Briefing
Residential leasing

Q3 2017

Image: Park Mansion Hinokicho Koen

SUMMARY

Gradual rental growth has continued in the central five wards, spurred by resilient occupancy and new development.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stood at JPY3,702 per sq m, up 1.3% quarter-on-quarter (QoQ) and 2.2% year-on-year (YoY).
- Average asking rents in the central five wards (C5W) stood at JPY4,331 per sq m, up 1.0% QoQ and 2.7% YoY.
- All geographic submarkets are up YoY, typically by a margin of about 2% to 3%.
- The C5W's rental premium over the 23-ward average held steady at 16.9%, unchanged from Q2. Tokyo's eastern submarkets are still seeing discounts, but have slightly narrowed the gap.
- Average occupancy rates remain comfortably above 95%.
- Certain submarkets are seeing rapid redevelopment. Over 9,600 tower residential units are planned in Minato Ward and its Toranomon district, which may transform drastically over the coming years.
- Parking spaces have steadily fallen out of favour over the past ten years.

"Mid-market asking rents continue their slow but steady ascent. If the recent growth trend persists, rents in the central five wards may surpass their 2008 levels sometime in 2018."
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 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) one- or two-bedroom rental apartments of up to 100 sq m in size;

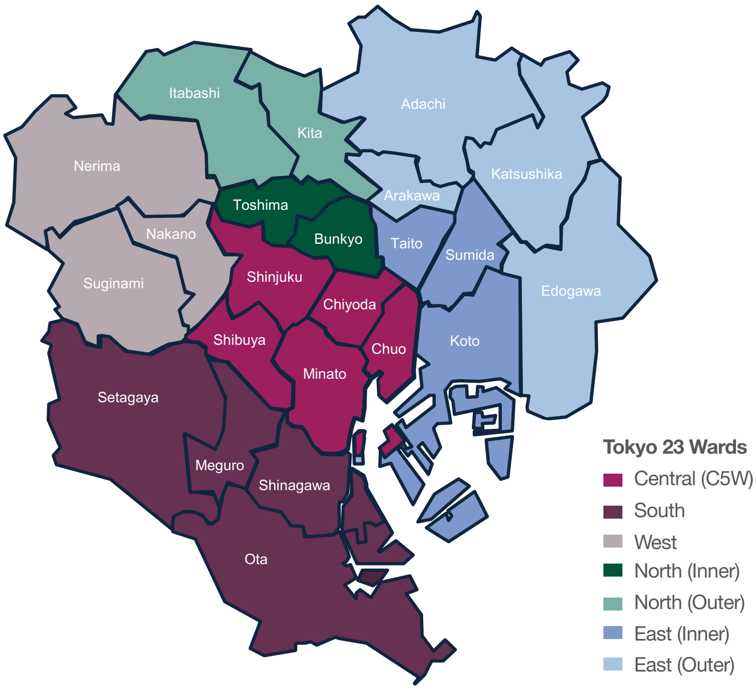
2) reinforced concrete structures built within the last ten years; and

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.

MAP 1

Tokyo's 23 wards by survey area



Source: Savills Research & Consultancy

Residential rents in Tokyo have continued their gradual upward trend. The average rent across Tokyo's 23 wards stood at JPY3,702 per sq m per month at the end of September, up 1.3% QoQ and 2.2% YoY. This represents a recovery from slightly softer figures in Q2. Because rental movements are typically quite gradual in central Tokyo, period-to-period fluctuations are often dependent on the number of new buildings commencing lease operations.

Average asking rents in the C5W stood at JPY4,331 per sq m, up 1.0% QoQ and 2.7% YoY. The C5W submarket has enjoyed three consecutive quarters of rental increases and is now just 1.5% below crisis-era levels in 2008. If the current growth rate persists, C5W asking rents could surpass their 2008 levels sometime in 2018.

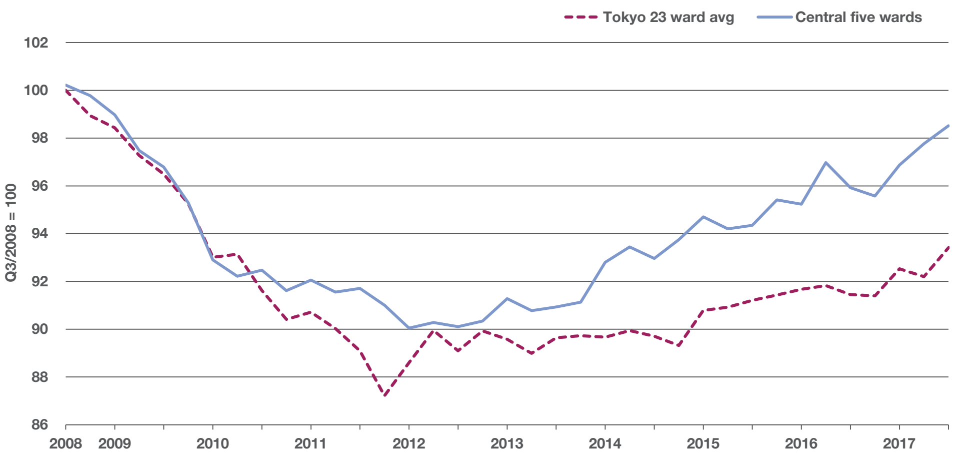
Newly completed rental properties in the C5W market in Q3/2017 include Roygent Kudan in August and City Current Daikanyama in September. Roygent Kudan, located in Chiyoda, offers mainly 1-2LDK apartments from 30 to 60 sq m at approximately JPY4,600 per sq m per month. City Current Daikanyama, located in Shibuya, is advertising 1-2LDK units from 50 to 60 sq m at approximately JPY5,300 per sq m per month.

Mid-market rental trends by survey area

On average, units in the C5W continue to lease at rents much higher than the city average. The average premium was 16.9% above

GRAPH 1

Mid-market apartment rental index, Q3/2008–Q3/2017



Source: Savills Research & Consultancy

the 23W average in Q3/2017, virtually unchanged from Q2. This gap has been widening over the past several years. In 2010, the C5W exhibited an average premium of just 11.3% vs the rest of the 23W.

Likely drivers of this widening premium in the C5W include greater household income growth and limited residential stock. Greater workforce participation, especially by women, has buoyed household incomes and generated demand for convenient locations. In Tokyo, central neighbourhoods are typically seen as wealthier than the surrounding bedroom communities. Residential space is also constrained by large commercial developments.

Rents in the South and Inner North submarkets also show consistent, 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.

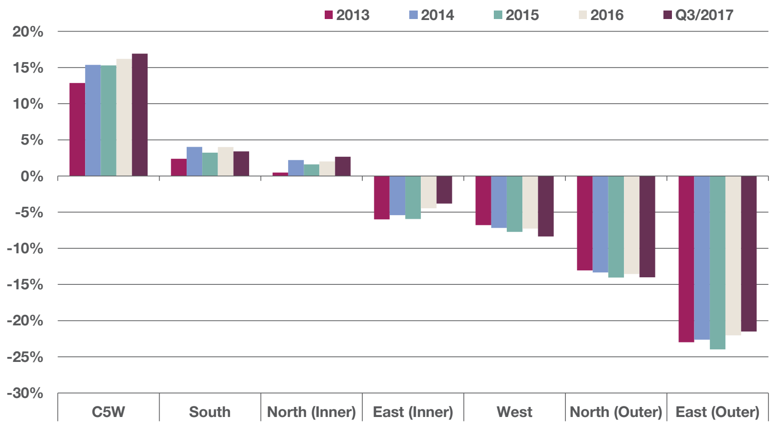
Premiums and discounts tend to change very slowly due to the gradual nature of rental growth in Tokyo. That said, Tokyo's eastern submarkets – among the most affordable areas to live, on average, in the 23W – have seen some success in catching up to the rest of the city over the past five years. The outer east wards of Adachi, Arakawa, Katsushika, and Edogawa together on average exhibit a rental discount of -21.5% vs the 23W average. This is up marginally from -23.0% in 2013.

The inner east wards of Taito, Sumida, and Koto have also narrowed their discounts over the same period. On average they currently exhibit a discount of -3.8%, very close to the city average. This is up from a trough of -6.0% in 2013.

Most other submarkets in Tokyo have grown at a pace relatively close to the city as a whole, resulting in very little change in average premiums and discounts. The eastern area's marginal outperformance in this regard could be due to rapid infrastructure and connectivity development along Tokyo Bay. More recently, the area also attracted some concerns about ground stability after the 2011 Tohoku

GRAPH 2

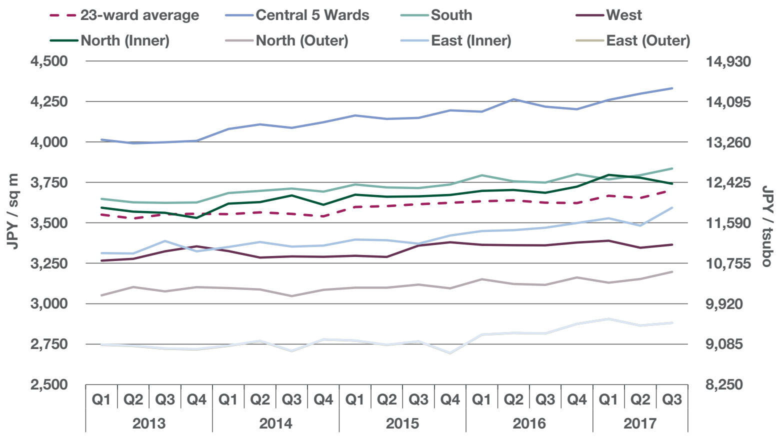
Rental premiums/discounts vs the 23W average, 2013–Q3/2017



Source: Savills Research & Consultancy

GRAPH 3

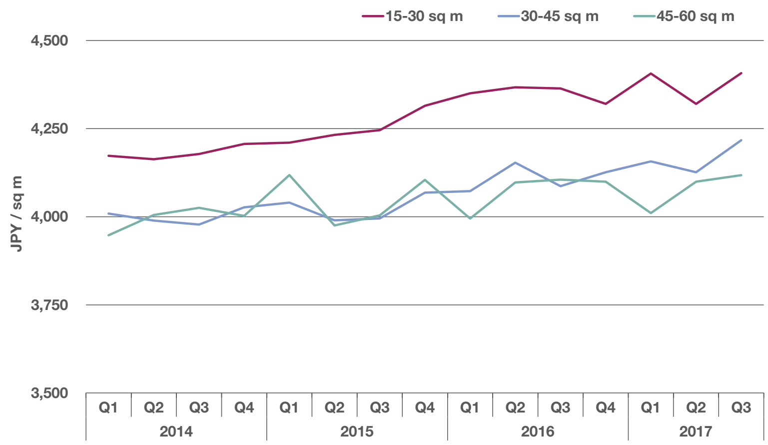
Mid-market apartment rents, 2013–Q3/2017



Source: Savills Research & Consultancy

GRAPH 4

Rents by unit size, C5W, 2014–Q3/2017



Source: Savills Research & Consultancy

Earthquake; these concerns have faded over the years and allowed for a slightly quicker rental recovery.

Graph 3 illustrates that the average rent in the C5W is up 2.7% YoY as of Q3/2017, driven by strong growth in Chuo (4.6%) and Chiyoda (4.1%). At the ward level, Katsushika and Shinagawa are exhibiting the strongest YoY growth at 7.3% and 6.2% respectively.

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 rents grew in all three major size bands in the 23W in Q3/2017. This represents a recovery from Q2/2017, when smaller units saw mild declines.

Though period-to-period fluctuations are common, the general trend has been that of gradual increase. 15-30 sq m unit rents have grown 3.3% since the beginning of 2014, while 30-45 sq m units have grown 4.8% and 45-60 sq m units have grown 4.6%. A sustained influx of young people in their 20s and 30s has led to high demand for small units; this has likely led to rental growth balanced by increased supply.

Occupancy rates

Average occupancy rates in Tokyo remain comfortably above 95% at a reading of 96.6%. This is 0.2ppts higher than a year earlier. During the same period, the C5W increased occupancy by 1.3ppts to also stand at 96.6%. The Outer North submarket saw the strongest occupancy at 98.8%, driven mainly by continued strong occupancy in Itabashi.

In the C5W, Chiyoda continued to show the tightest occupancy at 97.9%, followed by Chuo and Minato at 97.4% and 96.7%. Chiyoda has shown the strongest increase in occupancy vs a year ago, tightening a full 2.5 ppts since Q3/2016.

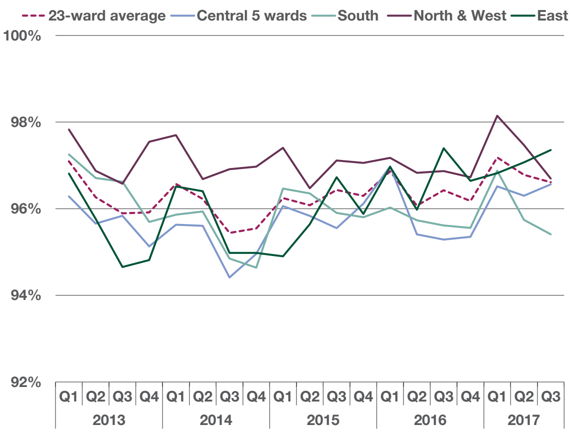
Occupancy is expected to remain strong in the central wards as a robust economy, high condo prices, and infrastructure development all contribute to leasing demand in the submarket. Investment-quality assets in outer areas should also continue to see high occupancy due to heightened demand from urbanisation.

Toranomon transformation

Toranomon has become a hotbed of redevelopment activity in recent years. Though market talk tends to focus on Toranomon's impressive upcoming office supply – including three state-of-the-art towers under construction by Mori Building and Mori Trust – the area is also expecting a heavy influx of residential units.

GRAPH 5

Average occupancy for J-REIT residential assets, 2013–Q3/2017*



* Q3/2017 estimate based on July – August data.
Source: Savills Research & Consultancy based on publically disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)

MAP 1

New large-scale developments in Toranomon, 2017

No. of units	Completion
Toranomon Nichome Project	
No residential	2019-24
Toranomon Hills Business Tower	
No residential	2019
Toranomon Hills Station Tower	
No residential	2022
Hotel Okura Redevelopment	
No residential	2019

No. of units	Completion
Toranomon Hills Mori Tower	
172 units	2014
Toranomon Hills Residential Tower	
550 units	2020
Tokyo World Gate	
12 units	2020
Toranomon-Azabudai Project	
1,300 units	2022

Source: Company disclosures, Savills Research & Consultancy

Mori Building's enormous mixed-use Toranomon-Azabudai project will add 1,300 new residential units across three towers by 2022. Features of the project include an international day care and supermarket, a block of premium-brand serviced apartments, and a 1,000 sq m penthouse unit atop the project's 330-metre central tower.

Mori Building is additionally planning a 56-storey tower in Atago which will offer 550 residential units under its high-end Mori Living brand. The project is scheduled to complete in 2020 and include 160 serviced apartment units, a daycare centre, and a three-floor retail base.

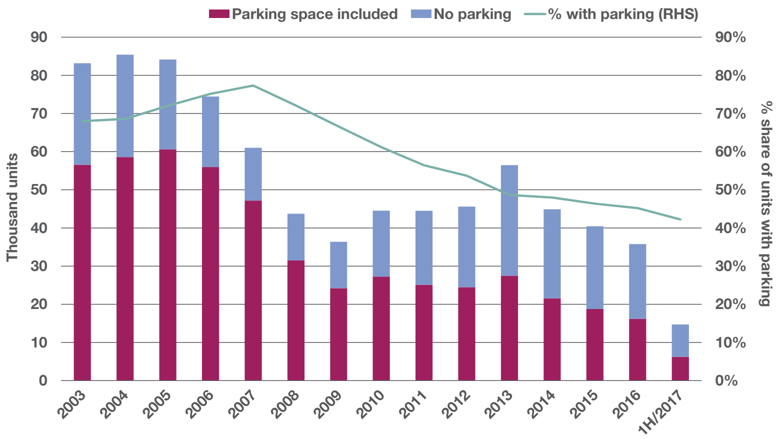
Overall, Toranomon and its surrounding submarkets are expecting unprecedented high-grade supply over the coming years. A report from the Real Estate Economic Institute (REEI) states that Minato Ward's planned future supply includes 32 tower condo buildings of 20 or more storeys totalling about 9,600 units. This is 17% of the 23W's 55,500 total expected units.

Though there exists strong demand for rental units and condos in the C5W, this is a large amount of supply and it remains to be seen whether the market will be able to absorb it cleanly. Rental prices have risen continuously over the past five years, especially in the C5W, but the condo market has shown slight softness since 2016. First-month contract rates for newly completed units are currently still fairly strong at 68.2% but have struggled to rise above 70% since early 2016, despite comfortably remaining in the 70%-80% range over the preceding years, and developers have built up some inventory. Some developers have begun to offer small discounts of 5%-10% on prices but the market still appears sound.

Toranomon's infrastructure is also expanding to accommodate resulting demand increases. Most notably, a new station on the Hibiya Line between Kasumigaseki and Kamiyacho due in 2022 will bolster transportation access and directly connect to Toranomon Hills. The Toranomon-Azabudai project will also add extensive green areas and open space in an effort to improve pedestrian quality of life. Other major projects could also revitalise their surrounding blocks.

GRAPH 6

New condo supply by parking presence, Greater Tokyo, 2003–1H/2017



Source: REEI, Savills Research & Consultancy
Greater Tokyo includes Tokyo, Saitama, Chiba, and Kanagawa prefectures

Fewer condos have parking spaces

A September paper by REEI shows that the provision of parking spaces has steadily fallen out of favour with Tokyo area condo developers and purchasers over the past ten years (Graph 6).

In 2007, immediately prior to the financial crisis, almost 80% of all new condo units came with parking attached. This figure has dropped to 42.2% in the first six months of 2017. A steady trend toward urbanisation and centralisation has intensified reliance on mass transit. The prevalence of car sharing has also led to a decrease in the preference for outright ownership.

The share is lowest within the 23W area, where just 29.5% of all new condo units come equipped with a parking space. This is down from 56.0% in 2007.

OUTLOOK

The prospects for the market

Tokyo's residential rents are continuing their slow climb. Though the average has seen some volatility from period to period, it has trended upward for the past five years. As a group, the central five wards have outperformed the rest of the city and may overtake their 2008 rental levels sometime in 2018 if the current pace continues.

There is little reason to believe that the current gradual rate of rental growth will change significantly over the near term, barring a sudden change in economic prospects. REEI published its most recent market outlook in September, in which it forecast that both rents and condo prices will continue to climb gradually until 2019. In 2019 the government's scheduled consumption tax hike may soften condo prices but have relatively little impact on rents.

Large-scale redevelopment projects may bring about transformational effects at the neighbourhood level. Toranomon, for example, is seeing a sudden influx of high-grade residential and office space over the coming years, along with infrastructural improvements. If demand remains strong and the developments are successful, Toranomon could evolve into one of Tokyo's most modern mixed-use business hubs.

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