

JAPAN INDUSTRIAL PROPERTY MARKET OVERVIEW

MACRO ECONOMY IN JAPAN

Overview

The Japan's economy has been on a recovery phase, although the global economy is under downward pressure due to Russia-Ukraine war, China's COVID-19 policy, global inflation, and rising interest rates.

Russia-Ukraine war has caused energy and food prices to soar, and China's lockdowns disrupted production and logistics supply chains, affecting global production and consumption. However, supply constraints waning with the lifting of the urban blockade. The Federal Reserve Board ("FRB") raised its policy rates to combat inflation, while the Bank of Japan ("BOJ") aims to keep its accommodative monetary policy, and the differences in monetary policy between the United States and Japan caused the yen to weaken significantly. As there will be a new governor of BOJ in April of 2023, a review of the monetary policy by the new governor is anticipated.

Individual Economic Activities

For Japan's individual economic activities, consumer spending recovered, while the lifting of restrictions on activity due to the spread of COVID-19 in March 2022 helped to restore daily life, and service-related activities such as dining out and lodging boosted overall consumer spending. In addition, the annual retail sales value was increased by 2.6% y-o-y in 2022. Retail sales growth has been significant in the E-commerce sector. Many retailers have outsourced their logistics to third parties to focus on their main businesses, resulting in third-party logistics ("3PL") providers benefitting. In particular, the E-commerce retailers are strong contributors for 3PL providers.

Manufacturing Industry

The corporate production activities were stagnant due to the shortage of material supply because of China's lockdowns, but they have picked up as supply constraints have eased with the lifting of the urban blockade. Japan's manufacturing industry, led by the automotive sector, accounts for roughly 20% of total GDP and is one of the most important industries in the economy. The Industrial Production Index, which represents the production activity of the manufacturing sector, declined in 2020 due to the impact of COVID-19, however, it began to grow in 2021 supported by the strengthening western economies. Expansion of the manufacturing sector is expected to boost the growth of the logistics market, by the increase in the transport volume of raw materials and semi-products, as well as the demand increase in storage. However, according to Oxford Economics, Industrial production is expected to fall 4.9% in 2022 while exports and imports are likely to rise 4.8% and 7.4%, respectively. Downside risks include a decline in exports due to the global economic slowdown and supply-side constraints.

GDP and CPI

In 2020, COVID-19 caused a significant negative growth, pulling down the nation's economy by 4.3% from a year ago, while the real GDP rose by 2.2% in 2021. The real GDP growth in the second quarter of 2022 was 4.5% on an annualized basis due to the recovery in private consumption and fixed investment, while a slight decline in third quarter of 2022 because of a significant increase of imports. According to Oxford Economics, it is expected to rise continuously by 1.3% in 2022.

CPI is relatively high, above 2%, in the short run due to the effects of a pass-through to consumer prices of cost increases led by a rise in import prices. According to the BOJ, the rate of increase is expected to decelerate toward the middle of fiscal 2023 due to a waning of these effects, as well as to the effects of pushing down energy prices from the government's economic measures.

INDUSTRIAL MARKET ENVIRONMENT

Modern Logistics Facilities

Prior to the introduction of modern logistics facilities in the early 2000s, traditional warehouses were the only choice of venue for storage and distribution in Japan. These warehouses were mostly owner-occupied and leasing opportunities were scarce.

Sophisticated tenants are increasingly attracted to modern logistic facilities over conventional facilities, as modern logistics facilities offer a variety of advantages, including: (i) leasing opportunities, (ii) multi-purpose uses of facilities with high-specifications, (iii) adequate seismic standards in construction for business continuity plans, and (iv) inclusion of amenities and good working environments.

COVID-19 has accelerated the changes of these trends in the logistics industry, leading to the continuous expansion of the demand for modern logistics facilities.

Modern logistics facilities accounts for only 12% of the total logistics supply in Japan, implying a potential of expansion in the future. Modern logistics facilities are mainly located in major urban regions, such as Greater Tokyo and Greater Osaka, while the regional areas have a limited quantity of modern facilities. The share in the Greater Nagoya and Greater Fukuoka is much smaller, as the number of new developments in these cities has been limited.

Fundamentals of Logistics Real Estate Market

Demand for logistics facilities has been expanding continuously, supported by the buoyant E-Commerce ("EC") market. In addition, the suspension of production activities in China in 2020 due to COVID-19, shortage of semiconductor and other supplied parts in 2021, as well as supply chain disruptions due to China's lockdowns in 2022, have made corporations more wary of the risk of supply chain disruptions. This has thus created a stockpiling effect, where companies now invest in additional inventories in case of unexpected situations, causing a short-term spike in demand. This may also result in a review of their supply chain, including the relocation of their logistics facilities to a more efficient warehouse. There is a high possibility that modern logistics facilities, which can be secured quickly with little initial investment, is selected. It is considered that this leads to an increased demand for modern logistics facility as well.

Although uncertainty continues to persist due to China's COVID-19 policy, Business-to-Business ("B2B") logistics is expected to continue to recover as well. As for the private sector, consumption of groceries and daily necessities has been steady, and the expansion of online shopping has continued, leading to a rise in deliveries and number of courier services. In particular, demand for modern logistics facilities remains strong, and vacancies remain low, although there are some properties which need more lease-up periods. The trend to install automated and labour-saving equipment continues, and demand for modern logistics facilities is expected to continue to grow.

Stock and Supply Analysis

In Japan, the total space of logistics facilities is approximately 547 million sqm, mostly concentrated in the Greater Tokyo, Greater Osaka, and Greater Nagoya regions. Approximately 52% of the total space is concentrated in these three regions, with 29% in Greater Tokyo, 16% in Greater Osaka and 7% in Greater Nagoya.

In Greater Tokyo, divestment of owner-occupied facilities for off-balance-sheet purpose and the shift in demand for modern logistics facilities have resulted in an increase in for-lease facilities. On the other hand, in Greater Osaka and Nagoya, as many facilities are owned by manufacturers and logistics companies, the increase of the share of for-lease facilities remained smaller than the ones in Greater Tokyo. In the long run, business expansion of EC firms and increases in outsourcing to 3PL service providers are expected to increase the demand for rental modern logistics facilities, lifting up its share in Greater Osaka and Greater Nagoya.

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Key Drivers of Demand

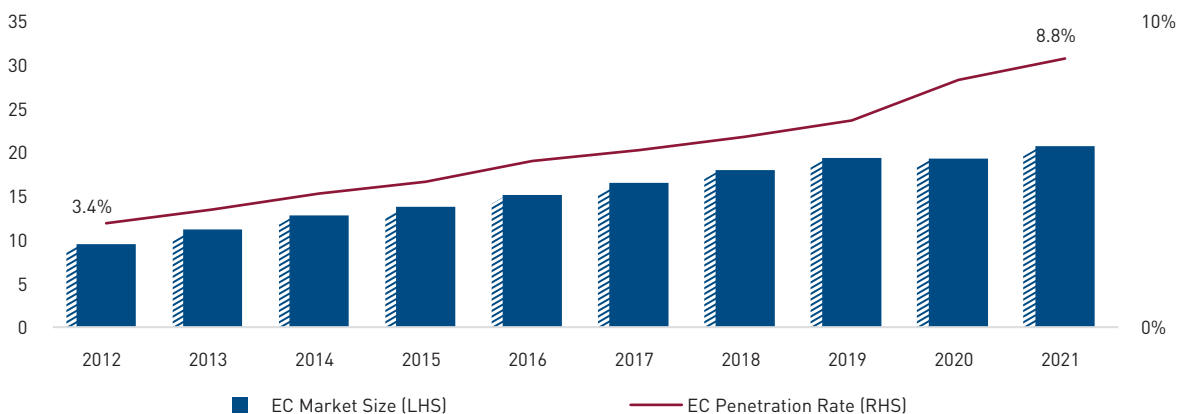
E-commerce ("EC")

In general, EC firms require large-scale logistics facilities to store and manage the large amounts of inventory in order to respond to online orders from across Japan. The Business to Consumers ("B2C") EC industry has grown at rate of 9.02% from 2013 to 2021 (worth approximately 21 trillion yen). The sales of B2C EC slightly declined in 2020, because of the contraction of consumption on services such as travels etc., due to COVID-19. However, EC has been continuously boosting the demand for modern logistics facilities, mainly driven by the expansion of product sales services. As a result, the sales of B2C EC in 2021 have increased by 7.4% y-o-y.

Although EC continues to grow at a fast pace on a global basis, traditional convenience store and drug store formats remain popular in Japan, slowing the dissemination of EC. However, this is changing, as some customers have shifted to on-line shopping from face-to-face shopping due to the COVID-19 restrictions. The number of people has increased to utilize EC. The EC penetration rate or EC rate has been increased to 8.8% in 2021 from 8.1% in 2020. The EC rate in Japan is still lower than that of other countries such as the US, UK, and China, 15%-30%, which indicates high growth potential.

B2C E-Commerce Market

JPY trillion



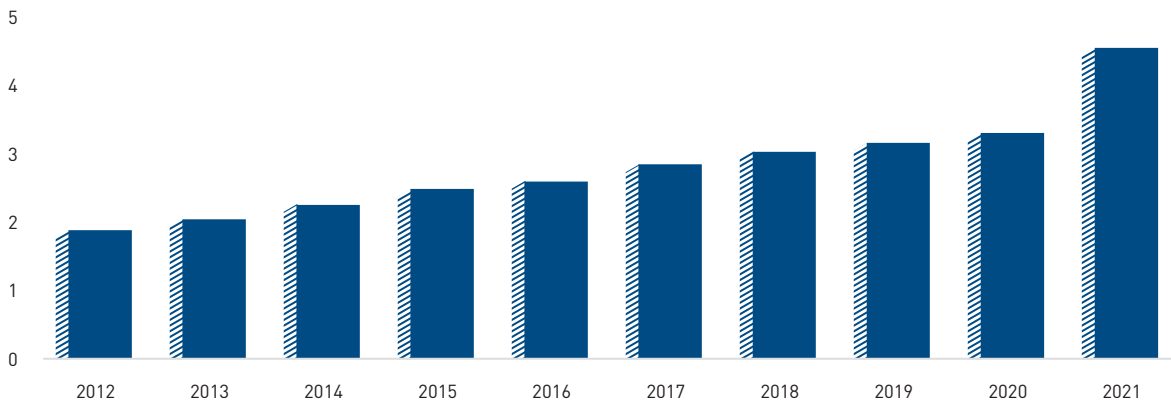
Source: Ministry of Economy, Trade and Industry

3PL

As retailers and manufacturing firms are under pressure to reduce costs and invest more capital into their core businesses, the outsourcing of logistical operations to 3PL companies has been growing in popularity. They also tend to have higher building specification requirements, such as heavier floor loads and taller ceiling heights, that are compatible with various inventory types. The recovery of B2B from the impact of COVID-19 and the continuous growth of the EC market are supporting logistics demand from this segment of customers. In addition, as rising logistics costs such as truck freight, labour costs, and fuel costs are included in transaction volume, 3PL companies' sales have grown significantly with an increase of 37.7% y-o-y in 2021.

3PL Sales

JPY trillion



Source: Ministry of Economy, Trade and Industry

Rising Operational Costs in the Logistics Sector

Structural shifts in the retail industry driven by the popularity of convenience and drugstores, as well as the expansion of EC, has resulted in a corresponding pickup in the number of deliveries. The increasing costs, particularly labor costs, are attributable to: (i) aging workforce; (ii) increased work strain from higher-frequency deliveries and re-deliveries; and (iii) reduced competitiveness to attract truck drivers from other sectors.

The increase in logistics operational costs has become an issue for many firms, encouraging them to review their existing logistics facility locations and develop more efficient operational strategies. As a result, the cases of consolidation of multiple facilities to a single large facility and/or relocation to facilities suitable for high-frequency deliveries and warehouse works have been increasing. Furthermore, in order to deal with high volume deliveries and structural shortages of labor force, logistics firms increasingly install automated machines and systems. The increase in the usage of automated machines in logistics facilities is prompting the need for more electric capacity and large-floor plate facilities. Older logistics facilities often provide limited electric capacity with small floor plates, as a result, demands are shifting towards modern logistics facilities.

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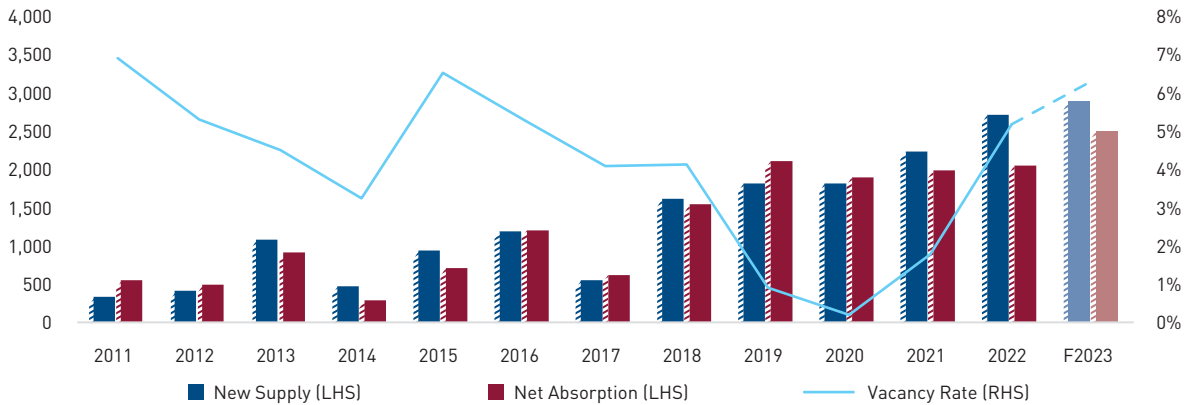
Greater Tokyo

In Greater Tokyo, the large amount of new supply with over 2 million sq m continues since 2021. The new supply is scheduled mostly in inland areas, which accounts for about 70% of the total supply in Greater Tokyo, as there are limited available land for acquisition in bay areas. Although there are strong demands, new supply far exceeding new demand in 2021 and 2022. As a result, the vacancy increased moderately to 5.2% in 2022. The increases of vacancy in Tokyo Bay area, Kanagawa Bay area, and Kanagawa Inland area were pushing up the overall vacancy rate. Some new logistics facilities located far from the centre of Tokyo may remain vacant upon the completion, and it often takes about one year after completion for full occupancy. The length of leasing-up period tends to be longer.

Although the demand is expected to increase significantly, more new supply is expected in 2023. The vacancy rate may continue to rise over 6% in 2023. Thereafter, the supply-demand balance is projected to remain tight, and vacancy rates will hover around the 5–6% range. However, the rent is expected to continue to increase moderately supported by the strong demand.

Greater Tokyo — New Supply, Net Absorption and Vacancy Rate

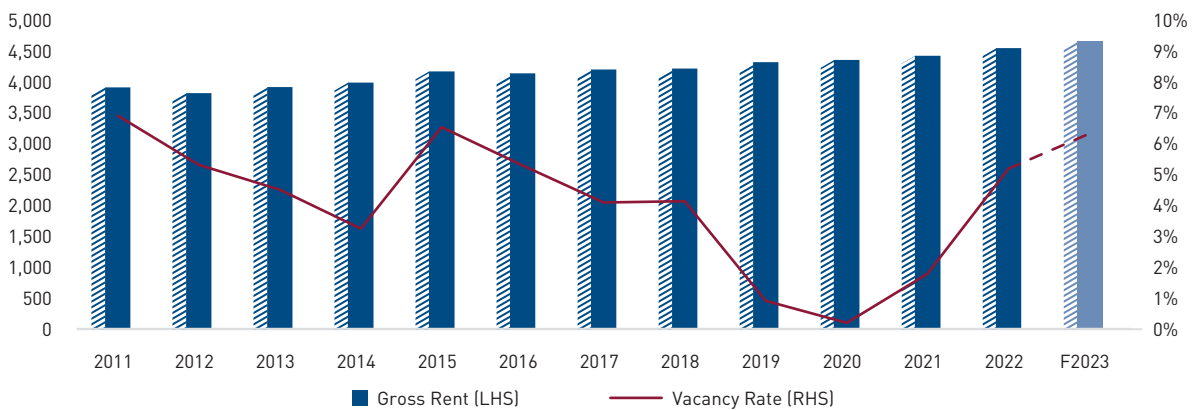
1,000 sq m



Source: JLL

Greater Tokyo — Rent and Vacancy Rate

JPY/tsubo/month



Source: JLL

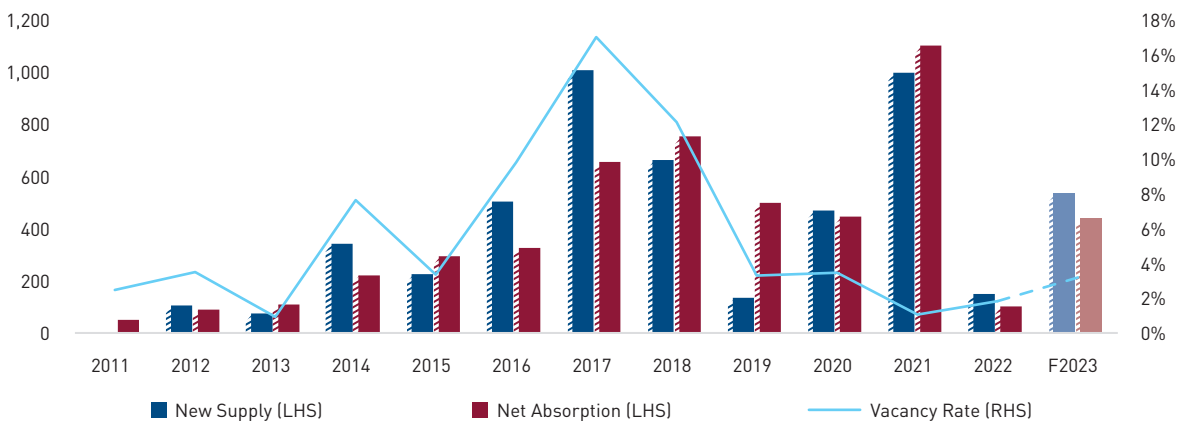
Greater Osaka

Until 2017, the stock of logistics facilities in Greater Osaka area was mostly located in the bay area. However, as infrastructure improvements create favourable access to East Japan and can more easily attract workers. In the past several years, more new supply has been shifting towards the inland areas. Same as the other regions, areas for development of logistics facilities have been expanding. In Greater Osaka, logistics companies and 3PL are more likely to locate in the bay area, while EC and retail companies tend to be more prevalent inland area. The large EC company, JP Rakuten Logistics, Inc., will be the single tent of the modern logistics facilities in Yao city, with the completion in 2023.

Although there was second largest supply with approximately 1 million sq m in 2021, demand exceeded the supply and the vacancy declined to 1.1%. As the amount of new supply in 2022 was limited, tight supply-demand balance kept the vacancy rate low at 1.8%. However, the vacancy rate might go up with the new supply in 2023, with 500,000 sq m. Since the rents in the inland area tend to be higher than those in the bay area, overall rent in Greater Osaka has been going up. Going forward, vacancy rate is expected to remain lows and rent continues to increase moderately.

Greater Osaka — New Supply, Net Absorption and Vacancy Rate

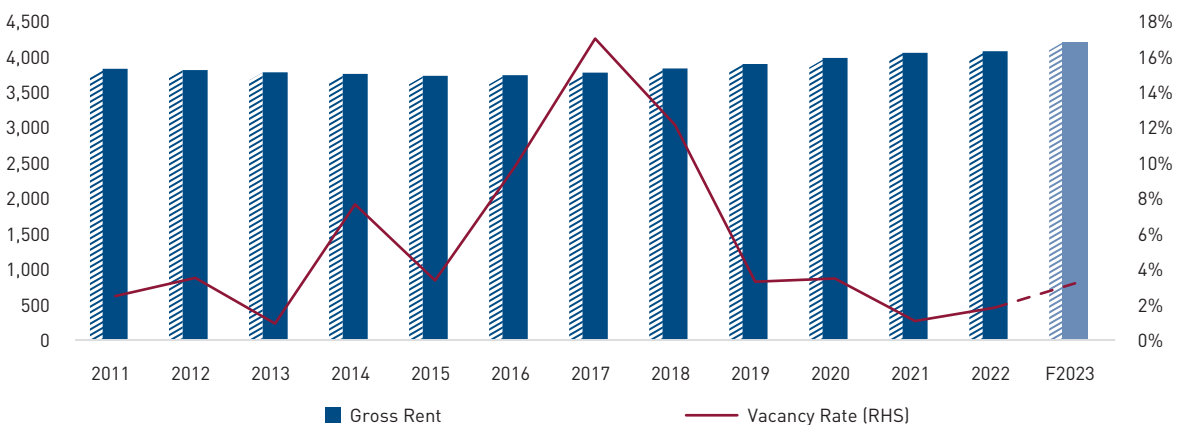
1,000 sq m



Source: JLL

Greater Osaka — Rent and Vacancy Rate

JPY/tsubo/month



Source: JLL

JAPAN INDUSTRIAL PROPERTY MARKET OVERVIEW

Greater Nagoya

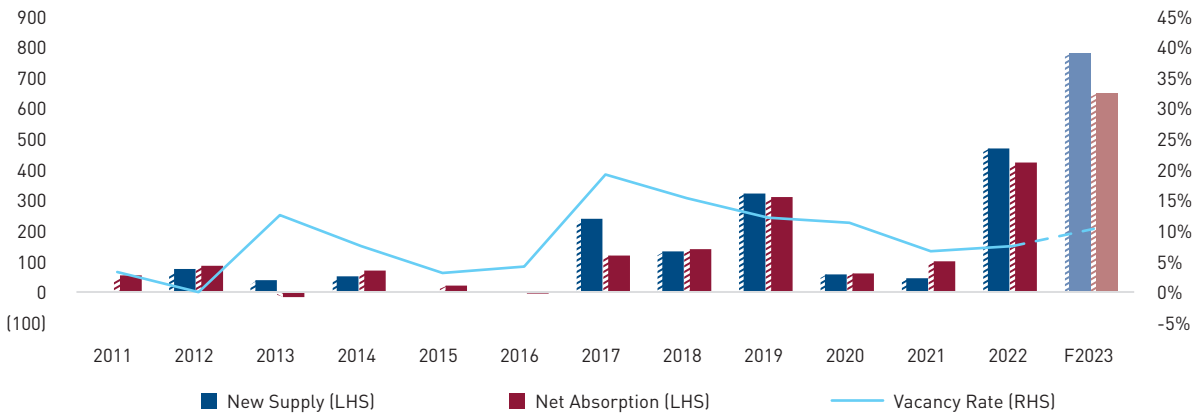
In Greater Nagoya, the manufacturing industry is highly developed, mainly with the automotive industry led by Toyota Motor Corporation. The Nagoya Area is important hub in the expressway network to connect Greater Tokyo and Greater Osaka. Along with the increase of available routes to the Port of Nagoya and Isewangan Expressway, the accessibility to wider areas has improved. With the opening of the Ise Bay Highway and the New Meishin Expressway, access to central Nagoya and wider areas has improved. The demand for logistic facilities is expanding to the Bay Area, while it used to be mostly in inland areas.

In Greater Nagoya, many manufacturing and logistics companies own their logistics facilities, while the number of modern logistics facilities is limited, compared to Greater Tokyo and Greater Osaka. The size of stock of modern logistics facilities in Greater Nagoya is relatively small and overall rent is easily impacted by new supply. As the rent for new properties is higher than that of existing properties, overall market rent in Nagoya has been rising.

Similar to Greater Tokyo and Greater Osaka, supply-demand balance is not expected to deteriorate significantly due to strong demand. It is expected that a large amount of new supply in 2023, 780,000 sq m, may raise vacancy to around 10%, however, vacancy rate may go down to around 6.7% in 2024 supported by a strong demand. The rent is expected to continue to increase.

Greater Nagoya — New Supply, Net Absorption and Vacancy Rate

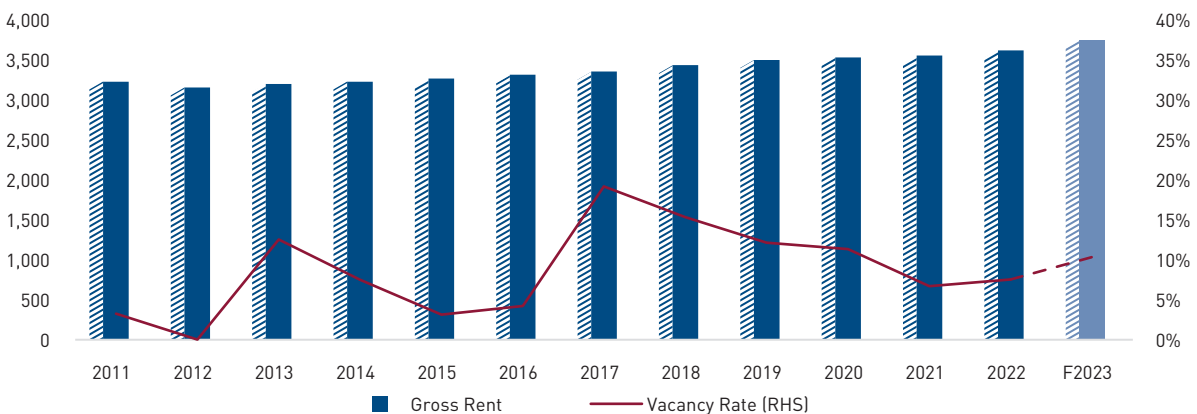
1,000 sq m



Source: JLL

Greater Nagoya – Rent and Vacancy Rate

JPY/tsubo/month



Source: JLL

Greater Fukuoka

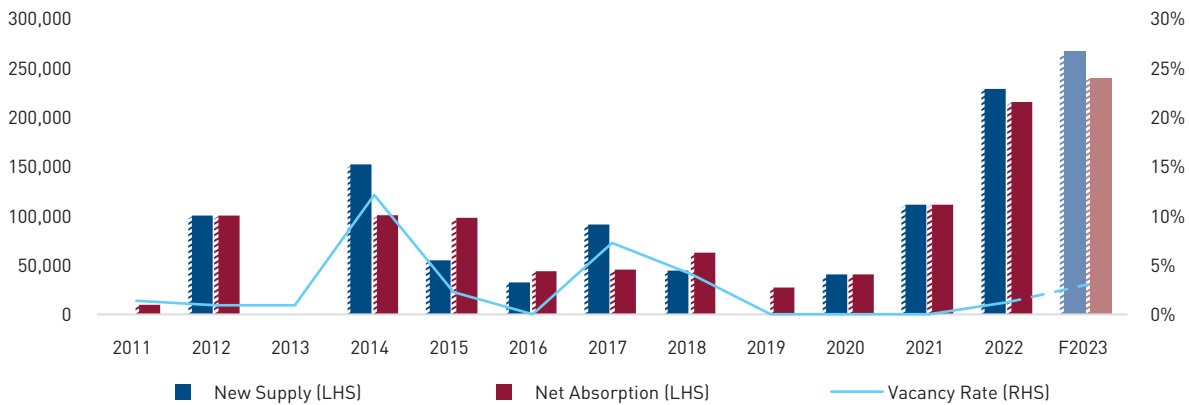
The logistics facilities are concentrated in northern Kyushu. Fukuoka prefecture has important rolls for all logistics routes, including the Port of Hakata and Fukuoka Airport, in addition to the Kyushu Expressway connecting to the Chugoku region. Fukuoka Prefecture accounts for 40% of the population in the Kyushu region, and Fukuoka City and Kitakyushu City are also important consumer destinations.

For the development of the large-scale logistics facilities, they used to be mainly by foreign funds, however, increased number of domestic real estate companies are also active nowadays. As available land for the development of logistics facilities is very limited, it also causes rental to increase in Greater Fukuoka. Similar to other regions, the moderate rental increase is expected to continue.

In Greater Fukuoka, the logistics facilities are used as logistics bases for manufacturing companies to serve entire Kyushu region and as distribution centres of convenience stores and supermarkets to cover Fukuoka City and northern Kyushu. Tenants include large companies with nationwide operations and local logistics companies, whose home-base is Kyushu etc. Although there are many multi-tenant logistics facilities, some of them are furnished rampways, and most of them are box-shaped and/or with slope. There is large new supply in Greater Fukuoka in 2022 and 2023 with 230,000 sq m and 270,000 sq m respectively, however, the vacancy rate remained low at 1.3% in 2022 and will slightly rise to 3.0% in 2023, however, it is still below 5%.

Greater Fukuoka — New Supply, Net Absorption and Vacancy Rate

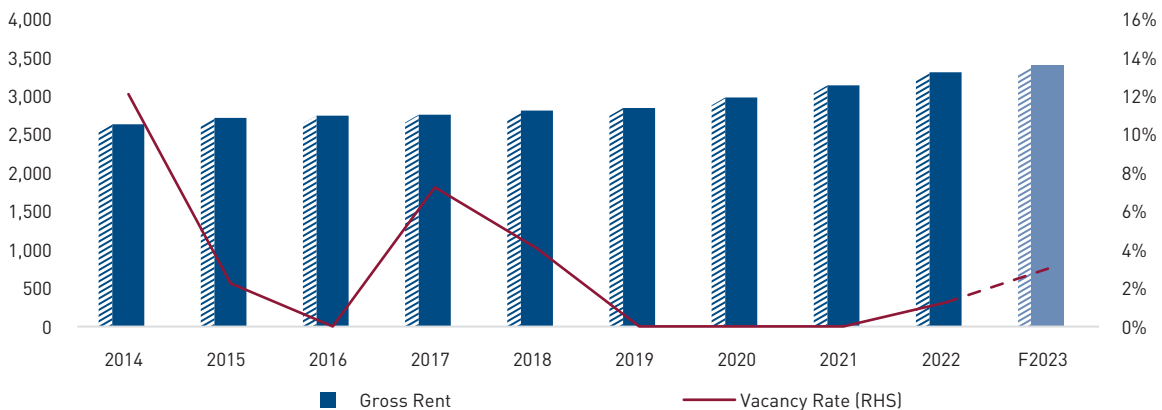
sq m



Source: JLL

Greater Fukuoka – Rent and Vacancy Rate

JPY/tsubo/month



Source: JLL

JAPAN INDUSTRIAL PROPERTY MARKET OVERVIEW

The restriction on number of overtime-working hours in 2024

Starting April 1st, 2024, truck drivers in Japan will be subject to a limit on the maximum number of overtime-working hours within a year, maximum to 960 hours. In addition, truck drivers can drive continuously 4-hour, however, they must take certain amount of time to rest during its driving hour. This restriction might have some impact on the transportation and logistics industry, such as decline in profit for transportation and logistics companies due to an increase in transportation fee paid by consignee, decrease in driver's income due to the shortage of working hours etc. In order to address these issues, companies may need to find solutions such as improving their working conditions, and investing in technology to increase efficiency etc. In addition, the development of logistics facilities in regional areas, where to reach the end consumers, might be widely selected across Japan.

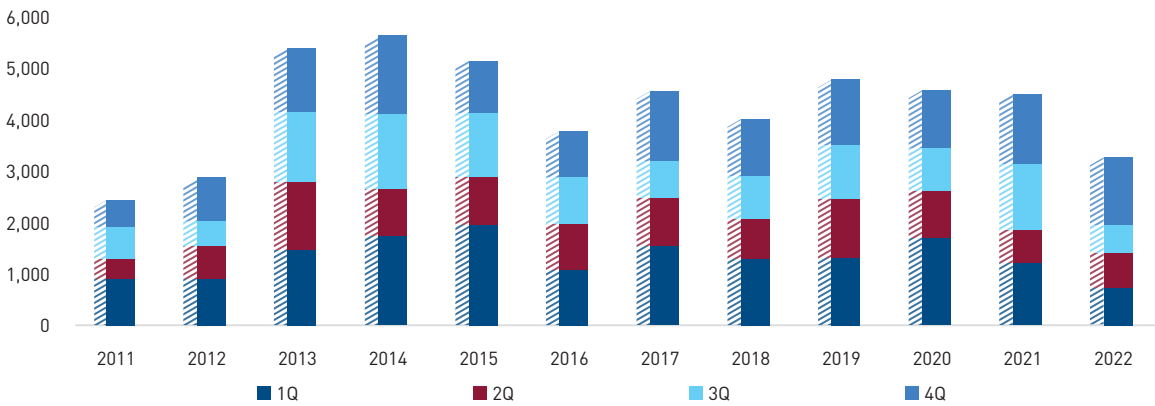
LOGISTICS INVESTMENT MARKET Sales Transaction

In terms of real estate investment and real estate development, logistics demand has been growing. Many investors have expanded their investment in logistics real estate and more developers have started development, as logistics assets are considered to offer a longer-term stable income attributing to the EC market growth. Many domestic and foreign players have been increasing their investment in logistics facilities. Investors' interests for large-scale modern logistics facilities with high specification in superior locations remain continuously strong. This has resulted in the continued rising prices of logistics real estate.

The decline in the number of transactions by J-REITs in 2022 resulted in the lower annual investment volumes compared to 2020 and 2021. Due to the limited number of investment opportunities and the strong investors' demands for high-quality logistics facilities, the logistics acquisition market has become competitive. As a result, transaction volume declined by 35% y-o-y in 2022.

All Sector Transaction in Japan

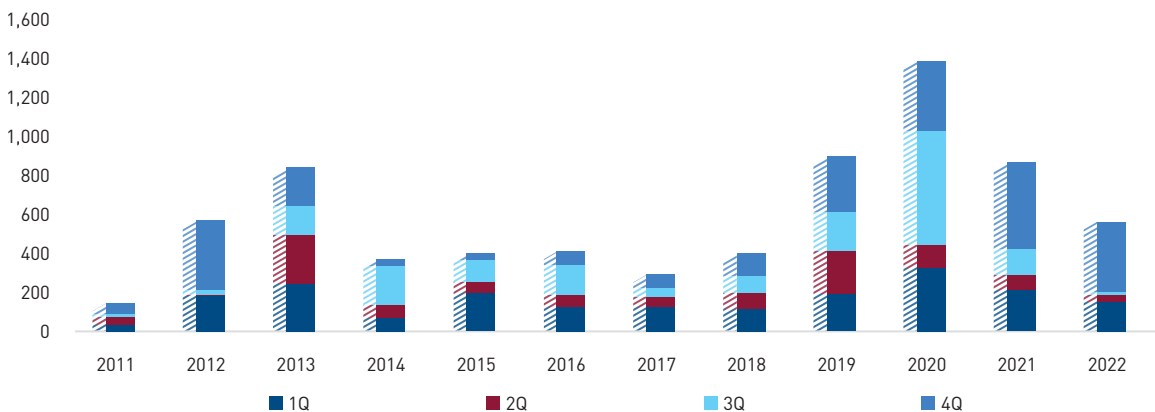
JPY billion



Source: JLL

Industrial Transaction in Japan

JPY billion

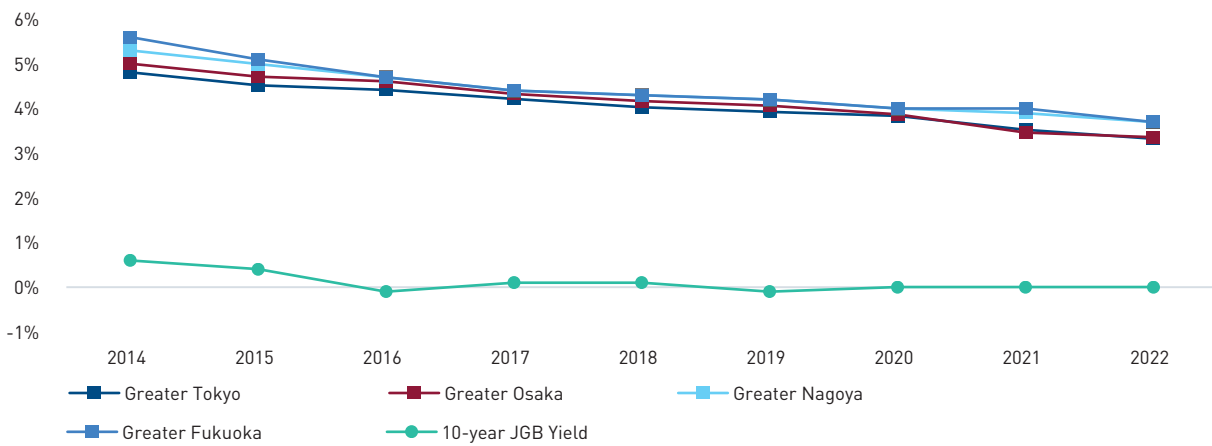


Source: JLL

Capitalisation Rate

The chart shows the capitalisation rate (“cap rate”) trend of logistics sector across Japan. The cap rates have continuously compressed over the years in all areas. The attention to logistics facilities from domestic and foreign investors has further increased, as the logistics sector is considered as a stable investment target due to its stable income under the COVID-19 situation supported by the buoyant EC market, in contrast to the office sector which was severely affected by the pandemic. Reflecting such strong investor demand, cap rates of logistics facilities in Greater Tokyo and Greater Osaka have been largely compressing, at lower 3%, and its trend is continuing. As a result, the cap rates of logistics facilities across Japan are compressing.

Cap Rates



Source: JLL, Oxford Economics

OUTLOOK

Japan’s economy is on the moderate recovery phase, however, there is a downside risk due to the downward pressure of global economy. It has been the favorable financial environment with low financing costs in Japan, as the BOJ keeps its accommodative monetary policy. However, a review of the monetary policy by the new governor of the BOJ is anticipated.

As for the logistics market, the demand of modern logistics facilities will remain strong supported by the buoyant EC market. The leasing-up period tends to be longer because of the large new supply, especially in Greater Tokyo. The areas for the development of logistics facilities expand in the most of regions across Japan. The strong investment appetite for modern logistics facilities continues and leads to rise its price and to compress cap rate. These trends on logistics sector in Japan likely continue.