

Briefing Office sector

Q3 2016



SUMMARY

Rents continue to rise, albeit very slowly and in select areas. Temporary corrections in some buildings have resulted in an average that is largely flat to the previous quarter.

■ Average estimated passing rents for Grade A office space increased to JPY31,631 per tsubo¹ per month, representing a 0.1% rise over the preceding quarter and a 2.5% increase year on year (YoY).

■ The average Grade A office vacancy rate in Tokyo's central five wards again improved marginally by 0.1 percentage point (ppt) over the preceding quarter to 1.6%, strengthening by 0.8ppts YoY.

■ The estimated passing rents for large-scale Grade B office space

reached JPY24,060 per tsubo, flat quarter-on-quarter (QoQ) and up 2.2% YoY.

■ The average vacancy rate for large-scale Grade B office properties improved 0.3ppts QoQ to 2.0%, a tightening of 0.6ppts over the same period the previous year.

■ Minato and Shibuya both saw small QoQ temporary rental corrections for the first time since 2012 and 2011 respectively.

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 “Q3/2016 Grade A and B office rents in the central five wards are slightly growing but largely flat to the previous quarter. Small, gradual increases are still visible, but a few select buildings have lowered asking rents, limiting overall growth.”
 Savills Research

¹ 1 tsubo = 3.306 sq m or 35.583 sq ft

➔ **Grade A offices**

Continued flow of lease agreements in the central five wards (C5W) has strengthened occupancy even more in the third quarter, despite already tight conditions. The average Grade A¹ office vacancy rate fell by 0.8ppts YoY to 1.6%, tightening an additional 0.1ppt against the preceding quarter.

The estimated passing rent for Grade A office space increased to JPY31,631 per tsubo per month, representing a 2.5% increase YoY and a 0.1% increase QoQ, reaching the highest rental figure since 2009. The rate of increase has slowed precipitously over the past few quarters, however. It may take some time before central Tokyo posts additional highs.

Large-scale Grade B offices

After a temporary softening in Q2, the average vacancy rate for large-scale Grade B² office properties has decreased by 0.3 ppts QoQ to 2.0% as of Q3/2016. Like in Grade A properties, high demand from tenants has led to a gradual tightening of occupancy conditions.

Rental slowdown is also visible in Grade B property. The average monthly rent for large-scale Grade B properties held steady at JPY24,060 per tsubo in the third quarter. This represents a YoY gain of 2.2% despite no quarterly movement.

Grade A rents and vacancy rates by ward Chiyoda

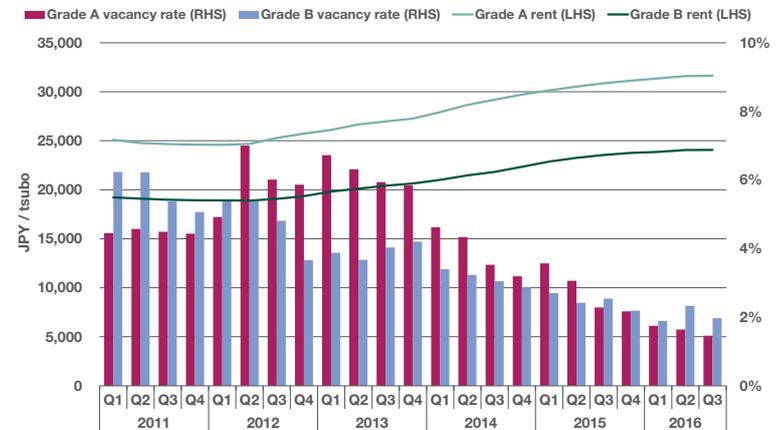
The Grade A vacancy rate in Chiyoda was 1.6% in Q3/2016, a slight softening of 0.4ppts YoY. The average Grade A passing rent in Chiyoda stood at JPY38,972 per tsubo, up by 0.3% QoQ and 3.2% YoY.

Notable tenant moves include website operator Next, which manages the real estate leasing site Home's. The company will relocate to the Zenitaka Annex in April 2017, leasing the building in its entirety and taking up 1,464 tsubo. Meanwhile, the Development Bank of Japan plans to

1 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.

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.

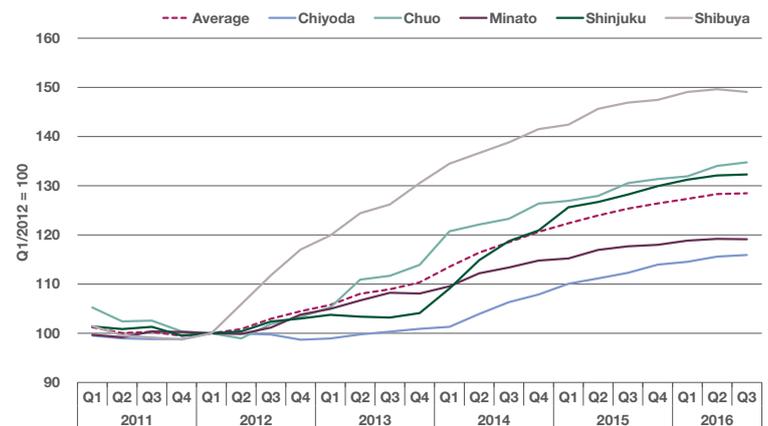
GRAPH 1 **Average office rents and vacancy rates in Tokyo's central five wards* , Q1/2011–Q3/2016**



Source: Savills Research & Consultancy

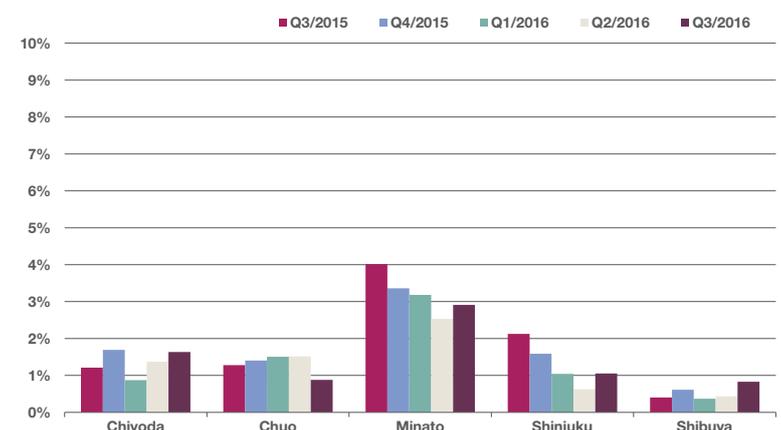
* Tokyo's central five wards (C5W) are comprised of Chiyoda, Chuo, Minato, Shibuya and Shinjuku.

GRAPH 2 **Grade A office rental index by ward, Q1/2011–Q3/2016**



Source: Savills Research & Consultancy

GRAPH 3 **Average Grade A office vacancy rates by ward, Q3/2015–Q3/2016**



Source: Savills Research & Consultancy

TABLE 1
Notable office leasing transactions, Q3/2016

Company	Business sector	Type	Former building(s) / location	New building(s) / location	Approximate space taken	
					tsubo	sq m
DMM.com	Media	HQ relocation	Yebisu Garden Place Tower / Shibuya	Sumitomo Fudosan Roppongi Grand Tower / Minato	5,000	16,500
Fast Retailing	Apparel	HQ relocation	Tokyo Midtown Tower / Minato	D Project Ariake / Koto	5,000	16,500
Mynavi	Media	Expansion	Palace Side Building / Chiyoda	JR Shinjuku Miraina Tower / Shinjuku	3,150	10,400
Roche Diagnostics	Pharma	HQ relocation	Shiba Ni-Chome Building / Minato	Shinagawa Season Terrace / Minato	3,000	9,900
Development Bank of Japan	Development bank	Subsidiary consolidation	Various (7 subsidiaries) / Various	Otemachi Grand Cube / Chiyoda	1,700	5,600

Source: Savills Research & Consultancy, Nikkei RE

→ consolidate seven of its subsidiaries in 1,700 tsubo of space leased in the brand-new Otemachi Grand Cube.

Chuo

Chuo ward’s average Grade A vacancy rate tightened an additional 0.6ppts QoQ to reach 0.9% in Q3/2016, a YoY improvement of 0.4ppts. The average Grade A passing rent in Chuo stood at JPY29,200 per tsubo, up by 0.6% QoQ and 3.3% YoY.

In February 2017, construction company Tomoe will lease 1,100 tsubo in the Daiwa Tsukishima Building while the area around its current headquarters, also in Chuo, undergoes redevelopment over the next ten years.

Minato

The average Grade A vacancy rate in Minato weakened slightly to 2.9% in Q3/2016 after five consecutive quarters of strengthening. This figure still represents an improvement of 1.1ppts YoY. The average Grade A office rent in Minato weakened slightly by 0.1% QoQ to JPY30,184 per tsubo, up 1.2% YoY.

Despite this apparent correction in vacancy, large companies continue to announce moves to Minato. Sumitomo Fudosan Roppongi Grand Tower and Shinagawa Season Terrace were both popular destinations in Q3. Media conglomerate DMM.com and Godiva will both move to the former, with DMM.com in particular planning to take up 5,000 tsubo of space on five floors. Roche Diagnostics and gambling

association JKA will meanwhile both move into Shinagawa Season Terrace, taking up a total of 4,500 tsubo.

Fast Retailing, owner of Japan’s global Uniqlo apparel brand, made headlines in Q3 by deciding to substantially relocate its space in Tokyo Midtown Tower to a 5,000 tsubo office floor in a newly-developed logistics facility in Koto Ward. This move surprised some market observers, but there is no evidence of an imminent exodus from the central five wards. Fast Retailing’s decision is a rare example of a large company developing and occupying its own industrial facility. Secondary vacancy has typically not been a problem in high-grade office buildings in the central five wards.

Shibuya

Shibuya’s average Grade A vacancy rate loosened 0.4ppts QoQ, but at 0.8% is still close to maximum capacity. Grade A rents declined by 0.4% QoQ to JPY31,846 per tsubo, exactly where they were in March, posting YoY growth of 1.5%.

As a result of steady increases in its average Grade A rent since 2012, Shibuya became the second most expensive ward in Tokyo in Q4/2013, and still maintains a significant lead over third-place Minato. The ward is a mecca for smaller, more youth- and tech-oriented companies. Web site operator and media company Peroli, for example, plans to lease about 600 tsubo in the newly-completed Nextsite Shibuya Building.

Shinjuku

In Q2/2016, Shinjuku’s average Grade A vacancy rate loosened half a percentage point QoQ to 1.1%, which is still 1.1ppts tighter than a year ago. Shinjuku is still very close to capacity. Grade A rents in Shinjuku climbed 0.2ppts QoQ to reach JPY27,955 per tsubo, representing a YoY increase of 3.2%. This is very similar to YoY growth of 3.2% in Chiyoda and 3.3% in Chuo.

Shinjuku’s leasing market has been quieter in the third quarter, but new property is still attracting attention from potential tenants. For example, job site operator Mynavi is leasing space in JR Shinjuku Miraina Tower and reportedly plans to occupy about five floors totalling over 3,000 tsubo.

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. ■

OUTLOOK

The prospects for the market

Though rental growth is still positive, increases have slowed to a crawl and Minato and Shibuya posted minor, temporary corrections in specific buildings. Occupancy nevertheless remains extremely strong and the leasing

market continues to see activity. Tenants appear to be adopting a wait-and-see attitude towards the end of the year until the direction of the world economy becomes clearer. We should have a better sense of the market's direction once major global

events such as the US election have been resolved.

Please contact us for further information

Savills Japan



Christian Mancini
 CEO, Asia Pacific
 (Ex Greater China)
 +81 3 6777 5150
 cmancini@savills.co.jp

Savills Research



Tetsuya Kaneko
 Director, Head of Research
 & Consultancy, Japan
 +81 3 6777 5192
 tkaneko@savills.co.jp



Hafiz Ismail
 Manager, Research &
 Consultancy, Japan
 +81 3 6777 5171
 hismail@savills.co.jp



Simon Smith
 Senior Director
 Asia Pacific
 +852 2842 4573
 ssmith@savills.com.hk

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