Tokyo – Q1/2021

MARKET IN MINUTES

Savills Research

Residential Leasing

savills

A mixed picture emerges

While subtle movement away from central areas has continued, some reversal of this trend has also been observed.

- Rents in the Tokyo 23 wards (23W) now stand at JPY4,046 per sq m, showing a quarterly recovery with an increase of 1.2% quarter-on-quarter (QoQ), despite seeing an annual decrease of 2.6% year-on-year (YoY).
- Average mid-market rents in the central five wards (C5W) have declined for the fourth consecutive quarter, and are currently at JPY4,749 per sq m, showing a decline of 3.6% YoY, amid a smaller quarterly decline of 0.6%.
- In line with its decreasing average rents, the C5W premium has narrowed to 17.4%, whereas the West and Outer East submarkets posted notable growth.
- At the ward level, Adachi in the Outer East, marked the strongest growth this quarter, posting a 7.2% QoQ gain. On an annual basis, Arakawa displayed the largest gain of 10.5% YoY.
- In the C5W, average rents for units in the 15-30 sq m size band – which represent the majority of listings – have remained flat, while larger units saw some small corrections.
- The average occupancy rate in the 23W has increased 0.2ppts to 96.1%. The C5W has begun to see recovery in occupancy rates, up 0.9ppts to 95.1% this quarter.
- Mixed trends have appeared in the market: while there has been subtle movement away from central areas, some evidence also points to a reversal of this trend, especially in quality assets.

"Average rents have improved over the quarter, although they have still seen an annual decline. Remote work is expected to continue into the upcoming fiscal year, and yet occupancy rates in the 23W have seen notable improvement from the last quarter. We expect a clearer view of the market direction once the dust settles after the moving season in spring."

SAVILLS RESEARCH & CONSULTANCY

Savills team

Please contact us for further information

JAPAN

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

RESEARCH

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

Yoshihiro Kanno
Manager, Research & Consultancy, Japan
+81 3 6777 5275
ykanno@savills.co.jp

Simon Smith
Regional Head of Research & Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East. This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.

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 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 dipping for three consecutive quarters in 2020, rents started to slowly flatten in the C5W, and have even inched upward in the 23W. That said, rents in both markets have still contracted YoY from their peak levels in Q1/2020. However, some level of growth appears to have materialised in certain submarkets, with some experiencing both impressive annual and quarterly growth.

Spring is a popular time for relocation in Japan, and a significant number of new-unit listings have emerged across multiple wards, contributing to rental growth in some wards, but at the same time possibly reflecting weaker demand. In addition, with the new fiscal year beginning in April 2021, many companies expect to have new employees in the office, and universities are expected to welcome students back on campus, which should somewhat support the declining demand for single bedroom and smaller units. With COVID-19 vaccinations starting to take place in Japan, albeit very slowly, the pandemic appears to have begun its long and probably bumpy journey to a close. This may overall provide some stability to the market as individuals will better be able to decide on their housing needs.

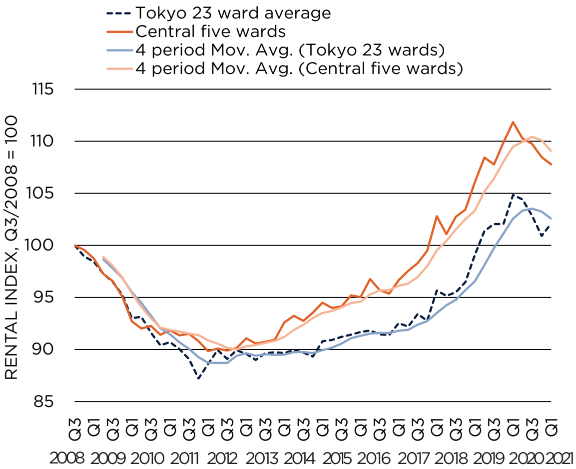
The C5W's premium over the 23W has shrunk 1.1ppts to 17.4%. Indeed, while rents in the C5W have somewhat decreased, rents in other regions, particularly in the Outer East and West, have seen notable growth. This has narrowed the spread in average rents. Average rents in the C5W have seen a decline over the year, which is likely linked to the impact derived from the pandemic and the decline of the foreign population. It is still too early to extrapolate this trend of decreasing rents in the C5W, and the results seen in the next quarter, which encompasses part of the peak season of residential movement, will be a good indicator of the market direction.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average multifamily asking rents for the 23W have rebounded upwards by 1.2% QoQ, and now stand at JPY4,046 per sq m. While rents have decreased 2.6% YoY, the contraction is from the all-time high levels of Q1/2020. In fact, current rents are actually 3.0% higher than Q1/2019. Across the market, rents have generally either stayed flattish or have seen increases over the quarter. However, annual changes would appear to indicate a generic trend of traditionally more expensive submarkets becoming slightly more affordable, and less expensive submarkets showing an increase in rents. Notable increases were observed in the most affordable Outer East submarket and well-balanced West submarket.

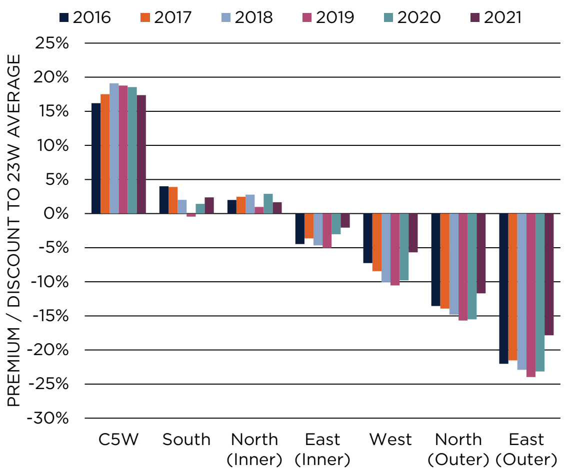
Across the quarter, rents in the C5W have only seen a small decrease. However, it was also the only submarket where every constituent showed an annual decrease in rents, with an overall decrease of 3.6% YoY. All annual contractions were greater than 3%, with the exception of Shinjuku, the most affordable member, that contracted by just 0.6%. The overall change in average rent from the highs seen before the COVID-19 pandemic likely reflects some shifts of tenant preference, suggesting that the premium of living in the C5W is not as valuable as it used to be. This sentiment is further reflected in the increase of listings, which are markedly higher than Q1/2020, thus indicating that the C5W has decreased in popularity compared to pre-COVID times. However, when the dust

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q1/2021



Source Savills Research & Consultancy

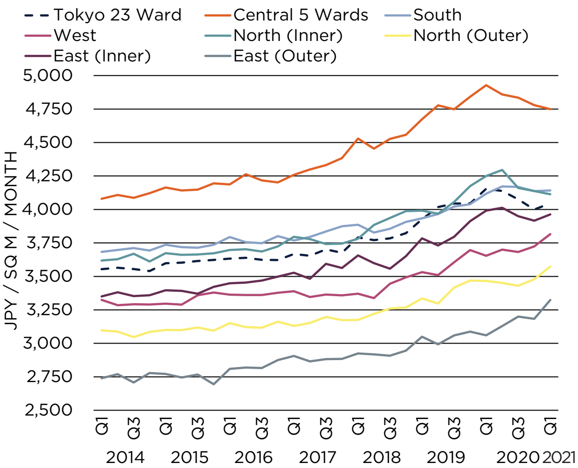
GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2016 to Q1/2021



Source Savills Research & Consultancy

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

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



Source Savills Research & Consultancy

settles, some reversal of this trend is likely to be observed based on the recent sound results of condo unit sales.

Rents in the South submarket have seen a slight increase of 0.6% YoY, marginally higher levels seen in Q1/2020. However, growth within the submarket was split unevenly. For instance, Ota saw a 2.8% increase in YoY rent growth. Meguro, although decreasing slightly from the last quarter, has seen an increase of 3.5% YoY. On the other hand, Shinagawa's rent levels have seen a fourth consecutive quarterly decrease in rents, resulting in a 3.1% decrease YoY. Shinagawa is dubbed as the central sixth ward, and it is possible that prevalent work-from-home conditions have led it to lose its premium, as shown in the C5W.

In the Inner North submarket, rents have seen a mild decline of 0.6% QoQ, albeit for the third consecutive quarter. Rents have consequently seen a decrease of 3.2% YoY, the largest decrease within a submarket next to the C5W. At the ward level, Toshima saw the larger annual drop in rents, decreasing by 4.5% YoY from its all-time high level in Q1/2020. Toshima ward is home to the Ikebukuro area, a major commercial hub. Toshima may therefore also have lost some of its competitive edge as an area close to the city centre, which is also demonstrated in the noteworthy increase in the number of listings of the ward.

Although rents in the Inner East have seen a slight decline of 0.7% YoY, the submarket has made a comeback, increasing from the previous quarter by 1.2% QoQ. Closely inspecting each ward, Sumida is the only ward to have seen an annual decline in average rents. Although it had the largest QoQ growth of 3.2%, this positive performance can be attributed to a large number of new-unit listings this quarter, suggesting that the average rent may once again decline after these units are occupied. Elsewhere, Koto and Taito do not appear to have been impacted significantly by the pandemic, and both wards have seen mild annual and quarterly increases.

The West submarket, known as a well-balanced area with convenient access to central areas and many recreational spots, has continued its ascent, seeing impressive growth this quarter increasing 2.5% QoQ and 4.4% YoY. At the ward level, Suginami and Nerima have grown 2.6% and 2.9% YoY respectively, and the former is also the only ward in the submarket to have grown consecutively for four quarters. However, the growth of the submarket has been carried by Nakano, which saw an increase of 7.7% YoY in rent. Average rents in the ward have crossed the JPY4,000 per sq m barrier for the first time, with a large number of new-unit listings in the ward contributing to its robust performance, and although average rents may therefore see some level of decline the next quarter, the submarket is still going strong.

The Outer North has exhibited an increase in rents of 2.7% QoQ. Much of this growth comes from Kita, which has grown 4.6% QoQ. As with other wards such as Nakano and Sumida, much of this quarterly growth has come from an increase in new-unit listings, and the coming quarter may see some corrections in average rent. Nonetheless, rent levels in Kita are at an all-time high, surpassing its previous record set in Q1/2020. Elsewhere, rents in Itabashi have decreased slightly, yet maintain YoY growth of 5.6%.

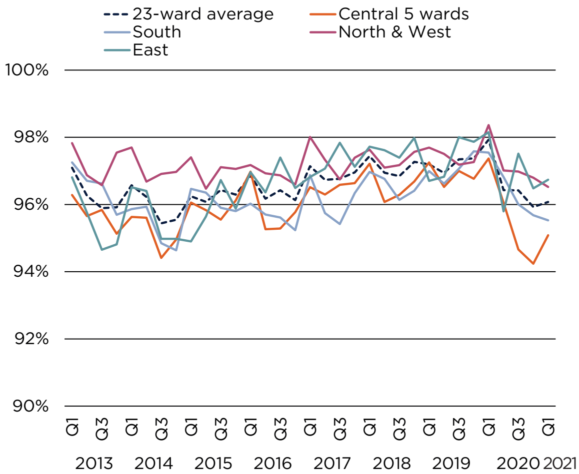
The Outer East is still the least expensive submarket within the 23W, although increases over the past year have seen its average rents catch up with the 23W average. Rents have increased 8.6% YoY, with all wards in the submarket showing notable increases. Following its decline in the previous quarter due to many below-average new-unit listings, Edogawa saw a slight increase of 0.4% QoQ as many of these listings were taken up. Arakawa saw an increase of 5.6% QoQ following a large number of new-unit listings posted this quarter. Nevertheless, the submarket has overall seen increases in rent, possibly as a result of renters moving away from the more expensive city centre to areas where they will be able to afford larger apartments to accommodate increased amounts of remote work. However, as the entire Outer East submarket saw an increase in the number of listings on par with the 23W increase, it might be somewhat premature to extrapolate this trend of increasing rents.

OCCUPANCY RATES

After decreasing throughout 2020 during the pandemic, average occupancy rates in the 23W have seen a slight uptick of 0.2ppts to 96.1%. This is a positive development that comes as the pandemic situation in Japan begins to calm down, and occupancy rates can be expected to see some gradual increase in the upcoming quarter, especially with the peak moving season. Tokyo's most expensive submarket, the C5W, saw the largest increase this quarter rising 0.9ppts QoQ to 95.1%. While occupancy in the C5W is still notably lower than its 2019 levels as well as the 23W average, the recovery is welcome.

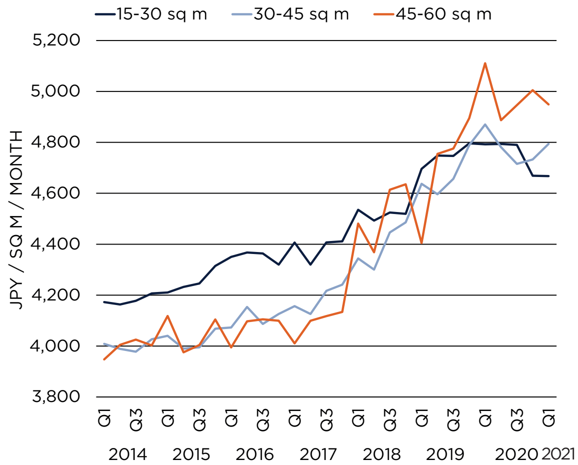
In the rest of the 23W, occupancy rates are generally hovering around levels seen in Q4/2020. Inspecting the data more closely, it can be seen that occupancy rates can vary appreciably even within the same submarket. Amongst these J-REIT residential assets, the occupancy rates for both single bedroom

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2013 to Q1/2021*



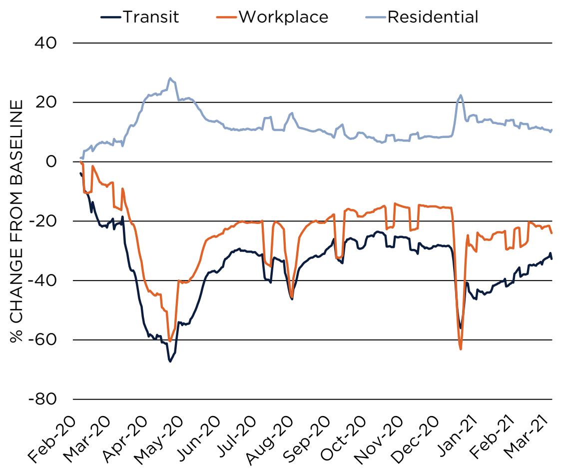
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
*Q1/2021 is as of February 2021

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



Source Savills Research & Consultancy

GRAPH 6: Google Mobility - Time Spent in Transit, Workplace and Residence, February 2020 to March 2021



Source Google LLC "Google COVID-19 Community Mobility Reports", Savills Research & Consultancy

units as well as larger family-sized units have both improved overall from the last quarter. This could suggest that quality assets are generally in higher demand and on the road to recovery.

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.

The 15-30 sq m size band still accounts for the vast portion of available units in the C5W. Although average rents slipped downward in the past quarter, they have seen a slight increase this quarter, growing 0.1% QoQ. However, rent levels for the band are still lower than levels seen in 2019 and 2020. As in the previous quarter, the overall lowered average asking rent seems to have arisen from a significant increase in the number of listings in the submarket, presumably arising from numerous single residents that chose to move to less expensive areas or back to their family homes as remote work and studying became more prevalent. However, a slow reversal of this trend is presently being observed, and may hasten in the upcoming quarter with the new fiscal year as companies make arrangements for new employees to begin work in the office and universities begin to reopen, consequentially supporting demand for single units.

The 30-45 sq m and 45-60 sq m size bands have also only seen small changes from the last quarter. Specifically, the 30-45 sq m size band saw an increase of 1.3% QoQ, and the 45-60 sq m size band saw a decrease of 1.1% QoQ. The pandemic seems to have accelerated the demand for larger units to accommodate remote work. However, as more companies transit back to work in the office, the spread between larger and smaller units may narrow further.

PROSPECTS OF THE RESIDENTIAL MARKET

One full year has elapsed since the onset of the COVID-19 pandemic, and some mixed trends, both old and new can be observed. For instance, looking at condominium sales, the average price per sq m of condominiums on sale in Tokyo 23W has increased 11.4% YoY according to the Real Estate Economic Institute. The rising prices of condominiums in the 23W has made purchasing unattainable, leaving many to choose to lease instead. The number of units on sale has decreased by 20.6% YoY, with the big drop partially due to the state of emergency that suspended all activity. Nonetheless, condominiums situated in central locations and close to train stations have remained popular targets for purchasing. Henceforth, the apartment leasing trend should somewhat follow suit, although the current market trend appears to see subtle movement away from central areas.

One major impetus for change in the upcoming quarter would be the start of the new fiscal year in April. Each spring, an average year would see a significant inflow of migrants into the capital, as new workers and students move into the capital. During the COVID-19 pandemic, many companies and educational institutes resorted to telework and online lectures. However, as the pandemic has somewhat calmed down, many new employees and students are expected to be welcomed back into the office and on campus. For instance, 60% of major universities in Tokyo plan to have mainly in-person lectures while only 10% of them intend to offer mainly online courses. Looking ahead, we therefore expect to see some net migration uptick, encouraging rental conditions particularly within the smaller units of 15-30 sq m normally occupied by young professionals and students.

Elsewhere, the residential market is also shifting in response to the emerging trends seen in the office sector. There has been rapid expansion in the number of satellite offices close to residential hubs, in accordance with to the promulgation of flexible work styles. Looking at data from Google Mobility, people in Japan are at home 10% more than they were before the pandemic. Therefore, there should still be some demand for larger apartments, realistically in suburban areas, that can better accommodate this overall lifestyle change. Furthermore, the slow pace of vaccinations taking place in Japan could mean that this trend will unlikely be short-lived.

To conclude, mixed trends have materialised in the market, with some movement away from central areas, and some concurrent reversal of this trend, albeit to a smaller extent. While this ongoing trend is likely to persist for a while, it may slow down when the pandemic situation calms down and there is less uncertainty in the market. The upcoming quarter transitioning into the new fiscal year will be a good indicator of shifts within the market.

OUTLOOK

Having declined three consecutive quarters since the start of the pandemic, average rents in the 23W have finally seen a turnaround in Q1/2021, although they are admittedly still lower than their peak levels in Q1/2020. The decline of COVID-19 cases and a lower positive rate, albeit somewhat inching up again, along with the vaccine rollout in Japan, have sparked enough optimism for companies and schools to open their office and campus doors wider. As more new employees and students make their way back into the city, this could in turn drive some demand for single bedroom and smaller units in the 23W. Furthermore, the occupancy rates in the 23W have also seen a pointed increase, particularly in the C5W, suggesting that some movement back to central areas might be on foot.

At the same time, however, the pandemic has also induced lifestyle changes in many, and people in general are spending more time at home than they were before the pandemic. This will consequentially lead to some people demanding larger apartments, which are considerably more affordable outside the 23W. These diverging trends have been realised in the market, and we will more likely have a clearer picture as to which is stronger in the upcoming quarter after the peak moving season in spring.

Despite some lingering uncertainty in the market, the situation is overall more likely improve for Tokyo going forward. In reality, there will be some who may choose to move out of the 23W. Nevertheless, Tokyo status as Japan's economic and educational centre will remain for the foreseeable future, and continue to attract budding youth in search of career and education opportunities. Even amidst its slight downturn in 2020 during the pandemic, the perceived resilience of the Tokyo residential market did not falter, and large institutional investors such as AXA Group and LaSalle Investment Management have already made large acquisitions of Tokyo residential properties between late 2020 and early 2021. With strong investor confidence backing it up, the Tokyo multifamily sector looks to be on stable ground.