Japan - November 2019

SPOTLIGHT
Savills Research

Japan Retail

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Retail rents rise in Tokyo

Summary

- Tokyo's average 1F retail rents are trending upwards, with strong growth in Ginza and Shinjuku this period.
- New retail developments abound, which could give rise to new prime markets in Tokyo and beyond.
- The number of Korean visitors has dropped significantly following the onset of the Japan-Korea dispute. Despite this, inbound spending in Japan is up 9.1% YoY for Q3 and 8.2% year to date (YTD), indicating that the impact on the retail sector should be limited.
- With limited opportunities to buy prime Tokyo retail, and available assets proving somewhat pricey for many investors, retail transaction volumes have declined substantially over the prior year. On the other hand, Osaka investment volumes YTD to Q3 are already 64% higher than 2018, and other regional markets have seen volumes pick up.
- The impact of e-commerce remains somewhat limited compared to global peers. However, growth in the sector has been stronger than expected and traditional bricks and mortar retailers are restructuring to remain competitive.

TOKYO SUBMARKET RENTS

According to a semi-annual survey by Japan Real Estate Institute (JREI) and BAC Urban Projects, most of Tokyo's prime retail submarkets saw rental growth in 1H/2019. Average 1F rents grew 9.5% half-year-on-half-year (HoH) and 8.8% year-on-year (YoY), with HoH growth largely led by Ginza's recovery from last period. Non-1F rents, which are more stable, posted even stronger growth of 10.1% YoY, probably backed by a favourable leasing market across all real estate sectors, especially office. Indeed, all submarkets saw YoY growth in non-1F rents. Ginza and Omotesando still maintain the top spots in 1F rents, though average non-1F rents are nearly level across Tokyo's prime submarkets, with Shibuya and Shinjuku making substantial gains over the prior year.

Ginza

Ginza 1F rents grew by 32.6% HoH and 11.6% YoY to JPY75,200 per tsubo per month, retaking the top position from Omotesando. As expected, the drop in Ginza 1F rents that was witnessed last period was short-lived, likely attributable to the relatively small number of listings in the market, a reflection of how tight the market is at present. For the same reason, however, this period's exceptional growth should be viewed with some degree of skepticism. It is also worth noting that the uptick in pricier listings this period could imply that landlords are having more difficulty filling such spaces.

That being said, non-1F rents, which are generally more stable indicators of the area's performance, also posted a fairly strong increase of 8.2% HoH and 10.9% YoY. Indeed, Ginza remains the premier shopping district of Japan, attracting retailers across the spectrum, from top luxury brands to drugstores. The expectation of increasing inbound tourism is drawing new tenants to the area, while existing tenants with high levels of storefront traffic are opening new locations on different streets in the submarket.

Omotesando

Omotesando 1F rents fell 14.2% HoH and 12.8% YoY to JPY52,400 per tsubo, falling back below the levels of Ginza, as expected. Non-1F rents fell 2.1% HoH, but were still up 4.8% YoY, landing at JPY33,000 per tsubo. The Omotesando market caters primarily to people under the age of 40 and therefore gains more attention on social media. Retailers have noted this marketing opportunity and, as a result, the area is particularly popular for pop-up stores and product launches.

A large mixed-use residential and retail project, With Harajuku, is set for completion near Harajuku Station in Spring 2020, while the station itself is undergoing renovations to be completed in time for the Tokyo Olympics. Further down the street by Jingumae Station, a retail development with 22,000 sq m of GFA that is tentatively referred to as the Jingumae 6-Chome District Project, is scheduled for completion in Autumn 2022. These developments will further increase traffic in this top-notch retail hot spot.

Shinjuku

In Shinjuku, 1F rents grew by 19.0% HoH and 22.1% YoY to JPY42,500 per tsubo. Non-1F rents in Shinjuku also continue to trend upward, posting growth of 12.8% HoH and 11.2% YoY. As with Ginza, the small number of 1F samples leads to volatility in average 1F rents. Non-1F rents have been rising steadily in the submarket since bottoming out in 2013 and are now above 2008 levels.

The East-West public passage is expected to open in 2020, offering a much welcome improvement in the connectivity of the now divided eastern and western sides of the world's busiest train station.

Shibuya

1F rents in Shibuya rose 4.9% HoH and 27.0% YoY to JPY45,200, maintaining strong long-term momentum. As in Shinjuku, non-1F rents are also growing steadily, now exceeding 2008 levels and nearly catching up to average rents in Omotesando and Ginza. Shibuya continues to undergo a major transformation through development, slowly evolving into a business district that attracts more seasoned professionals, while still maintaining the hip image that draws younger shoppers. (For a broad overview of Shibuya's development, please reference our spotlight report, A gravitational shift to Shibuya.)

Retail is beginning to reflect this change, as the area, mainly characterised by fast-fashion brands, is seeing luxury brands expand their presence. For example, Shibuya Parco, set to reopen in November, will host Gucci and Comme des Garçons, while Shibuya Scramble Square East Tower, which will open its doors in the same month, will include luxury brands such as Bulgari and Saint Laurent. The shift to luxury may be welcome as fast-fashion retailers face significant headwinds, and the opening of these landmark facilities should attract large footfalls to the Shibuya market.

NEW DEVELOPMENTS AND EMERGING RETAIL MARKETS IN TOKYO

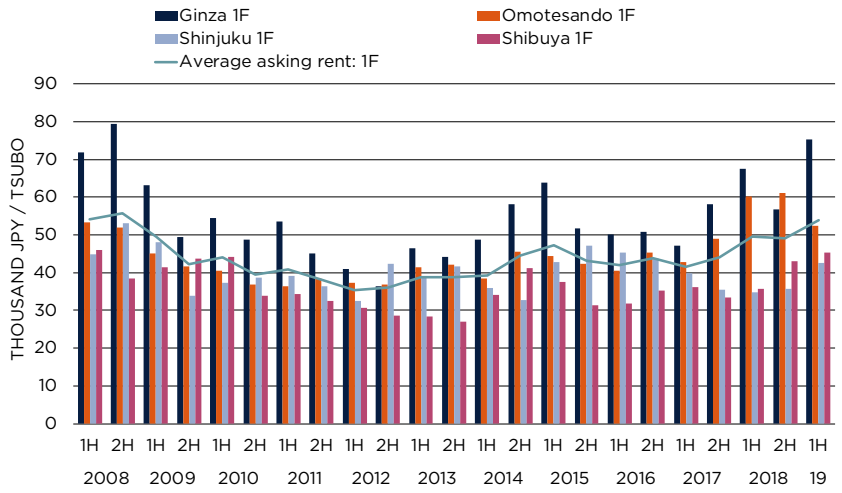
Tokyo is witnessing a spate of new developments that will help expand the retail sphere, bolstering well-established markets such as Shinjuku and Shibuya, and fostering more investment opportunities beyond prime areas. In Shibuya, the 230-meter Shibuya Scramble Square East Building is set to open on 1 November. As the tallest structure in the

ward, it will offer an open-air observation deck on the top floor, giving a panoramic view of central Tokyo and its landmarks, not to mention Mt. Fuji, which should attract even more overseas tourists to the area. In Shinjuku, the East-West passage, expected to open in time for the Olympics next year, will help consolidate Shinjuku's eastern and western submarkets, which are currently divided by the station. These developments should serve to close some of the rental gap with Ginza and Omotesando.

With the ongoing Toranomon Hills and upcoming Toranomon-Azabudai projects, the Toranomon area is undergoing large-scale redevelopment that may give rise to a secondary retail market, just as the Roppongi Hills and Tokyo Midtown developments did for nearby Roppongi. The projects will together constitute another massive commercial zone at the centre of the Minato Ward. The area's accessibility will be further improved by the new Toranomon Hills Station on the Metro Hibiya Line, which is set for a provisional opening next year.

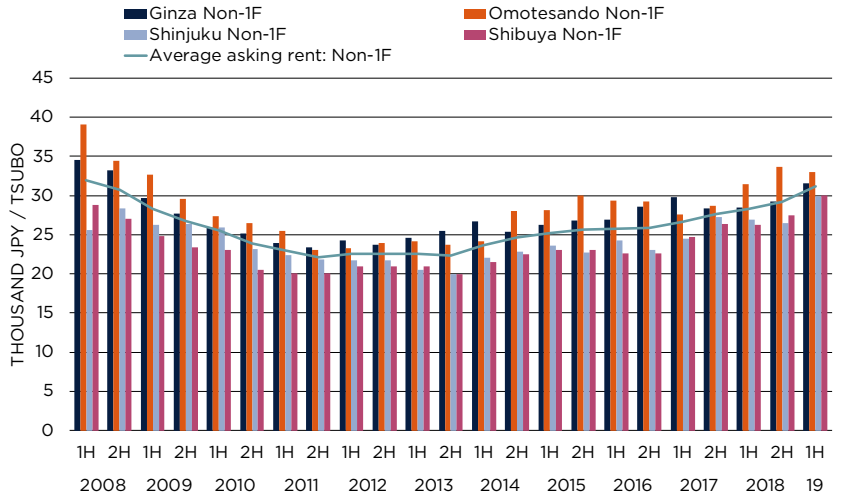
Demand for retail assets in prime locations remains strong, yet attractive deals in top markets are limited. Upcoming mixed-used developments are likely to add vibrancy to surrounding areas and give rise to new retail markets in major cities.

GRAPH 1: Tokyo 1F Rents, 2008 to 1H/2019



Source JREI, BAC Urban Projects, Savills Research & Consultancy

GRAPH 2: Tokyo Non-1F Rents, 2008 to 1H/2019



Source JREI, BAC Urban Projects, Savills Research & Consultancy

Development is occurring outside of the central five wards as well. The area to the East of Ikebukuro Station, Japan's second busiest rail station and an already-established retail hub that caters to anime and gaming subculture, has been another beneficiary of the inbound boom, and is undergoing large development for the first time in nearly four decades. Q Plaza Ikebukuro opened in July, offering 16 stores and an IMAX theater, and the mixed-use tower, Hareza Ikebukuro, is set to open in the summer of 2020. The West side of Ikebukuro Station, which has generally had a less-than-favourable reputation, is also undergoing a much-needed makeover that could yield more investment opportunities in the years ahead.

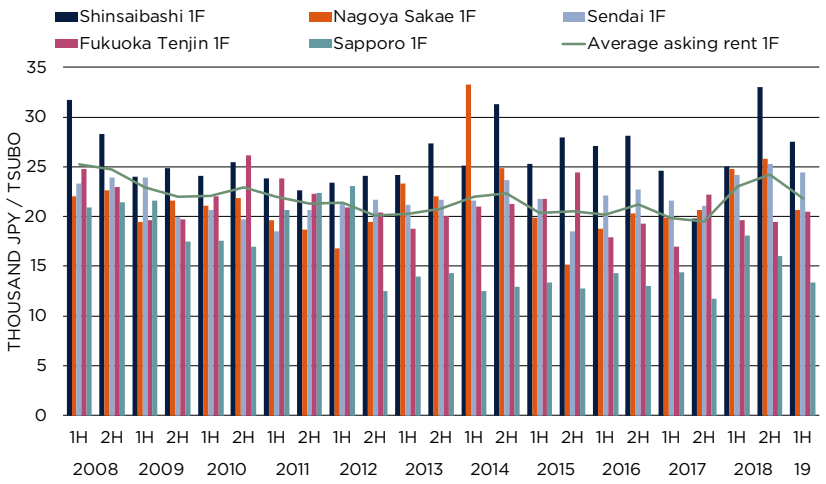
Looking beyond Tokyo, major regional cities, such as Osaka, Nagoya, and Fukuoka, will see further development that should attract additional footfalls to key retail districts.

REGIONAL CITIES

Since 2009, rents have generally been stable in key regional cities, though they experienced some pullback this period. On average, regional 1F rents fell by 10.0% HoH and 5.6% YoY to JPY21,783 in 1H/2019, while non-1F rents, on the other hand, grew 1.5% HoH to JPY12,783.

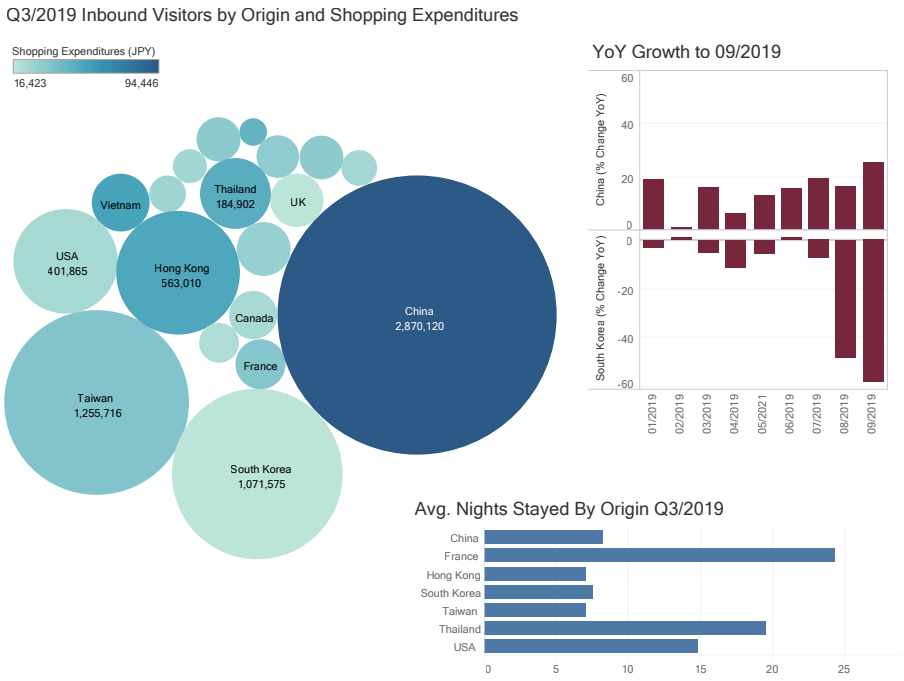
After exceptionally strong growth in late 2018, 1F rents in Osaka's Shinsaibashi have pulled back 16.7% HoH, but are still up 10.0% YoY. The main building of Daimaru Shinsaibashi, a landmark department store, reopened on 20 September, offering around 370 stores. Combined with the adjacent North and South buildings, the department store is expected to generate the highest duty free revenue – over JPY30 billion – in Japan. The

GRAPH 3: 1F Rents In Retail Districts Of Regional Cities, 2008 to 1H/2019



Source JREI, BAC Urban Projects, Savills Research & Consultancy

GRAPH 4: 2019 Inbound Tourism Overview



Source JNTO, Savills Research & Consultancy

first Parco location in Kansai will open across nine floors in the North Building in 2021, making the location an even stronger retail magnet.

Overall, Osaka maintains strong fundamentals across sectors and remains the number two tourist destination in Japan. The city was selected to host the 2025 World Expo and is a top candidate to host an integrated resort, which potential developers are aiming to open in time for the event. (For more information on Osaka real estate, please refer to our May 2019 special report, Osaka Real Estate: Rebirth of a Market.)

1F rents in Nagoya's Sakae have dropped 19.8% HoH and 16.5% YoY. More positively, non-1F rents are up 3.5% and 1.4%, respectively, over the same periods. The Sakae area has recently lagged the Nagoya station-side area in terms of development. The area is on course for an upward shift, however, as a spate of mixed-used developments are in the pipeline, three of which are slated to come online next year, and are expected to invigorate the area both as a retail district and as a business district.

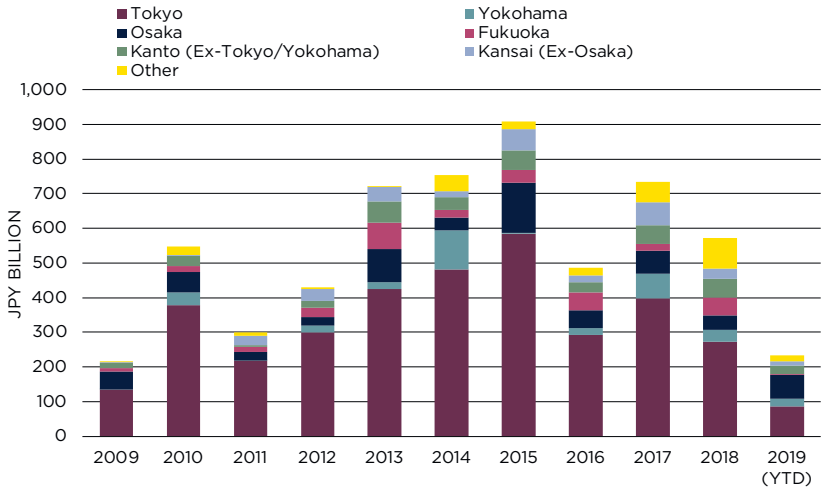
1F rents in Sendai fell 3.6% HoH, but are still up 0.8% YoY. In July, Sendai City announced a project to redevelop the area around Sendai Station, with the goal of reconstructing older buildings into high-specification office and retail facilities. In Sapporo, 1F rents fell 16.3% HoH and 26.0% YoY. As the number of listings has declined compared to 1H/2018, compounded by the fact that there was a large number of high-rent listings during that period, actual rents are likely much more stable.

Fukuoka Tenjin was the only regional market to post 1F rental growth over the prior period, ticking up 5.1% HoH and 4.6% YoY. The Tenjin Big Bang Project will serve as a major catalyst for the area's long-term growth. Multiple large-scale mixed-use redevelopment projects, including the Tenjin Business Centre Project, Former Daimyo Elementary School Project, and Fukuoka Building Project, are expected to be completed over the next five years, which should attract more businesses and visitors to the area. On the other hand, due to its close proximity to South Korea, Fukuoka is a popular destination for Korean tourists, the number of which has declined rapidly since June 2019. This may have an adverse impact on inbound spending in the area.

2019 INBOUND TOURISM

The Japan-Korea dispute has weighed heavily on tourism from South Korea, which had, until August 2019, been the second largest source of visitors. To wit, the number of Korean tourists fell 36.3% YoY in Q3/2019, with a particularly sharp drop seen at the end of the quarter. This will undoubtedly have a negative impact on the retail and hospitality sectors, even though Korean tourists tend to have somewhat shorter stays and spend less

GRAPH 5: Retail Property Investment Volume By Region, 2009 to Q3/2019*



Source RCA, Savills Research & Consultancy
*Q3/2019 volume is preliminary and is likely to be revised upwards. In principle, RCA investment volumes do not include related-party transactions, such as those among a J-REIT and its sponsor.

TABLE 1: Selected Retail Transactions, Announced Q2/2019 to Q3/2019

ANNOUNCED	PROPERTY	LOCATION	GFA (SQ M)	PRICE (JPY BIL)	DIRECT CAP RATE	BUYER
Apr 2019	Croesus Shinsaibashi	Chuo, Osaka	2,350	20.1	NA	Sumitomo Corporation
Sep 2019	AEON MALL Fukutsu	Fukutsu, Fukuoka	100,000	18.0	5.40%	AEON REIT
Sep 2019	Fululu Garden Yachiyo	Yachiyo, Chiba	117,000	15.2	4.70%	Undisclosed
May 2019	Ito-Yokado Nishikicho	Warabi, Saitama	73,500	14.5	5.00%	Japan Retail Fund
Aug 2019	Ikebukuro Globe (50%)	Toshima, Tokyo	6,100	10.5	3.80%	Frontier REIT

Source Press releases, RCA, Savills Research & Consultancy

on shopping during their visits (Graph 4). The potential impact of this loss of demand will vary greatly by region: in 2018, Korean visitors accounted for 49% and 20% of total inbound nights stayed in Fukuoka and Osaka, respectively, while only accounting for 8% of nights stayed in Tokyo.

Tourism from China and Taiwan, on the other hand, was up 20% and 6%, respectively, in Q3/2019, and Taiwan now holds the number two spot for inbound tourism. According to surveys conducted by the Japan National Tourism Agency (JNTO), Chinese visitors on average spend more on consumer goods during their stays than any other nationality. China's e-commerce and tax laws targeted at resellers of items purchased overseas, implemented in January of this year, appear to have had only a mild impact on purchases, as overall spending among Chinese tourists was up 22.3% in Q3/2019. Also, the strengthening of the Thai Baht appears to have encouraged greater spending among Thai tourists, which has risen 37.6% YoY.

As an additional positive for the year, the 2019 Rugby World Cup, which is being held in 12 cities across the country from 20 September to 2 November, is boosting visitors to regional cities during a non-peak travel season. The event is expected to draw around 600,000 international rugby fans to the country. Given the length of the tournament and the fact that many are traveling from further away, these visitors are probably spending more time in Japan than the average tourist, though their spending is more likely to be a boon for F&B, nighttime entertainment, and convenience stores rather than high-street retail, perhaps with the exception of sporting goods.

INVESTMENT TRENDS

The latest results of a semi-annual survey by JREI, reported in April 2019, indicated that expected cap rates for prime retail property in Ginza and Omotesando are at 3.4% and 3.5%, respectively, while expected cap rates for suburban shopping centres in the Tokyo area and in regional areas were 5.4% and 6.1%-6.5%, respectively. Actual market cap rates can be 50-100 basis points lower than these expected cap rates.

At the end of Q3/2019, year-to-date investment in retail property stood at a provisional JPY260 billion, a 41% decline from the same period in 2018, according to preliminary data from Real Capital Analytics (RCA). With limited opportunities to purchase prime urban retail properties in Tokyo, investment has been proportionally stronger outside of Japan's capital this year. Osaka saw the greatest gain among all markets, with YTD investment volume already 64% higher than that of the entirety of 2018. Indeed, regional assets have more immediately attractively yields compared to Tokyo's exceptionally sharp cap rates and increases in inbound tourism offer proportionally higher levels of upside in major regional cities.

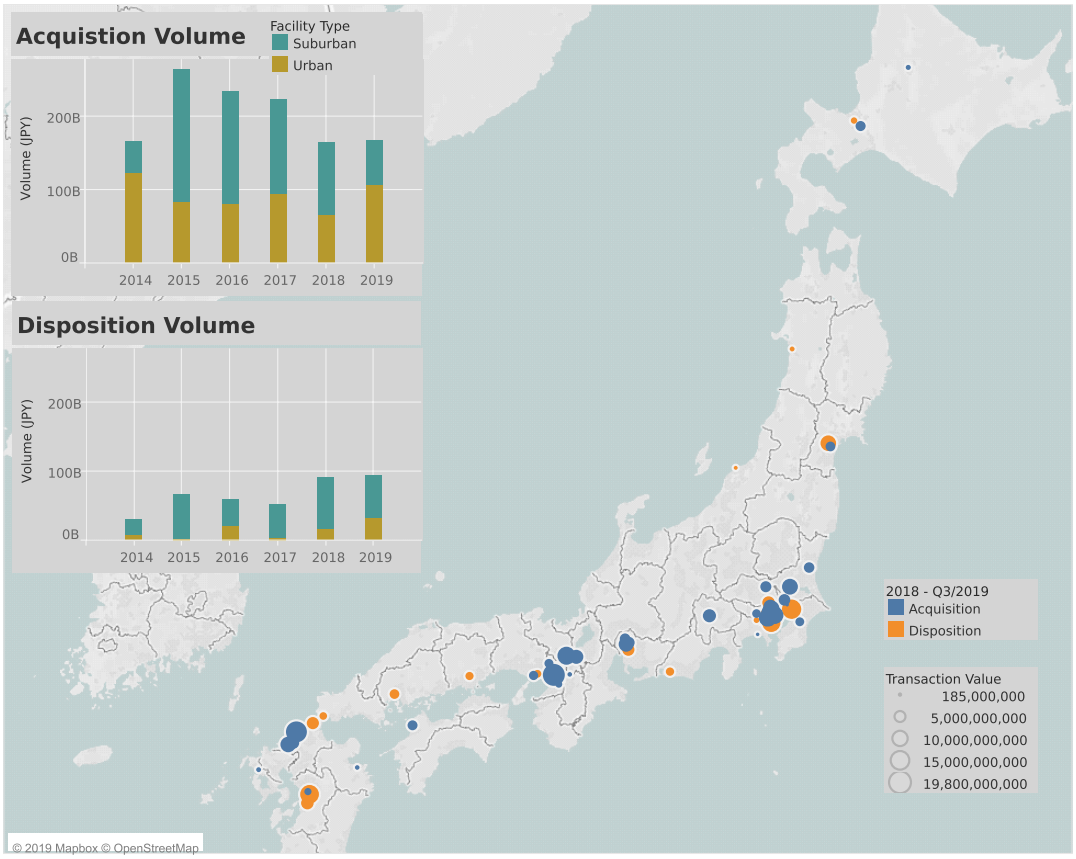
While some J-REITs, such as Japan Retail Fund, have been moving to replace regional retail assets with Tokyo assets, other domestic players are still focusing on regional markets, though are pivoting towards urban facilities. Orix J-REIT, for example, acquired the Sendai Minami-machidori Building, an urban retail facility near Sendai Station, in July, and swapped a suburban retail facility in Okayama for an urban retail facility in Kyoto in September. Overall data confirms that J-REIT acquisitions of suburban properties have recently been on the decline, while dispositions have recently been on the rise (Map 1).

Despite the implications of the above, suburban shopping centres have not necessarily fallen by the wayside. According to the Ministry of Economy, Trade and Industry, the market for groceries continues to expand, growing from JPY40.8 trillion in 2002 to JPY45.1 trillion in 2018. General merchandise stores (GMS), on the other hand, saw sales shrink from JPY7.5 trillion to JPY5.6 trillion over the same period. In light of this, rather than abandon suburban shopping centres entirely, institutional investors, such as Kenedix Retail REIT, are focusing on shopping centres with core tenants in retail sectors that have healthier revenues.

STRUCTURAL CHALLENGES

Although physical retail in Japan enjoys a firmer position than among global peers, the sector is still facing similar competitive pressures and structural challenges. Indeed, e-commerce growth has been stronger than expected and investors are bullish on the

MAP 1: J-REIT Retail Investment Overview, 2014 to Q3/2019



Source REITDB, Savills Research & Consultancy

sector, as evidenced by a strong pick-up of investment in logistics assets in 2019. Fast fashion in particular appears to be faltering and the power of e-commerce abroad is also having consequences in Japan, as in the case of U.S.-based Forever 21's bankruptcy, which has led to the closing of its 14 Japanese stores including locations in Shinjuku, Shibuya, and Fukuoka. To be sure, at 6.2% of total retail sales in 2018, e-commerce penetration remains relatively low compared to global peers; however, this low level also indicates that there is larger potential upside in the sector moving forward. (For a more in-depth look at e-commerce in Japan, please refer to our September 2019 Japan Logistics spotlight.)

Japan's overall labour crunch is also affecting the retail industry, particularly convenience stores. While sales are still growing annually, the need to operate convenience stores 24/7 requires owners to offer extra incentives to attract a nighttime workforce, and the cost burden is beginning to weigh on the sector. In response, Seven & I Holdings, for example, is restructuring to improve store allocation, closing or relocating up to 1,000 7-Eleven stores across the country, in addition to shutting down five Seibu department stores and 33 Ito-Yokado (GMS) locations. The firm has also lowered fees for franchise owners, taking a hit to its own profit margins but offering much-needed capacity for store owners to cover increasing labour costs. Investors have responded positively to this change, with shares of the firm closing 5% higher on the day of the announcement.

OUTLOOK

Japan's retail prospects remain relatively stable in the face of macro headwinds and competition from e-commerce. Despite lower consumer confidence, domestic household spending has been strong year to date. Overall retail sales continue to grow, though performance varies by sector, with GMS and department store sales generally on the decline. Sales of cosmetics, which are popular among inbound shoppers, are still posting healthy growth.

On the other hand, the industry is set to face structural challenges moving forward, requiring traditional retailers to innovate and reposition themselves in order to remain competitive. More imminently, the impact of the consumption tax hike implemented at the beginning of October has yet to be fully understood, and it is very possible that overall consumption will fall somewhat, despite the government's measures to soften the blow. The fact that purchases of food and drinks for at-home consumption are not subject to the new tax rate is, however, encouraging for supermarkets in particular.

With uncertain global economic prospects and slowing export demand throughout Asia, many domestic corporations have made downward revisions to their earnings forecasts, which could very well weigh on wage growth moving forward. Without meaningful wage growth, consumer confidence – already at its lowest level in six years – could deteriorate further and negatively affect retail spending.

The steep decline of visitors from South Korea will certainly have a negative impact on retail sales, especially in regional markets such as Fukuoka, and it is not clear how long the current tensions will persist. Encouragingly, the number of Chinese tourists, who on average spend more money on retail goods than any other nationality, continues to increase at a strong pace, and visitor growth among other higher-spending groups, such those from Thailand, is also picking up. Looking ahead, inbound tourism should continue to be a driver of Japanese retail.

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