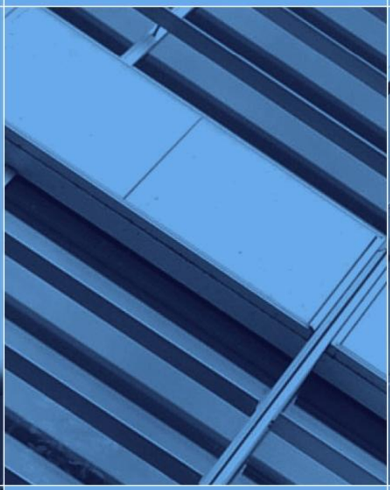
RESEARCH REPORT

Japan Real Estate First Quarter 2013

January 2013

RREEF Real Estate

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Table of Contents

Executive Summary 1

Macro Economy 2

Capital Market 4

- Lending 4
- Pricing 5
- Transactions 6
- Performance 8
- J-REITs 8

Market Fundamentals 11

- Office 11
- Retail 14
- Residential 15
- Industrial 16

Research Topic 18

Past Issues 23

Important Notes 24

Global Research Team 25

Executive Summary

Economy: Japan's Liberal Democratic Party (LDP) assumed power in December 2012 following a general election. The new Prime Minister, Shinzo Abe, announced aggressive policies for monetary easing and the fiscal stimulus aimed at ending deflation and weakening the Japanese yen's value. Capital markets reacted positively, and most economists revised their forecasts upward. The outlook now is for economic growth to resume by the second half of 2013.

Capital market: Unlike Europe, credit conditions in Japan remain favourable for borrowers. Lending volumes for new real estate projects posted positive growth for the past four consecutive quarters, and the amount of fund raising by J-REITs approached its highest level in five years. Further cap rate compression reflected an overall attractive investment environment.

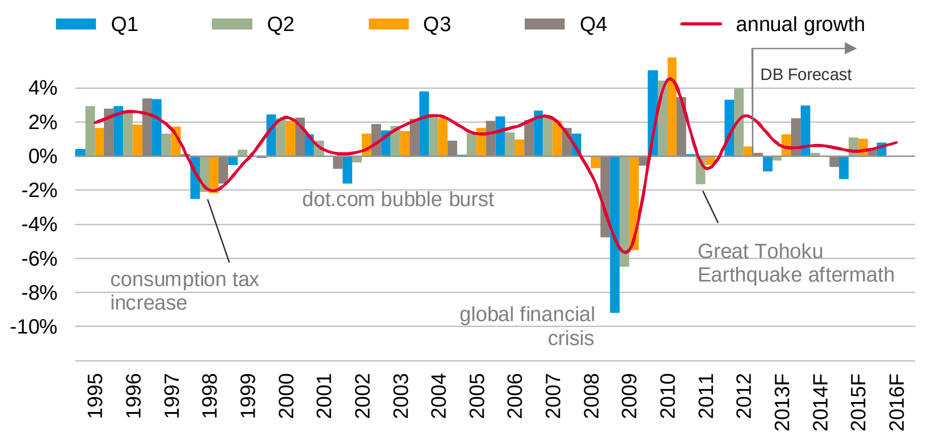
Property markets: Japan's property leasing markets provided mixed signals in the fourth quarter of 2012. Office rents remain soft, with Tokyo absorbing a recent supply increase and Osaka preparing for one in 2013. The outlook for the retail sector was cautious, as recent regional territorial disputes have deterred foreign tourism. Meanwhile, fundamentals in residential and industrial markets have been relatively healthy.

Research topic: Japan's government plans to boost the amount of the residential mortgage tax credit from 2014 through 2018 in order to stimulate the overall economy and to offset a rise in the consumption tax rate in April 2014. We analyze the effectiveness of a previous tax credit increase in stimulating the overall housing market and conclude that it did stimulate housing demand in the short-term by pulling it forward from the future. But we also raise questions as to whether consumers or developers received greater benefit from the tax break. While a well-timed tax incentive may offset the short-term negative impact of a consumption tax increase, we conclude that other government programmes may prove more effective in the long term.

Macro Economy

Japan's Liberal Democratic Party (LDP) assumed power in December 2012 following a general election. The new Prime Minister, Shinzo Abe, announced aggressive policies for monetary easing and the fiscal stimulus of JPY 20 trillion aimed at ending deflation and weakening the Japanese yen's value. Capital markets reacted strongly in anticipation of a recovery of business conditions backed by a more favourable exchange rate. Most economists revised their forecasts upward, although it remains to be seen whether LDP policies can stimulate a new cycle of real economic growth. For now, Japan's economy is expected to resume growth by the second half of 2013, according to forecasts by Deutsche Bank economist. The government plans to increase the consumption tax (VAT) rate from the current 5% to 8% in April 2014, and to 10% in October 2015.

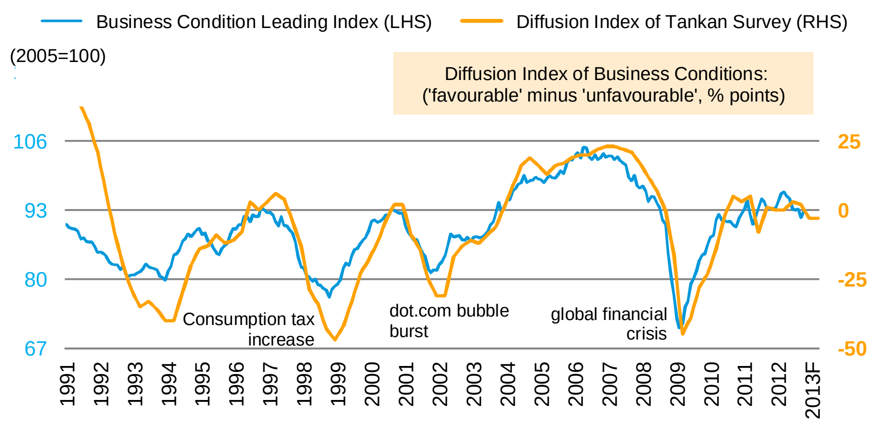
Exhibit 1 — GDP Growth Outlook for Japan



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast growth will materialise
Sources: Deutsche Bank, "Japan Economics Weekly"
As of January 2013

The diffusion index (DI) of the Tankan Survey conducted by the Bank of Japan decreased by four points from the previous quarter, with stable momentum expected for the next quarter. (The most recent survey was conducted in early December 2012 so it does not yet reflect market reaction to the policies proposed by the new LDP government.) The Business Condition Leading Index calculated by Japan's Cabinet Office also indicated softness, reflecting weak export demand to China and Europe in the latter half of 2012.

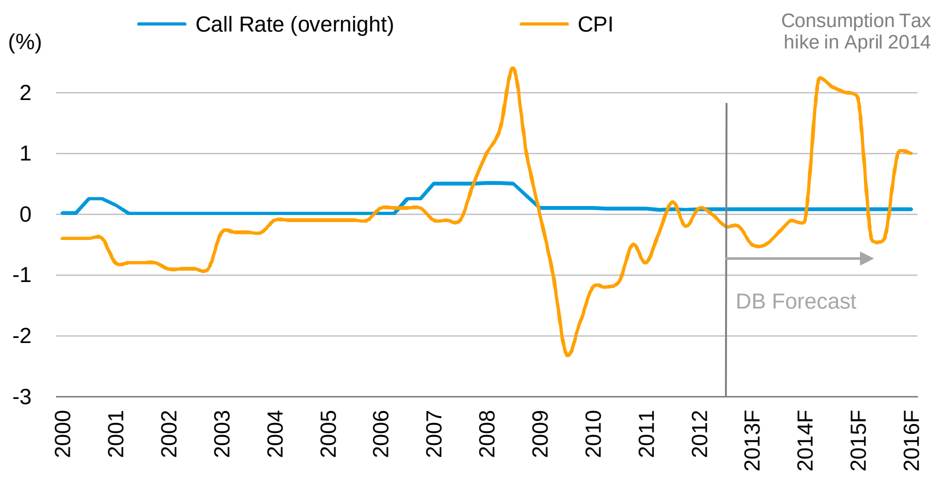
Exhibit 2 — Diffusion Index of Business Conditions



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast figures will materialise
Sources: The Bank of Japan, Japan's Cabinet Office, RREEF Real Estate
As of January 2013

To clarify the new LDP government's commitment to ending deflation, officials plan to issue a joint statement with the Bank of Japan to establish an inflation target of 2%. Regardless of this inflation target, however, prices are set to rise sharply temporarily to 2.4% in April 2014 due to the planned consumption tax increase.

Exhibit 3 — Forecast of Short-Term Interest Rate and CPI



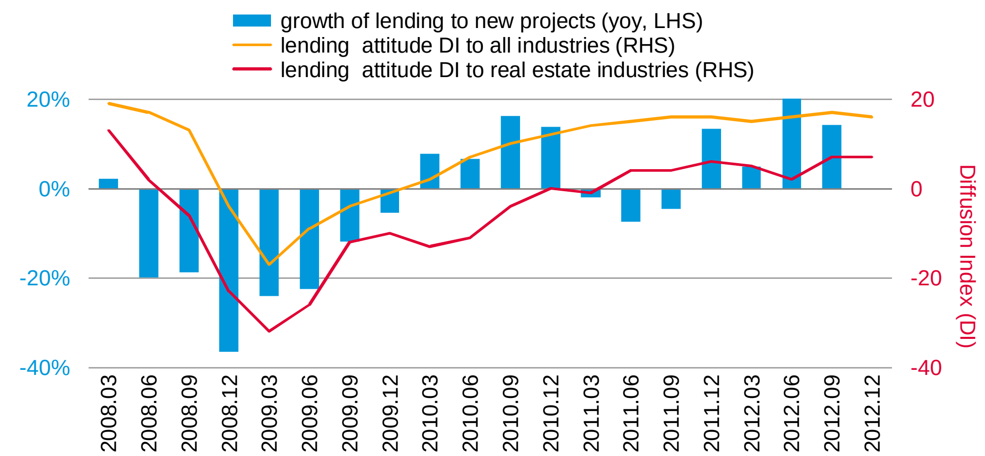
Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast figures will materialise
Sources: The Bank of Japan, Japan's Cabinet Office, RREEF Real Estate
As of January 2013

Capital Market

Lending

Just like other Asian nations Japan's credit conditions remain favourable for borrowers. The Bank of Japan's DI for the lending attitudes of banks to the real estate industry (red line in Exhibit 4) has been positive for seven consecutive quarters, and accordingly, lending volume to new real estate projects posted positive growth for the past four consecutive quarters to September 2012.

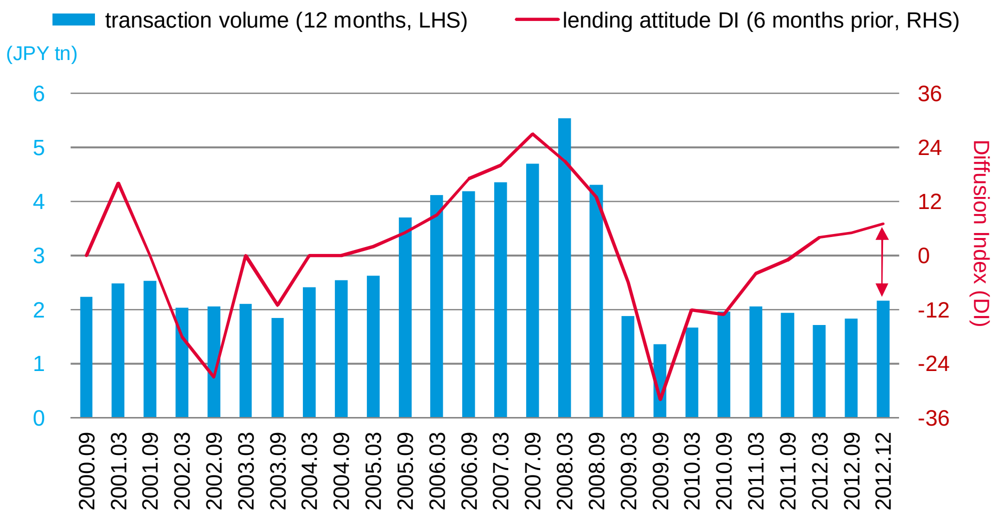
Exhibit 4 — Real Estate Lending by Japanese Banks



Sources: Bank of Japan, RREEF Real Estate
As of January 2013

Favourable credit conditions prompted property owners to refinance loans rather than dispose of assets at maturity. This resulted in limited transaction activity. The transaction volume amounted to just JPY 2 trillion in the 12 months to September 2012, a marginal increase from the same period in the previous year.

Exhibit 5 — Real Estate Transaction Volume and Lending Attitude DI

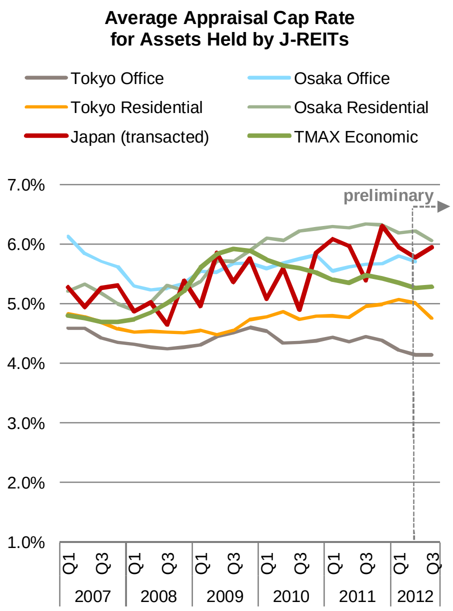


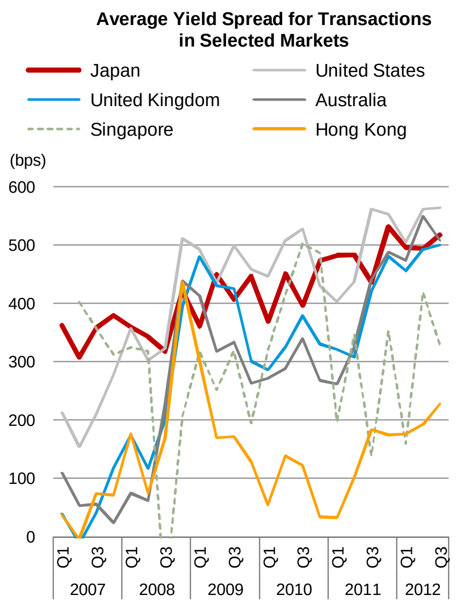
Sources: Urban Research Institute, Bank of Japan, Real Capital Analytics, RREEF Real Estate
As of January 2013

Pricing

Cap rates have compressed for investible assets in Japan. The TMAX "economic" cap rate which incorporates actual market prices has tightened since 2010 and "appraisal" cap rates for office and residential assets in Tokyo and Osaka have followed suit since the beginning of 2012. Further tightening is indicated by the most recent preliminary appraisal numbers. For completed transactions in Japan, however, the most recent average cap rate was 6.0% in the third quarter of 2012, 20 basis points higher than the previous quarter, reflecting the majority of the transactions being done outside prime locations. The average yield spread — the difference between the average cap rate of all reported commercial real estate transactions and government bond yields — held at about 500 basis points in the third quarter of 2012.

Exhibit 6 — Cap Rate (appraisal) and Yield Spread (transacted)

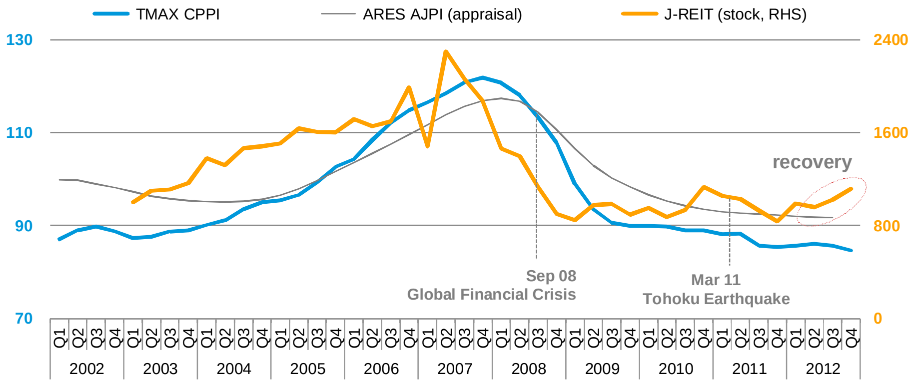




Past performance is no guarantee of future results
Sources: ARES, TMAX, Real Capital Analytics, Bloomberg, RREEF Real Estate
As of January 2013

The TMAX Commercial Property Price Index (CPPI), a capital value index incorporating actual price trends in the market, remained steady in the third quarter of 2012. The J-REIT index, on the other hand, posted a strong recovery in the second half of 2012, indicating a possible expectation of future capital value growth.

Exhibit 7 — Real Estate Capital Value in Japan



Sources: ARES, TMAX, Bloomberg, RREEF Real Estate
As of January 2013

Transactions

Exhibit 8 shows major real estate transactions either completed or announced since the beginning of the fourth quarter of 2012 to date. J-REITs were the most active group in the period, and a couple of assets were also acquired by foreign investors and managers. The prices of some of the office deals in Tokyo were very competitive, with cap rates just over 4% and the unit price exceeding JPY 2.0 million per square metre.

Exhibit 8 — Major Transactions in the Fourth Quarter 2012

JPY1 billion = US$12 million

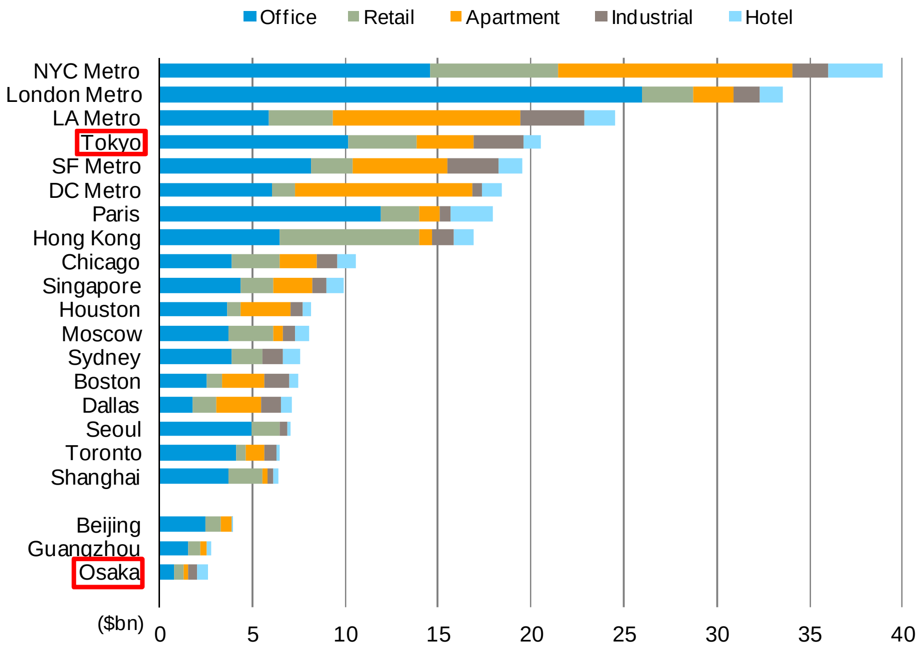
Month	Type	Asset	Price (JPY billion)	Unit price (JPY m /sum)	Cap rates	Pre-fecture	Acquired by	Investor origin
Apr-12	office	Osaka U2	2.0	0.28	-	Osaka	China Steel	Taiwan
Aug-12	land / dev. site	Former rail yard of Japanese National Railways	18.0	0.11		Saitama	Daiwa House Industry, AEON	Japan
Aug-12	office	Umeda Square Building	-	-	-	Osaka	Hypo Real Estate	Germany
Aug-12	M&A	Kiroro Resort	1.9	-	-	Hokkaido	Property Perfect	Thailand
Sep-12	residential	New City Residence Nishi-Azabu Twin Tower	2.2	0.60	-	Tokyo	Goldman Sachs	US
Sep-12	office / land	Shinagawa Bldg	11.5	0.82	-	Tokyo	Keikyu Corporation	Japan
Sep-12	office	Fuchu South Bldg etc (3 properties)	10.8	0.37	6.5%	Tokyo	Kenedix Realty (REIT)	Japan
Oct-12	logistics / dev. site	Logiport Hashimoto	-	-	-	Kanagawa	LaSalle Investment, Mitsubishi Estate	US/Japan
Oct-12	office	Glass City Shibuya	-	-	-	Tokyo	JV of Aviva and Secured Capital	UK/Japan
Oct-12	office	Harumi Front	31.3	1.45	5.2%	Tokyo	Japan Real Estate (REIT)	Japan
Oct-12	office	Higashi-nibancho Square	10.0	0.36	6.9%	Miyagi	Japan Real Estate (REIT)	Japan
Nov-12	residential	four apartemnts in Tokyo and Kanagawa	5.7	-	-	Tokyo, Kanagawa	iii-investments	Germany
Nov-12	hotel / dev. site	former U.S. military training site	60 (development)			Okinawa	Dijaya Corporation	Malaysia
Nov-12	office	Two floors of ARK Hills Sengokuyama Mori Tower	8.4	2.12	4.1%	Tokyo	Global One Real Estate (REIT)	Japan
Nov-12	office	Shinyon curumu Bldg	9.7	1.05	4.3%	Tokyo	Daiwa Office (REIT)	Japan
Nov-12	logistics / retail	D Project Urayasu II and others (20 properties)	114.5	0.30	5.1%	Tokyo, Chiba	Daiwa House REIT (REIT IPO)	Japan
Dec-12	office	Honshu Meieki Bldg etc (2 properties)	7.3	0.58	6.0%	Aichi, Kanagawa	Daiwa Office (REIT)	Japan
Dec-12	hotel	Hotel Resol Sapporo	0.4	0.07	-	Hokkaido	IPC Corporation	Singapore
Dec-12	hotel	Hilton Odawara	0.9	0.02	-	Kanagawa	Hilton Worldwide	US
Dec-12	logistics	part of the Wanbishi Kanto No. 5 center	4.6	0.04	-	Saitama	W. P. Carey	US
Dec-12	dev. site	former Shinsei Bank Headquarters Bldg	51.0	0.89	-	Tokyo	Development Bank of Japan, Kenedix, Tokyu Land	Japan
Dec-12	office / hotel	Rinku Gate Tower Building	3	0.03	-	Osaka	SiS International	Hong Kong
Dec-12	logistics	GLP Tokyo and a series of "GLP" etc (30 properties)	208.7	0.40	4.9%	Tokyo, Hyogo	GLP REIT (REIT IPO)	Japan
Jan-13	office	Celestine Shiba Mitsui Bldg etc (4 properties)	64.9	1.33	4.7%	Tokyo, Aichi	Nippon Building Fund (REIT)	Japan
Jan-13	office	NBF Nihonbashi Muromachi Center Bldg	14.1	0.17	4.3%	Tokyo	Mitsui Fudosan	Japan
Jan-13	logistics	A logistic property in Miyoshi	15	0.21	-	Saitama	askul Corporation	Japan
Jan-13	office	Akasaka Intercity etc (3 properties)	24	1.33	4.1%	Tokyo, Hokkaido	Japan Excellent (REIT)	Japan
Jan-13	logistics	IIF Osaka Toyonaka data center etc (6 properties)	18	0.28	7.5%	Osaka, Hyogo	Industrial & Infrastructure Fund (REIT)	Japan
Jan-13	logistics	GLP Tatsumi etc (3 properties)	12.6	0.41	5.0%	Tokyo, Miyagi	GLP REIT	Japan
Jan-13	office	Koji-machi Odori Bldg	17	0.68	-	Tokyo	Jowa Real Estate	Japan

Notes: Non-office deals, assets outside Tokyo, and acquisitions by foreign managers are highlighted in light blue. This table is prepared solely for information purposes and not intended to recommend or endorse any specific company's shares or other products.

Sources: Real Capital Analytics, Nikkei Real Estate Market Report, RREEF Real Estate, As of January 2013

Tokyo's volume of commercial real estate transactions for the rolling 12-month period ending in December was US$22.2 billion, a 5% increase from the previous 12-month period. Tokyo ranked fourth in the global market and first in the Asia Pacific region. The volume of office transactions in Tokyo accounted for only 50% of the total in this period, compared to the more typical average of 60-70%.

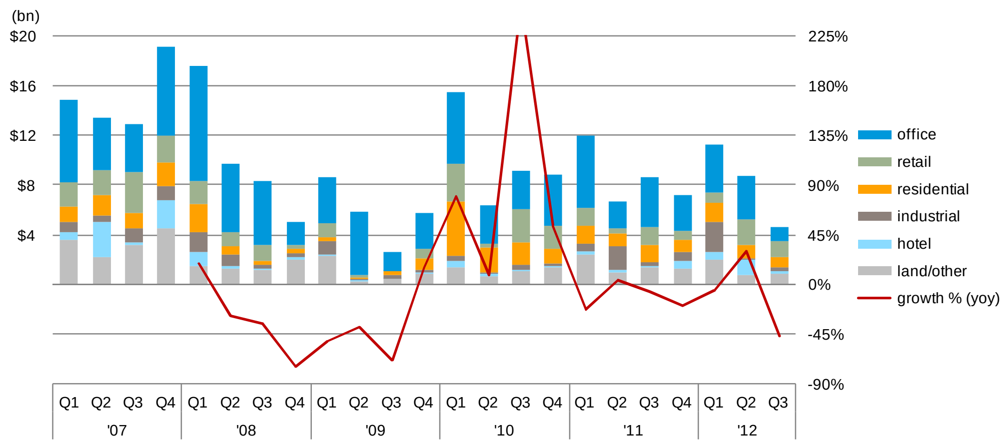
Exhibit 9.1 — Real Estate Transaction Volume by City (2012)



Notes: Commercial real estate transactions exclude non-income producing assets, such as development site transactions
Sources: Real Capital Analytics, RREEF Real Estate
As of January 2013

Exhibit 9.2 shows the commercial real estate transaction volume by property sector in Japan. The volume of transactions decreased about 40% in the third quarter of 2012 from the same period in the previous year, reflecting limited transactions in the office sector.

Exhibit 9.2 — Quarterly Real Estate Transaction Volumes by Sector in Japan

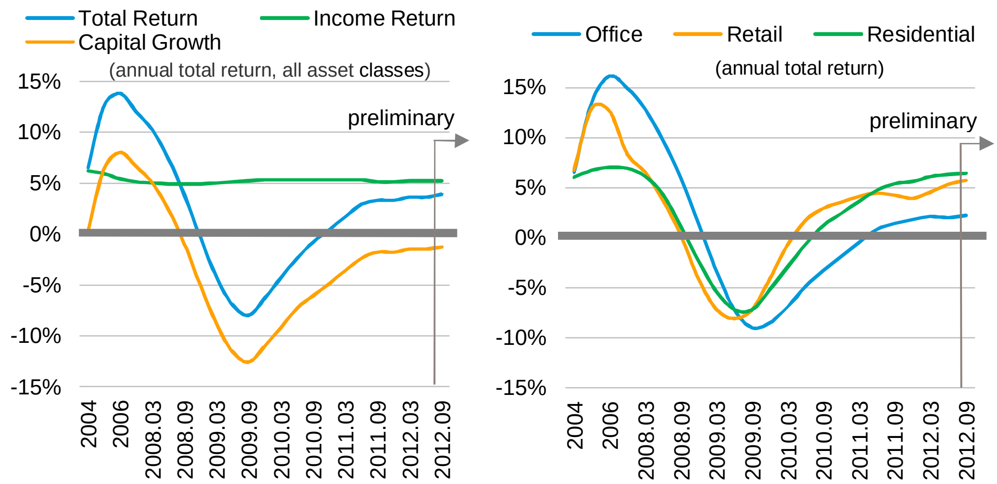


Notes: Commercial real estate transactions exclude non-income producing assets, such as development site transactions
Sources: Real Capital Analytics, RREEF Real Estate
As of January 2013

Performance

According to Investment Property Databank (IPD), the average annual total return for direct real estate investment on an unlevered basis in Japan was 3.9% in September 2012 (the latest preliminary number available). This represents steady improvement from 3.6% in the previous quarter. All sectors including office, residential, and retail showed incremental recovery in the period.

Exhibit 10 — Real Estate Total Returns in Japan (unlevered)



Notes: There is an inevitable time lag because appraisal information becomes available only at a later reporting date in Japan. Past performance is not indicative of future results

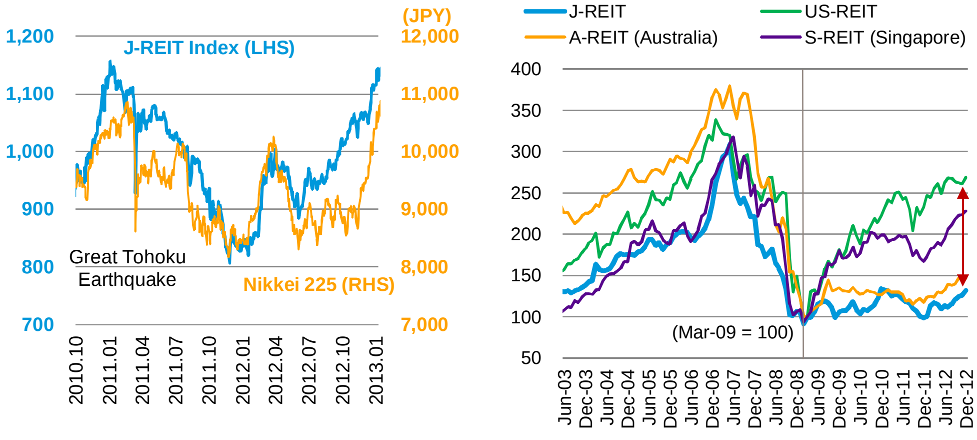
Sources: IPD Japan Monthly Index, RREEF Real Estate

As of January 2013

J-REITs

Since July 2012 the Japan REIT (J-REIT) index has been rapidly recovering, due mainly to the Bank of Japan's asset purchase programme. The J-REIT index exceeded the 1,100 threshold in December 2012 for the first time in almost two years, reflecting anticipation of the LDP's planned economic stimulus package. The new policies, if successful, could underpin the recovery of the real estate market. Over the longer time horizon, the recovery of the J-REIT index is still lagging compared to the United States and Singaporean REIT markets, perhaps leaving room for further upward momentum in the J-REIT index.

Exhibit 11 — Short-Term J-REIT Index and Long-Term Global Comparison



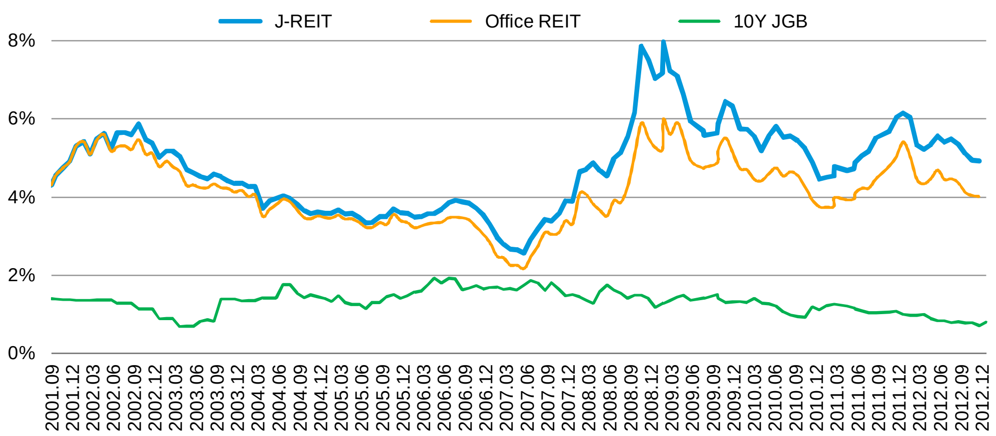
Notes: Past performance is not indicative of future results. Tokyo Stock Exchange REIT Index (J-REIT), FTSE NAREIT All Equity REITS Index (US-REIT), S&P/ASX 200 A-REIT Index (A-REIT), FTSE ST REIT Index (S-REIT)

Sources: Bloomberg, RREEF Real Estate

As of January 2013

On average, the expected J-REIT dividend yield is 4.9% (and 4.0% for office REITs), a 38 basis point drop from the previous quarter. The decline was narrow, however, when considering that the spread is still more than 420 basis points over the 10-year government bond yield. This is compared with spreads of about 200 basis points for US REITs and UK REITs in their respective domestic markets.

Exhibit 12 — J-REIT Expected Dividend Yield



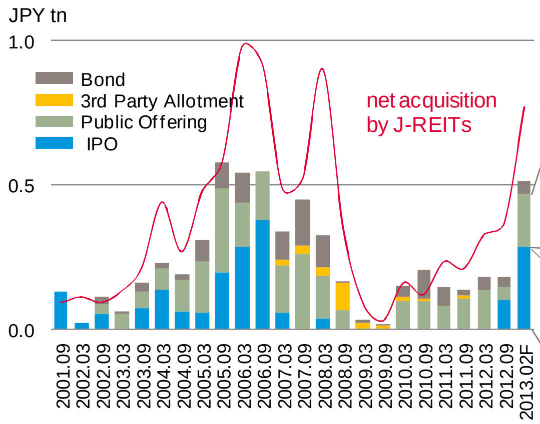
Note; Past performance is no guarantee of future results

Sources: Sumitomo Mitsui Trust Research Institute, Bloomberg, RREEF Real Estate

As of January 2013

Two new IPOs during the second quarter of 2012 were followed by another two IPOs in the fourth quarter, one by Daiwa House REIT and the other by GLP REIT. Both of the two new REITs focus on the logistics sector, reflecting the current zeal for the logistics assets among investors. On top of this, there were four other public offerings in the fourth quarter of 2012 which accompanied the strong recovery of equities. The net increase in asset acquisitions by J-REITs reached the highest level in five years.

Exhibit 13 — Capital Raising and Transactions by REITs in Japan



Recent Public Offerings (JPY bn)

Name of REIT	Month	Amount
Japan Retail Fund	Oct-12	25
Sekisui House SI	Oct-12	7
Japan Real Estate	Oct-12	33
Heiwa Real Estate REIT	Nov-12	5
Nippon Building Fund	Jan-13	68
Advance Residence	Jan-13	22
Japan Excellent	Jan-13	17
IIF	Jan-13	10

Initial Public Offerings

Daiwa House REIT	Nov-12	54
GLP REIT	Dec-12	111
Comforia Residential	Feb-13 plan	27
Nippon Prologis REIT	Feb-13 plan	91

Planned: Aeon, Hulic

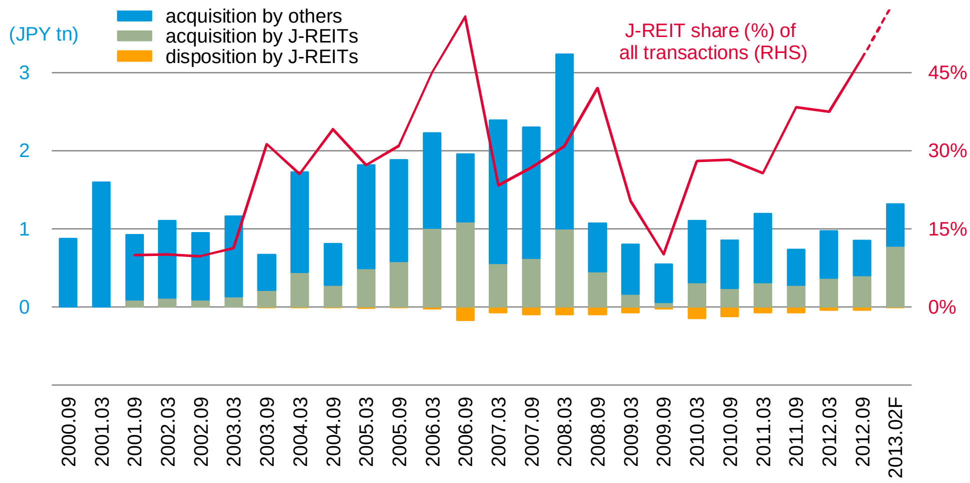
Notes: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast figures will materialise. This table is prepared solely for information purposes and not intended to recommend or endorse any specific company's shares or other products. All figures provided are based on publicly available documents not DB estimates.

Sources: ARES, Nikkei, RREEF Real Estate

As of January 2013

The preliminary volume of asset purchases by J-REITs in the four-month period to January 2013 reached JPY 406 billion, a level equal to the previous six-month period to September 2012. We estimate J-REITs accounted for more than 45% of all the commercial real estate transactions in Japan in the period, the highest level in six years.

Exhibit 14 — Real Estate Transactions in Japan and J-REIT share



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast figures will materialise

Sources: ARES, Urban Research Institute, Real Capital Analytics, RREEF Real Estate

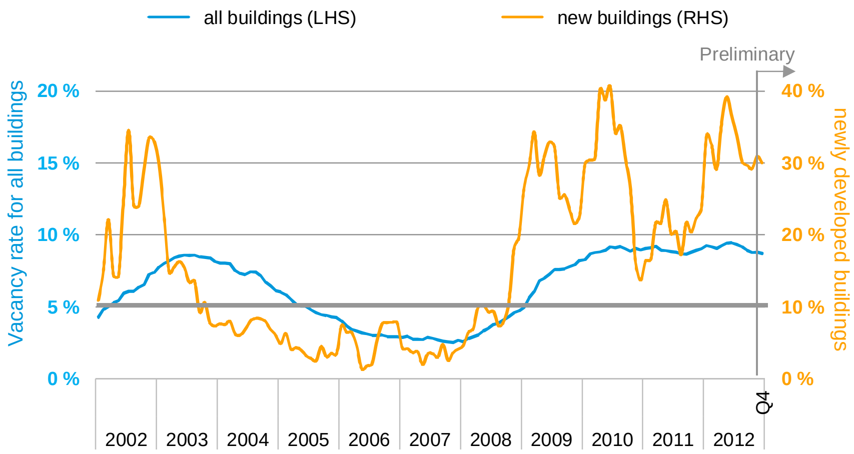
As of January 2013

Market Fundamentals

Office

A large pipeline of office construction peaked in 2012. With this milestone passed, the office vacancy rate has already begun to decline in Tokyo's central five wards. The average office vacancy rate was 8.7% in December 2012, a recovery from the previous peak of 9.4% in June 2012. The vacancy rate for newly developed buildings also declined to 29.9% in December 2012, from 39.2% in May 2012.

Exhibit 15 — Office Vacancy Rate in Central Tokyo (5 wards)



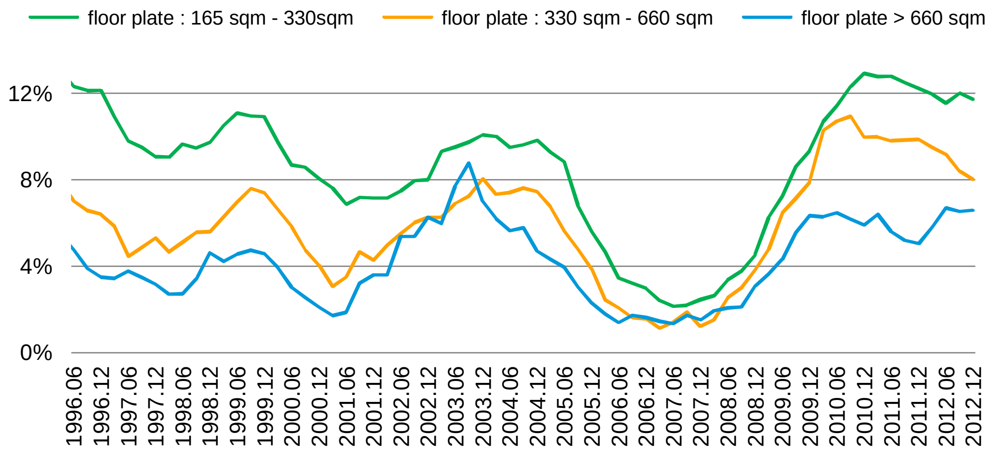
Major Office Supply in Tokyo

Building	Date	Floors	GFA (sqm)
Nakano Central Park	Mar-12	10	East 39,025
	May-12	21	South 190,000
JP Tower	May-12	38	213,323
Ark Hills Sengokuyama Mori Tower	Aug-12	47	143,720
Otemachi Financial City	Sep-12	31	North 110,000
	Sep-12	35	South 132,500
WATERRAS TOWER	Feb-13	41	129,223
New Kabuki-za Theater Building	Feb-13	29	94,097
Kyobashi 3-1 Project	Mar-13	24	117,025
Ochanomizu Sola City	Mar-13	23	102,179

Note: GFA = gross floor area. sqm = square metres
Sources: Miki Shoji, RREEF Real Estate
As of January 2013

The vacancy rate for larger assets was relatively flat at 6.6% in December 2012, but the vacancy rate declined for buildings of other sizes.

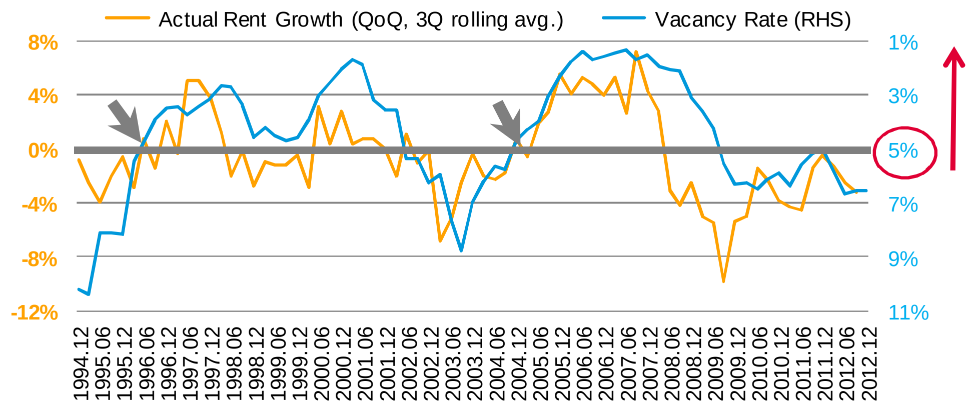
Exhibit 16 — Office Vacancy Rate in Central Tokyo by Building Floor Plate Size



Note: sqm = square metres
Sources: Sanko Estate, RREEF Real Estate
As of January 2013

Office rental growth rates correlate inversely to the vacancy rate. Historically in Tokyo, office rents start to increase when the vacancy rate falls below 5%. The vacancy rate for buildings with floor plates of 660 square meters or more was 6.6% in December 2012 in Tokyo, just above the pivotal 5% threshold, with corresponding rents still softening.

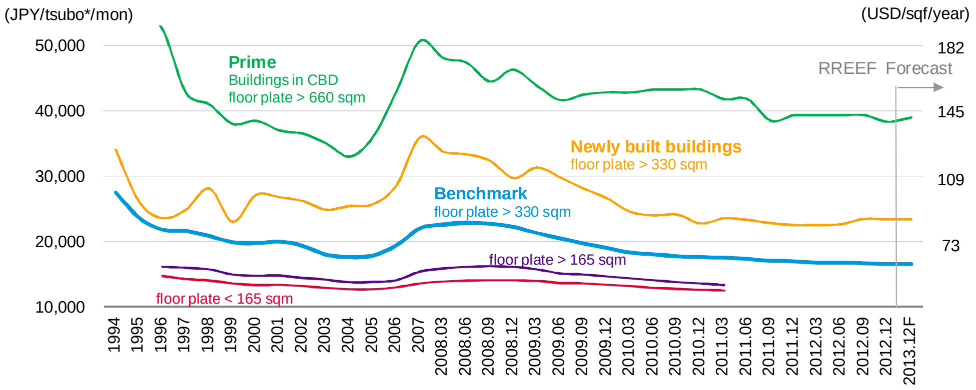
Exhibit 17 — Vacancy Rate and Rent Growth in Tokyo (floor plate < 660 sqm)



Note: sqm = square metres
Sources: Sanko Estate, NLI Research Institute, RREEF Real Estate
As of January 2013

The high vacancy rate and continuous supply of new spaces kept office rents in Tokyo on a downward trend for most building classes, but the speed of decline was modest. The only exception was an increase in average rents for newly constructed buildings. This segment of the market posted rental growth of 3.9% in the fourth quarter 2012 over the same period in the previous year. Given the above-average vacancy rate, we expect the marginal declining trend to persist for rents at benchmark buildings at least through the first half of 2013.

Exhibit 18 — Office Asking Rent in Central Tokyo by Building Floor Plate Size



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast growth will materialise

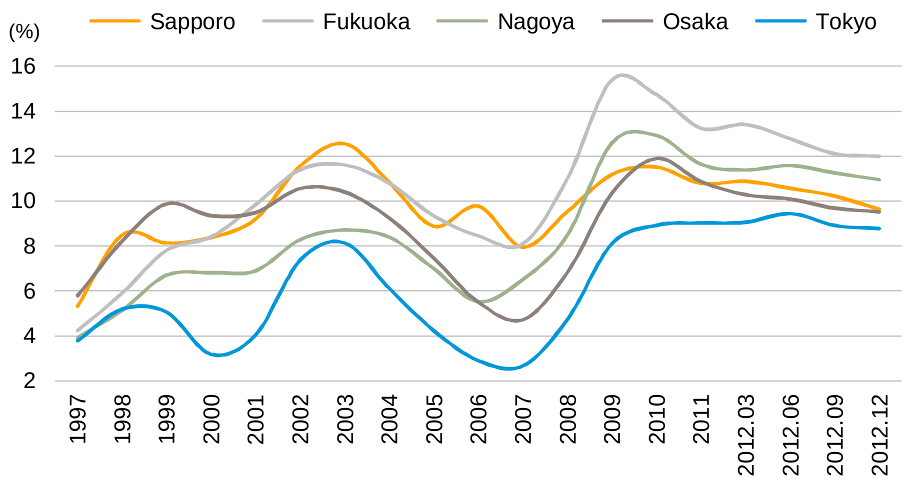
*The tsubo is a traditional measure of floor area in Japan. It is equivalent to 3.3 square metres (35.6 square feet)

Sources: Miki Shoji, Sanko Estate, RREEF Real Estate

As of January 2013

Unlike Tokyo, new office supply has been limited in major regional cities in Japan. Only two office buildings were supplied to the market between August 2012 and December 2012, one in Osaka and the other in Nagoya. Limited supply pipelines have allowed vacancy rates to recover in the regional cities. In Osaka, the market absorbed a new Grade-A building, Nakanoshima Festival Tower, in October 2012, and the vacancy rate still declined from 9.7% in September to 9.5% in December. Osaka's office vacancy rate is expected to rise again, however, in 2013 as further new completions are planned, including Daibiru Honkan (to be completed in February 2013) and Grand Front Osaka A/B (March 2013).

Exhibit 19 — Office Vacancy Rates in Major Cities in Japan (all grades)



Major Office Supply in Regional Cities

Building	Date	Floors	GFA (sqm)
ORE Nishiki 2 chome (Nagoya)	Aug-12	13	21,105
Nakanoshima Festival Tower	Oct-12	39	146,395
Daibiru Honkan (Osaka)	Feb-13	22	48,153
Grand Front Osaka A/B (Osaka)	Mar-13	38	net 236,800

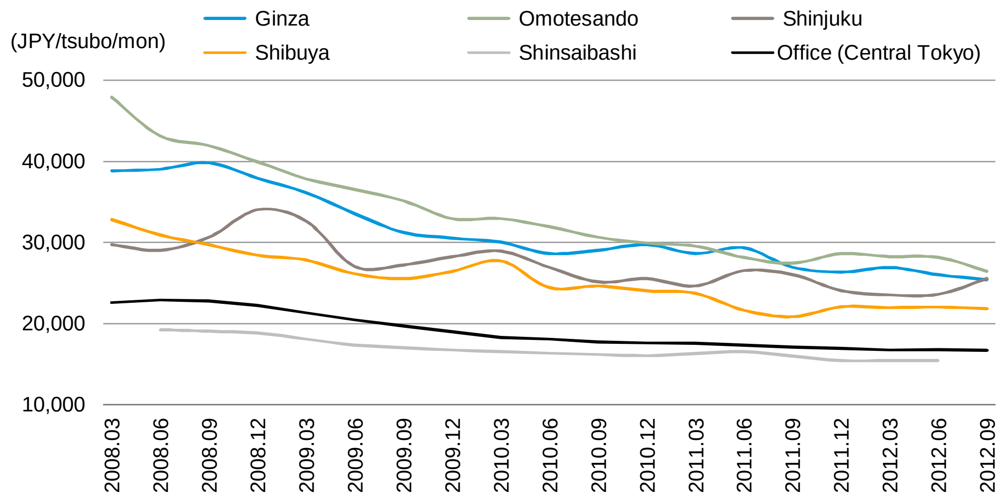
Sources: Miki Shoji, RREEF Real Estate

As of January 2013

Retail

The major high street rents softened again in the third quarter of 2012. Shinjuku was an exception, with the average asking rents in this submarket rising by 8.2%. As we anticipated in the previous publication, the territorial disputes with neighbouring countries cast a shadow over high street retail sales in Japan. Foreign tourist arrivals in Japan have been declining since September 2012.

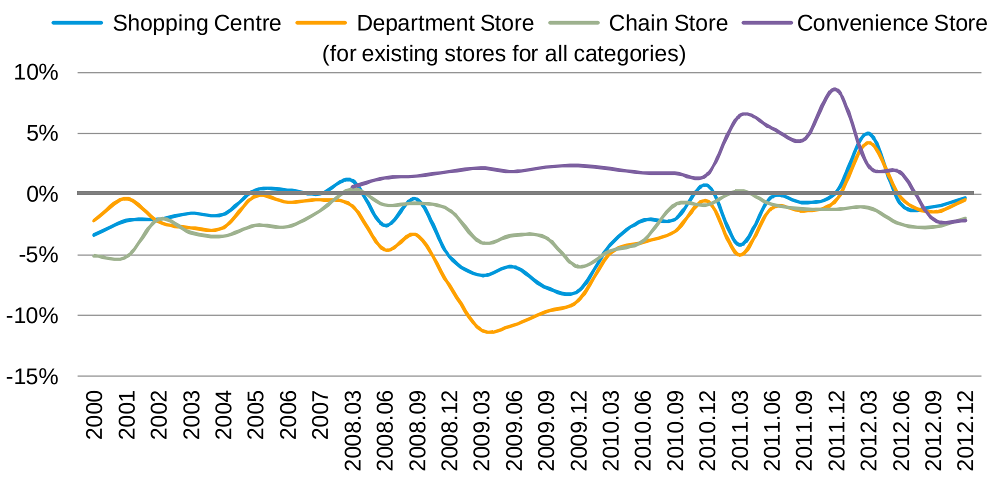
Exhibit 20 — Average High Street Retail Asking Rents in Tokyo and Osaka



Sources: Attractors Lab, Miki Shoji, RREEF Real Estate
As of January 2013

Retail sales showed some signs of recovery in the fourth quarter of 2012. Sales at shopping centres and department stores were mostly flat in the period (on an existing store basis) while sales at convenience stores posted negative growth due to a push back from a sales boom in the previous year.

Exhibit 21 — Retail Sales Growth in Japan (year on year)

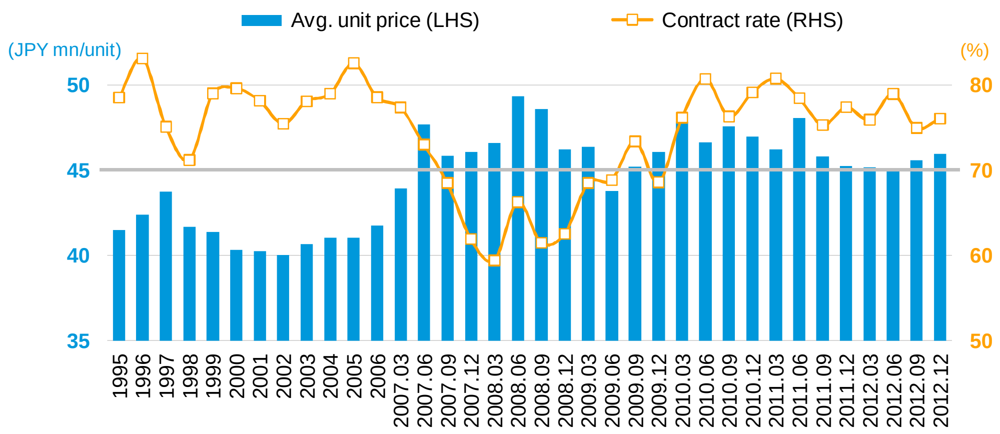


Sources: JCSC, JDSA, JCSA, RREEF Real Estate
As of January 2013

Residential

The average sales price per unit for newly-built for-sale condos in Greater Tokyo in the fourth quarter 2012 rose marginally to JPY 45.9 million for the first time in more than a year. The contract rate[1] (orange line in Exhibit 22) also recovered to 76.01% in the period, still maintaining the pivotal 70% threshold which is associated with healthy market conditions. We expect the price to rise again to JPY 47-48 million in the latter half of 2013 due to the expected plan to expand the housing tax credit (see Research Topic Chapter on page 18).

Exhibit 22 — Newly-built Condo Unit Price and Contract Rate in Greater Tokyo

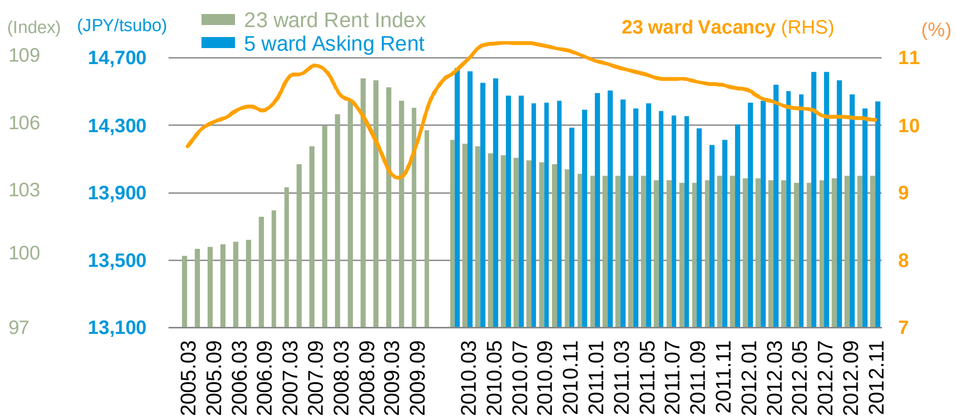


Sources: REEI, RREEF Real Estate

As of January 2013

Because of the limited development of new residential rental units in Tokyo in the last two years, the vacancy rate has been easing. It recovered to 10.1% in October 2012 in the 23-ward area (orange line in Exhibit 22), putting it near its long-term average of 10%. Asking rents showed corresponding year-on-year growth of 1.6% in the central 5-ward area and 0.1% in the broader 23-ward area of Tokyo (green bar) in October 2012.

Exhibit 23 — Residential Rent and Vacancy in Tokyo



Notes: The tsubo is a traditional measure of floor area in Japan. It is equivalent to 3.3 square metres (35.6 square feet)

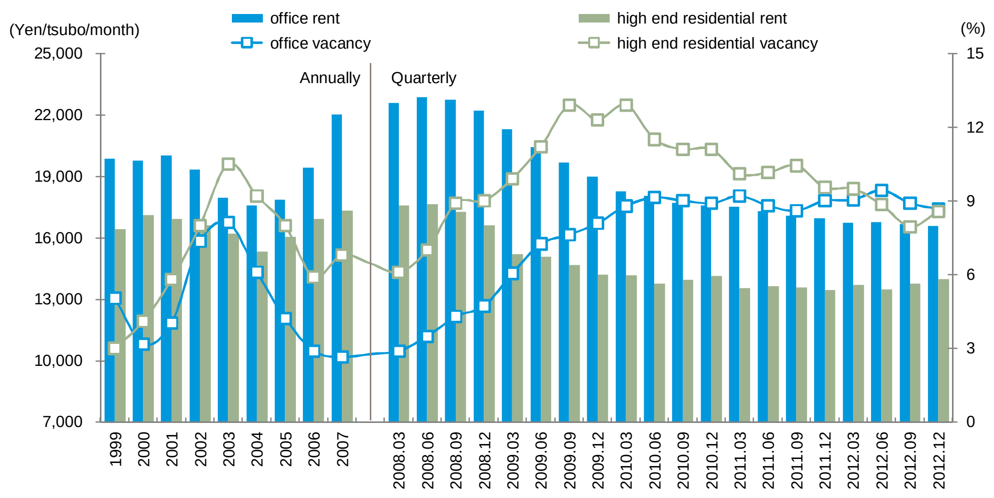
Sources: TAS Corporation with data sourced from At Home Co. Ltd. (23-ward vacancy), Leasing Management Consulting (5-ward asking rent), IPD-RECRUIT Residential Index (23-ward rent index)

As of January 2013

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

The high-end residential market correlates closely with the office leasing market. This high-end segment of the market is strongly affected by business conditions of the corporate sector, especially financial services. The vacancy rate of high-end apartments in Tokyo rose from 7.9% in the third quarter to 8.6% in the fourth quarter of 2012, while average rents rose 1.6% from the previous quarter, making two consecutive quarters of recovery. Weak fundamentals in the financial services sector signal a cautious outlook for the high-end residential market.

Exhibit 24 — High-end Residential Rent and Vacancy Rate in Tokyo

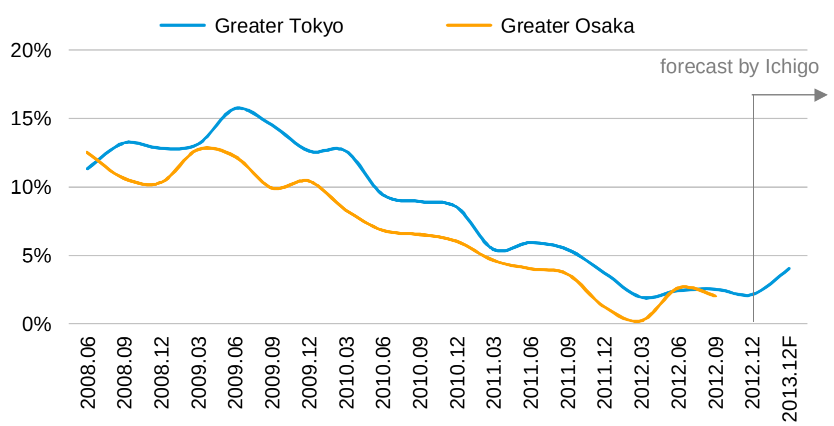


Sources: Ken Real Estate Investment Advisors Ltd., Miki Shoji, RREEF Real Estate
As of January 2013

Industrial

Due to a combination of limited supply and healthy demand for quality spaces, vacancy rates for multi-tenant logistics assets remained very tight in the third quarter of 2012, with 2.5% in Greater Tokyo and 2.0% in Greater Osaka, according to Ichigo Real Estate Service. With a number of new completions expected in 2013, however, the vacancy rate is expected to increase moderately in the medium term in both cities.

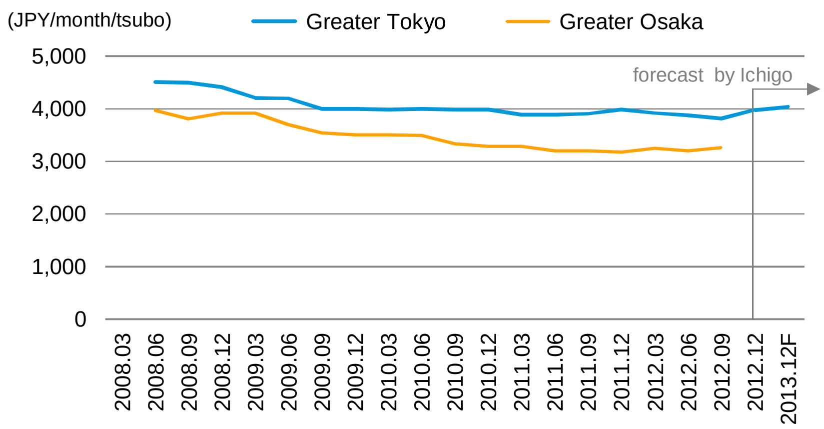
Exhibit 25 — Vacancy Rate of Multi-tenant Logistics



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast growth will materialise
Sources: Ichigo Real Estate Service, RREEF Real Estate
As of January 2013

Due to the limited availability of space, rents for logistics assets held broadly steady both in Tokyo and Osaka. Rents grew 1.9% in Osaka in the third quarter of 2012 but suffered a marginal 1.5% decline in Tokyo in the same period. The demand outlook remains positive for 2013, with rents expected to hold steady due to cost-cutting efforts among end users, such as retailers and manufacturers.

Exhibit 26 — Logistics Rent in Greater Tokyo and Greater Osaka



Note: F = forecast. Please refer to Important Notes (see end of report). There is no guarantee the forecast growth will materialise

Sources: Ichigo Real Estate Service, RREEF Real Estate

As of January 2013

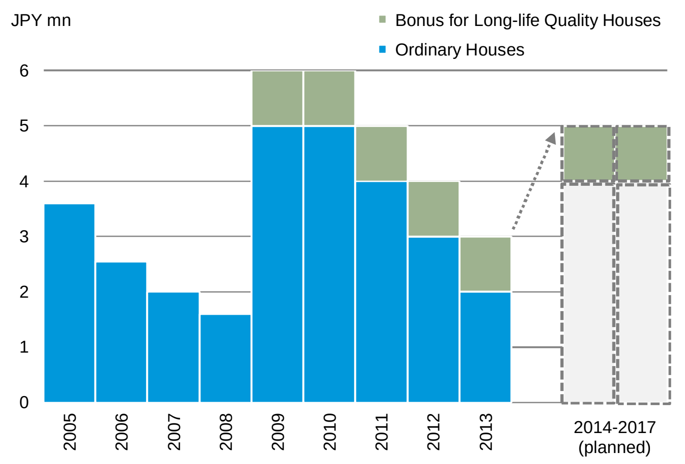
Research Topic

Can the Housing Tax Credit Boost Demand?

After the Global Financial Crisis, housing demand plummeted in Japan in 2009, prompting the government to expand the residential mortgage tax break by giving housing purchasers more tax credits. This was enacted in 2009 and has become widely used by borrowers since 2010. The government plans to boost the amount of the tax credit once again, from 2014 through 2018, in order to stimulate the overall economy. This is also intended to offset the rise in the consumption tax rate to 8% from 5% beginning in April 2014. In this chapter we analyze the effectiveness of the tax credit in stimulating the overall housing market in the previous cycle.

A mortgage tax credit is calculated on an outstanding mortgage balance. The mortgage must be longer than 10 years and made for the purpose of building or buying an owner-occupied home.[2] It cannot be applied to rental housing. The tax credit is available for a period of 10 years from purchase. The table below (Exhibit 27) shows the calculation of the maximum tax credit amount for purchasing ordinary housing and for long-life quality housing.[3] The maximum amount of the credit was increased from JPY 1.6 million to JPY 5.0 million for ordinary houses in 2009 (or to JPY 6.0 million for qualified long-life quality houses) followed by gradual declines until 2013. There are a couple of other housing tax incentives implemented in Japan.

Exhibit 27 — Maximum Tax Credit for Home Buyers in Japan



Registration and License Tax Credit for Houses and Land

FY	Land: Ownership Transfer	Land: Ownership Trust	Land and/or Building: Ownership Preservation	Land and/or Building: Mortgage Settlement	Land and/or Building: Ownership Transfer of Houses
2011	1.30%	0.25%	0.15%	0.10%	0.30%
2012	1.50%	0.30%	0.15%	0.10%	0.30%
2013	2.00%	0.40%	0.40%	0.40%	2.00%
2014	2.00%	0.40%	0.40%	0.40%	2.00%

Gift Tax Credit for Housing Purchase

JPY mn

FY	Ordinary Houses	Long-life Quality Houses
2011	10	
2012	10	15
2013	7	12
2014	5	10

Sources: Japan Ministry of Finance, RREEF Real Estate
As of January 2013

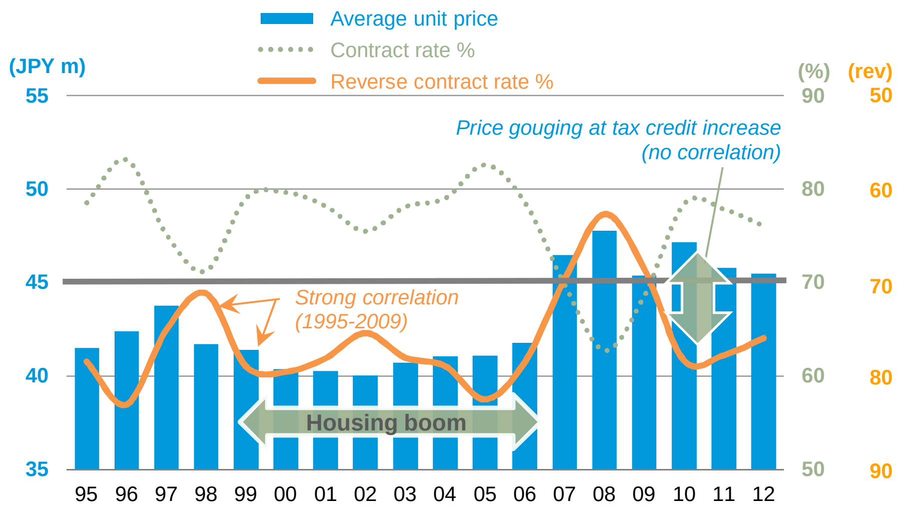
[2] The mortgage tax credit can also be applied to residential lots (land), renovations, or extensions. The home must have a floor area of greater than 50 square metres. The building must be less than 20 years old.

[3] Long-life quality housing needs to meet high standards set by the government which includes energy efficiency and earthquake-resistance strength.

Exhibit 28 shows the average condominium price per unit (LHS) and the average sales contract rate (RHS in green) in Greater Tokyo. The RHS axis in orange shows the mirror image of the contract rate when reversed. The mirror image indicates how strongly the condo contract rate is correlated — or to be more precise, negatively correlated — to the condo price between 1995 and 2009. When condo prices were cheap, they sold well creating housing boom between 1999 and 2006. And when the condo price soared in 2007 and 2008, the contract rate declined sharply.

The contract rate, however, suddenly recovered to a level close to 80% in 2010 even though the average condo price remained expensive, hovering well above JPY 45 million. The gap between the condo price and contract rate in Exhibit 28 was widest in 2010 and this significant gap remained until 2012.

Exhibit 28 — Annual Avg. Condo Unit Price and Contract Rate in Greater Tokyo



Sources: REEI, RREEF Real Estate
As of January 2013

This house price escalation in 2010-2012 paralleled the more generous mortgage tax credits. Despite the price increase, the contract rate rose at the same time due to the ample tax incentive package. About 90% of house buyers said they were motivated to purchase because of the generous tax credit.[4] This evidence supports the idea that tax credits contributed to housing demand, at least in the short term.

However, developers raised condo prices by an amount roughly equivalent to the tax credit increase. This means that buyers did not necessarily benefit from the increased tax credits because the price was raised almost by the same amount for the respective years of the incentive programme. The developers, however, benefited from the increased tax credit as well as the elevated contract rate.

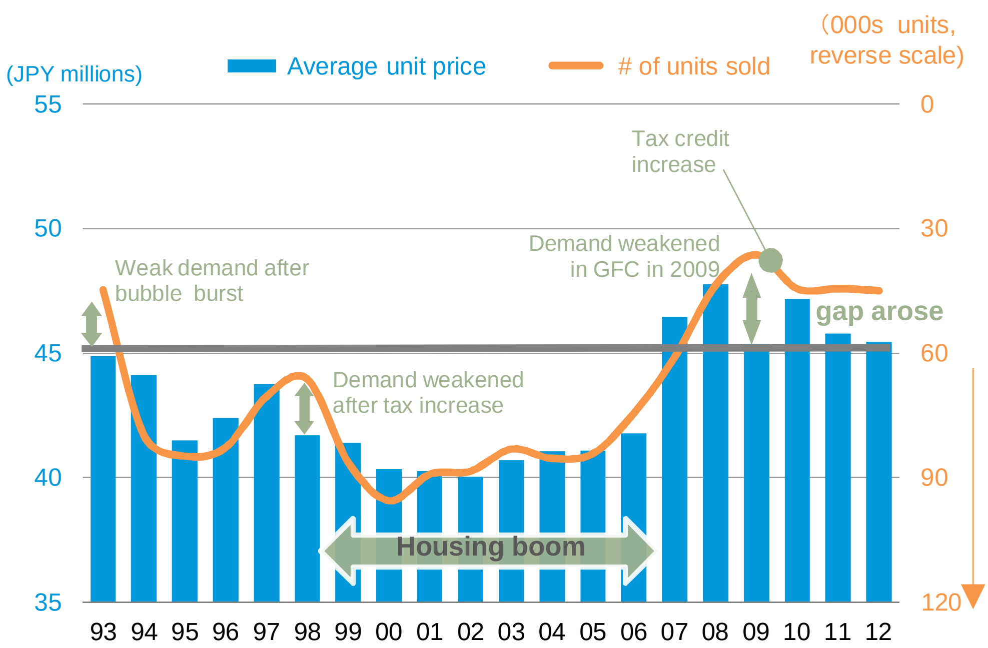
Exhibit 29 shows the number of condominium units brought to the market in Greater Tokyo and its average price, with the right axis (the number of units sold) reversed. This also shows strong negative correlation between the two variables. When the price was inexpensive the number of units sold was buoyant and it formed housing boom, while demand was weakest when the price soared in 2007 and 2008. The gap can be seen only in economic slumps such as in 1998 after the consumption tax increased or in 2009

[4] According to the Japan Federation of Housing Organizations, 88.1% of home buyers were motivated by the tax credit in 2011 when they decided to buy houses.

during the global financial crisis. Both price and demand artificially recovered in 2010 when many home buyers applied for the increased tax credits.

The volume of units sold, however, did not recover enough to fill the gap in 2011 and 2012. This is believed to be because the potential demand was front-loaded in 2010 when the tax credits were highest. In other words the house tax credit itself did not create new demand as much as it pulled forward future demand, thus the gap left in 2011 and 2012.

Exhibit 29 — Condo Unit Price and Units Sold in Greater Tokyo

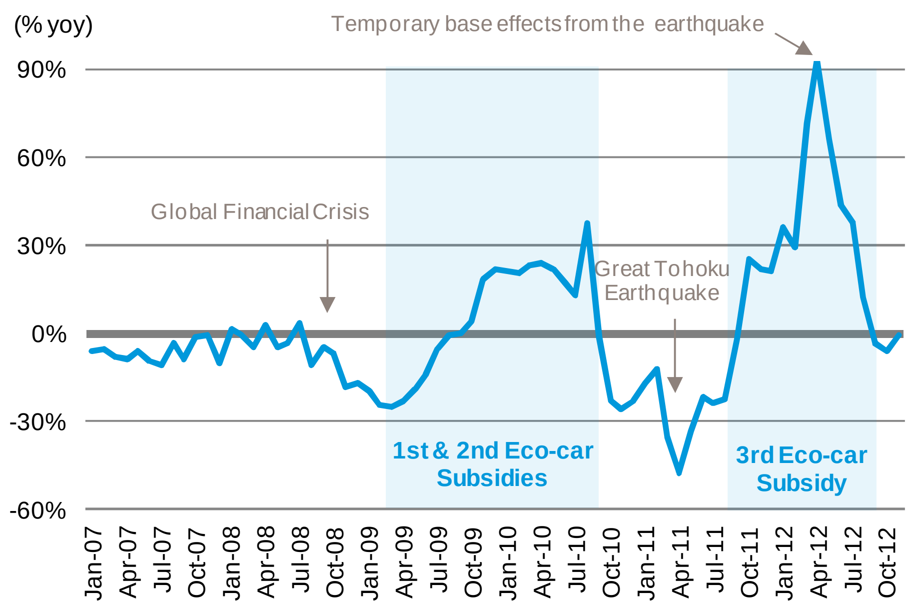


Sources: REEI, RREEF Real Estate
As of January 2013

A similar tax break was introduced for the automotive industry during the same period. In this programme, a combination of subsidies and tax credits were offered for purchasing ecologically-friendly cars, or eco-cars, in 2009-2010 and again in 2012. About 70% of the automobiles qualified for this tax break during the periods offered. Unlike the housing market, however, price “gouging” was not seen since buyers could always choose ordinary models that didn’t qualify for the tax break if they deemed eco-car prices to be uncompetitive. This means that all the eco-car buyers benefited from the tax credits, and it did create new demand.

During the incentive periods, demand was raised by the tax break by about 20% to 30% as shown in Exhibit 30 (excluding the temporary base effect from the earthquake). The independent Japan Center for Economic Research (JCER) estimates that the government’s budget for the eco-car tax break and other related subsidies amounted to about JPY 500 billion each year and contributed to an increase in Japan’s GDP of 0.5% in FY 2009 and FY 2010, respectively.

Exhibit 30 — Automotive sales growth in Japan

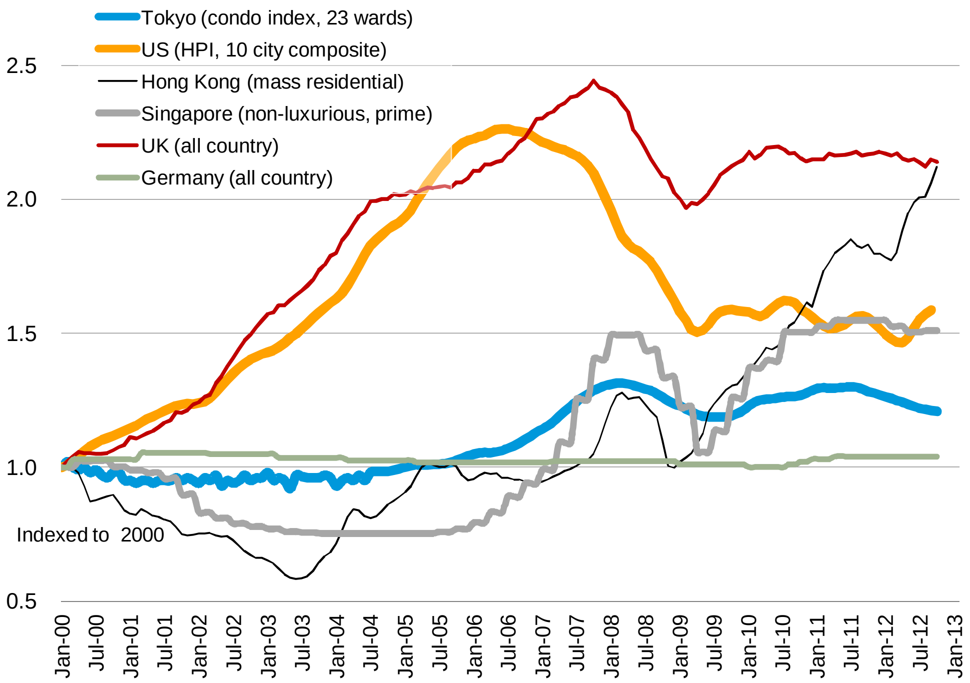


Sources: Japan Automobile Dealers Association, Japan Mini Vehicles Association
As of January 2013

A similar independent analysis of the macroeconomic impact of the mortgage tax credit programme has not been produced. It is worth noting, however, that the budget for the mortgage tax programme appears to be even larger (JPY 760 billion for FY2011) than the eco-car programme. While residential demand was stimulated in 2010, the tax credit itself is not believed to have created new demand. Theoretically, underlying demand for housing units can only be driven by demographic movements such as an increase of the number of households, etc. Otherwise, the perceived increase in demand is either a frontloading of future demand or a shift in demand away from rental units. The long-term contribution of the house tax credit to the economy is therefore doubtful.

Exhibit 31 shows the house price index in major countries and cities in the last 12 years. It is true that the house price index in Tokyo has been relatively stable compared to other markets which experienced steep housing booms in the last decade (Japan's unfavourable demographics was not necessarily the reason behind this since population in Tokyo is still growing). This contributed to a deflationary economic environment.

Exhibit 31 — House Price Index in Selected Markets



Sources: RREEF Real Estate based on IPD-Recruit (Tokyo), Case Shillaer (US), The Government of the Hong Kong Administrative Region (Hong Kong), JLL (Singapore), Nationwide (UK), Bulwien (Germany)

As of January 2013

House demand plummeted in 1998 in Japan, a year after the consumption tax was increased from 3% to 5%. With this history in mind, the government is motivated to implement policies that will offset any negative impact on housing demand when the next consumption tax hike occurs in April 2014. The government seeks policies to end the deflationary environment which has lasted almost two decades, and the new stimulus package for the residential market is an important part of it. This analysis confirms that the previous increase in the mortgage tax credit did stimulate housing demand in the short-term by pulling it forward from the future. The programme was welcomed not only by house developers but by other industries such as construction materials, household durables,[5] and automobiles since these industries are directly or indirectly affected by housing demand.

However, it also raises questions about the possibility of price “gouging” that was roughly proportionate to the increase of the tax credits in the built-for-sale condominium market. If this occurred, then consumers did not directly benefit from the tax break. Unlike the eco-car tax programme, housing tax credits do not seem to create new demand. As a result, such programmes will be less effective in the longer term since potential house demand will have been front-loaded. Just as occurred in 2010, the housing market is again expected to become buoyant in 2014 when the tax break is increased, but the demand growth is likely to be less evident in the outer years. In the longer term, government initiatives to stimulate Japan’s demography would do more to create actual housing demand in the future.

[5] Home buyers spend JPY 1.5-2.0 million for durable goods annually according to the Japan Housing Finance Agency.

Past Issues

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 its 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	Quarterly Report
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
13		Second Quarter	Jul 11	Adapting Japan's land price index for real estate analysis
14		Third Quarter	Oct 11	Quarterly Report
15	2012	First Quarter	Jan 12	The J-REITs next 10 years
16		Second Quarter	Apr 12	Quarterly Report
17		Third Quarter	Jul 12	Quarterly Report
18		Fourth Quarter	Oct 12	The inward-looking focus of the Real Estate investors in Japan
19	2013	First Quarter	Jan 13	Can the Housing Tax Credit Boost Demand?

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