savills

Briefing
Residential leasing

Q1 2014

Image: Shibaura, Minato-ku

SUMMARY

Recent signs of wage increases, as well as positive GDP figures, hint at a brightening outlook for Tokyo's residential leasing market. However, improving market sentiment remains key.

- In order to illustrate prevailing trends, Savills has broken down 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).
- The 23-ward population grew 1.2% year-on-year (YoY) as of 1 March 2014, with the highest rate of growth posted by the central five wards at 1.9%. This was closely followed by Inner East and Inner North.
- As of Q1/2014, average mid-market rents in the 23-ward area stood at JPY3,554 per sq m (JPY11,748 per tsubo), edging up 0.1% YoY.
- Six of our seven survey areas enjoyed moderate rental uplift on a YoY basis. These included the central five wards – Tokyo's central business district (CBD) – where rents increased 1.7% YoY to JPY4,080 per sq m (JPY13,488 per tsubo).
- The only area to record a rental decline was Outer East, our survey's least expensive submarket at JPY2,740 per sq m (JPY9,057 per tsubo), where average rents slipped a marginal 0.2% YoY.
- The average occupancy rate for J-REIT-owned residential properties in the 23-ward area was 96.5%, continuing its three-year trend above the 95% threshold.

"Mid-market apartment rents are expected to remain firm, supported by Tokyo's positive demographics and increasing tenant demand for centrally-located apartment units."
Will Johnson, Savills Research

The pull of Tokyo

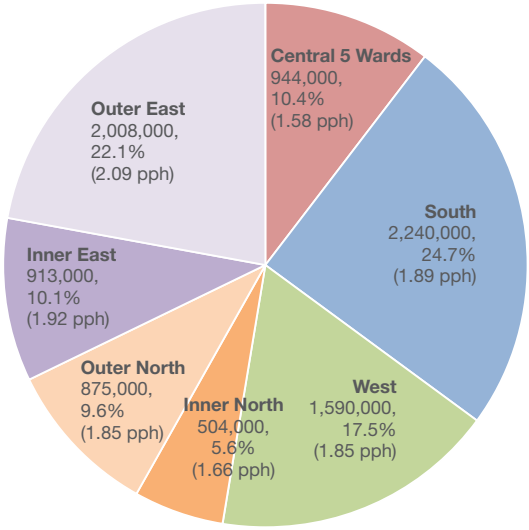
Encompassing the densely inhabited districts of neighbouring prefectures, Greater Tokyo's population incorporates in excess of 37 million people, making it the most populous urban agglomeration in the world[1]. The Greater Tokyo (Kanto) area also claims the top spot as the world's largest metropolitan area in terms of gross domestic product (GDP) – its total, at US$1,520 billion, comparable with that of entire nations such as South Korea, Canada and Spain[2].

Befitting its status as a regional economic, political and cultural powerhouse, Tokyo continues to draw new residents from across the country and beyond. At the prefectural level, Japan's capital had a population of approximately 13.3 million people as of 1 March 2014, up 0.6% YoY and reflecting aggregate growth of around 13% over the past two decades. Just fewer than 9.1 million reside in Tokyo's 23 special wards, or 68% of the prefectural population, the administrative districts that make up the centre of the city[3].

1 United Nations Department of Economic and Social Affairs, Population Division.
2 Brookings Institute and International Monetary Fund; comparison based on purchasing-power-parity valuation of nominal GDP as of 2012.
3 Analysis by Savills Research & Consultancy, based on TMG data.

GRAPH 1

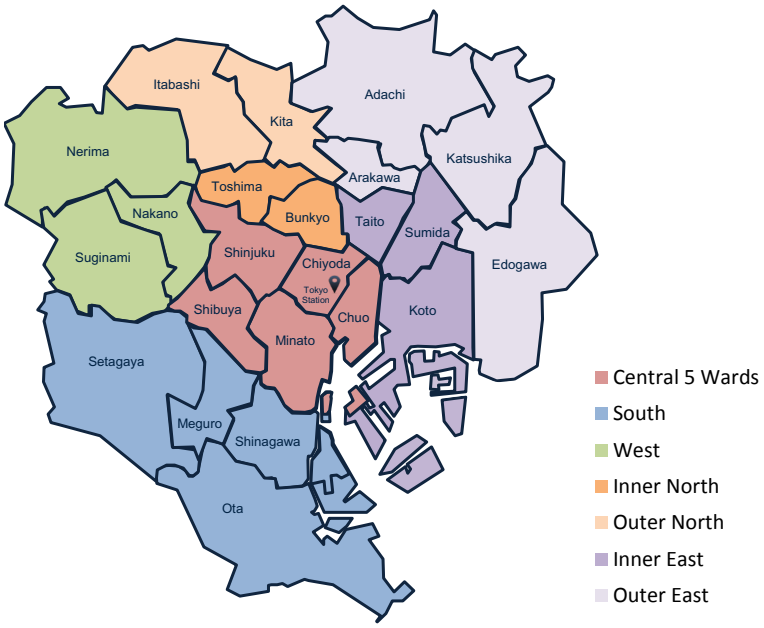
Population of Tokyo's 23 wards* by survey area, as of 1 March 2014



pph = number of persons per household
*Tokyo 23 wards total population: 9.07 million (1.87 pph)
Source: Savills Research & Consultancy, based on TMG data

MAP 1

Tokyo's 23 wards delineated by survey area



Source: Savills Research & Consultancy

Savills Tokyo residential survey: Breakdown by geography

In order to illustrate the prevailing trends affecting the residential market in central Tokyo, Savills has broken down 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).

Demographic trends: A closer look at central Tokyo

As a proportion of the 23-ward area, the central five wards that make up Tokyo's CBD are home to just over 10% of the total population. The South and West submarkets respectively account for approximately 25% and 18% of all residents. Meanwhile, combining the inner and outer areas, the North submarket comprises around 15% of the total, whereas the East accounts for the largest portion at approximately 32%. [GRAPH 1]

According to Tokyo Metropolitan Government (TMG) data, the Tokyo 23-ward area has seen its population expand by approximately 14% since 1995. Demonstrating above-average growth have been the central areas of the city: the central five wards expanded by close to 33%, while the Inner East and Inner North areas have grown by approximately 24% and 20% respectively. [GRAPH 2]

More recent data shows a similar trend, with the central five wards experiencing population growth of 1.9% YoY as of 1 March 2014, compared with 1.2% across the 23 wards as a whole. The Inner East area recorded a 1.8% increase, while the Inner North area expanded by 1.5%. By comparison, the Outer North, West and Outer East areas of the city have posted growth rates below the city average on both a long- and short-term basis.

The Outer East area posted the most nominal population growth, equivalent to 0.2% YoY in the March survey. This is in contrast with the annual rates of growth in excess of 1.0% recorded here prior to the Great East Japan Earthquake of March 2011. Government and academic studies suggest that reclaimed coastal land in this part of the city, as well as inland

sites along its rivers, are especially susceptible to soil liquefaction during or after a large earthquake. The seismic phenomenon is a process by which water-saturated sediment loses its structural integrity, potentially resulting in building subsidence as well as damage to groundwater and gas pipes. This risk, brought to the attention of the general public by the 2011 disaster, appears to be having a material impact on population flows.

New household formation

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 March 2014, Tokyo's 23 wards were home to approximately 4.85 million households – up 1.2% YoY. By comparison, the rate of growth in the central five wards was 1.9%, while the Inner East and Inner North areas grew by 1.8% and 1.5% respectively.

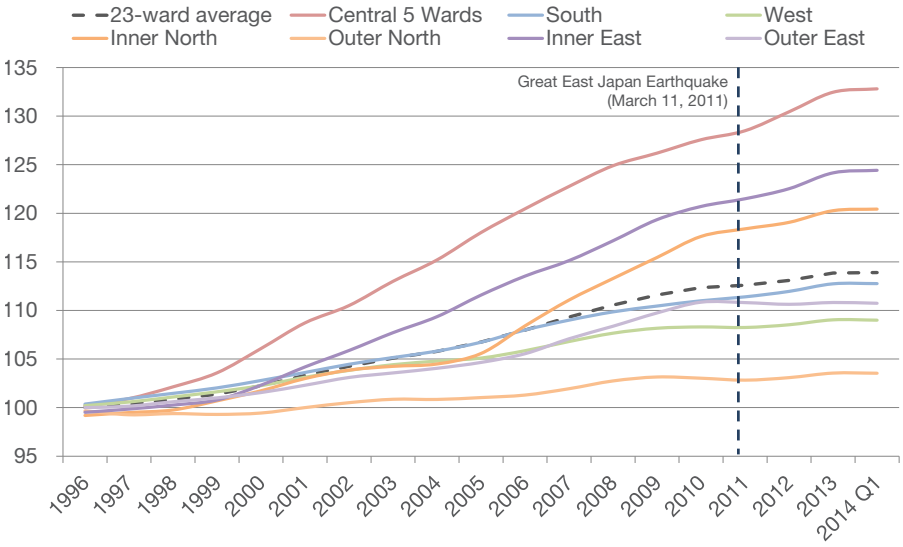
Japan's ongoing urbanisation and a trend towards smaller household sizes has led to an increase in the number of single-occupiers and DINKS (Dual Income, No Kids) households in its major cities. This, combined with improved economic sentiment over the last 12 to 18 months, has created robust demand for mid-market apartment units, particularly those located in and around the heart of Tokyo.

Savills rental index: Tokyo 'mid-market' apartments

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).

GRAPH 2

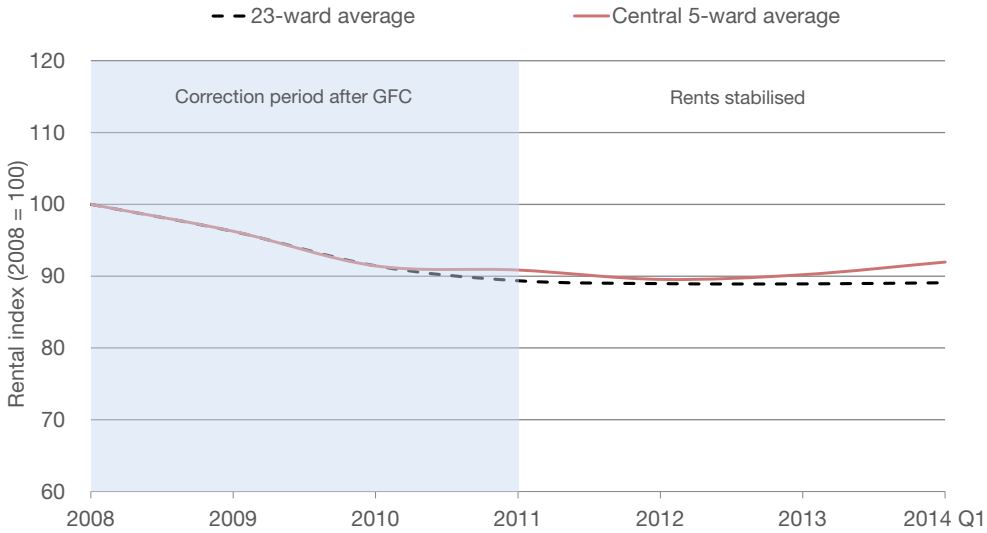
Population growth in Tokyo's 23 wards by survey area, 1996–Q1/2014



Source: Savills Research & Consultancy, based on TMG data

GRAPH 3

Tokyo mid-market apartment rental index, 2008–Q1/2014



Source: Savills Research & Consultancy

In the wake of the global financial crisis (GFC), Tokyo's 23-ward area saw a decline of approximately 10.6% in mid-market apartment rents over the three years from 2008 to 2011. Since this time, however, Savills mid-market apartment rental indices show that central Tokyo has entered a distinct stabilisation period. Average rents slipped a marginal 0.4% in 2012 and with downward pressure steadily dissipating, remained flat in 2013 through to Q1/2014.

Moreover, recent data suggests that the several areas of the city, including the central five wards, have shifted towards a modest rental recovery phase.

Tokyo mid-market apartment rental trends by survey area

In Q1/2014, mid-market rents in the 23-ward area stood at approximately JPY3,554 per sq m (JPY11,748 per tsubo). This rental figure is in line with the figure recorded in the same period of last year, edging up 0.1% YoY.

Six of the seven survey areas designated by Savills enjoyed a taste of rental uplift, albeit moderate, on a YoY basis. These included the central five wards – the most expensive of our residential survey areas – where the rental average increased by 1.7% YoY to JPY4,080 per sq m (JPY13,488 per tsubo). This figure represents a premium of approximately 15% over the 23-ward average and an 11% premium over the South area, Tokyo's second most expensive residential location.

The only area to record a rental decline on a YoY basis also happens to be Tokyo's least expensive: the Outer East. Here, average rents slipped a marginal 0.2% YoY to JPY2,740 per sq m (JPY9,057 per tsubo). This rental figure is approximately 23% lower than the 23-ward average and represents a 33% discount compared with the central five wards.

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.

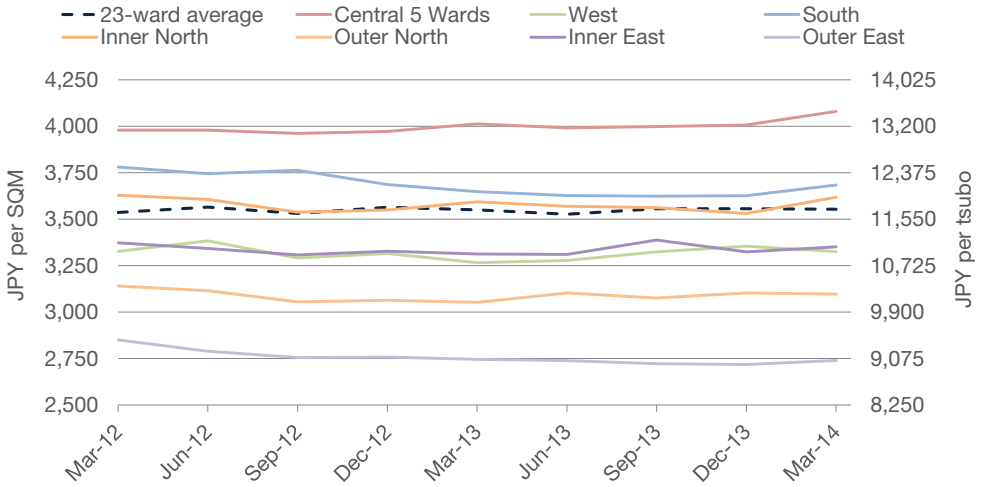
As shown in Table 1, rental pricing per sq m for smaller units targeting single occupiers is generally more expensive on average than that of larger units. This not only reflects the strong demand for compact units but also the higher gross rental costs involved in renting larger units, which: 1) decreases affordability for single-income households; and 2) makes the option of purchasing a condominium comparatively more cost-effective.

Across all unit size-bands, average rents in the 23-ward area were either stable or demonstrated moderate growth in Q1/2014 on a YoY basis. The central five wards outperformed the broader average, with asking rents up more than 2% in all size categories. The greatest annual movement was seen in the 60- to 75-sq m size-band, which posted an increase of 3.7% in the 23-ward area and 5.0% in the central five wards.

While too early to say whether this marks the beginning of a sustainable upwards trend, it is

GRAPH 4

Average asking rents for mid-market rental apartments by survey area, Q1/2012–Q1/2014



Source: Savills Research & Consultancy

TABLE 1

Average monthly asking rents broken down by size-band, Q1/2014

Size band	15–30 sq m		30–45 sq m		45–60 sq m		60–75 sq m	
Survey area	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	3,641 (12,036)	0.3	3,443 (11,383)	0.1	3,327 (10,999)	0.2	3,487 (11,529)	3.7
Central five wards	4,173 (13,794)	2.5	4,009 (13,252)	2.4	3,948 (13,050)	3.0	4,102 (13,560)	5.0
No. of units surveyed	>10,000		>5,000		>2,000		>500	

Source: Savills Research & Consultancy

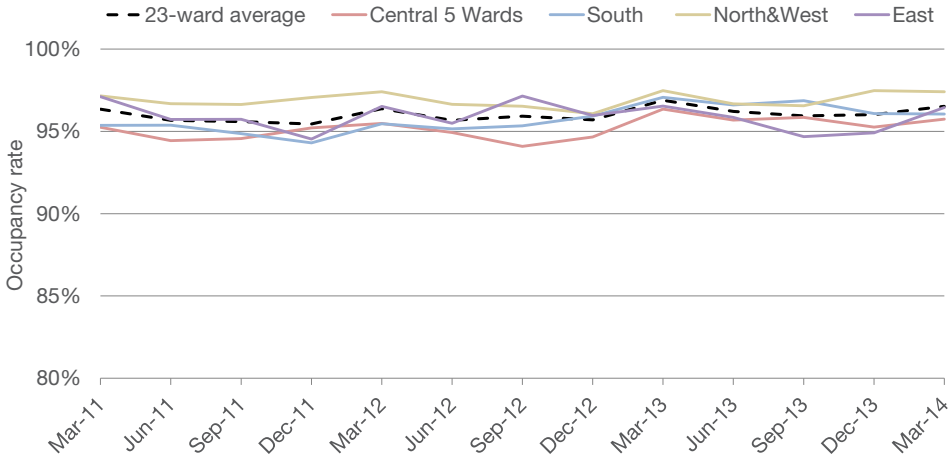
clear that landlords are becoming more aggressive in their rental expectations, particularly for newly-completed apartment units in central locations.

Mid-market apartment occupancy rates

J-REIT-owned residential assets provide a useful benchmark upon which to gauge mid-market apartment occupancy levels. The average occupancy rate for rental apartment buildings operated by J-REITs in Tokyo's 23 wards stood at 96.5% in Q1/2014, slipping 40 basis points YoY but continuing its three-year trend above the 95% threshold. The average occupancy rate in the central five wards was 95.7%, sitting above the 95% threshold for a fifth consecutive quarter.

GRAPH 5

Average occupancy rates for J-REIT residential assets, Q1/2012–Q1/2014



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

Recent signs of wage increases, as well as positive GDP figures, are suggestive of a brightening outlook for Tokyo's residential leasing market. However, improving market sentiment remains key. The 3-percentage point consumption tax hike that came into effect in April 2014 is likely to have a negative impact on consumer confidence. This may act to dampen the burgeoning rental recovery hinted at in our Q1 data over the short term.

Nonetheless, mid-market apartment rents are expected to remain firm, supported by Tokyo's positive demographics and increasing tenant demand for centrally-located units.

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