

# Briefing Office sector

Q4 2012

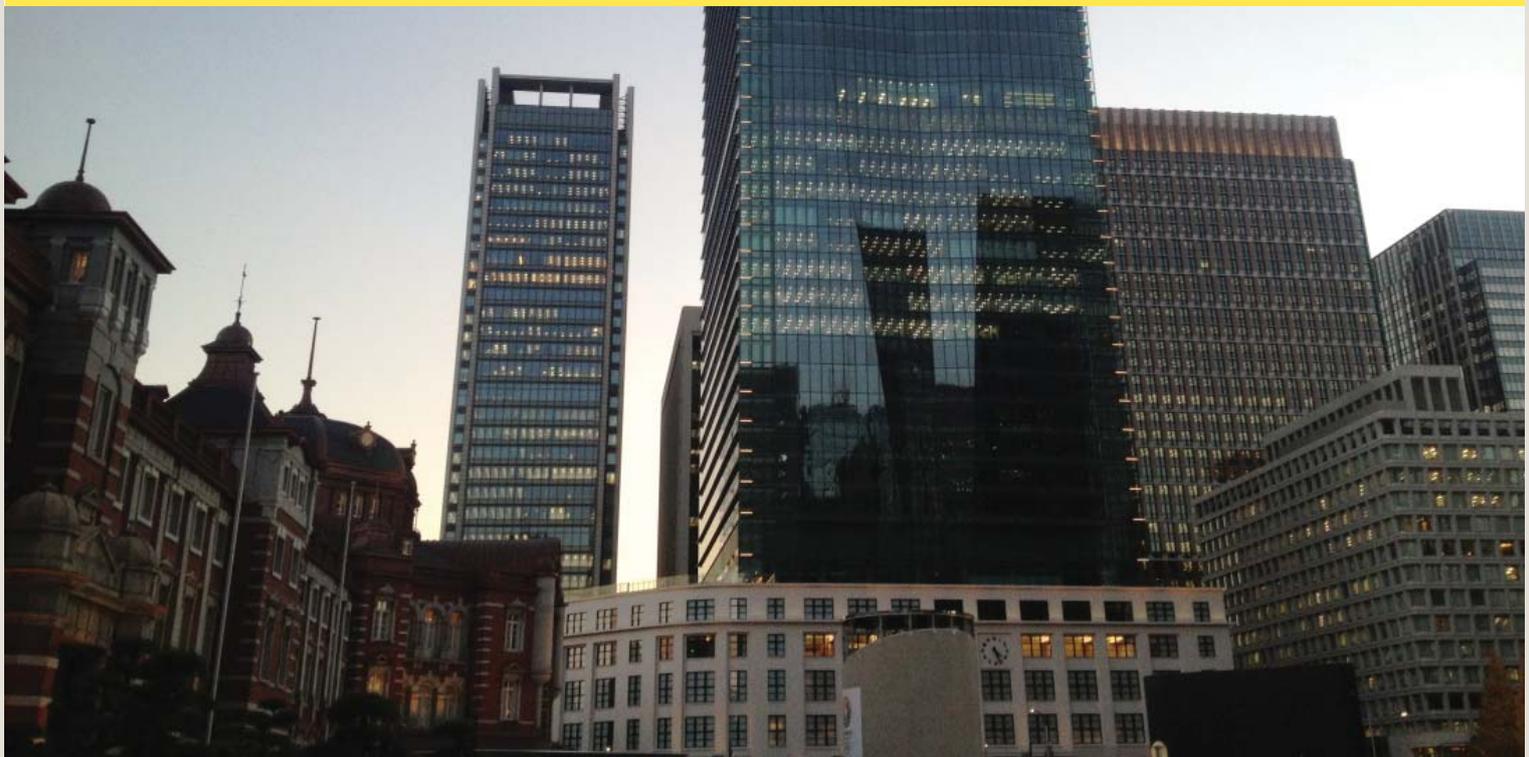


Image: JP Tower – Marunouchi, Chiyoda Ward

## SUMMARY

Each of Tokyo's central five wards demonstrated steady or moderately rising rental movement in Q4, while prime vacancy continued to fall back from its peak of Q2.

- Grade A office rents in the central business district (CBD) improved, on average, 1.7% quarter-on-quarter (QoQ) in Q4/2012 on the back of active requirements for relocation space.

- For 2012 as a whole, prime rental pricing picked up 1.2% compared with the previous year, marking the first annual growth since 2007.

- Average Grade A rents in the CBD stood at approximately JPY25,725 per tsubo per month, reflecting a premium of around 25% over average rental pricing for large-scale Grade B office properties.

- The Grade A office vacancy rate fell 10 basis points (bps) QoQ to 5.9%, marking its second consecutive quarter of improvement after hitting a peak of 7.0% in Q2/2012.

- The average vacancy rate in the large-scale Grade B office market stood at 3.7%, with robust demand for quality secondary product driving a decline of 110 bps QoQ.

- Tenant requirements for building upgrades and office expansions are expected to drive the upper end of the market in the short term. This is likely to result in further strengthening of Grade A occupancy rates and rents over the coming quarters.

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“Strong demand for relocation space was maintained through the fourth quarter, driven by requirements for building upgrades and, increasingly, office expansions. This brought about a net reduction in available supply in spite of new prime completions – a trend that is expected to continue in 2013.” Will Johnson, Savills Research

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➔ **Market commentary**

Each of Tokyo's central five wards<sup>1</sup> demonstrated steady or moderately rising rental movement in the last quarter of 2012, while prime vacancy continued to fall back from its peak of Q2. Grade A office<sup>2</sup> passing rents in the CBD improved, on average, 1.7% QoQ on the back of active requirements for relocation space. For 2012 as a whole, rental pricing picked up 1.2% compared with the previous year, marking the first annual growth since 2007.

As throughout 2012, tenant demand in Q4 was characterised by occupiers seeking to streamline their office operations within modern, high-specification buildings. With market rents at a cyclical low, improved affordability has encouraged some tenants to trade-up in terms of property grade, while others have opted to move from outmoded company-owned assets in order to free-up capital. Office consolidations and upgrades accounted for the majority of leasing transactions through the quarter, although an increased number of office expansions to facilitate growth in headcount were also seen.

1 The CBD is defined as Chiyoda, Chuo, Minato, Shibuya and Shinjuku wards.  
 2 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.

TABLE 1 **Savills Grade A office rental movements, 2012**

Survey area	Q4/2012 (% QoQ)	2012 (annual average, %)
Chiyoda	0.3	0.5
Chuo	0.7	-2.3
Minato	1.3	0.8
Shibuya	4.6	6.8
Shinjuku	2.4	0.5
Central five ward average	1.7	1.2

Source: Savills Research & Consultancy

As of Q4/2012, average Grade A rents in the CBD stood at approximately JPY25,725 per tsubo<sup>3</sup> per month. This figure represents a premium of around 25% over average rental pricing for the large-scale Grade B office market<sup>4</sup> in the same area, which remained flat over the preceding quarter at approximately JPY19,350 per tsubo per month.

The Grade A office vacancy rate in the central five wards fell 10 bps over

3 1 tsubo = 3,306 sq m or 35,583 sq ft.  
 4 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.

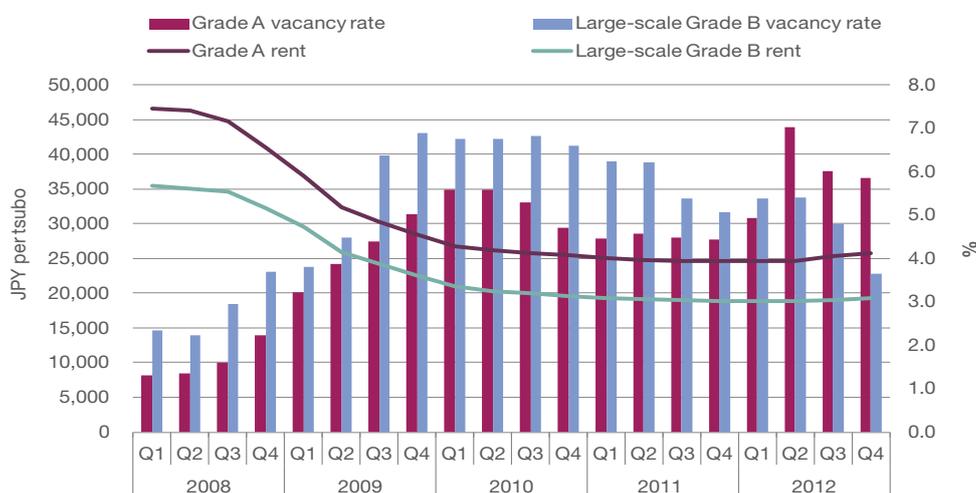
the quarter to 5.9%. This reflects its second consecutive quarter of improvement after hitting a recent peak of 7.0% in Q2/2012 as a result of a bulge in new supply. The vacancy rate for large-scale Grade B offices averaged 3.7%, with robust demand for quality secondary product driving a decline of 110 bps QoQ.

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**

Prime buildings in Chiyoda Ward, Tokyo's most expensive office location, maintained a premium of approximately 30% over average rental pricing across the four remaining wards. Average monthly Grade A office rents here stood at JPY33,700 per tsubo in Q4, up marginally from the previous quarter. The average prime vacancy rate in Chiyoda was 8.1%, up 90

GRAPH 1 **Office rents and vacancy rates in Tokyo's central five wards by grade, Q1/2008–Q4/2012**



Source: Savills Research & Consultancy

→ bps QoQ as a result of uncommitted space coming on line at the new Otemachi Financial City complex, which was completed in October.

Financial services firms, as well as manufacturing and services companies, were active in Chiyoda, taking-up office space of between 150 tsubo (500 sq m) and 3,000 tsubo (10,000 sq m). At JP Tower, a new landmark Tokyo office building, US-based cloud computing company Salesforce.com took an estimated 2,900 tsubo (9,600 sq m) to facilitate expansion of its headquarters, which is currently located at Roppongi Hills Mori Tower in Minato Ward. Other notable leasing transactions in the same building late in the year involved manufacturer Daiwa Can, multinational biopharmaceutical company Celgene and IT network integration business Net One Systems.

In Chuo Ward, prime rents averaged JPY22,210 per tsubo in the fourth quarter, up 0.7% QoQ. Grade A office vacancy here rose 70 bps over the preceding quarter, although remained low at approximately 3.5%. Leasing activity was concentrated in new, high-quality buildings, including a pre-let for approximately 5,200 tsubo (17,160 sq m) to tyre manufacturer Bridgestone at Tokyo Square Garden, a large mixed-use building scheduled to be completed in Kyobashi in March 2013.

In Minato Ward, new supply resulting from the completion of the Shin-Akasaka Center Building in November offset space taken off the market at existing prime properties. As a result, the prime vacancy rate remained stable from the preceding quarter at approximately 4.3%. Robust demand for high-grade stock combined with tightened availability at several major office buildings saw average prime rents rise an estimated 1.3% QoQ to JPY25,915 per tsubo. Large deals in the ward included NEC Group taking approximately 8,100 tsubo (26,730 sq m) within two buildings in Shiba to facilitate the consolidation of three nearby branch offices. Elsewhere, advertising agency ADK agreed a pre-let for around 5,000 tsubo (16,500 sq m)

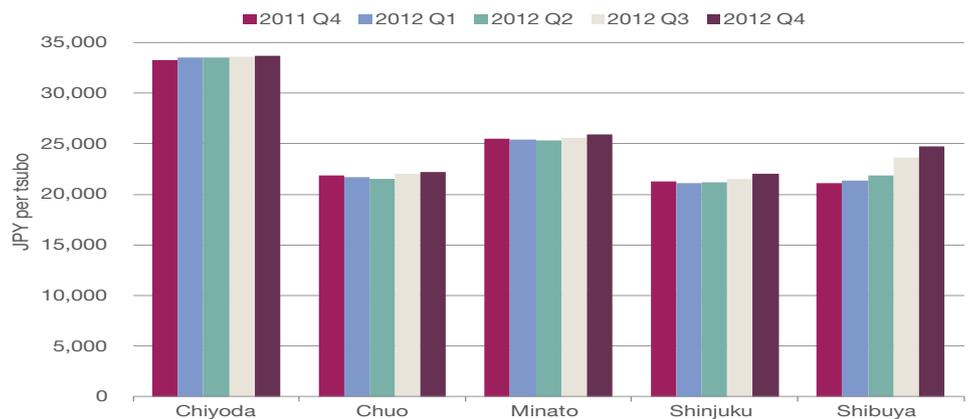
at Mori Building's tentatively-named Loop Road 2 Block III Project, which is currently under construction in Toranomon.

Shibuya Ward's low Grade A vacancy rate of 3.0% helped to support rents in Q4/2012, which rose 4.6% QoQ to stand at JPY24,745 per tsubo. In contrast to Q4/2011, when Shibuya offered, on average, the cheapest prime office space of the central five wards, rental pricing in this market is now estimated to exceed that of both Chuo and Shinjuku. Recent leasing activity here includes deals for whole floors (approximately 754 tsubo; 2,500 sq m) at the Shinjuku Bunka Quint Building in Yoyogi to measurement equipment distributor

Nishikawa Keisoku and Manulife Life Insurance.

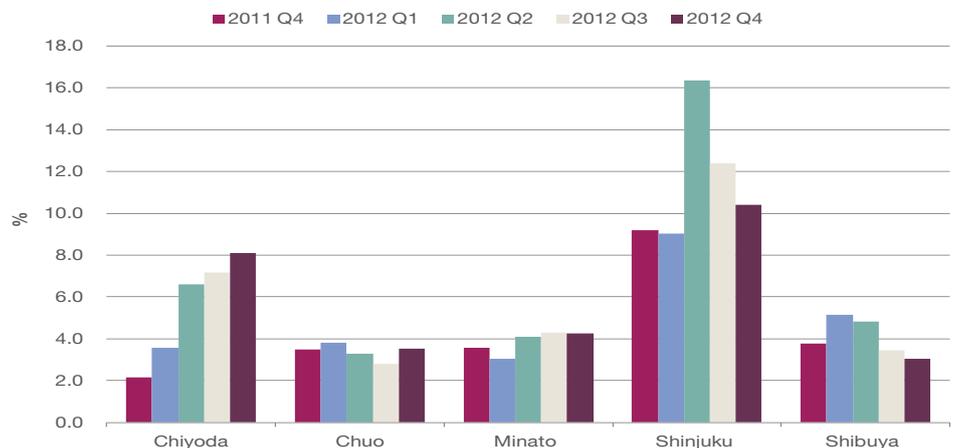
In Shinjuku Ward, prime vacancy continued to fall back from the second quarter, when the speculative completion of Shinjuku Eastside Square saw it spike to over 16%. The average Grade A vacancy rate declined 200 bps QoQ to just above the 10% threshold, with new leases helping to chip away at large vacancies in recently completed properties. The prime market rent improved approximately 2.3% over the preceding quarter to JPY22,060 per tsubo, driven by landlords taking a firmer rental stance at established properties where available floor space is limited. ■

GRAPH 2 Average Grade A rents by ward, Q4/2011–Q4/2012



Source: Savills Research & Consultancy

GRAPH 3 Average Grade A vacancy rates by ward, Q4/2011–Q4/2012



Source: Savills Research & Consultancy

TABLE 2  
**Notable office leasing transactions, Q4/2012**

Company	Type	Former building(s)/ location	New building(s)/ location	Approximate space taken	
				tsubo	sq m
NEC Group	Office consolidation/ streamlining	Three buildings/ Minato Ward	Daini-Tamachi Building & Celestine Shiba Mitsui Building/Shiba, Minato Ward	8,100	26,730
Bridgestone	HQ relocation/ building upgrade	Bridgestone Building/Kyobashi, Chuo Ward	Tokyo Square Garden (Kyobashi 3-1 Project)/ Kyobashi, Chuo Ward	5,200	17,160
ADK	HQ relocation/ streamlining	ADK Shochiku Square/Tsukiji, Chuo Ward	Loop Road 2 Block III Project/ Toranomom, Minato Ward	5,000	16,500
Sumitomo 3M	HQ relocation/ building upgrade	Company-owned building/ Tamagawadai, Setagaya Ward	Garden City Shinagawa Gotenyama/ Kita-Shinagawa, Shinagawa Ward	3,440	11,352
Salesforce.com	HQ relocation/ expansion	Roppongi Hills Mori Tower/ Roppongi, Minato Ward	JP Tower/ Marunouchi, Chiyoda Ward	2,900	9,570

Source: Savills Research & Consultancy

## OUTLOOK

### The prospects for the market

Over the year ahead we expect prime vacancy rates to move in steadily, spurred by robust demand for high-quality office space and a significant reduction in the annual volume of new supply. While tenants will continue to focus on office streamlining and rent optimisation, requirements for prime office space to facilitate building upgrades and headcount expansion are anticipated to increase. This owes to tightened business contingency planning after the Great East Japan Earthquake of March 2011, as well as natural growth following personnel cutbacks since the global financial crisis. Assertive initiatives by the government and the Bank of Japan to kick-start the economy may also have a positive effect on the business environment and, in turn, underpin improved tenant sentiment.

Moderate rental growth across the Grade A office market is therefore expected over the coming quarters. Secondary vacancies will chiefly be concentrated in poorer quality buildings, a factor that is likely to result in continued pressure on rents and occupancy levels in the lower-Grade B and Grade C office markets over the short- to mid-term.

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