Savills World Research
Japan

Spotlight
Japan retail

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"Stable rental trends appear to continue as 1/F rents increased after a temporary softening. Marginally improving economic conditions and strong tourism figures offer some upside for the retail sector."

SUMMARY

- 1/F rents in Tokyo increased after two consecutive periods of softness. Ginza 1/F rents remain the highest in the city, while Omotesando took second place from Shinjuku.
- Drugstore sales figures exceeded those of department stores for the first time on record, which highlights underlying changes in consumer spending patterns.
- Strong labour demand is slowly and slightly pushing wages upward.
- Investment volumes have decreased significantly in 2016 due to a lack of opportunities. Sound demand for prime retail assets is further compressing cap rates in select areas.
- Developers are still eyeing opportunities in strategic locations, with multiple major projects planned in Tokyo and beyond.

Rents have shown upward movements in 2H/2016

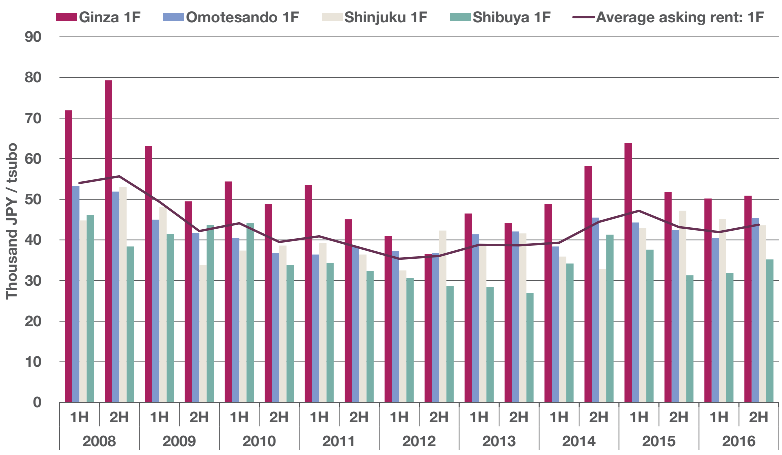
According to a semi-annual survey by Japan Real Estate Institute (JREI) and BAC Urban Projects, retail rents in Tokyo recorded steady growth from 2011 to early 2015. In 2H/2015 and 1H/2016, however, 1/F rents experienced a retreat as Ginza underwent rent corrections after three consecutive periods of double-digit growth. In 2H/2016, 1/F rents in Tokyo's major retail districts (defined as Ginza, Omotesando, Shinjuku, and Shibuya) increased to JPY43,775 per tsubo, up by 4.4% from 1H/2016.

Ginza 1/F rents registered at JPY50,900 per tsubo, still the highest average rent, and a 12% premium over Omotesando in second place. Ginza appears to benefit from continuing redevelopment along major streets. In March, Tokyu Plaza Ginza celebrated its first anniversary and Printemps Ginza reopened as Marronnier Gate Ginza 2 & 3. On Chuo Dori, Ginza Place opened in September and Ginza Six opened its retail floors in late April. The introduction of these new assets enhances the attractiveness of the entire area.

Omotesando 1/F rents rose to JPY45,400 per tsubo and took second place from Shinjuku. Continuing growth is anticipated in the district, with developments planned near Harajuku Station and along Meiji Dori. Jingumae 6-chome, which stretches between Harajuku Station and Shibuya Station, recorded an especially high average 1/F rent at JPY94,991 per tsubo.

GRAPH 1

1/F rents in major Tokyo retail districts, 2008–2016



Source: JREI, BAC Urban Projects, Savills Research & Consultancy

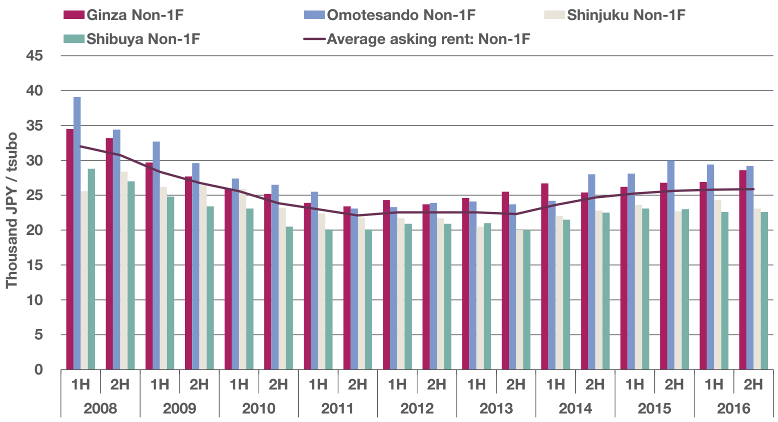
Non-1/F rents have grown at a steady pace, posting small single-digit growth almost every year since 2011. Omotesando led growth in non-1/F rents from 2H/2011 to 2H/2015, increasing by 30% over the period. However, the area slightly moderated in both halves of 2016.

A survey of 1/F rents in other major cities across Japan exhibits more sporadic trends. After a correction in 2015 and early 2016, the average 1/F rent in major retail districts of Osaka, Nagoya, Fukuoka, Sendai, and Sapporo began to rise again in 2H/2016, increasing by 5.2% vs 1H/2016 to JPY21,250 per tsubo.

1/F rents in Osaka's Shinsaibashi district stood at JPY28,100 per tsubo, a 3.7% gain over 1H/2016. Land prices in Osaka's shopping districts have demonstrated particularly strong growth, according to the national government's 2017 Chika Koji land

GRAPH 2

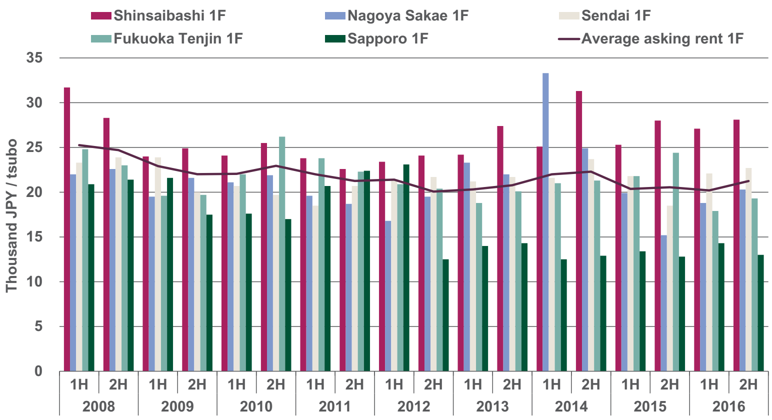
Non-1/F rents in major Tokyo retail districts, 2008–2016



Source: JREI, BAC Urban Projects, Savills Research & Consultancy

GRAPH 3

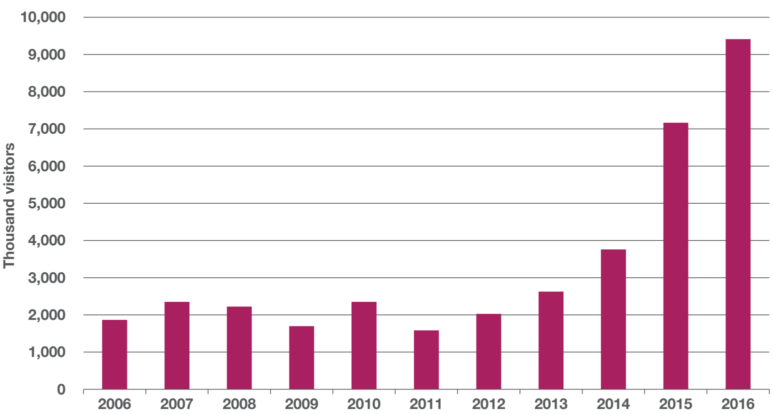
1/F rents in retail districts of regional cities, 2008–2016



Source: JREI, BAC Urban Projects, Savills Research & Consultancy

GRAPH 4

International arrivals to Osaka, 2006–2016



Source: Japan National Tourism Organization, Osaka Prefectural Government, Savills Research & Consultancy

price report. Retail districts in Osaka dominated the top five growth areas of commercial land prices nationwide. The government cited strong demand for new retail development due to increasing overseas visitors (Graph 4) as a major driver.

Domestic macro indicators

The Ministry of Health, Labour and Welfare (MHLW) announced that real wages increased by 0.7% in 2016, halting a softening streak that had persisted since 2011. Nominal wages grew by 0.5% and marked their third consecutive annual increase. Strong demand for labour is contributing to the gradual wage increases. Effective nationwide job opening-to-application ratios exceeded 1.00x in 2014 and have since climbed to 1.36x in 2016. Industries employing a large number of part-time workers such as retail, logistics, and hospitality are particularly under a labour crunch.

Consumer confidence has improved for four consecutive months for the first time since early 2015, and is up by 2.5 percentage points year-on-year (YoY). In addition to gradually increasing wages, an improving global economic outlook appears to be supporting this trend. In March, the government's Cabinet Office improved its view of consumer sentiment from "showing movements of picking up" to "picking up".

Inbound tourism also shows a positive trend. International arrivals to Japan increased by 21.8% YoY to 24 million and total retail expenditures[1] by overseas visitors grew by 4.2% YoY to 2.2 trillion yen in 2016. Furthermore, Japan took fourth place in the World Economic Forum's 2017 Travel & Tourism Competitiveness Index, advancing by five positions since 2015. Because the government aims to reach 40 million annual visitors by 2020, inbound tourism should continue to positively impact retail sales.

Paradigm shift in consumer spending

Drugstore sales figures exceeded those of department stores for the first time on record in 2016. This clearly shows how significantly the drugstore business has grown and department stores have declined over the past

1 Retail expenditures include shopping and food and beverage costs.

couple of decades, and marks a milestone for changing consumer spending habits.

Drugstore sales figures have grown from JPY4.2 trillion in 2004 to JPY6.5 trillion in 2016. This growth has been driven both by an increase in elderly and health-conscious customers and by a shift in tourist spending from luxury items to daily commodities and cosmetics. Osaka especially has seen an explosive increase of new drugstores as the city attracts more overseas visitors than ever before.

Department store sales, however, peaked in 1991 at JPY12.1 trillion and has been declining ever since. Based on the Ministry of Economy, Trade and Industry's study, apparel sales especially showed a rapid decrease in total department store sales from JPY6.1 trillion in 1991 to JPY2.9 trillion in 2016. The last recession resulted in further downward pressure, decreasing apparel sales by 17% in 2009.

Despite headwinds in the department store business, opportunities exist for retail operators that are flexible enough to adapt to new landscapes. For example, Takashimaya forecasts sales growth in the next fiscal period mainly due to increasing sales of duty-free items. Takashimaya was quick to identity a shift in international visitor spending away from luxury items and has moved its focus to daily commodities and cosmetics more quickly than its competitors. The company's duty-free sales were up by 34% and 51% YoY in February and March respectively, exceeding the industry average of 10%.

Furthermore, the restructuring of large department stores poses an opportunity for surviving competitors. Total sales of large retail facilities – mainly department stores – closed via recent restructuring are said to be more than JPY800 billion. This large demand could be absorbed by other facilities. Competitors that can effectively fill the vacuum should be able to increase their market share.

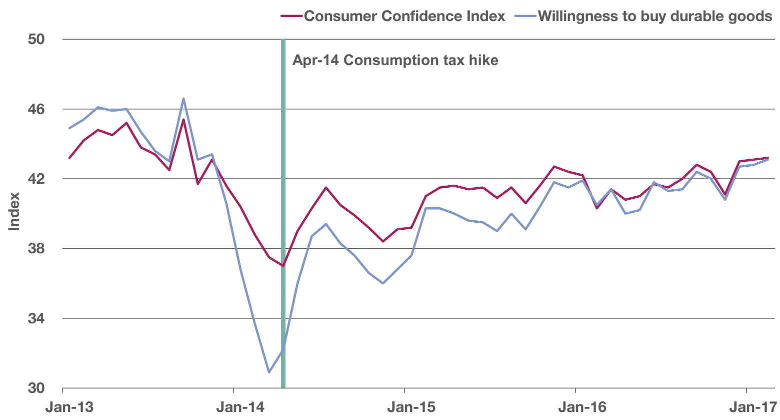
Development projects underway in Tokyo

In addition to the previously mentioned new facilities in Ginza, other retail districts are also getting a facelift.

Shibuya is currently undergoing large redevelopment, and the retail

GRAPH 5

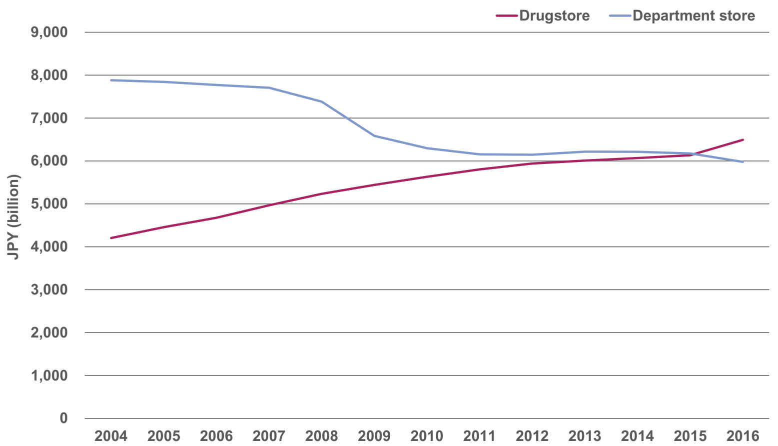
Japan consumer confidence, 2013–Mar 2017



Source: Cabinet Office, Savills Research & Consultancy

GRAPH 6

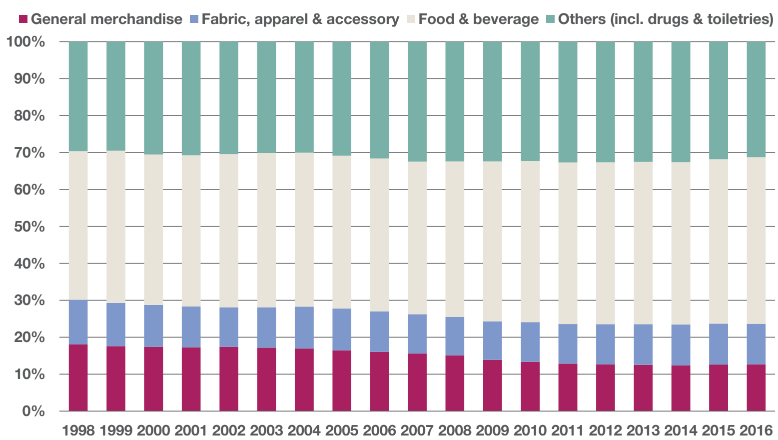
Drugstore and department store revenues in Japan, 2004–2016



*Drugstore sales are based on an annual survey conducted between fall and January.
Source: Japan Department Stores Association, Japan Association of Chain Drug Stores, Ministry of Economy, Trade and Industry, Savills Research & Consultancy

GRAPH 7

Retail sales patterns, 1998–2016



*Sales of motor vehicles, machinery & equipment, and fuel are excluded.
Source: Ministry of Economy, Trade and Industry, Savills Research & Consultancy

leasing market appears to be slowing. However, in the mid-to-long term, the area should see new life as redevelopment projects around the station progress. Additionally, Shibuya is expected to see the largest growth in office stock in percentage terms in the central five wards between 2017 and 2020, which could improve footfalls in the area.

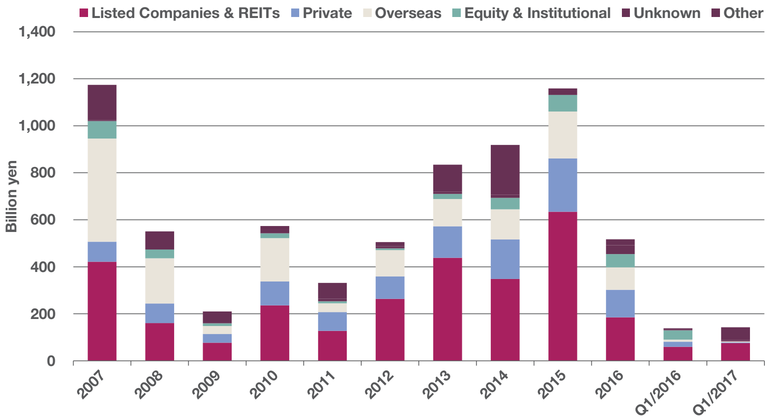
For example, Shibuya Parco Part 1 and Part 3 have temporarily closed for redevelopment. The new project will boast a B3/20F structure with a GFA of 65,000 sq m and nine floors of retail space. The construction is slated for completion in September 2019. Furthermore, a B2/16F mixed-use building, Shibuya Cast, opened its doors in late April. Retail spaces on the ground and first floors host restaurants, an apparel shop, and a grocery store.

In the Omotesando area, Parco announced its plan to open a small-size retail facility, Harajuku Zero Gate. The 4F structure will be located on Meiji Dori and will have a GFA of 890 sq m. This is one of three new Zero Gate projects (in Harajuku, Kyoto, and Kobe) that have been publicly announced. Additionally, the company aims to open Zero Gates in two other locations by 2020.

Beyond Tokyo, in anticipation of the Linear Chuo Shinkansen bullet train's opening in 2027, the Nagoya market has seen large foot traffic gradually moving from Sakae to Nagoya Station. The recent Dai Nagoya Building, JP Tower, and JR Gate Tower developments have further enhanced the overall attractiveness of the station front area. Large office areas featured in these buildings should draw a large number of workers and positively affect overall retail sales trends in the area.

GRAPH 8

Retail investment volume by buyer type, 2007–Q1/2017



Source: RCA, Savills Research & Consultancy

Investment volumes and major transactions

The market appears to be taking a breather after four consecutive annual increases in retail transaction volumes from 2011 to 2015. 2016 investment in Japan retail property totalled JPY517 billion, just 45% of 2015 volumes. Investment in Japanese real estate across all sectors has notably declined in 2016 due to fewer investment opportunities as well as the plentiful availability of attractive refinancing. 2015 trading volumes were also partially inflated by the IPO of Kenedix Retail REIT. Q1/2017 investment volume is slightly up YoY; however, investment opportunities are likely to remain scarce.

According to JREI, Net Operating Income (NOI) cap rates for luxury retail shops in Ginza have compressed from 3.8% in April 2016 to 3.7% in October 2016. During the same period, NOI cap rates for luxury shops in Omotesando stayed flat at 3.8%. The tightest reported cap rate in Q4/2016 was for Japan Prime Realty's purchase of Ginza Gates for JPY10.1 billion at an NOI yield of 3.2%.

TABLE 1

Large retail transactions, Q4/2016—Q1/2017

Announced	Property	Location	GFA (sq m)	Price (JPY bn)	NOI cap rate (%)	Buyer
Feb 2017	AEON MALL Itami Koya	Itami, Hyogo	123,000	16.8	6.1%	AEON REIT
Feb 2017	Nakaza Cui-daore Building	Osaka, Osaka	8,000	11.6	3.7%	Nomura Master Fund
Feb 2017	Marine & Walk Yokohama	Yokohama, Kanagawa	13,000	11.3	5.2%	Japan Retail Fund
Feb 2017	G-Building Midosuji	Osaka, Osaka	4,000	10	3.9%	Japan Retail Fund
Dec 2016	Ginza Gates	Ginza, Tokyo	1,800	10.1	3.2%	Japan Prime Realty

Source: RCA, Nikkei RE, Savills Research & Consultancy

OUTLOOK

The prospects for the market

After mild softness, 1/F rents in Tokyo and major regional retail districts have increased, continuing a stable trend despite short-term fluctuations. Improving economic conditions, strong tourism figures, and new developments may imply further rental growth ahead, at least in select areas.

Due to changes in consumer spending patterns and growing online businesses, retail is perhaps the most difficult sector globally, and Japan is no exception. Over the past decade, a clear line has materialised between winning and losing subsectors such as drugstores and department stores. Investors can reap good returns by identifying outperforming retail sectors.

Inbound tourism has also entered a new phase. Although spending per overseas visitor has declined, total aggregate spending of international tourists is still growing at a steady pace. Because inbound tourists can change spending habits quickly, companies that wish to chase tourist consumption must be flexible and adaptable. Market observers must pay attention to subtle indicators of coming changes, especially in inbound-related sectors.

Investment volumes decreased significantly in 2016 due to a lack of opportunities and Q1/2017 data shows that the cooldown has persisted. However, cap rates continued to compress in select areas, indicating that demand for prime retail assets remains sound.

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