

Residential Leasing



23W rents exceed 2008 levels

Rents are growing steadily, with both 23W and C5W averages now above their 2008 highs.

- Average mid-market asking rents in Tokyo's 23 wards (23W) stood at JPY4,018 per sq m at the end of Q2/2019, up 2.3% QoQ and 6.5% YoY.
- Average asking rents in the central five wards (C5W) were JPY4,778 per sq m at the end of Q2/2019, up 2.2% QoQ and 7.3% YoY.
- The C5W's premium over the 23W average is holding steady at 19%, but seems more likely to increase than decrease moving forward.
- Only the C5W and South recorded higher rents this quarter, demonstrating strong demand for centrally located apartments.
- Koto in the Inner East performed well this quarter, with its quarterly growth rate ranking fourth in the 23W, adding on to good performance in previous quarters.
- Smaller apartments continue to be popular, though larger apartments also appear to be in high demand, their rents having jumped above those of smaller apartments once again.
- Occupancy was slightly lower in Q2/2019, at 96.9% in the 23W, though the Outer East and West submarkets managed to post slight increases.
- The number of concluded leasing contracts has been in decline for five consecutive months. This might be an early sign of a ceiling in the property cycle.

“Residential assets in central Tokyo remain in high demand. As long as the economy continues to grow steadily, rents should also continue their gradual rise.”

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

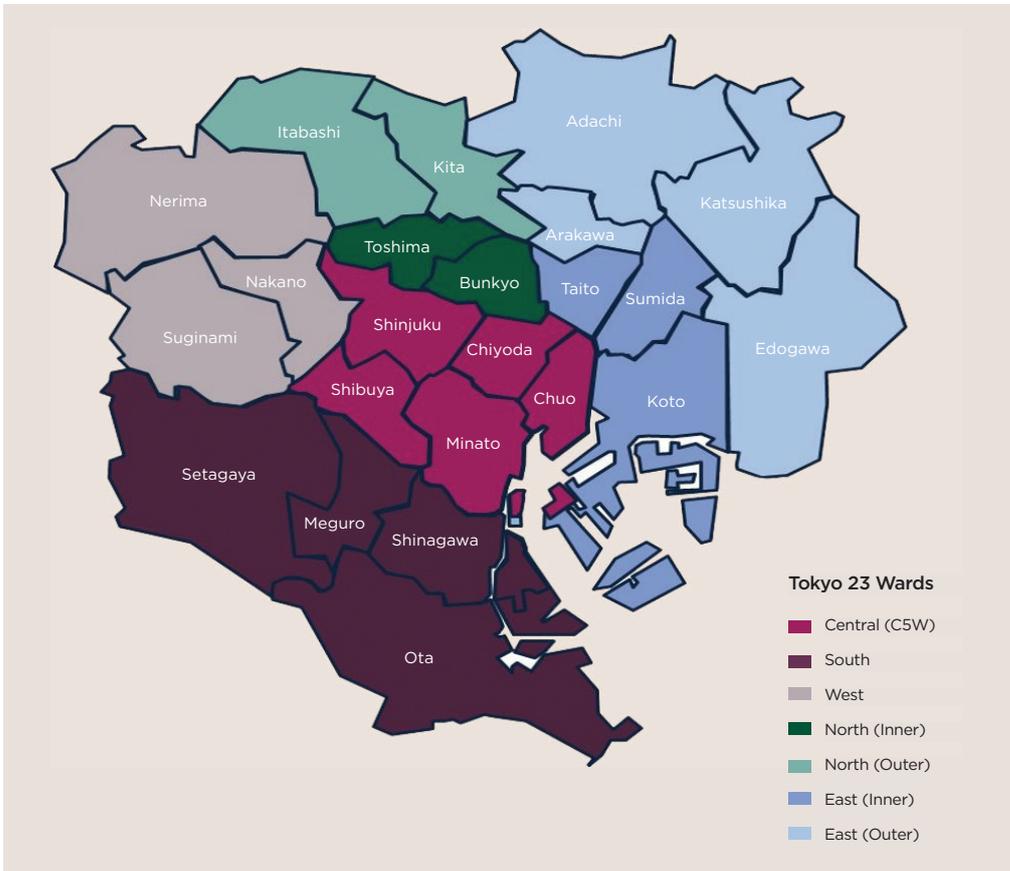
Tetsuya Kaneko
 Director, Head of Research & Consultancy, Japan
 +81 3 6777 5192
 tkaneko@savills.co.jp

Yoshihiro Kanno
 Manager, Research & Consultancy, Japan
 +81 3 6777 5142
 ykanno@savills.co.jp

Simon Smith
 Senior Director
 Asia Pacific
 +852 2842 4573
 ssmith@savills.com.hk

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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 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 movement in contract rents for the Tokyo market.

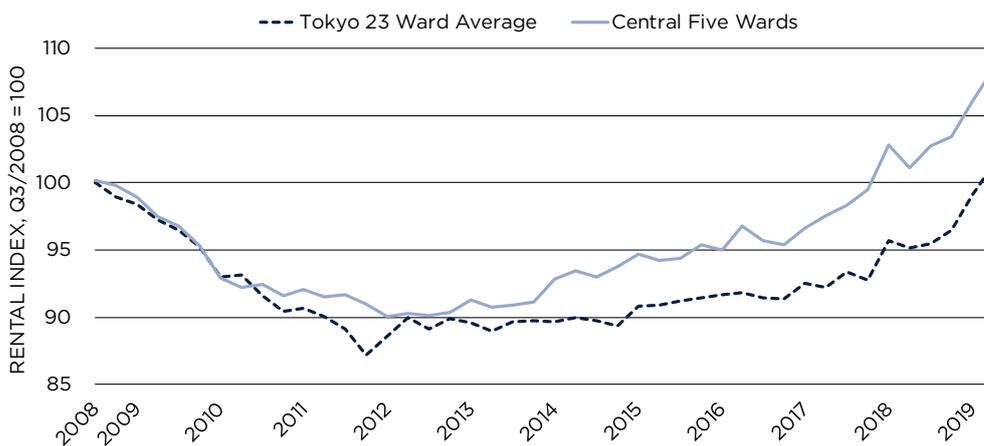
OVERALL RESULTS

C5W rents rose by 2.2% quarter-on-quarter (QoQ) and 7.3% year-on-year (YoY) to reach JPY4,778 per sq m¹ in Q2/2019. 23W average rents rose by 2.3% QoQ and 6.5% YoY, landing at JPY4,018 per sq m. The 23W has now surpassed its Q3/2008 level, joining up with the C5W – which achieved that milestone just over a year ago. Very tight market conditions appear to be making rental increases look stronger than in reality: the number of available listings has contracted significantly and new apartments are having a greater impact on overall rents. Indeed, there is a significant gap among newer and older units in the current market, with the former enjoying much stronger rental growth than the latter. Even so, older units are still seeing moderate rental increases dependent upon factors such as location and accessibility by railway.

The C5W's premium over the 23W held steady at 19.0% in Q2/2019 as both submarkets' growth rates continued to move at a similar pace. The Inner North is now the only submarket save the C5W that maintains a premium over the 23W, after the South moved to a discount this quarter. The Inner East extended its discount to 5.4%, while the West, Outer North and Outer East registered even wider discounts of 11.3%, 16.5% and 23.9%, respectively. The outer submarkets have tended to offer a discount, primarily due to their distance from the centre, and their discounts have steadily expanded over time (Graph 2).

Small apartments continue to be popular, with units in the 15-30 and 30-45 sq m size bands making up over three quarters of all listings in the 23W and an even higher proportion of listings in the C5W. The small sample size of larger size bands continues to fuel volatility in advertised rents. After posting a steep decline in Q1, rents for larger size bands rose sharply this quarter, once again pushing above those of smaller size

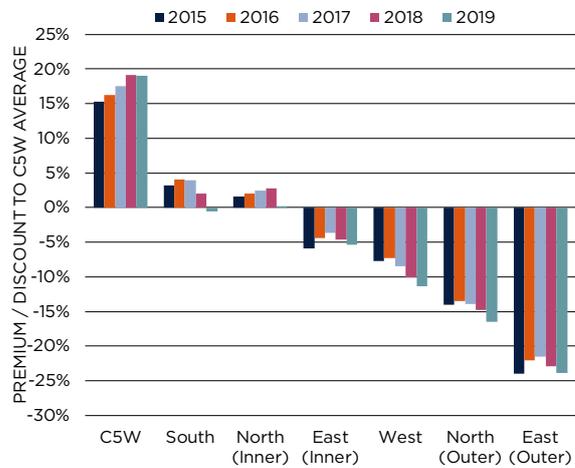
GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q2/2019



Source Savills Research & Consultancy

¹ Throughout the report, "per sq m" means "per square metre per month".

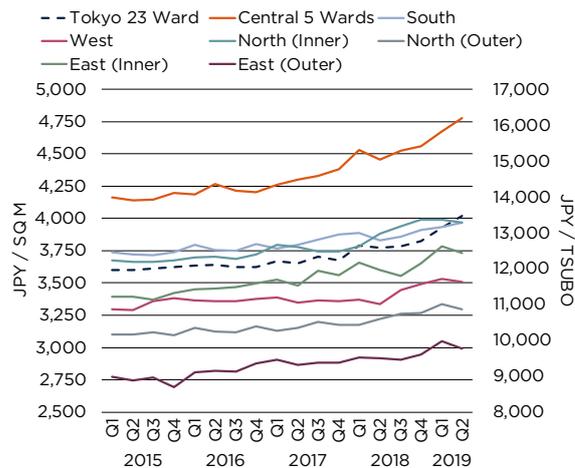
GRAPH 2: Rental Premiums/Discounts vs 23W Average, 2015 to 2019*



Source Savills Research & Consultancy

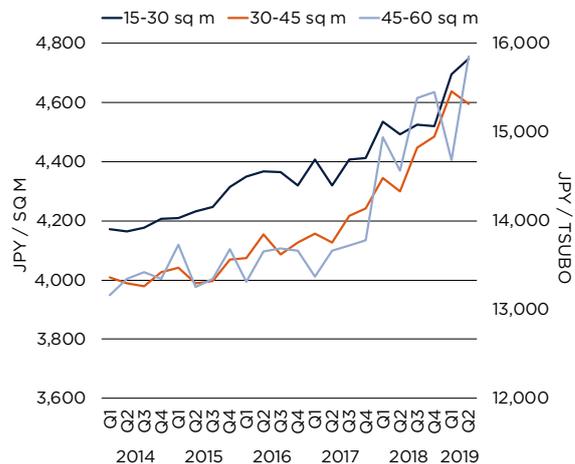
* 2019 is the average of the premium/discount registered in Q1 & Q2.

GRAPH 3: Mid-market Apartment Rents, Q1/2015 to Q2/2019



Source Savills Research & Consultancy

GRAPH 4: Rents By Unit Size, C5W, Q1/2014 to Q2/2019



Source Savills Research & Consultancy

bands. This provides further evidence that demand for larger apartments is increasing. On the other hand, the number of concluded leasing contracts has been in decline for five consecutive months, perhaps as a sign of a ceiling in the property cycle, though a similar decline was observed last year with no adverse effect.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Rents in Tokyo are growing at an impressive pace and have enjoyed uninterrupted quarterly growth since Q2/2018 in both the 23W and the C5W. The premium that C5W apartments command over the 23W has held at 19% so far this year, after having risen at a pace of about 0.9 percentage points (ppts) each year since 2015, when it was 15.3%. As C5W properties boast greater convenience, with close proximity to Tokyo’s primary business and entertainment centres, demand should continue to push rents in the submarket higher. Meanwhile, though demand is also strong in the 23W, greater supply opportunities in the wider Tokyo area should mean less of a demand squeeze in the outer wards, and it seems likely the premium for centrally located apartments will continue to grow over time.

C5W rents rose 2.2% QoQ and 7.3% YoY to reach JPY4,778 per sq m in Q2/2019. Rental growth was strong across four of the five wards, averaging 2.8% QoQ, though Chuo was down 0.3% QoQ. Chiyoda recorded the strongest YoY growth of all the 23W this quarter, up 10.4%, while Shinjuku and Shibuya averaged 6.9%, and Minato came in at 4.5% YoY. Chiyoda accounted for less than 10% of listings in the C5W this quarter, subjecting advertised rents to more volatility than in other central wards, though growth has been strong over a sustained period in Chiyoda as demand is sound and supply is quite limited.

Rental growth in the South was 0.8% QoQ and 3.6% YoY, with rents registering at JPY3,966 per sq m at the end of the quarter. In Meguro, rents stand firmly at the top of the submarket range, at JPY4,402 per sq m, similar to C5W rents, with growth also strong at 2.0% QoQ and 5.0% YoY. Shinagawa is also performing well, up 1.5% QoQ and 2.0% YoY. With average rents at JPY4,162 per sq m, Shinagawa offers good value considering its relatively central location and superb rail connections. Ota and Setagaya sit further out from the centre and rents are commensurately lower, at JPY3,559 and JPY3,740 per sq m, respectively. The outer southern wards grew at a slower pace this quarter, with Ota up 1.0% and Setagaya down 1.4%, though YoY growth is sound, at 5.3% and 2.3%, respectively.

The Inner North fell by 0.6% QoQ in Q2/2019 to JPY3,968, registering the lowest YoY growth among the submarkets at 2.2%.

Rents in both Bunkyo and Toshima fell this quarter, by 0.4% and 0.7%, respectively, though Bunkyo has performed better over the last year, up 4.3% YoY compared to Toshima, which was flat. The Inner North is adjacent to the C5W and is well connected, making it popular with local residents. It is likely to shake off at least some of this quarter’s weak performance over the next few periods.

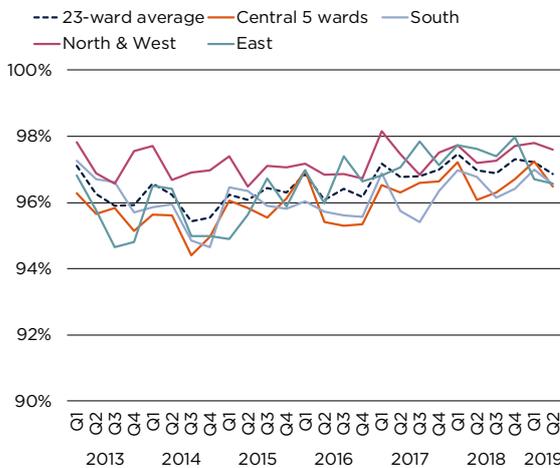
The Outer North fell 1.2% QoQ to JPY3,297, registering the second lowest YoY growth rate at 2.4%. In absolute terms, the submarket is the second cheapest after the Outer East, likely reflecting its distance from the centre of Tokyo. However, North Tokyo is popular with younger residents and it offers good connections to neighbouring prefectures; as such, well-located properties near to transport links could see strong appreciation from a low base over time.

The Inner East was down 1.4% QoQ, falling to JPY3,731 per sq m and giving back some of the gains it had seen over the past few quarters, though the submarket still posted solid YoY growth of 3.7%. The Inner East is a popular area, both for native Japanese and for communities of foreign residents, with the number of listings ranking third among the seven submarkets. Demand tends to be firm in Koto in particular, as migrants flock to the area, drawn by its strong cultural atmosphere.

The Outer East fell the most this quarter, by 1.9% QoQ, and grew by just 2.6% YoY, finishing the quarter at JPY2,993 per sq m. Katsushika rents are highly volatile as there are very few listings – a common trait among wards in the Outer East – and rents there fell by 5.8% QoQ. Edogawa also fell this quarter, down 3.3%, and has suffered from a sustained weakening in rents over the medium term as well, down some 5.8% YoY. Perhaps as demand continues to focus on more centrally located properties, and transport infrastructure is somewhat less well developed, Edogawa is justifiably cheap. However, as it is the cheapest submarket, and as availability in central wards dries up, now may be an attractive entry point to this up-and-coming area.

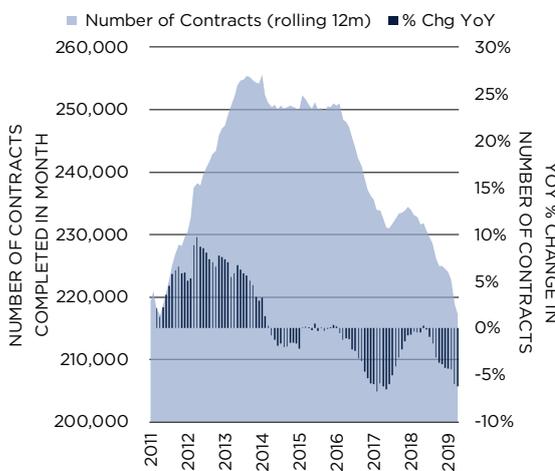
Rents in the West were down 0.6% QoQ, but up 5.1% YoY, to JPY3,510 per sq m. Nakano, the most centrally located ward in the submarket, continues to show strong and steady long-term growth, up 8.6% YoY, despite falling by 0.6% QoQ. Suginami fell by 2.1% QoQ, but has still grown a solid 4.9% YoY, beating quite a few other wards across Tokyo. Nerima, which sits relatively far from the centre, is growing at a slower, but more stable pace – up 1.1% QoQ, and 1.5% YoY. Bright spots in the West lie along the popular Chuo commuter line, which runs through Nakano and Suginami. Properties located near stations on this line tend to offer higher-than-average rents.

GRAPH 5: Average Occupancy For J-REIT Residential Assets, Q1/2013 to Q2/2019*



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
*Q2/2019 estimate based on April & May data.

GRAPH 6: Number Of Rental Contracts, (rolling-12-month basis) And YoY Change, 2011 to 2019



Source At Home, Savills Research & Consultancy

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.

Small apartments continue to be popular. Rents for the 15-30 sq m size band rose to JPY4,748 in Q2/2019, though the more volatile 45-60 sq m size band finished the quarter slightly higher at JPY4,754 per sq m, despite starting from a lower base. Their respective growth rates were 1.1% and 7.9% QoQ.

OCCUPANCY RATES

The average occupancy rate in the 23W in Q2/2019 was 96.9%, 0.3ppts lower than in Q1/2019, and 0.1ppts lower YoY. The C5W broke three consecutive quarters of higher occupancy in Q2/2019, falling by 0.8ppts QoQ, and was down 0.4ppts YoY. In fact, occupancy was down across most submarkets, with just the West and Outer East posting higher occupancy this quarter, up by 0.5ppts and 0.6ppts, respectively. While the Outer East saw lower occupancy last quarter, volatility stemming from a relatively small number of data points worked in its favour this quarter. Importantly, all submarkets show exceptionally strong occupancy, ranging between 95.5% and 97.9%, demonstrating sound demand for institutional-quality residences.

Despite volatility in some submarkets, overall J-REIT occupancy is expected to remain strong over the long term as their portfolios of institutional-quality residences are in high demand. A robust local economy, coupled with growing employment and rising corporate profits, should also support Tokyo residential demand. High-quality assets, such as those held by J-REITs, should be prime beneficiaries of this demand.

NUMBER OF COMPLETED CONTRACTS IN DECLINE

Results from a report by online listings portal At Home, which analysed the number of completed rental contracts, revealed that the

number of contracts for rental properties in the Greater Tokyo area has been in decline for five consecutive months. The number of contracts across the 23W fell by 12.2% YoY and the decline was even more pronounced for new condominiums 50 sq m or less in size, which saw a drop of 17% YoY.

A drop in location transfers resulting from Japan Inc.’s efforts to improve the work environment, as well as significant increases in the cost of moving services due to a severe labour shortage, appear to have slowed down relocation demand. Also, higher rents seem to have contributed to the slowdown, particularly as rents for larger size bands appear to have grown faster than for the smaller size bands since the beginning of 2018.

More broadly, a decline in the number of completed contracts could be an early sign of a downward shift in the property cycle. That said, a drop of similar magnitude was observed in 2017 and there was no shift from peak to downturn. At the very least it seems relocation demand has recently been slowing down overall. Lower turnover may limit rent increases over the short-to-medium term, since rents can be adjusted significantly higher when there is a change in tenancy.

OUTLOOK

Japan’s economy continues to grow steadily and prospects for the nation’s top residential market appear solid. Indeed, Tokyo’s population is increasing as young workers flock to the capital for work and study, driving demand for mid-market rental properties.

Although global economic uncertainty may weigh on the Japanese economy, the defensive Tokyo residential market should be relatively insulated from such conditions. The consumption tax hike slated for October 2019 also seems unlikely to significantly affect the residential market, though any effect would likely be somewhat negative.

Apartments should continue to be in high demand and see limited volatility in rents. Net migration to Tokyo and moderate new supply to the residential market support a favourable supply and demand balance. Centrally located apartments slightly underperformed this quarter but are growing more strongly on an annual basis. With their convenience proving popular, such apartments should continue to see stronger growth going forward.