Japan - December 2024

SPOTLIGHT
Savills Research

2024 Review and 2025 Prospects

savills

Renewed optimism for rental growth to drive market dynamics in 2025

INTRODUCTION

2024 has been marked by global instability, with prolonged conflicts in Ukraine and the Middle East exacerbating geopolitical tensions and disrupting trade. High interest rates and inflation persist worldwide, delaying economic normalisation, although China's economic slowdown and political conditions have been diverting significant capital to Japan.

In 2024, more than half of the global population participated in their respective parliamentary elections, leading to the ousting of many incumbent governments, including in the US with the incoming Trump administration. This political shift has prompted many nations to brace for potential new US policies.

In contrast, Japan has experienced relative stability in 2024, with moderate economic growth and strong corporate performance expected to continue into 2025. This stability is further supported by firm wage growth, boosting private consumption. Additionally, inflation has calmed and is projected to settle around mid-1% in 2025, indicating a normalised economic state for Japan: consistent "nominal" growth pushes real estate into a new phase.

Amid inflation and a weak yen, the Bank of Japan kicked off monetary policy normalisation by raising the policy rate to 25 basis points (bps) in mid-2024. More hikes are on the horizon, with a 50 bps increase already anticipated. We foresee the rate hitting 75 bps by mid-2025. If CPI stays strong, the policy rate could climb to 100 bps, and the 10-year rate might settle around 150 bps in 2025 and beyond. In this scenario, we also expect noticeable rental increments, potentially more than offsetting higher funding costs.

Despite moderate interest rate hikes in Japan causing some international investors to adopt a wait-and-see approach, leading to temporary hiccups in real estate transactions, Japan's lending players remain engaged. Banks are eager to provide attractive lending terms to experienced players with strong track records.

According to an October survey by JREI, over two-thirds of major investors in Japan do not expect rate hikes to impact the market, and nearly three-quarters plan to maintain their investment stance. Drastic changes are unlikely, as many have already factored potential rate hikes into their underwriting. International investors will need to adjust to higher debt costs by fine-tuning sector preferences and investment strategies. While rate hikes may slightly loosen cap rates in some sectors, overall investor appetite is expected to remain strong in 2025.

However, risk factors remain prevalent. Hastily raising interest rates could impact the government's fiscal and monetary policy. A resurgence of global inflation might disrupt the current scenario, leading to prolonged higher rates. Geopolitical tensions, especially involving US-China relations, continue to pose significant threats to global stability, especially in the region.

Overall, Japan is poised to play an increasingly important strategic role in the region. Investors seeking strong and stable returns have identified Japan as an attractive option, with its real estate markets benefitting from capital outflows from China due to Japan's vast size and high liquidity. As a mature economy with established government policies and robust social capital across the nation, Japan is set to attract significant global investment into 2025.

TABLE 1: Major Transactions in 2024

PROPERTY	TIMING	LOCATION	PRICE (JPY BILLION)	BUYER	USAGE
Tokyo Garden Terrace Kioicho	Dec	Tokyo	400	Blackstone	Office, hotel, residential, retail
LOGISTEED Logistics Portfolio (28 properties)	Feb	Various	108	IIF REIT	Logistics
Grand Nikko Tokyo Daiba	Oct	Tokyo	107	TPG Angelo Gordon	Hotel, retail
FIG Hotel Portfolio (12 properties)	Jul	Various	104	INV REIT	Hotel
Portion of Shibuya Sakura Stage	Feb	Tokyo	Over 100	Domestic SPC	Office, retail
Sharp Sakai Plant	Dec	Osaka	100	Softbank	Factory
Aoyama Building	Apr	Tokyo	90	Taisei	Office, retail
Shinagawa Redevelopment Site	Mar	Tokyo	Gain on sale of 85	Toyota Motor	Land
Akasaka Garden City	Oct	Tokyo	71	SPC of TPG Angelo Gordon	Office, retail
Logiport Nagoya (51% co-ownership interest)	Dec	Aichi	69.4	SPC invested in by LaSalle Logiport REIT, etc.	Logistics, office

Source Nikkei RE, MSCI, Company disclosures, Savills Research & Consultancy

Investment Trends

Japan has remained an active market for real estate transactions in 2024, and deal volumes have been firm. According to MSCI, as of Q3/2024, total investment in Japanese real estate amounted to approximately JPY4.7 trillion year-to-date (YTD), slightly shy of the total transaction volume over the same period in 2023, although this figure is preliminary, and this gap should gradually narrow as more transactions are announced[1].

This positive sentiment can be reflected by Savills' in-house cap rates, which saw no movement throughout the year across all asset classes, and generally remain at compressed levels. Moreover, according to the October 2024 investor survey on expected cap rates by JREI, expected cap rates for prime property witnessed some compression, notably in the hotel and retail asset classes, across multiple markets in Japan.

A few multiple US$ billion trophy deals appear to be progressing, with international buyers signalling their conviction in the continued strength of the Japanese market. A greater emphasis on efficient capital management among large Japanese companies may see further transactions of a similar scale over the coming years.

1 Figures currently do not include Blackstone's acquisition of Tokyo Garden Terrace Kioicho, for instance.

Japan's stability in 2024 continued to attract significant international investment despite gradual interest rate hikes. With renewed optimism for rental growth and strategic importance in the APAC region, further rate hikes should cause only temporary disruptions, paving the way for increased market dynamism and new players into 2025.

The largest transaction announced in 2024 was Blackstone's acquisition of Tokyo Garden Terrance Kioicho, a mixed-use development, for JPY400 billion from Seibu. This was one of the largest single-asset transactions ever recorded in Japan. The next largest was KKR-sponsored Industrial & Infrastructure Fund Investment Corporation's (IIF) acquisition of 28 logistics properties across Japan from LOGISTEED for JPY108 billion. A handful of other stand-out transactions over the year include TPG Angelo Gordon's acquisition of the Grand Nikko Tokyo Daiba hotel for JPY106 billion, and Invincible REIT's acquisition of a hotel portfolio comprising 12 properties for JPY104 billion from its sponsor Fortress, prompted by expanding inbound tourism demand.

Since bottoming out in 2023, the office sector has seen consistent moderate rental growth and improvements to vacancy levels, and the brighter outlook has underpinned several major transactions in 2024. Noteworthy office transactions include the acquisition of a portion of Shibuya Sakura Stage by a domestic SPC, which has a book value of JPY71.6 billion, while a domestic consortium comprising Chiba Bank, Fuyo General Lease, Daiei Real Estate & Development, and other players acquired World Business Garden in Chiba, in a deal worth up to a rumoured JPY70 billion.

Sound demographic fundamentals and strong wage growth have contributed to encouraging demand in the rental residential market, and the potential for strong rental growth has prompted significant interest in the sector, despite the threat of higher funding costs. For instance, Bridgestone's company housing in Minato was transacted, with the seller reporting a gain on sale of JPY63.4 billion. Given the prime location of the plot, it is likely to be redeveloped as ultra-luxury residential. Elsewhere, Alyssa Partners and Gaw Capital Partners acquired a portfolio of 29 residential properties for over JPY40.0 billion.

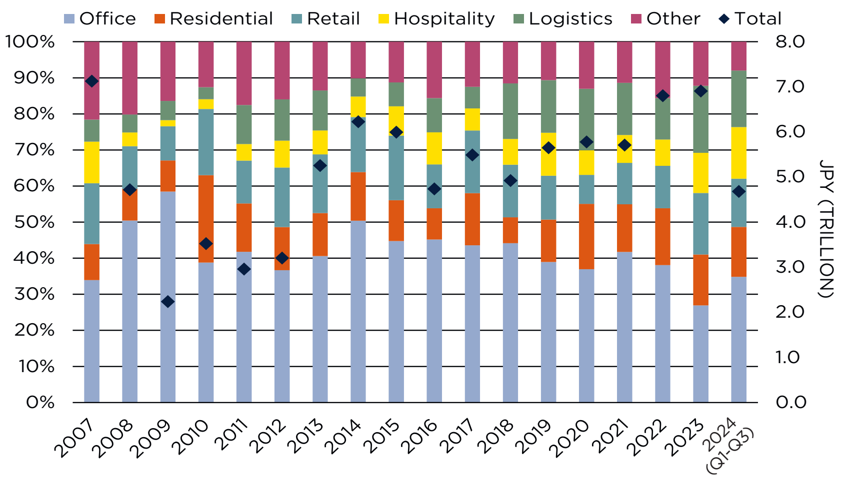
The retail sector has enjoyed a fruitful year, with high-spending inbound tourists supporting high-end stores in prime areas. Some notable transactions were observed, the largest being the LVMH Group acquiring the Abercrombie & Fitch Ginza Store building for JPY40 billion, an example of tenants acquiring their stores in response to bullish rental growth. In addition, players seeking stable, high yields have been active in the suburban retail market. For instance, Japan Metropolitan Fund REIT acquired unimo chiharadai, a suburban retail park in Chiba for JPY30.0 billion, while Mitsui & Co. Digital AM acquired Nasu Garden Outlet in Tochigi for JPY22.6 billion.

Although the logistics sector faces a number of challenges in the short term, mid-term growth prospects remain positive, and the upcoming supply bottleneck should raise the prospects of existing premium facilities in good locations. As such, investors appear to still be active in the market. For instance, GIC acquired the DPL Yokohama Totsuka facility in Kanagawa for JPY56.2 billion, while Amazon acquired the Hino Motors Hidaka Dispatch Center in Saitama for JPY44.1 billion.

The record number and spending of inbound tourists in Japan have underpinned strong performance in the hospitality market, and hotels have subsequently been in strong demand, consistently boosting ADRs and RevPARs, despite labour supply challenges constraining occupancy in the short term. This positive situation is demonstrated in the aforementioned largest deals.

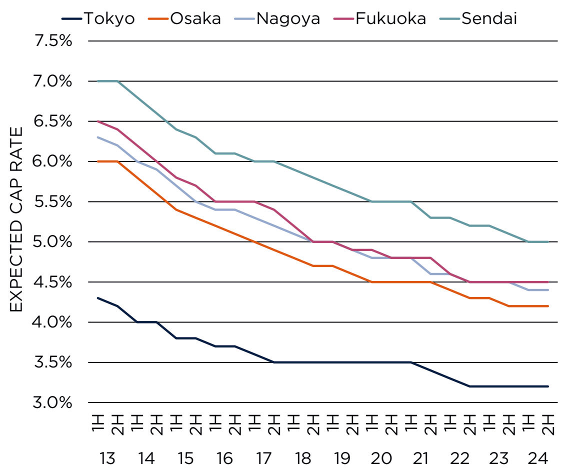
Overall, capital market prospects in Japan appear to be strong moving into 2025. Uncertainty regarding the impact of interest rate hikes may dampen some cross-border investment activity, but is unlikely to cause major changes to the current strong interest in Japanese real estate. Indeed, the positive outlook for many real estate sectors in Japan and attractive funding options should underpin significant transaction activity in the year to come, with many notable deals likely on the horizon.

GRAPH 1: Investment Volumes by Asset Type, 2007 to Q3/2024



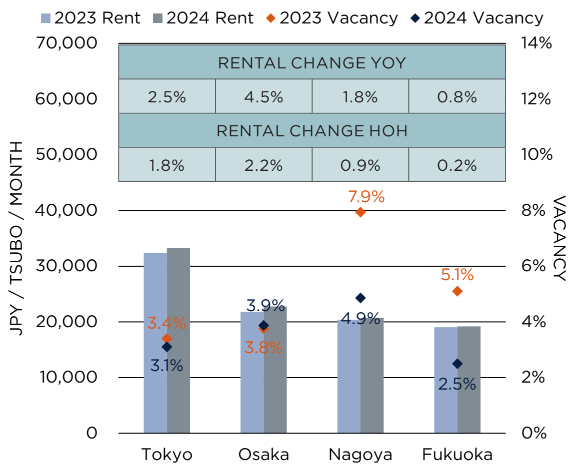
Source MSCI, Savills Research & Consultancy

GRAPH 2: JREI Expected Prime Office Cap Rates by City, 2013 to 2024



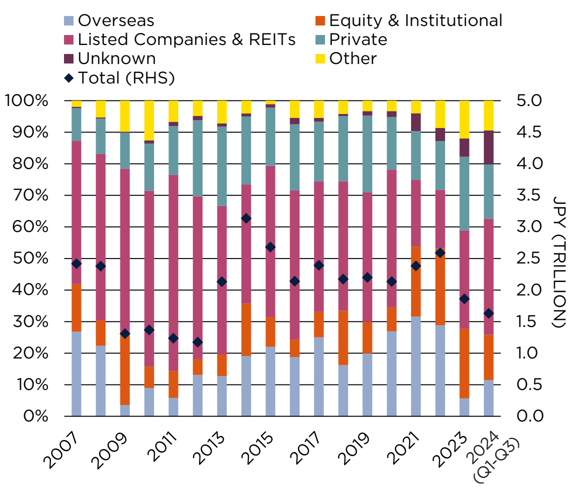
Source JREI, Savills Research & Consultancy

GRAPH 3: Investment-grade Office YoY and HoH Rental Growth and Vacancy Rates, 2H/2024



Source Savills Research & Consultancy

GRAPH 4: Office Investment Volumes, 2007 to Q3/2024



Source MSCI, Savills Research & Consultancy

OFFICE

Investment Trends

Office has been in strong demand in 2024, with several significant transactions exceeding JPY30 billion having taken place. Savills in-house office cap rates consequently remained at the tight level of 2.6% in 2024. Although some foreign players still appear to be cautious, especially western investors, domestic investors have remained active. Indeed, investment volumes in the office sector as of Q3/2024 have exceeded JPY1.6 trillion, a 15% increase over the same period in 2023, and should increase further as more significant deals are factored in.

A few major office transactions in the multiple US$ billion range appear to be progressing, on top of the Blackstone deal that was just announced. Indeed, with a greater emphasis on more efficient capital management, especially by large Japanese companies, we may witness more noteworthy transactions over the coming years, and overall investment figures should remain elevated for the meantime.

Several other notable office transactions took place in 2024. A domestic institutional investor acquired part of Shibuya Sakura Stage from Tokyu Land. The transacted portion has an appraised value of JPY71.6 billion, while a domestic consortium of Chiba Bank, Fuyo General Lease, Daiei Real Estate & Development, and other players notably acquired World Business Garden in Chiba, in a deal worth up to a rumoured JPY70 billion.

BentallGreenOak acquired the mixed-use Hommachi Garden City for JPY65.9 billion, while an undisclosed buyer acquired Garden City Shinagawa Gotenyama from Sekisui House REIT for JPY61.0 billion. Overall, strong corporate performance and growing office rents should raise the outlook of the office sector and prompt further investment throughout Japan.

Review and Prospects

Office markets in Japan have experienced strong momentum in 2024. Strong corporate performance and higher in-office participation have underpinned a resurgence in demand for office space in tandem with growing business operations and headcounts. Since bottoming out in mid-2023, the C5W except Minato and Chuo are nearing their ultra-tight pre-pandemic vacancy levels with increased rents, and signs point towards further sustained improvements in 2025.

The corporate performance in Japan has been strong in 2024, and many companies are looking to scale up business operations and hire more staff. Amidst the tight labour market, many tenants appear keen to relocate to newer offices in more central areas in order to secure scarce talent. In particular, potential tenants are attracted to premium features on offer in such properties, such as business lounges and conference space, in order to distinguish their properties.

While 2023 had a large office supply, new supply has been relatively limited in 2024, with many newly completed properties arriving to the market largely occupied. This gave the market more breathing room to continue absorbing existing vacant space, and contributed to tighter market conditions.

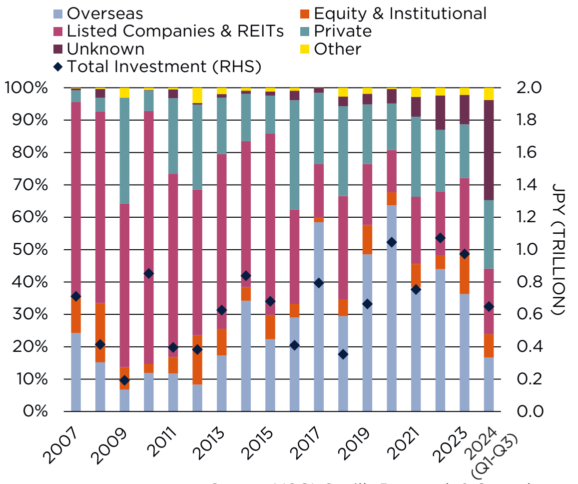
Elsewhere, regional office markets have generally followed a similarly positive trend. Despite a large influx of new supply in 2024, with some iconic developments completed such as GRAND GREEN OSAKA, this was generally handled smoothly, and rental growth and decreasing vacancy were observed in a majority of markets. Indeed, many companies in respective markets eagerly anticipated the completion of premium new supply, and moved quickly to secure space to help with business expansion and recruitment efforts. New office supply will be relatively moderate in regional markets over the coming years, which should provide further breathing room to absorb existing vacancies, and bring about further growth.

In 2025, new office supply in Tokyo is projected to exceed that of 2023, and will be largely concentrated in Minato. That said, many incoming developments are enjoying strong demand from tenants, and the Tokyo office market should remain resilient in the coming year despite the heightened supply.

While modern offices that are located near public transportation hubs are performing well, many older offices located in inconvenient areas still struggle to compete. Indeed, the labour market is extremely tight in Tokyo, and companies are highly incentivised to provide offices that are easy to commute to in order to attract and retain talented employees. As such, initiatives such as lengthy free-rent periods or landlords subsidising some fit-out costs are likely to remain a common practice among relatively poorly performing properties for the time being to remain competitive and attract tenants.

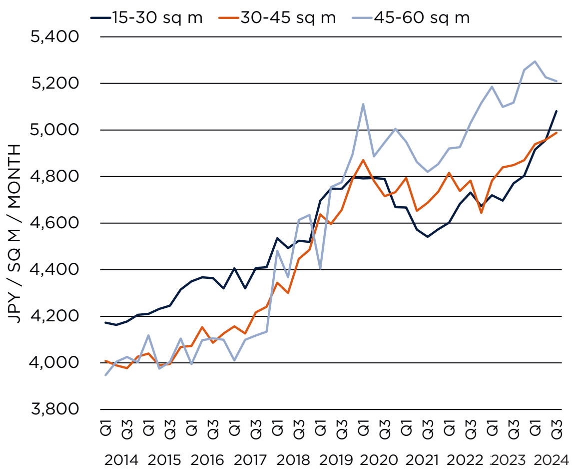
Overall, the office market has enjoyed a year of steady growth. Strong corporate performance has invigorated the market, with many tenants aiming to expand business operations and headcounts, subsequently increasing the demand for quality office space. This is demonstrated by the sound leasing performance of newly completed offices over the past few years, and bodes well for the stability of the market in anticipation of the large volume of office space scheduled for completion in 2025.

GRAPH 5: Residential Investment Volumes, 2007 to Q3/2024



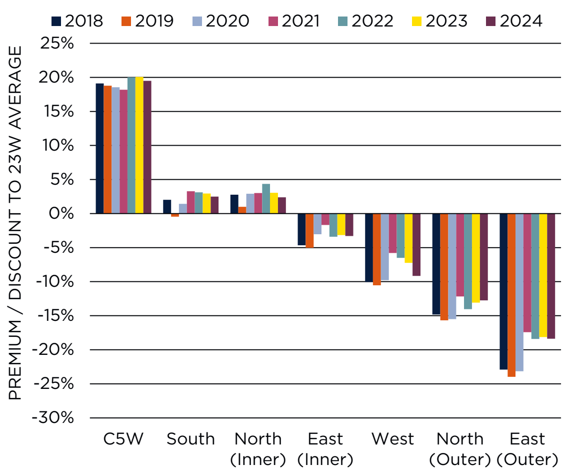
Source MSCI, Savills Research & Consultancy

GRAPH 6: Rents by Unit Size, C5W, 2014 to Q3/2024



Source Savills Research & Consultancy

GRAPH 7: Rental Premiums/discounts* vs 23W Average, 2018 to Q3/2024



Source Savills Research & Consultancy

*The above represents the average premium/discount over the respective year.

RESIDENTIAL

Investment Trends

Investor interest in residential assets has generally been strong, supported by the sector's sound fundamentals. In particular, the appetite for high quality residential assets in good locations remains strong. Residential investment volumes as of Q3/2024 reached JPY650 billion, which is marginally lower than those observed over the same period in 2023. That said, this figure is preliminary, and will likely increase as new deals are announced. Moreover, Savills in-house cap rates for mid-market residential properties remained flat over the past year at the tight level of 3.4%.

The largest residential transaction in 2024 was the acquisition of two Bridgestone company housing properties in Minato, with the seller posting a gain on sale of around JPY63.4 billion. Given the excellent location, this is likely to be redeveloped into ultra-luxury residential units. Meanwhile, M&G Real Estate acquired the Frontier Shinjuku Tower from LaSalle Investment Management for JPY30 billion.

Some moderately large portfolio transactions were observed over the year, the largest of which was Alyssa Partners and Gaw Capital Partners' acquisition of 29 apartment buildings in Tokyo from a domestic seller for JPY40 billion. The prospect of higher interest rates has shifted some investors' appetites, and large portfolios may no longer be as favoured. Overall, international investors maintain a positive outlook, but family offices and ultra-high-net-worth individuals (UHNWIs) are gaining more ground as some institutional players pull back.

Overall, demand for residential assets in Japan has remained strong in 2024 and likely in 2025. Net migration into Tokyo and other major cities looks to maintain its current strong momentum, especially with the likely further growth of the foreign national population, and demand for rental apartments should remain strong, not to mention the uptick in demand from those priced out of increasingly expensive for-sale condominiums. While some investors remain bullish, driven by expectations of rental growth, others have adopted a more cautious, wait-and-see approach. Time will soon reveal which perspective proves to be correct.

Review and Prospects

2024 has been a dynamic year for the Tokyo 23W residential market. Encouraging demographic fundamentals, in addition to strong wage growth, has driven the market to new levels. Average rents in Tokyo increased over consecutive quarters in 2024, with yearly growth reaching 5.9% in Q3/2024. On the other hand, occupancy remains slightly shy of the pre-pandemic level at a very tight 96%.

It must also be noted that many properties recently observed with below-average occupancy appear to be high-quality assets with elevated rents. Indeed, given the strong wage growth in 2024, it appears that many asset managers may be taking the opportunity to carry out bolder rent hikes, thus moving away from a focus on full occupancy in a shorter time horizon.

Population growth has continued in earnest in Tokyo, and ongoing urbanisation should be an encouraging sign. Foreign nationals made up around a half of these new entrants, and look to comprise a growing source of rental demand looking ahead, especially given their greater propensity to rent units rather than buy.

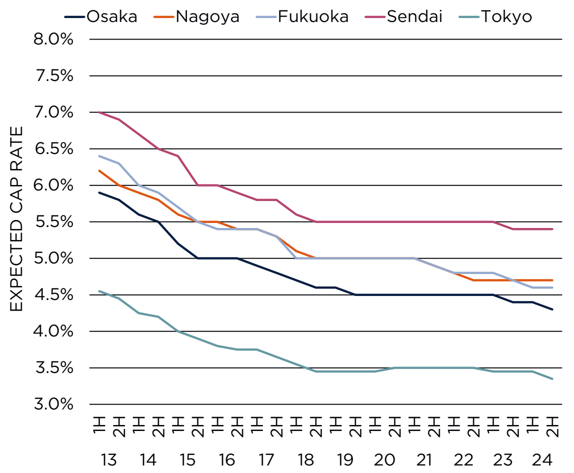
Location preferences also appear to have changed, with a greater emphasis now being placed on centrally located units. The shift towards greater rates of in-office participation has proceeded gradually, and demand has grown particularly among young professionals for more central properties, with better public transport connections. Moreover, foreign residents in Tokyo often gravitate towards central areas, and should become a more prominent driver of demand in the 23W and C5W areas. Moreover, units in the smaller 15-30 sq m size band have seen consistent quarterly rental growth, and there has been a noticeable drop in the availability of such units, narrowing the premium against larger units.

Elsewhere, the luxury residential sector has charted a course of strong growth. The growing interest in Japan as a global tourist destination, and the prominent population of younger ultra-high-net-worth-individuals that are interested in living in urban areas have driven the demand for luxury residences in Tokyo, including branded residences[2]. The luxury residential market in Japan is relatively untapped and gaining traction, leading to new demand and further growth.

Overall, the residential leasing market has witnessed strong growth. Looking ahead, Tokyo appears to remain a popular choice as a place to live and work, especially for foreign nationals, and this should predicate another year of strong net migration, underpinning firm leasing demand and further rental growth, particularly in central areas. The luxury residential market should shine brightly as well, with many players moving into the sector, and many more wealthy individuals looking to establish a base in Tokyo. Other tailwinds such as strong wage growth, elevated condominium prices, and greater levels of commuting should shore up demand, and drive rental growth moving forward. As such, the prospects for the rental residential market in 2025 appear to be bright.

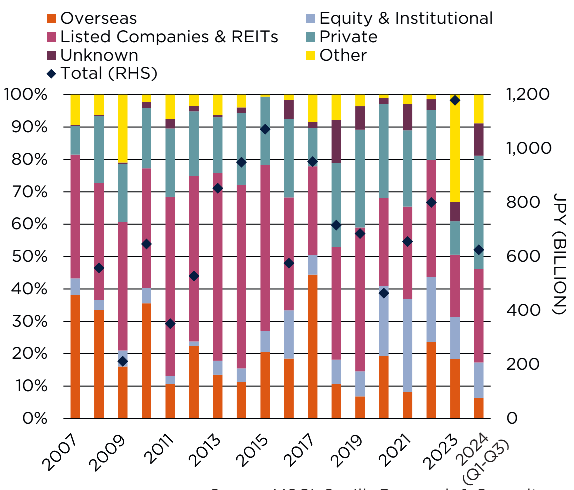
2 For a more detailed look at Japan's branded residence market, please refer to our "Branded Residences in Japan" report.

GRAPH 8: JREI Expected Retail Cap Rates by City, 2H/2013 to 2024



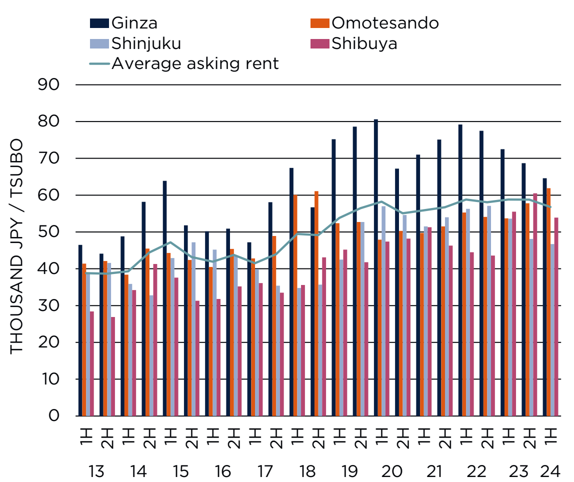
Source JREI, Savills Research & Consultancy

GRAPH 9: Retail Investment Volumes, 2007 to Q3/2024



Source MSCI, Savills Research & Consultancy

GRAPH 10: Tokyo 1F Rents, 2013 to 1H/2024



Source JREI, BAC Urban Projects, Savills Research & Consultancy

RETAIL

Investment Trends

Interest in the retail sector has been firm in 2024, and Savills in-house cap rates for high-street retail in Tokyo have therefore remained unchanged over the year at the tight level of 2.7%. Furthermore, expected cap rates for prime retail property in Ginza compressed by a further 10bps to 3.3% in 2024, according to JREI. Meanwhile, suburban retail facilities continue to offer attractive returns, with Savills in-house cap rates for such assets remaining unchanged at 5.0% over the year, which has prompted several large transactions.

Preliminary data from MSCI demonstrates this positive sentiment. As of Q3/2024, total retail transactions in Japan amounted to JPY625 billion. With the exception of a strong 2023, this figure is above those of the same period in previous years. Moreover, data is still preliminary, and the figure for 2024 will likely increase as more transactions are announced.

The bullish prospects for future rental growth, especially for high street retail, has prompted many tenants to purchase their current premises outright. For instance, the LVMH Group acquired the Abercrombie & Fitch Ginza Store in Tokyo for over JPY40 billion, reportedly for the purpose of store operations.

Suburban retail has also attracted significant interest in recent years, as the stable higher yields are an attractive play for some investors with strong operating acumen. Large acquisitions include the JPY30.0 billion unimo chiharadai in Chiba by KKR-sponsored Japan Metropolitan Fund REIT, and the Nasu Garden Outlet facility in Tochigi by Mitsui & Co. Digital AM, which has an appraised value of JPY22.6 billion. Additionally, Es-Con Japan acquired a plot of land in Nagoya from Denso for JPY20 billion to develop into a mixed-use retail facility.

Overall, footfall in most prime retail streets in Japan has continued to improve, and the favourable performance and sound fundamentals of the Japanese retail sector should continue to drive investment activity over the coming year.

Review and Prospects

The Japanese retail sector has charted a course of strong growth in 2024. The main factors supporting this have been the burgeoning demand from inbound tourists and improvements to domestic consumption due to strong wage growth. The luxury sector has been a standout performer, while sectors, like F&B, have made a strong comeback.

The rapid growth of inbound tourism has been a major tailwind for the sector, with tax-free sales reaching new highs in 2024. Indeed, according to the Japan National Tourism Organisation, Japan is forecast to welcome over 35 million inbound visits in 2024, and prime retail streets in popular tourist areas should continue to see growing footfall.

Given the bright prospects of the sector, there have been more upscale retail developments in the pipeline, including TOKYU PLAZA HARAJUKU “HARAKADO”, which opened in April 2024 in Omotesando. In particular, the luxury sector has been a particular beneficiary from this trend, and several high-profile luxury store openings have been observed over the year. Notable examples include Grand Seiko, Rolex Lexia, and Balenciaga opening their flagship stores in Ginza. Omotesando also welcomed luxury brands such as BVLGARI, while several high-end store openings took place in the new Azabudai Hills complex in 2024, including Hermes, Cartier, and Dior.

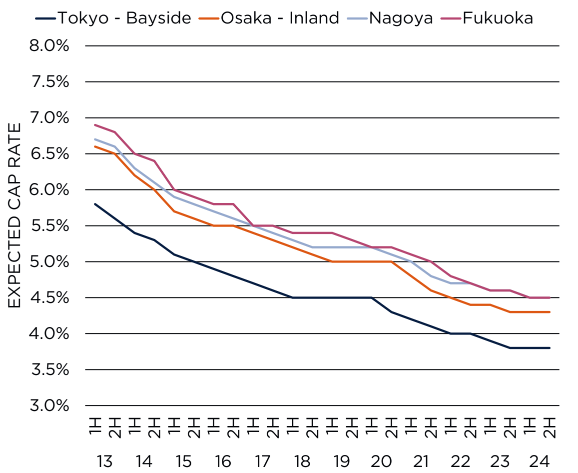
Regional retail markets have also performed well. Many regional tourist hotspots have witnessed strong demand for new store openings, which has supported rental growth. Major mixed-use development projects, such as GRAND GREEN OSAKA, the Chunichi Building in Nagoya, and ONE FUKUOKA BLDG. have attracted high-end tenants, and should revitalise central areas, increase footfall, and bolster the outlook of respective retail markets.

It appears that the luxury trend has also spread to popular tourist hotspots in regional markets, and many have successfully established themselves as destinations for high-income travellers. Niseko has been at the forefront in this regard, with Louis Vuitton testing the waters by opening a pop-up store in the last ski season.

While the mood in Japan’s retail market is generally optimistic, some level of bifurcation exists within most submarkets. Indeed, demand for space in many subprime retail streets has recovered relatively slowly, and such areas are being outpaced by prime ones in terms of occupancy and rental growth.

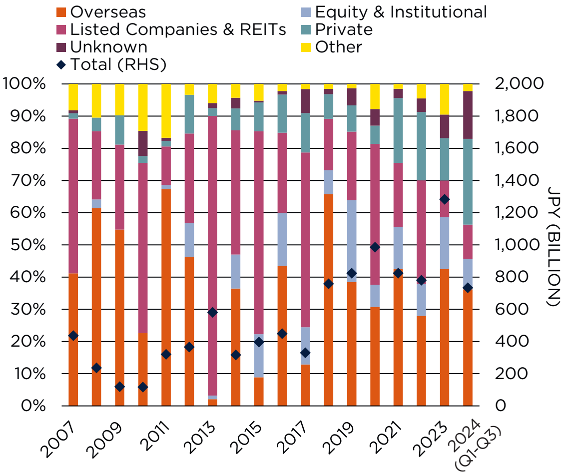
Nevertheless, prospects are bright for the retail sector in the coming year, and ever-growing demand from inbound tourists should preface strong growth. Moreover, several large mixed-use developments should revitalise and transform retail markets across Japan. That said, some challenges persist, including elevated energy and materials costs, as well as persistent labour shortages, which may make meaningful rental hikes unfeasible for properties located outside of prime areas, leading to market bifurcation.

GRAPH 11: JREI Expected Logistics Cap Rates by City, 2013 to 2024



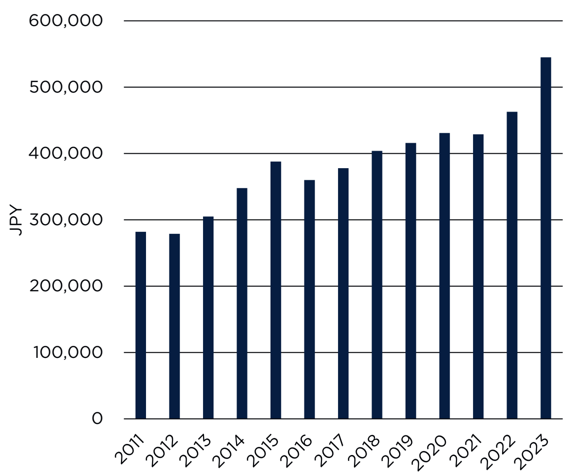
Source JREI, Savills Research & Consultancy

GRAPH 12: Logistics Investment Volumes, 2007 to Q3/2024



Source MSCI, Savills Research & Consultancy

GRAPH 13: Average Construction Cost for RC Logistics Facilities in Japan per Tsubo, 2011 to 2023



Source MLIT, Savills Research and Consultancy

LOGISTICS

Investment Trends

The logistics sector continues to enjoy strong demand in 2024, and preliminary transaction volumes as of Q3/2024 amounted to JPY734 billion according to MSCI. Although this figure is moderately lower than the record figure for the same period in 2023, it is higher than most years historically, and should increase as more transactions are publicly announced. As such, Savills in-house cap rates for prime logistics properties remain unchanged at the tight level of 3.3%. Meanwhile, according to JREI's October 2024 survey, expected cap rates either stayed flat or compressed in all major markets, with the Tokyo Bay area seeing no movement at the tight level of 3.8%.

The most significant transaction in 2024 was Industrial & Infrastructure Fund REIT's (IIF) acquisition of 28 logistics properties across Japan from LOGISTEED for JPY108 billion. IIF also made a silent partnership investment of JPY16.6 billion in HK Logistics GK, which acquired four properties from LOGISTEED for JPY104 billion. Other investors have also remained active in 2024. For instance, GIC acquired DPL Yokohama Totsuka from Daiwa House for JPY59.8 billion, while Amazon acquired the Hino Motors Hidaka Dispatch Center in Saitama for JPY44.1 billion.

Observers may be concerned by large volumes of supply and the subsequent vacancy. That said, the sector's fundamentals remain strong from a longer-term perspective, supported by growing e-commerce demand. Moreover, new supply will be more constrained over the coming years, which should improve the overall outlook. We anticipate that strong performance is likely to come back once near-term challenges are overcome.

Review and Prospects

Greater Tokyo's asking rents increased by 3.9% YoY to JPY4,780 per tsubo as of Q3/2024. Overall, rents have remained stable in Tokyo, with this uptick partly due to several listings in prime locations in Tokyo and Saitama. The average vacancy rate continued to increase, with an uptick of 1.5ppts YoY to 8.6% due to strong demand being outstripped by the large 3+ million sq m of new supply.

Meanwhile, the Greater Osaka market continues to be relatively more stable, with demand consistently exceeding supply, due to limited completions. As such, asking rents remained flat YoY at JPY4,230 per tsubo while vacancy decreased by 0.5ppts YoY to 3.6%.

Greater Tokyo is set to welcome a moderate 2.6 million sq m logistics supply in 2025, noticeably lower than over the past two years, providing much-needed breathing room to absorb existing space and further stabilise the market. On the other hand, Greater Osaka will receive a record new supply of 1.7 million sq m, which may cause some temporary disruption in the market. That said, with the relatively low levels of existing quality stock in Greater Osaka, there should be significant interest in new facilities equipped with modern amenities, as evidenced by the recent uneventful leasing of many new developments.

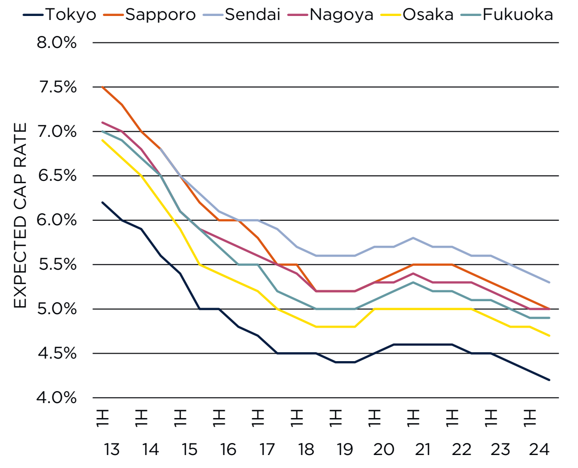
The logistics sector continues to struggle with high vacancy and a number of issues: elevated construction costs, material prices, and land prices make development increasingly unfeasible. The rising barriers to logistics development have prompted some investors to adjust plans or sell land, as reflected in the lower supply pipeline, allowing for the absorption of existing unoccupied space.

Meanwhile, the "2024 problem" appears to have materialised following new regulations issuing limits on overtime work, which have reduced driver availability and further exacerbated the existing labour shortage in the sector. As such, while many developers and landlords are struggling with heightened costs, they may be unable to increase rents, given the myriad of operating challenges facing tenants, with typically tight margins.

In response to this challenge, many logistics companies are adapting and creating new solutions, as seen with the growing development of relay bases. For instance, Daiwa Logistics is opening and expanding a handful of local relay centres in Hiroshima, Kagawa, and Fukushima prefectures, while GLP is developing facilities in Hiroshima and Okayama prefectures.

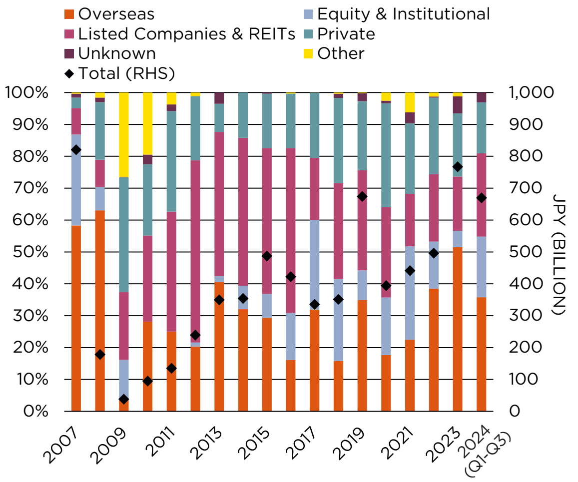
With these issues in mind, many players, in particular international ones, appear eager to reduce some exposure to the market, especially with the spectre of interest rate increments looking to depress net yields. While short-term challenges may linger, Japan's logistics sector remains resilient with a positive long-term outlook. Overall, the sector continues to evolve and adjust to various challenges, and investors who are able to weather the current storm are likely to reap the rewards once the market has stabilised.

GRAPH 14: JREI Expected Cap Rates for Hotels by City, 2006 to 2024



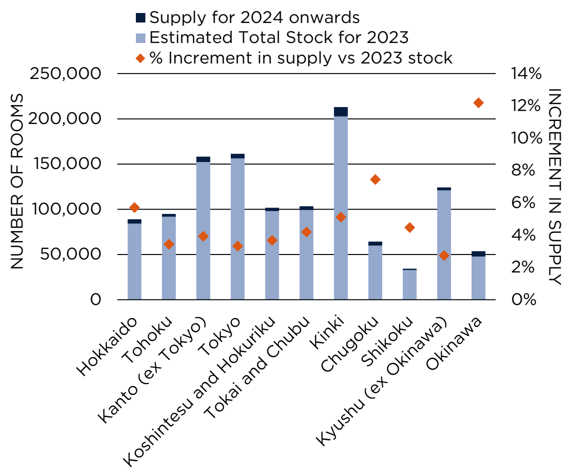
Source JREI, Savills Research & Consultancy

GRAPH 15: Hotel Investment Volumes, 2007 to Q3/2024



Source MSCI, Savills Research & Consultancy

GRAPH 16: Hotel* Stock as of 2023 vs Upcoming Supply for 2024 Onwards by Region, as of 2024



Source Hoteres, MHLW, Savills Research & Consultancy
* excludes Ryokan

HOTEL

Investment Trends

The hospitality sector has gone from strength to strength in 2024. The surge in inbound tourism has been a strong tailwind for the sector and there certainly appears to be room for further growth. As such, hotels have continued to be a highly desirable asset in 2024.

Indeed, according to preliminary transaction data by MSCI, transactions in the Japanese hotel sector as of Q3/2024 amount to JPY670 billion, which is already just shy of the historically strong total figure for 2023. Moreover, figures are preliminary and should elevate further. As such, given the popularity of the sector among investors, expected cap rates for hotels have compressed across most major markets in 2024, according to JREI.

The largest hotel transaction observed in 2024 was by TPG Angelo Gordon and Kenedix in October, which acquired the 882-key Grand Nikko Tokyo Daiba in Minato from Hulic for JPY106 billion. In August, Mizuho Leasing acquired the 1,053-key Hilton Fukuoka Sea Hawk from GIC for a price in the mid-JPY60 billion range, with rumoured plans to sell it directly after to Japan Hotel REIT. Meanwhile, international investors have been particularly active in the hotel sector this year, with overseas deals accounting for over a third of the total so far in 2024.

Overall, this flurry of investment activity is a testament to the strong performance of Japan's hospitality sector, and the growth of inbound tourism shows little sign of slowing in 2025. This should continue to instil investors with confidence, and observers may anticipate more notable hotel deals in the coming year.

Review and Prospects

The hotel sector has been a standout performer in 2024. Inbound tourism has seen dramatic growth over the year, with monthly overseas arrivals in 2024 exceeding the same monthly figure in every month in the previous peak period in 2019, and Japan is on track for a forecast total of over 35 million inbound visits this year. The number of mainland Chinese tourists has not yet recovered, implying that there is still potential for further growth.

Against this positive backdrop, hotels have performed well, with J-REIT hotel ADR and RevPAR indices increasing further well beyond the pre-pandemic level. Indeed, while the accommodation industry has been suffering from the chronic labour shortage, which has constrained occupancy rates, the situation has steadily been improving. Recruitment has been particularly successful in urban areas. That said, some resorts and remote areas will likely continue to struggle with labour shortages in the meantime. Nevertheless, hotel performance should continue to improve as a whole, given the unabated growth of inbound tourism.

The supply of hotels is limited amidst the present explosion in demand, which should contribute to heightened ADR in the meantime. Key bottlenecks constraining supply include heightened construction costs, on top of increased land prices. As such, the total stock of hotel and ryokan rooms in FY2023 increased by only 6,000 guestrooms from the previous year, according to data from the Ministry of Health, Labour and Welfare (MHLW). This increment was considerably smaller than those of (pre-) pandemic times - FY2020 and FY2021 saw increments of 32,000 and 19,000 guestrooms, respectively. Moreover, upcoming hotel supply is expected to be limited, especially in Tokyo and the wider Kanto area.

The luxury hospitality market in Japan is underdeveloped, but has been making notable progress in recent years, with several bright spots for future growth. The Osaka integrated resort will be a pillar of Japan's high-end tourism sector moving forward. The novel facility is a joint venture by MGM Resorts and ORIX Corp., and will be Japan's first large-scale entertainment and casino complex, scheduled for completion in 2030 with total investment slated at around JPY1.3 trillion. Developers are reportedly aiming to achieve a total annual revenue of over JPY500 billion, which could transform Osaka's economy and inspire similar IR developments nationwide, generating significant tourism benefits and a wider economic windfall effect[3].

Despite these encouraging prospects, Japan's hospitality sector continues to grapple with a number of challenges: some concerns exist regarding overtourism. That said, this issue is primarily prevalent in only a handful of cities and famous sites in a few prefectures. Elsewhere, many areas would gladly welcome more inbound tourists and still have significantly more room for growth. A greater supply of new hotels and more established infrastructure to accommodate overseas tourists could help to generate more traffic and demand more evenly.

Overall, the Japanese hospitality sector has continued to perform well and experienced strong growth in 2024, and this is likely to continue in the coming year. Hotels should perform well, due to the limited upcoming supply. Overall, investors should continue to be drawn to hotel assets in 2025, leading to elevated investment volumes.

3 For further information on the integrated resorts developments in Japan, please refer to our "Japan Hospitality - Integrated Resorts" report.

ALTERNATIVE ASSETS

Data centres have continued to grow, and are expected to consume significantly larger amounts of energy with rapid technological advancements, especially in artificial intelligence (AI). However, the difficulty of attaining power in popular data centre clusters appears to have prompted some players to make strategic pivots to prioritise power availability. Elsewhere, share houses have grown in number in Japan, and could see greater interest due to the growing foreign national population in the country. Moreover, multifamily asset yields have been compressed, and share houses which are more operational in nature should provide greater yields for skilful operators.

Data Centres

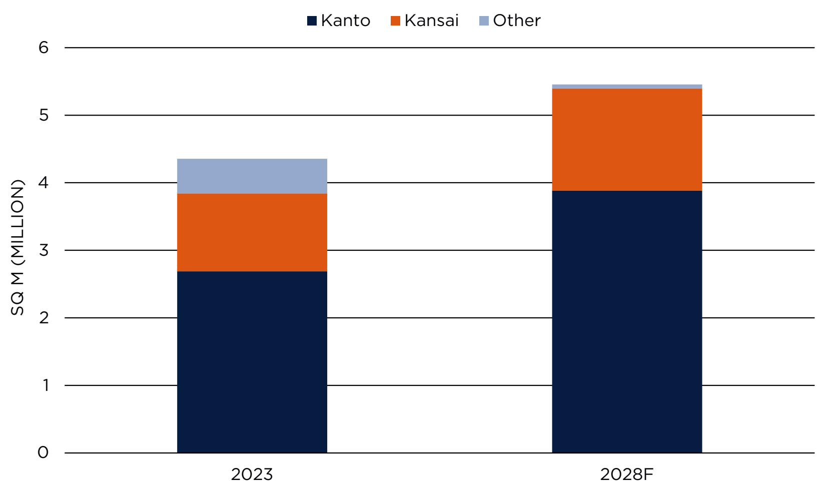
The market for data centres has continued to grow on the back of rapid technological advancements that have greatly bolstered demand for digital infrastructure. Over the past few years, many Japanese corporations have been playing catch up toward digital transformation and moving away from legacy enterprise systems and migrating toward cloud-based solutions. More recently, AI has exponentially increased the need for more power-hungry data centres, which has not only boosted the demand for such facilities, but has also impacted market dynamics in terms of tenant needs.

AI is a potentially groundbreaking technology that could reshape the world, but requires enormous amounts of power in order to operate. Fuji Chimera Institute forecasts that the amount of power required for Graphic Processing Units (GPUs) in data centres will increase hundredfold between 2022 and 2028. To wit, acquiring power has been the most significant bottleneck when looking to develop new data centres, which can take many years. Some major players appear prescient of this issue, and have taken strategic countermeasures, such as prioritising sites where power can be more easily attained, instead of sites that are in close proximity to city centres or availability zones. For instance, in January 2024, Google announced its acquisition of 275,000 sq m of land in Hiroshima, and 376,000 sq m of land in Wakayama, for a total of JPY10.8 billion, and reportedly plans to invest approximately JPY100 billion there into opening data centres to be fully operational by 2033. Such regional industrial parks seem to be suitable for some players and areas with lower utility bills may be more attractive.

However, the ideal site for data centres will differ significantly based on the player in question. Companies that have data centres that focus primarily on running AI models may not necessarily be as sensitive to latency and can hence be located further away from densely populated areas. On the other hand, cloud service providers, especially those for time-sensitive applications like high-frequency trading, will likely require low-latency connectivity, making it difficult for compromise on proximity to central locations.

As such, data centres in established availability zones have continued to see high levels of interest over the past year, with both international and domestic players making moves in the market. For instance, Softbank will acquire a factory in Osaka for JPY100 billion to convert into a data centre with a 250MW capacity. In addition, Mitsui Fudosan has announced plans to build data centres in Hino, Tokyo, and Sagamihara, Kanagawa, totalling 260MW, with the site in Hino having been acquired for approximately JPY50 billion from Hino Motors. Mitsui Fudosan also announced that it would partner with Keppel for data centre development and investments in Japan, and are reportedly developing a facility in Western Tokyo of around 28,000 sq m in GFA scheduled for 2027. Nearby, Keppel acquired a data centre of GFA 17,000 sq m in Tama, Tokyo, for JPY23.4 billion, which Amazon appears to be leasing in its entirety. Elsewhere, Gaw Capital has announced that it acquired a training centre in Fuchu, Tokyo, to develop a 38MW data centre with a GFA of 33,000 sq m. With this acquisition, the total power capacity of its data centre investments in Fuchu will reach 78MW. Separately, an SPC invested in by Dai-ichi Life Insurance and other entities acquired Cross Gate Shinsuna, a data centre in Koto, Tokyo, from AXA Investment Managers, which acquired it for JPY22 billion in 2020. Mapletree has also acquired a 30,000 sq m data centre in Tama, Tokyo, for JPY14.5 billion, marking its second acquisition in the Japan data centre market.

GRAPH 17: Data Centre Gross Floor Area Forecast, 2023 vs 2028F



Source Fuji Chimera Research Institute, Savills Research & Consultancy

TABLE 2: Graphics Processing Unit (GPU) Market Size and Power Forecast, 2022, 2023, 2028F

	2022	2023	2028F
GPU Market Size (For Data Centres only) (Million Yen)	4,520	11,300	72,500
GPU Server Housing Power Consumption (kW)	1,800	7,800	184,800

Source Fuji Chimera Research Institute, Savills Research & Consultancy

Overall, data centres in established availability zones have remained popular, and many investors have been active, both in acquiring operational assets or acquiring sites for development. At the same time, securing ample power remains a challenge, which has prompted some players with specific needs to look away from central locations to sites where power is more easily attained. The market thus appears to be expanding in terms of size, and assets have also become more diverse as data centres look to have different focuses and specialisations.

This should create more opportunities for investors keen entering the market, although the identification of the right partner will become increasingly important.

Share Houses

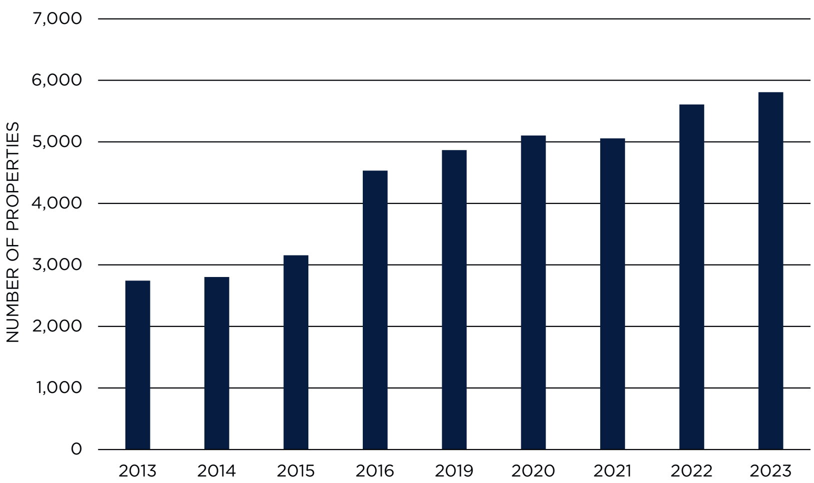
Unlike many metropolitan cities worldwide, share houses, or co-living spaces, have traditionally been a niche asset class in Japan. It faces stiff competition from the multifamily residential market, where a majority of its affordable stock is catered toward single occupiers. Moreover, from a cultural standpoint, Japanese people have generally preferred the privacy of a studio apartment. As such, a considerable amount of demand for share houses in Japan typically comes from foreign nationals, as they also have fewer administrative hurdles than traditional leases. Indeed, in 2024, occupancy rates of share houses have reportedly recovered due to strong inbound demand.

The number of share house properties has increased by more than 20% since 2019, and they have started gaining more traction with institutional investors. For instance, Samurai Capital kicked off its co-living fund of JPY15 billion with European investors amongst others, with the asset management company planning to supply 2,000 units going forward. The company appears focused on constructing new properties as opposed to acquiring existing ones and renovating, meaning that the properties should be better designed for co-living. Elsewhere, Capitaland has established an Asia Pacific US$600 million co-living fund that has made two acquisitions in Ginza and Shibuya operated under its lyf brand. Established domestic players have also been active, with Mitsubishi Estate Residence developing a share house property to be run by operators Hmlet in Ikebukuro, and possibly has plans for more going forward.

Indeed, many investors appear keen on entering the share house market. Share houses have a strong “social” aspect, which are favourable for boosting portfolio ESG ratings. Moreover, share houses are generally able to generate higher returns than traditional multifamily properties due to their highly operative nature. Nonetheless, the market size remains comparatively small, and the importance of partnering with a successful local operator could remain a challenge for newer investors.

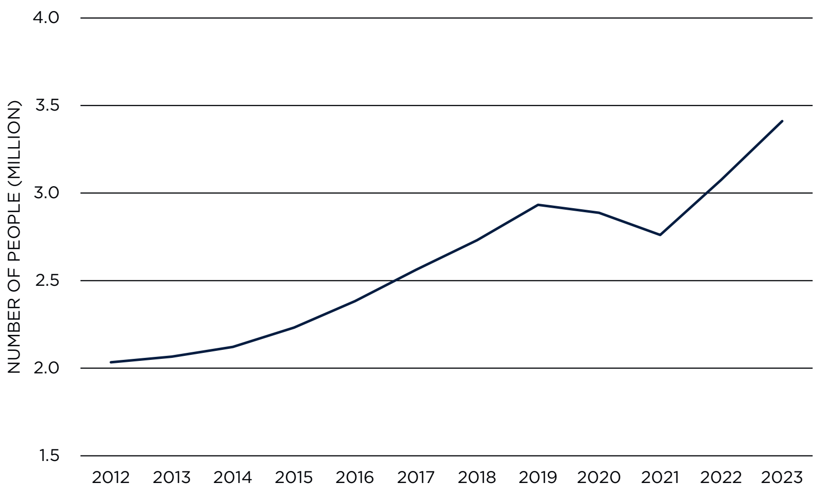
Going forward, share houses are likely to see continued interest from investors, as demand should continue to grow on the back of high foreign national immigration numbers. Some operators appear to be expanding to regions and cities beyond Tokyo 23W, which comprised more than 70% of stock in 2013, but less than 60% as of 2023, meaning that more diverse opportunities could arise as the market expands. At the same time, operators face some challenges, such as rising utility costs which have been eating into profit margins. As such, the success of investors in the sector will depend greatly on their ability to identify and partner with strong operators.

GRAPH 18: Number of Share Houses in Japan, 2013 to 2023*



Source Japan Share House Organisation, Savills Research & Consultancy
* Data unavailable for 2017 and 2018

GRAPH 19: Japan Foreign National Population, 2012 to 2023



Source Ministry of Justice, Savills Research & Consultancy

OPPORTUNITIES AND RISKS

Opportunities

As we exit 2024, Japan's real estate market continues to demonstrate resilience amidst a challenging global environment. While 2024 still presented headwinds, including inflationary pressures, geopolitical uncertainties, and elevated global interest rates, Japan fared better than many other economies. Despite subdued global transaction volumes, Japan managed to sustain steady activity across sectors.

While inflation in Japan appears to have peaked, it remains elevated by domestic standards. Interest rates have seen notable increments as the Bank of Japan began to normalise its monetary policy. Rates are expected to inch upward further, reshaping the investment landscape. Long-term rates are projected to stabilise at higher levels than in previous years, possibly requiring investors to adapt their strategies to the changing environment. Investment sentiment remains buoyant, with several significant transactions recorded in the hotel and logistics sectors. Additionally, the completion and rumoured progression of a few multi-billion-dollar deals reflects strong appetite from both domestic and international investors.

That said, the prospects of higher interest rates have shifted the appetites of some investors. While some remain bullish, driven by expectations of rental growth, others have adopted a more cautious, wait-and-see approach. International investors, on the whole, maintain a positive outlook, but family offices and ultra-high-net-worth individuals (UHNWIs) are gaining more ground as some institutional players have pulled back. Domestic players are also experiencing shifts. Once-dominant J-REITs have lost some of their prominence due to lukewarm unit performance, while other players, including strategic investors, remain active and engaged in the market.

Elevated construction costs are likely to change redevelopment plans, repurposing strategies, and tenant relations, which could have profound implications. The points below represent some of our views on investment strategies for Japanese real estate.

Core and Core-plus

Multi-billion-dollar mixed-use offices continue to be popular as trophy assets. This is evidenced by multiple high-profile negotiations currently underway, on top of the Blackstone deal, demonstrating the strong demand from both domestic and international investors who seek stability and prestige in their portfolios.

Prime retail remains highly sought after by a mix of investors and strategic players, driven by the resurgence of inbound tourism. The boom in international travel to Japan has rejuvenated retail sales, particularly in prime shopping districts, solidifying the sector's attractiveness. Retail assets with high footfall and located in iconic locations are especially appealing, offering robust returns and strategic value.

The enduring appeal of multi-family persists, further bolstered by the sector's ability to provide steady cash flows and hedge against inflation. Recent strong rental growth, fuelled by high occupancy rates and constrained supply in key urban areas, has enhanced the sector's allure.

Value-add

Grade B offices that have some levels of vacancy or host tenants with relatively modest rents present strong potential for value-add strategies. Owners can optimise space utilisation and attract new tenants through thoughtful capital expenditures and enhanced leasing strategies. An ESG angle may also still work well: some offices still need the shift from brown to green conversion.

Logistics facilities with high vacancy rates offer compelling entry points for value-add investors. Despite current oversupply concerns, the sector's mid- to long-term fundamentals remain robust. Japan's e-commerce penetration rate, currently below 10% and roughly half the APAC regional average, indicates significant growth potential. Shrinking supply soon should help to fill floors once the current slacks are taken up.

Older (20-25 years) multi-family residential properties are gaining popularity as value-add opportunities, offering upside potential through targeted capital expenditure. Renovations that modernise interiors, improve common spaces, and enhance building systems can justify rental increases, particularly in markets experiencing strong rental demand.

Opportunistic

Corporate real estate presents an exciting opportunity for opportunistic investors as companies continue to recalibrate their balance sheet for capital efficiency. Investors can reposition these assets for alternative uses. Additionally, sale-and-leaseback arrangements are becoming increasingly popular.

Luxury development continues to attract significant interest. The scarcity of luxury developments in Japan's key markets amplifies the appeal of this niche, making it a lucrative space for investors. On top of urban luxury residences, high-end tourism hubs also represent a strategic location for luxury developments, including branded residences and resort-style accommodations.

High-vacancy office, especially older or mismanaged ones, provide significant potential for opportunistic investors willing to undertake strategic efforts. These assets can often be acquired at discounted prices, and with thoughtful investments in renovations and leasing strategies, they can be transformed into competitive properties.

Risks

The current global landscape is fraught with uncertainty, presenting several critical risk factors that must be considered for real estate investment in 2025.

Interest rate risks

The trajectory of interest rates remains a key risk factor. Although inflation in Japan appears to have peaked, a resurgence of global inflation could disrupt the current scenario, prompting further rate hikes. Elevated interest rates could stifle economic activity and create upward pressure on Japanese rates, impacting borrowing costs and capital flows. In addition, the Bank of Japan holds a substantial portion of the country's government bonds, constraining its monetary policy flexibility.

Geopolitical risks

Geopolitical tensions continue to pose a major threat to global stability. The strained relations between the US and China, along with the elevated risks surrounding Taiwan, create uncertainty that reverberates through global supply chains and investor sentiment. Ongoing conflicts, such as the war in Ukraine and turmoil in the Middle East, further exacerbate these concerns. Furthermore, the unpredictable nature of the next US administration makes forecasting extremely challenging.

Natural disaster/climate change

Japan's susceptibility to natural disasters remains a persistent challenge. World leading technologies mitigate seismic risks, but earthquakes are a perennial threat, and the increasing frequency and intensity of climate change-related events add new dimensions of risk.

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