savills

Savills World Research
Japan

Spotlight
Japan logistics

September 2016

savills.com.jp/research

Spotlight
Japan logistics

An unprecedented influx of new supply is entering major markets, but take up has been strong and occupancy remains above 95%. Rents will likely stay soft as absorption continues, but yield compression and new developments proceed unabated as more and more players seek to take advantage of high demand from underlying industries.

SUMMARY

- Japan's modern logistics market is in the middle of its largest expansion in history. Supply in the Greater Tokyo area has so far increased 28% since January 2015, and Greater Osaka's increase over the coming quarters is expected to be even larger.
- Net absorption is strong. Occupancy has softened slightly but still remains above 95% in both markets despite this influx of supply.
- Average asking rents were JPY4,000 per sq m per month in Greater Tokyo and JPY3,390 in Greater Osaka. Rental growth will likely remain very limited until the development pipeline subsides.
- Yields continue to compress as investors compete to meet high demand from underlying logistics industries. NOI cap rates are now below 5.0% in Greater Tokyo and at 5.5% in Greater Osaka.
- Developers and investors are focusing more on inland areas. Cap rate spreads between bay area property and inland property have almost disappeared.

Introduction

The swift development of Japan's e-commerce and third party logistics (3PL) infrastructure continues to drive strong demand for modern logistics properties. Cap rates are still compressing as investors seek to get involved in major markets. The Greater Tokyo and Greater Osaka areas have entered a temporary period of heavy supply, which has slowed rental growth, but occupancy is still above 95% and tenants are gradually taking up new space.

Multiple new logistics REITs were formed in mid-2016, and other players have announced intentions to invest heavily in the Japanese market. Yield gaps between locations appear to have gradually tightened as investors focus more on areas outside of Tokyo Bay. Most new supply is concentrated in inland areas, where land is more readily available.

Market trends

The Greater Tokyo logistics market is in the middle of its largest expansion in history. Data from Ichigo Real Estate Services indicates that in Q1/2016 Tokyo saw over 700,000 sq m of new supply enter the market, the largest figure since Ichigo first started its survey in 2008. The second-highest quarter on record was immediately prior, Q4/2015, at approximately 550,000 sq m. Q2/2016 is the fourth highest at about 475,000 sq m. Altogether, the market size of investible logistics assets in Greater Tokyo has expanded 28% since January 2015 to reach a total of 12.6 million sq m. Net absorption is, impressively, almost keeping pace – vacancy in Greater Tokyo increased abruptly from 2.2% to 5.0% in Q4/2015 but has since declined back to 4.4%. Vacancy has remained limited at 5.0% or below since the end of 2011 despite new supply. Most of Tokyo's supply increase is concentrated in inland regions far from Tokyo Bay.

The influx of new supply has generally suppressed rental growth in inland regions, though growth continues along the bay. Average asking rents in Greater Tokyo were JPY4,000 per tsubo per month in Q2/2016, unchanged both quarter-on-quarter (QoQ) and year-on-year (YoY). We anticipate strong demand for logistics space to continue over the long term, however, and meaningful rental growth may materialise once Tokyo's supply pipeline cools down.

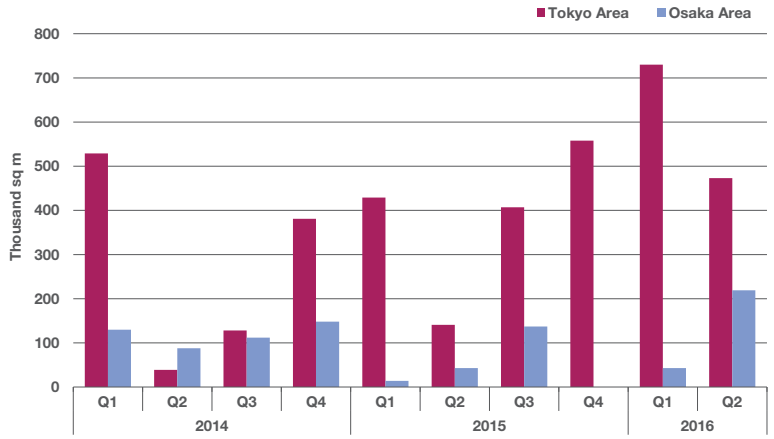
Greater Osaka is now seeing its own influx of new supply. The market expanded by 219,000 sq m in Q2/2016, the largest quarterly increase on record by over 70,000 sq m. Greater Osaka only absorbed 141,000 sq m over the quarter, leading to a rise in vacancy from 1.4% to 3.6%. This figure is still comfortably below 5%, however. Large supply increases are expected to continue over the next few years.

Average asking rents in Greater Osaka were JPY3,390 per tsubo per month in Q2/2016, flat to Q1 but down 4.8% YoY. This, coupled with the area's relative increase in vacancy, indicates that Osaka may be having more difficulty than Tokyo in absorbing its new supply.

Nevertheless, long-term demand for new logistics space remains strong. Japan still lags other developed markets in its share of modern warehouses and its requirements will only increase as more and more companies and consumers

GRAPH 1

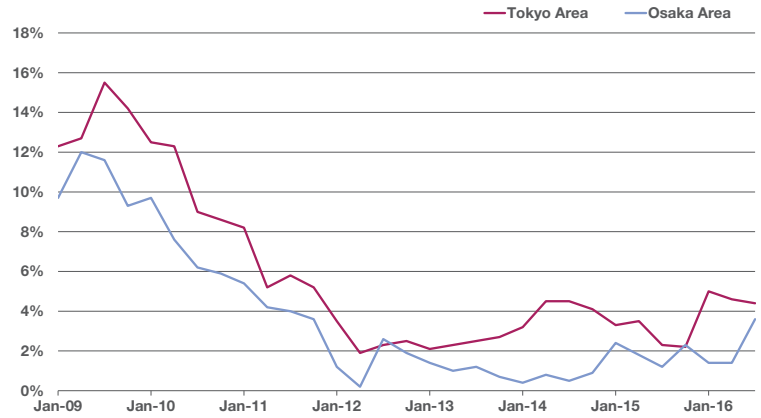
New supply completion in greater Tokyo and Osaka, Jan 2014–Jul 2016



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

GRAPH 2

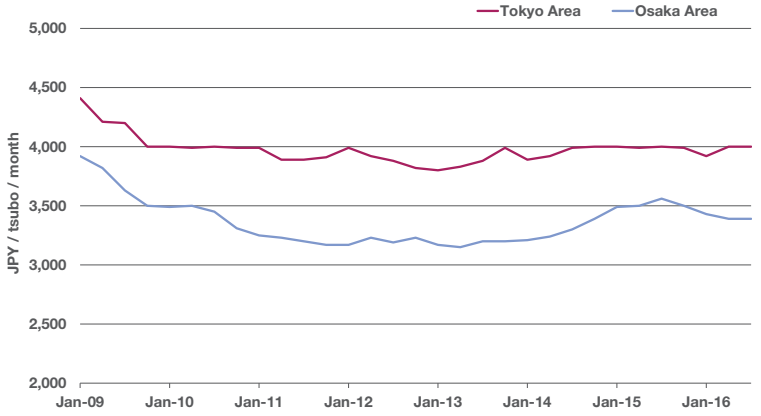
Vacancy rates in Greater Tokyo and Greater Osaka, Jan 2009–Jul 2016



Source: Ichigo Real Estate Services, Savills Research and Consultancy

GRAPH 3

Asking rents in Greater Tokyo and Greater Osaka, Jan 2009–Jul 2016



Source: Ichigo Real Estate Services, Savills Research and Consultancy

turn to e-commerce and 3PL for distribution.

Continuous cap rate compression supports this strong growth story. Data from a bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) indicates that cap rates in the Greater Tokyo area have tightened over 100 basis points (bps) since their post-crisis peak and now sit at 5.0% for inland property and marginally lower at 4.9% for bayside property. This 0.1ppt yield gap has narrowed gradually from 0.5ppts in 2010, indicating that investors now consider inland property almost as attractive as Tokyo's traditionally prime bay area. This compression is partially due to high demand in general, but also due to limited new supply on the bay as well as increased connectivity along Tokyo's outlying highway system.

Average cap rates in Osaka sit at 5.5% as of Q2/2016, sharper by 0.2ppts vs the previous year. Cap rates in Osaka compressed more rapidly than in Tokyo through 2013 and 2014 as the region began to attract significant investor attention, though the rate of tightening moderated somewhat in 2015 and appears to have fallen in line with Tokyo's.

Investment trends

Japan's heavy demand for logistics space has drawn more and more major players to the market. Mitsui Fudosan listed its new J-REIT, Mitsui Fudosan Logistics Park, on August 2. The J-REIT launched with nine properties, a total acquisition price of 75.5 billion yen, and an average asset age of 2.5 years. The majority of the facilities were developed by Mitsui Fudosan itself. The market appears to have received the new J-REIT favourably – unit prices closed 7% up on the first day of trading and have continued to climb in early September.

Daiwa House also commenced operation of its new private REIT focused exclusively on distribution centres occupied by Fast Retailing, an apparel company primarily known for its popular Uniqlo brand. The REIT will function as a

financing vehicle for On Hand, a new JV between Daiwa House and Fast Retailing, which plans to open 10 major logistics centres across Japan to support Fast Retailing's e-commerce activities.

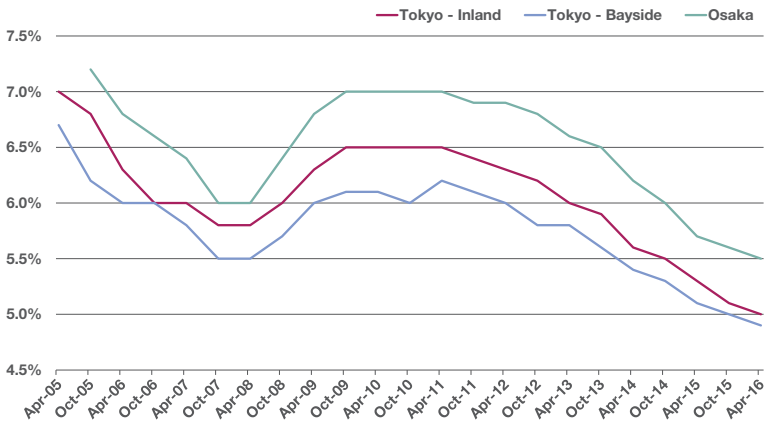
Itochu, one of the largest general trading houses, has also announced its intention to list a logistics J-REIT in fiscal year 2018. Itochu plans to launch the REIT with initial assets under management of JPY100 billion and will target JPY150 billion by the end of its first year. The company has acquired 11 in-progress projects so far, mainly around Tokyo and Osaka, and will maintain them under its "I Missions Park" brand.

Additionally, Ping An Real Estate of China announced that it will invest US$300 million worth of capital into e-Shang Redwood's logistics development pipeline in Japan through a new JV. Ping An has already committed to four co-investments near Tokyo and Nagoya.

Despite these large announcements, data from Real Capital Analytics (RCA) indicates that total transaction volumes have decreased across almost all Japanese regions and sectors, including logistics, in 1H/2016. This is mainly due to limited investment opportunities. Investment volumes totalled JPY127.3 billion from January through June 2016, down 47% from JPY242.5 billion over the same period last year. As a share of total investment volumes,

GRAPH 4

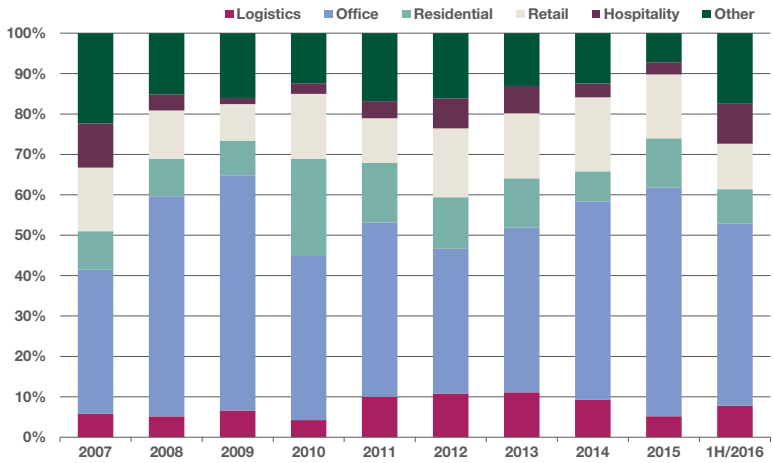
Cap rates for large modern logistics facilities, Apr 2005–Apr 2016



Source: Japan Real Estate Institute, Savills Research and Consultancy

GRAPH 5

Share of investment volumes by asset class, 2007–1H/2016



Source: RCA, Savills Research and Consultancy

TABLE 1

Selected investments, announced Mar 2016–Aug 2016

Property name	Transaction value (JPY million)	Direct cap rate (%)	Buyer	Seller
GLP Atsugi II	21,100	4.6	GLP J-REIT	GLP
GLP MFLP Ichikawa Shiohama (50% ownership)	15,500	4.5	GLP J-REIT	GLP/Mitsui Fudosan JV
Shinkiba Logistics Center II	15,270	4.4	Japan Logistics Fund	Kenedix/Itochu JV
GLP Yoshimi	11,200	5.1	GLP J-REIT	GLP
Landport Kashiwa Shonan II	10,800	4.8	Nomura Master Fund	Nomura RE Development

Source: Company disclosures, Savills Research and Consultancy

however, logistics properties remain stable at 8%.

One of the largest recent transactions was a portfolio acquisition by GLP's J-REIT, which obtained four properties from its sponsor for JPY42.7 billion. The facilities are located in Kanagawa, Saitama, Hyogo, and Miyagi, and direct cap rates ranged from 4.6% for the Kanagawa property to 5.3% for the property in Miyagi. The Kanagawa property, GLP Atsugi II, accounted for almost half of the total portfolio price and was fully pre-leased by Aeon Global nine months ahead of its completion in June.

New developments

Both investors and end users are showing strong appetites for new developments. Construction companies are working hard to complete many large scale modern logistics facilities over the next few years.

One of the most notable developments is a 560,000 sq m net leasable area (NLA) complex planned by Redwood near Haneda Airport. The facility will eventually consist of three state-of-the-art, eight-storey warehouses on prime Tokyo Bay property. Redwood purchased part of the land for its development in July at an undisclosed price.

GLP meanwhile plans to break ground on multiple new warehouses over the next twelve months, including a 121,000 sq m NLA facility in Ibaraki, a 98,500 sq m NLA facility in Osaka Prefecture, and a 34,000 sq m NLA facility in Aichi. The Aichi facility will be GLP's first foray into the Greater Nagoya region. The company plans to complete all three projects in 2018.

OUTLOOK

The prospects for the market

The Greater Tokyo and Greater Osaka logistics markets are seeing a major glut of new supply, but they appear to be absorbing it well. Rent levels will likely remain flat or even decline slightly until completions start to taper off in a few years. Occupancy may also temporarily drop below 95% for the first time in five years if demand does not keep pace.

The long term outlook, however, remains strong. Japan has a shortage of modern logistics facilities, and continuously compressing cap rates and ever-expanding developments from major players show that investors are eager to snap up new opportunities. Additional influxes of new supply over the coming years may intermittently suppress rental growth, but we expect the market to continue to expand over the long term.

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

Hafiz Ismail
Manager, Research &
Consultancy, Japan
+81 3 6777 5171
hismail@savills.co.jp

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