savills

Briefing
Residential leasing

Q3 2014

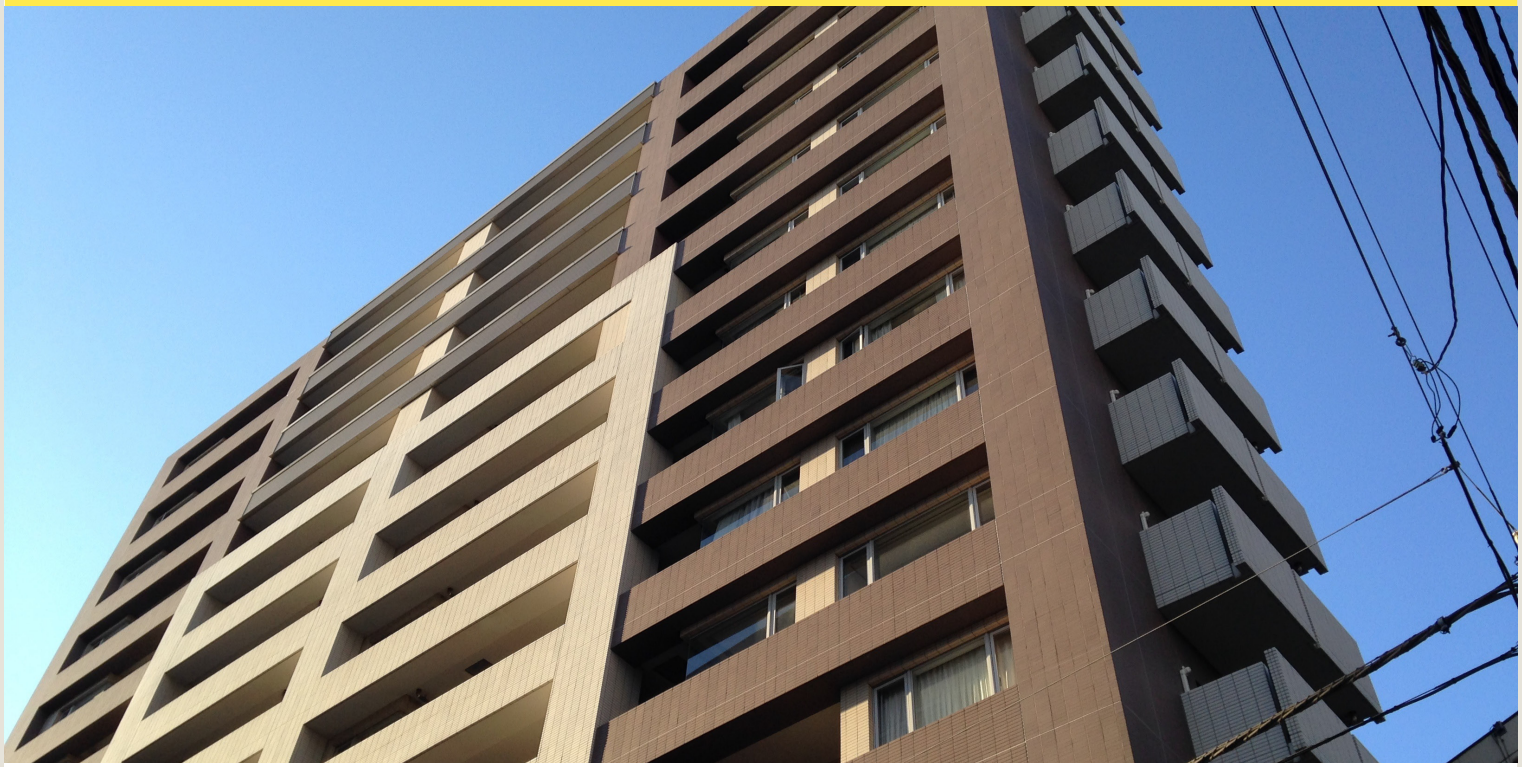


Image: HF Shirokanetakanawa Residence, Minato Ward

SUMMARY

Occupancy rates for mid-market apartment units are expected to stay high for the foreseeable future, maintaining the current firmness of average rents.

- Average mid-market asking rents in the 23-ward area stood at JPY3,555 per sq m (JPY11,750 per tsubo), down 0.3% quarter-on-quarter (QoQ) but flat on a year-on-year (YoY) comparison.
- Within our seven survey areas, rents in the Inner North increased at the fastest rate, up 3.0% YoY to JPY3,670 per sq m (JPY12,130 per tsubo).
- The South recorded the second fastest rate of rental growth at 2.4% YoY.
- In the heart of the city, rents in the central five wards rose 2.2% YoY to JPY4,085 per sq m (JPY13,510 per tsubo) – the highest level since Q4/2009.
- At the 23-ward level, average rents for units in the smaller size-bands dipped slightly, while the highest rate of growth was again recorded by the 60- to 75-sq m size-band at 1.4% YoY.
- The average occupancy rate for rental apartment buildings operated by J-REITs in Tokyo's 23 wards edged down 30 basis points (bps) YoY to 95.7%. Meanwhile, the central five wards and the South area both dipped 90 bps over the preceding quarter to 94.7%.

"Upwards movement in achievable rents is likely to be capped until Japan Inc.'s higher corporate earnings filter down into the pockets of its workforce."

Will Johnson, Savills Research

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 facing 'mid-market' rental apartment units in Tokyo. Our benchmark rental data is based on average advertised monthly rents for units that fit the following criteria:

1) one- or two-bedroom rental apartment units of up to 100 sq m in size;

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

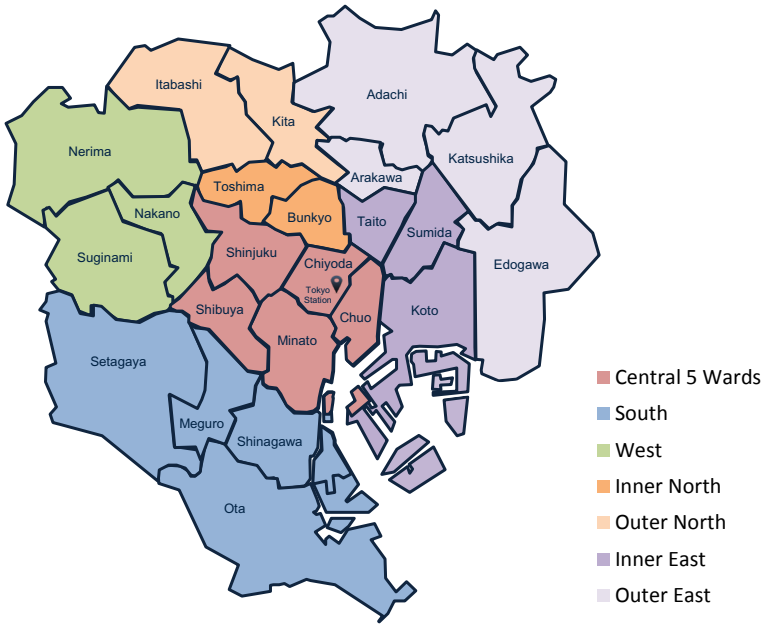
3) properties located in Tokyo's 23 wards and situated within a ten-minute walk of the nearest station(s).

Indicative of the limited volatility this market sector enjoys, average rents for mid-market apartments in Tokyo's 23-ward area have been remarkably stable since 2011. This follows an aggregate rental decline of slightly less than 11% over the three years from 2008, when the market was depressed in the wake of the global financial crisis (GFC).

More recently, data for the first three quarters of 2014 indicates that mid-market apartment rents have entered a gentle recovery phase. While growth across the 23 wards as a whole has been marginal, the core of the city has outperformed, with rental uplift strongest in the Central, Inner North and South districts.

MAP 1

Tokyo's 23 wards delineated by survey area



Source: Savills Research & Consultancy

Tokyo mid-market apartment rental trends by survey area

Average mid-market asking rents in the 23-ward area stood at JPY3,555 per sq m (JPY11,750 per tsubo[1]) in Q3/2014, slipping 0.3% from the previous quarter but remaining flat on a YoY comparison.

Our breakdown of rental trends within the 23 wards shows that the Inner North area posted the highest rate of growth on a YoY basis. The submarket commanded an average rent of JPY3,670 per sq m (JPY12,130 per tsubo), up 3.0% over the previous year.

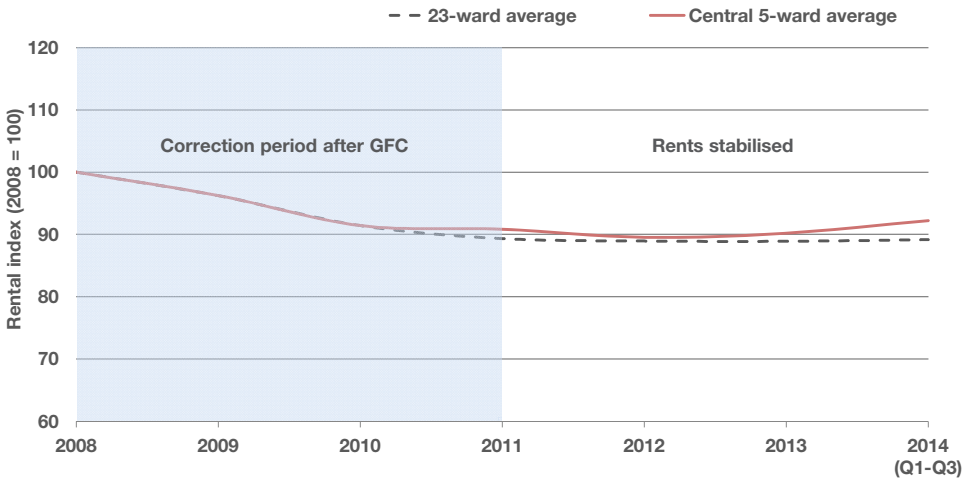
The rental average in the central five wards – the most expensive of our residential survey areas – continued to rise at a rate of 2.2% YoY to JPY4,085 per sq m (JPY13,510 per tsubo). This rental figure marks the highest level since Q4/2009 and represents a 15% premium over the 23-ward average and an 11% premium over the South area, Tokyo's second most expensive residential location.

Average rents in the South averaged JPY3,710 per sq m (JPY12,270 per tsubo), having risen at a pace of 2.4% YoY.

1 1 tsubo = approximately 3.306 sq m or 35.58 sq ft.

GRAPH 1

Tokyo mid-market apartment rental index, 2008 – 2014 (Q1-Q3)



Source: Savills Research & Consultancy

Looking at Tokyo's relatively less-expensive areas, the rental average in the Outer East slipped 0.5% YoY to JPY2,705 per sq m (JPY8,950 per tsubo), while the West, Outer North and Inner East each posted a modest rental decline of 1.0% on a YoY basis.

Tokyo mid-market apartment rents by unit size-band

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.

As shown in Table 1, rental pricing per sq m for smaller units targeting single occupiers is generally more expensive on average than that of larger units. This not only reflects the strong demand for compact units, but also the higher gross rental costs involved in renting larger units, which: 1) decreases affordability for single-income households; and 2) makes the option of purchasing a condominium comparatively more cost-effective. In recent decades, this price trend has encouraged developers to allocate a heavy weighting to studio and small, one-bedroom apartments when planning new rental schemes.

Demonstrating similar rental movement to the preceding quarter, average rents in the 23-ward area were squeezed across the smaller unit size-bands in Q3/2014 on a YoY basis. Asking rents for units sized 15 to 30 sq m and 30 to 45 sq m dipped 0.5% and 0.2% respectively, indicating that the rate of decline has moderated since Q2/2014.

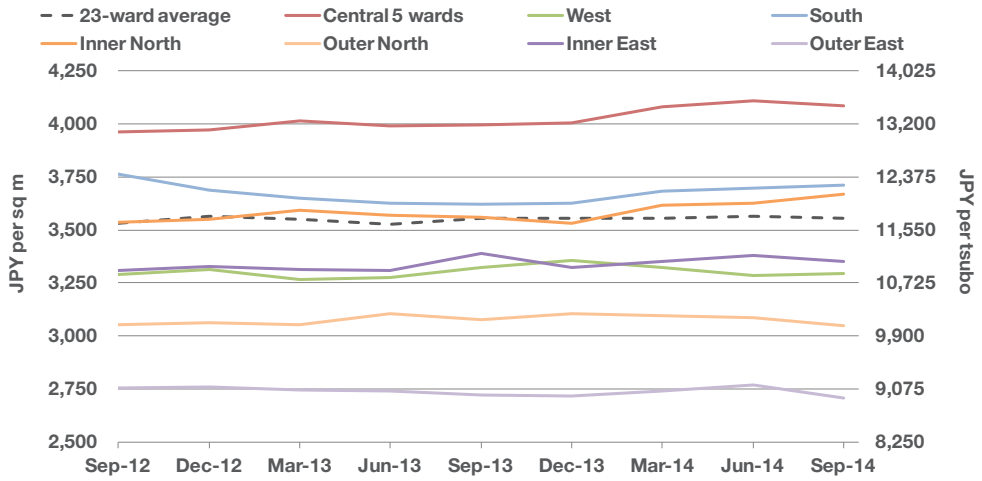
Comparatively larger units targeting single and dual-income households fared better. Average rents in the 45- to 60-sq m size-band ticked up 0.7% YoY, while the highest rate of growth was again recorded by the 60- to 75-sq m size-band at 1.4% YoY. These rental trends suggest that the plentiful supply of smaller units is dampening rent potential, whereas a shortage of more generously-sized one- and two-bedroom rental units relative to demand is creating a rental premium.

Continuing its recent growth trend, the central five ward area saw rents rise moderately across all size categories. Smaller units in the 15- to 30-sq m and 30- to 45-sq m size-bands posted rental growth in the upper-1% to lower-2% range on a YoY basis. Meanwhile, rents for units larger than 45 sq m – which are considered suitable for dual or family occupation – continued to increase at a faster pace. Rents in the 45- to 60-sq m size-band were up 4.4%, while the 60- to 75-sq m size-band increased by 3.2%.

With population growth in the core of the city outpacing the wider average, this recovery trend in the central five wards is indicative of the current supply-demand balance, which leans in the favour of the landlords. Indeed, many institutional property owners are now demanding higher rents upon tenant turnover, encouraged by growing demand for modern, well-

GRAPH 2

Average asking rents for mid-market rental apartments by survey area, Q3/2012–Q3/2014



Source: Savills Research & Consultancy

TABLE 1

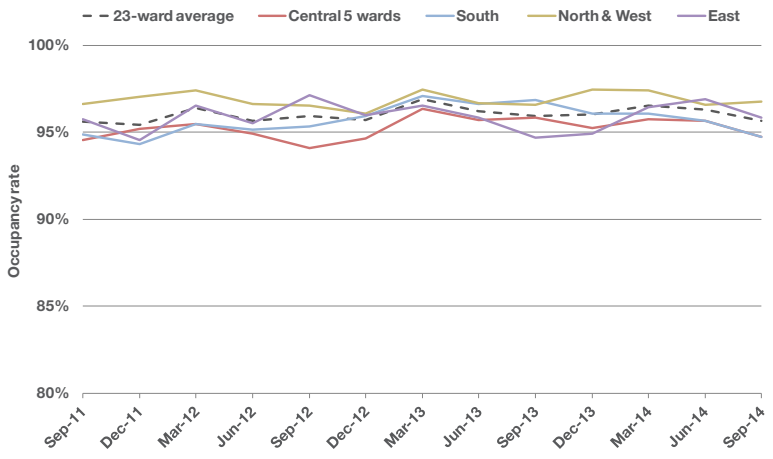
Average mid-market monthly asking rents by unit size-band, Q3/2014

Size band	15–30 sq m		30–45 sq m		45–60 sq m		60–75 sq m	
Survey area	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY	JPY per sq m (tsubo)	% YoY
23 wards	3,600 (11,900)	-0.5	3,460 (11,440)	-0.2	3,460 (11,440)	0.7	3,350 (11,075)	1.4
Central 5 wards	4,180 (13,820)	2.1	3,980 (13,155)	1.6	4,030 (13,320)	4.4	3,930 (12,990)	3.2
No. of units surveyed	>10,000		>5,000		>2,500		>500	

Source: Savills Research & Consultancy

GRAPH 4

Average occupancy rates for J-REIT residential assets, Q3/2011–Q3/2014



Source: Savills Research & Consultancy based on publicly disclosed J-REIT* property data
*Nippon Accommodations Fund, Advance Residence Investment Corporation and Heiwa Real Estate REIT.

located rental units in light of Japan's generally improved economic environment.

Mid-market apartment occupancy rates

Given their typical building age unit specifications, J-REIT-owned residential assets provide a useful benchmark upon which to gauge mid-market apartment occupancy levels. The average occupancy rate for rental apartment buildings operated by J-REITs in Tokyo's 23 wards edged down 30 bps YoY to 95.7% in Q3/2014. It remained above the 95% threshold, where it has been for 16 consecutive quarters since Q3/2010.

In Tokyo's two most expensive areas – the central five wards and the South – average occupancy rates equally dipped 90 bps over the preceding quarter to 94.7%. Although it is too early to assert that this is a trend, this movement may be indicative of latent resistance among tenants to pay the higher rents being offered by landlords.

OUTLOOK

The prospects for the market

Tokyo is an economic powerhouse, both domestically and internationally. As such, it continues to attract new residents and benefits from a gradually rising population, with the highest rates of growth in the core districts of the city. Japan's capital is also demonstrating a trend towards smaller household sizes, something that supports demand for compact rental units[1]. In this context, occupancy rates for mid-market apartment units are expected to stay high for the foreseeable future, thus maintaining the current firmness of average rents.

As ever, a robust, sustainable recovery in mid-market rental levels is reliant on the willingness of Tokyo's tenants to accept higher occupancy costs. Although residential rents are not subject to consumption tax, consumer confidence as of Q3/2014 remains dampened by its hike from 5% to 8% in April 2014, which increased the overall cost of living. Meanwhile, regardless of swollen corporate profits as a result of Abenomics and assertive monetary easing by the Bank of Japan, average incomes have posted only marginal nominal growth to date.

Therefore, despite recent concerted efforts by institutional landlords to achieve higher rents at well-positioned assets, upwards movement is likely to be capped until Japan Inc.'s higher corporate earnings filter down into the pockets of its workforce. In the near term, an overly aggressive push by landlords to boost rents significantly above current market levels would likely weigh on occupancy rates and lengthen lease-up periods.

1 More detailed commentary on Tokyo's demographic trends can be found in our Q2/2014 edition of this market briefing

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