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**Savills World Research**
Tokyo

# Briefing
# **Office sector**

Q1 2013

Image: Kabukiza Tower, Chuo Ward

## SUMMARY


Demand for high-quality office space is expected to remain strong in the near term, supported by the market's favourable positioning in the rent cycle and improved business sentiment.

- Grade A office passing rents in the central five wards rose, on average, 1.5% quarter-on-quarter (QoQ) in Q1/2013, marking a fourth consecutive quarter of improvement.

- On a year-on-year (YoY) comparison, the uplift in Grade A rents equated to a healthy 6.2% increase, driven in part by the completion of new landmark office buildings and falling availability in certain submarkets.

- Average Grade A rents stood at approximately JPY26,110 per tsubo per month, reflecting a premium of approximately 24.1% over average pricing for large-scale Grade B office properties.

- Cyclically low market rents encouraged a number of mid- to large-size tenants to relocate to newer, better equipped or better located premises.

- The Grade A office vacancy rate in the central five wards rose 90 basis points (bps) QoQ to 6.7%, up for the first time since Q2/2012 as a result of new completions and secondary vacancies. The vacancy rate for large-scale Grade B offices increased 20 bps QoQ to 3.9%.

- Although tenants continue to focus on rent optimisation, office expansions are expected to increase in number as business sentiment improves in light of the assertive government initiatives to rejuvenate the national economy.


"Savills survey data for Q1 indicates that Tokyo's Grade A office market is entering a recovery phase, with each of the central five wards demonstrating quarterly rental growth of between 0.5% and 3.2%."

Will Johnson, Savills Research

## Market commentary

Grade A office[1] passing rents rose moderately in each of Tokyo's central five wards[2] in the first quarter of 2013. On average, prime rents rose 1.5% QoQ to JPY26,110 per tsubo[3] per month, marking a fourth consecutive quarter of improvement. On a YoY comparison, the uplift in Grade A rents equated to a healthy 6.2% increase.

This growth has been driven in part by the completion of new landmark office buildings in prime locations, which, being priced at the upper-end of the rental spectrum have acted to pull up the market average. Additionally, falling prime office availability in certain submarkets has enabled landlords to firm-up their pricing expectations at some of the most competitive existing properties as a means to capitalise on robust leasing demand.

As in recent quarters, new lease agreements in Q1 predominantly involved tenants taking space in modern, high-specification buildings in order to facilitate office consolidations and business streamlining. With the office sector just entering a period of recovery from a cyclical nadir, historically low market rents have encouraged a number of mid- to large-size tenants to relocate to newer, better equipped or better located premises. Examples include tenants moving from less-competitive leased properties, as well as outmoded owner-occupied assets that will be taken off the company balance sheet and sold for redevelopment.

Grade A rents in the central five wards commanded a premium of approximately 24.1% over the large-scale Grade B office[4] properties, where average rental pricing stood at JPY19,815 per tsubo per month. Large-scale Grade B offices similarly demonstrated signs of improved competitiveness in Q1, with average rents rising 2.4% QoQ, or 4.2% on a YoY basis. Polarisation within the Grade B market since the Great East Japan Earthquake of March 2011 has seen tenant demand shift in favour of premises offering mid- to large floorplates, at the expense of older, small-scale buildings.

The Grade A office vacancy rate in the central five wards rose 90 bps over the preceding quarter to 6.7%, up for the first time since Q2/2012 as a result of new completions and secondary vacancies in certain submarkets. The vacancy rate for large-scale Grade B offices increased 20 bps QoQ to 3.9%.

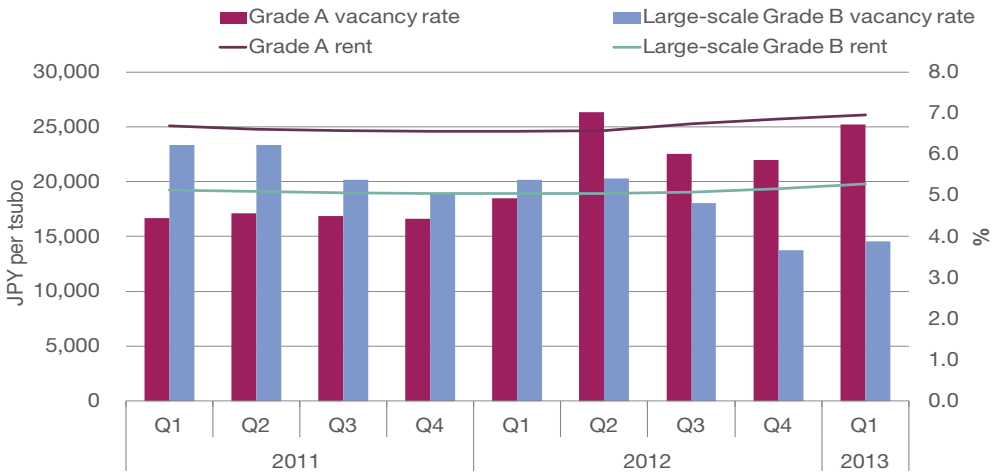
Savills monitors rents and vacancy levels in over 280 buildings located in Tokyo's central five wards with a GFA of 10,000 sq m or above. Unlike similar market information issued by other research institutions, the rental data provided relates to estimated passing rents as opposed to asking rents, whereas 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.

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.

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.

GRAPH 1

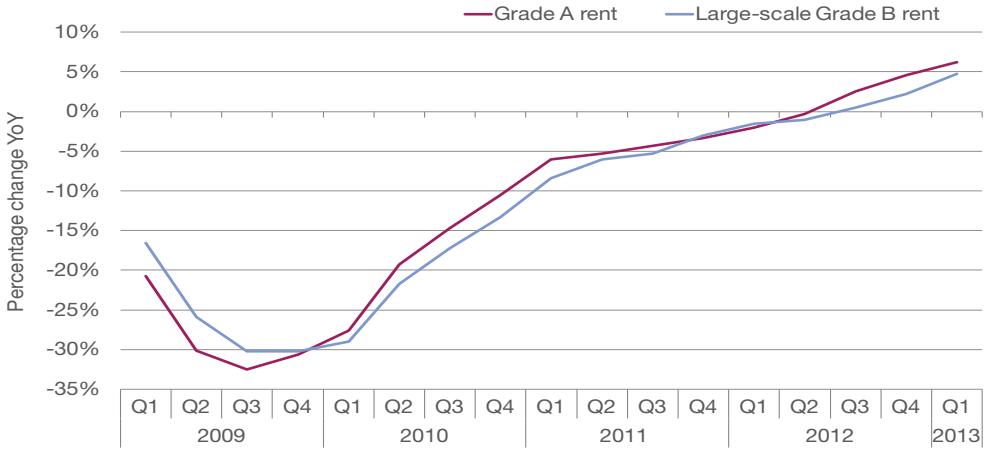
### Office rents and vacancy rates in Tokyo's central five wards by grade, Q1/2011–Q1/2013




Source: Savills Research & Consultancy

GRAPH 2

### YoY change in office passing rents in Tokyo's central five wards by grade, Q1/2009–Q1/2013




Source: Savills Research & Consultancy

## Grade A rents and vacancy rates by ward

**Chiyoda**

The average Grade A office rent in Tokyo's most expensive office location, Chiyoda Ward, stood at JPY33,865 per tsubo in Q1, up 0.5% QoQ. With the other four central wards rising at a faster rate during the first quarter, Chiyoda's rental premium, while still considerable, was reduced from approximately 29.6% to 28.6%.

The average Grade A vacancy rate in Chiyoda in Q1 was 6.4%, down approximately 170 bps from 8.1% in Q4/2012. Following a 3,550-tsubo (11,736-sq m) deal to ink manufacturer DIC, Yasuda Fudosan's brand-new Waterras Tower in Kanda-Awajicho was fully leased upon its completion early in the quarter. Significant deals at existing buildings included a 2,935-tsubo (9,703-sq m) lease to business services firm ABeam Consulting at the Marunouchi Eiraku Building, close to Tokyo Station.

**Chuo**

In Chuo Ward, prime rents rose 1.5% over the quarter to JPY22,546 per tsubo, with the above-average rents commanded by the newly-completed Kabukiza Tower in Ginza helping to pull up the ward-level average.

Opening with an occupancy rate of approximately 70%, this landmark building also had an effect on the ward's average vacancy rate, which jumped around 420 bps to reach 7.7%. Further influencing this rise was the release of space back to the market at Triton Office Tower Y in Harumi following Sumitomo Metal Industries' relocation to the Marunouchi district of Chiyoda Ward after its merger with Nippon Steel.

**Minato**

Estimated achievable passing rents increased at a number of Grade A buildings in Minato in the first quarter. As a result, the average market rent rose by a healthy 1.3% QoQ to JPY26,258 per tsubo. The average Grade A vacancy rate, meanwhile, remained stable for the third consecutive quarter at approximately 4.3%.

Recent large deals in Minato include a 3,440-tsubo (11,372-sq m) lease at the Kokusai Shin-Akasaka West Building in Akasaka, which recently-merged general contractors Hazama and Ando will occupy as their new head office. Elsewhere, law firm Anderson Mori & Tomotsune agreed to take around 2,800 tsubo (9,300 sq m) at Akasaka K-Tower in Moto-Akasaka, a 53,777-sq m office and residential tower completed in January 2012.

**Shibuya**

Shibuya recorded its fifth consecutive quarter of rental growth, with average Grade A passing rents picking up a further 3.2% QoQ to reach JPY25,526 per tsubo. This represents the market's highest rent level since Q4/2009.

Marking its first rise since Q1/2012, the ward's Grade A vacancy rate increased 120 bps over the previous quarter to 4.3%. This was driven by space coming back to the market at a handful of buildings in the Ebisu submarket.

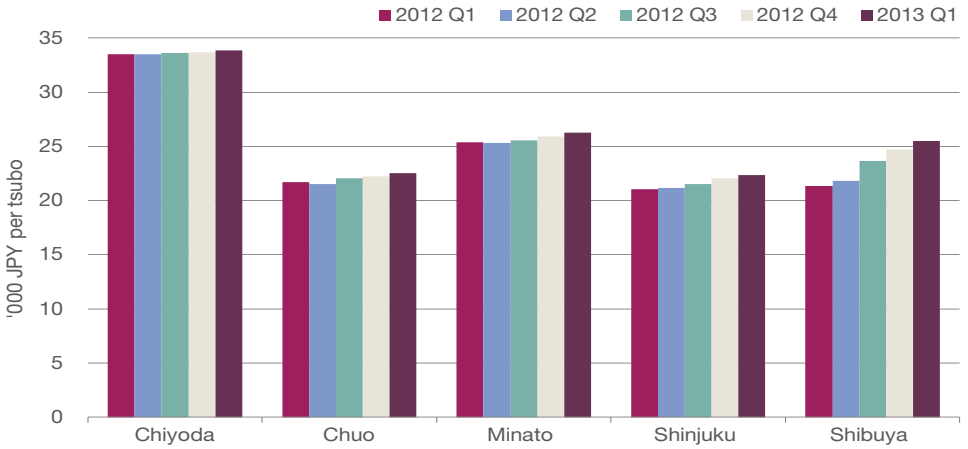
**Shinjuku**

In Q1, the average Grade A rent for Shinjuku stood at JPY22,364 per tsubo, up approximately 1.4% QoQ as a result of increased rent expectations at some of the ward's most competitive properties.

Shinjuku's prime vacancy rate, meanwhile, edged up 60 bps over the preceding quarter to approximately 11.0% as secondary vacancies in several buildings offset space taken-up in new lease agreements.

GRAPH 3

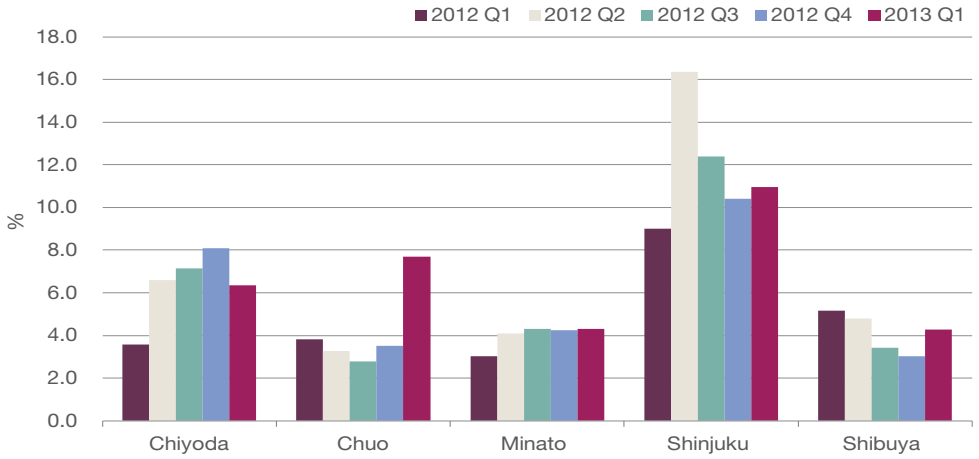
### Average Grade A rents by ward, Q1/2012–Q1/2013




Source: Savills Research & Consultancy

GRAPH 4

### Average Grade A vacancy rates by ward, Q1/2012–Q1/2013




Source: Savills Research & Consultancy

TABLE 1

## Notable office leasing transactions, Q1/2013

| Company | Business sector | Type | Former building(s)/location | New building(s)/location | Approximate space taken | |
|---|---|---|---|---|---|---|
| | | | | | tsubo | sq m |
| DIC | Ink manufacturer | Interim HQ relocation | DIC Building/Nihonbashi, Chuo Ward | Waterras Tower/Kanda-Awajicho, Chiyoda Ward | 3,550 | 11,736 |
| Hazama Ando | Construction | HQ consolidation following merger | Kyodo Tsushin Kaikan/Toranomon, Minato Ward; Ando HQ Building/Shibaura, Minato Ward | Kokusai Shin-Akasaka West Building/ Akasaka, Minato Ward | 3,440 | 11,372 |
| ABeam Consulting | Management consultancy | HQ relocation/ consolidation | Various, incl Yurakucho Building/Yurakucho, Chiyoda Ward | Marunouchi Eiraku Building/ Marunouchi, Chiyoda Ward | 2,935 | 9,703 |
| Anderson Mori & Tomotsune | Legal services | HQ relocation | Izumi Garden Tower/Roppongi, Minato Ward | Akasaka K-Tower/Moto-Akasaka, Minato Ward | 2,815 | 9,306 |
| Oracle Japan | IT | HQ relocation/cost saving | Oracle Aoyama Center/Kita-Aoyama, Minato Ward | Akasaka Center Building/Moto-Akasaka, Minato Ward | 2,000 | 6,612 |

Source: Savills Research & Consultancy

# OUTLOOK

## The prospects for the market

Tokyo's Grade A office development pipeline for 2013 is weighted heavily towards the first half of the year. In Q2, high levels of tenant commitments at two major new projects – Tokyo Square Garden in Chuo Ward and Ochanomizu Sola City in Chiyoda Ward – are expected to mitigate much of their impact on average vacancy rates. Thereafter, reduced levels of new supply combined with continued healthy take-up should see prime vacancy rates move in progressively through the second half of the year.

Although tenants continue to focus on office streamlining and rent optimisation, an increasing number of requirements for building upgrades and headcount expansion have been seen. Demand for high-grade relocation space is expected to remain strong in the near term as tenants seek to take advantage of the low market rents and competitive rental packages currently on offer. Office expansions should also become more prevalent as business sentiment improves in light of the new government's assertive drive to kick-start Japan's economic recovery.

We anticipate the healthy rental growth seen in Q1 to continue over the coming quarters in the Grade A market, with good-quality Grade B assets also showing signs of recovery. The ongoing flight to quality in Tokyo's leasing market will result in secondary vacancies being concentrated in the least competitive buildings in terms of property grade and location. This trend will maintain pressure on rents and occupancy levels in the lower Grade B and Grade C office segments for the foreseeable future.

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