

Tokyo rent rises attract Middle East money

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By Alison Tudor and Eriko Amaha

TOKYO, Dec 8 (Reuters) – Tokyo's real estate market is attracting increasing interest from Middle Eastern investors keen to put petrodollars to work, the president of Atlas Partners Japan Ltd said.

Mikihisa Hirai runs a \$140 million fund of which two-thirds of the capital comes from the Middle East.

"There is a growing interest among Middle East investors in Japanese and Asian real estate because they feel there is a rising risk element to investing in U.S. or UK real estate," Hirai told Reuters on the sidelines of a real estate conference in Tokyo.

They believe the risk is increasing because prices have peaked.

Middle Eastern investors have been trying to diversify away from the United States, partly because of geopolitical concerns, but they keep a very low profile which makes capital flows hard to track.

The Institute of International Finance has estimated that the Gulf Cooperation Council — Saudi Arabia, the United Arab Emirates, Kuwait, Oman, Qatar and Bahrain — will export at least \$450 billion of capital in 2006 and 2007. Analysts and private banking sources have said a growing percentage of that money is flowing into alternative assets, particularly in Asia.

#### ARBITRAGE GAINS SHRINK

Hirai has been at the helm of Atlas since November 2004 and has overseen a change in strategy from investing in residential properties to office space.

"Until a year ago, two-thirds of our portfolio was residential, but we exited and switched to office."

He said the opportunities that existed until recently were in amalgamating residential properties, selling them as a real estate investment trust (REIT).

"For example we were able to buy residential properties at a yield of 6 percent and then when we exited from the same portfolio we were selling it at 5.5 percent — which means capital gains."

Atlas generated an internal rate of return of 15–20 percent arbitraging private and public property valuations. On one exceptional transaction it earned more than 50 percent.

In some cases Atlas only held properties for nine months, and the maximum incubation

period was two years.

However, "The market has become more competitive and the government is watching the prices of properties traded from the private to the public sector."

**LANDLORDS IN ASCENDANCY** Tokyo has just begun to see rent rises, while the vacancy rate has dropped to the lowest in more than a decade. Atlas sees opportunities in longer-term holdings of five to seven years in class-B office buildings. Atlas does have one class-A office co-investment but that was an exception. The best way to generate returns in Tokyo's office market, Hirai said, is to buy offices where many of the tenants entered into lease agreements when the economy was moribund.

"If we are invited to compete on a building where most of the tenants have already renewed their leases, we tend to shy away as there is no real upside opportunity."

"The vacancy rate has dropped significantly in Tokyo and the rents are rising very sharply now. Tenants will try to negotiate to keep rents low, but the landlord seems to be winning the battle, which is good for us."

The average monthly office rent in central Tokyo rose to 19,221 yen (\$167) per tsubo (3.3 square meters) in November, the highest level since February 2003, according to office broker Miki Shoji.

Hirai predicted a rental increase of 20 percent when leases are renegotiated. The typical lease is two years, which means a 10 percent increase annually.

"We buy where tenants are paying 12,000 yen per tsubo and then try to raise it to 15,000."