MARKET IN MINUTES
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Residential Leasing

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Market sees recovery amidst mixed signals

Rents and occupancy rates have improved, while Tokyo continues to see its population decline modestly.

- This quarter, rents in the Tokyo 23 wards (23W) improved 0.9% QoQ to JPY3,963 per sq m, although they have still decreased 0.9% YoY.
- Likewise, mid-market rents in the central five wards (C5W) have also increased 1.1% QoQ to JPY4,713 per sq m, but faced an annual decline of 1.4% YoY.
- The C5W premium has inched up 0.3 percentage points (ppts) QoQ to 18.2%, although the premium is still lower than that of pre-pandemic times.
- Most wards have posted some recovery this quarter, with Shinjuku posting the largest gain on a quarterly basis of 3.0%. On an annual basis, Arakawa came on top, growing at 4.4% YoY.
- In the C5W, average rents for all unit sizes have seen some rental increments this quarter.
- The average occupancy rate in the 23W increased 0.3ppts from the previous quarter to 96.1%. The C5W saw an even larger recovery of 0.7ppts to 95.6%.
- The population decline of the 23W has continued into Q4/2021. In comparison, major regional cities Osaka, Nagoya, and Fukuoka have not seen population changes as noticeable as the 23W.

"Tokyo's rents and occupancy rates have increased over the past quarter, which may imply an inflection point. However, when compared to major regional cities, Tokyo has seen lower rents and occupancy than pre-pandemic times, and a more noticeable population decline. The implications of new variants may further affect future housing demand in Tokyo."

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MAP 1: Tokyo's 23 Wards by Survey Area

Source Savills Research & Consultancy

SURVEY GEOGRAPHY

In order to illustrate trends in the central Tokyo residential market, Savills has segmented Tokyo's 23 wards (23W) 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

After multiple corrections seen over the past year, rents in both the 23W and C5W have seen a reprieve this quarter, bouncing back to levels observed in Q2/2021. The high vaccination rates and plunge in COVID-19 cases in the country may have boosted the confidence that some recovery could be in sight.

Nonetheless, current demographic trends are worrying for Tokyo. This is particularly true for the 23W, whose population has decreased by over 0.4% YoY and more than 85,000 people from the peak population in May 2020. Indeed, the number of available listings has also increased about 20% from the previous quarter, and some of the rental increments could have been contributed by an increase in the number of listings priced above average as some tenants leave Tokyo. Such changes were unheard of before 2020, showing that the sentiment surrounding the pandemic still lingers. On another hand, major cities such as Osaka, Nagoya, and Fukuoka have not seen population changes as noticeable as those seen in Tokyo. One reason behind this trend would be the differences in the proliferation of remote work – Tokyo has by far seen the highest levels of remote work when compared to other cities. Furthermore, it is more common in Tokyo to commute from outside the prefecture, and the multiple train lines connecting the city centre to neighbouring prefectures make commutes relatively easy, making living outside of Tokyo a viable option. In regional cities, commuting within the same prefecture is much more common, and train lines may not be as extensive.

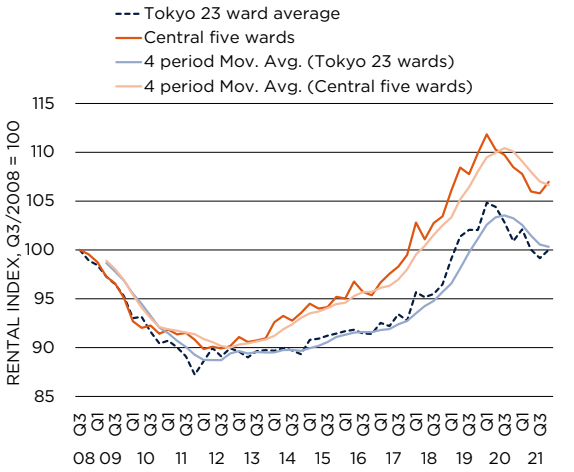
The appreciation in rents was more notable in the C5W this quarter, and its premium over the 23W has increased 0.3 ppts to 18.2% (Graph 2). However, this premium on the whole has been decreasing slowly over the past few years, and the pandemic has overall contributed to the tightening of the spread, with the prices of less expensive regions seeing comparatively stronger growth. Indeed, with the proliferation of remote work, the value of living closer to the city centre appears to have diminished. Despite the continuous population outflow over the past two quarters, occupancy rates have increased, probably with the aid of some rental adjustments, but nonetheless demonstrating the demand for residences of better quality.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

In Q4/2021, average multifamily asking rents for the 23W inched up 0.9% QoQ to JPY3,963 per sq m, although the multiple contractions seen over the past year have led to an annual decline of 0.9%. This quarter, most submarkets have seen slight rental increments, especially those comprised of more expensive wards. At the same time, rents of the more expensive wards have generally seen larger corrections during the pandemic, and are still well below pre-COVID levels. Overall, the fluctuations seen over the past few quarters suggest that rents might stay flattish for the time being. While the population of the 23W has admittedly been decreasing, some reversal in this trend is likely, especially as the pandemic calms down and office utilisation increases, and more foreigners return to Tokyo when restrictions are lifted. Indeed, the moving season in the spring of 2022, when a large number of people traditionally migrate to Tokyo, will be an important indicator of residential demand in the 23W for the coming year.

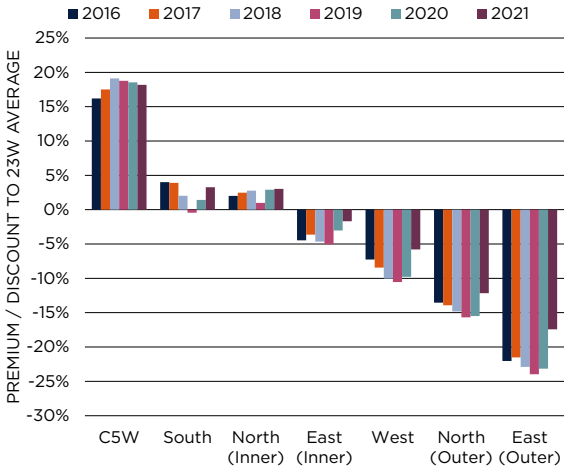
After multiple consecutive quarters of being the most poorly performing submarket, the C5W has turned the tables to become one with

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2021



Source Savills Research & Consultancy

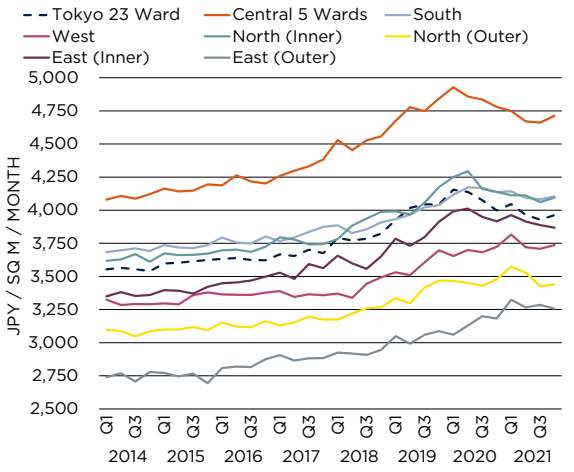
GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2016 to 2021



Source Savills Research & Consultancy

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

GRAPH 3: Mid-market Apartment Rents, Q1/2014 to Q4/2021



Source Savills Research & Consultancy

the highest growth this quarter, with average rents increasing 1.1% QoQ to JPY4,713 per sq m. Indeed, most members saw some quarterly growth, with Shinjuku demonstrating the largest increment, although rents have still contracted 1.4% YoY. Going forward, upcoming developments like the Toranomon Azabudai project in Minato, should boost the vibrancy of the area and increase its popularity as a place to live, especially for those looking at higher-end residences.

In the South submarket, rents have rebounded 0.5% QoQ to JPY4,104 per sq m, effectively reversing the correction seen in the previous quarter. As a whole, while the submarket saw a yearly correction of 0.8%, there were notable differences in the performance of each ward. For instance, Setagaya was the only member to have seen annual growth of 1.3% in the submarket. The ward is the most heavily populated in Tokyo and is known for its many residential neighbourhoods with plentiful greenery, and is likely to remain popular with families. On the other hand, Meguro's rents have continued to descend 0.3% QoQ. Indeed, the prolonged state of remote work would have lessened the appeal of paying a premium to live in the ward.

The Inner North also saw rents recover 0.8% QoQ to JPY4,095 per sq m, although it still experienced a correction of 1.0% on an annual basis. However, the two members of the submarket exhibited diverging trends. Toshima, the less expensive constituent, has seen rents grow 2.9% QoQ and 1.5% YoY. Although the ward saw some corrections during the pandemic, rents in Toshima have risen above pre-pandemic levels, partially stemming from the large number of newly completed buildings that came online this quarter. On the other hand, Bunkyo saw its rents contract again – decreasing 1.1% QoQ and 3.4% YoY. That said, Bunkyo's rents are also generally above pre-pandemic levels despite the decline, and the ward's population has also held steady over the past year, demonstrating the popularity of the area known as a family-friendly hub.

While many other submarkets saw rents recover this quarter, the Inner East submarket went against this trend, contracting 0.5% QoQ and 1.2% YoY to JPY3,868 per sq m. Taito saw the largest decline on an annual basis of 3.7%, whereas Sumida actually saw growth of 2.2% YoY. Overall, looking at population trends, the submarket's popularity as a place of residence has not wavered, with the number of residents of each ward holding mostly steady over the past year. Indeed, the submarket borders Chiyoda and Chuo with good transportation options to the city centre, and its many traditional downtown and waterfront areas have helped to maintain the Inner East's popularity with its residents.

The West was the only submarket that saw both annual and quarterly increments in Q4/2021. Specifically, average rents increased 0.8% QoQ and 0.3% YoY to JPY3,737 per sq m. Like the C5W, the West submarket also saw a large number of newly completed buildings come online this quarter, and this contributed to some of the submarket's rental increments. While the growth was fairly evenly distributed between the wards, Nakano saw the most growth of 1.5% QoQ and 1.6% YoY, and its rents are comfortably above pre-pandemic levels.

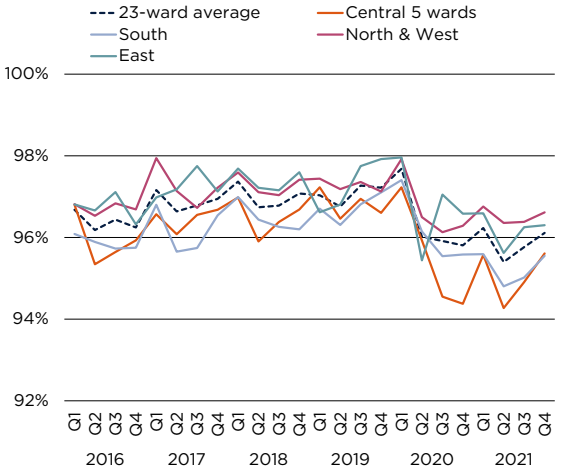
The Outer North submarket saw a moderate increase in rents of 0.4% QoQ to JPY3,440 per sq m, but still declined 1.1% YoY. However, like the Inner North, the two constituents of the Outer North also demonstrated deviating trends. Most of the growth came from Kita, the more expensive ward, whose rents are clearly above pre-pandemic levels. On the other hand, Itabashi saw rents decline 2.5% YoY, and rents are moderately below pre-pandemic levels.

Although the Outer East was the best performer over the past few quarters, Q4/2021 saw a complete turnaround in this trend, as the submarket actually saw the largest quarterly decline in rents of 0.9% to JPY3,256 per sq m. Arakawa contributed the most to this drop, with rents decreasing 2.6%, although this was likely contributed by some uptake of new, more expensive units that came onto the market in the last quarter. Despite the downturn, the submarket still had the largest positive annual growth of 2.3%, with Arakawa also seeing the greatest increment of 4.4% YoY. While some members have seen some fluctuations in rents, the submarket as a whole has generally seen an upward trend with current rents greater than pre-pandemic levels. However, it should be noted that all wards have seen some population decreases over the past year, like Edogawa whose population shrank 0.8%. Elsewhere, population changes in Katsushika and Adachi were more modest. In contrast, Arakawa only saw a decline of 0.1%, showing that the ward has maintained its popularity.

OCCUPANCY RATES

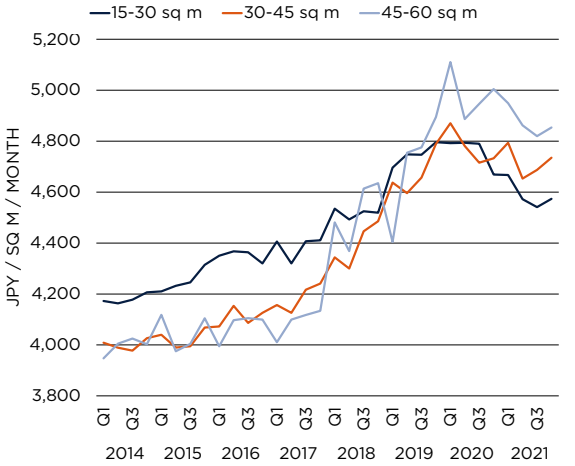
The population of the 23W has been on the decline since the end of the peak moving season in Q2/2021, decreasing by approximately 35,000 people. Paradoxically, J-REIT occupancy rates have been on the rise over the same period. Specifically, occupancy rates in the 23W inched up 0.3ppts from the previous quarter to 96.1%. The increment in occupancy rates was even more notable in the C5W, increasing 0.7ppts QoQ to 95.6%. Occupancy rates are currently around the highest levels they have been since the pandemic began. This recovery is encouraging because it could further signify that quality residences, like those owned by J-REITs, are still in demand in Tokyo. However, it should also be noted that J-REITs have a tendency to prioritise occupancy rates even at the expense of rents in order to distribute stable dividends.

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q4/2021*



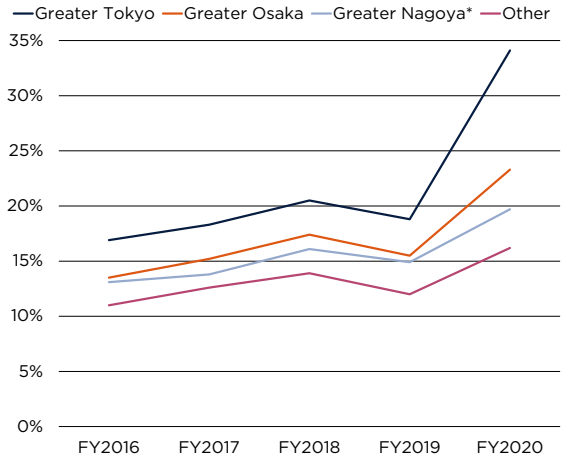
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data
*Q4/2021 is as of November 2021.

GRAPH 5: Rents by Unit Size, C5W, Q1/2014 to Q4/2021



Source Savills Research & Consultancy

GRAPH 6: Remote Work Levels by Region, FY2016 to FY2020



Source : Ministry of Land, Infrastructure and Transport and Tourism, Savills Research & Consultancy
*Greater Nagoya comprises Aichi, Gifu, and Mie prefecture.

Occupancy rates in other submarkets have also seen marginal increments over the past quarter, and almost all have higher rates than in the same period last year, demonstrating that overall occupancy rates are recovering in Tokyo. Moreover, occupancy rates should be expected to increase going into Q1/2022 as some people begin moving to Tokyo for work and education during the peak moving period in spring.

Going forward, potential changes in company policies pertaining to remote work will be an important factor in determining demand for residences in Tokyo. Presently, remote work is still prevalent, and many companies have adopted a hybrid model where some days are spent in the office and others are spent remotely. More people are expected to come back to Tokyo residences as the pandemic calms down, but the Omicron variant may change this, or delay the recovery timing by at least a few months. The population changes during the next peak moving period in spring 2022 will be an important indicator in gauging the market demand for the upcoming fiscal year.

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 tsubo) 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 small- to mid-sized units.

In line with the overall rental increments seen in the C5W this quarter, all size bands have seen upticks in rents. After seeing the largest corrections overall during the pandemic, the smallest 15-30 sq m band saw an uptick this quarter of 0.7% QoQ. However, the popularity of these smaller units is more likely to be dependent on the state of the pandemic over the next few months and how companies decide on office attendance policies and remote work.

Overall, the spread between the two larger bands and the smaller 15-30 sq m band has remained the same over the course of 2021. In detail, the 30-45 sq m band saw rents rise by 1.0%, and the 45-60 sq m band saw rents increase by 0.7%. This rental growth was partially attributed to the large number of newly developed units in this range over this quarter, but we expect that larger units will likely remain popular for the time being.

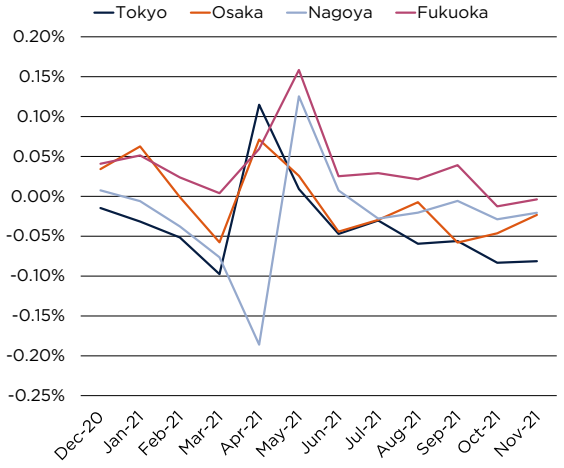
A COMPARISON BETWEEN REGIONAL CITIES

Tokyo is the undisputed economic powerhouse in Japan with the largest population. However, the economic strength of Tokyo served as a double-edged sword during the pandemic, as many large companies located in the city centre had the resources and infrastructure to implement remote work on a large scale. As a result of these increased levels of remote work, the 23W in Tokyo saw an exodus of people and comparatively fewer new entrants, leading to its population decreasing by more than 0.4%, or approximately 40,000 people from the same period last year. Indeed, the lessening needs of commuting to the office on a daily basis has weakened the appeal of paying a premium to live in the 23W, especially the most expensive central area. Many residents have reportedly moved to neighbouring prefectures like Saitama, Chiba, and Kanagawa where commuting to offices in Tokyo is still a possibility, rents are affordable, and bigger units are abundant. In addition, border restrictions from the pandemic have made it difficult for foreigners to move to Japan, and the decline in the foreign population has also contributed substantially to the overall population decrease.

Looking at the west, the eponymous Osaka City, which is the centre of the second largest economy in Japan, has seen a much milder population decline from last year of less than 0.1%. Remote work in the region is not nearly as prevalent as Tokyo, and many people have not moved out of the city, probably because of the high quality of life it provides. Overall, Osaka is a popular residential location and serves as a hub for the Kansai region, as mentioned in our [Osaka Residential Markets] report. Going forward, Osaka is expected to see a range of changes in the city, such as the Umekita 2nd Project which is expected to add a state-of-the-art commercial spaces and housing. In addition, the integrated resort developments planned to be completed in 2029 will give Osaka a flavour to the city that even Tokyo does not have. These developments should also boost economic growth and create jobs, and consequentially make Osaka into a more attractive place to live.

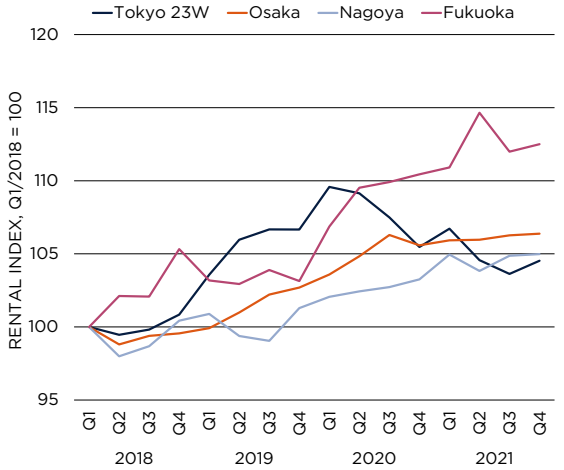
Nagoya City is sandwiched between Tokyo and Osaka, and is the economic hub of the Greater Nagoya region, which is home to one of the country's strongest manufacturing sectors. Although Nagoya attracts people from the region with its job and education opportunities (see [Nagoya Residential Markets]), it also faces population outflows to the stronger economic regions of Tokyo and Osaka. Furthermore, Nagoya is widely considered to be a "car society" due to its traditional dependence on cars, and hence the residential options for many people are not limited by train accessibility. Overall, while Nagoya's population saw a mild decline of less than 0.3% over the past year, the drop was still not as large as what Tokyo has seen. Going forward, the city will be the focal point of the Maglev Chuo Shinkansen, which will significantly decrease the travel time between Tokyo and Osaka, and areas close to Nagoya

GRAPH 7: Population Changes over the Past Year, December 2020 to November 2021



Source Tokyo Metropolitan Government, Osaka City Government, Nagoya City Government, Fukuoka City Government, Savills Research & Consultancy

GRAPH 8: Rental Index of Tokyo 23W vs Regional Cities, 2018 to 2021



Source Savills Research & Consultancy

station should further increase in popularity as a residential neighbourhood.

In the south, Fukuoka City has bucked the trend with its population increasing more than 0.4% from the previous year, outperforming other regional cities. Fukuoka is the regional hub of the Kyushu region, and like its counterparts, is known to attract many young migrants in search of jobs and education [Fukuoka Residential Markets]. The positive growth in the city could be linked to the ongoing large-scale redevelopment projects – Tenjin Big Bang and Hakata Connected, which aim to revitalise the city by redeveloping many old buildings and revamping the city landscape. Indeed, international firms like Google and the Boston Consulting Group have announced plans to set up offices in Fukuoka. These changes to the city are likely to create more jobs and further increase Fukuoka's popularity as a place of residence.

These relative population changes in each city appear in tandem with changes in residential rents. Looking at trends in rents in Graph 8, Tokyo 23W was also the only member to have seen a decline in rents from the pandemic. In comparison, rents in Osaka and Nagoya have seen mild increments, whereas Fukuoka has seen notable growth even during the pandemic.

While recent changes in Tokyo might be discouraging, these trends could see some reversal, especially when the pandemic winds down and companies decide to welcome employees back to the office more frequently. In addition, more foreigners are likely to migrate to Japan as border restrictions become relaxed. Going forward, multiple redevelopments are planned in many locations of central Tokyo over the next decade, such as the Toranomon Azabudai project, and are expected to increase the popularity of Tokyo as a residential area. Regional cities also look to attract more people with their own large-scale development plans to make the city a more desirable place to live, which will likely help rents grow.

OUTLOOK

In Q4/2021, some mixed signals were observed in the market. On a positive note, average rents in the 23W have overall bounced back from the dip seen in the previous quarter, although the price increment could be partially attributed to the increase in supply of new units priced above-average that came online this quarter. Furthermore, occupancy rates also saw an increment from the previous quarter, which was especially notable in the C5W. Overall, rental levels and occupancy rates are still lower than pre-pandemic levels, and the population decline in the 23W has continued modestly over the past quarter, showing the lukewarm state of the market in Tokyo. At the same time, it must be noted that this is a comparison to the period right before the pandemic, when the Tokyo residential market was especially tight and robust.

When compared with major regional economic hubs, Tokyo's decline is even more apparent. Neither Osaka, Nagoya, nor Fukuoka have seen population declines to the extent that Tokyo has. Furthermore, these regional hubs have not seen rental corrections – on the contrary, rents have generally trended upwards since the beginning of the pandemic. The less extensive levels of remote work and higher propensity to stay within the same prefecture because of the relatively higher quality of life are likely reasons for the stronger market and population retention observed in these cities. Moreover, Osaka, Nagoya, and Fukuoka also all have upcoming redevelopment projects that aim to revitalise the city and increase its attractiveness as a residential area.

Tokyo also has a plethora of developments in the pipeline that should likewise make living closer to central areas more popular. While Tokyo's population has modestly decreased, its fundamentals remain sound. Furthermore, some people may want to move back to the 23W if they are expected to commute to the office more frequently. Indeed, the number of fully vaccinated people in Japan has reached around 80%, and COVID-19 cases have plummeted in the country, which are strong signs that the economy was on the path to normalcy. Unfortunately, the uncertainty created by the newly discovered Omicron variant has thrown a spanner in the works, prompting companies to take a wait-and-see approach before making decisions about increasing office attendance – delaying previously expected recovery scenarios by at least a few months. The severity and future circumstances surrounding such new variants are likely to determine the speed of recovery in the coming year, but the resilience that the Tokyo residential market has demonstrated thus far will not change.