KENSHO INVESTMENT GROUP

November 15, 2022

CEO Insight: ESG compliance spills over from Europe to real estate investors in Japan

Japan is developing its own ESG profile. Social aspects of investing are becoming as important as environmental sustainability.

Construction giant Takenaka is transforming an existing 23-year-old office building in the Koto district of Tokyo into a smart building which cuts CO2 emissions in half. Mori Building creates a "city within a city" at the Toranomon Azabudai project in Tokyo by combining Japan's tallest building and a central plaza with lush greenery. The detached home builder Open House is providing affordable single-family homes in the 40-million-yen range (€280,000) in urban areas by dividing land in favorable locations and constructing three-story houses on the smaller plots.

These three initiatives show that the concept of ESG has reached the Japanese real estate sector. In Germany, EU regulations on environmental, social and governance issues have already caused a paradigm shift in real estate investment. More and more investors favor properties that meet ESG requirements. They believe that compliance with these criteria will determine their exit opportunities in five or ten years. In other words: Investors now see an ESG rating as essential to maintaining the value of a property. What is more, the classification of a property as ESG-compliant is becoming a factor in value creation.

We are currently seeing a similar development in Japan. From being a laggard in the field of sustainability, Japan has recently been catching up rapidly. One reason seems to be the spillover of European ESG regulations into Japan, as companies and investors closely follow developments abroad. Among the first movers were listed real estate investment trusts (J-REITS), which increased their ESG focus under pressure from institutional investors. The next driver was the Japanese government's commitment in October 2020 to achieve net-zero greenhouse gas emissions by 2050. Since then, ESG has become a primary consideration for more and more other players in the investment community.

Japan stands out in two areas. It is a leader in supporting the Task Force on Climate-related Financial Disclosures (TCFD), an advisory body set up by the G20 to address concerns about companies' inadequate disclosure of climate-related risks and opportunities. As of July 2022, more than 1,000 Japanese companies have declared their intention to implement the TCFD's recommendations. Second, Japanese companies make up the largest group in the RE100 global corporate renewable energy initiative for companies committed to 100% renewable electricity, accounting for 15% of all RE100 companies. Thirteen of the 57 Japanese RE100 companies are in the real estate sector. Japan also ranks third in support of the Science Based Targets Initiative (SBTi), which sets science-based climate targets.

Similar to Germany, more emphasis is placed on the "E" in the Japanese real estate sector, as buildings are seen as one of the key factors for climate protection. Our Kensho Wohnen Japan Fund, a German special fund, will also receive a green building certificate from the Development Bank of Japan for at least 70% of its capital. The increasing importance of the "S" aspect is also reflected in the Kensho Fund - all buildings to be acquired will earn the "S" label. The German Federal Financial Supervisory Authority (BaFin) approved its placement as a "dark green" Article 9 fund based on an investment strategy that focuses on "affordable, comfortable housing" as defined in Japan's 2021 guidelines.

Japan's national "Basic Act for Housing" sets clear requirements for the minimum size of housing for singles, working couples, and families. For single-person households, the recommended minimum living space is 25 square meters. For multi-person households, it is 10 square meters plus an additional 10 square meters for each person. In addition, the maximum rent per square meter must be within a defined income target corridor. Accordingly, the Kensho fund will be invested exclusively in residential properties that allow single-person and multi-person households to rent at least the minimum suggested space or more with a rent burden of no more than 33% of their income.

As in Germany, existing ESG regulations in Japan are still fragmented, the legal language is sometimes imprecise, and cases of "greenwashing" fuel fears about the value of the new framework. But a growing number of real estate investors in Japan, both domestic and foreign, are integrating ESG due diligence into their business strategies to protect and enhance the value of their assets. Soon, German and Japanese real estate investors will be able to share best business practices in ESG adoption and compliance.

Leonard Meyer zu Brickwedde

Dr. Leonard Meyer zu Brickwedde
President and 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