

Japan's Housing Market Enters a Transition Period

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1. Introduction

Good news seems to abound in the periphery of Japan's housing market—J-REIT funds have surged, the securitization of housing loans has steadily grown, and official residential land prices in central Tokyo finally rose for the first time in 17 years. Even the dark cloud on the economic horizon—population decline and mass retirement of baby boomers—reveals a silver lining of new opportunities in real estate and finance businesses.

However, housing conditions and the housing market are a different matter. No obvious developments have emerged that would lead to much-needed structural improvements. To shape a brighter future, we need an objective approach that evaluates present housing market conditions against the past and conditions in other countries. By identifying which aspects are changing, stagnating, or in need of improvement, we can seek better solutions for the housing market and housing conditions.

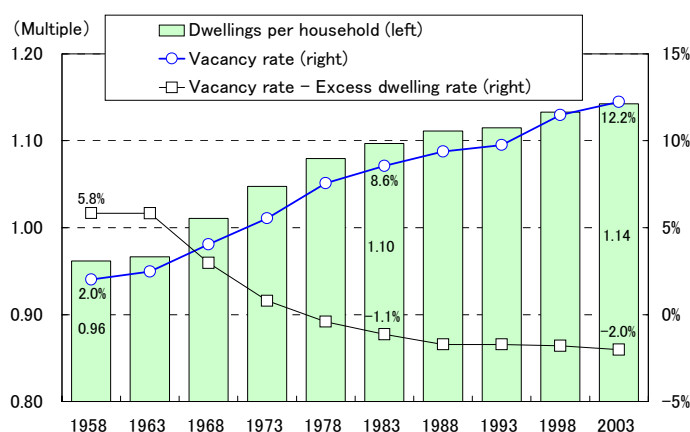
While focusing on the latest *Housing and Land Survey* (fiscal 2003), we also rely on other statistical and household survey results to paint an objective picture of Japan's present housing market.

2. Vacancies Rise for All Uses

As the general public knows, much time has passed since the housing market's focus shifted from supplying an adequate quantity of new housing to improving the quality of housing stock.

In fiscal 2003, the gap widened between the nation's housing stock (53.89 million dwellings) and total number of households (47.16 million households), pushing the dwelling-to-household ratio up to 1.14. At the national level, total dwellings first exceeded total households as early as 1968. But at that time, shortages still surfaced in some prefectures due to the skewed housing distribution. Some 35 years later, the lowest ratio today is 1.10 in Saga prefecture.

Figure 1 Ratio of Dwellings to Households and Vacancy Rate



Source: Ministry of Internal Affairs and Communications, *Housing and Land Survey*.

The inadequacy of the market for housing stock can be summed up as a quality issue, or the mismatch between what households seek and the available supply. Before examining this problem in detail, we first explore the close link between the dwelling-household ratio and vacancy rate.

As Figure 1 shows, the vacancy rate has risen in parallel with the dwelling-household ratio. On the other hand, the gap between the vacancy rate and excess-dwelling rate (dwelling-household ratio minus 1, expressed as a percentage) steadily declined until 1988. This suggests that an increase in excess dwellings does not immediately lead to more vacancies, but instead may be partially absorbed by wealthy households who buy second homes or other dwellings for their own use. Since fiscal 1993, the gap has edged down further, but remains almost flat compared to earlier.

Figure 2 shows how homeowners with more than one dwelling have used their additional dwellings. The share of vacation homes has risen while that of rental dwellings has declined.

Figure 2 Additional Dwellings Owned by Ordinary Households, by Use

Year	Percent of homeowners who own additional dwellings	Intended use			
		For relatives	Second home or villa	For rent	Other
1988	10.3%	30.1%	4.8%	51.8%	2.2%
1998	11.1%	32.2%	7.6%	42.5%	18.2%
2003	10.5%	35.6%	9.7%	38.0%	13.8%

Note: Numbers may not add up to 100% due to multiple responses and incomplete responses.
Source: MIC, *Housing and Land Survey*.

Figure 3 shows the composition of vacant dwellings. Surprisingly, since 1978, the composition has not changed significantly.

Figure 3 Composition of Housing Vacancies

Survey year	Second dwelling			For rent or sale	Other dwelling
		For vacation home	For other use		
1978	5.1%	–	–	58.4%	36.5%
1983	6.5%	–	–	55.5%	37.9%
1988	7.5%	3.5%	4.0%	59.3%	33.2%
1993	8.2%	4.0%	4.2%	58.5%	33.2%
1998	7.3%	3.8%	3.5%	61.1%	31.7%
2003	7.6%	3.9%	3.7%	60.3%	32.1%

Note: "Vacation home" and "other" refer to dwellings that are not in use.
Source: MIC, *Housing and Land Survey*.

From the above, it appears that after 1988, as growth leveled off among households using a second dwelling, the vacancy rate has continued to rise across all categories of intended use.

While location is also important, future reductions in the vacancy rate will rely less on households who use additional dwellings, and more on newly formed and other households who occupy dwellings anew.

Given the opportunity, for instance, some individuals and families who now live with parents would prefer to move out and become independent. They might be prompted to buy or rent the vacant dwellings if offered better terms.

Meanwhile, opinion surveys indicate that households are growing less enamored of lifestyles that seek weekend refuge in country homes.

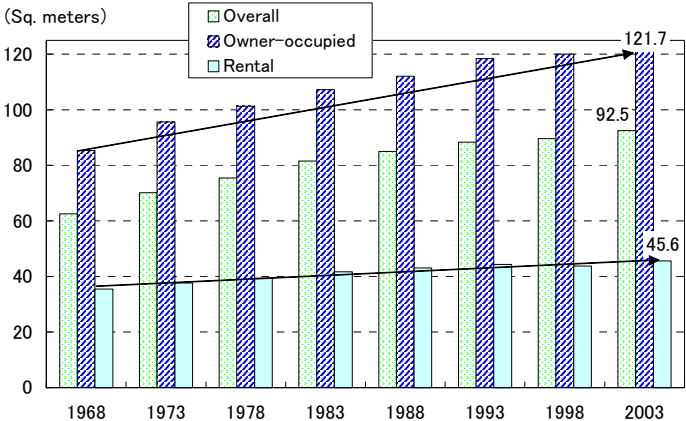
For example, in the *Opinion Survey of Housing* (Cabinet Office), the proportion of persons who desire multiple dwellings fell from 33.9% in 1998 to 28.9% in fiscal 2004. Similarly, the *Survey of Housing Demand* (Ministry of Land, Infrastructure and Transportation) finds that households who desire a vacation home or second home has plunged from 17.0% in 1993 to 13.6% in 1998, and 4.9% in 2003.

Rather than owning multiple dwellings simultaneously, perhaps a more realistic possibility is for people to move from dwelling to dwelling over the space of their lifetime. Indeed, the *Opinion Survey on Housing* finds that more households are reluctant to live in the same dwelling for their entire life. In particular, according to the *Fiscal 2005 White Paper on the Metropolitan Area* (MLIT), only 46.4% of households living in Tokyo's high-rise condominiums intend to live there permanently.

3. Slow Improvement in Rental Housing Floor Space

Floor space, the most basic indicator of housing quality, has grown for both owner-occupied and renter-occupied housing. However, as Figure 4 shows, rental housing has failed to keep pace, causing the gap to grow.

Figure 4 Floor Space of Owner-Occupied and Rental Housing



Source: MIC, *Housing and Land Survey*.

Of course, rental housing tends to be smaller than owner-occupied housing in other countries as well. But what makes Japan unique is the size of the gap—rental housing is not even 40% as large as owner-occupied housing, compared to 60% to 70% in other countries (Figure 5).

Figure 5 International Comparison of Owner-Occupied and Rental Housing (Floor Space)

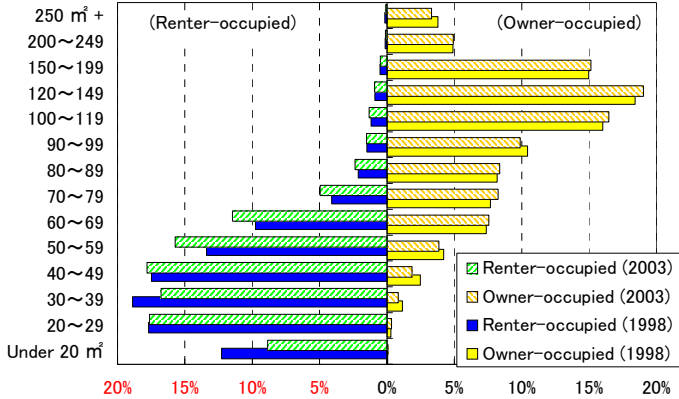
Country	Survey year	Owner-occupied	Rental	Rental /owner-occupied	Overall average
U.S.	2001	161.8	116.8	72%	154.2
Japan	2003	121.7	45.6	37%	92.5
Germany	1998	113.0	68.9	61%	86.9
France	1996	101.4	68.3	67%	86.4
U.K.	2001	95.0	68.2	72%	86.9

Sources: MIC, *Housing and Land Survey*; *American Housing Survey* (U.S.); *English House Condition Survey* (U.K.); *Datenreport 2002* (Germany); *Recensements la Population* (France).

Moreover, the difference is just as pronounced when we look at the distribution of dwellings by floor space. Little has changed from 1998 to 2003—most rental dwellings are still under 60 square meters in size, with less than 3% being over 100 square meters, while most owner-occupied dwellings are 100 to 199 square meters. The only improvement is that the share of very-small rental dwellings under 20 square meters has shrunk from 12% to 9% (Figure 6).

Thus the disparity between large owner-occupied dwellings and small rental dwellings is confirmed both by average size data and by more detailed distribution curves.

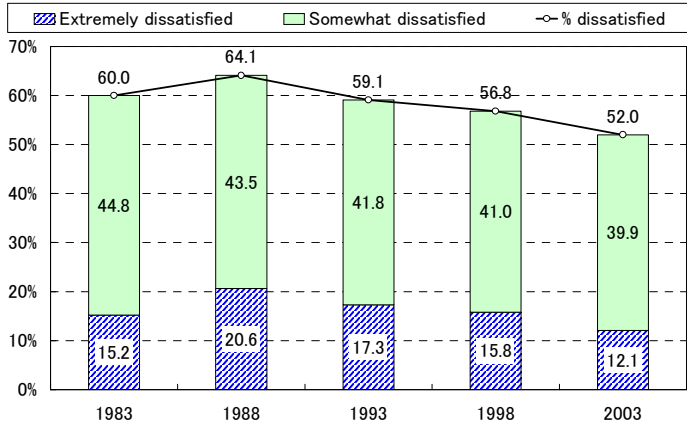
Figure 6 Distribution of Dwellings by Floor Space (1998 and 2003)



Source: MIC, *Housing and Land Survey*.

Needless to say, renter households are not happy with this condition. According to the *Survey of Housing Demand*, the proportion of renters dissatisfied with housing conditions (extremely dissatisfied and somewhat dissatisfied) peaked in 1988, but still exceeds 50% as of 2003 (Figure 7).

Figure 7 Share of Dissatisfied Renter Households



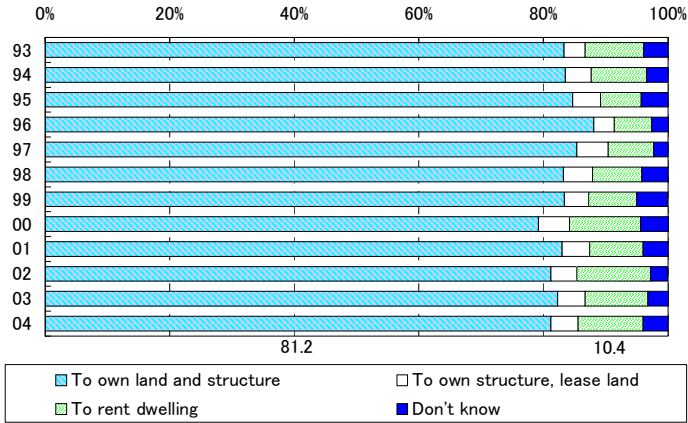
Source: MLIT, *Survey of Housing Demand*.

4. Ownership Desire is Unchanged, but Underlying Factors Change

Dissatisfaction with small rental dwellings apparently generates a strong desire for ownership. The home ownership ratio, which stood at 61.2% in 2003, has barely budged in the past three decades.

Meanwhile, according to the *National Opinion Survey on Land Issues* (MLIT), an even greater share—over 80% of respondents—said they would rather own than rent (Figure 8). This level has also remained stable over the past eleven years.

Figure 8 Home Ownership Desire

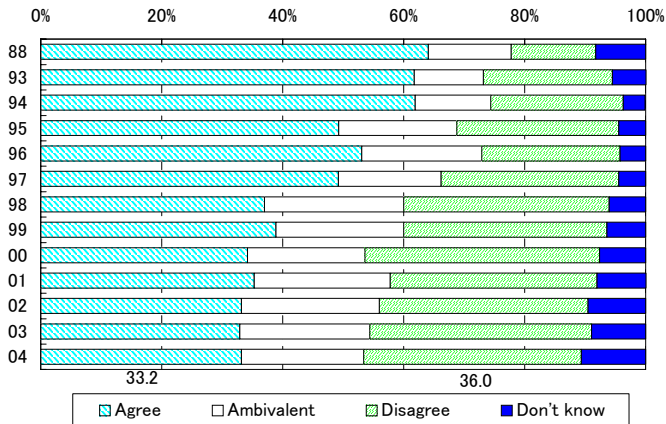


Source: MLIT, *National Opinion Survey on Land Issues*.

The existence of a strong latent demand for ownership is also supported by the *Public Opinion Survey on Household Financial Assets and Liabilities* (Central Council for Financial Services Information), which finds that almost half of renter households plan to purchase a home.

In contrast, the MLIT survey found that the perception of land as an asset has changed radically since land prices plummeted. In 1988, almost two-thirds of households thought that land was a better asset than saving deposits and stocks. Today that share has dropped to one-third, and is second to the dissenting opinion (Figure 9).

Figure 9 “As an Asset, is Land Preferable to Saving Deposits and Stocks?”



Source: MIC, *Housing and Land Survey*.

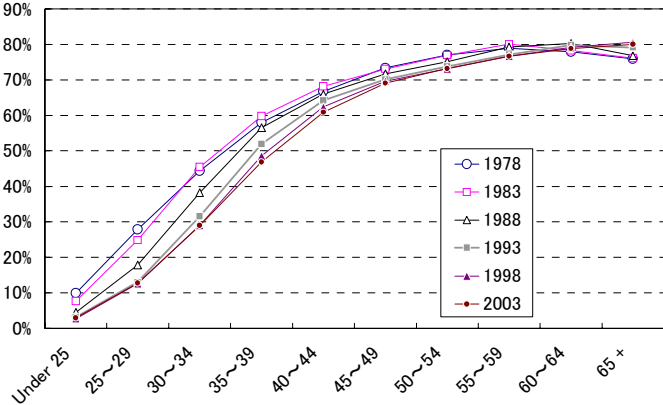
The long-term slide in land prices has debunked the “land myth” and altered public perceptions

so much that land is no longer the consensus favorite, even over assets such as near-zero interest saving accounts. Or perhaps more accurately, perceptions toward land have diversified to such an extent that no majority consensus emerges regarding its advantages as an asset.

Nonetheless, the distortion in Japan’s housing market is still epitomized by an overwhelmingly preference to own rather than rent. Put differently, rented dwellings in Japan have only 40% the floor space of owner-occupied dwellings, and are not recognized as comparable alternatives to owner-occupied homes. As a result, households bend over backwards to purchase homes with a housing loan.

Thus we now look at the age of first-time home buyers, and how the purchase fits in with their life plan. In Figure 10, we plot the home ownership ratio by age of householder for the years in which the *Housing and Land Survey* is conducted.

Figure 10 Home Ownership Rate by Age

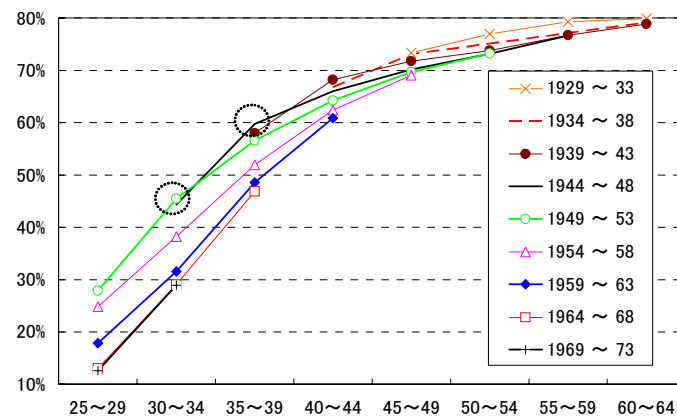


Source: MIC, *Housing and Land Survey*.

Common patterns emerge from the surveys: (1) the curves have a similar shape, indicating that the age pattern has not changed; (2) as the householder’s age increases, the ownership ratio rises; (3) the curves rise most steeply from the early to late 30s; (4) in the late 50s, the ownership ratio reaches 80%, and levels off; (5) the newer the survey, the lower the ownership ratio is in the 30s and younger groups, indicating that ownership is increasingly being delayed. In general, the data support the common perception of the standard timing and age of householders when they purchase homes—either right after having children, or when the oldest child enters elementary school.

However, we must note that this time series comparison actually plots different birth cohorts at a constant point in time. To obtain a more accurate life pattern, we reorganized the data to track how the ownership ratio changes for the same birth cohorts over a lifetime. The results are shown in Figure 11.

Figure 11 Ownership Rate by Age and Birth Cohort



Source: MIC, *Housing and Land Survey*.

For each birth cohort, the ownership rate varies considerably by generation. For example, for the 1944-48 birth cohort, 60% already owned homes by their late 30s, but the rate slips for later birth cohorts at the same age, and falls below 50% for those born in 1959 and after. Overall, later generations tend to have lower ownership rates at any given age, indicating that the age of home buyers is increasing.

However, there are two cases when a birth cohort's ownership rate spikes above predecessors at the same age: those born in 1944-48 who reach the late 30s, and those born in 1949-53 who reach the early 30s. Both spikes occurred in 1983, when the overall ownership rate edged up to a high of 62.0%. In any case, we know that persons born in 1944-53 (which includes baby boomers born in 1947-49) enjoyed home ownership at a relatively early stage of life.

Another interesting point is that the downtrend stops among later cohorts in their late 20s and early 30s. The ownership rate is almost even for 1964-68 and 1969-73 birth cohorts in their late 20s and early 30s. This has been the case since 1993, and particularly from 1998 to 2003, when many factors worked in favor of home purchase despite the worsening job and income environment,: aggressive lending by private financial institutions, falling interest rates, and larger income tax credit for mortgaged owner-occupied housing (direct income tax reduction proportional to outstanding loan amount).

This was a time when house prices (land and structure) fell relative to annual income. However, as incomes languished, both the loan-to-income ratio and loan term increased sharply.¹ Thus it can be said that the housing mortgage default risk is higher for 1964-68 and 1969-73 birth cohorts.

¹ For more information on the relationship between income and housing loan of home buyers, see "Homeownership and Loan Financing—A Comparison of Loan Payment vs. Imputed Rent, and Outstanding Debt vs. Home Market Value," *NLI Research*, April 2002 (<http://www.nli-research.co.jp/eng/resea/econo/eco0204a.pdf>).

5. Weak Presence of Elderly in the Existing Home Market

While the home ownership and purchase data reveal large differences by birth cohort, one pattern is consistent—the home ownership rate of elderly households has remained approximately 80%.

Since the early 1980s, Japan has aged at a rate unparalleled in the world. As a result, elderly households have grown in absolute number and as a share of total households with owner-occupied housing. In fact, as of 2003, over 30% of all homeowners are elderly households (Figure 12).

Figure 12 Home Ownership of Households Aged 65 and Over

(Million households)

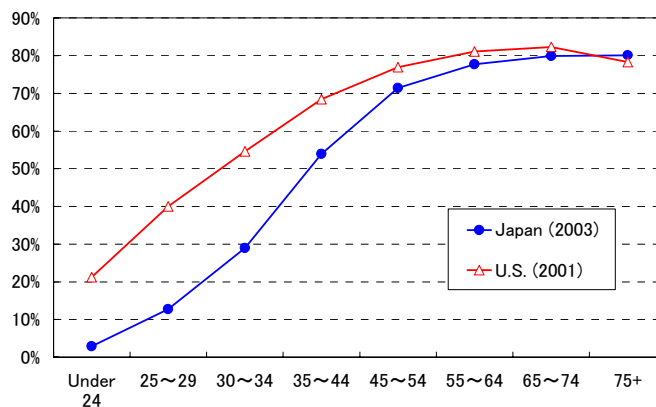
Year	All homeowners	Homeowners aged 65+	% of homeowners	Age 65~74	Age 75 +
1978	19.4284	1.92	9.9%	–	–
1983	21.6496	2.46	11.4%	–	–
1988	22.9482	3.30	14.4%	2.31	0.99
1993	24.3762	4.72	19.4%	3.29	1.43
1998	26.4678	6.95	26.3%	4.77	2.19
2003	28.6567	9.09	31.7%	5.80	3.29

Source: MIC, *Housing and Land Survey*.

Needless to say, a common characteristic of retired nonworking elderly households is their small current income and large asset holdings. Home ownership represents a sizable portion of these assets. Stated differently, even with a small household income, they can still live comfortably by putting their housing stock to good use.

Figure 13 compares home ownership rate by age in Japan and the U.S.

Figure 13 Home Ownership Rate by Age (Japan and U.S.)



Sources: MIC, *Housing and Land Survey*; U.S. Census Bureau, *American Housing Survey*.

In both countries, nonworking elderly households have a negative saving rate—meaning that consumption exceeds disposable income and must be funded out of accumulated assets. But compared to Japanese households, U.S. households are more likely to tap their tangible assets (owner-occupied home). In other words, they tend to sell their present home and buy a smaller home, pocketing the price difference.

Figure 14 The Negative Saving Rate of Elderly Households (Japan and U.S.)

	Japan (2004)	U.S. (1999–2003)
Saving rate	-23.2%	-4.1%
Change in financial assets	-22.1%	-1.3%
Change in tangible assets	-1.1%	-2.9%

Sources: MIC, *Family Income and Expenditure Survey*; U.S. Census Bureau, *American Housing Survey*.

Figure 15 compares the percent of elderly households in Japan and the U.S. who moved in the last year. While changes in dwelling size and value are not shown, the data shows that elderly households move more frequently in the U.S. than in Japan.

Figure 15 Percent of Elderly Households Who Moved in the Last Year (Japan and U.S.)

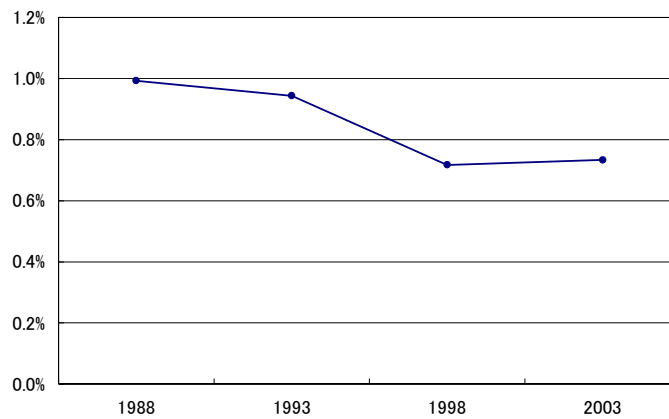
	Japan (2003)	U.S. (2001)
Homeowners	0.73%	2.88%
To other owner-occupied	0.46%	1.82%
To renter-occupied	0.22%	1.06%
Renters	4.36%	7.86%
To owner-occupied	0.83%	1.14%
To renter-occupied	2.84%	6.72%
All households	1.44%	4.31%
To owner-occupied	0.59%	1.92%
To renter-occupied	0.85%	2.39%

Sources: MIC, *Housing and Land Survey*; U.S. Census Bureau, *American Housing Survey*.

Figure 16 shows the percentage of households aged 65 and over who moved in the last four surveys. The decline appears to have finally stopped in 2003, but the level is still very low.

As our analysis shows, while Japan’s elderly households are large in terms of both number of homeowners and size of asset holdings, they do not exert a commensurate influence in the transaction market.

Figure 16 Percent of Elderly Households Who Moved in the Last Year (Japan)



Source: MIC, *Housing and Land Survey*.

6. Japan's Existing Home Market Remains Lackluster

In Europe and the U.S., households move frequently from owner-occupied to rental housing and vice versa depending on life-stage and financial factors. The frequency of moves is closely related to two characteristics of the housing market—the substitutability of rental units and owner-occupied units, and vitality of the existing home market.

The heavy bias of Japan's housing market toward new homes is readily apparent from international comparisons. In contrast, existing homes eclipse new homes in both the U.S. and U.K. housing markets (Figure 17).

Figure 17 Existing Home Market in Japan, the U.S., and U.K.

	Japan (2003)	U.S. (2001)	U.K. (2001)
① Total dwellings	28,665,900	119,117,000	22,408,000
② Existing home transactions	175,333	6,050,000	1,190,352
③ = ② ÷ ①	0.61%	5.08%	5.31%
④ Housing starts	699,291	1,602,700	158,648
⑤ = ② ÷ ④ (multiple)	0.25	3.77	7.50

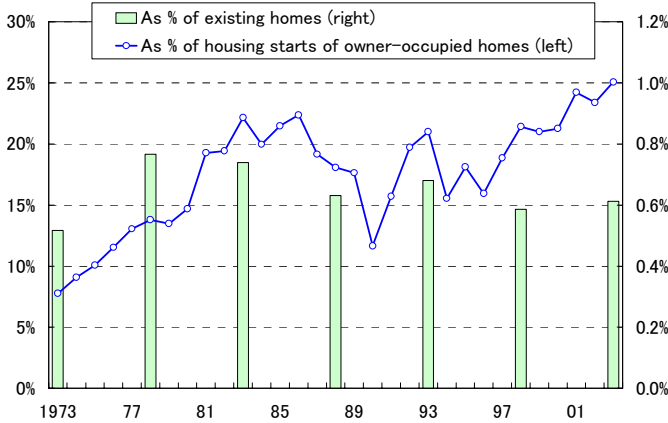
Note: Shows owner-occupied housing data for Japan (② is annualized rate), and owner-occupied and rental housing data for the U.S. and U.K.

Sources: For Japan, *Housing and Land Survey*; for U.S., *New Residential Construction*, and *Real Estate Outlook*; for U.K., *Housing Statistics 2004*.

But while still lagging by international standards, Japan's existing home market may have improved over the years. We examine this possibility using two indicators—the turnover rate of existing stock, and existing home sales as a multiple to new housing.

In the last decade, existing home sales volume has grown as a ratio to housing starts (built-by-owner and built-for-sale), but not as a ratio to the stock of owner-occupied homes (Figure 18).

Figure 18 Existing Home Sales in Japan



Sources: MIC, *Housing and Land Survey*; MLIT, *Housing Starts*.

Ideally, existing homes should compete with rental dwellings as equivalent alternatives in the housing market, enabling renters to move back and forth between renting and owning, or else rent continuously. Moreover, new homes, which are no longer new after being constructed, should compete with existing owner-occupied homes and renter-occupied homes in the housing market.

Unfortunately, Japan’s housing market has not improved significantly in the size disparity of owner-occupied and rental dwellings, nor in the vitality of the existing home market. And with vacancy rates rising, the housing stock is actually becoming less effectively used.

7. Toward Reform

Aside from the persistent desire to own, households are changing their perceptions of the housing market. However, the changes have yet to lead to quality improvements and the more effective use of the housing stock.

Optimists point out that improvements are possible simply by nudging the housing market in the right direction. Indeed, certain factors are mounting that could induce reform from the inside.

One factor is the changing behavior of elderly households. Retired nonworking elderly households have consistently had a negative saving rate since such data was first collected, and the rate has recently expanded in absolute terms. Clearly, they are liquidating assets more actively. Moreover, the fiscal 2004 public pension reform introduced a benefit indexation system that reflects labor

force size, which effectively reduces benefits. To live more prosperously while relying less on benefits, elderly households will increasingly liquidate their housing assets by moving.

Another factor is the expected surge in households who own additional dwellings through inheritance. At present, almost half of elderly households do not live with their children. Meanwhile, approximately 70% to 80% of baby boomers and younger cohorts now turning age 50 are already homeowners. Since many of them stand to inherit their parents' home, the ownership of additional dwellings is likely to become more widespread.

Since these beneficiaries will be in their late 50s or retired, they may be tempted to rent or sell the additional dwellings, which the latest data shows are often vacant. With many years still left to live, these homeowners are not likely to leave their unused assets idle for long.

Whether owning or renting, younger generations already realize that the value of housing lies not in holding it for eventual capital gains, but rather in using it effectively. Moreover, the real motivation behind the strongly rooted desire for ownership is the need for more space. Most of the "additional" housing will fulfill this need.

Finally, the market needs to more efficiently match renters with landlords, and buyers with sellers.

Of course, while owner-occupied dwellings of the elderly may be adequate in size, the dwellings are rather old and may fail to suit the quality preferences of younger persons such as floor plan. Also, the dwellings will eventually need to be remodeled or rebuilt after passing into the hands of the younger generation. To facilitate existing home transactions, it is particularly important that information on quality is disclosed so that dwellings can be fairly priced. Otherwise, properties that exceed a certain age will be assessed as having no value except for the land. This would discourage selling except by the most motivated sellers.

In that sense, fair valuation based on accumulated data is crucial for promoting existing home transactions. The housing performance evaluation system already provides data on the construction, maintenance and repair history of properties. The public needs to be better informed about this system so that more households can use it. In addition, property and price information is now available on the Internet for completed transactions registered with the Real Estate Information Network System. In the future, more detailed information must be made accessible in the form of standardized indicators so that the public can readily understand and use this data.

In addition, complex tax rules that impede real estate transactions must be revised. At the very least, tax neutrality should be secured for owning and transacting financial and tangible assets.