

## OUTLINE OF LAND POLICIES IN JAPAN

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### 1. History of Land Policies in Japan

After the World War II, Japan started its land policies with the agrarian reform. This reform was made under the direction of the occupation forces and accomplished without any significant confusion. Thus, the largest problem related to the land in Japan is the rise of land prices occurred in high economic growth and progress of urbanization thereafter. The land policies have been focused on land prices.

Since the World War II, Japan has experienced sharp rise of land prices three times except for confusion immediately after the War. The first rise was around 1960, the period when Japan started its rapid economic growth. In those days, the government intended to change the Japanese industrial structure. Though Japan's major industries had been light industries such as textile, the government took measures to bring up heavy chemical industries such as iron and steel, petrochemical and oil refining industries. The government promoted industrialization in order for rapid economic growth. Such measures were backed up by "Doubling Income Program" by the Ikeda Cabinet. In 1962, "National Comprehensive Development Program" was mapped out as a governmental plan to evolve industrial areas. The program contemplated to establish new industrial cities and specially improved industrial areas and led to construction of coastal industrial complexes all over Japan. In this period, land prices were driven by those for industrial areas, which showed more than 50% increase for the whole country in 1961. When focusing on the six largest cities, which are Tokyo except Tama district, Yokohama, Nagoya, Kyoto, Osaka and Kobe, increase was much sharper. The rise rate was 88.7% for industrial areas, 61.9% for commercial areas and 60.1% even for residential areas. In addition, in 1960s where the average economic growth marked about 10% in real terms, the population started to rapidly concentrate to big cities and in particular to Tokyo. It was in this period that our so-called "land myth" was formed: Prices of lands will necessarily rise, whether they are industrial and commercial areas or residential areas; lands produce a large amount of profits.

The second rise in land prices was observed in early 70s, when the prime minister Kakuei Tanaka draw up the "Plan for Remodeling the Japanese Archipelago". This large-scale plan was not limited to development of industrial areas including coastal complexes and industrial cities. It also contained development of resorts and foundation of new towns as well, together with improvement and extension of expressways and Shinkansen Lines. "New National Comprehensive Development Program", which was the second governmental development plan, had almost the same contents. The "remodeling boom" brought about by these plans, together with excess liquidation under financial conditions in those days, caused enthusiasm for real estates. In addition to real estate agents, general business companies positively acquired lands. It was even said that all Japanese became real estate agents. This period is characterized by increase of land prices not only in large cities but also in local districts. The rise rate of land prices in January 1974 was 35.4% for Tokyo area and 43.5% on average for local districts. The phrase "skyrocketing land prices" was often used in this period. However, this boom was collapsed by the first oil crisis and subsequent serious depression.

## 2. Land Price Rocketing in "Bubble Economy"

The third rocketing of land prices is the one in late 80s. It was from around 1983 that land prices for commercial areas started to rise mainly in the central part of Tokyo. In 1986 and 1987, the rate of land price increase from the previous year exceeded 40%. Then, after a period of relatively moderate rising, land prices went up to the peak in 1990 with the price level 2.7 times higher than that in 1985. This rapid increase can be attributed to expansion of demand for offices in Tokyo, particularly in three wards at the center: Chiyoda, Chuo and Minato. In this period, with the progress of financial liberalization and internationalization, Tokyo became an international financial city with a higher global information function. Many foreign companies wanted to establish offices in Tokyo, and domestic companies tend to place their head offices in Tokyo. This results in a sharp rise of demand for offices in the central part of Tokyo. Besides, the prime minister Nakasone promoted re-development of Tokyo utilizing private investment, and various large-scale development plans were mapped out. Under such circumstances, companies expect

much more enlargement of urban functions in Tokyo. In addition, the financial conditions became excessively loose after Plaza accord made by G5 countries in September 1985 and the interest rate was set quite low with causing loose money supply. It was quite advantageous to invest in land on loan. As a result, there occurred a boom for office building construction.

Land prices for residential areas also showed a sharp increase from about 1986, slightly later than those for commercial areas. At the peak in 1990, they are 2.3 times higher than those in 1985. The reason why the land price rocketing in commercial areas influenced residential areas is moving of people to the suburbs. When new buildings were to be constructed in the commercial areas at the center of Tokyo, people who had been living there were forced to move to the suburbs. They brought with them high level of land prices in urban commercial areas into suburban residential areas. This phenomenon was partly attributable to the taxation called "special tax treatment for residential property replacement". According to this taxation, when a person sells the house he has been living and purchases another house as his own dwelling, the subject of tax is limited to the difference between the selling price of the old house and the acquisition price of the new house. If the acquisition price is equivalent to or more than the selling price, no tax is imposed. For example, suppose you sold your house in the central part of Tokyo for 100 million yen. If you buy a new house in the suburb for 90 million yen, you have to pay some transfer tax imposed on the difference of 10 million yen. However, if you pay 100 million yen for that house, you do not have to pay any tax. In such case, you would pay 100 million yen for the house. Such transactions raised the land prices. This preference taxation itself was an incentive to better level of housings, but people did not use it appropriately.

In the late 80s, land price rocketing was spread from Tokyo area to Osaka and Nagoya areas and then to other local districts. Since land prices in Tokyo area had grown too high, expectation for future price rising in Tokyo became lower and the expected earnings rate was lowered. In contrast, lands in Osaka area looked reasonable and demand for lands was expanded there because of expectation for price rising. This demand was spurred by New Kansai Airport project and resort development boom after the enforcement of Resort Law in 1987.

As a result of such dynamic rise of land prices, the total amount of land assets, which was 1,004 trillion yen at the end of 1985, became 2,389 trillion yen at the end of 1990. The difference of 1,385 trillion yen is three times the value of the nominal GNP. Such sharp increase of land prices cannot be explained by economic fundamentals and we call it "bubble economy".

The land price rising during this period greatly enlarged the difference of assets between the people having lands and those without land. In Tokyo area, houses were sold at prices about ten times the annual income of an average employee. It was impossible for an ordinary worker to acquire a house even if he paid for the house all his life. On the other hand, from the aspect of business activities, land price was a large restriction factor. New venture enterprises without any land and foreign companies wishing to do business in Japan had much difficulty in finding places for business. In addition, increase of mortgage valuation amount caused a large difference between the companies having lands and those not having lands. Further, when enforcing public works, most of the costs were spent for acquisition of the land, which prevented improvement of the social infrastructure. For example, the ratio of the land cost to the total road improvement expenses in Tokyo increased from 48.3% in 1983 to 79.7% in 1989.

### 3. Countermeasures against Land Price Rocketing

Without any measures, the gap of assets among people would become much larger and acquisition of a house would be much more difficult for a worker, it was afraid. The government finally set to work in earnest on countermeasures.

At that time, the sharp increase of land prices started from the central part of Tokyo was about to spread to the whole Tokyo area. In response to such situation, the government mapped out the "Outline of Emergency Land Policies" in October 1987. According to this outline, the government took the following measures:

(1) Under the National Land Use Planning Act, the government established a surveillance district system in November 1987. Transactions more than a certain scale in the specified districts must be reported so that the prices can be checked by the authority. The reference scale for reporting varies depending on the district and it

can be 100 or 300 m<sup>2</sup>.

(2) The government held a special hearing on real estate loans provided by financial institutions in October 1987 so as to supervise loans for lands and prevent excessive loans.

(3) The government froze the sales through competitive bidding of lands owned by the former Japan National Railway, to which bidders rushed and said to be the main culprit of high land prices.

(4) The government decided to impose a heavy tax to capital gains obtained by selling land within two years from its acquisition in September 1987. This is to prevent artificial land price raising by repeated land purchases among real estate agents in a short term.

(5) In March 1988, the government limited the application of the special tax treatment for residential property replacement to those acquired by inheritance and lived for at least 30 years (This limitation was canceled in April 1993 for houses priced not more than 100 million yen. Since land prices fell down recently, this taxation as an incentive to better housings is restored).

In spite of the above emergency measures, land prices increased quite sharply in local districts from 1988 to 1989. There was a strong demand for drastic land measures with a comprehensive concept. In December 1989, the government established the Basic Land Act. The Act provides for four basic concepts: "Priority of public welfare", "Appropriate land use according to plans", "Suppression of speculative transactions" and "Proper burden corresponding to the profit obtained by value increase".

From the financial aspect, the official discount rate had been revised four times since May 1989 to raise the rate from 2.5% to 5.25%. In April 1990, the total amount of loans for real estate agents were restricted.

Besides, in January 1991, the cabinet meeting approved the Outline of Promoting Comprehensive Land Policies. It intended elimination of "land myth" where the land is believed to be the most valuable of assets, realization of appropriate land price standard, securement of appropriate and rational land use in order to prevent future rocketing of land prices. Its major contents are as follows:

(1) Planned Change of Agricultural Land into Residential Sites in Urbanization Area

The problem of agricultural land in urbanization promotion area has long been an issue of national politics. "Urbanization areas"

according to the city planning include already urbanized areas and other areas to be urbanized, but there are some agricultural lands remaining in such areas. For protection of agriculture, agricultural lands are treated advantageously. Specifically, the tax imposed on an agricultural land is about one twentieth or thirtieth of that for a residential land in the vicinity. When such agricultural land is inherited, payment of inheritance tax can be postponed if the successor declares to continue agriculture. If he continues to engage in agriculture for 20 years, he is exempted from paying the inheritance tax. Even though the land can be sold at the same price as residential land nearby, the tax imposed becomes much lower when it is treated as "agricultural land". Therefore, many successors pretended to continue engagement in agriculture though they are working for companies. Such lands were called disguised agricultural lands. This preference was felt quite unfair and strongly criticized. However, this issue has been related to a difficult problem of urban agriculture, and has been a long pending question.

Finally, from 1992, agricultural lands in certain urbanization areas in the three big cities are classified to those to be reserved and those to be converted to residential lands. The agricultural lands to be reserved must be included in the urbanization control area or the urban agricultural land. This makes it difficult to use these lands as residential areas but allows lower tax imposition as agricultural lands. On the other hand, the agricultural land to be converted to residential sites are imposed taxes equivalent to those for other residential lands. This will contribute to supply of housings. The subject agricultural lands in the urbanization areas in the three big cities amount to about 64,000 ha, of which 60 to 70% will be classified into the lands to be converted to residential lands.

## (2) Land-related Finance

It is said that this is the most effective measure for lowering land prices. As of March 1985, the total loans outstanding of banks was 25.78 billion yen, of which 7.8% (2.01 billion yen) was for real estate agents. After that time, the amount largely increased and reached 12.3% (4.88 billion yen) of the total loans outstanding in March 1990. Further, loans outstanding for money lenders other than banks amounted to 6.2 billion yen in March 1990, 40% of which was said to be lent to real estate agents. It was realized that such extraordinary

loose real estate loans provided by banks and other money lenders led to the skyrocketing of land prices. It was decided in April 1990 to restrict the increase in loans outstanding for real estate agents below the increase rate for the total loans outstanding.

This restriction of total amount of real estate loans, however, was canceled in December 1991 considering the serious depression in real estate industry due to decline of demand and lowering land prices, provided that it will be triggered again when certain conditions are satisfied.

### (3) Land Taxation

Conventional taxation allowed many preferential provisions for the tax imposed on profits obtained by transfer of lands. Besides, the land value had been evaluated much lower than actual prices in computation of the inheritance tax. Such circumstances emphasized advantageous nature of land as asset, and led Japanese people to have deep attachment to lands, resulting in so-called "land myth". To solve this problem, measures to reduce advantage of lands as asset have been taken since 1991.

First of all, Land Value Tax was introduced in 1992. This is a national tax imposed on lands in Japan at a rate of 0.3% of the asset value. Since a wide exemption range was specified at the Diet, it was considered not so much effective at first. When practiced, however, this tax is paid mostly by department stores, hotels and office building owners. The tax is now felt unfair and is the subject of active discussion for review including abolition.

For inheritance tax, the problem was that the land value had been evaluated quite lower than the actual market value in calculation of inheritance tax. This caused unnecessary demand for lands because people tend to change their assets into lands immediately before inheritance. Therefore, the evaluation value was in 1992 raised to 80% of the publication price. Similarly, for fixed asset tax imposed by local governments, excessively lower evaluation are to be corrected in revaluation in 1994. It is planned to raise the valuation value for fixed asset tax to 70% of the publication value.

Further, many other modifications have been made to the tax system. Modifications include the taxation equivalent to residential lands on agricultural lands in urbanization areas and other corrections to prevent tax saving taking advantage of defects in land tax system.

(4) Land Lease and Housing Lease Laws

The land lease and housing lease laws have been established in 1921 to protect the right of lessees. However, excessively strong right granted to the lessees impedes effective use of lands recently and review of these laws was required. The new land lease and housing lease laws were established in 1991 and enforced from August 1992. The new laws provide for "fixed term leasehold" where the land is securely returned to the lessor after expiration of the term set forth in the lease contract, and "limited term housing lease" where renewal is not allowed.

(5) Revision of Urbanization Planning Law and Building Standard Law

Conventional urbanization plan had only a few application classifications and residences, offices and shops are in a small area. This situation is said to be one of the reasons why land price rocketing in commercial areas affected the land prices in residential areas. To prevent such unnecessary influence, the urbanization planning law (for specification of area applications) and building standard law (for regulation on buildings in the areas with specified applications) are revised. This revision came into effect in June 1993. According to revised classification, three conventional residential areas are divided into 7 areas. Together with conventional two commercial areas and three industrial areas, there are eight to twelve areas now.

(6) Decentralization of Metropolitan and Industrial Functions

The primary cause of the land problem is concentration of various functions to Tokyo. Therefore, decentralization of administrative functions and metropolitan and industrial functions is required. In particular, transfer of capital is studied in relation to the administrative functions.

It was stated in the five-year economic plan mapped out in June 1992 that measures should be taken to allow an employee in big cities to obtain a high quality house at a price five times his average annual income. The new target at present is to realize such housing conditions.



#### 4. Decline of Land Prices

With the above measures working collectively, the market environment has been gradually changed. The total amount restriction suppressed new purchase of lands by real estate agents. In the market, shortage of buyers caused decrease in transactions and the actual land prices were lowered. When the inventory of houses exceeding the amount for a year was placing pressure on the market, some agents in financial difficulty sold their inventory, resulting in further lowering of land prices.

The rise of the official discount rate from 5.25% to 6.0% on August 30, 1990 further weakened the market sentiment, which led to reluctance in buying real estates. Land prices in Japan for the entire year of 1990 recorded 11.3% increase from the previous year according to statistics, but it seemed that they actually started to fall from the latter half of the year particularly in large city areas. From 1991, land prices in Japan clearly dropped for the entire year and marked -4.6% from the previous year. The drop rate of land prices in large city areas were two digits. While many buildings and apartment houses people had already started construction were completed, the real phases of the economy started to show signs of decline with decrease in demand for real estate. This spurred the lowering of the actual land prices. Besides, drop of land prices is accompanied by drop in security values, which restricted loans for real estate transactions and accelerated the falling of land prices.

Such decline of land prices occurred in the three big city areas almost at the same time, with the Osaka area recording the largest drop rate in accumulation. This suggests that, while the high land prices in Tokyo were caused by actual demand at the initial stage, land price rocketing in Osaka area was mainly caused by mere expectations. Larger drop rate in residential areas than that in commercial areas can be attributed to the same reason.

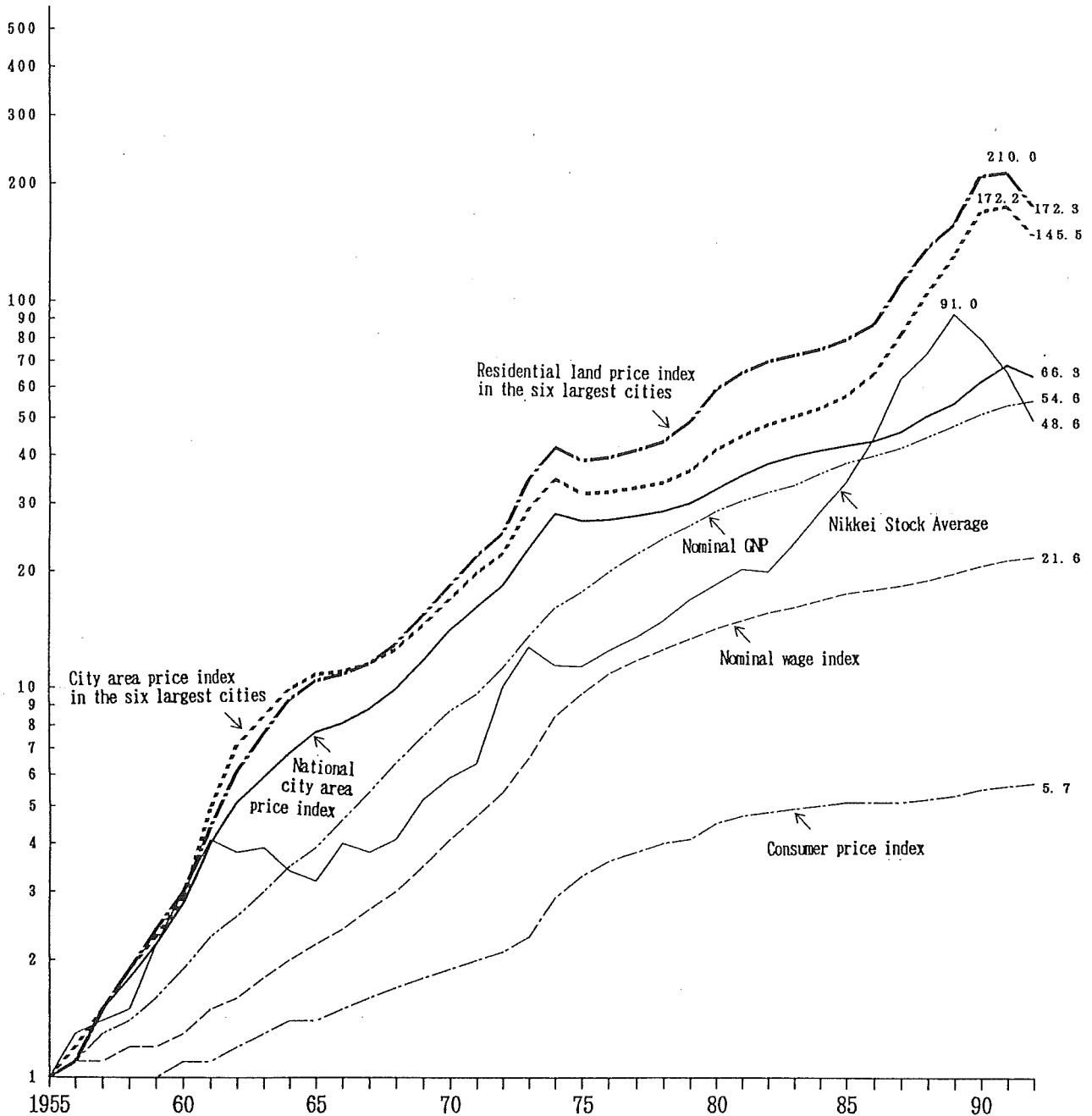
Finally, I would like to say something about drop of land prices.

During the process of land price rocketing, financial institutions have made enormous loans for real estates with greatly increasing the ratio of real estate loans to the total loans outstanding. This is because rapid drop of land prices results in remarkably numerous worthless debts. The amount of outstanding principal for securities under overdue for six months or more at city banks, long-term credit banks and trust banks is 12 trillion yen among the total loans

outstanding of about 400 trillion yen. Among them, about 4 trillion yen is not covered by any security. Thus, the assets of financial institutions have been becoming much worse. There are concerns about stability of Japan's financial system and influence to actual phases of the economy due to reluctance in lending money by banks. Therefore, for bad debts at financial institutions, a company to purchase real estate securities has been established in order to fix the security amount recoverable and disposal in order.

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## Change in land prices with reference to those in 1955



### Reference materials :

"City Area Price Index" by Japan Real Estate Institute,

"Annual Calculation Report on National Economy" by the Economy Planning Agency,

"Monthly Statics of Tokyo Stock Market" by the Tokyo Stock Exchange,

"Monthly Workers' Statistics Report" by the Ministry of Labor, and

"Annual Report of Consumer Price Indices" by Statistics Office, Management and Coordination Agency

### Notes :

(1) The price indices are as of March.

(2) The nominal GNP values are for fiscal years. The value for 1990 is according to prompt report.

(3) Yearly averages are used for Nikkei Stock Average, Nominal Wage Index and Consumer Price Index.

(4) All indices are calculated with considering the value in 1955 to be 1.

Source: Real Estate Statistics.16th ed. ; MITSUI FUDOSAN CO.,LTD.