

Briefing Office sector

Q2 2015

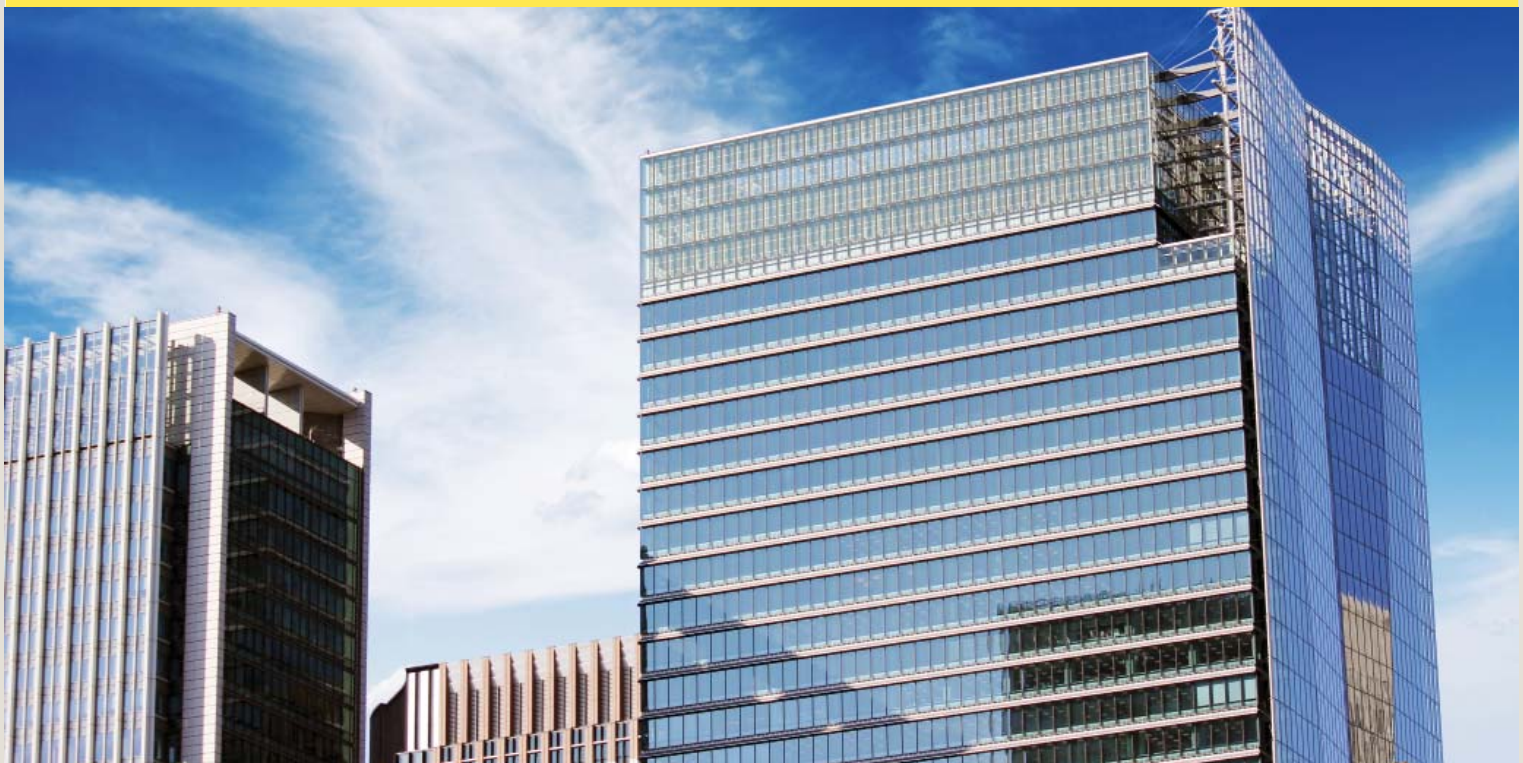


Image: Marunouchi, Chiyoda Ward

SUMMARY

Despite Grade A rents having risen steadily for consecutive quarters since Q2/2012, the rental average remains approximately 40% below the previous cyclical high of 2007.

- The average Grade A office vacancy rate in Tokyo's central five Wards improved by 1.3 percentage points (ppts) Year on Year (YoY) in the second quarter to 3.1%, falling 0.5% over the preceding quarter.

- The estimated passing rents for Grade A office space increased to JPY30,520 per tsubo per month, representing a 6.5% increase YoY and 1.3% rise over the preceding quarter.

- The average vacancy rate for large-scale Grade B office space drifted

downwards to 2.4%, an improvement of 0.3 ppts quarter-on-quarter (QoQ) and 0.8 ppts YoY.

- The estimated passing rents for large-scale Grade B office space reached JPY23,250 per tsubo, up 1.7% QoQ and 8.3% YoY.

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 “With limited available stock in certain locations, rental growth currently seems irresistible.”
 Savills Research

➔ **Grade A office segment**

The average Grade A¹ office vacancy rate in Tokyo's central five Wards improved by 1.3 ppts YoY in the second quarter to 3.1%, falling 0.5% over the preceding quarter.

In the second quarter, the estimated passing rents for Grade A office space increased to JPY30,520 per tsubo² per month, representing a 6.5% increase YoY, a 1.3% rise over the preceding quarter and the highest figure since Q2/2009.

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 1 tsubo = 3,306 sq m or 35,583 sq ft

A steady flow of large lease agreements has dramatically reduced the amount of office space in top-grade buildings available for headquarters relocations, i.e. properties with whole floors for lease or vacancies across contiguous floors. This is not only benefitting the landlords of existing buildings, who are requesting higher rents for new agreements and lease renewals, but also developers in the form of pre-agreements for planned schemes and projects under construction.

Large-scale Grade B office segment

Driven by strong occupier demand for high-quality consolidation space

and property upgrades, the average vacancy rate for large-scale Grade B³ office properties drifted downwards to another new cyclical low of 2.4%. An improvement of 0.3 ppts QoQ and 0.8 ppts YoY, this figure represents the lowest level of vacancy since Q2/2008.

Vacancy rates in this market segment have demonstrated a positive trend since early 2011, reflecting a flight to quality among tenants at the expense of older, small- to mid-scale rental buildings and outmoded owner-occupier stock. This bifurcation within the Grade B market has resulted in uncompetitive properties being removed from the market for both refurbishment and redevelopment.

Reduced levels of availability have buoyed achievable rents. The average monthly rent for large-scale Grade B properties monitored by Savills reached JPY23,250 per tsubo in Q2/2015, up 1.7% QoQ and 8.3% YoY – the second fastest rate of increase since the global financial crisis.

Grade A rents and vacancy rates by Ward Chiyoda

The average Grade A vacancy rate in Chiyoda continued to lead the positive trend to reach 1.5% rate in the second quarter – its lowest level since Q3/2008. This figure represents marginal in-movement of 0.1 ppts over the previous quarter and 2.7 ppts YoY. Grade A office passing rents in Chiyoda Ward averaged approximately JPY37,370 per tsubo in Q2/2015, up 1.0% QoQ or 6.9% YoY.

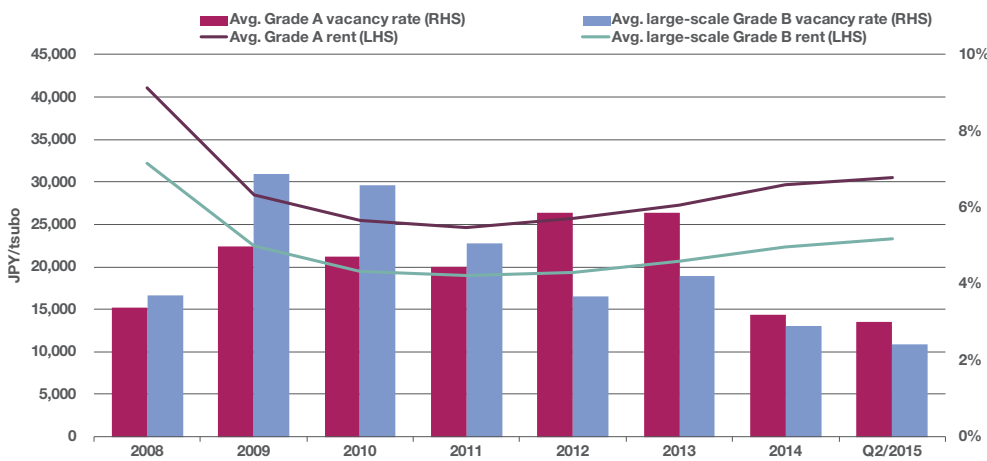
Reflecting its status as Tokyo's most expensive office location, Chiyoda maintains a strong rental premium relative to the five-Ward average. Nonetheless, faster rates of growth in the other Wards have resulted in this premium being compressed from around 36% at the bottom of the market in early 2012, to approximately 22% in Q2/2015.

Chuo

Chuo Ward's average Grade A vacancy rate strengthened to

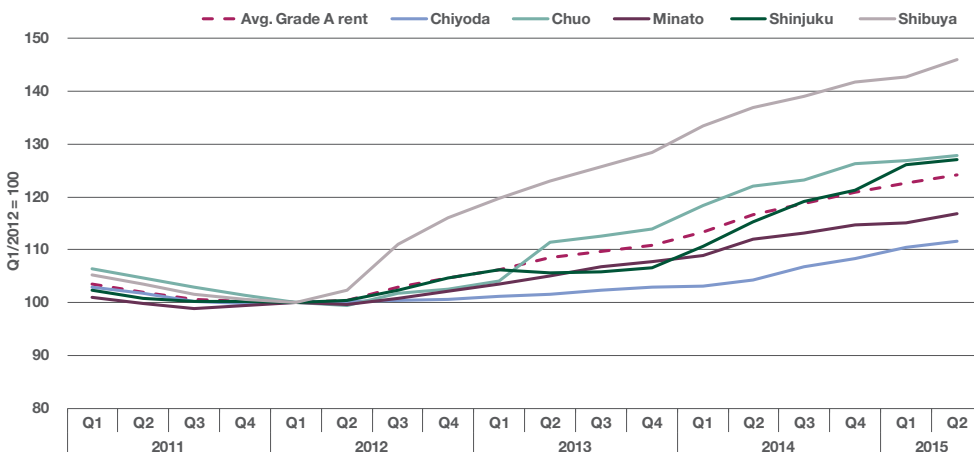
³ Large-scale Grade B office refers to buildings with a GFA of 15,000 sq m (4,500 tsubo) with a building age of less than 25 years. Some buildings are included that do not fit this definition.

GRAPH 1 **Office rents and vacancy rates in Tokyo's central five Wards* (C5W) by grade, 2008–Q2/2015**



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

GRAPH 2 **Grade A office rental index by Ward, Q1/2011–Q2/2015**



Source: Savills Research & Consultancy

→ 1.5%, a steady improvement of 1.0 ppts QoQ and 1.5 ppts compared to the same quarter of last year. The average Grade A passing rent in Chuo Ward stood at JPY27,720 per tsubo, up 0.8% QoQ and 4.8% YoY. The current occupancy in Tokyo Nihombashi Tower seems approximately 60% and its absorption is considered stable with multiple relocation activities from firms such as T&D Insurance Group, BOT Lease and Denso.

Minato

The Grade A vacancy rate improved in Minato, rising to 6.1% in the first quarter following the completion of Shinagawa Season Terrace in early 2015, due to the moderate pre-commitment activity in the building. As of the second quarter, the vacancy rate in Minato Ward fell to 5.5%, an improvement of 0.7% QoQ and 0.4% YoY, reflecting a solid demand in the area.

In addition to the small- to mid-sized lease agreements recorded at existing buildings, sizable leases were also reported. These include Fujitsu Systems East's relocation plan for its headquarters from Bunkyo Ward to Shinagawa Season Terrace, as well as Hitachi Metals. Shinagawa Season Terrace seems to secure tenants for more than half of its floors.

The average Grade A office rent in Minato rose 1.5% QoQ to approximately JPY29,630 per tsubo, up 4.2% on a YoY basis.

Shibuya

Shibuya's average Grade A vacancy rate improved further in the second quarter to 0.6%, a decline of 1.4% over the same period in 2014. With a limited number of prime buildings available for rent in this submarket comparative to the other Wards, the balance remains on the side of the landlords. Average Grade A rents increased 2.3% QoQ to JPY31,110 per tsubo, up for a fourteenth consecutive quarter, taking the annual growth rate to 6.6%.

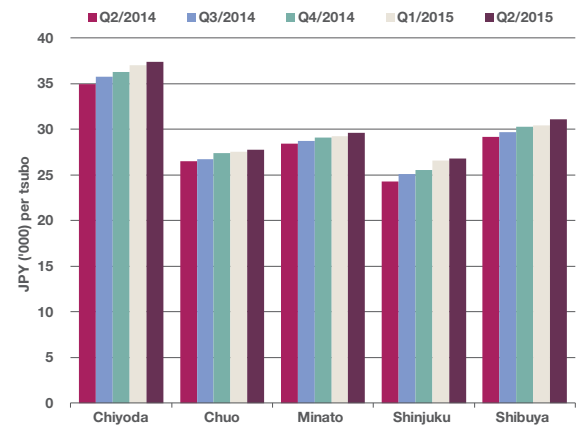
As a result of steady increases in its average Grade A rent since 2012, Shibuya became Tokyo's second most expensive Ward in Q4/2013, and still maintained a significant lead over third-place Minato in the second quarter.

Shinjuku

Shinjuku's average Grade A vacancy rate showed a blip in the second quarter, up 0.5 ppts QoQ to 2.9%. This represents a marginal increase of 0.3 ppts YoY, mainly due to the relocation of JTB Corporate Sales from Shinjuku Park Tower. The company vacated around 2,000 tsubo in the building and moved to the Shinjuku Mitsui Building in Nishi-Shinjuku, with some of its departments moving to the Kasumigaseki Building in the Chiyoda Ward.

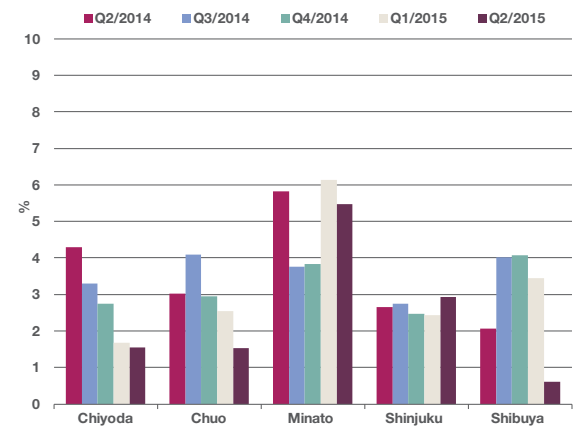
Shinjuku recorded the highest rate of Grade A office rental growth,

GRAPH 3 Average Grade A office rents by Ward, Q2/2014–Q2/2015



Source: Savills Research & Consultancy

GRAPH 4 Average Grade A office vacancy rates by Ward, Q2/2014–Q2/2015



Source: Savills Research & Consultancy

TABLE 1 Notable office leasing transactions, Q2/2015

Company	Business sector	Type	Former building(s)/location	New building(s)/location	Approximate space taken	
					tsubo	sq m
Fujitsu Systems East	System development	Headquarters relocation	Bunkyo Green Court Center Office / Bunkyo Ward	Shinagawa Season Terrace / Minato Ward	4,500	14,900
Taiyo Life Insurance, Daido Life Insurance, T&D Holdings	Insurance	Headquarters relocation	Shiodome Shiba-Rikyu Building / Minato Ward	Tokyo Nihonbashi Tower / Chuo Ward	4,000	13,200
Aozora Bank	Bank	Headquarters relocation	Tokyodo Chiyoda Building / Chiyoda Ward	Sophia Tower* / Chiyoda Ward	4,000	13,200
Pacific Consultants	Civil engineering consulting	Headquarters relocation / consolidation	Multiple, incl. Seiseki C-kan / Tama City	Terrace Square / Chiyoda Ward	3,200	10,600
Mitsubishi UFJ Kokusai Asset Management	Asset management	Headquarters relocation / consolidation	Multiple, incl. Mitsubishi UFJ Trust and Banking Head Office / Chiyoda City	Shin-Yurakucho Building / Chiyoda Ward	2,800	6,700

Source: Savills Research & Consultancy, Nikkei RE
 * Buildings under construction

having risen double-digits YoY at 10.3% to JPY26,770 per tsubo in the second quarter. Movement over the preceding quarter was a marginal 0.9%.

Savills monitors rents and vacancy levels at more than 450 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, 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. ■

OUTLOOK

The prospects for the market

Tokyo's rental recovery is expected to maintain its momentum through 2015, given the current limited volume of available space suitable for large-scale corporate relocations. This has not only encouraged landlords to demand higher rents for new leases, but also accelerate the absorption of buildings newly-supplied to the market in the near-term.

As more floors are filled up, vacancy rates are likely to go down and rents go up. We see this symptom especially in the West End of Tokyo, Shibuya and Shinjuku Wards. Then, this trend should be followed by the rest of central five

wards. In all areas, we see larger-scale leasing agreements than before.

Despite Grade A rents having risen steadily for consecutive quarters since Q2/2012, the rental average remains approximately 40% below the previous cyclical high of 2007. This not only mitigates downside risk but indicates that the market has considerable upside potential. However, any unpredictable event in global political and economic situations may lead to some market uncertainties. However, the current geopolitical and global economic uncertainty, particularly if lingering, might visibly affect the Japan's real economy and real estate market.

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