Residential

Q2/2011

"Mid-market residential fundamentals remained solid in Q2/2011 as tenant demand continues to focus on good-quality assets in central locations. Dampened business and consumer sentiment as a result of the Great East Japan Earthquake, will however, place pressure on the upper end of the market in the near term."

Image: World City Towers, Minato Ward, Tokyo

- Average asking rents for modern residential units in Tokyo's core eight wards fell marginally in Q2/2011 after recording an increase of 0.5% in the first quarter. On average, rents stood at JPY3,967 per sq m per month, reflecting a 0.8% decline year-on-year.
- Five wards recorded declines in the second quarter; the most significant equating to 3.8% in Minato, Tokyo's second most expensive ward.
- In contrast, Tokyo's first and third most expensive residential submarkets – Shibuya and Meguro Wards – saw asking rents increase by 1.0% and 1.4% respectively over the preceding quarter.
- The average occupancy rate of J-REIT residential assets in Tokyo's core eight wards stood at approximately 95%. This reflects a 100 basis-point decline from the previous quarter.
- The largest change in occupancy rates at the ward level occurred in Chiyoda, which saw a 370 basis point fall to 94.7%. Elsewhere, an increase of around 200 basis points was recorded in Meguro and Setagaya, taking them to approximately 97%.
- Average asking rents for luxury residential units in central Tokyo averaged JPY5,020 per sq m per month – approximately 21% higher than the mid-market rental average. This premium could tighten in the near term as a result of subdued post-quake sentiment, particularly amongst the expatriate community.

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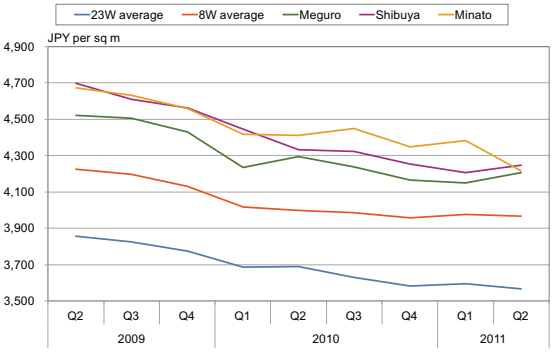
Tokyo residential leasing market overview

Asking rents for modern residential units[1] in Tokyo's core eight wards[2] recorded a marginal fall of 0.3% in Q2/2011 from the preceding quarter. This follows a 0.5% increase in Q1, when average rents rose for the first time in over two years. On average, rents stood at JPY3,967 per sq m (JPY13,114 per tsubo) per month, reflecting a decline of approximately 0.8% over the previous year.

Whereas just two of the core eight wards experienced rental depreciation between January and March, five wards recorded declines in the second quarter of the year. The most significant quarterly fall in average monthly rents equated to 3.8% and occurred in Minato Ward, Tokyo's second most expensive residential submarket. This can be attributed to a reduction in the asking price of larger one-bedroom units as landlords discount in the face of increased availability, as well as a decrease in the number of new or recently completed two-bedroom units as a proportion of available stock. Rental declines in the other four wards ranged between a nominal 0.3% and 0.7%.

Average residential asking rents, Q2/2009–Q2/2011



Source: Chintai, Savills Research & Consultancy

In contrast to the rental decline witnessed in Minato, asking rents in Shibuya and Meguro wards – Tokyo's first and third most expensive residential submarkets – recorded a quarterly increase of 1.0% and 1.4% respectively. In the former, healthy demand for single-tenant accommodation resulted in a notable drop in the number of one-bedroom units available for lease. This acted to bolster rental levels in this subcategory, off-setting a reduction in average asking rents for larger two-bedroom apartments.

1 Rental data has been complied by Savills using more than 16,000 leasing comparables published separately by Chintai, a major Japanese residential leasing broker. Selection criterion for the comparables is limited to assets of less than 100 sq m of net floor space, under ten years old and within ten minutes' walk of the nearest station.

2 Bunkyo, Chiyoda, Chuo, Meguro, Minato, Setagaya, Shibuya and Shinjuku Wards.

In Meguro, a decrease in the number of available one-bedroom units similarly provided an uplift to asking rents in that subcategory, while two-bedroom units also witnessed a rise in average rents per sq m of floor space.

Although the rental trend for mid-market residential assets in central Tokyo is considered to be largely unaffected by the Great East Japan Earthquake of 11 March, news of soil liquefaction at several reclaimed sites around Tokyo Bay have had a negative impact on demand in isolated areas. Both the owner-occupier and rental markets are reported to have been hit hard in the affected coastal districts, which include Ichikawa and Urayasu in Chiba Prefecture – the latter being famous for the Tokyo Disney Resort. Conversely, however, popular inland residential areas of Chiba and the outer wards of Tokyo are expected to benefit as occupier demand shifts to nearby locations undisrupted by the phenomenon. One example of this is Edogawa Ward, located to the immediate west of Urayasu City. The average asking rent here remained steady during the second quarter, supported by enhanced demand for one-bedroom apartments to facilitate short-term relocations.

Tokyo residential occupancy rates

Although reliable tenancy data remains limited for the Japanese residential market as a whole, analysis of J-REIT-owned assets can provide a useful benchmark with which to gauge general occupancy levels. While it should be noted that J-REIT data is slightly biased towards higher grade residential assets, the trends highlighted are considered to closely mirror those of the wider mid-market.

In Q2/2011, the average occupancy rate for J-REIT-owned properties in Tokyo's 23 wards stood at approximately 95%. This reflects a 100 basis-point decline from the previous quarter, when levels reached their highest in over two years. The average occupancy rate for Tokyo's core eight wards, where the majority of the REIT portfolio is located, fell by 90 basis points over the previous quarter to 95.1%. The largest change in total occupancy at the ward level occurred in Chiyoda, falling approximately 370 basis points over the three-month period to 94.7%. The ward, which is better known as an office and commercial district, is believed to have witnessed the modest reduction partly as a result of foreign executives relocating outside of Japan in the wake of the March earthquake.

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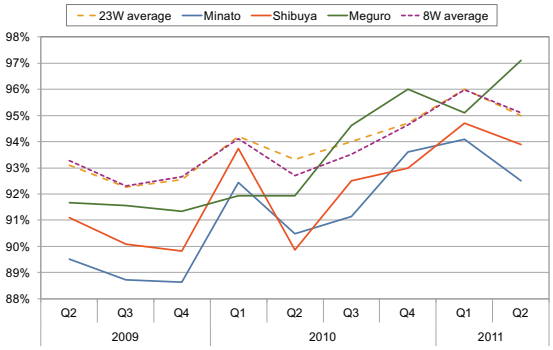
To the north of Chiyoda is Bunkyo Ward, where residential occupancy levels similarly slipped 350 basis points to approximately 95.2%. While slight declines were recorded by a number of properties, a fall in occupancy of around 10% at two properties owned by Advanced Residence Investment Corporation (ARI) in the Korakuen and Sengoku districts was the major contributing factor.

In Tokyo's three most expensive wards, average occupancy levels demonstrated diverging trends through the second quarter. Minato Ward recorded a dip in occupancy equivalent to 160 basis points, bringing its average rate down to 92.5%. This is considered to reflect a drop in demand from the expatriate community, which represents a strong driver of the mid-to-upper end of the market in the ward. Shibuya's average occupancy level demonstrated a more nominal fall of 80 basis points to stand at 93.9%. Meguro Ward, however, saw its average rate of occupation strengthen by 200 basis points to 97.1%. This can be largely attributed to a strong performance by several assets owned by ARI.

Average occupancy rates for J-REIT residential assets, Q2/2009–Q2/2011



Source: J-REITs*, Savills Research & Consultancy

Nippon Accommodations Fund, FC Residential, Advance Residence (including the former Nippon Residential Fund portfolio), Heiwa Real Estate REIT and Orix J-REIT

In Setagaya Ward, a popular residential area located within convenient commuting distance from the business districts of central Tokyo, REIT-owned residential properties also demonstrated a healthy increase in occupancy rates. On average, these increased by 220 basis points over the previous quarter to 97.0%. Three assets separately owned by Heiwa Real Estate REIT (HFR) and ARI witnessed particularly healthy demand, with occupancy levels rising between approximately 8 and 11 percentage points.

Tokyo luxury residential market update

Savills collates rental data for over 200 luxury residential properties located within nine wards in central Tokyo. The survey area is defined as the core eight wards with the addition of Shinagawa Ward. The luxury assets are required to satisfy the following criteria: 1) each unit has over 100 sq m of net leasable area; 2) the building should be less than ten years old; and 3) the properties must be located within ten minutes' walk of the nearest station(s).

According to our survey, the average monthly asking rent for luxury units in the nine wards was JPY5,020 per sq m (JPY16,592 per tsubo). This is approximately 21% higher than the average asking rent for mid-market properties as detailed above. No properties were marketed in Setagaya Ward fitting our definition of a luxury residential unit in Q2/2010, reflecting the limited supply of higher-end stock in the submarket. When looking at the remaining eight wards, quarter-on-quarter rental change equated to a nominal fall of 0.5%. It should be noted that this does not take into account incentives provided to new tenants, which can often include a rent-free period of one or two months. Market sentiment suggests that such incentives have increased in recent months as landlords compete to secure tenants in the face of softening expatriate demand.

The most expensive ward remained Shibuya, where asking rents rose approximately 2% over the previous quarter to JPY6,200 per sq m (JPY20,350 per tsubo) per month. This equates to a rental premium of approximately 18% over the luxury residential rental average and can be attributed to several prestigious residential districts within the ward. These include Daikanyama, Hiroo and Omotesando, which are popular with both high-wealth domestic and foreign residents alike. Overall, the Daikanyama submarket commands the highest average asking rent at an estimated JPY8,300 per sq m (JPY27,440 per tsubo) per month, which is some 40% higher than the central Tokyo average. This figure can be attributed to Sumitomo Realty & Development's one-year-old La Tour Daikanyama scheme, where available units include a one-bedroom apartment totalling approximately 500 sq m and marketed at over JPY5 million per month.

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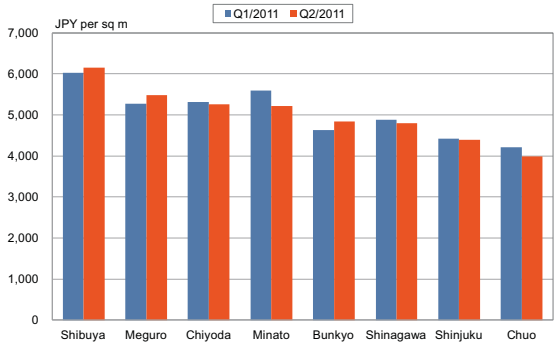
Tokyo luxury residential average asking rents by ward, Q2/2011 vs Q1/2011



Source : Tokyo Living, Savills Research & Consultancy

Following a rise of approximately 4% quarter-on-quarter, Meguro has moved from fourth to the second most expensive ward in terms of average luxury residential asking rents. High-end assets here are located between Ikejiri-ohashi and Naka-meguro stations in areas such as Higashiyama or in close vicinity to JR Meguro Station. The average rent for the ward in the second quarter was JPY5,480 per sq m (JPY18,116 tsubo). Minato Ward, where luxury residential demand is more focused on the expatiate community, saw notably different movement in the second quarter. Asking rents here fell on average 6.6% to approximately JPY5,230 per sq m (JPY17,290 tsubo) per month. Given that incentives are believed to have increased during the months following the Great East Japan Earthquake, the discount in terms of effective rents is likely to be comparatively larger.

As noted in our Q1/2011 report, the fundamentals of the luxury residential market are expected to be more seriously affected by the natural disasters of March than the mid-market. Rather than physical damage, this relates to negative sentiment stemming from the earthquake and more particularly the ongoing situation at the Fukushima Daiichi nuclear power plant. Anecdotal evidence suggests that an increased number of foreign executives are opting to repatriate their families over the school vacation period. This will, in turn, place downward pressure on occupancy levels, especially in larger units. While this is likely to induce landlords to increase incentives and reduce effective rents in the near term, some operators may elect to keep units vacant rather than cut rental levels so as not to impair the book values of their properties.

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