

Briefing Office sector

Q4 2015



Image: Shinjuku Ward, Tokyo

SUMMARY

Landlords remain somewhat optimistic on the rental market given low vacancy rates and stable pre-commitment activity for new development projects, despite a volatile economic outlook.

- The average Grade A office vacancy rate in Tokyo's central five wards marginally improved by 0.1 percentage points (ppts) over the preceding quarter to 2.2%, falling by 1.0 ppts year-on-year (YoY).

- The estimated passing rents for Grade A office space increased to JPY31,125 per tsubo per month, representing a 0.8% rise over the preceding quarter and a 4.8% increase YoY.

- The average vacancy rate for large-scale Grade B office properties

remained stable at 2.2%, an improvement of 0.7 ppts over the same period the previous year.

- The estimated passing rents for large-scale Grade B office space reached JPY23,758 per tsubo, up 0.9% quarter-on-quarter (QoQ) and 6.3% YoY.

- Under a very tight supply situation, especially in Shibuya and Shinjuku, landlords of prime buildings are bullish, with rental growth expectations at over 10%, although potential tenants are taking a wait and see approach.

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 “Leasing activity remains robust. Newly developed prime office buildings are showing a high level of pre-leasing activity. Many office buildings that had struggled to fill floors have secured tenants. The limited available space is likely to trigger a rental increase, albeit very slowly, even given economic uncertainty” Savills Research

➔ **Grade A office segment**

A steady flow of lease agreements has reduced large amount of office space in high-grade buildings. The average Grade A¹ office vacancy rate in Tokyo's central five wards improved by 1.0 ppts YoY in the fourth quarter to 2.2%, falling by 0.1 ppts over the preceding quarter.

In the fourth quarter, the estimated passing rents for Grade A office space increased to JPY31,125 per tsubo² per month, representing a 4.8% increase YoY and a 0.8% increase QoQ, reaching the highest rental figure since Q2/2009.

Large-scale Grade B office segment

The average vacancy rate for large-scale Grade B³ office properties remains steady at 2.2% as of the end of 2015. This represents an improvement of 0.7 ppts over the same period the previous year and a 0.3 ppts improvement QoQ.

Significantly reduced levels of availability have buoyed rents. The average monthly rent for large-scale Grade B properties increased by 0.9% QoQ and 6.3% YoY to JPY23,758 per tsubo in the fourth quarter, the highest rental figure since Q3/2009.

Grade A rents and vacancy rates by ward

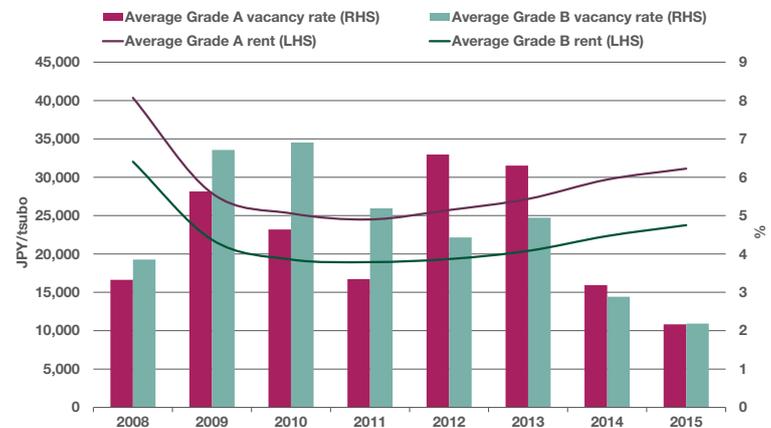
Chiyoda
There are a few sizable leases in Chiyoda Ward, including insurance company Fukoku Mutual Life Insurance, which is temporarily relocating from its 26-year-old Fukoku Seimei Building for renovation. The firm will lease 2,000 tsubo in Saiwai Building across the road.

An apparel manufacturer, Mash Holdings, has relocated from Shibuya Ward to Kojimachi Dai Building, aiming for expansion. The firm decided to lease the entire building with a floor size of approximately 3,200 tsubo.

The Grade A vacancy rate in Chiyoda was 1.7% in Q4/2015, an improvement of 1.1 ppts YoY. The average Grade A passing rent in Chiyoda Ward stood

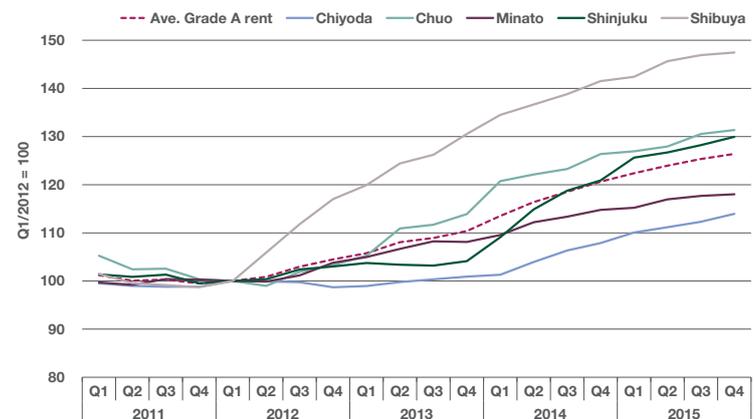
1 Grade A office refers to buildings located in the central five wards of Tokyo with a GFA of 9,000 tsubo (30,000 sq m) or larger and a building age of less than 15 years.
2 1 tsubo = 3.306 sq m or 35.583 sq ft
3 Large-scale Grade B office refers to buildings with a GFA of 4,500 tsubo (15,000 sq m) and a building age of less than 25 years. Some buildings are included that do not fit this definition.

GRAPH 1 **Office rent and vacancy rate trend in Tokyo's central five wards* (C5W) by grade, 2008–Q4/2015**



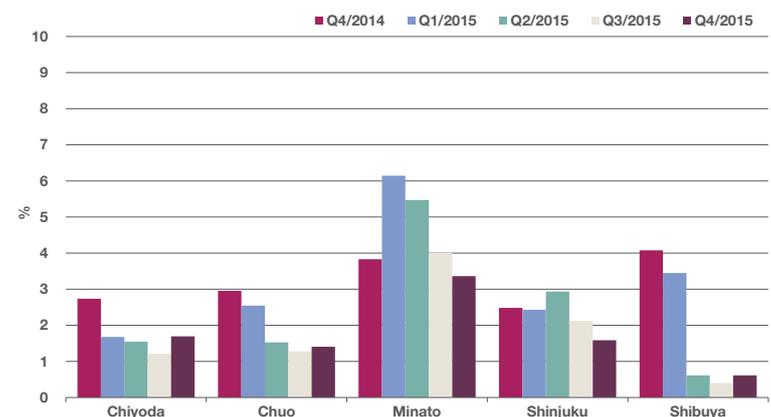
Source: Savills Research & Consultancy
*Tokyo's central five wards (C5W) comprise of Chiyoda, Chuo, Minato, Shibuya and Shinjuku Ward.

GRAPH 2 **Grade A office rental index by ward, Q1/2011–Q4/2015**



Source: Savills Research & Consultancy

GRAPH 3 **Average Grade A office vacancy rates by ward, Q4/2014–Q4/2015**



Source: Savills Research & Consultancy

→ at JPY38,314 per tsubo, up by 1.5% QoQ and 5.6% YoY.

Chuo

Chuo Ward's average Grade A vacancy rate improved by 1.6% YoY to 1.4% as of Q4/2015. However, the figure also remarked an increase of 0.1 ppts over the preceding quarter. The average Grade A passing rent in Chuo Ward stood at JPY28,460 per tsubo, up by 0.6% QoQ and 3.9% YoY.

Watch manufacturer Seiko Holdings is set to relocate its headquarters office from a 47-year old building in Toranomom to the new Urbannet Ginza 1-Chome Building, which is scheduled to complete in May 2016. The firm will lease the entire building, with a floor size of 2,240 tsubo, as well as 248 tsubo in the KDX Ginza 1-Chome Building nearby.

Minato

Amid the recent large amount of supply, the average Grade A vacancy rate in Minato continued to show a positive trend at 3.4% in Q4/2015 – the lowest level of vacancies since Q2/2012. This figure represents an improvement of 0.7 ppts over the preceding quarter and 0.5 ppts YoY, reflecting solid demand in the area. The average Grade A office rent in Minato rose by 0.3% QoQ to JPY29,898 per tsubo, up 2.8% on a YoY basis.

Jalux, a listed company that operates Blue Sky shops in airports, is set to lease 1,000 tsubo in Shinagawa Season Terrace, moving from two buildings in Higashi-Shinagawa. The relocation will take place in March 2016.

Shibuya

Shibuya's average Grade A vacancy rate continues to hover at its lowest level, with a marginal increase of 0.2 ppts over the preceding quarter. As of Q4/2015, the vacancy rate for Shibuya Ward was stable at 0.6%, improved by 3.5 ppts YoY. Grade A rents increased by 0.4% QoQ to JPY31,500 per tsubo, up for a sixteenth consecutive quarter, bringing the annual growth rate to 4.2%.

As a result of steady increases in its average Grade A rent since 2012, Shibuya became the second most expensive ward in Tokyo since Q4/2013, and still maintained a significant lead over third-placed Minato in Q4/2015. Relocation activities include the lease of Odakyu Southern Tower in Yoyogi, by software developer Ymirlink. The firm is set to relocate its headquarters from KDX Ebisu Building.

Shinjuku

In Q4/2015, Shinjuku's average Grade A vacancy rate improved by 0.5 ppts over the preceding quarter and by 0.9 ppts YoY to stand at 1.6%.

While Shinjuku's prime rental space is on average the most inexpensive of the central five wards, rents have been picking up in recent quarters and it recorded the highest rate of Grade A office rental growth, up by 7.5% YoY and 1.3% QoQ to JPY27,455 per tsubo.

Freund Corporation, a vendor of food processing machines and pharmaceutical additives, is set to relocate its headquarters and lease the entire Kyorin Nishi-Shinjuku Building. The 900-tsubo building is currently occupied by the Tokyo branch of Kyorin Pharmaceutical, which will later relocate to Yotsuya Medical Building following the sale of the building to an undisclosed buyer.

Savills monitors rents and vacancy levels at more than 450 buildings located in Tokyo's central five wards with a GFA of 3,000 tsubo (10,000 sq m) or above. Unlike similar market information issued by other 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. ■

TABLE 1 Notable office leasing transactions, Q4/2015

Company	Business sector	Type	Former building(s) / location	New building(s) / location	Approximate space taken	
					tsubo	sq m
Sony Mobile Communications, So-net	Internet provider	Headquarters relocation / consolidation	W Building, ThinkPark Tower / Minato, Shinagawa Ward	Shinagawa Seaside North Tower / Shinagawa Ward	13,109	43,337*
Nippon Koei	Construction consultant	Headquarters relocation	Nippon Koei Headquarters Building / Chiyoda Ward	Nippon Koei Kudan Office / Chiyoda Ward	4,537	15,000*
Mash Holdings	Apparel manufacturer	Headquarters relocation	Alive Mitake / Shibuya Ward	Kojimachi Dai Building / Chiyoda Ward	3,209	11,609*
Seiko Holdings	Manufacturer	Headquarters relocation	Urbannet Ginza 1-Chome Building, KDX Ginza 1-Chome Building / Chuo Ward	Toranomon 15 Building / Minato Ward	2,488	8,220**
Fukoku Mutual life Insurance	Insurer	Headquarters relocation / renovation	Fukoku Seimei Building / Chiyoda Ward	Saiwai Building / Chiyoda Ward	2,000	6,610

Source: Savills Research & Consultancy, Nikkei RE
 * Entire building space.
 **Total space of two buildings combined.

OUTLOOK

The prospects for the market

Leasing activity remains robust. Newly developed prime office buildings are showing a high level of pre-leasing activity. For instance, Otemachi Financial City Grand Cube, which is expected to complete this Spring, looks fully leased already. In addition, many

office buildings that had struggled to fill space have attracted tenants, using up available space.

The limited available space that remains is likely to trigger an increase in rental levels, even under uncertain economic conditions. Accelerated

uncertainty in the global economy has made tenants and property investors cautious, leaving a very unclear outlook. However, ultra-low vacancy rates for both newly developed and existing buildings are encouraging landlords to stay somewhat optimistic on the rental market.

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