GLOBAL VIEW

Walter Reiner

Watch for Opportunities in Japan

The Japanese real estate market is governed by complex factors like no other country. That being the case, to see clearly the investment potential that is emerging there, one must look at it in the light of past forces.

In 1989, when I visited the Asia Pacific Real Estate Conference in Japan, I saw the industry there had created a land-backed cash machine that seemed to defy economics and was not subject to international market intervention. At the time, the theoretical value of Japanese land surpassed that of the U.S. by four times. Sixty percent of Tokyo land was owned by corporations. Banks and insurers would lend at fair-market value to corporations against their stock portfolios, which included the value of their real estate. The amount of bank debt, collateralized directly or indirectly by real estate, was 30% or more.

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The big corporations in Japan, by the way, prefer to have their shares held by creditors and *keirtsu*—corporate members of industrial families—as well as by suppliers, customers and partners. In fact, at the time of my visit, 70% of all major corporate equity was held by other corporations. To a large extent, "land money" was responsible for bringing investors in and creating high stock prices. Real estate assets held by Japanese companies grew about $2 trillion between 1985 and 1989, an amount equal to one-half of the value of the Tokyo stock exchange. And straight across the board, real estate values increased as much as 68% in 1986.

Hajime Tsuboi, chairman of Mitsui Real Estate, said at the time that "the Japanese accounted for 30% of the world's money markets, bought 33% of U.S. treasury bonds and had national assets of $43.7 trillion." He further noted that Japan had a stock market value of $3.6 trillion, which was 1.5 times that of the New York Stock Exchange.

Finally, who could forget that, in the 1980s, Japanese companies were buying trophy buildings in New York City and elsewhere.

I remember sitting at the conference amazed and impressed, wondering how all this could be. In 1991, government officials would say they could not put Tokyo's Shidome rail yard on the market yet because, "it is too valuable. Its sudden availability to speculators would bid up real estate prices too high." Japan had leveraged its national real estate to achieve international dominance.

That's the history. Fast-forward a decade and see how the mighty have fallen. U.S. investors today have their first real opportunity to own real estate in the world's second largest economy. Here's why:

First, there is residential and commercial land deflation in Japan. Tokyo commercial land dropped 6% in 1992; 19% in 1993; 18% in 1994; 15% in 1995; 17% in 1996; and 13% in 1997. Central district land prices indicate a drop of 16.5%. The Japanese, by the way, measure land in *tsubo*, which is equal to a sleeping mat of 3.3 square meters. Land with an area of 50 to 100 tsubo dropped 17.6%.

Estimated yields for office building sales are 3.5% in the Chuo ward of the Ginza district; 5.2% for a Minato ward sale in the Roppongi district; and 3.6% for a Shinjuku Honsho-Cho office building. That asset, which sold for 2.05 billion yen ($15.77 million) and measured 800 tsubo (23,750 square feet), was completed in 1996.

Second, the dollar is fairly strong against the yen, making now a favorable time for investment.

Third—and this is really the big story for 1998—will be the deregulation of the financial system in which banks will have to recognize more than 20 billion in bad loans on their books, many of which are real estate related, prompting study of a solution similar to our resolution-trust approach to the problem. (Keep in mind that other countries—including Mexico—have adopted copycat RTCs to deal with devaluation.)

It should be noted that there is some good that could come out of the Asian turmoil. That is that the continent's economic philosophy, riddled with cronyism, may have to change. Pension funds are under-financed because they have been earning too little on their Japanese assets. After years of secrecy, the Japanese Ministry of Finance has disclosed $577.5 billion in bad or possible problem loans. Proportionately, this is not much larger than the U.S. savings-and-loan debacle.

Finally, up to 75% of leading Japanese companies are not showing a profit in the way we define it based on U.S. accounting principals. But deregulation could force them to streamline.

The Japanese government seems prepared to cut taxes and boost spending to restart the economy. With a deficit proportionate to that of the U.S. in 1993, this jump start is possible.

The Japanese have been resistant to foreigners entering the market. Yet the deregulation of the financial sector in April could unleash enormous energy. But given its apparent willingness to change in the face of its economic crisis, now is the time for foreign investors to get in on the ground floor. ■

***Walter Reiner** is president of the Ohio council of FIABCI USA, the International Real Estate Federation's U.S. chapter. He is also president of Reiner Realty & Consultants Inc. in Columbus, Ohio.*