MARKET IN MINUTES
Savills Research

Office Leasing

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Newer buildings driving rental growth

Strong demand, coupled with extremely low vacancy, is pushing up average rents in the C5W.

- Grade A stock in Tokyo's C5W is being snapped up by firms which are eager to expand or consolidate offices. Buildings with large floor plates that can accommodate these needs are thus in high demand.
- Average passing rents for Grade A office space in the C5W grew to JPY35,257 per tsubo[1] per month, representing a gain of 1.9% quarter-on-quarter (QoQ) and 5.6% year-on-year (YoY).
- The average Grade A office vacancy rate in the C5W hit 0.4% in Q1/2019, dipping by 0.1 percentage points (ppts) QoQ and by 0.4ppts YoY.
- Average passing rents for large-scale Grade B office space rose to JPY26,827 per tsubo per month, growing by 1.7% QoQ and 6.5% YoY.
- The average large-scale Grade B office vacancy rate is now 0.4%, unchanged QoQ but 0.3ppts lower YoY.
- Top-line rents are growing strongly in Shibuya, where vacancy is the tightest and the volume of new supply is large compared to existing stock.
- While the outlook for 2019 seems stable, rental growth could slow or evaporate if an external shock emerges and weakens demand.

"Average rents across the C5W have continued to push higher in Q1/2019, with Shibuya seeing particularly strong YoY growth. As the volume of supply abates somewhat this year, and pre-leasing is strong, rental growth seems likely to continue through 2019."

SAVILLS RESEARCH & CONSULTANCY

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

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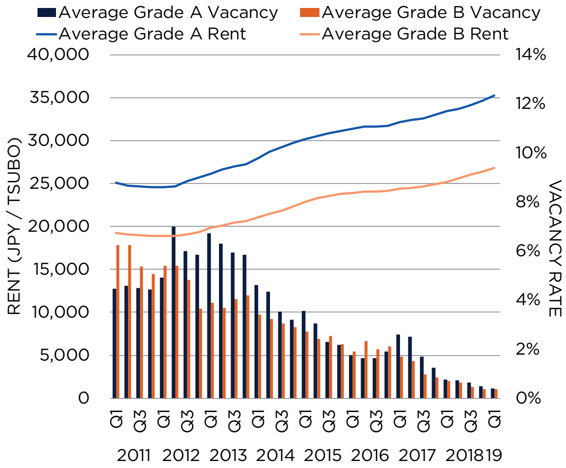
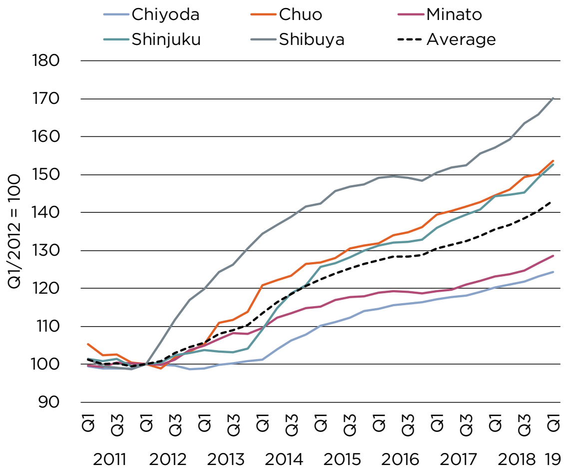
GRAPH 1: Office Rents And Vacancy In Tokyo's C5W*, 2011 to Q1/2019



Source Savills Research & Consultancy
*Chiyoda, Chuo, Minato, Shibuya, and Shinjuku

GRAPH 2: Grade A Office Rental Index By Ward, 2011 to Q1/2019



Source Savills Research & Consultancy

GRADE A OFFICES

Grade A office rents rose 1.9% QoQ and 5.6% YoY in Q1/2019 to JPY35,257 per tsubo[2]. Vacancy fell 0.1ppts QoQ to finish the quarter at 0.4%, some 0.4ppts lower YoY. Although business confidence has tapered somewhat as of late, companies are still enjoying healthy profits and looking to expand. According to the Nikkei, expansion is currently the number one driver of office demand, closely followed by a desire to consolidate office locations. As a result, in the absence of adequate vacancy in existing buildings, tenants are looking to secure space in buildings with large floor plates via the pre-leasing market. Indeed, the majority of 2019 and 2020 supply is already pre-leased, so the short-term outlook for rents appears stable.

LARGE-SCALE GRADE B OFFICES

Large-scale Grade B office[3] rents rose 1.7% QoQ and 6.5% YoY in Q1/2019, to JPY26,827 per tsubo. Vacancy was unchanged QoQ but dipped 0.3ppts YoY to finish the quarter at 0.4%. Even as vacancy materialises periodically, excess space is quickly swept up by strong demand. For example, Chuo saw a pocket of vacancy open up at the beginning of the quarter, raising the ward's average vacancy rate to 1.5%. Glass City Harumi, the building responsible for this uptick, was reported by the Nikkei to have just 47% occupancy in January. However, it is now rumoured to have already filled most of this space and, as a result, Chuo ended the quarter at 0.8% vacancy.

New completions in the large-scale Grade B market are scant, while such offices appeal to a wide range of tenants, from medium-sized businesses to larger corporations who are unable to find space in the Grade A market. Since vacancy is currently slightly tighter than in the Grade A market[4], and developers appear to be focusing on higher grade supply, this dynamic should remain for the time being and thus the outlook for rents is positive.

2 Throughout the report, "per tsubo" is shorthand for "per tsubo per month".
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.

GRADE A RENTS AND VACANCY RATES BY WARD

Chiyoda

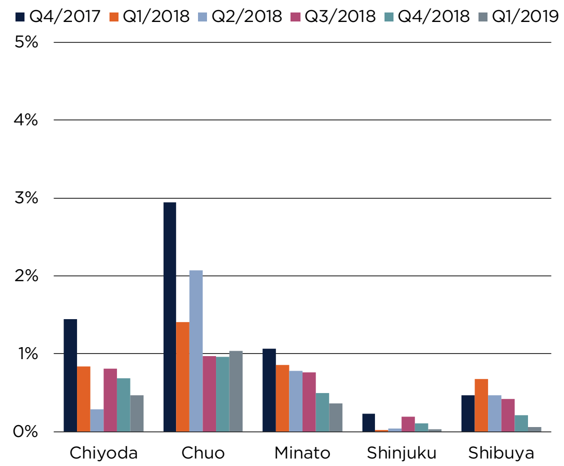
Chiyoda's Grade A vacancy rate of 0.5% was 0.2ppts tighter QoQ and 0.4ppts tighter YoY. Grade A rents climbed by 1.0% QoQ and 3.5% YoY to JPY41,819 per tsubo. Nippon Steel & Sumikin Metal Products will relocate its headquarters to Akihabara UDX in the summer of 2019, leasing approximately 1,200 tsubo for 450 employees. Improving business continuity measures and consolidating onto a single floor to streamline operations were both cited as reasons for the move. Carl Zeiss (Japan) will relocate its headquarters from its own building in Shinjuku to the Sumitomo Fudosan Kojimachi Building No. 4, taking approximately 880 tsubo.

Chuo

Chuo's Grade A vacancy rate of 1.0% was 0.1ppts higher than last period but 0.4ppts tighter YoY. Grade A rents grew 2.3% QoQ and 6.3% YoY, to JPY33,283 per tsubo. Sumitomo Life Insurance intends to relocate its Tokyo headquarters to the under-construction Yaesu 2-Chome North District Category I Urban Redevelopment Project in FY2022, after purchasing approximately seven floors. It will use five of these for its own offices, taking an estimated floor area of 5,600 tsubo. In February 2019, Yamato System Development leased approximately

4 While both vacancies appear equal after rounding, large-scale Grade B vacancy was slightly tighter than Grade A at the end of Q1/2019.

GRAPH 3: Grade A Office Vacancy By Ward, Q4/2017 to Q1/2019



Source Savills Research & Consultancy

TABLE 1: Major Tenant Relocations Q1/2019

ORIGIN: Chiyoda	Chuo	Minato	Shibuya	Shinjuku	Other	DESTINATION	
6	6	6	3	2	10		
2	2	1		1	1	7	Chiyoda
	4	1			1	6	Chuo
1		4	1	1	3	10	Minato
1			2		1	4	Shibuya
2						2	Shinjuku
					4	4	Other

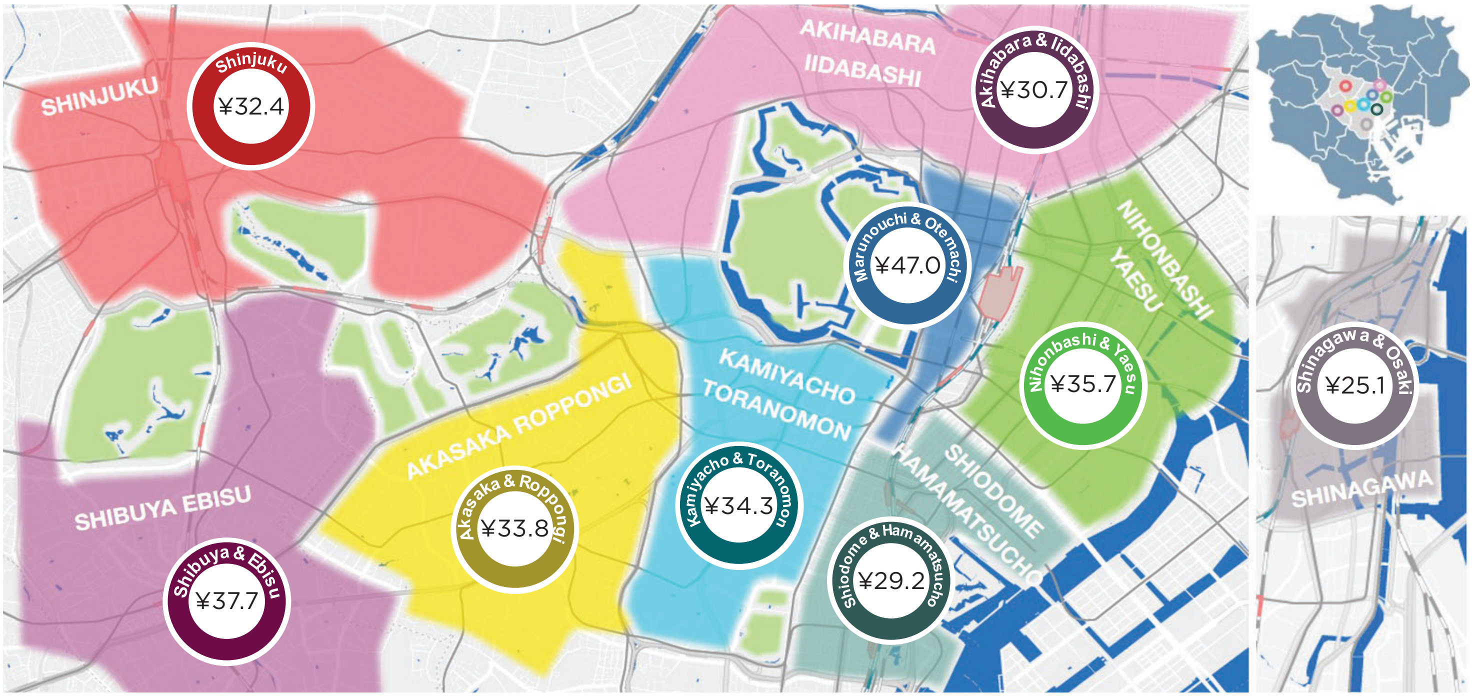
Source Nikkei RE, Savills Research & Consultancy

TABLE 2: Notable Office Leasing Transactions, Q1/2019

COMPANY	BUSINESS SECTOR	TYPE	FORMER/CURRENT LOCATION	NEW LOCATION	APPROXIMATE SPACE TSUBO	APPROXIMATE SPACE SQ M
SoftBank Group	Telecom	HQ relocation	Tokyo Shiodome Building Minato-ku	Takeshiba Area Development Project Office Building Minato-ku	24,000	79,300
Sumitomo Life Insurance	Financial	HQ relocation	Kowa Sumisei Tsukiji Building Chuo-ku	Yaesu 2-Chome North District Block A-1 Chuo-ku	5,600	18,500
Yakult Honsha	Consumer Discretionary	Expansion	Company owned building Minato-ku	Waters Takeshiba Minato-ku	4,500	14,900
Asahi Mutual Life Insurance	Financial	HQ relocation	Asahi Seimei Otemachi Building Chiyoda-ku	Yotsuya Station Area Category I Urban Redevelopment Project Shinjuku-ku	2,800	9,300
Yamato System Development	Technology	Expansion	KR Toyosu Building Koto-ku	Harumi Island Triton Square Office Tower Z Chuo-ku	2,400	7,900

Source Nikkei RE, Savills Research & Consultancy

MAP 1: Average Rents Per Tsubo In Selected Submarkets Q1/2019



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

2,400 tsubo across four floors in Harumi Island Triton Square Office Tower Z to house 1,200 employees.

Minato

Minato's Grade A vacancy rate tightened slightly by 0.1ppts QoQ and 0.5ppts YoY to 0.4% at the end of the quarter. Grade A rents climbed by 1.4% QoQ and 4.4% YoY to JPY32,558 per tsubo. In 2020, SoftBank Group will relocate its headquarters to the Takeshiba Area Development Project Office Building, taking a massive 24,000 tsubo across 28 floors. WeWork will design the offices, while also leasing around 2,600 tsubo for its own purposes. IT systems integrator NS Solutions plans to take 6,350 tsubo across seven floors in Toranomon Hills Business Tower once it is completed, though it has not confirmed whether it will relocate its current headquarters there. Meanwhile, Yakult Honsha will move to Waters Takeshiba, taking all ten office floors. The building is slated for completion in spring 2020.

Shibuya

Shibuya's Grade A vacancy rate dipped by 0.1ppts QoQ and 0.6ppts YoY to sit at 0.1%. Grade A rents climbed by 2.6% QoQ to JPY36,353 per tsubo, growing by 8.3% YoY. WeWork will open its largest base in Japan in Shibuya Scramble Square in December 2019, taking 4,350 tsubo across five floors in the East Tower in order to prepare 3,500 desks. NN Life Insurance will also move in to Shibuya Scramble Square, relocating its headquarters in the spring of 2020, leasing 1,700 tsubo for around 700 employees.

Shinjuku

Shinjuku's Grade A rents climbed by 2.5% QoQ and 5.8% YoY to JPY32,273 per tsubo. The Grade A vacancy rate tightened marginally by 0.1ppts QoQ but was unchanged YoY, ending the quarter at just a fraction above 0.0%. Asahi Mutual Life Insurance will relocate its headquarters to the tentatively-named Yotsuya Station Area Category I Urban Redevelopment Project Office Building, leasing an estimated 2,800 tsubo. Riken Vitamin will also move its headquarters to the building, leasing 1,300 tsubo for 500 employees. The building appears to be fully pre-leased according to market sources.

NEWER BUILDINGS GENERALLY DRIVING GROWTH

Newer buildings offer a generous amount of space at a time when there is little availability in the secondary market, making them the only realistic choice for large firms that are increasing headcount or looking to consolidate their various offices. Strong demand for newly completed offices is certainly evident in pre-leasing activity, which looks robust throughout 2020. Aside from this, the unemployment rate has remained at or below 2.5% since the beginning of 2018, and firms are competing for talent. Newer buildings tend to come with a higher quality of amenities and a more appealing work environment, which could tip the scales in the hiring process. Firms also tend to value buildings with large floor plates, a common standard for newer buildings, as they believe consolidating their workforce into one area can improve employee creativity and inter-departmental collaboration. More practically, newer buildings tend to offer improved BCP and earthquake protection standards.

In Shibuya, where there has historically been less development activity compared to Chiyoda and Minato, newer offices are seeing strong growth. For example, according to the latest semi-annual Nikkei Real Estate Market Report, top rents in the Shibuya Station area have risen faster than any other surveyed area, at 8.3% YoY as of December 2018. Top rents in the Yaesu, Kyobashi and Nihonbashi area, by comparison, rose 2% YoY over the same period. Top rents in both areas now sit at the same level - JPY39,000 per tsubo - so the difference in growth rates is not necessarily due to Shibuya growing from a lower base. In particular, offices built between in Shibuya 2015 and 2016 are seeing exceptionally strong growth.

OUTLOOK

The Tokyo office market appears sturdy, underpinned by robust demand from corporations. With vacancy low and pre-leasing commitments taking up most of supply through 2020, there is certainly reason to be optimistic. Indeed, in 2018, when supply loomed large, rental growth was stronger than expected. Now even large pockets of incoming vacancy, such as at Harumi Triton, seem likely to be filled within a short period. Since there appears to be little cause for concern in the short term, the outlook for hard assets is positive and rents should continue to rise through 2019.

On the other hand, the economic cycle appears well extended and business survey results have weakened somewhat recently. Global uncertainty has been rising over the last few quarters, and the risk of a shock cannot be ruled out. To wit, all major European economies are in a state of confusion, the US yield curve has inverted for the first time since 2007, and global trade growth slowed in 2018.

It is also possible that the worst is over and economic growth could resume towards the end of this year. For instance, in China, there are signs of credit growth and the state of the semiconductor industry appears to be improving. The US Federal Reserve, in a dovish turn, has postponed interest rate hikes for the time being, and some concessions between the US and China over the trade conflict appear increasingly likely.

As for the Tokyo office market, the short-term outlook appears positive. Major landlords have been conservative, focusing on the creditworthiness of tenants as opposed to setting higher rents. For their part, corporate profits are still at a historically high level despite weakening somewhat recently, and the majority of Japanese corporations have strong balance sheets with plenty of cash. Thus, it seems rents may maintain their momentum unless a severe external shock emerges.

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.