MARKET IN MINUTES
Savills Research

Residential Leasing

Rents experience slight pullback

As expected, rental growth has taken a pause in Q2/2020 following solid growth in the previous quarters, even as the population of Tokyo Prefecture encouragingly reached the 14 million mark for the first time.

- Rents in the Tokyo 23 wards (23W) saw a slight pullback during Q2/2020, now standing at JPY4,138 per sq m – a decrease of 0.4% quarter-on-quarter (QoQ), but still 3.0% higher year-on-year (YoY).
- Growth in average mid-market rents in the central five wards (C5W) also halted during the quarter. Rents for Tokyo's flagship submarket are now at JPY4,859 per sq m after a decline of 1.2% QoQ, though the average is still up 1.7% YoY.
- The C5W saw its premium over the 23W average contract to around 17%, as five of the six outer submarkets still managed to post rental growth.
- At the ward level, Meguro was the top performer this quarter following growth of 5.2% QoQ. Otherwise, Sumida marked impressive growth on an annual basis, with rents surging 12.5% YoY.
- In the C5W, average rents for units in the 15-30 sq m size band – which represent the majority of listings – remained flat, while larger units faced a pullback. Interestingly, the near-opposite appears to have occurred across the 23W at large.
- With leasing activity suspended during the April and May lockdown, the average occupancy rate for the 23W fell 1.5 percentage points (ppts) QoQ to 96.4% as of Q2/2020. Looking ahead, occupancy should be bolstered as some latent demand emerges over the coming months.
- Even in the face of a pandemic, young residents continued to flock to Tokyo during the quarter, leading the prefecture's population to achieve 14 million for the first time in history.

"After two quarters of solid growth, average multi-family rents across the 23W and C5W saw a slight pullback in Q2/2020. It is, however, too early to tell whether this is just a short-term correction or the opening salvo of a bearish leasing market. Encouragingly, Tokyo still witnessed an inflow of young residents during the lockdown."

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

Matthew D'Elia
Manager, Research & Consultancy, Japan
+81 3 6777 5179
mdelia@savills.co.jp

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

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:

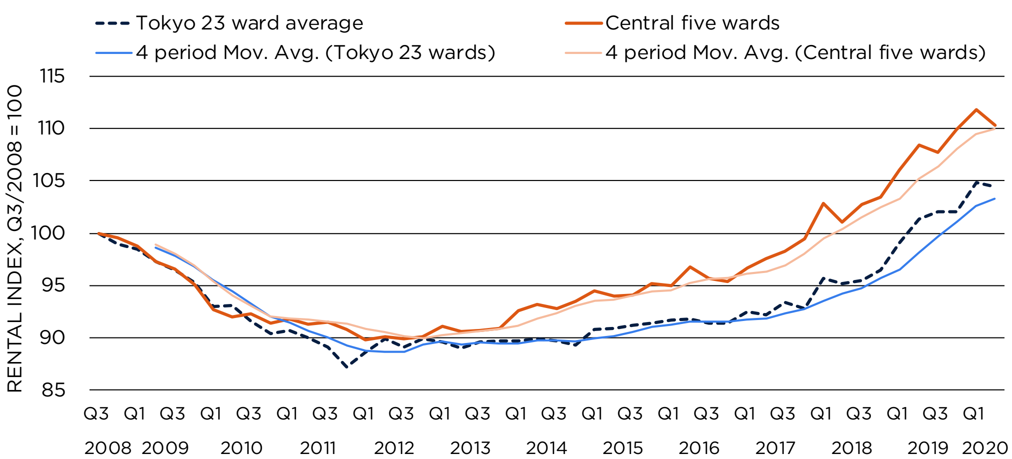
1) studio and one- or two-bedroom rental apartments of up to 100 sq m in size,

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.

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q2/2020



Source Savills Research & Consultancy

OVERALL RESULTS

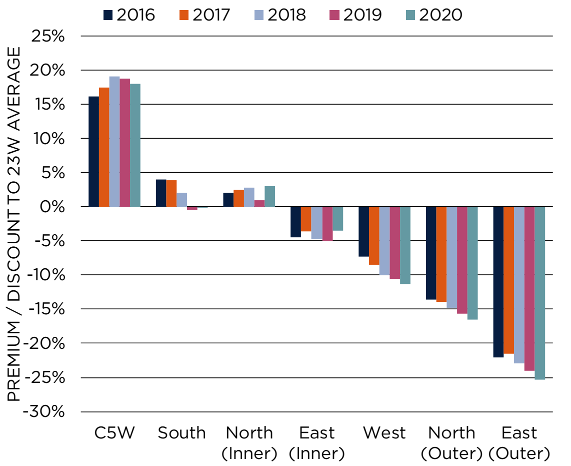
After achieving record highs in Q1/2020, both the 23W at large and the C5W submarket saw a slight decline in average rents – an outcome that was not unexpected given the circumstances. Indeed, even without factoring in the global pandemic, the multi-family leasing market tends to experience pullbacks after periods of strong rental growth. For now at least, average rents in both the 23W and C5W remain above their four-period moving averages, providing some comfort that the market has yet to enter a downturn (Graph 1).

To be sure, as the impacts of COVID-19 continue to reverberate through Japan's economy, this mild pullback could be the initial blow of a bearish multi-family leasing market. While Japan has a more stable labour market compared to other major economies, personal incomes will invariably be dragged down, with part-time and contract employees in the retail and hospitality sectors in particular bearing the brunt. Further, the pandemic came after Japan had already suffered an economic contraction in Q4/2019 as a result of the consumption tax hike implemented in October.

The impact of this slowdown will not be uniform across the sector, however. For instance, smaller units (15-20 sq m) in the outer wards could take a hit, though such units account for less than 5% of our samples. That being said, the typical tenant for units in our monitored residential sample set – which comprises newer, better-located units – tends to have a more stable income, and therefore the mid-market segment should remain fairly stable.

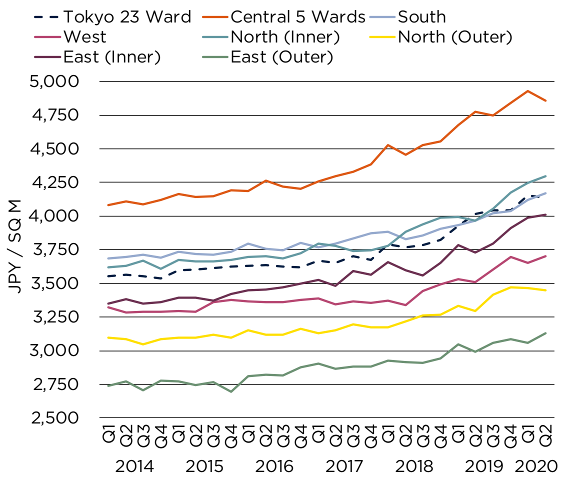
With the drop in rents less pronounced for the 23W as a whole, the C5W's premium has narrowed by around 1.2 ppts to 17.4% (Graph 2). In fact, five of the seven submarkets in our survey saw average rents grow on a quarterly

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2016 to 2020



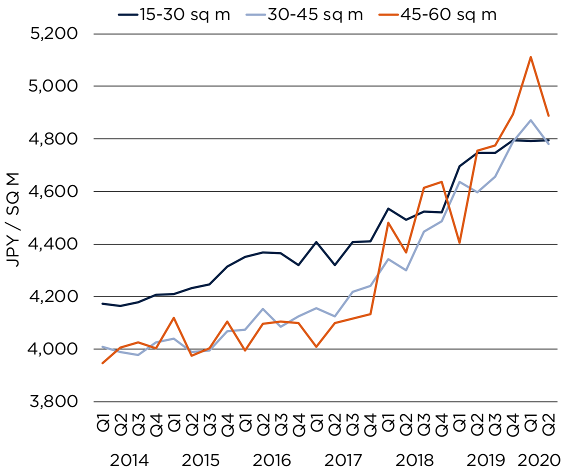
Source Savills Research & Consultancy
* The above represents the average premium/discount over the respective year.

GRAPH 3: Mid-market Apartment Rents, Q1/2014 to Q2/2020



Source Savills Research & Consultancy

GRAPH 4: Rents By Unit Size, C5W, Q1/2014 to Q2/2020



Source Savills Research & Consultancy

basis, with the Outer East submarket leading the pack at 2.3%. Only the C5W and Outer North submarkets experienced quarterly declines.

Overall, we have observed a substantial increase in the number of residential listings, indicating that some landlords appear to be having difficulty leasing out space. This is further corroborated by the decline in occupancy measured this quarter. Indeed, most leasing activity was suspended during Tokyo's state of emergency in April and May. As such, the leasing market will naturally take more time to recover, though this should lead to some pent-up demand coming to the foreground in Q3.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average multifamily asking rents for the 23W have fallen by a slight 0.4% QoQ, landing at JPY4,138 per sq m as of Q2/2020. Rents are still 3.0% higher YoY, keeping average asking rents higher than they were just prior to the Global Financial Crisis. It is a similar story for the C5W, where rents have seen a somewhat more substantial drop of 1.2% QoQ, though are still up 1.7% YoY. Average rents in Tokyo's flagship submarket are still 10% higher than where they were at the market's previous peak. That said, the C5W has been underperforming to some extent since 2018, when its premium over the 23W average was at its highest. The 18 outer wards (18W), which can offer substantial discounts compared to the C5W, had been performing relatively well even before the COVID-19 pandemic and it appears that this trend is persisting for the time being (Graph 3).

With the exception of Shibuya, where growth was flat, each ward in the C5W experienced a quarterly decline in average rents. Despite a decrease of 1.9% QoQ, Minato continues to hold the top spot for average rents in the 23W, a status that has recently been contested by Shibuya. Shinjuku, which has underperformed over the course of the year, saw only a modest rental decline of 0.2% QoQ. Chiyoda also experienced weakness on an annual basis, though Chuo, Minato, and Shibuya all posted YoY growth of 3.6% or higher.

The South submarket continues to reassert itself and, as of Q2/2020, has eliminated its discount compared to the 23W average, as rents grew 1.3% QoQ and 5.2% YoY to land at JPY4,172 per sq m. This uptick was primarily led by Meguro, which posted growth of 5.2% QoQ – the highest among the 23W this quarter – and 6.7% YoY. Office developments and corporate relocations to nearby Shinagawa, which also posted YoY growth of 6.7%, may be a factor in this rise in multi-family rents over the past year.

(Please refer to our Spotlight Report "Shinagawa" for further analysis on the South submarket)

Rental growth over the year in the Inner North submarket was an impressive 8.2% - the highest in the 23W. With quarterly growth of 1.1%, pushing rents to JPY4,295 per sq m, the submarket has further extended its premium against the 23W average. However, rental growth diverged substantially at the ward level: Bunkyo saw robust growth of 4.4% QoQ and 11.7% YoY, while Toshima posted a decline of 2.4% QoQ - which in turn weighed annual growth down to 4.5%. Toshima remains far cheaper than Bunkyo, however, and as such there may be more upside potential in the ward going forward. In fact, Bunkyo rents are now higher than those of Shinjuku in the C5W. Among the 18W, the ward is second only to Meguro.

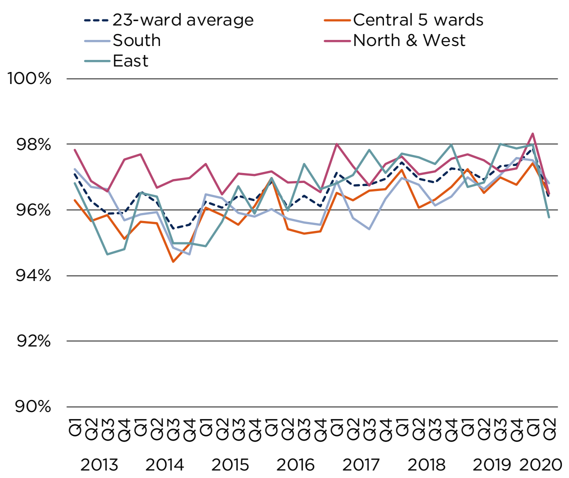
Following annual growth of 7.5%, Inner East rents have exceeded the JPY4,000 mark for the first time on record. Sumida, still the cheapest ward in the submarket, continues to lead rental growth, with its average now sitting at JPY3,952 per sq m after growing 12.5% YoY. To be sure, while displaying impressive annual growth, there has been a substantial slowdown on a quarterly basis, with rental growth falling below 1.0% in all three wards of the submarket.

The West submarket also held up fairly well in Q2/2020. Average rents now stand at JPY3,700 following growth of 1.3% QoQ and 5.4% YoY. After faltering through much of 2019 and early 2020, Nakano led the market's growth this quarter, posting a gain of 3.2% on a quarterly basis. Nerima, still the cheapest ward in the submarket, continued to lead on an annual basis as rents grew 6.9% YoY to JPY3,384 per sq m, though rents remained flat over the quarter. Suginami experienced a similar change, with rents growing 6.5% YoY but only 0.4% QoQ.

Average rents in the Outer North submarket faced a slight decline of 0.4% QoQ, in line with the 23W's movement this quarter, though outperformed on an annual basis with growth of 4.7% YoY. Itabashi has reversed its two-quarter losing streak to some extent, bucking the 23W trend and posting growth of 2.0% QoQ. Average rents in the ward are still down 0.7% on an annual basis, however, whilst Kita still maintains a 10% premium over last year's mark.

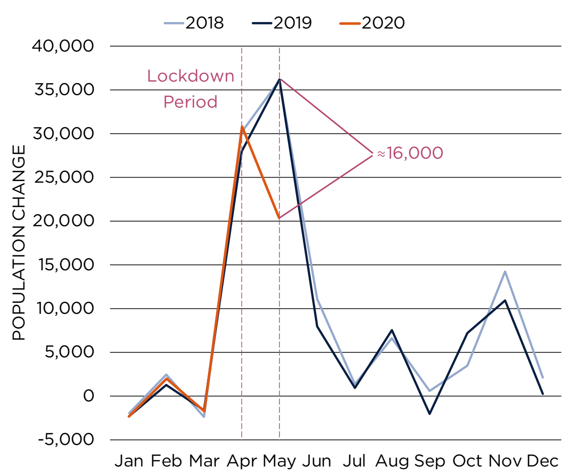
Finally, the 23W's cheapest submarket, the Outer East, posted the strongest growth of all surveyed submarkets this quarter, with rents increasing 2.3% QoQ to JPY3,129 per sq m in Q2/2020. Growth is still somewhat slower on an annual basis, marking an increase of only 4.6% YoY. Each ward in the submarket save for Edogawa saw growth this quarter, with the most expensive ward of the group, Arakawa, posting the strongest growth, rising 4.4% QoQ to JPY3,451. The cheaper Adachi Ward was the top performer on an annual basis with rents growing 6.9% YoY.

GRAPH 5: Average Occupancy For J-REIT Residential Assets, Q1/2013 to Q2/2020*



Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
* Q2/2020 is as of May 2020

GRAPH 6: Tokyo Population Change By Month, 2018 to 2020



Source Tokyo Metropolitan Government, 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.

As always, units between 15 and 60 sq m dominated supply, accounting for nearly all listings in Q2/2020. This quarter has witnessed a clear divergence amongst units within this group, however. Units in the smaller size band (15-30 sq m), which are the most numerous in our sample set, remained flat in the C5W. Larger unit sizes, having seen more robust growth since the beginning of 2019, saw a more marked pullback on a quarterly basis, with average rents amongst 30-45 sq m 45-60 sq m units falling 1.8% and 4.4%, respectively (Graph 4).

Interestingly, the near-opposite appears to have occurred across the 23W at large, with smaller units seeing a slight pullback while larger units posted growth for the quarter. This could be the result of the lockdown's impact on migration to Tokyo, as incoming university students and recent graduates are far more likely to lease units in the 15-30 sq m size band in the 18W.

As mentioned previously, quarterly contractions after periods of rapid growth are common in the multi-family sector and, moreover, sample sizes are smaller for larger units, causing more noticeable fluctuations each quarter. Therefore, it may be premature to assume that the downward shift is anything more than a temporary correction. To wit, on an annual basis, rents in the 15-30 sq m, 30-45 sq m, and 45-60 sq m size bands are up 1.0%, 4.0%, and 2.8%, respectively.

OCCUPANCY RATES

With leasing activity suspended during the April and May lockdown, the average occupancy rate in the 23W fell 1.5ppts QoQ to 96.4%, and this trend was most noticeable in the East submarket (Graph 5). Although this is a relatively sharp quarterly drop, occupancy rates have tended to fluctuate within the 96% to 98% range over the past several years. Indeed, this downward fluctuation was much less pronounced on an annual basis: average occupancy for the 23W fell only 0.5ppts YoY, while C5W vacancy remained flat over the same period. Occupancy could very well bounce back next quarter as latent demand begins to come to the foreground over the coming months.

TOKYO POPULATION REACHES 14 MILLION

Even as Japan's population declines, Tokyo – the political, economic, and cultural centre of Japan – continues to buck the trend. The primary driver of the prefecture's population growth is a continuous stream of youth seeking education and employment opportunities. Despite the fact that Tokyo was the epicentre of Japan's COVID-19 outbreak and therefore under a "soft" lockdown for the months of April and May, a large number of young people still moved to the prefecture, driving the total population to the 14 million mark for the first time in history.

As April marks the start of the Japanese fiscal year, companies have chosen this period to commence employment for recent graduates, whilst universities likewise commence their academic years on the same schedule. As such, the April-to-June period tends to see the largest influx of new residents during a given year. That said, the COVID-19 state of emergency declaration clearly weighed on relocations to Tokyo in May, with population growth underperforming the same month in 2018 and 2019 by around 16,000 people (Graph 6).

It is unclear how large the population rebound will be now that the state of emergency has been lifted. Universities are still conducting courses online and many companies, particularly large firms, have begun implementing remote working strategies and may not need new employees to move to the capital for the time being. Encouragingly, the population increase in April 2020 exceeded the levels seen in the same month over the past two years – indicating that the underlying growth trend is still robust.

To be sure, the concentration of people in Tokyo is not necessarily a positive for Japan as a whole and there could very well be some negative pressures on further population inflows going forward. It is worth noting that, even after increasing somewhat, the prefecture continues to have the lowest fertility rate in the country. This is not surprising given that living in the capital is substantially more expensive than in other regions and, therefore, residents may be more hesitant to start a family.

Indeed, concentration risk is by no means new to Japan. Prior to the pandemic, the government and some private organisations had already been considering decentralisation measures in order to mitigate the risk presented by natural disasters. This has unsurprisingly become even more of a concern in recent months. If the government does - as they are now discussing - decide to disperse certain functions to regional cities, then some corporations and residents are likely to follow. This push may rapidly decelerate, however, if a viable vaccine becomes available in the near future. In the end, even if there is some dispersion to regional markets, Tokyo should remain Japan's flagship city for the foreseeable future.

OUTLOOK

After achieving record highs in the previous quarter, average rents in the 23W saw a slight decline in Q2/2020 – an outcome that was not unexpected considering the robust growth witnessed to date and, of course, the COVID-19 pandemic. Indeed, after nearly seven years of economic growth, the longest expansion since the end of World War II, the combination of a consumption tax hike and a global pandemic have finally disrupted Japan's historic bull run, placing the country into a technical recession. While Japan has a more stable labour market compared to other major economies – as of May, the national unemployment rate stands at 2.9% and the job-to-application ratio in Tokyo is at 1.55x – personal incomes will invariably take a hit. Rental growth, if any, should therefore be modest at best while the economy recovers. Given the above, we predict that rental movements are likely to stay flattish for the time being, while occupancy should hold at the lower end of the 96%-98% range. With a larger number of listings than during the air-tight pre COVID-19 era, aggressive pricing is unlikely to be observed - even at brand-new apartments.

Encouragingly, even as Japan's population is declining, Tokyo continues to buck the country's demographic destiny, as youth continue to flock to the capital in search of education and employment opportunities. Despite the fact that Tokyo was the epicentre of Japan's COVID-19 outbreak in April and May, and therefore under a "soft" lockdown during that period, young people continued to move to the prefecture in large numbers, driving the total population to the 14 million mark for the first time in history. Further, five of the six outer submarkets in the Tokyo 23W, which tend to be more popular than the C5W amongst young residents, posted rental increases over the quarter. These favourable demographic drivers continue to make Tokyo multi-family residential a stable, defensive asset type.

To be sure, the economic and social impacts of COVID-19, particularly on the wallets of Tokyo residents, may lead some to consider moving to peripheral areas of Greater Tokyo - such as the Tama Region, Kanagawa, Saitama, and Chiba – or even abandoning the capital region entirely. That said, even if there is some reverse migration back to regional areas, Tokyo's position as Japan's top economic powerhouse is not going to change anytime soon. As such, we can expect to see younger residents, a key demand driver for mid-market, multi-family residential units, continue to set their sights on Tokyo for the foreseeable future, thus stabilising rents for the longer term.