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# Japanese real estate's investment appeal from a global perspective

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## Executive Summary



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*With housing price indices rising globally, the Japanese real estate market appears to have been bypassed by the boom. However, an international comparison of real estate's investment appeal reveals that Japanese real estate is still a bargain from the standpoint of economic fundamentals. It offers attractive yields by virtue of being relatively inexpensive per unit of floor area.*

### NOTE

1) <https://www.imf.org/external/research/housing/>

### Japan is lagging behind resurgent global housing markets

The International Monetary Fund (IMF) launched Global Housing Watch<sup>1)</sup> on its website in June 2014. Global Housing Watch publishes diverse content in light of the lessons learned from the 2008 global financial crisis that originated in the US housing market, including data and information on housing markets in countries throughout the world, analysis thereof, and commentary on policy measures' effectiveness.

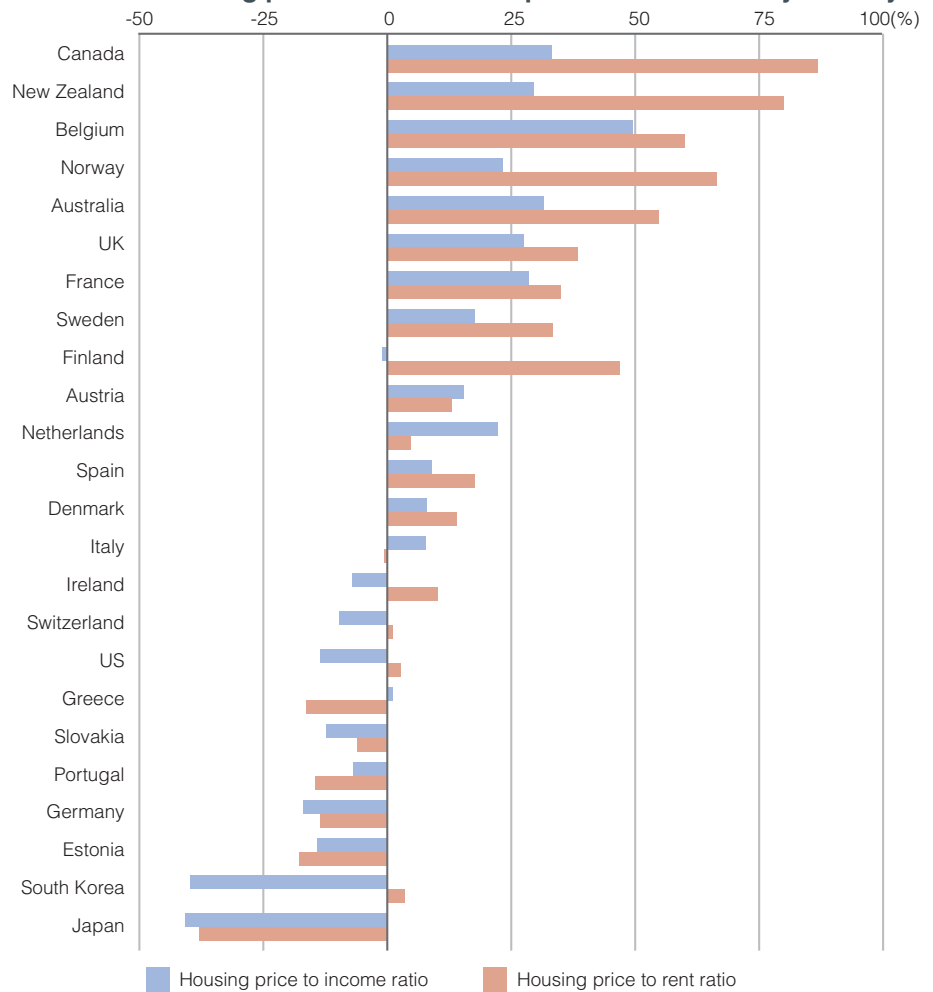
In 2013, housing prices rose in 33 of 52 countries tracked by Global Housing Watch. The GDP-weighted Global House Price Index resumed rising from the second quarter of 2012. It has risen for seven consecutive quarters through the fourth quarter of 2013, the latest quarter in the data series. Although the index has yet to recover to its 2008 pre-crisis level, housing markets have re-embarked on an appreciation trend globally.

Japanese housing prices, however, were down 1.93% year on year in the fourth quarter of 2013. Of the 52 countries tracked by Global Housing Watch, Japan was ranked 38th by year-on-year change in housing prices. Japan appears to be left out of a renewed global real estate boom.

### Japanese housing is a bargain from standpoint of fundamentals

A real estate bubble is generally defined as an upside deviation in real estate prices from their underlying economic fundamentals. The IMF's Global Housing Watch monitors whether housing prices have deviated from economic fundamentals by updating housing price-to-rent and price-to-income ratios on a country-by-country basis to identify signs of real estate bubbles.

**Exhibit 1. Housing price-to-income and price-to-rent ratios by country**



Note: Ratio values are plotted above as deviations from their respective historical averages. Data are the latest available (2013:Q4 in most cases).  
 Source: IMF Global Housing Watch

Exhibit 1 compares housing price-to-rent and price-to-income ratios among countries by plotting the ratios' deviation from their respective historical averages. A positive (negative) deviation means that housing is overpriced (underpriced) relative to its historical norm. As of the fourth quarter of 2013, housing was overpriced in most of the countries. In many of the countries, housing prices are not affordable from the standpoint of income levels and pose downside risk from the standpoint of rent levels. Japan, however, has the world's most underpriced housing in terms of both price-to-rent and price-to-income ratios. At present, Japanese housing appears to be a bargain from the standpoint of economic fundamentals.

The housing price-to-rent ratio is conceptually analogous to the price/earnings (P/E) ratio in the equity market. It is the inverse of real estate rental yield. Japanese

housing's price-to-rent ratio as of the fourth quarter of 2013 was well below its historical average, making Japan the world's most attractive housing market from the standpoint of rental yield. In general, investors that globally invest in real estate often use the spread between real estate's rental yield and a benchmark long-term bond yield as a valuation metric. With Japanese long-term bonds yields stuck at extremely low levels, Japanese housing has substantial investment appeal from the standpoint of this yield spread.

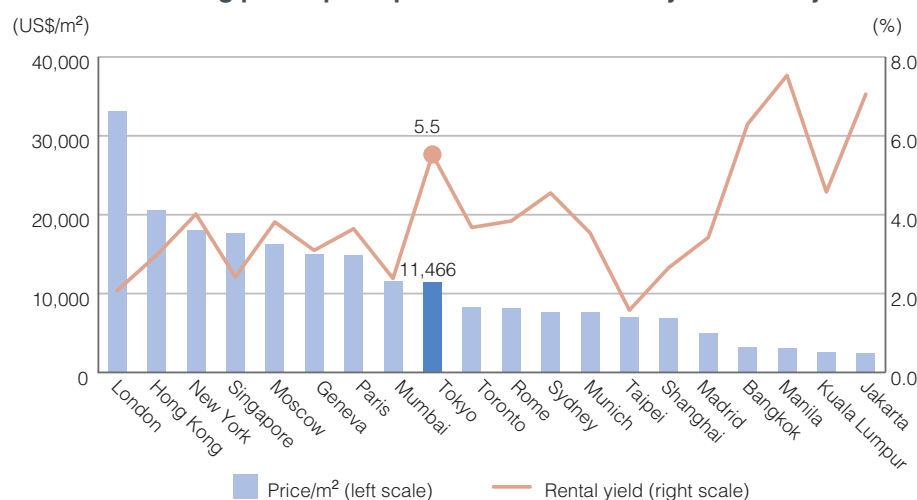
### Japanese real estate is attractive in terms of price per unit of area also

Next we look at Japanese real estate in terms of its price per unit of floor area. People looking to purchase a home are more likely to compare properties in terms of price per unit of floor area (e.g., square meter) than the yield they could earn from renting the property. Because real estate is a highly individualistic physical asset that cannot easily be subdivided, price per unit of area is generally an easily understandable metric for comparing multiple properties with different prices and floor areas<sup>2)</sup>. In fact, when viewed in terms of price per square meter, Japanese real estate's appeal becomes even more apparent. Exhibit 2 plots prices per square meter and rental yields of equivalently sized condominiums located in prime areas of major cities around the world<sup>3)</sup>. Tokyo properties are less expensive per square meter than properties in not only London and New York but also Hong Kong and Singapore, partly by virtue of deflation and yen depreciation. In other words, overseas investors can invest less capital and earn higher rental yields in Tokyo than in other cities.

2) Strictly speaking, real estate's price per unit of area, unit rental rate and expected yield are all closely related. Accordingly, we are merely looking at real estate's investment appeal from different perspectives.

3) As a general rule, the data in Exhibit 2 pertain to 120m<sup>2</sup> condominiums in prime areas of each city as of 2013. Examples of prime areas include Chiyoda, Minato and Shibuya Wards in Tokyo and lower Manhattan in New York.

**Exhibit 2. Housing prices per square meter and rental yields in major cities**



Source: NRI, based on Global Property Guide

Recently, there have been many media reports of overseas investors actively investing in Japanese real estate. Such investments include not only purchases of large office buildings by overseas institutional investors but also investments in luxury condominiums by wealthy individuals from Asia in particular. In fact, many overseas investors have commented that, "Tokyo real estate is cheap," implying that they analyze properties in terms of not only rental yield but also price per unit of area.

In sum, real estate is cheaper in Japan than in other countries around the world. Japanese real estate offers a hefty yield premium to long-term bonds and is inexpensively priced per unit of floor area also. Instead of making real estate investment decisions based solely on the domestic real estate market, Japanese investors should compare the domestic market with overseas real estate markets. Doing so would enable them to better understand the mindset of a growing legion of overseas investors and to recognize Japanese real estate's true investment appeal.

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