2021 Review and 2022 Prospects

SPOTLIGHT
Savills Research

Japan - December 2021
INTRODUCTION

Almost two years have passed since the onset of the pandemic in early 2020. During 2021, many sectors were weakened by rental corrections and vacancy increments, and the rollercoaster of COVID-19 cases accompanied by the delayed vaccination rollout added an additional layer of uncertainty into the Japan market. Despite the rocky start into the year, the property market has remained strong overall in Japan. Indeed, with its political and social stability, attractive borrowing options, and market depth, Japan's market shines more when there is uncertainty, and has remained popular with investors. In fact, the Urban Land Institute ranked Tokyo as the city with the most investment prospects for 2022 in Asia Pacific.

While vaccinations in Japan saw initial delays, the vaccine rollout was expedited in the second half of 2021, and approximately 80% of the population is fully vaccinated – one of the highest in the world. The number of cases of COVID-19 has plummeted in Japan, and the country looked set for a recovery in economic growth. However, while there are no significant risk factors specific to Japan at present, the Japanese economy faces multiple challenges tied to the world economy on its road to recovery and normalcy.

On a global level, the recently discovered Omicron variant has rekindled discussions about extending various restrictions. While a V-shaped recovery was initially expected when emerging from the pandemic, new variants has slowed this down, and the Omicron variant may have severe forthcoming implications on recovery. Furthermore, labour participation rates, especially those from the elderly and women with young children, are not expected to recover in the near term, further dampening output and consumption.

In the Asia Pacific region, China's rising debt levels have received more attention with the Evergrande crisis, which has the potential to destabilise or slow down the economy. Moreover, China is also facing an energy shortage stemming from increased coal prices and environmental regulations. These predicaments are likely to impede the country’s growth overall, and which will have spillover effects on the world.

Elsewhere, there are strong concerns regarding the tapering of asset purchases by central banks, and worldwide interest rate hikes are a possibility in order to reduce liquidity in the market and curb inflation. This may have a negative effect on equity markets which will likely consequentially impact the real economy. Moreover, some geopolitical tensions to divert domestic attention may rise as an indirect result of this economic slowdown, adding more uncertainty into global markets.

Despite the hurdles that Japan may encounter, there are also some tailwinds for the real estate sector. For instance, fixed income investments generally have nominal yields at present, making real estate an attractive alternative that has higher expected returns and provides portfolio diversity. Considering that pension fund portfolios in Asia Pacific still have a very low proportion of alternative investments - around 3.4%, according to research conducted by the Thinking Ahead Institute, the allocation for real estate can further expand. Furthermore, according to Preqin, in early 2021 private equity firms were sitting on around US$350 billion worldwide to spend on real estate. These targets and the large amount of funds available should provide an ample amount of dry powder for the Japanese real estate sector, which has maintained its popularity throughout the pandemic.

Furthermore, Asia Pacific has overall managed the pandemic well with a subdued number of COVID-19 cases, and members of the region have generally maintained mild restrictions, unlike western counterparts. Therefore, pent-up demand should only be demonstrated at reasonable levels, and will likely lead to manageable levels of inflation. Furthermore, supply chain issues such as significant delays in delivery and large spikes in freight costs that are currently present in the west are also more unlikely to be encountered in Asia Pacific because of the strong manufacturing sector in the region.

As noted in our ‘Japan’s Prospects Towards 2030’ report, Japan’s economic resilience, political stability, and manageable population outlook should overall support the country’s growth and continue attracting investors on a mid- to long-term basis. Moving forward, the major cities in the country can also expect a plethora of large-scale developments that aim to reinvigorate interest in respective cities and promote growth.

INVESTMENT TRENDS

Savills in-house cap rates have remained flat over the year. The stability that Japan provides during a crisis has attracted many investors, and many transactions have taken place between owners in financial distress and opportunistic buyers. Overall, with office transactions accounting for around...
There are plenty of lingering risks globally: new variants, likely interest hikes from the tapering of asset purchases, and a possible economic slowdown originating from China. However, amidst these circumstances, Japan’s market has remained attractive as a stable destination for real estate investment. Furthermore, the large amounts of unallocated capital worldwide and higher allocation targets for real estate should serve as a tailwind for the market going into 2022, further boosting investments into Japanese real estate.

Indeed, investment volumes from equity and institutional investors have increased, primarily from Hulic's acquisition of the Dentsu headquarters building for JPY270 billion. More corporate real estate disposals from companies badly hit by the pandemic are expected. Low interest rates are also likely to make real estate stand out as an attractive asset class. Going forward, J-REITs are expected to remain active in acquisitions because of higher unit prices, while also acting as active sellers to maintain dividend levels and nullify the pandemic damage. Overall, more transactions are predicted in 2022.
**OFFICE**

**Investment Trends**

The office sector continues to be a core asset type in Japanese real estate. Its fundamentals remain strong, with listed companies posting all-time high net profits in Q2/2021. Investor appetite for office assets has persisted despite rental softening. Savills in-house cap rates for Grade A offices in Tokyo have held at 2.7% through 2021. Meanwhile, the October 2021 Japan Real Estate Institute (JREI) survey shows that expected cap rates in Tokyo have compressed by 10 basis points (bps) YoY. Nagoya has also seen its expected cap rates compress by 20bps, while Osaka and Fukuoka have remained flat YoY.

Despite the pandemic and subsequent increase in telework, the office sector remains sought after and still accounted for the majority of real estate investments in 2021. However, the total investment into offices between Q1/2021 and Q3/2021 is 20.1% below the levels seen during the same period in 2020. Indeed, investors have become more cautious and selective during the pandemic. As a result, bifurcation has materialised within the office sector, as only well-located buildings are performing as strongly as they did in the pre-pandemic era.

A closer look at investor type reveals the percentage of cross-border investment remains at levels seen in 2020. In contrast, the share from institutional and equity investments has tripled, primarily due to Hulic’s purchase of Dentsu’s headquarters building for approximately JPY270 billion, which accounted for over 60% of the investment volume in this category.

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More office consolidations have been observed as telework has evolved into an increasingly integrated component of regular work practices. That said, with the pandemic appearing more manageable in the Asia Pacific region than in other parts of the world, the corrections seen in the office sector were not as drastic as the predictions at the start of the pandemic.

Burdened by secondary vacancy from previous years’ supply as well as the lukewarm market sentiment, Tokyo’s Grade A market’s rents contracted by 3.9% while vacancy loosened 1.3 percentage points (ppts) from Q1/2021 to Q3/2021. Nonetheless, there are some positive signs that the market fundamentals will gradually improve, such as recovering corporate profits, a high vaccination rate, and plummeted COVID cases.

Elsewhere, the Grade B market is expected to stabilise more quickly, making it an increasingly attractive investment option. Indeed, Grade B offices are generally occupied by smaller companies that lack the resources and capital to implement firm-wide remote work, and these tenants are thus less likely to return floor space. Moreover, Grade B offices have a larger tenant pool and have greater flexibility in filling floor space.

Looking at regional markets, all the regional cities have seen vacancy increase like Tokyo, though vacancy remains tight overall. As for rental trends, Osaka and Nagoya have seen rents contract, albeit at a modest rate. On the other hand, Fukuoka has bucked this trend with rents growing as large-scale redevelopment projects are adding high-quality offices that attract companies like Google and Boston Consulting Group.

Overall, despite the challenges caused by the pandemic, the changes in the market remain manageable with market fundamentals still stable. Moving forward, we expect the office market’s recovery to be K-shaped: while well-located and new offices should remain stable, older offices with poor accessibility will suffer. As a result of these opposing trends, overall average rents should remain flatish or slightly soften in the near future while businesses continue to adjust to working conditions under COVID-19. The large supply concentrated in select Tokyo submarkets in 2023 is a concern, but the low supply in 2022 and an expected economic recovery should give the market breathing room.
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### RESIDENTIAL

#### Investment Trends

Savills in-house cap rates for mid-market residential properties have remained steady over the past two years at 3.4%. Throughout the pandemic, such assets have represented one of the pillars of stability and has seen fierce competition surrounding their acquisitions.

According to JREI, expected cap rates for residential properties in Japan have tightened 20bps YoY to 4.0%, and those in Joto have similarly tightened 10bps YoY to 4.3%, demonstrating the demand in the sector.

As of Q3/2021, YTD residential investment volumes are around 44% lower than what was observed over the same period in 2020. However, the decrease comes from the exceptionally large transaction volumes seen in 2020. In fact, compared to 2019, they are about 3% larger in 2021. Indeed, multiple big-ticket J-REIT transactions have taken place in 2021, and international players have also been active. For instance, AXA IM acquired a portfolio of residential properties estimated to be over JPY31 billion.

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Despite the increasingly optimistic outlook, rents continued to slump both in the 23W and the C5W. Additionally, occupancy rates have been also trending lower than the levels prior to the pandemic. Indeed, the population of the 23W continues to be adversely affected by the pandemic and subsequent prevalence of teleworking, with some residents having moved out to neighbouring cities.

A large residential J-REIT has recently noted an increase in the number of tenants who have decided to move out after only two years, before the renewal fee is due. This was especially the case for those who entered their contracts when rents were close to their peak in 2020. This implies that further rental adjustments might be in the crosshairs.

More specifically on the C5W, population changes have exhibited some diverging trends in the central area. The largest population declines in the C5W in 2020 were from the 30-to-39-year-old, 40-to-49-year-old, and 0-to-9-year-old age groups, suggesting that many younger families contributed to this demographic outflow. On the other hand, the 20-to-29-year-old category has been the least affected by the pandemic. Nonetheless, as of November 2021, the population of the C5W has decreased by about 10,000 people, or about 1.0%, since Tokyo’s peak population in May 2020.

While the C5W has lost some of its lustre over the year, the numerous redevelopment projects planned in the submarket should reignite its appeal. Furthermore, new branded residences to be built in 2023 in Toranomon Azabudai may spark a new area of interest in the market especially when competition is high in the busy traditional residential development space.

Although the downward demographic trend has continued, there is a possible sign that the market is reaching a point of equilibrium. In Q3/2021, occupancy rates both in 23W and the C5W showed slight upticks. This may indicate that occupancy rates appear to have settled into a new cycle where average occupancy rates are a few ppts lower than 2019 levels, bearing resemblance to the average occupancy seen in 2015.

The pandemic has also changed size preferences among renters. Specifically, the flexible work policies and lifestyle changes that have arisen from the pandemic appear to have had influence in the increasing demand for larger apartments, which are considerably more affordable outside the 23W.

Overall, with the plummet in COVID-19 cases and the high vaccination rates in Japan, there is greater confidence that the pandemic era is nearing a close and the public discussion on post-pandemic life has started. Going forward, one of the greatest factors that will impact the residential market is how companies will adjust their remote work policies in a post pandemic world. To be sure, many companies expect most workers to be back in the office post-COVID, but many also plan to retain the option of partly working from home. As such, we should see some reversal of the recent trends that occurred during the pandemic, although this is likely to be further delayed by a few months because of the new Omicron variant. Residents may have to look for apartments that strike a balance between the convenience of commuting and the space to comfortably work from home.
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RETAIL

Investment Trends

As of Q4/2021, Savills in-house cap rates for high-street retail in Tokyo are at 2.7% and have remained at that level over the past two years. Likewise, according to JREI, expected cap rates for prime retail property in Ginza and Omotesando have also held firm at 2.7% - unchanged over the year.

With a sizeable number of large transactions led by J-REITs and other investors optimistic about a recovery, retail transaction volumes in 2021 look to surpass those of 2020, although they are likely to remain below 2019 levels. Indeed, the multiple transactions seen between a range of assets, both large shopping complexes as well as high street retail facilities, demonstrate the increasingly positive sentiment. More deals could be expected going forward as confidence levels in the sector grow.

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The pandemic has persisted for almost two years, and it has understandably resulted in brick-and-mortar retail being greatly damaged as people shop and eat out less frequently. In addition, the rapidly growing e-commerce sector may have made matters even worse.

Amidst this downturn, the F&B industry has been one of the hardest hit. Not only did it have to cope with the lower number of customers and increased hygiene-related spending, but also with the multiple restrictions imposed by the government. Furthermore, the prevalence of the F&B industry and its importance in occupying mid-high floors in retail space is likely to adversely affect many landlords who may struggle to find suitable tenants as replacements, and might lead to lower expected NOI, and consequently property prices. In contrast, the luxury goods industry has thrived on the back of increased domestic spending from the wealthy who have been unable to travel overseas.

Average asking rents appear to have seen incremental changes in the surface in many locations. However, they are not a reflection of improving market conditions, but the product of the increased vacancy of prime retail locations that were previously unavailable. In fact, the vacancy levels of many major retail areas in both Tokyo and regional cities remain high, with many shops having been forced to close due to the decreased footfall, especially in areas dependent on inbound tourism like Shinsaibashi and Sapporo.

Despite the depressing state of the retail market in 2021, there are beams of hope. The eased restrictions on restaurants are a breath of fresh air for the F&B industry. Furthermore, as the vaccination rate in Japan has increased rapidly to almost 80% and the number of new COVID-19 cases has plummeted, people are expected to shop and eat out more often.

This heightened optimism can be reflected in J-REIT markets as the performance of many retail J-REITs has surpassed that of the TSE REIT Index (Graph 11). Moreover, Aeon REIT, Kenedix REIT and Frontier REIT are also seeing unit prices above pre-pandemic levels at the start of 2020, further demonstrating the confidence in the suburban retail market, where stable revenue streams have been observed.

While the timing of a rebound in international travel remains uncertain, rapid recovery in the retail sector should still be possible on the back of domestic demand, which accounted for around 99% of total retail revenue even before the pandemic. Furthermore, there is pent-up demand as well as high levels of excess savings across the nation. That said, some retail types that were heavily reliant on inbound tourists, such as drug stores, should continue to suffer. Due to the very low number of new COVID-19 cases since October 2021, the footfall on streets has been steadily increasing. Once concerns over the likelihood of a new wave are alleviated, recovery in the retail sector should accelerate and be reflected in the performance of retail stores.
**LOGISTICS**

**Investment Trends**

Without doubt, the logistics sector has been the most sought-after sector during the pandemic. As a result, logistics has continued to see cap rates sharpen over the course of the year. According to JREI’s October 2021 survey, expected cap rates compressed in most major markets over the year, with the Tokyo bayside area marking a 20bps fall to 4.1%. At the same time, Savills in-house survey indicates that cap rates for prime logistics properties is as low as 3.3%, a 10bps compression over the year.

The major buyers of logistics facilities consist of J-REIT and overseas funds of logistics developers. While J-REIT purchase logistics facilities from its developer sponsors, most other buyers purchase them through extremely competitive bidding processes. As a result, the price keeps going up and many investors have given up even joining those bidding processes. As of Q3/2021, YTD investment in industrial property amounted to JPY422 billion, around 18% below that of the same period a year ago.

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Specifically, Greater Tokyo continues to show resilience over the year. While an influx of large supply continues to enter the region, strong pre-leasing activity with new facilities help maintain vacancy low. The average rent also increased 4.1% YoY to JPY4,380 per m²tsu as of Q3/2021. Nonetheless, tenants appear to have become stretched financially over the years, and vacancy increased to 1.7%, due to even larger supply than robust demand. Rental growth is likely to stabilise with continuous large supply in 2022 and beyond.

Greater Osaka has demonstrated its strength in 2021 as well. Indeed, the market saw a 1.4pts tightening in vacancy YoY to 1.1% in Q3/2021. Rents in the region have also seen a moderate improvement over the year. As supply is expected to be limited in 2022, Greater Osaka is likely to maintain its sound performance.

As such, the logistics leasing market has been demonstrating its resilience and investors have continued to funnel capital into this sector. However, cap rates have compressed to low 3% for prime logistics assets, rapidly getting closer to that of Grade A offices. Although this sector has very strong fundamentals, the current level of sharp pricing is worrisome considering that logistics facilities also have innate risks.

For instance, compared to urban properties like offices, logistics properties have significantly less land value because they are built in areas that have limited uses. This means that the potential for value-add initiatives is more limited. Also, it is difficult to find any other uses of large facilities in relatively remote areas.

What adds to the concern is the potential increases in operational cost of tenants. While most of new facilities are located proximate to residential areas, many are being built in areas that have already seen a flux of supply in recent years, which could lead to competition for workers and rising wages.

Additionally, as trucking companies are chronically short-staffed, and the average age of drivers is increasing, raising shipping fees seem inevitable. The Japanese government shares this view and is imposing a limit overtime hours in FY2024. In the short term, this new rule could worsen the labour shortage, but the government hopes that this will give more negotiation power to drivers and ultimately lead to wage increases and improved labour conditions.

If these cost increments manifest, some tenants may negotiate harder to lower rents, as transferring additional logistics costs to customers may be difficult. Indeed, e-commerce operators are focusing on further lowering shipping fees and expediting delivery speeds, which will incentivise them to further reduce storage costs through lowered rents.

Overall, fundamentals for the logistics sector remain robust, and it is likely to carry on attracting institutional capital with increased allocations as it is becoming a mainstream asset class. However, as reflected by the flood of supply, as well as sharp rising in recent years, the market has some signs of overheating. If the market softens and the negotiation power shifts to tenants, rents should start adjusting from less competitive properties.
HOTEL

Investment Trends
The hospitality sector, especially those exposed to inbound tourism, continues to struggle. However, the domestic market has started to see notable recovery. Investment volumes in this sector remained subdued and fell 29% YTD as of Q3/2021. Indeed, Japanese banks remain selective and cautious towards hotel acquisitions, although they have steadily become more accommodative to such deals.

Despite the decreased investment volumes, there were several notable transactions in 2021 between companies distressed from the pandemic and opportunistic buyers, like Kintetsu Group’s disposition of eight lodging properties to Blackstone in October 2021. Strategic investors have also been active. For instance, Santy acquired 32% of Wealth Management for JPY3.9 billion in August 2021, aiming to launch a hotel REIT in the future. Furthermore, Hoshino Resorts, which acquired WBF Hotel & Resorts in early 2021, seems to be aggressively expanding its footprint, especially with its Kai and OMO brands. In addition, there are also rumours of several large deals underway, on top of over JPY10bn acquisition in Osaka by Baring Private Equity Asia, and more transactions are expected going forward.

Investor appetite remains robust, and the hotel & resorts category and business mix, implying that the hospitality industry has gradually calmed down. Management contracts may become even more common, and this trend will accelerate if more large transactions are completed before the year-end.

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2021 was another troubled year for the hospitality sector. However, the vaccination rate in Japan has rapidly increased since summer, and around 80% of the population is fully vaccinated – one of the highest in the world. Consequently, the number of COVID cases has plummeted, and the government has lifted many restrictions in response. The Japanese government also planned to begin experiments that would slowly restart inbound tourism in December. However, this plan was postponed with the emergence of the new Omicron variant. In the meantime, the footfall around tourist destinations has been steadily increasing on the back of domestic travellers, which should be reflected in increases in hotel revenues in those areas.

However, budget hotels in major markets like Tokyo, Osaka, and Kyoto are expected to continue to suffer. Even before the pandemic, these hotels were not performing well because of the large supply present. As such, more troubled budget hotels are expected to appear on the disposition market. Therefore, the competition on room prices to attract budget travellers is unlikely to cool down anytime soon. Meanwhile, investor interest in higher grade hotels with larger guestrooms remains strong. The supply in this category has been limited, and the demand appears stable.

Market participants appear bullish on the luxury sector. For instance, Sekisui House and Tokyu Fudosan opened W Osaka in March and Roku Kyoto LXR Hotels & Resorts in September. More developments are also expected to continue in key cities. Luxury products, including hotels and branded residences, are currently limited in Japan overall, and the growth potential in this sector looks tremendous.

Hotel operations face additional challenges moving forward. Many workers left the hospitality industry during the pandemic, and hotels may struggle to find suitable employees as the competition for talent is likely to be fierce, which will likely come with additional costs. This will further tighten the already thin operating margins of the hospitality industry and may surprise unprepared investors when they look at actual cash flows later.

Overall, the situation surrounding the hospitality industry has gradually improved over the year and is expected to get even better with the pandemic calming down. Management contracts are becoming more common, and this trend will accelerate if more large developers start accepting this practice and will consequently lead to a wider operator and investor base. While risks abound, performance is likely to vary widely from hotel to hotel by location, category and business mix, implying that there are opportunities present in the market. The gap between some buyers and sellers has begun to narrow, which should bring more deals forward.
**ALTERNATIVE ASSETS**

The pandemic has continued to shift the alternative asset landscape over the year. Within this asset classification, data centres have arguably become the most sought-after due to the increasing need for hyperscale data centres. With the logistics sector seemingly nearing maturity in terms of new concepts, market entrants and pricing dynamics, the data centre sector has gained increasing interest amidst the pandemic. Meanwhile, the healthcare and student housing sectors remain alternative segments for popular and competitive residential assets, that can benefit from secular demographic changes.

**Data centres**

Amidst the continuing pandemic, the data centre sector has gained increasing interest. In particular, the demand for hyperscale data centres is notably strong due to a myriad of factors such as the absence of dominant domestic players in Japan, the country's strategic location as a network connection and distribution hub, a stable electricity supply, and the increased implementation of digital transformation during the pandemic. According to IDC Japan, the domestic data centre service market is forecast to increase 11.6% to JPY1.7 trillion in 2021, boosted by strong growth in public cloud services provided by companies like Amazon and Microsoft.

The growth is believed to continue through 2025 at an annual growth rate of 12.5%, keeping its strong momentum.

Emboldened by this strong outlook, as well as the demand to replace Japan’s ageing data centre stock, many large-scale data centres in 2021 were completed primarily in Greater Tokyo and Greater Osaka, many of which were large hyperscale data centres. While the procurement of suitable development sites has been a challenge for data centre developments, overseas data centre operators have been partnering up with large domestic companies with wide network, and the pace of developments has accelerated.

Specifically, Inzai City in Chiba continues to be the focal point for developments of new data centres. For instance, MC Digital Realty, which was launched through a partnership between Mitsubishi Corporation and Digital Realty Trust in 2017, completed NRT10, their first data centre in Kanto, in Inzai in September. This is the first of their four data centres planned in Inzai, which MC Digital Realty has envisioned to be its “Tokyo Connected Campus at Inzai” with over 120MW capacity. Elsewhere, Daiwa House has completed AirTrunk’s first data centre in Japan in November 2021. Daiwa House initially planned to build 35 data centres in Inzai by 2030, but it now aims to complete them by 2025 to meet the rapidly increasing demand. Equinix also opened the 54MW TY12x in Inzai in March, which is its first hyperscale data centre in Asia. Furthermore, In October, Goodman announced its plan to build two data centres, totalling 60MW in the city, which will be leased to STT GDC in its entirety starting from Q2/2024.

Osaka has been also seeing some major development in this sector. In April, Keihanshin Building completed the Keihanshin OBP Building, an urban data centre proximate to the central business district. Although the company has been active in this sector over the past three decades, this project is the largest so far and will be leased to tenants like Equinix and Digital Edge as OS3 and OS31, respectively. The success of these initiatives may rekindle another attempt by activist funds. Equinix is also opening a hyperscale data centre, OS2x, in Minoh, Osaka.

Minoh is currently like Inzai in Kansai, and MC Digital Realty completed 20MW KIX12 in August and plans to open KIX13 in 2023 in the nearby area. Additionally, Colt started constructing the 45MW Keihanna Data Center in Keihanna Science City in Osaka. The data centre is slated for completion in 2023.

A new area which has been getting more interest is Saitama. In June 2021, Princeton Digital Group announced its plan to build a 100MW hyperscale data centre on the site currently occupied by Marelli’s headquarters and research facilities in Saitama. The data centre will be built in two phases with the first and second phases completed in 2024 and 2026, respectively.

Given the strong growth in data usage predicted by various forecasters, as well as Japan’s ageing data centre stock, the interest in developing new data centres should continue to expand. However, as development sites in cities such as Inzai and Minoh get built out, the pace of developments may slow down. That said, domestic companies such as Mitsubishi Corporation, Mitsui & Co., and Daiwa House are committed to this sector and are investing JPY100 billion to JPY300 billion each.

The partnerships between overseas operators and these large domestic companies should help keep the momentum, and the potential market should continue to grow to a sizable scale.

Nonetheless, transactions of data centres are currently still limited, and many hurdles have to be overcome for the market to grow. Some challenges include a shortage of suitable development land, a large amount of capital expenditures, a limited number of operators, geographical diversity, and the limited availability of benchmark data. Although these hurdles are expected to eventually become lower with the number of data centres and active players in this sector increasing, investment opportunities will likely be limited in the short term.

**Healthcare**

As the pandemic continues to pose challenges for the healthcare sector, particularly nursing homes, Japanese nursing home operators have maintained rigorous measures to prevent the spread of infection within their facilities. Despite the concern about the increased strains on operators due to the additional measures, they seem to be navigating through the storm, and very high vaccination rates (well over 90% for those over 65 years old) and the plummeted COVID cases have eased some stress.

Consequently, some investors remain active in the healthcare sector and have continued to make acquisitions through the year. Indeed,

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**GRAPH 18: Broadband Traffic in Japan, 2013 to 1H/2021**

<table>
<thead>
<tr>
<th>Year</th>
<th>Traffic (GBPS)</th>
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</thead>
<tbody>
<tr>
<td>2013</td>
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<tr>
<td>2014</td>
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<td>2017</td>
<td>25,000</td>
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<td>2018</td>
<td>30,000</td>
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</table>

**Source** Ministry of International Affairs and Communications, Savills Research & Consultancy

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3. Besides NRT10, MC Digital Realty has HND10 and HND11 in Hitaka. But NRT10 is the first data centre that was built in Kanto after the joint venture was launched.

4. Mitsubishi Corporation and Mitsui & Co. target JPY100 billion each. Daiwa House is investing JPY120 billion in Inzai.
although it only represents 1.3% of the total AUM of J-REITs, the healthcare AUM of J-REITs as of November has grown a moderate 10% YoY from JPY524 billion to JPY728 billion. Out of that increment, Kenexid Residential Next and Daowa Securities Living Investment accounted for JPY7.4 billion and for JPY6.4 billion, respectively, with each J-REIT acquiring four nursing homes.

In addition to J-REITs, Singaporean entities are also active in this market. Singapore Parkway Life REIT, one of the first entrants in this market, acquired Willi Mark Kashiwama and Crea Adachi in July for JPY4.1 billion, as well as Habitation Kisarazu Ichibanbanc in December for JPY5.2 billion. The REIT is going through asset recycling initiatives, and these acquisitions came after the REIT’s disposition of P-Life Matsudo to Hulic for JPY2.9 billion in January. After these transactions, the Singaporean REIT’s total AUM of Japanese nursing homes increased to about JPY68 billion with 52 properties. Furthermore, Singapore Press Holdings, which acquired five senior homes in 2020, acquired Human Support Chikusei in Ibaraki in October through a joint venture with Creal.

The latest entrant to this sector is First REIT, another Singaporean REIT. The REIT has largely invested in healthcare assets in Indonesia and Singapore and has recently acquired 12 nursing homes in Japan from its sponsor, OUE Lippo Healthcare, for JPY2.4 billion in December. Seven of the acquired properties are located in Sapporo, and the rest are in Nara, Nagano, and Kyoto. Since the REIT expressed its intention to increase its exposure in developed countries including Japan in its “2.0 Growth Strategy”, it is likely that First REIT will continue to seek acquisition opportunities in the country.

While transactions of hospitals have not been observed since Healthcare & Medical’s acquisition of Niigata Rehabilitation Hospital in 2017 and Ship Senri Building in 2018, that asset type is considered to account for over JPY20 trillion and poses potential for growth. One example of recent development is Mitsubishi Estate’s Sapporo Minami Tokushukai Hospital, which was completed in May in Sapporo. The hospital is owned by the developer and leased to a hospital operator. This is the first hospital development project by Mitsubishi Estate, and the company aims to conduct such projects every year going forward. If the benefit of separating hospital operations and real estate ownership becomes widely understood among medical operators through examples like this, there might be more acquisition opportunities in the future.

Student Housing

The student housing sector’s popularity was initially rooted in the explosive growth of the international student population. Consequently, the pandemic and subsequent entry bans have undoubtedly dimmed the prospects for this sector. That said, the number of international students enrolled in Japanese universities are relatively steady*. For instance, Waseda University, the top host of international students in Japan, only saw a 6% decline between May 2020 and May 2021. Furthermore, the University of Tokyo, the top ranked national university with the largest international student population, actually saw an increase from 4,187 to 4,282 during the same period.

Specifically, Kyoritsu Maintenance, a major student housing operator, reveals that occupancy in its dormitory business segment, which was 98.7% in April 2019, declined further from 93.7% in April 2020 to 92.1% in April 2021. As such, the market continues to see a softening, but it is holding relatively well and maintaining high levels of usage given the circumstances.

Over the year, development activity was also active. For instance, Tokyu Land Corporation, which started its Campus Village brand in 2017 after its acquisition of Nasic in 2015, added four properties in 2021. The largest addition is Campus Village Tama Center, which houses 215 units and is located close to multiple university campuses. In 2022, Tokyu Land plans to add nine more properties in Tokyo, Kanagawa, Kyoto, Hyogo, and Osaka. Additionally, NTT launched its new student housing brand, Wellih IVY, and the first of this brand was completed in Nishinomiya, Hyogo in February 2021. Elsewhere, a female-only housing, classy BASE Mukogawa, will be built by Sumitomo Corporation in Nishinomiya, Hyogo, in 2022.

Overall, interest in this sector remains strong. Although the government has recently instituted a broad entry ban to keep the new Omicron variant at bay, the number of international students is likely to start growing again after the pandemic calms down. Furthermore, the National Federation of University Co-operative Associations, large, quality apartments still make up a relatively small portion of university student accommodations, and the market has more potential to expand. Moreover, tensions amongst China and the United States, as well as other Western nations, could make Japan a more attractive destination to Chinese students going forward. Japan’s sound labour market for young workers is also an incentive to study in the country.

*The survey excludes university students who live in their parents’ homes.

**The figures may include international students who are not physically in Japan due to the pandemic.
OPPORTUNITIES AND RISKS

Opportunities

Although the pandemic has continued into 2021, the second half of the year has shown significant progress in recovery worldwide. In Japan, COVID-19 cases have plummeted, and almost 80% of the country is fully vaccinated. Furthermore, corporate profits of many large firms were at all-time highs in Q3/2021. The recovery that the country has seen and the probable stability going forward should further solidify Japan’s appeal as a destination for investors.

Indeed, the 2021 market has seen many transactions taking place, including those between sellers distressed from the pandemic and opportunistic buyers anticipating recovery. Some notably large transactions include the sale of the Dentsu Headquarters to Hulic for approximately JP¥170 billion. Furthermore, J-REITs have also been active due to their elevated unit prices in 2021, allowing them to raise equity for acquisitions. That said, J-REITs may become weakish after interest rate hikes in the U.S. The overall high levels of activity in the market demonstrates the opportunities present, and the optimistic outlook with the pandemic waning may fuel greater confidence.

Interest in ESG and net zero carbon initiatives has been growing rapidly in the hard asset sector. While the progress surrounding these fields in public capital markets has gained notable momentum over the past few years, interest in ESG within the hard asset sector remained lukewarm until recently. However, 2021 was a turning point for ESG, and it is likely to have significant influence on hard assets going forward. This is especially true when considering the implications on public capital markets, including J-REIT. For instance, Japan Real Estate recently announced that it would introduce renewable electricity by late 2022 into all of the properties that it has full operational control of. Similar efforts are likely to be observed from other companies going forward.

With this in mind, the below represent some of our views on investment strategies for Japanese real estate.

Core and Core-plus

The logistics sector is thriving despite concerns over the large upcoming supply, and it is likely to carry on attracting institutional capital with increased allocations as it becomes a mainstream asset class. However, at cap rates around the low 3% range, logistics facilities might not be that attractive anymore. Meanwhile, investor appetite for multifamily and office has persisted despite rental softening.

Indeed, prime offices are situated on land that has very high value, and therefore has greater potential for value-add initiatives. In contrast, logistics facilities are built on land with much lower value, and older assets will become increasingly obsolete especially with the recent large supply and technological advancements in newer facilities, highlighting potential considerations of the sector down the road.

Within the residential sector specifically, investors chasing higher yields and more opportunities have broadened their focus and have kept looking towards more niche asset classes such as student housing and elderly care facilities. That said, opportunities in these classes have been limited and fragmented.

Value-add

Urban retail continues to lag, although high street retail remains sought-after as seen from the multiple flagship store openings in Tokyo in 2021. Nonetheless, the recovery of retail sales has been slow despite the plummet in COVID cases, suggesting that a greater upturn may be on the horizon. In the office sector, office buildings with some vacancy or without ideal access may have notable room to improve their property value. Disposals of corporate real estate, especially by the industries that were hit the hardest by the pandemic, are likely to continue.

Opportunistic

The hospitality sector has continued to garner interest, but sellers have not been flexible on pricing, resulting in a limited number of deals. Furthermore, sellers are likely to become increasingly optimistic with the second round of the “Go To” Travel campaign anticipated to resume early 2022. Elsewhere, new products such as branded residences might be interesting areas to explore fresh opportunities, especially because current mid-market residential developments are plentiful, and yields have become compressed. Tokyo will see its first branded residence in 2023, provided by Aman Tokyo Residences in the Toranomon Azabudai project. This could pave the way and spark new entries from other market participants. In fact, development plans by international luxury players have already been observed in major cities outside of Tokyo.

Risks

With the high vaccination rates and low number of COVID-19 cases, the pandemic situation has calmed down significantly in Japan. Nonetheless, there are potential risks post-pandemic that Japan may encounter. For instance, the overall slow economic growth in the country could bring about mild stagflation.

Pandemic risks

COVID-19 has demonstrated the vulnerability of the economy to a global pandemic. Although it has subsided to a large extent over the year, the threat of potential new variants could again put the global economy in a precarious state, and likewise affect Japan. Nonetheless, the high vaccination rates and precautionary measures that Japanese citizens have taken should serve as safeguards against such predicaments.

Overseas risks

Japan also should maintain good relationships with the United States, China, and its other neighbours in Asia Pacific. Over recent years, however, the region has seen rising geopolitical tensions that could call into question the safety and security of East Asia and stifle the region’s growth. Furthermore, Japan’s economy is integrated with those of neighbouring countries, and changes related to tariffs and import restrictions could have a negative impact. Furthermore, debt-related issues in China regarding Evergrande or any other large firms may significantly affect real estate markets in the world and Japan.

Interest rates

The prospect of interest rates rising across the world appears increasingly likely because the fear of inflation, Japan is not exempt from this, and it may be especially painful for the country because almost half of the government debt is owned by the Bank of Japan (BOJ); if interest rates go up, the balance sheet of the BOJ may face significant challenges. While this is unlikely to become an immediate problem, controlling the high levels of government debt may become an issue at some point.