

Koizumi's Structural Reform and Real Estate Market

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The basic policy of Koizumi Cabinet, “Economics and Financial Policy”, has been announced. The policy is very reasonable and I would give it an “A” for content, if the Cabinet can carry them out. This policy is “reform” not “revolution”, so we cannot expect an overnight change. However, it is important to see how this will affect the Japanese real estate market.

The fundamental of this policy is an “efficient economic society”. The problem of Japanese economy is that the cash flow, the blood stream of economy, is not flowing. Reasons behind this failure are:

- 1) Banks low credit due to the large NPL
- 2) Inefficient investment caused by “treasury investment and loan”
- 3) Inefficient national budget allocation e.g. “revenue for road construction”
- 4) Loss of urban function

The efficient systems of 1960s and 70s are now totally out of date and creating a low investment return and weakening the competitive power of Japan in the world wide market. Revival of these efficiencies are the intention of Koizumi's reform.

What would this reform mean to real estate market?

In the macro view, it would have positive affect on the Japanese real estate market. If 10% of national asset is utilized efficiently (100% is impossible and there is no need for that), it would have an enormous affect on the market, and Japanese economy will grow dramatically as the US did in the 1990s. The national financial assets under government's management, including postal saving, postal life insurance, and welfare pension, is now over 400 trillion yen, and mere 10% will amount to 40 trillion yen! If this is invested effectively, the positive impact will be far greater than introducing a special budget for economic recovery.

However, a micro approach is not that bright. Inefficiency is one of the investment opportunities in various fields, including the real estate. There are two completely different aspects to the inefficiency in real estate market. Inefficiency can bring both “over value” and “under value”. The typical examples of undervalued properties are retails and hotels. This is caused by the

inefficient management of the tenants, therefore value can be added by improving the operation and cutting costs. On the other hand, an example of over valued real estate property is class A office buildings in central Tokyo. This is brought about by the inefficient use of land in Tokyo. When redevelopment (i.e. efficient use of land) is promoted, the rent of prime Tokyo office buildings will face considerable down side risks. The currently over valued transactions of class A buildings are not reflecting this risk at all.

How about the demand and supply balance approach? The banks will dispose their bad loans in 2 to 3 years, and corporate Japan will focus on creating an efficient balance sheet, creating a pressure on supply side. However, potential funds for real estate investment is enormous, and it is unlikely that capital will be scarce in near future from the demand and supply point of view. Investment efficiency, as I mentioned earlier, will contribute to the steady growth of real estate investment capital.

The “Structural Reform” of Koizumi Cabinet is aiming to achieve a “fundamental reform”. We should not focus merely on the positive expectation of macro recovery, but study the micro impact when creating a investment strategy.