Q3 2018: Japan Commercial Property Monitor

Commercial property continues to defy late-cycle signals

Japan's commercial property market maintained moderately positive momentum in Q3 of 2018, as it has for the past several quarters. Despite concerns over streched valuations and the market peaking, monetary policy remains accomodative and economic fundamentals are supportive of growth. However, respondents are signaling a slowdown over the medium-term as both rents and capital value growth is seen slowing over the next three years.

Occupier Market

- The Occupier Sentiment Index (an amalgamated measure of occupier market indicators) was little changed at +14 in Q3 from +13 in Q2 (Chart 1), indicating a still modest improvement in occupier market conditions.
- Headline occupier demand continued to increase at a steady pace in net balance terms in Q3. Demand continued to be led by the office and industrial segments of the market, as it has been for the past year.
- Respondents highlighted tighter supply of properties to rent, driven primarily by fewer office properties available. The supply of industrial and retail properties were little changed from Q2.
- Perhaps unexpectedly, landlord incentives to rent office space declined in Q3, while those for industrial and retail properties were unchanged. New development starts were mixed. Respondents noted a very slight increase in office and industrial starts, while retail starts declined.
- Headline rents are seen increasing over the next three months, as seen in Chart 2, but at a slightly more modest pace than in previous quarters. However this is somewhat nuanced, as office rents are expected to increase at a similar pace to previous quarters while rents on industrial and retail properties are expected to be little changed over the next three months.
- Over the next year, both office and industrial rental values are seen rising. Chart 6 shows that forecasts for prime office and industrial rents were revised higher from Q2.
- Respondents continue to overwhelmingly see the market at its peak, with 87% holding this view. The share of respondents that have said the market was at its peak has been above 50% every quarter since 2015.

Investment Market

- The Investment Sentiment Index (an amalgamated measure of investment market indicators) was relatively stable at +24 in Q3 from +25 in Q2 (Chart 1), indicative of a continued expansion in investment market momentum.
- Headline investor interest increased at a quicker pace in Q3 than in Q2. This was largely driven by a pick-up in interest in industrial properties. Meanwhile, foreign investment demand increased in Q3 across all market segments (office, industrial, retail).
- Respondents highlighted tighter headline supply in Q3. All three segments of the market saw the supply of properties for sale contract in Q3, though to a lesser degree than in Q2.
- Chart 3 shows credit conditions remained neutral, with more than 60% (64%) reporting no change in conditions as has been the case for the past three quarters.
- Valuations continued to be seen as above fair value, with 82% of contributors saying that they were expensive to some degree. At least 60% of respondents have said that valuations have been above fair value to some degree every quarter since Q1 of 2015. This perception of valuations is even more acute in Tokyo.
- Headline capital values are expected to rise over the next three months (Chart 2) and the next year. Although all segments of the market are expected to see values increase, industrial properties are expected to have a particularly strong quarter.
- As shown in Chart 5, capital values are expected to increase by 1% over the next year. However this growth is expected to cool slightly to 0.8% annually over the next three years.

Commercial Property Market

Chart 1: Occupier, Investment Sentiment Indexes

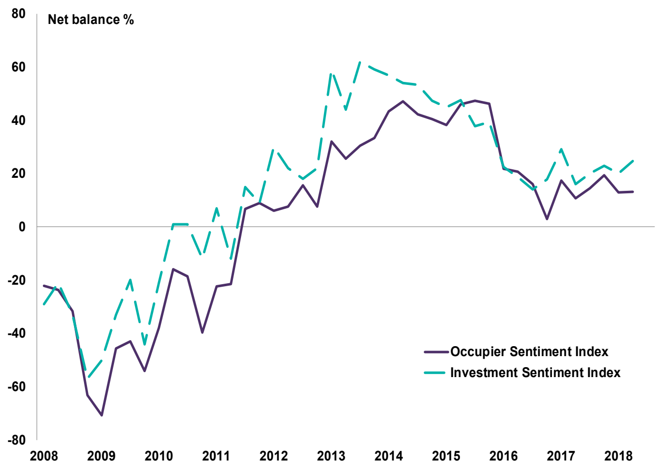

Chart 2: 3-month Rents, Capital Values

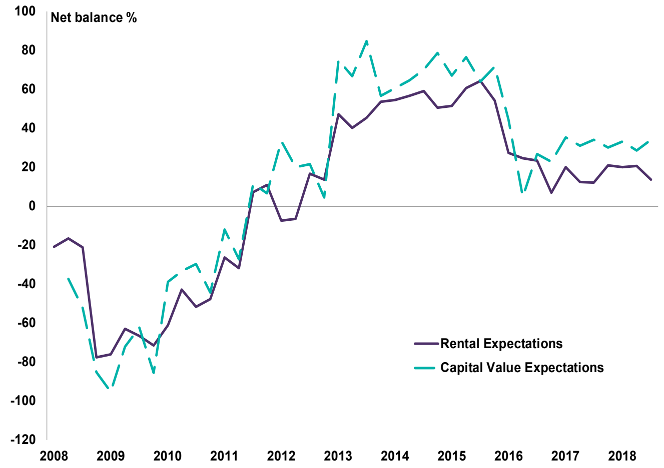

Chart 3: Credit Conditions

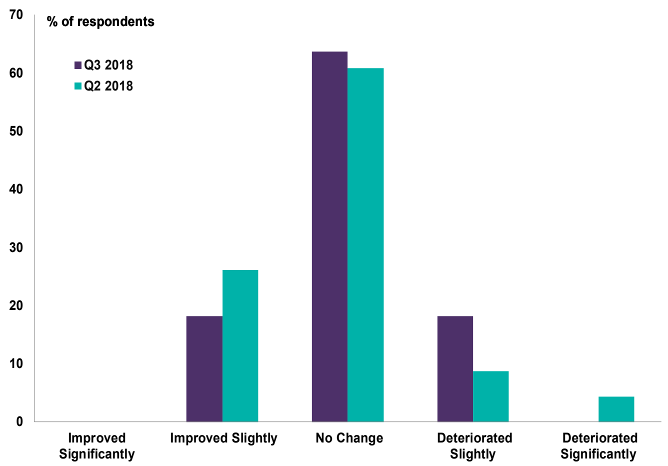

Chart 4: Valuations

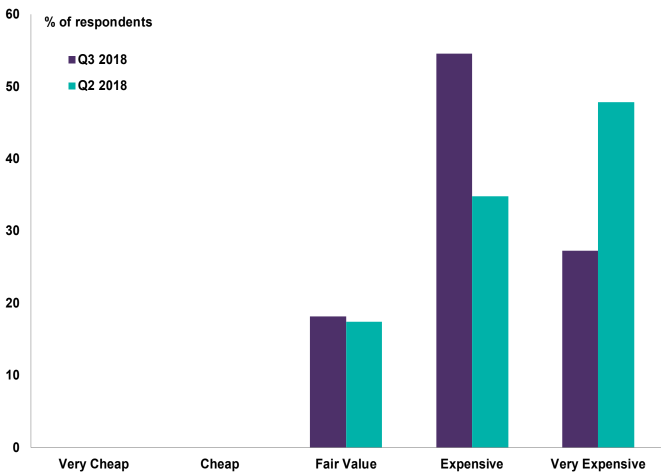

Chart 5: 12-month Capital Values Forecast

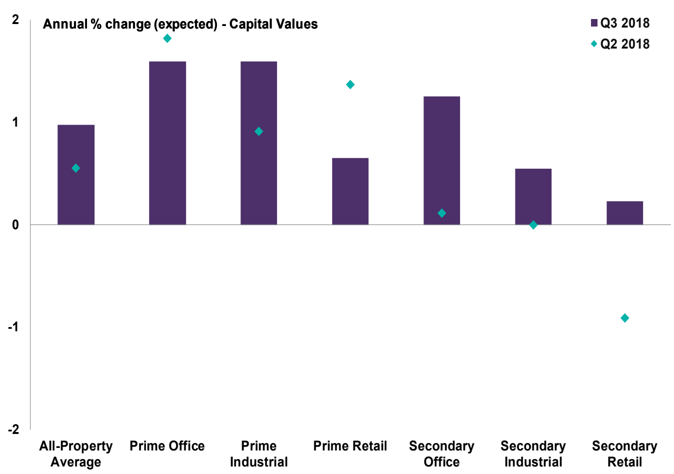

Chart 6: 12-month Rent Forecast

Information

Global Commercial Property Monitor

RICS' Global Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets. The report is available from the RICS website www.rics.org/economics along with other surveys covering the housing market, residential lettings, commercial property, construction activity and the rural land market.

Methodology

Survey questionnaires were sent out on 13 September 2018 with responses received until 14 October 2018. Respondents were asked to compare conditions over the latest three months with the previous three months as well as their views as to the outlook. A total of 1791 company responses were received, with 341 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland. Responses for Spain and Portugal were collated in conjunction with Iberian Property. Responses for New Zealand were collated in conjunction with Property Council New Zealand. Responses for Malaysia were collated in conjunction with the Royal Institution of Surveyors Malaysia.

Responses have been amalgamated across the three real estate sub-sectors (offices, retail and industrial) at a country level, to form a net balance reading for the market as a whole.

Net balance = Proportion of respondents reporting a rise in a variable (e.g. occupier demand) minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%). Net balance data can range from -100 to +100.

A positive net balance reading indicates an overall increase while a negative reading indicates an overall decline. The RICS Occupier Sentiment Index (OSI) is constructed by taking an unweighted average of readings for three series relating to the occupier market measured on a net balance basis; occupier demand, the level of inducements and rent expectations. The RICS Investment Sentiment Index (ISI) is constructed by taking an unweighted average of readings for three series relating to the investment market measured on a net balance basis; investment enquiries, capital value expectations and the supply of properties for sale.

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