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Japan

May 2024 • perenews.com

Looking up: Investors stay positive at the end of an era

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KEYNOTE INTERVIEW

Strong foundations support growth in Japan

A steady economy and record occupier demand for Japanese logistics put the sector in a strong position for the future, say Joshua Olsan and Hiroshi Takizawa

Japan is sometimes unfairly characterized as a static market, due to low GDP growth and its often-slated domestic outlook. However, the logistics real estate market is supported by a number of key drivers, including consolidation and modernization efforts, which means occupier demand will remain strong regardless of the country's aging population.

Indeed, changes in legislation could lead to new growth levers for the sector, which remains popular with domestic investors and overseas players alike, say Unified Industrial founder Joshua Olsan and Japan chief investment officer Hiroshi Takizawa.

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Q Has occupier demand for Japanese logistics been strong?

Joshua Olsan: CBRE estimates there was more than 36 million square feet of logistics space absorption in the major metropolitan areas in greater Tokyo, greater Nagoya, greater Osaka and greater Fukuoka in 2023. That is a record number.

Some of that demand came from occupiers trying to get ahead of changes in labor law legislation, some of it has been driven by reshoring and some of it is part of the ongoing measures to move supply chains from "just-in-time" to "just-in-case," which has created more demand for warehouse space.

Q What are the most important demand drivers for Japanese industrial and logistics real estate in the current market?

JO: The first important driver is consolidation and modernization. This has been going on for 20 years, but it is still a key driver of demand. There is still a lot of older space which is not suitable for current usage. This means primarily a move from smaller facilities to larger ones, but modern space also offers better floor to ceiling heights, suitability for automation, facilities and energy efficiency.

As an example of this, we are developing a project in Shiga Prefecture just outside of Kyoto, where Nippon Express will take almost 650,000 square feet of space and consolidate three facilities into that one.

The next thing is e-commerce, which is happening in Japan as it is everywhere else, but slowly. E-commerce is around 9 percent of the retail market in Japan, compared with 15 percent in the US and more than 25 percent in China.

However, Japan is the third largest in terms of the amount of goods transacted online so that obviously translates into substantial demand for facilities to serve e-commerce.

On the industrial side, Japan is reshoring like many other manufacturing nations, and that is leading to very large factories being built which will, in time, generate demand for logistics to facilitate the supply chain of those goods.

Finally, a new development is a change in Japanese labor laws designed to boost the welfare of truck drivers, as well as other workers. From April 2024, drivers will be limited to 960 driving hours a year, and that will be further reduced in time.

Given a tight labor market, this will create new issues for logistics companies.

They may need to relocate facilities in order to reduce the distance and therefore the time driving, or they will have to increase efficiencies with greater loads each time. We are seeing increased use of larger trucks and the emergence of tandem tractor trailers.

At the moment, most of Japan's logistics is carried out with trucks, but not the big tandem tractor trailers you see in the US or Europe. Moving to larger vehicles will push demand for warehousing that can cope with them.

Q Are these changes going to drive demand for different types of logistics space?

JO: Japan already has multi-story warehouses but many of these may not be suitable for larger trucks. There will be design changes but the process will be slow. At present, only a small percentage of large third-party logistics companies are using them.

Hiroshi Takizawa: Japan's very tight labor market is also creating demand for added facilities, such as worker amenities, in logistics facilities. It has become hard to recruit workers for warehousing because it is hard work and the supply of labor is limited.

So, employers have to provide extra amenities for their workers, such as a cafeteria, childcare facilities, lounges where workers can relax or truck drivers take breaks and even convenience stores for workers, as the warehouses may not be located in areas with many stores. Measures such as these to attract and retain staff are very important for logistics companies and a priority for their managers.

The labor shortage also means automation will become more prevalent in warehouses to reduce the number of workers that are needed; more logistics operators are looking at the use of robotics, although adoption is limited. This is leading to certain changes in requirements for logistics warehouses, such as more floor loading capabilities and higher ceilings.

Q Which city markets offer the best prospects?

Joshua Olsan: The Greater Tokyo and Greater Osaka markets always have strong demand. Tokyo is still growing through internal migration and there are about 38 million people, so the consumer demand for e-commerce is very strong. Osaka has around 18 million people, so similarly has a strong weight of demand, while Nagoya has 11 million people and is also one of the largest manufacturing locations in Japan, as it is the home of Toyota and Mitsubishi Heavy Industry, for example.

You also have to remember that consolidation and the modernization story is still relevant: only 25 percent of the logistics stock in Tokyo can be considered modern. Meanwhile, newer markets are emerging.

For example, to the northeast of Kyoto is Japan's largest lake, Lake Biwa. There is a lot of manufacturing there because of all the water from the lake, but it has been really underserved by logistics and there is pent-up demand.

Q What are the most important supply drivers for Japanese logistics and is there a risk of oversupply?

JO: There are now around 100 developers of logistics property in Japan. As well as sector specialists, we have seen residential developers, hotel developers and retail developers get into the market, especially during covid when their core business might have been restricted.

Those developers have added to supply, but it is often the wrong spec or the wrong location, so some are experiencing difficulty with leasing. Therefore, we see forecasts for future vacancy rates being overstated as a lot of new players have shelved projects due to rising construction costs, and there is strong demand on top of that.

HT: The sharp increases in construction costs over the past three years have also contributed, because some developers bought land and now the cost of construction is too high. Construction costs began rising due to covid and then kept on rising due to the conflict in Europe and unstable supply of many materials. Japan sources a lot of steel and concrete from overseas.

As well as this there has been huge competition for both construction materials and construction companies from the private sector for manufacturing plants and also government infrastructure works.

Another factor is that the construction sector has been suffering labor shortages like other industries. This shortage is especially notable for experienced workers and skilled tradespeople such as mechanical and electrical engineers. All of this means that construction costs have risen 20-30 percent over the past few years.

Q Are you concerned about a possible rise in Japanese interest rates?

JO: Some of the foreign investors we talk to are worried that Japan will inevitably follow the US and Europe: interest rates will go up and real estate will be hard to refinance. However, we are not seeing that.

We talked to all the major banks here and the consensus is that the Bank of Japan will move from negative interest rates to normalization and that interest rates will rise 10-30 basis points at the short end, maybe to 1 percent at the long end. That means there will still be a positive carry.

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JOSHUA OLSAN

"Automation will become more prevalent in warehouses to reduce the number of workers that are needed"

HIROSHI TAKIZAWA

Q Have investors maintained their interest in the sector?

HT: Domestic investors, especially Japanese real estate investment trusts, do not share overseas investors' concerns about interest rates and have been major buyers of logistics, especially the private REITs. A lot of Japanese companies, including contractors, regional banks and other private companies, have set up their own private REITs. We are not sure exactly how many of these vehicles are out there, but I have heard 20-30 names of companies in just the past few months which have set them up for real estate investment.

JO: CBRE's most recent investment intentions survey has Japan top of the list for Asia-Pacific investors, for the fifth consecutive year. And Japan has been a favored market for overseas investors for several years.

However, even though there has been a lot of capital raised for Japan, there is some uncertainty from foreign investors and some of them might be more focused on unwinding positions elsewhere in their portfolios. For that reason, I think it will be slow this year from their side.

That said, we are starting to see more overseas investor enquiries and interest compared to last year. And if US interest rates are cut this year, as is being predicted, that will allow global investors to work through their overseas positions and potentially get back to investing in Japan. ■