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Japan

Spotlight
Japan retail

October 2016

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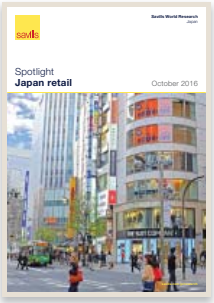

Spotlight
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"Stable rental trends from last year have continued through mid-2016. Slight moderations in 1/F rents are offset by growth in non-1/F rents, resulting in little overall movement. A late uptick in consumer confidence and retail sales may hint at mild increases ahead. Chinese "bakugai" appears to have fallen off due to new import duties in China, but the long-term trend for tourist spending is still positive."

Rents have moved minimally in 1H/2016

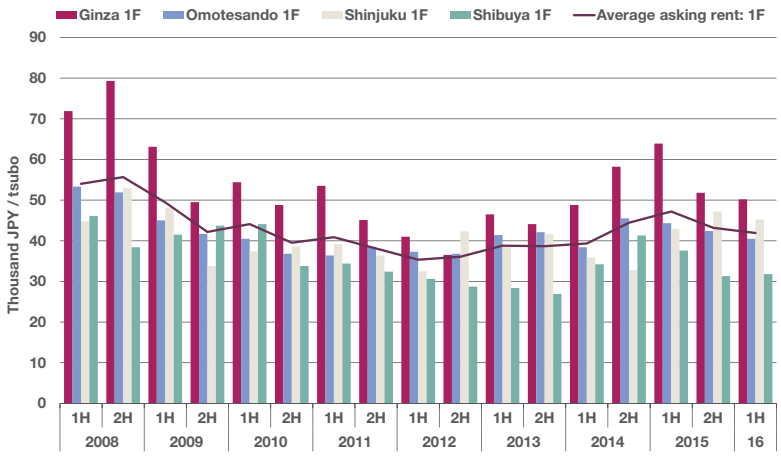
Retail rents in Tokyo grew steadily from 2011 to early 2015, but have since paused. Ginza 1/F rents experienced a correction in 2H/2015 after three periods of double-digit growth, offsetting smaller gains in Shinjuku and Omotesando. The situation changed little over 1H/2016 as 1/F rents in Tokyo's major retail districts (defined as Ginza, Omotesando, Shinjuku, and Shibuya) further moderated to JPY41,925 per tsubo, a decrease of 2.9% since 2015. Non-1/F rents have meanwhile continued their slow but steady climb, reaching JPY25,800 in 1H/2016. This is a 0.7% increase over the previous period.

Ginza 1/F rents sit at JPY50,200 per tsubo, still comfortably up 38% from their 2012 trough. According to the Japan Real Estate Institute, very limited vacancy data for first-floor lease contracts means that Ginza 1/F's growth and subsequent contraction in 2014 and 2015 was partially driven by a few high-price vacancies, later filled. There may be additional short-term softness ahead as the Matsuzakaya G6 project opens in April 2017 with approximately 250 high-end retail tenants. This influx of new supply may cause some secondary vacancies around the Ginza submarket as some brands take up prime space in the new shopping complex. Some believe that recently growing land prices in Ginza may also look overheated. The long-term trend is still stable, however, especially toward the Olympics.

Despite their recent moderation, 1/F rents in Ginza are still higher than in Shinjuku and Omotesando, which typically vie for second place. Both districts also experienced a small slowdown in 1H/2016 and now sit at JPY45,200 and JPY40,500 per tsubo respectively. 1/F rents in Shibuya are still noticeably lower than in other prime retail districts, partially due to

GRAPH 1

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



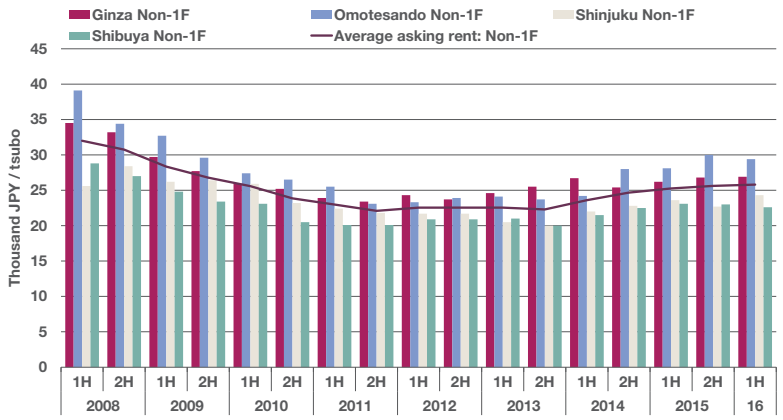
Source: Japan Real Estate Institute, BAC Urban Projects, Savills Research & Consultancy

SUMMARY

- Average all-floor Tokyo rents changed very little from 2015, moderating about 0.4% through mid 2016. Ginza 1/F rents remain the highest in the city, followed by Shinjuku, which competes with Omotesando for second place.
- Retail "bakugai" spending by Chinese tourists, one of the major stories of 2015, appears to have dropped off as suddenly as it appeared. Total aggregate spending by overseas visitors nevertheless continues to trend upward.
- Some important macro indicators are showing signs of life. Retail sales finally saw an uptick in July after decreasing for twelve months. More decisively, consumer confidence has climbed to its highest level since before the 2014 consumption tax hike, and real wages have increased marginally for seven consecutive months.
- Total 1H/2016 investment volumes in Japan have amounted to just 34% of volumes in 1H/2015, as excess liquidity chases few opportunities. The pullback is mainly from J-REITs, while overseas buyers continue to invest at the same rate.
- Developers have announced multiple new projects both in Tokyo and beyond, such as Yodobashi Camera's new mixed-use tower complex near Osaka Station.

GRAPH 2

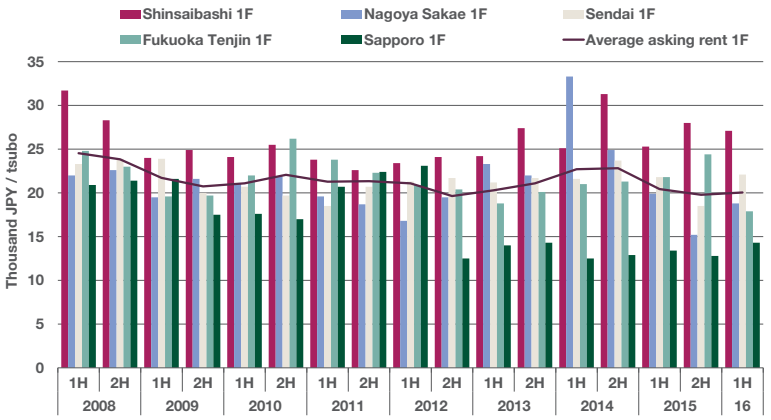
Non-1/F rents in major Tokyo retail districts, 2008–1H/2016



Source: Japan Real Estate Institute, BAC Urban Projects, Savills Research & Consultancy

GRAPH 3

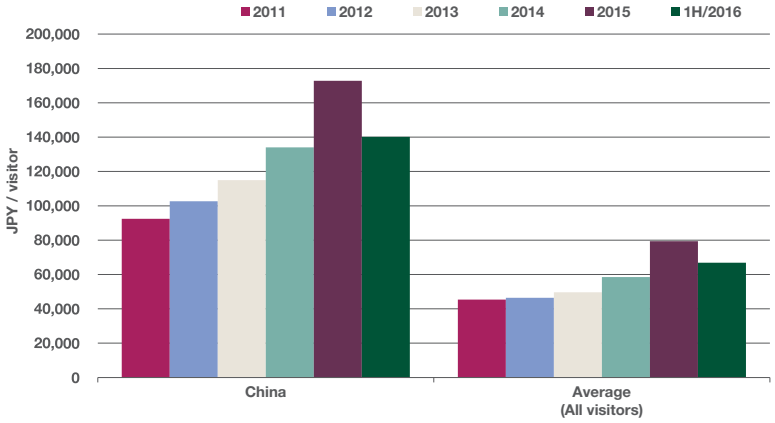
1/F rents in retail districts of regional cities, 2008–1H/2016



Source: Japan Real Estate Institute, BAC Urban Projects, Savills Research & Consultancy

GRAPH 4

Average shopping expenditure per visitor, 2011–1H/2016



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

large redevelopment projects ongoing around Shibuya Station. 1/F rents in Shibuya averaged JPY31,800 in 1H/2016.

Non-1/F rents paint a much steadier growth picture. Average non-1/F rents in major retail districts have remained flat or posted small, single-digit growth almost every year since 2011, with little variation between districts. The one exception is Omotesando, which has grown 27% since 2011, significantly outpacing the 17% average, and currently sits higher than even Ginza non-1/F rents at JPY29,400 per tsubo. As discussed in the previous report, this is largely due to the relatively small, boutique-style frontage and low total GFA of buildings in Omotesando, where 2/F and 3/F tenants enjoy relatively higher visibility than in other districts, and as such upper level rents are more highly correlated with 1/F rents.

Finally, non-1/F retail rents are understandably more uniform across Tokyo than are 1/F rents. The gap between Ginza and Shibuya 1/F rents was JPY18,400 in 1H/2016; the gap was only JPY4,300 when considering non-1/F leases.

A survey of 1/F rents in other major cities across Japan reveals more sporadic trends. After a correction in late 2014 and early 2015, the average 1/F rent in major retail districts of Osaka, Nagoya, Fukuoka, Sendai, and Sapporo began to rise again in 1H/2016, reaching JPY20,040. This represents an increase of 1.3% over 2H/2015. 1/F rents in Osaka's Shinsaibashi district have averaged between JPY25,000 and JPY30,000 over the past few years, putting them on part with non-1/F rents in prime Tokyo districts. 1/F rents in Fukuoka's Tenjin district appeared to be on track for six periods of consecutive gains until they fell back to JPY17,900 in 1H/2016, likely partially due to the Kumamoto earthquake earlier this year.

The rise and fall of Chinese retail spending

Up through early 2016, the market was abuzz with news of Chinese "bakugai" (literally, "explosive buying") and its potential positive impact on the Japanese retail sector. News reports characterized Chinese tour groups as swarms of hungry consumers, descending upon major retail centres

and purchasing mountains of both luxury and household merchandise in a single visit. Data from the Ministry of Land, Transport, and Tourism indicated that the average shopping expenditure per tourist in Japan increased 75% from 2011 to 2015, mainly driven by an 87% increase in expenditure by Chinese tourists specifically. Chinese consumers themselves cited the relative affordability and high quality of Japanese products as a major driver for these shopping sprees. Some Chinese travellers arrive or even live in Japan as "daigou", or professional shoppers, purchasing goods in bulk for clients back home.

Unfortunately, the bakugai trend appears to be vanishing almost as fast as it appeared. Government data shows a 20% decrease in average retail spending per Chinese tourist in 2016, down to JPY140,000 per visitor from a 2015 high of JPY173,000. The major immediate driver of this decrease appears to be a new tax law passed by the Chinese government effective April 2016, which severely increased import duties on cross-border retail goods and also stepped up penalties for false customs declarations. Duties on alcohol and luxuries specifically rose to 60%, in some cases doubling, making large purchases prohibitively expensive. Tariffs on even relatively mundane products such as books and food now sit at 15%. A 15-20% rise in the yen against the yuan since January also likely blunted Chinese shopping sprees.

Because the price and quality differential between Japanese and Chinese goods is largely an arbitrage opportunity, the bakugai trend was always destined to be a relatively short-term phenomenon. These new import tariffs, however, have accelerated the decline in buying as the Chinese government attempts to capture some of the surplus.

The long-term trend for overseas tourism spending in Japan nevertheless remains positive. Even though each individual tourist is spending less on average, the overall number of tourists continues to post record-breaking growth and aggregate shopping expenditure is consequently still increasing.

International arrivals to Japan totalled 18.0 million YTD as of September 2016, a 24% increase over the same period in the previous year. This increase comes despite a 16% rise in the value of the yen vs the US dollar and an 18% rise vs the yuan since January 1, alleviating concerns that Japan's exploding tourism would cool down if the yen strengthens. As of October, it appears that exchange rate movements have had little visible impact on the number of arrivals in Japan, though it has likely contributed to some of the slowdown in their per capita retail spending.

The government has set a target of 40 million visitors by 2020, and we believe that it can succeed provided that it continues to prioritise tourist-friendly programmes and that other Asian economies maintain reasonable growth.

Domestic macro indicators showing signs of life

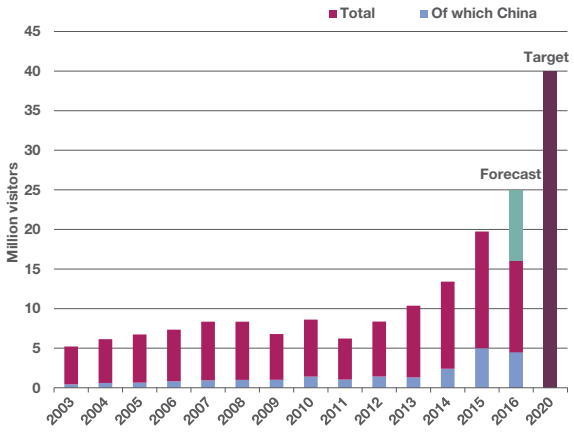
Two key macroeconomic indicators are showing signs of life after a choppy start to the year. In July, retail sales figures reversed a decline that began in mid 2015, hopefully signalling more improvement ahead. Consumer confidence likewise climbed in the third quarter to reach its highest level since the 2014 consumption tax hike.

Though long-term prospects for Japan's retail sector are stable to strong in light of the upcoming Tokyo Olympics and increased tourism, it may take more time for these influences to feed through to further rental increases.

Large-scale department store and supermarket retail sales figures for July totalled JPY1.72 trillion, a JPY14 billion or 0.8% increase over July 2015. The 12 month moving average rose just 0.1% from June 2016 to July 2016, but this was the first increase in

GRAPH 5

International arrivals to Japan, 2003–Sep 2016



Source: Japan National Tourism Organization, Savills Research & Consultancy

TABLE 1

New import duties on products in China, Apr 2016

Category	Products	Tariff
Category I	Books and newspapers, publications, audio and video materials for educational use; computers, video cameras, digital cameras and other IT products; food and beverages; gold and silver; furniture; toys, gaming products, and festive and other recreational products	15%
Category II	Sporting goods (excluding golf balls and clubs), fishing tools; textiles and their manufactured goods; TV cameras and other electrical appliances; bicycles; other goods not included in Category I and III	30%
Category III	Alcohol and tobacco; valuable accessories, jewelry and gemstones; golf balls and clubs; luxury watches; cosmetics	60%

Source: KPMG, Savills Research & Consultancy

a year, possibly signalling a change in momentum.

Official surveys show a marked increase in Japan's consumer confidence, rising 1.2 points or 2.9% over the third quarter to reach its highest level since before the consumption tax hike in April 2014. Some of this boost may be due to the strong outcome of summer elections, in which the Abe administration won a solid mandate to continue its economic policy and Tokyo elected a new governor in a highly publicised contest. Real wages have also risen marginally for seven consecutive months.

Development projects underway in Tokyo and beyond

Recent regional competition and continued urbanisation have led some department store operators to close extraneous stores in more distant areas. Sogo & Seibu Co announced that it is closing its outlet store in Kashiwa, Chiba Prefecture, as well as a branch in Asahikawa, Hokkaido Prefecture. Isetan Mitsukoshi and Hankyu have announced similar plans for outlets in suburban Kanto and Kansai areas.

Department store operators cite stiffer competition from local malls and specialty stores as one reason for the dwindling performance. Some investors such as United Urban REIT and Hankyu's own REIT are buying up such properties and adding them to their portfolios. Indeed, more mundane retailers such as pharmacies and daily goods vendors are flourishing. Part of this restructuring is driven by a larger national trend of population clustering around major stations, reducing the profitability of outlying department stores in satellite cities but creating investment opportunities near transportation hubs.

In terms of new developments, activity continues both in Toyo and farther afield.

Mori Building held a groundbreaking ceremony in July for its Shinbashi 4-chome development in Tokyo, centred on a new 15 storey building with 17,500 sq m of planned GFA and two floors of retail space. The multi-use building will also contain a floor reserved for incubation offices for start ups.

In May Mitsui Fudosan commenced work on its OH-1 redevelopment project in Otemachi. The project consists of two planned office towers and a 6,000 sq m green area adjacent to the Imperial Palace. Though the property will primarily consist of office space, it will also harbour multiple floors of retail space, a luxury hotel, and high-tech conference facilities.

Electronics retailer Yodobashi Camera announced in August that it will construct a new mixed-use B4/34F tower near the north exit of Osaka Station, tentatively titled Yodobashi Umeda Tower. The first eight floors of the facility will house retail space, while floors 9 through 34 will house a 1,000-room hotel. Yodobashi Camera says that it does not intend to house its own store in the retail space, and tenants have yet to be decided. A sightseeing bus terminal will occupy part of the first floor, which the company hopes will attract tourists.

Investment volumes and major transactions

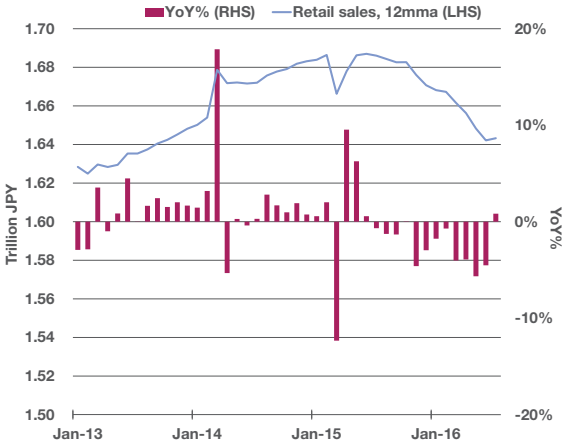
The market appears to be taking a breather after four consecutive annual increases in retail transaction volumes from 2011 to 2015. 1H/2016 investment in Japan retail property totalled JPY184 trillion, just 34% of 1H/2015 volumes. Investment in Japanese real estate across all sectors has declined precipitously in 2016 due to fewer investment opportunities as well as the availability of attractive refinancing. If the second half of 2016 follows the same trend, total volumes could fall just short of JPY400 trillion, or somewhere between 2011 and 2012 levels. Interestingly, the slowdown is primarily concentrated in transactions involving J-REITs and domestic private entities. Overseas investors are for now continuing to invest at levels similar to in previous years.

Net Operating Income (NOI) cap rates for the retail sector have compressed even as volumes slow, and rates for property in prime areas such as Ginza even dipped below 3% in early 2016. The 4-5% range is more typical of reported J-REIT transactions in greater Tokyo, depending on building quality and location. Cap rates can range as high as 8-9% in outlying regions.

Q2 and Q3/2016 saw several notable transactions, including deals involving

GRAPH 6

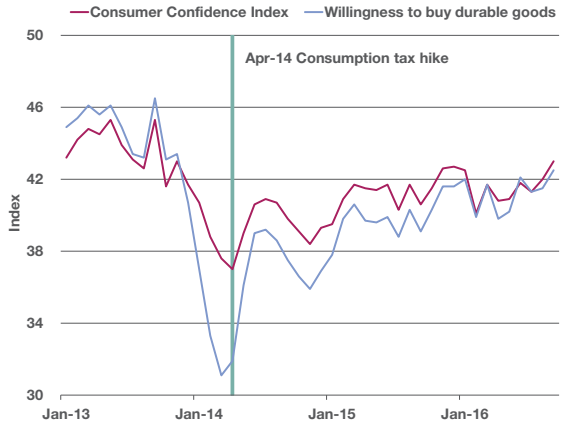
Japan retail sales trend (12m moving average), Jan 2013–Jul 2016



Data includes department stores and supermarkets
Source: METI, Savills Research & Consultancy

GRAPH 7

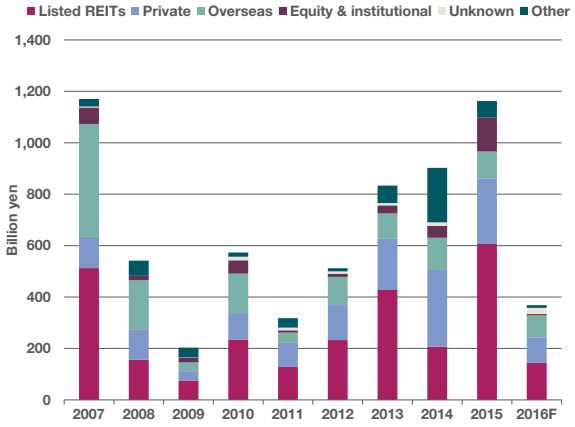
Japan consumer confidence, 2013–Sep 2016



Source: Cabinet Office, Savills Research & Consultancy

GRAPH 8

Retail property investment volume by buyer type, 2007–2016F



Source: RCA, Savills Research & Consultancy

large retail properties outside the 23 wards of Tokyo. Among the largest was Frontier REIT's acquisition of half of Mitsui Shopping Park LaLaport for JPY15.1 billion (US$140 million). The J-REIT reported an appraisal cap rate of 5.0% on the transaction.

Department store operator Marui also disposed of the Shinjuku Higashiguchi Building in Tokyo for JPY13.0 billion (US$120 million). The property stands adjacent to an exit of Shinjuku Sanchome Station. Marui managed the building as a rental property after 2012, when it consolidated some of its presence in Shinjuku. The buyer was an undisclosed domestic company.

TABLE 2

Large retail transactions, Q2/2016—Q3/2016

Announcement date	Property	Location	GFA (sq m)	Price (JPY bn)	Appraisal cap rate (%)	Buyer
Jul 16	Mitsui Shopping Park LaLaport (50% ownership)	Misato, Saitama	136,000	15.1	5.0%	Frontier REIT
Sep 16	Shinjuku Higashiguchi Building	Shinjuku, Tokyo	5,000	13.0	N/A	Domestic Company
Jul 16	Shinsaibashi GIGO	Chuo, Osaka	2,900	12.0	N/A	Domestic SPC
Aug 16	Aeon Mall Higashiura	Chita, Aichi	126,600	11.9*	5.5%	Undisclosed
Aug 16	Kururu	Fuchu, Tokyo	12,800	9.3	5.1%	United Urban REIT

* Price not disclosed; JPY11.9 bn estimate prorated based on book value
Source: RCA, Nikkei RE, Savills Research & Consultancy

OUTLOOK

The prospects for the market

Japan's relatively stable retail market has now seen two consecutive periods of mild softness, but some positive macroeconomic data and strong tourism figures may signal some upward movement ahead. The Abe administration's decision to delay its consumption tax hike to October 2019 undoubtedly spared the retail market another economic shock.

Per capita shopping expenditure by tourists has decreased, disappointing many market players, but the medium-term trend of increasing tourism still gives the sector growth potential.

Investment volumes have decreased significantly in 2016 due to a lack of opportunities, but investors are still eyeing possible acquisitions in strategic locations such as transport hubs in regional cities. Developers continue to work on new retail property, often as part of larger multi-use projects especially in Tokyo and Osaka. Volatile 1/F rents are already high and it may take time for underlying fundamentals to push them higher, but continued gradual increases in non-1/F rents could offer investors more subdued but steady growth in capital value.

Please contact us for further information

Savills Japan

Christian Mancini
Representative Director, CEO
+81 3 6777 5150
cmancini@savills.co.jp

Savills Research

Tetsuya Kaneko
Director, Head of Research & Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk