

## The Apartment Sector in the United States Implications for the Japanese Market

The United States was the first country to introduce securitization as a means of promoting the liquidity of its real estate markets, and when we consider the length of its experience with apartment investment markets, it is clear that any attempt to forecast future trends in the Japanese apartment market should begin with a careful analysis of the US housing sector. The average market capitalization of each of the top three apartment REITs in the United States is 1.76 trillion yen, which is about ten times larger than the biggest apartment REIT in Japan. In terms of units under management, the top US apartment REITs are at about the 200,000 unit level, which is two orders of magnitude larger than the typical apartment REITs in Japan, which typically own only a few thousand units. Moreover, the number of large-scale properties differs significantly between the two countries, with major REITs in the US having an average of 277 units per property, while the average for apartment REITs in Japan is still counted in the tens of units per property. As a result, the average price per property is also greater, averaging 2.7 billion yen in the US, but only 1~2 billion yen in Japan. Given this background, we conducted an analysis of US apartment REITs, and examined the implications of our findings for the apartment sector in Japan.

The Japanese apartment REIT sector is not very popular these days. However, our analysis of the performance of the Office, Apartment, Retail and Logistics sectors in the US real estate market revealed that while apartments were outperformed by other sectors over a 5-year or 10-year time frame, over a 25-year time frame the total return from apartments exceeded all other real estate sectors. The standard deviations also showed clearly that for all three time periods examined (5-, 10-, and 25-years), risks were significantly smaller and performance was more stable in the apartment sector. An analysis of average rents in Japan over the last 20 years demonstrated that the range of fluctuation in the apartment sector was only one-third that of the office sector, indicating that at least so far as stability is concerned, long term trends in Japan match those in the United States. Taken together, these results suggest that if stable long-term returns are a primary management goal, we may want to take a fresh look at the potential of Japanese apartment REITs.

In Japan today adequate indices are not yet available for evaluation of the various geographical sub-markets in the apartment sector. Therefore differences among the various apartment REITs remain unclear, with the result that all the different companies tend to be lumped together in the same basket. In the US market, however, data on vacancy rates, average rents, and NOI growth are available for all of the major apartment REIT sub-markets. By comparing the performance of the various companies relative to these indices it is possible to make a quantitative analysis of the profitability of each REIT, and to evaluate the abilities of their respective management teams. We expect that these types of sub-market indices will also become available in Japan over the next three or four years. When this happens, differences in management ability will become clear, and the market will begin the process of sorting out the winners from the losers.

We predict that in ten years the size of the apartment REIT market in Japan will reach 2.4 trillion yen. This represents an eight-fold increase compared with the size of today's market, which has an estimated market capitalization of around 300 billion yen. Our models indicate that ten years from now the top player in Japan will have a Market Capitalization of 550 billion yen, and will have a total of 22,000 units under management. The second largest player will have a Market Capitalization of 450 billion, with 18,000 units under management, and the number three REIT will have a Market Capitalization of 330 billion yen, and will own 13,000 units. If we consider the top three REITs as representing the eventual winners in this market, in order to survive, each of these top three will need to achieve a target Market Capitalization of at least 330 billion yen, which means that they will each need to acquire at least 30 billion yen of properties each year over the next ten years. Companies that are unable to accomplish this on their own will likely have to acquire or merge with other companies. We estimate that the apartment REIT market in Japan will expand eight-fold toward a target market capitalization of 2.4 trillion yen, and that it will eventually be recognized as a sector with risk/reward characteristics distinct from those in the Office, Retail or other real estate sectors.