The New York Times
nytimes.com

November 19, 2002

Falling Land Prices in Japan Take a Heavy Toll on Banks

By KEN BELSON

TOKYO, Nov. 18 — Of all the problems facing Japan's banks — falling stock prices, a weak economy, bloated payrolls, nonperforming loans — perhaps the most corrosive is the steady slide in land prices. If the latest statistics and other recent indicators are a guide, property values in Japan are going to sink even further, and undermine the banks' wobbly balance sheets even more in the months to come.

Taking advantage of falling construction costs and low interest rates, developers have plunged ahead with a thicket of new office towers in Tokyo. As they are completed over the next 18 months, the city may be glutted with office space, depressing rents and building prices in older office districts and in other cities.

At the same time, a small boom in demand for centrally located apartments in Tokyo appears to have ended, making it harder for builders to recoup their investments.

The twin declines in rents and property prices threaten to push more real estate companies out of business, leaving their bank creditors stuck with yet more nonperforming loans and yet more losses, analysts say. Land and buildings are pledged as collateral on most loans in Japan, so when the banks foreclose, they will be dumping even more real estate on a soft market, further depressing prices, which have already fallen by some 80 percent from their peak in 1988.

No immediate end to this vicious cycle of falling values, foreclosures and distress sales is in sight. The problem is sure to bring more calls for the Bank of Japan's policy board, which is meeting today and Tuesday, to broaden its market-supporting purchases of assets to include real estate as well as securities.

Prime Minister Junichiro Koizumi also faces political pressure to spend more on public works projects to keep the construction industry happy. After weeks of staving off demands for new spending, Mr. Koizumi's cabinet apparently changed tack on Friday and said it would begin work on new measures to reflate the economy.

But analysts say such measures will weaken the real estate market, not strengthen it. "What the government is doing is the 180-degree opposite of what logic dictates," said Akiyoshi Inoue, president of Sanyu System Research

Institute, Japan's leading property appraiser. "If they want to boost property prices, they have to cut supply or raise demand, but they are doing neither."

The government is also pushing the banks to move faster to write off their mountains of bad loans, which will lead to even more foreclosed property thrown on the market. And the government itself, hungry for cash to offset declining tax revenue, is considering selling some of its own vast holdings of idle land, perhaps as much as 310 billion ($2.5 billion) worth by next March.

Lawmakers, too, are assembling an "industrial revitalization" team that will be given the job of deciding which of the country's heavily indebted "zombie" companies should be resuscitated and which must close. One possible criterion is the ratio of a company's debts to its cash and liquid assets. On that standard, real estate companies, which have debt averaging 24 times their cash, may be among the first to be shut.

Even the property companies that survive government scrutiny are facing bleak times. About 23.7 million square feet of new commercial space will come on the market in central Tokyo in 2003, 20 percent more than in 1994, the height of the last building spree. The most modern buildings will fill up quickly, analysts say, but at the expense of older and less desirable buildings, where vacancy rates are starting to rise.

"The 2003 problem for new buildings will become the 2004 problem for older buildings," said Jim Fink, general manager for leasing at Colliers Halifax, which represents tenants in Tokyo.

Even the largest builders are feeling the pinch. Though Mitsubishi Estate reported on Friday that profits nearly tripled, to 19.4 billion yen ($161 million), in the half-year ended Sept. 30, its gains came from one-time asset sales; revenue from core operations fell 9 percent.

Some optimists have taken heart from relatively strong demand for condominiums in the Tokyo area. Enticed by mortgage rates below 3 percent, easy loan terms from the government and prices that had fallen back to 1985 levels, Japanese buyers have been scooping up small apartments over the last year or two.

But that rally has started to fade. In October, the number of unsold apartments in metropolitan Tokyo climbed above 10,000 for the first time in four years, according to the Real Estate Economics Research Institute.

Mr. Inoue, one of the most bearish watchers of the Tokyo property market, expects land prices to fall by half over the next five years. A recent government survey partly bears out his reading of the trend: residential land has fallen 12 percent this year. And over the last decade, property owners have accumulated more than 700 trillion yen ($5.8 trillion) in unrealized losses — more than shareholders have in the slumping Japanese stock market.