

# J-REIT Deregulation – Opportunities for Players in Non-Japanese Real Estate Markets

To date, J-REITs have been focusing on Japanese real estate markets for various reasons but this approach may be changing. J-REITs are expected to start looking into non-Japanese real estate markets due to the recent deregulation which is to be implemented in 2014. The deregulation is not only an opportunity for J-REITs to diversify their portfolio but also for players in non-Japanese real estate markets, although this is of course subject to details of the cabinet orders regarding the interpretation of the statute which are to be published later this year or early 2014. This briefing note summarises the deregulation as well as potential opportunities for players in the real estate market.

## Introduction

In recent years, investment in overseas real estate has garnered considerable attention in light of portfolio diversification as well as maintenance and enhancement of yields.

Prior to the enactment of the Amended Act (defined below), the acquisition of overseas real estate by a Japanese Real Estate Investment Trust ("**J-REIT**") was not prohibited under the Act on Investment Trusts and Investment Corporations (the "**Investment Trust Act**"). However, given investment corporations (which include J-REITs) are not allowed to engage in activities other than asset management, they were prohibited from holding a majority of voting rights of shares in a company because the acquisition of a controlling stake in a corporation by investing through an investment corporation was inconsistent with the restriction on activities of investment corporations. Consequently, it was practically difficult for J-REITs to acquire real estate in overseas countries where there were restrictions on foreign investment in real estate given that J-REITs were unable to hold a controlling stake in a corporate incorporated in that overseas jurisdiction which would then acquire the overseas real estate.

Given the above, a draft bill revising the Investment Trust Act was submitted to the ordinary session of the Diet on 16 April 2013 in order to review the investment trust and investment corporation regulations and was enacted on 12 June 2013 (the "**Amended Act**"). Details of the Amended Act are set out below.

## Deregulations to boost J-REIT investment into non-Japanese real estate

Pursuant to the Amended Act, where it is not possible for an investment corporation to acquire overseas real estate due to the regulations of the country where such real estate is located, the investment corporation is able to acquire a majority of the voting rights of the shares of a company whose sole business purpose is the acquisition of overseas real estate.

Prior to the Amended Act, in order to acquire overseas real estate, J-REITs could either acquire the actual overseas real estate (making the J-REIT subject to various risks (including litigation)) or acquire a minority share in a company, where control is limited.

Under the Amended Act, J-REIT can mitigate the risks arising from acquiring real estate directly by holding a majority of voting rights of shares in a target company whose sole purpose is to acquire overseas real estate.

Whether or not the Amended Act will actually stimulate the real estate market will however depend on how the following provision is interpreted: "where it is not possible for an investment corporation to acquire overseas real estate due to the regulations of the country where such real estate is located,...(omitted).....if such investment corporation is acquiring the shares issued by a company whose sole business purpose is to acquire overseas real estate." In this context, clarification of such requirement by future cabinet orders is likely to attract much scrutiny.

Please refer to the schedule for the outline of the structure which will become available under the Amended Act.

## Opportunities generated by the Amended Act

### Opportunities for J-REITs

#### **Maintenance or enhancement of yields to be received by investors**

It will become possible to maintain or enhance yields received by investors through the acquisition by a J-REIT of overseas real estate that offers a higher yield than real estate investments in Japan.

#### **Portfolio diversification and risk mitigation**

By diversifying its portfolio, J-REITs can mitigate the risks which arise from excessive reliance on the domestic real estate investment market.

#### **Recovery of capital by Japanese corporations which are expanding their business operations overseas**

Japanese retailers and logistics operators have been acquiring and developing real estate in other countries, centred on emerging markets that have high growth potential. These corporations are intending to sell and lease back such local real estate in order to cash in for further business expansion. The acquisition of this overseas real estate by J-REITs will enable these corporations to recover their capital earlier than anticipated and expand their business further.

### Opportunities for players in non-Japanese real estate markets

Compared to other REITs outside of Japan (such as Singapore REITs), J-REITs tend to focus on Japanese real estate markets. However, it is expected that J-REITs will start acquiring real estate in non-Japanese real estate markets due to the deregulation introduced by the Amended Act. This means that players in non-Japanese real estate markets (such as developers, equity investors and financiers) would be able to benefit from a wider range of potential buyers which could eventually lead to boosting of prices for real estate in non-Japanese real estate markets in the long term.

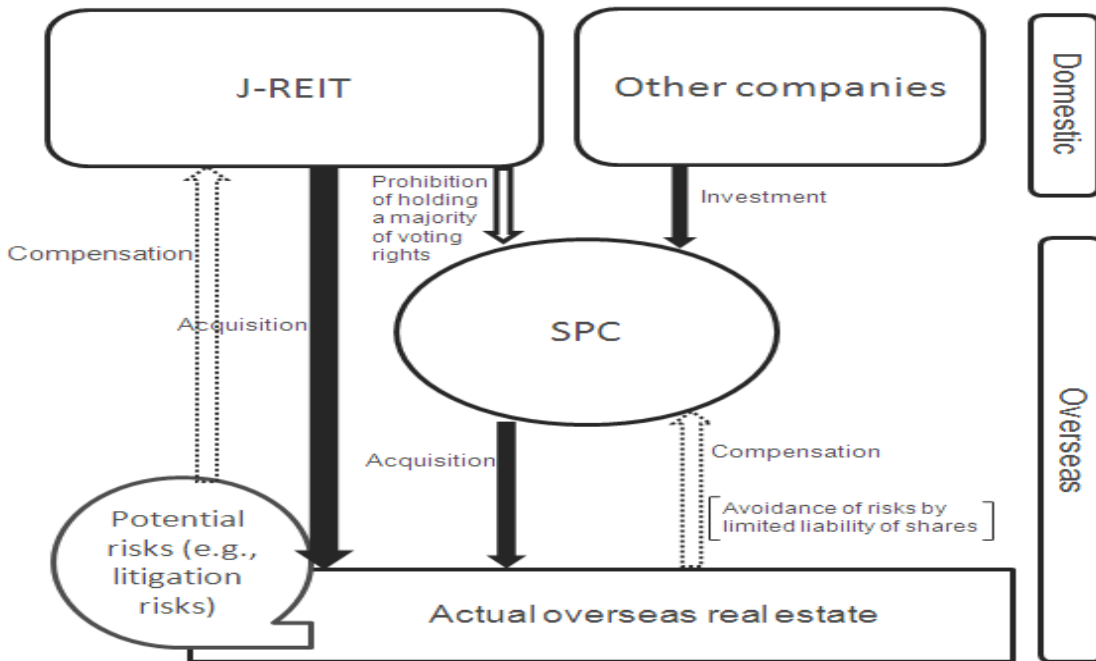
## Conclusion

The deregulation under the Amended Act would generate opportunities for J-REITs as well as players in non-Japanese real estate markets. It would be advisable for such market players to start exploring which J-REITs would be ready to start acquiring real estate in non-Japanese real estate markets and for J-REITs to start investigating which real estate markets would be suitable for them (and eventually for end investors).

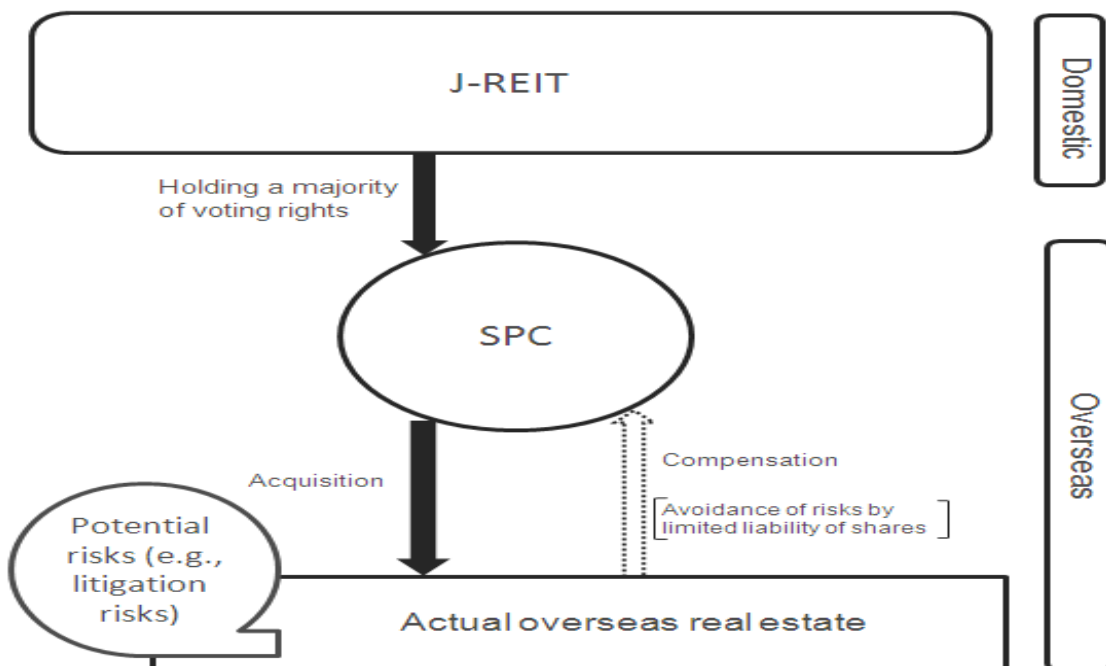
*Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.*

**Outline of the structure which will become available under the Amended Act**

Prior to the Amended Act



As of the Amended Act



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