Japan - September 2019

SPOTLIGHT
Savills Research

Japan Logistics

Logistics demand remains robust

Summary

- Although vacancy edged up slightly during the year in Greater Tokyo, due to a continuing influx of supply, the market remains tight with sound pre-leasing activity.
- Greater Osaka vacancy continued to tighten as the market enjoys a reprieve after record supply came online in 2017.
- Asking rents have been trending downward in Greater Tokyo, though this partially reflects the fact that bay-side facilities with higher rents are largely occupied and not listed.
- In light of tightening vacancy and less incoming supply, asking rents have been rising in Greater Osaka.
- Developers of geographically disadvantageous properties tend to ratchet up automation features to ease potential tenants' concerns over their low accessibility to labour pools.
- Japan's e-commerce market continues to grow, which is buttressing logistics demand. Home-delivery fees continue to rise, though new delivery modes, such as Amazon Flex, could serve to make the shipping industry more efficient and cost effective.

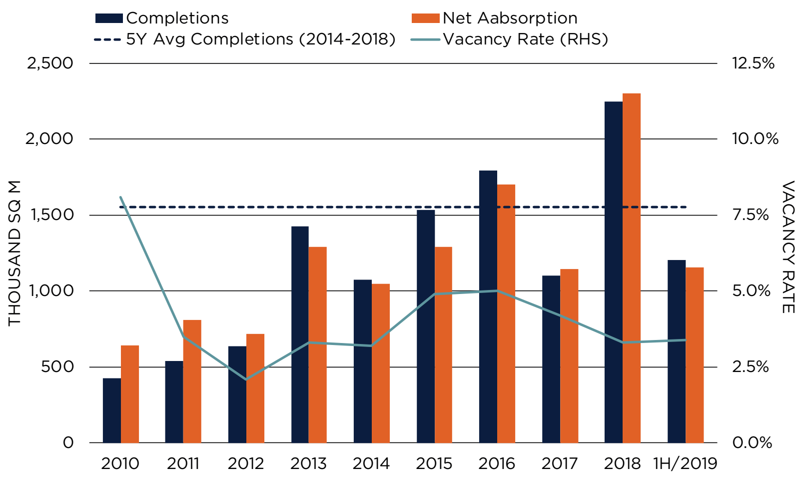
INTRODUCTION

Despite concerns over heightened supply in 2019, robust demand kept vacancy rates tight in Greater Tokyo, while Greater Osaka continued to show signs of improvement as excess supply caused by a supply surge in 2017 has been steadily absorbed. E-commerce, as well as third party logistics companies, are expected to drive demand over the long term. That being said, increasing labour costs and reduced delivery volumes due to higher fees are weighing on the business performance of major logistics companies such as Yamato Holdings. While the impacts on the logistics property market are unlikely to materialise immediately, this might be the precursor to a shift in the industrial sector.

MARKET TRENDS

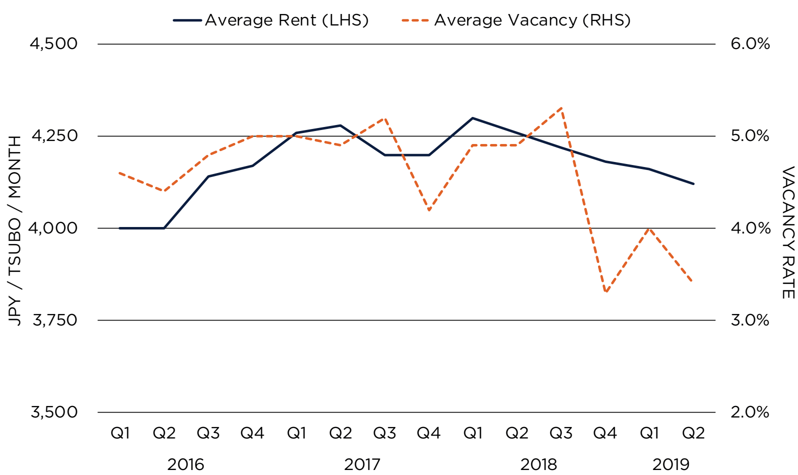
In Greater Tokyo, vacancy declined by 1.5 percentage points (ppts) year-on-year (YoY) to 3.4%, though saw a slight uptick of 0.1ppts over the end of 2018 (Graph 1). Even so, demand remains much stronger than initially expected. Despite a large influx of supply entering the market, pre-leasing for new facilities appears to be proceeding smoothly, supporting the long-term prospects of the Greater Tokyo

Graph 1: Supply, Take-up And Vacancy In Greater Tokyo, 2010 to 1H/2019



Note: Annual periods from February to January. Vacancy rates are as of the year end for each annual period, while the rate presented for 1H/2019 is as of July.
Source Ichigo Real Estate Service, Savills Research and Consultancy

Graph 2: Greater Tokyo Rent Vs Vacancy, Q1/2016 to Q2/2019



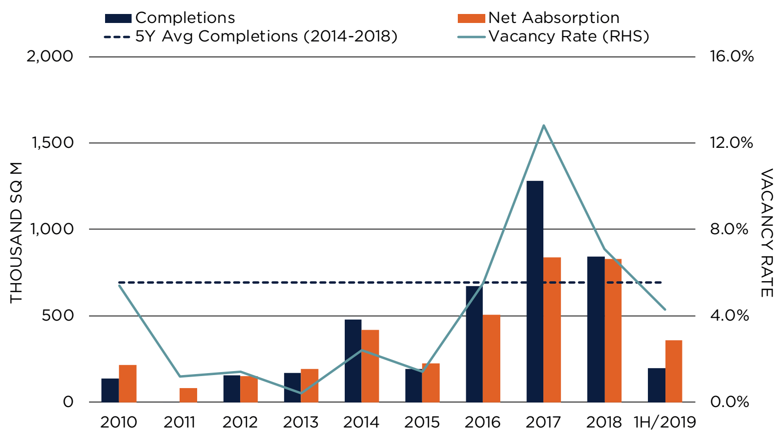
Note: Annual periods from February to January.
Source Ichigo Real Estate Service, Savills Research and Consultancy

market. Although average asking rents in the overall market have seen a steady drop since the highs posted in Q1/2018 (Graph 2), rents for facilities at the upper end of the market, particularly those in prime areas, have increased.

Indeed, rent and vacancy can vary significantly by submarket. With high demand and limited new supply, the Tokyo Bay submarket tends to see higher rents and lower vacancy rates. Limited space for development in the area has restricted supply, while convenient access to supply lines, as well as workforce in central Tokyo, is driving demand. On the other hand, due to its distance from residential centres and the resulting limitations in access to labour pools, the Ken-O Expressway submarket tends to see somewhat weaker performance, which has been accentuated by an influx of supply. That said, new facilities in the area tend to be marketed with extensive automation features to ease labour burdens and are thereby expected to alleviate some concerns harboured by potential tenants.

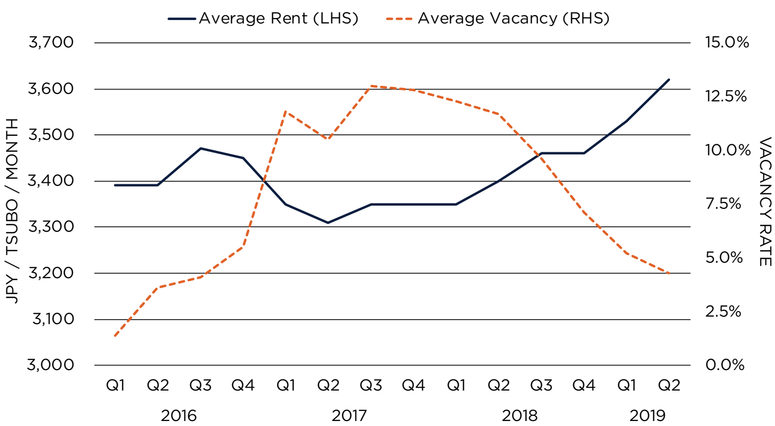
Even amidst historically high supply levels, the logistics market remains strong as tenant demand for conveniently located, high-specification facilities is on the rise. Greater Osaka in particular has been improving performance since the market was disrupted by oversupply in 2017. Property investors have generally adopted a more bullish attitude towards the sector, and investment volumes appear set to rise in the second half of 2019.

Graph 3: Supply, Take-up And Vacancy In Greater Osaka, 2010 to 1H/2019



Note: Annual periods from February to January. Vacancy rates are as of the year end for each annual period, while the rate presented for 1H/2019 is as of July.
Source Ichigo Real Estate Service, Savills Research and Consultancy

Graph 4: Greater Osaka Rent Vs Vacancy, Q1/2016 to Q2/2019



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

In Greater Osaka, vacancy tightened 7.4ppts YoY to land at 4.3%, a significant decline from its peak of 13% in Q3/2017. Average asking rents rose 6.5% YoY to land at JPY3,620 per tsubo. The inland submarket, which contains the areas north, east, and southeast of Osaka City, typically sees stronger performance and has tended to absorb new supply much more effectively. The submarket has convenient access to the Kinki Motorway, Hanwa Motorway, Nishi-meihan Motorway and Hanshin Highway, as well as to residential centres.

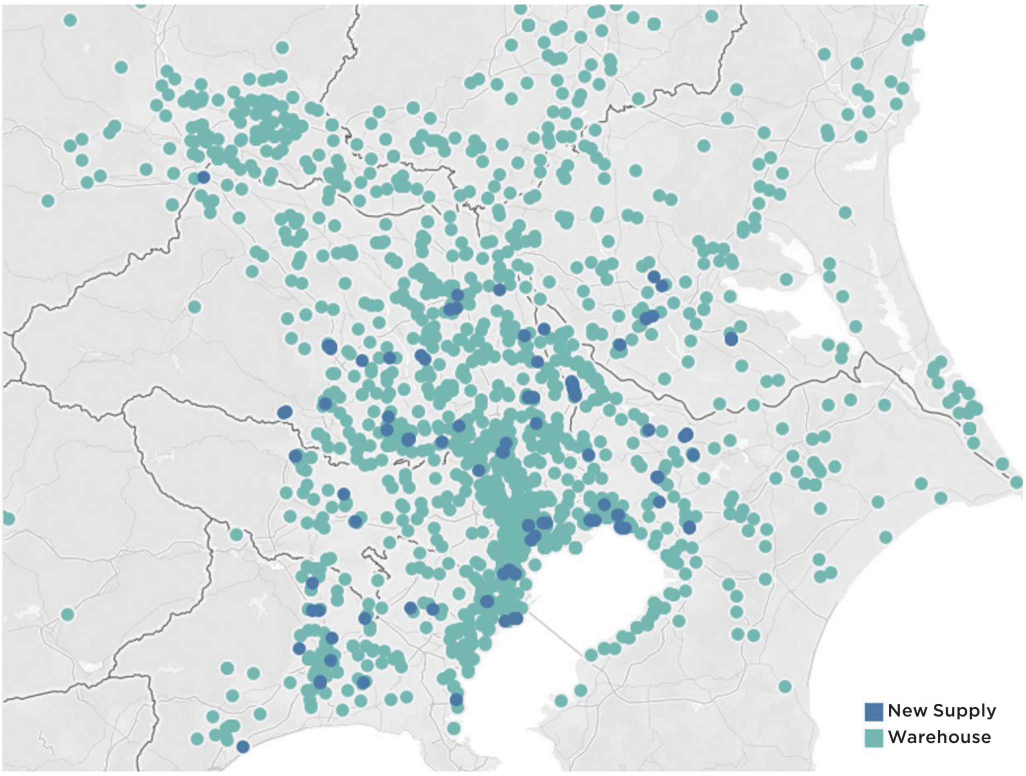
The Osaka Bay submarket, which was hit the hardest by high supply levels in 2017, continues to show signs of improvement. While the area has good access to seaports and airports, it is less suited for commuter travel and, therefore, worker retention is more challenging than for inland facilities. Reduced supply going forward should help support the submarket's performance.

INCOMING SUPPLY

Greater Tokyo continues to see high levels of supply that is mainly concentrated in Chiba and Saitama. Pre-leasing, however, has proceeded smoothly and thus newly-built facilities had only a minor negative impact on vacancy. In Kanagawa, for example, Logiport Kawasaki Bay, a multi-tenant facility with a GFA of 300,000 sq m, began its operation with full occupancy in June 2019. Daiwa Corporation and Maruwn Corporation are reportedly two of the seven tenants occupying the facility.

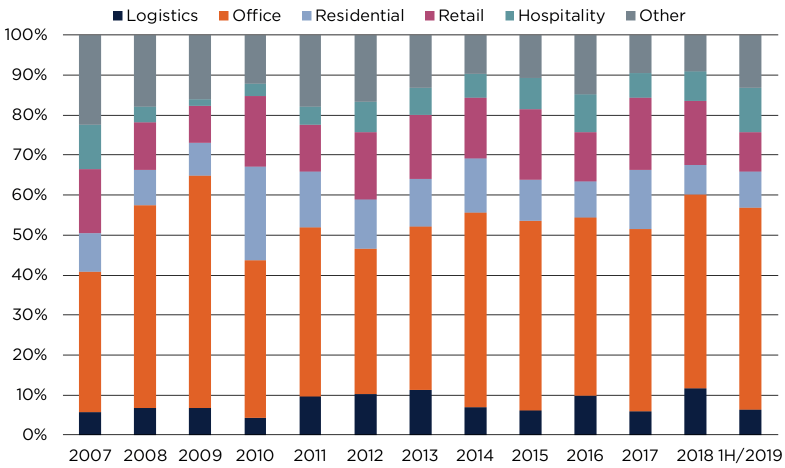
Based on the data available from the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), warehouses in Greater Tokyo that are registered under the

MAP 1: Existing Warehouse* And Logistics Facility Supply After 2018



* Warehouses registered as "Class 1 Warehouses" under the Warehouse Business Act
Source MLIT, Press Releases, Ichigo Real Estate Service, Savills Research and Consultancy

Graph 5: Share Of Investment Volumes By Asset Class, 2007 to 1H/2019



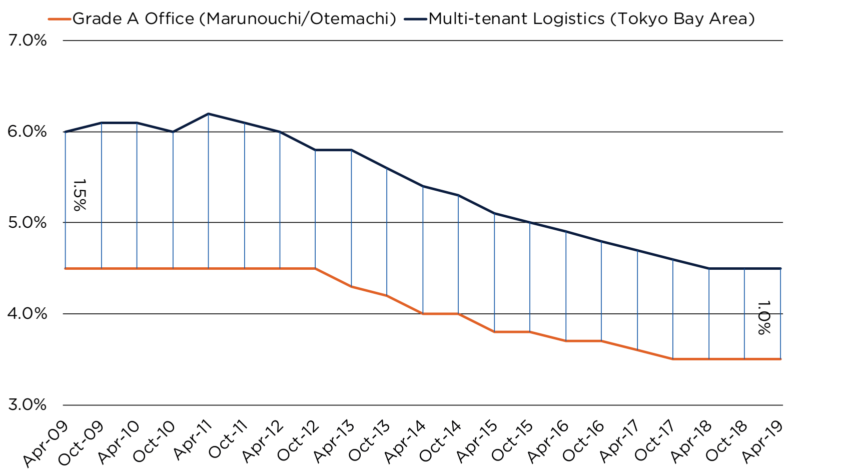
Source RCA, Savills Research and Consultancy

Warehouse Business Act are spread widely across the region with high concentrations along the bay area and highways. New logistics facilities in the pipeline are concentrated in those established areas, with only a handful of projects venturing away from the Ken-O Expressway ring.

In Greater Osaka, supply has moderated significantly in 2019, especially compared to 2017 when a glut of supply caused vacancy to rise sharply. Around 350,000 sq m is estimated to enter the market by the end of the year, less than one third of the nearly 1.3 million sq m of supply seen in 2017. Although over half of this supply has already opened, including the Mapletree Kobe Logistics Centre which has a GFA of 100,000 sq m, the impact on the market has been moderate to date.

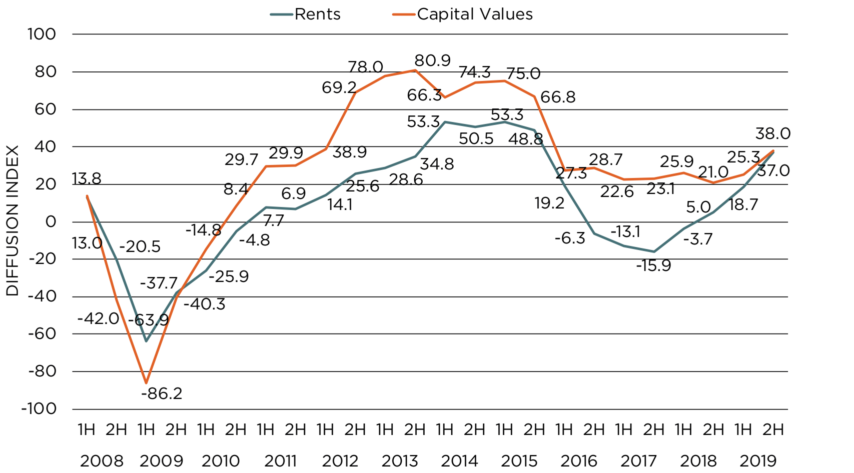
The extension of the Shin-Meishin Expressway was completed in March 2018 and added a new route between Osaka Prefecture's Takatsuki City and Kobe. According to West Nippon Expressway Company, traffic jams that affected any span of over 5 km occurred about 70% less compared to the period prior to the opening of the new thoroughfare.

Graph 6: Comparison Of Tokyo Grade A Office And Logistics Expected Cap Rates, April 2009 to April 2019



Source JREI, Savills Research and Consultancy

Graph 7: Six-month-ahead Expectations For Rent And Capital Appreciation, 2008 to 2H/2019



Source Ichigo Real Estate Service, Savills Research and Consultancy

INVESTMENT TRENDS

According to Real Capital Analytics (RCA), logistics investment volumes for the first half of 2019 stood around 131 billion yen[1], a 41% decrease over 1H/2018. While on the surface this may indicate a lull in investor demand, a large portion of early 2018's recorded volumes were due to the privatisation of GLP and the transfer of its Japan portfolio. More importantly, though recorded volumes for 1H/2019 may be comparatively weak, investment has already picked up during the second half of the year.

For instance, it was reported in July that Blackstone Group would acquire a portfolio of logistics facilities in Japan, including Amazon's fulfilment centre in Kanagawa, from Mapletree for a total value exceeding 100 billion yen. Other major foreign investment funds are rumoured to be targeting the sector and are likely to close on deals during the second half of the year. On the domestic side, the Government Pension Investment Fund's FY2018 annual report showed that the institution had gradually increased its domestic real estate investment to 125 billion yen since its launch in December 2017, with the largest share of 31% accounted for by logistics properties.

Indeed, Japan's logistics market continues to attract both domestic and foreign investor interest as prospects for the sector are favourable and yields remain attractive – potentially leaving room for further compression. Ichigo Real Estate Service's bi-annual survey of industrial market players has similarly revealed confidence in the sector, with a near 20-point increase in expectations for rental growth, as well as a 13-point increase in expectations for capital appreciation, over the next six months.

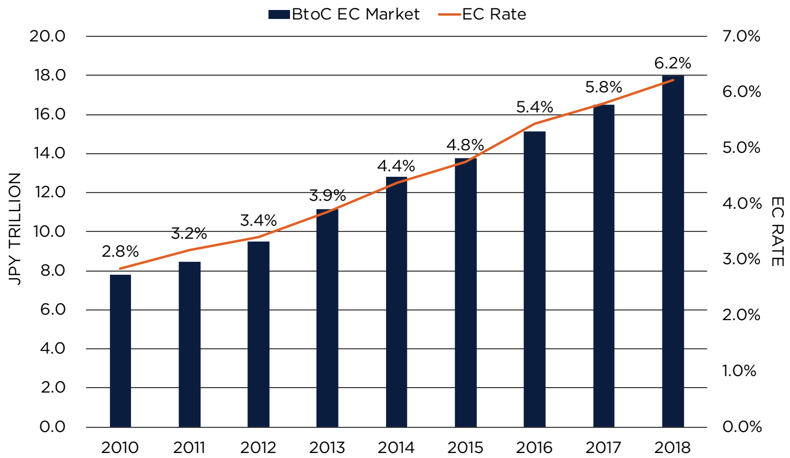
1 In principle, RCA investment volumes exclude related-party transactions, such as those between a J-REIT and its sponsor.

Table 1: Selected Investments, Announced February 2019 to July 2019

PROPERTY NAME	TRANSACTION VALUE (JPY MIL)	APPRAISAL DIRECT CAP RATE	BUYER	SELLER
Prologis Park Kyotanabe	35,800	4.4%	Nippon Prologis REIT	Prologis
Landport Ome I	13,640	4.5%	Nomura Master Fund	Nomura Real Estate Development
Prologis Park Higashimatsuyama	12,600	4.5%	Nippon Prologis REIT	Prologis
D Project Itabashi Shingashi	12,300	4.2%	Daiwa House REIT	Daiwa House Industry
Logiport Kashiwa Shonan	9,300	4.4%	LaSalle Logiport REIT	Undisclosed

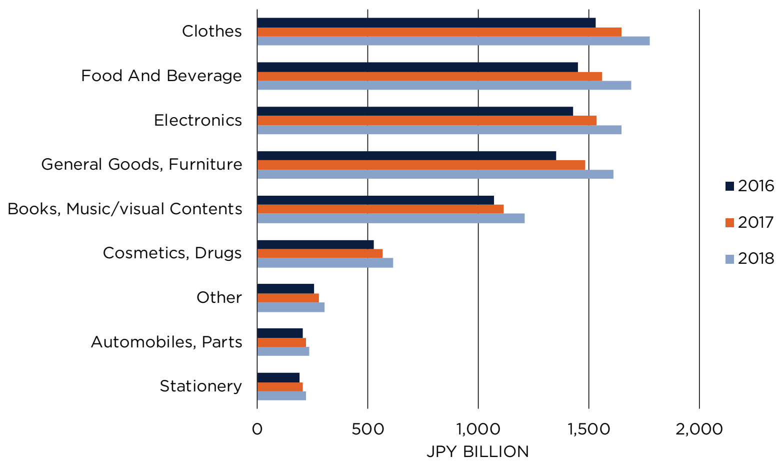
Source Company Disclosures, Savills Research and Consultancy

GRAPH 8: BtoC EC Market Size And EC Penetration Rate, 2010 to 2018



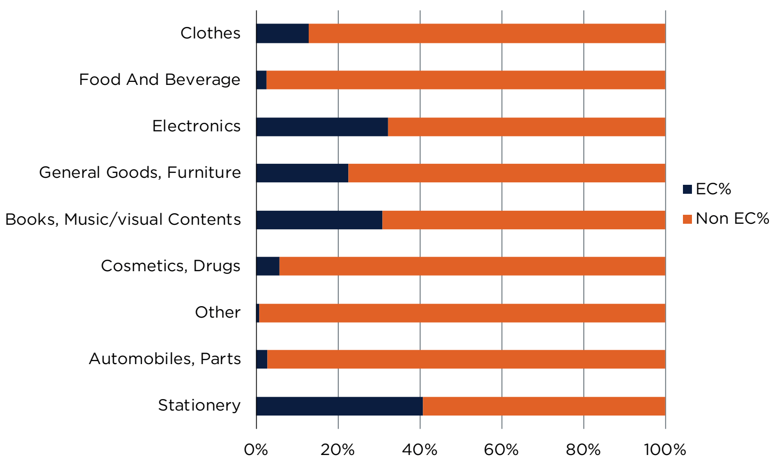
Source The Ministry of Economy, Trade, and Industry, Savills Research and Consultancy

GRAPH 9: BtoC EC Market Size By Category, 2016 to 2018



Source The Ministry of Economy, Trade, and Industry, Savills Research and Consultancy

GRAPH 10: EC Penetration Rate By Category, 2018



Source The Ministry of Economy, Trade, and Industry, Savills Research and Consultancy

E-COMMERCE

Japan's BtoC e-commerce market has been expanding year after year and reached JPY18 trillion in 2018, though still accounting for 6.2% of total retail sales, according to the Ministry of Economy, Trade, and Industry. The county's e-commerce penetration is expected to grow further as it remains relatively low compared to global peers such as the U.S., U.K., and China. Sales figures by category also exhibit upside potential as items such as clothes, as well as food and beverage, have low e-commerce rates while recording large online sales.

While the long-term growth of Japan's e-commerce market is favourable for the logistics market, rapid increases in home delivery in recent years are constraining distribution networks, resulting in increasingly high transportation costs. As a result, major shipping companies such as Yamato Holdings and Sagawa Express have increased delivery fees, with an especially rapid rise from FY2017. If this trend continues, increased transportation costs may reduce the profitability of e-commerce retailers and could affect their capacity to pay higher rents.

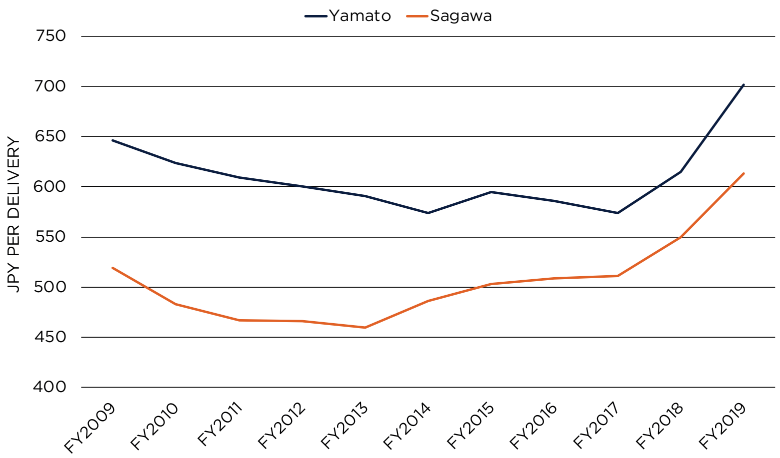
On the other hand, new initiatives in the delivery sector could serve to mitigate costs. In April, Amazon rolled out Amazon Flex in Japan. With this Uber-like network, individual contractors pick up packages from an Amazon delivery station and deliver them to customers. Home deliveries by automated vehicles are also being tested by multiple companies, which could significantly reduce ongoing costs.

OUTLOOK

Sound demand from e-commerce and 3PL companies continues to support the long-term prospects of Japan's logistics market. Greater Tokyo saw a loosening of vacancy, though the market remains tight, reinforced by smooth pre-leasing. Automation features appear especially important to attract tenants to properties located further away from labour pools. Greater Osaka continues to display resilience as vacancy falls and rents rise. That being said, the weakening business performance of logistics firms might eventually weigh on the now rapid growth of the industrial real estate market, though the potential gravity and timing of the impact is uncertain.

E-commerce in Japan is expected to increase its share and continue to boost logistics demand. As customers become increasingly demanding and purchase daily goods online, e-commerce companies are striving to provide fast and timely deliveries, which should continue to increase the need for last-one-mile logistics centres. While

GRAPH 11: Average Home Delivery Fees, FY2009 to FY2019



Source Corporate disclosures, Savills Research and Consultancy

major home-delivery service providers are increasing delivery cost, new technologies as well as transportation networks could improve cost efficiency in the long run.

Developers and investors alike continue to demonstrate strong interest in the sector. Bids for industrial development land in Greater Tokyo are in some cases seeing prices as high as three times the publicly disclosed value (Chika Koji) of neighbouring land. Strong investor interest has been illustrated by the large portfolio transaction involving Amazon's fulfilment centre. Although the overall investment outlook is marred by multiple global uncertainties, sound fundamentals and the relatively high yields of logistics properties are shoring up sentiment in the sector.

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