Japan - May 2019

SPOTLIGHT

*Savills Research*

# Osaka Real Estate: Rebirth Of A Market

# Stars aligned for Osaka revival


**Summary**

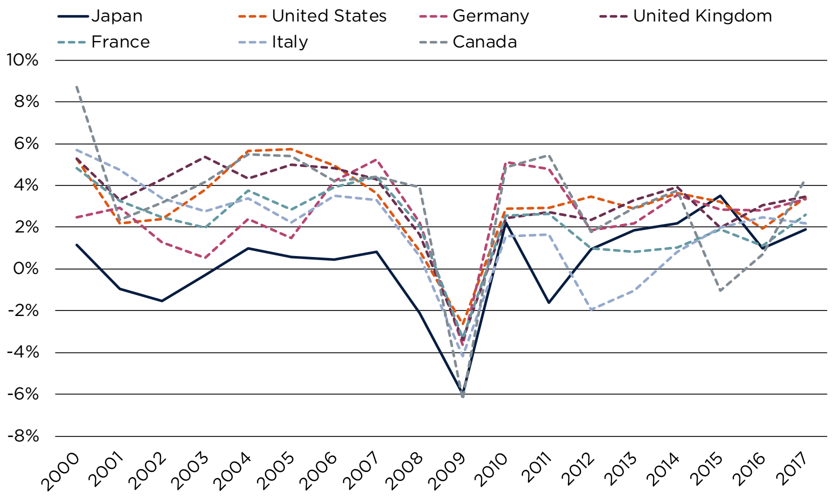
- In a world burdened with much uncertainty, Japan has seen an improvement in its economic prospects, especially relative to its global peers.
- Osaka will see multiple catalysts including the massive Umekita Project as well as infrastructure improvements, while a potential IR development and the World Expo 2025 are also expected to provide tailwinds.
- Osaka's economy is recovering after a long period of stagnation, buoying real estate demand.
- Urbanisation continues to support population growth in the city centre, firming up market fundamentals.
- External shocks from overseas, possible interest rate hikes, and a shift in the extended cycle might pose a risk to Osaka's outlook.


## INTRODUCTION

Supported by sound fundamentals, Japan's real estate market is growing strongly and showing resilience to the shifting global climate. Not so long ago, Japan was a laggard in the rapidly emerging Asia Pacific region as its economy faced a protracted stagnation through the 1990s, compounded by deteriorating demographic prospects. Japan's recovery was cut short by the Financial Crisis in 2008, and disrupted once again in 2011 by the East Japan Earthquake. Frequent changes in political leadership also exacerbated the confusion of the time: every year between 2006 and 2012, the country was led by a different prime minister. As a result, Japan Inc. had no compass to steer it in the right direction.

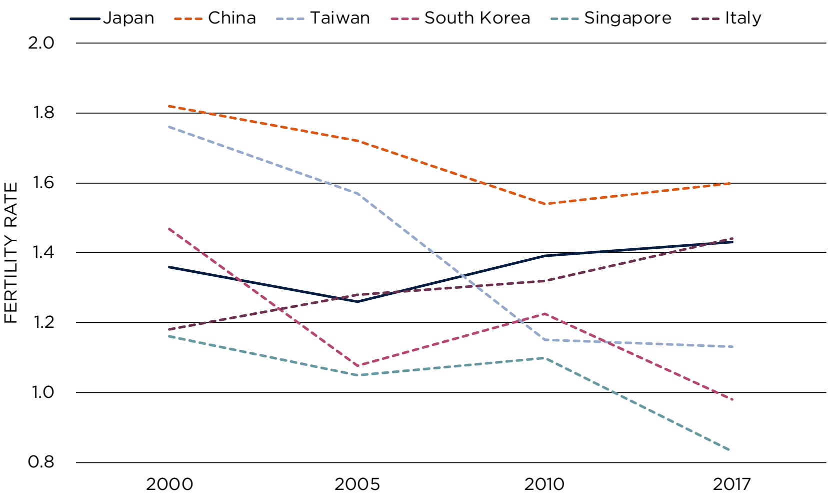
The advent of the Abe administration has triggered Japan's longest economic recovery recorded since World War II. Though this economic growth has been mild, corporate performance is constantly improving and profits are rising to an unprecedented level. Demographic factors such as urbanisation, a growing workforce in the face of a declining and ageing population, and improved fertility rates have also contributed positively to Japan's medium-term prospects. The nation's GDP per capita has recently shown stronger growth than before, especially over the last ten years, and is now in line with Western counterparts. Japan's status as the world's

**GRAPH 1: GDP Per Capita Growth By Country, 2000 to 2017**




**Source** OECD, Savills Research & Consultancy

**GRAPH 2: Fertility Rate By Country, 2000 to 2017**




**Source** Central Intelligence Agency, Statistics Korea, Ministry of Health, Labour and Welfare, Savills Research & Consultancy
*The latest figure exhibited for South Korea is for 2018.

largest creditor for almost three decades, with international investment income equivalent to 3% to 4% of GDP, supports its economic and currency stability. With these positive forces at play, Japan Inc. has started to show its potential and international investors are taking a renewed interest. Notably, as other major economies have begun looking inward, Japan has become one of the major champions of free trade, demonstrating its role as a global leader in some areas.

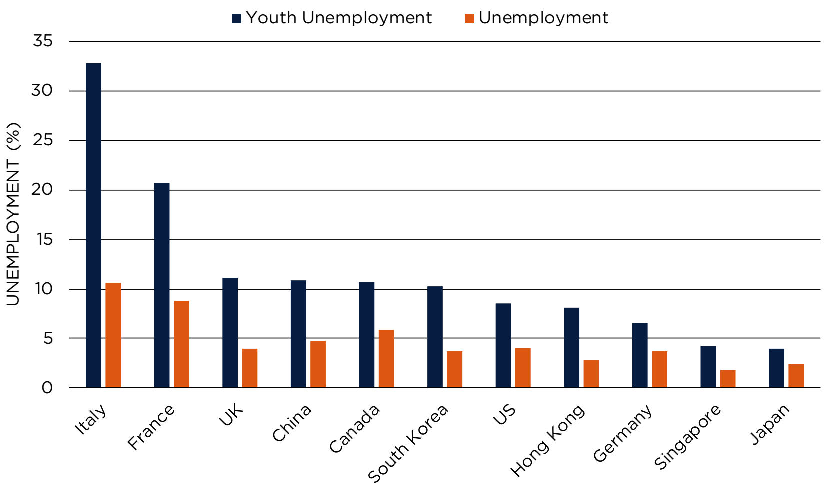
To be sure, Japan's recent pace of growth is by no means spectacular. Its population is ageing and declining, though at a more moderate pace than originally expected. Even so, the nation's political and economic stability appears to have drawn investor interest in an increasingly uncertain world. In recent years especially, major Western economies have faced political or economic difficulties, while some neighbouring countries in Asia have experienced slowing growth rates, rapidly ageing populations combined with lower fertility rates than Japan, and high youth unemployment. This shifting landscape may be an opportunity for Japan as its conditions look more attractive compared to ten years ago. As many perceive that the current cycle is well-extended and seek downside protection, the country's resilience and defensive nature appeals to a large cohort of investors, particularly those interested in core-type investments.

Osaka in particular is in a unique position to leverage the nation's ongoing growth as a series of events including the Rugby World Cup 2019, a potential integrated resort (IR) development, and the World Expo 2025 could provide strong tailwinds for inbound tourism - a key driver of Osaka's recovery. In just the last six years, the number of inbound visitors to Osaka Prefecture has surged from 2 million to 12 million[1]. Exponential growth in tourist numbers and their spending has resulted in strong retail performance and rapid hotel development.

More recently, this tourism-led momentum appears to be spreading further into other sectors of the region's real estate market. Developments at the station front and in the bay area are creating new landmarks, which should facilitate various commercial activities. Corporate demand for office space is strengthening, driving extremely tight vacancy and robust rental growth. Moreover, as represented by the recent sale of the most expensive condo in Kansai since 2001, as well as slated openings of luxury international hotels in Osaka and neighbouring prefectures, a positive economic environment appears to be facilitating the emergence of upscale markets in the residential and hospitality sectors. As Japan transitions from Heisei to Reiwa, the beginning of a new

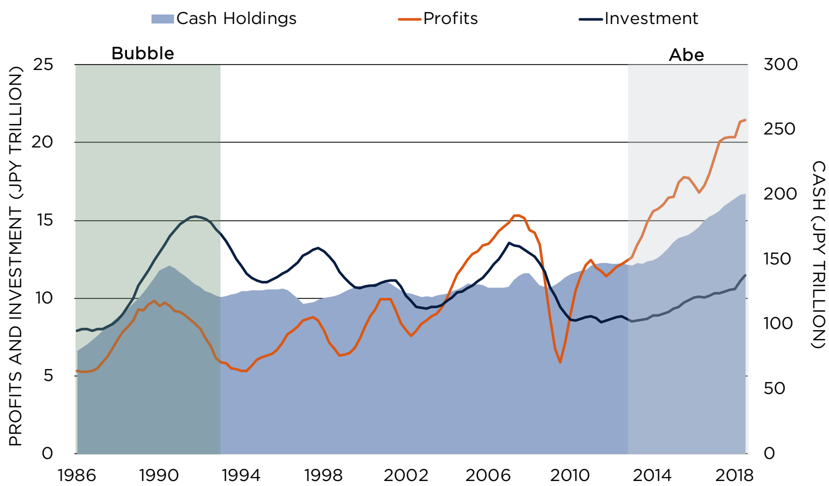
**As economic and political uncertainty remains elevated in many parts of the world, Japan stands firm. The nation's political and economic conditions have improved over the past ten years and fundamentals are especially strong in major cities. With a series of high-profile events in the pipeline, Osaka is in a unique position to take advantage of increasing investor interest.**

**GRAPH 3: Total And Youth Unemployment Rates By Country, 2018**




**Source** World Bank, Savills Research & Consultancy

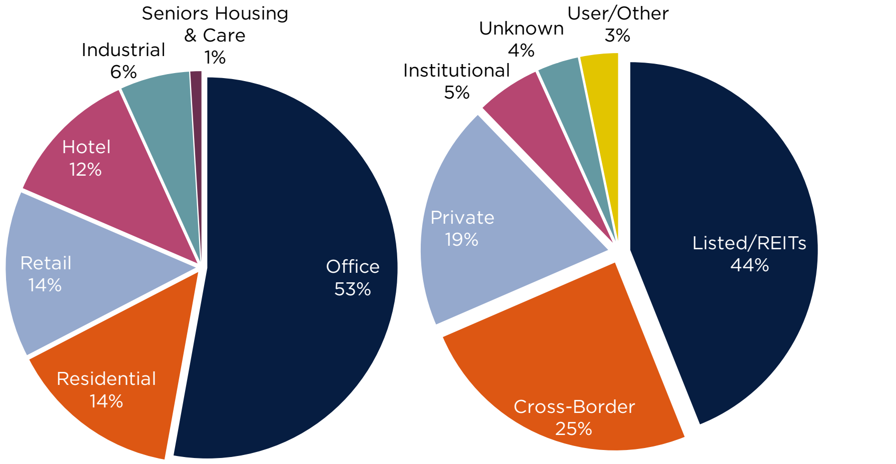
**GRAPH 4: Trailing-four-quarter Corporate Profits, Investment, And Cash Holdings, 1986 to 2018**




**Source** Ministry of Finance, Savills Research & Consultancy

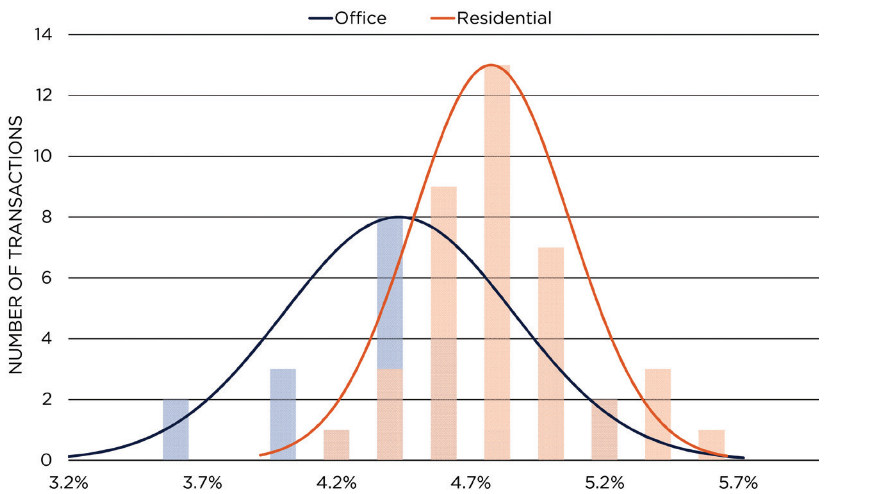
1 As of the report date, the estimate for 2018 ranges from 11.6 to 12 million visitors.

**GRAPH 5: Greater Osaka Transactions By Sector And Investor, 2016 to 2018**




**Source** RCA, Savills Research & Consultancy

**GRAPH 6: J-REIT Transaction Cap Rates For Office And Residential Assets, 2016 to 2018**




**Source** J-REIT disclosures, Savills Research & Consultancy

imperial era could mark Osaka's departure from its past and open a new chapter in the city's growth story.

## Osaka Investment Overview

In light of sound fundamentals combined with limited acquisition opportunities in Tokyo, Osaka attracts investor interest from both domestic and international players. The latest Urban Land Institute investor survey indicates that Osaka, along with Tokyo, is now among the top five markets in Asia Pacific for real estate investment. On top of Japan's attractive yield spread owing to low borrowing costs, Osaka's yield premium over Tokyo makes the city even more enticing for many investors.

Based on data provided by Real Capital Analytics (RCA), transaction volume in Greater Osaka between 2016 and 2018 registered at JPY1.3 trillion or about 10% of total transaction volumes in Japan. Although Greater Tokyo claims the lion's share at 68%, the market size of Greater Osaka is still about 1.7 times larger than the combined total of Greater Nagoya and Greater Fukuoka, which are the third and fourth largest markets, respectively.

The office sector makes up more than 50% of all transactions in Greater Osaka while the residential and retail sectors each account for 14%. Although domestic investors such as J-REITs dominate, overseas investors are also active in the market. To list a few examples from 2018, Blackstone Group acquired the Edobori Center Building for a rumoured JPY15 billion while LaSalle Investment Management acquired Midosuji Front Tower for JPY14 billion. GreenOak Real Estate also acquired Takeda's headquarters in Osaka as part of a 21-property portfolio.

## Development Trends

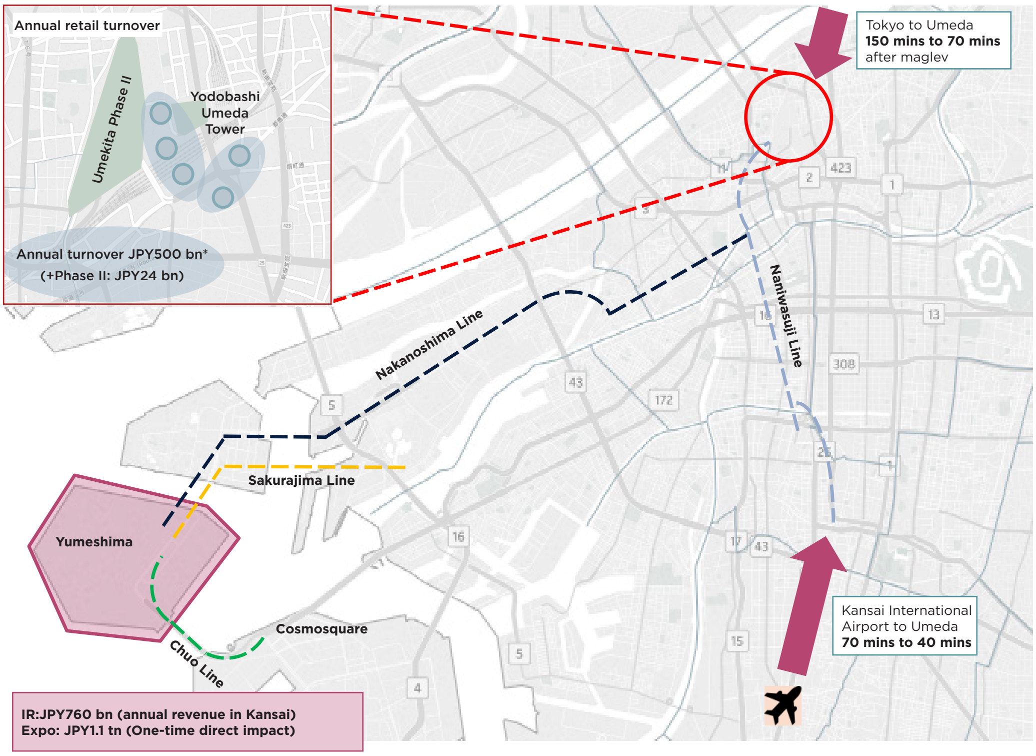
Multiple development projects are taking place across Osaka and revitalising the local real estate market. While the Umekita development continues to fuel the evolution of the highly-concentrated station-front district, preparations for a potential IR development and the World Expo 2025 are creating new opportunities in the bay area. Furthermore, the improvement of transportation infrastructure will enhance connectivity within the city and should have a positive impact on property performance.

Umekita Phase II, slated for completion in 2023, is expected to feature towers with office, retail, and residential components developed across 140,000 sq m of land. Despite the site's prime location, it is currently vacant and therefore presents a massive opportunity for growth. Umeda's station-front area is already an established retail centre with Hankyu Umeda, a department store that boasts the second largest revenue in Japan after Isetan Shinjuku, and other major stores generating revenues of approximately JPY500 billion a year in the compact district (Map 1). Phase I of the Umekita Project - "Grand Front Osaka" - the latest addition to the Umeda area, has increased sales since its opening in 2013 and recorded JPY47 billion in revenue for the 2018 fiscal year. Considering the scale of Phase II compared to that of Phase I, total revenue of the whole Umekita project could eventually exceed JPY70 billion[2]. In the case of Grand Front Osaka, diverging leasing strategies among the twelve-company consortium made it difficult to adequately pre-lease space by initial launch. Vacancy in Umeda subsequently rose to almost 10% as the project came online. However, Phase II stakeholders appear to be adopting a more united leasing strategy which, along with the current favourable market, is alleviating concerns of a similarly haphazard start. Facilities such as Hanshin Umeda and Yodobashi Umeda are also undergoing large-scale changes.

Development is not limited to Umekita. Yumeshima Island, an artificial island that started being reclaimed in 1977 with the audacious aim of creating a new urban hub, is the proposed site of a possible IR development and will host the World Expo in 2025. As the initial development project for the reclaimed land was stalled after the asset bubble burst, the island came to represent Japan's lost decades. With its new role as a stage for world-class developments, however, the island is becoming a symbol of Osaka's revival. An extension of the subway line between Yumeshima Island and Cosmo Square is also back on the table after the project was called off following Osaka's unsuccessful campaign to host the 2008 Olympics. There is currently no train station in Yumeshima; as such, planned extensions of train lines to the island are essential for successful development of the bay market (Map 1).

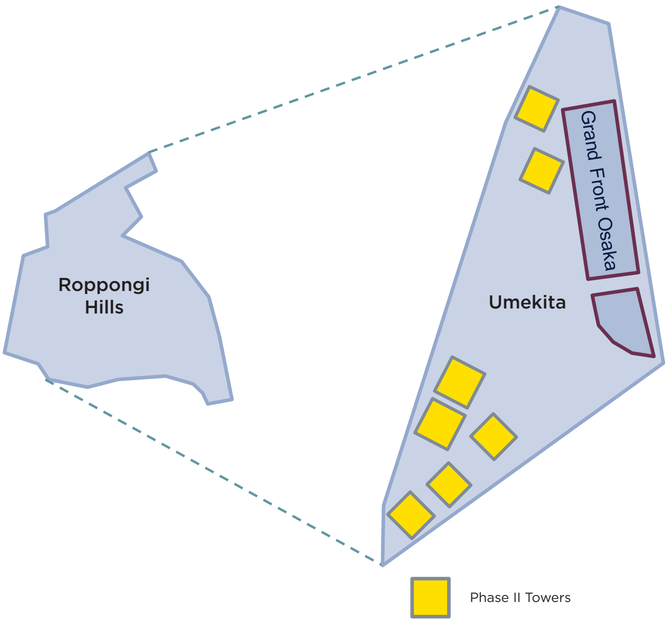
2 Retail revenue of Grand Front Osaka was about JPY586,000 per sq m in 2017/2018. Assuming that total retail space of Umekita Project amounts to about 122,000 sq m after the completion of Phase II, total revenue is estimated to be JPY71.5 billion.

**MAP 1: Osaka Development At A Glance***




**Source** Corporate disclosures, news articles, Osaka Prefecture, METI, Savills Research & Consultancy
*Sales of major retail shops including Hankyu Umeda, Daimaru Umeda, Hanshin Umeda, Grand Front Osaka, and Lucua Osaka. Hankyu Umeda, Daimaru Umeda, Hanshin Umeda, and Grand Front Osaka are for FY2018. Sales of Lucua Osaka is for FY2016. Hanshin Umeda is undergoing reconstruction in phases: Phase I started operation in June 2018 and aims to have sales of 42 billion yen in the first year.

**MAP 2: Roppongi Hills Vs Umekita**



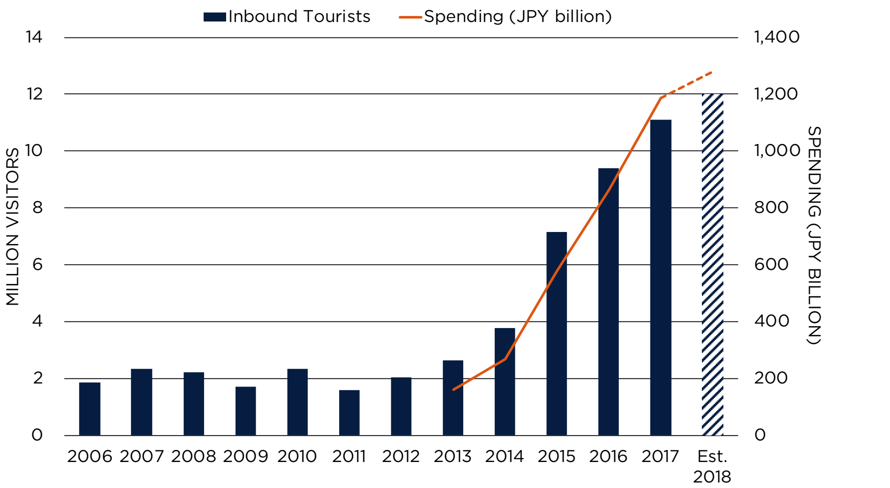

**Source** Savills Research & Consultancy

Likewise, the improvement of transportation infrastructure should vitalise Osaka and its surrounding prefectures. Completion of the new Umekita Station in 2023 and of the Naniwasuji Line in 2031 is expected to shorten the travel time between Osaka Station and Kansai International Airport by as much as 30 minutes. Further out, the new maglev bullet train will significantly improve connectivity between Osaka and Tokyo and create an enormous commuter belt.

## MACRO ECONOMY

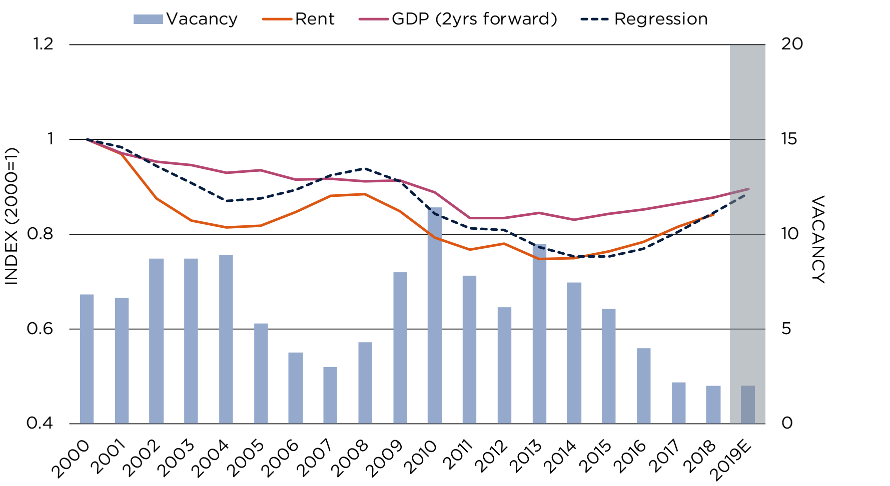
A recovery in economic conditions is one of the factors driving development across the city and improving market dynamics. In recent years, Osaka's economy has enjoyed - and will likely continue to enjoy - a windfall from rising inbound tourism (Graph 7), owing to the city's proximity to other parts of Asia and an abundance of tourist attractions including those in neighbouring prefectures like Kyoto and Nara. Significant growth in the number of low cost carrier routes is another factor. Unlike Narita and Haneda, which are close to full capacity, Kansai International Airport's flight traffic is still at about 80% of its capacity (230,000 departures/arrivals), thereby leaving room for increases in visitation. Furthermore, notwithstanding natural disasters in 2018, the Osaka market

**GRAPH 7: Number Of Inbound Tourists To Osaka And Their Spending, 2006 to 2018***




**Source** Osaka Prefectural Government, Savills Research & Consultancy
*The spending figure in 2018 was estimated based on spending per person in 2017 and the estimated number of inbound tourists in 2018.

**GRAPH 8: Umeda Office Performance vs Osaka City GDP, 2000 to 2019E***




**Source** Miki Shoji, Osaka City, Savills Research & Consultancy
* The model result for 2019E was computed for illustrative purposes using the 2017 GDP figure and the 2018 vacancy rate.

showed resiliency and experienced a quick recovery with a preliminary estimate for the year by the Osaka Convention & Tourism Bureau showing sound growth of inbound tourism from 11 million in 2017 to about 12 million in 2018. Total spending by inbound tourists in Osaka Prefecture exceeded JPY1 trillion in 2017, having a wide impact on the real estate market, particularly in the hospitality and retail sectors.

According to estimates made by the Osaka Prefectural Government, an IR could draw 25 million people and generate annual spending of JPY760 billion in the Kansai region. Major casino operators from around the world visit Osaka regularly to explore avenues for capitalising on this potential opportunity, a testament to the very high level of expectation. Further, the World Expo is expected to attract 28 million people, with the Ministry of Economy, Trade and Industry (METI) projecting that the direct economic impact of the event could be about JPY1.1 trillion. Likely reflecting upside potential from planned developments, the recent national land value survey (Chika Koji) indicated that land price growth turned positive, and residential development projects in the area are progressing.

Osaka is also promoting the health sciences industry as a catalyst for future growth. The Kansai region boasts a high concentration of biomedical institutions and corporations, including the Center for iPS Cell Research and Application (CiRA) led by Professor Shinya Yamanaka, a Nobel Laureate, and Saito Life Science Park, a regional medical cluster. The Osaka government is keen on strengthening its position in this field and is initiating the collaboration of public and private counterparties through the development of new, high-tech facilities. For instance, the redevelopment project in Nakanoshima consists of a 200,000 sq m medical tower and a 300,000 sq m R&D tower, which should enable smooth collaboration between research and practice, while the Umekita Project should also facilitate the further concentration of medical companies and research institutions in the area. Considering the growth potential of this field and total support from the government, life sciences are likely to play a major role in the future growth of the Osaka economy.

Economic strength has a direct impact on real estate market performance, as evidenced by the correlation between Osaka City's GDP and Umeda's office trends. According to the Osaka City Government, the city's real GDP has generally been growing since FY2009, and preliminary estimates for FY2016 and FY2017 show sound growth of 1.6% and 1.9%, respectively. Average office rents in the Umeda submarket have recorded growth since 2014, generally tracking the city's GDP growth trend with a two-year lag. Although other submarkets appear slower to respond to the economic recovery, rental growth is spreading beyond the top submarket to a wider area in recent years (please see the April 2019 Regional Japanese Office Markets spotlight). If economic growth and development continue to evolve in tandem, as envisioned by the Osaka government and Osaka Inc., the real estate market could further benefit, thereby possibly extending the investment window.

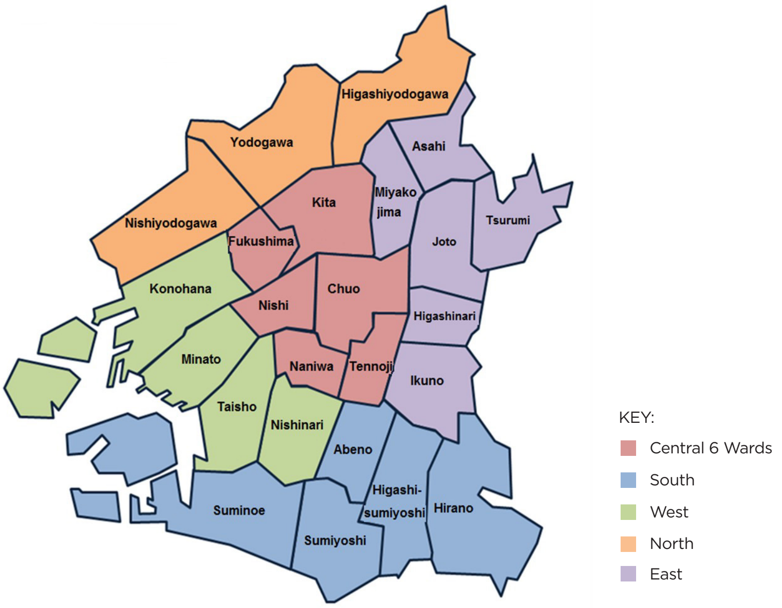
## Demographic Trends

In addition to improving economic conditions, an inflow of population into the convenient and accessible city centre is creating a positive market-driving force. This urbanisation trend has become more pronounced since the turn of the century, and the population of Osaka's central six wards (C6W) increased by almost 50% between 2000 and 2018. Continuing population growth shows that the current trend is stronger than expected as the National Institute of Population and Social Security Research (NIPSR)[3] had forecast a decline between 2015 and 2020. According to the United Nations, Greater Osaka, with a population of 20 million, was the seventh largest metropolitan area in the world as of 2015 and is forecast to remain among the top regions in 2030.

The impact of the urbanisation trend on the residential market becomes apparent when examining condo construction data. Graph 10 exhibits condo construction volumes in Osaka City and its share in the Kansai region. Although Osaka City's share was generally stable until 2010, at between 20% and 30%, the figure has since

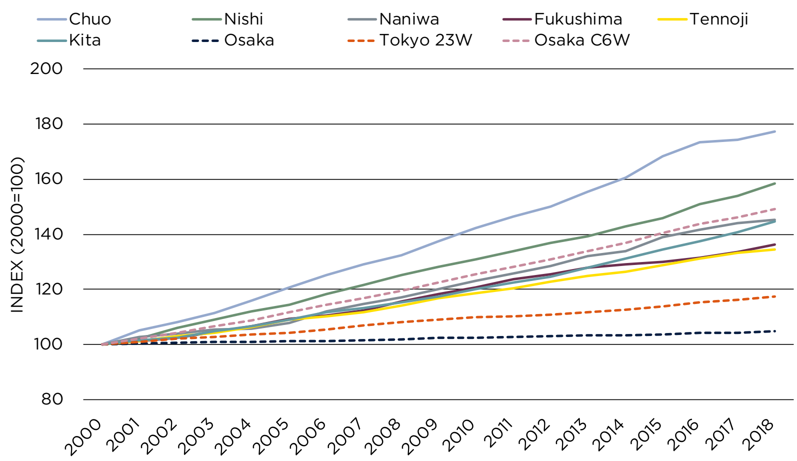
3 Based on the 2015 national census, NIPSR forecasted a population decline of 1.7% between 2015 and 2020. As of 2018, Osaka's population has increased by 1.3% compared to 2015.

**MAP 3: Osaka Submarket Map**



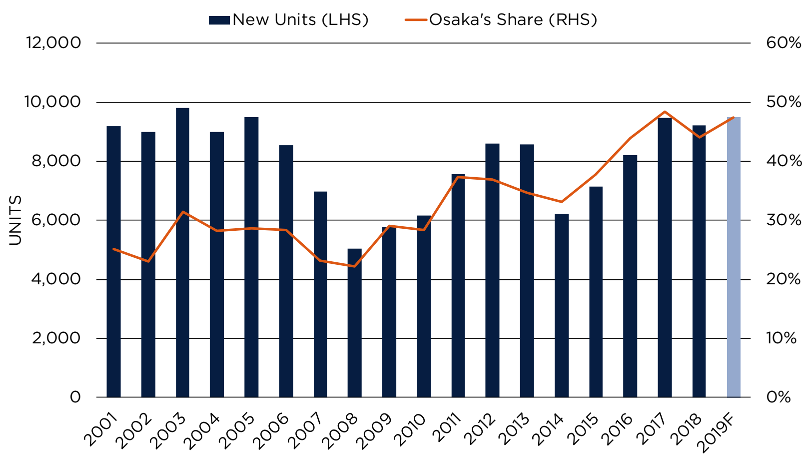

**Source** Savills Research & Consultancy

**GRAPH 9: Demographic Trend Of Osaka City, C6W, And Tokyo's 23W, 2000 to 2018**




**Source** Tokyo Metropolitan Government, Osaka City, Savills Research & Consultancy

**GRAPH 10: Osaka City's New Condo Units And Share In The Kansai Region, 2001 to 2019F**




**Source** Haseko Research Institute, Savills Research & Consultancy

significantly increased, nearing 50% in recent years. This is indicative of strong and resilient residential demand in Osaka City, which has proven less vulnerable to an economic shock than other areas in the region.

Demographic growth should also benefit commercial assets, such as retail facilities and offices, as population density tends to improve commercial productivity due to factors such as proximity to clients, high demand density, and efficient labour allocation. According to the 2015 census, daytime population densities in Chuo, Kita, and Nishi were comparable with those of Tokyo's central wards (Table 1). Indeed, according to the 2016 economic census, retail sales in Osaka City were the second largest among major cities - even surpassing Yokohama, a more populous city (Table 2).

Continuing migration to Osaka combined with economic growth and development might open up a new market for real estate investors. For instance, the aforementioned Umekita Phase II project is also expected to feature luxury condos targeted at high-net-worth individuals. The recently reported sale of Branz Ashiya The Residence in Hyogo for JPY500 million, the highest price for a new condo sold in Kansai since 2001, might indicate a nascent luxury trend for the Kansai residential market. Average income levels have been improving at a moderate pace in Osaka City since 2011[4], which could also increase demand for upscale residences.

## CAVEATS

As in Tokyo, real estate performance in regional markets is also influenced by broader macroeconomic conditions. As such, it is important to discuss the current state of the Japanese and global economy and identify factors that are likely to affect the direction of the Osaka market.

First, signs of a global economic slowdown are mounting. The International Monetary Fund has adjusted its outlook for global growth downward to its lowest rate since the Financial Crisis, and the Bank of Japan has voiced concerns over the impact of trade tensions between the US and China on the nation's regional economies. If the global economy truly starts contracting, Osaka could lose its momentum and the real estate market might reverse its bullish trend. This is especially concerning considering inbound tourism has partly driven Osaka's growth. However, the slowing Chinese economy, which has been weighing on the global economy, might turn around as fiscal stimulus kicks in, providing some breathing room.

Second, in the medium to long term, interest rates could edge up as there have been indications of tapering, both globally and domestically. The side effects of powerful monetary policy are also threatening the

4 According to the National Tax Agency, taxable income per tax payer in Osaka City increased by 6% from 2011 to 2017.

**TABLE 1: Daytime Population Density, 2015**

| AREA | DAYTIME POPULATION DENSITY (SQ KM) |
|---|---|
| Chiyoda (Tokyo) | 73,162 |
| Chuo (Tokyo) | 59,609 |
| Chuo (Osaka) | 51,246 |
| Minato (Tokyo) | 46,185 |
| Shinjuku (Tokyo) | 42,566 |
| Kita (Osaka) | 39,761 |
| Shibuya (Tokyo) | 35,679 |
| Nishi (Osaka) | 33,941 |
| Naka (Aichi) | 32,284 |
| Toshima (Tokyo) | 32,063 |

**Source** National Census, Savills Research & Consultancy

**TABLE 2: Retail Sales By City, 2015**

| CITY | RETAIL SALES (JPY BILLION) |
|---|---|
| Tokyo 23W | 15,077 |
| Osaka City | 4,578 |
| Yokohama City | 4,012 |
| Nagoya City | 3,476 |
| Sapporo City | 2,290 |
| Fukuoka City | 2,140 |
| Kobe City | 1,869 |
| Kyoto City | 1,830 |
| Sendai City | 1,491 |
| Hiroshima City | 1,463 |

**Source** Economic Census, Savills Research & Consultancy

financial sector. In the short term, however, central banks are taking a cautious view on economic conditions and becoming somewhat dovish. Furthermore, the plentiful cash holdings of Japanese companies and households suggest limited demand for additional capital.

Third, the planned consumption tax hike in October, which will be implemented during an extended upward phase of the cycle, could cause an economic contraction. Considering that the last tax hike severely disrupted the domestic economy, investors cannot be too optimistic about the impact. However, the government intends to implement various stimulus measures to reduce the effect on consumption. If economic conditions remain favorable, the Japanese economy may be able to push through.

## OUTLOOK

As the Japanese economy maintains its steadiness and resiliency, positive trends are appearing across major cities in the country. Metrics such as GDP, corporate profits, workforce growth, and fertility rates indicate a clear improvement in the nation's outlook compared to ten years ago. In the face of increasing political and economic uncertainty, Japan may remain a pillar of stability among global peers. As many investors perceive that the global economy is late in the cycle, Japan's sound fundamentals and defensive nature are now even more appealing.

Osaka in particular has an abundance of major growth catalysts over the next half decade. Development opportunities may arise as the Umekita project transforms the station-front market, while an IR development and the World Expo have begun to attract investment in the bay area. Socio-economic trends supporting Osaka's real estate market are well-rooted and should drive long-term growth. Furthermore, the long-awaited improvement of the local economy is underway and appears to be creating a favourable environment for the real estate market. Population growth in the central area is also bolstering property demand in central Osaka.

In terms of transaction volume, Greater Osaka is the second largest real estate market in Japan. As such, the region is unsurprisingly attracting interest from both domestic and overseas investors, especially now as investment opportunities are extremely limited in Tokyo. As Osaka has come under the global spotlight, anticipation for the market has risen. With various metrics signalling improvement, the city might be gearing up for a phenomenal turnaround from nadir to zenith.

That being said, these positive changes have only recently materialised. If economic fundamentals weaken, the city may not be able to fully capitalise on the opportunities discussed in this report. Development in the bay area might offer growth potential; however, the feasibility and timing of an IR development is still indefinite and any hiccup along the way could cloud investment prospects. Investors should adopt a somewhat cautionary approach while weighing upside potential.

For more information about this report, please contact us

**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