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Japan Real Estate Investment

REVIEW

NOMURA REAL ESTATE Development Co., Ltd

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Office Market Trends in Tokyo's 23 Wards

Changes since our 2005 study, and forecasts through 2010

1. Introduction

The “2006 problem” in retrospect

The office market in central Tokyo remained very strong throughout 2006. The Japanese economy is improving, and companies in various fields are expanding their businesses and opening new offices. As a result, the vacancy rate for office space in central Tokyo is on the decline. At the time of our previous study in the summer of 2005 we concluded that “the effect of the expected large increase in supply in 2006 (the so-called “2006 problem”) will be minor, and demand for office space in central Tokyo will remain strong”. We are pleased to report that our forecasts were right on the mark.

With this as the background, the present report will focus on two particular trends now affecting the office market.

(1) Changes in the ratio between owner-occupied and leased office buildings

The present study examined new supply trends for owner-occupied vs. leased office buildings

Currently about half of the office buildings in Tokyo's 23 wards are owner-occupied, while the remaining half are leased. However, a majority of new office buildings are being built for lease, and as a result the ratio of leased office space has gradually been rising. The present study, like the previous study in 2005, examines new supply of both owner-occupied and leased office buildings. Beginning in 2003 there was a clear shift away from owner-occupied and toward leased office space, but the present study found that this decline in new construction of owner-occupied office buildings appears to have bottomed out, with some companies beginning to choose ownership over leasing.

Effect of changes in ownership composition on the leasing market

Medium term changes in the amount and ratio of new supply of owner-occupied vs. leased office buildings clearly reflect a shift in the overall ownership composition of office building stocks. We examined how these changes in ownership structure might impact the rental office market.

(2) The new age of reconstruction and renovation

Nominal new supply vs. real new supply

Since 2006 large plots of vacant land have virtually disappeared from the Tokyo market, and as a result, future new supply will primarily be generated by reconstruction projects. This means that only part of the total floor space in new office buildings represents an actual net addition to overall supply. It is important, therefore, to recognize that office space in newly constructed buildings represents “nominal new supply”.

The amount of floor space lost through the demolition of older structures must be subtracted from the nominal new supply in reconstructed buildings to find “real new supply”, which is the actual net gain in overall office stock.

Therefore, the present study estimated the annual loss of both owner-occupied and leased office space. It can take more than three years from demolition to completion in the case of a large-scale

building project, so in developing our estimates we not only compiled data from the various reconstruction projects presently underway, we also calculated future losses assuming building lifecycles of 50 or 60 years, respectively. These estimates will have to be further refined by future study, but the present analysis indicates that future losses of floor space will not differ significantly from current levels.

Loss of major tenants presents good opportunity for renovation of existing buildings

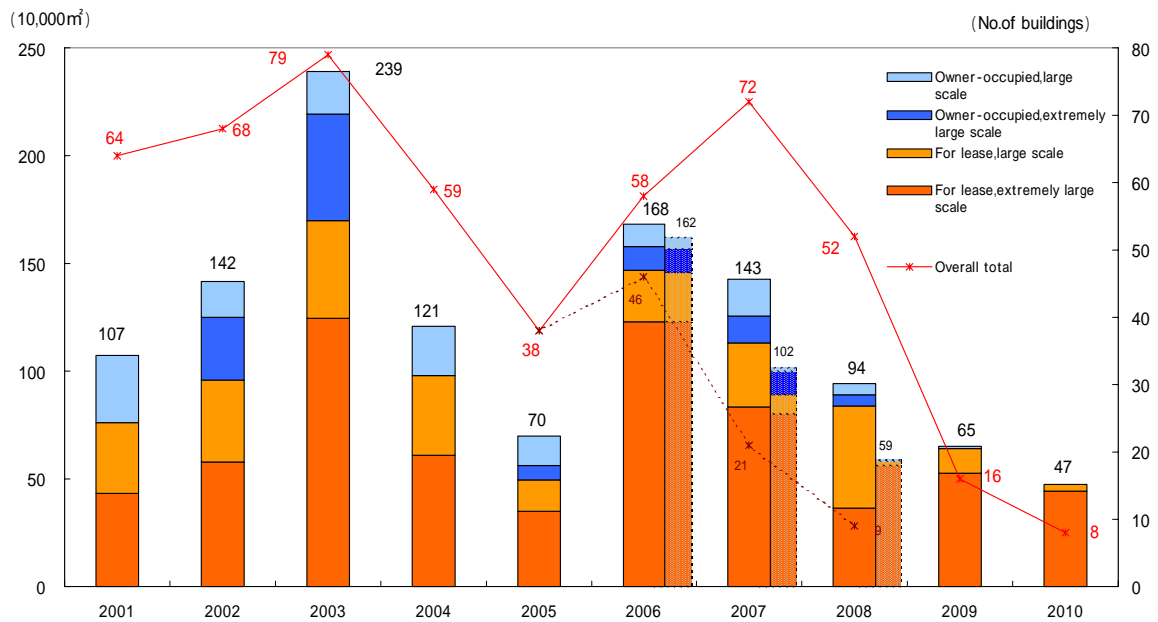
The large increase in new supply in 2003 triggered a sharp increase in vacancy rates in existing office buildings, and this led to many large-scale renovations. The result seems to have been the gradual emergence of sustainable building operation and management systems. During the renovation period, tenant recruitment stops, and this has the effect of driving down overall vacancy rates. The need for large-scale renovations is a natural consequence of the increase in building life cycles, and this trend is expected to continue for the foreseeable future.

2. Present Conditions in the Office Building Market

2-1 New supply of large-scale office buildings in Tokyo’s 23 wards

2-1-1 Nominal new supply of office buildings from 2001~2010

**Figure1 New office building supply in Tokyo’s 23 wards
(Buildings with a standard floor space of 100 tsubo [330 m²] or greater)**



Source: NRE

Note: The bar graph indicates new supply of large (standard floor space of at least 100 tsubo, total floor space between 1000 tsubo and 10,000 tsubo) and extremely large (standard floor space of at least 300 tsubo, and total floor space of 10,000 tsubo or greater) buildings mainly used as offices for each year from 2001 through 2010. Supply figures do not include floor space used for retail, residential, hotel, or other purposes. Figures on the line graph indicate the total number of buildings constructed each year.

Figure 1 shows the nominal supply of new office buildings in Tokyo's 23 wards from 2001 through 2010. The dotted lines are estimates for 2006~2008 from our previous study in 2005. The following trends can be discerned from this data.

New supply of large-scale buildings in 2007 and 2008 will increase by 870,000 m², a jump of 770% compared with our previous estimate (owner-occupied + leased)

2006: Twelve more buildings were completed than we had forecast, with a combined total floor space of 60,000 m². Most of this additional supply was due to an increase in large-scale (1000 tsubo class) owner-occupied office buildings.

2007: Fifty-one (51) more buildings will be completed than we had forecast, with a total floor space of 410,000 m². Of these, 48 will be large-scale buildings, representing an additional 370,000 m² of floor space, and three will be extremely large-scale projects, accounting for 40,000 m² of new office space.

2008: Forty-three more new buildings will be constructed than we had expected, providing an overall additional floor space of 350,000 m². Broken down, the number of large-scale buildings will increase by 45, representing 500,000 m² of new supply, whereas the number of extremely large-scale projects will decline by 2, a decrease of 150,000 m² compared with the earlier estimate.

The present study showed that total new supply of office space in large-scale buildings in 2007 and 2008 will reach 1,000,000 m², an increase of 770% compared with our previous forecasts.

New supply of large-scale leased office buildings in 2007 and 2008 will increase by 670,000 m², (700%) compared with our previous estimate

The above changes in the estimated supply of extremely large-scale building projects were primarily due to scheduling changes, with completion dates moved ahead in some cases, and delayed in others. In the case of large-scale projects (up to 3000 tsubo), however, our forecasts of new supply have increased significantly compared with the previous study. The growth in leased office space will be particularly remarkable, with increases of 300,000 m² forecast for 2007, and a further 480,000 m² for 2008, for a two-year total of 780,000 m². This represents an increase of 670,000 m² (700%) compared with our estimates in 2005. Although accurate information is not yet available on building plans for 2009 and beyond, it is possible that this growth in new supply of leased office space may continue.

From 2007 onward large-scale buildings will begin to account for an increasingly higher percentage of total new rental office space

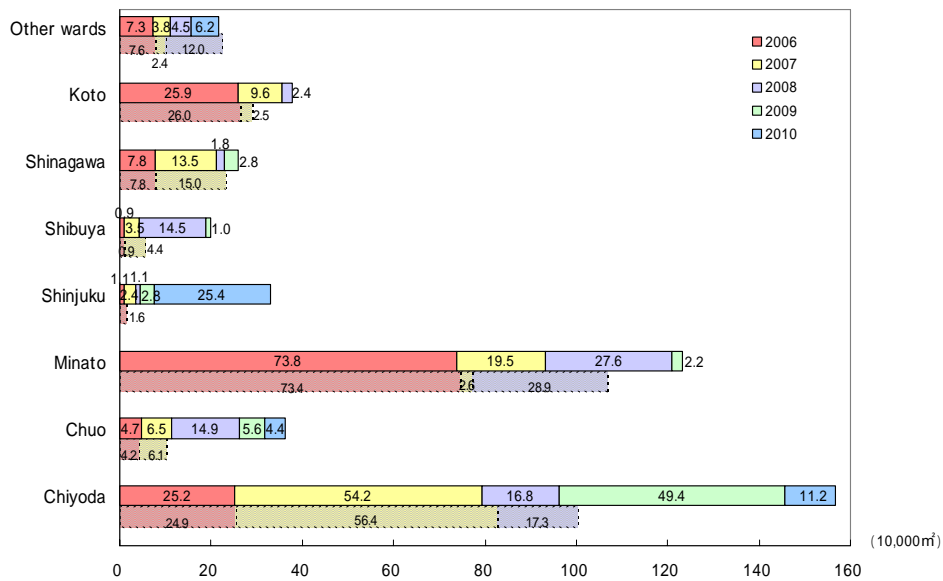
The percentage of rental office space located in large-scale office buildings fell to a low of 16% in 2006. However, this ratio will rise to 27% in 2007, and 57% in 2008. Building plans for 2009 and 2010 remain unclear, and future trends will need to be monitored carefully.

New supply of owner-occupied office buildings peaked in 2003. Average annual new supply from 2004-2007 will remain around 240,000 m²

New supply of owner-occupied office buildings peaked at 690,000 m² in 2003, and began to fall in 2004. However, the present survey found that levels have stabilized, and we forecast that average new supply will hold steady at around 240,000 m² per year through 2007. Construction plans from 2008 onward remain unclear at present, however the possibility exists that new supply of large-scale projects may increase with little advance warning, as we observed in the present study.

2-1-2 New supply of leased office buildings by district

Figure 2 Supply of leased office space in Tokyo’s major wards
(buildings with standard floor space of 100 tsubo [330 m²] or greater)



Source: NRE

Figure 2 shows cumulative new supply (nominal) of leased office space in Tokyo’s major wards for the period 2006~2010. The dotted line for 2006~2008 represents the amounts forecast in our previous study. We draw the following conclusions from this data.

New supply will continue to be concentrated in Chiyoda (35%) and Minato (27%) wards

From 2006~2010 approximately 62% of total new supply of rental office space will continue to be concentrated in the Chiyoda (35%) and Minato (27%) wards, followed by Koto (8%), Chuo (8%), Shinjuku (7%), Shinagawa (6%), and Shibuya (4%). Our previous study showed extremely low levels of new supply in Shinjuku and Shibuya, but this trend has now been reversed.

Chiyoda to top new supply in 2007; from 2009 redevelopment projects will dominate

New supply in Chiyoda in 2007 will total 542,000 m², more than any other ward in Tokyo. This is primarily due to the completion of several extremely large-scale office building projects near Tokyo station. Future reconstruction and linked urban redevelopment projects are scheduled in Marunouchi and Otemachi (2009~), and planning is also underway for extremely large-scale office buildings in Hirakawacho (2009) and Nagata-cho (2010).

Minato to top new supply in 2006; trend to continue through 2008

Since the completion of the three Tokyo Midtown project buildings at the end of 2006, the increase in new supply of office space from extremely large-scale buildings in Minato ward has come to a stop. However, new supply will remain plentiful through 2008 thanks to the completion of many large-scale office buildings. After 2006, the supply of extremely large-scale office buildings will be only Shiodome I-2 Project (2007), and the Akasaka Biz Tower (2008).

New supply in Koto ward will center on extremely large-scale office projects in Ariake and Toyosu through 2007

2006 saw the completion of the TOC Ariake complex, the TA Building and the TX Building in Koto ward, and these will be followed in 2007 by several other extremely large-scale projects, including Fukagawa Gatheria and the Toyosu 5-Chome Building. We have no information at present about any further projects of this scale planned for 2008 and beyond.

New supply in Chuo ward to come primarily from reconstruction of large-scale buildings

Most new office space in Chuo ward will be created as the result of the demolition and reconstruction of large buildings that have reached the end of their lifecycles. This will be particularly true in 2008, when 13 such projects are scheduled for completion, with a total floor space of 149,000 m². The present survey identified two upcoming extremely large-scale projects in Chuo ward. The Yaesu 1-Chome Building is scheduled for completion in 2007, while the Shiodome Hama-Rikyu project should be finished in 2009. The Nihonbashi district is expected to see a whole series of demolition and reconstruction projects from 2010 onward.

Three urban redevelopment projects will be completed in Shinjuku in 2010, marking the first major new supply in several years

The Shinjuku 7-Chome Building will be completed in 2009, and this will be followed by three urban redevelopment projects that should be ready for occupancy in 2010. This will mark the largest increase in new supply in Shinjuku since 2004.

2-1-3 Location of new supply of extremely large-scale office projects in Tokyo (2006-2010)

From 2007 onward new supply of extremely large-scale buildings in central Tokyo will be limited to reconstruction or urban redevelopment projects, and annual new supply of rental office space from buildings in this category is on the decline. Figure 3 shows the location of all new extremely large-scale building projects scheduled for completion in central Tokyo for each year from 2006-2010.

2006: Sixteen extremely large-scale projects with a total floor space of 1.23 million m² were completed in 2006, and they were distributed relatively widely throughout Tokyo.

2007: Most new supply will be in the area around Tokyo Station, with six new projects totaling 460,000 m² scheduled for completion, including the Gran Tokyo North and South Towers, and the Shin-Marunouchi Building. Six other buildings with a total of 370,000 m² of floor space are also due to be completed in Osaki, Shiodome, Fukagawa, Kasumigaseki, Toyosu and Ikebukuro

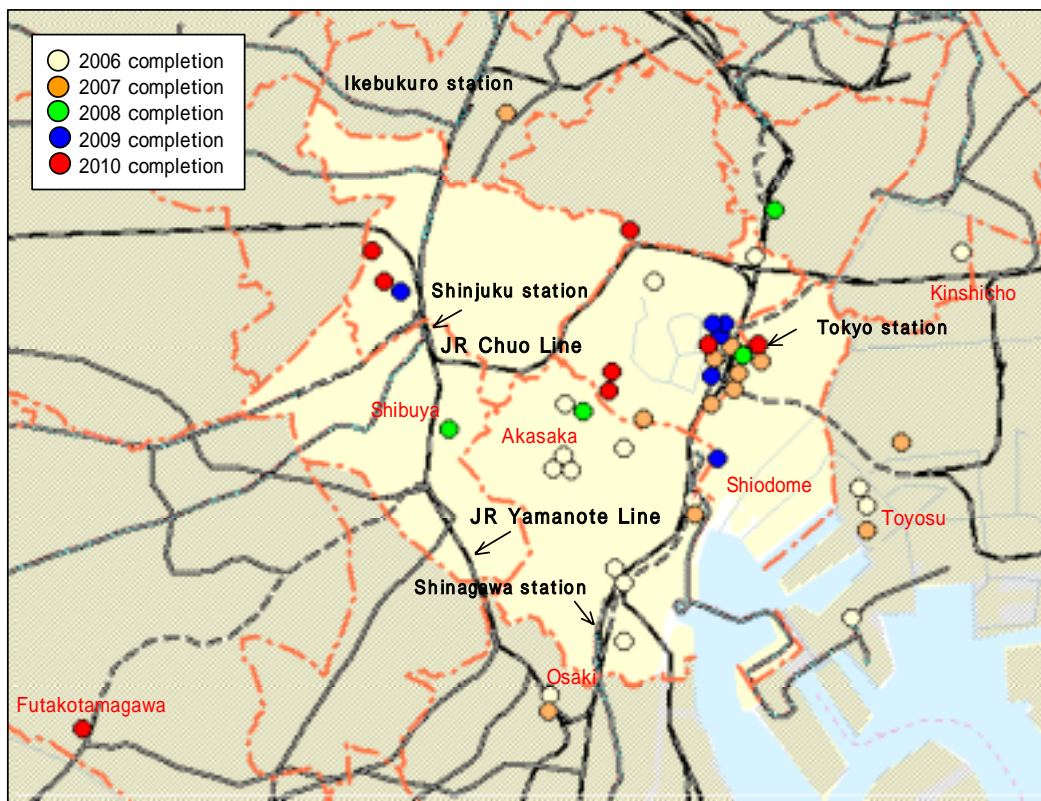
2008: Four projects with 360,000 m² of office space are planned, including the Marunouchi Trust Tower Head Office and Akasaka Biz, as well as others in Jingu-Mae and Higashi-Ueno.

2009: Four projects will be completed (420,000 m²) as part of the Otemachi Linked Urban Redevelopment project and the Marunouchi SF Plan, together with three projects in Hirakawa-cho, Ginza and Shinjuku (100,000 m²).

2010: Projects to be concluded in 2010 include two redevelopment schemes in Nishi-Shinjuku and Kita-Shinjuku, respectively, (230,000 m²), and five other buildings in Marunouchi, Nihonbashi, Koraku, Nagata-cho and Futakotamagawa (220,000 m²).

(See attached reference No. 1 for details on the office buildings scheduled for completion during this period).

Figure 3 Distribution of extremely large-scale office projects by year from 2006~2010

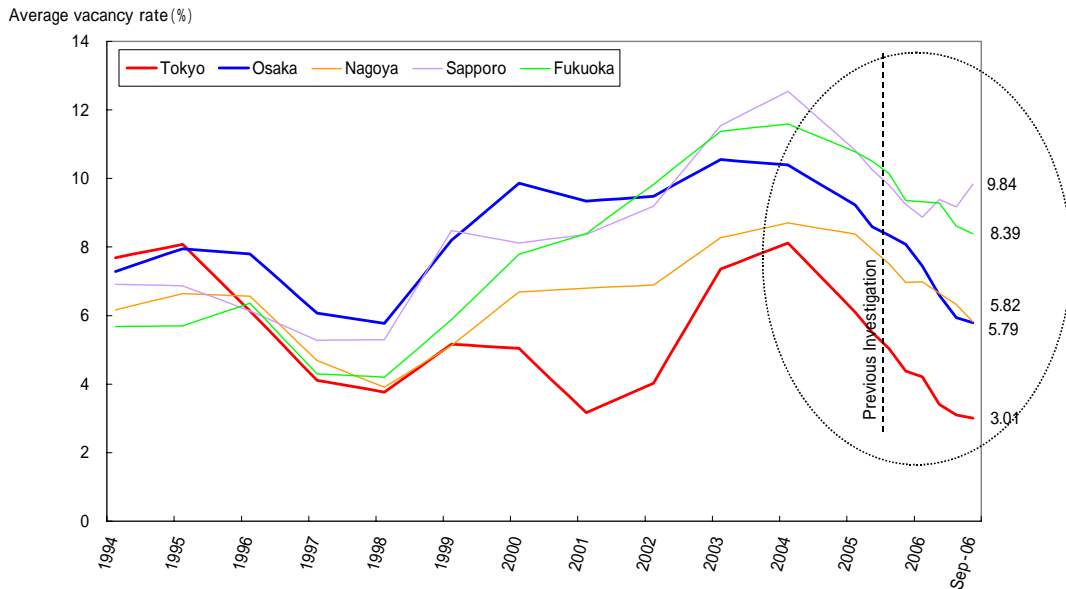


Source: NRE

2-2 Supply and Demand

2-2-1 Supply and demand trends in major cities

Figure 4 Average vacancy rates in business districts of major Japanese cities (end 1994–September 2006)



Source : NRE, based on date Miki Shoji Co.,Ltd.

Office vacancy rates in the business districts of Tokyo, Osaka and other major cities in Japan are shown in Figure 4. Vacancy rates have declined even further since our last study in June 2005, showing a continued recovery in office demand.

Tokyo showed a particularly remarkable improvement as vacancy rates fell to the 3% level despite the large increase in new supply. Tokyo is increasingly becoming a lender’s market.

As for regional cities, new supply kept vacancy rates flat in Sapporo, however in most of the other cities surveyed vacancies fell by around 2%. Recovery of the office market was most remarkable in Osaka, where low levels of new supply in 2006 drove vacancy rates down to the 5% level for the first time in 8 years. A similar trend was seen in Nagoya, where vacancy rates fell to the 5% level for the first time in 5 years.

Japan’s economic recovery has helped to activate the office market in Tokyo, and demand for office space is now recovering strongly in regional cities as well.

The present study analyzed the Tokyo area in more detail. Figure 5 shows the change in vacancy rates in large-scale buildings in central Tokyo and its neighboring districts between September 2005 and September 2006.

Figure 5 Change in vacancy rates in large-scale buildings by district between September 2005 and September 2006

Tokyo 23 wards	2.1%	(down 1.7 points vs.2005)		
3 central wards	1.7%	(down 1.3 points vs.2005)	}	Chiyoda 0.4% (-0.9)
				Chuo 1.3% (-2.2)
				Minato 3.0% (-0.8)
6 downtown wards	1.5%	(down 3.1 points vs.2005)	}	Shinjuku 1.8% (-2.0)
				Shibuya 0.4% (-0.6)
				Toshima 1.8% (-0.4)
14 neighboring wards	5.4%	(up 0.6 points vs.2005)		Bunkyo 0.8% (-4.5)
				Shinagawa 1.8% (-7.7)
				Taito 3.5% (-0.4)
3 neighboring prefectures	4.2%	(down 1.9 points vs.2005)		

Source : NRE, based on data from Sanko Estate

Note: Vacancy rates in Figures 4 and Figure 5 differ because they are based on data obtained by different research institutes using slightly different study criteria.

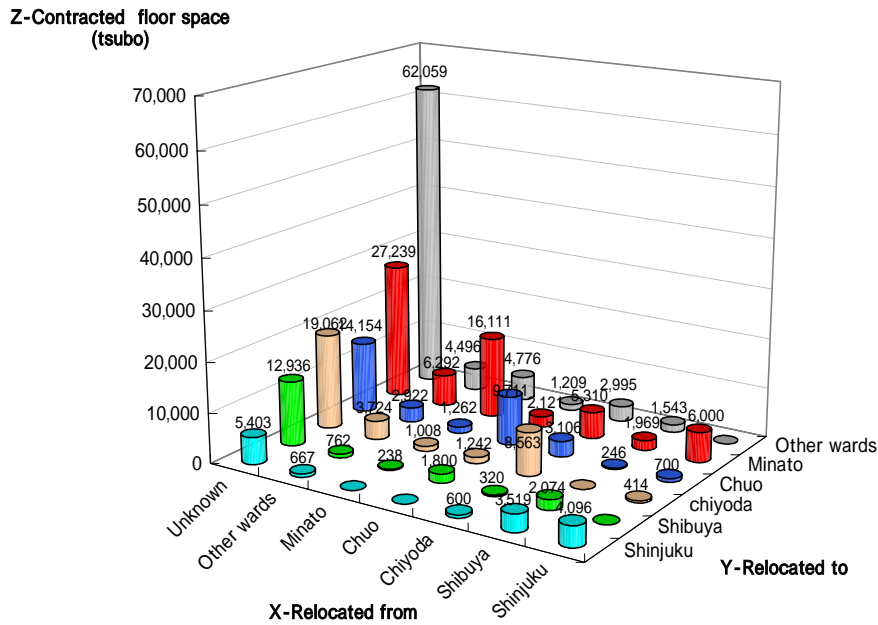
Vacancy rates improved not only in the 3 central wards, but also in the 6 neighboring wards. Vacancies increased slightly, however, in the 14 outlying wards, reflecting tenant preferences for the central part of the city. The data also shows that demand is growing faster than supply in central Tokyo despite the large amount of new supply that has come onto the market there.

2-2-2 Tenant relocation trends within Tokyo's 5 central wards in 2005 and 2006

Figures 6 and 7 illustrate tenant relocation trends on a contracted floor space basis between Tokyo's five central wards (Chiyoda, Chuo, Minato, Shinjuku, Shibuya) and "Other wards" for the 2005 calendar year, and for the January-September period in 2006.

On the "Relocated from" side, "Unknown" includes companies that moved out of offices that they owned, or tenants that integrated or consolidated multiple offices into a single location. The X-axis shows where tenants relocated from, the Y-axis shows where they relocated to, and the Z axis shows the total amount of contracted floor space leased by relocating tenants.

**Figure 6 Total tenant relocation within Tokyo’s 5 central wards (contracted floor space basis)
(January 2005 ~ December 2005)**



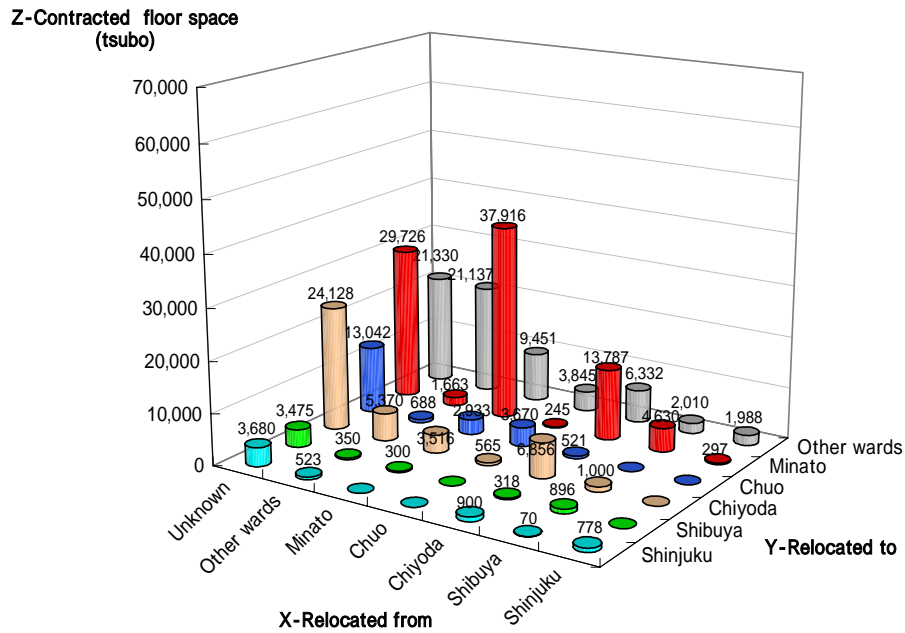
Source: NRE

Tenant relocation trends in 2005 (Fig. 6)

Figure 6 shows relocation trends in 2005. Looking at where tenants relocated from, the largest category was “Unknown”, and of these tenants, the most popular destinations were Shinagawa and Koto, which were categorized as “Other wards”. Major examples were Company ‘A’, which leased the entire TA Building in Toyosu, Koto ward (20,000 tsubo), and Company ‘B’, which consolidated its offices into the Shinagawa Think Park Tower (4,000 tsubo). The next most popular destination in this category was Minato ward, with Company ‘C’ moving to Tokyo Midtown (5,000 tsubo), Company ‘D’ moving into the NBF Platinum Tower (4,000 tsubo), and others. Next most common were relocations within Minato ward, examples of which were Company ‘E’, which moved into the Shiodome I-1 Building (5,000 tsubo), and Company ‘F’, which moved to the Dai-Ni Tamachi Building (4,000 tsubo).

These were all cases of companies taking aggressive steps to integrate and consolidate their major departments, including Head Office operations.

**Figure 7 Total tenant relocation within Tokyo’s 5 central wards (contracted floor space)
(January 2006 ~ September 2006)**



Source: NRE

Tenant relocation trends in 2006 (Fig. 7)

Figure 7 similarly shows tenant relocation trends for January~ September 2006. The most active relocation took place within Minato ward. Important examples were Company ‘G’ (10,000 tsubo), and Company ‘H’ (8,000 tsubo), each of which moved their Head Office functions to Tokyo Midtown. Next came tenants relocating from “Unknown” to Minato ward. Major examples were Company ‘I’, which consolidated its offices into a new location in the Tokyo Midtown building (11,000 tsubo). This was followed by relocations from “Unknown” to Chiyoda ward, including Company ‘K’, which moved its Headquarters to the Gran Tokyo South Tower (10,000 tsubo). Next most common were relocations from “Unknown” to “Other wards”, an example being Company ‘L’, which moved to the Olinasu Tower in Kinshi cho , Sumida ward (6,000 tsubo). Finally came shifts from “Other wards” to “Other wards”; and a major example was Company ‘J’, which stayed in Shinagawa but moved its Head Offices to the Think Park Tower (4,000 tsubo).

Dynamic trend toward tenant relocation as companies move to integrate and consolidate their operations

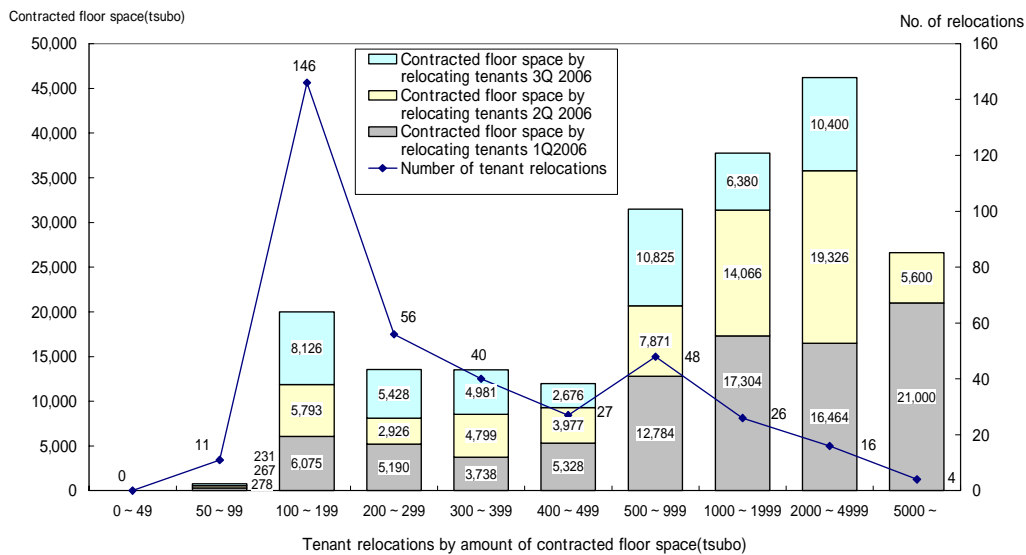
The data presented here consists of information available at the time of the survey, and includes information on new buildings under construction but not yet completed. Information obtained more recently indicates that major tenants have already been decided for many of the new buildings scheduled for completion in 2007. Looking at overall trends, the data we collected in 2004 showed that Minato ward was the most popular destination for relocating tenants. In 2005 this shifted to the “Other wards” category

(primarily Koto and Shinagawa). In 2006 our data through September showed a distinct trend towards integration and consolidation in Minato ward, particularly to the Tokyo Midtown Project. On the other hand, however, there were also signs that some firms were moving to disperse their functions. An examination of individual cases shows a remarkably dynamic pattern of activity on the part of companies as they look for ways to integrate and consolidate their office facilities.

2-2-3 Scale (floor space) and total number of tenant relocations within Tokyo’s 23 wards

Figure 8 shows the total number of relocations together with the amount of contracted floor space in Tokyo’s 23 wards for the first three quarters of 2006.(Data is not yet available for the 4th quarter of 2006, so overall totals are expected to increase further).

Figure 8 Total number of relocations, and total contracted floor space from relocations within Tokyo’s 23 wards, categorized by size (January-September 2006)



Source: NRE

The amounts of floor space leased by relocating tenants confirm distinct trend toward corporate integration and consolidation

Total overall contracted floor space was 200,000 tsubo, and the total number of relocations was 374. Most cases (146) involved offices in the range of 100-199 tsubo, however these taken together accounted for only about 20,000 tsubo, no more than 10% of the overall total. The largest component ratio was for tenants leasing 2,000-4,999 tsubo (16 cases, 46,000 tsubo, 23% of the total). It appears that most of these cases consisted of companies seeking to consolidate multiple office locations and functions into a single site. This conclusion is also supported by a look at the individual cases mentioned above. Moreover, there were 94 tenants in the 500 tsubo or greater category, accounting for 142,000 tsubo, or 70% of the overall relocation total. This data on the size of offices being leased by relocating tenants also clearly supports the conclusion that companies are actively moving to relocate in order to consolidate their office functions.

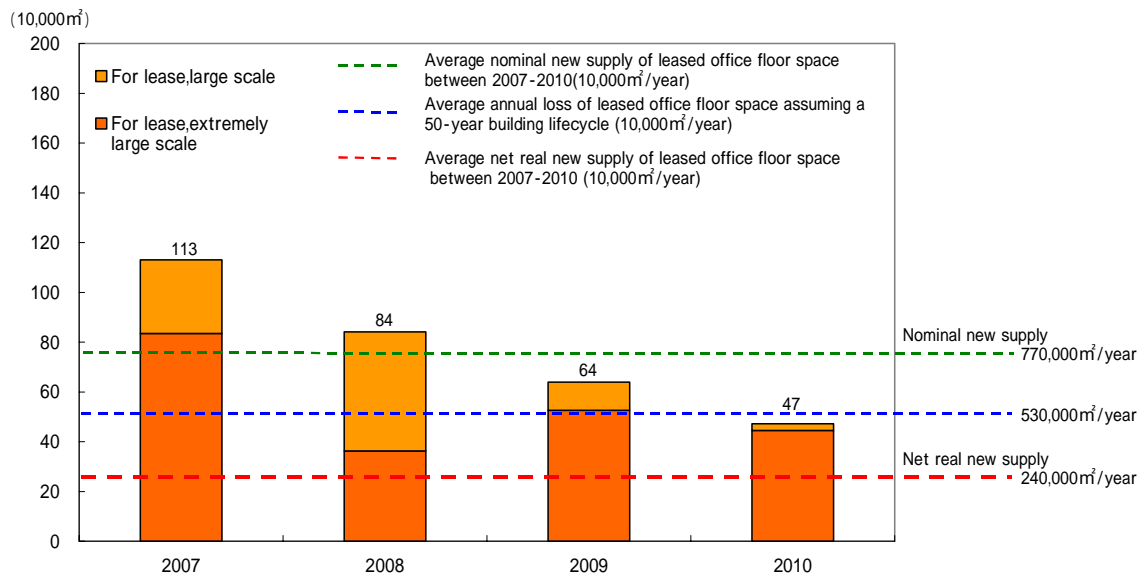
2-2-4 Market conditions in 2006

The nominal new supply of office buildings for lease in 2006 was rather high, about 86% of the peak seen in 2003. For extremely large-scale buildings, nominal new supply was 99% of that in 2003. Nevertheless, demand for office space in Tokyo’s 5 central wards is still very strong, with vacancy rates falling to as low as 2.9% at the end of November 2006, a decline of 132 basis points compared with the end of 2005. Few large blocks of office space in existing buildings are coming onto the market. Given this scarcity of supply, tenants are looking ahead to buildings now under construction to meet their needs. In fact, major tenants have already been decided for nearly all the extremely large-scale building projects scheduled for completion in 2007.

As described above, companies are looking for ways to integrate and consolidate their operations, but at the same time the selection of office space available in central Tokyo and its neighboring wards is becoming increasingly limited. Moreover, this supply crunch is driving up asking rents. For example, some of the extremely large-scale office buildings in the vicinity of Tokyo Station are now asking for as much as 60,000 yen per tsubo. In the case of large-scale relocations involving office integration, many contracts now specify not only rent levels, but also various other conditions, such as lease period, as is the case with long-term, fixed period leases. The content of individual lease contracts is becoming increasingly diverse. There is also a clear trend toward higher asking rents in existing office buildings, and rent increases at lease renewal are going up as well.

3. Supply and demand forecasts for 2007~2010

**Figure 9 Supply of leased office buildings in Tokyo’s 23 wards
(standard floor space of 100 tsubo [330 m²] or greater)**



Source: NRE

3-1 Nominal new supply vs. real new supply

Most estimates of new supply are inaccurate because they do not take into account the loss of floor space in office buildings that are demolished for reconstruction. This factor will become increasingly significant in future as the majority of new supply will be from building reconstruction projects. Therefore, in order to analyze changes in real new supply it is necessary to use the following formula.

$$\text{Nominal new supply} - \text{Loss in buildings demolished for reconstruction} = \text{Real new supply}$$

In calculating the amount of floor space lost, the time required for reconstruction can often lengthen considerably when one includes the time required for all the tenants to vacate a building, so it is important not only to gather and collect loss-related data for specific buildings, but also to analyze the problem based on simulations using different building lifecycle criteria. Our previous study assumed a building lifecycle of 50 years, and in the present study we performed an additional analysis assuming a 60-year lifecycle.

3-2 Supply and demand forecasts from 2007 through 2010

Our analysis indicated that nominal new supply of leased office floor space between 2007-2010 will be 770,000 m² per year (Fig. 9). This is equivalent to 2.3% of the total size of the leased office market.

Net real new supply of leased office space in 2007-2010

Case 1: Assuming a building lifecycle of 50 years (LC50 years)

About 660,000 m² of office space will be lost annually, the equivalent of 2% of the overall total of 33 million m². Space in older buildings is typically used only about 80% as efficiently as in the new buildings that replace them. Taking this into account, the actual net loss of office space is estimated to be 530,000 m² per year.

Case 2: Assuming a building lifecycle of 60 years (LC60 years)

In this case the annual loss will be 550,000 m², equivalent to about 1.6% of the overall total of 33 million m². As in Case 1, taking into the higher space conversion efficiency of the new buildings, the actual net loss is estimated to total 440,000 m² per year.

Therefore the net real new supply is calculated as follows.

$$\begin{aligned} \text{(LC50 years): } & 770,000 \text{ m}^2 \text{ (nominal new supply)} - 530,000 \text{ m}^2 \text{ (loss in supply due to reconstruction)} \\ & = 240,000 \text{ m}^2 \text{ (net real new supply)} \end{aligned}$$

$$\begin{aligned} \text{(LC60 years): } & 770,000 \text{ m}^2 \text{ (nominal new supply)} - 440,000 \text{ m}^2 \text{ (loss in supply due to reconstruction)} \\ & = 330,000 \text{ m}^2 \text{ (net real new supply)} \end{aligned}$$

Net real new supply of owner-occupied office space

Based on the information presently available we estimate that annual new supply of owner-occupied office space will be about 100,000 m² per year between 2007-2010. This is only about 40% of the nominal new supply of 240,000 m² per year for the period 2004-2007.

The question then arises of how stocks of owner-occupied office space may be expected to change in future. To answer this question we estimated the change in stocks of owner-occupied office space using the same type of building lifecycle-based analysis as we used above for leased office space.

Case 1: Assuming an owner-occupied building lifecycle of 50 years (LC50 years)

In this case 600,000 m² of floor space will be lost each year, equivalent to 2% of the overall total stock of 30 million m². Taking into account the higher space conversion efficiency of the new buildings, actual net losses are estimated to be 480,000 m² per year. Subtracting this amount from the amount of nominal new supply (100,000 m²) indicates that supply will shrink by 380,000 m² per year.

Case 2: Assuming an owner-occupied building lifecycle of 60 years (LC60 years)

In this case 500,000 m² of floor space will be lost each year, equivalent to 1.6% of the overall total stock of 30 million m². Taking into account the higher space conversion efficiency of the new buildings, actual net losses are estimated to be 400,000 m². Subtracting this amount from the amount of nominal new supply indicates that supply will shrink by 300,000 m² per year.

Formulas for calculating real new supply of owner-occupied office space:

$$\begin{aligned} \text{(LC50 years): } & 100,000 \text{ m}^2 \text{ (nominal new supply) - 480,000 m}^2 \text{ (loss in supply due to reconstruction)} \\ & = - 380,000 \text{ m}^2 \text{ (net real new supply) } \end{aligned}$$

$$\begin{aligned} \text{(LC60 years): } & 100,000 \text{ m}^2 \text{ (nominal new supply) - 400,000 m}^2 \text{ (loss in supply due to reconstruction)} \\ & = - 300,000 \text{ m}^2 \text{ (net real new supply) } \end{aligned}$$

Effect on the market expected to be negligible even in the absence of new sources of demand

In both of the above cases there is negative growth in real new supply of owner-occupied office buildings. Assuming that this represents latent demand for leased office space, subtracting this amount from the estimated net annual new supply of leased office space for the years 2007-2010 leaves a real supply- demand(latent) gap of only 140,000 m² per year, equivalent to around 0.4% of total stock in the leased office market. Therefore, even in the absence of new sources of demand, the overall effect on the market should be negligible. The same is true in Case 2, where the real supply-demand(latent) gap will be around 30,000 m² per year. This is even smaller than in Case 1, and is equivalent to only 0.1% of the total market.

Considering that demand is, in fact, trending upward, the overall effect on a market where occupancy rates are running close to full capacity is expected to be quite small.

4. Conclusions

4-1 Supply trends

Growth in nominal new supply will depend on large-scale projects

As stated above, our present estimate of annual nominal new supply for the period 2007 -2010 is 770,000 m² per year. As the number of new extremely large-scale projects is expected to become quite limited, any scarcity of supply will have to be remedied through the construction of large-scale buildings. This was confirmed in the present study, which showed that higher demand had pushed up the amount of floor space in large-scale rental office building projects scheduled for completion in 2007 and 2008 by 7 fold compared with our 2005 estimates (**Fig.1**).

Compared with extremely large-scale projects, large-scale buildings can provide new supply in a much shorter period. Therefore the number of such large-scale office buildings may change quickly in response to changes in demand. Considering recent growth in office demand, it is very likely that behind the scenes a large number of new large-scale projects are now in the planning stages, with developers aiming for completion in 2009~2010. These developers will probably look closely at demand trends in 2007 and 2008 before making any final decisions. Therefore, the estimated levels of growth in nominal supply in the present study, which are based mainly on new supply from extremely large-scale projects, will likely need to be adjusted upward for 2009 onward as new large-scale projects come on line.

On the other hand, if the rents in central Tokyo remain high, some of this demand may begin to shift to other areas.

Departure of major tenants from existing buildings will spur renovation

One factor that may affect future supply is the renovation of existing buildings. A number of first generation skyscrapers have already undergone extensive renovations, including the Kasumigaseki Building (constructed in 1968), the World Trade Center Building (1970), the Shinjuku Mitsui Building (1974), and the Shinjuku Nomura Building (1978). Second generation skyscrapers built in the 1980's and later are now reaching the stage where renovations are necessary. Examples are the Shuuwa Shiba Park Building (constructed in 1982), the Ark Mori Building (1986), and the New Kasumigaseki Building (1987).

It is apparent that the large increase in supply of office space in 2003 has stimulated a dynamic trend toward corporate office integration and consolidation. Many existing buildings that lost tenants due to this trend took advantage of the situation to carry out major renovations. They stopped looking for new tenants, and instead moved to significantly upgrade their facilities and services, particularly in the areas of IT and security. As a result, many of these buildings came back to life and have returned to the market in a form that meets the needs of today's tenants.

This renovation phenomenon began in 2003 and led to a domino phenomenon that continues today. As a result, new sustainable building management systems are steadily taking shape. This renewal through large-scale renovation is a natural consequence of the extension of building life cycles, and has the effect of temporarily preventing the creation of large vacancies in existing buildings when large amounts of new supply come onto the market.

4-2 Demand trends

Large corporations will continue to integrate and consolidate their office operations

As reported above, the vacancy rate in Tokyo's 5 central wards has dropped to the 2% level, and this strong demand shows no signs of weakening. Concerns that the large number of baby-boomers slated to retire in 2007 would precipitate a collapse in demand are disappearing. As the economy recovers, firms are becoming increasingly anxious to secure an adequate workforce, and are taking various steps to do so, such as extending mandatory retirement dates or actively hiring new workers. Many new companies are also forming, so the demand for office space will continue to expand.

As described earlier in section 2-2-2, as a result of M&A activities, mergers, and changes in business content, relocation demand in 2005 and 2006 on the part of large corporations hoping to integrate and consolidate operations in Tokyo's 5 central wards was stronger than we have ever seen before. Companies in many fields have learned to dispose of excess facilities or manpower, deal with non-performing loans, restructure operations, change business direction, reorganize, or merge with other firms in a more timely manner. As a result, corporations today have developed management cultures with a strong focus on generating profits. These steps are indispensable for survival in a global economy. In terms of the office market, demand will remain firm for buildings that can satisfy needs of companies wanting to integrate and consolidate dispersed operations, not only in terms of location, but also in terms of large standard floor spaces, sophisticated management systems, and high-quality facility specifications.

4-3 Balance of supply and demand

Office market will be a lender ' s market through 2010, barring major changes in economic conditions

Our present findings indicate that net real new supply of leased office space from 2007-2010 will be in the range of 240,000 ~ 330,000 m² per year (assuming building lifecycles of 50 or 60 years). If we assume that new demand remains at present levels, supply and demand are expected to remain in balance as new supply of rental office space will be offset by a loss of owner-occupied office . The demand crunch for leased office space in central Tokyo may stimulate an increase in supply in the form of large-scale buildings, but the potential for new extremely large-scale projects is quite limited, so we believe that, on average, we are unlikely to see large increases in new supply. As a result, we forecast that the Tokyo rental office sector will remain a lender ' s market through 2010, barring major changes in the performance of the economy.

Future new supply will come primarily from reconstruction. Barring significant changes in demand, supply and demand should remain in balance.

During this study we performed site inspections to determine new office supply in the central Tokyo area. Some of the large-scale buildings in this area were redevelopment projects in neighborhoods not usually known as office districts, but the majority of new supply was generated by reconstruction of older

buildings. Considering that nearly 40% of the office buildings in central Tokyo were built according to outdated seismic resistance standards, this trend toward demolition and reconstruction is expected to continue. The generation of new supply through the reconstruction of superannuated buildings will not produce large net increases in real new supply. Therefore the present balance in the market between supply and demand will likely remain in force, unless demand levels should rise or fall significantly.

Companies unable to find suitable offices in central Tokyo may relocate to surrounding districts


Many companies seeking to relocate their offices to central Tokyo are discovering that new supply in this area is inadequate to satisfy their needs. If leasing conditions in the central part of the city remain tight, it is likely that latent relocation-related demand will become an increasingly important issue. As a result, there is a strong likelihood that some companies will begin considering the possibility of integrating and consolidating certain functions, while dispersing others to satellite offices outside of central Tokyo. In such an environment companies may begin to consider relocating to some of the areas surrounding central Tokyo where office demand has been slower to recover. This would especially benefit districts with good access and a well-established infrastructure.

Reference materials

List of extremely large-scale office buildings scheduled for completion between 2006 and 2010

(Standard floor space of 300 tsubo or greater, and total floor space of 10,000 tsubo or greater)

2006					
No	Name of Project	Location	No. of floors	Total floor space (㎡)	Type of site
1	Akihabara UDX	Soto-Kanda, Chiyoda-ku	22/B3	161,676	—
2	Kitanomaru Square	Kudan Kita, Chiyoda-ku	26/B2	58,910	—
3	Shiodome Shibarikyu Building	Kaigan, Minato-ku	21/B3	35,015	—
4	Toranomon Towers Office	Toranomon, Minato-ku	23/B3	59,704	—
5	New Shibaura Development Project	Minato-minami, Minato-ku	20/B3	163,745	—
6	Sumitomo Fudosan Mita Twin Building West Wing	Mita, Minato-ku	43/B2	98,509	—
7	Sumitomo Fudosan Mita Twin Building East Wing	Shibaura, Minato-ku	17/B1	35,073	—
8	Akasaka Garden City	Akasaka, Minato-ku	19/B2	48,312	—
9	Midtown Front Tower	Akasaka, Minato-ku	12/B1	51,802	—
10	Midtown East	Akasaka, Minato-ku	25/B4	93,642	—
11	Midtown Tower	Akasaka, Minato-ku	54/B5	237,090	—
12	Art Village Osaki Central Tower	Osaki, Shinagawa-ku	22/B1	82,455	—
13	Toyosu IHI Building	Toyosu, Koto-ku	25/B2	89,557	—
14	TA Building	Toyosu, Koto-ku	33/B2	105,284	—
15	TOC Ariake	Ariake, Koto-ku	21/B1	111,594	—
16	Olinas Tower	Taihei, Sumida-ku	31/B2	72,944	—
17	Mitsubishi Shoji Marunouchi Head Office Building	Marunouchi, Chiyoda-ku	21/B3	62,000	—
18	G Project	Nishi Gotanda, Shinagawa-ku	26/B2	48,101	—
				1,615,412	
2007					
No	Name of Project	Location	No. of floors	Total floor space (㎡)	Type of site
1	Kasumigaseki R7 Project (Mixed Public/Private Building)	Kaumigaseki, Chiyoda-ku	38/B3	108,774	—
2	Gran Tokyo South Tower	Marunouchi, Chiyoda-ku	42/B4	140,168	—
3	Gran Tokyo North Tower	Marunouchi, Chiyoda-ku	43/B4	171,780	—
4	Shin-Marunouchi Building	Marunouchi, Chiyoda-ku	38/B4	195,011	—
5	Sabia Tower	Marunouchi, Chiyoda-ku	35/B4	79,182	—
6	Yurakucho Station Area Phase 1 Redevelopment	Yurakucho, Chiyoda-ku	21/B4	75,876	—
7	Yaesu 1-Chome Building	Yaesu, Chuo-ku	20/B3	45,418	—
8	Shiodome 1-2 Project	Kaigan, Minato-ku	24/B2	118,504	—
9	Think Park Tower	Osaki, Shinagawa-ku	30/B2	152,016	—
10	Toyosu 5-Chome Building	Toyosu, Koto-ku	10/B	36,449	—
11	Fukagawa Gatharia Tower North Wing	Kiba, Koto-ku	22/B2	43,150	—
12	Air Rise Tower	Higashi Ikebukuro, Toyoshima-ku	15/B2	38,502	—
13	Kasumigaseki R7 Project (Government Offices)	Kaumigaseki, Chiyoda-ku	33/B2	132,253	—
14	Kudan No. 3 Joint Chiyoda Ward Office	Kudan Minami, Chiyoda-ku	23/B3	59,831	—
15	Fuji Soft Akihabara Building	Kandaneribeicho, Chiyoda-ku	31/B2	58,493	—
16	New Annex Building	Akasaka, Minato-ku	15/B2	33,916	—
				1,489,322	
2008					
No	Name of Project	Location	No. of floors	Total floor space (㎡)	Type of site
1	Marunouchi Trust Tower Main Building	Marunouchi, Chiyoda-ku	37/B4	115,422	—
2	Akasaka Biz Tower	Akasaka, Minato-ku	39/B3	187,194	—
3	Jingumae Project	Akasaka, Minato-ku	23/B3	43,236	—
4	Higashi Ueno 2-Chome Project	Higashi Ueno, Daito-ku	29/B5	45,001	—
5	Kita Aoyama Project	Kita Aoyama, Minato-ku	25/B3	47,901	—
6	Gakushu Kenkyusha Gotanda New Headquarters Building	Gotanda, Shinagawa-ku	24/B3	25,831	—
				464,585	
2009					
No	Name of Project	Location	No. of floors	Total floor space (㎡)	Type of site
1	Otemachi Area Redevelopment Project Phase 1 District A	Otemachi, Chiyoda-ku	31/B3	74,402	—
2	Otemachi Area Redevelopment Project Phase 1 District B	Otemachi, Chiyoda-ku	37/B3	88,105	—
3	Otemachi Area Redevelopment Project Phase 1 District C	Otemachi, Chiyoda-ku	23/B4	71,502	—
4	Marunouchi SF Project	Marunouchi, Chiyoda-ku	35/B4	190,521	—
5	Shiodome Hama Rikyu Project	Ginza, Chuo-ku	21/B2	49,501	—
6	Nishi Shinjuku 7-Chome Project	Nishi Shinjuku, Shinjuku-ku	33/B2	39,242	—
				513,273	
2010					
No	Name of Project	Location	No. of floors	Total floor space (㎡)	Type of site
1	Nagatacho 2-Chome Project	Nagatacho, Chiyoda-ku	29/B4	90,000	—
2	Hirakawacho 2-chome East District, southern section, Class 1 Urban	Hirakawacho, Chiyoda-ku	24/B3	51,500	—
3	Reconstruction of former JFE Building	Marunouchi, Chiyoda-ku	23/B4	80,000	—
4	Reconstruction of Shin Muromachi Building	Nihonbashi Chuo-ku	18/B4	44,000	—
5	Nishi Shinjuku Naruko District	Nishi Shinjuku, Shinjuku-ku	40/B3	175,000	—
6	North Shinjuku Redevelopment Project (Block 1 Office Tower)	Kita Shinjuku, Shinjuku-ku	39/B2	91,320	—
7	Koraku 2-Chome West Redevelopment Project	Koraku, Bunkyo-ku	38/B2	75,000	—
8	Futakotamagawa East District Redevelopment Project, Phase 1 Office	Tamagawa, Setegaya-ku	16/B2	106,777	—
				713,597	

 Scheduled for owner occupancy (may include affiliated companies)

○ : Reconstruction ◐ : Redevelopment - : Low use, raw land, etc.

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