

BRIEF | Japan | Intelligent Investment

Impending end to negative interest rate policy to have limited impact on Japan's real estate investment market

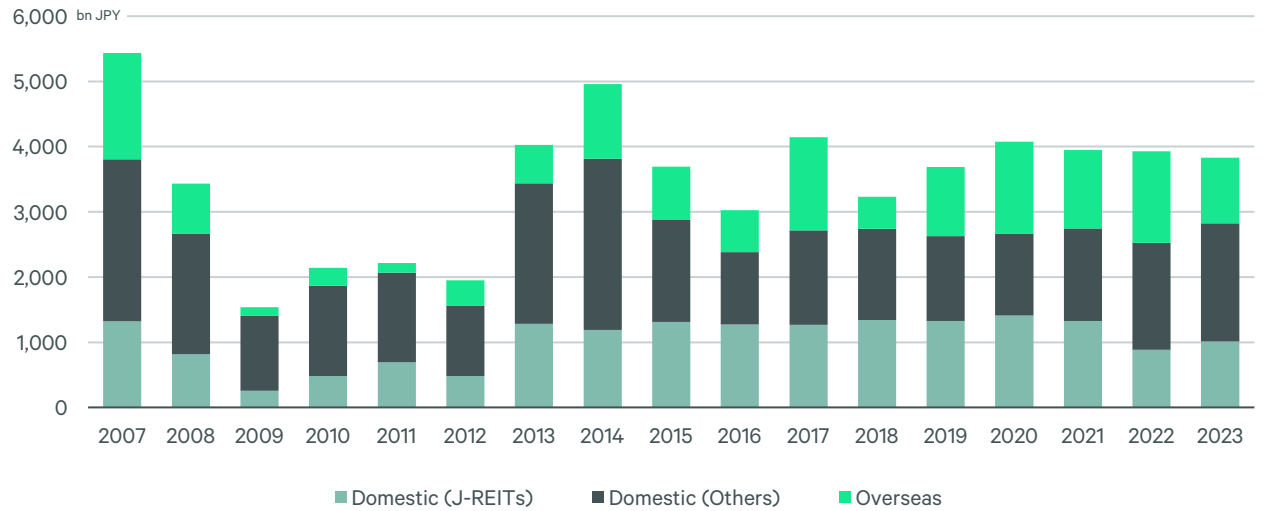
By Chinatsu Hani, March 2024

Following recent statements made by Governor Kuroda and Policy Board members, the Bank of Japan (BoJ) will likely lift its negative interest rate policy at the policy meetings in March or April. While the BoJ's decision to transition from the ultra-easy monetary policy that it has maintained for over a decade represents a significant milestone, CBRE does not anticipate a major change in real estate investment market conditions, such as a significant increase in cap rates or a substantial decline in transaction volume.

1. Moderate rise in interest rates is within investors' expectations

The BoJ's policy change in March or April is widely anticipated to involve a lifting of the negative interest rate policy. The BoJ has already made three adjustments to its yield curve control (YCC) policy in December 2022, July 2023, and October 2023. Specifically, the BoJ gradually widened the allowable band for long-term interest rates (10-year government bond yield), from $0\% \pm 0.25\%$ to $\pm 0.5\%$ and then to $\pm 1\%$, finally announcing that it would tolerate rates exceeding 1%. As speculation grew about the termination of the negative interest rate policy following these adjustments, foreign investors in Japanese real estate turned more cautious in H2 2023. CBRE data show that foreign investment in Japanese real estate (based on transactions worth over JPY 1 billion) fell by approximately 80% y-o-y in both Q3 2023 and Q4 2023, resulting in an annual decline of 30% y-o-y (Figure 1).

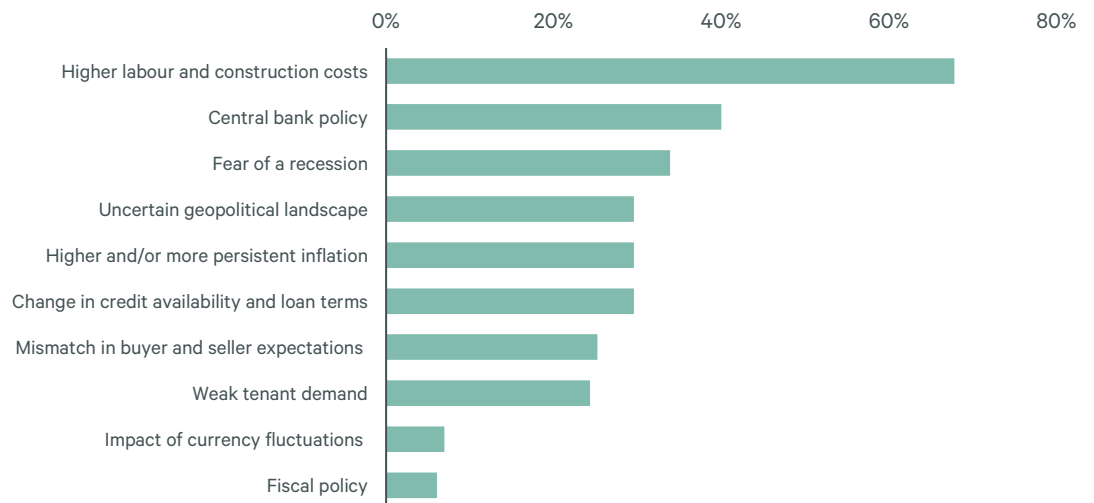
FIGURE 1: Major transaction volume by investor type



Note: Transactions of at least JPY 1 billion, excluding acquisitions by J-REITs at IPO.
 Source: MSCI Real Capital Analytics, CBRE Research, Q4 2023.

In addition, CBRE's recent poll of investors based in Japan (see "[2024 Asia Pacific Investor Intentions Survey: Japan Results](#)", February 2024) found that "central bank policy" was identified by respondents as the second biggest risk to real estate investment in 2024, after "higher labor and construction costs" (Figure 2). This suggests that many investors in Japanese real estate had already anticipated the shift in monetary policy by the BoJ at the end of last year.

FIGURE 2: Major challenges for real estate investment in 2024 (select top three)

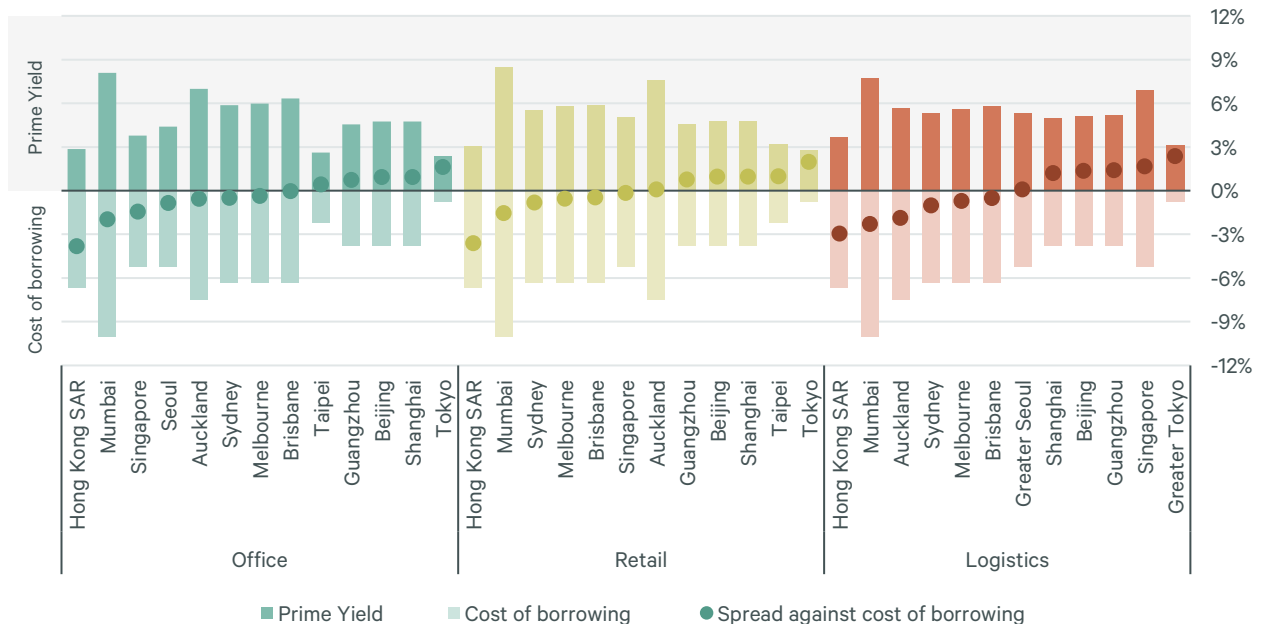


Source: 2024 Asia Pacific Investor Intentions Survey: Japan Results, CBRE Research, February 2024.

2. Japan remains the most attractive investment destination in Asia Pacific

Last year saw an increase in cap rates (decline in asset prices) in Asia Pacific markets such as Australia and Singapore. However, when examining the yield spread (based on CBRE estimates) against borrowing costs for prime assets as of Q4 2023, Tokyo remained the most attractive location for all asset classes, including office, retail, and logistics (Figure 3). CBRE Asia Pacific Research expects policy rate cuts to commence in H2 2024 in Asia Pacific markets other than Japan and China, and for yield spreads to turn positive in some major cities (see [“Asia Pacific Real Estate Market Outlook 2024”](#), January 2024). While there is a possibility that Japan may relinquish its position as the number one yield spread destination, the relative attractiveness of cash-on-cash returns, considering leverage and other factors, is unlikely to significantly decline, as long as interest rate hikes remain gradual.

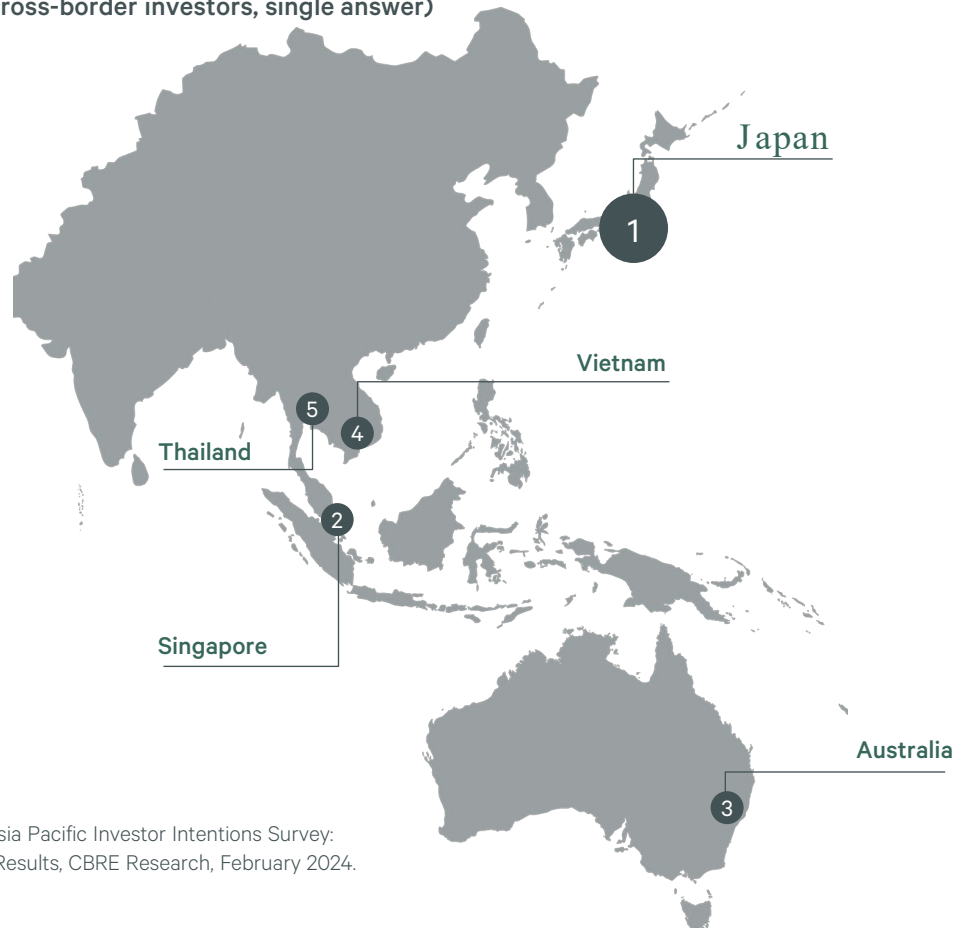
FIGURE 3: Prime yield spread against borrowing costs



Source : CBRE Research, Q4 2023

Respondents to CBRE's 2024 Asia Pacific Investor Intentions Survey named Japan as the most attractive investment destination in the region for the fifth consecutive year (Figure 4). Among cities, Tokyo extended its lead over second-place Singapore, while Osaka and other regional cities also ranked within the top 10. The continued selection of Japan as the top choice can be attributed to factors beyond the attractiveness of yield spread. Even with a slight decline in the relative appeal of yield spreads due to moderate interest rate hikes, Japan remains attractive as an investment destination due to ample liquidity owing to the size of its real estate investment market and depth of market participants. Funding availability on the back of financial institutions' willingness to lend, relative durability of asset fundamentals, and the country's political stability are also reasons for investors to continue to choose Japanese real estate (see report "[Why Japan remains an attractive real estate investment destination](#)", August 2023).

FIGURE 4: Top five most attractive investment destinations in Asia Pacific (cross-border investors, single answer)

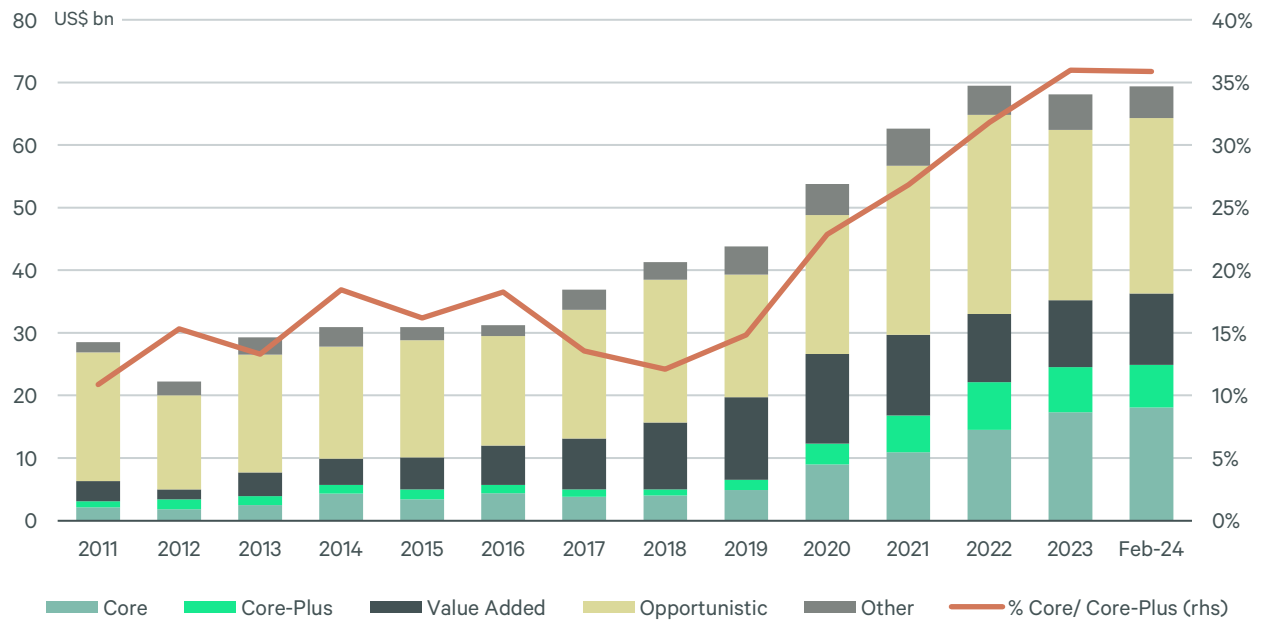


Source: 2024 Asia Pacific Investor Intentions Survey: Japan Results, CBRE Research, February 2024.

3. Abundant dry powder in Asia Pacific and rising real estate transactions among Japanese corporations

Prequin data show funds primarily focused on investment in Asia Pacific have approximately US\$70 billion of uninvested capital (“dry powder”), a level that has remained relatively unchanged since 2022 (Figure 5). Funds with core and core-plus strategies have increased substantially following the onset of the pandemic, of which a significant portion can be assumed to be targeting the stable cash flows offered by Japanese real estate. Investment capital flowing into Japan has therefore been considerable.

Figure 5: Asia-Pacific-focused dry powder



Source: Prequin, February 2024

On the domestic front, recent years have seen an increase in real estate transactions by corporations. In the 2000s, Japanese corporations' real estate strategies primarily revolved around the disposal of properties by firms facing financial difficulties. More recently, there has been a growing recognition of the need for strategies that encompass not only sales but also acquisitions and investments, driven in part by the Tokyo Stock Exchange's recommendation issued in March 2023 targeting listed corporations with a PBR of below 1x, to develop and execute management plans in consideration of share prices and cost of capital.

According to ARES, many of the sponsors of the 10 private REITs that were launched during 2023 were infrastructure-related corporations, such as railway and gas companies. Specific examples of transactions by corporations include the sale of former factory sites by JFE and Hino Motors, the acquisition of retail facilities by Yodobashi HD and Edion, and the acquisition of logistics facility sites by Nitori. Real estate transactions driven by factors such as the need to secure investment capital and changes in business strategies have already been witnessed in 2024, including the sale of a factory site by KIOXIA and logistics facilities by Logisteed.

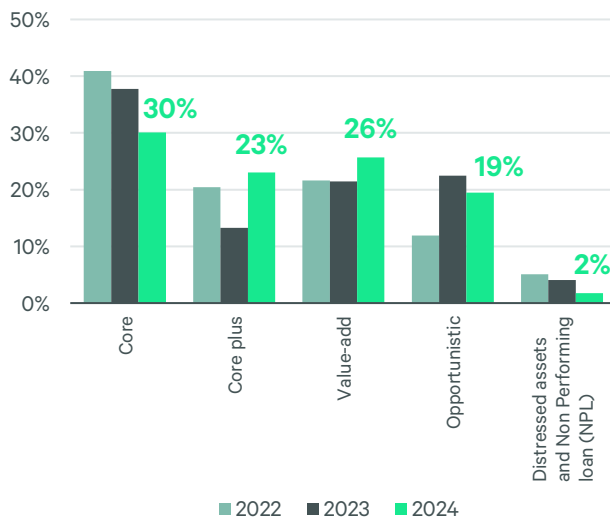
Investment strategies in a “world with interest rates”

Considering that many investors had already anticipated a gradual rise in interest rates during 2023, and that Japan's relative attractiveness as an investment destination remains intact from the perspectives of liquidity and stability even with the potential narrowing of yield spreads, as well as the significant accumulation of dry powder that could potentially be invested in Japanese real estate, the impact of the shift in monetary policy on Japan's real estate investment market should be limited.

However, investor preferences and strategies have been changing as the country nears the end of its negative interest rate era. According to CBRE's 2024 Investor Intentions Survey, investors are shifting towards strategies that aim for higher value creation, such as core-plus and value-add, in response to the potential narrowing of yield spreads due to rising interest rates (Figure 6). As a result, property types that offer upside potential in cash flows are gaining popularity. Specifically, there is increasing demand for residential assets that are likely beneficiaries of

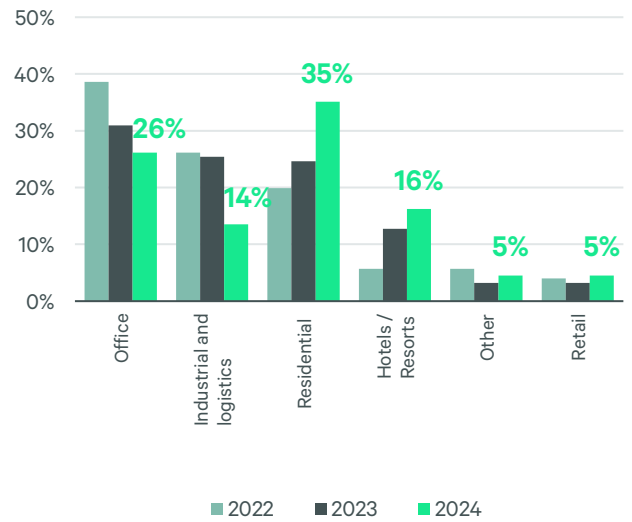
improved affordability due to rising wages, and hotels that have potential for further ADR growth amid inflation and the recovery in inbound tourism (Figure 7). Even for asset classes such as office and logistics where immediate rent increases are less likely, investor interest is focused on properties in competitive locations; those possessing attractive specifications; relatively old properties with value-add potential; and properties in regional areas where current rent levels are relatively low.

Figure 6: Preferred investment strategy (single answer)



Source: 2024 Asia Pacific Investor Intentions Survey: Japan Results, CBRE Research, February 2024.

Figure 7: Preferred asset type for investment (single answer)



Source: 2024 Asia Pacific Investor Intentions Survey: Japan Results, CBRE Research, February 2024.

CBRE expects Japanese real estate investment volume (including only transactions over JPY 1 billion) in 2024 to fall slightly below the JPY 3.8 trillion recorded in 2023. While CBRE's 2024 Investor Intentions Survey indicated that investors are more willing to sell properties this year, purchasers are planning to be more selective, making it challenging for sellers and buyers to align their price expectations. Furthermore, considering the shift in investor preferences towards residential properties and hotels, accompanied by a more selective approach, there is a possibility that while the number of transactions may not decrease, transaction sizes could become smaller.

Many investors anticipate policy interest rates remaining within the market consensus range of 0.1% to 0.2% (i.e., an increase of 20 to 30 bps from the current -0.1%) in 2024. If interest rate hikes largely exceed this pace, it could lead to an overall increase in cap rates, potentially resulting in a sluggish investment market.

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