Tokyo – Q4/2019

Office Leasing

savills

Office rents on an upward path

Rents have reached high levels following fervent growth in the C5W, especially in the Grade A market, whilst vacancy remains air-tight.

- Against a backdrop of limited availability, competition for space in the Grade A market was fierce in Q4/2019. Rents over both the quarter and year saw the greatest change since 2014, while vacancy remained at rock bottom.
- Average passing rents for Grade A office space in the C5W grew 2.7% quarter-on-quarter (QoQ) and 8.0% year-on-year (YoY) to JPY37,373 per tsubo[1] per month.
- The average Grade A office vacancy rate in the C5W remained at around 0.2% over the quarter in Q4/2019, while rates contracted 0.3ppts YoY.
- Average passing rents for large-scale Grade B office space rose to JPY28,178 per tsubo per month, growing by 1.0% QoQ and 6.8% YoY.
- The average large-scale Grade B office vacancy rate stands at 0.1% following a decline of 0.1ppts QoQ and 0.5ppts YoY.
- Shibuya has reinvented itself as the go-to location for technology firms specialising in internet-related services, and rents in the office sector have responded accordingly.
- Fundamentals in the office market remain strong. With most of the supply expected over the shorter term close to or already completed, rent growth should persist for now, albeit at a flat to moderate level.

"Rental growth in the office sector this quarter, and over the year, has been impressive, beating initial expectations. Growth should be flat to moderate going forward, however."

SAVILLS RESEARCH & CONSULTANCY

1 1 tsubo = 3.306 sq m or 35.583 sq ft.

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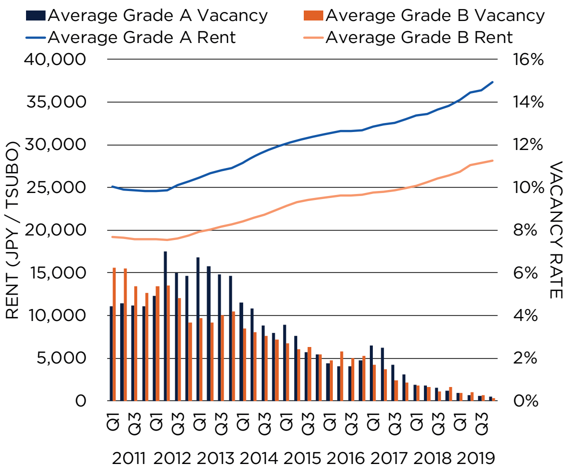
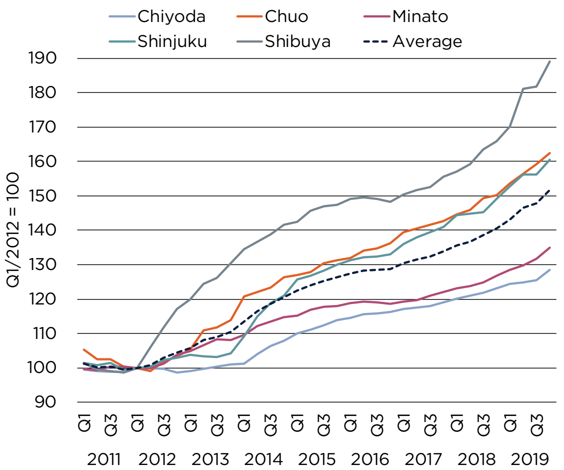
GRAPH 1: Office Rents And Vacancy In Tokyo's C5W*, 2011 to Q4/2019



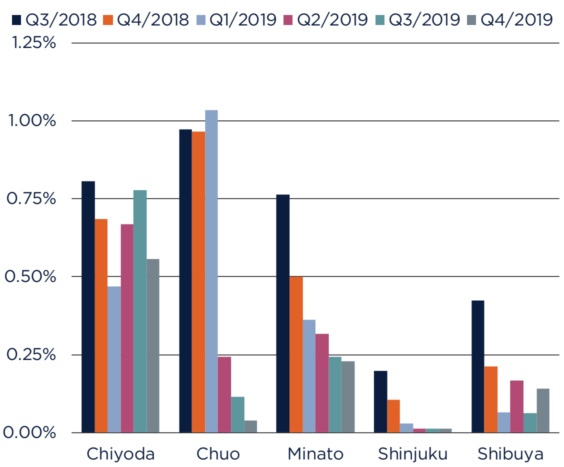
Source Savills Research & Consultancy
*Chiyoda, Chuo, Minato, Shibuya, and Shinjuku

GRAPH 2: Grade A Office Rental Index By Ward, 2011 to Q4/2019



Source Savills Research & Consultancy

GRAPH 3: Grade A Office Vacancy By Ward, Q3/2018 to Q4/2019



Source Savills Research & Consultancy

GRADE A OFFICES

Despite continued uncertainty regarding the global economic environment, it seems that the momentum is still with Grade A office rents, as evidenced by the increase of 2.7% QoQ and 8.0% YoY to JPY37,373 per tsubo[2] in Q4/2019 – the fastest rates of growth in five years. Shibuya continues to carry the day as technology companies, unperturbed by the level of passing rents in the ward, remain in the hunt for office space. It also appears landlords in Marunouchi, Chiyoda have jumped on the bandwagon by trying to woo these global tech players to the area, in the hope of increasing rents further, as well as tenant diversification. Vacancy, already at air-tight levels, unsurprisingly remained fairly flat over the quarter. During the year, however, the C5W Grade A office market experienced a 0.3ppts reduction, falling to 0.2% – the lowest level this decade.

LARGE-SCALE GRADE B OFFICES

Not wanting to be left out, large-scale Grade B office[3] rents also experienced solid gains in Q4/2019. Average passing rents now stand at JPY28,178 per tsubo, having increased by 1.0% QoQ and 6.8% YoY. As per the Grade A market, Shibuya was again the top performer over the year. Vacancy stands at 0.1% after a slight tightening of 0.1ppts QoQ and 0.5ppts YoY – mostly driven by the 2.0ppts contraction in Chuo. With large developers focused on the Grade A sector, the Grade B market continues to benefit from tight supply. This trend is expected to continue given the variation in rents, meaning these two markets do not directly compete. Nonetheless, as the tenant pool for these assets is dominated by smaller, less financially able companies, an ongoing concern is their resilience when this property upswing does inevitably come to an end. Given current economic conditions, however, such a downturn appears unlikely to manifest soon.

GRADE A RENTS AND VACANCY RATES BY WARD

Chiyoda

Grade A Offices in Chiyoda have historically commanded the highest rents, and this remains the case in Q4/2019 following growth of 2.5% QoQ and 4.4% YoY to JPY43,216 per tsubo. There are reports of instances whereby prime offices next to Tokyo station have asked for rents north of JPY60,000 per tsubo. That said, the ward's position at the top is under threat. The emergence of Shibuya as the go-to location for cash-rich internet-related technology companies has seen the spread between these top two wards narrow to 7%, having been around 15% at the start of the year. Vacancy in this ward remains the highest in the submarket at 0.6%, despite a 0.2ppts QoQ and 0.1ppts YoY contraction. The ward is not entirely without appeal to traditional technology companies, however. For example, it has been reported that Dell Japan and EMC Japan, both part of Dell Technologies, will relocate their headquarters to Otemachi One Tower in 2021/22, leasing around 7,800 tsubo across seven floors.

Chuo

It appears there is no longer any vacancy in Chuo following a 0.1ppts QoQ decline, while over the year, the ward was home to the biggest change in Grade A vacancy, with a 0.9ppts compression. Change is on the horizon for Museum Tower Kyobashi, with over 2,500 tsubo reportedly leased by four new tenants, including Eneos Frontier, who leased two floors totalling around 800 tsubo in November 2019. Grade A rents in Chuo grew 2.0% QoQ and a solid 8.2% YoY – the most in five years. Following another quarter of positive growth, this ward has now witnessed the longest streak of growth in the submarket, dating back to Q3/2012.

Minato

Minato has the second highest Grade A vacancy at 0.2%, despite a 0.3ppts contraction over the year. Over the quarter, vacancy held flat. Changes in Grade A rent, on the other hand, were more noticeable, with growth of 2.3% QoQ and 6.4% YoY – representing an expansion in growth every year since 2016. Rents now stand at JPY34,167, a level not seen since Q1/2009. That said, this ward still lags in terms of post-2008 recovery, with rents over 30% below peaks, suggesting potential upside going forward, especially with projects such as the Toranomon-Azabudai Project, slated for 2023. The biggest move announced this quarter is the Suntory Group's relocation into msb Tamachi Station Tower North in the spring of 2021. The firm is reportedly leasing around 7,000 tsubo, citing improved synergy following the consolidation of offices as a key factor in the move.

Shibuya

The Shibuya market was abuzz with activity as the competition for space intensified. The result has been a significant jump in passing rents over the quarter, and an even more impressive increase over the year. Rents now stand at JPY40,381 per tsubo, having grown 4.0% QoQ and 13.9% YoY. In fact, rents have exceeded JPY40,000 for the first time since mid-2008, and currently lie less than 10% below peaks set that year. That said, a slight

2 Throughout the report, "per tsubo" is shorthand for "per tsubo per month".
3 "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.

TABLE 1: Tenant Relocations, Q4/2019

ORIGIN: Chiyoda	Chuo	Minato	Shibuya	Shinjuku	Other	→	DESTINATION	
6	5	10	8	2	18			
5		2	1		5	→	13	Chiyoda
	3				4	→	7	Chuo
	1	6			3	→	10	Minato
			1		1	→	2	Shibuya
1		2	3	1	2	→	9	Shinjuku
	1		3	1	3	→	8	Other

Source Nikkei RE, Savills Research & Consultancy

TABLE 2: Notable Office Leasing Transactions, Q4/2019

COMPANY	BUSINESS SECTOR	TYPE	FORMER/CURRENT LOCATION		NEW LOCATION	APPROXIMATE SPACE TSUBO	APPROXIMATE SPACE SQ M
TIS	Technology	Consolidation	Various Various	→	Toyosu 2nd District Project (Towers A and C) Koto	10,000	33,000
Dell, EMC Japan	Technology	Consolidation	Various Various	→	Otemachi One Tower Chiyoda	7,800	25,700
Suntory Group	Consumer Staples	Consolidation	Various Various	→	msb Tamachi Tamachi Station Tower North Chiyoda-ku	7,000	23,100
Idemitsu Kosan	Energy	Consolidation	Various Various	→	Otemachi One Tower Chiyoda	5,600	18,500
Nintendo	Technology	Expansion	New Office New Office	→	Kanda Square Chiyoda	2,645	8,700

Source Nikkei RE, Savills Research & Consultancy

slowdown in leasing activity has been recently observed, which is understandable given the level of asking rents. Following the conclusion of some developments, the vacancy in this ward slightly loosened over the quarter, though, in truth, the market remains extremely tight at 0.1%.

Shinjuku

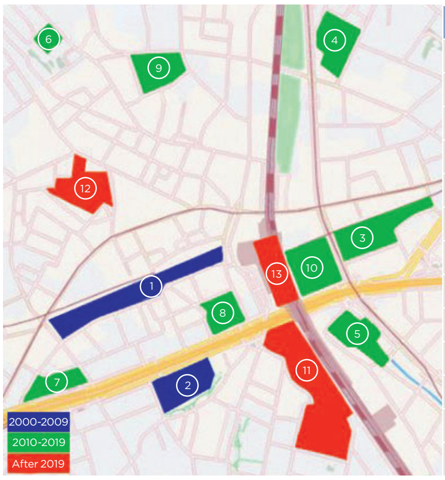
Despite temporarily exceeding Grade A rents in Minato in Q2/2019, Shinjuku once again languishes at the bottom this quarter. Yet, this could change going forward. Grade A rent growth over the calendar year in this ward has been outpacing its nearest rival consistently since 2014, and in 2019, growth equated to 7.6% YoY. Over the quarter, rents grew 2.8% to reach JPY33,909 per tsubo. Even so, a ceiling of around JPY40,000 appears likely for the time being considering the lack of prime office supply in close proximity to the station. Reports have suggested a busy end of 2019 in the Shinjuku Central Park Tower, as four new tenants move in, whilst another is expected in Q1/2020. The largest of the five, Coca-Cola Bottlers Japan, supposedly leased around 1,300 tsubo of space in November. Vacancy over the year and quarter remained fairly flat, which is unsurprising given it is currently non-existent.

The Re-emergence of Shibuya's Tech Scene

Shibuya, known for youth fashion and culture, has recently seen its office market thrive. Major drivers of this change have been the emergence of the ward as the go-to destination for technology firms as well as the spate of new office developments. For instance, Google is relocating to Shibuya Stream this year, where they have leased the entirety of the available office space, totalling 14,000 tsubo. This is not a new phenomenon, however. In fact, towards the end of the 1990s Shibuya was a hotbed for the technology and start-up community, with the ward even getting the nickname: "Bit Valley" (a play on the kanji used in Shibuya's name). However, by the mid-2000s the writing was on the wall. The bursting of the tech bubble combined with a dearth of suitable office space saw many tenants depart. Yet, it appears the ward's office market has gone full circle and is once again the top destination for companies in the technology sector.

The attraction of Shibuya is not hard to see. With its excellent transport links and a plethora of amenities, it is a truly cosmopolitan city with the power to draw an international workforce. It is this ability that appeals to global technology powerhouses such as Google, and rents have reacted accordingly. Since bottoming out towards the end of 2011, the surge in Grade A rents in the ward has been astonishing. Rents have nearly doubled, whilst the next best performer, Chuo, lies some 30% behind. Indeed, Grade A rents in Shibuya are now the second highest in the submarket, only 7% behind the leader, Chiyoda. Yet, this growth has not been restricted to prime offices. Grade B office rents have followed a similar trend, increasing by around 70% over the same period – again the highest in the submarket. Furthermore, according to Miki Shoji, as of November 2019, all-grade rents in Shibuya lead the submarket, having done so since August 2019, standing at JPY24,942 per tsubo – 3% higher than second placed Chiyoda.

MAP 1: The Shibuya Grade A Office Market



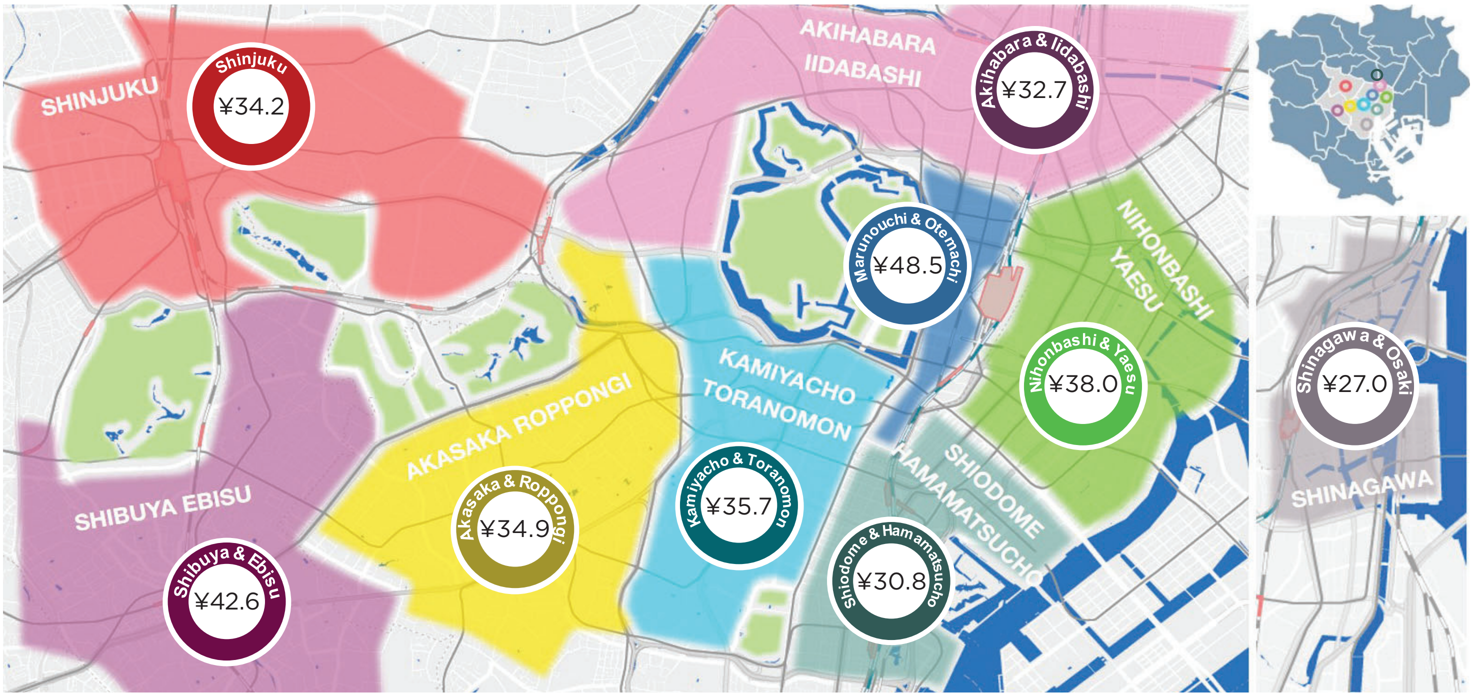
#	PROJECTS	GFA (SQ M)	COMPLETION
1	Shibuya Mark City (West)	138,620	2000
2	Cerulean Tower	105,950	2001
3	Shibuya Hikarie	144,546	2012
4	Shibuya Cast	34,981	2017
5	Shibuya Stream	117,000	2018
6	Abema Towers	37,949	2019
7	Shibuya Solasta	46,954	2019
8	Shibuya Fukuras	58,970	2019
9	Shibuya Parco	63,900	2019
10	Shibuya Scramble Square	181,000	2019
11	Shibuya Sakuragaoka A	254,000	2022
12	Dogenzaka 2 chome Plan	41,950	2023
13	Shibuya Scramble Square 2	96,000	2027

Source Nikkei RE, Press Releases, Savills Research & Consultancy

Furthermore, the area surrounding the station is set to benefit thanks to the ongoing Urban Core initiative. This project aims to greatly improve accessibility around Shibuya Station and the adjacent commercial facilities via elevated pathways across four floors. Capitalising on this added footfall, a major beneficiary of this project is Shibuya Scramble Square, which has accordingly set a retail sales target of JPY40 billion per year. The added vibrancy from the revitalised retail sector, therefore, should also act as a boon for the area as a whole.

Given the fundamentals, it appears that this upward trajectory in rents still has some legs, with projects, especially around the station, in full swing. For instance, the Shibuya Sakuragaoka-guchi District is expected to add over 76,000 tsubo of GFA in 2023, servicing the much needed supply of office space. Indeed, despite all the projects completed recently, Shibuya represents less than 10% of Grade A stock in the C5W, and as such, this limited supply should underpin rent growth going forward. As always, one must be cognisant of the current level of rents, though the fact that they remain below 2008-peaks, in addition to the improved financial position of tenants, should provide some comfort going forward.

MAP 2: Average Rents Per Tsubo In Selected Submarkets, Q4/2019



Source Savills Research & Consultancy
Grade A buildings, average passing rent + CAM per tsubo per month in thousand JPY. Coloured areas for illustrative purposes only.

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

Despite clouds of global economic and political uncertainty continuing to gather, Japan finds itself in somewhat calmer waters, and at present, there appears no catalyst to drastically change this narrative. As efforts to break the impasse of the U.S. -China trade negotiations have started to bear fruit, there are also signs that the relationship between Japan and South Korea is thawing. Any positive resolution arising from these deadlocks being broken can only be a boon for Japanese corporates, whose profits, though at historic levels, have been somewhat stymied recently. Despite the potential destabalising effect of the recent geopolitical issues in the Middle East, and while domestically, Japan continues to battle demographic challenges, the underlying fundamentals are sound. For instance, the unemployment rate remains below 2.5%, despite a slight uptick since July 2019. Indeed, if this labour market tightness were translated into wage growth, it would provide a much-needed fillip to the economy. That said, the aftermath of the consumption tax hike implemented in October remains a concern. The fact that the impact is yet to be fully understood may add a sense of uncertainty in 2020, though it appears fiscal stimulus is in the pipeline to somewhat soften the blow.

Undeterred by the ongoing global uncertainty, rent growth in the office market has continued full steam ahead, with both the Grade A and B markets posting solid figures. In fact, growth over the year has been the highest witnessed since 2014, surprising many observers who had anticipated greater supply towards 2020 to drag. As such, average Grade A rents in the C5W now lie around 20% below 2008-peaks, having languished close to 40% behind only five years ago. Vacancy remains extremely tight across the board, and this trend looks set to continue given most major new developments are close to or have been fully leased. Furthermore, as most major companies have already announced relocations, we are less likely to be surprised about large secondary vacancy in 2020. Most wards in this submarket have impressed over the year, though none more so than Shibuya. The ward's re-emergence as a tech hub has driven rents up at a fervent pace, and this looks set to continue against a backdrop of supply constraints.

The underlying fundamentals in the office market remain accommodative of rent growth and this should continue in 2020. Even so, given the elevated levels observed, rents may soon arrive at a delicate juncture as financial capabilities start to be tested. Indeed, it would not be inconceivable to witness growth in rents exhibiting a marked divergence based on location and convenience, with properties located further away from stations, as well as less attractive but pricier buildings, somewhat struggling to fill availability, especially in Shibuya and Chiyoda. All things considered, however, flat to moderate growth is expected for now.