

Japan - March 2021

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SPOTLIGHT
Savills Research

Japan Logistics



Logistics sector going strong

Summary

- Demand for logistics facilities in Greater Tokyo has again outpaced supply, and vacancy rates have dropped to record-low levels of 0.2%.
- Vacancy rates in Greater Osaka have remained at 2.8%, with demand catching up to the high levels of supply seen in the first half of 2020.
- High levels of rental growth seen previously in Greater Tokyo have slowed down to 0.9% YoY. However, rents in certain areas have still shown a disproportionate increase.
- Average rents in Greater Osaka have breached the JPY4,000 barrier, following a YoY increase of 7.5%.
- 2020 saw the highest proportion of investment into the logistics sector, signifying the increased interest with somewhat overheated valuation that the sector has gained during the pandemic.
- Modernised logistics facilities with increased automation capabilities and employee amenities that can attract both workers and high-profile tenants are expected to remain popular in the logistics sector as it had been facing a labour crunch.
- The inequality of the financial capabilities between burgeoning e-commerce tenants and the struggling retail tenants can be expected to grow, which will likely shape the growth of the sector.

INTRODUCTION

The logistics sector has reigned supreme during the COVID-19 era. Despite the adverse impact that the global pandemic has had on other sectors, rents have stayed strong and vacancy levels remain at all-time lows. The shift in consumer buying patterns from traditional retail stores to online retail was expedited by the pandemic, and this has in turn led to an increase in demand for warehouse space to better facilitate inventory management as some companies adapt to higher e-commerce volumes. Indeed, the

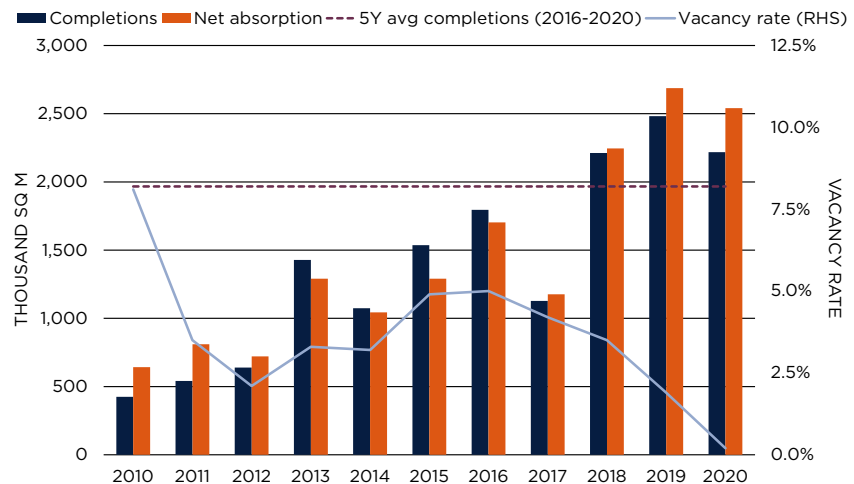
pandemic has served as a tailwind for the logistics sector, and growth looks promising with high levels of investment pouring in.

MARKET TRENDS

The strength of the logistics sector has held steadfast in the past year. Vacancy rates in Greater Tokyo are at all-time low levels of 0.2%, tightening 1.7 percentage points (ppts) year-on-year (YoY) despite the high levels of supply entering the market in recent years.

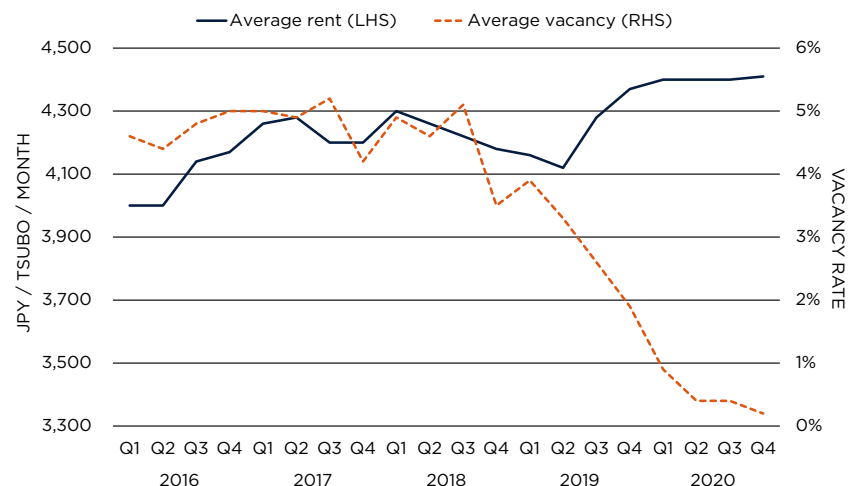
The low vacancy levels can be attributed to strong pre-leasing activity in both the bay

Graph 1: Supply, Net Absorption And Vacancy In Greater Tokyo, 2010 to 2020



Source Ichigo Real Estate Service, Savills Research and Consultancy
Note: Annual periods from February to January. Vacancy rates are as of the year end for each annual period, while the rate presented for 2020 is as of January 2021.

Graph 2: Greater Tokyo Rent Vs Vacancy, Q1/2016 to Q4/2020



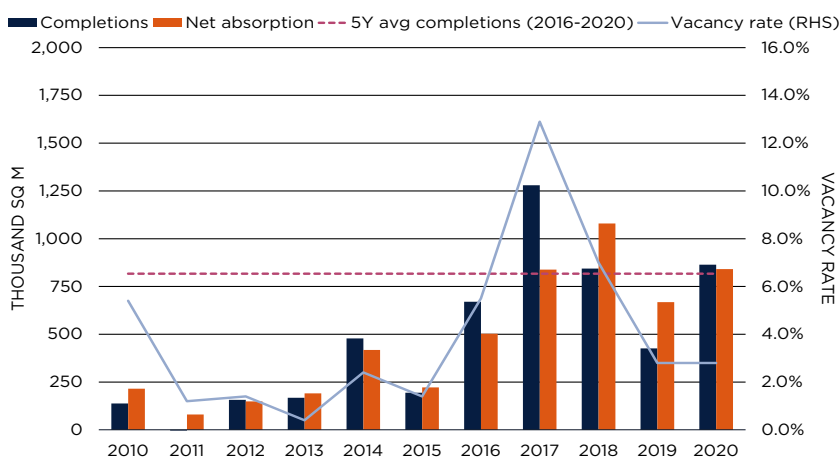
Source Ichigo Real Estate Service, Savills Research and Consultancy
Note: Annual periods from February to January.

area as well as inland areas, and it is worth noting that net absorption levels have been consistently higher than new completion levels since 2017. This trend has been bolstered by the pandemic accelerating the rise of online shopping which has consequentially boosted the demand for warehouse space. Hence, the surge of supply expected in 2021 appears welcome in the current market.

In alignment with prevailing robust market conditions, rents in the Greater Tokyo area have exhibited growth of 0.9% YoY, and currently stand at JPY4,410 per tsubo. For instance, asking rents in Kanagawa have surpassed JPY5,000 per tsubo, reaching record-high levels. Notable rent increases have also been observed in regions of Chiba. However, while rents maintain record levels, growth appears to have slowed since 2020, suggesting an affordability threshold

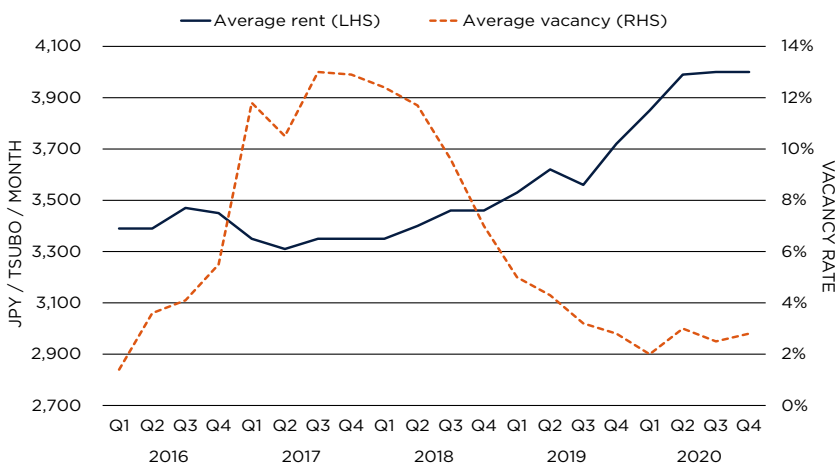
2020 was another milestone year for the logistics sector, with rent and occupancy levels both improving further, and many parties increasingly eager to gain exposure to the growing sector. While the interest pouring into the logistics sector appears to have skewed some valuations upward, its fundamentals remain sturdy.

Graph 3: Supply, Net Absorption And Vacancy In Greater Osaka, 2010 to 2020



Source: Ichigo Real Estate Service, Savills Research and Consultancy
Note: Annual periods from February to January. Vacancy rates are as of the year end for each annual period, while the rate presented for 2020 is as of January 2021.

Graph 4: Greater Osaka Rent Vs Vacancy, Q1/2016 to Q4/2020



Source: Ichigo Real Estate Service, Savills Research and Consultancy
Note: Annual periods from February to January.

has been reached for some industries.

Nevertheless, the market still shows promise with some areas showing marked increases in rents.

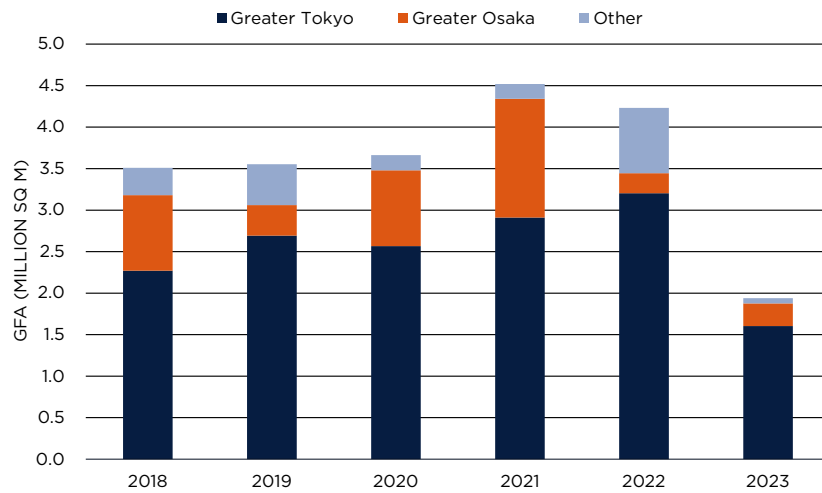
Similarly, in Greater Osaka, market fundamentals within the logistics sector have stayed strong. Vacancy rates have remained at levels of 2.8%, having increased slightly from the past quarter. Nonetheless, 2020 has still overall hosted the lowest vacancy levels in the region. Supply in Greater Osaka has cooled slightly in 2H/2020, allowing net absorption levels to catch up, and thus levelling demand with supply. Furthermore, average rent levels in the Greater Osaka region have breached the JPY4,000 per tsubo barrier for the first time, increasing by 7.5% YoY. In fact, rents have risen considerably over the past two years, growing 15.6%. Indeed, the Greater Osaka market has strong winds in its sails, and with preleasing activity for upcoming supply going smoothly, the region's outlook appears favourable.

INCOMING SUPPLY

There was no slowdown in Greater Tokyo supply during 2020 despite multiple consecutive years of increased volumes, and completed projects delivered only marginally less space than in 2019 - a record year. Some of the completions in 2H/2020 were of significant scale¹, and the largest addition to the region was the Goodman Business Park - East Gate in Chiba completed in October 2020. The 4F facility boasts an NRA of over 111,000 sq m and is already fully leased. Developed by Goodman Japan, the facility was the fourth stage of the Goodman Business Park series, with a fifth project

¹ Defined as exceeding 100,000 sq m in GFA

Graph 5: Annual New Supply* In Japan By Region, 2018 to 2023F



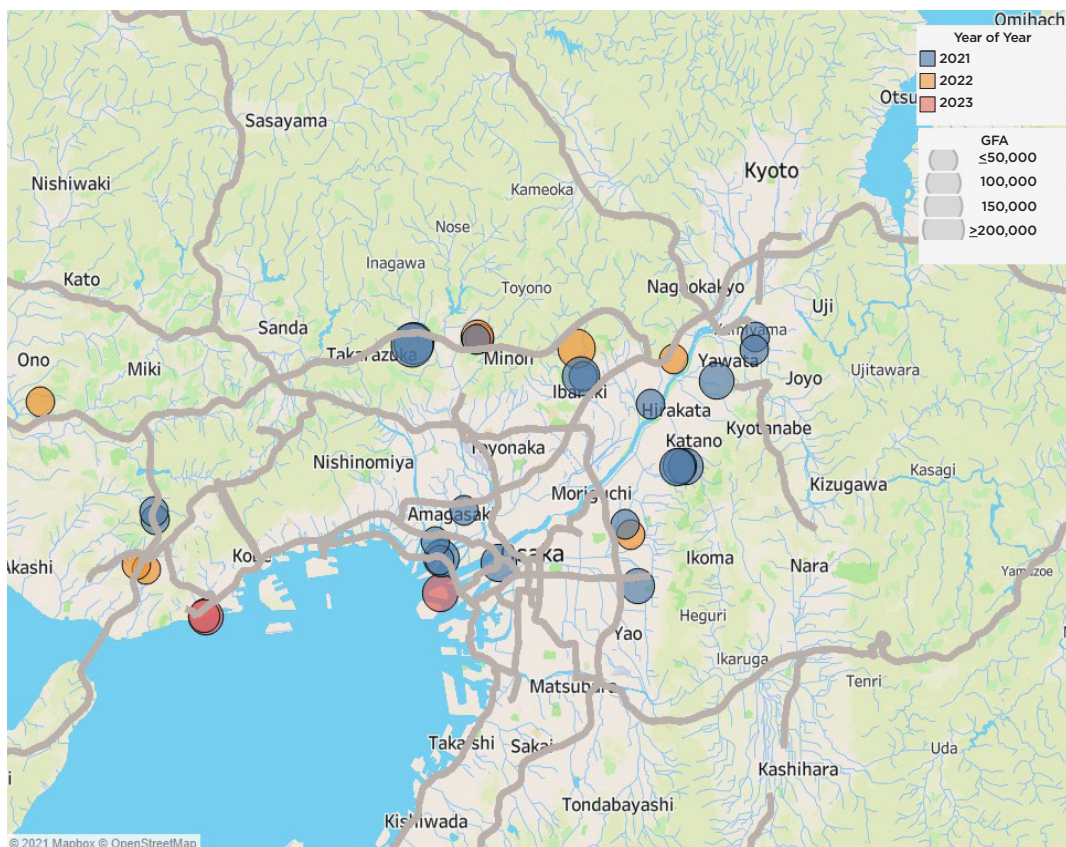
Source Ichigo Real Estate Service, Savills Research and Consultancy
 * Projects in 2022 and beyond tend to be added later once details are ready to be announced. The data provided by Ichigo only considers facilities with GFAs > 10,000 sq m and is as of 31 January 2021.

expected to be completed in mid-2021. Another large contender recently entering the market was the DPL Nagareyama III, developed by Daiwa House Industry. With an NRA of over 100,000 sq m, the facility is the second largest to have been built in 2020 by the developer.

Greater Tokyo is also looking forward to high levels of supply in the coming years. In fact, 2021 and 2022 are already forecast to have supply levels that surpass that of 2020. Looking closer, 2022 supply is forecast to be at a record level of greater than 3 million sq m, with fifteen projects of significant scale already announced. Vacancy levels of completed facilities in the area are at all-time lows, and therefore these high levels of supply should satisfy some of the current demand.

Like its counterpart, Greater Osaka is also looking forward to high levels of supply, with 2021 levels forecast to surpass its previous record, set in 2017. In addition to the Prologis Park Inagawa 1 and 2, expected to bring in a total of more than 370,000 sq m of GFA, there are other multiple projects of significant scale in the 2021

Map 1: Upcoming Completions in Greater Osaka, 2021 to 2023*



Source Ichigo Real Estate Service, Savills Research and Consultancy
 *Projects where GFA and/or completion date are unavailable are omitted from the dataset. New supply data as of 31 January 2021.

pipeline, including those from LOGISTA, LOGIFRONT and SOSiLA.

Recently, an increase in the number of upcoming inland logistics facilities that are located close to major expressways like Hanshin and Meishin has been observed. These areas provide convenient access to the transport network in the Kansai region of Japan, and such locations are likely to increase in popularity going forward.

Indeed, infrastructure development, as well as land readjustment projects have made more regions viable and available as suitable locations for logistics centres. Moreover, the strength of the sector has afforded developers the financial

capability to afford the higher land prices of more convenient locations that were previously unavailable. Given these factors, and the shorter lead time for logistics development, supply and demand may shift into equilibrium sooner than some market participants anticipate.

INVESTMENT TRENDS

With 2020 centred on the global pandemic, it was a challenging year for the real estate industry. According to data aggregated by Real Capital Analytics (RCA), overall yearly investment volumes in Japan have fallen more than 20% YoY to the lowest levels seen since 2012. However, this decrease was

unevenly distributed towards the hospitality and retail industries, with the two sectors bearing the brunt of the impact from the global pandemic. On the other hand, the logistics sector has emerged as one of the winners, with the drawn-out pandemic only appearing to have boosted it. While overall inflows in 2020 are around 10% lower than the record high volumes that 2019 had achieved, they are still more than 30% higher than 2018 volumes. Furthermore, 70% of the 2020 transaction volume occurred in 2H/2020, signalling a strong end to the year and providing the momentum for 2021.

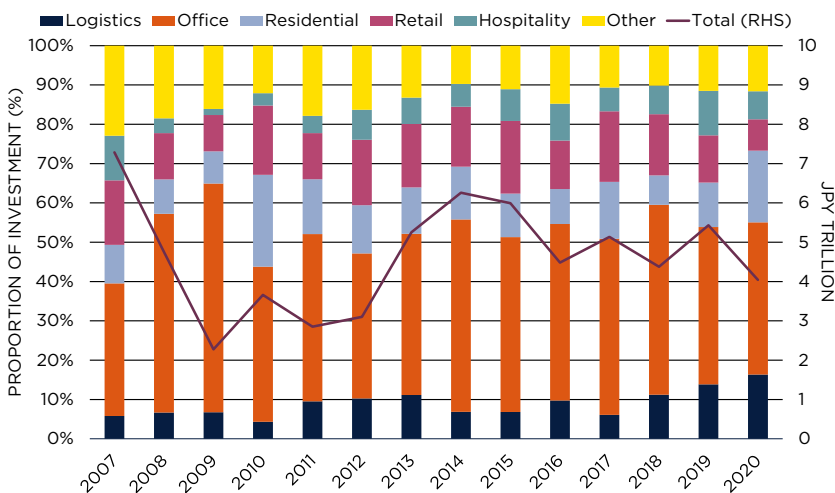
Many large companies had a busy second half of the year. GLP Japan Income Fund with US\$5.4 billion AUM completed its second round of fundraising. Elsewhere, Daiwa House Industry has also started to consider the establishment of a JPY300 billion logistics fund, funnelling additional capital into the market.

Cross-border investment was also active. ESR announced the development of ESR Higashi Ogishima DC that will be built in two phases, each with a GFA of over 300,000 sq m, completed in 2023 and 2025. Furthermore, Mapletree will be investing JPY43 billion to build two logistics facilities in Fukuoka prefecture, forecast to be the largest facilities in the Kyushu region, to be completed in 2023 and 2024.

Moreover, multiple headline transactions were also observed in 2H/2020 within the J-REIT space. Notable deals include GLP J-REIT's acquisition of seven logistics facilities in December for JPY98.2 billion, REIT Mitsui Fudosan Logistics Park's acquisition of two logistics facilities in October for JPY77.4 billion, and LaSalle Logiport REIT's acquisition of four logistics in September for JPY76.5 billion. The second half of 2020 was indeed a busy period for the hottest sector of the year, as supported by the strong J-REIT unit prices. The J-REIT market has rapidly recovered year to date, and logistics J-REITs will likely remain active this year.

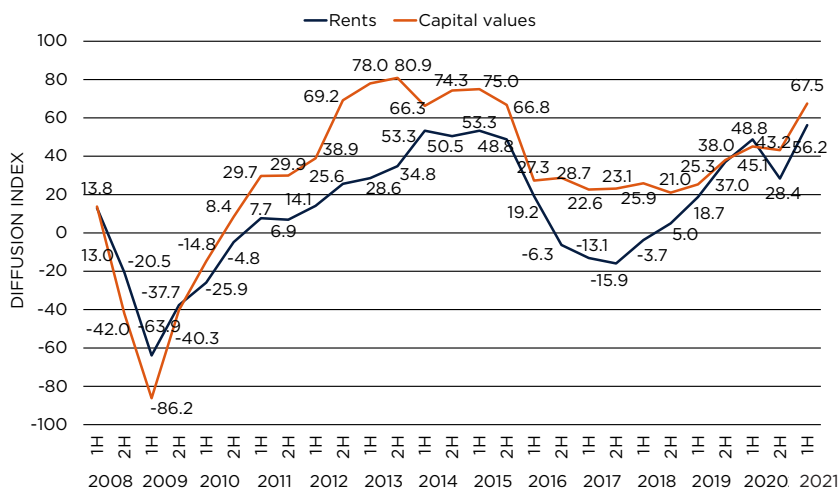
Indeed, with the high volume of large transactions and amount of investment pouring into the market, it is unsurprising that investor confidence levels should be high. The 27th bi-annual survey market sentiment conducted by Ichigo Real Estate Service echoes this opinion, with expectations of rent and capital appreciation increasing by 27 points and 23 points respectively, the largest jump since 2012. Understandably, investors have upgraded their views given the strong market fundamentals and the high level of activity around. 2021 so far has ticked many boxes required for us to expect a promising year for the logistics sector.

Graph 6: Share of Investment Volumes By Asset Class, 2007 to 2020



Source RCA, Savills Research and Consultancy

GRAPH 7: Six-month-ahead Expectations For Rent And Capital Appreciation, 2008 to 1H/2021



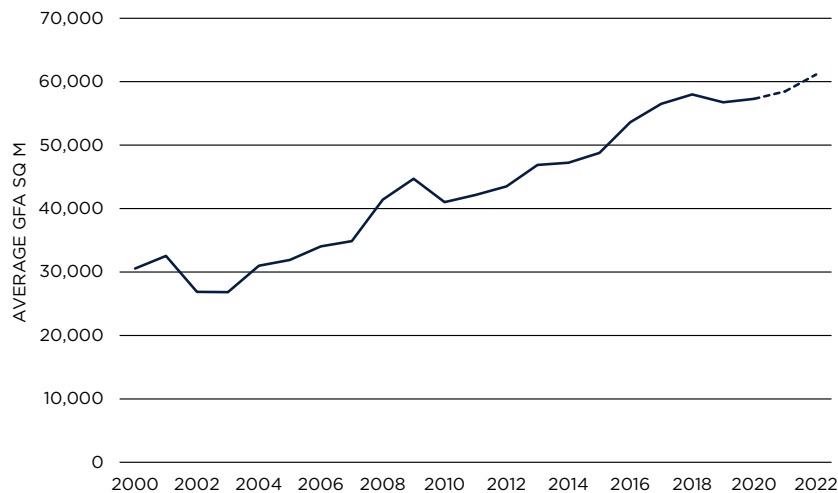
Source Ichigo Real Estate Service, Savills Research and Consultancy

Table 1: Selected Investments, Announced August 2020 to February 2021

PROPERTY NAME	TRANSACTION VALUE (JPY MIL)	APPRAISAL DIRECT CAP RATE	BUYER	SELLER
GLP Logistics Portfolio (3 facilities)	98,230	3.7% to 4.3%	GLP J-REIT	SPCs of Sumitomo Mitsui Financing and Leasing
MFLP Portfolio (2 facilities)	77,400	4.0% to 4.1%	MFLP REIT	SPC of Mitsui Fudosan
LaSalle Logiport Portfolio (4 facilities)	76,500	4.0% to 4.5%	LaSalle Logiport REIT	Various
Prologis Portfolio (3 facilities)	62,200	4.3% to 4.6%	Nippon Prologis REIT	SPC of Prologis
Cross Gate Shinsuna Data Centre	22,000	n/a	AXA Investment Managers	Dream Private REIT

Source J-REIT Disclosures, Company Disclosures, Nikkei RE, Savills Research and Consultancy

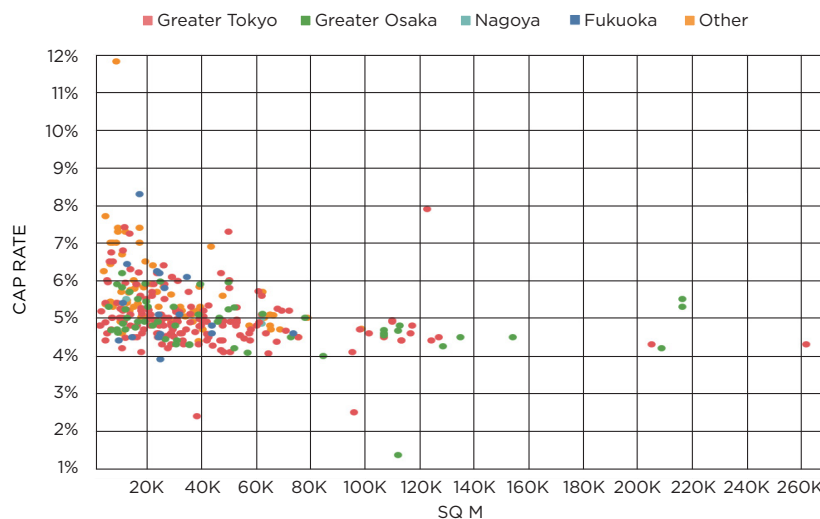
Graph 8: Average GFA Of Newly Built Logistics Facilities, 2000 to 2022*



Source RCA, Savills Research and Consultancy

*The average GFA is calculated as a 5-year moving average of logistics facilities larger than 1,000 sq.m. Data for 2021 onwards is based on the projected GFA of facilities that have been publicly announced.

Graph 9: Cap Rate Vs GFA Of Transacted Logistics Properties, 2016 to 2020*



Source RCA, Savills Research and Consultancy

* Only publicly announced transactions larger than JPY1 billion are included.

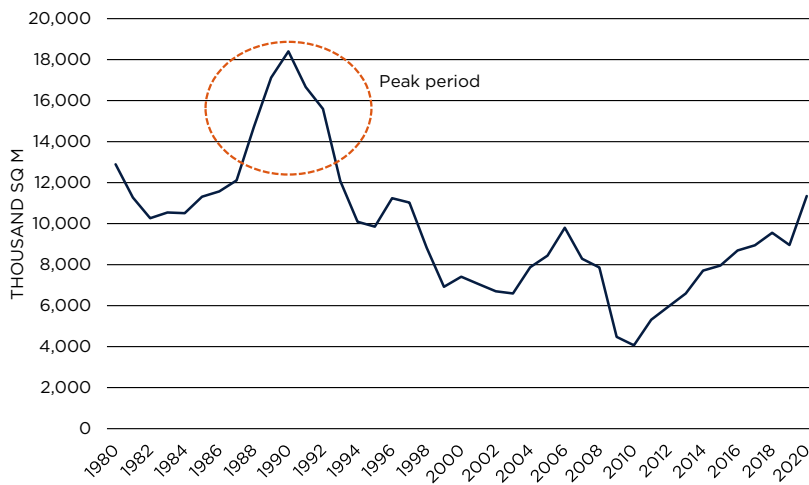
THE EVOLUTION OF THE LOGISTICS SECTOR

The Japanese logistics sector has enjoyed unprecedented growth over the past decade with an ever-increasing appetite for logistics space boosted by structural changes, including the growth of e-commerce. While the overall amount of new supply entering the market has risen rapidly in the past decade, facilities themselves have also undergone transformations to match the new logistics paradigm.

For instance, the declining population and low levels of unemployment in Japan has led to a persistent scarcity of labour, although the impact of COVID-19 has admittedly created some leeway in the labour market. In order to accommodate this, recent logistics facilities have become increasingly automated with advanced robotics and computerised racking systems. These newer facilities have a sharper competitive edge and have the potential to poach tenants from older buildings. Moreover, newer state-of-the-art logistics facilities may also come with additional amenities such as children day-care centres, as well as being equipped with feature such solar panels that will help attract high-profile clients.

Another noticeable trend that has taken place is the increase in size of newer facilities. From 2000 to 2020, the average size of newly built facilities has almost doubled. Larger facilities allow for increased economic and operational efficiency by maximizing land utilisation by building upwards, as well as allowing more space for automatic systems. Notably, the size of facilities does not seem to dramatically affect transaction cap rates. On the other hand, there may be two major drawbacks of large logistics facilities. The first would be maintaining the large workforce required to operate the facility in a country suffering from a labour-deficit. The second would be an increase in road traffic in certain areas around the facilities.

Bolstered by the pandemic, 2020 saw a 25-year high for new logistics facility construction starts to meet the increased demand for logistics space that arose from the boom in e-commerce, and high levels of supply are expected in upcoming years. However, according to data from the Ministry of Land, Industry, Transport and Tourism, the number of new logistics facility construction starts in recent years was only approximately half of Japan's previous peak periods, and even the 2020 levels draw pale in comparison. Therefore, as a vast majority of the current logistics stock was built decades ago, there appears to be a notable gap between the demand for facilities that can meet the various needs of tenants and the supply available in the market, meaning that there is still room for even more modernised logistics facility space to enter.

GRAPH 10: New Logistics Facilities Construction Starts, 1980 to 2020

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

OUTLOOK

The momentum that the logistics sector had built up was not lost in the second half of 2020. Despite record levels of supply entering the market in major areas, the demand for logistics facilities has kept up with or even superseded the new supply. This robust demand encouraged high levels of investment, crowning it the most popular sector of 2020.

However, while the sector as a whole has undoubtedly seen growth, there are stark differences between the strength and growth of the industries directly related to the sector. For instance, e-commerce had been on the rise, and the pandemic seems to have only spurred the growth of the sector further. Conversely, the global pandemic has greatly impacted the retail sector's decline. To wit, not all is equal within the logistics sector

itself; while the victors of the global pandemic have thrived, those on the other end of the spectrum are still hurting. As a result, slower rental growth can be expected in some areas, particularly after the strong growth already seen in the sector.

Given the robust fundamentals of the sector, both existing and new investors are enthusiastically seeking development and acquisition opportunities. Competition for attractive opportunities has intensified, pushing up prices for development land and compressing cap rates for stabilised assets. This in turn is increasing the pressure on developers and investors to seek higher rents, potentially testing affordability, and risking a slowdown in demand from some occupier segments. Notwithstanding, with current record-low vacancy in the sector, continued rental growth is expected, albeit at more moderate rates. Near-to-mid-term prospects for the sector therefore remain buoyant, although given the heated market environment some level of caution may be wise.



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