MARKET IN MINUTES
Savills Research

Residential Leasing

Steady and consistent rental growth

Tokyo market sees growth overall, with rents and net migration maintaining a steady upward trajectory

- Average rents in the Tokyo 23 wards (23W) witnessed a moderate uptick, increasing by 0.8% quarter-on-quarter (QoQ) and 3.5% year-on-year (YoY) to JPY4,071 per sq m.
- Rents in the central five wards (C5W) also experienced notable growth, increasing 0.7% QoQ and 4.0% YoY to JPY4,920 per sq m.
- The C5W rental premium over the 23W average is 20.1% and is likely to continue steadily increasing.
- Shibuya saw the most significant quarterly increase of 3.6% QoQ, whereas Minato witnessed the largest correction of 1.7% QoQ. Overall, the market appears to be on a steady upward trend over a longer-term timeframe.
- The average rental gap between the largest 45-60 sq m size band in the C5W continues to widen compared to its smaller 15-45 sq m counterparts.
- Average occupancy rates in the 23W increased by 0.3 percentage points (ppts) QoQ to 97.1%, while the C5W increased 0.6ppts QoQ to 97.0%.
- In Greater Tokyo, record-high condominium prices sit against a backdrop of a shrinking supply, a situation that will likely expedite a shift towards the leasing market among those who are priced out.

"In the 23W, average rents rose steadily on both a quarterly and annual basis, with 2023 concluding as a year of stable and strong growth. Net migration over the quarter, led by the sustained influx of foreign nationals, exceeded pre-pandemic levels. The allure of the C5W continues to strengthen, with the rental premium rising. That said, divergent wage growth hints at submarket-level bifurcation."

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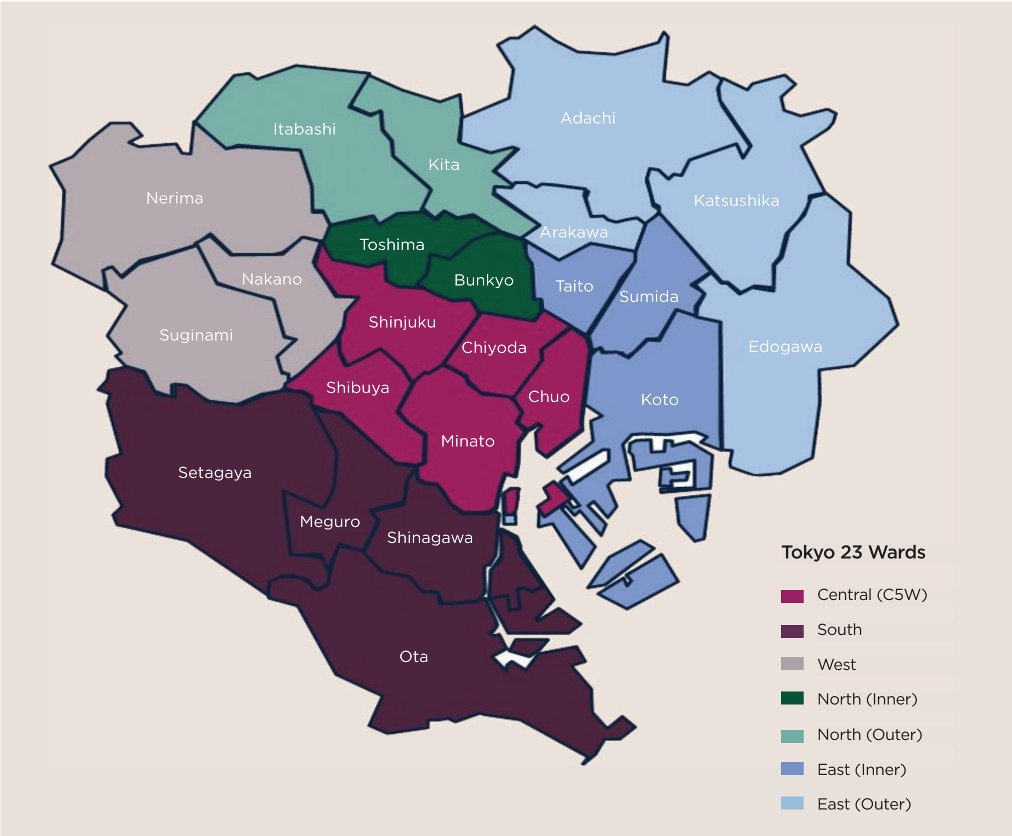
MAP 1: Tokyo's 23 Wards by Survey Area



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

Average rents in the Tokyo 23W experienced moderate growth overall in Q4/2023, amounting to a steady rebound from a modest trough in Q4/2022, with a majority of wards seeing rental increments, particularly on an annual basis. The overall market sentiment continues to improve as a growing number of people are returning to Tokyo, fuelled partly by a greater rate of in-person office attendance generally mandated by companies in the post-pandemic era.

Net migration into the 23W throughout September and November 2023 surpassed 21,000 people, which is around 45% higher than the level of migration over the same period in 2019 before the pandemic. The foreign population increased by about 20,000 people, which is more than double the figure recorded during the same period in 2019. On the other hand, the net migration of Japanese nationals remains lacklustre following the peak spring moving season, with an increase of only 1,000 people recorded, around one-fifth of 2019 figures. While net migration has recovered, its constitution appears to be considerably different than in pre-pandemic times.

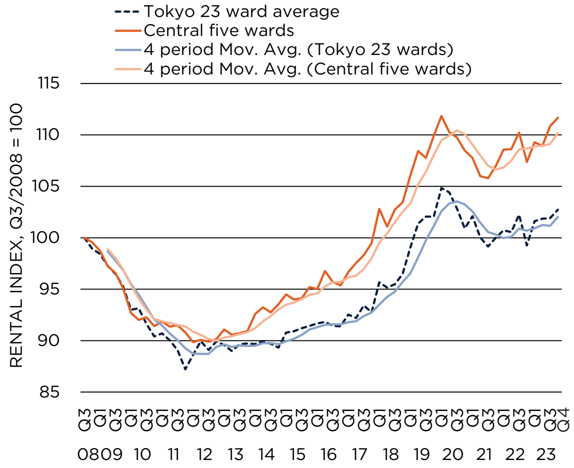
The C5W rental premium over the 23W average stands at 20.1%, hitting a historical peak, and appears to be on an upward trajectory. High-income professionals who have benefitted from recent wage growth and the tight labour market will be increasingly drawn to live closer to their workplaces in central areas. The C5W has upheld its reputation as a premier location to live, with the recent opening of the large-scale Azabudai Hills development, which houses Aman Residences Tokyo, further transforming the urban landscape of central Tokyo and enhancing its competitiveness with other global cities.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average mid-market rents in the 23W surpassed pre-pandemic levels, witnessing a moderate increment of 0.8% QoQ and 3.5% YoY to JPY4,071 per sq m in Q4/2023. A closer look at the figures reveals that annual increments appear slightly inflated due to the trough experienced in Q4/2022 that was rooted in significant uptakes of brand new units with above-average rents. Indeed, when compared to Q4/2021, the overall compounded annual growth rate was a steady 1.2%, which is a sign of a stable upward trend in mid-market rents. In addition, all constituent submarkets of the 23W experienced population growth between September and November, predominantly driven by the influx of foreign nationals. These positive migration trends have supported firm residential demand in the market.

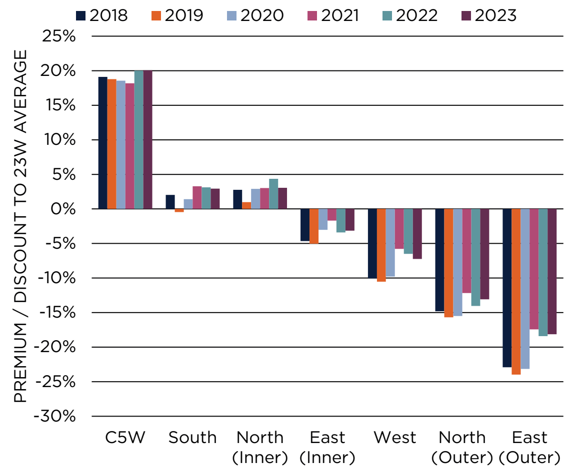
Average rents in the C5W increased notably, rising by 0.7% QoQ and 4.0% YoY to JPY4,920 per sq m, with the large annual increment stemming largely from the Q4/2022 trough. Looking at the ward level, most wards in the C5W experienced moderate rental increments over the quarter. However, Minato saw the largest quarterly contraction, decreasing by 1.7% QoQ from the highs observed in the previous quarter that arose due to the addition of expensive newly-built units to the market. Despite the contraction in rents over the quarter, annual growth stood at 5.2% in Minato, which was the largest among the constituent wards of

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2023



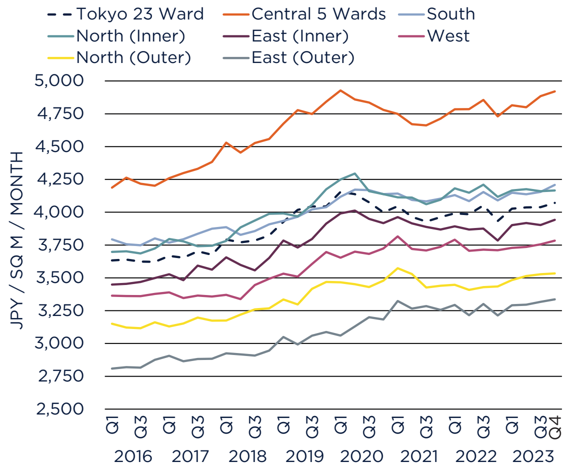
Source Savills Research & Consultancy

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2018 to 2023



Source Savills Research & Consultancy
*The above represents the average premium/discount over the respective year.

GRAPH 3: Mid-market Apartment Rents, Q1/2016 to Q4/2023



Source Savills Research & Consultancy

the C5W, and reinforces the submarket's reputation as a prime residential hub within Tokyo. New developments such as Azabudai Hills add further momentum to the ward. Furthermore, greater levels of office attendance should continue to enhance the C5W's position as a residential area, appealing particularly to young professionals who have benefitted from recent strong wage growth and who prefer to live closer to their workplaces in central business districts.

The South submarket experienced a moderate increment in rents in Q4/2023, climbing by 1.3% QoQ and 2.9% YoY to JPY4,208. At the ward level, Shinagawa saw the largest uptick, increasing by 2.3% QoQ and 3.6% YoY, although average rents remain slightly below the pre-pandemic peak level. Elsewhere, Setagaya and Meguro experienced slight quarterly and yearly rental growth. On the other hand, Ota witnessed a slight contraction of 0.3% QoQ but rose by 2.9% YoY. Net migration reached levels on par with those before the pandemic over the quarter, providing a base for growth in the submarket. In particular, Shinagawa has performed well in this aspect, enjoying the largest inflow of people relative to its total population, with around 1,000 people moving to the ward over the quarter. Indeed, residential properties located in close proximity to office hubs like Shinagawa are likely to experience increasing popularity in the post-pandemic era.

The Inner North submarket has seen a slight uptick in rents, increasing by 0.1% QoQ and 1.2% YoY to JPY4,166 per sq m. Bunkyo saw a modest uptick of 0.5% QoQ while rents in Toshima decreased slightly by 0.2% QoQ, and experienced annual rental growth of 0.5% and 1.8%, respectively. Net migration trends in the submarket remain encouraging, with an increment of over 3,000 people over the quarter, nearly doubling that of the same period in 2019. Toshima, well regarded for its bustling shopping and entertainment district in Ikebukuro, continues to draw people to the ward, especially foreign nationals. Bunkyo, on the other hand, is known as an education hub, also featuring many residential neighbourhoods with plentiful green space. Both wards should continue to attract residents moving forward given its family-friendly atmosphere and its proximity to central Tokyo.

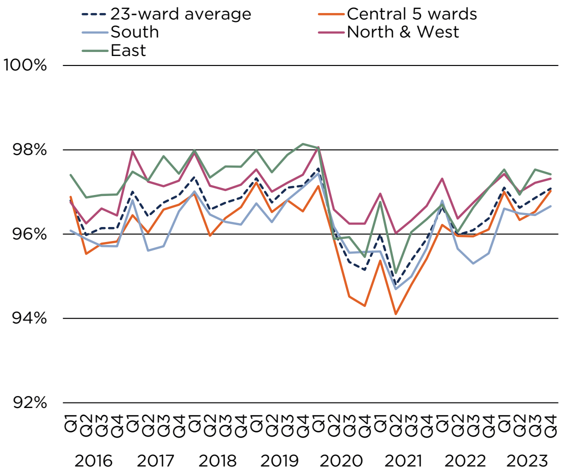
The Inner East submarket has witnessed prominent rental increments, increasing by 1.0% QoQ and 4.2% YoY, and reaching JPY3,942 per sq m. Rental growth was evenly spread out between the wards, with Taito growing the least, by 0.5% QoQ and Sumida growing the most, by 1.6% QoQ. Like the broader market, annual growth was high because of the trough in Q4/2022, but the submarket has had a compound annual growth rate of 0.9% from Q4/2021, showing its overall stable growth. The submarket was arguably the most popular destination to move to during the pandemic, likely due to the balance it provides between affordability and proximity to central wards, which was especially appealing to young, single professionals. This appeal has not wavered in the post-pandemic era, and the submarket still exhibits net migration trends that affirm its strength as a residential market.

Average rents in the West submarket increased moderately by 0.8% QoQ and 2.0% YoY, reaching JPY3,784 per sq m. Rental trends varied at the ward level, with Suginami and Nerima remaining largely flat on both a quarterly and an annual basis. Meanwhile, Nakano contributed the lion's share of growth, increasing by 2.0% QoQ and 5.9% YoY. However, it should be noted that this can largely be attributed to the trough being particularly deep in Nakano in Q4/2022, and rents in the ward have generally followed a stable growth trajectory throughout the pandemic, at around 0.6% annually for the last two years. Positive net migration continues, and the West submarket welcomed over 3,000 people throughout the quarter, over 30% higher than the same period in 2019. Nakano has a number of mixed-use redevelopment plans in the pipeline close to JR Nakano Station, including the redevelopment of Nakano Sun Plaza, which look to improve liveability in the ward. The convenient access to central wards, especially to Shinjuku via the Chuo line, should ensure that the West submarket remains a popular area to live in.

The Outer North submarket has witnessed a modest increase in rents, rising by 0.2% QoQ and 2.9% YoY to JPY3,534 per sq m. Average rents in Kita saw a slight increase of 0.6% QoQ, while those of Itabashi declined by 0.3% QoQ. On an annual basis, both wards experienced an increase in rents, by 2.8% and 2.9%, respectively. Net migration increased by 2,800 people between September and November 2023, doubling the figures seen over the same period in 2019. Indeed, the Outer North submarket is considerably more affordable than the more central wards and also has large amounts of public green space along the Arakawa River, with reasonable access to central areas, which should support its status as an affordable submarket to live.

The Outer East submarket saw a modest uptick in average rents, increasing by 0.6% QoQ and 3.8% YoY, reaching JPY3,336

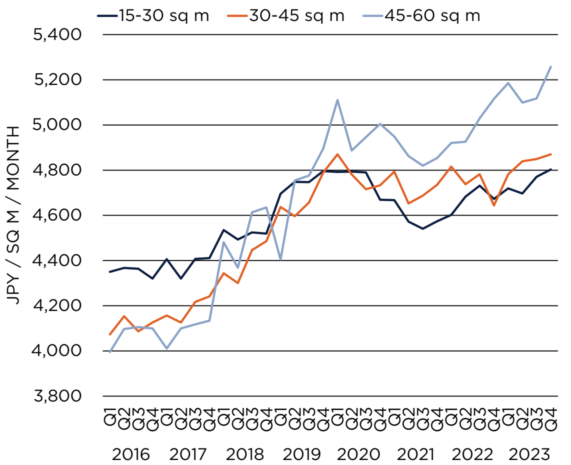
GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q4/2023*



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data

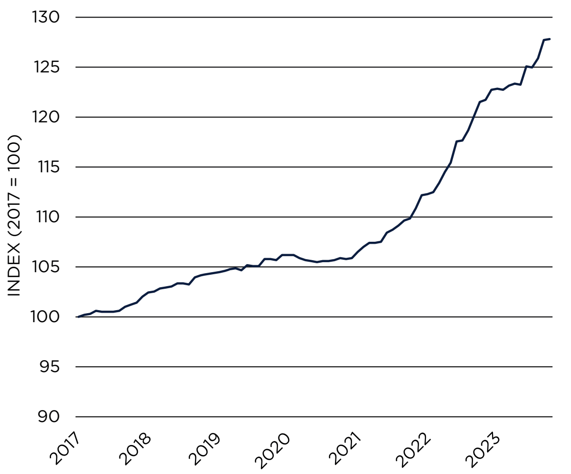
* Q4/2023 is as of November 2023.

GRAPH 5: Rents by Unit Size, C5W, Q1/2016 to Q4/2023



Source Savills Research & Consultancy

GRAPH 6: Construction Costs for Iron Reinforced Concrete Condominiums, 2017 to October 2023



Source Construction Research Institute, Savills Research & Consultancy

per sq m. On a quarterly basis, Adachi saw the largest increment of 1.7% QoQ, while Edogawa declined by 0.9%. Arakawa experienced the largest annual growth, increasing by 6.0% YoY. Similar to the Outer North submarket, net migration into the Outer East submarket is encouraging, with a net inflow of almost 5,000 people over the quarter – about 70% higher than the same period in 2019. With hybrid work arrangements here to stay in the post-pandemic era, peripheral wards appear to remain popular for the meantime.

OCCUPANCY RATES

Occupancy rates in the Tokyo 23W have risen 0.2ppts QoQ to 97.1% in Q4/2023, also increasing by 0.7ppts on an annual basis. Occupancy in the C5W has also improved, increasing by 0.5ppts QoQ and 0.9ppts YoY to 97.0%. Overall, occupancy rates appear to have generally recovered close to pre-pandemic levels, which is an encouraging sign for the market, especially for the C5W, where occupancy rates in Q4/2023 are comfortably above pre-pandemic levels. With office attendance rates having recovered noticeably in 2023, central wards are being increasingly viewed as an ideal choice for those that can afford it, especially in the case of highly skilled, young professionals, which will likely support sustained higher occupancy levels in such areas.

Going forward, the population of the 23W should continue growing and support firm residential demand in the post-pandemic environment. While central wards are expected to remain popular, residences in more affordable peripheral wards will also likely retain some popularity among renters, particularly those who are affected by inflation and lacklustre wage growth. In addition, hybrid work arrangements look to remain commonplace as a corporate perk, especially among large companies, which will likely support this trend. As such, while central wards are expected to retain much of the spotlight in the post-pandemic era, peripheral submarkets should still shine.

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 Western 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 Q4/2023, average rents across all size bands in the C5W have increased, but the gap between the largest and smaller size bands continues to widen. The largest 45-60 sq m size band, saw the most significant uptick, growing by 2.7% QoQ, hovering above the pre-pandemic peak. Meanwhile, rents in the smallest 15-30 sq m size band, and the medium 30-45 sq m size band, increased by 0.7% QoQ and 0.4% QoQ, respectively, and have recovered to their respective pre-pandemic levels. The strong performance of units in the C5W is two-pronged, stemming from the broad return to office participation by workers in the post-pandemic environment, and the limited stock of larger units in the submarket. Indeed, larger units that can accommodate home offices have thus remained popular. Nonetheless, this gap should narrow somewhat as we progress deeper into post-pandemic territory, and single-occupier units that appeal to young professionals working in the city should do well moving forward.

GREATER TOKYO FOR-SALE CONDOMINIUM MARKET

While the residential rental market has proven its stability, it admittedly did see slight corrections during the pandemic. On the other hand, for-sale condominiums have been unwavering in their price increments. According to the Real Estate Economic Institute (REEI), in 1H/2023, the average price new condominiums in Greater Tokyo reached a new record price of JPY88.7 million. While a number of luxury condominiums that were sold in the 23W skewed this figure by a considerable margin, the overall rhetoric of rising prices remains firm – prices in Greater Tokyo have grown 3.3% annually between 2012 and 2022. Despite the increasing prices, the overall market size[1] of for-sale condominiums in Greater Tokyo appears to have decreased during pandemic years (2020 to 2022) compared to pre-pandemic years (2017 to 2019), with average annual sales volumes between the pandemic years around 10% lower than those in the pre-pandemic years, showing that the higher prices were not sufficient to offset the decline in volume.

That said, the trends between respective markets have not been uniform. Firstly, the Tokyo 23W has seen the largest increase in average prices of 13% from pre-pandemic years to pandemic years, but also the largest decline in supply of 23%, resulting in a 14% decline in market size. Meanwhile, Tokyo ex-23W and Kanagawa saw similar trends, with both markets seeing almost no changes in condominium pricing, but with supply decreasing by 17% and 10%, respectively, hence leading to market size contracting by 16% and 11%. In these two markets, average

1 Yearly market size is defined as the supply of new condominiums multiplied by the average price of a new condominium for each year.

prices are thought to be approaching the upper limit of what prospective buyers are able to afford, leading to some postponing or forgoing purchases.

On the other hand, Saitama and Chiba have displayed trends somewhat different to their peers. Between pre-pandemic years and pandemic years, Saitama's supply of condominium units only saw a slight dip of 2%, while Chiba's supply increased by 10%. Prices of Saitama and Chiba grew by 11% and 4%, leading to the market sizes growing by 9% and 15%, respectively. Condominiums in Saitama and Chiba are the least expensive within Greater Tokyo, and this comparative affordability, on top of more prevalent remote work options, may have pushed some buyers to seek alternatives in these prefectures. Indeed, Saitama and Chiba have seen some higher-end developments pop up in the area, perhaps fuelled by this sentiment in the market.

Overall, the rising prices and decline in supply of condominiums in the 23W, and the extended shrinking market in the more suburban areas of Tokyo ex-23W and Kanagawa, will significantly raise the entry bar for people looking to buy condominiums in these locations, and many will likely resort to the rental market. Furthermore, there are multiple headwinds against the condominium market that are expected to keep prices elevated. On top of new labour regulations that will limit working hours in the construction industry, construction costs have seen significant increments in the past years, and land suitable for for-sale condominium developments has become more difficult and expensive to procure, which is not only likely to lower supply, but also compel developers to raise selling prices in order to maintain their profit margins. Additionally, the ultra-low mortgage rates that helped to fuel the market will likely see modest increments as the Bank of Japan further normalises monetary policy, hence impeding purchasing power somewhat. The for-sale market is likely to decrease in size at least in the short-term, meaning that there should be increased demand for the rental residential market.

OUTLOOK

The residential market in the 23W is steadily continuing an upward trajectory, and the sentiment in the market appears to be positive overall. Indeed, net migration continues to surpass pre-pandemic levels, driven largely by the sustained inflow of foreign nationals, which should support consistent recovery in terms of occupancy rates, which are gradually approaching pre-pandemic levels. Overall, the Tokyo 23W residential market should continue to gain momentum moving forward.

The C5W rental premium over the 23W continues to widen, indicating a growing demand for residential properties in the central areas of Tokyo, especially among high-income professionals who have benefited from the tight labour market. With the completion of the Azabudai Hills development, as well as further ongoing upscale developments, the central wards will likely continue to be popular. Elsewhere, peripheral submarkets, including the Outer North and Outer East have also remained popular given their relative affordability, especially among those affected by inflation and lukewarm wage growth, in addition to those seeking remote work options. The population of 23W is expected to continue increasing moving forward, particularly with the coming spring moving season, which should further strengthen demand in Tokyo 23W residential market.

Corporate profits have been thriving, albeit contrasting with lukewarm personal consumption. Employees at larger companies will likely anticipate another round of strong wage growth next spring, but the broader population situation faces uncertainty. As acceptance of rising prices becomes commonplace, strong rental growth may persist, especially if nominal growth materialises as expected in the equity capital market. That said, the likely persistent wage gap divergence suggests a further continuation of submarket bifurcation.