MARKET IN MINUTES
Savills Research

Residential Leasing

Further improvements moving into 2024

Strong growth experienced in the Tokyo 23W, with further improvements likely in 2024.

- Average rents in the Tokyo 23 wards (23W) increased notably by 4.1% quarter-on-quarter (QoQ) and 5.2% year-on-year (YoY) to JPY4,237 per sq m.
- Rents in the central five wards (C5W) increased in tandem by 2.2% QoQ and 4.4% YoY to JPY5,027 per sq m.
- The C5W rental premium over the 23W average decreased moderately to 18.6%.
- In the C5W, Chuo and Shinjuku saw the most significant quarterly increases of 3.8% QoQ and 2.8% QoQ, respectively. Overall, yearly growth among all wards in the C5W has been strong.
- Average rents for smaller units in the C5W in the 15-30 sq m size band increased at the largest rate, by 2.3% QoQ.
- Average occupancy rates in the 23W increased by 0.2 percentage points (ppts) QoQ to 97.2%, and rose marginally by 0.1ppts on an annual basis. Meanwhile, occupancy in the C5W remained unchanged QoQ at 96.9%.
- In Greater Tokyo, record-high condominium prices have forced many residents to seek more affordable options in the rental market. This has also likely contributed to the strong rental increments seen over the quarter.

"The 23W market kept posting strong quarterly rental growth in Q1/2024. This was supported by positive quarterly net migration, particularly by the foreign population, which continues to increase unabated. Domestic migration is also likely to fare well during this spring moving season. Meanwhile, demand for rental units will continue to be bolstered by those priced out of buying condominiums."

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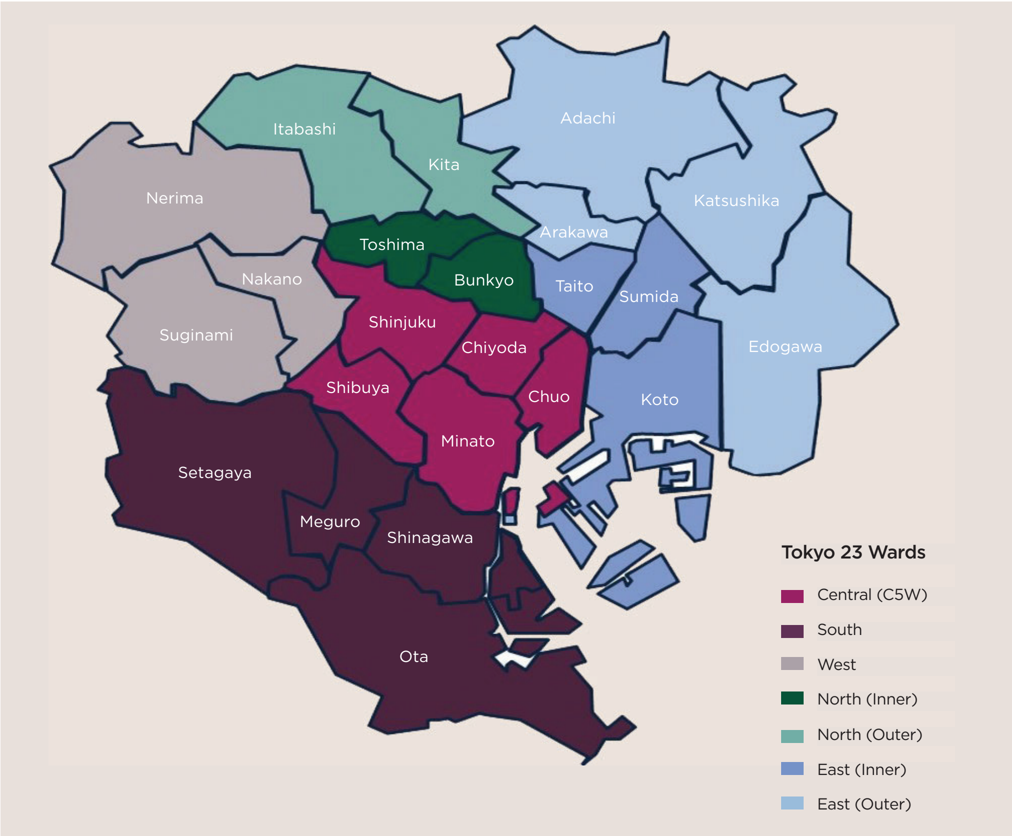
MAP 1: Tokyo's 23 Wards by Survey Area



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 notable growth in Q1/2024, building on the momentum from the previous quarter. This strong performance was enjoyed universally across the market, with all submarkets experiencing moderate quarterly rental growth, as well as posting strong growth on an annual basis. The average occupancy rate elevated moderately in the 23W over the quarter, and further improvements will likely be anticipated during this spring moving season.

Looking back at 2023, the demographic situation in the capital saw noticeable improvements, and the large influx of new residents has driven notable rental demand over the year. Indeed, since the pandemic subsided, rates of office participation have inched up, and a majority of Tokyo residents have resumed normal outdoor routines like during the pre-pandemic state. Migration to the 23W remained strong in Q1/2024, and the market welcomed a net-total of 6,800 new residents. All-in-all, Tokyo will likely continue to attract migration, which will strengthen demand and rental growth moving forward.

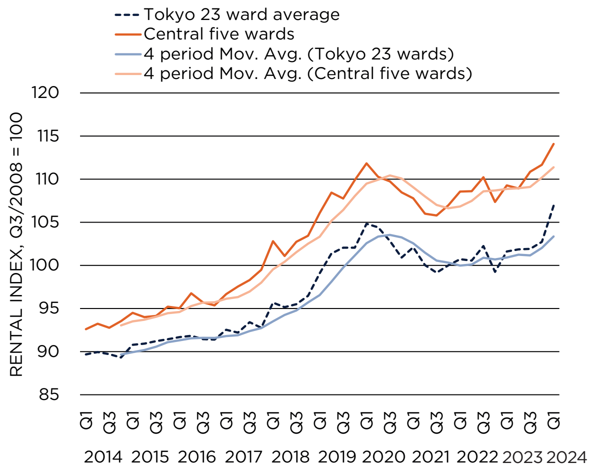
Meanwhile, price increments in the for-sale condominium market, due to a combination of supply constraints and sound demand, has left many residents priced out of buying and forced to resort to renting, which has contributed to further competition for reasonable units. Considerable rental increments should provide an adequate buffer for landlords against elevated construction and maintenance costs, in addition to upcoming interest rate hikes, albeit likely moderate, and higher refinancing costs.

Overall, we anticipate few changes to this status quo for the meantime. Although some observers hold justified concerns over future movements in the Japanese national population, this has been compensated for by firm growth in the foreign population. The sound fundamentals of the 23W market, in addition to the various urban regeneration and improvement projects taking place across the city hint at the positive trajectory of the rental residential market moving forward.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

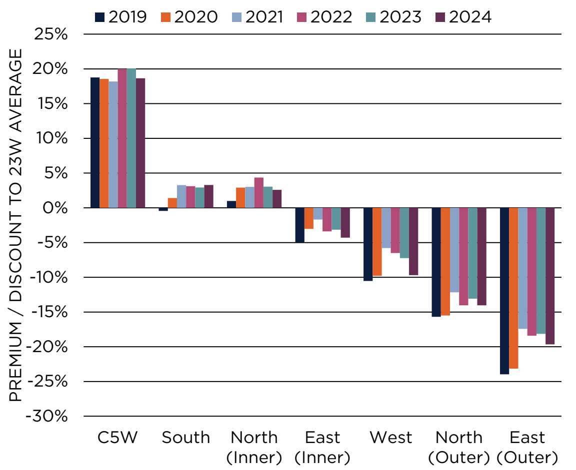
Sound rental growth continued for a second consecutive quarter among average mid-market units in the Tokyo 23W in Q1/2024, and Tokyo appears to have attained a new high. Average asking rents in the 23W increased by 4.1% QoQ and 5.2% YoY to JPY4,237 per sq m. Notably, the C5W premium over the 23W average has fallen moderately to 18.6% (Graph 2), which demonstrates the strength of broader growth in the 23W over the quarter. This may also imply price sensitivity of residents in each submarket. The city has been experiencing healthy demographic growth in the post-pandemic setting, with a total influx of almost 100,000 new residents to the 23W recorded in 2023. This trend has been driven in large part by increments in the foreign population, with foreign nationals comprising 55,000 of these new residents. Furthermore, over 7,000 foreign nationals moved to the 23W in Q1/2024, and this strong growth in demand has probably resulted in many affordable units being taken off the market. Looking ahead, a slurry of urban renewal projects taking place throughout the city should increase its appeal among potential residents, while higher rates of in-office participation should build on this momentum, and support further

GRAPH 1: Mid-market Apartment Rental Index, Q1/2014 to Q1/2024



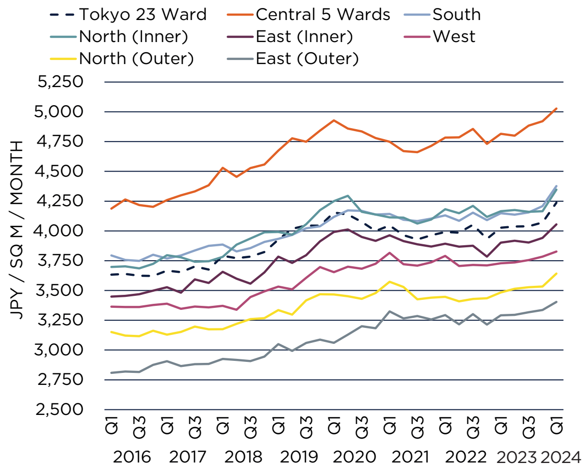
Source Savills Research & Consultancy

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2019 to Q1/2024



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

GRAPH 3: Mid-market Apartment Rents, Q1/2016 to Q1/2024



Source Savills Research & Consultancy

rental growth going forward in the Tokyo 23W market. Certainly, the market might experience some temporary corrections, especially after the recent strong growth.

Average rents in the C5W increased by 2.2% QoQ and 4.4% YoY to JPY5,027 per sq m in Q1/2024, and the demand for residences in Tokyo's central wards appears to go from strength to strength. Chuo and Shinjuku were the stand-out performers among the constituent central wards, posting quarterly rental growth of 3.8% and 2.8%, respectively. Elsewhere, rental growth was moderate among the other constituent wards, between 1.6% QoQ and 1.4% QoQ. Notably, the number of available units completed within less than 12 months increased by 10% QoQ to nearly 450 units in the C5W in Q1/2024, likely in anticipation of the burgeoning residential demand in central wards, with more professionals returning to their offices in the post-pandemic. Indeed, living in the C5W is considered a status symbol by many high-income young professionals, who likely prefer living within a short commute to their offices in central business districts, in addition to the convenience of having various amenities and entertainment options on their doorsteps.

Average rents in the South submarket experienced the largest increase among the surveyed submarkets, at 4.0% QoQ and 5.5% YoY to JPY4,376 per sq m. At the ward level, much of this growth was driven by Ota and Shinagawa wards, both of which saw rents grow by 4.8% QoQ, while Meguro and Setagaya also witnessed strong quarterly rental growth at 4.0% and 2.4%, respectively. Despite the marginal net-outflow of residents over the quarter, the South submarket appears to be a popular ward for residents, having enjoyed among the largest population increments in the 23W in 2023. Indeed, the submarket provides convenient access to central business districts due to its proximity and public transport options, while being renowned for many peaceful residential areas. As such, some areas in the submarket possess a similar rental level to the C5W market. With these factors in mind, the South submarket will likely see strong demand from many workers during this spring moving season.

The Inner North submarket enjoyed the largest rate of rental growth, at 4.3% on both a quarterly and annual basis, rising to JPY4,346 per sq m in Q1/2024. Rental growth was consistent at the constituent ward level, with average rents increasing by 4.4% QoQ in Toshima and 4.2% QoQ in the more expensive Bunkyo. Similar to the South, the Inner North has close proximity to multiple central business districts, including the Tokyo station area and Ikebukuro, while also boasting a liveable atmosphere, with plentiful green space, amenities, and leading educational options. As such, Toshima and Bunkyo wards will likely continue to be popular among both families and young workers, and demand for rental units should remain strong moving forward.

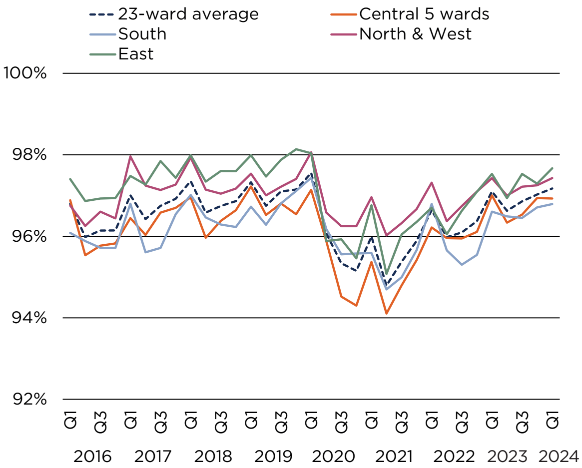
The Inner East submarket has been a stand-out performer in the Tokyo 23W residential market, exhibiting rental growth of 2.9% QoQ and 3.9% YoY to JPY4,055 per sq m. In contrast to the previous quarter, rents in Taito increased at the largest rate, by 3.8% QoQ, while rents in Koto and Sumida grew by 2.8% QoQ and 1.9% QoQ, respectively. The Inner East has been a winner in demographic terms, recording 12 successive months of positive net migration in 2023. Furthermore, unlike a majority of wards in the 23W, all constituent wards in the Inner East enjoyed moderate population influxes of nearly 2,000 residents in Q1/2024, which is a positive sign for rental demand this quarter. During this spring moving season, many young workers will likely be drawn to the Inner East, due to its relative proximity to the Tokyo station area, while remaining an affordable alternative to living in the C5W.

Average rents in the West submarket experienced a relatively moderate increment of 1.1% QoQ to JPY3,827 per sq m, translating to a 2.6% yearly increase. Rental growth varied slightly among the constituent wards - Nakano experienced the largest QoQ rental growth at 1.6%, while Suginami and Nerima were more modest at 0.9%. Yearly rental growth in Nakano stood out at 4.7% in the ward. As a popular residential area with various entertainment options, green space, and convenient public transport access to popular areas such as Shinjuku, Ikebukuro and Shibuya, the West submarket experienced moderately large net migration of 12,500 people in 2023. Although net migration was relatively limited in Q1/2024, the West should be in good standing over the coming year, especially with the forthcoming influx of workers in the next quarter.

Quarterly rental growth in the Outer North submarket was sound at 3.1% in Q1/2024, and increased on a yearly basis by 4.6% to JPY3,642 per sq m. Rental growth across the constituent wards Kita and Itabashi was relatively consistent at 3.3% QoQ and 2.8% QoQ, respectively, in addition to increments of 4.9% YoY and 4.2% YoY, respectively. As a proportion of the overall population, the Outer North enjoyed relatively large net migration of 12,000 residents in 2023, a trend that has continued in Q1/2024. Indeed, the balance of affordability, accessibility to central areas, and liveability likely makes the Outer North submarket a popular choice, which should contribute to the enduring appeal of the submarket.

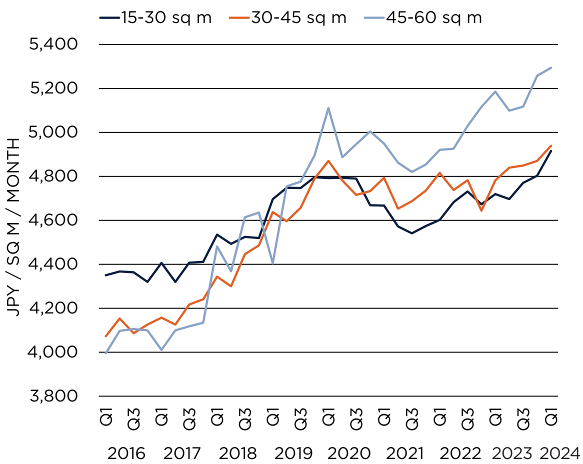
Lastly, the Outer East submarket enjoyed a similar trend, with overall average rents increasing by 2.0% QoQ and 3.4% YoY to JPY3,404 per sq m. Looking at the ward level, Edogawa enjoyed the largest quarterly

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q1/2024*



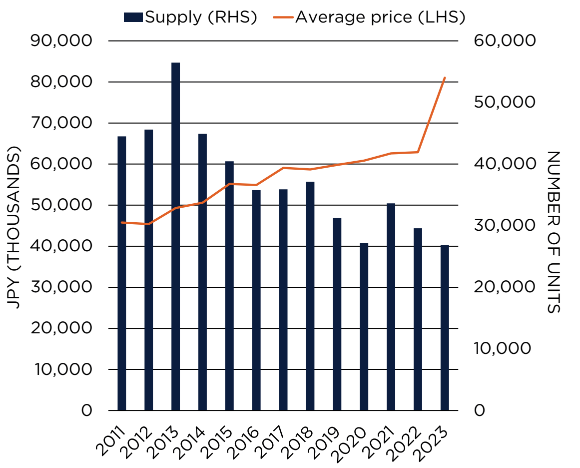
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data
* Q1/2024 is as of February 2024

GRAPH 5: Rents by Unit Size, C5W, Q1/2016 to Q1/2024



Source Savills Research & Consultancy

GRAPH 6: Supply and Average Price of New Condominiums in Greater Tokyo, 2011 to 2023



Source REEI, Savills Research & Consultancy

rental increment at 3.9%, respectively, while Adachi and Arakawa experienced moderate quarterly rental growth at 2.6% and 2.5%, respectively. In Q1/2024, the Outer East attracted the largest net migration among the 23W submarkets, with the bulk of new residents moving to Adachi and Katsushika. Demand for residences in these submarkets is likely high among families seeking a more residential atmosphere, and workers with more modest real incomes who have been impacted by inflation. In addition, with hybrid work arrangements looking to persist for the meantime, many workers will likely favour the relative affordability of larger units that support home offices in the Outer East. This trend is reflected also in the narrowing rental discount to the 23W average.

OCCUPANCY RATES

Occupancy rates in the Tokyo 23W rose by 0.2ppts QoQ to 97.2% in Q1/2024, while also increasing marginally by 0.1ppt on an annual basis. Although still slightly shy of the pre-pandemic peak level, average occupancy rates exhibited a steady improvement overall in 2023, and look to maintain this momentum moving into 2024. The situation in the C5W mirrors this sentiment, with occupancy remaining at a tight level of 96.9%, and is approaching the pre-pandemic figure.

Growing rates of in-office participation continue to proceed gradually but steadily. Although hybrid work arrangements will likely persist as a corporate perk, particularly among large companies, most workers commute to the office more often than working from home, which likely encourages greater interest in residences within closer proximity to offices in central business districts. This has been a major driver of net migration to the Tokyo 23W in the post-pandemic era. In addition, Japan has attracted noticeable numbers of foreign residents throughout 2023, which have comprised a majority of the population growth seen over recent quarters, and this trend looks to continue unabated for the meantime.

All constituent wards of the 23W have enjoyed positive net migration throughout 2023, which has supported the steady improvement in occupancy rates. Central wards will continue to attract high-income residents who are less affected by inflation, and who seek proximity to offices, amenities, and entertainment options. Meanwhile, peripheral areas will remain popular among renters who continue to work from home more often, those who have not enjoyed meaningful wage growth, and families seeking larger living spaces. Sound population growth will likely continue in 2024, especially with this spring moving season, and the prospects for further improvements in occupancy across all submarkets are bright.

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 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 most notable shift when looking at size bands in the C5W in Q1/2024 occurred in the smaller 15-30 sq m category. Average rents for smaller units increased by 2.3% QoQ, which should correlate with the general growing shift towards in-office participation. Although many large companies, and more so IT firms, keep hybrid work arrangements in place, a large proportion of workers who can afford to live in the C5W are likely employed by companies that have been mandating greater office attendance, such as finance and consulting firms. Therefore, proximity and access to offices are likely a priority for this demographic of renters, in addition to less emphasis on space for home offices. Moreover, a large proportion of this segment of residents likely comprises younger singles, translating into a greater emphasis on smaller and more reasonably priced units.

Meanwhile, the quarterly performance of units in the medium 30-45 sq m size band was relatively moderate, increasing by 1.4% QoQ, while rents among larger units of 45-60 sq m increased marginally by 0.7% QoQ, with per sq m asking rents of the former sitting marginally above those of units in the smallest size band. Although the demand for larger units that can accommodate home offices remains firm for the meantime, the scaling back of hybrid work arrangements may gradually reduce the emphasis for such specifications, which may impact the demand for larger units to some extent moving forward. Also, the premium for large units has become noticeable, possibly discouraging some renters. Overall, the C5W remains a popular residential destination due to its proximity to the city centre, availability of amenities, and status, with a recent slew of high-end residential developments that should raise the profile of the submarket.

GROWING DEMAND IN THE RENTAL MARKET DUE TO LIMITED SUPPLY OF FOR-SALE UNITS

Social and economic trends since the pandemic have facilitated a growing shift by residents towards the Tokyo 23W market, particularly among those who are returning to offices in central business districts more often. But the price increments of for-sale condominiums are proving prohibitive for many (Graph 6). This section will outline both the causes and the development of this trend in the 23W market, showing the impact of this shift on the rental market.

For-sale condominium prices have seen notable increments due to a combination of strong demand and supply constraints, and as of January 2024, the average price of a newly built for-sale condominium in the Tokyo 23W reached JPY115.6 million, with an average sq m price of JPY1.8 million, according to a monthly survey by the Real Estate Economic Institute (REEI). A long-term contributor to these high prices has been interest rates remaining at historic lows, which has effectively lowered the actual cost of purchasing a condominium. Furthermore, the increased number of dual-income households has led to greater purchasing power and contributed to stronger housing demand, especially for conveniently located units in central Tokyo. Indeed, according to the Ministry of Internal Affairs and Communications, the number of dual-income households has increased significantly over the past decade as more women have entered the workforce, especially as professionals.

In conjunction with strong demand, a handful of factors have led to a bottleneck in supply, with the number of for-sale condominiums built since the onset of the pandemic (between April 2020 and June 2023) dropping by over 22% compared to the equivalent period prior to the pandemic (between January 2017 and March 2020), according to a study in November 2023 by Urban Research Institute Corporation, affiliated with Mizuho Financial Group. A primary reason for this moderate level of supply lies in the difficulty in procuring plots of land suitable for the construction of for-sale condominiums, in conjunction with the increasing prices of land in Tokyo. Consequently, the same study reports that the average per-unit price of for-sale condominiums increased by 20% compared to prices in the pre-pandemic, which admittedly appears to have also been influenced partially by an uptick in more expensive luxury developments.

High construction costs are an additional reason for rising condominium prices. The construction industry suffers from chronic labour shortages and has seen labour costs increase. In addition, new labour regulations may deteriorate the situation. Moreover, in conjunction with the weak yen, the significant increase in raw materials prices, coupled with elevated energy prices, will further raise construction costs. Overall, the rising construction costs will likely further lift the prices of newly constructed condominiums even further, at least in the near future.

Meanwhile, more companies in Tokyo are mandating a return to in-office participation. A monthly survey on workstyle conditions in Tokyo prefecture published by the Tokyo Metropolitan Government reports that 41.6% of companies are currently implementing remote work arrangements in January 2024, which is a significant drop from the peak level of 65.0% in August 2020, and the lowest figure since the onset of the pandemic. This shift appears to have triggered a change in lifestyle preferences for some, and a rebound in net migration to the 23W has been observed since the winding down of the pandemic, reaching nearly 100,000 new residents in 2023. This heightened demand has put further upward pressure on for-sale condominium prices, and these barriers to purchasing, especially for those with relatively modest incomes, have forced increasing numbers of people to resort to the rental market.

Given the factors above, and the subsequent growth in demand for rental residences, average rents in the 23W have been on an upward trend. Looking ahead, the for-sale condominium market will continue to face multiple headwinds that are expected to keep prices elevated. Indeed, new labour regulations that limit working hours in the construction industry will likely put further pressure on the labour shortage and subsequently construction costs, in addition to persistently elevated raw materials and energy costs. On the other hand, net migration into the 23W looks to continue unabated, due to both declining rates of remote work and increments in the foreign population, which, against the background of limited new supply of for-sale condominiums, will fuel the growth in demand for rental units, likely stimulating further growth in the rental residential market.

OUTLOOK

The Tokyo 23W residential market appears to be going from strength to strength in the post-pandemic state, and observers should anticipate moderate and consistent growth in rents moving forward. This stable performance is underpinned by Tokyo's sound fundamentals, particularly strong net migration, a large proportion of which can be attributed to sustained inflows of foreign residents. Furthermore, the spring moving period should provide further momentum to this trend, and will likely elevate the rental residential market to new highs.

A notable paradigm shift in the post-pandemic has been the transition to greater levels of office participation, which has encouraged the growing net migration of residents to the 23W - a reversal of the trend observed during the pandemic. This partly explains the notable growth in rents and drop in the number of available units across all submarkets in the 23W in Q1/2024, with high-income young singles likely comprising a large proportion of the demand for units in central wards, while the popularity of peripheral wards has largely been sustained by families and those on more modest incomes.

With the influx of residents into the 23W, the demand for residential units has naturally increased in tandem. The for-sale condominium market has also experienced significant price increases over recent years, due to a combination of limited supply and strong demand. This situation has priced many residents out of buying, forcing many to turn to the rental market. With positive net migration into Tokyo set to continue for the meantime, and workers increasingly returning to their offices, this trend will likely continue, leading to further growth in the rental residential market. Furthermore, the notable rental growth seen recently should insulate landlords from the elevated maintenance and repair costs, as well as greater refinancing costs due to anticipated interest rate hikes.

Overall, the 23W residential market is renowned for its stability, and the post-pandemic setting has brought about a new era of growth in the market. Japan has reached a stage of nominal inflation, which implies at least consistent nominal rental growth going forward, and hopes are also high that this year's round of spring wage negotiations will bring further salary increases for a wider proportion of the working population. Certainly, the market might experience some temporary rental corrections, especially after the recent strong growth. That said, the strong momentum should herald further rental growth in the coming quarters, which raises the overall prospects of the sector.