MARKET IN MINUTES

Savills Research

Residential Leasing

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Growth in the C5W returns

Rental growth bounces back in the C5W, while the 23W remain unchanged over the quarter. Nonetheless, solid annual growth persists, with both submarkets rising by around 6% YoY.

- As of Q4/2019, average mid-market asking rents in the Tokyo 23 wards (23W) remained flat over the quarter at JPY4,044 per sq m, whilst rents grew 5.8% over the year.
- Average mid-market rents in the central five wards (C5W) stand at JPY4,842 per sq m after growth of 2.0% QoQ and 6.2% YoY.
- The C5W expanded its premium over the 23W average to around 20%. Discounts narrowed in the other wards.
- Nakano in the West was the top performer this quarter following growth of 7.8% QoQ. Otherwise, over the year, Sumida impressed, with asking rents jumping 9.5% as new units with above-average rents entered the market.
- Units in the 15-30 sq m size band continue to dominate the market. That said, asking rents for these properties in the 23W fell 0.4% QoQ to JPY4,027 per sq m. Listings for the largest apartments remain relatively sparse.
- Occupancy in the 23W held firm in Q4/2019. In the C5W, however, pockets of vacancy emerging in Shinjuku dragged the overall rate down slightly.
- Q4/2019 was the third quarter in a row where listings increased in the 23W – currently at levels not seen since Q2/2018.

"Rents continue to rise steadily, as annual growth quickened in Q4/2019 compared to the same period last year. That said, rents in some wards, especially in the C5W, could soon start to test the financial capabilities of tenants."

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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 movements in contract rents for the Tokyo market.

OVERALL RESULTS

Rent growth in the C5W rebounded in Q4/2019, reversing a temporary blip observed in the previous quarter. Rents grew 2.0% quarter-on-quarter (QoQ) climbing to JPY4,842 per sq m[1] – surpassing the previous high set in Q2/2019. Over the year, the pace of rent growth quickened to 6.2%. Rent growth in the 23W, on the other hand, ran out of steam over the quarter, remaining flat at JPY4,044 per sq m. As a result, the submarket's streak of five consecutive quarters of growth has come to an end. In truth, the rate of quarterly growth has been on a downward trajectory since the start of the year, perhaps an indication that rents are now starting to test the financial capabilities of tenants following sound growth in the past. That being said, year-on-year (YoY) returns of the broader market remain healthy, with rents growing by 5.8% (Graph 1). Despite the lack of movement of rents in the 23W this quarter, market forces remain accommodative of growth, and for now, average rents remain above their respective four-period moving averages.

Thanks to a relatively higher level of rent growth in Q3/2019, the 23W had managed to narrow the spread between its centrally located counterpart. Yet, it appears that the momentum has somewhat faded. To wit, having reduced the gap to 17.4%, the premium now stands at 19.7% on the back of solid rent growth in the C5W. As for the other submarkets, the Inner North is still the only non-central submarket at a premium, with the gap widening by 2.9 percentage points (ppts) over the quarter. The South is a whisker away following a 0.4 ppts change over the same period – currently standing at a 0.1% discount (Graph 3). The Outer East, on the other hand, continues to lag the other submarkets. Indeed, this submarket is close to 10% adrift of its closest rival, the Outer North.

Smaller-sized units continue to represent the lion's share of the sample size, and this is expected to continue for the foreseeable future. Rent growth in the most popular size band (15-30 sq m) was solid over the year, though varied over the quarter. Specifically, in the C5W, rents rose 1.0% QoQ as listings fell, whilst the broader market experienced a 0.4% drop in rents over the same period as listings increased. Of the three core size bands, the largest size band (45-60 sq m) has maintained the top spot for asking rents in both submarkets. It is worth remembering, however, the limited number of listings for this size band, and the subsequent volatility to asking rents that brings.

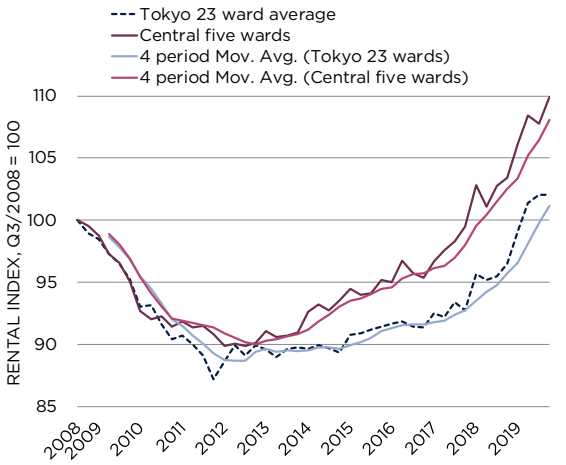
MID-MARKET RENTAL TRENDS BY SURVEY AREA

Despite the number of listings expanding over the year, rental growth in the 23W has been solid. That said, it appears the pace of growth has been slowing all year, and this has culminated in asking rents flattening this quarter, now standing at JPY4,044 per sq m. In contrast, the C5W managed to reverse the decline in rents observed in Q3/2019. In some submarkets divergence in growth among wards continues to be evident, though the volatility of listing numbers is partly to blame for this phenomenon. Despite the potential emergence of peaks, the market overall remains sound.

Following a slight adjustment in Q3/2019, the C5W is once again on an upward path. In fact, rents have reached a record high in the post-2008 era, rising to JPY4,842 per sq m after a 2.0% QoQ increase. The main driver of this growth over the quarter has been Shibuya, which saw rents jump by 6.2% QoQ to reach JPY5,136 per sq m – surpassing Minato to become the most expensive ward

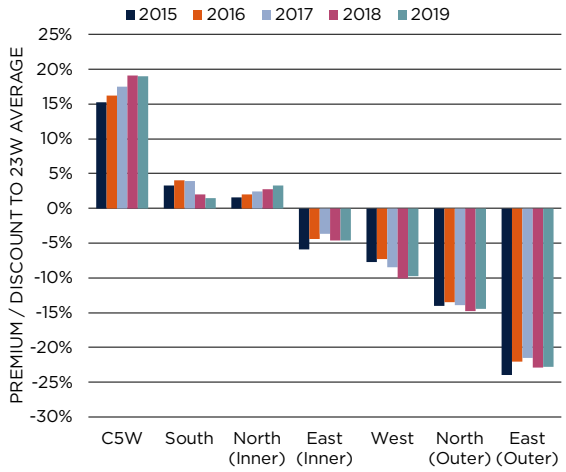
1 Throughout the report, "per sq m" means "per square metre per month".

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2019



Source Savills Research & Consultancy

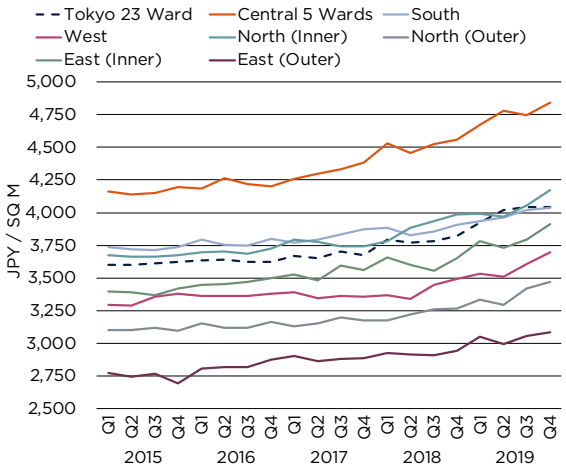
GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2015 to 2019



Source Savills Research & Consultancy

*The above represents the average premium/discount over the respective year.

GRAPH 3: Mid-market Apartment Rents, Q1/2015 to Q4/2019



Source Savills Research & Consultancy

in the submarket. Indeed, Minato now lies in second place following a decline of 1.1% QoQ to JPY5,058 per sq m. The reduction in listings at the top-end of the market, in concert with the addition of listings on the lower-end, appears to be the main catalyst for this pullback. Growth over the year in the C5W was even more impressive, rising 6.2%. Having witnessed sluggish growth of 0.7% QoQ, Shinjuku led the way over the year, with an impressive 8.7% jump in rents. Even so, Shinjuku is the only ward in this submarket that has yet to exceed 2008-peak asking rents.

In Q4/2019, the rate of growth experienced in the South slowed compared to the previous period. On a quarterly basis, the most expensive ward, Meguro, was the only ward to experience a fall in rents, declining by 1.9%. As for Ota, this ward saw growth return with rents increasing 1.4% QoQ – the highest in the submarket. Yet, growth over the year remains disappointing, coming in at 1.2%, lagging its peers for a second consecutive quarter. Having achieved close to 5% QoQ growth last quarter, rents in Setagaya experienced a sharp slowdown as growth fell to below 1.5%. It was a different story over the year, however, where the pace of growth quickened to a solid 5.9% YoY. Indeed, rents have surpassed the previous high to hit JPY3,971 per sq m. This is particularly impressive considering the number of listings YoY have increased by over 5%.

On the surface, growth in the Inner North appears somewhat encouraging. Rents in the submarket grew 2.9% QoQ and 4.7% YoY. In fact, the pace of growth has expanded for two quarters in a row. However, looking at the ward level tells another story. Having appeared to have returned to growth last quarter, Toshima has lost all momentum. Asking rents fell 1.5% QoQ to JPY3,937 per sq m, perhaps as a result of the number of listings rising by close to 30%. Over the year, growth has been close to nil. In comparison, growth in Bunkyo was spectacular. Asking rents increased to JPY4,412 per sq m following growth of 7.3% QoQ and 9.4% YoY.

Over the year, the Inner East saw the greatest supply expansion in the 23W, with listings growing to levels not seen since Q4/2017 following the completion of numerous condos in the area. It is therefore encouraging that rents have responded positively, rising 7.2% YoY – the highest in the 23W – to JPY3,913 per sq m. Sumida led the way over the quarter and year, growing 5.3% and 9.5%, respectively. Taito now commands the highest rents in the submarket, overtaking Koto, following a 3.4% QoQ increase to JPY4,009 per sq m.

Rent growth in the West has remained fairly solid, rising 2.5% QoQ and 5.8% YoY. That said, there is a large divergence in performance at the ward level. Nakano was in the vanguard, as rents surged to JPY3,981 per sq m – a growth of close to 8% QoQ. In contrast, Suginami disappointed. Rents fell by 2.9% QoQ to JPY3,677 per sq m, and as a result, the ward has lost its claim of having the highest rents in the submarket. Over the year, Nerima replaces Nakano as the top performer, while Suginami lags once more, with rents increasing by 7.5%, 7.3% and 2.8%, respectively.

The Outer North submarket saw rent growth slow to 1.5% over the quarter. Over the year, however, the pace intensified, with rents rising by 6.2% YoY. A significant contributor to this solid annual growth has been Itabashi, which saw rents rise by 7.9% YoY. In stark contrast, over the quarter, rents in the ward contracted by 4.2% to JPY3,354 per sq m. As a consequence, Kita has retaken the top spot in the submarket following a 7.6% QoQ jump in rents to JPY3,584.

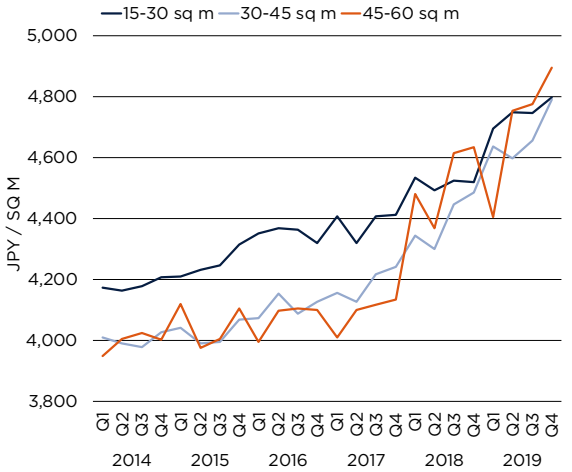
Asking rents in the Outer East have consistently been the lowest in the 23W. In fact, this submarket has held that crown every quarter for the last decade. This quarter, rents in this submarket grew 0.9% QoQ and 4.8% YoY. When looking at the wards, rents in Adachi are now the least expensive, at JPY2,900 per sq m, following a 1.2% QoQ decline and 3.5% YoY rise – the lowest in the submarket. Arakawa, in contrast, was able to retain the top spot despite falling 2.4% QoQ, while Edogawa was home to the greatest change over the year, rising 6.2% to JPY3,109 per sq m. The above should, however, be caveated with the reminder that rents in the Outer East are subject to volatility as a result of the lack of listings – just above 5% of the total figure.

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.

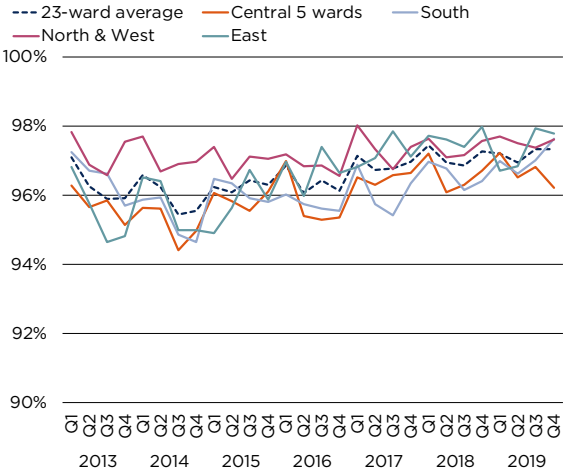
Representing around two thirds of total listings, the smallest band of apartments (15-30 sq m) remains the most popular layout in the 23W, as well as the C5W. As such, asking rents for this size-band have experienced solid growth rates of 5.2% and 6.1% YoY, respectively. That said, this quarter, it appears supply has outstripped demand in the 23W, as evidenced by the 0.4% QoQ decline in rents following a near 6% increase in listings. However, the opposite was observed in the C5W. The prime submarket saw rents return to growth, increasing 1.0% QoQ to JPY4,796 per sq m as listings fell by over 10%. When looking at the other size bands, it is evident

GRAPH 4: Rents By Unit Size, C5W, Q1/2014 to Q4/2019



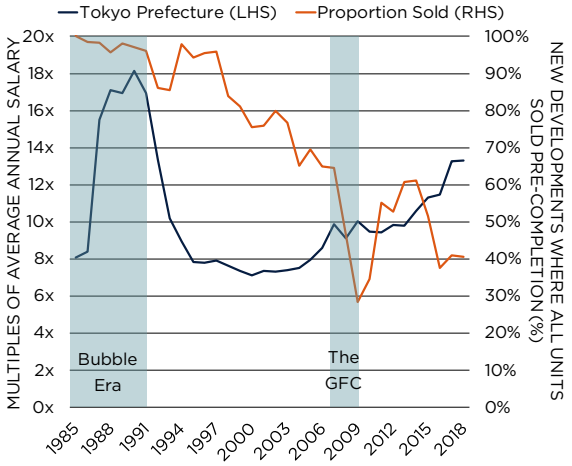
Source Savills Research & Consultancy

GRAPH 5: Average Occupancy For J-REIT Residential Assets, Q1/2013 to Q4/2019



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)

GRAPH 6: New Development Pre-completion Sales* And The Average Condo Price-to-Income Multiple In Tokyo Prefecture, 1985 to 2018



Source Tokyo Kantei, Savills Research & Consultancy
*The developments in question are from large-scale developers

that the larger size band (45-60 sq m) has continued to grow in popularity, and this has been reflected in the asking rents – now exceeding the other size bands in the 23W and the C5W. Indeed, the spread in rents between the main size bands have continued to tighten, especially in the C5W (Graph 4).

OCCUPANCY RATES

In Q4/2019, the average occupancy rate in the 23W held firm at 97.3% over the quarter, whilst a similar trend was observed over the year. The C5W was not able to follow suit, however. Occupancy in this central submarket fell by 0.6ppts QoQ and 0.5ppts YoY, driven by a decline in Shinjuku. More specifically, despite a fairly modest 0.4ppts fall over the year, over the quarter, occupancy in the ward decreased by 2.3ppts. On the other hand, Chiyoda was the sole ward to experience an increase in occupancy, both over the quarter and year. Over both periods, rates increased 1.0ppts – perhaps unsurprising given the lack of supply in the area, and as a result, occupancy in this ward is close to 99%.

The fact that occupancy in all submarkets remains above 95% confirms that demand for institutional-quality assets remains solid. Given Tokyo is expected to attract the lion's share of positive net migration, it would not be surprising if these levels of occupancy were to continue going forward.

WAGES FAIL TO KEEP UP WITH CONDO PRICES

According to data collected by Tokyo Kantei as of 2018, the average price-to-income multiple for new condo developments[2] in the Tokyo prefecture stands at around 13.3x – a level not seen since the bubble era (Graph 6). To put this figure into context, the national average is closer to 8x, whilst older condos in Tokyo built 10 years ago command a multiple of 10.5x. Historically, multiples between 6x to 10x are said to be appropriate, and therefore, even with historically low mortgage rates, current prices in Tokyo comfortably exceed this range. In fact, in the 10 years leading to 2018, prices have jumped by 25%, whilst changes in wages were meagre. Indeed, it looks unlikely that wage growth will be able to fully offset the impact of this trend any time soon.

It also appears that big-name developers are somewhat contributing to this trend. With the number of smaller players dwindling following the recession, these large developers now command a significant share of the market. As a result, they are not under pressure to immediately sell their properties, and instead have the luxury of listing the condos with little to no discount, keeping prices high and stable. As such, transactions take longer, and this is evidenced by the over 20% decline in the number of developments fully sold prior to completion since 2014.

Prospective buyers may therefore continue to be put off by the stretched average price-to-income multiple for the time being, and this should act as a fillip for the leasing market. However, this impact will vary across the submarkets. As we have seen so far, a potential peak in asking rents may be emerging in the pricier wards, and therefore, wards on the lower end of the scale may be set to benefit more over the medium to longer term.

OUTLOOK

The relative economic and political stability of Japan continues to attract capital. Indeed, the defensive nature of the residential market in this late property cycle remains especially appealing, with the recent deal between Allianz and Blackstone for the latter's JPY130 billion residential portfolio being case in point. Nonetheless, the usual warnings to the economy still ring true. Japan is not immune from prolonged global uncertainty, while closer to home, the impact of the consumption tax hike in October is not yet fully understood. These headwinds notwithstanding, the financial resilience of Japanese corporates provides a source of comfort, at least for the time being, though high levels of corporate profits have not yet translated into wage growth.

Despite the growth of asking rents coming to a halt in the 23W, over the year, growth remains solid. Going forward, therefore, a confluence of drivers, namely the lack of noticeable new developments in the near future, and the continued demand pressure from demographic tailwinds, should underpin rent growth for now. In addition, without meaningful wage growth, the average price-to-income multiple of a new condo should remain sufficiently high, benefitting the leasing market. That being said, if this lack of wage growth persists over the longer term, rents may begin to test an upper limit. For now, however, without a clear imminent risk to the leasing market, or to the economy, rents should still have some momentum left to grow, albeit moderately.

2 Based on the average value of a brand new 70 sq m condo.