


Is Long Term Lease Really a Low Risk?

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Since the introduction of “fixed term lease system”, a long lease term contract like Western countries, is now possible in Japan. This is expected to promote further liquidation of the Japanese real estate market and lower the investment risk. However, does a long lease contract mean lower risk and a short 2-year lease term mean higher risk as often said?

Japanese lease term is very favourable to the tenants. The contract term is 2 years, and the tenant can terminate the lease at any time with 6 months notice. Also, the tenant can re-negotiate the rent if it feels the rent is higher than the market level. This will not be the case, if the fixed term lease system is applied. The lease term will be long and fixed, and rent will be non-negotiable, which is a condition that makes investors and building owners very happy.

Current Japanese fixed term lease have been around 3 to 10 years, which is still short compared to the long lease term of 10 to 20 years of the US.

However, if this term becomes long, tenants are likely to request many rights and options that are very common in the American leasing market.

For example, in the US, tenants committing to longer lease terms that are concerned about accommodating future increases in staff size will negotiate for options for expanding its leased space. To accommodate such a clause the landlord, in some cases, will need to negotiate relocation clauses with other tenants occupying potential expansion space. To cover possible downside scenarios, tenants will negotiate for lease assignment and sublease rights. In the future, Japan, like the US, could have a considerable amount of sublease space available in the market.

A long remaining lease term for unwanted space will result in other issues and negotiations common in the US. If a tenant vacates the space and defaults in the payment of rent, can the landlord sue for the entire remaining balance or will it be restricted by the concept of “mitigating damages” meaning that it must first make a reasonable effort to release the space? A common negotiation is for both sides to agree to a lease buyout based on estimates of discounted value of the difference between the contract rent and the perceived market rate.

Many international investors seem to be very concerned about the Japanese 2-year lease term, however, we believe that the US long term lease contract also has its own risk with complicating the lease conditions and structures. In the case of Japan, even though the term is 2 years, the tenant makes an initial investment to the office area by bearing the construction fee, and it is very uncommon to see tenants moving out in two years. Also, relocating to another building is very costly operation, and tenants are not encouraged to do so, especially in this Japanese economical state.

We see the average tenant occupancy to be around 7 to 8 years, from the tenant history of the buildings we invested and building we considered about investing in the past.

So, the investors should not have to be intimidated by the “2 years lease term”. Tenants do not hop in and out of the buildings every other year in Japan.

However, if you are still frightened by the term “2 years”, more frightening fact is that Japanese lease term really is “6 months”. Technically speaking, tenants could move in and out of the building every 6 months, if they notify the landlord on the day they moved in.