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Since 2008, the condominium market has been declining rapidly, and many developers have experienced business failure. Most of these developers were not prudent enough to calmly identify the true purchasing power of home purchasers, and carelessly raised the prices of condominium units. On top of this imprudence, they were at a loss as to how to deal with rapid changes in the financial market.

Most of the failed developers had sharply expanded their liquidation businesses in which they repeated the acquisition and sales of office buildings and other real estate products. They cited "stabilization of business portfolios" as the primary reason for participating in this business. Nevertheless, it is nearly impossible for developers to know how the investment policies of professional institutional investors change. Careless expansion of the liquidation business proved fatal.

In the Greater Tokyo area, including Tokyo, Kanagawa, Chiba and Saitama, where basic economic conditions are relatively good, the condominium business is still viable (in this paper, the condominium market in Tokyo, Kanagawa, Chiba and Saitama is analyzed). The reasons behind this projection are that households that have not yet purchased homes have been accumulating, and the number of suppliers will decrease considerably.

Developers must upgrade their condominium business as their core business and, at the same time, must establish a long-term, stable source of profit. As the history of several decades tells, business structures that rely on borrowing fail. Not only developers but also financial institutions that provide loans to developers should learn these lessons from history.

I Basic Reasons for Failure in the Condominium Business

1 The Condominium Market Reduced by Half

The condominium market has been noticeably declining. As shown in Figure 1, during the period from 1999 to 2005, the market experienced a historic boom known as the "era of large supplies" in the Greater Tokyo area, and more than 80,000 units were sold every year. While the number of units sold in 2006 was below 80,000, the ratio[1] of contracts concluded within the first month after the start of sales was still high at 78 percent, showing that the demand for condominium units was still strong.

It was in 2007 that declining demand became apparent. In 2007, the number of units sold annually dropped to 60,000, and the first-month contract ratio decreased to 70 percent. Such a decline is partly attributable to a decrease in the number of condominium units for which construction had started due to the amendment of the Building Standards Law, which required stricter building inspections. While this procedural problem did not linger and building inspections were soon back on the rails, the condominium market has started to see poor sales since around the end of 2007. In 2008, the annual number of units sold dropped to about 43,000 with the first-month contract ratio decreased to about 60 percent.

Since around the end of 2008, it has become common to sell condominium units at a discount of 10 to 20 percent, and the Japanese term *outlet mansion* (meaning a condominium unit sold with a substantial discount to give consumers an impression of a good buy) has become popular. Having some 10,000 unsold units, developers will have a difficult time in promoting new supplies. This leads to a projection that the prices of condominium units will continue to fall for some time into the future.

2 General View on the Collapse of the Market

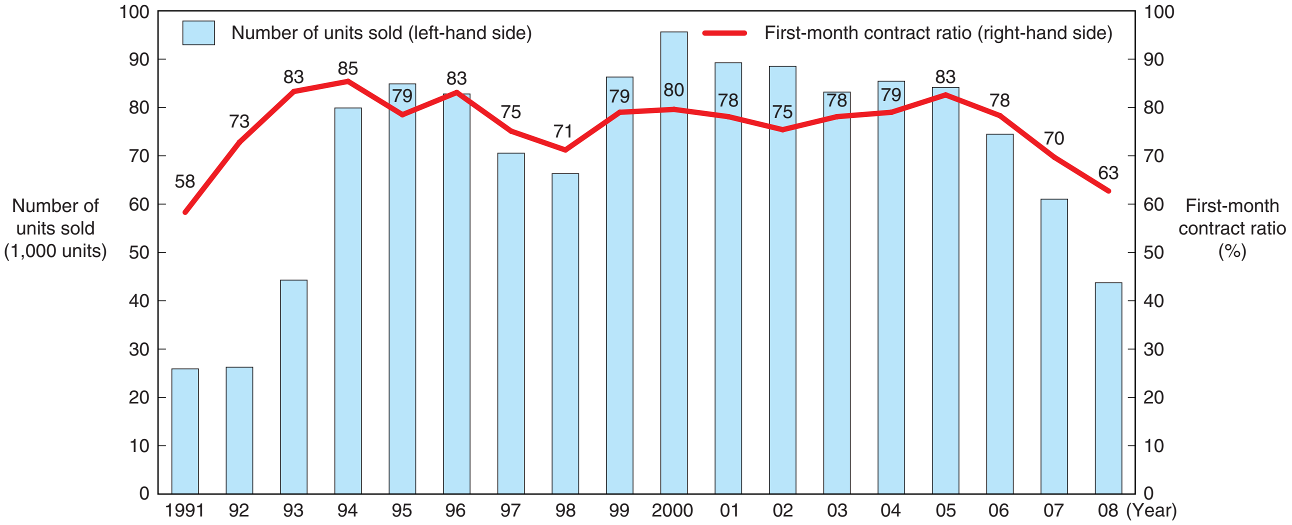
The primary reason for the reduction of the condominium market by half is often attributed to changes in the external environment. Major causes often cited include: (1) the worsening of the financial environment as represented by the reluctance of banks to extend loans, (2) increases in the costs of materials such as steel and (3) the deteriorating macroeconomic environment.

Undoubtedly, outstanding loans provided by financial institutions to real estate companies have been decreasing rapidly. While this trend might affect the development of new projects for the construction of condominiums, it would not have such a serious impact as anticipated on existing projects for which the necessary funds have already been procured. Although some observers might point out the difficulty in refinancing (replacing existing loans with loans having different terms and conditions), refinancing is generally required for the real estate liquidation business, which is explained later, rather than for the condominium development and sales business.

While it is true that increases in costs such as the prices of materials and land have acted as a brake on the condominium business, it is also obvious that such increases are not a direct cause of the market collapse. The issue of costs is discussed in the following section.

It was after September 2008 when the so-called "Lehman shock" hit world markets that the unstable macroeconomic environment became apparent. Demand has declined considerably in many industries including automobiles, semiconductors, electrical machinery and

Figure 1. Changes in the Number of Condominium Units Sold Annually and the First-Month Contract Ratio in the Greater Tokyo Area



Source: Compiled based on material published by the Real Estate Economic Institute Co., Ltd.

distribution. Even large companies are announcing downward revisions in performance forecasts and projected deficits. Because the condominium market started to show a declining trend in 2007, as stated in Section 1, such aggravation of the macroeconomic environment has acted as an additional factor.

It is easy to accuse the external environment as being responsible for the sluggish market. Nevertheless, such sluggishness should also be verified from the perspective of whether developers have conducted their business operations appropriately. Rather, the latter point of view is considered to bear more significance.

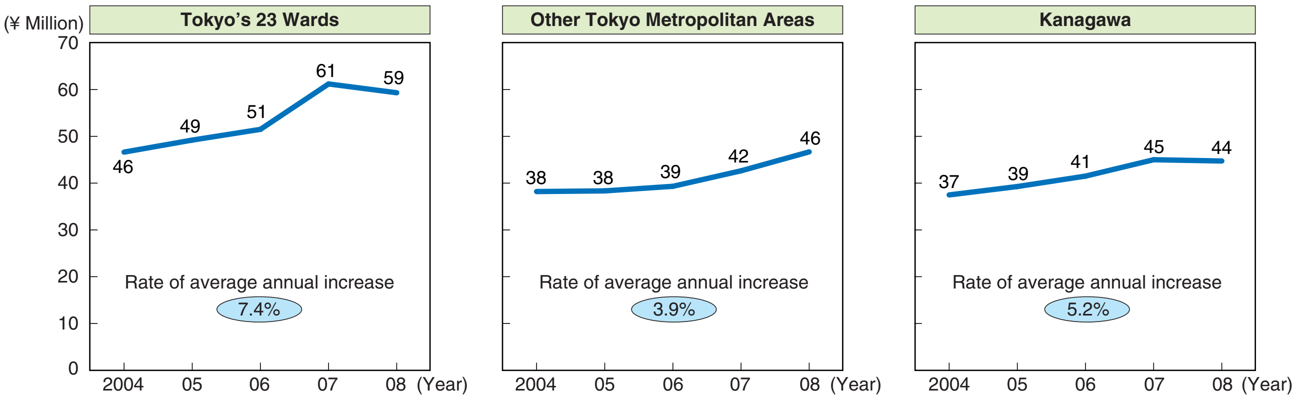
3 Laid-back Management Decisions Based on Faulty Projections for Actual Housing Demand

The authors believe that the fundamental cause that led to the collapse of the condominium market stems from management decisions for carelessly raising the prices of condominium units based on the supplier perspective, rather than the consumer perspective.

As shown in Figure 2, many developers in the Greater Tokyo area started to raise sales prices in 2005. The prices after the increases were called "new prices" and "extra new prices." In particular, price increases were prominent in Tokyo's 23 wards.

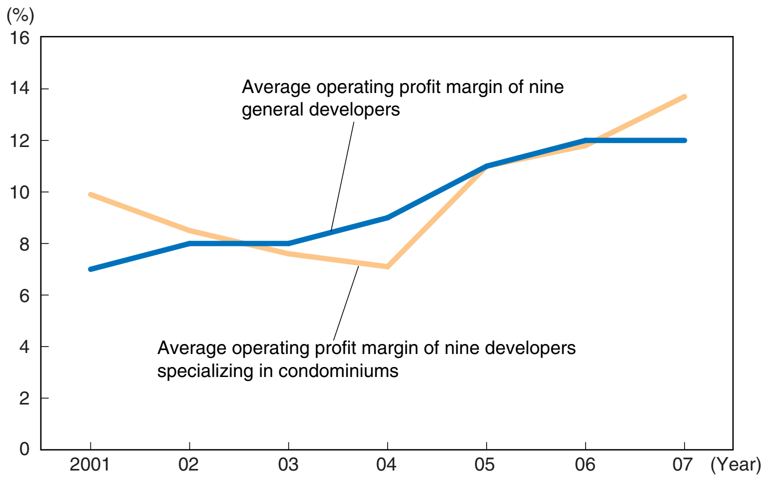
Undoubtedly, cost increases would be one of the reasons for the price increases. Land prices in Tokyo's 23 wards started to climb in the latter half of 2004 and, in 2007, reached a level that was about 1.3 times higher than that of 2005. Costs for steel and other building construction expenses had also increased. Be that as it may, developers took advantage of a market climate that favored sellers, and added such cost increments to sales prices. On top of such cost increments, they also added increased profits to sales prices. As shown in Figure 3, this aggressive approach on the part of developers can be substantiated by the fact that operating profit margins of developers grew sharply since 2005.

Figure 2. Changes in Condominium Unit Prices in Tokyo's 23 Wards, Other Tokyo Metropolitan Areas and Kanagawa



Source: Compiled based on material published by the Real Estate Economic Institute Co., Ltd.

Figure 3. Changes in Operating Profit Margins of Developers



Notes: General developers: Mitsui Fudosan Residential Co., Ltd., Mitsubishi Estate Co., Ltd., Sumitomo Realty & Development Co., Ltd., Nomura Real Estate Development, Tokyu Land Corporation, Tokyo Tatemono Co., Ltd., NTT Urban Development Co., Daiwa House Industry Co., Ltd., and Joint Corporation.
Developers specializing in condominiums: Gold Crest Co., Ltd., Cosmos Initia Co., Ltd., Daikyo Incorporated, The Japan General Estate Co., Ltd., Takara Leben Co., Ltd., Towa House Corporation, Hoosiers Co., Ltd., Properst, and Sunwood Corporation.
Source: Compiled based on financial statements of the above-mentioned companies.

The average operating profit margin of nine general developers that was about 9 percent in 2004 increased to about 12 percent in 2007. The average margin of nine developers specializing in the condominium business increased from about 7 percent to about 14 percent during the same period. By taking advantage of economic recovery and a favorable trend in condominium sales, it appeared that developers did not hesitate to set prices at a higher level, and unilaterally increased their own profits without giving consideration to the situation of consumers.

Since 2007, developers have appeared that held off starting sales in anticipation of a further rise in prices. Developers that had emphasized the sales of all units before beginning the construction of a building started to begin sales several months after the completion of construction. As such, the trend of being unwilling to sell in expectation of better prices has become pronounced among developers.

On the part of consumers, contrary to ever-increasing sales prices, the average wage and household income have continued to decline instead of increasing. According to the Sampling Survey of Wages and Salaries at Private Firms by the National Tax Agency, the average wage/salary of wage earners and salaried employees that was ¥4.61 million in 1996 decreased to ¥4.35 million in 2006, showing a drop of about 6 percent during the ten years from 1996 to 2006. According to the generally accepted criterion, the optimal ratio of the price of a condominium unit to one's annual income is 5. However, a survey by Tokyo Kantei Co., Ltd., a company providing real estate appraisal and assessment information, revealed that the average ratio of the price of a condominium unit to annual income increased to 7.77 in 2007 in the Greater Tokyo area and to 9.85 in Metropolitan Tokyo.

This means that many developers have indifferently continued to raise prices based on faulty projections of the purchasing power of consumers. Consequently, such prices were not accepted by consumers, resulting in poor sales and increased numbers of unsold units. Eventually, these irresponsible decisions led developers to business crises. If developers had been more prudent in estimating the actual purchasing power of consumers and adopted the strategy of maintaining stable price levels and profit margins, they would not have faced the crises that they now face.

II Traps behind Imprudent Expansion of Business Portfolios

1 Characteristics of Failing Developers

In addition to failures in the condominium business, many developers have also failed in the liquidation business. Such failures gave fatal blows to many developers. In the liquidation business, offices, condominium units and commercial facilities are sold to real estate funds financed by institutional investors. Initially, this business was called a liquidation business in the sense that the ownership of real estate is liquidated in such a way as that existing real estate is acquired from an original owner and sold to a new owner. Actually, however, business to newly develop real estate is also handled as part of the liquidation business. As such, the liquidation business discussed in this paper also includes both the acquisition and sales of existing property and the development and sales of new real estate.

Table 1 lists the developers that filed for bankruptcy in 2008 and 2009. Among 12 such failed companies, eight were engaged in the liquidation business. Of these eight, the ratio of liquidation business to total sales was more than 50 percent in at least three companies. For these companies, it can be assumed that the liquidation business triggered the collapse of the companies.

What developers must understand is that there are two decisive differences between the condominium business and the liquidation business. Unfortunately, however, many developers appeared to give less than adequate consideration to these differences.

One difference relates to customers. The condominium business is a B-to-C business (business-to-consumer transactions), in which condominium units are sold to purchasers of dwellings. The condominium business requires the abilities to provide detailed and easy-to-understand explanations to purchasers who do not have sufficient technical knowledge as well as to make proposals that can satisfy the needs of purchasers for residential living. Because buying a home means purchasing the single most valuable item in one's life, house purchasers are naturally careful and prudent in their selection. Accordingly, developers must adopt an attentive approach to dealing with customers.

On the other hand, the liquidation business is a B-to-B business (business-to-business transactions), in which the customers are professional real estate investors. Professional real estate investors make decisions quickly and logically according to their needs based on their own established investment criteria.

As such, the condominium business and the liquidation business face completely different sets of circumstances in terms of how consumers think, their expectations, dissatisfactions, etc.

Another difference is the target real estate that is sold. Developers having their strength in multi-family housing (condominium units) are also involved in business to operate offices, resort hotels, commercial facilities and distribution facilities. However, because most of these developers did not have the abilities necessary to attract customers and/or tenants to offices and resort hotels, they depended on outside partners in operating such a business.

Table 1. Listed Developers that Filed for Bankruptcy in 2008 and 2009

Company	Major area of operation	Consolidated sales (latest fiscal year; ¥ billion)	Ratio of condominium business to sales	Ratio of liquidation business to sales	Total liabilities (¥ billion)
Urban Corporation	Nationwide	243.685	19%	67%	255.832
Japan General Estate	Tokyo, Kanagawa	118.933	88%	0%	197.549
Morimoto	Tokyo, Kanagawa	117.636	33%	63%	161.520
Zephyr	Nationwide	109.172	52%	26%	94.948
Noel	Tokyo, Kanagawa	80.493	62% Note 1	34%	41.400
Dia Construction	Nationwide	56.086	72%	0%	30.000
Sohken Homes	Tokyo	41.805	Unknown	Unknown	33.890
Human 21	Tokyo	33.954	87% Note 1	0%	46.437
Dynacity	Tokyo	32.906	66%	26%	52.077
Landcom	Tokyo, Kanagawa	27.970	9%	83%	30.989
C's Create	Tokyo	21.069	53%	39%	11.442
L-Create	Tokyo, Kanagawa	2.555	100%	0%	6.060

Notes: (1) This ratio includes single-family dwellings. (2) The total ratio of condominium business and liquidation business is not 100% because condominium management business is also involved. (3) Developers listed above are those whose major areas of operation are in the Greater Tokyo area and that went into bankruptcy during the period between January 2008 and the beginning of February 2009.
Source: Compiled chiefly based on financial statements of the above-mentioned companies.

As such, for most developers, the liquidation business was completely beyond the scope of their experience because of completely different types of customers and products to be sold. Nevertheless, they were not aware of such fundamental differences. Rather, they carelessly expanded their liquidation businesses.

2 Stabilization of Business Portfolios Proved to be an Illusion

In entering the liquidation business, many developers cited the stabilization of business portfolios and the diversification of risk as the primary objectives. The logic behind such moves was that it was not possible to ensure stable growth only through the condominium business, which is susceptible to the fluctuations of the economic environment. However, the fact that participation in the liquidation business could not contribute to the diversification of risk has become apparent in that many developers who entered the liquidation business went into bankruptcy. This situation has proved that the stabilization of business portfolios by entering the liquidation business market was merely an illusion.

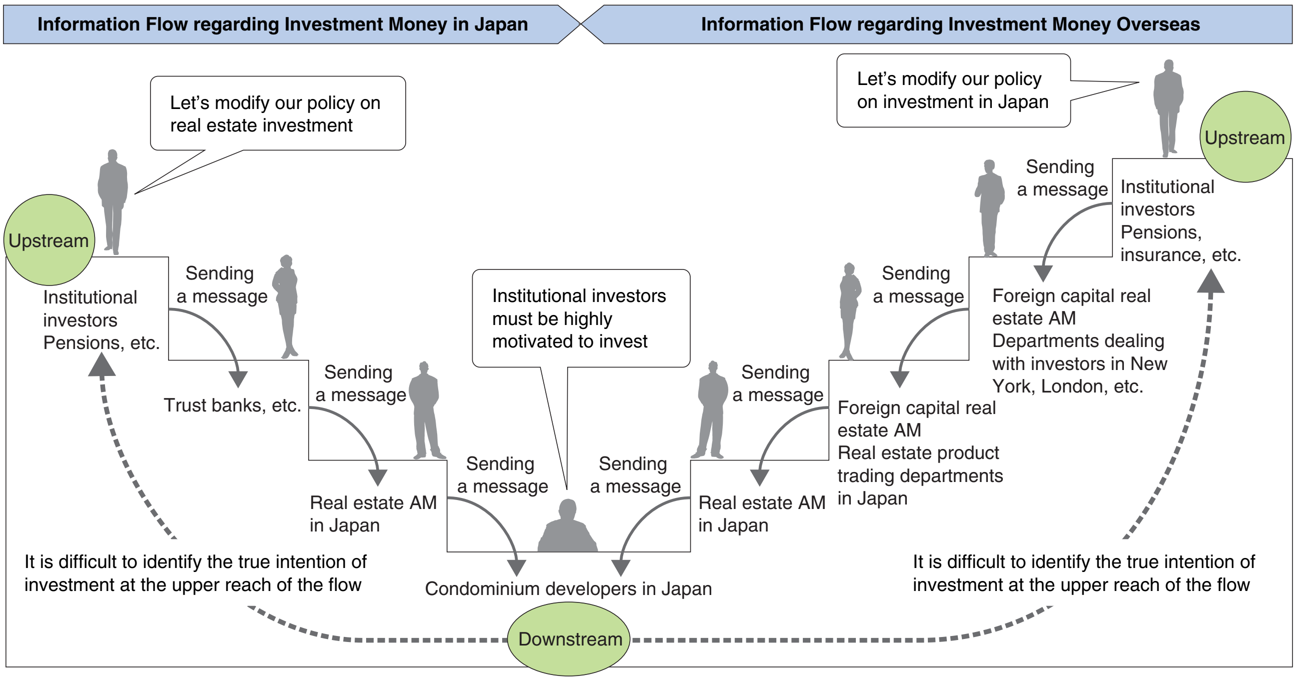
Why does entering the liquidation business not contribute to the diversification of risk? There are two reasons. One reason is that the liquidation business is also prone to be affected by changes in the economic environment. Another reason is that developers are not positioned to be able to acquire pertinent information regarding changes in the needs of institutional investors.

When we look at the history of the real estate bubbles and their collapse, which occurred all over the world, it is obvious that the real estate market is subject to frequent changes. We can say that the market condition is good only when all of the following requirements are satisfied: favorable macroeconomic conditions, the existence of a large number of investors interested in a variety of products, the existence of fund lenders and the operation of a stable financial system. Lack of any of these requirements leaves the market vulnerable to sudden change.

The largest reason why developers are unable to acquire relevant information regarding the financial market is asymmetry in terms of the information that can be acquired by developers and the information concerning the needs of professional investors, in particular, institutional investors. Developers engaged in the liquidation business acquire and develop real estate properties to sell them to real estate funds financed by institutional investors. As shown in Figure 4, however, an array of intermediaries exists between developers and institutional investors.

Intermediaries for Japanese institutional investors include trust banks and real estate asset management companies that serve as investment advisors for institutional investors. Intermediaries for overseas institutional investors include foreign capital real estate asset management companies and Japanese real estate asset management companies. Accordingly, there is a fairly long distance between developers and institutional investors. Such a far distance makes it extremely difficult for developers to obtain appropriate information at appropriate timing with respect to the investment needs of institutional investors. In many cases, developers are unable to obtain upstream information ahead of the real estate trading departments of Japanese and foreign capital real estate asset management companies.

Figure 4. Information Flow regarding Investment Money in Japan and Overseas



Note: AM = asset management companies.

Some trading departments of real estate asset management companies can improve their performance only by acquiring real estate properties. Irrespective of the true needs of institutional investors, such real estate asset management companies might request developers to speed up the development of real estate properties by giving false information that there were high investment needs on the part of institutional investors. Upon receiving such information, developers had no choice but to believe what they were told. In short, developers continued to acquire and develop real estate properties without knowing the true risks involved in selling such real estate products. Although these risks were extremely large, many developers continued to expand their liquidation businesses, and ultimately reached a deadlock in selling real estate products.

3 Excessive Expansion of Liquidation Business Resulting in Business Failure

Edward Luttwak, an American military strategist, pointed out "As victory is turned into defeat by overextension, as war brings peace by exhaustion, ordinary linear logic is overthrown." This means that overextension can easily be a mistake in the strategic decisions of a commander in waging war. The further troops go into the backlands pursuing a series of victories, the further is the ally camp and the longer become the supply lines. While a battle should be halted after gaining some sort of victory, many commanders tend to seek further victories and chase after an enemy too far. As a result, at some point the war situation is reversed, and victory is turned into defeat. The analyses reveal that a cause of defeat in Napoleon's Russian invasion and Peninsular War was also "chasing too far after a series of victories." Luttwak notes that for this reason in a war, success could turn into failure and victory could turn into defeat; or, failure could turn into success and defeat could turn into victory[2].

Rapid expansion and eventual failure in the liquidation business by developers can be likened to defeat as a result of "chasing too far after series of victories." From around 2003 to 2006, the liquidation business had achieved a high level of profitability and brought about sizeable profits to developers.

However, although developers should have ceased to pursue the liquidation business at the time they earned a certain amount of profit, they continued to make vast investments in the liquidation business, and expanded the business as if there were no limits. When they finally awoke to reality, the condominium business had become a "troublesome business" in which they were forced to deal with each individual purchaser in an attentive, careful and detailed manner, and they could no longer return to such a labor-intensive business. If we assume that the primary cause of failure in the condominium business is that developers have imprudently raised prices, the primary cause of failure in establishing business portfolios is considered to be that they pursued the liquidation business to an extent beyond that in which they had sufficient knowledge.

Consequently, the liquidation business triggered business bankruptcy. Because most developers assumed the resale of real estate products in a short period, they mostly relied on short-term borrowing for the funds for the liquidation business. When real estate funds became less enthusiastic about investing in real estate properties, developers had a difficult time selling their products and faced the need for refinancing. Unfortunately, however, the fund-raising environment has also rapidly worsened. As a result, as shown in Table 1, companies began to file for bankruptcy one after another. In the end, the liquidation business that developers expanded with the major aim of diversifying risk has proved to be the largest risk of all.

III Attention Should be Paid to Structural Changes in the Market

Condominium developers should cease to expand the liquidation business, and should instead return to their core condominium business. From the mid- and long-term perspectives, the condominium business is not as unattractive as is generally thought. As is clear from the explanations we provided in Chapter II, developers who engage in the liquidation business face many difficulties.

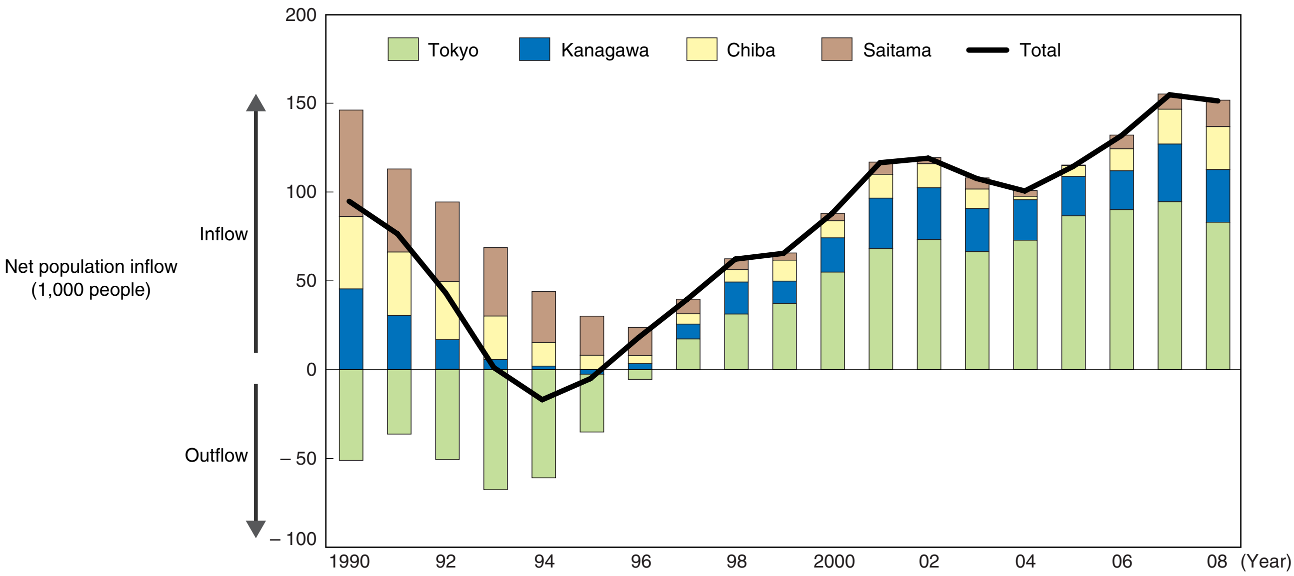
Some people point out that demand for condominiums in the Greater Tokyo area was assumed to be fully met during the period from 1999 to 2005 through the availability of large supplies. However, this indication is not correct because it does not consider population dynamics. In other words, there is demand and there is the market. In addition, if we consider the increasingly accelerated screening of suppliers, this situation implies that there are sufficient business opportunities for the developers that survive.

1 Increasing Inflows and Settled Habitation in Tokyo, Kanagawa, Chiba and Saitama

According to the Report on Internal Migration in Japan Derived from the Basic Resident Registers published by the Ministry of Internal Affairs and Communications, in 1996, outflows greater than inflows shifted to inflows greater than outflows in Tokyo, Kanagawa, Chiba and Saitama (Figure 5). Since then, the trend of net population inflow (more people moving in than moving out) has been increasing. In 2007, inflows were greater than outflows by about 155,000 people. In addition, because natural increase (more births than deaths) has also been continuing, population growth in these areas is expected to continue from the long-term perspective. Actually, according to population projections for 2020 in these areas by the National Institute of Population and Social Security Research, the projections made in 2002 for these areas, which totaled 34.49 million, were revised upward to 35.03 million in the projections made in 2007.

The censuses taken by the Ministry of Internal Affairs and Communications by age indicate that, in the past, more people aged 30 or above were moving out. Since 2001, however, a greater number of people of this age range have been moving in than moving out. With respect to people aged 25 – 29, although the number of these people moving out is still greater than that of those moving in, the outflow has sharply decreased. A typical pattern in the past was that people move to the metropolitan area to enter universities or to get jobs in their 20s, and several years later, return to their hometowns. However, in recent years, not only young people aged around 20, but also people aged above 20 have been moving

Figure 5. Changes in Net Population Inflows in Tokyo, Kanagawa, Chiba and Saitama



Note: Net population inflow = population inflow – population outflow.
Source: Compiled based on the Report on Internal Migration in Japan Derived from the Basic Resident Registers published by the Ministry of Internal Affairs and Communications.

Table 2. Changes in Net Population Inflows by Age in Tokyo, Kanagawa, Chiba and Saitama

(Unit: 1,000 people)

Age	1981 – 1985	1986 – 1990	1991 – 1995	1996 – 2000	2001 – 2005
5 – 9	Outflow – 13	Outflow – 1	Outflow – 22	Outflow – 6	Inflow 23
10 – 14	Inflow 21	Inflow 7	Outflow – 13	Outflow – 3	Inflow 17
15 – 19	Inflow 207	Inflow 216	Inflow 162	Inflow 155	Inflow 147
20 – 24	Inflow 460	Inflow 468	Inflow 357	Inflow 361	Inflow 334
25 – 29	Outflow – 138	Outflow – 90	Outflow – 117	Outflow – 90	Outflow – 18
30 – 34	Outflow – 27	Outflow – 12	Outflow – 46	Outflow – 36	Inflow 40
35 – 39	Outflow – 20	Outflow – 13	Outflow – 33	Outflow – 19	Inflow 30
40 – 44	Outflow – 5	Inflow 3	Outflow – 17	Outflow – 7	Inflow 33
45 – 49	Inflow 2	Inflow 8	Inflow 4	Outflow – 10	Inflow 24
50 – 54	Outflow – 8	Outflow – 1	Outflow – 5	Outflow – 27	Inflow 18
55 – 59	Outflow – 17	Outflow – 15	Outflow – 8	Outflow – 28	Inflow 13

Source: Compiled based on censuses taken by the Ministry of Internal Affairs and Communications.

into the metropolitan area, and a stronger trend has been seen among these people to settle in the metropolitan area without returning to their hometowns[3].

Another factor affecting this trend is that people in their 30s and 40s have been moving in with their children. Statistics reveal that more people aged 14 or below are moving in than are moving out. Expectations can also be given to these generations as future purchasers of condominium units.

2 Size of Condominium Market in the Greater Tokyo Area Projected at 60,000 – 70,000 Units Annually

The next question is the projected size of the housing market in Tokyo, Kanagawa, Chiba and Saitama. In order to identify potential first-time home purchase demand, we used the home ownership rate as a proxy indicator and estimated the increase in this rate every five years. Details of this projection method are explained in Note 4 at the end of this paper.

Figure 6 shows the results of the projections. In our intermediate scenario, we assume that the future net population inflow will remain at the same level as that in 2007, and that the home ownership rate will decline to the mean value between 2000 and 2005. Based on this intermediate scenario, the first-time home purchase demand will be 1.03 million units in the five years between 2006 and 2010 and will be 980,000 units in the five years between 2011 and 2015. The first-time home purchase demand in the five years between 2001 and 2005 that was calculated based on the actual results and by using the same method was 1.11 million units. Accordingly, while it is highly likely that the future first-time home purchase demand will decline as compared to the period of large supplies, our projections suggest that such a decline will be limited to 5 to 10 percent. In terms of the number of condominium units sold annually, it will be less than 80,000 units, but 60,000 to 70,000 units is a reasonable expectation.

The optimistic scenario assumes that the future net population inflow will continue to increase and the home ownership rate will remain at a high level. Based on this optimistic scenario, the first-time home purchase demand will be 1.11 million in the five years between 2006 and 2010 and will be 1.12 million in the five years between 2011 and 2015. In the pessimistic scenario that assumes decreasing net population inflow and a declining rate of home ownership, such demand will be 980,000 units in the five years between 2006 and 2010 and will be 940,000 units in the five years between 2011 and 2015. While the future first-time home purchase demand will remain nearly the same even in the optimistic scenario, it is highly likely to remain at the level of a 10- to 15-percent decrease from the period of large supplies even in the pessimistic scenario.

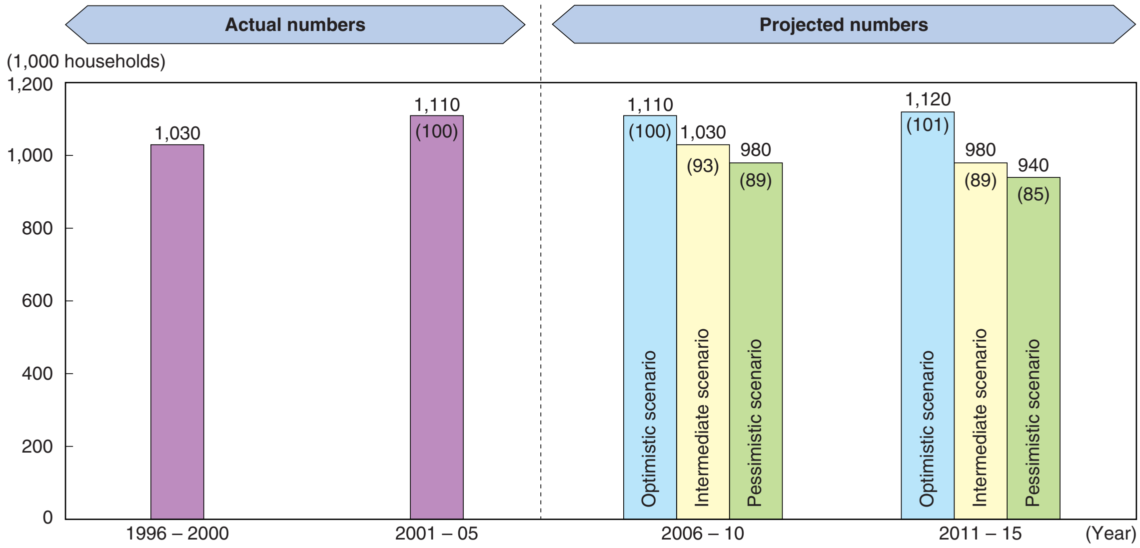
From a short-term perspective, the number of condominium units actually sold might deviate from the projected number by 20,000 to 30,000 units annually due to factors such as substantial discounts in prices, which are referred to as "reverse" new prices (which mean new prices are lower than old prices; because new prices were generally higher than old prices in the past, the term "reverse" is used), tax credits for housing loans, hikes in consumption taxes and the influence of the worldwide financial crisis. From a mid-term perspective (every five years), however, because there are many potential purchasers in Tokyo, Kanagawa, Chiba and Saitama, it can reasonably be assumed that the basis of first-time home purchase demand is firmly in place. The metropolitan condominium market in 2011 – 2015 is not necessarily pessimistic.

3 Expanded Age Segments of Major Purchasers

In addition to the size of the overall market, attention should be paid to the age segments of major purchasers. Figure 7 shows the actual values and projected values of first-time home purchase demand by age. The curve of demand distribution gradually becoming flat suggests that the age segments of major purchasers will become more extensive.

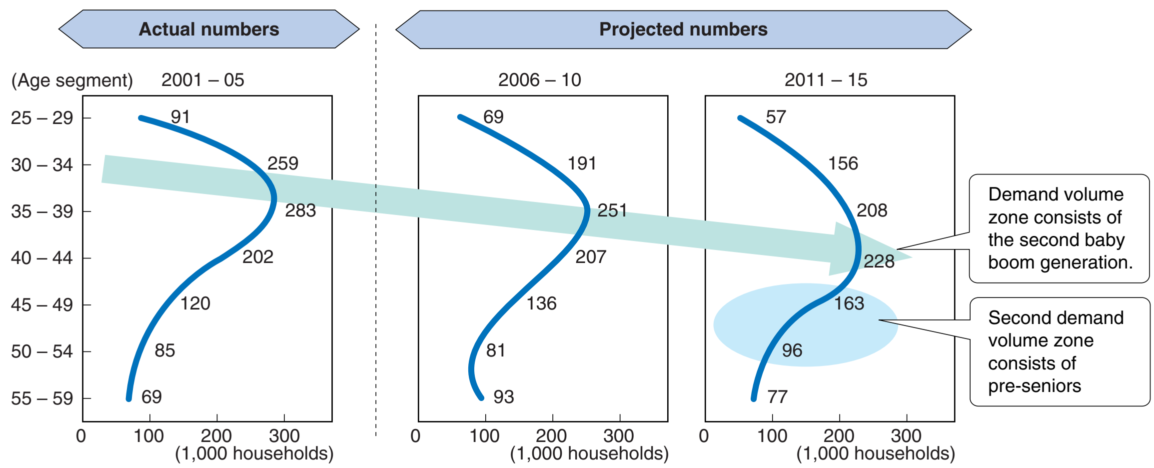
Undoubtedly, the second baby boom generation will remain to constitute the demand volume zone. Some economists thought that the needs of the second baby boom generation were fully met through large supplies of dwellings in the past several years. However, in the projections for 2006 – 2010, the 35 – 39 age segment

Figure 6. First-Time Home Purchase Demand Every Five Years in Tokyo, Kanagawa, Chiba and Saitama



Notes: (1) Figures in parentheses are indicators calculated by regarding the actual number in 2001 – 2005 as 100. (2) The age segment of heads of targeted households is 25 – 59. The first-time home purchase demand among people aged 24 or below and 60 or above is not considered.
Source: Compiled based on censuses taken by the Ministry of Internal Affairs and Communications and data published by the National Institute of Population and Social Security Research.

Figure 7. First-Time Home Purchase Demand by Age of Heads of Households in Tokyo, Kanagawa, Chiba and Saitama (Intermediate Scenario)



Source: Compiled based on censuses taken by the Ministry of Internal Affairs and Communications and data published by the National Institute of Population and Social Security Research.

shows the highest demand; in the projections for 2011 – 2015, the 40 – 44 age segment shows the highest demand. The first-time home purchase demand in the five years from 2006 to 2010 in the 35 – 39 age segment is 250,000 units; such demand in the five years from 2011 to 2015 in the 40 – 44 age segment is 230,000 units. These projections suggest that the second baby boom generation continues to be major purchasers, and that these second-generation baby boomers will still create demand.

In addition, the demand of the generation one segment above the second baby boom generation (the 45 – 54 age segment in 2011 – 15) will also rise. The first-time home purchase demand in this generation is 260,000 units in the five years from 2011 to 2015. This demand exceeds the first-time home purchase demand of people aged 34 or below in the same period, and constitutes the second volume zone next to the second baby boom generation.

While not shown in Figure 7, the number of single female purchasers is expected to increase. The number of females who make use of their high educational backgrounds for their careers and continue to live in the metropolitan area is rising. When we consider the trend toward late marriage among this group, the number of single females who will purchase condominium units is expected to expand.

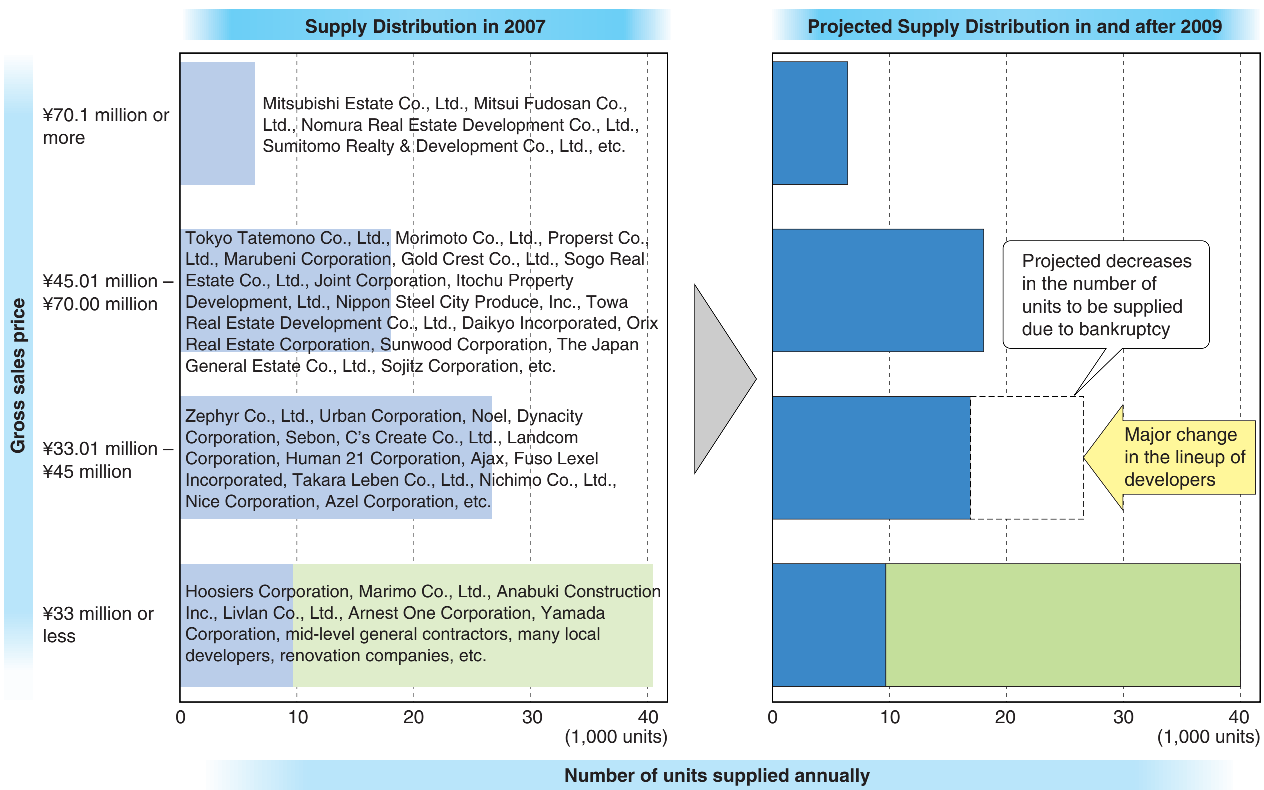
In the past, families consisting of parents in their 30s have been the principal purchasers of condominium units. In the future, new age segments will appear as major purchasers such as second-generation baby boomers nearing their 40s, pre-seniors aged around 50, and single females.

4 Structural Changes on the Part of Suppliers

In addition to structural changes on the part of consumers, as described in Section 3, major changes have also occurred on the part of suppliers. As noted in Chapter II, because the screening of developers has been accelerated since fall 2008, the number of condominium units to be supplied will decrease from a mid-term perspective. Such declining supplies will gradually eliminate the disadvantageous situation of sellers that stems from excess supplies.

According to Figure 8, which classifies developers by range of sales price, many developers that went bankrupt fall under the mid-price range of ¥33.01 million – ¥45 million (also see Table 1). If estimated based on actual supplies in the past by these failed developers, the supplies of mid-priced condominium units are projected to decrease by 7,000 to 13,000 units annually. Even developers that escaped bankruptcy face a situation in which

Figure 8. Structural Changes in Condominium Developers by Price Range in Tokyo, Kanagawa, Chiba and Saitama



Notes: (1) With respect to the price range of ¥33 million or less, the size of supplies is considered largest because a large number of units are not included in the publicly announced statistics (the dark-shaded portion refers to the number of units included in the published statistics; the light-shaded portion refers to those not included in the published statistics). This range also corresponds to that of the used condominium market. (2) Renovation refers to improving the value of an asset by substantially renovating a building.
Source: Compiled based on material published by the Real Estate Economic Institute Co., Ltd., etc.

they are unable to supply units due to complex reasons. As such, supplies are expected to shrink substantially for some time.

Furthermore, from a mid-term perspective, there will be only a limited number of new participants in the market. This is because the participation barrier is expected to be raised due to stricter credit scrutiny by financial institutions than in the past. Accordingly, with respect to mid-priced condominium units in particular, the structure of price competition as derived from excessive supplies will collapse, and the competitive environment will be relaxed.

5 Opportunities for Condominium Developers

As explained in the preceding sections in this chapter, the projected demand for condominium units in Tokyo, Kanagawa, Chiba and Saitama is 60,000 to 70,000 units annually. Because the number of developers and the number of units to be supplied has decreased, the supply-demand gap tends to widen. Developers might have accumulated unsold stock, and consumers might be temporarily reluctant to buy in anticipation of the expansion of tax credits for housing loans. Despite such negative factors, there will be business opportunities for developers from a mid-term perspective because of the accumulation of potential demand and decreased competition.

Developers should fully utilize such opportunities and should make every effort to appeal to newly emerging demand zones such as pre-seniors and single females in addition to second-generation baby boomers nearing their 40s, thereby restructuring their core condominium businesses.

IV Suggested Solutions for Condominium Developers

1 Persuing the Condominium Business from a Different Perspective

With diverse consumer segments becoming major purchasers in the future, developers must clearly identify the target segments of their condominium business.

In the past, it was sufficient for developers to make efforts to sell condominium units for families with the target set at second-generation baby boomers. Because a single consumer segment of second-generation baby boomers constituted the majority of purchasers, developers could sell condominium units that were designed for such families with some customized features based on respective needs.

In the future, however, purchasers of condominium units will be found in diverse consumer segments. In addition to pre-seniors and single females, as explained in Chapter III, potential purchasers would include DINKS (dual-income, no kids), seniors needing nursing care, and low-income earners.

With the diversification of purchasers, the condominium units to be supplied must be appropriately customized to the lifestyle of each purchaser segment. The uniform method applied for product planning and sales activities will no longer be effective. Rather, individual approaches to each customer segment will become necessary. Any attempt to cover all segments of customers will result in diffuse distribution of management resources.

On the other hand, focusing on any particular segment disproportionately would lead to losses of business opportunities such as that the amount of land to be procured would be limited and that customers other than the targeted customers might be lost.

What is necessary for developers in the future is a strategy to set their core business fields within the condominium business by narrowing the scope of target customers to several segments. Based on this strategy, developers should refine their condominium business within their business fields through the accumulation of expertise in product planning and the building of their brands. In the next several years in particular, the competitive environment will become lenient, during which developers will have time to distinguish themselves from their competitors. The key to success is to what extent developers can be innovative in their business operations during this period.

2 Business Portfolios to be Pursued

Business portfolios that developers should pursue must be established from a perspective that is different from that involving the liquidation business, which was pursued in the past.

Viewed in a historic light, we see that the collapse of developers often resulted from the following process: change in the economic environment → poor sales of real estate products → grave deficits and selling stock at a loss → damage of capital base and declining credibility → liabilities in excess of assets → business bankruptcy. What this repetitive routine means is that a business model that relies on profit from the sale of real estate products is not sustainable. To establish a sustainable business model, developers must consider the establishment of a long-term, stable source of profits that is qualitatively different from profit on sales. Naturally, the liquidation business cannot provide such a stable source of profits.

In the past, developers did recognize the need for and gave an emphasis to long-term, stable profits. Actually, developers have developed peripheral businesses to this end such as condominium management and remodeling. However, there are almost no companies in which peripheral businesses such as condominium management have grown to provide a stable source of profits. This situation is remote from business portfolios established from a different perspective. In view of these circumstances, developers should actively embark on office/house rentals although such businesses would lower the efficiency of fund management.

In short, the suggested business portfolios are neither those centered on the condominium business nor those combining the condominium business and the liquidation business. If a business portfolio includes only businesses focused on rapid return on investment, it is meaningless even if the real estate products being handled are expanded to include offices and hotels in addition to condominiums. What is necessary is a business portfolio that combines the condominium business with the rental business. Only after establishing this business portfolio to secure long-term, stable profits as a management foundation, can developers risk engaging in the condominium business that focuses on rapid return on investment.

The capital market is apt to expect new and mid-level developers to rapidly achieve growth and generate profits. In order to meet such expectations, these developers must turn over their funds as rapidly as possible to attain growth and generate profits. Even if they are successful in generating profits in the shortest period possible, it makes no sense if they file for bankruptcy. Expecting developers to keep their capital-to-asset ratio at the level of 40 percent would be considered outside the common sense prevailing in this industry. Be that as it may, to ensure the continuity of business, this level of fiscal soundness is considered necessary.

3 Lessons Learned from History

Looking back over the history of 20 – 30 years of the condominium business, an extremely limited number of developers escaped from falling into some sort of business crisis.

During the 15 years from 1993 to 2007, 43 developers were listed in the top 20 in terms of sales of condominium units in the Greater Tokyo area. Among them, 15 companies are general developers, general trading firms or subsidiaries of major manufacturers. The remaining 28 companies are developers specializing in the condominium business. Of these 28 companies, 11 have already gone into bankruptcy and 7 have withdrawn from the business or have been helped by other companies. Accordingly, only 10 companies remain. Among these 10 companies, several have run into situations where they must formulate a plan for reorganization or restructuring.

This fact suggests how unstable the condominium business is and how difficult it is to continue business only with a condominium business.

Any business model that cannot overcome economic fluctuations is not worth being called a business model. Any business model primarily consisting of a condominium business will fail to attain business continuity.

As described in Chapter III, we projected an annual supply of 60,000 to 70,000 units in the Greater Tokyo area. This projected supply could be 30,000 units or 100,000 units depending on changing conditions such as an increase in consumption taxes, amendment of the Building Standards Law of Japan and tax credits for housing loans. We should be mindful of this range of deviation between the projected figures and the actual numbers.

Any business model principally consisting of a combination of a condominium business and a liquidation business will also fail to attain business continuity. This is because both the condominium business and the liquidation business represent a capital gains model relying on return of investment. Operating these two types of businesses would not contribute to diversification of risk. In developing its business portfolio, a developer must, as explained in Section 2, secure a reliable, long-term and stable source of profits such as by including a rental business.

What is also important is that not only developers but also financial institutions that provide loans to developers thoroughly recognize the need for changes in concept and behavior. When the business environment of developers is favorable, financial institutions provide loans even if the capital-to-asset ratio is 20 percent. Whenever the business conditions become harsh, they immediately call in all the loans they provided. If financial institutions were to continue to take such an approach, it remains unlikely that developers that can grow and remain prosperous for a long time would appear. Fostering developers that can continue to operate in a stable manner for a long time means the creation of a sound housing market that can lead to the stabilization of the local economy. Financial institutions must fulfill their responsibilities in building relationships with developers.

Notes:

1 This refers to the ratio of the number of units for which contracts were concluded within one month after the start of sales to the total number of units to be sold.

2 Reference was made to *Senryaku no honshitsu—senshi ni manabu gyakuten no leadership* (Essence of Strategy—Leadership for Reversal Leaned from Military History) written by Ikujiro Nonaka, Ryoichi Tobe, Shinichi Kamata, Yoshiya Teramoto, Yoshio Suginoo and Tomohide Murai, and published by Nikkei Inc. in 2005.

3 Reference was made to *Josho suru Tokyo no moch-ie-ritsu—kakaku hikisage ni yoru jyutaku hanbai kakudai no kanosei* (Raising Tokyo's home ownership rate—possibility of expanding home sales by reducing prices) written by Kazumasa Takeuchi, in the real estate investment report of July 2008, NLI Research Institute.

4 With respect to the method for projecting first-time home purchase demand, we estimated the population of Tokyo,

Kanagawa, Chiba and Saitama by adding future net population inflows to the closed population (meaning population projected by assuming that there are no population inflows or outflows (social increase/decrease) and by considering only births and deaths (national increase/decrease)) based on Population Projections by Prefecture published by the National Institute of Population and Social Security Research. According to the projections made by this institute, the number of people moving in or out among prefectures is estimated to decrease from the current level. However, because net population inflows continue to increase as far as Tokyo, Kanagawa, Chiba and Saitama are concerned, it is likely that population movements might expand to some extent in these areas. Accordingly, we assumed the following three patterns for net population inflows:

(A) Net population inflows would continue to increase.
(B) Net population inflows would remain constant at the current level.
(C) Net population inflows would decrease from the current level.

In Pattern A, we assumed the increase in net population inflows to be constant every year during the period of 1996 – 2005, and calculated such annual increase based on the figures obtained from censuses. We further assumed that annual net population inflows in and after 2005 would continue to increase by half (about 7,100 persons annually) of this calculated increase.

In Pattern B, we assumed that annual net population inflows in and after 2005 would be the same (about 28,000 persons annually) as the average net population inflows during the period of 2001 – 2005, as obtained from censuses.

In Pattern C, in the same way as the projection method adopted by the National Institute of Population and Social Security Research, we assumed the population movement rate in 2006 – 2010 to be 0.85 times that in 2001 – 2005, and the rate in 2011 – 2015 to be 0.7 times that in 2001 – 2005.

At the next step, we calculated the future household ratio (ratio of the number of households to total population) based on the Overview of Household Projections for Japan published by the National Institute of Population and Social Security Research. We projected the number of households by multiplying this household ratio by population. These calculations reflected the characteristic of the Greater Tokyo area that the household ratio in this area is higher than the national average. We also calculated the difference between the national average household ratio in 2005 and the household ratio in Tokyo, Kanagawa, Chiba and Saitama during the same year, and increased the number of households in Tokyo, Kanagawa, Chiba and Saitama in the future by such difference.

Finally, we projected the number of households that own their homes by assuming the future home ownership rate and by multiplying the number of households by this rate. Here, we assumed three patterns as to the future home ownership rate. While the nationwide home ownership rate either remained at the same level or was in a declining trend, the home ownership rate in Tokyo, Kanagawa, Chiba and Saitama substantially increased in 2001 – 2005. However, it is difficult to expect the home ownership rate to continue to rise in the future, and it might be reasonable to assume the home ownership rate in 2005 as the upper limit. Accordingly, we assumed the following three patterns to be the home ownership rate in 2015:

(a) The home ownership rate would remain at the same high level as that in 2005.
(b) The home ownership rate would decrease to the mean value in 2000 – 2005.
(c) The home ownership rate would decrease to the level of 2000.

In each pattern, we adopted the mean value during 2005 – 2015 as the home ownership rate in 2010.

All calculations were made by age every 5 years. We assumed that households whose heads are aged 25 – 59 are the target households having first-time home purchase demand. Then, we projected the increase in the number of households having their own homes whose heads are aged 25 – 59 by regarding this increase as the first-time home purchase demand.

Then, we created three scenarios based on the total of nine patterns (thee patterns for net population inflows × three patterns for the rate of home ownership). The most optimistic scenario is the "(A) × (a)" pattern; the most pessimistic scenario is the "(C) × (c)" pattern; and the intermediate scenario is the "(B) × (b)" pattern. The

Attached Figure: First-Time Home Purchase Demand Every 5 Years in Tokyo, Kanagawa, Chiba and Saitama for Each Scenario

(Unit: 1,000 households)

Actual numbers, 2001 – 2005: 1,109

Projected numbers, 2006 – 2010:

Population \ Ownership	(c) Decrease	(b) Mean value	(a) Remain same
(A) Increase	1,052	1,082	1,113
(B) Constant	998	1,028	1,058
(C) Decrease	984	1,014	1,044

Projected numbers, 2011 – 2015:

Population \ Ownership	(c) Decrease	(b) Mean value	(a) Remain same
(A) Increase	1,066	1,091	1,115
(B) Constant	962	984	1,007
(C) Decrease	941	963	985

first-time home purchase demand by each type of scenario is shown in the attached figure.

While these projections covered overall first-time home purchase demand, we assumed that the ratio of newly constructed condominium units to all houses is constant. Our assumption is based on two factors, as follows.

First, according to surveys by Tokyo Kantei, a company providing real estate information services, the ratio of condominium units selected by purchasers to all homes has either remained the same or increased, and has never decreased in the past several years. Based on this data, we assumed that the current level of this ratio would remain constant in the future.

The second point is whether homes to be purchased are new or used. The fact that the number of used condominium units sold in the past several years has been increasing deserves attention. According to the Real Estate Information Network for East Japan, the average growth rate of used condominium units that were purchased in Tokyo, Kanagawa, Chiba and Saitama in 2002 – 2006 was 3.8 percent. Accordingly, we considered that in these projections, the used condominium market would not largely affect the market of newly constructed condominiums. Based on such consideration, we assumed that the ratio of newly constructed condominium units to all homes to be constant.

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