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CEO Insight: Japan attracts big players

Japanese residential real estate assets proved so resilient during the COVID crisis that they have drawn the interest of major foreign investors, including from Germany. But the size of such investors entails not only advantages.

Dear investors and partners,

The pandemic has left some skid marks on the Japanese real estate market. The office sector (more work from home), the retail sector (limited business hours), and the hotel industry (no tourists) suffered the most, according to the transaction volumes for the first three quarters of 2021. But the residential deal volume grew by 8% (Japan German Real Estate Bridge - Page 7).

This development is all the more impressive because prices also increased. The average selling price for all new apartments built in 2021 in the Tokyo metropolitan area (Tokyo, Saitama, Chiba, Kanagawa) rose by almost 3% for the third year in succession to a post-war high of 62.6 million yen (464,000 euros). The selling price per square meter of these 33,600 new units grew 1.2% year-on-year to 936,000 yen (6,900 euros), the ninth consecutive annual increase. (Source: REEI)

But during the same period, monthly rents for apartments also continued to climb – for example, in Greater Tokyo by 6.1% to 3,270 yen (24 euros) per square meter. (Source: Tokyo Kantei). As a result, yields remained at attractive levels: the capitalization rate of residential properties held by listed J-REITS declined only by 0.13 points to 4.17% during 2021 (year-end 2020 versus 2021). In Tokyo, this figure fell by 0.17 points to 3.85%.

Well-known investor wisdom is that humans always need housing, even in difficult times. But this fact only partly explains the resilience of these Japanese assets. After all, housing is more than a basic need: The experience of the pandemic has made many owners in Japan more aware of the circumstances of their accommodation - especially size and location. This has now resulted in visible shifts (Real Estate Investment in Japan - page 35).

Some are moving closer to the city center to shorten their commute. There, they compete with other buyers for a shrinking inventory. And those who want more space to work from home are now gravitating toward the more distant suburbs, where they can get more space for the same money – driving up demand there, too. These two trends caused residential land prices in Japan to increase 0.5% nationwide in 2021.

The handsome and comparatively stable yields, as well as the large and diverse supply of high-quality residential properties, are now attracting more large foreign investors to Japan. For example, Allianz Real Estate from Germany launched a $2 billion closed-end fund in Singapore with Canada's Ivanhoé Cambridge in December. The capital is to flow into newly completed residential properties in prime locations in the major cities of Tokyo, Osaka, Nagoya, and Fukuoka. The properties will be leased and held on a long-term basis.

An initial purchase of 12 properties totaling 250 apartments and 7,500 sq. m. of net rentable area was completed at US$90 million, according to an Allianz release. With a purchase price of around US$12,000 per square meter, which is high by local standards, Allianz is paying tribute to the shortage of attractive large portfolios of residential properties.

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Allianz Real Estate will certainly not remain alone with its foray into Japan. My assessment seems to be shared by the U.S. private equity fund KKR, which bought one of Japan's largest real estate asset managers in mid-March. KKR paid 230 billion yen (1.7 billion euros) for Mitsubishi Corp.-UBS Realty. Trading house Mitsubishi and investment bank UBS formed their joint venture in 2000 when the real estate market for institutional investors in Japan was just emerging. The then pioneer for J-REITS now manages assets of 1.7 trillion Yen (12.7 billion euros). With its acquisition, the U.S. equity fund is signaling that it expects such assets to grow strongly.

Of course, Kensho cannot compete in this league. But: The big players have to enter the market in big style because they invest large sums in one fell swoop, as the Allianz example described above shows. Such large purchases in residential real estate in Japan are almost only possible through large portfolio transactions and are therefore not easy. The sudden strong demand drives up prices and depresses the returns of such players. In contrast, we as a local direct investor and asset manager are assembling a portfolio property by property, generating added value. As a result, we can achieve higher returns. Size is not everything.

Conversion rate: 1 euro = 135 yen

Leonard Meyer zu Brickwedde

Dr. Leonard Meyer zu Brickwedde
President & CEO

Kensho Investment Corporation
Sanno Park Tower 3F
2-11-1 Nagata-cho,
Chiyoda-ku, Tokyo 100-6162

Tel: +81(0)3-6205-3039
contact@ken-sho-investment.com