Tokyo - Q4/2020

MARKET IN MINUTES
Savills Research

Residential Leasing

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Rents face uncertainty amidst shifting trends

Rents contracted over the year for the first time in 2020, with the C5W appearing to feel the effects of remote work more than most.

- Rents in the Tokyo 23 wards (23W) posted their first annual decline in Q4/2020, and now stand at JPY3,999 per sq m – a decrease of 1.9% quarter-on-quarter (QoQ), and 1.1% lower year-on-year (YoY).
- Average mid-market rents in the central five wards (C5W) also weakened, falling 1.2% QoQ to JPY4,780 per sq m. Within the C5W, Shibuya saw the sharpest QoQ decline of 2.8%.
- The C5W saw its premium over the 23W slightly narrow but remain at around 19%. In contrast, the other submarkets saw their standings improve relative to the 23W average.
- At the ward level, Nakano showed the strongest growth this quarter, posting a 2.2% QoQ gain and more than recovering from the dip seen at the start of Q1/2020. Meguro took the top spot on an annual basis, displaying robust growth of 7.3% YoY.
- In the C5W, average rents for units in the 15-30 sq m size band – which represent the majority of listings – have decreased 2.5% QoQ, while larger units saw rents remains fairly flat.
- The average occupancy rate for the 23W dipped slightly by 0.4 percentage points (ppts) QoQ to 96.0% as of Q4/2020. Occupancy in the C5W fell 0.3ppts QoQ to 94.4% - the lowest since 2012.
- Work-from-home arrangements are likely to stay for the time being and become the norm for some people as well as an occasional option for more.

"Average rents dipped slightly again, though most of the brunt has been borne by the C5W. Meanwhile, the previously observed shift in resident preferences for larger and more affordable units appears to have persisted. Work-from-home arrangements are expected to remain in place for the time being, adding momentum to this new trend."

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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 movements in contract rents for the Tokyo market.

OVERALL RESULTS

Average rents in the 23W and C5W have decreased for the third consecutive quarter, the first occurrence since 2011. Furthermore, YoY rents have also contracted for the first time this year, which might signal a downturn rather than a correction in the market. However, another interesting trend that has manifested is that the average space of available apartment units has been constantly decreasing in 2020, to a record low of below 30 sq m. This could possibly indicate that some residents are moving out of smaller apartments and into more spacious ones. Moreover, this status quo looks set to continue following the recent spike in daily COVID-19 case numbers. Indeed, with Japan bracing itself for the third wave of COVID-19, remote work and social distancing measures will likely remain in place. Demand for smaller residences in central locations could therefore lose further momentum.

Whilst its premium over the 23W average remains at near 19% (Graph 2), it should be noted that rents have decreased the fastest both over the quarter and year in the C5W. This contraction is also skewed towards smaller sized apartments, whereas larger units have generally been less impacted. At the same time, an improvement in rental conditions in the other submarkets has led to a respective widening/narrowing of premiums/discounts over the year – emphasising the growing demand for apartments outside the C5W.

COVID-19 has only had a slight impact on the population of Tokyo, with the number standing at 13.96 million as of December 2020, compared to the high of 14 million in May 2020. In truth, a significant proportion of this drop could be attributed to the fall in Tokyo's foreign population – a reasonable assumption due to the entry ban imposed on foreign nationals. Even so, we expect this decline to slowly reverse following the lifting of the ban in this autumn.

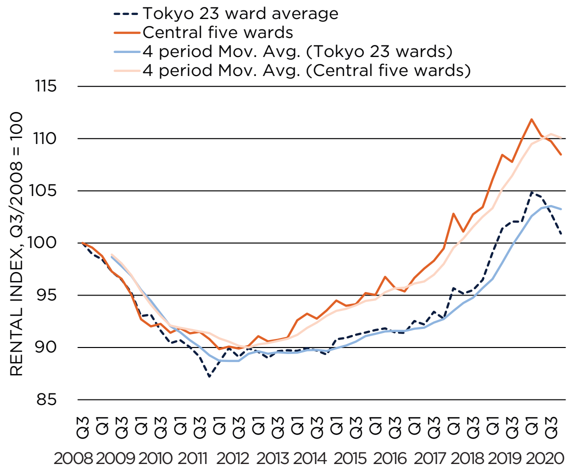
Although the decrease in the population of Tokyo since Q2/2020 might imply some difficulty in finding new tenants, signs of Japan's overall economic recovery should help calm landlords worried about leasing. The unemployment rate, meanwhile, remains low at 3.0%. All in all, therefore, the majority of tenants should have the capacity to afford their current rent levels.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

In Q4/2020, average rents in the 23W stood at JPY3,999 per sq m, a 1.9% decrease QoQ. Rents also contracted 1.1% YoY, meaning that for the first time since 2014 average rents have shown an annual contraction. Broadly speaking, almost all submarkets have seen a slight decline over the quarter, with some also experiencing an annual decline. Exceptions include the West submarket that saw growth of 1.1% QoQ and 0.7% YoY, primarily attributed to the strong performance of Suginami over the latter.

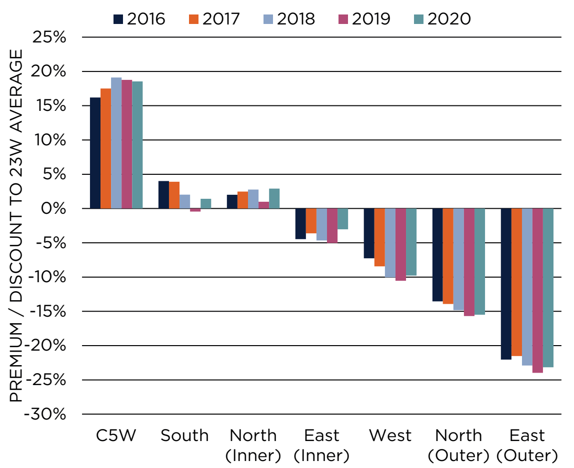
In the C5W, with the majority of wards marking a quarterly decline, average rents fell to JPY4,780 per sq m. Chuo and Shinjuku were the exceptions, with the two demonstrating a 0.9% and 0.1% QoQ increase, respectively. Whilst Shibuya was the only ward to have seen an uptick in the previous quarter, in Q4/2020, average rents contracted 2.8% QoQ. This may be partially because there were fewer listings of new apartments with higher rents, however. That

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q4/2020



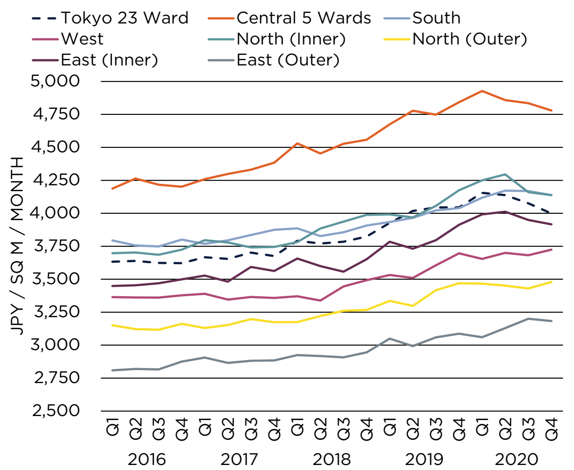
Source Savills Research & Consultancy

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, Q1/2016 to Q4/2020



Source Savills Research & Consultancy

said, the continued uptake of remote work may have also reduced the wider appeal that the convenience of living in the C5W previously provided. Currently, Minato and Shibuya stand at the top of the C5W in terms of average rent, with both being the only wards to have an average rent of over JPY5,000 per sq m.

The South submarket saw a slight quarterly decline in average rents of 0.7%. It does, however, boast the strongest gain over the year of 2.4% as rents rose to JPY4,137 per sq m. Annual growth in Meguro was particularly strong, with average rents increasing 7.3%. Perhaps as a result, it is currently the fourth most expensive ward in the 23W, standing at JPY4,656 per sq m, behind only Shibuya, Minato and Chiyoda. Ota also saw a moderately positive increase YoY of 1.4%. Whilst pleasing, this positive performance could also be due to the number of new listings for apartments to be completed in 2021, and so, we may see a slight dip in average rents once these units are fully leased.

The Inner North submarket has seen its second consecutive quarterly dip, with a small decrease of 0.6%, and an overall reduction of 0.9% YoY. At the ward level, both Toshima and Bunkyo, which is the more expensive ward, saw rents decline by a similar rate this quarter. The latter is known as an educational centre in Tokyo as well as being a popular family-orientated location – as demonstrated by the higher average unit size and the lower number of listings in the ward. Furthermore, Bunkyo is also situated next to Chiyoda and Shinjuku, and therefore continues to have a strong standing in the residential market.

As in the Inner North, average rents in the Inner East submarket also experienced a back-to-back quarterly contraction of 0.8%. Within the submarket, Sumida again saw the largest decline this quarter, falling 1.8% QoQ, whilst it also declined 2.2% YoY. Rents in Koto and Taito on the other hand, despite slightly shrinking over the quarter, have still maintained a positive growth of 1.7% and 0.7% YoY, respectively. In the same vein as the South, part of the reason for Koto's positive performance could be due to a significant number of new-unit listings, and the ward could therefore see a decline in rents once these units are occupied.

Prices in the West submarket have been stable, with an increase of 1.1% QoQ and 0.7% YoY. The best performing ward in the submarket is undoubtedly Suginami, which welcomed an uplift of 5.3% YoY. Nakano – the most expensive in the West – bounced back from the quarterly decline seen at the start of this year with a 2.2% QoQ rise. Rents remain 0.5% lower over the year, however. Lastly, the cheapest ward in the submarket, Nerima, saw average rents fall 2.6% YoY. The steepish decline in the ward may partly be an adjustment in response to the spectacular growth observed in the lead-up to the historic highs set in late-2019, with many of the new-unit listings now fully rented out.

In contrast to most of its peers, average rents have sprung to an all-time high in the Outer North submarket on the back of a 1.4% QoQ uptick. Itabashi was the primary source of this growth as rents grew 1.9% QoQ and 0.3% YoY. Kita, the more expensive of the two, also saw rents increase 1.0% QoQ. Overall, not only was this submarket one of the few to have demonstrated positive QoQ growth, but it also marked the highest QoQ growth in Q4/2020.

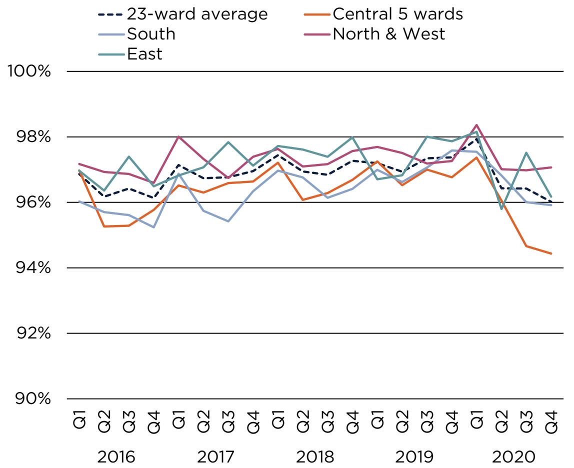
The Outer East, which is still the cheapest submarket in the 23W, has seen the strongest annual rental growth amongst all the submarkets, climbing 3.1% YoY. Within the submarket itself, Adachi, Arakawa and Katsushika all displayed an increase in average rents between 3.8% to 5.3% YoY. Edogawa was the outlier amongst the group, with rents decreasing 1.2%YoY. Yet, this decrease could be attributed to the rise in new-unit listings that are priced below the average market rent of around JPY3,100 per sq m. Rents could feasibly, therefore, move higher once these below-par units have been rented out.

OCCUPANCY RATES

Average occupancy rates in the 23W have seen a small dip of 0.4ppts QoQ to 96.0%. Within the different submarkets, the most apparent, and largest contributor, to this drop was the East submarket, which saw a contraction of 1.3ppts QoQ to 96.2%. Despite the slump, occupancy remains higher than Q2/2020 levels. In contrast, the other submarkets have only seen very slight movements, ranging between -0.2ppts to +0.1ppts.

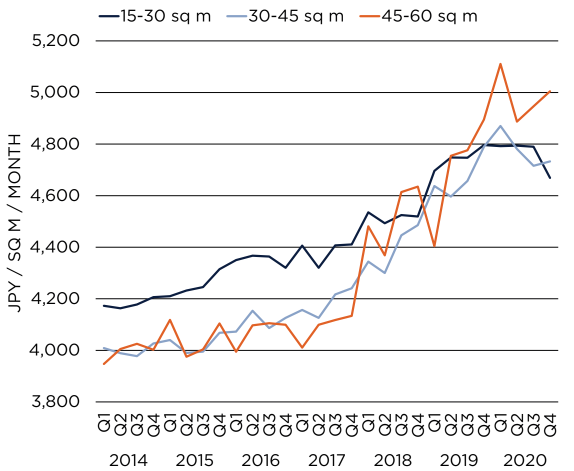
Although the most expensive C5W submarket, Minato, only saw a slight loosening of 0.2ppts QoQ to 94.4%, it has reached a level not seen since 2014. Overall, all members of the submarket demonstrated annual declines in occupancy rates, ranging between -1.5ppts to -3.4ppts. While the change has been gradual, this drop-off found in quality assets in the C5W may be the slight shift in resident preferences transitioning away from the most central locations in the city. At the same time, however, this trend may also partly be attributed to the significant reduction of foreign residents in central Tokyo since the onset of the global pandemic.

GRAPH 4: Average Occupancy For J-REIT Residential Assets, Q1/2016 to Q4/2020*



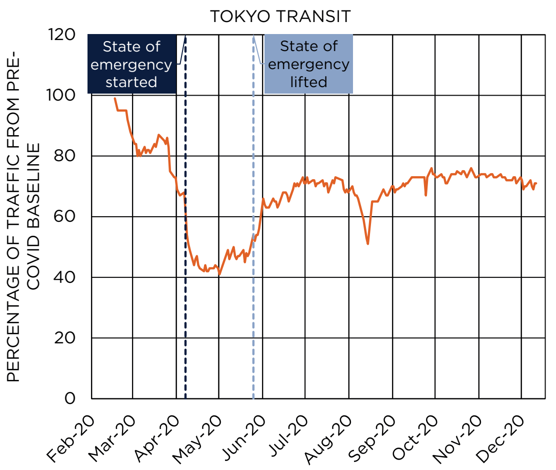
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
*Q4/2020 is as of November 2020

GRAPH 5: Rents By Unit Size, C5W, Q1/2014 to Q4/2020



Source Savills Research & Consultancy

GRAPH 6: Usage of trains in Tokyo, February 2020 to December 2020



Source Google LLC "Google COVID-19 Community Mobility Reports", 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.

In the C5W, average rents have exhibited diverging trends based on unit size. Specifically, units of the 30-45 sq m size band saw rents increase slightly by 0.4ppts QoQ, whilst the larger 45-60 sq m size band experienced a 1.2ppts QoQ climb. In contrast, having remained fairly flat across the previous four quarters, average rents for the most common size band, namely the 15-30 sq m cohort, felt a rental decline of 2.5% QoQ to about JPY4,700 per sq m.

Interestingly, while the total number of listings in the C5W has not changed significantly, when analysed by size, listings of the smallest units have markedly increased, by over 30%. One possible reason for this may be the fact that a majority of 15-30 sq m units in the C5W would normally be occupied by single residents, such as young professionals, who commute within the C5W. With the long-lasting implications of COVID-19 ultimately reducing the need to commute, the premium paid to live in the C5W by such individuals seems increasingly less well spent. As such, limited funds may be better spent by this demographic moving to more affordable locations, probably resulting in an increasing supply of smaller units in central areas.

Meanwhile, the dwindling supply of larger units above 30 sq m could also be attributed to the change in resident preferences arising from the proliferation of work-from-home arrangements. Indeed, individuals or families with greater purchasing power may find more utility in renting out larger apartments that provides them with enough space to work comfortably, without compromising their lifestyle.

THE SUBTLE SHIFT TOWARDS WORKING FROM HOME

The pandemic hit Japan in late February and a state of emergency was declared in Tokyo on 7 April 2020. At the time, in order to comply with the restrictions stipulated by the government, many companies scrambled to implement measures and establish systems to allow their employees to work from home. Now, three quarters later, these companies have had time to adjust to the new environment and are in the next phase of planning for what the 'new normal' will bring. Yet, employees themselves have also been on this journey, and it is they that will also have a large influence on what the workplace environment will be like in future.

In this regard, many workers appear to indicate a generally favourable opinion towards remote work. Firstly, according to data from Google Mobility and the Ministry of Land, Infrastructure, Transport and Tourism, since the lifting of the state of emergency in Tokyo on 25 May 2020, although train usage during peak hours has increased, it remains about 70-75% of pre-COVID levels (Graph 6). In fact, excluding the drop in mid-August, due to the annual Bon festival holidays, there have not been any significant changes to this level since June 2020. This may increase once the pandemic ends, but probably not to pre-COVID levels. This sentiment is also echoed in a survey conducted by Japan Productivity Centre. Here, it shows that the percentage of companies implementing some form of telework did not drastically change from July to October. Consequently, spending less time at the office, and as such, more time at home, should transform resident needs. Ultimately, to a certain extent, this demand is likely to shift away from compact units to more spacious ones which are more conducive for remote work.

Furthermore, a survey conducted by the Tokyo Metropolitan Government cites the societal benefits from teleworking. For example, in addition to factors such as reducing the amount of time spent on commuting to work, the implementation of telework has also benefitted aspects of childcare and caregiving, both of which are issues that the Japanese government has been trying to tackle in order to encourage more women as well as men to retain full-time jobs with greater responsibility. As such, any efforts to increase the proliferation of teleworking may likely also receive continuous support from the Japanese government. Also, given that basic wage growth has been nominal in Japan, offering teleworking as an option could be an attractive benefit that many companies in Japan have the capacity to afford.

While the population of Tokyo has decreased by about 40,000 from its peak of 14 million residents in May 2020, a significant proportion of this decline could be attributed to foreign residents who, having left Japan, are unable to return. For instance, their population in Tokyo fell by around 30,000 over the same period. Furthermore, on closer inspection, while the number of people living in the 23W has come down, the equivalent outside of the

23W has risen. Moreover, major cities in nearby prefectures like Omiya, Nagareyama and Fujisawa are also seeing population increases amid the general population decline of the prefecture. This suggests some level of movement from Tokyo 23W to the outskirts of Tokyo. Even beyond Tokyo, these major cities have an urban-city culture and community are within one hour away from central Tokyo, which still makes it possible to go to the office. Indeed, the conveniences that Tokyo provides in terms of education, jobs, and the proximity to the city centre, are not so easily foregone, and these outlying areas appear to provide residents that desired level of balance. Therefore, overall changes appear moderate and gradual.

We expect some form of working from home arrangements to remain, but these will function as a supplement to offices themselves. Most people will still either go to the main office or nearby satellite offices because most apartments in Tokyo are small and sub-optimal for working in, but maintain the flexibility to occasionally work from home based on personal preference and lifestyle. With the median age of Tokyo around the mid-40s, this gradient of the shift is expected to be gentle as a smaller proportion of the population would wish to make hasty changes to their lifestyle, especially if the economy could be expected to recover sooner than later.

OUTLOOK

Since the all-time highs recorded in Q1/2020, rents in the 23W have experienced another consecutive mild adjustment across all submarkets and, as such, they have slipped to levels not seen since early 2019. Whilst this reaction is not entirely surprising considering we are in the midst of a global pandemic, with demand for housing slightly waning in lockstep with the nominally decreasing population of Tokyo, average rents are expected to remain flattish in the near future. Nonetheless, with the economy starting to show signs of a recovery, and with the unemployment rate still remaining as low as 3.1%, tenants should still have the financial capacity to afford rents. Meanwhile, the safeguards that exist in the Japanese housing market, such as widely used insurance policies that ensure rent is paid to the landlord, mean that the nation is blessed with some of the lowest rent delinquency rates in the world. Multi-family residential investments are, therefore, especially sought after as a defensive asset. Nonetheless, a degree of uncertainty exists in the market and transactions with leasing risks such as forward commitments have been demonstrating a slight discount when compared with the pre-COVID era.

Although Tokyo has seen a decline in residents, the prohibition of international travel appeared to lead to a significant decline in foreign residents. Another likely contributor are younger workers and students living alone in the city who have decided to move back into their family homes, especially if they are located within Greater Tokyo. This suggests that this increase in room availability may be short-lived as the strict border restrictions are relaxed and younger workers yearn to live independently again. That said, even in this “new normal”, the preference towards size and price affordability over convenient location may prevail as remote working practices continue in one form or another.

The concept of working from home would be expected to remain but is likely to serve as a complement to offices rather than replacing them. In general, apartments in Tokyo are small, and do not provide the ideal environment for working from home, which would mean that most people would commute to the main office or nearby satellite offices. Therefore, the shift in resident preference should be subtle and gradual, although it may accelerate if economic hardship materialises and corporations look to reduce office space as an avenue to cut costs.

Looking ahead, the current slight softening of rents and occupancy levels is likely to continue. However, the advent of a viable vaccine looks to smoothen the existing friction in domestic and overseas movement, and this should provide greater stimulus to the Japanese economy as a whole, which hopefully will get the economy back on its growth trajectory. If economic conditions start to revert back to normal quicker than anticipated, the current preference shift could end up being transient, and we may eventually observe some reversal of the trend.