Tokyo – Q1/2020

MARKET IN MINUTES

Savills Research

Residential Leasing

savills

Future direction of rents uncertain

Rent growth was solid in both the C5W and the 23W, with the latter leading the way over the quarter and year. That said, given current market conditions, growth looks likely to pause until the impact of COVID-19 becomes clearer.

- Rent growth in the Tokyo 23 wards (23W) was solid during Q1/2020. Rents now stand at JPY4,155 per sq m – an increase of 2.7% quarter-on-quarter (QoQ) and 5.8% year-on-year (YoY).
- Average mid-market rents in the central five wards (C5W) continued their ascent towards JPY5,000. They are now at JPY4,928 per sq m after growth of 1.8% QoQ and 5.4% YoY.
- The C5W saw its premium over the 23W average contract to around 19%. Elsewhere, discounts widened in most other submarkets.
- Minato, in the C5W, was the top performer this quarter following growth of 5.6% QoQ. Otherwise, over the year, Kita impressed, with rents surging 11.6% YoY.
- Units in the 15-30 sq m size band still represent the majority of listings in the 23W. Yet, the larger units (45-60 sq m) have seen the strongest rent growth over the year, perhaps because of the growing demand from families.
- Average occupancy across the 23W and C5W rose in Q1/2020. Adachi is now the only ward in the 23W to have close to no vacancy.
- Apartment price growth shows little sign of abating. This phenomenon, as well as the current high level of rents, appears to have weighed on the number of tenants relocating. As such, occupancy should remain high, though further rent growth may be more limited.

> "Solid rent growth was observed in Q1/2020. Even so, COVID-19 is set to test the resilience of the residential market over the coming quarters. Subject to the extent of the resulting economic slowdown, the sector should, however, demonstrate its defensive nature, as observed after the global financial crisis."
>
> SAVILLS RESEARCH & CONSULTANCY

Savills team

Please contact us for further information

JAPAN

Christian Mancini
CEO, Asia Pacific
(Ex Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

RESEARCH

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

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

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

MAP 1: Tokyo's 23 Wards By Survey Area

Source Savills Research & Consultancy

SURVEY GEOGRAPHY

In order to illustrate trends in the central Tokyo residential market, Savills has divided 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 apartments in Tokyo. Our benchmark rental data is based on average advertised monthly rents for units which fit the following criteria:

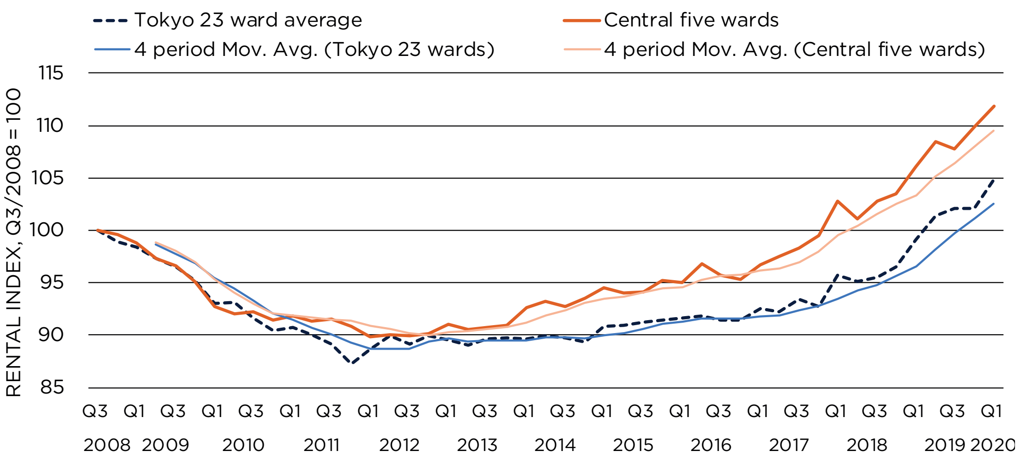
1) studio and one- or two-bedroom rental apartments of up to 100 sq m in size,

2) reinforced concrete structures built within the last ten years, and

3) properties located in Tokyo's 23 wards and situated within a ten-minute walk of the nearest station.

In contrast to the luxury residential market, advertised or "asking" rents for mid-market units fitting the above criteria are typically non-negotiable and are not subject to incentives such as rent-free periods. Savills mid-market rental indices are therefore considered to closely reflect movements in contract rents for the Tokyo market.

GRAPH 1: Mid-market Apartment Rental Index, Q3/2008 to Q1/2020



Source Savills Research & Consultancy

OVERALL RESULTS

The 23W saw the return of rental growth in Q1/2020, pushing rents to record highs. As for the C5W, the submarket has now experienced back-to-back quarterly growth and, like its counterpart, has also reached a new high. Even so, the rate of change in this central submarket has slightly declined as rents continue to test the financial capacity of Tokyo residents. With growth solid over the quarter and year in both submarkets, the spread between their respective four-period moving averages has expanded (Graph 1).

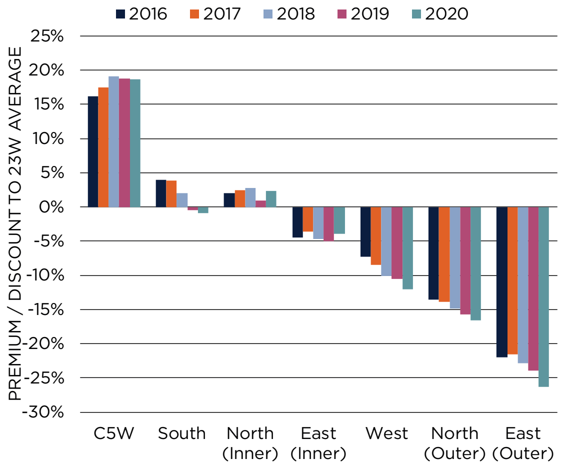
With rental growth in the 23W outstripping that of its centrally located peer, the divergence in rents between the two has narrowed by around 1.0 percentage points (ppts) to 18.6%. As for the other submarkets, rents in the South, having built up momentum since Q3/2019, have instead moved to a deeper discount as growth tailed off this period. Elsewhere, the West was home to the greatest widening of its discount after rents fell the most in the 23W. Other than the C5W, the Inner North remains the only submarket to hold a premium over the broader market average (Graph 2).

Units in the smaller size band (15-30 sq m) remain popular in the 23W, though the proportion of listings has declined in Q1/2020. This was especially true in the C5W. Rental growth over the quarter was mixed for these properties, with only those in the 23W experiencing an increase. As more families pursue properties in better locations, larger units (30-60 sq m) have benefitted. Indeed, rental growth of these units exceeded their smaller counterpart across both the submarkets and time frames (Graph 4). The largest band (45-60 sq m) stood out, with both submarkets experiencing double-digit rent increases.

MID-MARKET RENTAL TRENDS BY SURVEY AREA

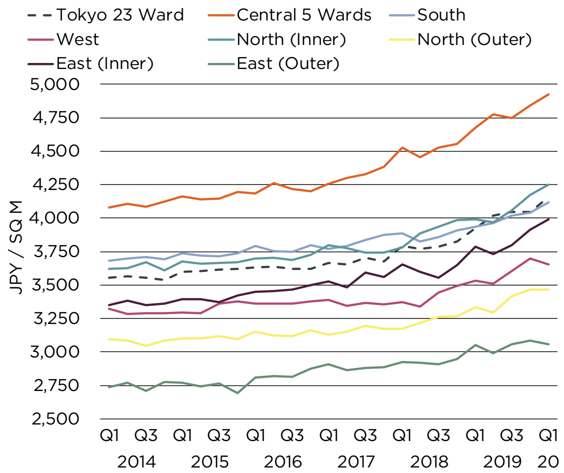
In Q1/2020, the 23W managed to crimp the slowdown in rental growth that had persisted throughout 2019, increasing at a solid 2.7% QoQ. In fact, in the process, rents reached

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



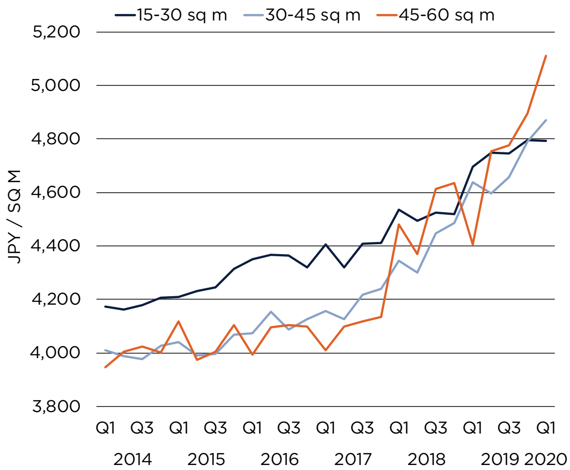
Source Savills Research & Consultancy
*The above represents the average premium/discount over the respective year. The 2020 average is, therefore, equal to Q1/2020.

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



Source Savills Research & Consultancy

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



Source Savills Research & Consultancy

a new high of JPY4,155 per sq m – a theme observed in three other submarkets in the 23W. Yet, it has not all been smooth sailing. Indeed, consistency has been hard to find at the ward level, with many that exhibited growth in the previous quarter losing momentum. That said, this inconsistency has, in some cases, also resulted in wards rediscovering rental growth over the quarter with Toshima, for instance, impressing. Over the year, rental growth in the 23W was also sound at 5.8%.

Record highs have been achieved once more this quarter in the C5W on the back of a 1.8% QoQ rise in rents. They now exceed 2008 levels by around 12%, and lie within reach of JPY5,000 per sq m. Growth over the year was even more impressive, coming in at 5.4%. At the ward level, Shibuya finds itself defying the submarket trend as rents slightly declined by 0.3% QoQ. Consequently, the ward has slipped back into second place with rents coming in at JPY5,120 per sq m. Like the broader market, however, annual growth remains strong at 6.3%. Meanwhile, Minato saw its fortunes reverse this quarter, leading the C5W in growth, both over the quarter and year – the first time since Q3/2018. Listed rents stand at JPY5,342 per sq m after growth of 5.6% QoQ – the most in the 23W – and 8.9% YoY. To be sure, quarterly rental growth in Shinjuku continues to decelerate – a trend observed since Q2/2019 – and have now turned negative, falling by 1.5%. As such, the ward remains the only one in the C5W with rents below its 2008 peak. That said, annual growth was a respectable 3.5%, and average rents are around JPY4,470 per sq m.

Rental growth in the South has improved of late. In fact, the rate of quarterly and yearly growth in Q1/2020 was the highest for over a decade. To wit, asking rents increased 2.0% QoQ and 4.7% YoY, and now stand at JPY4,118 per sq m. There was a clear divergence in performance within the wards, with the two most expensive comfortably leading the way. These two wards, Meguro and Shinagawa, experienced quarterly growth of 2.9% and 4.0%, respectively. Over the year, the latter was in the vanguard, pushing rents 8.9% higher to JPY4,466 per sq m. Setagaya, like Shibuya in the C5W, experienced a slight decline in rents over the quarter. Average rents are now JPY3,967 per sq m. Over the year, however, rental growth was an improved 4.6%.

Rental growth over the year in the Inner North submarket was an impressive 6.5% - the highest in the 23W. Subsequently, rents have risen to JPY4,250 per sq m and, along with the C5W, the submarket has maintained its premium against the 23W average, albeit tightening somewhat. At the ward level, annual growth rates were very similar with both seeing rents increase by around 6.5%. Over the quarter, however, things were very different. After a disappointing Q4/2019, Toshima has redeemed itself with a solid 5.4% increase in rents, which now lie at JPY4,148 per sq m. The opposite was true for Bunkyo, where rents declined by 1.4% to JPY4,352 per sq m.

Rents in the Inner East are within a whisker of the JPY4,000 mark following solid growth over the quarter and year of 2.0% and 5.5%, respectively. As in recent quarters, Sumida carries the day. The cheapest ward in the submarket has led quarterly growth for three consecutive periods, and in doing so, has made significant headway in catching its peers. Rents are now JPY3,927 per sq m after growing 3.3% QoQ and 9.8% YoY. Elsewhere, rental growth has been pared in Taito, with both quarterly and annual growth slowing to around 1.0%.

Having disappointed last quarter, Suginami came back stronger in Q1/2020 to become the only ward in the West to see positive rent change. Average rents stand at JPY3,816 per sq m following 3.8% QoQ growth. This feat was made more impressive by the fact that the ward saw listings increase by more than three quarters during the period. Over the year, rents grew at a similar clip. Despite disappointing over the quarter, Nerima – the cheapest ward – saw rents grow 8.0% YoY to JPY3,383 per sq m. In fact, yearly rental growth has accelerated for three consecutive quarters in this ward, underpinning the submarket's solid annual growth of 3.5%.

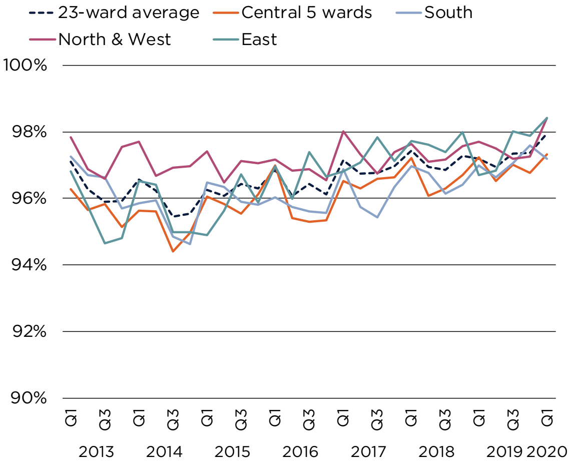
The near 6.5% QoQ growth in rents observed in Itabashi back in Q3/2019 feels like a lifetime ago. Beset by marked contractions for two consecutive quarters, the ward finds itself firmly behind Kita, with average rents at JPY3,206 per sq m. In contrast, the latter saw solid rental growth over the shorter and longer terms. Rents stand at JPY3,727 per sq m on the back of 4.0% QoQ and 11.6% YoY growth. In fact, the spread between these two submarket components was around 16% in Q1/2020 – the widest in over a decade. As for the submarket, dragged down by Itabashi, rents in the Outer North held firm over the quarter.

Within the 23W, the Outer East remains the cheapest place to live on average. This was further exacerbated by rents falling 0.9% QoQ to JPY3,060 per sq m in Q1/2020. Over the year, rents did in fact increase, albeit a paltry 0.4% - the lowest in the 23W. The spread between the best performing ward and the worst was vast, with Adachi and Edogawa taking those spots, respectively. The former saw rents rise by 4.3% QoQ and 4.8% YoY to JPY3,024 sq m. The latter, in contrast, experienced a near 10% QoQ fall in rents to JPY2,813, solidifying its status as the cheapest in the 23W. Rents also contracted over the year, albeit by relatively less at 1.3%. That said, this submarket represents around 5% of total listings in the 23W, and therefore, volatility in rental growth should be expected.

RENTS BY UNIT SIZE

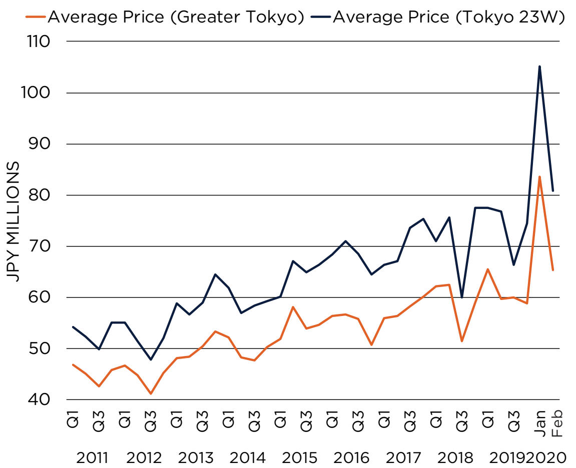
Tokyo's rental market is principally made up of compact single-occupier units, typically less than 45 sq m (13.6 tsubo) in size. Such units can often make up as much as 75% or more of the 23W area's rental listings. Unlike other major global cities such as London and New York,

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



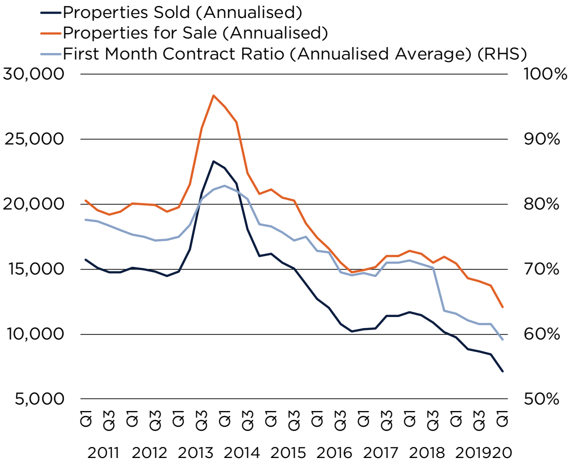
Source Savills Research & Consultancy based on publicly disclosed J-REIT property data (Advance Residence and Nippon Accommodation Fund)
*Q1/2020 is as of February 2020

GRAPH 6: Average Price Of Brand-new Apartments In Greater Tokyo And In The 23W, Q1/2011 to Feb 2020



Source Real Estate Economic Institute, Savills Research & Consultancy

GRAPH 7: The First Month Contract Ratio And The Number Of Brand-new Apartments For Sale And Sold In The 23W, Q1/2011 to Q1/2020*



Source Real Estate Economic Institute, Savills Research & Consultancy
*Q1/2020 is as of February 2020.

house or apartment sharing does not form a major segment of the rental market. As a result, there is a large, stable market for small- to mid-sized units.

As always, units between 15-60 sq m significantly dominate supply, accounting for nearly all listings. Within this range, however, the proportion of the smallest units (15-30 sq m) is the highest in the 23W, though this figure has declined somewhat this quarter. This was particularly evident in the C5W, where its share has fallen from over half to around 40%. Yet, despite the contraction, rental growth has been absent for centrally located units. Over the quarter, rents held firm at JPY4,792 per sq m (Graph 4). In contrast, rents rose 1.8% QoQ to JPY4,101 per sq m in the 23W. Over the year, rents for this smaller size band fared slightly better in both submarkets, growing 2.0% and 3.5%, respectively.

As for the other size bands, annual rental growth was impressive, particularly in the 45-60 sq m range. Average rents stand at JPY5,111 per sq m and JPY4,261 per sq m in the C5W and the 23W, respectively, following growth of 16.0% and 11.8%. A factor behind the double-digit rental growth in both the C5W and broader submarket appears to be the combination of an increase in the number of listings of newly built condos, as well as a rise in units at the upper end. Meanwhile, average rents for 15-30 sq m units are the least expensive in both the C5W and the 23W for the first time in a decade. This is perhaps unsurprising as growing demand from families has driven the transition towards larger condos – especially in centrally located areas. That said, growth figures, especially for the larger size bands, should continue to be caveated with the issues that arise from a small sample size.

OCCUPANCY RATES

In Q1/2020, the occupancy rate in the 23W grew by 0.7ppts YoY to 97.9%, driven predominantly by the Outer East and the West – the two submarkets where the largest uptick was observed. Of the two, the former experienced the biggest change in occupancy, with the rate growing by 3.1ppts YoY. At the ward level, Edogawa, in the Outer East submarket, saw an impressive 3.7ppts YoY increase, though, over the quarter, rates fell by 1.1ppts. As for the C5W, the loosening seen in the previous quarter was reversed, with the rate rising back above 97% after moving 0.6ppts higher this quarter. Within the submarket, Shibuya and Shinjuku saw the greatest change over the quarter, with the rate increasing by 0.7ppts in both wards. Over the year, however, the occupancy rate in the C5W remained somewhat flat.

Demand for institutional-quality assets remains strong, and occupancy rates across all submarkets now stand above 97%, with the Outer North leading the pack at an impressive 99%. To be sure, occupancy in the 23W will certainly be tested if the impact of the COVID-19 outbreak persists and weighs on leasing demand. It is however, encouraging that the sector has entered this tumultuous environment on a solid footing.

LESS IS MORE

As discussed in previous reports, it is no secret that apartment prices, especially for brand-new units, in Tokyo are high. Yet, they seem to have reached unprecedented highs in 2020. According to the Real Estate Economic Institute, the price of a brand-new apartment in the 23W stands at around JPY81 million as of February 2020 – an annualised growth rate of approximately 4.5% since 2011. Meanwhile, across Greater Tokyo at large, average prices are close to JPY65 million (Graph 6).

When observing the price movements over time, the spike witnessed in January 2020 is certainly eye-catching, albeit somewhat of an outlier. In fact, prices skyrocketed to JPY105.1 million and JPY83.6 million in the 23W and Greater Tokyo, respectively, with the latter marking an all-time high. Looking at prices in the 23W specifically, the 40% YoY increase in January appears to have been underpinned by the near 250% increase in sales of units priced at over JPY100 million, which includes nine properties sold for over JPY300 million. Even considering that January historically has low supply, this spike is notable, implying developers' bullish stance and a strong overall market sentiment. As for the ultra-luxury space, developments such as the Marq Omotesando One, with units costing up to a reported JPY6.8 billion – the most expensive property ever in Japan – as well as multiple units exceeding JPY1 billion, could be a bellwether for the market's direction going forward.

Over the longer term, with outliers smoothed out, market tightness continues to be the main factor supporting these elevated prices. Since peaking out towards the end of 2013, the number of brand-new apartments listed in the 23W, as well as those sold, has been declining to levels not seen for over a decade (Graph 7). The first month contract ratio has subsequently followed suit. With a rate of 70% considered positive, a reading of 60% in February emphasises how the lofty valuations are weighing on buyers' appetites.

These inflated prices have thus far been a boon for the rental market, as prospective house buyers wait on the side-lines for prices to moderate. Not everyone has benefitted, however. According to property platform AtHome, a variety of factors, including increasing relocation costs due to the ongoing labour shortage, lofty rents, as well as fewer job transfers, have led to a 14% YoY decline in completed leasing contracts in the 23W during 2019. Consequently, those involved in this line of work, such as residential leasing brokers, have struggled. To wit, bankruptcies in the Greater Tokyo real estate sector have increased by 6% according to data provided by Teikoku Databank, and COVID-19 is likely to accelerate this trend, at least temporarily. Despite occupancy remaining high, with tenant relocations falling, opportunities for landlords to increase rents may decrease. As such, rental growth is likely to be moderate going forward.

OUTLOOK

Underpinned by solid fundamentals, rents have seen strong growth during the start of this year. Yet, with the impact of the COVID-19 outbreak looming large, the outlook for the economy does not appear promising. Although Japan's economy has held somewhat steady thus far, an economic slowdown is inevitable. Indeed, with the nation still reeling from the consumption tax hike enacted in October, the already-fragile economy looks certain to head into at least a technical recession come Q2/2020. While the postponement of the Olympics is undeniably better than an outright cancellation, market sentiment has been dampened for the rest of the year.

Likewise, the residential sector is certainly not immune to this ongoing uncertainty. Corporate activity has slowed, with labour demand falling as a result. There have even been cases of soon-to-be university graduates having job offers rescinded by smaller companies, emphasising the uncertain market conditions ahead. Coupled with stubbornly low wage growth, as evidenced by the lower salary hikes than demanded in the annual spring negotiations (whereby increases in salaries are negotiated between companies and their respective unions), the affordability of current rent levels will be tested.

Despite the pessimism, it is important to keep in mind the defensive nature of the residential sector through times of stress. For instance, the sector held up relatively well even after the global financial crisis – rents adjusted by approximately 10% and occupancy remained stable in the subsequent years. Furthermore, firms have hitherto faced prolonged labour shortages, and are therefore likely to reduce other expenses before turning to workforce redundancies. More broadly, Japanese firms currently hold close to JPY500 trillion of cash, a strong reserve to help weather the COVID-19 storm, and this additional firepower should mitigate layoffs, pay cuts, and bankruptcies, thereby providing another layer of protection to the residential sector. Considering the above, therefore, rental growth, if any, is expected to be somewhat moderate, at least until the impact of COVID-19 becomes more visible.