

Briefing Retail sector

2H 2011



Image: Tenjin Iwataya, Fukuoka

SUMMARY

Strong retail sales growth was sustained in Japan's key southern markets.

- Whereas the retail markets of central Japan struggled to shake-off downward pressure, the more southerly markets of Fukuoka and Osaka demonstrated strong sales growth.
- The year-on-year (YoY) growth rate for Fukuoka over the last six months of 2011 equated to 11.4%, the highest of the six major cities by some 6.3 percentage points (ppts).
- International and domestic fast-fashion retailers continued to expand, with new store openings in both suburban malls and prime high-street locations.
- Overall, retail rents in Tokyo's major shopping districts are considered to have hit bottom, although moderate declines may persist in non-prime locations.
- Over 40 sizable retail property transactions were reported in 2H/2011, illustrative of a general pick-up in investor appetite for this asset class.
- J-REIT Japan Retail Fund was a particularly active buyer, acquiring 12 properties in the Greater Tokyo, Osaka and Nagoya regions for approximately JPY46 billion.

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 “Despite signs of recovery, the major commercial centres of central Japan were yet to fire on full cylinders in 2H/2011. This is in distinct contrast with the more southerly markets of Osaka and Fukuoka, where robust YoY sales growth has been recorded.”
 Savills Research & Consultancy

→ **Retail sales in Japan's six largest cities**

According to the Ministry of Economy, Trade and Industry (METI), the total sales figures for large-scale retail stores¹ in Japan's six biggest cities have shown considerable divergence since the Great East Japan Earthquake of March 2011. The major cities of central Japan, including Tokyo, Yokohama and Nagoya, struggled to shake-off downward market pressure in the second half of the year, although tentative signs of a recovery were seen in December. The more southerly markets of Fukuoka and Osaka, however, remained buoyant throughout 2H/2011, recording strong YoY growth in sales.

Although centred over 200 km to the north, the earthquake and tsunami disaster of 11 March had a significant short-term impact on retail sales in the Greater Tokyo region. Factors such as subdued consumer sentiment and mandatory energy saving measures led to YoY double-digit declines in overall sales in Tokyo and Yokohama in April. As consumer uncertainty eased, the rate of decline moderated quickly in May to less than 4%; however, despite tentative signs of a recovery in June and July, sales figures dipped back slightly into negative territory through to November 2011. Figures for December were more reassuring, with Yokohama and Nagoya staying steady over the previous year and sales declines in Tokyo easing to less than 2%.

¹ "Large-scale retail stores" are defined as department stores, shops and supermarkets with sales areas of 6,000 sq m and above.

By comparison, sales figures for Fukuoka and Osaka have been consistently strong in recent quarters. Since the cities are geographically distant from the earthquake epicentre, the markets were less impacted than their more northern counterparts, both physically and in terms of consumer sentiment. Moreover, both city markets benefited from positive retail demand generated by the opening of large-scale retail developments.

The average YoY growth rate for Fukuoka over the last six months of 2011 equated to 11.4%, the highest of the six major cities by some 6.3 ppts. Contributing to this growth was JR Hakata City, a new 200,000-sq m retail-led station building which opened in March 2011. The station-front shopping mall has transformed the Hakata train terminal into a sophisticated retail destination, capable of capitalising on the highest passenger volume in the Kyushu region.

A similar story can be seen in Osaka. Osaka Station City, which opened in May 2011 as part of expansion work on JR Osaka Station, has become one of the leading retail destinations in the Greater Osaka region. The two-wing shopping complex comprises the newly constructed North Gate Building and the expanded South Gate Building (formerly Acty Osaka), which provide a combined retail area of over 134,000 sq m. This makes the scheme the second largest shopping centre in Japan following AEON Laketown in Koshigaya City, Saitama Prefecture.

In May, Osaka's retail sales jumped 8.6% over the previous year, largely due to the opening of this new shopping destination. Although this initial impetus moderated after June, the YoY growth rate between July and December 2011 averaged a healthy 5.1%.

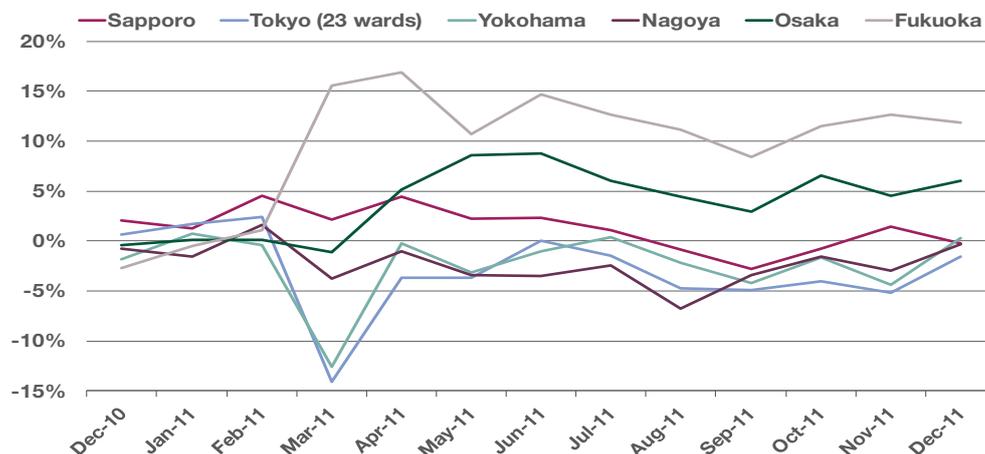
Retail market trends: Fast-fashion brands expand into malls and department stores

After the launch of Swedish apparel retailer H&M's first store in Ginza in September 2008, competition in the domestic fast-fashion market has been intense, involving both domestic and international brands. In 2011, several large international fast-fashion retailers expanded their businesses from high-street retail destinations to shopping malls in order to reach a wider demographic. Some of these retailers have also located flagship stores within department stores, where operators have struggled to realise positive sales figures in recent years.

Demonstrating its proactive growth strategy, H&M opened five stores in Japan in 2011. Four out of the five were located in suburban shopping malls, with the remainder being part of the Ebisubashi store expansion in central Osaka. Within the Greater Tokyo market, the retailer targeted busy suburban hubs such as Futako Tamagawa in Setagaya Ward and Fujisawa City in Kanagawa Prefecture. H&M's footprint also expanded to Kyushu, with its first regional store opening in a newly completed annex of Fukuoka's Canal City Hakata shopping mall in September. Other new entrants to the Fukuoka market include ZARA's sister brand Bershka and US fashion retailer Forever 21.

Forever 21 launched its Tokyo flagship store at the Matsuzakaya Ginza department store in April 2010, where it occupies eight floors. In a similar move, H&M has chosen the south wing of Matsuzakaya Nagoya for its first department store location in Japan, which is expected to open in April 2012. With declining sales figures in recent years and their traditional retail format appearing increasingly outdated, department

GRAPH 1 **YoY change in sales of large-scale retailers, Dec 2010–Dec 2011**



Source: METI, Savills Research & Consultancy

→ stores have sought big-name retailers to enhance their business platform. The pull factor of popular international fast-fashion brands provides an opportunity for traditional department stores to rejuvenate their sales strategy, in which brand image is king.

Further planned store openings in 2012 relate to standalone high-street retail buildings. Domestic fast-fashion giant UNIQLO will relocate to a new flagship store in Tokyo's Ginza shopping district in March. At approximately 5,000 sq m, the store will be the brand's largest in the world in terms of sales area. The store currently occupied by UNIQLO in Ginza will be taken over by its sister brand g.u., upon its relocation. These inexpensive fashion brands are not the first to enter the traditionally luxury-focused Ginza market. In March 2011, US retailer GAP opened a 1,400-sq m flagship store near Ginza's SukiyaBASHI crossing, returning to the site of its original 1995 Japan store.

Strong competition between fast-fashion retailers for prime retail locations is expected to continue going forward, with new entrants such as American Eagle Outfitters and GAP's sister brand Old Navy due to enter the Japanese market in the short term.

Tokyo retail leasing market

In the third quarter of 2011, average asking rents in the five major retail submarkets of Tokyo experienced a drop from the previous quarter of approximately 4.4%. Nevertheless, compared with the same period in 2010, Q3 saw a 6.8% increase. Overall, rents in all five submarkets are considered to have hit bottom, although moderate declines may continue to be recorded in non-prime locations.

A survey of advertised rents for ground floor (G/F) retail units in major commercial districts of Tokyo suggests that Ginza has retained its position as the most expensive retail area in the city as of Q3/2011. Despite a recorded decrease in average asking rents of around 13% from the previous quarter, the fundamentals of Ginza's retail market are considered to be strengthening, especially on the main retail thoroughfares where G/F occupancy is in the high 90% range. In fact, recent rental volatility is believed to be predominantly attributable to the relatively limited sample group, as opposed to heightened downward pressure on rents. On a YoY basis, average asking rents in Ginza in the

third quarter were approximately 2.6% more expensive than the same period of 2010.

Shinjuku was the second most expensive retail destination among Tokyo's five major commercial areas in terms of average asking rents. The submarket saw the completion of several new retail schemes in 2011, including along its main shopping streets. Omotesando remains in third position, regardless of a dip in average asking rents in Q3/2011 of 1.7% from the previous quarter and 2.7% from Q3/2010. G/F units facing Omotesando's main streets have demonstrated almost full occupancy over the past few years, which has helped to mitigate downward pressure on rents at top-grade properties. Vacancy in the submarket is largely limited to properties which are located a block or two inside from the main retail thoroughfare; the recent movement in average asking rents can be attributed to the inclusion of such properties into the survey sample group.

Negative consumer sentiment stemming from the Great East Japan Earthquake has dissipated in the Tokyo market. Moreover, the Japan National

TABLE 1 Store openings for selected retailers, 2011–2012

| Brand | Store name | City/ward | Prefecture | Open date | Type |
|----------------|-------------------------|-------------|------------|------------|------------------|
| H&M | Futako Tamagawa RISE SC | Setagaya | Tokyo | 17/3/2011 | Mall |
| | LaLaPort Koshien | Nishinomiya | Hyogo | 23/4/2011 | Mall |
| | Canal City | Fukuoka | Fukuoka | 30/9/2011 | Mall |
| | Terrace Mall Shonan | Fujisawa | Kanagawa | 11/11/2011 | Mall |
| | Ebisubashi 2 | Osaka | Osaka | 19/11/2011 | Standalone |
| | Tenjin | Fukuoka | Fukuoka | 17/4/2012* | Standalone |
| | Nagoya Matsuzakaya | Nagoya | Aichi | 21/4/2012* | Department store |
| Forever 21 | LaLaPort Yokohama | Yokohama | Kanagawa | 30/4/2011 | Mall |
| | Fukuoka Tenjin | Fukuoka | Fukuoka | 17/4/2012* | Standalone |
| Bershka | Canal City | Fukuoka | Fukuoka | 30/9/2011 | Mall |
| | Shinsaibashi | Osaka | Osaka | 16/3/2012* | Standalone |
| | DiverCity Tokyo | Minato | Tokyo | 19/4/2012* | Mall |
| TOPSHOP/TOPMAN | Lukua Osaka | Osaka | Osaka | 4/5/2011 | Mall |
| UNIQLO | Ginza Flagship | Chuo | Tokyo | 16/3/2012* | Standalone |
| GAP | Flagship Ginza | Chuo | Tokyo | 3/3/2011 | Standalone |

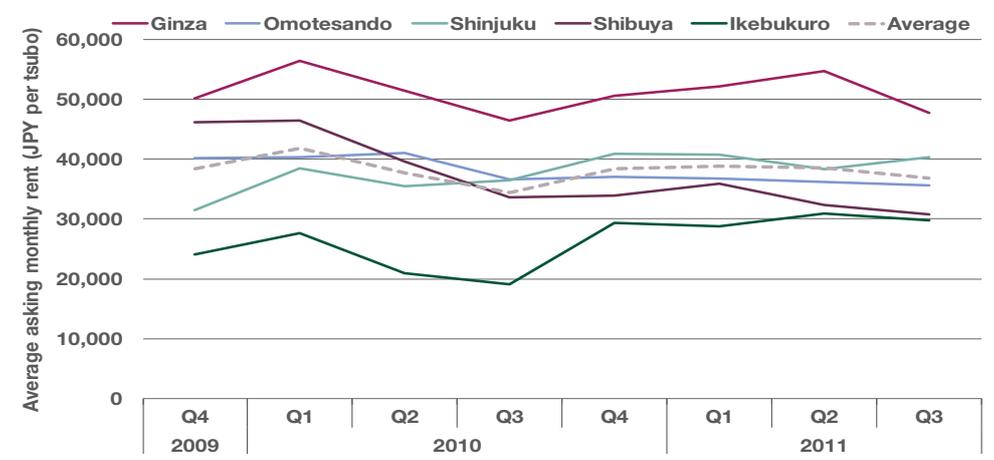
Source: Company websites, Ryutsu News, Savills Research & Consultancy
 * Scheduled store openings in 2012.

→ Tourism Organization indicates that there has been a recovery in the arrival numbers of tourists, particularly from China and the Asia-Pacific region. Such factors, combined with an expected recovery in the national economy and signs of a tentative easing in the strength of the yen, should help to buoy Japan's retail sector in the short- to mid-term.

The Japan retail investment market

Over 40 sizable retail property transactions were reported in 2H/2011. Although limited in number compared with Japan's other core sectors, recent trades are reflective of a general pick-up in investor appetite for retail assets over the course of the year. As would be expected given its economic dominance, the Greater Tokyo region accounted for more than half of the trades which took place. Suburban malls and high-street retail assets in smaller regional markets were, however, also the target of investors' acquisition strategies.

GRAPH 2 Average asking rent for G/F units in Tokyo's major retail submarkets, Q4/2009–Q3/2011



Source: Savills Research & Consultancy

One J-REIT, Japan Retail Fund Investment Corporation, was particularly active, acquiring 12 assets located across the Greater Tokyo, Osaka and Nagoya regions for approximately JPY46 billion. The

Mitsubishi Corporation and UBS-sponsored REIT acquired all but one of the properties from non-related parties, including investment vehicles of Round One and the Carlyle Group. Four of the REIT's acquisitions were →

TABLE 2 Selected retail transactions, 2H/2011^

| Property name | Location | GFA (sq m) | Price (JPY mil) | Cap rate (%) | Buyer |
|---------------------------------------|-------------------------|------------|-----------------|--------------|----------------------------|
| July | | | | | |
| Shinbashi Redbrick | Shinbashi, Tokyo | 2,794 | 4,000 | 5.1 | Alpha Investment Partners |
| Albore Daimyo | Daimyo, Fukuoka | 925 | N/A | N/A | HIT Corporation |
| Brooks Brothers Fukuoka | Imaizumi, Fukuoka | 914 | N/A | N/A | NTM |
| September | | | | | |
| Naias Jingumae | Jingumae, Tokyo | 939 | N/A | N/A | Morgan Stanley MSREF |
| Kishiwada CanCan Bayside Mall | Kishiwada, Osaka | 76,653 | 7,000 | 7.8 | Japan Retail Fund (REIT) |
| Makuhari Plaza | Makuharicho, Chiba | 12,624 | 5,700 | 6.4 | Japan Retail Fund (REIT) |
| MrMax Nagasaki | Iwamimachi, Nagasaki | 12,207 | 2,475 | 7.6 | Japan Retail Fund (REIT) |
| G Building Shinsaibashi 02 | Shinsaibashisuji, Osaka | 995 | 4,380 | 5.2 | Japan Retail Fund (REIT) |
| Urban Terrace Jingumae | Jingumae, Tokyo | 1,734 | 2,797 | 6.1 | Japan Retail Fund (REIT) |
| Round One Namba Sennnichimae* | Namba, Osaka | 1,712 | 8,000 | 4.6 | Japan Retail Fund (REIT) |
| Albore Tenjin | Tenjin, Fukuoka | 883 | 850 | 5.6 | Toho Housing |
| October | | | | | |
| Mozo Wonder City | Futakata-cho, Nagoya | 86,723 | 5,250 | 6.3 | Japan Retail Fund (REIT) |
| December | | | | | |
| GU Shinsaibashi | Shinsaibashisuji, Osaka | 3,838 | N/A | N/A | RREEF |
| Yodobashi Camara Multimedia Kichioji† | Kichioji, Tokyo | 37,933 | 2,200 | N/A | United Urban (REIT) |
| High Street Property | Tenjin, Fukuoka | over 1,000 | N/A | N/A | Undisclosed foreign entity |
| Musashino Building | Shinjuku, Tokyo | 11,512 | N/A | N/A | Mitsubishi Corporation |

Source: J-REITs, Real Capital Analytics, Savills Research & Consultancy
 ^Prices and NOI yields are estimated.
 * Investment in owning entity.
 † Land only transaction.

→ leased-land purchases – the most expensive being the 1,712-sq m site of the planned Round One Nanba-sennichimae Store in Chuo Ward, Osaka, at JPY8 billion. An 11-storey flagship building for amusement centre operator Round One is due to be completed on the site in May 2012. The most expensive combined land-and-building transaction related to the 76,653-sq m Kishiwada CanCan Bayside Mall in Kishiwada City, Osaka Prefecture, at JPY7.0 billion.

In addition to large shopping centre acquisitions, high-street retail units with strong tenant covenants have proven an attractive investment destination in some of Japan's key

regional cities. Six such transactions were completed in the central Fukuoka market in 2H/2011, concentrated in and around the core Tenjin submarket. In most cases, buyers in Fukuoka have been domestic and local real estate developers; however, the market's strong sales performance in recent quarters has attracted renewed attention from international investors. Reflecting this, one overseas group concluded a deal for a prime retail asset on the busy Tenjin Nishi Dori thoroughfare late in the year. Overseas capital was also put to play in Osaka, where RREEF acquired the flagship store of fast-fashion retailer, g.u., on the popular Shinsaibashisuji shopping arcade. ■

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