



## Views from the Japan Equities Small Cap Desk

**Real Estate names look attractive  
as far as their management style is healthy**

**16 July 2019**

Author: Tatsuro NIGAURI  
Senior Portfolio Manager

### **INTERVIEWED FEATURED IN THE NIKKEI - ARTICLE [16/07/2019]**

Most of the small cap real estate stocks have continued to be undervalued in recent years, despite the booming real estate market. Real estate stocks in the small cap space have been considered unattractive, as investors become increasingly risk averse against a back drop of few positive bright spots in the external environment. In addition, the real estate sector is likely to suffer earnings declines in the event of interest rate hikes. However, real estate stocks are attractive in my opinion as long as you avoid companies that are “overdoing it” or excessive in their approach.

#### ▪ **Booms and busts in the past**

The real estate industry has to date experienced booms and busts. Industry players develop many new business models during a boom period, but they tend to operate them far too “aggressively”. Once the economy takes a turn for the worse, many companies are forced to close businesses.

However, the broad-brush statement that the industry is not learning anything from the past is misplaced. In fact, there are many players who remain in business with solid strategies by drawing lessons from the failures of their rivals

In my view, few companies have been “overdoing it” during the past 10 years, despite a boom during the recovery phase post the global financial crisis. “Overdoing it” or excessive projects – such as the developments funds which anticipate significant property price increases in advance (thereby increase their risk profile); suburban condominiums which are located far from railway stations (making them less attractive); the involvement of underworld forces in redevelopment projects and so on were often seen before the global financial crisis (those suspicious transactions were dwarfed by sound and decent ones after the crisis).

#### ▪ **Signs of overheat in condominium as investments**

Condominiums as investments targeted for ordinary people who belong neither to the wealthy nor high-income classes, are a market where industry players were “overdoing it” for the last few years. As regional banks loosened their lending standards, people could sometimes take out housing loans without a down-payment. In addition, industry players started to sell properties to people with low risk-bearing capacities and as a result a variety of illegal activities became rampant there.

However last year, lending to people with low risk-bearing capacities dropped dramatically after banks tightened their lending standards for individual investors following a series of scandals. Banks now tend to take longer to do credit research – even on people with high risk-bearing capacities. However, I don’t think that this tightening has led to a collapse of the overall real estate market.

- **Properties which require attention**

Nevertheless, we have to be cautious about some properties. What I am most concerned about are hotels based in Osaka. The massive supply of accommodation has continued apace in the city - helped by a surge in foreign tourists. This is because there is little hindrance to development, land prices are relatively cheap and regulations on house accommodations are loose. By now there does seem to be a glut in the supply. Given the continuous large supply pipeline for some time in the future, we may have to brace ourselves for an extremely tough adjustment phase.

I don't see any big problems in other areas for the present. I was worried about large-scale redevelopment projects in Tokyo before, but the massive supply from 2019 to 2020 is likely to be absorbed by increasing demands for office space following the earnings recovery. With regard to small to mid-size properties in Tokyo and properties in major cities in the countryside, the supply of office space is extremely tight as there is only limited supply there in the first place due to factors such as increased cost of construction.

I expect an expansion of the rental housing market in the medium to long-term on the back of an acceptance of foreign workers. If an influx of people increases only by a small margin compared to the country-wide population decline, some regions or industries will be sure to gain momentum and benefit from that trend.

**Source: Article by Tatsuro NIGAURI, featured in The Nikkei, on 16 July 2019**



Notes: Some statements contained in this material concerning goals, strategies, outlook or other non-historical matters may be forward-looking statements and are based on current indicators and expectations. These forward-looking statements speak only as of the date on which they are made, and the Company undertakes no obligation to update or revise any forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. The Company and/or its affiliates may or may not have a position in any financial instrument mentioned and may or may not be actively trading in any such securities.

The organisations and/or financial instruments mentioned are for reference purposes only. The content of this material should not be construed as a recommendation for their purchase or sale. Any charts and graphs provided are for illustrative purposes only.



## Disclosures

Issued by Daiwa SB Investments (UK) Ltd. Registered in England and Wales

Registered office 5 King William Street, London, EC4N 7JA; registered number 1660184. Authorised and regulated by the Financial Conduct Authority.

**Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.**

The data contained in this document is for information purposes only. It is correct to the best of our knowledge at the date of issue and may be subject to change. The client legal agreement will take precedence over this document. This document is not legally binding and no party shall have any right of action against Daiwa SB Investments Ltd., in relation to the accuracy or completeness of the information contained in it or any other written or oral information made available in connection with it. Nothing in this document or any related presentation shall be deemed to constitute investment advice, nor shall we be deemed to be an investment advisor unless formally appointed as such, or as discretionary investment manager, by way of written agreement.

The information contained in this presentation is to be used by the professional client that this document is issued to only.

This document may not be copied, redistributed or reproduced in whole or in part without prior written approval from Daiwa SB Investments (UK) Ltd.