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Japan

Spotlight
Japan retail

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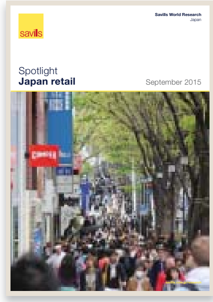


Spotlight
Japan retail

"Improvements in household spending and an increase in overseas tourists are tailwinds for the overall retail industry. Retail sales efficiency is on the rise and is expected to pick up further, especially in large cities. This will in turn lead to an improvement in rental affordability, and rental levels are likely to rise."

Retail rent trends

Given an ongoing recovery in retail sales efficiency, retail rents in Tokyo's four major commercial districts (Ginza, Omotesando, Shinjuku, and Shibuya) have been moving up since 2012. On a simple average basis, first floor retail rents increased by nearly 40% in Q1/2015 to JPY49,000 per tsubo compared to a market low of JPY35,400 per tsubo in 1H/2012. In Ginza, the most famous retail district in Tokyo, the asking rent in Q1/2015 hit JPY68,500 per tsubo, nearly 70% up compared to 1H/2012 and just 13% below the 2H/2008 peak.

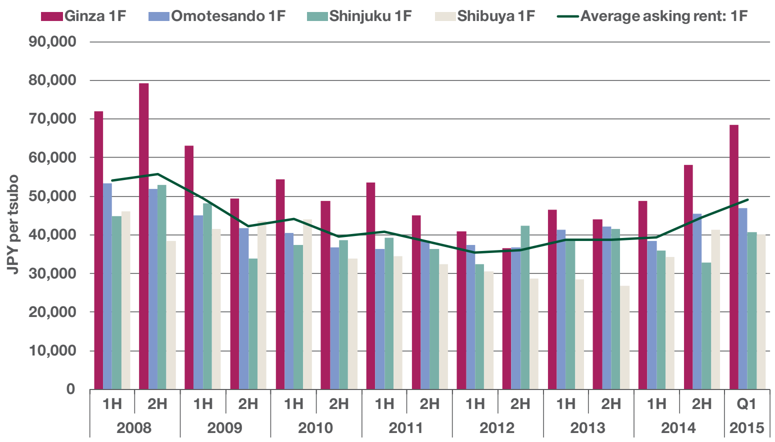
In fact, Ginza's rental levels have significantly outpaced other areas. For example, in Q1/2015, Ginza's average retail rent for a first floor unit was about 30% higher than the average of four other commercial districts of Tokyo, and over 30% higher than Omotesando. First floor rental levels in Shinjuku and Shibuya are 40% behind those of Ginza.

Rents in Shibuya climbed to JPY40,200 per tsubo in Q1/2015, up by 31% from 1H/2012. In Omotesando and Shinjuku rents rose by over 25% to JPY46,900 per tsubo and JPY40,600 per tsubo during the same period.

Other major commercial areas are also showing an upward trend in rents. On a simple average basis, rents in regional cities bottomed out in 2H/2012 (JPY19,600 per tsubo). While asking

GRAPH 1

Retail rents in Tokyo's major commercial districts, 1H/2008–1H/2015



Source: Attractors Lab and BAC Urban Projects, Savills Research & Consultancy

SUMMARY

- Retail rents in Tokyo's major commercial districts have increased since 2012. In particular, Ginza's asking rent in Q1/2015 increased by approximately 70% compared to 1H/2012, to stand just 13% below the 2H/2008 peak.

- Rising retail rents have also been a feature of regional cities, particularly Osaka. Whilst asking rents in regional cities stand at about half of Tokyo's average, rental levels have recorded a gradual but material upward trend.

- There is no shortage of new supply. In Ginza, Tokyu Land Corp and joint venture of four corporations including Mori Building are constructing new retail malls. The south exit of Shinjuku Station is being redeveloped by JR East, and Odakyu Electric Railway plans to redevelop the Shinjuku West Exit area in time for the 2020 Olympics.

- The total value of real estate investment in 2014 doubled compared to 2011, and Tokyo has proved to be by far the most popular investment destination. Whilst office investment accounts for more than half of total investment, retail investment follows with 16% of the total.

- Examples of large-scale retail transactions include the purchase of AEON Mall Kyoto in January 2015 by AEON REIT (JPY21.5 billion), and the JPY 24.3 billion transaction of Aoyama Bell Commons with Mitsubishi Estate as a buyer.

- J-REITs are significant buyers of retail investments and year-to-date in 2015, over 65% of total retail investment has been accounted for by J-REITs.

- Whilst household expenditure dropped significantly after the earthquake in March 2011 and the consumption tax hike in April 2014, spending has recovered from mid 2014, especially in Tokyo, leading to an improvement in retail sales.

- As a consequence, retail sales efficiency, or sales per sq m, showed some degree of recovery in 2014, partly because of a rise in the number of overseas visitors particularly from Asian countries, which has led to a significant increase in duty free sales.

- The sales efficiency of department stores in Tokyo's 23 Wards and Nagoya City in 2014 has recovered to above 2007 levels, and in other large cities is in the process of catch-up. Recent improvements in sales efficiency will translate into rental increases because of improved rental affordability.

rents in the regional cities currently stand at about half of Tokyo's average, rental levels have shown a gradual but material upward recovery trend.

Amongst regional cities, Osaka, the second largest city in Japan, usually records the highest rents with the notable exception of Nagoya in 1H/2014. Retail rents in Osaka Shinsaibashi in 2H/2014 were up by 30% compared to 2H/2012. In Shinsaibashi, there are two main retail streets (Midosuji and Shinsaibashisuji) where the flagship stores of high-end and medium-range retail brands agglomerate. Nagoya's retail rent in 2H/2014 was reduced to JPY24,900 per tsubo from 1H/2014, but had increased by nearly 50% from a low in 1H/2012. In contrast, rental rises in Sendai and Fukuoka have been relatively modest.

The underperformer is Sapporo. Sapporo's rents have shown a clear downward trend from their 1H/2012 peak. Compared to the peak (JPY23,100 per tsubo), Sapporo's average first floor rent in 2H/2014 stood at nearly half that level.

We believe that the rise of retail rents is likely to continue. Household spending has shown some degree of recovery (as will be shown in Graph 7), and foreign tourist numbers have been rising. Equally important, retail sales efficiency has been improving.

Upcoming supply

There are a few large-scale projects under construction or planned in central Tokyo. In Ginza 5-chome, Tokyu Land Corp. plans to open a retail building in the spring of 2016. The B5/11F building consists of a gross floor area (GFA) of 50,000 sq m on over 3,700 sq m of land and will host approximately 120 shops from apparel to duty-free and F&B. In addition, joint venture of J. Front Retailing, Mori Building, L Real Estate, and Sumitomo Corporation plans to open a B6/13F building in November 2016 in Ginza 6-chome. With a site area of over 9,000 sq m the largest planned floor plate is approximately 6,100 sq m.

In Shinjuku, a retail-office complex is under construction by JR East. The B2/33F building is planned to complete in March 2016, with the 5-floor retail space expected to be occupied by Lumine, a retailer subsidiary of JR East. The total gross floor area (GFA) will be approximately 147,900 sq m. At the west exit of Shinjuku Station, Odakyu Electric Railway announced re-development plans at its FY2015 results meeting in April 2015. The company plans to release details of the project by the end of FY2016. Similarly, Yodobashi Camera, an electronic product retailer, plans to redevelop its flagship store at Shinjuku West Exit in time for the 2020 Olympics. Together with MY Shinjuku Dai-ni building, which Yodobashi Camera purchased in 2010, the retailer plans to redevelop a large-scale retail building, which will double the existing retail space.

Investment in retail properties

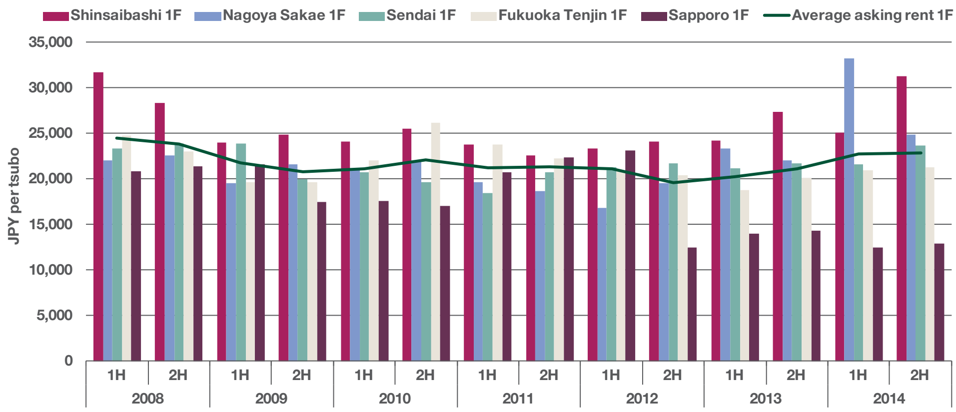
After the launch of Abenomics in early 2013, real estate investment in Japan has grown gradually. Compared to 2011, when the earthquake hit the country, the total value of real estate investment in 2014 has doubled.

Tokyo has been by far the dominant real estate investment destination over the years, as can be seen in Graph 3. Over 1H/2015, of more than JPY2.5 trillion of total real estate investment in Japan, Tokyo accounted for approximately 80%, followed by Osaka (over 12%), according to Real Capital Analytics (RCA) data.

By property type, office and retail investments lead the way. On an annual basis, office and retail investment has comprised 60% to 70% of total real estate investment. As of 1H/2015, office investment accounted for over 50% of total investment, followed by retail at 16%.

GRAPH 2

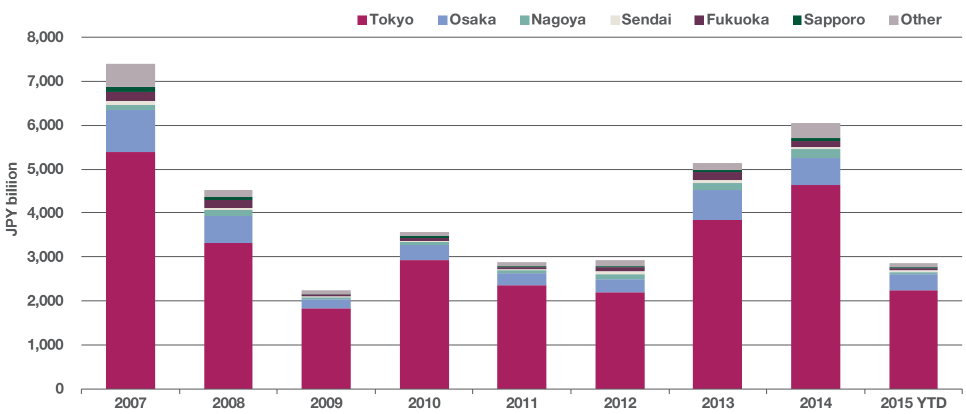
Retail rents in major commercial districts in regional cities, 1H/2008–2H/2014



Source: Attractors Lab and BAC Urban Projects, Savills Research & Consultancy

GRAPH 3

Real estate investment by city, 2007–2015 YTD



Source: RCA, Savills Research & Consultancy

At the end of 1H/2015, the total value of retail investment was already above total annual investment in 2009 and 2011, and was close to 2012 levels. Tokyo's dominance remains the same in retail investment. Approximately 70% of retail investment took place in Tokyo, with Osaka accounting for just under 20% in 1H/2015.

By type of investor, J-REITs accounted for a significant share of total retail investment. In 1H/2015, listed REITs accounted for over 65% of total retail investment.

Major transactions

Table 1 is a list of large retail property transactions in 2015. Given rising demand for retail properties in Japan, cap rates have been driven lower.

Typically, large-scale transactions are completed by REITs and their sponsors. In January 2015, AEON REIT purchased AEON Mall Kyoto for JPY21.5 billion (NOI yield of 5.1%) from AEON Mall, as part of AEON Group growth strategy. In the same month, Aoyama Bell Commons and Kita-Aoyama Teeth Building was acquired by Mitsubishi Estate for JPY24.3 billion through preferred equity investment. The property was completed as a landmark retail building in 1976 and is located on the corner of Aoyama-dori and Gaiennishi-dori in Aoyama, one of the prime shopping districts of Tokyo. Mitsubishi Estate will subsequently redevelop the area which totals approximately 2,000 sq m of land.

Japan Retail Fund (JRF) announced a bulk transaction in August 2015 (transaction on 15 September) for JPY38.9 billion. Of the seven properties involved, four are located in Tokyo, two in Osaka, and one in Nagoya. On average, according to a company announcement, the NOI yield (after depreciation) will be 3.9%. The highest acquisition price was paid for mozo wonder city in Nagoya in Aichi Prefecture which JRF purchased the remaining 20% ownership or JPY11.7 billion. JRF already owned 80% of the property.

Hulic purchased Tokyu Hands Ikebukuro for JPY22.4 billion from GE Capital Real Estate Japan in March. Upon the purchase, Hulic also acquired Ikebukuro GIO for JPY7.6 billion.

In February 2015, Kenedix Retail REIT (KRR) purchased 18 retail properties throughout Japan for JPY 80.8 billion. The largest in value was Fululu Garden Yachiyo in Yachiyo City, Chiba Prefecture for JPY14.8 billion (NOI cap rate 5.2%). Additionally, Kenedix Retail REIT (KRR) announced the bulk purchase of retail properties for a total of JPY37.9 billion on 27 August 2015 for an estimated NOI yield of 5.2% on average, according to a company announcement. All thirteen retail properties are located outside Tokyo, mainly in medium-sized regional cities.

Household spending

Although Japan's GDP growth for Q2/2015 fell by 1.6% on the year (annualized rate) to JPY528.4 trillion and household consumption fell by 3.1%, household consumption still accounted for about 60% of GDP, or approximately JPY300 trillion.

TABLE 1

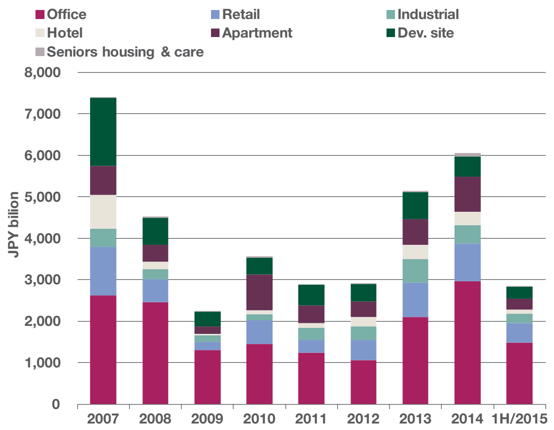
Large retail transactions in 2015

Date	Property	Location	GFA (sq m)	Price (JPY bil)	Cap rate (%)	Buyer
Jan 15	Aoyama Bell Commons	Minato Ward, Tokyo	14,756	24.3	N/A	Mitsubishi Estate
Mar 15	Tokyu Hands Ikebukuro	Toshima Ward, Tokyo	12,241	22.4	N/A	Hulic
Jan 15	AEON Mall Kyoto	Kyoto City, Kyoto	136,468	21.5	5.1	AEON REIT
Feb 15	Fululu Garden Yachiyo	Yachiyo City, Chiba	116,659	14.8	5.2	Kenedix Retail REIT

Source: Company filings, Savills Research & Consultancy

GRAPH 4

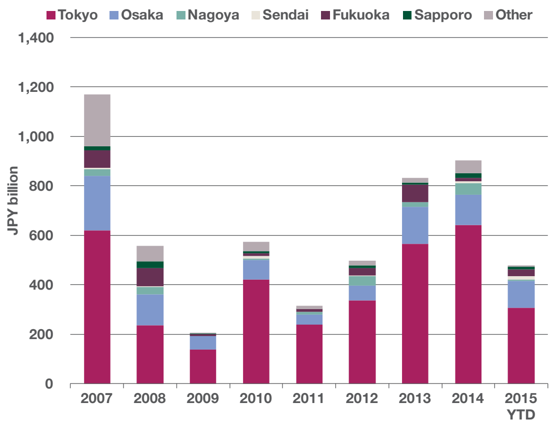
Real estate investment by property type, 2007–1H/2015



Source: RCA, Savills Research & Consultancy

GRAPH 5

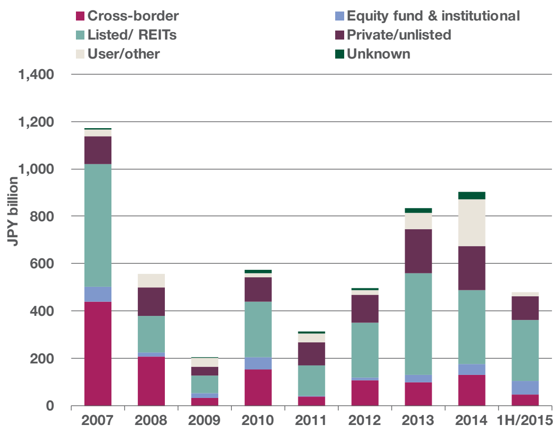
Retail investment by city, 2007–2015 YTD



Source: RCA, Savills Research & Consultancy

GRAPH 6

Retail investment by investor type, 2007–2015 YTD



Source: RCA, Savills Research & Consultancy

Household spending is rising slowly but surely. Graph 7 compares household spending trends compared to April 2011, a month after the Great Eastern Earthquake hit the Japanese economy.

While households generally refrained from spending after the earthquake, spending recovered strongly until the consumption tax rate hike in April 2014, particularly in Tokyo. Despite the negative impact of the rate hike, Japan's household expenditure recovered by 3% in Q1/2015. Tokyo households' propensity to spend recovered even more, by 8% compared to April 2011.

Sales growth data

The recovery in household spending has been reflected in retail sales growth. After the Lehman shock and following the Global Financial Crisis (GFC) in August 2008, Japan's retail sales growth had been stalling. The earthquake in March 2011 and the consumption tax rate hike in April 2014 were additional factors which contributed to disappointing sales.

However, looking at the12-month moving average (Graph 8), the latter two events were not as severe as the GFC. Importantly, retail sales growth has recovered strongly from early 2015.

Retail sales efficiency

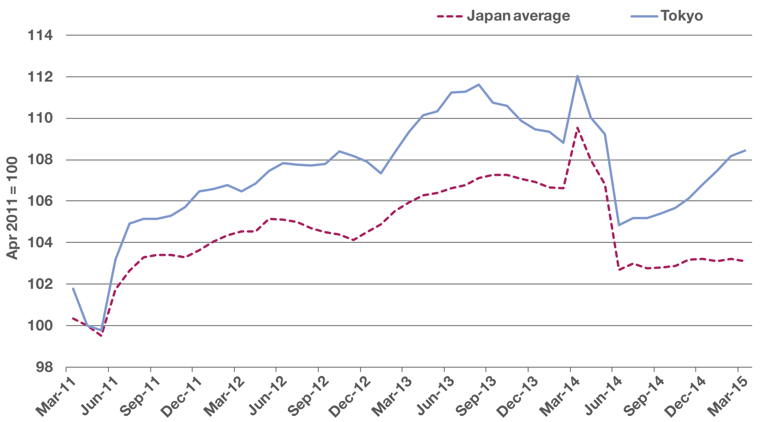
Improvement has also been noted in retail sales efficiency. Graph 9 shows nationwide retail sales per sq m, or sales efficiency, by retail category. It is clear from the chart that sales efficiency has declined over the years with the notable exception of convenience stores. On average, retail sales efficiency in Japan has stood at JPY1.3 million per sq m, but declined by 36% to JPY0.9 million per sq m in 2012 before recovering to JPY0.8 million per sq m in 2014.

Whilst the 2014 sales efficiency data for each category is yet to be released, it can be assumed that the sales efficiency of other categories has also improved by looking at prefectural data (Graph 10). It should also be noted that Tokyo's sales efficiency outpaces other prefectures by far.

Despite of general decline in efficiency, the sales per sq m of convenience

GRAPH 7

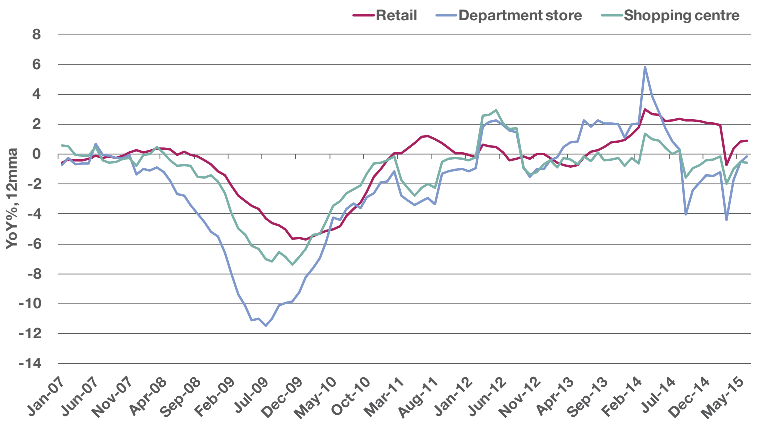
Household spending index, Mar 2011–Mar 2015



Source: Cabinet Office, Savills Research & Consultancy

GRAPH 8

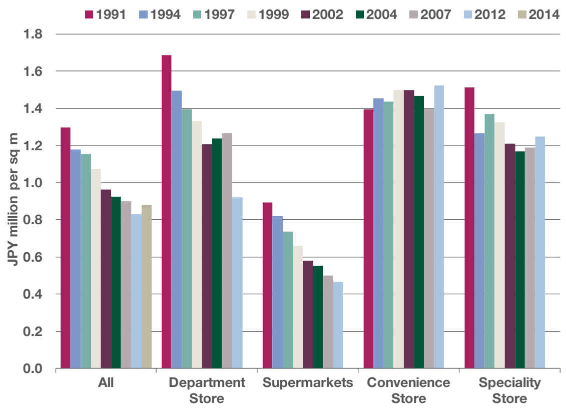
Retail sales growth, 12-month moving average, Jan 2007–May 2015



Source: Ministry of Economy, Trade and Industry (METI), Japan Council of Shopping Centers (JCSC), Savills Research & Consultancy

GRAPH 9

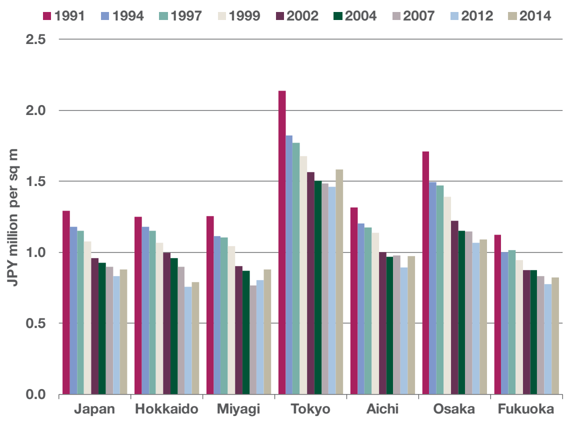
Retail sales efficiency (sales per sq m) by category, 1991–2014



Source: METI, Savills Research & Consultancy

GRAPH 10

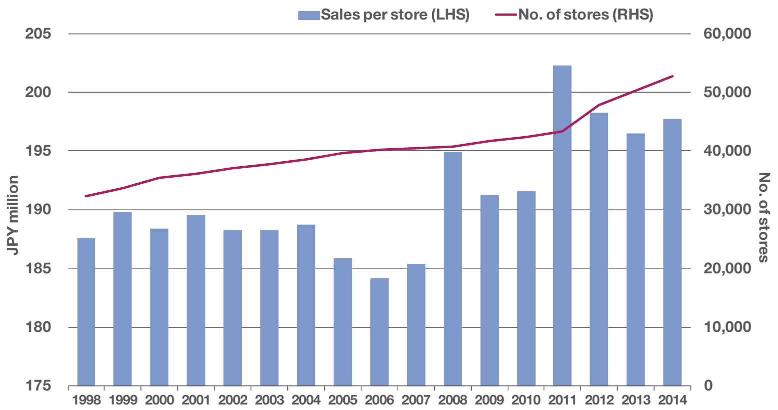
Retail sales efficiency by prefecture, 1991–2014



Source: METI, Savills Research & Consultancy

GRAPH 11

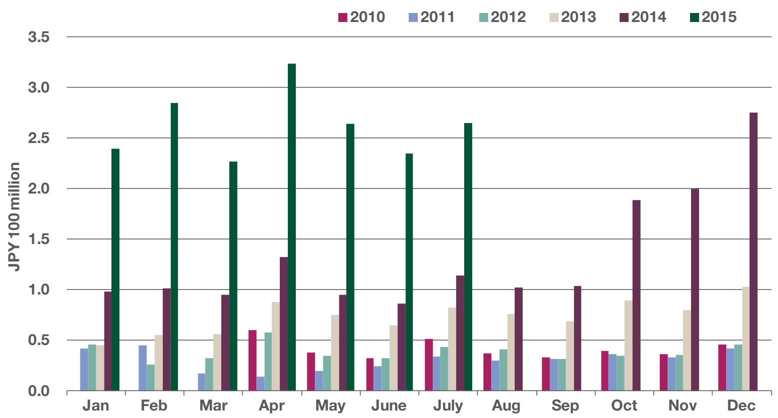
Convenience stores, sales per store and the number of stores, 1998–2014



Source: METI, Savills Research & Consultancy

GRAPH 12

Duty free sales per store at department stores, 2010–2015



Source: Japan Department Stores Association, Savills Research & Consultancy

stores were stable before dropping marginally in 2007, and recovering strongly in 2012. As can be seen in Graph 11, as the number of convenience stores increased, the per store sales also improved. This could be explained by changes in life style and an aging society prepared to take advantage of convenience stores.

Turning to department stores, the retail sales efficiency declined significantly in 2012 (Graph 9). Whilst the 2014 data has not been released, the department store sales efficiency can be assumed to have improved and will improve in future for two related reasons.

First, sales value has been improving since mid 2013, though it declined due to the consumption tax rate hike in April 2014. From January to March 2014, the sales value of department stores increased by JPY43 billion to over JPY1.7 trillion compared to the previous quarter. Furthermore, compared to 2012, the total sales value in 2014 increased by 3%.

Whilst the Q1/2014 department store sales dip could have been a short-term phenomena because of the rate hike, sales recovered and continued to recover in 2015. In August 2015, five major department stores (Isetan Mitsukoshi, Daimaru Matsuzakaya, Takashimaya, Sogo & Seibu, and Hankyu Hanshin) increased sales values for 5 months in a row, largely due to sales of luxury goods and inbound demand. Another reason is the contribution of foreign visitors. Thanks to the yen depreciation and visa relaxation, the number of overseas tourists has increased considerably, and is likely to achieve the 2020 target of 20 million tourists set by the Japanese government before 2020. For example, between January and July this year, the number of foreign visitors totalled over 11 million, up by 47% compared with the same period last year.

As the number of tourists increased, the government changed the duty free rules (item expansion, procedure easing) in October 2014. This resulted in an increase in duty free sales (Graph 12). In July 2015, 70 member stores of the Japan Department Stores Association achieved approximately 350% duty free sales growth from the same month last year to JPY18.5 billion.

Graph 13 shows the estimated expenditure of foreign visitors by nationality. In aggregate, total foreign visitor expenditure increased by 136% between 2011 and 2014 to JPY1.7 trillion. Chinese tourist expenditure in 2014 was by far the largest at JPY476 billion, followed by Taiwan (JPY252 billion), and Korea (JPY176 billion). Indeed, total estimated tourist expenditure of three countries, (China, Taiwan, and Korea) alone accounted for over JPY900 billion, about 55% of overall expenditure by foreign visitors in 2014.

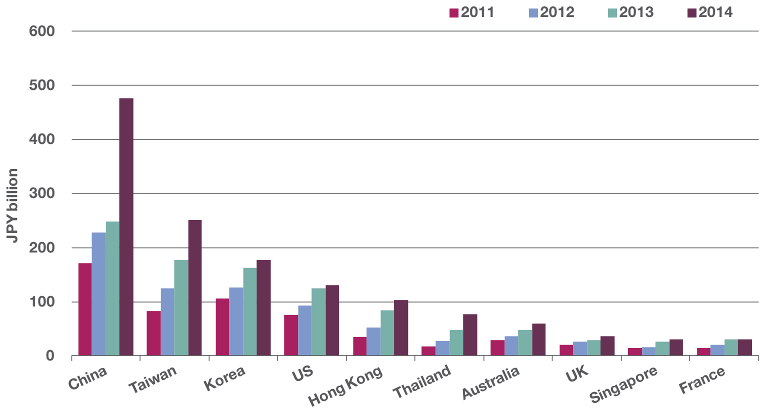
In order to benefit from the growing number of tourists and their purchasing power, department stores now accommodate shoppers from overseas in terms of language as well as faster duty free procedures. Matsuya Ginza announced on 1 September 2015 that it would open sales space catering for overseas visitors and hire additional bilingual sales staff, targeting JPY410 million sales in the first year of operation.

As expected, in Tokyo, as Japan's top tourist destination, the share of department store sales has steadily increased to over 26% in 1H/2015.

Graphs 15 and 16 show sales efficiency by major city for overall retail and department stores, with 2007 as a base year. Due to a lack of data, Sendai is excluded in Graph 16.

GRAPH 13

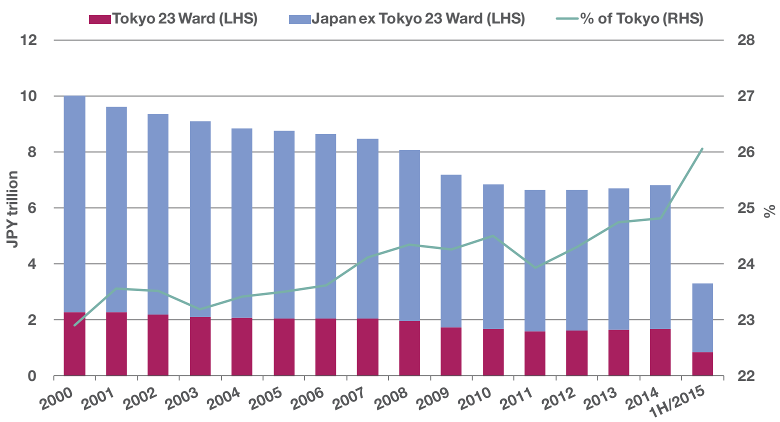
Estimated expenditure of foreign visitors by nationality, 2011–2014



Source: Ministry of Land, Infrastructure, Transport and Tourism (MLIT), Savills Research & Consultancy

GRAPH 14

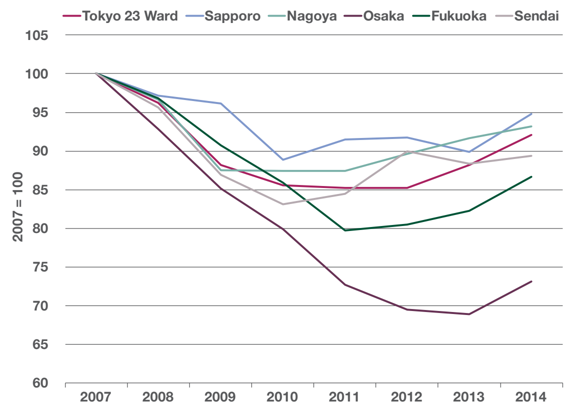
Department store sales, 2000–1H/2015



Source: METI, Savills Research & Consultancy

GRAPH 15

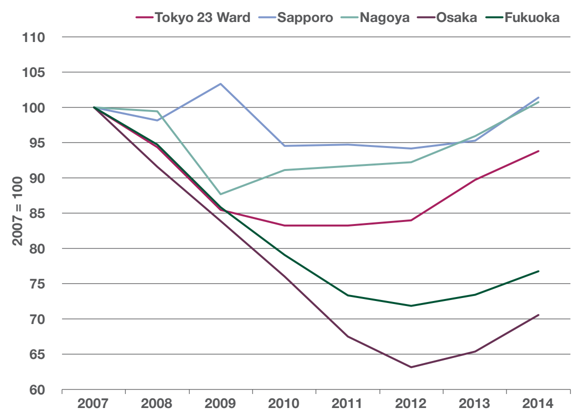
Retail sales efficiency by city, 2007–2014



Source: METI, Savills Research & Consultancy

GRAPH 16

Department store sales efficiency by city, 2007–2014



Source: METI, Savills Research & Consultancy

In value terms, Tokyo's retail sales efficiency accounted for JPY1.5 million per sq m in 2007. This declined to around JPY1.3 million per sq m between 2010 and 2012, before improving to JPY1.4 million per sq m in 2014. Tokyo's department stores are more efficient compared to overall retail sales: JPY2.0 million per sq m in 2007, down to around JPY1.6/1.7 million between 2009 and 2012, up to approximately JPY1.9 million per sq m in 2014.

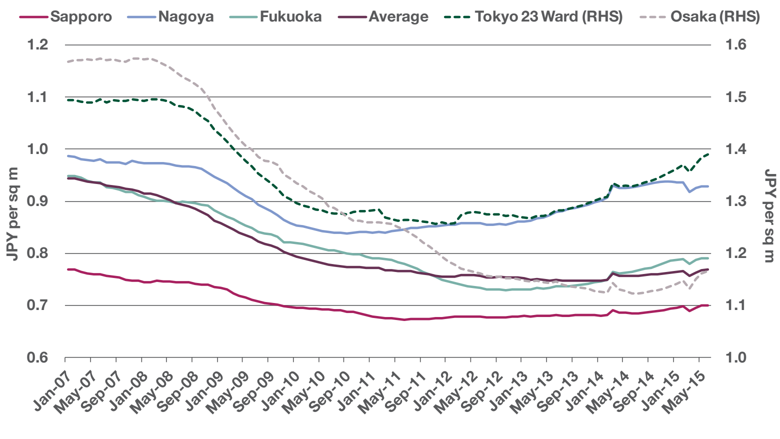
As can be seen in Graph 15, Tokyo's retail sales efficiency, though poorer after the GFC, proved to be more resilient compared to other major cities. Nonetheless, Sapporo, Nagoya, and Sendai retail efficiency levels in 2011 fell by 15%, followed by an upward swing to 2014. The exceptions were Fukuoka and Osaka, where efficiency levels between 2007 and 2011 were down by 20% and over 25% respectively, with only a slow recovery since then. In contrast, Nagoya and Sapporo exceeded 2007 levels in 2014, and so did Tokyo's 23 Wards. Given the household consumption pick-up (Graph 7), it is likely that retail sales efficiency in Tokyo's 23 Ward will improve further in 2015.

Turning to the department store sales efficiency, it is clear that there are disparities amongst cities. Tokyo's 23 Wards and Nagoya rebounded strongly after 2012, while Sapporo's department store sales efficiency was relatively stable. In contrast, Fukuoka and Osaka were the worst performers post-GFC, and recovery since 2013 has been slow. However, recent monthly data (12-month rolling) shows some support for sales efficiency trends in Fukuoka and Osaka, as seen in Graph 17, which shows improvements in both 2013 and 2014.

In Fukuoka, over 80% of foreign tourists in 2014 came from China, Korea and Taiwan, due to the geographical proximity of those countries. Domestic tourists, especially from Kyushu, also increased due to the opening of the high speed Shinkansen rail line. Moreover, Fukuoka's population has been expanding at about a 1% compound annual growth rate (CAGR) since 2000 despite the more general population decline in Japan.

GRAPH 17

12-month rolling sales efficiency, Jan 2007–Jun 2015



Source: METI, Savills Research & Consultancy

All these factors should account for further improvements in retail sales efficiency.

In Osaka, an increase in visitors to Universal Studios Japan (USJ) after the opening of the Harry Potter exhibition in July 2014 coincided with the recovery of Osaka's retail sales efficiency. Indeed, after the opening of the Harry Potter exhibition, visitors to USJ increased considerably, achieving more than a 2 million increase to 12.7 million in FY2014. In August 2015, the number of visitors stood at 1.4 million, up by 7% from August 2014. Located only 30 minutes by train from Shinsaibashi and 20 minutes from Umeda, retail sales in Osaka stand to benefit from the increasing number of visitors to USJ.

OUTLOOK

The prospects for the market

Given a moderate yet material recovery in household spending in recent months, the sales efficiency of retail properties is expected to recover further, especially in large cities such as Tokyo. Osaka, an underperformer since the start of Abenomics, has also started to show some degree of recovery recently. Whilst the improvement in household expenditure might take time to diffuse into local areas, improvements in sales efficiency in regional cities indicate that regional retail markets are also set to improve.

Recent improvements in sales efficiency will translate into increases in rents because of better rental affordability. Tokyo's commercial districts in Q1/2015 have turned around, especially Ginza, where the average asking rent is now just 13% below the 2H/2008 peak. A similar story can be applied to other districts, though to varying degrees.

One of driving forces is how to benefit from the increasing number of overseas tourists, especially Chinese, Koreans, and Taiwanese whose purchasing power accounts for the majority of shopping expenditure by overseas tourists. In particular, Ginza and Shinsaibashi, as showrooms for Japan's retailers, stand to benefit from the growing purchasing power of Asian tourists.

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