

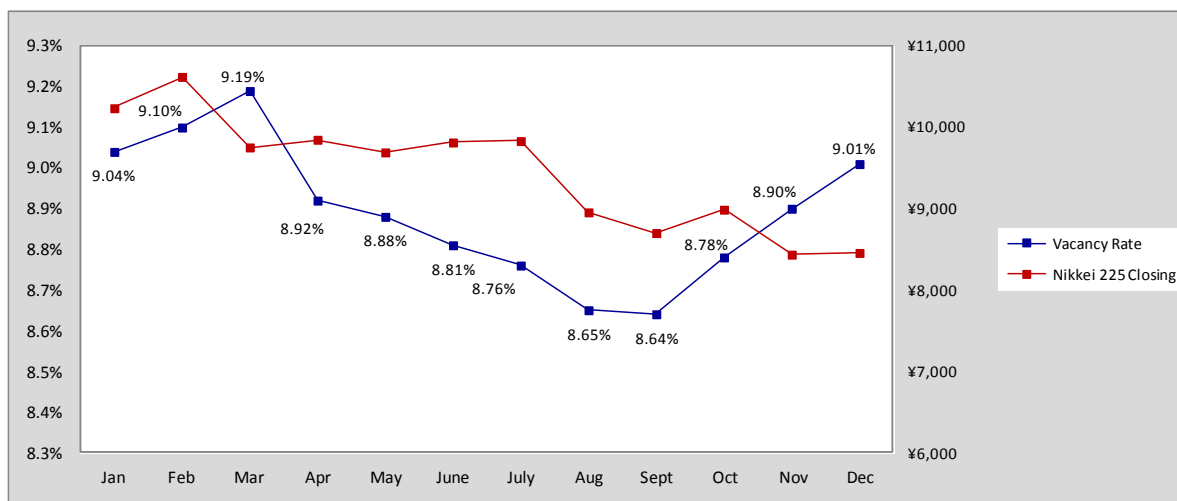
## The Office Building Market in 2012

### Average vacancy rate of large-scale office buildings in central Tokyo expected to exceed 10%

Earthquake disaster, radiation problems due to the nuclear accident, the prolonged strength of the yen versus the dollar, financial crisis in the EU, sanctions against crude oil from Iran: the environment that surrounds the Japanese economy just keeps getting worse.

According to a survey conducted by Miki Shoji Co., Ltd., the average vacancy rate for large-scale office buildings in the central 5 wards of Tokyo was 9.01% as of the end of December 2011. This figure closes in on the 9.19% average vacancy rate registered in March 2011, said to be the worst on record. (Refer to Figure 1.)

Figure 1. Vacancy Rates in Tokyo's Central 5 Wards (Chiyoda, Chuo, Minato, Shinjuku, Shibuya) (Year 2011)



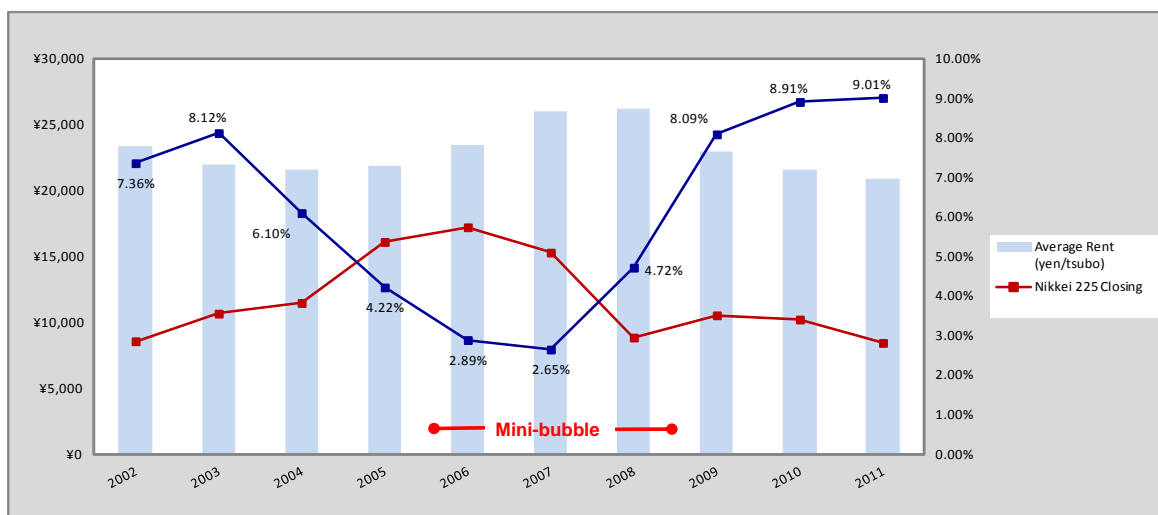
Source: Prepared by Level Best, Inc. based on data from Miki Shoji Co., Ltd.

\*Survey covers rental office buildings in Tokyo's central 5 wards having typical per-floor areas of 330 square meters (100 tsubo) or more.

After the earthquake disaster in March last year, many companies moved their offices to more earthquake-resistant buildings, leading to an improvement in the vacancy rate during the autumn period. However, vacancy rates have since gone back up by the end of the year.

Looking at the 10-year period from 2002, the average vacancy rate was highest in 2011, a huge change compared to the vacancy rates during the mini-bubble period around 2007. (Refer to Figure 2.)

**Figure 2. Average Vacancy Rate & Average Rent in Tokyo's Central 5 Wards**  
(Chiyoda, Chuo, Minato, Shinjuku, Shibuya)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Average Vacancy Rate	7.36%	8.12%	6.10%	4.22%	2.89%	2.65%	4.72%	8.09%	8.91%	9.01%
Average Rent (yen/tsubo)	¥23,310	¥21,954	¥21,577	¥21,844	¥23,406	¥25,998	¥26,186	¥22,978	¥21,585	¥20,932
Nikkei 225 Closing	¥8,578.95	¥10,676.64	¥11,488.76	¥16,111.43	¥17,225.83	¥15,307.78	¥8,859.56	¥10,546.44	¥10,228.92	¥8,455.35

Source: Prepared by Level Best, Inc. based on data from Miki Shoji Co., Ltd.

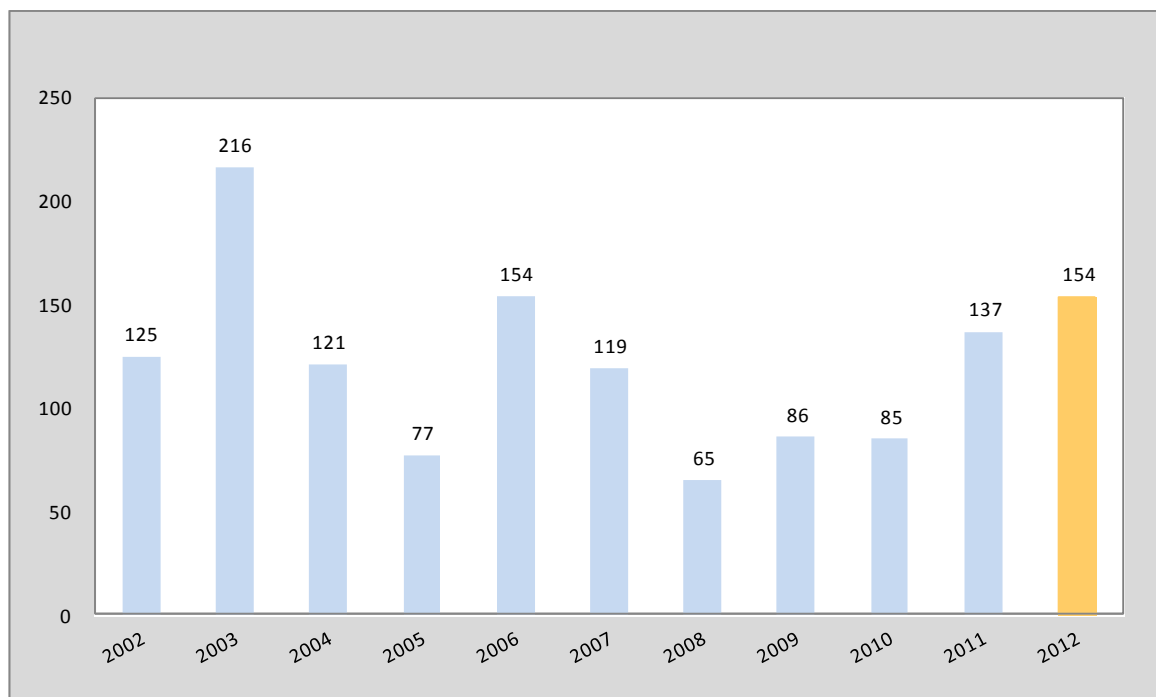
\*Survey covers rental office buildings in Tokyo's central 5 wards having typical per-floor areas of 330 square meters (100 tsubo) or more.

\*Survey is based on figures at the end of December of each year.

\*Average rent includes 4,000 yen/tsubo added as common fees on top of rent figures in Miki Shoji's survey data.

The vacancy rates of office buildings generally tend to have the same movement as that of the real economy. The Nikkei Stock Average, which is a major barometer of the real economy, fell under 10,000 yen after the earthquake disaster, and has hovered around the 8,000-yen level since summer last year. Consequently, no impetus can be found at this point to indicate that the vacancy rate will improve anytime soon.

Furthermore, the “Market Trend Survey of Large-scale Office Buildings” (a survey started by yours truly at my former post with Mori Building and now continued by my juniors) indicates that just as in 2011, 2012 will similarly see a huge amount of new office buildings being completed - as much as 1.5 times the average annual supply of the last 5 years. Moreover, many of these new buildings are in the prime central areas of the city such as Marunouchi. (Refer to Figures 3 & 4.)

**Figure 3. Annual Supply of Large-scale Office Buildings in Tokyo's 23 Wards**


Source: Prepared by Level Best, Inc. based on data from Mori Building Co., Ltd.

Unit: 10,000m<sup>2</sup>

**Figure 4. Major large-scale office buildings to be completed in 2012**

Project Name	Total Floor Area		Location	Scheduled Completion
	(m <sup>2</sup> )	(tsubo)		
Marunouchi Eiraku Building	139,600	42,229	Marunouchi, Chiyoda-ku	Jan
Palace Building	67,233	20,338	Marunouchi, Chiyoda-ku	Jan
Shibuya Hikarie	144,177	43,614	Shibuya, Shibuya-ku	April
DiverCity Tokyo	64,880	19,626	Aomi, Koto-ku	April
Shinjuku Eastside Square	170,300	51,516	Shinjuku, Shinjuku-ku	April
Sumitomo Fudosan Shibuya Garden Tower	60,000	18,150	Nampeidai, Shibuya-ku	April
Nakano Central Park East	39,025	11,805	Nakano, Nakano-ku	May
JP Tower (tentative name)	212,000	64,130	Marunouchi, Chiyoda-ku	May
Mita Bellju Building	56,500	17,091	Shiba, Minato-ku	May
Nakano Central Park South	151,577	45,852	Nakano, Nakano-ku	May
Sogokan 110 Tower	23,811	7,203	Kyobashi, Chuo-ku	June
JR Minami Shinjuku Building (tentative name)	58,024	17,552	Yoyogi, Shibuya-ku	June
Toranomon-Roppongi Area Project	143,550	43,424	Roppongi, Minato-ku	Aug
Otemachi Financial City North Tower	110,000	33,275	Otemachi, Chiyoda-ku	Sept
Otemachi Financial City South Tower	132,500	40,081	Otemachi, Chiyoda-ku	Sept
Shin Akasaka Center Building (tentative name)	39,787	12,036	Akasaka, Minato-ku	Sept
Meguro 1-chome Project	22,346	6,760	Meguro, Meguro-ku	Nov



In 2012, as much as 1.54 million square meters of new large-scale office building floor area (buildings having a total office floor area of 10,000 square meters or more) will be added to the current stock.

While it is, of course, possible that some of the new buildings with good locations and high-grade specifications may be inaugurated with high occupancy rates, this will be the result of companies vacating their current old offices to move into these new buildings. Under present conditions where there is essentially no new demand, merely shifting tenants from one building to another is not going to improve the vacancy rate.

In the midst of the economic slump and political gridlock, corporate performance has continued to deteriorate, and practically no company is seeking to expand office space. The current office building market in Tokyo represents a total mismatch between supply and demand. This situation will perhaps be most vividly manifested in 2012. We predict that the average vacancy rate of large-scale office buildings in central Tokyo will reach its highest level ever, exceeding 10%.

#### **Trend toward lower rents to continue**

Rent rates generally trail the movement of vacancy rates by six months to one year. (Refer to Figure 2.) As new large-scale office buildings are successively completed starting early 2012, vacancy rates will reach a peak from summer to autumn this year. (Refer to Figure 4.)

Accordingly, average rent rates for large-scale office buildings in central Tokyo will move towards new lows as early as the end of 2012, and may likely go under 19,000 yen/ tsubo (inclusive of common fees) in the first half of 2013.

Regardless of age, buildings that do not have the competitive edge of good location and high-quality specifications will have a difficult time of filling vacancies even if they lower their rents significantly.

We have entered an era of office buildings where only the strongest can survive. As the situation of weak demand, increasing vacancy rates, and falling rent becomes prolonged, building owners will be forced to change the strategies in development, location, marketing and product planning that they have cultivated in the past, thus requiring all their skills to maneuver difficult waters.

*-Yasuhiro Takeuchi*

Coming soon: A report on office buildings that will do well in a severe market.