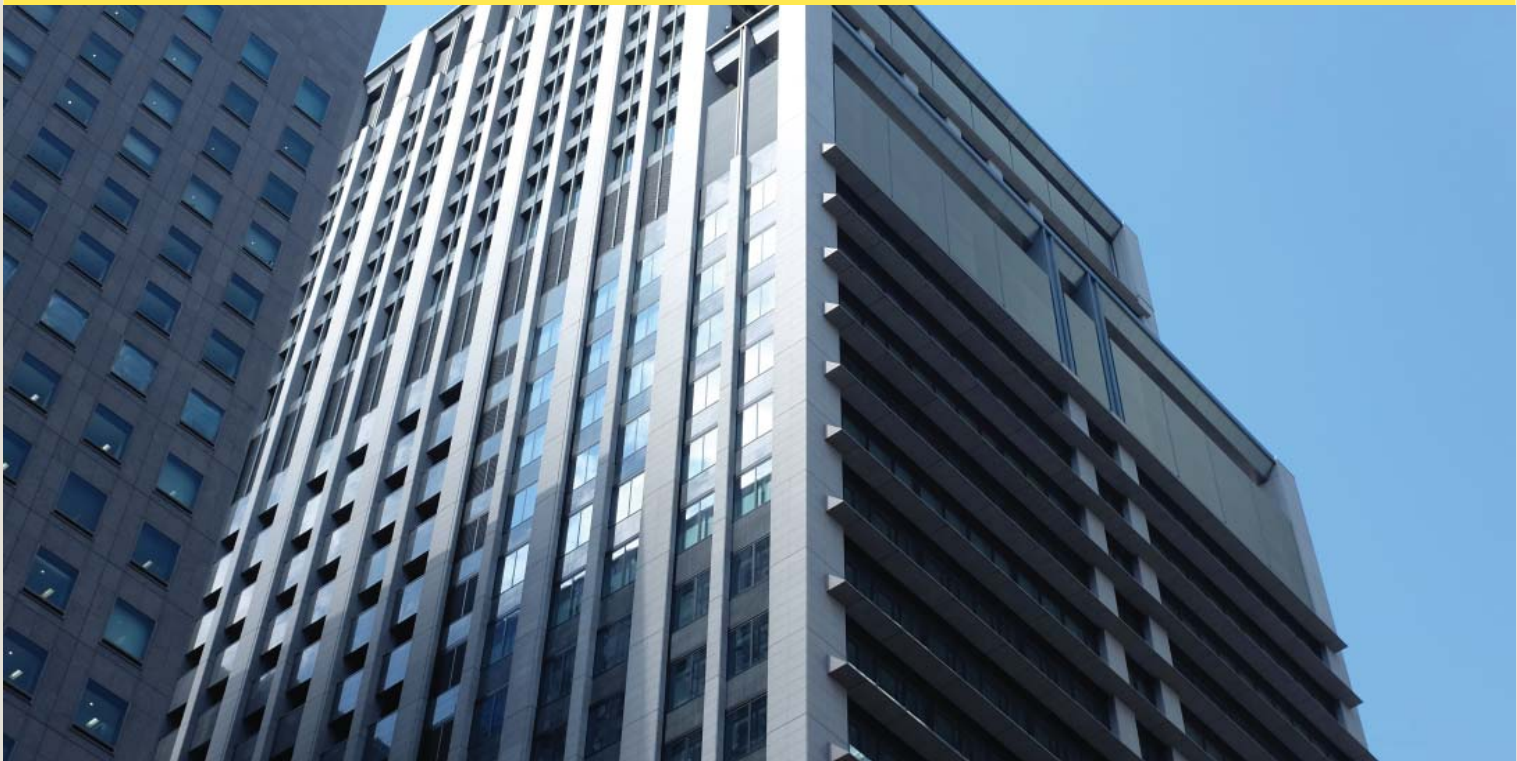


Briefing Office sector

Q1 2017



SUMMARY

Average rents continued to increase steadily in Q1/2017. Although vacancy rates appeared to soften for Grade A office space, pre-leasing activities are going better than originally anticipated.

- Average estimated passing rents for Grade A office space strengthened to JPY32,142 per tsubo¹ per month, representing a 1.4% rise quarter-on-quarter (QoQ) and a 2.5% increase year-on-year (YoY).

- The average Grade A office vacancy rate in Tokyo's central five wards softened by 0.7 percentage points (ppts) QoQ and 0.8 ppts YoY to 2.6%.

- Average estimated passing rents for large-scale Grade B office

1 1 tsubo = 3.306 sq m or 35.583 sq ft

space reached JPY24,374 per tsubo, climbing by 0.9% QoQ and 2.1% YoY.

- The average vacancy rate for large-scale Grade B office properties tightened by 0.4ppts QoQ and 0.2ppts YoY to 1.7%.

- Pre-leasing is going well, indicating sound underlying demand for prime offices.

.....
 “Average office rents continued to increase while vacancy rates for Grade A office space showed signs of temporary softening due to new supply. Pre-leasing activities are trending better than previously expected, which may lead to a slight upward adjustment to our outlook.” Savills Research

➔ **Grade A offices**

Major projects completed in Q1/2017 include the Sumitomo Azabu Juban Building, the Otemachi Park Building, and Ginza Six. This influx of new supply appears to have softened the average Grade A² vacancy rate in the central five wards (C5W) to 2.6%, loosening by 0.7ppts QoQ and 0.8ppts YoY.

On the other hand, the estimated passing rent for Grade A office space strengthened to JPY32,142 per tsubo per month, representing a 2.5% increase YoY and a 1.4% increase QoQ. Chuo and Shinjuku especially exhibited strong growth at 5.7% and 3.6% on a YoY basis as select properties successfully revised their rents upward.

We have observed a change in market momentum in Q1/2017. Towards the end of 2016, many tenants took a wait-and-see attitude due to uncertain global economic prospects. However, as the uncertainty recedes, more tenants are willing to expand to accommodate growing workforces. Consequently, some landlords have become bullish and are trying to increase rents.

Large-scale Grade B offices

The average vacancy rate for large-scale Grade B³ office properties has further tightened by 0.4ppts QoQ and 0.2ppts YoY to 1.7% as of Q1/2017. This is the tightest Grade B vacancy rate since we started our survey in 2008. Shinjuku, where availability of Grade A offices is extremely limited, experienced the largest drop in vacancy.

Rental growth also picked up in Grade B property. The average monthly rent for large-scale Grade B properties registered at JPY24,374 per tsubo in Q1/2017. This represents a QoQ gain of 0.9% and a YoY gain of 2.1%.

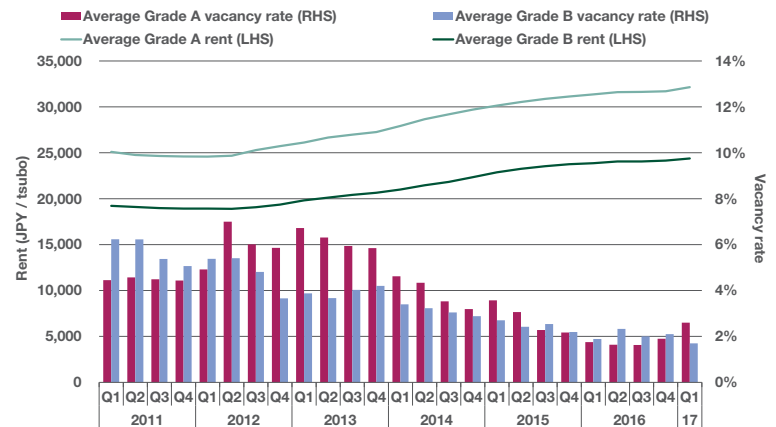
Grade A rents and vacancy rates by ward
Chiyoda

The Grade A vacancy rate in Chiyoda was 2.1% in Q1/2017, a softening of 1.1ppts QoQ and 1.2ppts YoY, largely

2 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.

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 that do not fit this definition are included.

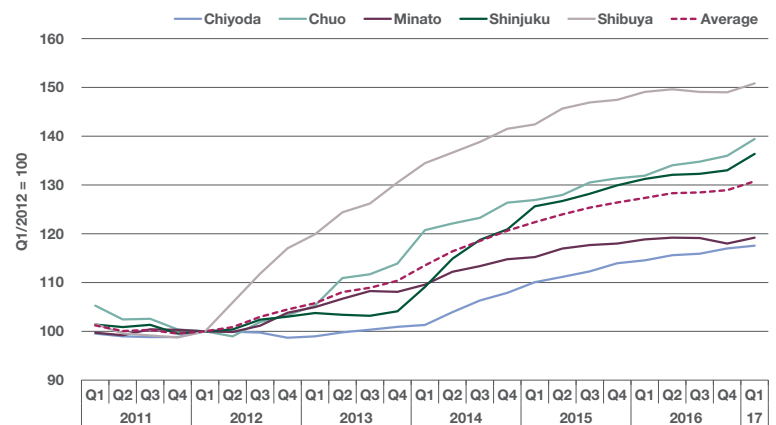
GRAPH 1 **Average office rents and vacancy rates in Tokyo's central five wards*, Q1/2011–Q1/2017**



Source: Savills Research & Consultancy

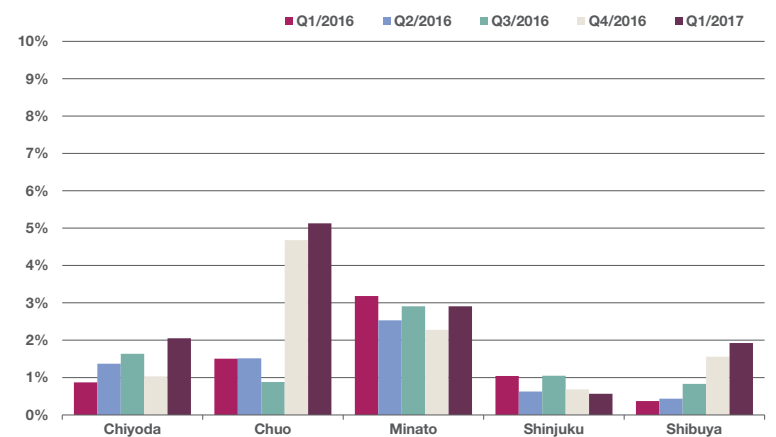
* Tokyo's central five wards (C5W) are comprised of Chiyoda, Chuo, Minato, Shibuya and Shinjuku.

GRAPH 2 **Grade A office rental index by ward, Q1/2011–Q1/2017**



Source: Savills Research & Consultancy

GRAPH 3 **Average Grade A office vacancy rates by ward, Q1/2016–Q1/2017**



Source: Savills Research & Consultancy

→ due to the opening of the Otemachi Park Building. The average Grade A passing rent in Chiyoda stood at JPY39,361 per tsubo, increasing by 0.7% QoQ and 2.2% YoY.

Multiple companies announced relocation plans to or within Chiyoda. Several companies decided to move into new offices such as Hibiya Park Front (Uchisaiwaicho 2-chome Project), the Otemachi Park Building, and the New Hibiya Project. Mitsubishi Estate will move to its own Otemachi Park Building in the latter half of 2017. Pasona Group announced the largest relocation plan in Q1/2017. It will move its headquarters to the Nihon Building in June 2017 and plans to lease about 15,000 tsubo in total.

Chuo

Chuo's average Grade A vacancy rate loosened by 0.4ppts QoQ and 3.6ppts YoY to 5.1% in Q1/2017. Rents in Chuo strengthened by the largest margins, recording growth of 2.4% QoQ and 5.7% YoY. A combination of the opening of Ginza Six and rental increases by existing properties resulted in this strong growth. The average Grade A passing rent in Chuo stood at JPY30,222 per tsubo.

The Kyobashi area is attracting interest. Kyobashi Edogrand continues to acquire new tenants such as Order-Cheese, Japan Space Imaging, and Riccoh. Additionally, Ajinomoto Healthy Supply and Marubeni Protechs completed their relocations to the

TABLE 1 **Tenant origins vs destinations, announced in Q1/2017**

Origin						Total arrivals	Destination
Chiyoda	Chuo	Minato	Shibuya	Shinjuku	Other		
9	9	6	5	4	6		
↓	↓	↓	↓	↓	↓		
5	3			1		9	Chiyoda
3	4	1		1	1	10	Chuo
1	2	4	3	1	3	14	Minato
		1	2	1		4	Shibuya
					1	1	Shinjuku
					1	1	Other

Source: Savills Research & Consultancy, Nikkei RE

Kyobashi OM Building in February. Kygnus Sekiyu is also considering relocating its headquarters to the area.

Minato

The average Grade A vacancy rate in Minato loosened by 0.6ppts QoQ, but tightened 0.3ppts YoY to 2.9%. The average Grade A office rent in Minato strengthened by 0.6% QoQ and 0.4% YoY to JPY30,245 per tsubo.

Due to attractiveness of the area and relatively loose vacancy, Minato continues to draw a large number of companies. Kokuyo will rent 1,460 tsubo in Shinagawa Season Terrace

for its new office. The company aims to restructure and enhance collaboration among different divisions through the move.

Shibuya

Shibuya's average Grade A vacancy rate loosened by 0.3ppts QoQ and 1.5ppts YoY to 1.9%. Grade A rents increased by 1.5% QoQ and 1.0% YoY to JPY32,154 per tsubo.

Shibuya attracts fashion- and tech-oriented companies. Japan Imagination and Furla Japan, both apparel companies, are relocating to the Yoyogi Community Building and the Jingumae Tower Building respectively. Agri Square Shinjuku,

TABLE 2 **Notable office leasing transactions, Q1/2017**

Company	Business sector	Type	Former/current location	New location	Approximate space	
					tsubo	sq m
Pasona Group	Recruiting	HQ relocation	Daiwa Gohokubashi Building	Nihon Building	15,000	50,000
			Chiyoda	Chiyoda		
Mitsubishi Estate	Real estate	HQ relocation	Otemachi Building	Otemachi Park Building	3,000-4,000	9,900-13,000
			Chiyoda	Chiyoda		
Sony Bank	Banking	HQ relocation	Hitotsubashi SI Building	Hibiya Park Front	1,900	6,300
			Chiyoda	Chiyoda		
Kokuyo	Manufacturing	Office expansion	Various	Shinagawa Season Terrace	1,500	5,000
			Various	Minato		
Takara Leben	Housing developer	HQ relocation	Shinjuku Sumitomo Building	Tekko Building	700	2,300
			Shinjuku	Chiyoda		

Source: Savills Research & Consultancy, Nikkei RE

→ which was completed in October near Shinjuku, will also receive JR East Net Station and Ikari Shodoku as tenants.

Shinjuku

In Q1/2017 Shinjuku's average Grade A vacancy rate tightened by 0.1ppts QoQ and 0.4ppts YoY to 0.6%, the lowest level in the C5W. Grade A rents in Shinjuku climbed by 2.3% QoQ and 3.6% YoY to reach JPY28,727 per tsubo.

Tight vacancy in Shinjuku appears to be limiting relocation activities in this ward. Kanto Mazda will occupy one floor of Takadanobaba Access. This is a temporary move while the company's own building undergoes reconstruction, which is expected to take about two years.

Pre-leasing activities

Vacancy has loosened in the C5W due to some supply increases; however, active pre-leasing bolstered by a sound economic environment has so far limited the supply's market impact. Furthermore, positive pre-leasing

trends for upcoming projects in 2017 and early 2018 indicate that the supply impact should remain relatively small, at least in the near term.

Leasing activities are going smoothly for major projects scheduled for completion in 2017, such as Hibiya Park Front and Akasaka Intercity Air. These buildings appear set to reach near-full occupancy by the end of this year. Moreover, projects scheduled for completion in late 2017 and early 2018 such as the Meguro-ekimae Redevelopment Project, the New Hibiya Project, and the Sumitomo Fudosan Osaki Project are also seeing strong pre-leasing activity.

Given the volume of new supply coming online through 2020, it is likely that vacancy and rental growth will soften over the medium term. However, pre-leasing trends so far indicate that demand for high quality offices remains strong. Better-than-expected pre-leasing trends imply that stable market conditions could continue, at least through early 2018. ■

OUTLOOK

The prospects for the market

Rental growth in Tokyo continues to climb as new, high-rent offices enter the market and select properties successfully increase passing rents. Although vacancy rates for Grade A buildings showed signs of softening, sound office demand continues to keep vacancy low in the C5W.

Supply increases are likely to further loosen vacancy temporarily, but the impact is expected to be moderate at least through early 2018 given smooth pre-leasing activities. Pre-leasing is going more smoothly than previously expected and demand for office space remains strong.

We may need to revise our somewhat bearish forecast upward if this strong trend continues.

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 result, benchmark figures, particularly vacancy rates, tend to be lower than other market indices.

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