Japan - May 2022

SPOTLIGHT
Savills Research

Japan Retail

Recovery slow but underway

Summary

- In 2H/2021, average 1F rents in Tokyo have once again increased slightly. Overall, the market has seen some slight improvements from half a year ago, although recovery in prime areas has been more apparent.
- In regional markets, rents have also generally increased. While vacancies have fallen in some areas, the situation in cities that were highly dependent on tourism remains grim.
- Transaction volumes in 2021 have surpassed levels in 2020. Some investors appear bullish as multiple large deals on high streets have been observed.
- Rising energy and commodity prices will apply inflationary pressure, although the CPI increase is only likely to be mild.
- The Bank of Japan has decided to keep interest rates low and Japan's yield curve appears manageable because worldwide interest rate increments are likely to be mild overall due to ageing populations and the global savings glut.
- The yen may continue weakening if current interest rate differences persist, and this should create an opportunity for inbound capital. Although, if the world economy slows down more, the yen is likely to appreciate.

TOKYO SUBMARKET RENTS

Two years have passed since the onset of the pandemic. In Q4/2021, COVID-19 cases plummeted to exceptionally low levels, and many anticipated a rapid recovery. However, in Q1/2022, COVID-19 cases surged to all-time highs, initiating a quasi-state of emergency and restrictions on going out, effectively slowing recovery. Furthermore, rising energy prices and a weakened yen have also put additional financial pressure on the retail sector.

Amidst the challenging circumstances, there are some positive signs for the retail sector. Although daily COVID-19 cases are still notably higher than levels seen in previous years, this does not appear to have significantly affected people's decisions to go out - according to Google's Mobility Reports, footfall in retail and recreational areas is only around 10% lower than pre-pandemic levels. Also, the government has started easing restrictions, including border control on foreign nationals entering the country.

According to the semi-annual survey by the Japan Real Estate Institute (JREI) and BAC Urban Projects, average asking rents in 1F in Tokyo have increased 3.0% year-on-year (YoY) and 1.5% half-year-on-half-year (HoH). Non-1F rents have followed a similar trend, increasing 4.2% YoY and 2.0% HoH. The overall increments in rents still primarily stem from the listings of prime locations that were previously unavailable and are not a reflection of improving market fundamentals. Nonetheless, while the retail sector still faces troubles, vacancies have stayed mostly flat over the past half-year. Although recovery for the sector is likely to be a long and arduous process, many countries, especially in the west, have already transitioned into an endemic state, providing hope that an end should be in sight.

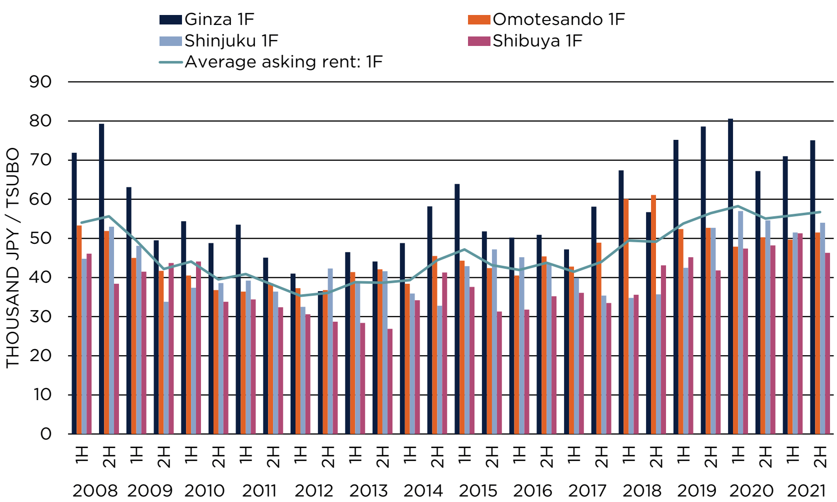
Ginza

Average 1F asking rents in Ginza rose 5.8% HoH and 11.8% YoY to JPY75,100 per tsubo – the highest rent levels seen since the pandemic began. Meanwhile, non-1F rents have increased 5.3% HoH to JPY31,900 per tsubo, translating to a slight annual decline of 0.3%. Ginza was also the only submarket in Tokyo to have seen an annual decline in rents. Overall, Ginza's 1F rents still stand a head above its peers in the Tokyo market, while its non-1F rents are actually below average.

Ginza is the epitome of high-end shopping districts, and many luxury brands have flagship stores in the area to associate their brands with the opulence of Ginza. The luxury goods industry has still seen favourable performance over the past half-year, and this has allowed Ginza to maintain low vacancy rates in prime locations. At the same time, the pool of districts regarded as prime areas has been shrinking, and some brands have been reportedly shifting stores to more prominent locations.

Meanwhile, the situation outside prime areas remains more challenging – vacancy rates are higher, especially along areas like Ginza 1-chome, and imminent recovery is unlikely without the return of inbound tourists. However, there are still some positives for these locations. Mid-to-high floors that generally performed poorly during the pandemic have seen vacancy rates flatten, and some have been filled by clinics and beauty services. Furthermore, there have even been some openings from the F&B industry. Overall, while the market situation in Ginza is

GRAPH 1: Tokyo 1F Rents, 2008 to 2H/2021



Source JREI, BAC Urban Projects, Savills Research & Consultancy still distant from pre-pandemic times, some gradual recovery has been observed in many areas.

The retail sector has begun to see some improvements over the past half year as COVID-19 has gradually shifted toward an endemic state. Nonetheless, this recovery has not been evenly distributed, and there is still a stark dichotomy between prime and non-prime locations. Rising costs and a weak yen will apply inflationary pressure, but the impact is likely to be manageable, while a weak yen also presents an opportunity for inbound capital.

Omotesando

Average 1F rents in Omotesando increased 3.6% HoH and 2.4% YoY to JPY51,500 per tsubo, while non-1F rents increased 3.4% HoH and 6.8% YoY to JPY36,100. For the first time since the pandemic started, rents have trended in the same direction. Omotesando continues to hold the highest non-1F rents in Tokyo. While the increment in rents is admittedly partially inflated because of the availability of some prime listings that were not previously available, the image that Omotesando presents and the customers that it lures, especially for the service industry, also contribute to the maintenance of these elevated levels.

Omotesando is well known as a fashion district, with many designer brands lined up in the Aoyama area, to areas in Harajuku that cater toward young fashion like Takeshita Street and Cat Street. While this characteristic used to be a strength of Omotesando, the submarket's reliance on the fashion industry has become a weakness as apparel stores, particularly those that cater primarily to young fashion, have generally continued to perform poorly during the pandemic, and have resulted in some visible long-term vacancies. On the other hand, the main shopping street between Omotesando and Jingumae that is propped up by luxury brands continues to thrive – making the dichotomy between prime and subprime areas more apparent.

Overall, location and accessibility at a micro level have become increasingly important in determining the success of a store in Omotesando, as the decreased footfall means that places with poorer accessibility are disproportionately more unlikely to receive customers. While many areas in Omotesando are still facing tough times, there are some aspects that have seen recovery. For instance, pop-up stores that had lost significant popularity due to the pandemic and the rise of e-commerce have seen some comeback as of late 2021.

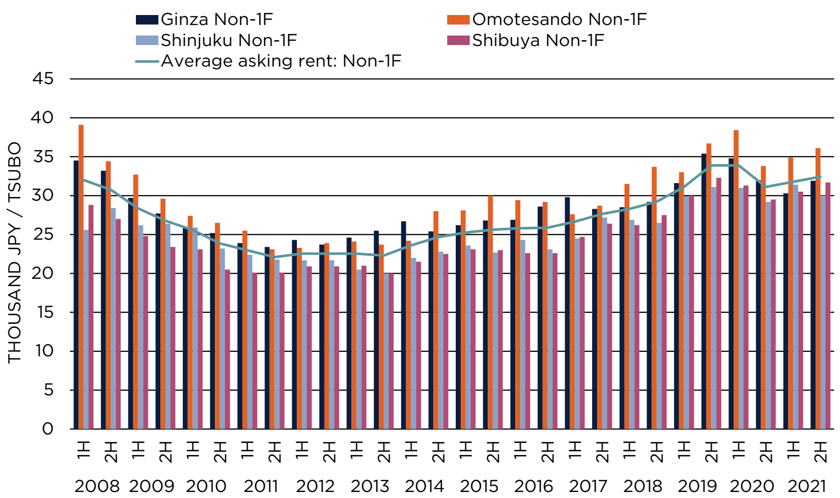
SHINJUKU

Average 1F rents in Shinjuku have bounced back, increasing 4.9% HoH to JPY54,000 per tsubo, although it remains slightly lower than levels seen one year ago. Meanwhile, average non-1F rents moved in the opposite direction from the uptick seen in the previous half-year, decreasing 4.5% to JPY30,000 per tsubo to become the least expensive submarket in Tokyo.

While Shinjuku is Japan's busiest terminal station, the pandemic has severely decreased footfall through the station, and consequently the number of customers that frequent its streets. Many shops along streets like Kabukicho that host F&B and entertainment stores that were initially holding out on the back of bank moratoriums and government aid may not have had the capital to continue operations and were forced to close. In particular, mid-to-high floors and minor streets continue to be badly affected, and vacancies remain high. On the other hand, prime locations such as Shinjuku Street and Shinjuku 3-Chome appear to remain popular, and some large brands have even taken the opportunity to set up new stores. For instance, Disney opened its new flagship store in late 2021 along Shinjuku Street.

Going forward, areas like Kabukicho, and mid-to-high floors are likely to continue struggling for the time being. In September 2022, the Odakyu department store next to the station will close and be rebuilt as part of the Shinjuku West Exit redevelopment project. This closure could divert some human traffic to other streets in Shinjuku. Moreover, the submarket has a large makeover to look forward to and will likely attract new footfall in the future when the project approaches stages of completion.

GRAPH 2: Tokyo Non-1F Rents, 2008 to 2H/2021



Source JREI, BAC Urban Projects, Savills Research & Consultancy

Shibuya

Average 1F asking rents in Shibuya have dipped 9.7% HoH and 3.9% YoY to JPY46,300 per tsubo – the lowest levels seen since the pandemic began. While like other submarkets, asking rents are still inflated due to listings of prime units that were previously unavailable, Shibuya has recently seen some uptake of these listings by new stores. At the same time, there are still vacant lots where iconic shops like FrancFranc used to be, showing that landlords are still having trouble finding tenants. Meanwhile, non-1F rents have trended in the opposite direction, increasing 3.9% HoH and 7.5% YoY to JPY31,700 per tsubo.

Shibuya's retail is still suffering from the effects of the pandemic, and there are still stark vacancies further from the station and on mid-to-high floors. Indeed, closures can still be seen from many restaurants and entertainment facilities – characteristics that used to be Shibuya's pull-factor. One positive aspect for the submarket is that areas closer to the main station have seen some new store openings. Nonetheless, vacancies are still significantly higher than pre-pandemic times, and it will take time for supply and demand to reach an equilibrium point.

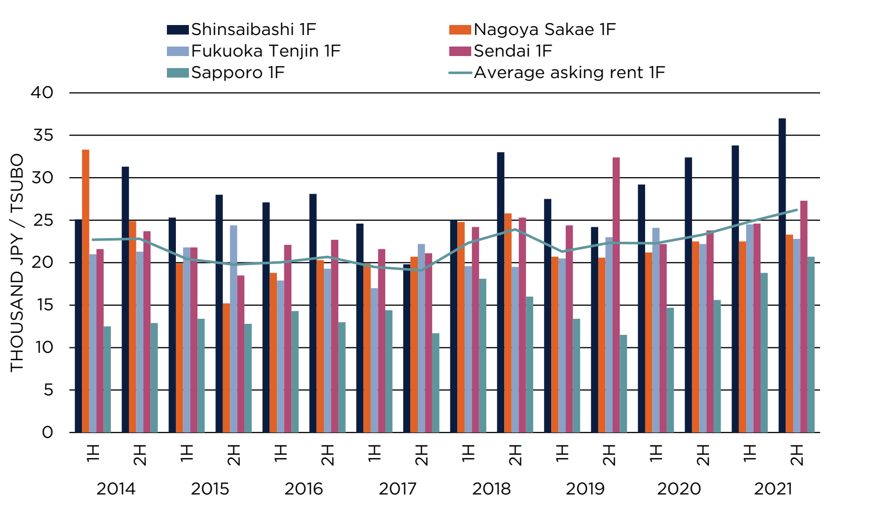
REGIONAL CITIES

In regional cities, 1F rents continued to grow 5.6% HoH and 12.5% YoY to the highest levels seen during the pandemic so far. Here, all markets have seen annual increments in rent. Despite these rental increments, the situation in many markets has not changed significantly from half a year ago, with areas dependent on inbound tourism still suffering and experiencing closures. Non-1F rents have seen a milder increment of 2.7% HoH and 1.2% YoY to JPY15,320 per tsubo, although the changes between regions have notable disparities.

In Osaka's Shinsaibashi, a dichotomy still exists in the market - areas traditionally focused on F&B and tourism like Dotonbori and American Village have noticeably higher vacancies, while luxury-centric areas like Midosuji are performing strong. Overall, like in the previous half-year, the market has once again seen a significant increase in both 1F and non-1F asking rents. 1F rents increased 9.5% HoH to JPY37,000 per tsubo, while non-1F rents increased 10.6% HoH to JPY16,700 per tsubo. While these increments were primarily led by the new availability of prime locations, the number of vacancies has overall remained flat over the past half-year, bringing some relief to the market. Nonetheless, given the grim situation in Shinsaibashi, the recovery of real rents is likely to be much further down the road.

In Sakae, Nagoya, average all-floor rents bounced back 4.2% HoH and 1.2% YoY to JPY17,500 per tsubo. Overall, rents and vacancy levels in Nagoya have not seen significant changes when compared to pre-pandemic times, primarily due to the region's low dependence on inbound tourism. The new department store Maruei Galleria, built on the site of the old Maruei that closed in 2018, also opened in March 2022, with Muji as its key tenant. The opening is expected to attract crowds and help revitalise Hirokoji Street. However, at the same time, the southern side of Sakae is performing poorly, and the relative lack of new redevelopment projects in the area is expected to lead to gradually weaker footfall going forward.

GRAPH 3: 1F Rents in Retail Districts of Regional Cities, 2014 to 2H/2021



Source JREI, BAC Urban Projects, Savills Research & Consultancy

While other markets generally saw rents increase, Fukuoka's Tenjin was the only one to buck this trend. Average 1F rents decreased 6.9% HoH to JPY22,800 per tsubo, while non-1F rents decreased 4.6% HoH to JPY16,600 per tsubo. While Tenjin's retail market was negatively affected by the pandemic and initially saw a substantial increase in the number of vacant units, vacancies have seen a marked decline over the past year and are almost on par with pre-pandemic levels. Tenjin Nishi-dori in particular, known for its line-up of casual international brands has remained popular. Tenjin has also seen a surprisingly small number of F&B closures, although many have likely been kept afloat by government grants as opposed to the prevailing market conditions.

Tenjin Business Center, part of the Tenjin Big Bang Project, opened in late 2021, and in 2022 featured new retail shops like Patagonia. Nevertheless, while more store openings have been observed since late 2021, the demand for multiple-floor units and large units has decreased, and long-term vacancies have become increasingly apparent. Indeed, the location, size, and the number of floors are factors that have become increasingly closely scrutinised and will determine the success of leasing a unit.

In Sendai, Miyagi, average 1F rents saw a sizable increment of 11.0% HoH and 14.7% YoY to JPY27,300 per tsubo. Indeed, vacancies on the first floor in Sendai have continued to remain high during the pandemic. In contrast, rents on non-1F floors have stayed flat over the past half-year at JPY14,700, and have seen vacancies decrease slightly. Sendai's retail market can broadly be categorised into two areas: Sendai station west exit, and the L-shaped shopping district stretching from Hapina Nakakecho to Mitsukoshi. The area around Sendai station has been undergoing redevelopments and has been attracting more footfall as a result. Consequentially, the shopping district has seen fewer customers, and remains in more bleak circumstances, especially within the F&B industry. The disparity between the two areas may not disappear even post-COVID, and the shopping district may have to brace for further tough times.

Average 1F rents in Sapporo have also seen a notable increment of 10.1% HoH and 32.7% YoY to JPY20,700 per tsubo. Vacancies are extremely high in this category, and the considerable number of available prime units has skewed average asking rents upward. Indeed, the area's underground walkways and streets are extensive due to the heavy snow in Sapporo, and there are cases where these underground rents can exceed first floor rents as a result. Meanwhile non-1F rents have seen a 2.5% HoH and 3.4% YoY to JPY12,300 per tsubo. Overall, the situation in Sapporo remains dire due to the lack of inbound tourism, especially in the Susukino area. One silver lining for the area is the ongoing redevelopment projects in the area. For instance, the redevelopment of Ikeuchi Gate and Susukino Lafiler are scheduled to open in the autumn of 2022 and 2023 and could provide a lifeline to retail establishments to the area.

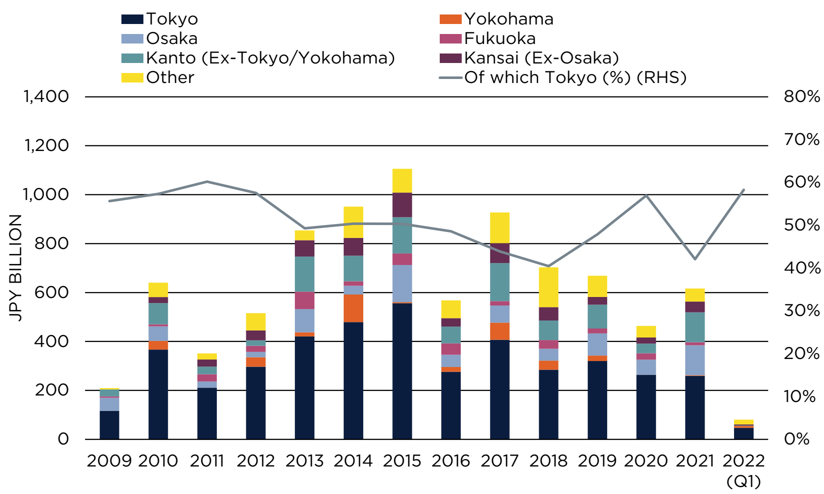
INVESTMENT TRENDS

The latest results of the October 2021 semi-annual survey conducted by JREI show that expected cap rates for prime retail property have stayed mostly flat over the past six months, with the exception of some cities experiencing tightening of cap rates. For example, while cap rates Tokyo's Ginza and Osaka have remained flat at 3.5% and 4.5%, respectively, cap rates in Nagoya and Fukuoka both tightened 10 basis points (bps) to 4.9%. Elsewhere, expected cap rates for suburban shopping centres in Tokyo and a majority of regional cities have also stayed flat, with the exception of Osaka and Nagoya, which both saw cap rates tighten by 10bps to 5.6% and 5.9%, respectively. However, it should be noted that actual market cap rates could be as much as 100bps lower than these surveyed cap rates and remain stable.

The retail sector has continued to face headwinds over the past two years of the pandemic as the multiple state of emergencies and restrictions have led to reduced footfall in stores and has likely shifted some spending habits from brick-and-mortar stores to online shopping. Nonetheless, some investors have been bullish about recovery in the sector as the pandemic wanes and as many countries in the world are approaching a state of normalcy. In fact, some properties in the high-end retail sector have seen particular interest over the past few months. For instance, the Ginza Yanagi-dori building, a premier retail and office building in the middle of Ginza, was acquired by four different domestic investors. In addition, as seen in Table 1, other transactions of prime retail properties like Clover Ginza in Ginza, and the JPR Umeda Loft Building in Osaka have also taken place.

Overall, retail transactions in 2021 have surpassed levels seen in 2020. According to preliminary data from Real Capital Analytics (RCA), transactional volumes in 2021 were over JPY610 billion in 2021 – a 33% increase from 2020. While volumes in the first quarter of 2022 have been slow, this figure is expected to increase as more transactions are confirmed. Indeed, the increased interest in retail properties in city centres could be a sign of expected recovery in the market.

GRAPH 4: Retail Property Investment by Region, 2009 to Q1/2022*



Source RCA, Savills Research & Consultancy
*Q1/2022 volume is preliminary and is likely to be revised upwards. In principle, RCA investment volumes do not include related-party transactions, such as those between a J-REIT and its sponsor.

TABLE 1: Selected Retail Transactions, announced Q4/2021 to Q1/2022

ANNOUNCED	PROPERTY	LOCATION	GFA (SQ M)	PRICE (JPY BIL)	DIRECT CAP RATE	BUYER
Dec 2021	JMF Portfolio (3 buidings)	Shinjuku and Chuo, Tokyo	6,700	20.6	3.5%-4.0%	Hulic
Dec 2021	JPR Umeda Loft Building	Kita, Osaka	18,000	17.5	3.8%	MBS Media Holdings
Feb 2021	Clover Ginza	Chuo, Tokyo	2,000	11.0*	-	Undisclosed individual
Nov 2021	G-Bldg Minami-Aoyama 01 (Building A and B)	Minato, Tokyo	1,600	10.1	2.9%-3.1%	GK No. 6 (SPC)
Feb 2022	Ito-Yokado Higashi-Yamato	Higashiyamato, Tokyo	53,000	9.5	6.0%	Hulic

Source Press releases, RCA, Savills Research & Consultancy
*The transaction price for Clover Ginza is a rumoured price quoted by RCA.

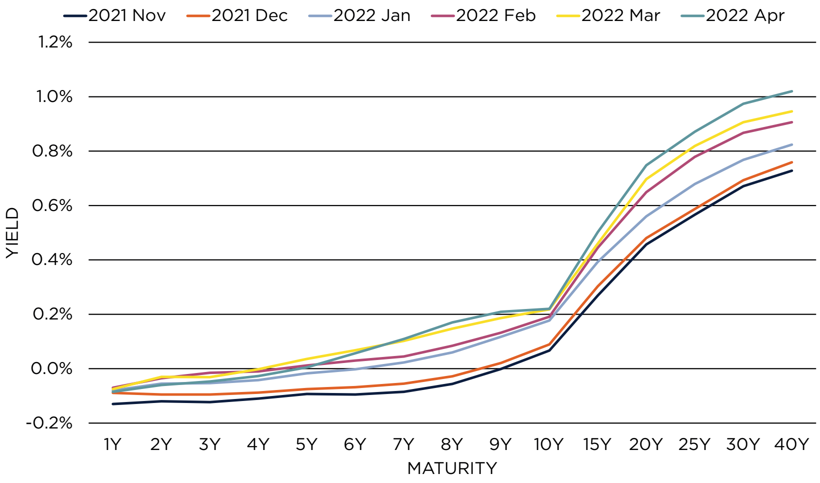
INFLATION IN JAPAN

Going forward, rising energy and commodity prices from the conflict in Ukraine are likely to increase inflationary pressure on the Japanese market. However, inflation is expected to be mild overall because wage movements have been stagnant, suggesting that demand-side factors should not apply much pressure on inflation. As a result, the CPI will mainly be elevated by cost-push factors, and it should rise to the mid-2% range. The weak demand is also likely to eventually curb inflationary pressure. If some wage increments in line with the growing cost of living are observed as a result, this should facilitate the positive inflation that the Bank of Japan and the government have strived to achieve. Otherwise, the country might be caught in stagflation if demand worsens.

There have also been concerns surrounding interest rates. Many countries, most notably the United States, have seen interest rate hikes in order to curb inflation. In contrast, the Bank of Japan has decided to keep interest rates low. Nonetheless, the movements of the Japanese government bond yield curve look mild so far and are expected to be manageable. We believe that interest rates in the world are unlikely to increase significantly overall, especially in developed economies because most major countries have an ageing population with low fertility rates, meaning that there is an increasing savings glut as well as greater reliance on pension management.

The Japanese yen has hit a 20-year low against the dollar and may weaken even further if current interest rate differences persist. While the weak yen might depress some consumer demand in Japan as the country has become less reliant on exports than before, it also creates an opportunity for inbound capital and tourists. That said, if the world economy slows down more, the yen is likely to appreciate. Overall, we believe that the change in exchange rates is unlikely to be significant enough to affect real estate investments. Also, Japan has announced plans to gradually reopen borders, and the increased purchasing power of international tourists should greatly benefit the retail sector.

GRAPH 5: JGB Yield Curve at Month End, November 2021 to April 2022



Source Ministry of Finance, Savills Research & Consultancy

OUTLOOK

The retail sector has overall seen modest improvements over the past half-year. Vacancies have stopped increasing in most markets, and some have even seen vacancy decline. At the same time, this recovery has not been distributed equally – a growing dichotomy between prime and non-prime locations has been observed, and tourism-dependant areas are still suffering in general.

Nonetheless, hope is in sight for the retail sector. Society has gradually gravitated toward an endemic state, and footfall has risen closer to pre-pandemic levels despite the substantial number of COVID-19 cases, suggesting that further restrictions are unlikely without the emergence of new oppressive variants. The government has also made steps toward reopening Japan's borders, and the pent-up demand from inbound tourists could provide considerable relief to many retail industries.

We believe the moderate inflationary pressure in Japan should not exert meaningful change on the market landscape, while the weaker yen may have a greater impact. Overseas investors may increase their stakes in Japan to take advantage of the weak yen. For instance, KKR announced that it would acquire Mitsubishi Corp.-UBS Realty Inc, one of the largest real estate asset managers in March 2022, exemplifying the high interest in Japanese real estate, including the large exposure to the retail sector. In addition, a weaker yen could mean that Japanese residents would become more reluctant to spend overseas, and effectively provide a tailwind for domestic consumption. Overall, the current market could remain favourable for Japanese real estate investment.

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