

Briefing Office sector

Q3 2015



Image: Chiyoda Ward, Tokyo

SUMMARY

The rental average still stands approximately 40% below the pre-crisis high of 2007, although Grade A rents have risen steadily for consecutive quarters since Q2/2012.

- The average Grade A office vacancy rate in Tokyo's central five wards improved by 1.2 percentage points (ppts) year-on-year (YoY) in the third quarter to 2.3%, falling by 0.8 ppts over the preceding quarter.
- The estimated passing rents for Grade A office space increased to JPY30,865 per tsubo per month, representing a 5.8% increase YoY and a 1.1% rise over the preceding quarter.
- The average vacancy rate for large-scale Grade B office properties remained stable at 2.4%, an improvement of 0.5 ppts over the same period in the previous year.
- The estimated passing rents for large-scale Grade B office space reached JPY23,540 per tsubo, up by 1.2% quarter-on-quarter (QoQ) and 7.9% YoY.

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 “Sustained demand led to a steady recovery in the prime vacancy rate and rents over the past three years. While this trend is expected to continue, the pace of rental growth may soften since tenants tend to be more price-sensitive.”
 Savills Research

➔ **Grade A office segment**

The average Grade A¹ office vacancy rate in Tokyo's central five wards² improved by 1.2 pts YoY in the third quarter to 2.3%, falling by 0.8 pts over the preceding quarter.

In the third quarter, the estimated passing rents for Grade A office space increased to JPY30,865 per tsubo³ per month, representing a 5.8% increase YoY, a 1.1% rise over the preceding quarter and the highest figure since Q2/2009.

A steady flow of lease agreements has reduced the amount of office space in high-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-leasing for planned schemes and projects.

Large-scale Grade B office segment

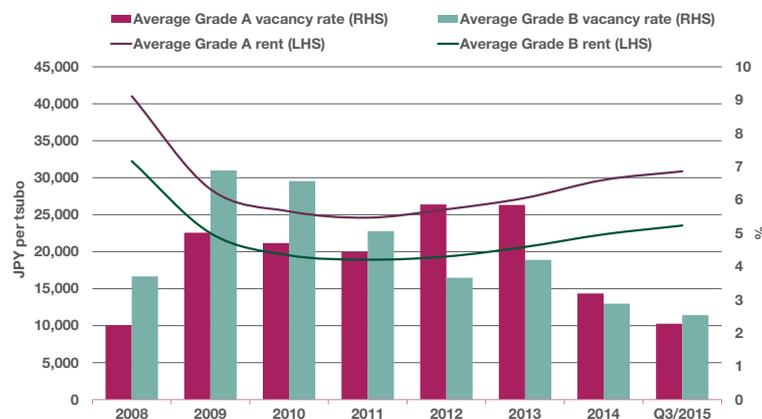
Driven by strong occupier demand for high-quality consolidation space and property upgrades, the average vacancy rate for large-scale Grade B⁴ office properties remains stable at 2.5%, an improvement of 0.5 pts over the same period in the previous year. However, this figure also represents a marginal decline of 0.1 pts QoQ.

Vacancy rates in this market segment have demonstrated a positive trend since early 2011, reflecting demand for quality among tenants at the expense of older, small- to mid-scale rental buildings. 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 JPY23,540 per tsubo in the third quarter, an increase of

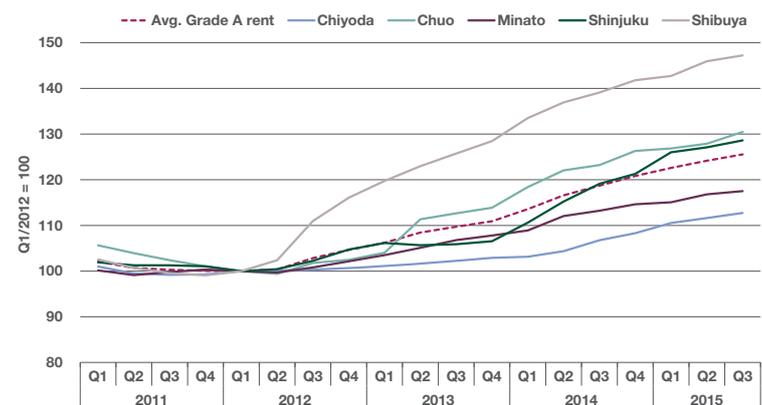
1 Grade A office refers to buildings located in the central five wards of Tokyo with a GFA of 9,000 tsubo (30,000 sq m) or larger and a building age of less than 15 years.
 2 Tokyo's central five wards (C5W) comprise of Chiyoda, Chuo, Minato, Shibuya and Shinjuku Ward.
 3 1 tsubo = 3.306 sq m or 35.583 sq ft
 4 Large-scale Grade B office refers to non-Grade A buildings with a GFA of 4,500 tsubo (15,000 sq m) or larger and a building age of less than 25 years. Some buildings are included that do not fit this definition.

GRAPH 1 **Office rent and vacancy rate trend in Tokyo's central five wards (C5W) by grade, 2008–Q3/2015**



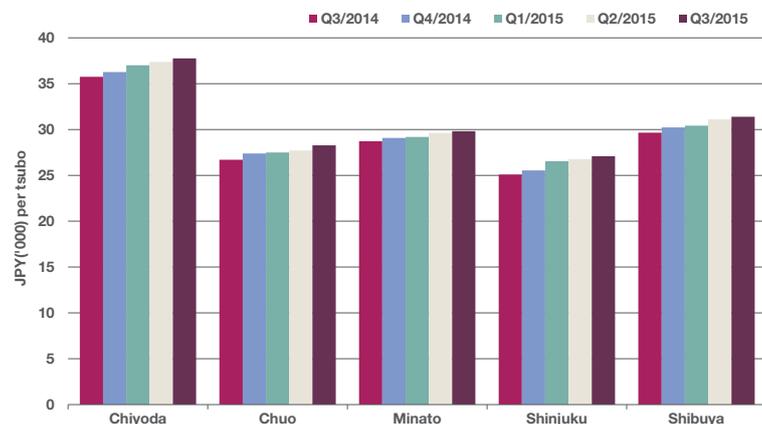
Source: Savills Research & Consultancy

GRAPH 2 **Grade A office rental index by ward, Q1/2011–Q3/2015**



Source: Savills Research & Consultancy

GRAPH 3 **Average Grade A office rents by ward, Q3/2014–Q3/2015**



Source: Savills Research & Consultancy

→ 1.2% QoQ and 7.9% YoY. This figure represents the highest rental figure since Q3/2009.

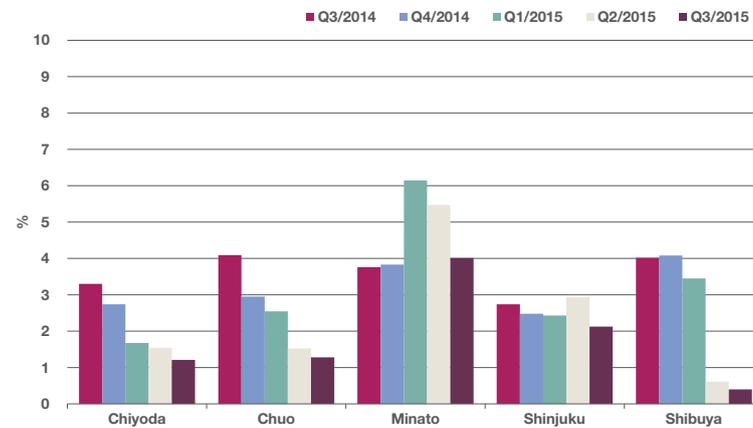
Savills monitors rents and vacancy levels at more than 450 buildings located in Tokyo's central five wards with a GFA of 3,020 tsubo (10,000 sq m) or above. Unlike similar market information issued by other research institutions, the rental data provided relates to estimated passing rents, inclusive 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 consequence, benchmark figures, particularly vacancy rates, tend to be lower than other market indices.

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 1.2% in the third quarter – the lowest level since Q3/2008. This figure represents an improvement of 0.3 ppts over the preceding quarter and 2.1 ppts YoY. Grade A office passing rents in Chiyoda Ward averaged approximately JPY37,755 per tsubo in Q3/2015, up by 1.0% QoQ or 5.6% 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 growth in the other

GRAPH 4 Average Grade A office vacancy rates by ward, Q3/2014–Q3/2015



Source: Savills Research & Consultancy

wards have resulted in this premium being compressed from around 36% at the bottom of the market in early 2012, to approximately 22% in Q3/2015.

Chuo
Chuo Ward's average Grade A vacancy rate strengthened to 1.3%, a steady improvement of 2.8 ppts YoY and 0.2 ppts over the preceding quarter. The average Grade A passing rent in Chuo Ward stood at JPY28,280 per tsubo, up by 1.0% QoQ and 5.6% YoY.

Major leasing activities include the relocation of JA Mitsui Leasing headquarters from Shinagawa Ward to Ginza Mitsui Building in Chuo Ward, and the relocation of Yoshinoya Holdings from its own building

in Bunkyo Ward to River Gate in Nihonbashi-Hakozakicho.

Minato
The Grade A vacancy rate in Minato improved to 4.0% in the third quarter. Early this year, Minato's vacancy rate was dampened to 6.1% following the completion of Shinagawa Season Terrace. This is mainly due to sluggish pre-commitment activity in the building. The absorption has since been steady with a few sizable leases reported during this quarter totalling around 7,500 tsubo in the building.

Minato's average Grade A vacancy rate increased by 0.3 ppts YoY, but maintained a steady improvement of 1.5 ppts over the preceding quarter, reflecting a solid demand in the

TABLE 1 Notable office leasing transactions, Q3/2015

Company	Business sector	Type	Former building(s) / location	New building(s) / location	Approximate space taken	
					tsubo	sq m
LINE	Social networking service operator	Headquarters relocation / consolidation	Multiple, incl. Shibuya Hikarie / Shibuya Ward	JR Shinjuku Miraina Tower* / Shinjuku Ward	5,670	18,700
JCB	Credit card company	Branch consolidation	Aoyama Rise Square / Minato Ward	Sumitomo Fudosan Shinjuku Garden Tower* / Shinjuku Ward	3,000	9,920
Hitachi Metals	Manufacturer	Headquarters relocation/ consolidation	Seavans North Building / Minato Ward	Shinagawa Season Terrace / Minato Ward	3,000	9,920
Medtronic Japan	Manufacturer	Headquarters relocation/ consolidation	Multiple, incl. NBF Comodio Shiodome / Minato Ward	Shinagawa Season Terrace / Minato Ward	3,000	9,920
JA Mitsui Leasing	Leasing business	Headquarters relocation	Higashi-Gotanda Square / Shinagawa Ward	Ginza Mitsui Building / Chiyoda Ward	2,530	8,360

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

→ area. The average Grade A office rent in Minato rose by 0.6% QoQ to JPY29,815 per tsubo, up 3.8% on a YoY basis.

Shibuya

Shibuya's average Grade A vacancy rate continues on a downward trend from the previous quarter to 0.4%, a strong improvement of 3.6% 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 supply and demand dynamics remain on the side of the landlords. Average Grade A rents increased by 0.9% QoQ to JPY31,385 per tsubo, up for a fifteenth consecutive quarter, taking the annual growth rate to 5.8%.

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

Shinjuku

In the third quarter, Shinjuku's average Grade A vacancy rate showed an improvement of 0.8 ppts over the preceding quarter and improved by 0.6 ppts YoY to stand at 2.1%.

While Shinjuku offers the most inexpensive prime rental space on average of the central five wards,

rents have been picking up in recent quarters, and it recorded the highest rate of Grade A office rental growth, having risen by 8.0% YoY to JPY27,090 per tsubo in the third quarter. Movement over the preceding quarter was steady at 1.2%.

Demonstrating demand for large upcoming developments, LINE and its affiliates agreed to take approximately

5,670 tsubo of space at JR Shinjuku Miraina Tower.

The prime office building is currently under construction by JR East and is scheduled to be completed in March next year. The social networking service operator will relocate and consolidate from three offices scattered over multiple locations including Shibuya Hikarie in Shibuya Ward. ■

OUTLOOK

The prospects for the market

Sustained demand for office consolidations and upgrades is likely to continue, and lead to a steady recovery in the prime vacancy rates and rental levels. While the market is expected to remain on a path to recovery, the pace of rental growth may soften since tenants tend to be more price-sensitive in the face of any economic uncertainties.

Despite Grade A rents in Tokyo 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 an upside potential. In combination with strong occupier demand and reduced availability, the recovery in rents is expected to continue.

However, any unpredictable event in global geopolitical and economic situations may potentially trigger some market uncertainties, which if persistent, might visibly affect Japan's real economy as well as the real estate market. Recent uncertainty in the global economy has made property investors cautious, although slow but steady growth is expected in the rental market.

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