SMTRI Topic Report Japanese Real Estate Market

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With Abenomics and Tokyo's successful bid for the 2020 Olympics and Paralympics, the Japanese economy is accelerating its recovery from its two lost decades. In this report, we describe the Japanese real estate market and its outlook, noting signs of a recovery from declines following the Lehman crisis and the Great East Japan Earthquake.

The Japanese real estate market bottoming out and recovering

In the latter half of 2012, expectations that the Japanese real estate market would begin bottoming out started to rise, backed by strong investment appetites among domestic and foreign funds. Just as the market was bottoming out, the Abe administration was inaugurated. From the end of 2012 to the first half of 2013, Abenomics and the Bank of Japan's monetary easing "of a different dimension" boosted market expectations. Real estate transactions have been increasing and prices have started to rise, especially in Tokyo. The benchmark land prices announced in September 2013 show that land prices have risen, especially in the three major metropolitan areas: Tokyo, Osaka, and Nagoya.

The main reason for the recovery and rise in real estate prices is a decrease in the risk premium, reflecting expectations of a recovery in rent associated with expected economic growth. In the office rental market, the market consensus was that the vacancy rate had peaked but it would take some time for rent rises to be confirmed due to cautious companies. However, the mood in the real estate market is increasingly bullish given rising expectations that the 2020 Tokyo Olympics and Paralympics will be the "fourth arrow" of Abenomics, associated with its growth strategy, and the increase in real GDP for the third consecutive quarter.

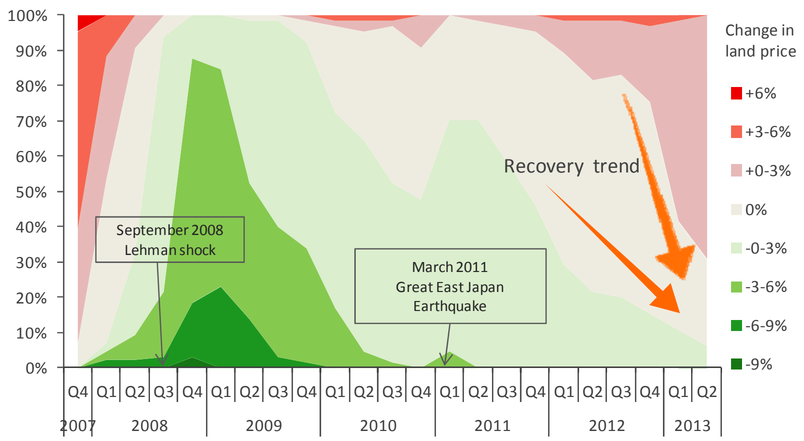
<Trends in the Japanese real estate market>

Second half of 2012	First half of 2013	From the second half of 2013
・Expectations of the market bottoming out	・Expectations of the market recovering (Prices expected to rise)	・Expectations of growth led by Tokyo (Rent expected to rise)

Abenomics

The 2020 Tokyo Olympics

<Composition of regions in Tokyo according to QoQ change in land price>



Source:SMTRI based on data of MLIT「Land Value LOOK Report」

Impacts of Abenomics and the 2020 Tokyo Olympics

In his speech at the New York Stock Exchange on September 26, Prime Minister Shinzo Abe called for Wall Street to invest in Japan, saying, "Buy my Abenomics." Abenomics consists of "three arrows": (1) bold monetary policy, (2) flexible fiscal policy, and (3) growth strategy to boost private investments. The table below describes the effects of policies in each "arrow" on the real estate market. Until now, the bold monetary easing has brought risk-on investments. J-REITs have aggressively purchased real estate through public stock offerings as their investment unit prices recovered sharply, leading the revitalization of real estate transactions. The market is carefully watching concrete policies and their effects to determine whether the growth strategy will bring sustainable rent rises.

<Major effects of Abenomics on the real estate market>

Three arrows	Concrete policies	Effects on the real estate market	
(1) Monetary policy	Bold quantitative and qualitative monetary easing (increasing purchases of risk assets, purchasing longer-term government bonds)	Short-term	Domestic and foreign investment funds making risk-on investments ➔ The risk premium declining
		Medium-term	Long-term interest rates rising ➔ The risk-free interest rate rising
(2) Fiscal policy	Large-scale public works projects (strengthening national land through countermeasures against decrepit infrastructure and disaster prevention measures)	Short- to medium-term	The economy recovering、demand from businesses and households expanding ➔ Rent rising
		Medium- to long-term	Improvement in the safety and convenience of infrastructure and the stock of real estate ➔ The risk premium declining
(3) Growth strategy	Regulatory reform, participation in TPP negotiations, restructuring of industry	Medium-term	Confidence in sustainable economic growth ➔ Sustainable growth in rent income

Just as details of the growth strategy were attracting attention, Tokyo was chosen to host the 2020 Olympics and Paralympics. The Tokyo metropolitan government has announced that the economic ripple effect (production inducement) of the Olympics during the seven years to 2020 will be 3 trillion yen. (The economic ripple effect of the London Olympics in the nine years before the Games was 31 billion to 33 billion pounds.) Since Tokyo is the capital of a mature economy, the expected economic ripple effect of the Olympics is only around 0.6% of the nominal GDP, and direct economic effects will be limited. Steady demand, however, mitigates economic fluctuations in a low-growth economy. Moreover, if 2020 is used for setting targets for implementing policies, such as the achievement of fiscal soundness – an international commitment for Japan – the realization of a low-carbon society, and the enhancement of Tokyo's international competitiveness, the Olympics are expected to promote economic growth over the medium to long terms.

The table below describes the major effects of the Olympics on the real estate market. The effect that particularly attracts attention is infrastructure building. The time required to reach Narita Airport and Haneda Airport is expected to be shortened through improvements to railways. Expected improvements in the network of the main roads in central Tokyo and the greater Tokyo area will mitigate traffic congestion and improve logistical efficiency. Tokyo is expected to take on a sustainable urban structure through the accelerated development of the Tokyo Bay area, where a range of athletic facilities will be built. Further increases in the number of tourists from abroad (especially Asia), which has already been increasing thanks to initiatives to promote tourism, are expected to boost demand for tourism-related facilities, including retail facilities and hotels. In the short term, real estate prices may rise in areas that will profit from these initiatives due to speculative investments.

There are, however, some concerns. The costs of construction work (especially labor costs), which are rising sharply with full-scale reconstruction in disaster-stricken Tohoku, may rise further, and as a result, real estate development costs may increase. Achieving fiscal soundness may be delayed due to excessive investment in sports facilities and infrastructure.

<Major effects of the 2020 Tokyo Olympics on the real estate market>

Positive effects	Negative effects
・Improvement in the convenience of infrastructure, including airports and roads ・The remodeling of Tokyo through the development of the Bay area ・Growth in the tourism industry ・Mitigation of an economic slowdown following consumption tax hikes	・Increases in development costs due to sharp rises in construction costs (especially labor costs) ・Fiscal deterioration as a result of excessive investments in sports facilities and infrastructure ・Declines in regional areas due to the excess concentration of population and industry in Tokyo

The outlook for the Japanese real estate market and investment opportunities

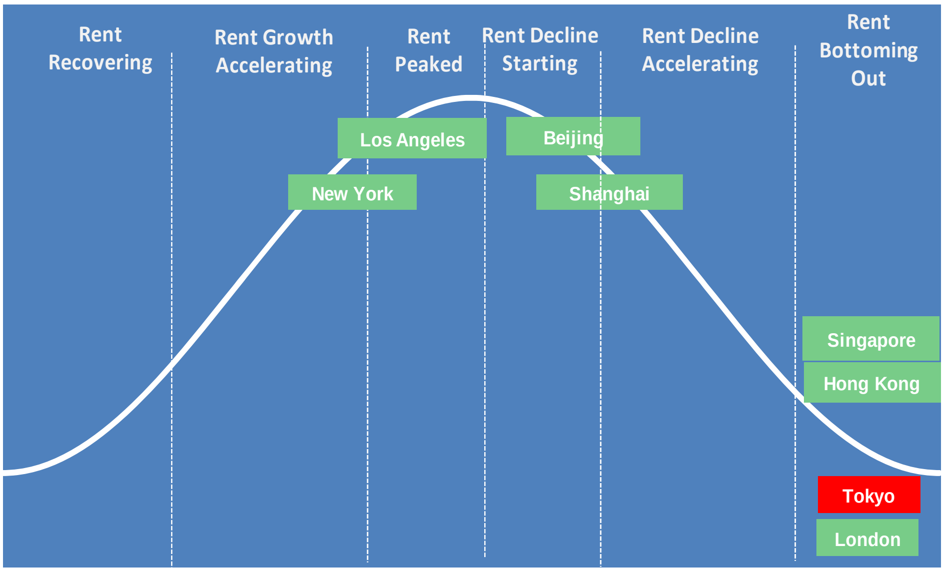
Real estate markets are expected to recover and grow in major cities in Asia, including Tokyo and Singapore, as well as in London. Tokyo in particular is attracting the attention of real estate investment funds worldwide as a city offering core investment opportunities based on stable economic growth after the end of monetary easing policies worldwide. As a consequence, real estate transactions in Tokyo are increasing. Until now, declines in the risk premium due to monetary easing have been the main reason for rises in real estate prices. If increases in rent income are confirmed against a backdrop of the end of deflation and economic growth, real estate prices will likely continue to rise moderately.

We forecast that the office market in Tokyo will stage a full-scale recovery in 2014, with the vacancy rate declining and rent starting to rise. However, if the consumption tax rate is raised twice, in 2014 and 2016, as planned, we anticipate that the economy will slow and the office market will soften in 2016. If the growth strategy of Abenomics is implemented steadily and the effects of the 2020 Tokyo Olympics mitigate the anticipated slowdown, the real estate market should grow steadily with stable economic growth.

We need, however, to be aware that Japan will be a very aged society (with persons aged 65 or over accounting for 29.1% of the population) in 2020, and that even in Tokyo those aged 65 or over are expected to account for 24% of the population. The key is for Tokyo to become a universal design city suitable for an aging society with fewer children and will present an urban model as an Asia headquarters that has strengths, including advanced technologies, and to boast strong economic vitality, from a long-term perspective.

If we focus on qualitative changes in demand for real estate in response to the excess concentration in Tokyo and the emergence of a social system compatible with a super-aged society, rather than declining total demand, we will continue to find many investment opportunities.

＜Global office rent cycle (as of 2Q 2013)＞



Source:SMTRI

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