Briefing
Residential leasing

Q2 2017

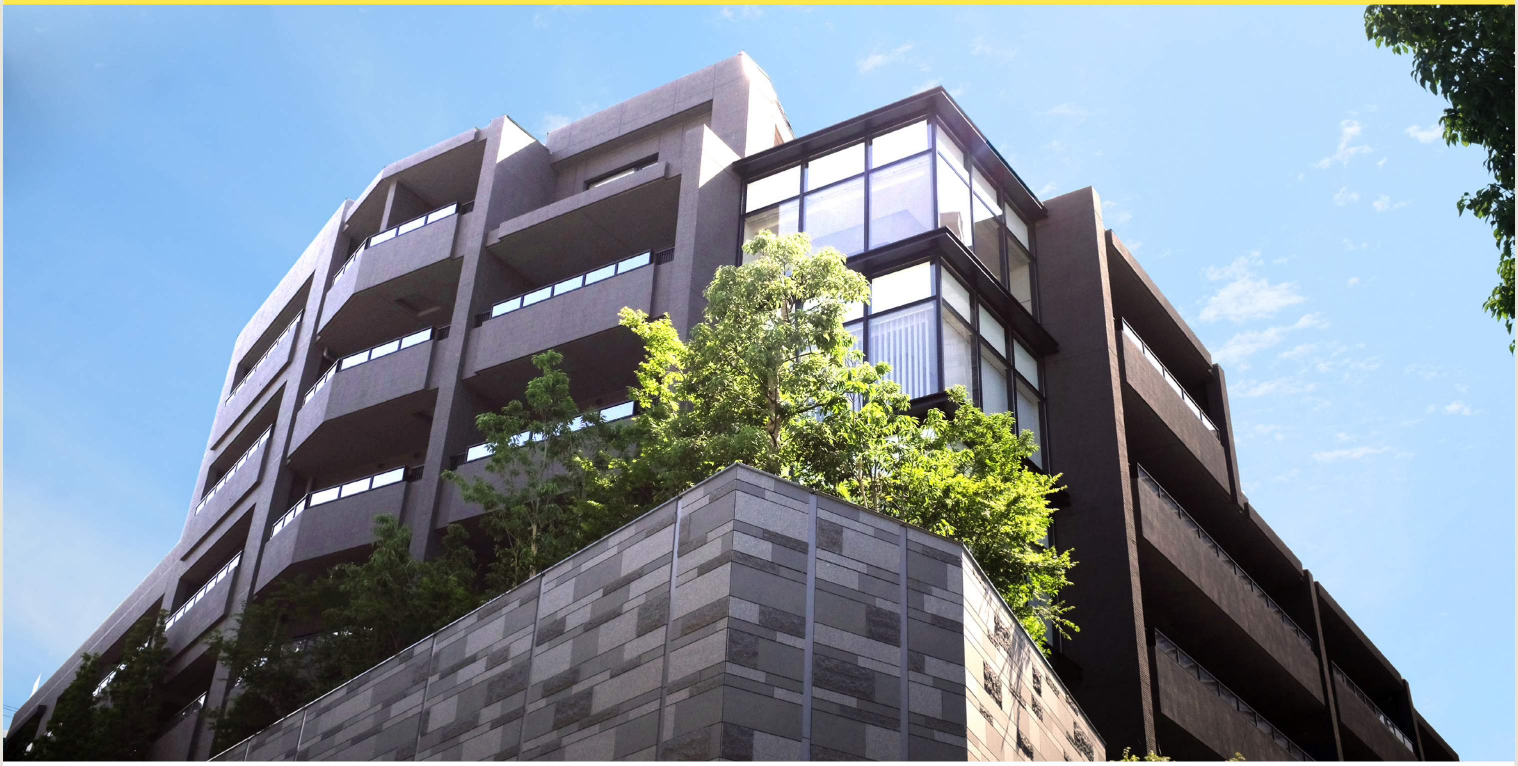


Image: The Parkhouse Shirokane Chojamaru

SUMMARY

Rental growth has continued in the C5W, and slow gradual increases are expected.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stood at JPY3,654 per sq m, down 0.4% quarter-on-quarter (QoQ) but still up 0.4% year-on-year (YoY).

- Average asking rents in the central five wards (C5W) stood at JPY4,298 per sq m, up 0.9% QoQ and 0.8% YoY.

- Tokyo's Inner North and Outer East areas continue to outperform other areas, registering 2.1% and 1.6% growth YoY respectively.

- The C5W's rental premium over the 23-ward average continues to increase, and stands at 16.9%.

- Though there have been minor fluctuations, average occupancy rates continue to remain above 95%.

- Overall, average rents of upscale residential units in the C5W in Q1/2017 were still 9% lower than the 2007 value. Shinjuku and Minato have continued rental growth against the 2016 averages.

"Mid-market asking rents in the C5W continued to see gradual rental increases in Q2/2017. With occupancy comfortably above 95%, residential demand in Tokyo appears to remain strong. Average rents of upscale apartments have continued to grow in Shinjuku and Minato."
Savills Research & Consultancy

Savills Tokyo residential survey: Breakdown by 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).

Savills rental index: Tokyo mid-market apartments

Savills collates over 20,000 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) 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

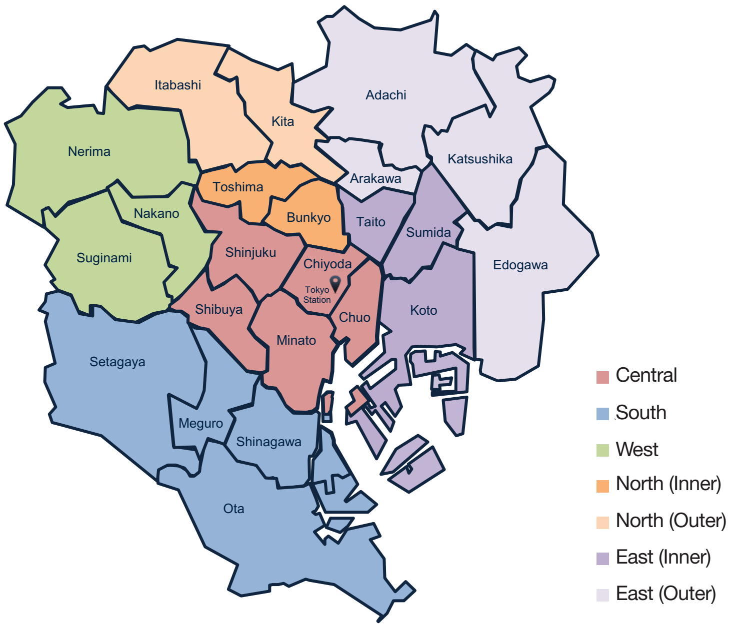
3) properties located in Tokyo's 23 wards and situated within a ten-minute walk of the nearest station.

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.

In Tokyo, rental growth has been under way at a steady pace, but rents still sit 7.8% below their 2008 average, leaving room for improvement. Rents in Tokyo's 23 wards were slightly down by 0.4% QoQ but up by 0.4% YoY in Q2/2017. In this quarter, the average rent registered at JPY3,654 per sq m.

MAP 1

Tokyo's 23 wards by survey area



Source: Savills Research & Consultancy

Rents in the C5W stood at JPY4,298 per sq m in Q2/2017, up 0.9% QoQ and 0.8% YoY. Rents in this area are now only 2.4% below 2008 levels, indicating a faster recovery than in Tokyo overall. Openings of new, quality apartment buildings are also bolstering the upward trend.

Newly completed rental properties on the market in Q2/2017 include Shibuya Cast and Axelis Shibuya Nanpeidai. Shibuya Cast is a mixed-use property with apartment units. Its advertised 1LDK rooms of about 60 sq m are about JPY5,200 per sq m. Axelis Shibuya Nanpeidai features 25 units with a size range of 20 to 50 sq m. Its advertised 2LDK rooms of about 50 sq m are about JPY6,000 per sq m.

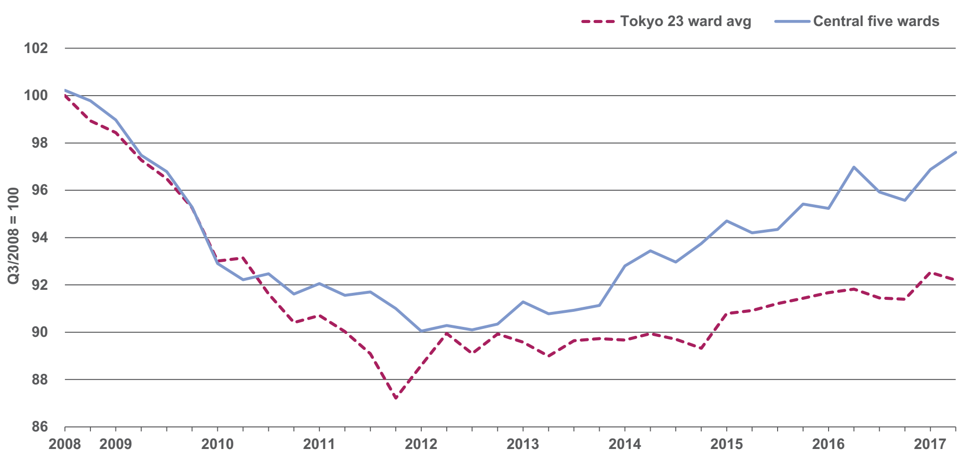
Tokyo mid-market rental trends by survey area

Rents in the C5W area consistently show large premiums over the city average. Rents in the South and Inner North submarkets also show small premiums over the 23W average due to their convenience and popularity. All other submarkets tend to advertise rents at a discount to the 23W average.

These premiums and discounts of markets in Q2/2017 are generally

GRAPH 1

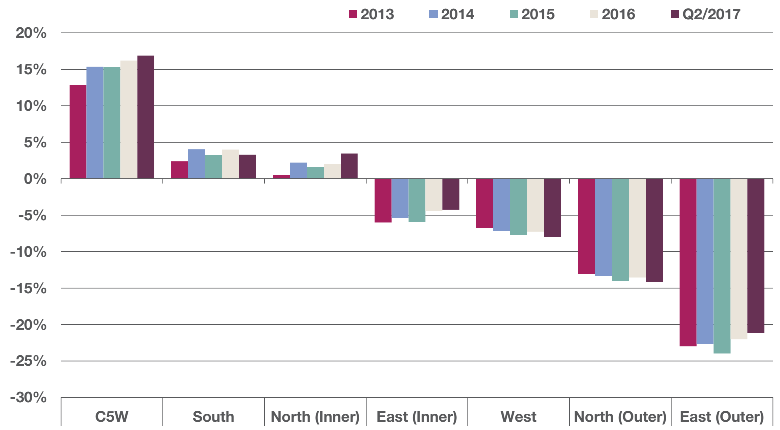
Tokyo mid-market apartment rental index, Q3/2008–Q2/2017



Source: Savills Research & Consultancy

GRAPH 2

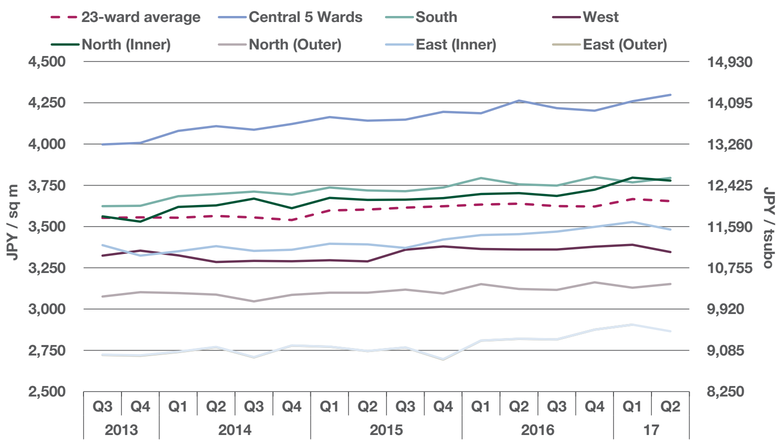
Rental premiums and discounts over the Tokyo 23-ward average, 2013–Q2/2017



Source: Savills Research & Consultancy

GRAPH 3

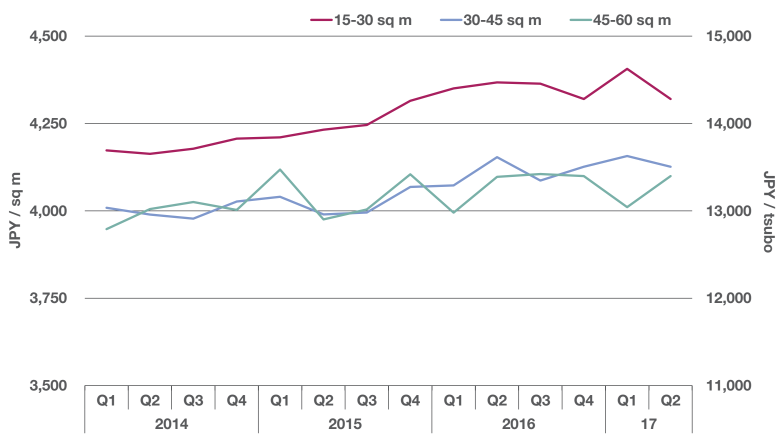
Average asking rents for mid-market rental apartments by survey area, Q3/2013–Q2/2017



Source: Savills Research & Consultancy

GRAPH 4

Average monthly asking rents by unit size, C5W, 2014–2017 YTD



Source: Savills Research & Consultancy

in line with trends of the past five years. The highest premium was observed in the C5W at 16.9%, up 0.7ppts from 2016. The South and Inner North areas kept positive premiums of 3.3% and 3.5% respectively. The outer areas, meanwhile, showed discounts. The greatest discount was seen in the Outer East area at -21.2%, followed by the Outer North area at -14.2% and the West area at -8.0%. The Inner East area currently shows a discount of -4.3%.

The Inner North, Inner East, and Outer East areas have performed well in recent years. The Inner North's premium has increased from 0.5% in 2013 to 3.5% in Q2/2017 while the Inner East and Outer East have shrank their discounts from -6.0% and -23.0% to -4.3% and -21.2% during the same period respectively.

The eastern areas have seen infrastructure and transportation development along Tokyo Bay, which has encouraged migration to these areas. The popularity of the Outer East area largely derives from its affordability, especially considering a majority of migrants are under 30 years old. Furthermore, the rental growth in the eastern area could be because the Tokyo's waterfront area is recovering in popularity after the 2011 Tohoku earthquake raised concerns about the safety of the area.

Graph 3 illustrates that the average rent in the C5W is up 0.8% YoY as of Q2/2017, with strong growth in Shibuya (5.5%) and Minato (3.6%). The opening of Shibuya Cast, Axelis Shibuya Nanpeidai, and Prime Residence Shibuya appear to have contributed to the growth in Shibuya. Additionally, Tokyo's Inner North and Outer East areas have shown sound growth of 2.1% and 1.6% YoY respectively.

Tokyo mid-market apartment 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. 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.

Graph 4 shows that apartments of 15-30 sq m have particularly increased rents in recent years. This may be related to increasing demand for smaller units, as over 90% of recent migrants to Tokyo are relatively young and likely do not require large-sized units.

Occupancy rates

Average occupancy rates in Tokyo remain comfortably above 95% at a reading of 96.9%. This is 0.8ppts higher than a year earlier. During the same period, the C5W increased occupancy by 0.7ppts to 96.1%. Occupancy in the North & West area is particularly strong at 97.9%, a 1.1ppts increase YoY. In Itabashi, occupancy was the strongest at 99.1% in Q2/2017.

In the C5W, Chiyoda showed the tightest occupancy at 97.1%, followed by Chuo and Minato at 96.6% and 96.2% in Q2/2017. Shibuya continued to strengthen occupancy to 95.2%, up 1.2ppts YoY.

The high occupancy may be partially attributable to high condo prices. Condo prices rose rapidly over the past several years, driven by Tokyo Olympics stories, low interest rates, and inheritance tax reforms. However, the trend appears to be slowing down lately. High condo prices may indicate that more occupiers are opting for the rental market.

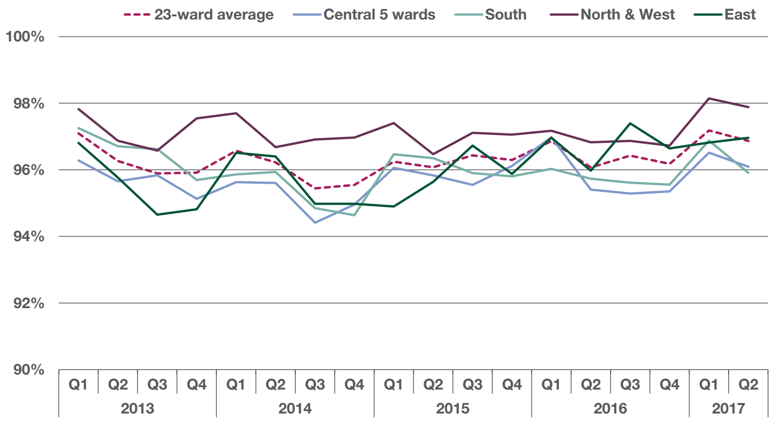
Upscale residential market

After years of steady growth, rental increases in the C5W appear to be taking a break. In Q1/2017, average rents of upscale residential properties[1] were JPY4,723 per sq m, 0.3% down YoY, with rental corrections seen in Chiyoda, Chuo, and Shibuya. Meanwhile, Shinjuku continues to improve average rents, showing an impressive 12.5%

1 "Upscale residential" is defined as more than JPY300,000 in rent or more than 30 tsubo (99.2 sq m) in an exclusive area in and located in the central five wards.

GRAPH 5

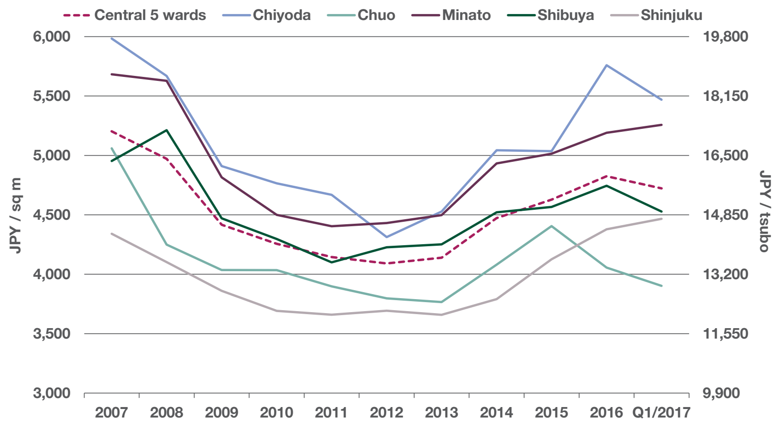
Average occupancy rates for J-REIT residential assets, Q1/2013–Q2/2017*



* Q2/2017 estimate based on April – May data.
Source: Savills Research & Consultancy based on publically disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)

GRAPH 6

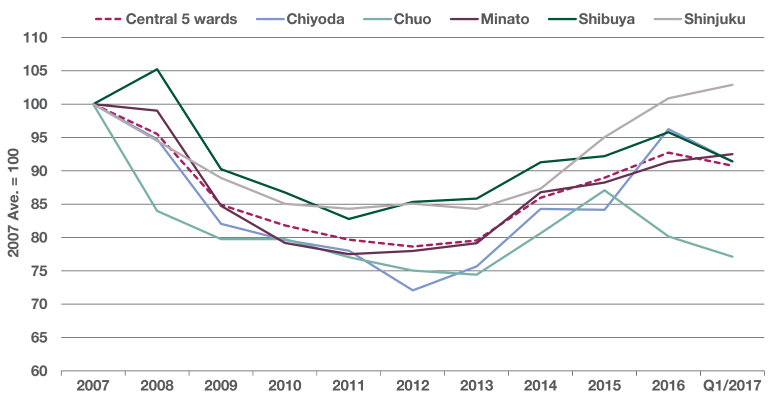
Average upscale residential contract rent by wards, 2007–Q1/2017



Source: Ken Corporation, Savills Research & Consultancy

GRAPH 7

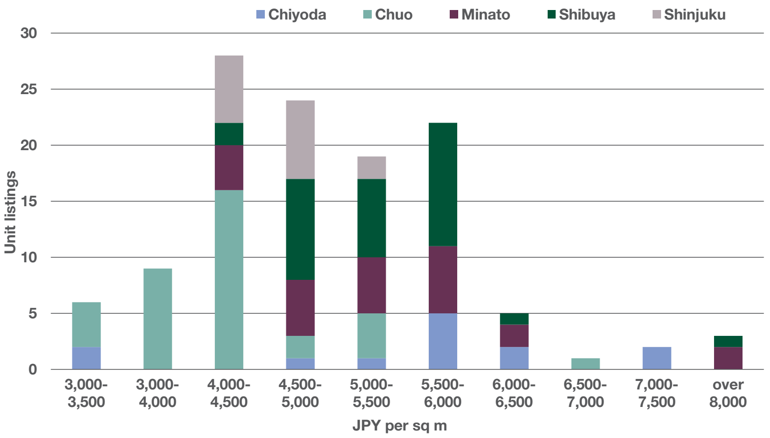
Upscale residential rental index, 2007–Q1/2017



Source: Ken Corporation, Savills Research & Consultancy

GRAPH 8

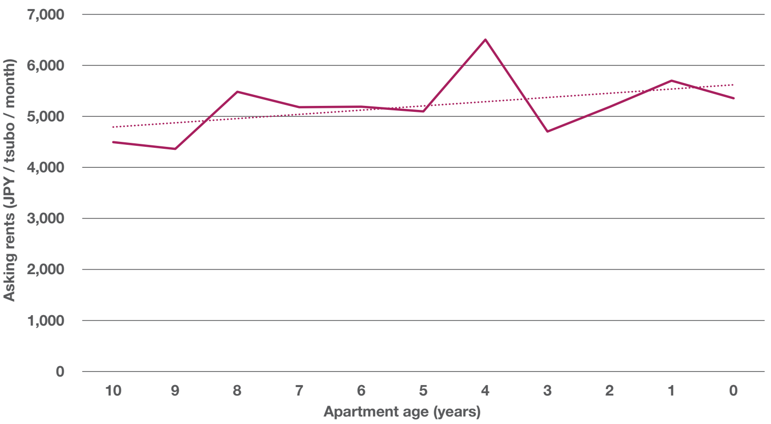
Upscale residential asking rent distribution by ward, Q2/2017



Source: Savills Research & Consultancy

GRAPH 9

Upscale residential asking rent and apartment age



Source: Savills Research & Consultancy

increase YoY to JPY4,459 per sq m, though this is a 0.3% decline QoQ. The ward experienced the smallest rental decline following the financial crisis and has been leading the recovery. Relatively low rents in Shinjuku has made it easier for the ward to post large growth in percentage terms. Growth was particularly visible in Q2/2016 after the completion of La Tour Shinjuku Garden, which likely contributed. Minato's average rents also increased 2.8% YoY to JPY5,275 per sq m.

Graph 8 indicates a wide rent range for upscale apartment asking rents in each ward. Typical ranges appear to extend ±1,000 JPY per sq m against averages. Additionally, Chuo's upscale units fall in the low to medium range while Chiyoda, Minato, and Shibuya tend to be found in the medium to high range. Chuo's low range is likely due to a glut of new supply in recent years in peripheral neighbourhoods of the ward near Koto, which is just across the river. In Minato and Shibuya, asking rents for some properties can exceed JPY8,000 per sq m.

According to Ken Corporation, Minato and Shibuya have particularly high average new supply[2], which partially contributes to higher rent ranges in these wards as new buildings pull up rents. Graph 9 illustrates a general correlation between asking rents and property ages. Going forward, continuing new supply of upscale units should support gradual rental increases in Tokyo.

Reported occupancy rates of upscale units in Tokyo have been slightly lower than the J-REITs' average but remain above 93%, according to Ken Corporation. In Q1/2017, occupancy rates in the major three wards and major nine wards[3], were 93.6% and 93.3% respectively. These represent slight corrections of 0.3ppts and 0.1ppts YoY.

2 Ken Corporation uses the number of properties that are newly registered in the company's system as a proxy for new supply.

3 Ken Corporation labels Minato, Setagaya, and Shinjuku as the "major three wards". Additionally, Bunkyo, Chiyoda, Meguro, Ota, Shinjuku, and Shinagawa make up the "major nine wards".

OUTLOOK

The prospects for the market

C5W residential rents are continuing to grow gradually. Shibuya and Minato in particular saw strong rental increases, partially due to openings of new residential properties in these wards. Although average rents in the 23W area have experienced some corrections from the previous quarter, they are still up on a YoY basis. Rents for small units have especially increased over the past years, driven by young migrants to Tokyo.

Rental growth in the upscale residential segment appears to be pausing after years of steady recovery. However, rents in Shinjuku and Minato continue to increase, and occupancy rates for the C5W remain sound. High condo prices may be driving occupants to the rental market.

Japan's real GDP recorded a fifth consecutive quarter of growth in Q1/2017, marking the longest string of increases in a decade. As Japan's economy continues to improve at a moderate pace, forces are in place for continuing, albeit slow, rental growth. The employment conditions in Japan have been very tight and the nation's labour participation rates have been increasing to fill rising demand. Labour reform could function as an additional driver for wage increases, and eventually rental growth.

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