savills

Briefing
Office sector

Q3 2013

Image: Ark Hills South Tower, Minato Ward

SUMMARY

As the rental market moves away from historic lows, improved business confidence and the ongoing 'flight to quality' will support demand for Grade A and good-quality Grade B properties.

- Average Grade A office passing rents in the central five wards rose by 1.2% quarter-on-quarter (QoQ) to JPY26,975 per tsubo, marking a sixth consecutive quarter of rental growth.
- On a year-on-year (YoY) basis, Grade A office rents were up a healthy 6.7%, reflective of buoyant demand and reduced supply in certain submarkets.
- Tokyo's Grade A vacancy rate continued on a downward trend from the previous quarter, declining 40 basis points (bps) QoQ to 5.9%.
- Indicative of limited availability in the top half of the secondary market, the average rent for large-scale Grade B office space increased 1.5% QoQ to JPY20,410 per tsubo.
- The average vacancy rate in the large-scale Grade B office market remained substantially lower than the Grade A market average at 4.0%, despite a 30-bp outward shift from Q2.
- While historically low office market rents continue to offer tenants cost-effective relocation opportunities, the steady absorption of excess supply is gradually shifting the balance of power in favour of the landlords – particularly at the capital's most competitive properties.

"With market vacancy rates falling back from cyclical highs, landlords are starting to report multiple applications for available units. This has led to more assertive pricing and reduced incentives at many of Tokyo's best properties."
Will Johnson, Savills Research

Market summary

In Q3/2013, the estimated average Grade A office[1] passing rent for the Tokyo central five ward[2] area stood at JPY26,975 per tsubo[3] per month, inclusive of common area management (CAM) fees. Up for a sixth consecutive quarter, prime rents rose on average 1.2% QoQ, or a healthy 6.7% on a YoY basis.

Tokyo's Grade A vacancy rate continued on a downward trend from the previous quarter, declining 40 bps QoQ to 5.9%. Despite the completion of a top-grade property in Minato Ward with limited pre-commitments, buoyant demand for existing buildings across the central five wards saw take-up outweigh new vacant supply.

Reflective of the limited amount of space available for lease in the top half of the secondary market, large-scale Grade B office properties[4] similarly witnessed sustained rental uplift through the quarter. On average, this subsector commanded passing rents of JPY20,410 per tsubo, up 1.5% QoQ or a robust 7.0% YoY. At 4.0%, the average vacancy rate for large-scale Grade B office properties stood substantially lower than the Grade A market average, despite witnessing a 30-bp outward shift from Q2.

Although the Grade A office market has demonstrated close to a 10% recovery since hitting its rental nadir Q2/2012, passing rents remain roughly 47% down from the peak pricing of late 2007. From a tenant's standpoint, the central Tokyo market therefore continues to offer opportunities for cost-effective office relocations for the purpose of building upgrade or business streamlining.

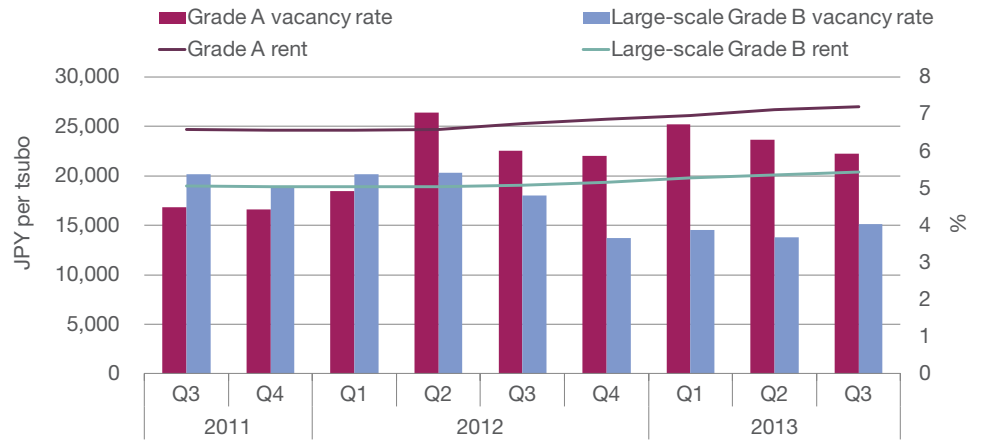
Nonetheless, the balance of power appears to be gradually shifting from tenants to the landlords as the market edges up from a five-year downturn that was prolonged by the Great East Japan Earthquake of March 2011 and a bulge in speculative completions in 2012. With the market steadily absorbing primary vacancies, building owners have started to reduce the level of incentives being offered to secure new lease agreements. Their more positive stance on the leasing market has also been supported by an increase in the number of tenants seeking space for expansion in light of improved business confidence.

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

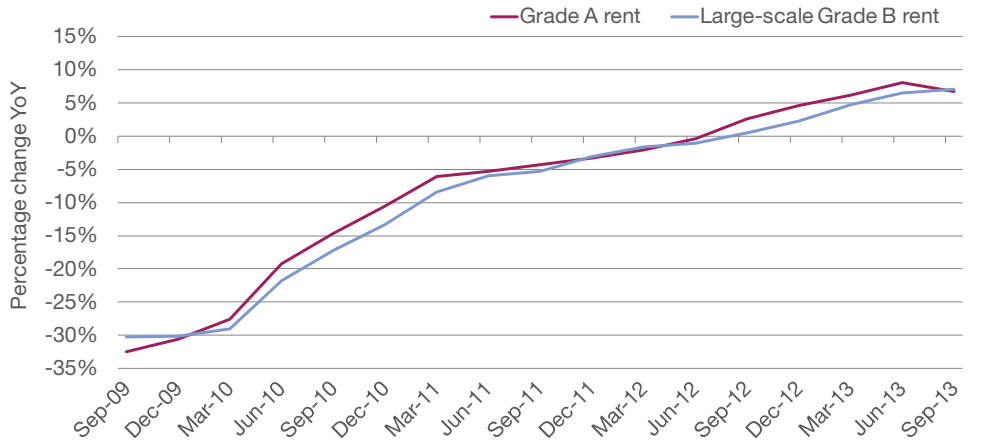
Office rents and vacancy rates in Tokyo's central five wards by grade, Q3/2011–Q3/2013



Source: Savills Research & Consultancy

GRAPH 2

YoY change in office passing rents in Tokyo's central five wards by grade, Q3/2009–Q3/2013



Source: Savills Research & Consultancy

Grade A rents and vacancy rates by ward

Chiyoda

Grade A office rents in Chiyoda Ward averaged approximately JPY34,245 per tsubo. Up 0.7% QoQ, this figure represents the eighth consecutive quarter where rents grew at a rate of less than 1%. Chiyoda – Tokyo's most expensive office submarket – retained a rental premium of approximately 27% over the other four wards that make up the capital's CBD. This spread, however, represented its lowest level since Q1/2009 on the back of

faster rates of growth in neighbouring submarkets.

As of Q3, Chiyoda's average Grade A vacancy rate was 4.8%, down 30 bps over the previous quarter. Compared with the ward's recent peak of 8.1% in Q4/2012, the current vacancy rate reflects some 330 bps worth of absorption in just three quarters.

Chuo
The average Grade A passing rent in Chuo Ward rose by an estimated 1.2% during the third quarter to JPY24,420 per tsubo. With space coming off line at established and recently-completed buildings, Chuo's average Grade A vacancy rate declined by a healthy 100 bps in Q3 to stand at 6.8%.

Demand for large upcoming developments was demonstrated, with Kubota Corporation agreeing to take approximately 3,000 tsubo (10,000 sq m) of space at Kyobashi Trust Tower. The prime office building is currently under construction in the Kyobashi district and is scheduled to complete at the end of February next year. The Osaka-based mechanical engineering company will relocate its Tokyo headquarters from a building it leases in nearby Nihonbashi-Muromachi, which is subject to a wider redevelopment plan.

Minato
Average Grade A office rents in Minato stood at approximately JPY27,090 per tsubo, up by an estimated 1.6% QoQ and reaching their highest level since Q1/2010.

While achievable passing rents for new leases increased at a number of prime buildings with limited available floor space, the average vacancy rate for the ward as a whole rose 60 bps over the previous quarter to 5.1%.

The principle cause of this rise was the completion of Ark Hills South Tower, a 16,650-tsubo (55,033-sq m) office development in Roppongi. Following lease agreements with Coca-Cola and games developer Gloops, tenants had been secured for roughly 35% of the rentable floor area upon completion.

Shibuya
With achievable Grade A passing rents rising an estimated 2.3% QoQ to approximately JPY26,810 per tsubo, Shibuya recorded the strongest growth among the central five wards in Q3.

Shibuya's prime vacancy rate increased by 20 bps to 2.2%, but remained close to its recent low of Q2. High levels of occupancy combined with strong latent demand for top-grade space has encouraged landlords to strengthen their pricing stance for the ward's best properties.

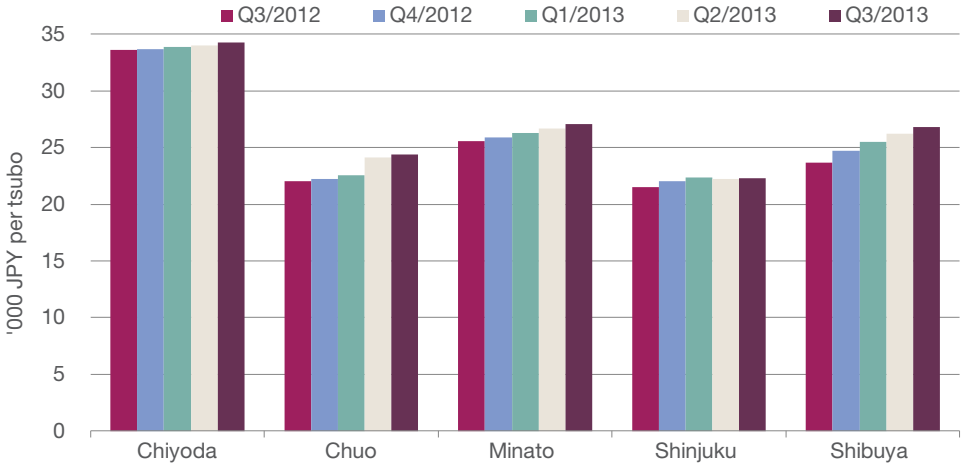
Shinjuku
Shinjuku's average Grade A office rent recorded a marginal quarterly improvement of 0.2% in Q3, to stand at JPY22,305 per tsubo. Despite offering the cheapest prime rental space on average of the central five wards, Shinjuku's rental recovery has so far been dampened by comparatively high levels of vacant stock, while historically low rents elsewhere have created stiff competition for occupier requirements.

Nonetheless, recent signs of improvement include a notable 130-bp fall in Shinjuku's average Grade A vacancy rate in Q3, bringing it to approximately 10.8%.

Large deals driving this movement include primary space taken offline at Shinjuku Eastside Square by SoftBank Technology. The telecoms group subsidiary will relocate its headquarters to the one-year-old landmark building from its existing location within the ward around February next year. The move will see the company expand its rented floor space by approximately 38% to 1,800 tsubo (5,950 sq m) in order to facilitate increased headcount, while its operations will be consolidated from three floors to just one.

GRAPH 3

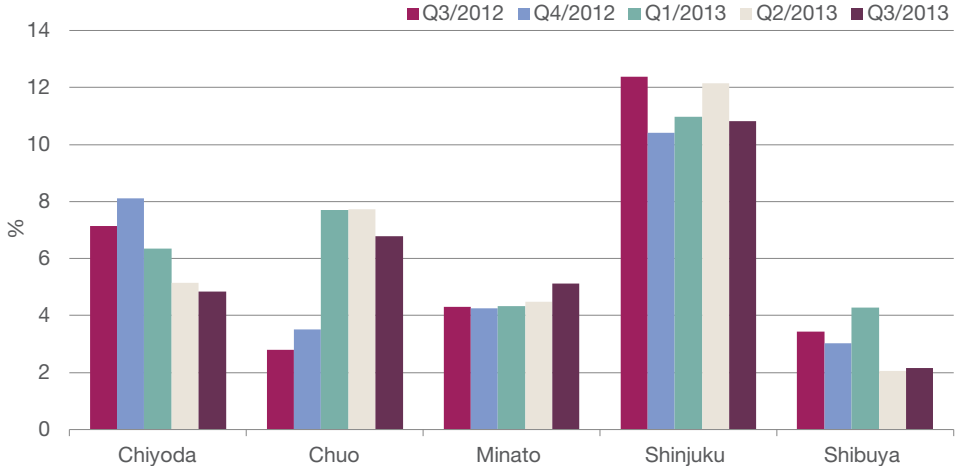
Average Grade A rents by ward, Q3/2012–Q3/2013



Source: Savills Research & Consultancy

GRAPH 4

Average Grade A vacancy rates by ward, Q3/2012–Q3/2013



Source: Savills Research & Consultancy

TABLE 1

Notable office leasing transactions, Q3/2013

Company	Business sector	Type	Former building(s)/ location	New building(s)/ location	Approximate space taken	
					tsubo	sq m
Kubota Corporation	Mechanical engineering	Headquarters relocation	Kubota Tokyo HQ Building/ Nihonbashi-Muromachi, Chuo Ward	Kyobashi Trust Tower/Kyobashi, Chuo Ward	3,036	10,036
Kajima Corporation	Construction/ civil engineering	Interim relocation (existing branch office to be reconstructed)	Kajima Tokyo Branch Building/ Moto-Akasaka, Minato Ward	Kokusai Shin-Akasaka East Building/Moto-Akasaka, Minato Ward	2,400	7,934
SoftBank Technology	IT/E-commerce systems	Headquarters relocation/ expansion	Sumitomo Fudosan Iidabashi Building 3-gokan/ Nishigokencho, Shinjuku Ward	Shinjuku Eastside Square/ Shinjuku, Shinjuku Ward	1,800	5,950
Itochu Enex	Energy/fuel trading	Headquarters relocation/ consolidation	Granpark Tower/ Shibaura, Minato, etc	Toranomon Twin Building/ Toranomon, Minato Ward	1,754	5,798
Coca-Cola Japan	Beverage manufacture and distribution	Interim headquarters relocation (existing headquarters to be reconstructed)	Coca-Cola Japan Headquarters Building/Shibuya, Shibuya Ward	Ark Hills South Tower/ Roppongi, Minato Ward	1,710	5,653

Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

As the rental market moves away from historic lows, the ongoing 'flight to quality' among tenants will continue to support demand for Grade A and good-quality Grade B properties at the expense of older, smaller-scale buildings. Signs of recovery in the wider economy, as well as improved performance in the Japanese corporate sector on the back of the weaker yen, should additionally lead to increased requirements from companies seeking expansion space.

Such demand drivers will eat away at existing available stock, enabling vacancy rates to fall back further over the coming quarters. Also supporting the supply-demand balance is the relatively moderate level of new supply expected in the near term. The total volume of planned large-scale office completions in 2014 will exceed that of 2013 but remain below the long-term average.

The combination of robust occupier demand and reduced availability is expected to sustain the recovery in rents. Higher rates of growth can be expected in the capital's most sought-after buildings – a trend that will increase the premium payable for prime space over the market average. Cost-conscious tenants may therefore redirect their focus towards modern mid- to large-scale properties located in less competitive locations going forward.

Please contact us for further information

Savills Japan

Christian Mancini
Representative Director, CEO
+81 3 5562 1717
cmancini@savills.co.jp

Savills Research

Will Johnson
Head of Research & Consultancy, Japan
+81 3 5562 1736
wjohnson@savills.co.jp

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