Notes to Consolidated Financial Statements

MITSUBISHI ESTATE CO., LTD. AND CONSOLIDATED SUBSIDIARIES

1. Basis of Presentation of Financial Statements

The accompanying financial statements have been prepared from the accounts maintained by Mitsubishi Estate Company, Limited (“the Company”) and its consolidated subsidiaries in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan, which may differ in some material respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In addition, the notes to the financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

2. Summary of Significant Accounting Policies

(A) Consolidation

The consolidated financial statements include the accounts of the Company and its significant subsidiaries (together, “the Companies”).

There were 128 consolidated subsidiaries in fiscal 1998 and 191 consolidated subsidiaries in fiscal 1999. All significant intercompany accounts and transactions have been eliminated.

In fiscal 1998, investments in unconsolidated subsidiaries and affiliates are stated at cost. The ordinance of the Ministry of Finance of Japan, which regulates consolidated financial statements, requires companies to account for investments in unconsolidated subsidiaries and affiliates by the equity method, but such investments are stated at cost as they are not significant in terms of net income. There were 49 such unconsolidated subsidiaries and affiliates in fiscal 1998.

Beginning in the fiscal year ended March 31, 1999, the Company adopted the equity method for certain unconsolidated subsidiaries and affiliates in accordance with a change in accounting principles in Japan regarding the scope of equity method accounting. As a result, there are seven unconsolidated subsidiaries and 21 affiliates accounted for by the equity method, and 11 unconsolidated subsidiaries and 15 affiliates stated at cost.

(B) Basis of Revenue Recognition

The statements of income reflect revenue from operations in the following manner:

- Revenue from leasing of office space is recognized as rents accrued in the leasing period.
- Revenue from sales of condominiums, residential houses and land is recognized when units are delivered and accepted by the customers.
- Revenue from design and supervision is recognized at the date of completion of the relevant project.
- Other operating revenues are recognized on an accrual basis.

(C) Inventories

Inventories are mainly stated at cost, determined by the identified cost method.

(D) Marketable Securities and Investments in Other Securities

Securities quoted on stock exchanges are mainly stated at the lower of cost or market, cost being determined by the moving average method. Non-quoted securities are mainly stated at cost, also determined by the moving average method.

(E) Property and Equipment

Domestic property and equipment are stated at cost. Fixed assets of overseas consolidated subsidiaries that have dropped substantially in value and are considered to have no prospects for recovery are stated at market value.

For the Company and its domestic subsidiaries, depreciation of property and equipment is mainly computed on the declining balance method, while overseas consolidated subsidiaries mainly use the straight line method.

Repairs and maintenance which do not improve or extend the life of the respective assets are expensed currently.

In accordance with revisions to the Corporate Tax Law of Japan, beginning the fiscal year ended March 31, 1999, the useful life used to calculate the depreciation of assets has been shortened. The effect of this change in accounting method was to increase depreciation of property and equipment by ¥3,419 million.

(F) Income Taxes

Income taxes currently payable by the Companies are based on the determination of taxable income, which may be different from the income shown in the financial statements. The differences arise from taking up certain items for taxation purposes in periods different from those for financial statement purposes. In accordance with accounting principles generally accepted in Japan, the Companies do not reflect the tax effect resulting from temporary differences.

(G) Employees’ and Directors’ Retirement Allowances

The Companies have employee retirement plans, and an allowance based on length of service and current basic salary is paid to employees on retirement. The amounts paid in the case of voluntary retirement will be less than the amounts paid in the case of involuntary retirement. The Companies mainly provide for 100% of this liability. The Companies provide for retirement benefits for directors and statutory auditors based on the Companies’ internal regulations reflecting their positions and length of service.

The directors’ retirement allowances are included in other long-term liabilities.

(H) Translation of Foreign Currency Accounts
The translation of foreign currency financial statements of overseas consolidated subsidiaries into yen has been made for consolidation purposes in accordance with the translation method prescribed in the statement revised in May 1995 issued by the Business Accounting Deliberation Council of Japan. Differences arising from translation are presented as “Translation adjustments” in the accompanying consolidated financial statements.

(I) Net Income per Share
In computing net income per share assuming no dilution, the average number of shares outstanding during each year, adjusted to give retroactive effect to the free distribution of shares, has been used. Net income per share assuming full dilution has been computed on the assumption that all convertible bonds were converted into common stock at the beginning of the year or at the time of issue in the case of newly issued bonds, with appropriate adjustments of the related interest expense, net of taxes, for such convertible bonds. Net income per share, assuming full dilution for the years ended March 31, 1997, 1998 and 1999, is not presented since the outstanding convertible bonds had no dilutive effect.

3. Fiscal Year

As the fiscal year of Rockefeller Group, Inc., and their subsidiaries ends on December 31 each year, accounts for the years ended December 31, 1997 and 1998 were consolidated in the Company’s consolidated financial statements for the years ended March 31, 1998 and 1999, respectively.

4. Basis of Translating Financial Statements

Yen amounts shown in the financial statements are translated into U.S. dollars, solely for convenience, at the prevailing exchange rate of ¥120.55 to U.S.$1.00 on March 31, 1999. These translations should not be construed as a representation that Japanese yen amounts have been, could have been, can be or could in the future be converted into U.S. dollars at that rate.

5. Special Profits and Losses

The Companies recorded special profits and losses in fiscal 1998 consisting of the following:

Years ended March 31, 1998	Millions of yen	Thousands of U.S. dollars
Gain from sales of fixed assets	¥ 49,159	$ 407,789
Gain from sales of affiliated company’s stock	7,715	63,998
Loss from write-down on fixed assets	(33,789)	(280,290)

6. Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided at the maximum amount permitted by Japanese tax law plus the excess, if any, of an estimated amount of probable bad debts above that maximum amount.

7. Inventories

Inventories at March 31, 1998 and 1999 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Real estate for sale	¥168,906	¥170,452	$1,413,953
Land and housing projects in progress	43,929	40,821	338,623
Land held for development	36,208	35,219	292,152
Other	15,842	13,246	109,880
Total	¥264,885	¥259,738	$2,154,608

8. Marketable Securities and Investments in Other Securities

Marketable securities and investments in other securities at March 31, 1998 and 1999 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Marketable securities:			
Listed equity securities	¥ 74,360	¥73,201	$607,225
Public bonds and corporate debentures	31,567	24,035	199,378
Total	¥105,927	¥97,236	$806,603
Investments in other securities:			
Non-listed equity securities	¥ 45,310	¥30,678	$254,484
Public bonds, corporate debentures and other	567	112	929
Total	¥ 45,877	¥30,790	$255,413

9. Other Investments

Other investments at March 31, 1998 and 1999 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Long-term loans to unconsolidated subsidiaries and affiliates	¥ 906	¥ 120	$ 995
Deposits and guarantee money paid	73,501	76,341	633,273
Other	60,087	55,301	458,739
Total	¥134,494	¥131,762	$1,093,007

Short-term loans to unconsolidated subsidiaries and affiliates are included in other current assets and amounted to ¥1,915 million ($14.5 million) at March 31, 1998.

10. Bank Loans and Long-Term Debt

Short-term bank loans are mainly represented by overdrafts that will generally mature in 12 months. The annual interest rates applicable to the short-term loans outstanding at March 31, 1998 and 1999 were 0.804%–6.94% and 0.4436%–6.34%, respectively.

Long-term debt at March 31, 1998 and 1999 was as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
5.5% mortgage bonds due 1998	¥ 9,000	¥ —	$ —
5.1% mortgage bonds due 1998	40,000	—	—
5.6% mortgage bonds due 1999	3,000	3,000	24,886
4.9% mortgage bonds due 2000	35,000	35,000	290,336
5.6% mortgage bonds due 2004	50,000	50,000	414,766
5.275% mortgage bonds due 2005	50,000	50,000	414,766
4.8% mortgage bonds due 2005	50,000	50,000	414,766
6% unsecured bonds due 1999	30,000	30,000	248,860
3.95% unsecured bonds due 1999	10,000	10,000	82,953
0.85% unsecured bonds due 1999	—	1,897	15,736
0.84% unsecured bonds due 1999	—	4,316	35,803
0.8% unsecured bonds due 1999	—	897	7,441
3.85% unsecured bonds due 2000	35,000	35,000	290,336
1.2% unsecured bonds due 2000	3,380	3,006	24,936
Floating rate unsecured bonds due 2001	8,462	2,522	20,921
6.2% unsecured bonds due 2001	—	7,525	62,422
4.4% unsecured bonds due 2001	10,000	10,000	82,953
2.7% unsecured bonds due 2001	5,000	5,000	41,477
1.1% unsecured bonds due 2001	—	2,694	22,348
8-5/8% unsecured bonds due 2001 (payable in U.S. dollars)	28,000	28,000	232,269
4% unsecured bonds due 2002	20,000	20,000	165,906
2.95% unsecured bonds due 2002	10,000	10,000	82,953
2.125% unsecured bonds due 2002	10,000	10,000	82,953
1.675% unsecured bonds due 2002	10,000	10,000	82,953
1.5% unsecured bonds due 2002	—	10,000	82,953
6.95% unsecured bonds due 2003	—	1,157	9,598
3.1% unsecured bonds due 2003	10,000	10,000	82,953
3.05% unsecured bonds due 2003	15,000	15,000	124,430
2.55% unsecured bonds due 2003	10,000	10,000	82,953
2.35% unsecured bonds due 2003	20,000	20,000	165,906
2.05% unsecured bonds due 2003	20,000	20,000	165,906
1.775% unsecured bonds due 2003	—	10,000	82,953
1.7% unsecured bonds due 2003	—	10,000	82,953
2.55% unsecured bonds due 2004	10,000	10,000	82,953
1.7% unsecured bonds due 2004	—	10,000	82,953
2.125% unsecured bonds due 2005	—	10,000	82,953
3.4% unsecured bonds due 2006	10,000	10,000	82,953
3% unsecured bonds due 2006	10,000	10,000	82,953
2.21% unsecured bonds due 2006	—	10,000	82,953
2.975% unsecured bonds due 2007	30,000	30,000	248,860
3.1% unsecured bonds due 2008	10,000	10,000	82,953
2.575% unsecured bonds due 2008	10,000	10,000	82,953
2.525% unsecured bonds due 2008	—	10,000	82,953
3.075% unsecured bonds due 2009	10,000	10,000	82,953
3.275% unsecured bonds due 2012	10,000	10,000	82,953
3.125% unsecured bonds due 2017	10,000	10,000	82,953
3% unsecured bonds due 2018	—	10,000	82,953
1.5% convertible bonds due 2003	94,185	92,682	768,825
Loans from banks and insurance companies:			
Secured	50,146	112,728	935,114
Unsecured	321,524	332,916	2,761,643
Loans from tenants	108	99	821
Total	1,067,805	1,183,439	9,816,997
Less current portion	(179,738)	(126,029)	(1,045,450)
Total long-term debt	¥ 888,067	¥1,057,410	$ 8,771,547

The agreement under which the 1.5% convertible bonds were issued provides for the conversion thereof into shares of common stock at the current conversion price per share of ¥2,600 ($21.57), subject to adjustments in certain events, including free distributions of shares and stock dividends by way of stock splits.

The current portion of long-term debt at March 31, 1999 was as follows:

	Millions of yen	Thousands of U.S. dollars
Mortgage bonds	¥ 50,109	$ 415,670
Long-term bank loans	75,890	629,531
Loans from others	30	249
Total	¥126,029	$1,045,450

The aggregate annual maturities of long-term debt are as follows:

	Millions of yen	Thousands of U.S. dollars
2000	¥ 126,029	$1,045,450
2001	104,438	866,346
2002	152,324	1,263,575
2003	190,446	1,579,809
2004 and thereafter	610,202	5,061,817
Total	¥1,183,439	$9,816,997

The following assets were pledged as collateral for long-term loans from banks at March 31, 1998 and 1999:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Land	¥ 22,670	¥ 31,433	$ 260,747
Leased land rights	—	10,300	85,442
Buildings and construction in progress	92,009	179,394	1,488,129
Marketable securities	525	12	99
Total	¥115,204	¥221,139	$1,834,417

Additionally, all assets of the Company are subject to an enterprise mortgage for mortgage bonds which amounted to ¥237,000 million ($1,794.1 million) at March 31, 1998 and ¥188,000 million ($1,559.5 million) at March 31, 1999.

As is customary in Japan, collateral must be given if requested by lending institutions under certain circumstances, and generally banks have the right to offset cash deposited with them against any debt or obligations payable to the bank that become due in case of default and certain other specified events. The Companies have never received any such requests nor do they expect that any such requests will be made.

11. Guarantee Deposits and Lease Deposits

The Companies made lease agreements for office space with tenants under which the Companies receive from tenants non-interest-bearing lease deposits or guarantee deposits.

Guarantee deposits and lease deposits at March 31, 1998 and 1999 were as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Guarantee deposits and lease deposits from tenants	¥239,639	¥272,645	$2,261,676
Guarantee deposits from others	27,174	25,163	208,735
Total	¥266,813	¥297,808	$2,470,411

12. Income Taxes

Income taxes applicable to the Companies comprise a corporation tax, inhabitant taxes and an enterprise tax. In the statements of income, the enterprise tax of ¥406 million in 1998 was included under “Selling, general and administrative expenses.” In accordance with a change in accounting standards for the preparation of consolidated financial statements, in 1999, enterprise tax of ¥113 million is included in income taxes.The effective tax rates on the statements of income differ from the normal tax rates primarily because of the effect of permanent non-deductible expenses and the lower tax rate applied to the portion of income distributed as dividends.

13. Shareholders' Equity

(A) Common Stock and Capital Surplus
Under the Japanese Commercial Code, at least 50% of the issue price of new shares, with a minimum of the par value thereof, is required to be credited to the common stock account. The portion which is to be credited to the common stock account is determined by resolution of the Board of Directors. Proceeds in excess of the amounts credited to common stock have been credited to the capital surplus account.

Japanese companies, upon approval by the Board of Directors, may make a free distribution of shares by way of stock split to shareholders. The Japanese Commercial Code permits the Board of Directors to distribute by way of stock split (1) an amount of capital surplus or legal reserve transferred to common stock and (2) the portion of the issue price of new shares which is in excess of the par value of such new shares accounted for as common stock in the form of free shares to shareholders. Accordingly, when the Company makes a free distribution of shares from common stock as in case (2) above, no accounting entry would be required.

(B) Legal Reserve
Under the Japanese Commercial Code, each domestic company is required to appropriate as legal reserve an amount equal to at least 10% of cash dividends and other payments made as disposition of profit until the reserve equals 25% of common stock account. This reserve is not available for dividends but may be used to reduce a deficit by resolution of the shareholders or may be capitalized by resolution of the Board of Directors.

14. Contingent Liabilities

At March 31, 1998 and 1999, the Companies were contingently liable as guarantors of unconsolidated subsidiaries, affiliates and individual customers as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Subsidiaries and affiliates	¥3,920	¥ 721	$ 5,981
Individual customers for housing loans	730	649	5,384
Other	0	2,406	19,958
Total	¥4,650	¥3,776	$31,323

Additionally, at March 31, 1999, the Company was contingently liable for the payment with respect to the following bonds which were transferred to banks under debt assumption agreements.

	Millions of yen	Thousands of U.S. dollars	Date of agreement
7.05% unsecured bonds due 2001	¥30,000	$248,859	Sept. 20, 1994
5.9% unsecured bonds due 1999	50,000	414,766	Mar. 22,1996
6.0% unsecured bonds due 2001	20,000	165,906	Feb. 28, 1997
6.0% unsecured bonds due 2002	50,000	414,766	Feb. 28, 1997

15. Segment Information

The Company and its consolidated subsidiaries are engaged in five major segments: (1) leasing and management of office buildings and commercial properties; (2) sales of housing, land and office buildings; (3) architectural design and supervision; (4) construction; and (5) other business.

Information by industry segment for the years ended March 31, 1998 and 1999 is summarized as follows:

	(Millions of yen)							
	1999							
	Leasing	Sales	Architectural	Construction	Other	Total	Elimination	Consolidated
Revenue from operations								
Outside customers	¥ 296,480	¥155,408	¥11,822	¥47,467	¥54,082	¥ 65,259	¥ —	¥ 65,259
Inter-segment	6,594	590	629	1,213	3,044	12,070	(12,070)	—
Total	303,074	155,998	12,451	48,680	57,126	577,329	(12,070)	565,259
Costs and expenses	215,233	151,531	12,055	49,338	61,922	490,079	6,352	496,432
Operating income	87,841	4,467	396	(658)	(4,796)	87,250	(18,422)	68,828
Assets	1,662,684	309,240	13,036	20,943	91,490	2,097,393	186,380	2,283,773
Depreciation	52,448	1,447	7	329	3,746	57,977	420	58,397
Capital expenditures	145,115	3,221	10	132	1,364	149,842	485	150,327

	(Millions of yen)							
	1998							
	Leasing	Sales	Architectural	Construction	Other	Total	Elimination	Consolidated
Revenue from operations								
Outside customers	¥ 279,161	¥151,255	¥11,593	¥66,404	¥40,318	¥ 548,731	¥ —	¥ 548,731
Inter-segment	5,843	12	1,037	3,013	3,019	12,924	(12,924)	—
Total	285,004	151,267	12,630	69,417	43,337	561,655	(12,924)	548,731
Costs and expenses	203,712	152,403	12,052	67,710	48,251	484,128	6,351	490,479
Operating income	81,292	(1,136)	578	1,707	(4,914)	77,527	(19,275)	58,252
Assets	1,428,782	288,482	11,777	20,648	69,718	1,819,407	283,851	2,103,258
Depreciation	48,439	1,433	14	129	2,982	52,997	935	53,932
Capital expenditures	128,568	1,436	4	2,052	1,125	133,185	5,933	139,118

	(Thousands of U.S. dollars)							
	1999							
	Leasing	Sales	Architectural	Construction	Other	Total	Elimination	Consolidated
Revenue from operations								
Outside customers	$ 2,459,396	$1,289,161	$ 98,067	$393,756	$448,622	$ 4,689,002	$ —	$ 4,689,002
Inter-segment	54,698	4,895	5,219	10,061	25,248	100,121	(100,121)	—
Total	2,514,094	1,294,056	103,286	403,817	473,870	4,789,123	(100,121)	4,689,002
Costs and expenses	1,785,424	1,257,001	99,997	409,277	513,660	4,065,359	52,696	4,118,055
Operating income	728,670	37,055	3,289	(5,460)	(39,790)	723,764	(152,817)	570,947
Assets	13,792,486	2,565,240	108,135	173,729	758,940	17,398,530	1,546,083	18,944,613
Depreciation	435,071	12,008	56	2,726	31,073	480,934	3,489	484,423
Capital expenditures	1,203,776	26,716	85	1,095	11,315	1,242,987	4,022	1,247,009

	(Thousands of U.S. dollars)							
	1998							
	Leasing	Sales	Architectural	Construction	Other	Total	Elimination	Consolidated
Revenue from operations								
Outside customers	$ 2,315,728	$1,254,707	$ 96,168	$550,842	$334,450	$ 4,551,895	$ —	$ 4,551,895
Inter-segment	48,469	100	8,602	24,994	25,044	107,209	(107,209)	—
Total	2,364,197	1,254,807	104,770	575,836	359,494	4,659,104	(107,209)	4,551,895
Costs and expenses	1,689,855	1,264,230	99,975	561,676	400,257	4,015,993	52,683	4,068,676
Operating income	674,342	(9,423)	4,795	14,160	(40,763)	643,111	(159,892)	483,219
Assets	11,852,194	2,393,048	97,694	171,282	578,333	15,092,551	2,354,633	17,447,184
Depreciation	401,817	11,887	116	1,070	24,737	439,627	7,756	447,383
Capital expenditures	1,066,512	11,912	33	17,022	9,332	1,104,811	49,216	1,154,027

16. Subsequent Events

On April 28, 1999, the Company sold the Chiyoda Building with leasehold rights to The Meiji Mutual Life Insurance Company (“Meiji Mutual”) for ¥51,000 million (US$423 million). Effective the same day (April 28, 1999), the Company purchased portions of the Matsudo Building and two other buildings from Meiji Mutual for ¥38,360 million (US$318 million).

On June 1, 1999, the Company issued ¥10,000 million ($83.0 million) 0.9% unsecured bonds due 2004, ¥10,000 million ($83.0 million) 1.325% unsecured bonds due 2006 and ¥10,000 million ($83.0 million) 1.82% unsecured bonds due 2009.

On June 29, 1999, the Company’s shareholders authorized payment of a cash dividend to shareholders of record on March 31, 1999 of ¥4.00 ($0.03) per share, or a total of ¥5,197 million ($43.1 million).