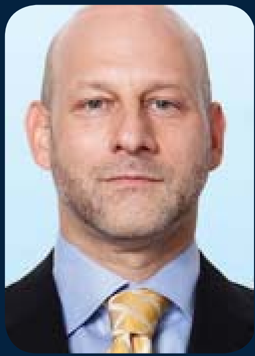


James "Jim" Fink, SIOR, has been resident in Tokyo since 1990, active in Japanese real estate from 1994 and is the only SIOR in Japan. He is responsible for two companies and six service lines. Colliers International established its Japan operations in 1952 and is active nationwide from offices in Tokyo and Osaka.

Tokyo Redux

By James Fink, SIOR

As China and India progressively capture the world's imagination, it has become common for the media to reduce Japan to a series of conflicting and oversimplified stereotypes for mass consumption. This is particularly true in economics, business and real estate, where Japan is often portrayed as a neo-mercantilist nation of savers with some of the most expensive real estate in the world. Alternatively it is purported to be a country in an unstoppable deflationary spiral, whose businesses have lost their competitive edge to Korea and China, with real estate values in perpetual decline. Neither extreme is a fair representation of Japan today.

Japan is, however, the ultimate "canary in the coalmine" for both the developed nations and China. The manner in which the country tackles problems stemming from export dependence, lower-cost foreign competition, an aging population, and high corporate, and individual taxation, as well as national pensions and healthcare, will be a laboratory for the entire world.

To understand the inconsistent views, you must first understand where Japan currently is in relation to the world.

Geography

The landmass is roughly the size of California or Germany, but it sustains a population equivalent to 40 percent of the United States. The density is similar to India. Much of the country is mountainous and unsuitable for urbanization or agriculture. Accordingly, most of the population lives in flatter plains, often near costal areas.

Population

With the world's tenth largest population of just over 127 million people, there are 12 cities of over one million people and another 15 cities with more than 500,000 residents. Germany has only 13 cities with 500,000 or more residents, while there are only four such cities in California. Tokyo is a city, federal district, and metropolitan area with a population of eight million to 34 million, depending on which Tokyo borders you select. It is the largest and certainly cleanest and best-functioning metropolitan area in the world.

Demographics

Japanese women have the longest lifespan in the world (average age, 85.6 years), with Japanese men ranked third (78.8 years). The Japanese are aging rapidly, with 23 percent over age 65 today, stretching to 30 percent within 10 years and 40 percent by 2050. The population is entering a gradual decline. In recent years there have been 9.6 deaths/1,000 of population versus 7.7 births/1000. On the bright side, the adult workforce remains massive at 66 million. There are only 19 countries that have even a total population greater than the number of workers in Japan.

Economy

Japan has enjoyed its position as the second largest economy globally for decades. It created over USD 45 trillion of GDP in 2009 while experiencing -1.4 percent inflation (deflation). It is the third largest importer and the fourth largest consumer of oil. During 2010, Japan and China traded the mantle of #2 economy back and forth. China will ultimately capture the second spot behind the United States, given that China's population is 11 times larger, its landmass is 25 times larger, and it has a massively larger pool of natural resources.

Japan remains a key source of manufacturing and intellectual property. Without the benefit of an "Intel Inside" branding strategy, Japanese firms supply the parts and technology that drive many Designed in the USA/Made in China products. There are many processes that are available only from Japanese firms. In other cases, Japanese firms represent half or more of the global capability to produce certain products or components. Japan is often the second largest destination for retailers after the United States, and Japan is one of the largest markets for American products and services ranging from McDonald's and Starbucks to Hollywood films, music, and television shows.

Residential

In a population 127 million people, there are some 50 million households, meaning that a typical household is comprised of only 2.5 people. A significant number of homes sit empty in rural areas. Economic opportunities are generally better in major cities. Combined with a declining population, residential demand has shifted rather than increased. Rural youth have long been relocating to prefectural capitals, regional hubs, and top-tier cities. Tokyo is the ultimate beneficiary of the trend. Demand for housing closer to urban areas has increased while distant suburbs and agricultural areas have languished. Major developers have successfully promoted center city mid- and high-rise condominium ownership. Today some 10 percent of Japanese own condos. New condo supply declined in recent years due to higher land prices, but it appears to have bottomed in the current cycle.

Industrial

With an economy rooted in manufacturing and export, Japan has a broad and deep industrial market. Large-scale manufacturing is generally located in industrial parks and land away from cities while warehousing and logistics are found close to major cities, airports, and seaports. Demand in the manufacturing sector has been stable to declining, with all but the most high-tech, value-added manufacturing shifting to lower-cost locations outside Japan. The logistics market has seen a gradual trading up to global standard warehouses and 3PL services.

Office

Office building quality is generally high. In Tokyo, land often represents more than 75 percent of total asset values, allowing outmoded structures to be demolished and replaced. Due to land values, buildings erected only 10 years or more are often considered middle-aged, while 40- to 50-year-old properties are commonly demolished and rebuilt. The Tokyo office market is one of the world's largest, with a gross floor area of nearly 1 billion square feet. One interesting aspect of the extended deflationary period is that the best office buildings in Tokyo today rent for 50 percent or less than comparable building rents in 1990.

Gloom and Boom

At this point you must have thought at least once, "I'm glad I don't work in Japan." The reality is that Japan is a very wealthy and developed society rather than something akin to a string of spent rust-belt towns. It does have a high debt/GDP, but most of the debt is owned domestically and it is JPY denominated. In spite of a long-term downward trend after a massive economic bubble in the 1980s, there have been real estate rallies where land and rental prices increased. As previously stated, larger urban centers have prospered to some extent over less central locales, rendering specific markets more attractive.

The trends in the real estate market are similar to other macro economic movements. Rents and property prices often shift in a consistent fashion with the Nikkei, as demand is partially a factor of corporate growth and employment. Property development and tenant activity, such as lease restructuring or relocation, also move in a manner consistent with financial markets.

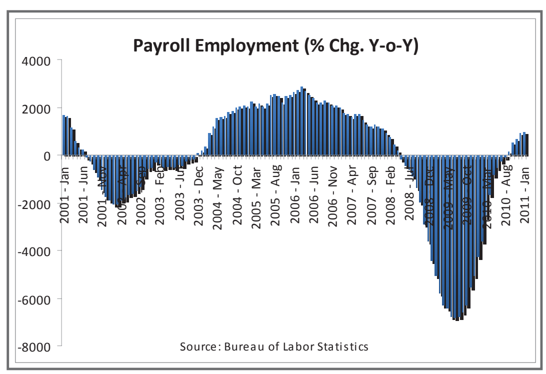
A strengthening market in 2004 through 2007 and the subsequent collapse after the global financial crisis are commonly viewed as a heady bubble and crash. This is true if you purchased property in 2007, decided to break ground on a new building thereafter, or signed a long-term lease near the market peak. But that is not true if you look through the lens of 1985-2003 data.

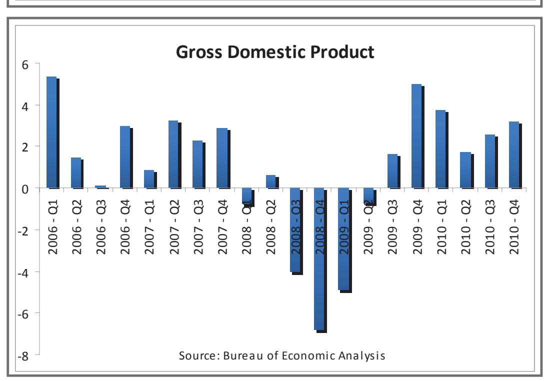
The current fundamentals have interesting undercurrents. Investors cautiously returned to the market in 2010, albeit with a Tokyo focus. Buyers and sellers are closer on pricing than at anytime since 2007. Financing for certain real estate acquisitions is once again available.

From a foreign capital investor perspective, Japan remains a focus for real estate acquisition. Cash yields have been higher than 10-year Japanese government bonds for an extended period. The recent decline in land values and rents appears to be slowing. Transparency, liquidity, political stability, and the ability to deploy large amounts of capital are above average compared to most of Asia. Japan also has a publicly traded REIT market.

The occupier position is equally interesting. Many office tenants that made commitments during peak years are currently seeing market rents dive below their lease rate and find themselves with fixed contracts through 2011 and beyond. Others negotiated reductions earlier in the downward cycle but should consider another round in the near future. Generally, leases signed in the last few years are progressively over market.

One demand driver is space efficiency and utilization. During the financial crunch, larger tenants were forced to reduce costs by partially returning space. They did not have the capital to relocate and simply tried to fit into a smaller space not designed





for this purpose. Relocations have been limited over the last few years, but the pace increased markedly during 2010. It is almost certain that the number of firms relocating will continue to increase through 2012. This is partly driven by the need to occupy a space designed to support current business and staffing requirements rather than continuing to try to use only a portion of an older office layout.

Other factors are supply and vacancy. Average Tokyo office market vacancy today is near 9 percent, but most buildings either enjoy very low vacancy or suffer with rates that are multiples of the market average. A new pressure on this unbalanced vacancy is a significant supply of large buildings completing construction in the 2011-2012 period. The first wave is mainly outside of the three main office wards, but central buildings are the focus in 2012 and for the smaller supply projected for 2013. This will pressure new buildings to offer lower rents and greater incentives to pull tenants from existing buildings. As relocations increase, the currently lumpy vacancy will become more balanced between buildings and locations before eventually shifting to inferior locations and older or smaller properties.

Investors

Asia has an amazing seven of the Top 10 cities for investment sales globally. Tokyo recently ranked #4. The decline in capital values across all property types nationwide since 2007 appears to be subsiding. Transaction volume has clearly begun to pick up after several anemic years. Financing remains challenging with strict valuations and LTVs (loan to value) in the 50 percent to 60 percent range. While there are a number of NPLs (non-performing loans), lenders are generally resetting maturities or quietly securing replacement owners and supplying any required capital in what sometimes represents, "extend and pretend." REITs have had the additional benefit of formal and tacit government support for credit, mergers and sponsorship changes. Overall, the economy has rallied from the last bottom, but is facing a number challenges including a near record strength Japanese yen (JPY).

There is a clear increase in investor sentiment towards Japan as many perceive that a market bottom is near. Tokyo remains the focus for institutional investors with little interest in properties outside the metropolitan area. The ability to secure financing continues to be a factor supporting Tokyo over other Japanese cities. Multifamily residential became a core interest to numerous investors in 2010 due to the stability of rents and occupancy in comparison to a less certain near-term dynamic in office and industrial markets. The rush to residential and ongoing cap-rate compression will begin to motivate investors back towards Tokyo office and industrial in 2011 and a few years later, into asset classes in other cities.

Occupiers

The Tokyo office market is one of the world's largest and most dynamic. Building scale, specifications, and quality have continually increased over several decades while rents have declined in JPY terms. Still, the market is always ranked in the top tier globally by cost. Most multinational firms maintain an office presence here.

Landlords suffered mightily during the financial crisis as tenants aggressively reduced space in currently leased locations while avoiding relocations. Demand has begun to stabilize, as have concerns about corporate balance sheets. The result was an increasing number of relocations in 2010 with an even more active market likely during the next 24 months. Coming out of intense restructuring, tenants are seeking better premises and a more efficient and modern office layout but are not planning to significantly increase the amount of space leased. While demand is stabilizing, supply is more problematic. New completions of larger buildings in and around Tokyo are greater in 2011-12 than any year since 2003.

Overall, the real estate market is emerging from a double whammy of homegrown and global turmoil. The recent crash was catastrophic for some and has created new opportunities for others. Compared to the 1980s economic bubble and the 1990s aftermath, the recent problems are small indeed. In the meantime, Japan continues to test solutions to its macroeconomic issues that will impact the real estate market and provide trail markers for other nations as their populations and markets mature.