MARKET IN MINUTES

Savills Research

Residential Leasing

savills

Rental growth pauses

Probably on the road to recovery, but recovery to pre-pandemic levels will likely vary by submarket.

- This quarter, average rents in the Tokyo 23 wards (23W) decreased 0.2% QoQ to JPY3,985 per sq m, although they remain 0.5% higher than a year ago.
- Rents in the central five wards (C5W) stayed flat over the quarter at JPY4,786 per sq m, translating to a yearly increment of 2.5%. The C5W was the only submarket that did not see a quarterly decline in rents.
- The C5W premium grew significantly to 20.0%, up 1.9 percentage points (ppts) from last year, exceeding the pre-pandemic level.
- Shibuya posted the largest gain on a quarterly basis of 1.7%, also seeing an annual increment of 5.1%. However, much of this growth was due to the addition of brand-new buildings that came out this quarter.
- Rents of different sizes in the C5W submarket saw diverging trends this quarter.
- The average occupancy rate in the 23W decreased 0.9ppts from the previous quarter to 95.9%. The East submarket experienced the largest contraction at 1.3ppts QoQ.
- The South submarket remains a popular destination for young crowds to migrate to, replacing demand from young families that have tended to move further afield.

"After sound growth in previous quarters, average rents have stagnated across the 23W, with the C5W staying flat. Many young crowds have moved to Tokyo this quarter while the population remains below the pre-pandemic peak, suggesting that demand might take some time to recover. The recovery to pre-pandemic levels is likely to vary by submarket."

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

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

Simon Smith
Regional Head of Research & Consultancy, 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 (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

After two quarters of moderate growth, the Tokyo 23W saw a mild correction in rents in Q2/2022, while rents in the C5W stayed flat. Although the C5W's rents are sitting slightly higher than in Q2/2021, many of the outer submarkets declined below figures from a year ago. Overall, recovery has been slightly weak, likely due to the lingering effects of the pandemic. That said, the 23W has recovered about 25% and the C5W about 50% from their troughs during the pandemic to their pre-pandemic peaks.

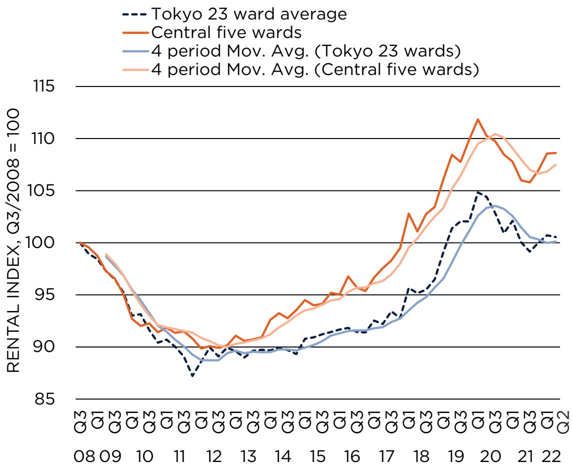
The annual spring migration of new graduates and students looking for opportunities in the capital has brought about a notable increase in residents throughout the city. The population of Tokyo's 23W grew by a total of 40,000 over the quarter, whilst the C5W submarket alone gained an additional 6,500 people. Border restrictions on foreign nationals entering Japan are also gradually being lifted, with the Ministry of Foreign Affairs further relaxing measures on issuing visas from early June, which will have a positive impact on housing demand. That said, Tokyo's population remains roughly 60,000 below its May 2020 peak and is not expected to grow much further this year until more foreign residents are able to enter the country. Furthermore, hybrid work styles are likely to remain due to the positive impact on work-life balance. Hence, moving to the 23W might still not be in the best interests for a number of workers and it might be some time before the population recovers to pre-pandemic levels, especially for those who have faced stagnant wage growth and are suffering from inflation.

The total number of available units has kept decreasing, by around 5% from the previous quarter, which can be seen as a sign that demand in Tokyo is recovering. However, there are still many more available units when compared to Q2/2020, especially when looking at the South and Central submarkets. However, the foreign population is expected to gradually return to Tokyo, which should allow some demand to remain buoyant. Furthermore, with some reversal of hybrid work styles that prevailed throughout the pandemic, more demand will likely shift towards the C5W submarket, potentially driving up average rents. While overall wage growth has been stagnant, some skilled workers have enjoyed higher salaries because of the stiff competition for talent in the market, suggesting that prime areas could keep seeing recovery. With COVID-19 becoming more endemic in Japan and many restrictions being lifted, there will likely be a gradual return to the pre-pandemic status quo, with some additional post-pandemic features. For instance, larger units and properties with facilities that accommodate remote working should see heightened levels of popularity going forward.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

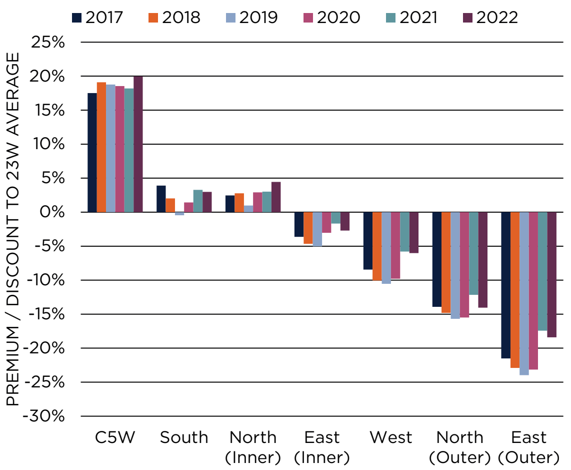
Average mid-market asking rents throughout Tokyo's 23W have fallen slightly, and currently sit at JPY3,985 per sq m. Rents are down 0.2% QoQ, but still exceed the previous year's average by 0.5%. In general, all submarkets have seen a slight correction in rents this quarter, with the exception of the C5W. Overall, it appears that rents in some submarkets are veering toward pre-pandemic levels, and recovery as well as adjustments may be expedited as population trends gradually reverse as well. For example, submarkets like the South and West may have served as a more affordable proximate of the C5W during the pandemic and therefore

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q2/2022



Source Savills Research & Consultancy

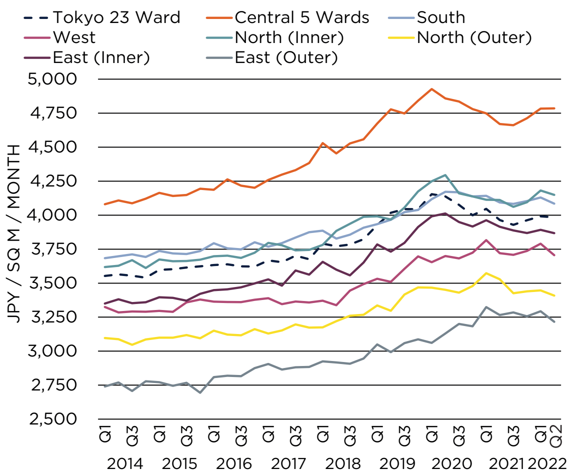
GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2017 to Q2/2022



Source Savills Research & Consultancy

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

GRAPH 3: Mid-market Apartment Rents, Q1/2014 to Q2/2022



Source Savills Research & Consultancy

performed well, but this trend might reverse as normalcy returns. Nonetheless, inflation and the economic uncertainty due to the situation in Ukraine could dampen recovery sentiments.

Growth in average rental prices in the C5W submarkets plateaued following two consecutive increments, and currently lie at JPY4,786 per sq m. The constituents of the C5W submarket experienced significant variation in terms of average rental growth, with Shibuya and Chiyoda experiencing some of the most positive quarterly expansions across the 23W at 1.7% and 1.0%, respectively. Meanwhile, Minato and Shinjuku saw rents decline by 2.6% QoQ and 0.3% QoQ, respectively. While the population of the C5W still remains below its peak in May 2020, there are tentative signs for optimism, with the population of the C5W submarket growing by around 6,500 people over the quarter. Demand is traditionally strong among young professionals and foreign residents in this submarket, due to the accessibility to workspaces, diversity, and range of entertainment options available. Therefore, as the pandemic mindset continues to fade and more foreign residents move to Tokyo, the C5W submarket should gradually experience an uptick in demand.

In the South submarket, average rents contracted at 1.1% QoQ to JPY4,084 per sq m, following three consecutive quarters of growth, translating to a mild annual decline of 0.2%. Overall, rents remain slightly below the peak prices seen at the onset of the pandemic. At the ward level, Meguro, which remains a popular residential and commercial area, experienced the largest quarterly decline in average rent, falling by 2.9%. Shinagawa similarly experienced a notable quarterly decline of 2.1%. Ota was the only ward to record a quarterly increment, with average rents rising QoQ by 1.6%, whilst Setagaya experienced positive annual growth at 2.0% despite dipping to 0.5% QoQ. However, the South submarket also experienced an increase in the number of available units - a similar trend to the C5W, suggesting that demand is still in the recovery phase. Overall, the close availability of amenities, green space and overall liveability of the area will ensure that demand remains consistent, especially among families and young people.

The Inner North submarket experienced a slight contraction in average rental prices, falling 0.8% QoQ to JPY4,149 per sq m, although still saw annual growth of 0.9%. However, there was a notable contrast at the ward level. Toshima experienced a significant quarterly decline of 2.7% while rents in Bunkyo grew by 1.1% QoQ and 0.7% YoY. The constituents' proximity to the C5W and the strength of major entertainment and business hub Ikebukuro will likely provide a strong base for residential demand, as evidenced by the Inner North submarket's annual population growth of 0.7%.

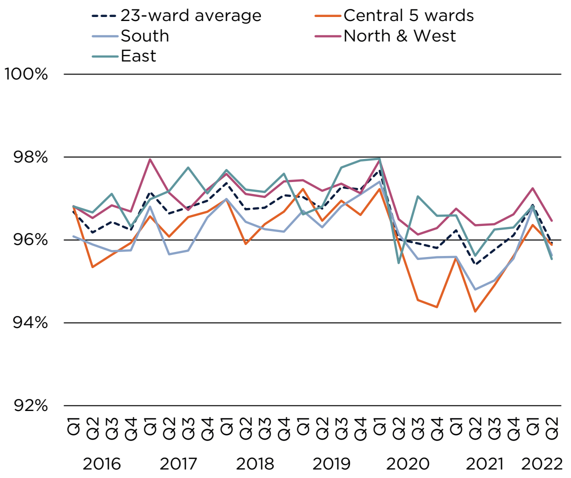
Likewise, the Inner East submarket exhibited a slight decline in average rental prices, having contracted quarterly at a rate of 0.6% to an annual decline of 1.2% to JPY3,868. Sumida ward experienced the most notable decline in average rental prices, falling by 1.4%. Rents in Koto and Taito shrank more moderately, falling 0.2% and 0.3% QoQ, respectively. This submarket is notable for its proximity to major business centres in the C5W, as well as the availability of entertainment and wide-ranging cuisine and shopping. Therefore, rental demand for the Inner East submarket will likely remain strong, despite falling average rents this quarter. This can be demonstrated by the fact that the total population of the submarket increased by around 5,500 people over the quarter and the number of available listings fell by over 20% across the submarket.

Despite its enviable and convenient location, with access to central locations via the JR Chuo Line, the West submarket demonstrated the most notable quarterly decline among the 23W at 2.2% to JPY3,706. However, the annual correction was less severe, with rents having fallen by only 0.4%. Average prices in Nakano and Suginami remain significantly higher than in Nerima. Nerima experienced the greatest QoQ decline in this submarket, falling 3.1%, whilst prices in Suginami and Nakano declined at a slightly shallower QoQ rate at 1.4% and 2.3%, respectively. Nakano and Suginami in particular feature major entertainment hubs with countless independent restaurants, venues, and events, which will appeal largely to a younger audience, whilst Nerima will likely be highly regarded for its affordability.

In terms of yearly changes, the Outer North submarket experienced a significant correction compared to other submarkets, falling 3.3% below Q2/2021 levels. Average rents fell by 1.0% QoQ, on par with what was experienced in many other non-C5W submarkets. Following an increase during the pandemic, average rents have largely corrected to pre-pandemic rates in the Outer North. Itabashi fell 0.9% QoQ and 4.0% YoY, whilst rents in Kita declined at a slightly higher quarterly rate, falling at 1.3% QoQ. Average rents remain on the more affordable end compared to other submarkets at JPY3,409 per sq m, the second lowest in the 23W.

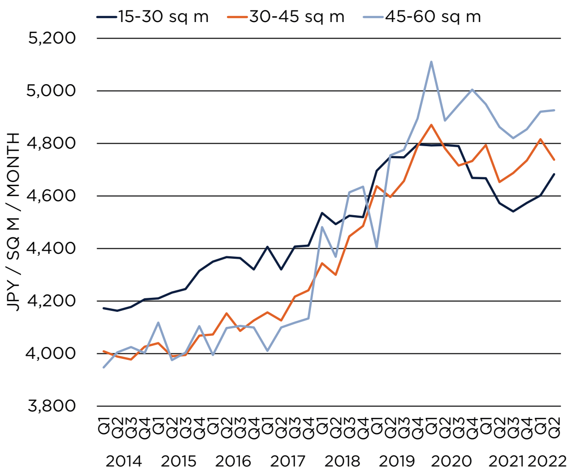
The Outer East submarket consistently features the lowest average rental prices in the 23W at JPY3,216 per sq m, having declined 2.4% QoQ - the largest fall among the submarkets. The Outer East saw significant variation, with Edogawa ward displaying the largest quarterly contraction among the 23W at 6.8%. However, it should be noted that

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q2/2022*



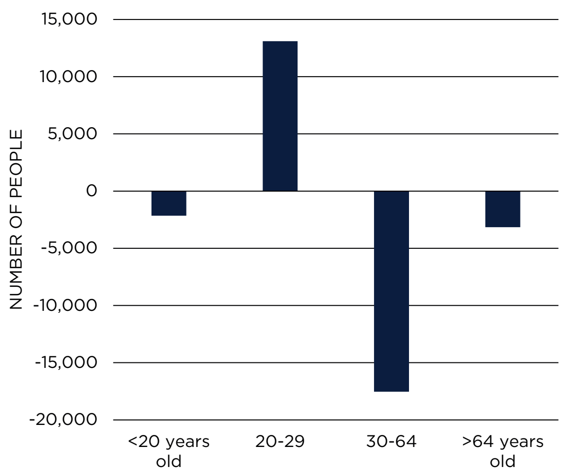
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data.
*Q2/2022 is as of May 2022.

GRAPH 5: Rents by Unit Size, C5W, Q1/2014 to Q2/2022



Source Savills Research & Consultancy

GRAPH 6: Southern Wards Net Migration of Different Age Groups, 2021



Source Ministry of Internal Affairs and Communications, Savills Research & Consultancy

Edogawa has a smaller sample of mid-market units and may see more fluctuations in rent. The only ward to experience quarterly growth, Katsushika ward's rents rose by 0.7% QoQ, although this is still 2.6% below last year's figure. At the same time, it should be noted that the Outer East had seen the most growth during the pandemic, and even with the corrections seen this quarter, rents still remain above pre-pandemic levels.

OCCUPANCY RATES

The effects of the pandemic appear to linger in the Tokyo 23W, with occupancy rates lagging pre-pandemic figures. Average occupancy rates contracted going into Q2/2022, falling uniformly across a majority of the 23W submarkets to an average of 95.9%, although they remain higher than one year ago.

Average occupancy rates fell across all Tokyo submarkets over the quarter, with the C5W observing the smallest change of 0.5ppts QoQ. That said, a contraction in occupancy rates in Q2 is in line with the typical occupancy cycle seen in the city. Tokyo experienced positive migration throughout Q2, with monthly increases exceeding that of the previous year. Nevertheless, occupancy levels in the 23W still remain below that of pre-pandemic times, and appear to have settled into a new cycle where the average occupancy is around 1.0ppts lower.

Overall, with the severity of the COVID-19 pandemic waning throughout the year, occupancy rates could eventually see a gradual recovery, with more people having the confidence to move to the 23W and more foreign residents entering the market. Furthermore, workers will increasingly return to pre-pandemic work styles whilst some companies will continue hybrid work styles, meaning demand for central units should improve.

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 the C5W, different size bands appear to have exhibited diverging trends. The 15-30 sq m size band has seen a slight increment in rents over the quarter, increasing 1.8% QoQ. Meanwhile, the 30-45 sq m size band saw a quarterly decline of 1.6%, whereas the larger 45-60 sq m size band has stayed flat. Overall, there still appears to still be a price premium for larger units, which are more uncommon in the market. Nonetheless, it should be noted that because of the smaller supply of these larger units, rents are more prone to fluctuations.

Although the severity of the pandemic has waned by a large extent, the population of the C5W is still notably smaller than pre-pandemic times. Before the pandemic, while younger families had a tendency to move out of the C5W, the large net inflow from the young professionals 20-29 age group into the submarket was more than enough to offset this. However, the number of people in this demographic moving into the C5W has declined, which has negatively affected the 15-30 sq m band in particular. These units have likely faced stiffer competition due to the generally smaller number of people moving to the C5W. However, going forward, some recovery could be expected especially as more foreign residents enter the country, which should increase the demand for such units. Meanwhile, larger residences will likely remain popular with people who work for companies with hybrid work styles.

TOKYO'S SOUTHERN WARDS

The South submarket is a popular residential market for families with convenient access to the C5W. It has the largest total population among the Tokyo submarkets and had been growing steadily, experiencing a net population increment of 20,000 in 2019, according to data from the Ministry of Internal Affairs and Communications. However, it experienced a significant outflow as a result of COVID-19, losing approximately 11,000 people between Q2/2020 and Q2/2021. Despite recent QoQ population growth of 5,000 people seen between February and May 2022 during the spring moving season, its population has yet to recover to pre-pandemic levels and sits 0.9% below its Q2/2020 peak.

The appeal of the South has been waning particularly among younger families in recent years, indicated by the largest net outfluxes in population occurring in the 0-to-9-year-old, 30-to-39-year-old, and 40-to-49-year-old age groups from 2019 to 2021. The proliferation of hybrid work styles has changed renting preferences, with families in particular searching for large spaces to accommodate working at home over proximity to central Tokyo, and have turned to places that are more affordable.

However, despite the decline in the number of people, the number of households in the submarket has not seen significant change. There are still a large number of younger, single professionals in the 20-to-29-year-old bracket moving into the Southern wards. Indeed, this age bracket alone saw a total net increment of nearly 31,000 people in 2020 and 2021. In recent years, the South submarket has witnessed a slight shift away from its family make up, instead becoming more popular with younger professionals, which is likely to gravitate demand toward single-person residential units. Indeed, within the 23W, Ota and Setagaya saw the second and third most number of migrants in this age group in 2021.

The pandemic appears to have shifted some popularity around within the submarket. Meguro and Shinagawa are located closer to the central business districts, and have traditionally been more popular and expensive. However, both wards have seen average rents decline since the pandemic. In contrast, Setagaya and Ota, the more affordable wards, have seen average rents increase slightly. Changes in occupancy rates and population changes also appear to support this trend. Meguro and Shinagawa have observed a slightly larger dip in occupancy rates since the pandemic begun, whereas occupancy rates in Setagaya and Ota have been more stable. Moreover, within the 20-29 age bracket, Meguro and Shinagawa have also seen a larger decline in the number of net migrants compared to Setagaya and Ota. Indeed, a greater preference for larger spaces appears to have benefited more affordable wards. Nonetheless, the pandemic is winding down, and some reversal of this trend could be observed as more people return to the office and school more frequently.

Overall, the South submarket has maintained its popularity particularly among young professionals. Demand is expected to increase in the more central areas of the submarket as Tokyo progresses to an endemic state, and with the easing of restrictions on new foreign arrivals in Japan. Meanwhile, the outer areas of the submarket will remain popular with young family age groups as they tend to have characteristics that are more family friendly. Major infrastructure projects will further contribute to improving the quality of living for residents across the submarket; the Takanawa Gateway City redevelopment, set for completion in 2024/2025, will deliver modern and bespoke residential, office and leisure facilities over a 9.5-hectare site, providing new jobs and amenities for the wider Shinagawa area, and may consequently create more residential demand for the South submarket and proximate submarkets.

OUTLOOK

Following sound growth in recent quarters, average rents experienced a slight dip in Q2/2022. This should not be a cause for concern, as demand should be expected to gradually recover going forward. Indeed, more people moved to the 23W in Q2/2022 than in Q2/2021, and the expected return of foreign residents due to relaxed restrictions should project heightened demand. The number of available listings has gone down, and occupancy appears to have moved away from the trough seen during the pandemic, which suggests that the market is currently on an encouraging trajectory - the 23W has recovered about 25% and the C5W about 50% from their troughs during the pandemic to their pre-pandemic peaks. Nevertheless, the population remains lower than its pre-pandemic peak and is unlikely to see significant increments from internal migration for the remainder of the year, which could possibly trigger mild rental corrections in units struggling to find tenants.

One trend observed during the pandemic was some convergence between the average rents in the 23W. For instance, while traditionally less expensive submarkets like the Outer East and West saw rents grow, more expensive submarkets like the C5W and Inner North experienced corrections. The rapid increase in remote work meant that many people, especially those in large companies, did not need to commute to the office as much, which decreased the value of residences proximate to central business districts. However, the past two quarters could possibly indicate some reversal of this trend, with the premium that the C5W has over the 23W having recovered. As the pandemic approaches an endemic state, more people are likely to move back to Tokyo, and market conditions could gradually resemble something closer to what was seen before the pandemic.

The high corporate profits in recent quarters suggest that employees of large corporations are likely to benefit and have greater spending power, which may expedite the recovery of units in the C5W, particularly quality units for the single skilled professionals that have seen salaries rise due to the fierce competition for talent in the labour market. On the other hand, the cost-driven inflation is likely to affect the purchasing power of employees of SMEs that have seen wages stagnate for over a decade, meaning that more affordable residences may find it comparatively difficult to increase rents. The lingering effects of COVID-19, inflation, and the uncertainty due to the crisis in Ukraine are likely to make tenants more cost-conscious. The divergence in recovery may become even clearer going forward.

That said, hybrid work styles appear as though they are here to stay. This paradigm shift has bolstered demand for units that are larger and have features that help support remote work. While a majority of companies have policies that are centred around commuting to the office, others have policies skewed toward remote work, creating a pool of residents that have a lesser incentive to move back to the 23W. As such, it may take a while before demand in the 23W can fully recover to its pre-pandemic state. Nonetheless, the 23W still remains a popular destination for young crowds, as suggested by the increase in the number of households over the year despite the decrease in population, which should cement its strengths as a residential hub.