

# Market Outlook Japan

## Seven good reasons to invest in Japanese real estate now

Tokyo, January 9th, 2018

*2017 has been a good year for Japan – First German Spezialfonds for Japan Estate launched*

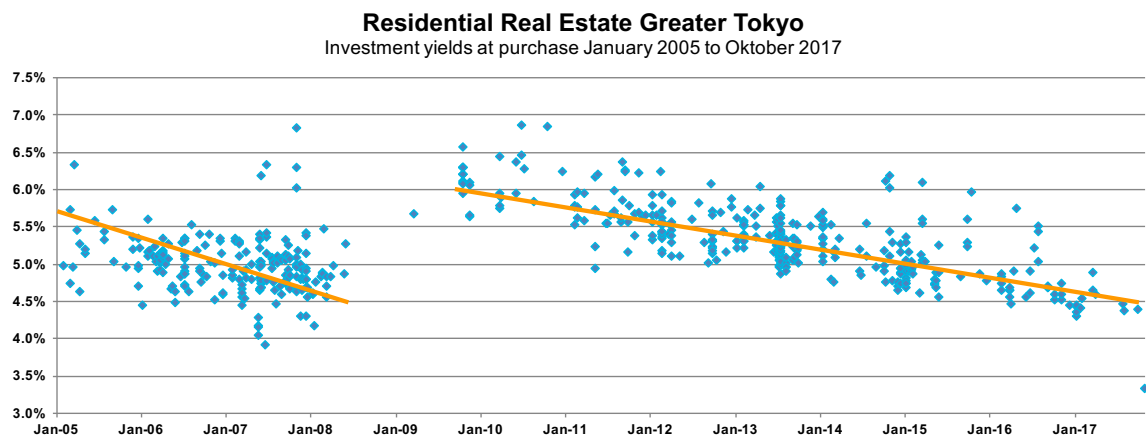
The spirit of optimism sparked by Prime Minister Shinzo Abe in 2013 has now spread throughout Japan. All sectors of Japanese society are pulling together to once again make their nation a leading economic force.

Japan's leading share index, the Nikkei 225, rose by 19% in 2017, thanks mainly to foreign investors, who helped propel it to its highest level since the beginning of 1992.

It was amid this positive atmosphere that the **Kenzo Japan Residential Fund** was launched in July – the first German real estate Spezialfonds (fund targeting institutional investors) interested in Japanese residential properties.

*In our opinion, 2018 will be another good year for Japanese real estate.*

First, some important background information: Even though Japan real estate prices have recently reached levels similar to that seen during the 2007/8 real estate boom (see below chart), the environment then contrasted dramatically from the one of today. Those differences are illustrated by the following seven factors:



Each blue dot represents a purchase of residential real estate by a J-REIT (exchange traded real estate investment trust)

### 1. *Japan's elite pursues a vision of the future*

For the first time in decades, Japanese bureaucrats, managers and politicians share a common vision – to modernize the economy and establish Japan as a leading global player.

Under the slogan “Society 5.0”, Japan intends to harness digitization as a means to accelerate globalization and to address the challenges posed by the country's rapidly aging population.

Once a consensus has been reached among, there is every indication that it will be implemented smoothly and consistently in terms of policy. By contrast, the Japan of ten years ago was politically weak and divided.

An example of this new, consistent, approach is the decline in the proportion of reciprocal shareholdings held by enterprises. According to the investment bank Nomura, the rate had shrunk to around 10% by the end of March 2017.

By contrast, the figure stood at 50% a decade ago. This means that the companies of today are almost free of conflicts of interest as they plan their future strategy.

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### *2. The long economic upswing will continue*

In each of the seven quarters from Q1 2016 to Q3 2017, Japan's real gross domestic product (GDP) grew compared to the previous quarter, marking the second longest period of recovery in the post-war period.

In 2017, nominal GDP rose to a record high, and Japan's government expects real GDP growth of 1.8% in 2018.

In just under five years, the Bank of Japan has bought more than 40% of Japanese government bonds and, in so doing, chased away the specter of state insolvency. Contrast that with the situation ten years ago, when high levels of government debt made headlines around the world.

### *3. Japan's economic strength finally recognized*

Japan's experience proves that economic growth is possible in a country with an aging and declining population, according to Daniel Gros, Director of the Centre for European Policy Studies ([Source](#)).

As evidence, Gros cites figures showing that since 2000, Japan's GDP has risen annually by just under 2%, if calculated per person of working age (15-64 years). This growth rate was twice as high as in the US.

Gros says Japan accomplished this feat because almost 80% of its working population is in employment. In Europe and the US, the share is lower, at about 70%. The situation in Japan was very different ten years ago, when it was regarded as the "sick man" of the global economy.

### *4. Political stability expected beyond the 2020 Olympics*

Prime Minister Abe's Liberal Democratic Party won a resounding election victory in October 2017 – a result that again gave his coalition government a two-thirds majority in both houses of parliament.

Voters have given Abe another four years to continue his economic reforms – known as "Abenomics" – up to and beyond the Tokyo 2020 Olympics.

For investors, this means a stable economic and political landscape over the long term. This contrasts with the instability of a decade ago, when Japanese prime ministers came and went so frequently that people were barely given enough time to remember their names.

### *5. Japan shakes off deflation*

Despite rising US interest rates and the European Central Bank's decision to taper monetary stimulus, Japan's central bank intends to maintain its extremely expansionary monetary policy until deflation is finally erased. The inflation rate climbed to 0.9% in November, the 11th consecutive monthly rise.

As a result of the continuing labor shortages, 2018 is expected to see stronger wage increases than before, and the long coveted virtuous cycle of higher prices, rising wages and healthier household consumption and capital expenditure is expected to be set in motion, albeit slowly. Ten years ago, by contrast, the Bank of Japan raised interest rates too early, and was later forced to correct itself.

### *6. Long-term oriented real estate investors dominate*

Domestic investors are shaping Japan's real estate market. Increasing inflows of capital come from domestic institutional investors, including insurance companies and pension funds, both of which invest in the long term.

This trend is supported politically, as the government calls on pension funds to change their risk orientation. This demonstrates a significant departure from the situation 10 years ago, when the market was dominated by short-term investments by overseas players.

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### *7. Real estate investments are financed conservatively*

For some time, borrowed funds have financed 60% to 70% of real estate transactions in Japan, which means they rest on solid foundations. That is a significantly lower proportion than the 80% to 95% of deal volumes financed with outside funds and securitized on the capital market seen ten years ago.

#### **Our conclusion:**

The current investment environment for Japanese real estate is far better than that during the mini-boom of ten years ago. There can be no talk of a bubble in the current context.

Rather, we expect a further rise in real estate prices in the coming years and a decline in risk premiums on real estate investments, despite rising rents in the residential and office sectors.

Our confidence in this environment is reflected by the Kenzo Japan Residential Fund, which on December 21 successfully acquired four more properties and increased its investment volume by JPY 4 billion (EUR 33 million).

As part of our Active Asset Management Strategy, we acquired three residential properties in Tokyo comprising 80 residential and five retail units. The fourth property containing 90 apartments, at risk class core, is located in Osaka.

The investment pipeline is already primed with up to JPY 6 billion (EUR 50 million) for our next purchase, scheduled for the first quarter of 2018.

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