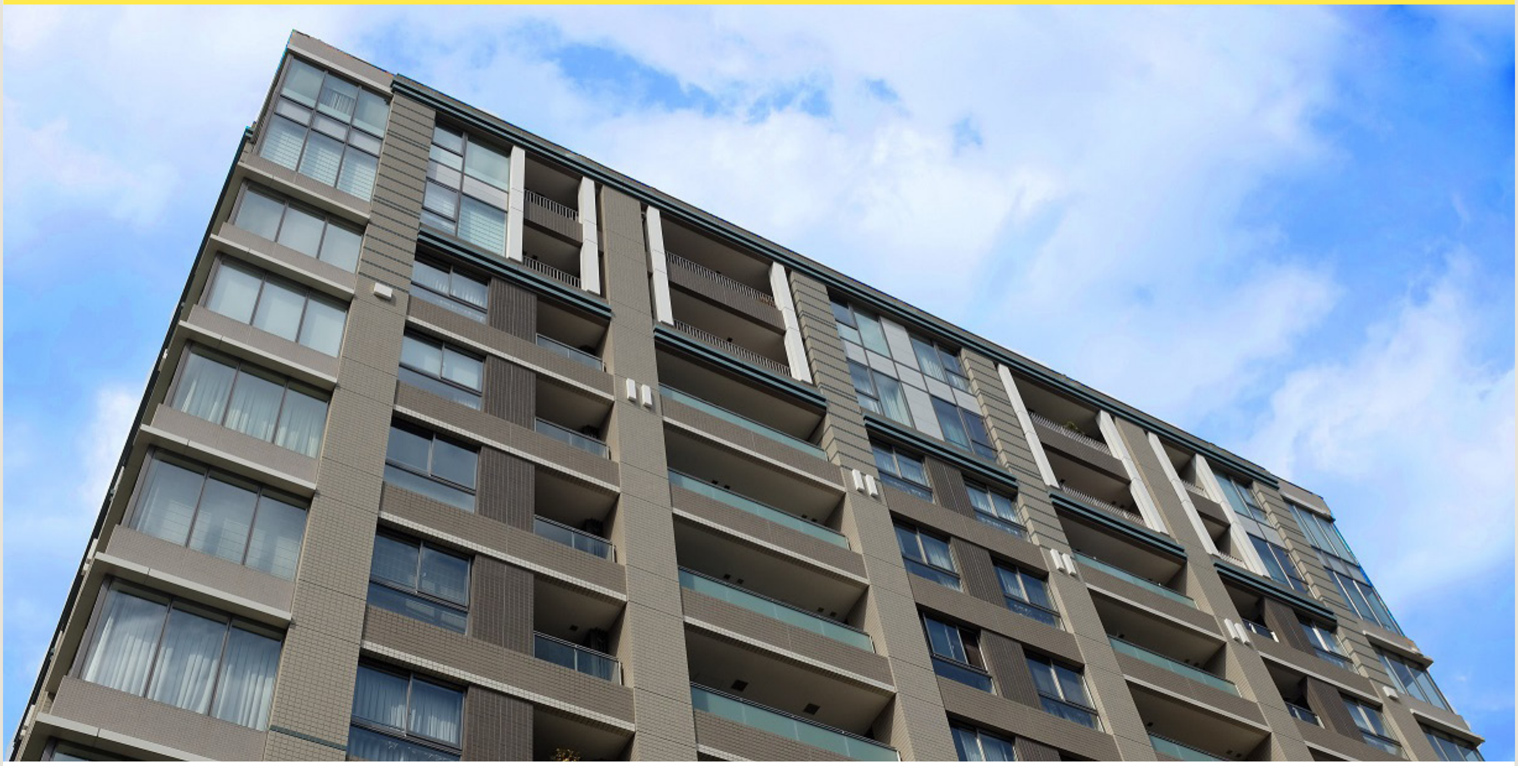
Briefing
Residential leasing

Q1 2017



SUMMARY

Rental growth has picked up in early 2017, and we expect further gradual increases.

- Average mid-market asking rents in the 23-ward area (23W) stood at JPY3,667 per sq m, up 1.2% quarter-on-quarter (QoQ) and 0.9% year-on-year (YoY).

- Rents in the central five wards (C5W) increased 1.4% QoQ and 1.7% YoY to stand at JPY4,259 per sq m.

- Tokyo's Outer East area once again registered the largest YoY growth at 3.5%. The Inner East and Inner North areas are also performing well at 2.3% and 2.7% YoY growth respectively.

- Average rents in the C5W area remain at a 16.2% premium over the 23W average. Southern wards saw a modest decrease in premium, while the Inner North, Inner East, and Outer East areas all saw notable increases.

- Institutional quality assets posted average occupancy of 96.9% in Q1/2017, up 0.7 percentage points (ppts) over the previous quarter and still comfortably above 95%.

- The Bank of Japan (BOJ) and Financial Services Agency (FSA) are actively monitoring apartment-related loans. Total credit to the real estate sector has surpassed JPY85 trillion, a historical high, though the pace of growth began to moderate in late 2016. Credit conditions remain attractive for institutional investors.

"Mid-market asking rents in Tokyo's 23 wards have returned to positive growth after a dip in late 2016. Northern and eastern areas have seen notable increases, and occupancy remains strong. It appears that high condo prices may be leading more people to rent."
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 "C5W"), South, West, North (Inner and Outer) and East (Inner and Outer).

Savills rental index: Tokyo mid-market apartments

Savills collates over 10,000 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,

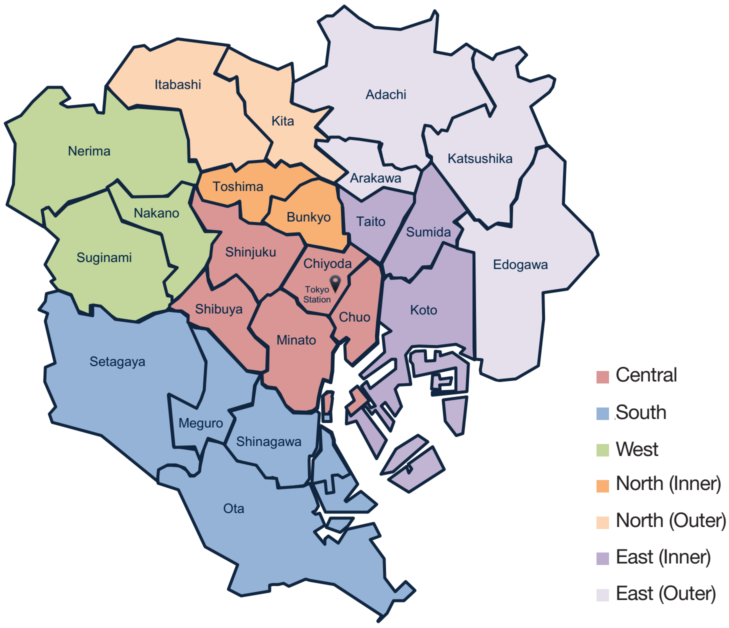
2) reinforced concrete structures built within the last ten years, and

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 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 delineated by survey area



Source: Savills Research & Consultancy

Rents in Tokyo's 23 wards stood at JPY3,667 per sq m as of Q1/2017, still 9.2% below 2008 peaks. Rents increased 1.2% on a QoQ basis and 0.9% YoY, returning to a trend of gradual growth after some softness in late 2016. Rents have been growing at a gradual, low-single-digit pace since bottoming out in 2011-2012. Brighter economic sentiment in early 2017 could indicate marginally stronger growth ahead, but significant changes in trend are unlikely.

Rents in the central five wards stood at JPY4,259 per sq m as of the same period, edging 1.4% higher QoQ and 1.7% YoY. This increase largely erased the softness that occurred in late 2016 and continues the CBD's trend of gradual and steady growth. Although the C5W's current rent is still 5.2% below 2008 peaks, it is expected to keep rising as developers continue to add high-quality properties in the central area and populations continue to increase around prime business hubs.

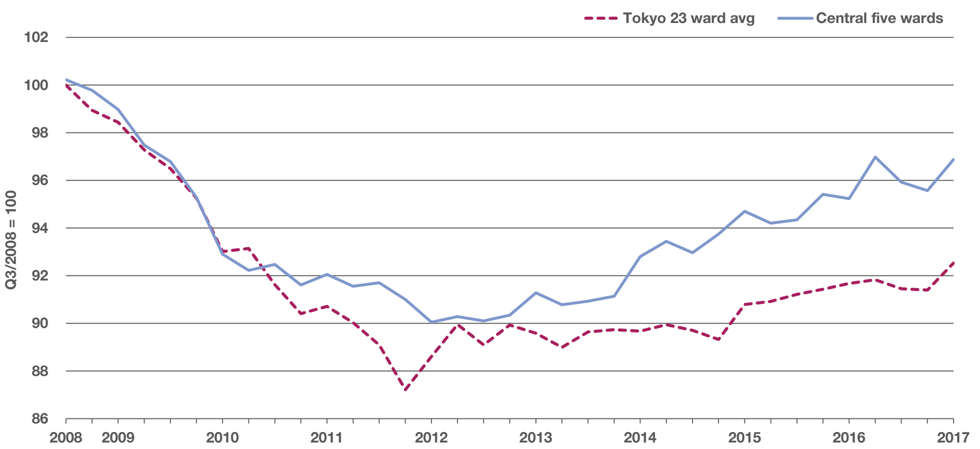
Newly completed rental property on the market in late Q1/2017 includes two high-quality Park Axis-branded properties by Mitsui Fudosan. Park Axis Kamiyacho is advertising 1LDK rooms of approximately 30 sq m for roughly JPY5,500 per sq m, while Park Axis Nihonbashi Kabutocho is also offering 30-40 sq m 1LDKs for about JPY5,000 per sq m.

Tokyo mid-market rental trends by survey area

Rents in the C5W area consistently show large premiums over the city average. Rents in the South and Inner North submarkets also show small premiums over the 23W

GRAPH 1

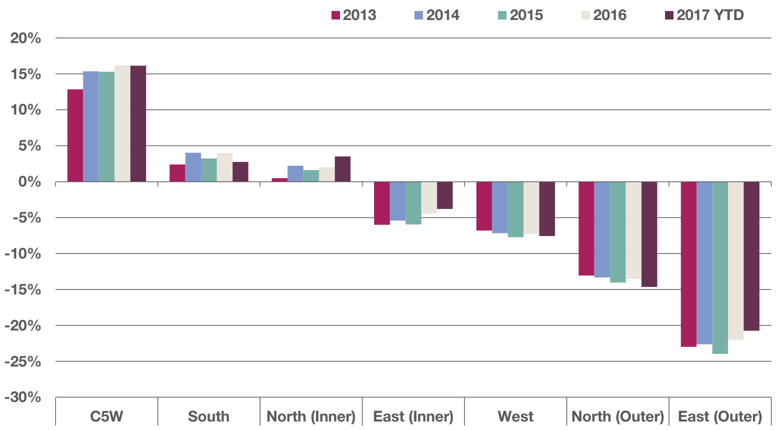
Tokyo mid-market apartment rental index, Q3/2008–Q1/2017



Source: Savills Research & Consultancy

GRAPH 2

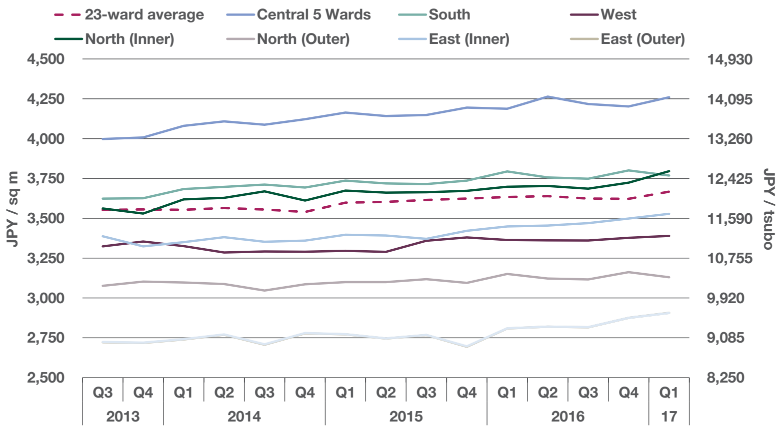
Rental premiums and discounts over the Tokyo 23-ward average, 2013–2017 YTD



Source: Savills Research & Consultancy

GRAPH 3

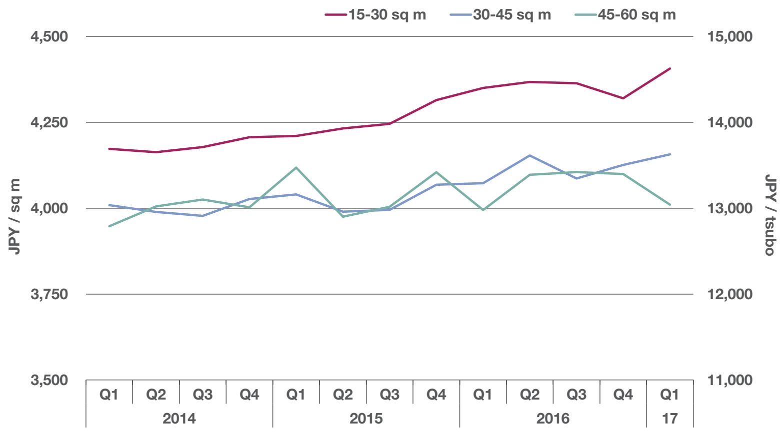
Average asking rents for mid-market rental apartments by survey area, 2013–2017 YTD



Source: Savills Research & Consultancy

GRAPH 4

Average monthly asking rents by unit size, C5W, 2014—2017 YTD



Source: Savills Research & Consultancy

average, reflecting their convenience and popularity. All other submarkets tend to advertise rents at a discount to 23W average.

Though these premiums and discounts tend to be stable over time, some trends have emerged over the past five years. For several years the C5W area appeared to be outpacing all others in rental growth as its premium climbed from 12% in 2012 to 16% in 2016. The C5W's growth has settled more in line with other submarkets since late 2015 and early 2016, however, giving other areas a chance to catch up. The Inner North, Inner East, and Outer East areas have performed particularly well in recent years. The Inner North's premium now stands at 3.5%, up from just above zero in 2013 and surpassing the South's current premium of 2.8%. The Inner East, meanwhile, has narrowed its discount from -6.0% to -3.8% over the past two years. The Outer East, which usually ranks most affordable on average, also narrowed its discount from -24.0% to -20.7% since 2015. It appears that rental growth has been picking up in some of Tokyo's outer wards relative to the city average.

Graph 3 illustrates that the average rent in the central five wards is up 1.7% YoY as of Q1/2017. This was primarily driven by higher advertised rents in Minato, which boosted the ward's average by 4.1% YoY after slow growth in 2016. The Inner North, Inner East, and Outer East submarkets all fared particularly well in Q1/2017, respectively increasing by 2.7%, 2.3%, and 3.5% YoY.

The 23W as a whole increased 0.9% YoY, continuing its trend of steady gradual increases.

Tokyo mid-market apartment rents by unit size

Tokyo's rental market is principally made up of compact single-occupier units, typically less than 45 sq m in size. Such units can often make up as much as 75% or more of the 23W area's rental listings. Unlike other global cities such as London and New York, house and apartment sharing does not form a major segment of the Tokyo rental market.

As a result, there is a large, stable market for small- to mid-sized units.

Graph 4 shows that in Q1/2017 apartments of 30 sq m or less bounced back from late-2016 softness and returned to positive trend. Units of 30-45 sq m continued their slow, gradual increases, while units over 45 sq m displayed more volatility. This is most likely due to relatively smaller sample sizes.

Occupancy rates

Assets owned by J-REITs posted impressive occupancy figures for the first quarter of 2017. Almost every submarket saw increases, and the 23W average remains comfortably above 95% at a reading of 96.9%. This is a 0.7ppt increase over the end of 2016 and flat YoY.

The C5W area registered an occupancy of 96.3% in Q1/2017, led by Chiyoda at 98.4%. Shibuya saw the weakest occupancy at 93.7% but still increased 1.0ppt against its Q4/2016 value.

Institutional investment-quality residential assets are typically in very high demand in Tokyo's 23W area and solid, 95%-plus occupancy is expected to continue over the coming years.

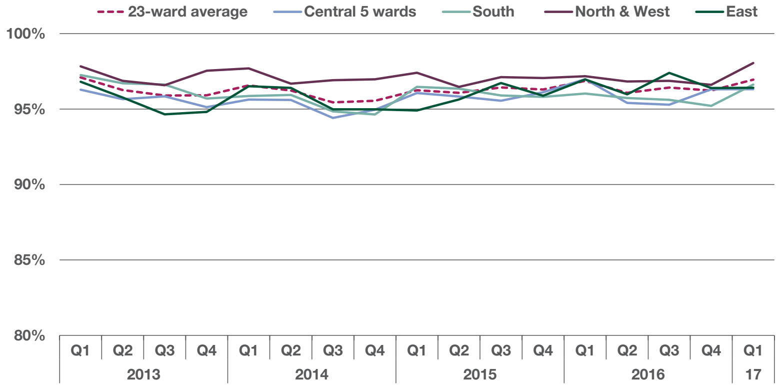
BOJ and FSA keeping a close eye on the apartment loan market

The Japanese residential sector has received increased attention lately due to a rapid increase in apartment-construction-related loan activity. It is cheaper and easier than ever to secure credit in Japan thanks to the advent of Abenomics in 2013 and the BOJ's subsequent "QQE", or qualitative and quantitative easing policy.

As the BOJ continues to target near-zero interest rates for 10-year bonds, fixed income yields remain low and less diversified lenders are searching for yield farther afield. Total credit to the real estate sector topped 85 trillion yen, a historical high, by the end of 2016. The BOJ and FSA are now closely monitoring real estate lending conditions to ensure that the market continues to operate within reasonable metrics. As a result, real estate credit growth

GRAPH 5

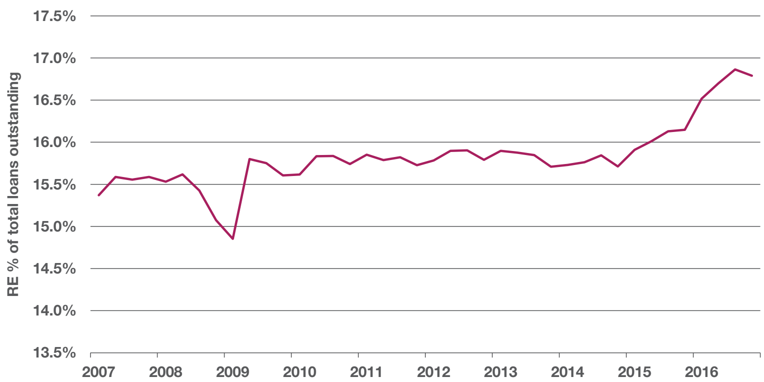
Average occupancy rates for J-REIT residential assets, 2013–2017 YTD



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

GRAPH 6

Loans to the real estate sector as a share of total loans outstanding, 2007–2016



Source: BOJ, Savills Research & Consultancy

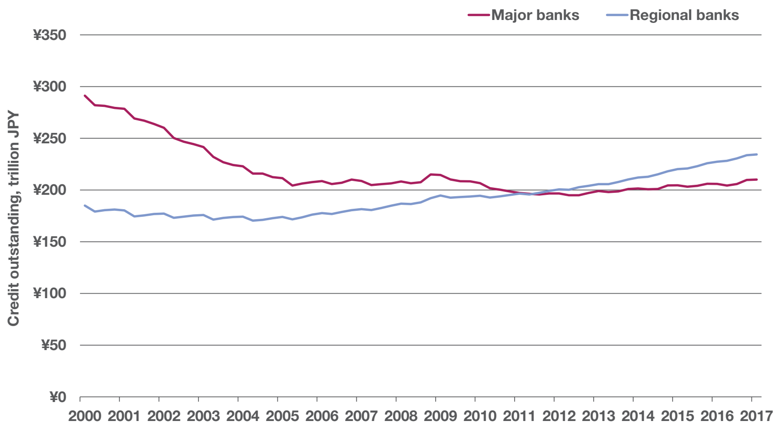
moderated slightly in Q4/2016, though total loans outstanding remain high. We do not expect any significant change in credit conditions in 2017 for institutional investors, though regional lenders are likely to tighten loan requirements.

Historically, the real estate sector's share of total loans outstanding in the Japanese market held steady from 2009 through early 2015. Real estate loans increased abruptly in late 2015, however, as the BOJ intensified its QQE programme and implemented a negative interest rate policy shortly thereafter. Real estate loans as a share of total loans outstanding shot up over a full percentage point over 2015 and 2016, an increase larger than the drop that occurred after the financial crisis in 2008 (Graph 6).

This loan growth was driven by small apartment block development in outlying areas. These developments have often been speculative in nature and not driven by an abrupt shift in housing demand. Land owners have been using the developments to chase tax breaks especially for inheritance. The BOJ and FSA consequently began to step up monitoring of the apartment loan market in late 2016, and have already cautioned some banks about lending practices. Real estate credit growth consequently slowed marginally in Q4/2016 and looks to be under control.

GRAPH 7

Major and regional bank credit growth, 2000–2017 YTD



Source: BOJ, Savills Research & Consultancy

It should be noted that this credit growth is concentrated primarily in lending by smaller, regional banks. Total credit outstanding by small banks has increased 22.0% since the end of 2008 while credit growth in Japan's megabanks has actually declined 2.3% over the same period. Regional banks have greater incentive to step up lending in low-rate environments due to their less-diversified business lines, encouraging more aggressive pursuit of yield. Larger institutions, which tend to finance most institutional investment-quality real estate transactions, have by contrast kept disciplined control of their balance sheets. It is therefore unlikely that this credit growth will pose any significant risk to institutional investors, especially as the pace has already started to moderate in late 2016.

OUTLOOK

The prospects for the market

Gradual and steady rental growth continues in the Tokyo market. The 23W area has returned to positive QoQ increases after slight softness in late 2016, once again demonstrating the Tokyo housing market's reliability. Q1/2017 growth was especially visible in some of Tokyo's outlying submarkets—notably the eastern and inner northern areas—marginally narrowing the rental gap between some outer wards and the C5W area. Occupancy in institutional investment-quality assets remains solidly above 95%. The World Bank and BOJ both revised their economic growth forecasts for Japan upward in early 2017, and slow, gradual expansion in Tokyo's housing market should continue.

Furthermore, condo prices appear to be stalling after several consecutive years of rapid increases. This could be a sign that more occupiers are moving to the rental market, which could positively influence rental growth. The government's efforts to encourage labour reform and wage increases may also help stimulate additional rental growth, if successful.

The BOJ and FSA have stepped up their monitoring of apartment construction loans as real estate credit growth expanded rapidly throughout late 2015 and 2016. As a result of this increased scrutiny, credit growth moderated slightly in Q4/2016 and lending appears under control. This recent increase in lending was primarily driven by smaller regional banks, while larger institutions have maintained steady lending patterns. Credit conditions should remain attractive for institutional investors throughout 2017.

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