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Japan-Office Demand Outlook From 2003 to 2010

When forecasting the fundamentals of the office market, the future supply is almost a “given”; therefore, future demand is obviously the most difficult element to estimate. Thus, office demand is always a major consideration in any real estate analysis. Furthermore, in relation with the “2003 problem” experienced by the Tokyo market, office demand has lately become the central subject of debate among Japanese analysts. Demand for office space is determined by multiple factors. Among them we can distinguish 1) economic factors and 2) social and cultural factors. These factors are currently undergoing major changes.

In concrete form,

- (1) The Japanese economy has recently begun to rebound. At the same time, the composition of the nation’s output is changing; As is the case for most developed countries, the service industry in Japan represents an increasing proportion of the output, which should create new demand for office space.
- (2) However, the Japanese society is aging and so-called “baby boomers” are expected to start retiring in large numbers by 2010, which would create a void in the number of office workers available to fill this demand.
- (3) Part of the answer will come from the creation of new day-care facilities, the development of part-time jobs and the suppression of tax exemptions for spouses, all of which will provide additional opportunities and incentives for women to work.
- (4) In addition, more and more workers will continue to remain in the workforce past the traditional Japanese retirement age as more and more Japanese corporations are shifting from a promotion by seniority system to an individual performance-based system.

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- (5) This fits in with the fact that facility managers at the largest Japanese corporations are shifting management objectives away from “cost reduction” by mere space reduction to “improvement of productivity”.

What impact will these trends have on the two components of office demand, which are the number of office workers and the space per worker? Here is a brief summary of our answer to this question. (This issue will be addressed in greater details in our next Review to be released at the end of February 2004):

First, by combining our forecasts on the growth rate of the number of office workers and on the growth rate in the amount of office space per worker, we estimate the growth for office space demand between 2003 and 2010 to be approximately 1% growth per annum (8% cumulative growth). Second, by comparing the national cumulative growth in demand to the cumulative growth in supply in the key marketplaces in Japan (Tokyo, Osaka and Nagoya) between 2003 and 2007, we have found that demand is expected to grow more than supply. Thus, since the growth rate of office space demand is expected to be above average in these key marketplaces, we are projecting an improvement of these markets' occupancy levels between 2003 and 2007.

We believe our approach to this analysis is unique from two points of view.

- 1) As in any market, the number of office workers has both a supply and a demand side. In addition to the traditional forecasts of the number of office workers based on demographic projections (“supply-side forecast”), we estimate the number of employees necessary to achieve the forecasted output (“demand-side forecast”).
- 2) Some analysts believe that it is a “given” that since the space per worker is small in Japan compared to other countries, it should be expected to grow. We do not see any rational reason that such a change is pre-ordained. However, we believe that the space per worker is economically determined both by the level of rents and by the revenue of the employers. Our forecast is derived from this assumption and supported by models based on a national series analysis and an international cross sectional analysis.

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