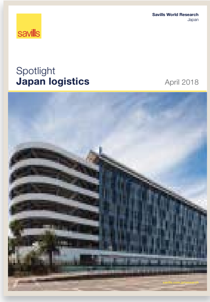
Savills World Research
Japan

Spotlight
Japan logistics

April 2018

savills.com.jp/research



Spotlight
Japan logistics

"The logistics industry continues to expand along with the steady growth of e-commerce. Large supply in Greater Osaka led to a significant divergence with the Greater Tokyo market in 2017; however, supply will rebalance to Tokyo in 2018 and beyond. Against this backdrop, a divergence of local demand within the Tokyo and Osaka markets is becoming more pronounced."

Introduction

Japan's logistics industry is undergoing rapid development and structural change in order to meet increasing demand. As modern logistics facilities continue to sprout up across the country, developers are emphasising convenience and comfort for employees in their design concepts given the acute labour shortage. 2017 also saw a significant strategic rebalancing in the domestic shipping industry, as major firms made unprecedented moves to improve efficiency and retain talent.

Though investment volumes in the logistics sector declined substantially in 2017, J-REITs announced JPY289 billion of acquisitions during the December 2017 to February 2018 period, all of which are set to be completed in early 2018. Market player sentiment has improved over 2H/2017, with expectations for rent and capital appreciation at their highest level since 1H/2016 and 2H/2016, respectively.

Despite these positive indicators, the current supply glut in Greater Osaka and large supply in the pipeline for Tokyo are cause for concern. Demand for logistics space should be bolstered by the continuing expansion of the shipping industry and e-commerce, as well as the stable growth of the Japanese economy as a whole. However, an increasingly uneven distribution of demand will require investors to be more selective than ever.

Market trends

The Greater Tokyo and Osaka markets diverged significantly in 2017. Demand for logistics space increased rapidly in the Greater Tokyo area towards the 2017 year end, as vacancy rates dropped 1.2ppts during the period from November 2017 to January 2018 (Q4/2017). In Osaka, though there was a slight downtick in vacancy rates toward the year end, from a peak of 12.9% in October 2017 (Q3/2017) to 12.8% in Q4/2017, vacancy rates have increased a startling 6.8ppts year-on-year (YoY).

Overall demand in 2016 and 2017 reached record levels, largely driven by third-party logistics (3PL) and e-commerce firms. While overall demand is expected to increase at a similar rate over the next few years, both major markets are experiencing an uneven geographic distribution of tenant interest. In Greater Tokyo, bayside and inland properties within the National Route 16 belt continue to attract tenants, while locations outside of population centres with less convenient access have seen less interest. Similarly, inland Greater Osaka properties remain relatively popular, especially those near junctions of major thoroughfares. This disparity has led properties in prime locations to have rent and capital appreciation higher than the overall area average, with less competitive properties moving in the opposite direction.

SUMMARY

- Investors have come out swinging around the start of 2018, as multiple J-REITs announced acquisitions in the logistics sector totaling JPY289 billion, already exceeding total sector investment for 2017.

- Greater Osaka took centre stage for new supply in 2017, with 1.3 million sq m of completions compared to Tokyo's 1.1 million. 2018, however, is expected to see a major supply shift back to Tokyo.

- A 1.2 percentage points (ppts) decrease in vacancy rates in Greater Tokyo in Q4/2017 should provide some stability for rent in 1H/2018. While a significant increase in new supply may mitigate the effect, pre-leasing activity for logistics space in Greater Tokyo, particularly for locations inside the National Route 16 belt, appears smooth.

- After three consecutive quarters of decline, rents in Greater Osaka saw a slight uptick and held steady at Q1/2017 levels. Vacancy rates rose a sharp 6.8ppts year-over-year, but levelled out during Q4/2017. A cooling of supply in the region should continue to help rent and vacancy rates recover.

- Though 2016 and 2017 saw record-high demand for logistics space, the Tokyo and Osaka markets are experiencing a localised disparity in demand. Tokyo central and Osaka inland locations with convenient access to residential areas have seen increased interest, while locations outside of major infrastructure networks and population centres remain less competitive.

- Investor sentiment indicates a moderate turnaround as the diffusion index of responses to a survey of market players currently sits at +25.9 for expectations of capital appreciation, a 2.8 point increase over the July 2017 survey, while expectations of further rental growth improved from -15.9 to -3.7 points.

- Major logistics firms continue to increase revenue and the sector has recently seen significant wage growth, which in turn should attract - or at least help retain - workers.

While rent per tsubo in Greater Tokyo is largely unchanged compared to the end of 1H/2017, vacancy rates are down 0.9ppts over Q4/2016 as net absorption exceeded completions in 2H/2017. According to Ichigo Real Estate Service, 553,000 sq m of new supply was added to the Tokyo market in 2H/2017. Net absorption spiked to 463,000 sq m in Q4/2017, an increase of more than 100% quarter-on-quarter (QoQ), exceeding new supply by 163,000 sq m.

Despite the year-end boost in demand in the Tokyo market, however, asking rent declined slightly from the Q3/2017 high of JPY4,280, to JPY4,200 per tsubo per month as of the end of Q4, an increase of only 0.7% YoY. Though certain inland properties in prime locations are seeing smooth leasing activity, inland areas with a high concentration of development have seen less demand overall than better-located properties. The expectation of a large amount of inland supply in 2018 is likely to make this divergence more pronounced. In the long-term, infrastructure developments such as the expansion of the Ken-O Expressway should facilitate demand.

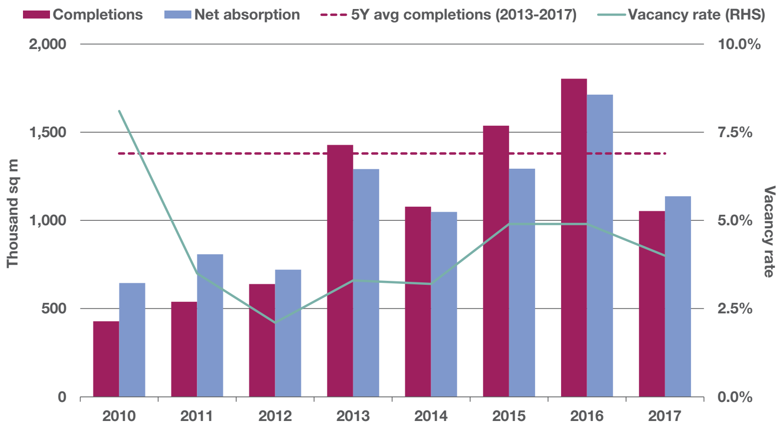
Large supply weighed heavily on the Greater Osaka market in 2017, though year-end trends indicate a potential recovery. According to Ichigo Real Estate Service, 688,000 sq m of new supply was added in the August to October 2017 period (Q3/2017), exceeding net absorption by 200,000 sq m. Supply cooled substantially during Q4/2017, as only 75,000 sq m of space was added, which was matched by net absorption. Based on disclosed information, new supply in the Greater Osaka market will cool down to some extent after 1H/2018, which should help reduce vacancies over time.

Average asking rent YoY dropped 2.9%, to JPY3,350 per tsubo per month, and remained flat QoQ. Rental prices reached a low of JPY3,310 in Q2/2017, a 4.6% decline over Q3/2016; however, rents appear to have levelled off towards the year end, with Q4/2017 seeing a slight increase of 1.2% over Q2/2017. Vacancies also appear to have levelled off as of the year end.

Rental growth in Osaka should stabilise over time as the development

GRAPH 1

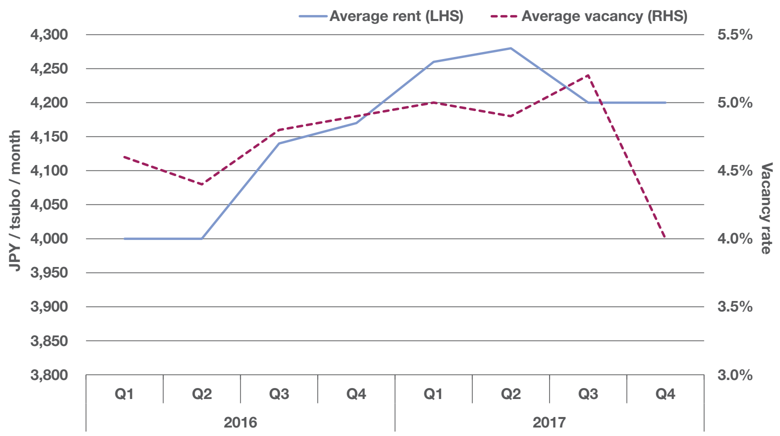
Supply, take-up, and vacancy in Greater Tokyo, 2010 – 2H/2017



Note: Annual periods from February to January.
Source: Ichigo Real Estate Service, Savills Research and Consultancy

GRAPH 2

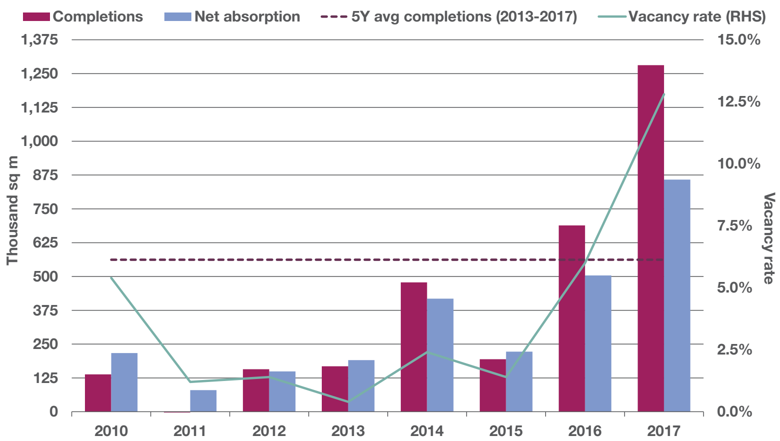
Greater Tokyo rent vs. vacancy, Q1/2016 – Q4/2017



Note: Annual periods from February to January.
Source: Ichigo Real Estate Service, Savills Research and Consultancy

GRAPH 3

Supply, take-up, and vacancy in Greater Osaka, 2010 – 2H/2017



Note: Annual periods from February to January.
Source: Ichigo Real Estate Service, Savills Research and Consultancy

pipeline subsides. In the long term, the continuing development of major highways such as the Shin-Meishin Expressway and the Osaka Urban Regeneration Loop should have a positive impact on the market.

Incoming supply

Based on public disclosures, over 3.3 million sq m of supply will be added to the Japanese market in 2018 (February 2018 - January 2019), over 2.3 million sq m of which will be supplied to the Greater Tokyo market, with over 800,000 sq m set to enter the Greater Osaka market. This represents a major geographic shift over 2017, which saw just under 1.1 million sq m added to the Tokyo market while the Osaka market had seen nearly 1.3 million sq m of completions. This rebalance should come as a welcome reprieve to the Osaka market.

In Greater Tokyo, much of the development will be located inland. Among this large supply, certain properties located around the Ken-O Expressway and further away from major junctions may have difficulty securing a workforce. In an effort to attract prospective employees, these modern facilities will also provide amenities such as shuttle buses, cafes, shower rooms, delivery lockers, and, in some cases, childcare services.

Major developments are also underway for the early 2020s. Nagareyama, Chiba alone will see just over 1.3 million sq m of logistics space added from 2018 to 2022, approximately 1 million sq m of which will be supplied by Daiwa House projects with the remaining amount supplied by Global Logistics Properties (GLP) projects. Notably, a portion of the land acquired for development by Daiwa House had been zoned for agricultural use. In an unprecedented move, the Ministry of Agriculture, Forestry and Fisheries, at the behest of the Nagareyama local government, granted Daiwa House permission to utilise the land for industrial development.

In the long term, the Nagareyama example may indicate that Japan's national and local governments are becoming more flexible in the face of a shifting economy, as the number of agricultural workers declines. If other municipalities follow suit, we may continue to see better-located land open up to logistics development. In the short term, however, competitive locations available for development will remain limited.

Pre-leasing activity in the area appears smooth so far, particularly for well-located mid-sized facilities, given the relative ease of securing a workforce. According to disclosures made by GLP, the firm signed 218,000 sq m of new leases in Q4/2017. This also included pre-leasing for inland locations, including the entirety of GLP Niiza, a 31,000 sq m multi-tenant (MT) facility to be located in Saitama, as well as 40,000 sq m of GLP Nagareyama III, an 89,000 sq m MT facility, both of which are slated for completion in early 2019. A 3PL firm has also pre-leased 30,000 sq m of GLP Nagareyama I, an MT facility which is scheduled for completion in March.

Osaka also continues to see development of large, modern facilities located inland near major thoroughfares.

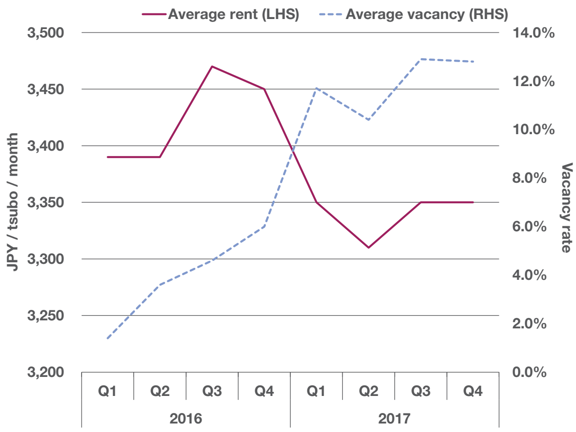
Construction has begun on Prologis Park Kyotanabe, a 161,000 sq m Prologis-developed MT facility in Kyoto Prefecture which is set to be completed in October 2018. The development site is roughly equidistant from Osaka City and Kyoto City and is located 300 metres from what will be an intersection of the Shin Meishin Expressway and the Second Keihan Highway, providing convenient access to the Chubu and Chugoku regions. Prologis announced in December 2017 that it had signed a contract to lease 15,000 sq m of the facility to a domestic logistics firm.

Investment trends

Investor outlook for rent and capital appreciation has improved over 2H/2017. Ichigo Real Estate Service's survey of market players indicates a steady improvement in capital appreciation as the diffusion index of responses currently sits at +25.9, a 2.8 point increase over the 1H/2017 survey while expectations of further rental growth improved from -15.9 to -3.7. Respondents increasingly cited the stable growth of the Japanese economy as the main factor for stable or increasing capital value. Notably, the number of respondents who cited demand driven by e-commerce as the basis for a positive outlook tripled compared to the prior survey.

GRAPH 4

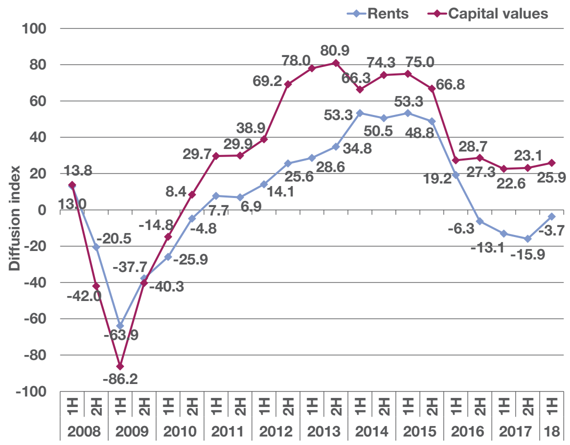
Greater Osaka rent vs. vacancy, Q1/2016 – Q4/2017



Note: Annual periods from February to January.
Source: Ichigo Real Estate Service, Savills Research and Consultancy

GRAPH 5

Six-month-ahead expectations for rent and capital appreciation, 2008 – 1H/2018



Note: Index is calculated as the number of responses saying rents/values will increase minus the number of responses saying rents/values will decrease.
Source: Ichigo Real Estate Service, Savills Research and Consultancy

According to data from Real Capital Analytics, investment volumes in the logistics sector for 2017 decreased by JPY196 billion, to JPY241 billion, a near 45% drop compared to 2016. However, during the December 2017 to February 2018 period, J-REITs announced acquisitions totaling JPY289 billion in the logistics sector to be completed during 1H/2018, exceeding the total 2017 transaction volume in the sector by JPY48 billion. This reveals that investor appetite remains strong, even as cap rates continue a seven-year compression trend.

Specifically, in December 2017, CRE, Inc. announced the listing of the CRE

Logistics Fund REIT along with the acquisition of four properties for JPY28 billion, with both the listing and initial acquisitions completed in February. In January 2018, Mitsubishi Fudousan Logistics Park REIT announced the acquisition of three properties in Nagoya and Greater Tokyo for around JPY20 billion.

February 2018 alone saw over JPY227 billion of investment. Industrial & Infrastructure Fund and Daiwa House REIT announced the acquisition of 27 logistics properties in Greater Tokyo, Greater Osaka, Fukuoka, and other regions, while Nippon Prologis REIT announced the acquisition of five properties in Greater Tokyo. GLP J-REIT also announced the purchase of two properties in Okayama along with interests in equipment located at 13 properties throughout Japan.

Indeed, investor demand for existing properties is strong. However, developers may want to offload certain properties in consideration of the development pipeline.

Based on the most recent bi-annual investor survey conducted by the Japan Real Estate Institute (JREI), cap rates for inland property in Tokyo and Osaka have, after stabilising in 2016, resumed their tightening trends while rates for bayside property in Tokyo continued their four-year compression. From their post-crisis peak, cap rates in Tokyo and Osaka have tightened over 150 basis points (bps) and now register at 4.8% (inland) and 4.6% (bayside) in Tokyo and 5.3% in Osaka (inland). Though Tokyo bayside and inland cap rates compressed to nearly the same level in 1H/2016, they have since returned to a 20 bps divergence as of 2H/2017, resuming a five-year trend.

Pivotal year for logistics industry

The domestic e-commerce market continues to expand revenue. Major firms such as Amazon and Rakuten have consistently increased annual sales in Japan since 2013, with the latter increasing sales in its domestic e-commerce segment by over 25% YoY for FY2017. Further, small to medium-sized companies are increasingly moving into online sales, including peer-to-peer flea-market applications, such as Mercari, which have recently become popularised in Japan. The increasing demand for shipping services accompanying this expansion has presented new challenges and opportunities to the logistics industry.

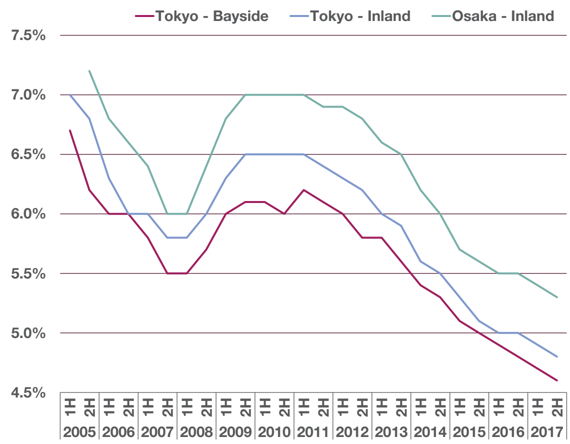
Though domestic shipping companies stand to benefit greatly from this demand, an increasingly competitive labour market – along with a new emphasis on single-package home deliveries – has expanded operating costs and pushed firms to further streamline the delivery process. 2017 saw significant strategic shifts in the sector as increases in wages and shipping rates, as well as successful capital raising, among major logistics players has set the tone for the industry moving forward.

Yamato Transport, which handles 47% of domestic parcel deliveries, kept its promise to raise wages for shipping workers. In some competitive areas, the firm has listed positions offering JPY2,000 per hour – an increase of JPY500, or 33% – over the prior year. Yamato has also announced that they will convert all 3,000 temporary truck drivers into permanent staff, in addition to 2,000 other contract workers at logistics facilities and in administrative positions. The firm listed “reforming working styles” as one of the three main pillars of its medium-term management plan announced in September 2017.

To cope with increased costs, Yamato also followed through with plans to raise shipping rates 15% on business customers with even higher rate increases on major corporate clients. According to the Nikkei, as

GRAPH 6

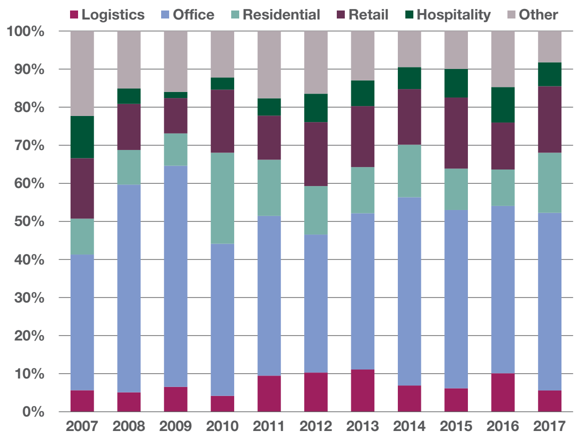
Cap rates for large modern logistics facilities, 1H/2005 – 2H/2017



Source: JREI, Savills Research and Consultancy

GRAPH 7

Share of investment volumes by asset class, 2007 – 2017



Note: Annual periods from January – December.
Source: RCA, Savills Research and Consultancy

TABLE 1

Selected investments, announced Oct 2017 – Mar 2018

Property name	Transaction value (JPY million)	Appraisal cap rate	Buyer	Seller
Prologis Park Yoshimi	21,300	4.7%	Nippon Prologis REIT	Hotaka SPC
DPL Fukuoka Kasuya	13,300	4.8%	Daiwa House REIT	Daiwa House Industry Co., Ltd.
LogiSquare Urawamisono	13,060	4.8%	CRE Logistics Fund REIT	CRE, Inc.
GLP Soja I	12,800	5.3%	GLP	Soja Logistics SPC
Landport Hachioji II	9,230	4.4%	Nomura Real Estate Master Fund	Nomura Real Estate Development

Source: Company disclosures, Savills Research and Consultancy of January 31, 2018, Yamato has retained 60% of such corporate customers, including its largest client by far: Amazon Japan. After three consecutive quarters of losses, the firm posted a profit of JPY29.5 billion for the three months ended December 31, 2017, a 22% increase over the prior-year period. As it appears the firm has successfully transferred its costs to customers, capital markets responded positively. Year to date, shares of Yamato have risen from JPY2,300 to JPY2,669 as of March 30, outperforming the Nikkei 225 index by 25%.

Indeed, despite persistent sector-wide challenges, the industry continues to attract significant investment. SG Holdings, Japan's second biggest home-parcel company by market share, held a successful IPO in December 2017. The largest IPO of the year, shares of the firm were offered for JPY1,620 on December 13, 2017 and were trading at JPY2,325 as of March 30, 2018, outperforming the Nikkei 225 by 50% over the same period. According to Nikkei news, gaining further legitimacy to attract talent was one of the major goals of listing the company. SG Holdings has forecasted a net profit of JPY33 billion for the year ended March 2018, up 16% from the prior year. The firm is also expected to merge Sagawa Express Co., Ltd., its shipping arm, with Hitachi Transport System in 2019.

OUTLOOK

The prospects for the market

Market player sentiment for increases in rental prices, while still relatively low, are the highest they have been since January 2016. Expectations for increases in logistics property value have improved over 2017, though positive sentiment is still well below 2015 levels. Japan's macroeconomic prospects support near-term growth in the industry, while the expansion of e-commerce, peer-to-peer sales platforms and the shipping industry provides a long-term foundation for demand in the logistics sector.

Large supply continues to weigh down the Greater Osaka market in particular, though average rent and vacancy rates stabilised during 2H/2017. Supply in the Osaka market should cool down somewhat in 2018 and beyond. A sharp decrease in vacancy rates in Greater Tokyo towards the end of 2017 should help keep rental prices steady, although a large amount of supply will come into the market in 2018 and 2019.

Indeed, public disclosures indicate that the next two years will see a record amount of supply enter the market. Generating demand during this period will be critical.

With easy access to labour becoming a key priority for tenants, we will likely see a divergence in leasing between new inland properties located around the Ken-O Expressway and more competitive inner properties, while small to mid-sized MT and built-to-suit (built to meet the needs of a specific tenant) facilities show stronger overall leasing activity than large MT facilities. This divergence should reflect investor appetite and cap rate movement.

Cap rates of prime properties will likely continue their compression as more investors enter the market, and competition for existing properties in key locations should remain tight. Extensive J-REIT acquisition activity in early 2018 may imply that developers want to unload some of their portfolio as the current market approaches a peak within the influx of supply. Investment opportunities will expand greatly over the next couple of years, though there will be clear winners and losers. This may in fact be a welcome chance for the selective investor to expand interests or enter the market.

Please contact us for further information

Savills Japan

Christian Mancini
CEO, Asia Pacific
(Ex Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

Savills Research

Tetsuya Kaneko
Director, Head of Research
& Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk