Aoyama Sogo Accounting Firm Innovation Speed Quality

NewsLetter

Aoyama Sogo Accounting Firm

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Chairman's Column

Real estate investments — Japan and U.S. interest rate difference

Among our clients, nearly half are related to real estate. Real estate like its name says is a special type of asset that can't be physically moved, but I am weary of the future since real estate markets are drastically different between Japan and the U.S.

For Japan, the Nikkei Stock Average has recently crossed the 30,000 JPY mark for the first time in years and continues to rise. Meanwhile, as noted in Daiwa House's earnings call (according to Nikkei Shinbun), the U.S. continues in its inflationary period with the 10-year treasury yield at 4.34% and fixed interest on real estate loans at 7.08%. FRB Chairman Powell has not commented about halting future rate hikes. I'm sure there's fewer people that are buying homes with a 7% mortgage (the Mizuho Bank Flat 35 mortgage starts at 1.55%). I'm curious of the implications of this interest rate difference on the real estate investment business as a whole.

Currently, the exchange rate is 151 yen per U.S. dollar. The yen has plummeted by nearly 30% from the time it was 110 yen. Since Japan relies heavily on imports, the price of food, gas, and cars is substantially higher now. In a way, it's still relatively stable even with the interest rate difference but if a further weakened yen is not desirable, the Bank of Japan may intervene. That sort of announcement may have a brief impact but will likely ring hollow in the long run.

It's understandable that investor money that can't make sufficient returns in the U.S. are crossing the ocean into Japan. But the reality is that Japanese S-class property sought after by institutional investors is a bit depleted. Not to mention, there is no guarantee that the Bank of Japan will maintain its zero-interest policy. There is also the scare that this zero-interest environment may suddenly end with just one word from BOJ Governor Ueda.

In either case, since our firm doesn't have any direct influence on the markets, we can only just quietly observe. As of yet, there seems to be no indication of bulk investments in distressed investment property loans like in the early 90s, but if there are similar products to be setup in the future, we will be ready and prepared to move at the opportunity.

It's said that for U.S. dollar-based investors, Japanese real estate is cheap. However, considering the weakened yen and the risk of the zero-interest rate policy ending, it seems that land and stock prices are appropriately priced right now. I think if Japan were to face excessive inflation, it may be wise to reallocate funds to assets like real estate and gold.

The Japanese may not be ready for inflation, since they're used to long periods of deflation since the early 90s through the 2000s. Without us realizing, inflation may now be just around the corner.

by Kazuhiro Matsuzawa, Chairman

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Real Estate Markets

Trends in the Real Estate Market

I asked several investment managers about the current RE market.

(Japanese firm employee)

—— What's your take on the current domestic and foreign RE markets.

Domestically, with the inbound market recovering, the competition for hotel-use land is particularly high. Foreign investors have a strong appetite for such properties.

In the U.S. residential rental market, investors face rising interest rates and a scenario where reverse leverage may be expected for several years after acquisition. Those investors are waiting on the sideline since they rely on external lenders for loans. Sales volume has dropped significantly as a result of sellers keeping properties off the market because they're unable to get the desired sales price. Generally, there are no distressed residential rental properties yet, but prior to this market correction, many investors purchased such properties with high leverage. As a result, the property loses equity and some cases are appearing where the property ultimately sells for the loan principal amount. Meanwhile, high grade properties are being aggressively purchased by investors with funds on hand and by long-term investors.

(Foreign firm employee)

—— What's your take on the current domestic market.

Continuing with last year's trend, the weakened yen has ushered in active purchases by wealthy Asian investors from Hong Kong, Taiwan, and Singapore. Since last Fall, many foreign firms increased their hurdle rate with concerns over a higher interest rate, essentially halting purchases. However, there was no interest rate hike, so they seem to be restarting their acquisitions. The players have changed but property sales volume remains high.

—— Looking at real estate market reports issued by financial institutions, investors seem to have a waning investment appetite globally. So, Japan with its low risk of interest rate hikes is being bought almost by process of elimination. How is it actually? Is there a shift from investor capital from Core to Opportunistic?

From a global perspective, Japan is the only option right now. There's massive dry powder available. Although, with respect to Core to Opportunistic, the Opportunistic opportunities seem very limited in Japan.

—— What asset classes are investors targeting?

Hotels. It's easier to envision a story around them. Residential as well, since they're stable.

—— Does the Kansai Exposition and increasing inbound visitors have to do with it?

Yes, to a certain extent.

—— I've heard from a lender recently that the company is full of borrowers and that there is no more available credit for hotels. What's the lender's mood right now?

Hotels are starting to be financed again depending on the operator, but I have the impression that lender valuations haven't grown.

by Shigeru Hirai, Client Relations Group

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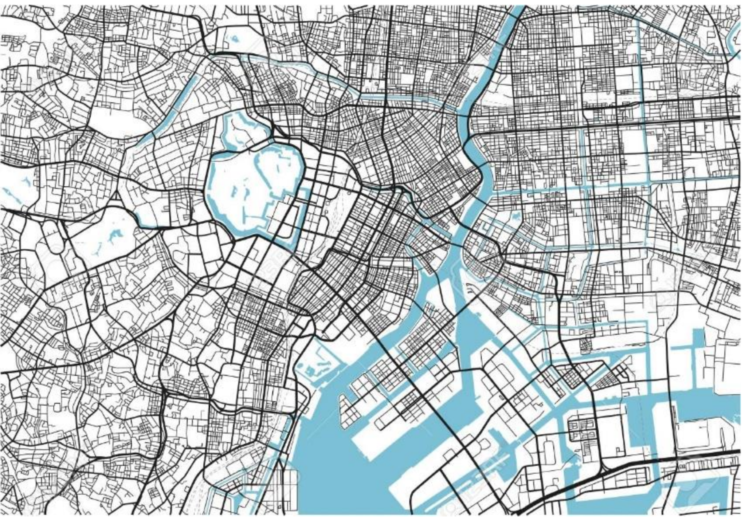
Prop Tech

Implications of the Real Estate ID



On May 30, 2023, the first public-private partnership council for the Real Estate ID was held.

According to the disclosed council documents, the Real Estate ID public-private partnership council consists of organizations, businesses, municipalities that make up the 251 members, experts, and related government agencies. The council was established with the purpose of progressing “architecture and city DX”, cooperating with members of the public and private sectors to use the “real estate ID” for expanding data utilization, and to ultimately maximize the country’s real estate to realize growth and provide solutions for a wide range of fields (① the acceleration of urban development and planning ② Creation of new industries and services ③ Improvement of local policy).

A plan was also announced that by Fall 2023, using the registration data from 440 municipalities nation-wide, a “real estate ID confirmation system” will be provided as a beta version to council members to confirm real estate ID from addresses and to test pilot programs (like policies for vacant homes, tourist area management, and revitalization of shopping areas)
In demonstration testing, the real estate ID’s use and effect on the following will be analyzed.

- Reduction of property research time and effort

Property research requires data collection methods and also time and effort to meet the appropriate contact person. By searching with the real estate ID, urban planning information and other data will be easily obtainable. The flow of search is expected to be ① entry of real estate ID ② plotting of coordinates on the map linked to ID ③ urban planning and other info will appear with a click.

- Elimination of duplicate postings on real estate websites and bait-and-switch advertisements

LIFULL Co., Ltd. will perform assessment of bait-and-switch property, At Home Co., Ltd. will connect the nationwide vacant homes/land database to real estate IDs, and Recruit Co., Ltd. will estimate the reduction in bait-and-switch listings.

The real estate ID will be used in architecture and city DX in conjunction with architectural BIM and PLATEAU. Architectural BIM is used for 3D modeling for individual architectural data, while PLATEAU does 3D modeling based on an entire city space. Combining these technologies, new solutions for green/carbon neutrality, disaster prevention, and improvement in services with mobility and robots are expected to be feasible.

With the widespread adoption of architectural and city DX coming in 2028, we’ll be keeping an eye on the progress of these three measures.

by Masanori Ikematsu, ASA Advisory

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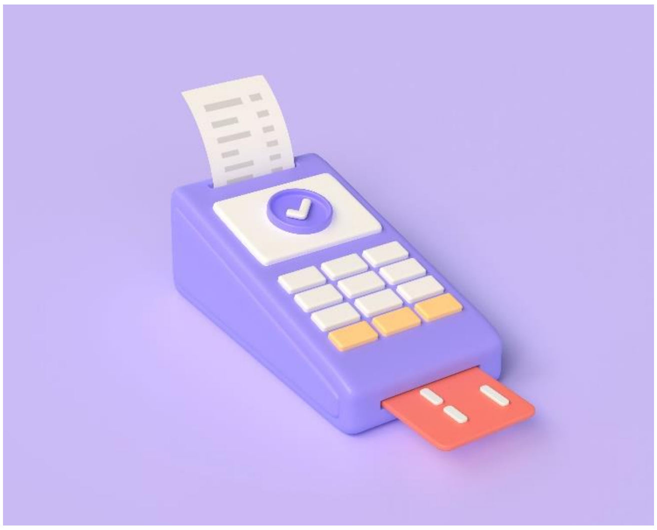
Japan Tax Update

[Tax Treatment] Meals and Entertainment expenses of 5,000 yen under the Invoice System



Once the Invoice system begins on October 1, businesses that use the tax-exclusion method of accounting should be cautious when determining the deductibility of meals and entertainment expenses of 5,000 yen.

Under the Invoice system, meals and entertainment expenses from a restaurant that is not a qualified invoice issuer should include the excluded purchase tax credit amount in the "base price without sales tax" to determine whether it is under 5,000 yen.

For example, if a meal was 5,500 yen (tax included) per person at a restaurant in October 2023, the base price would be calculated as:

① Amount with tax: 5,500 yen
② Sales tax amount: 500 yen (① x 10/110)
③ Non-deductible purchase tax credit:
100 yen (② x (1-0.8 ※1)
④ Base price: 5,100 yen (① - ② + ③)

As a result, for the tax-included amount 5,500 yen, the base price will be 5,100 yen which exceeds the qualifying amount of 5,000 yen. Thus, the tax treatment will differ from that prior to October 2023, and meals and entertainment expense will be non-deductible.

The tax-included amount that is determined to qualify under 5,000 yen will vary depending the deductible ratio under the transition period measure.

Pre-Invoice system (September 30, 2023 and prior) : 5,500 yen

October 1, 2023 ~ September 30, 2026	:	5,392 yen ※1
October 1, 2026 ~ September 30, 2029	:	5,238 yen ※2
October 1, 2029 and after	:	5,000 yen ※3

※1 Deductible ratio 80% under the relief measure from October 1, 2023~September 30, 2026
※2 Deductible ratio 50% under the relief measure from October 1, 2026~September 30, 2029
※3 No relief measure from October 1, 2029 and after

by Satoshi Gondaira, Tax Advisory Group

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Editor's Afterword

On August 25th, Aoyama Sogo Accounting Firm marked its 24th anniversary. Equivalent to two cycles of the Chinese Zodiac calendar. Next year will be the quarter-century mark and I feel that there is still room for improvement. Employee recruitment and training is the biggest topic of them all.

In the historical drama series, the topic of human capital is portrayed during the Japanese Sengoku period by Shingen Takeda's poem "People are your castle. People are your stone walls. People are your moat." In modern times, many firms voice that their biggest concern is the lack of human capital. In any era, I believe the single most important thing is "people".

Actually, the poem continues with "People are your castle. People are your stone walls. People are your moat. Compassion is your ally, and ill will is your enemy." Shingen Takeda is often thought to have attempted the unification of Japan through military power, but perhaps it was actually a benevolent government that values the connection between people that was his greatest focus to unify the country.

In the next quarter-century, how will you and your company grow your workforce?

by Jun Murata, Corporate Officer