

savills

Spotlight
**Beyond Tokyo 2020:
Prospects for the Japanese
real estate market**

April 2018



Spotlight Beyond Tokyo 2020: Prospects for the Japanese real estate market



“A series of nation-wide infrastructure improvement and large-scale redevelopment projects towards and beyond the 2020 Tokyo Olympics should have a positive influence on the real estate market in the long term. Macroeconomic and demographic trends are driving demand for real estate and encourage continuing development, especially in key cities. The Olympics could be a stage to showcase a new Japan and set the country on a resilient growth track.”

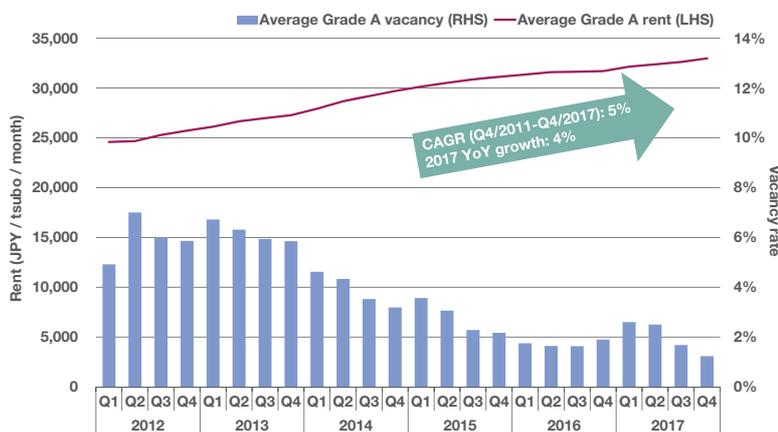
Introduction

With the closing of a successful Winter Olympics in PyeongChang, the spotlight has now turned towards the Tokyo 2020 Summer Olympics. The first Olympics held in Tokyo in 1964 marked the beginning of a new era for Japan after World War II, preceding the Izanagi economic boom (1965-1970) that made the country the world’s second largest economy. Although Japan fell into a long bout of economic stagnation after the asset bubble burst in the

early 1990s, the country is currently experiencing its second longest post-war economic recovery.

Nominal GDP reached JPY545 trillion in 2017, a JPY57 trillion or 12% increase from 2011. Corporate profits have been steadily growing and continue to set new highs. Demographic shifts are driving the population into cities, including an expanding foreign workforce that mitigates a severe labour shortage and contributes to the economy.

GRAPH 1 Office rents and vacancy in Tokyo’s C5W, 2012 – Q4/2017



Source: Savills Research & Consultancy

SUMMARY

- The upcoming 2020 Olympics has triggered a wave of redevelopment transforming Tokyo and key regional cities.
- Massive redevelopment projects, as well as infrastructure improvements towards and beyond 2020, will renew Tokyo’s landscape and make the city more attractive and accessible.
- Macroeconomic and demographic trends should continue to support development after 2020 in key cities.
- The Olympics could highlight the beginning of a new growth period for Japan’s economy and real estate market.
- Several risk factors need to be carefully monitored, including rising protectionism, the planned consumption tax hike, and a possible loosening of cap rates.

Expansion of tourism is likely to continue, benefiting large cities - as well as regional economies - as more overseas tourists visit cities beyond Tokyo and Osaka.

The real estate market is also strengthening, as reflected in extremely tight office vacancy and slow but steady rental growth. Massive redevelopment projects are making Tokyo and key regional cities more attractive and accessible. The 2020 Olympics could mark the beginning of a new resilient growth period for Japan, just as the 1964 Olympics did over 50 years ago.

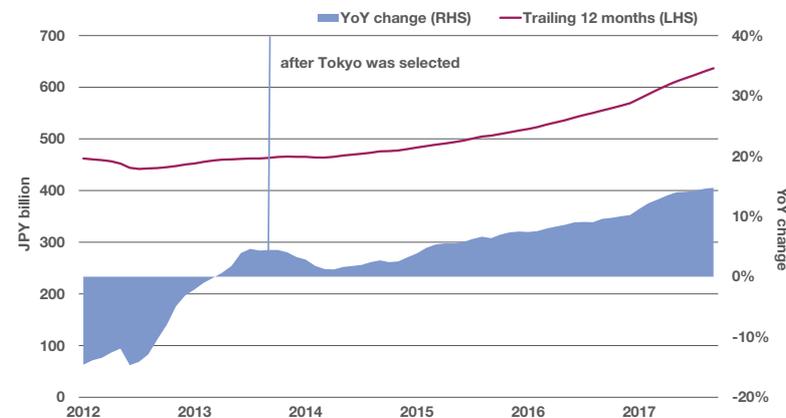
Infrastructure improvement & urban developments

Construction volume in Tokyo took off in 2013, right around the time the city was selected to host the 2020

→ Olympics. Not surprisingly, many projects are aiming for completion in time for the event. This has led to some concern that the construction boom may cool abruptly. Regardless, ongoing developments will have a long-term impact on Tokyo and ultimately improve its status as a global gateway city. Mega-scale development projects that will have a local and national impact have already been planned for the post-Olympic period.

Toranomon and Shibuya are going through a substantial redevelopment phase (as for Shibuya's redevelopment, please refer to our report published in November 2017, "A gravitational shift to Shibuya"). Mori Building will accelerate its Toranomon redevelopment projects that began with the completion of Toranomon Hills in 2014. Its JPY400-billion projects include three state-of-the-art towers designed by globally-recognized architects and feature high-specification office space and ultra-luxury residential units (possibly including an over JPY10 billion condo unit), as well as other upscale facilities. After these projects are completed, the Toranomon Hills development will exceed 800,000 sq m - almost

GRAPH 2 Construction volume in Tokyo, 2012 – 2017



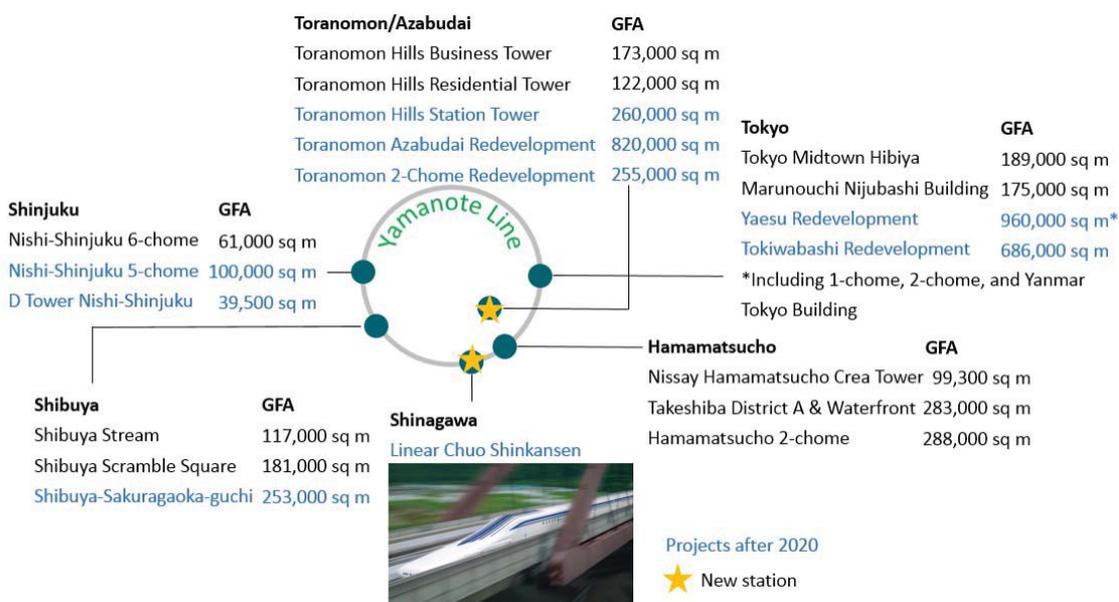
Source: Ministry of Land, Infrastructure, Transport, and Tourism (MLIT), Savills Research & Consultancy

matching Roppongi Hills. In addition to Mori Building's projects, Urban Renaissance Agency is leading a 255,000-sq-m redevelopment project involving a hospital and an office tower. The Toranomon/Azabudai District Redevelopment Project is another mega mixed-use development with a total GFA of 820,000 sq m. The area will also see infrastructure improvement including the new Toranomon station and a 1,000-sq-m

bus terminal for limousine buses from airports and bus rapid transit (BRT) systems which will connect central Tokyo with the bay area.

The bay area itself has experienced a rapid increase in population following developments of residential towers. The Tokyo Metropolitan Government has designated the area as a strategic place for tourism, as well as meetings, incentives, conventions,

MAP 1 Major development projects in Tokyo towards and after 2020



Source: Press releases, Central Japan Railway Company, Savills Research & Consultancy

→ and exhibitions (MICE). The Olympics will facilitate the area's growth as the Tokyo Big Sight significantly expands its capacity to accommodate the international broadcasting centre and main press centre. Additionally, the Olympic Village will be converted into residential towers with 6,000 units and a retail facility after the Games. Connectivity of this area will improve as the BRT systems are scheduled to be installed between Shinbashi and Toyosu by 2020, with an extension between Toranomom and Ariake planned after the Olympics. New roads will also improve access to city centres and international airports (Map 2). Haneda Airport plans to increase its capacity from 80 flights per hour to 90 flights per hour by modifying flight courses, and the proposed Haneda Access Line will directly connect the bay area to the airport. Furthermore, the area's development will continue beyond the Olympics as a 465,000-sq-m mixed-use project located north of the Tokyo Big Sight is planned to be completed in phases between 2019 and 2026.

The wave of new construction is not limited to Tokyo. In Osaka, the second phase of the Umekita development, which is located on a 160,000-sq-m site, is set to partially open in 2024 and be completed by 2027. Fukuoka's Tenjin Big Bang initiative aims to expand total floor space in Tenjin by 70% and working population by 140%. Also, large development is underway in Nagoya's Meieki area. Meitetsu plans to build a 30-storey mixed-use building directly south of Nagoya Station and will double the size of Meitetsu Nagoya Station in time for the Linear Chuo Shinkansen bullet train's opening in 2027. The new maglev line will run at a maximum speed of 505 km/h and eventually connect Tokyo with Nagoya and Osaka in 40 minutes and 67 minutes, respectively, thereby forming a gigantic commuter belt with 70 million residents.

Nationally, the integrated resort (IR) developments should be a significant tailwind for expanding tourism. Under the assumption that two urban IRs and ten regional casinos would be built, CLSA has estimated potential annual gross gaming revenue of US\$25 billion in Japan, comparable with US\$33 billion in Macau for 2017. Considering the World Tourism Organization (UNWTO) forecasts that the Asia

MAP 2 **Development in and around the bay area**



Source: Tokyo Metropolitan Government, Savills Research & Consultancy

Pacific region's international visitation will grow 65% by 2030 and IR developments are expected to take off, Japan has a good chance of achieving the government's audacious goals, namely 40 million overseas visitors and JPY8 trillion (40% of Vietnam's 2016 GDP) in their spending, not long after the 2020 target.

Macro economy

Positive macroeconomic conditions are fuelling development, and the momentum is likely to continue as the Japanese economy is on a steady growth track. In January, the International Monetary Fund (IMF) and the World Bank both made upward revisions to their GDP projections for Japan, encouraged by sound growth in 2017. The IMF projects real GDP growth of 1.2% in 2018 and 0.9% in 2019, and the World Bank's figures are similar. In the medium term, Oxford Economics forecasts a ramp-up to 0.9% in 2022 after a temporary fall to 0.5% in 2020. Considering that the Cabinet Office expects 1.7% growth

in its growth forecast it seems safer to say that approximately 1.0% growth is expected, after the Olympics.

The influence of macroeconomics on real estate can be clearly illustrated by comparing office market performance with corporate profitability trends. Historically, corporate profits have exhibited a strong correlation with overall office market performance in the central five wards (Graph 3)¹. Corporate profits rapidly recovered after a sharp drop in 2009 and reached JPY22 trillion in 2017, a JPY7 trillion increase over the pre-recession peak. Total office rental revenue shows less volatility but appears to follow corporate performance trends with some lag. Strengthening corporate performance should continue to

¹ To measure office market performance, we have used total rental revenue, which is computed by multiplying average rent by total leased space in the C5W. This performance metric shows a better correlation with corporate profits than rental levels. This is likely because strengthening corporate demand was translated into increases in occupancy rather than rental increases, especially after the recession. In this sense, total rental revenue is a more comprehensive metric.

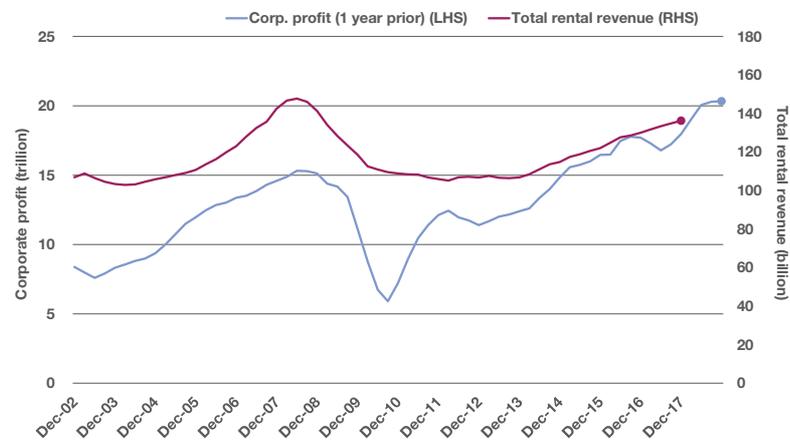
→ increase office demand, filling out new spaces and mitigating the impact of large supply in the pipeline towards the Olympics. This is also why the current office market has been robust, despite a glut of supply and the initially bearish forecast.

In addition to positive domestic economic growth, Japanese companies' overseas expansion has also improved corporate performance. Although some critics point out that the Japanese manufacturing industry's reliance on exports has made sales vulnerable to exchange rate fluctuations, many companies have started overseas operations, and sales of these offshore subsidiaries expanded from JPY165 trillion in FY2009 to JPY274 trillion in FY2015. During the same period, dividends and other fees from these overseas subsidiaries increased from JPY2.2 trillion to JPY4.5 trillion, thereby creating a large cash inflow to Japan.

Although Japan's economic growth is expected to continue as domestic and global demand levels are on a steady rise, the current domestic labour shortage could be a growth bottleneck. The workforce increased by 2.5 million over the past five years, largely due to increasing labour participation of female and elderly workers. However, as the labour participation rate of these groups is already high, there appears to be limited room for further improvement. As such, it is essential for Japanese companies to improve productivity in order to foster the country's continuing growth.

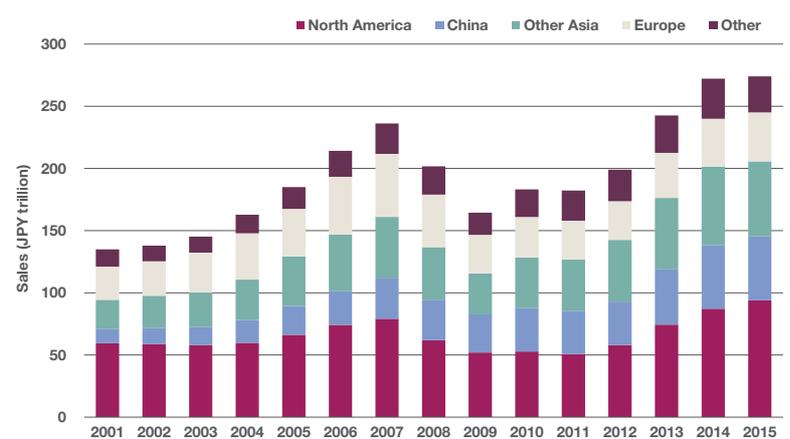
According to Japan Productivity Center, Japan's labour productivity in 2016 was US\$81,777 per person, 21st among the member countries of the OECD, an intergovernmental think-tank of developed countries, leaving much room for improvement. Leveraging the build-up of national sentiment against overwork and an increased majority in the National Diet after the snap election, Prime Minister Abe is in a good position to advance promised labour reform. If his party can swiftly recover from the recent political scandal, the government will be able to push for policy changes necessary for his promised reform. Japan's strength in robotics and automation

GRAPH 3
Total office rental revenue in the C5W and corporate profits, Dec 2002 – Dec 2017



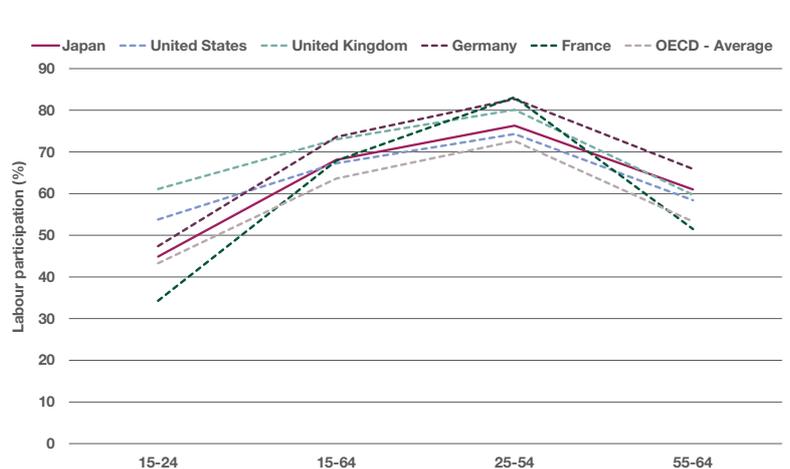
Source: Miki Shoji, Ministry of Finance, Savills Research & Consultancy

GRAPH 4
Sales of Japanese companies' overseas subsidiaries, FY2001 – FY2015



Source: MLIT, Savills Research & Consultancy

GRAPH 5
Female labour participation rate by country, 2016



Source: Organization for Economic Co-operation and Development (OECD), Savills Research & Consultancy

TABLE 1
World city ranking by population, 2014 and 2030F

City	Country	2014 (thousand)	Rank	2030 (thousand)	Rank
Greater Tokyo	Japan	37,833	1	37,190	1
Delhi	India	24,953	2	36,060	2
Shanghai	China	22,991	3	30,751	3
Mumbai	India	20,741	6	27,797	4
Beijing	China	19,520	8	27,706	5
Dhaka	Bangladesh	16,982	11	27,374	6
Karachi	Pakistan	16,126	12	24,838	7
Cairo	Egypt	18,419	10	24,502	8
Lagos	Nigeria	12,614	14	24,239	9
Mexico City	Mexico	20,843	4	23,865	10
Sao Paulo	Brazil	20,831	5	23,444	11
Kinshasa	DR Congo	11,116	15	19,996	12
Greater Osaka	Japan	20,123	7	19,976	13
New York-Newark	USA	18,591	9	19,885	14
Kolkata	India	14,766	13	19,092	15

Source: UN World Urbanization Prospects 2014 Revision, Savills Research & Consultancy

→ should also help the country alleviate labour constraints in areas such as healthcare, hospitality, and logistics.

Demographic shifts

Demographic shifts are another major driver of the real estate market. In Tokyo's 23 wards, annual population growth has been about 80,000 persons on average between 2000 and 2017. According to the Tokyo Metropolitan Government's projection based on 2015 census figures, urbanisation is expected to maintain population growth until 2025 in Tokyo Prefecture and until 2035 in the central five wards. This forecast has been revised upward from its estimate based on 2010 census figures. The majority of migrants consist of the working population in their 20s, providing a steady flow of workforce in a tightening market and ultimately resulting in increasing demand for residential property (please refer to report published in June 2017, "Tokyo residential: A new demographic wave"). Japan's fertility rate has improved and population

declines are likely to be more moderate than previously estimated. According to the United Nations World Urbanization Prospects, Greater Tokyo will remain the most populated metropolitan area in the world until at least 2030.

With the construction boom preceding the Olympics, a foreign workforce is also increasingly contributing to population and economic growth. As of June 2017, Japan has over 2.4 million foreign residents, up 22% from 2012. Over the same period, the size of the foreign workforce in the construction industry increased by 42,000, or 320%. The growth of the foreign workforce, however, is not limited to the construction industry. Between 2012 and 2017, the foreign workforce in the logistics, hospitality, and healthcare industries substantially increased. The lack of workforce in these labour-intensive industries is severe, and real estate sectors related to these industries directly benefit from an expansion of the foreign workforce.

Additionally, the Japanese government has set a goal of increasing the number of international students studying in Japan to 300,000 by 2020. As of 2017, the figure is over 267,000, suggesting that the target will be achieved. Growing demand for higher education from middle-to-high-income families in Asia is a driving force for the inflow of students. In addition to quality higher education, safety, proximity, and affordable tuition fees, some are attracted to Japan by better job prospects as many youths struggle to find jobs in their own countries (Graph 6). In the Japan Revitalization Strategy 2016, the government stated that it would collaborate with stakeholders, such as universities and corporations, to increase the share of international students who find jobs in Japan after graduation from 30% to 50%. These graduates should provide a vibrant talent pool and a source of future tax revenue.

Increases in international students should also help nurture a global mind-set and competitive spirit

→ among the Japanese youth. According to a 2017 survey by the Ministry of Internal Affairs and Communications, 70% of surveyed companies answered that talent needed for overseas projects was lacking, even though such talent has increased over the past decade. Considering the employment rate of new graduates is almost 100% in Japan, increases in foreign students could fill the gap in the workforce, rather than intensify competition with Japanese students. As such, a backlash against foreign residents as seen in western countries is less likely to occur in Japan, another reason that Japan may be an attractive option for international students.

Growing foreign population is an especially positive sign for regions where depopulation is an imminent issue. Combined with growing tourism in regional cities, an inflow of people may buoy economic conditions and trigger a positive development cycle. According to the “Chika Koji” land price report, commercial land prices in regional areas (excluding Greater Osaka and Greater Nagoya) posted the first positive growth in 25 years since 1991. In particular, station-front developments are likely to increase as the Japanese government promotes the formation of closely-knitted, “compact city networks” where urban functions such as transportation, commerce, and healthcare concentrate primarily around major train stations.

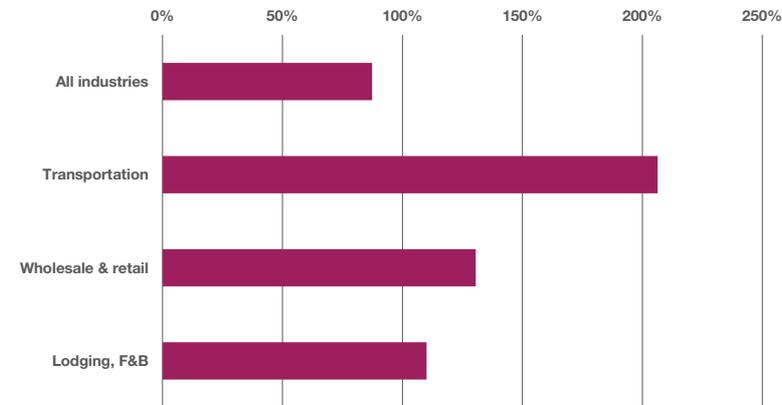
Caveats

As long as the above trends continue to sustain economic strength and real estate demand, the real estate market is likely to remain on a sound growth track. However, there are several risk factors that could threaten this growth trajectory.

Although the global economy is expected to continue its steady growth, several uncertainties, such as rising protectionism, geopolitical issues, interest rate hikes, could make the global economy recoil.

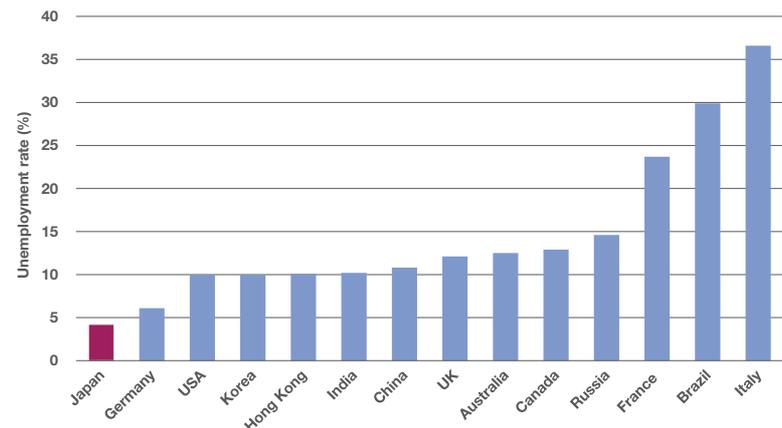
On top of the current domestic political confusion, the consumption tax hike planned for 2019 is another risk that could cause an economic slowdown as household spending might lessen.

GRAPH 6 **Increases in foreign workforce, 2012 vs 2017**



Source: Ministry of Health, Labour and Welfare, Savills Research & Consultancy

GRAPH 7 **Youth unemployment rate, 2017**



Source: World Bank, Savills Research & Consultancy

The impact on the real estate market could be substantial if a large influx of supply in the pipeline leads to a loosening of the market at the same time. However, learning from the tax hike in 2014, the government expressed its commitment to economic stimulus policies, such as reduced tax rates on certain items, which could mitigate its negative impact on the economy.

The current bullish cycle which is already extended, may continue, but a potential loosening of cap rates is another concern among market participants. Cap rates are already tight, and upward pressure on interest rates is expected to grow as central banks unwind monetary

easing. However, as discussed in our January report, “2017 Review and 2018 Prospects”, macro factors such as a growing need for stable yields from pension funds and a ballooning investment appetite in Asia should somewhat maintain downward pressures on yields. If global economic conditions remain sound and capital continues to flow into Japan, cap rates could remain tight or exhibit slight compression. ■

OUTLOOK

The prospects for the market

Since the Tokyo Olympics in 1964, Japan has experienced a rocky ride of booms and busts. Although the country has suffered from a long bout of stagnation, Japan is now once again enjoying a period of economic recovery. Corporate profits are setting new highs. Urbanisation and inflows of people from overseas are mitigating the labour shortage while driving the economy and residential demand in cities.

The Shibuya, Toranomon and Tokyo bay areas are undergoing major transformations. Infrastructural improvements such as BRT systems and the new Toranomon station will enhance accessibility of these areas. In other submarkets, Mitsubishi Estate's development in Tokiwabashi and the Roppongi

5-chome redevelopment, a massive project of over 1 million GFA, will become new landmarks in the Nihonbashi/Yaesu and Roppongi/Akasaka submarkets.

Developments are not limited to Tokyo. Major redevelopment projects are underway in Osaka, Nagoya, and Fukuoka. The completion of the new maglev line will significantly reduce travel times between Tokyo and regional cities, forming a commuter belt of 70 million residents. Expanding tourism and IRs should also benefit regional cities.

Although there are global and domestic risks that could slow down the pace of growth, current macro conditions appear to indicate that the Japanese market has solid fundamentals. Cap rates might even compress slightly if the inflow of capital continues.

Considering that real estate development is driven by long-term economic and demographic trends, the current momentum is likely to continue to 2020 and beyond. As with the 1964 Olympics, the 2020 Olympics could be the beginning of a period of long-term economic expansion.

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

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.