

## Real Estate Finance in Japan Is Gaining Momentum

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### SUMMARY

Japan's real estate markets have been revived against the backdrop of economic recovery and low interest rates. Land is regarded as a separate asset from buildings. Traditionally, land prices have been determined by market comparisons utilizing land price indices prepared by the Japanese government. Recently, land prices are beginning

to be determined by reflecting the income from the subject properties, where real property assets are considered as a whole, using the income approach. The financing takes place without recourse to the originator.

There are no special restrictions on investments by foreigners. Expropriation requires a special need and has to be compensated. The Constitution guarantees ownership as a human right. Recently, private financing initiative projects in conformity with the Law for the Development of Public Facilities Using Private Capital have gained importance.

There is no comprehensive statute that governs the regulation of real estate funds. Private real estate funds are often set up as partnerships or as undisclosed associations. The requirements and restrictions of the Real Estate – Specific Joint Business Law (RESJB) can be avoided when real estate has been placed into trust. When a residential lot or building is the subject of an investment contract, the RESJB is applicable and special investor protection and supervision take place.

Publicly placed structures are usually set up under the Law Concerning Investment Trusts and Investment Corporations (ITICL). Investment trusts can be divided into contract types and corporation types. They are either directed by settlor or not directed by settlor. J-REITs can be created as either open-end funds or closed-end funds. Listed J-REITs usually use the closed-end investment corporation structure; consequently, the article focuses on the investment corporation structure under the ITICL.

In all structures, trusts are used regularly. The article briefly introduces the contents of the Trust Law and the Trust Business Law.

Real estate securitization is used when placing real estate into a structure where investors have greater liquidity. The originator transfers the assets to a special purpose vehicle. Investment products with greater liquidity than the underlying assets are then issued to investors. The basic requirements of the real estate monetization scheme are bankruptcy remoteness and pass- or pay-through taxation.

There are two forms of securitization vehicles: contract- and corporate-based vehicles. In practice, the specific purpose company (SPC) under the Asset Monetization Law is of utmost importance. The parent of the SPC is often set up as a Cayman limited company with charitable trust or, more recently, as a mid-sector company under Japanese law. The utilization of a public interest corporation is currently under discussion.

Typical credit securities are pledge, security assignment, hypothec, base hypothec, provisional registration, and personal guarantees. Hypothecs, however, are not used very often in real estate finance.

The statutory law protects the position of secured creditors in insolvency procedures to a certain extent. In addition to or instead of the four statutory insolvency laws, private arrangement procedures (out-of-court workouts) are often used.

Finally, the article gives an outlook on the new Financial Instruments and Exchange Law (FIEL) that succeeds the Security and Exchange Law completely, foreseeably by December 13, 2007. The amendment includes major items with respect to investment services such as the enhancement of investor protection. The author concludes that the

FIEL will improve the quality of the capital markets and thereby stimulate further investment in financial instruments in Japan.