

Survey of Office Market Trends in Tokyo's 23 Wards

We have recently completed a medium-term study of trends affecting the office market sector in Tokyo's 23 wards. The results indicate a change in the nature of demand for existing office buildings. Large-scale office building projects in recent years have evolved into multifunctional developments designed to satisfy a variety of needs encompassing the areas of "work, living, study, and recreation". Until recently, specific urban functions have typically been located in separate districts, however these new large-scale projects are mixing and integrating these functions into a single location. Conventional office buildings can no longer compete with these new types of developments by relying on location alone. Although the issues of improved building functionality and earthquake resistance remain important, in this changing urban environment the present trend is to upgrade tenant services by actively promoting building renovation, renewal, conversion or even reconstruction.

A summary of our medium-term study of the office market for the period 2004-2008 is given below.

1. During the medium-term 5-year period from 2004-2008 there will be a significant trend toward large-scale redevelopment in the prime locations of center Tokyo, primarily through reconstruction.

The so-called "2003 problem" (the surge in supply of new large-scale office buildings in central Tokyo) stimulated latent demand from large corporations wanting to relocate or integrate their operations. Existing buildings in the three wards of central Tokyo have continued to maintain high occupancy because of their prime locations, however, the owners are now planning and successively implementing plans for the reconstruction, conversion, or large-scale redevelopment of superannuated buildings. The market has matured and the trend is shifting from conventional quantitative increases in new volume to qualitative improvement through reconstruction and renovation.

From 2004 onward we expect that new supply will be provided primarily through extremely large-scale renovation and redevelopment projects in Tokyo's traditional prime office districts such as Marunouchi, and as a result Chiyoda and Minato wards will account for 68% of total new supply in all of Tokyo's 23 wards.

2. Corporations are shifting from self-owned to leased office buildings.

The results of our analysis show that since 2004 there has been a clear downward trend in the construction of new office buildings by companies for their own use. The office market consists of the owner-occupied market and the leased market, and we expect that this decline in the supply of owner-occupied office buildings will be reflected in an increase in demand in the leased market.

Toshio Komachi

Tao Wang

3. Calculations of the net increase in supply of new floor area must take into account the amount of supply lost through reconstruction.

The net increase in new supply is determined by taking total newly constructed floor area and subtracting the amount of floor area removed from the market in buildings that have been torn down for reconstruction. It is clear from our medium term forecasts for the period under review that it will be necessary to pay close attention to changes in the owner-occupied office building market. Therefore, the present study analyzed changes in net increase in supply not only for leased office buildings, but also for owner-occupied office buildings.

The impact of the large increase in supply predicted for 2006 will be negligible compared with 2003, and its effects will endure for only a limited period.

For the medium-term period ending in 2008, the office market will be stable and occupancy rates will remain high.

New supply in 2005 is expected to be extremely small at around 460,000 tsubo . This will be the smallest increase in supply for any year from 2001 through 2008, and represents less than 30% of the new supply that came onto the market in 2003. Demand is strong at present and is already being directed toward new development projects set to come on line in 2006. New supply in 2006 is forecast to be about 86% of the all-time record set in 2003, although the number of extremely large-scale building projects will be about the same as in 2003. The net increase in supply after deducting the amount lost through reconstruction activities, however, will be much less than the amount supplied by new construction, and taking into account the shift away from self-ownership and toward leasing, we estimate that the overall effect on the market will be negligible. Vacancies may rise temporarily, but the amount of new supply in 2007 and 2008 is expected to decline steadily, so demand should recover relatively quickly and occupancy rates will remain high. New supply is concentrated in the form of large-scale, highly functional buildings located in the center of the city, so the newly available space will be competitive, and there is little likelihood that rents will face significant downward pressure. We predict that leasing conditions in this market sector will remain relatively stable.

For more details please refer to our “Investment Review 2005” which will be published soon.

Toshio Komachi

Tao Wang