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Survey of Tokyo Office Market Trends (2011)

Office vacancy rates in Tokyo's 5 central wards (Chiyoda, Chuo, Minato, Shinjuku and Shibuya) reached an all-time high in August 2010. While business results improved in 2010, to the extent that some companies posted record profits, business sentiment was tempered by a flood of political and economic risk factors after the emergence of the Greece debt crisis in May, including appreciation of the yen and sharp increases in the costs of raw materials.

With regard to the Tokyo office market, most forecasts have been rather pessimistic. The main reason for this pessimism is the fact that a large surge in new office supply is scheduled to hit the market in 2012. Some reports have gone so far as to state, "···new supply in 2012 will reach record highs, exceeding even the previous peak in 2003."

How will the Tokyo office market perform in 2011 and beyond? To answer this question we performed a survey to determine new supply of large-scale office buildings (floor space ≥ 1,000 *tsubo*) in Tokyo's 23 wards over the next 4 years (2011~2014), and we evaluated tenant relocation trends in 2010. Based on these results we discuss demand-supply scenarios in Tokyo's 5 central wards over the next 4 years.

Leasing market trends in Tokyo's 5 central wards through 2010

- Average vacancy rates rose to an all-time high in August 2010, but vacancy rates in newly constructed office buildings less than one year old, a leading indicator of future market trends, have improved.
- More office space was removed from the market in 2010 than was added as new supply. The total stock of leased floor space fell slightly, whereas the total amount of vacant office space increased.
- Most new supply in the 5-ward area is now generated through reconstruction of existing buildings. As a result, the annual amount of office space removed from the market is growing, and has now reached the 138,000 *tsubo*/year level.

New Supply in Tokyo's 23 wards

- New supply will increase sharply in 2011 (460,000 *tsubo*) and 2012 (560,000 *tsubo*); nevertheless new supply in 2012 will be only 78% of the total recorded in 2003.
- Most new supply will be created in Chiyoda, followed by Minato, Chuo, and Shinjuku.
- Supply in Chiyoda will be centered on the Marunouchi district, where large amounts of new office space will come onto the market in 2012 (210,000 *tsubo*) and 2014 (140,000 *tsubo*).
- The proportion of new supply generated by reconstruction projects has fallen to 38% in Minato as the result of large-scale urban redevelopment projects; new supply will surge in 2014 (100,000 *tsubo*).
- Chuo has the highest rate of new supply through reconstruction, at 81%. New supply will peak at 100,000 *tsubo* in 2013.
- Most new supply in Shinjuku will come from new construction in areas adjacent to traditional business districts. Reconstruction will account for only 16% of the total.

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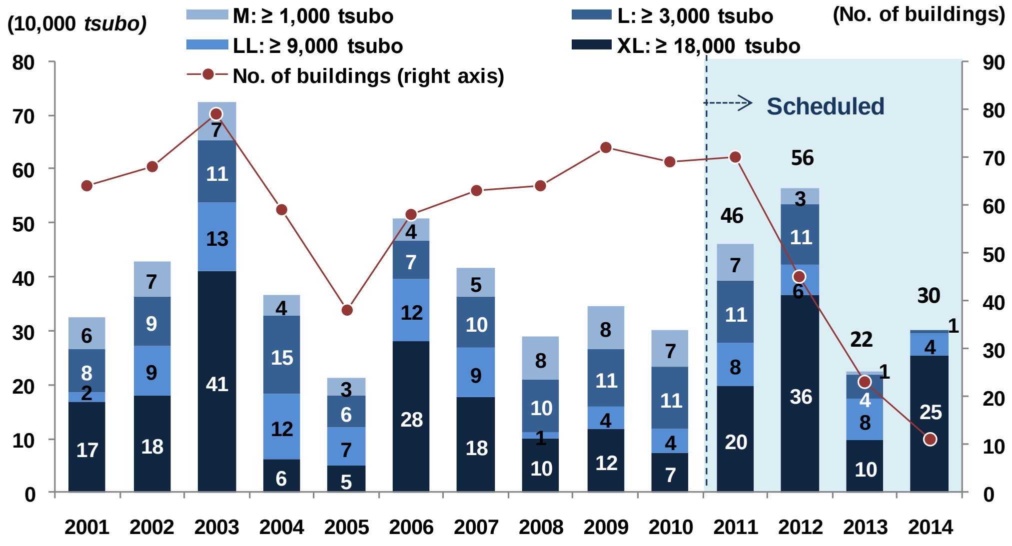
Office supply in Tokyo's 23 wards (buildings with floor space ≥ 1,000 tsubo)



Source: NRE

Recent tenant relocation trends in Tokyo's 23 wards

- The ratio of large-scale relocations increased in 2010
- Nearly all large-scale relocations took place within the 5 central wards. The three most popular destinations were Marunouchi, Konan and Toyosu.
- The most common reasons given for relocation were "Integration as a result of organizational restructuring", "Reconstruction of former office building", and "Merger/ consolidation."

Demand and supply balance in Tokyo's 5 central wards

- Net new supply will remain at low levels except in 2012 (130,000 *tsubo*), and even in 2012 net new supply will be only 43% of the amount recorded in 2003.
- The average annual gain in net new demand in the 5-ward area over the last ten years was 70,000 *tsubo*/ year, which amounts to 1% of total leased office stocks.
- Conditions are in place for a recovery in demand; the key factor now is business sentiment.
- Net new supply over the next four years will average 45,000 *tsubo*/ year, which is less than two-thirds of the average annual growth in office leasing demand over the last ten years .
- Supply side factors will have relatively little impact on the demand-supply equilibrium, so the market could fluctuate significantly depending on the direction of demand trends.
- Buildings that have no competitive edge will have trouble attracting tenants. Vacancy rates could rise to relatively high levels compared with the historical average.

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For more details please refer to the full report: "*Real Estate Investment Review—Spring 2011*"