Japanese housing lenders (jusen), mired in 6 trillion yen ($65.7 billion) of bad debt, stand at the heart of the nation’s worst banking crisis in half a century. Seven of Japan’s eight mortgage companies are slipping toward insolvency as bureaucrats from the elite Ministry of Finance (MOF) struggle with angry banks, farmers and the public over an acceptable bailout plan.

The powerful finance ministry is far from a disinterested party, however. The MOF staffed the industry’s top positions with its own retired officials, made regulatory decisions that led to the lenders’ plunge into speculative real estate and failed to intervene as the loans ballooned out of control.

Established in the early 1970s with encouragement from the MOF, housing lenders performed their role well for nearly two decades, providing mortgages for tens of thousands of Japanese. But conditions changed sharply for the companies in the mid-1980s. Japan’s financial system was beginning to deregulate, the nation’s credit shortage eased and for the first time the major banks were eyeing individuals as a profitable market. Faced with the new competition—in some cases from their own owners—the housing lenders turned to real estate developers, who were willing to pay higher rates than individual homeowners.

The housing lenders—several boasting two and three former MOF officials among their leadership—jumped into Japan’s booming property market. While continuing to make home mortgage loans, the companies threw trillions of yen into high-stakes real estate and construction projects. In practices that mirrored those of America’s S&Ls, money once meant for homeowners poured into golf courses, resorts, luxury condominiums and office towers. In 1975 nearly 100 percent of industry loans went to homeowners; by 1990 only 22 percent was going to individuals; 78 percent went to speculative projects.

When speculation peaked in 1989, the industry’s loans totaled 6.14 trillion yen, according to analyst reports. By the following year, top lender Nippon Housing Loan Co. was pouring more than half its money into speculative real estate projects. With property prices still rising, funds kept flowing to the housing lenders—especially from agricultural cooperatives. By early 1990, co-ops’ lending to the industry had pulled nearly even with lending by the major banks.
In April 1990 came a turning point. The MOF, concerned that property prices were out of control, passed a regulation capping the total amount of loans that each major bank could extend to real estate developers. For the agricultural cooperatives—which were not included in the new rule—that left a huge hole to fill.

As major bank loans to the housing lenders leveled off, loans made by agricultural co-ops soared. MOF officials never intervened, even when the co-ops became the single largest source of funds for the housing lenders. And despite the presence of at least 10 MOF alumni in the industry’s top management and despite growing signs that the economic bubble was beginning to burst, no warnings were given. Why didn’t the MOF intervene? “We don’t have jurisdiction over the co-ops’ lending,” says a ranking MOF official. “[Co-ops] are regulated by the Ministry of Agriculture.”

The agriculture ministry challenges that explanation, saying that both agencies share responsibility for the co-ops. But co-op officials contend it wasn’t their job to sound an alarm. The result: With fresh funds from the co-ops, the housing lenders lost no steam . . . until the crash came.

After peaking in December 1989, the Japanese stock market plunged over the next nine months to nearly half its value. The property market wasn’t far behind. As Japan fell into its worst recession in decades, commercial real estate lost nearly half its value. Housing lenders found themselves swimming in loans that would never be repaid. Industrywide, as much as 60 percent of the housing lenders’ portfolios became nonperforming, according to industry reports. Yet the housing lenders still owed trillions of yen to the banks and agricultural cooperatives from which they had borrowed. So massive were their loans to the housing lenders that a growing number of agricultural co-ops began teetering on the edge of bankruptcy. Even small losses would directly endanger the savings of one of Japan’s most powerful political constituencies.

For their woes, the cooperatives blame the banks, which, they say, in effect guaranteed the loans of their affiliated housing lenders—a charge the bankers deny. But the co-ops also believe the finance ministry holds special responsibility. “We understood that loans to the housing lenders were safe because MOF stood behind the firms,” says an official at a large regional agricultural cooperative from which the housing lenders borrowed heavily. “Now we’re finding out they weren’t.”

MOF officials see the situation differently. “Looking back, our policies may not have been the best,” responds a ranking MOF official, who suggests that responsibility lay with the creditors. “The loans were made based on the lenders’ judgment.”

The judgment needed now involves how to clean up the mess, which is steadily spreading. In August 1995, authorities shut down Hyogo, Japan’s 38th-largest bank, with assets of 3.6 trillion yen. Hyogo’s failure marked the first time a publicly held bank was allowed to go under. Kizu, the nation’s largest credit union, closed down the same day. It was about half the size of Hyogo and privately held by its members. Together the two institutions hold nearly 4 trillion yen in deposits.
Kizu was pushed over the edge by the failure of a Tokyo thrift, Cosmo Credit Union, in late July. Cosmo collapsed during a depositor run that sucked out one-third of its deposits in a week. In response, Kizu depositors withdrew more than 100 billion yen—a hemorrhage that finally forced regulators to shut the thrift down.

Kizu collapsed holding 600 billion yen in irrecoverable loans; nearly 90 percent of them went to real estate companies. Hyogo holds 630 billion yen in bad loans, most of which went to the real estate and construction industries.

Although the bank failures—the largest in postwar history—drew attention to Japan’s beleaguered financial system, the toughest problems have yet to be addressed. Proposals released by the government in late June of last year lack specifics on how taxpayer money may be used to address the problem—a step most observers see as inevitable. Also missing was any mention of the housing lenders. Such perceived shortcomings helped send Japanese stocks into a nosedive, as investors concluded that the government had yet to become serious about solving the banking system’s problems.

Although government may be content to sit tight, the banking industry is not. Top Japanese banking executives are preparing a far-reaching plan that calls for shutting down the lending companies and liquidating their assets. That industry plan could be implemented during 1996, when the housing lenders—four of which are now technically insolvent—finally run out of cash.

The banking industry’s new measures would close down at least seven of the eight housing lenders, say five bankers who represent firms from among the nation’s top 21 banks. The stronger banks are willing to take the largest share of the burden of closing down the housing lenders. The weaker agricultural cooperatives and small banks would get all the real estate collateral of the closed housing lenders and absorb a smaller portion of the housing lenders’ bad debts. In the process, they say, it’s inevitable that taxpayer funds will be used to give low-interest loans to the agricultural cooperatives and small banks to help them write off their share.

Tax breaks for the major banks also will be needed as compensation for abandoning their claims to the remaining assets of housing lenders, say the bankers, who asked to remain anonymous. Such a plan could cost the public as much as 2 trillion yen, according to Goro Kumagai, banking industry analyst at Nomura Research Institute.

Generally, the big banks are profitable enough to survive the losses—as long as the MOF gives them a tax break, according to David Atkinson of Goldman, Sachs & Co. Their bad loans represent between 3 and 7 percent of total assets. But the politically powerful agricultural cooperatives are in far more difficult straits. Considered as a group—under an umbrella financial institution called the Norinchukin Bank—their bad debts may total as much as a quarter of their 43.5 yen trillion in assets.
Sogo Jukin, the most troubled lender in the group, reported losses of 7.9 billion yen in the 12 months ending March 1995. Like the others, Sogo Jukin has no more equity or cash and can’t keep up with the repayment obligations of a restructuring plan hammered out in 1993, as losses mounted. Under that plan, creditors agreed to reduce the interest payments made by the housing lenders, and many of the larger banks slashed their interest rates to zero. The agricultural cooperatives continued to be repaid with 4.5 percent interest in exchange for agreeing to allow their principal to be paid back earlier than scheduled.

But that plan, which depended on an economic recovery, is in shambles, say analysts. Altogether, the housing companies owe about 6.5 trillion yen to major banks and another 5.5 trillion yen to local agricultural cooperatives. Soon other housing lenders will find themselves in similar predicaments to Sogo Jukin. In other words, it’s time to shoot the horse.

But shutting down the housing lenders requires a three-quarters majority vote of all creditors, including Norinchukin Bank, which holds nearly half the vote. And Norinchukin’s support will be hard-won. Agriculture, Forestry and Fisheries Minister Taichiro Okawara has said there will be no revisions to the housing lenders’ restructuring plan unless it is also determined who was responsible for mismanaging the lenders. Okawara’s comment echoes the opinion of officials at the agricultural cooperatives, who feel the banks should take responsibility for the housing lender debacle. “It’s not enough for the banks to forfeit their collateral,” says a spokesman at Norinchukin. “The banks did more than just own shares in the housing lenders, and it was the finance ministry that gave the lenders its stamp of approval.” In other words, this is also shaping up into a major conflict between government ministries.

By itself, the MOF’s close ties to the housing lenders may not in fact justify an extensive public bailout. But the ministry’s long-standing involvement has made the co-ops’ claims credible enough to help delay the untangling of the worst portion of Japan’s bad loan problem. Eventually, though, the Norinchukin will have to give in and allow the housing lenders to close, the bankers say.

Government officials raise with increasing frequency the sensitive topic of public funds and tax breaks. Yoshimasa Nishimura, head of the finance ministry’s Banking Bureau, said in June that the government is willing to stand behind banks and credit unions once they begin taking huge losses on loans made to the housing lenders. Such moves may be part of an attempt to build--within the ministry and among the public--a consensus that the taxpayers must play a role in solving the bank problems. “The bankers have reached a consensus, but the bureaucrats have not,” says Elizabeth Daniels, financial industry analyst with Morgan Stanley & Co.

And so the Ministry of Finance has found itself at the center of a blame game in the form of a three-year standoff between the banks that own the housing lenders, the debt-racked housing lenders themselves, and the financially weak but resolute agricultural cooperatives (who are backed by the agricultural ministry). “The commercial banks want to erase the housing loan debts, but their big problem is that the agricultural cooperatives are wound up
in everything,” says Kenichi Ueda, financial system expert at Sumitomo Life Research Institute. “And the cooperatives can’t get out of it without the help of financial authorities.” In the end, analysts predict, MOF will have to solve the problem by dissolving the very industry it helped to build.

This article first appeared in a slightly different form in Bloomberg Magazine, Vol. 4, No. 10 (October 1995). It is reprinted here with permission. The authors are staff members of Bloomberg Business News’ Tokyo Office.