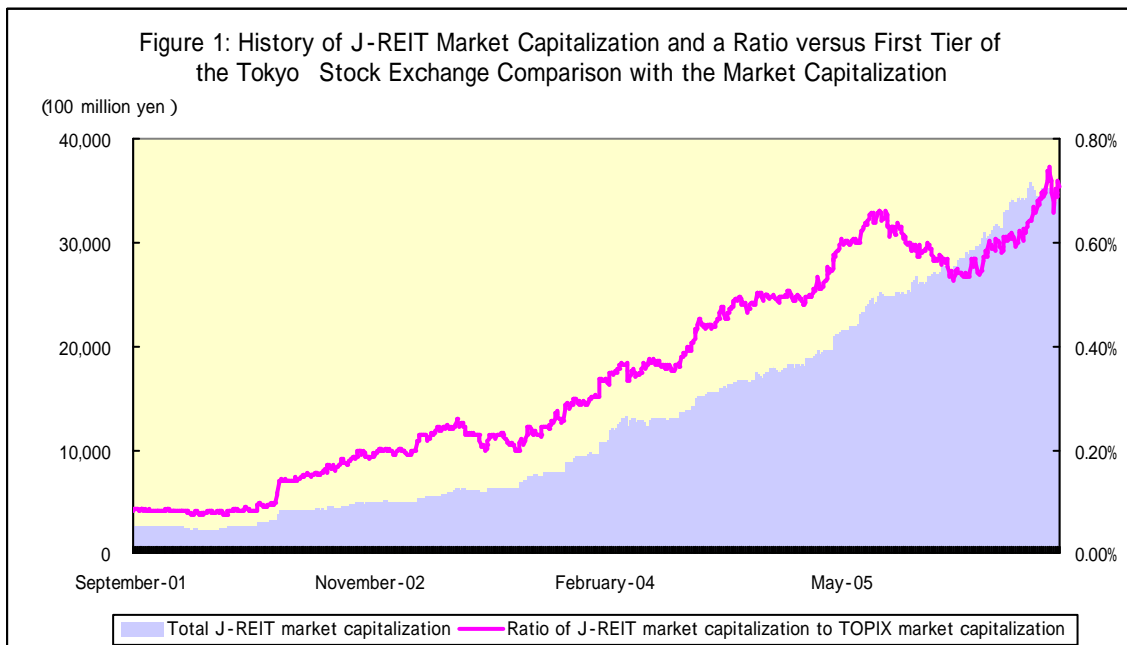


# The History of J-REIT Pricing Since Their Birth 5 Years Ago and the Background for this Movement

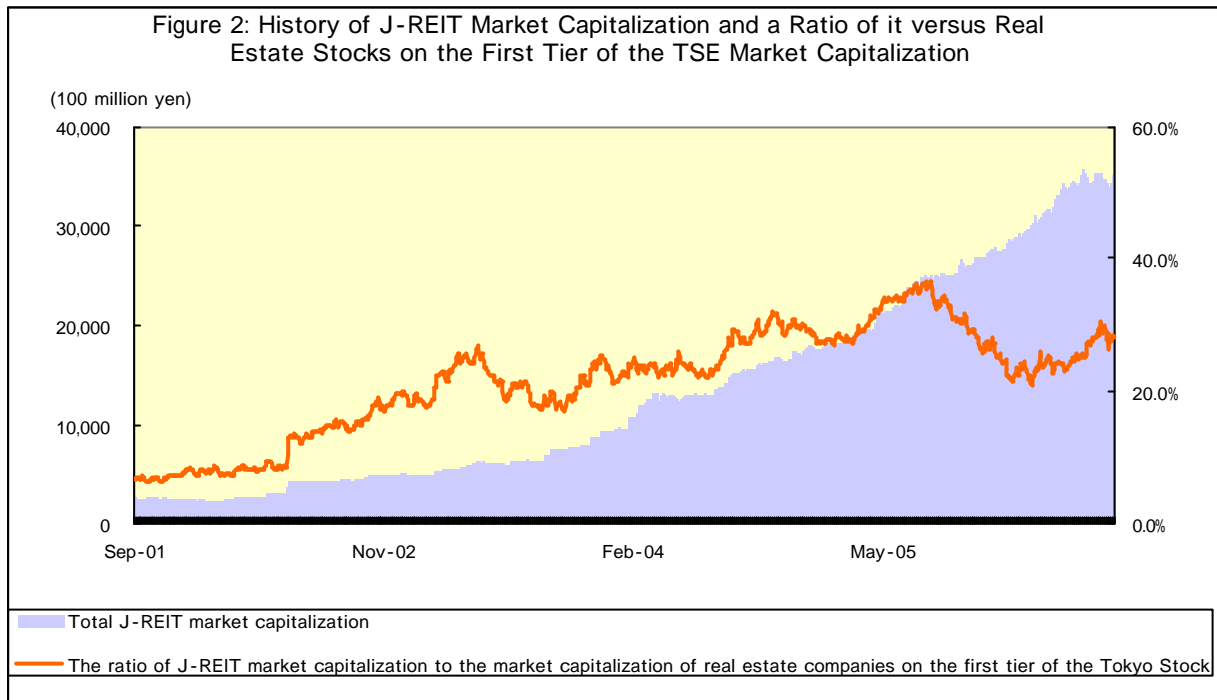
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## 1. Introduction

Initially, the market of Japan Real Estate Investment Trusts (J-REITs) was comprised of two issues with a total market capitalization of about 260 billion yen. The two issues were the Nippon Building Fund Inc. and the Japan Real Estate Investment Corporation, both listed on September 10, 2001. Since then the market has grown to the point where, at the end of June 2006, there were 36 issues with a total market capitalization of about 3.5 trillion yen. The market size of J-REITs has grown more than ten times in less than ten years (see Figures 1 and 2).



(Remarks) The J-REIT market capitalization was calculated by totaling the market capitalization of already listed J-REITs (Tokyo Stock Exchange, Osaka Securities Exchange and JASDAQ Securities Exchange).



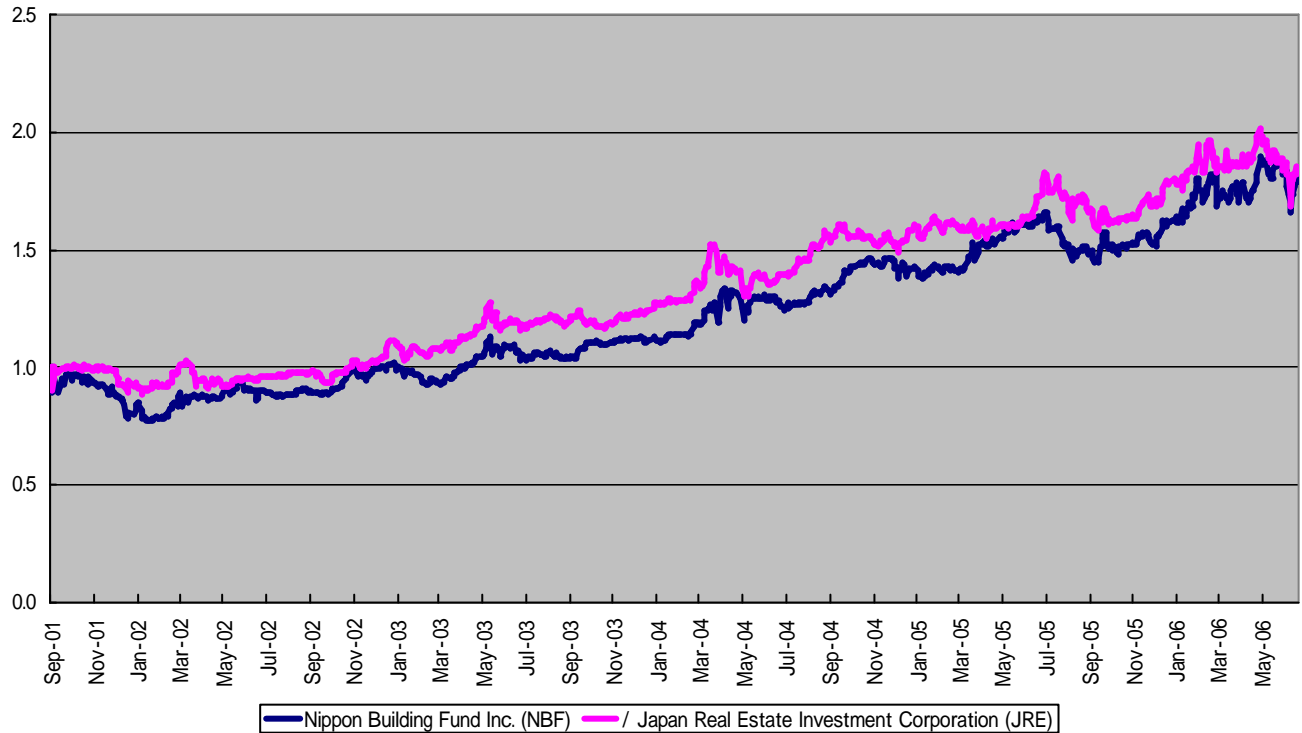
(Remarks) The J-REIT market capitalization was calculated by totaling the market capitalization of already listed J-REITs (Tokyo Stock Exchange, Osaka Securities Exchange and Jasdq Securities Exchange).

A comparison of their shares to the total market capitalization of the stock market reveals that J-REITs are equivalent to about 0.7% of the total market capitalization of the first tier of the Tokyo Stock Exchange. Further, they are about 28% of this for the real estate company stocks listed on the first tier of the Exchange, as of the end of June 2006. As indicated in Figures 1 and 2, there has been a large increase in value since the J-REIT market was born. This points to the presence of J-REITs on the market significantly expanding. Though both of the percentages showed a decline in the latter half of 2005, these were due to a buoyant stock market rather than a slump in the total market capitalization of J-REITs).

In addition, the J-REIT market has only just recently progressed from its formative phase and entered a period of full-fledged growth. There are many developments that prove this. For example, an analysis of the change in the number of J-REIT issues reveals that initially the increase in the quantity of issues was very gradual, with only six issues for the year from September 2002. However, the number of issues doubled in fiscal 2005 from 16 to 32 (see Figure 3). There are signs today that we are entering a listing rush with many new listings still expected.



Figure 4: Price History of NBF and JRE  
(Index value when the closing price of the listed date is standardized as 1)

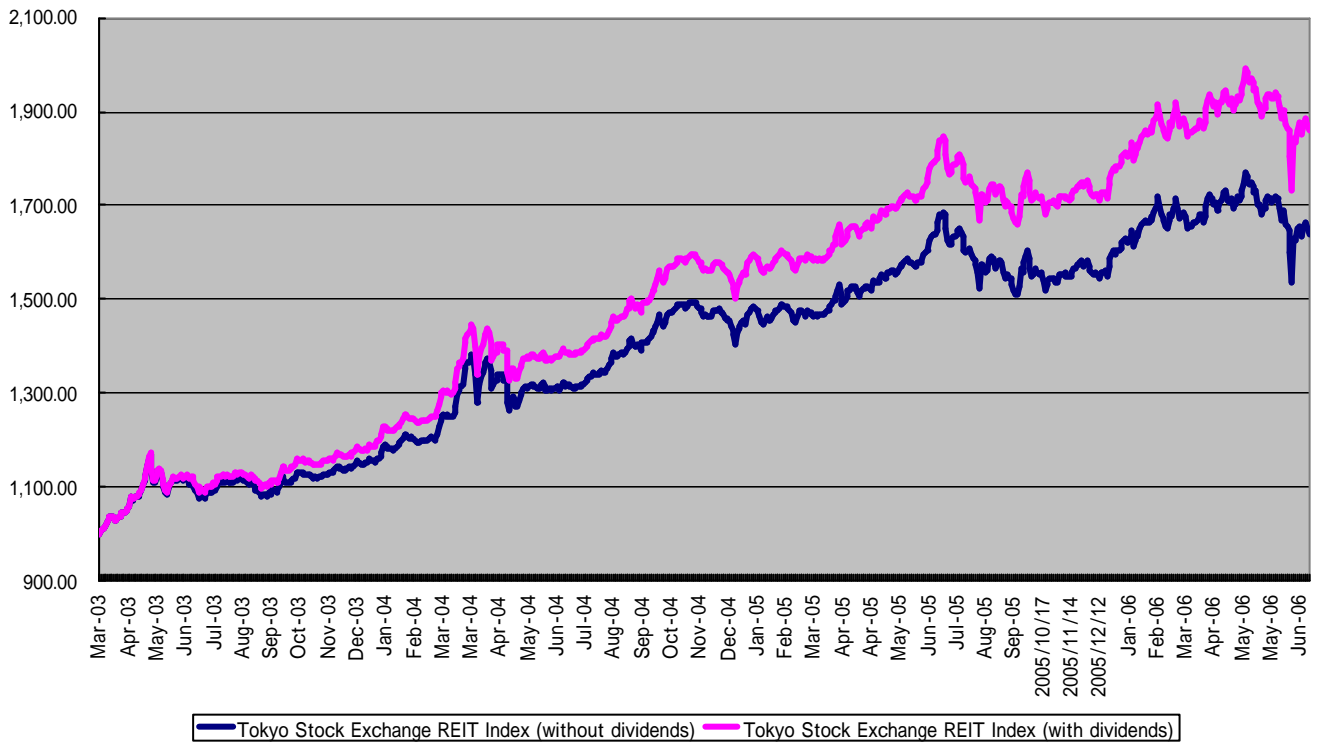


One of the reasons for this initial slump in the J-REIT price is that J-REITs were a completely new product for Japan. It is no surprise that J-REITs were judged to be a high risk product when considering that their settlement performance and price fluctuation remained unclear. Compounded with this were fears that the supply and demand relationship of the real estate industry would deteriorate due to a massive supply of real estate due to large buildings coming on in 2003. This also worked as a negative factor on the J-REIT price. Thus J-REITs began in an adverse climate.

## (2) Market Escapes from Slump to Enter Period of Continual Price Increases

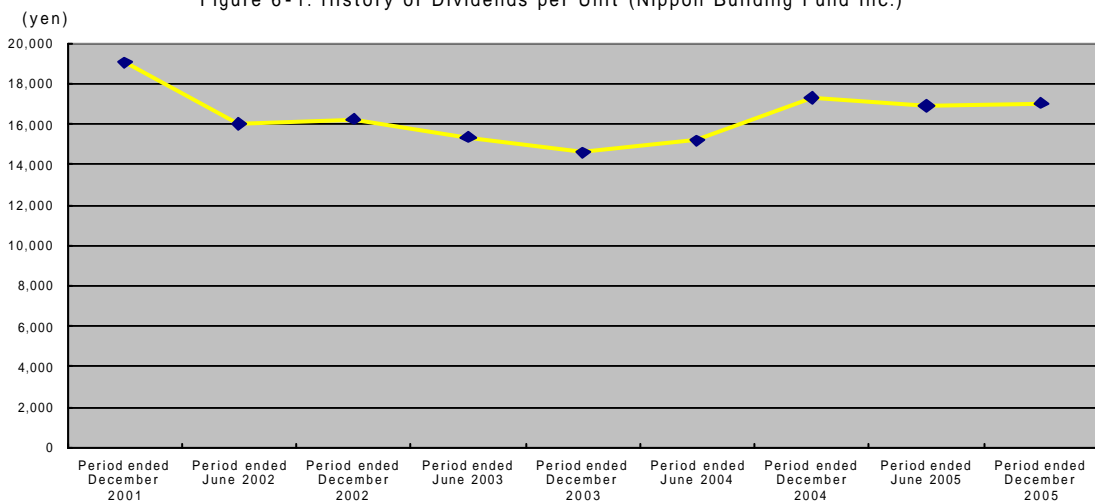
Upon entering 2003 J-REIT prices exited the slump and began to rise. Figure 5 shows the history of the Tokyo Stock Exchange REIT Index and indicates that between April 2003 (when the Index was first published) and July 2005 the Index continued to rise. The unique aspect of this rise in J-REIT prices is that it occurred without any expectations for future growth in cash flows.

Figure 5: History of Tokyo Stock Exchange REIT Index



The cash flows of a J-REIT are dividends (strictly speaking, commissions, taxes, etc. are deducted). Figures 6-1 through 6-5 indicate the dividends of J-REITs (equivalent to a share dividend) for each fiscal period (based on figures announced at the end of June 2006 and the five J-REITs that have figures for at least eight fiscal periods (six-months) after listing.

Figure 6-1: History of Dividends per Unit (Nippon Building Fund Inc.)



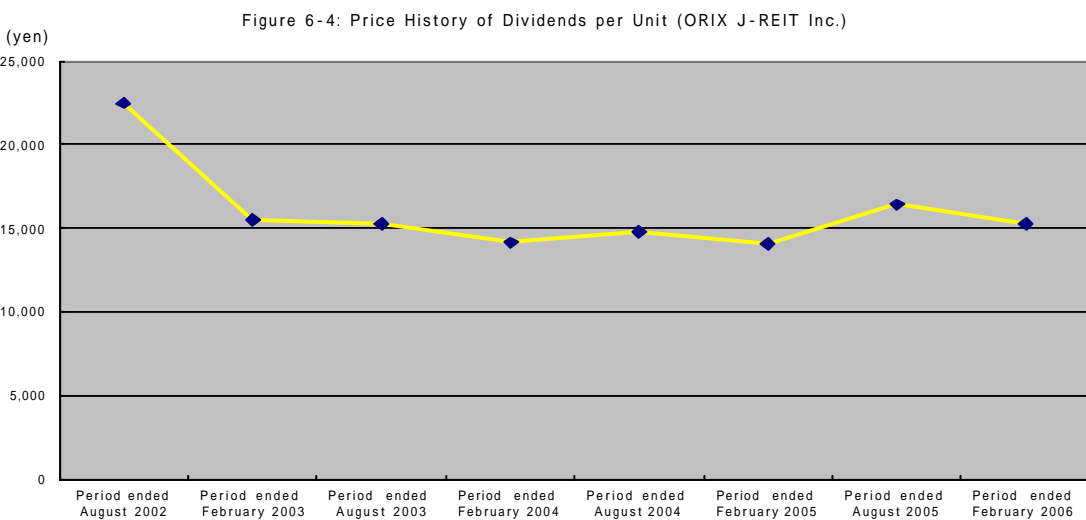
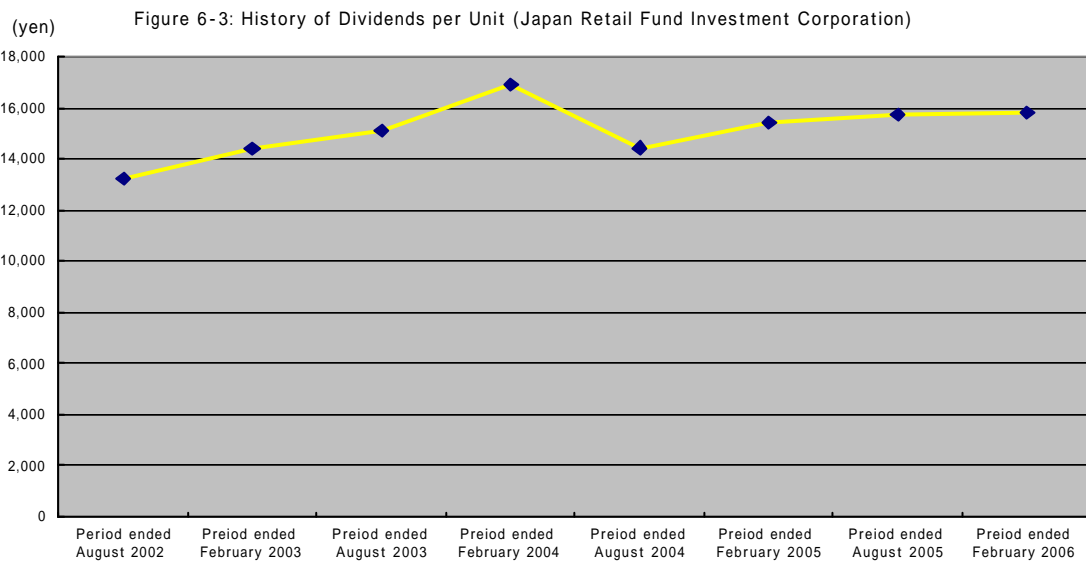
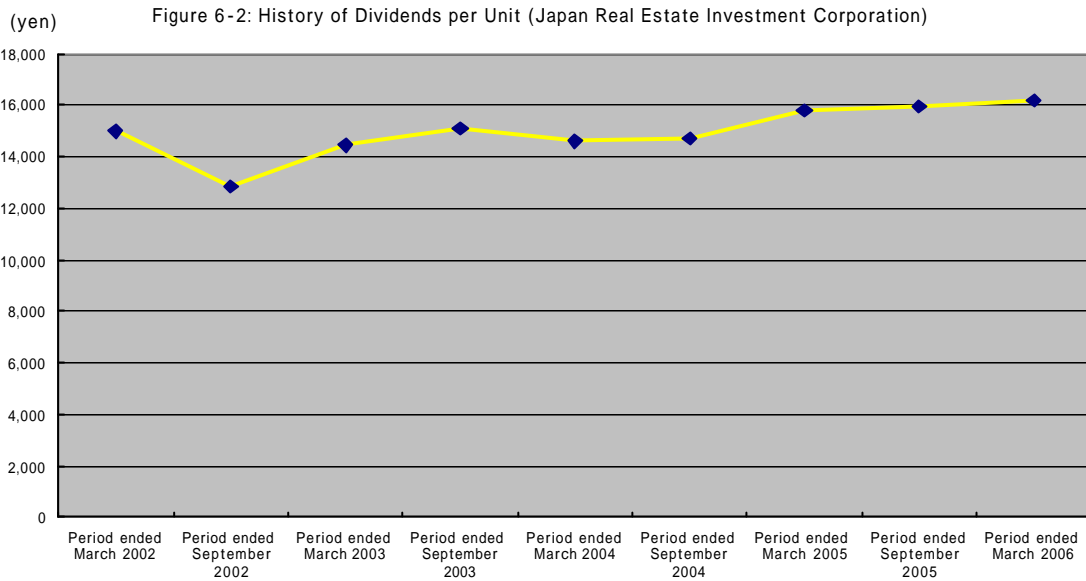
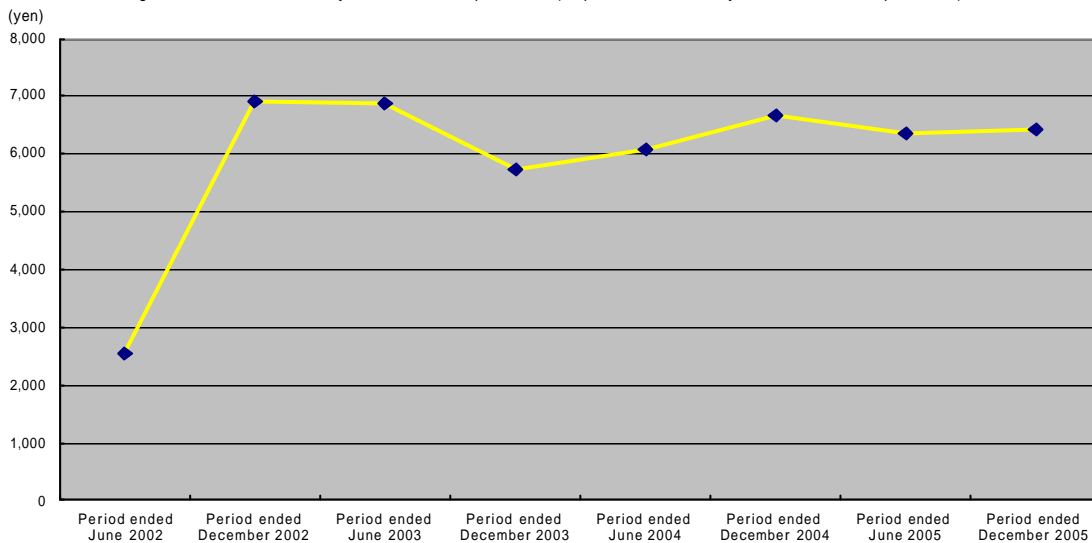


Figure 6-5: Price History of Dividends per Unit (Japan Prime Realty Investment Corporation)



There is obviously minimal fluctuation in the dividends for the second fiscal period and after (the first fiscal period is excluded due to the difference in number of management days).

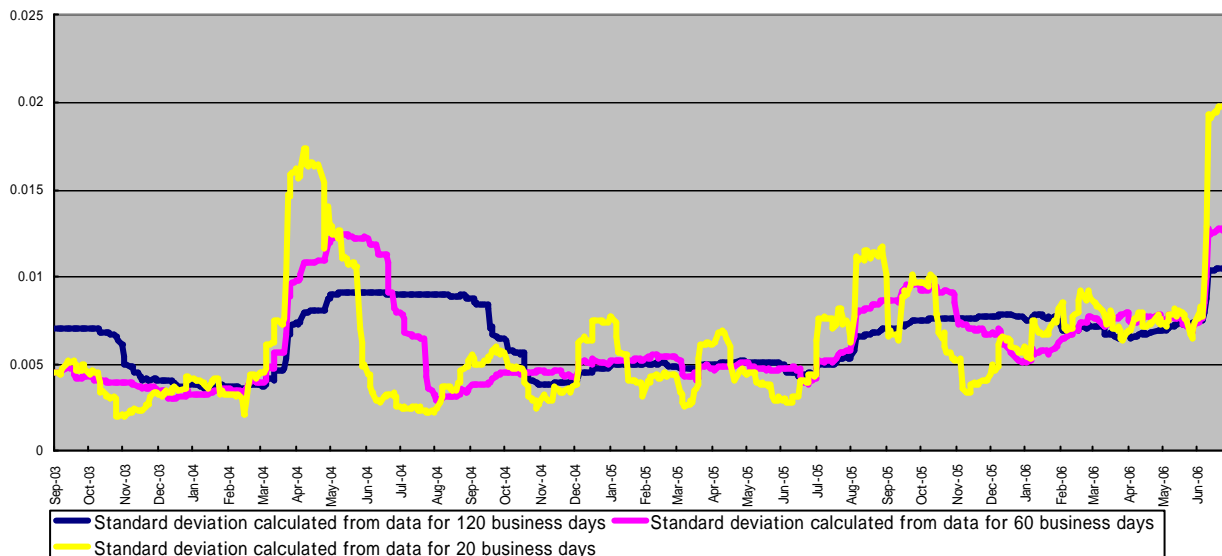
The increase in price that occurred without an increase in the expected cash flow is a result of decreasing return demands among investors who invested in J-REITs.

However, the reality is that the variable risk of the J-REIT's return did not just decrease. Figure 7 indicates the change in standard deviation of the daily return for J-REITs calculated from the Tokyo Stock Exchange REIT Index (with dividends included).

The figure shows that the standard deviation of the return temporarily grew between the end of 2003 and the beginning of 2004 while also growing for three months from July 2005. The deviation hasn't grown since entering 2006 but there is no sign of it having fallen for J-REIT returns.

The fact is that the returns demanded of J-REITs have dropped despite the variable risk of returns not having dropped. This is probably because of a change in investor's perceptions of J-REITs.

Figure 7: History of the Volatility of Daily Returns for the Tokyo Stock Exchange REIT Index (with dividend) (rolling data)



The standard deviation of the daily return indicated in Figure 7 using the indicated daily return based on consecutive compound returns calculated with the formula of daily return =  $\ln(\text{index value on said business day}) - \ln(\text{index value of previous business day})$  with  $\ln$  being a natural logarithm. It is a standard deviation calculated using past data of each business day.

It is no surprise that when the JREIT market was originally formed there were concerns among investors regarding J-REITs. This was because it was a completely new product and there was no history of dividends or price fluctuations. In other words, there is the possibility that the risk of J-REITs was initially over-assessed. However, the concerns that existed when the JREIT market was formed disappeared as the settlement performance of J-REITs and their price fluctuations became apparent. The fact that the negative impact of the year 2003 problem did not affect properties owned by J-REITs also worked positively for J-REIT prices.

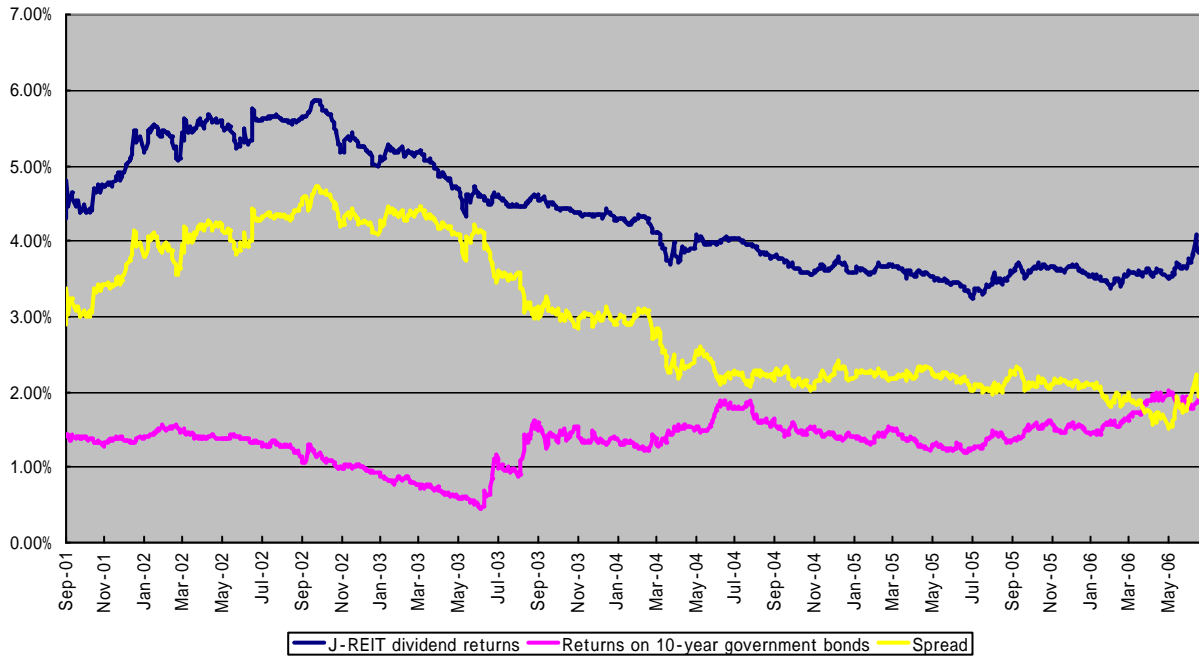
As a result, the perception spread that J-REITs were a safer asset than foreseen and the return demanded of the J-REIT decreased. This is why the J-REIT price emerged from stagnation into continual rise.

### (3) Stable Fluctuation of J-REIT Prices After Elimination of Concerns

Beginning around mid July 2005, the J-REIT price stopped its continual rise and began to fluctuate steadily. This is because the over assessment of J-REIT risk came to an end, leading J-REIT prices to reach a level near a balance that properly reflects the J-REIT risk in the price.

Figure 8 indicates the fluctuation of the spread between the J-REIT dividend returns and government bond returns.

Figure 8: History of the Spread between J-REIT Dividend Returns and Returns of 10-Year Government Bonds



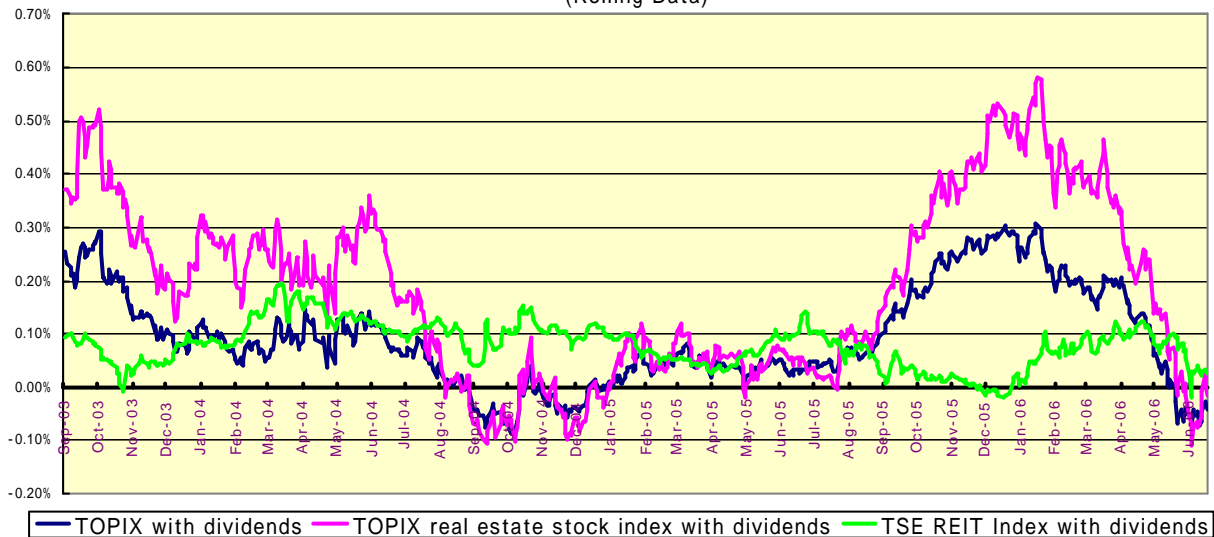
Generally, the greater the risk recognized for a product the greater the return that is demanded. Government bonds are near to being a no risk asset as returns can be obtained almost without question. Additionally, the greater the spread between the product and the return of the government bond, the more the product is recognized as having a high risk.

Figure 8 reveals that the spread initially rose to a level of more than 4% but fell as time passed. This illustrates the process of concerns over J-REITs being eliminated. On the other hand, during the adjustment phase from mid 2005 to the end of 2005 the spread fluctuated steadily at around 2%. It is also apparent that whenever the spread fell below 2% due to a rise in the J-REIT prices, the brakes were quickly applied to the rise and the spread returned to the 2% level. As a result of this, the over assessment of J-REIT risk was eliminated by mid July 2005 and the perception was formed in the market that a spread of 2% was appropriate.

The question is, was the price of JREITs at this time a price that appropriately reflected the J-REIT risk? Additionally, has the over assessment of the J-REIT risk actually been eliminated? Figures 9 and 10 are used to answer these questions. Figure

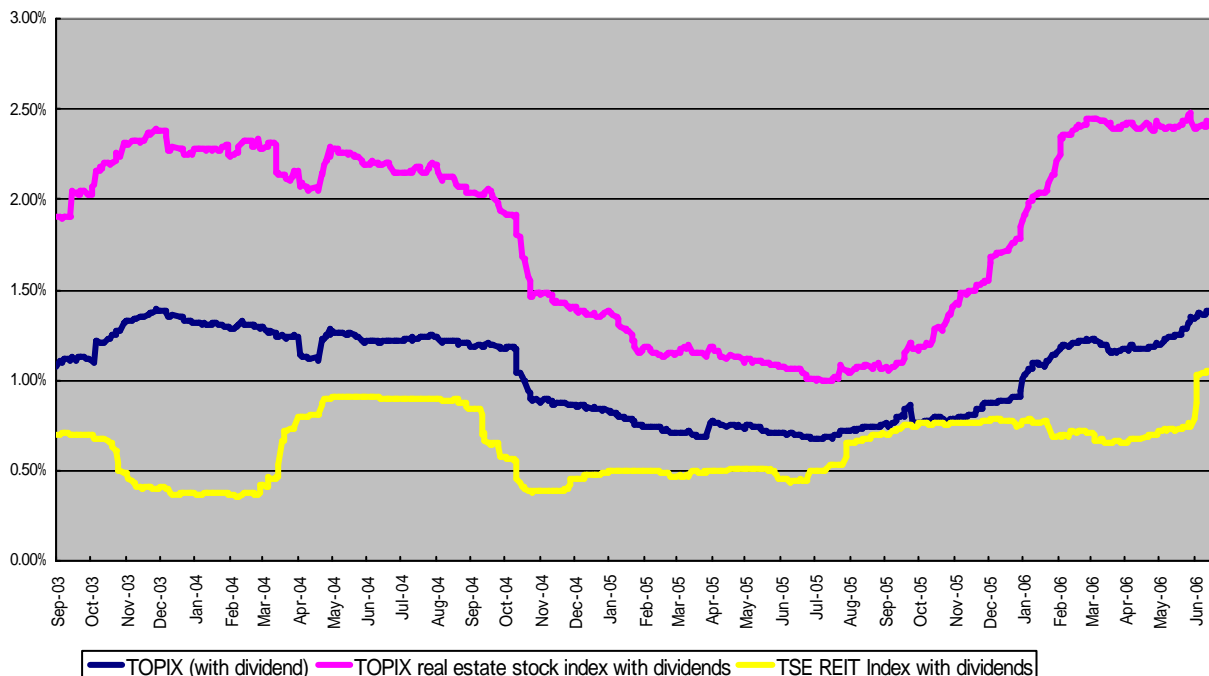
9 shows the average daily profitability of the Tokyo Stock Exchange REIT Index (with dividend included) and Figure 10 the rolling data for standard deviation.

Figure 9: History of Average Value for the Past 120 Business Days of the Daily Rate of Returns (Rolling Data)



The standard deviation of the daily return indicated in Figure 9 uses the indicated daily return based on consecutive compound returns calculated using the formula:  $\text{daily return} = \ln(\text{index value on said business day}) - \ln(\text{index value of previous business day})$  with  $\ln$  being a natural logarithm. The standard deviation is calculated using past data from each business day.

Figure 10: Standard Deviation for 120 Business Days of the Daily Return (Rolling Data)



The standard deviation of the daily return indicated in Figure 10 using the indicated daily return based on consecutive compound returns calculated with the formula of  $\text{daily return} = \ln(\text{index value on said business day}) - \ln(\text{index value of previous business day})$  with  $\ln$  being a natural logarithm. It is a standard deviation calculated using past data of each business day.

An analysis of the history of the standard deviation of returns indicated in Figure 10 reveals that the standard deviation for J-REIT returns is consistently less than that of the TOPIX and TOPIC Real Estate. In other words, the variable risk of JREIT returns is lower than that of stock returns. Considering the fact that the risk and return of financial products generally have a positive correlation, ordinarily the average value of the J-REIT return should be lower than the average value of the stock return (generally the lower the variable risk of a return the lower the average value of the return). However, the history of the average value of returns indicated in Figure 9 reveals that there was a lengthy period in which the average value of J-REIT returns exceeded the average value of stock returns. In other words, during this period, J-REITs generated a greater return than their risk indicated.

This is because the over assessment of the J-REIT risk lowered the price below the appropriate level. Subsequently, higher returns than the actual risk assessment suggested were achieved. This portrayed J-REITs as attractive investment products, increased investment demand for J-REITs. This in turn led to a rise in prices.

However, the period between mid July 2005 and the end of 2005 when the prices stably fluctuated at a spread of around 2% is a period during which the possibility that J-REITs were getting higher returns than their risk was low. This is because the data corresponding to the period from the end of 2005 to the beginning of 2006 indicated in Figures 9 and 10 reveals that the returns of J-REITs were lower than stock returns (note that the data for each point in Figures 9 and 10 relate to the past 120 business days). In other words, the data in Figures 9 and 10 that indicate conditions from mid July 2005 to the end of 2005 are presented as data relating to the period from the end of December 2005 to early 2006. Thus the fact that J-REIT returns are lower than stock returns is consistent with J-REIT return risks being lower than stock return risks.

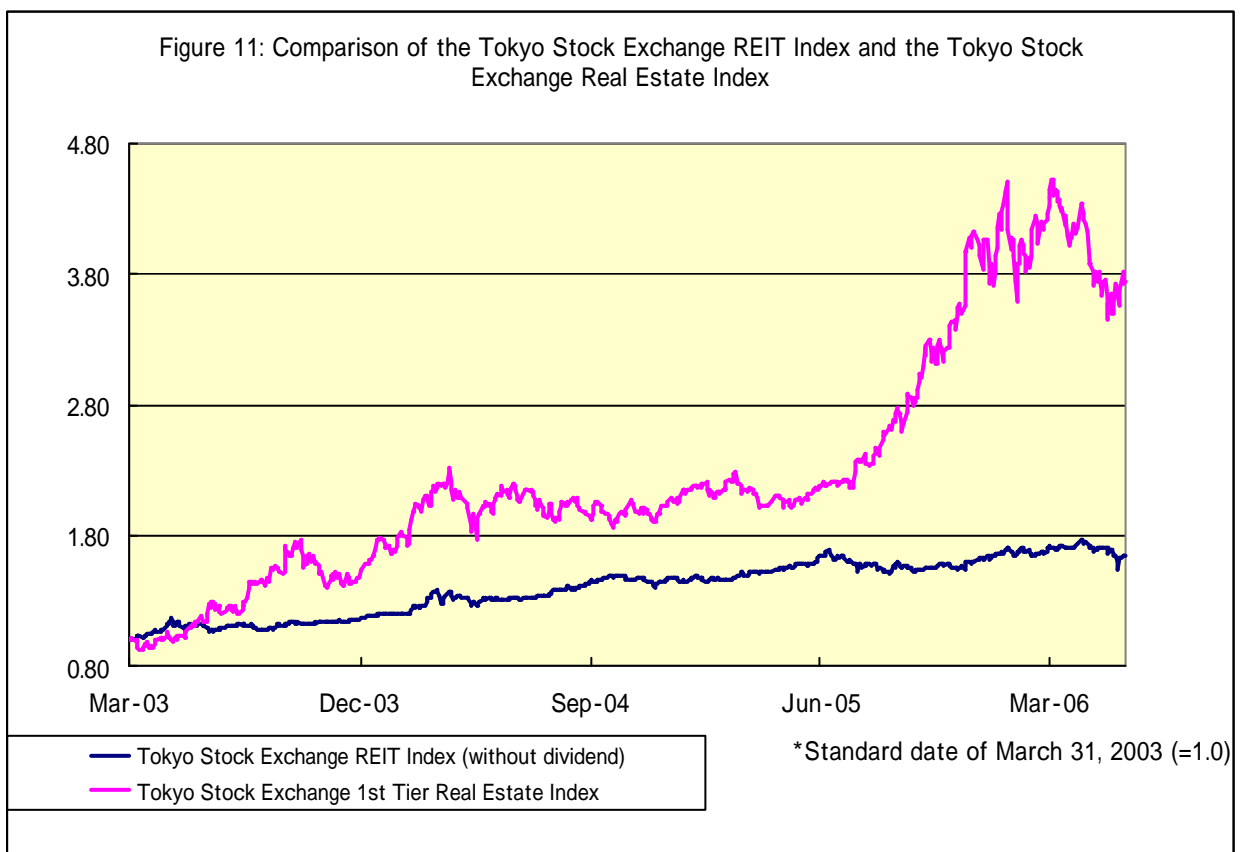
As a result, there is a distinct possibility that the over assessment of J-REITs was eliminated during this period. If this is the case, it is no surprise that a perception had formed within the market that a spread of the 2% level is an appropriate level.

#### (4) Price Rise backed by Improved Fundamentals in the Real Estate Market

After entering 2006, J-REIT prices began to rise once again.

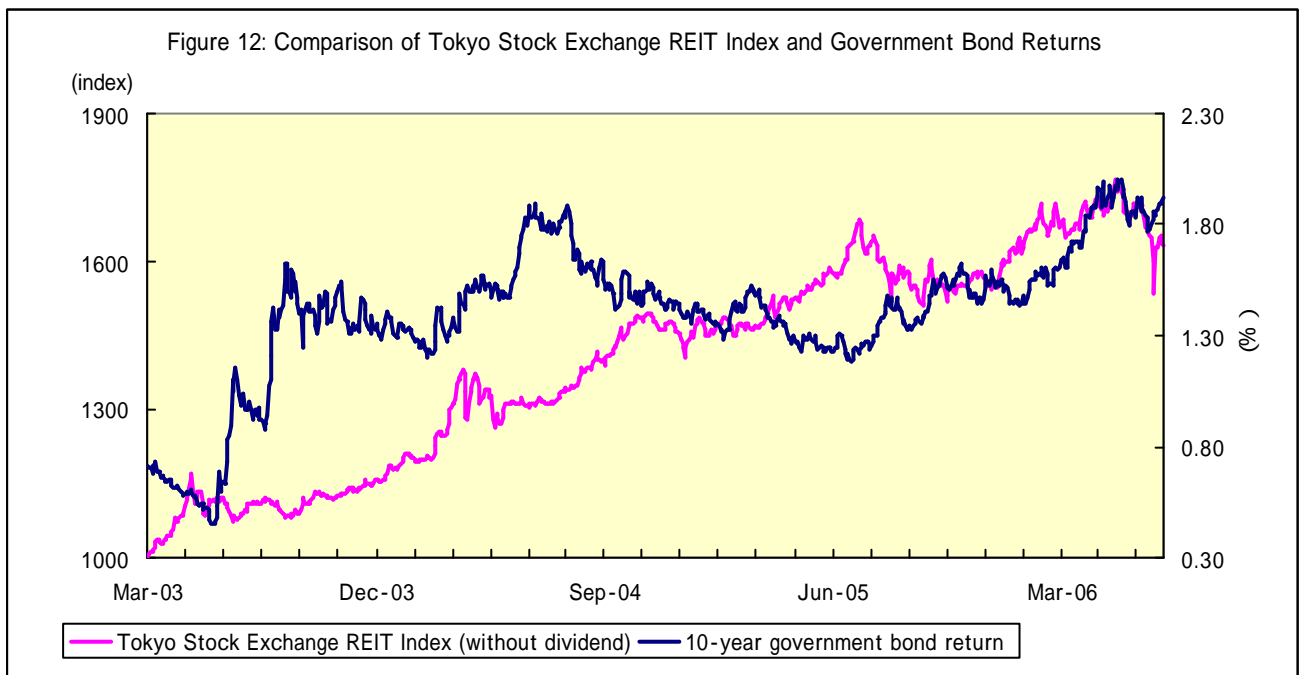
The rise in J-REIT prices during this period is a reflection of improved fundamentals in the real estate market. In the urban centers, expectations of an economic recovery have increased demand for office space and consequently pushed down vacancies and raised advertised rents. Additionally, there are signs - though still local in nature - of land prices having hit bottom and beginning to improve. This type of improvement in the fundamentals of the real estate market has a positive affect on the J-REIT prices.

Figure 11 compares the Tokyo Stock Exchange REIT Index and Tokyo Stock Exchange Real Estate Index. The latter has risen dramatically since the second half of 2005. Clearly, the improved fundamentals of the real estate market were reflected most quickly in the price of real estate stocks.



On the other hand, there was a sense during this period that investors were anticipating the rise in interest rates, expecting that the zero interest policy would end. When all other terms are fixed, a rise in interest rates would have a negative impact on J-REIT prices, resulting in fears that the prices of J-REITs would drop.

However, as Figure 12 indicates, the prices of J-REITs actually rose along with interest rates in early 2006. The optimistic outlook of real estate market forecasts placed even greater pressure on J-REIT prices, resulting in the rise.



Since May 2006, the Tokyo Stock Exchange REIT Index has continued to fall. There are many possible reasons for this including the effect of the rise in interest rates, price adjustment after the excessive rises (the spread is presently returning to the 2% level) and a decrease based on a temporary shock. The cause should become clearer as we place greater focus on future developments from this point forward.

### 3. Recent Trends of the J-REIT Market

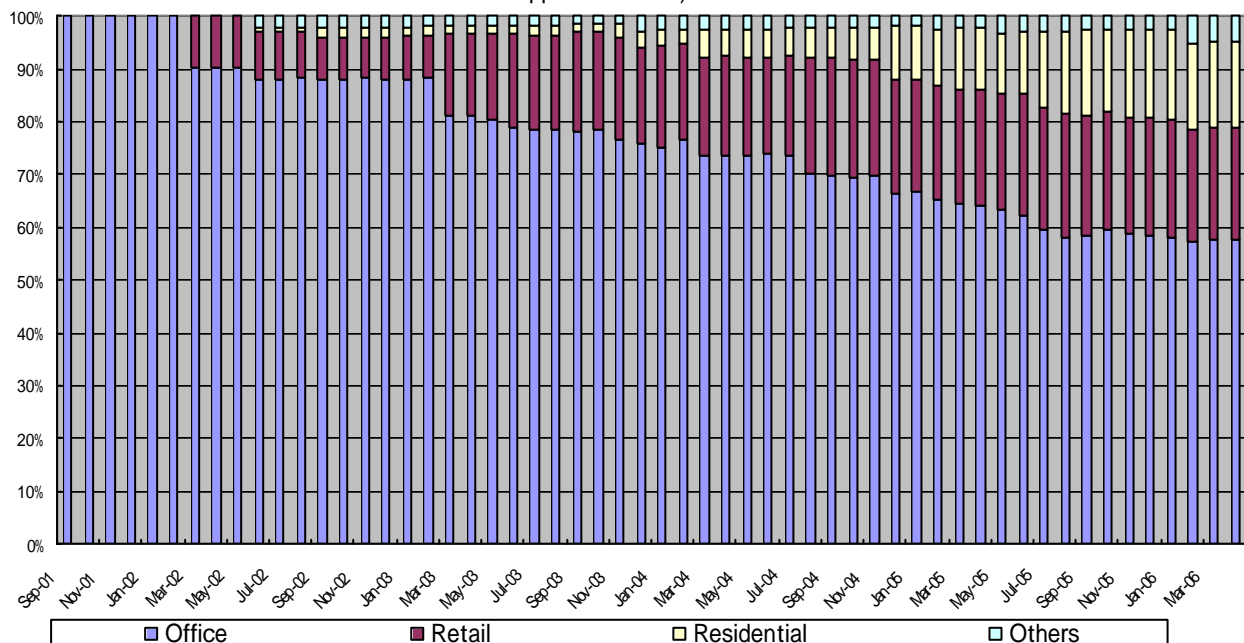
#### Progress of Diversification

In correlation with the increase in the number of J-REITs, there has been a growth in the diversity of J-REITs, including the type of assets under management, management policies and stock markets in which they list.

For example, an analysis of the type of assets under management reveals that the Fukuoka REIT Corporation, which listed in June 2005, and the Hankyu REIT Inc., listed in October 2005, have established investment policies centered on specific regions and thus represent a diversification in regions subject to investment. In addition, the Japan Logistics Fund, Inc., a J-REIT specializing in logistics investment, listed in May 2005 and the Japan Hotel and Resort Inc., a J-REIT specializing in hotels, listed in February 2006. Thus there are now J-REITs that are investing in previously untapped asset types.

Figure 13 represents the historical breakdown of asset types that are owned by J-REITs and indicates the diversification of types of assets under management.

Figure 13: History of Asset Type Breakdowns by J-REIT Owned Assets (based on disclosed appraisal values)



Prepared by ARES using data published by the Investment Trusts Association, Japan

Additionally, there are both specialized J-REITs that only invest in a single type of asset and compound and general JREITs that invest in multiple types of assets. This represents another form of diversification.

In addition to the diversification of these management policies, there has also been a diversification of the stock markets on which the JREITs have listed, which now

include the Tokyo Stock Exchange, Osaka Securities Exchange, Fukuoka Stock Exchange and Jasdq Securities Exchange. This diversification is expected to continue as the market expands.

It is unavoidable that further diversification will lead to a stark difference in the management results of J-REITs as a result of differences in the management results of the J-REITs. J-REITs are in a position in which they are selected by investors carefully and receive benefits when management results are good and may be eliminated by the market when their results are bad. This is believed to have a positive affect on the real estate management of J-REITs because it leads to competition among the respective J-REITs. Of course, to secure these positive results, there is a need for an environment where adequate information for making accurate judgments regarding J-REITs is disclosed and correctly used.

On the other hand, for investors into J-REITs this diversification means an increase in investment choices. As a result, even though diversified investment further reduces the variable risk for revenues, efficient management should become possible because it ultimately leads to realizing the same returns with less risk.

In this manner, the diversification of J-REITs improves the efficiency of both the real estate market and the financial market.

## (2) Accumulation of a Wealth of Disclosure Information

J-REITs are presently the only real estate securitization product in Japan that is a listed product and the information disclosed by J-REITs is very rich. For example, there is a timely, prompt disclosure of material decisions, including the acquisition of properties and raising capital. Further, with regards to the settlement of accounts, the balance sheet and profit and loss statement of J-REITs as a corporation are disclosed along with the income and expenditure information and appraisal amounts of individual properties. There are aspects of information disclosed by J-REITs that exceed the disclosures made by listed real estate companies.

The fact is that outside of J-REITs there are almost no cases in real estate where detailed information is provided to this extent. J-REITs have a very high level of transparency.

In the past, the accumulated historical data on J-REITs was insufficient because J-REITs were still new products and therefore difficult to analyze. However, with the ongoing accumulation of information, an environment is almost in place where investors can make an accurate analysis.

For example, it is becoming possible to analyze J-REITs with the same criteria as other financial assets using data on J-REIT prices and dividend performance. In addition, it is also possible to use information on real estate owned by J-REITs to analyze the actual property itself. The ARES J-REIT Property Index in Figure 14 is calculated by the Association of Real Estate Securitization (ARES) based on data published on properties owned by J-REITs. This data includes information on income, expenditure and appraisal. This real estate investment index is published on the ARES website and is calculated using a method that follows the calculation method of the NCREIF Index in the U.S., using disclosed data on properties owned by J-REITs. (Please see the ARES website ([www.ares.or.jp](http://www.ares.or.jp)) for a detailed definition).

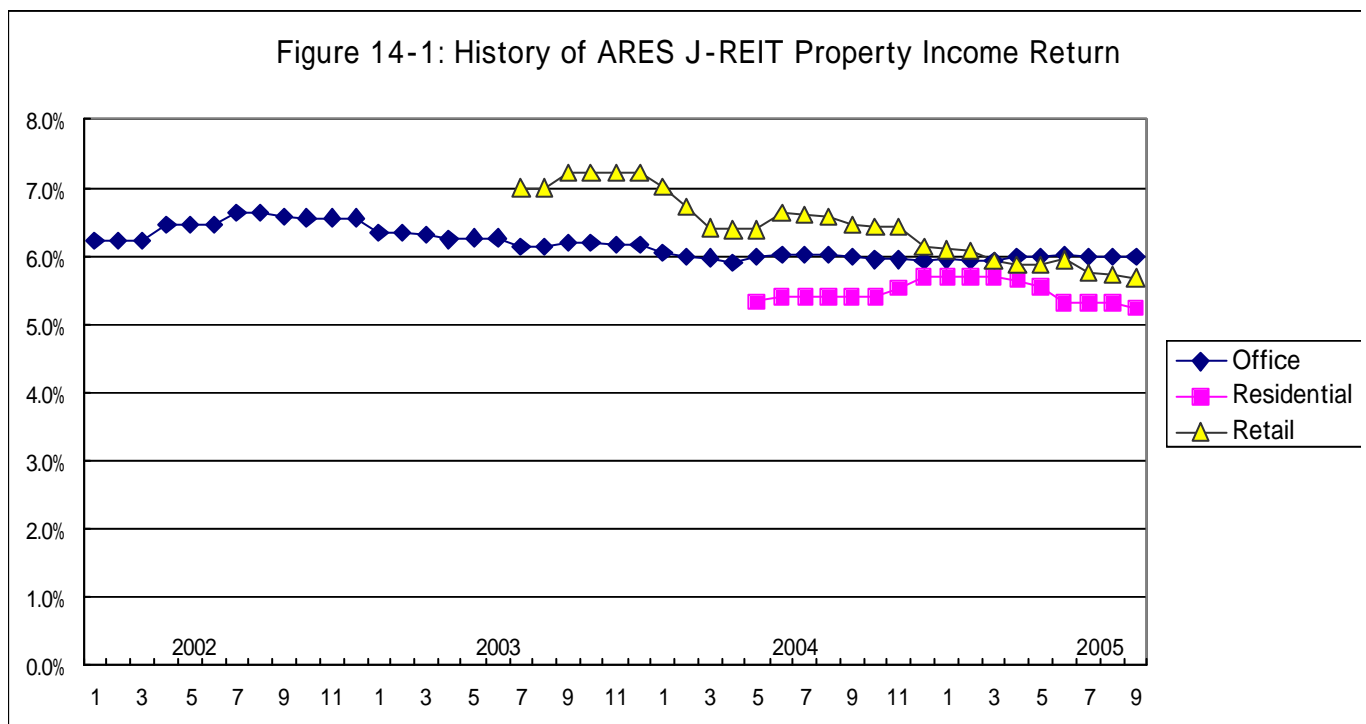


Figure 14-2: History of ARES J-REIT Property Index Capital Return

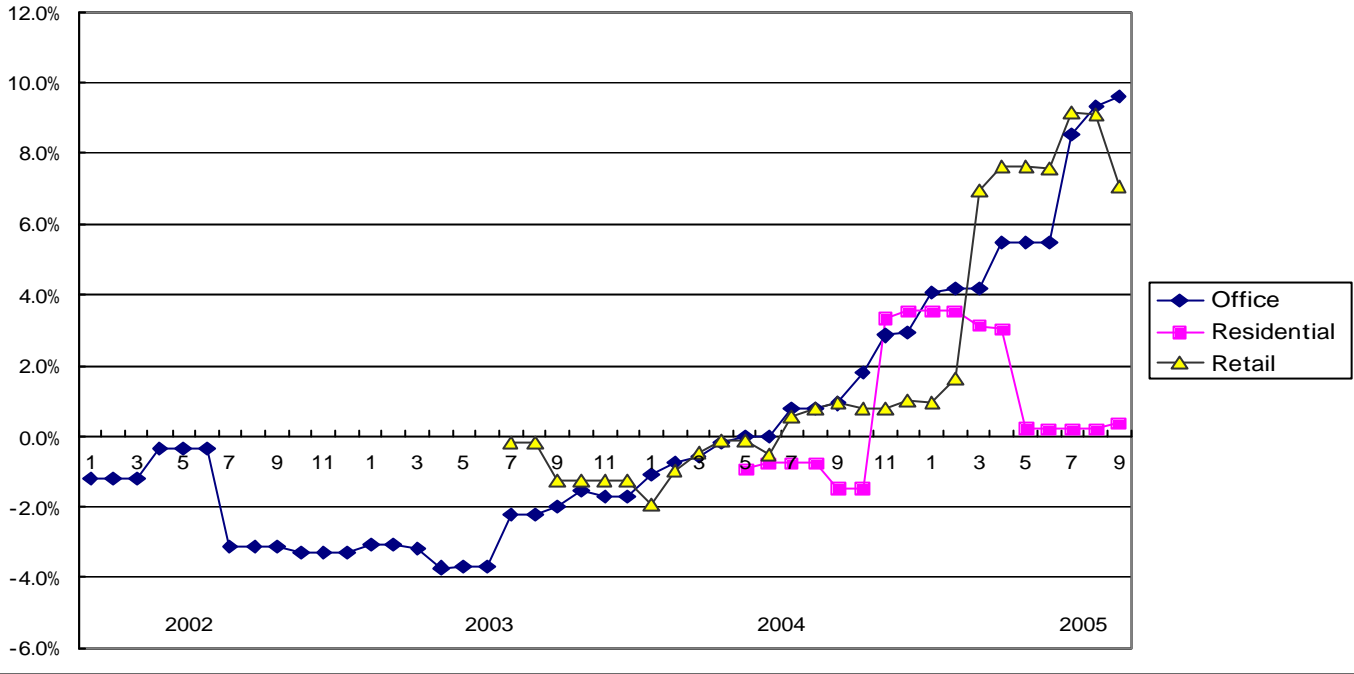
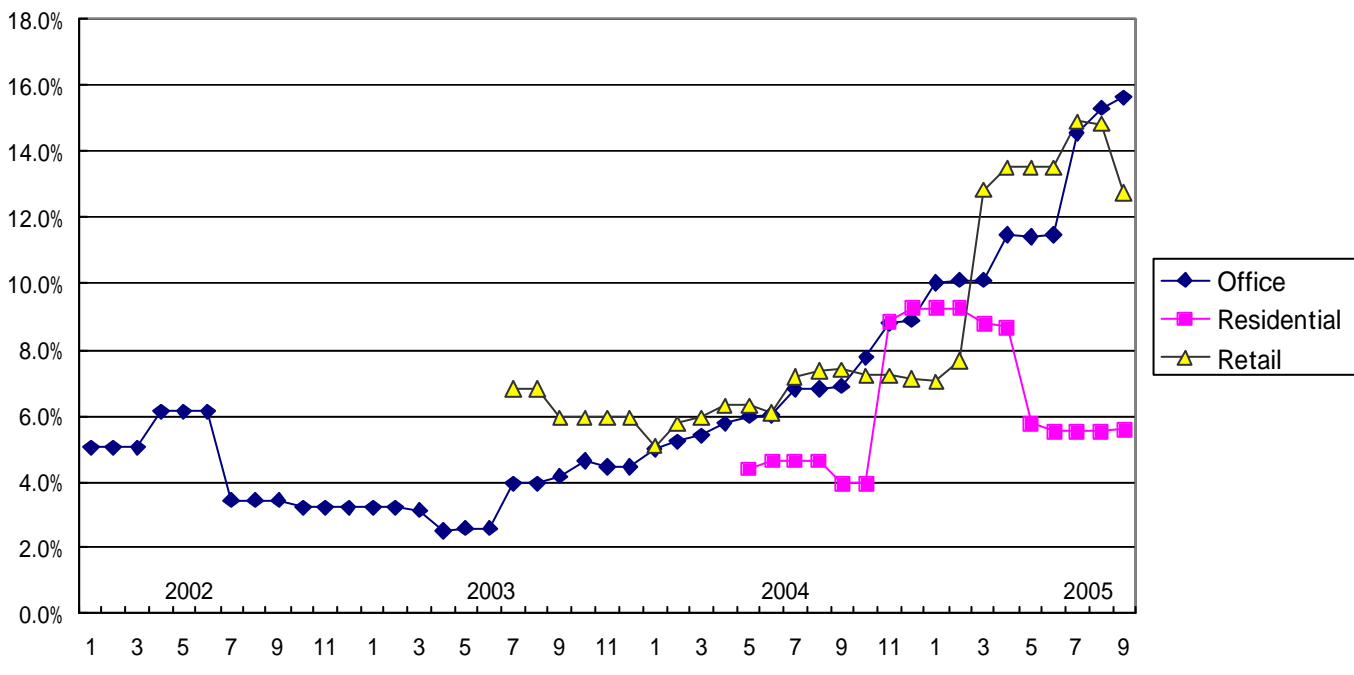


Figure 14-3: History of ARES J-REIT Property Index General Return



The ARES J-REIT Property Index enables macro trends concerning real estate conditions to be grasped by indicating the average value for real estate return and analyzing those trends. For example, Figure 14-2 reveals that the capital profitability has switched from negative to positive and that on average, the prices of real estate owned by J-REITs have turned a corner.

It is also possible to conduct analyses from a micro perspective using data on individual properties. Analyses should become easier with the launch of the ARES JREIT Property Database. This is a service in which the information on individual properties disclosed by J-REITs in the past is formed into a database and an environment created where necessary information can be extracted and downloaded.

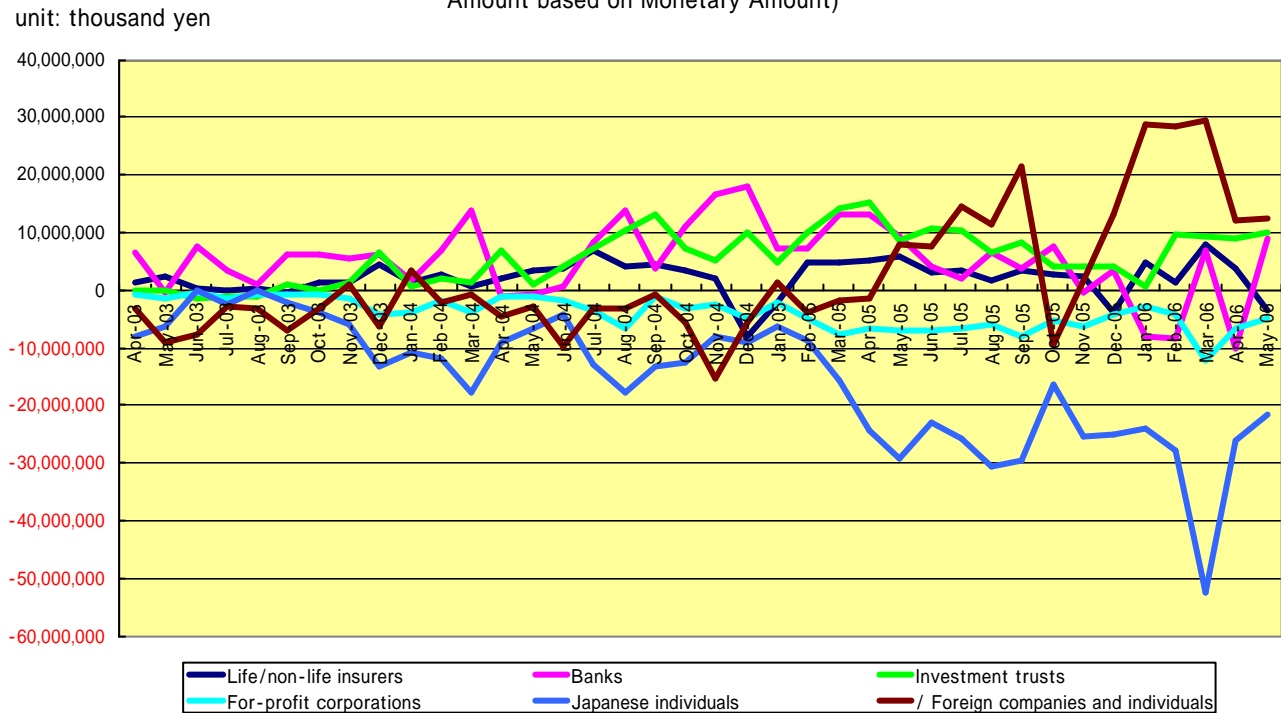
### (3) Change in the Investment Attitude of Foreign Investors

Previously, the investors that were most proactively investing in J-REITs were banks and other financial institutions. This is because financial institutions judged J-REITs to be a more attractive investment destination than other destinations as they were indicating strong performance and because of the continuing low interest rates (unlike other stocks).

However, there are risks inherent in J-REIT investments and it cannot be definitely stated that the strong performance to date will continue. As indicated earlier, there is a strong possibility that the rise in J-REIT prices is due to the elimination of an over assessment of J-REIT risks during the formative years of the market. Therefore, it cannot be irrefutably concluded that the prices will continue to rise in the same manner. There is the possibility that the recovery in stock prices and recognition of the potential for rising interest rates will make J-REITs a less attractive investment destination for financial institutions than before. Consequently, it would not be surprising for the investor structure of J-REITs to change in the future.

Figure 15 indicates the history of net purchases relating to J-REITs based on sales and purchasing data of J-REITs organized by investment category that are published by the Tokyo Stock Exchange. The figure reveals that financial institutions were almost consistently buyers and individuals were almost consistently sellers. However, since entering 2006 financial institutions have turned to being net sellers.

Figure 15: History of Sale and Purchase Conditions by Investment Category (Net Purchase Amount based on Monetary Amount)



On the other hand, foreign investors have changed their investment attitude since 2005 from consistently being sellers to overwhelmingly being net buyers. This has had a tremendous impact on the J-REIT market and reveals that J-REITs have been recognized by foreign investors as an attractive investment destination.

As Figure 3 indicates, many new J-REITs were listed in fiscal 2005. If there are an inadequate number of J-REITs, there is the possibility that the massive number of new J-REIT IPOs will cause prices to fall. This is because the supply of J-REITs would be increasing within a condition of limited demand. However, in an environment where not only Japanese investors but also overseas investors are investing in J-REITs, there is room for the demand to spread not only among the Japanese investors but also the foreign investors. This is true even if many new J-REITs are listed, so the drop in prices would be expected to be limited.

One reason why any price drop was limited during fiscal 2005 - despite the many new listings - was that there were increased purchases by foreign investors. Furthermore, the facts that the primary buyers of J-REIT stock since 2006 have been foreign investors and that prices have risen during this time is a result of a very positive interpretation by foreign investors of the improved fundamentals of the Japanese real estate market.

If the acquisition of J-REIT stock by foreign investors continues, naturally the ratio of foreign investors among J-REIT investors will grow. A risk that cannot be denied is that if this ratio grows too high the price of J-REITs may fluctuate at the “whims” of foreign investors. On the other hand, a greater increase in foreign investors investing in J-REITs also works to suppress the impact of any price falls in J-REITs brought on by the supply of new J-REITs. Therefore, the rise in foreign investor share works to lower the risk of the J-REIT prices deviating from the appropriate price.

#### 4. Conclusion

The J-REIT market has already grown enormously and has entered a true growth phase. Reflecting on the past, the J-REIT market has achieved steady growth.

Furthermore there is greater diversification in the J-REITs emerging in the market. This disparity is not limited to the individual characteristics of each J-REIT issue but also in the actual performance of each J-REIT.

In essence, the investment and management of property is a skill that is not easy for anyone to immediately pick up and requires extensive know-how. Therefore, it is only natural for a disparity in management performance to emerge as the number of J-REITs increase. The important point is that J-REITs achieving truly superior management performance need to be highly appraised. This requires the creation of an environment in which investors can make appropriate judgments concerning J-REITs.

Information on J-REITs is an essential precursor to good judgment. Fortunately, there is a wealth of disclosed information on J-REITs. However, this information is not in a data format that can be quickly and easily analyzed.

In response, ARES has begun services to provide J-REIT information including J-REIT View and the ARES J-REIT Property Database. Further, the association is working to create an environment in which information is easy to use. ARES intends to continue activities for preparing an infrastructure in which disclosed information is conveyed to investors in an easily understandable manner.