Japan - November 2020

SPOTLIGHT

Savills Research

Savills 2020 Year Book

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Early predictions largely holding true

Summary

In light of the COVID-19 pandemic, we have published multiple special reports this year that reflect our expectations of Japan's "new normal" and its potential impact on the built environment (see appendices). The overall predictions we made for each property sector at the beginning of the pandemic appear to be holding true for the moment.

Based on an analysis of Greater Tokyo's railways, we have identified three key areas – Yokohama, Shinagawa, and Ikebukuro – that are likely to gain more prominence in the post COVID-19 environment.

We have also analysed J-REIT unit prices and yields as an indirect, but timely barometer for the state of Japanese property, and have observed some substantial contrasts between the hard asset and listed vehicle markets. Ultimately, we believe that diligent and flexible investors should continue to find attractive opportunities in Japan.

INTRODUCTION

2020 has been a watershed moment for global society. Indeed, the COVID-19 pandemic has fundamentally changed our lifestyles and behaviours, the effects of which have reverberated across the real estate market. In response to this game-changing event, we have published multiple reports that reflect our expectations of Japan's "new normal" and its potential impact on property.

With the large-scale implementation of work from home, once a rarity amongst Japanese companies, some have chosen to relocate from the crowded urban environment to a more relaxed suburban or regional lifestyle. As such, we have focused on Japan's largest metropolitan area, Tokyo, and have identified the submarkets which are likely to emerge based on an analysis of the region's railways, which are the primary mode of transport for residents in the capital region.

We have thereby identified three key areas – Yokohama, Shinagawa, and Ikebukuro – which we believe are likely to gain more prominence in the post COVID-19 world. These three submarkets lie on the periphery[1] of Greater Tokyo ("Tokyo Periphery") and offer an urban and convenient commercial environment whilst being more affordable as residential bases with more green spaces. Overall, we believe that Japan's central business districts will continue to thrive; however, there is likely to be some dispersion of people and commercial activity to peripheral hubs.

Given that the hard asset markets take time to reflect economic and social conditions, we have also analysed J-REIT unit prices and yields as an indirect but timely barometer for the state of the Japan property market. We believe that the violent volatility of the J-REIT market during the first global wave of the pandemic in March demonstrates the extreme uncertainty and caution pervading the investment community, with credit default swaps suddenly skyrocketing. We did, however, observe substantial variance in J-REIT unit prices based on the sector focus of the J-REIT, revealing how investors perceived the impacts of the pandemic on specific sectors.

LOOKING BACKWARD AND LOOKING FORWARD

The general predictions we made earlier in the year appear to be holding true for the moment. Japan has managed the crisis relatively well compared to global peers and, as a result, all but the universally hard-hit hospitality and retail sectors have maintained somewhat sound fundamentals. The same can be said for the nation's political and social climate, which remains stable even after Prime Minister Shinzo Abe's resignation. Investors, bolstered by the astronomical levels of liquidity offered by central banks and drawn to Japan's stability, are therefore aiming to deploy more capital to the country. This trend may accelerate if the global pandemic drags on and Japan continues to keep the outbreak under some measure of control. Prime assets continue to enjoy pre-pandemic cap rates and the logistics sector has actually seen cap rates compress during the year.

The population of Tokyo appears to have plateaued since hitting a historic high of 14 million in May of this year. Occupancy rates for residential assets in central urban areas have been decreasing slightly, whilst key areas in the Tokyo Periphery appear more popular. Given that the median age of a Tokyoite is around 45 years old, relatively older than in other global cities, we predict that any shift in the population should be gradual and modest. Nevertheless, more affordable areas that are still proximate to central Tokyo are likely to become more popular and larger units will be more sought after to allow residents to work from home more comfortably. This view is supported by a survey conducted by Haseko, a major condominium builder, in July. According to this survey of the top cities to live in Greater Tokyo, three peripheral municipalities, Urawa, Mitaka, and Tachikawa, were listed in the top five for the first time. Although located in the suburbs, these areas have great railway access to central Tokyo, whilst offering retail facilities and more green spaces.

We believe that some form of remote-working will remain in place even after the pandemic ends - with hybrid arrangements likely being the most common. As a result, we expect office demand to weaken somewhat, though companies, particularly larger, more established firms, will continue to maintain a significant office presence, and some may move to a hub-and-spoke model via a centrally-located office complemented by satellite offices in peripheral hubs. We expect that these flexible arrangements, supported by digitalisation, will help streamline business processes and increase overall productivity. This also means there should be more availability in central areas. Less conveniently located office buildings may need to set more attractive rents, even in the emerging Tokyo Periphery. As a result, office demand should become more polarised going forward.

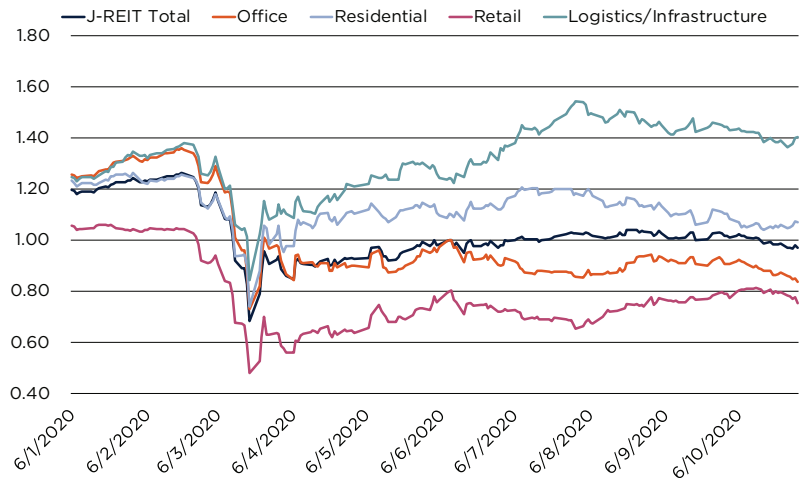
1 Locations outside of Tokyo's central five wards.

J-REIT MARKET

The TSE REIT index, an aggregate of the performance of all J-REITs weighted by market cap, has made a mild recovery and remained at a similar level since we released a report covering the topic in mid-April. However, as noted previously, performance has varied significantly by the sector focus of the J-REIT. From the start of the year to mid-April, logistics, residential, and office J-REITs fared well; however, performance started to diverge after the state of emergency was lifted in June. The logistics sector saw improved performance, while the residential and office sectors started to soften, with the latter showing the weakest performance amongst the three. In addition, we have observed some substantial contrasts between the hard asset and listed vehicle markets. Diligent and flexible investors should continue to find attractive opportunities.

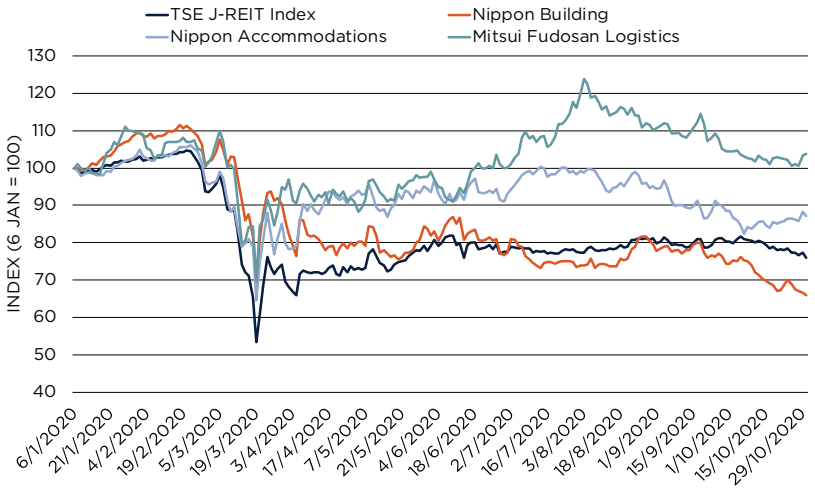
With the pandemic potentially reshaping Japan's property markets, we have striven to keep our readership updated throughout the year on the latest trends and possible outcomes, whilst also shedding light on promising opportunities.

GRAPH 1: NAV Multiple By Asset Class, January to October 2020



Source Savills Research and Consultancy

GRAPH 2: Year-to-date Performance Of High Quality J-REITs In The Logistics, Residential, And Office Sectors vs TSE REIT Index, As Of October 2020



Source Savills Research and Consultancy

With the exception of those targeting the logistics and residential sectors, most J-REITs are trading negative to their NAVs. Office sector J-REITs, which had enjoyed the lowest dividend yield and largest market capitalisation since the first J-REIT was listed in 2001, has now yielded its crown to the logistics sector. Prologis REIT had been the largest J-REIT in terms of market capitalisation after the onset of the pandemic and maintained that position until the office-focused Nippon Building Fund raised more than JPY120 billion of equity in October, the largest follow-on offering in J-REIT history. Although Japan office REITs have lost their dominant position, as had already been the case in other major markets, the Japanese office market itself looks relatively stable compared to global peers. It is also worth noting the impact that the global REIT market has had on the J-REIT market, the former's price adjustments leading to lukewarm performance of the latter in October.

Office

If we consider the popularity of high-quality, well-located office buildings, Nippon Building Fund ("NBF") and Japan Real Estate may be a good buy because they have dividend yields that are well over 4%, but with unit prices trading slightly negative to NAV. Indeed, the timing of NBF's massive offering dampened investor sentiment, and concerns over the office market have been growing somewhat. That said, the fact that the dividend yield spread against the J-REIT index in this sector has significantly widened – the most among all J-REIT sectors – since April may imply an over-correction. As such, concerns over the office sector may be much larger for J-REIT equity investors than for hard asset investors.

TABLE 1: Dividend Yield Spreads Of Each Sector Against The TSE REIT Index

YIELD SPREAD	OFFICE	RESIDENTIAL	RETAIL	LOGISTICS	HOTEL
Peak (Feb)	-0.5%	-0.2%	0.7%	0.0%	1.5%
Nadir (Mar)	-1.0%	-1.2%	2.6%	-1.1%	5.5%
Then (Apr)	-0.6%	-0.9%	2.6%	-0.9%	5.1%
Now (Oct)	0.9%	-0.1%	1.4%	-1.0%	-1.7%

Source : JAPAN-REIT.com, Savills Research and Consultancy

TABLE 2: Dividend Yield Of Each Sector, As of 31 October 2020

	DIVIDEND YIELD
Office	5.2%
Residential	4.2%
Retail	5.8%
Logistics	3.4%
Hotel	2.7%
All sectors	4.4%

Source : JAPAN-REIT.com, Savills Research and Consultancy

Retail

Prospects for the retail sector are mixed from a hard asset point of view. Prime urban assets are still sought after; however, Japan Retail Fund is trading at a strong negative to NAV, probably because of its large exposure to high-street assets. Its unit price has recovered somewhat after the announcement of its merger with an office-centric REIT under the same sponsor. Frontier and Aeon REIT are faring relatively well, though the large regional malls that make up their portfolios are not as popular for hard asset investors, given that revenues are declining somewhat and that capex requirements are growing. This contrast may reflect the creditability of sponsors.

Residential

Residential REIT performance has softened to some extent recently, likely due to concerns over a mild softening in leasing activity and a potential population decrease in Tokyo, as some people migrate outside of urban centres. That said, this unit price adjustment appears large compared with the hard asset environment, in which pricing is reportedly firm.

Logistics

Logistics J-REITs may be a bit over-valued now, as some J-REITs enjoy NAV premiums of 50% and dividends under 3%, even after price adjustments resulting from multiple large equity offerings. Logistics assets are also the most popular amongst all hard assets in Japan, thereby leading to high price tags. Many players are competing fiercely for land, leading to previously unheard of land prices for industrial sites. Indeed, both hard asset and equity investor enthusiasm appear to be in line for what has become the most popular sector in the pandemic era.

Hotel

Some hotel J-REITs may be overvalued, probably reflecting high hopes of a quick recovery in the domestic travel market via the "Go To" campaign, the government-sponsored travel subsidy program. Required dividend yields in the hotel sector are now much lower than those of the logistics sector, which implies that a rapid recovery has already been priced into the market. At the very least, the price recovery of Hoshino Resorts REIT appears fair as its portfolio is heavily weighted towards relatively high-end hotels and ryokan that appeal to domestic travellers and enjoy good operating indicators.

OUTLOOK

Japan has just experienced one of its longest economic expansions since the end of World War II, leading corporate profits to historic highs and generating solid income growth for households. While economic growth was modest, it was still sufficient enough to allow the country to finally escape from the deflationary spiral that had plagued it for more than a decade. Unfortunately, the combination of a consumption tax hike and a global pandemic have finally disrupted Japan's historic bull run, placing the country into a recession. Although Japan has managed to contain the COVID-19 outbreak relatively well thus far, the impacts of the global pandemic will certainly put a damper on Japan's economy and, by extension, the broader real estate market. Fiscal and structural supports aside, Japan's recovery would appear slow as economic growth tends to be modest even under normal circumstances.

Against this gloomy backdrop, Japan has witnessed a smooth transition of leadership – one which could be long lasting, as Prime Minister Suga is maintaining a sound approval rating. In the meantime, PM Suga appears set to maintain the policies of his predecessor, alongside some additional structural reforms. Digitalisation and decentralisation, for instance, will take on added importance, with the former aimed at increasing the country's productivity, whilst

the latter is intended to bolster regional Japan and mitigate population decline.

Most listed Japanese corporates have released forecasts for the upcoming financial year and the results are indeed discouraging, though not disastrous. According to the Nikkei, net profits are expected to continue falling, with the figure halving from the year ended March 2018 – the recent peak – to March 2021. With healthy balance sheets, most corporates have adopted a wait-and-see approach for the time being. Prospects for the next fiscal year should be a key determinant of corporate strategy, including office usage strategies. As such, we may observe a significant shift in office leasing next spring and beyond, depending upon domestic and global economic conditions. These decisions will subsequently impact relocation trends amongst Tokyo residents.

Given that there is no end in sight for the pandemic, most of the aforementioned trends are likely to persist. However, any change should be gradual and modest, so long as Japan can maintain a similar measure of control over the outbreak. Japanese corporates and households are moderately levered and appear well positioned to weather the storm for the time being. Also, given the high median age of Japan residents and Tokyoites, people should be reluctant to make significant lifestyle changes unless required. Regardless, we will continue to closely monitor the full impacts of the pandemic on Japan's property markets.

APPENDICES

- **COVID-19 and Japan Property, April 2020**
- **J-REIT Volatility and Japan Property, May 2020**
- **Tokyo Periphery and Rail Transit, May 2020**
- **Tokyo Periphery, Yokohama, June 2020**
- **Tokyo Periphery, Shinagawa, June 2020**
- **Tokyo Periphery, Ikebukuro, August 2020**
- **Tokyo Office Supply, June 2020**

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For more information about this report, please contact us

Savills Japan

Christian Mancini
CEO, Asia Pacific
(Ex. Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

Savills Research

Tetsuya Kaneko
Director, Head of Research
& Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

Japan - April 2020

SPOTLIGHT

Savills Research

COVID-19 and Japan Property

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Japan's conservative approach to pay dividends

Summary

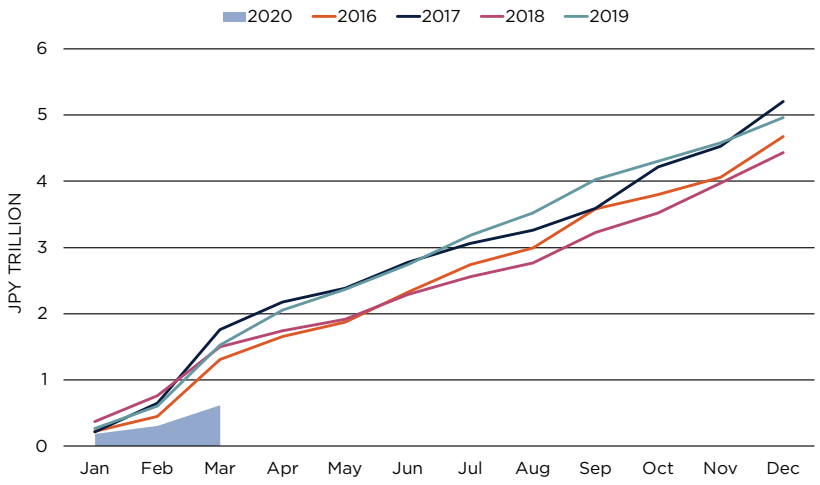
- With the economy already under pressure following the consumption tax hike of October 2019, the COVID-19 crisis has created a perfect storm for Japan. The one-year postponement of the Tokyo Olympics has further dampened market sentiment for 2020, though it is far more welcome than an outright cancellation.
- Cap rates across sectors other than hospitality and retail should hold in place for the time being as transaction activity comes to a halt.
- Compared to other nations, Japan has less exposure to overseas demand including trade and inbound tourism, lending some insulation from border closures.
- Listed Japanese firms hold JPY500 trillion in cash and cash equivalents, whilst households are less indebted than during the lead up to the global financial crisis, and less so compared to international peers.
- The sectors with the most resilience to the COVID-19 pandemic, in order, are 1) residential, 2) logistics, 3) office, 4) retail, and 5) hospitality.

MARKETS ON HOLD

With the world gripped by the COVID-19 pandemic, governments are scrambling to assess disease prevalence and apply stringent containment measures that limit physical interaction – essential for saving lives, but catastrophic for the economy as global business activity is effectively put on pause. The international investment community has naturally responded with a massive selloff of all liquid assets, and Japanese markets have been no exception, with sentiment being further dampened following the postponement of the 2020 Olympics. Given the nature of hard assets, property performance and the resulting valuations have yet to reflect the COVID-19 shock – but market players are bracing themselves for impact.

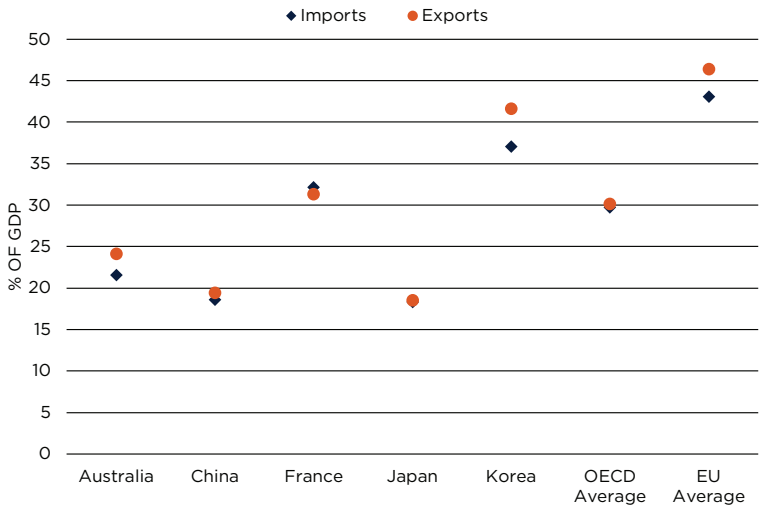
Indeed, as a black swan event for which few in the investment community might have accounted, investors must now revisit their assumptions and assess their global positions. Within the Japanese property market, at present, nearly all rumoured transactions appear to have been suspended or postponed. Unlike the previous crisis, sellers and owners have, for the most part, a solid financial standing. As such, excluding holders of hard-hit hotels and retail assets that may breach covenants, owners have no need for a fire sale.

Graph 1: Japan Cumulative Investment Volume by Month



Source Real Capital Analytics, Savills Research & Consultancy

Graph 2: Imports And Exports As A Percentage Of GDP, 2018



Source OECD, Savills Research & Consultancy

Certain investors, particularly domestic ones, still appear interested in acquisitions; however, they appear to be seeking deeply discounted opportunities, for instance, with a 1% wider cap rate than before. This has led to a lack of compromise on pricing, as most owners have no urgency to sell. International investors, on the other hand, have put overseas transactions on hold. Indeed, worldwide travel restrictions are preventing them from physically inspecting assets, halting the due diligence process in its tracks. This trend is unlikely to shift anytime soon and is not inconceivable to persist months after the pandemic has started to recede.

While travel restrictions might present a physical roadblock to investment, the shock to the capital markets could shift the buyer landscape and open more opportunities to overseas investors. The J-REIT market saw a significant correction after mid-February, with the TSE REIT Index plummeting almost by half towards mid-March. Although the index has since recovered somewhat, it remains over 30% lower than before the COVID-19 shock. Unit price/NAV and property purchasing power have been reduced accordingly, likely putting a damper on acquisition activity this year.

Given that J-REITs have recently been active buyers, accounting for approximately 30% of market transactions, their now limited purchasing power should pave way for much-awaited opportunities for other investors who have previously struggled to acquire properties in a very competitive acquisition market. Indeed, private real estate, pension, and sovereign wealth funds still hold a historically high level of dry powder to deploy. For that reason, these investors are likely to grow their clout this year as cash reclaims its throne in the COVID-19 world.

With the Tokyo Olympics in sight, Japan entered 2020 with high hopes and sound fundamentals. Sadly, the COVID-19 pandemic has dashed these hopes and presents a major challenge to the domestic property market. Certain sectors are better positioned to weather the storm, however, and frugality among Japanese corporates and households should offer an additional buffer to the domestic market.

CAP RATES FREEZE...FOR NOW

With essentially no transactions being closed, there are no real benchmarks by which market players can judge "actual" property values in the current environment. As a result, cap rates are, for the moment, frozen in place. Moving forward, appraisal reports are likely to show cap rates that are somewhat looser, though not to the extent that property values decline so drastically as to cause breaches in lending covenants.

Lending attitudes have become more reserved, but windows are still open for certain assets and asset types, especially in the residential, logistics, and office sectors. Assumptions on rent increases and leverage have been adjusted to a more conservative level, however. With Japan's fiscal year commencing in April, lenders may use this opportunity to adopt more conservative strategies.

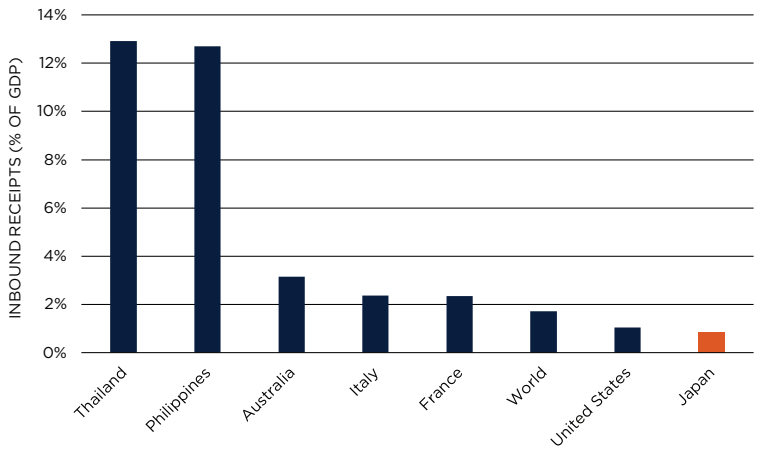
Meanwhile, most asset owners, other than those with hotels and retail properties, can maintain a wait and see approach while continuing to collect rental income. Hard-hit hotels and retail properties will likely face immediate rent adjustments and thereby see cap rates change more rapidly. Office, logistics, and multi-family rents should stay relatively flat for the time being, as rents are fixed during the contracted period, providing a layer of protection for cash flows. Hence, it is likely that actual property values will not fluctuate much, at least until the end of the year. That said, lower-quality properties may face issues sooner given that the tenants are generally less creditable.

OVERSEAS EXPOSURE MORE LIMITED THAN IT IS PERCEIVED

Although the Japanese economy is far removed from the spectacular growth of the 80s and even from the recent growth of the world economy, it is still one of the most stable in the world. Some still believe that Japan is highly export oriented and, as such, COVID-19's disruption of global supply chains could damage the Japanese economy disproportionately. Yet, in truth, Japan is more similar to the U.S. in that domestic demand dominates economic activity: trade accounts for only around 35% of GDP, among the lowest in the world. This misconception may come from the Japanese public equity market where, compared with other countries, multiple large manufacturing companies with sizable market caps have an outsized weight among major indices.

Similarly, while inbound tourism has been a major boon to the Japanese economy, serving as an important growth catalyst since 2013, it remains a small part of total economic activity in Japan, with hoteliers and retailers relying primarily on a stable base of domestic demand to support their businesses. Specifically, inbound tourism still accounts for less than 1% of Japan's GDP and less than 20% of total nights stayed in its accommodations, while inbound retail accounts for a mere 1% of total retail revenue (Graph 3).

Graph 3: Inbound Tourist Receipts As A Percentage Of GDP, 2018



Source OECD, Thailand Ministry of Tourism and Sports, Philippine Department of Tourism, Savills Research & Consultancy

WHEN FRUGALITY PAYS DIVIDENDS

Japan's exceptionally high level of government debt is well known. However, the story is quite different when looking at companies and households.

Listed Japanese firms hold more than JPY500 trillion in cash and cash equivalents, an amount that is essentially equivalent to the country's annual GDP. For perspective, U.S. firms hold around USD4 trillion in cash, or around 20% of annual GDP. Japan Inc.'s rampant cash hoarding, marked by modest investment and limited share buybacks, has of course been a point of contention for overseas investors; however, this strategy has enabled Japanese businesses to be well-positioned to weather this crisis. Households have been similarly frugal over the past decade, with the debt-to-GDP ratio among Japanese families generally declining since the global financial crisis (Graph 4).

Despite these financial buffers among companies and households, the timing of the COVID-19 crisis has created a perfect storm for Japan. Indeed, with the nation still reeling from the consumption tax hike enacted in October, the already-fragile Japanese economy looks certain to head into a technical recession - and possibly worse. Further, unlike during the global financial crisis, there appears to be no nation that still has sufficient firepower to drive a global economic recovery.

THE IMPACT TO JAPANESE PROPERTY

In the case of Japan, we believe the sectors with the most resilience to the COVID-19 pandemic, in order, are 1) residential, 2) logistics, 3) office, 4) retail, and 5) hospitality.

Considering local market practices, we believe that only the hospitality and retail sectors should experience immediate negative impacts. These sectors are most susceptible to government containment policies, including travel restrictions, and social distancing guidelines, and some hotels and retail property owners have already received rent reduction requests from struggling tenants. Unlike in Western countries, there are at present no legal moratoriums on rent payments. The government has instead requested that real estate owners consider a flexible response to accommodate struggling tenants. That said, some lawmakers are considering legally-binding measures.

Investors should now focus on asset management while assessing the impact of COVID-19 and rethink their investment and portfolio strategies. In the short-term, managing tenant relations and maintaining rents at an appropriate level should be the primary concern of owners. Thereafter, some may want to consider adjusting asset type allocation to a more defensive mix. In these testing times, the quality of the underlying assets as well as the creditworthiness of tenants matters more than ever. Those unable to satisfy these conditions are therefore expected to suffer disproportionately.

The property markets are ultimately linked to economic fundamentals, and current prospects for global economic growth appear daunting. Double-digit quarterly contractions in GDP appear inevitable in many parts of the world, and a short-term recovery scenario is unlikely. Equity and credit markets appear to have calmed somewhat, but the violent volatility observed during March may return.

To wit, major economic indicators continue to deteriorate and corporations are increasingly announcing grim financial results. This may soon derail the capital markets and subsequently the property market. In addition, measures to control extreme volatility in capital markets have brought interest rates across the world even lower, which may make Japan's wide yield spread less attractive to investors.

To be sure, it is still too early to grasp a full picture of the post-COVID-19 world. The impacts of this crisis are likely to persist even after the pandemic comes under some measure of control, as populations across the globe alter their behaviour and lifestyle. These changes should affect the entire property sector, though the impacts will vary by asset type. As such, this report will focus on the most likely short-term scenarios and repercussions by sector based on currently-available data and observed market trends.

OFFICE

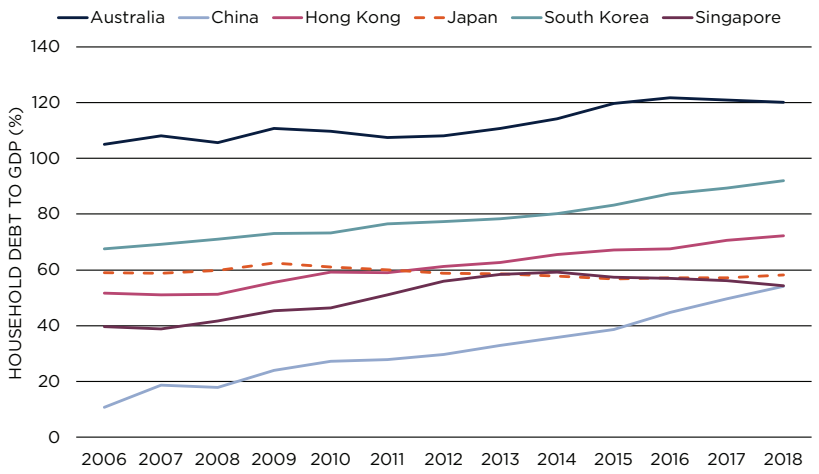
The office market entered 2020 with promising prospects, which will now more than likely prove to be short-lived. Yet, all things considered, Grade A and B office markets in Tokyo both saw impressive rental growth over 2019, whilst maintaining extremely low vacancy. Many regional markets have proven to be similarly robust over the past two years. With office demand largely tracking economic growth, however, office fundamentals are likely to deteriorate as the economy weakens, albeit with a delay of at least a few months to a half year.

Encouragingly, well over 95% of office supply in 2020 has been filled or pre-leased and supply in 2021 and 2022 is low, helping the market remain stable. With vacancy rates already at record lows, tenants have limited options if they did decide to move, and for that reason, landlords would be justified in keeping rents unchanged. Moreover, with the requirement to provide advance notice if they do decide to leave, the tangible impact of tenant relocations could take up to six months to emerge, adding to market stability, at least until late 2020.

What's more, amid a previously buoyant market, with fierce competition for space, financial incentives such as rent-free periods were limited. Landlords therefore would most likely prefer to offer these incentives to prospective tenants before allowing vacancies to rise. Hence, rents should stay flattish before vacancy goes up. On the other hand, this somewhat optimistic scenario may not apply to lower-grade buildings – where our coverage is limited – accommodating lower-credit tenants, some of which may be financially vulnerable and may soon need to seek rent reductions or shrink leased floor areas.

With governments across the globe advising or enforcing self-isolation, the

GRAPH 4: Household Debt To GDP Ratio Among Major APAC Markets, 2006 to 2018



Source International Monetary Fund, Savills Research & Consultancy

requirement to work remotely is likely to shape tenant preferences even after the pandemic recedes. Indeed, those who had indicated a desire to expand leased floor space before the COVID-19 outbreak may change tack as the current turmoil weighs on demand for workforce.

Moving forward, there should be cases of companies shrinking office space by maintaining some remote working practices, or setting up satellite offices closer to residential areas such as Omiya, thereby creating new opportunities for market participants. Centrally located co-working spaces, in contrast, should lose some of their appeal as a result of these demand shifts, but co-working spaces closer to residential areas should be able to capitalise.

RESIDENTIAL

The multi-family residential sector stands as the most resilient in the face of the current crisis. Solid rental growth was observed in most submarkets in Tokyo in Q1/2020 and, so far, fundamentals have appeared sound.

To be sure, the residential sector is certainly not immune to this ongoing uncertainty. Corporate activity has slowed, with labour demand falling as a result. There have even been cases of soon-to-be university graduates having job offers rescinded by smaller companies, emphasising the uncertain market conditions ahead. Coupled with stubbornly low wage growth, as evidenced by the lower salary hikes than demanded in the annual spring negotiations (whereby increases in salaries are negotiated between companies and their respective unions), the affordability of current rent levels will be tested.

Despite the pessimism, it is important to keep in mind the defensive nature of the residential sector through times of stress. For instance, the sector held up relatively well even after the global financial crisis – rents adjusted by approximately 10% and occupancy remained stable in the subsequent years. Furthermore, firms have hitherto faced prolonged labour shortages, and are therefore likely to reduce other expenses before turning to workforce redundancies.

More broadly, the cash reserves of Japanese firms serve as a strong reserve to help weather the COVID-19 storm, and this additional firepower should mitigate layoffs, pay cuts, and bankruptcies, thereby providing another layer of protection to the residential sector. Considering the above, therefore, rental growth, if any, is expected to be moderate, at least until the impact of COVID-19 becomes more apparent.

Looking further ahead, residential unit preferences may change if a substantial number of companies continue some form of remote work and/or flexible working hours after the pandemic subsides. Having impetus to spend more time at home may prompt residents to prioritise larger spaces with better amenities as opposed to proximity to train stations, a feature that is highly-valued outside of Tokyo's central five wards. Conversely, COVID-19 may deliver a blow to the emerging co-living and share house subsector, as convenient locations and social environments may lose some of their lustre.

RETAIL

Although Japan has yet to implement a strict lockdown, caution among residents has been high since February, with many avoiding crowded commercial centres. According to Google, as of late March, footfall in retail and entertainment properties in Tokyo has fallen by over 60%. These numbers are likely to fall further in April and May as the government steps up restrictions to further limit business activity and the movement of people.

This sharp decline in footfall has unsurprisingly hit retail revenues. For instance, Renown, a major apparel retailer, recorded a drop of over 40% in its March store sales. Meanwhile, Saizeriya, an Italian restaurant chain, marked a 20% decline – the largest decrease in a decade. The break-even point of the food service industry is said to be approximately 90% and, as such, the pandemic is a catastrophic blow to this industry.

Department stores, many of which had already been in a fragile state, are among the hardest hit subsectors of the retail market. Major department stores showed a 30-40% decrease in their March sales. Duty free sales – previously the best performing segment – have plummeted by over 90%. On the other hand, supermarkets, convenience stores, and drug stores are faring well thanks to growing demand from people spending more time at home and stocking up on daily essentials.

In this difficult environment, multiple retail property managers have begun to receive rent reduction requests, especially from thinly capitalised subsectors such as food services and event planning. More requests should follow as operating activity is further constrained by social distancing guidelines and closed borders. As a result, we should see some consolidation in this fragile sector, which should be a positive development in the long-term. In the meantime, skilful asset management matters more than ever.

Prime retail sales are also under pressure. For now, however, owners in this subsector have a higher degree of protection as rents are fixed with creditable tenants, whilst the most sought after locations still have the advantage of high land values and strong demand. As such, the prime subsector is perceived to be defensive.

The disparity amongst winners and losers in the retail sector has been stark and this trend is likely to become more pronounced. Those who implemented digital platforms early can continue to leverage these channels during the COVID-19 crisis and beyond, while those who are late to the digital game will continue to struggle. On a longer-term basis, this crisis will likely change shopping behaviour, with retailers now needing to respond to not only e-commerce but post COVID-19 customers.

LOGISTICS

The logistics sector will likely emerge as one of the survivors of this crisis. Despite supply increasing significantly in Greater Tokyo during 2019, vacancy rates tightened and rents rose, highlighting the sector's solid underlying fundamentals. The Greater Osaka market continued to see a recovery from 2017's supply glut, with solid rental and occupancy growth. Even so, the sector is not immune to a short-term shock, as supply chains are disrupted and labour shortages may be exacerbated.

New supply in both submarkets is expected to be solid in 2020. Despite demand remaining sound, COVID-19 will undoubtedly weigh on certain subsectors. For example, demand for storage locations from high-street retailers should be curbed, while e-commerce distribution centres and F&B storage facilities for grocers should fare well during the pandemic.

As for investors, the sector's long-term prospects remain attractive given the structural changes facing the logistics industry. The rise in e-commerce is expected to be a long-term transition, and therefore the sector is somewhat shielded from short-term adjustments. In addition, modern facilities, which have features that mitigate labour shortages and are more resilient to natural disasters, should have sound long-term demand. Also, the nature of the current crisis – prompting people to avoid crowded commercial hubs – will likely facilitate e-commerce by changing consumer behaviour. For the time being, rental growth should be flat, but long-term prospect looks brighter.

HOSPITALITY

The COVID-19 crisis arguably came at the worst possible time for already struggling hoteliers in Japan. Indeed, the travel restrictions resulting from the pandemic are a catastrophic blow for the fragile sector. Japan Hotel REIT, the largest hotel J-REIT, posted an almost 30% decrease in its February RevPAR, and has mentioned that March RevPAR may decline by 70%. Some operators will likely need to conduct hard negotiations with banks to secure a vital cash reserve to weather the storm. NOI and cap rate adjustments are thus inevitable.

Hospitality is undoubtedly the hardest hit sector. With the virus spreading across the world, international travel should continue to be restricted, and as such, a full recovery is likely to be a protracted process. While this is a

challenging time for the industry, it may also be a great opportunity for cash-rich longer-term investors to pick up attractive assets with high growth potential. Opportunistic investors may similarly be able to pick up distressed assets that perform well under normal circumstances. As such, this could be an opportunity for industry consolidation in order to transform its profitability.

Japan remains an emerging market for inbound tourism and therefore the adverse effects from the pandemic are somewhat more manageable, especially when compared to regional peers. Broadly speaking, inbound tourism accounts for less than 1% of its GDP, though certain areas and hotels are more dependent on these visitors than others.

Although inbound tourism may take a year or longer to recover, domestic travel demand could see a faster recovery as the outbreak is brought under some degree of control. For instance, popular tourist destinations like Kyoto have recently been shunned by some Japanese visitors due to over-crowding. The extreme lull in inbound visitation to Kyoto and other top destinations should help draw domestic visitors once more. Regardless, hoteliers and investors may need to pay more heed to the balance between inbound and domestic demand going forward.

Japan - May 2020

SPOTLIGHT

Savills Research

J-REIT Volatility and Japan Property

savills

Volatility in J-REIT unit prices may be a sign of things to come

Summary

- Having had a fairly strong start to 2020, the COVID-19 outbreak has significantly weighed on global capital markets, and the J-REIT market was no exception.
- Over the course of a month, the TSE REIT Index experienced a decline of close to 50% as anxiety spread amongst investors. Though prices have somewhat stabilised since, many J-REITs remain at a discount to NAV.
- J-REITs, normally active deal makers, have seen their acquisition capacity weakened following the sudden drop in their value. As a result, opportunities have opened up for those with dry power at the ready.
- Consolidation within the J-REIT market may become more common, with smaller-scale entities becoming prime targets.
- Defensive sectors such as Residential and Logistics, as well as Office - all with somewhat solid fundamentals - have unsurprisingly fared better than the likes of Hospitality and Retail, and this can be seen in the respective J-REIT indices.
- Within each sector, the flight to safety has been apparent, with higher quality J-REITs coming out as winners.
- Looser monetary policy in the US, a boon to the J-REIT market under normal circumstances, has instead dragged given the current challenges. There may be further turbulence ahead as it would seem that a significant outbreak in Japan is yet to be priced into markets.

INTRODUCTION

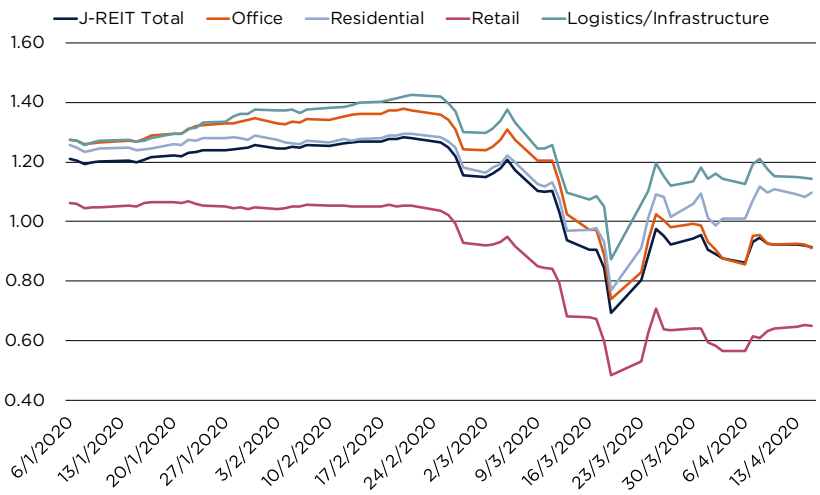
As COVID-19 continues to spread across the world without an end in sight, global capital markets have unsurprisingly been hit hard and the J-REIT market has suffered more than most. Yet, under the current circumstances, it is easy to forget that J-REITs had performed solidly up until 20 February – when the TSE REIT Index peaked at over 2,250 (Dividend: 3.5%, NAV: 1.28). Things swiftly changed thereafter, however, as the index lost around half of its value over the course of the following month, plummeting to 1,145 (Dividend: 6.8%, NAV: 0.69) by 19 March. A modest recovery to 1,640 (Dividend: 4.8%, NAV: 0.97) by 25 March notwithstanding, the index has hovered around the 1,500 mark (Dividend: 5.2%, NAV: 0.90) since the start of April – around 30% below its pre-COVID-19 high. J-REIT acquisition capacity has consequently been weakened. As such, given that they have accounted for over 30% of recent market transactions, this should pave the way for other investors previously struggling to acquire assets.

All things considered, therefore, J-REITs are likely to become rather active sellers of assets. Indeed, given the unprecedented levels of uncertainty, and with global interest rates moving even lower, defensive assets with stable incomes should remain popular for the time being. At the same time, deep discounts to NAV may facilitate consolidation within the J-REIT market. Cases of hostile takeovers – previously a rarity in Japan – have been on the up recently as attitudes within the market shift. For instance, real estate firm Unizo received multiple offers from major private equity players after travel agency HIS initially announced its hostile takeover bid. Meanwhile, Star Asia and Sakura REIT are currently in the process of merging after the former's proposed hostile bid was successful. This trend is likely to accelerate thanks to the ongoing price adjustments, especially for smaller, less financially endowed players whose unit prices are expected to remain supressed amid the uncertainty. To be sure, these smaller J-REITs with low NAV multiples face the prospect of being left behind without the ability to raise equity to fuel growth. As a countermeasure, therefore, they could start to seek out white knights before a hostile bid letter is delivered. Hence, the current scenario may provide larger sponsors or buyers with historically high levels of dry powder the opportunity to act.

As of mid-April, over half of listed J-REITs have NAV multiples of 0.8 or lower – suggesting that the majority of them are unable to raise equity capital for additional property acquisitions, and may instead become acquisition targets themselves. During the recent bull run, there were many J-REITs that were listed with a small initial AUM and without the property pipeline for further growth. These smaller entities may experience the most upheaval going forward.

The violent price swings we have witnessed thus far can be partly explained by the composition of the investor base. Specifically, it is made up of mainly domestic financial

GRAPH 1: NAV Multiple By Asset Class To Mid-April 2020



Source Savills Research and Consultancy

institutions, particularly regional banks, who have historically held J-REITs due to their favourable accounting treatment. Therefore, with the end of the fiscal year approaching in March, many of these regional banks were forced to sell off these holdings in order to stem their annual losses. Given that regional banks tend to take cues from one another, those who had not sold by the fiscal year end may still feel pressure to offload J-REIT investments as soon as any sign of market uncertainty returns. Regional banks are also major investors in private REITs. As such, we may see these banks rush for an exit amid fears of further market turmoil. That said, this development may in fact be positive for long-term investors, presenting much-awaited opportunities to buy at a discount.

Capital markets around the world were hit hard by the COVID-19 outbreak, and the J-REIT markets have been no exception. This has, however, given rise to discounted opportunities, especially in the hospitality and retail sectors, and those with ample dry powder may be able to capitalise. Even so, further pain could lie ahead in the J-REIT markets.

TABLE 1: List of J-REITs at a NAV Discount and with a Market Cap of Less Than JPY100 Billion, as of 15 April 2020

REIT NAME	PRICE/NAV
Ichigo Hotel REIT	0.40
Ooedo Onsen REIT	0.53
MORI TRUST Hotel	0.60
Fukuoka REIT	0.61
XYMAX REIT	0.61
Kenedix Retail	0.64
Global One	0.65
Hoshino Resorts	0.65
Hankyu Hanshin REIT	0.67
SAKURA SOGO REIT	0.67
Star Asia	0.69
Marimo Regional Revitalization	0.70
HEIWA	0.71
Tosei REIT	0.73
Takara Leben REIT	0.78
SANKEI REAL ESTATE	0.79
ONE REIT	0.79
MIRAI Corporation	0.80
ESCON JAPAN REIT	0.80

Source JAPAN-REIT.com, Savills Research and Consultancy

TABLE 2: Dividend Yield Spreads of Each Sector Against The TSE REIT Index

YIELD SPREAD	OFFICE	RESIDENTIAL	RETAIL	LOGISTICS	HOTEL
Peak (Feb)	-0.5%	-0.2%	0.7%	0.0%	1.5%
Nadir (Mar)	-1.0%	-1.2%	2.6%	-1.1%	5.5%
Now (Apr)	-0.6%	-0.9%	2.6%	-0.9%	5.1%

Source Savills Research and Consultancy
Note: Feb, Mar, and Apr indicate 20 February, 19 March, and 1 April, respectively.

FLIGHT TO QUALITY

During times of uncertainty, the flight to safety is a well-trodden path, and this time is no exception. During the aforementioned decline of J-REIT prices from peak to trough between 20 February and 19 March, defensive sectors saw their premiums widen, whilst the hardest hit sectors, namely hospitality and retail, witnessed their discounts deepen. This trend can be seen in the table (Table 2), showing the dividend yield spreads of each respective sector against the TSE REIT index over time. The residential, logistics and office sectors are the clear winners of this flight to quality, whereas the hotel and retail sectors have significantly lagged. Recent property performance disclosures, which reflect the initial impacts of COVID-19, endorse this sector view.

To be sure, J-REITs are listed investment vehicles, and hence, in contrast to hard assets, exposure to instant trading activity can lead to an immediate and often exaggerated adjustment in prices – not to mention other non-property specific factors such as the sponsor's credit. Further, dividend yields (levered) are not equivalent to NOI yields. Given the absence of an actual benchmark that closely mimics the movement of hard asset prices, mainly due to the suspension of almost all transaction activity, Table 2 may shed some light on the scale of COVID-19's impact to these asset types.

For further reading on the impact of COVID-19 on Japan property, please read our spotlight report "COVID-19 and Japan Property".

SECTOR VIEW

When looking closer within each sector, a stark difference in the required dividend yield by investor emerges, demonstrating the winners and losers among each asset type (Table 3).

Office

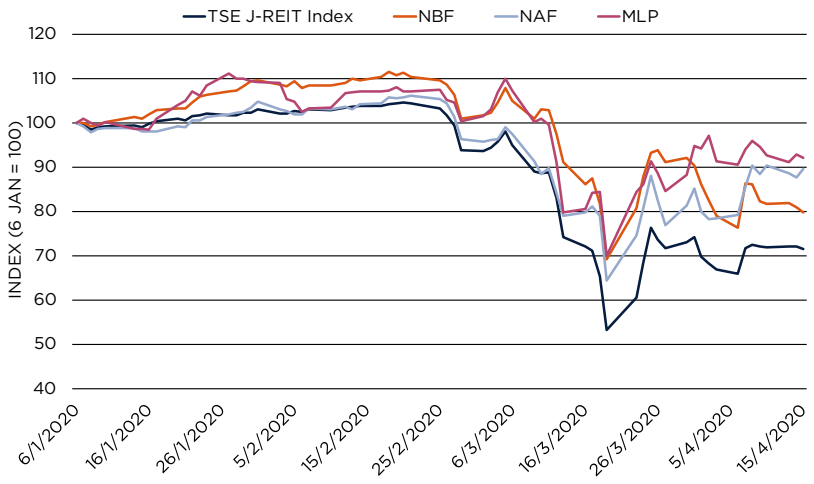
The table compares Nippon Building Fund (NBF), a holder of Grade A Tokyo office assets, and Ichigo Office REIT (Ichigo), an investor of Grade B/C offices. The spread between these two tends to be tight during upbeat periods, though this trend has historically reversed when markets are under stress. For instance, the gap between these two was 120 basis points (bps) at the recent peak in February but widened by almost 300bps at the nadir. Thereafter, the spread has stabilised at around 300bps. Unsurprisingly, Grade A offices, typically with cash-rich creditable tenants, should be able to weather this crisis with relative ease, whilst lower grade offices may not be as fortunate.

TABLE 3: Dividend Yield by Sector of Select J-REIT

YIELD SPREAD	PEAK (FEB)	NADIR (MAR)	NOW (APR)
Office: Grade A vs Lower Grade			
NBF	2.4%	3.9%	3.1%
Ichigo	3.6%	8.0%	6.3%
Premium	-1.2%	-4.1%	-3.2%
Residential: Tokyo vs Nationwide			
NAF	2.7%	4.5%	3.6%
Samty	4.9%	7.8%	6.5%
Premium	-2.1%	-3.3%	-2.8%
Retail: High street vs Shopping Centres			
JRF	3.8%	9.4%	8.2%
Frontier	4.8%	8.9%	7.6%
Premium	-1.0%	0.6%	0.6%
Logistics: Grade A vs Lower Grade			
MLP	2.7%	4.1%	3.1%
CRE	4.2%	7.2%	4.9%
Premium	-1.5%	-3.0%	-1.9%
Hotel: Unique vs Budget			
Hoshino	5.0%	10.1%	8.2%
Invincible	6.5%	17.7%	15.1%
Premium	-1.5%	-7.6%	-6.9%

Source Savills Research and Consultancy

GRAPH 2: Year-to-date Performance of High Quality J-REITs in the Three Most Defensive Sectors* vs TSE REIT Index as of 15 April 2020



Source JPX, Savills Research and Consultancy
*The three most defensive sectors, in no particular order, are Office, Residential and Logistics

Residential

Here we compare Nippon Accommodation Fund (NAF), representing a middle-market residential portfolio tilted towards Tokyo, and Samty Residential REIT (Samty), which has a greater exposure to nationwide assets. This time, the spread was 210 bps at the index peak but widened by over 100bps on the bottom day, stabilising at 280bps since. Residential assets in Tokyo are renowned for their defensive nature, though it would appear that quality mid-market residential assets across the nation are also exhibiting stability, as long as the overall quality is sound.

Retail

The spread between Japan Retail Fund (JRF), made up of high street retail assets, and Frontier REIT (Frontier), an investor of shopping centres, including supermarkets, stood at 100 bps on 20 February. Interestingly, come 19 March, Frontier's discount had swung to a premium following a 150bps adjustment, stabilising at around a 60bps premium since. Indeed, high street retail has emerged from the current uncertainty as a clear loser, whilst supermarkets are one of a few winners. This reversal in fortunes during the drawdown may give food for thought for the prospects of the rapidly changing retail sector. Now, market participants have to contend with not only the rise of e-commerce, but also how the COVID-19 outbreak will transform consumer behaviour going forward.

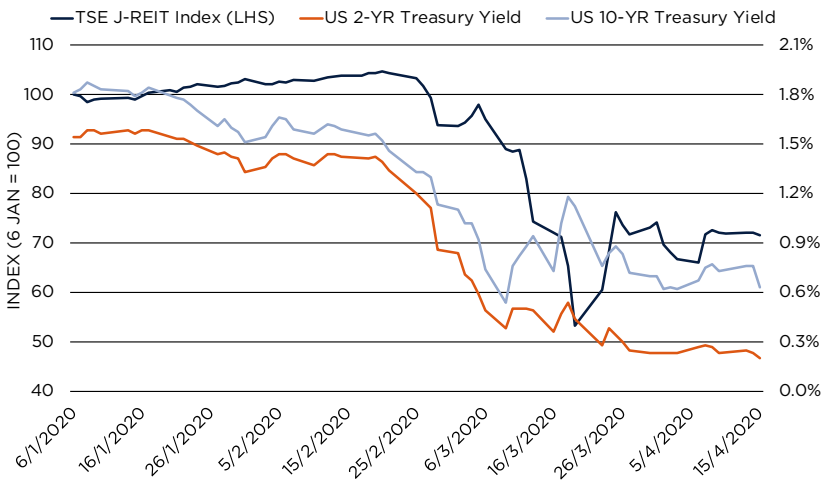
Logistics

We now turn our attention to the logistics sector. The table compares Mitsui Fudosan Logistics Park (MPL), a good indicator of the Grade A logistics sector and CRE Logistics Fund (CRE), which represents mid-scale logistics facilities. At the index peak, the spread between the former and the latter was 150 bps. This expanded by 150bps over the ensuing month, before tightening to 190 bps, where it has remained since. With robust demand for logistics assets, the impact from COVID-19 certainly looks more manageable. Given the lingering labour shortage, mid-scale facilities also have sound demand.

Hotel

Hotels continue to bear the brunt of the COVID-19 outbreak, and this can be seen in the table. The spread between Hoshino Resorts REIT, who invests in unique hotels with a strong brand appeal, and Invincible, an investor in budget hotels, was 150 bps

GRAPH 3: The Relationship Between US Treasuries and the TSE REIT Index Year-to-date as of 15 April 2020



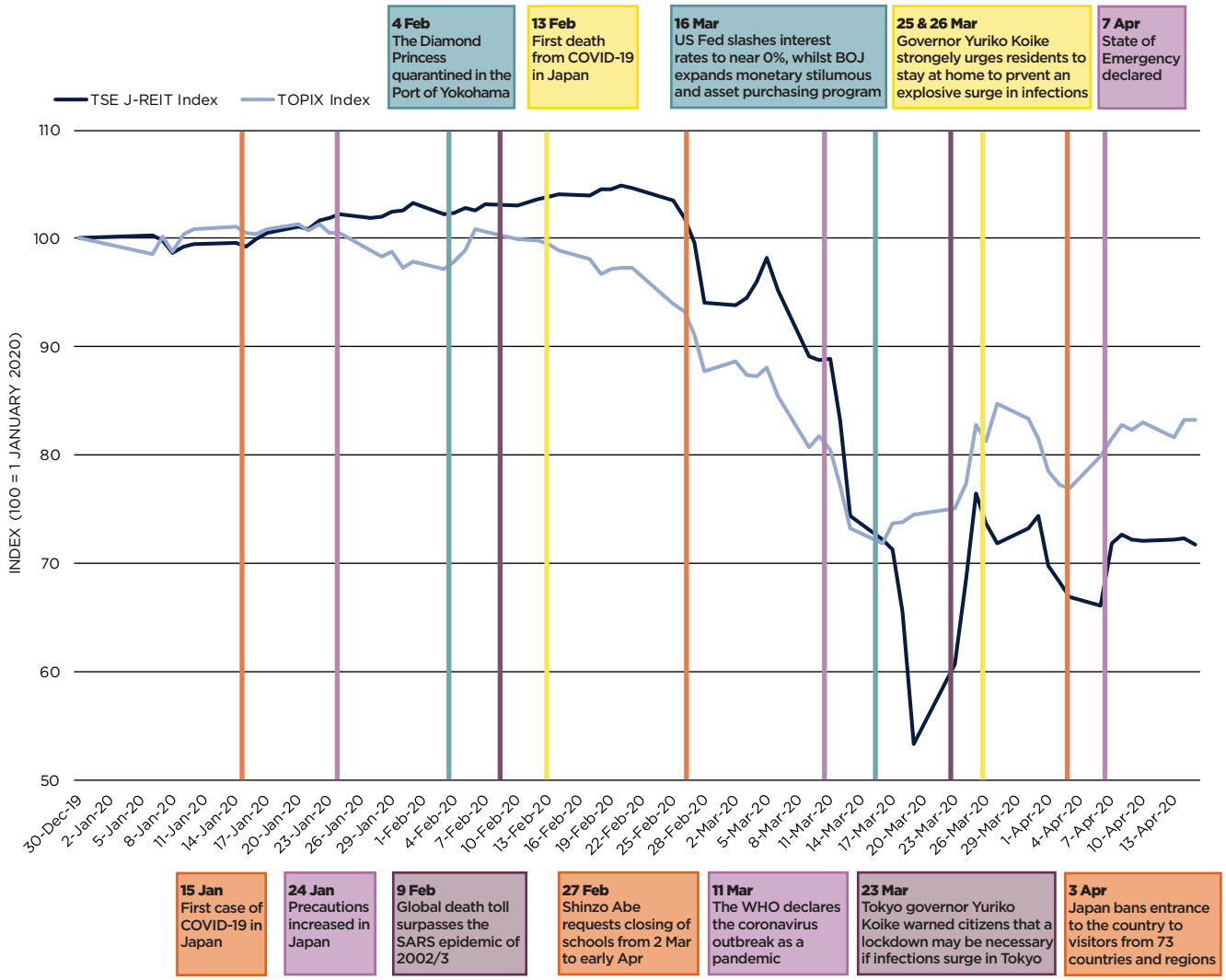
Source US Department of the Treasury, JPX, Savills Research and Consultancy

at the broader market peak. Subsequently, this increased by over 600bps by the time the index had reached its lowest point. The spread has now found firmer footing at around 690 bps. The hotel sector has not been helped by the large supply of mostly of budget hotels, and as a consequence, this has significantly adjusted required dividend yield, with concerns mounting for these assets.

IMPACT FROM ABROAD

Under normal circumstances, the reduction of global interest rates, especially in the US, has been a tailwind for the J-REIT market. The compression of government bond yields that followed the Global Financial Crisis further enhanced the attraction of the wider yield spreads found amongst J-REITs and, in doing so, had recently pushed unit prices to historic highs.

GRAPH 4: COVID-19 Timeline of Events in 2020 as of 15 April 2020



Source Savills Research and Consultancy

The current situation is far from normal, however. In an attempt to cushion the blow caused by the COVID-19 outbreak, the Fed Funds Rate was initially cut by 50bps on 3 March. As the global situation deteriorated, a larger-than-expected cut in rates on 15 March saw US interest rates languish close to zero – a level not seen since 2015 – and the fallout from these extensive measures has been clear amongst both credit and capital markets. For instance, a major listed credit default swap index in Japan has skyrocketed, implying extreme uncertainty in the credit markets. Meanwhile, acknowledging the severity of the global pandemic, J-REIT unit prices plummeted soon after the latest Fed rate cut, and despite some recovery since, unit prices remain far below previous highs (Graph 4).

Looking further ahead, however, there may be a sense that if market stabilisation can be achieved, the potential for significant upside remains for J-REITs. That said, with the full scale of the COVID-19 pandemic in Japan still unclear, this optimism may be short-lived. Indeed, it would seem that the Japanese markets have priced in the severe outbreak in the West, but is yet to price in a full-blown epidemic in Japan. As such, if the domestic situation were to significantly worsen, the J-REIT market could very well take another dive. Alternatively, global capital makets may have become accustomed to the grim news related to COVID-19, including the significant deteroration of major ecomonic indicators, keeping the market strangely calm during the pandemic.

Japan - May 2020

SPOTLIGHT

Savills Research

Tokyo Periphery and Rail Transit

savills

Investment opportunities may emerge beyond central Tokyo

Summary

- Land prices at many station-side areas on the Tokyo periphery have already surpassed 2008 levels and, in many cases, have seen stronger growth than key hubs in the central five wards.
- Population growth in Greater Tokyo has outperformed forecasts based on the 2015 census, with population estimates for most wards and cities already exceeding the levels forecasted for October 2020.
- Annual surveys of Greater Tokyo residents demonstrate a strong interest in peripheral railway hubs, with the Yokohama, Kichijoji, Ikebukuro, and Omiya station areas consistently ranking among the most desirable locations to live.
- Office and residential investment volumes in Greater Tokyo outside of the C5W amounted to JPY874 billion in 2019, growing 34% YoY, and stands even higher than that of the C5W in 2020.
- Preferences for locations to live and work are likely to change once the COVID-19 pandemic comes under control, as companies may look to open satellite offices in railway hubs outside of central Tokyo whilst residents may seek more spacious accommodations as more time is spent at home.
- A portion of land in Western Tokyo that was once designated exclusively for agricultural use may be opened up for non-agricultural development, potentially leading to a glut of land entering the market.

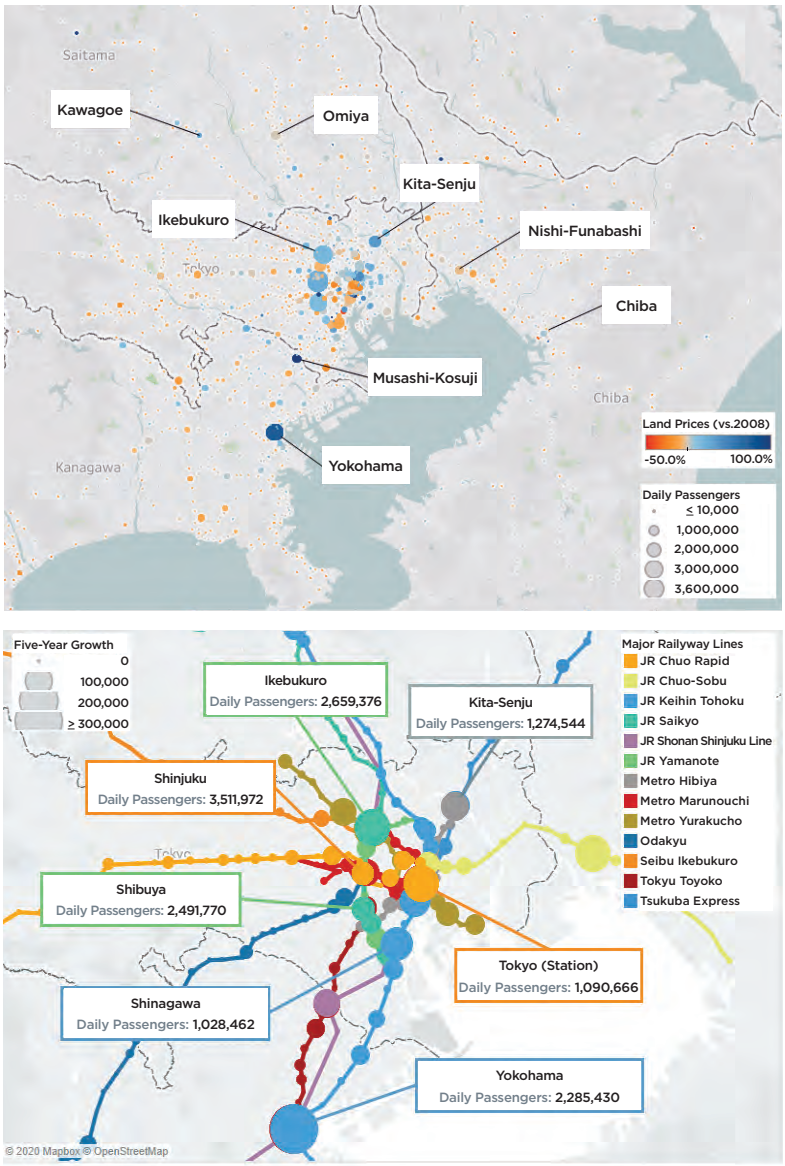
THE WORLD'S MOST RELIABLE RAIL NETWORK

While real estate value is unsurprisingly concentrated in Tokyo's central business district, namely the central five wards of Chiyoda, Chuo, Minato, Shinjuku, and Shibuya, Greater Tokyo's comprehensive rail system grants great accessibility to outlying areas. The key advantage of Tokyo's rail network is its density and globally-renowned punctuality. Although delays certainly occur and carriages become overcrowded during rush hour, commuters can largely count on trains arriving on time and at a high frequency. Looking at global comparisons, Tokyo is often ranked as having the most efficient and punctual railway system, especially considering its vast transport capacity.

These factors are a key driver of real estate value in Tokyo's periphery, making outlying areas appealing for residents, businesses, and investors alike. That being said, popularity and perceptions undoubtedly vary by area. Certain areas have stood out during the current cycle, in some cases posting stronger growth than the top areas in central Tokyo (Map 1).

The COVID-19 pandemic and resulting mitigation steps will undoubtedly curb

Map 1: Greater Tokyo Railway Lines And Daily Passengers Per Station



Source Ministry of Land, Infrastructure, Transport and Tourism (MLIT), Savills Research & Consultancy
Note: Lines represent segments connecting stations and are not fully representative of actual railway routes. The points listed above represent the average of land prices for properties of all use types in the vicinity of the respective stations, as designated by MLIT in the Chika Koji survey. The Chika Koji survey has added additional land reference points over time. Passenger data is not available for certain stations, though they have been included in the above map to maintain consistency.

railway use in the short-term, however. At present, it is near impossible to predict how life and work will change post-pandemic, though some increase in the number of people working from home and dispersion of personnel should be expected. Perhaps more helpfully, flexible work schedules may make the rush hour train more bearable for commuters. Given these known unknowns, this report will focus more on the trends and shifts that have been seen during the latest upswing, whilst providing some speculation on how the dynamic could change after the pandemic comes under some degree of control.

Even as COVID-19 has disrupted Japan's bullish market, opportunities to purchase core-type assets in Tokyo's CBD remain limited, as most owners choose to hold on to prime property. Given the capital region's comprehensive railway infrastructure, investors may be able to look beyond central Tokyo for buying opportunities, potentially capitalising off of shifting demand trends – especially those that may emerge during/after the pandemic.

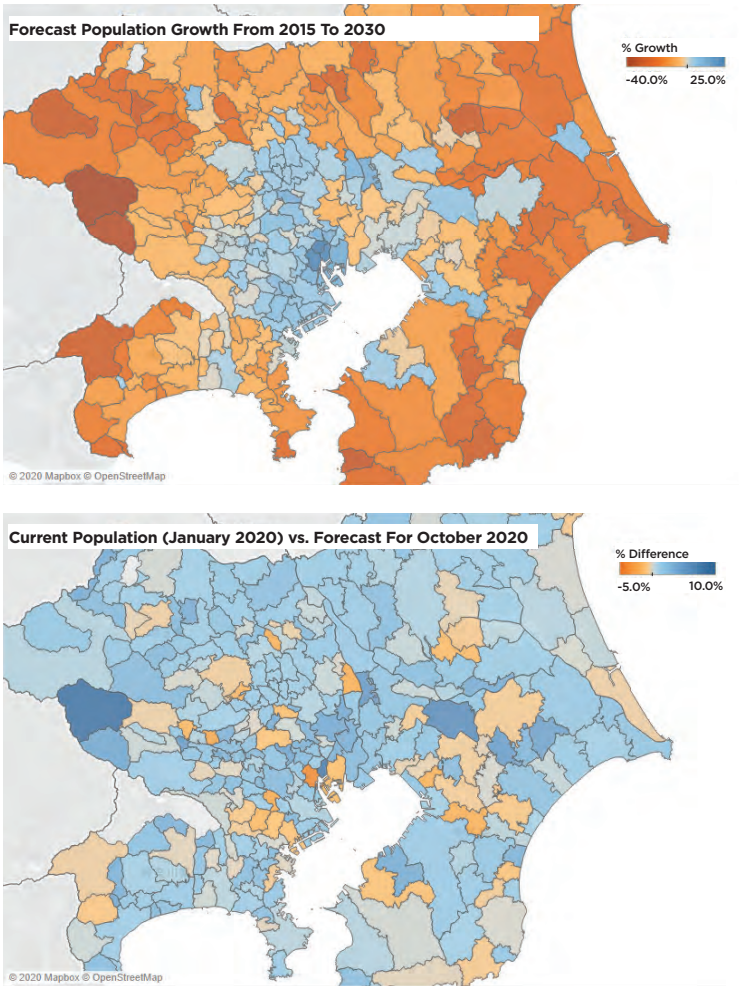
GREATER TOKYO DEMOGRAPHICS

Demographic shifts are also favouring the region at large. Indeed, while Japan is forecasted to see its total population continue to decline over the coming decades, the prospects for Greater Tokyo are more encouraging, with the population of central Tokyo and Yokohama expected to grow to 2030 and beyond. In fact, forecasts produced based on the 2015 national census appear to have underestimated actual population growth in the region, as most municipalities of Greater Tokyo have, as of January 2020, already exceeded the population levels forecasted for October of this year.

Counterintuitively, some central wards of Tokyo appear to have undershot estimates. For example, Minato Ward's population has underperformed its 2020 forecast by 3.8%, while Chuo Ward has outperformed its forecast by 7.7%. Rising housing costs and new large-scale developments may be driving this shift. Although the Ginza area of Chuo Ward sees prices comparable to that of Minato, there has been ample supply of more affordable residential units on the artificial islands of the ward, namely Tsukishima, Kachidoki, and Harumi, over the past five years.

Further, the national government's forecasts typically do not account for immigration. Shinjuku Ward and Toshima Ward appear to be outperforming for this reason, having drawn in a significant number of foreign residents over the past decade. Ordinances affecting housing supply also appear to have impacted initial estimates in Koto Ward, with restrictions on the development of family-type residences implemented in March 2018 likely weighing on migration to the ward, causing it to underperform previous forecasts.

Map 2: Demographic Shifts By Municipality In Greater Tokyo



Source National Institute of Population and Social Security Research, Prefectural Governments, Savills Research & Consultancy

RESIDENTS LOOK OUTSIDE OF THE C5W, BUT NOT VERY FAR

Annual surveys of residents in Greater Tokyo have consistently revealed a similar set of stations and train lines that rank as the most desirable areas to live. While many of the locations that top the list are centrally

Table 1: Most Desirable Train Lines To Live Near In The Kanto Region

SUUMO RANK	LINE	MAJOR STATIONS	RUSH HOUR CAPACITY (# OF TRAINS/HOUR X TRAIN CAPACITY)	PASSENGER TRAFFIC GROWTH (YOY)
1	JR Yamanote	Shibuya, Shinjuku, Ikebukuro, Ueno, Tokyo, Shinagawa	37,000	0.9%
2	Tokyu Toyoko	Shibuya, Nakameguro, Jiyugaoka, Musashi Kosugi, Kikuna, Yokohama	32,000	0.7%
3	JR Keihin Tohoku	Omiya, Urawa, Ueno, Tokyo, Shinagawa, Kawasaki, Yokohama	38,000	-
4	JR Chuo	Tokyo, Yotsuya, Shinjuku, Nakano, Kichijoji, Tachikawa, Hachioji	44,000	0.5%
5	Tokyu Denentoshi	Shibuya, Sangenjaya, Futako Tamagawa, Mizunokuchi, Chuorinkan	40,000	0.4%
6	Tokyo Metro Marunouchi	Ogikubo, Shinjuku, Yotsuya, Ginza, Tokyo, Ikebukuro	23,,000	1.9%
7	Tokyo Metro Ginza	Shibuya, Omotesando, Akasaka-mitsuke, Ginza, Ueno, Asakusa	18,000	0.9%
8	JR Jouban Line	Nippori, Minami-Senju, Kita-Senju, Matsudo, Kashiwa, Toride	39,000	-0.8%
9	Tokyo Metro Hibiya	Nakameguro, Ebisu, Roppongi, Ginza, Ueno, Kitasenju	27,000	2.4%
10	Odakyu	Shinjuku, Shimokitazawa, Seijogakuen-mae, Shin-Yurigaoka, Machida, Fujisawa	48,000	2.2%

Source Suumo, MLIT, Savills Research & Consultancy

located, some outlying areas consistently rank high. Yokohama Station, for example, has been voted as the top location for three consecutive years in an annual survey conducted by Suumo, whilst Omiya (Saitama) has steadily climbed in the rankings. Kichijoji, located along the Chuo Line in Musashino City also consistently ranks towards the top of the list.

JR Yamanote Line (Suumo Rank 1)

Major Stations:	Shibuya, Shinjuku, Ikebukuro, Ueno, Tokyo, Shinagawa
Average Daily Ridership:	4,099,000 (FY2015)

Founded in 1885 and originally connecting Shinagawa and Akabane, the Yamanote Line has come to serve as the anchor of Greater Tokyo's rail network. All major train and subway lines connect to a station along the Yamanote Line and the line itself passes through most of central Tokyo's major stations and business centres. Not surprisingly, the line has the highest average daily ridership in all of Japan, with around 4 million daily passengers.

In terms of price, stations on the northern side of the Yamanote Line, such as Ikebukuro, generally offer a discount over stations in the south such as Shibuya and Ebisu (Table 2). However, land price data reveals some shift in the balance of value along the line, with the western section of the line showing stronger growth since 2008. Average commercial land prices around Harajuku Station, for example, have increased by over 180% since January 2008, while those of Tamachi still remain 37% below previous peak levels. Other stations on the northern side, such as Ikebukuro and Akihabara, have seen increases of around 26% and 48%, respectively.

Tokyu Toyoko Line (Suumo Rank 2)

Major Stations:	Shibuya, Nakameguro, Jiyugaoka, Musashi Kosugi, Kikuna, Yokohama
Average Daily Ridership:	1,166,000 (FY2015)

Connecting Shibuya to Yokohama Station, this line is an important spoke in Tokyo's railway network and is not surprisingly a desirable area to live among residents. Notable areas include Jiyugaoka (Table 2), a cosy neighbourhood that has been referred to as Tokyo's "Little Europe" and is known for its stylish boutiques and bakeries. Surveys indicate that the area is especially popular among women.

Keihin Tohoku Line (Suumo Rank 3)

Major Stations:	Omiya, Urawa, Ueno, Tokyo, Shinagawa, Kawasaki, Yokohama
Average Daily Ridership:	2,975,000 (FY2015)

The Keihin Tohoku Line is a major artery connecting Saitama, Tokyo, and Yokohama. The line runs parallel to the Yamanote Line in central Tokyo between Tabata and Shinagawa, and is therefore highly accessible for transfers. Some trains on the Keihin-Tohoku Line operate as rapid trains, which stop only at Ueno, Akihabara, Kanda and Tokyo between Tabata and Hamamatsucho.

JR Chuo (Main) Line (Suumo Rank 4)

Major Stations:	Tokyo, Yotsuya, Shinjuku, Nakano, Kichijoji, Mitaka, Tachikawa, Hachioji
Average Daily Ridership:	2,260,000 (FY2015)

Stations along the Chuo Line have long been popular as residential hubs, with easy access to central Tokyo. Indeed, it is a vitally important line that connects Shinjuku, as well as Tokyo Station, to Western Tokyo Prefecture (Tama Region). The line was founded in 1889, though became more prominent after large migrations to Western Tokyo after 1923. During the post-war period, further developments proceeded in areas such as Mitaka City. Nearby Kichijoji in Musashino City became a popular centre of subculture, gaining renown for its jazz cafes and live music houses. While retaining this vintage character, the area has become a lively commercial and entertainment centre, and also offers a large green space through Inokashira Park.

STATION SPOTLIGHT
Yokohama – Suumo Ranking 1 (1) [1]

Yokohama City has been popular not only as the commercial centre of Kanagawa Prefecture, but also as a residential hub for Tokyo commuters since the post-war economic boom. The city has recently been undergoing a transformation into a business hub, propelled by the massive Minato Mirai 21 Development Project. Yokohama Station itself is a major transit hub and offers convenient access to central Tokyo and has plenty of local amenities, all while offering a substantial discount over most of the Tokyo 23W.

1 Indicates Suumo's 2020 and 2019 rankings, respectively.

Table 2: Most Desirable Train Lines To Live Near In The Kanto Region

SUUMO RANK	STATION (LINE)	AVERAGE DAILY PASSENGERS	AREA TYPE	CITY, PREFECTURE	AVG. INCOME (CITY) JPY THOUSAND	AVG. RENT FOR ONE BEDROOM APARTMENT	AVERAGE LAND PRICES (ALL PROPERTY TYPES)		
							CURRENT (JPY/TSUBO)	VS. 2013	VS. 2008
1	Yokohama (Tokaido Main)	2,250,318	Commercial / Business Centre	Yokohama, Kanagawa	4,036	97,200	2,132,000	42.0%	76.1%
2	Ebisu (JR Yamanote)	395,490	Residential / Entertainment	Shibuya, Tokyo	8,011	226,500	2,384,714	38.3%	2.0%
3	Kichijoji (JR Chuo)	428,072	Residential / Entertainment	Musashino, Tokyo	5,246	100,000	1,299,563	24.2%	-0.1%
4	Shinagawa (JR Yamanote)	1,002,150	Commercial / Business Centre	Minato, Tokyo	11,151	211,500	4,494,000	54.6%	-11.2%
5	Meguro (JR Yamanote)	475,708	Residential	Meguro, Tokyo	6,020	196,500	1,556,600	46.1%	9.6%
6	Shinjuku (JR Yamanote)	3,453,212	Commercial / Business Centre / Entertainment	Shinjuku, Tokyo	5,186	166,100	11,006,364	64.8%	25.0%
7	Musashi Kosugi (Tokyu Toyoko)	465,749	Residential	Kawasaki, Kanagawa	3,958	104,800	992,333	24.4%	139.7%
8	Omiya (JR Keihin Tohoku)	682,594	Commercial / Business Centre	Saitama, Saitama	3,879	72,300	563,035	26.3%	-0.6%
9	Ikebukuro (JR Yamanote)	2,635,423	Commercial / Business Centre / Entertainment	Toshima, Tokyo	4,290	130,900	3,055,824	50.2%	16.6%
10	Nakameguro (Tokyu Toyoko)	191,065	Residential	Meguro, Tokyo	6,020	177,200	1,544,833	37.7%	-9.8%
11	Urawa (JR Keihin Tohoku)	175,300	Residential / Government Centre	Saitama, Saitama	3,879	73,800	452,619	29.8%	19.6%
12	Shibuya (JR Yamanote)	2,456,342	Commercial / Business Centre / Entertainment	Shibuya, Tokyo	8,011	213,100	7,427,059	67.3%	14.0%
13	Kamakura (Enoshima Dentetsu)	113,364	Residential	Kamakura, Kanagawa	4,567	94,200	263,882	2.6%	-9.1%
14	Tokyo (JR Yamanote)	1,073,553	Commercial / Business Centre	Chiyoda, Tokyo	9,445	179,800	26,380,000	35.8%	-3.6%
15	Jiyugaoka (Tokyu Toyoko)	152,396	Residential	Meguro, Tokyo	6,020	130,000	2,252,000	41.7%	10.6%
16	Nakano (JR Chuo Line)	289,832	Commercial / Residential	Nakano, Tokyo	4,130	116,900	1,158,333	49.2%	16.3%
17	Futako Tamagawa (Tokyu Den-en-toshi)	152,565	Commercial / Residential	Setagaya, Tokyo	5,450	112,400	636,250	27.9%	-7.4%
18	Kitasenju (Tokyo Metro Hibiya)	1,254,598	Residential / Entertainment	Adachi, Tokyo	3,390	90,000	823,455	32.8%	33.5%
19	Tachikawa (JR Chuo)	327,806	Commercial / Residential	Tachikawa, Tokyo	3,672	75,800	711,632	16.5%	-5.2%
20	Omotesando (Tokyo Metro Ginza)	177,078	Commercial / Residential	Minato, Tokyo	11,151	257,400	2,081,667	35.0%	-10.0%

Source Suumo, At Home, MLIT, Ministry of Internal Affairs, Savills Research & Consultancy
Note: Ranking based on total votes cast in Suumo's 2017, 2018, and 2019 surveys. Train lines are presented for each station as listed by Suumo, though other train lines connect to the above stations in most instances. Average daily passengers based on statistics published by MLIT for 2017.

Ikebukuro (Toshima) – Suumo Ranking 8 (11)

Along with Shinjuku and Shibuya, Toshima is known as one of the "Fukutoshin" (subcentres) of the Tokyo 23W. The ward is home to Ikebukuro Station, which hosts eight train lines and on average sees roughly 2.6 – 2.7 million passengers pass through every day, making it the second busiest station in the world, with passenger traffic being surpassed only by Shinjuku. The area serves as a hub for those coming to central Tokyo from Western Tokyo and Saitama, and provides convenient access, to Shinjuku, Shibuya, and Yokohama via the Fukutoshin Line and Shonan Shinjuku Line. While Toshima may not be as prominent as its Fukutoshin compatriots, Ikebukuro is undergoing large development that is changing the area's character (Map 3).

Musashi-Kosugi (Kawasaki) – Suumo Ranking 20 (9)

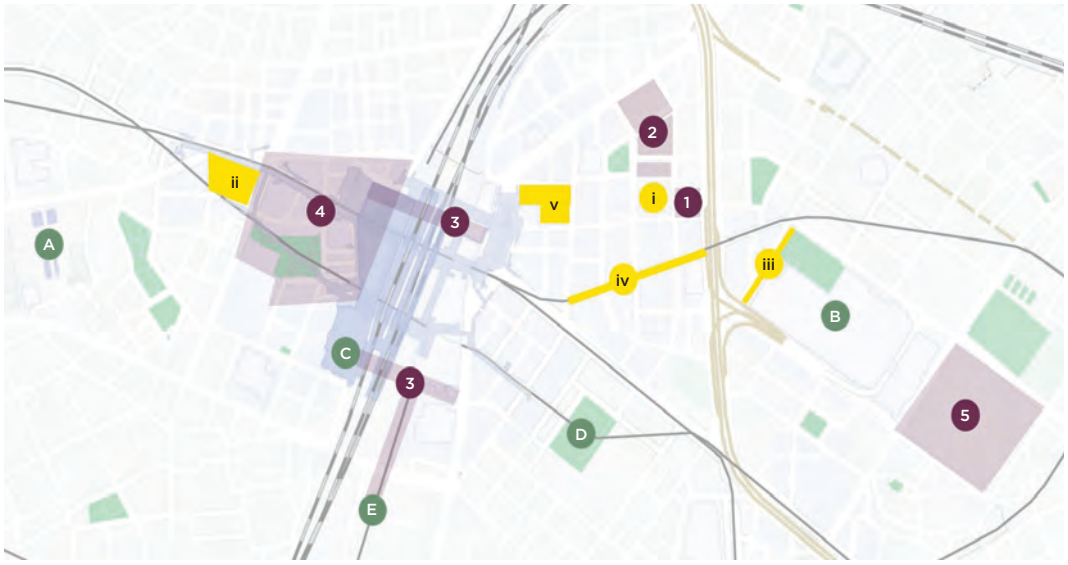
The area around Musashi-Kosugi Station, located in Kawasaki City just across the river from the Ota Ward, is arguably the most prominent gem to emerge along the Tokyu Toyoko Line in the current cycle. Once a prominent industrial district, the area re-emerged after facility closures and relocations in the early 2000s, with factories being replaced by a spate of tower condominiums. As a result, average land prices around Musashi-Kosugi Station have increased 158% since January 2008. This growth has been fuelled by a rush of tower apartment completions and shopping centres, including Mitsui Fudosan's LaLa Terrace, Tokyu Square, and Grand Tree Musashi Kosugi, a large-scale retail facility owned by Ito Yokado.

The station allows for access to both Tokyo and Yokohama stations in under 20 minutes via the JR Lines, and Shibuya Station in 15 minutes via the Tokyu Toyoko Line. According to Toyo Keizai Inc. and used-condominium marketplace Kawlu, the average sales price for 70 sq m second-hand condominiums in the Musashi-Kosugi Station area as of late 2018 was around JPY60 – 70 million, while the average sale price of such condominiums was JPY51.5 million upon completion in 2008. Despite these recent successes, the area's reputation took a hit in October 2019, as Typhoon Hagibis led to extensive flooding around JR Musashi-Kosugi Station, damaging residential properties including two condominium towers.

Kita-Senju (Adachi) - Suumo Ranking 22 (20)

An area that perhaps offers some more value compared to its C5W peers is Kitasenju, in

MAP 3: Ikebukuro Station Area Overview



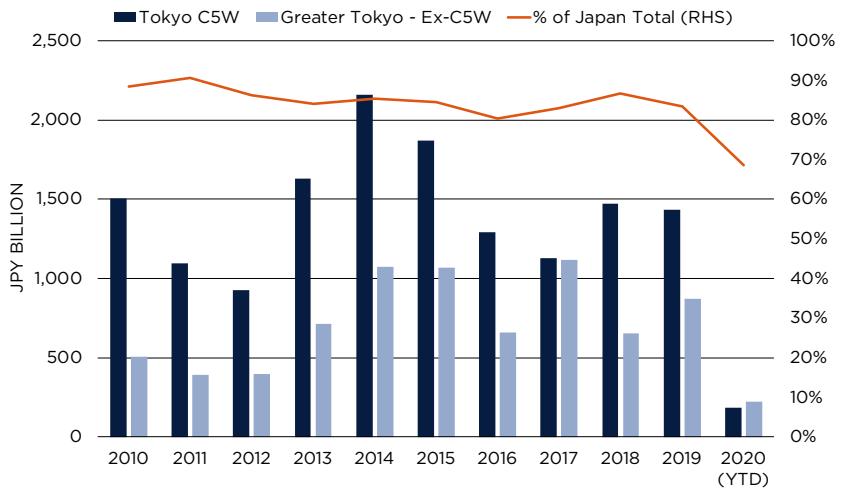
LANDMARKS		EST.
A	Rikkyo University	1874
B	Sunshine City	1978
C	Metropolitan Plaza Building	1994
D	Minami Ikebukuro Park	2016
E	Daiya Gate Ikebukuro	2019

DEVELOPMENTS		COMP.
1	Q Plaza	2019
2	Hareza Project	2020
3	East-West Deck	TBD
4	Ikebukuro West Gate Project	Ongoing
5	Ikebukuro International Campus	2023

RETAIL HOTSPOTS	
i	Animate
ii	Marui
iii	Otome Road
iv	Sunshine 60 Street
v	Yamada Denki

Source Public disclosures, Savills Research & Consultancy

Graph 1: Greater Tokyo Office And Residential Investment Volumes, 2010 to 2020*



Source Real Capital Analytics, Savills Research & Consultancy
*As of 14 April 2020

Adachi Ward. Not only is it home to one of the busiest train stations in Tokyo, it also scores fairly high in Suumo's "Most desirable places to live in Kanto" survey. Despite this, rents are 35% cheaper compared to Ebisu, which came second in the survey. With a 25 minute commute to central Tokyo, it represents a well-located area for those seeking value.

GREATER TOKYO INVESTMENT

According to transaction data from Real Capital Analytics, office and residential investment volumes in Greater Tokyo outside of the C5W amounted to JPY874 billion in 2019, growing 34% YoY. Investment volumes in the periphery have been consistently high, with the ratio of periphery investment vs. central Tokyo investment pushing higher in 2019. This is unsurprising considering that cap rates have become tight in the C5W, leading investors to look outside of Japan's top CBD in order to meet yield targets. Early 2020 also saw a major ex-C5W transaction, with Goldman Sachs acquiring the Minato Mirai Centre Building in Yokohama from Gaw Capital Partners in January 2020 for JPY98 billion.

With the onset of COVID-19, however, property investment has largely ground to a halt across the board. Even so, there remains

significant dry powder allocated to Asia-Pacific real estate, and Japan should remain a key component of regional strategies. Moving forward, investors will need to carefully deploy capital on a case-by-case basis, seeking out attractive deals.

POTENTIAL SHIFTS IN SUPPLY AND DEMAND

Demand shifts resulting from COVID-19

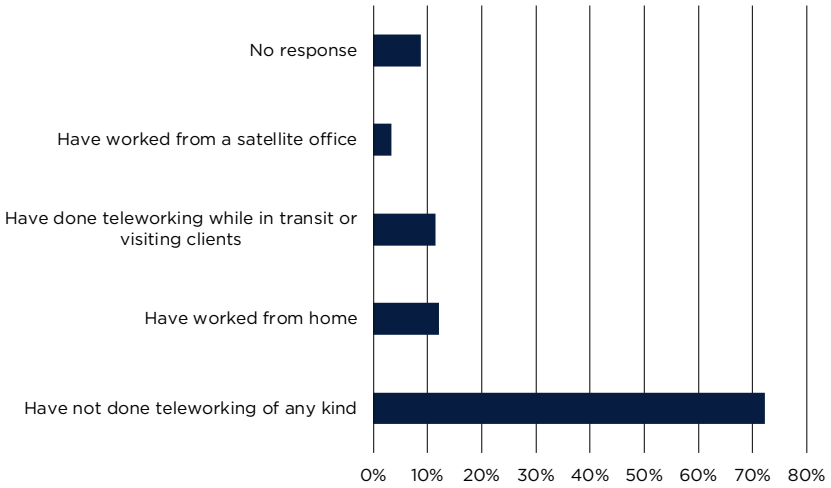
Looking ahead, investors may want to pursue assets in areas that could see new drivers of demand going forward. For example, satellite offices closer to residential areas, such as Omiya, could become attractive. In fact, the area has already seen some degree of office investment from J-REITs (Map 4). Work and lifestyle changes resulting from COVID-19 will likely facilitate this transition. (Please refer to our Spotlight Report "COVID-19 and Japan Property" for further analysis on this subject)

Japanese firms have been relatively slow to implement teleworking initiatives and, even among those that have implemented such measures, employees have rarely taken advantage of the option to do so. A survey of workers conducted by the Tokyo Metropolitan Government in July 2019 (Graph 2) shows that only 12.1% of respondents had any experience working from home over a one-year period, while only 3.4% had experience working from a satellite office. That said, utilisation has been higher amongst larger companies: 30.9% and 10.7% of respondents at firms with 300 or more employees reported having had experience teleworking from home and from a satellite office, respectively.

This is set to change drastically in the short-term. According to Google's mobility report as of 17 April, visits and length of stay at workplaces are down 23% in Tokyo versus the baseline period in January. The same data shows a 14% uptick in time spent at residences – even more striking when considering that the baseline period was the middle of winter.

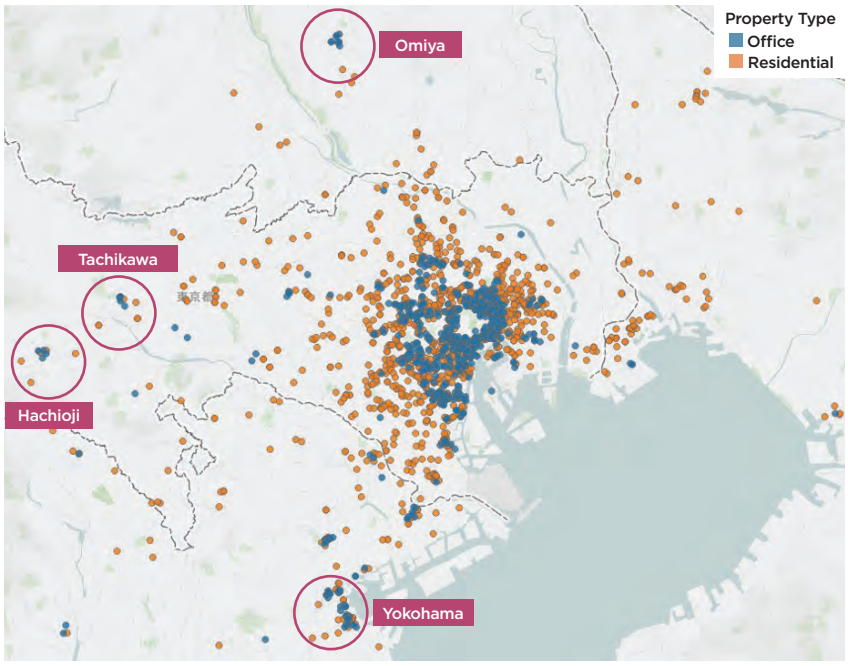
Residential unit preferences may change if a meaningful number of companies continue some form of remote work and/or flexible working hours after the pandemic subsides. Having impetus to spend more time at home may prompt residents to prioritise larger spaces with better amenities as opposed to proximity to train stations, which has recently been a key selling point for properties outside of the central five wards.

Graph 2: Teleworking Experience Over the Past One-Year (As of July 2019)



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

Map 4: J-REIT Acquisitions In Greater Tokyo Since January 2008



Source REITDB, Savills Research & Consultancy

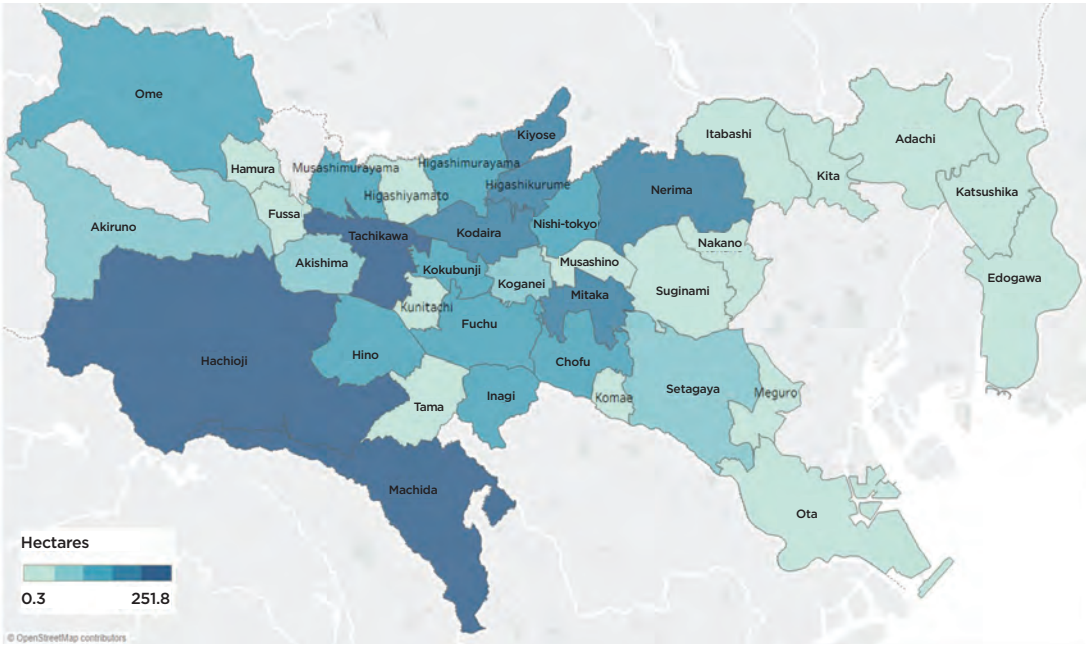
Potential development of agricultural land "Seisan Ryokuchi"

In a bid to protect the environment and preserve green land in areas surrounding large cities, the government granted very generous tax breaks to owners of specially-designated agricultural land in the nineties if they commit to long-term agricultural use. Known as "seisan ryokuchi", these tracts of land, designated exclusively for agriculture, were strictly regulated and, as a result, private property development has been disincentivised.

To be entitled to these generous benefits, among other requirements, it was necessary for the plot of land to exceed 500 sq m as well as 30 year commitment for agricultural use. Once all requirements were satisfied, the landowner was granted the benefits for a 30-year period (in most cases to 2022), after which they would have to decide whether or not to retain the land's special status. If retaining the seisan ryokuchi status, the owner would then be entitled to the benefits on a 10-year rolling basis, as long as the initial requirements were still satisfied. Otherwise, these tax benefits would be lost – though the land could then be disposed of or used for non-agricultural developments.

In Tokyo, these pieces of protected land are mainly located in the Western wards of the 23W and the Tama Region (Map 5). It is worth noting, however, that within these areas, properties located near stations have largely been developed already and are in

Map 5: Seisan Ryokuchi by City And Ward In Tokyo Prefecture



Source MLIT, Savills Research & Consultancy

high demand. Therefore, favourable locations are relatively insulated from the potential glut of emerging land, highlighting the need for prospective investors to be selective.

OUTLOOK

As redevelopment proceeds across Tokyo, areas of preference for living and working will undoubtedly shift; the COVID-19 pandemic may very well accelerate or reverse some of these trends. Central Tokyo will continue to host the top business hubs and should thus remain attractive for residents and businesses who can afford higher premiums. However, some degree of dispersion beyond the Tokyo C5W is likely.

In the short-term, given the economic slowdown resulting from the pandemic, cheaper locations on the periphery – which would ideally still have strong access to central Tokyo – should look more attractive to both residents and businesses who are facing a financial squeeze. In the medium-to-long term, the further implementation of flexible work styles including teleworking and revised business continuity planning among corporates may accelerate a dispersion of life and work outside of central Tokyo. This new workstyle will prompt Japan Inc. to further digitise and thereby increase productivity, possibly leading to more significant wage increases, which have thus far been lacklustre.

Residents spending more time at home may want more spacious accommodations – a luxury all but a few can afford in the central wards. More flexible work arrangements may allow more people to avoid overcrowded rush-hour trains, arguably the greatest pain point for those commuting from the periphery. Businesses may find it necessary to disperse office locations somewhat to avoid the now apparent risks of overcrowding in the CBD. Such dispersion is likely to occur along key railway hubs and new peripheral sub-centres may emerge as a result.

Looking further ahead, despite the demographic outlook appearing somewhat more positive than initially forecasted, a number of municipalities in Greater Tokyo will see populations decline over the coming decade. Station-front areas should, however, continue to see migration and new hubs will likely crop up outside of central Tokyo as development proceeds throughout the region.

Japan - June 2020

SPOTLIGHT
Savills Research

Yokohama

savills

An old fishing village takes centre stage once more

Summary

- Following numerous redevelopment projects, such as The Minato Mirai 21 Project, Yokohama has reinvented itself since its post-war slump, becoming a genuine alternative to Tokyo.
- Investment volumes into the capital have slowly been decreasing as valuations and opportunities become less favourable. Consequently, some of these flows have been directed to peripheral markets such as Yokohama, which has seen steady increases since 2017.
- As well as the amenities available and its accessibility to Tokyo, the lower cost of living found in Yokohama makes it a popular residential hub, and this looks set to continue.
- With a strength in R&D, the office market in Yokohama is an attractive proposition for businesses. Meanwhile, as the pandemic continues to change working culture, the emergence of satellite offices for example could be a boon for the city.
- Both the retail and hospitality sectors in Yokohama have suffered the same fate as the rest of Japan. Yet the types of projects in progress could be well-positioned to benefit in future.
- The positive demographic outlook should continue to drive Yokohama's growth over the longer term, despite the challenges faced by the country as a whole.
- Much of Yokohama's future success depends on a sustained economic recovery in Japan. Regardless, solid demand fundamentals should underpin the market's resilience for the time being.

OVERVIEW

Yokohama has come a long way since Japan opened to the world in the late 19th century. Initially a small fishing village, it came to serve as the primary port and gateway to the country, eventually becoming the centre of foreign trade. Thanks in part to its proximity to Tokyo, Yokohama prospered over the following decades. Things swiftly changed, however, as a result of the large-scale destruction and confiscation of the downtown area during and after World War II. Without the required redevelopment, many companies consequently relocated to Tokyo, taking with them the economic drive that had been prevalent in the city up until then. Indeed, by the time Japan's post-war economic boom had arrived, Yokohama had been somewhat left on the side-lines, relegated to a residential hub for Tokyo commuters.

In 1965, however, with the intention of re-modelling itself as a major city once more, six strategic projects aimed at reconnecting the various districts were announced. A core tenet of the strategies was The Minato Mirai 21 Project – a huge 186-hectare land reclamation, building, and infrastructure project, conceived as a means of regaining the city's status as a business centre. Since construction began in 1983, 76 hectares of land have been developed with the area now hosting more than 1,800 companies and over 110,000 employees. Given the city's international background, this figure includes almost 200 international corporate HQs, second only to Tokyo.

Today, Yokohama has largely reclaimed its status as an economic hub and companies are increasingly drawn to the area. Tokyo office rent premiums – driven by strong demand – in addition to the generous economic incentive programs have made the city an attractive alternative. The office sector is not alone in reaping the rewards of redevelopment, however. Rising corporate activity has also increased demand for residential assets, adding to the estimated 3.8 million people already living in the city. As such, with the city proving popular for locals and visitors alike, the recently much-maligned retail and hospitality sectors should see better days.

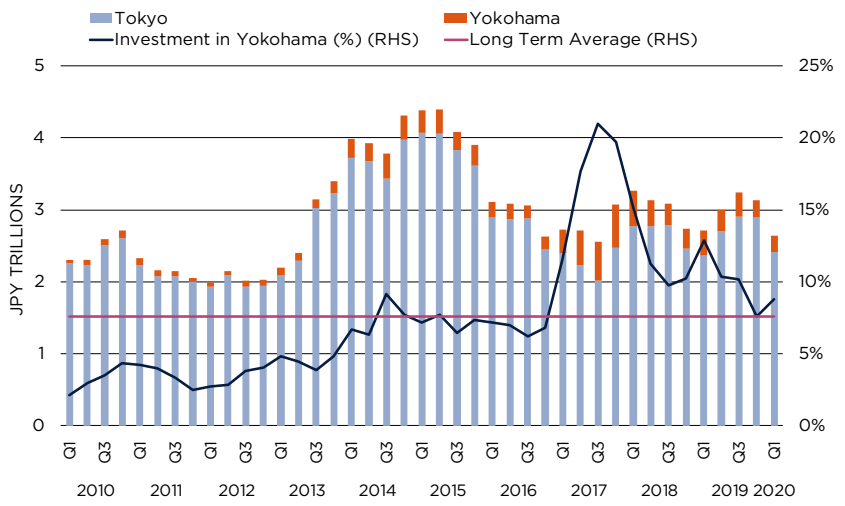
Whilst touching on the impact of COVID-19, given the above, this report will focus more on the longer-term trends that should see Yokohama emerge as a credible alternative to Tokyo.

INVESTMENT

Against a backdrop of rock-bottom interest rates and uncertain global prospects, the Japanese real estate market continued to entice investors in search of stable yields. Meanwhile, when looking at the major cities, it's safe to say that Tokyo finds itself as the number one location. Based on data provided by Real Capital Analytics (RCA), on average, the capital was home to around 60% of total investment flows across all asset classes between 2010 and 2019. In reality, however, this figure had been on a downtrend before the COVID-19 outbreak due to the limited number of affordable opportunities in Tokyo.

As such, with the intense competition for quality assets stretching valuations in Tokyo, less financially capable market participants had no choice but to look elsewhere for opportunities.

Graph 1: Rolling Annual Investment Flows into Tokyo and Yokohama, 2010 to Q1/2020



Source RCA, Savills Research & Consultancy

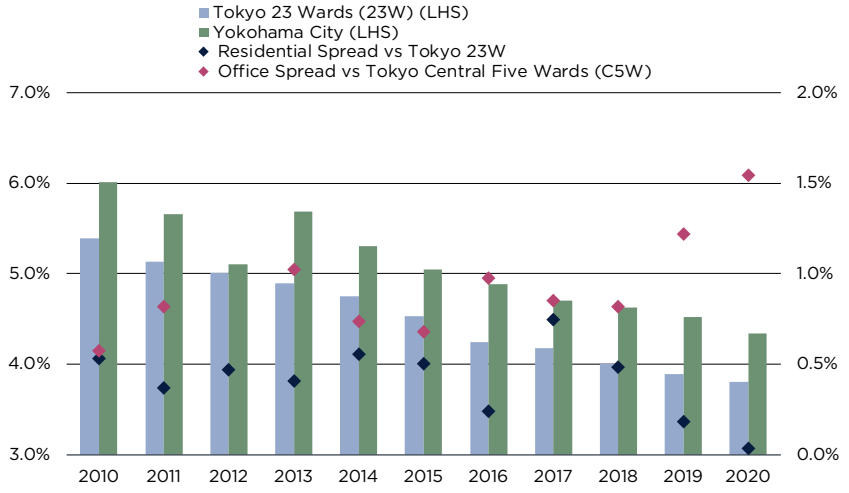
In truth, they did not have to look far. When looking at rolling annualised investment volumes specifically into Tokyo and Yokohama, since early-2017, the latter has seen a notable uptick, ensuring that its share of annual investment sits above its long term average of around 8%. To put this into perspective, Yokohama represented a mere 2% of the total transacted volume at the start of 2010 (Graph 1).

This competition for real estate assets has also led to cap rate compression over the period. Indeed, when using completed J-REIT transactions as a proxy for the broader market, the attractiveness of Yokohama becomes evident. Despite tightening in lockstep with Tokyo, across all asset classes, the cap rate remains around 50 basis points higher than its larger counterpart (Graph 2).

Looking at offices in particular, underpinned by strong investment demand for prime assets, cap rates in Tokyo have continued to tighten, whilst the equivalent in Yokohama has remained relatively flat. Consequently, the spread between the two in this sector has reached a decade high of around 150bps in Q1/2020. Meanwhile, the multifamily residential sector in Yokohama remains stable and rents notably showed as much resilience as Tokyo following the Global Financial Crisis. Given this defensive nature, the spreads between residential assets remain close to nil, implying Yokohama's attractiveness, especially for residents. Under the current uncertainty, therefore, the discrepancy in valuations within certain sectors may accelerate the flight to quality. Alternatively, the "new normal" after COVID-19 may also present fresh demands and opportunities such as satellite offices.

Thanks in part to the success of its many redevelopment projects, Yokohama has once again established itself as a major economic hub. Moreover, the onset of COVID-19 could see its popularity rise further owing to its favourable work-life environment. Meanwhile, the relative youthfulness of the city should help ensure that real estate fundamentals remain firm in the years to come, despite Japan's demographic challenges.

GRAPH 2: J-REIT Transaction Cap Rates* and Spreads Across Asset Classes and Cities, 2010 to Q1/2020



Source J-REIT DB, Savills Research & Consultancy
* Cap rate information was not available for transactions involving office assets in Yokohama during 2012.

TABLE 1: Major Transactions in Yokohama, 2017 to Q1/2020

ANNOUNCED	PROPERTY	BUILDING USE	GFA (TSUBO)	PRICE (JPY BIL)	BUYER
Jan 2020	Minato Mirai Center Building	Office, Retail	28,800	98.0	GK Zest Leasing (SPC of Goldman Sachs)
Mar 2017	TOC Minato Mirai	Office, Retail, Hotel	30,900	66.5 (c70:30 - Building: Land)	Fuyo General Lease (Building) and Hulic (Land)
Dec 2017	MHI Yokohama Building	Office, Retail	33,100	64.0	GK YMM Investment (SPC of Kenedix Office REIT, Kenedix Private REIT, Kenedix)
Sep 2018	Ocean Gate Minato Mirai	Office, Retail	16,800	45.0	PLC8 GK (SPC of LaSalle Investment Management)
May 2017	Concurred Yokohama (75%)	Office, Retail	12,200	39.2	GK Yokohama Office Management (SPC of Daiwa Office REIT and Daiwa PI Partners)

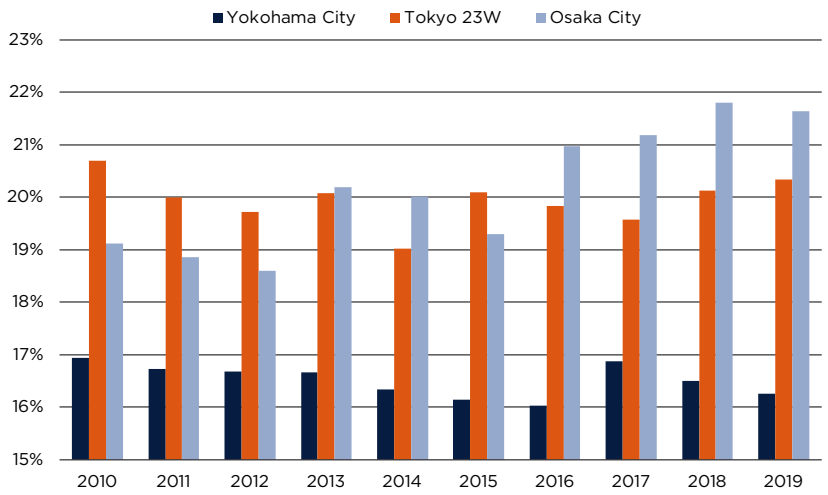
Source Nikkei RE, Savills Research and Consultancy

RESIDENTIAL

As well as an economic hub, Yokohama continues to be a popular location for would-be residents, and a big reason for this is the convenience of Yokohama Station. With a choice of around ten train lines, the station sees an estimated 2.3 million daily passengers, 400,000 of which are locals making the 30-minute commute to Tokyo. Popular lines include the Tokyu Toyoko Line going through Shibuya and the Tokaido Line, which connects the city with Shinagawa and Shinbashi – a popular destination for office workers – as well as Tokyo Station itself. Meanwhile, being within half an hour to other popular destinations, such as Kamakura to the south, as well as Shinkansen stations and Haneda Airport to the East, certainly adds to the appeal.

Though convenience is important, another vital consideration is the cost-of-living, and in

GRAPH 3: Average Rent as a Proportion of Average Annual Taxable Income*, 2010 to 2019

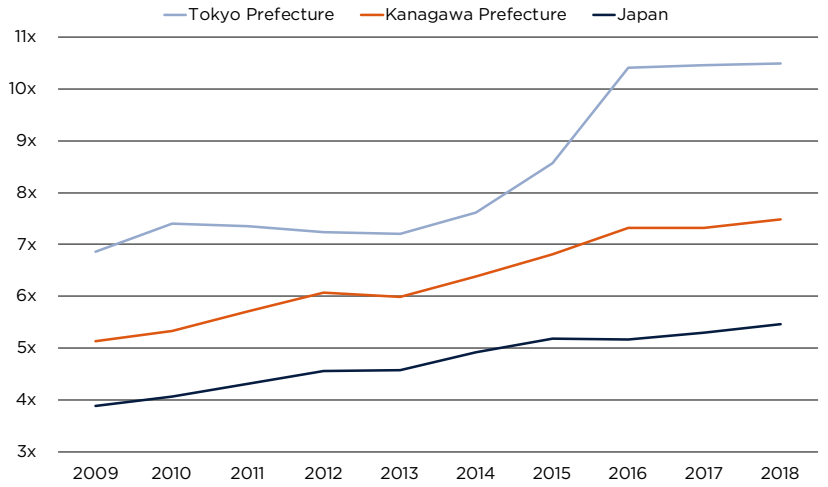


Average Annual Taxable Income (JPY million)

YEAR	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Tokyo C5W	6.74	6.75	6.74	6.84	8.05	7.41	7.88	8.03	8.34	8.82
Tokyo 23W	4.57	4.59	4.59	4.62	5.03	4.87	5.03	5.10	5.22	5.39
Yokohama City	3.88	3.90	3.91	3.89	3.97	3.99	4.01	4.04	4.07	4.11
Osaka City	3.13	3.13	3.15	3.15	3.24	3.26	3.29	3.32	3.37	3.41
National	2.77	2.76	2.75	2.75	2.78	2.80	2.83	2.86	2.89	2.91

Source Tokyo Kantei, Ministry of Internal Affairs and Communications, Savills Research & Consultancy
*Based on an average unit size of 25 sq m.

GRAPH 4: Average Second-hand Condo Price-to-Income Multiple by Prefecture, 2009 to 2018



Source Tokyo Kantei, Savills Research & Consultancy

this context, Yokohama once again comes out favourably. A key component of this measure, namely taxable income, is unsurprisingly the highest in Tokyo. This is especially true in the central five wards (C5W) where average earnings are just shy of JPY9 million – over double that of Yokohama. Nonetheless, as with other asset classes, there is a premium to being in the capital. For instance, as of March 2020, average rents in the Tokyo 23 wards (23W) were over 50% higher than in Yokohama according to data provided by Tokyo Kantei. As such, when combining these two metrics, the affordability of Yokohama becomes apparent (Graph 3). To wit, for residents of Yokohama, rent accounted for 16% of taxable income, on average, in 2019 compared to 20% in the capital. Surprisingly, this figure was surpassed by the 22% observed in Osaka city – another major residential hub. In fact, the premiums of these two cities over Yokohama in 2019 of 4.1% and 5.4%, respectively, were at their highest in a decade.

For those hoping to buy rather than lease, the story is somewhat similar. Here, the average price-to-income multiple for second-hand condo developments[1] as of 2018 in the Tokyo Prefecture stands at around 10.5x, whilst in Kanagawa Prefecture, the figure is closer to 7.5x (Graph 4). To put these figures into perspective, the national average is around 5.5x. On the proviso that multiples between 6x to 10x have historically been assumed reasonable, Yokohama seems relatively more affordable. Indeed, this dynamic looks set to continue, with meaningful income growth looking unlikely in the foreseeable future, especially in a post COVID-19 world.

Meanwhile, a study conducted by SUUMO in March, whereby 7,000 participants were asked about their ideal station to live near in the Kanto Region, ranked the city as number one, ahead of the other top-3 stalwarts: Ebisu and Kichijoji (both in Tokyo). In fact, Yokohama has topped the table for three consecutive years, whilst it has also been in the top three since 2015. With further redevelopments in the pipeline, it would not be a surprise to see Yokohama retain its crown once again in 2021.

(Please refer to our Spotlight Report "Tokyo Periphery and Rail Transit" for further analysis on the residential market in the Tokyo periphery).

OFFICE

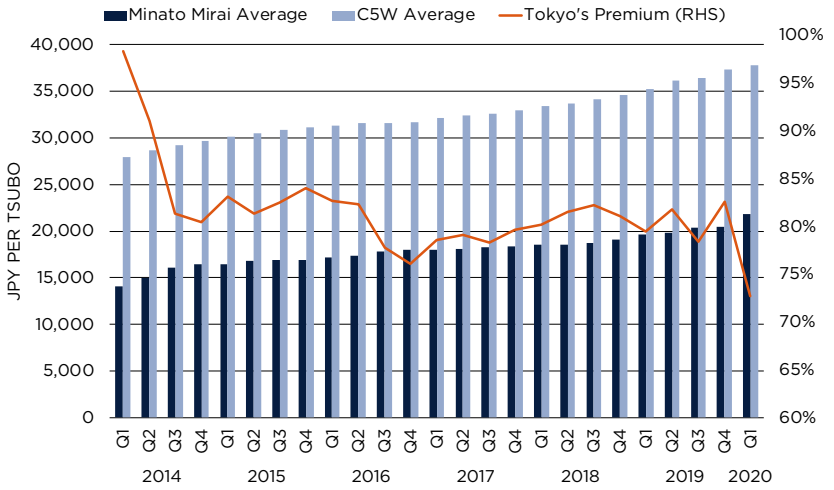
Along with the modernisation of the area surrounding the station, the success of the initial Minato Mirai 21 Project has seen Yokohama regain its status as an economic hub. Yet, with multiple eye-catching new

1 Based on the average value of a 70 sq m condo built 10 years ago.

developments and the significant levels of demand for Tokyo offices, much of the attention had been stolen, and with good reason. Corporate profits had been expanding consistently – particularly in the technology sector – and, as a result, Grade A office rents had been trending higher. Meanwhile, faced with labour shortages, a focus on retaining talented staff by improving the working environment had further enhanced the appeal of the modern, open-spaced, high-grade office – a spec found more commonly in Tokyo's C5W. None of this is to say Yokohama office rents have lagged, however. On an annualised basis, rental growth in Minato Mirai has actually outpaced the C5W average by an additional 2% p.a since 2014. In turn, the capital's premium has narrowed from just under 100% to around 75% over the period (Graph 5). Yet, rents remain at an affordable level, with good potential for further upside – especially compared with the C5W.

With Kanagawa Prefecture's Keihan industrial zone long recognised as a major R&D centre in Japan, nearby Minato Mirai has also attracted interest as an R&D hub for international companies, partly due to the provision of generous financial incentives. Starting with the completion of Fuji Xerox R&D Square in 2010, global players such as Shiseido and Kyocera have recently established themselves in the area, bringing the total number of R&D bases to over 20. In order to accommodate this growing demand, therefore, Minato Mirai has been undergoing large development of late – much of it owner occupied. In fact, the total GFA set to come online over the next four years could eclipse the total witnessed in the previous decade (Table 2). With much of this new supply expected around Shin-Takashima Station, however, it should have a limited impact on existing supply. More broadly, although this surge in office supply presents a potential headwind, current vacancy rates are extremely low – contracting from highs of 14% in 2011 to around 0.8% as of Q1/2020. As such, along with the increased demand,

GRAPH 5: Grade A Office Rents and Tokyo's Premium over Yokohama, 2014 to Q1/2020



Source Savills Research & Consultancy

TABLE 2: Office Supply in Minato Mirai, 2010 to 2024

BUILDING NAME	NEAREST STATION	COMPLETION YEAR	GFA (TSUBO)*	TOTAL GFA
Minato Mirai Center Building	Minato Mirai	2010	28,800	179,200
Yokohama Mitsui Building	Shin-Takashima	2012	27,300	
MM Grand Central Tower	Minato Mirai	2012	34,600	
Yokohama i-Mark Place	Shin-Takashima	2014	29,400	
Yokohama Nomura Building	Shin-Takashima	2017	24,800	
Ocean Gate Minato Mirai	Minato Mirai	2017	16,800	
Shiseido Global Innovation Center	Shin-Takashima	2019	17,500	
Murata Manufacturing MM Inovation Center	Shin-Takashima	2020	18,100	180,800
Yokohama Grangate	Shin-Takashima	2020	30,600	
Yokohama Gate Tower Project	Shin-Takashima	2021	25,400	
LG Global R&D Center	Shin-Takashima	2021	11,200	
Metropolitan Expressway Kanagawa Bureau Development Project	Takashimacho	2021	4,200	
MM21 District Block 37 Development Project	Minato Mirai	2023	36,900	
MM21 District Block 53 Development Project	Shin-Takashima	2024	54,400	

Source City of Yokohama, Savills Research and Consultancy
*The GFA relates to the entire building.

the rise in office supply should be somewhat manageable going forward.

In a COVID-19 world, the valuations given to a previously robust C5W office market may instead make Yokohama seem even more attractive, due to its relative affordability and proximity to residential hubs. The pandemic, it would seem, has not only accelerated the requirement to be able to work from home, but has also potentially made this nascent trend a permanent part of corporate policy. For instance, in a report published by the Tokyo Metropolitan Government relating to remote work (394 responses), from March to April, the ratio of firms using, or planning to use, working-from-home policies more than doubled to just under 70%. Indeed, with many firms anticipating the potential cost savings from having the policy in place, and with social distancing requirements remaining for the time being, a paradigm shift in the office sector may be emerging. Without the need to cram employees into a large central location with lofty rents attached, previous plans to expand office space, especially in the C5W, are, in most cases, being put on ice. In its stead, a focus on cost effective satellite offices with easy access from residential hubs such as Yokohama. Indeed, the deep discount to Tokyo as well as the "new normal" in a post-COVID-19 world should be a recipe for success for this semi-regional market.

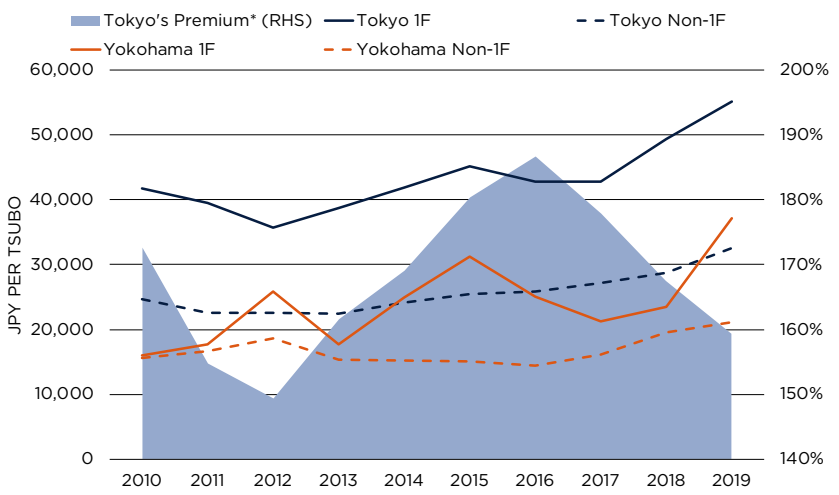
RETAIL

Yokohama is a popular destination for locals in addition to well over 80 million visitors per annum, and the resulting level of footfall has been a boon for retail rents in the main shopping districts adjacent to the station. In fact, rental growth has been strong since 2018, with 1F rents in particular exhibiting exceptional year-on-year change. Whilst still markedly behind the levels of rent found in prime retail districts in Tokyo, such as Ginza, this recent uptick has led to a noticeable narrowing in rents between the two cities (Graph 6).

That said, with the prospects of the retail sector intertwined with the outcome of the COVID-19 pandemic, the immediate outlook for the sector is certainty unnerving. The impact from the substantial drop in footfall following the declaration of the state of emergency in early April is striking to say the least. Having previously been delayed to the end of May, the date at which the newly completed NEWoMan Yokohama is set to open its doors is now undecided. Housed in the retail portion of JR Yokohama Tower, the 10F structure, with around 20,000 tsubo of GFA, was supposed to be the centrepiece of the station redevelopment project but has instead remained out of operation.

Yet, the relationship with the outbreak could also provide a tailwind going forward for this sector. Namely, the emergence of working-from-home as a permanent part of corporate life could see an added vibrancy in the city, and not just on weekends. What's more, assuming the economic recovery begins in earnest, the time and money usually spent on commuting could be diverted towards improving work-life balance, possibly spilling over into the retail sector. As such, with the facilities currently available, as well as those in the pipeline, the potential for Yokohama to emerge as a major retail hub gives some confidence in the sector's longer term prospects.

GRAPH 6: Listed Retail Rents and Tokyo's Premium over Yokohama, 2010 to 2019



Source JREI, BAC Urban Projects, Savills Research and Consultancy
*Based on overall retail rents, including both 1F and non-1F.

HOSPITALITY

According to the Japan Tourism Agency (JTA), based on a questionnaire provided to inbound visitors, around 8% of respondents visited Kanagawa Prefecture during their trip in 2019. In contrast, Greater Tokyo was visited by over 47% of those asked. Hence, with the Tokyo Olympics on the horizon there was plenty of upside for the city, and in order to capitalise from the surge in visitors, a significant number of hotel developments were underway. Unfortunately, the COVID-19-induced postponement of the Tokyo Olympics, as well as the subsequent decimation of the tourism industry, has dealt a significant blow. With the recovery of the industry expected to outlast the pandemic itself, there are major hurdles going forward.

As for Integrated Resorts (IR), despite remaining in the running alongside Osaka, Wakayama and Nagasaki, the prospect of one opening in Yokohama now appears less clear. Indeed, the restrictions to movement and the subsequent drop in revenue have led to operators shifting their focus from expansion to survival. What's more, the recent decision by Las Vegas Sands – a supporter of Yokohama – to drop its pursuit of a licence due to the inauspicious framework around Japan's future casino industry certainly does not help. All that being said, if an IR were to be built, it could potentially generate 100,000 jobs and provide economic benefits of JPY1 trillion, according to the City of Yokohama.

Nonetheless, despite the gloomy outlook over the shorter term, the fundamentals in Yokohama appear relatively stable. For instance, compared to international peers, luxury hotels are somewhat of a rarity in Japan and, here, Yokohama is once again positioned to profit. For that reason, projects such as the recently completed Intercontinental Yokohama Pier 8, as well as projects in progress such as The Westin Hotel, The Kahala and Yokohama Baycourt Club give a glimmer of hope for the future.

YOUTHFUL YOKOHAMA

The demographic challenges facing Japan as a result of both an aging and shrinking population is well known. According to forecasts made by the National Institute of Population and Social Security Research in 2015, the population is anticipated to shrink by around 16% between 2015 and 2045. Actual figures make for slightly better reading, however. Namely, the actual population in 2020, based on provisional data, is around 2% higher than forecasted, whilst the rate of decline since 2015 is also slightly less severe. That said, the drop in numbers remains a long-lasting issue.

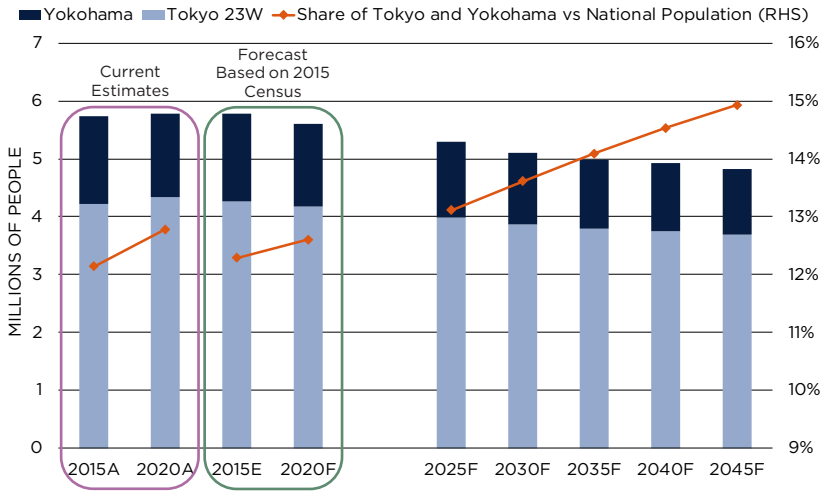
The problems resulting from a shrinking population notwithstanding, major cities typically have younger demographics, driven by

TABLE 3: The Number of University Students by City, 2019

LOCATION		NO. OF STUDENTS	% OF TOTAL
1	Tokyo 23W	539,470	38.2%
2	Kyoto City	144,713	10.2%
3	Nagoya City	102,626	7.3%
4	Yokohama City	82,389	5.8%
5	Fukuoka City	72,980	5.2%
	Total	**942,178**	**66.7%**

Source Ministry of Education, Culture, Sports, Science and Technology (MEXT), Savills Research and Consultancy

GRAPH 7: Actual* and Forecasted Population in Cities of People Aged Between 20-49 and the Share of Those Living in Tokyo and Yokohama vs National, 2015 to 2045F



Source National Institute of Population and Social Security Research, Municipal Data, Savills Research and Consultancy
*These estimates are made by municipalities based on the "Jumin Kihon Daicho" registration system. Therefore, estimates are subject to change once the 2020 census has been conducted.

various economic and social factors, including migration for employment and educational opportunities. For instance, come 2045, the 20 to 39 cohort in Tokyo and Yokohama is forecasted to be around 30% and 10% higher, respectively, compared to the national average. As such, aided by these demographic tailwinds, the outlook for these major cities appear more positive than first thought.

One factor that may further drive this trend going forward relates to those even younger than the aforementioned demographic. With multiple competitive universities, Kanagawa Prefecture is an appealing destination for young people. Specifically, when looking at the proportion of students attending universities located in cities, Yokohama ranks fourth overall with around a 6% share (Table 3). Unsurprisingly, Tokyo leads the way with 38%. With labour shortages to persist even after the pandemic, the combined pool of well-educated students in these two neighbouring cities, therefore, appears very attractive for prospective employers, mitigating the issues of talent acquisition. Subsequently, if these students end up working in Tokyo or Yokohama, the latter should be strongly considered as a place to live, given its amenities.

Alternatively, looking a little deeper into the SUUMO study mentioned above may also present some potential clues on the prospects for Yokohama. Around 10% of respondents, all aged between 20 and 49 who live in either Tokyo or Kanagawa Prefecture, had the station in their top three. What's more, two of the five most popular stations after Yokohama, namely Meguro and Shinagawa, are located on train lines between the city and the capital. With rents in these locations typically at a noticeable premium, Yokohama should appear an acceptable substitute for those without deeper pockets.

Meanwhile, when looking at this 20 to 49 demographic for the 23W and Yokohama City together, this group currently accounts for around 13% of the national total (Graph 7). Despite the forecasted number of people in this age band declining, the share attributed to the two cities is forecasted to actually increase to around 15% by 2045. Indeed, with COVID-19 accelerating the desire for a better work-life balance, especially in the younger generation, and if the results of the SUUMO study are anything to go by, Yokohama has the potential to maintain its relative youthfulness going forward, despite the broader population shrinking.

OUTLOOK

Leading up to the end of 2019, rents had continued their seemingly unstoppable rise across most core asset classes in Tokyo, and subsequently the financial capacity of tenants had started to be tested. Meanwhile, intense competition for assets had also stretched valuations in the capital, bringing with it cap rate compression. Amid the upswing, however, having previously been somewhat overshadowed by the capital, Yokohama has re-emerged as a credible and affordable alternative following the success of its many redevelopment projects. Whilst COVID-19 may be a turning point for the property cycle, as well as a key reagent in reshaping the ideal lifestyle, many of these trends had emerged before the outbreak, and have since gained further traction. As such, these growth catalysts, allied with the demographic tailwinds, should drive Yokohama's appeal for the foreseeable future.

That said, Yokohama's prospects are largely interwoven with those of Tokyo. Accordingly, given the presence of various unknowns in the post-COVID-19 world, there is no guarantee that the themes discussed above will come to fruition. Indeed, with many predicting a long road to recovery, difficulties along the way are expected. Nonetheless, the sound fundamentals built from the progress made thus far should stand Yokohama in good stead for the time being.

Japan - June 2020

SPOTLIGHT

Savills Research

Shinagawa

savills

Tokyo's newest gateway has long-term potential

Summary

- Being located just outside of Tokyo's central five wards (C5W), and with a well-established business district, Shinagawa real estate is likely the safest bet in Greater Tokyo outside of the C5W (the Tokyo Periphery).
- Despite having some of the highest rents amongst Tokyo's 18 outer wards (18W), the Shinagawa Ward continues to attract a large number of residents in their 20s, with the number picking up over the past two years.
- Housing starts data indicates that the market has been undersupplied in terms of multifamily residential units – suggesting that rents could see some additional upside.
- Although office rents have grown substantially over the past few years, the market still offers a nearly 40% discount in Grade A office space over the C5W. That said, pricing varies significantly by neighbourhood.
- Increasing availability in the C5W resulting from COVID-19 could lead to an early rise in vacancy in Shinagawa Ward's peripheral neighbourhoods, such as Tennozu Isle and Shinagawa Seaside, as tenants take advantage of the opportunity to secure more convenient office space in the city centre.
- Looking ahead, Shinagawa Station will host the Tokyo platform of the first Maglev line, which is set to open in 2027 and will reduce railway travel time to Nagoya by 60%. Leading up to this, the station is set to see a major expansion accompanied by new developments in the surrounding area.

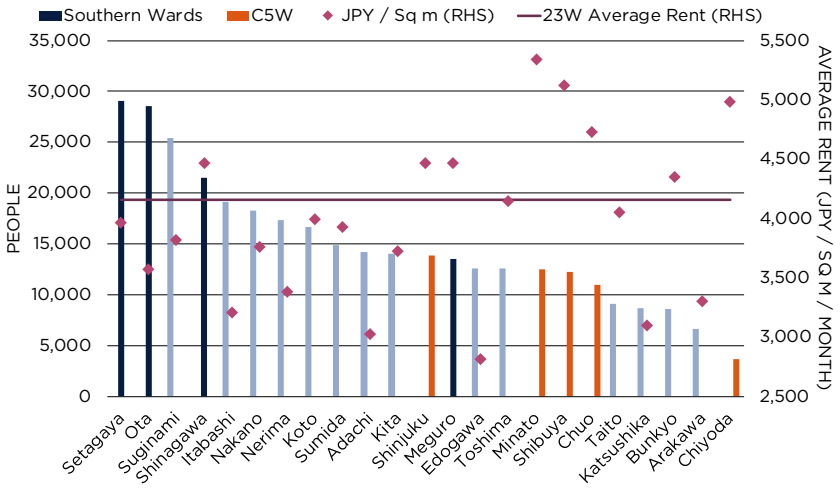
INTRODUCTION

Although Japan has managed to contain the COVID-19 outbreak relatively well thus far, the impacts of the global pandemic will certainly put a damper on Japan's economy and by extension the broader real estate market. As of April 2020, the IMF has forecasted that Japan's economy will contract by 4.8% in 2020. To make matters worse, the Tokyo Olympics – which are now slated for July 2021 – could face an outright cancellation.

Notwithstanding the near-term impacts of COVID-19, Tokyo will continue to see significant investment into the early 2020s and beyond. Major development projects are already underway around the C5W in areas such as Toranomon and Shibuya. Along with these developments, Shinagawa Station will undergo massive redevelopment that will prime it, as well as the Shinagawa Ward just to the south, for a boom over the course of the decade.

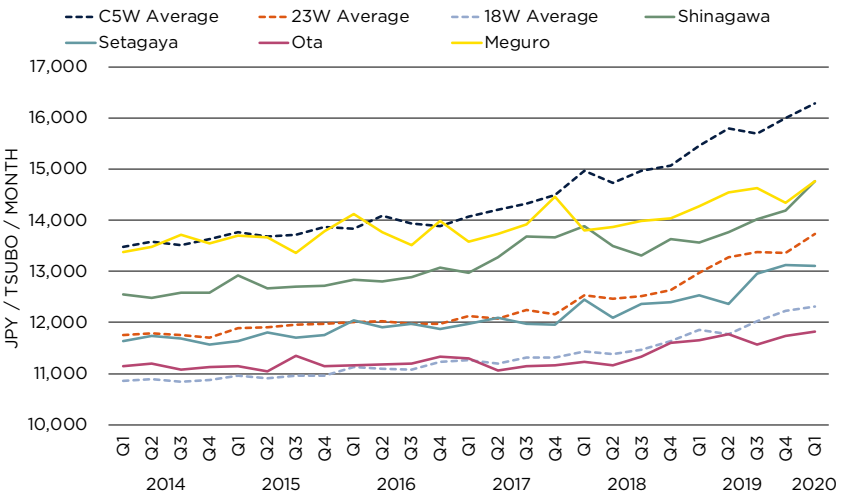
The area was historically the last (or first) lodging stop along the old Tokaido Route between Kyoto, then the seat of the Emperor, and Nihonbashi in Edo (Tokyo). The district retains some of this character as it is still reported to have the highest concentration of hotel accommodations in Tokyo. More recently,

Graph 1: 20-29 Year-Old Net Migration by Ward, 2014 to 2018



Source Ministry of Internal Affairs, Savills Research and Consultancy

Graph 2: Multi-family Rents Amongst the Southern Wards, Q1/2014 to Q1/2020



Source Savills Research and Consultancy

Shinagawa has developed into an industrial district and, subsequently, a business centre and residential hub, with the area's connection to the Shinkansen line and the redevelopment of the national railway's marshalling yard in 2003 being major catalysts for this trend.

The area is now in the midst of a new redevelopment phase meant to transform the Shinagawa district into a global transportation and business hub. A major milestone of this project has just been reached with the opening of the Takanawa Gateway Station on the Yamanote Line in March 2020. Moving forward, the area is set to see a number of mixed-use developments coming online in the surrounding area, culminating in the opening of the Tokyo platform of the Chuo Shinkansen (Maglev line) at Shinagawa Station in 2027.

C6W

Given that it is essentially an extension of the C5W, Shinagawa is likely the safest bet amongst the markets surveyed in our reports covering the Tokyo Periphery, though upside potential may be comparatively limited as a result. Indeed, the ward has already been something of a popular target amongst overseas investors given that attractive deals in Tokyo's top submarkets have been few and far between in recent years.

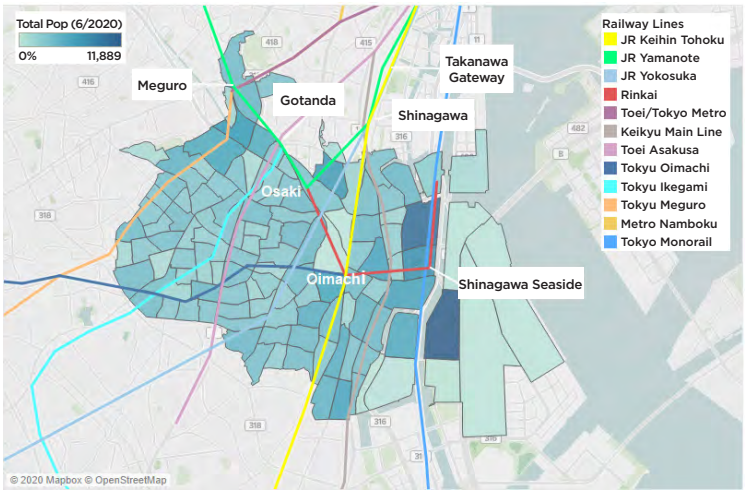
Shinagawa's convenience combined with its affordability compared to Tokyo's central five wards have made it an attractive alternative for residents and corporate tenants alike, particularly in the latter stages of this upswing. Although the submarket might experience some volatility in the near-term as a result of COVID-19, Shinagawa's prospects are positive on a long-term basis.

Still, there are a few key differences with the central wards. For example, unlike the nearby wards of the C5W, Shinagawa has attracted a large number of young residents. Rents in the C5W are often well out of reach for the average person and this is particularly true for those in their 20s, Tokyo's largest group of migrants. In general, many have looked to peripheral wards in the South and West as a convenient alternative. It is worth noting, however, that Shinagawa is significantly more expensive than these other wards - especially nearby Ota and Setagaya - that have been magnets for these young residents (Graphs 1 & 2).

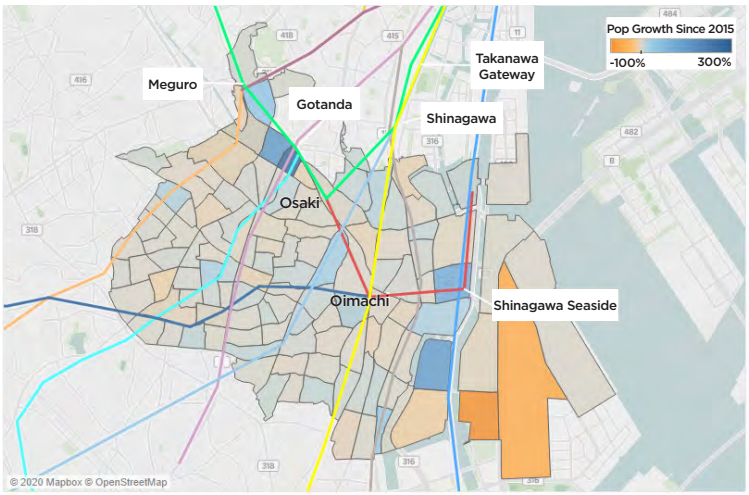
It may be the case that the ward is popular amongst new arrivals with higher incomes, possibly in the IT and software sectors. Indeed, the area has been a magnet for foreign IT giants in particular: Microsoft Japan's headquarters is located near Shinagawa Station and Amazon Japan's headquarters as well as AWS's Japan headquarters are both located near Meguro Station. Both of these areas are on the border or just outside of Shinagawa Ward, namely in Meguro and Minato, which tend to be more expensive than Shinagawa. Recent demographic data appears to lend some credence to this argument, as neighbourhoods near Meguro and Gotanda stations, as well as areas to the southeast with good access to Shinagawa Station, have seen marked increases in their populations over the past five years (Map 1).

Map 1: Shinagawa Demographics by Neighbourhood

Population By Neighbourhood And Local Railways As Of June 2020

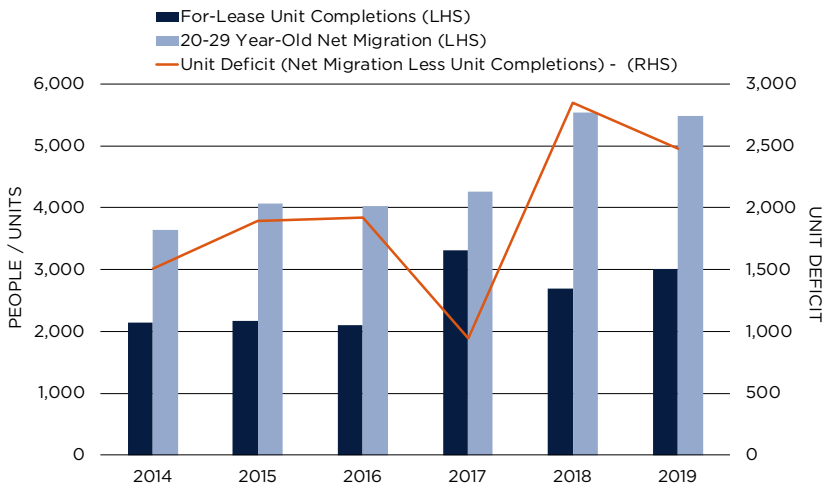


Population Growth Since 2015



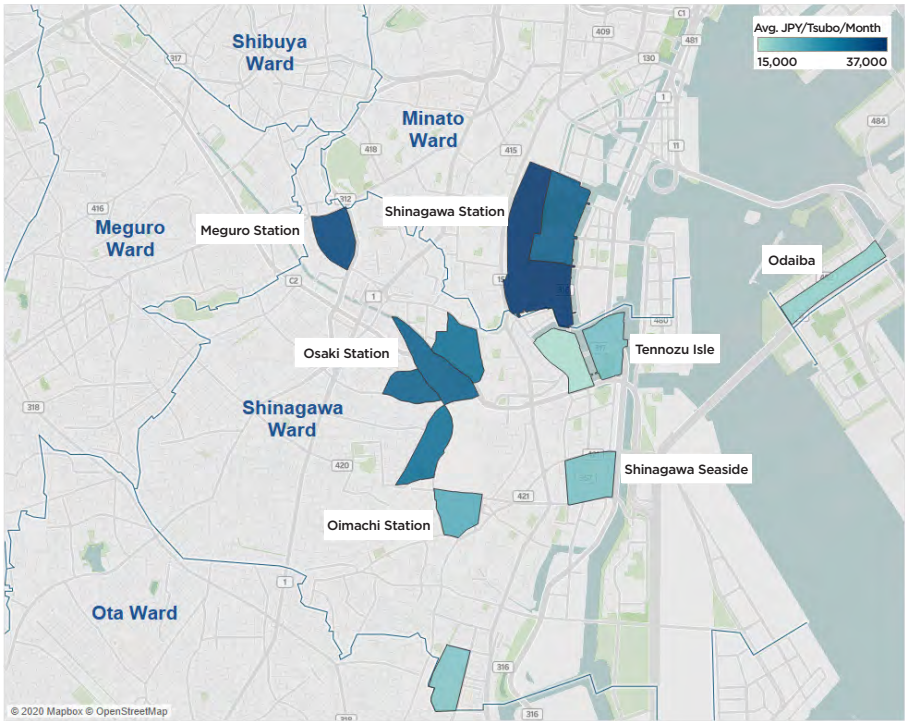
Source Shinagawa City, Statistics Bureau of Japan, Savills Research and Consultancy

GRAPH 3: 20-29 Year-Old Net Migration for Shinagawa Ward vs Completion of Multifamily Units, 2014 to 2019



Source Ministry of Land, Infrastructure, Transport, and Tourism (MLIT), Savills Research and Consultancy
Note: Unit completions are estimates based on housing starts disclosed by MLIT.

MAP 2: Shinagawa Area Office Submarkets (Grade A), Q1/2020



Source Savills Research and Consultancy
Note: Highlighted areas above reflect the "Cho" (neighbourhoods) containing Grade A offices in - and near the border of - the Shinagawa Ward.

The ward has in fact seen a notable uptick in net migration over the past two years. Large office developments proceeding around Shibuya Station and additional corporate relocations to the Shinagawa office market may be partly responsible for this increase. As in the Tokyo 23W at large, the supply-demand balance of multifamily residential units appears to be favourable for landlords. Graph 3 compares housing starts data and the net migration of residents in the 20-29 age bracket over the past six years. On average over this period, migrants in this age bracket have exceeded new multi-family units coming online by around 2,000 each year. Given that residents in their 20s are unlikely to purchase condominiums in the ward, it appears that new demand for units is outpacing new supply. As such, there may still be room for rental growth in the submarket, assuming that migration does not grind to a halt.

A TALE OF TWO SHINAGAWAS

Despite its name, Shinagawa Station is not in fact located in the Shinagawa Ward, but just a stone's throw to the north in the Konan neighbourhood of the Minato Ward. Even so, the name "Shinagawa" itself is often used to refer to the business district surrounding the station. Due to its location in the Minato Ward and convenient access, this area tends to be much pricier than the Shinagawa Ward proper, especially compared to nearby Higashi Shinagawa, which includes the Tennozu Isle and Shinagawa Seaside office submarkets (Map 2).

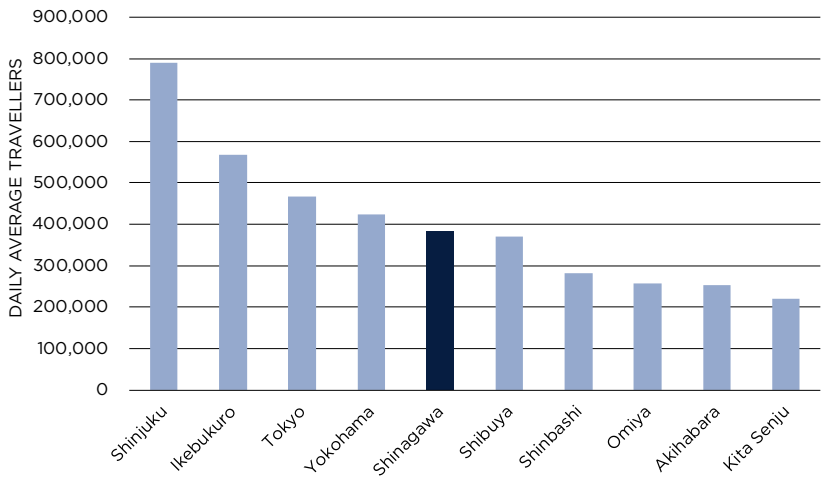
Shinagawa Station is a major railway hub in the Takanawa and Konan districts of Minato, operated by East Japan Railway Company (JR East), Central Japan Railway Company, and the private railway operator Keikyu. Among the largest JR Stations in the region, Shinagawa Station sees approximately 400,000 passengers board or disembark from the station on average every day (Graph 4). The Tokaido Shinkansen and other trains to the Miura Peninsula, Izu Peninsula, and the Tokai region pass through here, connecting with Nagoya and Osaka. Shinagawa is not served by the Tokyo subway network, though it is connected to the Toei Asakusa Line via Keikyu through services. Haneda International Airport, the busiest airport in the country, is also accessible in under 20 minutes.

With excellent transport access to other parts of the Tokyo Metropolitan area, as well as serving as a gateway to Tokyo from other parts of the country via the Tokaido Shinkansen and Haneda Airport, all the while being affordable, the Shinagawa business district is home to a number of major corporations. Electronics and IT companies have a particularly strong presence in the area. The Japan headquarters of Samsung and Microsoft for example, are both located in Shinagawa Grand Central Tower,

while Sony City, Sony's global headquarters complex, is also located just east of Shinagawa Station. Further, Toyota Systems will base its Tokyo head office in Shinagawa Heart, which was completed in February 2019, along with multiple companies related to Macnica Fuji Electronics Holdings.

Looking ahead, the Linear Chuo Shinkansen (Maglev line) Station is set to open in 2027, which will reduce travel time from Tokyo to Nagoya by 60%, from 100 minutes to 40 minutes. The extension of the line to Osaka is scheduled for completion in 2037, connecting Tokyo and Osaka in around 70 minutes. This will create a massive commuter belt extending from East to West Japan.

GRAPH 4: Top 10 JR East (Tokyo Metropolitan Area) Stations by Average Daily Footfall, FY2018



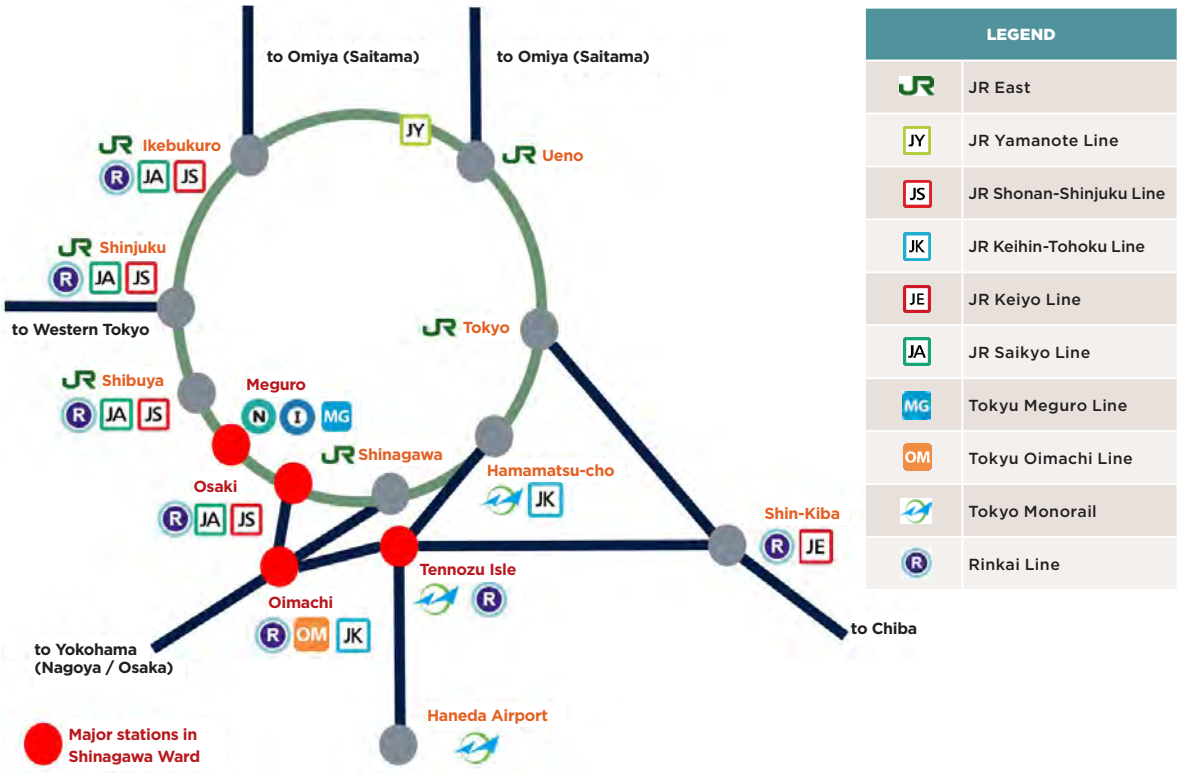
Source JR East, Savills Research and Consultancy
Note: Passenger numbers above only represent riders using JR East.

In anticipation of the Maglev line and in an effort to transform the area into a global business hub, JR East has undertaken a massive 500 billion yen development project around Shinagawa Station. Dubbed the Shinagawa Development Project (phase I), this initiative is set to bring online 260,000 tsubo of mixed-used space by 2025. This development is likely to make 2025 a major office supply year, comparable to the levels of 2020 and 2023 in the C5W as a whole. If completed as planned, the scale of the project would be larger than that of Roppongi Hills in terms of GFA. The development will include four high-rise towers around 170 metres tall, including an office tower, two mixed-use hotel and office towers, and an 860-unit apartment building. The station itself will see refurbishment to accommodate the Maglev line.

A major leg of the project was completed just to the north of Shinagawa Station in March 2020, with the opening of the new Takanawa Gateway Station, adding a new stop along the Yamanote Line – the first since 1971 – as well as the Keihin-Tohoku Line, which extends north to Omiya, Saitama and south to Yokohama.

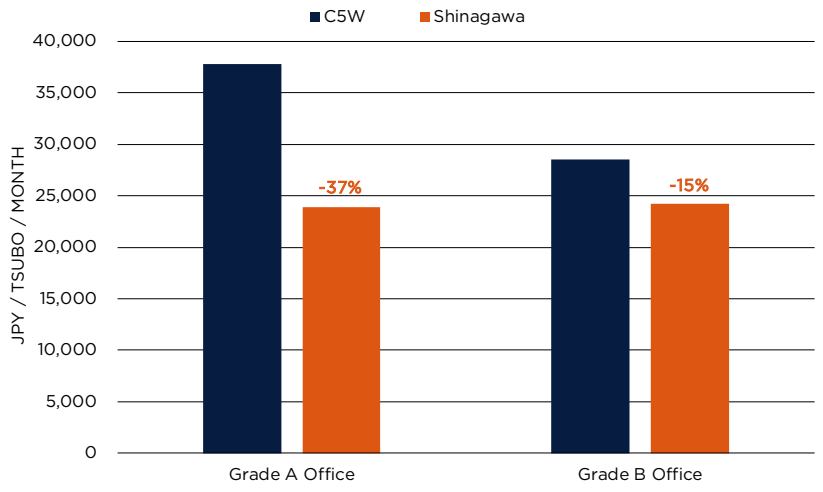
(Please refer to our Spotlight Report "Tokyo Periphery and Rail Transit" for further analysis on rail access and major transit hubs in the Tokyo Periphery).

MAP 3: Overview of Railway Access around Shinagawa



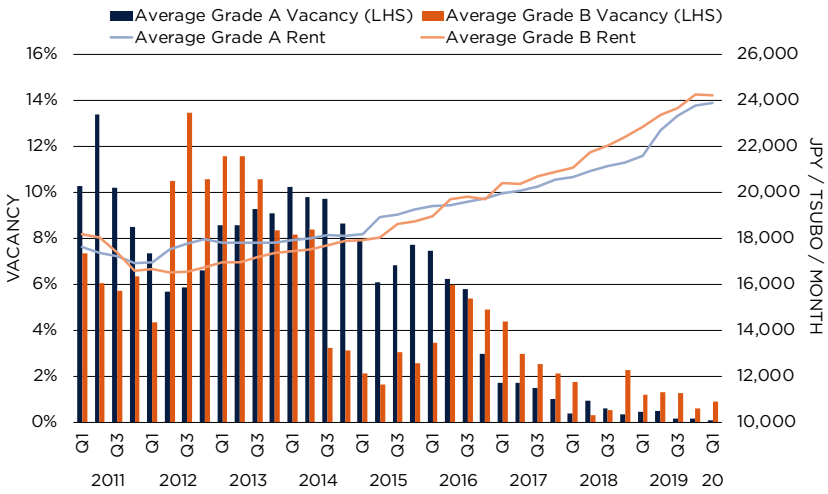
Source Savills Research and Consultancy

GRAPH 5: C5W Rents vs. Shinagawa Ward Office Rents, Q1/2020



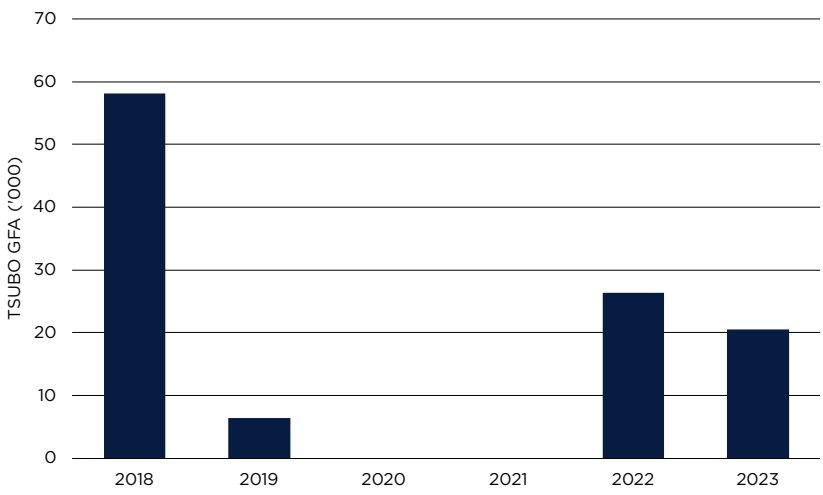
Source Savills Research and Consultancy

GRAPH 6: Shinagawa Ward Grade A and Grade B Rents, 2011 to Q1/2020



Source Savills Research and Consultancy

GRAPH 7: Shinagawa Large-Scale Office Supply, 2018 to 2023



Source Savills Research and Consultancy

AN ALTERNATIVE OPTION FOR CORPORATES

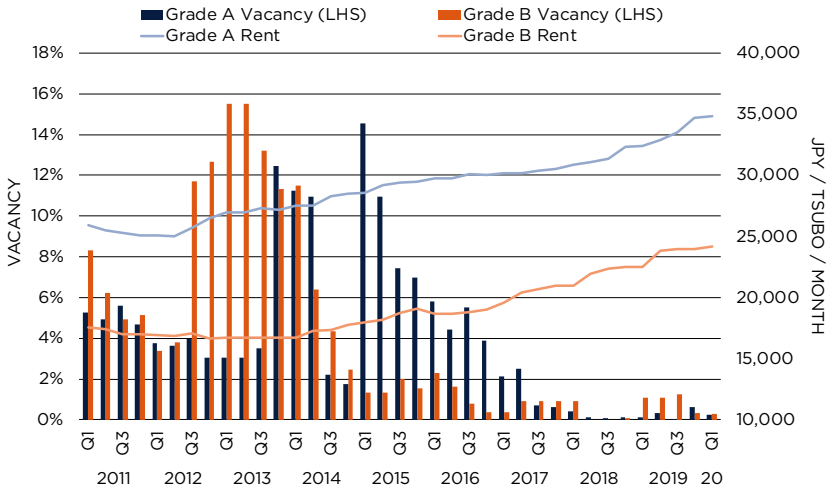
As conveniently located and affordable space in the C5W has been essentially unavailable, tenants have been increasingly looking outside of central Tokyo to find office space. Shinagawa Ward appears to have been one of the primary beneficiaries of this trend, with its market heating up considerably in recent years. In addition to being a popular residential district itself, Shinagawa is also easily accessible from other popular residential areas, such as Ota and Setagaya, as well as Kawasaki and the residential districts of Yokohama. Rents have picked up substantially as a result, though the ward still offers a substantial discount over the C5W (Graph 5). As companies adjust their office leasing strategies in response to COVID-19, this trend may accelerate.

Rents in the ward vary widely depending on the submarket, with the highest passing rents occurring around Meguro and Osaki stations. Moreover, buildings around Shinagawa Station, which – as noted previously - is technically located in the Minato Ward, also tend to have much higher rents. On the other hand, the eastern and southern areas of the ward, such as Tennozu Isle, generally see lower rents. Office buildings in these areas also tend to have larger floor plates and are thus considered Grade A office property. Despite offering more space, the location of these buildings tends to bring down passing rents, resulting in the ward's Grade B rents effectively exceeding those of Grade A (Graph 6). That said, the gap has largely closed over the past year, as Grade A vacancy has fallen to an airtight 0.1% while the Grade B subsector has had some lingering vacancy.

Shinagawa has already seen much of its large-scale office development pipeline completed in 2018, with the addition of the Osaki Garden Tower, coming in at almost 55,000 tsubo of GFA. No additional large-scale supply is expected until 2022, when Sumitomo Realty & Development expects to complete a 15,000 tsubo office building in Kita-Shinagawa, while Japan Post is set to complete a 20,000 tsubo office in Gotanda. Looking further ahead, 2025 will likely be one of the largest office supply years on record for the Shinagawa area, as phase I of the Shinagawa Development Project (developments around Takanawa Gateway Station) is completed.

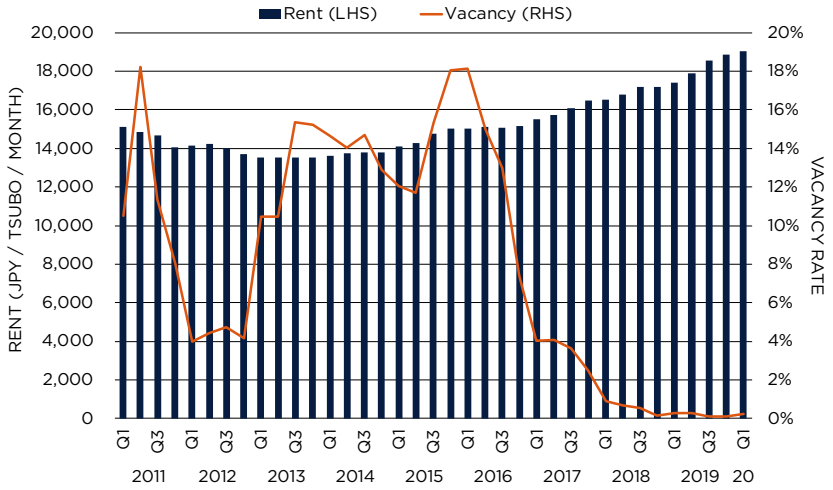
The Shinagawa Station area has a higher premium than surrounding areas, particularly Tennozu Isle and Shinagawa Seaside, but provides excellent access to other parts of Tokyo as well as other regions of Japan. Indeed, as of Q1/2020, average Grade A office rents in the Shinagawa Station area landed around JPY35,000 per tsubo per month, an estimated

GRAPH 8: Office Rents and Vacancy in Shinagawa Station, 2011 to Q1/2020



Source Savills Research and Consultancy

GRAPH 9: Office Rents and Vacancy in Higashi Shinagawa, 2011 to Q1/2020



Source Savills Research and Consultancy

83% premium over average rents in Tennozu. Grade B rents in the area are more mild, coming in at JPY24,000 per tsubo per month as of Q1/2020. Grade A office vacancy in Shinagawa Station has contracted to 0.3% and availability remains severely limited. Grade B vacancy briefly ticked up as a result of the relocation of a mid-sized tenant in early 2019; however, this space was soon leased up and vacancy now sits at an airtight 0.1%. Indeed, the area is likely to remain attractive for both office tenants and residents for the foreseeable future.

HIGASHI SHINAGAWA (TENNOZU ISLE & SHINAGAWA SEASIDE)

Given the lack of opportunities in more centrally located areas, the Higashi Shinagawa submarket in particular has been a common target for cross-border office investment in recent years. The submarket itself can be roughly divided into the Tennozu Isle and Shinagawa Seaside neighbourhoods, both of which contain high-grade office buildings.

Tennozu Isle has been developed since the late 1980s and is packed with offices offering large standard floor plates and vistas of the bay area. As transit access is somewhat limited, the area is not an ideal base for employees conducting outside sales activities. For this reason, companies tend to house administrative functions on the island. On the other hand, Tennozu Isle is easily accessible from Haneda International Airport via the Tokyo Monorail. As such, major tenants in the area include shipping and transport companies, such as DHL, as well as the headquarters of Japan Airlines and the domestic travel company JTB. Even so, area tenants are not necessarily limited to transport firms. Panasonic, for example, bases its Tokyo office in the area at Tokyo Front Terrace.

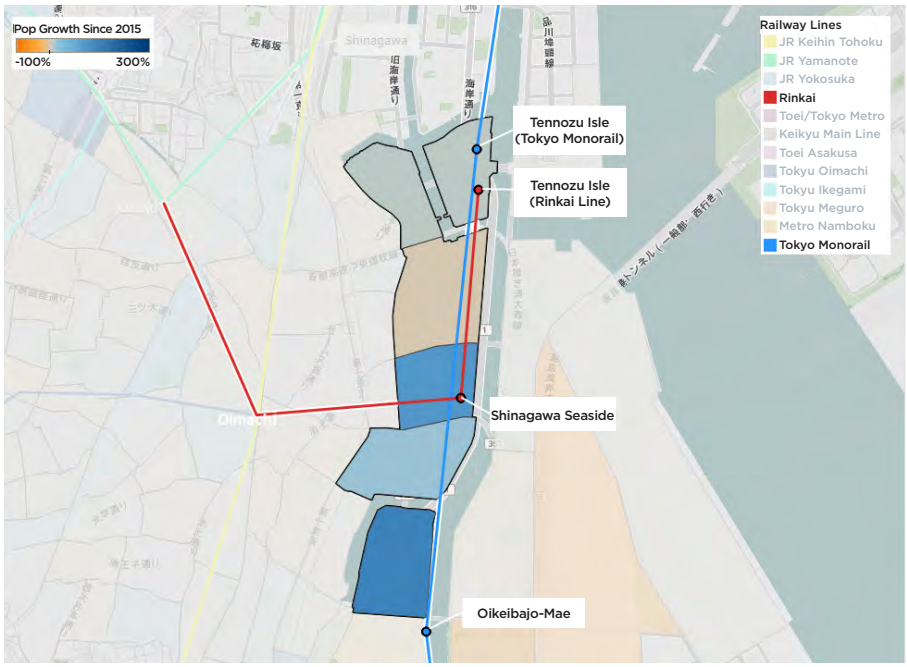
The Shinagawa Seaside area, one stop to the south of Tennozu Isle on the Rinkai Line, was developed as a high-grade office area since the early 2000s. This large development includes Hitachi Solutions Tower A and B, which were completed in September 2002, Rakuten Tower (Shinagawa Seaside North Tower) and Shinagawa Seaside Towers Park, South, East, and West in 2003 and 2004. Though Rakuten relocated its headquarters to Futako Tamagawa in the Setagaya Ward in 2014, the area offers relatively new, large-scale buildings, which have seen strong demand from companies in need of a large floor plates. Major tenants in the area include Mercedes Benz, which bases its Japan headquarters in Shinagawa Seaside Park Tower, as well as Hitachi Solutions, a subsidiary of Hitachi Group, which occupies Hitachi Solutions Tower A and B.

The Higashi Shinagawa submarket suffered from large vacancy several years ago after companies moved to central Tokyo. However, vacant space has since been rapidly absorbed and vacancy rates have tightened as large-scale availability has now become extremely limited in more central areas. Rents in the submarket have grown rapidly through the current upswing, now landing around JPY19,000 per tsubo per month, with some buildings achieving rents of over JPY20,000 per tsubo. This is still well below the average for the Shinagawa Ward, however, and a far cry from passing rents around Shinagawa Station.

Indeed, Higashi Shinagawa has one of the highest discounts among office submarkets in central Tokyo. On the other hand, railway access is less convenient than in other areas. The average employee of a company based here may have to make multiple transfers in order to commute. Additionally, despite offering larger floorplates, office buildings in the area - particularly those of Tennozu Isle - are somewhat older than in other submarkets. Prospective tenants would have to weigh the cost savings potential with these factors.

When central areas start to see more availability, tenants in Higashi Shinagawa may move to more convenient central areas – likely causing vacancy to increase earlier than in other submarkets. That said, as shown in Map 4 overleaf, some neighbourhoods in the area have seen substantial increases in their residential populations, perhaps making these offices accessible to a larger set of the workforce and thereby improving the submarket's staying power going forward.

MAP 4: Higashi Shinagawa Population Growth and Railway Access



Source Shinagawa City, Statistics Bureau of Japan, Savills Research and Consultancy

OUTLOOK

During the latter stages of the latest property upswing, Shinagawa quickly emerged as an affordable, centrally located alternative for households and companies alike. Investors have similarly been targeting assets in the area in light of the bullish pricing at the capital's core. Trends in living and working may be on the cusp of a major shift, however, and it ultimately remains to be seen how well Shinagawa will fare under the "new normal".

Regardless, the area is on a long-term growth track spurred by multiple development projects. The opening of the Takanawa Gateway Station in March 2020, along with the surrounding developments coming online over the next five years, should make both Shinagawa Station and nearby Shinagawa Ward a more attractive area for corporate tenants and residents. The inauguration of the Maglev line in 2027 will further build on this momentum and solidify the area's position as a global gateway.

Japan - August 2020

SPOTLIGHT
Savills Research

Ikebukuro

savills

Post-COVID potential for a diamond in the rough

Summary

- Located in Tokyo's Toshima Ward, Ikebukuro Station is the second busiest railway hub in the world, hosting eight train lines and recording around 2.7 million passengers each day.
- Toshima Ward is rebuffing expectations of population decline and Ikebukuro is redefining its image as both a business and residential hub.
- Retail activity in the submarket has been largely concentrated amongst department stores integrated within the station and owned by railway operators. However, new, mixed-use developments and entertainment complexes are drawing large footfalls outside of the station.
- Ikebukuro is home to a number of institutions of higher education and a new international campus is in the pipeline. Notwithstanding the immediate impacts of COVID-19, demand for compact housing and student accommodation should increase over the mid-to-long term.
- New offices in the area offer a 40% discount over comparable properties in Shibuya. Given its affordability and robust railway access, Ikebukuro should become a popular target for satellite offices in the "new normal".

INTRODUCTION

Along with Shinjuku and Shibuya, the Toshima Ward is known as one of the "Fukutoshin" (subcentres) of the Tokyo 23 wards (23W). The ward is home to Ikebukuro Station, which hosts eight train lines and on average sees roughly 2.7 million passengers board or disembark every day, making it the second busiest station in the world – surpassed only by Shinjuku (Graph 1). The area serves as a hub for those coming to central Tokyo from Saitama and Northwestern Tokyo, and provides strong access to Shinjuku, Shibuya, and Yokohama via the Fukutoshin Line and Shonan Shinjuku Line. While Toshima may not be as eminent as its Fukutoshin compatriots, Ikebukuro is undergoing large-scale development that is improving the area's character.

To be sure, Ikebukuro is not as prominent as Yokohama and Shinagawa, the other two submarkets surveyed in our "Tokyo Periphery" report series. In 2014, a report published by the Japan Policy Council labelled Toshima as the only ward of the 23W with the potential to "vanish", based on a projected decline in the 20-39 year old female population. While some have disputed the accuracy of the assertion, the ward's administration has taken this report seriously. As a result, they have been actively introducing measures to avoid Toshima's projected fate by making the ward more attractive to families. In addition, the national government designated the area around Ikebukuro Station as a National Strategic Special Zone[1] and a Special Urgent Urban Renewal District[2] in 2015.

A potential shift to satellite offices could make Ikebukuro a winner going forward, with around 1 million commuters passing through the station each day from Saitama Prefecture alone. At present, the area offers a relatively limited amount of office space and what little space there is tends to be in older, lower-grade offices. Encouragingly, the few office projects that have come online recently have been fully filled out – a sign of latent demand for offices in the area. Upcoming mixed-use developments and the area's affordability, with the newest offices still offering a significant discount to many older offices in central Tokyo, should draw more corporate tenants to the submarket.

A LONG-AWAITED MAKEOVER

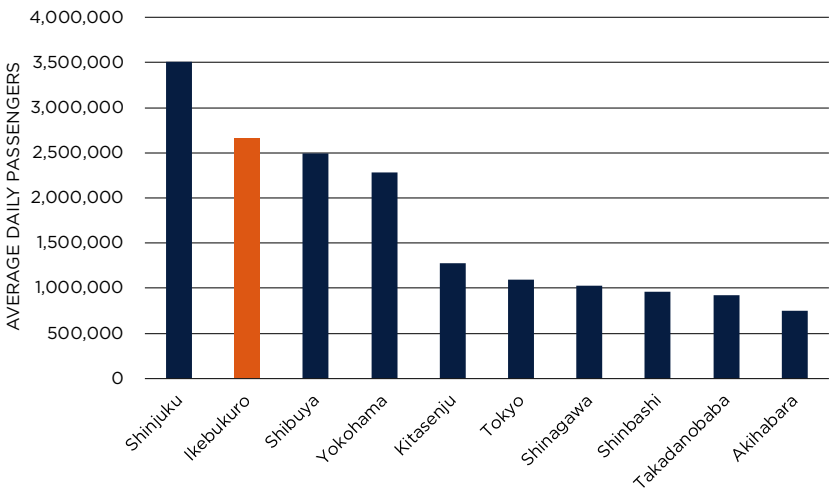
A lack of suitable parks and green spaces was among the top issues identified regarding Toshima's ability to attract families. As such, the recent redevelopment of local parks should serve to improve the area's image and draw residents. For instance, after being closed down for six years, Minami-Ikebukuro Park was renewed in 2016 and has since become a popular rest and relaxation spot for local families, equipped with an open-style café (Map 1, (E)), (cover image).

Revitalisation of Ikebukuro West Gate Park, a location that – via a TV drama bearing the same name – gained some notoriety as a hub for "yankee" (delinquent youth), was

1 The "National Strategic Special Zones" are designated by the national government to boost the international competitiveness of industry and to promote the creation of centres of international economic activities by giving priority to advancing structural reform of the economic system.

2 The Act on Special Measures Concerning Urban Reconstruction established a zoning category called "Special Urban Renaissance Districts" that is highly flexible and free from restrictions of conventional city planning (e.g. use districts) within urgent redevelopment areas.

Graph 1: Top 10 Stations by Average Daily Footfall (Tokyo Metropolitan Area), FY2018



Source Ministry of Land, Infrastructure, Transport and Tourism (MLIT), Savills Research & Consultancy
Note: The data above refers to passengers that have boarded or disembarked from the respective station. As such, through traffic is not included.

completed in the fall of last year as a part of the extensive West Gate Redevelopment Project (Map 1, (5)). As a further boon to the area's image, Toshima was also selected as Japan's "2019 Culture City of East Asia", a distinction that has also been held by cultural centres such as Kyoto and Kanazawa.

Ikebukuro is also seeing a long-awaited boom in office development and has been attracting more attention as a business hub. In January 2019, WeWork opened its first Tokyo location outside of Tokyo's central five wards (C5W) in the Metropolitan Plaza Building (Map 1, (C)), which was subsequently followed by a location encompassing 2,400 tsubo across five floors at Hareza Tower (Map 1, (3)). Daiya Gate Ikebukuro, completed in March 2019, offers 15 office floors with around 640 tsubo of leasable area per floor (Map 1, (E)). Regus, meanwhile, opened its second Ikebukuro location on the 5th floor of the building in April 2019.

Ikebukuro is a late bloomer in the current cycle, undergoing large-scale redevelopment for the first time in 40 years. This may be well-timed as, with nearly 3 million commuters passing through the station on a daily basis, the surrounding area could be a prime location for satellite offices.

The redevelopment of the former site of the city municipal office, now called the Hareza project, was completed in May 2020 with a 20,000 tsubo retail and office tower, as well as separate theatre and public halls, while a new set of bridges, named the "East-West Deck", will connect the eastern and western sides of the station, improving the area's overall connectivity (Map 1, (4)). Looking further ahead, the Higashi-Ikebukuro 1-Chome Project, consisting of a mixed-use 180 metre tower that has a total GFA of 44,000 tsubo, is scheduled to open its doors in 2024.

MAP 1: Ikebukuro Station Area

NEW DEVELOPMENTS		TYPE	COMP.
1	Daiya Gate Ikebukuro	Office	2019
2	Q Plaza	Retail	2019
3	Hareza Project	Mixed-use	2020
4	East-West Deck	Infrastructure	TBD
5	Ikebukuro West Gate Project	Mixed-use	Ongoing
6	TIU International Campus	Education	2023
7	Higashi-Ikebukuro 1-Chome	Mixed-use	2024
8	Minami-Ikebukuro 2-Chome	Residential	2025

LANDMARKS		EST.
A	Rikkyo University	1874
B	Sunshine City	1978
C	Metropolitan Plaza Building	1994
D	Brillia Tower Ikebukuro	2015
E	Minami Ikebukuro Park	2016

RETAIL HOTSPOTS	
i	Animate
ii	Marui
iii	Otome Road
iv	Sunshine 60 Street
v	Yamada Denki

Source Savills Research & Consultancy

RETAIL

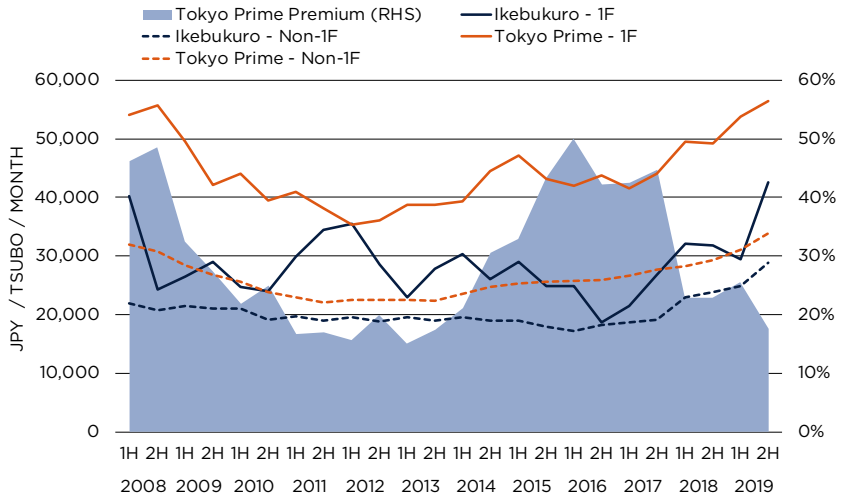
As Tokyo's number two transit hub, Ikebukuro Station sees a vast amount of footfall. However, much of the area's retail activity has been absorbed by large department store chains owned by major rail companies, including Seibu, Tobu, and Lumine (JR), all of which are directly attached to the station. The Seibu location, for instance, is the chain's flagship store, recording sales of JPY180 billion in 2019 – the third highest of all department stores in Japan. As a result, there is comparatively low spillover to the surrounding area and most retail activity has been concentrated in the zone between Ikebukuro Station and Sunshine City (Map 1, (B)). New developments and cultural trends may be shifting this balance, however.

The east side of Ikebukuro Station offers a diverse array of retail facilities, though its primary draw has been fashion stores along Sunshine 60 Street (Map 1 (iv)) and Meiji Street, which fronts Ikebukuro Station. That said, openings amongst apparel companies have been few as of late, with new developments increasingly focused on entertainment, arts, and culture. 2019 saw the addition of Q Plaza in July, a retail facility that includes the first movie theatre in East Japan offering IMAX® with Laser (Map 1, (2)). The first through seventh floors of Hareza Tower offer additional retail facilities including a Toho Cinemas location that offers 10 screens and 1,700 seats, whilst the other buildings in the development include a theatre and civic hall.

Ikebukuro is also developing a niche in anime and gaming subculture, gaining ground on Akihabara (Chiyoda), Japan's top geek haven. LFS Ikebukuro, the largest E-sports centre in the 23W, was opened in April 2018, adding to the area's status as a hub for gamers. This has been further complemented by the opening of Namco Ikebukuro (a chain of arcades) in late 2019. The area notably contains the flagship store of Animate, the largest retailer of anime, video games, and comics in Japan (Map 1, (i)). In contrast to the male-oriented image of Akihabara, Ikebukuro is distinguishing itself as a haven for female anime fans specifically. This subculture is centered around Otome Road, which literally translates as "Maiden's Road", a street in front of Sunshine City that hosts branches of major comic stores including K-books, Lashinbang, and Mandarake, all of which cater more strongly to a female audience (Map 1, (iii)).

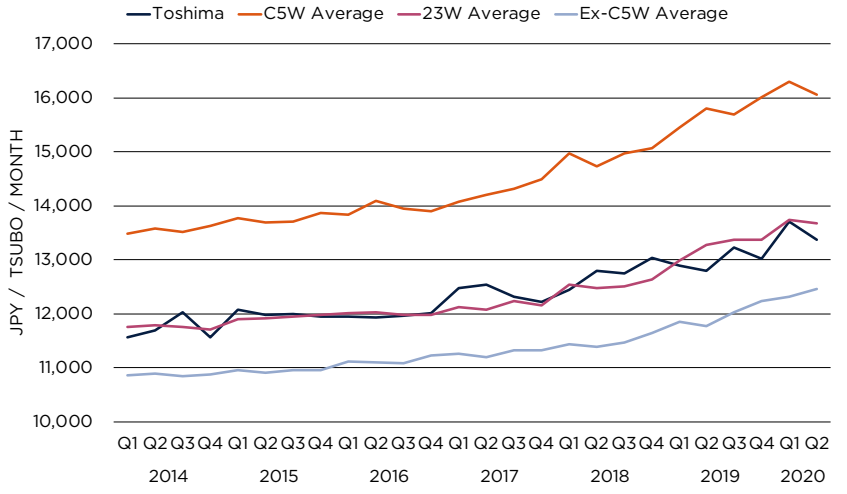
With an emphasis on entertainment and supported by these niche segments, footfalls are steadily being drawn beyond the station, supporting robust rental growth in the market (Graph 2). The southern portion of the East-West deck is also scheduled for completion this year, which will support traffic between the two halves of the submarket. This diffusion in activity should create more opportunities for investors, who have generally had little room to buy into the now densely-packed retail cluster. To be sure, high-street retail will likely take a hit in the short run. As in Tokyo's prime retail submarkets, inbound tourists have been an important driver of sales. That said, Ikebukuro caters heavily to a cohort of young local shoppers, which may be a key support through the duration of the pandemic and beyond.

Graph 2: Ikebukuro vs Tokyo Prime* Retail Rents, 2008 to 2019



Source Japan Real Estate Institute, Savills Research & Consultancy
*Tokyo Prime refers the average rents of the Ginza, Omotesando, Shinjuku and Shibuya submarkets.

Graph 3: Toshima Ward Residential rents, Q1/2014 to Q2/2020



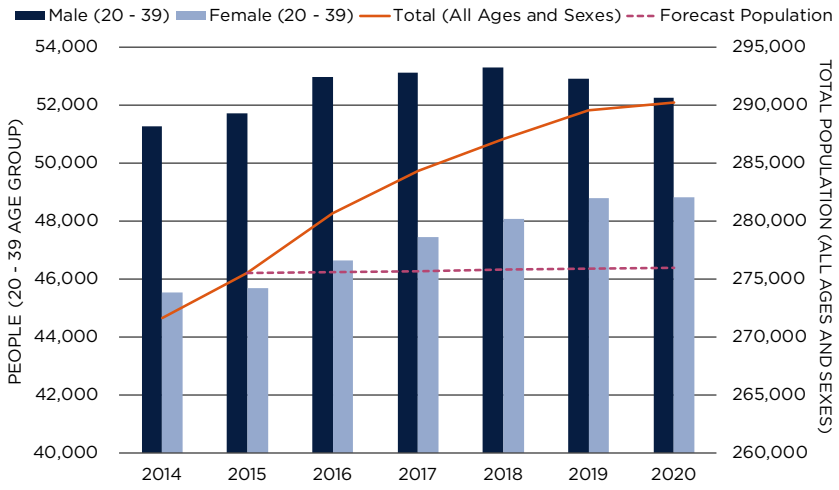
Source Savills Research & Consultancy

RESIDENTIAL

Despite the Toshima Ward's 2014 designation as the only ward of the 23W with the potential to "vanish", Ikebukuro was ranked as the third most desirable area to live among residents of Greater Tokyo in that same year, according to a survey by Suumo - Japan's largest apartment search platform - coming in behind Kichijoji (Musashino City) and Ebisu (Shibuya). Though dropping somewhat in recent overall rankings, Ikebukuro was still ranked at number three among residents of Tokyo Prefecture in Suumo's 2018 survey. The area's affordability and convenient access make it an attractive location for single workers or college students, with asking rents around 17% lower than the C5W average as of Q2/2020 (Graph 3).

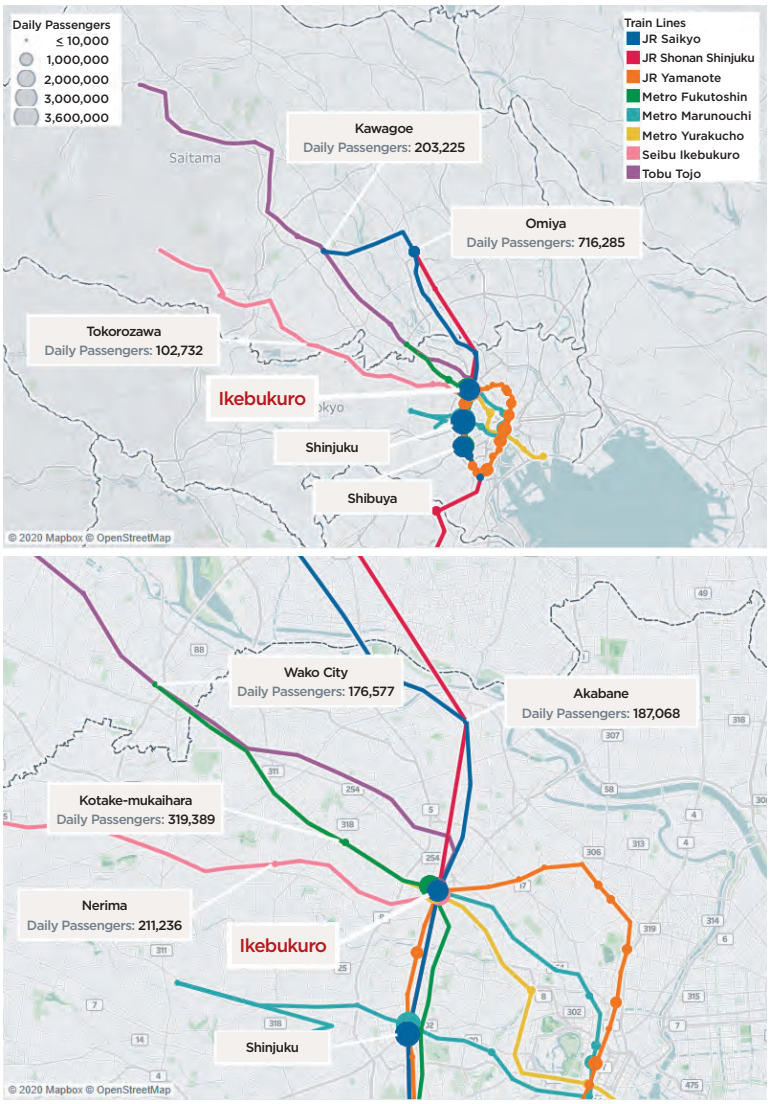
Indeed, more so than a business district, Toshima, along with neighbouring Bunkyo, has been well known as a host to institutions of higher education, including Rikkyo University (Map 1, (A)), Gakushuin University, Taisho University, and the Tokyo College of Music. Adding to these institutions, Tokyo International University is aiming to open a new campus in Ikebukuro in 2023, where it intends to base 3,500

Graph 4: Toshima Ward Population Growth*, 2014 to 2020



Source Toshima Municipal Government, Savills Research & Consultancy
*The population figures are as of 1 January of the respective year.

Map 2: Train Lines with Direct Connection to Ikebukuro



Source MLIT, Savills Research & Consultancy
Note: Lines represent segments connecting stations on a given railway line and are not fully representative of actual railway routes.

students (Map 1, (6)). Notwithstanding the immediate impacts of COVID-19, demand for compact housing and student accommodation in the ward should increase over the long term as a result of student demand.

While young, single residents may be the core demand driver for Toshima housing, recent redevelopments, including those of green spaces discussed above, should make the area more attractive to families as well. 2015 saw the addition of a first in Japanese real estate: a residential tower combined with a municipal office. The 49F residential tower, dubbed Brillia Tower Ikebukuro, offers 432 condo units, most of which are family sized. Demand during the initial sales period was reportedly robust enough to warrant a lottery system and units sold out within only two months (Map 1 (D)). It has recently been disclosed that, immediately adjacent to Brillia Tower, a consortium led by Sumitomo Realty & Development is planning a massive redevelopment project consisting of two large-scale residential towers offering 1,500 units, which is slated for completion in 2025 (Map 1 (8)).

The local government has also implemented measures to attract families, including a "child-rearing navigator" at the municipal office, which reportedly had 5,300 users during its implementation in FY2015. If such measures continue to be successful, the 2014 prediction of the ward's disappearance is unlikely to come to fruition. Encouragingly, current estimates reveal that the female population in the 20-39 age group has been on the rise since that initial forecast, whilst the ward's total population has also grown more than expected over the same period (Graph 4). New residential developments, such as Sumitomo Realty's large-scale project, should continue to draw more families to the area.

It is also important to note that the government's population forecasts do not factor in immigration. As of 2020, residents with foreign nationalities account for 10% of Toshima Ward's population and the number has been growing. Given this, as well as the upcoming residential developments, it would be reasonable, therefore, to conclude that the actual population growth in the ward will outperform forecasts.

OFFICE

Even with the second busiest rail station in the world, Ikebukuro carries a much more prominent image as a retail and entertainment district than as a business district. Indeed, the Ikebukuro office market has seen few significant additions since the completion of Sunshine 60 in 1978, which – with a GFA of 73,000 tsubo and standing at 240 metres – was the tallest building in Japan at the time. Data from MLIT as of 2017 shows that Toshima Ward had the oldest office stock amongst the 23W, averaging 33 years old – 6 years older than the average for the C5W – with 45% of office floor area completed before 1979. Accordingly,

recent and upcoming redevelopment projects, which generally include significant office components, should help Ikebukuro establish itself as a business district.

Daiya Gate Ikebukuro was the first major station-side office project since the completion of the Metropolitan Plaza Building in 1994, and is the first in a series of office developments coming online across the submarket over the next few years. These developments are a much-needed catalyst for Ikebukuro's office market and should carry overall market rents higher. According to Sanko Estate, rents for large-scale offices[3] in the Higashi-Ikebukuro / Minami-Ikebukuro submarket stood at JPY24,000 as of June 2020. Hareza Tower is rumoured to have opened its doors fully leased in July at an average one-floor rent of over JPY30,000 per tsubo – a 25% premium on average rents in the surrounding area, but still 40% cheaper than the newest office buildings in Shibuya. The west side of Ikebukuro Station has even more of a discount, with Sanko reporting rents of JPY20,000 per tsubo per month for large-scale offices – mainly due to the age of the buildings in the area. The Ikebukuro West Gate Development project is expected to bring new office space online over the coming years, breathing new life into the submarket.

3 "Large-scale offices" refers to office buildings offering floor plates of 200 tsubo (661 sq m) or greater.

Given its affordability compared to the C5W and its connection to eight train lines, Ikebukuro is a strong target for satellite offices or relocations for tenants looking to cut rental costs. Firms that have a substantial employee base in Saitama and/or Northwest Tokyo should find the area to be especially appealing (Map 2). JR East reports that 750,000 passengers utilise the JR Saikyo Line between Akabane (Kita Ward) and Ikebukuro stations alone on a daily basis.

OUTLOOK

Ikebukuro's redevelopment is occurring much later than other sections of Tokyo in the current cycle. Growing demand for satellite offices should support Ikebukuro as a business hub, while cultural trends and improvement of the area's image should support retail activity and boost residency. Development over the past few decades has favoured the east side of Ikebukuro Station and, though this area remains the primary focus of redevelopment, the west side of the station is undergoing a long-awaited makeover. This, along with improved connectivity with the east side of the station, should reduce the value gap between East and West Ikebukuro and unlock more attractive investments.

To be sure, investment opportunities are still limited around Ikebukuro. The submarket has one of the most compact retail and office clusters in Tokyo, and pricing tends to be firm near the station. However, with most sellers maintaining pre-COVID pricing levels in prime markets, Ikebukuro could still offer a comparative bargain for those looking to deploy capital. The area should have greater upside potential compared to its counterparts in Tokyo's CBD, given the submarket's relatively late development phase and positioning within the post-COVID work environment.

Japan - June 2020

SPOTLIGHT
Savills Research

Tokyo Office Supply

savills

Imminent supply appears manageable but potential paradigm shift awaits

Summary

- With existing vacancy airtight and new supply in 2020 mostly filled or pre-leased, the Grade A office market, which typically hosts high credit tenants, currently remains on firm ground.
- 2020 is set to be a historic year in terms of office supply, with some 450,000 tsubo of GFA estimated to come online in the central five wards (C5W) alone. After a lull in the two years to follow, 2023 is the next milestone, likely succeeded by 2025 thereafter.
- Although much of the new supply remains concentrated in the C5W, the relative value offered in the 18 outer wards (18W) should lead to a rise in the area's proportion of projects over the next few years.
- Shibuya, which saw significant levels of new supply in 2019, will be much quieter this time around. Business districts such as Otemachi and Toranomon will instead lead the charge in 2020. Meanwhile, 2023 is likely to be a year to remember for the latter, following the completion of the Toranomon-Azabudai Project.
- COVID-19 has already had a profound impact on daily working life for employees. For landlords, the crisis appears to have made prime assets even more valuable as location now matters more than ever.
- With the transition in work styles notably varying amongst companies of different industries and scale, the landscape of the Grade A office market in the C5W could undergo noticeable change.
- Alternatively, the rapid and widespread distribution of a viable vaccine could see these seismic shifts crimped.
- Uncertainties abound and some market volatility is expected on the path to normalisation, with vacancy rates likely to pick up going forward.

SUPPLY PIPELINE

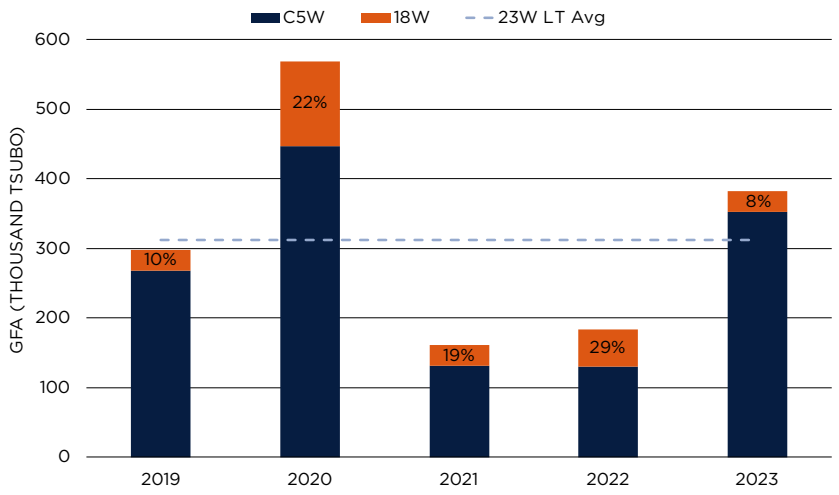
With 2019 being an average year in terms of new office supply, amid the intense competition for space, Grade A office vacancy in the C5W was close to nil. Meanwhile, underpinned by solid corporate profit growth – particularly in the technology sector – rents continued their upswing. Specifically, by year end, average Grade A rents in the C5W had reached JPY37,373 per tsubo per month – an increase of 8.0% year-on-year (YoY). Indeed, fundamentals appeared solid heading into the new decade, only for the COVID-19 outbreak to scupper the sector's previously optimistic prospects.

Looking further ahead, the Grade A office market could be set for a bumpy ride. Supply this year is predicted to be almost double that of 2019 (Graph 1), and the most since 2003. Thereafter, the next surge in supply is expected in 2023, where around 380,000 tsubo could come online. Bookended by these instances of significant supply, the difference during 2021 and 2022 will be stark. The lower levels of new supply expected in these years will do much to alleviate the pain from secondary vacancy, which will likely make a noticeable appearance in 2021. As such, viewing this four-year period as a whole, supply is anticipated to be somewhat similar to the long-term average. As for 2024, whilst information is limited, the expectation is for supply to be similar to 2019. In contrast, 2025 is anticipated to see another supply boom led by East Japan Railway's Shinagawa Development Project (phase I). The development will certainly be a boon for Tokyo's status as a dynamic, global city, though its large office component may soften mid-term rental growth in the sector.

Of the many projects to be completed, a common theme is size. In fact, aligned with the previous calls for larger floor plates in order to foster collaboration, the number of large-scale projects (with GFA of over 30,000 tsubo) in 2020 is set to be the most in history (Table 1). Yet, the requirements for social distancing, and the emergence of both remote work and flexible hours as part of corporate life, could have a marked impact on office preferences in the post-pandemic world. That said, the talk of potentially drastic changes might be premature without a known timeline for the availability of a viable vaccine. After all, large companies may end up keeping the majority of currently leased space for the time being if, during strategic review and before implementation – which could easily take more than a year, the threat of the pandemic starts to subside.

Unsurprisingly, given the economic importance of the C5W, most new office developments are located in this submarket. That said, there are signs that developers are looking further afield in search of opportunities. For instance, having accounted for around 13% of new office supply in 2018 and 2019, the 18W's average share is likely to increase to around 18% during 2020 to 2023. Most notably in 2022, this figure could be as high as 29% (Graph 1), with Shinagawa

GRAPH 1: Combined Office Supply (GFA) Estimates for the C5W and the 18W, 2019 to 2023



Source Savills Research & Consultancy

making up an estimated 50% of this floor space. Indeed, functioning as something of an extension to the C5W, this ward is set to undergo significant redevelopment, with projects such as Sumitomo Fudosan Osaki East Project bringing close to 15,000 tsubo of GFA to the table. Meanwhile, with the arrival of the Maglev line in 2027, the area around Shinagawa station is also undergoing substantial change. For example, the tentatively named Shinagawa Development Project (phase I) is anticipated to add around 260,000 tsubo of mixed-used space by 2025, likely exceeding Roppongi Hills on a GFA basis.

(Please refer to our Spotlight Report "Shinagawa" for further insight into the developments shaping the future of Shinagawa)

Despite the significant levels of office supply expected this year, any lingering concerns about a glut have been eased with most of it already filled or pre-leased. For now, office fundamentals appear sound, but the long-lasting effects of the pandemic and the resulting acceleration of workplace reform could lead to a paradigm shift in the office market.

TABLE 1: Major Development Projects In Tokyo, 2020 to 2024

BUILDING NAME	SUBMARKET	FLOORS	GFA	YEAR
Otemachi One Tower	Marunouchi & Otemachi	39	60,000	2020
Tokyo World Gate / Kamiyacho Trust Tower	Kamiyacho & Toranomon	38	59,000	
Toyosu Bayside Cross Towers A & C	Toyosu	36	56,000	
Tokyo Port City Takeshiba Tower	Shibaura & Hamamatsucho	40	55,000	
Marunouchi 1-3 Project	Marunouchi & Otemachi	29	55,000	
Toranomon Hills Business Tower	Kamiyacho & Toranomon	36	52,000	
Mitsui-Bussan Building	Marunouchi & Otemachi	31	48,000	
msb Tamachi Station Tower N	Shibaura & Hamamatsucho	36	46,000	
COMORE YOTSUYA	Shinjuku	31	42,000	
Tokyo Station Front Tokiwabashi Project Tower A	Marunouchi & Otemachi	37	44,000	2021
Shinbashi Tamuracho Project	Kamiyacho & Toranomon	27	32,000	
Yaesu 2-Chome North District A-1 Block	Nihonbashi & Yaesu	45	86,000	2022
Toranomon-Azabudai Project District A	Toranomon & Roppongi	65	140,000	2023
Toranomon Hills Station Tower	Toranomon & Roppongi	49	77,000	
Mita 3-4 Chome Mixed Use Tower 1	Shibaura & Hamamatsucho	42	61,000	
Shibuya Sakuragaoka Project A District	Shibuya & Ebisu	39	56,000	
Toranomon 2-Chome Centre Redevelopment	Kamiyacho & Toranomon	38	55,000	
Toranomon-Azabudai Project District B-1	Toranomon & Roppongi	63	51,000	
Park Tower Kachi Doki Mid	Nihonbashi & Yaesu	45	42,000	
TTM Project	Shibaura & Hamamatsucho	29	34,000	
Shibaura 1-Chome Project S	Shibaura & Hamamatsucho	45	68,000	2024
Akasaka 2-Chome Project	Akasaka & Roppongi	43	67,000	
Shin-Toda Building	Nihonbashi & Yaesu	28	31,000	

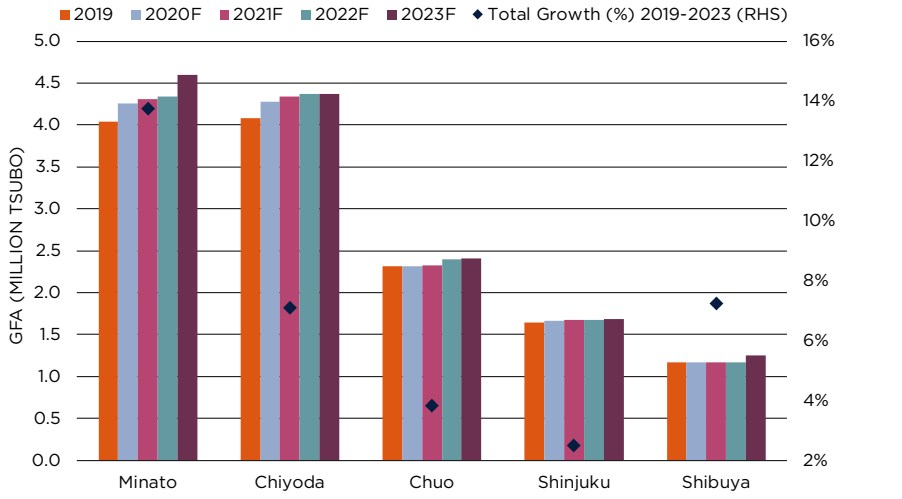
*Projects whose GFA is over 30,000 tsubo
Source Savills Research & Consultancy

2019 was certainly a big year for Shibuya and competition for space was particularly fierce. Faced with labour shortages, especially among software engineers, a focus on retaining and attracting talented staff by improving the working environment had further enhanced the appeal of the modern, open-spaced, high-grade office. As a result, completion of projects such as Shibuya Scramble Square – a B7/47F structure with around 55,000 tsubo of GFA – saw a variety of technology companies with solid profit growth, such as SoftBank, join the fray. Rents duly responded with double-digit YoY growth.

Even so, a reversal in this trend is likely to be on the cards going forward amid the ongoing workplace reforms, especially surrounding working from home. This could be especially pronounced in Shibuya, home to a cluster of technology companies and where recent rental growth in the C5W has been the strongest. Neighbouring submarkets such as Ebisu and Gotanda are likely to have collateral damage as a result.

Elsewhere, having seen the least change in office supply over the same period, Chiyoda and Minato are expected to lead the way in 2020 (Map 1), with both submarkets likely to expand by around 5% over the year. Notable projects include Otemachi One in the former – a huge multi-tower complex with around 80,000 tsubo of GFA completed in February – and Kamiyacho Trust Tower in the latter – a B3/28F structure with a GFA of over 40,000 tsubo. A clear divergence manifests between the two submarkets in 2023, however, and with the momentum in Chiyoda running out of steam, Minato could eventually become home to the largest stock of offices in the C5W (Graph 2). What's more, with the ward

GRAPH 2: Total Office Stock By Ward and % Increase, 2019 to 2023



Source Miki Shoji, Savills Research & Consultancy

containing relatively more residences and amenities than its central peers, any material changes to working habits may actually be a somewhat tailwind over the longer term compared to the other C5W constituents.

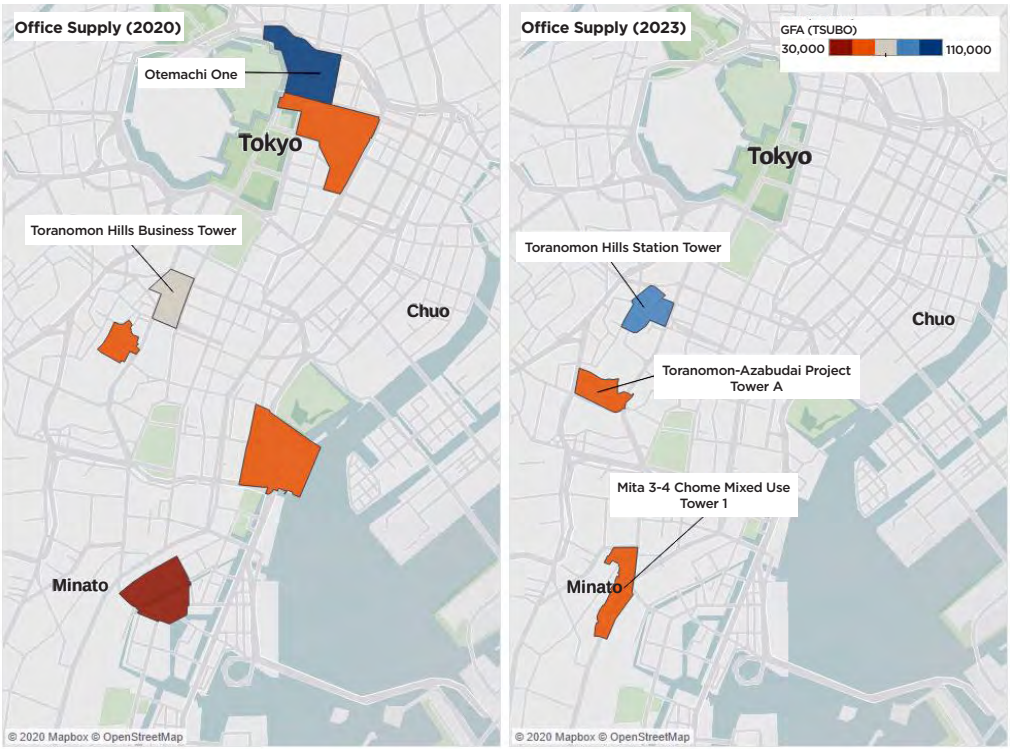
For the three main business districts anticipated to undergo a marked expansion during the early part of this decade, 2019 was somewhat placid. In fact, the Marunouchi & Otemachi district – set to witness the greatest change in 2020 – saw less than 10,000 tsubo come online last year. That said, this was perhaps understandable considering the significant expansion that took place in 2018. In total, the area looks likely to see an additional 150,000 tsubo of GFA in 2020 (Graph 3), with the aforementioned Otemachi One project counting towards around half of that total. Interest in the property was strong from the outset, with demand from international companies such as UBS and PwC. With close to 70% of its imminent pipeline set to be completed this year, however, activity in the main financial district of Tokyo could be fairly quiet towards the end of the supply boom in four years' time.

Meanwhile, given the tenant profile in this area – where large Japanese corporations are concentrated – the response to COVID-19 is likely to be observed later than in other areas. Indeed, though not unheard of globally, it is perhaps more likely in Japan for these types of multinational firms to take a year or two to make decisive decisions such as company-wide work style reforms.

THE "NEW NORMAL" IN A POST-COVID WORLD

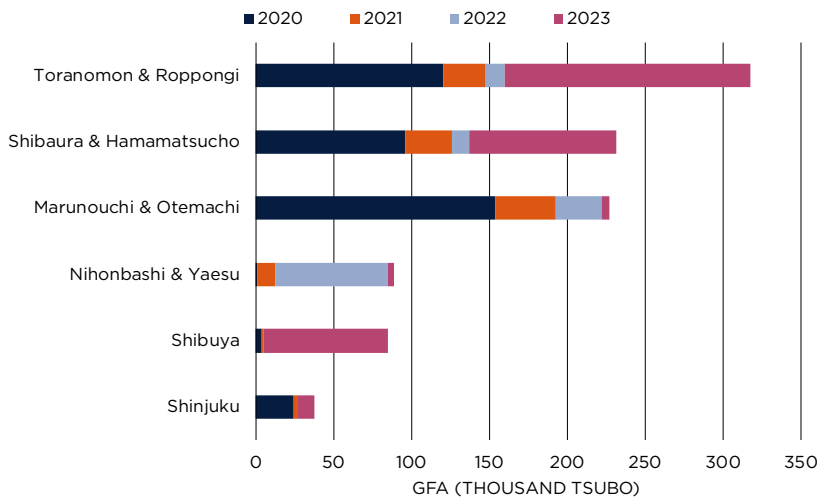
Amid the ongoing global pandemic, what has become abundantly clear is that noticeable parts of the working environment that had persisted before the outbreak may need to change post-COVID-19. This is especially true for Japan, where workplace reforms have often lagged western counterparts. Still, to some degree, this suggests that there is

MAP 1: C5W Office Supply, 2020 and 2023



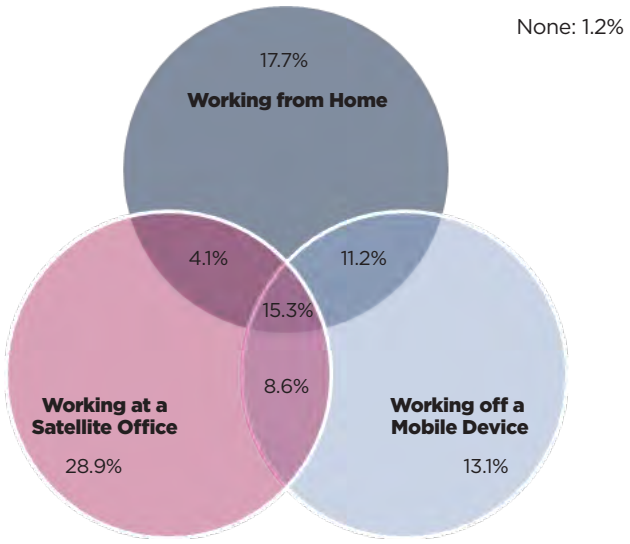
Note: Highlighted areas above reflect office supply in the "Cho" (neighbourhoods) where GFA is 30,000 tsubo or greater.
Source Savills Research & Consultancy

GRAPH 3: Supply By Submarket, 2020 to 2023



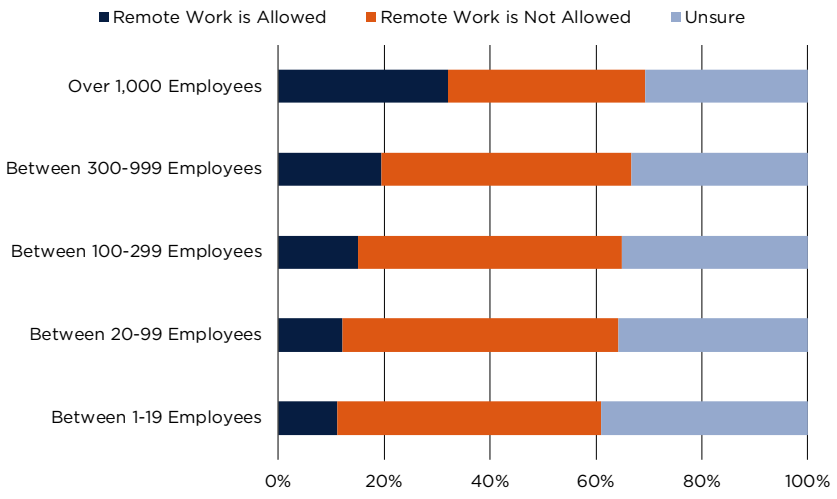
Source Savills Research & Consultancy

GRAPH 4: Remote Work Utilisation, 2019



Source MLIT, Savills Research & Consultancy

GRAPH 5: Remote Work Adoption By Company Size, 2019



Source MLIT, Savills Research & Consultancy

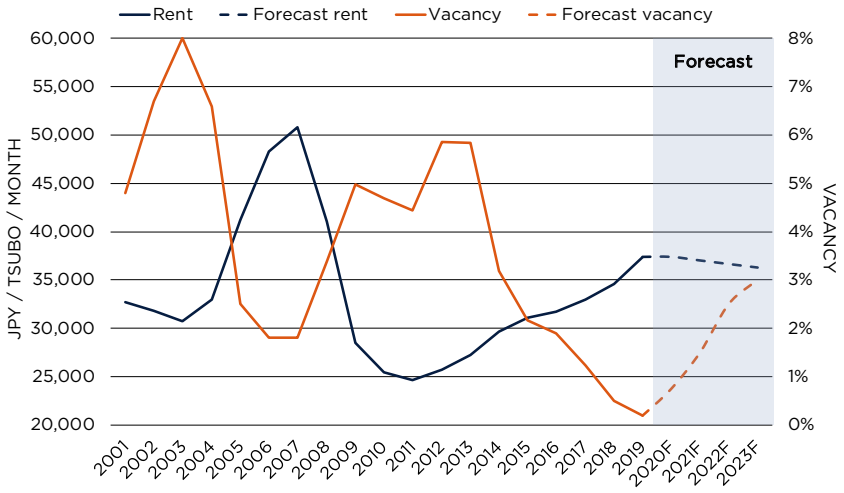
plentiful room for improvement with changes such as improved productivity (subsequent wage growth) and an increased fertility rate (through flexible work arrangements). Some aspects of reform had already been underway before the virus struck, however, which should now be accelerated. Looking at working practices before and during the outbreak, therefore, could shed some light into what the "new normal" may look like, and the potential impact this may have to the broader office market over the longer term.

According to a study conducted by Xymax in December 2019 (2,060 participants), among the reasons for workplace environment dissatisfaction, the inability to work flexibly and the lack of policies surrounding teleworking ranked highly. Perhaps unsurprisingly, therefore, before the turn of the decade, only 13% of those asked had worked remotely. Yet, when instead queried as to whether they wanted to do so, this figure jumped to 35%. At the same time, when questioned about their views on what working practices in 2025 could entail, many of the responses related to the merits of working from home, such as a better use of time due to the lack of commuting and an improvement in the work-life balance that allows more time for non-work-related activities. It would appear, therefore, that much of what was predicted may become reality sooner than anticipated.

Even so, working from home is far from a panacea. In fact, in the same study, of those who demonstrated some hesitancy towards the new work style, one of the most common responses was the difficulty in switching between work and private life. As such, alternatives such as satellite offices have gained some popularity of late. For example, in a study conducted by the Ministry of Land Infrastructure, Transport and Tourism (MLIT) in October 2019, where 40,000 workers (including the self-employed) across the largest regions in Japan were asked about telecommuting policies, the most common location for those who worked remotely (6,172 people) was a satellite office. To wit, nearly 30% of respondents said they primarily used these facilities whilst working (Graph 4). In contrast, those who solely worked from home or without a fixed location, but on a personal device, had responses of 17.7% and 13.1%, respectively. With social distancing measures somewhat hindering shared offices, satellite offices appear well-placed to satisfy requirements in the "new normal".

Meanwhile, whilst the overall take-up of those working remotely was relatively low before reform began in earnest, the divergence in the proportion of users varied markedly by company size. As demonstrated in the MLIT study, around 19% of those at medium-sized companies (between 300 and 999 employees) and 32% of those at larger companies (above 1,000 employees) were

GRAPH 6: Grade A Vacancy Rate and Rent Forecasts, 2001 to 2023F



Source Miki Shoji, Sanko Real Estate, Savills Research & Consultancy

permitted to work remotely in one form or another (Graph 5). The equivalent at smaller firms (between 20 and 99 employees) was 12%. This trend has persisted even in the midst of the pandemic. According to the Tokyo Metropolitan Government, between March and April 2020, these medium-to-large sized companies (more than 300 employees) saw remote work usage jump from 45% to close to 80%. For the small firms, the proportion stood at 55% over the same period.

This dynamic has been clearly demonstrated by companies such as NTT, who is reportedly looking to keep 50% of its 180,000 employees working from home, at least until a vaccine is widely available. Meanwhile, Hitachi has said that it expects around 70% of its roughly 33,000 person workforce to come to the office on just two or three days a week, whilst Mitsubishi Electric Corp. has also announced similar initiatives. Indeed, with the Keidanren – the country's largest business lobby – encouraging companies to embrace various working styles, initiatives such as teleworking and flexible working hours look likely to be permanent fixtures for the time being, benefitting the broader economy.

SUMMARY AND FORECASTS

With all the potential unknowns to emerge over the coming months and years, the Grade A office sector may find itself at a crossroads. On the one hand, vacancy is air-tight and cash-rich Japan Inc. tenants are unlikely to make any immediate, drastic changes over leased space. Instead, preferring to steadily navigate the uncertainty over a year or two as they come to grips with the new meaning of having a centrally located office and any lingering effects from the pandemic. On the other hand, the likelihood of flexible working practices remaining as a part of corporate life may negate the need for office consolidation, and in its place, diversification of locations and the emergence of satellite offices. Even so, centrally located offices are deemed to be necessary to retain in order to cultivate idea generation through collaboration, foster teamwork and nurture a sense of belonging. As such, those closest to transport links should garner the most demand. The idea being, any time reduced commuting could be better used, thus increasing productivity.

Indeed, the paradigm shift at these larger companies mentioned above, who are commonly tenants of Grade A Offices, could have a profound impact on the dynamics of the wider office sector in the "new normal". At the same time, the pandemic has come at a delicate juncture for the broader economy. Unlike some of its international peers, the Japanese economy went into the outbreak already in a fragile state following the Consumption Tax hike in October. With the economy now in a technical recession – it's first since 2015 – office demand is waning. In truth, thinly capitalised tenants, facing financial difficulty as a result, may even be forced to return some leased space, further exposing the disparity in performance amongst office tenants and submarkets. These weak links may have a more widespread impact if the economic recovery is prolonged.

Under the current circumstances, the emergence of some vacancy later this year should come as no surprise (Graph 6). Yet, with the availability of office space already at historic lows, coupled with the dearth of suitable alternatives, the loosening of Grade A vacancy rates in the C5W appears manageable this year. As for rents, the expansion experienced up to this point is forecasted to take a breather or even reverse, with the office location and quality likely playing a major role in determining the outcome. We therefore predict flattish rental movement overall, assuming both the economy and pandemic are somewhat under control with strong support from government policies. Indeed, when the full impact of the pandemic becomes a little clearer, the market will know the direction and the magnitude of the changes. We may even see rental growth resume in 2022 if the economy recovers.

Some wards and areas are expected to suffer more than most with Shibuya likely to bear the brunt given its exceptional growth of late, as well as its tilt towards technology firms. These weaker performing markets are likely to drag down average C5W rents, even if other markets are resilient or strong. Still, the lull in 2021 and 2022 is more than welcome, allowing some breathing space in the market, whilst also preparing for the significant jump in supply a year later. Speaking of 2023, it is worth mentioning that a large proportion of total supply is attributed to a few developers. With a focus on tenants with better creditworthiness and by building long-term relationships rather than achieving the highest rents possible – observed recently – this should help alleviate concerns regarding vacancy over that period. By that time, however, with the hope that the economy is back on track, strong office demand may return, with rental growth following in tow. Even so, the extent to which this plays out could also depend on how the large level of supply predicted to come online in 2025 is received.

Finally, regarding the co-working sector, as covered in last year's report, it had emerged as a tailwind for the office market on the back of solid momentum. Unfortunately, with the pandemic significantly weighing on the industry, it has become a headwind. Despite the proportion of office supply owned or leased by industry players being relatively less than other international equivalents, the potential downside to the broader office market in the C5W cannot be ignored. With social distancing measures loosening somewhat, however, there may be some hope for this battered industry.

OUTLOOK

With the office market riding high towards the end of 2019, the mid-term prospects of the sector appeared bright, even when considering the high levels of supply expected in 2020 and 2023. Yet, the COVID-19 outbreak has led much of this positivity to dissipate as the clouds of uncertainty started to loom large.

It is worth remembering, however, that well over 95% of the supply expected in 2020

has already been filled or pre-leased, whilst existing supply has little vacancy. What's more, thanks to their strong balance sheets, Grade A office tenants are allowed the luxury of taking a wait-and-see approach in order to comprehend the full impact of COVID-19. As such, we have yet to see notable new cases of relocations amongst the Grade A office market. Assets considered Grade B and lower may not be so lucky over the shorter term, however. With instances of smaller firms in general, and start-ups in particular, deciding to reduce or get rid of office space completely, some vacancy is likely to emerge. Looking ahead, technology companies may also follow suit, regardless of their size. Nonetheless, with much of the upcoming supply focused on Grade A assets, at least supply concerns amongst the Grade B or smaller office markets are limited.

Meanwhile, within wards and business districts, the location of an office looks set to play a major role in determining its rental growth prospects. With higher quality tenants often in prime locations, the gap in rents with less conveniently located offices, housing their financially weaker peers, looks likely to widen even more. Indeed, crises typically make the strong even stronger.

Finally, having made significant strides to reform the workplace, it is no shock that the previous trend of office expansion has been reconsidered. Even so, depending on how space is utilised even after a vaccine becomes widely available, it could determine the long-term demand for office supply in the capital. For example, as evidenced in a 2019 study conducted by Mori Building (1,827 respondents), after the 2011 Great East Japan Earthquake, resiliency to natural disasters was the most important aspect of an office. Within five years, however, this feature was not even in the top three considerations for would-be tenants. It is therefore conceivable that whilst the emphasis on a good work-life balance remains, teleworking as the "new normal" may not be significant come 2023. As such, demand for high quality central offices in prime locations should remain for the foreseeable future, though the large supply anticipated in 2025 could soften growth expectations over the mid-term.

Savills Japan
Yurakucho ITOCiA 15F
2-7-1 Yurakucho, Chiyoda-ku,
Tokyo 100-0006, Japan
+81 3 6777 5100