

## Real Estate Strategic Outlook: Japan

### Strong business sentiment of non-manufacturing industries

#### A gradual shift of loose monetary policy is ongoing

Despite a weaker GDP growth forecast for 2024, the BoJ's Tankan Survey showed that the Diffusion Index (DI) for non-manufacturing industries marked the highest level in the last 33 years. This reflects enhanced business sentiment in retail services and hospitality, boosted by the strong recovery in overseas tourist consumption.

Following a robust Spring Negotiation pay rise, the BoJ abandoned its negative base rate policy by increasing the base rate from -0.1% to 0.1% in March 2024. With further rate hikes expected in the remainder of 2024, long-term bond yields soared above 1% in May 2024 for the first time in twelve years.

### Modest upward pressure on transaction cap rates leads to moderate capital value correction.

#### Mild pricing correction opens a window for portfolio optimization

Japan is the only market with constant capital value growth of commercial real estate compared to other mature markets that struggled with a significant rapid capital value correction in the last two years. But now, the market cycle is turning in the opposite direction for Japan, with capital values potentially decreasing moderately by around 5-10% in Japan for 2024.

Given the above, investors should explore market entry for the office and logistics sectors from 2025 onwards. Meanwhile, the market momentum remains reasonably strong for multifamily residential sectors and the high street/urban retail sector in 2024.

#### Residential: Strong demand for quality rental houses

The average sales price of for-sale condominiums in Tokyo's 23 wards rose to above JPY 100 million (per unit) in March 2024. It has driven the strong leasing demand for quality rental houses, mainly by 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.

#### Retail: Turnaround of High Street/Urban Retail

Retail rents of key high street areas in Japan, once sinking to 50-80% of pre-COVID levels in 2022, have seen a robust

recovery to climb above the previous peak in 1Q 2024, underpinned by the rapid increase of overseas tourist arrivals to the country. Given the expected further recovery of air traffic in the region and the relatively weak Japanese yen, the demand for inbound tourism in the country is expected to remain healthy and boost the sales of tourism destination-type retail in the next 2-3 years.

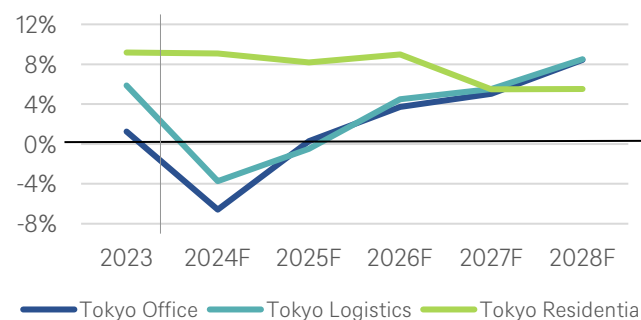
#### Logistics: Short-term market disruption and limited supply pipeline

The logistics market is facing record-high supply, with multi-tenanted logistics vacancy in Greater Tokyo rising to 9% in December 2023 from 6% a year before, while vacancy in Greater Osaka and Greater Nagoya also remained loose in the same period. On the other hand, rising construction costs are expected to delay or even result in cancellation of the planned supply beyond 2026 which could aid the rental uplift of existing assets in the same period.

#### Office: A large supply would keep the vacancy rate high

The average office vacancy rate in Tokyo's central five wards fell below 6% in March 2024 for the first time in three years. Foreign companies have relocated to newly opened buildings in the Minato area, while businesses in the IT, entertainment, and amusement sectors are expanding their offices in the Shibuya area. Tokyo's office vacancy rate is expected to remain elevated in the foreseeable future due to the large incoming office supply.

### Total Return Forecasts by Sector in Tokyo



Source: DWS, Miki Shoji, JREI, June 2024

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