Japan - April 2024

SPOTLIGHT

Savills Research

Japan Retail

Market optimism high, but tenants feeling cost pressures

Summary

- Average 1F rents in Tokyo have remained mostly flat over the past half-year, and the retail sector has overall been thriving with vacant units becoming harder to spot.
- In regional markets, average rents dipped slightly, although most regions, especially those dependent on inbound tourism, have continued to improve.
- Investment volumes in the retail sector in 2023 have leapfrogged those of 2022, partly due to the large Seibu and Sogo deal.
- The number of inbound tourists has hit new highs, and many areas have seen an increasing number of stores catering to them. However, some non-prime areas still appear to be suffering.
- Appetite for luxury products amongst both domestic and international consumers remains elevated, and high-end retail is likely to draw increasing amounts of interest.
- Optimism in the market is high and some landlords have thus been eyeing rental increments. However, inflationary pressures have depressed operating margins of tenants, many of whom may not be able to handle higher rents.
- While the retail sector is recovering overall, performance still varies greatly depending on location and tenant.

TOKYO SUBMARKET RENTS

According to the semi-annual survey conducted by the Japan Real Estate Institute (JREI) and BAC Urban Projects, average asking rents for 1F units in Tokyo saw minimal changes, decreasing 0.1% half-year-on-half-year (HoH) in 2H/2023, but rising 1.2% year-on-year (YoY). Non-1F average asking rents moved in a similar direction, dipping by a slight 0.9% HoH, while increasing 1.7% YoY. Overall, market sentiment has become more positive as society has progressed deeper into post-pandemic territory, and all areas, especially inbound tourist dependent ones, have been faring better.

The retail sector has continued to improve, with 2023 seeing record-high sales in the country, partially supported by the number of inbound tourists that continues to grow and has hit new highs. According to Graph 1, retail sales in Japan in 2023 hit JPY163 trillion, having increased 6% from the previous year, and even surpassing levels of the bubble era. At the same time, moderate inflation has played some part in this trend over the past year. In fact, although sales have increased, rising material costs, labour costs, and higher energy prices are still causing many stores to struggle, in stark contrast with landlords that have become more bullish on market prospects and are eyeing rental increments.

The market has been in the best condition since the pandemic began, and inbound tourism is serving as a large tailwind for the retail sector. Domestic consumption should also improve, supported by noticeable wage growth. At the same time, bifurcation in the market is still present, and the general rhetoric of prime locations faring considerably better than non-prime counterparts continues to ring true. This will likely persist for the time being, as the market adjusts to new conditions, and sectors, like F&B, make a steady comeback.

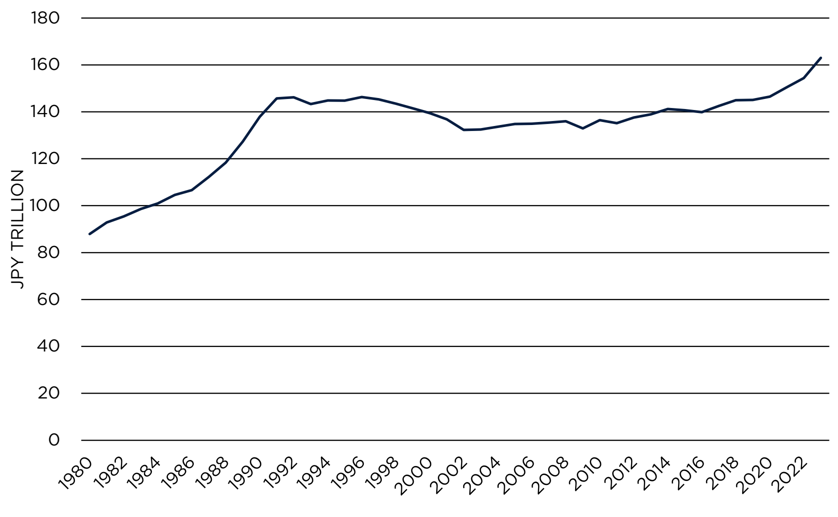
Ginza

Average 1F asking rents in Ginza continued to contract by 5.2% HoH and 11.4% YoY to JPY68,700 per tsubo in 2H/2023. However, this decline in rents was primarily due to more units in prime locations being taken off the market, and indeed there have been fewer 1F listings compared to 2022. Non-1F rents saw much smaller changes, dipping by a slight 0.8% HoH to a 2.6% annual increment at JPY35,000 per tsubo.

Ginza is the premier retail district in Japan, known for showcasing luxury brands, and its name is associated with being high-end. A number of new openings of such branded goods, have been observed, including Jimmy Choo along Chuo Street, where Balenciaga is also reportedly opening a new store in May 2024. Other notable openings include Onitsuka Tiger's Red Concept Store along Matsuya Street and Nike in Ginza Glasse. Elsewhere, a more unlikely player, the discount supermarket OK, has made its entrance into the basement floors of Marronnier Gate Ginza 2, showing that the area could still have room for different content genres.

The resurgence of inbound tourism has undoubtedly helped to prop up Ginza, with stores of luxury brands, department stores enjoying notably higher levels of footfall. In

GRAPH 1: Japan Retail Sales, 1980 to 2023



Source Ministry of Economy, Trade and Industry, Savills Research & Consultancy the case of the F&B industry, vacant units can still be observed, especially on mid-level floors. This situation is expected to steadily improve with both domestic and inbound inflows continuing to rise. Overall, the area is expected to continue doing better, especially in the case of luxury goods, which demand has not waned for.

The retail sector has continued improving, especially in areas popular with inbound tourists, and there have been more store openings catering to international visitors. Lukewarm domestic consumption should also improve due to noticeable wage growth. While prime areas are performing very well, some non-prime areas are still struggling, showing some bifurcation in the market. The optimistic market sentiment has led some landlords to eye rental increments, in contrast to tenants who already have had operating margins thinned from rising costs, and this gap in expectations is likely to persist.

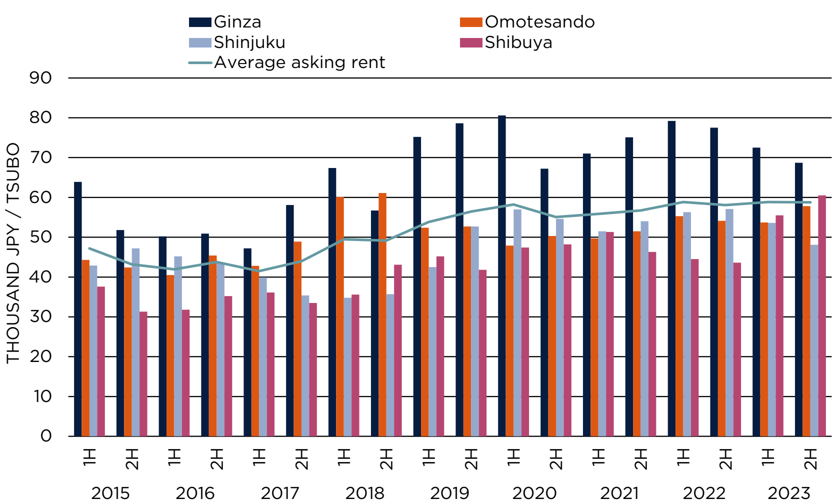
Omotesando

Average 1F rents in Omotesando have risen 7.6% HoH and 6.8% YoY to JPY57,800 per tsubo. Vacancies in 1F reportedly remain high in non-prime areas, although this has admittedly begun to improve. Non-1F rents have seen more marginal changes, having dipped 1.3% HoH and increasing 5.8% YoY to JPY36,600 per tsubo. Regarding non-1F rents, Omotesando continues to be the most expensive in Tokyo.

The main Omotesando street is home to a lineup of luxury brands that rivals that of Ginza, and vacancies in this prime area are generally few and far between. This area has continued to perform well, with brands such as Loewe, Celine, Chanel, and Maison Margiela either increasing floor space or conducting interior renovations. Nearby, cosmetics retailer Prada Beauty has opened a new store off the main Omotesando street near Cat Street, suggesting that a new trend of high-end cosmetics in the area could be underway. Other streets cater generally to a wider array of tenants, and have seen a number of new openings over the past half-year, including Universal Music Store along Takeshita-dori and Ralph Lauren in Cat Street. In fact, these streets, along with others like Meiji-dori, which had high levels of vacancies during the pandemic, have improved significantly, with multiple new openings of second-hand clothing stores and casual fashion shops.

The significantly improved footfall from inbound tourists has helped to breathe new life into Omotesando, which should continue to gradually see vacancies decrease. Even the fashion industry, which had a late recovery, has seen more new store openings, suggesting that optimism is high.

GRAPH 2: Tokyo 1F Rents, 2015 to 2023



Source JREI, BAC Urban Projects, Savills Research & Consultancy

Shinjuku

Average 1F rents in Shinjuku fell sharply by 10.3% HoH and 15.8% YoY to JPY48,100 per tsubo. However, this drop in rents is thought to be due to a decline in the number of available prime units, and actually points to signs that the market is improving. Non-1F rents have decreased 4.7% HoH and 6.3% YoY to JPY32,500 per tsubo, and are now the lowest amongst the four submarkets in Tokyo.

Isetan Shinjuku has hit new record high revenues, with 2023 levels surpassing those of FY2022. The department store has been a major beneficiary of the rebound in inbound tourism, with Louis Vuitton opening a new store targeted at male patrons, in March 2024. Meanwhile, Lumine and similar fashion-centric malls and buildings have reportedly recovered to about 5% to 10% shy of 2019 levels as of 2023, but nonetheless look to continue improving going forward as both the fashion and F&B industries have more optimistic outlooks.

Vacancies along Shinjuku-dori appear to be more sparse, and some lots that were vacant for prolonged periods of time appear to have found tenants. High-end brand stores have been comparatively rare in Shinjuku, but it appears that some brands have looked to capitalise on this and the large inbound tourism traffic that the area brings, with reports of some new openings in the pipeline. Overall, the prospects of Shinjuku retail are bright.

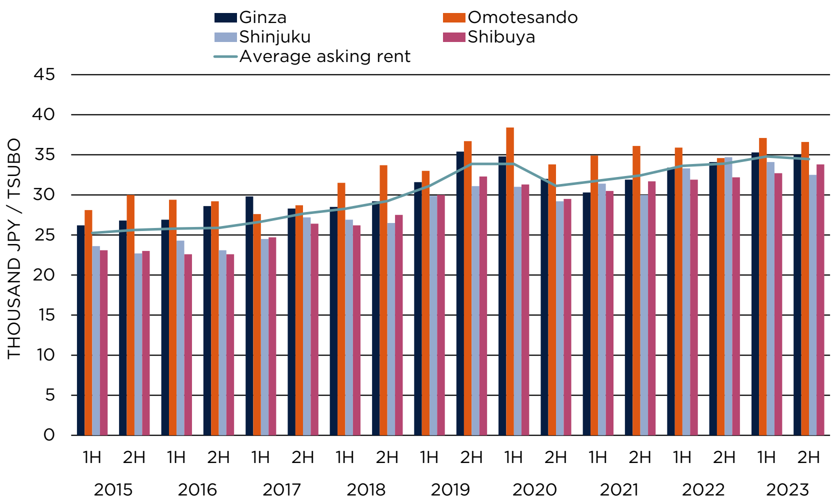
Shibuya

Average 1F asking rents in Shibuya have grown by a considerable 9.0% HoH and 38.8% YoY to JPY60,500 per tsubo, and are now the second most expensive in Tokyo. New listings have been on the decline, and there is considerably more confidence in the market. Meanwhile, rents on non-1F floors have risen slightly by 3.4% HoH and 5.0% YoY to JPY33,800 per tsubo.

Shibuya is reported to have welcomed even more inbound visitors than Shinjuku, claiming the number one spot in Japan. Shopping malls have also been performing well, with Shibuya Parco reporting a 63.8% increase in sales between March and August 2023 compared to the same period in the previous year, with tax-free sales accounting for a third of revenue. Unlike its counterparts in the Tokyo market, Shibuya does not have a particular street dedicated to luxury brands, but the variety of unique entertainment that it boasts has allowed it to become a key global tourist destination. Indeed, it has shone elsewhere as a cultural hub of Tokyo, and the multiple developments that have transformed the submarket over the past decade has helped to constantly renew interest in the area. For instance, QFRONT, which hosts the iconic Shibuya Tsutaya store at the forefront of the scramble crossing will have its renewed opening at the end of April 2024.

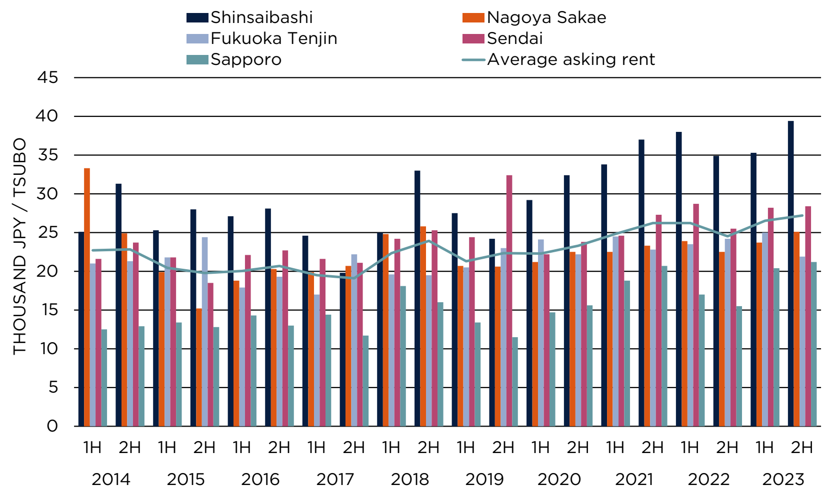
Prospects for Shibuya are high, and its ability to attract inbound visitors and young crowds is unrivalled. More upcoming developments like Shibuya Sakura Stage in summer 2024 will continue to add to the excitement that the area has to offer. Given the strength of Shibuya, rents in the area are expected to remain high going forward.

GRAPH 3: Tokyo Non-1F Rents, 2015 to 2023



Source JREI, BAC Urban Projects, Savills Research & Consultancy

GRAPH 4: 1F Rents in Retail Districts of Regional Cities, 2014 to 2023



Source JREI, BAC Urban Projects, Savills Research & Consultancy

REGIONAL CITIES

Average 1F asking rents in regional cities rose by 2.6% HoH and 10.9% YoY to JPY27,200 per tsubo in 2H/2023. Non-1F rents moved in the opposite direction, declining 4.3% to JPY16,140 per tsubo, albeit remaining 0.2% higher on an annual basis. In general, optimism has significantly improved as society has progressed further into post-pandemic territory, and the return of enthusiastic inbound tourists has prompted an increase in the number of stores catering to them. At the same time, rising operating costs due to inflation and higher energy prices have put considerable downward pressure on profit margins, in contrast with landlords that have become more bullish in the current market environment and might be eyeing rental increments. As such, rental increments could be on the horizon but would be dependent on the area and tenant in question.

In Osaka's Shinsaibashi, average asking 1F rents have increased by 11.6% HoH and 12.9% YoY to JPY39,400 per tsubo, attaining the highest levels in the past decade. Non-1F rents moved in the opposite direction, dipping 8.5% HoH and 5.2% YoY to JPY18,400 per tsubo. While the area is highly dependent on inbound tourism and has hence seen significant recovery in accordance with the return of international visitors, bifurcation within the submarket has been observed. For instance, drugstores have reportedly been fighting for new space along the main Shinsaibashi-suji shopping street, like with Matsumoto Kiyoshi opening three new stores within a short period of time, and luxury brands have also been competing for space along Midosuji. In such cases, landlords will likely have been able to increase rents due to the high demand from potential tenants, with rumours of some luxury tenants paying rents that greatly surpass pre-pandemic levels. At the same time, the number of vacancies in less prime locations does not appear to have improved as much. Nevertheless, optimism is high due to the comeback of inbound tourism, which could look to propel the submarket to higher rental levels.

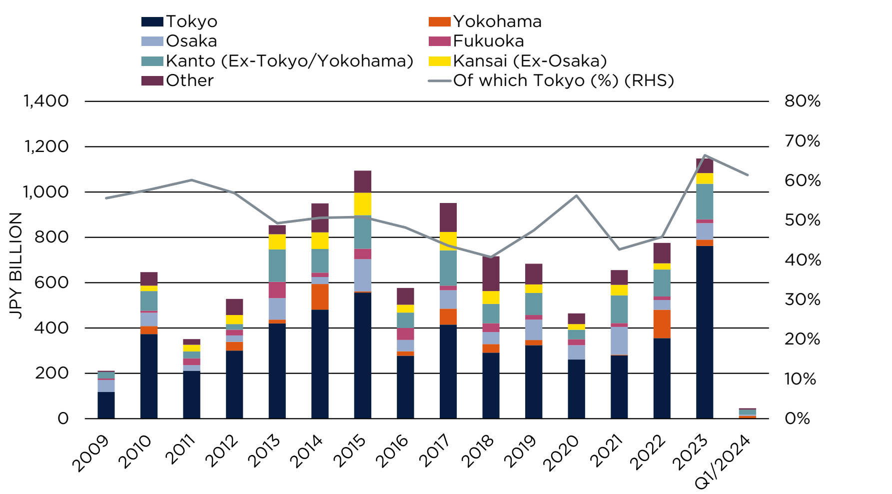
In Nagoya's Sakae, asking 1F rents have risen by 5.9% HoH and 11.6% YoY to JPY25,100 per tsubo, while non-1F rents dipped by a slight 0.6% HoH and YoY. While not historically an inbound-tourism dependent area, Sakae has benefitted somewhat from the inflows of international visitors and retail performance in the area has overall been improving, with its landmark Matsuzakaya department store reporting a 6% increase in sales in 2023 compared to 2019 levels. New store openings continued, especially along Otsu-dori. For instance, Alpen has opened its flagship store in nearby Nadya Park. At the same time, the number of vacancies has generally remained unabated, partially contributed by the new supply entering the market, but also a harbinger of more prominent bifurcation materialising. Nonetheless, 2024 is an exciting year for Sakae, with the full opening of the Chunichi Building that should increase traffic around the area, and the first phase opening of Matsuzakaya's renovation towards the end of 2024.

Average asking 1F rents in Tenjin's Fukuoka dipped by 12.4% HoH and 9.5% YoY to JPY21,900 per tsubo, and non-1F rents moved in a similar direction, decreasing 14.7% HoH and 3.1% YoY to JPY15,700 per tsubo. However, the decline in rents is reported to be a result of more expensive units being taken up. Tenjin has ridden the rapid surge of inbound tourism, with market conditions improving notably and seeing a large number of store openings catering to international visitors. Luxury goods have been faring particularly well. With revenues at Iwataya Mitsukoshi seeing about a 14% increase from the previous year in FY2023. Vacant space has become harder to spot, although still visible in some areas where landlords have been more unwilling to compromise on rents. Overall, expectations for the area are high with Tenjin Big Bang redevelopments underway, and Fukuoka Airport's expansions that will increase capacity and further encourage inbound visitor inflows.

In Sendai, average asking 1F rents increased by 0.7% HoH and 11.4% YoY to JPY28,400 per tsubo. Non-1F rents increased by 3.8% HoH and 6.5% YoY to JPY16,400 per tsubo. The Sendai market has made gradual improvements, and vacancies in 1F units have become scarcer. At the same time, the Yodobashi Sendai No.1 Building that opened in June 2023 appears to have further gravitated traffic towards the Sendai station area. The shopping streets have also demonstrated steady improvements, but listings remain elevated, with notable vacancies observed along areas with many F&B tenants. While more attention has been focused on the station area, prospects for the shopping arcade may look more promising with some redevelopment plans in the pipeline, like the new medical mall by Aqua that plans to be opened in the summer of 2025.

Sapporo's 1F rents have increased 3.9% HoH, and a spectacular 36.8% YoY to JPY21,200 per tsubo. Non-1F rents have increased 2.3% HoH and 6.3% YoY to JPY13,500 per tsubo. As a popular inbound tourist destination, the retail market in Sapporo has also benefited from the return of international visitors, especially in the case of 1F and other prime units along the connected underground. For instance, Louis Vuitton has opened a new store in Daimaru. At the same time, some areas are still struggling, most notably the higher floors in the Susukino area, where vacancies are still high. Going forward, inbound tourism is expected to play an increasingly big role in the area's continued recovery, while struggling areas like Susukino have redevelopment plans to look forward to. Chipmaking factories near Chitose are also likely to contribute to F&B revenues in mid-term.

GRAPH 5: Retail Property Investment by Region, 2009 to Q1/2024*



Source MSCI Real Capital Analytics, Savills Research & Consultancy
* Q1/2024 volumes are preliminary and are likely to be revised upwards.
In principle, MSCI investment volumes do not include related-party transactions, such as those between a J-REIT and its sponsor.

INVESTMENT TRENDS

The semi-annual survey conducted by JREI in October 2023 shows that cap rates of prime retail properties have tightened in many markets across Japan. Sapporo decreased by 20 basis points (bps), while Sendai, Kyoto, Osaka, Hiroshima, and Fukuoka decreased by 10bps. Meanwhile, suburban shopping centres in Sendai and Hiroshima have also tightened by 10bps over the past half-year. That said, it should be noted that actual market cap rates could be as much as 100bps lower than these surveyed cap rates.

The retail sector has seen heightened interest, as seen by the compressing cap rates of retail properties nationwide. Indeed, optimism has increased in the market due to the surge of demand from inbound tourists and recovery in domestic consumer confidence. Retail assets in prime locations have thus been highly coveted, and some major deals in this sector were observed. For instance, in November 2023, major home appliance retailer Edion acquired the Edion Namba Main Store in Osaka City for JPY54 billion from Mapletree, citing cost reduction and stable store operations as reasons for the acquisition. Elsewhere, in a similar transaction, Pan Pacific International Holdings Corporation acquired Don Quijote Akihabara from Deka in Chiyoda for an estimated JPY10 to JPY15 billion.

Meanwhile, suburban retail properties also appear to have gained greater traction in the market. Indeed, such assets are able to provide higher yet stable yields, which has grown to be increasingly attractive in the current climate where cap rates of many other asset classes have become compressed. Furthermore, such properties also should have potential for value-add through more strategic asset management. For instance, in February 2024, Mitsui & Co. Digital Asset Management acquired Nasu Garden Outlet in Tochigi, which had an appraised value of JPY22.6 billion, from Sojitz, reportedly through a securitised token offering that had raised up to JPY11.4 billion. While

TABLE 1: Selected Retail Transactions, announced Q4/2023 to Q1/2024

ANNOUNCED	PROPERTY	LOCATION	GFA (SQ M)	PRICE (JPY BIL)	DIRECT CAP RATE	BUYER
Dec 2023	Edion Namba	Osaka City, Osaka	23,000	54.0	-	Edion
Feb 2024	Nasu Garden Outlet	Nasushiobara, Tochigi	31,600	22.6 (appraisal value)	-	Mitsui & Co. Digital AM
Dec 2023	Don Quijote Akihabara	Chiyoda, Tokyo	7,400	10.0 - 15.0 (estimated)	-	Pan Pacific International Holdings Corp
Mar 2024	iias Kasugai (30% quasi co-ownership interest)	Kasugai, Aichi	70,000 (total)	6.1	4.4%	Frontier REIT
Mar 2024	Laforet Harajuku (14% quasi co-ownership interest in land)	Shibuya, Tokyo	2,600 (entire site)	5.9	3.7%	Mori Building

Source Press releases, MSCI Real Capital Analytics, Savills Research & Consultancy

such properties, especially those with stable revenue and occupancy rates, make for appealing acquisition opportunities, asset management could also prove to be a challenge, especially for international players that lack the experience and on-the-ground talent for managing such large suburban assets. As such, there are likely to be opportunities available for investors that are able to overcome such hurdles.

According to preliminary data from MSCI, retail transactions in 2023 were 40% larger than in 2022, with volumes at nearly JPY1.1 trillion. While colossal deals such as that of the Sogo and Seibu department stores have contributed to a significant portion of these figures, they are also representative of improving market sentiments of the sector overall.

HIGH-END RETAIL

The retail sector in central areas has seen tremendous growth, with the continued rebound of inbound tourism supporting this positive trend. During the pandemic era, luxury retail was already performing well due to the pent-up demand from wealthy domestic residents. In the present post-pandemic era, while luxury conglomerates appear to have recently slowed down at the global level, tailwinds in Japan do not appear to have petered out. In fact, luxury retail appears to have continued on an upward trend, and could be expected to keep improving as overall tourism in Japan appears to have shifted some focus on appealing to the high-end market. More details can be found in our "High-End Tourism in Japan" report.

There have been a number of luxury store openings in Tokyo over the past year. For instance, Grand Seiko opened their flagship store in Ginza, which is their third location in the area, and several luxury brands, such as Jimmy Choo have opened in Ginza Six. Elsewhere, Omotesando's main luxury retail street has welcomed famous luxury brands BVLGARI and Tiffany & Co., while luxury watch boutique Rolex opened a store in Shinjuku in 2023. In the new Azabudai Hills complex, brands including Hermes, Cartier, Dior, and Celine have added new stores in 2024. The multiple new openings suggest that many brands demonstrate the confidence in the Japanese market, and more stores of similar calibre could be seen in other large-scale developments taking place in Tokyo over the next few years.

Meanwhile, high-end department stores have continued to break sales records throughout 2023 and entering 2024, showing the heightened demand for luxury brands. To exemplify this, Isetan Mitsukoshi, Takashimaya, and Daimaru Matsuzakaya have all reported considerably higher sales in 2023 than in 2022 for their outlets in Greater Tokyo. For instance, Isetan Mitsukoshi's sales for FY2023 are reported to be close to 20% higher than those of FY2022, Takashimaya's sales in the first quarter of 2024 were around 15% higher than the same period in the previous year. Tax-free sales reportedly hit new levels for these department stores, showing that inbound tourists have made significant contributions to the spectacular performance of these department stores. The significant role that inbound tourism has played in the high-end retail sector is likely to be highlighted even further, with major players taking significant steps in appealing to international clientele. For example, Isetan Mitsukoshi has doubled the number of Gaisho[1] staff that serve foreign customers, and have also promoted foreigner-friendly membership apps.

Indeed, the average amount spent by inbound tourists has increased significantly in the post-pandemic era, with the weakened yen bolstering purchasing power. This factor has undoubtedly played an important role in boosting revenues of high-end retail. However, there have also been other factors feeding into this, like governmental efforts over the past decade to promote inbound tourism through increased numbers of duty-free stores and foreign language services, for instance. Furthermore, with the global economic slowdown hitting harder on the working class on top of elevated airfares, travellers in Japan are generally wealthier on average than before, and this can also be seen in the heightened hotel rates that have surpassed pre-pandemic levels, resulting in overall spending trends having gravitated towards those on the higher end. Elsewhere, ultra-luxury residential developments have also gained greater traction in the market over the past few years, many of which are part of a large-scale mixed-use development that will also tend to have high-end retail outlets. Going forward, with Japan's emergence as a premier global tourist destination, on top of the emergence of luxury offerings in residences, hotels, and more, not to mention the Integrated Resort (IR) development in Osaka, more wealthy visitors and clientele will emerge, meaning that high-end retail stores should also look on track to perform well.

OUTLOOK

The Japan retail market has continued to improve, with popular tourist destinations coming out as clear winners due to the rise of inbound visitors, which can also be seen by an emergence of a growing number of shops that appeal to inbound clientele. This resurgence has helped to propagate retail sales to hit a new record high in 2023. Going forward, domestic consumption should improve due to the recent robust wage growth. At the same time, while prime locations are performing well in general, many non-prime areas still appear to be struggling with securing tenants and attracting footfall. Nonetheless, momentum for the sector is strong overall, and should continue improving.

1 Gaisho refers to direct sales to clients that are typically high-net-worth individuals.

In fact, suburban retail properties have attracted some attention from institutional investors due to the higher, yet stable yields that they are able to offer.

Elsewhere, high-end retail has also garnered a large amount of interest. Aided by a growing number of wealthy tourists travelling to Japan, and a number of ultra-luxury residential developments in the pipeline, demand for luxury retail space and products should continue to rise. Indeed, this can be seen by the growing revenues of high-end department stores, and more openings of luxury brand stores. Admittedly, the "boom" that luxury brands has seen worldwide appears to have fizzled out to some extent, with luxury good conglomerates such as LVMH reporting revenue slowdown. Nonetheless, prospects for high-end retail in Japan look more positive, as they are being propped up not only by the weakened yen, but also the improved infrastructure and services to inbound tourists, such as more duty-free shops and better multi-language information services. As such, this sector should still have room to grow in Japan.

Going forward, the retail market should look to continue improving with heightened demand from inbound tourism, and with solid domestic demand which should be supported by strong wage growth, and hence some eager landlords are reportedly looking to use this as an opportunity to increase rents. However, tenants still face a multitude of cost-side pressures, with elevated raw materials prices, energy prices, and higher labour costs eating into operating profit margins. As such, some tenants, especially those struggling to transfer cost increases to customers, are unlikely to be able to stomach rental increments, and this discrepancy between expectations of landlords and tenants is likely to persist. Landlords could potentially become more selective with tenants, focusing on industries that have greater room to pass costs onto consumers.

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