savills

Savills World Research
Japan

Spotlight
Japan retail

May 2018

savills.com.jp/research

Spotlight
Japan retail

"Positive macro conditions such as growing tourism and a mild uptick in consumer confidence appear to be improving retail rents in some submarkets. Investment interest, notably in Japanese prime retail assets as core assets, remains strong, leading to further cap rate compression."

Tokyo submarket rents

According to a semi-annual survey by Japan Real Estate Institute (JREI) and BAC Urban Projects, Tokyo's retail rents have on average held fairly steady since 2016. Non-1F rents continue their steady march upward as 1F rents edged up year-on-year (YoY), although with diverged performance between submarkets. The largest growth was seen in Ginza, which could be resulting from consistently strong tourism and improving luxury retail sales. The opening of Ginza Six is also increasing footfall in the submarket. On the other hand, a slowdown of fast fashion might have led to store closures in some submarkets.

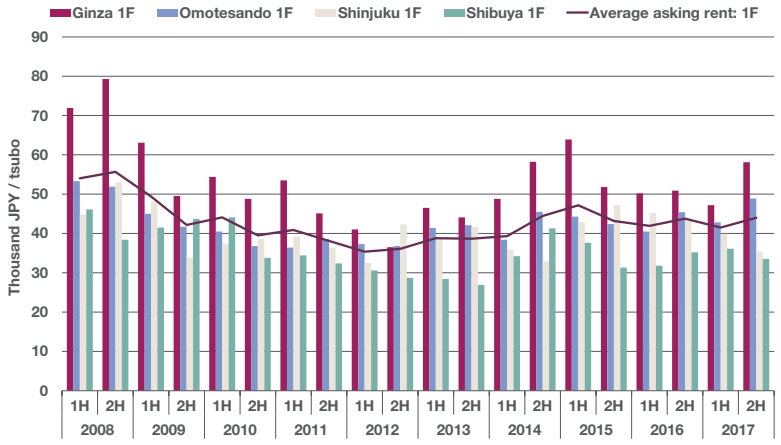
Ginza 1F rents sat at JPY58,100 per tsubo, remaining the highest among the surveyed submarkets. 1F rents in Ginza grew 14.1% YoY while non-1F rents fell 1.0% YoY. 1F rents in Ginza had been declining since 1H/2015, concurrent with a decrease in average spending per overseas tourist. As discussed later in this report, the spending decline has halted and total shopping expenditures by overseas tourists have been increasing due to the growing number of visitors. Luxury retail sales are also on the rise, which may have contributed to the rental increases. Furthermore, Ginza Six appears to have had a solid first year, and it is expected to reach its goals, namely 20 million visitors and JPY60

SUMMARY

- Tokyo's average 1F retail rent has generally remained stable since 2016.
- Non-1F rents continue their steady trend upward.
- 1F Ginza rents have improved 14.1% YoY, possibly due to increasing overseas tourist expenditures and positive luxury product sales.
- Consumer confidence is mildly improving with high-income households seeing the largest improvement.
- Drugstores and daily goods stores sales continued to increase in 2017, growing 5.8% YoY.
- Investment volumes in retail have increased to JPY771 billion in 2017. Q1/2018 has not seen many transactions because of limited opportunities, but investment interest appears to remain sound.

GRAPH 1

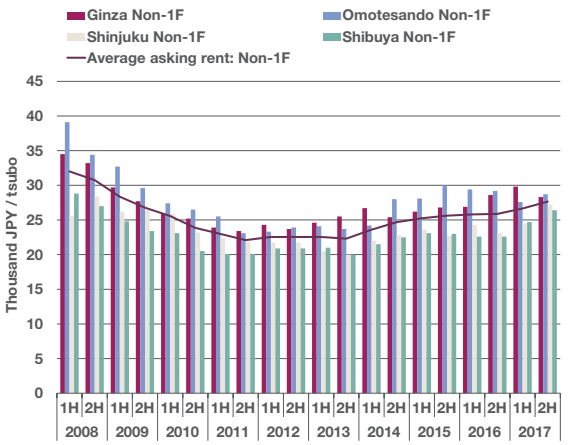
Tokyo 1F rents, 2008 – 2H/2017



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

GRAPH 2

Tokyo non-1F rents, 2008–2H/2017



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

billion in sales. Considering these positive factors, the rental growth in Q1 could be the beginning of another gradual upward trend.

1F rents in Omotesando/Harajuku rose 7.7% YoY to JPY48,900 per tsubo while non-1F rents fell 1.7% YoY to JPY28,700 per tsubo. While apparel stores such as Forever 21 and Harajuku's iconic Spinns closed, new stores continue to open in the area. Tenant movements are rapid as many lease spaces for a short period of time for advertising purposes. For example, after Urban Research closed its Harajuku store, the space was used as a pop-up store by Jack & Marie, a lifestyle brand newly launched by automotive parts company Autobacs. The Harajuku Takara Estate Building, which housed Forever 21 until October 2017, is currently under renovation.

In Shinjuku and Shibuya, 1F rents declined 18.8% to JPY35,400 and 4.8% to JPY33,500 YoY, respectively. However, the rental declines can be largely explained by a decrease in survey samples. Vacancy is tight and there appears to be limited availability in high-rent areas. Since these areas are popular destinations among overseas tourists, expanding tourism should benefit the submarkets. According to a 2016 survey by the Tokyo Metropolitan Government, Shinjuku is the most visited ward in Tokyo while Shibuya is in fourth place: 57% and 44% of inbound tourists coming to Tokyo visit Shinjuku and Shibuya, respectively. Although the old GAP site in Shibuya is yet to find a tenant, Louis Vuitton opened a pop-up store in April that featured Kim Jones' Fall-Winter 2018 Men's Precollection on the site, highlighting the area's attractiveness.

Regional cities

Overall, regional 1F rents have not been performing well. The average 1F rent across prime districts outside of Tokyo sat at JPY19,483 based on the latest survey, down 8.3% YoY. On the other hand, non-1F rents registered positive growth of 1.6% YoY to JPY12,617.

At the submarket level, 1F rents in Tenjin saw positive growth of 15% YoY to JPY22,200. According to JREI, reconstruction of existing buildings is tightening vacancy, thereby resulting in rental increases. Although 1F rents decreased 29.5% YoY to JPY19,800 in Shinsaibashi, an abnormally large decline in Q3 affected the 2H average. In Q4, 1F rents rebounded to around JPY24,000, and top rents along Midosuji and Shinsaibashisuji appear to remain stable. It also appears that the limited sample size is making the trend look volatile. Although the Mikigakki Shinsaibashi Building is currently closed for reconstruction, it is scheduled to reopen in autumn 2018 and will house Mikigakki stores and GAP. With the opening of the new Daimaru Shinsaibashi Main Tower in 2019, as well as the opening of Parco and W Osaka, a luxury Marriott hotel, planned for 2021, the dynamism of the area, which is currently dominated by drugstore openings, might change. Nikkei has recently reported Louis Vuitton's plan to build a B1/7F retail building by November 2019 on a vacant site next to Prada.

Although growing e-commerce is a threat especially for regional retail stores, as discussed in the previous retail report, the impact from e-commerce appears to have been limited due to constraints such as a labour shortage in the logistics industry, a relatively older conservative Japanese population, and comparatively low credit card usage. In Japan, retail space per person is about half of that in the U.S. and Japanese regional malls mainly function as supermarkets selling fresh food as opposed to department stores in the U.S., which also mitigates the impact from growing e-commerce – which has had little influence in the fresh food sector so far. Enhancing in-store experience, especially in regions lacking in entertainment venues, should also help as consumers increasingly value experience over material goods.

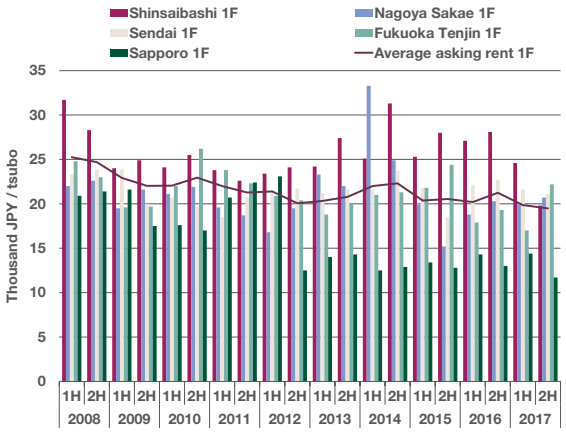
Inbound tourism

Although a rapid increase of Chinese tourist spending due to "bakugai" ("explosive buying") abruptly ended in 2015, expanding tourism continues to have a large positive impact on the Japanese retail sector as total expenditures by overseas tourists are steadily growing. In 2017, total shopping expenditures by overseas tourists increased by JPY214 billion, or 15% YoY, to JPY1.6 trillion. While Chinese tourists account for over 50% of the spending, expenditures by tourists from other countries also saw a rapid increase of JPY119 billion yen or 19% YoY. Notably, Korean tourist spending increased by about JPY40 billion, or 40% YoY, due to increased visitation.

The shift in tourist spending from luxury goods to daily necessities such as cosmetics and health products appears to be responsible for decreases in shopping expenditure per person, as unit prices are low.

GRAPH 3

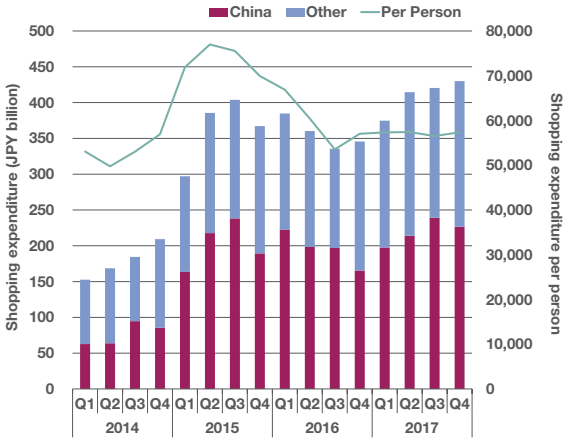
1F rents in retail districts of regional cities, 2008 – 2017



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

GRAPH 4

Overseas tourist shopping expenditure, 2014 – 2017



Source: Japan Tourism Agency, Savills Research & Consultancy

Unlike the short-lived shopping sprees surrounding certain electronics and luxury items, however, the popularity of daily necessities is likely to be more sustainable. According to the Ministry of Economy, Trade, and Industry (METI), drugstore sales nationwide in 2017 have grown 5.8% from 2016. Food and cosmetics have led the growth, increasing sales by 8.7% and 6.8%, respectively. Additionally, according to the Japan Department Store Association (JDSA), duty-free sales at department stores have soared to JPY270 billion in 2017, a whopping 46% growth YoY.

Osaka is an especially popular destination among overseas tourists due to its unique culture, proximity to Kyoto, and access to a major international airport with large low cost carrier (LCC) capacity. When compared to Tokyo, the area has more room for growth in tourism. Kansai International Airport was served by about 18,000 LCC flights in 2016, which made travels from neighbouring Asian cities affordable. Although the figure is more than the combined number of LCC flights to Narita and Haneda, Kansai International Airport is still running around 80% of its capacity, unlike the two Tokyo airports at almost full capacity. Additionally, visitation to Universal Studios Japan (USJ) in FY2016 grew 5% YoY. The number of international visitors to the park is rapidly growing, doubling the 2014 figure to reach 2 million in CY2017. In contrast, Tokyo Disney Resort (TDR) experienced a slight increase of 0.3% in FY2017, indicating that TDR is reaching full capacity. The pace of growth in visitation to Osaka is likely to continue to exceed that of Tokyo, likely resulting in increases in tourist retail spending. According to JDSA, sales in Osaka grew 6.8% YoY in 2017. In Shinsaibashi in particular, Daimaru increased its total sales by 14% and duty-free sales by 71% YoY.

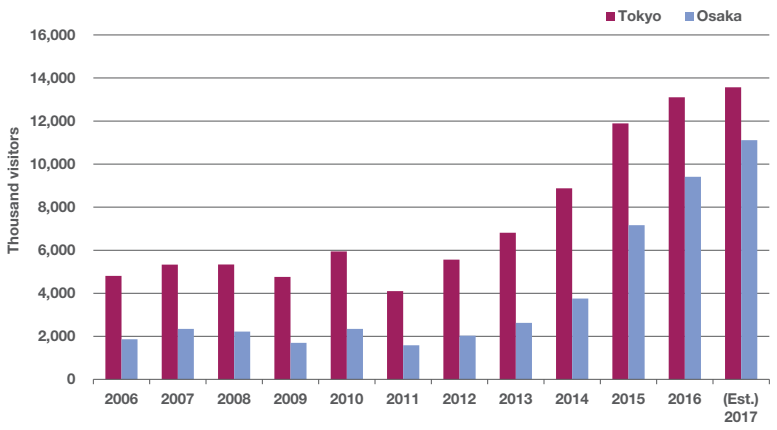
Department store sales

According to JDSA, department store sales in ten major cities grew by 1.7% YoY, with Osaka leading the growth at 6.8% YoY.

In addition to cosmetics, JDSA reported that sales of luxury items

GRAPH 5

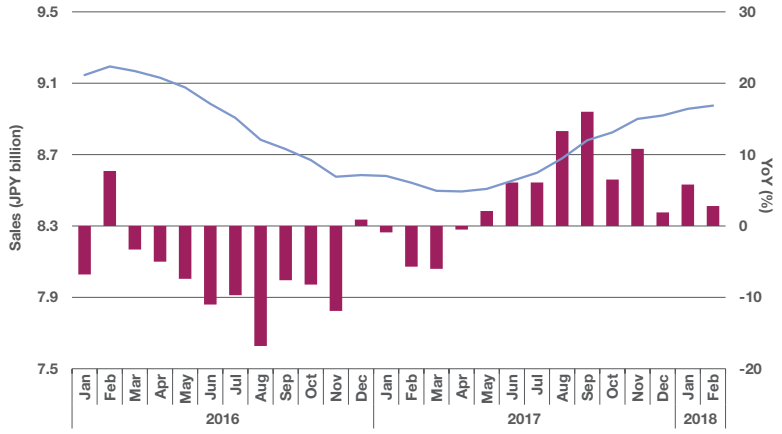
Overseas tourists to Tokyo and Osaka, 2006 – 2017



Source: Tokyo Metropolitan Government, Osaka Metropolitan Government, Savills Research & Consultancy

GRAPH 6

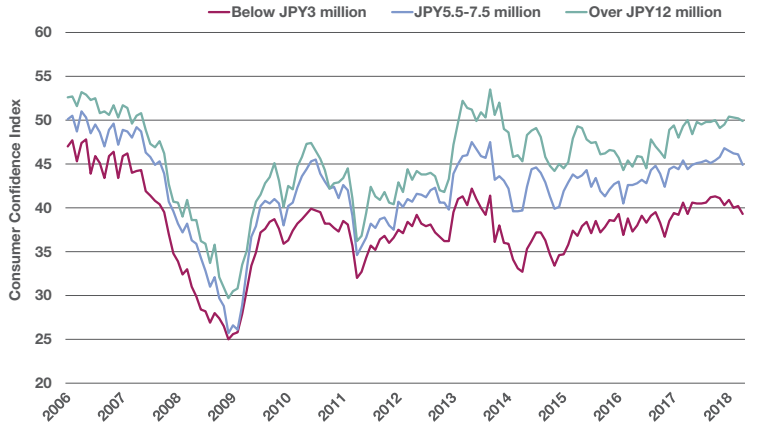
Luxury item sales at department stores (12-month moving average), 2016 – Feb 2018



Source: JDSA, Savills Research & Consultancy

GRAPH 7

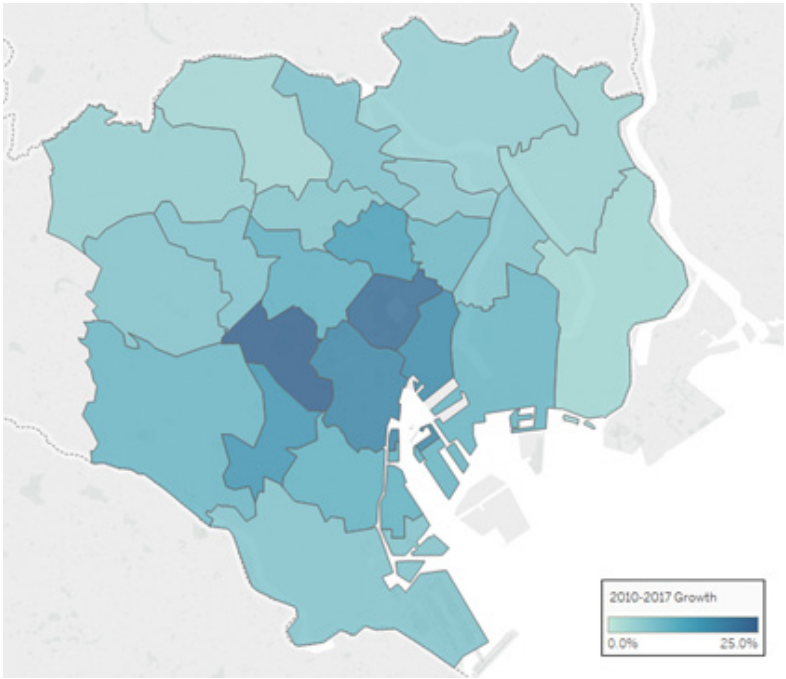
Japan consumer confidence by income level, 2006 – Apr 2018



Source: Cabinet Office, Savills Research & Consultancy

MAP 1

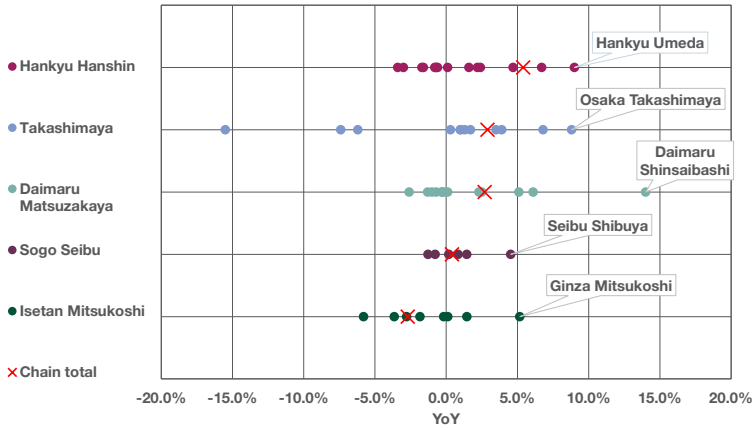
Taxable income growth, 2010 – 2017



Source: MHLW, @OpenStreetMap (www.openstreetmap.org/copyright), Savills Research & Consultancy

GRAPH 8

Comparison of store sales growth of major department store chains, FY2017 vs FY2016



Source: Company disclosures, Savills Research & Consultancy

such as art, jewellery, and precious metals are on the rise at department stores. Although luxury item sales largely declined after the Chinese government imposed new tariffs in 2016, they started posting positive growth in May 2017. 2017 was also a strong year for luxury brands such as LVMH and Kering, with sales of LVMH and Kering brands in Japan increasing 12% and 11%, respectively.

In addition to increasing tourist spending, mild improvement in consumer confidence of domestic shoppers, with high-income households recording the largest improvement, may be contributing to the growth. Despite slow wage growth across the nation, taxable income levels in the central five wards, where average household incomes are high, are increasing.

High asset prices should increase income levels among high-income households as they typically own multiple assets including equity and real estate, which can generate large capital gains upon sale. Moreover, according to the Ministry of Health, Labour and Welfare, wage growth in Tokyo in 2017 was 1.2% YoY, much higher than the national average of 0.1% growth.

At the store level, some chains appear to be outperforming others. In FY2017, the Hankyu/Hanshin, Takashimaya, and Daimaru/Matsuzakaya chains have increased sales by 5.4%, 2.9% and 2.7% YoY, respectively. Meanwhile, sales of major Sogo/Seibu stores have only marginally increased at 0.4% YoY, and Isetan/Mitsukoshi has registered at -2.7% YoY.

Examining the top performing stores of each chain, overseas tourists are playing a major role in increasing sales, as the top performers are located in popular destinations such as Shinsaibashi, Ginza, and Shibuya. Daimaru Shinsaibashi registered at the highest growth of 14% YoY in 2017, as a result of actively going after inbound tourist demand by setting up two cosmetics spaces, promoting through social networking services, and expanding the use of a mobile billing method.

New projects in 2018

Tokyo Midtown Hibiya fully opened to the public in March 2018. The 35-storey mixed-use tower has 60 retail stores and 13 movie screens. The new iconic building overlooking the Imperial Palace attracted 100,000 visitors on its opening day. Mitsui Fudosan, the developer of the tower, is targeting JPY13 billion in revenue for the first year of its operation. The introduction of this new retail venue may change the dynamism of footfall in the western part of Ginza.

Shibuya Stream is slated to open in fall 2018. The mixed-use tower will have 3,000-sq-m retail spaces, a multi-purpose space, a 180-room hotel, and a 14,000-tsubo office component. The retail space will target adult customers, reflecting Shibuya's transformation from a pop-culture mecca to a more matured city appealing to a wider

range of clientele. Additionally, Google is leasing the entirety of the office space in Shibuya Stream. More high-earning office workers in the area should result in growing footfall and will likely have a positive impact on retail sales.

Investment trends

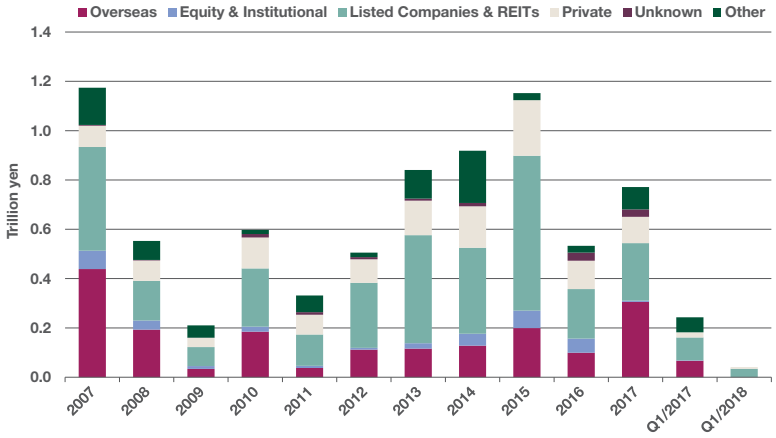
In 2017, investment in retail property picked up compared to 2016. Total volumes amounted to JPY771 billion through 2017 according to preliminary data from Real Capital Analytics (RCA). This is up 45% compared to 2016, mainly due to two large portfolio transactions by Blackstone and Norges Bank. In Q1/2018, transaction volumes have significantly decreased compared to the same period in 2017. However, investment interest in the Japanese retail market appears to remain sound, as illustrated by Norges Bank and Tokyu Land Corporation's acquisition of five prime retail assets in Tokyo.

A semi-annual survey by JREI revealed that expected cap rates for prime retail property in Ginza and Omotesando sat at 3.6% and 3.7%, respectively, in October 2017, a tightening of 10 basis points from six months prior. Actual transaction cap rates appear much tighter, however. In Ginza and Shinsaibashi, cap rates could now be in the mid 2% to 3% range.

In Q4/2017 and Q1/2018, large transactions were seen in regional cities. In Nagoya and Osaka, retail buildings housing international fashion brands such as Prada, Dolce & Gabbana, and Zara were transacted. Prime Square Shinsaibashi was reportedly sold for JPY22 billion by Elliott Management, about 70% appreciation from the price the seller paid to acquire the building in 2014.

GRAPH 9

Retail property investment volume by buyer type, 2007 – Q1/2018



Source: RCA, Savills Research & Consultancy

TABLE 2

Selected retail transactions, announced Q4/2017—Q1/2018

Announced	Property	Location	GFA (sq m)	Price (JPY billion)	NOI cap rate	Buyer
Dec 2017	Prime Square Shinsaibashi	Chuo, Osaka	9,414	Approx 22.0	NA	Marubeni
Nov 2017	G Bldg Midosuji 02	Chuo, Osaka	1,390	15.0	3.3% (Appraised)	Japan Retail Fund
Mar 2018	Sakae Globe (60%)	Sakae, Aichi	4,596	9.3	3.7% (Appraised)	Frontier REIT
Nov 2017	Summit Store Mukodaicho	Nishi Tokyo, Tokyo	10,660	5.1	4.4% (Appraised)	Nomura Master Fund
Mar 2018	Costco Wholesale Sapporo Warehouse	Sapporo City, Hokkaido	24,000	4.2	4.5% (Appraised)	Kenedix Retail REIT

Source: RCA, Nikkei RE, Savills Research & Consultancy

OUTLOOK

The prospects for the market

Retail rents are broadly flat at high levels, though they look to be fluctuating because of small sample sizes resulting from limited available space. The overall steady trend appears to continue while increasing inbound tourism encourages increases in average rents, especially in areas popular among visitors.

Consumer confidence has been improving with high-income households seeing the largest uptick. Although wage growth is limited across Japan, income levels have steadily increased in the Tokyo central five wards and major regional cities in recent years.

As the line between winners and losers materialises, it is increasingly important to gain a competitive advantage through capturing inbound tourist demand, identifying advantageous locations, and enhancing in-store experience.

Investment volumes in 2017 have picked up from 2016. Although volumes in Q1/2018 declined compared to the prior-year period, small transaction volumes are due to limited availability. Investment interest, especially for prime retail property, remains strong as illustrated by acquisitions made by Norges Bank and Tokyu Land Corporation. With more acquisition opportunities available in regional cities, investment volumes in such areas may increase as investors look outside of Tokyo in search of new opportunities and better yields.

Please contact us for further information

Savills Japan

Christian Mancini
CEO, Asia Pacific
(Ex Greater China)
+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