

Briefing Residential leasing

Q4 2012



Image: Sea Tower and Mid Tower, Chuo Ward

SUMMARY

New household formation significantly outpaced housing construction starts in 2012, keeping demand for modern apartment units steady and occupancy rates high.

- Tokyo's prefectural population totalled just over 13.2 million as of 1 December 2012, up 0.3% year-on-year (YoY). Household formation grew at a faster rate of 4.2% YoY, with almost 269,000 new households created.

- New housing construction starts in Tokyo Prefecture totalled around 130,000 units in 2012, in line with the 2007 to 2011 yearly average.

- The rate of decline in mid-market apartment rents has slowed considerably since 2010, with the 23-ward area average slipping just 0.4% YoY in 2012.

- The average asking rent in Tokyo's 23-ward area was JPY3,565 per sq m as of Q4/2012. Up 0.9% quarter-on-quarter (QoQ), this figure marks its strongest quarterly rise since Q1/2008.

- The average rental level for the more expensive core eight-ward area was JPY3,880 per sq m, down 1.0% QoQ as a result of more lower-priced units being listed for rent.

- The 23-ward average occupancy rate for J-REIT-owned residential assets slipped 20 basis points (bps) QoQ to 95.7%, remaining above the 95% threshold for the ninth consecutive quarter.

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“After five years of decline, mid-market apartment rents appear to have reached their cyclical nadir. Leasing fundamentals are expected to remain sound going into 2013, buoyed by positive demographics and improved economic conditions.”

Will Johnson, Savills Research

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➔ **Demographic trends**

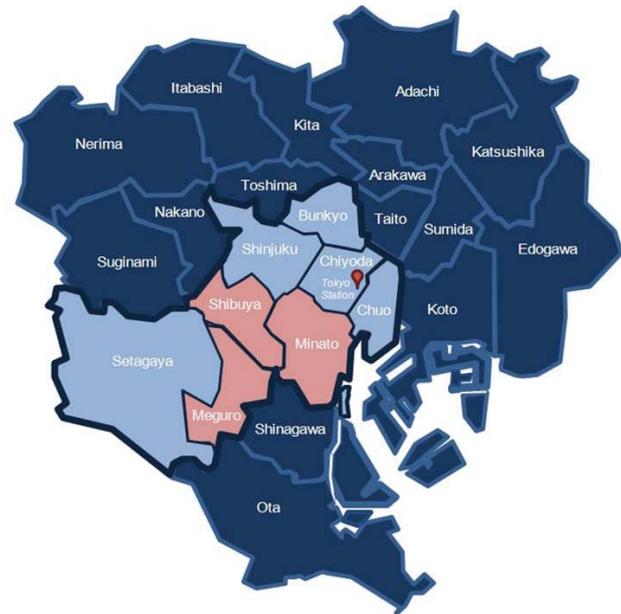
Despite occupying just 0.6% of the total area of Japan, approximately 10.4% of the national population – just over 13.2 million people – were residents of Tokyo Prefecture as of 1 December 2012. Approximately 9.0 million, or 68% of these people, reside in the capital’s 23-ward area. Expanding the geographical definition to encompass the densely inhabited districts of neighbouring prefectures, Greater Tokyo’s population incorporates in excess of 37 million people, making it the most populous urban agglomeration in the world.¹

Continued urbanisation, bringing with it in-migration from regional towns and cities, saw Tokyo’s prefectural population rise 0.3% between December 2011 and December 2012. Higher rates of growth have been seen in the central areas of the capital in recent years, particularly since the Great East Japan Earthquake of March 2011. Reflecting this, the population residing in Tokyo’s 23 wards was up 0.4% YoY in December 2012, while the core eight-ward² and core three-ward³ areas recorded increases of 1.0% and 1.2% respectively.

The rising population of central Tokyo can be explained by both economic and cultural factors. With the Greater Tokyo region boasting an economy equivalent to that of entire G8 nations, economic factors include access to employment opportunities as business operations centralise within the capital. Cultural factors, meanwhile, include access to educational facilities as well as regeneration initiatives, which have created desirable mixed-use environments in previously commercial or semi-industrial locations. In addition, there is the willingness of tenants to pay a locational premium, thought to have increased as an indirect result of the March 2011 earthquake which disrupted transport and communications, and left thousands of commuters unable to return to their homes in Greater Tokyo’s numerous sleeper towns and cities.

1 Tokyo Metropolitan Government, MIAC, United Nations Department of Economic and Social Affairs, Population Division.
 2 Tokyo’s core eight wards are defined as Bunkyo, Chiyoda, Chuo, Meguro, Minato, Setagaya, Shibuya and Shinjuku.
 3 Tokyo’s core three wards are defined as Meguro, Minato and Shibuya.

MAP 1 **Tokyo’s 23 wards delineated by survey area**



Source: Savills Research & Consultancy

Household formation in Tokyo Prefecture rose at a faster rate than its population, increasing 4.2% in December compared with the same month of the preceding year – equivalent to just under 269,000 new households. The number of households in the 23-ward area rose at an even higher rate of 4.9% YoY. Reasons behind the rise include a growing tendency for Japanese people to marry later, divorce or remain single. This, along with the

large and rising population, has helped to support demand for residential units, particularly those designed for single occupier and so-called DINKs (Dual Income, No Kids) households.

Residential supply

Analysis of data collated by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) suggests that the number of housing construction starts in Tokyo

TABLE 1 **Population and households in Tokyo as of 1 Dec 2012**

	Population	% YoY	% change over 1 Dec 2005
Tokyo Prefecture	13,228,912	0.3	5.0
23 wards	9,007,407	0.4	5.9
Core eight wards	2,294,039	1.0	7.4
Core three wards	691,208	1.2	5.5
	No. of households	% YoY	% change over 1 Dec 2005
Tokyo Prefecture	6,706,293	4.2	13.8
23 wards	4,798,176	4.9	15.7

Source: Tokyo Metropolitan Government, Savills Research & Consultancy

→ Prefecture totalled around 130,000 units in 2012.⁴ This figure is steady from the preceding year and in line with the five-year annual average recorded between 2007 and 2011.

As shown in Graph 2, the yearly number of residential construction starts has fallen since the global financial crisis, with the 2012 figure remaining approximately 30% down from the annual average recorded between 2002 and 2006. However, with new supply amounting to less than half of the number of new households formed through the year, it would appear that there is scope for a moderate increase in new development going forward without adversely affecting the supply-demand balance.

Tokyo mid-market apartment rental trends

Average asking rents for mid-market apartments⁵ in Tokyo's 23-ward area have fallen approximately 11% since 2008, having remained on a declining trend since the global financial crisis. This compares with a drop in rents of around 45% in the prime central Tokyo office market over the same period.

Survey data compiled by Savills indicates that the rate of decline in mid-market apartment rents has slowed considerably since 2010, with the 23-ward area slipping just 0.4% YoY in 2012. Focusing on the central wards of the city, the rental average in the core eight-ward area was down 1.3% YoY in 2012, whereas the core three wards rose by 0.4% YoY. As of Q4/2012, mid-market asking rents in the 23-ward area stood at approximately JPY3,565 per sq m (JPY11,781 per tsubo⁶). This rental figure represents a 0.9% increase over the preceding quarter – its largest QoQ rise since Q1/2008.

Reflecting a locational premium of around 8% compared with the 23-ward average, the core eight-ward area commanded an average monthly rent of approximately JPY3,880 per sq m (JPY12,830 per tsubo) as of Q4/2012. This figure reflects a 1.0% decline over the preceding quarter, which can be principally attributed to an increased

⁴ Preliminary figure for 2012 based on January to November data only.

⁵ Rental data has been compiled by Savills utilising over 20,000 leasing comparables and is based on average advertised monthly asking 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) located within a ten-minute walk of the nearest station(s).

⁶ 1 tsubo = approximately 3.3 sq m or 35.6 sq ft.

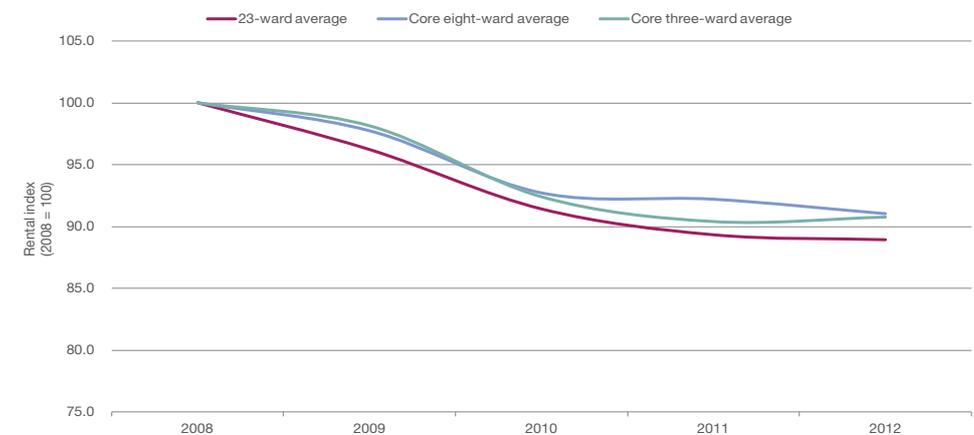
GRAPH 1 New housing construction starts by use in Tokyo Prefecture, 2002–2012



Source: Savills Research & Consultancy based on MLIT data

* Preliminary figure

GRAPH 2 Five-year rental index for Tokyo mid-market rental apartments by survey area, 2008–2012



Source: Savills Research & Consultancy

number of lower-priced units, particularly smaller-sized apartments, listed for rent.

The rental premium for Tokyo's core three residential wards was approximately 15% compared with the 23-ward average, down from 17% in the third quarter. Mid-market apartment rents in the capital's three most expensive wards averaged approximately JPY4,170 per sq m (JPY13,784 per tsubo), slipping 2.2% QoQ. Rental movement mirrored that of the core eight-ward area, with increased supply of lower-priced units pulling down the average rent in the survey area.

Tokyo mid-market apartment rents by unit size-band

Tokyo's rental market is dominated by small- to mid-sized units, which account for the large majority of apartments listed for rent. House or apartment sharing – something which is common in other major developed cities such as London and New York – is not an established practice in Japan. As a result, there is a large, stable market for compact single-occupier units, which are typically less than 45 sq m (13.6 tsubo) in size.

As illustrated in Table 2, rental pricing per sq m for units in the small- to

mid-sized bands is on average more expensive 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.

On average, the average asking rent level for small- to mid-sized apartments in Tokyo's 23 wards rose moderately in Q4/2012 compared with the preceding quarter. Listed rents for units sized between 60 sq m and 75 sq m were up 3.0% QoQ. Units with a leasable area of 45 sq m to 60 sq m, meanwhile, demonstrated rental growth of 1.0%, while the 30 sq m to 45 sq m size-band rose 1.3% through

the quarter. Rental movement in the smaller 15 sq m to 30 sq size-band was more marginal at 0.4% QoQ. This reflected a squeezing of average rents in the core eight wards driven by increased supply of studio-type apartments.

The particularly healthy quarterly movement in rents for relatively larger units of 60 sq m to 75 sq m across Tokyo's 23 wards is considered to reflect solid demand for centrally-located units at the upper end of the mid-market. Such demand comes from domestic professionals as well as corporate 'half-pats', locally-hired international staff with responsibility for their own rental expenses.

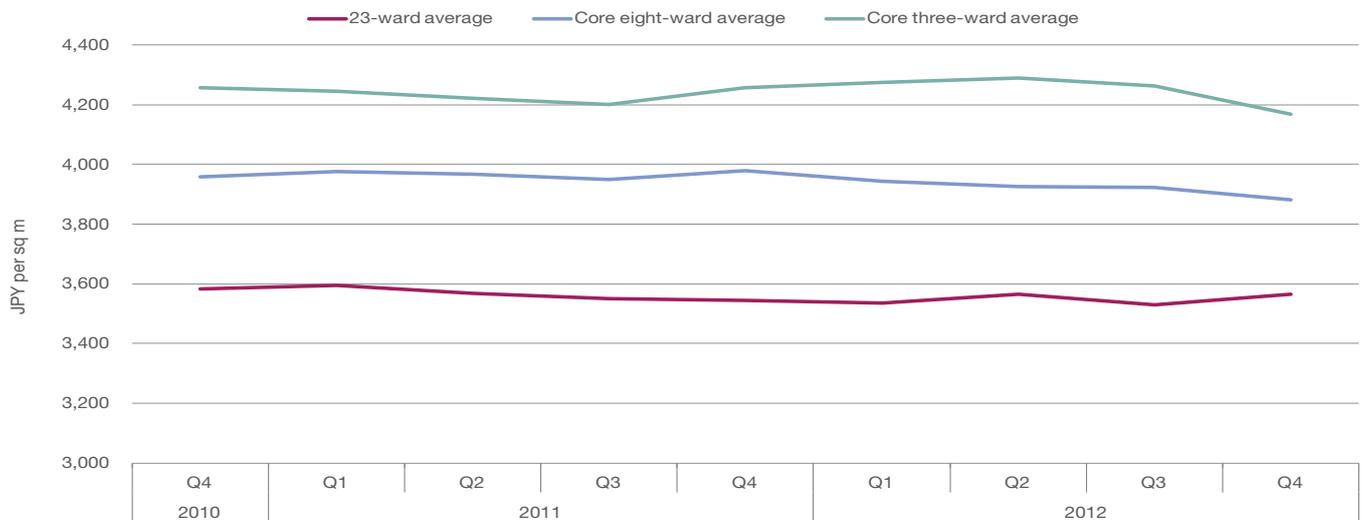
Mid-market apartment occupancy rates

J-REIT-owned residential assets provide a useful benchmark upon which to gauge mid-market apartment occupancy levels. In Q4/2012, the average occupancy rate for apartment buildings operated by J-REITs in Tokyo's 23 wards stood at 95.7%. Although down 20 bps QoQ, this figure marks the ninth consecutive quarter that the average occupancy rate has been recorded above the 95% level.

Average occupancy in Tokyo's core eight wards stood at 95.2%, up 50 bps QoQ. The core three-ward area, meanwhile, recorded a slight increase of 20 bps over the preceding quarter, taking its average occupancy rate to approximately 94.7%. Individually, all of the 23 wards recorded an average occupancy rate above 93%. ■

GRAPH 3

Average asking rents for mid-market rental apartments by survey area, Q4/2010–Q4/2012



Source: Savills Research & Consultancy

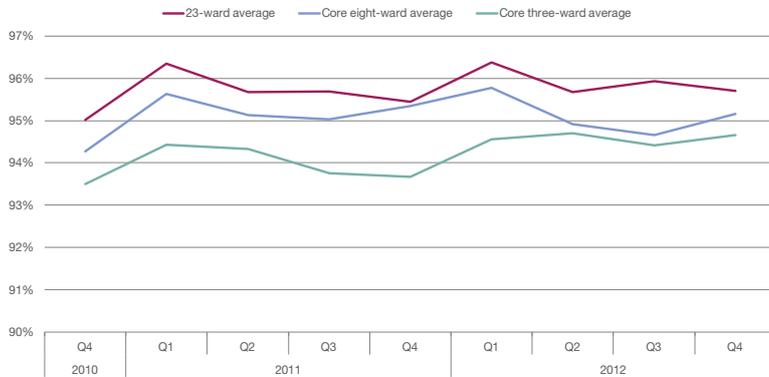
TABLE 2

Average monthly asking rents broken down by size-band, Q4/2012

Size band	15–30 sq m		30–45 sq m		45–60 sq m		60–75 sq m	
	JPY per sq m	% QoQ						
23 wards	3,644	0.4	3,485	1.3	3,277	1.0	3,358	3.0
Core eight wards	3,983	-1.2	3,833	1.7	3,643	1.6	3,704	1.7
Core three wards	4,282	-2.9	4,182	2.1	4,009	0.7	4,129	0.8
No. of units surveyed	>10,000		>5,000		>2,000		>500	

Source: Savills Research & Consultancy

→ GRAPH 4 **Average occupancy rates for J-REIT residential assets, Q4/2010–Q4/2012**



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

OUTLOOK

The prospects for the market

Leasing fundamentals for mid-market apartments are expected to remain sound in the short to mid term, supported by the capital's large and growing population, as well as a trend towards smaller household sizes. Additionally, assertive fiscal initiatives introduced by the government and central bank to stimulate the domestic economy may strengthen consumer sentiment over the coming quarters. Such a scenario would likely spur increased demand for units priced at the upper end of the mid-market in 2013, buoying, in turn, occupancy rates and upward pressure on rents.

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