KENSHO INVESTMENT GROUP

May 15, 2024

CEO Insight: Japan's institutional property market reaches full maturity

In pursuit of greater capital efficiency, more and more Japanese companies are selling land and buildings. This is likely to triple the market volume.

In the historic heart of Edo, as Tokyo was known before 1868, the railroad and hotel group Seibu built the multi-purpose Tokyo Garden Terrace Kioicho complex in 2016, consisting of a 36-storey building with offices, stores and a hotel and a 21-storey tower with 135 apartments. Seibu is now actively seeking a buyer for the complex, which was built on the valuable site of the former Grand Prince Hotel Akasaka. Experts estimate the potential proceeds to be at least 300 billion yen (1.8 billion euros). It would be one of the largest real estate transactions in Japan.

Seibu is not alone in its sales plan. More and more companies are putting their often not self-utilized real estate assets up for sale. For example, Mitsubishi Heavy Industries, the steel manufacturer JFE, and the car manufacturer Hino sold former factory premises. In response to the reforms in corporate governance over the past ten years, group management are focusing on their core businesses. With the help of their real estate holdings, they can elegantly improve capital efficiency. Commercial real estate yields a meager average annual return of 3%. On the other hand, selling properties not only brings a lot of money into the coffers but often also allows high book profits to be realized. Seibu, for example, wants to increase its return on equity from the expected 5.9% this year to over 10%.

The reduction in the real estate assets of Japan's major companies represents the final step in the maturing process of the market for institutional investors in Japan. According to estimates, real estate worth the equivalent of 400 billion euros could come onto the market for the first time. The current institutional market volume of 200 billion euros would therefore triple to 600 billion euros.

The pent-up demand for real estate investments among institutional investors is huge, meaning that the additional volume can be easily digested. The four “big whales” alone - the state pension funds, Japan Post Bank, and Japan Post Insurance - have total assets of over 3,000 billion euros to manage. As Japanese institutional investors have only been investing in real estate since around 2016, their real estate ratio is still below 3%. By comparison, European insurers and pension funds allocate about 10% to real estate investments.

Even traditional real estate developers now feel under pressure to deliver more to their shareholders. As a result, they are even questioning their current business model, according to which the properties they build are held for the long term and their income is used for cash flow. Mitsui Fudosan, the largest developer in Japan in terms of market capitalization, announced the sale of its own real estate and other fixed assets for a total of 2 trillion yen (12 billion euros) over the next three years.

>>>

In doing so, Mitsui Fudosan is turning previously hidden assets worth billions on its balance sheet into cash. For example, the 54-story Tokyo Midtown skyscraper with offices, Ritz-Carlton hotel, and lots of retail shops in the heart of the Japanese capital: the Mitsui balance sheet shows a book value of 190 billion yen, depressed by the low costs of land and depreciation on the construction since the inauguration in 2007. But the current market value is estimated at 500 billion yen, which is 2.6 times higher.

This is not an isolated case: according to an analysis by investment bank CLSA, there is a huge gap of 22 trillion yen (134 billion euros) between the book value and market value of real estate on the balance sheets of listed companies in Japan. CLSA puts the book value at 44 trillion and the market value at 66 trillion yen. This is because many companies have long since written off their real estate, while the prices of land and buildings have risen sharply, especially after the Great Financial Crisis. For example, the development giant Mitsubishi Estate, whose predecessor acquired the entire area of today's Marunouchi banking district over a century ago. The group still owns many of the plots and buildings today. The 22-year-old Marunouchi Building at Tokyo Station, for example, is valued at 100 billion yen on Mitsubishi's balance sheet but is now worth more than five times that amount at 570 billion yen.

While at Mitsui Fudosan it was Elliott Management, an activist hedge fund from the USA, that pushed for bringing hidden balance sheet treasures to light, Japanese investors are also likely to increasingly push company managements to sell unprofitable real estate outside their core businesses and use the capital gains for special dividends and share buybacks. After its beginnings around 25 years ago, Japan's real estate market for institutional investors is thus finally reaching the same level of maturity as the much older markets in Germany, Europe, and the USA.

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