COLLIERS QUARTERLY

OFFICE | TOKYO | RESEARCH | Q1 2019 | 25 APRIL 2019

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TOKYO'S TIGHT MARKET CONTINUES

Higher pre-commitments are expected to exceed rising supply

Summary & Recommendations

Tokyo's business sentiment remained strong in Q1 2019, with pent-up demand continuing to outstrip rising supply. Minimal vacancy continued to nudge up overall rents along with higher net take-up, offsetting prior market concerns on rising supply.

The price response in each submarket remains mixed, suggesting a more moderate price response over the coming quarters. While we do not expect further rental growth in prime districts, we still expect steady rental growth led by newer buildings suitable for younger technology tenants, especially in Shibuya.

We recommend occupiers wishing to have a presence in the CBD to explore options in refurbished buildings as wider leasing options have become available in recent quarters.

		Q1 2019	Full Year 2019	2018–23 Annual Average
Demand	> Leasing activity was steady despite a more cautious business outlook. Functional consolidations and flexible workspace operators continued to support the underlying demand.	▲ 169,600 sq m	▲ 461,000 sq m	▲ 492,000 sq m
Supply	> The annual Grade A office supply from 2019 to 2023 has increased to 508,000 sq m (5.8 million sq ft) on average, up 63% from the average level of the previous five year period before adjusting for demolitions.	▲ 178,700 sq m	▲ 542,000 sq m	▲ 508,000 sq m

		QOQ/ End Q1	YOY / End 2019	Annual Average Growth 2018–23 / End 2023
Rent	> We remain optimistic that rental growth will edge higher than the consensus at least through H1 2020, given higher pre-commitments and growing demand from technology tenants amid still-tight markets.	1.1% ▲ JPY 39,804	3.0% ▲ JPY 40,200	0.6% ◀▶ JPY 40,600
Vacancy	> The vacancy rate in both new and existing buildings will probably remain flattish throughout 2019, but afterwards rising supply ought to push vacancy up in existing building.	0.0pp ◀▶ 1.1%	0.1pp ◀▶ 1.2%	0.3pp ▲ 2.8%
Capital Values	> Capital values continued to hit historical highs in Q1 2019 despite the low market turnover. We expect volumes to remain low in 2019 with few investment alternatives for domestic investors.	4.5% ▲ JPY 3.1 mil	6.0% ▲ JPY3.3 mil	3.1% ◀▶ JPY3.5 mil

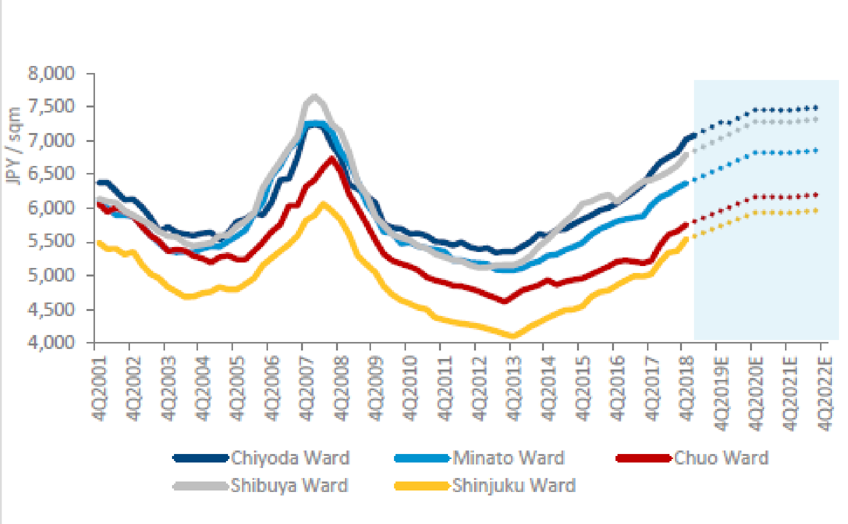
Source: Colliers International. USD = 112 JPY using the historical average for 1Q2019. 1 sq m = 10.76 sq ft., 1 tsubo = 3.306 sq m.
Note: Rent = net effective rent in JPY per sq m per month based on NFA. Capital Values = JPY per sq m based on NFA.

MARKET REMAINS AIRTIGHT

The overall net-take-up almost doubled from the previous quarter to 169,600 sq metres (1.8 million sq feet) in Q1 thanks to rising supply matched with continuing company expansions. In particular, pre-commitments remain strong, tracking above 88% of incoming supply in 2019, and above 63% of supply in 2020. This positive net take-up since 2013 has led to a steady rental increase of 1.1% QOQ ,with our annual asking rent forecast calling for further increase of 3.0% (Grade A) and 6.5% for the all-grade market in 2019.

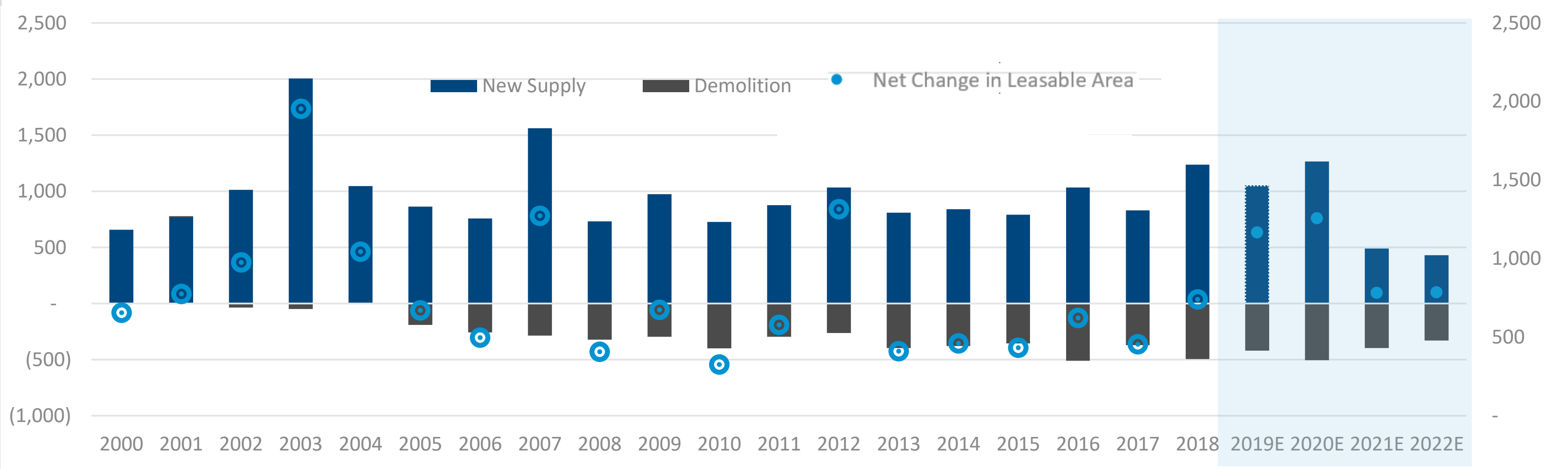
While we expect retraction in demand from traditional banking occupiers, the Marunouchi submarket remains relatively steady as this fading demand is replaced by fintech firms and professional services firms. Interestingly, both leasing and investment requirements from the insurance sector were strong in Q1 2019, suggesting a lack of investable assets in other asset classes. In our view, Tokyo's rent gap between grades remains significantly wider than its peers with top rents more than 3.5 times the non-Grade A buildings in outer districts. As such, we expect that the migration to lower grade buildings will continue as most occupiers remain cost-cautious in anticipation of lower economic growth in the coming years.

Tokyo Grade A office rental trend (Unit : JPY per sqm)



Source: Colliers International

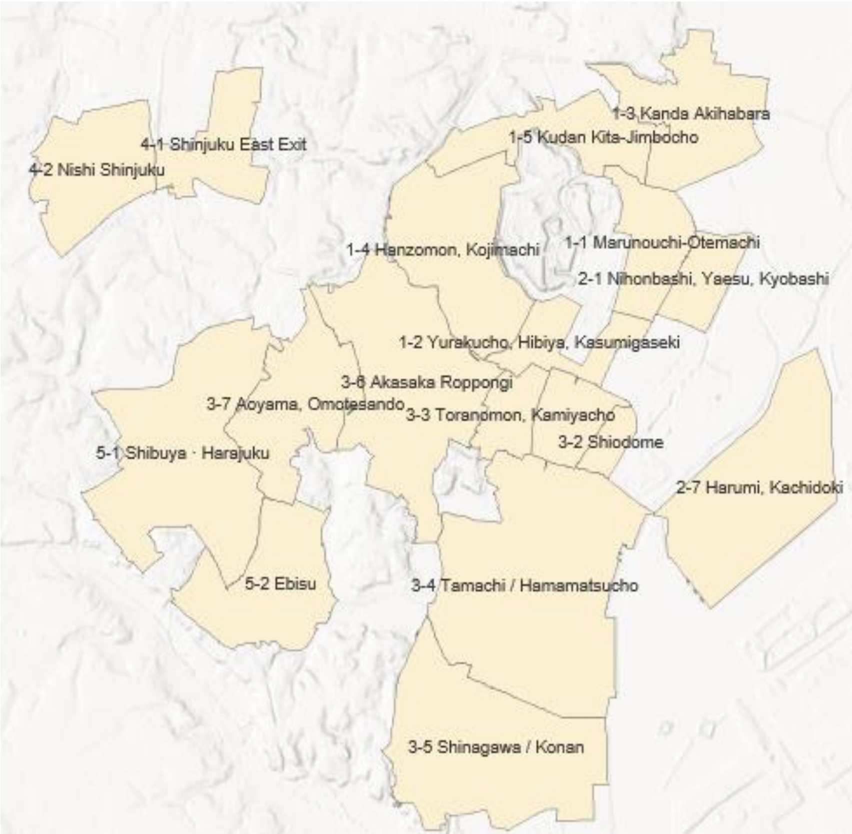
Tokyo Grade A office: New supply, Demolition and NFA change projection through 2022 (Unit: 1,000 sq m)



Source: Colliers International

SUBMARKET PERFORMANCE MIXED

The overall market remains strong as Shibuya/Harajuku continues to benefit the most from the growing technology talent pool available in this area. We expect Toranomon/Kamiyacho also to outperform until the area's new infrastructure and upgrades of key landlords' portfolios, including a new subway station opening, are completed in 2020. Tokyo's flexible workspace operators are still leasing larger footprints mostly in prime districts on a relatively large scale.



Source: Colliers International, Urban Planning Bureau – the Metropolitan Government of Tokyo.
Note: the index number on the map corresponds to the table at right.

District	Grade	Rent (m²)	Rent (Tsubo)	Vacancy Rate (%)
1-1 Marunouchi, Otemachi	A	$1,362.7	¥46,170	1.4%
1-1 Marunouchi, Otemachi	B	$1,033.1	¥35,000	3.3%
1-3 Kanda, Akihabara	A	$885.5	¥30,000	0.4%
1-3 Kanda, Akihabara	B	$692.6	¥23,465	2.8%
1-4 Hanzomon, Kojimachi, Ichihara	A	$931.6	¥31,563	2.8%
1-4 Hanzomon, Kojimachi, Ichigaya	B	$739.0	¥25,037	2.0%
2-1 Nihonbashi, Yaesu, Kyobashi	A	$1,106.6	¥37,490	0.8%
2-1 Nihonbashi, Yaesu, Kyobashi	B	$903.3	¥30,604	5.7%
2-7 Harumi, Kachidoki	A	$579.8	¥19,644	11.8%
2-7 Harumi, Kachidoki	B	$368.9	¥12,500	1.3%
3-2 Shiodome	A	$1,087.0	¥36,829	1.6%
3-2 Shiodome	B	$737.9	¥25,000	1.6%
3-3 Toranomon, Kamiyacho	A	$993.0	¥33,642	2.8%
3-3 Toranomon, Kamiyacho	B	$687.8	¥23,303	0.9%
3-4 Tamachi, Hamamatsucho	A	$791.9	¥26,829	1.1%
3-4 Tamachi, Hamamatsucho	B	$681.7	¥23,096	0.9%
3-6 Akasaka, Roppongi	A	$1,181.3	¥40,023	1.5%
3-6 Akasaka, Roppongi	B	$819.2	¥27,753	1.6%
4-2 Nishi-Shinjuku	A	$883.4	¥29,930	0.7%
4-2 Nishi-Shinjuku	B	$618.6	¥20,958	1.8%
5-1 Shibuya, Harajuku	A	$1,033.5	¥35,014	1.4%
5-1 Shibuya, Harajuku	B	$988.6	¥33,495	2.8%

Source: Colliers International. Note: Net effective rents are monthly rents on net floor area basis.

A lack of convenient access to the Tokyo Bay area, including the Harumi and Kachidoki areas, remains a challenge to attracting more demand from the area's largest occupier profile, servicing back office operations. This has kept the area's vacancy above 10%. However, some tenants have started to give up premium locations for the larger available floorplates in upgraded facilities available in these areas. For example, the planned completion of the UR Toyosu 2-chome station front redevelopment, a new Grade A office building available from 2020, is already fully committed. We expect more tenants in search of large floor plates will be forced to consider outer districts given the near-full pre-commitment levels within major CBDs over the next 18 months.

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