savills

Briefing
Residential leasing

Q2 2018

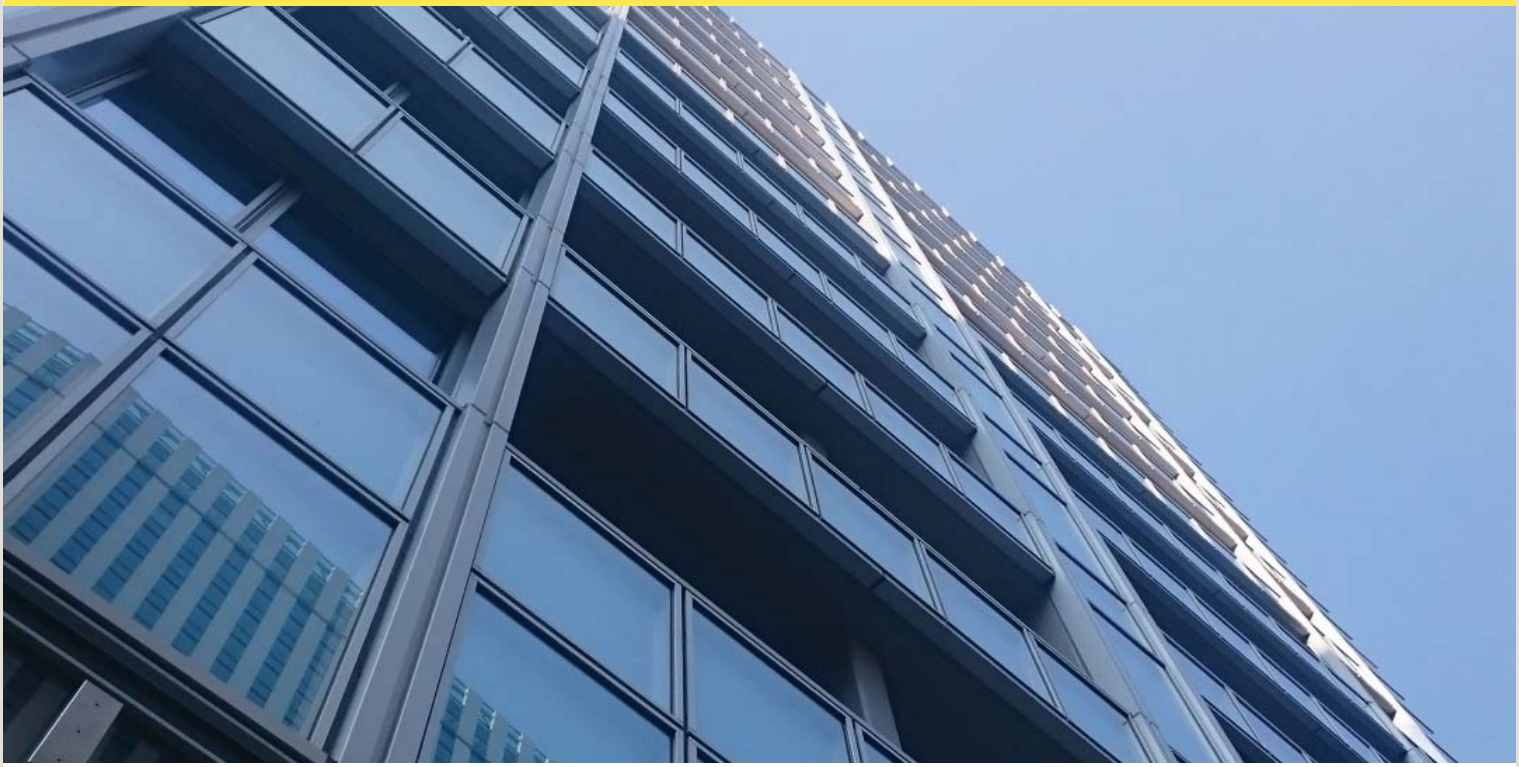


Image: Mirea Court Ginza Premier

SUMMARY

Average rents consolidated in Q2, as expected following the robust gains in Q1. Annual growth should remain healthy and continue its upward trend.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stood at JPY3,771 per sq m, down 0.5% quarter-on-quarter (QoQ) but up 3.2% year-on-year (YoY).
- Average asking rents in the central five wards (C5W) stood at JPY4,454 per sq m, down 1.7% QoQ but up 3.6% YoY.
- Both Inner and Outer North submarkets posted gains, rising 2.7% and 1.4% QoQ, respectively, while YoY growth was 2.2% and 2.8%.
- The C5W's rental premium over the 23W average stands at 18.1%, up 1.3% since 2017.
- Average occupancy rates for institutional-quality assets temporarily dipped this quarter but are likely to remain high as demand for conveniently located and quality residences is strong.
- Increased upkeep costs for homeowners have the potential to boost demand for rental properties as purchases are postponed.

"C5W average asking rents have remained above the 2008 peak for a second consecutive quarter. We expect growth in C5W rents to proceed steadily, supported by strong demand. Similarly, in the 23W we forecast continued growth in rents albeit at a slower pace." 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.

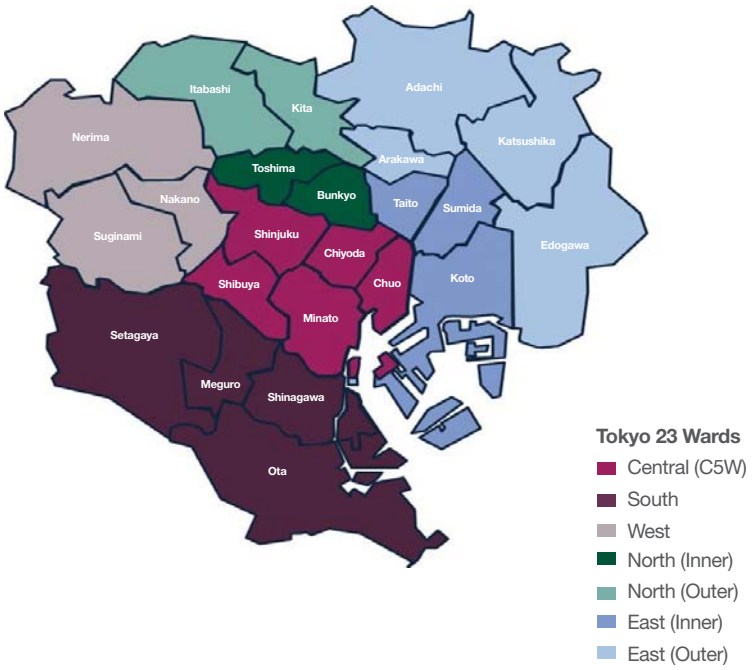
In contrast to the luxury residential market, advertised or 'asking' rents for mid-market units fitting the above criteria are typically non-negotiable and are not subject to incentives such as rent-free periods. Savills mid-market rental indices are therefore considered to closely reflect movement in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

Overall results

Rents gave back some of last quarter's gains in Q2/2018 as we expected in the previous briefing, with the 23W average dipping to JPY3,771 per sq m, a decrease of 0.5% QoQ. Therefore, this quarter's consolidation is not surprising and importantly does not disturb the longer term trend with annual growth remaining strong at 3.2% YoY. C5W rents fell faster than the 23W average, dropping 1.7% QoQ. Annual growth in the C5W remains stronger than in the 23W, at 3.6% YoY. Growth in rents across Tokyo is expected to persist, albeit with fluctuations, as demand remains strong, underpinning the market.

MAP 1

Tokyo's 23 wards by survey area



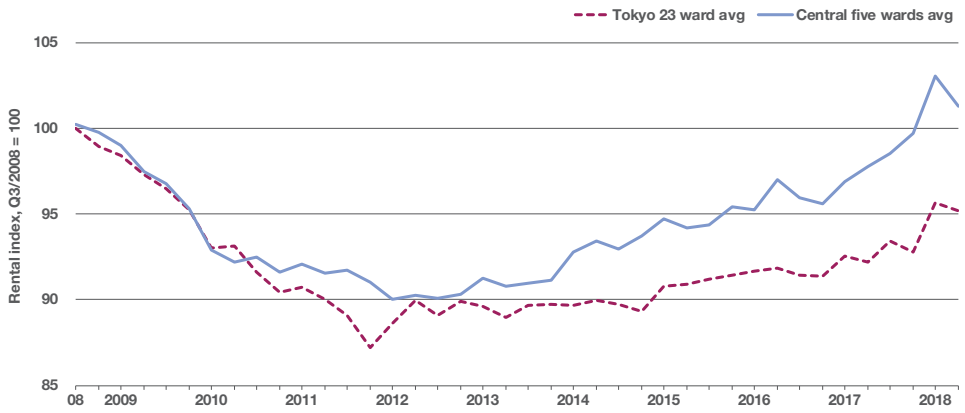
Source: Savills Research & Consultancy

Average rents in the majority of Tokyo's submarkets fell in Q2/2018; pockets of growth remained, however, as both Inner and Outer North submarkets posted higher rents, up 1.4% and 2.7% QoQ, respectively. Inner East, South and West submarkets' rents declined 1.6%, 1.5% and 1.0% QoQ, respectively, marginally less than the C5W, while Outer East rents fell just 0.3% QoQ. Only the West submarket posted both a quarterly and annual decline this quarter, in fact doing so for the third consecutive quarter. The West's discount to the 23W average has grown since 2016 as its stock has aged and, possibly, over concerns of increased supply in the future.

Rents in the 45-60 sq m size band decreased faster than other size bands this quarter, mainly reversing last quarter's exceptionally robust increase, though remained above those in the 30-45 sq m size band for a second consecutive quarter. Annual trends show steady growth across all size bands with the 15-30 sq m size band maintaining its premium over larger size bands, demonstrating continued demand for smaller rental properties in Tokyo.

GRAPH 1

Mid-market apartment rental index, Q3/2008 – Q2/2018



Source: Savills Research & Consultancy

Mid-market rental trends by survey area

Although the premium of C5W rents over the average of 23W rents shrank this quarter, Graph 2 shows steady growth in the average annual premium since 2014; it has grown from an average of 11.9% in 2012 to stand at 18.1% as of Q2/2018. Increasing demand for centrally located properties should drive this premium higher for the foreseeable future, as should a steady supply of new buildings. It stands to reason that fresh stock in the C5W is likely to command a quality premium over ageing stock in outer wards such as those in the West submarket, for instance, where the average age of listed buildings has risen.

A law governing land use that incentivised owners to maintain farmland through tax relief, enacted in 1992, is due to expire in 2022. The expiry could result in increased supply of residential property as owners are finally able to sell their land without additional tax being levied under this law. Developers are expected to seek to maximise profits from converted land use and take advantage of the strong market, if good sentiment continues. The addition of fresh, higher specification housing stock might help narrow the discount of the West submarket, but excess supply may work adversely. This effect would be greatest in Nerima in the West submarket and Setagaya in the South submarket, where a significant proportion of such land is concentrated. The real impact is still uncertain and it is too early to tell how farmland owners are likely to respond to the change.

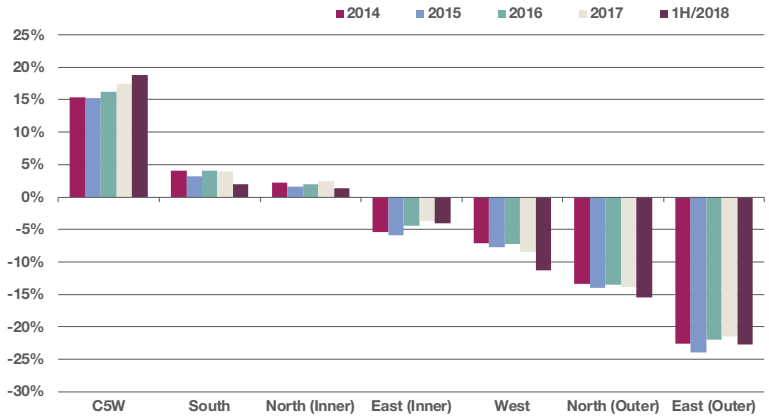
The bright spot in the C5W was Shinjuku which registered a fourth consecutive quarter of rental growth, reaching 6.0% YoY after a 1.9% gain this quarter. For instance, Comforia Shinjuku Eastside Tower, a block of luxurious flats, is currently advertising multiple units over 40 sq m at an almost 30% premium to last quarter's average rent for the ward. Given its high quality and that occupancy in this building has comfortably met or exceeded 95% for the last year, these rents should be attainable.

Elsewhere in the C5W, Chuo posted an unprecedented decline of 3.8% QoQ as premium listings from last quarter dropped out of the sample and numerous more affordable listings were added in less convenient locations such as Harumi and Hatchobori. In Chiyoda, premium listings which had brought up the average last quarter appear to have been snapped up, causing the ward average to fall 1.8% QoQ. YoY growth in both wards is strong at 5.7% and 6.3% for Chuo and Chiyoda, respectively. In Shibuya, multiple units at Zoom Sasazuka are offered at a discount of over 10% to this quarter's average asking rent, partly contributing to a 2.7% QoQ fall in average asking rents across the ward. In Minato, asking rents dropped 1.7% QoQ despite a slew of multiple premium listings at the recently completed Canalfront Shibaura representing more than 10% of Minato's listed space this quarter. YoY growth for Minato rents currently stands at 2.8%.

In the South submarket, average rents fell 1.5% QoQ, led by Setagaya and Shinagawa, down 3.0% and 2.9%, respectively, but balanced by a fall of 0.5% in Ota and growth in Meguro of 0.4%. The West submarket registered a decline of 1.0% QoQ, with Suginami falling 3.0% and Nakano 2.3%, but Nerima rising 3.0%. In the Outer North submarket, rents grew 1.4% this quarter, while the Inner North submarket saw even better growth than its neighbour, rising 2.7% QoQ.

GRAPH 2

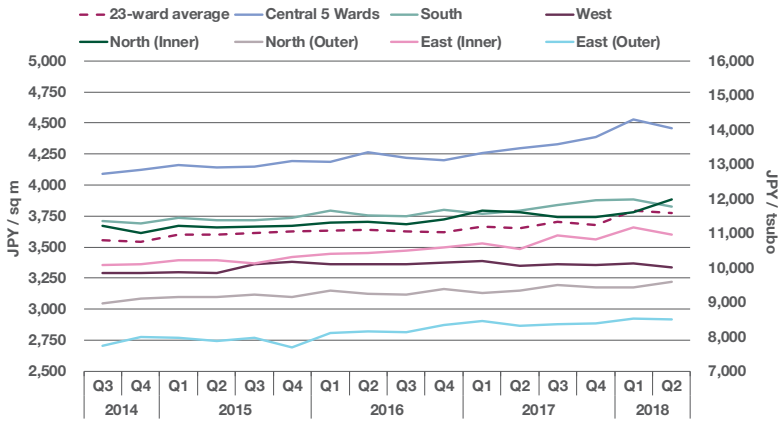
Rental premiums/discounts vs 23W average, 2014 – 1H/2018



Source: Savills Research & Consultancy

GRAPH 3

Mid-market apartment rents, Q3/2014 – Q2/2018



Source: Savills Research & Consultancy

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.

Rents across all size bands contracted in Q2/2018, but continued to grow steadily on an annual basis (Graph 4). Average rents in the 15-30 sq m size band now stand slightly lower than last quarter at JPY4,493 per sq m, but continue to command the highest rent per sq m as young workers with a preference for smaller units migrate to central Tokyo and bolster demand. Properties in the 30-45 sq m size band now sit at JPY4,300 per sq m. Average rents for listings in the 45-60 sq m size band remained higher than those in the 30-45 sq m size band for a second consecutive quarter, at JPY4,369 per sq m.

Occupancy rates

Average occupancy rates in Tokyo remain high, with the current 23W average 0.2ppts higher than the prior year at 96.9%, though this is 0.5ppts lower than last quarter. C5W average occupancy fell more than the 23W average this quarter, down 1.1ppts QoQ but still up 0.2ppts YoY, finishing Q2/2018 at 96.1%. Only a very small number of apartments registered occupancy below 90% this quarter, suggesting the overall decrease was temporary and due to tenant relocations rather than excess supply.

The largest increases in occupancy this quarter came from peripheral wards Ota and Edogawa, each up 1.3% QoQ, with the latter registering 100% occupancy, a feat not seen across the whole of the 23W since Q3/2012. Each member of the C5W saw lower occupancy this quarter: Shibuya fell the least, down just 0.2ppts QoQ, while Shinjuku fell the most, down 2.6ppts after a strong increase last quarter.

While changes in occupancy across submarkets varied this quarter, over the longer term the range between highest and lowest occupancy continues to narrow (Graph 6), highlighting the high demand for institutional-quality assets across all of Tokyo. Strong fundamentals including a robust economy and increased demand for centrally located homes should contribute to leasing demand and support the institutional market for the time being.

Running costs for apartments increasing

Repair costs appear to have risen approximately 20% to 30% since spring 2013 and it is becoming apparent that this is likely to continue beyond the Olympics in 2020. Depressed levels of reserve funds are contributing to increased upkeep payments required of owners, who must prepare for costs now, even though the actual repairs may take place as far as a decade ahead. Initial reserve fund payments are often set lower than necessary by developers in order to mask the true costs from purchasers, though this will necessarily result in higher payments in later years to compensate. Guidance from the Ministry of Land, Infrastructure and Transport for monthly reserve fund payments is between JPY178 and JPY218 per sq m per month, yet Tokyo Kantei, an appraisal firm, estimates the current average is only around JPY95 per sq m per month.

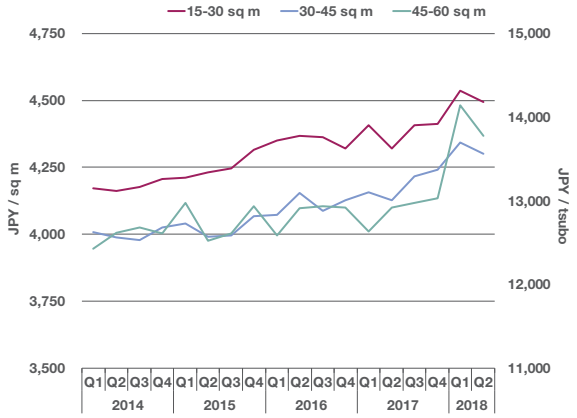
In addition, reserve funds have in the past been topped up by revenues from car parks installed on the premises, but reduced demand for car parking spaces has depressed these revenues, exacerbating the current shortfall. Tokyo Kantei reports that there were just 33 car parking spaces per 100 apartments in 2017 compared to 67 per 100 in 2001. In some buildings, mechanical car parking maintenance costs are even draining reserve funds as opposed to contributing to them.

Limited reserve funds may become an issue in the future when apartments require a large amount of capital expenditure for repairs. Some property management companies have even resorted to taking out loans to pay for necessary works when faced with inadequate reserve funds.

Increased upkeep costs for homeowners are unlikely to directly affect rents soon. However, the prospect of higher costs may spur would-be buyers to postpone purchases and return to the rental market in the short term, potentially increasing demand. Given that demand for rental properties is already high, and that availability of rental properties is relatively low, it is possible that incremental demand from postponed home purchases could manifest itself in higher rents, albeit slightly.

GRAPH 4

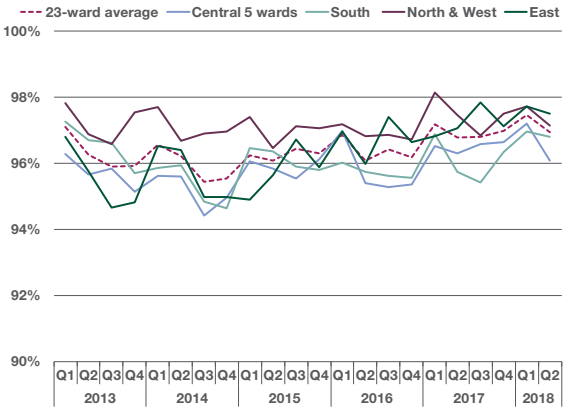
Rents by unit size, C5W, 2014 – Q2/2018



Source: Savills Research & Consultancy

GRAPH 5

Average occupancy for J-REIT residential assets, 2013 – Q2/2018*

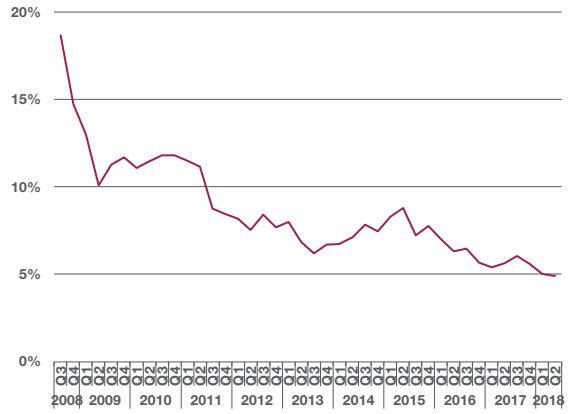


* Q2/2018 estimate based on April – May data.

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

GRAPH 6

Range between highest and lowest occupancy levels across 23W (rolling 4Q average), Q3/2008 – Q2/2018



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

OUTLOOK

The prospects for the market

Asking rents in the C5W have remained above 2008 levels for two consecutive quarters, despite correcting as expected this quarter after an exceptionally strong prior result. Continuing migration to city centres and an increase in dual-income households should help rents grow slowly but steadily. Similarly, the 23W should experience continued growth in rents, albeit at a slower pace than in the C5W, eventually surpassing its own 2008 watermark. The C5W continues to extend its premium over other submarkets. For instance, the West is experiencing a widening in its discount as the average age of listed apartments rises.

Over the medium term, increased repair costs which show no sign of abating will add to homeowners' running costs, as will increased contributions to limited reserve funds which may not be able to maintain the quality of apartments. Such pressures have the potential to push prospective homeowners back into rental properties which should in theory cause rents to rise through increased demand.

Occupancy in institutional-quality residences is strong and unlikely to weaken, as their high quality and convenient locations are attractive to prospective tenants. Low unemployment and a rise in the number of dual-income households should allow rents to continue to slowly grow, given limited supply. Even if global economic uncertainty persists, negatively impacting capital markets, mid-market residential properties in Tokyo should remain relatively stable and attractive to investors given their defensive qualities.

Please contact us for further information

Savills Japan

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

Savills 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

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.