

# Real Estate Analysis Report

## Japan's Property Business Frontiers: Declining Birthrate and Aging Population

This is the English translation of “[少子高齢化時代の不動産ビジネス・フロンティア](#)”

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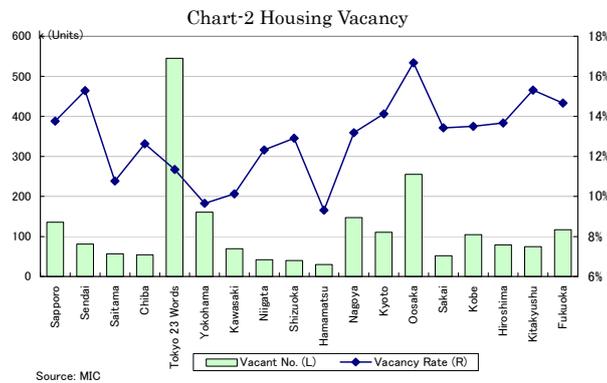
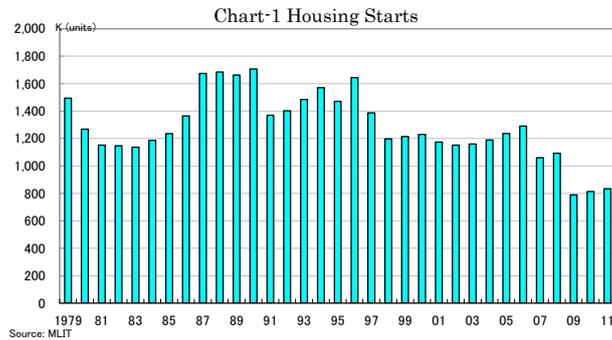
### Summary

- Following the global financial crisis, the annual housing starts, which were over one million before, have remained around 800k since 2009. Considering the shrinking housing demand and increasing number of vacant houses based on the declining birthrate and aging population, it is unlikely that the volume will return to one million. Further, making decisions to rebuild old condominiums has become increasingly difficult due to many aged unit owners.
- The Tokyo office worker head-count is predicted to begin declining in 2015. The shrinking of the domestic office demand may accelerate if Tokyo's competitiveness to invite global companies weakens among large Asian cities. Recently office buildings are required to meet a variety of tenant requirements as operational assets, thus making planning and management capabilities of developers and building owners more important.
- Retailers are sensitive to the economic cycle and quick to respond to market changes. We cannot, however, ignore the long-term negative impact of the declining birthrate and aging population on retail sales. Competition in the domestic retail market is extremely intense and needs more expertise in choosing locations, planning venues, leasing tenants, and operating shops.
- The hotel sector can expect inbound demand and will consequently be impacted less by the declining domestic birthrate and aging population than other property sectors. Even domestic demand may grow with an increasing number of senior tourists, while a larger number of foreign visitors are counted on supported by the government policy that aims for a “tourism-oriented nation.”
- Strong demands shifting from old simple storages to new large systematic logistics facilities have been observed in the logistics sector, lifting the sector as one of the property business frontiers.
- Asian markets and domestic elderly nursing housing are also property business frontiers. Other than these, through the reconstructing of existing businesses, several business frontiers can be identified in the domestic property industry,

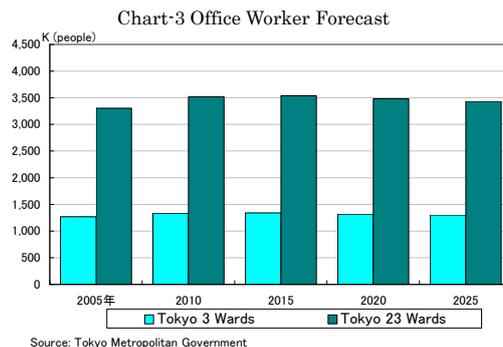
integrated housing service, CRE strategy advisory, new business incubation, energy saving management, and property investment management.

## 1. Impact of the Declining Birthrate and Aging Population

Following the global financial crisis, the annual housing starts, which were over one million before, have remained around 800k since 2009 (Char-1). Considering the shrinking housing demand and increasing number of vacant houses based on the declining birthrate, it is unlikely that the volume will return to one million (Chart-2). Further, making decisions to rebuild old condominiums has become increasingly difficult due to many aged unit owners.



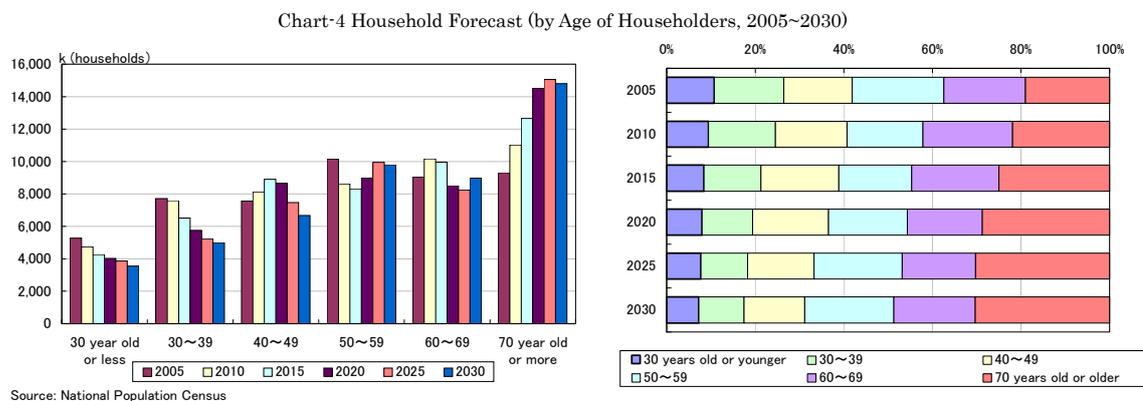
The Tokyo office worker head-count is predicted to begin declining in 2015 (Chart-3). The baby boomers are currently entering a retirement phase, which was delayed following the related low-revision in 2012. Some large companies cut recruitments domestically to reinforce their global networks.



Though Tokyo enjoys the domestically dominant position at this point, the shrinking of the domestic office demand may accelerate if Tokyo's competitiveness to invite global companies weakens among large Asian cities.

Recently office buildings are required to meet a variety of tenant requirements, in terms of CRE (Corporate Real Estate) strategy and BCP (Business Continuity Plan), to become operational assets, thus making planning and management capabilities of developers and building owners more important.

While reviewing domestic store strategies to focus on senior customers and adjust to growing internet shopping, retailers have aggressively expanded to growing overseas markets. As service providers, they are sensitive to the economic cycle and quick to respond to market changes due to the declining birthrate and aging population. Increasing retired householders can contribute positively to the retail sector (Chart-4), though negatively to the office and housing sector as they already have their own houses. For example, senior customers can be said to account for the increasing percentage of convenient store sales, which is one of the rare growing markets in Japan. We cannot, however, ignore the long-term negative impact of the declining birthrate and aging population on retail sales. Competition in the domestic retail market is extremely intense and needs more expertise in choosing locations, planning venues, leasing tenants, and operating shops.



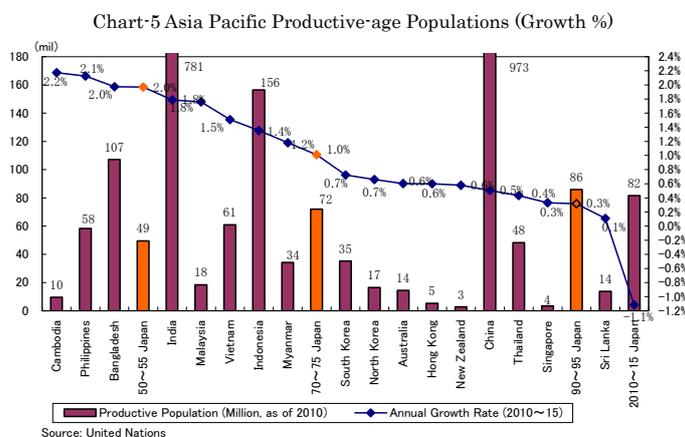
The hotel sector can expect inbound demand and will consequently be impacted less by the declining domestic birthrate and aging population than other property sectors. Even domestic demand may grow with an increasing number of senior tourists, while a larger number of foreign visitors are counted on supported by the government policy that aims for a “tourism-oriented nation.” However, event risks sometimes become serious, such as the nuclear power plant accident in Fukushima or the territorial disputes with China and Korea.

In the logistics sector, which is one of property business frontiers, foreign developers

have developed large logistics facilities following the related deregulation in 2002,<sup>1</sup> while domestic property companies have recently begun developing them too.<sup>2</sup> Strong demands shifting from old simple storages to new large systematic logistics facilities have been observed in the growing trends of 3PL (third party logistics) and internet shopping, which need highly systematic and speedy logistics facilities.

## 2. Business Frontiers

The two main businesses in the domestic property industry, selling new condominium units and houses and leasing offices, apparently do not have room for promising growth due to the declining birthrate and aging population. In that sense, Asian markets, which have growing productive-age populations, should be business frontiers for Japanese property companies (Chart-5).<sup>3</sup>



In the domestic market, property companies are shifting to developing nursing houses and condominiums for the elderly.

Other than nursing houses, several potential businesses can be created in the domestic property market based on the ensuing changes. For example, corporate globalization has brought more foreigners to Tokyo and pushed natives overseas, and the penetration of the internet has made retailers reconsider their store strategies and create new demand for large systematic logistics facilities. Additionally, the internet helps users to get property information easily and changes the way of housing sales and brokerage services.

Other than overseas businesses, elderly nursing houses and large logistics facilities, the following five business frontiers can be identified in the domestic property industry. These five categories share the idea that providing spaces is not good enough in the property industry; it must serve users.

<sup>1</sup> Each company used to be required to get a regulator allowance to start a logistics business, but just applying is now required following the deregulation in 2002.

<sup>2</sup> Major Japanese property companies like Mitsui Fudosan, Mitsubishi Real Estate, Orix Real Estate and Mitsui & Co., Realty Management are developing large logistics facilities.

<sup>3</sup> Mamoru Masumiya, “[Current Asian Property Markets - Poised for Strong Growth](#)” in the Real Estate Analysis Report, NLI Research Institute, October 12, 2010.

## 1) Integrated Housing Services

Though people are still eager to own houses and condominium units, new housing sales have faced difficulties to sustain growth, while renovating old houses and house leasing services have become common. The one stop housing service concept has emerged in the market recently,<sup>4</sup> integrating related housing services into stores and websites, providing professional housing advice for building, purchasing, selling, leasing, letting, renovating, rebuilding, moving, succeeding, investing, and financing.

New condominiums have recently become fully equipped with security technology, disaster prevention, and energy saving in addition to strong building structures. Other additional services like nursing babies and supporting community activities have become popular. Introducing these concepts into existing housing is also important for anyone to enjoy a comfortable and secure housing life.

## 2) CRE Strategy Advisory

CRE (Corporate Real Estate) strategies generally refer to methods of utilizing land owned by corporations who have main businesses other than property. Property companies have aggressively got involved in client's CRE strategies to receive development fees for developing those lands, because the total size of such lands are much bigger than those of property companies. How to lease properties is also an important aspect of CRE strategies; maximizing corporate value by arranging properties both owned and leased is especially significant. Generally, even a corporation with its own head quarter building in Tokyo has to lease spaces for their branches and other operations.

Corporations have recently become more capable of retrieving information and analyzing the property market. As offices become operational assets, building owners and brokers have to improve their capabilities of contacting clients, leasing spaces, providing solutions, and disclosing related costs that will be charged. For example, energy saving for whole buildings needs tenant support, which requires disclosure of energy consumption. While disclosing energy consumption is a way to get tenant support for energy saving, it can potentially create new services to earn additional fees. In fact, some owners earn additional fees on leased spaces by setting tenants' power batteries for emergencies in occupied spaces. Others charge tenants more for LED lighting replacements. Furthermore, when regulations get tighter and require additional work, as is often the case, disclosure can help owners explain to tenants why they charge more.

Property companies have begun exploring new categories like developing logistics facilities for supporting logistics operators and developing Mega-Solar (large scale solar power generation) facilities, when advising manufactures on their factory land usage.

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<sup>4</sup> Mitsui Fudosan opened the first one stop housing service store "Sumai Mall," in which separate group companies for new condominium sales, new house sales, renovations, brokerage and other services are gathered to serve customers at the same store.

Other than these, considering globalization, advisory services for overseas property strategies and arranging accommodations for expatriate families could be sizable businesses.

Overall, property companies that can comprehensively provide solutions to corporate clients in areas covering offices, housings, logistics, factories and land for owning-using, leasing, selling and buying, should survive in the extremely competitive corporate client market.

### 3) New Business Incubation

Property companies can create new businesses through supporting entrepreneurs as business incubators. For example, property companies can support entrepreneurs and foreign firms entering into Japan by providing spaces and other business infrastructures in advantageous conditions, such as preparing co-working spaces and shared offices to internet related companies, SNS businesses, and social business entrepreneurs.

Social businesses are involved in various social issues such as helping with baby-nursing, the disabled, and the poor and supporting environmentally friendly activities.

As property businesses contribute to local communities by developing new towns and environments, property businesses and social businesses have good potential to work together and create new related businesses.

Collaborating with other industry partners has other possibilities. For example, in the housing market, collaborations with luxury brands of interior, furniture, car, and select shops are increasing, which may possibly create another business.

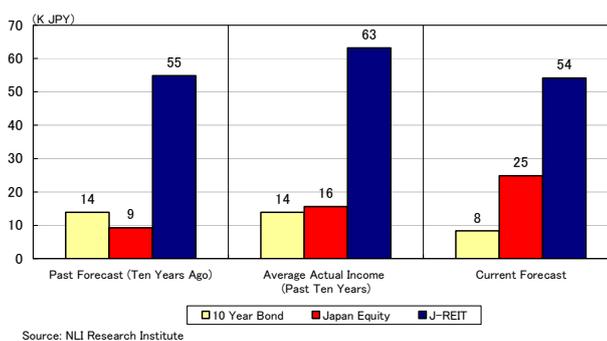
### 4) Energy Saving Management

Property companies can enhance energy saving capabilities of both new and existing properties since they are broadly involved in cases and sectors from city office to suburban housing. They have already developed energy consumption monitoring and management systems, introduced them into some buildings, and constructed some net zero energy consuming buildings. More smart-city and smart-grid laboratories are being constructed and there is high expectation that their exportation will lead to sizable businesses. Concerning renewable energy, not only solar power panels are placed on offices, houses and logistics facilities, but Mega-Solar facilities are being developed with manufactures as part of CRE strategies. Particularly, Tokyo, where offices and households account for two thirds of all the energy consumed, will be the main energy saving service market, as the municipal government declares that the city aims for a self-sustainable and diversified energy society. Property companies should work more closely with other industries like power companies, car makers, appliance makers, telecommunication operators.

## 5) Property Investment Management

The property industry offers long-term investment opportunities to both institutional and retail investors in the forms of J-REITs and other securitized products even though the J-REIT market capitalization is relatively small for the industry size. J-REITs are expected to provide long-term, stable, and much higher income compared to other types of assets such as bonds and equities (Chart-6), and are suitable to individuals who are not fully covered by pension payments when retired.

Chart-6 Annual Income on JPY One Million Investment (after Tax)



But to attract a larger number of retail investors, J-REITs have to fix the issues that have been the subject of criticism for several years. One is that J-REITs acquire lower quality assets from the sponsors, which makes investors sense a conflict of interest between sponsors and J-REITs. The other is that the J-REIT market allows insider trades because it is regarded in a different category from the individual stock market.

The conflict of interest is based on sponsor property companies keeping the best quality assets on their balance sheets and seldom passing them to J-REITs. If sponsor companies share some portions of those assets with J-REIT, the conflict of interest should diminish. Furthermore, repurchasing old assets by sponsors from J-REIT and re-developing them in a cycle would be positively accepted by investors as well.

Regarding insider trades, the J-REIT market will be covered by the revised related law next year, which will secure fair dealing to retail investors.

To get more credit from investors, the property industry should secure and enlarge good long-term investment opportunities, while expanding investment coverage into other long-term assets like infrastructures should be helpful.

## 3. Final Note

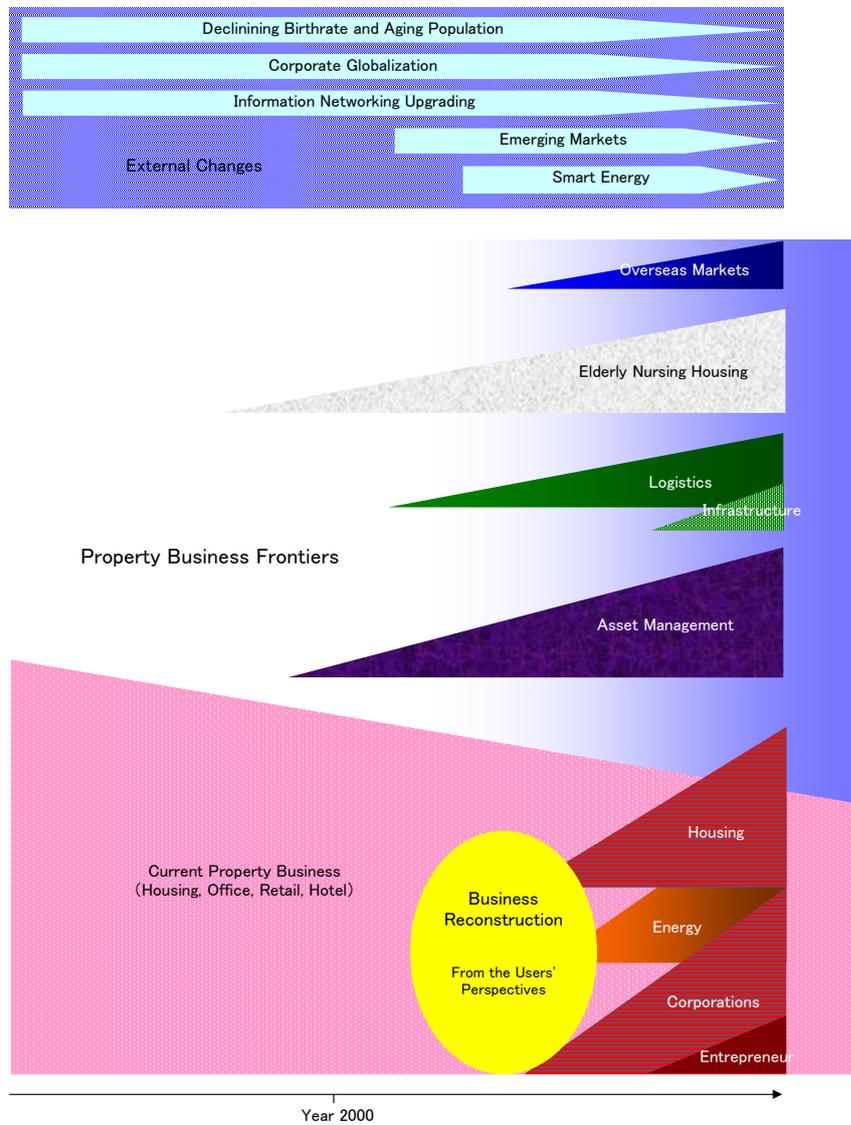
Several property business frontiers can be identified even amidst the declining birth rate and aging population (Chart-7). As a country facing many economic and social problems, Japan can become a leading country which works out solutions to those problems.

Property companies should reconstruct existing businesses dynamically into new businesses, adjusting to the changing environment without falling just into pessimism.

The property industry can contribute to Japan's growth strategy by absorbing young

and different preferences and cultures with an open mind. By deciding not to seek only the interests of suppliers nor cling to past successes, better services from the users' perspectives should be considered important and be pursued.

Chart-7 Property Business Frontiers



Source: NLI Research Institute

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