April 2011

Japan Real Estate First Quarter 2011

Executive Summary

The 4.4 per cent GDP growth that Japan experienced in 2010 was the best economic performance the country had seen in years. Going into 2011, economists were predicting a soft landing with modest growth. All of this changed on 11 March when the Great Tohoku Earthquake shook the nation with the highest magnitude the country had ever experienced. Revised forecasts of Deutsche Bank's economists now predict an economic dip of negative 2.1 per cent for 2011, but with the promise of a slightly stronger rebound in 2012-2013 as reconstruction moves into high gear.

Japan's invested real estate sector suffered less immediate physical damage than might have been expected. For example, the total damage on properties reported by all J-REITs is just 0.02 per cent of their total real estate stock in value. The greater impact to real estate appears to lie with near-term demand and office market recovery has now been pushed back for a year. Retail sales will inevitably suffer from shorter hours, store closings, and more importantly, reluctant consumers.

The 'Research Topic' section provides a brief analysis of the anticipated impact of the Great Tohoku Earthquake on the Japanese macro economy as well as on the real estate market. Despite the physical destruction and lives lost along Japan's northern coast and despite the nuclear accident caused by the tsunami, the most immediate economic problem left behind is a power crisis. TEPCO, the quasi-monopoly electricity provider for the Kanto region (which includes Tokyo) draws 27 per cent of its capacity from nuclear energy, much of it from the damaged Fukushima Daiichi nuclear plant in Tohoku where the tsunami struck. With summer approaching, the shortage of electricity in the world's largest urban area threatens not only the regional economy; the power crisis has already sent ripples throughout the entire global supply chain for manufactured goods. Power cuts could feasibly continue beyond 2011 until TEPCO's generating capacity is replaced or restored.

While the implications for real estate could change —too many questions ranging from the Japanese government's financing of reconstruction to TEPCO's legal and financial liabilities remain unanswered— a few things appear clear with what we know so far: Firstly, space demand for office properties in Tokyo and beyond will tilt toward high-grade properties built to exacting standards for seismic resistance and energy efficiency, and the recovery of the overall market will be pushed back. Secondly, investors, especially foreign ones, may stay on the sidelines until the extent and impact of radiation contamination is determined, but this will be temporary. With the already widest yield spreads among major markets, buyers may find Japanese real estate too enticing to ignore once things stabilise. Finally, the dire fiscal situation of Japan's public sector was further complicated by the earthquake. Governments at the national as well as the local levels will struggle to find options for financing reconstruction. They may find that privatization of public assets is a more palatable option than it was before.

April 2011

Table of Contents:

Prepared by:

Koichiro (Ko) Obu
Director
Head of Research, Japan
+81 (0) 3 5156 6522
koichiro.obu@rreef.com

Orie Endo
Assistant Vice President
+81 (0) 3 5156 6514
orie.endo@rreef.com

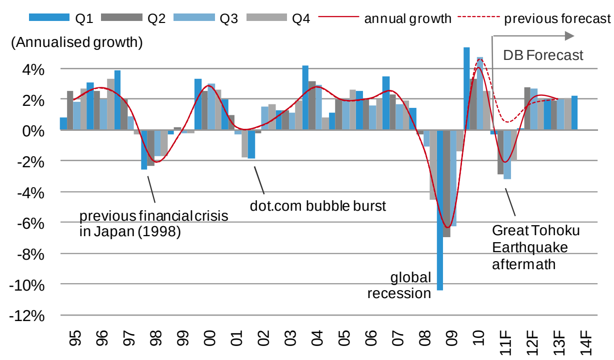
First Quarter 2011 Market Outlook

1. Macro Economy

Japan's economy grew 4.4 per cent in 2010, fuelled by external demand and waning ripples of government stimulus. But after the Great Tohoku Earthquake shook the country on March 11, significant constraints on economic activity have occurred, including shorter business hours and the closure of stores and plants, even in Tokyo and other cities not directly hit by the quake or tsunami. The sources of these disruptions—electric power shortages—are expected to last for the remainder of the year. Deutsche Bank's economists have incorporated these impacts and lowered Japan's real GDP forecast for 2011 to negative 2.1 per cent, followed by a slightly stronger rebound in the 2 per cent range in 2012 and 2013 as reconstruction moves into higher gear.

Chart 1

GDP Growth Outlook for Japan

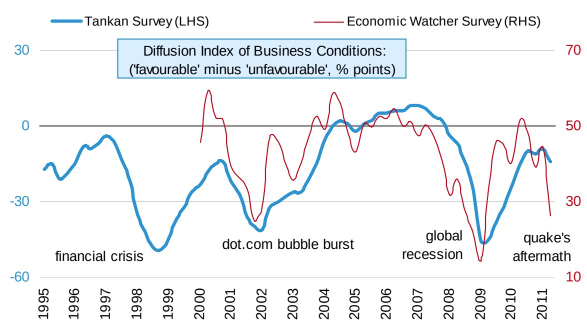


Source: Deutsche Bank — *Data as of April 2011*
Note: F=forecast

The Tankan Survey conducted by the Bank of Japan partially reflects the recent slowdown in the economy. The Economy Watcher Survey[1] reflects severer drop in March 2011, recording the sharpest plummet in a month in the diffusion index (DI) of business conditions for all industries since 2000.

Chart 2

Diffusion Index of Business Conditions



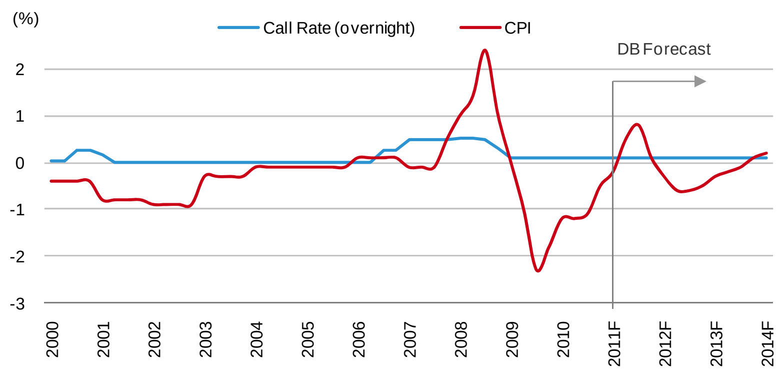
Sources: The Bank of Japan, Japan's Cabinet Office — *Data as of April 2011*

[1] *A monthly survey by Japan's Cabinet Office on business sentiment among taxi drivers, store owners and others in jobs from over 10,000 companies seen as sensitive to economic changes*

After the quake, Japan's consumer price index (CPI) responded rapidly to supply constraints and the effects of hoarding. Downward pressure on pricing is expected to resume in 2012 once supply constraints are resolved. Deutsche Bank's economists expect the Bank of Japan to keep the interest rate close to zero through 2013.

Chart 3

Forecast of Short-Term Interest Rate and CPI



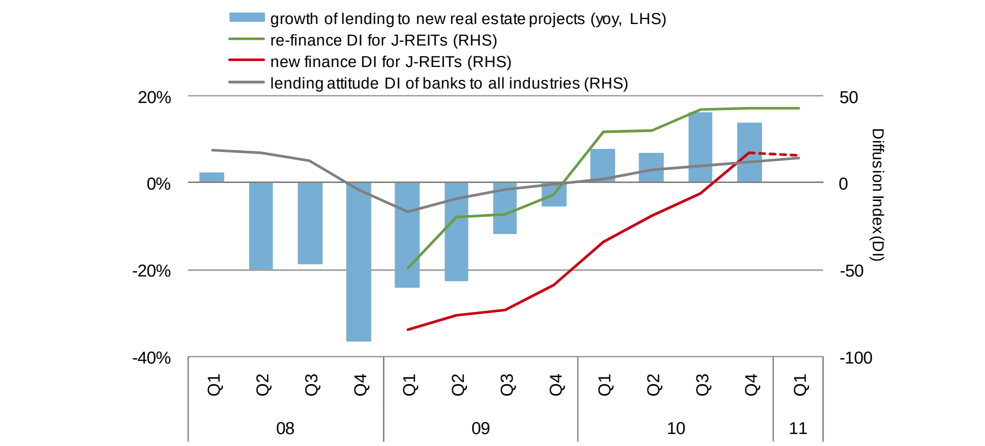
Source: Deutsche Bank *Data as of April 2011*
Note: F=forecast

2. Capital Market & Pricing

Credit conditions continued to ease in the Japanese real estate markets, at least until the earthquake occurred. New lending by banks for real estate projects increased by 14 per cent in the fourth quarter of 2010 compared to the same period in the previous year[2]. This marked four consecutive quarters of increase. The Bank of Japan's DI for the lending attitudes of banks (grey line in Chart 4) improved in the first quarter 2011 for the eighth consecutive period. This upward momentum, however, may be curtailed as banks might be required to reallocate resources toward post-quake reconstruction. For more on this issue, see the 'Research Topic' section.

Chart 4

Real Estate Lending by Japanese Banks



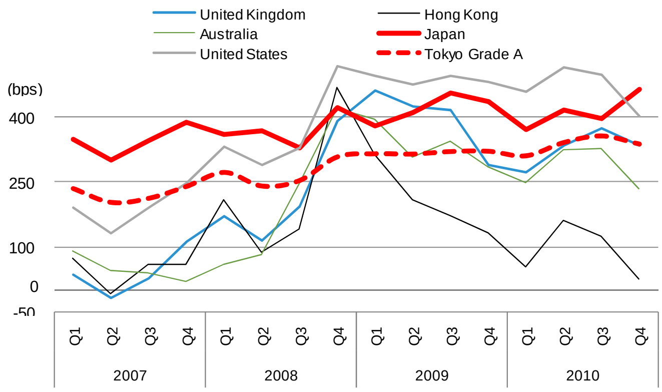
Source: RREEF Research based on Bank of Japan, ARES *Data as of April 2011*

The average cap rate for reported commercial real estate transactions in Japan peaked in 2009 while the average yield spread of these transactions over government bonds has remained near or above 400 basis points ever since. The country's yield spread is one of the widest among the major markets. Japan's cap rate for high quality grade A buildings in Tokyo started to show recovery signs in the first quarter of 2011 before the quake, but the overall cap rate recovery lags, particularly for regional cities and for non-grade A buildings in Tokyo. For investors, this has translated to attractive buying opportunities in Japan.

[2] *Back-to-back quarterly increases in new bank lending according to the Bank of Japan*

Chart 5

Average Yield Spread for All Transactions in Selected Countries



Source: RREEF Research, Real Capital Analytics *As of April 2011*

Chart 6 shows major real estate transactions either completed or announced since the beginning of the year. In the first quarter of 2011, acquisitions of office buildings by J-REITs dominated the market. This was fuelled by a series of successful rights issues of J-REITs in the period (such as Nippon Building Fund and Japan Excellent REIT), similar to the same quarter in 2010.

Chart 6

Major Real Estate Transactions in Japan in the First Quarter of 2011

JPY1 billion = US$12 million

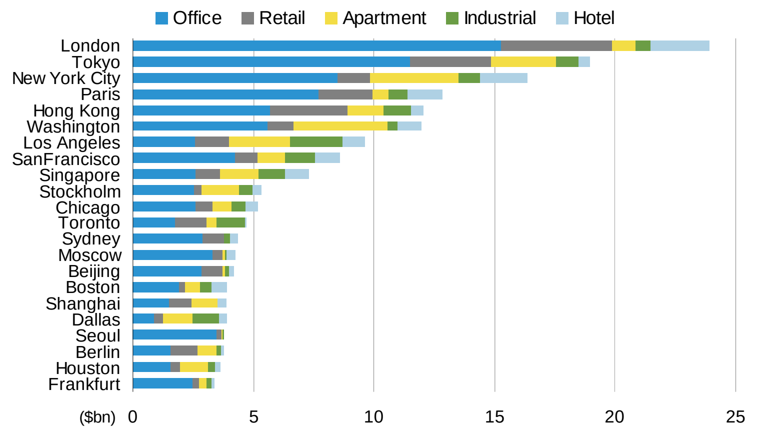
Month	Type	Asset	Price (JPY billion)	Unit pice (JPY m /sqm)	Cap rates	Pre-fecture	Acquired by	Investor origin
Jan-11	office	River City M-Square	13.0	0.8	5.0%	Tokyo	Nippon Building Fund (REIT)	Japan
Jan-11	land	Land of TKS's Tamagawa plant	16.0	1.2	-	Kanagawa*	Sumitomo Realty & Develop't	Japan
Jan-11	office	River City M-Square	13.3	0.8	5.0%	Tokyo	Nippon Building Fund (REIT)	Japan
Jan-11	office	Daiba Garden City Building	11.0	0.3	5.4%	Tokyo	Japan Excellent (REIT)	Japan
Jan-11	sch'l/office	Tokyo University of Science	2.2	1.6	-	Tokyo	Practical Ethics Association	Japan
Feb-11	office	Osaki Front Tower	12.3	0.6	6.9%	Tokyo	Japan Excellent (REIT)	Japan
Feb-11	office	LAQUAS Higashi Shinjyuku	n.a.	-	-	Tokyo	Prudential Real Estate	USA
Feb-11	office	GateCity Osaki (5.7%)	11.7	1.3	4.5%	Tokyo	Nippon Building Fund (REIT)	Japan
Feb-11	senior home	senior home in Fukuoka	0.6	0.2	-	Fukuoka	Parkway Life	Singapore
Feb-11	hotel	Confort Hotel Okayama	0.7	0.1	-	Okayama	IPC Corporation	Singapore
Feb-11	retail	Shinjyku Flags (land)	10.7	-	-	Tokyo	Odakyu Railway	Japan
Feb-11	retail	Canal City Hakata (44.8%)	28.7	0.3	5.8%	Fukuoka	Fukuoka REIT	Japan
Feb-11	retail	LaLa Garden Kasukabe	10.0	0.2	6.2%	Saitama*	Frontier Real Estate (REIT)	Japan
Mar-11	office	Kokusai Shin Akasaka Blds	90.0	1.0	-	Tokyo	Mitsubishi Estate	Japan
Mar-11	office	Hirakawacho Mori Tower	18.2	1.4	4.5%	Tokyo	Global One (REIT)	Japan
Mar-11	office	Promise Headquarters Bld	72.0	2.6	-	Tokyo	Mitsui Fudosan/ Mitsui & Co	Japan
Mar-11	land	land for Toyosu new fishmarket	55.9	-	-	Tokyo	Tokyo Metropolitan Gov't	Japan
Apr-11	logistics	logistics in Hiroshima	7.3	0.2	-	Hiroshima	Mapletree Logistics	Singapore

Source: Real Capital Analytics, Nikkei Real Estate Market Report, RREEF Research *Data as of April 2011*
*Note: * Both Kanagawa and Saitama are adjacent to Tokyo and represent part of the urbanized area that forms Greater Tokyo.*
This table is prepared solely for information purposes and not intended to recommend or endorse any specific company's shares or other products. Non-office deals, assets outside Tokyo, and acquisitions by foreign managers are highlighted in yellow

Tokyo's volume of commercial real estate transactions in 2010 ranked second after London for the second year in a row, according to Real Capital Analytics. The total volume was USD 18.9 billion in 2010, a 31.8 per cent increase from the previous year. Office transactions accounted for 60.7 per cent of the volume, followed by 17.6 per cent in the retail and 14.3 per cent in the residential sectors. The market remained active in the first quarter of 2011 as shown in the Exhibit 6. However, some foreign investors have put new investments on hold, following the earthquake and pending resolution of problems with the nuclear reactors at the Fukushima Daiichi plant in northern Japan.

Chart 7

Commercial Real Estate Transaction Volumes by City in 2010

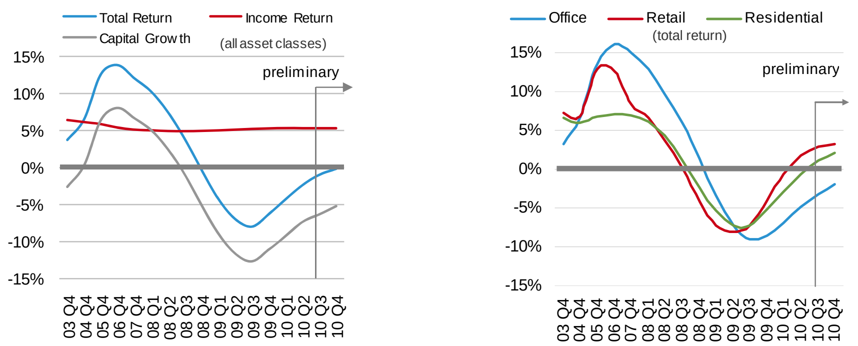


Source: Real Capital Analytics, RREEF Research *Data as of April 2011*
Note: Commercial real estate transactions exclude non-income producing assets, such as development site transactions

Based on the monthly indicator tracked by Investment Property Databank (IPD), the average annual total return for direct real estate investment on an unlevered basis in Japan improved steadily during 2010. The 12-month rolling IPD index for total return has produced four consecutive quarters of improvement, recovering to negative 0.2 per cent as of December 2010 on a preliminary basis. Total returns were positive in the retail and residential sectors for the same period while the recovery lagged in the office sector in 2010.

Chart 8

Return of Unlevered Direct Investment in Japan



Source: RREEF Research based on IPD Japan Monthly Indicator *Data as of April 2011*
Note: There is a time lag because of raw data being collected through semi annual reports

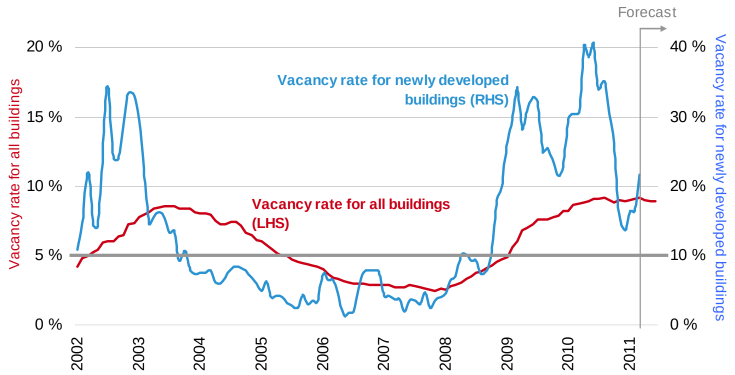
3. Market Fundamentals

Office

In March 2011, the vacancy rate for newly developed buildings[3] in Central Tokyo[4] (blue line in Chart 9) rebounded above the 20 per cent level for the first time in five months. Similarly, the overall office vacancy rate in Central Tokyo reached 9.19 per cent in March, its highest point thus far in the cycle. Deutsche Bank's economists expect the unemployment rate will rise to 5.6 per cent by the fourth quarter of 2011, compared to 4.9 per cent in a pre-quake forecast for the same period, indicating soft demand to persist during the year.

Chart 9

Office Vacancy Rate in Central Tokyo (5 wards)

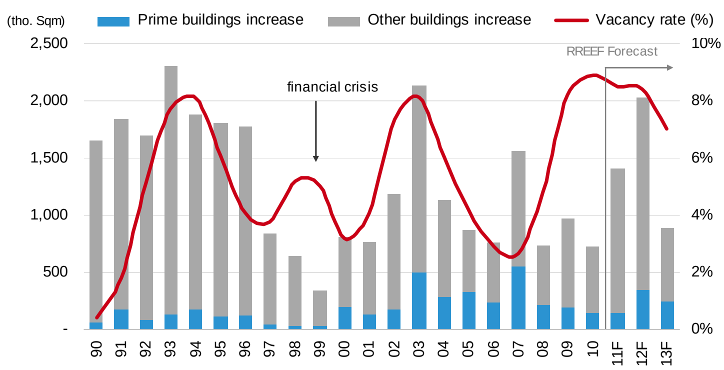


Source: RREEF Research, Miki Shoji *Data as of April 2011*

Overshadowing the already weakening fundamentals is a surge of new office supply expected in 2011 and 2012 in Tokyo. Because of weak demand and the supply increase, a significant recovery is not expected in the vacancy rate in Tokyo until 2012.

Chart 10

Office Stock Increase and Vacancy Rate in Central Tokyo



Source: RREEF Research, Miki Shoji *Data as of April 2011*
F = forecast

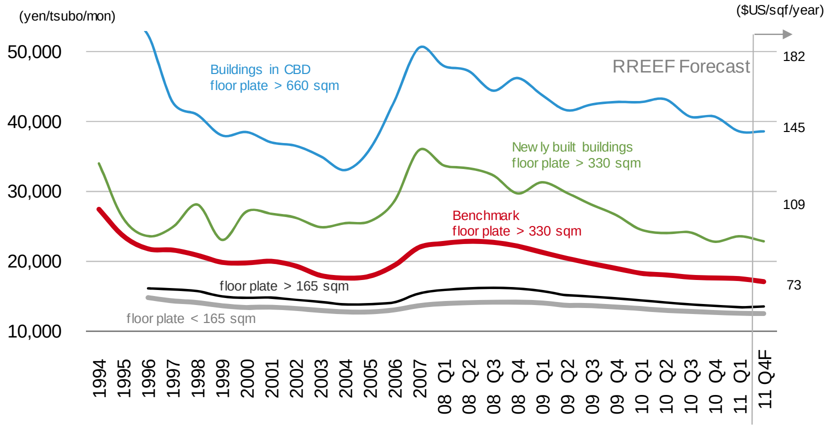
---

[3] *Newly developed buildings are those completed within the last 12 months.*
[4] *Central Tokyo is defined here as the central five wards (or "ku") of Chiyoda, Chuo, Minato, Shinjuku, and Shibuya.*

The average asking rents for benchmark properties have declined for the 31 consecutive months to March 2011, falling 23.5 per cent from their peak. With a surge of new supply on the way by 2012, demand will soften further, causing asking rents for benchmark buildings to come under pressure. These changes in market fundamentals, however, will occur unevenly and may vary across unique building specifications going forward. Old, low-grade buildings will suffer more than new, high quality, quake-resistant, energy efficient buildings.

Chart 11

Office Asking Rents in Central Tokyo by Building Floor Plate Size



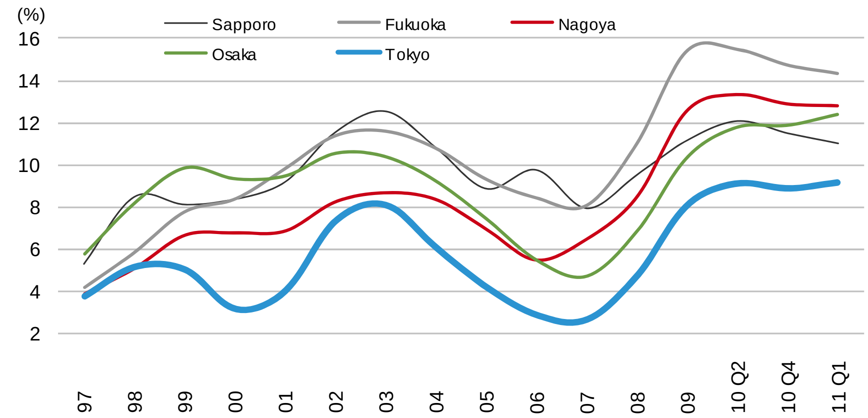
Sources: RREEF Research, Miki Shoji, Sanko Estate *Data as of April 2011*

Note: 1 tsubo = 3.3 sqm or 35.6 sf. F = forecast

Office vacancy rates have marginally recovered for two consecutive quarters in some second tier cities in Japan, namely Sapporo, Nagoya, and Fukuoka, although the absolute rates are still high at above 10 per cent. In Tokyo and Osaka, however, where there is a continuous supply of new offices, the recovery is lagging. The vacancy rate for newly completed offices is still very high in Osaka— 45.6 per cent as of March 2011, compared to 10-20 per cent in other cities. With office demand weakening even more after the earthquake, a very slow recovery in vacancy rates is expected in the short to mid term, if at all.

Chart 12

Office Vacancy Rates in Major Cities in Japan (all grades)



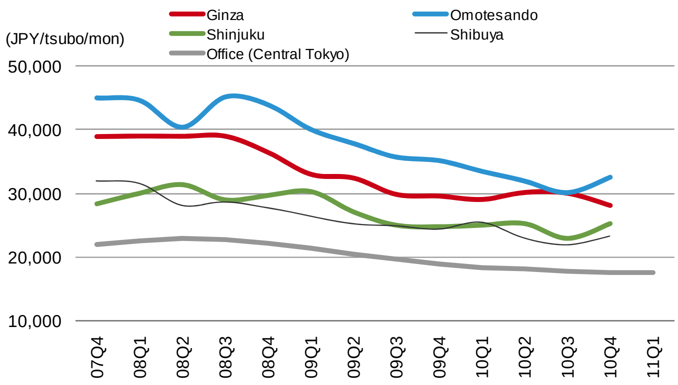
Source: RREEF Research, Miki Shoji *Data as of April 2011*

Retail

The average asking retail rents for major high streets in Tokyo rebounded in the fourth quarter in the Omotesando, Shinjuku, and Shibuya submarkets in the fourth quarter when consumer confidence showed signs of a recovery, while it has been stable at around JPY 30,000 per tsubo in Ginza for the last 15 months. Early reports indicate that high street retail sales plummeted after the quake, and this weak trend in retail sales in Tokyo is expected to persist at least for a short period of time, causing rents to resume a downward trend again in 2011.

Chart 13

Average High Street Retail Asking Rents in Tokyo

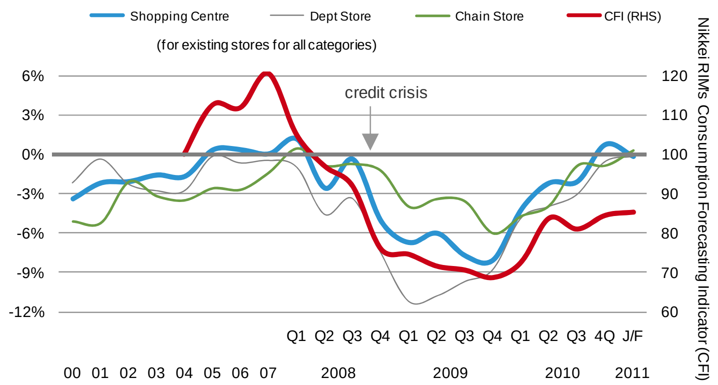


Source: RREEF Research based on data from Attractors Lab and Miki Shoji *Data as of April 2011*

Sales at shopping centres, department stores, and chain stores in January and February 2011 (on an existing store basis) were relatively flat compared with the same period in the previous year. Nikkei RIM's consumption forecasting indicator (CFI),[5] a survey that predicts future consumption trends six months in advance, remained above the 80-point index value for the eighth consecutive month in February 2011, but as indicated by the Economy Watcher Survey in Chart 2, the retail sales is expected to plummet at least for a short period of time. Western Japan, such as Osaka, is expected to be less affected than Eastern Japan.

Chart 14

Retail Sales Growth in Japan (year on year) and CFI



Source: RREEF Research, JCSC, JDSA, JCSA, Nikkei RIM *Data as of April 2011*

---

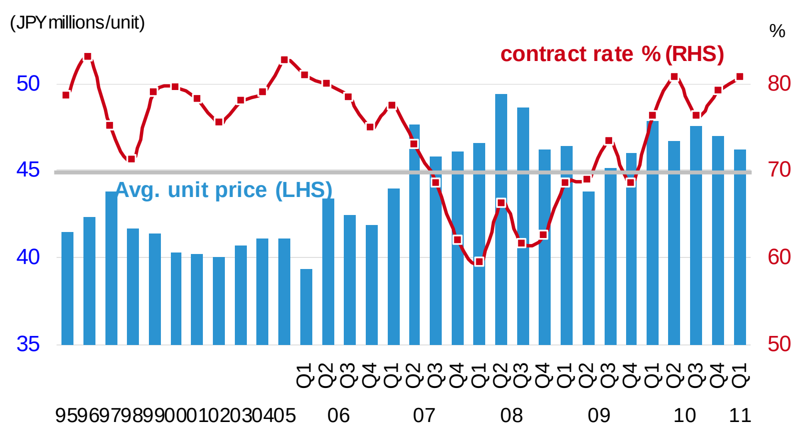
[5] *The CFI is based on a weighted monthly survey of up to 600 working-age adults (age 20 to 69) in the Tokyo metropolitan area. December 2004 = 100.*

Residential

The built-for-sale condominium (condo) market is currently one of the healthiest sectors in Japan. Propelled by the enhanced mortgage tax break offered by the government, the built-for-sale condo contract rate[6] (red line in Chart 15) remained at a buoyant level of above 80 per cent in the first quarter of 2011. The average sales price per unit was JPY 46 million.

Chart 15

Condominium Unit Price and Contract Rate in Greater Tokyo

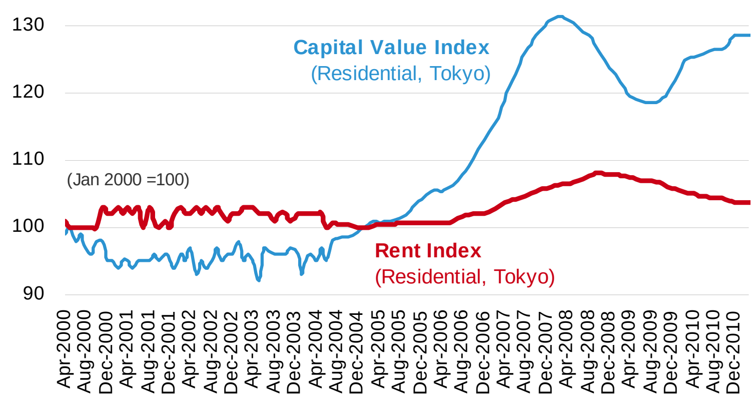


Source: RREEF Research based on REEI *Data as of April 2011*

The indices in the sales and rental residential markets show contrasting patterns. The capital value index of existing condos (i.e., the re-sale price index) gradually recovered through February 2011 as residential rents weakened. The high-end rent residential market is most affected due to softened demand for expatriates. Privately granting new tenants a rent-free period for a month or two is a popular incentive, although it is not reflected in the statistics.

Chart 16

Residential Capital Value and Rent Index in Tokyo



Source: IPD-RECRUIT Residential Index, RREEF Research *Data as of April 2011*

[6] *The contract rate is the ratio of units contracted (sold) to the number of units delivered for sale.*

4. Research Topic:

The Great Tohoku Earthquake and its impact on the Japanese real estate market

The Great Tohoku Earthquake struck the eastern coast of Japan on 11 March 2011. A month later in mid-April, the count of those either dead or missing exceeded 27,000, with most of the losses concentrated along the Pacific coast of the Tohoku region in northern Japan, the worst hit area by the post-quake tsunami.

Although reported damages were minimal in Tokyo and other cities where day-to-day lives have resumed, the ongoing power shortages and the unresolved fear of radiation contamination have inevitably cast a negative impact on the economy of the Kanto region, including Tokyo.

International media attention initially focused heavily on the nuclear problems rather than the crisis associated with the energy shortage, although the latter is now having a greater impact on the economy. Moreover, media coverage of the quake's aftermath missed one key fact: the amount of reported damages on the assets held by J-REITs is smaller than 0.02 per cent of their total combined asset value. This edition of 'Research Topic' provides a brief analysis on the impact of the earthquake, focusing on the factual data and expected impacts of power shortages on the economy and the real estate market.

Chart 17

Map of Japan and Nuclear Power Plants

Source: RREEF Research *Data as of April 2011*

Structural damage

Nearly two weeks after the earthquake, on March 24, the Japan's Cabinet Office announced the amount of the structural damage on dwellings, buildings, infrastructure, and utilities caused directly by the earthquake and the subsequent tsunami. The government estimated the total to be about JPY 16-25 trillion, or some 3-5 per cent of Japan's GDP. This is twice the size of the Great Hanshin Earthquake in 1995[7]. More than 90 per cent of the estimated damage is concentrated along the Pacific coast of the Tohoku region, namely Iwate, Miyagi and Fukushima prefectures, but severe soil liquefaction was also observed in Chiba prefecture[8], adjacent to Tokyo.

Chart 18

Reported Damages of Major Earthquakes in Japan

Earthquake name	Nearest city	Year	Magni-tude	Dead or missing	Estimated damage			Reconstruction	
						Real estate	Infrastr-ucture		public budget
			Richter scale	*persons*	*Y trn*	*Y trn*	*Y trn*	*Y trn*	*Y trn*
Great Tohoku	Sendai	2011	9.0	27,600	16-25	9-16	10	10-30?	6-8
Great Hanshin	Kobe	1995	7.3	6,437	10	6	3	16	3-11*
Great Kanto	Tokyo	1923	7.9	142,800					

**Reconstruction budget was JPY 3trn, but JPY 7trn was addtionally spent by government and mincupalities*

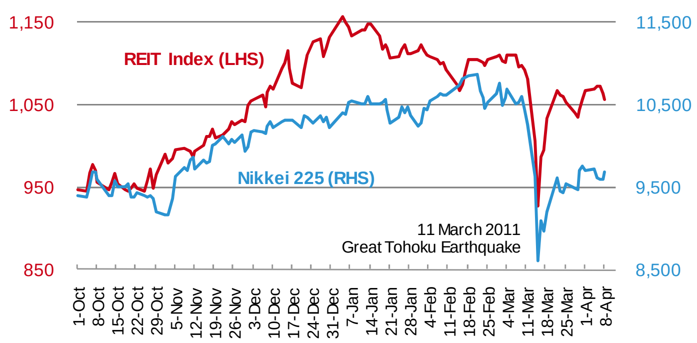
Source: RREEF Research *Data as of April 2011*

J-REIT Index

The J-REIT index fell immediately after the earthquake, losing 15 per cent of its value in the following three working days. The Bank of Japan quickly reacted to this, moving to expand its J-REIT share purchase package. Originally the total purchase amount was capped at JPY 50 billion when it was announced in late 2010 but on 14 March, it was increased to JPY 100 billion in order to revitalize the market. The J-REIT index then recovered substantially. By the end of March, it was only 3 per cent below its pre-quake level. The Nikkei 225, by comparison, fell 6.5 per cent during the same period.

Chart 19

Share Price Index of Nikkei and J-REIT



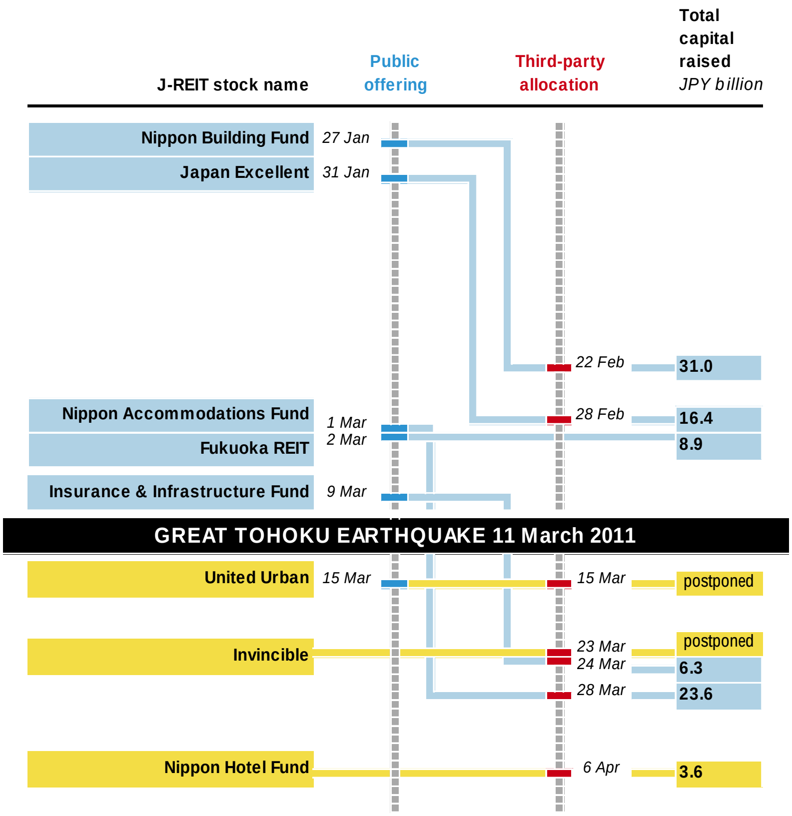
Source: Bloomberg, RREEF Research *Data as of April 2011*

[7] *The Great Hanshin Earthquake occurred near the city of Kobe in January 1995. Kobe, a port city in Hyogo prefecture, lies about 30 kilometres west of Osaka.*
[8] *Chiba prefecture is familiar to most foreign visitors to Japan as the home of Tokyo's Narita International Airport and Tokyo Disney Resort.*

The post-earthquake environment hampered the efforts of J-REITs to raise capital. There were five successful public offerings at J-REITs in 2011 before the earthquake, and together they raised a total of JPY 86 billion. Since the quake, no other public offerings have proceeded successfully. Nippon Hotel Fund was able to raise a small amount of capital, but this was accomplished through its sponsor rather than through the market.

Chart 20

Capital Raising Activities at J-REITs in YTD 2011



Source: Bloomberg, RREEF Research *Data as of April 2011*

Note: This table is prepared solely for information purposes and not intended to recommend or endorse any specific company's shares or other products.

Damage to real estate stock

Despite major structural damage to infrastructure, utilities, and private property, surprisingly, very limited damage was reported for invested real estate stock, i.e., assets that are held or managed by developers, J-REITs, or managers.

The J-REIT is the most transparent vehicle in the Japanese real estate market, making it a good proxy of the broader invested stock in the country. The estimated recovery cost for all J-REITs reported so far amounts to JPY 1.5 billion, or only 0.02 per cent of the value of the total invested stock of JPY 7.7 trillion. This is partly because only 49 assets, out of a total of 1,856 J-REIT-owned buildings, are located in Tohoku. In addition, invested stock in Japan tends to utilize high standards of quake-resistant technology, including seismically isolated and/or quake-absorbing structures to protect the assets from major damages. Chart 21 below shows the detailed damages RREEF Research collected from publications of each J-REIT. No downgrades on credit ratings resulting from the event have been reported so far.

Similarly, most other developers and managers have not reported severe damage either, apart from minor cracks, peeled plasterboard, or water leakage. Among asset types, logistics assets on the coastline were affected because of ground liquefaction caused by the earthquake (e.g., ProLogis reported that repair and replacement costs could total USD 4-6 million). Some damage has also been seen in shopping malls.

Chart 21

Structural Damages on Assets Held by J-REITS

Asset class	J-REIT stock name	Market cap	Appraisal value	Assets located in Tohoku		Reported damage or recovery cost	
		JPY m	*JPY m*	*number*	*value %*	*JPY m*	*%*
Office	Nihon Building Fund	466,271	855,648	3	2.0%	-	-
	Japan Real Estate	390,382	646,772	2	0.6%	-	-
	Global One Real Estate	62,985	152,993	-	-	-	-
	Nomura Real Estate Office	174,835	344,873	1	0.9%	-	-
	Daiwa - DA Office	111,100	252,009	-	-	-	-
	Ichigo - Japan Office	21,201	88,518	2	2.9%	-	-
	Japan Excellent	86,307	180,831	-	-	-	-
Retail	Japan Retail Fund	210,181	598,727	1	1.8%	666	0.11%
	Frontier Real Estate	138,904	225,750	-	-	-	-
Residential	Advance Residence	161,700	337,114	3	0.6%	50	0.01%
	Starts Proceed	13,767	36,146	2	2.1%	-	-
	Japan Rental Housing	47,243	134,768	10	2.7%	-	-
	Nippon Accommodations Fund	115,658	208,258	1	1.2%	-	-
	Nomura Real Estate Residential	59,253	121,305	5	2.9%	-	-
Hotel	Japan Hotel and Resort	17,782	86,620	1	-	-	-
	Nippon Hotel Fund	15,378	39,848	-	-	-	-
Industrial	Japan Logistic Fund	97,088	166,879	-	-	480	0.29%
	IIF	38,904	105,310	-	-	17	0.02%
Diversified	ORIX JREIT	113,859	292,824	1	2.8%	67	0.02%
	Japan Prime Realty	160,732	315,806	1	0.9%	-	-
	Premier Investment	55,059	152,178	-	-	-	-
	Tokyu REIT	91,465	192,910	-	-	60	0.03%
	United Urban	213,704	386,373	3	2.1%	114	0.03%
	Mori Trust Sogo Reit	188,760	279,760	-	-	-	-
	Invincible Investment	7,226	66,305	5	10.2%	-	-
	Heiwa Real Estate REIT	35,839	128,955	4	2.7%	-	-
	Fukuoka REIT	74,199	154,100	-	-	-	-
	Kenedix Realty	81,042	217,862	1	0.9%	-	-
	Sekisui - Joint Reit	42,633	89,934	-	-	-	-
	FC Residence	9,522	20,525	-	-	-	-
	Hankyu REIT	38,515	110,406	-	-	-	-
	Top REIT	80,135	175,351	-	-	-	-
	Blife	70,291	180,251	3	1.0%	-	-
	MID REIT	45,851	137,620	-	-	-	-
	Mori Hills REIT	62,071	201,220	-	-	-	-
Total		3,599,842	7,684,749	49	1.1%	1,454	0.02%

Source: Bloomberg, RREEF Research *Data as of April 2011*
Note: This table is prepared solely for information purposes and not intended to recommend or endorse any specific company's shares or other products.

RREEF

Power shortage

There is no national energy grid in Japan. Instead, the nation is divided into ten regional service areas, including Tohoku (northern Japan), Kanto (which includes Tokyo) and Kansai (which includes Osaka), and each region has a quasi-monopoly private power grid. The Tokyo Electric Power Company, or TEPCO, provides electricity solely in Kanto and is the largest energy firm in Japan. TEPCO draws 27 per cent of its electric-generating capacity from nuclear power plants, including the damaged Fukushima Daiichi nuclear power plant, and this explains why the Kanto region is experiencing a massive power shortage. This shortage has been managed with enforced planned blackouts in some suburban residential areas in Kanto in the weeks following the quake, but more severe power shortages are expected in the coming summer months as electricity demand peaks. These shortages could persist into winter 2011-2012 or onward.

The government and TEPCO are considering power cuts on industrial electricity usage by 20-30 per cent in summer 2011 in order to prevent any unexpected blackouts. These power cuts will cause severe disruptions for businesses, industries, and services, especially in supply chain management in the manufacturing sector.

Macro economy

Kanto was not directly hit by the tsunami, nor did it experience severe damage to buildings or infrastructure. Nevertheless, Kanto – a single region whose regional GDP is as big as that of Italy – is now bracing for significant constraints on economic activity, including shorter business hours, store and plant closures, and transportation disruptions caused by electric power shortages. Consumer activity also suffers as the fear of nuclear radiation contamination compels consumers to stay at home, thus spending less on dining, travel, and entertainment.

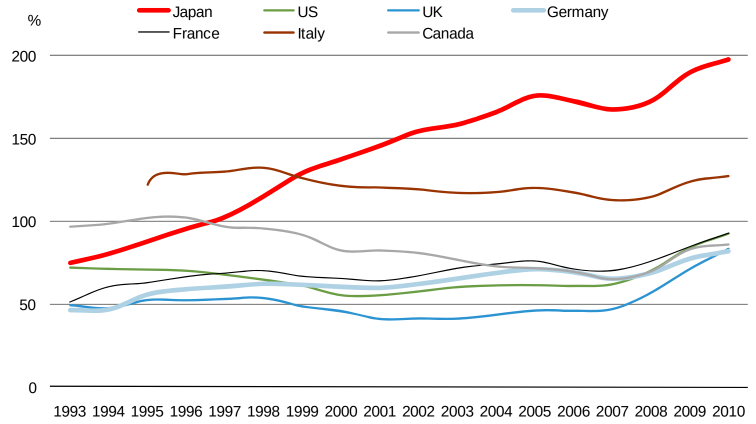
Since Kanto is the heart of Japan's economy, this is affecting the whole nation. Deutsche Bank's macro-economists have incorporated the expected impact of the catastrophe in Japan, leading them to lower their 2011 forecast for real GDP by 2.7 points to negative 2.1 per cent, followed by healthier economic growth in the 2 per cent range in 2012 and 2013.

Privatization need

Deutsche Bank's economists estimate that the government's reconstruction-related spending through supplementary budgets will be about JPY 6-8 trillion in the coming two years; other economists predict that it will require as much as JPY 10-30 trillion in coming years, if spending on reconstruction through other-purposed budgets on national and local levels is included. Part of this will be funded by a reallocation of government spending rather than an issuance of new bonds or an extension of public debt, nonetheless, it will be a burden for the national budget. As shown in Chart 22, the ratio of public debt (both national and local) in Japan to GDP is already close to 200 per cent, by far the highest among major nations.

Chart 22

Ratio of Public Debt to GDP in G7 Countries



Source: RREEF Research *Data as of April 2011*

Because an immediate tax increase is not realistic in Japan at this time, other options must be considered. One alternative is for the Japanese government and local municipalities to consider selling public assets in order to finance urgent demand for reconstruction. The amount of real assets held by the public sector in Japan is around JPY 454 trillion, including infrastructure (such as roads, airports, ports and schools) and real estate (such as government offices, local facilities and social housing). None of these have been sold directly to the private investors to date in Japan, except for minor peripheral businesses in local municipalities through private finance initiatives (PFIs).

Credit condition

TEPCO owns the quasi-monopoly electricity grid in Kanto, making it the most pivotal company for the economic recovery in Greater Tokyo and beyond. Major Japanese banks recognize TEPCO's central role in recovery, so they jointly granted a JPY 2 trillion credit line to the company in March 2011, paving the way for TEPCO to fund reconstruction of its power plants, engage in procurement, and maintain ample operating capital,. The worry, however, is that TEPCO will be obliged to pay restitution to a wide group of claimants, including victims and evacuees as well as farmers and fishermen whose livelihoods were severely battered by nuclear radiation contamination. This would put Japanese banks in a difficult position if they were required to provide more capital to TEPCO in order to keep it afloat. None of the major banks have officially tightened their credit to the real estate transactions to date, but there is uncertainty over their credit policy going forward since these banks are currently in the process of compliance with the Basel III accord[9], and might become reluctant to increase their risks in non-reconstruction-related sectors.

Implications for the real estate market

The analysis thus far has provided context for the post-quake situation in Japan. The remainder of this analysis will focus on the implications for the real estate market, but with an important caveat: there are many uncertainties and unresolved issues surrounding the current energy shortage and the public panic over radiation exposure. Consequently, it is still premature to draw definitive conclusions since the existing situation could evolve in many ways.

---

[9] *International regulations require banks to reserve specified capital levels to guard against financial and operational risks. Banks are currently in a transitional period from Basel II to the stricter requirements of Basel III.*

Vacancy and rent

Deutsche Bank's economists expect Japan's unemployment rate to increase to 5.6 per cent by the fourth quarter of 2011, compared to 4.9 per cent in a pre-quake forecast for the same period. Office demand in general will remain soft for the remainder of 2011, but market fundamentals will be spread unevenly depending on individual building specifications. New, high quality, quake-resistant, energy efficient buildings will be relatively less affected while older, lower grade buildings will suffer more. RREEF Research's previous forecast for rental recovery for the benchmark Tokyo office buildings is pushed back by 6-12 months and can be expected to begin in 2012-2013.

Cap rates

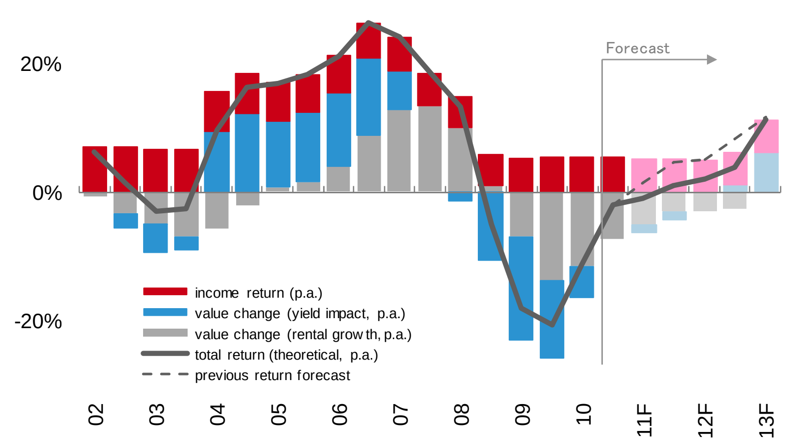
Real estate cap rates were already showing a recovery trend in Japan at the beginning of 2011, but we expect them to remain flat (or perhaps slightly wider for low-grade buildings) through the fourth quarter of 2011. This is because foreign capital is expected to stay on the sidelines for new investment, at least until the nuclear radiation issue appears to be firmly under control. As shown on Chart 20, fund raising activities became inactive, leaving less capital available for investment activities. Also, finance conditions for non-reconstruction-related sectors could be affected during the year.

Investment opportunities

This capital value softening will create attractive buying opportunities for investors. RREEF Research's previous forecast showed total returns for Tokyo office assets turning positive again in 2011. This recovery is now pushed back to 2012 due to uncertainties about the capital value component of total returns. Investors may also find opportunities as Japan's public sector (both national and local governments) falls under increasing pressure to privatize assets. In the private sector as well, some of the firms most impacted by the quake will be forced to liquidate some of their assets in order to finance their immediate needs[10]. All of these situations, however unfortunate they may be, will nonetheless create attractive opportunities for property acquirers.

Chart 23

Theoretical Total Return of Office in Tokyo by Component (illustrative)



Source: RREEF Research *Data as of April 2011*
Note: Certain of the information set forth above constitute projections or forecasts, which are based upon numerous assumptions, are inherently uncertain and may not be realized. No representation or warranty is made as to future returns.

[10] *TEPCO announced the intention to sell JPY 100 billion of real estate assets in FY2011 and FY2012.*

Conclusions

The Great Tohoku Earthquake of March 11 left a trail of physical as well as economic destruction. Some of the economic aftermath is to be expected: GDP growth will be shaved in the near-term but reconstruction may trigger a slightly stronger medium-term rebound than might otherwise have occurred. While media accounts have focused heavily on the nuclear accident that resulted from the tsunami, it is electric power shortage that has immediately impacted Japan's economy and indeed the entire global supply chain for certain manufactured goods.

On the other hand it became clear that the assets of the country's primary real estate players, JREITs, had been much less impacted than anyone would have expected. Preliminary losses appear to be only about 0.02 per cent of total J-REIT holdings, revealing extremely high seismically-resistant technology implemented in assets held by investors and/or REITs in Japan.

Still, the wider implications for real estate are nuanced. Newer properties built to higher construction standards will attract more demand than older properties of lower grade construction. Like GDP growth, the recovery of Tokyo's office market fundamentals is likely to be pushed back to 2012. However, with one of the widest yield spreads of any major market in the world right now, domestic and foreign capital will inevitably be pulled from the sidelines once this situation stabilises at Fukushima nuclear power plant. Given the dire fiscal situation that Japan already faced, the government will be required to consider selling public assets in order to finance urgent demand for reconstruction, or repay existing debts.

Vol	Year	Publication		Research Topic
1	2008	Second Quarter	Jun 08	Making sense of the rental market in Japan
2		Third Quarter	Sep 08	Impact of the credit crunch
3		Fourth Quarter	Dec 08	Revitalisation of ailing J-REITs
4	2009	First Quarter	Mar 09	Tokyo office market in it global context
5		Second Quarter	Jul 09	Japan residential market
6		Third Quarter	Oct 09	History repeats itself? A comparison of the 'Year 2003 Problem' with 2009
7		Fourth Quarter	Jan 10	Introducing unit pricing analysis in Japan
8	2010	First Quarter	Apr 10	Portfolio optimisation analysis in Japan
9		Second Quarter	Jul 10	Japan's capital market in a global context
10		Third Quarter	Oct 10	-
11		Fourth Quarter	Jan 11	Cross-border investment into and out of Japan
12	2011	First Quarter	Apr 11	The Great Tohoku Earthquake and its impact on the Japanese real estate market

Important Notes

 RREEF is the brand name of the real estate division for the asset management activities of Deutsche Bank AG. In the US this relates to the asset management activities of RREEF America L.L.C.; in Germany: RREEF Investment GmbH, RREEF Management GmbH, and RREEF Spezial Invest GmbH; in Australia: Deutsche Asset Management (Australia) Limited (ABN 63 116 232 154) Australian financial services license holder; in Japan: Deutsche Securities Inc.*; in Hong Kong: Deutsche Bank Aktiengesellschaft, Hong Kong Branch (for Direct Real Estate business), and Deutsche Asset Management Hong Kong (for Real Estate Securities Business); in Singapore: Deutsche Asset Management (Asia) Limited (Company Reg. No. 198701485N); and in the United Kingdom: Deutsche Alternative Asset Management (UK) Limited, Deutsche Alternative Asset Management (Global) Limited, and Deutsche Asset Management (UK) Limited; and in Denmark, Finland, Norway and Sweden: Deutsche Alternative Asset Management (UK) Ltd and Deutsche Alternative Asset Management (Global) Ltd; in addition to other regional entities in the Deutsche Bank Group. (*) For DSI, financial advisory (not investment advisory) and distribution services only.

Key RREEF research personnel are voting members of various RREEF investment committees. Members of the investment committees vote with respect to underlying investments and/or transactions and certain other matters subjected to a vote of such investment committee. Additionally, research personnel receive, and may in the future receive incentive compensation based on the performance of a certain investment accounts and investment vehicles managed by RREEF and its affiliates.

This material is intended for informational purposes only and it is not intended that it be relied on to make any investment decision. It does not constitute investment advice or a recommendation or an offer or solicitation and is not the basis for any contract to purchase or sell any security or other instrument, or for Deutsche Bank AG and its affiliates to enter into or arrange any type of transaction as a consequence of any information contained herein. Neither Deutsche Bank AG nor any of its affiliates, gives any warranty as to the accuracy, reliability or completeness of information which is contained in this document. Except insofar as liability under any statute cannot be excluded, no member of the Deutsche Bank Group, the Issuer or any officer, employee or associate of them accepts any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this document or for any resulting loss or damage whether direct, indirect, consequential or otherwise suffered by the recipient of this document or any other person.

The views expressed in this document constitute Deutsche Bank AG or its affiliates' judgment at the time of issue and are subject to change. This document is only for professional investors. This document was prepared without regard to the specific objectives, financial situation or needs of any particular person who may receive it. No further distribution is allowed without prior written consent of the Issuer.

An investment in real estate involves a high degree of risk and is suitable only for sophisticated investors who can bear substantial investment losses. The value of shares/units and their derived income may fall as well as rise. Past performance or any prediction or forecast is not indicative of future results.

The forecasts provided are based upon our opinion of the market as at this date and are subject to change, dependent on future changes in the market. Any prediction, projection or forecast on the economy, stock market, bond market or the economic trends of the markets is not necessarily indicative of the future or likely performance.

Issued in the United Kingdom by Deutsche Alternative Asset Management (UK) Limited of One Appold Street, London, EC2A 2UU. Authorised and regulated by the Financial Services Authority. This document is a "non-retail communication" within the meaning of the FSA's Rules and is directed only at persons satisfying the FSA's client categorisation criteria for an eligible counterparty or a professional client. This document is not intended for and should not be relied upon by a retail client.

When making an investment decision, potential investors should rely solely on the final documentation relating to the investment or service and not the information contained herein. The investments or services mentioned herein may not be appropriate for all investors and before entering into any transaction you should take steps to ensure that you fully understand the transaction and have made an independent assessment of the appropriateness of the transaction in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also consider seeking advice from your own advisers in making this assessment. If you decide to enter into a transaction with us you do so in reliance on your own judgment.

I-021972-1.1