

Topics

Japanese Structural Changes

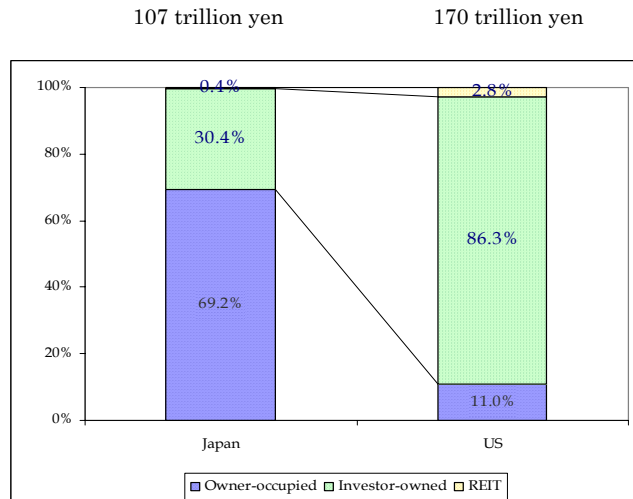
Vol.2 Asset Holding Structures

Changes in Asset Holding Structures

The series of three “Topics”, named “Changes in the Japanese Structure”, will explore structural changes that are impacting Japan currently, including land prices, asset holding structures and capital flows.

The second issue of the series deals with asset holding structures. Generally speaking, the majority of assets are used by their owners (so-called “owner-occupied buildings”) in Japan. Figure (1) below is the comparison of asset holding structures between Japan and the U.S., which shows a much higher rate of owner-occupied buildings in Japan. We calculate that the aggregate market value of office buildings in Japan totals 107 trillion yen, which is approximately 60% of that of the U.S. (170 trillion yen). However, in respect to “owner occupied buildings”, the amount totals 75 trillion yen in Japan, which is four times as much as that in the U.S. (19 trillion yen).

Figure1: Asset (office building) Holding Structures of Japan and the U.S.



Source: Land, Infrastructure and Transportation Ministry, Prudential Realty, NAREIT, and estimates based on NREIM data

Will asset holding structures change in the future? I will discuss this particular issue by comparing it to the stock market.

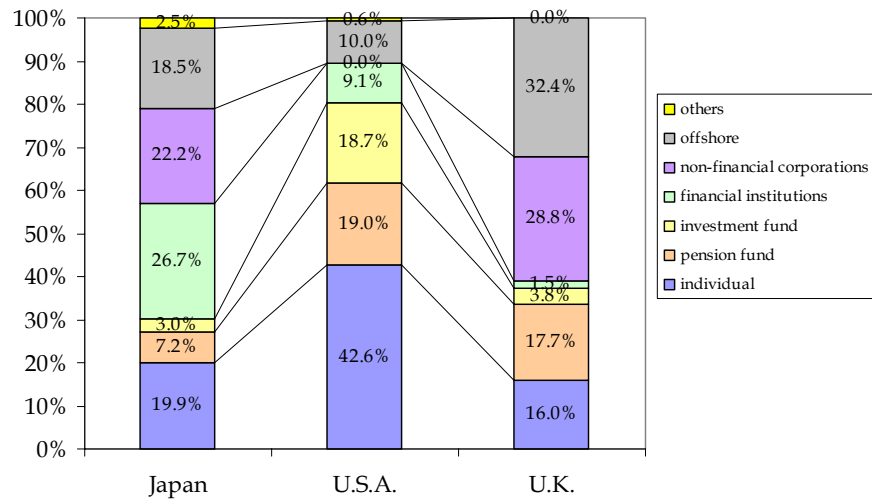
The asset holding structure in Japan can be characterized as (1) a high holding percentage by financial institutions and non-financial corporations caused by “cross-holding of shares”, (2) a low holding percentage by individuals and their funds (i.e. pension funds and investment trusts), and (3) a low holding percentage by offshore investors, compared with the U.K. (Note: The reason behind the comparison with the U.K. is that the main actor in the global market is American investors, thus the U.K. is appropriate to compare this issue.)

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Topics

Japanese Structural Changes

Figure2: Stock Holding Structures by Sectors (Japan, U.S., U.K.)



Source: Bank of Japan

However, these characteristics are likely to change in the near future. There is a growing concern that price fluctuations in stock prices could risk management’s continued control due to the implementation of impairment accounting and market-to-market accounting systems. Issuing entities are beginning to recognize that such growing concerns will discourage cross-holding of stocks, and therefore, securing individuals, pension funds, investment trusts and offshore investors is crucial to stable management for the future.

Will a similar trend be seen in the real estate market? The answer is “Yes”. Disposals of real estate holdings by corporations and financial institutions are increasing due to two major reasons. There is a growing concern for (1) price fluctuation risks, as is the case in the stock market, and (2) accountability of corporations (i.e. if a corporation occupies its own building, the corporation has to justify the reason).

But, who would be the buyer? Along with the case of the stock market, individuals, pension funds, investment trusts and offshore investors are the players expected. The real estate market has been closed to only limited players for a long time. In order to transit itself to an open market, it is necessary to attract funds from these sources.

What is necessary to encourage these players to increase their involvement in the real estate market? The Japanese real estate market has been generally said to have “poor transparency (the market is cloaked in secrecy and difficult to understand)” and “poor liquidity (the market is not prepared for players with high concerns about exit strategies)”. These are major reasons why investors have generally avoided participating in the Japanese market.

As for “transparency”, it is being improved. As J-REIT, which discloses information on its acquisitions and cash-flows, increases its presence in the market, transparency of the market is steadily improving. Moreover, several research institutions have developed and publicized real estate indices, and as a result, criterion for investors’ decision making has been enhanced.

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## Topics

Japanese Structural  
Changes

How is the situation of “liquidity”? Figure (3) shows a comparison of liquidity between Japan and the U.S.

Figure 3: Liquidity of the Japanese and American Markets

	Volume of Trading (trillion yen)			Trading Value (trillion yen)			Turnover Rate (%)		
	Japan	(Tokyo)	U.S.A	Japan	(Tokyo)	U.S.A	Japan	(Tokyo)	U.S.A
Office	107.2	49.0	170.2	2.19	1.66	5.77	2.04	3.39	3.39
Residential	67.1	23.6	216.2	0.75	0.53	2.77	1.12	2.24	1.28
Retail	31.3	5.6	169.1	0.76	0.33	3.84	2.44	5.88	2.27
Industrial	26.2	2.5	130.0	0.10	0.03	1.32	0.39	1.25	1.02
Hotel	6.9	1.7	43.7	0.12	0.02	na	1.76	1.20	na
Total	238.7	82.4	729.1	3.92	2.57	13.70	1.64	3.12	2.00

Source: Nikkei BP, Prudential Real Estate, Real Capital Analytics and estimates based on NREIM data

According to our estimation, the liquidity of the Japanese real estate market is 60% of that of the U.S., however, that of Tokyo is almost equivalent to the level of liquidity in the U.S. Thus, “liquidity” is also improving, as transfers of real estate are increasing. The gap between the U.S. and Japan seems to be shrinking (please refer our “Review” scheduled to publish in August for details).

Taking all of the above into concern, the basis for change of asset holding structures seems to be steadily improving.

Currently, Japan’s 1,400 trillion yen of individual financial assets and capital from all over the world are having difficulty in finding places to invest. As the Japanese real estate market loses its mysterious image and more of its institutions realize that real estate is a key financial product similar to stocks and bonds, an immense amount of individual and offshore capital can be expected to surge into Japanese real estate.

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