Briefing
Residential leasing

Q4 2017

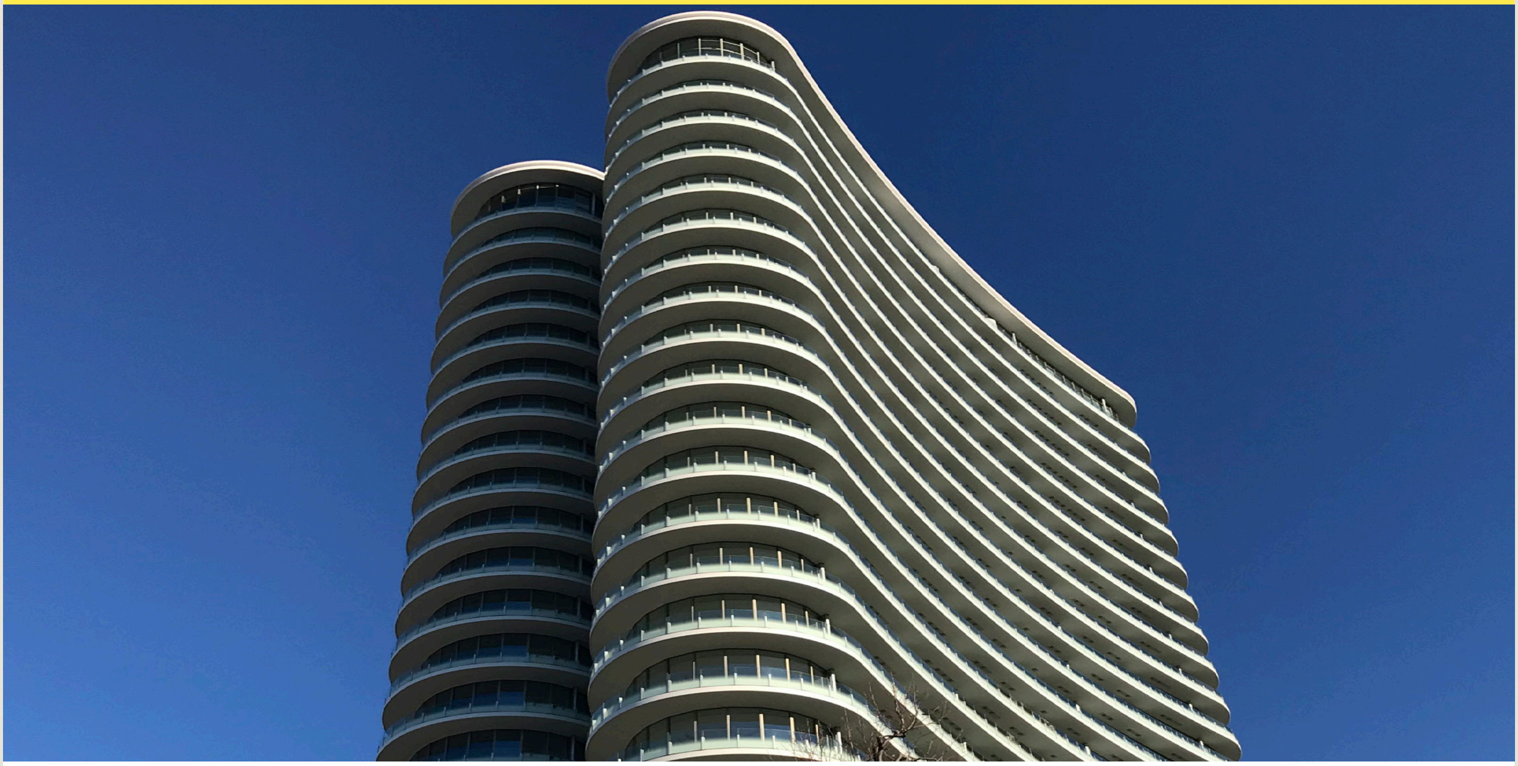


Image: Park Court Aoyama The Tower

SUMMARY

19 of Tokyo's 23 wards finished 2017 with YoY gains. C5W rental growth has picked up, and increases in outer wards are still slow but positive.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stood at JPY3,676 per sq m, down 0.7% quarter-on-quarter (QoQ) but up 1.5% year-on-year (YoY).
- Average asking rents in the central five wards (C5W) stood at JPY4,383 per sq m, up 1.2% QoQ and 4.3% YoY. This is stronger growth than the 23W as a whole.
- The C5W's rapid increases in 2017 were mainly due to outperformance in Shibuya and Chuo, up 10.3% and 4.7% YoY respectively. New developments are seeking rents well above average.
- The C5W's rental premium over the 23-ward average increased to 17.5%, up 130bps from a year ago. Eastern ward averages are still showing discounts vs the 23W average but have narrowed their gaps by around 50-100bps.
- Average occupancy rates remain comfortably above 95%.
- Especially, new buildings appear to be driving rental increases.

"New high-grade buildings have accelerated rental growth, especially in the C5W, while growth in outer wards is less steady. C5W rents look likely to overtake their 2008 levels in 2018." 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

Mid-market residential rents are continuing their upward trend. Growth in the C5W was particularly strong throughout 2017, growing close to 1.0% or more every quarter – a rapid pace for Tokyo's relatively stable leasing market. Rents in the C5W finished the year at JPY4,383 per sq m per month, up 4.3% since the end of 2016.

The growth was largely due to continuous completion of high-end residential units throughout the year. New developments appear to be consistently aiming for above-average rents, partially to account for high land prices and construction costs.

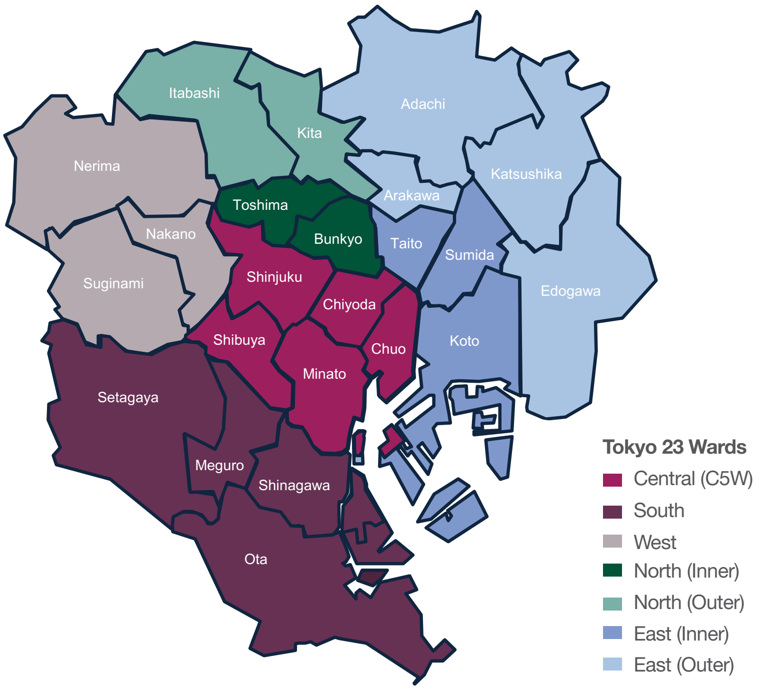
Newly completed rental properties in the C5W market in Q4/2017 include Zoom Jingumae, which completed in November with 68 units sized around 30 to 70 sq m. Units are leasing for about JPY5,500 per sq m and up. Patina Azabujuban also completed in November and is advertising studio units at around JPY4,800 per sq m and up.

Some other buildings completed earlier in the year, such as City Current Daikanyama, Prime Residence Shibuya, and The Parkhouse Nishi-Shinjuku 60, are still advertising multiple units at relatively high rents and bringing up the C5W average.

Average asking rents in the 23W as a whole stood at JPY3,676 per sq m, down 0.7% QoQ and up 1.5% YoY. The 23W average appears to be continuing its upward trend, but growth has proven spottier than in the C5W. Growth is typically shallow enough that quarter-to-quarter increases are not always guaranteed – as in this quarter – though the city has maintained an average annual growth rate of 1.0% since 2012.

MAP 1

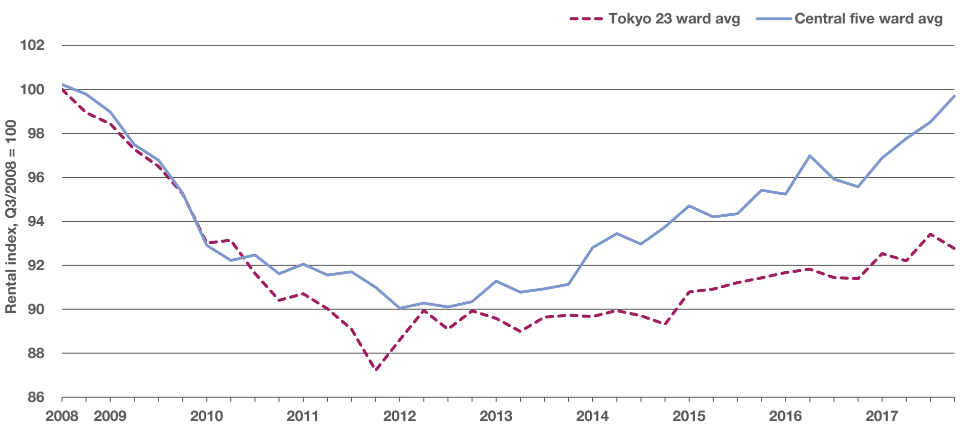
Tokyo's 23 wards by survey area



Source: Savills Research & Consultancy

GRAPH 1

Mid-market apartment rental index, Q3/2008–Q4/2017



Source: Savills Research & Consultancy

Mid-market rental trends by survey area

Rents in the C5W grew more than twice as fast as in the 23W in 2017. As a result, the rental premium for property in the C5W over the city average has grown to 17.5%, up from 11.3% in 2010 and likely to climb further given the area's ongoing redevelopment.

Continued urbanisation and high demand are the most likely drivers of C5W increases, along with greater household incomes and limited residential stock. New large-scale, mixed-use developments appearing around central Tokyo are also likely exerting upward pressure on surrounding residential rents, especially in areas such as Shibuya and Toranomon.

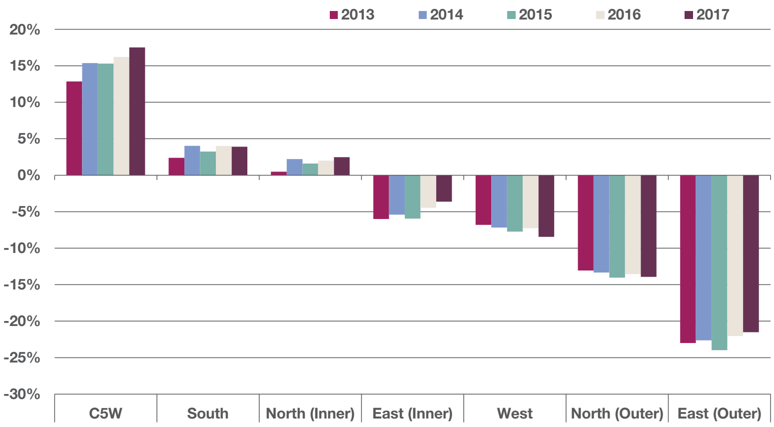
Both the Inner East and Outer East submarkets have also shown improvement, narrowing their discounts by 90bps and 50bps respectively in 2017. Both submarkets have shown strong performance against the average over the past three years and have successfully narrowed their discounts. If this trend continues in the Inner East – comprised of Koto, Sumida, and Taito – its submarket average could eventually rise above the Tokyo 23W average (Graph 2).

While the C5W and Tokyo's eastern submarkets have outperformed the city average over the past three years, other submarkets have grown at about the same pace or slower. The South, Inner North, and Outer North submarkets have barely budged in terms of premium and discount, while the West has softened slightly. Its wards – Nakano, Nerima, and Suginami – are currently seeing a discount of 8.4% against the 23W average. This has widened marginally almost every year from 6.0% in 2012. Rents in the West are growing on a case-by-case basis, but as a whole they are not currently keeping pace with the city average.

Graph 3 illustrates that the C5W submarket has seen some of the strongest growth throughout 2017, led by Shibuya with a whopping 10.3% YoY increase as of Q4. The area's growth is significantly driven by frequent openings of new, high-quality buildings, in addition to high demand and a positive economic outlook. The South submarket has also seen a notable increase of 1.9% YoY, led by Shinagawa at 4.6% and Meguro at 3.4%. Both areas benefit from their proximity to the C5W and relatively good access. Shinagawa in particular is home to its own office submarket, and is situated between Tokyo and Yokohama, granting it transit options to both Tokyo's CBD and to Yokohama.

GRAPH 2

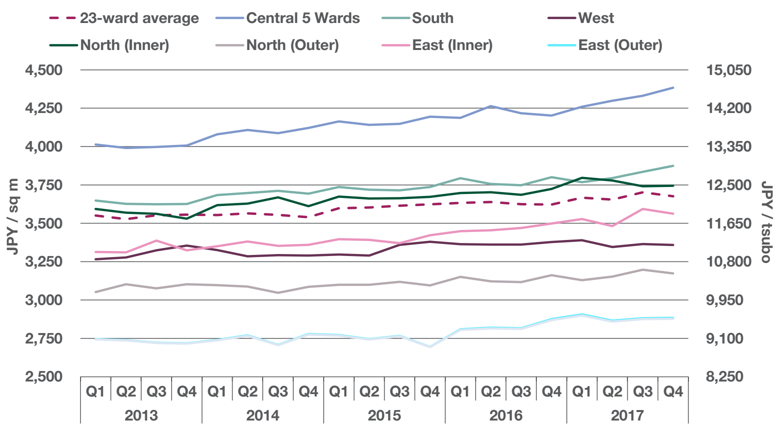
Rental premiums/discounts vs 23W average, 2013–2017



Source: Savills Research & Consultancy

GRAPH 3

Mid-market apartment rents, 2013–2017



Source: Savills Research & Consultancy

Most other areas are increasing as well on a YoY basis, though slowness in Q4 led to a QoQ correction in the 23W average. Nevertheless we expect Tokyo's average as a whole to continue to trend gradually upwards over at least the medium term.

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 C5W in Q4/2017. On a YoY basis, units in the 30-45 sq m range appear to have posted the steadiest growth in 2017, increasing 2.8% from Q4/2016 to stand at JPY4,241 per tsubo. Small 15-30 sq m apartments saw a YoY increase of 2.1%, while growth in 45-60 sq m apartments was more subdued at 0.8%.

Smaller household sizes and a sustained influx of people in their 20s and 30s has contributed to an increase in demand for smaller units. Many of the new developments appearing in Tokyo's 23W, and especially the C5W, are offering smaller unit sizes to try to capture this demand. Because new, high-grade developments drive a significant portion of rental growth, it is reasonable that units 45 sq m and under are seeing the steadiest increases.

Occupancy rates

Average occupancy rates in Tokyo remain comfortably above 95% at a reading of 97.0%. This is 0.8ppts higher than a year earlier. During the same period, the C5W increased occupancy by 0.4ppts to stand at 96.7%. The Outer North submarket is still seeing the strongest occupancy at 98.4%, though all surveyed submarkets are showing between 96% and 99% average occupancy. High demand for investment-grade assets shows no sign of slowing.

In the C5W, Chuo has pulled ahead and shows the tightest occupancy at 98.6%. Shibuya and Shinjuku are tied for the lowest average occupancies in the C5W at a still-strong 95.6%. Shibuya has seen one of the strongest YoY improvements across the 23W, strengthening a full 3.0ppts from 92.7% a year ago.

Occupancy across the 23W has increased 0.9ppts YoY and is expected to remain strong as a robust economy, high condo prices, and infrastructure development all contribute to leasing demand.

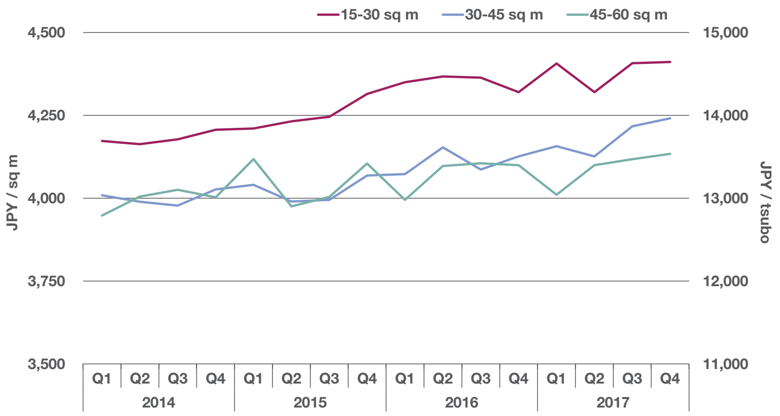
New buildings driving growth

There is evidence that rental trends in older buildings and newer buildings have slightly diverged in 2017. Tokyo Kantei, an appraiser, tracks a rental index of properties in the 23W with an average age of approximately 20 years – this is twice as old as the oldest building in the Savills index, which only includes properties completed in the last ten years. While our index shows a YoY rental increase of 1.5% in 2017, Tokyo Kantei's index of older properties shows a decline of 0.6% over approximately the same period (Graph 6).

This appears to partially be a correction from rapid increases in 2015, where the Tokyo Kantei index of

GRAPH 4

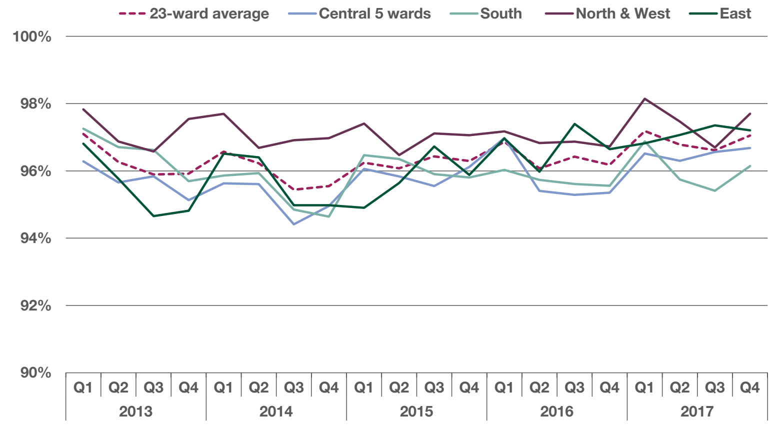
Rents by unit size, C5W, 2014–2017



Source: Savills Research & Consultancy

GRAPH 5

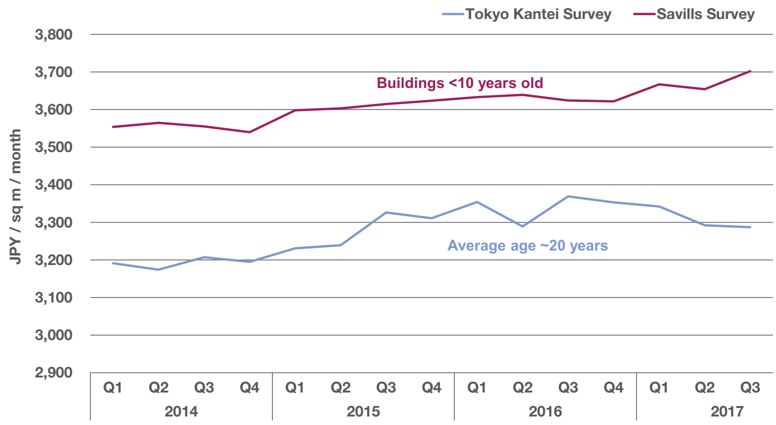
Average occupancy for J-REIT residential assets, 2013–2017*



* Q4/2017 estimate based on October – November data.
Source: Savills Research & Consultancy based on publically disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)

GRAPH 6

Rents of new vs old buildings in the 23W, 2014–Q3/2017



Source: Tokyo Kantei, Savills Research & Consultancy. Tokyo Kantei Q4 data not available as of writing.

older buildings outpaced growth in the Savills index.

This divergence is now visible even in buildings with just a few years' age difference. Even within the Savills index, we have observed a widening between rents in buildings completed in the last few years versus older stock. Rents in buildings aged three years or less are currently seeing a rental premium of 7.0% over buildings aged 4-10 years. This is approximately double the premium observed two years ago in early 2015.

These gaps give reason to believe that rental growth is now largely driven by new developments coming online. As previously discussed, most new developments appear to be targeting above average rents, both because the cost of construction and land acquisition have grown in recent years and because the mid-to-high-end market is seeing persistent demand. Continuously strengthening occupancy in J-REIT-held assets is further evidence of this.

OUTLOOK

The prospects for the market

Tokyo's residential rents are continuing their slow climb. Robust increases are visible in the C5W and in brand-new assets in general. The C5W average now sits virtually even with its 2008 level, although this is due to above-trend growth in 2017 driven by new completions. It is likely that the C5W index will surpass its 2008 level in 2018, though the pace of increases could slow back to trend.

Growth in the 23W as a whole remains visible. Some submarkets – especially the eastern submarkets – outperformed the 23W average in 2017. Continuous redevelopment in Tokyo is likely to pull rents up over the long term as the quality of infrastructure, access, and buildings improve, but it appears unlikely that the 23W average will surpass 2008 levels before 2020.

Occupancy stands solidly above 95% and is unlikely to weaken in the absence of a new supply glut. The enduring stability of Tokyo's rental market should continue to attract market interest, and could make mid-market apartments a compelling defensive investment even if global macro conditions deteriorate.

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