Trends in Tokyo's Office Market — Tokyo's Dominance Grows Amid Concern of a Market Downturn

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Introduction

Tokyo's office market enjoyed steady growth last year as strong demand from foreign financial institutions and IT companies brought the vacancy rate down to 3.6% in the first quarter of 2001. In particular, new large office buildings were in short supply, becoming almost fully occupied by the time construction was completed.

However, the effects of the ailing U.S. economy and IT downturn from the second half of 2000 have been cropping up in the market data from the second quarter of 2001. Moreover, with the terrorist attacks in the U.S. and war in Afghanistan creating uncertainty in the global economy, many companies including foreign financial institutions and hi-tech companies are postponing office relocations and implementing further cost cuts. Considering these market conditions and the large supply of large office buildings slated to come on line in 2003 in central Tokyo, there is growing concern that the market will deteriorate further.

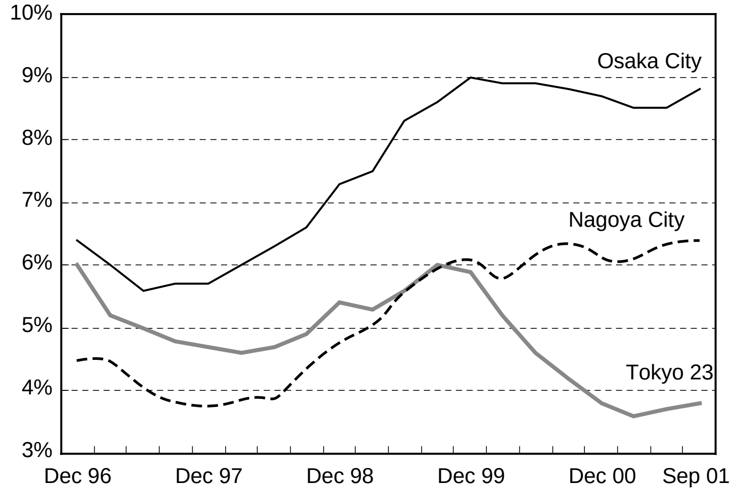
However, compared to Osaka and Nagoya, Tokyo's office market, being at the center of Japan's economy, has strong potential. Demand for advanced and diverse office space is concentrated in Tokyo, giving depth to the market. This, along with the renewed population concentration in Tokyo, are enhancing Tokyo's preeminent position.

1. Tokyo's Clear Dominance

(1) Vacancy Rate Trend

After dropping to 3.6% in March 2001, the vacancy rate in Tokyo's 23 wards (Tokyo 23) rose for two consecutive quarters. By comparison, vacancy rates in Osaka City and Nagoya City began rising in 1998, and hovered at 9% and 6% respectively before resuming their climb recently (Figure 1).

Figure 1 Office Vacancy Rates

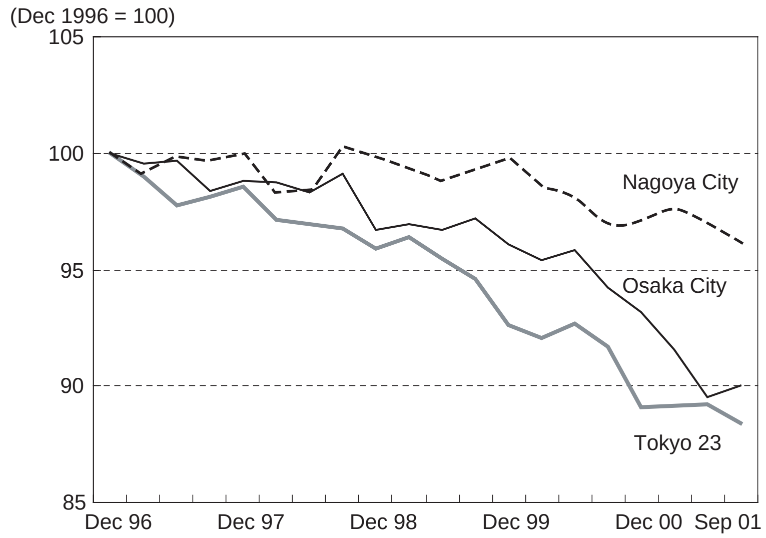


Source: Ikoma C.B. Richard Ellis

During this time, Tokyo's office rents declined the most, and this decline is attributed with having stimulated latent demand. On the other hand, demand has failed to respond to declining rents in Osaka and Nagoya (Figure 2).

In Tokyo, computer software and communications-related companies have helped keep office demand steady by picking up the slack left by foreign firms and IT companies. As a result, despite deteriorating market conditions, the vacancy rate has remained extremely low.

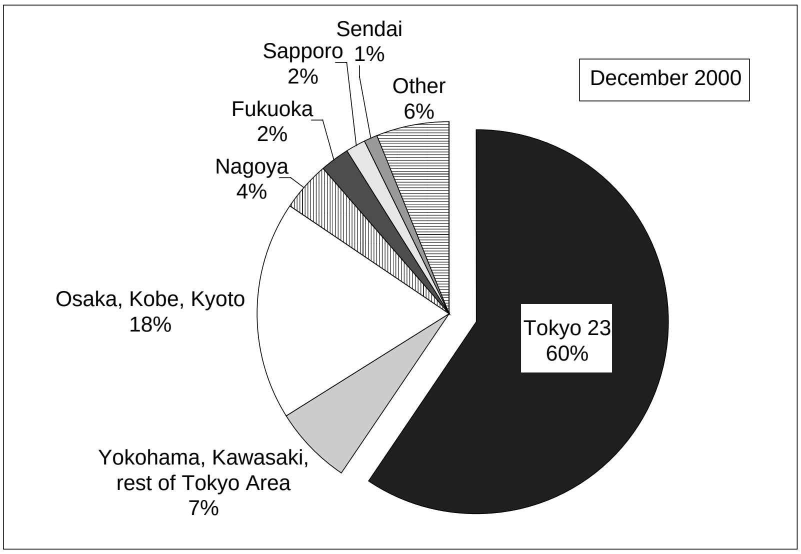
Figure 2 Average Advertised Rents (December 1996 = 100)



Source: Compiled from Ikoma C.B. Richard Ellis, *Office Market Report.*

In December 2000, the leased office space nationwide totaled approximately 56 million square meters, half of which was located in Tokyo's 23 wards (28.5 million square meters). When the market size is calculated by taking into account rents and operating rates, Tokyo comprises 60% of the national market.

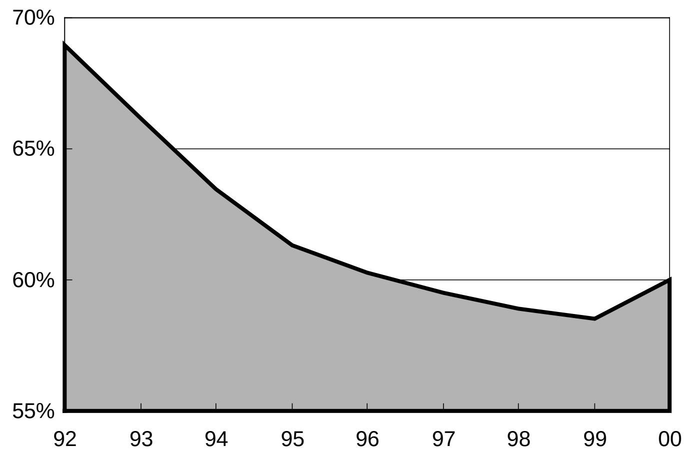
Figure 3 Market Composition by Region



Note: Calculated as follows: Leased space x (1 – Vacancy rate) x Annual real rent. Real rent refers to rent plus investment return on deposit money, and is on an advertised rent basis.
Source: Compiled from Ikoma Data Service System, *White Paper on Real Estate*.

Tokyo's share of the national market had trended downward due to post-bubble rent adjustments, it turned upward in 2000 (Figure 4).

Figure 4 Share of Tokyo's 23 Wards in the National Market

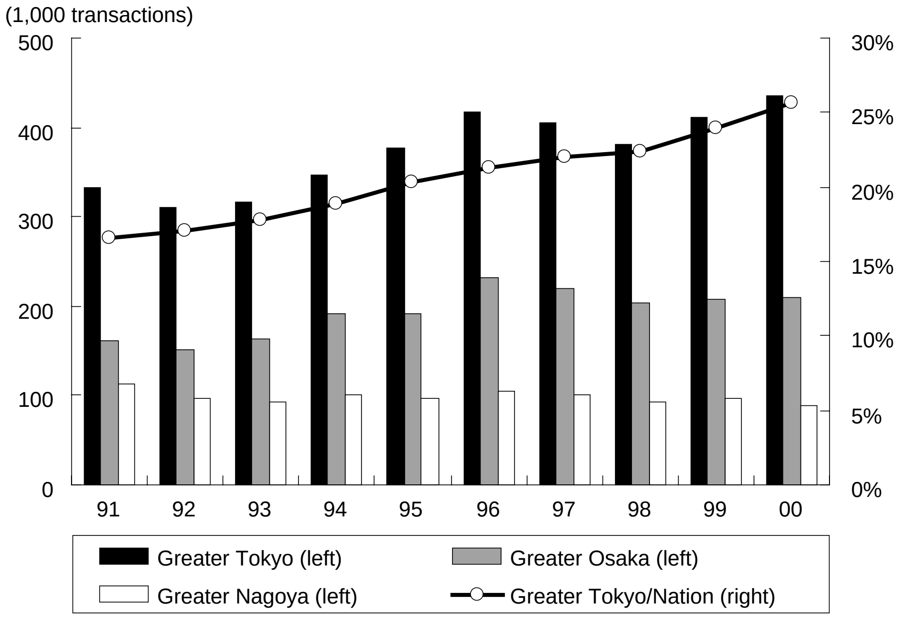


Note: Shows annual data as of December.
Source: See Figure 3

(3) Number of Land Transactions

In 2000, there were 435,759 land transactions in the Greater Tokyo area, comprising one-fourth of the national total. In the past decade, compared to small or no increases in the Greater Osaka and Greater Nagoya areas, both transaction volume and market share have been growing in the Greater Tokyo area (Figure 5).

Figure 5 Number of Land Transactions

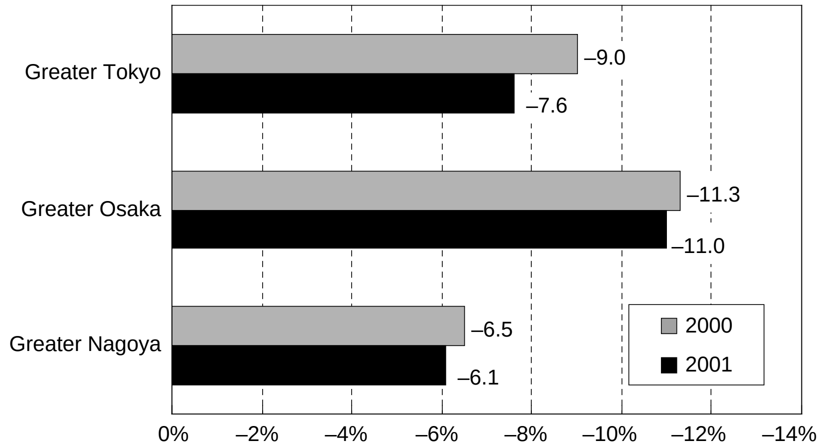


Note: Greater Tokyo area consists of Saitama, Chiba, Tokyo, and Kanagawa prefectures. Greater Osaka area consists of Osaka, Kyoto, and Hyogo prefectures. Greater Nagoya area consists of Aichi and Mie prefectures.
Source: Ministry of Land, Infrastructure and Transportation, *2001 White Paper on Land*.

(4) Commercial Land Prices

According to the standard land prices released in July 2000, while commercial land prices in the Greater Tokyo area dropped 7.6% year-on-year, the rate of decline was 1.4 percentage-points smaller. By comparison, prices in the Greater Osaka and Greater Nagoya areas dropped 11.0% and 6.1% respectively, with no abatement (Figure 6).

Figure 6 Change in Standard Land Prices for Commerical Land



Note: Greater Tokyo area consists of Tokyo's 23 wards, Tama district, and Kanagawa, Saitama, Chiba, and part of Ibaragi prefectures.
Greater Osaka area consists of Osaka, Hyogo, Kyoto, and part of Nara prefectures.
Greater Nagoya area consists of Aichi and part of Mie prefectures.
Source: MLIT, *Prefectural Land Price Survey*.

In Tokyo's 23 wards, while land price increases did not occur at any of the surveyed locations in 1999, the number of price increases expanded to two locations in 2000, and 11 locations in 2001. In addition, the number of unchanged prices expanded from four locations in 1999 to eight locations in 2000, and 21 locations in 2001. By comparison, no locations in either Osaka City or Nagoya City posted either a price increase or unchanged price during this time (Figure 7).

Figure 7 Standard Land Prices for Commercial Land: No. of Nonnegative Price Changes

		Tokyo 23 wards	Osaka City	Nagoya City
1999	Increase	0	0	0
	Same	4	0	0
2000	Increase	2	0	0
	Same	8	0	0
2001	Increase	11	0	0
	Same	21	0	0

Source: MLIT, *Prefectural Land Price Survey.*

2. Advanced Functions and Diversity Characterize Office Demand

(1) Concentration of Specialized & Technical Office Workers

As the nation's economic and political center, Tokyo is characterized by a highly integrated structure of business and government functions. Of the office workers in the Greater Tokyo area, those in specialized and technical occupations have grown by 600,000 persons in the past decade from 2.28 million to 2.88 million.[1] The growth rate of office workers is 26.1%, significantly higher than the national average (20.1%) as well as the Kinki area (13.3%) and Greater Nagoya area (15.8%).

One of the main specialized technical occupations is system engineer (SE), for which there is still a serious shortage even after the waning of the IT boom. While semiconductor and other slumping sectors have triggered massive layoffs among large electrical makers, the computer sector has announced plans to hire 30,000 workers in the next two to three years (Figure 8). In some cases, technicians and workers from hardware factories in non-metropolitan areas are being converted into software workers.

Figure 8 Employment Plans of Large Electrical Manufacturers

Planned Domestic Job Cuts

	Job cuts (domestic)	Target date
Fujitsu	9,700	March 2002
NEC	2,500	March 2002
Hitachi	10,200	March 2002
Toshiba	17,000	End of 2003

Source: Compiled from publicly available materials.

Planned Job Increases in Software Services

	Target level	Increase	Target date
Fujitsu	40,000	5,000	March 2004
NEC	60,000	10,000	2003-0 4
Hitachi	49,300	2,300	March 2003
IBM Japan	22,000	10,000	End of 2003

Note: Numbers are for corporate groups. For NEC, includes collaborating companies.
Source: *Nikkei Sangyo Shimbun*, October 4, 2001.

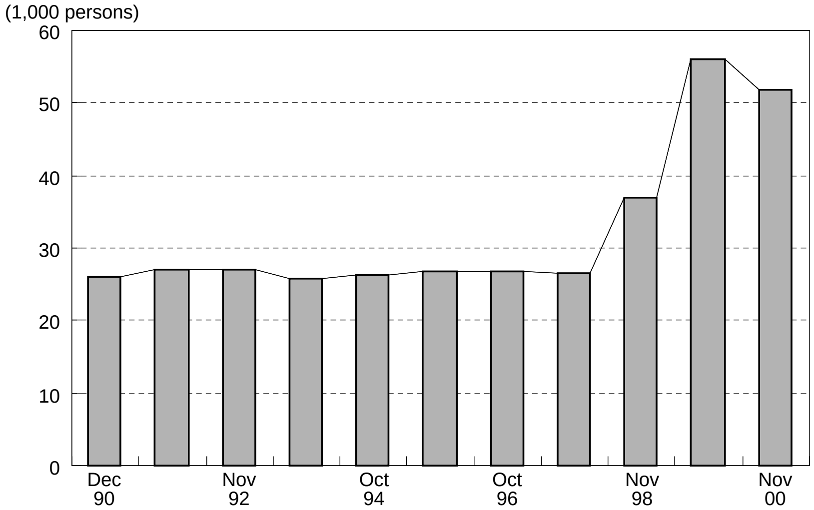
In addition, Internet venture companies have been moving their headquarters and business functions to Tokyo to expand business capacity and secure workers.[2]

Also, the revised Commercial Code in April 2001 introduced the company spinoff system. Its use is spreading among companies because of tax advantages, creating business opportunities for specialized and technical occupations such as legal and accounting offices to handle business restructuring procedures.[3]

(2) Concentration of Foreign Financial Firms

Compared to Japanese financial companies, the number of employees and operating budgets of foreign financial firms tend to fluctuate significantly depending on their parent company's business performance or management policies. Thus many foreign firms revised their office expansion plans after the U.S. economy slowed down in the second half of 2000. However, many companies also anticipate expanded business opportunities accompanying the financial restructuring in Japan. Of the 191 foreign financial institutions in Japan, 188 companies have headquarters or branch offices in Tokyo, and the number of employees has surged since 1998 to over 50,000 persons (Figure 9).[4]

Figure 9 Number of Employees at Foreign Financial Institutions



Note: Includes employees outside of Tokyo.
Source: Compiled from Toyo Keizai Shinposha, *Handbook of Foreign Companies*.

(3) Concentration of Service Offices

At prime locations in central Tokyo, there are concentrations of service offices that provide office booths and secretarial services on a short-term basis (Figure 10). Service offices are primarily used by foreign companies staging an entry into the Japanese market, and Japanese companies conducting short-term projects.

Figure 10 Major Service Office Locations

Management co.		Location	Building
Servcorp Japan	Tokyo Pref.	Marunouchi, Chiyoda-ku	AIG Building
		Nishi Shimbashi, Minato-ku	Hibiya Central Building
		Kita Aoyama, Minato-ku	Palacio Tower
		Nishi Shinjuku, Shinjuku-ku	Park West Building
		Nishi Shinjuku, Shinjuku-ku	Shinjuku Nomura Building
		Toranomon, Minato-ku	JT Building
		Ebisu, Shibuya-ku	Yebisu Garden Place Tower
		Toranomon, Minato-ku	Shiroyama Hills
	Osaka Pref.	Nishi-ku, Osaka	Edobori Centre Building
Regus Japan	Tokyo Pref.	Nishi Shinjuku, Shinjuku-ku	Shinjuku Park Tower
		Toranomon, Minato-ku	Kamiyacho Mori Building
		Otemachi, Chiyoda-ku	Otemachi First Square
		Uchisaiwaicho, Chiyoda-ku	Imperial Tower
Mitsui Fudosan	Tokyo Pref.	Kasumigaseki, Chiyoda-ku	Kasumigaseki Building
	Chiba Pref.	Mihama-ku, Chiba City	WBG Marive East
Mori Building	Tokyo Pref.	Roppongi, Minato-ku	Roppongi 21 Mori Building

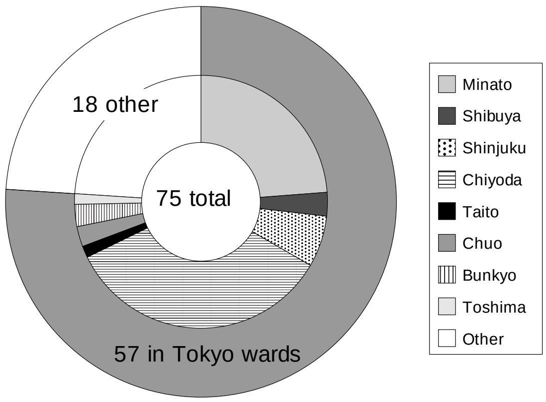
Source: Company web sites

(4) Concentration of Public Corporations

At present, there are 75 special public corporations under review for reorganization by the Administrative Reform Agency.[5] Three out of four, or 57 of these corporations have headquarters located in the 23-ward Tokyo area (Figure 11).

While the reform of special corporations will reduce this office demand, new demand for office space is expected from the business opportunities that the reforms will create for private sector companies taking their place. For example, if the Housing Finance Corporation undertakes the business of buying and securitizing private sector home loans, it would provide a boost not only to private banks and securities companies but to peripheral businesses engaged in due diligence and servicing.

Figure 11 Headquarter Locations of Special Public Corporations

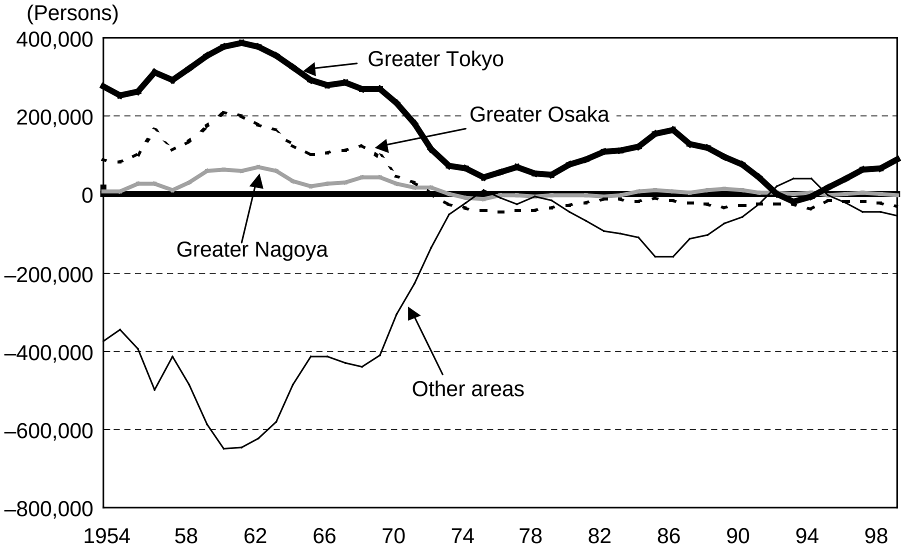


Source: Compiled from Government Administration Research Center, *2001 Handbook of Special Corporations*.

3. Renewed Concentration of Population in Tokyo

After the alarming population growth in the Greater Tokyo area was recognized as a problem in the late 1980s, the net inflow of people began decreasing, turning into a net outflow in 1994 and 1995. However, the net inflow resumed in 1996, and the population has continued to grow. However, other metropolitan populations are not growing; the Greater Osaka area has seen a consistent net outflow since 1974, while the Greater Nagoya area has remained unchanged since 1975 (Figure 12).

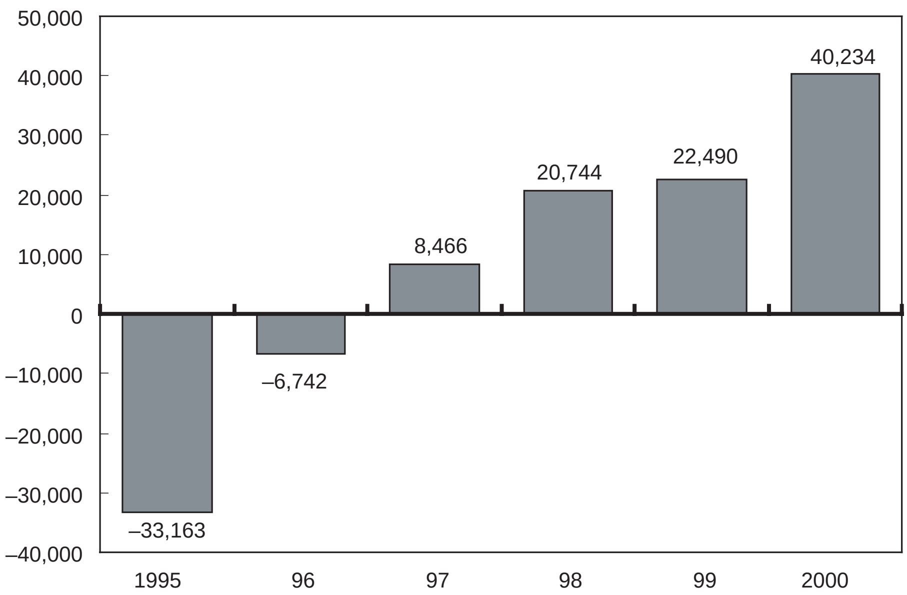
Figure 12 Population Trends



Notes: Greater Tokyo area consists of Tokyo, Kanagawa, Saitama, and Chiba prefectures.
Greater Osaka area consists of Osaka, Hyogo, Kyoto, and Nara prefectures.
Greater Nagoya area consists of Aichi, Gifu, and Mie prefectures.
Other areas: Shows the negative of the total net inflow into the three metropolitan areas.
Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Annual Report on Population Movements According to Family Registers*.

In Tokyo's 23 wards, where the renewed population concentration is pronounced, the net inflow reappeared in 1997, growing to over 40,000 persons in 2000, or 40% of that of the Greater Tokyo area (Figure 13).

Figure 13 Population Net Inflow into Tokyo's 23 Wards

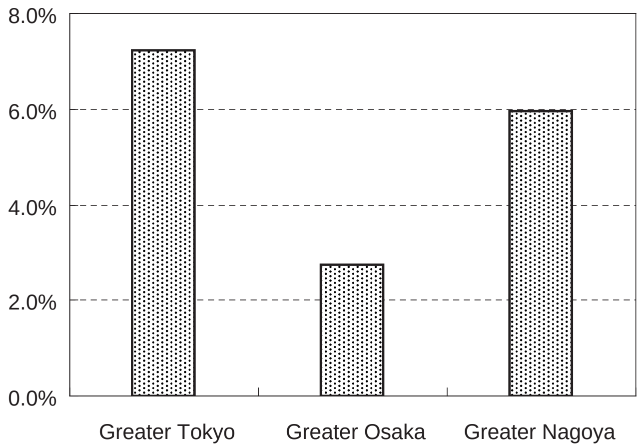


Source: See Figure 12.

While the net increase in residential population will increase housing demand in local communities, it does not directly lead to growth in office demand. However, from the perspective of the greater metropolitan area, there is a positive correlation between population growth and growth in office workers.

In fact, the number of office workers in the Greater Tokyo area (the total of specialized and technical, administrative, and clerical workers) grew from 6.93 million persons in 1991 to 7.43 million persons in 2000, an increase of 7.2% in one decade.[6] This exceeds the 6.3% growth rate for the nation (1.39 million persons), 2.7% percent in the Greater Osaka area (100,000 persons), and 5.9% in the Greater Nagoya area (150,000 persons; Figure 14).

Figure 14 Growth Rate of Office Workers in the Past Decade



Note: Greater Tokyo are consists of Saitama, Chiba, Tokyo and Kanagawa prefectures (South Kanto).
Greater Osaka area consists of Kyoto, Osaka, Hyogo, Nara, and Wakayama prefectures (Kinki).
Greater Nagoya area consists of Gifu, Aichi, and Mie prefectures (Tokai).
Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Labor Force Survey*.

Conclusion

The large supply of office buildings slated to hit the market in 2003 has raised concern that Tokyo's office market will deteriorate. However, from a national perspective, the Tokyo market is actually in a singularly dominant position. And if the recession worsens, the economic vitality and ample job opportunities in Tokyo stand to attract an even greater concentration of people, goods, money, and information, thereby further widening the disparity with other metropolitan areas.

Notes

1. Compares the average for 1991 and simple average of first and second quarters of 2001.

2. *Nikkei Shimbun*, Osaka evening edition, February 13, 2001.

3. *Nikkei Shimbun*, evening edition, October 22, 2001.

4. In principle, includes banks, trust banks, securities companies, insurance companies, investment trusts and advisories with capitalization of at least 50 million yen and foreign ownership ratio of at least 49%.

5. These are the special corporations mentioned in the Administrative Reform Agency's report, "Approach to Reviewing Individual Business Operations of Special Corporations," August 31, 2001. (http://www.gyoukaku.go.jp/jimukyoku/tokushu/kangae/html)

6. Same as in note 1.