Savills World Research
Japan

Asian Cities Report
Tokyo Residential Sales

1H 2017

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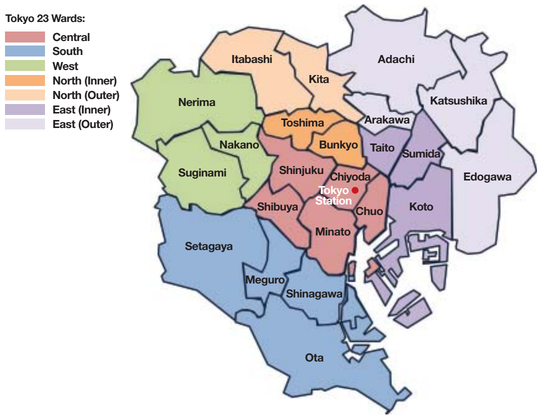
MAP 1

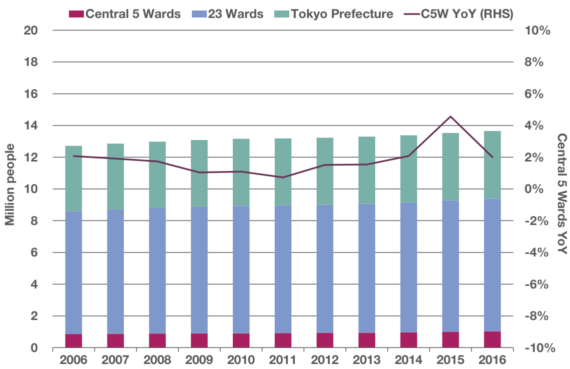
Tokyo 23 wards (23W) by submarket



Source: Savills Research & Consultancy

GRAPH 1

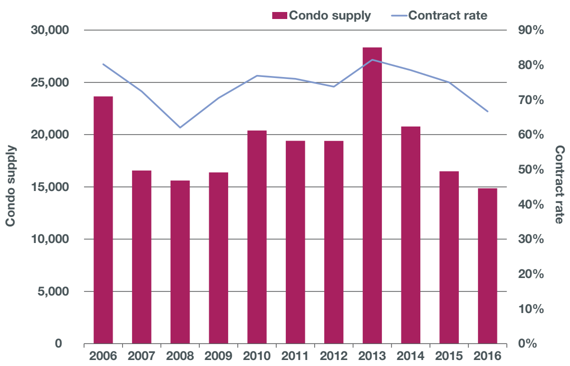
Population in Tokyo, 2000–2016



Note: Government adjusted 2015 figures to bring in line with national census
Source: Tokyo Metropolitan Government, Savills Research & Consultancy

GRAPH 2

New condo supply and contract rate, 23W, 2006–2016



Source: REEI, Savills Research & Consultancy

Introduction

New condo prices in Tokyo have been setting new cyclical highs since 2013. Tokyo Kantei, an appraiser, reported that new units were selling for an average of 28.7x Tokyo's annual rent in 2016, up 1.4 points from twelve months earlier and 4.9 points from 2012. Low borrowing rates and tax incentives, especially for inheritances, as well as bullish sentiment have enticed more and more buyers into the market. Overseas retail investors have also gotten involved by leveraging the softer yen. First-month contract rates held steady above 70%, and large developers poured new units into the city.

The trend began to wobble in late 2015, however, when the average first-month contract rate finally dipped below 70%. Signs of a pause increased in Q4/2016, when the average quarterly per-sq m price in Tokyo Prefecture experienced its first year-on-year (YoY) correction in five years. Prospective homeowners and investors began to hesitate after such a long stretch of successive increases. Prices have since experienced a softening in trend. We expect near-term growth to be more gradual as the market stops to catch its breath.

Sales have slowed...

The quarterly average first-month contract rate remained above 70% in the 23 wards for six years following the global financial crisis to 2015. In Q1/2016, however, the rate dipped to 66.5%. It briefly climbed back above 70% in Q2 but fell again in the latter half of the year and ended Q4 at 68.1%.

New supply, meanwhile, will likely be smaller going forward due to the limited availability of affordable shovel-ready land and high construction costs. New for-sale units in the 23W area amounted to just 14,858 in 2016, down 10% from 2015, and the lowest total since 1992. This is balanced by an increase in transactions involving second-hand units. Real Estate Economic Institute (REEI) data indicates that in 2016 sales of second-hand units in the Tokyo area exceeded sales for newly constructed units for the first time since recordkeeping began in 1996. New condo units are also facing increased competition from detached houses, which require smaller plots, making land acquisition easier.

A number of factors are driving slower sales of new units, but the primary culprit is likely a rapid rise in prices. After a long period of stability, average unit prices in the 23W began to increase in 2013 and grew 30% through Q3/2016 before paring gains in Q4. Rents, meanwhile, grew just 2.1% over the same period. One of the biggest reasons for this mismatch is Japan's very low cost of credit. The Flat 35 rate, Japan's most common measurement of mortgage prices, has been falling steadily since 2011 and briefly dropped below 1.0% in 2016 after the BOJ adopted a negative interest rate policy. It has risen marginally after Trump's election, however.

Other factors driving price increases included buyers seeking shelter from inheritance taxes, and an influx of investors expecting appreciation from Abenomics and the Tokyo Olympics. These investors included overseas parties, mainly from other parts of Asia. Rapidly rising land prices have also been increasing condo prices. Condo developers have fiercely competed for sizable land acquisitions with aggressive hotel developers. As China tightened capital controls, however, and yields on units tightened, demand began to wane. It appears that the market was willing to absorb increases for a brief period, but these high ticket prices are now weighing on contract rates.

...and prices have followed

Prices appear to have stopped their relentless march upward, and as of the end of 2016 have marginally walked back some gains. The average price per sq m in the 23W area gained just 0.6% YoY in Q3/2016, and then adjusted in the following quarter. Tokyo Prefecture as a whole has shown resilience, declining just 0.2% YoY in Q4/2016, though this was the first correction since early 2012. Per-unit prices have seen similar trends. Seller inventory, meanwhile, climbed 13% from January 2016 to sit at 7,160 units as of December.

January and February data appeared to break this softening trend, showing a sharp double-digit YoY increase in the 23W area, but this is likely an outlier due to luxury sales and a small number of units coming on the market. It is highly unusual to see such an extreme price increase in a period of low contract rates and climbing inventory.

Slight, additional price softness is possible. Global interest rates may increase marginally in 2017, though we expect rates to remain quite low in Japan over the medium term. The BOJ has for now committed to keep the 10-year JGB at approximately 0%; however, it may inch up its rate target. Home loans may become marginally more expensive than they were in 2016. Sellers may need to reduce prices to sell inventory and compete with the second-hand market. Some reports indicate that sellers are increasingly trying to market properties as more budget-friendly to attract buyers reeling from sticker shock.

Second-hand market flourishing

Prices have also been rising for Tokyo's second-hand units, but their discount relative to new units has made them more attractive to prospective buyers. Construction costs have helped widen the price gap between newly constructed units and the second-hand market. Although raw material costs have moderated slightly in recent months, labour costs remain elevated due to Japan's extremely tight labour market.

Tokyo Kantei reports that second-hand unit prices are still increasing as of early 2017 – a typical 70 sq m condo in Tokyo's 23 wards is currently selling for JPY53 million according to February data. This is 3% higher than pre-owned sales prices in the first half of 2016, but still represents a 14% discount against new condo prices in Q4, showing the relative competitiveness of pre-owned assets.

Developer impact expected, but probably limited

Price softness may impact the profitability of scheduled projects around Tokyo. Extensive development continues along the coast of Tokyo Bay, for example, where in Kachidoki plans were recently announced for two 56-storey skyscrapers totalling 2,150 units. Mori Building has likewise unveiled plans for a large, mixed-use facility in Toranomon with a significant high-end residential component – the development's centrepiece will be a 330-metre tower, the penthouse of which will contain an apartment over 1,000 sq m. More immediately, Mitsui Fudosan's Park Court Aoyama The Tower is scheduled to finish in 2018, complete with sky lounge and infinity pool. Selling is currently underway at prices rumoured to range as high as 2-3 billion yen for high-end units.

Though current market conditions may negatively impact profitability, these landmark projects typically belong to large developers with sound balance sheets. Any potential losses should be manageable. Tokyo's smaller and more vulnerable developers largely exited the market during the financial crisis and few have returned, leaving construction primarily in the hands of larger, more stable players. Approximately 130 condo developers currently operate in Greater Tokyo, less than 30% of the number of developers at the peak in 1994. This tends to keep the condo market stable even during potential downturns.

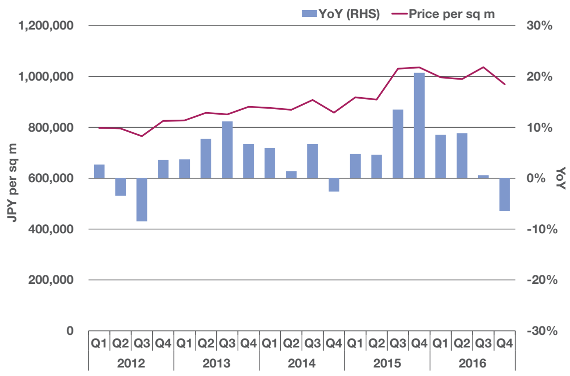
Outlook

Until recently, Tokyo's condo market had been growing at a breakneck pace, seeing per-unit price increases of approximately 30% from Q1/2013 to Q4/2016. This trend was not reflected in the rental apartment market, however, and was largely driven by easy credit, yield hunting, and favourable inheritance tax treatment. In late 2016 the trend finally slowed as potential buyers grew wary of high prices and the global interest rate environment appeared to show possible signs of a reversal. New units are now facing increased competition from second-hand units and from detached houses, which have become relatively more affordable.

We expect softer growth and possibly slight adjustments in 2017 as buyers take a breather and sellers attempt to reduce inventories. Large projects scheduled for completion in 2017 may feel a mild price squeeze, but Tokyo's established developers have strong balance sheets and thus little pressure to move units quickly at discount. Prices are likely to remain relatively stable as these developers sell down inventory.

GRAPH 3

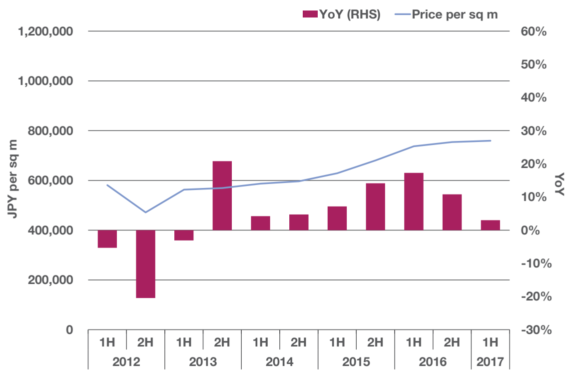
Average price for new units, 23W, 2012–2016



Source: REEI, Savills Research & Consultancy

GRAPH 4

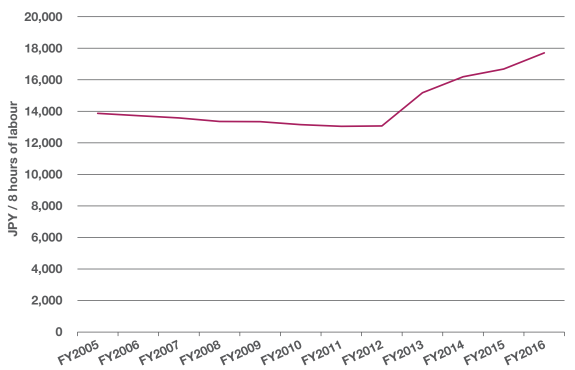
Average price for second-hand units, 23W, 2012–1H/2017



Source: Tokyo Kantei, Savills Research & Consultancy

GRAPH 5

Hourly labour cost, FY2005–FY2016



Note: Based on public works projects
Source: Ministry of Land, Infrastructure, Transport, & Tourism (MLIT), Savills Research & Consultancy

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