Japan - October 2023

SPOTLIGHT
*Savills Research*

# Japan Retail

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# Retail continues to recover, but persistent challenges warrant a cautious view


**Summary**

- Average 1F rents in Tokyo increased in 1H/2023, while vacancy has contracted across most submarkets, driven largely by demand from inbound tourists and a growing willingness from locals to patronise brick-and-mortar stores again.
- In regional markets, average 1F rents have remained flat, although they are still at peak levels, indicating that demand remains sound.
- Investment volumes in Q3/2023 already mirrored those of the same period in 2022 even before factoring in the colossal Seibu and Sogo transaction, and the overall momentum looks strong.
- The luxury sector continues to perform well and used luxury stores have similarly grown in popularity.
- Businesses catering to inbound tourism and the food and beverage (F&B) industry struggled during the pandemic but are re-emerging, contributing to the sector's overall strength.
- The pandemic has undeniably altered behaviours and perceptions, particularly with its contribution towards the rise of e-commerce. As such, the retail industry has been shifting further towards prioritising in-person experiences and optimising floor usage.
- The retail market continues to recover, supported by the overall economic recovery and the resurgence of inbound tourism. However, challenges such as labour shortages and rising costs are putting pressure on store operations and may dampen the positive sentiment.


## 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 an uptick of 1.3% half-year-on-half-year (HoH) in 1H/2023, while remaining flat year-on-year (YoY). Non-1F average asking rents have also experienced a moderate increment of 2.7% HoH and 3.5% YoY. Overall, there have been an increasing number of new store openings in previously underperforming areas, and rents appear to be gradually growing.

Japan is steadily returning to its pre-pandemic state of affairs, driven largely by the resurgence of inbound tourism, which has contributed notably to the growth of new store openings in tourism-reliant areas. According to the Japan National Tourism Organisation, the number of inbound tourists in September 2023 recovered to 96% of the level of the same month in 2019. Despite rising materials and energy prices, luxury brands have maintained firm sales growth, supported partially by the weakened yen. Upper floors, which suffered due to lacklustre foot traffic during the pandemic, are now experiencing a resurgence, primarily given strong demand in the service sector, notably beauty clinics. In addition, F&B stores, which were heavily impacted by the pandemic, have also seen a comeback.

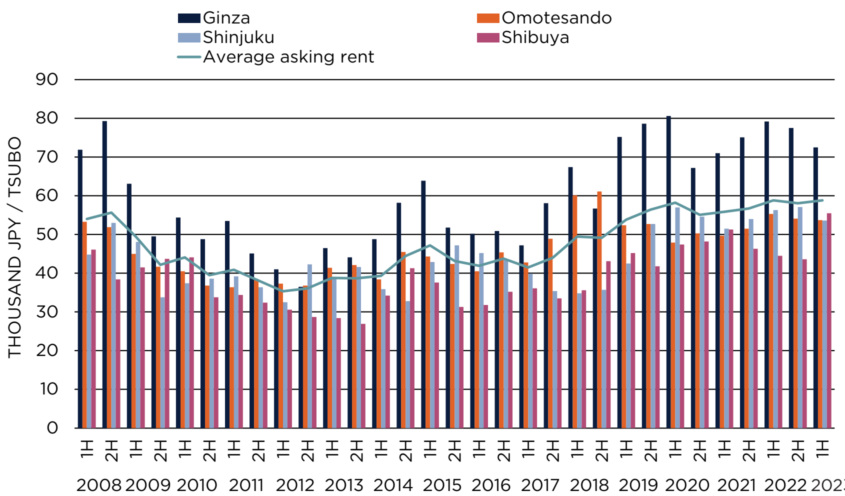
With the waning impact of the pandemic, previously weak areas are witnessing heightened interest among potential tenants and rental levels are beginning to stabilise. However, economic pressures such as rising raw material prices, energy costs and labour shortages are weighing heavily on store operations. Some businesses have been additionally cautious about opening new stores as they generally struggle to pass on these increased costs to customers. That said, market sentiment has consistently improved, and with inbound tourism anticipated to recover even further, the retail market is likely to perform well going forward.

### Ginza

Average 1F asking rents in Ginza experienced a contraction of 6.5% HoH and 8.5% YoY, reaching JPY72,500 per tsubo in 1H/2023. Despite this decline, Ginza still maintains a significant premium compared to other submarkets in Tokyo. In contrast, non-1F rents increased by 3.5% HoH and 5.7% YoY to JPY35,300 per tsubo. While non-1F rents are slightly above the Tokyo average, they are still below those of Omotesando and the gap continues to widen.

Ginza's retail landscape is characterised by the pre-eminence of luxury and renowned brands, which thrived during the pandemic, and appear to have continued this momentum. Indeed, the pace of new store openings and relocations into the Ginza submarket is expected to persist, bolstered by the influx of wealthy inbound tourists. Some notable examples include the opening of the Canada Goose flagship store and the Grand Seiko flagship store along Namiki-dori, which is the largest in Japan, and the brand's third outlet in Ginza. Furthermore, affordable brands have also showed an interest in

**GRAPH 1: Tokyo 1F Rents, 2008 to 1H/2023**




**Source** JREI, BAC Urban Projects, Savills Research & Consultancy establishing a foothold in the submarket, exemplified by H&M's recent reopening in Namiki-dori.

Overall, Ginza is expected to continue performing well in the post-pandemic market. 1F rents have returned to pre-pandemic levels, though it will take some time for vacancy rates to follow suit. Service-oriented businesses have excelled in filling vacancies in mid and high floors during the pandemic and are expected to continue doing so moving forward. While evening footfall has not completely recovered for the F&B industry, there are more restaurants moving into vacant spaces. Rents remain high along the main streets, with several stores scheduled for opening. That said, the disparity in performance in terms of both rent and vacancy between main streets and non-main streets appears to persist.

**Japan's retail sector is experiencing a notable resurgence, with areas that typically cater more towards inbound tourists seeing greater interest among potential tenants for new store openings. Despite the recovery, factors such as rising material and energy costs, on top of labour shortages, may continue to present hurdles for retail operators. As such, while the overall momentum in the sector looks favourable, observers may need to keep an eye on rental levels moving forward.**

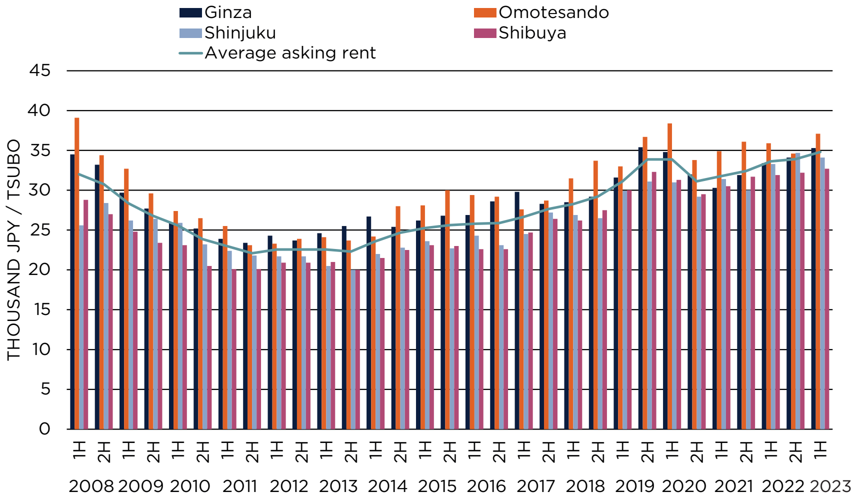
### Omotesando

Average 1F rents in Omotesando dipped slightly by 0.7% HoH and 2.9% YoY, settling at JPY53,700 per tsubo. Conversely, non-1F rents experienced considerable growth at 7.2% HoH and 3.3% YoY, reaching JPY37,100 per tsubo, making them the most expensive non-1F rents in Tokyo by a significant margin.

The Omotesando area is known for its wide spectrum of fashion stores, from extravagant luxury brands to affordable options, and caters to a wide range of shoppers. Similar to Ginza, luxury brands are concentrated along its main street, Omotesando-dori, which has continued to perform well, demonstrated by the arrival of famous brands like BVLGARI and Tiffany & Co. Nearby, Meiji-dori and Takeshita-dori, known for their popularity among young people and overseas tourists have seen greater levels of activity following a prolonged period of dampened activity during the pandemic. Notable examples of new openings of flagship stores along Meiji-dori include UGG and Fender. However, the recovery of general fashion stores has been slow, with the exception of internationally renowned brands. On the other hand, businesses that are popular particularly among inbound tourists, including sneakers, casual streetwear, and used clothing, have been performing well.

Vacancies in Omotesando have increased in 2023, despite having gradually decreased since the pandemic. This situation may persist for some time, potentially due to the sluggish turnover of larger properties with high monthly rents. Although there are a number of notable developments in the pipeline for Omotesando, such as Tokyu Plaza Harajuku Harakado, which is slated for completion in 2024, demand appears to struggle to keep pace with new supply, and the overall recovery of the submarket is expected to take some time.

**GRAPH 2: Tokyo Non-1F Rents, 2008 to 1H/2023**




**Source** JREI, BAC Urban Projects, Savills Research & Consultancy

### Shinjuku

Average 1F rents in Shinjuku contracted by 6.1% HoH and 4.8% YoY, to JPY53,600. Similarly, non-1F rents, experienced a modest decline of 1.7% HoH to JPY34,100, although amounted to an annual increment of 2.4% YoY.

The resurgence of inbound tourism has had a positive impact on the entire submarket. Commercial activity appears to have focused in the East Exit area, particularly Shinjuku-dori, due to ongoing redevelopment around the West Exit area, and Isetan Shinjuku continues to thrive. Shinjuku-dori, Shinjuku-dori South, and Meiji-dori will welcome several new store openings, catering to a diverse range of brands and price ranges, with rents in these areas expected to remain elevated. A significant addition to the Shinjuku-dori area will be the luxury watch boutique Rolex, following the recent establishment of its high-end watch counterpart, IWC Schaffhausen, in the same area. The Kabukicho area has also gained momentum, bolstered by the opening of Tokyu Kabukicho Tower in April 2023, a new trendsetter in entertainment, breathing new life into Kabukicho and signalling a broader area-wide recovery.

Vacancies continue to fall in Shinjuku, driven by the influx of new establishments due to the growing number of inbound tourists. Overall, demand for retail space in Shinjuku is expected to continue its upward trajectory, especially with many developments in the pipeline that look to make the area more appealing. Hence, rent levels will likely remain stable and elevated, especially in the East Exit area.

### Shibuya

Average 1F asking rents in Shibuya have risen by 27.3% HoH and 24.7% YoY, reaching JPY55,500 per tsubo. As such, Shibuya is currently the second most expensive submarket in terms of 1F asking rents, despite historically having some of the cheapest over the past decade. Non-1F rents also increased by 1.6% HoH and 2.5% YoY, to JPY32,700 per tsubo, albeit remaining the least expensive.

Shibuya has made a comeback, invigorated by a surge in inbound tourism, with the iconic Shibuya Scramble Crossing bustling with people. Restaurants and bars have become increasingly lively, exemplified by the transformation of the well-known Fukutaro drugstore into an izakaya, a Japanese-style pub, signalling the bright prospects of night-time businesses. The entertainment industry is also booming, with major venues such as LINE CUBE SHIBUYA and the live music club eggman CLUB QUATTRO expanding their operations. On the southern side of the station, the opening of Shibuya Sakura Stage is scheduled for November 2023. The development also includes a three-way elevated deck that links Shibuya Sakura Stage, Shibuya Fukuras and Shibuya Stream to a new ticket gate inside Shibuya station, which has the potential to boost commercial activities and generate new foot traffic routes. Meanwhile, QFRONT, situated opposite Shibuya station, is scheduled to undergo renovations in October 2023 and will reopen in spring 2024, which should further polish the image of the station front area.

While vacancies have been gently decreasing overall in Shibuya, large properties in the Jinnan area and on the north side of Koen-dori have remained vacant for extended periods. Furthermore, areas located further away from the station continue to struggle. Conversely, the return of inbound tourists has generated new demand for space among tenants looking to establish retail stores in the traditionally popular west side of Shibuya, contributing to a significant increase in 1F rents, indicating that wide-scale recovery is underway in the Shibuya submarket.

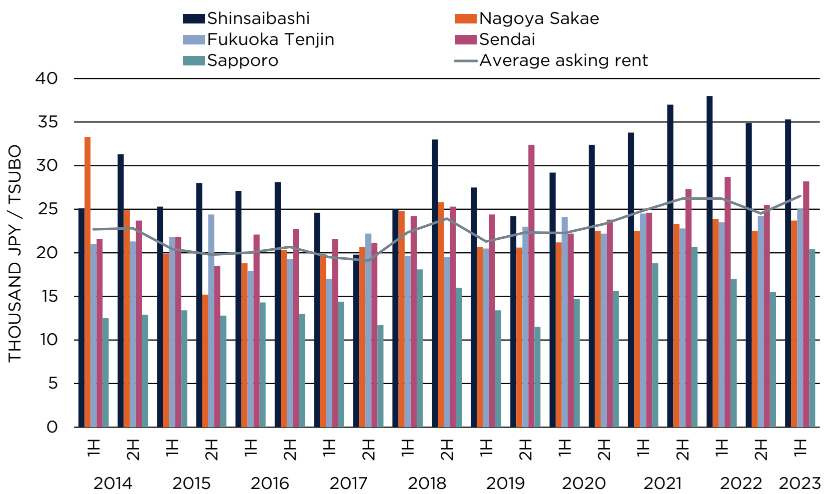
### REGIONAL CITIES

Average 1F asking rents in regional cities rose by 8.2% HoH and 1.1% YoY, reaching JPY26,520 per tsubo in 1H/2023. Non-1F rents also witnessed an uptick of 4.7% HoH and 8.2% YoY to JPY16,860 per tsubo. Most markets have attained a greater sense of stability due to the recovery of inbound tourism and the transition to a post-pandemic mindset. Prime areas, especially those accommodating luxury brands, continue to perform well while less prime locations and larger-scale properties continue to struggle. At the same time, the retail market is also facing challenges of inflation, heightened operational costs, and labour shortages. Nonetheless, the overall outlook of regional city retail remains optimistic, bolstered by multiple ongoing redevelopment projects and inbound tourism, most notably the recent return of Chinese tourists.

In Osaka's Shinsaibashi, average asking 1F rents increased by 1.1% HoH but decreased by 7.1% to JPY35,300 per tsubo, and are now slightly higher than the pre-pandemic level. Non-1F rents also saw a strong increment of 3.6% HoH and 15.5% YoY. Overall, vacancies appear to remain elevated, especially in areas such as Minami-Semba 3-chome located north of Nagahori-dori. Elsewhere, the prime areas of Midosuji that host many luxury brands remain tight and have seen stronger competition in recent times, resulting in increased rental prices with minimal vacancies. Similarly, businesses in the Shinsaibashi-suji shopping street, Dotonbori, and its surrounding areas, which suffered the largest impact during the pandemic, have witnessed a resurgence of inbound traffic, stimulating the emergence of new store openings, and driving down vacancies. Drugstores in the area have also been making a comeback, although many are operating in smaller spaces and at lower rental levels compared to pre-pandemic times. Looking ahead, while the continued growth of inbound tourism is expected to put upward pressure on the average asking rents in the area, they are unlikely to reach the elevated levels observed before the pandemic anytime soon.

In Nagoya's Sakae, asking 1F rents have increased by 5.3% HoH but saw a marginal decrease of 0.8% YoY to JPY23,700 per tsubo, while non-1F rents remained flat. Vacancy levels have seen a slight uptick, with Otsu-dori being the notable exception primarily due to its prime location and concentration of luxury brands. The Sakae Intersection is currently undergoing a major transformation, and new developments include a high-end commercial facility by Parco, a cinema complex, offices, and a Conrad hotel, slated to open in summer 2026. The north of the Sakae Intersection will be the site of various prominent redevelopment projects, including Rayard Hisaya-odori Park and BINO Sakae. In addition, the retail segment of the Chunichi Building is scheduled to open in the spring of 2024. On a separate note, Mitsukoshi Building's planned reconstruction into a mixed-use facility has been put on hold due to escalating

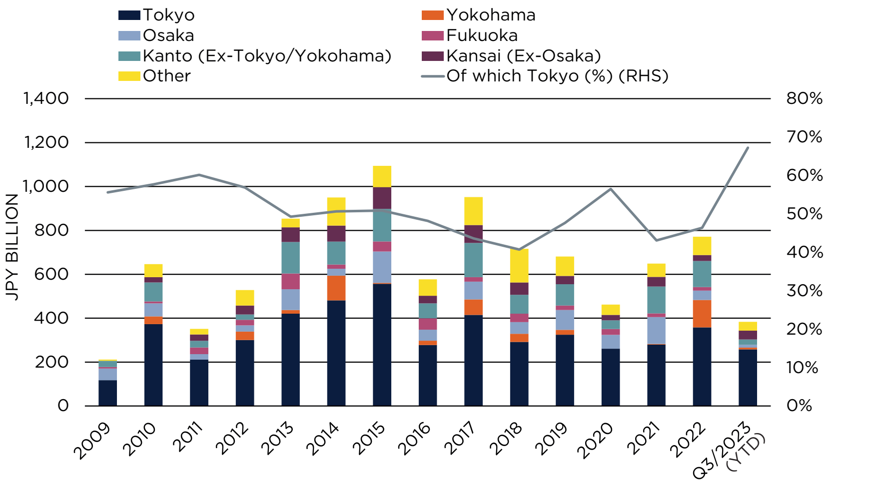
**GRAPH 3: 1F Rents in Retail Districts of Regional Cities, 2014 to 1H/2023**




**Source** JREI, BAC Urban Projects, Savills Research & Consultancy construction costs and uncertain office market outlook. The overall outlook of the submarket is improving steadily, and future developments will help the area gain further momentum.

Tenjin's average 1F asking rents increased by 3.3% HoH and 6.4% YoY to JPY25,000 per tsubo and non-1F asking rents increased by 13.6% HoH. Overall, vacancies have stabilised, while rents have gradually grown in the post-pandemic environment. In addition, the easing of travel restrictions has contributed to a rise in inbound tourist traffic and overall sales, exemplified by sales of SOLARIA PLAZA surpassing pre-pandemic levels. In the prime district of Nishi-dori, while interest in new store openings has been increasing, rents have remained high as many landlords have been reluctant to negotiate, leading to some vacant spaces especially in multi-storied and large-scale stores. Going forward, the upcoming redevelopment of Tenjin Big Bang and the extension of the Nanakuma Line are expected to boost foot traffic and encourage overall growth. The submarket also anticipates an influx of Chinese visitors going forward, sparking increased interest in retail space from businesses catering to inbound tourists.

**GRAPH 4: Retail Property Investment by Region, 2009 to Q3/2023***




**Source** MSCI Real Capital Analytics, Savills Research & Consultancy
* Q3/2023 volumes are preliminary and are likely to be revised upwards; notably, these figures are yet to account for the Seibu and Sogo, and Sun Square transactions. 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 Q2/2023 to Q3/2023**

| ANNOUNCED | PROPERTY | LOCATION | GFA (SQ M) | PRICE (JPY BIL) | DIRECT CAP RATE | BUYER |
|---|---|---|---|---|---|---|
| Sep 2023 | Land and part of Seibu Ikebukuro, Sogo Chiba, and Seibu Shibuya | Various | - | Approx 300.0 | - | Yodobashi Holdings |
| Aug 2023 | Sun Square | Kita, Tokyo | 15,100 | Undisclosed but reported a capital gain of approx 25.4 | - | Undisclosed |
| Aug 2023 | Shin-Kawasaki Square | Kawasaki, Kanagawa | 17,400 | 9.4 | 4.2% | Frontier REIT |
| Apr 2023 | Aeon Mall Tsurumi Ryokuchi (25% quasi co-ownership) | Osaka City, Osaka | 139,000 | 6.4 | 5.2% | Asset Finance Osaka Tsurumi GK |
| Aug 2023 | G-Bldg. Minami Aoyama 02 | Minato, Tokyo | 1,700 | 5.4 | 3.1% | Domestic company |
| Aug 2023 | Mitsui Shopping Park LaLaport IZUMI (18.5% quasi co-ownership) | Izumi, Osaka | 152,000 | 5.2 | 4.9% | Frontier REIT |

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

In Sendai, 1F rents increased by 10.6% HoH but saw a slight decline of 1.7% YoY to JPY28,200 per tsubo. The area around Sendai Station has seen a prominent transformation with the opening of the Yodobashi Sendai No.1 Building, bringing in a new wave of retail stores including UNIQLO, GU, and various restaurants, some having relocated from the shopping arcade area. The Yodobashi Sendai No. 2 Building has also seen a major expansion, with the addition of sporting goods stores and a large supermarket, making the area around the station livelier. On the other hand, vacancies remain high in the shopping arcade area due to competition from retail facilities around the station. Nonetheless, footfall has recovered in the post-pandemic environment, and various new store openings have been observed, including restaurants and a DIY store. While the shopping arcade area will be less active than the station area for the time being, revitalisation plans are in place that look to improve its prospects in the future.

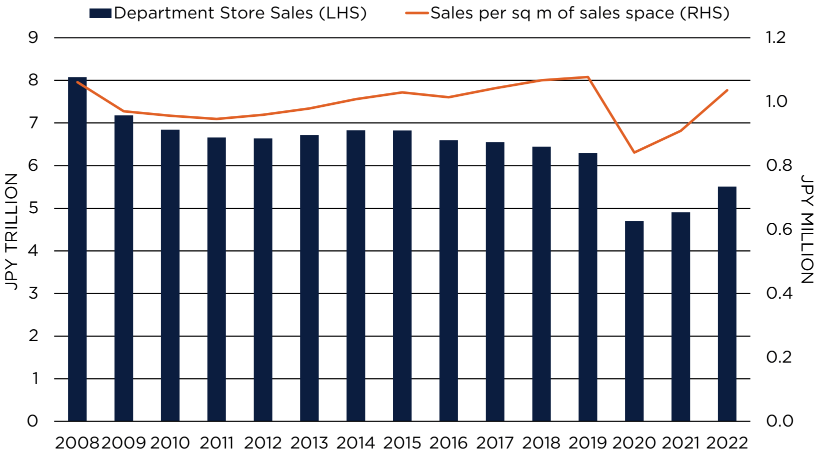
Sapporo's 1F rents have seen a prominent uptick of 31.6% HoH and 20.0% YoY to JPY20,400 per tsubo. Overall, vacancies remained high since the beginning of 2021. In Susukino, vacancies have been on a downward trend as foot traffic recovers, although many restaurants are facing challenges in terms of rising costs and labour shortages. Elsewhere, the large-scale redevelopment around Sapporo station has led to the closure of many facilities, which will inevitably lead to decreased footfall in the area, at least in the short term. Looking forward, as the facilities that are undergoing redevelopment open and commercial activity picks up, the Sapporo station area is expected to regain its competitive edge.

## INVESTMENT TRENDS

The semi-annual survey conducted by JREI in April 2023 shows that cap rates have remained relatively flat across Japan over the past half year, demonstrating the stability of the retail market for both prime and suburban retail properties in the post-pandemic era. In addition, Ginza saw cap rates tighten by 10 basis points (bp) to 3.4%, driven by a comeback in tourism in the post-pandemic environment, as well as increased wages, which have helped to bolster prime retail properties in Ginza. 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 witnessed a surge in interest, driven by the recovering domestic economy and robust demand from inbound tourists. This is also echoed by a survey by MUFG Trust showing

**GRAPH 5: Department Store Sales, vs Sales Per Sq m of Sales Space, 2008 to 2022**




**Source** Ministry of Economy, Trade and Industry, Savills Research & Consultancy

that 56% of investors want to invest in the retail sector in 2H/2023, up from 41% in 1H/2023. In addition to institutional investors, retail facilities strategically positioned in prime locations continue to be highly coveted among high-net-worth individuals as a means of preserving and enhancing their wealth. Suburban malls may also see heightened attention given the attractive and stable yields that they offer. However, despite the recovery in Japan's economy, concerns are arising from higher operational costs due to increased material and fuel prices, which supresses retail stores operations. The transference of costs to the customer depends on the type of business, and close monitoring will be necessary to determine the performance of each respective business.

Notably, Fortress Investment Group plans to capitalise on the acquisition of the struggling department stores, Sogo and Seibu, by implementing a turnaround strategy, and subsequently selling the land and part of the assets to Yodobashi Holdings for JPY300 billion. Another notable transaction that occurred between Q2/2023 and Q3/2023 was the sale of Sun Square by Nippon Paper Industries, reportedly resulting in a capital gain of JPY25.4 billion. The buyer likely intends on redeveloping the property in the future.

According to preliminary data from MSCI Real Capital Analytics (RCA), retail transactions in year-to-date Q3/2023 are in line with those from the same period in 2022, with transactional volumes of roughly JPY400 billion, signifying a sense of stability persisting in retail investment market. These preliminary figures will continue to increase as more deals are announced, especially as they have yet to account for the gargantuan deals involving the Sogo and Seibu department stores, and Sun Square. In addition, with the continuous weakening of yen, increased spending power among inbound tourists as well as heightened interest from international investors can be expected, exemplified by the acquisition of the Sogo and Seibu department stores by Fortress Investment Group. Consequently, the overall appeal of investing in the retail market should naturally grow further.

## BUSINESS TRANSFORMATION OF RETAIL FACILITIES

Department stores used to represent a high watermark of prestige, and the largest operators boast roots dating back to Edo-period Japan. They were a staple of weekend family outings and where most people would go shopping. However, department stores have gradually been declining in prominence, with the emergence of GMS and amusement parks. In addition, the recent development of e-commerce has also accelerated their decline. Presently in 2023, there are fewer than 200 department stores in Japan, down from its peak of over 300 in 1999, and a survey from the Ministry of Economy, Trade and Industry (METI) estimates that the number of employees at department stores has halved between 2008 and 2023. This declining trend in department stores can be highlighted by the recent enormous deal of Seibu and Sogo.

In the meantime, surviving department stores appear to have maintained high levels of space efficiency. According to METI, while overall department store sales have been tapering off, decreasing from JPY8.1 trillion in 2008 to JPY5.5 trillion in 2022, space efficiency has been on an increasing trend since the great financial crisis (Graph 5). Going forward, greater levels of retail space consolidation, especially in industries that have lost significant market share to e-commerce such as clothing and household goods, are likely to be in the crosshairs, consequently freeing up space for other uses. Floor usage should be optimised in response to the changing consumer behaviour and preference. The pandemic has undeniably altered behaviours and perceptions, profoundly reshaping daily lives. Yet, the retail industry has been slow to adapt to these transformative shifts, failing to adequately respond to the evolving needs and preferences of consumers. This has been exacerbated by the industry's belated reaction to the accelerated penetration of e-commerce.

Developers and landlords have had to become more innovative to thrive in the current environment. For instance, the 47-floor Tokyu Kabukicho Tower is an entertainment high-rise which combines two hotels on top of retail floors that primarily feature facilities such as cinemas and live entertainment. The establishment appears to have taken a two-pronged approach in focusing on tenants that provide experiences that can only be enjoyed in-person, and having a myriad of facilities that cater to both daytime and nighttime crowds. Given that the location is famous for nighttime entertainment, tenants also catering to nighttime businesses are preferred due to their economical advantage. Indeed, this development could represent the beginning of a shift toward more retail outlets focusing on customer experiences that cannot be duplicated online, and casting a wider net in their target audiences.

Nonetheless, traditional retail space is unlikely to disappear significantly; Isetan Mitsukoshi's flagship store in Shinjuku recorded their highest year of sales in 2022, while department stores such as Marui and Lumine that have a business model centred on leasing floor space to independent retailers appear to also be faring well. While e-commerce gradually gains a larger presence, brick-and-mortar retailers will need to become increasingly strategic with land and floor space utilisation, providing customer experience in person at their premises.

## OUTLOOK

The Japan retail market has seen considerable recovery, and should continue to improve moving forward. The most recent quarterly performances of publicly listed retailers have shattered historical records. Notably, luxury products, especially in urban areas, have thrived, partly attributed to robust inbound demand. As long as recent wage growth trends persist into next spring, consumer sentiment should be bolstered and ignite further consumption growth. At the same time, the bifurcation narrative persists; prime areas have continued to perform well, exceptionally so in the case of luxury goods, while non-prime areas are still struggling in general, although there have admittedly been gradual improvements.

The retail industry has undergone tremendous changes over the past decade, most notably with the proliferation of e-commerce, which looks to continue chipping away at the market share of brick-and-mortar stores, on top of Japan's declining population. Retail spaces must continue evolving and transforming to adapt to the changing lifestyles and consumer preferences. The sale of Seibu Ikebukuro, formerly the king of department stores, has marked the end of an era. The retail landscape is likely to continue evolving, and many shopping areas may look to introduce greater proportions of shops that focus heavily on in-person experiences that cannot be replicated online in an attempt to diversity and attract different crowds, and recently developed establishments such as Tokyu Kabukicho Tower, a 47F entertainment high-rise building, exemplify this.

Looking ahead, businesses that have suffered during the pandemic, including restaurants, bars and mid-market fashion, are expected to make a comeback, driven by the higher footfall bolstered by inbound tourists and the growing willingness to venture outside among locals. However, challenges such as labour shortages and elevated raw material and energy costs continue to put pressure on store operations, especially those in the F&B industry due to their wafer-thin profit margins. In the interim, the recent ongoing momentum in wage growth stands out as a silver lining. As long as this positive trend persists into the coming spring, it is poised to act as a catalyst for further expansion in the retail markets. Overall, the sentiment is favourable in the retail sector, but future performance will depend greatly on the industry and location.

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