Tokyo - Q2/2023

MARKET IN MINUTES

*Savills Research*

# Residential Leasing

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## Modest rental growth recorded

Rents continue to rise, with mild increments during the peak moving season.

- Average rents in the Tokyo 23 wards (23W) have seen mild increments over the quarter, inching up 0.2% quarter-on-quarter (QoQ) to JPY4,037 per sq m, and increasing 1.3% year-on-year (YoY).
- Rents in the central five wards (C5W) also saw minimal changes, decreasing 0.3% QoQ to JPY4,800 per sq m, to a yearly increase of 0.3%.
- The C5W premium over the 23W average is 19.2%, and has been higher than pre-pandemic levels since 2022.
- Minato saw the largest quarterly increment of 2.2%, while Chuo saw the largest correction of 2.0%. The market has been stable overall in the 23W.
- The 45-60 sq m size band saw some corrections this quarter, but maintains a comfortable premium over smaller counterparts.
- Average occupancy rates in the 23W declined by 0.5 percentage points (ppts) to 96.6%, while those of the C5W dipped 0.7ppts to 96.3%.
- An analysis of rental housing stock and supply data suggests a greater focus on larger units, as well as on the Inner East submarket.

"Average rents in the 23W have kept increasing albeit slightly. Net migration into the 23W during this peak spring moving season has seen a notable recovery, reaching 2019 levels, and with foreign nationals playing a bigger part. Multiple upcoming development projects in the C5W are likely to make it an increasingly popular area to live."

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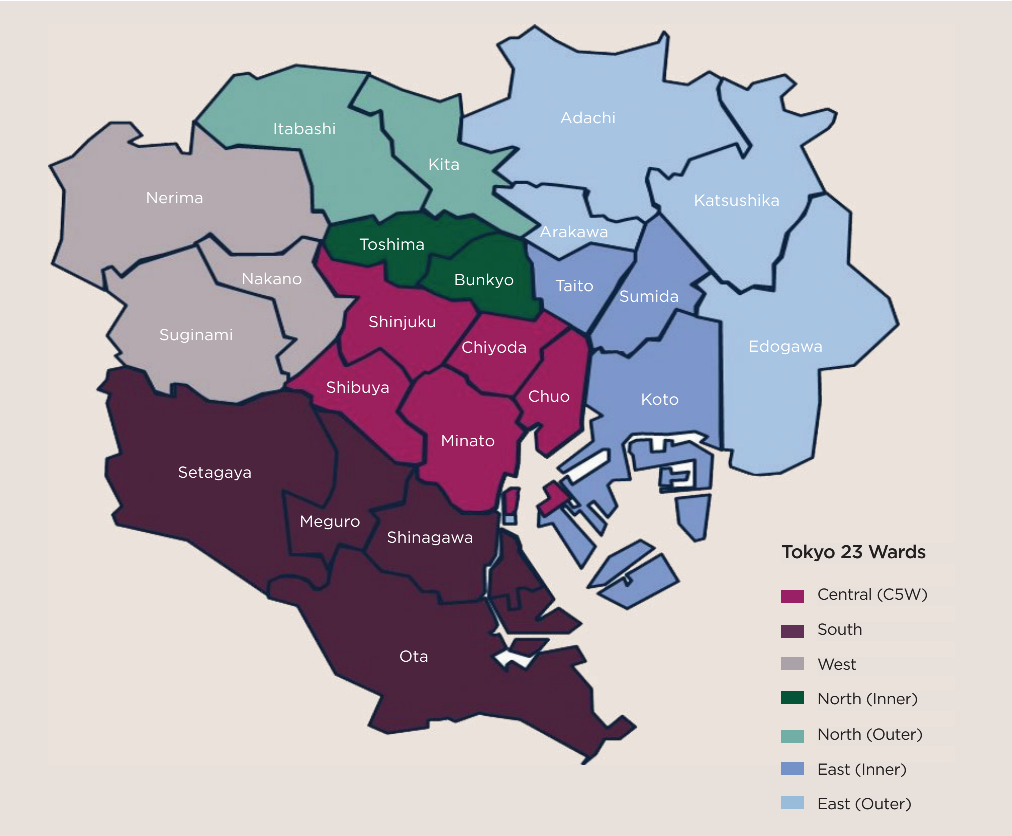
**MAP 1: Tokyo's 23 Wards by Survey Area**




**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

Rents in the Tokyo 23W in Q2/2023 have seen marginal increments from the previous quarter, and the overall sentiment in the market is increasingly positive. Society has transitioned to a post-pandemic state, and many companies have generally moved toward pushing for higher levels of office attendance. In accordance with this shift in workplace policies, more people have moved to the 23W.

From March 2023 to May 2023, net-migration into the 23W was more than 55,000 people. This net-migration can be broken down into movements from the Japanese population, and the foreign population. The foreign population increased by 16,000 over this timeframe - almost double the same period in 2019. Meanwhile, the Japanese population has increased by 39,000 - this still lags the peak growth seen over the same period in 2019 by around 30%, but is about 50% higher than those of 2021 and 2022. Overall, net-migration has been recovering, aided by the large number of foreign nationals moving to Japan, but the Japanese population growth will likely take more time to recover.

The C5W premium over the 23W average is at 19.2%, and has been higher than pre-pandemic levels since 2022. To a certain extent, the continuation of remote work for some companies will likely contribute to increased popularity of areas further away that are more affordable. At the same time, with commuting to the office regularly becoming more commonplace, some demand has indeed returned to the C5W. In particular, young skilled professionals have enjoyed noticeable wage growth and tend to prefer the convenience of living in more central areas. Furthermore, there are multiple developments in the pipeline that will transform the landscape of central Tokyo, making it a more desirable place to live in. As such, the C5W should be able to gain further momentum going forward.

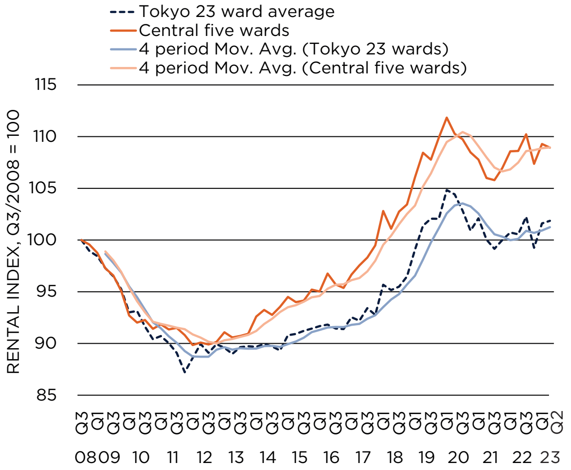
## MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average rents in the 23W have increased slightly from the previous quarter, by 0.2% QoQ to JPY4,037 per sq m in Q2/2023, increasing 1.3% on an annual basis. Most wards saw minimal changes from the previous quarter, suggesting that there is some sense of stability in the market now. Indeed, Japan has moved to a post-pandemic era, and the population inflow into the 23W between March and May 2023 has recovered to levels close to the pre-pandemic peak. While some paradigm shifts that occurred during the pandemic such as remote work are likely to linger, and the global economic slowdown will have an impact on the market, prospects for the 23W look good overall.

Average asking rents in the C5W have observed a slight downtick, decreasing 0.3% QoQ to JPY4,800 per sq m. At the same time, they are also 0.3% higher than a year ago. At the ward level, Minato had the largest increment of 2.2% QoQ, while Chuo had the largest decline of 2.0%, and all other wards saw moderate changes in between. The population of the C5W has recovered. Overall, rents in the C5W have seen recovery from the trough observed during the pandemic, and central Tokyo should continue to grow as an attractive area for people to live because of the plethora of new developments down the road.

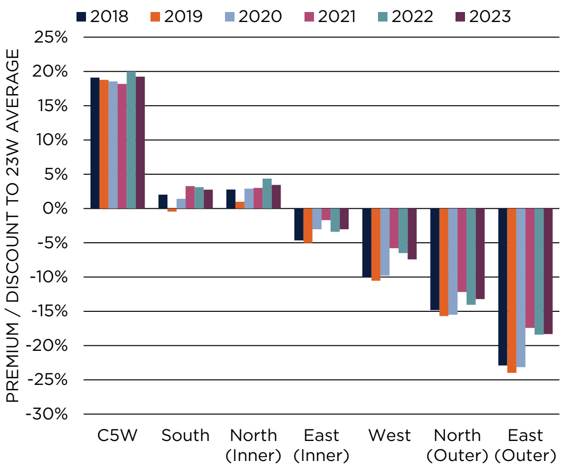
The South submarket has moved in a similar direction as the C5W, dipping a slight

**GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q2/2023**




**Source** Savills Research & Consultancy

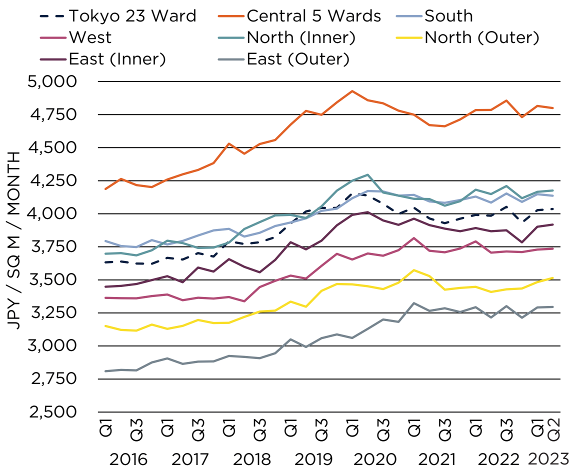
**GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2018 to Q2/2023**




**Source** Savills Research & Consultancy

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

**GRAPH 3: Mid-market Apartment Rents, Q1/2016 to Q2/2023**




**Source** Savills Research & Consultancy

0.3% over the quarter to JPY4,137 per sq m, but maintaining rents 1.3% higher YoY. However, this quarterly decline was not evenly spread, as Setagaya saw the most notable drop of 1.2% QoQ, while rents in other wards remained more or less flat over the quarter. Meanwhile, the two wards closest to central business districts, Meguro and Shinagawa, contributed to most of the growth on an annual basis, increasing 2.8% YoY and 2.4% YoY, respectively. Indeed, with society in a post-pandemic mindset and with more foreign nationals migrating to Japan, family-friendly wards located proximate to central business districts are likely to become more popular.

The Inner North submarket has seen slightly more positive movements than the C5W, with rents inching upwards 0.2% QoQ to JPY4,176 per sq m, and remain higher 0.6% YoY. Rents in Bunkyo saw a mild dip of 1.2% QoQ, while rents in Toshima moved in the opposite direction, increasing 1.8% QoQ. However, rents of both wards remain higher on an annual basis by 0.7% and 0.6% respectively. Overall, both wards should continue to perform strongly in the post-pandemic environment as residential hubs located close to the city centre.

Rents in the Inner East submarket saw a mild increment of 0.4% QoQ to JPY JPY3,918 per sq m, and remain 1.3% higher YoY. Rental growth saw some divergence between the wards, with Taito contributing to most of it by increasing 1.8% QoQ and 3.8% YoY, whereas other wards saw comparatively minor changes. On another note, the submarket has performed extremely well in terms of population growth. Indeed, population inflows between March and May 2023 for each ward was more than 50% than the same period in 2019. The submarket offers a good balance between affordability and access to central areas, which likely contributed to its overall strength. Going forward, with the multiple developments in the pipeline located on the east of Tokyo station, the Inner East submarket will likely continue growing as an attractive residential area.

Changes in the West submarket were mild, with rents increasing 0.2% QoQ and 0.8% YoY to JPY3,736 per sq m. Nerima, the least expensive ward in the submarket was the only ward to see a dip in rents, albeit mild at 0.5% QoQ, although it was also the primary contributor to annual growth, increasing 3.1% YoY. Meanwhile, changes in the other two more expensive wards, Nakano and Suginami, were mild both quarterly and annually. However, Nakano overall appears to be the winner in terms of migration, as it was the only ward to post greater net migration during the 2023 spring moving season than that of 2019. Nakano is the most central of the three members, and this may be a reflection of more people going back to the office, and consequently wanting to live in areas closer to the central business district.

The Outer North submarket has seen the most impressive rental growth this quarter, increasing 0.9% QoQ and 3.1% YoY to JPY3,514 per sq m. Both members of the submarket performed well, with Itabashi contributing to most of the quarterly growth at 1.9% QoQ, and both Itabashi and Kita seeing rents increasing 3.1% YoY. Looking at population trends, Kita looks to have performed well as its net migration growth between March and May 2023 surpassed that of 2019. Indeed, there appears to be some lingering demand for wards that are relatively less expensive, perhaps from those who require more space at home due to increased levels of remote work, as well as from those who have been suffering from the impact of inflation.

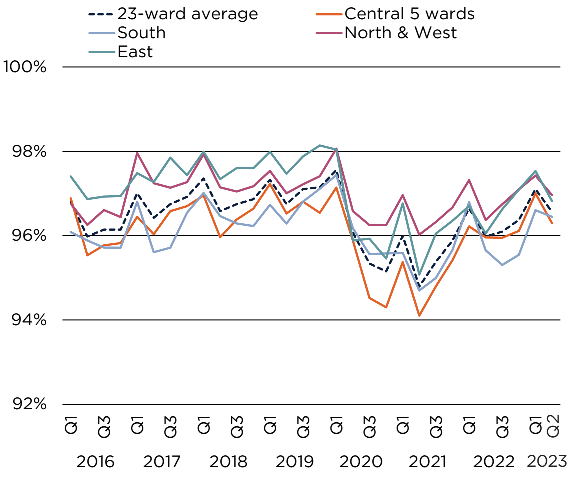
Rents in the Outer East submarket have seen little change over the past quarter, edging up 0.1% QoQ to JPY3,296 per sq m, but remain 2.5% higher annually. At the ward level, Arakawa, which is also the ward in closest proximity to central areas, was the strongest performer, with rents increasing 1.4% QoQ and 3.7% YoY. Meanwhile, Adachi and Edogawa saw mild dips in rents over the quarter. However, all wards have rents higher than a year ago. Overall, the Outer East has done well in terms of both rental growth and net migration, and may continue to see greater increments going forward as demand for larger units is expected to linger.

## OCCUPANCY RATES

Occupancy rates in the Tokyo 23W have dipped by 0.5ppts to 96.6% this quarter. While occupancy contractions in the second quarter of the year are in line with its annual cycle, it should be noted that occupancy rates have overall been the highest since the pandemic started, and are almost at the highs observed in pre-pandemic times.

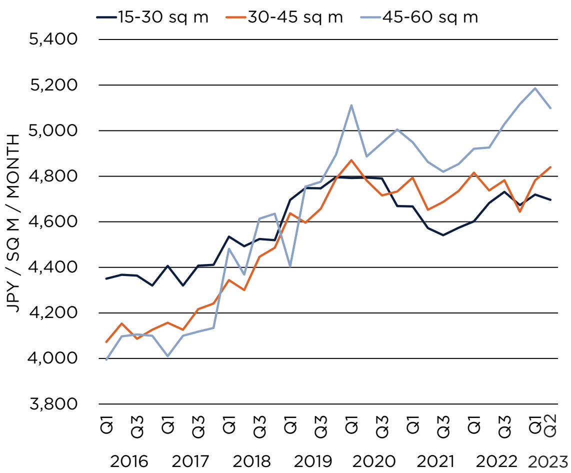
Occupancy rates in the C5W have also moved to around the same levels as the broader 23W market, decreasing 0.7ppts to 96.3%, although it should be noted that this is around the same level as the highs seen in 2019, which is an encouraging sign for the submarket as it demonstrates the strength of, and the recovery observed in the C5W. Due to the high levels of remote work introduced at the start of the pandemic, the C5W was initially the most impacted by far. Now that society has moved to a post-pandemic state, demand for units in more central areas will likely continue to grow. Indeed, when considering the strong performance of Japanese blue-

**GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q2/2023***



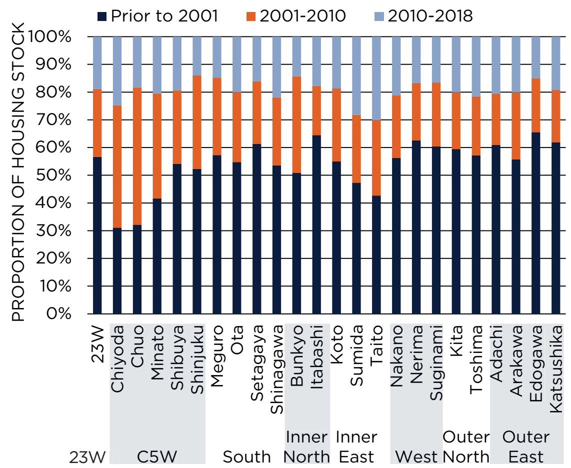

**Source** Savills Research & Consultancy based on publicly disclosed J-REIT property data
* Q2/2023 is as of May 2023.

**GRAPH 5: Rents by Unit Size, C5W, Q1/2016 to Q2/2023**




**Source** Savills Research & Consultancy

**GRAPH 6: Tokyo 23W Rental Housing Stock by Ward and Year of Construction, as of September 2018**




**Source** Ministry of Land, Infrastructure, Transport, and Tourism, Savills Research & Consultancy

chip companies and the noticeable wage increments that they have been offering, especially for young workers, single-occupier units in the C5W are likely to see increased popularity.

Going forward, the population of the 23W is likely to grow as more people move to the city centre to be closer to the office, and as more foreign nationals migrate to Japan. With these strong fundamentals bolstering the market, occupancy rates will likely remain high and improve. Nonetheless, some trends that materialised during the pandemic may linger and influence the performance of residential properties. For instance, people might be increasingly partial toward units that have floor plans, facilities, or amenities that make it more conducive for remote work. As such, occupancy levels may vary considerably at the property level, which will likely give landlords that have been quick to adapt and plan appropriate upgrades a greater advantage.

## 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 Q2/2023, there were some divergent trends observed between different size bands in the C5W. Rents in the largest 45-60 sq m size band saw the most notable dip of 1.7% QoQ, bringing it down to Q4/2022 levels. Despite the correction observed this quarter, it must be noted that rents in this size band have seen continuous growth over the past two years, and that rents are comfortably higher than pre-pandemic times. Indeed, this overall trend is likely a testament to the heightened popularity of larger units, and their relative scarcity in the C5W, which caused rents to increase. Meanwhile, the 30-45 sq m size band rose modestly by 1.2% QoQ, while the smallest 15-30 sq m size band saw a mild contraction of 0.5% QoQ. Overall, larger units appear to hold a premium over smaller ones.

Society has moved to a post-pandemic state, and the C5W is expected to see a resurgence in popularity as generally greater office attendance is expected, and more young professionals move into the submarket to be closer to the office, suggesting that single-occupier units should see more recovery. Furthermore, the multiple developments in the pipeline will make the central business districts even more attractive to live in. At the same time, existing trends that emerged during the pandemic, like the increased preference for larger units to facilitate remote work, will likely linger and support the larger size-bands.

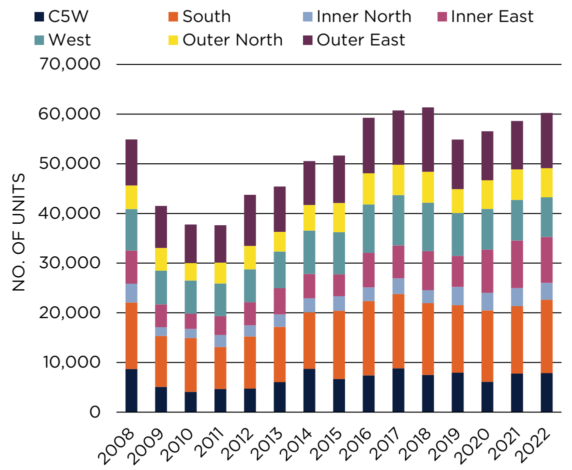
## HOUSING STOCK ANALYSIS

Renters have a wide variety of housing stock in the 23W to choose from, and taking a closer inspection at the kinds of availabilities across different submarkets could provide investors an insight into the renovation and value-add opportunities that might be lurking in certain areas, and what lies in store for the overall market in terms of development plans.

The first factor that will be analysed below is the age of properties. The age of the property is a major factor that renters take into consideration, with newer units often holding a notable premium over older units. As of September 2018, in the 23W, approximately more than half of the rental housing stock was built before 2001, and about one quarter built between 2001 and 2010. However, this distribution varies notably from ward to ward. For instance, the proportion of older units in the C5W, most notably in Chiyoda, Chuo, and Minato, was significantly lower than those of other wards. This greater availability of newer units in the C5W has likely contributed to some of the premium that the submarket has enjoyed over the rest of the 23W, and also to its overall attractiveness as a place to live. These wards were traditionally thought of as a business or commercial district, and as a place to work but not to live in, which led to few housing developments prior to 2000. However, this perception has evolved over the years with societal changes and the moderated land prices in the 1990s, and they are now considered premier areas to live in, resulting in more new housing supply to meet this demand. Conversely, Katsushika and Edogawa of the Outer East submarket, and Itabashi of the Outer North submarket had a higher proportion of older units than the overall average. The next paragraph will explore upcoming supply, and which areas have seen greater attention.

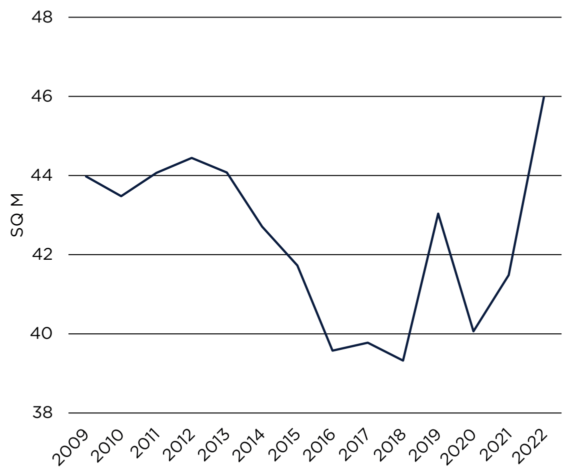
In order to observe upcoming housing supply, we can turn to the number of rental housing starts published by the Ministry of Land, Infrastructure, Transport, and Tourism to have an idea of what is in the pipeline. Overall, the number of rental housing starts in the 23W has been on an increasing trend since 2010, albeit a slight dip in 2019 before the pandemic. One trend that has materialised in recent years is the large increase in the number of rental housing starts in the Inner East. Indeed, the Inner East submarket comprised about 11% of annual starts in the 23W between 2008 and 2019, but this percentage jumped to 16% between 2020 and 2022, and has shown a sizable increase in absolute terms

**GRAPH 7: Rental Housing Starts in Tokyo 23W by Ward, 2008 to 2022**




**Source** Ministry of Land, Infrastructure, Transport, and Tourism, Savills Research & Consultancy

**GRAPH 8: Average Size of Rental Housing Starts Tokyo 23W, 2009 to 2022**




**Source** Ministry of Land, Infrastructure, Transport, and Tourism, Savills Research & Consultancy

as well. The Inner East is located in close proximity to Chuo ward, which has multiple development projects in the pipeline that will transform the landscape of the vicinity, and the increase in housing starts in the submarket may be in response to anticipated heightened demand to live close to these new developments. In addition, Tokyo Metro also has plans to extend the Yurakucho line from Toyosu to Sumiyoshi, which will improve the connectivity of the submarket. Indeed, the increase in the number of housing starts may have helped to facilitate the strong population growth that the Inner East has observed.

Another interesting trend can be observed when looking at the average size of new rental housing starts. After the global financial crisis, rental apartments were gradually built smaller in size, going from an average of around 44 sq m in 2009 to less than 40 sq m in 2018. The decrease in size was likely in a bid to build a greater quantity to capitalise on the demand from the rapidly growing Tokyo 23W population. However, the average size increased in recent years, and reached 46 sq m in 2022. The female labour participation rate has continued to rise, and societal changes have facilitated a greater supply of larger units to accommodate dual-income households. Furthermore, during the pandemic, demand for larger units rose with the proliferation of remote work, and hence for more spacious residences to better accommodate it. Due to their innate scarcity in the market from the historically limited supply, some larger units began offering a rental premium over smaller counterparts per sq m, hence causing some developers to shift their focus to such units. However, with the stock of larger units in the 23W expected to rise in the mid-term, and with some demand returning for single-occupier units due to society's transition to a post-pandemic state, this rental premium will likely shrink. Nonetheless, larger units should remain popular for the time being.

## OUTLOOK

The peak spring moving season in 2023 was the first that took place in a post-pandemic environment, and it appears that the market has held steady overall. Net-migration into the 23W have rebounded to around pre-pandemic levels, which is a positive sign for the market, and it appears that many foreign nationals are continuing to move to the 23W. At the same time, net-migration from the Japanese population somewhat lags pre-pandemic times, although this could gradually recover as society moves firmer into post-pandemic territory.

Some paradigm shifts that materialised during the pandemic are likely to linger, like the continuation of some form of remote work for many companies. In particular, employees of companies that have more extensive remote work policies are less incentivised to live closer to the city centre. Furthermore, there are other macroeconomic push and pull factors that will influence demand for residences in the 23W, such as the Shunto wage negotiations in 2023 that have seen notable wage increments among many major Japanese corporations, and the global economic slowdown paired with inflation. The market may thus see some fluctuations until these dynamics have fully assimilated.

Overall, the C5W should steadily grow in popularity and take centre stage in the mid-term with the multiple development projects taking place that will reshape the city landscape, and make central wards a more attractive place to live in. Nearby, the Inner East also appears to have gained significant traction over the past few years when looking at population trends and the number of housing starts in the submarket. The post-pandemic environment should gradually usher in more migrants that wish to be closer to the dominant economic hub of Japan, and strengthen its residential market.