Tokyo - Q3/2023

MARKET IN MINUTES

Savills Research

Residential Leasing

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Rents continue to see modest growth

Fundamentals for the Tokyo market remain sound with continued positive net-migration.

- Average rents in the Tokyo 23 wards (23W) increased slightly by 0.1% quarter-on-quarter (QoQ) to JPY4,039 per sq m, despite a 0.3% year-on-year (YoY) decrease.
- Rents in the central five wards (C5W) witnessed a moderate uptick, increasing 1.6% QoQ to JPY4,877 per sq m, and a yearly increase of 0.4%.
- The C5W rental premium over the 23W average is 19.6%, and has been higher than pre-pandemic levels since 2022.
- Chuo saw the largest quarterly rental increment of 3.7% QoQ, while Shinjuku saw the largest rental correction of 1.9% QoQ. Overall, the market appears to be stable.
- The smallest 15-30 sq m size band saw the largest rental increment at 1.6% over the quarter, although the 45-60 sq m size band maintains a notable premium.
- Average occupancy rates in the 23W increased by 0.4 percentage points (ppts) QoQ to 97.0%, while the C5W increased by 0.3ppts QoQ to 96.6%.
- Over the past decade, there has been a notable shift in preferences towards renting over buying condominiums, stemming primarily from rising condominium prices, changing mindsets, as well as the greater presence of institutional investors.

"Average rents in the 23W have increased slightly over the past quarter but experienced a mild dip on a yearly basis. Net-migration into the 23W has remained positive, and has surpassed pre-pandemic levels due to significant contributions from foreign nationals. Meanwhile, rental growth in the C5W remains stronger."

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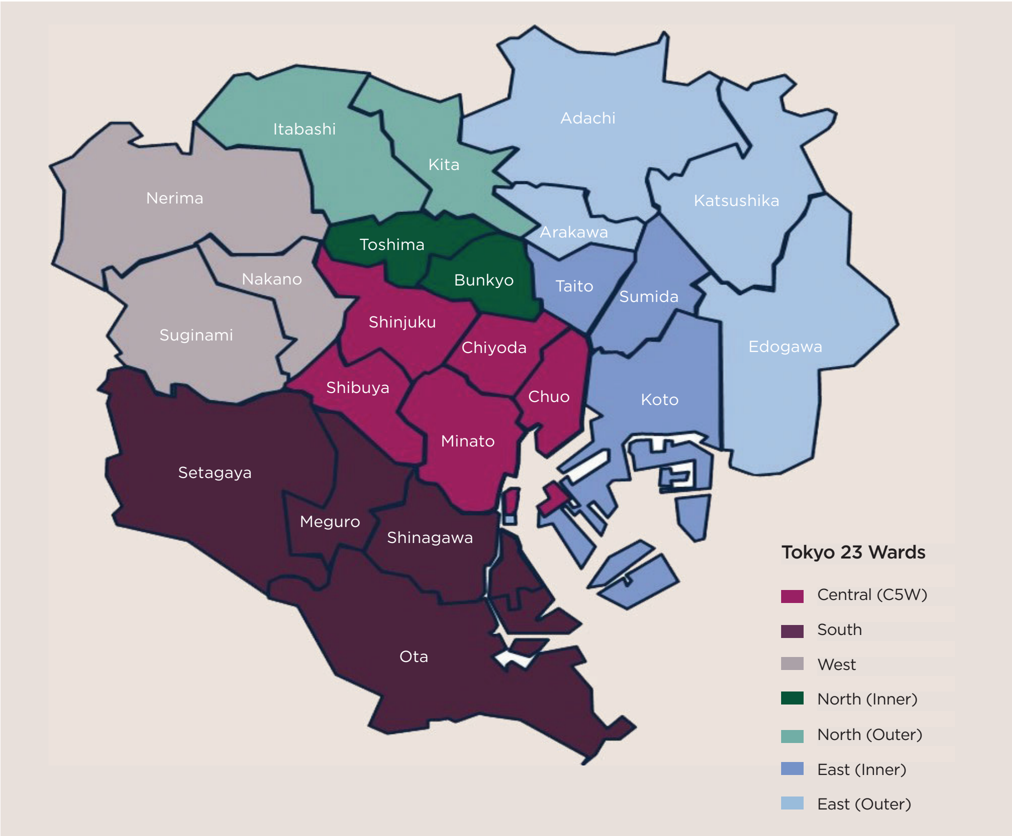
MAP 1: Tokyo's 23 Wards by Survey Area



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

In Q3/2023, rents in the Tokyo 23W have observed marginal increments from the previous quarter, approaching levels seen in the pre-pandemic period. The overall market sentiment is positive, as companies have been encouraging greater levels of office attendance, contributing to sustained positive net-migration into the 23W.

From June to August 2023, net-migration into the 23W exceeded 18,000 people, which can be broken down into movements between Japanese and foreign nationals. The foreign national population increased by more than 13,000 people, which is approximately six times higher than that of the same period before the pandemic in 2019. In contrast, the Japanese population increased by just under 5,000 people, approximately one third of that in 2019, but a remarkable improvement compared to the negative net-migration seen in 2021 and 2022. Overall, net-migration has been recovering, largely driven by the number of foreign nationals, while Japanese population growth may take more time to recover.

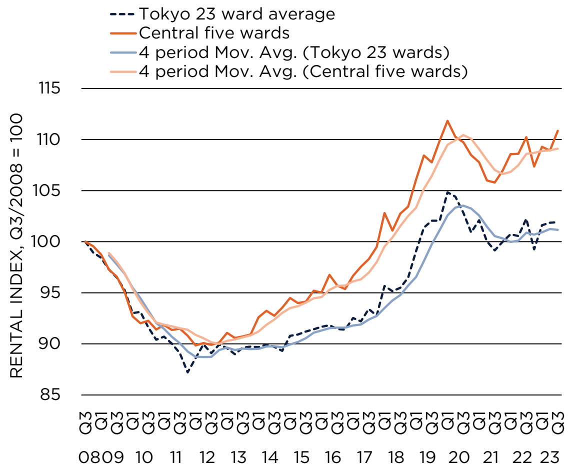
The C5W rental premium over the 23W average is at 19.6% in Q3/2023, and has continued to surpass pre-pandemic levels since 2022. While the outer submarkets have also experienced increased average rents, probably due to the persistence of hybrid work arrangements, the return of more workers to offices is likely to drive up demand for units closer to the city centre. Furthermore, young professionals who have benefitted from recent significant wage growth tend to prefer the convenience of living in central areas closer to their workplaces. With multiple upcoming developments that will transform the landscape of central Tokyo, the C5W is poised to continue attracting residents and emerge as an increasingly appealing residential area moving forward.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

Average mid-market asking rents in the 23W have experienced a slight uptick from the previous quarter, by 0.1% QoQ to JPY4,039 per sq m in Q3/2023. Despite witnessing a mild decline of 0.3% YoY, average rents are effectively on par with the pre-pandemic period in 2019, albeit still slightly lower than the pre-pandemic peak. In terms of population, the 23W registered a positive increment of around 14,000 residents between June and August, mostly comprising foreign nationals, which should support firm residential demand in the 23W market. Looking ahead, the population of the 23W is likely to continue increasing as major developments and infrastructure improvements make the city an increasingly attractive place to live, suggesting rosier prospects for central Tokyo overall.

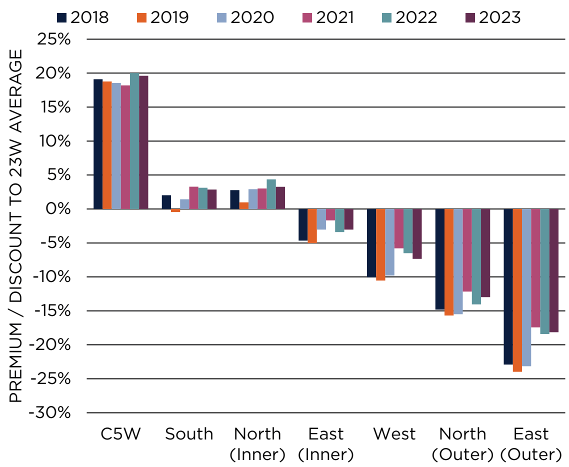
Average asking rents in the C5W have increased by 1.8% QoQ and 0.6% YoY to JPY4,885 per sq m. At the ward level, Chuo, Minato and Chiyoda saw rental increments of 3.7%, 3.6% and 2.8% QoQ, respectively, partially due to a number of new, expensive units released to the market over the quarter. On an annual basis, Minato saw the most prominent uptick, increasing by 5.2% YoY, while Chiyoda witnessed the largest contraction at 3.3% YoY, this was from its peak in the same quarter last year. Net-migration into the C5W continues to remain positive, reaching around 2,300 between June and August, which is 13% higher than that of the same period in 2019, although it should be

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



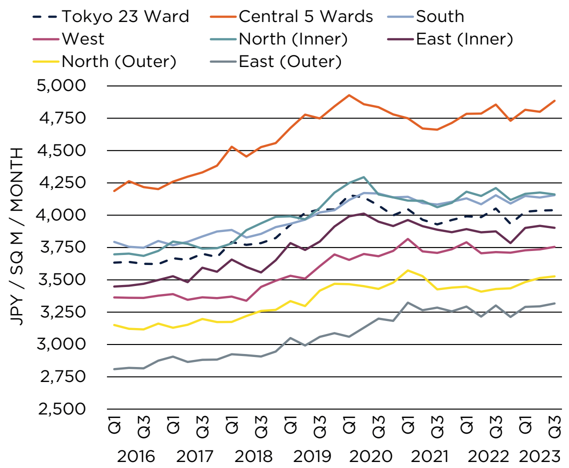
Source Savills Research & Consultancy

GRAPH 2: Rental Premiums/Discounts* vs 23W Average, 2018 to 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 Q3/2023



Source Savills Research & Consultancy

noted that foreign migration is the primary driver of this. Overall, the C5W remains a popular choice for high income locals and foreign expatriates, and the upcoming pipeline of major developments looks to improve the attractiveness and liveability of the area. Furthermore, recent notable wage growth among young professionals will also support residential leasing demand going forward.

The South submarket has seen rents increase slightly by 0.4% QoQ to JPY4,155 per sq m in Q3/2023, while remaining flat YoY. Looking at the submarket's constituent wards, Meguro and Shinagawa experienced a slight contraction of 0.3% QoQ and 0.1% QoQ, respectively. On the other hand, rents in the more affordable Ota and Setagaya wards increased by 0.9% QoQ and 1.5% QoQ, respectively. Looking at migration trends, the situation in the South submarket has gradually improved over the past few years, although net-migration remains lower than in 2019. However, Ota appears to be an outlier in this regard, exhibiting stronger net-migration in 2023 than in 2019, possibly due to the greater availability of more affordable, and larger units that better accommodate post-pandemic lifestyles. Going forward, new trends in the post-pandemic environment are likely to contribute to an increase in popularity for the South submarket due to its proximity to central Tokyo and overall liveability.

Rents in the Inner North submarket saw a slight dip of 0.4% QoQ, and 1.2% YoY to JPY4,160 per sq m. Bunkyo and Toshima demonstrated diverging trends, with the former witnessing a 0.4% QoQ increase while the latter contracted by 1.2% QoQ. On an annual basis, both wards saw mild corrections, but average rents nonetheless remain higher than pre-pandemic times. Toshima's strengths lie primarily in its proximity to Ikebukuro, and its popularity among foreign residents, who have been the primary driver of population growth over the past year. Meanwhile, Bunkyo is a popular residential area with many wealthy, young households due to the substantial number of prestigious schools, and is well regarded as an educational hub. Overall, both wards possess many important characteristics that should encourage and sustain further population and rental growth going forward.

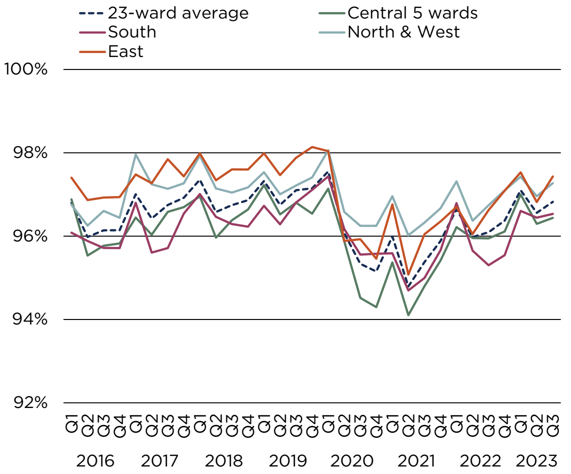
Average rents in the Inner East submarket saw a slight decrease of 0.4% QoQ to JPY3,903 per sq m, while growing 0.7% YoY. Within the submarket, all constituents experienced a slight quarterly contraction between 0.2% QoQ and 0.6% QoQ. On an annual basis, Taito recorded a moderate increase of 2.0% while Sumida witnessed a mild decline of 0.3%. The Inner East has also seen relatively strong population growth compared to other submarkets within the 23W, with the submarket's population increasing at a compound annual growth rate of 0.8% since the beginning of the pandemic, and net-migration inflows have not waned. Some investors appear to have taken note of this potential and are looking to capitalise on this trend. For instance, UBS Asset Management has launched a US$230 million multifamily development project in the Kiba area of Koto ward. Such development activities will look to cement the Inner East as a major residential hub, and may help to continue attracting new migrants.

The West submarket experienced a mild uptick in average rents, increasing 0.5% QoQ and 1.1% YoY to JPY3,755 per sq m. All wards saw rents rise on a quarterly and annual basis, with Suginami contributing to most of this growth, increasing by 1.0% QoQ and 1.8% YoY. Net-migration into the submarket has remained positive throughout 2023, and should look to increase going forward. The most central ward, Nakano, will welcome a dozen redevelopment projects within the vicinity of JR Nakano station. Net-migration has also seen a remarkable recovery, coming closest to pre-pandemic times, suggesting that a good balance between proximity to the city centre and affordability is likely highly sought after in the current market dynamics.

The Outer North submarket has experienced a slight increase this quarter, rising by 0.4% QoQ and 2.9% YoY to JPY3,527 per sq m. Annual increments in the Outer North were the largest in the 23W this quarter, although they also appear to have been fluctuating around the same level for the past two years. Nonetheless, the submarket has demonstrated clear rental growth from pre-pandemic times. Net-migration trends are also encouraging, with net population inflows between June and August 2023 over double that of the same period in 2019. On top of the lingering effects of the pandemic that saw people moving away from the city centre in search of more spacious housing in peripheral wards, the current levels of inflation may also have prompted some to seek more affordable housing, contributing to the growing popularity of the Outer North.

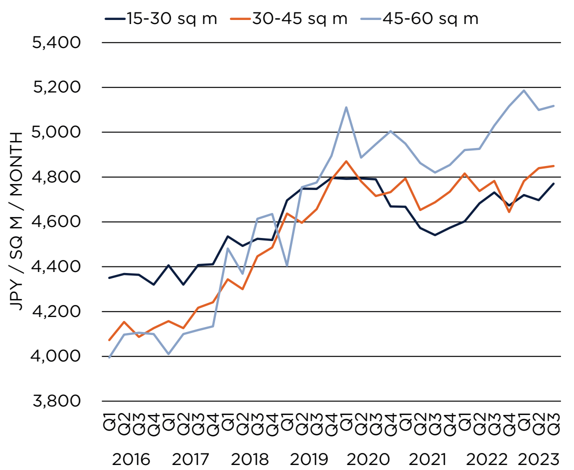
The Outer East submarket experienced moderate rental increments at 0.7% QoQ and 0.5% YoY to JPY3,318 per sq m. Changes at the ward level were similarly moderate, with the exception of Edogawa, which saw outsized levels of rental growth at 3.6% QoQ and 2.5% YoY, likely due to a number of expensive units that came to the market

GRAPH 4: Average Occupancy for J-REIT Residential Assets, Q1/2016 to Q3/2023*



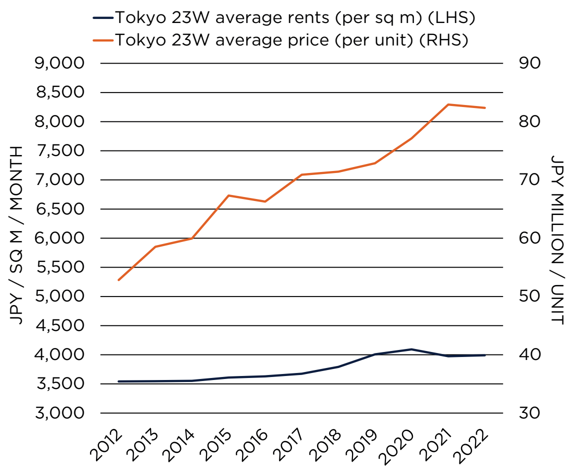
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data
* Q3/2023 is as of Aug 2023

GRAPH 5: Rents by Unit Size, C5W, Q1/2016 to Q3/2023



Source Savills Research & Consultancy

GRAPH 6: Tokyo 23W Average Rents vs Average Price of New Condominiums, 2012 to 2022



Source Real Estate Economic Institute, Savills Research & Consultancy

this quarter. Similar to the Outer North submarket, net-migration into the Outer East has surpassed pre-pandemic levels. Indeed, peripheral wards generally appear to have maintained heightened popularity due to lingering effects from the pandemic, and current elevated levels of inflation that have likely resulted in tighter budgets for housing, and this trend will likely persist for the time being.

OCCUPANCY RATES

Occupancy rates in the Tokyo 23W increased slightly by 0.2ppts QoQ to 96.8% in Q3/2023, and are 0.7ppts higher than during the same period of 2022. Similarly, occupancy in the C5W increased by 0.1ppts QoQ and 0.5ppts YoY to 96.4%. Overall, occupancy rates appear to be inching closer to pre-pandemic norms as society progresses further toward normalcy territory. Indeed, the demand for units closer to business districts should steadily improve as more employees return to working at the office, further bolstered by strong wage growth this year, especially amongst younger professionals.

Looking ahead, the population growth of the 23W is expected to continue, and the foreign national population will likely continue to comprise a sizable proportion of this, meaning that wards that have traditionally been popular with foreign nationals are likely to fare comparatively well. Overall, population growth should lead to increased demand for residential properties within the 23W, consequently pushing occupancy rates higher. That said, it is also worth noting that inflation may force many average households to seek more affordable housing alternatives.

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 New York or London, 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 Q3/2023, rents of all size bands in the C5W increased, albeit at different rates. Rents in the smallest 15-30 sq m size band increased moderately by 1.6% QoQ, recovering close to pre-pandemic peak levels. Meanwhile, the larger size bands saw mild increments, with the 30-45 sq m increasing by 0.2% QoQ and the 45-60 sq m band growing 0.4% QoQ. Overall, the smaller 15-30 sq m size band, which typically houses single occupiers, appears to be recovering, which is in line with the overall rhetoric of a growing number of people, especially younger professionals, returning to central areas to be closer to offices and more vibrant city life.

Net-migration into the C5W has recovered to levels slightly greater than those seen in pre-pandemic times. Indeed, the gradual but steady push back towards working in the office has encouraged more people to move closer to central areas. At the same time, many companies appear to keep some flexible workstyles, meaning that larger units that could better accommodate such arrangements would still be preferred among residents. As such, the premium for larger units in the C5W will likely continue due to the limited stock of such units.

PARADIGM SHIFT IN HOMEOWNERSHIP

The ownership of a newly built home was traditionally considered a major goal for Japanese households, representing a significant milestone for an individual or family. However, this norm has seen significant changes over the past decade. The market size for new condominiums has been shrinking, while those of used condominiums and rental condominiums have been on the rise, and many units are purchased with the intent of future resales. The rising prices of condominiums and the increased presence of institutional investors, along with a shift in the mindsets of individuals toward housing, are believed to be major contributors to this paradigm shift. In this section, we will delve into the changing perspectives on homeownership and the evolving dynamics of the residential market in Tokyo.

Firstly, average prices of condominiums have been increasing for the past decade due to rising land and construction costs. Furthermore, condominiums have also risen in popularity compared to detached housing amongst the wealthy, leading to a growing supply of luxury condominiums with well-integrated into the transport network, especially in central areas. In Tokyo 23W, average prices of new condominiums increased by 56% from 2012 to 2022, while average rents for residential units increased by only 13% over the same period. The widening price disparity has likely encouraged a growing number of households to rent instead of buy, leading to a more stable leasing market.

Indeed, rents have not risen as much as the price of new condominiums, and there are a few factors that have led to this. Firstly, institutional investors have become much more active in the residential sector, and cap rates have compressed significantly over the past decade, by about 200 basis points. Together with the lowering costs of financing, this has allowed investors to attain desired returns without the need for significant rental appreciation. Institutional investors, notably J-REITs, have capital and access to high levels of professional property management, and timely renovations have greatly improved the quality of such rental condominiums, making them more attractive to live in. Moreover, Japanese laws are protective of tenants, making increasing the rents of existing occupiers difficult in practice, and resulting in staggered rental increments, which usually take place only when a new tenant is contracted.

Lastly, the desire to own property in Japan has declined, and a growing number of individuals appear content with renting. According to the Ministry of Land, Infrastructure, Transport, and Tourism's "National Survey on Public Awareness of Land Issues," the percentage of individuals aspiring to own property has decreased from 80% in 2012 to 65% in 2022. This shift is particularly prominent among individuals in their 20s and 30s, suggesting that this figure could decline further in the future. Part of this change could be attributed to a change in mentality, where homebuyers view their properties as assets that could be sold for a profit in the future, rather than using them solely as long-term residences.

Overall, a paradigm shift with regard to renting over buying appears to have materialised over the past decade. Supply side issues from the declining number of new condominiums built and disproportionately rising prices over rents, and a general change in mindset of younger people have been the primary contributors to this trend. Going forward, demand for rental units in Tokyo should therefore continue to grow.

OUTLOOK

The residential market in the Tokyo 23W has remained stable following the first peak moving season of the post-pandemic era. Despite minor fluctuations in a handful of submarkets, mid-market rents have recovered close to pre-pandemic levels and are anticipated to continue growing moving forward. Positive net-migration has continued across a majority of the 23W, and occupancy rates in the 23W and C5W are inching towards pre-pandemic levels, indicating further market recovery.

Overall, the C5W has seen some rental increments, likely driven by demand from both high income locals and expatriates, coupled with multiple ongoing development projects. The Inner East submarket has garnered the interest of investors and developers due to its consistent growth in net-migration, and established itself as a popular residential destination. Elsewhere, outer submarkets like the Outer North and Outer East are benefiting from a sustained interest in spacious and affordable housing options, fuelled by pandemic-induced lifestyle changes and inflation. Tokyo's residential market appears to be on a positive trajectory, supported by factors such as population growth and positive net-migration. As more people return to offices, the Tokyo 23W is expected to experience steady population growth, and this trend should continue to strengthen the residential market.