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SPOTLIGHT

Savills Research

Tokyo Residential: Ultra Luxury

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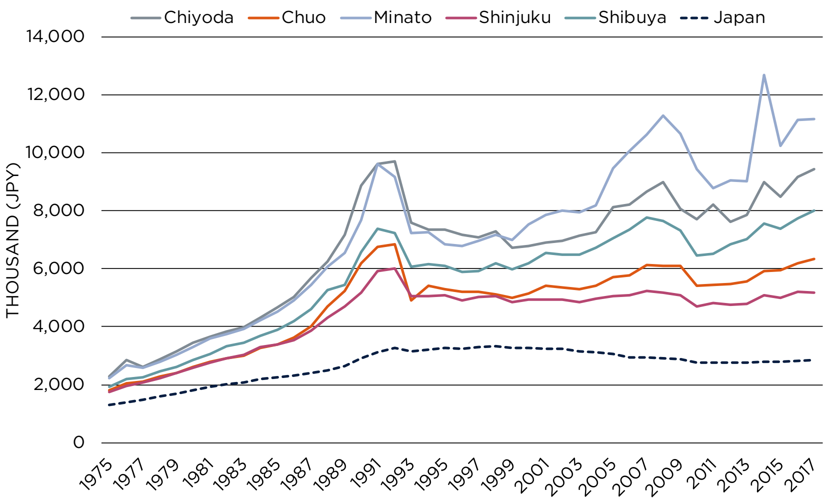
Tokyo's ultra-luxury condo market is gaining traction

MAP 1: Recent Ultra-luxury Condo Developments In Tokyo

#	BUILDING NAME
1	Toranomon Hills Residence
2	Park Mansion Hinokicho Koen
3	Proud Roppongi
4	Park Court Akasaka Hinokicho The Tower
5	Park Court Aoyama The Tower

Source Savills Research & Consultancy

GRAPH 1: Taxable Income Per Taxpayer - C5W vs Japan, 1975 to 2017



Source National Tax Agency, Savills Research & Consultancy

Introduction

Tokyo's ultra-luxury residential market is historically considered undersupplied, despite the city's status as one of the largest gateway cities in the world. Indeed, until quite recently there were probably fewer than ten units fitting our ultra-luxury definition, namely those with a sale price exceeding JPY1 billion. Over the past few years, however, there have been signs that the tide is turning.

In 2017, it was rumoured that a penthouse of Park Mansion Hinokicho Koen was sold for JPY5.5 billion, an unheard of price in Japan, causing a stir in the market. On a per-tsubo basis, though the Hinokicho condo's price of JPY31 million stands out, a handful of units in other buildings exceeding JPY20 million per tsubo have actually been sold in recent years. At present, the number of ultra-luxury units probably sits in the range of 20 to 30, a figure that will more than double over the next few years. Rents in the luxury residential market are growing at a rate of approximately 5 to 10% upon rent renewal.

As Tokyo continues to go through a large development phase and solidifies its status as a global tourist destination, high-quality residential properties in prime locations may enjoy increasing popularity. Over the next few years, Mori Building's Toranomon Residential Tower is expected to feature ultra-luxury residential units, which could possibly include an over-JPY10 billion unit, depending on floor layout. Tokyo World Gate and development in Azabudai are likely to supply in this sector.

Ultra-luxury Residential Market

Although there is no single definition of "ultra-luxury" in the industry, properties that meet our criteria are extremely limited and exclusive in Tokyo. Even in the most prestigious condo towers, only a few units could fetch such high prices. The market is very opaque as those units tend to be quietly marketed to a shortlist of potential buyers. However, interviews with market participants and media reports indicate that several ultra-luxury units have been sold in recent years (Map 1).

Ultra-luxury condos are concentrated in Minato, especially in the Aoyama, Akasaka, and Roppongi areas where a large number of embassies, international businesses, high-end retail stores and restaurants are situated. Although developments of ultra-luxury condos are a burgeoning trend, Minato has a history of serving the wealthy and has subsequently attracted a large cohort of high-profile individuals.

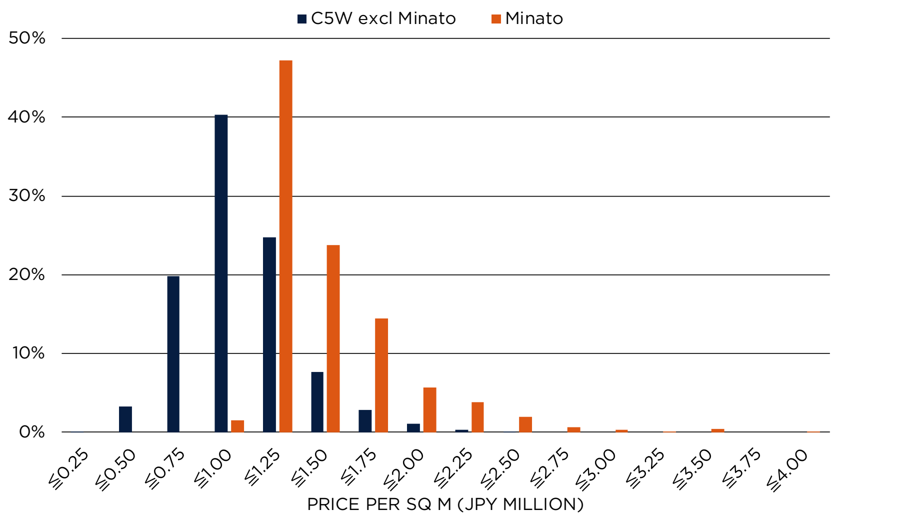
Average taxable income levels in Minato have been the highest among Tokyo's central

Demand for Tokyo's ultra-luxury condos, both from domestic and international investors, is steadily growing, reinforced by socio-economic shifts as well as the relative affordability of the city's residential properties. Continuing development and growing inbound tourism are improving prospects for this sector.

five wards since 1999, and its premium over other wards appears to have widened since 2003, the year Roppongi Hills was completed as a new Tokyo landmark. Tokyo Midtown came to fruition several years later, further solidifying Minato's brand image. The Ritz-Carlton Tokyo, which is located in one of the towers of the Midtown complex, houses a suite that is one of the most expensive hotel rooms in the city.

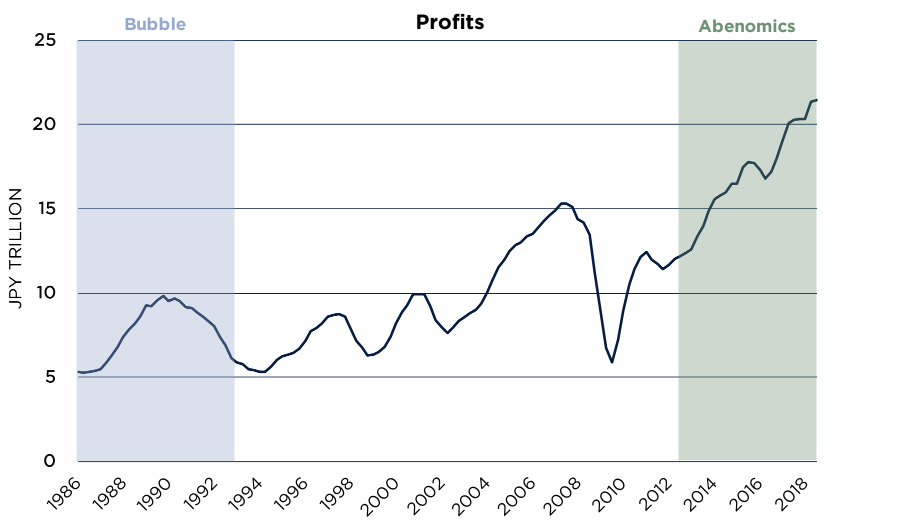
On average, Minato's condo sales prices are substantially higher than those of other wards. According to Real Estate Information Network System (REINS), the majority of sales started from JPY1-1.25 million per sq m between Q4/2017 and Q3/2018, and the most expensive sale recorded was as high as JPY3.9 million per sq m in Toranomon (Graph 2). We note that ultra-luxury unit sales are unlikely to be captured by a multiple listing service such as REINS. However, in order to maximise sales, even condo buildings of the highest calibre must largely offer units worth a few hundred million yen. As such, the data available indicates that Minato has a sound demand base that makes ultra-luxury developments more feasible.

GRAPH 2: Condo Sales - Minato vs Other C5W, Q4/2017 to Q3/2018



Source REINS, Savills Research & Consultancy

GRAPH 3: Corporate Profits, 1985 to Q3/2018



Source Ministry of Finance, Savills Research & Consultancy

Demand Drivers

Tokyo enjoys a high concentration of the ultra-high-net-worth (UHNW) individuals, which underpins demand for ultra-luxury properties. According to Wealth-X, a global wealth information provider, in 2017, Japan was home to 17,915 individuals with a net worth of US$30 million or more, the second highest number in the world. Out of that sum, 6,785 or about 38% were located in Tokyo, and the population increased 11.9% year-on-year largely due to the favourable economic conditions in recent years (Graph 3). Additionally, neighbouring regions such as Hong Kong and China also house a large UHNW population, together totalling about 27,000. Provided that over 2.2 million Hong Kongese or the equivalent of 30% of the territory's total population visited Japan in 2018, Tokyo has great exposure to large groups of potential buyers from overseas as well.

If we assume that the main asset holdings and breakdown of wealth tiers for the global UHNW population in Wealth-X's report can be applied to individual countries, net worth of about JPY15 billion is estimated to be necessary to own an ultra-luxury property, and less than 4,000 individuals in Japan could fall in this cohort[1]. Weighing this estimate from a different perspective, we

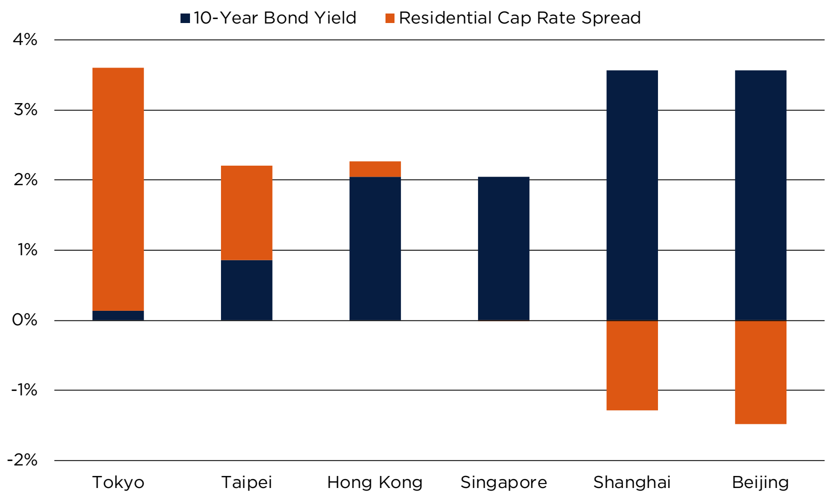
1 According to the World Ultra Wealth Report 2018, alternative assets including real estate account for 6.6% of the main asset holdings of the global UHNW population in 2017. This indicates that, to own a JPY1 billion property, individuals are expected to be worth, at least, US$150 million. Globally, about 22% of the UHNW population is worth more than US$100 million. If we assume this ratio is also applicable in Japan, about 3,900 individuals fall in this tier (22% of 17,915).

TABLE 1: City Rankings By Number Of Corporate Presidents

RANKING	2017	2003
1	Akasaka (Minato)	Den-en-chofu (Ota)
2	Nishi-shinjuku (Shinjuku)	Seijo (Setagaya)
3	Roppongi (Minato)	Oizumi-gakuen (Nerima)
4	Yoyogi (Shibuya)	Aoyama (Minato)
5	Aoyama (Minato)	Kameido (Koto)
6	Takanawa (Minato)	Kamisumachi-cho (Ibaraki)
7	Shinjuku (Shinjuku)	Okusawa (Setagaya)
8	Mita (Minato)	Ryuo-cho (Yamanashi)
9	Kameido (Koto)	Fuchu-cho (Hiroshima)
10	Hiroo (Shibuya)	Oshima (Koto)

Source Tokyo Shoko Research, Savills Research & Consultancy

GRAPH 4: Prime Residential Spreads, Q4/2018



Source Savills Research & Consultancy

highlight that the top 4,000 individuals in the National Tax Agency's survey on self-assessed taxable income reported at least JPY200 million in 2016. Although data is limited to test the accuracy of our estimate, it appears safe to say that ultra-luxury condos are targeted at a fraction of the wealthiest 1% in Japan, who are somewhat insulated from economic cycles.

In addition to increasing wealth, the shift in preference among high-income earners from large detached homes in suburbs to condos in the city centre appears to be reinforcing demand for luxury condo units in Minato. For example, Tokyo Shoko Research's surveys show that Den-en-chofu and Seijo slipped in the rankings of numbers of corporate presidents over the decade (Table 1). These are districts where corporate executives, politicians, and celebrities built their grandiose houses, being away from the hustle and bustle of city life. The tide appears to have turned towards more central areas recently, as Akasaka and Roppongi advanced to the top of the rankings, while Nishishinjuku and Yoyogi also became popular among corporate presidents. These changes illustrate the growing importance of the convenience offered by the city centre over the reclusiveness of the suburbs.

Although their presence is still relatively limited, international buyers are also visible in the market. Indeed, the JPY5.5 billion penthouse was once rumoured to have been acquired by a wealthy Hong Kongese, though a more recent rumour suggests that the buyer was a Japanese financier. Relative affordability of properties in Japan is one reason for interest from overseas. According to the Japan Real Estate Institute, luxury condos in Hong Kong are almost twice as expensive as in Tokyo. Even the most expensive dwellings in Japan are still somewhat affordable compared with global peers.

Growing tourism is also a tailwind for foreign demand as Tokyo is transforming into a global destination with world-class amenities. From 2011 to 2018, the number of inbound tourists increased fivefold to over 31 million, and international luxury brands such as EDITION by Marriott, Kimpton by IHG, The Langham, Bulgari Hotel, and Four Seasons are in the pipeline to take advantage of growing demand from wealthy travellers.

Japan's extremely low borrowing cost is also attractive for buyers. Although lenders are becoming more cautious and selective, proven investors or HNWIs are still able to borrow at an all-in interest rate of at or below 1%, and yield spreads are still appealing compared to other global cities.

Supply Prospects

While demand is expected to strengthen in the ultra-luxury condo market, supply should be scarce in the near term. Areas suited for premium condo developments in Tokyo are largely limited to Minato. Considering that the ward's high-end communities were formed by gradual demographic shifts and long-term development, it is not easy to venture out of established markets.

That being said, as Tokyo goes through a massive transformation fuelled by the Olympics and the Linear Chuo Shinkansen (Maglev) development in Shinagawa, which will eventually connect 65 million people, the market appears to be evolving to accommodate more ultra-luxury properties. Continuing redevelopment of various areas in Tokyo should enhance the city's attractiveness for wealthy buyers.

As it did successfully with Roppongi, Mori Building is placing a huge bet on the Toranomon area with a commitment of JPY400 billion, which will create a new high-profile community and could widen Tokyo's ultra-luxury market. Further, Shibuya's recent redevelopment is comparable with Roppongi Hills in terms of GFA, which may also change the area's dynamics and lay the foundations for more luxurious developments.

Outlook

Despite being the world's largest metropolitan area and a powerhouse of the third largest economy, Tokyo has yet to see a true launch of its ultra-luxury condo market. In addition to growing domestic demand underlined by socio-economic shifts, the relative affordability of properties in Tokyo, along with a higher level of recognition fostered by burgeoning inbound tourism, is attracting development interest.

The barrier to entry for this market is still considered high given its limited stock and there is scarce supply in the pipeline. Considering that development land is extremely lacking in prime areas and there are only a few major developers in this ultra-luxury tier, the market is protected from an abrupt supply shock. However, the growing popularity of this sector is attracting interest from new domestic and overseas, such as Westbank Corp. Mixed-use developments beyond established luxury areas, such as Toranomon, and renovation of existing buildings might allow for some supply increases.

While the ultra-luxury condo market poses opportunities, demand dynamics could change depending on the economic climate. Supported by bullish capital markets, corporate and stock performance in Japan has been strong over the past few years, resulting in growth of the UHNW population. However, while corporate profits are still high, slight but potentially harmful downward revisions of forecasts are looming. Volatile capital markets could also cloud prospects for the ultra-luxury market. Moreover, the recent popularity of condo towers was partially derived from domestic buyers considering estate planning, though this demand might have already been captured, limiting room for further growth.

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