

Mari Kumagai  
Head of Research | Tokyo  
+81 3 4572 1009  
[mari.kumagai@colliers.com](mailto:mari.kumagai@colliers.com)

# OPTIMIZING THE COST STRUCTURE

Tokyo Office Market Q2 2020 Review and Outlook

## Insights & Recommendations

For 2020, Tokyo should still benefit from a better buffer of low vacancy and high pre-commitment rates. However, as more occupiers shifting in favour of fixed cost reduction, we expect a modest rise in vacancy in existing buildings leading to downward pressures on rent.

We recommend occupiers to:











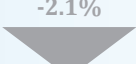









- > Adapt their strategies to the near-term uncertainty over workstyle and future location and rationalize the rent payments along with upcoming contract renewals.

We recommend landlords to:

- > Offer incentives to retain tenants, thereby forestalling cancellations and requests for space reduction in a situation of likely rising vacancy.

We recommend investors to:

- > Seek opportunities related to developers as we expect the volume of their divestments to increase.

		Q2 2020	Full Year 2020	2020-24 Annual Average
 <b>Demand</b>	In Japan, the number of office workers remains steady despite recession. However, office space demand has started to see weakness with greater remote working prompting more occupiers to redefine their office space needs.	 -56,370 sq m	 316,000 sq m	 492,000 sq m
 <b>Supply</b>	This year's new supply is almost double that of 2019. However, Tokyo should still see positive net absorption in 2020 with pre-commitments still tracking above 85% of new supply for 2020 and 65% of new supply for 2021.	 101,030 sq m	 918,800 sq m	 508,000 sq m
		QOQ/End Q2	YOY / End 2020	Annual Average Growth 2019-24 / End 2024
 <b>Rent</b>	In Q2 2020, the net effective achievable rent <sup>1</sup> fell despite face rent being almost flat. This is because larger incentives became available for established occupiers in flagship buildings.	 -1.8% JPY 37,600	 -2.1% JPY 38,000	 0.4% JPY 39,900
 <b>Vacancy</b>	Vacancy increased across submarkets with future vacancy nearing to 500,000 sqm. With CBD stock nearing 25 million sq m, we expect vacancy to be around 3.0% through 2024.	 0.4 pp 1.4%	 0.4 pp 1.8%	 0.3 pp 2.7%
 <b>Cap Rate</b>	With a sound banking system, investment sentiments have already started to improve. However, quarterly transaction volumes remain depressed, down 32.4% YOY.	 0.0pp 3.5%	 0.2 pp 3.7%	 0.1 pp 3.6%

Source: Colliers International. USD = 107.6 JPY using the historical average for Q2 2020. 1 sq m = 10.76 sq ft., 1 tsubo = 3.306 sq m. <sup>1</sup>Net effective achieved rent is in JPY per tsubo per month based on NFA. Forecasted change covers the overall average rent movement during the period

## Cost pressures are expected to increase

### Rising vacancy with limited effect on rents except Shibuya

This quarter marks the onset of rental declines as Tokyo emerges from a *state of emergency*<sup>2</sup> from April 7 to May 25. In the absence of government support, CBD Grade A net effective achievable rents fell by 2.8% QOQ, while Grade B rents stayed near flat QOQ. Submarket rental performance remains mixed. More IT venture companies around Shibuya have started to surrender office space to support an emerging trend in favor of permanent remote working. Notwithstanding the rental declines, where remote working is possible, demand for quality office space remains resilient with the Grade A vacancy still tracking below 2.0%. We expect the 2020 net absorption to remain positive, driven mainly by established occupiers being attracted to the [National Strategic Special Zone](#)<sup>1</sup>. Such pre-commitment remains a key market driver representing 21% of total leasing volume in Q2 2020.

### Increased remote working to accelerate cost saving initiatives

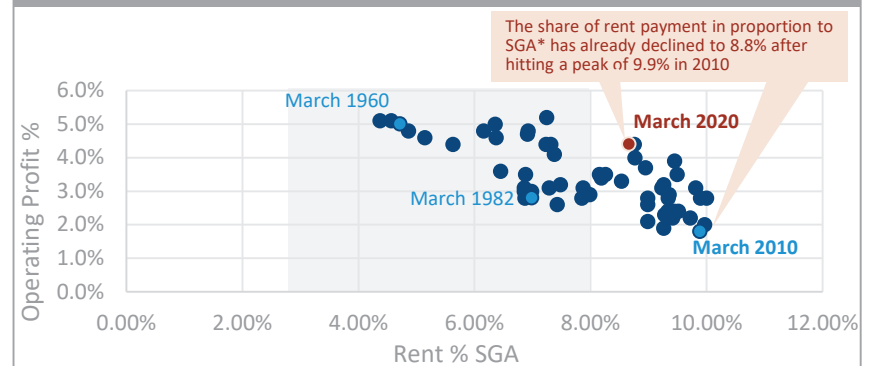
With reduced office space per person, the share of rent payment in proportion to SGA\* has already declined to 8.8% after hitting a peak of 9.9% a year after the GFC (see charts at right). Looking ahead, we expect cost pressure to increase for the large volume of small tenants in affected industries. In consumer-related services industries, the scale of the economic damage has exceeded those in the GFC of 2009. Notwithstanding the size and the profitability of a given company, we expect more occupiers to pursue a new office space strategy to reduce cost and enable a new workstyle post COVID-19.

### A long-term reality of virtual office, increasing workspace options

A long-term reality of virtual office is yet to affect Tokyo's market fundamentals with the Grade A vacancy tracking below 2.0%. Unlike the GFC, an increasing proportion of the contracts are fixed term leasing contracts, without allowing the mid-term cancellation. Additional headcounts may no longer require office space expansion. With increasing workspace options, we expect the future office demand should be distributed across various locations, reducing the space used for HQ while accommodating more satellite office locations. In the coming years, future offices need to deliver long-term benefits exceeding any incremental cost saving arising from remote working. We expect an effective rents will start to see downward pressure, reversing the seven-year upward cycle from 2013. This is likely to extend the free rent period from the current 3.2 months toward the ten-year average of 4.5 months.

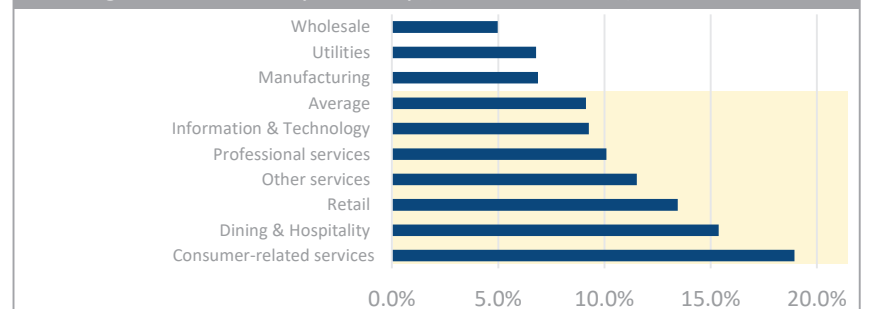
<sup>2</sup>Includes major CBDs such as Marunouchi, Nihonbashi, Toranomom and Tamachi as of July 2020. \*Sales, general and administrative expenses.

## Mapping Rent % SGA\* & Operating Profit Margin since 1960s



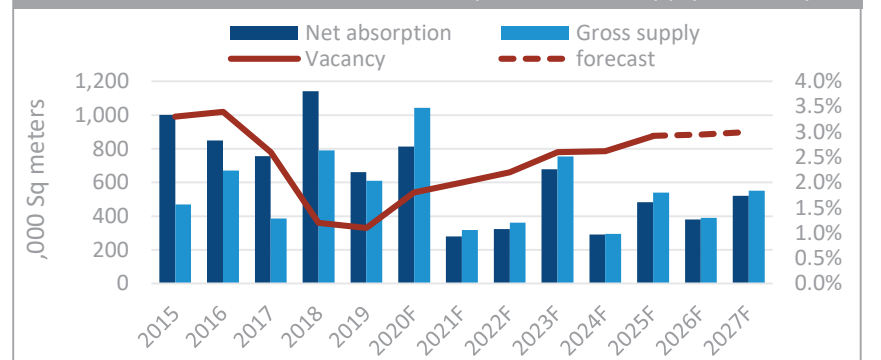
Source: Colliers International, Ministry of Finance

## Ranking Rent % SGA\* by Industry (FYE March 2020)



Source: Colliers International, Bank of Japan

## Historical trend & forecast : Net absorption. Gross Supply, Vacancy %



Source: Colliers International

## Ranking average achieved rent by major CBDs Q2 2020 Market Survey (Unit : m2 unless otherwise noted)

	Achieved Rent per tsubo per month	Achieved Rent per sqm per month	Vacancy	Available NFA (m2) QOQ change	Total NFA sqm	Under Construction 2020/2021 sqm	LTM 12 Delivery sqm	LTM 12 Net Absorption sqm (Negative) in parenthesis	Area Grade A % of total
1 Marunouchi/Otemachi	¥43,325	\$121.4	1.4%	10,692	2,577,908	197,025	102,479	109,313	96.0%
2 Nihonbashi/Yaesu/Kyobashi	¥42,318	\$118.5	1.1%	830	1,020,792	-	-	(2,393)	40.3%
3 Shiodome <sup>1</sup>	¥39,871	\$111.7	37.6%	0	289,949	8,264	-	(105,476)	79.3%
4 Akasaka/Roppongi	¥38,936	\$109.1	3.8%	18,788	1,903,169	5,461	-	(15,740)	69.1%
5 Yurakucho, Hibiya, Kasumigaseki	¥37,575	\$105.2	0.7%	1,872	904,743	2,909	-	9,204	73.1%
6 Shibuya/Harajuku	¥36,209	\$101.4	3.5%	15,439	1,221,027	32,622	6,093	(26,356)	26.8%
7 Ebisu	¥36,111	\$101.1	5.3%	10,774	339,776	-	-	(15,943)	44.5%
8 Toranomon/Kamiyacho	¥36,058	\$101.0	2.1%	2,707	1,246,120	5,864	134,605	134,547	69.8%
9 Kudan Kita/Jimbocho	¥32,861	\$92.0	1.3%	(38)	672,117	-	52,413	49,349	38.7%
10 Nishi Shinjuku	¥32,659	\$91.5	1.9%	3,626	1,765,467	-	16,261	1,174	80.0%
11 Mitsukoshi-mae	¥32,508	\$91.1	0.4%	2,314	539,781	-	90,926	93,196	34.4%
12 Shinagawa/Konan	¥31,973	\$89.6	0.8%	2,298	1,094,065	-	2,975	2,837	74.2%
13 Aoyama/Omoteshando	¥31,350	\$87.8	1.9%	5,661	519,955	-	11,379	6,064	26.3%
14 Osaki/Gotanda	¥28,453	\$79.7	0.8%	4,511	558,940	-	-	(4,722)	92.3%
15 Yoyogi	¥27,928	\$78.2	2.8%	6,641	411,004	-	-	(8,343)	50.4%
16 Hanzomon/Kojimachi	¥27,456	\$76.9	0.8%	(1,457)	1,113,656	-	38,625	33,572	38.7%
17 Ikebukuro	¥27,008	\$75.6	9.4%	0	180,493	-	39,296	22,308	46.9%
18 Ginza	¥26,035	\$72.9	1.4%	(13,471)	512,157	-	-	(5,874)	23.9%
19 Shimbashi	¥25,792	\$72.2	1.0%	1,327	670,879	69,676	6,598	3,742	23.7%
22 Tamachi/Hamamatsu-cho	¥24,755	\$69.3	1.3%	18,361	2,482,587	118,678	115,584	93,209	55.7%
23 Tsukiji/Hatchobori/Kayabacho	¥24,090	\$67.5	1.1%	6,961	987,718	44,132	3,917	1,174	26.4%
24 Yotsuya	¥23,549	\$66.0	3.5%	1,535	360,964	-	58,843	60,435	48.2%
25 Iidabashi/Suidobashi	¥22,063	\$61.8	2.3%	4,811	293,861	-	-	(5,399)	36.6%
26 Hamacho/Higashi Nihonbashi	¥21,912	\$61.4	1.3%	2,326	216,182	-	-	(2,374)	12.0%
27 Harumi/Kachidoki	¥21,732	\$60.9	6.0%	4,002	460,497	-	-	13,710	57.7%
28 Ningyocho/Kodenmacho	¥19,063	\$53.4	1.2%	1,803	360,219	-	-	(3,803)	0.0%

Source: Colliers International. Note<sup>1</sup>: Softbank has vacated over 83,000 sq meters occupying 28 floors in Tokyo Shiodome Building as they move their HQ functions to Waters Takeshiba. Note: **Red** refers to districts with major vacancy increases, **Yellow** refers to districts that have been impacted by large new supply during the past twelve months. The net effective rents are monthly rents on a net floor area basis. The above figures refer to all grade buildings unless otherwise noted. *All grade* refers to key buildings with average floor plates of 100 tsubo or larger with the majority of use dedicated to office. *Grade A* refers to those buildings with the total NFA of 10,000 tsubo or larger, built within the last fifteen years and are compliant with the government's anti-seismic standards, originally established in 1981.

## Primary Author:

### **Mari Kumagai**

Head of Research | Tokyo

+81.3.4572.1009

[mari.kumagai@colliers.com](mailto:mari.kumagai@colliers.com)

## For further information, please contact:

### **Katsuji Tokita**

Management Director | Country Head | Japan

+81 3 4572.8607

[katsuji.tokita@colliers.com](mailto:katsuji.tokita@colliers.com)

### **John Suzuki**

Executive Director | Occupier Services | Japan

+81 3 4540 8604

[john.suzki@colliers.com](mailto:john.suzki@colliers.com)

### **Hazumu Iwase**

Executive Director | Capital Markets | Japan

+81 3 4572.8603

[hazumu.iwase@colliers.com](mailto:hazumu.iwase@colliers.com)

### **Hideki Ota**

Executive Director | Capital Markets | Japan

+81 3 4572.1005

[hideki.ota@colliers.com](mailto:hideki.ota@colliers.com)

### **Dick Olango**

Senior Director | Occupier Services / Project Management | Japan

+81 3 4572.1004

[dick.olango@colliers.com](mailto:dick.olango@colliers.com)

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