Topics

Survey of Tokyo Office Market Trends (2009)

After enjoying strong growth for many years, the Tokyo office market reached a major turning point in 2008. Various surveys showed that vacancy rates were on the rise, fueling fears that a further contraction in demand could push the market into the doldrums. What are the prospects for the office leasing market in 2009 and beyond?

To answer this question, we carried out a study (using the same methods described in our 2008 report) to determine new supply of large-scale office buildings in Tokyo's 23 wards during the next four years (2009~2012), broken down according to size and location. We then developed office supply and demand forecasts for the 2009 ~ 2012 period, based on an analysis of tenant company trends and office relocation demand. Next we looked specifically at the stock of large-scale buildings (floor space ≧ 10,000m^2), and tenant company trends in the top 5 business districts in our 2008 ranking of prime business areas (Investment Review 2008 Summer Edition, Part I). We focused on these districts because the behaviour of tenant companies in these core areas is expected to have a major impact on future trends in the overall market.

In the investment market, the supply of short-term funds seeking capital returns has completely dried up, and investor sentiment has cooled considerably. On the other hand, if the current downward adjustment in prices continues, the climate may improve for long-term investment. In such a scenario the ability to evaluate properties on a case-by-case basis will acquire increasing importance. The aim of the present survey was to clarify the types of properties that are enjoying stable operations during this economic slowdown. Major factors considered to influence office capacity utilization rates are location, size, functions (specifications), rent level, type of real estate investor (owner), and tenants. We examined the influence of each of these factors on the present status of large-scale office buildings in Tokyo's prime business areas.

【Supply】 New Supply in Tokyo's 23 Wards Will Match the 8-Year Average; Supply in Peripheral Wards to Reach Record Levels

New supply during the next four years (2009~2012) will average 1.36 million m^2 per year. After bottoming out in 2008 at 950,000 m^2, new office supply has rebounded and is expected to return to about the same average level seen during the past 8 years (1.35 million m^2). What is different now compared with the previous 8 years is the sharp increase in new office supply in areas outside the six central wards. Our data indicate that annual new supply in these peripheral wards will reach 380,000 m^2, particularly in Toyosu/ Shinonome and Aomi/ Ariake in Koto ward. New supply in these areas will be generated almost entirely by new development projects. In contrast, reconstruction of existing buildings will account for most new supply in central Tokyo (over 70% in Chuo and Chiyoda), so the actual net increase in office floor space in Tokyo's core business districts will be limited.

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Topics

【Demand】 Sharp Contraction in Demand for Existing Offices Will Widen Gap Between Winners and Losers

Tenant relocation demand in 2008 on a floor-space basis was about the same as in 2007. The fact that vacancy rates are rising despite stable levels of new demand indicates a sharp contraction in demand on the part of firms that had formerly been occupying office space in existing buildings. Tenant relocation to new buildings is driving up vacancy rates in existing buildings, and the number of properties with empty office space is expected to increase, even in central Tokyo. In the peripheral wards a large increase in new demand for office space is considered unlikely, and if construction of new supply goes ahead according to the current schedule, the balance between supply and demand could be seriously disrupted. This will lead to increasing polarization within the market, and a widening of the gap between superior and inferior properties.

【Top Five Business Areas】 Most Large-Scale Buildings Operating at High Capacity; Factors Closely Associated with Vacancies are 'Structural', 'Owner-related' and 'Tenant-related'

There are 272 large-scale (floor space ≧ 10,000m^2) office buildings in Tokyo's top five prime business areas (See Note *). Marunouchi has the largest number of buildings and the most total floor space, followed (on a floor space basis) by Nishi-Shinjuku and Akasaka. Future demand will depend largely on the distinctive attributes and characteristics of each area. A total of 476 tenant companies occupied at least 500tsubo (1650m^2) of office space in these 272 large-scale buildings. These companies accounted for an aggregate total of 1.46 million tsubo of floor space. All the buildings meeting our inclusion criteria were of superior rank in terms of location and size, and most were operating at high capacity; however 19 were found to have vacancy rates of 5% or greater (as of February 2009). Factors responsible for high vacancies were 'Structural and Functional Characteristics', 'Owner's Leasing Strategy', and 'Strength of Tenant Companies, and Tenant Composition'.

The sudden economic downturn is forcing some tenants in the top five areas to consider relocating to new areas. This trend could have a significant ripple effect throughout the market.

For the time being the Tokyo office market will not be able to escape the effects of the economic recession. This does not mean, however, that the performance of all office buildings will suffer equally. Rather, this situation presents an opportunity for the discerning investor to identify properties with stable operations as suitable targets for long-term investment.

For more details please see our 'Investment Review, Spring Edition 2009'.

* 'Prime business areas' are districts with high concentrations of large-scale office buildings and major corporate headquarters. The top five business areas referred to here are Otemachi/ Marunouchi/ Yurakucho, Nishi-Shinjuku, Uchisaiwaicho/ Kasumigaseki/ Nagatacho, Nihonbashi/ Yaesu/ Kyobashi, and Akasaka. (See our Investment Review, Summer Edition 2008, Part I).

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