Briefing
Office sector

Q1 2018

Image: Marunouchi Nijubashi Building

SUMMARY

Pre-leasing activity remains strong and occupancy levels are approaching 100% in some submarkets. Average rents in the C5W registered another gain in Q1/2018.

- New offices continue to attract tenants in the central five wards (C5W), tightening both Grade A and Grade B vacancy to the lowest level since we started our survey.

- Pre-leasing activity in our sample of new developments is robust, indicating strong underlying demand growth.

- Average passing rents for Grade A office space in the C5W strengthened to JPY33,400 per tsubo[1] per month, representing a 1.3% rise quarter-on-quarter (QoQ) and a 3.9% increase year-on-year (YoY).

- The average Grade A office vacancy rate in the C5W tightened to 0.8%, a narrowing of 0.5 percentage points (ppts) QoQ and 1.8ppts YoY.

- Average passing rents for large-scale Grade B office space rose to JPY25,200 per tsubo per month, climbing by 1.0% QoQ and 3.4% YoY.

- The average vacancy rate for large-scale Grade B office properties tightened further to 0.7%, moving down by 0.2ppts QoQ and 0.8ppts YoY.

1 1 tsubo = 3.306 sq m or 35.583 sq ft

"Tokyo offices had another strong quarter of rental growth and extremely low vacancy. A tight labour market and healthy corporate profits have translated into strong demand for new offices which is likely to continue towards late 2018."
Savills Research

Grade A offices

Tokyo Grade A office market fundamentals strengthened further in Q1/2018. New, high-specification offices are continuing to see steady absorption and achieve high rents. With unemployment low, employers realise that attractive office space is one factor that helps secure talent. Despite a glut of upcoming supply towards the Olympics, pre-leasing of new developments remains strong, underpinning the market. Although there is risk of secondary vacancy as companies move to newer offices, existing tenants expanding into vacated space have appeared to sustain market momentum, particularly in popular central districts. Tokyo's vacancy rate continued to tighten in Q1/2018 and reached 0.8% in the C5W, an improvement of 1.8ppts YoY.

Grade A office rents in the C5W strengthened 1.3% QoQ to JPY33,400 per tsubo per month. On a YoY basis, growth in Q1/2018 was 3.9%, slightly lower than total growth of 4.0% for 2017.

Large-scale Grade B offices

The average vacancy rate for large-scale Grade B office[2] properties sat at 0.7%, setting a fifth consecutive record low on a quarterly basis since our survey started, tightening by 0.2ppts QoQ and 0.8ppts YoY. Vacancy remains tight due to the grade's wide demand base, driven by its affordability and limited upcoming supply.

Grade B rental growth is slightly softer than Grade A, but still noticeably strong. A lack of new supply in the sector is moderating relocations and keeping secondary vacancy low. The average monthly rent for large-scale Grade B properties was JPY25,200 per tsubo per month in Q1, representing a QoQ gain of 1.0% and a YoY gain of 3.4%.

Grade A rents and vacancy rates by ward

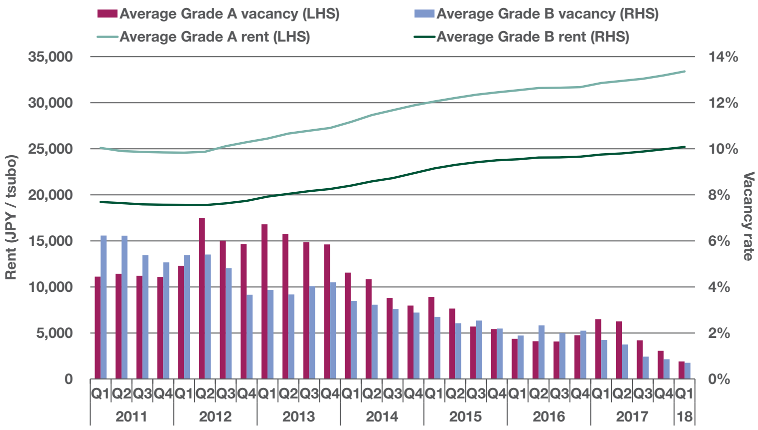
Chiyoda

The average Grade A vacancy rate in Chiyoda was 0.8% in Q1, representing a tightening of 0.6ppts QoQ and

2 "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 rents and vacancy in Tokyo's C5W*, 2011–Q1/2018

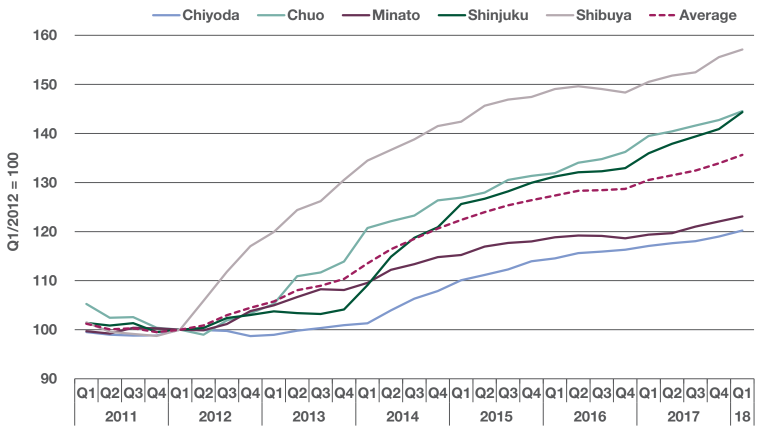


Source: Savills Research & Consultancy

* Chiyoda, Chuo, Minato, Shibuya, and Shinjuku.

GRAPH 2

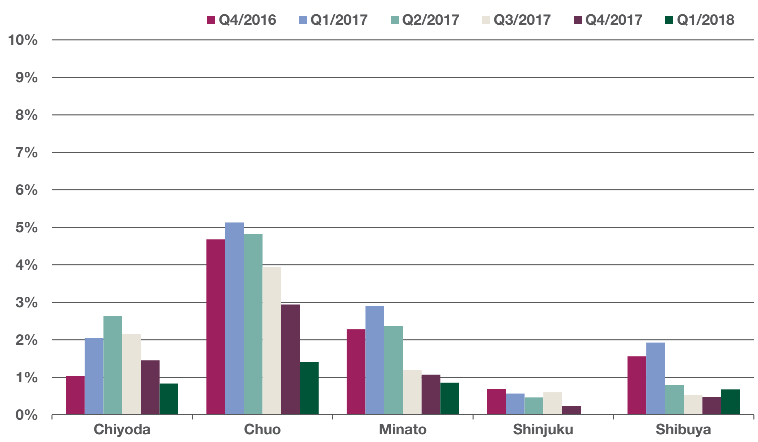
Grade A office rental index by ward, 2011–Q1/2018



Source: Savills Research & Consultancy

GRAPH 3

Grade A office vacancy by ward, Q4/2016–Q1/2018



Source: Savills Research & Consultancy

1.5ppts YoY. The average Grade A passing rent in Chiyoda stood at JPY40,420 per tsubo per month, increasing by 1.0% QoQ and 2.7% YoY.

Civil engineering consultant Ohba will relocate its headquarters and Tokyo office to the Kowa Hitotsubashi Building in December 2018, leasing an estimated 1,000 tsubo on the 11th and the 12th floors. This move will follow the sale of its HQ & Tokyo Branch Building and is aimed at improving accessibility with its clients and streamlining its business operations.

Chuo
Chuo's average Grade A vacancy rate tightened 1.5ppts QoQ to sit at 1.4% in Q1. Rents strengthened 1.3% QoQ and 3.6% YoY. The average Grade A passing rent in Chuo stood at JPY31,321 per tsubo per month.

The Tokyo Organising Committee of the Olympic and Paralympic Games will establish new offices in Harumi Island Triton Square in Harumi in 2018 and 2019. It expects to increase headcount from 1,500 to 4,550 in the winter of 2019. Toyota Mobility Service will relocate its headquarters to the SSP Building in Nihonbashi-Hamacho. The company will lease the building in its entirety and slightly more than 600 employees will work there. The move is slated for the spring or summer of 2018.

TABLE 1
Major tenant relocations, Q1/2018

Origin: Chiyoda	Origin: Chuo	Origin: Minato	Origin: Shibuya	Origin: Shinjuku	Origin: Other		Destination	
2	7	16		1	16			
	1	1			1	→	3	Chiyoda
	4	2			4	→	10	Chuo
	1	9			3	→	13	Minato
					3	→	3	Shibuya
1				1		→	2	Shinjuku
1	1	4			5	→	11	Other

Source: Nikkei RE, Savills Research & Consultancy

Other significant moves include the Japan Securities Dealers Association and FWD Fuji Life Insurance.

Minato
Average Grade A vacancy in Minato tightened 0.2ppts QoQ and 2.1ppts YoY to sit at 0.9%. Grade A rents strengthened 0.8% QoQ and 3.1% YoY to JPY31,190 per tsubo per month.

Shiseido Japan will relocate its headquarters to Nippon Life Hamamatsucho Crea Tower. It seems that the company will lease at least 4,700 tsubo over six floors. The relocation period is unknown. By relocating its sales and marketing division as well as headquarters functions to the same building, it expects it will enhance mutual collaboration. Sumitomo Mitsui Trust Asset Management will lease around 3,400 tsubo in Sumitomo Fudosan Onarimon Tower, expected to be completed in April 2018. The company will start relocating in December 2018.

Shibuya
The average Grade A vacancy rate in Shibuya sat at 0.7%, up 0.2ppts QoQ but down 1.3ppts YoY. Grade A rents increased 1.0% QoQ and 4.4% YoY to JPY33,567 per tsubo per month.

TABLE 2
Notable office leasing transactions, Q1/2018

Company	Business sector	Type	Former/current location		New location	Approximate space: tsubo	Approximate space: sq m
Sumitomo Corporation	Financial	HQ relocation	Harumi Island Triton Square Chuo-ku	→	Building B, Otemachi 2-Chome District Chuo-ku	17,000	56,200
Tokyo Organising Committee of the Olympic and Paralympic Games	Government	Expansion	Various Various	→	Harumi Island Triton Square Chuo-ku	10,000	33,000
CyberAgent	IT	HQ relocation	Various Various	→	Sumitomo Fudosan Shibuya Tower Shibuya-ku	5,700	18,800
Mitsubishi Shokuhin	Wholesaler	HQ relocation	Various Various	→	S-A Building, Kasuga/Korakuen Ekimae Bunkyo-ku	5,400	17,800
Shiseido	Cosmetics	HQ relocation	Shiodome Tower Minato-ku	→	Nippon Life Hamamatsucho Crea Tower Minato-ku	4,700	15,500

Source: Nikkei RE, Savills Research & Consultancy

MAP 1

Average rents per tsubo per month in selected submarkets, Q1/2018

Grade A buildings, average passing rent + CAM per tsubo per month in thousand JPY. Coloured areas for illustrative purposes only.
Source: Savills Research & Consultancy

CyberAgent will integrate its dispersed offices into two buildings that will be completed in Shibuya in 2019. The internet advertising agency will move its headquarters to Sumitomo Fudosan Shibuya Tower, nicknamed Abema Towers after its online television business, which is being constructed in Udagawacho. The company has announced that it will also have an office in the Shibuya Scramble Square East Tower which will be constructed above JR Shibuya Station. The number of employees to be relocated to each building is yet to be decided.

Shinjuku

Shinjuku's Grade A vacancy rate tightened 0.2ppts QoQ and 0.5ppts YoY to end the quarter a fraction above 0.0%. Grade A rents climbed by 2.4% QoQ and 6.2% YoY to JPY30,500 per tsubo per month. In addition to Shinjuku's extremely tight occupancy, lower rents than other wards make it easier for landlords to raise rents.

Geniee will relocate its headquarters to Sumitomo Fudosan Shinjuku Oak Tower in Nishi-Shinjuku. The ad tech company will lease the entire sixth floor of the building, which has a typical floor plate of 573 tsubo. Slightly fewer than 200 employees will initially work at the new location. KNT-CT Holdings, which has companies including travel agency Kinki Nippon Tourist and Club Tourism under its umbrella, will relocate its headquarters to the Shinjuku Sumitomo Building in Nishi-Shinjuku. The relocation is aimed at restructuring the organization to strengthen intra-group collaboration. The group currently uses around 900 tsubo of floor area.

Pre-leasing is strong; secondary vacancy could emerge

2017 was an unexpectedly strong year for the Japanese office market and 2018 is turning out to be equally strong so far. Pre-leasing activity for 2018 is even stronger than in 2017: a representative sample of large Grade A buildings due to complete by Spring 2019 is three quarters pre-leased compared to less than half for a representative sample taken the same time last year. Rental growth has continued at a strong pace and vacancy levels continue to drop.

There has been concern over upcoming large supply. While Q1 did bring an increase in Minato vacancies, all other C5W submarkets tightened and Shinjuku ended the quarter with just 0.02% of vacancy. Stronger than expected demand thanks to robust corporate profitability and a shortage of talent have supported the market. Nonetheless, the economic backdrop could worsen considering the extent to which the property cycle has run, increasing global geopolitical tension and domestic political confusion. Should conditions worsen, landlords may prioritise occupancy by somewhat relaxing rent increases: after all, some rent is better than none.

OUTLOOK

The prospects for the market

Pre-leasing activity for 2018 is even stronger than in 2017. Rental growth has continued at a strong pace and vacancy levels continue to drop. Companies increasingly report that the reason for their relocation is to enhance collaboration among employees and to attract top talent. Companies are more likely to bear their employees in mind when considering moves.

Despite large upcoming supply, Tokyo Grade A and Grade B offices continued to show resilience in Q1/2018. Strong demand filled the remaining space left by incomplete pre-leasing, with rents climbing QoQ and YoY, keeping pace with the strong growth seen in 2017.

Positive economic trends, including a long string of consecutive quarters of GDP growth and increasing corporate profits, are likely to maintain this momentum.

So far strong demand has outstripped large supply. Both the World Bank and the International Monetary Fund have raised their forecasts for the Japanese economy's growth in 2018 & 2019 and corporate profits remain robust. Development and infrastructure projects including preparations for the Olympics will serve as catalysts for the market over the next few years.

On the other hand, there are concerns that the positive trend established so far could reverse. Increasing global uncertainty, domestic political confusion, and a stronger yen may dampen the economy, eventually curtailing the current strong demand for office spaces. In addition, the marketing of large secondary vacancy becoming available in 2019 has started, which might soften the market. Finally, the current upward trend has continued for years, raising some concerns that the cycle is extended.

Landlords have so far been somewhat flexible on pricing and focused on occupancy: maintaining this attitude should help keep the market stable, especially if any harbinger of change appears. The market has performed well year to date, but participants should be cautious and pay extra attention to even subtle changes.

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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