

Real Estate Strategic Outlook: Japan

Strong business sentiment of consumer-related industries

Real wage-driven recovery expected to support GDP growth in 2025

Japan's real GDP is expected to see healthy growth of 1.1% in 2025, as domestic economic developments indicate a continuous wage-driven recovery trend. Despite the ruling parties losing their majority in the October lower house elections, the ruling Liberal Democratic Party's wage-driven growth strategy has broad opposition support.

The Bank of Japan implemented two interest rate hikes bringing its policy rate from -0.1% to 0.25% throughout 2024 with an additional rate hike expected by end of 2024 or early 2025. The latest Tankan survey shows the strong business sentiment of consumer-related sectors driven not only by strong inbound tourism, but also domestic consumption boosted by widespread wage increases.

Ongoing modest capital value correction and rising construction costs to limit new supply

Rental growth expected to be the key driver for returns in the foreseeable future.

Driven by continuous interest rate hikes in Japan, commercial real estate cap rates increased by 20-30 basis points (bps) in 2024 and are expected to rise by another 10-20 bps in 2025. This correction is more pronounced for assets with large vacancies and weak leasing fundamentals, while core stabilized assets have seen only marginal valuation changes so far.

Additionally, the impact of rising construction costs on new developments has become more significant, particularly in the logistics sector where construction costs account for a much larger share in overall valuation compared to other sectors. The weak Japanese Yen and associated inflation pressures may continue keeping replacement costs high across most sectors along with imminent construction labor shortage, constraining new supply with rental growth a key driver for returns in the foreseeable future.

Logistics: Soaring development costs

With the surge of construction costs in the last 3 years, breakeven rents for new logistics developments are now 30-35% higher than current market rents. This should support strong rental growth beyond 2026, if the logistics vacancy rate in Greater Tokyo stabilizes from current elevated levels

of 10% in September 2024 following recent record-high new supply.

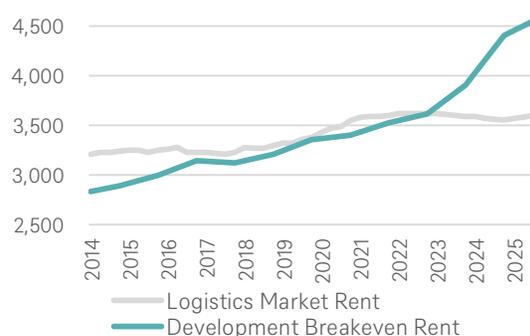
Residential: Strong demand for quality rental houses

The average unit sales price of for-sale condominiums in Tokyo's 23 wards rose above JPY 110 million in the rolling six months to September 2024. This has driven the strong leasing demand for quality rental units, mainly among working couples and professionals who prefer larger spaces for their work-from-home arrangements. As for-sale condo prices remain elevated in Tokyo, demand for rental houses is expected to be resilient.

Office: A large supply will keep the vacancy rate high

The average office vacancy rate in Tokyo's central five wards fell below 5% in August 2024 for the first time in four years with limited supply in 2024. This improvement is partly due to foreign companies relocating to newly opened buildings in the Minato area and domestic companies encouraging employees to return to the office for better communication and efficiency. Despite a short-term market tightening, Tokyo's office vacancy rate is expected to rise to above 5% level in the longer term due to the large incoming office supply beyond 2025.

Logistics Market Rent and Breakeven Rent in Greater Tokyo



Source DWS, December 2024

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