Growth in the C5W returns

Rental growth bounces back in the C5W, while the 23W remain unchanged over the quarter. Nonetheless, solid annual growth persists, with both submarkets rising by around 6% YoY.

- As of Q4/2019, average mid-market asking rents in the Tokyo 23 wards (23W) remained flat over the quarter at JPY4,044 per sq m, whilst rents grew 5.8% over the year.
- Average mid-market rents in the central five wards (C5W) stand at JPY4,842 per sq m after growth of 2.0% QoQ and 6.2% YoY.
- The C5W expanded its premium over the 23W average to around 20%. Discounts narrowed in the other wards.
- Nakano in the West was the top performer this quarter following growth of 7.8% QoQ. Otherwise, over the year, Sumida impressed, with asking rents jumping 9.5% as new units with above-average rents entered the market.

- Units in the 15-30 sq m size band continue to dominate the market. That said, asking rents for these properties in the 23W fell 0.4% QoQ to JPY4,027 per sq m. Listings for the largest apartments remain relatively sparse.
- Occupancy in the 23W held firm in Q4/2019. In the C5W, however, pockets of vacancy emerging in Shinjuku dragged the overall rate down slightly.

Q4/2019 was the third quarter in a row where listings increased in the 23W – currently at levels not seen since Q2/2018.

“Rents continue to rise steadily, as annual growth quickened in Q4/2019 compared to the same period last year. That said, rents in some wards, especially in the C5W, could soon start to test the financial capabilities of tenants.”

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SURVEY GEOGRAPHY
In order to illustrate trends in the central Tokyo residential market, Savills has segmented Tokyo’s 23 wards into seven distinct geographical areas: Central (or “central five wards”), South, West, North (Inner and Outer) and East (Inner and Outer).

RENTAL INDEX DATA CHARACTERISTICS
Savills collates thousands of leasing comparables each quarter in order to analyse trends affecting “mid-market” rental apartment units in Tokyo. Our benchmark rental data is based on average advertised monthly rents for units which fit the following criteria:

1) studio and one- or two-bedroom rental apartments of up to 100 sq m in size,
2) reinforced concrete structures built within the last ten years, and
3) properties located in Tokyo’s 23 wards and situated within a ten-minute walk of the nearest station.

In contrast to the luxury residential market, advertised or “asking” rents for mid-market units fitting the above criteria are typically non-negotiable and are not subject to incentives such as rent-free periods. Savills mid-market rental indices are therefore considered to closely reflect movements in contract rents for the Tokyo market.

OVERALL RESULTS
Rent growth in the C5W rebounded in Q3/2019, reversing a temporary blip observed in the previous quarter. Rents grew 2.0% quarter-on-quarter (QoQ) climbing to JPY4,842 per sq m – surpassing the previous high set in Q2/2019. Over the year, the pace of rent growth quickened to 6.2%. Rent growth in the 23W has been solid. That said, it appears the pace of growth in the C5W is once again on an upward path. Despite the lack of movement of rents in the 23W this quarter, market forces remain accommodative of growth, and for now, average rents remain above their respective four-period moving averages.

Thanks to a relatively higher level of rent growth in Q3/2019, the C5W had managed to narrow the spread between its centrally located counterpart. Yet, it appears that the momentum has somewhat faded. To wit, having reduced the gap to 17.4%, the premium now stands at 19.7% on the back of solid rent growth in the C5W. As for the other submarkets, the Inner North is still the only non-central submarket at a premium, with the gap widening by 2.9 percentage points (ppt) over the quarter. The South is a whisker away following a 0.4 percentage point over the same period – currently standing at a 0.1% discount (Graph 3). The Outer East, on the other hand, continues to lag the other submarkets. Indeed, this submarket is close to 1% adrift of its closest rival, the Outer North.

Smaller-sized units continue to represent the lion’s share of the sample size, and this is expected to continue for the foreseeable future. Rent growth in the most popular size band (15-30 sq m) was solid over the year, though varied over the quarter. Specifically, in the C5W, rents rose 1.0% QoQ as listings fell, whilst the broader market experienced a 0.4% drop in rents over the same period as listings increased. Of the three core size bands, the largest size band (45-60 sq m) has maintained the top spot for asking rents in both submarkets. It is worth remembering, however, the limited number of listings for this size band, and the subsequent volatility to asking rents that brings.

MID-MARKET RENTAL TRENDS BY SURVEY AREA
Despite the number of listings expanding over the year, rental growth in the 23W has been solid. That said, it appears the pace of growth has been slowing all year, and this has culminated in asking rents flattening this quarter, now standing at JPY4,044 per sq m.

In contrast, the C5W managed to reverse the decline in Q3/2019. In some submarkets divergence in growth among wards continues to be evident, though the volatility of listing numbers is partly to blame for this phenomenon. Despite the potential emergence of peaks, the market overall remains sound.

Following a slight adjustment in Q3/2019, the C5W is once again on an upward path. In fact, rents have reached a record high in the post-2008 era, rising to JPY4,842 per sq m after a 2.0% QoQ increase. The main driver of this growth over the quarter has been Shibuya, which saw rents jump by 6.2% QoQ to reach JPY5,136 per sq m – surpassing Minato to become the most expensive ward
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GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2019

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2015 to 2019

GRAPH 3: Mid-market Apartment Rents, Q1/2015 to Q4/2019

in the submarket. Indeed, Minato now lies in second place following a decline of 1.1% QoQ to JPY1,981 per sq m. The reduction in listings at the top-end of the market, in concert with the addition of listings on the lower-end, appears to be the main catalyst for this pullback. Growth over the year in the C5W was even more impressive, rising 6.2%. Having witnessed sluggish growth of 0.7% QoQ, Shinjuku led the way over the year, with an impressive 8.7% jump in rents. Even so, Shinjuku is the only ward in this submarket that has yet to exceed 2008-peak asking rents.

In Q4/2019, the rate of growth experienced in the South slowed compared to the previous period. On a quarterly basis, the most expensive ward, Meguro, was the only ward to experience a fall in rents, declining by 1.9%. As for Ota, this ward saw growth return with rents increasing 14.4% QoQ – the highest in the submarket. Yet, growth over the year remains disappointing, coming in at 1.2%, lagging its peers for a second consecutive quarter. Having achieved close to 5% QoQ growth last quarter, rents in Setagaya experienced a slow slowdown as growth fell just below 1.5%. It was a different story over the year, however, where the pace of growth quickened to a solid 5.9% YoY. Indeed, rents have surpassed the previous high to hit JPY3,971 per sq m. This is particularly impressive considering the number of listings YoY have increased by over 5%.

On the surface, growth in the Inner North appears somewhat encouraging. Rents in the submarket grew 2.9% QoQ and 4.7% YoY. In fact, the pace of growth has expanded for two quarters in a row. However, looking at the ward level tells another story. Having appeared to have returned to growth last quarter, Toshima has lost all momentum. Asking rents fell 1.5% QoQ to JPY3,913 per sq m, perhaps as a result of the number of listings – just above 5% of the total figure. Remarkably, this submarket has held that crown every quarter for the last decade. This quarter, rents in this submarket grew 0.9% QoQ and 4.8% YoY. When looking at the wards, rents in Adachi are now the least expensive, at JPY2,900 per sq m, following a 1.2% QoQ decline and 3.5% YoY rise – the lowest in the submarket. Arakawa, in contrast, was able to retain the top spot despite falling 2.4% QoQ, while Edogawa was home to the greatest change over the year, rising 6.2% to JPY3,109 per sq m. The above should, however, be caved with the reminder that rents in the Outer East are subject to volatility as a result of the lack of listings – just above 5% of the total figure.

RENTS BY UNIT SIZE

Tokyo's rental market is principally made up of compact single-occupier units, typically less than 45 sq m (13.6 tsuibo) in size. Such units can often make up as much as 75% or more of the 23W area's rental listings. Unlike other major global cities such as London and New York, house or apartment sharing does not form a major segment of the rental market. As a result, there is a large, stable market for smaller- to mid-sized units.

Representing around two thirds of total listings, the smallest band of apartments (15-30 sq m) remains the most popular layout in the 23W, as well as the C5W. As such, asking rents for this size-band have experienced solid growth rates of 5.2% and 6.1% YoY, respectively. That said, this quarter, it appears supply has outstripped demand in the 23W, as evidenced by the 0.4% QoQ decline in rents following a near 6% increase in listings. However, the opposite was observed in the C5W. The prime submarket saw rents return to growth, increasing 1.0% QoQ to JPY4,796 per sq m as listings fell by over 10%. When looking at the other size bands, it is evident

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that the larger size band (45-60 sq m) has
continued to grow in popularity, and this
has been reflected in the asking rents – now
exceeding the other size bands in the 23W
and the CSW. Indeed, the spread in rents
between the main size bands has continued
to tighten, especially in the CSW (Graph 4).

OCCUPANCY RATES
In Q4/2019, the average occupancy rate in
the 23W held firm at 97.3% over the quarter,
whilst a similar trend was observed over
the year. The CSW was not able to follow
suit, however. Occupancy in this central
submarket fell by 0.6pps QoQ and 0.5pps
YoY, driven by a decline in Shinjuku. More
specifically, despite a fairly modest 0.4pps
fall over the year, over the quarter, occupancy
in the ward decreased by 2.3pps. On the
other hand, Chiyoda was the sole ward
to experience an increase in occupancy,
both over the quarter and year. Over both
periods, rates increased 1.2pps – perhaps
unsurprising given the lack of supply in the
area, and as a result, occupancy in this ward
is close to 99%.

The fact that occupancy in all submarkets
remains above 95% confirms that demand
for institutional-quality assets remains solid.
Given Tokyo is expected to attract the lion's
share of positive net migration, it would not
be surprising if these levels of occupancy
were to continue going forward.

WAGES FAIL TO KEEP UP WITH
CONDO PRICES
According to data collected by Tokyo Kantei
as of 2018, the average price-to-income
multiple for new condo developments\(^2\) in
the Tokyo prefecture stands at around 13.3x – a
level not seen since the bubble era (Graph 6).
To put this figure into context, the national
average is closer to 8x, whilst older condos in
Tokyo built 10 years ago command a multiple
of 10.5x. Historically, multiples between 6x to
10x are said to be appropriate, and therefore,
even with historically low mortgage rates,
current prices in Tokyo comfortably exceed
this range. In fact, in the 10 years leading
to 2018, prices have jumped by 25%, whilst
changes in wages were meagre. Indeed, it
looks unlikely that wage growth will be able
to fully offset the impact of this trend any
time soon.

It also appears that big-name developers
are somewhat contributing to this trend.
With the number of smaller players
dwindling following the recession, these
large developers now command a significant
share of the market. As a result, they are
not under pressure to immediately sell
their properties, and instead have the
luxury of listing the condos with little to
no discount, keeping prices high and stable.
As such, transactions take longer, and this

is evidenced by the over 20% decline in the
number of developments fully sold prior to
completion since 2014.

Prospective buyers may therefore continue
to be put off by the stretched average price-
to-income multiple for the time being, and
this should act as a fillip for the leasing
market. However, this impact will vary
across the submarkets. As we have seen so
far, a potential peak in asking rents may be
emerging in the pricier wards, and therefore,
wards on the lower end of the scale may be
set to benefit more over the medium to longer
term.

OUTLOOK
The relative economic and political stability
of Japan continues to attract capital. Indeed,
the defensive nature of the residential
market in this late property cycle remains
especially appealing, with the recent deal
between Allianz and Blackstone for the
latter's JP¥330 billion residential portfolio
being case in point. Nonetheless, the usual
warnings to the economy still ring true.
Japan is not immune from prolonged global
uncertainty, while closer to home, the impact
of the consumption tax hike in October is
not yet fully understood. These headwinds
notwithstanding, the financial resilience of
Japanese corporates provides a source of
comfort, at least for the time being, though
high levels of corporate profits have not yet
translated into wage growth.

Despite the growth of asking rents coming
to a halt in the 23W, over the year, growth
remains solid. Going forward, therefore,
a confluence of drivers, namely the lack of
noticeable new developments in the near
future, and the continued demand pressure
from demographic tailwinds, should
underpin rent growth for now. In addition,
without meaningful wage growth, the average
price-to-income multiple of a new condo
should remain sufficiently high, benefitting
the leasing market. That being said, if this
lack of wage growth persists over the longer
term, rents may begin to test an upper limit.
For now, however, without a clear imminent
risk to the leasing market, or to the economy,
rents should still have some momentum left
to grow, albeit moderately.

\(^2\) Based on the average value of a brand new 70 sq m
condo.