MARKET IN MINUTES
Savills Research

Residential Leasing

savills

Tokyo rents continue to rise

All submarkets ended the year with some measure of growth, with the C5W recording a rising premium over the rest of the market.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stand at JPY3,823 per sq m, up 1.0% QoQ and 4.0% YoY.
- Average asking rents in the central five wards (C5W) ended the year at JPY4,558 per sq m, up 0.7% QoQ and 4.0% YoY.
- The C5W's premium over average 23W rents has reached 19.1%, a new high for a third consecutive year.
- Inner North has seen steady growth this year, and the submarket's premium over the 23W has surpassed that of South.
- Occupancy rates held up in Q4/2018, remaining above 95% in all wards for a second consecutive quarter.
- Apartments completed within the last four to five years have begun to see strong rental appreciation, with their rents approaching those of newer completions.
- Larger size bands have seen impressive rental growth in 2018, probably due to strong demand from dual-income households and limited existing stock.
- Co-living may grow in popularity, particularly among the younger generation, while interest may be held back in Tokyo as a result of its vast existing stock of compact living spaces and its reliable, well-connected public transit network.

"Tokyo continues to enjoy solid fundamentals. Average rents are moving steadily upwards while C5W rents continue to stride ahead, widening their premium over the average as convenient locations prove the most popular."

SAVILLS RESEARCH & CONSULTANCY

Savills team

Please contact us for further information

JAPAN

Christian Mancini
CEO, Asia Pacific
(Ex Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

RESEARCH

Tetsuya Kaneko
Director, Head of Research & Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Yoshihiro Kanno
Associate, Research & Consultancy, Japan
+81 3 6777 5142
ykanno@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

MAP 1: Tokyo's 23 Wards By Survey Area

Source Savills Research & Consultancy

SURVEY GEOGRAPHY

In order to illustrate trends in the central Tokyo residential market, Savills has segmented Tokyo's 23 wards into seven distinct geographical areas: Central (or "central five wards"), South, West, North (Inner and Outer) and East (Inner and Outer).

RENTAL INDEX DATA CHARACTERISTICS

Savills collates thousands of leasing comparables each quarter in order to analyse trends affecting "mid-market" rental apartment units in Tokyo. Our benchmark rental data is based on average advertised monthly rents for units which fit the following criteria:

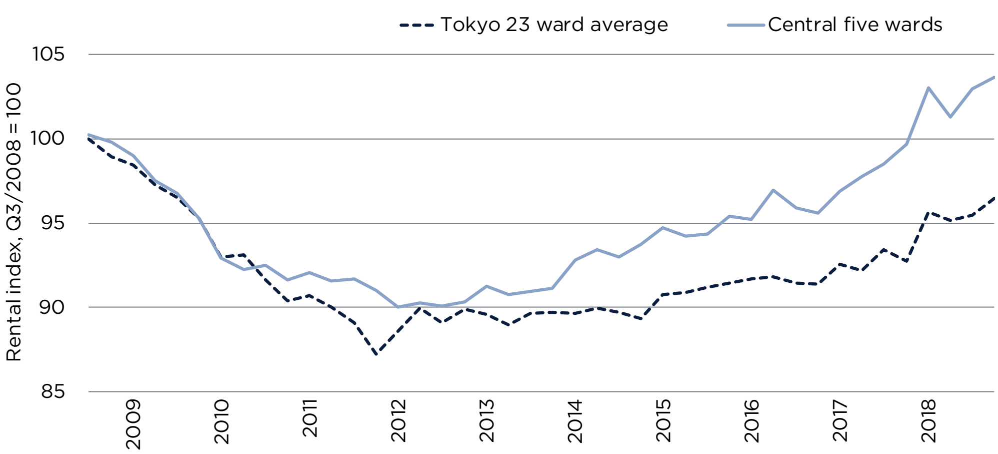
1) studio and one- or two-bedroom rental apartments of up to 100 sq m in size,

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.

In contrast to the luxury residential market, advertised or 'asking' rents for mid-market units fitting the above criteria are typically non-negotiable and are not subject to incentives such as rent-free periods. Savills mid-market rental indices are therefore considered to closely reflect movement in contract rents for the Tokyo market.

GRAPH 1: Mid-market Apartment Rental Index Q3/2008 to Q4/2018



Source Savills Research & Consultancy

OVERALL RESULTS

C5W rents rose by 0.7% quarter-on-quarter (QoQ) and 4.0% year-on-year (YoY) to reach JPY4,558 per sq m[1] in Q4/2018. 23W average rents were slightly stronger this quarter, up by 1.0% QoQ, but matched the C5W's annual growth rate, rising 4.0% YoY to JPY3,823 per sq m. The C5W's premium over the 23W averaged 19.1% over the course of 2018, some 1.6% higher than last year.

Inner North saw phenomenal rental growth in 2018, rising some 6.5% YoY. As a result, Inner North's premium to the 23W average has surpassed that of South, which, at the other end of the spectrum, grew a less impressive 0.9% YoY. Growth in other submarkets ranged between 2.1% and 4.0% YoY.

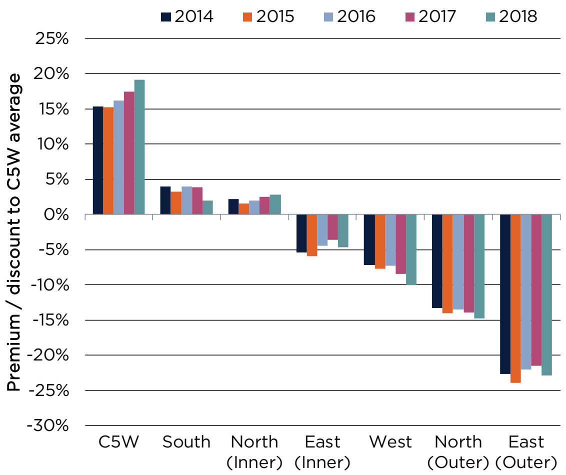
Larger size bands have seen impressive rental growth this year, perhaps reflecting strong demand from dual-income households and limited existing stock. Housing starts for 50-70 sq m units tripled between 2012 and 2017, however, which might bring rents for larger size bands back below those of smaller size bands over time as new supply hits the market. In addition, the proportion of new completions and of those in higher-income submarkets has grown over the past few years, which could be skewing average rents to look higher.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Growth for the year registered at 4.0% YoY in both the C5W and the 23W and, aside from a brief adjustment in Q2/2018, was steady quarter to quarter. Urbanisation is a powerful long-term factor that continues to support demand for apartments across the 23W. The appeal of more conveniently located apartments with strong transport links appears to be even stronger: the C5W's premium over the 23W average has grown

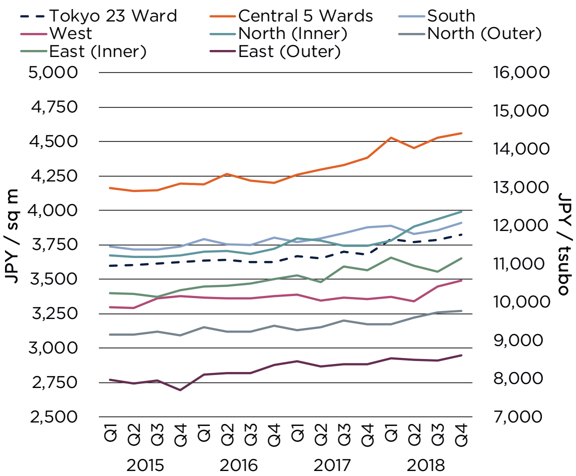
1 Throughout the report, "per sq m" means "per square metre per month".

GRAPH 2: Rental Premiums/Discounts vs 23W Average 2014 to 2018



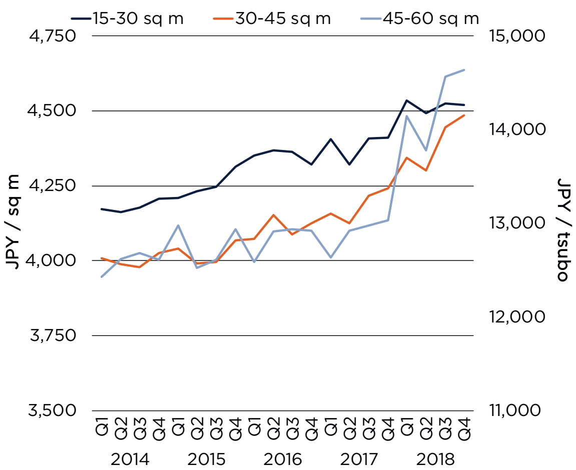
Source Savills Research & Consultancy

GRAPH 3: Mid-market Apartment Rents Q1/2015 to Q4/2018



Source Savills Research & Consultancy

GRAPH 4: Rents By Unit Size Q1/2014 to Q4/2018



Source Savills Research & Consultancy

from 17.5% in 2017 to 19.1% in 2018 as it continues to reach new annual highs.

C5W rents rose 1.0% QoQ and 4.0% YoY to reach JPY4,558 per sq m, with Chiyoda rising 7.8% YoY. Minato, made up of well-established luxury neighbourhoods popular with high earners, remained in pole position despite growing at a more steady 1.7% YoY. The Toranomon development project is drawing nearer to completion and may create another luxury residential neighbourhood in Minato, further boosting the ward's appeal.

The South paused for breath in 2018, with rents at JPY3,908 per sq m, some 1.3% higher QoQ but only up 0.9% YoY. The outer wards of Ota and Setagaya continued to ascend steadily, growing 4.0% and 3.7% YoY, respectively, but Meguro and Shinagawa consolidated after strong growth in 2017, with the former falling 2.9% YoY and the latter down 0.2%. Rents should resume their upward march in 2019 as the two wards have many favourable qualities.

Inner North was the rising star of the submarkets this year, perhaps because of its convenient location. Quarterly growth for the two constituent wards of Bunkyo and Toshima was steady at 0.4% and 2.2%, respectively, but annual growth registered at 6.3% and 6.7%. As a result, the Inner North submarket, sitting at JPY3,988 per sq m, now commands the second highest premium over the 23W average. Outer North grew 0.2% QoQ and 3.0% YoY to JPY3,268 per sq m, lagging behind its sibling as its less preferential location and lower average income levels held back growth.

Inner and Outer East rents were less volatile than in other submarkets, but this steadiness came at the cost of slower trend growth. Inner East grew 2.7% QoQ and 2.5% YoY to JPY3,652 per sq m, while Outer East grew just 1.3% QoQ and 2.1% YoY, ending the year at JPY2,945 per sq m.

Rents in the West were up 1.4% QoQ and 4.0% YoY, registering JPY3,493 per sq m, somewhat lower than the 23W average. While Nakano saw strong rental growth of 6.2% YoY, probably thanks to its close proximity to the C5W and relative affordability, the more peripheral wards registered somewhat lower growth of 3.0% YoY on average, perhaps partly because properties there are generally older than average and new development has been relatively weak.

RENTS BY UNIT SIZE

Tokyo's rental market is principally made up of compact single-occupier units, typically less than 45 sq m (13.6 tsubo) in size. Such units can often make up as much as 75% or more of the 23W area's rental listings. 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.

Throughout 2H/2018, the 45-60 size band average rent, currently JPY4,635 per sq m, exceeded the 15-30 sq m size band average of JPY4,519 per sq m. The former has grown 4.3% QoQ and a whopping 12.1% YoY, far outstripping the QoQ fall of 0.1% and the 2.5% YoY rise for the latter. The 30-45 size band has also seen strong growth, reaching JPY4,486 per sq m, almost matching rents in the 15-30 size band.

Demand for larger apartments appears to be growing. As more women enter the workforce, creating dual-income households, living in a convenient location is becoming more important. A study by Mitsubishi Research Institute found that the proportion of dual-income households classed as "power couples" who earn 10 million yen or more is rising every year. Conservatively assuming that 30% of gross household income is allocated to housing costs, these "power couples" could comfortably afford to spend JPY5,000 per sq m on a 50 sq m apartment[2], a little higher than the currently surveyed level in that size band.

Rent per sq m has generally had an inverse relationship to the size of the property. Thus, over the longer term, rent per sq m for larger units may fall below smaller units as any market imbalance is worked out. One catalyst could already be on the horizon: the number of 50-70 sq m rental housing starts in 2017 was triple the 2012 amount (Graph 5), indicating that a wave of supply could be around the corner. As this new stock makes its way into the market, we may see rents come down accordingly. Furthermore, the proportion of new completions and of those in higher-income submarkets has grown over the past few years, which could be creating an upward bias in average rents.

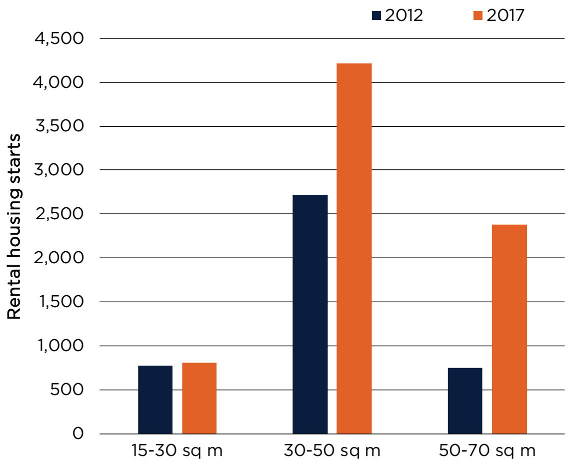
Some condominium developers have begun to focus more strongly on central areas as they face lackluster contract rates on sales, especially in non-central areas. Over the last year there has been a noticeable increase in the proportion of large upscale supply in Minato and Chuo, where rents are higher than average. In the meanwhile, land acquisition has become more difficult. Developers such as Mitsui Fudosan Residential are actively targeting older buildings with units of over 50 sq m in the C5W for renovation. If developers continue to bring larger units to market in more expensive neighbourhoods, the average rent for such units could continue to rise as a result of the composition of the dataset alone.

OCCUPANCY RATES

The average occupancy rate in the 23W rebounded by 0.6 percentage points (ppts) in Q4/2018 to reach 97.5%, up 0.5ppts YoY. C5W occupancy recovered by 0.4ppts QoQ to register at 96.7%, marginally up by 0.1ppts YoY. Demand for institutional-quality residences remains robust across all wards: in particular,

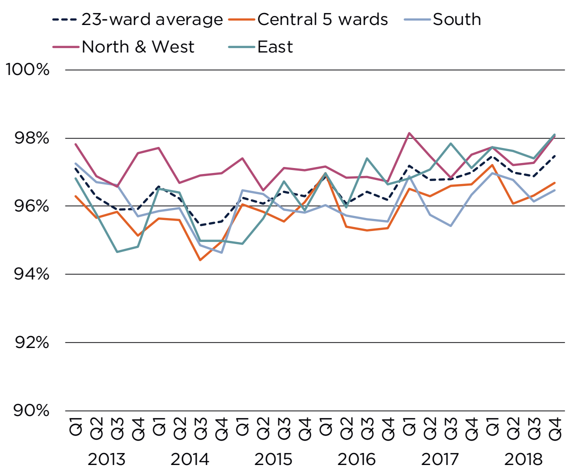
2 Annual rent = JPY5,000 x 50 sq m (or JPY 4,166 x 60 sq m) x 12 = JPY3m, or 30% of JPY10m household income.

GRAPH 5: Rental Housing Starts In The C5W By Size 2012 vs 2017



Source Ministry of Land, Infrastructure, Transport and Tourism, Savills Research & Consultancy

GRAPH 6: Average Occupancy For J-REIT Residential Assets Q1/2013 to Q4/2018*



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
* Q4/2018 estimate based on October & November data.

Adachi and Nakano both registered an impressive 100% occupancy in Q4/2018.

Occupancy has maintained at a record minimum level of 95.5% across all wards for a second consecutive quarter, with just 4.1% of surveyed assets sitting below 90%. J-REIT occupancy is expected to remain strong over the long term as Japan's robust economy continues to feed through to household income growth and urbanisation drives population growth in Tokyo. Also, high condo prices appear to be leading potential homeowners to delay purchases and choose rentals instead.

CO-LIVING

As the cost of renting in the 23W rises, co-living may grow in popularity, particularly among the younger generation. Shared living brings not only convenience and affordability – initial moving costs are often much lower – but also the opportunity for cultural and language exchange. On the other hand, interest may be held back in Tokyo as a result of its vast existing stock of compact living spaces and its reliable, well-connected public transit network.

Achievable rents per sq m for compact single-occupier units are on average higher than for larger two-bedroom or family-type units. For co-living spaces, return per sq m can be even higher than traditional compact housing, with more rooms per building and additional revenue from services; however, operator risk should be a key concern. For example, Smart Days, an operator of a network of women-only share houses in Japan, filed for bankruptcy in March 2018 after struggling to fill spaces and eventually failing to meet its rent obligations to owners. On top of allegations of fraud and poor management, reports also suggest that small common areas and pricing comparable to compact apartments weakened performance.

Looking ahead, it is certainly possible that co-living models could be more widely expanded to other demographics, particularly the elderly. Even now, Japan's senior housing with support services ("satsuki") mimics certain aspects of co-living. Most private rooms in these apartment buildings are between 18–20 sq m, while cafeterias and other amenities are available in common areas. These concepts could be more widely adapted to create co-living type senior housing communities.

OUTLOOK

Tokyo continues to see net migration, a strong employment market and growing household incomes. These demographic trends have so far manifested in rising rents across the 23W and should continue. The benefits of a convenient location and better access to transport infrastructure should help C5W rents to carry on growing faster than the 23W average, particularly as dual-income households show a preference for such apartments and are more likely to be able to afford them. Our rent index may look stronger than the reality, given that new listing units make up an increasing proportion of the dataset.

Global economic uncertainty could affect the wider Japanese economy, but its effect on the residential leasing market should be relatively muted. Institutional-quality assets in particular should retain sound occupancy levels throughout the cycle thanks to stable demographic fundamentals in Tokyo and high demand.

Investors may want to target older properties with renovation potential as a source of rental growth. Location appears to be the primary driver of residential performance, so targeting centrally located properties with scope for increasing their market value could be an attractive yet defensive investment strategy. Rents for larger size bands are currently elevated: this phenomenon is likely to continue for the time being until supply runs ahead of currently unsatisfied demand. Alternative housing sectors, such as co-living, may also offer attractive opportunities in this low-yield environment.