MARKET IN MINUTES
Savills Research

Office Leasing

Further stability with some challenges ahead

The Tokyo office market has stabilised, but the large volume of incoming supply may threaten this equilibrium.

- Rental corrections have been mild and indicate that the market is moving towards greater stability in 2023. Meanwhile, vacancy rates remain low overall.
- Average Grade A office rents in the C5W decreased by 0.5% quarter-on-quarter (QoQ) to JPY32,386 per tsubo per month, falling 1.3% year-on-year (YoY).
- The average Grade A office vacancy rate in the C5W tightened by 0.4 percentage points (ppts) QoQ and 0.5 ppts YoY to 2.6%.
- Average large-scale Grade B office rents remained stable over the quarter at JPY24,490 per tsubo per month, translating to a decline of 0.6% YoY.
- Vacancy rates in the Grade B market tightened slightly by 0.3ppts over the quarter to 3.8%.
- A large amount of new office supply will enter the market in 2023 and 2025, but office completions will be relatively limited in 2024 and 2026, which should give the market some time to absorb the large supply.

"The Tokyo office market has achieved greater stability in the post-pandemic era. Vacancy rates also appear to be approaching the tight levels observed pre-pandemic. The introduction of large office supply may threaten occupancy recovery but pre-leasing has been largely encouraging, and the mixed-use features with ESG specifications should attract tenants and ease some concerns."

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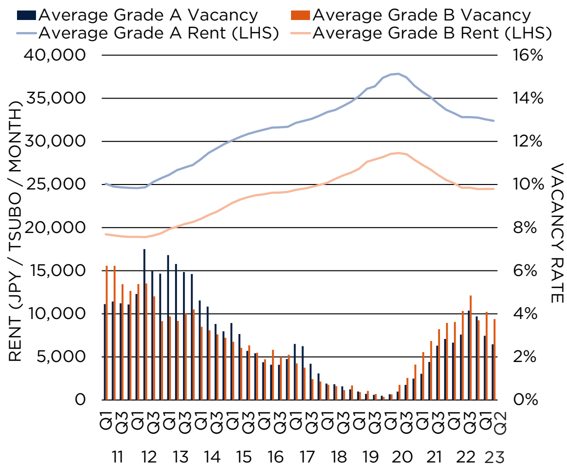
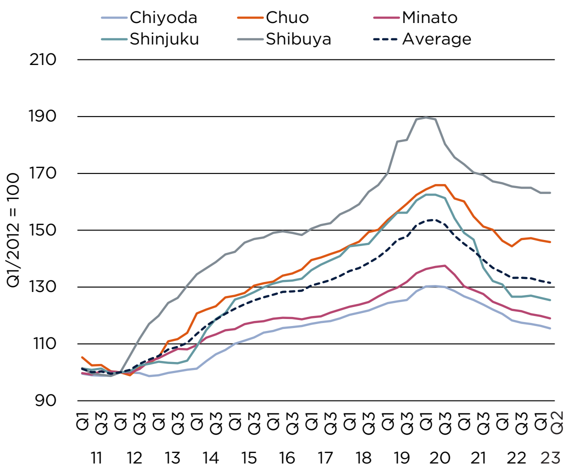
GRAPH 1: Office Rents and Vacancy in Tokyo's C5W*, 2011 to Q2/2023



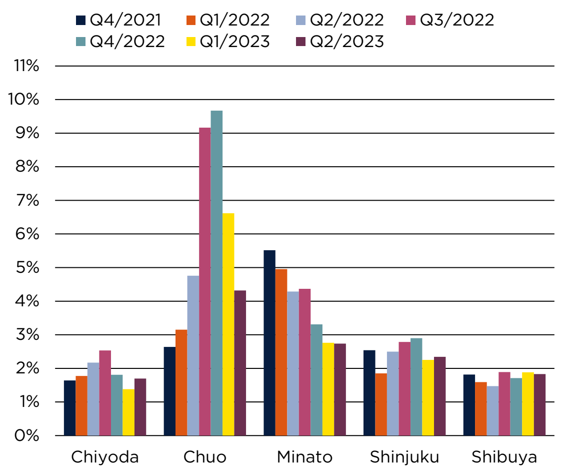
Source Savills Research & Consultancy
* Chiyoda, Chuo, Minato, Shibuya, and Shinjuku

GRAPH 2: Grade A Office Rental Index by Ward, 2011 to Q2/2023



Source Savills Research & Consultancy

GRAPH 3: Grade A Office Vacancy by Ward, Q4/2021 to Q2/2023



Source Savills Research & Consultancy

GRADE A OFFICE

In the Grade A office market, the encouraging situation of the previous quarter has continued in Q2/2023 and we continue to see broadly stable conditions. Average rents in the central five wards (C5W) contracted by a marginal 0.5% over the quarter to JPY32,386 per tsubo, amounting to an annual decline of 1.3%. As a result, the total rental correction from the peak levels of Q2/2020 increased to 14.4% for the Tokyo C5W Grade A office market.

Chiyoda, Minato, Shinjuku, and Chuo experienced some minor corrections in rents, at 0.8%, 0.7%, 0.6%, and 0.4% QoQ, respectively. Although rents in Shibuya contracted moderately in the previous quarter, they were unchanged in Q2/2023. Overall, rental changes in the Grade A office market have been nominal this quarter, which is an encouraging sign that the market is achieving greater stabilisation.

Meanwhile, the average vacancy rate for Grade A offices improved for another consecutive quarter to 2.6%, tightening by 0.4ppts QoQ and 0.5ppts YoY. An outsized proportion of this tightening took place in Chuo, which can be attributed to the absorption of the large 2022 supply from Midtown Yaesu Central Tower. Elsewhere, some moderate loosening was observed in Minato, Chiyoda, and Shinjuku.

Many companies are continuing to gravitate towards greater employee attendance in the office, which has led to some recovery in demand for office space. Furthermore, some Japanese companies are reportedly looking to expand their office footprints as part of their post-pandemic strategies, which should help with the absorption of the large amounts of new supply slated to arrive in 2023. However, the global economic slowdown is having a bearing on overseas companies, and some appear to be either postponing office expansions or returning floor space. Furthermore, hybrid work arrangements appear to linger in the post-pandemic era as a company benefit, especially among larger corporations that typically occupy Grade A and large-scale Grade B buildings, and this may dampen demand for office space. Nevertheless, the Grade A office market remains stable and rental corrections have become increasingly mild over recent quarters, and vacancy remains tight across the C5W.

LARGE-SCALE GRADE B OFFICES

The large-scale Grade B market appears to have also achieved a greater sense of stability in Japan's post-pandemic era. Rents in the large-scale Grade B market were virtually unchanged QoQ at JPY24,490 per tsubo, amounting to a YoY contraction of 0.6%. Minato experienced the largest quarterly rental contraction of 0.4%, which stems largely from a handful buildings with elevated levels of vacancy having lowered rents due to landlords seeking to remain competitive. Chiyoda also saw rents dip by 0.1% QoQ. That said, these revisions were marginal, and other offices have seen moderate increments in rents over the past quarter, which is a sign that recovery is taking hold. Elsewhere, average rents increased by 0.4% QoQ in Shinjuku, 0.2% QoQ in Shibuya, and were unchanged in Chuo.

Average Grade B office vacancy tightened slightly by 0.3 ppts QoQ to 3.8%. Shibuya was the only submarket to experience some loosening at 0.5% QoQ. On the other hand, the other constituents of the C5W all experienced modest tightening of between 0.2% and 1.0%. Vacancy in the Grade B market remains highest in Minato at 7.5%, which largely stems from properties located far away from stations and in remote areas within the submarket exhibiting high levels of vacancy, which has dragged up the ward average.

Overall, similar to the Grade A office market, Grade B office rents have experienced encouraging stability over recent quarters and will likely continue to improve in 2023. That said, some buildings have continued to struggle with high levels of vacancy since the previous quarter, notably those located further away from central areas, as can be observed among some offices in Minato and Chuo. Moreover, as hybrid work persists as a company perk among many large corporations in Tokyo, modern offices with greater hybrid working capabilities will likely attract more attention, while older offices lacking good transport access may need to resort to other measures to attract tenants going forward.

GRADE A RENTS AND VACANCY RATES BY WARD

Chiyoda

Chiyoda's rents declined moderately by 0.8% QoQ and 2.4% YoY to JPY38,823 per tsubo. That said, Chiyoda's average rents remained notably higher than its counterparts, due to its position as the premier business district in Tokyo with a vast number of domestic and international blue-chip companies located in the ward. Meanwhile, vacancy rose slightly by 0.3ppts QoQ, but is still the lowest among the constituent wards of the C5W at 1.7%.

This quarter, the messaging app operator, Line, will reportedly return 6,500 tsubo of office space in its current headquarters in Yotsuya Tower in Shinjuku and relocate to Kioi Tower in Chiyoda, although additional details have yet to be announced. Elsewhere, Rokinren Bank and Nippon Soda are both said to be relocating within Chiyoda, with Rokinren Bank set to lease over 1,900 tsubo in the Central Shin-Otemachi Building, while Nippon Soda will reportedly relocate its headquarters to JP Tower, leasing around 650 tsubo in November 2023.

Chuo

Average rents fell in Chuo by 0.4% QoQ to JPY31,603 per tsubo, but was the only ward to experience a yearly increment at 1.1%. Despite remaining elevated at 4.3%, Chuo's vacancy rate tightened by 2.3ppts QoQ as the submarket continues to gradually absorb several vacancies. Indeed, while Tokyo Midtown Yaesu initially opened with high levels of vacancy, its uneventful absorption over the past half-year demonstrates the sound demand in the market. Observers should anticipate the Chuo submarket progressing to similarly tight vacancy rates seen across the C5W market.

In Chuo, the largest reported office movement will involve Cosmo Oil, which will reportedly relocate its headquarters from the Hamamatsucho Building in Minato to the Toda Building, slated for completion in 2024, and will lease an estimated 2,900 tsubo over four floors. Meanwhile, TbcScat and Toho Holdings are reportedly scheduled to lease 2,400 tsubo and 1,450 tsubo in Tokyo Midtown Yaesu, respectively.

Minato

Rents declined modestly in Minato by 0.7% QoQ to JPY30,145 per tsubo, which equated to a yearly decline of 2.5%. Meanwhile, vacancy loosened by a slight 0.1ppts over the quarter to 2.7%, and tightened by 1.5ppts YoY. Although vacancy is quite tight overall, rental reductions were seen across a number of properties over the quarter, especially to the south of the submarket, which is a sign that some instability may persist in the submarket.

In Minato, KDDI will reportedly take an enormous lease of approximately 28,500 tsubo in the Takanawa Gateway City complex, relocating its headquarters from Iidabashi, Chiyoda, in the process. The development, which is scheduled for completion in 2025, caused some initial concerns regarding the future situation of the submarket, given the sheer size of the development and the relatively poor performance of some offices in Minato ward, especially in the bay area. However, a number of large companies have reportedly also taken out leases, which is an encouraging sign for the development.

TABLE 1: Tenant Relocations, Q2/2023

ORIGIN →	Chiyoda	Chuo	Minato	Shibuya	Shinjuku	Other	DESTINATION	
	19	13	20	7	8	15		
	10	4	1		1	2	18	Chiyoda
	3	5	1		1	1	11	Chuo
	4	3	16	2	1	3	29	Minato
			1	3	1	2	7	Shibuya
					3	2	5	Shinjuku
	2	1	1	2	1	5	12	Other

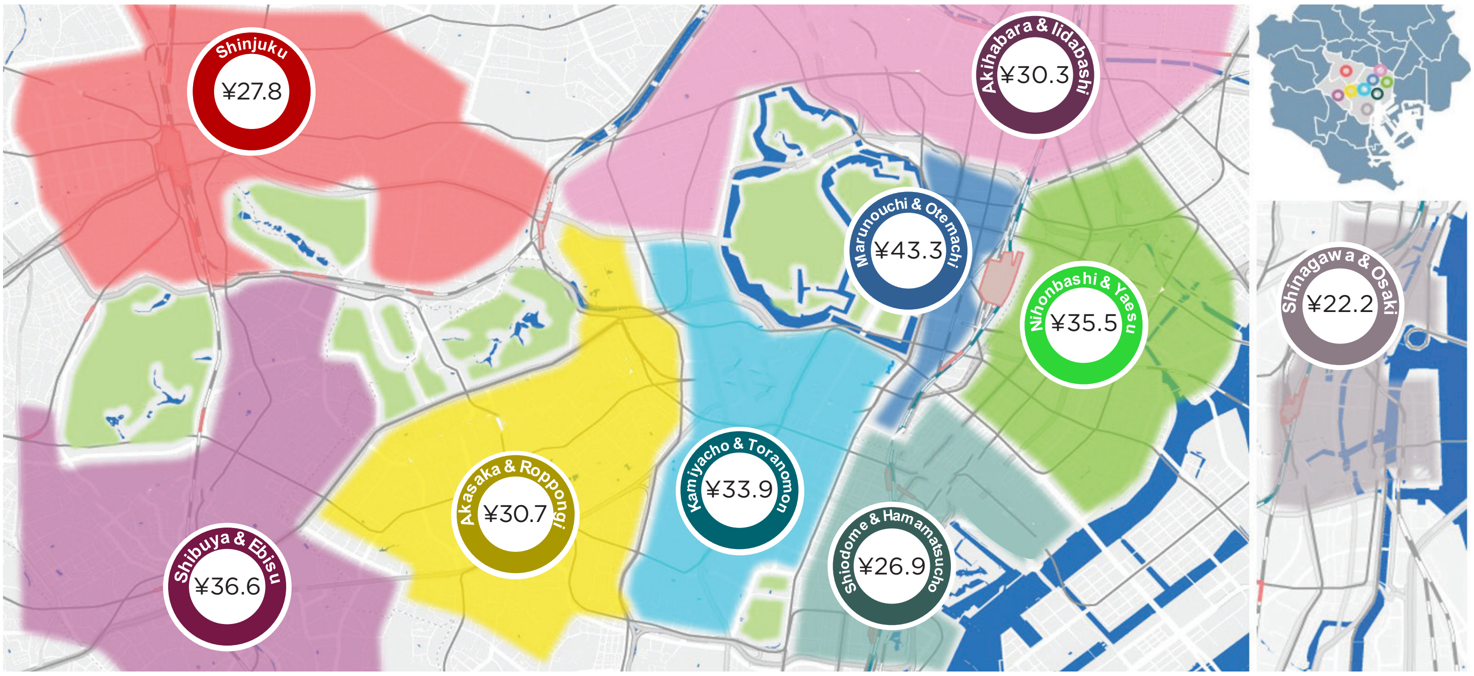
Source Nikkei RE, Savills Research & Consultancy

TABLE 2: Notable Office Leasing Transactions, Q2/2023

COMPANY	BUSINESS SECTOR	TYPE	FORMER/CURRENT LOCATION	NEW LOCATION	APPROXIMATE SPACE TSUBO	APPROXIMATE SPACE SQ M
KDDI	Software	HQ Relocation	Garden Air Tower, Chiyoda	Complex Building I North Takanawa Gateway City, Minato	28,500	94,200
Line	Software	HQ Relocation	Yotsuya Tower, Shinjuku	Kioi Tower, Chiyoda	6,500	21,500
Fujifilm Business Innovation	Technology and Electronics	Office Relocation	Nakanosakaue Sunbright Twin, Nakano	Sumitomo Fudosan Shinjuku First Tower, Shinjuku	4,800	15,900
Honda Motor	Automotive	HQ Relocation	Honda Aoyama Building, Minato	Toranomon 2-Chome District Category I Urban Redevelopment Project Office Building, Minato	4,000	13,200
Mitsubishi UFJ Trust and Banking Corporation	Financial	Office Relocation	Mitsubishi UFJ Trust and Banking Building, Chiyoda	Tokyo Shiodome Building, Minato	3,000	9,900

Source Nikkei RE, Savills Research & Consultancy

MAP 1: Average Rents Per Tsubo in Selected Submarkets, Q2/2023



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

Honda Motor will relocate its headquarters to an office building developed under the Toranomon 2-Chome District Category I Urban Redevelopment Project, which is slated for completion in 2025, where it will reportedly lease 4,000 tsubo across four floors. Mitsubishi UFJ Trust and Banking Corporation will reportedly occupy 3,000 tsubo in the Tokyo Shiodome Building. Meanwhile, Tokyu Housing Lease will also relocate its headquarters to Minato ward, and is reportedly set to occupy over 2,100 tsubo over two floors in the Shiodome Building.

Despite the modest contraction in rents and loosening vacancy, the situation in Minato appears to be gradually stabilising. Azabudai Hills will be a notable addition in 2023, and it appears to be 50% pre-leased. The mixed-use amenities featured in the development will transform the area, and will likely generate further interest among tenants.

Shibuya

Despite the previous quarterly contraction, average rents in Shibuya were unchanged QoQ at JPY34,857 per tsubo, which amounts to a yearly decline of 1.3%. Meanwhile, vacancy tightened by 0.1ppt to 1.8%, which is relatively low and a testament to the growing stability of office leasing demand in the submarket. Indeed, the Shibuya market is popular and prime office space is in short supply. Therefore, the major new development Sakura Stage Shibuya Tower, slated for completion in 2023 in the Shibuya station front area, should not experience difficulties with leasing demand, which is an encouraging sign for the Shibuya market.

Shibuya is home to many technology firms, and the recent global restructuring initiatives among many international firms have raised some concerns regarding vacancy increments in the ward. Nevertheless, tenant movement appears to have picked up in Q2/2023, and newly constructed offices received a notable level of attention, demonstrating the strength of the submarket.

For instance, LegalOn Technologies and Coincheck will lease 1,700 tsubo and 850 tsubo in Sakura Stage Shibuya Tower, respectively, with tenants noting the building's convenient location among other features. Meanwhile, Koshidaka holdings will occupy 550 tsubo in dogenzaka-dori, and will be joined by Torihada, which will lease the same amount of space in the same building. Lastly, AR Advanced Technology will reportedly relocate its headquarters and lease 300 tsubo in the new development SHIBUYA AXSH, which will be completed in 2024.

Shinjuku

Shinjuku's rents contracted moderately by 0.6% QoQ in Q2/2023, while also contracting by 0.9% YoY to JPY26,500 per tsubo, which remain the lowest among the constituent submarkets of the C5W. Meanwhile, vacancy rates remained flat at 2.3%. New major office developments will be limited for the meantime, which should create some breathing room for the market to continue stabilising in 2023.

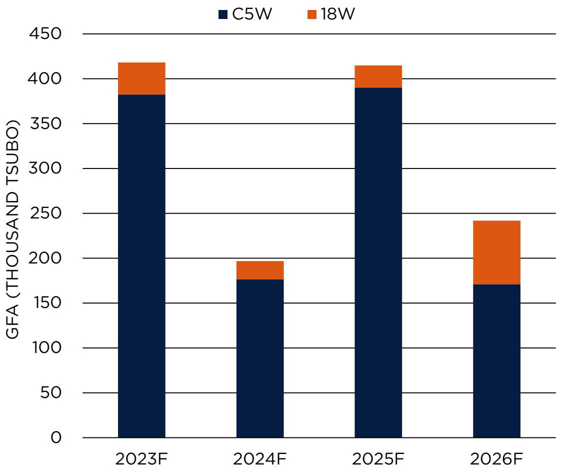
Leasing activity was moderate in Shinjuku, and a few notable relocations were observed in Q2/2023. Fujifilm Business Innovation will reportedly relocate its office to Sumitomo Fudosan Shinjuku First Tower, leasing around 4,800 tsubo together with its group companies. In addition, Adways also appears to be relocating to the same building, leasing around 600 tsubo. Meanwhile, Anicom holdings will relocate some of its group's offices to Shinjuku Square Tower around July 2023, although details regarding leased floor space have not been disclosed.

TOKYO OFFICE SUPPLY

Japan has transitioned to a post-pandemic state, and the next few years from 2023 are set to see a large amount of new supply come to the market in Tokyo (Graph 4), particularly in the Toranomon & Roppongi, and Takanawa submarkets (Graph 5). The Japanese economy is looking to fare well in 2023 and many companies are gravitating towards greater office attendance, which should be a boost for this incoming supply. However, the lingering effects of the pandemic, namely hybrid work arrangements persisting among large companies in Tokyo, in addition to the global economic slowdown, may dampen this sentiment, which will be discussed in greater detail in our spotlight report "Tokyo Office Supply 2023".

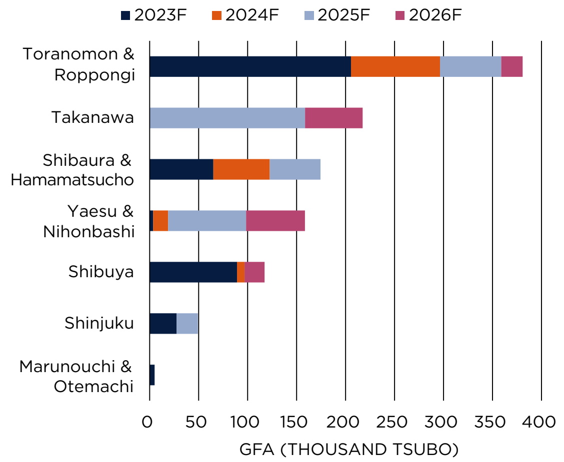
A large amount of supply is forecast for the second half of 2023, especially in the Toranomon area of Minato. Mori Building's Azabudai Hills and Toranomon Hills Station Tower developments

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



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

GRAPH 5: Office Supply (GFA) Estimates* by Submarket, 2023F to 2026F



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

will deliver the bulk of new supply in 2023. Rents at both projects are rumoured to be in the mid-to-high JPY30,000 per tsubo range, and pre-leasing activity has reportedly been sound. For instance, multiple financial institutions appear to be taking sizeable leases in Toranomon Hills Station Tower. Although there were some notable rumours of large-scale cancellations for Azabudai Hills, potential tenants will likely be attracted to the mixed-use features of the development, including an international school, high-end residential and retail facilities, and it should be able to continue gradually filling up the available space . Meanwhile, Sakura Stage Shibuya Tower is set for completion in 2023 in the popular Shibuya station-front area, with pre-leasing appearing to progress smoothly. Overall, the market has responded reasonably well to the new supply in 2023, and disruptions should be manageable.

Likewise, there will be significant levels of new supply in 2025, mainly located in the Takanawa submarket, with the enormous Takanawa Gateway City complex set to transform the landscape of the submarket. The comprehensive development will feature residential space and an international school, which should allow it to lure a number of high-profile residents, and make the area more attractive for tenants. Indeed, some large tenants have reportedly already been secured, despite some initial concerns regarding the size of the development.

However, the issue of secondary vacancy persists with these large-scale new developments, and may threaten to cause some fluctuations in nearby submarkets. That said, this also presents pockets of opportunity, with long-term tenants vacating their existing buildings, and potentially allowing the time for overdue refurbishments. Moreover, there will be comparatively little supply in 2024 and 2026, which will be spread out across different submarkets. This will give the market breathing room to absorb the large amounts of supply from 2023 and 2025 and alleviate some concerns regarding secondary vacancies, especially given market rumours pointing towards encouraging pre-leasing progress among the new prime offices.

Overall, the new supply forecast over the next few years looks to be manageable for the market, with some concerns regarding potential fluctuations. Indeed, many of these developments will be mixed-use, including residential, hotel, and retail space, and the actual amount of office space introduced to the market will likely be more limited than originally thought. These diversified developments with top notch ESG features should create various integrated spaces that could feel like a "city within a city" and should be attractive to prospective tenants.

OUTLOOK

We are cautiously optimistic for the Tokyo office market in 2023 as Japan moves away from a pandemic mindset. Rental corrections have been increasingly mild over recent quarters and rents should remain flat in 2023, while vacancy rates are currently low and leasing activity has been moderate. Office performance is usually correlated with corporate performance, and Japan's economic performance in 2023 gives a good indication that sentiment in the office market will be positive going forward.

Although many corporations are increasing office attendance in Tokyo, hybrid working arrangements look to persist as a corporate benefit, especially among large corporations and technology companies. With this fundamental workstyle shift, vacancy rates will likely not return to the tight levels seen in the pre-pandemic era, and companies will have a greater choice when looking for available office space. This will lead to some bifurcation in the market, with older offices in inconvenient locations likely becoming less attractive to prospective tenants.

Upcoming new office supply is slated to be substantial in 2023 and 2025, and these developments will transform the landscapes of their respective submarkets. Many developments will aim to attract tenants by integrating commercial, hotel, and residential space, and integrate the office within the local community. The desirability of the location will help to attract workers in the current tight labour market, hence this mixed-use feature is likely to be highly sought after by tenants. Pre-leasing has been strong thus far, while supply is expected to be limited in 2024 and 2026, which will give the market some breathing space to absorb incoming supply and manage secondary vacancies.

Overall, the Tokyo office market will remain stable over the coming year, and rents should be consistent. New offices with mixed-use features and strong ESG certifications will likely be well-received and should face fewer hurdles with absorption. That said, some temporary rental fluctuation is likely later this year given the substantial volume of new supply, and the bifurcation between modern offices and struggling offices is likely to widen further.

Savills monitors rents and vacancy levels of more than 500 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 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, our benchmark figures, particularly vacancy rates, tend to be lower than other market indices.