Savills World Research
Japan

Spotlight
Japan logistics

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Supply growth continues in Greater Tokyo and Greater Osaka as investment interest remains sound. Although there are signs of softening occupancy in Osaka, strong demand from underlying industries should continue to support long-term rental growth in the logistics market.

Introduction

Japan's logistics market continues to attract investment interest. Cap rates have compressed rapidly over the past four years and new logistics facilities are continuously sprouting in Greater Tokyo and Greater Osaka. Although there are signs of softening occupancy in Osaka due to a glut of new supply, high demand from underlying industries provides a sound foundation for future growth. Additionally, developments of major thoroughfares such as the Ken-O Expressway, the Shin-Meishin Expressway, and the Osaka Urban Regeneration Loop will improve the efficiency of logistics networks in the long term.
Although total real estate investment volumes in Japan declined in 2016, transactions in the logistics sector specifically increased by over JPY15 billion vs 2015. Logistics investment increased to 11% of total volume, exceeding volumes in both the hospitality and residential sectors.

Market trends

According to Ichigo Real Estate Services, Greater Tokyo continues to see a large amount of new logistics projects, adding 583,000 sq m of new supply in 2H/2016. Examples of newly completed facilities are MFLP Funabashi I (182,000 sq m), GLP Sayama Hidaka II (86,000 sq m), and Landport Hachioji II (37,000 sq m). Additionally, Prologis Park Koga (36,000 sq m) was completed along the newly opened thoroughfare between the Sakai Koga Interchange and the Tsukuba Cho Interchange. Despite large increases in supply, vacancy stood at 4.9% in Q4/2016, 0.1 percentage point tighter year-on-year (YoY). This is impressive given that about 1,783,000 sq m of new logistics facilities came into operation in 2016.

Supported by strengthening underlying business environments, average asking rents in Greater Tokyo exceeded JPY4,100 per tsubo per month in Q3/2016 for the first time since the market started the recovery. In Q4/2016, average rents recorded another increase, edging up to JPY4,170 per tsubo per month.

The Greater Osaka market also continues to expand at an unprecedented pace. In 2H/2016, 440,000 sq m of new supply entered the market. Major projects include Prologis Park Ibaraki (190,000 sq m) and Prologis Park Kobe 2 (68,000 sq m). Nissay Logistics Center Osaka

SUMMARY

- A large number of new logistics facilities continue to enter Greater Tokyo and Greater Osaka. The Greater Tokyo market expanded by 583,000 sq m in 2H/2016 while the Greater Osaka market added 440,000 sq m during the same period.

- Net absorption is still strong especially in Greater Tokyo, keeping vacancy below 5%. Vacancy in Greater Osaka weakened to 5.9% as a surge of new supply exceeded absorption.

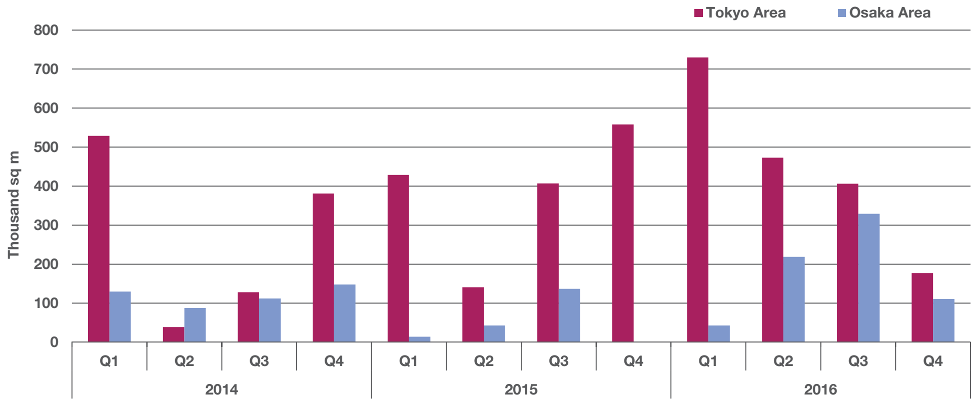
- As absorption keeps up with new supply, average asking rents rose to JPY4,170 per tsubo in Greater Tokyo. In Greater Osaka, average asking rents fell to JPY3,450 per tsubo under mounting supply pressure.

- In inland Tokyo and Osaka areas, cap rates have paused their tightening trend and held steady at 5.0% and 5.5% respectively. However, cap rates for bayside property in Tokyo further compressed to 4.8%.

- As labour supply falls behind a rapid increase in online retail demand, Yamato Transport may initiate meaningful wage increases. The change could induce a ripple effect of long-desired wage increases across, and possibly beyond, the logistics industry. Alternatively, additional costs on logistics tenants may dampen facility demand and rental prospects.

GRAPH 1

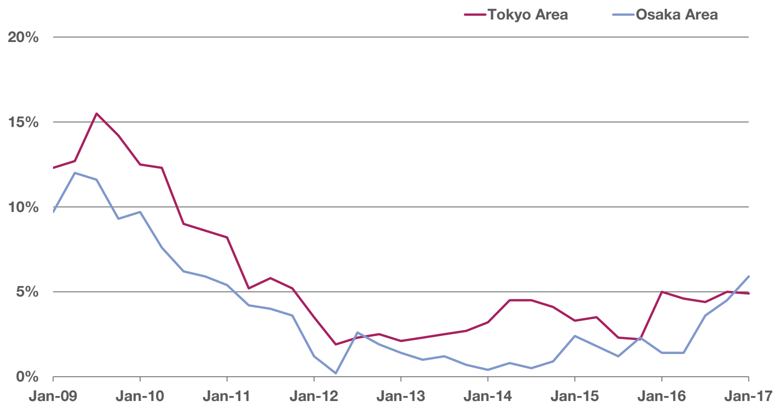
New supply completion in greater Tokyo and Osaka, Q1/2014–Q4/2016



Source: Ichigo Real Estate Services, Savills Research & Consultancy
Note: Data is compiled with a one-month lag, eg "Q1" indicates the period from February to April

GRAPH 2

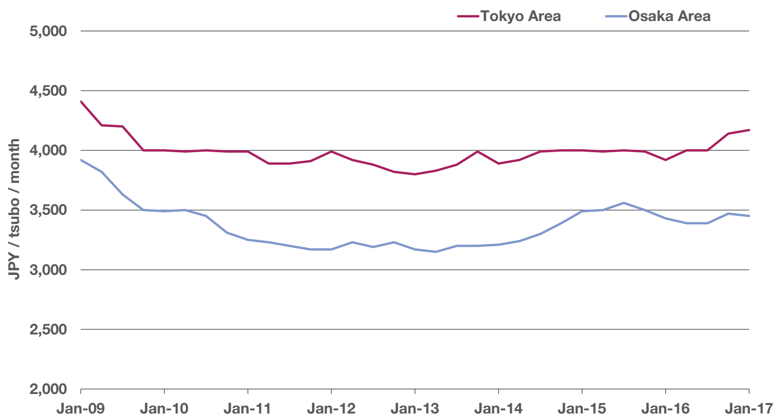
Vacancy rates in Greater Tokyo and Greater Osaka, Jan 2009–Jan 2017



Source: Ichigo Real Estate Services, Savills Research & Consultancy

GRAPH 3

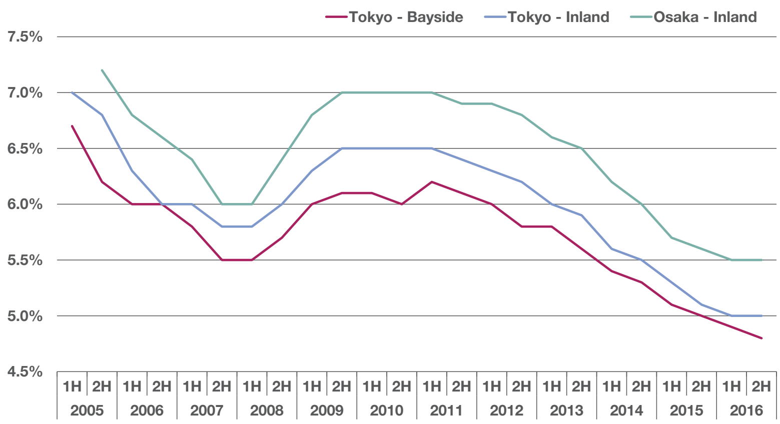
Asking rents in Greater Tokyo and Greater Osaka, Jan 2009–Jan 2017



Source: Ichigo Real Estate Services, Savills Research & Consultancy

GRAPH 4

Cap rates for large modern logistics facilities, 1H/2005–2H/2016



Source: JREI, Savills Research & Consultancy

Matsubara (18,000 sq m) was the first logistics project that Nippon Life Insurance Company developed. Facing this wave of new developments, Greater Osaka saw a loosening in vacancy from 4.5% to 5.9%. As over 800,000 sq m of logistics facilities is scheduled for completion in 2017, vacancy could further weaken in the near term.

Under supply pressure, average asking rents in Greater Osaka declined to JPY3,450 per tsubo per month in Q4/2016, down 0.6% quarter-on-quarter (QoQ). In the short term, rental growth will likely remain limited until the development pipeline subsides. In the long term, however, the continuing development of expressways such as the Shin-Meishin Expressway and the Osaka Urban Regeneration Loop should have a positive impact on the market.

According to data from 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 paused their tightening trends, while cap rates further compressed for bayside property in Tokyo. From their post-crisis peak, cap rates in Tokyo and Osaka have tightened over 100 basis points (bps) and now register at 5.0% (inland) and 4.8% (bayside) in Tokyo and 5.5% in Osaka. Cap rates in Osaka compressed more rapidly than in Tokyo through 2013 and 2014 as the region began to attract significant investor attention. The fact that cap rates ceased to decrease may signal that investors are growing more cautious in light of increasing supply.

Investment trends

Japan's growing demand for logistics space continues to attract investment interest. Despite an overall decline of total investment volumes, approximately JPY394 billion's worth of assets were transacted in the logistics sector in 2016. This represents more than a JPY15 billion increase from 2015. Logistics became the third largest investment sector, next to office and retail.

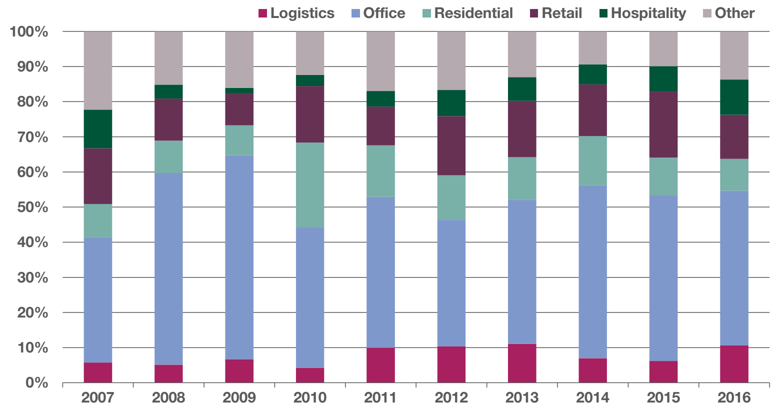
One of the largest recent transactions was a portfolio acquisition by Industrial & Infrastructure Fund, which obtained nine logistics properties from multiple domestic sellers for JPY28.6 billion. The facilities are mainly located in

Greater Tokyo and Greater Osaka, but the portfolio also includes properties in Miyagi, Fukuoka, and Iwate. Direct cap rates ranged from 4.4% for IIF Osaka Suminoe Logistics Center I (75% co-ownership interest) to 5.6% for IIF Ota Logistics Center.

Demand from foreign investors also remains strong. SOFAZ, Azerbaijan's state oil fund, has announced plans to invest US$100 million into E-Shang Redwood's Japan Logistics Fund II. The fund reportedly targets an IRR of 15% and a life span of five to seven years. In early 2016, Ping An Real Estate of China also announced a plan to invest US$300 million in Redwood's logistics development pipeline in Japan.

GRAPH 5

Share of investment volumes by asset class, 2007–2016



Source: RCA, Savills Research & Consultancy

New developments

Appetite for new developments continues to be robust. Although modern logistics facilities are now appearing across Japan, a majority of new projects are still focused in Greater Tokyo and Greater Osaka. In addition to proximity to major thoroughfares, facilities' accessibility from residential areas is becoming more important as labour shortages are a persistent issue in the logistics industry.

One of the most notable projects is a Global Logistic Properties (GLP) complex in Sagamihara, Kanagawa. GLP plans to build the largest logistics facility in Japan at a total cost of JPY130 billion. The project consists of six buildings and its total GFA is expected to be approximately 650,000 sq m. The construction is scheduled to commence in 2020 and the project is to be completed in stages.

In Greater Osaka, following the completion of Redwood Nanko Distribution Centre 1 (cover photo) in November, Redwood Nanko Distribution Centre 2 is scheduled for completion in February 2018. Redwood Nanko Distribution Centre demonstrates Redwood's new "human centric design" concept and features a children's nursery room, a spacious lounge with Wi-Fi and large screen televisions, and a terrace area overlooking Osaka Bay. These unique amenities should attract workers and give the facility strong competitive advantages especially in the short-staffed logistics industry.

Additionally, Prologis is scheduled to break ground on Prologis Park Kyotanabe this year. The GFA of the project is planned to be 156,000 sq m and it will be the first Prologis-developed facility in Kyoto Prefecture. The development site is roughly equidistant from Osaka City and Kyoto City. Once the Shin Meishin Expressway is completed, the project will also benefit from convenient access to the Chubu and Chugoku regions.

Wage growth on the horizon

It appears that wage increases could be more imminent in the logistics industry than other industries. Yamato Transport, which was warned for breaking the labour standards law for not compensating overtime work, has begun investigating how it can correct its labour practices. Yamato Transport handles around 50% of domestic

TABLE 1

Selected investments, announced Sep 2016–Feb 2017

Property name	Transaction value (JPY million)	Direct cap rate (%)	Buyer	Seller
Prologis Park Kobe 2	13,700	5.0	Nippon Prologis REIT	SPC of Prologis
Logiport Kawagoe	11,950	4.6	LaSalle Logiport REIT	SPC of LaSalle Investment Management
Prologis Park Narita 3	9,240	5.0	Nippon Prologis REIT	SPC of Prologis
IIF Osaka Suminoe Logistics Centre I (75% of co-ownership)	9,075	4.4	Industrial & Infrastructure Fund	Undisclosed domestic company
Souka Logistics Centre (additional 50% of co-ownership)	8,080	4.4	Japan Logistics Fund	SPC of Mitsui & Co., Realty Management

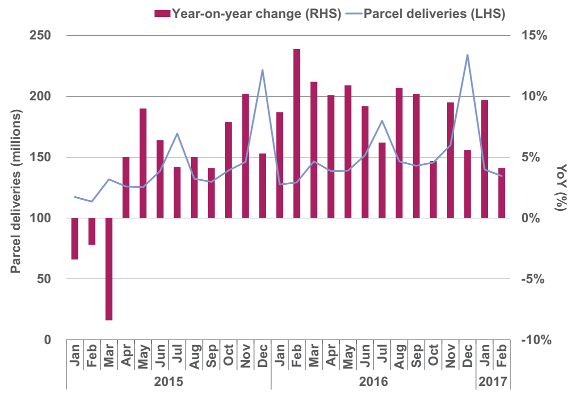
Source: Company disclosures, Savills Research & Consultancy home deliveries and the company's decision is likely to have a significant impact on the logistics industry as a whole.

According to the Nikkei, Yamato Transport also plans to raise the shipping rates it charges its commercial clients, including Amazon Japan, which is by far Yamato's largest client. The change comes in light of increasing volumes of home deliveries fuelled by rapid growth of online retail. In addition, Yamato hinted at starting to charge for redelivery, which accounts for 20% of total home deliveries according to a survey by the Ministry of Land, Infrastructure, Transport, and Tourism.

If Yamato successfully transfers some additional labour costs to its clients and consumers with little operational disruption, competitors are likely to follow suit. Possible wage increases could then spread within and conceivably beyond the logistics industry. This may have a tremendous impact on the Japanese economy and could lead to stronger consumer confidence and moderate inflation. That being said, it is also possible that the exponential growth of online retail could moderate if online retailers and end users of their service start shouldering the burdens of increasing labour costs. As a result, this may dampen rapidly increasing demand on logistics facilities.

GRAPH 6

Yamato parcel deliveries, Jan 2015–Feb 2017



Source: Yamato Transport, Savills Research & Consultancy

OUTLOOK

The prospects for the market

The Greater Tokyo and Greater Osaka logistics markets continue to see a surge of new supply. Extensions of major expressways appear to be fuelling further developments of inland logistics facilities. Despite this influx of new supply, average rents in Greater Tokyo recorded another post-recession high. However, the Greater Osaka market showed signs of softening occupancy, resulting in lower rents.

Although the logistics sector still attracts investment interest, a pause in cap rate tightening may suggest that investors perceive more risk as rapid supply growth is expected to continue in the near term. However, underlying demand growth continues unabated and the long-term outlook of the logistics industry is still positive. Additionally, recent developments at Yamato Transport highlight the importance of addressing labour shortages to keep up with demand. If logistics companies start increasing wages while successfully transferring some of the labour costs to clients and consumers, it might help catalyse a positive economic cycle in Japan.

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

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