MARKET IN MINUTES

Savills Research

Residential Leasing

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Rents recover strongly across the market

Rents in the 23W have increased in anticipation of the peak spring moving season in a post-pandemic era.

- Average rents in Tokyo's 23 wards (23W) recovered 2.4% QoQ and 0.9% YoY to JPY4,027 per sq m, reversing most of the temporary correction in the last quarter.
- Rents in the central five wards (C5W) moved in tandem with the broader market, increasing 1.8% QoQ and 0.7% YoY.
- The C5W premium is at 19.6%, and remains slightly higher than pre-pandemic times.
- Adachi experienced the largest quarterly increment of 4.6%, while Suginami saw the largest correction of 1.6%, although still remaining higher than Q3/2022 levels.
- The 45-60 sq m size band maintains a notable premium, although smaller units saw some recovery this quarter.
- The average occupancy rate in the 23W rose by 0.6ppts QoQ and 0.2ppts YoY to 97.1%, while the C5W increased 0.8ppts to 97.0%.
- Ultra-luxury rental residences should see greater attention given their growing popularity, especially amongst the relatively younger new rich, as well as the very limited stock of such units.

"Average rents in the 23W have rebounded close to Q3/2022 levels, and with society having moved to a post-pandemic state, market demand for units in the 23W is expected to keep increasing. Given the inflationary environment and robust wage growth particularly amongst young high income earners, central areas are likely to perform well, while the broader 23W remains stable."

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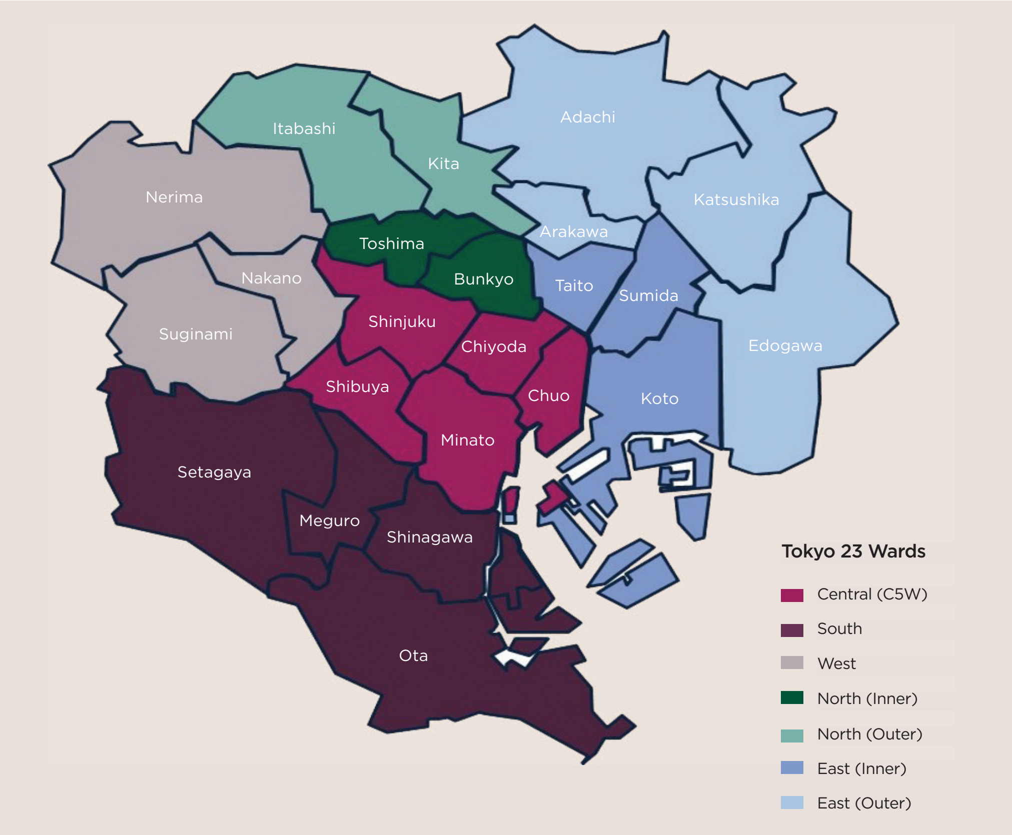
MAP 1: Tokyo's 23 Wards by Survey Area



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 Q1/2023, rents rebounded close to Q3/2022 levels in the Tokyo 23W, following a cyclical downtick in the previous quarter. Society has largely progressed to a post-pandemic era, with the government drastically easing guidelines on mask wearing, and also deciding to downgrade COIVD-19 to the same category as the seasonal flu. The move toward normalcy has likely contributed to a recovery in rents in both the 23W as a whole and the C5W.

The C5W premium over the rest of the 23W is at 19.6%. While this premium dipped slightly during the pandemic, it has recovered and gained further momentum. Young, highly-skilled professionals in the C5W have seen substantial wage growth, which should help to drive demand. At the same time, average rents in wards further away from central areas like the Outer North and Outer East also remain considerably above pre-pandemic times. Lingering effects from more prolific remote work might have contributed to this increase as some people that desire more space would likely turn to more affordable areas like such.

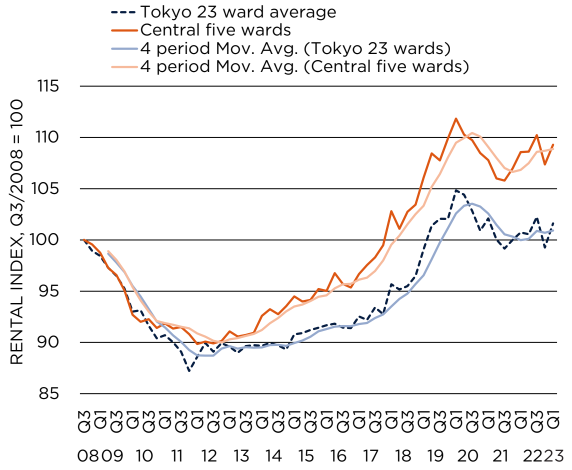
From December 2022 to February 2023, the population of Tokyo 23W saw a decline of around 7,000 people. However, most of this decline stemmed from natural attrition (more deaths than births), whereas internal migration into Tokyo 23W was still positive. Nonetheless, the current positive net-migration was primarily due to foreigners returning to Japan. Overall, the spring peak moving season is approaching and should look to introduce a sizable number of new Japanese residents to the market in the next quarter, which should be a good gauge of expected housing demand in the 23W going forward.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average rents in the 23W rebounded by 2.4% QoQ to JPY4,027 per sq m in Q1/2023, almost recovering to the Q3/2022 figure after the temporal revision in the previous quarter, which translates to an increment of 0.9% on an annual basis. While all wards in the 23W experienced some rental increments, this was most notable in affluent wards, particularly the C5W. Indeed, population inflow into the 23W has been positive over the past quarter, again primarily backed by foreign nationals migrating into the country. With the peak spring moving season just around the corner, the 23W should see another population increase in the next quarter, which should paint a clearer picture of the amount of residential demand in the post-pandemic economy.

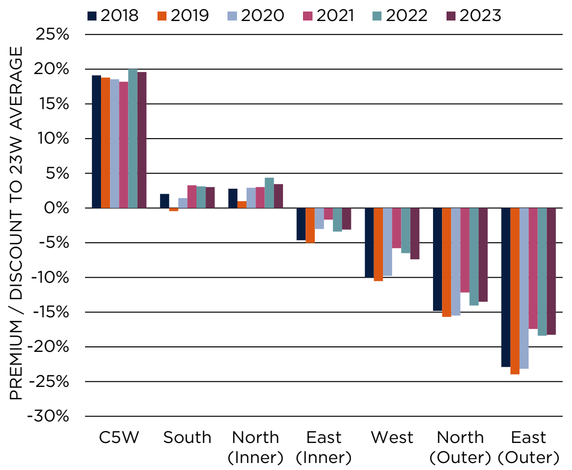
Average asking rents in the C5W submarket have rebounded by 1.8% QoQ to JPY4,815 per sq m. Indeed, annual growth was at 0.7%, and rents have nearly returned to Q3/2022 levels, before the revisions across the 23W in the previous quarter. All constituent wards experienced rental increments on a quarterly basis. Looking at the ward level, Chuo experienced the largest increment at 3.8% QoQ, while all other wards either saw mild increments or stayed flat. Its total population has continued to increase over the quarter, signifying that it remains the premier choice of residence especially for young professionals, who typically have enjoyed robust wage growth, and should see a considerable number of

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q1/2023



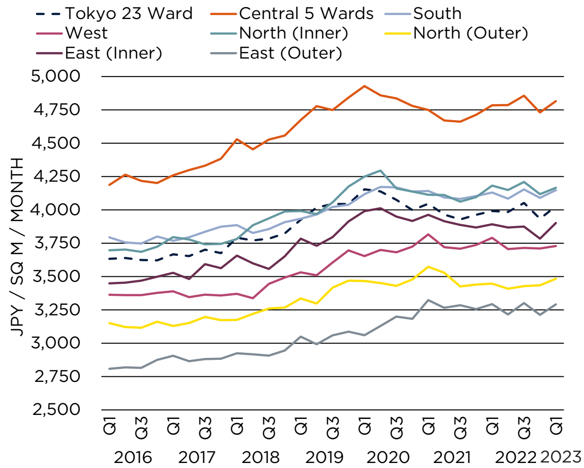
Source Savills Research & Consultancy

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2018 to Q1/2023



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

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



Source Savills Research & Consultancy

people move into the submarket during the peak spring moving season.

The South submarket has also seen rents recover 1.4% QoQ and 0.4% YoY to JPY4,148 per sq m, around the same levels as Q3/2022. The submarket is typically characterised as a residential area popular with family units due to the large amount of greenery and open spaces that it provides. Meguro and Shinagawa in particular have rents on par, or close to some wards in the C5W due to their proximity to central locations. However, looking at the net population outflow over the past quarter, Setagaya appears to have fallen slightly out of favour with some people, probably families, that may have chosen to relocate to more affordable areas. Nonetheless, with society in a post-pandemic state, the submarket should remain popular overall.

Average rents in the Inner North submarket saw rents increase 1.2% over the quarter to JPY4,166 per sq m, but fell by a slight 0.4% YoY. Looking at individual constituents, rents in Toshima remained flat over the quarter, and are 3.9% lower YoY. Meanwhile, the more expensive Bunkyo made most of the contribution this quarter, increasing 2.2% QoQ, and remains 3.1% higher on a yearly basis. Bunkyo is known as a high-end educational centre in Tokyo due to the number of prestigious schools in the ward and its central location and will likely stay popular with families for this reason, cementing its strong standing in the residential market.

The Inner East submarket saw rents rise 3.1% QoQ, the largest increment observed across the 23W this quarter, to JPY3,902 per sq m. Rental growth was spread fairly evenly across the wards, which grew between 2.5% and 3.7% QoQ. The Inner East has overall performed very strongly in terms of population growth, and was the only submarket where every constituent saw population increments this quarter. The rising popularity of the Inner East could be due to the ongoing and upcoming large-scale redevelopment projects on the east of Tokyo station, including Tokyo Midtown Yaesu, which may have made the Inner East a more appealing place to live in.

The West submarket has seen rents inch up over the quarter by 0.5% to JPY3,729 per sq m, but to a mild decline of 1.6% YoY. Performance was divergent within the submarket, with Nakano leading the quarterly gains at 2.8%, while Suginami contracted 1.6% over the same period. However, it should be noted that both wards have settled around levels seen two quarters ago in Q3/2022. The West has overall remained popular during the pandemic due to the large amount of greenery it has and its convenient access to central areas, and average rents are currently slightly above pre-pandemic highs, showing the overall strength of the submarket.

Average rents in the Outer North have increased 1.4% QoQ to JPY3,483 per sq m, growing 1.1% yearly. The more expensive Kita saw an increase of 1.3% QoQ, while Itabashi saw an increase of 1.5% QoQ. Overall, both wards have moved in tandem over the past few quarters, and remain amongst the more affordable areas to live in the 23W. While both wards have continued to see positive net migration throughout the pandemic, Kita ward has shined particularly brightly in this aspect, perhaps due to the good balance it provides in terms of accessibility to the city centre, greenery and open spaces, and affordability.

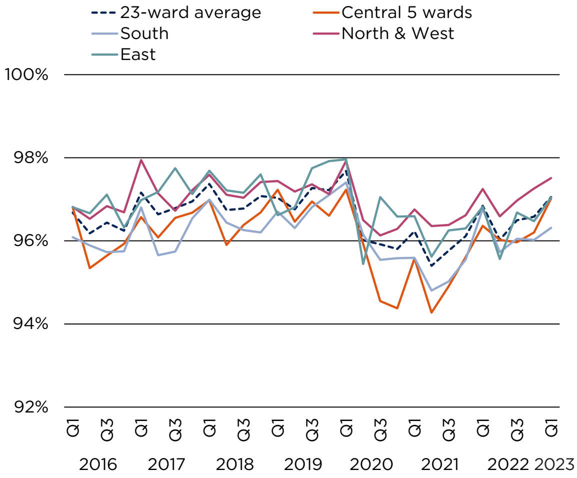
The Outer East submarket has seen rents grow 2.4% QoQ to JPY3,291, but remain flat over the year. Within the submarket, performances were divergent, with Adachi seeing the largest quarterly increment of 4.6%, and Katsushika seeing the smallest increment of 0.7% QoQ. Throughout the duration of the pandemic, all constituents have performed well and have seen rental growth. However, at a fundamental level, Adachi and Katsushika have seen the largest net migration within the submarket as a percentage of their respective populations, suggesting that these two wards in particular might have gained favour and could see greater increments going forward.

OCCUPANCY RATES

Occupancy rates in the Tokyo 23W increased slightly this quarter to 97.1%, an increment of 0.6ppts QoQ. This equates to a yearly improvement of 0.2ppts, and demonstrates that recovery is progressing in the 23W market in a post-pandemic state. Indeed, occupancy is only slightly shy of the high levels observed before the pandemic.

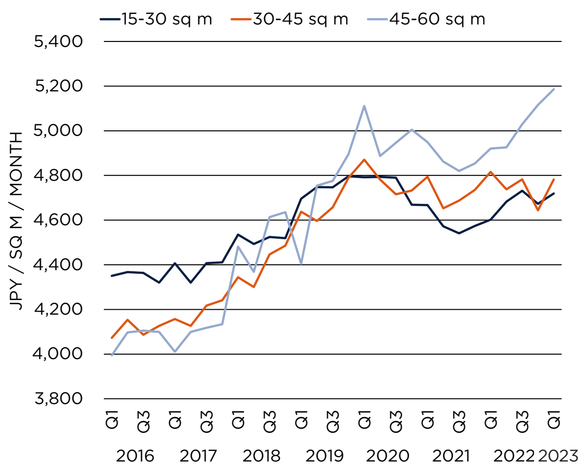
Occupancy rates in the C5W increased at a slightly higher rate than the 23W, seeing an uptick of 0.8ppts over the quarter to 97.0%. Moreover, Q1/2023 occupancy rates in the C5W are closer to the submarket's respective pre-pandemic peak levels, demonstrating the strength of leasing demand in the submarket. Typical residents of the affluent C5W submarkets are less likely to be affected by inflation due to their higher incomes, and thus do not need to seek more affordable options outside of the submarket. Elsewhere, all wards in the 23W saw slight upticks in occupancy over the quarter, aside from a few outliers in the outer East and inner North submarkets, where occupancy loosened slightly.

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



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data
* Q1/2023 is as of February 2023.

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



Source Savills Research & Consultancy

Going forward, the 23W is likely to see some additional population growth, and particularly the upcoming spring moving season will likely cause an expansion in residential leasing demand as people move to Tokyo for work and educational opportunities. Additionally, the non-Japanese population appears to keep expanding. That said, remote work policies remain in place at many companies in Tokyo, despite increasing efforts to push office attendance closer to pre-pandemic levels. Many residents with average incomes may still be in favour of living outside the 23W, especially while inflation persists and puts pressure on average households, which may constrain occupancy growth slightly.

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 Q1/2023, all size bands in the C5W saw some growth. Rents in the most prolific 15-30 sq m size band saw an increment of 1.0% QoQ, pushing it back to Q3/2022 levels. Likewise, the 30-45 sq m size band saw the largest increment of 3.0% QoQ, and has also recovered to Q3/2022 levels. Meanwhile, the largest 45-60 sq m size band continued increasing 1.4% QoQ this quarter, and was the only size band to see continuous rental growth over the past year. Indeed, the increase in demand for larger spaces at home and the smaller stock of units in this size band has allowed it to maintain its premium over smaller units.

Compact rental units in the C5W have been the premier choice for many young professionals due to its proximity to a majority of corporate offices. Several years before the pandemic, the increase in the number of dual-income households has also started to generate more demand for larger units. When the pandemic struck, demand shifted further away from smaller units to larger units, and in more affordable locations, causing some rental contraction in such units. However, in a post-pandemic state, more people, especially young professionals, are likely to move to the C5W as requirements for greater presence in the office is growing, even amongst larger firms with remote work arrangements. Hence, demand for single-occupier units will likely increase going forward, while larger units remain highly sought after. We will have a clearer idea of the expected amount of demand once the dust from the spring moving season settles.

ULTRA-LUXURY RENTAL RESIDENTIAL

Ultra-luxury residences[1] have been growing in popularity, particularly over the past half decade. As covered in our [Tokyo Residential: Ultra Luxury] report, Tokyo has seen multiple redevelopment projects over the past half decade that have transformed the landscape of the city centre, and created spaces that feel like a "city within a city", making it a more luxurious and attractive location to live in. In fact, residential preferences amongst the wealthy have further shifted towards high-end condominiums in the city centre.

Within the ultra-luxury residential market, rental properties have also gained greater traction, likely due to the growing number of new, entrepreneurial younger ultra-high-net-worth individuals (UHNWIs)[2] that have amassed wealth through IPOs and corporate sales, and also due to an increasing number of wealthy foreign residents in Tokyo. The flexibility that rental units provides is an attractive point, as even amongst the UHNWI population, only those on the higher end of the spectrum would be able to afford purchasing an ultra-luxury residence outright.

While ultra-luxury rental residences may appear egregiously expensive on the surface, they are not excessively so. Ultra-luxury residence units exceed monthly rents of JPY2.5 million generally because they have a floor area of at least 200 sq m, while in comparison, a majority of multifamily units in Tokyo 23W are less than 80 sq m. From a per-floor area basis, most ultra-luxury residences are around two to three times more expensive than mid-market residences in the C5W, which seems reasonable and sustainable given the vast array of services that have to be provided.

Overall, given the very limited stock of ultra-luxury residences in Tokyo, especially when compared to cities like Manhattan, London, or Hong Kong, and the number of UHNWIs providing the backbone of demand, a greater amount of ultra-luxury residential supply is likely to be absorbed uneventfully for the right products. Major large developments located on prime,

1 Typically defined here as either having a sales price of greater than JPY1.0 billion, or monthly rents of more than JPY2.5 million.
2 UHNWI is defined as an individual with a net worth in excess of US$30 million.

central real estate, will likely feature ultra-luxury residential rental units, like Torch Tower plans to, given that they can provide higher rents per floor space than office counterparts, on top of revenue diversification. While it is a difficult market to penetrate given the niche expertise required for marketing and providing exceptional customer service, it should continue to grow as more players turn their eyes to it.

OUTLOOK

The Tokyo 23W saw rents rebound from the dip seen in the previous quarter, and occupancy rates have improved, showing that the market has experienced recovery in line with the transition toward an endemic state, although they still remain slightly lower than their respective pre-pandemic highs. The peak spring moving season is approaching, and should attract a large number of young workers and students into the 23W over the next few months. Market conditions for the residential sector in the 23W appear to be at their best since the pandemic began. Elsewhere, the ultra-luxury residential leasing sector is likely to see an increased amount of attention given the very low levels of stock, and the strong performance of many such units currently on the market.

At the same time, the pandemic has induced some more long-lasting effects on the market. For instance, while many companies have generally toned down working from home and largely look to welcome employees back to the office, remote work still remains much more prolific than in pre-pandemic times. Those that have relocated to larger units in less central locations may have gotten used to more spacious residences, and be more reluctant to move back to more expensive and smaller places in the city centre subject to the frequency of the office attendance. The extent of recovery will be clearer after the peak spring moving season is over.

Due to its belated reopening, the Japanese economy is likely to see stronger performance going into 2023, although this will be impeded by the global economic slowdown. The yearly Shunto wage negotiations this year have seen most major Japanese corporations agree to raise wages noticeably, which should help contribute to residential demand, especially in affluent submarkets. On the other hand, average households are likely to keep suffering from inflation, which may adversely affect some affordable submarkets. These macroeconomic factors, on top of population trends into the Tokyo 23W, will dictate the extent of recovery in the residential market.