KENSHO INVESTMENT GROUP

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CEO Insight: A world turned upside down: Japanese investors support Western real estate markets

The wave of overseas purchases by institutional investors from Japan is also the result of the foresight of the Bank of Japan, which has not been deterred by inflation.

The contrast between the real estate markets in Germany, the EU and the US on the one hand and Japan on the other could hardly be greater: According to the analytics company bulwiengesa, investment volumes in Germany have plunged by more than three-quarters this year compared with 2021, while valuations of office buildings in major US cities have fallen by up to almost 60%.

Meanwhile, institutional investors from Japan are going on a shopping spree abroad. Mitsubishi Estate just bought an office building in London's West End for a reported 150 million British pounds. Telecommunications provider KDDI acquired data centers in downtown Toronto for about 1 billion dollars. Mori Trust took over half of a skyscraper near Grand Central Station in New York for 680 million dollars.

In Germany, as in Japan, builders and project developers are suffering from sharp increases in labor, energy and material costs. But the key difference for their real estate markets is interest rates. The European Central Bank and the Federal Reserve Board have responded to soaring inflation with a rapid succession of interest rate hikes. This has literally frozen the real estate markets - buyers can no longer obtain capital cheaply, or their hands are tied because the proportion of real estate in their portfolios has grown beyond the allocation limit due to the decline in the value of their bond holdings. As a result, developers are sitting on their developed properties and cannot not start new projects because their capital is tied up in these projects.

The Bank of Japan, on the other hand, pursued a steady hand policy, sticking to negative interest rates and yield curve control. In its view, inflation was not caused by stronger demand, but largely by more expensive imports. The price for its consistent policy has been a sharp depreciation of its currency, the yen. But the economically important real estate market continues to function. Developers remain liquid and institutional investors can easily obtain financing. Although valuations are rising and yields are falling, the business is still profitable.

With the end of the pandemic, Japan's real estate investors are increasingly moving abroad. As a statistics from Bloomberg shows, the Japanese had invested US$ 7.4 billion abroad by the beginning of December 2023. This corresponds to around three times the average investment volume of the last 15 years. They are primarily looking to diversify away from their home market. Large private developers such as Mori Trust, Mitsubishi Estate and Mitsui Fudosan led the way, followed initially by the world's largest government pension fund, GPIF, and the banking division of Japan Post Holdings. Now, both institutional and private companies are seeking diversification through overseas real estate investments.

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The seemingly sudden surge in investment this year can be explained in part by capital reserves built up during the pandemic. Also, the wave of overseas purchases is due to the fact that, after about a decade of research and preparation, institutional investors have gained sufficient experience and established business relationships to find good properties abroad and acquire them at the desired conditions.

Japanese investors are ignoring the weak yen because they take a long-term view and rarely have had such good buying opportunities, as is the case now. Properties that under normal circumstances would be immediately added to the portfolios of major domestic investors are now within the reach of foreign buyers with sufficient liquid funds during the current crisis.

German developers, asset managers and vendors should welcome interested investors from Japan with open arms. They are not competitors and are not out to make a quick profit. They negotiate transparently, pay fair prices, invest their capital for the long term and seek harmony with the market and their partners.

I know this firsthand, as Kensho actively advises Japanese investors on how to enter the German market. After the Asian financial crisis in 1997/98, it was Anglo-Saxon investment banks and hedge funds that brought liquidity to Japan at deep discounts – now investors from Japan have taken on the role of saviors. Their capital is injecting fresh liquidity into the German real estate market and helping to restart the frozen market mechanisms.

At the same time, German investors should keep their eyes open for the favorable financing conditions in Japan, and look in particular at residential real estate, which continues to generate positive real returns despite rising inflation in Japan. The weak yen allows German and foreign investors to obtain low purchase prices and offers the chance of a lucrative bonus: As a result of the upcoming interest rate turnaround in Europe and the U.S., the yen will appreciate significantly and provide euro and dollar investors in Japanese real estate assets with high currency gains. But hurry: This window will close soon.

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