Savills World Research
Tokyo

Briefing
Residential leasing

Q3 2018

Image: Open Residencia Roppongi

SUMMARY

Rents continue to grow steadily across the 23W in general, with all submarkets except Inner and Outer East posting gains this quarter.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stand at JPY3,784 per sq m, up 0.4% QoQ and 2.2% YoY.
- Average asking rents in the central five wards (C5W) stand at JPY4,527 per sq m, up 1.6% QoQ and 4.5% YoY.
- Both Inner and Outer East submarkets were down this quarter, while all other submarkets were up.
- The C5W's premium over average 23W rents, at greater than 19% year to date, looks set to reach a new annual high.
- Occupancy rates fluctuated slightly in Q3/2018, but remain robust and are above 95% in all wards.
- The number of upscale listings has been slowly rising, and so far in 2018 rents for larger apartments have increased faster than for smaller residences.

"Average asking rents are steadily rising across the 23W as demand is strong. Rents for new, conveniently located residences in the C5W are rising even faster as they meet current household preferences."
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

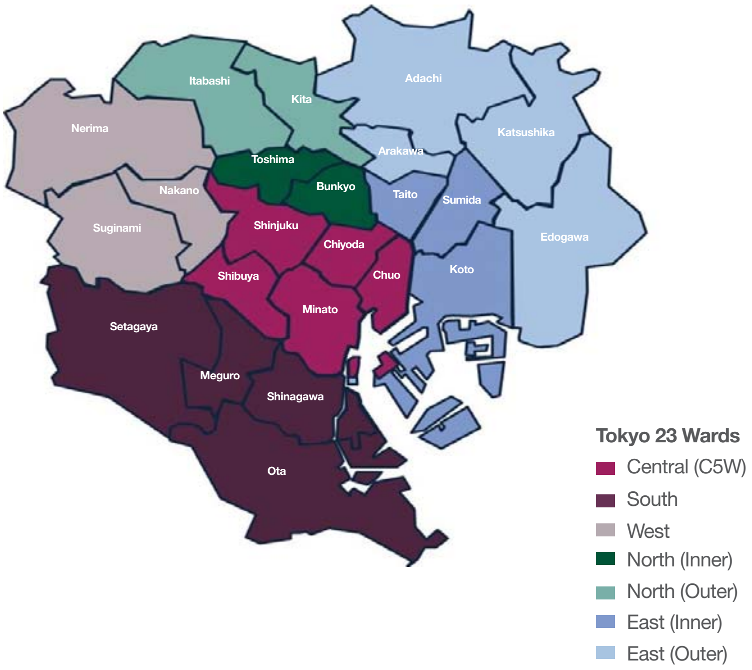
C5W rents rose at a good pace in Q3/2018, rebounding 1.6% quarter-on-quarter (QoQ) to reach JPY4,527 per sq m[1]. In the 23W, average rents grew more steadily, up 0.4% QoQ to JPY3,784 per sq m. Both market averages continue to grow on an annual basis, up 4.5% and 2.2% year-on-year (YoY), respectively. The C5W's premium over the 23W average increased to a record level this quarter.

Rents in eastern submarkets, following a strong Q3/2017 with a further uptick in Q1/2018, have since stalled, with a particularly weak performance this quarter. It is possible that rental growth is being held back by residents' income levels, which tend

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

MAP 1

Tokyo's 23 wards by survey area



Source: Savills Research & Consultancy

to be lower than in other submarkets of the 23W, while strong supply levels may also be weighing on the market. South, Inner North and Outer North rents rose faster than the 23W average this quarter, but still trailed the C5W. On the other hand, rents in the West rose the most this quarter, twice as quickly as the C5W. So far in 2018, however, only the C5W has widened its premium versus the 23W.

Rents for 45-60 sq m apartments in the C5W spiked for the second time this year and again stand higher than the 15-30 sq m and 30-45 sq m size bands. A trend of higher rents per sq m for larger properties may be forming. However, given that large units constitute a much smaller segment of the market, thereby reducing our sample set, new completions are having a pronounced impact on average rents in the size band.

In general, the total number of listings in our sample set has decreased over the past few years, while new buildings have been accounting for an increasing proportion of the total. As central Tokyo continues to attract residents, it is likely that strong occupancy is reducing the overall number of listings, particularly for existing apartments, thereby shifting the balance to listings for new or yet-to-be-completed apartments. As a result, the average rents derived from these listings may be somewhat higher than actual rents.

The number of upscale[2] apartments on offer also appears to be growing, though supply does not appear to be excessive. Upscale listings appear to be steadily filling up, albeit not rapidly, implying that demand for property with above-average rents is keeping pace with supply. Rising household incomes in Tokyo, particularly Minato, are likely playing a role here.

Mid-market rental trends by survey area

The gap between C5W and 23W rents widened in Q3/2018: the C5W's premium now stands at over 19% and looks set to reach a new annual high. Though there is generally growing demand for residences within commuting distance of the city centre, demand for more central locations appears to be stronger. This, combined with a much more rapid rise in income compared to the rest of Tokyo, should be helping to push up C5W prices faster than in the 23W.

2 "Upscale" refers to C5W apartments larger than 100 sq m or with total asking rent of over JPY300,000.

Rents in the C5W are performing well, having risen 1.6% QoQ and 4.5% YoY to JPY4,527 per sq m in Q3/2018. Even as individual incomes rise, the number of dual-income households is also growing. These households appear to be willing to pay a premium for the convenience of living in a central location, with a preference for new completions. With a preponderance of properties with these qualities, the C5W appears to be able to command premium rents.

Rents in the South submarket averaged JPY3,856 per sq m at the end of Q3/2018, having grown 0.7% QoQ and 0.5% YoY. Shinagawa, down 2.8% YoY, has underperformed over the last few quarters. Although rents there have tended to fluctuate more than in the other southern wards, growth over the longer term has been remarkably strong and is likely to continue, albeit possibly with short-term corrections, in turn boosting the wider submarket average.

Inner North rose faster than the 23W average in Q3/2018, with QoQ growth of 1.3% and YoY growth of 5.2%. Outer North was slightly behind, with QoQ growth of 1.2% and YoY growth of 2.0%. Outer North appears to have relatively few new listings this quarter, while Inner North continues to see large additions, such as The Park Habio Sugamo, which offers residences of between 25 and 52 sq m at a significant premium to the submarket average rent. The greater number of new developments in Inner North might explain the difference in growth rates.

Both East submarkets fell this quarter, with Inner down 1.2% QoQ and 1.0% YoY, and Outer down 0.3% QoQ but still up 0.9% YoY. While most eastern wards were down this quarter, the standout performer was Adachi in Outer East, which rose 2.7% QoQ. Impressive YoY growth of 8.7% was also the strongest in Tokyo this quarter. Reasonable transport links make the ward popular with commuters, while two new completions at high rents also contributed to this quarter's growth. Neighbouring Katsushika, the cheapest ward in Tokyo, grew just 0.4% QoQ but saw the steepest YoY contraction in the 23W this quarter, falling 5.5% after a strong result in Q3/2017. There do not appear to be any immediate demand drivers for Katsushika and rents are expected to remain at the lower end of the Tokyo range over the medium term.

In the West, rents are up 3.2% QoQ and 2.4% YoY. Nakano is growing quickly, up 5.8% QoQ and 3.0% YoY, likely benefiting from its relative proximity to the C5W, but Suginami and Nerima, which lie further out from the centre of Tokyo, have mostly treaded water over the last few years. Although rental growth was sturdy in Q3/2018, year-to-date performance remains weak and the West's discount to the 23W has widened significantly (Graph 2). The average age of listed buildings in the submarket is above that of the 23W average. Possible rezoning of farmland for residential use in the West may be leading developers to concentrate their efforts elsewhere until the outlook is clearer.

Rents by unit size

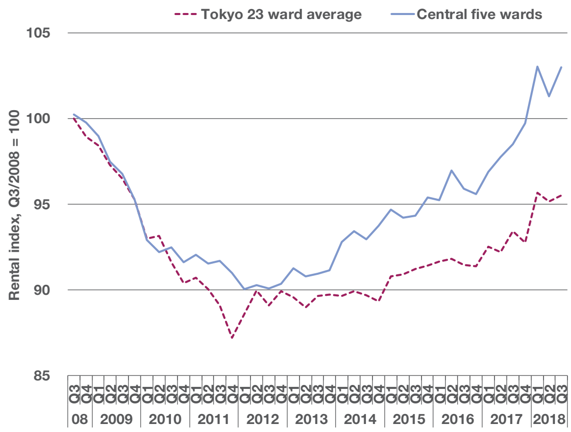
Tokyo's rental market is principally made up of compact single-occupier units, typically less than 45 sq m (13.6 tsubo) in size. Such units can often make up as much as 75% or more of the 23W area's rental listings. Unlike other major global cities such as London and New York, house or apartment sharing 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 for the 15-30 sq m size band ended the quarter at JPY4,525 per sq m, up 0.7% QoQ and 2.7% YoY. Rents for larger size bands rose faster: average rents for the 30-45 sq m size band grew 3.4% QoQ and 5.4% YoY, reaching JPY4,446 per sq m. Average rents for the 45-60 sq m size band rose an impressive 5.6% QoQ and 12.0% YoY to JPY4,614 per sq m. This is the third consecutive quarter in which rents in the 45-60 sq m size band have exceeded those of the other size bands. Certain developers have been completing buildings that, in addition to compact studio apartments, offer larger one-to-two bedroom apartments in the 45-60 sq m range. As units in this size band comprise a relatively small segment of the market, new units are having a more pronounced impact on average rents. Development of these residences may be prompted by a shift in demand.

Whereas in the past, new families may have been satisfied with larger

GRAPH 1

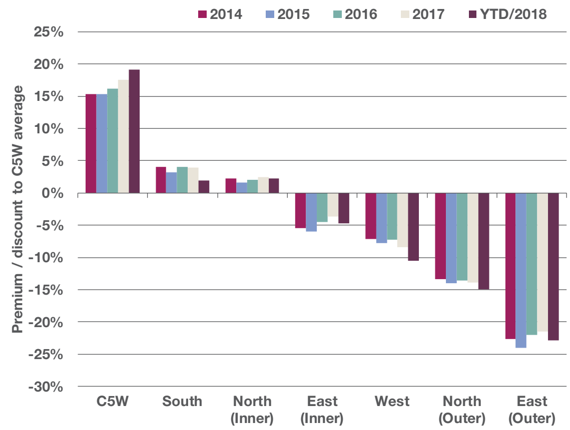
Mid-market apartment rental index, Q3/2008 – Q3/2018



Source: Savills Research & Consultancy

GRAPH 2

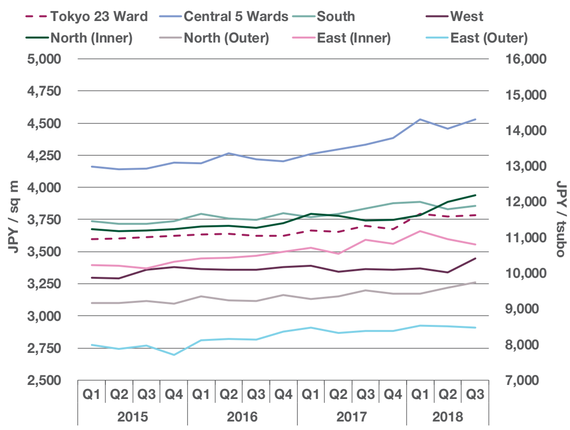
Rental premiums/discounts vs 23W average, 2014 – Q3/2018



Source: Savills Research & Consultancy

GRAPH 3

Mid-market apartment rents, 2015 – Q3/2018



Source: Savills Research & Consultancy

residences further away from the centre of Tokyo, changing family structures may be pushing this demographic into city centres. As an increasing number of women join the workforce, demand for centrally located apartments that are large enough to house a small family yet provide convenient access to childcare facilities and both parents' places of work is growing. Developers have historically tended to focus on smaller size bands as demand for that segment has been stable and strong. Until supply catches up, apparent increased demand for larger properties in central Tokyo may continue to push up prices as we have seen so far in 2018.

Occupancy rates

The average occupancy rate in the 23W dipped by 0.3 percentage points (ppts) in Q3/2018, but still boasts a healthy average rate of 96.7% and is down just 0.1ppts YoY. C5W occupancy recovered by 0.1ppts QoQ to register at 96.1%, though is still down 0.3ppts YoY. Small fluctuations in occupancy should not be a concern, however, as occupancy is above 95% in all wards.

Only a few out of every 100 surveyed properties currently have vacancy below 90% and, of these, the lowest average monthly occupancy for the past year is 87%. Furthermore, such small changes are often down to relocations, which, through careful management, can be redirected to other properties in a landlord's portfolio. For example, Advance Residence, the largest residential J-REIT, offers commission-free moves between its Residia brand apartments, presumably in an attempt to reduce the number of relocations that turn into vacancies.

Shinjuku and Shibuya have the highest average vacancy levels in the C5W, though average occupancy, at 95.5% and 95.2%, respectively, is still robust. Currently elevated vacancy is largely attributable to just a single, relatively small property in each case. Outside of the C5W, Nerima has the lowest occupancy at 95.2%, down 4.1ppts from a high of 99.3% in Q1/2017.

Although low interest rates should tempt renters to consider owning their homes, high condominium prices could be influencing them to delay their purchases. The steep ratio of condominium prices to household incomes makes purchases less attractive relative to renting and should help support occupancy levels at rental apartments for the time being.

Upscale apartments

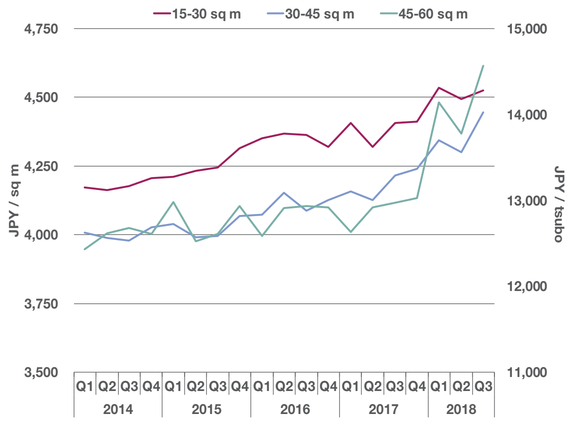
Upscale apartments have appeared in greater numbers so far this year after a relatively weak 2H/2017. Demand for upscale apartments appears to be present, as listings for new completions tend to drop out of the database within a reasonable period of time. The continuing rise in Tokyo salaries, as well as the increase in the number of dual income households, is likely playing a role here. Government statistics confirm that between 2010 and 2017 taxable incomes grew 3.3% nationwide, but the C5W average grew a remarkable 18.6%.

Residents of Minato have seen exceptional income growth since 2013, up 23.7%, and accordingly Minato has the largest share of upscale apartments listings at nearly 40% (Graph 6). Its convenient location is also attractive. For example, Open Residencia Azabu Roppongi (cover photo), completed in September, is just five minutes' walk from two major metro lines and enjoys excellent access to Tokyo's office districts. The block offers a mix of compact units and larger upscale apartments at an average of JPY5,900 per sq m.

As construction costs have risen, developers have begun to concentrate more on upscale apartments in order to protect profits. They should continue to provide upscale supply as long as asking rents are achieved relatively smoothly. Households with improved earnings capacity should more readily pay for the luxury of a swanky upscale apartment, and asking rents for upscale apartments do not appear excessive given income growth levels. So long as demand fundamentals maintain their momentum, the number of upscale listings should continue to rise.

GRAPH 4

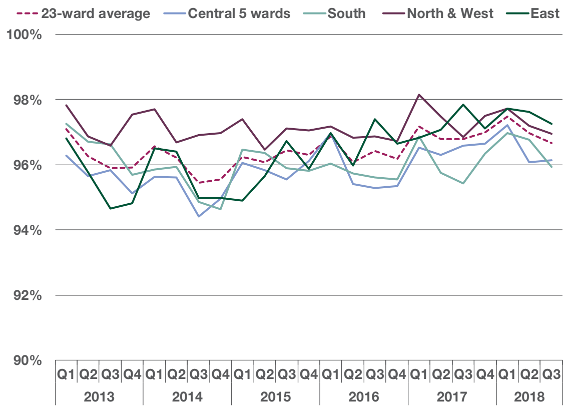
Rents by unit size, C5W, 2014 – Q3/2018



Source: Savills Research & Consultancy

GRAPH 5

Average occupancy for J-REIT residential assets, 2013 – Q3/2018*

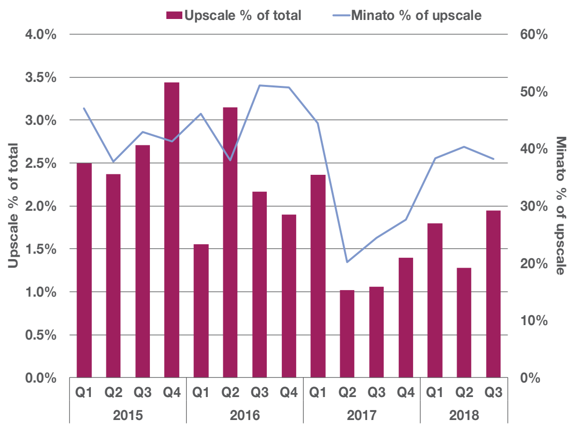


* Q3/2018 estimate based on July and August data.

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

GRAPH 6

Upscale as a proportion of total listings, Q1/2015 – Q3/2018



Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

The labour market is tight and Tokyo households, with rising incomes, appear to be readily absorbing new supply at steadily higher rents. Continued migration to city centres should help rents rise further over the medium term, and household preferences for conveniently located residences should help particularly in the C5W. Occupancy in institutional-quality residences is unlikely to weaken for the same reasons.

There appears to be some demand for upscale apartments as their share of the market is recovering, and they do not appear to be struggling to attract tenants. The balance of supply and demand in this sector appears to have been somewhat steady.

To be sure, global economic uncertainty could affect the wider Japanese economy, but the effect on the residential leasing market should be relatively muted. Fundamentals are solid: demand growth from net migration to the 23W appears to be outpacing supply, and residents' incomes are growing. More pressing concerns include the plan to raise consumption tax in October 2019, though the government is proposing countermeasures to offset the expected reduction in demand.

If the economy enters a downturn, high quality mid-market apartments with reasonable rents in the city centre should show their defensive nature, as they did following the financial crisis, though upscale apartments are likely to be the first to feel the effects. The speed with which upscale apartments attract, or rather fail to attract, tenants could potentially serve as a leading indicator for the mid-residential lettings market.

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