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Japan

Spotlight
Japan retail

November 2017

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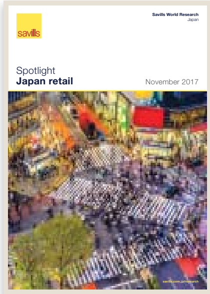


Spotlight
Japan retail

"Ginza, Omotesando, Shibuya, and Shinjuku are seeing redevelopment and expansion. Retail sales, wages, and consumer confidence are all mildly positive. Investment volumes appear on track to exceed 2016 totals, though tight yields are still making buyers cautious."

Tokyo submarket rents

Tokyo's retail rents have on average held fairly steady since 2016. 1F averages, especially in Ginza, are continuing to moderate from 2014-2015 highs as the last of the fervour over tourist shopping sprees subsides. Prime street locations remain as in-demand as ever, though, and top rents have barely budged. Non-1F rents continue their slow but steady march upward.

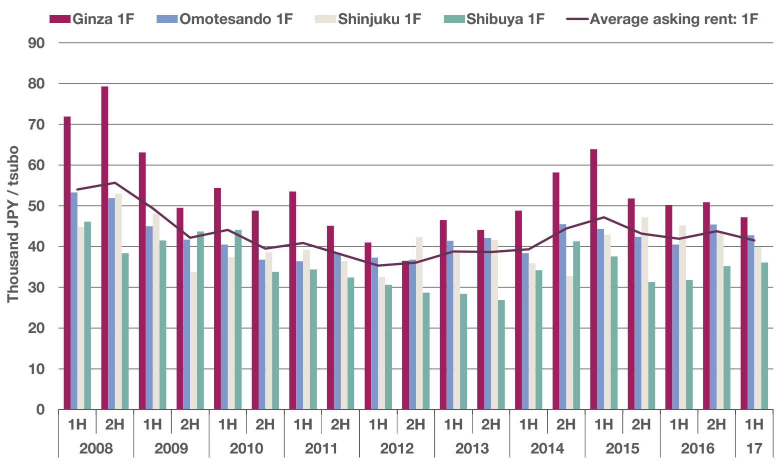
1F rents across Ginza, Omotesando, Shibuya, and Shinjuku averaged JPY41,500 per tsubo in 1H/2017, down 1.0% year-on-year (YoY). This calm masks fairly significant movements at the submarket level. Ginza and Shinjuku are down 6% and 12% respectively YoY, while Omotesando and Shibuya are up 6% and 14% over the same period. Although small sample sizes typically make 1F rents quite volatile, and short-term movements should be taken with a grain of salt, this divergence could reflect the recent trendiness of Tokyo's southwestern submarkets. The shrinking sample size indicates low availability, increasing data volatility.

Non-1F rents continue to grow at a steady pace. The average non-1F rent across Ginza, Omotesando, Shibuya, and Shinjuku stood at JPY26,650 per tsubo in 1H/2017, up 3.3% over a year earlier. This growth was driven by Shibuya and Ginza, which saw YoY increases of 9% and 11% respectively. Omotesando non-1F rents declined 6% while Shinjuku was largely flat.

SUMMARY

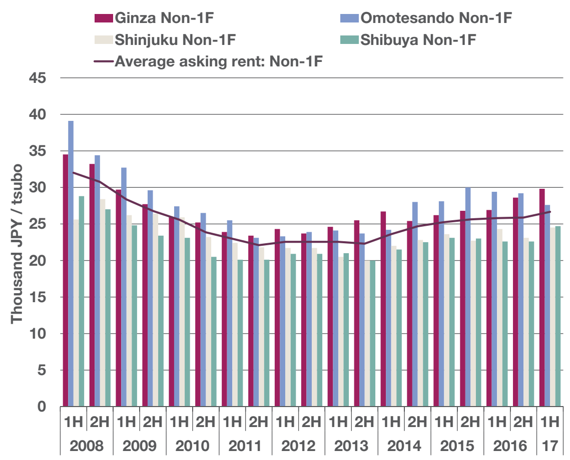
- Tokyo's average 1F retail rent has generally remained stable since 2016. There have been notable variations across submarkets, however.
- Non-1F rents continue their slow but steady trend upward.
- Prime street locations in Ginza, Omotesando, Shibuya, and Shinjuku continue to see high rents and almost no vacancy.
- Rapid development and expansion in some areas is shifting attention toward new, up-and-coming neighbourhoods.
- Drugstore and daily goods stores continue to outperform luxury, and are leading leasing demand.
- Investment volumes in retail have increased to JPY468 billion YTD and are on track to beat 2016's volumes but still fall short of 2013-2015 highs.
- Retail sales and consumer confidence are the highest in years.
- YTD tourist spending is up 15% from 2016 and has set a new all-time record.

GRAPH 1
Tokyo 1F rents, 2008–1H/2017



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

GRAPH 2
Tokyo non-1F rents, 2008–1H/2017



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

Submarket development

A slew of high-profile redevelopment and expansion is gradually redefining the structure of Tokyo's major districts.

Ginza

Ginza Six opened to shoppers in April and is operating full-swing. J Front Retailing disclosed that the facility generated 22 billion yen in sales revenue and attracted seven million visitors during the first four months of its operation. This puts it on track to meet its first-year targets. Though luxury consumption may have cooled, the facility's status as a prestige location and a tourist attraction should keep it popular with tenants.

Ginza Six appears to have contributed to Ginza area sales, and has also drawn additional crowds of tourists. The district is in the middle of a hotel boom – over 2,000 rooms are scheduled to complete between now and 2019. The resulting influx of tourists should generate more revenue for the area and help keep retail tenants healthy.

Ginza's neighbourhoods are undergoing a moderate change in character. More than any other district in Tokyo, Ginza has been historically notable for its high concentration of top-class apparel and luxury good stores. Ginza's tenant mix appears to be gradually diversifying, however, as luxury brands grow more cautious and sporting goods stores and other miscellaneous retailers seek to capitalise on the area's prestige and popularity with tourists. Sundry goods store Loft relocated its Yurakucho location to a three-storey space in Mitsui's newly refurbished Velvia-kan. Its prior space was absorbed by a Sports Authority and Muji, its previous upstairs neighbour.

Tokyo Midtown Hibiya, Mitsui's new premium-grade, mixed-use development near Hibiya Station, is scheduled to open in March 2018 with 18,000 sq m of retail space, including an 11-screen cinema. Though it is located beyond the Ginza submarket, the development could attract more attention to Ginza's western periphery. Western Ginza has seen some high-profile development in recent years, such as the opening of Tokyu Plaza Ginza in 2016, but it is still not as popular as Ginza's central districts between Chuo-dori and Namiki-dori.

Omotesando

Omotesando is seeing continuous store openings as it solidifies its position as perhaps Tokyo's trendiest high-street district among the 20-30 crowd. Omotesando 1F rents overtook Shinjuku 1F rents in late 2016 and remain elevated as new pop-up shops and onetime events compete for space.

Redevelopment continues apace around the district's western hub intersection of the main boulevard and Meiji-dori. Parco's Harajuku Zero Gate is scheduled to open in winter. The Jingumae Tower Building, the area's first Grade A office tower, opened in September and is already over 90% occupied. Tenants are mainly apparel and music companies, and office rents stand in the mid- to high-JPY30,000 per tsubo range. This is higher than the Shibuya ward average, despite the absence of other Grade A office buildings nearby.

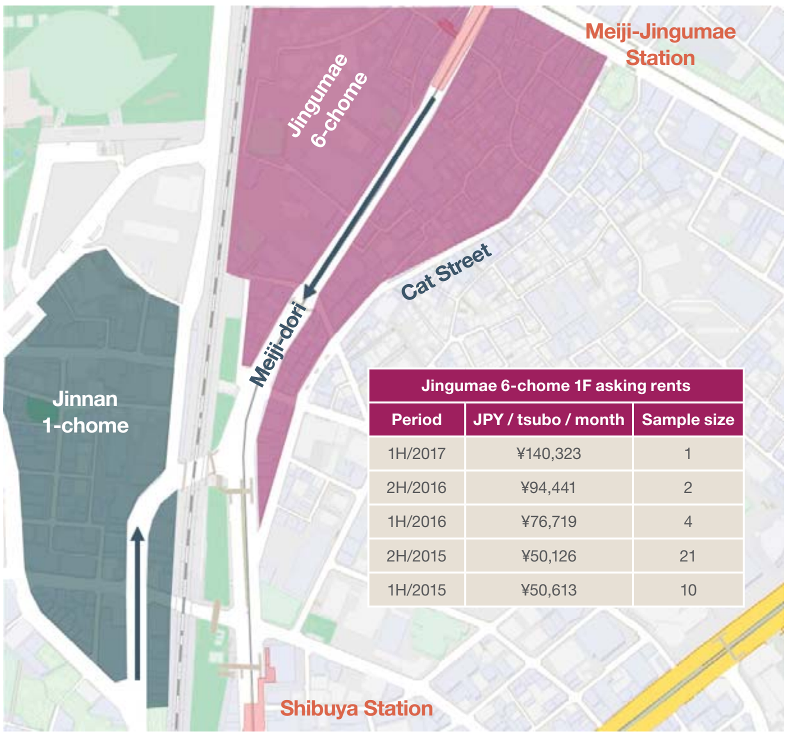
Omotesando's eastern Miyuki-dori area appears to be developing somewhat less quickly, perhaps due to its more homogeneous concentration of luxury apparel stores. Nevertheless it continues to attract significant foot traffic. Earlier this year Prada Holdings acquired the MM Aoyama Building, which houses Miu Miu, the group's casual brand. The Nikkei reported 1F rents in the building to be JPY240,000 per tsubo per month.

The north-south stretch of Meiji-dori connecting the Harajuku and Shibuya submarkets is one of Tokyo's most rapidly developing retail neighbourhoods. Popular apparel, F&B, and sundry goods stores are creeping further and further south from Harajuku and north from Shibuya's Jinnan neighbourhood. It is gradually becoming difficult to identify the border between the two submarkets.

A report by the Real Estate Economic Institute (REEI) and BAC Urban Projects states that 1F asking rents in Jingumae 6-chome, Harajuku's southernmost district, have averaged JPY63,000 per tsubo over the past five years. This has been dramatically pulled up over the past three halves, however – 1F rents reached JPY77,000 in 1H/2016, JPY94,000 in 2H/2016, and now JPY140,000 in 1H/2017 (Map 1). The report notes that a recent small sample size is also a factor, but

MAP 1

Convergence of Shibuya and Harajuku



Jingumae 6-chome 1F asking rents		
Period	JPY / tsubo / month	Sample size
1H/2017	¥140,323	1
2H/2016	¥94,441	2
1H/2016	¥76,719	4
2H/2015	¥50,126	21
1H/2015	¥50,613	10

Source: REEI, BAC Urban Projects, Savills Research & Consultancy this could be another indication of the area's rising popularity and declining availability.

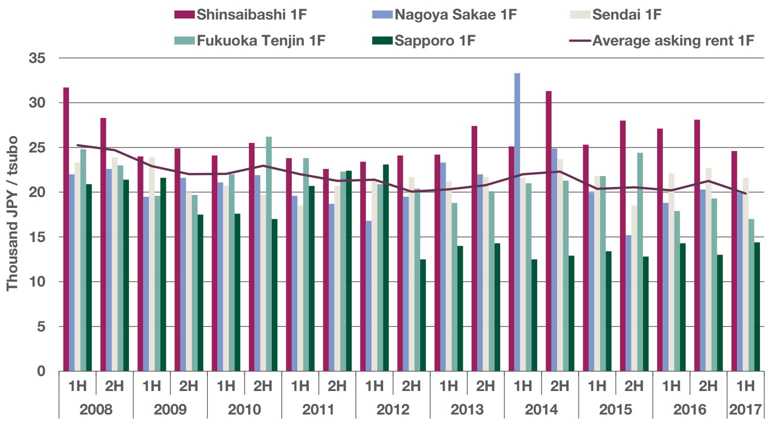
Shibuya's Jinnan area, situated across the train tracks from Jingumae 6-chome, is not developing as quickly, perhaps partially due to a shift in attention to the back streets of Harajuku.

Shinjuku
Shinjuku, meanwhile, possesses an eclectic mix of tenants and extremely high commuter traffic, making it a continuously competitive retail submarket. Redevelopment projects are proceeding along the area's central Shinjuku-dori street, where 1F rents frequently reach JPY150-200,000 per tsubo.

Mitsui's mixed-use Shinjuku 3-chome Project due in early 2018 and Mitsubishi Estate's Sendagaya 5-chome Project due in 2019 are two of the area's most high-profile construction projects. Shinjuku's most significant improvement, however, will come in 2020 when a passage connecting the east and west sides of Shinjuku Station opens.

Regional cities
Taken as a whole, regional 1F rents have been struggling. The average 1F rent across prime districts outside of Tokyo sat at JPY19,850 in 1H/2017, down 1.7% YoY and the softest reading since 2008. Regional retail rents saw upward momentum in 2013 to 2014, but have cooled in recent years as Osaka and Fukuoka trends weakened.

GRAPH 3
1F rents in retail districts of regional cities, 2008–1H/2017



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

At the submarket level, however, there is reason to be optimistic. 1F rents in Sapporo's Odori district, which has frequently dragged down the average, have risen 15% since 2012 and are now at their highest level since then. Nagoya's Sakae area also appears to have recovered from 2015 weakness and has seen YoY growth of 6%.

The MLIT's Land Value LOOK Report for Q2/2017 indicated continued strong commercial land price growth in Japan's major urban centres, especially in regional cities. Commercial land prices increased in 86 surveyed districts nationwide, remained flat in 14 districts, and no districts declined. Increases were more pronounced in regional cities than in Tokyo. Though central Tokyo saw growth, no commercial site increased by more than 3% over the quarter. Central districts in Osaka, Nagoya, Fukuoka, Sapporo, and Sendai, however, all increased between 3% and 6% over Q1/2017.

Macro indicators
The government's Consumer Confidence index has hovered near recent highs for virtually all of 2017. The index stood at a reading of 43.9 points as of September, up almost seven points from its trough of 37.0 following the 2014 consumption tax hike. Consumer sentiment has remained close to this high throughout the year.

Wages are slowly growing. The Ministry of Health, Labour, and Welfare's most recent monthly labour survey indicates that August wages

TABLE 1
Commercial land value increases, Q1/2017–Q2/2017

City	Area	+QoQ value growth
Tokyo	Ginza / Omotesando / Shibuya / Shinjuku	0%-3%
Osaka	Shinsaibashi	3%-6%
Osaka	Namba	3%-6%
Nagoya	Meieki	3%-6%
Nagoya	Sakae	0%-3%
Fukuoka	Hakata Station	3%-6%
Sapporo	Sapporo Station	3%-6%
Sendai	Chuo	3%-6%

Source: MLIT, Savills Research & Consultancy were up 0.9% YoY, the highest increase in the last 12 months. Earlier, in May, the survey reported that base pay notched 0.7% growth YoY, tied for the highest YoY increase since 1998. The number of part-time workers as a share of the total workforce has also declined slightly, which could result in a stronger and more secure labour market.

E-commerce

Market players are understandably concerned about the rapid development of online shopping, and its potential impact on Japanese retail tenants. There is no question that the e-commerce industry is growing in Japan, and that retailers must think creatively about in-store experience and other ways that a brick-and-mortar establishment can add value. That being said, Japanese retailers are enjoying some insulation from the global e-commerce zeitgeist for several reasons.

First, the logistics industry is facing several challenges, including labour shortages, cost increases, and last-mile bottlenecks (see our September 2017 Logistics Spotlight). These issues are starting to weigh on the expansion plans of large logistics companies.

Second, the Japanese population is relatively older than those of other countries – the median age is just over 45 – and hence typically more conservative. This slows adoption of new, technology-based shopping methods.

Finally, credit card usage is still relatively uncommon, especially outside of Tokyo, making it harder to shop online.

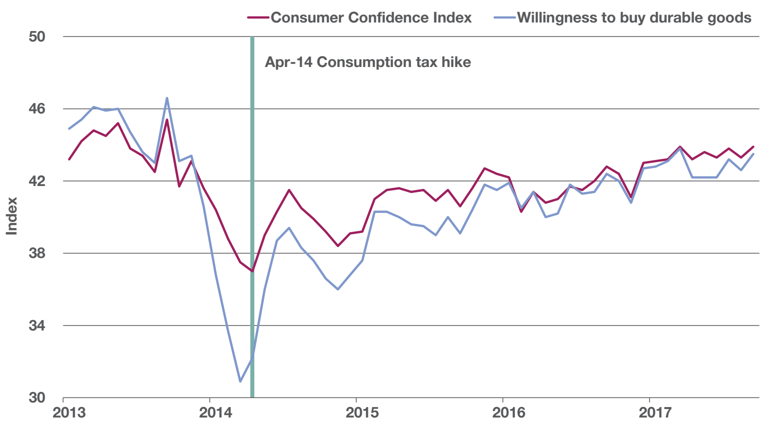
Drugstores outperforming

National retail sales have grown 1.8% YoY as of August. Though mild, this figure has held fairly steady for the past six months, and represents some of the most consistent YoY growth since the impact of the 2014 consumption tax hike.

Data from the Ministry of Economy, Trade, and Industry (METI) indicates that drugstore sales nationwide are up 5.7% YoY as of August, in line with growth for the preceding three years. Drugstores in the Greater Osaka and Greater Nagoya regions scored 8.7% and 7.1% growth respectively, outperforming the Greater Tokyo area's

GRAPH 4

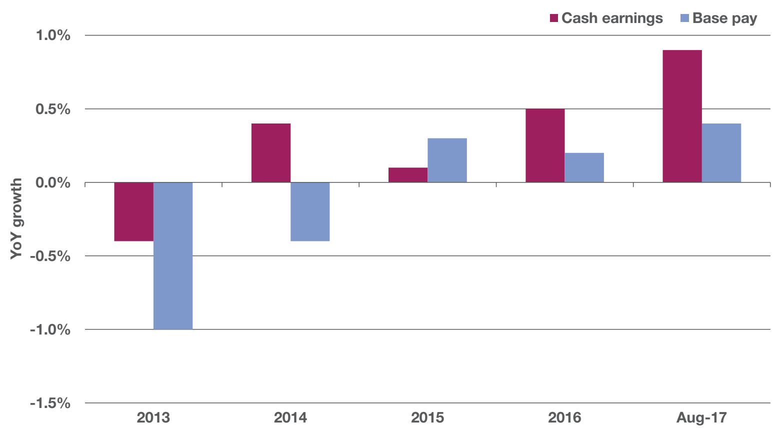
Japan consumer confidence, 2013–Sep 2017



Source: Cabinet Office, Savills Research & Consultancy

GRAPH 5

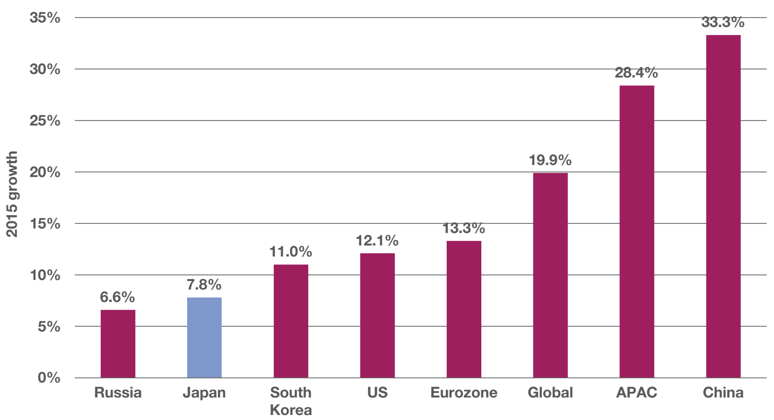
Nominal wage growth, 2013–Aug 2017



Source: MHLW, Savills Research & Consultancy

GRAPH 6

B2C e-commerce growth, 2015 YoY



Source: Ecommerce Foundation, Savills Research & Consultancy

4.7%. REEI reports that drugstores bidding for prime space are now often a main driver of 1F rental growth in some of Japan's major retail markets.

Sales growth in beauty products has typically outperformed growth in most other drugstore goods. Overall growth is likely driven both by an increase in elderly and health-conscious customers, as well as a switch in tourist spending from luxury goods to daily necessities. Japanese health products and cosmetics have a reputation for quality and safety, especially among visitors from other Asian countries. The especially strong increases in Osaka and Nagoya could be driven in part by greater tourist travel to regional cities.

Investment trends

Investment in retail property has picked up since 2016. Total YTD volumes amount to 468 billion yen through Q3/2017, according to preliminary data from Real Capital Analytics (RCA). This is up 9% compared to YTD Q3/2016. If the trend continues, investment will likely beat 2016 figures but still fall somewhat short of recent 2013-2015 highs.

Overseas buyers have accounted for a larger share of investment, almost doubling to 31% from a recent 5Y average of around 17% of total purchases. This is partially due to Blackstone's acquisition of Croesus Retail Trust for SGD901 million, or about 70 billion yen – roughly 15% of all YTD retail investment.

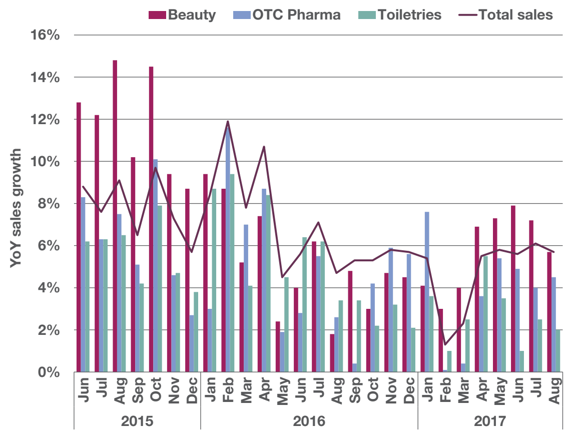
Continued low volumes stem in part from Japan's tight cap rates in core assets. A semi-annual survey by the Japan Real Estate Institute (JREI) revealed that expected cap rates for prime retail property in Ginza and Omotesando sat at 3.7% and 3.8% respectively in April 2017, unchanged from six months prior. This pause in compression offers core investors little relief, however, as ticket prices are still high and core buyers are having difficulty sourcing acquisitions.

Actual market cap rates are typically much tighter than those in JREI's survey. Two J-REIT acquisitions announced in 2017 have ranged as low as 3.4% on an appraisal NOI basis. Hulic incorporated 50% of its new prime Shibuya development Hulic &New into its public REIT at a cap rate of 3.4% in April. Since this was a transaction between related parties, it is reasonable to believe that a third party transaction price would be even sharper. Japan Retail Fund, meanwhile, has announced that it will obtain the G-Bldg. Jingumae 07 on 22 November at an appraisal NOI yield of 3.4%. The seller is an undisclosed domestic party.

Retail transactions in Osaka's Shinsaibashi neighbourhood are rumoured to have approached 3.0% flat, implying that prime Ginza cap rates could now be in the low-to-mid 2% range.

GRAPH 7

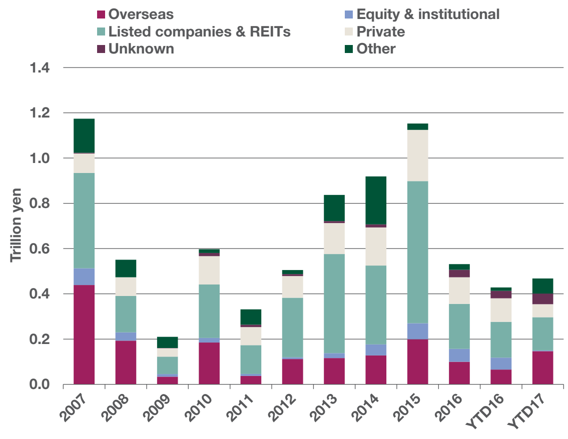
Japan drugstore YoY sales growth, Jun 2015–Aug 2017



Source: METI, Savills Research & Consultancy

GRAPH 8

Retail investment volume by buyer type, 2007–Q3/2017



Source: RCA, Savills Research & Consultancy

TABLE 2

Selected retail transactions, announced Q2/2017—Q3/2017

Announced	Property	Location	GFA (sq m)	Price (JPY bn)	NOI cap rate	Buyer
Sep 2017	Morisia Tsudanuma	Narashino, Chiba	105,491	18.0	5.8% (Appraised)	Nomura Real Estate Development
May 2017	Ito Yokado Shin-Urayasu	Urayasu, Chiba	57,621	14.25	3.8% (Appraised)	Domestic company
Sep 2017	Aeon Mall Shimotsuma	Shimotsuma, Ibaraki	58,403	9.55	6.6% (Appraised)	Aeon REIT
Jul 2017	Resona Obu Shopping Terrace	Obu, Aichi	24,093	7.91	5.2% (Appraised)	Hulk Property GK
Jun 2016	Merad Owada	Nishiyodogawa, Osaka	19,848	7.38	6.3% (Appraised)	Domestic company

Source: RCA, Nikkei RE, Savills Research & Consultancy

OUTLOOK

The prospects for the market

1F rental trends in Tokyo's major retail districts appear to be varying by submarket.

Ginza is still on top, but has calmed since 2014 and 2015 when tourist shopping sprees were overexciting the market. The opening of Ginza Six has consolidated many of the area's flagship luxury brands under one roof and attracted attention from shoppers, tenants, and investors. This explosion of high-end retail tenants may result in slower luxury tenant demand in the market over the next few years.

Omotesando is seeing rapid store openings, especially along back streets, and rental growth seems relatively resilient. New development is centred around the Meiji-dori intersection and tenant demand is spreading outward.

Rents in Shibuya and Shinjuku appear more stable as both areas await the impact of long-term, large-scale development projects. Shibuya will see continuous openings of new mixed-use facilities through 2020 and beyond, adding total GFA rivalling that of Roppongi Hills. Shinjuku, meanwhile, should benefit from infrastructure projects that improve access.

Retail rents in regional cities have not increased overall, but other macro indicators have exhibited strength. In recent quarters, commercial land values in prime regional areas have increased faster than they have in Tokyo, and rents in Sapporo and Nagoya appear to be recovering from prior weakness.

National consumer confidence and wage growth have both increased gradually and are stronger than they have been in years. Drugstores are performing especially well and are paying aggressive rents to secure platforms in popular areas.

Rapidly growing tourism continues to be a bright spot for the retail sector. On 18 October, the Japan Tourism Agency announced that total spending by tourists amounted to 3.3 trillion yen through Q3/2017, a 15% increase over the same period in 2016. This is the first time YTD Q3 spending surpassed 3 trillion yen. Per capita spending amounted to 165,000 yen, with especially high spending by Chinese, Vietnamese, English, and French tourists. Tourism growth should continue, offering upside to well-positioned facilities.

Investment volumes have picked up from 2016's stale performance, but tight yields are still weighing on volumes. As in Tokyo's office market, there is a great deal of capital chasing opportunities, but high prices are making it difficult to source deals in core areas. Ultra-low borrowing costs as well as the stable nature of the market, however, still make Tokyo retail an attractive market.

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