

Survey of the Tokyo Office Market (2008)

The face of the office market in Tokyo changed somewhat in 2008 as compared with the pattern that had prevailed through 2007. More and more companies adopted a wait-and-see attitude as rising rents leveled off and vacancy rates started to climb. Will this year mark a turning point in the Tokyo office market? In the present survey we looked at new supply, demand and tenant relocation trends, and evaluated the expected impact of these trends and other key factors on the balance between supply and demand in Tokyo's office market between 2008 and 2011.

1. Nominal new supply from 2008~2011 will average 1,000,000 m² per year, a 30% drop compared with 2003~2007

The nominal new supply of office space in B-class or larger buildings (floor space $\geq 3,300$ m²) scheduled for completion between 2008 and 2011 will be 1,000,000 m² per year. This is about 30% lower than the average of 1.47 million m² recorded each year from 2003~2007. In terms of building scale, new supply in extremely large-scale buildings of S-class or greater ($\geq 30,000$ m²) will remain low through 2010. Over the next few years new supply will be dominated primarily by buildings of A class or smaller ($< 30,000$ m²).

2. Most new supply will be located in Chiyoda; Shinagawa and Koto also very active

Chiyoda will account for 34% of total new office supply in 2008~2011. The three central wards will provide 70% of new supply in 2009, but this ratio will then fall to the 50% level thereafter as supply grows in surrounding wards. Shinagawa and Koto will be especially active. A more detailed breakdown shows Otemachi/ Marunouchi/ Yurakucho on top, followed by Akasaka and Osaki/Kita-Shinagawa.

3. Supply and demand trends slack in anticipation of market correction

Vacancy rates in the 5 central wards bottomed out in November 2007 and have been rising ever since. Tenant relocation volume also fell in 2007, especially among larger companies. Moreover, scheduled relocations to new buildings (including those still under construction) are falling. It appears that a significant number of companies are waiting to see which way the market will move before finalizing their relocation decisions. Although it is still a lender's market, it appears that we are entering a period of correction.

4. New supply through 2011 will not significantly affect the current balance between supply and demand

Actual net new supply from 2008~2011 will average only about 130,000 m² per year after taking account removal from the market of older generation buildings constructed prior to the introduction of current seismic resistance standards (assuming a building lifecycle of 50 years). This represents only 0.4% of the total office stock in Tokyo's 5 central wards, and

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even in the absence of new demand this amount is not expected to significantly impact the current balance between supply and demand.

5. Shift from 'Quantity' to 'Quality'

The impact of new supply on the office market is weakening, and it is no longer possible to discuss the supply and demand equilibrium simply in terms of quantity of supply and demand. Going forward the question of whether individual buildings can meet the needs of corporate tenants in terms of quality and rent levels will become increasingly important as a determinant of market trends.

Under these conditions there will be a greater demand than ever before for office space that meets the needs of companies thinking of consolidating their office operations, in terms of rent, location, standard floor size, specifications, and building management systems. Moreover, from the standpoint of corporate social responsibility, we expect to see a growing need for environmental protection and energy efficiency in the office sector.

Although companies will be paying closer attention to the quality of individual office buildings, the first step in the office selection process generally involves deciding which business district to settle in. The key factor here is likely to be the quality of the transportation infrastructure, however these decisions are also affected by factors such as urban design and layout, the degree of integration of urban functions, as well as the size, type, and influence of other companies located in the area

Our 'Investment Review 2008 Summer Edition: Part I' showed quite clearly that Prime Business Areas change and move over time. We shall continue to follow these trends carefully.

For more details please refer to our 'Investment Review 2008 Summer Edition: Part II'

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