

Tokyo Office Market Summer 2020

~How will Corona affect the office market?~

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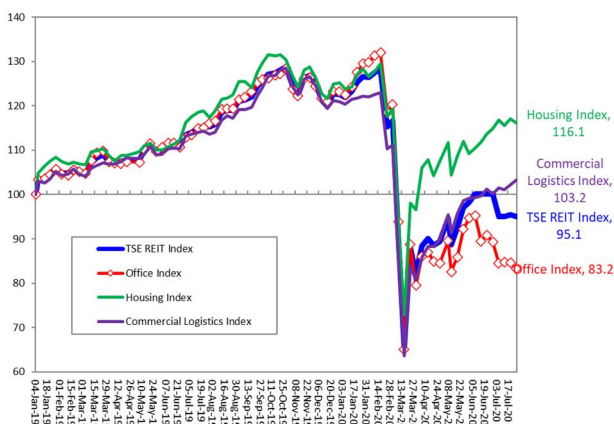
The re-emergence of the new corona virus has raised concerns about trends in the office market. The Nikkei continued to report that IT-related companies continue to pull out as tenants as working from home has become more prevalent, with headlines such as "The emerging argument about no longer needing offices" (May 5 morning edition). It also highlighted the deterioration of the office market in Shibuya as "Is the office bubble in Shibuya bursting?" However, the decline of the office market is limited at this point.

The following is an overview of the office market in the five wards of central Tokyo and, in particular, the current situation in the Shibuya Ward, where IT-related companies are concentrated and where the downturn in the office market is leading the way. We hope these will help you consider future trends of Tokyo's office market.

1. Tokyo Central 5 Wards Office Market—Has the Office Market Entered a Phase of Adjustment?

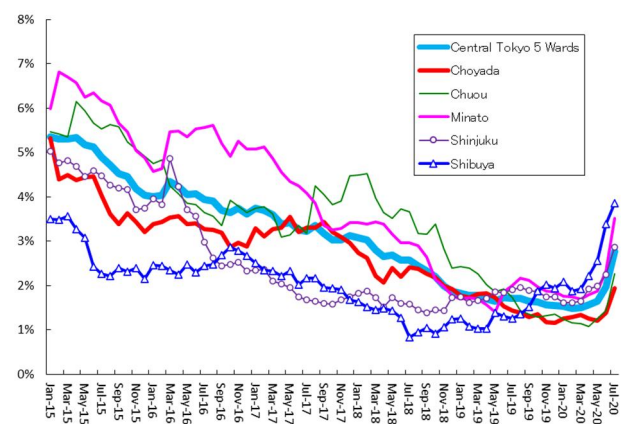
- The TSE REIT Index closed at 74% of its yearly high (weekly close) on July 31, a slow recovery compared to 90% of the Nikkei average due to the slow return of the office index at 63%.
- In Japan, office tenants are required to give six months' notice of termination in advance, so the impact of this infection on the office market has been relatively small so far. The deterioration in the TSE REIT Office Index is likely because investors expect that the impact on the office market will become more apparent in the future.
- The office vacancy rate in the central 5 wards of Tokyo in July was 2.77%, up +128 basis points from the bottoming out in February, and roughly unchanged from March 2018. The vacancy rate in the Shibuya ward was 3.85%, up 198 basis points from February this year.

Chart 1: TSE REIT Index of Use (January 2019=100)



Source: Quick

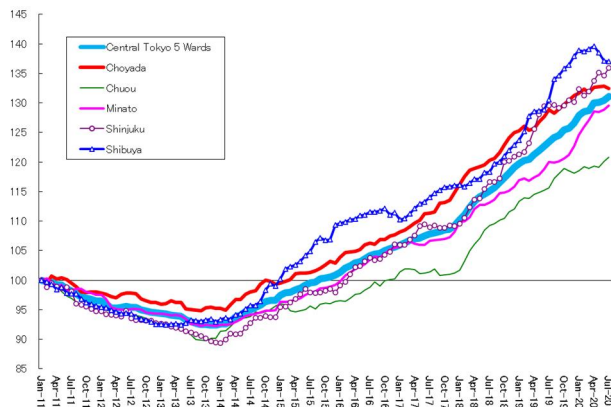
Chart 2: Vacancy Rate in Central 5 Wards of Tokyo



Source: Miki Shoji Co.

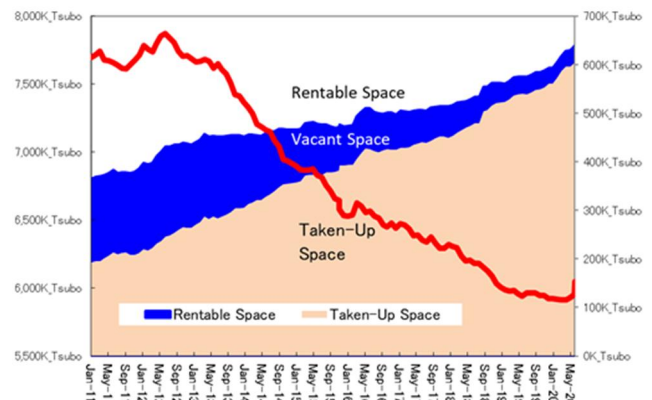
- Although vacancy rates began to increase, asking rents in the central 5 wards of Tokyo continued to rise by 0.6% MoM and 6.2% YoY, with rents in Chuo, Minato and Shinjuku wards reaching their highest levels in recent years in July. Nevertheless, in Shibuya Ward, the market is beginning to deteriorate, ahead of the central 5 wards of Tokyo, with rents falling for three months in a row.
 - While supply continued to increase, the leased area fell by 33,000 tsubo in July compared to the previous month, the second consecutive month of decline. This was the first time since January 2010 that the leased area fell by more than 30,000 tsubo.
 - All wards saw a decrease in the available area in June and July, and in Shibuya Ward, the available area decreased for the fifth consecutive month since March.
 - The large increase in leasable area in July was accompanied by a large decrease in leased area, resulting in a significant increase in vacant area. There was an increase in vacancies due to the SoftBank Group's relocation to a new building. According to Miki Shoji, the vacant area generated in July was largely due to this year's large-scale redevelopment.
- The decline in leased area and increase in vacant area for the second month in a row indicate that the office market has entered a period of adjustment amid the economic downturn.

Chart 3: Asking Rents in the Central 5 Wards of Tokyo (January 2011=100)



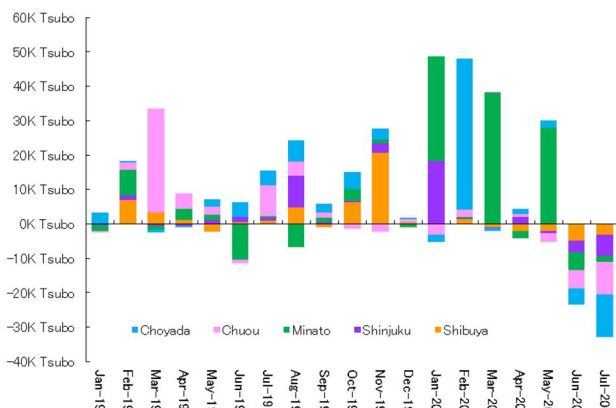
Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 4: Office Supply and Demand in the Central 5 Wards of Tokyo



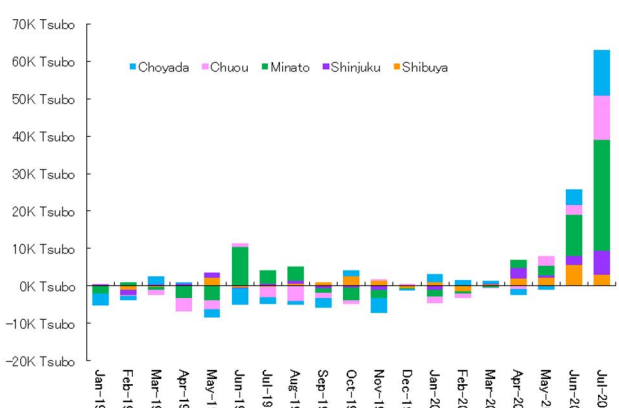
Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 5: Change in The Leased Space in The Central 5 Wards of Tokyo (MoM)



Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 6: Change in The Vacant Space in The Central 5 Wards of Tokyo (MoM)

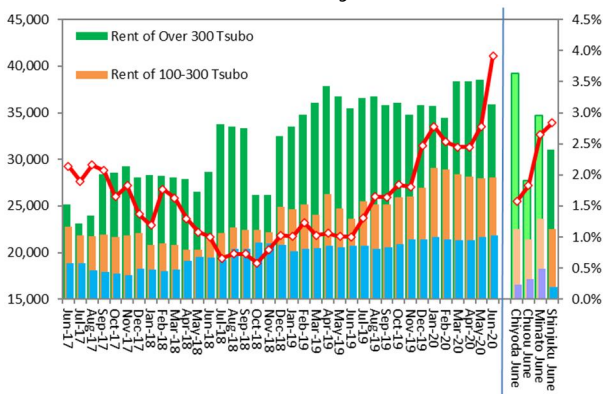


Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

2. Shibuya Office Market

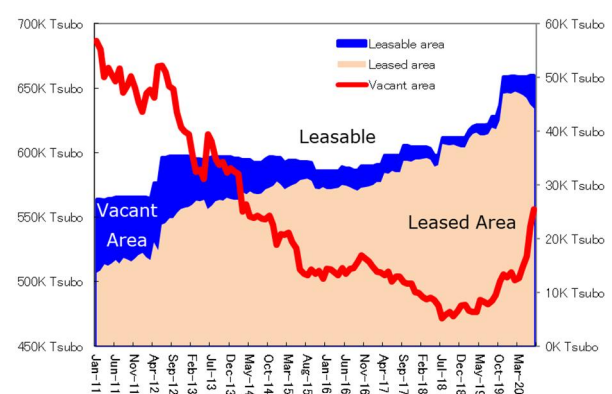
- The vacancy rate in Shibuya Ward has begun to rise. The estimated achievable rent in the 100 to 300 tsubo category has been on a downward trend since February, but rents in the 300 tsubo and above category, which has increased by 42% over the past two years, remained high and unchanged. Rents in the 20 to 100 tsubo category also continued to rise.
- The number of large-scale buildings in Shibuya Ward was notably low after the 2012. But as since 2018, there was a massive development of large buildings in Shibuya-ward, including Shibuya Stream, Abema Towers, Shibuya Solasta, Shibuya Scramble Square, Link Square Shinjuku, Shibuya Fukulus, Shibuya Parco Hulic Building, and other large buildings, the leasable area of the building has increased rapidly.
- Although the leasable area in Shibuya Ward accounts for 9% of the central 5 wards of Tokyo, the new supply in Shibuya Ward accounted for 40% of the total supplied area in the five central wards of Tokyo in 2019. Despite the tiny increase in leasable area this year, the vacant area began to increase due to lower demand from smaller tenants. The change to work from home due to the new corona measures and the rising rents in Shibuya Ward, as well as tighter financing for start-up companies starting in fall 2019, are likely to have affected the increase in vacant floor space.

Chart 7: Estimated Achievable Rent and Vacancy Rate in Shibuya Ward



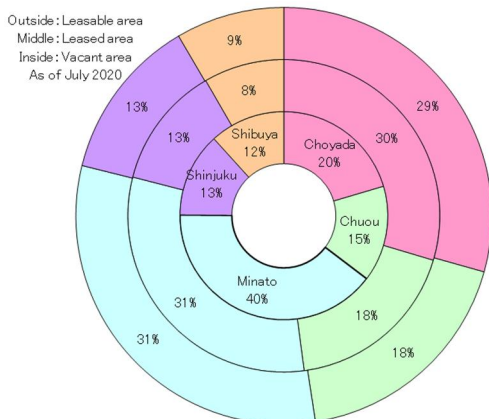
Source: Building Group

Chart 8: Office Supply and Demand in Shibuya Ward



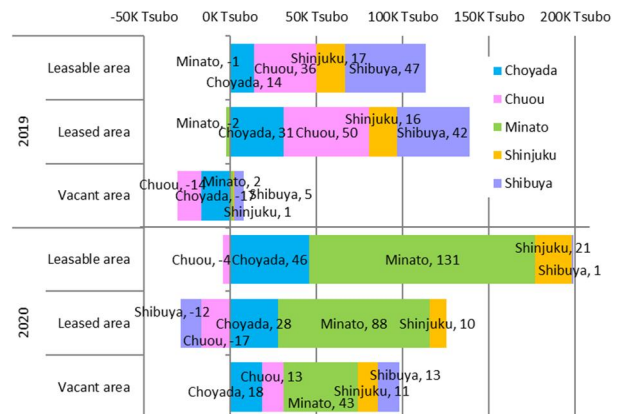
Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 9: Central 5 Wards of Tokyo Office Area Ratio



Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 10: Change in Office Space in the Central 5 Wards of Tokyo

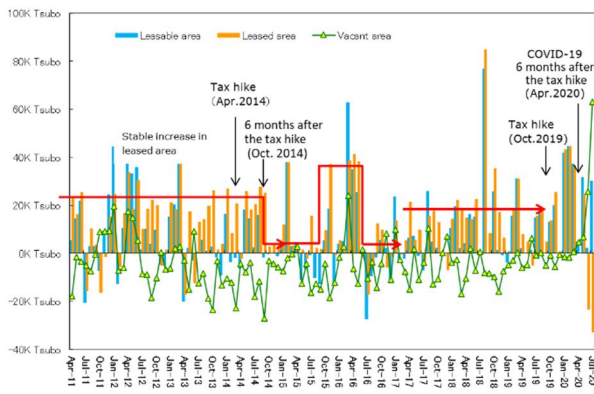


Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

3. Economic Growth and Changes in Office Leased Space

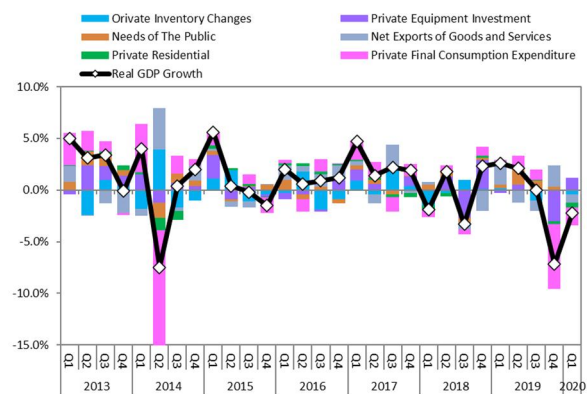
- In addition to new supply, economic changes, such as the collapse of Lehman Brothers, have an impact on office space leased. Last year's tax hike is likely to have an impact on future leased space, as the pace of growth in leased space slowed six months after the 2014's tax hike.
- By July, leased area had risen by 100,000 tsubo compared to the previous year. If the amount of leased space in 2020 is at the same level as it was at the end of last year, the vacancy rate would increase from 2.77% in July to 4.00%, due to the increase in supply in 2020.
- Additionally, ESP Forecast predicts an average growth rate of +2.4% in 2021 and a high average of +5.7%. Therefore, a higher growth rate in 2021 can be expected to result in a significant increase in leased space by the middle of 2021.
- Pessimism about the office market is not widespread so far. Although vacant space in the five central wards of Tokyo doubled from February this year to 220,000 tsubo, this includes the area that has begun to be advertised while tenants are still present. The reduction in office space at large firms is not in full swing. In addition, the new supply of large buildings in metropolitan areas in 2021 and 2022 is less than 30% of that of 2020.

Chart 11: Change in the Area of Supply and Demand in The Central 5 Wards of Tokyo (MoM)



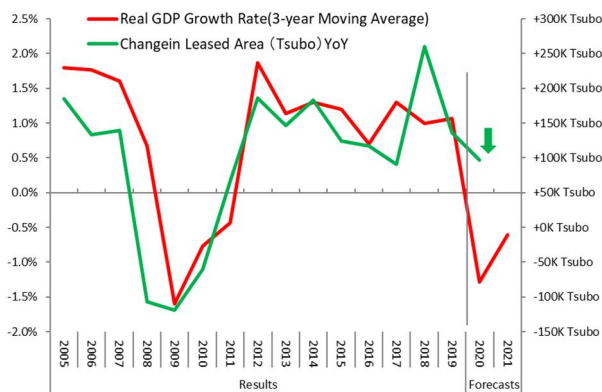
Source: Prepared by Daiwa Real Estate Appraisal based on Miki Shoji's data

Chart 12: Real GDP Growth YoY (Seasonally Adjusted Annual Rate)



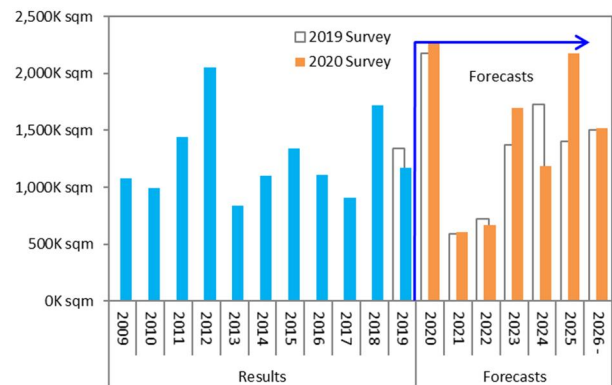
Source: Cabinet Office

Chart 13: Rental Area and Real GDP Growth Rate in the Central 5 Wards of Tokyo (3-year Simple Moving Average)



Source: Miki Shoji, Cabinet Office and ESP Forecast

Chart 14: Supply Forecast for New Large-Scale Buildings in Metropolitan Areas

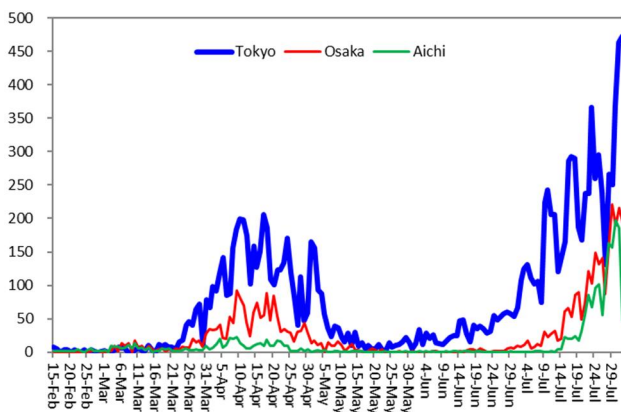


Source: Nikkei Real Estate Market Report

4. Re-expansion of the COVID-19 and Future Office Demand

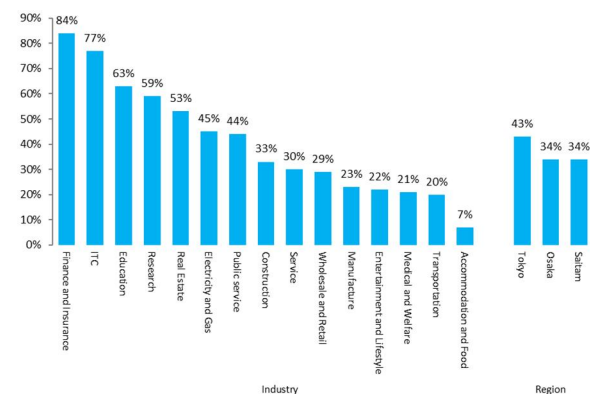
- The re-emergence of the infection will stagnate the economy and prolong the downturn in corporate profits, which have been declining year-over-year for four consecutive quarters, and furthermore negatively impact future office demand.
- Companies are under pressure to cut office costs as their profits deteriorate, while also having to consider changes in their office plans for the future, such as increasing the number of employees working from home.
- According to a survey by Xymax Research Institute, 92% of companies have started working from home, and 83% of companies were still working from home as of early June, 43% of respondents said they were still in the process of doing so.
- The Mizuho Research Institute reports that only about 30% of workers are able to work from home (43% in Tokyo), and 70% of workers need to come to work to maintain productivity, which means that companies are likely to experience a decline in productivity if a large number of employees continue to work from home.
- Despite many companies downsizing their offices due to the recession and relocated to buildings in the suburbs after the Lehman shock in 2008, the vacancy rates are already low in the surrounding wards today. According to Sanko Estate, the rate as of July 1 was 1.0% in Shinagawa Ward, 1.7% in Edogawa Ward and 3.7% in the Tama Area.
- The downward trend in leased space can be explained at this point by a decrease in demand due to the economic downturn and an increase in relocations and closures for the purpose of reducing fixed costs. Of course, this is being driven by a long-term trend of office reductions, with a shift to remote working. On the other hand, this shift to remote working is likely to increase the demand for shared offices.
- Since the spread of the infection, we are often told that offices are no longer needed due to the expansion of work from home. At the same time, there is a reevaluation of the role of the office as a hub of creativity where people interact with each other and the advantages of the central office in terms of securing human resources. Companies are now at a point in time where they need to think about the office plan from multiple perspectives.

Chart 15: Number of COVID-19 Cases in Tokyo



Source: Jag Japan

Chart 16: Percentage of Employees Who Work at Home



Source: Mizuho Research Institute