MARKET IN MINUTES
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Office Leasing

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Moderate recovery takes hold

Moderate recovery has taken hold in the Tokyo office market, and the limited supply in 2024 should help to stabilise the situation further

- Office markets enjoyed moderate rental growth in Q4/2023 and the outlook continues to improve. Vacancy rates are approaching pre-pandemic levels, but the widespread proliferation of hybrid work arrangements may delay further progress.
- Average Grade A office[1] rents in the C5W increased by 0.5% quarter-on-quarter (QoQ) to JPY32,579 per tsubo[2] per month, amounting to a decline of 0.6% on a year-on-year (YoY) basis.
- The average Grade A office vacancy rate in the C5W tightened by 0.2 percentage points (ppts) QoQ, and tightened by 0.7 ppts YoY to 3.2%.
- Average large-scale Grade B office[3] rents also increased by 0.5% over the quarter to JPY24,553 per tsubo per month, amounting to a yearly increment of 0.3%.
- Vacancy rates in the Grade B market tightened by 0.4ppts over the quarter to 3.6%.
- New office supply in 2023 has been absorbed with limited issues, and the modest new supply in 2024 should provide breathing room for further recovery. That said, bifurcation by location and age persists as tenants reassess their office needs in the post-pandemic era.

1 Grade A offices refer to buildings with a GFA of 9,000 tsubo (30,000 sq m) and a building age of less than 15 years. Some buildings that do not fit this definition are included.
2 1 tsubo = 3.306 sq m or 35.583 sq ft.
3 Large-scale Grade B offices refer to buildings with a GFA of 4,500 tsubo (15,000 sq m) and a building age of less than 25 years. Some buildings that do not fit this definition are included.

"Moderate improvements to rents and vacancy were observed over the quarter in both Grade A and Grade B office markets. There were limited issues with absorbing the large office supply in 2023, and the modest incoming supply in 2024 bodes well for the additional stability of the market. However, bifurcation based on location and age may deepen further."

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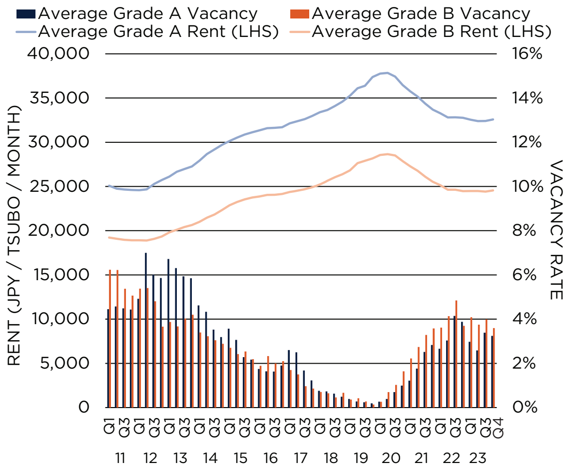
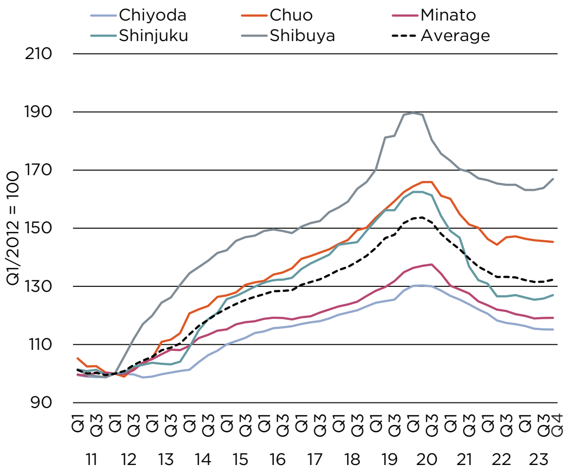
GRAPH 1: Office Rents and Vacancy in Tokyo's C5W*, 2011 to Q4/2023



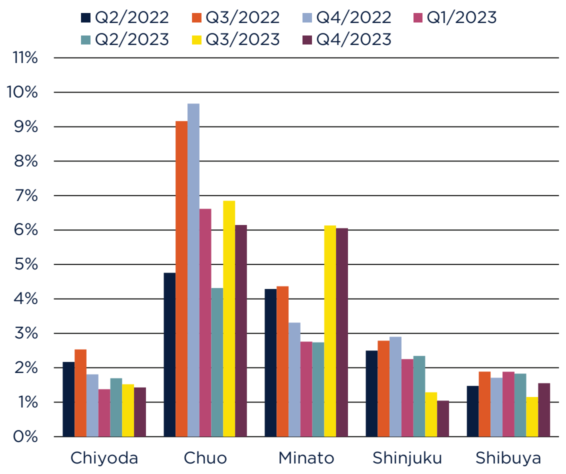
Source Savills Research & Consultancy
* Chiyoda, Chuo, Minato, Shibuya, and Shinjuku

GRAPH 2: Grade A Office Rental Index by Ward, 2011 to Q4/2023



Source Savills Research & Consultancy

GRAPH 3: Grade A Office Vacancy by Ward, Q2/2022 to Q4/2023



Source Savills Research & Consultancy

GRADE A OFFICE

In the Tokyo Grade A office market, rental levels and vacancy have enjoyed modest improvements over the latter part of 2023, and sound domestic economic growth has been a tailwind for the office sector. For the second quarter in a row, average rents in the central five wards (C5W) experienced quarterly growth in Q4/2023 at 0.5% to JPY32,579 per tsubo, while annual rental changes amounted to a 0.6% decline, which is more modest than in the previous quarter. As such, the total rental contraction from the peak levels of Q2/2020 decreased marginally to around 13.9% for the Tokyo C5W Grade A office market.

Quarterly rental changes were moderate across the C5W over the past quarter, although some fluctuations were observed at the constituent ward level. Shibuya recorded the largest rental increment at 1.9% QoQ, and average rents in Shinjuku increased by 0.9% QoQ. Elsewhere, Chiyoda and Minato rents remained unchanged over the quarter, while Chuo was the only ward to experience a rental contraction at 0.2% QoQ.

On a similar note, the average vacancy rate for Grade A offices in the C5W tightened modestly by 0.2ppts QoQ to 3.2%, and vacancy performance looks to continue to make gentle improvements, especially given the limited incoming supply in 2024. Chuo witnessed the largest quarterly decrease in vacancy by 0.8ppts to 6.1%, due to progress made across a handful of offices with moderate amounts of empty space in previous quarters. Meanwhile, vacancy rates fell in Shinjuku and Chiyoda by 0.3ppts QoQ and 0.1ppts QoQ, respectively. There were no changes over the quarter in Minato, while average vacancy loosened slightly by 0.5ppts QoQ in Shibuya, largely due to the addition of new offices that still have some available floors. However, the demand for new offices remains firm in Shibuya, and the submarket should have few problems dealing with remaining vacancies moving forward.

2023 emerged as a favourable year for tenants, marked by multiple large leases ranging from 2,000 to 3,000 tsubo. The leasing landscape remains favourable for tenants, with rental corrections and enticing financial incentives. In addition, the market has slackened with greater rental floor flexibility, creating an ideal environment for prospective tenants. Hence, tenants have secured advantageous leasing conditions and have carried out overdue relocations in the recovering market, expanding or contracting their office footprints based on their revised needs in the post-pandemic landscape. Overall, this trend has been particularly welcoming for modern offices with strong ESG specifications, and located in areas with good access and amenities, which have garnered significantly heightened interest for relocations.

However, these pandemic-induced shifts have culminated in a noticeably bifurcated market. Hybrid work arrangements have persisted as a corporate perk, especially as firms navigate the severe worker deficit in Japan. In response, companies have been forced to reconsider the roles and functions of their offices. This often includes a focus on high-quality and specialised environments that support employee communication and well-being. Several older offices with poor access are likely unable to provide the same practical and psychological benefits, and so will be unable to compete, a situation that will be compounded by the large amounts of modern office space that arrived to the market in 2023, as well as the impending large supply expected in 2025. Overall, while the Tokyo office market should continue to improve, there will likely be winners and losers in the post-pandemic market, and fluctuations may intensify going forward.

LARGE-SCALE GRADE B OFFICES

Recovery appears to have also taken hold in the large-scale Grade B market, with moderate improvements observed in terms of rental level and vacancy over the quarter. Average rents increased by 0.5% QoQ to JPY24,553 per tsubo, which translates to a slight increment on a yearly basis. Quarterly changes were moderate, with most submarkets experiencing some encouraging rental growth. The largest quarterly increments were experienced in Shibuya and Shinjuku at 0.9% and 0.8%, respectively, while more gentle growth was seen in other submarkets over the quarter. Indeed, some landlords appear to have had the confidence to raise rents in the current recovering market, given the strong appetite for office space and relocations among tenants, on top of the lack of new Grade B office supply in most constituent submarkets in the C5W.

Meanwhile, average Grade B office vacancy tightened by 0.4ppts QoQ in Q4/2023 to 3.6%. Notably, a handful of office properties with moderate amounts of unoccupied space in Shibuya were completely filled over the quarter, and the ward consequently saw the largest decrease in vacancy at 1.4ppts QoQ to 1.1%, which is the lowest level among the constituent wards of the C5W. Elsewhere, vacancy rates fell in Chiyoda, Minato, and Shinjuku, all by 0.4ppts QoQ. On the other hand, vacancy loosened by 0.5ppts QoQ in Chuo to 5.4%, which can be attributed to a handful of underperforming assets that are either located in peripheral areas or have above-market rents.

There have been relatively few changes in the Grade B office market over the past quarter, and the current trajectory appears to be stable and positive. Overall, the demand for office space has been improving among tenants throughout the year, due to strong corporate performance and greater rates of office attendance in 2023. Indeed, according to Mitsubishi Real Estate Services, instances of office relocations involving either expanding or maintaining current office footprint sizes increased notably between Q2/2022 and Q2/2023, from 53% and 9%, respectively, to 59% and 22%. In particular, many office expansions have taken place over recent quarters, with many firms proactively increasing their staff headcounts due to improved economic sentiment in Japan, even despite hybrid work arrangements appearing to remain in place.

However, bifurcation by location and age is a persistent issue, and a handful of large-scale Grade B offices located in peripheral areas, such as Harumi in Chuo and Daiba in Minato, continue to experience hurdles in filling vacant space. Struggling properties will be increasingly forced to revise rents and offer other incentives such as longer free rent periods in order to manage this situation. Nevertheless, encouraging prospects for future nominal growth in Japan, as well as further gradual increments in office attendance, should continue to support recovery in the market, which raises the possibility of further rental growth moving forward.

GRADE A RENTS AND VACANCY RATES BY WARD

Chiyoda

Chiyoda's rents remained flat over the quarter at JPY38,718 per tsubo, while average vacancy tightened by 0.1ppt QoQ to 1.4%. There are few concerns about the situation in Chiyoda, which retains the highest rents and some of the lowest vacancy rates among the constituent wards of the C5W. Indeed, changes were marginal over the quarter, and Chiyoda's enduring reputation as Japan's premier business hub should bode well for leasing demand moving into 2024.

Office movement activity has been relatively slow in Chiyoda over the quarter. The largest relocation will be by PHC holdings, which will reportedly take a 500 tsubo lease in Dai-ichi Life Hibiya First in April 2024, consolidating scattered offices into a single floor to boost communication and productivity. Clifix Certified Public Tax Accountant's Corporation will relocate its headquarters to Otemachi First Square East Tower around March 2024, reportedly leasing 300 tsubo in the East Tower section. Meanwhile, an affiliate of Nagoya-based Paloma will lease around 180 tsubo in Marunouchi Trust Tower Main.

Chuo

Average rents in Chuo decreased marginally by 0.2% QoQ to JPY31,485 per tsubo in Q4/2023, while vacancy tightened by 0.8ppts QoQ to 6.1%, following the moderate loosening in the previous quarter. The strong leasing performance of many modern properties in the Nihonbashi and Yaesu submarket is an indication of the encouraging economic situation and sound sentiment in the office sector in the post-pandemic era. That said, Chuo ward is large and diverse, containing both prime business areas next to Tokyo station, as well as more peripheral districts in the Tokyo Bay area, where a handful of buildings struggle with large amounts of vacant space. Rents and vacancy differ considerably between these areas, and bifurcation in the performance of individual properties will likely continue depending on accessibility and age.

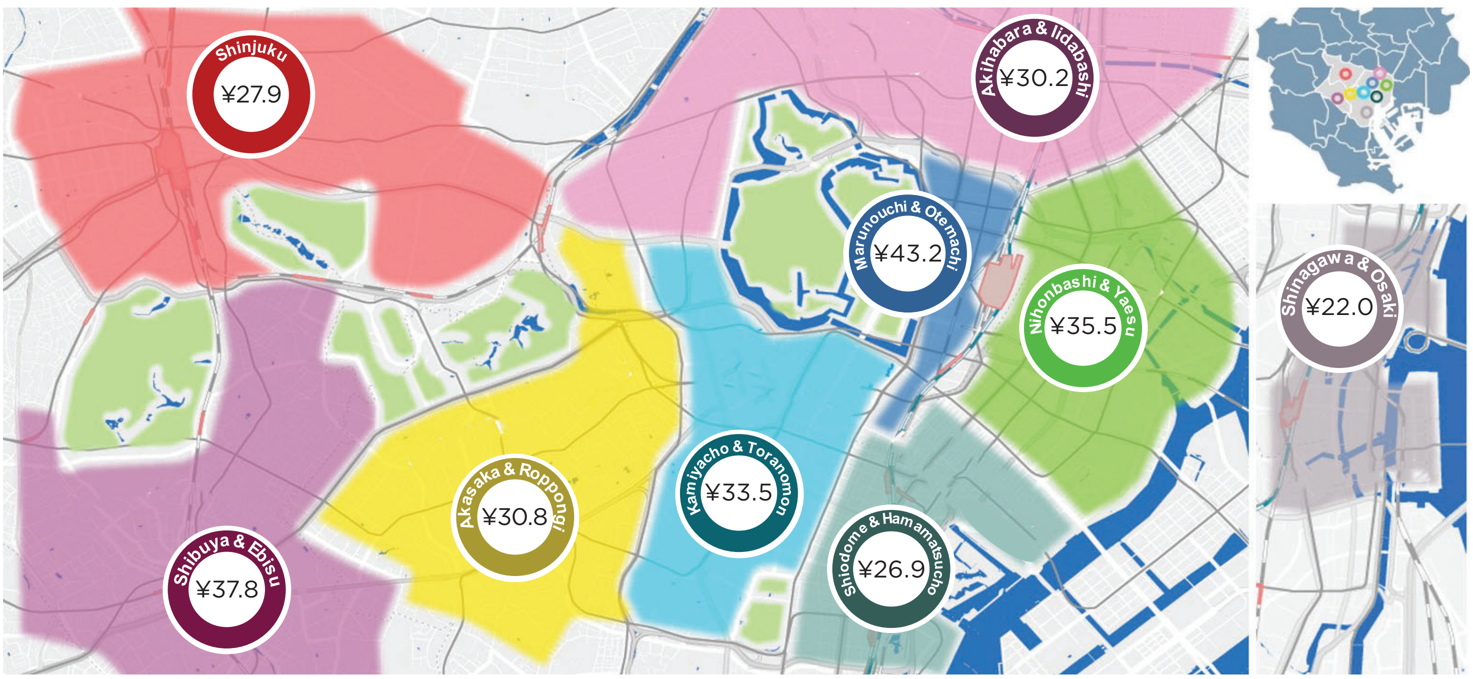
Leasing activity appears to have accelerated in Chuo in Q4/2023. Marubeni will relocate its headquarters to Tokyo Midtown Yaesu in May 2025, reportedly leasing an estimated 2,660 tsubo, which was the largest announcement in the ward over the quarter. Elsewhere, there were a number of moderately sized relocations announced, including Dolbix Consulting taking a 350 tsubo lease in the Muromachi Furukawa Mitsui Building in July 2024, as well as Sunny Health's 350 tsubo lease in the Toda Building in early 2025, relocating away from the struggling Harumi area in the process.

Minato

The situation appears to remain steady in Minato over the past quarter, with average rents unchanged QoQ at JPY30,200 per tsubo, which translates to an annual decline of 1.0%. Similarly, vacancy was unchanged QoQ at 6.1%. The spotlight has been on the Toranomon area in 2023 with a number of large additions arriving to the market in the latter part of 2023, including Azabudai Hills Mori JP Tower and Toranomon Station Tower, which should transform the area.

Toranomon Station Tower has been performing well in particular, having received firm interest from prospective tenants over the quarter, and appears to be aiming for effectively full occupancy by the end of the year. Indeed, Goldman Sachs and IBM Japan took out relatively large leases of 6,000 tsubo and 1,500 tsubo, respectively in the building, with the prior reportedly occupying six floors and becoming the main tenant of the property. Meanwhile, Azabudai Hills Mori JP Tower has made some decent progress with filling up space since its completion in the latter half of 2023. Philips Japan, GO, and Kakao Piccoma will

MAP 1: Average Rents Per Tsubo in Selected Submarkets, Q4/2023



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

TABLE 1: Tenant Relocations, Q4/2023

ORIGIN: Chiyoda	Chuo	Minato	Shibuya	Shinjuku	Other	DESTINATION	
3	11	19	6	1	18		
2		1			2	5	Chiyoda
	7		1		1	9	Chuo
1	4	15			1	21	Minato
		1	3		1	5	Shibuya
				1	1	2	Shinjuku
		2	2		12	16	Other

Source Nikkei RE, Savills Research & Consultancy

TABLE 2: Notable Office Leasing Transactions, Q4/2023

COMPANY	BUSINESS SECTOR	TYPE	FORMER/CURRENT LOCATION	NEW LOCATION	APPROXIMATE SPACE	
					TSUBO	SQ M
Goldman Sachs Japan	Financial Services	Office Relocation	Roppongi Hills Mori Tower Minato	Toranomon Hills Station Tower Minato	6,000	19,800
Marubeni-Itochu Steel	Trading Company	HQ Relocation	Nihombashi 1-Chome Mitsui Building Chuo	Yaesu Central Tower in Tokyo Midtown Yaesu Chuo	2,660	8,790
Nihon Chouzai	Pharmaceuticals	Undisclosed	GranTokyo North Tower Chiyoda	Tamachi Tower Minato	1,580	5,220
Edwards Lifesciences	Medical Technology	HQ Relocation	Nittochi Nishi-Shinjuku Building Shinjuku	Shinjuku Front Tower Shinjuku	1,500	4,960
Marubeni I-Digio Holdings	Information Technology	HQ Relocation	Various Various	Sumitomo Fudosan Iidabashi First Tower Bunkyo	1,500	4,960

Source Nikkei RE, Savills Research & Consultancy

lease nearly 1,100 tsubo, 600 tsubo, and 500 tsubo, respectively in the building, and the property is expected to push to reach 90% occupancy by early 2024. That said, in the meantime, there are still fairly large amounts of vacant space in the building, and competition from other new developments in the area may hamper this progress somewhat.

Elsewhere, Nippon Kinzoku will reportedly sell its current headquarters in Minato and relocate to G-Base Tamachi, leasing approximately 680 tsubo of office space. The company plans to reduce the number of leased floors through the move, streamline operations, and create an office suitable for a range of working styles. Overall, more companies moved to Minato than exited the ward, and the situation in the submarket appears to gradually improve looking ahead.

Shibuya

Shibuya appears to be a standout performer amongst the C5W in 2023. Rents increased by 1.9% QoQ at JPY35,659 per tsubo. Although vacancy loosened slightly by 0.5ppts QoQ, the situation in Shibuya remains tight, with average vacancy at 1.6% in Q4/2023, which is among the lowest in the C5W. Shibuya is a popular office location, due to its convenient location and range of amenities nearby, and is a particularly popular area among IT firms, as well as foreign companies. Modern offices have enjoyed strong interest among tenants in 2023, demonstrated by firm pre-leasing activity and low levels of vacancy among such developments, particularly Shibuya Sakura Stage, and availabilities are currently scarce overall in the market. As such, landlords are in a strong position and future rental increments are possible.

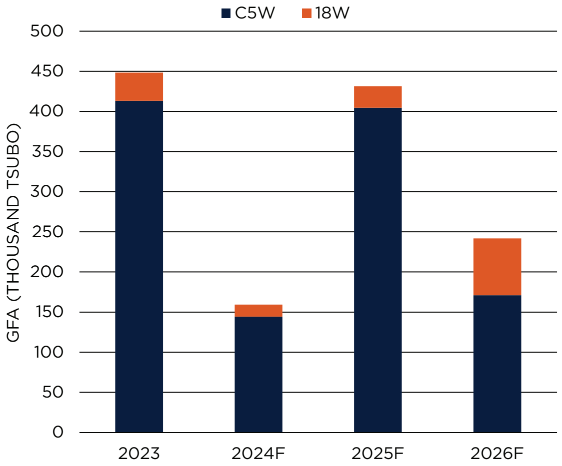
Given the tight conditions in the Shibuya market, tenant relocation activity has been relatively limited over the quarter. Broad-minded will relocate its headquarters to Shibuya Sakura Stage in October 2024, reportedly leasing 500 tsubo in the building, which will be the largest move in Shibuya announced in Q4/2023. The company plans to expand its staff headcount, and aims to provide a comfortable working environment that enables communication and has close proximity to Shibuya station.

Meanwhile, Ject One will relocate its headquarters to SHIBUYA AXSH in December 2024, which is currently under construction near Shibuya station. The company plans to expand on its current office space, leasing around 400 tsubo, in anticipation for accelerating hiring activity, but appears to maintain hybrid work arrangements for the time being.

Shinjuku

Shinjuku's office market has displayed further improvements over the quarter. Quarterly rental growth was strong at 0.9%, reaching JPY26,833 per tsubo, while vacancy fell by 0.3ppts to 1.0%. The Shinjuku office market is also in a positive situation - occupancy levels are high, and availabilities are scarce. As such, there were only a few notable office relocations over the quarter, and the Shinjuku market appears to be stable going into 2024.

GRAPH 4: Office Supply (GFA) Estimates* for the C5W and the 18W, 2023 to 2026F



Source Savills Research & Consultancy
*Adjusted GFA figures based on estimated office floor space

Edwards Lifesciences will relocate their headquarters to Shinjuku Front Tower, taking out a lease of 1,500 tsubo, which is the largest office movement in Shinjuku over the quarter. Meanwhile, Movensys reportedly also leased approximately 150 tsubo in Shinjuku Front Tower in October 2023. Similar to other tenants in 2023, Movensys aimed to expand its floor space with a view to increase its employee headcount, and considers the convenience of Shinjuku as a major factor in its recruitment efforts. There will reportedly be no new office supply in the Shinjuku market until the completion of the Meiji Yasuda Seimei Shinjuku Building, slated to open in early 2026. As such, the current tight situation is likely to continue into the near future.

2024 OFFICE SUPPLY

2023 was a significant year for new office supply, with a total GFA of nearly 450,000 tsubo completed over the year. With the Tokyo office market still in a recovery phase, many observers were initially concerned about a potential uptick in vacancies and general instability, especially because many new developments have high target rents. However, Japan's economic performance has been strong in 2023, and a number of companies have expanded their headcounts. At the same time, average vacancy has still been relatively loose in 2023, and some landlords have continued to offer generous incentives in order to quickly secure tenants. As such, many companies have seized opportunities to carry out overdue office relocations and consolidations throughout the year while premium space is available, which has eased many concerns among observers.

This encouraging momentum bodes well for the market, and the limited supply forecast in 2024 should help to further stabilise the situation going forward. The pipeline of new office supply in 2024 comprises a total GFA of roughly 150,000 tsubo (Graph 4), which is around one third of the 2023 level, and pre-leasing activity has been encouraging so far at over 30% overall. New offices with good access remain highly sought after. In particular, the Shin-Tora Yasuda Building, scheduled for completion in February 2024, is reportedly fully pre-leased. Similarly, SHIBUYA AXSH, to be completed in May 2024, is reportedly nearly fully pre-leased, benefitting from the extremely tight market conditions in Shibuya, while over half of the TODA Building, to be completed in September 2024, appears to be filled. Not all new supply has been that fortunate, but the current pre-leasing trend hints towards overall stability and sound demand for offices with good access and ESG features.

Sentiment among market players appears to be relatively positive with respect to the situation in 2024. According to a recent survey regarding Grade A offices in Tokyo by Nikkei Real Estate Market Report, over half of respondents predicted moderate improvements in vacancy in both 1H/2024 and 2H/2024. With regards to asking rents in 1H/2024, half of respondents predicted no changes, and nearly a fifth saw some rental growth potential, while for 2H/2024, the same proportion predicted no changes, and the proportion predicting rental growth increased moderately. Vacancy rates currently hover around the 1% level in Shibuya, Shinjuku, and Chiyoda, and the limited incoming supply in 2024 should not disrupt the situation. This appears to be a sign of overall market stability, and rental growth should be a distinct possibility in 2024.

That said, a large expansion in office supply in 2025 may present further issues for the office market. Although leasing demand has been sound enough in 2023 to absorb incoming large supply with limited issues, which is another positive sign for 2024, the same is not guaranteed to occur in 2025. Like 2023, over 400,000 tsubo of office supply (GRA) is slated for completion in 2025, with a considerable amount contributed by the enormous Takanawa Gateway City complex in Minato ward. While the project has already generated some interest, with KDDI reportedly taking a large lease of almost 30,000 tsubo in the building, it remains to be seen how the remaining new supply is received, and the absorption of new properties may generate large amounts of secondary vacancies. In addition, global, and subsequent Japanese macro-economic instability in 2024 may threaten to dampen office leasing demand moving forward. Also, expected delays to the much awaited Chuo Linear Shinkansen project have not boosted prospects.

The strength of leasing demand may change, depending on macro-economic conditions, although new office supply may cause secondary vacancies elsewhere in the Tokyo office market, exacerbating bifurcation and contributing to further instability. That said, the office market has responded well to the uptick in new office completions in 2023, and pre-leasing activity among upcoming properties in 2024 has been sound. Indeed, the limited amount of new supply arriving in 2024 should bode well for the stability of the Tokyo market moving forward. New labour laws in 2024 surrounding the construction industry might also delay projects, and result in the staggering of supply. Overall, steady improvements in the office sector look encouraging.

OUTLOOK

Recovery appears to be progressing steadily in the Tokyo Grade A and large-scale B office market in Q4/2023, buoyed by strong economic growth in 2023. Average rents increased moderately in both Grade A and Grade B markets, while vacancies tightened for a consecutive quarter. Indeed, demand among tenants for office relocations has remained firm over the quarter, and a growing number of tenants are actively growing their staff count and looking to increase their office footprints. As such, vacancy rates are noticeably lower now than during the height of the pandemic, and most submarkets are gradually approaching pre-pandemic levels.

The Tokyo office market responded well to the large amount of new office supply completed in 2023, which appears to have had limited bearing on the stable recovery seen over recent quarters. This may be serendipitous for the market looking ahead, due to the limited amount of new supply slated for completion in 2024, which should create some breathing room for further recovery and further stabilise the situation overall. Pre-leasing activity for new offices in 2024 appears to be progressing, given the strong appetite for modern offices in favourable locations. As such, any notable deviations from the current stable recovery trend are unlikely for the time being, while some submarkets with tight levels of vacancy may experience moderate rental growth over the coming year.

Nevertheless, the office market still has some way to go until full recovery, and there are still many uncertainties that may delay this progress. Hybrid work arrangements appear to remain a common feature, especially among large companies, as tenants adapt to the newly established roles and functions of their offices in the post-pandemic environment. This may result in some limitations regarding future office leasing demand, and will also contribute to the trend of bifurcation in office performance based on location and age, as many tenants clearly favour modern offices with good accessibility and amenities, and modern ESG specifications.

The influx of a large amount of new supply in 2025 may exacerbate this issue even further, and some older offices with undesirable features will likely continue to struggle, and observers may anticipate an uptick in secondary vacancies going forward. Nevertheless, the market looks to continue improving overall, albeit gradually. It remains to be seen how broader economic trends will affect corporate behaviour in the coming year, yet the encouraging performance of the Japanese economy in 2023 is a positive sign for leasing demand moving forward.