Deutsche Bank Group
Markets Research

Industry

Real estate sector

Date
4 August 2015

Japan

Real Estate

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F.I.T.T. for investors

Last dance

Bubbles always come in different forms

With the big cliff of April 2017 in sight, enjoy the last party like a driver careening to the cliff's brink. Japan is now painted in a completely optimistic light, with the pessimism which permeated Japan after the Great East Japan Earthquake in 2011 forgotten and expectations for the 2020 Tokyo Olympics riding high. The bank lending balance to the real estate sector is at a record high, and we expect bubble-like conditions in the real estate market to heighten due to increased investment in real estate to save on inheritance taxes. History repeats itself, but always in a slightly different form. We have no choice but to dance while the dance music continues to play.

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Japan heading towards its fourth bubble

Japan has seen three bubble-like rises in real estate prices; in the early 1970s, the late 1980s, and the mid 2000s. We are now jumping into a fourth bubble. The three preconditions needed for a real estate bubble are: 1) a plausible scenario that supports the bubble, 2) more aggressive bank lending to the real estate sector, and 3) tax reforms that boost real estate prices. We believe that current conditions neatly meet these requirements: 1) a plausible scenario – although we see no reason to believe that everything will be fine until the Tokyo Olympics, it sounds plausible on the surface; 2) record-high bank lending to the real estate sector; and 3) widespread real estate investment to save on inheritance taxes which were raised.

We currently have no choice but to continue dancing

The Japan Revitalization Strategy, announced as the government's new growth strategy, includes many policies which push Abenomics' bedrock philosophy of survival of the fittest, and thus Japan's globalization seems right around the corner. As a result the middle class will likely be greatly segmented, with the gap between the rich and poor widening. An increase in high-net-worth individuals will boost savings, which will keep interest rates declining. This will likely push up real estate prices as many investors seek higher yields. Moreover, Japan's promotion of English language education is also likely to increase Japanese real estate investment by overseas high-net-worth individuals. It is uncertain whether these strategies will prove successful. However, the party music is currently high and loud in Japan and we can only continue to dance – even though we know it would be the last dance.

Mitsui Fudosan and Sumitomo R&D are our top picks

Physical property investors' expected cap rates have declined to the same or lower levels as those of the mini-bubble around 2007. In such an environment, it is easy for physical property investors to generate abundant capital gain. However, we believe that real estate majors' share prices have not currently factored this in. Mitsui Fudosan and Sumitomo R&D, which have pipelines bursting with development projects, seem markedly undervalued.

We determine our target prices for the real estate sector by using a residual income model. We also take NAV into account. Downside risks to the real estate sector include: 1) higher risk premiums due to lower bank lending to the real estate sector, 2) tax hikes (e.g. consumption tax and income tax) and lower government spending due to a rush toward fiscal restructuring, and 3) tax revisions or regulations that inhibit real estate liquidity. Upside risks include: 1) sharp increases in private sector wages and 2) clarification that fiscal stimulatory measures such as lowering income tax will be taken.

Top picks	
Mitsui Fudosan (8801.T),¥3,464	Buy
Sumitomo R&D (8830.T),¥4,300	Buy

Source: Deutsche Securities Inc.

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Overview

History repeats itself but in different forms

Three preconditions for an asset bubble to occur

We believe there are three preconditions for an asset bubble to occur: 1) a plausible scenario that supports the bubble, 2) aggressive bank lending to the real estate sector, and 3) tax reforms that boost real estate prices,

Japan now has these three preconditions in place. The plausible scenario this time is the upcoming 2020 Tokyo Olympics. We see no basis for believing that everything will be fine for the economy and the real estate markets until the Tokyo Olympics, but it sounds plausible on the surface (although we believe the plausibility for that broke down since Japan's real GDP growth was negative in FY2014). The image of many foreigners visiting Japan to see the Olympics is being stirred up, and the recent increase in the number of overseas tourists is boosting that image.

The next element is the banks' stance on real estate lending. Banks are initially cautious toward lending to the real estate sector, but their attitude tends to ease as the real estate market recovers. Bank loan balances to the real estate sector reached a record in Jan-Mar 2015, and the balance of new loans grew to ¥10.2tr in FY2014 – the same level as in FY2007, which was the peak of the mini-bubble.

Investors are mainly individuals trying to reduce taxes

Another important element is the changes to the tax system that help raise real estate prices. Various incentive measures were introduced after the Lehman Shock, including larger tax reductions on housing loans and eco-points. However, we cannot say they were effective. It is indicated by the weak recovery in the new housing starts, especially detached housing starts.

Ironically, the reason the real estate market is buoyant is not due to tax cuts but due to higher taxes, such as increased inheritance taxes. Basic tax deductions were sharply lowered from April 2015 and high-net-worth families consequently increased their real estate investments to save on taxes. In the late 1980s during the real estate bubble, basic tax deductions were raised to curb an overheating real estate prices. This time, the government did the opposite of the 1980s. Therefore, the reduction in basic tax deductions is accelerating the increase in real estate prices.

2% inflation target brings a fourth bubble

With the three elements coming together, this trend will not come to an end easily. Based on historical evidence, the only thing that could stop this trend would be for the government to impose regulations that curb lending to the real estate sector. One example of this would be the regulations imposed in December 2006 on lending to real estate funds.

Likelihood of government regulations is quite low

Lending to the real estate sector is at a high, and government authorities would be considering introducing some kind of regulations under normal circumstances. However, we have not seen the slightest movement toward renewed regulation. This is because the current rate of price increase is far from the BoJ's inflation target of 2%. In other words, the likelihood of renewed government regulation is quite low, in our view.

Recent investors are mainly individuals trying to reduce taxes. We expect yields will continue to decline because the primary purpose is to reduce taxes and not to earn a good investment return. In other words, even if prices increase and yields decline, the number of investors willing to purchase real estate will not decline as long as the benefit of reducing taxes remains. This is likely to be reinforced by the baseless scenario that the real estate market will remain buoyant until the 2020 Tokyo Olympics, thereby precipitating Japan's fourth asset bubble.

Moreover, the Social Security and Tax Number System ('individual number system') to be introduced on 1 October 2015 should increase the transparency of individual income and assets. In turn, we expect real estate investments to become even more popular as a legal way to reduce taxes.

Spurring Japan's globalization

Winners take all

The Japanese government is targeting the strengthening of shareholder rights, progress in deregulation and liberalization thorough implementation of individual responsibility, and economic growth through improved productivity resulting from the introduction of strict competition principles. It aims for "a society that rewards hard workers," "a society in which winner takes all" and "a society that clarifies individual responsibility."

Measures to facilitate this are the strengthening of the Corporate Governance Code and the Stewardship Code, amendments to the Worker Dispatch Act, and the proposed zero overtime payment law. This should create a society that benefits investors and company management and is highly likely to further improve earnings for winning companies.

Weeding out and reorganization of low-productivity SMEs

The flip side of this, however, is that low-productivity SMEs would be weeded out and reorganized amid the progressive concentration of market share to major corporations. We believe the middle class population will thus be segmented by an intensely competitive society. We expect Japanese traditional customs that extolled co-existence and co-prosperity to be replaced by international rules such as TPP.

In addition, the Japan Revitalization Strategy announced on 22 June regards emphasizing English language education over Japanese language education. We believe that Japan is thus likely to lose not only its customs but also its culture. Japan's globalization, which investors and company management desire, seems to be at the doorstep.

Increase in high-net-worth individuals and promotion of English language education are set to boost real estate prices

The segmentation of the middle class with an increase in high-net-worth individuals, and the promotion of English language education look unconnected with the real estate market, but we believe these developments could boost real estate prices. Unlike the middle class, high-net-worth individuals do not use their entire income for consumption, so savings tend to accumulate. The middle-class people are unable to save because their incomes are low, but high-net-worth individuals conversely have difficulty in consuming their entire income. In short, an increase in high-net-worth individuals is a factor in excess savings for the society as a whole. Prices consequently do not rise, and interest rates remain at low levels. High-net-worth individuals start yield-hunting, and prices of assets including real estate are prone to rise more than justified by fundamentals, in our view.

Chinese high-net-worth individuals show a strong tendency to buy real estate in English-speaking countries such as Canada, the US, Australia, and New Zealand. This is because they are committed to educating their children in English. Investment in Japan is limited because their children's English language abilities will not be improved in Japan. If Japanese university education is conducted in English, there is consequently a strong likelihood of Chinese capital inflow to Japan as the country also has geographical advantages.

Whether or not intended by the government, Abenomics is thus a strategy which could boost real estate prices. It is uncertain, however, whether these strategies will prove successful as they are completely at odds with the Japanese culture and traditions.

No choice but to continue dancing, even knowing it would be the last dance

Market peak likely in April 2017

We believe that the bubble economy will continue and will peak in April 2017, when the consumption tax will be raised again. We expect this tax hike to again hurt Japan's economy, with negative growth beyond that of FY14.

The government will hike the consumption tax in April 2017 without reflecting on the negative fallout of the April 2014 hike. Some are expecting the tax to be raised further. We believe that overdone fiscal reconstruction will only result in failure and Japan will likely again enter a period of turmoil without having found the right prescription for what ails its economy.

Moreover, we expect adverse effects of Japan's participation in TPP, exhaustion of the domestic demand-based economy due to ongoing deregulation, and globalization based on the Japan Revitalization Strategy will have progressed further by around 2017. The segmentation of the middle class, weeding out of low-productivity SMEs, and oligopolization of large companies will also likely have progressed. We expect Japanese customs and culture to walk down the path toward extinction due to policies under Abenomics that promote the survival of the fittest.

Mitsui Fudosan and Sumitomo R&D are our top picks

We believe this party will most likely be the last one for the Japanese real estate market. In other words, it could well be the last dance. Despite that, the dance music is playing a lively tune. For now, we see no choice but to continue to dance.

Investors expected cap rates in the real estate market have declined to the same or lower levels as those of the mini-bubble around 2007. In such an environment, it is easy to generate abundant capital gain. However, we believe that real estate majors’ share prices have not currently factored this in. Mitsui Fudosan and Sumitomo R&D, which have pipelines bursting with development projects, seem markedly undervalued. We recommend Mitsui Fudosan and Sumitomo Realty & Development as our top picks. We see significant upside potential for both the stocks and believe they will provide much enjoyment in the last dance.

The market appears to us like a driver enjoying himself as he speeds fast toward a cliff. We hope the driver can put on the brakes and successfully stop at the edge without going over the cliff, but this requires a high level of skill. Can the market exhibit such a skill?

Enjoy last dance until then!

Figure 1: The three preconditions needed for a real estate bubble

1) Plausible scenario that supports the bubble

2) More aggressive bank lending to the real estate sector

3) Tax reforms that boost real estate prices.

Source: Deutsche Securities

History of real estate bubbles

Three periods of asset inflation

Japan has seen three bubble-like rises in real estate prices; in the early 1970s, the late 1980s, and the mid 2000s. In the early 1970s, a real estate boom emerged based on then Prime Minister Kakuei Tanaka's "Plan for Remodeling the Japanese Archipelago" which was announced in 1972. Since its aim was to evenly develop Japan and since Japanese population was still growing, real estate prices shot up not only in big cities but also in regional areas.

Era of Japan as number one

The second asset bubble was recorded in the late 1980s. This period in particular was marked by the "Japan as number one" mentality. Many people thought that asset prices would continue rising forever and that a bright future was assured. Indeed, land prices in Japan's six largest cities grew by double digits in the late 1980s, and during some years rose by almost 50%.

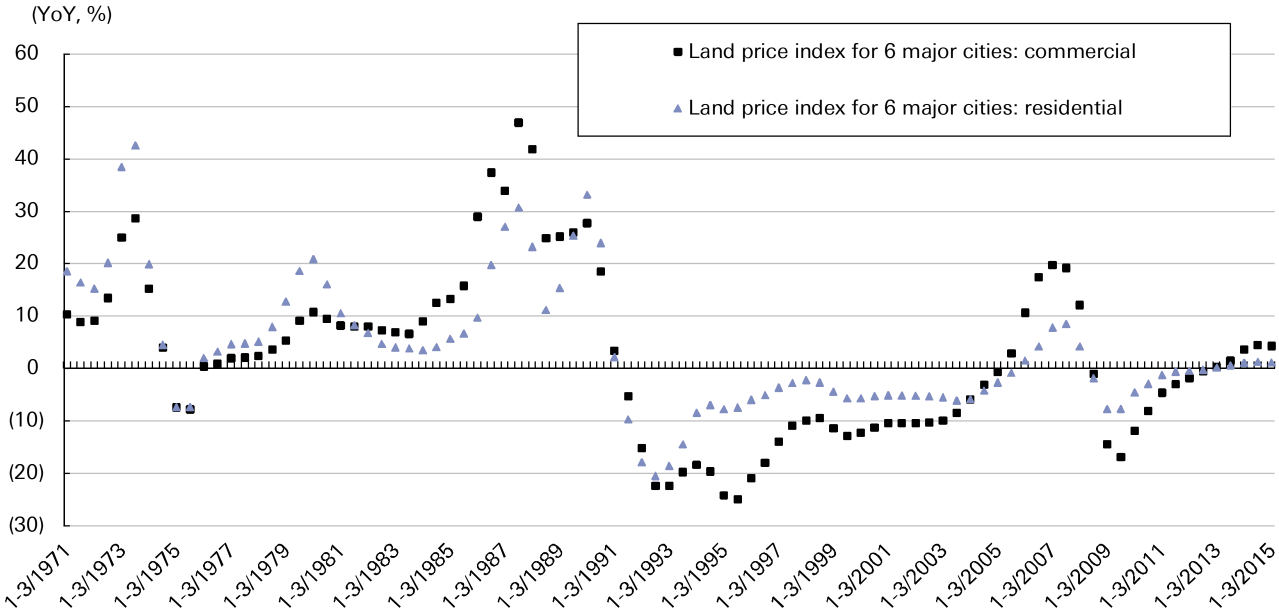
Looking back, investment behavior of most individuals, companies, and banks was abnormal at that time. For example, "Shiki no Oka" detached homes in Tama Newtown (a 17-minute walk from Minami Osawa Station on the Keio Sagamihara Line, western part of Tokyo) which were sold in September 1989 were priced at ¥63m for a floor space of 120m^2 and the competition rate reached 4,706 to one.

The competition rate for buying a detached home in Tama Newtown (priced at ¥63m) reached 4,706x

Furthermore, the revolving mortgage for Mitsui Trust & Banking (now Sumitomo Mitsui Trust Bank) on the Shuwa Kioicho TBR Building (5-7 Kojimachi, Chiyoda-ku, Tokyo) was ¥3bn in 1972, ¥12.3bn in 1981, but expanded substantially to ¥37.3bn by 1987.

Companies invested similarly in employee facilities with Hitachi spending ¥70bn over five years to purchase 900 company homes and 2,000 dormitory rooms. Toshiba invested ¥90bn for 2,640 company homes and 2,700 dormitory rooms. Mitsubishi Electric also spent ¥100bn for 1,300 company homes and 1,500 dormitory rooms.

Figure 2: Urban Land Index for six major cities



Source: Deutsche Securities based on data by Japan Real Estate Institute

Mini-bubble in 2003-2007

After the late 1980s' bubble burst, the real estate market remained stagnant for over ten years. However, it gradually began to show signs of a recovery from 2003. In 2007, commercial real estate in central Tokyo recorded annual growth of more than 20%, according to data compiled by the Japan Real Estate Institute. This is commonly known as the "mini-bubble."

Barista (DJREP-I) operated for 3 years and 9 months, original investment grew 2.26x

Statistics showed a gradual market rise, but actual growth in the real estate market was much more than that, with quite a few properties (mainly in central Tokyo) more than doubling in value. For example, Barista (DJREP-I), the first opportunity fund managed by daVinci Advisors (a real estate fund management company) started in November 2002. Over the fund's duration (3 years and 9 months), investors' original investment of ¥17.3bn increased 2.26x to ¥39.2bn (before fees).

This mini-bubble was created not by domestic investors but by overseas investors who rushed into Japan's real estate market. With the SPC Law revised in 1999, the Securities Investment Trust Law revised in 2000, and the J-REIT market starting in 2001, the trigger for the mini-bubble was the merging of the finance and real estate markets.

An extremely rare opportunity for real estate investors

In addition, driven by the notion of reducing bad debts of the banking sector under the then Finance Minister Heizo Takenaka, many properties were sold cheaply. Although there were assets next to no value such as forests, many of the assets sold were blue chip properties. With such properties sold in bulk without being assessed adequately, the sale presented an extremely rare opportunity for real estate investors. Many overseas investors flocked to Japan looking for such an investment opportunity.

As overseas real estate markets already rose and were expensive, many foreign investors focused attention on the Japan's lagging market. Not only US investors such as Goldman Sachs and Morgan Stanley, but also European investors entered Japanese real estate market. For example, Morgan Stanley acquired the Shinagawa Mitsubishi Building in Konan, Minato-ku, for about ¥140bn, and Goldman Sachs the Tiffany Building in Ginza, Chuo-ku, for about ¥38bn.

Morgan Stanley acquired the Shinagawa Mitsubishi Building for about ¥140bn, Goldman Sachs the Tiffany Building in Ginza for about ¥38bn

In addition to Morgan Stanley, which is well versed in global real estate markets, the number of overseas investors interested in Japan's real estate market increased. However, going it single-handedly was difficult not only because of the language barrier but also because of a lack of knowledge about Japan's real estate market. To fulfill this need, companies that manage real estate funds such as daVinci Advisors, Kennedy-Wilson Japan (the current Kenedix), Pacific Management, and Creed were established one after another.

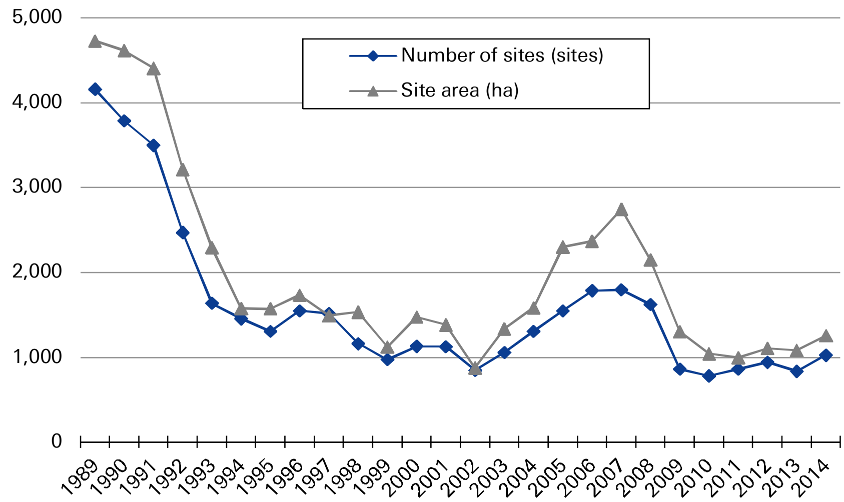
While large capital (including plant construction funds) is required from the beginning to enter the manufacturing business, production facilities are unnecessary for the real estate business and thus large funds are not required. For this reason, once signs of a recovery were seen in the real estate market, new real estate companies such as such as Zephyr, Japan General Estate, and Joint Corporation sprung up like bamboo shoots after a rain.

In summary, overseas investors first set up the mini-bubble in 2003, and subsequently many new domestic real estate companies jumped onto the bandwagon, although many of these companies wound up fast. Furthermore, the movement toward real estate acquisition spread to the manufacturing industry with aggressive purchases of plant sites driving the mini-bubble.

Toshiba invested about ¥500bn in total for semiconductor plants in Oita City and Yokkaichi City; Sharp spent ¥150bn for an LCD plant in Kameyama City

According to the Survey of Factory Location Trends compiled by the Ministry of Economy, Trade, and Industry, investments in plants, which had fallen to 844 factories in 2002 (about 20% of the peak recorded in early 1990) doubled to 1,791 in 2007. This in turn led to the phrase "the return of domestic manufacturing" being used often around this time. Indeed, Toshiba invested slightly less than ¥500bn in total for semiconductor plants in Oita City and Yokkaichi City, while Sharp spent ¥150bn for an LCD plant in Kameyama City.

Figure 3: Trends in factory site investment



Note: Solar power generation-related investments are excluded
Source: Ministry of Economy, Trade and Industry

Lessons from the past on how to bring about real estate market recovery after collapse

Implementation of an emergency economic package

LDP's three groundbreaking economic packages

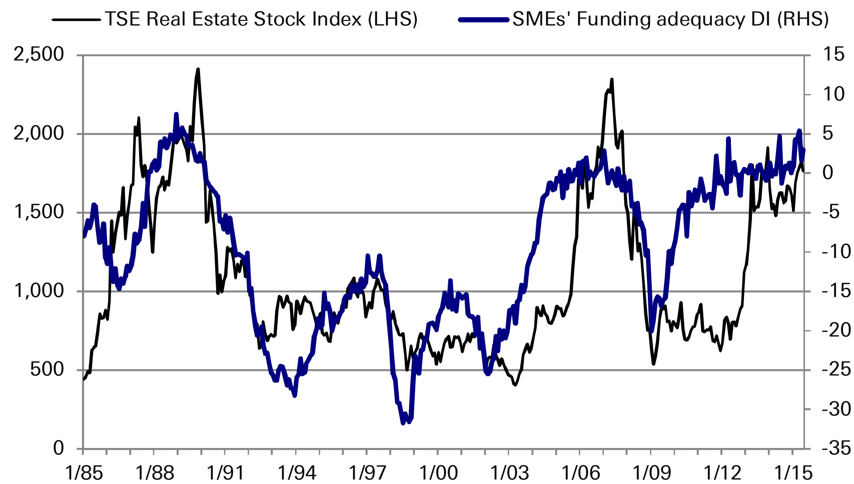
It is not easy to make the real estate market recover after limiting lending and letting it collapse. Nonetheless, the method has always been the same, namely, taking economic measures, easing monetary policy, and in particular improving financing. The recovery process after the mini-bubble burst is as follows.

The government, then led by the LDP, took action by announcing three economic packages on 29 August 2008, 30 October 2008 and 10 April 2009. The LDP's approval rating was low, and the packages received chilling responses from the public.

However, the policies were groundbreaking and did in fact prove effective. The most valuable measure was the emergency system established on 21 October 2008 by the Ministry of Economy, Trade and Industry and the Small and Medium Enterprise Agency offering protection against surges in material prices. This was essentially a measure to support financing for SMEs. The measure provided full government guarantees for small business loans of up to ¥80m with no collateral. The principal was thus guaranteed even if borrowers were to fail, allowing banks to lend with no risk.

A similar system had been in place from 1998-2001 during the financial crisis when major corporations such as Yamaichi Securities and Long-Term Credit Bank went bankrupt. The loan limit then was ¥50m per company, but has since been raised to ¥80m, a major increase. Following the implementation of this measure, small business finances improved, share prices, a leading economic indicator, rebounded, and foreign investors began to return to the real estate market.

Figure 4: SMEs' funding adequacy DI and TSE Real Estate Stock Index



Source: Deutsche Securities based on data by Japan Finance Corporation, Datastream

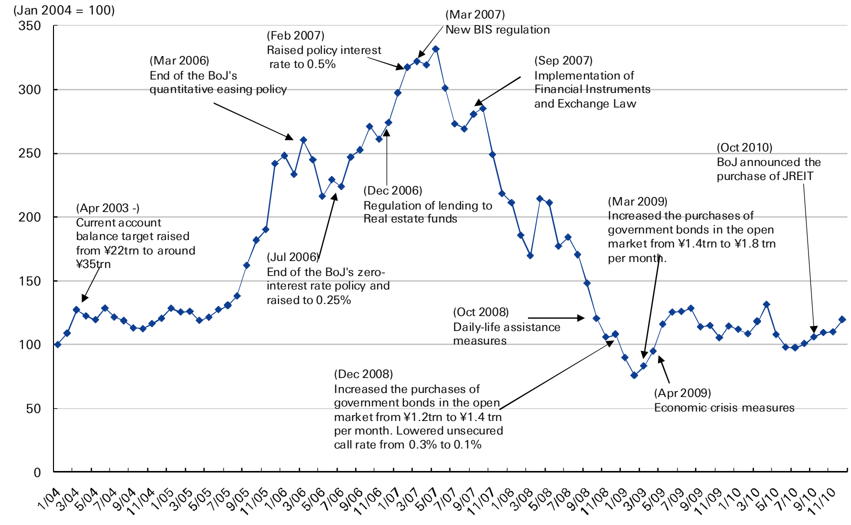
Shizuka Kamei's (then-financial services minister) keen eye

The DPJ assumed power in August 2009. Public support for the LDP had slumped, but its economic packages were beginning to have an effect. Fears that the DPJ's policies would neutralize the effect triggered a sharp downturn in the Nikkei average, which skidded below ¥10,000.

Passage of a small business financial support measure (December 2009)

The concern was addressed with the passage of a small business financial support measure crafted by the then-financial services minister Shizuka Kamei of the People's New Party in December 2009. This encouraged lenders to respond as flexibly as possible to requests from small businesses for interest rate relief and changes in repayment conditions. From the measure's implementation through March 2012, there were 3.09m applications for help totaling about ¥85tr. The banks responded positively in around 92.3% of the cases. There was much criticism that the measure simply put off the problem and delayed a much-needed industry shakeout. However, it contributed significantly to the economic recovery. The Nikkei average regained the ¥10,000 level in December 2009 and entered a sustained uptrend.

Figure 5: TSE Real Estate Stock Index and regulations/economic measures (2004-2011)



Source: Deutsche Securities based on data by Datastream, various public information

Establishment of the Real Estate Market Stability Fund

Establishment of "Kanmin Fund"

The LDP's three economic packages also included a measure aimed specifically at reviving the real estate market. This was the Real Estate Market Stability Fund, known colloquially as the "Kanmin Fund" (literally, public-private fund). Under normal market conditions, J-REITs have little problem procuring funds thanks to their low debt ratios and stable rental revenues. Banks welcome them as clients. However, J-REITs are required by their own rules to distribute nearly all rental income from tenants to their investors and do not have the internal reserves that a company would normally save for emergencies. Thus, if a J-REIT fails to receive bank lending, it is immediately faced with funding problems. In fact, New City Residence Investment Corporation went bankrupt.

The Kanmin Fund was established in September 2009 to support financing at J-REITs in the event that they were unable to secure loans from banks. The fund was worth ¥450bn, including ¥30bn from 40 private firms such as Mitsui Fudosan, ¥60bn in mezzanine loans from the Development Bank of Japan, and ¥360bn in loans. The aim of the Kanmin Fund was to provide J-REITs with funds as 'show money'. The idea was that since the fund would supply cash in emergencies, the banks would see no bankruptcy risk and respond positively to loan requests. It is difficult to prove any impact, but we believe that the absence of any J-REIT bankruptcies since the advent of the Kanmin Fund is the result of this 'show money'.

Developments since the end of the 'mini-bubble'

Real estate market developments from 2008 are summarized as follows:

- Many real estate firms went bankrupt in 2008, sparking a sharp downturn in share prices on fears that the repercussions would spread throughout the industry.

The real estate market bottomed in 2009

- The government succeeded in reducing the risk premium the following year through three successive economic packages – the Comprehensive Immediate Policy Package (29 August 2008), Measures to Support People's Daily Lives (30 October 2008), and Policy Package to Address Economic Crisis (10 April 2009). Then, share prices soared.
- The most effective of the measures were the introduction of an emergency credit guarantee system for small businesses, the establishment of a semi-public fund ("Kanmin Fund") to support J-REIT financing, and the addition of J-REITs as an eligible asset for the Banks' Shareholding Purchase Corporation.
- The real estate market bottomed in 2009

BoJ started buying J-REITs in October 2010

BoJ decided to buy J-REITs due to a decline in the risk premium

The real estate market clearly started improving from 2009. Contract closures for existing housing turned around in early 2009, and new condo sales rebounded from mid year. This was followed in 2010 by a decline in vacancy rates in high-grade and newly constructed buildings and an improvement in the fundamentals. Moreover, the J-REIT market rebounded strongly when the BoJ announced in October that it would acquire J-REITs so as to guide risk premium lower. The BoJ's decision to buy non-JGB assets despite its long wariness over monetary easing caught the markets off guard. In 2010, the real estate market's recovery became clearer.

BoJ purchases totaled only ¥2.2bn at end-Dec 2010

Against an overall J-REIT market value of around ¥3tr at that time, the BoJ's acquisitions came to ¥50bn, which was only 1.5% of the total. There was some doubt at first over the booster effect that the move would have on the J-REIT market. However, J-REITs did in fact rebound strongly in October 2010, expanding at a pace of over 20%. The BoJ did not invest the ¥50bn all at once in a bid to lift J-REIT prices. On the contrary, by the end of December 2010, it had invested only ¥2.2bn.

Figure 6: TSE REIT Index (From Oct to Dec 2010)

Source: Bloomberg Finance LP

Why, then, did the J-REIT market swing back so quickly? The reason was the announcement effect. The fact that the BoJ was buying J-REITs created a tacit understanding that these were relatively safe risk assets, which helped draw more cautious investors into the market.

Full recovery of real estate market brought on by policies following the 2011 earthquake

A number of J-REITs raised funds to buy properties from the start of 2011. Condo sales were firm, office vacancies were falling, and the real estate loan balance – a crucial element for the real estate market – stopped falling, beginning a virtuous cycle.

However, on 11 March 2011 a huge earthquake (magnitude 9.0) hit Japan. This was the Great East Japan Earthquake. There was general concern that the earthquake would halt the stable recovery in fundamentals, but the robust real estate market was impervious to the effects of the disaster and bounced back forcefully.

Indeed, overcoming the adversity caused by the earthquake, 12 J-REIT companies increased capitalizations with annual purchases reaching ¥714bn in 2011 (¥544bn in 2010). Of the purchases by J-REIT, 15 transactions exceeded ¥10bn.

There is a saying in the stock market: Do not sell on disasters

As demonstrated previously, the 2011 earthquake did not have a negative impact on the real estate sector. This is in line with the stock market maxim "do not sell on disasters." In other words, enterprise value does not come under any pressure from a short-term deterioration in earnings caused by an earthquake. Enterprise value is the present value of all the company's future cash flows.

In addition, monetary easing and fiscal stimulatory measures were taken, both of which are crucial for a real estate market recovery. The then incumbent Democratic Party of Japan (DPJ) was cutting its public works investment budget under the slogan "from concrete to people", but we believe fiscal spending to restore areas devastated by the earthquake facilitated a full recovery of the real estate market. The BoJ also moved to ease monetary policy further. In other words, the DPJ unknowingly launched the first and second arrows of Abenomics.

Figure 7: Property acquisitions over 10bn yen by J-REITs in 2011 (15 properties)

	Acquisition Date	REIT	Name of property	Location		Asset type	Price (mn yen)	Seller
1	15 Nov	JRE	Akasaka Park Bldg.	Minato-ku	Tokyo	Office	60,800	Mitsubishi Estate
2	1 Sep	NBF	Mitsubishi Heavy Industries Head Office	Minato-ku	Tokyo	Office	36,300	Mitsubishi Heavy Industries
3	2 Mar	FRC	Canal City Hakata B	Fukuoka City	Fukuoka	Retail	28,700	No detail
4	8 Jul	DOI	E Space Tower	Shibuya-ku	Tokyo	Office	24,000	No detail
5	1 Aug	MHR	Roppongi Hills Mori Tower	Minato-ku	Tokyo	Office	18,680	Mori Building
6	1 Mar	GOR	Hirakawacho Mori Tower	Chiyoda-ku	Tokyo	Office	18,200	Mori Building
7	1 Aug	MHR	Ark Mori Bldg.	Minato-ku	Tokyo	Office	17,200	Mori Building
8	28 Feb	NBF	River City M-SQUARE	Chuo-ku	Tokyo	Office	13,350	Mitsui Fudosan
9	1 Feb	JRE	Osaki Front Tower	Shinagawa-ku	Tokyo	Office	12,300	SPC invested by Mitsubishi Estate
10	31 Mar	NBF	Gate City Ohsaki	Shinagawa-ku	Tokyo	Office	11,631	Sumitomo Life
11	26 Dec	KRI	Kabutocho Nikko Bldg.	Chuo-ku	Tokyo	Office	11,270	AIG Edison Life Insurance
12	4 Feb	JEI	Daiba Garden City Bldg.	Minato-ku	Tokyo	Office	11,000	Sekisui House
13	31 Jan	NBF	NBF Ueno Bldg.	Taito-ku	Tokyo	Office	10,400	Shimizu Corporation
14	18 Nov	PIC	Urbannet Mita Bldg.	Minato-ku	Tokyo	Office	10,300	Private fund operated by NTT Urban
15	16 Feb	FRI	Mitsui Shopping Park LaLagarden Kasukabe	Kasukabe City	Saitama	Retail	10,000	SPC invested by Mitsui Fudosan
							294,131	

Source: Company

Figure 8: Equity finance by J-REITs in 2011

			Announce-ment date	Funding amount* (bn yen)	No. of units increased	Main purpose of funding			Asset type of acquired properties (No. of properties)					Purchase amount (bn yen)
						1: property acquisition 2: debt repayment			1: office 2: residential		3: retail 4: industrial			
CY2011						1	2	other	1	2	3	4	other	
1	NBF	8951	11-Jan	28.9	7%	○			6					57.6
2	JEI	8987	13-Jan	15.0	22%	○	○		1					11.0
3	FRC	8968	7-Feb	8.9	15%	○					1			28.7
4	NAF	3226	10-Feb	22.1	25%	○				19				30.6
5	IIF	3249	21-Feb	5.7	20%	○						5		11.3
After the earthquake														
6	OJR	8954	9-May	13.1	13%	○			1	5				21.4
7	UUR	8960	23-May	57.6	45%	○	○		1	1	2			20.8
8	KRI	8972	5-Jul	14.0	23%	○	○		4					14.3
9	JRF	8953	24-Aug	20.0	11%	○					12			46.0
10	DHR	8984	15-Sep	17.6	35%	○	○			3				14.8
11	PIC	8956	26-Oct	13.7	41%	○			6	1				33.1
12	NRF	3240	14-Nov	7.2	20%	○				8				15.1
	Total	12		223.8										304.7

Note: Funding amount is net amount including capital increase via third-party allotment.
Source: Company

Driving forces behind the real estate bubble

The second ingredient after a plausible scenario

We looked at past asset inflations in the previous chapter. When asset inflation occurs, it is always supported by the notion that asset prices will rise, backed by some social phenomenon of the time.

In the 1970s, there was an expectation that nationwide infrastructure construction would push Japan's land development, as promoted in the "Plan for Remodeling the Japanese Archipelago" – the heightened sentiment marked as “Japan as number one” mentality in the 1980s that Japan would become the richest country in the world, and a scenario during the mini-bubble in 2003 was that the merging of financial and real estate markets would boost global money and therefore the real estate market.

To realize asset inflation, increased bank lending to the real estate sector is necessary

The likely scenario this time, in our view, will be the 2020 Tokyo Olympics and the progress that Japan makes toward globalization.

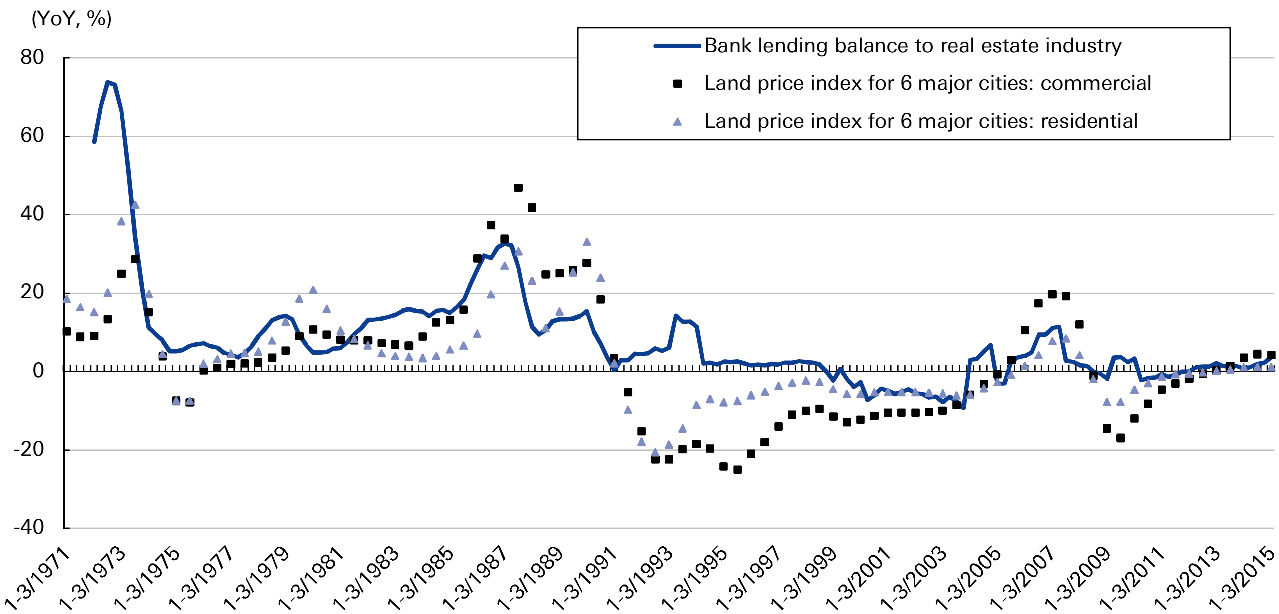
However, a plausible scenario alone does not cause a bubble. In our view, to realize asset inflation, bank lending to the real estate sector must become aggressive and increase sharply.

Real estate loan balance doubled in the late 1980s

The real estate market is controlled not by real estate companies but by banks, or more accurately, the stance of banks toward property loans. A tighter lending posture by banks toward the real estate sector triggers a drop in property prices and slumping market conditions. In contrast, an increase in lending spurs a rise in property prices and a buoyant real estate market.

Figure 9 adds loan balances to the real estate sector to the data shown in Figure 2. We can clearly see that rising real estate prices during the past three asset inflation periods are clearly correlated with trends in bank loan balances toward the real estate sector.

Figure 9: Bank lending balance to the real estate industry and land prices (YoY%)



Source: Deutsche Securities based on data by Bank of Japan and Japan Real Estate Institute

This is obviously a very natural result, because even if an investor is aggressive about real estate investment, nothing can be done if banks decline loans. Unlike with other assets, there are normally only a handful of people who can use cash on hand to invest in real estate. The reverse is also true in that if banks become aggressive about lending, it becomes easier to invest in real estate. With banks taking an aggressive loan stance, funds flow into the real estate market and drive asset inflation.

The total loan balance jumped from about ¥50tr to ¥115tr

The banks' real estate lending climbed from about ¥20tr to ¥50tr when activity in Japan's real estate market was at its peak between the late 1980s and the early 1990s. At the time, the construction and non-bank (for finance business) sectors were also active players in real estate investment, albeit indirectly. Aggregate lending to these two sectors and the real estate sector during the period climbed from about ¥50tr to roughly ¥115tr. If lending to the real estate market increased by ¥65tr, this means ¥150tr-¥200tr flowed into the real estate market - assuming conservative leveraging.

Figure 10: Bank lending balance in Japan (domestic banks)

	Total balance		To Real estate sector		To Construction sector		To Financial sector		Total of 3 sectors	
	(¥tr)	(YoY)	(¥tr)	(YoY)	(¥tr)	(YoY)	(¥tr)	(YoY)	(¥tr)	(YoY)
Mar-84	233.0		17.5		13.8		14.4		45.6	
Mar-85	257.8	10.6%	20.1	14.9%	15.5	12.4%	17.9	24.4%	53.5	17.1%
Mar-86	279.2	8.3%	25.3	25.9%	16.7	7.6%	22.2	23.9%	64.1	19.9%
Mar-87	303.7	8.8%	33.6	32.7%	17.8	6.6%	27.3	23.2%	78.6	22.6%
Mar-88	330.9	9.0%	37.4	11.3%	18.2	2.7%	34.2	25.3%	89.8	14.2%
Mar-89	358.9	8.4%	42.3	13.3%	19.3	5.9%	38.0	11.0%	99.6	10.9%
Mar-90	397.8	10.8%	48.8	15.3%	20.6	6.8%	46.0	21.1%	115.4	15.9%
Mar-91	413.3	3.9%	48.9	0.3%	21.4	3.9%	44.8	-2.4%	115.2	-0.2%
Mar-92	422.0	2.1%	51.1	4.4%	23.4	9.2%	45.0	0.4%	119.5	3.7%
Mar-93	428.0	1.4%	54.1	6.0%	24.7	5.5%	43.9	-2.5%	122.7	2.7%
Mar-94	508.0	18.7%	60.3	11.5%	31.1	26.1%	55.5	26.5%	147.0	19.8%
Mar-95	506.1	-0.4%	61.8	2.4%	32.0	2.7%	55.6	0.1%	149.3	1.6%
Mar-96	509.0	0.6%	62.7	1.4%	31.4	-1.9%	53.1	-4.5%	147.1	-1.5%
Mar-97	505.3	-0.7%	63.8	1.7%	31.4	0.2%	50.2	-5.5%	145.4	-1.2%
Mar-98	498.2	-1.4%	65.2	2.3%	31.0	-1.4%	47.9	-4.4%	144.2	-0.8%
Mar-99	486.4	-2.4%	63.7	-2.4%	30.6	-1.4%	43.8	-8.6%	138.1	-4.2%
Mar-00	485.1	-0.3%	61.9	-2.8%	30.0	-1.9%	44.0	0.4%	135.9	-1.6%
Mar-01	469.2	-3.3%	58.8	-5.0%	28.2	-5.9%	41.0	-6.9%	128.0	-5.8%
Mar-02	446.4	-4.9%	55.5	-5.7%	25.3	-10.4%	39.3	-4.2%	120.0	-6.2%
Mar-03	424.8	-4.8%	51.1	-7.8%	22.2	-12.3%	37.5	-4.4%	110.9	-7.6%
Mar-04	408.6	-3.8%	52.6	2.9%	19.2	-13.4%	35.5	-5.4%	107.3	-3.2%
Mar-05	396.0	-3.1%	50.9	-3.2%	17.6	-8.6%	34.9	-1.7%	103.4	-3.7%
Mar-06	401.5	1.4%	52.9	3.9%	16.2	-7.7%	37.5	7.4%	106.7	3.1%
Mar-07	405.5	1.0%	58.8	11.1%	15.6	-3.9%	36.5	-2.8%	110.8	3.9%
Mar-08	411.1	1.4%	59.7	1.5%	15.0	-3.7%	36.6	0.3%	111.3	0.4%
Mar-09	427.7	4.0%	58.5	-2.0%	14.8	-1.1%	38.9	6.2%	112.2	0.9%
Mar-10	420.6	-1.7%	60.4	3.2%	13.4	-9.7%	36.7	-5.7%	110.5	-1.6%
Mar-11	417.5	-0.7%	60.0	-0.6%	12.5	-6.9%	36.0	-1.7%	108.5	-1.8%
Mar-12	419.8	0.5%	60.0	-0.1%	12.0	-3.7%	34.2	-5.0%	106.2	-2.1%
Mar-13	429.3	2.2%	61.2	2.0%	11.5	-4.1%	35.5	3.7%	108.2	1.9%
Mar-14	440.1	2.5%	61.5	0.5%	11.3	-2.1%	38.6	8.8%	111.4	3.0%
Mar-15	455.2	3.4%	63.7	3.6%	11.4	1.1%	40.6	5.2%	115.7	3.9%

Source: Bank of Japan

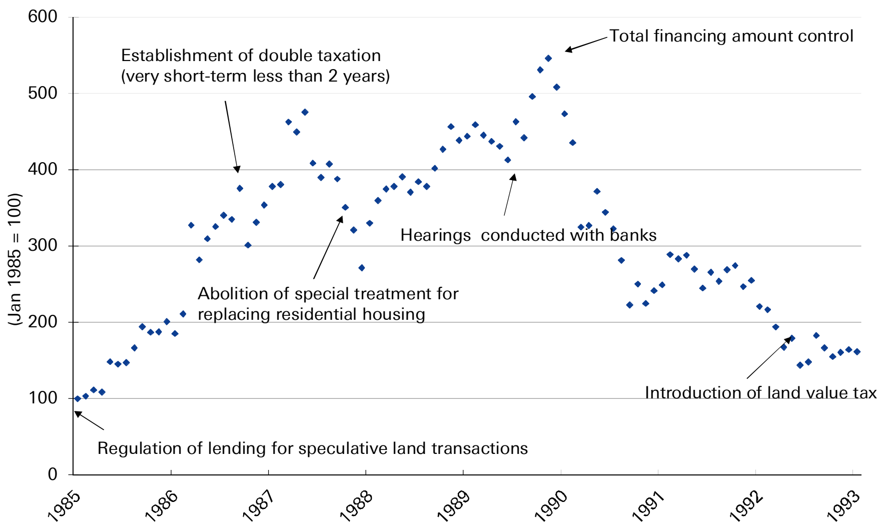
Why the mini-bubble burst

Restrictions on total loan volume and loan restrictions to real estate funds

A good example of limits in bank lending slowing the real estate market's growth is the lending volume regulation of 1990 to curtail real estate lending growth to less than overall loan growth as well as loan restrictions to real estate funds introduced in December 2006 which burst the mini-bubble of 2003-2007.

It was bad timing that the lending regulations were implemented in December 2006. Many real estate companies went bankrupt between summer 2008 and early 2009 as the regulations overlapped with a global credit crunch triggered by the Lehman Brothers' collapse.

Figure 11: TSE Real Estate Stock Index and regulations from 1985-1992



Source: Deutsche Securities based on Datastream and various public information

In fact, many real estate companies that had been thriving during the mini-bubble went into bankruptcy, including Urban Corporation, Japan General Estate, Zephyr, Dynacity, Pacific Holdings, and Creed.

New City Residence, a J-REIT, filed for court bankruptcy protection

Figure 12: Major real estate bankruptcies (2008-2009)

Zepher	Jul-08	Civil Rehabilitation Law
Urban Corporation	Aug-08	Civil Rehabilitation Law
Dinacity	Oct-08	Civil Rehabilitation Law
Morimoto	Nov-08	Civil Rehabilitation Law
Creed	Jan-09	Corporate Rehabilitation Law
Japan General Estate	Feb-09	Corporate Rehabilitation Law
Pacific Holdings	Mar-09	Corporate Rehabilitation Law
Joint Corporation	May-09	Corporate Rehabilitation Law

Source: Deutsche Securities based on company release

J-REITs had been considered safe from bankruptcy because of their low debt ratios and stable cash flow from rental income. New City Residence Investment Corporation put an end to this myth when it filed for court bankruptcy protection after banks shut off its lending. Many foreign real estate funds were also forced to pull out of the market.

Recovery following the burst of the mini-bubble

The decline in the balance of lending to the real estate sector ended in FY3/12

The continued decline in lending balance to the real estate sector following the burst of the mini-bubble finally flattened out YoY in FY3/12. It was a notable improvement given the annual decline of about ¥400bn in FY3/11. Meanwhile, new lending to the real estate sector bottomed in FY3/11 and rose for two years in a row to reach ¥7.8tr.

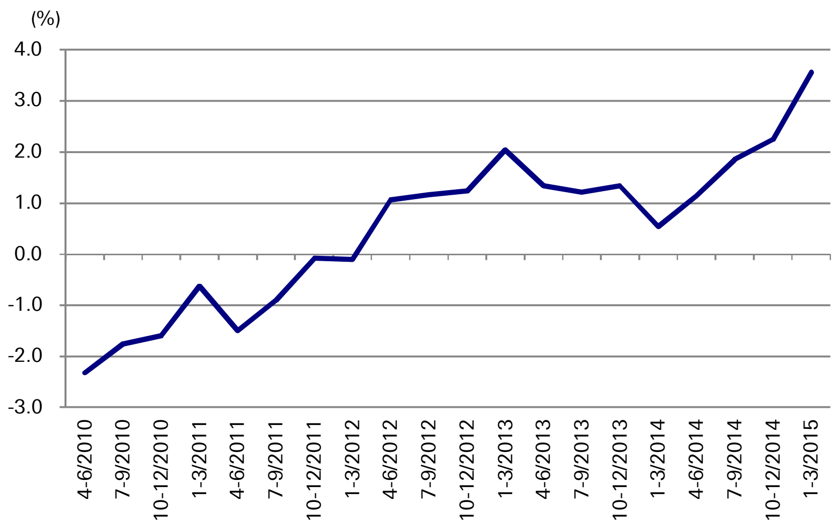
This development represents a significant turning point for the real estate sector. A halt in the decline in lending balance to the real estate sector indicates funds are starting to pool in the real estate market, which means real estate prices should be about to rise.

Loan balance to the real estate sector hits a record high

Loans to the real estate sector continued to grow despite the 2011 earthquake and the consumption tax hike, reaching ¥63.7tr in Jan-Mar 2015, the highest on record since the disclosure method was revised in 2009. Growth also accelerated, from 2.2% YoY in Oct-Dec 2014 to 3.6% YoY.

The ¥63.7tr balance is the highest since the disclosure method was revised in 2009

Figure 13: Lending balance to the real estate industry (domestic banks, YoY)



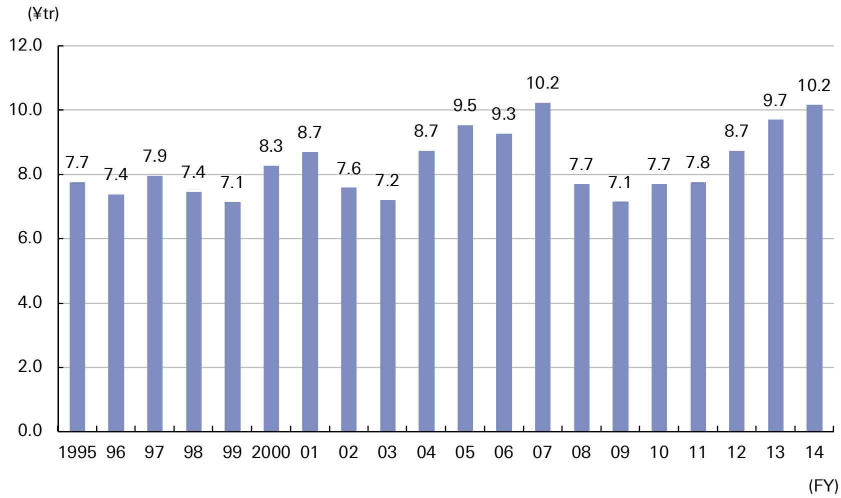
Source: Bank of Japan, 'Outstanding Loan Balances by Industry'

New loans to the real estate sector topped ¥10tr in FY2014, equal to the peak level of FY2007's mini-bubble and showing the first signs of another real estate bubble.

Possibility of real estate prices rising further

Real estate prices may rise even further, given that the real estate loan balance has expanded to its highest level of ¥10.2tr (same as FY2007) and that the pace of growth in the loan balance has begun to accelerate.

Figure 14: New lending to the real estate industry (domestic banks)



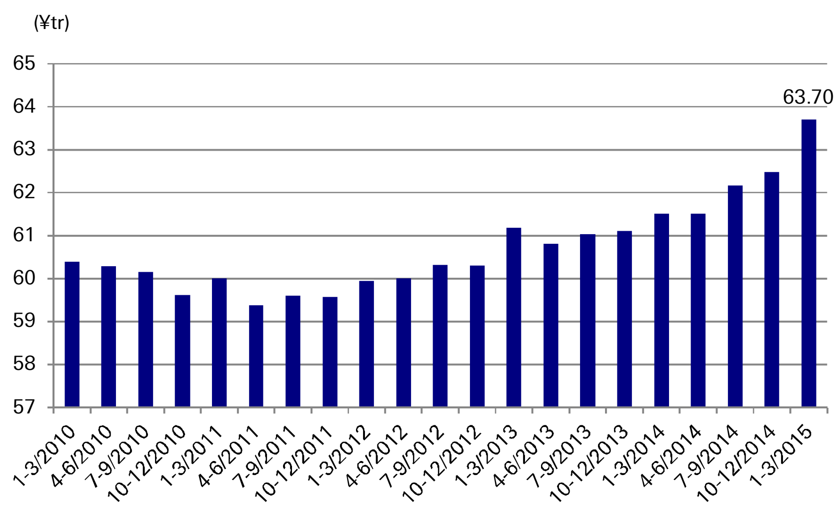
Source: Bank of Japan, 'Outstanding Loan Balances by Industry'

This trend can be stemmed only by regulatory action, but those conditions do not apply at present. Indeed, the BoJ merely cautioned that the real estate market needs better monitoring in its Financial System Report of 22 April.

We believe the long way toward meeting the BoJ's 2% inflation target and continued L-shaped economic recovery will result in monetary easing being drawn out, delaying the introduction of regulations to address the record high pace of growth in bank lending to the real estate sector, and accelerating the bubble-like conditions for asset prices.

Long road toward meeting the BoJ's 2% inflation target and continued L-shaped economic data could create bubble

Figure 15: Lending balance to the real estate industry (domestic banks)



Source: Bank of Japan, 'Outstanding Loan Balances by Industry'

Higher tax drives bubble

Real estate investments to reduce inheritance taxes

Drawing on past examples, we discussed: 1) plausible scenarios that support a bubble; and 2) increased bank lending to the real estate sector as part of the three elements needed for asset inflation. The third element for asset inflation is a tax reform that boosts real estate prices.

Ironically, tax hikes work as incentives for real estate investment

Ordinarily, tax system reforms that boost real estate prices involve tax cuts, but this time tax hikes have ironically become the incentive for real estate investments. This tax increase is for inheritance taxes. While there had long been discussions about revising inheritance taxes, the tax reform of 2013 finally resulted in raising inheritance taxes and the new tax law became effective in April 2014. The main revisions were a lower basic exemption and a higher rate for calculating inheritance taxes.

It is well known that real estate investment is a simple and effective means of dealing with inheritance taxes. For example, the taxable assessed value of a high-rise condo would be lowered on average by about 70%. The assessed value of ¥100m in cash (deposits) is ¥100m, but if this is used to purchase a high-rise condominium, the taxable assessed value would be only ¥30m, or a reduction of ¥70m.

One in four people in Tokyo's 23 wards might have to pay inheritance tax

Looking at Tokyo's 23 wards, it has been said that one in four people will be subject to inheritance taxes due to the tax hike. Accordingly, it had been expected that real estate investments - which are highly effective in reducing taxes - would increase.

Figure 16: Key changes in inheritance tax

- Basic exemption
  From ¥50m to ¥30m
- Statutory heir
  From ¥10m to ¥6m
- Tax rate and maximum rate
  From 6 brackets to 8, maximum rate from 50% to 55%

Source: Ministry of Finance

Figure 17: Inheritance tax rate structure under consideration

Current		Proposed	
Taxable amount	Tax rate	Taxable amount	Tax rate
¥10m or less	10%	¥10m or less	10%
¥30m or less	15%	¥30m or less	15%
¥50m or less	20%	¥50m or less	20%
¥100m or less	30%	¥100m or less	30%
¥300m or less	40%	¥200m or less	40%
-	-	¥300m or less	45%
Over ¥300m	50%	¥600m or less	50%
-	-	Over ¥600m	55%

Source: Ministry of Finance

However, the real estate investment bubble, which was created by high-net-worth individuals in an effort to save on taxes, has become much larger than we had expected. In particular, high-rise condos, which offer substantial tax savings, are being sold in central Tokyo despite having a gross yield of about 3%. Excluding expenses such as maintenance fees, the rate of return would be almost zero. The popularity of these properties despite their miniscule return is more due to the investor incentive focusing on inheritance tax reduction than on investment return.

The three conditions that can cause asset inflation are in place

Indeed, during the real estate bubble back in the late 1980s, there was an inordinate volume of real estate investments as a countermeasure against inheritance taxes. The government thus implemented a policy to raise the basic tax deduction on inheritance taxes, thereby cooling the market.

Lowering the basic tax deduction on inheritance taxes has effectively served to spur real estate investments, though this was not what the government intended.

High-net-worth individuals drive the real estate market

Brillia Towers Meguro in Meguro-ku Tokyo, mainly being developed by Tokyo Tatemono, is a recent example of overheated investment by high-net-worth individuals in high-ticket condos in central Tokyo as an inheritance tax countermeasure.

The most expensive unit in Brillia Towers Meguro sold for ¥459m.

A first phase of 495 condos was offered for sale in mid-July. All units quickly sold out even though the most expensive was ¥459m, and over half of the units cost ¥100m-plus. The most popular units were 43x oversubscribed. People over the age of 50 accounted for 60% of the buyers.

People over the age of 50 also accounted for 80%-plus of the Branz Tower Minato Mirai unit purchasers, developed by Tokyu Land in Minato Mirai, Yokohama in June. In our view, inheritance tax measures taken by older people are driving the real estate market, and demand is limited to urban areas, particularly Tokyo, where inheritance tax countermeasures are required.

Globalization and changes it brings to the real estate market

Revised Worker Dispatch Law to be enacted

Limits on period for use of temporary workers effectively eliminated

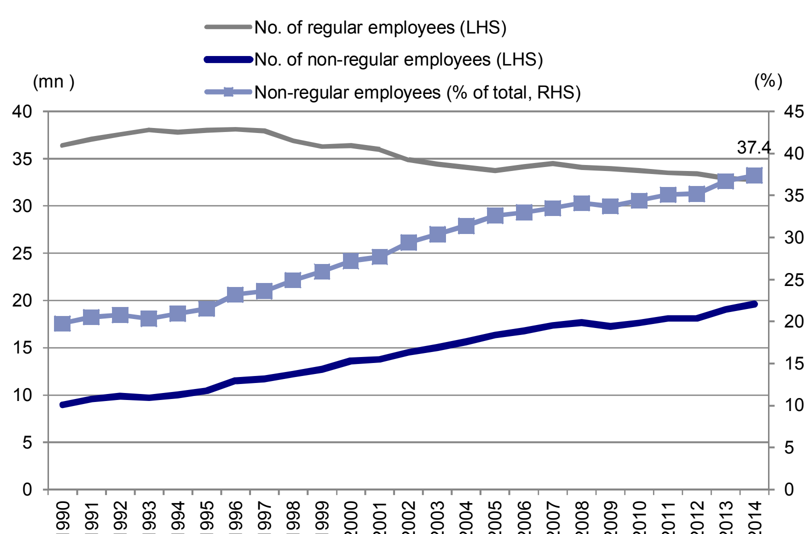
The Lower House has finally passed the bill to amend the Worker Dispatch Law after it was tabled for the third time. The current law limits the use of temporary workers for the same job for a period of more than three years to 26 fields requiring special skills. However, the amendment allows all companies to use temporary staff indefinitely as long as they replace individual workers every three years.

Temporary workers are usually paid less than full-time staff, and companies are also obliged to pay insurance premiums and other allowances if the temporary workers are converted to full-time staff. We believe the amendment represents deregulation that benefits companies by allowing them to reduce costs.

Non-regular employees already increased to close to 40% of total

Staff shortages are already a problem in some industries, and the hiring activity of full-time staff in these industries could increase. We believe, however, that many companies are suffering no major staff shortages. In our opinion, the view that the Revised Worker Dispatch Act will encourage the conversion of temporary workers to full-time staff is optimistic, and we see a strong likelihood of the ratio of temporary staff to total, which has already risen to close to 40%, continuing to increase.

Figure 18: Trend of regular/non-regular employees



Source: Ministry of Internal Affairs and Communications, 'Labour Force Survey'

Japan Revitalization Strategy includes policies to enhance ROE

The 22nd Industrial Competitiveness Council meeting was held on 22 June, and the Abe government's Japan Revitalization Strategy 2015 (draft) (Japan Revitalization Strategy) growth strategy was announced. It incorporates deregulation allowing companies to cap personnel costs. We believe it includes a broad range of policies to enhance Japanese companies' ROE.

Prompt establishment of a system for highly skilled professionals

One example is the prompt establishment of a system for highly skilled professionals. This rewards staff based on performance rather than on the number of hours worked, and is generally viewed as a "zero overtime payment law". In the Japan Revitalization Strategy, after enactment of the draft, investigations will be undertaken by the Labor Policy Council enabling conclusions to be promptly reached premised on "annual income of at least ¥10m" and "clarity of scope of duties for businesses" prescribed by ministerial ordinance.

Introduction of pecuniary dismissals

The Japan Revitalization Strategy also incorporates the introduction of pecuniary dismissals to avert labor disputes and support for re-employment of middle-aged employees, as well as measures to increase foreign labor as a means of addressing the labor shortage. We believe these are all linked with reducing companies' personnel expenses.

Figure 19: Employment-related measures in Japan Revitalization Policy Revised 2015

Employment system reform/human resources strengthening measures

Objectives (1):	Labor mobility without unemployment, strengthening of matching function, diversification of employment formats	
	Promotion of active participation by the young and elderly, human resources strengthening in keeping with globalization	
	Examples of specific future measures	
		Strengthening of efforts to prevent overwork (strengthened oversight of work in excess of 100 hours per month, etc)
		Prompt establishment of a system for highly skilled professionals (zero overtime payment law)
		Promotion of introduction of Self Career Dock
		Support/placement for middle-aged re-employment
		Settlement of labor disputes with money
Objectives (2):	Promotion of active participation by women, use of foreign human resources	
	Examples of specific future measures	
		Securement of child minders, overhaul of nurseries
		Targeting leave eligibility for 80% of men directly after spouse gives birth in 2020
		Housework assistance services quality assurance
		Strengthening of efforts to bring in highly skilled foreign human resources
		Further acceleration of overseas student uptake, and strengthening of support for active participation after overseas study
		Doubling of the number of foreign IT personnel engaged in the IT business from the current 30,000 to 60,000 in 2020

Source: Compiled by Deutsche Securities from the Cabinet Office's Japan Revitalization Strategy Revised 2015 (draft)

Developments favoring large companies gathering pace

The government is aware of the need to enhance productivity in order to promote economic growth as Japan's society ages

We believe the Japan Revitalization Strategy 2015 indicates that the government is adopting or considering a range of employment-related deregulation measures to limit the risk of future growth in personnel costs. We believe the government is aware of the need to enhance productivity in order to promote economic growth as Japan's society ages.

At the 22 June Industrial Competitiveness Council meeting, Prime Minister Abe said "The Abe Cabinet's growth strategy is entering a new stage. Overcoming supply constraints while the population is declining will be an issue, and the only way to overcome this is increased productivity. For Japan again to be a global front-runner, a productivity revolution through forward-looking investment is important. It is now the private sector's turn, and time for action."

Although real GDP growth turned negative in FY14, listed companies' profits remained high. We believe that the abovementioned deregulation measures will further boost their profits, and that developments favoring large companies will continue.

Further strengthening of Corporate Governance Code

Measures related to Corporate Governance Code are at the beginning of the Japan Revitalization Strategy 2015

The Thee Action Plans presented in the Japan Revitalization Strategy 2015 are grandiose plans taking up 140 pages, but measures related to the Corporate Governance Code are at the beginning of the Thee Action Plans.

Progress to date has been the announcement of corporate governance proposals to the effect that listed companies should appoint two or more independent external directors, and that those that have listed equities as strategic shareholdings should disclose their policies with regard to such holdings. Based on this, the TSE formulated a Corporate Governance Code, to be applied to listed companies from June 2015.

To further strengthen corporate governance, the Japan Revitalization Strategy 2015 states that the introduction of more flexible compensation schemes will be arranged, enabling management to receive compensation with stocks or earnings-linked compensation.

Figure 20: Principles of Corporate Governance Code

Principle 1	Securing the Rights and Equal Treatment of Shareholders
	1-4 Cross Shareholdings
	When listed companies hold shares of other listed companies as cross shareholdings, they should disclose their policy with respect to doing so. In addition, the Board should examine the mid- to long-term economic rationale and future outlook of major cross shareholdings on an annual basis, taking into consideration both associated risks and returns.
	1-5 Anti-Takeover Measures
	With respect to the adoption or implementation of anti-takeover measures, the Board should carefully examine their necessity and rationale, ensure appropriate procedures, and provide sufficient explanation to shareholders.
Principle 2	Appropriate Cooperation with Stakeholders Other Than Shareholders
Principle 3	Ensuring Appropriate Information Disclosure and Transparency
Principle 4	Responsibilities of the Board
	Given its fiduciary responsibility and accountability to shareholders, the Board should work to promote sustainable corporate growth and improve corporate value over the mid to long term, while aiming to boost its capacity for earnings generation and optimize capital efficiency.
	4-2 Roles and Responsibilities of the Board
	The remuneration of management should include incentives such that it reflects mid- to long-term business results and potential risks, as well as promotes healthy entrepreneurship.
	4-8 Effective Use of Independent Directors
	Companies should appoint at least two independent directors, who should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid to long term.
Principle 5	Dialogue with Shareholders
	5-2 Establishing and Disclosing Business Strategy and Business Plan
	Companies should present targets for profitability and capital efficiency, and provide explanations that are clear and logical to shareholders with respect to the allocation of management resources and specific measures that will be taken in order to achieve their plans and targets.

Excerpts, summary based on the Corporate Governance Code Draft submitted by the FSA's Council of Experts Concerning the Corporate Governance Code (15 March 2015)
Source: Tokyo Stock Exchange, Deutsche Securities

Japan globalization close at hand

Winners take all

We believe that the Japan Revitalization Strategy 2015 targets Japan's economic growth through improved productivity resulting from strengthening of shareholder rights, promoting deregulation and liberalization, thorough implementation of individual responsibility and introduction of strict competition principles. It aims for "a society that rewards hard workers," "a winner-takes-all society" and "a society that clarify individual responsibility."

Measures to facilitate this are the strengthening of the Corporate Governance Code for investors, the Revised Worker Dispatch Act and the proposed zero overtime payment law for companies. Together these will create companies that are beneficial to investors and management, are highly likely to further improve the earnings of winning companies, and should maintain strength in the stock market, in our view.

Shakeout and reorganization among low-productivity SMEs

The flip side of this, however, is that there will be shakeout and reorganization of low-productivity SMEs with progressive oligopolization by major corporations. We believe the middle class will be reduced by an intensely competitive society. We believe typical international rules such as TPP will also become the norm in Japan, where co-existence, co-prosperity and old-fashioned customs have to date been the norm.

Japan will likely become a hot market for activist investors

The Japan Revitalization Strategy also regards strengthening of English language education rather than Japanese language education as important. As such, Japan is likely to lose not only its customs but also its culture. The Japan globalization desired by investors and managements is close at hand.

Increase in high-net-worth individuals and promotion of English language education are set to boost real estate prices

The segmentation of the middle class with an increase in high-net-worth individuals, and the promotion of English language education look unconnected with the real estate market, but we believe these developments could boost real estate prices. Unlike the middle class, high-net-worth individuals do not use their entire income for consumption, so savings tend to accumulate. The middle-class people are unable to save because their incomes are low, but high-net-worth individuals conversely have difficulty in consuming their entire income. In short, an increase in high-net-worth individuals is a factor in excess savings for the society as a whole. Prices consequently do not rise, and interest rates remain at low levels. High-net-worth individuals start yield-hunting, and prices of assets including real estate are prone to rise more than justified by fundamentals, in our view.

Chinese high-net-worth individuals show a strong tendency to buy real estate in English-speaking countries such as Canada, the US, Australia, and New Zealand. This is because they are committed to educating their children in English. Investment in Japan is limited because their children's English language abilities will not be improved in Japan. If Japanese university education is conducted in English, there is consequently a strong likelihood of Chinese capital inflow to Japan as the country also has geographical advantages.

Whether or not intended by the government, Abenomics is thus a strategy which could boost real estate prices. It is uncertain, however, whether these strategies will prove successful as they are completely at odds with the Japanese culture and traditions.

Figure 21: The real meaning of "Buy my Abenomics" – to get firms to use their retained earnings

1	All listed companies to comply with a new Corporate Governance Code in line with international stan
2	Introduction of a Japanese version of the Stewardship Code
3	Unwinding cross shareholdings; increase in hostile takeover
4	Higher ROE can be achieved more easily by the revised Dispatch Worker Act, relaxing labor conditior a bill that allows for zero overtime pay, and lifting the ban on foreign workers in certain fields
5	Japanese traditions and customs will likely die off
6	So Japan will likely become a hot market for activist investors

Source: Deutsche Securities

Reform is progressing steadily

We have compiled the Abe administration's policies based on the Prime Minister's speech on 22 January 2014 at the World Economic Forum in Davos, Switzerland. We have mentioned many times to date that, judging solely from these policies, we believe Abenomics simply envisions a US-style society. In other words, the policy goal is to create a society in which the gap between the rich and poor expands as corporations and investors become more powerful, the rich get richer, and the middle class shrinks as many fall into low-income jobs, in our view.

Heading toward a US-style society

It has now been a year and five months since the Davos Forum, and two years and six months since the LDP scored its major victory in the December 2012 Lower House elections. Some market watchers believe that the progress of Abenomics is slow or the pain of reform is being put off due to factors such as the planned consumption tax hike to 10%, which has been postponed. However, we believe that progress is being made toward implementation of most of the 11 policies on the next page, and the reform is steadily progressing. In short, we believe Japan is heading toward a US-style society.

Prime Minister Abe's 11 policies to bore through Japan's 'regulatory bedrock'

1. Complete deregulation of the electricity market; separating generation from transmission

'We will completely liberalize Japan's electricity market. By the time the Olympians compete in Tokyo in 2020, Japan's electricity market will also be completely competitive, for both power generation and retail, with power generation split off from power transmission.'

2. Privatizing and fostering medical care as an industry

'Japan is at the leading edge in regenerative medicine. We will make it possible to generate cells at private-sector factories.' 'We also need large-scale health care companies in the form of holding companies, much like the Mayo Clinic.'

3. Deregulating agriculture

'We are also doing away with the 'rice production adjustment' system. This system has been in place for more than 40 years.' 'Private companies will be able to engage in farming without barriers and grow the crops they want, without artificial control over supply and demand.'

4. National Strategic Special Economic Zones, easing floor area ratio regulations

'In cities hoping to join the world-class, limits on floor area ratios will become a thing of the past. The sky will be the limit.' 'We will soon see high-quality housing, or business complexes, and zero-emissions towns appearing, one after another.'

5. Participation in the Trans Pacific Partnership (TPP)

'TPP will remain a central pillar of my economic policies.' 'We will push ahead the Japan-EU Economic Partnership Agreement.' 'Those will surely make Japan's economy even more deeply integrated into global flows of knowledge, trade and investment.' 'Companies and people from abroad will find Japan among the most business friendly places in the world.'

6. Changes in the Government Pension Investment Fund's (GPIF) portfolio, allowing foreign companies to manage portfolio assets

'Japan's public fund management will also change a great deal.' 'Japan's Government Pension Investment Fund now holds about $1.2tr. We will press ahead with forward-looking reforms, including a review of that portfolio.'

7. Reducing corporate taxes

'We must also make the tax system for companies internationally competitive.' 'We will reduce the corporate tax rate by 2.4% from April this year.' '… we will set about further reform on corporate tax.'

8. Reforming the labor market

'We will reform the labor market that ties workers to old industries.' 'New industries require innovative and creative human resources.' 'We will re-direct our subsidies so that workers without meaningful work in old industries can move to new industries that require good human resources.'

9. Encouraging women to participate in the labor market

'After all, the female labor force in Japan is the most under-utilized resource.' 'By 2020 we will ensure that 30% of leading positions are occupied by women.'

10. Easing immigration

'In order to have a large number of women become leading players in the market we will need a diverse working environment. Support from foreign workers will also be needed for help with the housework, care for the elderly, and the like.'

11. Reforming Japan's corporate law, and introducing a Japanese-version stewardship code

'We will soon put forward changes in the corporate law to the upcoming parliamentary session. Under these changes, external directors will increase.' '…we will also draw up a stewardship code. It will make it easier for institutional investors to have a greater role in corporate governance.'

Global standards eliminating excessive profits

If Japan joins the TPP, dual intermediation is likely to be prohibited, as in the US

The Real Estate Information Network for East Japan (REINS) revised a number of its rules from 1 October 2013. The revision included a clear prohibition of "captive properties" with punishments becoming more severe.

"Captive properties" refers to a real estate brokerage company refusing to introduce properties to other brokerage companies, giving top priority to receiving a commission from both the seller and buyer (dual intermediation). This is seen as harming customers by obstructing the swift conclusion of contracts and creating disadvantageous pricing.

If rules prohibiting "captive property" are tightened, we believe dual intermediation would decline, enabling customers to close contracts more quickly at advantageous prices. Over the long term, we see this leading to a more active market for existing homes.

For major brokerage companies, however, a decrease in dual intermediation will clearly decrease their profits. Furthermore, if Japan joins the Trans-Pacific Partnership (TPP), dual intermediation is likely to be prohibited in principle, as in the US, and property contract prices will generally be disclosed. For major brokerage companies, stricter prohibitions on "captive property" and Japan's possible TPP entry would pose major risk to their excessive profits, which they have been accruing until now.

As we have repeatedly mentioned, we believe Japan's TPP entry would have the following impact on the real estate and J-REIT sectors.

Figure 22: Possible impact of Japan's TPP entry on the real estate and J-REIT sectors

1. All contracts would be in English because Japanese poses a barrier to entry for foreign investors
2. Practices particular to Japan such as key money and lease renewal fees could be abolished
3. The Act on Land and Building Leases (favorable for tenants) could be abolished
4. Qualifications only valid in Japan such as real-estate appraiser could lose value
5. Relaxation of the Building Standards Law
6. A sharp increase in lawsuits to raise rents
7. J-REIT purchases of property from sponsors could be deemed unfair and thus banned
8. Rents and sale prices would require full disclosure

Source: Deutsche Securities

Sony Real Estate looses an arrow at the industry

Double-ending prohibited in principle

Sony launched its new Sony Real Estate business mainly as a real-estate brokerage. We had not expected the real-estate brokerage to draw any special attention simply based on the Sony brand.

However, Sony Real Estate is setting itself apart from other brokers that practice double-ending, introducing a system similar to that of the US, where agents only act on behalf of either the buyer or the seller. We believe this could transform the industry's normal practices. The problem with double-ending is that the brokerage takes total control over the transaction, which could result in sale closures taking a long time and prevent the seller from getting a high price.

Commissions set in keeping with costs means lower fees

Real estate brokerages typically charge clients the maximum allowable fees: 3% of the sale price plus ¥60,000. However, Sony Real Estate will likely charge lower than usual commissions as fees will be determined by services provided.

Moreover, the government is considering relaxing the requirements for brokers to explain important clauses of a real estate transaction in-person so that this can be conducted via the internet. If this materializes, Sony Real Estate could further lower its fees. We believe that the real estate industry could see a change similar to that experienced by securities brokerages that normally carried out business in person – losing market share to online brokerages.

Real estate brokerage industry poised for period of serious competition

We believe the entry of Sony Real Estate, the implementation of REINS' regulations, and potential entry of TPP will give the real estate brokerage business no option but to revamp its outmoded business structure.

Specifically, we envisage a decline in fee rates and the collapse of the major property companies' oligopoly. We believe the real estate brokerage industry is set to be overtaken by a wave of stiffer competition due to deregulation, similar to what the electronics industry has already experienced.

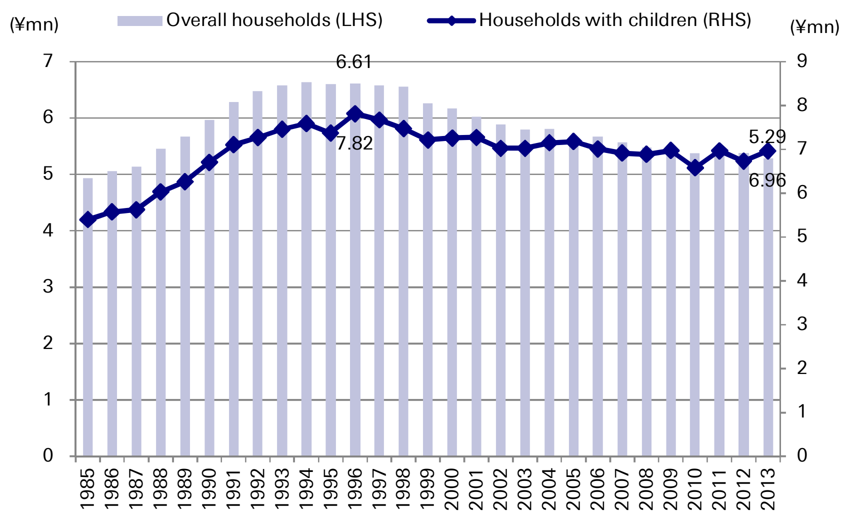
The cliff of April 2017

Japan is becoming poorer

Income per household has fallen about ¥1.3m over 17 years

According to the Ministry of Health, Labour and Welfare's "Comprehensive Survey of Living Conditions 2014" published on 2 July 2015, average income per household in 2013 was ¥5.29m. In 1996, a year before the first consumption tax hike, the average was ¥6.61m; so household income has declined by about ¥1.3m over the past 17 years.

Figure 23: Trend in average income per household



Source: Ministry of Health, Labour and Welfare, 'Comprehensive Surevey of Living Conditions'

The road to hell is paved with good intentions

Abenomics repeating history

The Abe government is repeating history as the Prime Minister and his Cabinet force extreme tax hikes to accelerate fiscal reconstruction. Japan's economic growth turned negative due to the consumption tax hike in April 2014, which raised the rate from 5% to 8%. Nonetheless, a further consumption tax hike to 10% is planned for April 2017.

Following the collapse of the bubble economy, Japan has had several opportunities to escape deflation. However, on each occasion, measures were rapidly introduced that ended the recovery, and deflation has consequently persisted up to the present.

Historically, Japan has immediately followed an upturn in economic conditions with tax hikes and budget austerity under the banner of fiscal reconstruction. As a result, a transition to a full-fledged economic recovery has not been possible. For example, Japan raised the consumption tax in FY14, increasing citizen’s tax burden by ¥8tr, and the government simultaneously cut its budget by about ¥6tr. As a result, Japan recorded a decline in real GDP. Accordingly, we believe that while fiscal reconstruction sounds appealing, it could be leading Japan into a disaster.

Japan is the world's leading creditor, not debtor nation

Japan is the world's leading creditor nation, and not a debtor nation. It is the government that is in debt, to the tune of about ¥1,000tr. In other words, the debt is about ¥250m per government employee, while Japan's assets per capita are approximately ¥8m.

Many people mistakenly believe that the private sector's financial assets (the total of household and corporate financial assets) buy JGBs and that those assets are gradually running out. In other words, they believe that the private sector's financial assets flow into JGBs. We have been hearing this above prediction for 20-30 years, but it has yet to happen.

The higher the JGB balance, the higher the private sector's financial assets become.

That is because the flip side of this flow is that JGBs become the private sector's financial assets. In other words, government issuance of JGBs in turn leads to higher financial assets in the private sector. Put more simply, the higher the JGB balance, the higher the private sector's financial assets. Therefore, the difference between the private sector's financial asset balance and the balance of JGB issuance would not narrow.

Indeed, the private sector's total financial assets (combining those of households and corporations) in FY14 increased by ¥972tr from FY98 to ¥2,096tr. Meanwhile, government debt (the JGB balance) grew ¥669tr to ¥1,038tr over the same period. However, the difference between the private sector's financial assets and the JGB balance expanded to ¥1,058tr in FY14 versus ¥756tr in FY98.

This is to say, the growth in private financial assets is no more than a gift from the government to the private sector. Put differently, the reason the difference (private sector's financial assets - JGB balance) is growing is due to Japan having a current account surplus.

Figure 24: Net financial assets after subtracting liabilities

Unit: ¥tr

FY	1998	2012	2013	2014	Chg (vs1998)	Chg (vs2013)
Household	911	1,220	1,256	1,331	419	75
Private non-financial companies	213	533	638	765	552	127
Private sector - Financial assets (1)	**1,124**	**1,753**	**1,893**	**2,096**	**972**	**203**
Outstanding government bonds (JGB) (2)	**369**	**970**	**996**	**1,038**	**669**	**42**
(Government Debts)	202	619	623	632	430	9
Private sector financial assets - Outstanding JGBs (1) - (2)	**756**	**783**	**898**	**1,058**	**303**	**160**

Source: Deutsche Securities based on Bank of Japan, 'Flow of Funds Accounts'

The government issues JGBs, which are purchased by private-sector banks via credit creation. The government then uses the funds raised for spending and investment within Japan, and all of the funds thus flow back to the private sector.

The key point is that the purchasing of JGBs is not being funded by the private sector's deposits, but by credit creation at private-sector banks. The private sector's financial assets have consequently expanded. To repeat, the expansion in the JGB balance has caused the growth of private-sector financial assets.

Private-sector deposits are not used to purchase JGBs

One person's borrowing is another person's asset

One person's borrowing is another person's asset in a money economy. As such, action that drives down borrowing (fiscal reform and reduction of bank lending) also reduces assets, and is thus a cause of economic stagnation.

The lending balance at Japanese banks fell by approximately ¥100tr between FY98 and FY03. Given the basic principle of a money economy that one person's borrowing is another person's asset, the Japanese economy was at risk of collapse without increase in borrowing by someone during the period. This situation was remedied by growth in the government's JGB balance.

The lending balance at Japanese banks fell by approximately ¥100tr between FY98 and FY03

The problem is that households and corporations have been excessively drawn to financial assets, resulting in the additional accumulation of c.¥972tr since FY98.

The balance of bank lending has finally started expanding in Japan, and the Japanese economy is headed toward normalization. If the private sector expands its borrowing, the government would no longer have to issue JGBs. However, the government has applied the brake too early, as in the past.

Too early to apply the brake, as in the past

Fiscal reconstruction was carried out in FY14 through budget austerity and higher taxation. An austerity budget of about ¥6tr was passed, together with the consumption tax hike that placed an additional tax burden of ¥8tr on the population. Japan's economy fell into negative growth in FY14 as the government stomped on the economic brake in the name of fiscal consolidation.

The cliff of April 2017

The basic deduction for inheritance taxes was also lowered and the top tax rate was raised from 50% to 55%. The top income tax rate was also increased from 40% to 45%, and social insurance premiums were raised.

Consumption tax to be hiked to 10% in April 2017

Employees whose annual incomes exceed ¥12m in 2016, and ¥10m in 2017, are facing smaller income tax deductions and higher rates for income and resident taxes. Employees with annual incomes of ¥15m or more are already paying higher income and resident taxes from 2013, but the government has decided to expand the applicable income brackets.

The rush to raise taxes does not even stop there, as the consumption tax is to be raised to 10% in April 2017.

We reiterate that a consumption tax hike for the sake of fiscal reconstruction carries a high risk of significant adverse impact on the economy. Indeed, Japan's economy fell into negative growth in FY14 and the wound has not yet healed.

However, compared to European countries where the value-added tax (VAT) is above 20% across the board, Japan's consumption tax seems low. Hence, some people continue to argue that there is still ample room to raise it.

Figure 25: Schedule for tax hikes

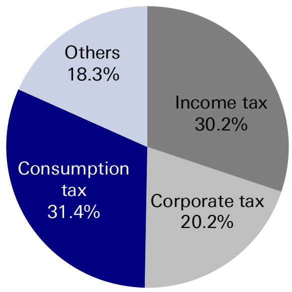
		Item	Details
2012	June	Addition of income limits to child allowance	Up to three years old, ¥15,000, from three years through primary school (up to the second child), ¥10,000, and ¥15,000 for the third child and beyond. Junior high school students, ¥10,000. Income limited (¥5,000 for annual income of ¥9.6m and up)
		Individual residential tax (reduction and removal of dependent exemptions)	Removal of ¥330,000 dependent exemption for children aged 0-15; ¥33,000 tax increase since residential tax is 10% (removal of dependent exemption because of ¥26,000 in child allowance)
	September	Electricity rate hikes by Tokyo Electric Power	
	October	Increase in employee pension scheme premiums	Annual increase of 0.354% up to 2017 (of which 0.177% borne by individuals)
2013	January	Temporary income tax hike for tsunami reconstruction (2.1% additional tax over 25 years)	2.1% levied on all income tax, including interest of deposits and dividends
		Ceiling on employment income tax deduction	Setting exemption ceiling of ¥2.45m for employees whose annual incomes exceed ¥15m
		Removal of residential tax exemptions on retirement bonus	Removal of 10% exemption
	April	Increase in national insurance premiums	
	October	Increase in employee pension scheme premiums	
2014	January	Higher tax rate on transfer gains and dividends on equities,	From 10% at present to 20%
	April	Increase in consumption tax to 8%	
		Increase in national pension premiums	
	June	Temporary residential tax for tsunami reconstruction (¥1,000/year for 10 years)	¥1,000 increase per year, per person
	October	Increase in employee pension scheme premiums	
2015		Reduction of basic inheritance tax exemption, and raising of maximum tax rate from 50% to 55%	
		Raising of income tax rate from 40% to 45% on taxable income exceeding ¥40m	
	April	Increase in employee pension scheme premiums	
		Increase in national pension premiums	
2016		Reduction of income tax deduction for employees whose annual incomes exceed ¥12m	Lowering exemption ceiling to ¥2.30m for employees whose annual incomes exceed ¥12m
2017	April	Increase in consumption tax to 10%	
		Reduction of income tax deduction for employees whose annual incomes exceed ¥10m	Lowering exemption ceiling to ¥2.20m for employees whose annual incomes exceed ¥10m

Source: Deutsche Securities based on various public data

However, Japan's consumption tax of 8% accounts for 32% of tax revenues, which is higher than the 25% of tax revenues accounted for by the UK's 20% VAT (Figure 26 and Figure 27). Japan's real GDP thus declined in FY14 when the consumption tax was hiked to 8%.

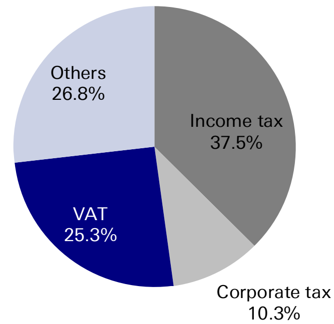
Before raising the consumption tax from 5% to 8%, the government and the BoJ repeatedly insisted that it would not hurt economic growth. But, the economy fell into negative territory. The biggest problem is that the government still plans to raise the tax again in April 2017 to 10% without verifying whether the tax hike to 8% was the correct choice for the Japanese economy.

Figure 26: Japan's national tax revenue (based on FY2015 budget)



Source: Ministry of Finance, Deutsche Securities

Figure 27: UK national tax revenue (based on 2012 actual figures)



Source: Ministry of Finance, Deutsche Securities

Condo market outlook

Repeat of 1997 scenario

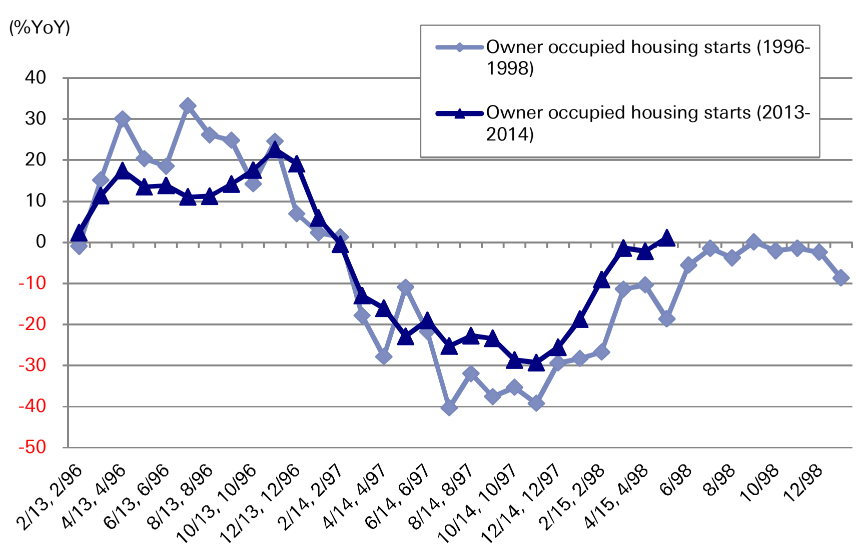
Human behavior and psychology unchanged by times

Housing demand slumped following the consumption tax hike in April 2014, in line with historical precedent, moving in the opposite direction to the consensus forecast. This illustrates that human behavior and psychology remain consistent even when times have changed.

Current housing demand is tracing a similar trajectory to that seen in 1997

Indeed, current housing demand is tracing a similar trajectory to that seen in 1997, when the consumption tax was raised from 3% to 5% (Figure 28). In 1997, owner-occupied housing starts also eased from nine successive months of double-digit YoY gains to single-digit growth in the subsequent three months, followed by 15 straight months of double-digit drops. This time we saw 10 straight months of double-digit YoY growth, then a slowdown to a single-digit rise in January 2014, followed by 11 consecutive months of double-digit declines.

Figure 28: Trend of owner-occupied housing starts (1997 consumption tax hike and current) (% YoY)

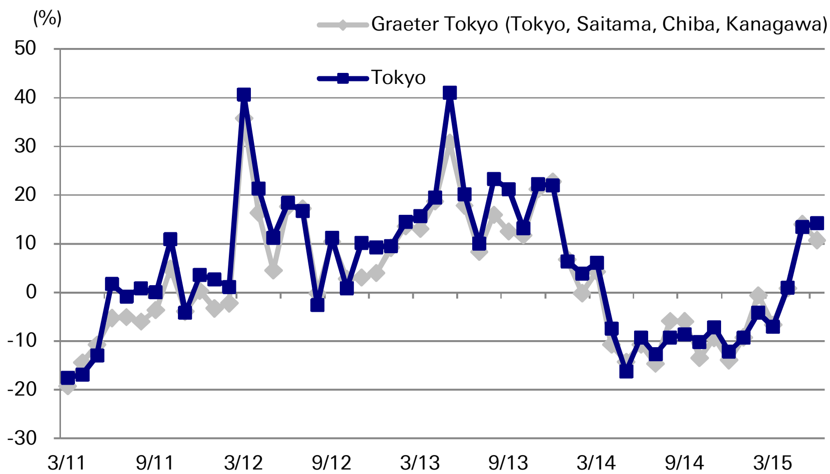


Source: Deutsche Securities based on 'Housing Starts' by Ministry of Land, Infrastructure, Transport and Tourism

Monthly orders at housing companies have turned positive (YoY) since the end of last year. Therefore, we expect owner-occupied housing starts for FY15 to recover to FY14 levels. However, we expect the speed of recovery to be slow and growth to dip again below year-ago levels before end-FY15.

Although the decline is narrower than for the owner-occupied housing market, the number of sales contracts for existing condos and the total number of sales contracts for newly constructed condos in the Tokyo metropolitan area have also continued to decline YoY (Figure 29). Similar to the owner-occupied housing market, the margin of YoY decline has gradually narrowed for the condo market, and we expect the condo market to grow slightly or remain virtually flat YoY.

Figure 29: Transaction volume of existing condominiums in Tokyo (% YoY)



Source: Real Estate Information Network for East Japan

Condo market also continued its YoY decline

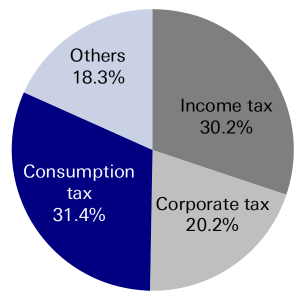
Impact of consumption tax hike unlikely to end within a year

At ¥17.1tr, consumption tax revenues now make up over 30% of total tax revenues

According to a breakdown of 2015 projected tax revenues released by the Ministry of Finance, consumption tax income is slated to reach ¥17.1tr or 31.4% of total revenues, which will be the first time it breaches the 30% mark. Meanwhile, income tax revenues are estimated at ¥16.4tr (30.2%) and corporate tax revenues at ¥11.0tr (20.2%) (Figure 30). Income tax revenues are expected to decline ¥10tr from their peak and corporate tax revenues to fall by ¥8tr. In other words, consumption tax income is now offsetting declines in income and corporate tax revenues.

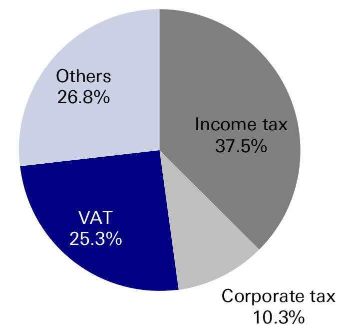
Compared with the value added tax (VAT) rates in Europe, some believe the single-digit Japanese consumption tax is still relatively low, leaving ample scope for further hikes. However, while VAT in the UK is indeed set at 20%, the weighting of VAT revenue within total tax revenues for the country is only 25.3% (based on FY2012 data), which is below the current corresponding percentage of 31.4% for Japan. This is because the UK does not levy VAT on certain goods such as housing. For this reason, we believe the consumption tax burden in Japan is already sufficiently heavy.

Figure 30: Japan's national tax revenue (based on FY2015 budget)



Source: Ministry of Finance, Deutsche Securities

Figure 31: UK national tax revenue (based on 2012 actual figures)



Source: Ministry of Finance, Deutsche Securities

Nevertheless, we estimate consumption tax income will eventually account for some 40% of total tax revenues, given the government's intention to further reduce corporate taxes while pushing through another consumption tax hike in April 2017. This will further increase the tax burden on average households, likely leaving little prospect of a recovery from the slowdown in consumer spending and housing investment following the consumption tax hike to 8% in April 2014.

Wage hikes are essential

It is difficult to expect increased spending on expensive housing-related investment given reduced disposable income due to an increased tax burden and concerns about additional consumption tax hikes. The only thing that can dispel such concerns is an increase in wages, in our view. However, wages declined in FY2014 and strong growth in FY2015 looks unlikely. As mentioned later in this report, the recovery on the employment front has hit a ceiling, making it difficult for wages to rise.

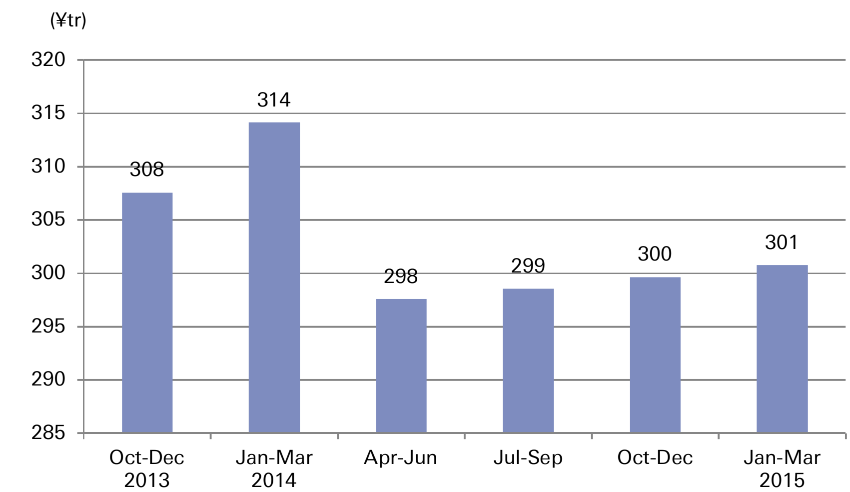
Downward shift in consumption

The consumption tax hike has had a serious impact. Real GDP (seasonally-adjusted) was ¥529tr in January-March 2015, so growth in the past two years has been almost negligible.

We believe the reason for weak consumer spending is that household purchasing power has undergone a downward shift due to the consumption tax hike. Considering what is happening in the US, cheap crude oil might not reinvigorate consumer spending in Japan. Moreover, the Japanese government plans to implement a second consecutive austerity budget, which means the second arrow of Abenomics is already broken. We believe it will not be easy to recover from the difficult economic conditions.

GDP statistics and the Family Income and Expenditure Survey suggest no change in households' inclination to save following the consumption tax hike. The recovery in household consumption in January-March 2014, when rush demand expanded ahead of the consumption tax hike, has been dulled, and the figure has decreased to around ¥14tr (Figure 32).

Figure 32: Trend of consumption of households (real base, seasonally adjusted)



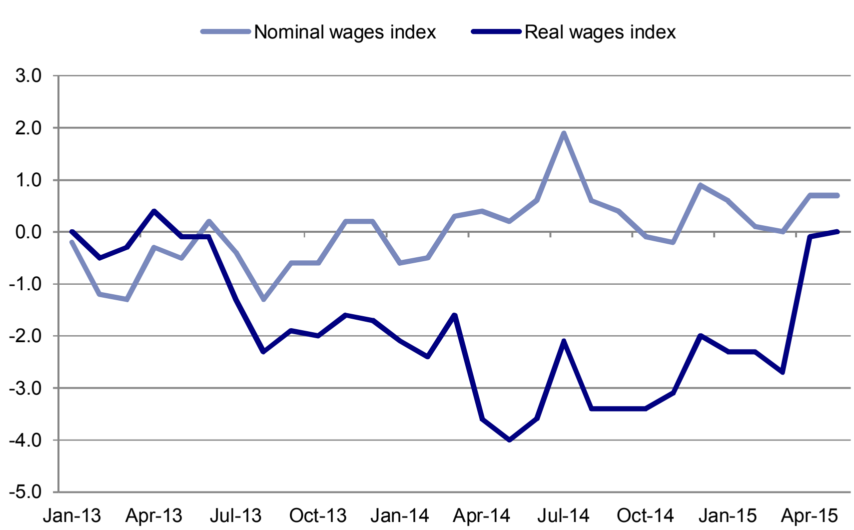
Source: Cabinet Office

Higher taxes destructive amid real wage decline

Real wages continue to fall by 3.0%

It goes without saying that as long as real wages do not rise, we cannot expect consumer spending and investment to increase. According to the Ministry of Health, Labour and Welfare's monthly labor survey statistics, although the wage index for FY2014 rose 0.5% YoY on a nominal basis, it was the fourth straight year of decline on a real basis, decreasing by 3.0%, the greatest decrease since FY1991. Conditions now are tougher than when the consumption tax was hiked from 3% to 5% in 1997.

Figure 33: Wages index (%YoY)

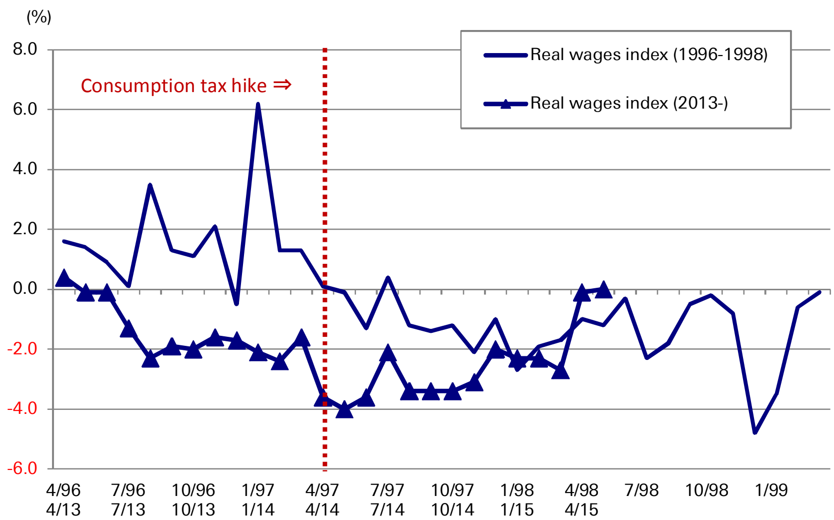


Source: Ministry of Health, Labour and Welfare, 'Monthly Labour Survey'

As shown in Figure 34, real wages were broadly up YoY when the consumption tax was increased in 1997, but turned negative after the tax hike. This time, the consumption tax was increased while real wages were already declining, and this has driven a sharper downturn in private consumption and investment.

Real wages were rising YoY when tax increased in 1997

Figure 34: Monthly Labour Survey – Wages index (%YoY) (1997 consumption tax hike and current)



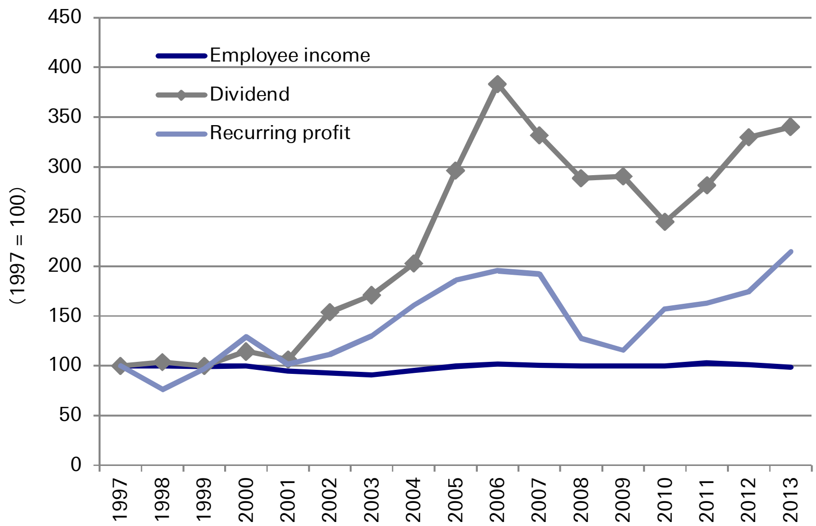
Source: Deutsche Securities based on 'Monthly Labour Survey' by Ministry of Health, Labour and Welfare

Absence of growth in wages and bonuses despite all-time high RP levels

According to the Financial Statements Statistics of Corporations by Industry released by the Ministry of Finance, employee salaries and bonuses have shown zero growth since 1997, while recurring profit (RP) levels have more than doubled and reached record highs over the same period (Figure 35).

Meanwhile, dividends have increased sharply. We expect dividends at the end of this fiscal year to be more than four times higher than in 1997. Domestic demand is unlikely to grow unless such corporate practices change.

Figure 35: Financial Statements Statistics of Corporations by Industry – Employee income, dividends, and recurring profits of Japanese corporations



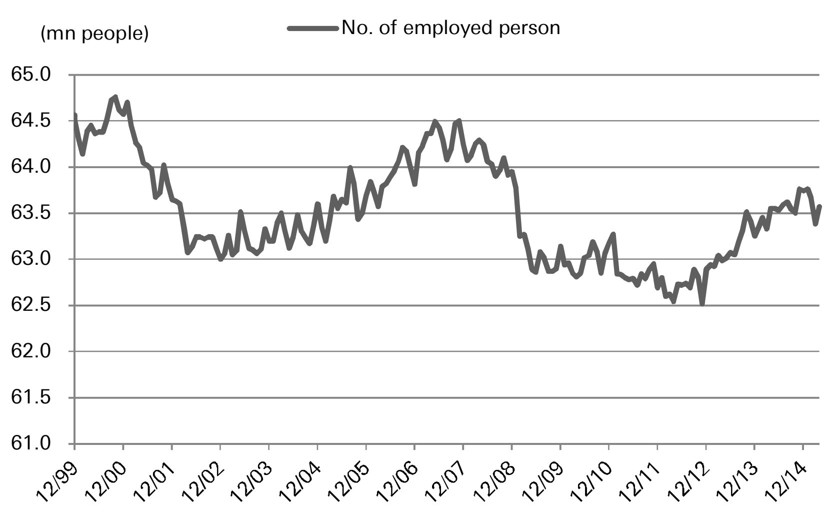
All industries excluding finance and insurance.
Source: Deutsche Securities based on 'Financial Statements Statistics of Corporations by Industry' by Ministry of Finance,

Employment figures down again

For employment to improve, qualitative improvement rather than quantitative expansion is key, but little headway has been made in this respect. Seasonally-adjusted employment data for May increased for the first time in the last three months (+190,000 persons MoM). However, it declined from the end of December 2014. October and November saw MoM declines of 80,000 and 40,000, respectively, while December saw an increase of 260,000. In January, there was a decline of 20,000, while February showed an increase of 20,000, followed by declines of 100,000 in March and 280,000 in April.

Seasonally-adjusted employment data for May increased for the first time in the last three months (+190,000 persons MoM), but it declined from the end of December 2014

Figure 36: Number of employed person (seasonally-adjusted)



Source: Ministry of Internal Affairs and Communications (Statistics Bureau), 'Labor Force Survey and Population Estimates'

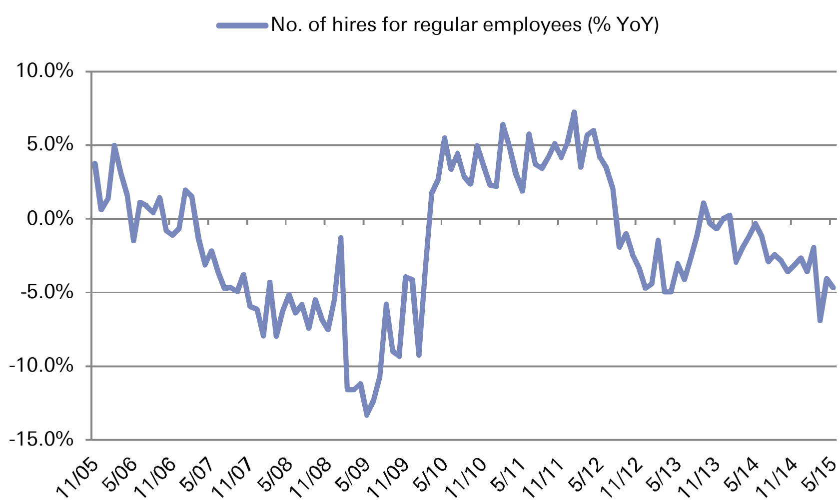
Even if the number of temporary workers rises, we doubt it will drive demand for houses, which are big-ticket purchases. Accordingly, we remain focused on trends in full-time employment.

The number of permanent hires continued to fall with a decrease of 4.7% YoY in May (Figure 37).

The job-offer-to-applicant ratio for full-time positions is 0.75, still below 1.0, reflecting a tough employment market (Figure 38). The problem is that the permanent hire ratio (number of permanent hires/number of job openings) remains low at 7.0% (Figure 39). In short, it is still difficult to become a regular employee.

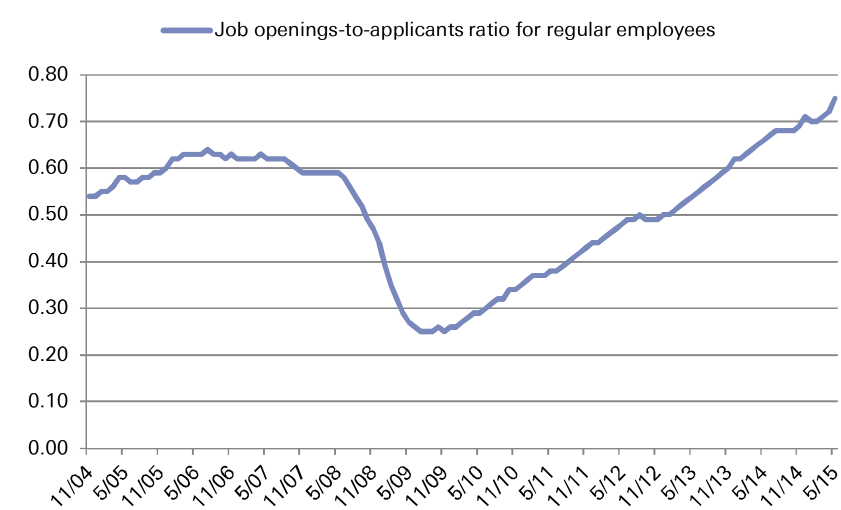
It is still difficult to become a regular employee

Figure 37: Number of hires (regular employees, % YoY)



Source: Ministry of Health, Labour and Welfare, 'Employment Referrals For General Workers'

Figure 38: Job openings-to-applicants ratio for regular employees



Source: Ministry of Health, Labour and Welfare, 'Employment Referrals For General Workers'

Figure 39: Rate of hiring for regular employees (number of people who found jobs to number of job openings)

Source: Deutsche Securities based on Ministry of Health, Labour and Welfare, 'Employment Referrals For General Workers'

Fundamental problem is decreasing young population

Companies are increasing temporary employment, which is relatively low cost. This is a problem, but it is not the only issue. The fundamental problem is the rapidly decreasing population of young people in Japan.

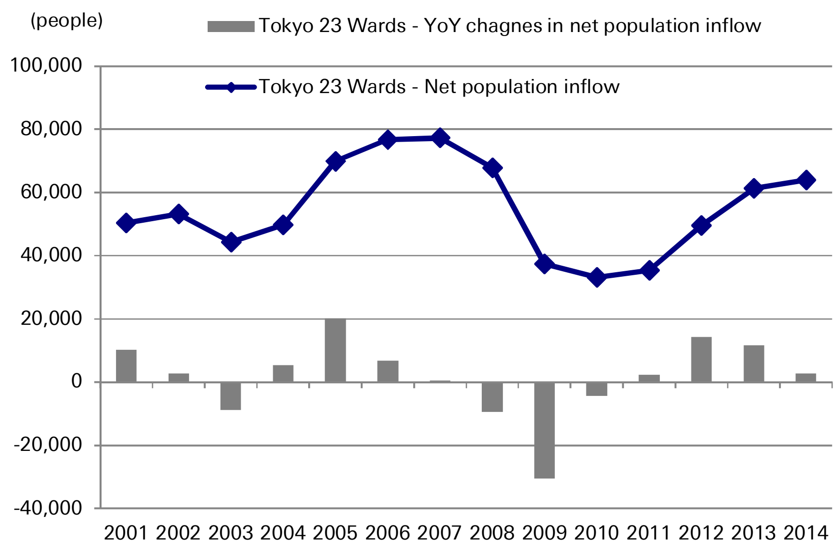
Substantial slowdown in net migration to Tokyo's 23 wards

Concerns are increasing even for Tokyo, which is regarded as the city with the fewest population problems in Japan. According to the Ministry of Internal Affairs and Communications' Report on Internal Migration in Japan, growth of net migration to Tokyo's 23 wards slowed substantially in 2014 (Figure 40).

Following increases of 14,220 in 2012 and 11,626 in 2013, growth in 2014 was 2,695, representing a marked slowdown in momentum. The numbers indicate that the concentration of population in Tokyo's 23 wards is not accelerating.

While the scale of the decline in migration growth in Osaka, Sapporo, Sendai, and Fukuoka in 2014 (growth in Nagoya was about flat) makes the numbers for Tokyo's 23 wards look comparatively firm, the momentum of the preceding two years has disappeared.

Figure 40: Net inflow of population in Tokyo's 23 wards



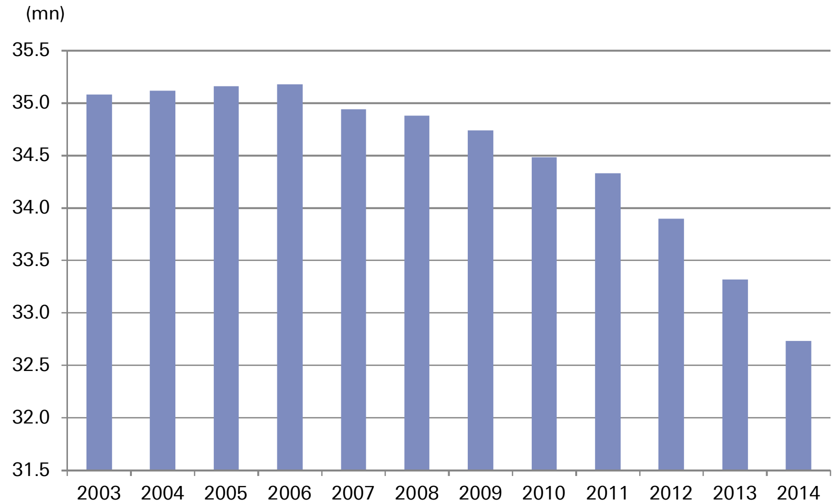
Source: Ministry of Internal Affairs and Communications, Deutsche Securities

The population of the most-productive 25-44 years-old bracket decreased by some 2.65m compared with 2006

On a nationwide basis, the population of the most-productive 25-44 years-old bracket in 2014 was down some 2.65m compared with 2006, and this decrease is accelerating. According to the Ministry of Internal Affairs and Communications, the declines were 150,000 in 2011, 430,000 in 2012, 580,000 in 2013, and 590,000 in 2014 (Figure 41).

Specifically, in demographic terms, we expect nationwide housing demand to remain weak, and we believe that demand for detached housing, in particular, will likely decline steeply. With regard to demand in the greater Tokyo area, however, we believe it will remain steady for the foreseeable future as there is a population inflow. But, we believe the demand will likely be driven mainly by rental accommodation rather than owner-occupied housing due to the growing number of low-income earners.

Figure 41: Population between ages of 25 and 44



Source: Ministry of Internal Affairs and Communications

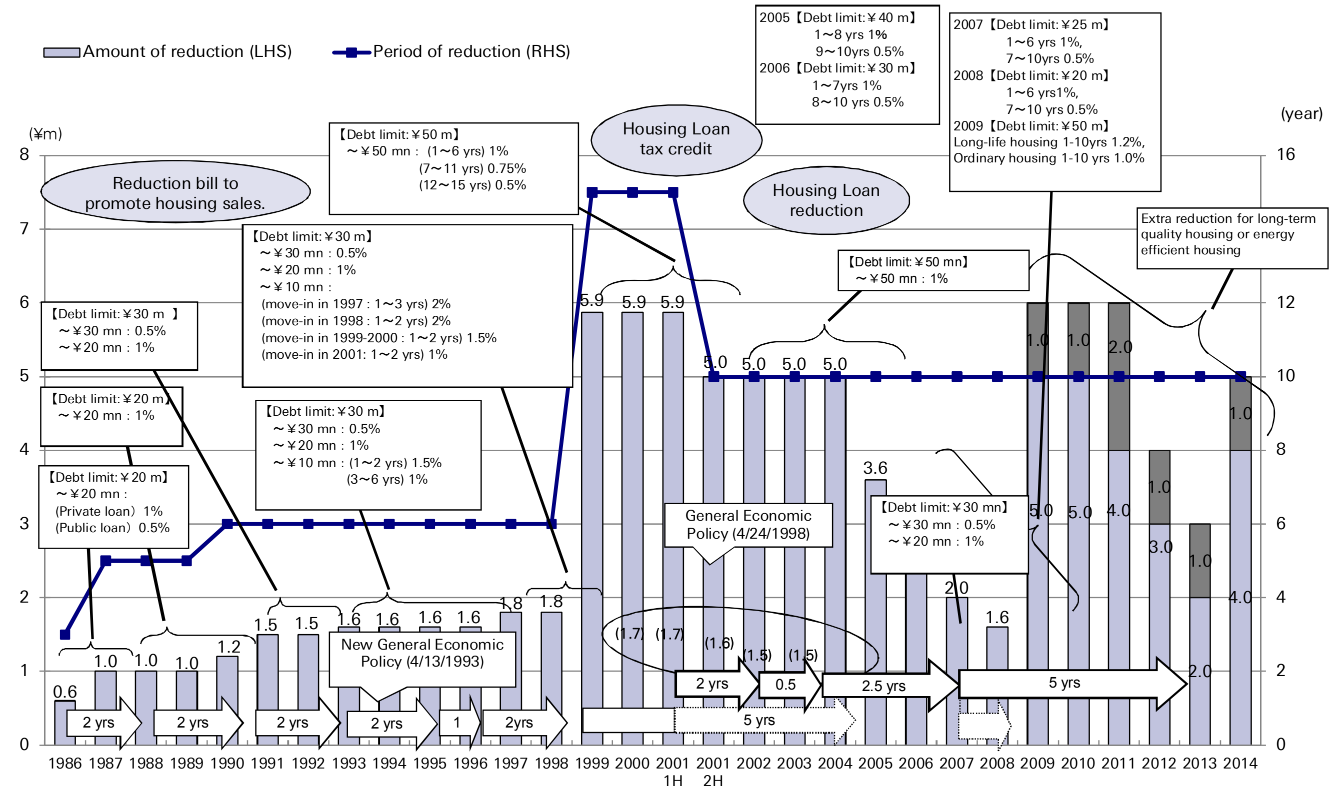
Government housing stimulus policy would be ineffectual

Measures such as increased mortgage tax deductions are ineffectual, as seen from past experience. From 1999 to 2001, when housing demand was stagnant, mortgage tax deductions totaled ¥5.875m; this increased to ¥6m from 2009 to 2011 (Figure 42).

Current system extended to June 2019

This is a good example, which suggests that in a cooling economy increasing mortgage tax deductions have no impact. The current mortgage tax deduction of ¥4m (¥2m in 2013) is, moreover, not large by historical comparison. The government has decided to extend the current system to June 2019.

Figure 42: History of mortgage tax breaks (current system extended to June 2019)

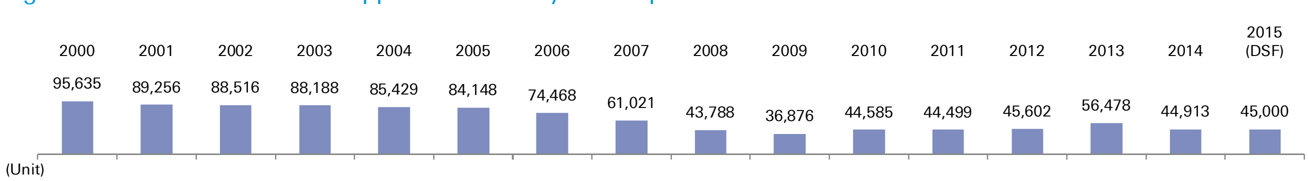


Source: Deutsche Securities based on Ministry of Land, Infrastructure, Transport and Tourism, and various media reports

2014 condo supply volume declines YoY

In 2013, condo supply sharply increased 23.8% YoY to 56,478 units in the Tokyo Metropolitan area. Supply has clearly improved from the 2009 bottom of 36,876 units. However, it decreased 20.5% YoY to 44,913 units in 2014. We believe this was due to the significant impact of the consumption tax hike. We expect supply to remain almost unchanged from the 2014 level at 45,000 units for 2015.

Figure 43: No. of condo units supplied in the Tokyo Metropolitan area



Note: Figure for 2015 is estimate by Deutsche Securities.
Source: Major 7 (based on f), Deutsche Securities forecast

Market share growing for major seven condo developers

Major seven account for around 40% market share

Although conditions in the condo market are difficult overall, condo sales by the real estate majors are brisk. The reason for the strong sales is that market share is increasing for the top seven condo companies (Nomura Real Estate Development, Mitsui Fudosan, Mitsubishi Estate, Tokyo Tatemomo, Tokyu

Land, Sumitomo R&D and Daikyo). The share of these companies was just 28% in 2004, but rose to 41.4% in 2013. We believe this trend is likely to continue, given their financial strength, favorable brand image, and high quality of condos supplied.

Figure 44: Major seven's shares of condo supply

CY	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Major Seven's supply (unit)	22,943	21,009	17,536	19,103	23,881	21,800	18,393	14,635	12,889	12,943	18,684	17,209	18,895	23,394
Tokyo Metropolitan Area condominium supply (unit)	95,635	89,256	88,516	83,183	85,429	84,148	74,463	61,021	43,733	36,376	44,535	44,499	45,602	56,478
Major Seven's share	**24.0%**	**23.5%**	**19.8%**	**23.0%**	**28.0%**	**25.9%**	**24.7%**	**24.0%**	**29.5%**	**35.6%**	**42.0%**	**38.7%**	**41.4%**	**41.4%**

Major 7 … Nomura Real Estate Development, Mitsui Fudosan, Mitsubishi Estate, Sumitomo R&D, Tokyo Tatemono, Tokyu Land, Daikyo
Source: Major Seven (based on Real Estate Economic Institute)

However, the increase in share of real estate majors means that they have acquired a significant level of land for such condo sales. We estimate the five major real estate companies we cover have a supply capacity of about 80,000 units. We believe condo sales at the real estate majors will gradually slow down if the condo market continues to worsen, and see a possible risk of future impairment losses.

Why are expensive city center condos selling?

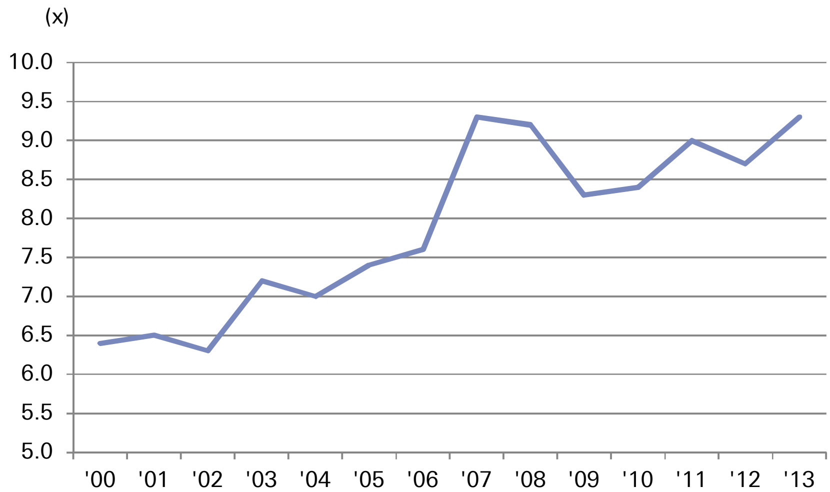
It has become difficult for general households to keep up with rising housing prices while employment and income are stagnating. The average price per m^2 in the Tokyo Metropolitan area exceeded ¥700,000 in some months.

Tokyo condos cost 9.3x annual household income

According to the Tokyo Land 2013 report released by Tokyo Metropolitan Government's Bureau of Urban Development, the ratio of the average condominium price (¥64.88m in 2013, standardized for 75 m^2) to annual household income in the Tokyo metropolitan area stood at 9.3x in 2013, at par with the post-2000 high recorded in 2007 (Figure 45).

Although the corresponding ratio for 2014 has yet to be announced, we suspect it rose further, to close to 10x. Ironically, this means that condominiums in Tokyo, which are still considered undervalued by overseas standards, have become quite expensive for domestic buyers.

Figure 45: Condominium affordability



Source: 'Tokyo Land report' by Tokyo Metropolitan Government's Bureau of Urban Development

Inheritance tax increase supports performance of expensive city center condos

However, expensive city center condos are selling well. The reason for the robust sales is neither low interest rates nor expanded mortgage tax deductions. Instead, we believe increased tax is actually supporting sales of expensive city center condos. This tax increase means an increase in inheritance taxes.

Inheritance taxes have increased since 2015. There are many high-net-worth individuals who invested in expensive city center condos (particularly tower condos) as a tax-saving measure. The purchase of a city center tower mansion has the advantage of greatly reducing assessed valuation. Investment in rental apartments has also been increasing. We view this to be the result of inheritance tax countermeasures, as well.

Introduction of restrictions could adversely affect favorable expensive city center condo sales

If some sort of restriction is introduced on tax advantages for purchases of city center tower condos, we believe it could adversely affect the sales of expensive city center condos.

Office market outlook

The office market has already shown an adequate recovery

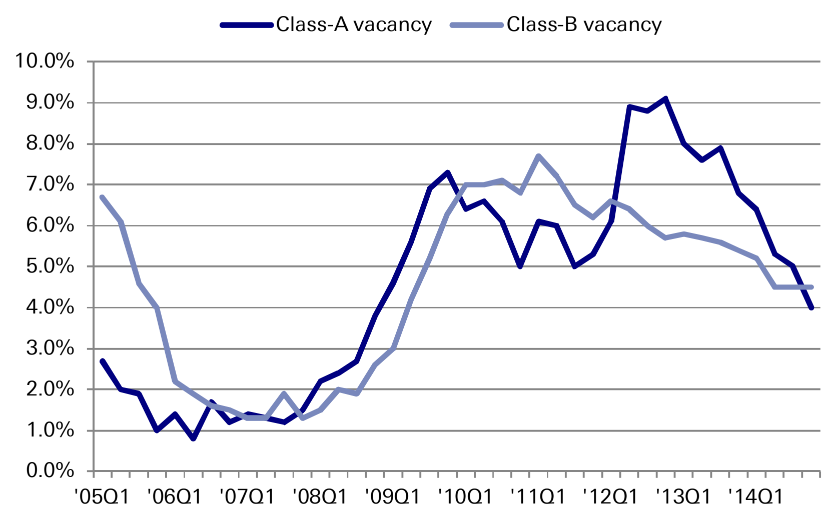
In our view, the office market has already shown an adequate recovery. Despite this, vacancy rates and rents have not reached pre-Lehman shock levels. We believe a return to those levels will be difficult. We explain the reasons below.

The NLI Research Institute also points out that the office rent cycle appears to have peaked, and is trending downward. (Source: NLI Research Institute, 12 February 2015 real estate investment report, "Tokyo city center Class-A building office market outlook (2015)". The NLI Research Institute compiles a joint office market index with Sanko Estate.)

Class-A building vacancy rate down from 9.1% in 4Q 2012 to 4.0% in 4Q 2014

In fact, Tokyo city center Class-A building market conditions have steadily improved, with the vacancy rate decreasing from 9.1% in 4Q (October-December) 2012 to 4.0% in 4Q 2014 (Figure 46). However, vacancy rates are still high compared with the sub-2% levels around 2007.

Figure 46: Vacancy rates for Tokyo city center Class-A and Class-B office buildings

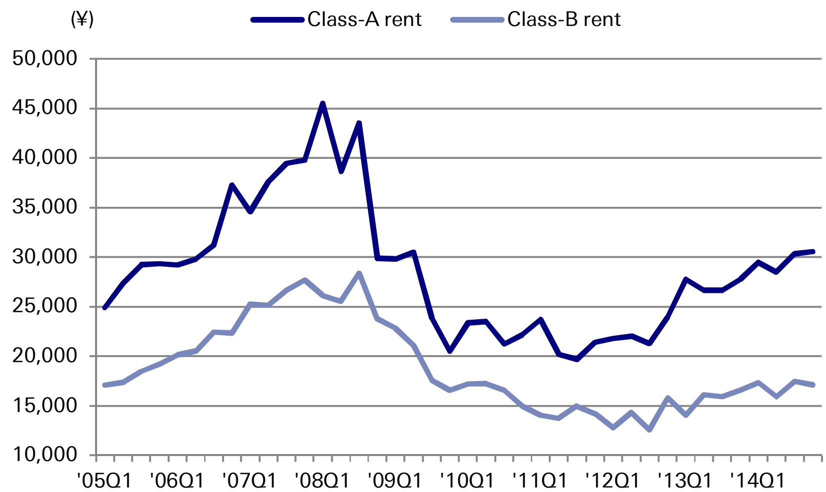


Source: Sanko Estate

Rent levels have also shown positive trends. Contract-basis rents (per tsubo per month) increased 55% from ¥19,706 in 3Q (July-September) 2011 to ¥30,573 in 4Q 2014 (Figure 47). However, current rent levels are around 60% of the latest peak.

Figure 47: Rent rates for Tokyo city center Class-A and Class-B office buildings

Class-A building rents up 55% from 3Q 2011



Source: Sanko Estate

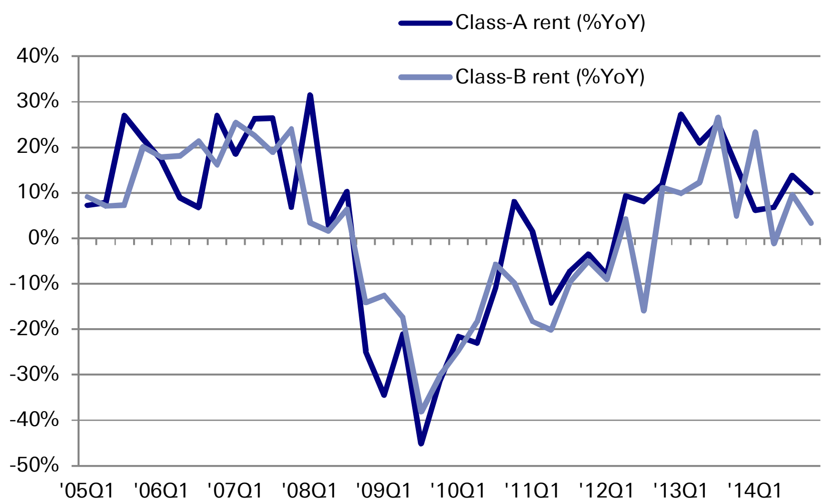
The vacancy rate for city center Class-B buildings has also decreased, down from 7.7% in 1Q (January-March) 2011 to 4.5% in 4Q 2014. Rents increased 36% from 3Q 2012 through 4Q 2014.

Recovery momentum peaking out

Cycle peaked in 1-3Q 2013

It cannot be said that the current office market has shown full-fledged improvement. Nevertheless, recovery momentum is already slowing. According to the research institute, rent growth rates suggest that the cycle has already entered a downtrend after peaking in 1-3Q 2013 (Figure 48).

Figure 48: Rental growth for Tokyo city center Class-A and Class-B office buildings (% YoY)

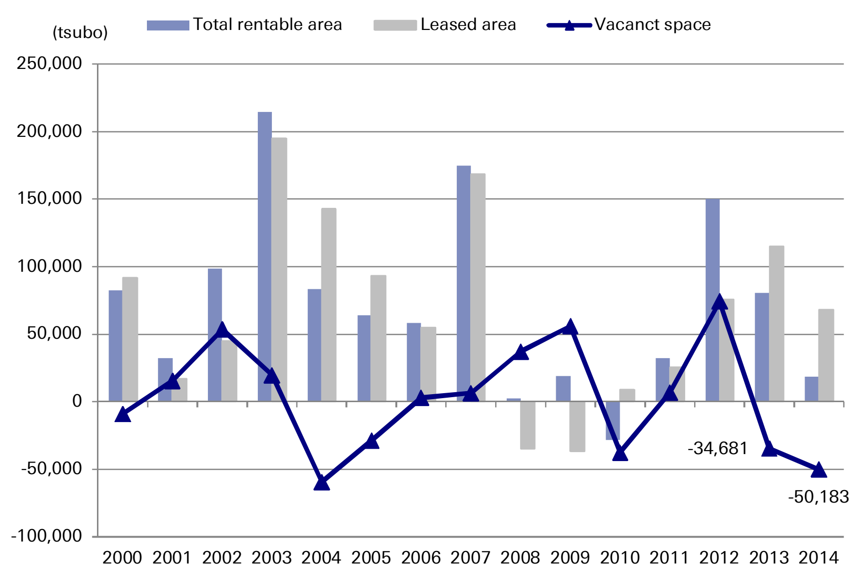


Source: Sanko Estate

Vacant floor area decreased greatly for two straight years in 2013 and 2014

Tokyo city center Class-A building vacant floor area decreased significantly for two straight years in 2013 and 2014, falling from more than 150,000 tsubo at end-4Q 2012 to 70,000 tsubo at end-4Q 2014. The reduction in vacant floor area was especially meaningful in 2014, as building supply declined while demand expanded (Figure 49) during the period.

Figure 49: Rentable area, leased space, vacant space for Tokyo city center Class-A buildings (YoY changes)



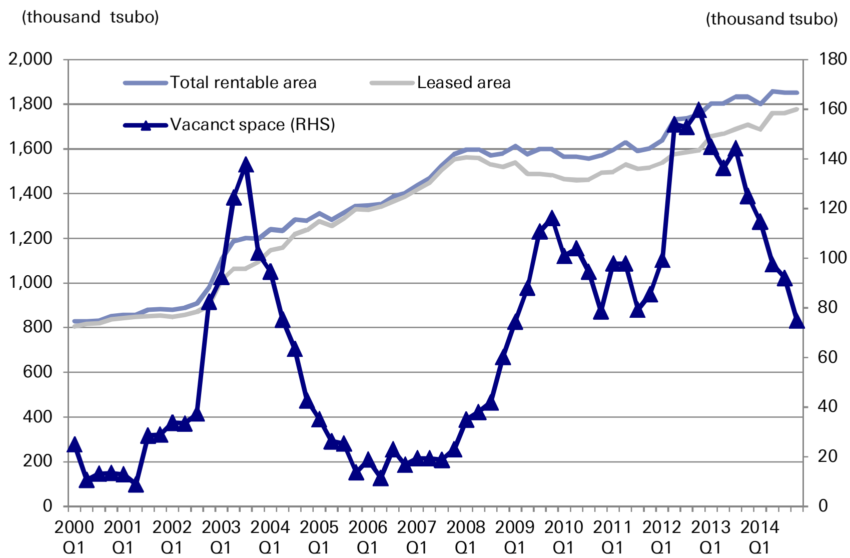
Source: Sanko Estate

There is still 70,000 tsubo of vacant floor space

According to the research institute's analysis, Class-A building rent growth has nevertheless remained sluggish because there is still 70,000 tsubo of vacant floor space, which is not low enough for rents to rise on tight supply/demand.

As shown in Figure 50, vacant floor area levels are drastically different from the prior mini-bubble periods (2005-2008). The vacant area around 2007 was less than 20,000 tsubo.

Figure 50: Rentable area, leased space, vacant space for Tokyo city center Class-A buildings (each quarter-end)



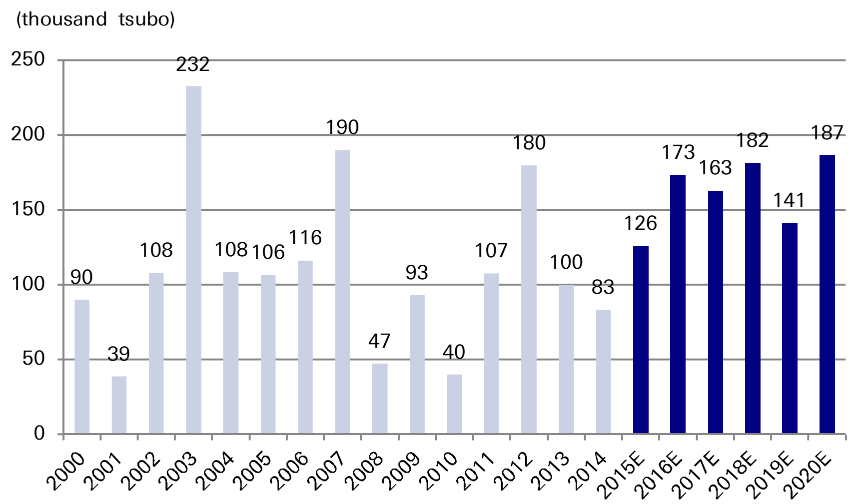
Source: Sanko Estate

High supply level similar to 2012 expected to continue

Despite the existing vacant space of 70,000 tsubo, office supply will continue to rise. Sanko Estate expects new office building supply volume to increase continuously over the next three years from 2016 to 2018, anticipating large space of 160,000-180,000 tsubo, at par with that in 2012 (Figure 51). Meanwhile, the number of office workers in the Tokyo city center area is expected to remain virtually flat (Figure 52).

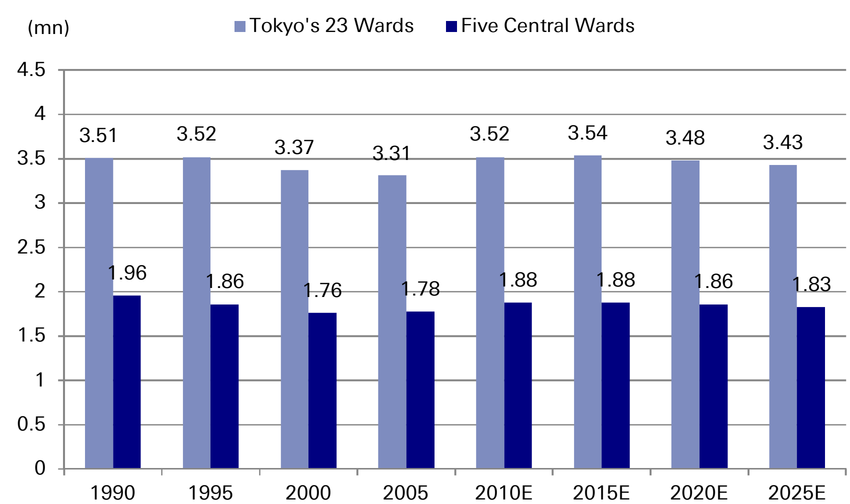
The number of office workers in the Tokyo city center area is expected to remain virtually flat

Figure 51: Supply of Class-A buildings, central area of Tokyo



Figures from 2015 are forecasted by Sanko Estate
Source: Sanko Estate

Figure 52: Number of office workers in Tokyo's 23 wards and five central wards



Figures from 2010 are forecasted by the Tokyo Government
Source: NLI Research Institute based on the Tokyo Government's data

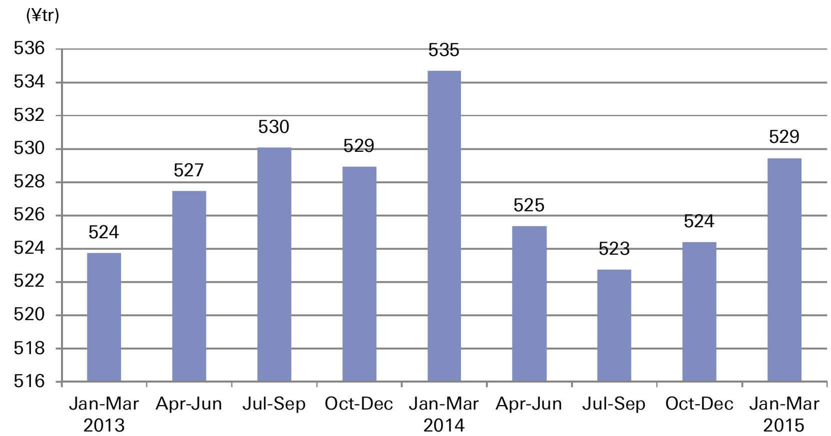
Economic growth virtually zero for past two years

Meanwhile, the real economy is still slowly recovering following the consumption tax hike of April 2014.

Real GDP was ¥524tr in January-March 2013 when Abenomics started, and ¥529tr in January-March 2015. In other words, growth in the last two years has been negligible.

Japan has recorded virtually no economic growth in the past two years

Figure 53: Real GDP trend (seasonally adjusted)



Source: Cabinet Office

Employment still not growing

Around 2007, vacancy rates for Tokyo city center class A buildings were below 2%, vacant area was less than 20,000 tsubo, and rent levels were more than 50% higher than current levels. The current recovery in the office market has spanned a similar period of time as around 2007, but the market has not improved fully.

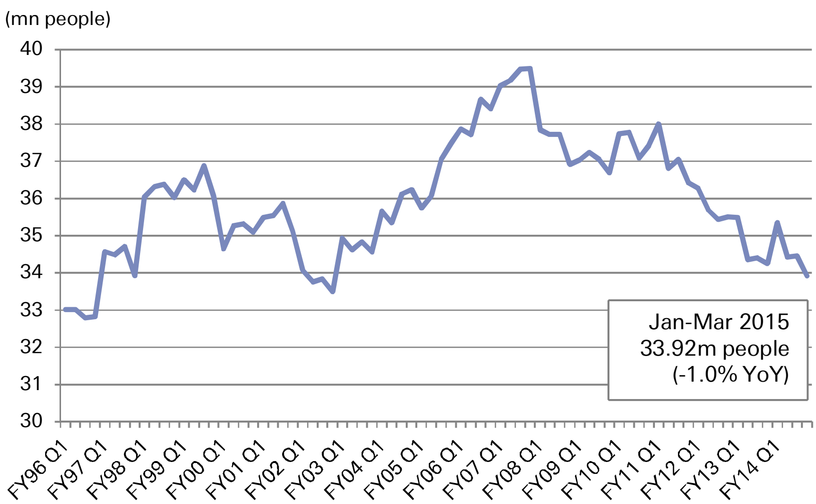
We believe increased employment led to the improvement in the office market from 2003 to 2007. According to the Financial Statements Statistics of Corporations by Industry (data for large companies capitalized at ¥10m or more), the number of employed persons rose from 33m to about 39m during this period (Figure 54).

However, employment has been declining since 2008. The latest data shows that employee headcount as of January-March 2015 was 33.92m (-1.0% YoY), which was still deteriorating.

Employment is now approximately 5m below the latest peak

Employment has declined from 39.51m at the end of the January-March quarter of 2008, and is now approximately 5m below that level. The current modest recovery in the office market is partly attributable to stalled employment, and if these are the conditions at large companies, conditions at SMEs are likely worsen.

Figure 54: Term end employee numbers (Financial Statements Statistics of Corporations by Industry)



Including executive officers, temporary staff. All industries excluding finance and insurance.
Source: Ministry of Finance, 'Financial Statements Statistics of Corporations by Industry'

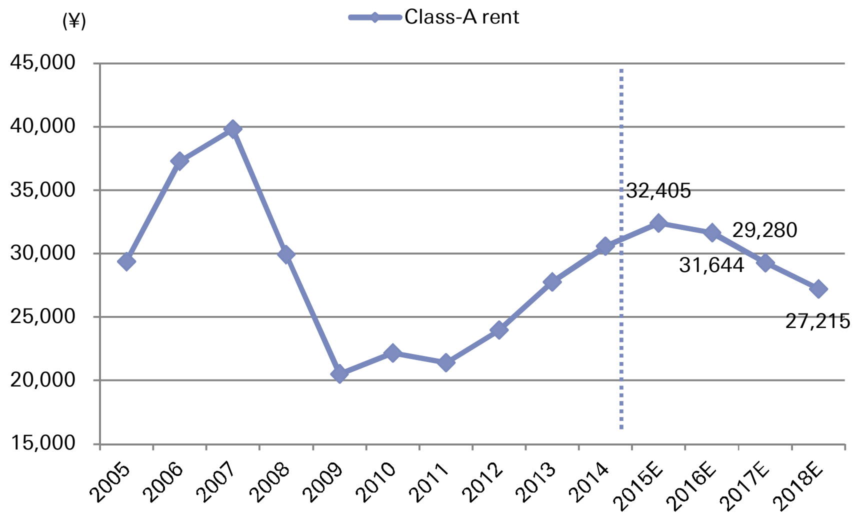
Rent decline likely to start from 2016

Class-A building rent outlook: 2015 +6% YoY, 2016 -2.3% YoY, 2017 -7.5% YoY

Vacant space is currently 70,000 tsubo, and with average annual supply likely to continue in excess of 160,000 tsubo until 2020, we see little hope of full-fledged rent rises if office population is not expected to increase. In short, the current office market has already peaked, in our view.

Based on the outlook for the Japanese economy, new office building supply plans and forecast office worker numbers, the research institute estimates that Tokyo city center Class-A building rents will rise 6% YoY in 2015, followed by declines of 2.3% in 2016, 7.5% in 2017, and 7.1% in 2018 (Figure 55).

Figure 55: Tokyo city center Class-A rent forecasts (baseline scenario)



Figures from 2015 are forecasted by NLI Research Institute
Source: Sanko Estate, NLI Research Institute

Figure 56: Large scale office buildings completed in 2012 – 2014

Project name (Building name)	Major developers	# of floors	Total floor area		Location
			(m2)	(Tsubo)	
YR2012					
Tokyo Sky Tower Tree East Tower	Tobu Railway	31	229,237	69,466	Oshiage, Sumida-ku
Marunouchi Eiraku Bldg.	Mitsubishi Estate, Mitsubishi UFJ Trust and Banking, Sumitomo Mitsui Trust Bank	27	139,800	42,364	Marunouchi, Chiyoda-ku
Harumi Front	Mitsubishi Estate, Kajima	17	47,700	14,455	Harumi, Chuo-ku
Shinjuku Eastside Square	Mitsubishi Estate, Nittochi Group, Daiwa House Industry, Heiwa Real Estate	20	170,274	51,598	Shinjuku, Shinjuku-ku
Palace Hotel	Palace Hotel	23	140,000	42,424	Marunouchi, Chiyoda-ku
DiverCity Tokyo Office Tower	Mitsui Fudosan, Daiwa House Industry, Sankei Building	21	64,880	19,661	Aomi, Koto-ku
Mitsui Sumitomo Insurance Kanda-Surugadai New Tower	Mitsui Sumitomo Insurance	22	65,475	19,841	Kanda-Surugadai, Chiyoda-ku
Shibuya Hikarie	Tokyu Corporation, etc	34	144,546	43,802	Shibuya, Shibuya-ku
Nakano Central Park East	Tokyo Tatemono	10	39,025	11,826	Nakano, Nakano-ku
Nakano Central Park South		21	151,577	45,932	
JP Tower	Japan Post Holdings	38	212,000	64,242	Marunouchi, Chiyoda-ku
Mita Berge Building	Berge	33	55,811	16,912	Shiba, Minato-ku
Akasaka K-Tower	Kajima	30	53,777	16,296	Moto-Akasaka, Minato-ku
JR South Shinjuku Building	East Japan Railway	18	58,023	17,583	Yoyogi, Shibuya-ku
Sumitomo Fudosan Shibuya Garden Tower	Sumitomo R&D	24	59,375	17,992	Minami-Nampeidai, Shibuya-ku
Arkhills Sengokuyama Mori Tower	Mori Building	47	143,720	43,552	Roppongi, Minato-ku
Otemachi Financial City North Tower	NTT Urban Development, Mitsubishi Estate, Tokyo Tatemono, Sankei Building	31	242,500	73,485	Otemachi, Chiyoda-ku
Otemachi Financial City South Tower	Mitsubishi Estate	35			
Shimizu New HQ Building	Shimizu	22	51,365	15,565	Kyobashi, Chuo-ku
Subtotal			**2,069,085**	**626,995**	
YR2013					
Shin-Akasaka Center Building	Kanden Fudosan	20	39,761	12,049	Moto-Akasaka, Minato-ku
Waterras Tower	Yasuda Real Estate, Tokyu Land, Tokyo Tatemono	41	129,222	39,158	Kanda-Awajicho, Chiyoda-ku
Kabukiza Tower	Shochiku, Kabukiza	29	94,097	28,514	Ginza, Chuo-ku
Ochanomizu Sola City	Taisei, Hulic, Yasuda Real Estate, Yuraku Tochi	23	102,232	30,979	Kanda-Surugadai, Chiyoda-ku
Tokyo Square Garden	Tokyo Tatemono, Dai-ichi Life Insurance, Katakura Industries	24	117,461	35,594	Kyobashi, Chuo-ku
Otemachi Tower	Tokyo Tatemono, Taisei	38	198,467	60,142	Otemachi, Chiyoda-ku
Arkhills South Tower	Mori Building	20	55,033	16,677	Roppongi, Minato-ku
Subtotal			**736,273**	**223,113**	
YR2014					
Muromachi Furukawa Mitsui Building	Mitsui Fudosan, Furukawa, Ninben	22	62,470	18,930	Nihonbashi-Muromachi,
Kyobashi Trust Tower	Mori Trust	21	52,471	15,900	Kyobashi, Chuo-ku
Nishi-Shinbashi Square (ex Nippon Oil Corp Building Reconstruction)	Mitsubishi Estate	22	55,373	16,780	Nishi-Shinbashi, Minato-ku
Toranomon Hills	Tokyo Metropolitan Government (Mori Building)	52	244,360	74,048	Toranomon, Minato-ku
Nissay Otemachi Building	Nippon Life Insurance	23	56,120	17,006	Marunouchi, Chiyoda-ku
Iidabashi Grand Bloom (The site of Tokyo Metropolitan Police Hospital)	Mitsui Fudosan	30	123,353	37,380	Fujimi, Chiyoda-ku
Toyosu Foresia	IHI, Mitsubishi Estate	16	101,376	30,720	Toyosu, Koto-ku
Subtotal			**695,523**	**210,765**	
Total (2012 - 2014)			**3,500,881**	**1,060,873**	

Source: Deutsche Securities based on each company release, various media reports

Figure 57: Large scale office buildings to be completed in 2015 – 2017

Project name (Building name)	Major developers	# of floors	Total floor area (m2)	Total floor area (Tsubo)	Location
YR2015					
Shinagawa Season Terrace (Shibaura sewage treatment equipment Building Reconstruction)	NTT Urban Development, Taisei, Hulic	32	206,025	62,432	Konan, Minato-ku
Tokyo Nihonbashi Tower (Nihonbashi 2-chome North Area E Block)	Sumitomo R&D	35	138,600	42,000	Nihonbshi, Chuo-ku
SMBC HQ building Redevelopment	SMBC	29	89,116	27,005	Marunouchi, Chiyoda-ku
Otemon Tower・JX Buildig (ex Resona-maruha Building)	Mitsubishi Estate, JX Holdings	22	108,000	32,727	Otemachi, Chiyoda-ku
Jimbocho Terrace Square	Hakuhodo, Sumitomo Corp, Mitsui Sumitomo Insurance, Yasuda Real Estate, etc	17	52,850	16,015	Kanda Nishiki-cho, Chiyoda-ku
Kita-Shinagawa 5-chome 1st Area Redevelopment	Nittochi, Mitsui Fudosan, Taisei, Daiwa House, Nippon Steel Kowa Real Estate				Kita-Shinagawa, Shinagawa-ku
Osaki Bright Tower		31	91,957	27,866	
Osaki Brihgt Core		20	44,769	13,566	
Futako-Tamagawa Rise ・Tower Office	Tokyu Land, Tokyu Corp	30	86,900	26,333	Tamagawa, Setagaya-ku
Shin-Tekko Building (Tekko bldg. Reconstruction)	Tekko Building	26	117,000	35,455	Marunouchi, Chiyoda-ku
Higashi-Ueno 2-chome Project	Shimizu	30	40,627	12,311	Higashi-Ueno, Daito-ku
Subtotal			**975,844**	**295,710**	
YR2016					
Roppongi 3-chome Easet Area Redevelopment South Block Operation Tower (ex Japan IBM HQ Bldg.)	Sumitomo R&D	40	204,600	62,000	Roppongi, Minato-ku
Shinjuku Sky Forest Project (Okubo 3 -chome West Area Development)	Sumitomo R&D	38	138,600	42,000	Okubo, Shinjuku-ku
Otemachi Financial City Grand Cube (Otemachi B-2 Block Redevelopment A Tower)	Mitsubishi Estate	31	193,800	58,727	Otemachi, Chiyoda-ku
Shinjuku Station New South Exit Building	East Japan Railway	33	111,000	33,636	Sendagaya, Shibuya-ku
Tokyo Garden Terrace Office・Hotel Tower (ex Akasaka Price Hotel)	Seibu Holdings	36	147,000	44,545	Kioicho, Chiyoda-ku
Kyobashi Redevelopment Project (Meidi-ya Bldg. Reconstruction)	Nittochi, Tokyo Tatemono, Nikken Sekkei, Shimizu	32	113,534	34,404	Kyobashi, Chuo-ku
Ginza 6 -chome Project (Matsuzakaya Redevelopment)	L Real Estate, Sumitomo Corp, Mori Building, Kajima	13	147,900	44,818	Ginza, Chuo-ku
Subtotal			**1,056,434**	**320,132**	
YR2017					
Otemachi Park Building (ex BTMU Building Reconstruction)	Mitsubishi Estate	29	149,000	45,152	Otemachi, Chiyoda-ku
Shin Tokyo Takeda Building (Nihonbashi-Honcho 2-chome Area Development Project North Block)	Mitsui Fudosan, Takeda Chemical Fudosan	24	45,116	13,672	Nihonbashi-Honcho, Chuo-ku
Uchisaiwaicho 2-chome Project (ex Sinsei Bank HQ Bldg. Reconstruction)	Kenedix, Tokyu Land, DBJ	20	67,000	20,303	Uchisaiwaicho, Chiyoda-ku
Akasaka 1-chome redevelopment	Nippon Steel Kowa Real Estate	37	175,297	53,120	Akasaka, Minato-ku
Meguro Station Front Area Redevelopment A Zone Office Tower	Tokyo Tatemono, Dai-ichi Life Insurance, Taisei, Takenaka Corp	33	61,200	18,545	Kamiosaki, Shinagawa-ku
Hamamatsucho West Exit Area Redevelopment (WTC Bldg. Reconstruction)					Hamamatsucho, Minato-ku
A Block A-3 Tower	WTC Bldg., Tokyo Monorail	42	TBD (270,000㎡including A-1 tower which will be completed in 2024)		
B Block B Tower	East Japan Railway, Kokusai Kogyo	26	99,000	30,000	
Matsuzakaya Ueno Shop South Bldg. Reconstruction Project	Daimaru Matsuzakaya Department Stores	23	41,000	12,424	Ueno, Daito-ku
Shibakoen 1-chome Building Project (Panasonic Bldg. Reconstruction)	Sumitomo R&D	22	33,000	10,000	Shibakoen, Minato-ku
Mita 1-chome Project (the site of JT Hospital)	Sumitomo R&D	10	45,870	13,900	Mita, Minato-ku
Subtotal (excluding undecided item)			**716,483**	**217,116**	
Total (2015 - 2017)			**2,748,761**	**832,958**	
Average (2015 - 2017)			***916,254***	***277,653***	

Source: Deutsche Securities based on each company release, various media reports

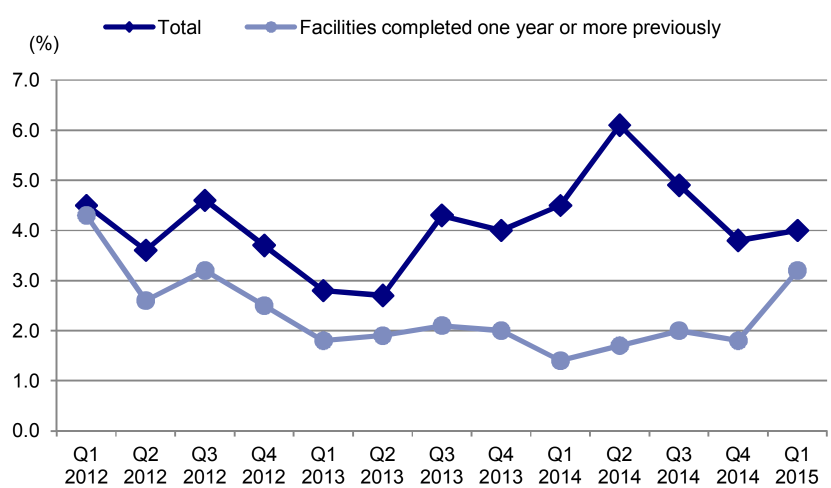
Logistics property market outlook

1Q: Tokyo Metropolitan area large-scale multi-tenant vacancy rate at 4.0%

Vacancy rate for large facilities completed one year or more previously rose by 1.4ppt to 3.2%

According to a report by CBRE on market trends for Japan's logistics facilities ("Japan Industrial & Logistics Market View Q1 2015"), the 1Q (January-March) vacancy rate for large-scale multi-tenant logistics facilities (total floor area 10,000 tsubo or more, or about 33,000m^2) in the Tokyo Metropolitan area rose by 0.2ppt to 4.0%, and the vacancy rate for large facilities completed one year or more previously rose by 1.4ppt to 3.2% (Figure 58).

Figure 58: Vacancy rate for large-scale multi-tenant logistics facilities in the Tokyo Metropolitan area



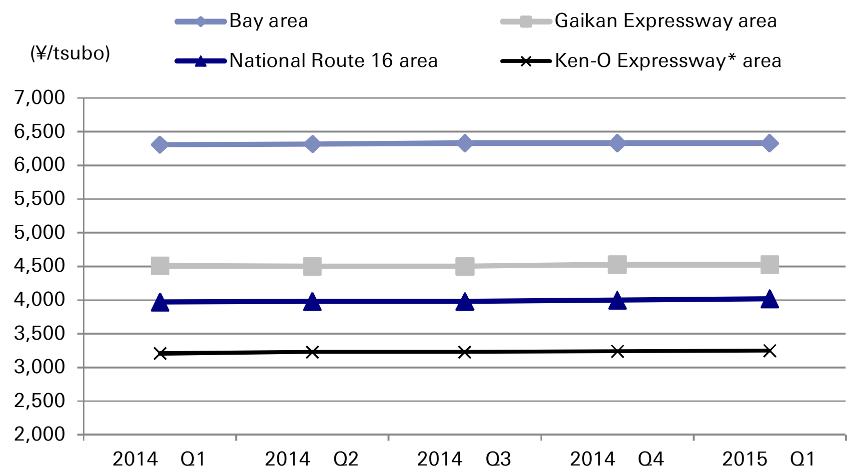
Source: Deutsche Securities based on CBRE's data

Three large-scale facilities (total floor area of around 69,000 tsubo) were completed in 1Q. While two of these were full at completion, one (Logiport Hashimoto, around 50,000 tsubo) had vacancies on completion, increasing the vacancy rate. Apparently, however, tenants for some 70% of Logiport Hashimoto have already been informally decided.

Rents virtually flat in main Tokyo Metropolitan areas

In its latest report, CBRE divided the Tokyo Metropolitan region into four areas – Tokyo Bay area, Gaikan Expressway area, National Route 16 area, and Metropolitan Inter-City Expressway area ("Ken-O Expressway'") – and disclosed indexed real rents for each area. According to the report, rents for each of the areas are broadly flat (Figure 59).

Figure 59: Rent index for large-scale multi-tenant logistics facilities in the Tokyo Metropolitan area (monthly rent rate, per tsubo)



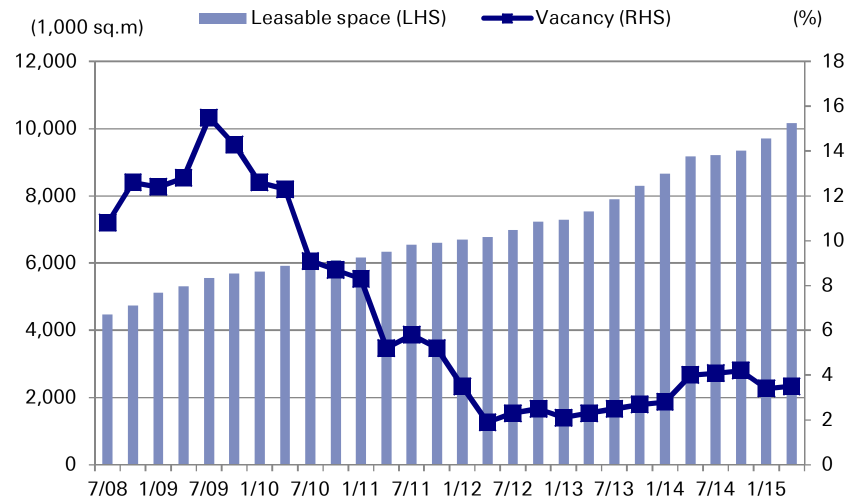
**Metropolitan Inter-City Expressway*
Source: Deutsche Securities based on CBRE's data

No major changes seen in medium-scale and BTS-type facilities

Indices targeting wider logistics facilities—not only large-scale multi-tenant facilities but also medium-scale and build-to-suit (BTS) ones—have shown no significant changes recently.

According to Ichigo Real Estate Service, an independent real estate research company specializing in logistics facilities and other industrial-use real estate, the vacancy rate for logistics facilities (total floor area 10,000m^2 or more) in the Tokyo area in April was 3.5%, almost unchanged from 3.4% in January (Figure 60).

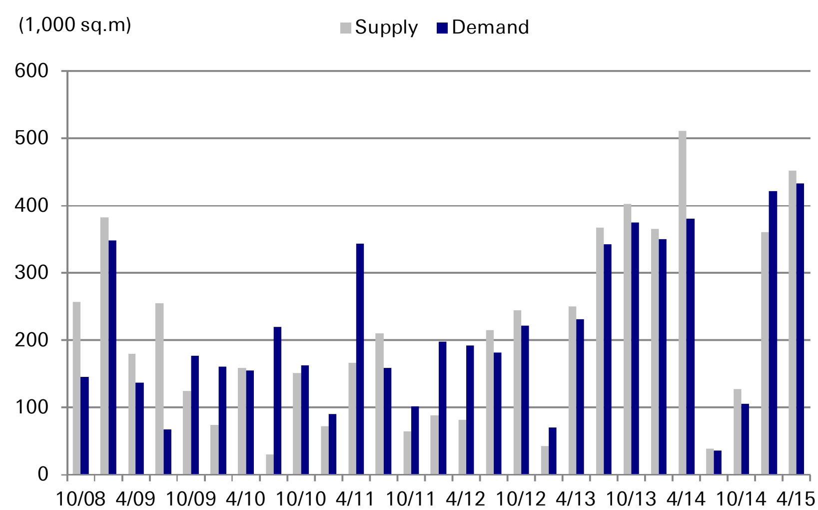
Figure 60: Leasable space and vacancy rate of logistics facilities in the Tokyo Metropolitan area



Note: The survey targets logistics facilities in the Tokyo area (Saitama, Chiba, Kanagawa, Ibaraki prefectures, and Tokyo) with total floor space or site area over 10,000 sqm.
Source: Ichigo Real Estate Service

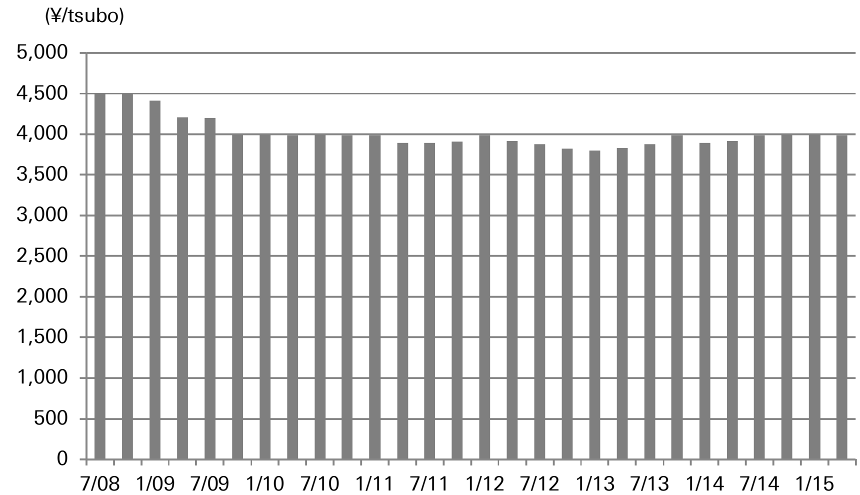
New supply during February-April 2015 was 452,000m^2, the second largest supply in this survey, but new demand was the largest at 433,000m^2 (Figure 61). Monthly rent has been stable at around ¥4,000/tsubo (Figure 62).

Figure 61: Supply/demand conditions of logistics facilities in the Tokyo Metropolitan area



Note: The survey targets logistics facilities in the Tokyo area (Saitama, Chiba, Kanagawa, Ibaraki prefectures, and Tokyo) with total floor space or site area over 10,000 sqm.
Source: Ichigo Real Estate Service

Figure 62: Monthly rent rate (asking) of logistics facilities in the Tokyo Metropolitan area



Note: The survey targets logistics facilities in the Tokyo area (Saitama, Chiba, Kanagawa, Ibaraki prefectures, and Tokyo) which have over 1,000 sqm of vacant space for leasing.
Tsubo = about 3.3 sqm.
Source: Ichigo Real Estate Service

Vacancy rates in Tokyo Metropolitan area may sharply rise in 2016

High level of new supply continues in 2015 and 2016

There are plans to add about 400,000 tsubo of large logistics facilities in 2015, with some half of this concentrated in 4Q (October-December), expected to be a historical high for quarterly supply. However, according to CBRE, there are still many logistics companies and clients considering properties prior to completion, and apparently informal decisions on tenancy had already started to be made in 1Q for a number of facilities.

As the current demand looks firm, we see little concern regarding a sharp rise in vacancy rates within FY2015. However, we expect a high level of supply to continue in 2016 (Figure 63), so the supply/demand balance from 2016 forward is unclear.

Over the longer term, the Tokyo Ryutsu Center is scheduled to open a large (51,000 tsubo) logistics facility in Ota Ward in 2017, and the Japan Freight Railway Company is planning to start operating two large logistics facilities (total of 67,000 tsubo) in Shinagawa Ward between 2018 and 2020. We believe these facilities will hold a significant advantage in terms of access to central Tokyo. We will watch to see whether tenants move from inland facilities when demand is weak, and will keep an eye on the level of rent rates.

Figure 63: Major development plans for logistics facilities in the Tokyo Metropolitan area

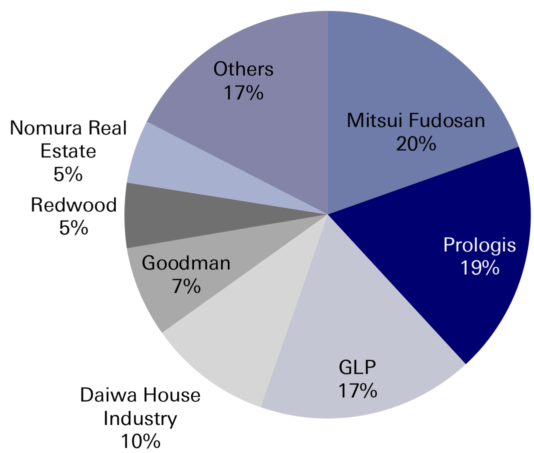
Construction completed (plan)		Facility name	Developer/owner	Area	Location		Space (sqm)	Space (Tsubo)
	Jan	GLP・MFLP Ichikawa Shiohama	GLP, Mitsui Fudosan	Bay	Ichikawa	Chiba	121,964	36,959
	Feb	MFLP Yashio	Mitsui Fudosan	Inland	Yashio	Saitama	41,607	12,608
	Feb	DLP Yokohama Daikoku	Daiwa House Industry	Bay	Yokohama	Kanagawa	149,339	45,254
	Mar	Prologis Park Kawajima 2	Prologis	Inland	Hiki	Saitama	45,602	13,819
	Mar	Yashio Logistics Center	Oji Paper	Inland	Yashio	Saitama	83,557	25,320
	Apr	Prologis Park Kitamoto	Prologis	Inland	Kitamoto	Saitama	74,460	22,564
	Jul	MFLP Kuki	Mitsui Fudosan	Inland	Kuki	Saitama	74,521	22,582
	Nov	Prologis Park Joso	Prologis	Inland	Joso	Ibaraki	38,633	11,707
	Dec	Yachiyo Logistics Center	Japan Logistics Fund, Inc.	Inland	Yachiyo	Chiba	58,177	17,629
	Dec	Goodman Mizue	Goodman Japan	Bay	Kawasaki	Kanagawa	59,261	17,958
2014							747,121	226,400
	Jan	Prologis Park Narita 1-D	Prologis	Inland	Narita	Chiba	23,871	7,234
	Jan	Logiport Hashimoto	LaSalle Investment, Mitsubishi Estate	Inland	Sagamihara	Kanagawa	156,589	47,451
	Jan	Landport Atsugi II	Nomura Real Estate Development Nomura Real Estate Asset Management	Inland	Atsugi	Kanagawa	38,660	11,715
	Mar	MFLP Funabashi Nishiura	Mitsui Fudosan	Bay	Funabashi	Chiba	31,000	9,394
	TBD	MFLP Atsugi	Mitsui Fudosan	Inland	Aikou	Kanagawa	43,000	13,030
	Apr	Goodman Ichikawa	Goodman Japan	Bay	Ichikawa	Chiba	75,579	22,903
	Apr	GLP Ayase	GLP	Inland	Ayase	Kanagawa	68,642	20,801
	Jul	GLP Zama	GLP	Inland	Zama	Kanagawa	131,913	39,974
	Aug	Shin-kiba Distribution Center	IK Investment 3	Bay	Koto	Tokyo	46,370	14,052
	Aug	GLP Yoshimi	GLP	Inland	Hiki	Saitama	61,000	18,485
	Oct	GLP Yachiyo	GLP	Inland	Yachiyo	Chiba	71,610	21,700
	Oct	MFLP Hino	Mitsui Fudosan	Inland	Hino	Tokyo	212,760	64,473
	Oct	Redwood Namamugi	Redwood Group	Bay	Yokohama	Kanagawa	62,120	18,824
	Nov	Redwood Sakura	Redwood Group	Inland	Sakura	Chiba	83,039	25,163
	Dec	GLP Sayama Hidaka I	GLP	Inland	Hidaka	Saitama	41,818	12,672
	Jan	Prologis Park Yoshimi	Prologis	Inland	Hiki	Saitama	105,000	31,818
	Dec	Honmoku Logistics Center Project	Mitsubishi Corporation Urban Development	Bay	Yokohama	Kanagawa	70,639	21,406
2015							1,323,610	401,094
	Jan	Redwood Kawagoe (Tower B)	Redwood Group	Inland	Kawagoe	Saitama	38,353	11,622
	Jan	D Project Ariake I	Daiwa House Industry	Bay	Koto	Tokyo	112,402	34,061
	Feb	Landport Kashiwanuma-minami I	Nomura Real Estate Development	Inland	Kashiwa	Chiba	49,523	15,007
	Feb	Noda Distribution Center	Itochu Corporation, Mapletree Group	Inland	Noda	Chiba	74,228	22,493
	Mar	Prologis Park Narashino 5	Prologis	Inland	Narashino	Chiba	64,600	19,576
	Mar	Goddman Business Park Chiba East	Goodman Japan	Inland	Inzai	Chiba	120,000	36,364
	Apr	Moriya Logistics Center	Orix Real Estate	Inland	Joso	Ibaraki	47,818	14,490
	Apr	Landport Kashiwanuma-minami II	Nomura Real Estate Development	Inland	Kashiwa	Chiba	54,113	16,398
	Spring	DLP Ichikawa	Daiwa House Industry	Bay	Ichikawa	Chiba	87,302	26,455
	Jun	LogiSquare Kuki	CRE	Inland	Kuki	Saitama	43,800	13,273
	Jun	Prologis Park Chiba New Town	Prologis	Inland	Inzai	Chiba	127,523	38,643
	Jun	GLP Atsugi II	GLP	Inland	Atsugi	Kanagawa	89,104	27,001
	Aug	Narashino Akanehama III	Sumitomo Corporation	Bay	Narashino	Chiba	38,419	11,642
	Sep	GLP Sayama Hidaka II	GLP	Inland	Hidaka	Saitama	85,539	25,921
	Sep	MFLP Funabashi	Mitsui Fudosan	Bay	Funabashi	Chiba	198,200	60,061
	Sep	Landport Hachioji II	Nomura Real Estate Development	Inland	Hachioji	Tokyo	36,322	11,007
	Oct	Prologis Park Ichikawa 3	Prologis	Bay	Ichikawa	Chiba	60,000	18,182
	Nov	MFLP Hiratsuka I	Mitsui Fudosan	Inland	Hiratsuka	Kanagawa	33,221	10,067
	TBD	Prologis Park Koga 1	Prologis	Inland	Koga	Ibaraki	62,068	18,808
	TBD	Prologis Park Koga 2	Prologis	Inland	Koga	Ibaraki	55,470	16,809
2016							1,478,005	447,880
Total (2014-2016)							3,548,736	1,075,375
From 2017								
2017	Summer	Distribution Building B	Tokyo Ryutsu Center	Bay	Ota	Tokyo	170,000	51,515
2018	Jan	F-Plaza Tower M	Japan Freight Railway Company	Bay	Shinagawa	Tokyo	61,000	18,485
2020	Jun	F-Plaza Tower N	Japan Freight Railway Company	Bay	Shinagawa	Tokyo	162,000	49,091

Above data include BTS facilities.
Source: Deutsche Securities based on data by each company release and CBRE

Mitsui Fudosan, Prologis, and GLP compete in new development

Figure 64 shows the total floor space by developer of major developments in the Tokyo Metropolitan area from 2014 to 2016. Three companies are competing: Mitsui Fudosan (around 210,000 tsubo; 700,000m^2), Prologis Group (around 200,000 tsubo; 660,000m^2), and GLP Group (around 190,000 tsubo; 610,000m^2).

Figure 64: Major development plans for logistics facilities in the Tokyo Metropolitan area, 2014-2016, floor space share by developer



Source: Deutsche Securities based on data by each company release and CBRE

Steady progress recorded for the ¥200bn investment

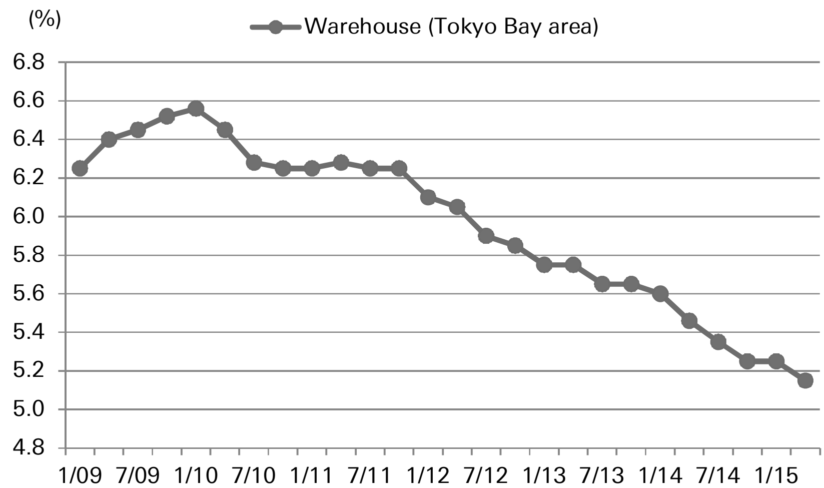
Mitsui Fudosan has announced that it intends to accelerate the development of cutting-edge logistics facilities as one of its longer-term management plans (Innovation 2017). This includes investment of about ¥200bn by FY2017 and development of four to five logistics facilities per year. According to Mitsui Fudosan, the ¥200bn investment has progressed smoothly so far.

5.15% expected NOI yield on Tokyo Metropolitan bay area logistics facilities

According to CBRE's real estate investor survey (April 2015 survey), the expected NOI yield on multi-tenant logistics facilities in the Tokyo Metropolitan bay area has further decreased to 5.15% from the July 2014 survey's 5.35% and the October 2014 and January 2015 surveys' 5.25% (Figure 65).

A survey by the Japan Real Estate Institute (April 2015 survey) also shows expected yields on multi-tenant logistics facilities in the Tokyo Metropolitan area of 5.0% for the bay area and 5.3% for the inland area.

Figure 65: Expected cap rates for logistics facilities

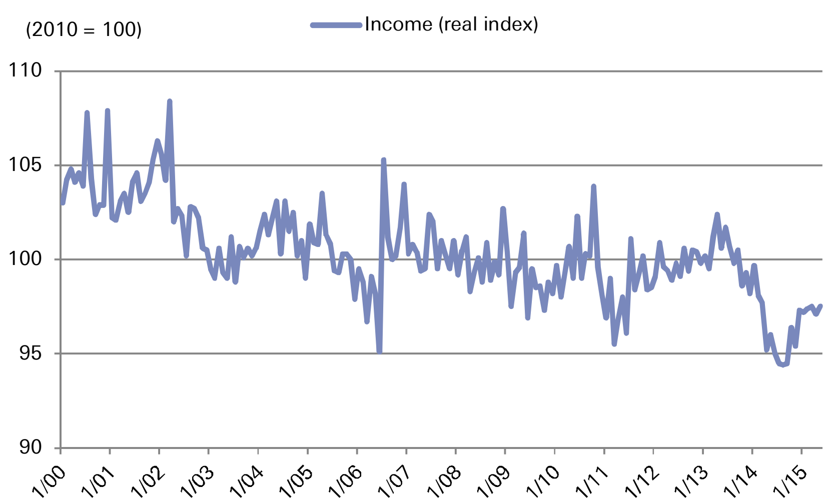


Source: CBRE

Family Income and Expenditure Survey: incomes, expenditures remain soft

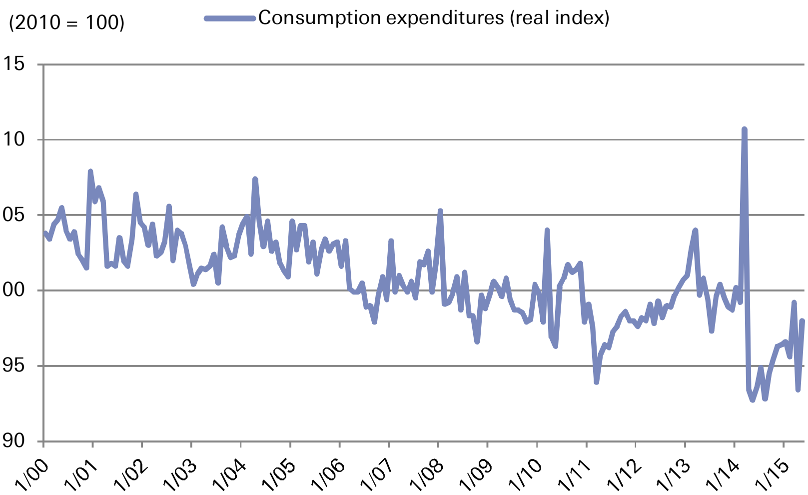
The Family Income and Expenditure Survey shows that real incomes for worker households (seasonally adjusted, real base) stood at 97.5 in May (+0.4% MoM), almost unchanged during the last six months (Figure 66). Expenditures (seasonally adjusted, real base) rose 4.9% MoM in May, but this is a rebound from the large dip of 5.8% in April (Figure 67). As real GDP data indicate, the weakness in consumption is significant, which is in line with the past experience that the adverse impact of a consumption tax hike is prolonged.

Figure 66: Worker households' income (seasonally adjusted, real base)



Source: Ministry of Internal Affairs and Communications (Statistics Bureau), 'Family Income and Expenditure Survey'

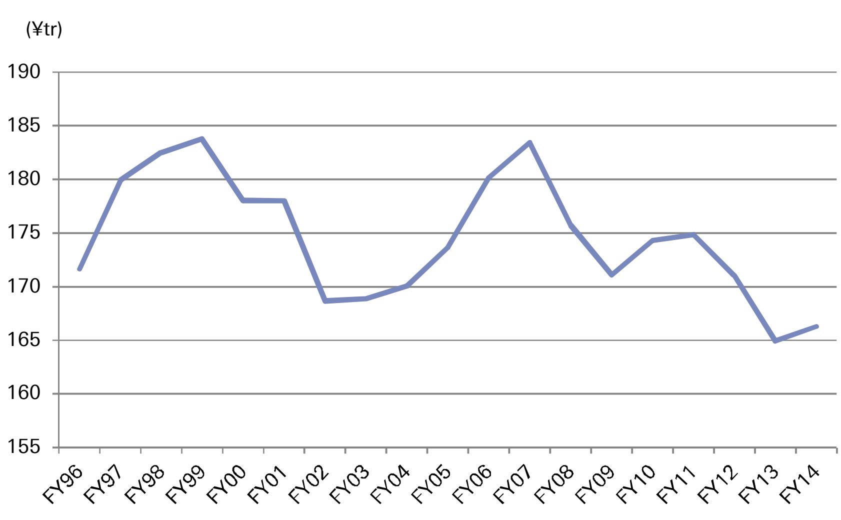
Figure 67: Worker households' consumption expenditures (seasonally adjusted, real basis)



Source: Ministry of Internal Affairs and Communications (Statistics Bureau), 'Family Income and Expenditure Survey'

We believe a recovery in consumption will be contingent on an increase in wages. So far, only a few companies have moved to raise salaries. Indeed, the Financial Statements Statistics of Corporations by Industry (mainly large corporations), announced on 1 June, show sluggish growth in personnel costs (+0.8% YoY) for FY2014 (Figure 68).

Figure 68: Financial Statements Statistics of Corporations by Industry – Personnel expenses



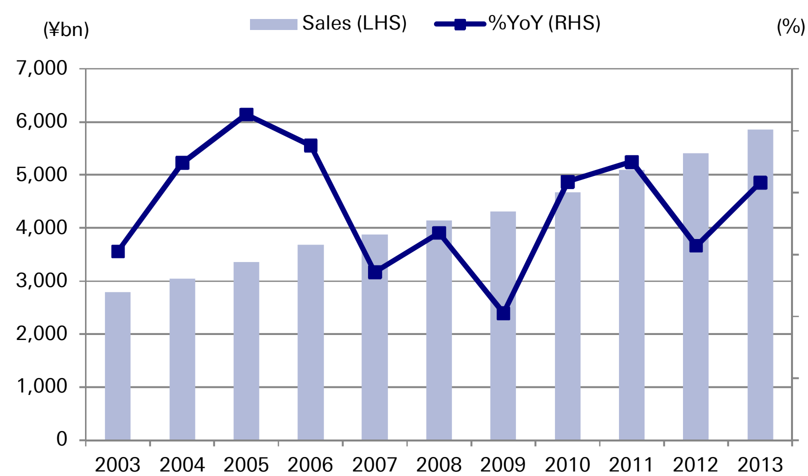
Including executive officers, temporary staff. All industries excluding finance and insurance.
Source: Ministry of Finance, 'Financial Statements Statistics of Corporations by Industry'

E-commerce also to slow down

The Internet sales business, which has to date boosted the logistics real estate market, is unlikely to be able to escape the impact of reduced household income and spending.

According to the Japan Direct Marketing Association (JADMA), the mail-order market continues to expand steadily, with 2013 sales up 8.3% YoY to ¥5.86tr (Figure 69). However, sales appear to have softened since the consumption tax hike in April 2014. We forecast mail-order sales slowed in 2014, and we do not expect sales in 2015 to grow at the previous high rate.

Figure 69: Mail-order sales (estimated by JADMA)



Source: Japan Direct Marketing Association (JADMA)

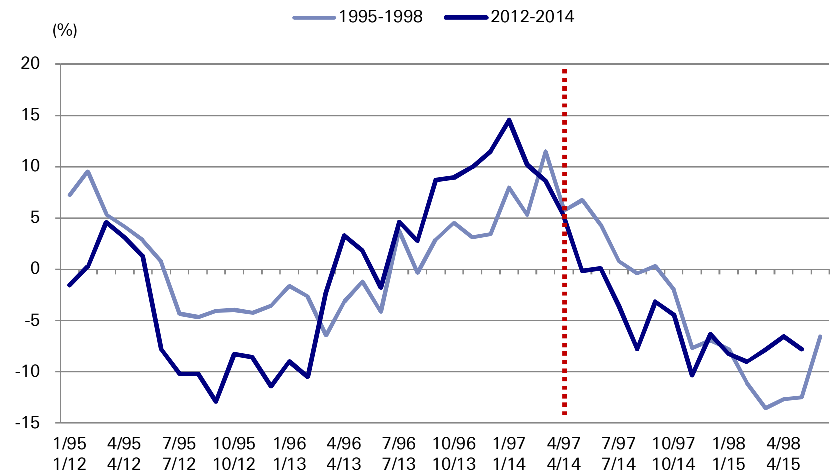
Risk of slower revamping of logistics strategies

In addition to online retailers, third-party logistics (3PL) service providers have supported demand for logistics facilities, and their emergence is directly attributable to the revamped logistics strategies observed at many companies. 3PL service providers occupy a position in the middle of freight owners and transportation companies. Hired by freight owners, they typically manage the distribution of goods via outsourcing to logistics facilities. There are various types of 3PL service providers, including affiliates of transportation and warehouse companies such as Nippon Express and Senko, as well as companies under manufacturers like Hitachi Transport System.

The industrial production index momentum (defined as YoY production growth minus YoY inventory growth), which we use as a leading indicator of corporate production activity, has not fallen further but remains soft (Figure 70).

Recent momentum is -8.2% for January, -9.0% for February, -7.9% for March, -6.5% for April, and -7.8% for May. If we look at the details, output recovery is still weak, while inventory levels remain high. These conditions do not seem conducive to a pickup in investment in logistics facilities. At the very least, they are unlikely to prompt investment that would result in sharp expansion of leased floor space, in our view.

Figure 70: Industrial production momentum (1997 consumption tax hike and current)



Note: Industrial production momentum refers to YoY production minus YoY inventories.
Source: Deutsche Securities based on Ministry of Economy, Trade and Industry, 'Industrial Index'

As previously mentioned, about 400,000 tsubo of supply is expected (plans for large-scale facilities) for 2015, and 450,000 tsubo for 2016 in the Tokyo metropolitan area. We expect the vacancy rate to start worsening. Therefore, we see a risk of an increase in expected yields.

J-REIT market overview

We upgraded NBF and JRE to Buy

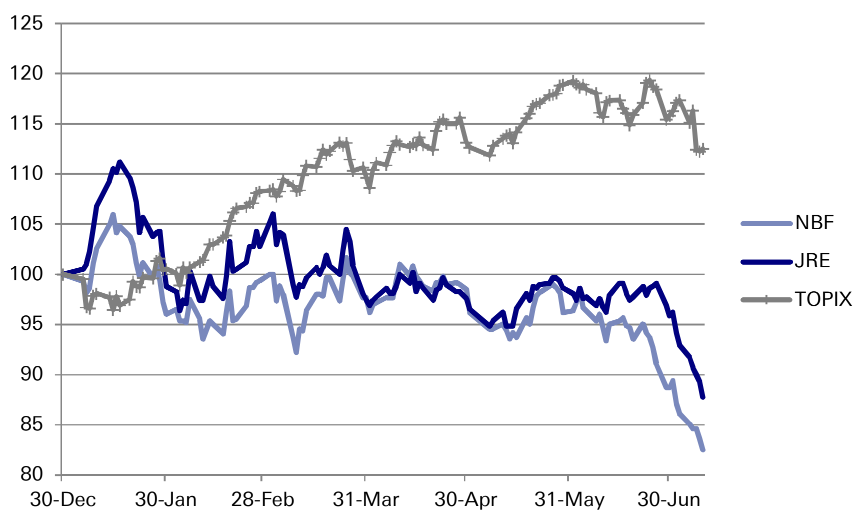
We maintain our view that the improvement of the office leasing market has already peaked

We upgraded Nippon Building Fund (NBF) and Japan Real Estate Investment Corporation (JRE) from Hold to Buy on 13 July 2015.

Unit prices of NBF and JRE fell from the beginning of 2015, underperforming TOPIX by about 30ppt (as of 10 July). As they fell well below our target price, we upgrade our rating to Buy. We maintained our earnings forecasts, valuations and target prices.

We also maintained our view that the improvement of the office leasing market has already peaked, as we discussed in the section entitled, "Office market outlook".

Figure 71: Unit price performance of NBF and JRE (30 December 2014=100)



Unite price performance from 30 December 2014 to 10 July 2015
Source: Bloomberg Finance LP, Deutsche Securities

Figure 72: Our coverage of J-REIT sector

		Rating	Target unit price	Target FFO multiple	Relative to NBF's FFO multiple	Current unit price	Upside /downside	Distribution yield	FFO multiple	NAV multiple
NBF	8951	Buy	¥610,000	24.0	-	¥554,000	10%	2.8%	21.8	1.2
JRE	8952	Buy	¥610,000	24.0	1.00	¥556,000	10%	2.8%	21.9	1.2
JRF	8953	Hold	¥210,000	15.6	0.65	¥243,000	-14%	3.5%	18.3	1.3
UUR	8960	Hold	¥165,000	19.2	0.80	¥180,000	-8%	3.3%	21.1	1.4
KDO	8972	Sell	¥480,000	15.6	0.65	¥574,000	-16%	3.6%	18.7	1.0
NAF	3226	Hold	¥440,000	18.0	0.75	¥440,500	0%	3.6%	18.0	1.2
IIF	3249	Hold	¥510,000	21.6	0.90	¥552,000	-8%	3.3%	22.7	1.6
ADR	3269	Hold	¥280,000	21.6	0.90	¥270,500	4%	3.3%	21.0	1.3
NPR	3283	Hold	¥275,000	26.4	1.10	¥244,500	12%	3.3%	23.6	1.6

Price as of 31 July 2015
Distribution yield, FFO multiple and NAV multiple are based on our forecasts.
Source: Bloomberg Finance LP, Deutsche Securities forecast

Medium- and long-term recommendation: residential REITs

We have not changed our view that the residential subsector remains attractive

We have not changed our view that the residential subsector remains attractive among J-REITs. We expect the number of temporary staff to increase due to the government's policy of easing regulations, which will likely boost demand for rental housing rather than for purchasing houses.

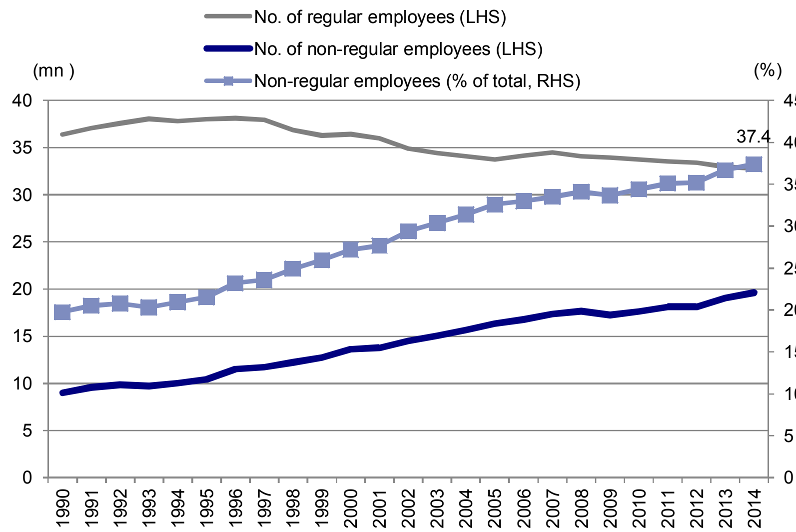
The consumption tax hike to 8% has been increasing the incentive for companies to hire more part-time staff. This is because part-time staff costs are an input cost, not a labor cost, so the greater use of temporary staff would result in greater refunds of the increased consumption tax.

Moreover, the Revised Worker Dispatch Law is scheduled to come into force in autumn this year (the bill was passed by the Lower House in June and is now under deliberation in the Upper House). This revised law will enable the continuous use of temporary staff. In other words, we believe that companies will have no reason to increase their permanent full-time staff.

Temporary workers already make up more than 37% of workforce

As shown in Figure 73, temporary workers already make up more than 37% of the Japanese workforce, and the ratio is increasing every year.

Figure 73: Trend of permanent/temporary employees

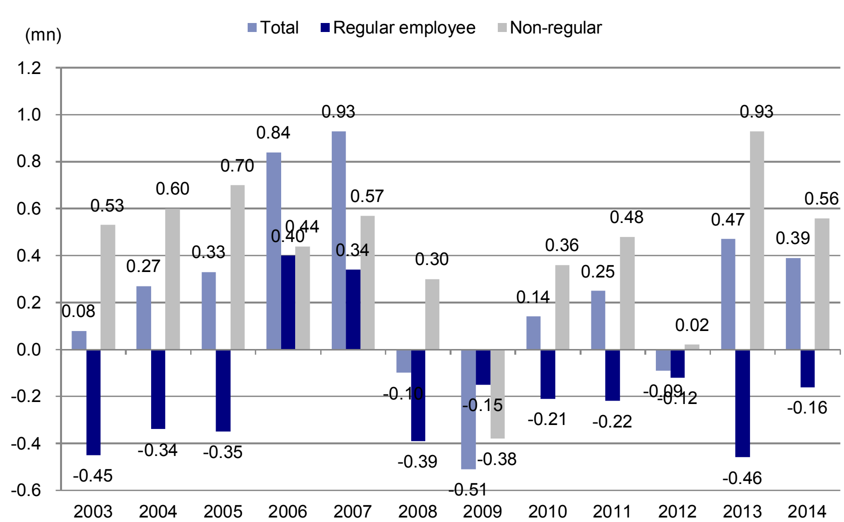


Source: Ministry of Internal Affairs and Communications, 'Labour Force Survey'

The total number of employees increased during 2013 and 2014, when Abenomics started, but the number of regular employees decreased (Figure 74).

Regular employee numbers decreased in 2013 and 2014

Figure 74: Number of employees (YoY change)

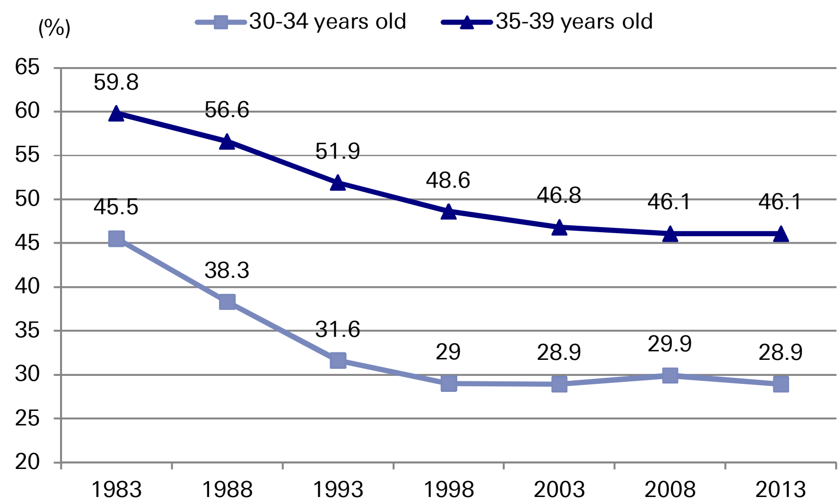


Source: Deutsche Securities based on Ministry of Internal Affairs and Communications, 'Labour Force Survey'

Rationale for drop in home ownership ratio among people in 30s

We attribute the decline in the home ownership ratio among young people to the expansion of temporary staff with relatively weak purchasing power, reflecting temporary workers' lower wages relative to permanent, full-time employees. According to the Ministry of Internal Affairs and Communication, the home ownership ratio among people aged 30-34 years declined from 45.5% in 1983 to 28.9% in 2013. Also, the ratio among those aged 35-39 years fell from 59.8% in 1983 to 46.1% in 2013 (Figure 75).

Figure 75: House ownership rate by age group (30s)



Source: Ministry of Internal Affairs and Communications 'Housing and Land Survey'

Corporate Governance Code also sparks leasing demand

Japan has started corporate governance reforms that should ensure companies release the internal reserves they built up over the years. We believe this trend will likely accelerate, because Abenomics aims to boost share prices by pushing corporations to focus more on ROE and to increase shareholder returns aggressively, including higher dividend hikes and share repurchases.

Abenomics emphasizes shareholder returns based on cost cutting rather than on employee pay increases

In his 12 February policy speech, Prime Minister Shinzo Abe said, "we will make it mandatory for all listed companies to comply with a new Corporate Governance Code in line with international standards". He has reiterated on several occasions that, in order for institutional investors to play a larger role in corporate governance, his administration will implement rules to increase the number of external directors on company boards and draw up a Japanese version of the Stewardship Code.

In other words, Abenomics emphasizes shareholder returns based on cost cutting rather than on employee pay increases. Some large companies have raised wages, but we do not expect this trend to spread throughout the Japanese economy; rather, we believe segmentation of the middle class will accelerate, leading to fewer people who can afford to buy homes. However, this means demand for rental properties will likely increase.

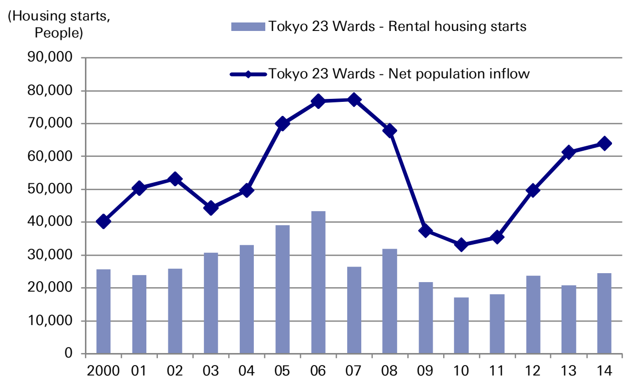
Stricter selection is needed in cities other than Tokyo

We believe demand for rental housing will likely increase, but demand outside the Tokyo region appears limited.

Population influx to 23 wards of Tokyo greatly exceeds new housing starts

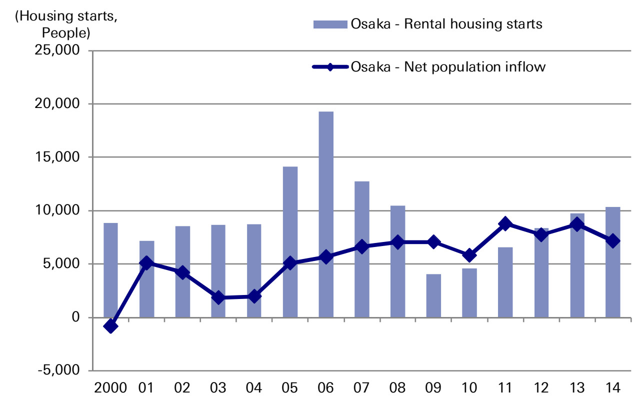
As shown in Figure 76, the population inflow into Tokyo's 23 wards greatly exceeds the number of construction starts. However, population inflow and construction numbers are about the same in other cities, even in large cities such as Nagoya and Osaka (Figure 77 to Figure 79). As the scale of the market of those cities is small compared to Tokyo, the supply/demand balance is not necessarily stable.

Figure 76: Rental housing starts and net inflow of population in Tokyo's 23 wards



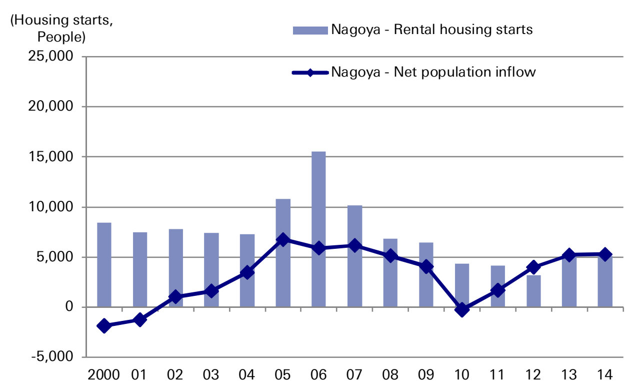
Source: Deutsche Securities, based on data provided by Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Nippon Accommodations Fund

Figure 77: Rental housing starts and net inflow of population in Osaka City



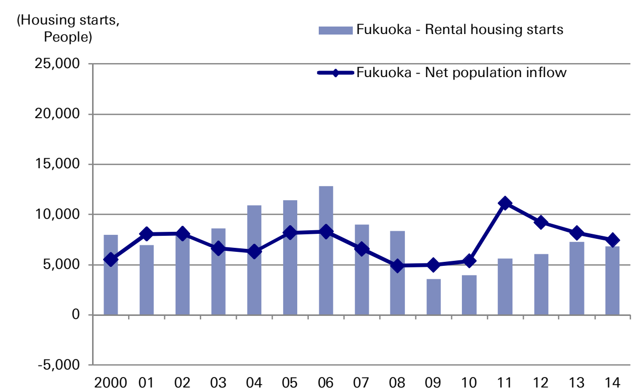
Source: Deutsche Securities, based on data provided by Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Nippon Accommodations Fund

Figure 78: Rental housing starts and net inflow of population in Nagoya City



Source: Deutsche Securities, based on data provided by Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Nippon Accommodations Fund

Figure 79: Rental housing starts and net inflow of population in Fukuoka City



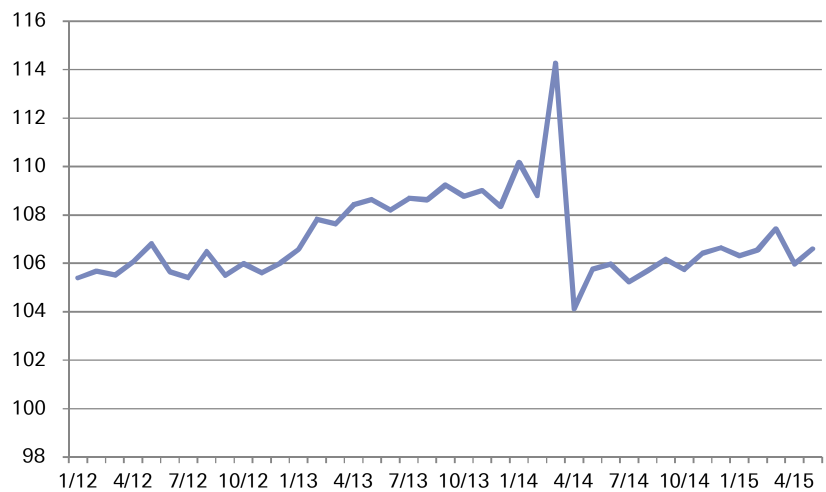
Source: Deutsche Securities, based on data provided by Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Nippon Accommodations Fund

Logistics and retail sectors need watching

We believe J-REITs specializing in logistics properties, which are expected to continue to add a large supply of around 400,000 tsubo (1,322,300 sqm) in 2015 and 2016, will need careful monitoring (see the section entitled "Logistics property market outlook" for details). Demand for large logistics centers equipped with advanced equipment is generally expected to remain firm, fueled by growing internet sales and by distribution restructuring in the manufacturing and retail sectors. However, we doubt such demand can forestall macroeconomic effects. GDP growth turned negative in 2014 and a substantial recovery is not expected in 2015. Given this, we doubt that companies will aggressively invest in distribution facilities.

We are even more cautious about the retail REIT sector. As stated in the section entitled, "Condo market outlook," household purchasing power shrank following the consumption tax rate hike in April 2014. The subsequent recovery has been feeble, and the adverse impact of consumption tax rate hikes has continued, as happened after previous tax hikes. We are concerned that large tenants may start to ask for rent reductions.

Figure 80: Private Consumption Index (seasonally-adjusted series, real base)



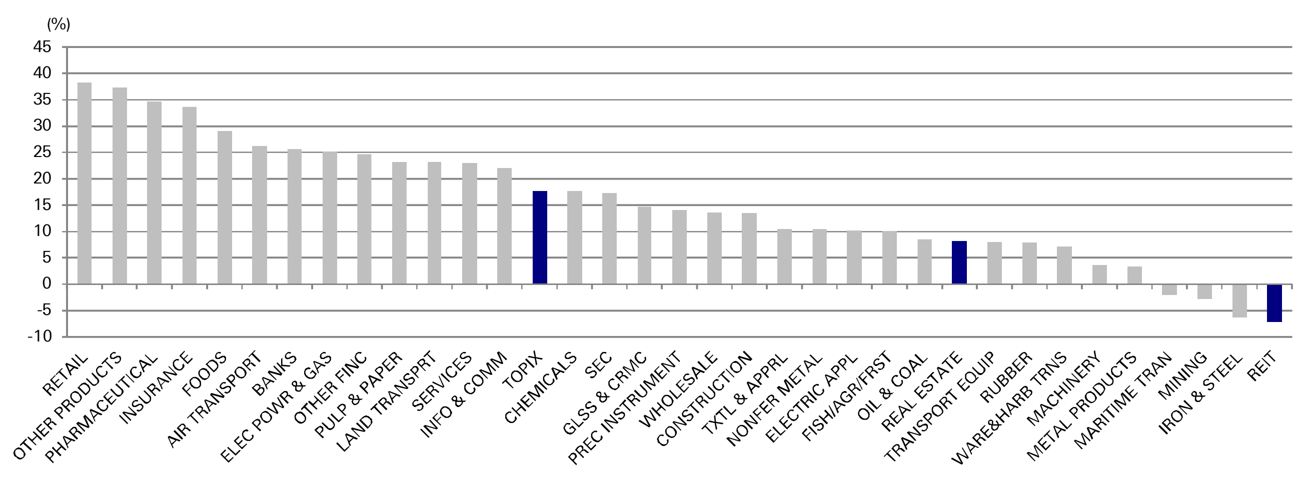
Source: Cabinet Office

Recovery of private consumption is weak

Companies swayed by shareholder returns

The TSE REIT Index performed well in 2014, but turned sharply lower from the start of 2015. It has had the worst performance of all sectors this year (Figure 81).

Figure 81: CYTD performance – TSE REIT Index, TOPIX and TSE 33 Sector

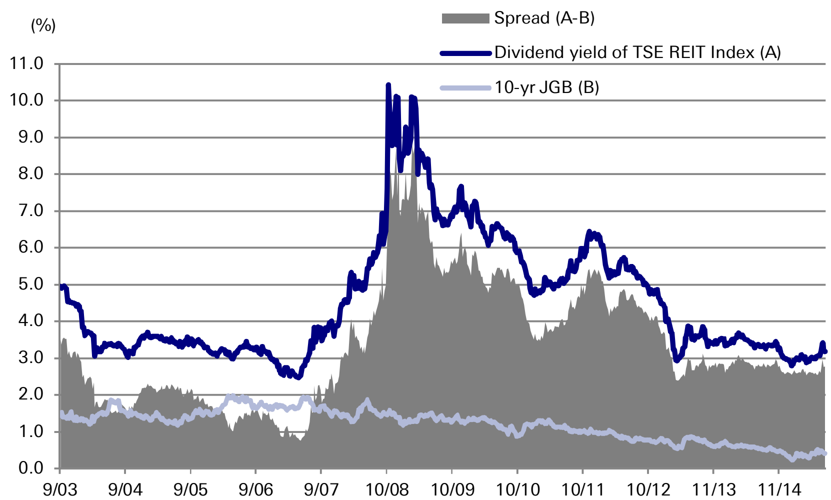


As of 24 July 2015
Source: Bloomberg Finance LP

We attribute the worst performance among all sectors to, in part, inroads in corporate government practices being promoted by the Abe administration. This is prompting many listed companies to begin to actively raise dividends and buy back shares.

The TSE REIT index has a dividend yield of 3.2% (as of 24 July), but some listed companies that pay corporate taxes have higher dividend yields than J-REITs (Figure 83).

Figure 82: Dividend yields of the TSE REIT Index and 10-year JGB



As of 24 July 2015
Source: Bloomberg Finance LP

Figure 83: Companies in TOPIX index with dividend yields above 3.2%

	Code	Name	Div. yield
1	8613	MARUSAN SECURITIES CO LTD	5.96
2	8706	KYOKUTO SECURITIES	4.87
3	8708	AIZAWA SECURITIES CO LTD	4.57
4	5015	BP CASTROL KK	4.46
5	9381	AIT CORP	4.41
6	9759	NSD CO LTD	4.38
7	8151	TOYO CORP	4.29
8	7615	KYOTO KIMONO YUZEN CO LTD	4.13
9	5208	ARISAWA MFG CO LTD	4.08
10	8707	IWAICOSMO HOLDINGS INC	4.04
11	1884	NIPPON ROAD CO LTD	4.01
12	8031	MITSUI & CO LTD	3.98
13	6727	WACOM CO LTD	3.97
14	6430	DAIKOKU DENKI CO LTD	3.97
15	9622	SPACE CO LTD	3.95
16	1873	NIHON HOUSE HOLDINGS CO LTD	3.87
17	7455	PARIS MIKI HOLDINGS INC	3.81
18	1975	ASAHI KOGYOSHA CO LTD	3.80
19	7480	SUZUDEN CORP	3.80
20	8002	MARUBENI CORP	3.76
21	9788	NAC CO LTD	3.74
22	2169	CDS CO LTD	3.74
23	1866	KITANO CONSTRUCTION CORP	3.73
24	8860	FUJI CORP LTD	3.71
25	8622	MITO SECURITIES CO LTD	3.69
26	8616	TOKAI TOKYO FINANCIAL HOLDIN	3.68
27	7518	NET ONE SYSTEMS CO LTD	3.65
28	6932	ENDO LIGHTING CORP	3.64
29	2760	TOKYO ELECTRON DEVICE LTD	3.61
30	6715	NAKAYO INC	3.59
31	8061	SEIKA CORP	3.58
32	8628	MATSUI SECURITIES CO LTD	3.57
33	8053	SUMITOMO CORP	3.57
34	4762	XNET CORP	3.57
35	6272	RHEON AUTOMATIC MACHINERY	3.57
36	5002	SHOWA SHELL SEKIYU KK	3.48
37	7150	SHIMANE BANK LTD/ THE	3.47
38	8624	ICHIYOSHI SECURITIES CO LTD	3.47
39	7838	KYORITSU PRINTING CO LTD	3.46
40	5187	CREATE MEDIC CO LTD	3.45
41	8118	KING CO LTD	3.43
42	9986	ZAOH COMPANY LTD	3.42
43	3834	ASAHI NET INC	3.41
44	4718	WASEDA ACADEMY CO LTD	3.39
45	7872	AS-ME ESTELLE CO LTD	3.39
46	7637	HAKUDO CO LTD	3.37
47	7442	NAKAYAMAFUKU CO LTD	3.35
48	4312	CYBERNET SYSTEMS CO	3.33
49	4719	ALPHA SYSTEMS INC	3.33
50	8005	SCROLL CORP	3.32
51	3321	MITACHI CO LTD	3.32
52	7995	NIPPON VALQUA INDUSTRIES LTD	3.31

As of 24 July 2015
Stocks shaded in blue are members of Nikkei 225
Source: Bloomberg Finance LP

We believe J-REITs should be given higher valuations compared to companies with the same dividend yields because of J-REITs' stable dividends. However, some companies that have until now paid little attention to shareholder returns have started to raise dividends, buy back shares and unwind cross-shareholdings. These changing corporate practices are attracting investor interest to industrial companies, rather than to J-REITs.

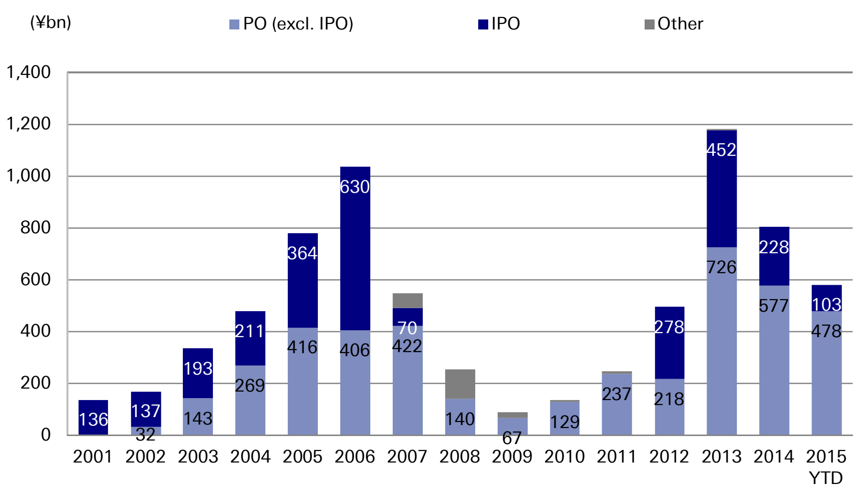
Capital increases up 36% YoY in 1H 2015

Almost all J-REITs have NAV multiples above 1x

However, the TSE REIT index ranged from 1,700 to 1,800, which is not low, in our view. Indeed, almost all J-REITs have NAV multiples above 1x, making it easy for them to raise funds through equity financing.

A total of ¥555.4bn was raised through equity financing announced in 1H (January–June) 2015. This is 36% more than in 1H 2014 (¥408.0bn). Including equity financing announced in July, there were 27 cases, with fund procurements totaling ¥581.3bn, of which ¥103bn was for four newly listed REITs (Figure 85).

Figure 84: Capital increases by J-REITs



TTL	136	169	336	480	780	1,036	548	254	89	137	247	496	1,181	805	581

As of 24 July 2015
Figures for 2015 include company plans.
Source: Company, ARES

Four REITs newly listed

Figure 85: Capital increases by J-REITs (2015 YTD)

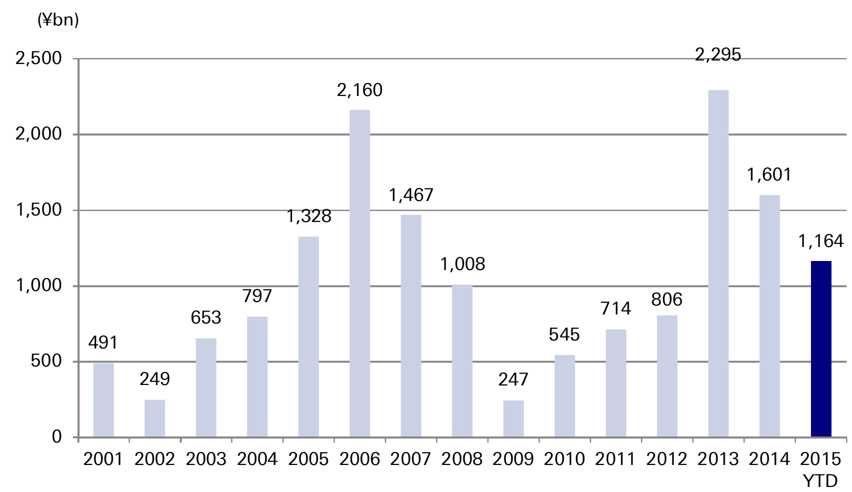
			Announce-ment date	Capital raised* (¥bn)	No. of units increased	Main purpose of funding			Asset type of acquired properties (No. of properties)						Purchase amount* (bn yen)
						1: property acquisition 2: debt repayment			1: office 2: residential	3: retail 4: industrial		5: hotel			
CY2015						1	2	other	1	2	3	4	5	other	
1	PIC	8956	5-Jan	27.2	20.4%	○			3						22.0
2	**KRR**	**3453**	**6-Jan**	**57.7**	**IPO**	○					**18**				**80.8**
3	CRR	3282	7-Jan	18.9	17.7%	○				12					23.5
4	JHR	8985	9-Jan	16.2	7.5%	○							6		23.1
5	KDR	3278	15-Jan	23.8	25.1%	○				11					23.6
6	NRT	3296	19-Jan	50.2	100.3%	○			28	1	2				76.9
7	ARI	3292	22-Jan	20.7	14.8%	○					6				35.3
8	NAF	3226	6-Feb	10.2	5.0%	○				4					7.2
9	**HCM**	**3455**	**17-Feb**	**13.0**	**IPO**	○				**16**				(Healthcare)	**23.7**
10	OJR	8954	2-Mar	18.4	5.4%	○			1	1					14.8
11	DHR	3263	5-Mar	28.3	19.5%	○						7			48.4
12	JRE	8952	18-Mar	32.2	4.6%	○			4						37.0
13	FRC	8968	8-Apr	12.1	8.3%	○					1				5.3
14	IRE	8975	9-Apr	25.5	25.3%	○			12						44.0
15	HRR	3287	10-Apr	9.4	15.6%	○							8		7.2
16	SHR	3309	24-Apr	21.3	25.6%	○			1						38.6
17	DOI	8976	27-Apr	25.0	9.8%	○			3						49.6
18	IOJ	3298	7-May	11.3	25.3%	○			2						19.7
19	JRH	8986	8-May	12.6	11.2%	○				7					14.3
20	**SRI**	**3459**	**29-May**	**16.4**	**IPO**	○				**18**					**19.2**
21	JPR	8955	1-Jun	18.9	5.8%		○								0.0
22	JHR	8985	4-Jun	11.1	4.8%	○							1		15.0
23	NRT	3296	10-Jun	24.8	28.8%	○			11						46.7
24	JEI	8987	24-Jun	6.7	4.3%		○								0.0
25	**JSL**	**3460**	**25-Jun**	**15.9**	**IPO**	○				**14**				(Healthcare)	**28.0**
26	INV	8963	25-Jun	30.3	19.7%	○				3			11		35.6
27	MID	3227	9-Jul	23.2	38.5%	○			5						49.3
	PO			478.3											637.1
	IPO			103.0											151.7
	Total			581.3											788.8

As of 24 July 2015
**Figures for capital raised and purchase amount include company plans.*
Source: Company, Deutsche Securities

Property acquisition becoming even more competitive

In addition to capital increases, J-REITs have aggressively acquired property. In 2014, J-REIT's acquisitions decreased to ¥1.6tr, down 30% from the record-high of ¥2.3tr in 2013. However, the acquisition pace has picked up again this year, reaching ¥930bn in 1H alone. They totaled ¥1.16tr as of 24 July (Figure 86). In 2015, they are unlikely to reach the 2013 level, when large IPOs continued, but we forecast that acquisitions will likely reach nearly ¥2.0tr.

Figure 86: Property acquisition by J-REITs (based on purchase price)



As of 24 July 2015
Figures for 2015 include properties for which contract details have been announced but that have not been delivered.
Source: Company, ARES, Deutsche Securities

MCUBS MidCity to purchase a Shibuya office building with a NOI yield of 3.5%

Nonetheless, the pace to acquire properties is intensifying in all asset categories. The cap rate has fallen rapidly. For example, MCUBS MidCity has announced its intention to buy a Shibuya office building with a NOI yield of 3.5% (G Square in Shibuya Dogenzaka, estimated at ¥12.22bn) and a Kawasaki office building with a NOI yield of 4.2% (Cube Kawasaki at ¥20.05bn).

Also, high-net-worth individuals are said to be stepping up purchases of small offices and residential properties. We believe individual measures to deal with inheritance taxes are playing a role (see section entitled "Higher tax drives bubble"), even in the type of real estate markets in which J-REITs invest.

Expecting the TSE REIT index to remain flat

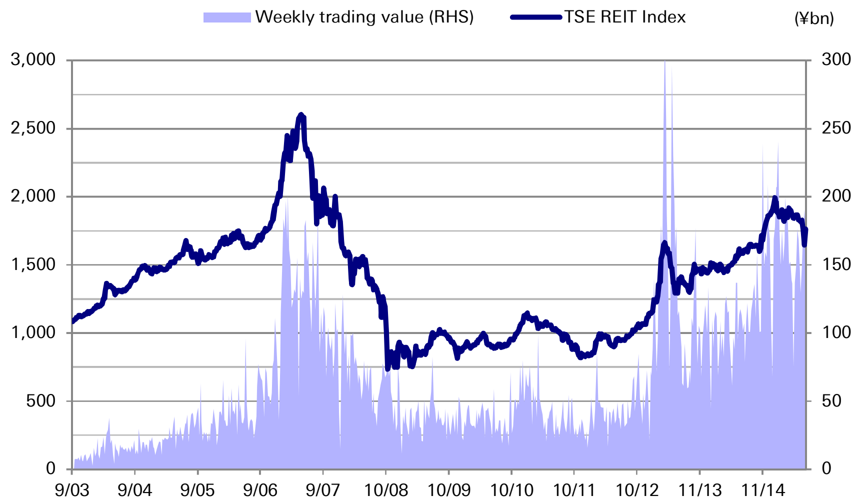
Conditions remain favorable for both debt and equity J-REIT financing, but we expect J-REITs to have increasing difficulties buying properties. As rents are still not rising on a full scale, definitive internal growth cannot be expected. We forecast that DPU for many J-REITs will stay at current levels or rise modestly. Consequently, we expect the TSE REIT index to remain flat.

J-REIT market data

(Price as of 24 July 2015; all prices on the following pages are the same unless otherwise indicated)

Figure 87: Trend of TSE REIT Index and trading values of J-REITs

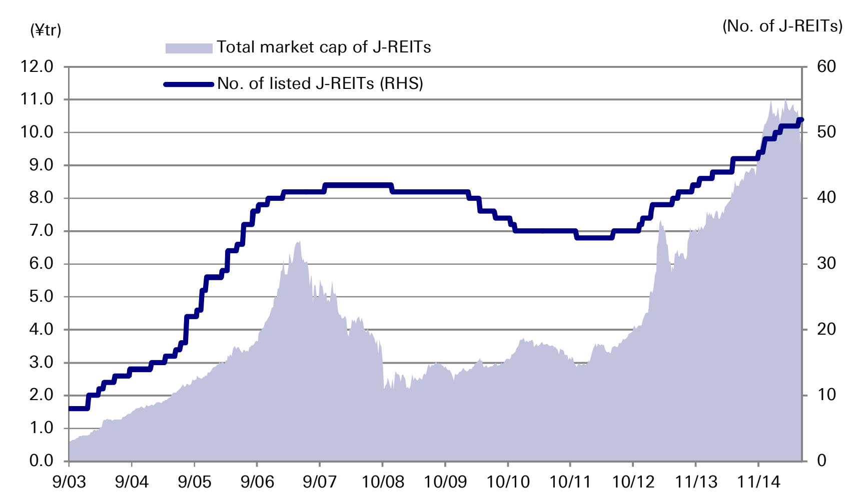
TSE REIT index weakened after reaching 2,000 in January



Source: Bloomberg Finance LP

Figure 88: Market cap of J-REITs and number of listed J-REITs

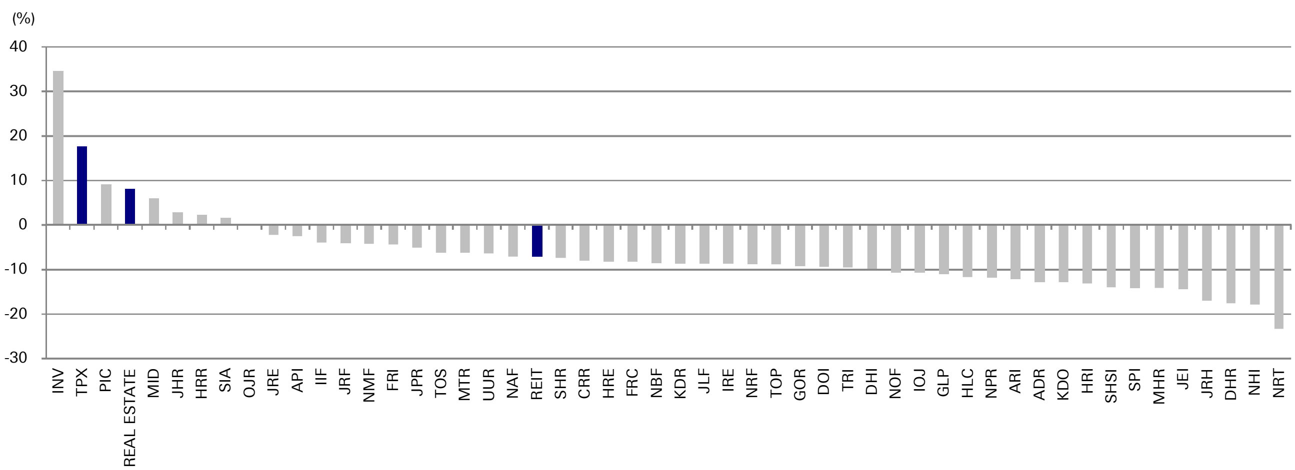
Listed J-REITs at 53, total market cap exceeds ¥10tr



Source: Bloomberg Finance LP

Only one REIT outperforms TOPIX

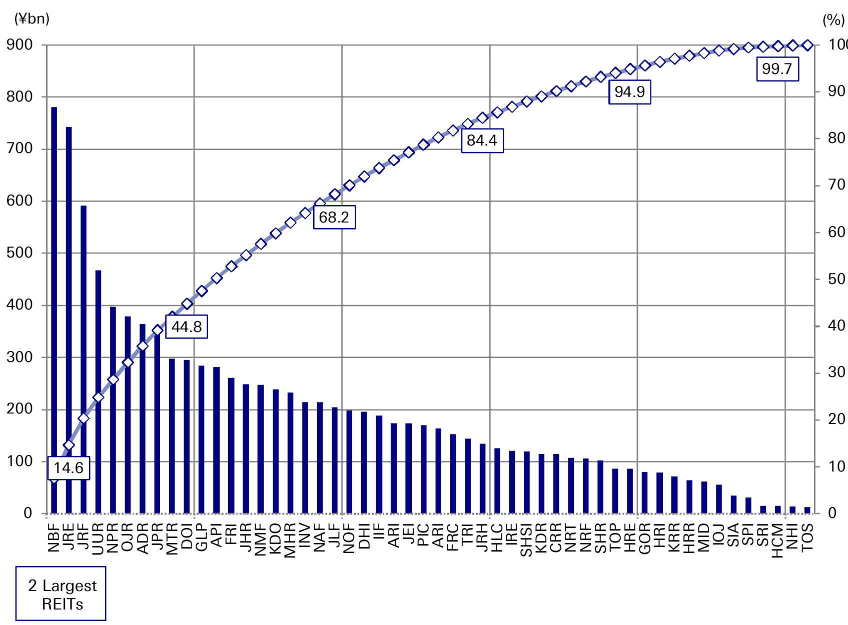
Figure 89: CYTD performance – individual J-REITs



Note: Real Estate: TSE Real Estate Stock Index. REIT: TSE REIT Index. J-REITs that had not listed as of the end of December 2014 are excluded.
Source: Bloomberg Finance LP

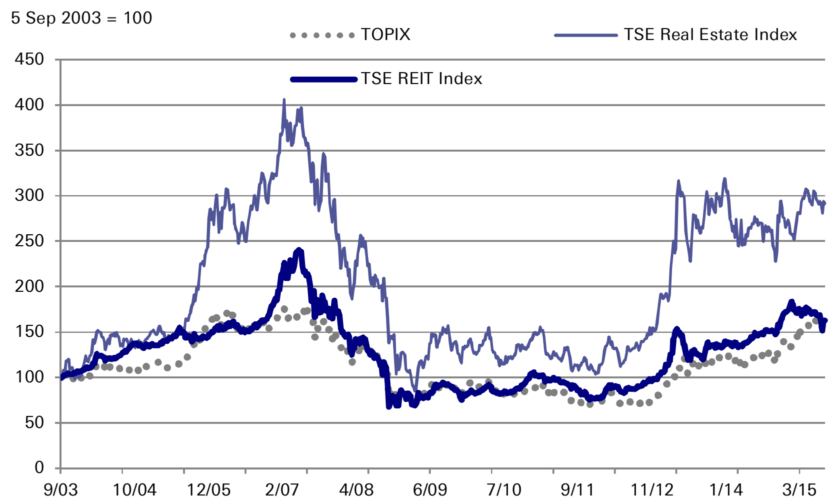
NBF and JRE's market share has fallen to 14.6%

Figure 90: Market cap and weight for each J-REIT



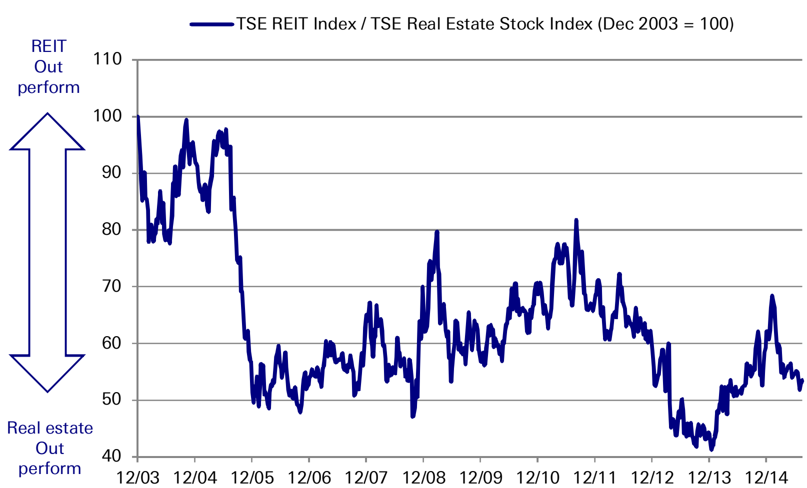
Source: Bloomberg Finance LP

Figure 91: Index performance (September 2003 = 100)



Source: Bloomberg Finance LP

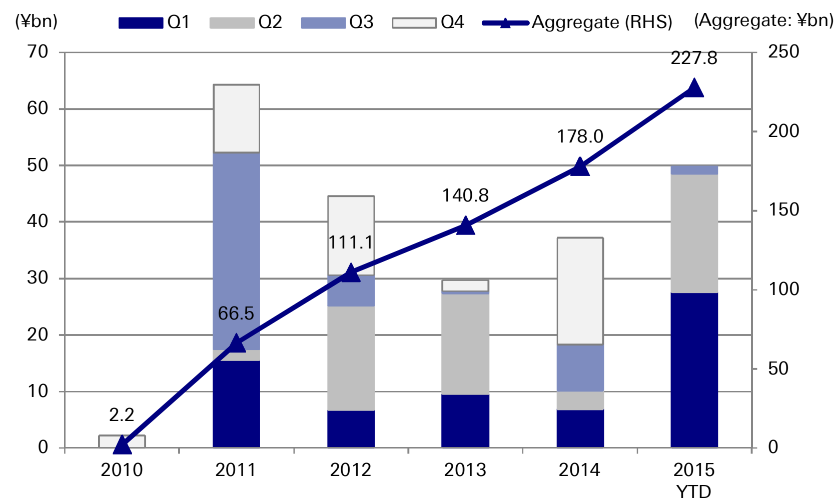
Figure 92: Comparison between Real Estate Stock Index and REIT Index



Source: Bloomberg Finance LP, Deutsche Securities

TSE REIT Index, TSE Real Estate Stock Index moving in reverse of 2014

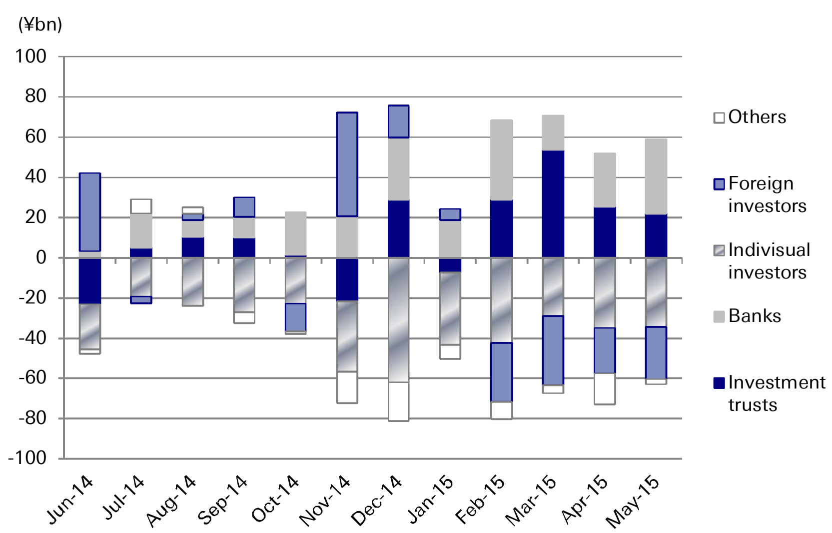
Figure 93: J-REIT purchase by the BoJ



Source: Bank of Japan, Deutsche Securities

BoJ purchased ¥48.5bn in J-REIT shares in 1H 2015 alone

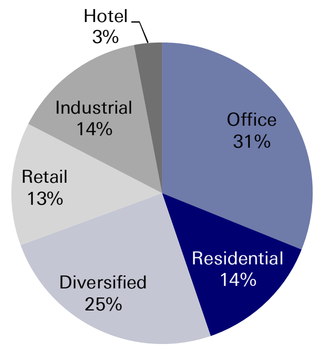
Figure 94: Trading value of J-REITs by investor type (monthly)



Source: Tokyo Stock Exchange, Deutsche Securities

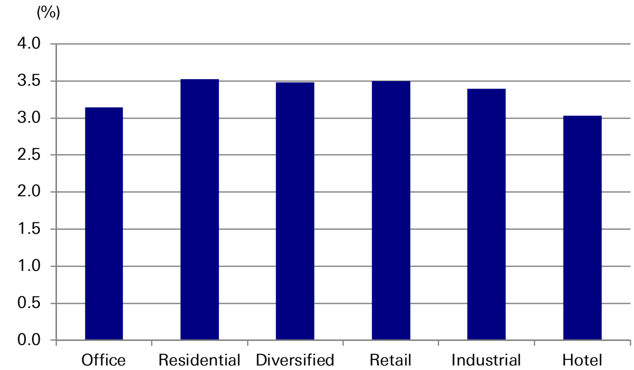
Overseas investors net sellers since February

Figure 95: Market cap breakdown by asset class



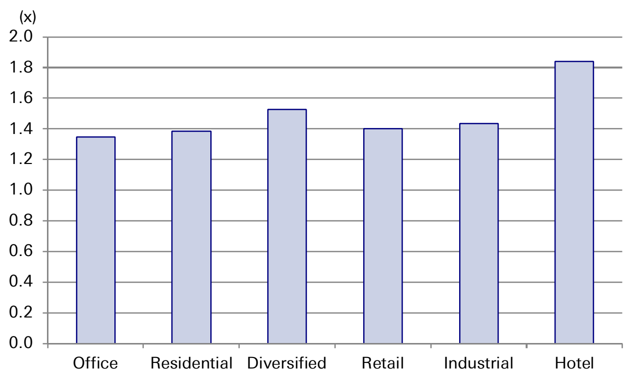
Source: Bloomberg Finance LP, Deutsche Securities

Figure 96: Average dividend yield for each asset class



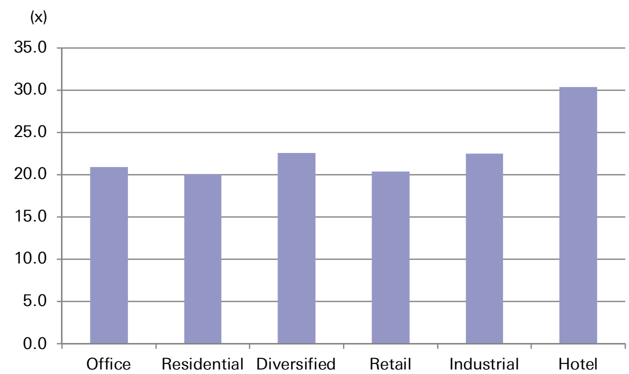
Note: Div. Yield = DPU (Company estimates are for this fiscal period, annualized)/Latest price
Source: Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

Figure 97: Average NAV multiple for each asset class



Note: NAV multiple = Latest price/NAV per unit as of the latest fiscal period end
Source: Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

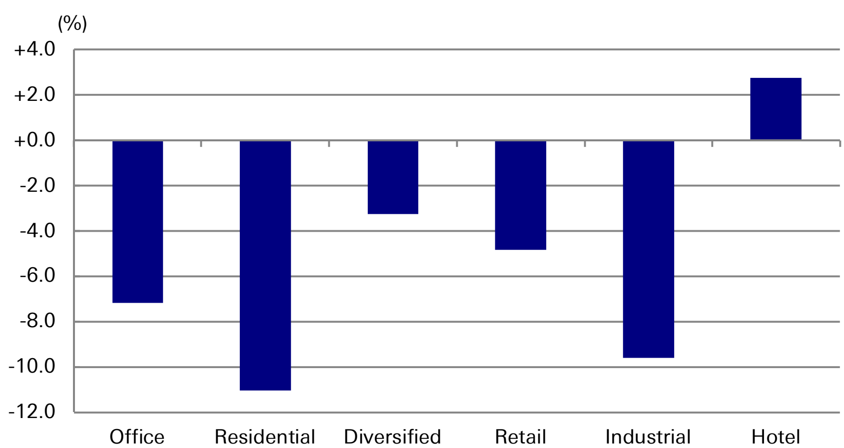
Figure 98: Average FFO multiple for each asset class



Note: FFO multiple = Latest price/FFO per unit as of the latest fiscal period (annualized)
Source: Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

Figure 99: 2015 YTD unit price performance by asset class

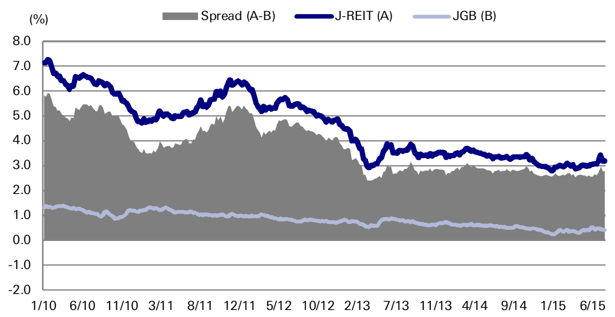
Only Hotel REITs are up



Source: Bloomberg Finance LP, Deutsche Securities

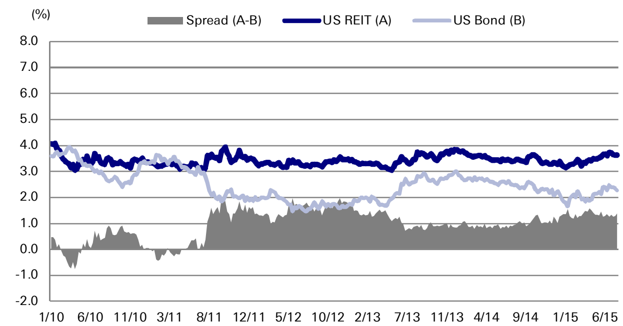
Yield gap, performance for REITs of major countries

Figure 100: Yield gap between J-REITs and Japanese government bond



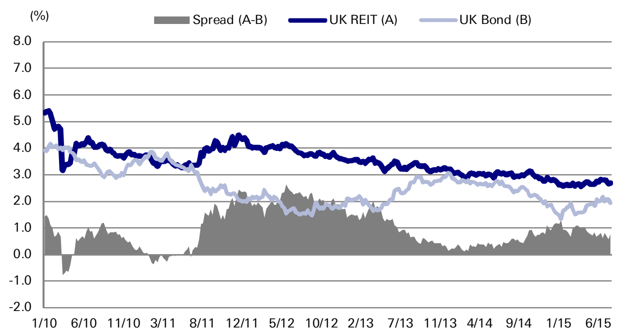
Note: A: TSE REIT index. B: Japanese government bond (10-year)
Source: Bloomberg Finance LP

Figure 101: Yield gap between REITs and government bond in the US



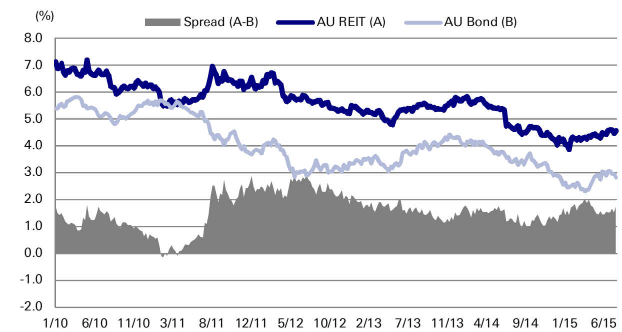
Note: A: Dow Jones U.S. Select REIT Index. B: U.S. government bond (10-year)
Source: Bloomberg Finance LP

Figure 102: Yield gap between REITs and government bond in the UK



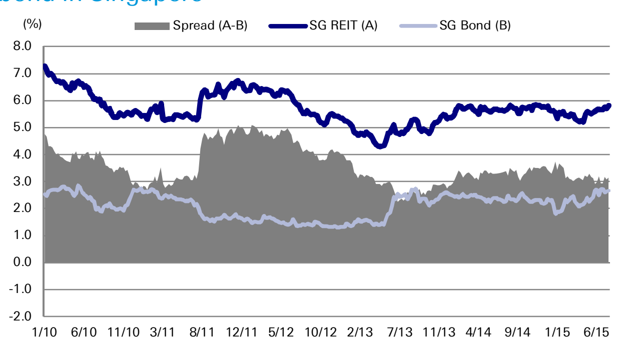
Note: A: FTSE EPRA/NAREIT UK REITs Index. B: U.K. government bond (10-year)
Source: Bloomberg Finance LP

Figure 103: Yield gap between REITs and government bond in Australia



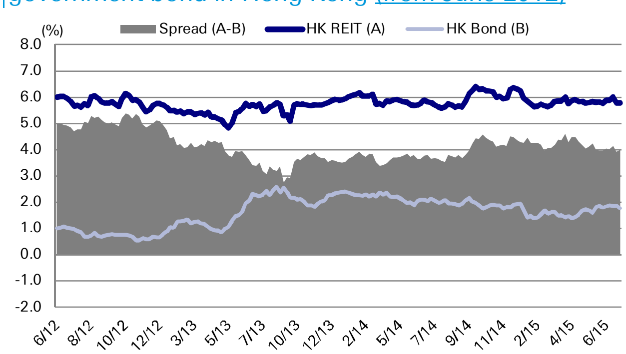
Note: A: S&P/ASX200 A-REIT Index. B: Australian government bond (10-year)
Source: Bloomberg Finance LP

Figure 104: Yield gap between REITs and government bond in Singapore



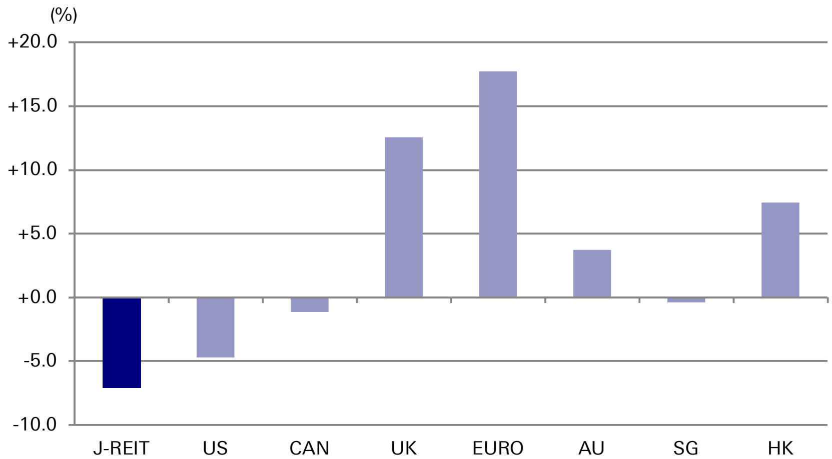
Note: A: FTSE ST REIT Index. B: Singapore's government bond (10-year)
Source: Bloomberg Finance LP

Figure 105: Yield gap between property index and government bond in Hong Kong <u>(from June 2012)</u>



Note: A: Hang Seng REIT Index. B: Hong Kong's government bond (10-year)
Source: Bloomberg Finance LP

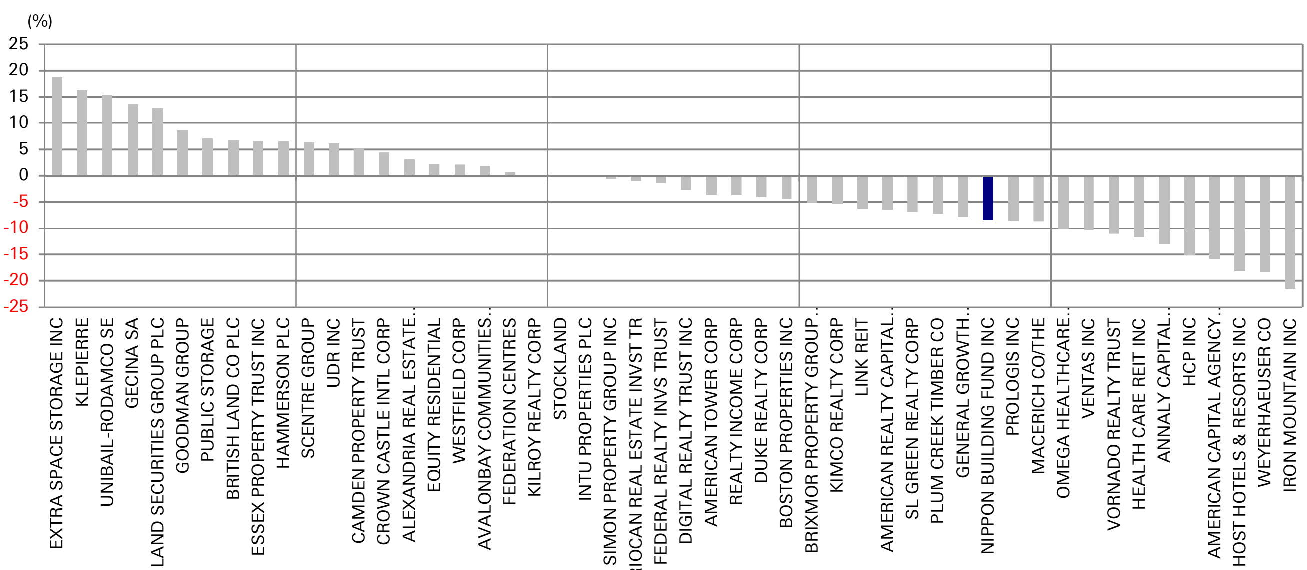
Figure 106: 2015 YTD index performance for REITs of major countries (based on local currency)



Note: J-REIT: TSE REIT Index. US: Dow Jones U.S. Select REIT Index. CAN: BLOOMBERG CANADIAN REIT Index. UK: FTSE EPRA/NAREIT UK REITs Index. EURO: FTSE EPRA/NAREIT Developed Europe REITs Index. AU: S&P/ASX200 A-REIT Index. SG: FTSE ST REIT Index. HK: Hang Seng REIT Index. All figures are based on local currency.
Source: Bloomberg Finance LP

Only NBF ranked among the global top 50

Figure 107: 2015 YTD performance ranking of 50 largest* REITs worldwide (based on local currency)



Source: Bloomberg Finance LP

Figure 108: Code, name and end of fiscal period

Code	Ticker	Name	Fiscal period
NBF	8951	Nippon Building Fund Inc.	Jun / Dec
JRE	8952	Japan Real Estate Investment Corporation	Mar / Sep
JRF	8953	Japan Retail Fund Investment Corporation	Feb / Aug
OJR	8954	ORIX JREIT Inc.	Feb / Aug
JPR	8955	Japan Prime Realty Investment Corporation	Jun / Dec
PIC	8956	Premier Investment Corporation	Apr / Oct
TRI	8957	TOKYU REIT, Inc.	Jan / Jul
GOR	8958	Global One Real Estate Investment Corp.	Mar / Sep
NOF	8959	Nomura Real Estate Office Fund, Inc.	Apr / Oct
UUR	8960	United Urban Investment Corporation	May / Nov
MTR	8961	MORI TRUST Sogo Reit, Inc.	Mar / Sep
INV	8963	Invincible Investment Corporation	Jun / Dec
FRI	8964	Frontier Real Estate Investment Corporation	Jun / Dec
HRE	8966	HEIWA REAL ESTATE REIT, Inc	May / Nov
JLF	8967	Japan Logistics Fund, Inc.	Jan / Jul
FRC	8968	Fukuoka REIT Corporation	Feb / Aug
KDO	8972	Kenedix Office Investment Corporation	Apr / Oct
SHSI	8973	Sekisui House SI Residential Investment Corporation	Mar / Sep
IRE	8975	Ichigo Real Estate Investment Corporation	Apr / Oct
DOI	8976	Daiwa Office Investment Corporation	May / Nov
HRI	8977	Hankyu REIT, Inc.	May / Nov
SPI	8979	Starts Proceed Investment Corporation	Apr / Oct
TOP	8982	TOP REIT, Inc.	Apr / Oct
DHI	8984	Daiwa House Residential Investment Corporation	Feb / Aug
JHR	8985	Japan Hotel REIT Investment Corporation	Dec
JRH	8986	Japan Rental Housing Investments Inc.	Mar / Sep
JEI	8987	Japan Excellent, Inc.	Jun / Dec
NAF	3226	Nippon Accommodations Fund Inc.	Feb / Aug
MID	3227	MCUBS MidCity Investment Corporation	Jun / Dec
MHR	3234	Mori Hills REIT Investment Corporation	Jan / Jul
NRF	3240	Nomura Real Estate Residential Fund, Inc.	May / Nov
IIF	3249	Industrial & Infrastructure Fund Investment Corporation	Jun / Dec
DHR	3263	Daiwa House REIT Investment Corporation	Feb / Aug
ADR	3269	Advance Residence Investment Corporation	Jan / Jul
KDR	3278	Kenedix Residential Investment Corporation	Jan / Jul
API	3279	Activia Properties Inc.	May / Nov
GLP	3281	GLP J-REIT	Feb / Aug
CRR	3282	Conforia Residential REIT, Inc.	Jan / Jul
NPR	3283	Nippon Prologis REIT, Inc.	May / Nov
NMF	3285	Nomura Real Estate Master Fund, Inc.	Feb / Aug
HRR	3287	Hoshino Resorts REIT, Inc.	Apr / Oct
SIA	3290	SIA REIT, Inc	Feb / Aug
ARI	3292	AEON REIT Investment Corporation	Jan / Jul
HLC	3295	Hulic Reit, Inc.	Feb / Aug
NRT	3296	Nippon REIT Investment Corporation	Jun / Dec
IOJ	3298	Invesco Office J-REIT Inc.	Apr / Oct
NHI	3308	Nippon Healthcare Investment Corporation	Apr / Oct
SHR	3309	Sekisui House REIT, Inc.	Apr / Oct
TOS	3451	Tosei Reit Investment Corporation	Apr / Oct
KRR	3453	Kenedix Retail REIT Corporation	Mar / Sep
HCM	3455	Healthcare & Medical Investment Corporation	Jan / Jul
SRI	3459	Samty Residential Investment Corporation	Jan / Jul
JSL	3460	Japan Senior Living Investment Corporation	Feb / Aug

Source: Company

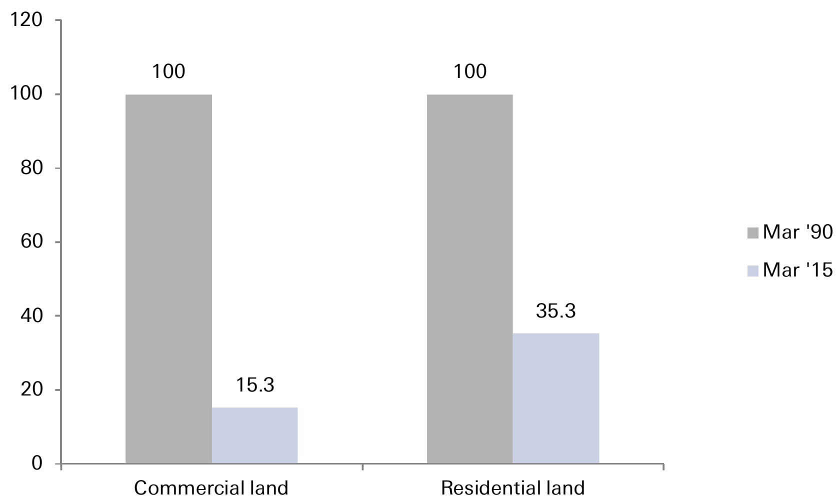
Land price trend

85% drop from the peak

Japanese real estate prices peaked in 1991. The subsequent collapse of the real estate bubble resulted in prices falling steadily until 2003. This downtrend was followed by a mini-bubble that saw prices in metropolitan Tokyo rise roughly 70% from their bottom, but it was short-lived. If we base the peak in real estate prices in Japan's six major cities at 100, current prices stand at only about 15.

If we base the peak in real estate prices in Japan's six major cities at 100, current prices stand at only about 15

Figure 109: Urban land price index versus 1990 index of 100 (six major cities)



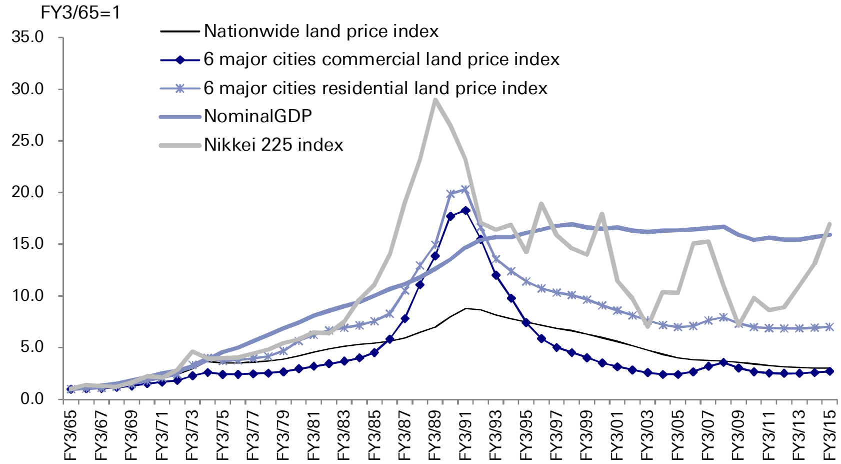
Source: Deutsche Securities, based on data from Real Estate Economic Institute

Furthermore, land prices have fallen sharply relative to nominal GDP (Figure 110). The price of land is determined by the future potential earnings that can be generated from it. We, therefore, believe that land prices that are lower than the aggregate shown in nominal GDP indicate pessimism toward the Japanese economy.

Land prices have fallen sharply relative to nominal GDP

Meanwhile, the Nikkei Average also tracked below-nominal GDP for a long time. It fell to the same level as the residential land price index of six major cities, but has finally recovered to the same level as nominal GDP following the last two years of increase in stock prices.

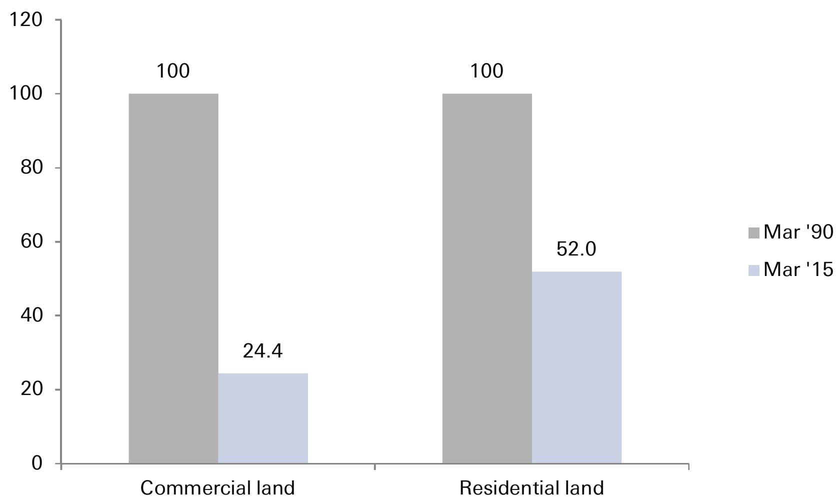
Figure 110: Land prices, nominal GDP and Nikkei 225 index



Source: Deutsche Securities, based on data from Japan Real Estate Institute, Cabinet Office, Datastream

Figure 111: Urban land price index versus 1990 index of 100 (nationwide)

The Nikkei Average has recovered to the same level as nominal GDP



Source: Deutsche Securities, based on data by Real Estate Economic Institute

Figure 112: Urban Land Index (Tokyo's 23 wards; end of March 2000=100)

	Commercial	HoH%	YoY%	Residential	HoH%	YoY%	Industrial	HoH%	YoY%	Average	HoH%	YoY%	The Highest Price Lot	HoH%	YoY%
86/3	277.5	25.5	52.0	142.2	26.3	41.5	68.8	5.8	8.5	174.3	22.8	41.0	266.8	25.3	57.1
87/3	442.7	22.9	59.5	287.9	32.4	102.5	142.7	77.0	107.4	323.6	34.7	85.7	351.9	8.2	31.9
88/3	475.2	-2.5	7.3	294.4	-7.5	2.3	183.5	2.6	28.6	349.7	-4.0	8.1	362.6	0.0	3.0
89/3	451.8	-0.9	-4.9	264.2	-4.1	-10.3	218.1	0.0	18.9	331.8	-2.2	-5.1	363.7	0.3	0.3
90/3	458.7	1.0	1.5	268.8	1.6	1.7	225.7	3.5	3.5	337.8	1.5	1.8	381.7	2.6	4.9
91/3	463.3	-0.3	1.0	265.9	-1.7	-1.1	227.8	0.0	0.9	338.2	-0.9	0.1	390.8	0.0	2.4
92/3	424.3	-7.5	-8.4	223.4	-12.2	-16.0	209.0	-7.6	-8.3	298.3	-9.6	-11.8	371.8	-4.9	-4.9
93/3	326.1	-15.8	-23.1	170.2	-14.7	-23.8	177.7	-9.6	-15.0	230.4	-14.8	-22.8	299.2	-15.5	-19.5
94/3	251.8	-13.1	-22.8	144.4	-8.0	-15.2	156.4	-6.2	-12.0	187.5	-10.3	-18.6	218.3	-17.6	-27.0
95/3	198.2	-10.9	-21.3	128.8	-5.3	-10.8	139.1	-3.9	-11.1	157.8	-7.9	-15.8	164.5	-12.6	-24.6
96/3	154.6	-11.1	-22.0	117.5	-3.7	-8.8	123.9	-5.7	-10.9	133.8	-7.3	-15.2	124.8	-11.6	-24.1
97/3	131.7	-6.5	-14.8	112.6	-1.7	-4.2	116.3	-1.7	-6.1	121.3	-3.7	-9.3	110.7	-2.4	-11.3
98/3	119.7	-4.4	-9.1	109.4	-1.4	-2.8	114.9	-0.8	-1.2	114.9	-2.5	-5.3	108.0	-1.4	-2.4
99/3	109.2	-4.8	-8.8	104.8	-2.8	-4.2	108.8	-3.0	-5.3	107.4	-3.7	-6.5	104.2	-1.8	-3.5
00/3	100.0	-4.4	-8.4	100.0	-2.4	-4.6	100.0	-4.9	-8.1	100.0	-3.6	-6.9	100.0	-1.9	-4.0
01/3	93.6	-3.1	-6.4	96.8	-1.3	-3.2	90.6	-4.3	-9.4	94.8	-2.4	-5.2	97.4	-0.8	-2.6
02/3	89.5	-2.1	-4.4	94.4	-1.2	-2.5	83.6	-4.0	-7.7	91.2	-1.8	-3.8	96.3	-0.8	-1.1
03/3	85.8	-2.1	-4.1	92.5	-1.0	-2.0	79.4	-2.5	-5.1	88.2	-1.7	-3.2	95.7	0.0	-0.7
04/3	83.5	-1.1	-2.7	91.2	-0.5	-1.4	77.4	-1.0	-2.5	86.4	-0.8	-2.1	97.0	1.1	1.4
05/3	83.8	0.5	0.3	93.7	1.5	2.7	75.6	-1.2	-2.3	87.4	0.8	1.2	105.0	2.4	8.2
06/3	88.9	4.1	6.1	100.6	4.5	7.3	76.3	0.9	0.9	92.8	4.0	6.2	114.6	5.7	9.2
07/3	105.5	11.1	18.7	112.4	6.7	11.8	81.1	3.6	6.3	106.4	8.6	14.6	149.4	17.7	30.4
08/3	115.9	1.4	9.8	118.2	-0.2	5.1	87.1	0.0	7.5	114.4	0.6	7.5	177.3	4.1	18.6
09/3	97.6	-10.2	-15.8	101.2	-6.7	-14.4	81.8	-3.2	-6.1	97.9	-8.1	-14.4	148.6	-13.1	-16.2
10/3	91.2	-2.4	-6.5	100.7	0.0	-0.5	77.3	-2.5	-5.5	94.2	-1.3	-3.8	136.1	-3.2	-8.4
11/3	89.4	-0.4	-2.0	100.6	0.0	-0.1	74.7	-1.3	-3.3	93.0	-0.3	-1.3	132.4	-0.5	-2.7
12/3	88.3	-0.5	-1.2	100.4	-0.1	-0.1	73.2	-1.0	-2.0	92.3	-0.4	-0.8	133.0	0.0	0.4
13/3	88.2	0.2	-0.1	100.3	0.1	-0.1	72.8	0.0	-0.5	92.1	0.1	-0.1	134.6	1.0	1.2
14/3	90.6	1.7	2.8	102.0	1.2	1.7	73.4	0.7	0.7	94.1	1.4	2.1	144.4	3.9	7.3
15/3	93.9	1.9	3.6	104.1	1.0	2.1	74.7	0.7	1.8	96.7	1.4	2.8	155.9	4.0	8.0

Source: Japan Real Estate Institute

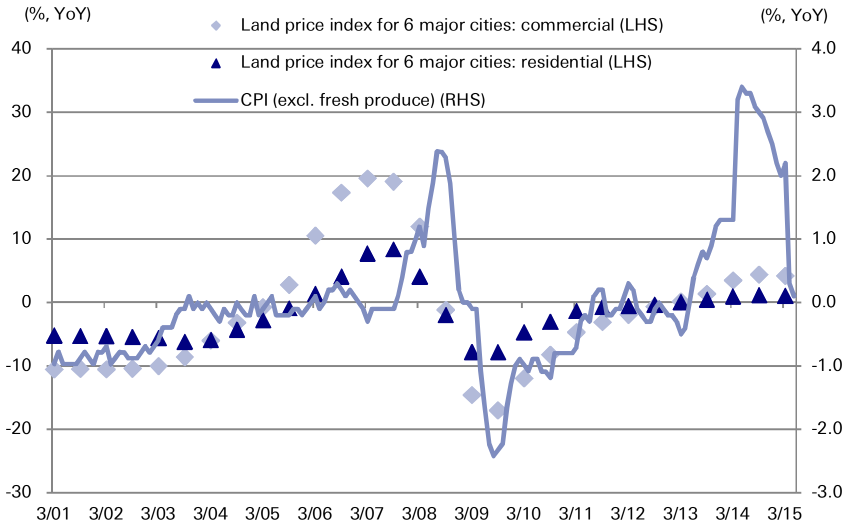
If the wage-driven inflation arrives...

The BoJ uses CPI growth of 2% as its inflation target. Historical precedent indicates that a turn to positive CPI growth brings strong growth in real estate prices.

The consumption tax hike to 8% boosted CPI sharply, but this was due to cost-push inflation rather than demand-pull inflation. Consequently, CPI growth fell to near zero again once the effect of the tax hike faded from April 2015.

If demand-driven CPI growth occurs due to rising wages, land prices, which are much lower than nominal GDP, will likely enter a stable expansionary period, just as share prices did.

Figure 113: CPI and land price index



Source: Deutsche Securities, based on data from Ministry of Internal Affairs and Communications and Japan Real Estate Institute

History and future outlook of key development projects

Compact city versus shopping malls

A rush of shopping mall openings in the Hokuriku area

The first outlet mall in the Hokuriku area, Mitsui Outlet Park Hokuriku Oyabe (developed by Mitsui Fudosan), opened on 16 July. Thanks to the start of the Hokuriku Shinkansen, the Hokuriku area is seeing a rush of shopping mall openings. The Aeon Mall Tonami (city of Tonami) opened on 14 July, and Costco is opening stores on 21 and 22 August in Nonoichi and Imizu, respectively.

Sharp rise in part-time wages a sign of labor shortages

Improved business conditions for manufacturers due to the weaker yen and the opening of the Hokuriku Shinkansen are resulting in firms such as Komatsu and YKK shifting some head office functions to the Hokuriku region. This trend is creating a significant labor shortage in Toyama Prefecture. Combined with the rush of shopping mall openings, the prefecture's job openings-to-applicants ratio is among Japan's top three (1.51 in May). As a result, shopping malls are having serious difficulty in securing staff for openings, and part-time hourly wages are rising to the same level as that in central Tokyo.

Concerns over Toyama City's compact city initiative

Toyama City is moving forward with a compact city initiative that has garnered praise from around the world. In fact, it is the only Japanese city selected for the Rockefeller Foundation's Resilient Cities program. However, Toyama City's outlying area is witnessing a rush in shopping mall openings as mentioned above, while there is no significant progress in concentrating retail facilities near the Toyama Station. Even with Toyama City trying to become a compact city, the initiative will not likely make progress while outlying cities are attracting shopping mall developments.

Prefectural government needs to exercise control

Cities are carrying out various measures to improve their own economic and employment conditions. In Toyama Prefecture, Toyama City is promoting a compact city initiative, while Tonami and Oyabe are attracting shopping malls. These city strategies are contradictory, leading to fierce competition. Normally, we would expect Toyama Prefecture to introduce clear zoning regulations that block the opening of shopping malls in areas where the malls would become an obstacle to Toyama City's compact city initiative.

However, this idea is usually disregarded in Japan. Revitalization is underway in "special zones", where deregulation is only focused on increasing the supply of buildings.

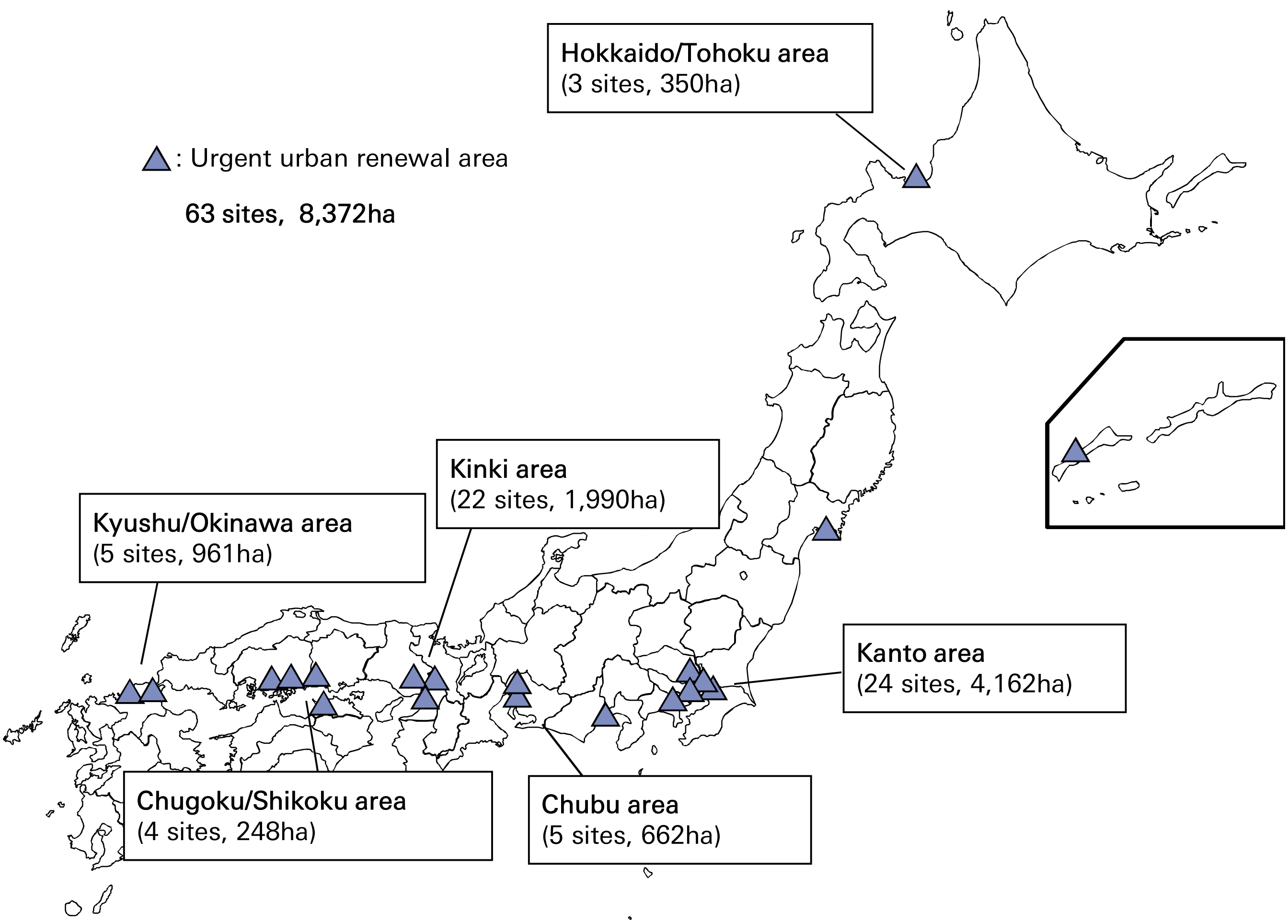
Merits and demerits of the Urban Renewal Special Measures Law

Presently designated "urgent urban renewal areas" are in 63 regions, for 8,372 hectares

Under the Act on Special Measures Concerning Urban Reconstruction, enacted in June 2002, a total of 63 regions, and around 8,372 hectares have been designated as "urgent urban renewal areas" as of July 2015. Areas with this designation have looser restrictions on the floor area ratio, sunlight rights, simplified administrative procedures, and access to interest-free loans from public institutions.

Legal restrictions on factories and other industrial buildings also simultaneously scrapped. Regulations on new factory and university construction had been in place until that time in Tokyo's 23 wards and Mitaka City. The elimination of these controls sparked a reconstruction boom at universities, which built high-rises, leading to the opening of graduate schools in the city center.

Figure 114: Urgent urban renewal areas



Source: Deutsche Securities based on data from Cabinet Secretariat

Due to the Urban Renewal Special Measures Law, the floor area ratios were relaxed in many areas. As a result, older buildings were redeveloped as state-of-the-art buildings and changed to new towns. This may seem like a good policy at first glance. However, relaxing the floor area ratio requirements while the real estate market is weak would only increase supply and exert pressure on real estate prices.

The aim of relaxing floor area ratio requirements has traditionally been to promote redevelopment in areas dense in wood frame buildings so that fire trucks can pass through if there is a fire. In addition, such measures should be limited to areas where supply cannot meet demand. We believe that it is a fallacy to believe that deregulation will naturally set the economy off in the right direction and revitalize business. Moreover, if such a policy is implemented under deflation, we expect a miserable fate such as the one that befell the taxi industry.

Many people still remember the deregulation of taxi businesses under the Koizumi government. In cities such as London and New York, the number of taxi cabs is controlled. However, Japan removed its controls based on the idea that "deregulation is good". What happened was the exact opposite of the intended contribution to economic development: 1) the incomes of taxi drivers dropped; 2) traffic jams occurred; and 3) the average age of taxi drivers increased, as did traffic accidents.

National Strategic Special Economic Zones contain office rent rate

We expect a negative impact on the property market in the medium-to-long term

Regarding National Strategic Special Economic Zones, which the Abe administration is promoting, we see no impact on the property market in the near term; however, we expect a negative impact in the medium-to-long term. We take this view because floor area ratios are the centerpiece of deregulation.

Figure 115: Outline of National Strategic Special Economic Zones and measures of deregulation for urban revitalization and town development

National Strategic Special Economic Zones

National Strategic Special Economic Zones are special zones intended to break through the so-called bedrock regulations during a designated period of concentrated reform, which extends through FY15. Their establishment serves to comprehensively and thoroughly promote measures to strengthen the international competitiveness of Japanese industry and create bases for international economic activity.

National Strategic Zones designated to date

1. Tokyo area (Chiyoda-ku, Chuo-ku, Minato-ku, Shinjuku-ku, Bunkyo-ku, Koto-ku, Shinagawa-ku, Ota-ku, and Shibuya ku in Tokyo, Kanagawa Prefecture and Narita City, Chiba Prefecture)
2. Kansai area (Osaka Prefecture, Hyogo Prefecture, and Kyoto Prefecture)
3. Niigata City, Niigata Prefecture
4. Yabu City, Hyogo Prefecture
5. Fukuoka City, Fukuoka Prefecture
6. Okinawa Prefecture

Deregulation categories that may apply to National Strategic Special Economic Zones

National Strategic Special Economic Zones may engage in businesses subject to deregulation categories outlined below.
Based on proposals submitted at National Strategic Special Economic Zone Meetings and collected nationwide, further deregulation categories will be added going forward.

■Measures of deregulations on urban revitalization and town development
- Review of floor area ratio and land use regulations ⇒ creating urban environment including homes
- Exceptions to Road Law related to area management ⇒ enhancing appeal of urban areas through use of road space
- Exemption from Hotel Business Law for accommodation ⇒ responding to foreigners' accommodation needs

Other deregulation areas

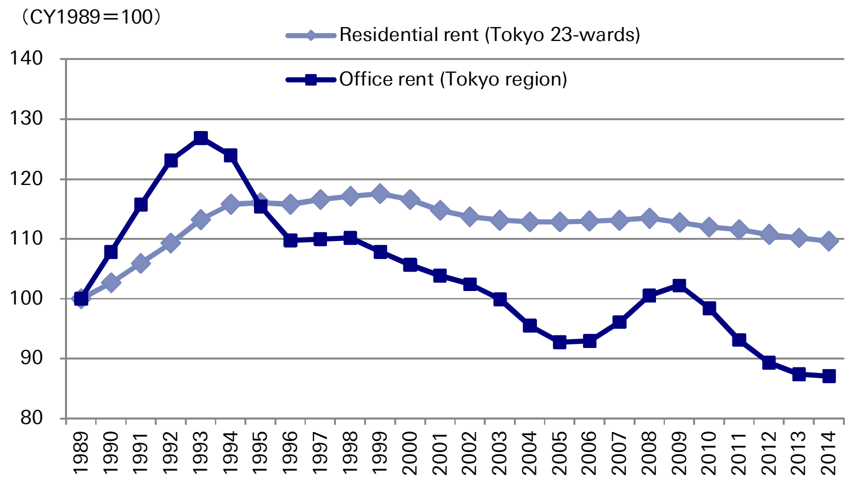
■Improving business environment	■Use of foreign workers
■Employment	■Agriculture, forestry, and fisheries
■Medical	■Education
■Use of historic structures	■Nursery schools

Source: Deutsche Securities based on Cabinet Secretariat's homepage

Competition among districts depresses office rents

As we mentioned, the deregulation of floor area ratios due to a series of approvals of special zones since the Urban Renewal Special Measures Law of 2002 has led to a steady supply of large-scale buildings, and competition among districts has already intensified. We believe this depresses office rents, and makes it difficult for rents to rise even in phases of economic recovery. In fact, office rent has been declining, while residential rent has been stable (Figure 116).

Figure 116: Residential rent and office rent



Source: Statistics Bureau, Ministry of Internal Affairs and Communications "Consumer Price Index", Bank of Japan "Corporate Service Price Index"

National Strategic Special Economic Zones will favor real estate majors

Nevertheless, the government is trying to increase supply by setting up the National Strategic Special Economic Zones. Therefore, continued increase in supply means that we cannot expect average rent rate to increase. As a result, real estate companies will grow only by increasing assets. We believe the National Strategic Special Economic Zones will be negative to the Japanese real estate market as a whole, but it will favor real estate majors with strong balance sheets.

Otemachi-Marunouchi

Is there a Marunouchi premium?

Marunouchi is currently Japan's premier business district. However, the so-called "Marunouchi premium" for rents has contracted considerably since the bubble economy of the early 1990s. We believe that this is the result of the implementation of the Urban Renewal Special Measures Law in June 2002 which we mentioned earlier. This sparked redevelopment activity in many areas, increasing the number of business districts in Tokyo and intensifying competition between them. We regard this as a prime example of how deregulation can, by increasing supply, reduce "excess profit".

The location of foreign financial institutions is testament to these changes. In the past, most were located in the Marunouchi-Otemachi area, but now they are scattered throughout Tokyo, with Goldman Sachs and Barclays in Roppongi Hills and Deutsche Bank in Akasaka, for example.

National strategic districts will reduce "excess profit" of Marunouchi further

National strategic districts, a key feature of Abenomics' "third arrow," are about to be launched. We believe this will increase development and supply in lesser-known business districts. A typical example is the completion of Toranomon Hills, a large building comparable with Roppongi Hills. The Toranomon Hills' site was formerly an area occupied by an assortment of small, old properties. The developer raised the value of the area by gathering those small lots and constructing a single, huge building.

Although the value of newer business districts will increase, relative values in areas such as Marunouchi, an established business district, are decreasing.

Competition among districts is already intense, and looks set to become yet more severe with the establishment of new special zones under Abenomics

Marunouchi's role as a business district is set to change

We also believe that the completion of the Linear Chuo Shinkansen (the operation is scheduled to start in 2027) will change Marunouchi's role as a business district. Once the Linear Chuo Shinkansen is completed, the Shinagawa Station will likely have the best access to transportation since it will connect directly, without any transfers, to Narita Airport, Haneda Airport, Nagoya, and Osaka. Also, we believe the further internationalization of Haneda Airport will cement Shinagawa's status as Japan's new premier business district. Specifically, transportation-wise, Haneda Airport is located only 20 kilometers from central Tokyo. This compares favorably with JFK Airport and Heathrow Airport, which are located 24 kilometers from New York City and central London, respectively.

Marunouchi already changing

Marunouchi as a center of creativity

If Marunouchi loses its role as a pure business district, what sort of area will it likely turn into? We believe Marunouchi will survive by becoming a "creator's town" like Shibuya.

We believe Marunouchi will lose its status as Japan's premier business district, but can transform into a lively center of creativity with a large residential population. In fact, the Marunouchi area is already a convenient place to live. Tokyo Station and public transportation around Otemachi provide excellent access to all areas of Tokyo. And recently, the area has hosted more shopping facilities. Moreover, the area has a hospital (St. Luke International Hospital) in Otemachi Financial City, the "Otemachi Second Redevelopment Project" spearheaded by Mitsubishi Estate.

Japanese-style hotels and serviced apartments to be built in Marunouchi

A traditional Japanese inn where people can enjoy a natural spa is also to be built in Marunouchi. Hoshino Resort, known for its ability to revamp regional inns, will come to Otemachi and to open a Japanese inn, named Hoshinoya Tokyo, in 2016. The inn is to be Hoshino's first facility in central Tokyo. The inn will have 84 purely Japanese-style rooms from 45m^2 to 80m^2 and Japanese restaurants, providing truly Japanese-style service in the center of Tokyo. The average room rate is planned to be around ¥55,000.

Serviced apartments, part hotel and part apartment, will also be built for longer-term business travelers. These will be included in the Otemon Tower JX Building (former "Building A, Otemachi 1-1 Project") and the Otemachi Park Building (former "Building B, Otemachi 1-1 Project"). The Otemachi Park Building will offer 120 serviced apartments. Slowly but surely, Marunouchi will transform into a place not just to work but to live.

Marunouchi also needs regular apartments and condominiums

Besides hotels and serviced apartments, we believe that Marunouchi also needs regular apartments and condominiums. Put more bluntly, as the center of business activity in Tokyo shifts to the Shinagawa area, Marunouchi will no longer be able to survive as a business district alone. This means that office buildings in the Marunouchi area will no longer be able to charge relatively high rents. For this reason, Marunouchi will need to transform from a business district to a "creator's town" where young people gather.

Office centers are not permanent but change with the times

Office centers are not permanent but change with the times. Historically, the center of business activity in Tokyo has shifted from Asakusa to Nihonbashi and Ginza, and then to Marunouchi. So it should not come as a surprise that Shinagawa likely will become the center of business activity in the near future. Towns, like living creatures, must evolve with the times.

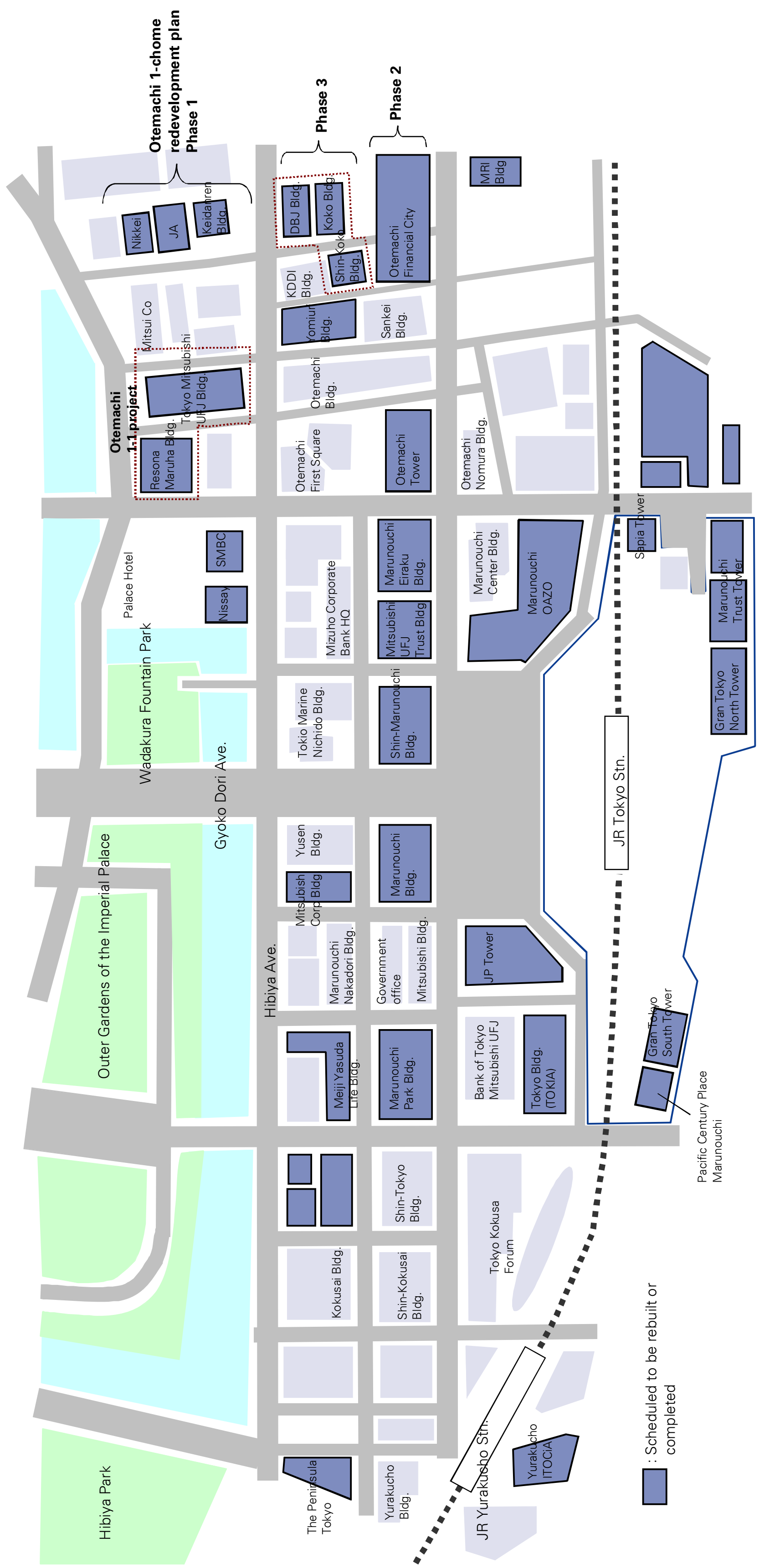
Marunouchi only developed as a business district after the Tokyo Station was built. The development of the Tokyo Station turned Marunouchi, which formerly consisted of rice fields, into the business district it is today. Now, a similar change promises to transform Shinagawa. It is only natural that the Shinagawa Station area will become Japan's premier business district after the Linear Chuo Shinkansen opens, as this will significantly improve access to Nagoya, Osaka, Haneda Airport, and Narita Airport. The decision to have the Linear Chuo Shinkansen start from the Shinagawa Station – not the Tokyo Station – basically sealed Marunouchi's fall from the status of Japan's premier business district while at the same time guaranteeing Shinagawa Station's ascension.

Figure 117: Major redevelopment projects in Marunouchi, Otemachi and Yurakucho areas

Project name	Completion	Developer	Outline	Use application	Comments
Pacific Century Place Marunouchi	Nov-01	Japan Pacific Century Group, JR East	32 fl. above ground, 4 fl. below Floor space of 81,752m2	Office, Shops, Hotel	Purchased 0.5ha of the site disposed by The Japan National Railwa Co-developed with JR East which owns adjoining site.
Marunouchi Building (renewal)	Aug-02	Mitsubishi Estate, Mitsubishi Corp	37 fl. above ground, 4 fl. below Floor space of 160,000m2	Office, Shops, Hotel	Scrap & build of Marunouchi Building.. Marunouchi 2-chome desig a special zone (Same special zone as Mitsubishi Corp HQ Building)
Sankei Building	Sep-02	Sankei Building	31fl. above ground, 4 fl. below Floor space of 83,260m2	Office, Shops, Hall	Overall design
Marunouchi Chuo Building	Feb-03	JR Tokai	14 fl. above ground, 3 fl. below Floor space of 36,000m2	Office	First floor is used as concourse to Tokyo station Nihonbashi entran
Nihon Kogyo Club Kaikan Mitsubishi Trust Banking HQ Building	Mar-03	Mitsubishi Estate, Japan Industry Club	30 fl. above ground, 4 fl. below Floor space of 109,830m2 (total)	Office, Shops	Important cultural property, falling under the Marunouchi 1-chome special zone. Demolition and replacement of Eiraku Building.
Marunouchi 1-chome Yaesu project (Marunouchi Trust Tower N Tower)	Sep-03	Mori Trust	19 fl. above ground, 4 fl. below Floor space of 65 195,m2	Office, Shops	Purchased 1.2ha of the site disposed by The Japan National Railwa Overall design
Meiji Life Building area	Aug-04	Meiji Life	30 fl. above ground, 4 fl. below Floor space of 182,000m2	Office, Shops	Important cultural property, falling under the Marunouchi 2-chome special zone.
Marunouchi 1-chome the first area development plan (Marunouchi Oazo)	Sep-04	Mitsubishi Estate, Marunouchi Hotel, Nippon Life Insurance, Chuo Fudosan, Asahi Life	Nissay Building 28 fl. above ground, 4 fl. below Marunouchi Kitaguchi Building 29 fl. above ground, 4 fl. below Floor space of 66,000m2	Office, Shops, Hotel	Overall design Application of Rentan design system (file 2.10), which takes into account floor space to available land site, degree of light blockage, and other factors.
Tokyo Building (TOKIA) (renewal)	Jan-05	Mitsubishi Estate, JR East, Bank of Tokyo Mitsubishi UFJ	33 fl. above ground, 4 fl. below Floor space of 150,000m2	Office, Shops	Overall design. First case for the application of special plot ratio. Application of Rentan design system, file 2.10
Mitsubishi Corp Marunouchi HQ office	Mar-06	Mitsubishi Corporation	20 fl. above ground, 3 fl. below Floor space of 61,000m2	Office	Scrap & build of Mitsubishi Corp building.. Marunouchi 2-chome designated a special zone (Same special zone as Marunouchi Buildi
JR East Tokyo station Nihonbashi Exit (Sapia Tower)	Mar-07	JR East group	35 fl. above ground, 4 fl. below Floor space of 79,000m2	Office, Shops, Hotel, Parking	—
Shin-Marunouchi Building (renewal)	Apr-07	Mitsubishi Estate	38 fl. above ground, 4 fl. below Floor space of 195,000m2	Office, Shops, Parking	Scrap & build of Shin-Marunouchi Building Final plan of Marunouchi redevelopment plan 1st stage.
The Peninsula Tokyo (hotel)	May-07	Mitsubishi Estate, The Hong Kong and Shanghai Hotels Ltd.	24 fl. above ground, 4 fl. below Floor space of 59,500m2	Hotel	Center for cultural use, such as facilities for educational exchange.
Yurakucho 1-chome urban area redevelopment plan	Oct-07	Yurakucho redevelopment union	21 fl. above ground, 4 fl. below Floor space of 76,000m2	Shop, Office	Town redevelopment project. Main tenant: Marui
Marunouchi 1-chome Yaesu project (Marunouchi Trust Tower Main Tower)	Dec-08	Mori trust	37 fl. above ground, 4 fl. below Floor space of 115,000m2	Office, Shops, Hotel, Parking	Purchased 1.2ha of the site disposed by The Japan National Railwa Overall design
Marunouchi Park Building	Apr-09	Mitsubishi Estate	34 fl. above ground, 4 fl. below Floor space of 205,000m2	Office, Shops, Museum	Restore Mitsubishi No.1 building and set out leafy open space. Utili the unused plot ratio of Tokyo station, Marunouchi station house.
Gran Tokyo North Tower	Jan-07	JR East, Mitsui Fudosan、Kokusai Kanko Kaikan	43 fl. above ground, 4 fl. below Floor space of 171,000m2	Office, Shops	Tokyo station area redevelopment project: Tokyo Station City
Gran Tokyo South Tower	Nov-07	Nippon Oil, JR East, Kajima Yaesu Development	42 fl. above ground, 4 fl. below Floor space of 140,000m2	Office, Shops	Tokyo station area redevelopment project: Tokyo Station City
Otemachi area redevelopment plan phase 1	Apr-09	Mitsubishi Estate, NTT Urban Development, Tokyo Tatemono, Sankei Building	37 fl. above ground, 3 fl. below Floor space of 240,000m2	Office, Shops, Conference Hall	Building service includes international conference hall, multi purpose hall, shops, parking lots. Environment-conscious building which has urban garden.
SMBC HQ Building (JFE Building renewal)	Jul-10	Mitsui Fudosan	23 fl. above ground, 4 fl. below Floor space of 80,047m2	Office, Shops	
Marunouchi Eiraku Building (Marunouchi 1-4 Project)	Jan-12	Mitsubishi Estate, Sumitomo TB, Tokyo Mitsubishi UFJ Bank	27 fl. above ground, 4 fl. below Floor space of 139,800m2	Office, Shops	Special plot ratio applicable area
Palace Building	Jan-12	Palace Hotel	23 fl. above ground, 4 fl. below Floor space of 140,000m2	Office, Shops	
JP Tower (Tokyo Central Post Office renewal)	May-12	Japan Post Holdings Mitsubishi Estate	38 fl. above ground, 4 fl. below Floor space of 212,000m2	Office, Shops, Conference Hall	Special zone for urban regeneration, application of special plot ratio
Otemachi Financial City (Otemachi 1-chome No.2 area redevelopment plan)	Sep-12	UR, Mitsubishi Estate	A: 31 fl. above ground, 4 fl. below B: 35 fl. above ground, 4 fl. below Floor space of 242,000m2	Office, Shops, Medical facility	
Otemachi Tower (Otemachi 1-6 development plan) (Mizuho Bank, Otemachi Financial Center renewal)	2014	Tokyo Tatemono, Taisei	38 fl. above ground, 6 fl. below Floor space of 200,000m2	Office, Shops, Hotel	Urgent urban renewal area, real forest
Otemachi 1-1 project					
Otemon Tower JX Building (Resona Maruha Bldg. renewal)	FY2015	Mitsubishi Estate, JX Holdings	22 fl. above ground, 5 fl. below	Office, Shops	Special zone for urban regeneration Disaster-prevention facility
Otemachi Park Building (the Bank of Tokyo-Mitsubishi UFJ Bldg. renewal)	FY2016	Mitsubishi Estate	29 fl. above ground, 5 fl. below Floor space of 149,000m2	Office, Shops Service apartment	
Otemachi B-2 project			Floor space of 205,000m2		
A Tower	FY2016	Mitsubishi Estate	31 fl. above ground, 4 fl. below	Office, Shops	land readjustment project, urban redevelopment project
B Tower			18 fl. above ground, 3 fl. below	Hotel	
Fuji Building Block (Marunouchi 3-2 Project)	FY2017	Mitsubishi Estate, The Tokyo Chamber of Commerce and Industry, Tokyo Kaikan	Floor space of 172,000m2 29 fl. above ground, 4 fl. below	Office, Shops, Hall	
Tokiwabashi Area Redevelopment	TBA	Mitsubishi Estate	TBA		(Construction starts after Nihon Building closes in Mar 2016.)

Source: Company, various public information, Deutsche Securities

Figure 118: Major redevelopment projects in the Marunouchi, Otemachi and Yurakucho areas



Source: Deutsche Securities based on data by Mitsubishi Estate

Nihonbashi

The townscape of the Nihonbashi area has been changing steadily. In 2004, Coredo Nihonbashi was built on the site previously occupied by the Tokyu Department Store. This was followed by the Nihonbashi Mitsui Tower, which was completed in the following year. The name "Coredo" combines two words: "core" and "Edo". This reflects the idea that the structure, while preserving the history and culture of old Edo, will also become the hub of the modern city. The Nihonbashi Mitsui Tower has preserved the historical Mitsui Honkan (Main) Building, a designated Important Cultural Property. As a result, the Nihonbashi Mitsui Tower development has received add-on plot ratio of 500%, and the structure includes the flagship store of the famous fruit store Sembikiya.

Muromachi Chibagin Mitsui Building and Muromachi Furukawa Mitsui Building have already opened

The redevelopment of this area is essentially a part of the Nihonbashi East Muromachi District Development Project, which covers five areas over a total site area of 11,900m^2. Operations first began with the opening of the Nihonbashi Nomura Building and the Coredo Muromachi in 2010. Shinsei Bank has already moved its head office into the Nihonbashi Nomura Building. Block numbers 1-5 (Muromachi Chibagin Mitsui Building) and 2-3 (Muromachi Furukawa Mitsui Building) have already opened, and 2-5 (Mitsui No. 5 Annex) has also been completed.

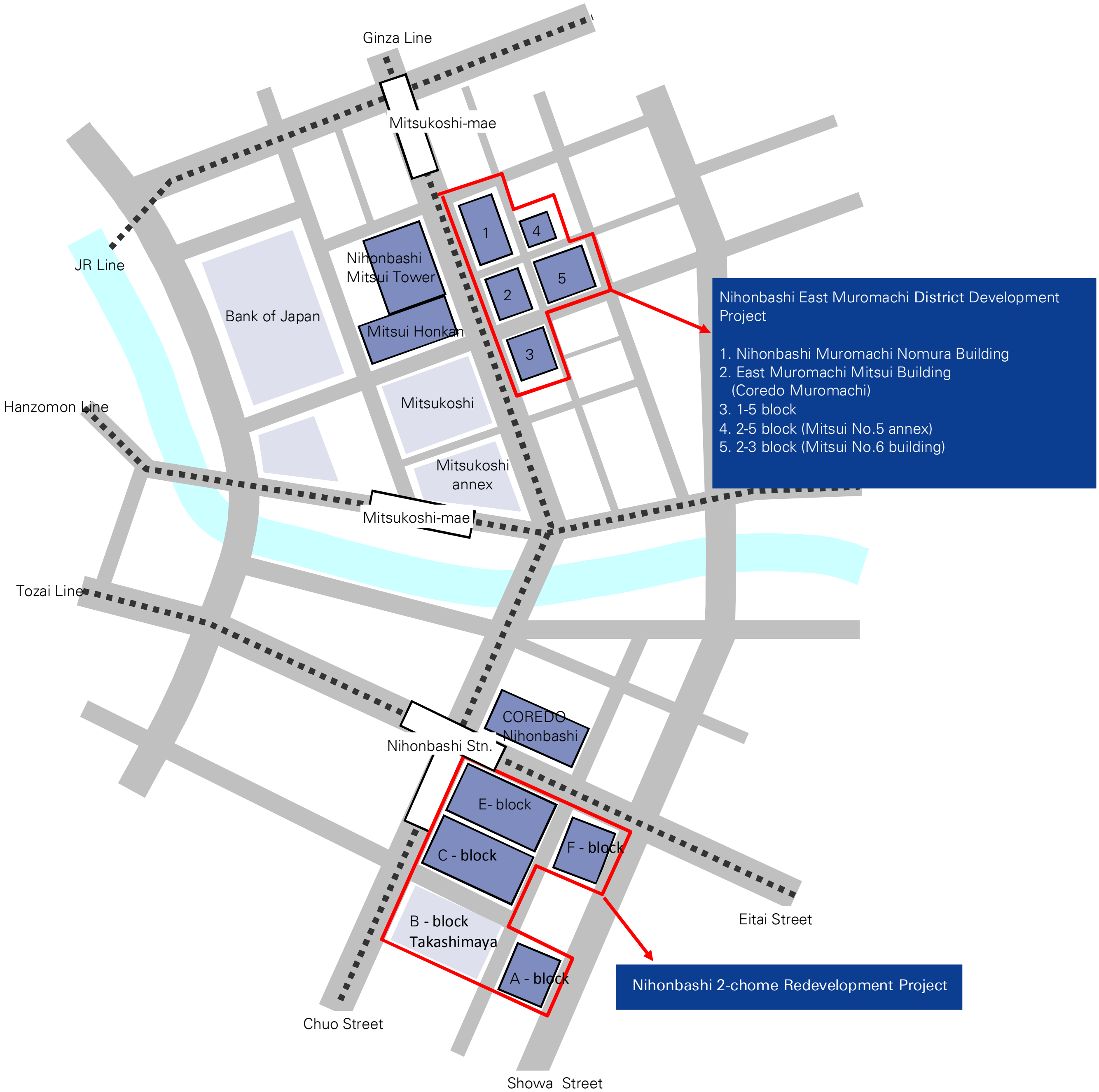
According to Mitsui Fudosan, which is developing and managing this area, the initiative is based on the concept of "preserving and revitalizing the past, while creating the future". It plans streets that exude the essence of the Edo era alongside office, retail, and residential areas, as well as sites providing information on local entertainment culture. The final objective is to again offer a glimpse of the Nihonbashi that played such an active role in Japanese life during the Edo period.

Figure 119: Development projects in Nihonbashi area

Building/project name	Completion	Developer	Number of floors Total floor space (m^2)	Use application	Feature
Marunouchi Chuo Building	Feb-03	JR Tokai	14 fl. above ground 36,000m^2	Office, Tokyo station concourse	First floor section is used as Nihonbashi concourse of Tokyo Stn.
Marunouchi 1-chome Yaesu Project I	Sep-03	Mori Trust	19 fl. above ground 65,800m^2	Office, hotel, residence	Site of former Japanese National Railways Developed by Mori Trust
Coredo Nihonbashi	Jan-04	Mitsui Fudosan, Tokyu Corp, Tokyu Land	20 fl. above ground 98,300m^2	Office, commercial facility	Site of former Tokyu department store
Muromachi Mitsui New Building plan (Nihonbashi Mitsui Tower)	Jul-05	Mitsui Fudosan, Senbikiya	39 fl. above ground 133,855m^2	Office, hotel, commercial facility	Specially designed cultural zone Mandarin Oriental Hotel is principal tenant
Mitsukoshi Honten Annex plan	Jan-04	Mitsukoshi, Niko Ichikoshi, Tsuzureya	13 fl. above ground 51,022m^2	Commercial facility	Preservation of main building
Nihonbashi East Muromachi District Development Project	2014		180,000m^2		
((Nomura Real Estate)) Nihonbashi Muromachi Nomura B	Sep-10	Nomura Real Estate	21 fl. above ground 46,421m^2	Office, commercial facility	Underground evacuation space
((Mitsui Fudosan)) East Muromachi Mitsui Building (Coredo Muromachi)	Oct-10	Mitsui Fudosan	22 fl. above ground 41,000m^2	Office, commercial facility, Multipurpose hall	Special plot ratio applicable area (1300%) Special height limit applicable (125m)
Block 1-5 Muromachi Chibagin Mitsui Building	Dec-13	Mitsui Fudosan, Chiba Bank	17 fl. above ground 30,000m^2	Office, commercial facility	
Block 2-3 (Mitsui No.6 building) Muromachi Furukawa Mitsui Building	Jan-14	Mitsui Fudosan, Furukawa Co., Ninben and others	22 63,000m^2	Office, residence, commercial facility, cinema complex,	
Block 2-5 (Mitsui No.5 annex)	Jun-14	Mitsui Fudosan	3 fl. above ground 1,100m^2	Shrine, warehouse commercial facility,	
Nihonbashi 2-chome Redevelopment Project	2018		420,000m^2		
Block A	FY2018	Mitsui Fudosan	29 fl. above ground 59,000m^2	Office	A total of 5,300m^2 of green space is planned for the grounds and the roof, to mitigate the heat island phenomenon.
Block C	FY2018	Mitsui Fudosan	35 fl. above ground 144,000m^2	Office, commercial facility	The DHC (central heat source) will be placed in Block A, to supply heat to Blocks B and C and reduce CO^2 emissions. Buildings will be equipped with solar panels and will use Low-e glass and LED lighting.
Block E	FY2015	Sumitomo R&D	36 fl. above ground 138,000m^2	Office	

Source: Deutsche Securities based on each company release, various public information

Figure 120: Nihonbashi area



Source: Deutsche Securities based on each company release, various public information

Kyobashi

The appearance of the area bordering the Tokyo Station, Marunouchi, and Yaesu is completely different. While the Marunouchi side of the Tokyo Station is smartly zoned, the Yaesu side presents a totally different picture. The area's somewhat unkempt look may provide a certain charm, but it lacks the beauty needed in an area so close to Japan's landmark train station.

Development of the Kyobashi area bordering Yaesu is getting underway

However, the development of the Kyobashi area bordering Yaesu is getting underway. In fact, the Tokyo Square Garden was opened in 2013. This redevelopment became possible due to Urban Corporation's (the company filed under the Civil Rehabilitation Law in 2008) buying out of all the other stakeholders. The land was bought by Tokyo Tatemono, and jointly developed with Shimizu and others as the Kyobashi 3-1 Project.

Major tire-maker Bridgestone is the main tenant in the Tokyo Square Garden. Bridgestone has leased five floors (20 to 24), which account for about 20% of the total office space in the building.

Also, Mori Trust completed the development of the Kyobashi Trust Tower in 2014. Floors 2-4 are occupied by a hotel (a Marriott brand), and floors 5-21 are for office space. Kubota has leased floors 16-21 as its Tokyo head office.

Figure 121: Development project in Kyobashi and Yaesu areas

Building/project name	Developer	Outline	Use application	Completion
Tokyo Square Garden (Kyobashi 3-1 project)	Tokyo Tatemono, Katakura Industries, Shimizu Jisho, Dai-ichi Life Insurance, J and S Insurance Service	4 floors below ground, 24 floors above ground Floor space: approx. 117,000m^2	Office, Shop, Communication facility, Medical service, Child support facility, Parking	Mar-13
Kyobashi Trust Tower (Kyobashi 2-chome project)	Mori Trust	3 floors below ground, 21 floors above ground Floor space: approx.52,000m^2	Office, Hotel, Shop	Feb-14
Kyobashi 2-chome West development project	Nippon Tochi-Tatemono Co, Tokyo Tatemono, Nikken Sekkei, Shimizu	3 floors below ground, 33 floors above ground Floor space: approx.118,000m^2	Office, Shop, Communal facility	Aug-16
Yaesu 2-chome North project	Mitsui Fudosan	Total floor space: approx. 293,600m^2	Office, Hotel, Shop, Bus terminals	FY2021
Block A-1		45 floors/ 4 floors (below ground)		
Block A-2		10 floors/ 4 floors (below ground)		
Yaesu 1-chome East project	Tokyo Tatemono	Total floor space: approx. 240,000m^2	Office, Shop, Bus terminals, Hall Medical service	Mar-24
Block A		11 floors/ 3 floors (below ground)		
Block B		54 floors/ 4 floors (below ground)		

Source: Deutsche Securities based on each company release, various public information

Many live in the bay area

We believe the Yaesu and Kyobashi areas could reap the greatest benefits after the 2020 Tokyo Olympics. The reason the Tokyo Olympics will change the real estate market is simply that many people will live in the bay area.

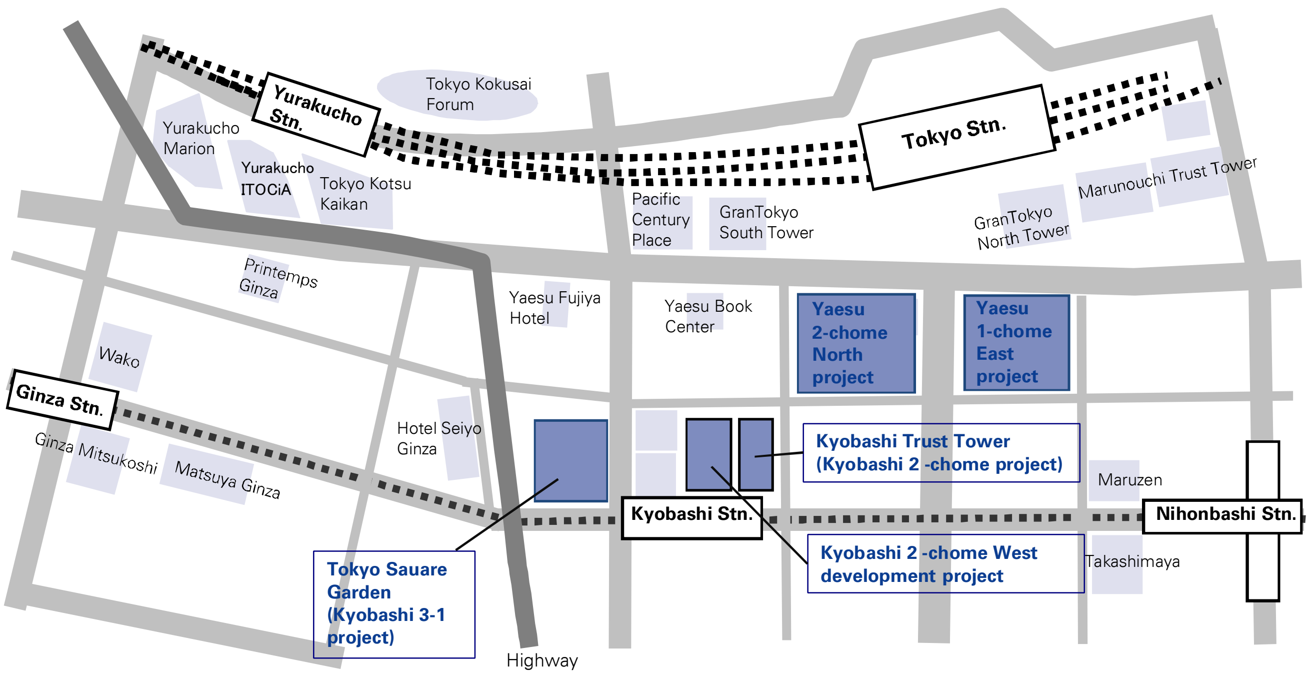
Many condos have been already built in the bay area. In addition, the Olympic Village will be up for general sale after the Olympics. In short, we see the massive purchasing power of those living in the bay area flowing into Ginza, Kyobashi, Nihonbashi and Yaesu, transforming the region into a huge commercial area.

The Yoyogi National Gymnasium, the event arena for the previous Olympics (1964), had triggered the development of Shibuya after the Olympics. After the 2020 Olympics, 11 arenas are planned to be permanent facilities. Young people are also likely to congregate in the bay area as many events would be held there.

We believe the residential bay area will be supported by the commercial areas of Kyobashi, Yaesu, Nihonbashi, and Ginza after the Tokyo Olympics.

Mitsui Fudosan and Tokyo Tatemono to invest ¥600bn to redevelopment of Yaesu area

Figure 122: Kyobashi and Yaesu areas



Source: Deutsche Securities based on each company release, various public information

Ginza

The Ginza has changed with the times and the changes show very well the nuances of each particular period. While this may seem altogether normal in the current age, at one time it was impossible to imagine the presence of fast-fashion labels such as Uniqlo in an area such as the Ginza. Over time, the district has become the home to a diverse range of retail establishments, ranging from premium brands to old-established stores, karaoke bars and stand-and-drink pubs.

The building that houses the Ginza Chanel store was previously owned by the supermarket Daiei

An interesting fact about the Ginza is that premium brands have entered the district by purchasing buildings rather than leasing them. For example, the building where Chanel has its store was previously owned by the supermarket Daiei. The financial crisis that saw the bankruptcy of financial institutions such as Yamaichi Securities also triggered a spate of building sales in the Ginza, which were then purchased by companies known for their premium luxury brands such as Chanel. Although the more obvious reason for this surge of purchases may seem to lie in the owners' urgency to sell, the other factor is that premium brands had so far not been able to open stores freely in the market. Premium luxury brands must completely re-do interiors to reflect their brand identity. From the point of view of property owners, this made for an unattractive option since it involved considerable time and costs (to restore the property to its original condition) once the tenant departed. As a result premium brands, which were constrained in their efforts to operate in their ideal retail store environment, opted then to purchase properties.

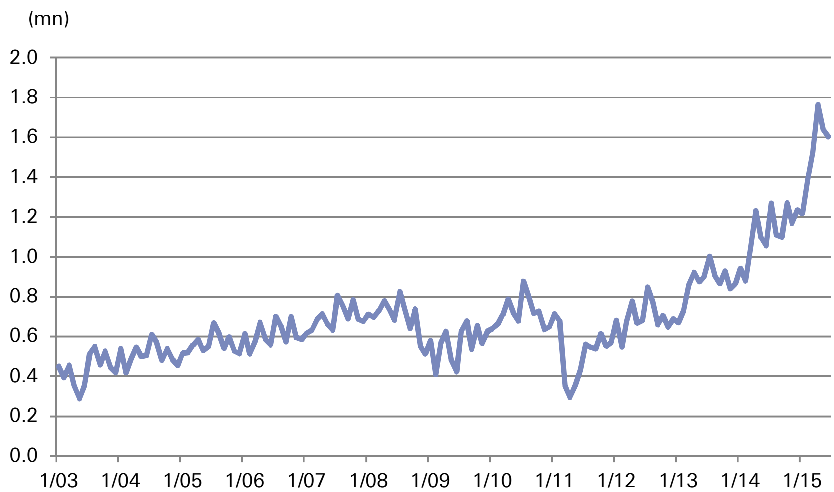
The JR Yurakucho station, which created easy access to Ginza, also contributed to changing the landscape of the district. The start of operations at the Yurakucho ITOCiA complex in 2007 and the sprucing up of the station area went a long way toward improving access to Ginza. However, this did not lead to a happy end on all fronts. One example is the closing of the Seibu Department Store in 2010. Seibu was the main tenant of Yurakucho Marion. It began operations in 1984 and was the benchmark for bustling and stylish department stores during the bubble years.

As a business model, department stores work best when customers favor a more uniform and conventional buying pattern. However, consumer needs are shifting to more segmented retailing, and niche silos of retailers. Thus, for Seibu there was no particular reason to continue operations in the Ginza, especially since it is not even a key store. The Lumine chain has opened a store in Seibu’s former location. Lumine stores are basically directly connected to train stations. In the Ginza, however, Lumine established its first standalone store, away from a station. Matsuzakaya has also closed its Ginza store and plans to open a new facility by 2016.

Binge buying by foreign visitors

Ginza has seen a surge in traffic in recent years, reflecting "inbound" demand. A large number of foreigner tourists mainly from Asia have visited Ginza since around 2014. Their shopping sprees have attracted a lot of attention. Not only department store and specialty store operators, but hotel, restaurant and other businesses have targeted foreign tourists for sales. For example, sales at the Mitsukoshi Ginza store increased 42.7% YoY in April, 33.2% in May and 32.8% in June. Of course, some of this growth was attributable to reactionary gains YoY after sales slumped due the consumption tax hike in April 2014. However, the Mitsukoshi Ginza store's duty-free sales ratio has increased to about 25%, leaving no room for doubt that sales to foreign visitors are having a significant impact.

Figure 123: Number of foreign visitors to Japan

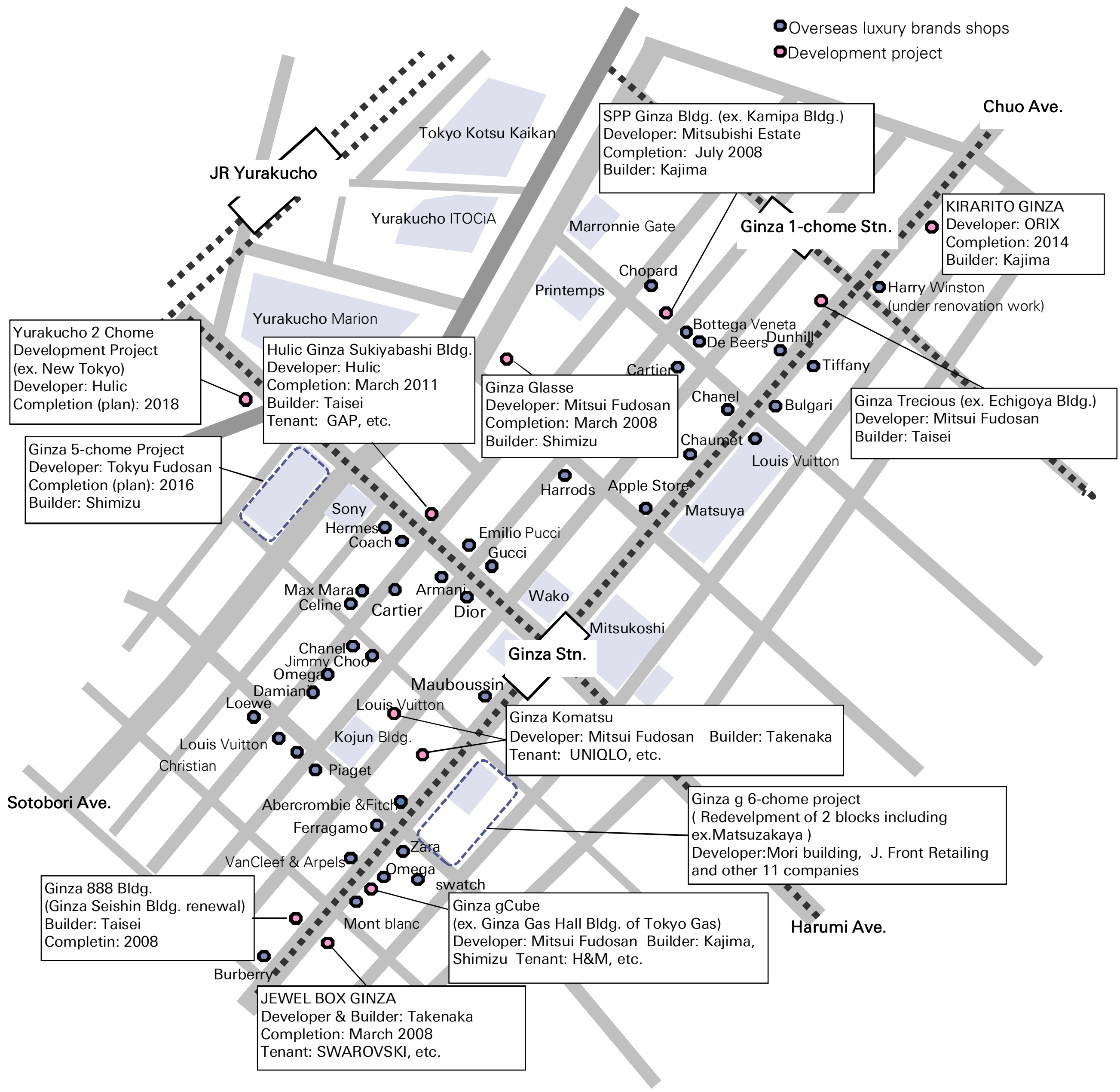


Source: Japan National Tourism Organization 'Number of foreign visitors to Japan'

Two duty-free shops to open in Ginza

In 2015, the Mitsukoshi Ginza store plans to open 3,300m^2 of sales floor space to duty-free goods on its 8th floor. In addition, Lotte Duty Free store will open on the 8th and 9th floors of the Ginza 5-chome Project (tentative name) scheduled to be completed in spring 2016 (developed by Tokyu Land). Ginza's streets are already teeming with foreign tourists. We intend to closely monitor whether or not this trend will continue.

Figure 124: Ginza area: overseas luxury brands opening shops and development projects



Source: Deutsche Securities based on each company release, various public information

Toyosu

Waterfront property related stocks surged in 1988

There was a "waterfront boom" in the area in 1988, when shares of companies that own properties in the Tokyo Bay area surged. Tokyo Bay area maps reportedly sold in huge numbers as speculators sought companies owning land in the area.

In the latter half of the 1980s, when the stock market rose on the "waterfront boom", the investors' hope on the Toyosu area is just a hope. Although the area is located close to central Tokyo, there were no offices or condominiums. The area was entirely populated with shipbuilding facilities and factories. Particularly, after the bursting of the bubble economy, it seemed as though the stock market's vision of Toyosu as a residential area would remain only a dream.

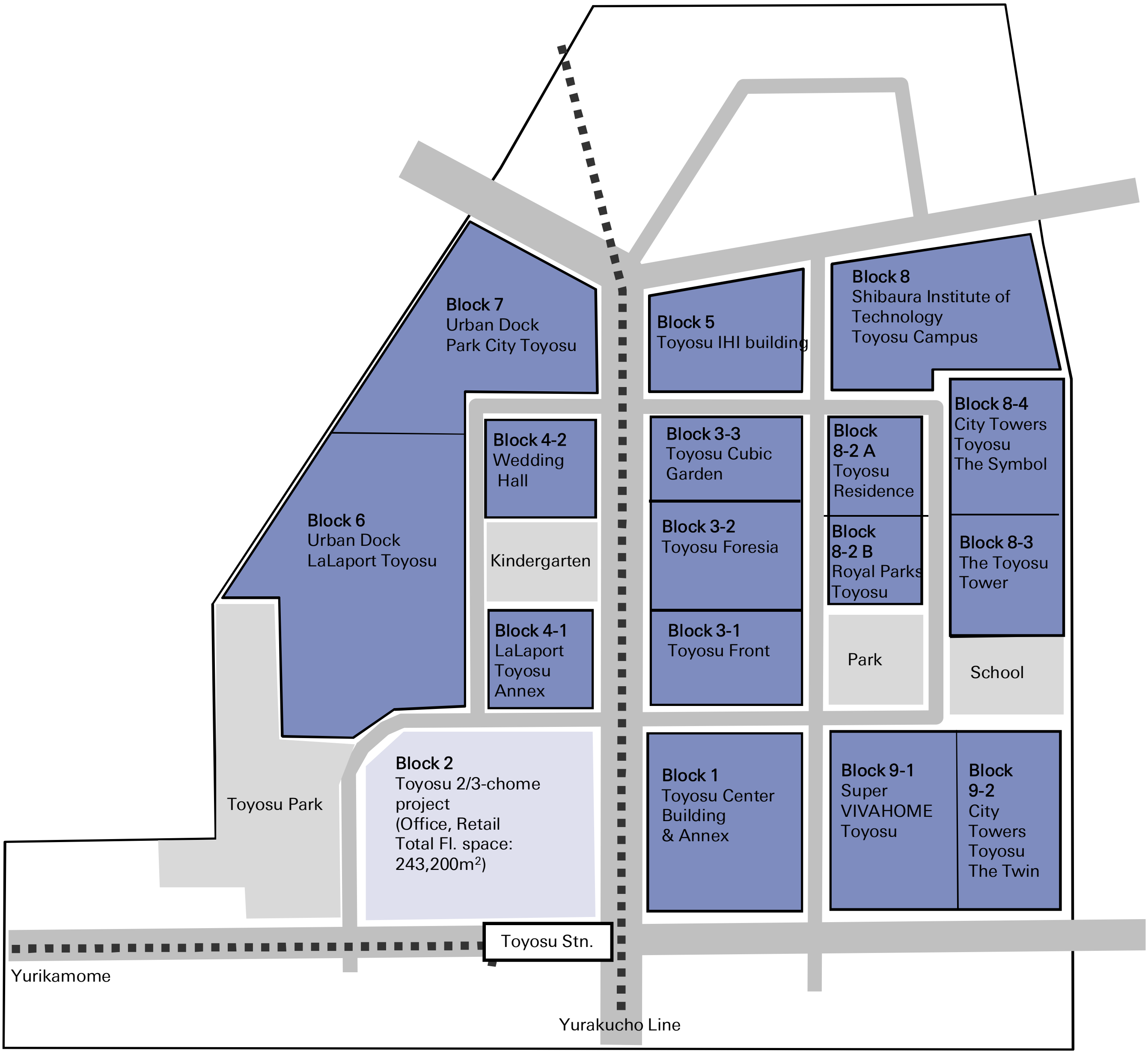
However, this is no longer the case. Toyosu is now home not only to shopping centers and elementary/junior high schools but also to universities, major hospitals, state-of-the-art office buildings, and high-rise condos. The dream that was conceptualized in the bubble era appears to have finally turned into reality.

Opening of Urban Dock LaLaport Toyosu

What truly changed the face of the area was the large-scale shopping center, Urban Dock LaLaport Toyosu, developed by Mitsui Fudosan. One of the key factors that affect sales of condominiums is 'ease of shopping.' In Japan, even a highly-attractive high-rise condo with good access to the city center will not sell if people cannot easily buy for foods and daily products near the residence.

Toyosu has changed drastically in the two decades. Most of the blocks in the area have now been redeveloped. In the remaining block (block number 2), Koto Ward, Mitsui Fudosan and IHI have announced that they will jointly build office buildings with retail facilities.

Figure 125: Toyosu 2-chome and 3-chome



Source: Deutsche Securities based on each company release, various public information

Shiodome

The Shiodome area (Sio-Site) opened for operations in 2003. 31 hectares around the old Shiodome rail freight station was redeveloped as part of the project, and the area is currently home to the head office of companies such as Dentsu, NTV, Toppan Forms and Nippon Express. The project buildings have a daytime population of around 60,000 and residential population of 6,000.

The project buildings have a daytime population of around 60,000 and residential population of 6,000

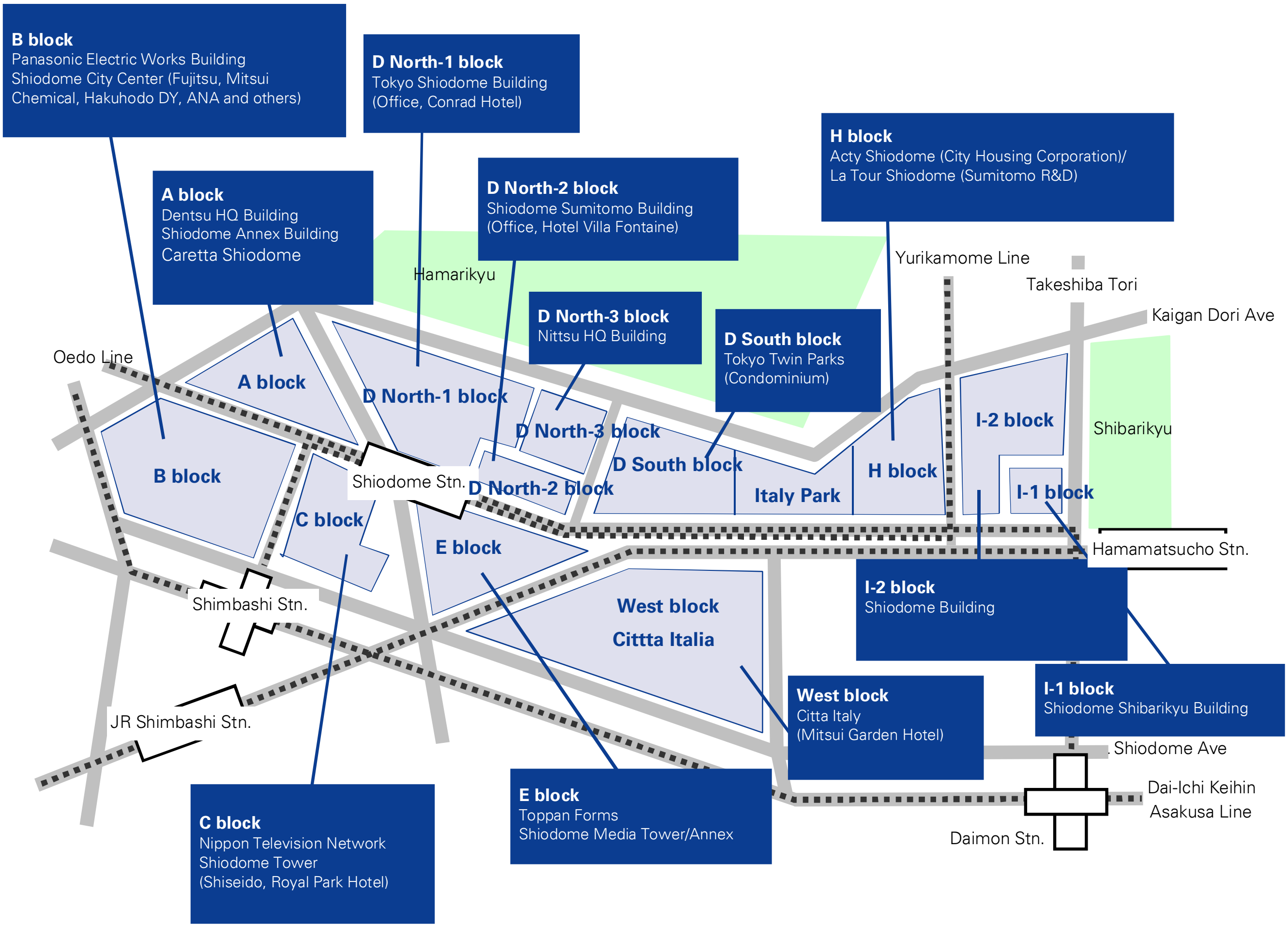
The sale of land in the Shiodome area to private parties started in the latter half of the 1980s, and the project was supposed to be completed in the early 1990s. However, actual start of operations in the area was postponed to 2003. This was because the timing of sale of land in the area was pushed back by the authorities on the assumption that selling land during the peak bubble period would push up real estate prices further.

Figure 126: Development projects in Shiodome area

Area	Block	Building/project name	Outline	Applications other than office
Area 1	A block	Dentsu HQ Building Shiodome Annex Building Caretta Shiodome	HQ building: 5 floors below ground, 48 floors above ground Annex building: 3 floors below ground, 8 floors above ground Floor space of 232,290m2 Construction period: Oct'99-Oct'02	Theater (Shiki)
	B block	Shiodome City Center	4 floors below ground, 43 floors above ground, floor space of 187,745m2 Construction period: Mar'00-Jan'03	
		Panasonic Electric Works Building	4 floors below ground, 24 floors above ground, floor space of 47,308m2 Construction period: Aug'01-Feb'03	
		Ex-Shinbashi restored station	2 floors above ground, floor space of 1,351m2 Construction period: Dec'01-Apr'03	
	C block	Nippon Television Network Tower	4 floors below ground, 32 floors above ground, floor space of 131,468m2 Construction period: Jan'00-Apr'03	
		Shiodome Tower (Shiseido)	4 floors below ground, 38 floors above ground, floor space of 78,800m2 Construction period: Jan'00-Apr'03	Royal Park Hotel Shiodome Tower
Area 2	North-1 block	Tokyo Shiodome building	4 floors below ground, 37 floors above ground, floor space of 192,000m2 Construction period: Oct'02-Jan'05	Conrad Hotel
	North-2 block	Shiodome Sumitomo Building	3 floors below ground, 25 floors above ground, floor space of 99,900m2 Construction period: Mar'02-Jul'04	Villa Fontaine
	North-3 block	Nippon Express HQ Building	4 floors below ground, 28 floors above ground, floor space of 54,214m2 Construction period: Jul'00-Jun'03	
	E block	Toppan Forms HQ Building	1 floor below ground, 19 floors above ground, floor space of 26,656m2 Construction period: Dec'00-Apr'03	
		Shiodome Media Tower	4 floors below ground, 34 floors above ground, floor space of 63,472m2 Construction period: Oct'00-Jun'03	Park Hotel Tokyo
		Shiodome Media Tower Annex	1floor below ground, 8 floors above ground, floor space of 3,016m2 Construction period: Oct'00-Jun'03	
Area 3	D South block	Shiodome Twin Parks	2 floors below ground, 47 floors above ground, floor space of 149,000m2 Construction period: Oct'99-Sep'02	
	H block	Acty Shiodome / La Tour Shiodome	2 floors below ground, 56 floors above ground, floor space of 100,700m2 Construction period: 00-Feb'04	Rental floor space to Sumitomo R&D is approx. 12,000m2, covering floors 45-56, Skelton
Area 4	I-1 block	Shiodome Shibarikyu Building	3 floors below ground, 21floors above ground, floor space of 33,000m2 Construction period: Aug'04-Jun'06	
	I-2 block	Shiodome Building	2 floors below ground, 24 floors above ground, floor space of 118,700m2 Construction period: 2005-Dec'07	Complex building (Office, shop, parking)
		Sky Grande Shiodome (condominium)	2 floors below ground, 22 floors above ground, floor space of 11,700m2 Construction period: 2003-2005	

Source: Deutsche Securities based on each company release, various public information

Figure 127: Shiodome area



Source: Deutsche Securities based on each company release, various public information

Shibuya

Passenger traffic at the Shibuya railway station (JR) had consistently maintained its third-largest position since the economic bubble period, and was believed to be able to retain this position. In FY13, however, the station suddenly dropped to the fifth position. Ironically, the reason for this was the opening of the Fukutoshin Line.

On 16 March 2013, the Fukutoshin Line (Tokyo Metro No. 13) and Tokyu Toyoko Line began to run on the same line, creating a broad railway network that connects Saitama and Yokohama. While the Tokyu Toyoko Line platform was moved to the subterranean level, Hikarie retail facilities were built on the former Tokyu Bunka Kaikan site, thereby creating a new Shibuya.

We had expected that this sharing of railway lines would intensify the competition of the top three stations in terms of passenger traffic, namely, Shinjuku, Ikebukuro, and Shibuya in descending order, and that Shibuya has great growth potential because of the many redevelopment projects being planned there.

Figure 128: Top 10 stations by average daily passenger count (number of people)

Ranking	FY1991		FY2000		FY2010		FY2013		FY2014	
1	Shinjuku	741,422	Shinjuku	753,791	Shinjuku	736,715	Shinjuku	751,018	Shinjuku	748,157
2	Ikebukuro	606,778	Ikebukuro	570,255	Ikebukuro	544,222	Ikebukuro	550,350	Ikebukuro	549,503
3	Shibuya	420,825	Shibuya	428,165	Shibuya	403,277	Tokyo	415,908	Tokyo	418,184
4	Tokyo	418,858	Yokohama	385,023	Yokohama	398,052	Yokohama	406,594	Yokohama	403,905
5	Yokohama	378,262	Tokyo	372,611	Tokyo	381,704	Shibuya	378,539	Shibuya	371,789
6	Shinbashi	235,242	Shinagawa	253,575	Shinagawa	321,711	Shinagawa	335,661	Shinagawa	342,475
7	Takadanobaba	223,990	Shinbashi	230,393	Shinbashi	244,916	Shinbashi	254,945	Shinbashi	253,874
8	Omiya	218,025	Omiya	228,219	Omiya	235,151	Omiya	245,479	Omiya	244,556
9	Ueno	216,593	Takadanobaba	211,761	Akihabara	226,646	Akihabara	240,327	Akihabara	241,063
10	Shinagawa	213,928	Ueno	189,388	Takadanobaba	202,396	Kitasenju	203,428	Kawasaki	204,153

Source: East Japan Railway

However, Shibuya turned out to be a complete disappointment. Indeed, after the Fukutoshin Line and the Tokyu Toyoko Line began sharing the railway, the number of passengers using the Shibuya station declined, whereas traffic at Ikebukuro, Shinjuku 3-chome, and Meiji Jingumae stations has increased. JR East President Tetsuro Tomita also referred to the declining passenger traffic at Shibuya.

The Tokyo Metro Line announced that daily average passenger traffic at the Ikebukuro, Shinjuku 3-chome, and Meiji Jingumae stations increased nearly 40% versus before the commencement of railway sharing on weekdays. And, on holidays, it increased 60% at Ikebukuro, 80% at Shinjuku 3-chome, and 50% at Meiji Jingumae.

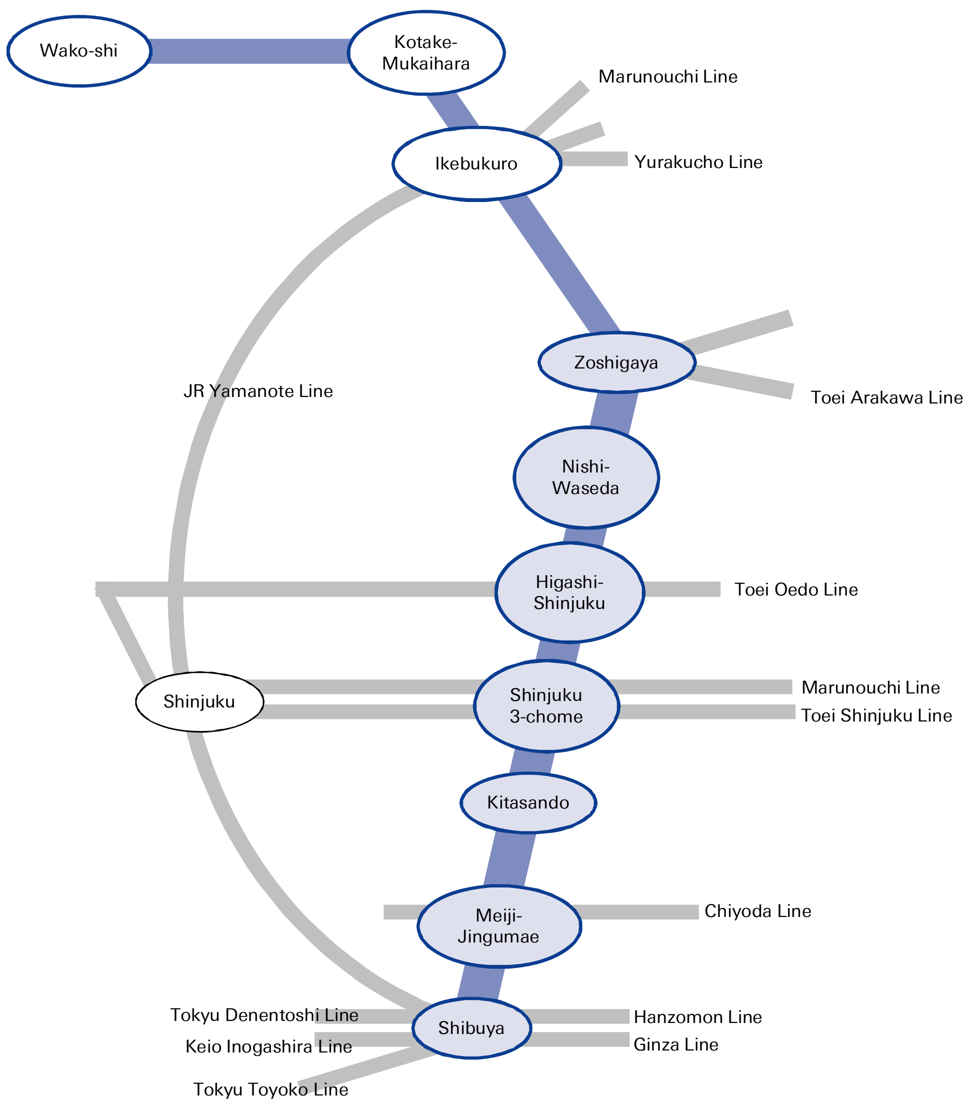
Transfer to JR or Ginza lines has become inconvenient

The reasons for the downfall of Shibuya are obvious. Transfer between the Tokyu Toyoko Line/JR Line and Ginza Line became inconvenient, and passengers are therefore using Shibuya station much less. After the Tokyu Toyoko platform was moved from the second floor to the fifth basement level, access to the JR Line became extremely inconvenient. Furthermore, the Ginza Line was easily accessible when exiting from the main exit of the Tokyu

Toyoko Line and climbing the stairs, such that the transfer took only one to two minutes. Now that the Tokyu Toyoko Line platform moved to the fifth basement level, passengers have to climb seven floors to reach the Ginza Line platform on the third floor.

Moreover, the passageway to all the platforms is so narrow that security guards have to engage in traffic control. The new Shibuya station is no longer a gentle place for children and the elderly, and it should be no surprise if nobody wants to go to Shibuya anymore. Passengers who used to shop at Shibuya's Tokyu Department Store are even going to Shinjuku 3-chome to shop at the Isetan Department Store, even though it takes a longer train ride.

Figure 129: Fukutoshin Line (Tokyo Metro No.13 line)



Source: Tokyo Metro

Three projects: Shibuya Station South Project, Shibuya Station Dogenzaka Development Plan, and Shibuya Station Development Plan

Even under these circumstances, large redevelopment projects are steadily moving forward in Shibuya. On 17 June 2013, the Tokyo Metropolitan Government approved three projects in which five medium-to-high-rise buildings will be built around the Shibuya station. These are the Shibuya Station South project, Shibuya Station Dogenzaka Development Plan, and the Shibuya Station Development Plan.

The project slated to be completed in autumn 2018 is the Shibuya Station South Project which will be led by Tokyu Corporation. A office, hotel, and retail building is to be built where the former Tokyu Toyoko Line Shibuya station used to be. Led by Tokyu Land, the Shibuya Station Dogenzaka Development Plan to rebuild the Tokyu Plaza at Shibuya Station West Exit area is to be completed in FY18. The square around the station is also to be revamped. Lastly, the Shibuya Station Development Plan will be completed: the east tower is to be completed in FY19, followed by the central and west towers in FY27.

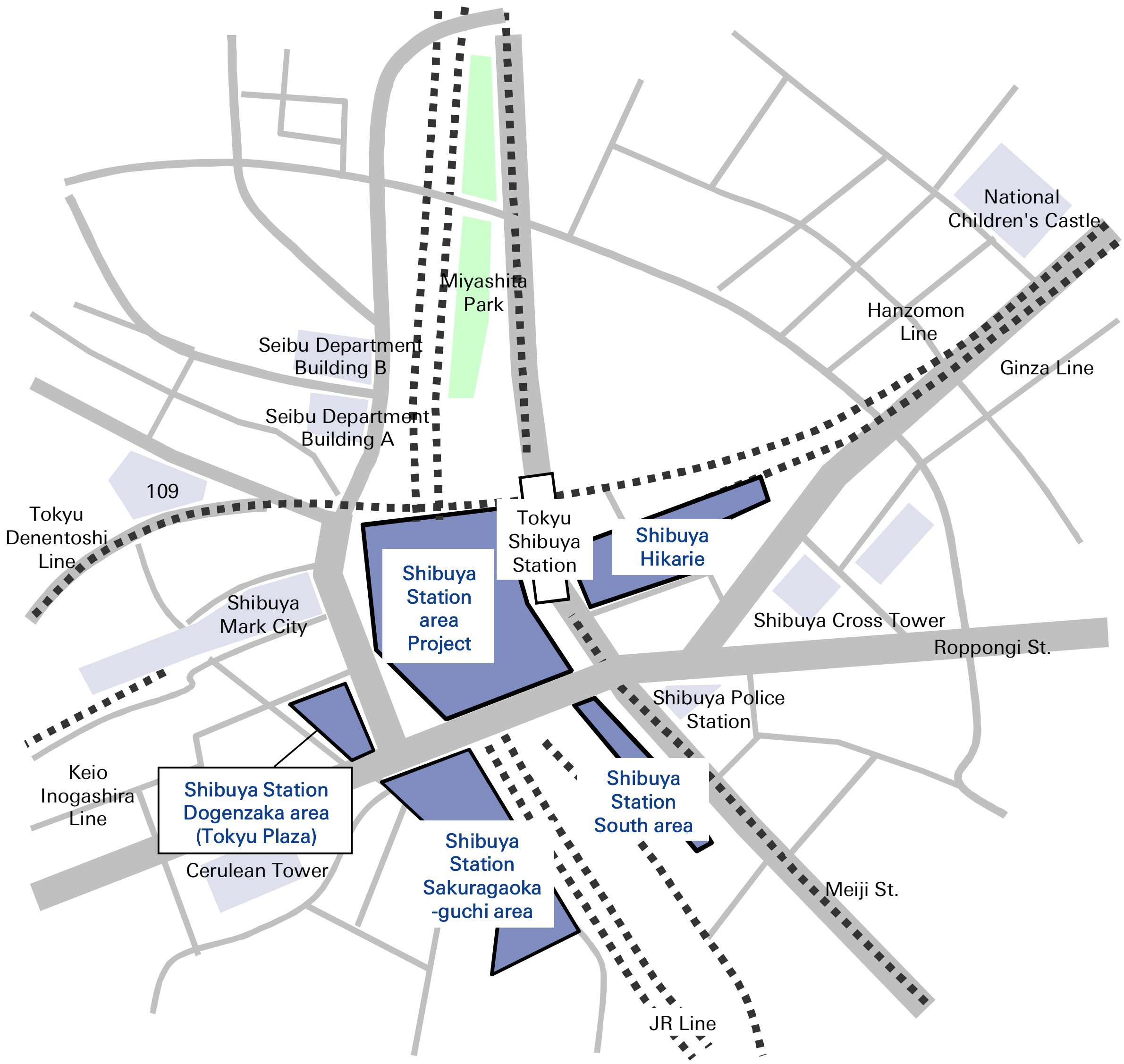
Redevelopment plans around Shibuya station look attractive. But we believe the inconvenience of transfer and the poor railway lines going into the station appear fatal. Unless these problems are addressed in the new redevelopment plans, Shibuya's decline could become permanent.

Figure 130: Major redevelopment project around the Shibuya station

Project	Main developer	Outline	Use application	Completion
Shibuya Hikarie (Shibuya new cultural area development project)	Tokyu Corporation	Site area: 9,640m^2 Floor space area: 144,000m^2 34fl (above ground)/ 4fl (below ground) Height: 182.5m	Office: approx. 50,000m^2 Retail: approx. 32,000m^2 Cultural facility: approx. 24,000m^2 Others	Completed in April 2012
Shibuya station South area	Tokyu Corporation	Site area: 7,100m^2 Floor space area: 116,300m^2 35fl (above ground)/ 4fl (below ground) Height: 180m	Office: approx. 45,000m^2 Retail: approx. 3,000m^2 Hotel: 180 rooms Convention hall, others	Autumn 2018
Shibuya station Dogenzaka area (block including former Tokyu Plaza Shibuya)	Tokyu Land	Site area: 3,330m^2 Floor space area: 58,900m^2 18fl (above ground)/ 4fl (below ground) Height: 110m	Office, retail, others	FY2018
Shibuya station area	Tokyu Corporation East Japan Railway Tokyo Metro	Site area: 15,300m^2 Floor space area: 276,000m^2 East tower: 47fl (above)/ 7fl (below), height 230m Central tower: 10fl (above)/ 2fl (below), height 61m West tower: 13fl (above)/ 5fl (below), height 76m	East tower Office: approx. 73,000m^2 Retail: approx. 30,000m^2	East tower: FY2019 Central and West tower: FY2027
Shibuya Sakuragaoka-guchi area	Tokyu Land	Site area: 17,000m^2 Floor space area: 241,400m^2 Block A: Floor space area 174,800m^2 A1 tower: 36fl (above)/ 5fl (below), height 180m A2 tower: 15fl (above)/ 4fl (below), height 90m Block B: Floor space area 65,900m^2 32fl (above)/ 2fl (below), height 150m Block C: Floor space area 700m^2 4fl (above)/ 1fl (below), height 30m	Block A Office, retail, others Block B Residential, office, retail, others Block C Church, others	Around 2020

Source: Deutsche Securities based on each company release

Figure 131: Redevelopment plans for the Shibuya station area



Source: Deutsche Securities based on each company release

Valuation

Stable earnings trends through FY2016

OP at the five major real estate companies has grown since FY2012 (FY3/13). We believe this trend will continue through FY2016 (FY3/17) for the fifth consecutive year. However, we expect FY2017 (FY3/18) to be a bleak year, and have discounted the negative impact of the consumption tax rise to 10% from April 2017 in our earnings forecasts.

Earnings cliff of FY2017 (FY3/18)

Figure 132: OP forecasts of the five real estate companies

	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Actual	FY15 DSF	FY16 DSF	FY17 DSF
OP (¥bn)	**469.2**	**500.7**	**585.1**	**602.2**	**605.9**	**639.9**	**581.7**
Mitsui Fudosan	126.0	148.2	172.6	186.1	198.6	206.6	178.8
Mitsubishi Estate	146.3	118.3	161.3	156.3	137.5	154.8	139.0
Sumitomo Realty	147.5	151.3	160.5	165.9	174.7	180.5	172.4
Tokyu Fudosan Holdings	50.1	52.0	61.4	63.3	65.1	67.0	59.1
Tokyo Tatemono	-0.7	30.9	29.4	30.6	30.0	31.1	32.4
YoY (%)	**-6.8**	**6.7**	**16.8**	**2.9**	**0.6**	**5.6**	**-9.1**
Mitsui Fudosan	4.9	17.6	16.5	7.8	6.7	4.0	-13.4
Mitsubishi Estate	-7.6	-19.1	36.3	-3.1	-12.0	12.6	-10.2
Sumitomo Realty	6.5	2.6	6.0	3.4	5.3	3.3	-4.5
Tokyu Fudosan Holdings	-19.9	3.8	18.2	3.0	2.8	2.9	-11.7
Tokyo Tatemono	n.a.	n.a,	-5.0	4.1	-1.8	3.7	4.2

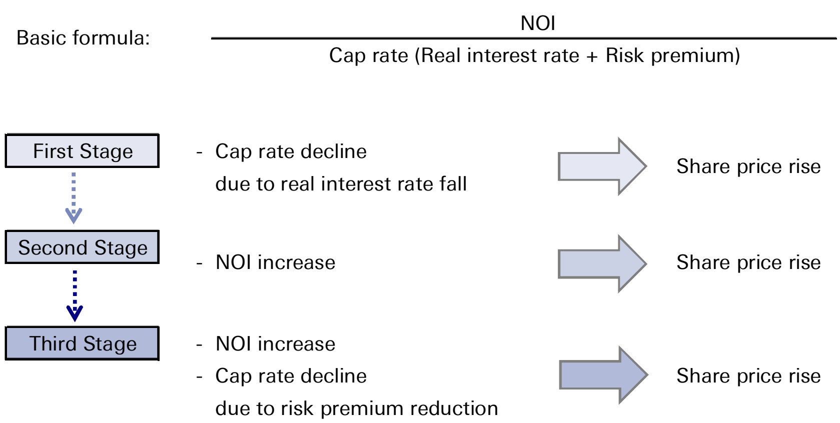
Tokyo Tatemono's fiscal year ends in December
Source: Company, Deutsche Securities forecast

Entering a third stage

We believe only two factors matter for real estate stocks: cap rate and NOI. In addition, share price rises are driven by three stages: 1) a falling cap rate; 2) growing NOI, and 3) a falling cap rate accompanied by expectations of future NOI growth increase.

Second stage did not occur

Figure 133: Only two factors drive real estate stocks



Source: Deutsche Securities

Second stage did not materialize

Real estate sector stocks grew 80% YoY in 2012 and 71% in 2013, wiping out their previous apparent undervaluation. This was the first stage, with share prices rising as the cap rate fell.

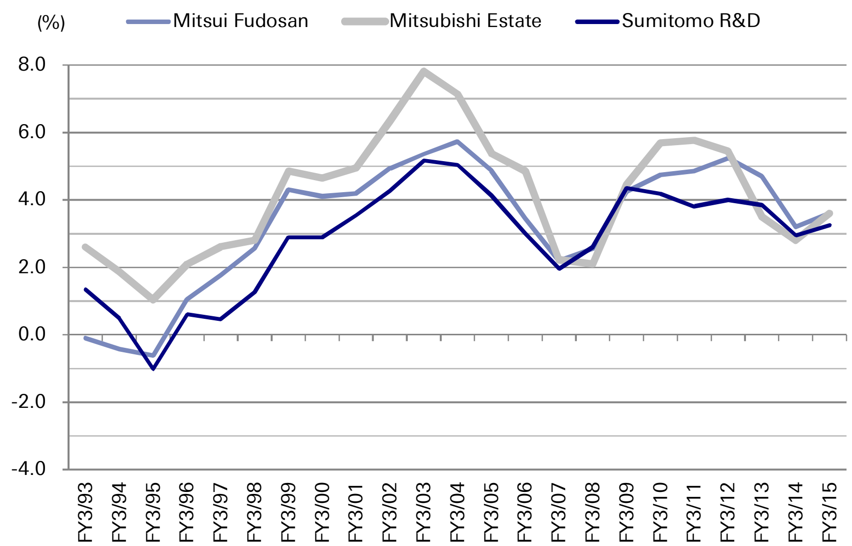
However, the sector's performance in 2014 did an about-face, when it was one of the worst among the 33 TOPIX sectors. This is because the second stage (stock prices rising due to NOI rising) turned out to be disappointing. In other words, rent declines bottomed out and were on a recovery path, but the increase was too small.

A normal third stage in which share prices rise strongly cannot be expected

And now, we are heading into the third stage. In this stage, share prices should rise as the cap rate rise and investors anticipate NOI growth. However, since this second stage did not materialize, expectations of future NOI growth are low. We are currently in the third stage, but normal, strong share price growth is unlikely with one of the two factors (expectations of NOI growth) trending weakly.

Therefore, the yield gap, which fell to around 2.0% in 2007 (Figure 134), is now just slightly below 4.0%. This will likely shrink by 50-70bp, but we still expect the yield gap to stay in the 3.0-3.9% range.

Figure 134: Yield gaps for the three major developers



Source: Company, Bloomberg Finance LP, Deutsche Securities

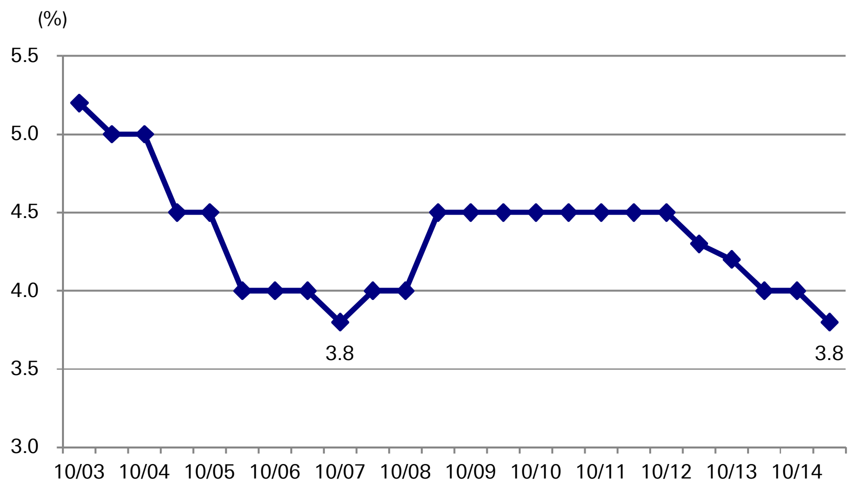
Even as we assume this, we expect substantial upside for the shares of real estate majors. Actual transaction cap rates that have reached or renewed historical lows are also likely to underpin this.

Expected cap rates in Marunouchi, Otemachi fall to 3.8%

Expected cap rates in Marunouchi and Otemachi down to Oct 2007 level

According to the Japan Real Estate Institute's (JREI's) "32nd Japanese Real Estate Investor Survey (April 2015)", expected cap rates for Class A office buildings in Marunouchi and Otemachi fell to 3.8%, a decline of 0.2ppt versus the previous survey conducted in October 2014 (Figure 135). This is the same level as in October 2007, the lowest since the JREI began its surveys.

Figure 135: Expected cap rates for Class A buildings in Marunouchi/Otemachi



Source: Deutsche Securities, based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Expected cap rates for Tokyo logistics facilities are 0.5ppt below 2007 level

Expected cap rates fell in almost all property categories and regions. They reached a new low for residential properties, studio apartments in Tokyo (Joto/Jonan regions) and family housing (Joto region). For retail properties, the expected cap rate for high-end boutiques in Ginza and Omotesando reached the previous low, while rates for Tokyo's logistics facilities were 0.5ppt below the 2007 level. Expected cap rates for hotels in Tokyo and other regions are also approaching the 2007 level.

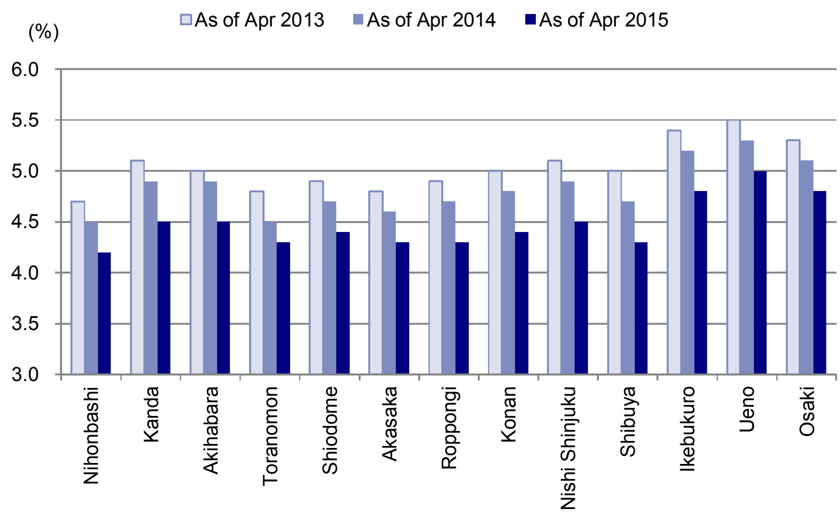
Offices: Expected cap rates down uniformly in regional cities

Nihonbashi, Konan, Shibuya hit new lows

The decline in expected cap rates is not limited to Marunouchi and Otemachi. In other regions within Tokyo and in regional cities, expected cap rates have fallen about 0.2ppt versus the October 2014 survey, and about 0.6ppt versus the April 2013 survey (Figure 136, Figure 137).

The largest declines versus two years ago are in Shibuya (5.0% to 4.3%) and Fukuoka (6.5% to 5.8%). Nihonbashi, Konan and Shibuya have reached new lows. By contrast, expected cap rates in most regional cities are 0.5-0.7ppt higher than in the October 2007 survey.

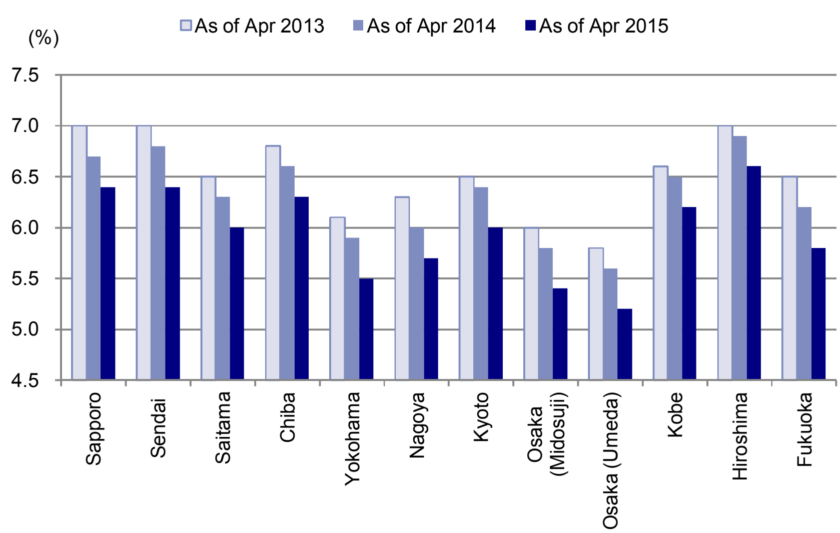
Figure 136: Expected cap rates for Class A buildings in Tokyo (as of April of each year)



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 137: Expected cap rates for Class A buildings in major cities (as of April of each year)

Expected cap rates in most regional cities are 0.5-0.7ppt higher than in Oct 2007

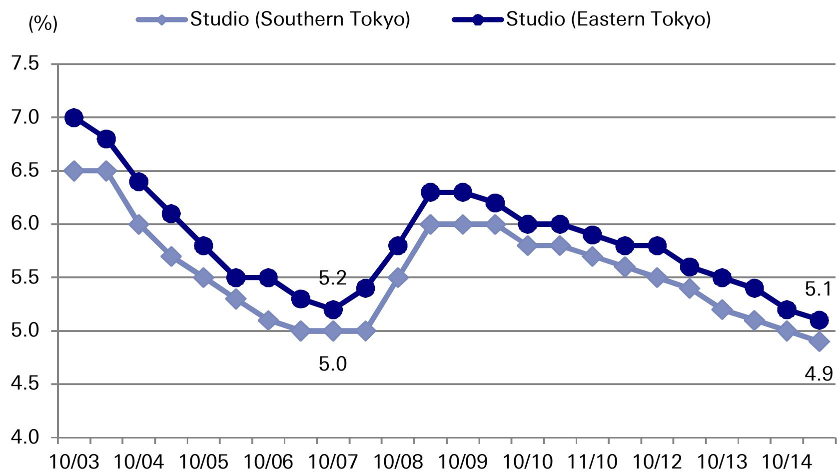


Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Residential: Tokyo studio apartments at lowest level ever

Expected cap rates for studio apartments were 0.1ppt below the previous low in Tokyo's Joto (Eastern Tokyo) and Jonan regions (Southern Tokyo) (Figure 138).

Figure 138: Expected cap rates for studios in Tokyo

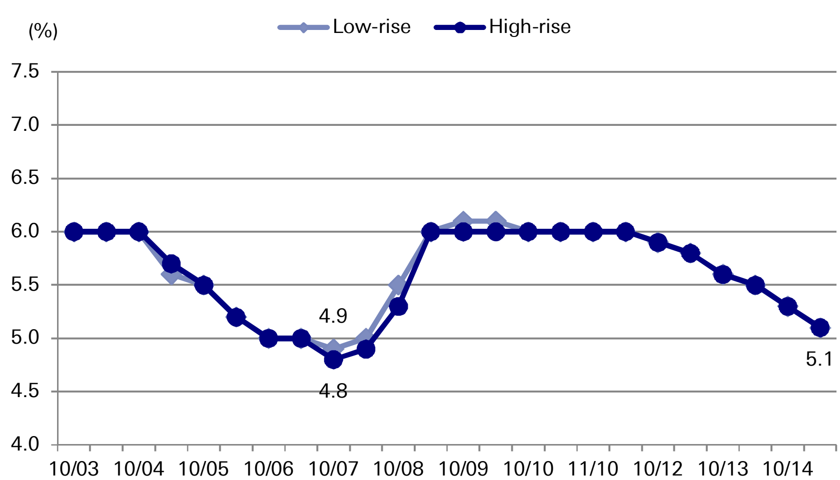


Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Expected rates for luxury apartments for foreigners are near the Oct 2007 level

Similarly, expected cap rates have fallen for Tokyo's family residences and luxury apartments for foreigners. Expected cap rates for family residences in the Jonan region have fallen to be equivalent with the October 2007 rate of 5.0%. In the Joto region, the rate fell to a new low of 5.2%. For luxury apartments for foreigners, the expected cap rates have come close to but have yet to reach the October 2007 level (Figure 139).

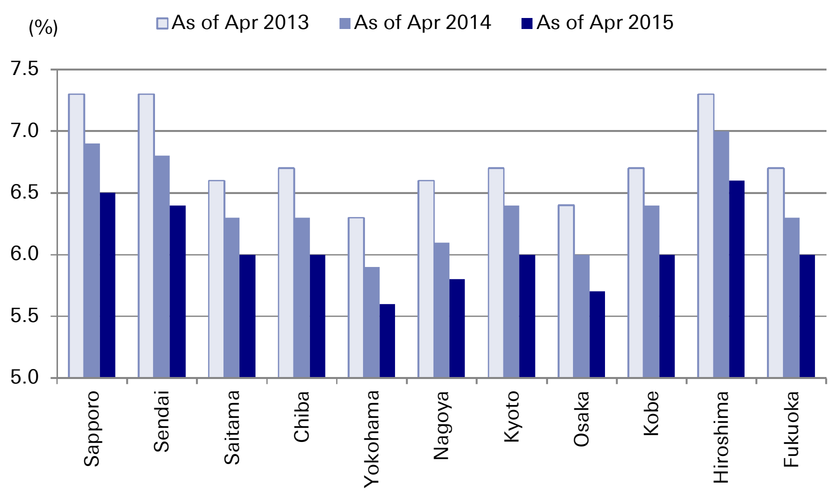
Figure 139: Expected cap rates for high-end multi-family properties for expatriates in Tokyo



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Expected cap rates for studio apartments in regional cities have also fallen substantially over the past two years, with especially large declines in Sapporo, Sendai and Nagoya. However, as with office buildings in regional areas, the expected cap rates for residential buildings in these areas have not declined to their lowest levels.

Figure 140: Expected cap rates for studios in major cities (as of April of each year)



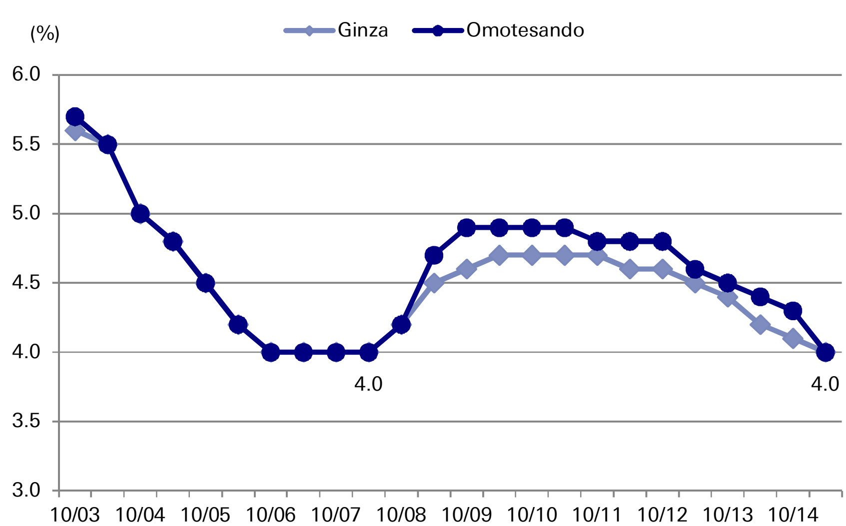
Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Retail: Expected cap rate at 4.0% in Ginza and Omotesando

Expected cap rates for Ginza and Omotesando boutiques down to Oct 2007 levels

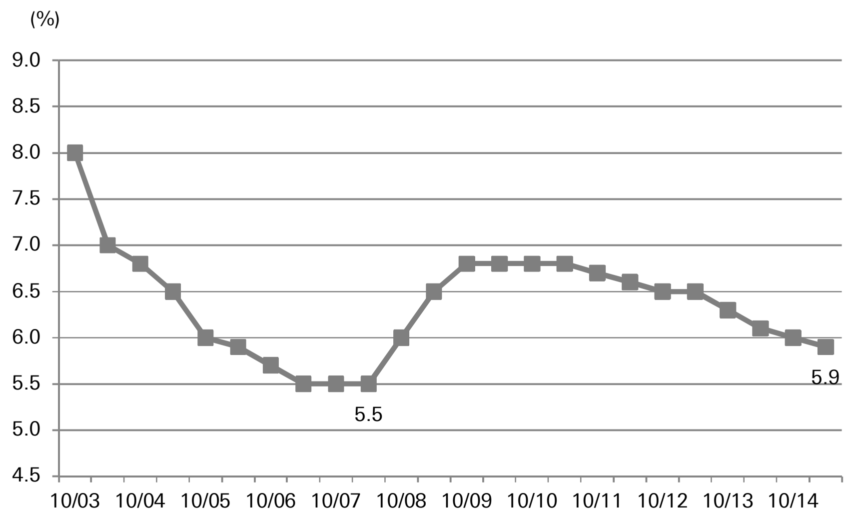
Expected cap rates for retail properties are trending similarly to offices and residential properties. Rates for Ginza and Omotesando boutiques have fallen to the October 2007 level (Figure 141). Those for suburban shopping centers in Tokyo and for retail properties in major regional cities have declined, without reaching historically low levels (Figure 142 and Figure 143).

Figure 141: Expected cap rates for high-end retail properties in Ginza and Omotesando



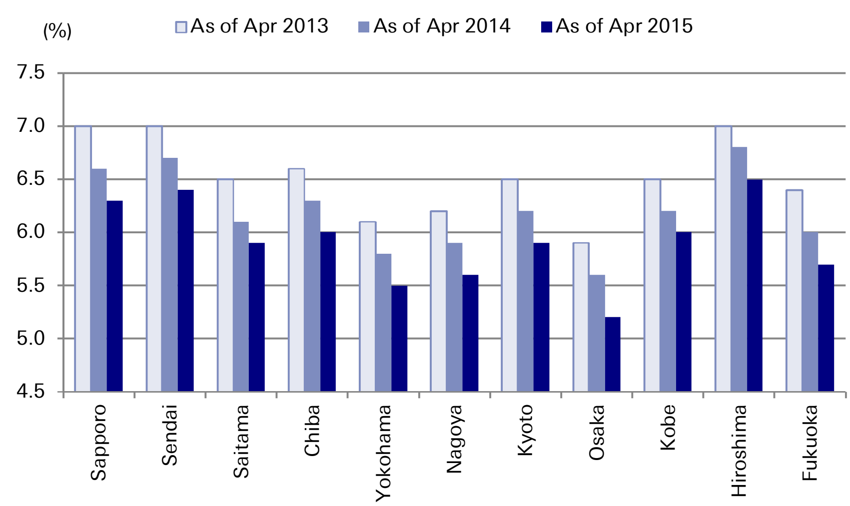
Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 142: Expected cap rates for shopping centers in Tokyo suburbs



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 143: Expected cap rate for shopping centers in major cities (as of April of each year)



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

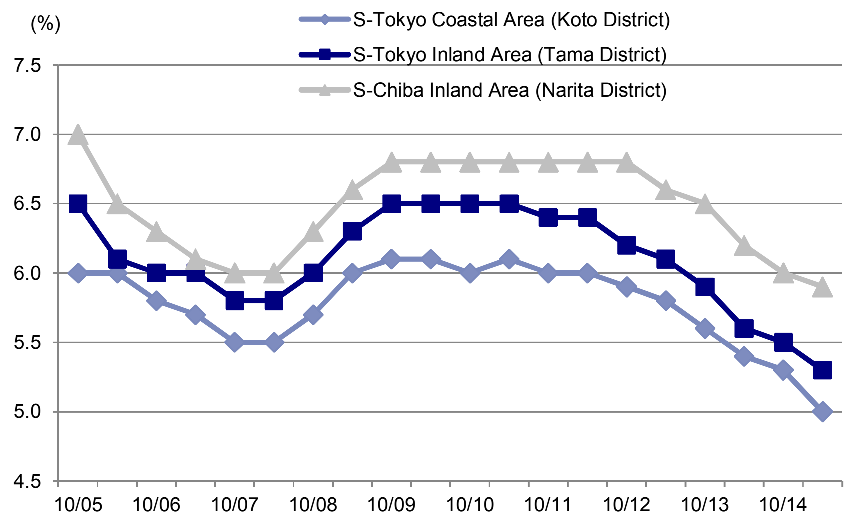
Logistics: Expected cap rates markedly below 2007 level

Expected cap rates for logistics facilities in Tokyo differ from other asset classes, having fallen markedly below 2007 levels. Expected cap rates for Tokyo Bay logistics facilities (single-tenant type) are at 5.0% in the latest survey, having declined 0.5ppt from 5.5% in October 2007. Expected cap rates for logistics facilities further inland also dropped 0.5ppt to 5.3%, from 5.8% in October (Figure 144).

Expected cap rates for Tokyo Bay logistics facilities at 5.0% (vs. 5.5% in Oct 2007)

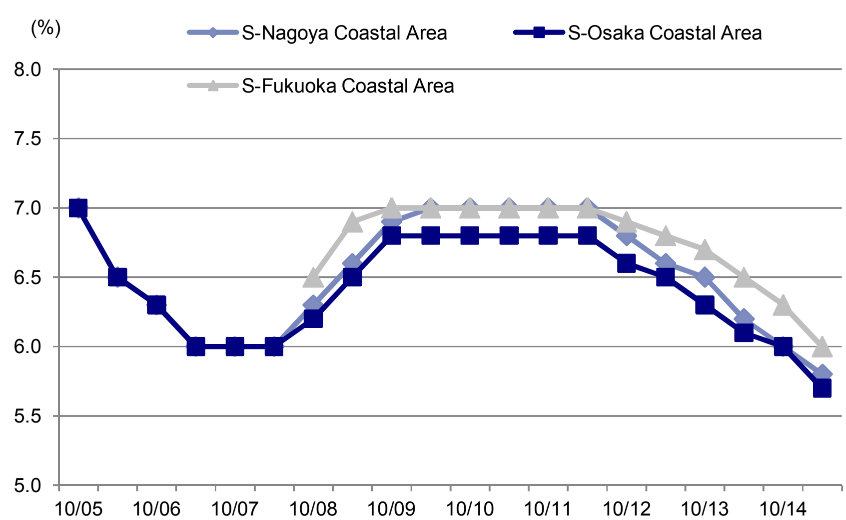
Expected cap rates are also at their lowest levels in Nagoya and Osaka (Figure 145), tracing a similar trend to multi-tenant logistics facilities.

Figure 144: Expected cap rates for single-tenant type warehouse properties in Tokyo metropolitan area



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 145: Expected cap rates for single-tenant warehouse properties in major cities

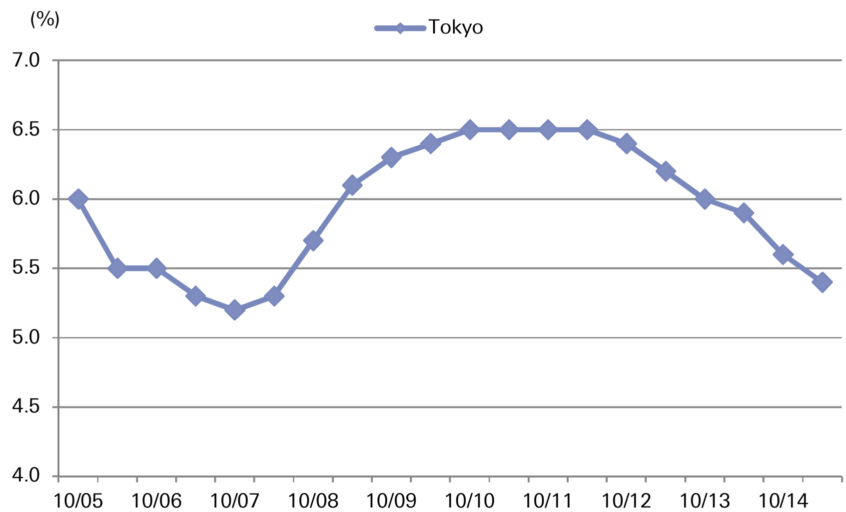


Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Hotels: Margin of decline widens in regional cities

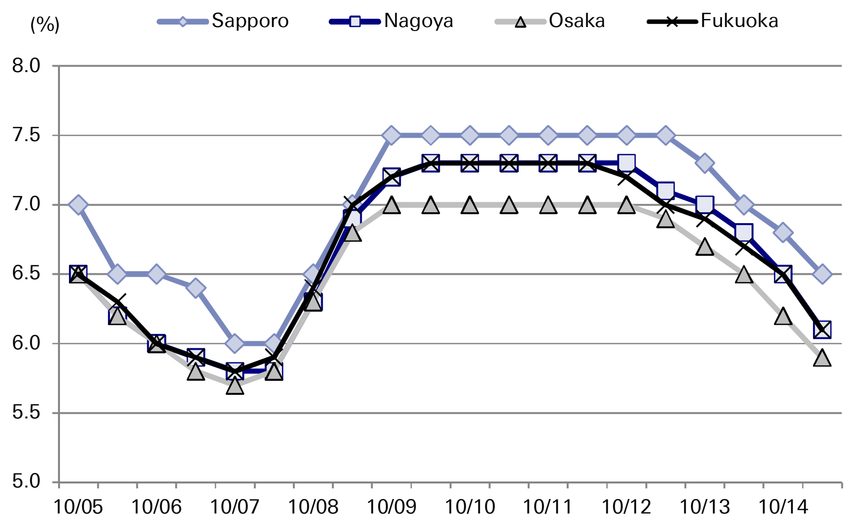
For hotels, expected cap rates have fallen close to 2007 levels in Tokyo and major regional cities (Figure 146 and Figure 147). In regional cities, the margin of decline has widened in the latest survey.

Figure 146: Expected cap rates for economy hotels in Tokyo



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 147: Expected cap rate for economy hotels in major cities



Source: Deutsche Securities based on 'Japan Real Estate Investor Survey' by Japan Real Estate Institute

Figure 148: Sensitivity analysis – major developers (based on our FY3/17 forecasts)

Cap rate (%)	4.25	4.00	3.75	3.50	3.25	3.00
NAV per share (¥)						
Mitsui Fudosan	3,358	3,630	3,938	4,290	4,696	5,101
(After tax)	2,878	3,049	3,243	3,465	3,721	4,002
Mitsubishi Estate	2,158	2,371	2,613	2,889	3,207	3,579
(After tax)	1,784	1,919	2,071	2,245	2,445	2,679
Sumitomo R&D	3,542	4,037	4,598	5,240	5,980	6,844
(After tax)	3,011	3,323	3,676	4,080	4,547	5,091
Tokyu Fudosan Holdings	858	985	1,128	1,292	1,481	1,701
(After tax)	790	866	952	1,050	1,164	1,296
Tokyo Tatemono	1,050	1,190	1,340	1,520	1,730	1,960
(After tax)	915	999	1,089	1,197	1,323	1,461

Tokyo Tatemono's NAV per share is based on our FY12/16 earnings forecasts.
Source: Deutsche Securities forecast

Figure 149: Sensitivity analysis – NBF and JRE

Cap rate (%)	4.25	4.00	3.75	3.50	3.25	3.00
NAV per unit (¥)						
NBF	448,780	494,427	546,161	605,285	673,505	753,095
JRE	445,533	488,990	538,241	594,528	659,475	735,246

NBF's NAV per unit is based on our FP12/15 and FP6/16 earnings forecasts. JRE's NAV per unit is based on our FP9/15 and FP3/16 earnings forecasts.
Source: Deutsche Securities forecast

Figure 150: Ranking – Dividend yield, P/NAV, P/FFO

			Div. Yield (Co.E, F1) (%)				P/NAV (actual) (x)				P/FFO (actual) (x)
1	NRT	(3296)	5.3	1	GOR	(8958)	0.91	1	SPI	(8979)	13.1
2	SIA	(3290)	4.8	2	HRE	(8966)	0.92	2	SIA	(3290)	13.6
3	TOS	(3451)	4.5	3	SPI	(8979)	0.92	3	MID	(3227)	13.8
4	SPI	(8979)	4.4	4	SIA	(3290)	0.99	4	HRI	(8977)	15.8
5	IOJ	(3298)	4.4	5	TOP	(8982)	1.01	5	TOP	(8982)	15.9
6	MID	(3227)	4.2	6	HRI	(8977)	1.02	6	HRE	(8966)	16.7
7	JRH	(8986)	4.1	7	MID	(3227)	1.03	7	SHSI	(8973)	16.9
8	KRR	(3453)	4.1	8	TRI	(8957)	1.10	8	JRH	(8986)	17.2
9	TOP	(8982)	3.9	9	IOJ	(3298)	1.11	9	KDO	(8972)	17.3
10	IRE	(8975)	3.9	10	KDO	(8972)	1.12	10	IOJ	(3298)	17.8
11	MTR	(8961)	3.9	11	TOS	(3451)	1.13	11	ARI	(3292)	17.8
12	HRI	(8977)	3.8	12	SHSI	(8973)	1.18	12	NRF	(3240)	18.0
13	HRE	(8966)	3.8	13	JLF	(8967)	1.19	13	NOF	(8959)	18.2
14	SHR	(3309)	3.8	14	NOF	(8959)	1.20	14	JEI	(8987)	18.4
15	KDR	(3278)	3.7	15	NBF	(8951)	1.26	15	JRF	(8953)	18.5
16	GLP	(3281)	3.7	16	JRH	(8986)	1.26	16	NAF	(3226)	18.6
17	JEI	(8987)	3.6	17	HLC	(3295)	1.27	17	GLP	(3281)	20.2
18	SHSI	(8973)	3.6	18	DOI	(8976)	1.30	18	FRC	(8968)	20.3
19	CRR	(3282)	3.6	19	NMF	(3285)	1.30	19	OJR	(8954)	20.5
20	FRI	(8964)	3.6	20	JRF	(8953)	1.34	20	FRI	(8964)	20.5
21	ARI	(3292)	3.6	21	OJR	(8954)	1.34	21	DHI	(8984)	20.5
22	NRF	(3240)	3.5	22	NRF	(3240)	1.34	22	UUR	(8960)	20.6
23	HLC	(3295)	3.5	23	PIC	(8956)	1.36	23	MTR	(8961)	20.8
24	KDO	(8972)	3.5	24	JEI	(8987)	1.37	24	NMF	(3285)	21.2
25	NHI	(3308)	3.5	25	NAF	(3226)	1.38	25	ADR	(3269)	21.5
26	JRF	(8953)	3.4	26	ADR	(3269)	1.38	26	NBF	(8951)	21.7
27	IIF	(3249)	3.4	27	SHR	(3309)	1.38	27	TOS	(3451)	22.2
28	NOF	(8959)	3.4	28	UUR	(8960)	1.39	28	PIC	(8956)	22.3
29	NPR	(3283)	3.4	29	FRI	(8964)	1.39	29	TRI	(8957)	22.6
30	NAF	(3226)	3.4	30	NPR	(3283)	1.40	30	NPR	(3283)	22.8
31	DHI	(8984)	3.4	31	GLP	(3281)	1.41	31	JLF	(8967)	23.1
32	API	(3279)	3.4	32	JRE	(8952)	1.43	32	HLC	(3295)	23.3
33	FRC	(8968)	3.4	33	ARI	(3292)	1.45	33	GOR	(8958)	23.7
34	PIC	(8956)	3.3	34	DHI	(8984)	1.47	34	CRR	(3282)	23.7
35	NMF	(3285)	3.3	35	MHR	(3234)	1.48	35	JRE	(8952)	23.8
36	DHR	(3263)	3.3	36	API	(3279)	1.52	36	KDR	(3278)	24.0
37	UUR	(8960)	3.3	37	CRR	(3282)	1.52	37	DHR	(3263)	24.2
38	JPR	(8955)	3.3	38	FRC	(8968)	1.59	38	JPR	(8955)	24.4
39	TRI	(8957)	3.3	39	IRE	(8975)	1.65	39	IIF	(3249)	24.8
40	ADR	(3269)	3.2	40	DHR	(3263)	1.66	40	MHR	(3234)	25.8
41	OJR	(8954)	3.2	41	KDR	(3278)	1.66	41	API	(3279)	25.8
42	MHR	(3234)	3.2	42	JPR	(8955)	1.77	42	DOI	(8976)	27.6
43	JLF	(8967)	3.1	43	IIF	(3249)	1.77	43	HRR	(3287)	29.9
44	DOI	(8976)	3.1	44	JHR	(8985)	1.84	44	JHR	(8985)	30.4
45	INV	(8963)	3.0	45	MTR	(8961)	1.85	45	INV	(8963)	38.4
46	JHR	(8985)	3.0	46	HRR	(3287)	1.91				
47	HRR	(3287)	2.8	47	INV	(8963)	2.93				
48	NBF	(8951)	2.8								
49	JRE	(8952)	2.8								
50	GOR	(8958)	2.5								

As of 24 July, 2015
Note: Div. Yield: DPU (company estimate for this fiscal period, annualized) / latest price
P/NAV: Latest price / NAV per unit as of the latest fiscal period-end
P/FFO: Latest price / FFO per unit as of the latest fiscal period (annualized)
From some or all the rankings, we omit REITs for which data are not available/valid due to new listing, merger, etc.
Source: Company, Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

Figure 151: Valuation (by asset class 1 – Office and Residential)

	Ticker	Abbrev.	Asset type	Unit price (yen)	Market cap (bn yen)	Latest FP end (mm/yy)		Co.E (F1) Div. Yield (%)	Actual DPU (yen)	Co.E (F1) DPU (yen)	P/NAV (x)	P/FFO (x)	NOI yield (%)	LTV (%)	Total assets (acquisition price) (¥bn)	Occu-pancy (%)	Unit price performance (%) 5D	1m	3m	6m	1y	CYTD	52-week highest / lowest price (yen) High	Low
	Office				3,230.0			3.1			1.3	20.9	4.2	43.6	4,551.2		0	-2	-7	-10	6	-7		
	Residential				1,437.8			3.5			1.4	20.0	5.4	51.8	1,801.1		-1	-7	-6	-12	15	-11		
	Diversified				2,554.8			3.5			1.5	22.6	5.0	45.8	6,235.6		0	-3	-6	-8	27	-3		
	Retail				1,370.4			3.5			1.4	20.4	5.4	39.7	1,553.2		0	-3	-7	-8	5	-5		
	Logistics				1,495.2			3.4			1.4	22.5	5.7	42.1	1,268.5		0	-2	-8	-13	7	-10		
	Hotel				313.0			3.0			1.8	30.3	6.3	43.1	206.8		3	-5	-9	-1	42	3		
1	8951	NBF	Office	553,000	780.8	12/14	1,412	2.8	7,681	7,700	1.3	21.7	4.1	41.9	1,074.4	98.0	0	-1	-8	-9	-3	-8	652,000	493,000
2	8952	JRE	Office	567,000	742.4	3/15	1,252	2.8	7,681	7,840	1.4	23.8	4.2	42.3	883.5	97.8	0	-1	-1	-8	-1	-2	650,000	504,000
3	8955	JPR	Office	396,500	346.1	12/14	825	3.3	6,351	6,370	1.8	24.4	4.4	46.1	405.5	97.0	2	0	-9	-7	10	-5	453,000	350,000
4	8958	GOR	Office	415,000	80.4	3/15	194	2.5	9,703	5,200	0.9	23.7	3.4	50.1	161.3	96.4	1	-9	-3	-18	35	-9	517,000	303,000
5	8959	NOF	Office	532,000	198.2	4/15	373	3.4	9,699	9,120	1.2	18.2	4.0	44.8	414.4	97.5	1	-4	-8	-13	9	-11	629,000	461,000
6	8972	KDO	Office	590,000	238.9	4/15	405	3.5	11,363	10,300	1.1	17.3	4.5	42.8	385.1	96.5	-1	-5	-12	-16	6	-13	717,000	539,000
7	8975	IRE	Office	85,500	121.1	4/15	1,130	3.9	1,603	1,670	1.7		5.5	43.8	123.3	96.0	2	-5	-8	-13	23	-9	103,700	69,100
8	8976	DOI	Office	610,000	295.2	5/15	441	3.1	9,142	9,350	1.3	27.6	3.5	44.3	413.3	97.3	2	3	-7	-10	21	-9	719,000	495,000
9	8987	JEI	Office	137,500	173.2	12/14	1,213	3.6	2,507	2,450	1.4	18.4	4.7	48.2	265.4	99.1	2	-6	-14	-14	0	-14	169,500	126,200
10	3227	MID	Office	320,000	61.4	12/14	184	4.2	5,958	5,900	1.0	13.8	4.0	38.7	157.7	97.7	-9	-15	-11	1	31	6	390,000	239,000
11	3290	SIA	Office	463,000	34.8	2/15	75	4.8	12,196	11,000	1.0	13.6	5.1	51.9	74.3	91.4	-2	-6	-9	-13	6	2	548,000	405,000
12	3298	IOJ	Office	102,100	55.4	4/15	433	4.4	2,605	2,256	1.1	17.8	5.2	45.0	78.6	89.2	0	-4	-13	-17	-1	-11	127,500	95,000
13	3309	SHR	Office	128,500	102.0	4/15	632	3.8	1,603	2,420	1.4		3.6	42.5	114.3	100.0	-1	-6	-11	-12		-7	149,000	110,000
	Office		Total		3,230.0										4,551.2									
			Weighted average					3.1			1.3	20.9	4.2	43.6			0	-2	-7	-10	6	-7		
1	8973	SHSI	Residential	117,100	119.2	3/15	1,018	3.6	2,185	2,120	1.2	16.9	4.9	51.1	188.8	97.4	-1	-9	-13	-15	13	-14	150,900	99,600
2	8979	SPI	Residential	181,000	31.5	4/15	174	4.4	4,182	4,020	0.9	13.1	5.9	48.6	57.1	96.3	-2	-9	-15	-19	2	-14	233,700	172,000
3	8984	DHI	Residential	261,500	195.5	2/15	374	3.4	8,691	4,440	1.5	20.5	5.5	51.3	237.6	97.1	0	-6	-2	-11	9	-10	304,000	222,000
4	8986	JRH	Residential	82,100	134.6	3/15	1,475	4.1	1,680	1,700	1.3	17.2	5.6	51.7	197.2	98.8	-1	-3	-5	-17	10	-17	104,800	73,500
5	3226	NAF	Residential	441,000	213.7	2/15	461	3.4	7,984	7,500	1.4	18.6	5.2	53.2	287.7	96.6	-2	-8	-6	-11	12	-7	503,000	368,500
6	3240	NRF	Residential	659,000	106.0	5/15	161	3.5	11,642	11,600	1.3	18.0	5.1	53.8	163.8	96.6	0	-5	-5	-6	21	-9	740,000	541,000
7	3269	ADR	Residential	280,200	364.3	1/15	1,300	3.2	5,130	4,540	1.4	21.5	5.6	50.1	410.5	96.5	-1	-7	-2	-13	12	-13	326,000	242,600
8	3278	KDR	Residential	329,500	115.0	1/15	279	3.7	6,232	6,150	1.7	24.0	5.3	53.7	122.1	95.7	-3	-11	-10	-11	35	-9	399,500	234,900
9	3282	CRR	Residential	241,800	114.6	1/15	403	3.6	4,296	4,372	1.5	23.7	5.3	54.2	122.9	95.2	-2	-8	-8	-13	26	-8	284,300	184,100
10	3308	NHI	Residential	228,300	13.9	4/15	61	3.5	3,471	3,950			7.2	42.3	13.3	100.0	-1	-6	-20	-16		-18	293,950	149,567
11	3455	HCM	Residential	122,200	14.7												-5	-11	-27				172,200	110,000
12	3459	SRI	Residential	90,900	14.8												-1						102,000	87,800
	Residential		Total		1,437.8										1,801.1									
			Weighted average					3.5			1.4	20.0	5.4	51.8			-1	-7	-6	-12	15	-11		

As of 24 July, 2015
Note: Deutsche Securities officially covers; NBF (8951, Buy rating), JRE (8952, Buy), JRF (8953, Hold), UUR (8960, Hold), KDO (8972, Sell), NAF (3226, Hold), IIF (3249, Hold), ADR (3269, Hold), NPR (3283, Hold). Other companies are not covered by us. From the above list, we omit some data on REITs for which data are not available/valid due to new listing, merger, etc.
Source: Company, Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

Figure 152: Valuation (by asset class 2 – Diversified, Retail, Industrial and Hotel)

	Ticker	Abbrev.	Asset type	Unit price (yen)	Market cap (bn yen)	Latest FP end (mm/yy)		Co.E (F1) Div. Yield (%)	Actual DPU (yen)	Co.E (F1) DPU (yen)	P/NAV (x)	P/FFO (x)	NOI yield (%)	LTV (%)	Total assets (acquisition price) (¥bn)	Occu-pancy (%)	Unit price performance (%) 5D	1m	3m	6m	1y	CYTD	52-week highest / lowest price (yen) High	Low
1	8954	OJR	Diversified	169,200	378.3	2/15	2,121	3.2	2,717	2,720	1.3	20.5	4.9	47.1	502.2	98.9	0	-3	-3	-7	21	0	183,800	130,900
2	8956	PIC	Diversified	644,000	169.6	4/15	263	3.3	10,731	10,750	1.4	22.3	4.3	44.8	215.9	96.0	0	-4	-3	-2	55	9	710,000	415,000
3	8957	TRI	Diversified	148,000	144.7	1/15	978	3.3	2,586	2,420	1.1	22.6	4.1	43.4	222.1	97.1	0	-3	-7	-11	2	-10	168,500	135,000
4	8960	UUR	Diversified	176,700	467.2	5/15	2,644	3.3	2,900	2,910	1.4	20.6	5.6	44.5	520.1	98.8	1	-1	-8	-9	7	-6	199,400	157,700
5	8961	MTR	Diversified	225,900	298.2	3/15	1,320	3.9	3,921	4,350	1.9	20.8	4.5	49.6	338.5	98.9	0	-5	-5	-11	30	-6	267,200	172,900
6	8963	INV	Diversified	67,700	214.5	12/14	2,669	3.0	733	824	2.9	38.4	6.5	51.6	117.9	96.1	5	15	7	25	169	35	69,700	24,800
7	8966	HRE	Diversified	90,100	85.7	5/15	951	3.8	1,742	1,719	0.9	16.7	5.0	43.1	155.0	96.8	2	-4	-5	-13	6	-8	105,700	80,600
8	8968	FRC	Diversified	204,700	152.9	2/15	690	3.4	3,435	3,450	1.6	20.3	5.8	42.3	165.8	99.6	0	-5	-6	-16	13	-8	247,400	180,300
9	8977	HRI	Diversified	133,000	79.5	5/15	598	3.8	2,567	2,550	1.0	15.8	4.8	42.9	139.3	98.7	1	-5	-13	-19	17	-13	168,800	111,000
10	8982	TOP	Diversified	491,500	86.5	4/15	176	3.9	9,680	9,700	1.0	15.9	4.1	47.8	190.5	98.9	-2	-5	-8	-7	8	-9	544,000	438,500
11	3234	MHR	Diversified	148,000	232.4	1/15	1,570	3.2	2,303	2,360	1.5	25.8	4.0	44.1	281.8	99.8	-2	-7	-9	-17	-5	-14	183,600	141,500
12	3295	HLC	Diversified	160,900	125.7	2/15	781	3.5	2,926	2,830	1.3	23.3	4.8	38.5	148.2	99.0	-2	-8	-14	-11	-7	-12	194,500	150,000
13	3296	NRT	Diversified	276,700	107.4	12/14	152	5.3	7,109	6,527			5.0	49.2	73.9	94.1	-1	-7	-17	-28	5	-23	400,000	260,000
14	3451	TOS	Diversified	127,500	12.2	4/15	96	4.5	1,938	2,855	1.1	22.2	5.7	46.1	17.4	96.2	-3	-5	-5	-9		-6	148,700	103,000
	Diversified		Total		2,554.8										6,235.6									
			Weighted average					3.5			1.5	22.6	5.0	45.8			0	-3	-6	-8	27	-3		
1	8953	JRF	Retail	243,600	592.0	2/15	2,430	3.4	4,180	4,180	1.3	18.5	5.2	44.6	845.6	99.8	0	1	-4	-7	7	-4	269,900	209,300
2	8964	FRI	Retail	526,000	260.9	12/14	496	3.6	9,707	9,200	1.4	20.5	5.5	26.7	266.0	100.0	-3	-7	-9	-7	-6	-4	597,000	493,000
3	3279	API	Retail	1,019,000	282.4	5/15	277	3.4	16,535	17,195	1.5	25.8	4.8	42.7	282.6	99.7	2	-3	-7	-6	9	-3	1,137,000	853,000
4	3292	ARI	Retail	149,900	163.4	1/15	950	3.6	2,473	2,665	1.5	17.8	6.9	37.1	159.0	100.0	0	-8	-9	-15	8	-12	181,000	130,100
5	3453	KRR	Retail	275,000	71.7					7,127							1	-5	-8				309,500	230,000
	Retail		Total		1,370.4										1,553.2									
			Weighted average					3.5			1.4	20.4	5.4	39.7			0	-3	-7	-8	5	-5		
1	8967	JLF	Industrial	246,200	204.3	1/15	830	3.1	3,900	3,800	1.2	23.1	5.7	35.2	194.9	95.1	1	-1	-3	-9	1	-9	278,600	227,100
2	3249	IIF	Industrial	533,000	187.9	12/14	166	3.4	16,911	8,625	1.8	24.8	5.9	50.5	182.1	98.8	-1	-3	-9	-11	20	-4	620,000	439,000
3	3263	DHR	Industrial	494,500	173.4	2/15	293	3.3	8,674	8,150	1.7	24.2	6.1	46.5	147.6	100.0	-1	-5	-8	-15	9	-18	623,000	445,000
4	3281	GLP	Industrial	118,800	284.0	2/15	2,391	3.7	2,256	2,195	1.4	20.2	5.5	49.1	338.9	98.6	0	0	-5	-14	4	-11	140,282	107,900
5	3283	NPR	Industrial	229,600	397.4	5/15	1,731	3.4	3,920	3,925	1.4	22.8	5.5	38.6	405.1	98.6	-2	-2	-13	-17	-3	-12	281,746	212,800
6	3285	NMF	Industrial	149,000	248.1	2/15	1,665	3.3	2,490	2,480	1.3	21.2	5.8	35.9	255.6	99.8	0	-4	-4	-6	20	-4	161,000	123,200
	Logistics		Total		1,495.2										1,268.5									
			Weighted average					3.4			1.4	22.5	5.7	42.1			0	-2	-8	-13	7	-10		
1	8985	JHR	Hotel	79,200	248.7	12/14	2,791	3.0	2,155	2,402	1.8	30.4	6.3	43.1	173.4	99.9	3	-4	-8	0	43	3	88,300	54,400
2	3287	HRR	Hotel	1,294,000	64.3	4/15	43	2.8	17,075	18,128	1.9	29.9	8.4	20.6	33.4	100.0	0	-5	-13	-3	40	2	1,534,000	911,000
	Hotel		Total		313.0										206.8									
			Weighted average					3.0			1.8	30.3	6.3	43.1			3	-5	-9	-1	42	3		

As of 24 July, 2015
Note: Same as the previous page
Source: Company, Nikkei Astra, Bloomberg Finance LP, Deutsche Securities

Coverage list

Figure 153: Real estate majors – our assumption of office rent change for existing buildings (YoY%)

	FY10 actual	FY11 actual	FY12 actual	FY13 actual	FY14 actual	FY15 DSF	FY16 DSF	FY17 DSF
Mitsui Fudosan	-14.0	-8.3	-4.0	0.0	1.5	**6.0**	**3.0**	**3.0**
Mitsubishi Estate	-4.0	-7.0	-0.9	0.0	1.5	**2.0**	**2.0**	**1.0**
Sumitomo R&D	-15.0	-4.5	-1.6	-3.2	0.0	**2.0**	**2.5**	**1.0**
Tokyu Fudosan Holdings	-15.0	-11.0	-5.0	-2.8	0.0	**2.1**	**1.0**	**0.0**
Tokyo Tatemono	-8.0	-2.0	-6.3	0.0	0.0	**1.0**	**0.0**	**0.0**

Note: Figures for Tokyu Fudosan Holdings prior to FY3/13 indicate results of Tokyu Land (8815.T, delisted on 26 September 2013). Tokyo Tatemono's fiscal year ends in December.
Source: Company, Deutsche Securities forecast

Figure 154: Real estate majors – our assumption of office vacancy for leasing business buildings (%)

	FY10 actual	FY11 actual	FY12 actual	FY13 actual	FY14 actual	FY15 DSF	FY16 DSF	FY17 DSF
Mitsui Fudosan	4.0	4.4	3.8	3.3	3.2	**3.0**	**3.0**	**3.0**
Mitsubishi Estate	3.6	3.6	4.0	5.3	2.8	**2.5**	**2.5**	**2.5**
Sumitomo R&D	8.2	7.8	7.1	5.9	4.9	**4.5**	**4.5**	**4.5**
Tokyu Fudosan Holdings	3.7	2.0	2.1	1.8	2.8	**2.8**	**2.8**	**2.8**
Tokyo Tatemono	7.6	13.5	6.3	4.3	7.7	**4.8**	**4.5**	**4.5**

Note: Figures for Tokyu Fudosan Holdings prior to FY3/13 indicate results of Tokyu Land (8815.T, delisted on 26 September 2013). Tokyo Tatemono's fiscal year ends in December.
Source: Company, Deutsche Securities forecast

Figure 155: Real estate majors – our assumptions for condo businesses for real estate majors (units, %)

	FY09	FY10	FY11	FY12	FY13	FY14	FY15		FY16	FY17	FY14	Land for condo development (unit)
	# of units delivered (units)										FY-end inventory (unit)	
	actual	actual	actual	actual	actual	actual	Co. F	DSF	DSF	DSF		
Mitsui Fudosan	4,651	5,455	4,512	4,956	6,557	4,858	4,500	4,500	5,500	5,000	170	23,000
Mitsubishi Estate	6,987	6,148	5,482	4,552	6,259	4,603	4,100	4,100	4,800	4,000	107	16,500
Parent	2,779	Merged as Mitsubishi Jisho Residence										
Towa Real Estate	4,208											
Sumitomo R&D	4,113	4,741	4,033	4,618	4,900	5,260	5,400	5,300	5,400	4,500	488	37,000
Tokyu Fudosan Holdings	2,189	2,637	2,426	2,367	2,633	2,027	1,927	1,930	2,200	1,600	260	7,000
Tokyo Tatemono (excl. SPC)	2,738	1,421	1,271	1,143	1,902	1,376	1,500	1,500	1,000	1,500	261	5,000
Total	**20,678**	**20,402**	**17,724**	**17,636**	**22,251**	**18,124**	**17,427**	**17,330**	**18,900**	**16,600**	**1,286**	**88,500**
Profit margin (%)												
Mitsui Fudosan - OPM	3.8	3.1	4.0	5.4	6.6	9.0		7.7	8.0	8.0		
Mitsubishi Estate - GPM	-2.8	16.0	17.3	18.8	19.1	17.3		17.0	17.0	17.0		
Parent - GPM	8.8	Merged as Mitsubishi Jisho Residence										
Towa Real Estate - GPM	12.6											
Sumitomo R&D - OPM	8.9	13.9	19.1	16.8	16.7	16.6		15.2	15.5	15.3		
Tokyu Fudosan Holdings - GPM	-7.9	3.4	17.6	21.0	19.4	23.0		21.0	21.0	21.0		
Tokyo Tatemono (excl. SPC) - GPM	12.7	14.6	15.9	17.8	17.0	17.2		21.0	21.0	18.0		

Note: Figures for Tokyu Fudosan Holdings prior to FY3/13 indicate results of Tokyu Land (8815.T, delisted on 26 September 2013). Tokyo Tatemono's fiscal year ends in December.
Source: Company, Deutsche Securities forecasts

Figure 156: Our covered real estate companies – Ratings, target prices and earnings forecasts

Code	Company	Rating / Target Price (¥)	Earnings result and forecast (¥bn, ¥)	Actual FY3/15	Co.E FY3/16	DSF FY3/16	DSF FY3/17	DSF FY3/18
8801	Mitsui Fudosan	Buy ¥4,730	Sales	1,529.0	1,610.0	1,614.0	1,724.4	1,595.2
			OP	186.1	195.0	198.6	206.6	178.8
			RP	163.4	171.0	178.6	186.6	158.8
			NP	100.2	107.0	108.8	114.2	96.4
			EPS	103.9	108.3	110.1	115.6	97.6
8802	Mitsubishi Estate	Hold ¥2,900	Sales	1,110.3	995.0	1,022.8	1,145.1	1,003.8
			OP	156.3	135.0	137.5	154.8	139.0
			RP	133.1	113.0	113.5	129.0	113.2
			NP	73.3	70.0	70.3	70.7	59.7
			EPS	52.9	50.5	50.7	51.0	43.0
8830	Sumitomo R&D	Buy ¥5,850	Sales	806.8	850.0	845.9	884.7	804.5
			OP	165.9	174.0	174.7	180.5	172.4
			RP	139.1	147.0	147.8	150.4	142.3
			NP	80.6	88.0	89.6	91.4	86.8
			EPS	170.0	185.7	189.0	192.8	183.1
3289	Tokyu Fudosan Holdings	Hold ¥950	Sales	773.1	780.0	780.8	783.0	691.2
			OP	63.3	65.0	65.1	67.0	59.1
			RP	51.7	52.0	52.2	54.1	46.3
			NP	25.2	26.5	28.6	30.7	25.6
			EPS	41.4	43.5	46.9	50.4	42.0
Code	Company	Rating / Target Price (¥)	Earnings result and forecast (¥bn, ¥)	Actual FY12/14	Co.E FY12/15	DSF FY12/15	DSF FY12/16	DSF FY12/17
8804	Tokyo Tatemono	Hold ¥1,940	Sales	237.0	230.0	230.7	216.0	243.6
			OP	30.6	30.0	30.0	31.1	32.4
			RP	17.3	18.0	18.0	18.8	19.8
			NP	82.9	13.0	13.0	8.1	8.7
			EPS	386.2	121.1	60.5	37.6	40.4

Source: Company, Deutsche Securities forecast

Figure 157: Our coverage list of J-REIT sector

		Rating	Target unit price	Target FFO multiple	Relative to NBF's FFO multiple	Current unit price	Upside /downside	Distribution yield	FFO multiple	NAV multiple
NBF	8951	Buy	¥610,000	24.0	-	¥554,000	10%	2.8%	21.8	1.2
JRE	8952	Buy	¥610,000	24.0	1.00	¥556,000	10%	2.8%	21.9	1.2
JRF	8953	Hold	¥210,000	15.6	0.65	¥243,000	-14%	3.5%	18.3	1.3
UUR	8960	Hold	¥165,000	19.2	0.80	¥180,000	-8%	3.3%	21.1	1.4
KDO	8972	Sell	¥480,000	15.6	0.65	¥574,000	-16%	3.6%	18.7	1.0
NAF	3226	Hold	¥440,000	18.0	0.75	¥440,500	0%	3.6%	18.0	1.2
IIF	3249	Hold	¥510,000	21.6	0.90	¥552,000	-8%	3.3%	22.7	1.6
ADR	3269	Hold	¥280,000	21.6	0.90	¥270,500	4%	3.3%	21.0	1.3
NPR	3283	Hold	¥275,000	26.4	1.10	¥244,500	12%	3.3%	23.6	1.6

Price as of 31 July, 2015
Note: Distribution yield, FFO multiple and NAV multiple are based on our forecasts.
Source: Bloomberg Finance LP, Deutsche Securities forecast

Real estate chronology

Figure 158: Japanese real estate market chronology

FY	Land price trend (official land price)	Events
1984	Greater Tokyo 2.7%	Yurakucho Mullion opens Nikkei average tops ¥10,000
1985	Greater Tokyo 2.4%	Metro Tokyo renovation scheme Plaza Accord
1986	Greater Tokyo 4.1%	Ark Hills opens Equal Employment Opportunity Law implemented
1987	Greater Tokyo 23.8%	Double taxation adopted for property held for less than two years ODR lowered by 2.5%
1988	Greater Tokyo 65.3%	Narrowing of criteria for special capital gains tax breaks on real estate repurchases Recruit scandal
1989	Greater Tokyo 1.8%	Consumption tax introduced, Nikkei average hits record high Basic Act for Land established
1990	Greater Tokyo 7.2%	Restrictions on total credit supply for real estate purchases Mitsubishi Estate acquires Rockefeller Center
1991	Greater Tokyo 7.0%	Land Value Tax Act passed by Diet Hike in basic deduction from inheritance tax
1992	Greater Tokyo -8.4%	Land Value Tax Act implemented Farmland tax raised to residential land level
1993	Greater Tokyo -14.9%	Financial deregulation, eg deregulation of stock trading commissions Cooperative Credit Purchasing Company established
1994	Greater Tokyo -9.4%	Real Estate Specified Joint Enterprise Act established General contractor corruption scandal
1995	Greater Tokyo -5.0%	¥685bn for housing loan company cleanup Yen hits record ¥79.75/dollar
1996	Greater Tokyo -7.0%	Bank of Tokyo-Mitsubishi launched Announcement of Financial Big Bang vision
1997	Greater Tokyo -5.1%	Bankruptcy of Sanyo Securities, Hokkaido Takushoku Bank, Yamaichi Securities Consumption tax hiked to 5%
1998	Greater Tokyo -3.9%	Land value tax cut to 0% Bankruptcy of Long-Term Credit Bank of Japan, Nippon Credit Bank
1999	Greater Tokyo -7.1%	Housing Quality Assurance Act established Zero interest rate policy adopted
2000	Greater Tokyo -7.4%	Ban lifted on real estate investment trusts Fixed-Term Rental Housing Act established
2001	Greater Tokyo -6.4%	Listing of J-REIT in 2001 Terrorist attacks in US
2002	Greater Tokyo -6.4%	Act on Special Measures Concerning Urban Reconstruction established Marunouchi Building opens
2003	Greater Tokyo -5.9%	Massive supply of office space in 2003 Roppongi Hills opens
2004	Greater Tokyo -4.9%	Landscape Act established Niigata Chuetsu Earthquake
2005	Greater Tokyo -3.2%	Falsification of anti-seismic design documents scandal Kyoto Protocol
2006	Greater Tokyo -0.7%	Lifting of quantitative monetary easing and zero interest rate policies FSA strengthens oversight of real estate lending
2007	Greater Tokyo 4.6%	Five real estate majors post record profits Morgan Stanley group buys 13 hotels from ANA for ¥281.3bn
2008	Greater Tokyo 6.7%	US subprime loan crisis sparks wave of losses at US and European banks Failures begin among Japanese condo developers
2009	Greater Tokyo -4.7%	Record cut in home mortgage taxes Governments worldwide carry out massive public fund injections. BoJ cuts rates for first time in over 7.5 years.
2010	Greater Tokyo -5.4%	Miki Shoji vacancy rate exceeds 9% BoJ begins ¥50bn J-REIT purchase program, eases monetary policy
2011	Greater Tokyo -1.9%	The Great East Japan Earthquake European sovereign debt crisis
2012	Greater Tokyo -1.7%	The government is changed from DPJ to LDP (the second administration of Abe) The stock prices hike after the dissolution of the Lower House
2013	Greater Tokyo -0.6%	The government decided consumption tax hike from 5% to 8% from April 2014 Abenomics (Abe administration's economic measures) started. Tokyo selected as 2020 Olympic host.
2014	Greater Tokyo 0.9%	Real GDP growth fell negative in FY2014 Nikkei 225 average: 17,450.77 yen

Source: Ministry of Land, Infrastructure, Transport and Tourism 'Official Land Price Survey', Deutsche Securities

Valuation and risks

Valuation

Real estate sector
We base our target prices on a residual income model. We also take NAV into account.

Mitsui Fudosan (8801)
Our target price is based on a theoretical share price obtained from our residual income model (using a 3.41% cost of equity, 1.207 beta, and earnings estimates for three years), and other factors including after-tax unrealized gains on investment properties.

Mitsubishi Estate (8802)
Our target price is based on a theoretical share price obtained from our residual income model (using a 3.32% cost of equity, 1.159 beta, and earnings estimates for three years), and other factors including after-tax unrealized gains on investment properties.

Sumitomo Realty & Development (8830)
Our target price is based on a theoretical share price obtained from our residual income model (using a 4.60% cost of equity, 1.441 beta, and earnings estimates for three years), and other factors including after-tax unrealized gains on investment properties.

Tokyu Fudosan Holdings (3289)
Our target price is based on a theoretical share price obtained from our residual income model (using a 4.73% cost of equity, 1.492 beta, and earnings estimates for three years), and other factors including after-tax unrealized gains on investment properties.

Tokyo Tatemono (8804)
Our target price is based on a theoretical share price obtained from our residual income model (using a 4.82% cost of equity, 1.527 beta, and earnings estimates for three years), and other factors including after-tax unrealized gains on investment properties.

J-REIT sector
We base our valuation on the FFO multiple for J-REITs. We first set the FFO multiple for NBF, the largest J-REIT, and then set multiples for other J-REITs by referencing historical movements relative to NBF. Then, we derive our target price from our FFO per unit forecasts and the target multiple.

Nippon Building Fund (8951)
Our target price is derived from our forecast NOI, estimating market capitalization from the applied implied cap rate of 3.5%, and dividing by the number of investment units outstanding. We base our assumption for the implied cap rate of 3.5% on a general risk premium of 3% for Japanese stocks and real interest 0.5%. This target price is equivalent to an FFO multiple of 24.0x.

Japan Real Estate Investment (8952)

We use an FFO multiple of 24.0x for JRE, the same as NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Japan Retail Fund Investment (8953)

We use an FFO multiple of 15.6x for JRF, which is 0.65x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

United Urban Investment (8960)

We use an FFO multiple of 19.2x for UUR, which is 0.8x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Kenedix Office Investment (8972)

We use an FFO multiple of 15.6x for KDO, which is 0.65x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Nippon Accommodation Fund (3226)

We use an FFO multiple of 18.0x for NAF, which is 0.75x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Industrial & Infrastructure Fund Investment (3249)

We use an FFO multiple of 21.6x for IIF, which is 0.9x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Advance Residence Investment (3269)

We use an FFO multiple of 21.6x for ADR, which is 0.9x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Nippon Prologis REIT (3283)

We use an FFO multiple of 26.4x for ADR, which is 1.1x of NBF's target multiple. Our target price is derived from our forecast FFO per unit and the target multiple.

Risks

Real estate sector

Our recommendation for the real estate sector is ‘Market weight’. Downside risks to the real estate sector include: 1) higher risk premiums due to lower bank lending to the sector; 2) tax hikes (e.g., consumption tax and income tax) and lower government spending due to a rush toward fiscal restructuring; and 3) tax revisions or regulations that inhibit real estate liquidity. Upside risks include: 1) sharp increases in private sector wages; and 2) clarification that fiscal stimulatory measures such as lowering income tax will be taken.

Mitsui Fudosan (8801)

Downside risks include: 1) a halt in the real estate investment market recovery; 2) renewed weakness in personal consumption and investment sentiment; and 3) further corporate cost-cutting.

Mitsubishi Estate (8802)

Downside risks include: 1) a shift in Japan's main business district away from the Marunouchi-Otemachi area; and 2) sluggish building business and residential business operations, due to a poor macroeconomic environment. Upside risks include: 1) the BoJ announcing further monetary easing; and 2) expanding demand for office space as the economy continues to rebound.

Sumitomo Realty & Development (8830)

Downside risks include: 1) the introduction of a tax system that would negatively affect bank loans to the real estate industry; 2) renewed weakness in personal consumption and investment sentiment; and 3) further corporate cost-cutting.

Tokyu Fudosan Holdings (3289)

Downside risks include: 1) unexpectedly low profitability in the large Ginza development project; and 2) difficulty in procuring funds because of a financial crisis. Upside risks include: 1) a major yen depreciation; and 2) a low cap rate supporting real estate transactions.

Tokyo Tatemono (8804)

Downside risks include: 1) a decline in unrealized gains on the Otemachi Tower; and 2) difficulty in procuring funds due to financial crisis. Upside risks include: 1) an increase in inflation expectations; and 2) Japanese companies becoming proactive in increasing employee wages.

J-REIT sector

Our recommendation for the J-REIT sector is 'Market weight'. Downside risks to the J-REIT sector include: 1) a drawn-out economic recession due to a consumption tax hike resulting in a weak real estate market; 2) a decrease in the BoJ's monetary easing and the elimination of the BoJ's J-REIT purchase program; 3) a sharp decline in lending to the real estate sector by financial institutions; and 4) legal revisions that could have an adverse impact on J-REIT operations or accounting rules. Upside risks include: 1) a reduction of the consumption tax rate to 5%; 2) consumer spending and corporate capital investment remaining robust with no drop-off; 3) a clear rise in rents of the entire office market; and 4) further monetary easing by the BoJ and a major expansion of the BoJ's J-REIT purchase program.

Nippon Building Fund (8951)

Downside risks include: 1) another fall in revenues from existing buildings; 2) losing property pipelines from its sponsor; and 3) a substantial dilution in equity from a capital increase.

Japan Real Estate Investment (8952)

Downside risks include: 1) a reduction in target LTV; 2) losing property pipelines from its sponsor; and 3) a substantial dilution in equity from a capital increase.

Japan Retail Fund Investment (8953)

Downside risks include: 1) stagnant private consumption and deterioration in retail sector earnings; 2) major tenant rents being lowered or tenants leaving; and 3) a substantial dilution in equity from a capital increase. Upside risks include: 1) a significant improvement in private consumption and retail sector earnings; and 2) a sharp fall in expected yield for retail properties.

United Urban Investment (8960)

Downside risks include: 1) losing tenants and/or a substantial reduction in rents at office, retail and hotel properties; and 2) a substantial dilution in equity from a capital increase. Upside risks include: 1) a clear rise in existing tenants' rents, particularly in office buildings; and 2) the acquisition of properties with yields significantly higher than its overall portfolio.

Kenedix Office Investment (8972)

Upside risks include: 1) Japanese economic expansion, improvement in business sentiment at SMEs, and the medium-scale office market becoming more favorable than the overall office market; 2) increased rent from existing tenants; and 3) the acquisition of properties with yields significantly higher than its overall portfolio.

Nippon Accommodation Fund (3226)

Downside risks include: 1) losing property pipelines from its sponsor; 2) the adoption of policies giving an extreme advantage for home ownership and a disadvantage for rental housing; and 3) a substantial dilution in equity from a capital increase. Upside risks include: 1) the acquisition of prime properties with high yields; and 2) government policies that drive up residential leasing demand.

Industrial & Infrastructure Fund Investment (3249)

Downside risks include: 1) tenants breaking their leases or contractual rent reductions; 2) a failure to acquire properties using their sponsor's credit; 3) substantial dilution in equity from a capital increase. Upside risks include: 1) the acquisition of prime properties with high yields as companies sell more assets for their balance sheet restructuring; and 2) a sharp decline in expected yield for logistics properties.

Advance Residence Investment (3269)

Downside risks include: 1) losing property pipelines from its sponsor; and 2) the adoption of policies giving an extreme advantage for home ownership and a disadvantage for rental housing. Upside risks include: 1) the acquisition of prime properties with high yields; and 2) government policies that drive up residential leasing demand.

Nippon Prologis REIT (3283)

Downside risks include: 1) sluggish earnings at retailers and distributors amid an economic downturn squeezing demand for logistics facilities; 2) losing property pipelines from its sponsor; and 3) suspension of surplus cash distribution. Upside risks include: 1) a significant increase in rents driven by earnings growth at retailers and distributors amid an economic recovery; and 2) a sharp decline in the expected yield for logistics properties.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Mitsui Fudosan	8801.T	3,464 (JPY) 3 Aug 15	14,15
Sumitomo R&D	8830.T	4,300 (JPY) 3 Aug 15	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Important Disclosures Required by U.S. Regulators

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14. Deutsche Bank and/or its affiliate(s) has received non-investment banking related compensation from this company within the past year.

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Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Yoji Otani

Historical recommendations and target price: Mitsui Fudosan (8801.T)
(as of 8/3/2015)

1.	20/09/2013:	Downgrade to Hold, JPY3,900	3.	17/04/2015:	Hold, Target Price Change JPY3,450
2.	08/04/2014:	Hold, Target Price Change JPY3,350	4.	09/06/2015:	Upgrade to Buy, Target Price Change JPY4,730

Historical recommendations and target price: Sumitomo R&D (8830.T)
(as of 8/3/2015)

1.	20/09/2013:	Downgrade to Hold, JPY4,800	3.	20/04/2015:	Hold, Target Price Change JPY4,650
2.	08/04/2014:	Hold, Target Price Change JPY4,200	4.	09/06/2015:	Upgrade to Buy, Target Price Change JPY5,850

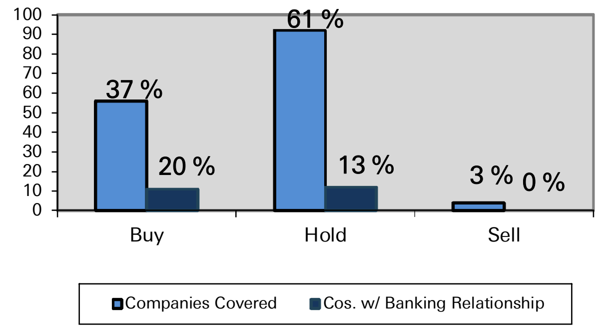
Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:

    Buy: Expected total return (including dividends) of 10% or more over a 12-month period
    Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
    Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Japan Universe

Regulatory Disclosures

1.Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

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Participants in foreign exchange transactions may incur risks arising from several factors, including the following: (i) exchange rates can be volatile and are subject to large fluctuations; (ii) the value of currencies may be affected by numerous market factors, including world and national economic, political and regulatory events, events in equity and debt markets and changes in interest rates; and (iii) currencies may be subject to devaluation or government imposed exchange controls which could affect the value of the currency. Investors in securities such as ADRs, whose values are affected by the currency of an underlying security, effectively assume currency risk.

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