Real Estate Research

May, 2024

Japan Real Estate Market Outlook Report

With further interest rate hikes expected in the coming quarters, transaction yields in Japan are expected to get modest upward pressure to present a window of opportunity for investors to potentially optimize their portfolio.

IN A NUTSHELL

- Following a robust Spring Negotiation pay rise, the Bank of Japan (BoJ) abandoned its negative rate policy by increasing the base rate from -0.1% to 0.1% in March 2024 while long-term yields remained calm below 1%.
- The prime office appraisal cap rate in Tokyo slightly increased from 3.1% to 3.3% in the year to March 2024, a potential reversal of the compressing trend since 2010.
- Amid uncertainties in monetary policies, the J-REIT index remained 16% lower than the previous peak in the first quarter of 2024, while the capital value for Grade A offices remained 12% lower in the same period.
- Office vacancy rates in Tokyo have fallen below 6% for the first time in three years, with the active expansion of foreign companies in the Minato area and IT & entertainment companies in the Shibuya area.
- All the key logistics markets saw a rapid increase in vacancy rates with large amounts of supply surpassing robust demand, while rising construction costs might delay or cancel the logistics supply beyond 2026.
- Prices of for-sale condos maintained strong momentum with limited future supply expectations, keeping demand for rental houses resilient in the foreseeable future.
- Investors should view potential modest upward pressure on the real estate transaction yields as a window of opportunity for investors to potentially optimize their portfolio.

1 / Macro Economy and Investment Market

Japan's GDP growth forecast for 2024 is expected to weaken to 0.5% from 1.9% in 2023, due to trade challenges, especially given sluggish external demands in China. Despite a surprisingly strong headline pay rise at 5.1% in March 2024, persistent sluggishness in consumption and weak external demand will continue to constrain the economic recovery in 2024. However, it is noteworthy that The BoJ's Tankan Survey showed the Diffusion Index (DI) for the non-manufacturing industry marked the highest level in the last 33 years, reflecting the enhanced business sentiments of retail services and hospitality with a boost from the strong recovery in overseas tourist consumption.

Following a robust Spring Negotiation pay rise, the BoJ abandoned its negative rate policy by increasing the base rate from -0.1% to 0.1% in March 2024. The BoJ also ceased yield curve control and halted new ETF/REIT purchases, while the BoJ showed a commitment to purchasing Japanese government bonds at a consistent pace. The long-term yields remained calm below 1% following the BoJ's decisions, helping the Nikkei 225 index hit its all-time high above 40,000 points in mid-March 2024.

Exhibit 1: Japan Macroeconomy and Stock Market

	2023	1Q2024	2024F
Real GDP (%)	**1.9**	**0.5**	**0.5**
Core CPI (%)	3.3	2.8	1.9
Base Rate (%)	-0.1	0.1	0.1

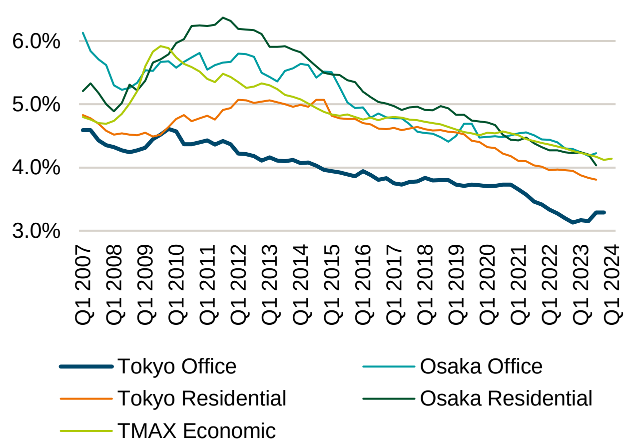
	2023	1Q2024	2024F
JGB Yield (10 Yrs, %)	0.6	0.7	0.9
Tankan DI (Business Sentiment)	21	16	-
Nikkei 225 Index	33,464	40,318	-

Sources: Association for Real Estate Securitization, TMAX, Real Capital Analytics, DWS. As of April 2024.
Past performance is not a reliable indicator of future performance. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

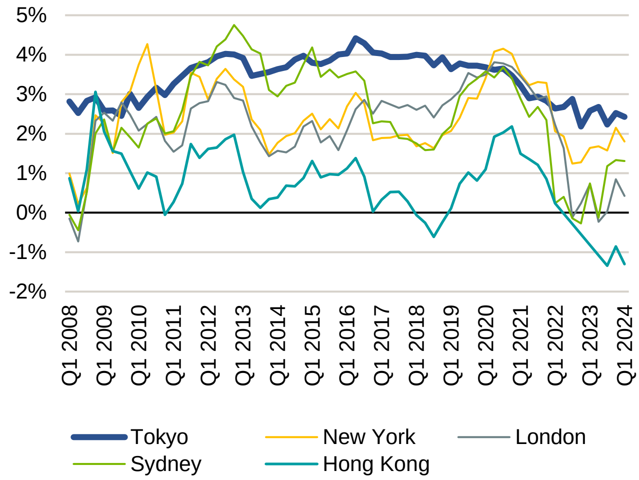
The preliminary prime office appraisal cap rate figures in Tokyo have shown a slight increase to 3.3% in the fourth quarter of 2023, from 3.1% in the first quarter of 2023. Although still preliminary, but if confirmed it could signal the first time figures have demonstrated a meaningful widening since 2010. The office yield spread in Tokyo — the difference between the average cap rates and 10-year bond yields — decreased by 20 basis points from 2.6% in the first quarter of 2023 to 2.4% in the first quarter of 2024 (preliminary), while the spreads remained much lower in major markets including New York (1.8%), Sydney (1.4%) and London (0.4%).

Exhibit 2: Cap Rate and Yield Spread

APPRAISAL PRIME CAP RATE



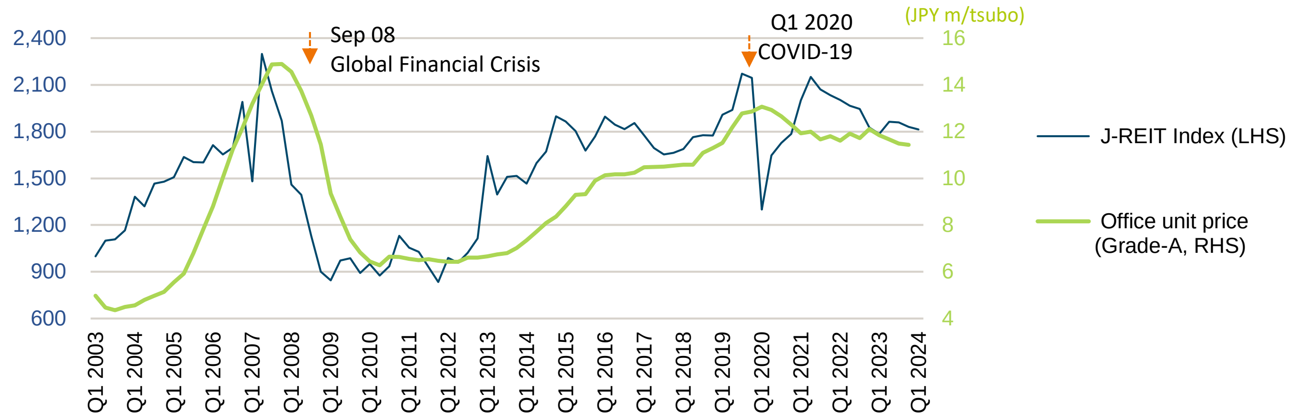
OFFICE YIELD SPREAD (AVERAGE TRANSACTED)



Sources: Association for Real Estate Securitization, TMAX, Real Capital Analytics, DWS. As of April 2024.
Past performance is not a reliable indicator of future performance.

Amid uncertainties in monetary policies between Japan and the United States, the J-REIT index has exhibited a subdued trend and remained 16% lower in the first quarter of 2024 from the previous peak observed in the second quarter of 2021. Additionally, the indicative capital value of Grade A offices in Central Tokyo declined around 12% from its previous peak in the same period. This decline reflects muted demand from occupiers, which led to rental adjustments in the office leasing market.

Exhibit 3: J-REIT Price Index and Real Estate Capital Value in Japan



Sources: DWS. As of April 2024.
Past performance is not a reliable indicator of future returns.
*Tsubo is a Japanese unit of area. It is equivalent to 3.3 square meters (35.6 square feet). Past performance is not a reliable indicator of future growth.

Exhibit 4 shows major real estate transactions announced in the past six months since October 2023. The largest deal in the period was the acquisition of Seibu Ikebukuro Department Store by Yodobashi Camera at JPY 300 billion. The second largest deal was the hotel portfolio including Royton Sapporo at JPY 125 billion by co-investment of SC Capital Partners, Abu Dhabi Investment Authority, and Goldman Sachs Asset Management. During the period, the most expensive unit price recorded was the acquisition of Edion Namba Main Store for JPY 2.4 million per square meter, while the acquisition of the hotel portion of Honmachi Garden City had the lowest cap rate at 3.0% among the confirmed transactions.
Underpinned by the recovery in tourism demand and the significant depreciation of the Japanese Yen, there was a surge of investment demand in Japanese hotels by overseas investors. However, the volume of office building transactions, which had usually accounted for a significant portion, experienced a decline with a decrease in large-scale transactions in the central areas of Tokyo.

Exhibit 4: Major Real Estate Transactions in Japan Announced between October 2023 and April 2024

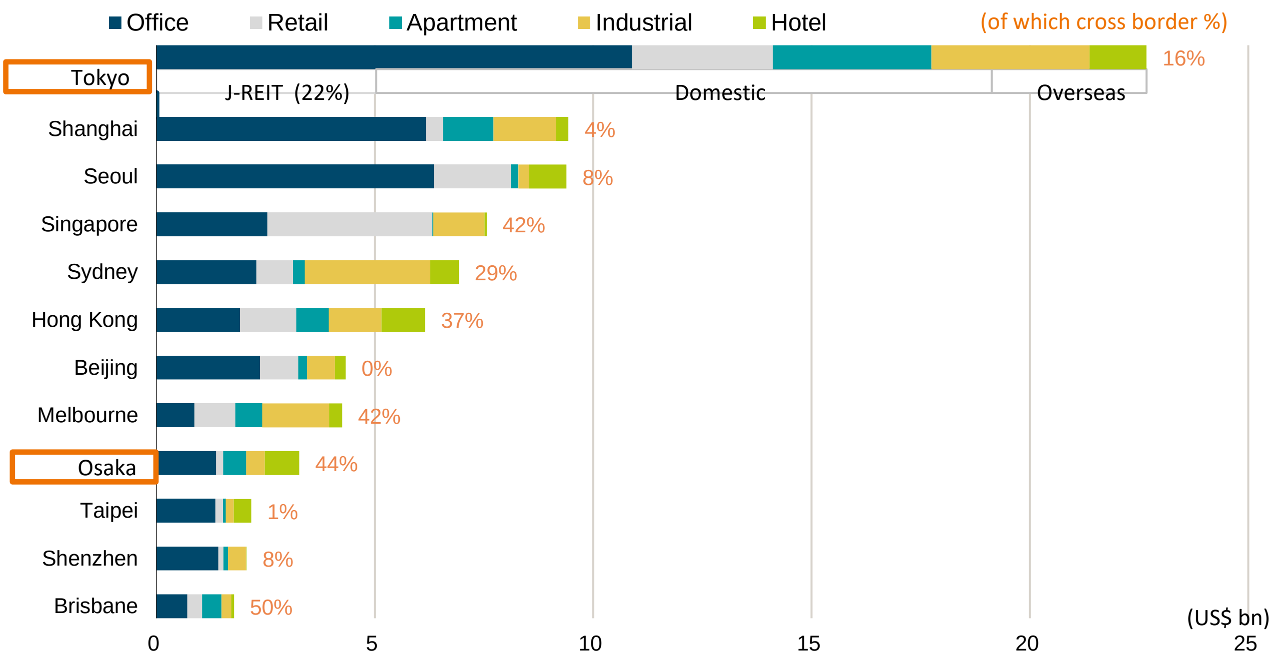
Type	Asset	Price (JPY bn)	Unit price (JPYm /GFA sqm)	Cap rate	Location	Month	Acquired by	Investor Origin
Office	Garden City Shinagawa Gotenyama	61	0.97	3.5%	Shinagawa	Mar-24	Unknown	Japan
	Office of Honmachi Garden City	45	-	3.4%	Osaka	Mar-24	Unknown	Japan
	27% of Toyosu Bayside Cross Tower	44	1.54	3.5%	Koto	Jan-24	NBF REIT	J-REIT
	Prime Takanawa Gateway	32	2.00	-	Minato	Mar-24	Daiichi Kosho	Japan
	53% of Nakano Central Park East	29	1.43	3.2%	Nakano	Feb-24	JPR REIT	J-REIT
	Iwatani Corp. HQ Bldg	22	1.77	-	Minato	Mar-24	Unknown	Japan
	Shin-Yokohama Squre Bldg	20	0.83	4.0%	Yokohama	Dec-23	ORIX REIT	J-REIT
	22% of Toyosu Foresia	20	0.91	3.6%	Koto	Feb-24	JRE REIT	J-REIT
Retail	Seibu Ikebukuro Department Store	300	-	-	Toshima	Oct-23	Yodobashi Camera	Japan
	Edion Namba Main Branch	54	2.35	-	Osaka	Nov-23	Edion	Japan
Logistics	DPL Urayasu 3	30	0.49	3.5%	Chiba	Mar-24	Daiwa House REIT	J-REIT
	MJ Logi Park Sendai 1	10	0.27	3.6%	Miyagi	Mar-24	MEL REIT	J-REIT

Resi-dential	Bridgestone Dormitory	63	-	-	Minato	Feb-24	Unknown	Japan
	Sanko Kigyo Sirogane Dorm.	50	-	-	Minato	Dec-23	Daikyo Estate	Japan
	Platinum Court Hiroo etc. (25 props)	35	42/unit	-	Minato etc.	Dec-23	CDL	Singapore
	Resiur-H Namba etc. (15 props)	30	24/unit	-	Osaka etc.	Jan-24	Invesco/ Alyssa Partners	US /Hong Kong
Hotel /Health care	Royton hotel etc. (27 props)	125	17/rm	-	Sapporo etc.	Jul-23	SC Capital /ADIA /Goldman Sachs AM	Singapore /UAE/US
	Okinawa Prince Hotel Ocean View Ginowan	22	65/rm	4.9%	Okinawa	Jan-24	KDX REIT	J-REIT
	Hotel Portion of Honmachi Garden City	21	-	3.0%	Osaka	Mar-24	Unknown	Japan
Cross-sector Portfolio	Tech Land Hachioji-Takao etc. (7 props)	17	-	3.9-4.9%	Tokyo etc.	Feb-24	Takara Leven REIT	J-REIT

Source: Real Capital Analytics, Nikkei Real Estate Market, DWS. As of April 2024.
Notes: Acquisitions by foreign managers are highlighted in grey and by J-REITs in green. This table is prepared solely for information purposes and is not intended to recommend or endorse any specific company's shares or other products. Although the information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness, or fairness, and it should not be relied upon as such.

During the rolling 12-month period ending in December 2023, Tokyo's commercial real estate transactions totaled US$ 22.7 billion, showing a minimal decrease of 3% from the previous year. Tokyo maintained its position as the top transaction volume market in the Asia Pacific region, followed by Shanghai and Seoul. Osaka secured the ninth rank during the same period. Notably, approximately 22% of transactions in Tokyo were acquired by J-REITs, while cross-border capital contributed to around 16%. In terms of sectors, the office sector continued to dominate transaction volumes across five sectors, although its share dipped slightly to 48%, falling below the 50% mark for the first time in the last 14 years. It is also noteworthy that the quarterly transaction volume of Tokyo saw a healthy recovery by 34% from the same period of the previous year, though it was still on a preliminary basis.

Exhibit 5: Real Estate Transaction Volume by City in Asia Pacific (12 Months Rolling till December 2023)



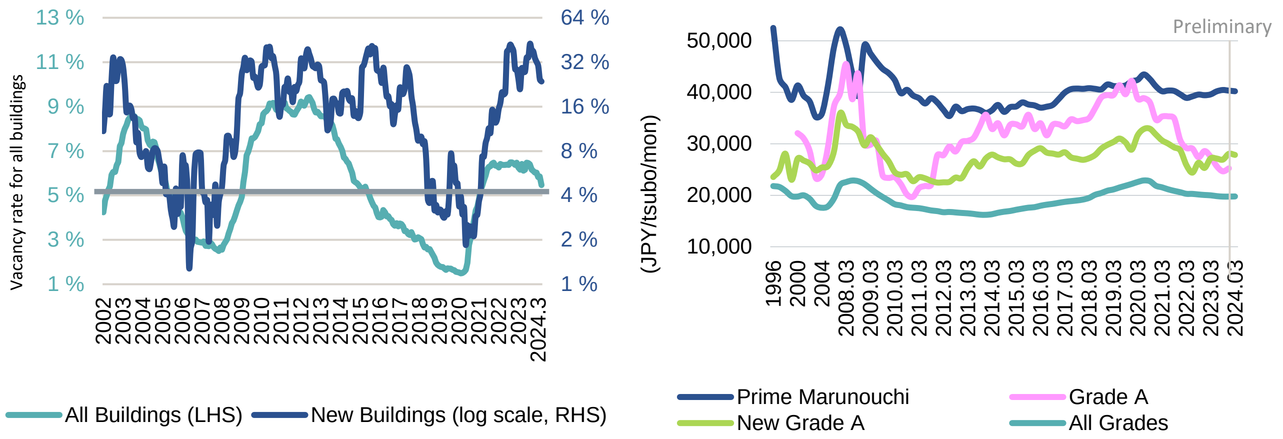
Notes: Commercial real estate transactions exclude non-income producing assets, such as development site transactions. Past performance is not indicative of future results.
Sources: Real Capital Analytics, DWS. As of April 2024.

2 / Market Fundamentals

2.1 Office

The average office vacancy rates in Tokyo's central five wards have modestly decreased to 5.4% in March 2024, down from 6.2% six months earlier, falling below 6% for the first time in three years. Additionally, the average vacancy rate for newly constructed buildings has significantly dropped from 42.7% to 23.7% during the same period. Foreign companies have relocated to newly opened buildings in the Minato area, while businesses in the IT, entertainment, and amusement sectors are actively expanding their offices in the Shibuya area. These trends have collectively contributed to a reduction in overall vacancy rates. Along with the vacancy rate decreases, prime office rents in Marunouchi and new grade A offices in Tokyo continued modest rental growth for five consecutive quarters. Tokyo's office vacancy rate is expected to remain elevated in the foreseeable future due to the large incoming office supply.

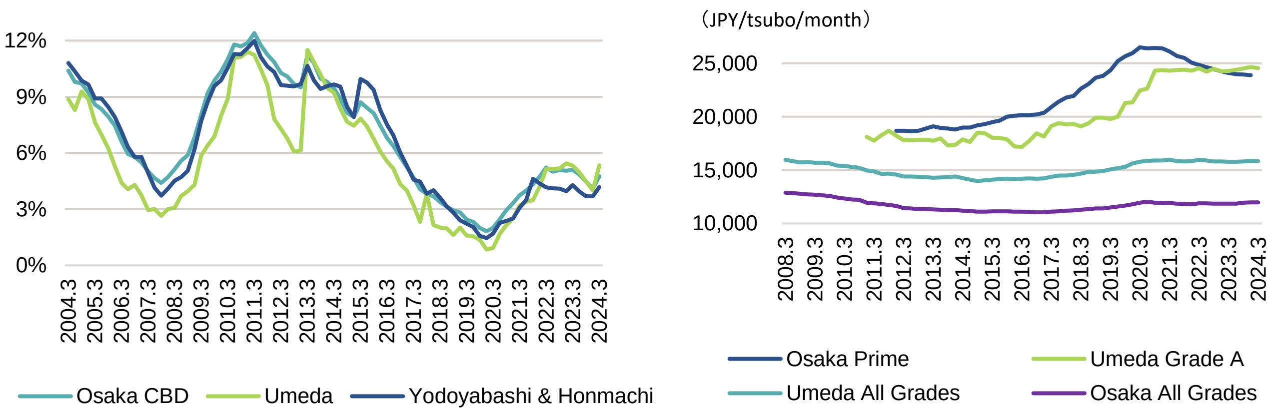
Exhibit 6: Office Vacancy Rates and Office Rents in Central Tokyo (5 Wards*)



Sources: Mori Building, Miki Shoji, Sanko Estate, Nikkei Fudosan Market, DWS. As of April 2024.
Notes: GFA = gross floor area. sqm = square meters. *5 Wards includes Chiyoda, Chuo, Minato, Shibuya and Shinjuku. There is no guarantee the supply pipeline will materialize. Past performance is not a reliable indicator of future growth. This information is intended for informational purposes only and does not constitute investment advice, a recommendation, an offer, or solicitation.

Average office vacancy rates in the Osaka CBD slightly decreased to 4.7% in March 2024 from 5.1% a year ago. Cases of companies relocating from their obsolete buildings to rental office buildings in major areas are increasingly observed, to enjoy the advantages of recruitment, rather than opting for costly renovation or reconstruction. Among submarkets, the vacancy rate in Umeda remained relatively higher at 5.3% in the same period, compared to 4.2% in Yodoyabashi & Honmachi. The office vacancy rate in Osaka is expected to increase once again in the remainder of 2024, with a record 330,000 sqm of new office supply expected in 2024.

Exhibit 7: Office Vacancy Rates and Office Rents in Osaka



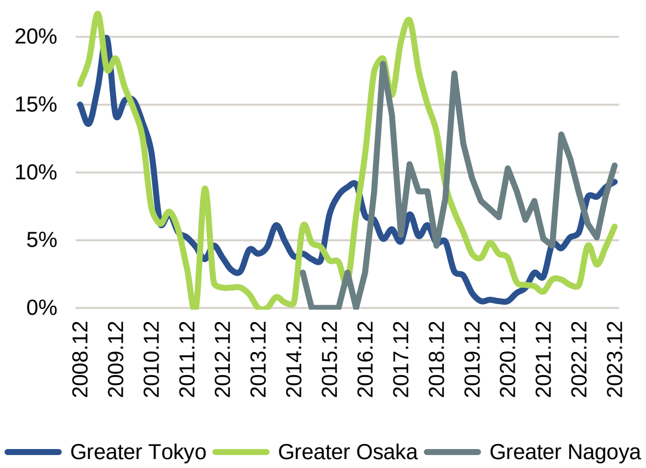
Notes: Past performance is not indicative of future results.
Sources: Avison Young, DWS. As of April 2024.

2.2 Industrial

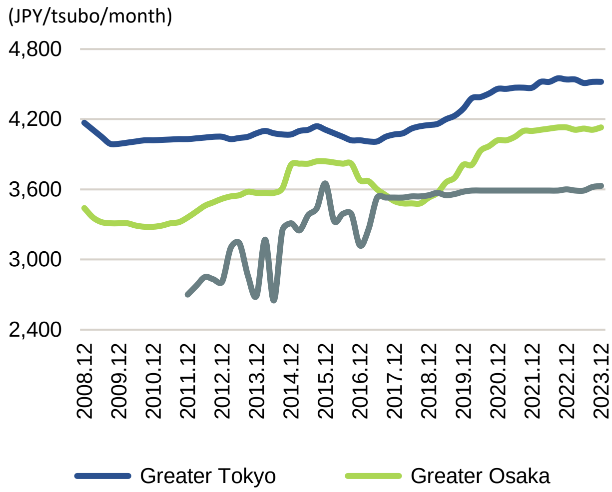
With the logistics market facing record-high supply, the multi-tenanted logistics vacancy in Greater Tokyo increased from 5.6% in December 2022 to 9.3% in December 2023. Vacancy also increased modestly from 1.7% to 6.0% in Greater Osaka, while it remained loose in Greater Nagoya from 8.5% to 10.5% in the same period. Logistics rents remained broadly flat in all three markets in the year to December 2023.

Exhibit 8: Logistics Vacancy Rates and Logistics Rents in Japan by Metro

VACANCY RATES OF MULTI-TENANT LOGISTICS



LOGISTICS RENTS

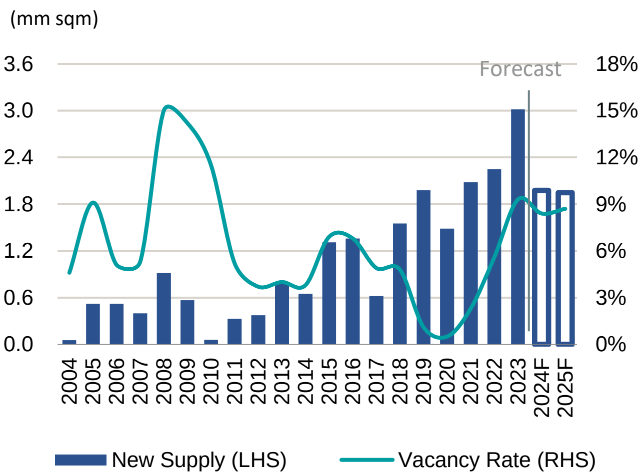


Sources: CBRE, DWS. As of April 2024.
Notes: Past performance is not indicative of future results.

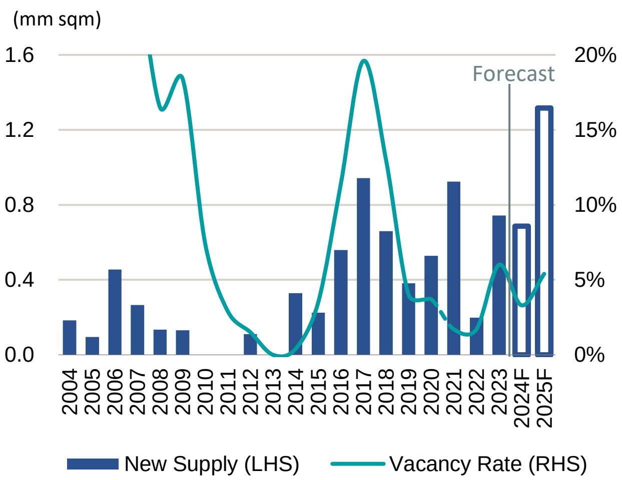
In 2024 and 2025, the new modern multi-tenant logistics supply in Greater Tokyo is projected to remain at an elevated level of c. 1.9 million square meters, which is expected to keep the vacancy rate above 8% till 2025. In Greater Osaka, there is anticipation of an upcoming record supply of c. 1.2 million square meters in 2025 to push up the vacancy rates to above 5%. Notably, the logistics sector faces a more pronounced impact from rising construction costs compared to the CBD office and high street retail spaces due to the smaller proportion of land value, which could potentially lead to delays in new supply beyond 2026.

Exhibit 9: Logistics Supply in Greater Tokyo and Greater Osaka

Greater Tokyo



Greater Osaka

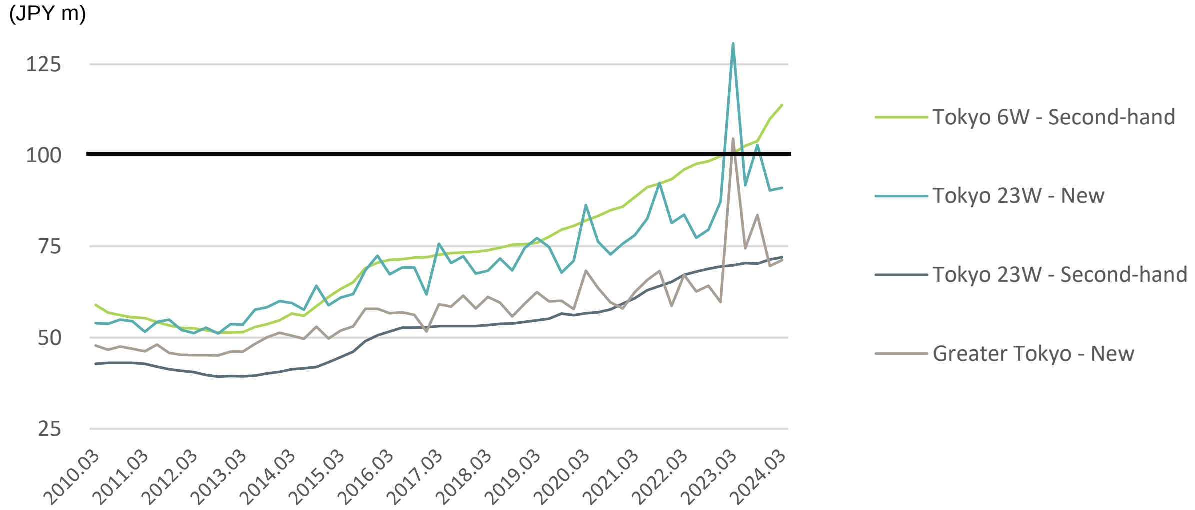


Sources: CBRE, DWS. As of April 2024.
Notes: Past performance is not indicative of future results. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

2.3 Residential

The average sales price of second-hand condominiums in the Tokyo 6 wards rose to a record high of JPY 114 million (per unit) in the first quarter of 2024, while the average sales price of new condominiums in the Tokyo 23 wards remained at the escalated level above JPY 90 million in the same period. With the rise of construction costs, for-sale condo supply is expected to remain subdued in the foreseeable future, activating strong purchase demands of high-income working professional couples who prefer large-size units located in inner city areas. Also, mortgage loan yields were rarely impacted by the marginal interest rate hike of the BoJ and are expected to underpin the housing price momentum in the coming quarters.

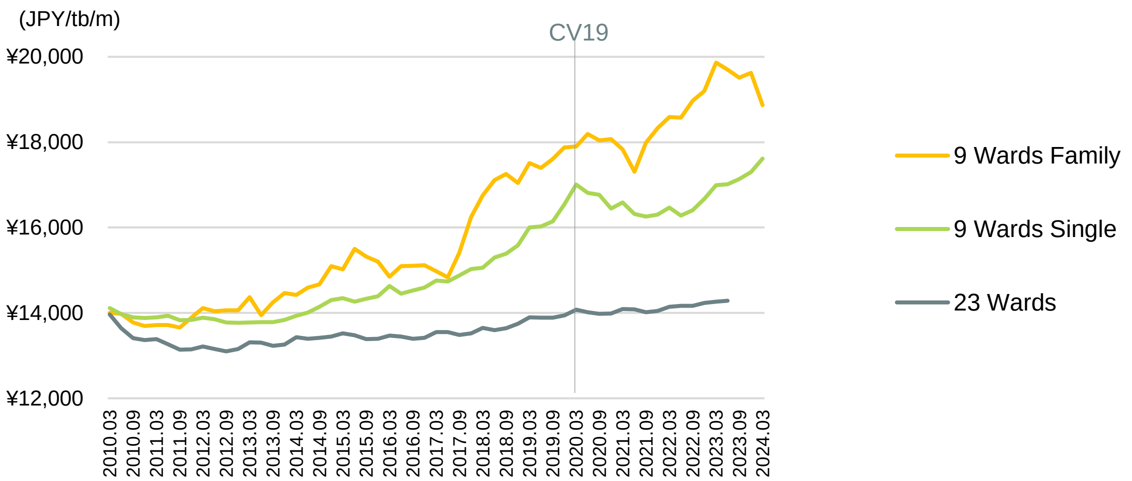
Exhibit 10: Average New Condo Price and the Growth of Units Sold in Greater Tokyo



Sources: Real Estate Economic Institute, DWS. As of April 2024.
Notes: Past performance is not a reliable indicator of future growth.

Residential rents for units with multiple bedrooms in the central nine wards in Tokyo decreased by 5% in the year to March 2024 but are still 6% above the pre-CV period at the year-end of 2019. Smaller units for singles (incl. studios) in the central nine wards of Tokyo posted a healthy growth of 3.6% in the same period. As for-sale condo prices remain elevated in Tokyo, demand for rental houses is expected to be resilient.

Exhibit 11: Residential Rents in Tokyo



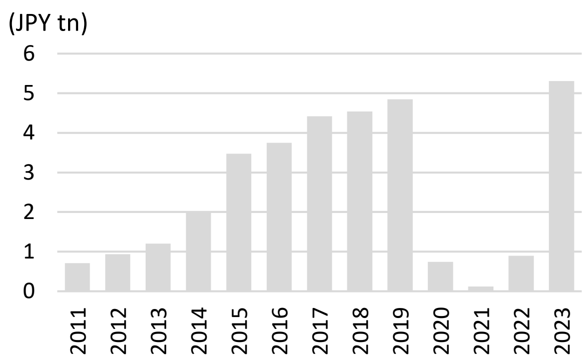
Sources: REINS (23-ward rent), Leasing Management Consulting (9-ward asking rent), DWS. As of April 2024.
Past performance is not a reliable indicator of future growth. Forecasts are not a reliable indicator of future returns.

2.4 Retail

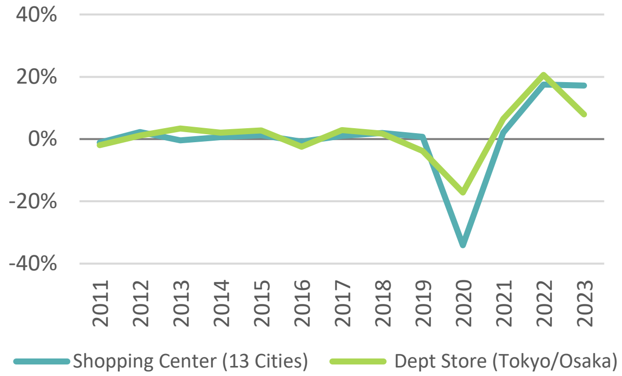
As border controls for inbound tourists started to ease from October 2022, overseas tourist spending experienced a robust recovery throughout 2023, surpassing the previous peak in 2019 by approximately 10%, which was further accelerated by the recent depreciation of the Japanese yen. Healthy tourist consumption underpinned significant sales growth of 17.2% in shopping malls and 7.9% in department stores during 2023. Additionally, the rising stock market acted as a tailwind, driving strong sales of luxury brands and high-end electronic products among domestic consumers.

Exhibit 12: Retail Sales Growth by Store Category (Year on Year)

Overseas Tourist Spending in Japan



Retail Sales by Type

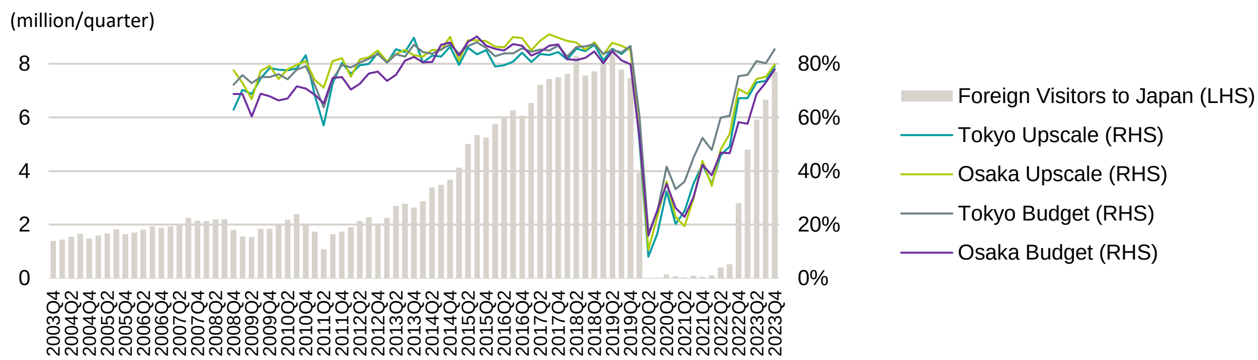


Source: Japan Council of Shopping Center, Japan Franchise Association, Japan Chain Store Association, Japan Department Store Association, DWS. As of April 2024.
Note: Past growth is not a reliable indicator of future growth.

2.5 Hotel

Throughout 2023, hotel occupancy rates in Tokyo and Osaka steadily improved. In the first quarter of 2024, Tokyo's budget hotels achieved an impressive 85% occupancy rate, coming close to their previous peak of 87% in the fourth quarter of 2018. Despite the slower recovery of Chinese tourist arrivals to Japan, the entire Japanese hospitality market experienced significant growth. Tourist arrivals from neighboring Asian countries and the United States contributed to this rebound, along with increased accommodation spending driven by a weaker yen. According to Nikkei, average room rates for select key hotels in Japan during the first quarter of 2024 exceeded pre-COVID levels by as much as 35%. Looking ahead, an even stronger recovery is anticipated in the coming quarters, supported by ongoing improvements in international air connectivity and limited future hotel supply.

Exhibit 13: Quarterly Hotel Occupancy Rates in Tokyo and Osaka



Sources: Japan Tourism Agency, DWS. As of April 2024.
Past growth is not a reliable indicator of future growth.

4 / Conclusion

The real estate transaction market in Japan slowed with muted office transaction volumes in the second half of 2023, in anticipation of the BoJ's policy shift to end its negative interest rates policy in early 2024. Transaction activities in other sectors remained relatively healthy underpinned by favorable lending circumstances and strong investment demand, especially for the hotel sector recording record transaction volumes in 2023.

Office transaction yields in Tokyo marginally widened with an increasing number of investors adopting a wait-and-see attitude to the potential impact of a monetary policy shift on real estate valuations, together with concerns the expected supply wave will have on office vacancy rates in Tokyo. On the contrary, residential transaction yields keep compressing to a record low level underpinned by the escalated for-sale condo price and strong leasing demands for rental houses. Tourist destination retail and hospitality sectors enjoyed a strong rebound of overseas tourist arrivals to the country, whose sales revenue and operational performances in 2023 surpassed the previous peak in 2019 by 20-40%. The lower levels of modern logistics stock in key regional cities may present attractive investment opportunities via active asset management including development funding and lease-up strategies.

With a further interest rate hike expected in the coming quarters, real estate transaction yields are expecting modest upward pressure, presenting a window of opportunity for investors to potentially optimize their portfolio and recycle capital for opportunities in markets with strong long-term growth potential.

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