

Autumn 2009 Part I

Japan Real Estate Investment

**REVIEW**



**Nomura Real Estate Development Co., Ltd.**

## Overview

The market for large-scale logistics facilities in the Tokyo area began expanding rapidly in 2005 with the emergence of a full-scale leasing market, financed primarily by fund management companies. Vacancy rates started to rise in 2008 as new supply reached an all-time high, but most vacancies were concentrated in a small number of areas and overall demand remained firm.

Everything changed, however, after the global financial crisis hit in the fall of 2008. The present report, based on our own independent research, examines how this worldwide financial crisis has affected the leasing market for large-scale logistics facilities in metropolitan Tokyo, and discusses future supply and demand trends and other key factors related to investment.

### **Large-scale logistics facilities in metropolitan Tokyo: Market trends**

#### **Factors Affecting Supply**

- New supply remained high from 2005~2009, but will fall to a ten-year low of only 260,000m<sup>2</sup> in 2010. Supply will remain low in 2011 (600,000m<sup>2</sup>).
- Since 2005 fund management companies have been responsible for the high levels of new supply of leased properties, and they will be the major determinant of future supply.
- There can be no full-fledged recovery in new supply until financial markets begin to operate normally, the economy recovers, and investors return to the market. Such a recovery is unlikely before 2012 at the earliest.

#### **Factors Affecting Demand**

- Next-generation leased logistics facilities tend to handle items used in daily living, which are less affected by changes in the overall economy than other types of products.
- The Third Party Logistics (3PL) industry will continue to expand in 2010, indicating that demand for large-scale next-generation logistics facilities remains fundamentally strong.
- Relative demand will strengthen in 2010~2011 due to a sharp fall in new supply, however there will also be a clear polarization in the market between desirable properties and those that fail to meet the needs of the market in terms of location or rent level.

The logistics facility sector is one that generates fundamentally stable returns, but at present few management companies have a thorough grasp of Japan's logistics real estate, or possess the capacity to effectively evaluate and select logistics properties. The forces of natural selection will compel these companies to adapt and reorganize, and eventually the logistics leasing market will pass through its infancy and reach a new stage of maturity. More long-term investors will begin to enter the market, and we believe that in future this sector will become one of the main pillars of real estate investment.

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## Large-scale Logistics Facilities in Metropolitan Tokyo -- Survey of Market Trends (2009) --

### Introduction

#### How has the global economic crisis affected the market for logistic facilities?

The global financial crisis precipitated an unprecedented decline in Japan's GDP and led to a rapid contraction of the economy. This impacted the leasing market for logistics facilities, which until then had been enjoying a steady expansion, by driving up vacancy rates while at the same time putting downward pressure on rents.

The questions that arise are how this will affect the relationship between supply and demand, and when the market is likely to recover.

In our previous Survey (Note 1; September 2008) we reported, "vacancy rates have risen in the greater Tokyo region, but with the exception of a few areas and a limited number of facilities these increases will be temporary. In the medium term the trend toward improved logistics efficiency will continue, and the underlying demand for large-scale logistics facilities is expected to remain firm."

In the present report (Note 2), based on site surveys, public records, and interviews, we follow up our earlier study by investigating new facilities (completed or scheduled for completion), together with all other leased logistics facilities constructed since 2000, in order to clarify the volume of new supply, ownership trends (types of investors), industry category of cargo owners, types of goods handled, recent vacancy rates and current operational status. Based on this survey data we then developed estimates of future supply and demand.

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Note 1: Large-scale Logistics Facilities in Metropolitan Tokyo -- Survey of Market trends (2008) –

(Japanese version published January 5, 2009; [http://www.nomura-re.co.jp/business/shisan\\_report.html](http://www.nomura-re.co.jp/business/shisan_report.html);

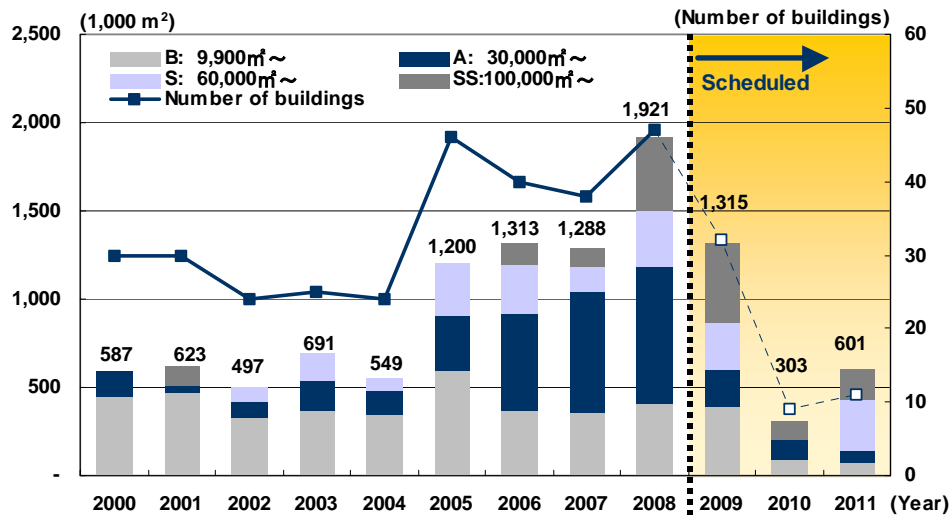
Englishversion: [http://www.nomura-re.co.jp/english/report/pdf/review\\_winter2009E.pdf](http://www.nomura-re.co.jp/english/report/pdf/review_winter2009E.pdf) )

Note 2: The present survey covers all facilities completed as of August 2009, as well as facilities scheduled for completion by 2011.

# 1. Supply trends

## 1-1 Supply trends for large-scale logistics facilities

**Figure 1 New supply of large-scale logistics facilities in metropolitan Tokyo (floor space  $\geq 9,900\text{m}^2$ )**



Source : NRE

\* Properties subject to this study were ordinary or refrigerated warehouse facilities located in the greater Tokyo metropolitan area (Tokyo, Kanagawa, Saitama, Chiba) with a total available floor space of at least 9,900m<sup>2</sup>. (Specialty warehouses for hazardous goods, warehouses located on factory premises, and pier sheds or other port facilities were excluded).

### New supply to drop sharply in 2010 and 2011

Figure 1 shows new supply trends for large-scale logistics facilities in the Tokyo metropolitan area (existing buildings and those scheduled for completion between 2009~2011), based on data we collected in a proprietary survey. Subjects were all of the ordinary or refrigerated warehouse facilities located in the greater Tokyo metropolitan area with a total floor space of at least 9,900m<sup>2</sup> (3,000 tsubo). (See Note below graph for more details).

We can see from this Figure that new supply grew sharply in 2005, and we also notice a clear trend toward construction of larger facilities. From 2005~2007 average annual new supply was 1.27 million m<sup>2</sup> (about 380,000 tsubo), which is nearly double the amounts recorded in 2000~2004. New supply peaked in 2008 at 1.92 million m<sup>2</sup> (about 580,000 tsubo). In 2009, as of the date of our survey, new supply was expected to total 1.32m<sup>2</sup> (400,000 tsubo). This represents a drop of 32% compared with 2008, but is still relatively high.

The effects of the Lehman shock in September 2008, however, are reflected in the volume of new supply for 2010. As of the date of our survey, nine facilities with a total floor space of 300,000 m<sup>2</sup> (90,000 tsubo) had started or were about to begin construction. It appears that about 600,000 m<sup>2</sup> of facilities originally scheduled for construction in 2010 have either been

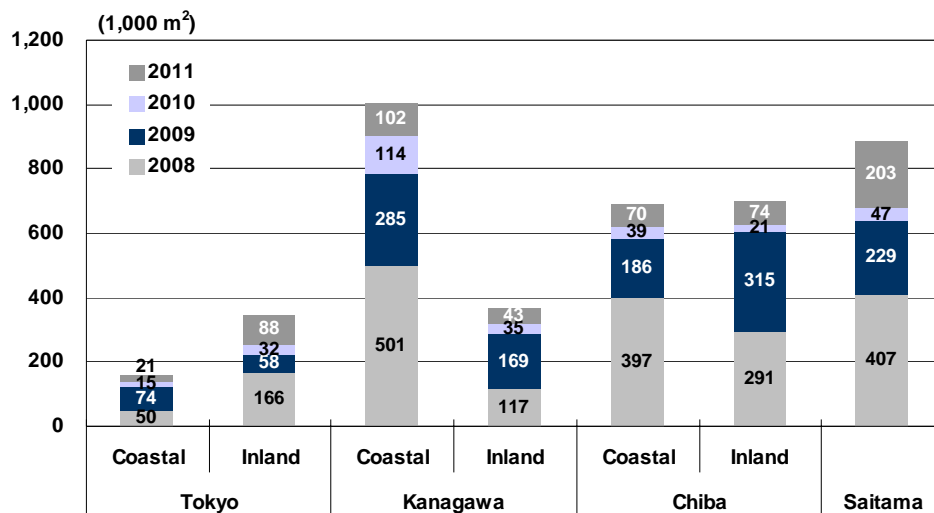
delayed until 2011 or later, or cancelled altogether. This is a decline of 77% compared with 2009, and represents only 61% of the amount of new supply in 2002 (500,000 m<sup>2</sup>), which marked the lowest level recorded in the previous ten years.

Because even large-scale logistics facilities can be constructed in about one year, it is possible that actual supply could end up being somewhat higher than our current estimate, but even so the level is expected to be rather low. We forecast that new supply will total about 600,000 m<sup>2</sup> in 2011, but this figure could be even lower if the recovery of the market is delayed.

Looking at the ten-year period from 2000~2009, we find that average annual new supply of logistics facilities during the first 5 years was 590,000 m<sup>2</sup>, whereas it reached 1.41 million m<sup>2</sup> during the second 5 years, an increase of 139%. On the other hand, our data indicate that new supply in 2010 and 2011 will average only 450,000 m<sup>2</sup>. This is a decline of 68% compared with 2005~2009, and 24% compared with 2000~2004.

## 1-2 New supply trends by area

Figure 2 New supply in inland vs. coastal districts (2008~2011)



Source : NRE

### New supply highest in the Kanagawa coastal district

Figure 2 shows total new supply in metropolitan Tokyo from 2008~2011 by prefecture, classified according to whether the facilities were located in coastal districts (defined as being on the seaward side of National Highway Routes 14 and 15), or inland districts.

New supply is relatively low in Tokyo compared with the surrounding prefectures. In 2009 new supply in Tokyo proper reached only 130,000m<sup>2</sup>. In contrast, the level of new supply exceeded 200,000 m<sup>2</sup> in the coastal districts of Kanagawa (290,000 m<sup>2</sup>), inland Chiba (320,000 m<sup>2</sup>), and Saitama (230,000 m<sup>2</sup>). Supply in the coastal zone of Chiba (190,000 m<sup>2</sup>) fell by 53% year on year, unable to keep pace with the sharp increase seen in 2008.

The chart below shows the composition of new supply by area in 2008~2009, and lists the names of major facilities constructed during this period.

| Region     |                    | Floor space<br>(10,000 m <sup>2</sup> ) | Number of buildings |   |   |    |                  |        |    | Total   | Major facilities |
|------------|--------------------|---|---------------------|---|---|----|------------------|--------|----|---|------------------|
| Prefecture | Coastal/<br>Inland |   | Scale               |   |   |    | Owned/<br>Leased |        |    |   |                  |
|            |                    | Total                                   | SS                  | S | A | B  | Owned            | Leased |    |   |                  |
| Tokyo      | Coastal            | 12.4                                    | 0                   | 0 | 2 | 3  | 4                | 1      | 5  | Hitachi Transport System Keihin Distribution Center   |                  |
|            | Inland             | 22.4                                    | 0                   | 0 | 4 | 2  | 2                | 4      | 6  | Hachioji Minami Osawa Distribution Center/ Hamura Distribution Center/ Landport Itabashi                |                  |
| Kanagawa   | Coastal            | 78.6                                    | 3                   | 2 | 4 | 6  | 8                | 7      | 15 | Logi-port Kawasaki/ Yokohama Logistics Park Building A/ Sankyu Flagship Distribution Center             |                  |
|            | Inland             | 28.6                                    | 1                   | 0 | 1 | 6  | 5                | 3      | 8  | ProLogis Park Zama I/ Atsugi Sakai Distribution Center  |                  |
| Chiba      | Coastal            | 58.3                                    | 1                   | 2 | 4 | 5  | 3                | 9      | 12 | ProLogis Park Ichikawa I/ ProLogis Park Ichikawa II/ Land-port Urayasu                                  |                  |
|            | Inland             | 60.6                                    | 2                   | 1 | 3 | 7  | 9                | 4      | 13 | Nagareyama Logistics Center Building B/ Logistics Park Noda Funagata/ CX-Cargo Noda Distribution Center |                  |
| Saitama    | -                  | 63.6                                    | 0                   | 2 | 5 | 12 | 8                | 11     | 19 | Kanso-Inc. Kawagoe Branch Distribution Center/ Landport Kawagoe   |                  |

### Tokyo coastal zone

This area will generate the lowest level of new supply. Most facilities are used by the owners. This area is closest to the Tokyo mass consumption zone so demand is strong, but land prices are high and very little new land is available for development.

### Tokyo inland zone

No S class or higher facilities will be constructed; most new supply is centered on the Tama district. The one facility in Itabashi is unique to the area and therefore commands a premium price.

### Kanagawa coastal zone

This area will generate the highest amount of new supply, including 5 facilities of S class or larger. About half will be leased facilities.

### Kanagawa inland zone

New supply will be only about 36% that of the Kanagawa coastal zone. Only three facilities are being built for lease.

### Chiba coastal zone

Nine of 12 facilities, including three of S class or larger, will be built for lease.

### Chiba inland zone

Will generate even more new supply than the coastal zone, including three facilities of S class or larger.

### Saitama inland zone

Will be the second largest source of new supply, following the Kanagawa coastal zone, including twelve B class facilities.

(Floor space by size class)

SS Class: 100,000m<sup>2</sup> ~    S Class: 60,000m<sup>2</sup> ~    A Class: 30,000m<sup>2</sup> ~    B Class: 9,900m<sup>2</sup> ~

Figure 3 Geographical distribution of large-scale logistics facility projects (2008~2011)



Source : NRE

- \* Yellow: Used by owners / Blue: Leased (Fully occupied) / Red: Leased (Partially vacant) /  
White: Planned construction

### 1-3 Reasons for the decline in new supply, and conditions required for a recovery

Before we examine the reasons behind the sharp decline in new supply from 2010 onward, we should first review the causes for the steep growth in supply that began in 2005 (see our Investment Review, Winter 2009, for further details).

1. Expansion of the 3PL industry due to revision of laws regulating freight transport (deregulation).
2. Increased need for improved logistics efficiency (cost cutting) on the part of cargo owners.
3. Increase in investment by foreign investment funds.
4. Economic recovery.

With this as a background we will now discuss the reasons for the large decline in new supply forecast for 2010 onward, and the conditions that will need to be met for a recovery to occur. To answer these questions we performed a survey of land and construction price trends, which represent bottlenecks on the construction side, and the activities of real estate investment funds, which have been the main driving force behind the growth in new supply in recent years.

1-3-1 Costs of land and building construction

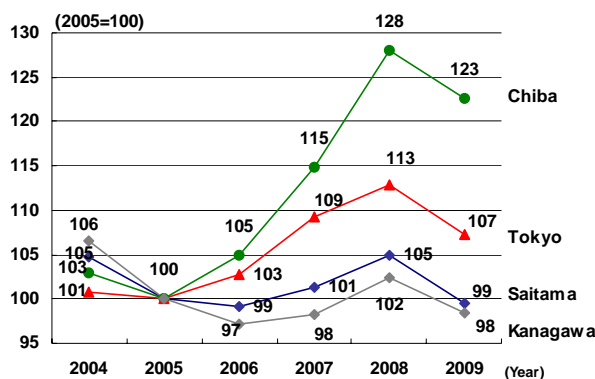
**Cost of industrial property in Chiba and Tokyo rose sharply through 2008**

Figure 4 shows the relative changes in industrial property prices in the Tokyo region according to a land price survey done by the Ministry of Land, Infrastructure Transport and Tourism (prices are as of July 1 each year, with 2005=100 as the base year).

Prices in Tokyo and Chiba peaked in 2008, and began to fall in 2009. Industrial property prices in Tokyo have spiked 28% since 2005. This, together with a shortage of suitable land, has hindered the creation of new supply in Tokyo proper.

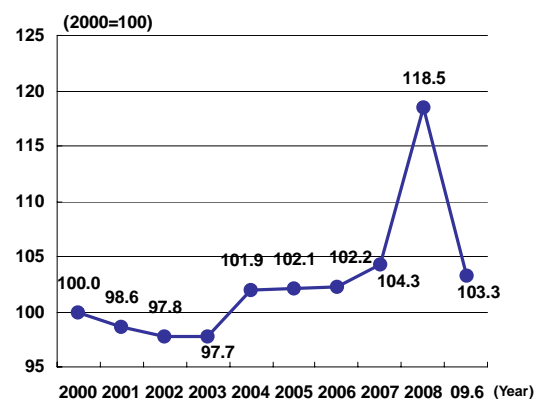
On the other hand, many former industrial sites have come onto the market in the Kanagawa coastal zone. This increase in the amount of available land has kept prices low and led to the development of a large amount of new logistics facilities in that area.

**Figure 4 Change over time in industrial land prices (2005=100 as the base year)**



Source: Ministry of Land, Infrastructure Transport and Tourism

**Figure 5 Change over time in construction costs (construction cost index) Steel construction/floor space 4,000m<sup>2</sup>/warehouse or plant/Tokyo**



Source: Construction Research Institute

**Soaring construction costs to fall back after peaking in 2008**

Figure 5 shows the change in construction costs in Tokyo (base year 2000=100) according to figures published by the Construction Research Institute.

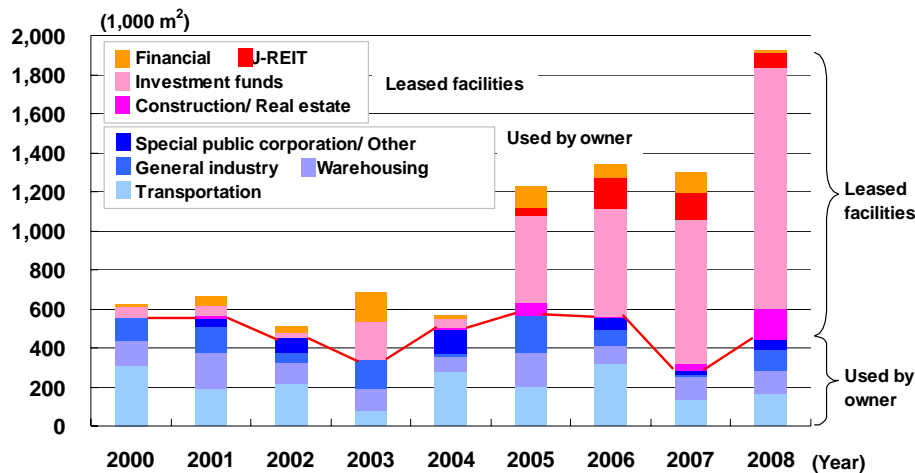
Costs shot up dramatically in 2008 due to sharp increases in the prices of building materials. The impact of these price increases was amplified by the fact that a large amount of new logistics floor space was under construction at that time. These factors conspired to push up construction costs and may also have affected asking rents.

However, more recent data from June 2009 indicates that costs have now returned to 2007 levels, so the constraint on new supply due to excessively high construction costs has largely disappeared. Therefore, of the factors tending to restrain new supply, it may be safe to say that rising land and construction costs are no longer a major issue.

However, the sharp rises in land and construction costs have also had other effects. For example, some companies, in an effort to compensate for these cost increases, decided to construct logistics facilities in areas that are not well suited for use as distribution centers. Other companies purchased land at the peak of the market, and are now being forced to reconsider their plans. Companies such as these are facing a serious threat to their survival.

### 1-3-2 Types of investors

**Figure 6 Changes in composition of ownership of large-scale logistics facilities in metropolitan Tokyo**



Source : NRE

#### Investment funds have been responsible for expansion of the leasing market

Figure 6 illustrates the change in composition of ownership (See Note 3) of logistics floor space by industry category from 2000~2008. It is clear that investment funds have played a major role in the expansion of the leasing market.

The amount of floor space owned by these funds has skyrocketed since 2005, reaching an all-time peak of 1.23 million m<sup>2</sup> in 2008. This accounted for 63% of the overall market. However, ownership by publicly offered J-REITs is on a rather small scale compared with privately placed investment funds, so it is apparent that the leasing market for logistics facilities has primarily been developed by these private funds.

On the other hand, most warehouses owned by the users are the property of companies in the category of general industry, or transportation and warehousing. These industry categories are not as greatly affected by economic ups and downs as most other categories, and they tend to generate a relatively stable volume of new supply.

Note 3 : "Owner" for the purposes of this study was the owner of record, or, in the case of a beneficiary trust right, the beneficiary.

1-3-3 Trends in leased facilities

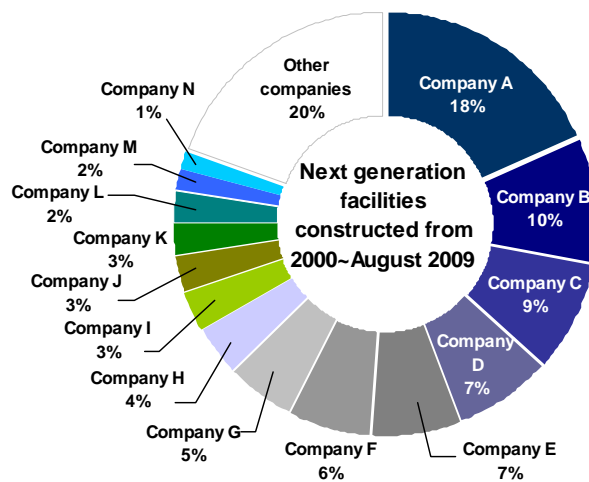
**Top five owners of leased warehouse facilities are investment funds**

Next we will look at the composition of ownership of leased warehouse facilities.

Figure 7 shows the ownership ratios on a floor space basis of all large-scale next generation logistics facilities constructed for lease from 2000 ~ August 2009. What is most remarkable is the turnover among the top players.

The leading owner is foreign capitalized Company A, which acquired the assets of Company D during the recent financial crisis and has now emerged as a new fund-based asset management company with 18% of the total market (floor space basis). Next comes Company B, a Japanese firm, with a 10% share, Company C, a foreign firm (9%), Company D (7%), which was forced to sell most of its assets to Company A, and foreign Company E (7%). These top five companies own 51% of the total leased warehouse floor space, and they are all investment funds. In fact, 11 of the top 14 companies, which comprise 80% of the market on a floor space basis, are all investment funds. The fact that the leasing market for logistics facilities is dominated by a small number of investment funds is a distinctive feature of this market.

**Figure 7 Market share of leased large-scale logistics facilities**



Source : NRE

### **1-3-4 Conditions for a recovery in supply**

#### **Investment funds hold the key to any recovery in new supply**

We see from the above data that investment funds have been responsible for the large-scale boost in new supply from 2000~2009. The fact that these funds have stopped investing in new facilities is the major reason for the current decline in new supply. The global financial crisis caused some funds to go bankrupt, and even Company D, which was formerly the top player in the market, saw its share price collapse to the extent that it was forced to package up many of its facilities and sell them as a block to Company A.

The downturn in the real economy is certainly a factor, but the main reason for the sharp fall in new supply forecast for 2010 and beyond has been the global financial crisis, which has caused the collapse of some investment funds and stopped the flow of investment capital.

This in turn has forced companies to postpone or cancel investment plans. So long as financial and economic prospects remain unclear, lenders can be expected to maintain a very conservative approach. The former business model, which was characterized by rapid, highly leveraged expansion, has receded into the shadows. In its place we expect to see a gradual increase in new supply in the form of facilities with low tenant-related risk, such as single-tenant facilities, and facilities with superior characteristics.

#### **Full-fledged recovery will have to wait until at least 2012**

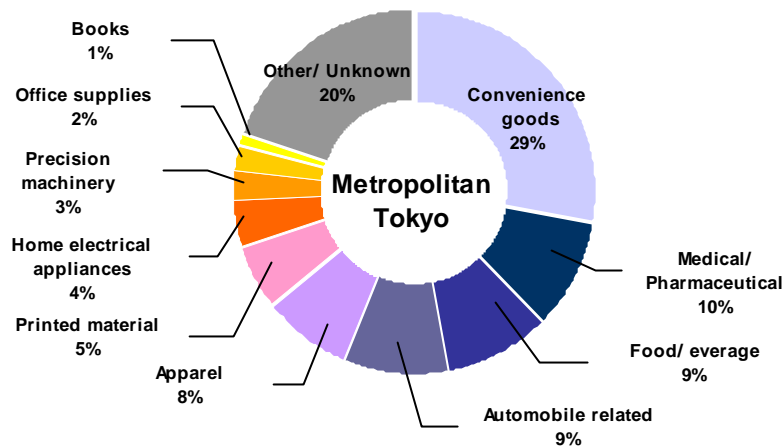
A number of conditions must be met in order for new supply to recover to its former levels. First, there must be a normalization of global financial markets and a revival of business activity. Second, there must be a shakeout and reorganization among fund management companies, and investors must decide to come back into the market. Not until these conditions are met will it be possible to even begin planning for new construction, so a full recovery in new supply is unlikely to occur before 2012 at the earliest.

Furthermore, for a recovery in supply to occur it is essential that there be a strong underlying demand for large-scale next-generation logistics facilities. To help elucidate current demand trends and future prospects, we analyzed the types of goods being handled by recently completed logistics facilities, and we looked at the revenues of the 3PL companies that are distributing these goods.

## 2. Supply and Demand trends

### 2-1 Logistics requirements for leased facilities

**Figure 8** Composition of goods handled by leased logistics facilities (floor space basis)  
(Facilities constructed from 2008~August 2009)



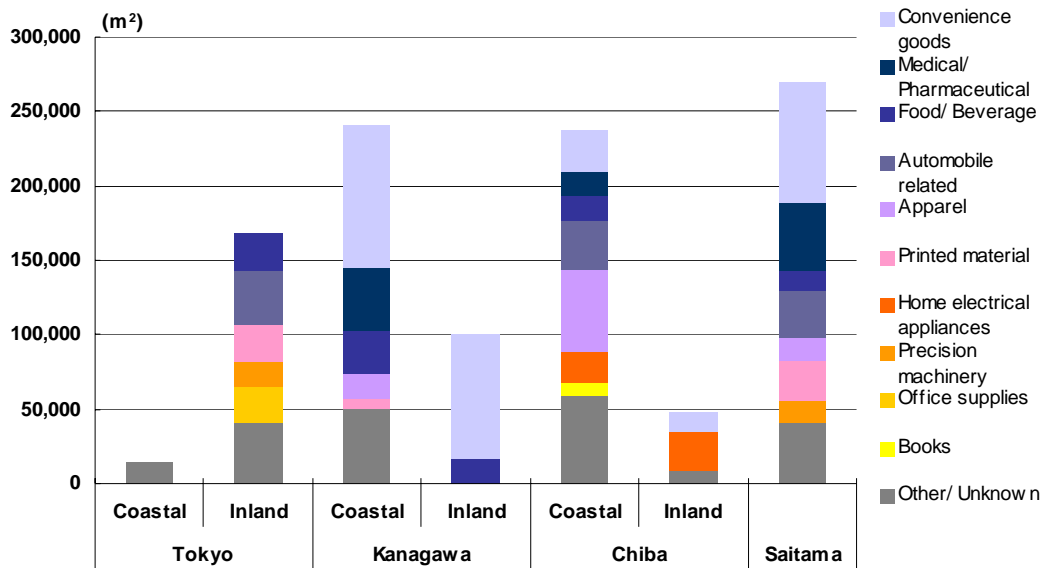
Source : NRE

#### Most leased facilities handle items for use in daily living

In order to develop estimates of future demand for logistics facilities we performed a survey to clarify the types of goods currently being handled at such facilities, and the industry categories of cargo owners. Figure 8 shows the composition of goods being handled at leased distribution facilities constructed from 2008~ August 2009 on a floor space basis. The largest component overall was convenience goods at 29%, followed by Medical/ Pharmaceutical (10%), Food/ Beverage (9%), Automobile related (9%), and Apparel (8%). From the data we were able to acquire, it is evident that industrial goods compose only a small fraction of the overall total, whereas the vast majority of the goods handled fall into the category of items for use in daily living. These results would suggest that most industrial products are being handled at warehouses located at or near the factory premises.

Figure 9 shows this same information categorized by area. We found no convenience goods being handled in the Tokyo inland district. This appears to be because cargo owners are choosing to utilize other areas where large-scale facilities are available at relatively lower rents. It also appears that a disproportionately large percentage of home electrical appliances are handled in the Chiba inland zone. This is likely because of its physical proximity to manufacturing sites. We observed no other significant regional differences, as convenience goods, medical/ pharmaceutical goods, food and beverages, etc., were handled in each of the areas surveyed.

Figure 9 Composition of goods handled by leased logistics facilities, by area



Source : NRE

These findings demonstrate that leased distribution facilities in metropolitan Tokyo are being utilized primarily as distribution points for convenience goods because of their proximity to major centers of mass consumption. On the one hand, industries involved in the production of convenience goods are relatively insulated from economic ups and downs. On the other hand, however, the Japanese market for such goods has become very saturated, and manufacturers are looking to find ways to cut costs even further. Cargo owners have a strong incentive to cut distribution costs through the use of 3PL or similar services, and while the urgency of this need may fluctuate somewhat depending on the strength of the overall economy, we expect that the demand for improved efficiency and integration of logistics facilities remains fundamentally strong.

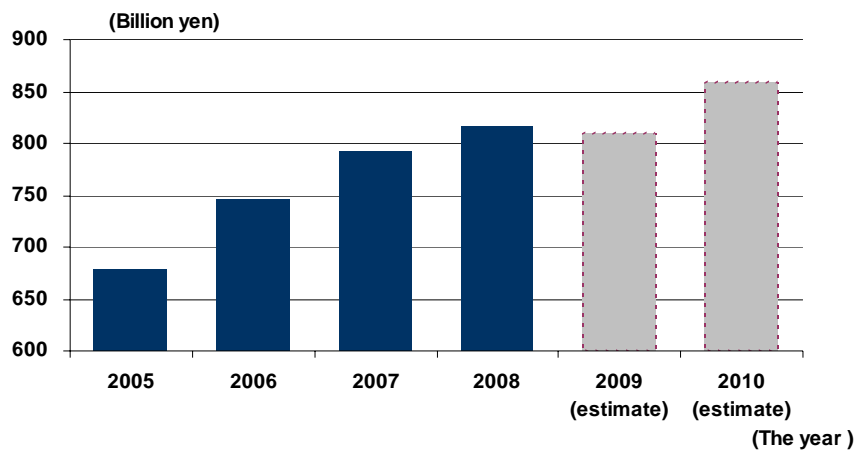
Moreover, of the facilities covered in the above survey, 10% handle goods from mail order and other companies that rely on nonstore retailing. A further 12% specialize in handling items from home centers or drug stores. As this type of business model expands and evolves, even more demand will be created for sophisticated logistics facilities.

## 2-2 3PL business trends

As described above, most of the large-scale logistics facilities in the Tokyo area are used as distribution centers for items used in daily living, and it is 3PL companies that manage the logistics. The 3PL industry, which developed after Japan revised its carrier laws and deregulated the transportation industry, makes it possible for cargo owners such as manufacturers and large-volume retailers to outsource all their distribution services, from manufacturing plant all the way through to retail outlet or end user. The demand for large-scale logistics facilities has been directly linked to the expansion and development of the 3PL industry.

Figure 10 shows aggregate 3PL-related sales revenues for the top ten 3PL companies in Japan from 2005–2010. Revenues are likely to level off temporarily in fiscal 2009 due to severe economic conditions, but are projected to recover in 2010. The overall growth trend observed since 2005 is expected to continue.

**Figure 10 Aggregate revenues of the top ten 3PL companies in Japan**



*Source: Compiled by NRE based on data published by the respective 3PL companies, Bloomberg, and others.*

Revenues of 3PL companies should be a good indicator of demand for large-scale logistics facilities. 3PL revenues will level off in fiscal 2009, but our data indicate that they will recover in 2010. Since the performance of 3PL companies closely reflects demand on the part of cargo owners, these results support the conclusion that demand for logistics facilities will remain fundamentally strong.

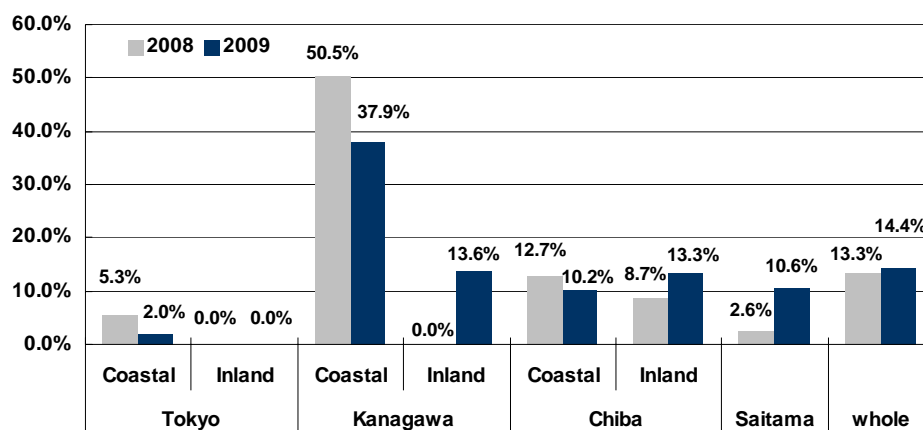
## 2-3 Vacancy rates

### Vacancy rate in 126 next-generation facilities rises to 14.4%

As of the end of September 2008 when we completed our previous survey, the vacancy rate in 110 next-generation facilities was 13.3%. However, most of the vacancies were concentrated in the Kanagawa coastal zone, and when 4 facilities along the Kawasaki waterfront were excluded, the vacancy rate dropped to only 6.4%. The current survey includes all new warehouses constructed as of August 2009, and now covers a total of 126 facilities. Our results show that the overall vacancy rate is now 14.4%, an increase of 1.1% over the last year.

Figure 11 compares vacancy rates by area in 2008 with those in 2009. Geographical discrepancies have narrowed somewhat, but vacancies in the Kanagawa coastal zone are still remarkably high.

Figure 11 Vacancy rates by area



Source : NRE

Following is a summary of supply-demand trends by area. SS class refers to facilities with at least 100,000m<sup>2</sup> of floor space; S class facilities have at least 60,000m<sup>2</sup> of floor space; A class have at least 30,000m<sup>2</sup> of floor space; and B class have at least 9,900m<sup>2</sup> of floor space.

### [Kanagawa Coastal Zone] Vacancy rates are falling, but there is still a significant gap between supply and demand

The vacancy rate has improved by 12.6 points since last year's survey, but at 37.9% it is still the highest in the Tokyo region. Five facilities are saddled with vacancies. One new SS class facility was completed this year, one A class facility that had vacancies last year, and one newly constructed S class facility are all now operating at full capacity. (The A class tenant is a logistics company, and the S class warehouse was leased by a logistics company as a single tenant operation). Vacancy rates in existing buildings are expected to come down further.

However, one new SS class facility is scheduled for completion in 2010, so it will take some time for the supply-demand gap to close completely.

**[Kanagawa inland zone] Vacancies limited to a single SS class facility; demand-supply balance expected to improve**

The main reason that vacancy rates in this area rose to 13.6% was the construction of one new SS class facility. A new A class distribution center is to be completed in 2010, but a tenant has already been found to lease the entire facility. We believe that the supply-demand balance will begin to improve in this area.

**[Chiba coastal zone] Vacancy rate will rise temporarily due to completion of new S class facility, but will gradually improve thereafter**

Vacancies rates in this district fell to 10.2%. A new SS class structure was completed, but existing S class facilities are now operating at 75% capacity, while A class facilities are operating at full capacity. Two new warehouses will be finished in 2010, but the tenant (a logistics company) for one of these (B class) has already been decided. The other new building is an S class facility, so it is likely that vacancy rates may show a slight rise, but demand remains firm so we believe these vacancies will gradually be filled.

**[Chiba inland zone] Completion of new SS class property to boost vacancy rate**

The vacancy rate will rise to 13.3%. Most vacancies are in the Narita area, apparently because of a decline in airfreight shipments of luxury goods. A new SS class facility is scheduled for completion shortly in the Noda area, so the vacancy rate is likely to turn higher.

**[Saitama inland zone] Vacancies up temporarily due to completion of two new facilities, but overall trend is positive**

The vacancy rate rose to 10.6%, primarily because of the completion of one new S- and B class facility, respectively, however these are gradually succeeding in attracting tenants. One new B class structure is slated for completion in 2010, but the tenants have already been recruited, so vacancy rates are expected to decline in this area.

## 2-4 Future supply and demand balance

### Supply-demand balance to improve in most areas

With regard to supply, new construction of multi-tenant type leased facilities has ground to a halt, and no full-fledged recovery in supply can be expected until 2012 or later. On the demand side, business prospects of tenant companies and cargo owners are showing signs of improvement, and 3PL company revenues appear to be on the way to recovery, so underlying demand appears strong. Therefore, although the overall vacancy rate rose to 14.4% in 2009, we predict that it will gradually improve as demand and supply come back into balance.

By area, vacancies are rather high in the Kanagawa coastal zone, but very low (0~2.0%) in the Tokyo seafront and inland zones, and are trending around 10.2%~13.6% in the remaining districts.

Solving the vacancy problem in the Kanagawa coastal zone is the key to bringing down the overall vacancy rate, but in 2010 another new large-scale facility is scheduled for completion, so it will take some time before the supply-demand equilibrium is restored there. In the remaining areas new supply is decreasing (Figure 2), and as a result vacancy rates in these areas are expected to gradually improve.

However, when we look at logistics properties on an individual basis we still see a number of mismatches between demand and supply in terms of location, product planning, and rent level. To solve these problems it will be necessary to convince the investors or lenders to take action. For example, companies may have to consider offsetting their losses with gains on the sale of other properties in order to avoid having to record a loss on their financial statements. It will be important to keep a close eye on the strategies adopted by these underperforming facilities in future.

## Conclusion

The market for large-scale logistics facilities in metropolitan Tokyo expanded rapidly after the emergence of a fully-fledged leasing market in 2005, and new supply reached an all-time high in 2008. The prime movers responsible for this growth have been investment fund companies. However, high land prices and soaring construction costs led to the rapid dissemination of distribution centers in areas that were not well suited for the purpose, and this boosted overall vacancy rates. On the supply side, some investment companies were clearly inexperienced in the field of logistics real estate, and the current financial crisis has precipitated a shakeout that is gradually weeding the weaker players out of the market.

On the other hand, the need for large-scale logistics facilities in order to improve distribution efficiency remains fundamentally strong, and the revenues of the major 3PL companies are continuing to expand. Going forward we believe that the current sharp decline in supply, coupled with fundamentally firm demand, will gradually bring supply and demand back into equilibrium. At the same time, however, the gap between successful and underperforming facilities is also expected to widen.

Logistics facilities represent an investment sector that, generally speaking, generates very stable returns. However, the history of this market is rather short compared with other real estate sectors, and the number of management companies familiar with logistics real estate in Japan is quite limited. Because of the relatively large amounts of capital required, only a few players are able to enter this arena. Nevertheless, further expansion in the market for large-scale logistics facilities is essential to meet the needs of companies looking for ways to cut their distribution costs. We estimated in our earlier report (Investment Review, Winter 2009), that there is a very large latent demand of around ten million tsubo for large-scale facilities. The leasing market for large-scale facilities has passed through its infancy and is now entering a new stage of development. We predict that an increasing number of long-term investors will gradually become interested in this sector, and that logistics will eventually take its place alongside the office and residential sectors as a major pillar of the real estate investment market.

In Part II of this report we will look at how the global financial crisis has affected investment strategies in the logistics sector. Using our own proprietary data, together with data available from published sources, we present an overview of the logistics real estate market since 2003, and discuss investment strategies for new and current investors.

Reference : List of major large-scale logistics facilities constructed between 2008~2010

(S class: floor space  $\geq 60,000\text{m}^2$ )

2008

| Name of warehouse                        | Prefecture | City/Ward             | No. of floors | Total floor space (m <sup>2</sup> ) |
|--|------------|-----------------------|---------------|-------------------------------------|
| Logiport Kawasaki                        | Kanagawa   | Kawasaki-ku, Kawasaki | 5             | 145,000                             |
| ProLogis Park Ichikawa I                 | Chiba      | Ichikawa              | 6             | 137,000                             |
| Nagareyama Logistics Center B            | Chiba      | Nagareyama            | 5             | 133,000                             |
| J-REP Investment Logistation Mizuecho    | Kanagawa   | Kawasaki-ku, Kawasaki | 5             | 100,000                             |
| KANSO The Kawagoe Branch Delivery Center | Saitama    | Kawashima, Hiki-gun   | 2             | 80,000                              |
| Landport Urayasu                         | Chiba      | Urayasu               | 5             | 72,000                              |
| AMB Tsurumi Distribution Center          | Kanagawa   | Tsurumi-ku, Yokohama  | 5             | 65,000                              |

2009

| Name of warehouse                                       | Prefecture | City/Ward             | No. of floors | Total floor space (m <sup>2</sup> ) |
|---|------------|-----------------------|---------------|-------------------------------------|
| Logistics Park Noda Funagata                            | Chiba      | Machida               | 5             | 122,000                             |
| ProLogis Park Zama I                                    | Kanagawa   | Zama                  | 5             | 118,000                             |
| Sankyu Flagship Distribution Center in Tokyo Metropolis | Kanagawa   | Kawasaki-ku, Kawasaki | 4             | 110,000                             |
| Yokohama Logistics Park A                               | Kanagawa   | Tsurumi-ku, Yokohama  | 7             | 101,000                             |
| CX-CARGO Noda Distribution Center                       | Chiba      | Machida               | 3             | 92,000                              |
| ProLogis Park Ichikawa II                               | Chiba      | Ichikawa              | 6             | 92,000                              |
| Landport Kawagoe  | Saitama    | Kawagoe               | 4             | 79,000                              |

2010

| Name of warehouse            | Prefecture | City/Ward            | No. of floors | Total floor space (m <sup>2</sup> ) |
|------------------------------|------------|----------------------|---------------|-------------------------------------|
| Daikoku-cho Logistics Center | Kanagawa   | Tsurumi-ku, Yokohama | 4             | 103,000                             |

2011

| Name of warehouse                    | Prefecture | City/Ward            | No. of floors | Total floor space (m <sup>2</sup> ) |
|--------------------------------------|------------|----------------------|---------------|-------------------------------------|
| ProLogis Park Kawashima              | Saitama    | Hiki-gun             | 5             | 170,000                             |
| Yokohama Machida IC Logistics Center | Tokyo      | Machida              | 4             | 78,000                              |
| Matsudo Logistics Center Project     | Chiba      | Matsudo              | 5             | 74,000                              |
| Ichikawa Chidori Logistics Center    | Chiba      | Ichikawa             | 5             | 70,000                              |
| Landport Yokohama Namamugi           | Kanagawa   | Tsurumi-ku, Yokohama | 4             | 66,000                              |

\* Buildings not yet completed have been included if appropriate data was available from construction permit signboards, Internet home pages, or other sources.

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