TOP OCCUPIER LOCATIONS IN ASIA – IMPLICATIONS FOR INVESTORS

Demand from tech tenants will drive rent and capital growth in Bangalore and Singapore, and over the medium term Shenzhen. Traditional strength and new trends in finance create opportunities in Hong Kong, Tokyo and again Singapore.
Bangalore

Bangalore is the #1 location for technology firms, with long-run GDP growth of 9.6%, a deep talent pool and Asia’s second highest stock of Grade A office space. For investors, rent growth of about 4% p.a. seems achievable over five to ten years, with capital values growing at a similar pace. The 8.9% yield on office assets, Asia’s highest, is appealing.

Singapore

As a location, Singapore is #2 for technology and #3 for finance, with high scores on employment criteria, talent availability and human factors. Rent growth from Singapore office assets should reach 8% in 2019 and average 5.4% over 2018–2022, helping drive solid capital growth for investors over that period. Business park assets also look attractive.

Shenzhen

Shenzhen is #3 for technology firms. It has higher GDP than Hong Kong, a broad technological base, and wide choice of offices and flexible workspace. One area, Qianhai, faces a near-term issue of oversupply. Citywide demand should exceed supply by 2020, driving rent and price growth again after likely volatility next year. Nanshan offers the best returns on a five-year view, while Qianhai has long-term promise as Shenzhen’s new CBD and Luohu is undergoing large-scale renewal.

Tokyo

Tokyo is #2 for finance. It enjoys stability and wealth, with low scores on property offset by high scores on human factors. Employment growth in central Tokyo and low net supply after demolition are driving office rents, with capital values rising by about 3% p.a. Tenants can locate units in both core finance areas like Marunouchi and outer areas like Toyosu and Higashi Shinagawa, but the best investment opportunities are in the centre. Tokyo office assets offer a 3.5–4.0pp yield gap over bonds.

Hong Kong

Hong Kong dominates traditional finance and enjoys new growth in fintech. Investors should follow tenants to CBD fringe areas such as Wanchai. Employment inflows and low net supply drive Tokyo’s office market. Core areas will continue to be good investment targets. Tokyo assets also happen to offer Asia’s widest yield gap over bonds.

Colliers’ “Top Occupier Locations in Asia: Implications for Investors” report assesses the investment implications of our “Top Locations” research. This work determines the best urban centres for technology and finance occupiers by examining 50–60 criteria relevant to choice of location under three headings, socio-economic, property and human factors, across 16 Asian cities.

Growth potential and availability of talent are vital to technology firms, for which the top three locations are Bangalore, Singapore and Shenzhen. Economic scale and wealth measures are very important to financial groups, for which the top three locations are Hong Kong, Tokyo and Singapore.

For investors, office assets in Bangalore offer Asia’s top long-run rent and capital growth potential. Singapore appeals to firms and staff in both technology and finance, and promises firm medium-term rent growth. Shenzhen benefits from a broad technological base and GBA integration, while new supply gives investors wide choice of assets.

Hong Kong dominates traditional finance and enjoys new growth in fintech. Investors should follow tenants to CBD fringe areas such as Wanchai. Employment inflows and low net supply drive Tokyo’s office market. Core areas will continue to be good investment targets. Tokyo assets also happen to offer Asia’s widest yield gap over bonds.
The “Top Locations in Asia (Technology)” report recommends the best urban locations for technology occupiers.

For 16 cities, we examine 50 criteria under three headings, socio-economic factors (50% weighting), property factors (30%) and human factors (20%) and assign a score on each metric. We sum these to a score out of 100.

**Top Three Tech Locations**

**Bangalore**
- Score: 68%. Overall position: #1
- Est. avg. real GDP growth 9.6% over 5 years
- Office stock (GFA basis): 141mn sq ft (13.1mn sq metres)

Bangalore’s top place reflects high long-run GDP growth, depth of talent pool, high availability of quality office stock, low staff costs and rents, and low living cost.

**Singapore**
- Score: 63%. Overall position: #2
- #1 on employment criteria and for availability of talent
- #1 on human aspirational metrics

Singapore’s #2 rank reflects high availability of talent and top position on human factors; this outweighs a lower ranking on property metrics.

**Shenzhen**
- Score: 61%. Overall position: #3
- Higher GDP than HK, broad technology base
- High supply of new office and flexible space, but demand should exceed supply by 2020

Shenzhen has expanded its tech base by high R&D. It scores well on property factors, reflecting quality office stock and high planned new supply.

**Alternative Tech Locations**

**Beijing**
- Score: 60%. Overall position: #4

Beijing scores well on scale and growth potential. As China’s top university city and a centre of AI research, it also offers high availability of talent.

**Hyderabad**
- Score: 59%. Overall position: #7

Hyderabad has the second highest GDP growth; office development is proceeding apace; and it scores well for an Indian city on human factors.

**“Wild Card” Tech Location**

**Hong Kong**
- Score: 59%. Overall position: #8

Rising attractions include proximity to Shenzhen, recent expansion by tech leaders like Alibaba and Facebook, and surging investment in fintech.
The “Top Locations in Asia (Finance)” report recommends the best urban locations for financial occupiers. For 16 cities, we examine over 60 criteria under three headings, socio-economic factors (55% weighting), property factors (25%) and human factors (20%), and assign a score on each metric. We sum these to a score out of 100. We highlight some of the most interesting scores at right.

## Top Three Finance Locations

### Hong Kong
- Score: 61%. Overall position: #1
  > Politically stable, business-friendly, low corp. tax rate, strong regulatory governance
  > High CBD rents, other areas much cheaper
  > Low personal tax, safe city, high life quality

Hong Kong scores well on employment and wealth factors, and on office accommodation metrics. It comes #2 in Asia on human factors.

### Tokyo
- Score: 60%. Overall position: #2
  > #2 on economic scale (city GDP, position in national economy, value of finance to city)
  > Top by wealth (equity and bond market value, total public companies, total savings)
  > #3 on human factors, e.g. safety, living quality, environment

Tokyo’s high rank reflects its wealth and stability as a global financial hub. A low score on property factors is offset by a #3 rank on human metrics.

### Singapore
- Score: 55%. Overall position: #3
  > Politically stable, business-friendly, strong infrastructure, strong regulatory governance
  > Important wealth management centre
  > Top in Asia on human factors (safety, quality of living, environment, high-tech city)

Singapore ranks first in Asia on employment criteria, and is a major wealth management hub. It is top in Asia on human aspirational factors.

## Alternative Finance Location

### Shanghai
- Score: 54%. Overall position: #4

Shanghai does well on scale and wealth metrics. It ranks third on property factors, and is profiting highly from financial liberalisation in China.

## “Wild Card” Finance Location

### Seoul
- Score: 54%. Overall position: #5

Seoul scores well on scale and wealth metrics, as well as employment criteria. Seoul’s ranking on property factors is modest, but it ranks fourth on human factors like safety and environment.
DEMAND DRIVERS BEHIND THE FINDINGS FROM THE SCORING

Our Technology report follows our “Tech Trends in Asia” report, which was based on interviews with big occupiers. “Tech Trends” had four conclusions. Acquiring Talent is tech groups’ top challenge. Talent is concentrated in key markets, notably Chindia (China and India), which also offer high growth. To retain talent, tech groups must move towards the CBD or CBD fringe. Finally, artificial intelligence threatens demand for space, but will drive growth and returns.

These conclusions mean that tech occupiers especially value growth and talent. In our scoring, we therefore assign high weightings to the categories of economic output/growth (15%) and availability of talent (10%). According to Oxford Economics, Bangalore will achieve Asia’s fastest five-year real GDP growth, at 9.6%, followed by Hyderabad on 8.1%. Based on the Times Higher Education World University Rankings, Singapore ranks top in Asia as a source of talent due to strength of its educational and research facilities.

The drivers of demand for Finance occupiers are different. A leading financial city will have high capital markets liquidity, will attract investment, will amass large cross-border banking liabilities, and will have built up high wealth. Under socio-economic factors, we therefore assign a weighting of 13.5% to the category of economic output, and of 25.0% to the category of wealth-related factors.

Tokyo scores especially highly on economic output and wealth, since it has:
> Asia’s largest capitalisation of the domestic equity and debt markets
> Asia’s largest total wealth with high savings and investments
> Asia’s highest number of top global public companies

Hong Kong is in a similar position to Tokyo, enjoying:
> The third largest equity market capitalisation after Tokyo and Shanghai
> The top value of cross-border banking liabilities, due to its large banks
> A high net savings position due to high foreign investment into the city

Singapore is smaller in scale. Nevertheless, it is a major wealth management hub, and in the sub-category of wealth factors comes second among Asian cities by cross-border banking liabilities and by net international investment.

¹ See, e.g. Oxford Economics’ “Asia Pacific Cities & Regions Outlook” of March 2018

Figure 1: Technology – overall score: three cities on 61% or higher

Figure 2: Finance – Overall score: Hong Kong, Tokyo, Singapore

Source: Colliers International, based on data inputs from numerous sources
Technology Sector

Bangalore

India is starting to emerge as an investment destination. Figures from Real Capital Analytics (RCA) for the first nine months of 2018 show that total transactions of completed properties in India grew by 21% YOY to USD3.44 billion. We expect investment interest to increase further, both because India offers Asia’s strongest long-run economic growth, and because it is the large Asian market least exposed to the US-China trade war.

The Indian office market is dominated by technology groups, which account for 60–70% of gross absorption of office space, and by Bangalore, which with office stock of 13.1 million sq metres on a GFA basis (as of end-H1 2018) represents about one-quarter of the national total. We think tech occupiers will continue to favour Bangalore and Hyderabad. In Bangalore, we predict average annual rent growth of 4.1% over 2018–2021, and this growth rate should be sustained for several years afterwards. Given the outlook for firm and stable rental income, we expect capital values to rise at a similar 3–4% rate. This should mean that Bangalore’s high net yield of nearly 9% persists, driving continued investor demand for office assets.

Figure 3: Comparison – Bengaluru vs Hyderabad

Source: Colliers International India Research
Note: Only Grade A office spaces are considered; Forecasted vacancies are for Q4 2018 and Q4 2021 respectively

Singapore

We expect that Singapore will remain attractive to tech occupiers for the next 10–20 years, despite limited supply of prime-grade office stock. This reflects the city’s top position in Asia as a source of talent, on employment criteria (e.g. political stability, ease of doing business, city infrastructure), and on human measures (e.g. safety, living quality, air pollution).

Looking ahead, Singapore should continue to profit from its status as South East Asia’s finance and communications hub, and from the state-supported transition to the so-called Fourth Industrial Revolution. We expect supply of business park and high-specification industrial space to double by 2030.

Strong demand from tech occupiers should underpin occupancy and rent growth in office buildings, but also industrial and business park assets, which investors are already targeting. Examples of interest in industrial assets from Q2 2018 include BlackRock’s purchase of Admirax, a hi-specification light industrial building in Woodlands, for SGD106 million (USD78 million), and the purchase of Ceva Logistics Center, a modern ramp-up logistics facility, by ESR-REIT for SGD96 million (USD70 million). Such activity should persist and strengthen.

Shenzhen

From now on, we expect MNC occupiers and international institutional investors to pay greater attention to South China for at least five reasons:

- South China continues to record China’s fastest economic growth
- Shenzhen and Guangzhou now have similar GDP to Hong Kong
- Regional integration should increase under the Greater Bay Area plan
- High investment in R&D has widened Shenzhen’s technology base far beyond once dominant hardware manufacturing (see table overlap)
- Total office space in Shenzhen and Guangzhou should roughly double over the next three years
For Shenzhen, over 2018–2022 we predict new Grade A office supply of 5.5 million sq metres, equal to 107% of total stock at end-2017. The new supply ensures that adequate quality office stock will be available for technology groups to occupy, and for investors to purchase. There are some concerns about oversupply in the near term, especially in the Qianhai district which is where the new supply is concentrated, and for which infrastructure remains inadequate. We suspect that many occupiers will wait till 2020, by which time the infrastructure in Qianhai should have improved, before making decisions about new leases.

In consequence, we predict the following:

- Recently strong net absorption will decline in 2019 before recovering in 2020 and beyond
- Net absorption over 2018–2022 will be 4.7mn sq metres, equal to 85% of new supply; and net absorption will exceed new supply over 2020–2022
- Average rent for Shenzhen will rise by 5.0% in 2018, but fall by 4% in 2019. Over 2020–2022, annual rent growth will return to 4.5–6.0%
- Over the period 2018–2022, this forecast implies average annual rent growth of 3.0–3.5%.

From the perspective of investors, this outlook implies capital values may fluctuate between now and late 2019 while the temporary oversupply in Qianhai persists. However, the prospect of rent growth of 4.5–6.0% from 2020 onwards should drive similar appreciation in capital values for investors beyond next year.

The following are the areas of Shenzhen to focus on for investment:

- **Nanshan.** Over the next five years, this district probably offers investors the best returns.
- **Qianhai.** However, as the planned future CBD of Shenzhen, we expect that rent in Qianhai will pick up steadily after the completion of new infrastructure projects. This should allow yields to rise, driving faster price growth for investors than elsewhere in the city.
- **Luohu.** This is Shenzhen’s earliest developed district and is undergoing large-scale renewal. For example, the Caiwuwei area has planned three super skyscrapers with a height of over 600 metres.

Beyond five years, we believe that Qianhai and Luohu offer superior investment returns to Nanshan.
Finance Sector

Hong Kong

We highlight Hong Kong not only as the top location in Asia for financial occupiers, but also as an emerging location for technology occupiers. The reasons include proximity to Shenzhen, recent expansion by tech leaders like Alibaba and Facebook, and surging investment in the emerging fintech sector, i.e. the area where finance and technology overlap.

Our research into Hong Kong financial occupiers suggests that Central will remain the preference for front-office operations. However, both large banks and tech occupiers are also likely to target CBD fringe locations, in the banks’ case for their middle and back office operations. Financial occupiers may also consider areas slightly further afield like Kowloon Bay (where the US bank JP Morgan plans to build a big technology centre for greater China).

For investors, the tight supply in the core Central/Admiralty district implies that CBD fringe locations may well present the best opportunities to acquire office assets that offer the prospect of steady rent growth from both finance and technology tenants at reasonable prices. Our recently completed Hong Kong Occupier Survey has shown that the main CBD fringe areas, namely Sheung Wan, Wanchai and Causeway Bay, are the most fluid markets in terms of tenants moving in and out of the area.

Among these three sub-districts, we believe that Wanchai offers the greatest potential for tenants looking for large office space, affordable rents, easy accessibility, and good business amenities. Wanchai should therefore be a key target for investors too. Furthermore, Wanchai should stay popular for the next decade as transport links improve further due to the completion of the Shatin to Central MTR link, and as new supply appears in Wanchai North following the relocation of government offices.

We expect Hong Kong to remain one of the top finance locations in Asia for many years, with rent from financial tenants underpinning income streams to investors. That said, our forecast for average annual rent growth from Grade A offices in Hong Kong over 2018–2022 is only 2.5%, compared to 5.4% in Singapore. A key reason for our cautious forecast is the vulnerability of rents in Hong Kong in the near term to falling financial markets.

As mentioned in our “Top Locations in Asia (Finance)”, and in detail in our supplementary report “Hong Kong and Seoul rents vulnerable to falling stock markets” (6 November 2018), Hong Kong shows the highest correlation of any Asian financial centre between the level of the stock market and office rents. This is explained by the fact that financial stocks have a 48% weighting in the Hang Seng Index, while financial tenants occupy 54% of Grade A office space in the CBD. This is the background to our new forecast of flat citywide Grade A rents in Hong Kong in 2019, but a 3.8% decline in Central/Admiralty.

With no evidence so far that international or Chinese banks plan to retrench significantly or depart from Hong Kong, we expect rents to steady in 2020.
Tokyo

Tokyo scores highly in our Finance ranking due to its wealth and stability as a global finance hub; it also scores well on human factors. Tokyo ranks last in Asia on property factors, due to high staff costs and rents and a conservative office facility offering. Nevertheless, Tokyo offers Asia’s highest Grade A office stock at 18.0 million sq metres. This ensures ample options for tenants seeking quality space, even if vacancy stands at the lowest level for 11 years.

Stable employment inflows into Central Tokyo are a key demand driver for office space. We think that Tokyo’s net employment growth will persist, averaging 0.7% over the next five years. The finance sector is an important source of employment growth (see Figure 7), though others like professional services and IT are also significant. Besides employment growth, low net supply after demolition (see page 11) is another driver of office rent growth.

Singapore

Singapore is #2 in our scoring in Technology and #3 in Finance. Interest from financial tenants should continue to fuel demand for prime CBD office space; demand should also be firm from technology, professional services and flexible workspace groups. We predict average net absorption over 2018–2022 of 824,000 sq feet (76,550 sq metres) p.a. While this is below annual average new supply of 914,000 sq feet (84,910 sq metres), after several quarters of market strength the vacancy rate has fallen below the ten-year average of 6.2%, and should reach 4.4% by end-2018. The tight demand/supply balance leads us to expect vacancy to stay low for a few years yet.

We forecast citywide prime office rent growth of 13.5% for 2018, and of 8.0% for 2019, with an average of 5.4% for the period 2018–2022. Thus, we believe that Singapore offers investors the highest income growth among developed Asian cities. Hence we anticipate that investors will continue to target office assets in Singapore, with prices likely to follow rents upwards.

As in technology, the Singapore government is striving to ensure that the city stays attractive to finance tenants. This should help assure investors that they can expect firm long-run demand from financial groups for office space. A key policy measure is the Monetary Authority of Singapore (MAS)’s goal of establishing the city as a Smart Financial Centre. MAS has released plans for transforming Singapore into a centre for capital raising and enterprise financing, infrastructure financing, and insurance and risk transfer. The emerging fintech sector, representing the area of overlap between finance and technology, is a key element in these plans. As in Hong Kong, we expect fintech companies to be an expanding source of new tenants.

Figure 7: Employment growth in Tokyo by industry (2008–2017)

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Source: Colliers International Japan Research, Metropolitan Government of Tokyo
From an investment perspective, the Indian cities, notably Bangalore, offer high long-run growth potential in rents and capital values. We see Bangalore as the #1 location in Asia for tech groups, and the city ought to hold this position for the next five to ten years. Steady office rent growth of close to 5% annually seems achievable over the medium term. Capital values for Bangalore offices should expand at a similar rate. With a net yield of 8.9%, Bangalore also happens to be Asia’s highest-yielding major office market. Please see Figure 8 overleaf for yields and yield spreads over bonds in Asia.

Singapore stands out as an attractive investment destination. It is the only Asian city which counts as a top three location for both tech and finance tenants, and is seeing strong demand for office space from other sectors such as flexible workspace. Given our forecast of limited new supply until 2021, the near-term supply-demand balance in Singapore is favourable unless the economy weakens far faster in 2019 than we currently assume. Moreover, Singapore’s hub position in South East Asia and pro-technology and pro-finance policies should ensure continued occupier demand over the medium term.

Investors in Singapore office properties can expect steady rent growth of over 5% p.a. for the next five years, and hopefully beyond. This robust income growth should drive steady increases in capital values over the same period. With supply of office assets limited in Singapore, business park assets represent an attractive alternative.

In valuation terms, Singapore property looks reasonable. The net yield of 3.6% for office assets is within the 3.5–4.5% range for most Asian developed cities other than Hong Kong. Meanwhile, Colliers estimates that business park assets in Singapore yield 5.2-6.2%, and logistics assets yield 6.0-7.0%.

Shenzhen

As the technology capital of China located in China’s fastest-growing region, we expect Shenzhen to attract strong demand from occupiers for the next decade. Shenzhen faces a temporary oversupply problem concentrated in one district, Qianhai. We expect a supply-demand imbalance which pushes citywide net absorption and rent downwards over 2019. Rents should recover from 2020 as net absorption moves back above new supply.

Over 2020–2022, we expect rent growth in a range of 4.5–6.0% annually. This should allow capital values in Shenzhen to appreciate at a similar rate after likely volatility over 2019. On a five-year view, Nanshan probably offers investors the best returns.

We regard Qianhai as the most promising sub-market on a longer-term view. As the planned future CBD of Shenzhen, we think that rent in Qianhai will pick up after the completion of new infrastructure projects. This should allow yields to rise steadily, driving price growth for investors. Another area worthy of attention is Luohu, Shenzhen’s earliest developed district, which is undergoing large-scale renewal. Quality new supply in this area also should provide a range of opportunities for both tenants and investors.

Hong Kong

Hong Kong is the top city in Asia for finance occupiers in our scoring, and a “wild card” tech location with the potential to improve its ranking sharply. Given firm demand and limited supply, and rapid expansion in the fintech sector, prospects for medium-term rent growth are good. While office rents in Central are the highest in the world, there is a wide gap in rents between the CBD and outlying districts, giving financial tenants the chance to locate their middle and back office operations outside the centre. Like the tenants, investors can decentralise. CBD fringe locations, especially Wanchai, may well present the best opportunities to acquire office assets at good prices.
Tokyo

Tokyo is attractive as an investment target for several reasons:

> Stable employment inflows into Central Tokyo from finance, IT and other sectors are a key demand driver for office space

We expect this situation to persist. As noted, the wide gap in rents between central and outlying districts means big financial groups can locate front office units in core areas, but middle and back office activities in cheaper areas. For long-term investors we recommend owning assets within Tokyo’s three central wards due to stable rent growth prospects. However, certain office investment opportunities may also materialise in outlying areas.

> Tokyo office rents have been rising since 2014, and should rise further

Tokyo office rents have been rising steadily since January 2014 as demand – tracking at around 2.7% of existing stock – has outstripped the negative net supply after adjusting for increasing demolition for five years in a row. We expect that record low vacancy of below 3.0% will persist with rent growth peaking at 4.5% YOY within the next several quarters before tapering to a more sustainable annual growth rate of 0.8%. At least in the near term, solid rental growth for investors in office assets in Tokyo looks almost guaranteed.

> We expect capital values to rise by at least 3% annually

Our forecast reflects not only the favourable near-term demand/supply balance, but also the fact that more old buildings are being redeveloped in central locations. This has been a key trend since 2003. Capital value should appreciate in line with the better earnings power investors that investors can expect from rising rents.

> Tokyo offers the best value among the developed Asian markets, with a net yield on office property of 3.5–4.0%

Tokyo office assets also offer the widest spread over ten-year bond yields of any Asian centre. This situation should persist for the next several years due to very low Japanese interest rates.
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