

Japan - November 2021

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SPOTLIGHT
Savills Research

Japan's Prospects Towards 2030

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Steady growth in Asia's largest real estate market expected to 2030

Summary

- Japan's social, political and economic stability, combined with low interest rates, continues to attract international capital.
- The populations of Japan and Tokyo are not forecast to see major changes over the next decade and should provide a steady foundation for the economy.
- Multiple large-scale developments are in the pipeline for completion by 2030, and they are expected to enhance the appeal of central Tokyo and attract more office and residential tenants.
- Other major cities across Japan have their own large-scale development plans and are likely to thrive as regional hubs.
- Technological game changers such as the proliferation of electric vehicles and autonomous driving could impact the economy and transform property demand.
- Potential concerns for Japan include the country's high public debt levels, natural disasters, and geopolitical tensions.
- The country's safe-haven status, alongside the depth and liquidity of its real estate markets supported by some of the region's best infrastructure, will ensure the enduring appeal of Japan among international real estate investors.

CURRENT STATE OF JAPAN AND POST-PANDEMIC LANDSCAPE

Japan has faced its share of troubles from the pandemic, and some sectors, like hospitality and retail, have been disproportionately affected. The markets that received a boon from the rapid growth of inbound tourism prior to the pandemic have been dealt a notably heavy blow and saw their economic conditions weaken. Moreover, particularly in Tokyo, the greater prevalence of remote work has reduced demand for office space and reshaped residential preferences, which resulted in some population outflows from Tokyo's central areas.

Despite these headwinds, the stable nature of Japan remains attractive for international capital. Specifically, Japan remains the third largest economy in the world with a significant lead over Germany, the fourth largest. Furthermore, although the population has started declining, Greater Tokyo and Greater Osaka are still the first and tenth largest metropolitan areas in the world.

Japan's social and political stability is also an attractive factor. For instance, the current ruling Liberal Democratic Party has almost continuously been in power since its foundation in 1955. Perhaps the most important factor that has helped to build a more stable political environment in the country is Japan's relatively higher economic equality and smaller social divide. According to the OECD, the top 1% in Japan own 10.7% of the country's wealth, in contrast with the United States where the figure is around 40% (Graph 1). While a new prime minister, Fumio Kishida, was inaugurated in October and has seen through an uneventful

national election, major changes to current policies are unlikely, again highlighting the stability of Japan.

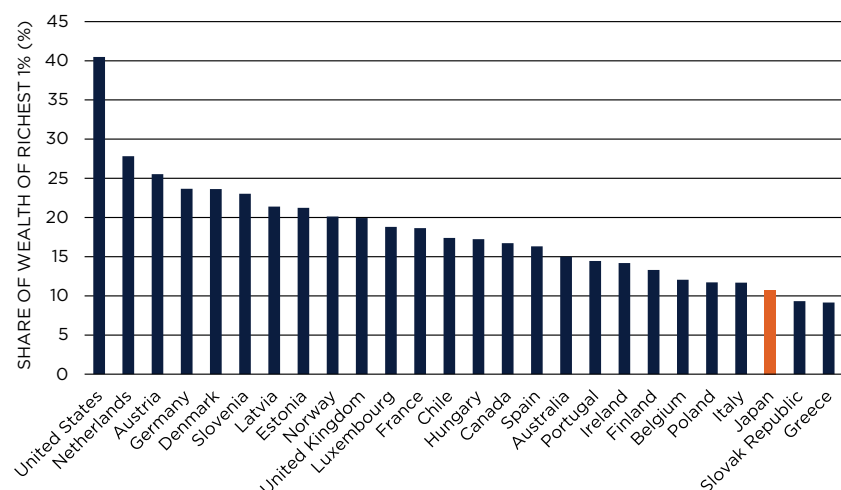
On top of these advantageous characteristics, favourable borrowing conditions help investment returns stay competitive, especially when compared with other regional markets in Asia Pacific. For instance, while the fierce competition for quality assets in Japan has kept Grade A office yields as low as 2.7% in Tokyo, the spread over the country's bond yield is one of the highest in Asia Pacific.

As the pandemic looks to be approaching a close with the recent plummet in COVID-19 cases and high vaccination rates in the country, the real estate market should see some recovery soon. This holds especially true for the office market, as most companies are expected to gradually welcome employees back to the office, while limited supply is also expected to give the market some breathing room.

GLOBAL TRENDS

The previous decade began with many setbacks – the global economy had just started recovering from the financial crisis, and Japan had to deal with the repercussions of the 2011 Great East Japan Earthquake on top of that. Despite these circumstances, Japan's economy performed well against the odds and although very modest, the country's economy experienced a consecutive 71-month expansion from December 2012 to November 2018, recording the second longest economic growth after World War II. Japan's political leadership also stabilised during this period. Furthermore, while the nation's population started declining after peaking in 2008,

GRAPH 1: Share of Wealth of Richest 1% by Country, 2019*



Source OECD, Savills Research & Consultancy

*The most recent data is used for countries where 2019 data was unavailable.

major real estate markets continued to see population growth thanks to urbanisation, and the labour force also increased due to rising labour participation rates among women and the elderly.

Japan faces ongoing challenges. Specifically, the country has very high debt levels, and the Bank of Japan (BOJ) has had to hold nearly half of the outstanding JGBs on its balance sheet. Additionally, its slowed economic growth, and ageing and shrinking population also add to the hurdles to be overcome. Nonetheless, despite these challenges, Japan's prospects for 2030 are positive, and should remain competitive on a global scale because of its solid foundations.

First and foremost, Japan's strengths lie in its social and political stability, as well as its economic size. These characteristics have allowed it to solidify its strategic importance and tend to shine brighter when there is greater uncertainty in the global economy. Indeed, according to reports published by Urban Land Institute, the highest levels of real estate investment interest in Asia were in emerging markets such as Bangalore and Mumbai in 2017, but the following years saw interest shift to markets with greater stability. In 2021, Tokyo ranked number two, only behind Singapore as the pandemic continued to pose significant uncertainty.

Looking at population trends, Japan is still projected to remain one of the most populous countries worldwide in 2030 with a population of 122 million, a slight drop from current levels. At the urban agglomeration¹ level, Greater Tokyo housed the largest population in 2020, and the only

city that is forecast to supersede it by 2030 is Delhi. In fact, Greater Tokyo has been the largest metropolitan area in the world over the last half century and in the top ten over the last four centuries, demonstrating the exceptional power of the region even at a global level. Additionally, although

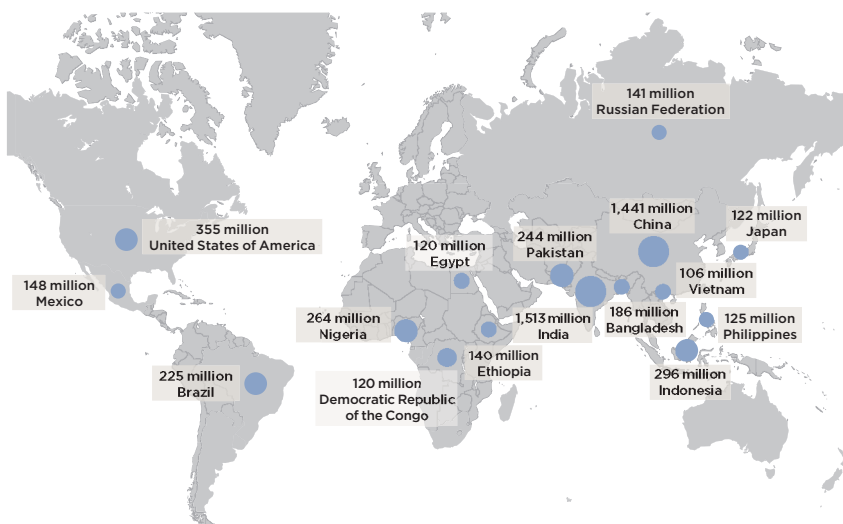
Japan remains a popular destination for international real estate capital due to its stable government, the resilience of its large economy and its attractive funding conditions. The country typically accounts for the largest share of real estate transaction volumes in the region, supported by a strong domestic investor base. While the country's population is ageing and shrinking, this is occurring at manageable levels, at least over the next decade. Looking ahead, the depth and liquidity of the Tokyo market is increasingly being mirrored in other cities including Osaka, Nagoya, and Fukuoka, offering a more diverse choice to investors.

low, Japan's fertility rates have remained mostly unchanged over the past two decades (Graph 2), whereas other similar developed countries like South Korea and Singapore have seen notable drops. The growing number of foreign residents, currently accounting for 2.3% of Japan's population, may further help support the country's population base.

Moreover, given the strength of its economy, Japan's significance on a global level is unlikely to change in the near future. The country is currently home to the third largest economy in the world, and its GDP in 2020 was much larger than that of Germany, the fourth largest (US\$5.1 trillion vs. US\$3.8 trillion according to World Bank). Furthermore, Japan's position as one of the largest economies is unlikely to change over the next decade especially because the growth of emerging economies, which were rapidly expanding since 2000, are showing signs of slowing down. As seen in Graph 3, the growth of BRICS countries has slowed since the global financial crisis, with the exception of China and India. The pandemic has also affected emerging economies more negatively, and this relative slowdown looks likely to linger. Therefore, Japan's position as a key global economic power is likely to remain in a post-pandemic world.

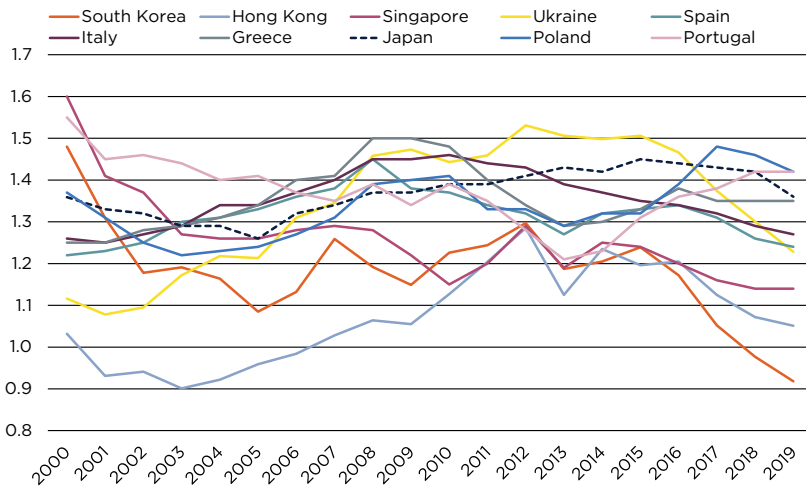
¹ The United Nations defines "urban agglomeration" as the population contained within the contours of a contiguous territory inhabited at urban density levels without regard to administrative boundaries.

MAP 1: Most Populated Countries in 2030



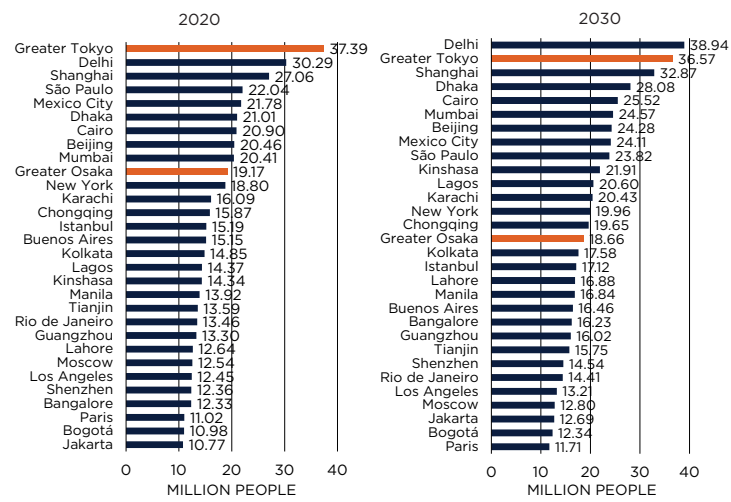
Source United Nations, Savills Research & Consultancy

GRAPH 2: Fertility Rates of Major Countries/Regions in the bottom 20, 2000 to 2019



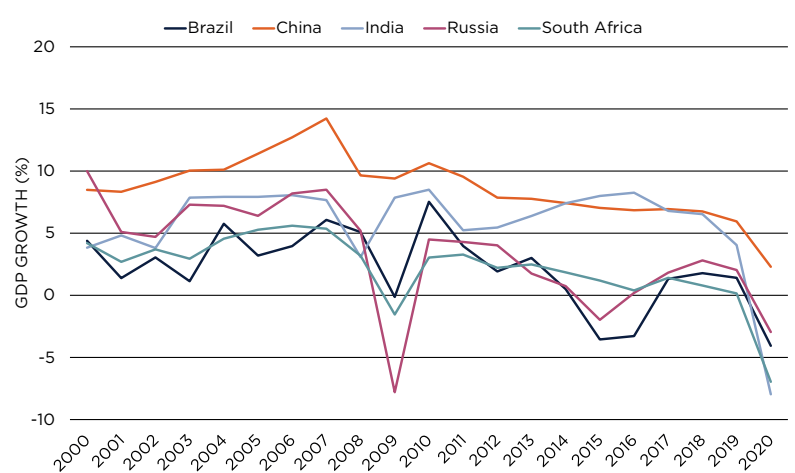
Source World Bank, Savills Research & Consultancy

GRAPH 3: Most Populated Cities, 2020 and 2030



Source United Nations, Savills Research & Consultancy

GRAPH 4: GDP Growth of BRICS Countries, 2000 to 2020



Source World Bank, Savills Research & Consultancy

GAME CHANGERS

When considering Japan's prospects towards 2030, technological advancements also have the potential to become game changers for the country. Just as ground-breaking technological innovations, like the smartphone, have quickly transformed the way society functions, future breakthroughs on the back of the exponential advancement and convergence in technology have the potential to reshape societal norms and expectations, and Japan will need to be swift in adapting to such changes.

This rings especially true for the automobile industry which is slowly adapting to the growing popularity of electric vehicles. Encouragingly, some companies like Toyota have made progress in hydrogen technology, solid-state batteries, and connected-city projects. However, if the demand for electric vehicle continues to grow, Japanese automobile companies may lose some of their competitive strengths. Considering that the industry has been a cornerstone of the Japanese economy, the potential negative economic damage from this delay could be significant to the country as a whole.

Furthermore, advancements in Mobility-as-a-Service, such as autonomous driving could have a direct impact on property demand. For example, in Tokyo, the median commuting time is 41 minutes², and the demand for residences and offices close to train stations has therefore been strong. However, if autonomous vehicles become cheap and convenient enough, less emphasis may be placed on proximity to train stations. This technology should also have a positive impact on the logistics industry where a shortage of truck drivers is a persistent issue. Luckily, Japanese companies have been active in this area, with Honda being the first in the world to produce a car with certified level 3 autonomous driving technology. Furthermore, such services are already present in some rural areas in Japan, and its proliferation is likely to eventually expand to suburban parts of Tokyo.

Overall, any of these game changing technologies could potentially alter the course of the Japanese economy to 2030. However, looking ahead, the Tokyo real estate market has a wide range of plans for the city over the next decade that will boost its economic value and investment appeal regardless.

MARKET PROSPECTS OF TOKYO TOWARDS 2030

When we shift our focus to Tokyo, multiple mixed-use developments are in the pipeline up until 2030 and will continue to renew the city's landscape. Many of these projects are located close to stations in central locations, and comprise of offices, ultra-luxury residential, retail, high-end hotels, international schools, MICE facilities, and more that should invigorate their respective

² Commuting time within the same prefecture, according to the Ministry of Internal Affairs and Communications.

surroundings. One area of interest is ultra-luxury, which is presently limited, stemming from the relatively equal wealth distribution and progressive tax systems, and thus has potential for further growth. This could also be promising for high-end inbound tourism, which is likely to thrive even after the pandemic.

Firstly, the Toranomon area in Minato is undergoing a major redevelopment phase with a new station and multiple buildings. Two upcoming developments that will be completed in 2023 are the Toranomon Hills Station Tower and the Toranomon Azabudai Project, adding notable office, retail, and residential space to the market. They are expected to create a “city within a city” feel and should increase the neighbouring land value, similar to what Roppongi Hills has done. Such developments in Minato over the past years have contributed greatly to the residential appeal of the ward, and it is

a popular location for wealthy locals and foreign expatriates. These developments will continue adding dozens of ultra-luxury condominium units priced at billions of yen to the ward and could solidify its position as a base station for high-end inbound tourism in the future. The prospects of the area look even brighter with these new projects in sight.

A spate of new developments is also underway in the Yaesu and Nihonbashi regions of Chuo. Located next to Tokyo station, Mitsui Fudosan's third “Midtown” complex, Tokyo Midtown Yaesu, will open in 2022 and hopes to mirror the success of earlier developments. This development is one part of the Yaesu 1-chome and 2-chome projects, which are slated for completion in 2025. Slightly further away, the Nihonbashi 1-chome project will also be completed in 2025. This will be followed by the Torch Tower in 2027, which will be the tallest

building in the area, and has an observatory that will attract tourists. Overall, all these mixed-use developments will not only add substantial office supply to the area but revitalise it and shift some attention from the western Marunouchi side of Tokyo station to the eastern Yaesu side. This should apply to the residential sector also, which has gained traction in Chuo on the back of its proximity to previous large developments in Chiyoda and Minato. These upcoming projects will create greater demand stemming from the attractiveness of the ward. Overall, these developments in Chuo and Minato, will establish the areas as future high-end centres for foreign expatriates. This might be realised as Japan looks to attract more people in this category with tax reforms that the government is considering.

Looking further south, four large mixed-use buildings will be built along the new Takanawa Gateway station by 2025 as part of the Shinagawa redevelopment project. They will add a large amount of office supply to the market and may attract some tenants from the Shinagawa submarket. Takanawa Gateway station will also host the new Maglev line to Nagoya and will be connected to Osaka in the future to become a commuter belt for the 65 million residents of the three metropolitan areas. This project may have a tremendous impact on the area. Two stations away in Hamamatsucho, the reconstruction of the World Trade Center Building is slated for completion in 2026. In addition to space for office, retail, and conference halls, a new monorail station bus terminal will also be constructed to improve access to the area. Overall, this region should see its popularity increase, thanks to these developments and its status as a new transit hub.

Shibuya is another area that has seen many large new buildings around the station rapidly built over the past few years, such as Shibuya Stream, Scramble Square, and Miyashita Park, to name a few. In addition, the Metro Ginza line unveiled a new platform with notably improved connectivity to other lines. With these infrastructure improvements, the area has been rejuvenated as a hub for IT companies. In 2029, the Shibuya 2-Chome West Project is set to welcome three developments consisting of office, hotel, residential, and retail uses in an area slightly east of Shibuya station. The development will also contain a bus terminal that will enhance station-front access and may encourage more redevelopment of the older infrastructure around it.

Shinjuku, home to the busiest train station in the world, is one of the more mature estates in Tokyo and has seen few new developments in recent memory. However, by 2029, the Shinjuku West Exit Redevelopment Project will be completed on the site of the Odakyu department store and other buildings around Shinjuku station, adding new office and retail space. The rarity of large new developments so close to the station in

MAP 2: Major Future Developments toward 2030



DEVELOPMENT	YEAR
1 Toranomon Hills Station Tower	2023
2 Toranomon Azabudai Project	2023
3 Yaesu 1-chome Project	2025
4 Yaesu 2-chome Project	2025
5 Nihonbashi 1-chome Project	2025
6 Takanawa Gateway	2025
7 World Trade Center Building Reconstruction	2026
8 Torch Tower	2027
9 Shibuya 2-chome West Project	2029
10 Shinjuku West Exit Redevelopment Project	2029
11 Uchisaiwaicho 1-chome Development (Imperial)	2036

Source Company disclosures, Savills Research & Consultancy

Shinjuku should bring this particular project into the spotlight, and the new office space added to the district's ageing stock is a strong positive for the area. Shinjuku should gain greater traction as a residential and office market with this development attracting new tenants to the area. Also, there may be an increase in demand for more suburban cities along the already popular JR Chuo line which provides convenient access to the station.

Lastly, the Uchisaiwaicho 1-chome development in Hibiya is expected to change the landscape of the area. The project includes three new mixed-use buildings, and the redevelopment of the main building of the Imperial Hotel and will take place between 2028 and 2036. Furthermore, Hibiya Park also has plans to be redeveloped by 2033. Overall, the proximity that these projects have to the new Tokyo Midtown Hibiya will spark new interest in the area.

DEVELOPMENTS IN REGIONAL CITIES

While Tokyo may take centre stage in Japan, other regional cities are also making progress in developing new infrastructure. In Osaka, the large-scale Umekita 2nd Project in the prime area of the city is expected to rejuvenate the city with its multitude of offices, residences, and other commercial space. Moreover, Osaka intends to team up with MGM Resorts and Orix Corp to construct the country's first integrated resort in Osaka Bay, giving the city a unique flavour and an opportunity for a large revenue stream that even Tokyo does not have. Elsewhere, Nagoya is advancing its infrastructure with a Maglev project connecting Tokyo and Osaka. This development will improve Nagoya's accessibility between these two regions, as well as prefectures in between, and will increase its status as a regional hub. The Sakae area also has multiple development plans, which offer an attractive alternative to

the Nagoya station front.

In the south, the Tenjin Big Bang Project and Hakata Connected project in Fukuoka both look to revitalise established commercial districts with the redevelopment of around 50 old buildings and add a large amount of office space into the market. Indeed, the landscape in both Tenjin and Hakata will be very different after the completion of these two projects. Up north in Sapporo, the development of the Hokkaido Shinkansen connecting to Sapporo is underway with plans to open in 2031. The Sapporo station front has many development plans geared toward the opening of the Shinkansen. In addition, Hokkaido may see future strategic importance with the Arctic passage becoming a viable trade route, especially for goods that require cold storage. Future developments in Hokkaido may see ports in the prefecture become a hub for this new trade route.

MARKET TRANSPARENCY

Compared to other countries, Japan's real estate market has traditionally been known for its opacity, and public market information on transactions is hard to come by. The Japanese market has been dominated by strong domestic buyers that have the local expertise required to make investments, and therefore the need to increase current disclosure levels has not arisen. Many of these domestic buyers are J-REITs. In fact, since 2007, the average percentage of transactions by J-REITs has been around 45%, although this has fallen over the past few years as international investors have become increasingly active.

International capital looking to Japan for investments therefore faces difficulties navigating the market at the beginning. Fortunately, one reliable and publicly available source of information would be the

legally mandated J-REIT disclosures that are of high quality and consistency and have become a key benchmark for the otherwise translucent Japanese market. Nevertheless, in order to keep attracting international capital in the long term, Japan will need to improve current disclosure levels. Going forward, we are also likely to see a rapid and large-scale shift in the importance of ESG-related products as global institutions place increased emphasis on the sustainability of their investments, especially in the West.

POTENTIAL CONCERNS

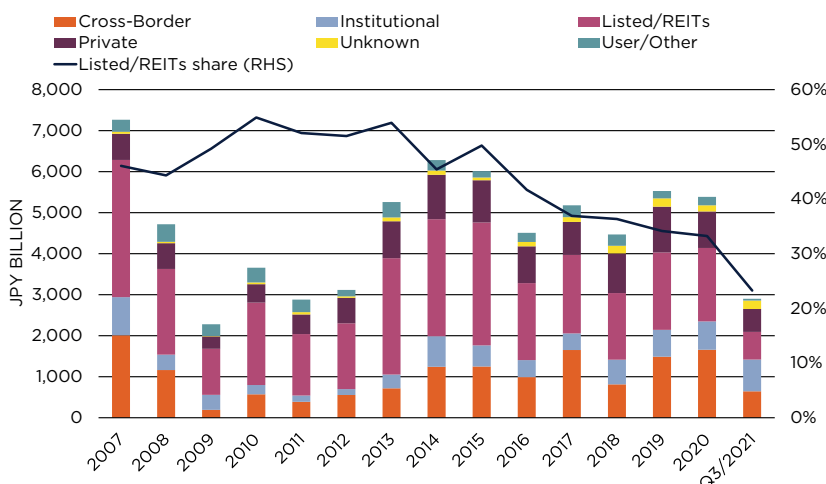
Japan also faces potential risks that may affect its mid-or-long-term prospects. For instance, while its population remains substantial at 126 million, it has nonetheless been falling slowly over the past decade because of its ageing demographic and low birth rates, and this is a concern for the country. However, forecasts estimate that population changes should be manageable over the next ten years and should not have major economic implications.

Another concern is the level of government debt as a percentage of GDP which is one of the highest in the world. However, when factoring private debt into consideration, Japan's total debt levels are only somewhat higher than many other advanced economies. Moreover, according to the IMF, the Japanese public sector has a large amount of financial and nonfinancial assets that offset its debt, demonstrating the country's balanced financial position. In fact, Japan is the world's largest creditor, which should tilt the scales in its favour. Nonetheless almost half of the government debt is owned by the BOJ, and 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.

Although nothing new, another concern is the plethora of natural disasters that the island country is prone to. Japan has experienced major earthquakes, typhoons, volcanic eruptions, and tsunamis over the past decade, and each disaster has had a toll on local economies. A large earthquake in Tokyo or the eruption of Mount Fuji for example could be catastrophic. Nevertheless, while these disasters cannot be avoided, it should be noted that the strict building standards and insurance policies in place should mitigate substantial damage. In fact, Tokyo has been evolving to become one of the world's most resilient cities, according to the Urban Land Institute.

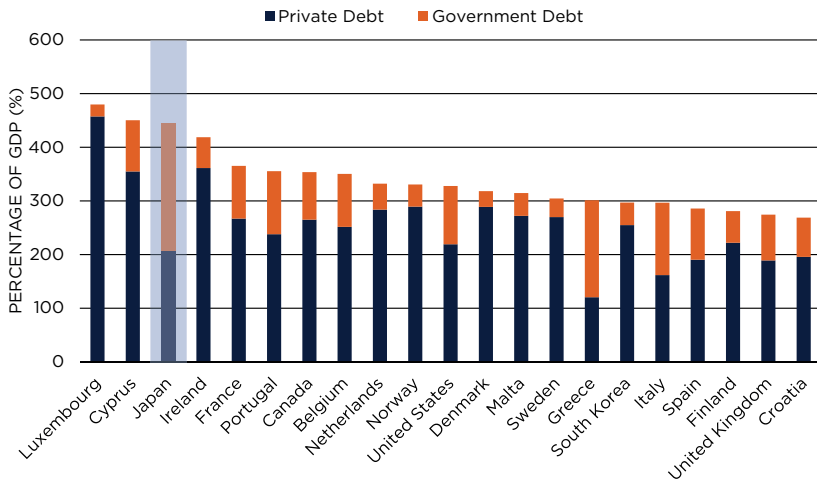
Japan also has to maintain good relationships with the United States, China, and its other neighbours in Asia Pacific. Over recent years however the region has seen rising geopolitical tensions that could call into question the safety and security of East Asia and stifle the region's growth. Furthermore, Japan's economy is deeply integrated with those of neighbouring countries, and changes related to tariffs and

GRAPH 5: Investment Volumes and Cross Border Share, 2007 to Q3/2021*



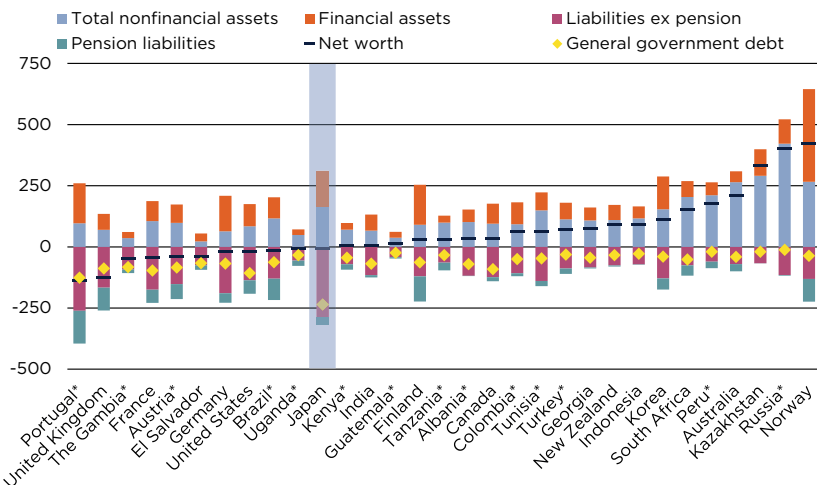
Source Real Capital Analytics (RCA), Savills Research & Consultancy
 *Q3/2021 volume is preliminary and is likely to be revised upwards. In principle, RCA investment volumes do not include related-party transactions, such as those between a J-REIT and its sponsor.

GRAPH 6: Countries* with Highest Debt-to-GDP Ratio (2019)



Source : International Monetary Fund, Savills Research & Consultancy
 *Does not include countries where data on private debt is unavailable.

GRAPH 7: Public Sector Balance Sheets (Percent of 2016 GDP*)



Source International Monetary Fund, Savills Research & Consultancy
 *The most recent data is used for countries where 2016 data was unavailable.

import restrictions could have a substantial negative impact. Nonetheless, Japan has made efforts to play its part in building stability in the region to deter potential conflicts.

OUTLOOK

Japan's position as a global economic powerhouse is unlikely to change over the next decade. It holds a competitive edge over its neighbours as a place for stable investment, and the size of its economy is unlikely to be surpassed in the near future. There are, however, some potential risk factors such as an ageing and shrinking population, high debt levels, a propensity for natural disasters, and rising geopolitical tensions.

Looking ahead, potential advances in technology have the power to reshape property demand. As an example, if services related to autonomous driving becomes prolific and affordable, a boost in demand for housing further away from stations is likely, especially in more suburban areas. With the breakneck speed at which technology is evolving, such changes could be with us sooner rather than later.

The pandemic has greatly expedited the introduction of remote work and satellite offices in Japan, which has reshaped its office and residential sectors. However, with the pandemic approaching a close, these changes are likely to see some reversal as more people return to working in the office, and consequently increase demand for offices and residences in the city centre. Moreover, the multiple large-scale developments scheduled for the Tokyo city centre by 2030 should markedly improve the attractiveness of the respective areas and boost demand. As second tier cities also embark on ambitious plans for urban renewal and infrastructure improvements, the appeal of the country's highly sought-after property markets can only broaden among domestic and international investors.



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