

Real Estate Analysis Report

Forecast for Office Rent Prices in the Tokyo CBD

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Preface

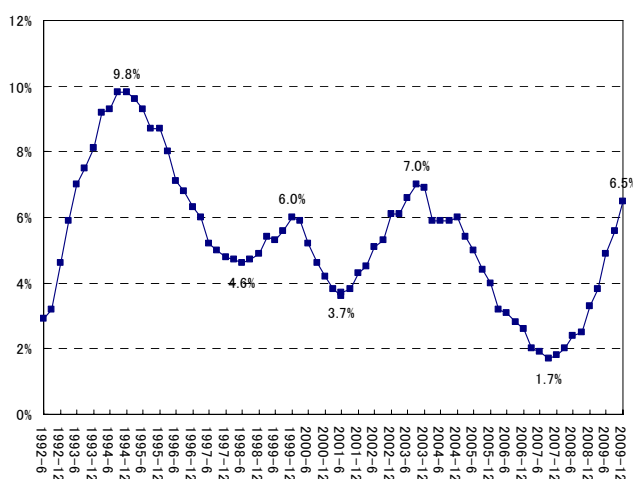
Following on last year, we forecasted rent price indices again for large-scale office buildings in the Tokyo CBD.² This year, however, we added quarterly forecasts to the annual forecast in the hope of detecting sooner when the current downtrend will end.

1. Trends in Office Vacancy Rates and Rent Price Indices in Tokyo CBD

The Tokyo office market has suffered significantly from the deterioration of the world economy. The vacancy rate in the Tokyo 23 wards increased from 1.7% in September 2007 to 6.5% in December 2009 (Figure 1).

Rent prices have also decreased remarkably. The rent price of large-scale office buildings has dropped 36% since 4Q 2007 (Figure 2).

Figure 1 Vacancy Rate in Tokyo 23 Wards

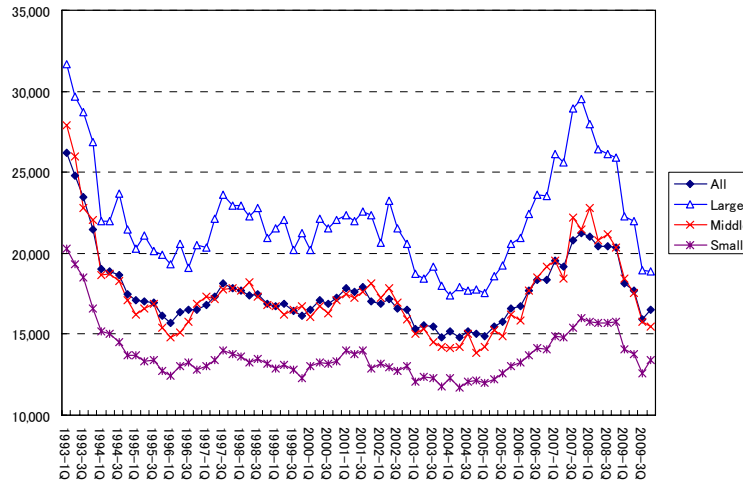


Source: CB Richard Ellis Research Institute

¹ The original Japanese version (<http://www.nli-research.co.jp/report/misc/2009/fudo100216.pdf>) was released on February 16, 2010. The author wishes to thank James Parker of NLI Research Institute for his generous assistance with editing this translation.

² The Tokyo CBD (central business district) refers to the major three wards of Chiyoda, Chuo, and Minato.

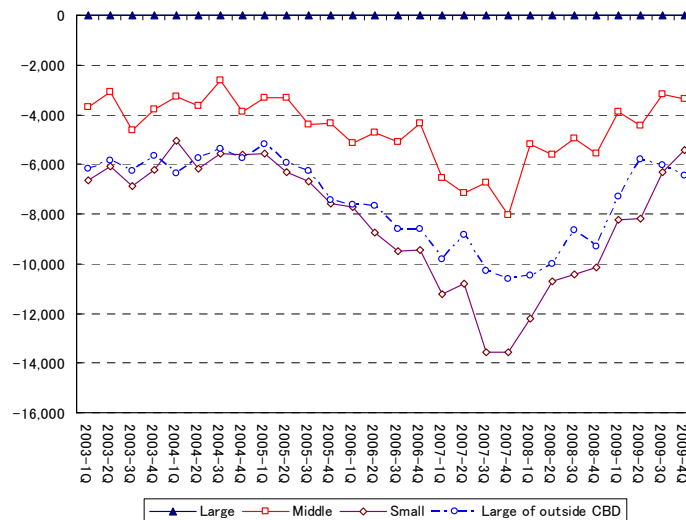
Figure 2 Rent Price indices in Tokyo CBD



Note: Large buildings have over 200 tsubo of space per floor, medium-scale buildings have between 100 and 200 tsubo/floor, and small-scale buildings have less than 100 tsubo/floor.
Source: NLI Research Institute

Figure 3 shows that rent price indices of large-scale buildings and other buildings have been converging. From 4Q 2007 through 4Q 2009, the rent price difference between large-scale and medium-scale buildings declined from 8,000 yen/tsubo³ to 3,000 yen/tsubo, and the difference between large-scale and small-scale buildings decreased from 14,000 yen/tsubo to 5,000 yen/tsubo. In the same period, rent price indices of large-scale buildings also converged between the Tokyo CBD and other areas — for example, the difference with the outside CBD area declined from 11,000 yen/tsubo to 6,000 yen/tsubo.

Figure 3 Difference in Rent Price Indices Compared to Large-Scale Office Buildings in Tokyo CBD



Note: Outside CBD area: Shinagawa, Toshima, Koto, Meguro, Bunkyo and Taito wards
Source: NLI Research Institute

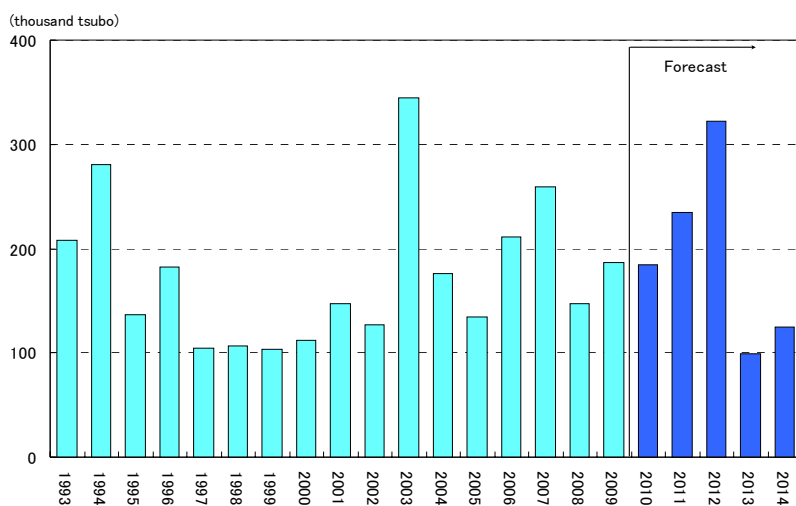
³ The “tsubo” is a Japanese unit of area equal to 3.306 square meters.

2. Supply of New Office Buildings

An average of approximately 190,000 tsubo of office space was supplied per year between 2004 and 2009 in the Tokyo 23 wards. An average of approximately 250,000 tsubo of office space is expected to be supplied per year from 2010 through 2012 (Figure 4). In particular, the office supply is expected to surge in 2012 to the 2003 level, when a huge office supply caused the so-called “2003 problem” in Tokyo.

On the other hand, the portion of new supply in the CBD will be decreasing from now on. According to Mori Building, from 1999 to 2008, the major three wards accounted for approximately two-thirds of new office supply in the Tokyo 23 wards. However, in the 2010-2013 period, they will account for less than 40% of new office supply. Moreover, as much as 63% of their planned new supply will not actually be “new supply” but reconstruction.

Figure 4 Planned Supply of New Large-Scale Office Buildings in Tokyo 23 Wards



Note: Outside CBD area refers to Shinagawa, Toshima, Koto, Meguro, Bunkyo and Taito wards
Source: CB Richard Ellis Research Institute

3. Forecast for Rent Price Indices

To forecast rent price indices of large-scale office buildings in the Tokyo CBD, I estimated both the vacancy rate function and the rent price function using large-scale office supply, number of office workers,⁴ and real GDP growth rate among others as dependent variables. The real GDP growth rate forecast was obtained from short-term and medium-term economic forecasts by NLI Research Institute (Figures 5 and 6).⁵

According to the standard forecast, the rent price index will drop until 2Q 2010, bottom out

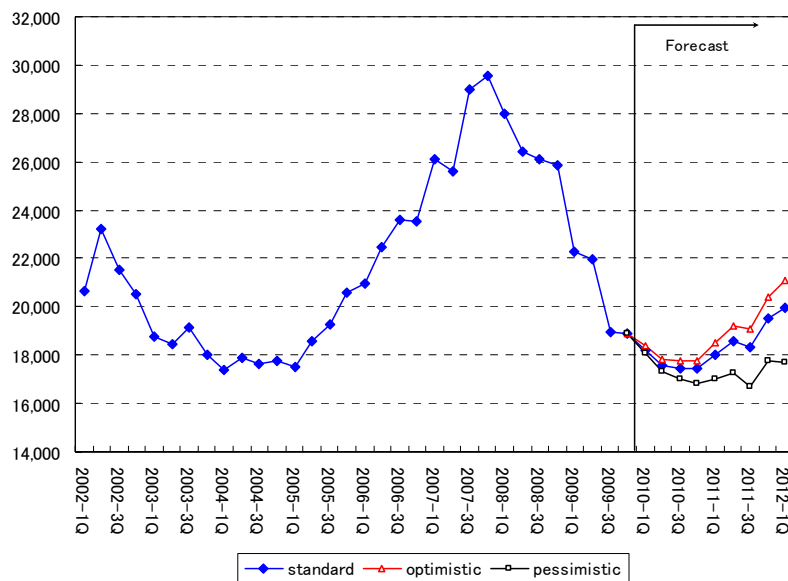
⁴ The forecast for office workers in Tokyo is available in Japanese at <http://www.nli-research.co.jp/report/misc/2008/fudo090226.pdf>.

⁵ The NLI Research Institute medium-term economic forecast is available in English. See [Koichi Haji, “Global Financial Crisis Increases the Presence of Emerging Markets—Medium-Term Economic Forecast \(FY 2010—2019\)”, NLI Research Institute](#). The short term economic forecast is available in Japanese at http://www.nli-research.co.jp/report/econo_letter/japan/we091210.html.

until 4Q 2010 (the trough will occur in 3Q 2010), and start to climb in 1Q 2011. The bottom in 3Q 2010 will be as much as 41% below the last peak in 4Q 2007 (down 7.6% from the current quarter, 4Q 2009).

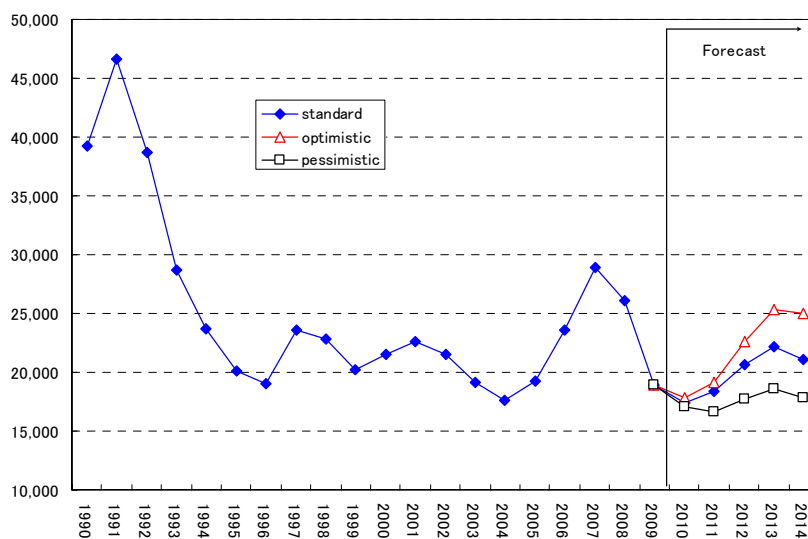
From 1Q 2011, the rent price index will rise slowly, peaking out in 2013. Thus for the five-year period from 2009 to 2014, after dropping -27.6% in 2009, the rent price is forecast to fluctuate as follows: -7.9% in 2010, +5.2% in 2011, +13.1% in 2012, +6.8% in 2013, and -4.5% in 2014.

Figure 5 Forecast for Rent Price Index of Large-Scale Office Buildings in Tokyo CBD (quarterly)



Note: Outside CBD area refers to Shinagawa, Toshima, Koto, Meguro, Bunkyo and Taito wards
Source: NLI Research Institute

Figure 6 Forecast for Rent Price Index of Large-Scale Office Buildings in Tokyo CBD (annual)



Note: Outside CBD area refers to Shinagawa, Toshima, Koto, Meguro, Bunkyo and Taito wards
Source: NLI Research Institute

4. Conclusion

The standard forecast tells us the rent price index of large-scale office buildings in the Tokyo CBD will bottom out in 3Q 2010 (but remain stagnant from 2Q 2010 through 4Q 2010) and then peak out in 2013. However, it will not soar due to the huge supply of large-scale office buildings forecast in areas outside the Tokyo CBD.

Rent prices will bottom out in 3Q 2010 according to both the standard and optimistic forecasts, and in 3Q 2011 according to the pessimistic forecast. Even in the pessimistic forecast, the decline from 4Q 2009 will be only -11.6% (-2,000 yen/tsubo), which is quite small compared to the decline of -27.1% (-7,000 yen/tsubo) in the previous year from 4Q 2008 to 4Q 2009. The vacancy rate in the Tokyo CBD will peak in 1Q 2010 or 2Q 2010.

From the bottom in 2010 to the peak in 2013, the rent price index is predicted to rise 27.0% in the standard forecast, 45.4% in the optimistic forecast, and 6.9% in the pessimistic forecast.

In 1Q 2011, not only will the rent price index start to rise, but a huge supply of office buildings will go online outside the Tokyo CBD. If buildings located outside the Tokyo CBD seek to boost occupancy rates by cutting lower rent prices, a significant impact would be felt in the large-scale office building market in the Tokyo CBD. The recent decline in rent price differences with other Tokyo areas and with smaller buildings suggests that this impact will be limited. However, if the impact exceeds expectations for some reason, or if the economic recovery fails to generate as much office demand (employment of office workers) as in previous economic recoveries, the pessimistic forecast (which assumes economic recovery will be delayed) could prevail.