KENSHO INVESTMENT GROUP

February 15, 2024

CEO Insight: Blessed are those who are invested in Japan

Western investors are taking advantage of the strength and liquidity of Japan's property market. The current reluctance on the buyer side has no performance-specific causes, while sellers are benefiting from the stability of the market.

Under the headline " Japan real estate loses shine with foreign investors", the Japanese financial newspaper "Nikkei" reported at the beginning of last week on a decline in net foreign investment in 2023.

According to CBRE data, new investment fell by around 30% to 1 trillion yen (6.25 billion euro), while sales fell to 1.37 trillion yen (8.5 billion euro). This resulted in net sales of 370 billion yen (2.3 billion euros), the highest figure for five years. The total transaction volume of 3.8 trillion yen in 2023 remained almost at the previous year's level, and the share of foreigners fell by only four points to 26%.

However, we see the lower investment and higher sales as confirmation of the strength of the Japanese property market, particularly the continued availability of liquidity. This, together with the stability of the local market, is enabling foreign investors to cash in their high profits from previous transactions and achieve their desired prices. They face highly liquid buyers who can also easily finance the purchase of properties.

Blessed are those who are invested in Japan. They can either continue to enjoy positive real yields and look forward to the currency premium when the yen strengthens again. Or they can harvest their large gains by selling at any time. Either way, those who seized the Japan opportunity early on and believed in the value of diversification will be well rewarded.

Japan is and remains the only region where capital gains on real estate have not shrunk and, more importantly, where liquidity is abundant on both the debt and equity sides. This high liquidity, combined with a solid, strong property market with no capital depreciation, explains why some foreigners have liquidated some of their holdings in Japan.

It should be noted that the CBRE data refer to commercial properties. The large properties sold that the Nikkei article cites as examples are all in the office and hotel sectors. Meanwhile, demand in the residential sector remains strong, as we know from our own experience. Foreign investors are even buying each other's residential assets, such as in January, when Britain's M&G Real Estate bought Tokyo's Frontier Shinjuku Tower from LaSalle Investment Management for 30 billion yen (188 million euros) at a price of 9.8 million yen per square meter (61,000 euros).

Nikkei links the net sales to the prospect of rising interest rates. Apart from the fact that the financial market has been waiting for the first rate hike since the end of 2022, CBRE considers the potential impact to be small. In its Asia-Pacific Market Outlook 2024, CBRE writes that while the Bank of Japan could raise its key interest rate, "any increases are likely to be marginal and should not have much impact on investors' borrowing costs."

This view was confirmed a few days ago by Shinichi Uchida, Deputy Governor of the Bank of Japan. Uchida, the architect of monetary easing over the past decade, ruled out aggressive rate hikes like those in Europe and the US. "Even if the bank were to terminate the negative interest rate policy, it is hard to imagine a path in which it would then keep raising the interest rate rapidly," Uchida said.

Rather, other factors explain why foreigners are investing less in (commercial) property in Japan and selling more. First, many European, including German, and US investors have less capital to invest in Japan because of the problems in their property markets. Some investors are trying to limit their domestic losses by selling property in Japan, where prices remain high.

Second, many foreign investors are already positioning themselves for a recovery in their domestic markets if interest rates fall as expected later this year. There should then be many opportunities to acquire distressed properties at bargain prices. Investors who still have access to sources of liquidity and room to manoeuvre in their allocation ratios will therefore be more likely to take advantage of such opportunities than in Japan.

Finally, not entirely, but to a large extent, European and US investors are being replaced by Asian investors who are increasingly investing in Japan. In some cases, they are repatriating funds from the US via Japan to take advantage of what they see as a much too weak Japanese yen. We can confirm this trend from our own experience with such investors. The Japanese residential property market therefore continues to shine in all its glory. It should be still worth getting into, and the currency bonus is still virtually guaranteed.

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