MARKET IN MINUTES
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Residential Leasing

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Strong demand paradoxically corrects rents

The 23W saw listed rental corrections, but paradoxically, this is probably a sign of strong leasing demand.

- Average rents in the Tokyo 23 wards (23W) saw a notable decline of 2.9% quarter-on-quarter (QoQ) and 0.7% year-on-year (YoY) to JPY3,933 per sq m, although this is likely due to strong leasing demand taking up many newly completed premium units from the market.
- Rents in the central five wards (C5W) moved in tandem, decreasing 2.6% QoQ likely due to the same reasons, but remain higher 0.4% YoY.
- The C5W premium grew to 20.0%, up 1.8 percentage points (ppts) from last year, and still exceeds the pre-pandemic level.
- Suginami saw the largest gain of 2.1% on a quarterly basis, while Chiyoda saw the largest decline of 4.5% QoQ. However, it should be noted that Chiyoda also saw a large gain in the previous quarter, and that rents are still higher than one year ago.
- After narrowing slightly in the previous quarter, the premium for the 45-60 sq m size band widened again this quarter.
- The average occupancy rate in the 23W rose by 0.1ppts from the previous quarter to 96.6%, while that of the C5W rose by 0.2ppts to 96.2%.
- In the short term, the return of foreign nationals will likely lead to continued moderate net population growth in the 23W and support rental demand.

> "While average rents declined across the 23W, this is likely due to strong leasing demand taking up many newly completed premium units. Indeed, occupancy has increased, and the population of the 23W has continued to see monthly growth, mostly supported by the return of foreign nationals. This temporary correction should be proof of strong demand as well as a necessary step for further growth."
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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

In Q4/2022, rents saw a notable decline across the Tokyo 23W, following sound increments in the previous quarters. While the rental growth seen in the previous quarter appears to have stemmed from a large increase in the number of newly constructed units with above average rents, especially in the C5W, strong leasing demand in Q4/2022 seems to have paradoxically resulted in a contraction of average listed asking rents. Indeed, as normalcy returns and demand, particularly from overseas residents, picks up, many of those newly completed premium units from the recent quarter have been taken up, while a below-average number of new units have arrived to the market. Although a contraction in asking rents might appear to be a cause for concern at first glance, the contraction this quarter is more likely a positive demonstration of a recovery in leasing demand in the 23W from the difficult situation during the pandemic.

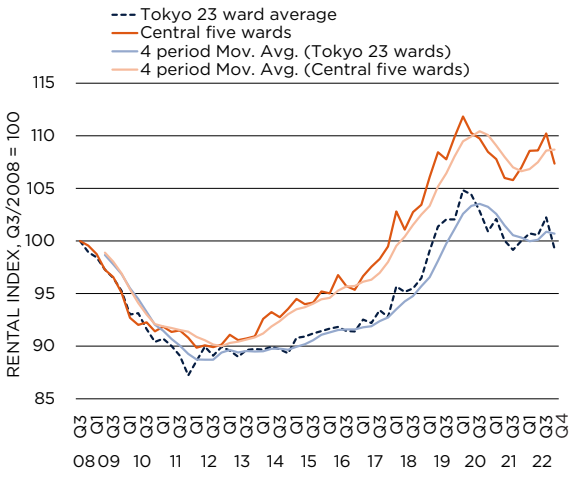
The 23W has continued to see positive population growth between September and November 2022, in contrast to the same periods in 2020 and 2021 which saw the population decline. Like the previous quarter, this growth was mostly supported by a sizable increase in the foreign national population, which increased by about 16,000 people. On the other hand, the Japanese population of the 23W shrank by around 8,000 people. Overall, while the population of the 23W increased by 8,000 people, the number of households increased by 12,000 over the same period. This suggests that a majority of those moving out of the 23W are families, while many singles, both Japanese and non-Japanese, are moving in. Overall, this increase in population, and increase in the number of households is a strong sign for the 23W residential market, which traditionally catered to single-occupier households.

The number of available listings has declined by more than a third - a notable drop from the previous quarter. When taking this into consideration with the rental decline observed, this suggests that the demand for quality units has likely seen a robust increment. In conjunction with the population that is likely to continue growing moderately over the next few months on the back of foreign nationals moving to Japan, overall residential demand should prove strong.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

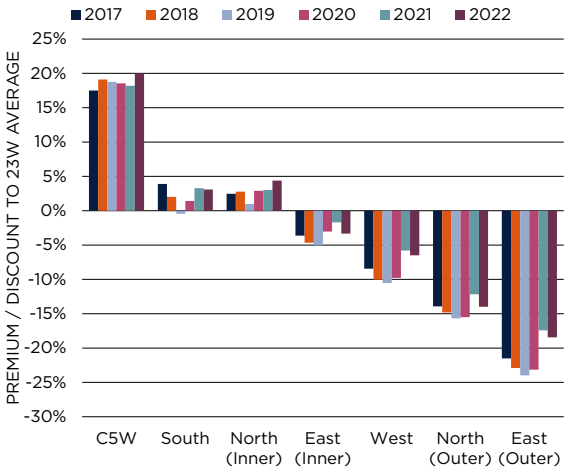
Average mid-market asking rents in Tokyo's 23W are currently at JPY3,933 per sq m, having declined by 2.9% QoQ. However, it should be noted that a large number of newly constructed units with above-average rents contributed to the increment in the previous quarter, and it appears that many of these units have been leased throughout the fourth quarter. Indeed, on an annual basis, this translates to a more modest decline of 0.7%. Moreover, most submarkets in the Tokyo 23W have seen some positive net migration, primarily due to the relaxation of entry restrictions in 2022, which has contributed to a rebound in rental demand and a decrease in the number of available units. Furthermore, with hybrid working arrangements commonplace in Tokyo, there has been particular interest in larger units that can accommodate home offices. Overall, Tokyo's demographic situation currently appears to be stable and improving, and the influx of foreign nationals should more than offset the natural decline of the Japanese population, and see a net increase in the 23W population for the meantime. However, investors should pay

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2022



Source Savills Research & Consultancy

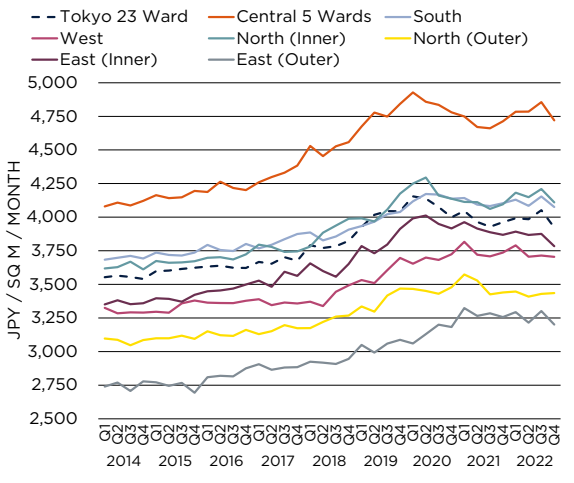
GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2017 to Q4/2022



Source Savills Research & Consultancy

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

GRAPH 3: Mid-market Apartment Rents, Q1/2014 to Q4/2022



Source Savills Research & Consultancy

attention to demographic shifts going forward.

Average asking rents in the C5W submarket have contracted by 2.6% QoQ, but grew 0.4% YoY, and are currently at JPY4,731 per sq m. All constituents experienced rental corrections on a quarterly basis. Looking at the ward level, Chiyoda experienced the largest change, decreasing by 4.5% QoQ, while other wards had milder declines ranging between 1.3% and 3.3%. The C5W experienced the second largest net migration of the Tokyo submarkets between September and November, with a net inflow of 3,100 new residents, most of whom are foreign nationals. This has led to a significant decline in the number of available units in all wards in the submarket. Furthermore, the submarket typically attracts high income earners. Hence, many larger units with high rental levels have been taken off the market, which has caused some noticeable downward movement in average asking rents.

The South submarket also saw a contraction in average rents this quarter, but this was more moderate at 1.5% QoQ, with rents falling to JPY4,090 per sq m. Although the submarket experienced a slight net population contraction between September and November, the expansion in demand from young, single professionals, both Japanese and non-Japanese, for single units has resulted in a notable drop in the available unit count. Hybrid work styles are commonplace in Tokyo, and units that can facilitate working from home arrangements remain popular. Similar to the C5W, demand has been strong for large, premium units this quarter, leaving a higher proportion of less expensive and smaller units available on the market, which makes our rental indices look somewhat weak, though the reality appears to be the opposite.

Average rents in the Inner North submarket experienced a moderate contraction of 2.2% QoQ to JPY4,118 per sq m, which amounts to a slight yearly increment of 0.5%. Average rents in the more expensive Bunkyo sit 2.3% higher than Q4/2021, but declined 2.8% QoQ. Toshima also saw a moderate decline in asking rents by 1.6% QoQ, which translates to a yearly decline of 1.2%. Indeed, both constituent wards attracted a net influx of people, primarily supported by foreign nationals. Hence, the submarket saw a drop in the number of available units by almost half QoQ in Bunkyo, and nearly a quarter in Toshima. Demand from these new residents has helped to absorb the newly constructed units with expensive rents in the submarket, as well as other larger units that can facilitate hybrid work, which has led to the overall contraction in average submarket asking rents. The Inner North submarket will likely continue to attract new residents due to its many entertainment offerings in Ikebukuro and close proximity to the C5W submarket.

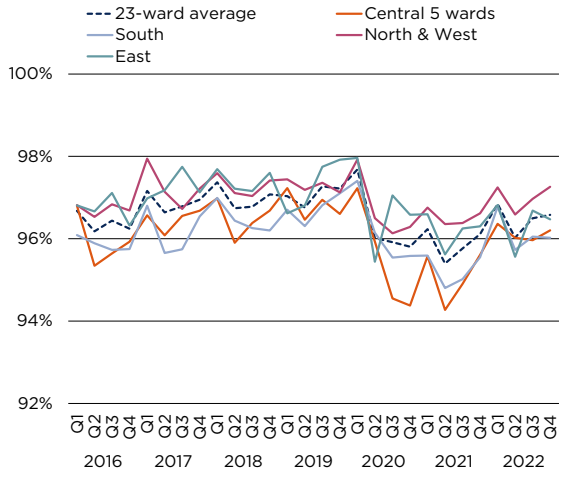
The Inner East submarket experienced a similar trend, and average asking rents fell by 2.4% QoQ to JPY3,784 per sq m which is a YoY contraction of 2.2%. As this report discusses in further detail in a later section, the Inner East was the only submarket in the Tokyo 23W to experience yearly population increments throughout the pandemic. Demand may continue to grow going forward in the Inner East submarket, which, like the Inner North, has convenient access to the C5W at a more affordable rental level.

The West submarket is considered a popular residential area, and too has attracted a moderate net positive influx of migrants in Q4/2022. The West also experienced a mild contraction in average asking rents to of 0.1% QoQ to JPY3,710 per sq m. Suginami and Nerima saw the largest quarterly rental increments in the Tokyo 23W at 2.1% and 0.9%, respectively. However, asking rents in Nakano fell by 3.1% QoQ, largely due to a significant drop in the availability of expensive units in Q4/2022, which caused average submarket-level rents to trend downwards. Indeed, demand has been strong since the onset of the pandemic in the West, as people seek good access to offices in the C5W along the Chuo line, but also require more space for home offices. The West submarket should continue to perform well and attract migration due to its convenience and entertainment offerings for residents.

Average rents in the Outer North submarket were the only ones to see positive growth this quarter, increasing 0.2% QoQ to JPY3,435 per sq m, and still feature the second lowest average asking rents in the 23W. At the ward level, Itabashi saw rents stay flat, and remains one of the cheapest wards in the Tokyo 23W for renters. Rents in Kita increased by 0.3% QoQ, which is likely due to a large proportion of newly completed units having been rented throughout Q4/2022. The Outer North experienced a net influx of over 1,400 new residents between September and November, which has fueled some expansion in demand for residential units. The relative affordability of the submarket will likely be attractive to movers and should sustain some rental demand going forward.

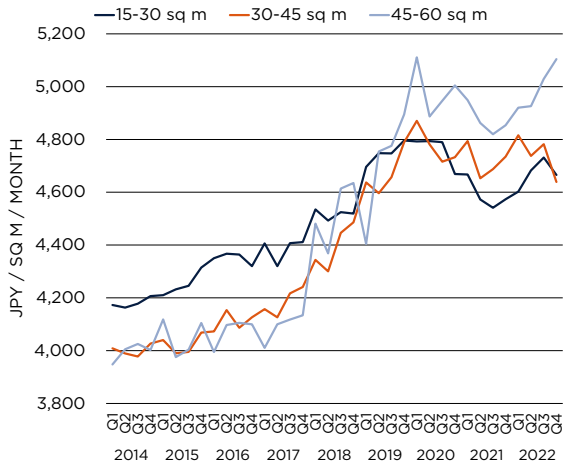
The Outer East submarket has consistently offered the most affordable rents in the Tokyo 23W market, and rents declined further over the quarter. Average asking rents were JPY3,213 per sq m in Q4/2022, having contracted by 2.7% QoQ and 1.3% YoY. The submarket attracted a net 2,400 new residents between September and November, with notable migration taking place in Adachi and Katsushika. Arakawa experienced the largest contraction in asking rents at 4.2% QoQ. The Outer East submarket will likely retain its popularity among most demographics due to its relative affordability and the availability of living space.

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q4/2022*



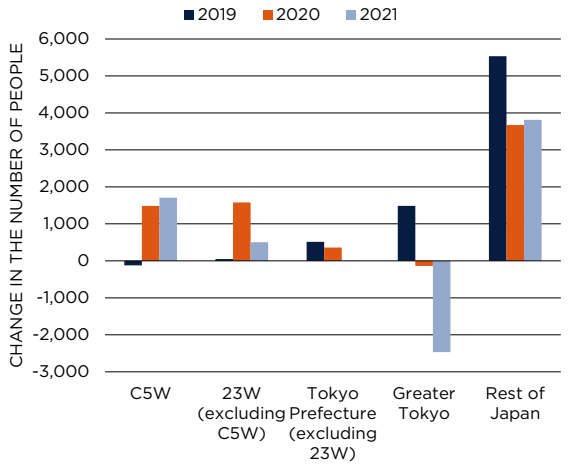
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data
* Q4/2022 is as of November 2022.

GRAPH 5: Rents by Unit Size, C5W, Q1/2014 to Q4/2022



Source Savills Research & Consultancy

GRAPH 6: Domestic Net-migration into the Inner East Submarket, 2019 to 2021



Source Ministry of Internal Affairs and Communications, Savills Research & Consultancy

OCCUPANCY RATES

Occupancy rates in the Tokyo 23W improved slightly again this quarter to 96.6%, increasing 0.1ppts QoQ. Overall, occupancy levels are high, although they are still slightly lower than the high levels observed before the pandemic. Nonetheless, they have been gradually improving since the pandemic has progressed to an endemic state. Specifically, occupancy rates in Tokyo 23W are 0.5ppts higher than the same period in 2021, and 0.8ppts higher than in 2020.

Occupancy rates in the C5W observed a similar trend, increasing 0.2ppts over the quarter to 96.2%. Likewise, they have also improved over the past two years, and are 0.6ppts and 1.8ppts higher than the same period in 2021 and 2020, respectively. Meanwhile, occupancy rates in the South saw a slight downtick over the quarter, while the North and West saw a slight uptick. The East also saw a slight downtick, after the large increment in the previous quarter.

Going forward, occupancy rates should remain stable as the population of the 23W should continue to grow on the back of some foreign nationals moving to Japan. Indeed, the high occupancy rates of J-REIT properties and quick absorption of new units on the market suggest that there is greater demand for quality units in the 23W. Nonetheless, remote work policies will likely remain in place, and this will have an effect on residential choices as some might feel less need to move to more central locations, especially with the inflationary environment present. Overall, while the market should improve steadily, it may not reach the recent peak observed in 2020 soon.

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.

Smaller size bands in the C5W experienced some contraction in Q4/2022. Rents in the 15-30 sq m size band, which comprises the majority of rental units in the C5W market, fell moderately this quarter, decreasing by 1.2% QoQ. Rents declined more in the larger 30-45 sq m size band, by 2.9% QoQ. Meanwhile, the largest 45-60 sq m size band moved in the opposite direction, seeing an increase of 1.7% QoQ. Overall, this relative scarcity of units in this larger size band has allowed it to maintain a premium over smaller counterparts as remote work remains prevalent.

The C5W has attracted the largest level of migration into the submarket among the 23W submarkets over the fourth quarter. The influx of foreign nationals has driven this population increment in all wards across the C5W, and Shinjuku and Minato have been the most popular wards for movers. High income earning professionals should continue to drive demand for larger units going forward, which will continue to perform well due to relative scarcity. That said, inflation is still a pertinent issue for average households, and many might still be hesitant to move to the central wards, instead seeking more affordable alternatives in nearby submarkets.

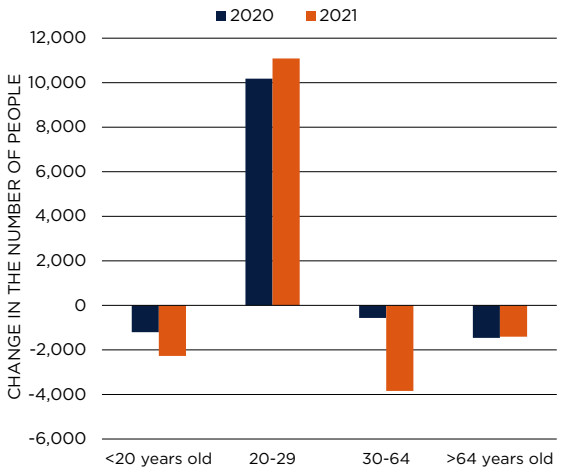
INNER EAST SUBMARKET

The Inner East submarket offers various cultural and entertainment options, as well as being a popular residential district. In pre-pandemic times, the Inner East submarket typically attracted movers from nearby prefectures as well as from within Tokyo. The submarket offers convenient access to the C5W through several JR and metro lines, and is often considered a more affordable alternative to living in Chuo or Chiyoda, and is therefore especially popular among young professionals. Indeed, as Graph 6 demonstrates, the Inner East submarket experienced an uptick in migration from the C5W from 2020, with some former residents of the C5W likely looking to move out due to more prolific remote work.

The allure of the Inner East has endured among renters throughout the pandemic, and its constituent wards, Koto, Sumida, and Taito have seen their total populations grow by 5,900, 4,900, and 5,500 people, respectively since the peak population of the 23W in May 2020, according to data from the Ministry of Internal Affairs and Communications. Overall, the population of the Inner East submarket increased by 1.6% between May 2020 and November 2022, which was the largest relative and absolute increment among the constituent submarkets of the 23W. In fact, the Inner East was the only submarket in the 23W that experienced positive net-migration consistently throughout the pandemic, which demonstrates the robustness of leasing demand in the submarket.

Although the Inner East continued to attract new residents over the course of the pandemic, we observed a notable demographic shift from 2020. Much like the South submarket (please refer to our Residential Briefing Q2/2022), the Inner East wards appear to be losing their appeal among young families, and there has been a notable outflux of residents in the 0-to-9-year-old, 30-to-39-year-old, and 40-to-49-year-old age brackets since 2022. Indeed, many in these age brackets have migrated away from the Inner East to outlying prefectures that retain convenient transport links to the C5W, such as Chiba, Saitama, and Kanagawa, probably in search of larger units that can facilitate hybrid work at cheaper rental levels, as well as greater outdoor space suitable for raising children.

GRAPH 7: Inner East Wards Net Migration of Different Age Groups, 2020 to 2021



Source Ministry of Internal Affairs and Communications, Savills Research & Consultancy
* These population changes do not include natural attrition (new births and deaths).

However, this outflow has been more than offset by an outsized increment in the 20-to-29-year-old age bracket. Indeed, the appeal of the Inner East submarket endures among younger single people who require less space than those in other age brackets, particularly due to its proximity to the C5W and the availability of units below the Tokyo 23W average rental level. With young professionals composing a greater proportion of residents in the submarket, the number of single-person households has increased over the past few years.

With normalcy coming back, business confidence and hiring activity has received a boost and all of Tokyo's constituent submarkets are starting to see some population recovery. The Inner East submarket experienced the largest overall population growth throughout the year, and has also successfully been attracting foreign nationals into the submarket, with over 7,000 new entrants coming from overseas. With strict border measures on entry to Japan by foreign nationals having been lifted, Tokyo's international population is expected to continue to grow over the coming year, and the positive qualities of the Inner East submarket will likely be a major draw to new residents. As such, a growing non-Japanese population will likely further supplement the population growth in the submarket, which should help drive residential leasing demand over the coming years.

OUTLOOK

The Tokyo 23W residential market experienced a noteworthy shift in Q4/2022, and all constituent submarkets experienced some revision in asking rents. Many observers might be concerned by this sudden contraction across the 23W, but this is instead more likely an indication of positive sentiment and a sign that the Tokyo residential market is on track for further growth. Indeed, occupancy has experienced a consecutive quarterly improving, showing that the market has broad and sound demand.

This rapid fluctuation is grounded in a recent demographic trend, namely an influx in the non-Japanese population in Tokyo triggered by the easing of border restrictions. Most submarkets experienced a population decline throughout the pandemic as many residents sought larger or cheaper space outside the 23W, and foreign nationals were unable to enter Japan. However, the tides have changed as most submarkets saw their populations increase between September and November 2022, and the demand for premium units with above-average rents appears to have paradoxically put downward pressure on average "listed" asking rents. Hence, the residential market appears to have demonstrated sound demand this quarter.

In the short-term, the return of foreign nationals will likely lead to further moderate net population growth in the 23W, which should support sound rental demand. However, the 23W still faces competition from outer prefectures that can offer more affordable rents, especially as residents in Japan face heightened costs of living due to inflation. Furthermore, hybrid workstyles are common in Tokyo. Therefore, many residents may remain reluctant to move to the 23W for the meantime. That said, the C5W may perform well in spite of the inflationary pressure, given the typically high-income status of residents in these submarkets who will be less affected.

Overall, economic conditions, wage growth, and demographic changes will primarily dictate the pace of the recovery of the 23W residential market going forward. Indeed, the Japanese economy looks to fare better in 2023 due to its belated opening. Meanwhile, although more companies are expecting greater office attendance, many hybrid work policies are in place, which might slow the recovery of demand in the 23W somewhat. Going forward, with the decreasing number of available units in the market, accompanied with the increasing population and consequently, leasing demand, rental levels are expected to pick up again soon.