



Savills Corporate Finance | **Asia Pacific**

## Asia Institutional Investor Insights - Focus on Japan

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# Japan Institutional Investors

***According to a recent Bank of Japan report, domestic financial assets exceed US\$19 trillion making Japan the largest source of investment capital in Asia. Moreover, with limited domestic growth, the strong yen, a need to diversify risk and for higher yield-producing investments, Japanese institutional investors are increasingly looking overseas to allocate capital, including real estate investments. This makes Japan a top priority for fund managers seeking to raise capital in Asia.***

Discussions with over eighty of the largest Japanese institutional investors have yielded a changing view of investment allocation strategy. The Japanese investors we have spoken with are diverse and include financial firms, pension funds, insurance companies, asset and private wealth management firms, real estate companies and trading companies. A reoccurring response from these investors is a broad and growing intent to increase allocations to alternative investments, including overseas real estate funds.

## ***Japanese investor portfolio strategy***

Japanese institutional investors typically place up to 60% of their portfolios in fixed income, primarily low-yielding Japanese government bonds, 30% to 40% in equities, and the remainder in alternative investments, including hedge funds, private equity and real estate. Up to the global financial crisis in 2008, many institutional investors had large investment exposure to both domestic and global opportunistic real estate funds, resulting in significant losses during the downturn. From 2008 to 2010, most institutions were not considering new fund investments as they were ascertaining the extent of their losses and were hesitant to invest in a largely uncertain economic environment. Beginning in 2011, institutional investors have expressed a renewed interest in allocating capital to alternative investments, including overseas real estate funds. Investors have pointed out that real estate funds are attractive due to their

higher dividend yields and a low correlation to stocks and bonds as part of an overall portfolio strategy.

A number of institutional investors have expressed a desire to construct balanced real estate portfolios to include core/core plus, value-added and opportunistic strategies across multiple geographies. There is a strengthening appeal, however, among investors for overseas open-ended core funds with gateway city assets providing dividend yields in excess of 5%. Real estate debt funds were also included as part of several investors' allocation plans.

## ***Why the change in investment strategy?***

With the ten-year Japanese government bond currently yielding 0.97% and the Nikkei providing inadequate returns, institutional investors are increasingly turning to alternative classes such as real estate, private equity and hedge funds in order to achieve required returns. Real estate in particular, which has historically made up a low percentage of fund managers' portfolios, is an attractive asset class as an income-producing investment compared with domestic bonds and stocks. For example, pension funds in Japan typically need a total return of 3% to 5% to maintain their payment obligations to retirees. Thus, real estate funds which have income returns exceeding this level are increasingly attractive.

Japanese firms are also looking overseas to diversify their risk exposure after experiencing the impact of the 2011 earthquake, tsunami and nuclear crisis. Foreign real estate investment helps to mitigate, through geographic diversification, the catastrophic risk exposure to an entirely domestic portfolio. Many investors have also expressed a desire to take advantage of the stronger yen currently at approximately JPY77 to the US dollar.

### ***Investment selection criteria***

In comparison with the market prior to 2008 when investors tended to invest in the marquee real estate funds offered by large Wall Street firms, institutional investors have strongly indicated they are now looking for real estate fund managers with the following characteristics:

- Dedicated real estate firms with a strong track record of investment success and interests aligned with investors.
- Funds which offer stable yields with an amount of leverage appropriate for the investment strategy.
- Funds which have superior local knowledge and expertise in the markets in which they invest.
- Funds which can quickly respond to, and communicate well with, overseas investors.

From our discussions with investors, we clearly anticipate interest to continue to grow in overseas real estate fund investments. Japanese institutional investors are in the process of understanding the opportunities in overseas real estate markets and, more

importantly, better understand their choice of real estate fund managers. As such, the marketing process can be more research intensive and the amount of time for due diligence longer than is typical in the US.

### ***Fund marketing – key success factors***

It is important for real estate fund managers to begin to build relationships with institutional investors at an early stage, prior to the launch of a fund. An investment management firm must commit to long-term relationship building in Japan, including having the firm's senior management involved throughout the marketing process. Fund managers should also be prepared to spend considerable upfront time in educating investors about their firms, as well as about overseas investment markets. This means firms must understand the investment decision process of the Japanese investor and adapt their marketing process accordingly. Having someone on the ground to quickly respond to investor needs is also a best practice highlighted by many Japanese institutions.

### ***Conclusion***

For real estate fund managers who are seeking to raise capital from some of the largest global institutional investors, Japan will be a market with increasing opportunities over the next three to five years

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