokyo commercial properties, namely Tokyu Plaza Omotesando Harajuku and Shinbashi Place.
Q2	Atago Green Hills (sectional ownership)	Atago, Minato Ward, Tokyo	JPY25.6 bil/ US$320.0 mil	Mori Hills REIT	Office/retail/ residential	Property transfer between Mori Hills REIT and its sponsor, Mori Building.
Q2	TIX Tower Ueno (sectional ownership)	Higashi-Ueno, Taito Ward, Tokyo	JPY22.0 bil/ US$275.0 mil	Japan Real Estate Investment Corp (J-REIT)	Office	Purchase of the office and retail portion of a mixed-use tower from Itochu Property Development, Tokyo Tatemono and Tokyo Kaihatsu K (a special purpose company [SPC]).
Q3	Toshin Building	Shinbashi, Minato Ward, Tokyo	JPY25.05 bil/ US$320.4 mil	NTT Urban Development	Office	Seller was utility firm Tokyo Electric Power Company (TEPCO).
Q3	3 properties	Central Tokyo	JPY25.0 bil/ US$316.2 mil	Goldman Sachs Asset Management	Office/residential	Two office assets and one residential property acquired for incorporation into Japan Private REIT, the first private trust set up by an overseas financial institution in Japan.
Q3	Kinshicho Olinas (Olinas Mall, Olinas Core)	Taihei, Sumida Ward, Tokyo	JPY22.8 bil/ US$288.4 mil	CapitaMalls Asia	Retail	Purchase of retail element of Olinas, a mixed-use facility in Tokyo, from an SPC of Invesco Global Real Estate Asia Pacific.
Q3	24-property portfolio	Greater Tokyo, Nagoya and Kansai areas	JPY14.04 bil/ US$179.6 mil	Invincible Investment Corp (J-REIT)	Residential	Acquired properties are located in Tokyo, Aichi, Osaka, Hyogo and Shiga prefectures. The vendor was Rhodia Godo Kaisha an SPC that has received anonymous association investment through a fund affiliated with Calliope, a sponsor of the REIT.
Q4	20-asset portfolio	Nationwide	JPY95.1 bil/ US$1.2 bil	Daiwa House REIT	Logistics/ commercial	Transfer of 19 logistics facilities and one commercial mall to the newly-listed REIT from its sponsor, Daiwa House Industry and related companies.
Q4	Former Shinsei Bank HQ Building	Uchisaiwaicho, Chiyoda Ward, Tokyo	JPY51.0 bil/ US$609.8 mil	Kenedix, Tokyu Land and the Development Bank of Japan (DBJ)	Office	The vendor is a fund established by the Morgan Stanley Group. Kenedix, Tokyu Land and DBJ plan to reconstruct the building into a new large-scale rental office property.
Q4	3-asset portfolio	Greater Tokyo	JPY31.7 bil/ US$402.0 mil	DREAM Private REIT	Logistics/ commercial	Diamond Realty Management Inc (DREAM), a Mitsubishi Corporation Group company, invested in three Tokyo properties for its newly-structured private REIT.
Q4	Mozo Wonder City	Futakata-cho, Nishi Ward, Nagoya	JPY26.8 bil/ US$342.1 mil	Japan Retail Fund (J-REIT)	Retail	50% co-ownership investment in a 233,606-sq m shopping centre. Part of a JPY52.2 billion (US$671.7 million), seven-asset commerical property portfolio acquisition by the Mitsubishi Corporation and UBS-sponsored J-REIT.

Source: Savills Research & Consultancy

Outlook for 2013

Prospects for the market

Investment volume across all real estate sectors is expected to increase in 2013, driven by continued growth in the REIT market and improved investor sentiment. Currently, as many as four new J-REIT listings are earmarked to take place in the short term, including Nippon Prologis REIT and Comforia Residential REIT, which are set to IPO in February, and those planned by retail giant Aeon and property company Hulic. The private REIT market is also expected to see further expansion, exemplified by the anticipated launch of Japan's first open-ended unlisted residential REIT by Daiwa Real Estate Asset Management in March 2013.

The recovery in Tokyo's prime office leasing market is expected to see modest rental growth continue through 2013, driven by strengthened economic fundamentals and a significant reduction in new office supply. New opportunities to acquire large-scale Tokyo office properties may present themselves as several Japanese corporations consider selling-off non-core assets in an effort to free-up capital. Such assets are reported to include the headquarters facilities of major electronics groups Sony, Panasonic and Sharp, and leading beverage manufacturer Kirin.

The weight of capital chasing investment opportunities should increase slightly from 2012. Additionally, 2013 may see a return of the European open-ended funds, as they hunt for durable yields in the region and reallocate away from certain markets which enjoyed significant attention over the past three years, namely Singapore and Australia. This may result in: 1) moderate cap rate compression across sectors for core assets throughout 2013; and 2) increased appetite for certain asset classes outside Greater Tokyo, as investors expand their geographical sphere in order to secure required returns. Aside from well-positioned residential and logistics assets located in and around Japan's major regional cities, commercial and office properties in Kansai as well as high-street retail in Fukuoka appear to generate significant interest.

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