Briefing
Office sector

Q4 2014

Image: Marunouchi, Chiyoda Ward

SUMMARY

Strong momentum in the occupier market fed the rental recovery, with Grade A office rents increasing approximately 9.0% year-on-year (YoY).

- The average Grade A office vacancy rate in Tokyo's central five wards improved by 0.3 percentage points (ppts) in Q4 and a sharp 2.7 ppts YoY to 3.2% – its lowest fourth-quarter reading since 2008.

- Strong momentum in the occupier market fed the rental recovery, with Grade A office rents increasing 1.7% quarter-on-quarter (QoQ) and a robust 9.0% YoY.

- The average vacancy rate for large-scale Grade B offices similarly drifted downwards to a new cyclical low of 2.9%.

- Average monthly rents for the large-scale Grade B segment rose 2.4% QoQ and 8.2% YoY – the fastest rate of increase since the global financial crisis.

- In both the Grade A and large-scale Grade B office segments, average rents across the central five wards remain roughly 40% down from their cyclical highs of 2007.

- Nonetheless, cumulative growth since the market bottomed out in 2012 has been solid, with Grade A rents up 20% from their 2012 nadir.

"Tokyo's rental recovery is expected to maintain its momentum through 2015 and beyond on the back of cyclical and economic tailwinds."
Will Johnson, Savills Research

Market summary

Grade A office segment

In 2014, Tokyo's Grade A office[1] vacancy rate benefitted from the highest level of absorption since 2007. With around 1.2 million sq m of unoccupied office space taken up, the prime vacancy rate for the central five wards[2] fell a sharp 2.7 ppts YoY to 3.2% in Q4/2014. This figure marks an improvement of 0.3 ppts QoQ and is the lowest fourth-quarter reading since 2008.

Strong momentum in the occupier market fed the rental recovery, with Grade A office rents increasing approximately 9.0% YoY. This outpaces the healthy 6.0% recovery recorded in 2013. As of Q4/2014, estimated passing rents for Grade A office space reached JPY29,700 per tsubo[3] per month, representing a 1.7% rise over the preceding quarter and the highest year-end figure since 2008.

A steady flow of large lease agreements has dramatically reduced the amount of office space in top-grade buildings available for headquarters relocations, i.e. properties with whole floors for lease or vacancies across contiguous floors. This is not only benefitting the landlords of existing buildings, who are requesting higher rents for new agreements and lease renewals, but also developers in the form of pre-agreements for planned schemes and projects under construction.

Large-scale Grade B office segment

Supported by steady occupier demand for high-quality consolidation space and property upgrades, the average vacancy rate for large-scale Grade B office[4] properties drifted downwards to a new cyclical low of 2.9%. Improving 0.2 ppts QoQ and 1.3 ppts YoY, this figure represents the lowest level of vacancy since Q2/2008.

Vacancy rates in this market segment have demonstrated a positive trend since early 2011, reflecting a flight to quality among tenants at the expense of older, small- to mid-scale rental buildings and outmoded owner-occupier stock. This bifurcation within the Grade B market has resulted in uncompetitive properties being removed from the market, for both refurbishment and redevelopment.

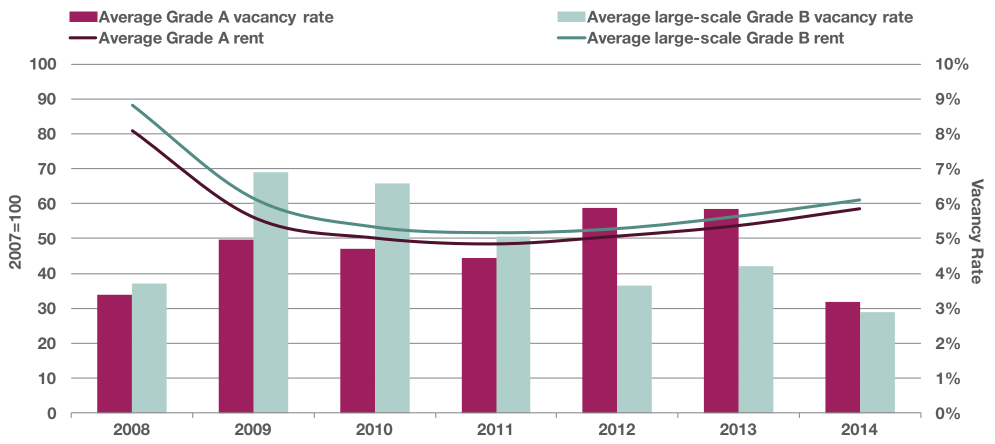
Reduced levels of availability have buoyed achievable rents. The average monthly rent for large-scale Grade B properties monitored by Savills reached JPY22,340 per tsubo in Q4/2014, up 2.4% QoQ and 8.2% YoY – the fastest rate of increase since the global financial crisis.

With quarterly rental growth in the large-scale Grade B segment moderately outpacing that of Grade A in the fourth quarter, the rental premium payable for prime office space slipped 0.8 ppts to 33%. However, it remained wider than the 32% spread recorded in Q4/2013, and approximately 5 ppts wider than the cyclical low of approximately 25% posted in 2009.

Savills monitors rents and vacancy levels at more than 300 buildings located in Tokyo's central five wards with a GFA of 10,000 sq m or above. Unlike similar market information issued by other

GRAPH 1

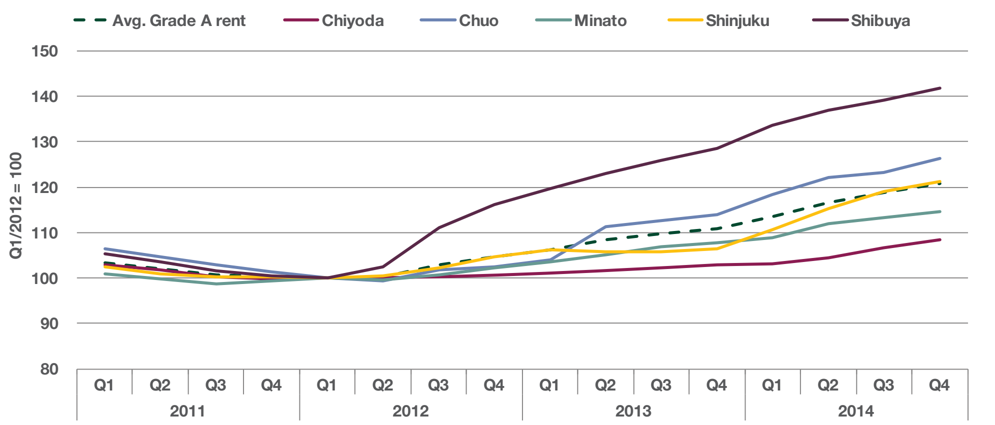
Office rent and vacancy rate trend in Tokyo's central five wards by grade, 2008–2014



Source: Savills Research & Consultancy

GRAPH 2

Grade A office rental index by ward, Q1/2011–Q4/2014



Source: Savills Research & Consultancy

1 Grade A office refers to buildings located in the central five wards of Tokyo with a GFA of 30,000 sq m (9,000 tsubo) or higher and a building age of less than 15 years.
2 The central five wards that make up the Tokyo CBD are Chiyoda, Chuo, Minato, Shibuya and Shinjuku.

3 1 tsubo = 3.306 sq m or 35.583 sq ft.

4 Grade B office refers to buildings with a GFA of 15,000 sq m (4,500 tsubo) with a building age of less than 25 years. Some buildings are included that do not fit this definition.

research institutions, the rental data provided relates to estimated passing rents, inclusive of common area management fees, as opposed to asking rents. Meanwhile, vacancy figures reflect current vacant space without the inclusion of 'expected' vacancy, or that reported prior to tenants vacating their premises. As a consequence, benchmark figures, particularly vacancy rates, tend to be lower than other market indices.

The rent recovery story – where has growth been focused?

In both the Grade A and large-scale Grade B office segments, average rents across the central five wards remain roughly 40% down from their cyclical highs of 2007. Nonetheless, cumulative growth since the market bottomed out in 2012 has been solid. This is particularly true of Shibuya and Chuo wards, where a confluence of low-market vacancy rates and landmark building completions supported rents in 2012, and 2013 when growth in the other major submarkets was dampened by pockets of oversupply.

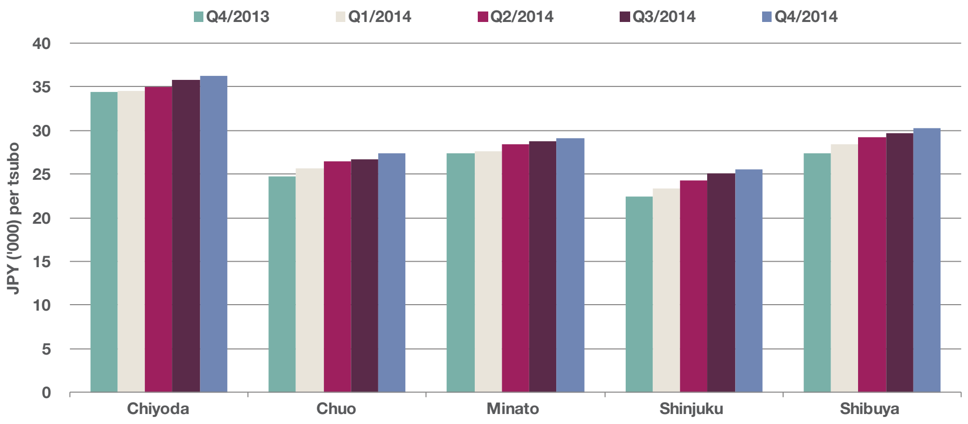
Taking the rental nadir of Q1/2012 as an indexed value of 100, Graph 2 demonstrates that average Grade A rents in Tokyo have recovered to 120, a rise of approximately 20%. Shibuya has outpaced the market, reaching a value of 142, followed by Chuo at 126.

On the back of its dramatically improved occupancy situation, Shinjuku recorded the fastest rate of growth of the five wards during 2014, taking it to third place in terms of a rent recovery since 2012, at an index value of 121.

Minato and Chiyoda wards – Tokyo's largest office submarkets in terms of stock – have posted the slowest rates of recovery to date. Grade A rents here have recovered to 115 and 108, respectively, from the benchmark low of 2012. However, with vacancy rates falling steadily and limited speculative new supply coming on line over the year ahead, the rate of growth in these

GRAPH 3

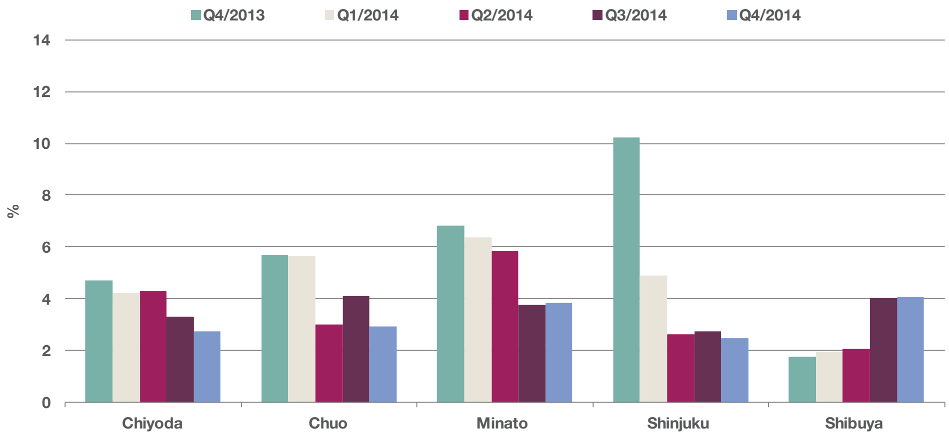
Average Grade A office rents by ward, Q4/2013–Q4/2014



Source: Savills Research & Consultancy

GRAPH 4

Average Grade A office vacancy rates by ward, Q4/2013–Q4/2014



Source: Savills Research & Consultancy

two submarkets is expected to accelerate.

Grade A rents and vacancy rates by ward

Chiyoda

The average Grade A vacancy rate in Chiyoda improved sharply in 2014 to reach 2.7% in the fourth quarter – its lowest level since Q4/2011. This figure represents in-movement of 0.6 ppts over the quarter and 2.0 ppts YoY.

Notable leasing activity has involved companies from sectors including trading, legal, media, business services, public services and manufacturing.

Grade A office passing rents in Chiyoda Ward averaged approximately JPY36,270 per tsubo in Q4/2014, up 1.5% QoQ or 5.3% YoY. The annual growth rate was the slowest of the central five wards, but continued on a steady upwards trend for a third consecutive quarter.

Reflecting its status as Tokyo's most expensive office location, Chiyoda maintains a strong rental premium relative to the five-ward average. Nonetheless, faster rates of growth in

TABLE 1

Notable office leasing transactions, Q4/2014

Company	Business sector	Type	Former building(s)/location	New building(s)/location	Approximate space taken	
					tsubo	sq m
Bandai Namco Holdings	Entertainment/video games	Headquarters relocation	Bandai Namco Mirai-Kenkyusho/Shinagawa Ward	Sumitomo Fudosan Mita Building*/Minato Ward	5,200	17,200
Nagashima Ohno & Tsunematsu	Legal services	Headquarters relocation	Kioicho Building/Chiyoda Ward	JP Tower/Chiyoda Ward	3,800	12,550
Lenovo Japan	ICT hardware	Headquarters relocation following M&A activity	Roppongi Hills Mori Tower/Minato Ward	Akihabara UDX/Chiyoda Ward	2,100	6,950
Japan Agency for Medical Research and Development (A-MED)	Government agency	Headquarters relocation	Tokyo Sakurada Building/Minato Ward	Yomiuri Shimbun Building/Chiyoda Ward	2,085	6,900
Tanseisha	Retail design consultancy	Headquarters relocation/consolidation	Tanseisha Headquarters Building/Taito Ward	Shinagawa Season Terrace*/Minato Ward	1,900	6,300

Source: Savills Research & Consultancy
* Buildings under construction

the other wards have resulted in this premium being reduced from around 36% at the bottom of the market in early 2012, to approximately 22% in Q4/2014.

Chuo

Chuo Ward's average Grade A vacancy rate improved to 3.0%, strengthening 1.1 ppts QoQ and 2.7 ppts compared with the same quarter of last year. This movement was supported by take up at a handful of prime buildings by companies representing industries such as business services, manufacturing and ICT.

The average Grade A passing rent in Chuo Ward stood at JPY27,380 per tsubo, up 2.5% QoQ and double-digits YoY at 10.9%.

Minato

The Grade A vacancy rate in Minato remained stable during the last quarter of the year at 3.8%. This figure marks an improvement of 3.0 ppts YoY and is the ward's lowest level of prime availability since Q1/2012.

In addition to small- to mid-sized lease agreements recorded at existing buildings, sizable leases were reported at buildings currently under construction. These include Bandai Namco Holding's decision to relocate its headquarters operations from Higashi-Shinagawa to the tentatively-named Sumitomo Fudosan Mita Building in Shiba, a 13-storey tower due for completion in November 2015. Separately, retail shop design consultancy Tanseisha is to consolidate staff from its owner-occupied head office and nearby leased annex building in Taito Ward at Shinagawa Season Terrace, a high-rise office in the Konan area that is scheduled to complete in February 2015.

Up 1.2% QoQ, the average Grade A office rent in Minato recorded moderate growth for a tenth consecutive quarter. It reached JPY29,080 per tsubo, up 6.3% YoY.

Shibuya

Shibuya's average Grade A vacancy rate edged up 0.1 ppts over the quarter to 4.1%. This figure sits 2.3 ppts higher than the same period a year ago as a result of secondary space released back to the market in the Ebisu district.

Even so, with a limited number of prime buildings available for rent in this submarket comparative to the other wards, the balance remains on the side of the landlords. Average Grade A rents increased 1.9% QoQ to JPY30,230 per tsubo, up for a twelfth consecutive quarter and taking the annual growth rate to 10.4%.

As a result of steady increases in its average Grade A rent since 2012, Shibuya became Tokyo's second most expensive ward in Q4/2013, and maintained a slight lead over third-place Minato throughout 2014.

Shinjuku

Shinjuku's average Grade A vacancy rate sustained its positive trend for a sixth consecutive quarter, edging down 0.3 ppts QoQ to 2.5%. This represents an improvement of 7.8 ppts YoY and follows particularly strong absorption of large vacancies in the first two quarters of the year.

Shinjuku recorded the highest overall rate of Grade A office rental growth through 2014, having risen 13.8% YoY to JPY25,550 per tsubo in the fourth quarter. Movement over the preceding quarter was a healthy 1.8%.

OUTLOOK

The prospects for the market

Tokyo's rental recovery is expected to maintain its momentum through 2015 and beyond on the back of cyclical and economic tailwinds. The volume of available space suitable for large-scale corporate relocations has become limited; this will not only encourage landlords to demand higher rents for new leases but also accelerate the absorption of buildings newly supplied to the market in the near-term.

The rental spread between prime assets and secondary stock will steadily widen as the supply-demand balance tips further in the favour of Tokyo's landlords. This will support demand for high quality Grade B properties from those small- to mid-sized tenants who are priced out of top-tier properties as a result of the higher gross occupancy costs.

Downwards rental adjustments in in-place rents have already been priced into the market since the global financial crisis. Indeed, despite Grade A rents having risen steadily for consecutive quarters since Q2/2012, the rental average remains approximately 42% below the previous cyclical high of 2007. This not only mitigates downside risk but indicates that the market has considerable upside potential.

Fresh out of snap parliamentary elections in December, the Abe administration has a renewed mandate for its assertive policy measures designed to reinvigorate the national economy. While much-awaited structural reforms are likely to face political headwinds, the monetary initiatives being delivered by the Bank of Japan are having a material impact on office demand. In particular, higher equity prices and the significantly weaker yen have bolstered corporate profitability, which is encouraging business expansion and headcount growth in certain sectors.

Please contact us for further information

Savills Japan

Christian Mancini
Representative Director, CEO
+81 3 5562 1717
cmancini@savills.co.jp

Savills Research

Will Johnson
Head of Research & Consultancy, Japan
+81 3 5562 1736
wjohnson@savills.co.jp

Hafiz Ismail
Manager, Research & Consultancy, Japan
+81 3 5562 1787
hismail@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk