Savills World Research
Japan

Spotlight
Japan retail

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"Retail rents are trending upward, supported by a positive economic climate. Inbound tourism and improvements in transportation infrastructure should be key to the growth of regional markets. Although investment volumes have declined, acquisition interest, particularly in prime retail, appears to remain sound."

SUMMARY

- Tokyo's average 1F retail rent is trending upward, especially in Ginza and Omotesando.
- Regional cities are seeing signs of increasing rents, supported by inbound tourism.
- Pop-up stores are an increasingly popular option for tenants and landlords.
- General merchandise stores (GMSs) are seeing signs of improvement with major GMS brands trying new tactics.
- Although investment volumes in Q3/2018 declined, expected cap rates continued to compress, reflecting sound investment interest.

Tokyo submarket rents

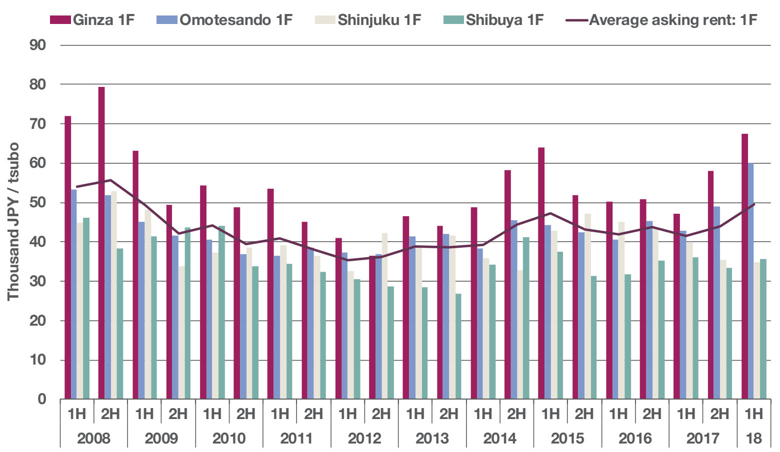
According to a semi-annual survey by Japan Real Estate Institute (JREI) and BAC Urban Projects, Tokyo's retail 1F rents on average have held fairly steady since 2016 and have begun to improve since 2017. Non-1F rents, which are less susceptible to fluctuations, have been gradually increasing since 2011, reflecting stable market fundamentals and improving consumer confidence. In surveyed submarkets, prime rents are generally unchanged. While store closures continue, demand for prime retail locations is still strong and is quickly filling vacant spaces.

Ginza 1F rents reached JPY67,400 per tsubo, remaining the highest among the surveyed submarkets. 1F rents in Ginza grew 16.0% half-year-on-half-year (HoH) while non-1F rents increased 0.7% HoH. 1F rents in Ginza have been rising for three consecutive periods and recorded the highest level since 2009 this quarter. Although readers should look at the data merely as a guideline due to the limited sample size, growing inbound tourism and improving luxury demand do appear to be sustaining rental increases. Cosmetic and luxury brand tenants continue to seek spaces in Ginza. Secondary vacancies created by relocations of brand stores to Ginza Six appear to have been absorbed, indicating sound demand on Chuo-dori and Harumi-dori.

1F rents in Omotesando/Harajuku rose 22.9% HoH to JPY60,100 per tsubo while non-1F rents rose 9.8% HoH to JPY31,500 per tsubo. Supported by sound demand from luxury and designer brands, landlords appear to be aggressive on rents. While the area's iconic stores such as Spinns and WEGO

GRAPH 1

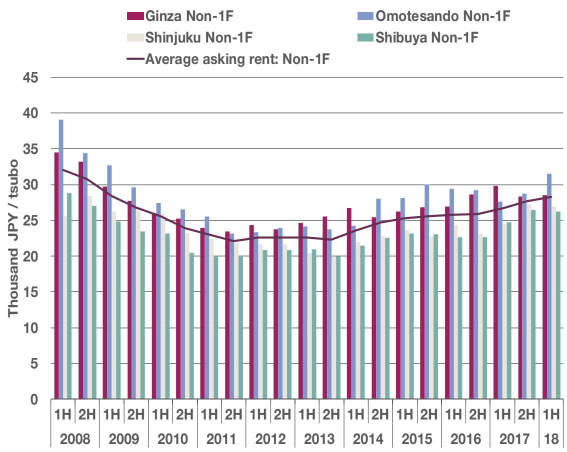
Tokyo 1F rents, 2008 – 1H/2018



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

GRAPH 2

Tokyo non-1F rents, 2008–1H/2018



Source: JREI, BAC Urban Projects, Savills Research & Consultancy closed, new stores continue to open on Meiji-dori and Omotesando. Red Valentino opened its flagship store along Omotesando in September after the brand gained exposure in the area via its pop-up store between October 2017 and March 2018. Considering the area's influence on trends, pop-up store demand is likely to strengthen. The former Forever 21 site on Meiji-dori is still vacant, however. It might be challenging to find a tenant that is willing to lease the large space.

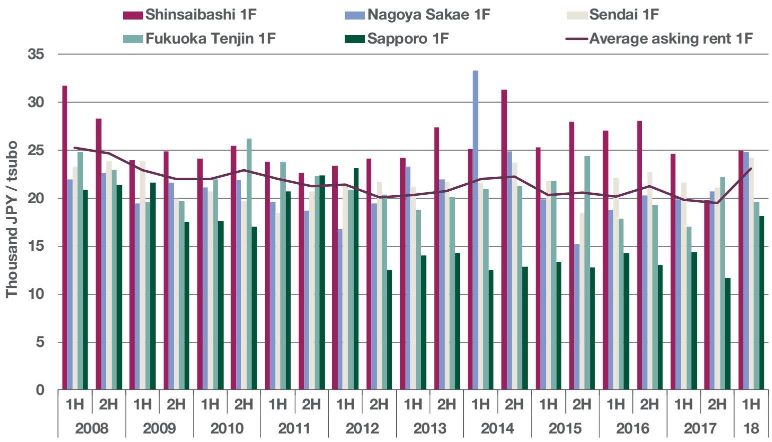
In Shinjuku, 1F rents declined 1.7% HoH to JPY34,800, while those of Shibuya rose 6.3% HoH to JPY35,600. These areas remain popular among overseas tourists. According to a 2017 survey by the Tokyo Metropolitan Government, Shinjuku is the most visited ward in Tokyo while Shibuya is in fourth place: 56% and 43% of tourists visit Shinjuku and Shibuya, respectively. On Shinjuku-dori, Gucci and Apple opened stores in April. Shibuya's station-front area is undergoing enormous redevelopment, and the opening of Shibuya Stream in September marks the first phase of Tokyu's ambitious plan. Away from the station, Xebio, a sporting goods shop, opened on the former GAP site. While Koen-dori sees sound demand, relatively large spaces in the Jinnan area appear to be struggling after Parco, which attracted large footfalls, closed for reconstruction.

Regional cities

In regional cities, inbound tourism is a primary driving force for retail markets. As discussed in our recently published "Japan inbound retail" report, capital is flowing into regions as many stakeholders are now betting on continued inbound tourism growth. According to the Japan Department Stores Association, duty-free sales set a new high at JPY31.6 billion in May, indicating that tourists' shopping appetite remains strong. Up through early 2016, "bakugai" ("explosive buying") was largely fuelled by semi-professional shoppers who purchased goods in bulk for clients back home. Considering that this practice was virtually eradicated by customs duties imposed by the Chinese government, current demand appears to be driven by actual consumers.

GRAPH 3

1F rents in retail districts of regional cities, 2008 – 1H/2018



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

According to the 2018 national land value survey (Chika Koji), the highest land price in Osaka was recorded at CROESUS Shinsaibashi, located in a popular tourist area, overtaking Grand Front Osaka near Umeda Station. This change illustrates the importance of capturing inbound demand. According to JREI, inbound demand is also sound in areas such as Sakae (Nagoya) and Tenjin (Fukuoka). In Fukuoka, while the highest land price was recorded in Tenjin, the strongest growth was recorded between Hakata Station and Canal City Hakata, which may be explained by the area's better accessibility by large transit bus compared to Tenjin's narrow roads. In Nagoya, ongoing development at the station front should sustain the area's growth.

Regional 1F rents on average increased 18.4% HoH to JPY23,067, while non-1F rents rose 1.6% HoH to JPY13,483. Shinsaibashi and Sakae increased 1F rents by 26.3% and 19.8% HoH, respectively, while 1F rents in Tenjin decreased 11.7% HoH. After accounting for period-to-period fluctuations, rental trends have been generally stable in key regional cities. However, the line between winners and losers is expected to become more clearly defined, as even station-front department stores have been closed.

Emerging trends

Despite concerns about e-commerce, demand for physical retail spaces is sound, especially in prime locations in major submarkets. Physical stores still generate the most retail sales, and many retailers acknowledge the importance of store experience to nurture brand loyalty. There are cases where retailers who started online have opened physical stores as well. While some retailers give up larger spaces to be able to afford prime locations, there is also demand for expanded space from those who wish to host events and feature promotion areas. Landlords need to understand shifting needs and find tenants who see the most potential in the space. The following are some examples of relatively new trends in the retail market.

Pop-up stores are gaining traction as landlords seek to fill temporary vacancy with short-term tenants or enhance store experience with fresh offerings. This is also a beneficial arrangement for some tenants who wish to gain exposure in highly visible, footfall-heavy areas. For example, in April and May, Volvo opened its first pop-up store in Japan, displaying its new SUV model and XC series at Roppongi Hills. Between May and July, Zara, which is accelerating the integration of online and offline shopping, also opened a pop-up showroom in Roppongi: shoppers were able to try on clothes in store and order items online for on-site collection afterwards. The pop-up store platform is also expanding, as exemplified by the website Shopcounter by Counterworks. The website lists spaces available for short-term use, and Counterworks now collaborates with companies such as Aeon Retail, Mitsui Fudosan, Mitsubishi Real Estate, and Tokyu Fudosan.

Additionally, co-working offices could fill up some spaces in conveniently located department stores and shopping centres. For instance, Kintetsu Department Store Yokkaichi in Mie is currently undergoing renovation and will feature a serviced office operated by Synth once it is opened in November. The department store is located within Yokkaichi Station, about 60 minutes away from Nagoya Station, and appears to target small local companies and teleworkers. In the U.S., Macerich, a major retail owner and operator, is collaborating with industries to bring shared office spaces into shopping centres. In Japan, shopping malls are growing more community-oriented by featuring nurseries and community events. Offering work spaces might be a natural extension of that trend.

General merchandise store

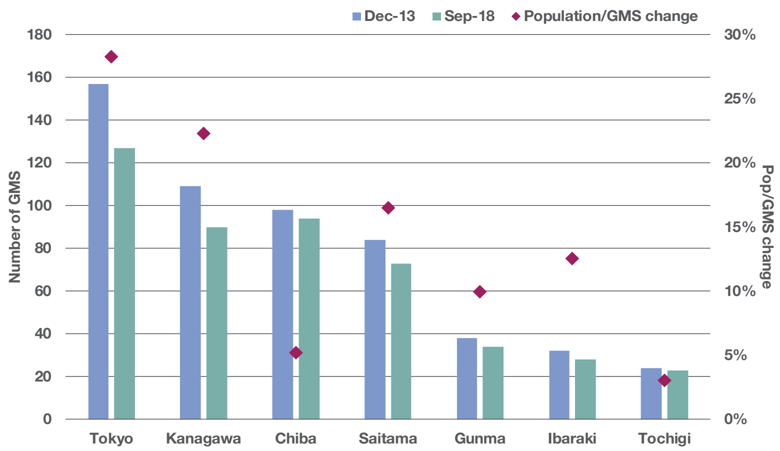
General merchandise store (GMS) brands such as Aeon and Ito-Yokado are working on restructuring their business models and appear to be seeing some positive results. In Q1/FY2018 (March – May 2018), Aeon recorded a profit of JPY40 billion, its highest ever, largely due to improvement in its GMS performance. Although Aeon's GMS business is still losing money, it reduced losses by JPY1.8 billion, from JPY6.3 billion in Q1/FY2017 (March – May 2017), to JPY4.5 billion in Q1/FY2018. Ito-Yokado, a unit of Seven & i Holdings, also increased profits from JPY0.7 billion in Q1/FY2017 to JPY2.4 billion Q1/FY2018.

Aeon focused on sales of its own Topvalu brand and succeeded in raising sales per person. The firm also plans to establish separate companies for each product category such as food, apparel, and home products and deepen its expertise in each area. On the other hand, Ito-Yokado decided to lease out underperforming apparel and home product sales spaces to tenants with stronger draws.

Closures of underperforming stores may also create opportunities for surviving GMSs. According to the National Supermarket Association of Japan, the number of GMSs has decreased between 2014 and 2018. The majority of downsizings were observed in the Kanto region, which significantly increased population-per-store ratios in some prefectures. For instance, Tokyo experienced the largest amount of store closures: combined with population increases due to urbanisation, the population per GSM ratio in the prefecture has increased by over 25% between December 2013 and September 2018. Although this trend does not guarantee larger market shares for surviving GMSs due to heightened competition from different store types, such as convenience stores, drug stores, and e-commerce, some GMSs could outperform others by offering specialised products and services.

GRAPH 4

Number of GMSs and population-per-GMS ratios in Kanto, Dec 2013 vs Sep 2018



Source: National Supermarket Association of Japan, Savills Research & Consultancy

New projects

Nihonbashi Takashimaya S.C. opened in September 2018. The B5/27F building features over 100 stores from B1 through 7F with a strong focus on food and beverage. The concept of the new tower was developed with residents in the Nihonbashi area in mind and offers open walkable areas on both ground and above-ground levels.

In its 15th anniversary year, Roppongi Hills opened Premium Dining Floor and Grand Food Hall. Premium Dining Floor features top-quality restaurants, including Michelin-starred restaurants, and provides visitors the opportunity to experience the world of the chef through dialogues, presentations, and plate exhibitions. Grand Food Hall first opened in Ashiya in Hyogo, and this venue in Roppongi is the second location.

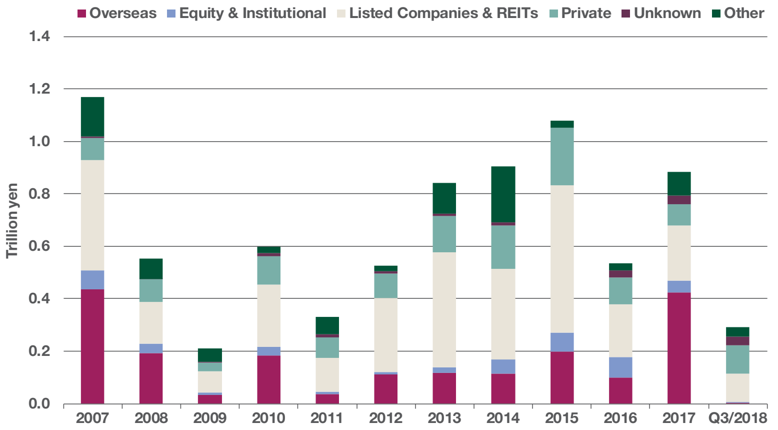
In Osaka, a joint venture led by Mitsubishi Estate was selected as the developer of the Umekita Phase 2 project, which is slated for completion in 2024. The development site is a former retail depot located next to Osaka Station. Mixed-use facilities including rail centres, hotels, offices, and residential units will be built over 46,000 sq m of land. Although Shinsaibashi is currently the top shopping destination for tourists in Osaka, the balance could shift towards the Umeda area after the development.

Investment trends

In Q3/2018, year-to-date investment in retail property stood at JPY292 billion, a 43% decline from the same period in 2017, according to preliminary data from Real Capital Analytics (RCA). The decline is largely due to relatively few transactions by overseas investors, especially against a strong 2017. Specifically, Blackstone's Croesus Retail Trust buyout and Norges Bank's acquisitions accounted for over JPY200 billion of 2017 investment.

GRAPH 5

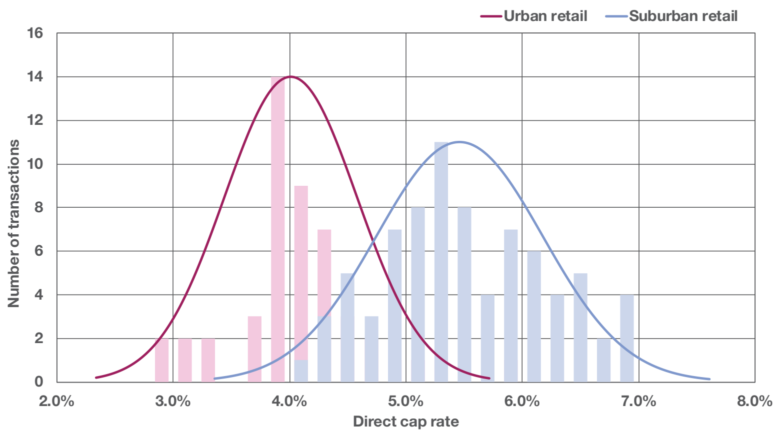
Retail property investment volume by buyer type, 2007 – Q3/2018



Source: RCA, Savills Research & Consultancy

GRAPH 6

Appraisal direct cap rate of transacted retail properties, 2016 – Sep 2018*



Source: Japan REIT DB, Savills Research & Consultancy

* Among transactions in the data available from Japan REIT DB as of October 2018, we have included the ones whose appraisal valuation dates were after January 2016.

A semi-annual survey by JREI revealed that expected cap rates for prime retail property in Ginza and Omotesando sat at 3.5% and 3.6%, respectively, in April 2018, a tightening of 10 basis points from six months prior. The expected cap rate for suburban shopping centres in the Tokyo area is 5.5%, gradually widening the spread over that of prime retail in Ginza from 1.8% in October 2015 to 2.0% in April 2018. Analysis of appraisal direct cap rates for properties transacted by J-REITs in recent years generally validates surveyed expected cap rates. In prime locations, however, a buyer may need to be willing to accept cap rates in the mid 2% range in order to be a winning bidder.

Some J-REITs are reshuffling their portfolios by divesting properties. United Urban Investment decided to sell Himonya Shopping Centre for JPY27.5 billion at a direct cap rate of 5.1% in May. The disposition followed a large-scale renovation in 2016 and increased rental levels. Aeon REIT replaced Aeon Mall Kumamoto, which was seeing an unrealised loss, with Aeon Mall Kyoto Gojo. Although it is not within the surveyed period, Japan Retail Fund acquired G-Bldg. Minami Aoyama 03 for JPY12.2 million at a direct cap rate of 3.0% in October.

TABLE 2

Selected retail transactions, announced Q2/2018—Q3/2018

Announced	Property	Location	GFA (sq m)	Price (JPY billion)	Direct cap rate	Buyer
May 2018	Himonya Shopping Centre	Meguro, Tokyo	27,000	27.5	5.1%	Undisclosed
Jun 2018	AEON Mall Kumamoto	Kamimashiki, Kumamoto	101,000	14.5	6.0%	Undisclosed
Jul 2018	North Tenjin	Chuo, Fukuoka	22,000	14.0	NA	Fukuoka Standard Sekiyu
Jun 2018	AEON Mall Kyoto Gojo	Kyoto, Kyoto	87,000	13.3	4.9%	AEON REIT
Jun 2018	Hulic Shimaura-Sakaue (retail portion)	Itabashi, Tokyo	14,000	7.6	4.6%	Hulic REIT

Source: RCA, Nikkei RE, Savills Research & Consultancy

OUTLOOK

The prospects for the market

In Tokyo, retail rents are trending upwards, reflecting an improving economic climate and growth in inbound tourism. Although some submarkets have experienced store closures, strong demand is filling vacancies in prime areas. Additionally, key regional cities are beginning to see signs of rental growth. Inbound tourism and improvements in transportation infrastructure should be important for regional markets in particular.

Some markets are more likely to benefit from growing tourism than others. In regional cities where inbound influence is limited, overall market sizes should dwindle but demand could consolidate around city cores. This might create opportunistic investment targets near transportation hubs, albeit even station-front areas may suffer in some markets.

To capture new types of demand, landlords are turning to pop-up stores. While many use pop-up stores just to fill temporary vacancies, some properties have set dedicated spaces for use by short-term tenants. Although it is still uncommon, co-working spaces in neighbourhood malls and department stores could be a new trend if interest in flexible work environments increases.

After years of disappointing performance, GMSs saw a silver lining with major GMS brands improving profitability. GMS brands are employing strategies to provide more specialised products and services. Ongoing consolidation of stores may be reducing competition. Having said that, the business environment surrounding GMSs presents challenges.

Although investment volumes in Q3/2018 declined from the same period in 2017, investment interest, particularly in Japan's prime urban retail assets, appears sound. With the stable performance of underlying assets, investors could reap handsome returns if they can improve properties' competitiveness through renovations and changing tenant mixes.

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