Japanese Foreign Direct Investment in Real Estate 1985–1994

Roger Farrell
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Roger Farrell
Australian National University

Australia–Japan Research Centre
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JAPANESE FOREIGN DIRECT INVESTMENT IN REAL ESTATE 1985–1994

This paper explores the political economy of Japanese real estate foreign direct investment between 1985 and 1994. In this period there was a remarkable rise and decline in Japanese real estate investment abroad. The experience was important, not only because of the large growth in the share of real estate FDI in Japan’s overall FDI in these years, but because real estate investment became a focal point of international tension between Japan and other countries which absorbed it.

To understand both the speed of the advance and retreat of Japanese FDI and its impact on host economies and communities, it is necessary to explain its principal causes. There are two main explanations of foreign direct investment in the economic literature on the theory of foreign investment. One derives from the traditional industrial organisation theories of FDI, which explain direct investment in terms of the specific advantages and characteristics of investor firms. This type of investment promises investor control over assets and an active managerial role and is associated with the strategic international expansion of firms, based on their specific advantages over local firms (Dunning 1981). The second explains capital flows as a response to the differing yields on investment associated with variations in financial conditions across countries, developments in foreign exchange markets and regulations affecting capital flows. This type of investment occurs without significant investor control over assets held abroad (Hymer 1960).

The paper argues that, for the most part, Japanese real estate investment was of the latter type and that the organisational and corporate strengths of investment firms explain little of the timing or impact of Japanese real estate FDI in the 1980s. A wide range of Japanese investors, without specific capabilities or expertise in international real estate markets, participated in the often speculative acquisition and development of foreign office, hotel and other properties. This conclusion is critical to understanding not only why Japanese real estate investment emerged and retreated so quickly, but also why host countries responded to this experience in the way in which they did.

Introduction

Japan became the world’s largest creditor during the 1980s and real estate emerged as the largest single component of Japanese foreign direct investment (FDI). From 1985 onwards a range of Japanese construction firms, realtors, trading and insurance companies, and other investors acquired and developed office buildings, hotels, resort complexes and residential real estate in major cities and tourist destinations around the world, but particularly in the United States and Australia. By the early 1990s, however, many investors had withdrawn from foreign real estate
markets and incurred large losses from falling property values, both in Japan and in other countries.

Surprisingly, there has been little detailed analysis of trends in Japanese FDI in real estate between 1985 and 1994. Indeed, little information is available on the nature, organisational structure and motivations of this form of investment. Yet Japanese FDI in real estate has created political tensions in a number of host countries because of its remarkable scale and rapid expansion. Similarly, the relationship between Japanese investment in real estate abroad and the parallel development of the domestic real estate ‘bubble’ has not been subject to detailed examination.

In addressing these issues, the paper firstly considers the pattern of Japanese FDI in real estate between 1985 and 1994 when a range of Japanese firms, particularly those in the real estate and construction industries, engaged in an unprecedented period of acquisition and development of real estate around the world. Many firms in other Japanese industries also participated in FDI in foreign real estate either directly, or through the establishment of real estate subsidiaries in Japan or other countries (Table 1).

Within the decade under review, two phases can be identified: the first phase of rapid expansion of investment from 1985 to 1989 and a second phase from 1990 to 1995, characterised by a slowing of new investment and the beginning of significant divestment of foreign real estate by Japanese investors. During the first phase a wide range of investors in Japan participated in overseas real estate investment, especially large real estate and construction firms, tourism entrepreneurs and institutional investors.

Major Japanese manufacturing, transport and airline firms also used their real estate subsidiaries in Japan to direct the acquisition or development of overseas real estate. For some investors, investment in hotel, resort or office real estate involved an active business strategy. Many others were owners and not owner-managers of these assets. Marketing of foreign real estate by real estate, finance and trading companies in Japan increased markedly in the 1980s and smaller investors gained access to foreign markets through the networks established by these firms.

The Japanese Ministry of Finance statistics on notifications of FDI are the main source of information on investment by industry as the Bank of Japan’s balance of payments series is not broken down by industry of investor. According to the former source, outflows of Japanese FDI in real estate peaked in the late 1980s and then declined relative to total FDI flows. In 1994 the cumulative level of Japanese FDI in real estate reached US$71 billion, or 15 per cent of the total stock of Japanese FDI since 1951, when statistics were first collected.
It should be noted that these statistics do not reveal the scale of the divestment of foreign real estate after 1989, or the extent of losses incurred by investors in this period. They also do not include foreign real estate investment by Japanese individuals or firms in other industries and may understate the true scale of investment during this period (Wakasugi and Komiya 1990, p. 4). Nevertheless, the available statistics appear to provide a reliable guide to the pattern of investment.

**Key issues**

The predominant framework for understanding the causes of FDI is the theory of industrial organisation of FDI, which focuses on the motivations of investors, their firm-specific advantages.
and their strategic approach. This approach can be expanded to also emphasise the role of country-specific differences in financial, regulatory, locational and political determinants of FDI. Since Hymer’s study (1976), which emphasised the key element of investor control, explanations of FDI have generally focused on firm-specific factors.

The motivation to invest is typically seen as based on the characteristics or advantages of the investor. The firm’s decision to exploit its advantage explains its decision to expand internationally. Hymer emphasised that passive (type I) investment could be distinguished from active flows of foreign investment (type II), by the latter’s element of investor control and the two-way direction of FDI between countries. Hence, while passive investors respond to country-specific factors, such as short-term variations in international yields, active investors give priority to the longer-term strategic goal of competing in the host country.

As investor control is the definitional distinction between type I and type II flows of international investment, assessing the character of investment, as either active or passive, is critical in assessing whether a specific or general explanation of real estate FDI is more appropriate. Theoretical explanations of FDI reflect the conceptual distinction between active investment, involving management influence or control, and passive investment with ownership but not control.

Hence, passive or ‘ordinary’ investment involves merely ownership while active FDI involves active owner-managers and a longer-term approach to corporate planning (Kindleberger 1969, pp. 24–25). As overseas operations become more mature, firms develop an ‘integrated world-wide approach in their business strategy’ (Porter 1990).

International investment is merely a flow of capital from a country of low financial returns to one of higher returns, if the investing firm operates as an arbitrager of capital. In this case, the investor has not expanded its corporate activities beyond the home country (Caves 1982, p. 31). In practice, however, there are a number of grey areas in the concept of FDI. These include the unclear definition of corporate control and the general assumption that an investor can influence management, if ownership exceeds a specified ratio.²

By definition, FDI cannot be indirect if ownership allows control—but a proportion of FDI is passive rather than active in nature and does not involve investor control or management involvement. Also, passive FDI may be influenced more by country-specific than firm-specific factors based on investor advantages or other attributes. The distinction between passive or type I FDI and active or type II FDI is central to a study of its causes and is reflected in the level of investor control and organisation of foreign activities. For passive firms which sub-contract
management functions, ownership and internalisation advantages are less relevant than they are to owner-managers, which utilise control and firm-specific niches to expand into other markets.

The typology of real estate FDI relates directly to the relative significance of investor motivations based on firm-specific advantages, compared with the role of more general country-specific determinants of both FDI and divestment. Hence the applicability of either general or firm-specific explanations of the pattern of Japanese real estate FDI between 1985 and 1994 depends on whether investment was type I or type II in character (see Figure 1).

Investor advantages

An explicit assumption in the industrial organisation explanation of FDI is that foreign investors require an advantage over local competitors to justify the higher cost of operating in a host country and to ‘compete effectively with host-country firms on the latter’s own turf’ (Aliber 1970, p. 254). Firms with such advantages are assumed to have a clear motivation to undertake FDI in the particular host country in which they are competitive with local firms.

In Dunning’s (1981) broadly accepted eclectic theory, the general preconditions for FDI are that direct foreign investors must not only possess ownership advantages, but must also have a locational incentive to establish in the host country, as well as internalisation advantages which encourage foreign companies to retain control over their foreign activities. Much of Dunning’s theory was developed to explain FDI in manufacturing, for example, US FDI in the United Kingdom during the 1970s. Service industries have received less attention, although the advantage of investors may be ‘in their detailed knowledge of how to service the needs of their domestic clients which have established overseas subsidiaries and branches’ (Dunning 1993, p. 142).

Advantages in funding FDI, as noted by Kindleberger (1972) and Baldwin (1986), may also be important, particularly for large firms (Horst 1972). The easy availability of funds for US international firms in the 1960s, compared to non-US companies, was a major advantage for investors during this period. Did such an investor advantage exist for Japanese real estate investors between 1985 and 1994?

Firm-specific advantages may include firm size, established market position, access to raw materials and exclusive access to intangible assets such as patents. The existence of significant management and organisational skills, or marketing networks, may also provide a motivation for FDI to occur (Dunning 1993, p. 160). Investors with proprietary assets, such as high levels of research and development, may be more able to overcome the entry costs of operating in a foreign
## Figure 1  Typology of Japanese FDI in real estate

<table>
<thead>
<tr>
<th>Ownership and control</th>
<th>Type I</th>
<th>Type II</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 10 per cent or greater share of ownership, but indirect control and no voice in management (owner)</td>
<td>A 10 per cent or greater share of ownership, direct control and an active voice in management (owner-manager)</td>
<td></td>
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<tr>
<th>Financial and strategic approaches</th>
<th>Passive and generally speculative holding of overseas real estate assets, often based on short-term financial fluctuations in international yields and prices</th>
<th>Active utilisation of firm-specific advantages, over the long-term, to achieve corporate strategy goals in the host country.</th>
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<tr>
<th>Corporate and financial organisation</th>
<th>Insubstantial expansion of corporate activities, often based on short-term access to funding in the home or host country. Divestment often followed loss of funding advantages</th>
<th>Establishment of significant corporate activities in the host country, based on the exploitation of proprietary advantages. Funding not crucial to sustainability of international expansion</th>
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<th>Direction of investment</th>
<th>Generally one-way flow</th>
<th>Two-way FDI flows</th>
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<tr>
<th>Motivations and determinants</th>
<th>Country-specific factors were significant determinants</th>
<th>Firms expanded to exploit firm-specific advantages</th>
</tr>
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6
market (Drake and Caves 1992, pp. 234–35). The significance of such entry costs is likely to vary from industry to industry.

Given its high initial cost, it is typically assumed that FDI is made by concentrated industries with significant ‘bundles of proprietary assets’, while ‘simpler’ industries or firms are characterised by more entrants or ‘exitants’ (Caves 1994, p. 4). If few immediate barriers to FDI exist in the host country, it is possible that firms with few proprietary assets or advantages, compared to local firms, could become active foreign direct investors.

The first involvement of a firm in FDI is likely to be a learning experience. Invariably, investors make significant mistakes as they seek to compete in host countries for the first time (Aharoni 1966). As the information costs associated with FDI may be both ‘heavy and relatively fixed, small but rising firms that might eventually find direct investment profitable may rationally postpone it until penetration of the home market is more advanced’ (Caves 1982, p. 130).

The initial entry cost of FDI may be reduced by investment in culturally or linguistically similar or familiar host countries, particularly if other related firms have also established operations in the host country. Investors may need time to realise that an apparent advantage or opportunity in foreign markets was only temporary or even non-existent. A key question is whether the firm-specific theory of FDI can explain FDI entry into a ‘simpler’ industry such as real estate.

Other motivations

The industrial organisation theory of investment was initially developed to explain FDI by large US firms with significant proprietary assets, often in concentrated industries such as motor vehicles or chemicals. This pattern, however, may not be typical of other cases of FDI involving investors from other countries. Large numbers of Japanese small and medium firms, for example, engage in FDI, despite their apparent lack of size and of complex proprietary assets (EXIM 1991, p. 3).

One approach is to distinguish between mature, experienced and immature foreign investors to allow for internationalisation as a learning experience, during which mistakes may be made (Aliber 1970, p. 71). If firms expand internationally to gain experience, rather than to exploit an existing advantage, their involvement in FDI may not be explained by Dunning’s (1981) eclectic theory. The motivation for FDI may be rivalry between firms in the home country, or to acquire international standing or prestige. The propensity of firms to engage in ‘bunched’ FDI,
in which competitors establish foreign subsidiaries in rivalry with domestic competitors, has been examined for US firms in the 1960s (Flowers 1976; Knickerbocker 1973).

Evidence of a ‘follow-the-leader’ FDI strategy has been found for Japanese FDI in US tyre and textile industries, in European and US motor vehicle and consumer electronics sectors and for FDI in selected global service companies, e.g. (Li and Guisinger 1992; Yu and Ito 1986). In these studies, rivalry between firms was a major motivation for investment, but the relative importance of firm-specific advantages is unclear. Were Japanese real estate investors between 1985 and 1994 influenced by rivalry or related motivations? Were they also passive investors, comparatively inexperienced and without a clear firm-specific advantage?

**Foreign direct divestment**

Relatively few researchers have focused on the reasons for unsuccessful FDI and divestment, and the link between motivations for investment and divestment is also relatively unexplored (Caves 1994). Investors following a strategy of gradual expansion, as they better understand their competitive strengths, may be more successful, so that sequential firms appear more successful than ‘large jumpers’ which make sudden acquisitions through FDI (Kogut 1983). A strategy based on transient advantages, however, may be more likely to lead to divestment.

Firms pursuing FDI may be unaware of their actual competitiveness in a foreign market until after entry, so that divestment is inevitable in some cases (Jovanovic 1982, pp. 649–70). This result does not identify which firms are likely to exit early, or the characteristics of successful or unsuccessful investors. Another approach is to ask whether the lack of a sustainable investor advantage leads to foreign divestment. If a firm ceases to possess net competitive advantages over firms of other nationalities, it may lease its operations to foreign firms or abandon FDI (Boddewyn 1983, p. 346).

Subsequent research has neglected the latter approach, which represents a reverse side of the industrial organisation theory of FDI. There is therefore an opportunity to focus on the impact of transient investor advantages, such as easy access to finance for FDI on motivations for foreign direct investment and divestment. This course is particularly apposite in the case of Japanese FDI in real estate, in which there has been significant divestment and an apparent failure of FDI strategies.

If control and strategy are not important, real estate FDI may resemble international indirect or portfolio investment (Graham and Krugman 1989). Firm-specific motivations of FDI may not explain the form or pattern of investment if investor control or management involvement
is not clearly evident. In this case, the organisational form of the subsidiary or investment structure may be essentially indirect even if classified as FDI.

The need for a firm-specific investor advantage, through the ownership of complex proprietary assets, as a precondition for FDI could also be questionable if entry and exit into the target industry is relatively open (Caves 1994). Hence, determinants of its timing and location may be country-specific in nature, such as variations in exchange rates, international property yields and interest rates, and the value of real estate assets in the home country.

**Country-specific determinants**

Rising land values in Japan increased the collateral base of some investors and is likely to have increased investor purchasing power. Changes in property yields in Tokyo and major US cities during this period may have stimulated Japanese real estate FDI (see Figures 2 and 3). Hence, investors may require only a financial and not a strategic motivation for FDI. Consequently, we need to study the role of currency fluctuations, changes in asset values, relative prices and returns for real estate, and the access to finance of real estate investors in motivating real estate FDI flows.

**Figure 2** Property yields in Tokyo and major US cities 1980–92, per cent

Note: Property yields or ‘equivalent yields’ are defined as the percentage return on price or value derived from the current net passing income and the increases to current market rents, the latter being deferred until the date of the next market review. The figures depict the lowest prime office investment yields.

Source: Jones Lang Wootton (JLW) International, Property Digest, various countries and years.
The various country-specific determinants of Japanese FDI in overseas real estate can be considered using a broader locational perspective. The political environment in host countries also affects the geographical distribution of FDI. Initially, investment flowed broadly to resort locations familiar to Japanese tourists, such as Guam and Hawaii, or world cities with a high proportion of finance and other service industries and developed property markets.

Typically, FDI was also attracted to relatively open, advanced economies, because policy barriers to real estate FDI are still common in many countries. The geographical distribution of Japanese financial institutions appears closely linked to the location of Japanese real estate investment in developed countries with sophisticated, well-developed financial markets.

In these countries, and in the United States in particular, Japanese firms formed links with locally established banks, security houses and realtors to utilise their specialised knowledge in areas such as securitisation. Restrictions on domestic real estate, such as a high capital gains tax on short-term buying and selling of land, and the low rate of taxation on holding real estate, discouraged the operation of an active market in Japan.

This regulatory environment, combined with the pressures of economic growth and the concentration of economic activity in major Japanese cities and Tokyo in particular, contributed to the rising price of land in the 1980s (EPA 1990–91, pp. 148–49). Construction and real estate

Figure 3  Index of urban land prices in Japan, 1955–94

Note: The ‘Index of Urban Land Prices’ has March 1990 as its base period and is compiled semi-annually. Land prices incorporated in the index calculation are surveyed in 223 cities and based on real estate appraisals.

firms faced considerable difficulties in accumulating urban land for development, although the supply of rural land was eased by the 1987 Resort Law, which encouraged the creation of resorts in other prefectures.

The frenetic pace of the bubble economy in Japan after 1985 lowered domestic yields and encouraged investment in appreciating assets, including overseas real estate (EPA 1990–91, p. 133). Rival firms competed with each other for prestigious development sites and buildings in major foreign cities, thereby bidding up prices. Some investors acquired or developed foreign real estate to achieve short-term speculative capital gains or higher yields. Others sought to establish an international presence as long-term owners or owner-managers.

In the 1980s, Japanese real estate FDI followed and supported the rising property markets in the United States, Europe and Australia. In the first half of the 1990s, it declined in line with falling international prices for real estate. The scale of investment from Japan helped to maintain property values until the end of the decade. This effect was reinforced by the convergence of investor interest in particular areas of major cities and resort areas, due to shared perceptions of the value of foreign real estate.

Motivations for investment

Accustomed to the long-term upward movement of real estate values in Japan, investors did not expect overseas property markets to be volatile and planned on both capital gains and yields, to justify their investment. Hence, as Keynes (1936, p. 149–50) noted, investment decisions are often affected by ‘animal spirits’, or the optimism or pessimism of investors.

The bubble period in Japan in the second half of the 1980s was characterised by great optimism over the prospects for capital growth in domestic and overseas real estate markets. Investors seemed to adopt a long-term approach to achieving profitability. For example, one cost–benefit study suggested that Mr Takeshi Sekiguchi’s purchase of the Grand Hyatt Wailea Hotel in Hawaii for US$600 million could only be viable at a price of only US$200 million (Australian Financial Review 28 February 1992).

Often there was little investigation of the viability or purpose of the investment. Firms with limited experience of the ownership or management of international real estate were able to acquire large international properties (Dalrymple 1992). The predilection of Japanese investors for large-scale development projects and the bidding up of prices for established properties meant that investors accepted lower yields, as the fundamental demand for office space or hotel accommodation did not increase proportionately.
In Japan the traditional method of valuing real estate has been to compare the value of similar land or buildings from recent transactions, the ‘dealing example comparison method’. In this approach, the value of land significantly exceeds the value of construction and yields are not directly relevant. This contrasts with the traditional ‘benefit return’ method used in the United States and Australia, which values real estate as the expected income divided by the expected yield, so that the yield equals the expected income divided by the estimated value of the real estate.\(^{10}\)

Japanese investors adopted the traditional ‘dealing example comparison method’ in assessing the value of foreign real estate. This valuation technique made foreign offices and hotels assets appear inexpensive compared to similar real estate in Japan. Investors also overestimated the value of land compared to buildings in foreign real estate and overlooked the close relationship between capital values and yields for real estate outside of Japan, which can cause significant fluctuations in the price of real estate. The idea that Japanese investors were attracted to inexpensive foreign real estate is called into question by Froot (1991 p. 18):

One frequently hears that yen appreciation makes foreign assets appear cheap to Japanese companies. For example, stories abound that Japanese investors are prepared to bid the highest prices for prime properties in Manhattan because Japanese real estate prices in dollar terms are even higher. This simple argument makes little sense however: Manhattan buildings should sell for the present value of the after-tax rents they are expected to generate. Even if Japanese real estate is overpriced, so that buyers cannot hope to break even, that is no reason to overpay for office space in Manhattan. [emphasis added]

This argument would apply if Japanese investors had evaluated the present value of the after-tax rents from foreign real estate. They would not then have considered foreign real estate as particularly cheap, compared to similar assets in Japan. The yen-denominated return on such assets would also have been assessed as unacceptably low, particularly given the exchange rate risk of foreign investment. However, speculative motivations and inexperience were also important.

The price gap which developed between domestic and foreign real estate due to the asset bubble in Japan influenced investor expectations. Investors generally used the ‘dealing example comparison method’ to assess real estate values. If a Manhattan building’s value was compared to the value of similar buildings in Japan, it seemed remarkably inexpensive, because of asset inflation in Japan. In the 1980s, the rising real estate market in Manhattan also suggested the possibility of capital gains for investors. In either case, falling yields did not put a brake on further investment.
Hence, the use of domestic valuation techniques by Japanese developers and buyers blinded them to the coming downturn in foreign real estate markets. Moreover, overpaying for foreign real estate assets made it more difficult for Japanese firms to sustain their overseas activities even if they had significant firm-specific advantages in areas such as tourism management and organisation.

Many of the new Japanese real estate investors were entering foreign real estate markets for the first time, after a long period of restriction on this form of investment, and were comparatively inexperienced. Even those firms, such as Mitsui Real Estate, which had previously invested outside Japan had done so only on a small scale. While Japanese real estate investors based investment decisions on intensive research, they used a different valuation model, with an explicit expectation of stable or rising prices for real estate. A past managing director of EIE International, Dr Ishizaki, stated in 1995 (Australian Financial Review 3 March 1995, p. 1):

I do take a lot of responsibility and I have a lot of remorse for concentrating absolutely on capital gains type investment and ignoring the ability to service debt. I did put EIE in the position when the bubble burst, that we could no longer just flip a property over and make a killing; that we couldn’t service our debt. Our portfolio should have been more balanced with cashflow. But in those days, talking about 6 per cent yields just wasn’t in vogue. That was our big mistake, there’s no doubt about it.12

The rapid expansion of Japanese financial institutions into overseas markets in the 1980s paved the way for investment by other firms in Japan. Through the establishment of an international network and links with host country financial institutions and realtors, they were able to offer a package of services to investors in Japan who were attracted by the apparent cheapness of overseas real estate. Investors tended to use the same valuation methods overseas, as in the Japanese real estate market. After 1985, investors appear to have been less diligent in gathering market knowledge and accounting for risk, compared to the first half of the decade, when one observer noted:

When the Japanese examine a project, they are not subjective. They do an incredible amount of homework and it takes a long time to get them to the table … they look at premier properties more or less like a US pension fund that has no in-house, hands on expertise … the Japanese are willing to take the safety of a premium property and a lower return. They would rather have a 9 per cent return on a sure property than have a 15 per cent return where there is too much risk (Reier 1985).
The focus of Japanese investors on the potential for capital gains from real estate investment also led them to ignore the availability of much higher yields in foreign government securities in the United States and Australia. With little prior experience of investing in international real estate, many Japanese investors were reliant on the advice of both Japanese and foreign financiers and advisers.

To increase their knowledge of overseas real estate markets and the operations of foreign realtors, particularly in specialised areas such as real estate investment trusts (REITs), Japanese investors formed partnerships with US real estate firms, as well as joint ventures with Japanese advisers, such as trading companies and banks. In 1986 Nomura Securities formed a partnership with Eastdil Realtor, a major New York realtor and in 1987 the partners acquired the office building, 919 Third Avenue, through the use of a convertible mortgage of US$325 million.

Apparently, many investors were not warned of the cyclical nature of such markets and the danger of capital losses and rising vacancy rates, particularly if an oversupply of office or hotel property occurred. Even as capital values in the US and Australian property markets were beginning to decline after 1990, Japanese investment continued at an optimistic pace due to unfamiliarity with host country property cycles. In a number of cases, investors were also clearly disadvantaged by a lack of knowledge of local regulations, as with the Pebble Beach acquisition.

Timing of investment

The timing of investment from Japan contrasted with that of investors from other countries, who preferred to buy during periods of lower capital values and higher yields. Japanese investors appeared optimistic about the long-term prospects for capital appreciation and accepted lower yields to secure landmark properties, even in the late 1980s when more experienced local and other foreign investors were withdrawing from the market (see Figure 4).

The chief economist for the Long-Term Credit Bank, Takashi Kiuchi, noted in 1992 that ‘suddenly, everybody realised that the rate at which they had purchased real estate in the United States was somewhat higher than the market price, so that the only buyers were Japanese buyers’, while the director of the Goldman Sachs real estate department observed that ‘the Japanese supported the US real estate market long after others had withdrawn’ (Australian Financial Review 28 February 1992).

This pattern of investment timing suggests that domestic criteria were used, with an emphasis on capital appreciation to justify acquisition, instead of the present value of real estate
assets based on yields alone. The acceptance of low yields also suggests that investors expected eventual capital gains and were taking a long-term perspective (Walkley 1994). Investment based on capital gains becomes increasingly speculative over time (Ito 1993, p. 407). Surveys of investors suggest that few investors estimated the present value of overseas real estate assets, but instead used direct price comparisons to assess asset values.

By the end of the decade, the convergence of Japanese investment interest in particular types of overseas real estate led to the bidding up of prices and falling yields. Most investors reacted slowly to the market decline. The consensus approach of Japanese investors contributed to this slow response. Individual decision makers within firms were also reluctant to break with the group philosophy. Decision makers involved in the acquisition of overseas real estate often had prior

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**Figure 4** Timing of FDI in US real estate market, 1976–93, per cent

*Note:* Right scale refers to capital index.

experience only of the postwar bull market and were not familiar with the cyclical nature of many overseas markets (see Walkley 1994).

Other investors accepted the optimistic advice of Japanese realtors and financial institutions because of their inexperience and hoped to replicate the large gains earlier investors had reaped. High real estate prices in Japan and the appreciation of the yen in the 1980s made overseas real estate appear very cheap, so that the ‘low dollar means the US has become a bargain basement’ (See Ohmae 1988b). Rivalry between Japanese investors to obtain prime trophy buildings also contributed to the high prices they paid (Kester 1991, p. 109). Examples of such acquisitions are given in Table 2.

The development of the bubble economy in the 1980s had a persuasive influence on the financing and timing of Japanese real estate FDI. A range of Japanese firms, particularly realtor, leisure and construction firms, were easily able to borrow large amounts from Japanese financial institutions to fund real estate investment in Japan and overseas. The higher cost of land in Japan for development encouraged contractors to expand into offshore real estate development projects. Lower yields in Tokyo or Osaka real estate stimulated Japanese institutions to invest in major office buildings, especially in the United States.

Similarly, the appreciation of land assets held by a wide range of Japanese firms, especially realtors with significant inventories, increased their purchasing power in overseas markets, reinforced by the appreciation of the yen. Relaxed bank and non-bank lending standards during the bubble years also provided easy funding for real estate FDI. Smaller firms and individuals were attracted by the relative decline in the prices of foreign real estate, such as condominiums in Hawaii or Los Angeles, compared to similar properties in Japan.

For a time, real estate investors in the United States, Australia and elsewhere were unable to compete with the financial reach of Japanese investors in the 1980s, who consistently outbid their host country counterparts, albeit at the cost of lower yields (Graham and Krugman 1989). Yet, this financial advantage was not robust enough to sustain the fortunes of investors against subsequent fluctuations in foreign real estate markets.

**Strategic advantages?**

In the industrial organisation model of FDI, foreign investors are assumed to require an advantage over local competitors to justify the higher cost of operating in a new environment (Aliber 1970, p. 254). Nevertheless, in ‘simple’ industries, such as real estate, with few barriers to
entry, ‘bundles of proprietary assets’ may not be so important (Caves 1994, p. 4). Compared to FDI in industries such as manufacturing, where there are often scale economies and minimum technology requirements to enter foreign markets, there are few barriers to the ownership of international real estate, apart from foreign investment regulations. Real estate investment requires only a financial transfer and the sub-contracting of management functions.

Between 1985 and 1994, many Japanese real estate investors had no prior experience of the ownership of overseas offices or hotels and employed local real estate firms and international hotel

Table 2 Selected examples of Japanese real estate acquisitions in the United States (US$ million)

<table>
<thead>
<tr>
<th>Date</th>
<th>Company</th>
<th>Acquisition</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 1986</td>
<td>Shuwa Corporation</td>
<td>Arco Plaza (Los Angeles) $620m</td>
<td>‘largest all-cash real estate deal in US history’</td>
</tr>
<tr>
<td>November 1986</td>
<td>Daiichi Real Estate</td>
<td>Tiffany Building (NY) $94m</td>
<td>‘highest price ever paid per square foot for retail space in the US’</td>
</tr>
<tr>
<td>December 1986</td>
<td>Mitsui Real Estate (New York)</td>
<td>Exxon Building (NY) $610m</td>
<td>‘highest price ever for a Manhattan office building’</td>
</tr>
<tr>
<td>December 1986</td>
<td>Kato Kangaku Company</td>
<td>Tower 49 (NY) $303.5m</td>
<td>‘set a record for a US office building of $478/square ft’</td>
</tr>
<tr>
<td>1986</td>
<td>Shuwa Investment Corporation</td>
<td>ABC Building (NY) $175m</td>
<td>‘...a far higher figure than other bidders were willing to offer’</td>
</tr>
<tr>
<td>1987</td>
<td>Kokusai Motorcars</td>
<td>Hyatt Regency Maui Hotel (Hawaii) $319m</td>
<td>‘record for a single hotel’</td>
</tr>
<tr>
<td>1987</td>
<td>Nomura Securities/ Eastdil Realty</td>
<td>919 Third Ave (NY) $325m (convertible mortgage)</td>
<td>Convertible mortgage syndicated to small and medium Japanese companies</td>
</tr>
<tr>
<td>1987</td>
<td>Sumitomo Realty &amp; Development Co</td>
<td>666 Fifth Avenue (NY) $500m</td>
<td>Price of $365/square foot</td>
</tr>
</tbody>
</table>

managers to manage these assets. Japanese firms often made ‘large jumps’ in rapidly acquiring overseas portfolios of offices and hotels, a strategy which is generally less sustainable than a more gradual international expansion through FDI (Caves 1994; Kogut 1983). As owners, rather than owner-managers, such firms also took a passive approach to strategic corporate issues (Dunning 1993, p. 81).

The wide range of participants, including steel, transport, real estate, construction, airline, insurance, trading and financial enterprises, suggests that firm-specific characteristics were not generally relevant, as all Japanese investors could not have possessed particular firm-specific advantages in real estate investment. Even large and experienced Japanese real estate and construction firms appointed local realtors and financiers to advise them on foreign real estate investments. Smaller investors drew on the information sourced from these networks, or from

Figure 5  Timing of FDI in the Australian real estate market, 1980—94, per cent

Note: Right scale refers to capital index.

Source: Calculated from Australian Treasury/Foreign Investment Review Board (FIRB) Annual Reports and J.E.W. International Office Survey, various years.
Japanese trading companies. A common practice was to seek advice from foreign real estate, accountancy and legal companies before pursuing an acquisition.

Ownership and internalisation advantages were less relevant for owners than for owner-managers, as firms in the former category did not expand internationally through active corporate strategies, but sub-contracted management functions (Dunning 1993, p. 81). Internalisation advantages had little relevance for Japanese real estate investors as alternatives to ownership or owner-managing, such as franchising or licensing, were not possible for most investors (Nicholas 1996, p. 17). There were also few alternatives to FDI for Japanese investors wishing to acquire ownership over foreign property.

In general, Japanese investors sought to acquire or develop real estate for their own use, or for lease or to sell to other Japanese firms. According to the 1990 Japanese Ministry of Construction (Kensetsu-sho) survey of the motivations of Japanese real estate investors, 55 of the 64 respondent firms involved in foreign real estate investment acquired foreign real estate in order to lease it to other companies. This leasing function was delegated to local firms as few investors had the management experience or personnel to directly manage office buildings in New York, London or Sydney.

Few Japanese investors had *a priori* advantages in their knowledge of overseas property markets. The small size of their overseas subsidiary also reflected a lack of internationally trained personnel to directly manage foreign investments (Kawai 1996). In many real estate acquisitions or developments, investors did not use an ‘integrated world-wide approach’ in their business strategy (Porter 1990). Owners often did not have ‘detailed knowledge of how to service the needs of their domestic clients which have established overseas subsidiaries and branches’ (Dunning 1993), because of the lack of an investor role in the management of the overseas assets.

In the international hotel industry, it is common for indirect investors to take ownership of a hotel, but to then contract its management to a specialist firm. Few traditional Japanese hoteliers sought to expand rapidly into other countries despite the availability of funding for expansion between 1985 and 1990. According to the Toyo Keizai Shinposha listings of Japanese overseas investment, after 1985, Daiichi Hotel made only two acquisitions in Saipan and Singapore, Tokyu Hotels made only one in Kuala Lumpur, while Prince Hotels, the Hotel Okura and the Hotel New Otani made no acquisitions after 1985. Aoki is an exception, since it owned hotels outside of Japan before its acquisition of the Westin Hotel group in 1988 (see Toyo Keizai Shinposha).
When Japanese investors delegated the management function to non-owner managers, such as Holiday Inn, Hyatt International or Nikko, they did so because of their lack of firm-specific proprietary assets in regard to the active utilisation of these assets. The acquisition of Inter-Continental Hotels by Saison Corporation in 1989, for example, was fundamentally indirect in nature, since the Japanese firm did not have prior experience of the international hotel industry and did not seek to exercise direct control.

The industrial organisation explanation of FDI gives great weight to the role of investor advantages and the utilisation of firm-specific proprietary advantages, but in practice firms also respond to less rational motivations, such as rivalry, prestige and a desire to ‘follow-the-leader’ into overseas markets (Knickerbocker 1973). A sudden increase in opportunities for overseas expansion, because of exchange rate appreciation in the home country, ease of funding or a land-boom induced rise in the financial power of investors, can also encourage ‘empire-building’ (Froot and Stein 1989; Graham and Krugman 1989). These motivations were also evident in the development and acquisition of foreign real estate by Japanese investors after 1985.

The positions of Mitsubishi Estate, Mitsui Real Estate and Sumitomo Real Estate Development within the leading Japanese keiretsu groupings made each firm closely conscious of the relative prestige and strategies of the other firms. Hence, when Mitsui Real Estate acquired the Exxon Building in New York in 1986 for US$610 million, in order to diversify its domestic real estate operations, other realtors in Japan sought to follow its lead and recapture their relative position, in terms of prestige in Japan and internationally. According to Lewis (1993, pp. 80–83)

Until 1986 no Japanese real estate company owned a building that could be considered a flagship, which as a rule of thumb, is a prestigious building of at least one million square feet … Then, late in 1986, Mitsui Real Estate made its first big purchase east of the Rocky Mountains. It paid $610 million for the Exxon Building. Soon thereafter, Mitsui announced its decision to invest 25 per cent of its assets in properties outside Japan. When Mitsui bought the Exxon Building, its chief zaibatsu rivals, Sumitomo and Mitsubishi, found themselves embarrassingly short of prestige … Not long afterward, Sumitomo bought 666 Fifth Avenue … and on October 29 (Mitsubishi) offered $846 million for 51 per cent of the Rockefeller shares; Mitsui, believing itself to be valuing the property generously, would have come in a distant second had it bid. Its offer would have been around $400 million. Proving that Mitsubishi Estate overpaid for Rockefeller Center to avoid humiliation at the hands of its rivals is difficult. On the other hand, would anyone care to argue the opposing case?
There is also anecdotal evidence that Mitsui Real Estate, the original Japanese purchaser of a major US trophy building, overpaid for the acquisition. According to an investment banker in IBJ at the time of Mitsui’s acquisition of the Exxon Building, the then President of Mitsui refused to buy the building for its set price of US$330 million, but insisted on offering US$610 million for reasons of prestige. The motivation of Mitsui was apparently to set a record for the acquisition of a prestige property in New York and to outdo the company’s main rival: Mitsubishi Estate. In the words of New York banker Ted Rall:

In early 1986, one of our clients, Mitsui Real Estate Ltd, expressed interest in purchasing the Exxon Building in Manhattan. Mitsui asked us (IBJ) to contact Exxon and find out how much they wanted. Exxon’s asking price of $US375 million for the 1970s-style building seemed high to us, and we knew that Exxon was hot to sell. We relayed the price to Mitsui and told them that Exxon would probably accept a lower offer. A few weeks later Mitsui called to say that they wanted to offer Exxon $US610 million. Neither my boss nor I could believe it. We prodded our representative at Mitsui for information and he finally admitted their reason for deliberately overpaying by $US235 million: ‘Our President read that the current record price paid for a single building, as listed in the Guinness Book of World Records, is $US600 million. He wants to beat the record’ (Rall 1995).

Rivalry was also a major motivation for other Japanese real estate investors, such as Mitsui, Mitsubishi and Sumitomo Real Estate, which competed to acquire landmark buildings in New York after 1984 (Lewis 1993). The pioneer role of Kumagai Gumi, for example, in developing and retaining ownership in overseas property developments led to an exodus of other Japanese construction firms, such as Kajima, Hazama and Ohbayashi, which adopted the same strategy of pursuing international projects, especially in the United States.

In the same way, tourism and leisure companies followed the leadership of Aoki and Saison in acquiring overseas hotels and resorts, even if their corporate activities in Japan did not imbue them with particular advantages to use in the strategic utilisation of these overseas assets. Similarly, other Japanese insurance companies followed the example of Nippon Life, when it began to acquire foreign office buildings in the 1980s. Some firms were successful and were able to use their proprietary advantages to take advantage of the ownership of various foreign real estate assets, while many others were unsuccessful.
The role of relative prices and yields

After 1985, overseas real estate began to appear increasingly inexpensive to investors in Japan. The upward trend of both domestic land prices and the international value of the yen reinforced this perspective. Investors in Japan responded to the change in relative prices of domestic and overseas real estate, due to the appreciation of the yen and the rapid rise of urban land prices in Japan, through real estate FDI. The sharply declining price of foreign real estate to Japanese investors, in terms of the home currency, meant that yields were also falling.

Figure 6  The relative price of foreign real estate and Japanese real estate FDI, 1977–93

Note: Relative price index calculated as the ratio of foreign to Japanese real estate prices. Japanese real estate prices taken from index of Land/GDP ratio for Japan (Source: EPA). Other indexes, such as the Commercial Land Price Index for Six Capital Cities (Source: Japan Real Estate Institute) yield a similar index. Foreign prices calculated using index of Yen/$US exchange rate to show increased purchasing power of Japanese investors overseas.

This trend was conspicuous after 1985, when the cost of foreign real estate halved and then halved again in successive years, compared to the cost of domestic real estate. Simultaneously, the financial reach of investors increased, which can be defined here as the ‘reservation price’, or inverse of the relative price ratio. The reservation price measures the price up to which Japanese investors were willing to bid in terms of host currency (Froot and Stein 1989).

Figure 6 illustrates the clear relationship between the relative price of foreign real estate to Japanese investors and the expansion and contraction of real estate FDI by the Japanese real estate industry. Nevertheless, by 1989 the yield on foreign real estate had fallen significantly, due to continued depreciation of the US and Australian dollars. Similarly, high land prices in Japan inhibited inward FDI (Mason 1995, p. 129; Wakasugi 1995, pp. 114–17). It also inhibited FDI in Japanese real estate in the decade under review.27

In acquiring or developing foreign real estate, investors in Japan were optimistic about the prospects for continued capital appreciation and the long-term economic viability of assets acquired at low yields.28 Investors also anticipated that continued depreciation of the host currency would not occur (Kawai 1991, p. 17). Many investors hedged against exchange rate fluctuations by borrowing in the host country to fund real estate FDI, often through the guarantees of their parent company and based on land collateral in Japan. It was not possible, however, to hedge against falling real estate prices, both in Japan and overseas, for investments made at the peak of the market.

Japanese FDI in US real estate

The US property market has historically attracted a major share of international real estate investment, because of its security, political stability, openness and depth. Between 1977 and 1993 the major investors in US real estate, by country, were Japan, the United Kingdom, the Netherlands and Canada, with smaller inflows from Latin America and the Middle East. The timing of real estate FDI into the United States for Japanese and other investors is shown for the period 1977 to 1993, in Figure 7. The relationship between inflows of FDI in United States real estate, to total FDI, by country, is shown in Figure 7.

The timing of real estate FDI into the United States for Japanese and other investors is shown for the period 1979 to 1994 in Figure 8.

The trend of declining yields reflects rising capital values until 1989, while rising vacancy rates after 1987 is indicative of the slowing US real estate market and the growing oversupply of
buildings in major cities, partly due to the large-scale rise in Japanese office developments. Compared to real estate FDI by investors of other countries, Japanese investors appear to have been much less responsive to falling yields or rising vacancy rates until the 1990s.

Table 3 shows the correlations between the ratio of FDI in real estate to total FDI into the United States of each investor country, for the period between 1976 and 1993. This measure indicates that the timing of Japanese investment in US real estate differed significantly from that of investors from other countries.

The relationship between Japanese inflows and inflows from other countries, as measured by the coefficient of correlation, or $R^2$, is negligible for all sources except Canada, the Netherlands and the Middle East. Part of the explanation for this result is that Japanese real estate FDI began somewhat later than for longer established investors, but investors from Japan also reacted differently to the real estate market in the United States.

Unlike those of other countries, such as the Netherlands Antilles, the Bahamas, Bermuda and the UK Caribbean Islands, Japanese investors were not strongly influenced by changes in
taxation policy. The Netherlands Antilles, for example, had a favourable bilateral tax treaty which gave an exemption from withholding tax on certain interest payments from US affiliates to their Antilles parents. Most of this tax advantage was eliminated in 1984 by the ending of US withholding taxes on interest payments to foreigners (see *Survey of Current Business* 1992).

Japanese investors were unaffected by the 1986 Tax Act, which removed a tax-minimisation incentive to invest in US real estate. While real estate FDI from other countries, particularly tax havens such as the Netherlands Antilles, fell away, Japanese investors became more active. The divestment strategy of other investors also seems to have increased the supply of available prime properties for acquisition (Mead Ventures 1990).

Figure 8  US property cycles and Japanese real estate FDI, 1979–94, per cent

Note: Right scale refers to yields and vacancy rates.

The relative determinants of Japanese real estate investors can be examined econometrically. FDI data is sourced from the surveys of the US Department of Commerce. The dependent variable is the share of FDI in real estate to total FDI for each source country. The main independent variables used relate to macroeconomic indicators, such as interest rates, capital values, yields, GDP trends, exchange rates and taxation policy.

While different variables were significant for investors of different countries, the estimation results explain a considerable part of the pattern of FDI in US real estate (Table 4). The adjusted $R^2$ for all equations exceeds 0.6 and for all investors, except the Netherlands Antilles, Latin America and the Middle East, is above 0.8. The adjusted $R^2$ for Japan is a high 0.93. The results of this regression analysis highlight significant differences between Japanese and other investment in US real estate. Firstly, the strong positive correlation between the US property index and Japanese real estate FDI indicates that capital gains were a major motivation for Japanese investors, compared to those of other countries.

### Table 3 Cross-country correlations of FDI in US real estate, 1976–93

<table>
<thead>
<tr>
<th></th>
<th>Can</th>
<th>Eur</th>
<th>Ger</th>
<th>Neth</th>
<th>UK</th>
<th>NA</th>
<th>LA</th>
<th>Middle East</th>
<th>Japan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>Europe</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>0.676</td>
<td>0.836</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>0.654</td>
<td>0.458</td>
<td>1</td>
<td>0.838</td>
<td>0.389</td>
<td>1</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>UK</td>
<td>0.634</td>
<td>0.910</td>
<td>0.838</td>
<td>0.389</td>
<td>1</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Netherlands Antilles</td>
<td>0.403</td>
<td>0.553</td>
<td>0.588</td>
<td>0.106</td>
<td>0.619</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Latin America</td>
<td>0.429</td>
<td>0.592</td>
<td>0.613</td>
<td>0.764</td>
<td>0.610</td>
<td>0.764</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle East</td>
<td>0.629</td>
<td>0.563</td>
<td>0.495</td>
<td>0.721</td>
<td>0.433</td>
<td>0.071</td>
<td>0.243</td>
<td>1</td>
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<tr>
<td>Japan</td>
<td>0.227</td>
<td>0.042</td>
<td>-0.06</td>
<td>-0.04</td>
<td>-0.06</td>
<td>-0.01</td>
<td>0.222</td>
<td>-0.01</td>
<td>0.222</td>
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<tr>
<td>Total</td>
<td>0.939</td>
<td>0.937</td>
<td>0.780</td>
<td>0.779</td>
<td>0.770</td>
<td>0.496</td>
<td>0.549</td>
<td>0.614</td>
<td>0.174</td>
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</tr>
</tbody>
</table>

**Note:** Adjusted $R^2$ calculated using Ordinary Least Squares (OLS).


### Determinants of Japanese FDI in US real estate

The relative determinants of Japanese real estate investors can be examined econometrically. FDI data is sourced from the surveys of the US Department of Commerce. The dependent variable is the share of FDI in real estate to total FDI for each source country. The main independent variables used relate to macroeconomic indicators, such as interest rates, capital values, yields, GDP trends, exchange rates and taxation policy.

While different variables were significant for investors of different countries, the estimation results explain a considerable part of the pattern of FDI in US real estate (Table 4). The adjusted $R^2$ for all equations exceeds 0.6 and for all investors, except the Netherlands Antilles, Latin America and the Middle East, is above 0.8. The adjusted $R^2$ for Japan is a high 0.93. The results of this regression analysis highlight significant differences between Japanese and other investment in US real estate. Firstly, the strong positive correlation between the US property index and Japanese real estate FDI indicates that capital gains were a major motivation for Japanese investors, compared to those of other countries.
Table 4 Estimation results of foreign demand for US real estate, 1977–93

<table>
<thead>
<tr>
<th>Determinant</th>
<th>Canada</th>
<th>Germany</th>
<th>Netherlands</th>
<th>UK</th>
<th>Neth Antilles</th>
<th>Latin</th>
<th>Middle East America</th>
<th>Japan</th>
<th>All</th>
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</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-28.2</td>
<td>-15.4</td>
<td>-11.6</td>
<td>-23.6</td>
<td>-49.1</td>
<td>-31.8</td>
<td>163.3</td>
<td>7.15</td>
<td>-13.4</td>
</tr>
<tr>
<td></td>
<td>(-3.83)</td>
<td>(-4.36)</td>
<td>(-2.75)</td>
<td>(-4.71)</td>
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<td>(1.62)</td>
<td>(4.65)</td>
<td>(1.52)</td>
<td>(-3.79)</td>
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<tr>
<td>US interest ratesa</td>
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<td>0.89</td>
<td>0.47</td>
<td>0.86</td>
<td>3.23</td>
<td>2.36</td>
<td>-2.53</td>
<td>-0.51</td>
<td>0.81</td>
</tr>
<tr>
<td></td>
<td>(2.66)</td>
<td>(3.22)</td>
<td>(1.42)</td>
<td>(2.21)**</td>
<td>(1.83)**</td>
<td>(1.54)</td>
<td>(-0.92)</td>
<td>(-1.37)</td>
<td>(2.95)**</td>
</tr>
<tr>
<td>US property indexb</td>
<td>0.06</td>
<td>0.01</td>
<td>0.04</td>
<td>..</td>
<td>..</td>
<td>0.06</td>
<td>-0.39</td>
<td>0.10</td>
<td>0.01</td>
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<tr>
<td></td>
<td>(1.32)</td>
<td>(0.51)</td>
<td>(1.72)</td>
<td>(0.29)</td>
<td>(-0.07)</td>
<td>(0.54)</td>
<td>(-1.94)</td>
<td>(3.08)**</td>
<td>(0.61)</td>
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<tr>
<td>US yieldsc</td>
<td>1.54</td>
<td>0.83</td>
<td>1.09</td>
<td>1.38</td>
<td>1.10</td>
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<td>-11.69</td>
<td>0.15</td>
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<tr>
<td></td>
<td>(1.96)**</td>
<td>(2.19)**</td>
<td>(2.41)**</td>
<td>(2.58)**</td>
<td>(0.45)</td>
<td>(0.54)</td>
<td>(-3.10)</td>
<td>(0.30)</td>
<td>(2.00)**</td>
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<tr>
<td>US GDPd</td>
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<td>0.12</td>
<td>0.10</td>
<td>0.32</td>
<td>1.95</td>
<td>1.41</td>
<td>-1.72</td>
<td>0.11</td>
<td>0.15</td>
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<tr>
<td></td>
<td>(0.27)</td>
<td>(0.71)</td>
<td>(0.49)</td>
<td>(0.36)</td>
<td>(0.99)</td>
<td>(1.54)</td>
<td>(-1.04)</td>
<td>(0.52)</td>
<td>(0.88)</td>
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<tr>
<td>US real exchangeratee</td>
<td>0.13</td>
<td>0.06</td>
<td>0.50</td>
<td>0.17</td>
<td>0.45</td>
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<td>0.32</td>
<td>-0.08</td>
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<tr>
<td></td>
<td>(1.76)**</td>
<td>(1.66)</td>
<td>(0.12)</td>
<td>(3.30)*</td>
<td>(1.94)**</td>
<td>(0.69)</td>
<td>(0.90)</td>
<td>(-1.66)</td>
<td>(2.84)**</td>
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<td>-1.85</td>
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<tr>
<td></td>
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<td>(-1.32)</td>
<td>(-0.45)</td>
<td>(-2.49)**</td>
<td>(-1.32)</td>
<td>(-0.51)</td>
<td>(-0.60)</td>
<td>(0.83)</td>
<td>(-2.52)**</td>
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<tr>
<td>Adjusted R²</td>
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<td>0.840</td>
<td>0.802</td>
<td>0.825</td>
<td>0.689</td>
<td>0.566</td>
<td>0.615</td>
<td>0.931</td>
<td>0.890</td>
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<td>DW statisticg</td>
<td>1.83</td>
<td>2.08</td>
<td>1.98</td>
<td>2.53</td>
<td>1.19</td>
<td>1.51</td>
<td>1.39</td>
<td>1.99</td>
<td>2.43</td>
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<tr>
<td>F statistic</td>
<td>22.2</td>
<td>159.0</td>
<td>12.5</td>
<td>14.3</td>
<td>7.3</td>
<td>4.70</td>
<td>5.53</td>
<td>39.5</td>
<td>23.9</td>
</tr>
</tbody>
</table>

Notes: Estimated by OLS. Significance level **5%*1%. Dependent variable is share of FDI in real estate by country/total FDI by country.

a Reserve Bank of Australia; b JLW International; c JLW International; Note that yield on NY prime office buildings is the equivalent yield based on the percentage return on price or value derived from the current net passing income and the increase to current market rents; d RBA Bulletin; e IMF, International Financial Statistics Yearbook, various issues; f Tax policy dummy variable set at 1 for 1976–85 when US tax policy favoured real estate investment, and 0 afterwards; g Durbin Watson statistic.
This is reinforced by the lesser importance of yields for Japanese investors. In contrast, rising yields in the United States were a major positive influence for virtually all other investors. Secondly, the results for Japan are compared with all investors. The negative sign for ‘interest’ for Japan implies that local finance, through Japanese financial subsidiaries, was important for Japanese investors. Host country finance could be procured by a guarantee provided by a Japanese bank, based on collateral in Japan. In contrast, all other investors, except for the Middle East, had a positive association between the cost of finance and real estate FDI.

Other foreign investors clearly preferred to acquire US real estate when local investors had a comparative disadvantage in funding. In periods of high US interest rates, prices for real estate were also depressed, so that non-Japanese foreign investors were more likely to pursue bargains during such downturns. Japan also emerges as an outlier on the basis of the exchange rate variable. The falling real US dollar attracted Japanese investors because of the falling relative price of real estate assets compared to those in Japan, since these assets appeared undervalued (Landefeld et al. 1992, p. 82). It is also possible that Japanese investors did not expect further dollar depreciations (Kawai 1991).

All other investors had a positive correlation between real estate FDI and the real US dollar value and thereby sought to avoid exchange losses. As Japanese real estate investors were not motivated by yields, their valuation of foreign real estate was strongly influenced by experience of the bull market in Japan. Comparative values rather than present values were used to justify a particular investment.

The estimation results using the ‘policy’ variable suggest that tax motivations were important for investors from all countries except Japan. Generally, investors from these countries divested after 1986 when Japanese investors were becoming more active. This pattern can be explained by the greater experience of other investors in the US real estate market and by the higher priority given by these investors to their (after tax) yields.

Unlike most other foreign investors, Japanese investors missed the market signals of declining prices and higher vacancy rates and were exposed to large losses when property values collapsed in the 1990s. In terms of both investment and divestment, Japanese real estate FDI can be distinguished from that of other countries. Japanese investors reacted primarily to domestic rather than overseas financial factors. This phenomenon reflected the scale of the domestic land bubble and the ‘comparative cost’ criteria of investors instead of the ‘present value’ criteria traditionally used to assess the value of real estate in the United States.
Japanese FDI in Australian real estate

Australia has been a traditional recipient of foreign real estate investment, although inflows have only been recorded since 1979–80. In the 1960s, restrictions in the London property market led to an influx of UK real estate developers into Australia (Daly 1982). By the 1970s and early 1980s, inflows from Southeast Asian Chinese investors increased considerably (Thrift 1983).

The recent wave of Japanese investment in Australian real estate followed the 1986 deregulation of foreign investment regulations and is the most significant so far (Figure 9). Between 1985 and 1991, tourism and real estate FDI accounted for over 50 per cent of all Japanese FDI into Australia, peaking at 93 per cent in 1988. This influx coincided with the relaxation of Foreign Investment Review Board (FIRB) restrictions on the need for local partners (Drysdale 1993).

Determinants of Japanese FDI in Australian real estate

Much of Japanese investment occurred as prices of office and tourist property were rising or had levelled out. Real estate FDI by investors in other countries was more responsive to higher yields, both in the early 1980s and 1990s (Figures 9 and 10). The following review of the determinants of FDI in Australian real estate considers the role of the host country real estate market in explaining the timing and scale of investment (Table 5).

While there are problems using annual FIRB data, which refer to notifications and not actual investment, trends in inflows closely follow outflow statistics in the home countries of investors, where data is available. Table 5 details cross-country correlations of FDI into Australian real estate. In contrast to the ‘outlier’ nature of Japanese FDI in the United States, inflows into Australia were more closely correlated with inflows from other countries.

The influence of type I financial factors on FDI in Australian real estate is explored in Table 6. Notably, Japanese real estate FDI in Australia occurred after depreciation of the dollar against the yen, as well as other currencies, and non-Japanese investors were also influenced by this event. The timing of this investment was also clearly influenced by the anticipation of capital gains, rather than yields.

The major factor explaining Japanese real estate FDI in Australia is the movement of property prices, proxied by the estimated value of CBD office buildings in Sydney. This is supported by the result that yields in Sydney are negatively correlated with Japanese investment.
The expectation of capital gains seems therefore to have been a major motivation for investment.

The negative correlation between local interest rates and Japanese FDI suggests that the cost of local funding was relevant, although Japanese real estate investors neglected the higher return available elsewhere, such as in Australian government securities. One explanation for this would be that real estate FDI was predominantly debt-funded. Other variables for GDP, exchange rates and foreign investment policy are not significant for Japan, or most other sources of real estate FDI.

Financial factors appear to be important determinants of Japanese FDI in Australian real estate as the adjusted $R^2$ and DW statistics are both high and significant, compared to FDI from

Figure 9  Australian property cycles and Japanese real estate FDI, 1980–84

Note: Ratio of Japanese FDI in real estate to total FDI calculated from statistics published by the Australian Treasury (FIRB).

Sources: FIRB, Annual Reports, various years; JLW, International Property Indicators, various years.
<table>
<thead>
<tr>
<th>Determinant</th>
<th>US</th>
<th>Japan</th>
<th>Hong Kong</th>
<th>Malaysia</th>
<th>Singapore</th>
<th>UK</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>46.5</td>
<td>98.1</td>
<td>-127.1</td>
<td>-156.1</td>
<td>-233.1</td>
<td>17.1</td>
<td>185.9</td>
</tr>
<tr>
<td></td>
<td>(1.8)</td>
<td>(1.13)</td>
<td>(-0.60)</td>
<td>(-0.81)</td>
<td>(-1.6)</td>
<td>(0.19)</td>
<td>(1.56)</td>
</tr>
<tr>
<td>Australian interest rates&lt;sup&gt;a&lt;/sup&gt;</td>
<td>-0.94</td>
<td>-1.67</td>
<td>-1.41</td>
<td>0.05</td>
<td>-0.17</td>
<td>0.60</td>
<td>-1.07</td>
</tr>
<tr>
<td></td>
<td>(-2.4)**</td>
<td>(-1.25)</td>
<td>(-0.43)</td>
<td>(0.02)</td>
<td>(-0.07)</td>
<td>(-0.44)</td>
<td>(-0.51)</td>
</tr>
<tr>
<td>Australian property index&lt;sup&gt;b&lt;/sup&gt;</td>
<td>-0.44</td>
<td>9.31</td>
<td>4.35</td>
<td>14.4</td>
<td>11.5</td>
<td>3.46</td>
<td>8.01</td>
</tr>
<tr>
<td></td>
<td>(-0.58)</td>
<td>(3.59)*</td>
<td>(0.68)</td>
<td>(2.54)**</td>
<td>(2.64)**</td>
<td>(1.32)</td>
<td>(1.97)**</td>
</tr>
<tr>
<td>Australian office yields&lt;sup&gt;c&lt;/sup&gt;</td>
<td>0.77</td>
<td>-7.05</td>
<td>2.98</td>
<td>19.5</td>
<td>14.7</td>
<td>0.10</td>
<td>-3.77</td>
</tr>
<tr>
<td></td>
<td>(0.38)</td>
<td>(-1.53)</td>
<td>(0.26)</td>
<td>(1.95)**</td>
<td>(1.91)**</td>
<td>(0.02)</td>
<td>(-0.52)</td>
</tr>
<tr>
<td>Australian GDP&lt;sup&gt;d&lt;/sup&gt;</td>
<td>-0.64</td>
<td>-0.20</td>
<td>2.52</td>
<td>-0.86</td>
<td>-1.36</td>
<td>-0.72</td>
<td>-0.25</td>
</tr>
<tr>
<td></td>
<td>(-0.67)</td>
<td>(-1.80)**</td>
<td>(-0.16)</td>
<td>(0.85)</td>
<td>(-0.35)</td>
<td>(0.59)</td>
<td>(-0.13)</td>
</tr>
<tr>
<td>Australian real exchange rate&lt;sup&gt;e&lt;/sup&gt;</td>
<td>0.59</td>
<td>-0.51</td>
<td>1.57</td>
<td>0.50</td>
<td>1.64</td>
<td>0.01</td>
<td>-1.59</td>
</tr>
<tr>
<td></td>
<td>(2.41)**</td>
<td>(0.61)</td>
<td>(0.77)</td>
<td>(0.27)</td>
<td>(1.17)</td>
<td>(0.38)</td>
<td>(-1.21)</td>
</tr>
<tr>
<td>Australian tax policy&lt;sup&gt;f&lt;/sup&gt;</td>
<td>17.9</td>
<td>11.7</td>
<td>24.9</td>
<td>-55.2</td>
<td>-0.43</td>
<td>-7.55</td>
<td>-40.8</td>
</tr>
<tr>
<td></td>
<td>(2.51)**</td>
<td>(0.48)</td>
<td>(0.41)</td>
<td>(-1.03)</td>
<td>(-0.01)</td>
<td>(0.31)</td>
<td>(-1.06)</td>
</tr>
<tr>
<td>Adjusted R&lt;sup&gt;2&lt;/sup&gt;</td>
<td>0.870</td>
<td>0.955</td>
<td>0.10</td>
<td>0.428</td>
<td>0.614</td>
<td>0.056</td>
<td>0.366</td>
</tr>
<tr>
<td>DW statistic</td>
<td>1.76</td>
<td>3.08</td>
<td>1.67</td>
<td>2.86</td>
<td>2.40</td>
<td>2.41</td>
<td>3.22</td>
</tr>
<tr>
<td>F statistic</td>
<td>7.8</td>
<td>24.8</td>
<td>0.8</td>
<td>2.62</td>
<td>4.45</td>
<td>1.12</td>
<td>2.25</td>
</tr>
</tbody>
</table>

**Note:** Estimated by OLS. Significance level **5%*1%. Dependent variable is share of FDI in real estate by country/total FDI by country. (a) Reserve Bank of Australia; (b) JLW International; (c) JLW International; Note that yield on Sydney prime office buildings is the equivalent yield based on the percentage return on price or value derived from the current net passing income and the increases to current market rents; (d) RBA Bulletin; (e) IMF, IFS Yearbook, various issues; (f) Policy dummy variable set at 0 for 1980–85 when Australian foreign investment policy was more restrictive towards real estate investment and 1 afterwards.
other countries. The result underlines the speculative nature of Japanese real estate FDI in Australia and the anticipation of investors that prices would continue to rise. Nevertheless, there are not many degrees of freedom and the limitations of annual FDI notifications data need to be borne in mind, suggesting that further estimation of these causal factors is indicated.

Japan and others: comparative motivations

Evidence provided so far supports the hypothesis that Japanese real estate investors behaved differently from real estate investors from other countries. FDI inflows into US and Australian real estate, relative to total FDI by country, are compared for Japanese and other investors. From this comparison it is clear that the scale and timing of Japanese real estate FDI differed significantly, especially for the United States. In the case of Australia, the large share of Japanese FDI in real estate to total FDI is noticeable, and the ‘bubble’-like build-up and decline of inflows contrasts with the more frequent peaks and troughs of investment from other countries.

Figure 10 FDI in Australian real estate, yields and capital values, 1980–94

Note: Notifications of intended investment in Australian real estate, nominal dollars.

Source: Australian Treasury/FIRB, Annual Reports, various years.
Generally, non-Japanese investment declined with the falling value of the US dollar and the Australian dollar, while Japanese interest increased. The revision of US taxation laws in 1986 discouraged most other investors, but Japanese investment rose. Similarly, declining yields in major US cities did not dissuade Japanese investors, compared to investors from other countries.

In the United States, Japanese real estate FDI was an outlier, responding conversely to virtually all variables, compared to other countries. Its major influences were a positive association with the US property capital index and the appreciation of the yen against the dollar. A similar explanation applies for Japanese investment in Australia (Figures 11 and 13).

The study of real estate FDI into Australia also found that the appreciation of the yen, reflecting the increasingly low cost for Japanese investors, was important. Variations in yields in the host country were not strongly linked to real estate FDI, compared to capital growth. These results indicate that investors in Japan took advantage of their greater purchasing power in the

Figure 11  FDI in US real estate: Japan and others, 1976–93

Note: a Share of FDI in real estate to total FDI, by country.

Source: Calculated from US Department of Commerce, Survey of Current Business, various years.
host country and the appearance of inexpensive prices relative to Japan, but that they neglected yields.

**Conclusion**

This paper has examined the reasons for the large expansion and contraction of Japanese real estate FDI between 1985 and 1994. Two central issues were raised: what have been the main features of the pattern of Japanese FDI in real estate; and how can we explain Japanese FDI in real estate? Japanese real estate FDI does not readily fit into ‘the existing inventory of models and evidence’ of Japanese FDI or FDI generally (Caves 1993).

Instead it is explicable more as ‘indirect’ investment, influenced by country-specific factors rather than the firm-specific characteristics and strategies of investors. Hence, the emphasis in
industrial organisation theory on the role of firm-specific factors, such as investor advantages, is less relevant in the case of Japanese real estate FDI than the influence of country-specific determinants.

A distinction was made between financial or type I real estate FDI and type II strategic real estate FDI, according to both the motivation of investors and the organisation of investment. Investors in the former category are characterised as owners, while the latter are predominantly owner-managers, with respectively passive and active approaches to the management and control of their foreign real estate assets and subsidiaries. The land bubble in Japan bolstered speculative development and acquisition of foreign real estate by Japanese investors. Many type I investors speculated on rising prices and eschewed a type II strategic approach to real estate FDI.

The widespread failure of Japanese real estate investors in the decade under review suggests that investor advantages were transitory and insufficient to sustain FDI in the long term. Instead, short-term investment flows were significantly influenced by general macroeconomic variables. Japanese investors in overseas real estate lost vast sums on their investment splurge and viable long-term investment was the exception rather than the rule. The absence of sustainable type II investor advantages contributed to the widespread divestment by Japanese investors in the early 1990s.

Japanese real estate FDI was also striking in that it occurred when property market cycles in the United States, Europe and Australia had peaked or were declining. The prospect of high returns or yields, relative to the domestic real estate market, was a more important factor for Japanese investors in the United States than in Australia, suggesting that these locations were perceived differently. One explanation is the higher proportion of Japanese tourism real estate to total real estate FDI in Australia, compared to the United States.

Evidence in the paper supports the proposition that Japanese real estate investors behaved differently to those from other countries. Generally, non-Japanese investment declined with the falling value of the American and Australian dollars, while Japanese interest increased. Revision of US taxation laws in 1986 discouraged most other investors, but Japanese investment rose. Similarly, declining yields in major US cities did not dissuade Japanese investors, in contrast to investors in other countries. These results imply that events in the Japanese economy were the driving force for real estate FDI.
Notes

1 The MOF statistics are broken down into investor by industry in Japan and the host country of investment, but the definition of FDI has changed over time. Up to November 1980, the statistics refer to proposed investment approved by the Ministry, but from December 1980 they are on a notification basis, following the revision of the Foreign Exchange Law in Japan. The accuracy of the statistics may also be questioned, as it is unlikely that either approved or notified FDI equates with actual investment and divestment is also not included (Stein 1995, p. 2). Other classification and coverage problems also exist with the MOF series. The classification of direct and portfolio foreign investment changed from December 1980, when the existing 25 per cent ownership benchmark was replaced by an ownership ratio of 10 per cent as the definition of FDI. Further, small amounts of direct investment (less than ¥3 million in 1980–84 and less than ¥10 million after April 1984) do not have to be notified. Nevertheless, the exclusion of such small investments in MOF statistics is likely to be unimportant. Similarly, the absence of data on direct investment from the retained earnings of Japanese companies is a minor problem, as such reinvestment would not be large due to the recent nature of investment.

2 Foreign direct investment involves a significant level of ownership of assets, sufficient to constitute a ‘lasting interest’ and is generally considered to require an active involvement in the control and management of the acquisition (OECD 1983). It is difficult to define ‘control’ precisely, but FDI implicitly refers to ‘the extension of corporate control across national boundaries’ (Froot 1991, p. 3). In practice, official statistics usually define investment as FDI if the level of foreign control exceeds 10 per cent of an entity’s shares or assets, although this varies by country. At this level of control the foreign investor is assumed to be an active participant in the management of the enterprise.

3 Dunning (1979, p. 275) states in his eclectic theory of FDI that ‘a firm will engage in FDI if three conditions are satisfied: (1) It possesses net ownership advantages vis-a-vis firms of other nationalities in serving particular markets. These ownership advantages largely take the form of the possession of intangible assets, which are, at least for a period of time, exclusive or specific to the firm possessing them; (2) Assuming condition (1) is satisfied, it must be more beneficial to the enterprise possessing these advantages to use them itself rather than to sell or lease them to foreign firms, ie, for it to internalise its advantages through an extension of its own activities rather than externalise them through licensing and similar contracts with independent firms; (3) Assuming conditions (1) and (2) are satisfied, it must be profitable for the enterprise to utilise these advantages in conjunction with at least some factor inputs (including natural resources) outside its home country; otherwise foreign markets would be served entirely by exports, and domestic markets by domestic production.’ Rugman (1980, p. 365) defines internalisation as the establishment of an ‘internal market’ in a multinational firm in response to ‘failures or imperfections’ in the external market for goods and services.
During the 1980s both land and equities had high price earnings ratios, but, as Ito (1992) notes, high price earnings ratios were a temporary phenomenon due to the rising price levels during the bubble economy. In theory the price of an asset is determined by the present value of the stream of its future earnings — rents in the case of housing and dividends in the case of stocks. However, during the bubble, the current values of land and stock prices in Japan could not be justified on the basis of the present value calculation, unless price increases occurred indefinitely so as to guarantee capital gains.

One real estate analyst in the US noted that: ‘The reality is that real estate at this point in time is perceived as a high risk investment … The Japanese are unsure … They made a lot of assumptions that weren’t correct to begin with, and they are saying, “How do we know that we’re not committing further errors?”’ Lewis M. Goodkin, President of Goodkin Research Corp., Florida, December 1991. See Mead Ventures (1990).

Japanese investors typically bought at the peak of the real estate market in the late 1980s and the values of many commercial and resort properties had since lost up to 30 per cent of their value. Hence, having lost once, many Japanese investors were reluctant to continue to invest in the US market, even though credit controls on such lending were formally removed at the end of 1991.

The convergence of Japanese investor interest in the CBD locations of major overseas cities led to the overbuilding of office buildings in these locations, rising vacancy rates in the 1990s and a sharp fall in property capital values. A similar pattern also occurred in Japan.

Richard Ellis believes that Japanese hotel investors in Australia were not expecting a profit for 7–10 years, following their experience in Hawaii. This analysis assumes an occupancy rate of 55 per cent and an average room rate of A$101 a day, multiplied by the number of rooms, making revenue A$60 million. Based on the industry accepted standard that 45 per cent of a hotel’s total revenue comes from room rates, total revenue was estimated at A$135 million. R. Weatherdon, ‘Debate over pros and cons of tourism’, AFR, 18 September 1990.

An example of the unmonitored growth of bank lending for real estate in Japan and overseas is given by the case of loans by the Industrial Bank of Japan (IBJ) to property groups in the Osaka region. IBJ lent over ¥240 billion to a Nui Onoue, the owner of an Osaka restaurant who falsified IBJ debentures to claim assets of ¥290 billion. IBJ was also the main banker to Fuji Juken, an Osaka condominium company which went bankrupt with debts of ¥834 billion. Similarly, IBJ was a principal lender to Asahi Juken, also an Osaka condominium developer, which had debts of over ¥600 billion. Lending also occurred to Sueno Kosan, an Osaka property company linked to the Yamaguchi Gumi Yakuza group. IBJ’s direct property associate Kowa Real Estate borrowed over ¥1.16 trillion by 1990 (Tokyo Shoko Research) and acquired 95 office buildings, 35 blocks of units in Japan and property overseas. See ‘Unmasking honourable IBJ’, The Economist, 12 October 1991.
This point was emphasised in interviews during the author’s fieldwork in Tokyo and Osaka.

The Japanese Ministry of Construction (Kensetsu-sho) survey of the motivations of Japanese real estate investors (conducted in 1990) reveals the one-way nature of Japanese real estate investment, since no companies were apparently involved in the sale of foreign real estate to non-Japanese investors. The flow of investment was also one-way due to the impact of high land prices in Japan in this period, and only one company reported that it was involved in the sale of domestic real estate in foreign countries. About 40 per cent of companies reported that they were involved in selling overseas real estate in Japan, but their mode of entry was often not limited to an agency function.

Dr Ishizaki also noted that ‘it got to the point where it was an embarrassment even for us. We did these … feasibility studies with flowery words and some glorified numbers. They (the Long-Term Credit Bank) wouldn’t even scrutinise it, but rip the cover off, put their own cover on it and then syndicate the damned thing.’

Dunning (1993, p. 62) notes that most real estate FDI in land, hotels or office buildings appears to have been based on some expectation of future rises in property values. These firms generated fees from encouraging further investment and may have been optimistic about the prospects for profitable investment in foreign real estate markets.

See Institutional Investor, January 1988. In this case, the convertible mortgage transferred ownership of the building to the partnership after a number of years, thereby avoiding the need to pay stamp duties on the sale of the property or capital gains tax on New York property.

The Isutani company acquired Pebble Beach, a famous US golf course, but was unable to issue exclusive club memberships to finance the acquisition because of legal guarantees of access for the general public in Californian law.

The present value of an asset is equal to the expected future earnings of the asset (in the case of real estate, earnings are rental income), discounted by the sum of the long-term interest rate and a given risk premium. Investors may also assess the expected future returns of an asset to include capital gains on it, which includes a measure of speculation. See EPA (1990–91), p. 107.

Japanese insurance companies slowed their investment in US real estate in the late 1980s as yields began to fall.

As Clark (1979, p. 128) notes: ‘… individual decision-making involves risk not merely for the firm but also for the decision-maker. The risks for the firm are that the decision-maker may be unable to persuade his nominal subordinates to follow his orders, and that he may be biased or dishonest. The risks for the decision-maker himself are that if he makes a mistake he alone will be responsible for the consequences, and that even if his decisions are right he may be accused of tyranny, dishonesty or bias.’
Small to medium-sized Japanese investors in overseas real estate were able to obtain information from financial institutions, trading companies and the real estate industry in Japan, all of whom established subsidiaries overseas to collect information and facilitate transactions. However, Japanese investors formed extensive ties, including joint ventures, with US real estate firms, construction firms and financial institutions and in the initial phase of investment, in the early 1980s, were particularly careful; for example, Mitsui Real Estate Sales became an agency for overseas real estate investment in December 1986 (Nikkei Sangyo, 24.12.86), Toyo Real Estate established an information network in the US to promote overseas real estate sales to Japanese investors (Nikkei, 24.1.87), Itochu expanded its network for overseas real estate sales (Nikkei, 14.8.87), Sumitomo established a subsidiary company in Los Angeles for real estate investment (Nikkei Sangyo, 2.9.87), Mitsui established a subsidiary company in Hawaii to promote sales (Nikkei Sangyo, 9.10.87), Seiyo Kankyo Kaihatsu expanded its operations in Maui and San Francisco (Nikkei Finance 31.10.87), and Daiwa linked with a US real estate company (Nikkei 31.7.88).

‘As project supervisor, C. Itoh assumes all responsibility for construction, from selection of contractors to on site work … C. Itoh has a strong international distribution and marketing network, including branches throughout Japan and the world. Our network includes the major real estate broker, Century 21. C. Itoh’s prominence as an international trading company means it has a high reputation and access to an enormous intelligence network. We can utilise these for the advantage and service of our clients and partners in the form of market consulting, brokerage and information access.’ See C. Itoh, Corporate Brochure, 1991 (Construction Division).

In the 1970s Inter-Continental Hotels was owned by Pan-Am and Hilton International was owned by TWA. A typical management contract for an international hotel company covers most aspects of day-to-day control of a hotel, such as controlling management operations, setting prices and arranging reservations, sales promotions and administration, with a basic fee and incentive for profitability. See UNCTC 1990.

Indirect investment in London offices and hotels by OPEC countries in the 1970s is comparable to that of many Japanese investors after 1985. The organisational advantages of international hotel management companies include ‘on the premises services which offer a particular lifestyle’, off-premises services such as booking facilities, and a ‘trademark of guarantee’ that the services offered by the hotel are of a consistently high standard. See Dunning and McQueen 1982.

Saison paid US$2.27 billion for the company’s 100 international hotels, about 41 times the 1988 projected earnings for Inter-Continental, or at a yield of only 2.5 per cent.

The Mitsui Real Estate company’s annual report (1990, p. 8) states: ‘Prime-quality properties in developed countries account for a significant portion of the company’s overseas assets, underscoring Mitsui Real Estate’s desire to diversify its portfolio of
investment assets. Through its investment in overseas real estate, Mitsui Real Estate seeks long-term sources of cash flow rather than one-time capital gains.’

26 In 1980 the Ministry of Finance freed the approval process for almost all forms of Japanese FDI, thereby allowing insurance companies and other investors to invest in overseas property. Approval for the large Japanese pension funds to make significant investments was limited to 2 per cent of total pension fund assets (a 20% ceiling on real estate investment in a 10 per cent ceiling on overseas investment for pension funds).

27 Regulatory restrictions on inward real estate FDI were abolished in 1984, apart from the need to notify the Ministry of Finance, so that there were no formal barriers to inward investment. See Ito (1992, p. 321).

28 Hence: ‘Foreign investors may focus on the fact that US real assets appear cheap compared with physically equivalent assets abroad and neglect the question of whether the economic returns are really equivalent’ (Graham and Krugman 1989).

29 The upsurge in Japanese investment also occurred as the Australian dollar depreciated against the yen and real estate prices rose and yields declined. The Treasurer announced in July 1986 that the requirement that foreign acquisitions of real estate worth $10 million or more needed 50 per cent local equity had been lifted. See FIRB, Annual Report, 1986–87. However, the acquisition of developed commercial real estate was still subject to this requirement.
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