

Vacancies improving on rising demand, demolitions Completion of major buildings in October may cause vacancy rates to deteriorate temporarily

Demand rising at annualized rate of 2.2%

Major office brokerage Miki Shoji released its report on office supply-demand conditions in Tokyo's five central wards in September 2016 on 13 October. The vacancy rate was down 20bp m-m at 3.70%, and moreover rising demand was cited as the reason for the improvement for the first time in four months, unlike in Jun-Aug, when the demolition of empty buildings was given as the reason. We think this is a positive for real estate leasing-related stocks such as Mitsui Fudosan [8801]. The total increase in the amount of office floor space required in Jan-Sep was 114,077 tsubo (1 tsubo = 3.3m²), up 45% on the increase in the same period in 2015, and equivalent to 88% of our initial estimate of a 130,000 tsubo increase in demand. This works out at an annualized rate of increase in demand of 2.2%. However, with October seeing the completion of Kyobashi Edogrand (34,000 tsubo of floor space, 20,000 tsubo of leasable floor space), and the grand opening of Sumitomo Fudosan Roppongi Grand Tower (61,000 tsubo, 31,000 tsubo), we think the vacancy rate may deteriorate temporarily.

More vacant space in Minato Ward, vacancy rate higher too

No new buildings opened in September, and in Chuo Ward a smaller building (leasable floor space of 1,755 tsubo) was demolished. Moreover, office demand rose by 12,495 tsubo m-m on the signing of major tenancies for new buildings completed over the last 12 months in Minato Ward. Indeed, 76% of the rise in office demand in September was in Minato Ward. End-September vacancy rates were 2.45% for Shinjuku Ward, 2.68% for Shibuya Ward, 3.19% for Chiyoda Ward, 3.35% for Chuo Ward, and 5.20% for Minato Ward, while vacant space at end-September came to 116,832 tsubo for Minato Ward, versus 67,966 tsubo for Chiyoda Ward, 45,591 tsubo for Chuo Ward, 23,542 tsubo for Shinjuku Ward, and 15,715 tsubo for Shibuya Ward. We will be keeping an eye on leasing activities at buildings located in Minato Ward. We also note unofficial agreements for 50% of the space at Edobashi Edogrand (Chuo Ward) and around 60% of the space at Sumitomo Fudosan Roppongi Grand Tower (Minato Ward) at this juncture.

Not much progress in enticing overseas companies, number of office workers on the rise

With almost no moves by overseas companies to locate their Asian headquarters in Tokyo, there are concerns about demand for office space in Tokyo now that Japan's population has started to decline. However, the Ministry of Internal Affairs and Communications' Labour Force Survey is showing a rise in the number of office workers in greater Tokyo. Indeed, the number of office workers has risen by 15.4% over the past 16 years, which we view as an indication of the concentration of the population in the greater Tokyo area. Along with the economic recovery and accompanying improvement in the unemployment rate (which stood at 3.1% in greater Tokyo at end-June), the number of office workers rose 2.4% y-y in 2014, 1.3% in 2015, and 2.2% in Apr-Jun 2016.

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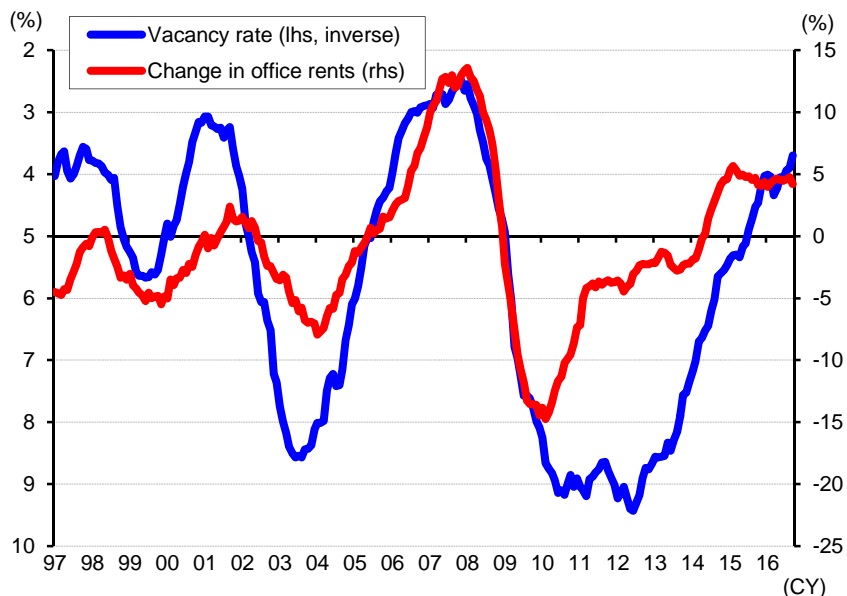
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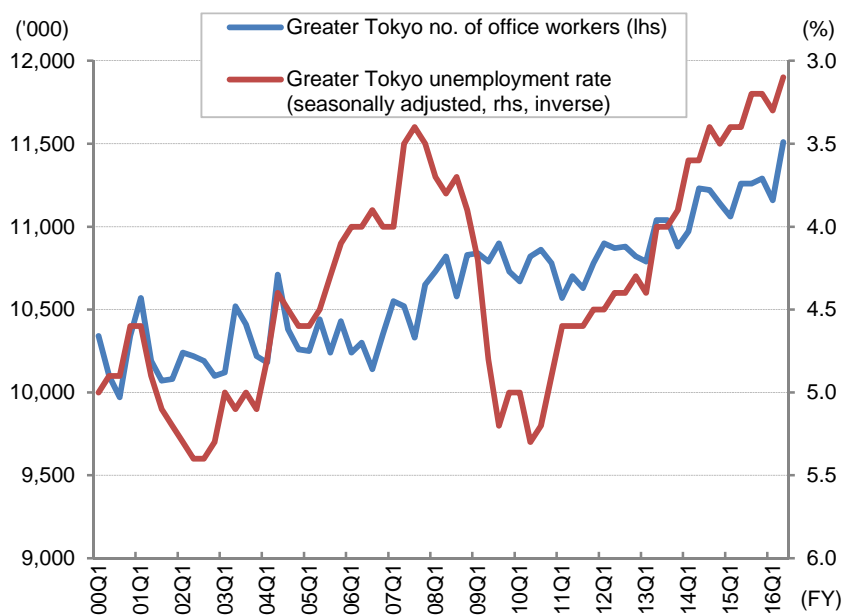
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Fig. 1: Office vacancy rate and y-y change in office rents in the five central wards of Tokyo



Source: Nomura, based on Miki Shoji data

Fig. 2: Number of office workers and unemployment rate in greater Tokyo



Note: (1) Greater Tokyo refers to Tokyo, Chiba, Saitama, and Kanagawa prefectures here. (2) The number of office workers is the total of managers, specialists/technicians, clerical workers, and sales staff.

Source: Nomura, based on Ministry of Internal Affairs and Communications data

Appendix A-1

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In OTC transactions of credit default swaps (CDS), no sales commission will be charged. When entering into CDS transactions, the protection buyer will be required to pledge or entrust an agreed amount of margin collateral. In some of these cases, the transaction payments may exceed the amount of margin collateral. There shall be no advance notification of required collateral value or collateral ratios as they vary depending on the financial position of the protection buyer. CDS transactions carry the risk of losses owing to changes in the credit position of some or all of the referenced entities, and/or fluctuations of the interest rate market. The amount the protection buyer receives in the event that the CDS is triggered by a credit event may undercut the total amount of premiums that he/she has paid in the course of the transaction. Similarly, the amount the protection seller pays in the event of a credit event may exceed the total amount of premiums that he/she has received in the

transaction. All other conditions being equal, the amount of premiums that the protection buyer pays and that received by the protection seller shall differ. In principle, CDS transactions will be limited to financial instruments business operators and qualified institutional investors. No account fee will be charged for marketable securities or monies deposited. Transfers of equities to another securities company via the Japan Securities Depository Center are subject to a transfer fee of up to ¥10,800 per issue transferred depending on volume.

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