



NUS
INVESTMENT
SOCIETY

IMPACT OF JAPAN'S RISING GOVERNMENT BOND YIELD ON REAL ESTATE

FROM BENCHMARK YIELDS TO PROPERTY VALUATIONS

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INTRODUCTION

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INVESTING IN A BOND

Imagine:

- You are looking to invest for the first time!
- You are risk-averse: preference for low-risk, predictable outcomes over potentially greater returns

What would you do?

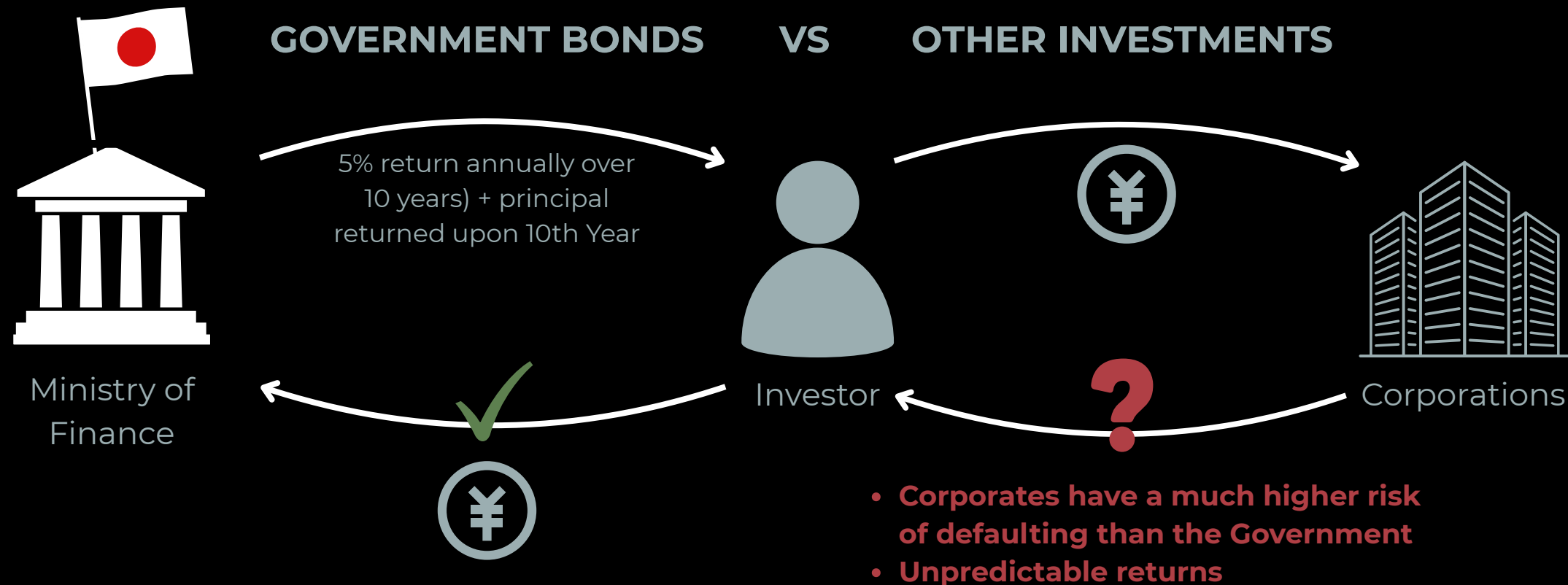
- You choose to park your investment in **government bonds** as it is considered '**risk-free**'
- Annual returns are determined by the **government bond yield**

What is a government bond yield?

The annual return for lending money to the government, expressed as a percentage of principal amount

WHY ARE GOVERNMENT BONDS “RISK-FREE”?

ASSUME: You have **¥10,000** to invest in 10-year Japanese Government Bonds (“JGB”), with **5% bond yield**



REAL ESTATE

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REAL ESTATE IS NOT RISK-FREE

Unlike government bonds, real estate carries several investment risks:

Vacancy / tenant risk

- **Vacancy risk:** Property may remain unoccupied, reducing rental income
- **Tenant risk:** Tenants may default on rent or leave the property

Operating & maintenance costs

- Costs such as maintenance, property management and repairs can reduce the income generated
- **Higher operating costs → lower NOI**

Property value fluctuations

- Property prices can fall due to changes in interest rates, market conditions or demand
- **Lower property value → potential capital losses**

Illiquidity

- **Illiquidity:** An asset cannot be easily converted into cash without significant time or loss in value
- Investors **may not be able to sell the property quickly** when they need cash

SO... INVESTORS DEMAND A RISK PREMIUM



10Y JGB

If risk-free rate:
5%

Investors
would expect



REAL ESTATE

Required return:
>5%

Required return = Risk-free rate + Risk premium

- **As real estate carries additional risks**, investors require a **higher return** than the risk-free rate to compensate for taking on those risks
- When **JGB yield increases**, investors may **demand higher required returns** from real estate

REAL ESTATE CAN INCREASE RETURN THROUGH NOI

NOI

=

**Rental
Income**

-

**Operating
Costs**

Net Operating Income (NOI)

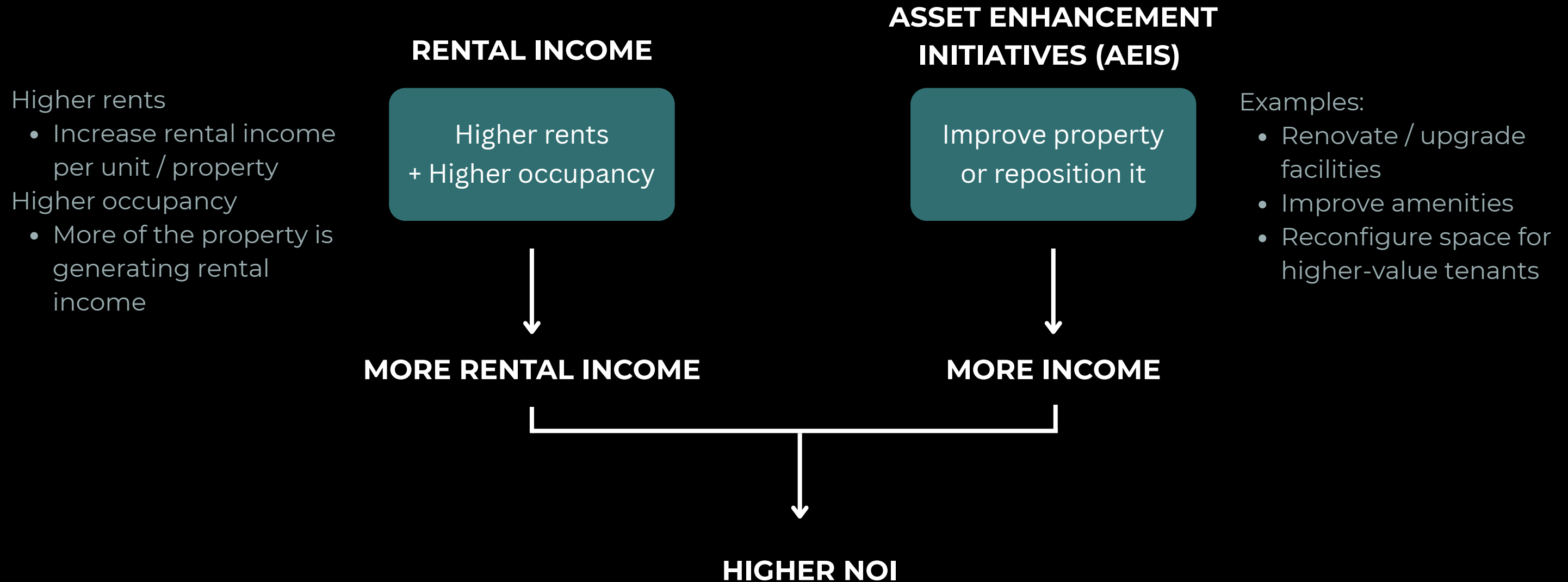
E.g. Maintenance,
management, insurance,
property tax

Why does NOI matter?

- NOI refers to the income a property generates from its normal operations, after operating expenses
- NOI reflects the property's income-generating ability
- Higher NOI can support a higher property value

As interest rates rise, the property's ability to grow NOI becomes increasingly important in supporting its value

WAYS THAT NOI CAN GROW



VALUATION BASICS

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GORDON GROWTH MODEL

What is the Gordon Growth Model?

The Gordon Growth Model is a valuation method that estimates a property's worth today based on the income it generates, and how much that income is expected to grow into perpetuity (i.e. forever).

According to the Gordon Growth Model...

Cap Rate

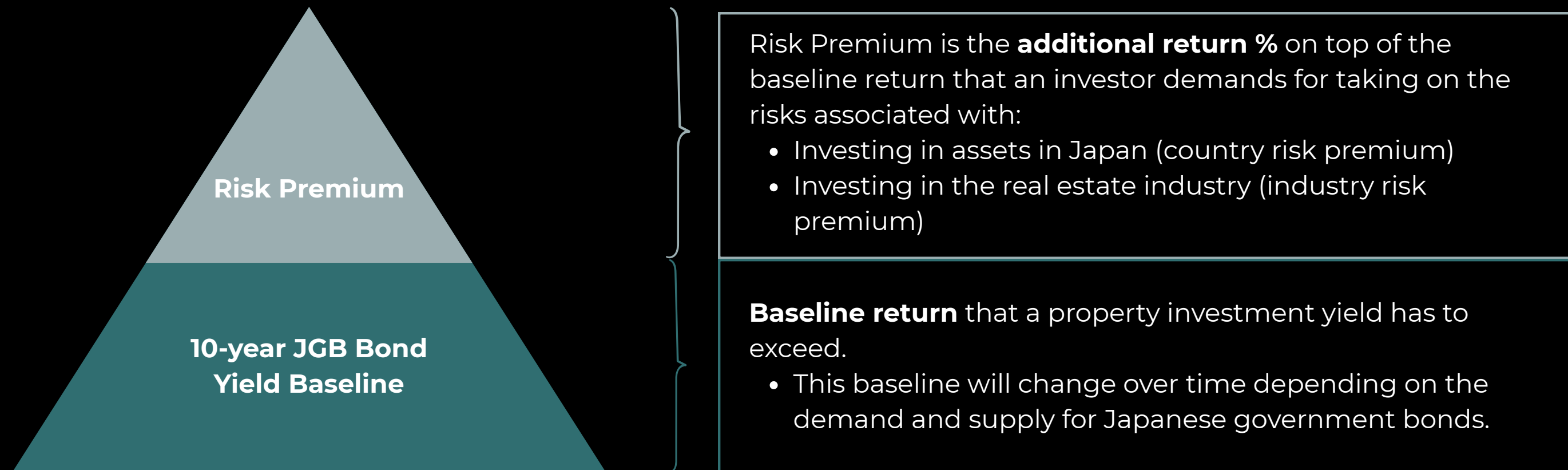
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Required Rate
of Return (r)

—

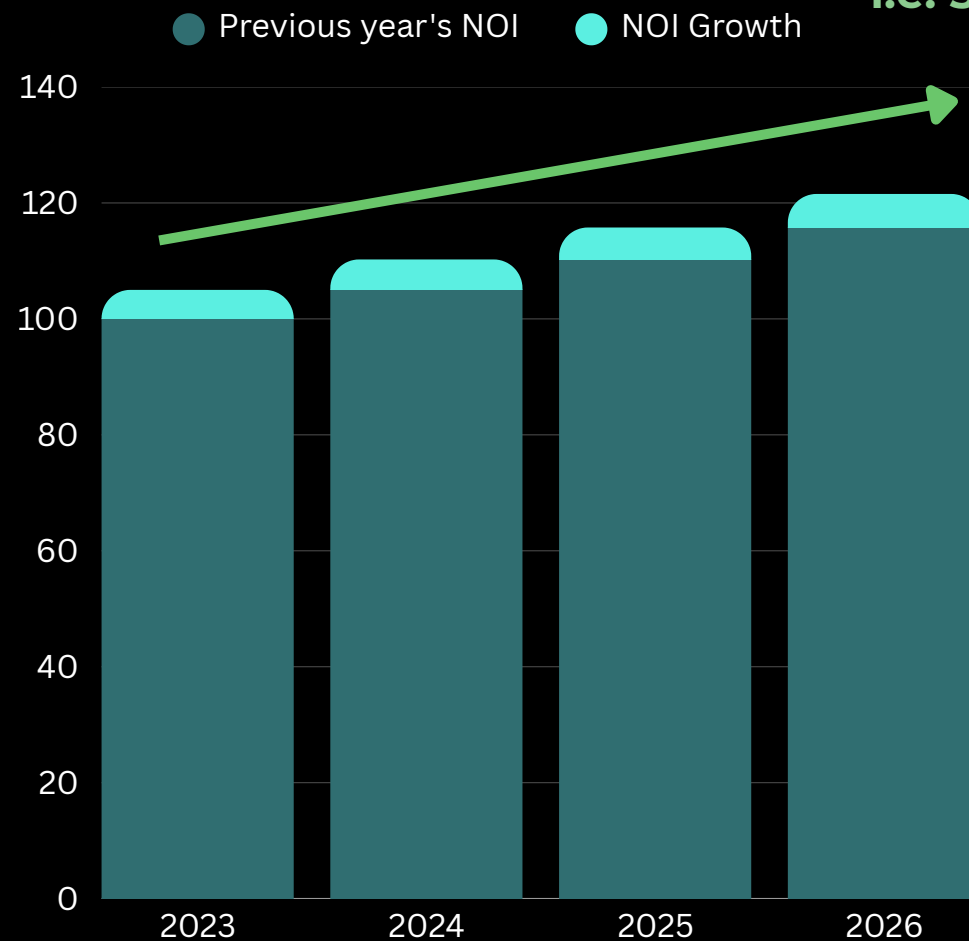
Growth Rate
(g)

REQUIRED RATE OF RETURN



GROWTH RATE

**NOI increases 5% from one year to the next
i.e. 5% year-on-year (YoY) growth**



Growth rate, 'g', is the expected annual increase in a property's income, driven by factors such as higher rents, occupancy, or asset enhancement initiatives ("AEIs").

- 'g' can differ from property to property, depending on various factors such as location, property type, etc.
- 'g' is forward-looking, reflecting expected future income growth.
- Higher 'g' means faster expected growth in property income.

In Japan, rental rates are increasing, which helps to prop up 'g'.

CAPITALIZATION RATE (“CAP RATE”)

What is “cap rate”?

Cap rate shows the annual income a property generates as a percentage of the price you pay for the building.

Why is cap rate important?

This is because a small change in % can significantly change the price of a property.

For example...



Generates annual rental income of...

¥1,000,000



At cap rate of...

5%,



Property price

= ¥1,000,000 / 5%

= ¥20,000,000



At cap rate of...

4%,



Property price

= ¥1,000,000 / 4%

= ¥25,000,000

CAP RATE COMPRESSION



Same property, same income,
but property price increases...

**WHEN CAP
RATE SHRINKS,**
as seen on the right...



CAP RATE	PROPERTY PRICE
5%	¥20,000,000
4%	¥25,000,000

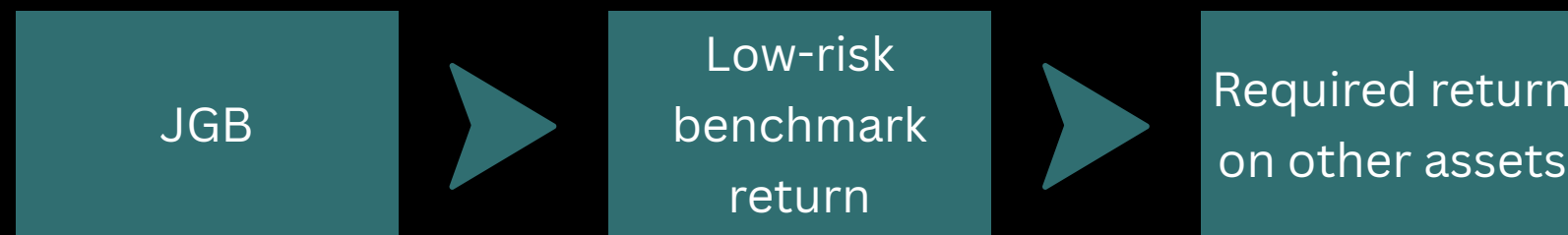
Implication for Investors

Investors should seek cap rate compression by either:

- Betting on lower JGB yields, which lowers the required return (r) and compresses cap rates; or
- Increasing NOI, such as through rental growth, higher occupancy, or AEs, to increase growth rate (g). However, this requires a more hands-on approach to asset management.

REAL ESTATE VALUATION BASICS

Japanese Government Bond (JGB) Yields



When JGB yield ↑

- Investors can earn more from a relatively low-risk asset
- Other assets may need to offer higher expected returns
- Upward pressure on required property returns

A rising long-term bond yield can reflect expectations of higher inflation, future interest rates, nominal growth, or term premiums.
It does not automatically mean the economy is stronger.

Before looking at property itself, we need to understand the benchmark investors compare it against.

- JGB yields represent the return from lending to the government, which is generally considered relatively low risk.
- Thus, when that benchmark return rises, investors may also demand a higher return from riskier assets like real estate.

RELEVANCE

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REVERSAL IN JAPAN'S 10Y BOND YIELD

Previously...

- Persistent deflation & economic slowdown
- Bank of Japan (BOJ) pinned rates to near-zero / negative to encourage borrowing and demand

Why the sudden reversal of interest rates?

- Rising wages, higher energy costs and a weak Yen contribute to domestic inflation
- Increased interest rates control inflation

USD/JPY

156.88

▲ Weaker Yen

Up from ~147 a year ago

Interest Rates

1.25%

▲ + 0.25 bp

Highest since 1995

10Y JGB Yield

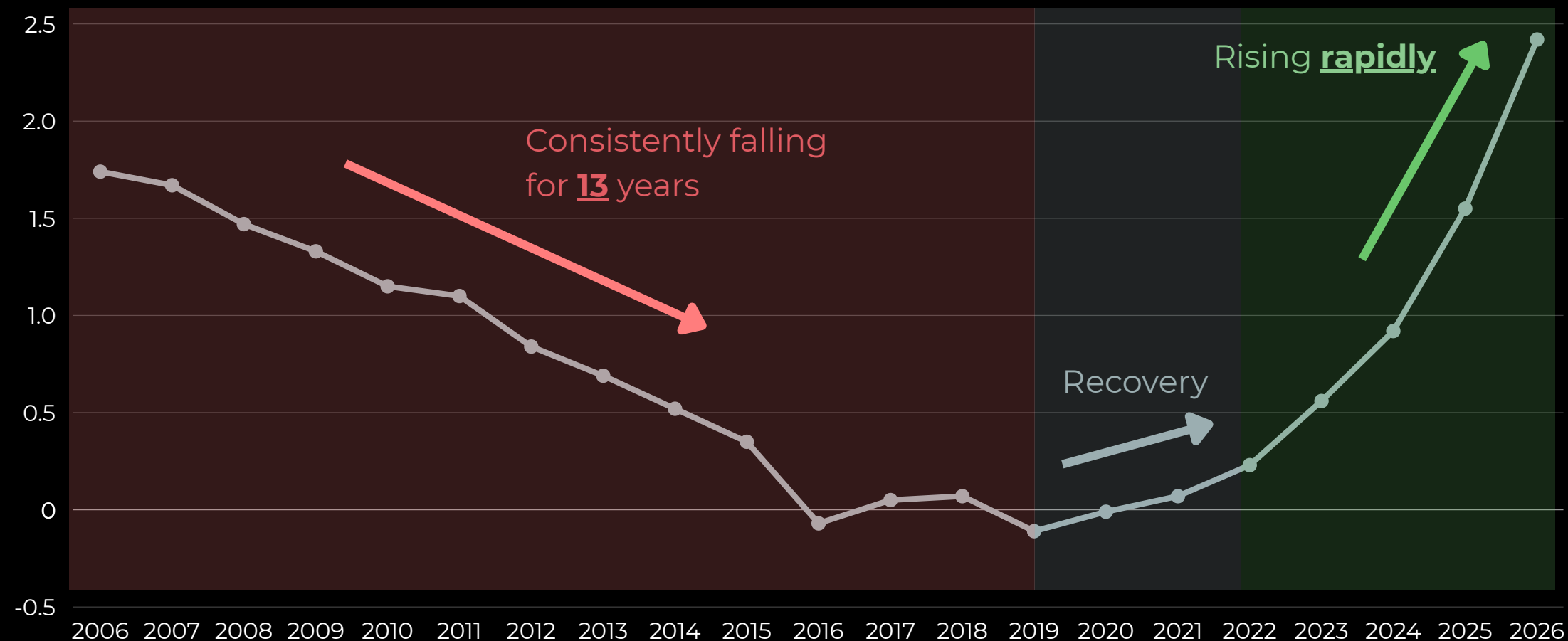
3.000%

▲ 3x in 2 years

The first time this century.

Market data as of 18 Sep, 2026

REVERSAL IN JAPAN'S 10Y BOND YIELD



September bond yield reached multidecade high of 3.000%

 Bond yield projected to increase further!

WHAT DOES THIS MEAN FOR INVESTORS?

Pre-2024

- Falling r compressed cap rates, which investors captured as positive carry e.g., borrow at 1%, purchase at 3.5% cap rate
- Investors allowed further compression rather than demand a repricing of property yields

Present

- Little movement in cap rate and increase in bond yield narrows risk premium
- Cap rate of 3.15% in Q1 2026, narrowing the spread to only ~ 25 bps
- Carry shrinks to 0.65% – is there still an incentive to invest in real estate?

We discussed increasing AIOs to generate cap rate compression on slide 12 – what does this look like in context?

- Mitsui Fudosan built an ecosystem for startups in the life sciences domain, providing wet-lab specifications and dedicated exhaust ducts, creating an integrated ecosystem increases switching costs for corporate tenants, making NOI more durable. *Read up on MITSUI LINK-Lab SHINKIBA 2 if you are interested in its developments!*

CONCLUSION

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CONCLUSION

FROM THE INTRODUCTION SECTION, WE LEARNT THAT:

- Government bonds are considered 'risk-free', and generates a baseline return; real-estate carries greater risk. Investors demand a 'risk premium' to compensate for added risk.

FROM THE REAL ESTATE SECTION, WE LEARNT THAT:

- NOI is an important metric. NOI growth through rental growth and AEs is increasingly important amidst interest rate hikes to sustain prevent market downturns.

FROM THE VALUATION BASICS SECTION, WE LEARNT THAT:

- The Gordon Growth Model is a valuation method based on income-generating capacity.
- Capitalisation rate estimates annual income generated as a percentage of price paid – any incremental change significantly varies property price.

THE KEY TAKEAWAY:

- For investors, cap rate compression can be generated by lowering JGB yields or increasing NOI.
- With the increase of bond yield since early 2024, the risk-free rate no longer provides a sustainable source of cap-rate compression.

