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Savills World Research
Tokyo

Briefing
Office sector

Q1 2014

Image: Minato Ward

SUMMARY

With Japan's economy projected to follow a moderate growth trend for the foreseeable future, demand for top-quality office space is expected to remain high.

- Tokyo's Grade A vacancy rate fell back 120 basis points (bps) quarter-on-quarter (QoQ) to stand at 4.6%, spurred by strong absorption of 2012-vintage vacancies and high levels of pre-commitments in new completions.

- The average Grade A office passing rent in Tokyo's central five wards stood at JPY27,880 per tsubo, up 2.3% QoQ and 6.8% year-on-year (YoY).

- Catalysts for this upward trend include restricted availability in many submarkets, underpinned by robust demand across all of the major industry sectors.

- The average vacancy rate for large-scale Grade B office properties stood at 3.4%, marking its lowest level since Q3/2008.

- The average rent for large-scale Grade B office space stood at JPY21,005 per tsubo, up 1.8% QoQ or 6.0% YoY.

- Cyclically low availability in the upper Grade B sector, together with a fallback in average vacancy rates at Grade A office properties, will help to maintain the pace of the rental recovery in the near term.

"Strong absorption has seen the Grade A vacancy rate fall below the threshold 5% level for the first time since 2012's supply bulge."
Will Johnson, Savills Research

Market summary

Grade A office segment

Tokyo's Grade A vacancy rate continued its downward trend for a fourth consecutive quarter, falling back a significant 120 bps QoQ to stand at 4.6% in Q1/2014. This marks its first time below the threshold 5% level since a bulge in speculative supply saw the vacancy rate jump to a recent high of 7.0% in Q2/2012.

The significant improvement in prime availability can be largely ascribed to strong absorption of 2012-vintage primary vacancies, as well as high levels of pre-commitments at new buildings completed during the quarter.

The average passing rent of Savills basket of Grade A office buildings[1] in Tokyo's central five wards[2] was JPY27,880 per tsubo[3] per month, inclusive of common area management fees. This represents a healthy increase of 2.3% QoQ and a 6.8% improvement over the same period of last year.

Catalysts for this upward trend include restricted or falling availability in many of Tokyo's most competitive submarkets, underpinned by robust tenant demand. Requirements for relocation space have been recorded across all of the major industry sectors, fed both by the desire to secure quality space before rental prices rise further and Japan's brighter economic outlook.

Improving corporate performance has prompted an increasing number of companies to implement floor space expansions to facilitate headcount growth, with notable examples in the ITC/software, manufacturing and services sectors.

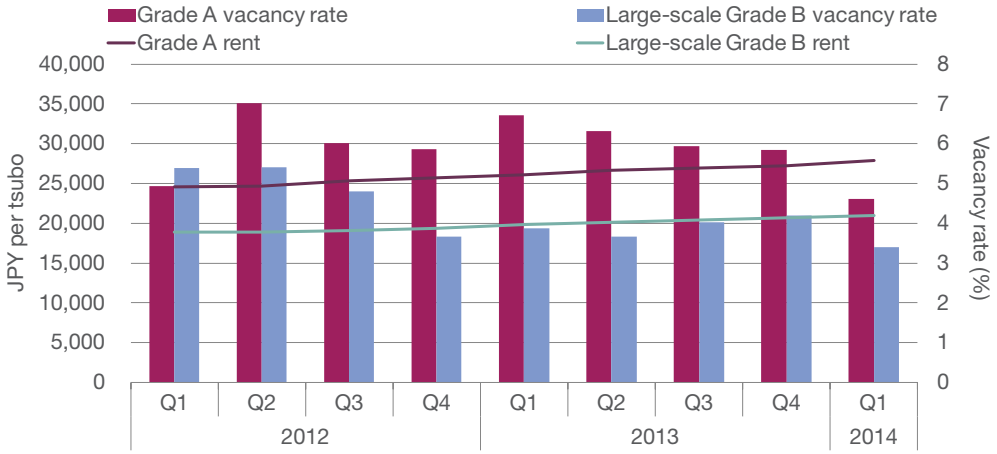
1 Grade A office refers to buildings located in the central five wards of Tokyo with a GFA of 30,000 sq m (9,000 tsubo) or higher and a building age of less than 15 years.

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.

GRAPH 1

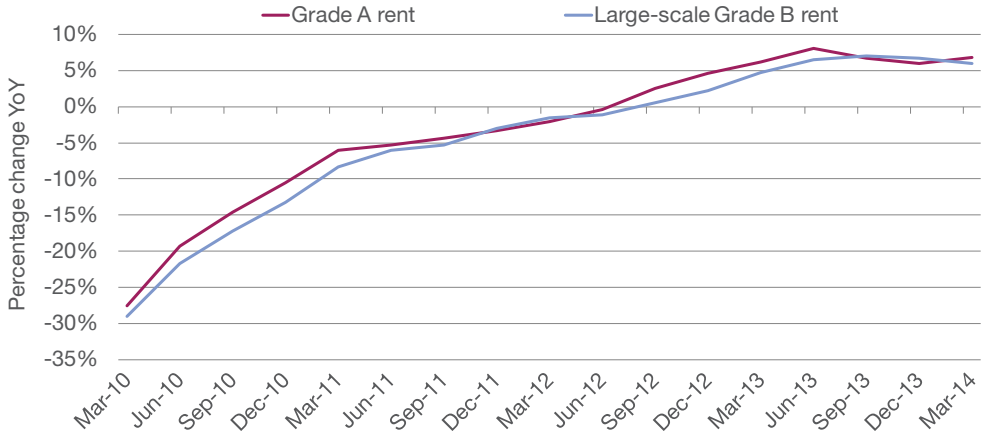
Office rents and vacancy rates in Tokyo's central five wards by grade, Q1/2012–Q1/2014



Source: Savills Research & Consultancy

GRAPH 2

YoY change in office passing rents in Tokyo's central five wards by grade, Q1/2010–Q1/2014



Source: Savills Research & Consultancy

Large-scale Grade B office segment

The average vacancy rate for large-scale Grade B office[4] properties stood at 3.4%, marking its lowest level since Q3/2008. Quarterly movement was equivalent to 80 bps, with availability in quality secondary properties remaining substantially lower than the Grade A average.

Take-up in this market segment has predominantly been at the expense of older, small- to mid-scale Grade B stock and outmoded owner-occupier buildings. This divergence within the Grade B market has resulted in uncompetitive properties being removed from the market, often for redevelopment.

Reflective of the limited amount of space available for lease, large-scale Grade B office properties posted a seventh straight quarter of modest rental growth. On average, such properties commanded passing rents of JPY21,005 per tsubo in Q1/2014, up 1.8% QoQ or 6.0% on a YoY basis.

Savills monitors rents and vacancy levels in over 280 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 research institutions, the rental data provided relates to estimated passing rents as opposed to asking rents, whereas 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.

Grade A rents and vacancy rates by ward

Chiyoda

Grade A office passing rents in Chiyoda Ward averaged approximately JPY34,535 per tsubo in Q1/2014, edging up 0.2% QoQ or 2.0% on a YoY basis.

Reflecting its status as Tokyo's most expensive office submarket, Chiyoda commands a rental premium of around 24% relative to the five-ward average. This rental premium has steadily tightened in recent years,

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.

reaching its lowest level since 2008 in the first quarter. Driving this movement has been comparatively faster rates of rental growth in neighbouring wards, spurred in part by the completion of new landmark buildings in commercial districts where Grade A stock is relatively limited.

Chiyoda's average Grade A vacancy rate fell 50 bps over the quarter to 4.2%, close to half of the ward's recent peak level of 8.1% recorded in Q4/2012.

Notable leasing deals at existing buildings include Mitsubishi UFJ Morgan Stanley PB Securities' relocation to Otemachi Financial City North Tower, where it will occupy approximately 1,576 tsubo (5,210 sq m) of floor space. Demand for upcoming projects was also seen, evidenced by internet services provider Internet Initiative Japan's planned relocation to Iidabashi Grand Bloom, which will reach completion in Fujimi this summer. Eight group companies separated across four different buildings will be consolidated in roughly 6,400 tsubo (21,157 sq m), representing a floor-space expansion of around 30%.

Chuo
The average Grade A passing rent in Chuo Ward stood at JPY25,665 per tsubo. While rents at existing properties remained stable, the inclusion of three newly-completed properties in the survey basket resulted in a quarterly increase of 4.0% in the ward's average rental level.

Strong tenant demand for prime space in this previously under-supplied submarket saw these new buildings come to the market either fully occupied or with high levels of pre-commitments. Resultantly, Chuo Ward's average Grade A vacancy rate was stable compared with the previous quarter at 5.7%.

The first quarter saw Osaka-based steel trading firm Hanwa announce the relocation of its headquarters to Ginza Shochiku Square in Tsukiji from the 32-year-old Ginza MTR Building. The company will lease approximately 2,251 tsubo (7,441 sq m) at its new location.

Minato
The average Grade A office rent in Minato stood at approximately JPY27,630 per tsubo, up 1.0% for the second quarter in a row, or 5.2% on a YoY basis.

Following a jump in Minato's Grade A vacancy rate last quarter due to the release of previously-occupied space back to the market in Shinagawa district, movement was more positive in Q1/2014. The prime vacancy rate fell back 50 bps QoQ to 6.4%, with sizable vacancies filled in the Roppongi and Akasaka submarkets.

Shibuya
Grade A passing rents in Shibuya stood at approximately JPY28,460 per tsubo in Q1/2014, up 3.9% QoQ or 11.5% YoY. Steady increases in passing rents in Shibuya since 2012 have made it the second most expensive ward on average for prime space, taking it ahead of Minato Ward as of the first quarter.

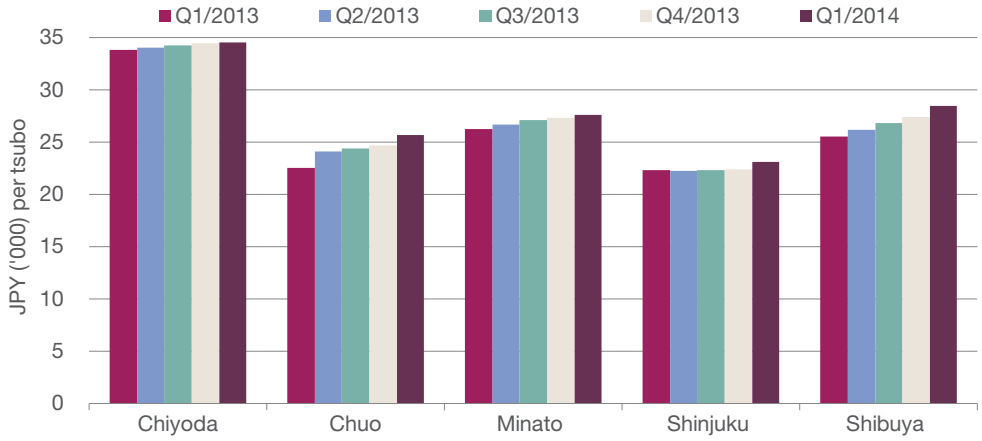
The ward's strong rental growth is attributable to its favourable supply-demand balance: the Grade A vacancy rate in Shibuya continued to hover around the 2.0% level for a fourth consecutive quarter.

Shinjuku
The average Grade A rental level in Shinjuku Ward posted its strongest performance since the global financial crisis, rising 3.0% QoQ to approximately JPY23,105 per tsubo. Spurring this rise was a sharp improvement in the ward's average Grade A vacancy rate, which fell some 540 bps over the quarter to 4.9%. This marks the lowest level since Q1/2011 and its first time below the 10% threshold since being oversupplied with speculatively-developed space back in Q2/2012.

Accounting for much of the recent drop in Shinjuku's prime vacancy rate was a series of leasing deals at Shinjuku Eastside Square. Approximately 3,580 tsubo (11,835 sq m) was taken here by department store operator Isetan Mitsukoshi Holdings and 2,100 tsubo (6,942 sq m) by Takasago Thermal Engineering. Around 608 tsubo (2,010 sqm) separately came off the market in a deal involving Cross Marketing, an internet research company, at Tokyo Opera City.

GRAPH 3

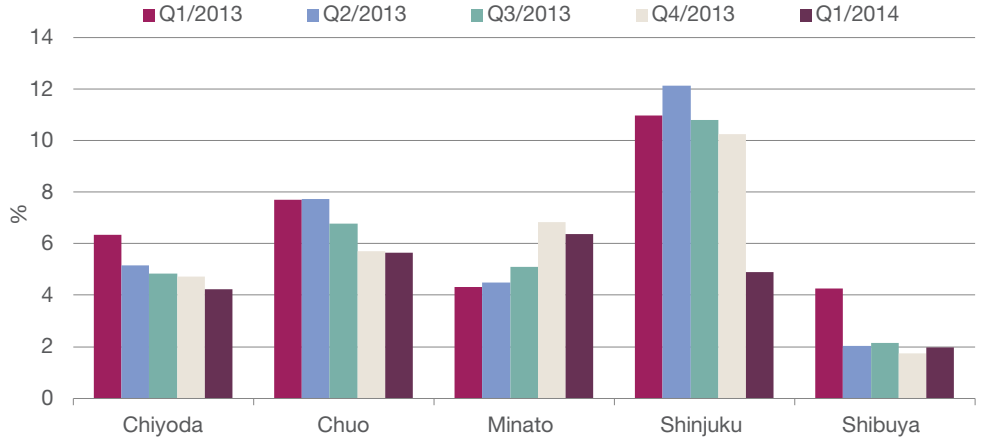
Average Grade A office rents by ward, Q1/2013–Q1/2014



Source: Savills Research & Consultancy

GRAPH 4

Average Grade A office vacancy rates by ward, Q1/2013–Q1/2014



Source: Savills Research & Consultancy

TABLE 1

Notable office leasing transactions, Q1/2014

Company	Business sector	Type	Former building(s)/ location	New building(s)/ location	Approximate space taken	
					tsubo	sq m
Internet Initiative Japan	Internet services	Headquarters relocation/ consolidation/ expansion	Four locations including the Jinbocho Mitsui Building/Chiyoda	Iidabashi Grand Bloom/Chiyoda Ward	6,400	21,157
Isetan Mitsukoshi Holdings	Department store operator	Headquarters relocation/ consolidation	Isetan Annex 2 and nearby buildings/ Shinjuku Ward	Shinjuku Eastside Square/Shinjuku Ward	3,580	11,835
Hanwa	Steel trading	Headquarters relocation	Ginza MTR Building/Chuo Ward	Ginza Shochiku Square/Chuo Ward	2,251	7,441
Takasago Thermal Engineering	Engineering/ manufacturing	Headquarters relocation/ consolidation	Four locations in Chiyoda and Shinjuku wards, including TriEdge Ochanomizu	Shinjuku Eastside Square/Shinjuku Ward	2,100	6,942
Mitsubishi UFJ Morgan Stanley PB Securities	Banking and securities	Headquarters relocation/ expansion	Nihonbashi Itchome Building/Chuo Ward	Otemachi Financial City North Tower/ Chiyoda Ward	1,576	5,210

Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

Many domestic companies reported record levels of profits in fiscal year 2013, buoyed by a combination of the yen's depreciation, the economic recovery fostered by 'Abenomics' and business restructuring to raise efficiency. With Japan's economy projected to follow a modest growth trend for the foreseeable future, office demand is expected to remain high, particularly from companies seeking to upgrade to better premises, consolidate operations separated across multiple locations or expand their workspace footprint.

Cyclically low availability in the large-scale Grade B sector, together with declining vacancy rates at Grade A office properties, will help to maintain the pace of the rental recovery in the near term. Major landlords will increasingly adopt a more bullish stance to raise rents for existing tenants upon lease renewal. This outlook is supported by a favourable supply pipeline, as high levels of pre-commitments will largely mitigate the impact of new prime completions this year.

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