PCG INSIGHTS –

AN EYE ON JAPAN

Japan Real Estate Market Outlook

PATIENCE CAPITAL GROUP

APRIL 2024

Japan Real Estate Market[1] Outlook - April 2024

Summary

- In 2023, Japan's GDP growth rose to 1.9%, mainly driven by pent-up demand for Japanese goods and services, business investment and government stimulus. Despite inflationary pressures, retail spending remained resilient due to robust job market conditions. While BOJ ended Japan's negative policy rate in March 2024, any increase in interest rates is likely to be very limited. Outlook is fairly positive, with sustained but moderated growth going forward.

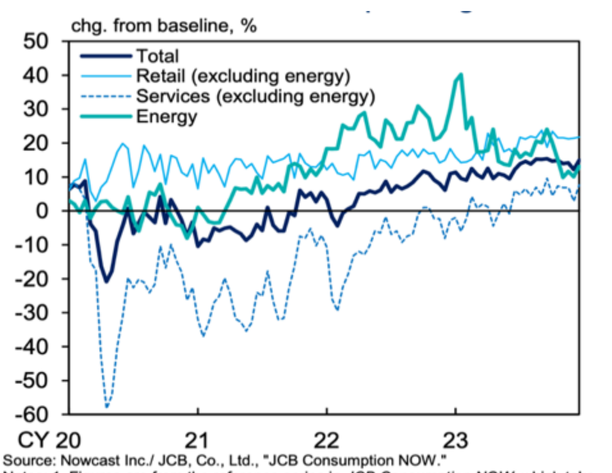
- The residential sector witnessed increased occupancies and stabilized or rising rents, while the new condo market saw record-high prices, indicating strong demand, especially in core city centre districts. The hospitality sector rebounded post-border re-opening, with average rooms rates surpassing pre-pandemic levels, although labour shortages remained a challenge. The retail sector saw stable to higher occupancy and sales, driven by robust tourist consumption and increased luxury spending. High street rents in key shopping districts experienced robust growth, fuelled by competition among retailers.

- Amidst global geopolitical and macro uncertainties, Japan continues to offer attractive investment opportunities, with further growth potential in the residential, hospitality, and retail sectors.

Economy Overview

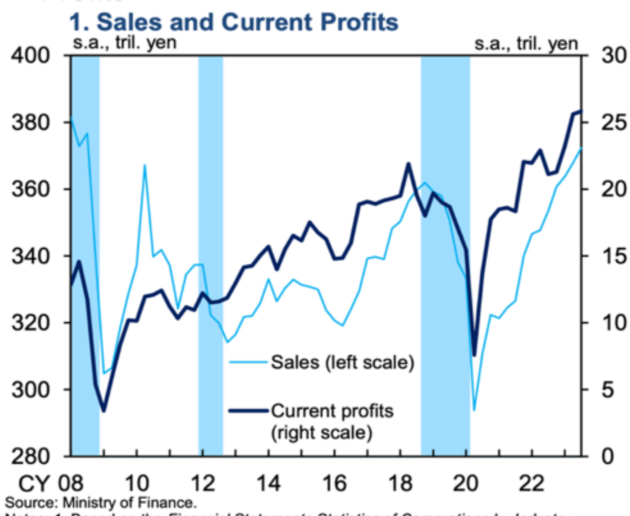
- Japan's economic growth strengthened from 1.0% in 2022 to 1.9% in 2023, well above its long-term[2] growth rate of 0.6%. This was underpinned mainly by pent up domestic spending and external demand for Japanese goods and services following the post pandemic re-opening of global borders in 2022/2023[3]. However, real GDP growth slowed in 2H 2023 as rising prices[4] dampened overall private consumption spending. Notwithstanding, spending on retail goods and services (Chart 1) has remained resilient.

Chart 1: Resilience in Retail Goods Spending – Credit Card Spending Trends



Source: Nowcast Inc./ JCB, Co., Ltd., "JCB Consumption NOW."
Notes: 1. Figures are from the reference series in *JCB Consumption NOW*, which take changes in the number of consumers into account. The baseline is the average for the corresponding half of the month for fiscal 2016 through fiscal 2018.
2. Figures for the total and for services exclude telecommunications, and figures for energy consist of those for fuel, electricity, gas, heat supply, and water. Based on staff calculations.

Chart 2: Strongest Corporate Profitability since 2018



Source: Ministry of Finance.
Notes: 1. Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding "finance and insurance."
2. Figures from 2009/Q2 onward exclude pure holding companies.
3. Shaded areas denote recession periods.

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[1] In this report we focused on the residential and hospitality sectors, in line with the focus of PCG's real estate funds, with an ad hoc feature section on retail given our positive outlook on the sector.

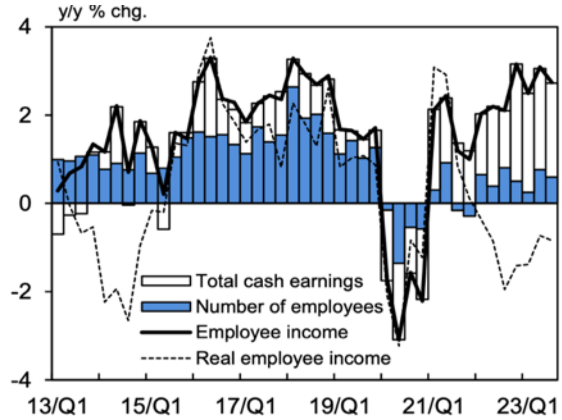
[2] Long-term averages in this report refer to past 20-year average (2003-2022).

[3] Japan fully opened up its borders in 3Q 2022. China and South Korea (Japan's largest sources of inbound tourists pre-COVID) progressively opened its borders from January 2023 and 2Q 2022 respectively.

[4] CPI rose from 2.5% in 2022 to 3.2% in 2023 vs long-term average of 0.3% pa. Source: Statistics Bureau of Japan

- One main factor behind this has been robust job market conditions[5]. Unemployment rate fell to 2.4% at end Dec 2023 (vs 2.6% at end 2022 and 3.8% long-term average), near historic lows. Corporate profitability (Chart 2) and business conditions across all industries are at their strongest since 2018 in 4Q 2023. The government also set out new tax incentives[6] for companies that give large wage increases. Given these factors and moderating inflation[7], real wage growth is likely to turn positive in 2024. Already earnings growth has seen growing momentum (Chart 3) with Shunto negotiations in 2023 seeing a 3.6% wage increase, its highest in 30 years. For the 2024 Shunto negotiations[8], the 7 million-strong Rengo Labour Union won an [average 5.28% wage increase](), the biggest since 1991, according to its initial tally of negotiation results.

Chart 3: Growing Earnings Growth Momentum



Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*)
3. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions of the *Monthly Labour Survey*.
4. Figures for real employee income are based on staff calculations using the CPI (less imputed rent).

- In Nov 2023, the government also announced a very large stimulus package totalling US$239 billion, including US$110 billion in measures[9] to stimulate consumption. This together with more wage hikes should help boost household spending, directly benefiting the retail, hospitality and residential sectors. Additional measures to boost digital and green investment should stimulate business investment over the longer term.

- Another key economic growth driver will be the tourism sector.

  - Inbound tourism flows in 2023 totalled 25.1 million (Chart 4), still down 21.4% from 2019 pre-Covid levels. However from Oct 2023, monthly inflows exceeded 2019 levels. Tourism expenditure by inbound visitors also reached a record JPY5.3 trillion in 2023 (Chart 5), as per-capita spending per visitor rose by 33% to reach a high of JPY218,200 vs JPY159,000 in 2019, exceeding Japanese government's 2025 goal[10] of JPY 200,000. Other key sources of inbound travel have emerged, namely Taiwan, Korea, and US (they made up 53% of all foreign visitors in 2023 vs 38% in 2019), whilst China's share fell from 30% to 10%. Barring any major exogenous shocks, this uptrend is expected to continue over the next few years (refer to Hospitality section for more detail on Japan's key tourism growth drivers).

  - Domestic tourism has also done well, with domestic tourist volume estimated[11] to rise by ~14% in 2023 to ~281 million (still 4% below 2019 levels), whilst spending rose sharply by 23% yoy to a record high of JPY12 trillion (9% above 2019). Forecasts for 2024 indicate a marginal decline as the government's Go To Travel/Nationwide Discount campaign ended in mid 2023 and outbound travel recovers.

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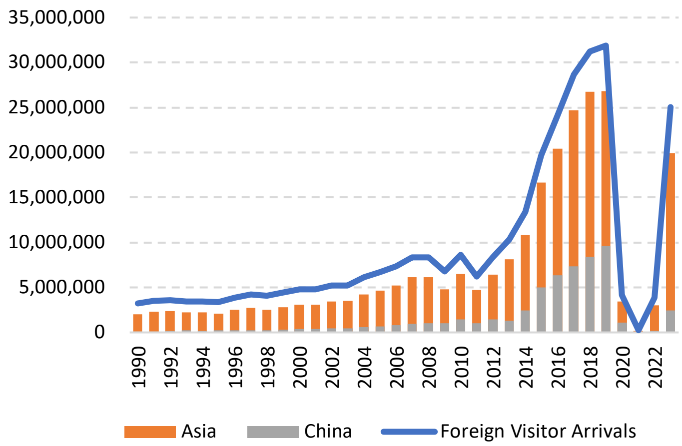
[5] More policies are being introduced to address Japan's labour shortage issues with increased retirement ages, flexible working arrangements, and enhanced foreign internship programmes. Foreign worker inflows reached a record 2.05 million from Jan to Oct 2023, up 12% from 2022.
[6] Ministry of Economy, Trade and Industry (METI) created a new category for companies with 2,000 or less employees as "midsize companies" and provided them with tax incentives to promote wage increases. Large companies require a wage increase of 7% or more to deduct 25% of salary increases from corporate taxes, while midsize companies require a wage increase of 4% or more. Previously, midsize and large-sized companies were treated the same.
[7] Japan CPI fell from its peak at 4.3% yoy in Jan 2023 to 2.2% yoy in Jan 2024. Source: Statistics Bureau of Japan
[8] Source: Nikkei News Report "Japan wage talks start amid hopes for return to 'virtuous cycle'" on 24 Jan 2024
[9] Includes extension of subsidies to April 2024 to reduce gasoline prices, electricity charges, and gas charges, one-time transfer of JPY70,000 to low-income households, and cuts in income tax and inhabitant tax.
[10] The Japanese government issued a policy package of "The New Tourism Nation Promotion Tourism" in 2023 and stated that the government aims to achieve various tourism goals by 2025.
[11] Source: Japan Tourism Board (https://www.jtbcorp.jp/en/newsroom/2023/12/20_jtb_2024-annual-outlook.html)

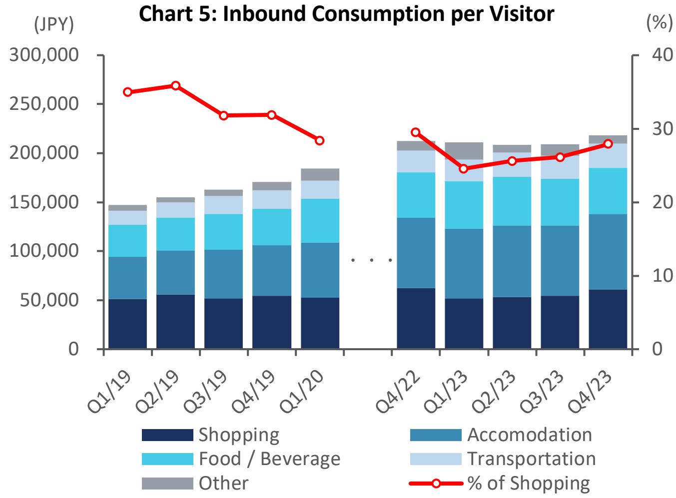
- World Tourism and Travel Council[12] estimates that tourism share of GDP and jobs in Japan will rise from 7.2% and 8.7% respectively in 2019, to reach ~8% of GDP and exceed 10% of jobs by 2033 (1 in 10 jobs). This reflects positive long-term demand prospects for Japan's retail and hospitality sectors, notably in the key Japanese cities.

Chart 4: Foreign Visitor Arrivals into Japan



Source: JTB, JNTO

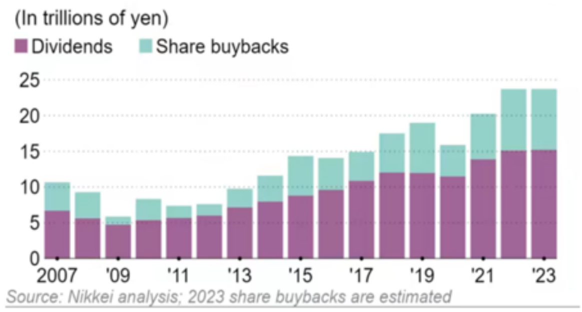
Chart 5: Inbound Consumption per Visitor



Source: Japan Tourism Agency

- Investor sentiment in Japan's corporate sector is also expected to improve further:
  - We continue to see further progress in its corporate reforms programme to boost capital efficiency[13]. Following TSE's announcement in March 2023 for all listed companies in the Prime and Standard markets whose shares trade below a price-to-book ratio of one (indicating it may not be using its capital efficiently) to "comply or explain", TSE began publishing the lists of firms (released monthly from January 2024) that were taking action to meet those goals. The implication is that those companies that had not made the disclosures list would be pressured to act. The February 2024 list showed that 49% of the Prime market companies responded to TSE's request, up from 31% as of mid-July 2023.
  - Other improvements in corporate reform activity can already be seen by the numerous corporate actions[14], share buybacks and dividend hikes over past 12 months (Chart 6).

Chart 6: Corporate Reform Activity Increasing



  - A new policy was launched in 2024 to stimulate Japan's asset management industry and create a virtuous cycle of growth for corporates and individuals' wealth. Previously, low inflation and stagnant growth prospects had discouraged Japanese households from investing, with the latter holding 53% of their wealth in cash and 12.7% in equities, vs US households which hold 14% of their assets in cash and 39% in equities[15]. To increase retail

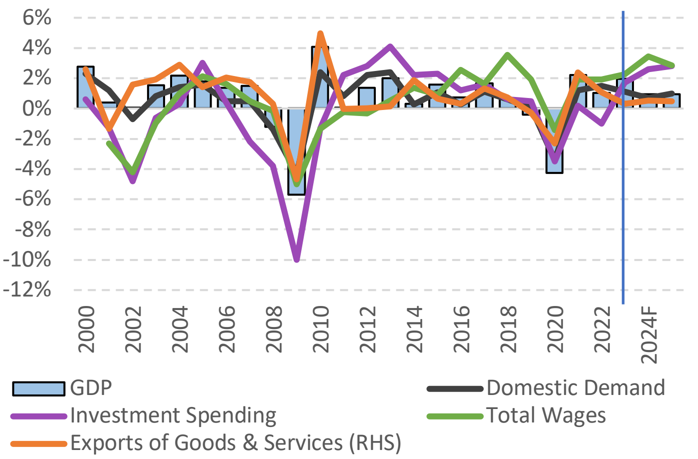
[12] Source: World Travel & Tourism Council (https://wttc.org/news-article/japan-eir-2023)
[13] Japan has significant room for improvement in this area as MSCI Japan's price-to-book (P/B) ratio was only 1.4x while return on equity (ROE) was at 8.6%, compared with 2.8x and 13.6%, respectively, for the MSCI All Country World Index.
[14] Some key examples include Toyota who is cutting its stakes in telecom company KDDI and car parts maker Denso, Fujitsu announced the sale of its semiconductor chip packaging subsidiary Shinko Electric.
[15] Source: Japan's Long Comeback by Charles Schwab (https://www.schwab.com/learn/story/japans-long-comeback)

investor participation, a new Nippon Individual Savings Account (NISA) programme was introduced in Jan 2024 (Table 1), whereby annual investment limits were increased, and individuals are now able to hold up to JPY18 million across their NISA accounts on a permanently tax-exempt basis. As some of this will likely flow into domestic equity funds and stocks, this will provide a boost for Japan's equity markets.

Table 1	**New NISA**		**Current NISA**	
Types of NISA	Tsumitate Quota	Growth Quota	Tsumitate NISA	General NISA
Annual Investment Limit	JPY 1.2 million	JPY 2.4 million	JPY 0.4 million	JPY 1.2 million
Allowed to combine	Up to JPY 3.6 million can be invested per year		Not allowed to combine	
Tax-free Period	No limit		20 years	5 years
Validity of Account	Permanent		Until end of 2023	
Max Amount for Tax-Free Holdings	JPY 18million (JPY 12million for Growth Quota)		JPY 8 million	JPY 6 million

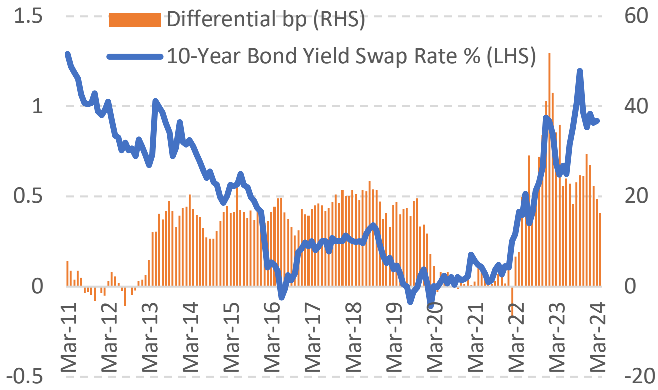
- Looking ahead, Japan's GDP growth is expected to moderate, but still stay above long-term average in the next 2 years. Real GDP growth forecasts[16] are 1.9% in 2023, ~1% pa in 2024-25 (Chart 7), and 0.6% pa in 2026-29, with inflation easing from 3.3% in 2023 to 2.2% pa in 2024-25 and ~2% pa in 2026-29. This is expected to be supported mainly by domestic demand, on the back of real wage growth, fiscal stimulus, and business investment. Core CPI (CPI less fresh food) is forecast by BOJ to decline from 2.8% in FY2023 to 2.4% in FY2024 and 1.8% in FY/2025[17] as the effects of the past increases in import prices fade.

Chart 7: Japan Key Macro Indicator Trends (Real Terms)



Source:IMF Economic Outlook, OECD Country Profile

Chart 8: Japan 10-Year Bond Yield Swaps & Differential To Actual Rates



Source: Investing.com

- The highly uncertain global geopolitical and macro environment present upside and downside risks to these forecasts - geopolitical conflicts which could have a knock-on effect on oil and commodity prices and supply chain costs, slower or faster economic recovery in China, climate/pandemic-related shocks, faster disinflation/persistent inflation leading to looser/tighter monetary policy. 2024 also stands out as a super elections year with over 60 national elections taking place globally, including key markets like US, India, Indonesia, Taiwan, EU etc. Any drastic policy changes could have spillover effects on geopolitics and supply chains.

- Notwithstanding, one key concern has been the direction of Japan's interest rates going forward. Our view is that policy tightening, if any, is likely to be limited and gradual. Japan is one of the world's most indebted countries[18] with a debt to GDP ratio of 252% in 2023. If the government's interest expense rises substantially, this could create concerns about debt sustainability and force the government to make difficult budget choices, leading to tax rises, expenditure cuts etc.

- At its March 2024 meeting, the BOJ announced the following:

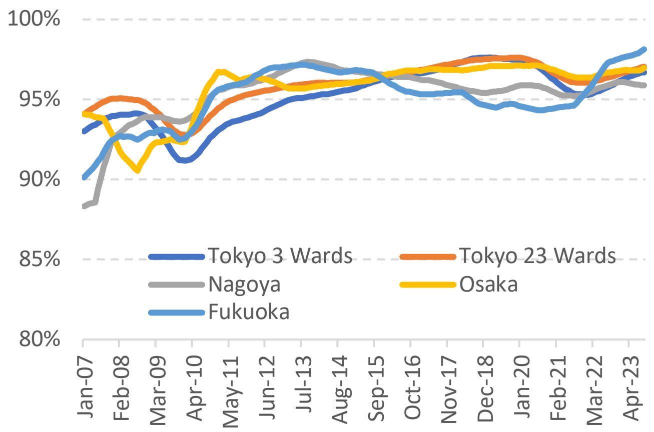
[16] Source: IMF World Economic Outlook April 2024 (2023-29)
[17] Source: BOJ Outlook for Economic Activity and Prices (January 2024)
[18] Source: IMF (https://www.imf.org/en/Countries/JPN#countrydata; https://www.imf.org/external/datamapper/datasets/GDD)

- Japan's key interest rate raised from -0.1% to a range of 0-0.1%.
- Yield curve control (YCC), a policy that had been in place since 2016 that capped long-term interest rates around zero, was abolished, but the BOJ would keep buying "broadly the same amount" of government bonds as before and ramp up purchases in case yields rise rapidly.
- They will stop their purchases of risky assets like exchange-traded funds (ETF) and Japanese real estate investment trusts.
- This is a significant move by the BOJ as it was Japan's first rate hike in 17 years and marked the end of its negative interest rate policy. However, the markets expect the actual impact on household mortgage rates and borrowing costs to be very small, with latest swap rates (on 7 April 2024) adding only a slight +16bp differential over 10-year bond yields (Chart 8).

Residential Property Sector Overview

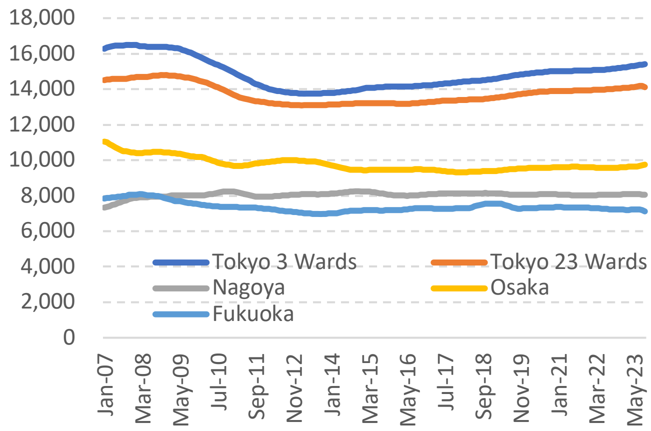
- The residential market remained resilient in 2023 with increasing occupancies and stable/rising rents across the key cities (Charts 9 and 10[19]), while existing apartments prices (Chart 11) rose by ~5% in Tokyo Metropolitan Area (includes Kanagawa, Saitama, Chiba and Tokyo 23 wards).

Chart 9: Average Monthly Residential Occupancy (Rolling 12 Months)



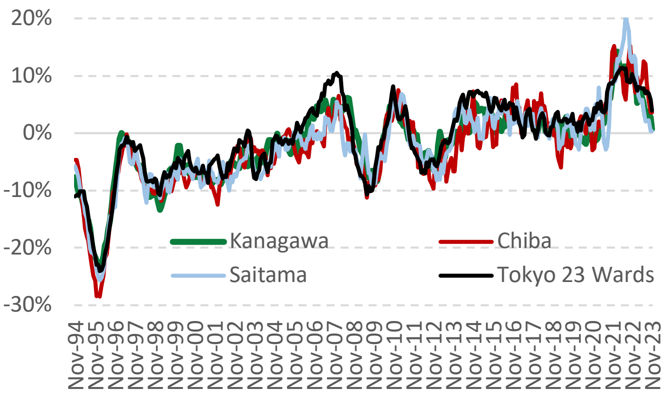
Source: ARES AJPI JREIT Databook

Chart 10: Average Residential Rent Per Tsu/Month (Rolling 12 months)



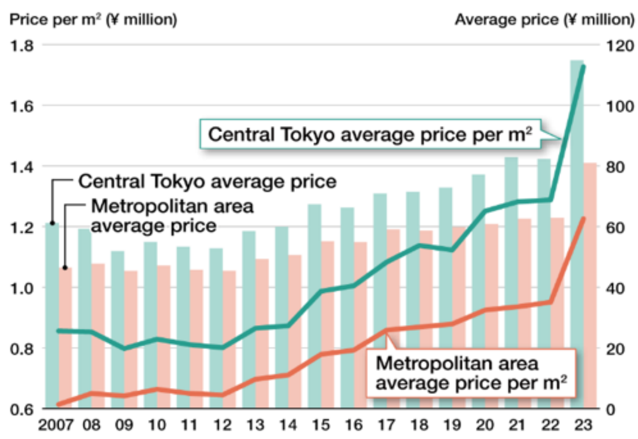
Source: ARES AJPI JREIT Databook

Chart 11: Annual YoY Change in Second Hand Apartment Sale Prices in Greater Tokyo



Source: JREI

Chart 12: Average New Condominium Prices in Tokyo



Created by *Nippon.com* based on data from the Real Estate Economic Institute.

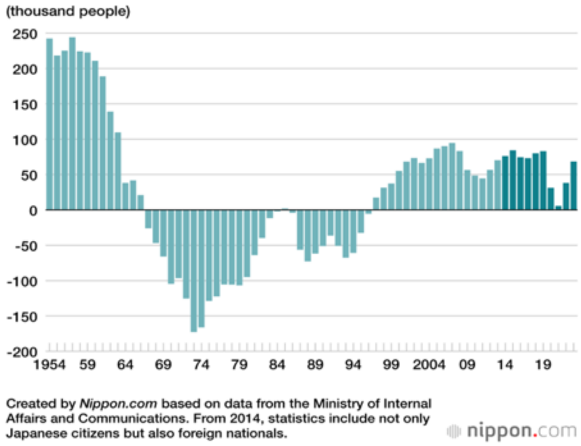
nippon.com

[19] Charts reflect monthly data on a rolling 12-month basis as data for the last six months are preliminary estimates only.

- In the new condo market, Tokyo 23 wards housing prices (Chart 12) rose to a new peak of JPY115 million (US$815,000[20]), up 39.4% from 2022. In Tokyo metropolitan area, average new condo prices reached a high of JPY81 million (US$574,000), up 28.8% from 2022. This is largely driven by higher land and construction costs and launch of numerous high-end condominiums[21] in the core city centre districts over the period. The number of units sold in Tokyo metropolitan area fell by 9.1% to 26,886 in 2023, but the number of units priced at JPY100 million (US$709,000) or higher rose by 1,683 yoy to 4,174[22]. However, after such sustained price increases, the momentum in the housing market has eased in recent months.

- Overall demand prospects remain resilient for Japan's largest housing markets, notably the Tokyo Metropolitan Area, supported by continued net migration flows (chart 13), growing number of HNWI[23], foreign buyers/ renters and dual-income households earning high salaries. For example, the number of affluent domestic households with financial assets (excluding liabilities from real estate purchases) of JPY100 million or more climbed to 1.5 million[24] in 2021, up over 70% from 2005.

Chart 13: Net Population Inflow to Tokyo



- According to Japan's National Institute of Population and Social Security Research (IPSS)[25], population concentration in the major cities will further accelerate over the next 20-30 years. The population share in the major 21 cities (20 key cities plus Tokyo 23 wards vs 792 cities across Japan) is projected to rise from below 30% in 2020 to 34% by 2050. For the working-age population (15-64 years), the share of the 21 cities is forecast to rise from 32% to 36% in 2050. This reflects a faster pace of population concentration vs the 2018 projections.

- Given Japan's ageing population issue, the aggregate population of the 21 cities is also expected to fall, but the rate of decline is projected to be slower than the national average (Chart 14). Only Tokyo 23 wards, Kawasaki, Saitama and Fukuoka are forecasted to see their population grow until 2040, with Tokyo 23 wards to grow from 9.8 million (2023) to over 10 million by 2050.

- Moreover, despite the run-up in prices in recent years, Japan remains attractively priced vs other similar major economies when making global comparisons for high-end housing (Charts 15 and 16). Japan also ranks favourably in terms of income affordability, especially when paired with its high quality of living (Table 2), making it an appealing destination for both foreign and domestic buyers.

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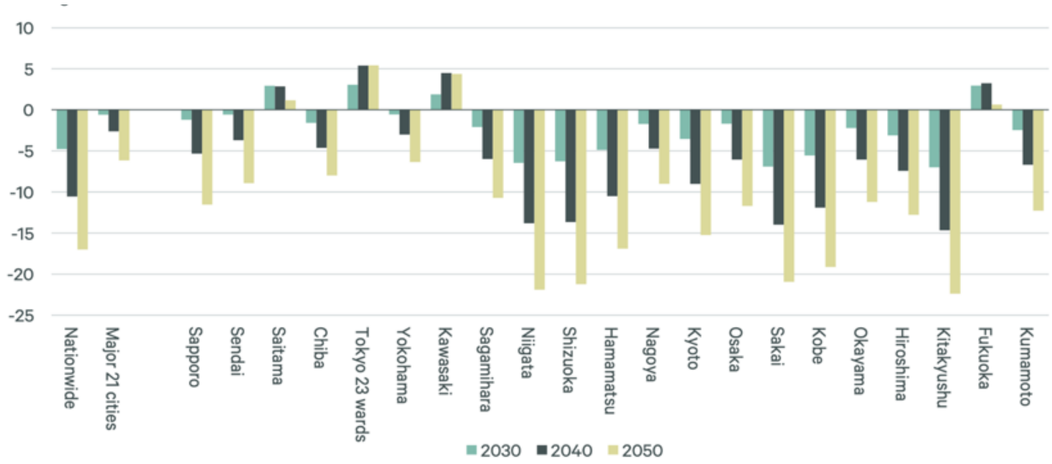
[20] Source: https://www.exchange-rates.org/exchange-rate-history/jpy-usd-2023; Based on end 2023 exchange rate.
[21] Source: CNA Report "New Tokyo apartments averaged above 100 million yen in 2023 for first time ever" on 25 Jan 2024
[22] Source: Nippon.com Report "Average Condominium Price in Central Tokyo Tops ¥100 Million" on 8 Feb 2024
[23] HNWI (High Net Worth Individuals) - Based on the Knight Frank Wealth Report 2024, Japan ranked 5th largest with ~22,000 HNWI with over US$30 million, accounting for 3.5% of all similar HNWI globally. Largest being the US (35.9%), China (15.7%), Germany (4.6), France (4%), and UK (3.7%). The rankings remain similar in 2028, with Japan forecast to see an increase of 2,792 to ~24,500 HNWI.
[24] Source: Nomura Research Institute (https://www.nri.com/jp/news/newsrelease/lst/2023/cc/0301_1)
[25] These projections do not differentiate between local and foreign residents. As of June 2023, the number of foreign residents in Japan reached a record 3.2 million. With the Japanese government revamping immigration policies to encourage more foreign workers, these projections could deviate in a positive way, especially in the key cities.

Chart 14: Total Population Projection – Nationwide vs Major 21 Cities (% change vs 2020)



Source: National Institute of Population and Social Security Research (IPSS), December 2023

Chart 15: Rent Comparison of High-End Condos

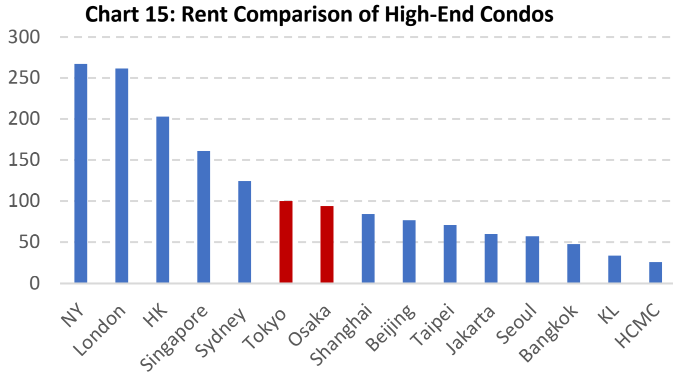
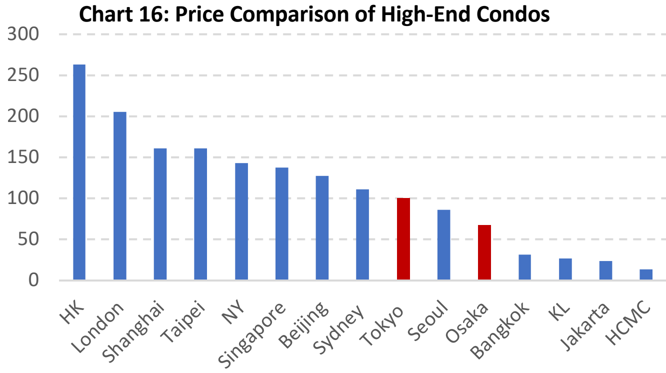


Chart 16: Price Comparison of High-End Condos



*Index number per sqm of high-end condo in each city vs Tokyo. (Tokyo's Moto Azabu District as at Oct 2023 = 100)
Source: JREI (Nov 2023)

Table 2: Housing Affordability vs Quality of Life Index

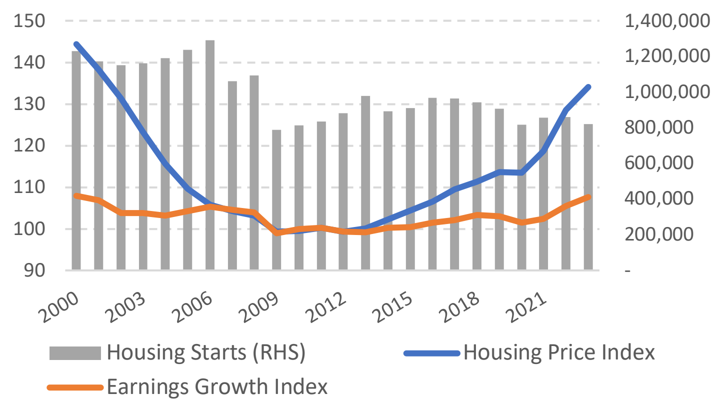
Economy	Price To Income Ratio	Mortgage As A Percentage Of Income	Affordability Index	Quality of Life[26] Index
Japan	10	59.9	1.7	177.6
Germany	9.8	71.6	1.4	176.5
United States	4.1	36.8	2.7	174
Australia	11	98.2	1	163.8
Singapore	14.9	102.6	1	160.9
United Kingdom	9.9	84.3	1.2	160.3
Taiwan	19.5	115.7	0.9	152.9
France	12.3	85.7	1.2	152
South Korea	19.9	150.2	0.7	142.3
Hong Kong	32.1	230.6	0.4	121.9
India	13.3	141.8	0.7	111.8
China	29.6	228.9	0.4	110.9

Source: Numbeo

- On the supply side, we see a continued decline in housing starts (Chart 17) in 2023, as construction costs rise (Chart 18), forcing delays, scaling down of projects or developers to focus more on higher end projects in the key city centre areas. This is expected to worsen when the legal cap on overtime hours (aka "2024 problem") in transportation and construction goes into effect in April 2024, whereby construction workers and truck drivers will not be allowed to work more than 720 hours/year, and 960 hours/year respectively.

[26] Numbeo's quality of life index is based on average citizen's purchasing power (including rent), safety, health care, cost of living, property price to income ratio, traffic commute time, pollution and climate. (https://www.numbeo.com/quality-of-life/rankings_by_country.jsp)

Chart 17: Japan Housing Price Vs Private Sector Earnings Growth Vs Housing Starts ('000sm)



Source: MLIT, Federal Reserve Economic Data

Chart 18: Construction Cost Trends by Property Sector in Tokyo

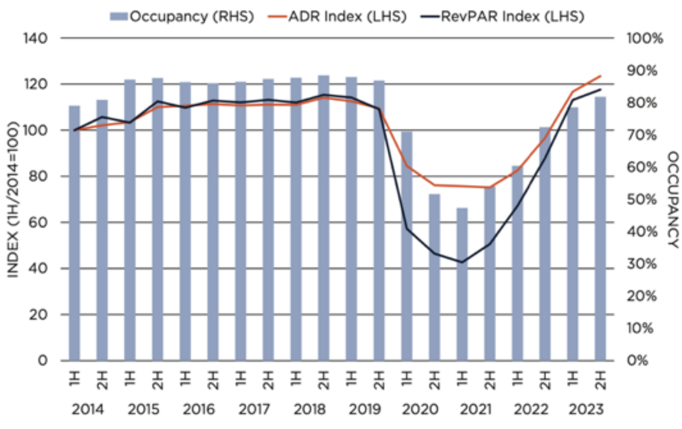
Source: Construction Research Institute, CBRE Research, October 2023

- Rising housing prices and limited new supply have resulted in lower transaction volumes, with many turning to the rental market. These factors amidst very low vacancies, rising wages and positive net migration inflows should help drive further rental growth in the key cities in the next few years. Existing apartment prices in core locations are projected to rise further but at a slower rate due to interest rate concerns. For new high-end condos, demand should be supported by the large growing base of HNWI, notably in Tokyo, but pricing growth will depend on the quantity and quality of product launched over the period.

Hospitality Property Sector Overview

- Japan's hospitality sector performed strongly in 2023 following its full border re-opening in 4Q 2022. Pent-up travel demand amidst the weak yen drove up foreign tourism volumes and spending, which by 4Q 2023 exceeded pre-pandemic levels. ADR (Average Daily Room Rate) and RevPAR (Revenue Per Available Room) also rose sharply, exceeding 2019 levels and outperforming other major Asia markets (Charts 19, 20 and 21), while the occupancy recovery lagged due to labour shortages. Labour is a bigger challenge for luxury full-service vs limited service hotels, as the former need a larger number of staff for their operations. In addition, the pick-up in business travel, MICE (meetings, incentives, conferences, and exhibitions) activity and banqueting, has lagged[27], thus a full recovery in full-service hotel occupancy could take even longer.

Chart 19: Limited-service Hotel Performance



Source J-REIT disclosures, Savills Research & Consultancy
Note: Occupancy is calculated based on the total number of rooms each month.

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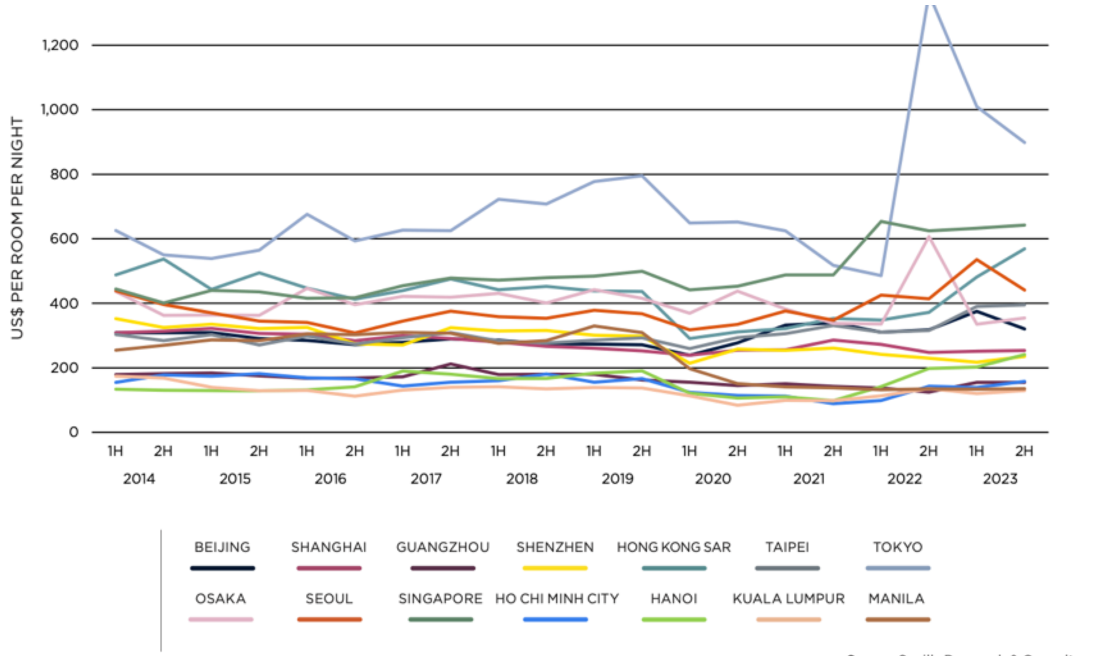
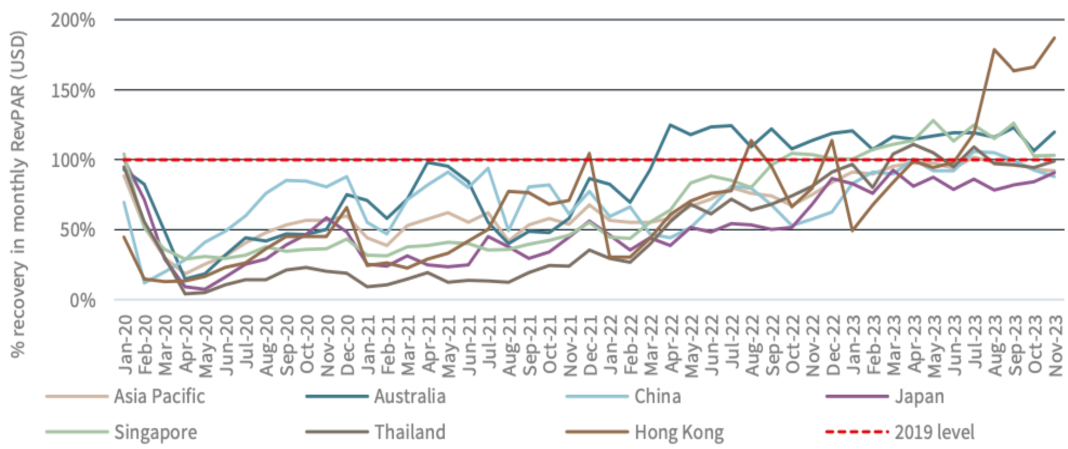
[27] Japan hosted 553 international conferences in 2022, sharply down from 3,621 in 2019, before COVID-19 pandemic. Source: Japan Tourism Agency.

Chart 20: Prime Hotel Room Rate Trends Across Asia



Source Savills Research & Consultancy
Note *Manila data has been revised in 2H/2023, due to reassessment of room rate by local research team.

Chart 21: Prime Hotel RevPAR Trends across Asia

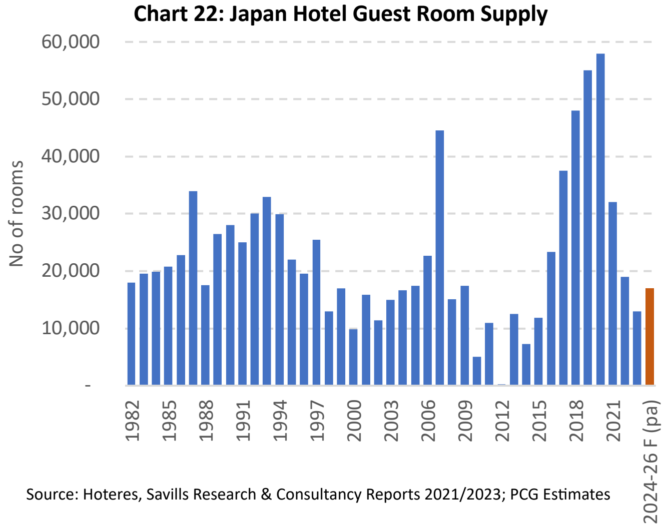


Source; STR, JLL

- Hotel supply fundamentals remain positive with declining room additions in recent years, and limited stock growth planned (Charts 22 and 23) over the next few years. Projected stock growth is ~5% or less for most prefectures, except for Chugoku and Okinawa, though these are off much lower stock base levels. Like the residential sector, this has been due largely to rising construction and land costs.

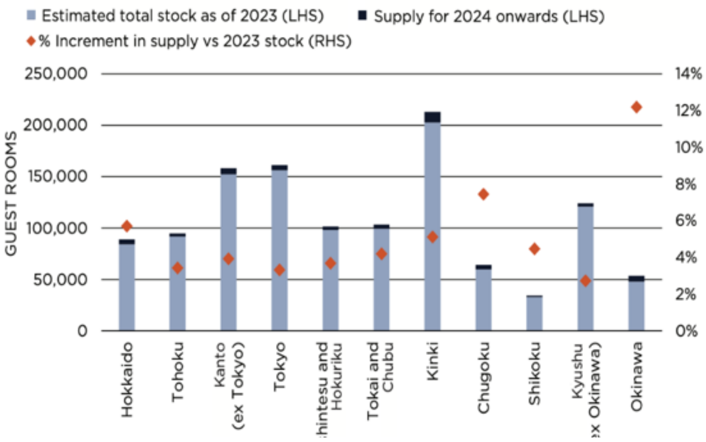
- Provision of luxury hotels is still low versus other major economies and Japan's tourist volumes (Chart 24). Hence, interest by foreign hotel operators has been high as can be seen by the list (Table 3) of planned openings in the next few years.

Chart 22: Japan Hotel Guest Room Supply



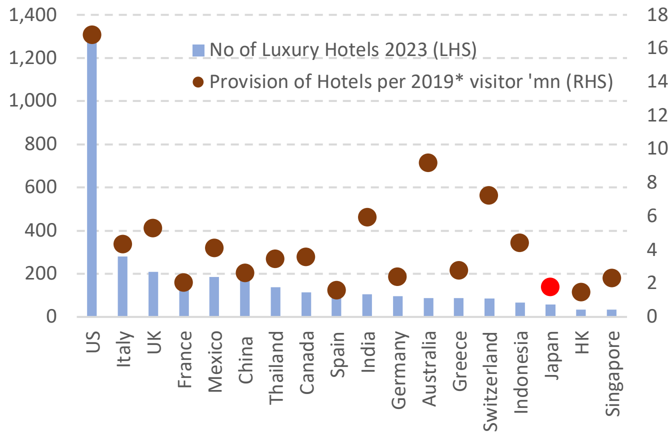
Source: Hoteres, Savills Research & Consultancy Reports 2021/2023; PCG Estimates

Chart 23: New Supply Forecasts by Prefecture



Source: Hoteres, MHLW, Savills

Chart 24: Provision of Luxury Hotels by Country



Source: UNWTO, Savills Japan Hospitality Report Nov 2023

Table 3: Planned Hotel Openings by Foreign Operators

Year of opening	Tokyo metropolitan area and Kansai area	Local
2023	Tokyo metropolitan area: Bvlgari Hotel Tokyo, Hotel Indigo Tokyo Shibuya, Hilton Yokohama, Hotel Toranomon Hills, Janu Tokyo, Tokyo EDITION Ginza Kansai area: voco Osaka Central, ASAI Kyoto Shijo, Centara Grand Hotel Osaka, DoubleTree by Hilton Kyoto Higashiyama, Dusitani Kyoto	Doubletree by Hilton Toyama, The Ritz-Carlton Fukuoka, Sheraton Kagoshima, Hilton Miyakojima Resort, Shisui Luxury Collection Nara
2024	Tokyo metropolitan area: Hyatt House Tokyo Shibuya Kansai area: Canopy by Hilton Osaka Umeda, Regent Kyoto, Six Senses Kyoto, Banyan Tree Higashiyama Kyoto, Hilton Kyoto, DoubleTree by Hilton Osaka Castle, Caption by Hyatt Namba Osaka	Nagasaki Marriott Hotel, Courtyard by Marriott Fukui
2025	Metropolitan area: JW Marriott Hotel Tokyo, Fairmont Tokyo, Caption by Hyatt Kabutocho Tokyo Kansai area: Waldorf Astoria Osaka, Patina Osaka, Capella Kyoto, Shangri-La Kyoto Nijo Castle	InterContinental Sapporo
2026	Waldorf Astoria Tokyo Nihonbashi	Hyatt Centric Sapporo, Canopy by Hilton Okinawa Miyakojima Resort, Conrad Nagoya
2028	Dorchester Collection	-

Source: JLL prepared from some reports (including the opening schedule) and press releases of hotel companies.

- Looking ahead, we see continued tourism demand upside due to the following:
  - Japan Tourism Agency (JTA) has introduced more measures[28] in 2024 to help host more international conferences and business events (goal is for Japan to rise from 12th in 2022 to 5th in the world by 2030 in terms of hosting international conferences);
  - Government's plans[29] to boost sustainable, adventure and regional tourism across Japan, and digitalisation of the industry;
  - Japan's continued favoured destination status[30] given its rich and diverse cultural and nature resources;

[28] This includes a new subsidy program, whereby the agency will shoulder part of costs of installing communications networks at event venues and developing human resources with know-how on attracting MICE events.
[29] Japan Tourism Agency's Tourism Nation Promotion Basic Plan FY2023-25 was approved by the Government in April 2023. https://www.mlit.go.jp/common/000234920.pdf
[30] According to a survey by Global Hotel Alliance (GHA) on leading destinations for 2024, Japan and Thailand were the most popular destinations, followed by Spain, Canada and Hawaii. In Jan 2024, according to Tripadvisor® (world's largest travel guidance platform) Travellers' Choice® Award for 2024: Best of the Best Destinations, Tokyo emerged as the world's most trending destination. In Feb 2024, Conde Nast Traveller revealed that its Readers' Choice Wards ranked Japan as the world's top travel destination.

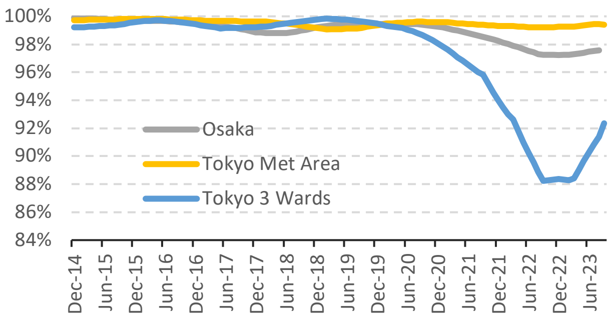
- Improved access to and across Japan via increased flight routes and frequencies, extension of shinkansen routes etc;
- Gradual recovery in China tourism inflows (China has resumed outbound group tours to Japan from Aug 2023 and started visa free travel with Japan from Feb 2024);
- Some of Japan's biggest tourism feeder markets, ASEAN, South Korea and Taiwan, are expected to see slightly stronger GDP growth in 2024-25 given a more positive macro environment with the pause in global interest rates hikes, lower inflation, and sizable stimulus in countries like China and Thailand;
- Launch of the first US-Japan Tourism Year 2024[31] with efforts to increase travel flows between the 2 countries. The US accounted for over 2 million inbound visitors (up 19% from 2019) and 8% of foreign visitors into Japan in 2023 (up from 5% in 2019);
- Japan Immigration Services Agency (ISA) announced plans to launch a six-month digital nomad visa[32] in late March 2024.The visa will be open to remote workers who make at least JPY10 million a year. They can bring along their spouse and children;
- Potential success of the Integrated Resorts in Osaka in 2030 could attract a steady inflow of high spenders for Osaka and Japan, and
- Expansion of the concert economy given Japan's favourable status as a key stop[33] for major megastar concerts in Asia.

- Given healthy long-term demand and supply fundamentals, ADRs are projected to continue rising albeit at a slower rate, particularly for the luxury hotels where rates have risen to record levels in both US$ and local currency terms. We also expect occupancy growth to play a more meaningful role in driving RevPAR growth going forward.

Retail Property Sector Overview

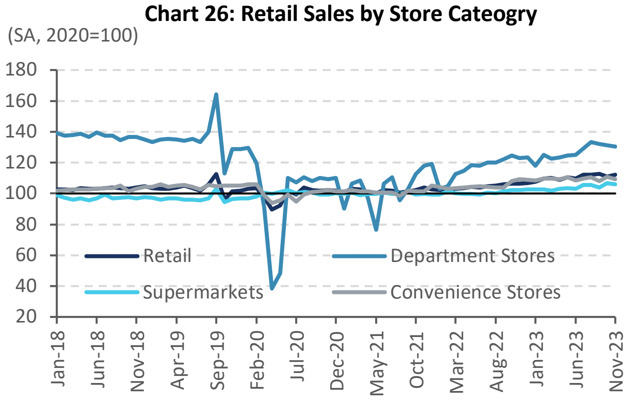
- Japan's retail market saw moderate improvements in occupancy and sales across different store categories in 2023 (Charts 25 and 26). This was primarily driven by robust tourist consumption and increased luxury spending following the post pandemic re-opening of Japan's borders.

Chart 25: Average Monthly Retail Occupancy - (Rolling 12 Months)



Source: ARES AJPI JREIT Databook

Chart 26: Retail Sales by Store Cateogry



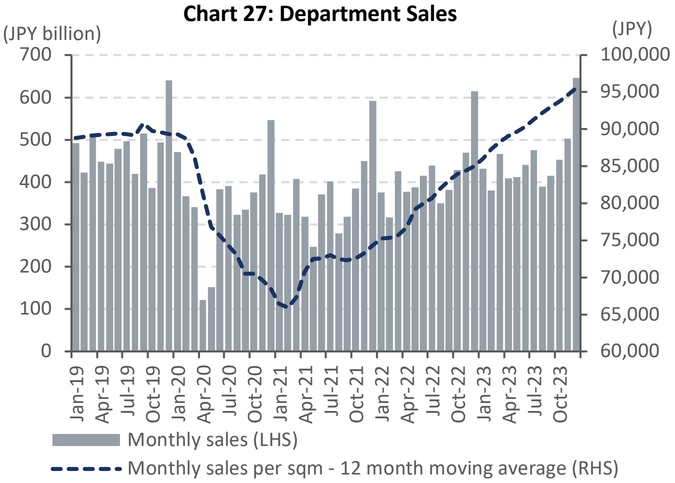
Source: METI

- As seen in Chart 25, the occupancy rate (12-month rolling average) bottomed out in 2H 2022, with Tokyo 3 wards seeing the biggest hit and then recovery due to the greater exposure to inbound tourism trends. Even through the pandemic, average monthly occupancy rate for J-REIT retail properties across Japan was 99.5% (Jan 20 – Dec 22), helped by domestic travel which was boosted by the national travel campaign, demonstrating the overall resilience of the sector.

[31] https://www.japan.travel/en/us/press-release/japan-looks-ahead-to-u-s-japan-tourism-year-2024/
[32] https://www.ey.com/en_gl/tax-alerts/japan-to-launch-digital-nomad-visa-in-march-2024
[33] The "Swiftonomics" effect — or the economic impact of Taylor Swift — on Japan from her four days of shows in Tokyo in Feb 2024 is estimated at ~ JPY34 billion (US$230 million). Source: Economic Impact Research Laboratory.

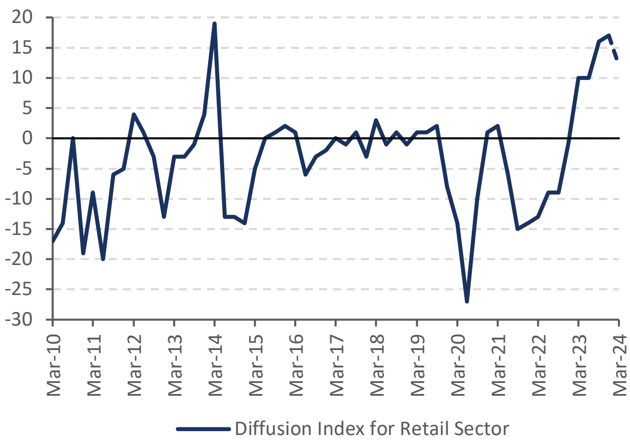
- While retail sales grew across various distribution channels (including department stores, supermarkets, and convenience stores), department sales outperformed. In fact, department sales rebounded to pre-Covid levels while sales per sqm (12-month moving average) also exceeded by +7% (Chart 27) in December 2023, underscoring the growing consumer appetite for higher-priced goods. The weak yen also helped made luxury goods more affordable and attracted spending by inbound tourists and local wealthy residents.

Chart 27: Department Sales



Source: Japan Department Stores Association

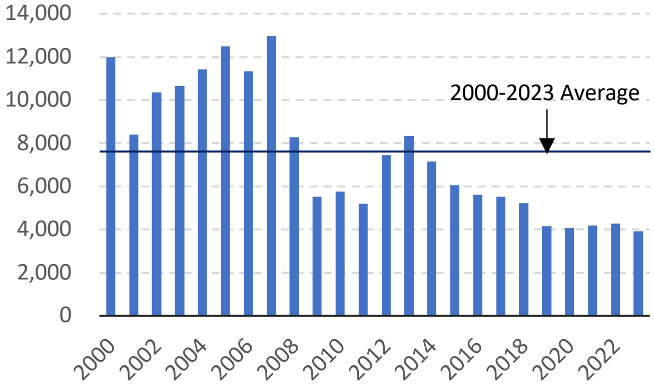
Chart 28: Business Sentiment of Retail Sector



Source: BOJ

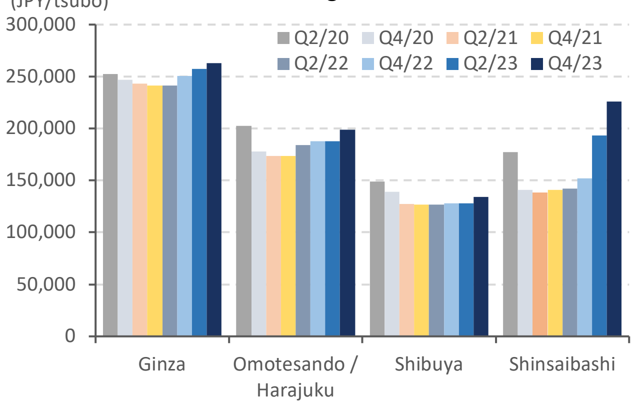
- Additionally, retailer sentiment on their business outlook based on the latest BOJ's Tankan survey from December 2023 showed favourable conditions to continue for the near term. The diffusion index, which has rebounded sharply and remained positive since March 2023 survey, is expected to continue to stay positive with 12%pt forecast in March 2024 survey (Chart 28).

Chart 29: Stores Building Starts in Japan ('000sm)



Source: MLIT

Chart 30: High Street Rents

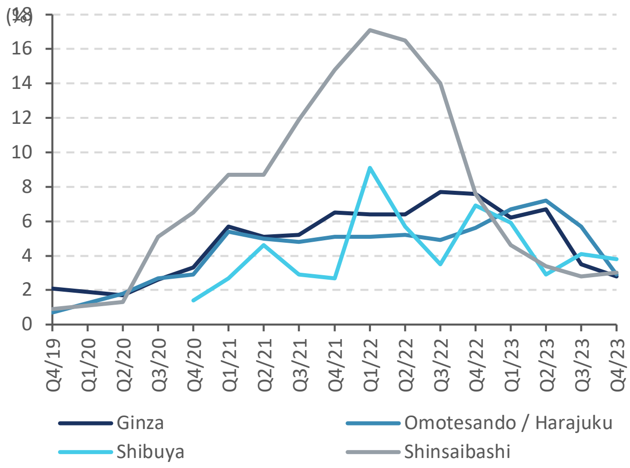


Source: CBRE

- Positive retailer confidence combined with the positive tourism outlook and limited new supply (chart 29), helped drive heightened competition among retailers to secure space in prime locations in key cities, contributing to the recovery in Japan's high-street markets. In 2023, high street rents in Japan's key shopping districts (Ginza, Omotesando/Harajuku, and Shibuya in Tokyo, and Shinsaibashi in Osaka) saw robust growth, with Shinsaibashi district leading at +49% yoy increase in 4Q, and vacancy rates falling below 4% (Charts 30 and 31) across these districts[34]. In some key locations, high street rents are still below their pre-pandemic levels. Brokers reported growing leasing interest from a wider range of tenants for both prime and secondary locations, in response to increasing footfall from inbound tourism.

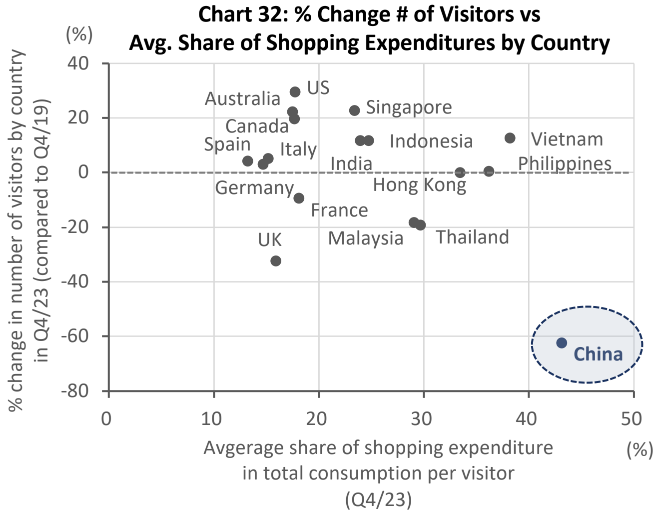
[34] Q1/20 data is not available as the CBRE survey was not conducted due to COVID-19 pandemic. Survey data on vacancy for Shibuya is available from Q4/20 onwards. Vacancy rates account for all floors prior to Q3/21 and only the 1st floor from Q4/21 onwards.

Chart 32: High Street Vacancy Rate



Source: CBRE

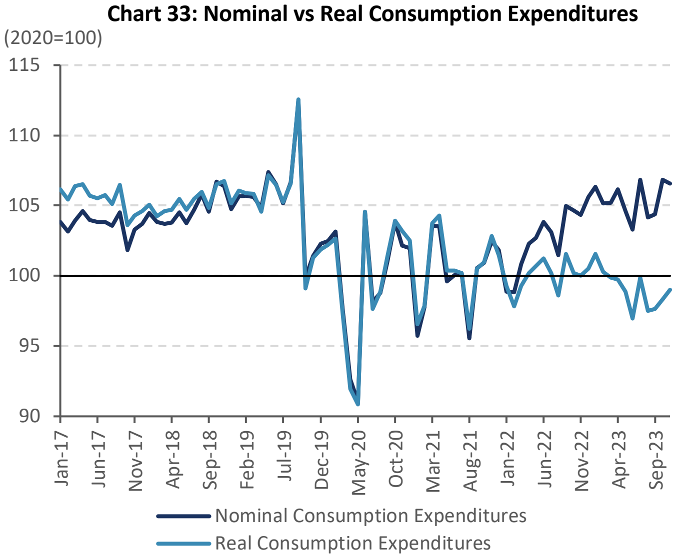
Chart 32: % Change # of Visitors vs Avg. Share of Shopping Expenditures by Country



Source: Japan Tourism Agency

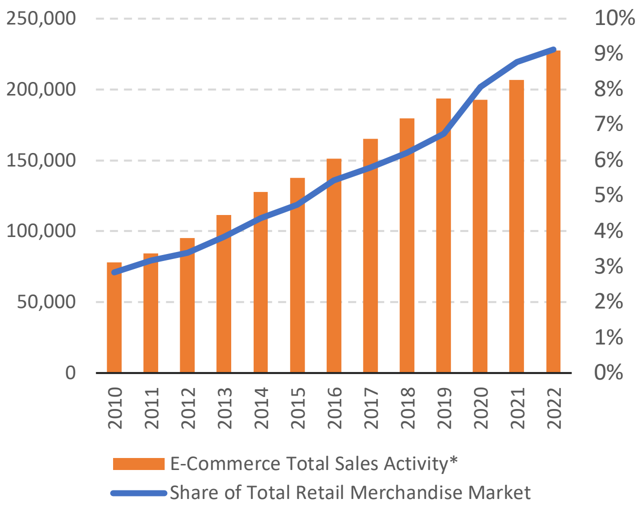
- Meanwhile, the lagged recovery of Chinese visitors remained a challenge for the retail sector in 2023 as they typically allocate 40% of their total expenditure to shopping, the highest among all countries (Chart 32). Propitiously, this suggests that a continued recovery in Chinese tourists should significantly boost inbound spending and contribute to Japan's retail sector going forward.

Chart 33: Nominal vs Real Consumption Expenditures



Source: Statistics Bureau of Japan

Chart 34: Japan E-Commerce Retail Penetration



Source: METI

* (Incl. Merchandise, digital and services)

- One potential headwind is the impact of inflationary pressures. In 2023, we saw weaker real consumption growth vs nominal growth (Chart 33) from 2022 as inflation rose to its highest levels since the early 1980s. Hence, should inflationary conditions worsen further, retailers could potentially face headwinds from both dampened domestic consumption and rising operational costs. Another challenge has been the growing penetration of e-commerce (Chart 34) vs traditional brick-and-mortar stores, especially in industries like clothing and household goods and appliances, with the recent pandemic causing a permanent shift in consumer behaviour[35]. In response, landlords, developers and retailers have to be more strategic and innovative in their space utilisation and offering of differentiated customer experiences.

[35] Share of households shopping online rose from 35.8% in 2018 to over 50% by 2022 (https://www.trade.gov/country-commercial-guides/japan-ecommerce-0)

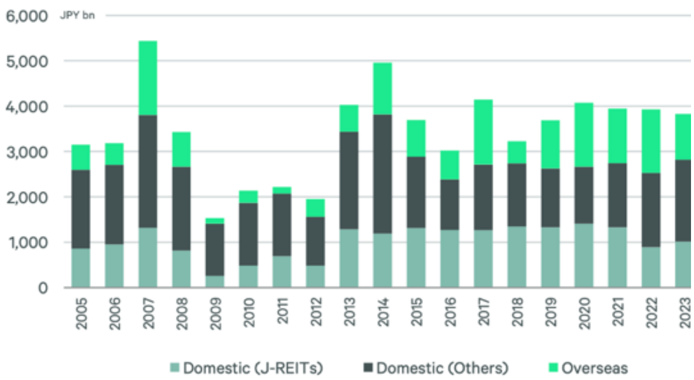
- The overall outlook for high street rents remains positive as the return of inbound tourists have significantly improved retailer sentiment, while supply and vacancies remain very limited especially in prime high street locations. Suburban retail rents could face more challenges in light of overall population declines, and risks from inflation and e-commerce pressures.

Investment Market Outlook

- Global investment activity in 2023 was dampened by concerns regarding rising interest rates, geopolitical conflicts in Ukraine and the Middle East, and uncertain economic prospects in China. By region, Asia fared best with total commercial real estate investment down by 32.0% to US$128.7 billion in 2023 vs declines of 50.9% in Europe and 54.4% in the Americas.

- Japan performed relatively well with transaction volumes (Chart 35) remaining resilient (-3% yoy in 2023) given healthy market fundamentals, weak yen, and attractive yield spreads due to very low financing rates. However, volumes slowed in 2H 2023 as foreign investors grew more cautious of a potential rise in interest rates and its spill-over impact on the economy and cap rates. Investment by domestic investors (includes J-REITs) rose by 12%, but fell by 28% for foreign investors in 2023. Investors targeted more defensive or higher growth sectors like residential, hotel and logistics (Chart 36). Retail rose sharply given the sector's ability to benefit from the tourism uptrend and rising wages.

Chart 35: Major Transaction Volumes in Japan by Investor Type



*Transactions of at least JPY1 billion, excluding acquisitions by J-REITs at IPO.
Source: MSCI Real Capital Analytics, CBRE 4Q 2023

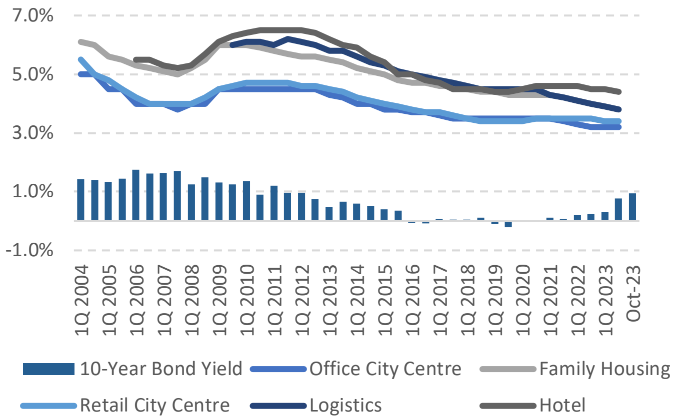
Chart 36: Japan Annual Transaction Volume by Sector

Note:Transactions of at least JPY 1bn, excluding acquisitions by J-REITs at IPO. Source : MSCI Real Capital Analytics, CBRE, Q4 2023.

- Latest JREI investor survey data (Chart 37) showed that expected cap rates in Tokyo remained stable (Office) or compressed further (Retail, Logistics, Residential, Hotels) over the year to 3Q 2023. CBRE's cap rate survey reflected further declines for Hotels and Logistics and no change for the other sectors over 4Q 2023. Do note that transacted cap rates tend to be ~100bp lower.

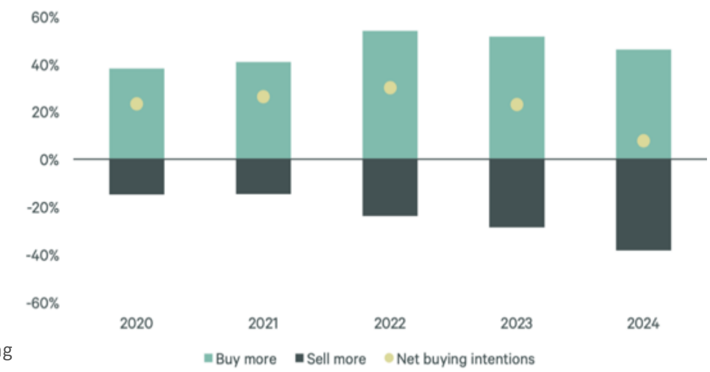
- Expected cap rates for quality assets in Japan's larger regional cities (Osaka, Kyoto, Yokohama, Nagoya, Sapporo, Fukuoka) tightened over the period. We highlighted in the last report that these cities had healthy sector fundamentals and attractive spreads over long bond yields and Tokyo cap rates. Retail currently seems more attractive from an investment value perspective as compared to residential and hotels where the expected cap rate spreads over 10-year bond yields and Tokyo Cap Rates are tighter (Table 4).

Chart 37: Tokyo Expected Cap Rate Trends



Source: JREI Investor Survey

Chart 38: Investor Buying & Selling Intentions



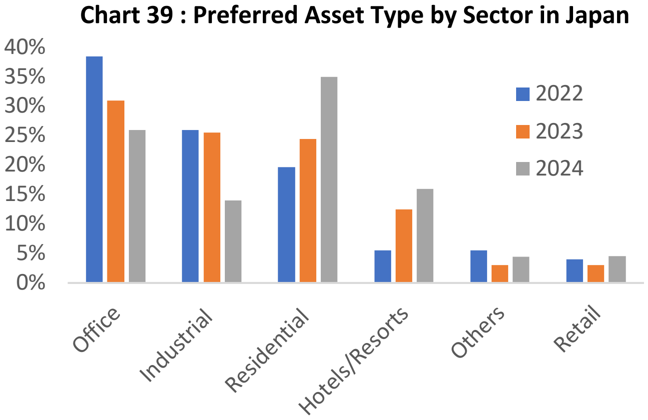
Source : 2024 Asia Pacific Investor Intentions Survey: Japan Results, CBRE Research

Table 4: Expected Cap Rates	Multifamily Apartment	Limited Service Hotel	Downtown Retail
Tokyo	3.8%	4.3%	3.4%
Osaka	4.4%	4.8%	4.4%
Yokohama	4.4%	na	4.5%
Nagoya	4.6%	5.1%	4.7%
Fukuoka	4.6%	5.0%	4.7%
Kyoto	4.8%	4.8%	4.8%
Sapporo	5.0%	5.2%	5.3%
Spread vs 10-Year Bond Yields	310 – 430 bp	350 - 450 bp	270 – 460 bp
Spread vs Tokyo Cap Rates (3Q 2023)	60 - 120 bp	50 - 90 bp	100 - 190 bp

Source: JREI Investor Survey

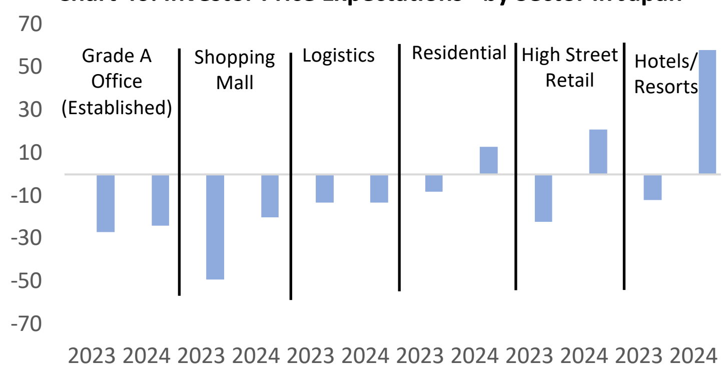
- While recent investor sentiment surveys[36] continue to highlight Japan, notably Tokyo and Osaka, as one of the most favoured markets in Asia Pacific, there are also indications of waning "buy" sentiment (Chart 38) in light of Japan's cyclical positioning. With cap rates at their historical lows, more investors may look to take profit, or target assets where value can be added or sectors where there is more growth upside. CBRE's latest Asia Pacific Investor Intention Survey (Feb 2024) favours residential, hospitality and retail sectors in Japan (Charts 39 and 40), while Japan's property spreads are still compelling versus other major property markets globally (Chart 41).

Chart 39 : Preferred Asset Type by Sector in Japan



Source: CBRE Japan Investor Survey 4Q 2023

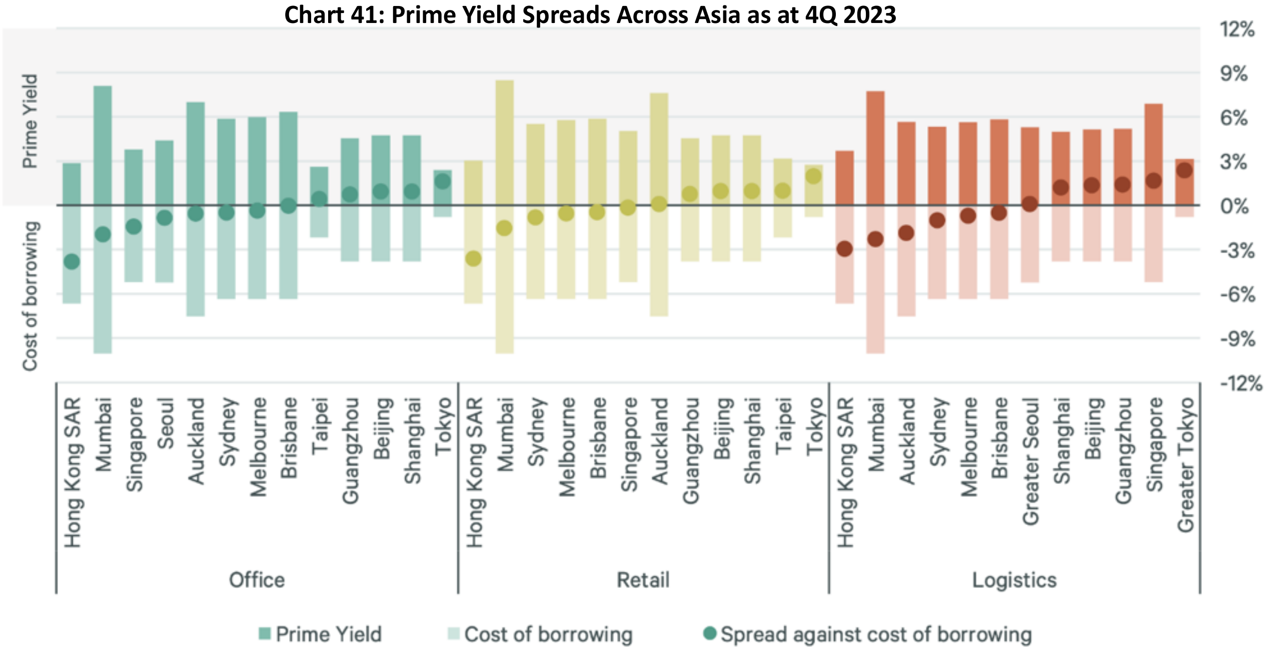
Chart 40: Investor Price Expectations* by Sector in Japan



*Investor net pricing expectations by asset type (increase - decrease)
Source: CBRE Japan Investor Survey 4Q 2023

[36] This includes CBRE's 2024 Asia Pacific Investor Intentions Survey, Emerging Trends in Real Estate @Asia Pacific 2024, State of Play: Current Trends in APAC Private Real Estate Funds by Goodwin Law/KPMG/IQ-EQ Oct 2023; Investment Intentions Survey 2024 by ANREV, INREV and PREA.

Chart 41: Prime Yield Spreads Across Asia as at 4Q 2023



Source : CBRE Research, Q4 2023

- In summary, assuming no major adverse exogenous shocks, we expect demand for quality retail, residential and hotel assets in Tokyo and the key regional cities to remain resilient given healthy demand (real wage growth, increase in overall/regional tourism and net migration trends) and supply (low vacancies and limited pipeline) fundamentals, and positive yield spreads.

This report was written by Wendy Wong, Research Advisor to Patience Capital Group (PCG) Pte Ltd. Prior to this, Wendy was Senior Vice President at GIC Pte Ltd. During her 24 years (1998-2022) with GIC, her responsibilities covered global research and strategic planning in GIC Real Estate, and building up thought leadership in GIC's Corporate Affairs & Communications Department. The retail sector section was contributed by Daiki Yonemaru, who is part of PCG's investment team and was formerly a real estate investment banking associate with Nomura Securities Co., Ltd. and a research analyst at Bank of Japan.