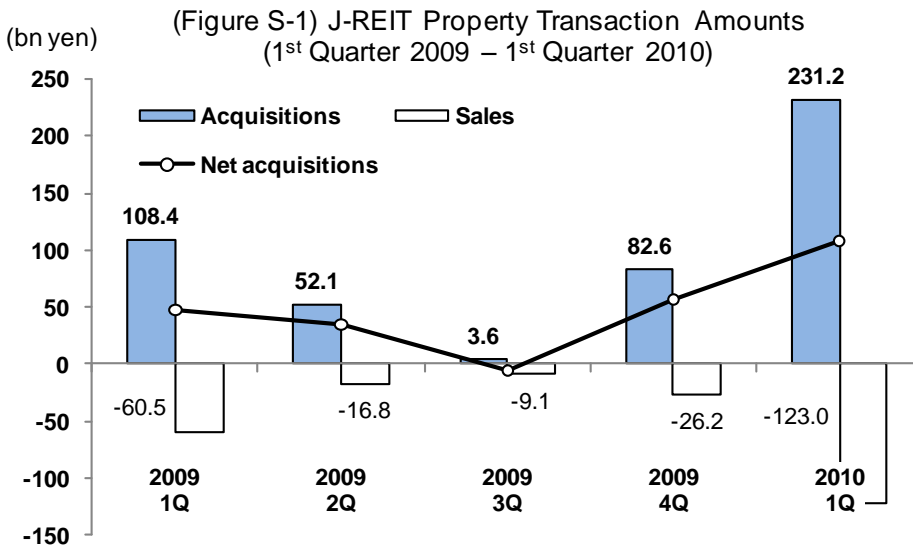


Market Summary

- **J-REITs acquire real estate totaling over 230 billion yen in January – March period <Surpassing 90% of acquisitions conducted throughout 2009>**



- ✓ J-REITs acquired properties in 3 months totaling over 90% of acquisitions through the year of 2009
- ✓ J-REITs aim to enhance profitability through asset replacement (Also, employ new investment strategy such as proactively acquiring land with leasehold interests)
- ✓ Transactions between J-REITs increase rapidly

(Note) Based on the date of acquisition or sale

(Source) ARES

After a period of stagnancy, property acquisitions by J-REITs are regaining strength. In the three months of January through March 2010 alone, J-REITs acquired real estate (including beneficiary interests in real estate trust) amounting to 231.2 billion yen – equivalent to 93.7% of the total acquisitions (246.7 billion yen) conducted throughout the year of 2009 (or 213.3% compared to the same period a year ago – see Figure S-1),

Behind the increased property acquisitions, there are presumably such factors as the following: (1) REITs have restarted public offerings and the issuance of investment corporation bonds as the financing environment surrounding them has loosened from the earlier level of severity; (2) conditions for conducting borrowings have also improved; (3) asset replacement is becoming increasingly necessary in order to improve the portfolio profitability; and (4) an increasing number of REITs have gained high creditworthiness through changes in sponsors and other means.

In addition, some REITs, primarily retail and logistics REITs, have recently started to employ an investment strategy in which they actively acquire “land with leasehold interest,” which does not require depreciation and thus features high cap rates after depreciation, in order to realize higher dividends. Another characteristic was the rapid increase in transactions among J-REITs, which had rarely happened before.

[→ For more details, see [TOPIC: Latest trends in property acquisitions.](#)]

- **Merger between BLife and New City Residence completed <Finalizing first civil rehabilitation proceedings among J-REITs>**

The merger of BLife Investment Corporation (BLI, securities code: 8984) and New City Residence Investment Corporation (NCR) was completed on April 1. The merger is an absorption type, with BLI designated as the surviving entity, making the portfolio size after the merger approximately 190.5 billion yen (consisting of 127 residential properties and 2 retail facilities). NCR filed a petition for commencement of civil rehabilitation proceedings – a first among J-REITs – in October 2008, and was delisted in the following month. It concluded an agreement to merge with BLI in November 2009, after undergoing various difficulties in selecting a new sponsor.

With the merger, BLI has expanded its value of properties and net assets by approximately 3.7 times and 2.9 times, respectively. Moreover, the merger has allowed expectations for increased dividends through enhanced profitability, improved liquidity of its investment units and other advantages.

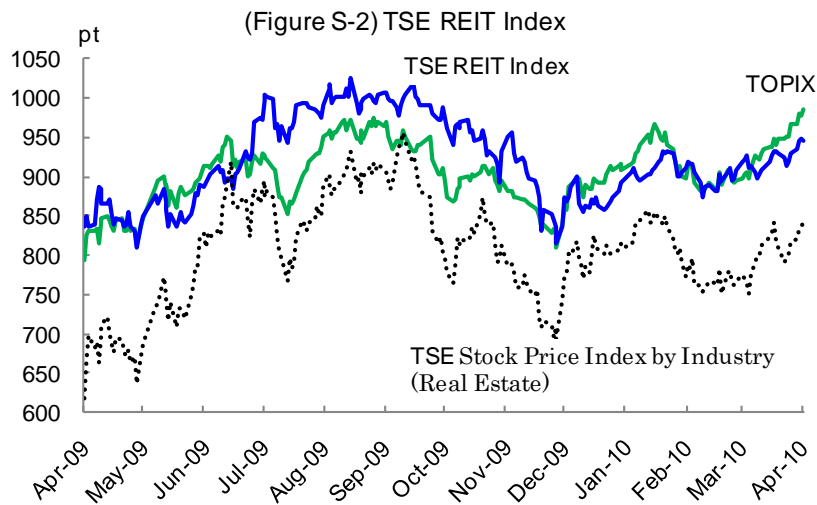
BLI's investment units were allocated and issued to NCR's unitholders, at a proportion of 0.23 BLI units for 1 NCR unit. Furthermore, it was decided to conclude NCR's civil rehabilitation proceedings as of March 30.

➤ **Real Estate Market Stabilization Fund grants its first loan <Prospect Reit>**

On March 15, Prospect Reit Investment Corporation (PRI, securities code: 8969) received a loan of 10 billion yen granted by the Real Estate Market Stabilization Fund (final repayment date of loan principal: September 2012; initial interest rate: TIBOR + 4.98368%; collateralized).

The Real Estate Market Stabilization Fund was established in September 2009, with an aim to provide funds to J-REITs that have difficulties financing due to the credit crunch caused by the financial crisis, etc., despite their stable cash flows and ensured profits. Capital for loans consists of investments by real estate firms and other companies, mezzanine loans from Development Bank of Japan, and senior loans from other financial institutions. The loan granted to PRI is the first financing arrangement made by the Fund. PRI will utilize the loan from the Fund for refinancing, such as bridge financing for the redemption of its investment corporation bonds.

Furthermore, PRI is scheduled to merge with Japan Rental Housing Investments, Inc. (JRH, securities code: 8986) in July this year (with a basic agreement to merge concluded on March 26.)



(Note) Both indices excluded dividends.

(Source) Bloomberg

(Figure S-3) Major Market Indices

	End of Mar. 2010	1-month	6-month	1-year
TSE REIT Index (excluding dividends)	948.9	+ 4.5%	- 3.9%	+ 12.2%
Market cap (bn yen)	2,951.7	(Note) The dividend yield is a weighted average of the market cap based on dividend forecasts by respective J-REITs.		
Average estimated dividend yield	5.6%			

(Source) Prepared by ARES based on disclosed materials of TSE and each J-REIT

<Announcement of Financial Results>

(Figure S-4) Highlights of Financial Results (period ended January 2010)

Figures in parentheses () are the percentage of increase/decrease from the previous period.

Code	Investment Corporation	Financial Period	Operating Revenue		Operating Income		Ordinary Income		Net Income		Dividend per Unit	
			(mm yen)	(%)	(mm yen)	(%)	(mm yen)	(%)	(mm yen)	(%)	Current period	Next period
8967	Japan Logistics Fund	9th	4,576	(1.2)	2,353	(10.2)	2,108	(8.0)	2,107	(8.0)	17,234	17,200
8969	Prospect Reit	9th	2,191	(-2.0)	878	(4.2)	194	(-46.4)	193	(-46.6)	2,577	(*) 406
8957	TOKYU REIT	13th	25,359	(239.0)	14,374	(313.5)	13,457	(412.2)	13,456	(412.4)	79,446	11,900
8970	Japan Single-residence REIT	9th	1,766	(-0.6)	721	(-5.0)	237	(-6.0)	236	(-6.1)	4,206	750
3234	Mori Hills REIT	7th	5,520	(-4.6)	2,821	(-6.1)	1,729	(-14.7)	1,728	(-14.7)	10,857	6,550

(*) Deemed fiscal period (five months) until the merger

(Source) ARES

<Financing>

Mori Hills procures about 15 billion yen through public offering, Japan Excellent and Japan Prime Realty issue investment corporation bonds (totaling 12 billion yen and 6 billion yen respectively)

- ✓ On March 5, Mori Hills REIT (MHR, securities code: 3234) announced its decision to conduct a public offering. It plans to issue an additional 73,700 investment units (the maximum including portions for over-allotment) totaling 14.9 billion yen (same). The procured capital will be used to acquire new properties (Roppongi Hills Mori Tower and ARK Mori Building, totaling 10.2 billion yen) and to repay borrowings.
- ✓ On March 11, Japan Excellent, Inc. (JEI, securities code: 8987) publicly issued investment corporation bonds (total issuance amount: 12 billion yen; maturity: 4 years; annual interest rate: 1.52%). JEI will use the procured capital to repay borrowings in an attempt to shift to long-term interest-bearing liabilities and to increase the ratio of fixed-rate borrowings.
- ✓ On March 12, Japan Prime Realty (JPR, securities code: 8955) publicly issued investment corporation bonds (total issuance amount: 6 billion yen; maturity: 5 years; annual interest rate: 1.68%). JPR will use the procured capital to repay borrowings in order to increase the ratio of long-term loans among interest-bearing liabilities.

<Property Transactions>

Property acquisitions exceeded 140 billion yen in March.

(1) Major acquisition cases

- ✓ TOKYU REIT ORIX Shinjuku Building; 9 bn yen *Acquired from ORIX JREIT Inc.
- ✓ ORIX JREIT 1 logistics facility, 2 offices and 3 retail facilities (1 of them is land with leasehold interest); 31.5 bn yen in total
- ✓ Japan Retail Fund 6 retail facilities; 22.7 bn yen in total
- ✓ Mori Hills REIT Roppongi Hills Mori Tower and ARK Mori Building; 10.2 bn yen in total
- ✓ Japan Prime Realty TK Horidome Building; 5.1 bn yen

(2) Major transfer case

- ✓ Japan Retail Fund Sold 8953 Saitama Urawa Building (Urawa PARCO) to its tenant, PARCO; 26.1 bn yen
- ✓ Nippon Building Fund NBF Hakata Gion Bldg. and NBF Ebisu-Minami Bldg.: 3.5 bn yen in total
- ✓ ORIX JREIT ORIX Shinjuku Building (refer to (1) above) and ORIX Jimbo-cho Building; 13.1 bn yen in total
- ✓ Industrial & Infrastructure Fund IIF Funabashi Logistics Center; 9.0 bn yen

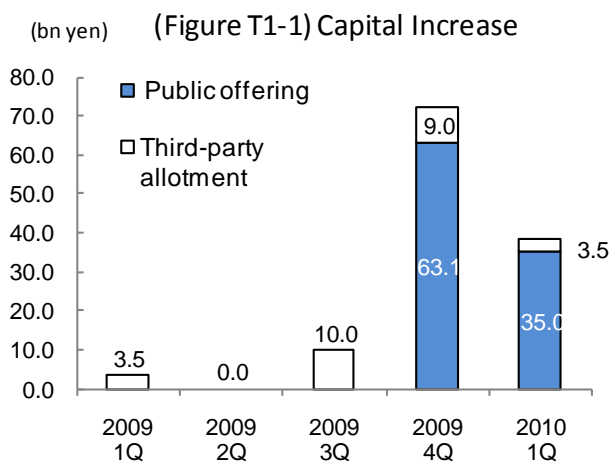
TOPIC: Latest trends in property acquisitions

1. Background of proactive property acquisitions

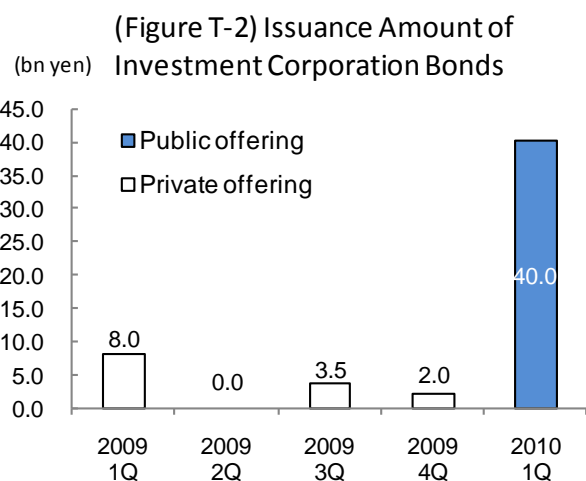
(1) Restart of fund procurement from the capital market

The first quarter of 2010 was a period in which J-REITs recouped their vitality in conducting property acquisitions (see "Market Summary"). The revival began with the re-start of public offerings. A J-REIT conducted a public offering in October 2009 – the first time in one year and three months in the industry – against the background where investment unit prices recovered to a certain extent through the summer of 2009. By the end of March 2010, seven cases of public offerings successfully procured a little less than 100 billion yen (Figure T-1). The amount of capital increases conducted since July 2009 has totaled approximately 120 billion yen, including issuances of new investment units by way of third-party allotment that accompanied the designations of new sponsors, etc. Moreover, investment corporation bonds were publicly issued in January 2010 – the first time in one year and eight months in the J-REIT market. By the end of March, the issuance amount of such bonds reached 40 billion yen (Figure T-2).

In addition to such fund procurement through the capital market becoming possible, financial institutions have taken a less stringent attitude toward providing loans. Combined, these factors have created improved financing conditions for J-REITs to acquire properties. In fact, many of the J-REITs that acquired real estate (including beneficiary interests in real estate trust) in the January – March period have recently conducted capital increases or issued investment corporation bonds (see the remarks in Figure T-3).



(Note) Public offering includes portions of over-allotment.
(Source) ARES



(Source) ARES

(Figure T-3) Amount of Assets Acquired by Investment Corporation

(Jan. 2010 – Mar. 2010)

Investment Corporation	Acquisition Price (mm yen)	Remarks (fund procurement and other measures since July 2009)
1 Japan Real Estate	77,026	Capital increase
2 ORIX JREIT	31,540	Replacement of portfolio and issuance of investment corporation bonds
3 Japan Retail Fund	23,179	Replacement of portfolio
4 TOKYU REIT	18,030	Replacement of portfolio
5 Japan Prime Realty	15,600	Capital increase, replacement of portfolio and issuance of investment corporation bonds
6 TOP REIT	12,700	NA
7 Mori Hills REIT	10,210	Capital increase
8 Japan Logistics Fund	7,875	Capital increase
9 Kenedix Realty	6,800	Capital increase
10 Nippon Accommodations Fund	6,502	Capital increase
11 Industrial & Infrastructure Fund	5,690	Replacement of portfolio
12 CRESCENDO	4,798	Capital increase (through third-party allotment)
13 DA Office	4,150	Capital increase (through third-party allotment) and issuance of investment corporation bonds (through private offering)
14 FC Residential	3,617	NA
15 Japan Rental Housing	3,440	Capital increase (through third-party allotment)
TOTAL	231,157 mm yen	

(2) Asset replacement

Another factor that has had an even heavier impact than the improvement in the fund procurement environment is the increase in the number of REITs that endeavored to reconstruct their portfolio. A look at the list of REITs that acquired large amounts of assets in the January – March 2010 period reveals that many of these REITs also sold assets along with the acquisitions. While property acquisitions reached approximately 230 billion yen during the period, property sales also rose significantly to approximately 120 billion yen. While some properties were sold for financial reasons, larger proportions of such sales were conducted to realize “asset replacement,” in which the REITs aim to enhance the quality and profitability of their portfolio by selling low-profit assets and acquiring new properties instead.

Behind the increase in the number of REITs conducting asset replacement is the fact that they are required to act in order to maintain and raise dividend levels. They must do so as they face increasingly strong downward pressure on the cash flows their assets should generate, due to increased vacancy and decreased rents as a result of deteriorating fundamentals caused by the weak domestic economy. In addition, they can scarcely expect gains on sales of properties since real estate prices remain low.

Moreover, the situation in which real estate prices remain low provides buyers with a good opportunity to acquire blue-chip properties at higher cap rates than before. Real estate prices in Japan had experienced a declining trend for some time, but there is a gradually growing recognition that they are nearing the bottom. Presumably, a growing number of REITs are trying to seize this opportunity to proactively conduct asset replacement.

This asset replacement strategy has been explicitly demonstrated by Japan Retail Fund (JRF, securities code: 8953) and Industrial & Infrastructure Fund (IIF, securities code: 3249), both of which are managed by Mitsubishi Corp. - UBS Realty Inc. JRF sold the 8953 Saitama Urawa Building for 26.1 billion yen and used the proceeds from the sale to acquire eight properties totaling approximately 24.3 billion yen (one of the properties was acquired on April 2). JRF claimed that the asset replacement should improve its NOI cap rate after depreciation from 2.5% (property sold) to 3.7% (total of properties acquired). Meanwhile, IIF sold its IIF Funabashi Logistics Center for approximately 9 billion yen and acquired two properties (both of which are land with leasehold interests and feature high cap rates after depreciation) for a total of about 5.7 billion yen.

Aside from these two REITs, ORIX JREIT Inc. (OJR, securities code: 8954) also announced an asset replacement, acquiring six properties for approximately 31.5 billion yen in exchange for selling two office buildings for about 13.2 billion yen.

Words

- Land with leasehold interest (site):
Ownership right of the land to which a leasehold interest (primarily the right to lease) is established. The lessee (tenant) of the land owns the buildings (stores, warehouses, etc.) built on the land, while the right holder of the land with leasehold interest (owner of the land with leasehold interest) leases the site to the tenant. This format is often applied for retail stores and logistics facilities.
- Depreciation:
When a fixed asset is acquired for use over a long period of time, the amount of expenses required for the acquisition is allocated over its useful life as expenses in each period. This allocated expense is called “depreciation.” For land with leasehold interests, there is no depreciation expense as the buildings are not owned.
- NOI after depreciation:
Net Operation Income (NOI) is annual revenue less annual expenses, and if depreciation expense is then deducted, the figure is “NOI after depreciation.” Because the source of dividends is NOI after depreciation, the dividend is impacted by the increase or decrease in NOI after depreciation.

2. Characteristics of the transactions

(1) Aiming to increase dividends by acquiring “land with leasehold interests” with high cap rates after depreciation

An aspect observed in the recent asset replacement strategy that stands out is the acquisition of “land with leasehold interests” (refer to “Words” to the right). Although some cases had existed previously, the number of acquisitions of land with leasehold interests by J-REITs has been increasing since the beginning of 2010 (Figure T1-7).

The high NOI after depreciation (refer to “Words”) is hailed as an advantage with regard to acquiring land with leasehold interests. Ownership of such land does not require depreciation – as there is no building owned – and the NOI cap rate is equivalent to the cap rate after depreciation. Accordingly, if the NOI cap rates are the same, land with leasehold interests offer higher cap rates after depreciation compared with those other types of land, and can generate a greater source of dividends. In addition, in terms of the NOI cap rate itself, land with leasehold interests generally produce relatively higher figures (Figure T1-7).

Words

Leasehold for business use: A type of fixed-term land leasehold, representing a right to lease a piece of land for a business purpose for a certain period (10 years or more and less than 50 years – 20 years or less before January 2, 2008). No renewal of the contract is allowed, and the lessee shall demolish buildings upon the expiration of the contract and return the vacant lot to the lessor.

In addition, it is often the case that, when REITs acquire land with leasehold interests, the established land leasehold is a leasehold for business use (refer to “Words”). Stable rental revenues can be expected under a leasehold for business use, as it features a long contract period and often sets limitations on mid-term cancellations and downward rental revisions. Moreover, there is no need for the lessor to renew the contract upon expiration, and it is legally designated that the land must be returned in the form of a vacant lot.

Because of these advantages, acquisition of land with leasehold interests will possibly continue to increase going forward, primarily by REITs focusing on retail and logistics facilities.

(2) A sharp increase in transactions between REITs

Another major characteristic aspect of recent property deals is the sharp increase in transactions between REITs. Although the number of such transactions conducted before November 2009 was as low as two, transactions of seven properties (totaling about 31.8 billion yen) were completed between December 2009 and the end of March 2010.

The first of these transactions was the one in which TOKYU REIT (TRE, securities code: 8957) sold its Ryoshin Harajuku Building to Japan Prime Realty (JPR, securities code: 8955) for 8.4 billion yen in December 2009, followed by a series of deals involving properties priced at from several billion yen to around 10 billion yen each.

In these transactions, the sellers decided to sell their properties for the purpose of asset replacement and for accounting and financial reasons. Meanwhile, REITs are evaluated as very solid buyers in terms of fund procurement and other factors. Moreover, as is understandably the case (because the properties are assets owned by REITs), REITs are the main players involved in retail properties in these price zones, and thus it may be natural that REITs are willing to accept the properties for sale.

Transactions between REITs are advantageous for both parties, as buyers in turn can acquire blue-chip properties.

3. Future outlook – Will the momentum of property acquisitions continue?

Will the voracious property acquisitions observed in the first quarter of 2010 continue in the future? (For reference, as of the end of March 2010, three properties totaling 27.8 billion yen are planned to be acquired after April.)

Many REITs carried out public offerings in the fourth quarter of 2009. Entering 2010, however, the pace decelerated due to drops in investment unit prices. Nevertheless, the unit prices are again on a recovery trend since February. With a further recovery in investment unit prices, the number of REITs that can conduct capital increases will possibly increase again. The conditions for issuing investment corporation bonds have also been gradually improving. Moreover, reorganization in the industry has been steadily progressing through such measures as mergers and sponsor changes. Through better credibility and other strengths, more REITs are likely to have a larger capacity to acquire properties.

On the other hand, under the present situation in which the appraisal values of properties owned by REITs remain low and LTVs (the ratio of interest-bearing liabilities to total assets) have not been sufficiently lowered, it is difficult to imagine that REITs will “devote themselves only to new acquisitions” as they once did. Therefore, they are likely to acquire new properties in tactful combination with sales of owned properties - such as asset replacement - in order to improve their entire portfolio. In this way, the trend of restarting property acquisitions will continue going forward. Having said this, there are not necessarily many factors that would allow a presumption that the pace will surpass the level achieved in the January - March period. Nevertheless, it seems certain that the real estate investment market has entered a phase of making a new start.

[DISCLAIMER]

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