MARKET IN MINUTES
Savills Research

Residential Leasing

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Quarterly growth slows in the 23W

Despite rental growth slowing over the quarter, annual growth remains robust in both the 23W and the C5W.

- Average mid-market asking rents in the Tokyo 23 wards (23W) stood at JPY4,045 per sq m at the end of Q3/2019, up 0.7% QoQ and 6.9% YoY.
- Average asking rents in the central five wards (C5W) were JPY4,748 per sq m at the end of Q3/2019, down 0.6% QoQ but up 4.9% YoY.
- The C5W's premium over the 23W average fell to around 17%, while discounts for the other submarkets also narrowed over the quarter.
- All submarkets recorded higher rents apart from the C5W as lofty rental values in the submarket may have weighed on demand.
- Itabashi in the Outer North was the star performer this quarter. The ward witnessed the highest rate of quarterly growth, as well as annual growth, in the 23W as an increasing number of new units, commanding higher rents, were listed.
- Smaller apartments continue to dominate the market, with rents in the 23W reaching a high of JPY4,042 per sq m. Listings for the largest apartments remain relatively sparse.
- Occupancy in the 23W crept up to 97.5% in Q3/2019, though movements varied among submarkets.
- The number of property listings has increased once more, although the rate of increase has slowed.

"Although the pace of rental growth has slowed, the residential market in Tokyo remains resilient, as evidenced by occupancy rates in the 23W reaching record highs. Nonetheless, global economic uncertainty continues to present risks to the market."

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MAP 1: Tokyo's 23 Wards By Survey Area

Source 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 movements in contract rents for the Tokyo market.

OVERALL RESULTS

C5W rents experienced an adjustment in Q3/2019, declining 0.6% quarter-on-quarter (QoQ) to JPY4,748 per sq m[1], while year-on-year (YoY) returns were more positive, increasing 4.9%. Given the continuous rental growth for the four quarters up to Q2/2019, an adjustment of this sort is not unexpected in the submarket, having experienced something similar in Q2/2018 and Q3/2016 (Graph 1). Rents in the 23W, however, were more stable over the quarter, gaining 0.7% QoQ, representing five consecutive quarters of growth. Despite the mediocre growth over the shorter term, growth over the year was robust, growing 6.9% YoY to JPY4,045 per sq m – the highest level since Q4/2007, which may reflect the current tight leasing market. Overall, residential fundamentals remain sound and market sentiment continues to be positive, as reflected by rents continuing to exceed the respective four-period moving averages.

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

The divergence of growth in Q3/2019 has resulted in the fall of the C5W's premium over the 23W. As a result, the spread has tightened by around one and a half percentage points (ppts) over the quarter, dropping to 17.4%. Tightening spreads was a theme seen across all the non-central submarkets with the West and the Outer North registering the biggest changes, narrowing to a discount of 10.8% and 15.5%, respectively. Therefore, other than the C5W, the Inner North is the sole submarket that exhibits a premium over the 23W. Over the longer term, the Outer East continues to have the widest discount, which has been expanding since 2017, given the relative location of the submarket (Graph 2).

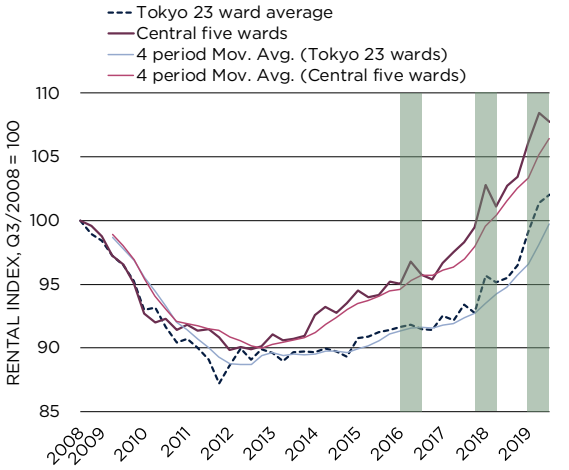
Apartments that fall in the 15-30 and 30-45 sq m size bands continue to dominate the market, exceeding three quarters of all listings in both the C5W and the 23W. In the C5W, units in the 30-45 sq m band were the sole variant to experience noticeable change, growing 1.3% QoQ. Growth in the other size bands was muted. Over the longer term, rents across the size bands have generally been trending upwards. In addition, increasing demand for larger, family-friendly units has led to a convergence of rents for the various size bands, narrowing the spread. It is important to remember, however, that the rents of the larger size bands should be viewed with caution, given the limited number of listings.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

The underlying trends remain bullish, as average rents in Tokyo continue to demonstrate robust annual growth, albeit the pace has slowed compared to last quarter. This is especially true for the C5W, which saw rents contract, as the factors driving supply and demand started to regain some composure. Despite this, rents in the C5W remain high given its desirable location and sturdy rental growth over the longer term. The 23W, meanwhile, continues to experience rental growth both over the shorter and longer term as the relatively affordable rents of the outer wards draw those squeezed out of the centre, narrowing spreads accordingly. It is worth noting, however, that growth in some of the outer submarkets has been driven by a select few wards, emphasising the importance of being selective.

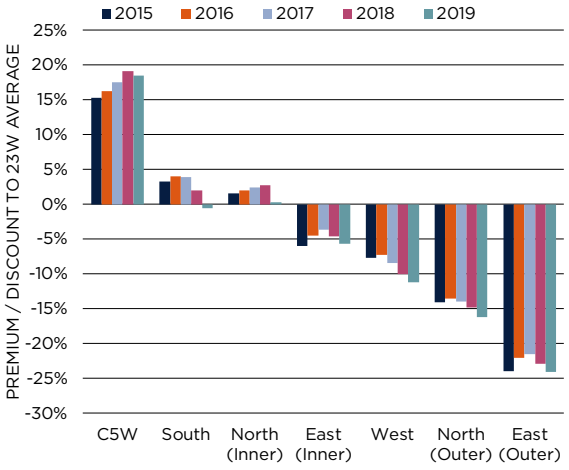
Rents in the C5W declined 0.6% QoQ, falling from a recent high, to JPY4,748 per sq m in Q3/2019. Despite this, over the previous 12 months, rents managed to sustain their positive momentum, growing 4.9% YoY, maintaining a premium over the four-period moving average. Within the submarkets, growth across the wards stuttered. Minato and Shinjuku were the only wards able to buck the trend by rising 1.2% and 1.1% QoQ, respectively. Chiyoda suffered disproportionately more, owing to

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q3/2019



Source Savills Research & Consultancy

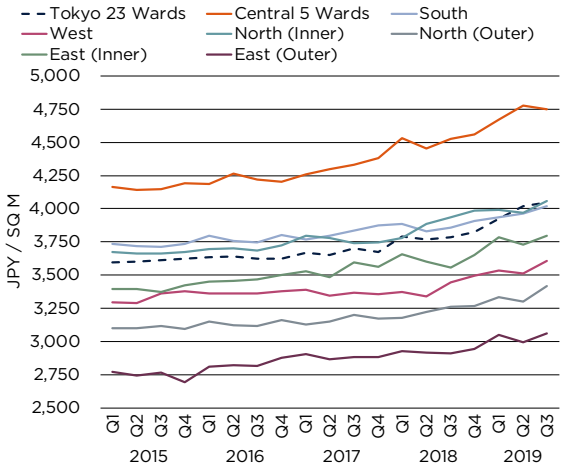
GRAPH 2: Rental Premiums/Discounts vs 23W Average, 2015 to 2019*



Source Savills Research & Consultancy

* 2019 is the average of the premium/discount registered in Q1, Q2 & Q3.

GRAPH 3: Mid-market Apartment Rents, Q1/2015 to Q3/2019



Source Savills Research & Consultancy

its limited number of listings – under 10% of the C5W total this quarter. Accordingly, this ward is more volatile compared to the other constituents as outliers cause large fluctuations in average rents. Nonetheless, over the year, Chiyoda experienced the second largest YoY growth of all the C5W, accelerating 6.8%, supported by robust demand and tight supply. Shinjuku, Chuo and Minato grew 6.9%, 5.2% and 3.2%, respectively. Shibuya was the laggard, increasing 2.7% YoY.

The South grew 1.4% QoQ and 4.3% YoY. Subsequently, rents have reached a new high of JPY4,022 per sq m. However, growth over the quarter was not consistent across all the wards. For example, Setagaya and Shinagawa saw increases of 4.8% and 1.9%, respectively, compared to 0.5% for Meguro and a fall of 1.7% in Ota. Shinagawa, underpinned by its near-central location and convenient transport options, saw rents continue their ascent, rising 5.4% YoY, to a new high of JPY4,242. Despite muted growth, rents in Meguro have once again surpassed that of Chuo in the C5W. Rents stood at JPY4,426 per sq m following growth of 4.6% YoY. Meanwhile, Ota and Setagaya, given their distance from the centre, understandably warrant lower rents in the submarket, at JPY3,499 and JPY3,920 per sq m, respectively. As per the previous quarter, rental growth among these two wards diverged once more. Setagaya, having experienced a slight decline in rental growth in Q2/2019, has seen its fortunes reverse, growing 4.7% YoY in Q3/2019. On the other hand, Ota's decline this quarter has seen its rental growth lag, growing by 2.1% YoY. Consequently, the spread between these two regions has expanded to the highest level in nine years.

The Inner North regained some poise compared to the prior quarter as rents grew, albeit at a subdued rate. Toshima led the way, growing 3.3% QoQ whilst Bunkyo increased by 1.2% QoQ. Nevertheless, rents in both regions hit recent highs, coming in at JPY3,999 and JPY4,113 per sq m, respectively. Annual growth rates were slightly higher coming in at 3.7% for Toshima and 2.4% for Bunkyo, as the number of listings fell by over 18%, highlighting tight supply.

Given its reasonable entry point – the second lowest rents in the 23W – the Outer North continues to attract the younger demographic. Overall rental growth has been buoyant as a result. For example, the submarket experienced the highest quarterly increase, growing 3.6% QoQ, whilst YoY growth was close to 5%. When looking at the wards specifically, however, the growth profiles are very different. Itabashi was the clear winner in the 23W, both over the quarter and the year. Rents grew 6.3% QoQ and 11.6% YoY, driven by a significant increase in the number of listings for recently built units commanding at least JPY4,000 per sq m, compared to Q3/2018. Kita significantly lagged Itabashi. Rents in the ward grew 1.0% QoQ and declined 1.5% YoY – the largest fall in the 23W.

Rents in the Inner East increased to JPY3,796 per sq m following growth of 1.7% QoQ. The submarket continues to attract a blend of both domestic and foreign communities, illustrated by the number of listings available – over three times as many compared to its Outer compatriot, and the third highest in the 23W. The range of quarterly growth rates between the wards was fairly tight, with Sumida rising 2.8% and Koto growing 0.7%. The spread in annual growth rates, on the other hand, was more varied, with rents in Taito, Koto and Sumida expanding 8.8%, 6.1% and 5.2%, respectively.

The Outer East maintained its status as the cheapest submarket to live in despite growing 2.2% QoQ and 5.2% YoY. Rents were JPY3,059 per sq m in Q3/2019. Growth over the quarter within the wards, however, was mixed. For instance, rents in Edogawa grew 9.0% QoQ while Katsushika experienced a fall in rents for a second consecutive quarter, declining 1.2% QoQ. A similar divergence in rental growth was also seen over the year, as rents in Arakawa grew 8.4% YoY compared to 3.1% YoY in Adachi. It is worth remembering, however, that the relatively low number of listings in this submarket can ultimately lead to volatility in rental growth. Nonetheless, reasonable rents found in the Outer East, relative to the other submarkets, could represent value for money.

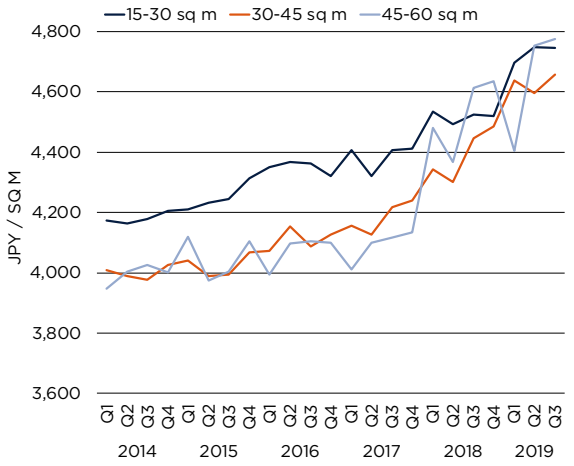
The West experienced rental growth of 2.7% QoQ – the second highest of the submarkets – and 4.7% YoY to reach JPY3,606 per sq m. Buoyed by advantageous transport links, rents in Suginami saw the biggest change, increasing 5.3% QoQ and 7.7% YoY, propelling itself into the top spot for rental values in the submarket. Rents in Nakano saw the second largest decline among all 23 wards, falling 2.0% QoQ. Over the year, rents in the ward remained somewhat flat, increasing 0.6%. Nerima, the most outlying and the most affordable ward in the West, continues to grow at a respectable pace, increasing 5.4% QoQ and 6.0% YoY.

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.

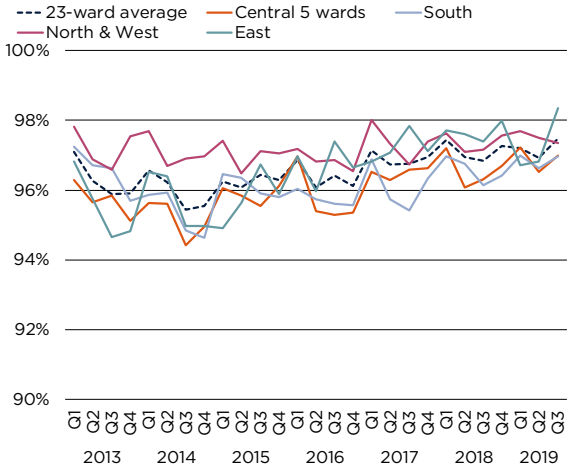
The smallest band of apartments continues to be the most sought after both centrally and overall. This was evidenced by the unchanged levels of rents in the C5W despite a near 11%

GRAPH 4: Rents By Unit Size, C5W, Q1/2014 to Q3/2019



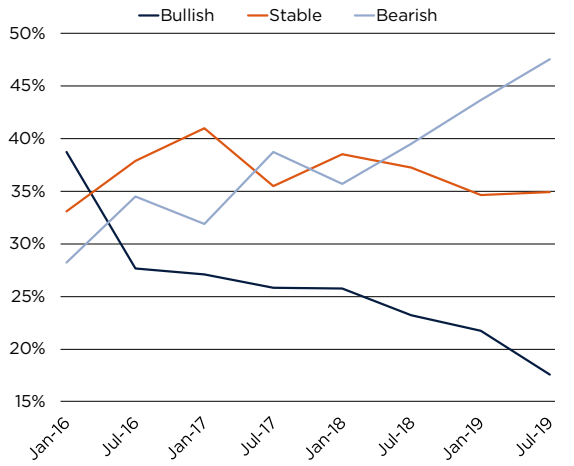
Source Savills Research & Consultancy

GRAPH 5: Average Occupancy For J-REIT Residential Assets, Q1/2013 to Q3/2019*



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
*Q3/2019 estimate based on July & August data.

GRAPH 6: Respondents' views on real estate valuations going forward, July 2019



Source Nomu, Savills Research & Consultancy

increase in listings of this type compared to the previous quarter. Rental growth for the smallest units in the 23W was also muted, increasing 0.6% QoQ to JPY4,042 per sq m. Over the year, however, growth was more robust. In the C5W, for example, rents for these smaller units grew 4.9% to JPY4,747 per sq m. Over time, rents between the size bands have started to converge as the demand for larger, family-friendly units has increased (Graph 4). It is worth noting, however, the spread is subject to volatile swings as a result of the scarcity of listings for the largest units.

OCCUPANCY RATES

In Q3/2019, the average occupancy rate in the 23W hit a record high, increasing to 97.5%, following growth of 0.5ppts QoQ and 0.6ppts YoY. The C5W experienced similar quarterly growth as the decline in the previous quarter was halted. Annual growth in the central submarket was slightly higher, growing 0.7ppts, as occupancy grew to 97.0%. Over the quarter, changes to the occupancy rates across the submarkets were mostly positive. The Outer East, for example, saw the greatest increase in occupancy rates, jumping to 98.6%, growing 2.6ppts QoQ and 1.7ppts YoY. The inherent volatility, as a result of the relative lack of listings in this submarket, should, however, be considered when looking at these figures. The submarket which saw the largest increase in vacancy rates was the Inner North, albeit just a 0.5ppts change over the quarter. The annual change was slightly higher, coming in at 0.8ppts.

Overall, all submarkets continue to demonstrate solid occupancy rates, exceeding 96%, as demand for institutional-quality assets remains robust. Positive macroeconomic trends, especially in Tokyo where there is evidence of positive net migration and solid corporate profits, act as tailwinds, helping support positive momentum for the time being.

INDIVIDUAL INVESTORS THROW CAUTION TO THE WIND

The differences between retail and institutional markets are currently stark, with the former perceived as vulnerable, for instance, due to the recent investment loan scandals and subsequent limited liquidity. On the other hand, the institutional market is seen as stable. Regardless, the views of individual investors can be useful to identify market trends, with the growth in the leasing market being an example of this.

A half-yearly survey compiled by online listings portal Nomu, which asked over 1,000 individual participants about property valuations and investment prospects, painted a somewhat cautious picture. The belief that property valuations had peaked outweighed the opposite for the third consecutive year as the spread between the two conflicting opinions widened significantly (Graph 6). Those who thought that valuations would increase accounted for around 18%, citing upcoming events such as the Olympics and increasing costs, as catalysts. In contrast, close to 48% of respondents were bearish, swayed by an uncertain economic environment and demographic headwinds. They also believed that any economic enhancements from the Olympics would be short-lived.

When asked about the investment prospects for real estate, responses were once again somewhat cagey. The minority of respondents felt it was a good time to invest, representing a 48% share. However, when compared to the six months prior, this represented an increase, albeit less than a percent. The slightly more positive outlook was mostly inspired by loose monetary policy.

In the January 2019 survey, respondents were asked about the impact of the consumption tax increase on their plans to purchase property. Although 62% of people responded that their plans would be impacted, this was a near 15ppts decline compared to the survey conducted prior to the previous tax increase in 2014, suggesting that the impact of the October tax hike would be less severe.

OUTLOOK

The Japanese economy continues to appear resilient relative to its peers, supported by steady economic growth and healthy corporate profits. Furthermore, political and economic stability in Japan stands out, attracting international capital. Despite this, uncertainty continues to weigh on the economy. Firstly, despite maintaining high levels, corporate profits have been slowly declining over the past three quarters. This trend is expected to continue, as indicated by downward revisions in forecasts. Further, the ongoing trade war continues to burden the global economy and Japanese corporates, potentially trickling down to the residential sector. Finally, the consumption tax hike implemented in October 2019 remains a risk. Any impact, however, should be subdued compared to the previous hike, as there was only a limited spike in sales just prior to its implementation. Nonetheless, if these risks materialise, they may weigh on the market.

The residential market in Tokyo remains sound, thanks to the capital's prospects for work and study, which is especially appealing for the younger demographic. Tightening market supply has accelerated rental growth, although signs of a peak are yet to be observed. High condominium prices, in addition to continued demand, should, therefore, act as a tailwind for the Tokyo residential leasing market. However, the cloud of uncertainty remains, adding caution to the market. That said, in this environment, growth should be able to continue at a steady pace.