

Briefing Residential leasing

Q4 2013



Image: Moto-Azabu/Roppongi, Minato Ward

SUMMARY

Tokyo's affordable mid-market rents and positive demographics mitigate near-term rental downside; the improved economic outlook meanwhile offers some upside potential.

- Tokyo Prefecture's population totalled 13.3 million as of 1 December 2013, up 0.5% year-on-year (YoY). Reflecting the trend towards centralisation, the total number of households grew by 0.9%.
- Housing construction starts in Tokyo Prefecture totalled 144,562 units in 2013, 2.6% higher than 2012.
- Following a marginal annual decline of 0.4% in 2012, average mid-market apartment rents remained flat in 2013 as a whole.
- As of Q4/2013, rents in Tokyo's 23-ward area stood at JPY3,556 per sq m (JPY11,755 per tsubo), steady quarter-on-quarter (QoQ).
- Rents of Tokyo's core-eight residential wards averaged JPY3,895 per sq m (JPY12,877 per tsubo), edging up 0.3% QoQ.
- Rents in the core-three residential wards rose 1.1% QoQ to JPY4,251 per sq m (JPY14,052 per tsubo), representing a 19.5% premium over the 23-ward average.
- The average occupancy rate for J-REIT-owned residential properties in the 23-ward area was 96.0%, up 10 basis points (bps) QoQ.

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 "Rents for mid-market apartments have remained remarkably flat over the last three years, suggesting that the Tokyo market is firmly at its cyclical bottom."
 Will Johnson, Savills Research

➔ **Demographic trends**

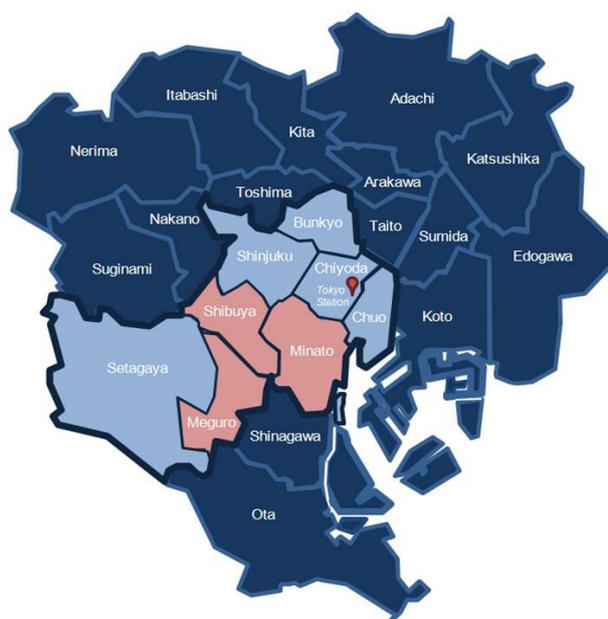
According to a survey by the Tokyo Metropolitan Government (TMG), approximately 13.3 million people reside in Japan's capital city as of 1 December 2013. The long-term growth trend in Tokyo continued, with its population up 0.5% YoY, supported by inflow from regional towns and the countryside.

As shown in Table 1, urban centralisation has been particularly evident since the Great East Japan Earthquake of March 2011, with the highest rates of population growth recorded in the core areas of the city. The number of residents in Tokyo's 23-ward area rose by 0.7% YoY, while both of the core-eight¹ and core-three² residential wards (as defined by Savills) rose by 1.2% respectively.

The central areas of the capital are not only the focus of population growth, but continue to see higher-than-average rates of household formation. As of 1 December 2013,

¹ Tokyo's core-eight wards are defined as Bunkyo, Chiyoda, Chuo, Meguro, Minato, Setagaya, Shibuya and Shinjuku.
² Tokyo's core-three wards are defined as Meguro, Minato and Shibuya.

MAP 1 **Tokyo's 23 wards delineated by survey area**



Source: Savills Research & Consultancy

Tokyo Prefecture had approximately 6.77 million households, up 0.9% YoY. Accounting for around 72% of this total is the 23-ward area, where the number of households rose 1.1% YoY to 4.85 million. The

household growth rate was faster still in Tokyo's core areas: the core-eight residential wards grew by approximately 1.2% while the core-three wards recorded an increase of 1.3% YoY.

Japan's ongoing urbanisation and a trend towards smaller household sizes has led to an increase in the number of single-occupiers and DINKS (Dual Income, No Kids) households in its major cities. This, combined with improved economic sentiment in recent quarters, has created robust demand for mid-market apartment units, particularly those located in and around the heart of Tokyo.

Residential supply

Ministry of Land, Infrastructure, Transport and Tourism (MLIT) data shows that the number of housing construction starts in Tokyo Prefecture totalled 144,562 units in 2013, approximately 2.6% higher than the previous year. While up moderately YoY, the annual total in 2013 remained around 6.6% lower than the ten-year average of 154,740 units recorded between 2003 and 2012.

When broken down by use, approximately 44% of Tokyo's

TABLE 1 **Population and households in Tokyo as of 1 Dec 2013**

	Population	% YoY	% change over 1 Dec 2011
Tokyo Prefecture	13,296,019	0.5	0.8
23 wards	9,068,918	0.7	1.1
Core-eight wards	2,320,496	1.2	2.1
Core-three wards	699,664	1.2	2.5
	No. of households	% YoY	% change over 1 Dec 2011
Tokyo Prefecture	6,769,999	0.9	5.2
23 wards	4,849,704	1.1	6.1
Core-eight wards	1,327,006	1.2	7.6
Core-three wards	409,216	1.3	8.7
No. of persons per household			
	1 Dec 2013	1 Dec 2012	1 Dec 2011
Tokyo Prefecture	1.96	1.97	2.05
23 wards	1.87	1.88	1.96
Core-eight wards	1.75	1.75	1.84
Core-three wards	1.71	1.71	1.81

Source: Savills Research & Consultancy based on TMG data

→ housing construction starts last year were housing units built for sale. This was followed by rental housing units at around 40%, while roughly 15% were owner-commissioned housing units and just 0.7% company housing units.

The highest annual increase in construction starts by use was in the owner-commissioned housing category, which saw a rise of 10.4% YoY on the back of strong demand leading up to the planned sales tax increase from 5.0% to 8.0% in April 2014. Construction starts for rental units also recorded a pick-up of 5.9% YoY.

By contrast, the total number housing units built for sale in 2013 declined 2.3% compared with the previous year. This not only reflects a material rise in construction costs through the year, which has reduced the feasibility of some speculative development projects, but also caution on the part of developers not to oversupply the market in anticipation of a slowdown in residential sales after the April consumption tax hike.

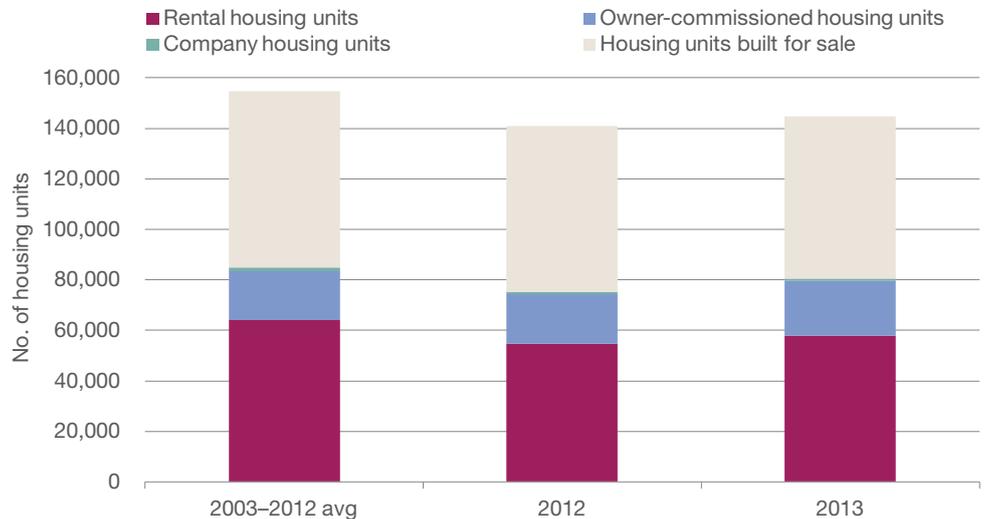
Tokyo mid-market apartment rental trends

Savills collates over 20,000 leasing comparables each quarter in order to analyse trends facing 'mid-market' rental apartment units in Tokyo. Our benchmark rental data is based on average advertised monthly rents for units that fit the following criteria:

- 1) One- or two-bedroom rental apartment units of up to 100 sq m in size;
- 2) Reinforced concrete structures built within the last ten years; and
- 3) Properties located in Tokyo's 23 wards and situated within a ten-minute walk of the nearest station(s).

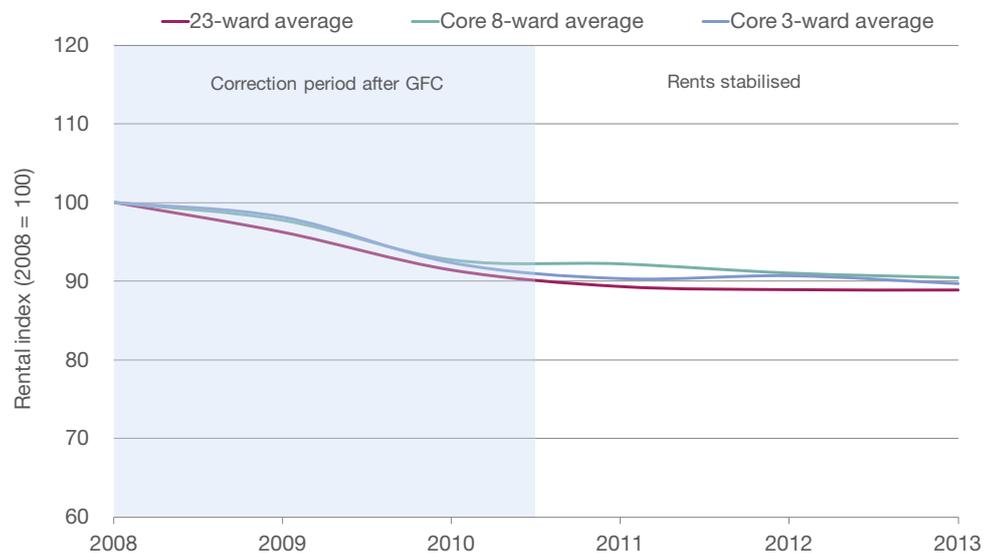
Savills mid-market apartment rent index indicates that central Tokyo has been in a distinct stabilisation period since 2011. Between 2008 and 2010, Tokyo's 23-ward area saw a decline of approximately 8.6% in mid-market apartment rents in the wake of the global financial crisis (GFC). Subsequent years, however, have

GRAPH 1 Housing construction starts in Tokyo Prefecture by use, 2003–2013



Source: Savills Research & Consultancy based on MLIT data

GRAPH 2 Tokyo mid-market apartment rental index by survey area, 2008–2013



Source: Savills Research & Consultancy

seen downward pressure steadily dissipate: following a marginal annual decline of 0.4% in 2012, average rents remained flat in 2013 from the previous year.

On a quarterly basis, mid-market rents in the 23-ward area stood at approximately JPY3,556 per sq m (JPY11,755 per tsubo³) as of 3 1 tsubo = approximately 3.306 sq m or 35.58 sq ft.

Q4/2013. This rental figure is steady from the preceding quarter and in line with the figure recorded in the same period of last year, down by just 0.2% YoY.

In the capital's core-eight residential wards, asking rents averaged approximately JPY3,895 per sq m (JPY12,877 per tsubo), representing a premium of approximately 9.5%

→ over the 23-ward average. Rental movement in this central survey area crept into positive territory – albeit nominally – recording growth of 0.3% and 0.4% on a QoQ and YoY basis respectively.

Asking rents for mid-market apartment units in the core-three residential wards increased by 1.1% QoQ, or 1.9% YoY, to reach JPY4,251 per sq m (JPY14,052 per tsubo). This marks the highest rental level since Q3/2012 and is reflective of buoyant tenant demand for units at the more expensive end of the mid-market rental spectrum. Due to this recent movement, the rental premium commanded by the core-three wards over the 23-ward average increased by 120 bps in Q4/2013 to stand at 19.5%.

Tokyo mid-market apartment rents by unit size-band

Tokyo’s rental market is principally made up of compact single-occupier units, typically less than 45 sq m (13.6 tsubo) in size. Unlike other major global cities such as London and New York, house or apartment sharing does not form a major segment of the rental market. As a result, there is a large, stable market for small- to mid-sized units.

As shown in Table 2, rental pricing per sq m for smaller units targeting single occupiers is generally more expensive on average than that of larger units. This not only reflects

the strong demand for compact units but also the higher gross rental costs involved in renting larger units, which: 1) decreases affordability for single-income households; and 2) makes the option of purchasing a condominium comparatively more cost-effective.

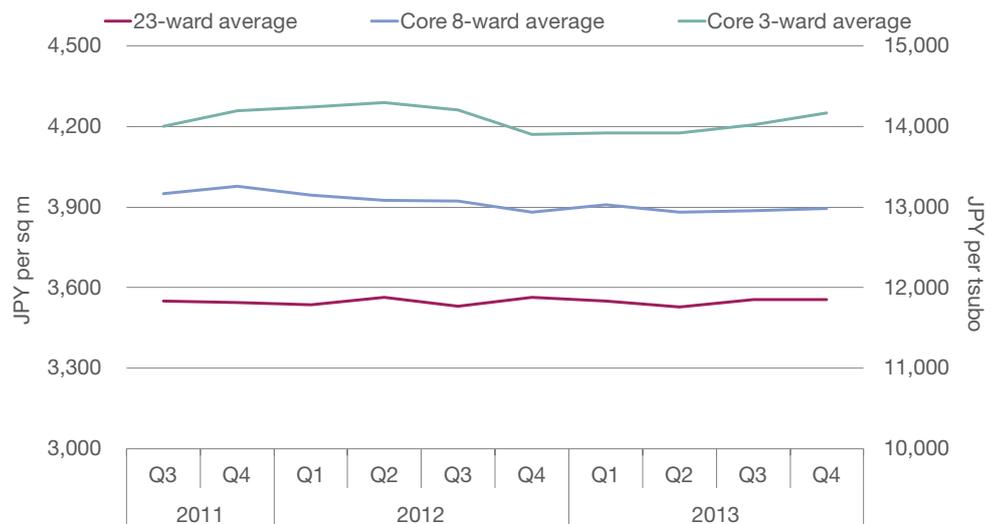
With the exception of a 0.8% uptick in the 45- to 60-sq m size-band, average asking rents for all unit size-bands declined marginally at the 23-ward level on a YoY basis. The core-eight and core-three ward survey areas performed better, with rents

up in all size categories apart from one: the 30- to 45-sq m size-band, where an increase in the number of lower-priced units being marketed pulled down the rental average. The greatest annual movement was seen in the core-three ward area, which saw rents in the 45- to 60-sq m and 60- to 75-sq m size-bands recover by 2.3% and 1.7% respectively.

Mid-market apartment occupancy rates

J-REIT-owned residential assets provide a useful benchmark upon which to gauge mid-market

GRAPH 3 Average asking rents for mid-market rental apartments by survey area, Q4/2011–Q4/2013



Source: Savills Research & Consultancy

TABLE 2 Average monthly asking rents broken down by size-band, Q4/2013

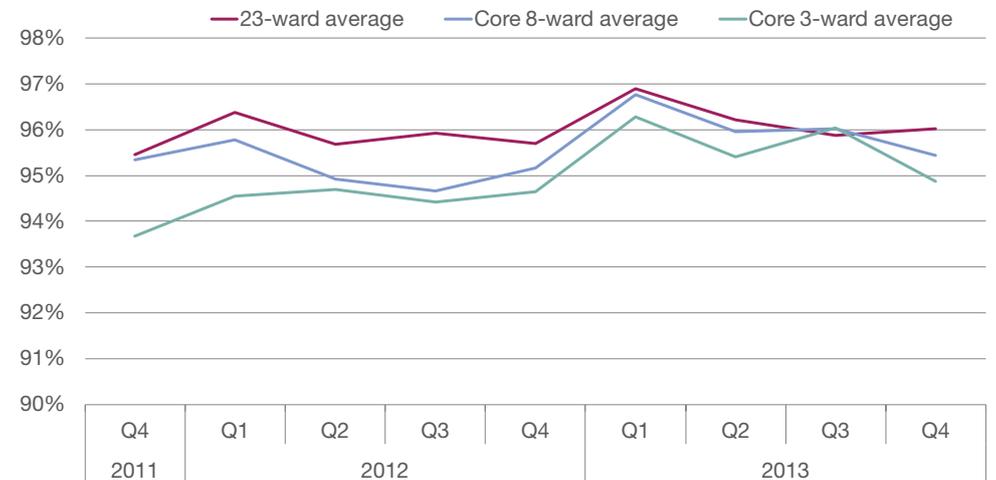
Size band	15–30 sq m		30–45 sq m		45–60 sq m		60–75 sq m	
	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY
23 wards	3,634 (12,013)	-0.3	3,465 (11,455)	-0.6	3,303 (10,919)	0.8	3,328 (11,002)	-0.9
Core-eight wards	4,009 (13,252)	0.6	3,809 (12,591)	-0.6	3,655 (12,083)	0.3	3,733 (12,341)	0.8
Core-three wards	4,333 (14,325)	1.2	4,123 (13,629)	-1.4	4,100 (13,552)	2.3	4,199 (13,882)	1.7
No. of units surveyed	>10,000		>5,000		>2,000		>500	

Source: Savills Research & Consultancy

apartment occupancy levels. In the fourth quarter, the average occupancy rate for rental apartment buildings operated by J-REITs in Tokyo's 23 wards stood at 96.0%, up 10 bps QoQ and remaining above the 95% threshold for the 13th consecutive quarter.

Although demonstrating a moderate dip in the fourth quarter, occupancy rates in the core-eight and core-three wards have generally strengthened since the Great East Japan Earthquake, reflecting the demographic shift towards the central areas of the city. As a result, the gap in average occupancy rates between the 23 wards and core-three wards has gradually tightened, down to 110 bps in Q4/2013 compared with 460 bps in Q4/2009. ■

GRAPH 4 Average occupancy rates for J-REIT residential assets, Q4/2011–Q4/2013



Source: Savills Research & Consultancy based on publicly disclosed J-REIT property data
 *Nippon Accommodations Fund, Advance Residence Investment Corporation and Heiwa Real Estate REIT.

OUTLOOK

The prospects for the market

With rental data for 2013 as a whole remaining steady from the preceding year, mid-market apartment rents in Tokyo are considered to be firmly at their cyclical bottom. Should Japan's economic recovery lose

its momentum, Tokyo's already affordable market rents and positive demographics are expected to mitigate further rental downside. Conversely, the burgeoning economic recovery provides scope for a degree of rental upside. The

extent of these potential gains will likely depend heavily on the ability of Prime Minister Abe's government to boost household income amid strengthened corporate sector profitability.

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