

Determinants of the Office Investment Performance

In recent years, conventional wisdom about the Japanese real estate market has frequently been off the mark. For example, the so-called “2003 problem”^{*}, as announced, did not result in the complete collapse of the Tokyo office market, nor did it result in the lower-end of the rental structure becoming “dead stock”. On the contrary, we observed that most of the adjustments in rents have taken place only at the higher-end of the rental structure (i.e. at existing “class A” buildings), with the middle and lower-ends showing a remarkable resilience to the supply shock.

A deep-seated belief within the Japanese investors’ community relates to tenants’ preferences with respect to the location and the physical characteristics of an office building. This belief summarizes tenants’ preferences by the following axiom: “New, Close, Large”. This expression means that tenants will favour first and foremost “new”, then “well located” and eventually “large” office spaces. Although when devising a long-term investment strategy, the determination of which properties are and will be in demand is fundamental, no serious research has been carried out on this subject in Japan.

How do the factors “age”, “location” and “size” affect the level and the stability of the performance of an office building? Is really the factor “age” a reliable criterion when deciding upon investment? As an investment manager, can Nomura Real Estate Investment Management create value by enhancing the competitiveness of “old” properties through the proper management of their life cycles?

In order to answer to these questions, we use in this report an intuitive analytical framework.

Based on occupancy rates collected between 1990 and the present on several hundreds of individual properties located in Tokyo’s 5 central wards, we performed two sets of analysis. The first set is designed to estimate the influence of the factors “age”, “location” and “size” on the long-term average occupancy rate of office buildings. The second set, based upon an analysis of the long-term fluctuations of the occupancy rate, is designed to assess the impact of the same factors (age, location and size) on the “stability” of occupancy rates. These results are graphically presented.

^{*}In 2003 approximately 2.2 million square meters of office space were supplied to the Tokyo office market, increasing overall supply by more than 10%.

Toshio Komachi

Olivier Mege

Tao Wang