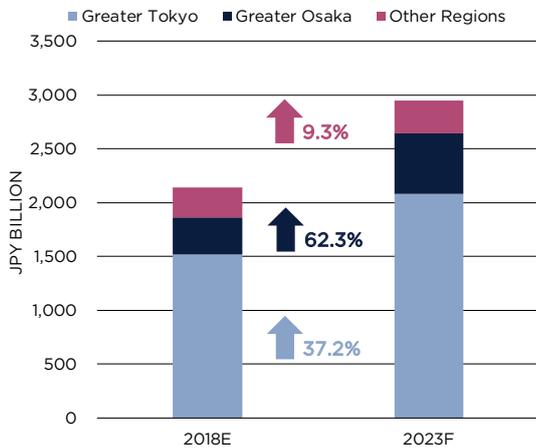


Tokyo Data Centres



An unforeseen tailwind for an already promising sector

GRAPH 1: Forecast Data Centre Services Market Value By Region, 2018 vs. 2023



Source Fuji Chimera Research Institute, Savills Research & Consultancy

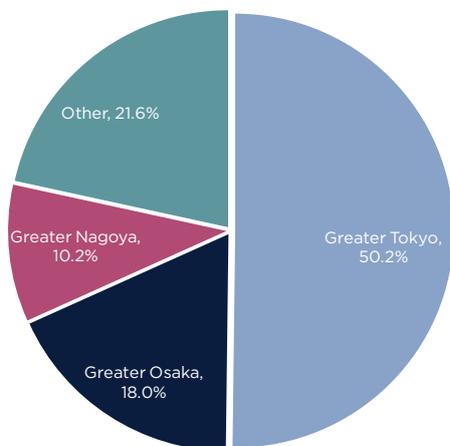
EMERGING FROM A (SOFT) LOCKDOWN

Since early April, Japan's top metropolitan areas have been under a state of emergency – marked by partial business closures and advice to avoid unnecessary outings. Indeed, Tokyo's lockdown is little more than a government recommendation, carrying no legal weight. Even so, residents and businesses are generally abiding by the Metropolitan Government's guidelines. A full lockdown has been avoided, but the damage is clear and will likely continue for some time after the state of emergency is lifted in late May and the pandemic comes under some measure of control. Inbound tourism has been an important demand catalyst for the hospitality and retail sectors, and overseas visitors are unlikely to return anytime soon. The residential and logistics sectors, on the other hand, appear to be among the most poised to weather the pandemic and its aftermath.

Although we can do little more than speculate as to what Tokyo's "new normal" will look like post-pandemic, workstyles are likely to change. As such, the office sector, while likely to fare much better than hospitality and retail, arguably has a more uncertain future than before. Companies may look to reduce their headcount at offices in Tokyo's central five wards, favouring teleworking and satellite offices - a reversal of the consolidation trend observed over the past several years. On the other hand, in keeping with some form of social distancing, firms may seek to increase the amount of office space per employee and, as a result, requirements for floor space in the CBD may not drop significantly. With all asset types likely to undergo a transition of some form, emerging sectors with growing demand such as data centres and healthcare facilities should have their moment in the sun.

“ Considering the proliferation of internet usage and the advent of 5G, Japan's data centre market was already primed for rapid expansion. The COVID-19 pandemic looks set to accelerate this trend as domestic firms are compelled to modernise their IT infrastructure. ”

GRAPH 2: Regional Allocation Of Data Centres, 2020



Source Japan Data Centre Council, Savills Research & Consultancy

TOKYO DATA CENTRES

Despite the uncertainties discussed above, given the tangible changes that were already underway before the COVID-19 outbreak, Japan's data centre market looks set for significant growth over the next few years (Graph 1). The market has traditionally been very insular, dominated by domestic systems integrators and IT companies such as Fujitsu, Hitachi, Mitsubishi Electric and NEC. Recently, driven by the expansion of global cloud services into the country, major international data centre firms have been making forays into the sector and the momentum has accelerated during the pandemic.

Greater Tokyo is not surprisingly Japan's top data centre market and Inzai City, Chiba, has emerged as a hub for large-scale data centres servicing the region (Graph 2). Colt DCS, for instance, has a campus with two facilities in the area and is planning to complete a third - its largest facility in Japan - by the end of 2020. Equinix, having leased most of its properties to date, is developing its first owned-facility in Chiba and appears set to acquire more land for development.

COVID-19 COMPELS SYSTEM MODERNISATION

COVID-19 has served as an abrupt wake-up call for Japan Inc, which has previously been hesitant to adopt remote-working solutions. Even among those that have implemented such measures, employees have rarely taken the option to do so. For instance, a survey of workers conducted by the Tokyo Metropolitan Government in July 2019 (Graph 3) demonstrates that only 12.1% of respondents had any experience working from home over a one-year period.

Compounding this situation, Japanese firms – particularly SMEs - have been slow to modernise their IT environments, with many still relying on in-house systems and servers. The sudden need to accommodate teleworking arrangements

should lead to a significant boost in demand for external options, such as cloud-based platforms and server co-location services.

JVS PAVING THE WAY

Identifying available land that also has access to the appropriate energy and fibre-optic infrastructure remains a key challenge. This has been a roadblock for major cloud providers in particular, as they generally prefer to develop and operate their own out-of-the-box facilities. Instead, they have had to rely heavily on third-party colocation centres to deploy and strengthen the capacity of their cloud regions. Even major colocation operators such as Equinix have largely leased their Japan facilities from domestic corporates.

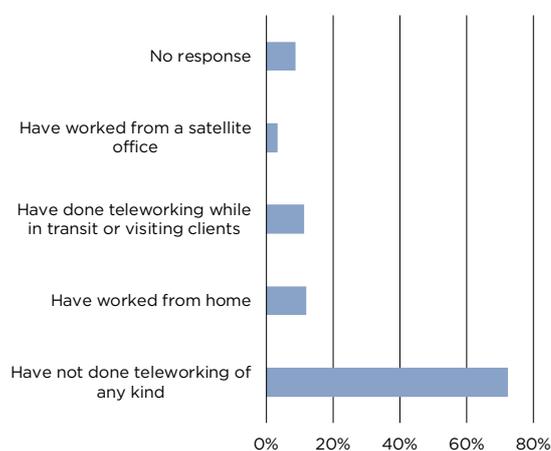
Joint-ventures with entities that have existing platforms in Japan appear to be the new modus operandi for operators looking to secure hard assets and property investors aiming to get a slice of the pie. In 2017, Digital Realty announced a 50/50 joint-venture with Mitsubishi Corporation to begin acquiring land and developing their own facilities. Similarly, Equinix's new 1 billion dollar tie up with GIC marks a shift in its strategy from leasing to acquisition. Further, other recently established joint ventures and newly merged organisations in the Asia Pacific region are now rumoured to be targeting Japan, along with overseas service providers and operators.

OUTLOOK

Indeed, investment in the Tokyo data centre market has been limited thus far due to a persistent lack of opportunities for buyers. Even so, enquiries from institutional investors regarding the sector have picked up dramatically since the onset of COVID-19 – given that the crisis has been an accelerant for the global digitisation trend. As major overseas operators shift to a development strategy in Japan, we may soon see a market where more institutional investors can deploy capital.

Looking ahead, demand for data centre capacity in Japan at large and Tokyo in particular should continue to outstrip supply. As such, regardless of the current hurdles to investment, with cloud operators expanding aggressively in Japan and 5G technology on the horizon, demand fundamentals should remain strong.

GRAPH 3: Teleworking Experience Over the Past One-Year (As of July 2019)



Source Tokyo Metropolitan Government, Savills Research & Consultancy
Note: Survey conducted by the Tokyo Metropolitan Government by randomly selecting 10,000 firms in Tokyo Prefecture with at least 30 full-time employees, and randomly selecting two employees from each firm (20,000 total). Of these, 3,798 people submitted responses.

TABLE 1: Recent Ventures and Industry Operators Targeting Japan

VENTURE PARTNERS	VENTURE TYPE	INITIAL COMMITMENT	ANNOUNCED	TARGET MARKET
Equinix / GIC	JV	>US\$1.0 Billion	Apr 2020	Japan (Mainly Tokyo & Osaka)
AirTrunk / Macquarie	M&A	-	Jan 2020	Asia Pacific (Japan rumoured)
Digital Realty / Mitsubishi	JV	US\$350 Million	Oct 2017	Japan (Mainly Tokyo & Osaka)
INDUSTRY OPERATORS	BUSINESS TYPE	INITIAL COMMITMENT	ANNOUNCED	DISCLOSED ACTIVITY IN JAPAN
Inspur	Server manufacturing	US\$9.3 million	May 2020	Established local entity
NextDC	Colocation services	Not disclosed	Aug 2019	Launched office in Tokyo

Source Various media, company disclosures, Savills Research & Consultancy

TABLE 2: J-REIT Data Centre Acquisitions in Greater Tokyo

PROPERTY	LOCATION	PRICE	CAP RATE AT ACQUISITION	BUYER	TRANSACTION DATE
MFIP Inzai (80%)	Inzai, Chiba	JPY10.3 bn / US\$95.5 mn	4.70%	Mitsui Fudosan Logistics Park Inc.	Feb 2019
MFIP Inzai (20%)	Inzai, Chiba	JPY2.2 bn / US\$20.6 mn	5.40%	Mitsui Fudosan Logistics Park Inc.	Aug 2016
IIF Shinagawa IT Solutions Center	Shinagawa, Tokyo	JPY7.2 bn / US\$67.3 mn	5.00%	IIF Investment Corporation	Mar 2015
Chiba Network Center	Inzai, Chiba	JPY7.0 bn / US\$65.4 mn	5.30%	Hulic Reit Inc.	Dec 2014
Tabata Network Center	Kita, Tokyo	JPY1.4 bn / US\$13.0 mn	5.40%	Hulic Reit Inc.	Feb 2014

Source Company disclosures, Savills Research & Consultancy

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